FORSYTH BARR

Argosy Property

NEUTRAL

1H20 — Seeing Green

Argosy Property (ARG) reported a result slightly ahead of expectations in terms of distributable profit per share due to lower interest costs than forecast, and announced an interim revaluation gain that lifted NTA +5% to NZ$1.28. ARG has highlighted its 'green' development focus and this is a key strategic priority for the business and a nice niche in the sector. We have not changed our forecasts and our rating is NEUTRAL.

What's changed?

- **Target Price:** Lifted slightly from NZ$1.35 to NZ$1.38 on the back of a small lift in DCF since our last update and an increase in NAV.

Key take-outs

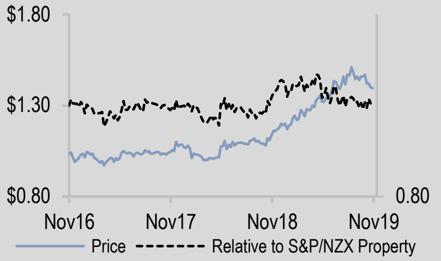
- **FY20 guidance reiterated** — The ARG 1H20 result was close to expectations with flat revenue and EBIT, and a gain in distributable EPS of +4% boosted by slightly lower interest costs than we forecast. The 2Q dividend is 1.57cps (record date 5 December 2019 / payment date 19 December 2019) providing a flat 1H20 dividend of 3.14cps, slightly ahead of ARG's published AFFO of 3.06cps. The flat DPS guidance of 6.275cps for FY20 has been re-iterated. The near term dividend outlook remains flat as ARG looks to hold its dividend level until it is covered by AFFO, something quite common in the LPV sector at present.
- **Rare interim reval reflecting Auckland and industrial strength** — There was an interim revaluation gain of +3.1% (NZ$50m) which has lifted the NTA from NZ$1.22 to NZ$1.28. The bulk of the gain was from Auckland assets and the industry properties in particular. The average cap rate firmed from 6.65% to 6.36% and the portfolio is 1% under-rented. Gearing is steady at 36%.
- **Solid WALT plus near-term leasing opportunities** — The WALT of 6 years has been maintained; however, it would have been pleasing to get a lift in occupancy rates which remain steady at 97.6%. ARG noted that it is advanced in terms of leasing the long standing vacancy in the CitiBank building in Auckland. The lease expiry looks manageable with an average of just 7% of the portfolio expiring each year over the next five. The major leasing concern is 147 Lambton Quay and ARG hopes to address this over 2H20. Like for like rental growth was +3.2% in 1H20.
- **7 Waterloo Quay redevelopment project** — This is now 82% leased, with good interest in the remaining space and completion is expected before the end of FY20. As expected, insurance negotiations are still ongoing and are overhanging ARG somewhat. We continue to assume 75% of its claim is covered. The portfolio remains well positioned with a 70% weighting to Auckland and a 47% weighting to the industrial sector.

Investment View

ARG continues to improve the quality of its portfolio through asset recycling and is actively working through opportunities for non-core assets. ARG offers an attractive dividend yield above its peers which fairly compensates shareholders for its portfolio attributes, in our view. Key risks for ARG are centred on vacancy for its CBD fringe office portfolio and potential capex requirements to reposition some of these assets. ARG has a well-positioned portfolio with a strong Auckland weighting and a large industrial holding. Our rating is NEUTRAL.

NZX Code	ARG
Share price	NZ$1.40
Target price	NZ$1.38
Risk rating	Low
Issued shares	827.0m
Market cap	NZ$1,154m
Average daily turnover	514.3k (NZ$683k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ$m)	57.4	54.5	56.9	56.9
EPS* (NZc)	6.9	6.6	6.9	6.9
EPS growth* (%)	4.8	-4.9	4.3	0.0
DPS (NZc)	6.3	6.3	6.3	6.3
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	18.7	20.0	19.0	17.9
EV/EBIT	18.7	20.0	19.0	17.9
PE	20.1	21.2	20.3	20.3
Price / NTA	1.1	1.1	1.0	n/a
Cash dividend yield (%)	4.5	4.5	4.5	4.5
Gross dividend yield (%)	6.4	6.4	6.4	6.4

