

Precinct Properties NZ

1H21 Result – Prime Time

ROHAN KOREMAN-SMIT CFA

rohan.koreman-smit@forsythbarr.co.nz
+64 9 368 0085

ASHTON OLDS CFA

ashton.olds@forsythbarr.co.nz
+64 9 368 0127

OUTPERFORM

Precinct Properties (PCT) portfolio has fared well despite COVID-19 pressures, with portfolio fundamentals remaining solid, and operations tracking broadly in-line with expectations. While we expect that the Auckland and Wellington office markets will experience some level of softness in coming year, PCT is in good shape to withstand these pressures given its best in class offering, portfolio under-renting, high quality corporate and government tenants, structured rent growth, and a 7.7 year WALT. We lift our rating from NEUTRAL to OUTPERFORM reflecting a better earnings outlook and attractive valuation metrics with PCT trading at a 3% premium to NTA vs. the sector 8.5% and offering a gross yield 5.9% vs. the sector at 5.5%.

NZX Code	PCT	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.57	NPAT* (NZ\$m)	82.5	89.2	97.1	100.7	PE	25.0	23.1	23.3	23.1
Target price	NZ\$1.74	EPS* (NZc)	6.3	6.8	6.7	6.8	EV/EBIT	31.9	25.9	23.5	21.7
Risk rating	Medium	EPS growth* (%)	0.8	8.2	-0.9	0.7	EV/EBITDA	31.9	25.9	23.5	21.7
Issued shares	1313.8m	DPS (NZc)	6.3	6.5	6.7	6.8	Price / NTA	1.1	1.1	1.1	1.1
Market cap	NZ\$2,063m	Imputation (%)	100	100	100	100	Cash div yld (%)	4.0	4.1	4.3	4.3
Avg daily turnover	1,407k (NZ\$2,365k)	*Based on normalised profits					Gross div yld (%)	5.7	5.9	6.1	6.2

What's changed?

- **Earnings:** AFFO lifted +1.3%/+3.0%/+2.0% in FY21/FY22/FY23
- **Target price:** Lifted +2cps to NZ\$1.74
- **Rating:** Up to OUTPERFORM

Operationally sound, impacted by one offs

PCT reported 1H21 AFFO of NZ\$43.8m, +5.7% ahead of our estimated NZ\$41.5m. Key variances versus our expectations were a softer operating outcome (lower rent and higher operating costs) more than offset by lower tax expense. Operating income missed due to COVID-19 related one-offs including NZ\$1m of retail rental support, an NZ\$0.8m loss from the Commercial Bay hospitality business, and a lower than expected contribution from Generator; these impacts are not expected to reoccur in the second half, with management confident of a normalisation in 2H21. Tenant incentives were also above expectations in the half due to elevated leasing activity as PCT completed the remaining backfill leasing at HSBC tower. PCT has maintained AFFO/DPS guidance for FY21 of 6.5cps.

Prime office resilient

Working-from-home is yet to crimp rental growth in PCT's portfolio, with strong re-leasing spreads of +8.7% in Auckland and +4.3% in Wellington in the half. Strong market sales evidence (particularly in Wellington) compressed portfolio cap rates -39bps and lifted asset values NZ\$148.5m. While vacancy rates have increased in Auckland, this is predominantly in secondary stock and city-fringe locations, with demand for prime office space remaining strong. To date, only 1 of 161 tenants in PCT's portfolio has pursued a subleasing deal. PCT expects to recommence its One Queen Street development later this year, albeit featuring less hotel space.

Valuation

We make changes to our risk free rate (from 1.3% to 2.3%) and market risk premium (from 6.0% to 5.5%), consistent with our strategy report, *Still a One Way Bet? – Updated WACC Assumptions*, published 12 February 2021. The net impact of this is a +47bp increase in our WACC which, along with our earnings changes, lowers our DCF by c.7%. This impact is broadly offset by a 10% lift in our NAV.

