

# Property For Industry

## Upgrade to OUTPERFORM

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### OUTPERFORM

In our sector report *Real Estate Reflections* dated 26 March 2020, we looked at sector gearing and provided an update on our preferred LPVs. We also provided some thoughts on how investors should be positioned as uncertainty persists, and a reminder of what happened during the global financial crisis (GFC) and how things may be 'different this cycle'. We also upgraded our PFI investment rating from NEUTRAL to OUTPERFORM.

NZX Code	PFI	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.06	NPAT* (NZ\$m)	42.6	43.8	43.7	44.5	EV/EBITDA	19.2	19.2	19.1	18.8
Target price	NZ\$2.15	EPS* (NZc)	8.5	8.8	8.8	8.9	EV/EBIT	19.2	19.2	19.1	18.8
Risk rating	Low	EPS growth* (%)	1.9	2.8	-0.1	1.9	PE	24.1	23.5	23.5	23.1
Issued shares	498.7m	DPS (NZc)	7.6	7.7	7.8	7.9	Price / NTA	1.0	1.0	1.0	0.9
Market cap	NZ\$1,027m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.7	3.7	3.8	3.8
Avg daily turnover	273.5k (NZ\$623k)	*Based on normalised profits					Gross div yld (%)	5.3	5.3	5.4	5.4

### Industrial well positioned

Good, well located, industrial property has proven to be fairly resilient through the cycle, typically with a lower level of vacancy than office, but it has had a massive re-rating in terms of asset values over the last eight years. The industrial space in the NZ LPV market is GMT at 100% (although that includes some office space in industrial parks), PFI ~90%, ARG ~50% and SPG ~30%. Most are typically Auckland based and/or good quality.

PFI's smaller average asset size means it is popular with private investors and this should continue to be the case, depending on private balance sheets. Small asset size also makes it helpful for divesting assets to reduce debt in a slower market, although is not helpful for cap rates. Quality listed industrial occupancy only dropped to around the ~95% level last cycle.

### Upgraded from NEUTRAL to OUTPERFORM

PFI has a strong track record and is well managed, and has an appealing internal management structure. As mentioned above, its relatively smaller asset size helps with managing liquidity if needed and it successfully did this through the GFC period, without raising new capital. It has a defensive asset base, essentially being prime and secondary Auckland industrial assets. PFI has occupancy of 99% and a WALT of 5.4 years. A deep occupier market and change of use optionality over the medium term provides defensive attributes for the industrial market. PFI is geared to 28% versus a sector average of ~31% and has recently renegotiated its debt facilities. We have not changed our forecasts or NZ\$2.15 target price.

**Property for Industry Ltd (PFI)**

Priced as at 26 Mar 2020 (NZ\$)