*Historic and forecast numbers based on underlying profits

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Argosy Property Limited (ARG)		Priced as at 20 Nov 2019: NZ$1.40	
Forsyth Barr valuation			
Valuation methodology		Blended DCF (50%) and NAV (50%)	
12-month target price (NZ$)*	**1.38**	**Spot valuations (NZ$)**	
Expected share price return	-1.4%	1. DCF	1.37
Net dividend yield	4.5%	2. NAV	1.32
Estimated 12-month return	3.1%	n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.0%	Total firm value	1,790
Equity beta	0.77	(Net debt)/cash	(591)
WACC	5.5%	Value of equity	1,158
Terminal growth	1.5%	Shares (m)	827

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	101	102	100	107	113
Normalised EBITDA	**91**	**92**	**89**	**95**	**101**
Depreciation and amortisation	-	-	-	-	-
Normalised EBIT	**91**	**92**	**89**	**95**	**101**
Net interest	(25)	(24)	(25)	(26)	(31)
Associate income	-	-	-	-	-
Tax	(11)	(10)	(10)	(12)	(14)
Minority interests	-	-	-	-	-
Normalised NPAT	**55**	**57**	**55**	**57**	**57**
Abnormals/other	44	76	41	42	27
Reported NPAT	**98**	**134**	**95**	**99**	**84**
Normalised EPS (cps)	6.6	6.9	6.6	6.9	6.9
DPS (cps)	6.2	6.3	6.3	6.3	6.3

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	0.2	1.5	-2.4	6.7	6.1
EBITDA (%)	-0.4	0.5	-2.7	7.0	6.4
EBIT (%)	-0.4	0.5	-2.7	7.0	6.4
Normalised NPAT (%)	2.0	5.0	-4.9	4.3	0.0
Normalised EPS (%)	1.0	4.8	-4.9	4.3	0.0
DPS (%)	1.6	1.2	0.0	0.0	0.0

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**91**	**92**	**89**	**95**	**101**
Working capital change	7	9	-	0	-
Interest & tax paid	(35)	(34)	(34)	(38)	(44)
Other	-	-	-	-	-
Operating cash flow	**62**	**67**	**55**	**57**	**57**
Capital expenditure	(63)	(95)	(88)	(37)	(6)
(Acquisitions)/divestments	25	41	-	-	-
Other	(1)	(2)	16	16	-
Funding available/(required)	**23**	**11**	**(17)**	**36**	**51**
Dividends paid	(47)	(52)	(52)	(52)	(52)
Equity raised/(returned)	-	-	-	-	-
Increase/(decrease) in net debt	**24**	**41**	**69**	**16**	**1**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(11)	(14)	(14)	(14)	(14)
Fixed assets	1,513	1,667	1,779	1,842	1,875
Intangibles	-	-	-	-	-
Other assets	29	4	4	4	4
Total funds employed	**1,531**	**1,657**	**1,770**	**1,833**	**1,865**
Net debt/(cash)	552	591	660	677	677
Other non current liabilities	53	57	57	57	57
Shareholder's funds	927	1,009	1,052	1,099	1,131
Minority interests	-	-	-	-	-
Total funding sources	**1,531**	**1,657**	**1,770**	**1,833**	**1,865**

March year end

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	18.4	18.7	20.0	19.1	17.9
EV/EBIT (x)	18.4	18.7	20.0	19.1	17.9
PE (x)	21.2	20.2	21.2	20.4	20.4
Price/NTA (x)	1.25	1.15	1.10	1.05	1.02
Free cash flow yield (%)	-0.1	-2.4	-2.9	1.7	4.4
Net dividend yield (%)	4.4	4.5	4.5	4.5	4.5
Gross dividend yield (%)	6.3	6.4	6.4	6.4	6.4
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	94	90	95	91	91

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	3.6	3.8	3.6	3.6	3.3
Net debt/ tangible assets (%)	36.0	35.7	37.3	36.9	36.3
Net debt/ND+E (%)	37.3	37.0	38.6	38.1	37.5
Net debt/EBITDA (x)	6.1	6.5	7.4	7.1	6.7

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	5.9	5.5	5.0	5.1	5.4
Return on equity (%)	5.9	5.7	5.2	5.2	5.0
Return on funds employed (%)	5.1	4.9	4.4	4.4	4.4
EBITDA margin (%)	90.2	89.3	89.1	89.3	89.5
EBIT margin (%)	90.2	89.3	89.1	89.3	89.5
Capex to sales (%)	62.5	92.5	88.1	35.1	4.9
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a

