

# Precinct Properties NZ

## In the Middle of Town

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### NEUTRAL

We have reviewed our Precinct Properties NZ (PCT) forecasts and adjusted our earnings and DPS forecasts for lower post lockdown tenant support, delayed Commercial Bay completion, and a higher payout ratio. While the prime location of PCT's portfolio and quality of its tenants should see earnings hold up relatively well; we forecast a relatively flat track with cyclical vacancy and rent pressure offset by Commercial Bay contribution. We lift our target price +6cps to NZ\$1.58 and retain our NEUTRAL rating on valuation grounds with PCT trading at a 14% premium to its NTA. PCT will deliver its FY20 result on 13 August.

NZX Code	PCT	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$1.69	NPAT* (NZ\$m)	77.4	87.6	88.0	98.7	EV/EBITDA	37.4	33.1	24.1	23.0
Target price	NZ\$1.58	EPS* (NZc)	6.2	6.7	6.7	6.8	EV/EBIT	37.4	33.1	24.1	23.0
Risk rating	Medium	EPS growth* (%)	-1.8	7.5	0.5	2.1	PE	27.1	25.3	25.1	24.6
Issued shares	1313.7m	DPS (NZc)	6.0	6.3	6.3	6.3	Price / NTA	1.2	1.1	1.1	1.2
Market cap	NZ\$2,214m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.6	3.7	3.7	3.8
Avg daily turnover	1,330k (NZ\$2,309k)	*Based on normalised profits					Gross div yld (%)	5.1	5.3	5.3	5.4

### Office down cycle approaching

Office is typically a cyclical market. We expect this cycle will be no different to the past with rising vacancy and lower market rents. We expect Auckland rents to be pressured by business failures, backfill created by development completions, as well as growing subleasing as occupiers resize their footprint. While PCT is in a better position than last cycle with a better quality portfolio, longer weighted average lease term (WALT), and high quality tenant mix, it won't be immune to cyclical pressures. As such rent growth will be hard to find muting PCT earnings outlook. Lower rents and higher vacancy will also impact office valuations but with some offset from low interest rates. PCT's NTA may hold up better due to its high quality assets. We note that PCT typically release draft valuations pre-result but have not yet provided an update suggesting a flat outcome for FY20.

### Lifting our EPS and DPS forecasts

We have adjusted our earnings for lower than previously forecast COVID tenant support, the delayed opening of Commercial Bay, the deferral of 1 Queen St redevelopment, settlement of the Pastoral House divestment, development of Bowen Campus stage 2 building 1, and higher levels of capitalised interest. Our FY20-22 EPS forecasts increase +8.3%/+2.4%/+4.1% to 6.7/6.7/6.8cps and our DPS forecasts increase +11.5%/+19.2%/+20.8% to 6.3/6.3/6.3cps aided by a higher medium term payout ratio (up from 90% to 100% of AFFO). Despite the significant tailwind from Commercial Bay finally contributing to earnings we forecast relatively modest earnings and DPS growth over the next 3 years (FY20-22E CAGR of 1.3% and 0.2% respectively) reflecting the softer economic backdrop impacting occupancy and rent growth. We forecast occupancy to decline from 99% at 1H20 to trough at c.95% in FY21.

### Valuation keeps us NEUTRAL

Despite the upward revisions to our EPS and DPS track we retain our NEUTRAL rating on valuation grounds. PCT is currently trading at a 14% premium to its NTA; slightly above NZ listed property vehicle (LPV) peers at a 10% premium at the median level. We also highlight that PCT's gross yield of 5.3% is in line with the sector median of 5.5%, with a similar dividend growth outlook.

