

Kiwi Property Group

1H21 Result – Transitory Pains

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UNDERPERFORM

Kiwi Property Group (KPG) reported a soft interim result, with AFFO down -21% versus the pcp due to the impacts of COVID-19. While KPG's office portfolio showed resilience in a difficult period, this was overshadowed by significant rental abatements and large negative releasing spreads in its retail portfolio. FY21 guidance surprised to the downside for both AFFO and DPS. While KPG has logical plans to dilute its retail concentration via development of its larger assets, the funding and earnings pathway for this transition will not be straightforward and execution risks are heightened. UNDERPERFORM.

NZX Code	KPG	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.28	NPAT* (NZ\$m)	106.6	87.8	104.0	107.7	PE	18.0	23.0	19.4	18.7
Target price	NZ\$1.25	EPS* (NZc)	7.1	5.6	6.6	6.9	EV/EBIT	18.2	21.8	18.3	18.0
Risk rating	Medium	EPS growth* (%)	2.1	-21.6	18.4	3.6	EV/EBITDA	18.2	21.8	18.3	18.0
Issued shares	1569.1m	DPS (NZc)	3.5	4.8	5.8	6.0	Price / NTA	1.0	1.0	1.0	0.9
Market cap	NZ\$2,016m	Imputation (%)	100	100	100	100	Cash div yld (%)	2.7	3.7	4.5	4.7
Avg daily turnover	1,990k (NZ\$2,249k)	*Based on normalised profits					Gross div yld (%)	3.9	5.3	6.5	6.7

What's changed?

- **Earnings:** FY21/FY22/FY23 AFFO revised -11%/-4%/-4%
- **Target price:** Lifted +15cps to NZ\$1.25

Retail woes unavoidable

KPG's soft result was largely attributable to NZ\$17m of COVID-19 related rental abatements, although, there was no change in expected total abatements of NZ\$20m even with a second lockdown in Auckland. Retail metrics softened with increased vacancy and lower WALT across most centres. Re-leasing spreads were -9%/-23% in mixed-use/retail, boosted by a significant short term deal to one tenant. While this sharp downward move in re-leasing spreads likely has some one-off features, with deals signed during a period of significant uncertainty, it is a metric that we believe will remain closely watched going forward.

Positive signs from office

KPG's office portfolio was the shining light in its interim report, providing a contrast to the variability in the retail portfolio. Given KPG's mixed use strategy, office assets are likely the best use of development funds with KPG targeting two new office towers at Sylvia Park, alongside a build-to-rent complex. The divestment of The Plaza (book value NZ\$169m) will be funding for these developments, with further retail divestments likely to build-out other mixed-use centres such as The Base and Lynn Mall.

Earnings down, target price up, UNDERPERFORM retained

KPG's FY21 AFFO guidance of 4.90–5.15cps was weaker than we expected. The large revision to our FY21 estimates reflects Sylvia Park Galleria timing. We also make some additional IRFS16 adjustments to lease/net interest expense for all years. The lift in our 12-month forward target price reflects greater confidence in the current book values of KPG's office and mixed-use assets. While KPG's valuation remains undemanding versus LPV peers, we believe it carries higher risks with a long dated transition away from a retail heavy portfolio.

Kiwi Property Group Limited (KPG)