Property Statistics	2015A	2016A	2017A	2018A	2019A
Total					
Value (NZ$m)	1,306	1,368	1,442	1,513	1,667
No. buildings	68	66	64	61	60
WALT (years)	5.54	5.24	5.59	6.08	6.14
Occupancy	99.2%	99.4%	98.6%	98.8%	97.7%
Contract yield	7.6%	7.6%	7.2%	6.9%	6.4%
Market yield	7.6%	7.5%	7.3%	7.0%	6.7%
Industrial					
Value (NZ$m)	510	507	583	638	738
No. buildings	40	39	38	36	37
WALT (years)	5.72	5.99	6.40	7.35	7.22
Occupancy	99.7%	99.9%	98.3%	99.9%	97.8%
Contract yield	7.6%	7.7%	6.9%	6.7%	6.2%
Market yield	7.6%	7.7%	7.1%	6.7%	6.5%
Office					
Value (NZ$m)	484	549	548	577	627
No. buildings	17	17	17	17	16
WALT (years)	5.60	4.82	4.87	4.99	4.94
Occupancy	98.8%	99.1%	98.4%	97.3%	96.8%
Contract yield	7.6%	7.6%	7.3%	7.0%	6.9%
Market yield	7.6%	7.6%	7.6%	7.4%	7.1%
Retail					
Value (NZ$m)	312	312	311	298	303
No. buildings	11	10	9	8	7
WALT (years)	5.15	4.78	5.46	5.69	5.96
Occupancy	98.9%	99.2%	99.4%	100.0%	100.0%
Contract yield	7.5%	7.4%	7.4%	7.1%	6.2%
Market yield	7.4%	7.1%	7.3%	6.8%	6.3%

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Results Summary

Figure 1. 1H20 Result Summary

Financial period	1H18	1H19	1H20	Change	Forecast	Var
Six months ending:	*09/17*	*09/18*	*09/19*			
Underlying profit & loss (NZ$000s)						
Net rental income	48.5	50.8	51.0	0.5%	51.0	0.1%
Base corporate costs	(4.7)	(5.1)	(5.6)	9.4%	(5.4)	4.6%
EBITDA	**43.8**	**45.6**	**45.4**	**-0.5%**	**45.6**	**-0.5%**
Net interest	(12.6)	(12.2)	(11.1)	-8.9%	(12.4)	-10.4%
PBT	31.2	33.4	34.3	2.5%	33.2	3.2%
Current tax	(4.9)	(4.7)	(4.4)	-7.1%	(4.8)	-9.7%
NPAT (underlying)	**26.3**	**28.7**	**29.9**	4.1%	**28.4**	**5.4%**
Adjustments:						
Investment property revaluations	-	34.6	50.8	46.6%	-	-
Other non-operating adjustments	(3.2)	3.4	(3.8)	-211.8%	-	-
NPAT (reported)	**23.1**	**66.8**	**76.9**	15.2%	**28.4**	**n/a**
Funds from operations						
NPAT - underlying profit	26.3	28.7	29.9	4.1%	28.4	5.4%
Amortisation of tenant incentives	2.1	2.0	1.7	-15.0%	1.7	2.0%
FFO	**28.4**	**30.7**	**31.6**	2.9%	**30.0**	**5.2%**
Adjusted funds from operations						
Maintenance capex	(3.4)	(2.4)	(4.0)	66.7%	(2.9)	37.9%
Tenant incentives	(1.8)	(3.0)	(2.0)	-33.3%	(2.3)	-13.0%
AFFO	**23.2**	**25.3**	**25.6**	1.1%	**24.8**	**3.4%**
Financials per share (cps)						
Period weighted shares on issue	824	827	827	0.0%	827	0.0%
EBITDA per share	5.32	5.52	5.49	-0.5%	5.52	-0.5%
NPAT per share (underlying)	**3.19**	**3.47**	**3.62**	4.1%	3.43	**5.4%**
FFO per share	**3.45**	**3.72**	**3.82**	2.9%	3.63	**5.2%**
AFFO per share	**2.82**	**3.06**	**3.10**	1.1%	3.00	**3.4%**
Dividends						
1Q cash dividend (cps)	1.55	1.56	1.56	-	1.56	
2Q cash dividend (cps)	1.55	1.56	1.56	-	1.56	
3Q cash dividend (cps)	-	-	-	-		
4Q cash dividend (cps)	-	-	-	-		
FY cash dividend (cps)				-	**6.28**	
Payout - NPAT (underlying)	97%	90%	86%	-3.5pp	92%	
Payout - FFO	90%	84%	82%	-2.3pp	87%	
Payout - AFFO	110%	102%	101%	-1.1pp	105%	

