

Property For Industry

Upgrade to OUTPERFORM

JEREMY SIMPSON CFA

jeremy.simpson@forsythbarr.co.nz

+64 9 368 0022

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

12-month target price (NZ\$)*

2.15

Expected share price return

4.4%

Net dividend yield

3.8%

Estimated 12-month return

8.1%

Spot valuations (NZ\$)

1. DCF

1.99

2. NAV

2.06

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.00%

Equity beta

0.70

WACC

5.3%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

1,480

(Net debt)/cash

(412)

Less: Capitalised operating leases

0

Value of equity

1,062

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	76.1	79.8	80.4	81.5	82.9	EV/EBITDA (x)	19.8	19.2	19.2	19.1	18.8
Normalised EBITDA	71.4	74.7	74.8	75.3	76.6	EV/EBIT (x)	19.8	19.2	19.2	19.1	18.8
Depreciation and amortisation	0	0	0	0	0	PE (x)	24.6	24.1	23.5	23.5	23.1
Normalised EBIT	71.4	74.7	74.8	75.3	76.6	Price/NTA (x)	1.2	1.0	1.0	1.0	0.9
Net interest	(18.8)	(19.0)	(19.0)	(19.4)	(19.4)	Free cash flow yield (%)	3.8	3.1	3.8	3.8	3.8
Associate income	0	0	0	0	0	Net dividend yield (%)	3.7	3.7	3.7	3.8	3.8
Tax	(10.9)	(13.1)	(12.1)	(12.2)	(12.7)	Gross dividend yield (%)	5.2	5.3	5.3	5.4	5.4
Minority interests	0	0	0	0	0						
Normalised NPAT	41.8	42.6	43.8	43.7	44.5	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	68.3	133.7	20.4	18.5	18.8	Interest cover EBIT (x)	3.8	3.9	3.9	3.9	4.0
Reported NPAT	110.1	176.3	64.2	62.3	63.4	Interest cover EBITDA (x)	3.8	3.9	3.9	3.9	4.0
Normalised EPS (cps)	8.4	8.5	8.8	8.8	8.9	Net debt/ND+E (%)	30.3	28.2	27.8	27.4	26.9
DPS (cps)	7.6	7.6	7.7	7.8	7.9	Net debt/EBITDA (x)	5.6	5.5	5.5	5.5	5.4
Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	7.7	4.9	0.8	1.3	1.7	Return on assets (%)	5.3	4.9	4.9	4.8	4.8
EBITDA (%)	10.1	4.6	0.2	0.7	1.8	Return on equity (%)	4.6	4.1	4.1	4.0	4.0
EBIT (%)	10.1	4.6	0.2	0.7	1.8	Return on funds employed (%)	4.4	4.1	3.9	3.9	3.9
Normalised NPAT (%)	12.5	1.9	2.8	-0.1	1.9	EBITDA margin (%)	93.9	93.6	93.0	92.5	92.5
Normalised EPS (%)	3.7	1.9	2.8	-0.1	1.9	EBIT margin (%)	93.9	93.6	93.0	92.5	92.5
Ordinary DPS (%)	1.3	0.7	1.3	1.3	0.6	Capex to sales (%)	19.5	20.1	6.5	6.5	6.5
						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	71.4	74.7	74.8	75.3	76.6	Pay-out ratio (%)	90	89	88	89	88
Working capital change	1.6	1.7	0.2	0.3	0.4						
Interest & tax paid	(19.2)	(28.1)	(31.1)	(31.6)	(32.1)	Property Statistics	2015A	2016A	2017A	2018A	2019A
Other	0	0	0	0	0	Major Prop. Values - PFI (NZ\$m)					
Operating cash flow	53.7	48.4	43.9	44.0	44.9	7-9 Niall Burgess Rd, Mt Wellington	27.3	28.9	31.0	32.0	43.5
Capital expenditure	(14.8)	(16.1)	(5.2)	(5.3)	(5.4)	54 Carbine Rd, Mt Wellington	22.4	25.8	26.4	28.6	33.0
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0	6 Donner Place, Mt Wellington	14.5	15.0	15.1	15.1	24.8
Other	(0.1)	0.7	0	0	0	686 Rosebank Rd, Avondale	32.2	33.4	35.0	40.0	44.5
Funding available/(required)	10.6	22.8	38.7	38.7	39.5	212 Cavendish Drive, Manukau	17.1	19.1	22.4	29.7	29.7
Dividends paid	(37.9)	(37.7)	(38.2)	(38.7)	(38.9)	3-5 Niall Burgess Rd, Mt Wellington	15.7	17.3	17.7	20.0	21.0
Equity raised/(returned)	0	0	0	0	0	30-32 Bowden Rd, Mt Wellington	20.7	21.4	25.4	27.0	27.8
(Increase)/decrease in net debt	(27.3)	(14.9)	0.6	0.0	0.6						
						Major Prop. Values - DPF (NZ\$m)					
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Carlaw Commerical, Parnell	60.8	61.8	62.1	63.8	72.0
Working capital	(9.2)	(7.2)	(7.2)	(7.3)	(7.5)	Carlaw Gateway, Parnell	33.8	35.0	35.0	35.5	34.4
Fixed assets	1,318.7	1,469.3	1,489.0	1,512.9	1,537.1	78 Springs Road, East Tamaki	72.0	78.5	82.8	83.0	95.0
Intangibles	29.1	29.1	29.1	29.1	29.1	229 Dairy Flat Highway, Albany	22.9	24.7	27.0	28.0	
Right of use asset	0	0	0	0	0	15 Jomac Place, Avondale	21.0	23.6	24.0	24.5	25.1
Other assets	5.0	13.8	13.8	13.8	13.8						
Total funds employed	1,343.5	1,505.0	1,524.7	1,548.4	1,572.5	Portfolio Summary					
Net debt/(cash)	396.6	411.8	411.2	411.2	410.5	Investment properties (NZ\$m)	987	1,083	1,211	1,322	1,476
Lease liability	0	0	0	0	0	Weighted average lease term (yrs)	5.2	4.8	5.3	5.4	5.4
Other liabilities	35.1	46.1	46.2	46.4	46.6	Occupancy rate (%)	99.6	99.6	99.9	99.3	99.0
Shareholder's funds	911.8	1,047.1	1,067.3	1,090.9	1,115.4	Number of properties	84	83	92	94	94
Minority interests	0	0	0	0	0	NTA per share (NZ\$)	1.41	1.61	1.63	1.78	2.06
Total funding sources	1,343.5	1,505.0	1,524.7	1,548.4	1,572.5						