**2.06**

<b>12-month target price (NZ\$)*</b>					<b>2.15</b>	<b>Spot valuations (NZ\$)</b>				
Expected share price return					4.4%	1. DCF				
Net dividend yield					3.8%	2. NAV				
Estimated 12-month return					8.1%	3. n/a				
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>				
Risk free rate						Total firm value	1,480			
Equity beta						(Net debt)/cash	(412)			
WACC						Less: Capitalised operating leases	0			
Terminal growth						Value of equity	1,062			
<b>Profit and Loss Account (NZ\$m)</b>					<b>Valuation Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Sales revenue					2.00%	EV/EBITDA (x)	19.8	19.2	19.2	19.1
<b>Normalised EBITDA</b>					18.8	EV/EBIT (x)	19.8	19.2	19.2	19.1
Depreciation and amortisation					18.8	PE (x)	24.6	24.1	23.5	23.5
<b>Normalised EBIT</b>					23.1	Price/NTA (x)	1.2	1.0	1.0	0.9
Net interest					3.8	Free cash flow yield (%)	3.8	3.1	3.8	3.8
Associate income					3.8	Net dividend yield (%)	3.7	3.7	3.8	3.8
Tax					3.8	Gross dividend yield (%)	5.2	5.3	5.3	5.4
Minority interests					5.4					
<b>Normalised NPAT</b>										
Abnormals/other						<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>
<b>Reported NPAT</b>						Interest cover EBIT (x)	3.8	3.9	3.9	3.9
Normalised EPS (cps)						Interest cover EBITDA (x)	3.8	3.9	3.9	4.0
DPS (cps)						Net debt/ND+E (%)	30.3	28.2	27.8	27.4
						Net debt/EBITDA (x)	5.6	5.5	5.5	5.4
<b>Growth Rates</b>					<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Revenue (%)					4.8	Return on assets (%)	5.3	4.9	4.9	4.8
EBITDA (%)					4.0	Return on equity (%)	4.6	4.1	4.1	4.0
EBIT (%)					3.9	Return on funds employed (%)	4.4	4.1	3.9	3.9
Normalised NPAT (%)					92.5	EBITDA margin (%)	93.9	93.6	93.0	92.5
Normalised EPS (%)					92.5	EBIT margin (%)	93.9	93.6	93.0	92.5
Ordinary DPS (%)					6.5	Capex to sales (%)	19.5	20.1	6.5	6.5
					6.5	Capex to depreciation (%)	n/a	n/a	n/a	n/a
<b>Cash Flow (NZ\$m)</b>					100	Imputation (%)	100	100	100	100
<b>EBITDA</b>					88	Pay-out ratio (%)	90	89	88	89
Working capital change					88					
Interest & tax paid						<b>Property Statistics</b>	<b>2015A</b>	<b>2016A</b>	<b>2017A</b>	<b>2018A</b>
Other						<b>Major Prop. Values - PFI (NZ\$m)</b>				<b>2019A</b>
<b>Operating cash flow</b>						7-9 Niall Burgess Rd, Mt Wellington	27.3	28.9	31.0	32.0
Capital expenditure						54 Carbine Rd, Mt Wellington	22.4	25.8	26.4	28.6
(Acquisitions)/divestments						6 Donner Place, Mt Wellington	14.5	15.0	15.1	15.1
Other						686 Rosebank Rd, Avondale	32.2	33.4	35.0	40.0
<b>Funding available/(required)</b>						212 Cavendish Drive, Manukau	17.1	19.1	22.4	29.7
Dividends paid						3-5 Niall Burgess Rd, Mt Wellington	15.7	17.3	17.7	20.0
Equity raised/(returned)						30-32 Bowden Rd, Mt Wellington	20.7	21.4	25.4	27.0
(Increase)/decrease in net debt										27.8
<b>Balance Sheet (NZ\$m)</b>						<b>Major Prop. Values - DPF (NZ\$m)</b>				
Working capital						Carlaw Commerical, Parnell	60.8	61.8	62.1	63.8
Fixed assets						Carlaw Gateway, Parnell	33.8	35.0	35.0	35.5
Intangibles						78 Springs Road, East Tamaki	72.0	78.5	82.8	83.0
Right of use asset						229 Dairy Flat Highway, Albany	22.9	24.7	27.0	28.0
Other assets						15 Jomac Place, Avondale	21.0	23.6	24.0	24.5
<b>Total funds employed</b>										25.1
Net debt/(cash)						<b>Portfolio Summary</b>				
Lease liability						Investment properties (NZ\$m)	987	1,083	1,211	1,322
Other liabilities						Weighted average lease term (yrs)	5.2	4.8	5.3	5.4
Shareholder's funds						Occupancy rate (%)	99.6	99.6	99.9	99.3
Minority interests						Number of properties	84	83	92	94
<b>Total funding sources</b>						NTA per share (NZ\$)	1.41	1.61	1.63	1.78
										2.06