Precinct Properties NZ Limited (PCT)

Priced as at 25 Feb 2021 (NZ\$) **1.57**

12-month target price (NZ\$)*	1.74
Expected share price return	10.8%
Net dividend yield	4.2%
Estimated 12-month return	15.0%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.77
WACC	4.8%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. DCF	1.74
2. NAV	1.70
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	3,251
(Net debt)/cash	(1,021)
Less: Capitalised operating leases	0
Value of equity	2,239

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	95.3	105.8	133.3	143.2	154.0
Normalised EBITDA	79.5	92.5	117.7	128.0	138.2
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	79.5	92.5	117.7	128.0	138.2
Net interest	(1.7)	(5.0)	(27.4)	(22.5)	(26.1)
Associate income	0	0	0	0	0
Tax	(0.1)	(5.0)	(1.1)	(8.3)	(11.4)
Minority interests	0	0	0	0	0
Normalised NPAT	77.7	82.5	89.2	97.1	100.7
Abnormals/other	110.5	(52.3)	148.5	49.3	59.8
Reported NPAT	188.2	30.2	237.7	146.5	160.5
Normalised EPS (cps)	6.2	6.3	6.8	6.7	6.8
DPS (cps)	6.0	6.3	6.5	6.7	6.8

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	0.0	11.0	26.0	7.4	7.6
EBITDA (%)	-6.6	16.4	27.2	8.7	8.0
EBIT (%)	-6.6	16.4	27.2	8.7	8.0
Normalised NPAT (%)	1.4	6.2	8.2	8.8	3.7
Normalised EPS (%)	-1.5	0.8	8.2	-0.9	0.7
Ordinary DPS (%)	3.4	5.0	3.2	2.7	1.6

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	79.5	92.5	117.7	128.0	138.2
Working capital change	(8.0)	7.9	0.0	(0.0)	0
Interest & tax paid	(7.3)	(17.7)	(28.4)	(30.8)	(37.5)
Other	0	0	0	0	0
Operating cash flow	64.2	82.7	89.2	97.1	100.7
Capital expenditure	(271.9)	(297.1)	(102.0)	(145.3)	(72.7)
(Acquisitions)/divestments	188.2	67.3	177.8	0	0
Other	(2.1)	(6.1)	0	0	0
Funding available/(required)	(21.6)	(153.2)	165.1	(48.1)	28.1
Dividends paid	(75.1)	(81.8)	(84.7)	(95.7)	(100.3)
Equity raised/(returned)	149.3	(0.1)	0	0	0
(Increase)/decrease in net debt	52.6	(235.1)	80.4	(143.8)	(72.3)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(33.2)	(8.7)	(8.7)	(8.7)	(8.7)
Fixed assets	2,793.7	2,990.7	2,914.9	3,109.5	3,241.9
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	44.2	104.0	104.0	104.0	104.0
Total funds employed	2,804.7	3,086.0	3,010.2	3,204.8	3,337.2
Net debt/(cash)	751.5	1,021.1	940.7	931.5	1,003.8
Lease liability	0	0	0	0	0
Other liabilities	127.2	179.7	179.7	179.7	179.7
Shareholder's funds	1,926.0	1,885.2	1,889.7	2,093.5	2,153.7
Minority interests	0	0	0	0	0
Total funding sources	2,804.7	3,086.0	3,010.2	3,204.8	3,337.2

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	35.4	31.9	25.9	23.5	21.7
EV/EBIT (x)	35.4	31.9	25.9	23.5	21.7
PE (x)	25.2	25.0	23.1	23.3	23.1
Price/NTA (x)	1.1	1.1	1.1	1.1	1.1
Free cash flow yield (%)	-10.1	-10.4	-0.6	-2.3	1.4
Net dividend yield (%)	3.8	4.0	4.1	4.3	4.3
Gross dividend yield (%)	5.5	5.7	5.9	6.1	6.2

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	46.8	18.5	4.3	5.7	5.3
Interest cover EBITDA (x)	46.8	18.5	4.3	5.7	5.3
Net debt/ND+E (%)	28.1	35.1	33.2	30.8	31.8
Net debt/EBITDA (x)	9.5	11.0	8.0	7.3	7.3