Priced as at 23 Nov 2020 (NZ\$)						1.29						
12-month target price (NZ\$)*						1.25	Spot valuations (NZ\$)					
Expected share price return						-3.1%	1. DCF					1.27
Net dividend yield						4.2%	2. NAV					1.24
Estimated 12-month return						1.1%	n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						1.30%	Total firm value					2,997
Equity beta						0.81	(Net debt)/cash					(998)
WACC						4.8%	Less: Capitalised operating leases					0
Terminal growth						1.5%	Value of equity					1,976
Profit and Loss Account (NZ\$m)						Valuation Ratios						
	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Sales revenue	180.8	187.9	160.0	189.1	191.7	EV/EBITDA (x)	18.6	18.2	21.9	18.3	18.1	
Normalised EBITDA	160.0	165.3	138.7	166.9	169.1	EV/EBIT (x)	18.6	18.2	21.9	18.3	18.1	
Depreciation and amortisation	0	0	0	0	0	PE (x)	18.4	18.1	23.1	19.5	18.8	
Normalised EBIT	160.0	165.3	138.7	166.9	169.1	Price/NTA (x)	0.9	1.0	1.0	1.0	1.0	
Net interest	(37.5)	(36.8)	(37.6)	(40.0)	(36.3)	Free cash flow yield (%)	-3.4	-3.1	-0.8	4.8	4.7	
Associate income	0	0	0	0	0	Net dividend yield (%)	5.4	2.7	3.7	4.5	4.7	
Tax	(22.6)	(21.9)	(13.4)	(22.9)	(25.1)	Gross dividend yield (%)	7.7	3.9	5.3	6.4	6.7	
Minority interests	0	0	0	0	0	Capital Structure						
Normalised NPAT	99.9	106.6	87.8	104.0	107.7	Interest cover EBIT (x)	4.3	4.5	3.7	4.2	4.7	
Abnormals/other	(38.2)	293.3	(0.9)	(1.0)	(46.3)	Interest cover EBITDA (x)	4.3	4.5	3.7	4.2	4.7	
Reported NPAT	138.1	(186.7)	88.7	104.9	154.0	Net debt/ND+E (%)	32.6	33.3	33.5	33.1	32.4	
Normalised EPS (cps)	7.0	7.1	5.6	6.6	6.9	Net debt/EBITDA (x)	6.2	6.0	7.4	6.1	6.0	
DPS (cps)	7.0	3.5	4.8	5.8	6.0	Key Ratios						
Growth Rates							2019A	2020A	2021E	2022E	2023E	
Revenue (%)	-5.7	3.9	-14.8	18.2	1.3	Return on assets (%)	4.9	5.2	4.3	5.1	5.1	
EBITDA (%)	-6.5	3.4	-16.1	20.3	1.3	Return on equity (%)	4.9	5.4	4.3	5.0	5.1	
EBIT (%)	-6.5	3.4	-16.1	20.3	1.3	Return on funds employed (%)	4.3	4.4	3.8	4.3	4.3	
Normalised NPAT (%)	-3.4	6.7	-17.6	18.4	3.6	EBITDA margin (%)	88.5	88.0	86.7	88.2	88.2	
Normalised EPS (%)	-6.2	2.1	-21.6	18.4	3.6	EBIT margin (%)	88.5	88.0	86.7	88.2	88.2	
Ordinary DPS (%)	1.5	-49.3	36.2	21.0	3.7	Capex to sales (%)	93.9	90.7	61.8	7.5	7.3	
Cash Flow (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
EBITDA	160.0	165.3	138.7	166.9	169.1	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a	
Working capital change	3.4	7.1	(5.3)	7.4	1.2	Imputation (%)	100	100	100	100	100	
Interest & tax paid	(63.4)	(65.2)	(50.9)	(62.9)	(61.4)	Pay-out ratio (%)	99	49	86	88	88	
Other	0	0	0	0	0	Property Statistics						
Operating cash flow	100.0	107.3	82.5	111.4	108.9		2016A	2017A	2018A	2019A	2020A	
Capital expenditure	(169.8)	(170.4)	(98.9)	(14.1)	(14.0)	Retail portfolio						
(Acquisitions)/divestments	67.3	(25.8)	0	0	0	No. properties	9	9	4	4	4	
Other	(2.6)	(13.0)	0	0	0	WALT (years)	3.9	3.8	3.6	3.3	3.2	
Funding available/(required)	(5.1)	(101.9)	(16.4)	97.3	94.9	Occupancy rate (%)	99.1%	99.1%	99.4%	99.4%	99.4%	
Dividends paid	(81.5)	(87.5)	(25.9)	(86.4)	(92.9)	Cap rate (%)	6.7%	6.5%	6.2%	7.5%	8.1%	
Equity raised/(returned)	0	193.7	0	0	0	Office portfolio						
(Increase)/decrease in net debt	(86.6)	4.3	(42.3)	10.9	2.0	No. properties	5	5	4	4	4	
Balance Sheet (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
Working capital	(47.1)	(41.6)	(35.4)	(41.9)	(42.4)	WALT (years)	8.2	10.1	10.1	9.3	8.7	
Fixed assets	3,207.4	3,114.7	3,213.7	3,227.8	3,287.4	Occupancy rate (%)	97.4%	97.8%	99.3%	98.7%	99.0%	
Intangibles	0	0	0	0	0	Cap rate (%)	6.4%	6.1%	5.8%	5.5%	5.5%	
Right of use asset	0	0	0	0	0	Mixed-use portfolio						
Other assets	5.9	8.5	8.5	8.5	8.5	No. properties			4	4	0	
Total funds employed	3,166.2	3,081.6	3,186.7	3,194.3	3,253.4	WALT (years)			4.0	4.1	3.7	
Net debt/(cash)	991.8	988.6	1,030.9	1,020.0	1,017.9	Occupancy rate (%)			100.0%	99.5%	99.9%	
Lease liability	0	0	0	0	0	Cap rate (%)			5.72%	5.71%	5.87%	
Other liabilities	123.5	111.6	111.6	111.6	111.6	Total portfolio						
Shareholder's funds	2,050.9	1,981.4	2,044.2	2,062.8	2,123.9	WALT (years)	5.1	5.6	5.3	5.2	4.9	
Minority interests	0	0	0	0	0	Occupancy rate (%)	98.7%	98.8%	99.6%	99.3%	99.5%	
Total funding sources	3,166.2	3,081.6	3,186.7	3,194.3	3,253.4	Cap rate (%)	6.6%	6.4%	6.1%	6.0%	6.1%	
							2019A	2020A	2021E	2022E	2023E	
							1.34	1.39	1.39	1.43	1.26	

