

Argosy

Company Update

JEREMY SIMPSON CFA

jeremy.simpson@forsythbarr.co.nz

+64 9 368 0022

NEUTRAL 

ARG has favourable attributes such as large weightings to industrial, Auckland and the Government sector and it has reiterated its FY20 dividend guidance. While ARG is one of the highest geared in the sector, its relatively smaller average asset size was a helpful source of liquidity during the last recession. With all businesses facing uncertain near-term earnings, including those in the listed property sector, ARG remains a useful member of an LPV portfolio and is trading at a very large discount to NTA to offset near-term uncertainties. Our earnings are unchanged at this time, however, our target price is down from NZ\$1.39 to NZ\$1.13 due to a pull back in our NAV valuation from NZ\$1.32 to NZ\$1.02. The NTA is currently NZ\$1.28. NEUTRAL.

NZX Code	ARG	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$0.90	NPAT* (NZ\$m)	57.4	54.5	56.9	56.9	EV/EBITDA	14.2	15.4	14.7	13.9
Target price	NZ\$1.13	EPS* (NZc)	6.9	6.6	6.9	6.9	EV/EBIT	14.2	15.4	14.7	13.9
Risk rating	Medium	EPS growth* (%)	4.8	-4.9	4.3	0.0	PE	13.0	13.6	13.1	13.1
Issued shares	827.0m	DPS (NZc)	6.3	6.3	6.3	6.3	Price / NTA	0.7	0.7	0.7	0.7
Market cap	NZ\$744m	Imputation (%)	100	100	100	100	Cash div yld (%)	7.0	7.0	7.0	7.0
Avg daily turnover	622.7k (NZ\$828k)	*Based on normalised profits					Gross div yld (%)	10.0	10.0	10.0	10.0

Large discount to NTA

ARG has been very heavily sold off, down -34% YTD, and trading at one of the largest NTA discounts in the sector (Figure 4). As is the case with the other LPVs, there is near-term asset valuation uncertainty as valuers review assets with a 31 March year-end. We do not expect significant cap rate expansion immediately given the lack of market evidence and lower long term interest rates; however, valuers will be cautious about vacancy, re-leasing time frames, and rental growth levels. The retail sector is a key concern, but the office market is also vulnerable in a recession given the typical increase in vacancy, sub-leasing and a pull back in market rental levels.

A diversified portfolio that is 47% industrial, 70% Auckland and 33% Government

ARG has a relatively low level of retail exposure compared to the other diversified funds such as KPG, SPG and APL. In its update last week ARG stated that 13% of its portfolio was retail and the bulk was large format retailer which should be more resilient to the slowdown than speciality tenants, plus the tenant covenant is strong. Office is 40% of ARG's portfolio. In addition to the uncertainty of space requirements for tenants going forward (as well as how firms re-think working from home following the Government lockdown) and the possibility of a recession, there is also the added near-term uncertainty of rental payments under earthquake lock out clauses. Almost all businesses have uncertain revenue lines over the next six months, and while most LPVs will be more resilient than many, they are not fully immune to the high level of economic uncertainty near-term.

In a solid position

ARG's appeal remains its large ~NZ\$800m industrial portfolio. ARG's total portfolio is 70% weighted to Auckland and one third of its portfolio is leased to the Government. While ARG has higher than average sector gearing at ~38% as detailed in Figure 1, it still has considerable headroom as detailed in Figure 2. Also, ARG has a relatively smaller average asset size than some of the other LPVs which is helpful for balance sheet management.