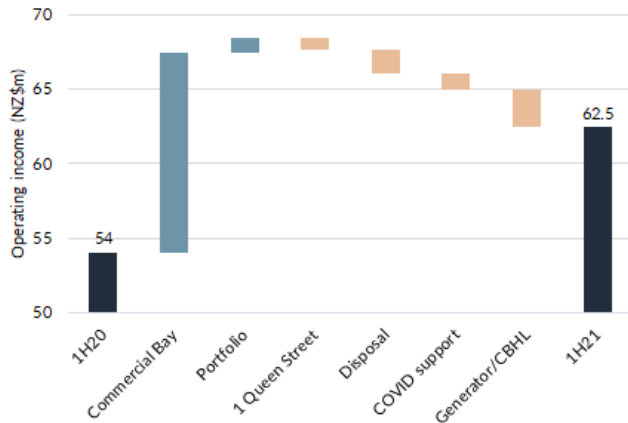
Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	2.8	3.0	3.9	4.0	4.1
Return on equity (%)	4.0	4.4	4.7	4.6	4.7
Return on funds employed (%)	2.7	2.7	3.7	3.8	3.8
EBITDA margin (%)	83.4	87.4	88.3	89.4	89.8
EBIT margin (%)	83.4	87.4	88.3	89.4	89.8
Capex to sales (%)	285.3	280.8	76.5	101.5	47.2
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	96	100	96	99	100

Property Statistics	2015A	2016A	2017A	2018A	2019A
Key metrics					
No. properties	15	13	12	12	14
Net lettable area (000sqm)	304	226	224	225	232
Average lease term (years)	5.0	6.3	8.7	6.9	7.6
Occupancy rate (%)	98	98	100	99	99
Cap rate (%)	7.0	6.5	6.2	5.8	5.7
Initial yield (%)	7.0	6.7	6.5	5.8	5.2
Over / (under) renting (%)	(1.8)	(3.6)	(4.7)	(6.4)	(5.2)

Total portfolio (NZ\$m)					
Investment properties	1,612	1,514	1,535	1,488	1,871
Properties held for sale	76	0	0	191	0
Development properties	0	190	509	838	923
Total	1,688	1,704	2,045	2,517	2,794
NTA per share (NZ\$)	1.11	1.17	1.24	1.40	1.47

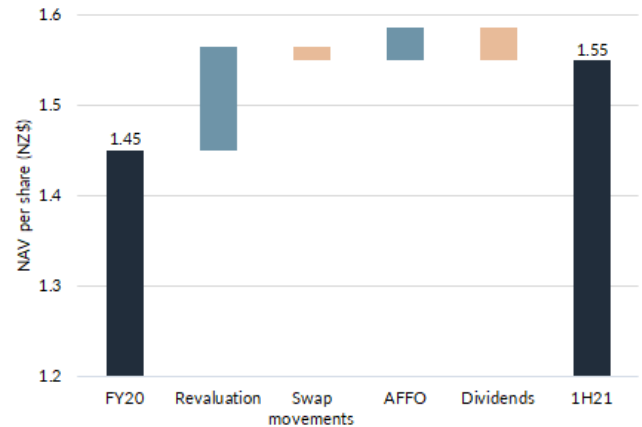
PCT in charts

Figure 1. 1H21 operating income bridge (NZ\$m)