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

Figure 1. Balance Sheet summary

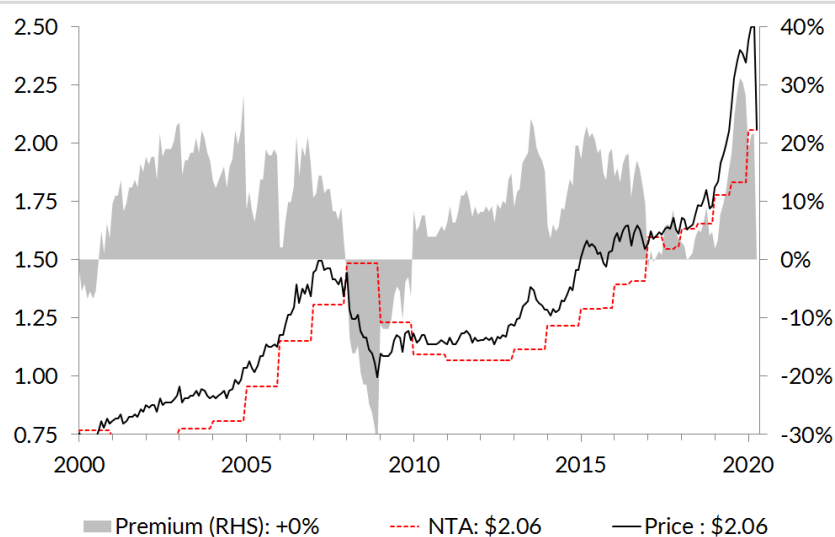
	As at	Reported gearing	Target gearing	Bank covenant	Bank facilities (NZ\$m)	Issued Bonds (NZ\$m)	Facility capacity (NZ\$m)	Term - bank (years)	Term - bonds (years)	Term - weighted (years)
APL	Mar-20	30.2%	35-40%	50%	75	-	27	2.2	-	2.2
ARG	Sep-19	36.2%	30-40%	50%	535	200	85	2.7	6.3	3.7
GMT	Sep-19	17.9%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

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%
Core simple average					7.6%	5.1%	90%	91%

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

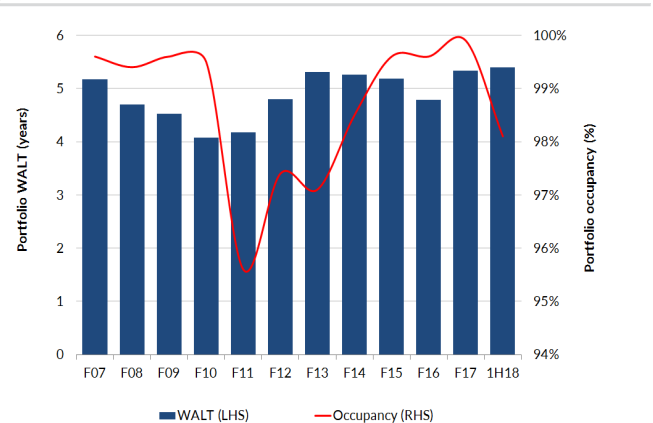
- **Rising interest rates:** Higher interest rates make other yield investments more attractive relative to listed property dividend yields.