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

Result summary

- **COVID-19 impact:** KPG is providing rent abatements and deferrals to assist tenants with the financial impact of COVID-19. Abatements in 1H21 impacted AFFO by NZ\$17m or 7% of gross annual rent. KPG still expects the full year cost to be NZ\$14m as previously advised. Partially offsetting this is an NZ\$4.5m benefit from the reintroduction of depreciation on building structure.
- **Retail metrics soft:** Adjusted for the lockdown periods, total MAT was -1.7% and flat on a like-for-like basis. Adjusted for lockdowns Cinemas (-52%) and Food (-10% and -5%) were down while other categories had flat to slightly up outcomes on a like-for-like basis with supermarkets the standout (+6%).
- **Office solid:** Portfolio occupancy lifted marginally to 99.6% due to leasing at Vero. KPG's office WALT remains strong at 8.5 years.
- **Retail slipping:** Mixed-use occupancy was down -60bp to 99.3% while retail occupancy was down -100bp to 98.4%. WALT also declined and was 3.6 years for mixed-use and 2.9 years for retail. Releasing spreads were -9% for mixed-use and -23% for retail which KPG attributed to a lift in short term deals.
- **Future developments focussed on Office and BTR:** KPG has announced that it will look to reduce its retail exposure having initiated the sale process of The Plaza (Palmerston North). While future developments are dependent on market conditions (i.e. tenant commitment), KPG is looking to build a further two office towers at Sylvia Park, alongside a build-to-rent complex. This change in strategy has been well-signalled in recent years, however, re-mixing the portfolio will be a long process.
- **AFFO and DPS guidance:** KPG has provided FY21 AFFO guidance of 4.90-5.15cps (FY20: 6.85). KPG's dividend policy is 95% of AFFO, so with 2.2cps being paid in 1H21, DPS guidance for 2H21 is essentially 2.46 to 2.69cps.

Figure 1. Result summary

Financial period	1H20	1H21	Chg	Forbar	Var %
Net rental income	89.9	72.3	(20%)	73.7	(2%)
Corporate costs	(11.0)	(10.8)	(2%)	(10.7)	1%
EBITDA	78.9	61.5	(22%)	63.0	(3%)
Net interest	(19.3)	(19.8)	3%	(16.3)	22%
PBT	59.6	41.6	(30%)	46.8	(11%)
Current tax	(11.4)	(5.3)	(53%)	(6.8)	(21%)
NPAT (underlying)	48.3	36.3	(25%)	40.0	(9%)
Investment property revaluations	-	11.8	-	-	-
Other non-operating adjustments	(11.5)	(6.1)	(47%)	0.5	n/a
NPAT (reported)	36.8	54.2	47%	40.5	34%
FFO	51.9	39.7	(23%)	43.6	(9%)
AFFO	46.2	36.4	(21%)	39.1	(7%)
EPS	3.35	2.32	(31%)	2.55	(9%)
FFO (cps)	3.60	2.53	(30%)	2.78	(9%)
AFFO (cps)	3.21	2.32	(28%)	2.49	(7%)
DPS	3.53	2.20	(38%)	2.10	4.8%