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

**Figure 1. Balance Sheet summary**

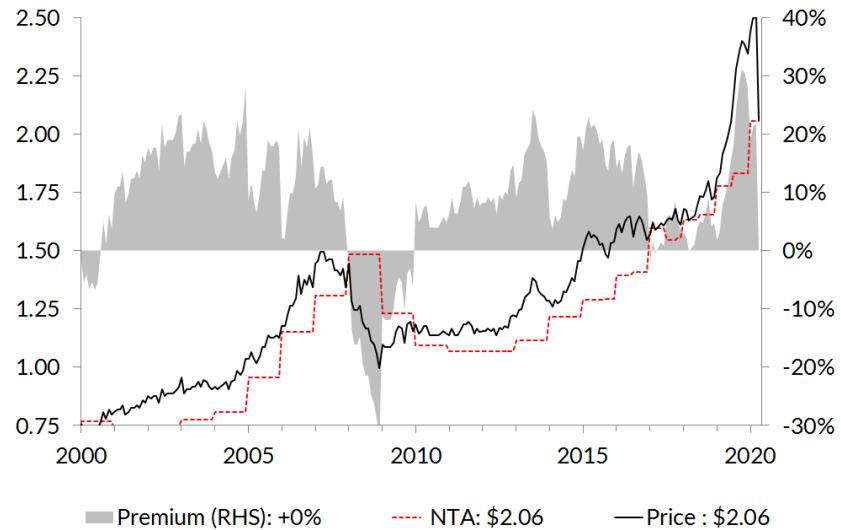
	As at	Reported gearing	Target gearing	Bank covenant	Bank facilities (NZ\$m)	Issued Bonds (NZ\$m)	Facility capacity (NZ\$m)	Term - bank (years)	Term - bonds (years)	Term - weighted (years)
APL	Mar-20	30.2%	35-40%	50%	75	-	27	2.2	-	2.2
ARG	Sep-19	36.2%	30-40%	50%	535	200	85	2.7	6.3	3.7
GMT	Sep-19	17.9%	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
<b>Average/total</b>		<b>30.6%</b>		<b>51.1%</b>	<b>4,285</b>	<b>2,117</b>	<b>1,479</b>	<b>2.5</b>	<b>3.2</b>	<b>3.0</b>

Source: Forsyth Barr analysis, company reports

**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. PFI long-run P/NTA**


Source: Forsyth Barr analysis

**Figure 4. LPV compco table**

LPV	Code	Rating	Price 26-Mar	Target price	Gross yield	AFFO yield	P/NAV	P/NTA
Asset Plus	APL	UNDERPERFORM	\$0.42	\$0.65	12.4%	7.6%	63%	58%
Argosy Property	ARG	NEUTRAL	\$0.86	\$1.38	10.4%	7.2%	65%	67%
Augusta Capital	AUG	NEUTRAL	\$0.98	\$1.38	9.3%	7.3%	70%	132%
Goodman Property	GMT	NEUTRAL	\$2.19	\$1.92	4.3%	2.9%	115%	127%
Investore	IPL	OUTPERFORM	\$1.50	\$1.85	7.3%	5.0%	90%	88%
Kiwi Property Group	KPG	NEUTRAL	\$0.87	\$1.29	11.7%	7.5%	76%	61%
Precinct Properties	PCT	NEUTRAL	\$1.66	\$1.52	5.4%	3.6%	103%	113%
Property for Industry	PFI	OUTPERFORM	\$2.06	\$2.15	5.4%	3.7%	100%	104%
Stride Property	SPG	NEUTRAL	\$1.35	\$2.18	10.5%	7.0%	66%	69%
Vital Healthcare	VHP	OUTPERFORM	\$2.36	\$2.76	5.5%	3.8%	100%	102%
<b>Core simple average</b>					<b>7.6%</b>	<b>5.1%</b>	<b>90%</b>	<b>91%</b>

Source: Forsyth Barr analysis

## Investment Summary

Property for Industry (PFI) has continued its track record of reliable and steady performance underpinned by a clear, low risk strategy. PFI's large industrial portfolio is centred on the key precincts in Auckland, and it is well positioned to continue to deliver its defensive attributes. Revaluation gains have been strong, driven by significant cap rate firming. OUTPERFORM.