Argosy Property Limited (ARG)

Priced as at 31 Mar 2020 (NZ\$)

0.90
12-month target price (NZ\$)*
1.13

Expected share price return	25.6%
Net dividend yield	7.0%
Estimated 12-month return	32.5%

Spot valuations (NZ\$)

1. DCF	1.35
2. NAV	1.02
n/a	n/a

Key WACC assumptions

Risk free rate	2.00%
Equity beta	0.77
WACC	5.5%
Terminal growth	1.5%

DCF valuation summary (NZ\$m)

Total firm value	1,825
(Net debt)/cash	(591)
Less: Capitalised operating leases	0
Value of equity	1,193

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	101.0	102.5	100.0	106.7	113.2	EV/EBITDA (x)	13.9	14.2	15.4	14.7	13.9
Normalised EBITDA	91.1	91.5	89.0	95.3	101.3	EV/EBIT (x)	13.9	14.2	15.4	14.7	13.9
Depreciation and amortisation	0	0	0	0	0	PE (x)	13.6	13.0	13.6	13.1	13.1
Normalised EBIT	91.1	91.5	89.0	95.3	101.3	Price/NTA (x)	0.8	0.7	0.7	0.7	0.7
Net interest	(25.5)	(24.2)	(24.8)	(26.4)	(30.5)	Free cash flow yield (%)	-0.1	-3.7	-4.5	2.6	6.9
Associate income	0	0	0	0	0	Net dividend yield (%)	6.9	7.0	7.0	7.0	7.0
Tax	(11.0)	(10.0)	(9.7)	(12.0)	(14.0)	Gross dividend yield (%)	9.6	9.7	9.7	9.7	9.7
Minority interests	0	0	0	0	0						
Normalised NPAT	54.6	57.4	54.5	56.9	56.9	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	(43.6)	(76.3)	(40.5)	(42.0)	(26.7)	Interest cover EBIT (x)	3.6	3.8	3.6	3.6	3.3
Reported NPAT	98.2	133.7	95.1	98.9	83.5	Interest cover EBITDA (x)	3.6	3.8	3.6	3.6	3.3
Normalised EPS (cps)	6.6	6.9	6.6	6.9	6.9	Net debt/ND+E (%)	37.3	37.0	38.6	38.1	37.5
DPS (cps)	6.2	6.3	6.3	6.3	6.3	Net debt/EBITDA (x)	6.1	6.5	7.4	7.1	6.7
Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	0.2	1.5	-2.4	6.7	6.1	Return on assets (%)	5.9	5.5	5.0	5.1	5.4
EBITDA (%)	-0.4	0.5	-2.7	7.0	6.4	Return on equity (%)	5.9	5.7	5.2	5.2	5.0
EBIT (%)	-0.4	0.5	-2.7	7.0	6.4	Return on funds employed (%)	5.1	4.9	4.4	4.4	4.4
Normalised NPAT (%)	2.0	5.0	-4.9	4.3	0.0	EBITDA margin (%)	90.2	89.3	89.1	89.3	89.5
Normalised EPS (%)	1.0	4.8	-4.9	4.3	0.0	EBIT margin (%)	90.2	89.3	89.1	89.3	89.5
Ordinary DPS (%)	1.6	1.2	0.0	0.0	0.0	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
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Imputation (%)	100	100	100	100	100
EBITDA	91.1	91.5	89.0	95.3	101.3	Pay-out ratio (%)	94	90	95	91	91
Working capital change	6.6	9.2	0	0.0	0						
Interest & tax paid	(35.4)	(33.8)	(34.5)	(38.4)	(44.5)	Property Statistics	2015A	2016A	2017A	2018A	2019A
Other	0	0	0	0	0	Industrial					
Operating cash flow	62.3	66.9	54.5	56.9	56.9	Value (NZ\$m)	510	507	583	638	738
Capital expenditure	(63.1)	(94.8)	(88.1)	(37.4)	(5.6)	No. buildings	40	39	38	36	37
(Acquisitions)/divestments	24.8	40.7	0	0	0	WALT (years)	5.72	5.99	6.40	7.35	7.22
Other	(0.7)	(1.6)	16.3	16.3	0	Occupancy	99.7%	99.9%	98.3%	99.9%	97.8%
Funding available/(required)	23.3	11.3	(17.2)	35.8	51.3	Contract yield	7.6%	7.7%	6.9%	6.7%	6.2%
Dividends paid	(47.3)	(52.4)	(51.9)	(51.9)	(51.9)	Market yield	7.6%	7.7%	7.1%	6.7%	6.5%
Equity raised/(returned)	0	0	0	0	0						
(Increase)/decrease in net debt	(24.0)	(41.1)	(69.1)	(16.1)	(0.6)	Office					
						Value (NZ\$m)	484	549	548	577	627
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	No. buildings	17	17	17	17	16
Working capital	(10.6)	(13.9)	(13.9)	(13.9)	(13.9)	WALT (years)	5.60	4.82	4.87	4.99	4.94
Fixed assets	1,513.1	1,667.0	1,779.3	1,842.4	1,874.7	Occupancy	98.8%	99.1%	98.4%	97.2%	96.8%
Intangibles	0	0	0	0	0	Contract yield	7.6%	7.6%	7.3%	7.0%	6.9%
Right of use asset	0	0	0	0	0	Market yield	7.6%	7.6%	7.6%	7.4%	7.1%
Other assets	28.8	4.4	4.4	4.4	4.4						
Total funds employed	1,531.3	1,657.5	1,769.7	1,832.9	1,865.1	Retail					
Net debt/(cash)	551.5	591.3	660.5	676.6	677.2	Value (NZ\$m)	312	312	311	298	303
Lease liability	0	0	0	0	0	No. buildings	11	10	9	8	7
Other liabilities	52.9	57.1	57.1	57.1	57.1	WALT (years)	5.15	4.78	5.46	5.69	5.96
Shareholder's funds	926.9	1,009.0	1,052.1	1,099.1	1,130.8	Occupancy	98.9%	99.2%	99.4%	100.0%	100.0%
Minority interests	0	0	0	0	0	Contract yield	7.5%	7.4%	7.4%	7.1%	6.2%
Total funding sources	1,531.3	1,657.5	1,769.7	1,832.9	1,865.1	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