## Precinct Properties NZ Limited (PCT)

Priced as at 27 Jul 2020 (NZ\$)

**1.69**

### 12-month target price (NZ\$)\*

**1.58**

Expected share price return	-6.5%
Net dividend yield	3.7%
Estimated 12-month return	-2.8%

### Spot valuations (NZ\$)

1. DCF	1.45
2. NAV	1.60
3. n/a	n/a

### Key WACC assumptions

Risk free rate	2.75%
Equity beta	0.69
WACC	5.8%
Terminal growth	1.5%

### DCF valuation summary (NZ\$m)

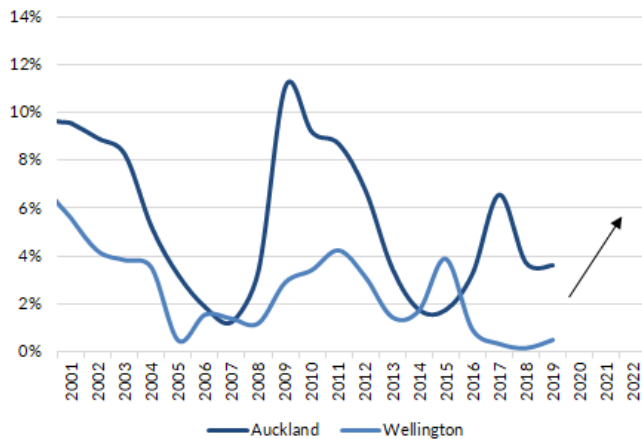
Total firm value	2,680
(Net debt)/cash	(752)
Less: Capitalised operating leases	0
Value of equity	1,906