Source: Forsyth Barr analysis, Company Reports

Investment summary

Argosy Property (ARG) continues to recycle non-core assets and actively work through incremental development opportunities to improve portfolio quality. Fundamentals are improving following leasing success which is reflected in strong portfolio metrics. The outlook for the earthquake-impacted 7 Waterloo Quay is clearer with reinstatement works tracking for completion in late 2019, and leasing demand looking robust. In our sector report 'Real Estate Reflections' dated 5 September we adopted our new Research team risk free rate of 2% and market risk premium of 7.5% which increased the ARG target price by +13%. NEUTRAL.

Earnings and cash flow outlook

- **Rental growth:** ARG achieved robust rental growth of +3.2% (annualised) across rent reviews in 1H20 with the industrial portfolio particularly strong.
- **Development activity:** ARG has completed a number of refurbishment projects where it has focussed on improving energy efficiency and 'greening' its buildings. Developments include office at 107 Carlton Gore Road (12 year lease to Housing NZ) and 8–14 Willis Street (leased to Statistics NZ for 15 years), and retail at Stewart Dawson's corner in Wellington.

Business quality

- **Revaluation gains:** ARG reported a 1H20 revaluation gain of NZ$50.8m (+3.1%), lifting NTA per share +6cps to NZ$1.28.
- **Industrial assets underpin portfolio:** ARG's portfolio WALT was steady in 1H20 at 6 yrs. ARG's WALT is underpinned by its NZ$750m+ industrial portfolio (7.2 yrs), which is sector-leading versus industrial peers, Property for Industry and Goodman Property. ARG has the highest exposure to industrial assets in the sector (47%) after GMT (100%) and PFI (86%).

Financial structure

- **Balance sheet:** Gearing is around sector average levels at ~36% and it pays out around AFFO, providing an attractive dividend yield.
- **Dividends:** ARG has guided to a flat dividend in FY20 as it looks to move close to covering its dividend by AFFO on a sustainable basis.

Risks factors

- **Auckland office conditions:** Auckland office is vulnerable from increasing supply and the drive for space efficiency, however, recently this has been offset by assets leaving the market and increased government space.
- **Lease expiry:** ~18% of leases (by rent) are expiring in FY20 and FY21 including 8,100m to MBIE at 147 Lambton Quay in the near-term.

Company description

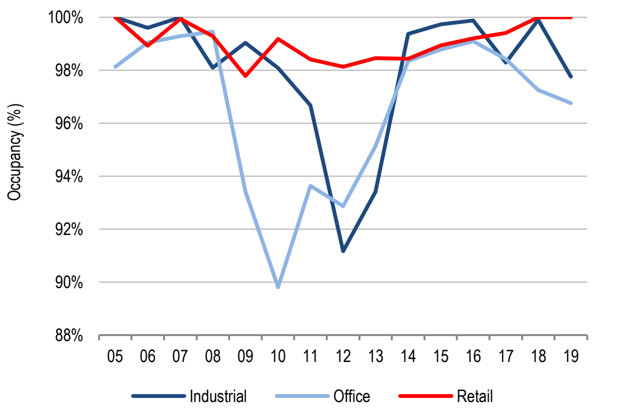
Argosy (ARG) owns a portfolio of 59 investment properties valued at NZ$1.7bn. Its portfolio is diversified across office, retail and industrial assets and regionally weighted to Auckland (70%). ARG has been active selling non-core assets in recent years, and we expect this to continue. ARG was listed in 2002 (previously named ING Property Trust) with a portfolio of two Auckland office buildings and in June 2005 completed the takeover of Urbus Properties. ARG's management structure was internalised in 2011 and in 2012 it converted its corporate structure from a trust to a company.