Source: Forsyth Barr analysis, Company reports

Earnings changes

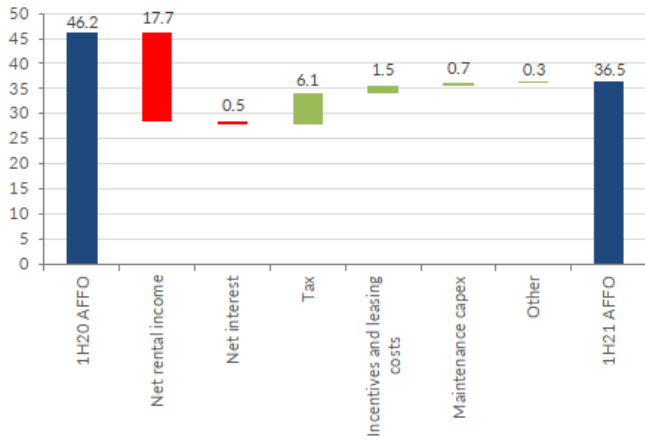
Figure 2. Earnings changes

	2021E			2022E			2023E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	168.3	160.0	-4.9%	190.5	189.1	-0.7%	194.3	191.7	-1.3%
Corporate costs	(21.4)	(21.3)	-0.7%	(21.6)	(22.3)	3.4%	(21.8)	(22.6)	3.4%
EBITDA	146.9	138.7	-5.5%	168.9	166.9	-1.2%	172.5	169.1	-2.0%
Net interest	(32.6)	(37.6)	15.2%	(37.0)	(40.0)	8.2%	(33.7)	(36.3)	7.6%
Current tax	(16.5)	(13.4)	-18.9%	(24.3)	(22.9)	-6.0%	(26.8)	(25.1)	-6.3%
NPAT (underlying)	97.8	87.8	-10.2%	107.6	104.0	-3.4%	112.0	107.7	-3.8%
Maintenance capex	(7.8)	(7.8)	-	(8.0)	(8.0)	0.0%	(8.1)	(8.1)	0.0%
AFFO	90.0	80.0	-11.1%	99.6	96.0	-3.7%	103.9	99.6	-4.1%
EPS (cps)	6.23	5.60	-10.2%	6.86	6.63	-3.4%	7.14	6.86	-3.8%
AFFO (cps)	5.74	5.10	-11.1%	6.35	6.12	-3.7%	6.62	6.35	-4.1%
DPS (cps)	5.20	4.80	-7.7%	6.11	5.81	-4.9%	6.28	6.03	-4.1%