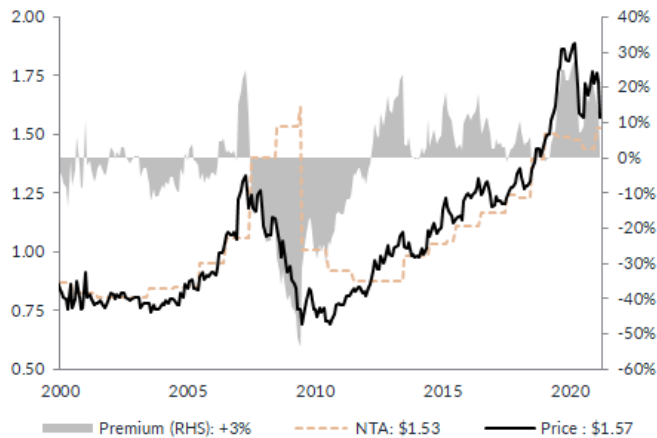
Source: Forsyth Barr analysis

Figure 2. NAV uplift to NZ\$1.55 per share



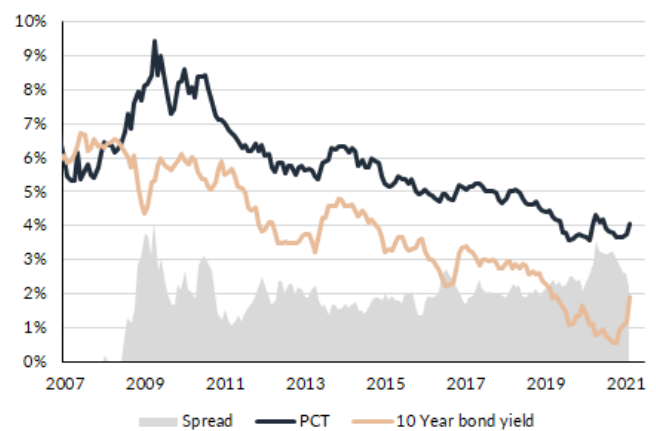
Source: Forsyth Barr analysis

Figure 3. PCT price to NTA time series



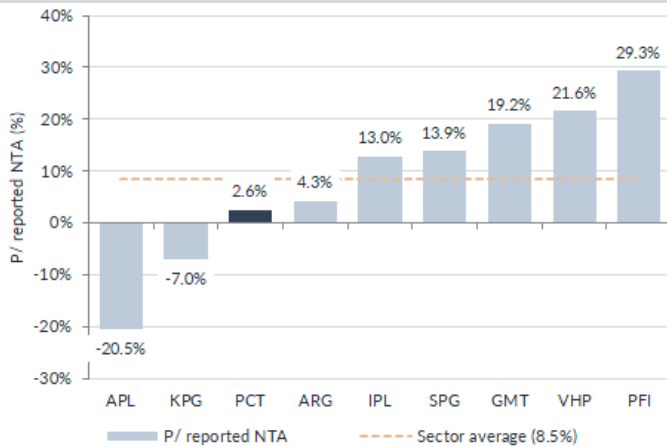
Source: Forsyth Barr analysis

Figure 4. PCT gross yield (6.0%) spread to 10y bonds



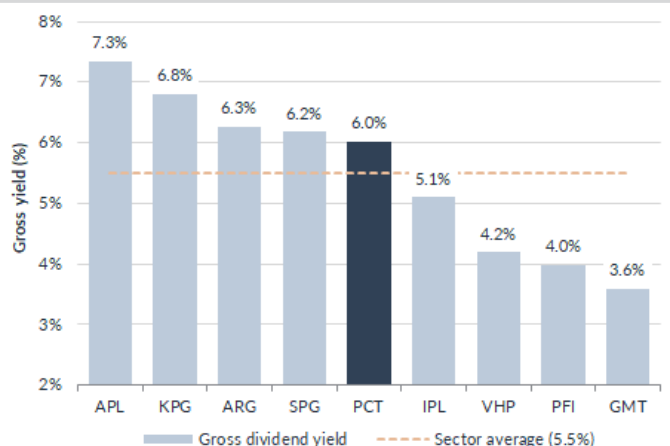
Source: Forsyth Barr analysis

Figure 5. LPVs price to NTA



Source: Forsyth Barr analysis

Figure 6. LPVs gross yield



Source: Forsyth Barr analysis

Result summary and earnings changes

Figure 7. Result summary

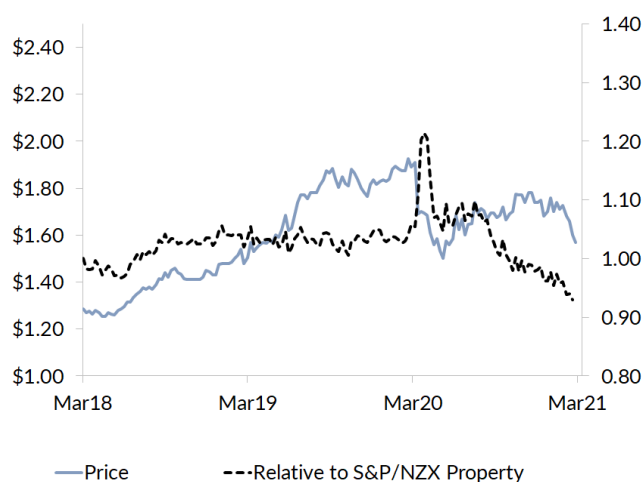
Financial period	1H20	1H21	% chg	Forecast	% var
6 months ending:	12/19	12/20			
Underlying profit & loss (\$'000s)					
Net income	54,000	62,500	15.7%	63,483	-1.5%
Base corporate costs	(6,600)	(9,000)	36.4%	(7,820)	15.1%
EBITDA	47,400	53,500	12.9%	55,663	-3.9%
Net interest	(2,500)	(10,700)	328.0%	(11,467)	-6.7%
PBT	44,900	42,800	-4.7%	44,196	-3.2%
Current tax	(7,600)	6,500	-185.5%	(2,345)	-377.2%
Net operating income (NPAT)	37,300	49,300	32.2%	41,851	17.8%
Amortisation of incentives and other	7,600	1,500	-80.3%	5,600	-73.2%
Funds from operations (FFO)	44,900	50,800	13.1%	47,451	7.1%
Maintenance capex	(2,000)	(2,700)	35.0%	(2,000)	35.0%
Liquidated Damages (net of tax)	-	-	-	-	-
Incentives and leasing costs	(2,000)	(4,300)	115.0%	(4,000)	7.5%
Adjusted funds from operations (AFFO)	40,900	43,800	7.1%	41,451	5.7%