Operational update

On 25 March ARG confirmed it had added an additional NZ\$50m tranche to its bank facilities to provide further liquidity and its first bank facility expiry is October 2021. ARG, at the end of February, had only 0.4% of leases expiring in FY20 yet to be finalised. The WALT was 6.1 years and occupancy was 98.4%. Settlement of the sale of the Albany Lifestyle Centre was due to complete on 27 March, however, this has unfortunately been delayed. ARG paid its 3Q20 dividend on 25 March and continues to have guidance for a full year dividend of 6.35cps, a +1.2% increase on the pcp.

Figure 1. LPV Balance sheet overview

	As at	Reported gearing	Target gearing	Bank covenant	Bank facilities (NZ\$m)	Issued Bonds (NZ\$m)	Facility capacity (NZ\$m)	Term - bank (years)	Term - bonds (years)	Term - weighted (years)
APL	Mar-20	30.2%	35-40%	50%	75	-	27	2.2	-	2.2
ARG	Sep-19	36.2%	30-40%	50%	585	200	135	2.7	6.3	3.6
GMT	Sep-19	17.9%	25-35%	50%	400	556	400	2.6	4.6	3.8
IPL	Sep-19	40.6%	<48%	65%	270	100	65	1.5	4.1	2.2
KPG	Sep-19	27.4%	25-35%	45%	825	475	303	3.5	3.7	3.6
PCT	Dec-19	25.4%	<37.5%	50%	610	586	322	3.3	5.1	4.2
PFI	Dec-19	28.2%	<40%	50%	300	200	84	3.1	5.1	3.9
SPG	Sep-19	34.4%	38-42%	50%	400	-	67	1.8	-	1.8
VHP	Dec-19	35.1%	na	50%	870	-	225	2.0	-	2.0
Average/total		30.6%		51.1%	4,335	2,117	1,628	2.5	3.2	3.0