Source: Forsyth Barr analysis

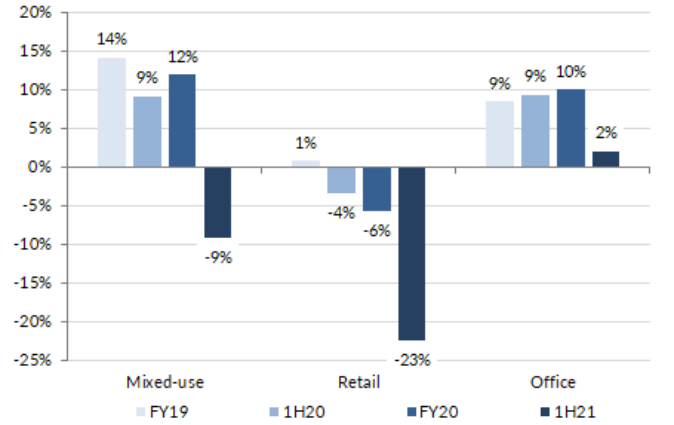
1H21 in charts

Figure 3. AFFO bridge



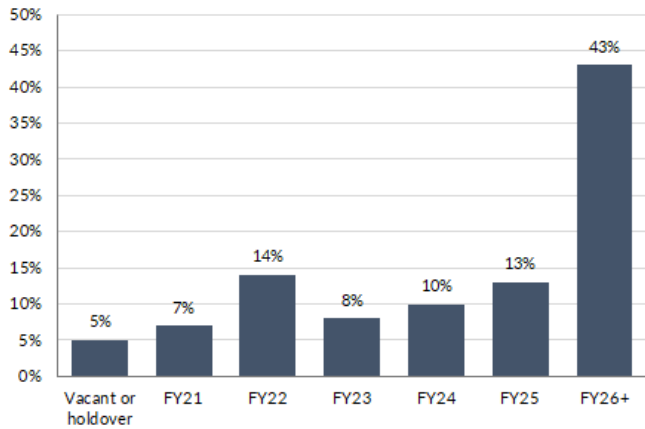
Source: Forsyth Barr analysis

Figure 4. Releasing spreads



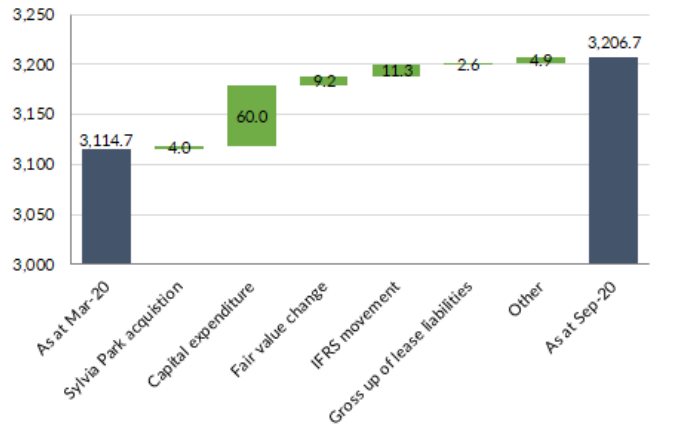
Source: Forsyth Barr analysis

Figure 5. Portfolio lease expiry



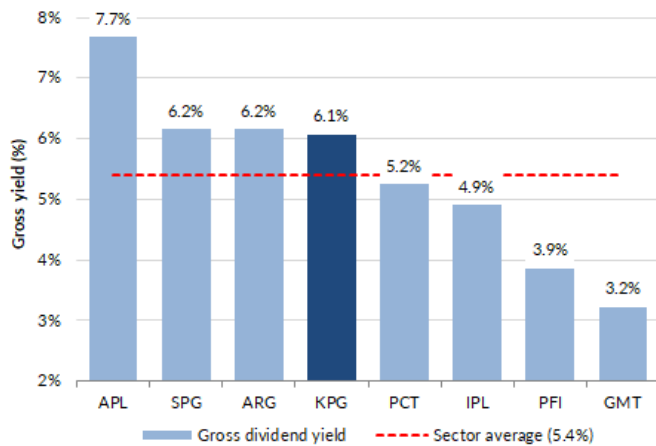
Source: Forsyth Barr analysis, Company reports

Figure 6. Portfolio book value bridge



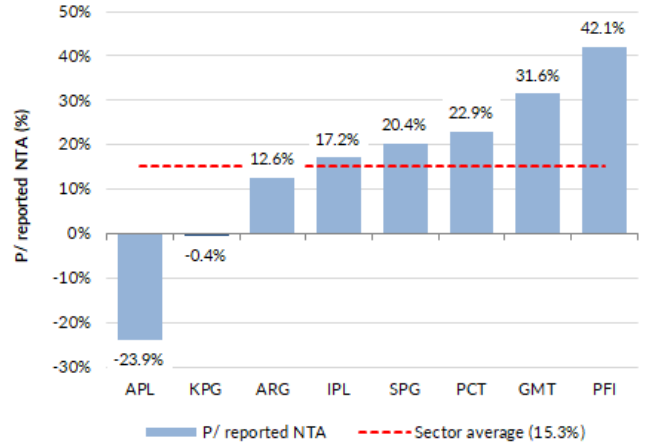
Source: Forsyth Barr analysis, Company reports