Figure 5. Sector and regional portfolio exposure

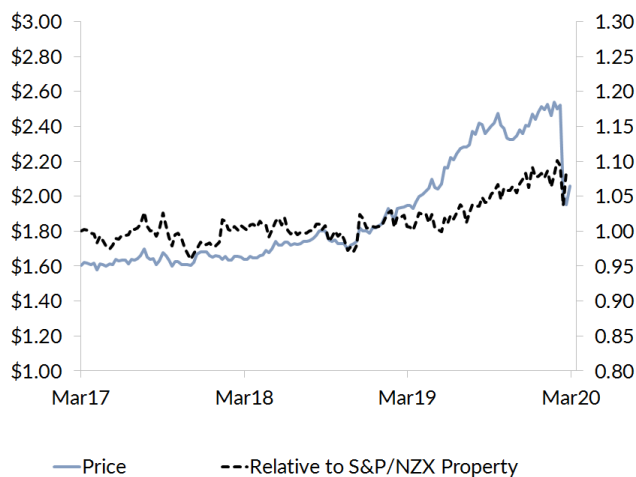
	Auckland	Other North Island	South Island	Total
Industrial	70%	12%	5%	87%
Office	7%	0%	0%	7%
Mixed use	5%	1%	0%	6%
Total	83%	13%	5%	100%

Source: Forsyth Barr analysis, Company Reports

Figure 6. Portfolio metrics



Source: Forsyth Barr analysis, Company Reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

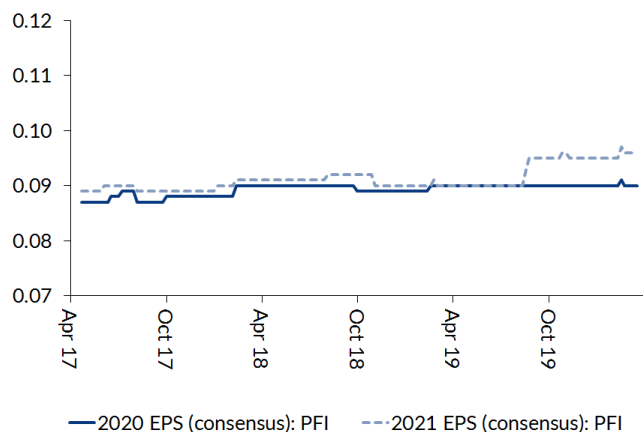
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 9. International valuation comparisons

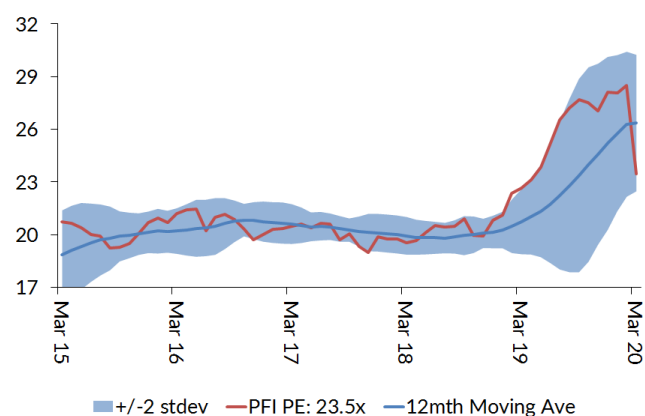
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect PFI's balance date - December)				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Property For Industry	PFI NZ	NZ\$2.06	NZ\$1,027	23.5x	23.5x	19.2x	19.1x	19.2x	19.1x	3.8%
Argosy Property *	ARG NZ	NZ\$0.84	NZ\$695	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%
Compco Average:				17.1x	16.8x	16.5x	15.7x	16.5x	15.7x	6.3%
PFI Relative:				37%	40%	16%	22%	16%	22%	-39%

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\$)


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 25 Mar 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
35.3%	51.0%	13.7%

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.