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	95.3	95.0	103.8	142.2	148.9	EV/EBITDA (x)	33.1	37.5	33.1	24.2	23.0
<b>Normalised EBITDA</b>	<b>85.1</b>	<b>79.2</b>	<b>90.9</b>	<b>126.2</b>	<b>132.5</b>	EV/EBIT (x)	33.1	37.5	33.1	24.2	23.0
Depreciation and amortisation	0	0	0	0	0	PE (x)	26.7	27.2	25.3	25.2	24.7
<b>Normalised EBIT</b>	<b>85.1</b>	<b>79.2</b>	<b>90.9</b>	<b>126.2</b>	<b>132.5</b>	Price/NTA (x)	1.2	1.2	1.1	1.1	1.2
Net interest	(2.2)	(1.8)	(3.6)	(32.0)	(28.3)	Free cash flow yield (%)	-9.9	-9.4	-3.7	-0.7	-2.2
Associate income	0	0	0	0	0	Net dividend yield (%)	3.4	3.6	3.7	3.7	3.7
Tax	(6.3)	0	0.3	(6.1)	(5.6)	Gross dividend yield (%)	4.9	5.1	5.3	5.3	5.3
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>76.6</b>	<b>77.4</b>	<b>87.6</b>	<b>88.0</b>	<b>98.7</b>	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	178.3	110.5	81.6	0	14.2	Interest cover EBIT (x)	38.7	44.0	25.5	3.9	4.7
<b>Reported NPAT</b>	<b>254.9</b>	<b>187.9</b>	<b>169.2</b>	<b>88.0</b>	<b>112.8</b>	Interest cover EBITDA (x)	38.7	44.0	25.5	3.9	4.7
Normalised EPS (cps)	6.3	6.2	6.7	6.7	6.8	Net debt/ND+E (%)	31.0	28.1	29.6	31.9	29.8
DPS (cps)	5.8	6.0	6.3	6.3	6.3	Net debt/EBITDA (x)	8.9	9.5	9.2	7.4	6.9
Growth Rates	2018A	2019A	2020E	2021E	2022E	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	5.4	-0.3	9.3	36.9	4.7	Return on assets (%)	3.3	2.8	3.0	4.1	4.1
EBITDA (%)	5.6	-6.9	14.8	38.8	5.0	Return on equity (%)	4.5	4.0	4.4	4.4	4.6
EBIT (%)	5.6	-6.9	14.8	38.8	5.0	Return on funds employed (%)	3.1	2.7	2.9	3.8	3.9
Normalised NPAT (%)	2.5	1.0	13.2	0.5	12.0	EBITDA margin (%)	89.3	83.4	87.6	88.8	89.0
Normalised EPS (%)	2.5	-1.8	7.5	0.5	2.1	EBIT margin (%)	89.3	83.4	87.6	88.8	89.0
Ordinary DPS (%)	3.6	3.4	5.0	0.1	0.3	Capex to sales (%)	308.9	286.2	164.3	73.2	99.0
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
<b>EBITDA</b>	<b>85.1</b>	<b>79.2</b>	<b>90.9</b>	<b>126.2</b>	<b>132.5</b>	Imputation (%)	100	100	100	100	100
Working capital change	(2.6)	(7.8)	0	0	0.0	Pay-out ratio (%)	92	97	94	94	92
Interest & tax paid	(7.6)	(7.3)	(3.3)	(38.1)	(33.9)	Property Statistics	2015A	2016A	2017A	2018A	2019A
Other	0	0	0	0	0	Key metrics					
<b>Operating cash flow</b>	<b>74.9</b>	<b>64.1</b>	<b>87.6</b>	<b>88.0</b>	<b>98.7</b>	No. properties	15	13	12	12	14
Capital expenditure	(294.4)	(271.9)	(170.6)	(104.0)	(147.4)	Net lettable area (000sqm)	304	226	224	225	232
(Acquisitions)/divestments	0	180.8	82.9	0	0	Average lease term (years)	5.0	6.3	8.7	6.9	7.6
Other	(11.5)	(2.4)	0	0	0	Occupancy rate (%)	98	98	100	99	99
<b>Funding available/(required)</b>	<b>(231.0)</b>	<b>(29.4)</b>	<b>(0.1)</b>	<b>(16.0)</b>	<b>(48.7)</b>	Cap rate (%)	7.0	6.5	6.2	5.8	5.7
Dividends paid	(69.6)	(75.1)	(81.8)	(82.8)	(91.2)	Initial yield (%)	7.0	6.7	6.5	5.8	5.2
Equity raised/(returned)	0	149.3	0	0	0	Over / (under) renting (%)	(1.8)	(3.6)	(4.7)	(6.4)	(5.2)
<b>(Increase)/decrease in net debt</b>	<b>(300.6)</b>	<b>44.8</b>	<b>(81.9)</b>	<b>(98.8)</b>	<b>(139.9)</b>	Total portfolio (NZ\$m)					
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Investment properties	1,612	1,514	1,535	1,488	1,871
Working capital	(6.0)	(33.2)	(33.2)	(33.2)	(33.2)	Properties held for sale	76	0	0	191	0
Fixed assets	2,325.7	2,793.7	2,936.3	3,040.3	3,201.9	Development properties	0	190	509	838	923
Intangibles	0	0	0	0	0	Total	1,688	1,704	2,045	2,517	2,794
Right of use asset	0	0	0	0	0	NTA per share (NZ\$)	1.11	1.17	1.24	1.40	1.47
Other assets	225.7	44.2	44.2	44.2	44.2						
<b>Total funds employed</b>	<b>2,545.4</b>	<b>2,804.7</b>	<b>2,947.3</b>	<b>3,051.3</b>	<b>3,212.9</b>						
Net debt/(cash)	758.8	751.5	833.4	932.1	919.0						
Lease liability	0	0	0	0	0						
Other liabilities	95.9	129.4	129.4	129.4	129.4						
Shareholder's funds	1,690.7	1,923.8	1,984.6	1,989.8	2,164.5						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>2,545.4</b>	<b>2,804.7</b>	<b>2,947.3</b>	<b>3,051.3</b>	<b>3,212.9</b>						