Reported profit					
NPAT (underlying)	37,300	49,300	32.2%	41,851	17.8%
Investment property revaluations	-	148,500	-	-	-
Other non-operating adjustments	17,000	(34,600)	-303.5%	-	-
NPAT (reported)	54,300	163,200	200.6%	41,851	290.0%
Financials per share (cps)					
NPAT per share	2.84	3.75	32.2%	3.19	17.8%
FFO per share	3.42	3.87	13.1%	3.61	7.1%
AFFO per share	3.11	3.33	7.1%	3.16	5.7%

Source: Forsyth Barr analysis, Company reports

Figure 8. Earnings changes

	2021E			2022E			2023E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	134.8	133.3	-1.1%	138.8	143.2	3.1%	150.5	154.0	2.3%
Corporate costs	(15.6)	(15.6)	-0.1%	(15.1)	(15.2)	0.5%	(15.6)	(15.8)	1.2%
EBITDA	119.1	117.7	-1.2%	123.7	128.0	3.4%	134.9	138.2	2.5%
Net interest	(30.5)	(27.4)	-10.2%	(24.2)	(22.5)	-7.0%	(26.4)	(26.1)	-1.2%
Current tax	(4.7)	(1.1)	-77.0%	(6.5)	(8.3)	28.8%	(10.4)	(11.4)	9.9%
NPAT (underlying)	84.0	89.2	6.3%	93.0	97.1	4.4%	98.1	100.7	2.7%
Amortisation of incentives and leasing costs	10.4	8.2	-20.9%	10.7	9.2	-13.8%	11.7	10.4	-11.2%
FFO	94.3	97.5	3.3%	103.7	106.4	2.5%	109.8	111.1	1.2%
Incentives and leasing costs	(4.0)	(6.0)	49.5%	(3.3)	(3.4)	3.4%	(4.1)	(4.2)	2.6%
Maintenance capex	(5.4)	(5.4)	-	(6.0)	(5.7)	-6.1%	(6.9)	(6.2)	-10.9%
AFFO	84.9	86.0	1.3%	94.4	97.3	3.0%	98.8	100.7	2.0%
EPS (cps)	6.39	6.79	6.3%	6.45	6.73	4.4%	6.61	6.78	2.7%
AFFO (cps)	6.46	6.55	1.3%	6.55	6.74	3.0%	6.65	6.78	2.0%
DPS (cps)	6.47	6.50	0.5%	6.55	6.68	2.0%	6.65	6.78	2.0%