### Business quality

- **Property fundamentals:** PFI has occupancy of 99% and a WALT of 5.4 years. A deep occupier market and change of use optionality over the medium term provides defensive attributes for the industrial market.
- **Defensive qualities:** Industrial property has a very stable earnings profile and has been resilient through the cycle. Over 80% of PFI's portfolio is weighted to Auckland with record low vacancy and strong tenant demand.

### Earnings and cashflow outlook

- **Transactional activity:** PFI has ~NZ\$80m of uncommitted debt capacity. We expect PFI will continue to be opportunistic with respect to acquisitions.
- **Development activity:** PFI's NZ\$7m spec development on surplus land at 212 Cavendish Drive has now been leased to Kiwi Steel on a 15-year term.

### Financial structure

- **Balance sheet capacity plus an intention to recycle more assets:** Balance sheet is solid at 28% geared, well below the 50% banking covenant limit and its self-imposed 40% maximum. PFI has a well diversified debt book with four banks in its syndicate and two issued bonds, and continues to divest non-core property.

### Risk factors

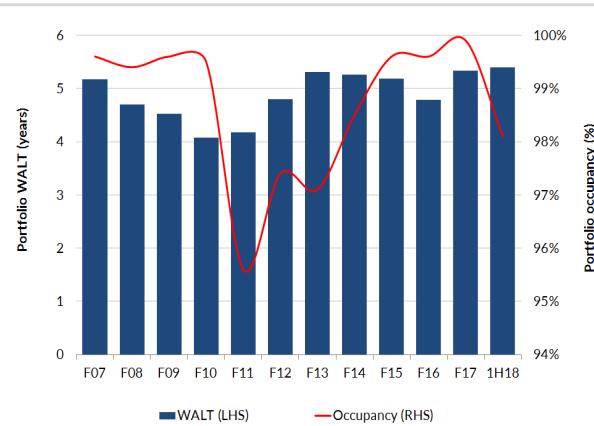
- **Rising interest rates:** Higher interest rates make other yield investments more attractive relative to listed property dividend yields.

**Figure 5. Sector and regional portfolio exposure**

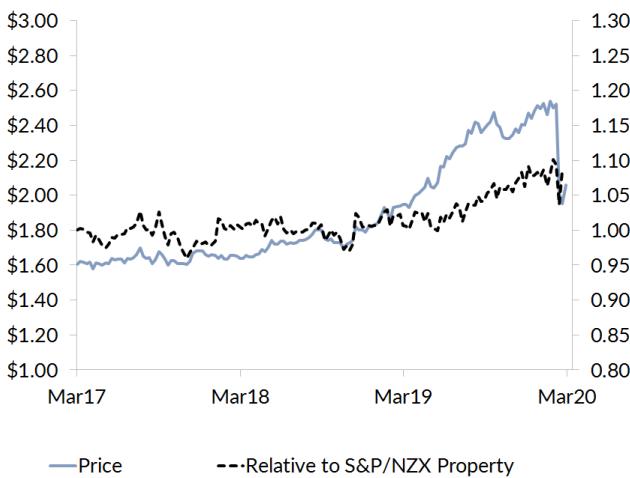
	Auckland	Other North Island	South Island	Total
Industrial	70%	12%	5%	<b>87%</b>
Office	7%	0%	0%	<b>7%</b>
Mixed use	5%	1%	0%	<b>6%</b>
<b>Total</b>	<b>83%</b>	<b>13%</b>	<b>5%</b>	<b>100%</b>