Figure 2. Sector and regional portfolio exposure

	Auckland	Other North Island	South Island	Total
Industrial	32%	8%	1%	41%
Office	20%	17%	-	37%
Retail	20%	2%	-	22%
Total	71%	28%	1%	100%

Source: Forsyth Barr analysis, Company Reports

Figure 3. ARG occupancy by sector



Source: Forsyth Barr analysis, Company Reports

Figure 4. Substantial Shareholders

Shareholder	Latest Holding
ACC	5.2%
The Vanguard Group	5.1%
Milford Asset Management	5.0%

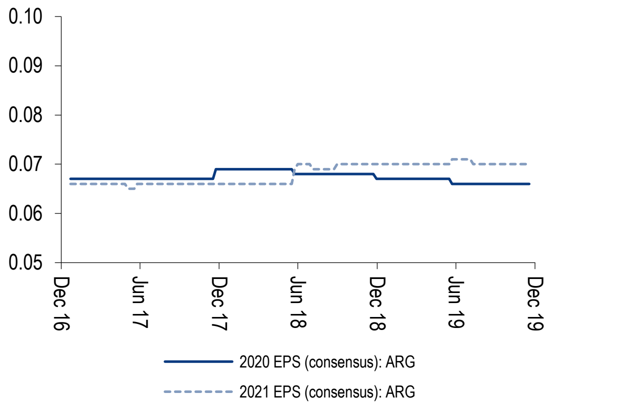
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect ARG's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Argosy Property	**ARG NZ**	**NZ$1.40**	**NZ$1,154**	**21.2x**	**20.3x**	**19.6x**	**18.3x**	**19.6x**	**18.3x**	**4.5%**
Goodman Property Trust *	GMT NZ	NZ$2.09	NZ$2,889	30.9x	30.3x	27.1x	24.7x	27.1x	24.7x	3.2%
Investore *	IPL NZ	NZ$1.91	NZ$497	23.6x	23.2x	20.0x	19.7x	20.0x	19.7x	4.0%
Kiwi Property Group *	KPG NZ	NZ$1.55	NZ$2,407	21.7x	21.4x	20.6x	19.3x	20.6x	19.3x	4.6%
Asset Plus *	APL NZ	NZ$0.64	NZ$104	16.6x	17.7x	12.3x	13.2x	12.3x	13.2x	5.6%
Precinct Properties NZ *	PCT NZ	NZ$1.75	NZ$2,293	26.6x	25.2x	27.1x	22.3x	27.1x	22.3x	3.7%
Property For Industry *	PFI NZ	NZ$2.33	NZ$1,160	26.9x	26.7x	20.9x	20.6x	20.9x	20.6x	3.3%
Stride Property *	SPG NZ	NZ$2.20	NZ$804	21.0x	19.8x	20.1x	18.3x	20.1x	18.3x	4.5%
Vital Healthcare *	VHP NZ	NZ$2.66	NZ$1,200	27.3x	26.0x	23.3x	22.1x	23.3x	22.1x	3.4%
			Compco Average:	**24.3x**	**23.8x**	**21.4x**	**20.0x**	**21.4x**	**20.0x**	**4.0%**
EV = Current Market Cap + Actual Net Debt			**ARG Relative:**	**-13%**	**-15%**	**-8%**	**-9%**	**-8%**	**-9%**	**+12%**

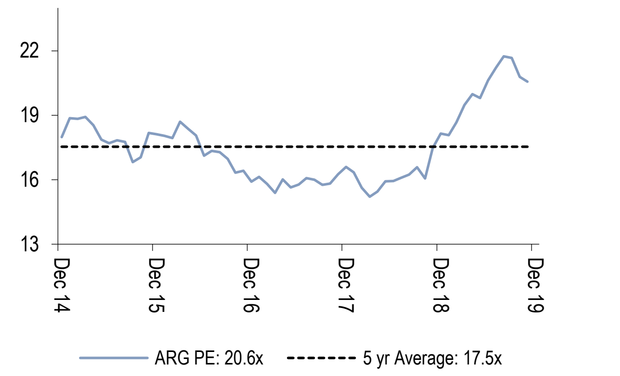
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ARG) companies fiscal year end

Figure 6. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 7. 12 Month Forward PE



Source: Forsyth Barr analysis