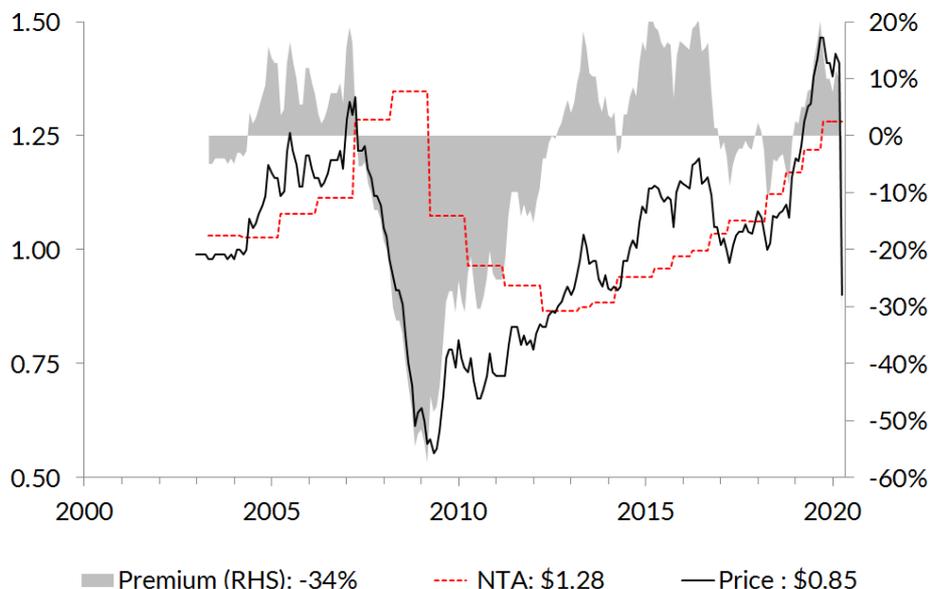
Source: Forsyth Barr analysis

Figure 2. Hypothetical asset value declines required to breach banking covenant

	Reported Gearing	Bank Covenant	Approx Debt Drawn	Approx Asset Value	Minimum Asset Value	Asset Value Decline
APL	30.2%	50%	50.0	160.0	100.0	-40%
ARG	36.2%	50%	650.0	1,790.0	1,300.0	-28%
GMT	17.9%	50%	530.0	2,960.0	1,060.0	-64%
IPL	40.6%	65%	300.0	750.0	470.0	-38%
KPG	27.4%	45%	930.0	3,400.0	2,070.0	-39%
PCT	25.4%	50%	870.0	3,440.0	1,750.0	-49%
PFI	28.2%	50%	430.0	1,520.0	860.0	-44%
SPG	34.4%	50%	300.0	880.0	610.0	-31%
VHP	35.1%	50%	680.0	1,940.0	1,360.0	-30%

Source: Forsyth Barr analysis, Company reports

Figure 3. ARG long-run P/NTA



Source: Forsyth Barr analysis

Figure 4. LPV compco

LPV	Code	Rating	Price 31-Mar	Target price	Gross yield	AFFO yield	P/NAV	P/NTA
Asset Plus	APL	UNDERPERFORM	\$0.39	\$0.65	13.2%	8.1%	60%	55%
Argosy Property	ARG	NEUTRAL	\$0.90	\$1.13	10.0%	6.9%	88%	70%
Augusta Capital	AUG	NEUTRAL	\$0.85	\$1.38	10.6%	8.4%	61%	115%
Goodman Property	GMT	NEUTRAL	\$2.15	\$1.92	4.4%	2.9%	113%	124%
Investore	IPL	OUTPERFORM	\$1.65	\$1.85	6.6%	4.6%	99%	97%
Kiwi Property Group	KPG	NEUTRAL	\$0.94	\$1.29	10.9%	7.0%	82%	66%
Precinct Properties	PCT	NEUTRAL	\$1.71	\$1.52	5.3%	3.5%	107%	116%
Property for Industry	PFI	OUTPERFORM	\$2.02	\$2.15	5.5%	3.8%	98%	102%
Stride Property	SPG	NEUTRAL	\$1.37	\$2.18	10.3%	6.9%	67%	70%
Vital Healthcare	VHP	OUTPERFORM	\$2.34	\$2.76	5.5%	3.8%	99%	101%
Core simple average					7.3%	4.9%	94%	93%

Source: Forsyth Barr analysis, company reports, Eikon

AUG's and SPG's NTA per share is adjusted to include an estimated value for funds management operations.