Source: Forsyth Barr analysis, Company Reports

**Figure 6. Portfolio metrics**



Source: Forsyth Barr analysis, Company Reports

**Figure 7. Price performance**

**Figure 8. Substantial shareholders**

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

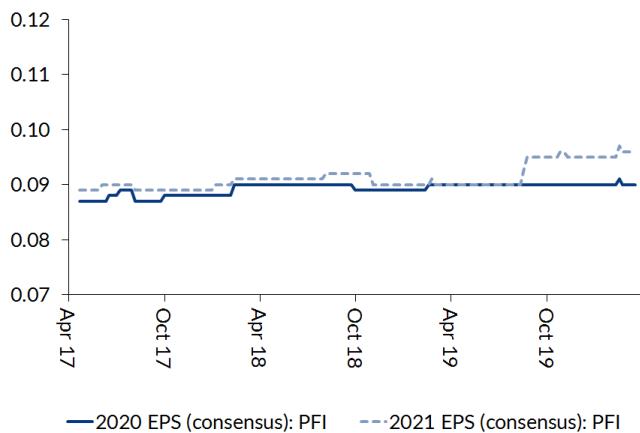
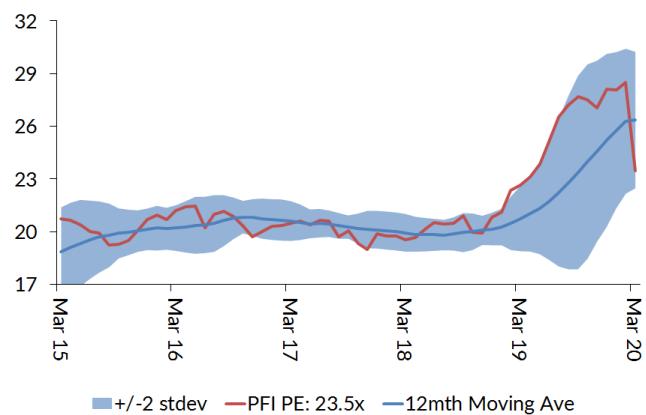
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 9. International valuation comparisons**

Company (metrics re-weighted to reflect PFI's balance date - December)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E	
				2020E	2021E	2020E	2021E	2020E	2021E		
<b>Property For Industry</b>	PFI NZ	NZ\$2.06	NZ\$1,027	23.5x	23.5x	19.2x	19.1x	19.2x	19.1x	3.8%	
Argosy Property *	ARG NZ	NZ\$0.84	NZ\$695	12.3x	12.2x	13.7x	12.9x	13.7x	12.9x	7.5%	
Goodman Property Trust *	GMT NZ	NZ\$2.05	NZ\$2,841	29.9x	29.0x	25.0x	23.4x	25.0x	23.4x	3.2%	
Investore *	IPL NZ	NZ\$1.41	NZ\$429	17.2x	16.9x	18.1x	18.0x	18.1x	18.0x	5.4%	
Kiwi Property Group *	KPG NZ	NZ\$0.84	NZ\$1,318	11.7x	11.6x	13.3x	12.7x	13.3x	12.7x	8.6%	
Asset Plus *	APL NZ	NZ\$0.42	NZ\$68	11.4x	12.0x	8.9x	9.0x	8.9x	9.0x	8.6%	
Precinct Properties NZ *	PCT NZ	NZ\$1.47	NZ\$1,931	21.8x	21.8x	20.5x	19.0x	20.5x	19.0x	4.3%	
Stride Property *	SPG NZ	NZ\$1.30	NZ\$475	11.9x	11.6x	13.3x	12.8x	13.3x	12.8x	8.1%	
Vital Healthcare *	VHP NZ	NZ\$2.05	NZ\$928	20.4x	19.6x	19.3x	17.9x	19.3x	17.9x	4.4%	
				<b>Compco Average:</b>	<b>17.1x</b>	<b>16.8x</b>	<b>16.5x</b>	<b>15.7x</b>	<b>16.5x</b>	<b>15.7x</b>	<b>6.3%</b>
				<b>PFI Relative:</b>	<b>37%</b>	<b>40%</b>	<b>16%</b>	<b>22%</b>	<b>16%</b>	<b>22%</b>	<b>-39%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 10. Consensus EPS momentum (NZ\$)**

**Figure 11. One year forward PE (x)**


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