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

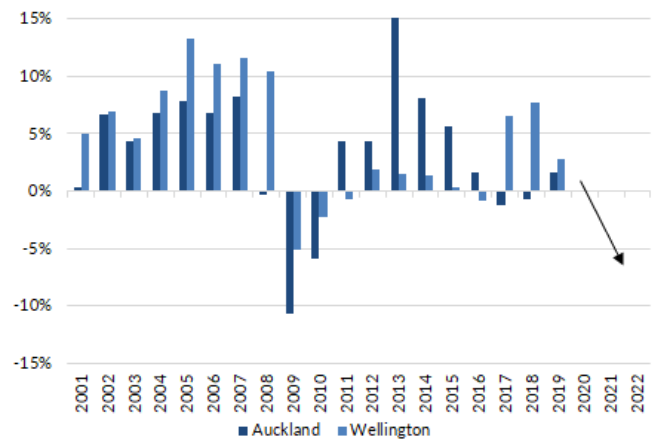
## PCT in 6 charts

**Figure 1. Auckland and Wellington prime office vacancy**



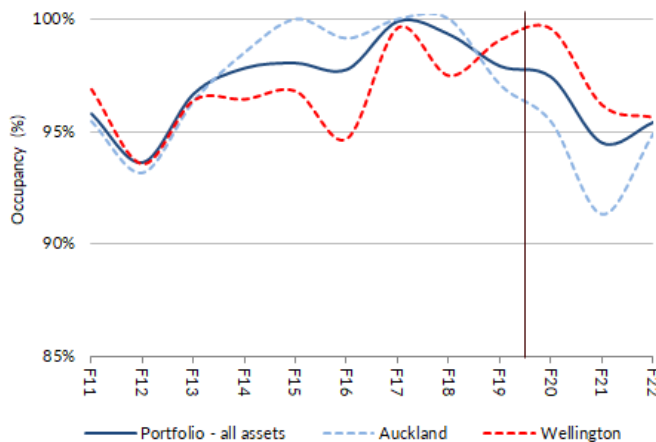
Source: Forsyth Barr analysis, CBRE

**Figure 2. Auckland and Wellington prime office rent growth**



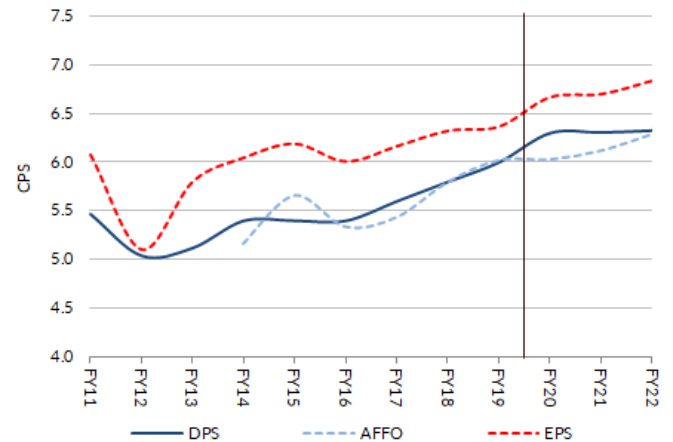
Source: Forsyth Barr analysis, CBRE

**Figure 3. PCT occupancy**



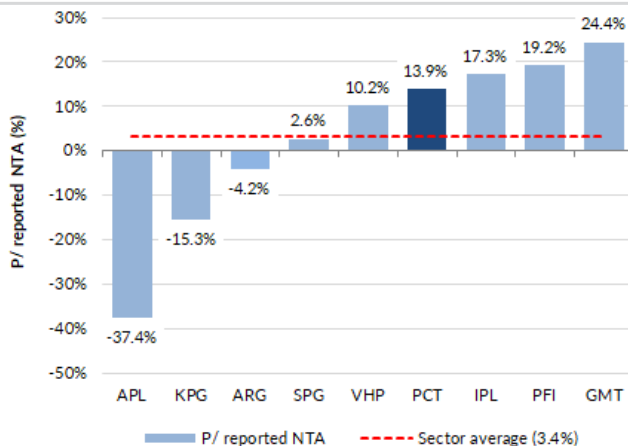
Source: Forsyth Barr analysis

**Figure 4. PCT per share metrics**



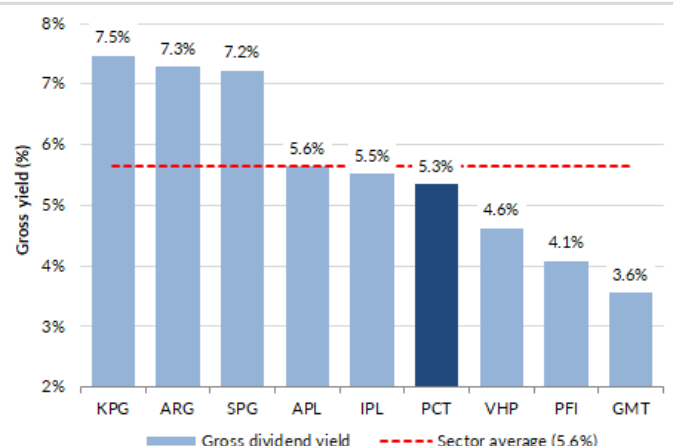
Source: Forsyth Barr analysis, Company reports Note: FY20-22 reflects FB forecasts

**Figure 5. PCT premium to NTA vs. the LPV sector**



Source: Forsyth Barr analysis

**Figure 6. PCT gross yield**



Source: Forsyth Barr analysis

## Earnings changes

Figure 7. Earnings changes

	2020E			2021E			2022E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	131.0	103.8	-20.7%	142.9	142.2	-0.5%	152.8	148.9	-2.6%
Corporate costs	(12.8)	(12.9)	1.2%	(16.0)	(16.0)	-0.4%	(16.4)	(16.4)	-0.4%
<b>EBITDA</b>	<b>118.3</b>	<b>90.9</b>	<b>-23.1%</b>	<b>126.9</b>	<b>126.2</b>	<b>-0.5%</b>	<b>136.3</b>	<b>132.5</b>	<b>-2.8%</b>