Source: Forsyth Barr analysis

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
Haumi	17.7%
ANZ NZ Investments	9.8%

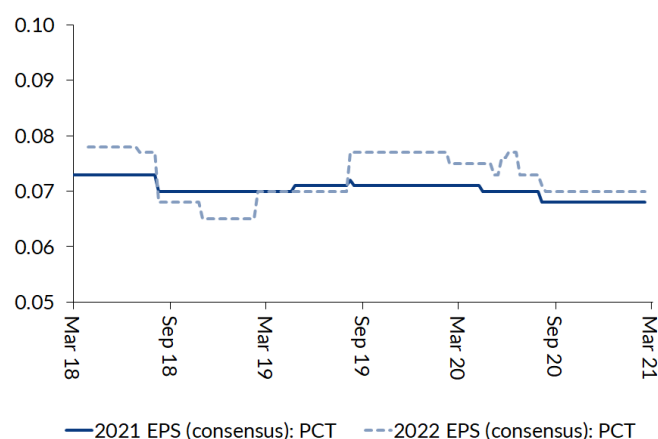
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 11. International valuation comparisons

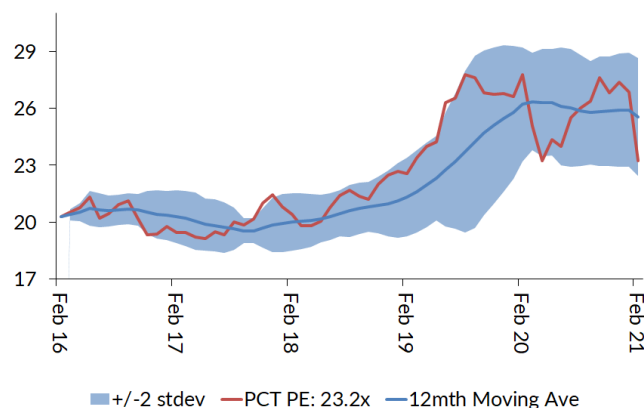
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect PCT's balance date - June)										
Precinct Properties NZ	PCT NZ	NZ\$1.57	NZ\$2,063	23.1x	23.3x	26.2x	24.1x	26.2x	24.1x	4.3%
ARGOSY PROPERTY *	ARG NZ	NZ\$1.46	NZ\$1,218	19.4x	19.7x	21.0x	19.7x	21.0x	19.7x	4.5%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ\$2.18	NZ\$3,033	32.3x	31.6x	26.5x	25.0x	26.5x	25.0x	2.5%
INVESTORE *	IPL NZ	NZ\$2.20	NZ\$810	27.7x	25.5x	22.4x	20.6x	22.4x	20.6x	3.6%
KIWI PROPERTY GROUP *	KPG NZ	NZ\$1.20	NZ\$1,883	20.6x	18.0x	19.8x	17.2x	19.8x	17.2x	4.9%
ASSET PLUS *	APL NZ	NZ\$0.36	NZ\$137	18.0x	28.3x	25.3x	32.6x	25.3x	32.6x	5.0%
PROPERTY FOR INDUSTRY *	PFI NZ	NZ\$2.88	NZ\$1,441	31.5x	31.5x	26.1x	26.9x	26.1x	26.9x	2.8%
STRIDE PROPERTY *	SPG NZ	NZ\$2.26	NZ\$1,069	20.8x	21.3x	30.2x	27.0x	30.2x	27.0x	4.4%
VITAL HEALTHCARE *	VHP NZ	NZ\$3.06	NZ\$1,578	27.7x	26.0x	26.4x	24.3x	26.4x	24.3x	3.0%
Compco Average:				24.8x	25.2x	24.7x	24.2x	24.7x	24.2x	3.8%
PCT Relative:				-7%	-8%	6%	-0%	6%	-0%	11%

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 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
44.2%	36.5%	19.2%

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