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. NEUTRAL.

Business quality

- **Revaluation gains:** ARG reported a 1H20 revaluation gain of NZ\$50.8m (+31%), lifting NTA per share +6cps to NZ\$1.28.
- **Industrial assets underpin portfolio:** ARG's portfolio WALT was steady in 1H20 at 6yrs. ARG's WALT is underpinned by its NZ \$750m+ industrial portfolio (7.2yrs), which is sector-leading versus industrial peers.

Earnings and cashflow 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:** Developments include office at 107 Carlton Gore Road (12 year lease to Housing NZ) and 814 Willis Street (leased to Statistics NZ for 15 years), and retail at Stewart Dawsons corner in Wellington.

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 sustainably covering its dividend by AFFO.

Risk factors

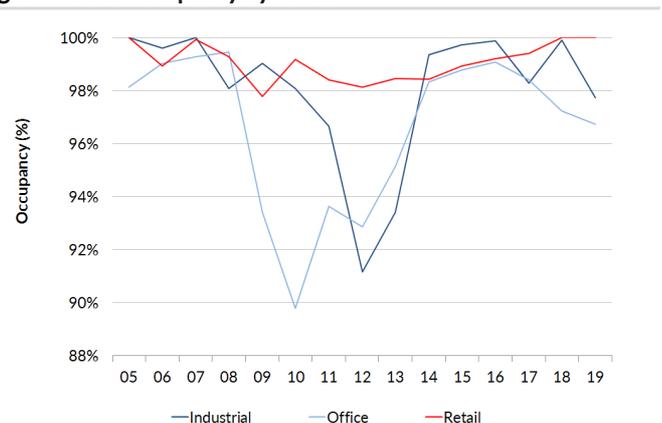
- **Auckland office conditions:** Auckland office is vulnerable from increasing supply and the drive for space efficiency, however, recently this has been offset by assets leaving the market and increased government space.
- **Lease expiry:** ~18% of leases (by rent) are expiring in FY20 and FY21 including 8,100m² to MBIE at 147 Lambton Quay.

Figure 5. Sector and regional portfolio exposure

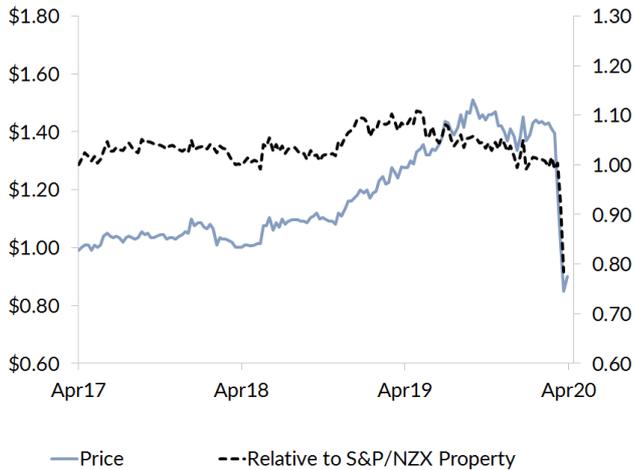
	Auckland	Other North Island	South Island	Total
Industrial	33%	9%	1%	42%
Office	21%	17%	-	38%
Retail	18%	2%	-	20%
Total	72%	27%	1%	100%

Source: Forsyth Barr analysis, Company Reports. Note: Data is based on reported portfolio as at 31/03/19

Figure 6. ARG occupancy by sector



Source: Forsyth Barr analysis, Company Reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