Figure 7. Gross yield

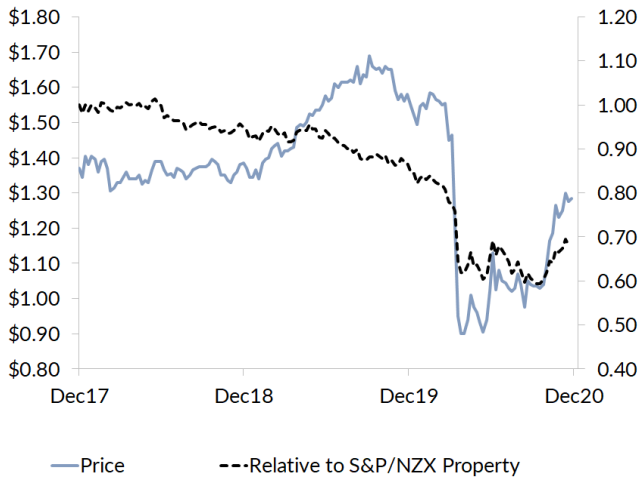


Source: Forsyth Barr analysis, Company reports

Figure 8. Price to reported NTA



Source: Forsyth Barr analysis, Company reports

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
ACC	10.5%
ANZ NZ Investments	8.3%
The Vanguard Group	5.1%

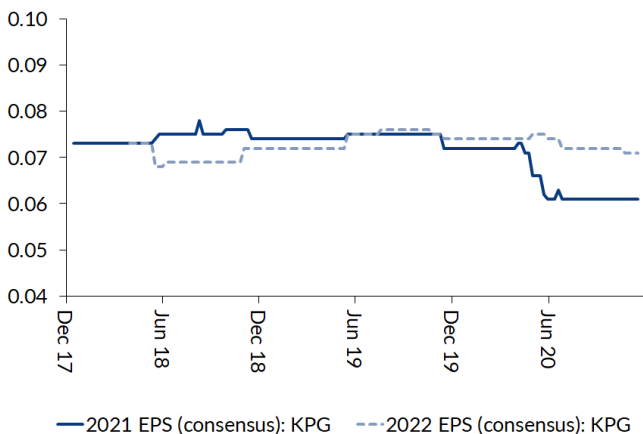
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 11. International valuation comparisons

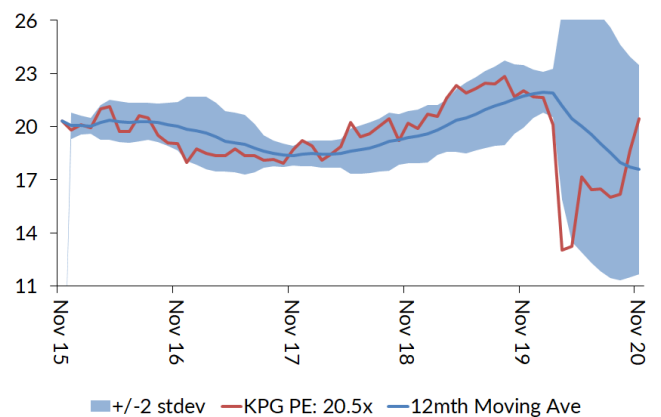
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Kiwi Property Group	KPG NZ	NZ\$1.29	NZ\$2,016	23.0x	19.4x	21.7x	18.0x	21.7x	18.0x	4.5%
ARGOSY PROPERTY *	ARG NZ	NZ\$1.47	NZ\$1,226	21.0x	21.0x	21.6x	20.9x	21.6x	20.9x	4.3%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ\$2.42	NZ\$3,360	36.8x	35.9x	30.4x	28.9x	30.4x	28.9x	2.3%
INVESTORE *	IPL NZ	NZ\$2.25	NZ\$828	29.0x	26.4x	23.4x	21.1x	23.4x	21.1x	3.5%
ASSET PLUS *	APL NZ	NZ\$0.33	NZ\$123	15.3x	23.3x	23.7x	27.5x	23.7x	27.5x	5.5%
PRECINCT PROPERTIES NZ *	PCT NZ	NZ\$1.78	NZ\$2,339	28.0x	27.7x	30.2x	27.4x	30.2x	27.4x	3.7%
PROPERTY FOR INDUSTRY *	PFI NZ	NZ\$2.94	NZ\$1,471	33.3x	32.8x	26.3x	26.5x	26.3x	26.5x	2.7%
STRIDE PROPERTY *	SPG NZ	NZ\$2.31	NZ\$844	22.1x	24.0x	31.3x	37.1x	31.3x	37.1x	4.3%
VITAL HEALTHCARE *	VHP NZ	NZ\$2.96	NZ\$1,519	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Compcop Average:				26.5x	27.3x	26.7x	27.1x	26.7x	27.1x	3.7%
KPG Relative:				-13%	-29%	-19%	-33%	-19%	-33%	21%

EV = Current Market Cap + Actual Net Debt

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

Figure 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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