Net interest	(32.9)	(3.6)	-89.2%	(33.8)	(32.0)	-5.2%	(34.8)	(28.3)	-18.8%
Current tax	(4.4)	0.3	-106.2%	(7.1)	(6.1)	-14.2%	(6.8)	(5.6)	-17.8%
<b>NPAT (underlying)</b>	<b>80.9</b>	<b>87.6</b>	<b>8.3%</b>	<b>86.0</b>	<b>88.0</b>	<b>2.4%</b>	<b>94.7</b>	<b>98.7</b>	<b>4.1%</b>
Maintenance capex	(8.3)	(8.2)	-1.5%	(10.4)	(7.5)	-28.4%	(10.8)	(7.8)	-27.5%
<b>AFFO</b>	<b>72.4</b>	<b>79.2</b>	<b>9.5%</b>	<b>75.4</b>	<b>80.4</b>	<b>6.7%</b>	<b>83.9</b>	<b>90.8</b>	<b>8.2%</b>
EPS (cps)	6.16	6.67	8.3%	6.54	6.70	2.4%	6.57	6.84	4.1%
AFFO (cps)	5.51	6.03	9.5%	5.74	6.12	6.7%	5.82	6.29	8.2%
DPS (cps)	5.65	6.30	11.5%	5.16	6.31	22.1%	5.24	6.33	20.8%
Payout - EPS	92%	94%	2.9%	79%	94%	19.2%	80%	92%	16.0%
Payout - AFFO	103%	104%	1.9%	90%	103%	14.4%	90%	101%	11.7%

Source: Forsyth Barr analysis

## Investment Summary

Precinct Properties' (PCT) substantially completed development pipeline has improved the quality of its portfolio and will contribute to higher EPS. While cyclical factors may weigh on its portfolio over the medium term, it has positioned itself better than in previous cycles, with better quality assets, tenants, and longer lease terms. NEUTRAL.