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

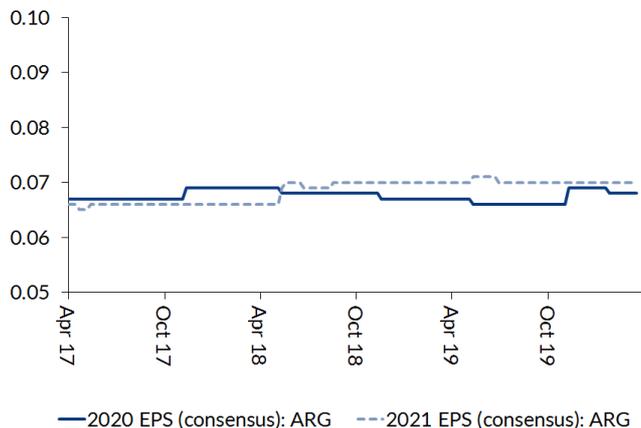
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 9. International valuation comparisons

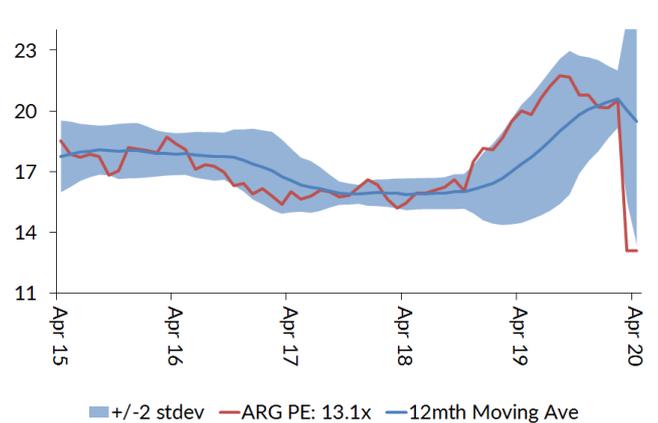
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Argosy Property	ARG NZ	NZ\$0.90	NZ\$744	13.6x	13.1x	15.0x	14.0x	15.0x	14.0x	7.0%
Goodman Property Trust *	GMT NZ	NZ\$2.05	NZ\$2,841	30.4x	29.8x	26.8x	24.4x	26.8x	24.4x	3.2%
Investore *	IPL NZ	NZ\$1.41	NZ\$429	17.4x	17.1x	18.3x	18.1x	18.3x	18.1x	5.4%
Kiwi Property Group *	KPG NZ	NZ\$0.84	NZ\$1,318	11.8x	11.7x	14.0x	13.1x	14.0x	13.1x	8.5%
Asset Plus *	APL NZ	NZ\$0.42	NZ\$68	10.9x	11.6x	8.4x	9.1x	8.4x	9.1x	8.6%
Precinct Properties NZ *	PCT NZ	NZ\$1.47	NZ\$1,931	22.6x	21.6x	24.4x	20.2x	24.4x	20.2x	4.3%
Property For Industry *	PFI NZ	NZ\$1.76	NZ\$878	20.5x	20.1x	17.3x	17.2x	17.3x	17.2x	4.4%
Stride Property *	SPG NZ	NZ\$1.30	NZ\$475	12.4x	11.7x	14.2x	13.0x	14.2x	13.0x	7.6%
Vital Healthcare *	VHP NZ	NZ\$2.05	NZ\$928	21.1x	20.1x	20.0x	18.9x	20.0x	18.9x	4.4%
Compcpo Average:				18.4x	18.0x	17.9x	16.7x	17.9x	16.7x	5.8%
ARG Relative:				-26%	-27%	-16%	-16%	-16%	-16%	20%

EV = Current Market Cap + Actual Net Debt

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

Figure 10. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 11. One year forward PE (x)


Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: Jeremy Simpson. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 30 Mar 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
37.3%	51.0%	11.8%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the following issuers that are the subject of this publication: ARG

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.