### Business quality

- **Portfolio fundamentals:** PCT has 99% occupancy and a high portfolio WALT of 9 years including developments as at its FY19 result.
- **Prime location:** PCT is well positioned given its key precincts in Auckland and Wellington. While cyclical factors will impact PCT over the medium term, it will be supported by high quality assets and strong tenant covenants, particularly from its Wellington government leases. PCT is in a stronger position than last cycle.

### Earnings and cashflow outlook

- **Development milestones:** The Commercial Bay retail precinct opened in mid June, and early trading appears positive. Tenants are currently moving into the office tower, and its nearing full occupancy (92%). One Queen Street is currently on hold, Wynyard Quarter stage 2 is 100% leased, and Bowen Campus stage 2 building 1 has commenced.
- **Development margins:** Commercial Bay and Bowen Campus are expected to generate a yield on cost of 7.5% and ~7.0% respectively, as well as substantial development margins.

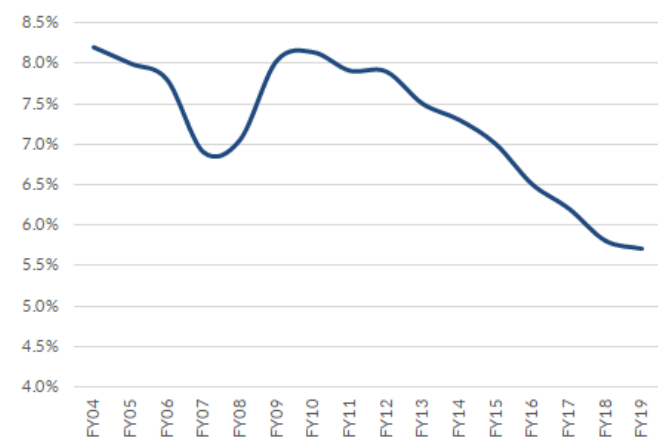
### Financial structure

- **Balance sheet:** 1H20 gearing is 22% and committed gearing is ~32% post the sale of Pastoral House in Wellington for NZ\$77m, which settled in 2H20.

### Risk factors

- **CBD office supply:** Auckland and Wellington have office supply planned in coming years, which could impact vacancy and rents particularly given the impending cyclical pressures. Offsetting this is the number of project delays in Auckland.
- **Economic slowdown:** Traditionally the office market is relatively volatile through a downturn in terms of rental levels, vacancy and values.

Figure 8. Portfolio market capitalisation rate

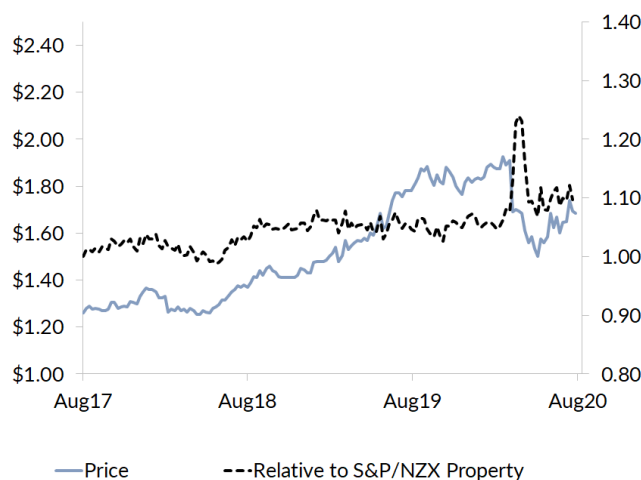


Source: Forsyth Barr analysis, Company Reports

Figure 9. Portfolio Occupancy



Source: Forsyth Barr analysis, Company Reports

**Figure 10. Price performance**


Source: Forsyth Barr analysis

**Figure 11. Substantial shareholders**

Shareholder	Latest Holding
Haumi	17.7%
ANZ NZ Investments	9.8%

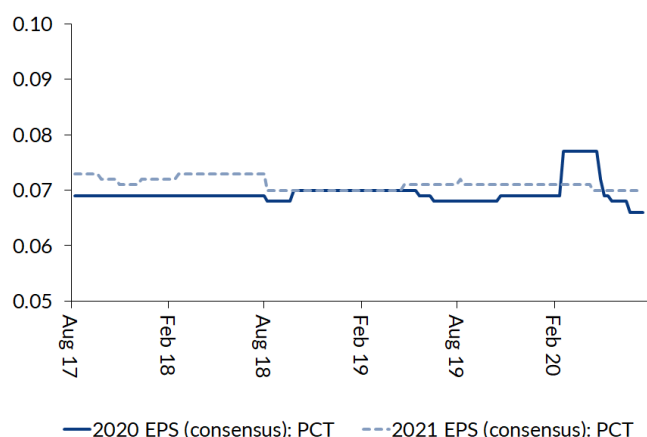
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 12. International valuation comparisons**

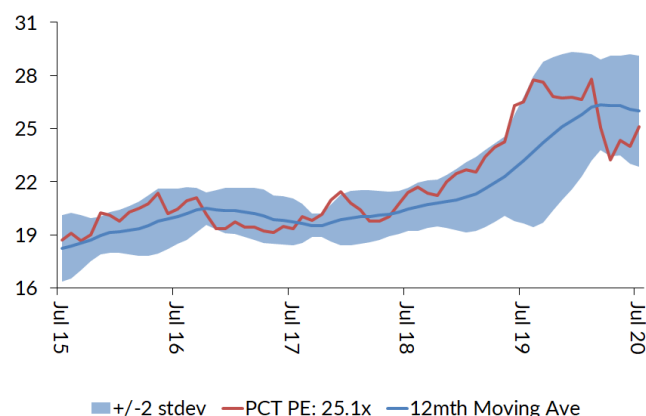
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect PCT's balance date - June)										
Precinct Properties NZ	PCT NZ	NZ\$1.69	NZ\$2,214	25.3x	25.1x	32.6x	23.5x	32.6x	23.5x	3.7%
ARGOSY PROPERTY *	ARG NZ	NZ\$1.29	NZ\$1,067	18.0x	18.4x	20.2x	19.7x	20.2x	19.7x	4.9%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ\$2.18	NZ\$3,033	32.6x	33.1x	27.8x	27.7x	27.8x	27.7x	2.4%
INVESTORE *	IPL NZ	NZ\$1.97	NZ\$725	25.8x	25.7x	23.4x	20.9x	23.4x	20.9x	3.9%
KIWI PROPERTY GROUP *	KPG NZ	NZ\$1.03	NZ\$1,616	14.9x	16.1x	16.2x	17.2x	16.2x	17.2x	5.3%
ASSET PLUS *	APL NZ	NZ\$0.36	NZ\$57	11.6x	12.7x	13.8x	16.8x	13.8x	16.8x	3.8%
PROPERTY FOR INDUSTRY *	PFI NZ	NZ\$2.48	NZ\$1,237	29.2x	29.1x	23.0x	23.9x	23.0x	23.9x	2.8%
STRIDE PROPERTY *	SPG NZ	NZ\$1.96	NZ\$716	18.9x	19.2x	21.4x	29.3x	21.4x	29.3x	5.1%
VITAL HEALTHCARE *	VHP NZ	NZ\$2.62	NZ\$1,187	26.5x	26.2x	23.8x	23.6x	23.8x	23.6x	3.2%
Compco Average:				22.2x	22.6x	21.2x	22.4x	21.2x	22.4x	3.9%
PCT Relative:				14%	11%	54%	5%	54%	5%	-5%

EV = Current Market Cap + Actual Net Debt

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

**Figure 13. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 14. One year forward PE (x)**


Source: Forsyth Barr analysis

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