

# Property For Industry

## Shock Absorber – Downgrade to NEUTRAL

**ROHAN KOREMAN-SMIT CFA**

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

**ASHTON OLDS**

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

### NEUTRAL

Property for Industry (PFI) has performed strongly through the pandemic driven market volatility, with the share price having now largely recovered from the initial sell off as the defensive qualities of industrial property gained favour. The industrial property sub-sector has seen 1) strong rent collection vs. other types of properties, 2) increased demand particularly in logistics, and 3) limited downward revaluations to date. As a result PFI is now trading on a gross yield of 4.2%, a forward Adjusted Funds From Operations (AFFO) multiple of 28.2x, and a 16% premium to its net tangible assets (NTA) backing vs. peers on a 5.5% average gross yield, a forward AFFO multiple of 25.6x, and a 2% premium to NTA. As a result, we see limited scope for further outperformance vs. the sector and downgrade our rating to NEUTRAL.

NZX Code	PFI	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.38	NPAT* (NZ\$m)	42.6	41.9	43.0	44.0	EV/EBITDA	21.3	23.1	23.2	23.0
Target price	NZ\$2.15	EPS* (NZc)	8.5	8.4	8.6	8.8	EV/EBIT	21.3	23.1	23.2	23.0
Risk rating	Low	EPS growth* (%)	1.9	-1.6	2.7	2.2	PE	27.9	28.3	27.6	27.0
Issued shares	498.7m	DPS (NZc)	7.6	7.0	7.0	7.0	Price / NTA	1.2	1.2	1.2	1.2
Market cap	NZ\$1,187m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.2	2.9	2.9	2.9
Avg daily turnover	292.1k (NZ\$673k)	*Based on normalised profits					Gross div yld (%)	4.6	4.2	4.2	4.2

### Trading updates have been solid

PFI has provided a few market updates since the pandemic began unfolding in March. PFI secured NZ\$50m of additional funding to ensure liquidity, cut costs, and provided assistance to tenants where required. To date, PFI has signed 45 tenant support deals totalling 1.2% of annual rent, split 50/50 between deferrals and abatements. Rent and operating expense collection was ~90% in April and May and in line with listed industrial peers and sector anecdotes. We have not made any changes to our earnings and distribution estimates.

Additionally, recent revaluations have seen industrial property assets hold up better than their retail and office counterparts. Stride's (SPG) industrial assets increased in value by +14% over the 12 months to 31 March 2020, while Argosy's (ARG) lifted by +7%. Although further NTA upside is limited given PFI's +9% revaluation over the 12 months to 31 December 2019, it is comforting to see industrial asset values have remained solid during times of stress.

### Safe haven buying

The strong rent collection rates relative to the office/retail sub-sectors and positive valuation outcomes for industrial assets has seen PFI and Goodman Property (GMT) hold up well relative to other LPVs. PFI was initially been sold off but has recovered strongly, leading the listed property vehicle (LPV) sector in performance in May, up +13%. Since we upgraded PFI to OUTPERFORM on 27 March 2020, it has returned +15.9% and +250bp vs. the S&P/NZX Property Gross Index.

**Property for Industry Ltd (PFI)**

Priced as at 09 Jun 2020 (NZ\$)

**2.38**
**12-month target price (NZ\$)\***
**2.15**

Expected share price return

-9.7%

Net dividend yield

2.9%

Estimated 12-month return

-6.7%

**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

1,418

(Net debt)/cash

(412)

Less: Capitalised operating leases

0

Value of equity

999

**Profit and Loss Account (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
Sales revenue	76.1	79.8	74.7	75.0	75.8
<b>Normalised EBITDA</b>	<b>71.4</b>	<b>74.7</b>	<b>69.1</b>	<b>68.8</b>	<b>69.6</b>
Depreciation and amortisation	0	0	0	0	0
<b>Normalised EBIT</b>	<b>71.4</b>	<b>74.7</b>	<b>69.1</b>	<b>68.8</b>	<b>69.6</b>
Net interest	(18.8)	(19.0)	(17.9)	(16.4)	(15.6)
Associate income	0	0	0	0	0
Tax	(10.9)	(13.1)	(9.4)	(9.4)	(10.0)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>41.8</b>	<b>42.6</b>	<b>41.9</b>	<b>43.0</b>	<b>44.0</b>
Abnormals/other	68.3	133.7	(5.1)	(5.1)	6.6
<b>Reported NPAT</b>	<b>110.1</b>	<b>176.3</b>	<b>36.8</b>	<b>37.9</b>	<b>50.6</b>
Normalised EPS (cps)	8.4	8.5	8.4	8.6	8.8
DPS (cps)	7.6	7.6	7.0	7.0	7.0

**Growth Rates**

	2018A	2019A	2020E	2021E	2022E
Revenue (%)	7.7	4.9	-6.3	0.3	1.1
EBITDA (%)	10.1	4.6	-7.4	-0.4	1.1
EBIT (%)	10.1	4.6	-7.4	-0.4	1.1
Normalised NPAT (%)	12.5	1.9	-1.6	2.7	2.2
Normalised EPS (%)	3.7	1.9	-1.6	2.7	2.2
Ordinary DPS (%)	1.3	0.7	-7.9	-0.1	0.3

**Cash Flow (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>71.4</b>	<b>74.7</b>	<b>69.1</b>	<b>68.8</b>	<b>69.6</b>
Working capital change	1.6	1.7	(1.3)	0.1	0.2
Interest & tax paid	(19.2)	(28.1)	(27.3)	(25.8)	(25.6)
Other	0	0	0	0	0
<b>Operating cash flow</b>	<b>53.7</b>	<b>48.4</b>	<b>40.6</b>	<b>43.1</b>	<b>44.2</b>
Capital expenditure	(14.8)	(16.1)	(5.1)	(5.1)	(5.1)
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0
Other	(0.1)	0.7	0	0	0
<b>Funding available/(required)</b>	<b>10.6</b>	<b>22.8</b>	<b>35.5</b>	<b>38.0</b>	<b>39.1</b>
Dividends paid	(37.9)	(37.7)	(35.2)	(36.6)	(34.9)
Equity raised/(returned)	0	0	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(27.3)</b>	<b>(14.9)</b>	<b>0.3</b>	<b>1.3</b>	<b>4.1</b>

**Balance Sheet (NZ\$m)**

	2018A	2019A	2020E	2021E	2022E
Working capital	(9.2)	(7.2)	(6.7)	(6.7)	(6.8)
Fixed assets	1,318.7	1,469.3	1,463.4	1,463.4	1,475.1
Intangibles	29.1	29.1	29.1	29.1	29.1
Right of use asset	0	0	0	0	0
Other assets	5.0	13.8	13.8	13.8	13.8
<b>Total funds employed</b>	<b>1,343.5</b>	<b>1,505.0</b>	<b>1,499.6</b>	<b>1,499.6</b>	<b>1,511.2</b>
Net debt/(cash)	396.6	411.8	411.4	410.1	406.0
Lease liability	0	0	0	0	0
Other liabilities	35.1	46.1	45.3	45.3	45.5
Shareholder's funds	911.8	1,047.1	1,042.9	1,044.2	1,059.8
Minority interests	0	0	0	0	0
<b>Total funding sources</b>	<b>1,343.5</b>	<b>1,505.0</b>	<b>1,499.6</b>	<b>1,499.6</b>	<b>1,511.2</b>

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

**Valuation Ratios**

	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	22.0	21.3	23.1	23.2	23.0
EV/EBIT (x)	22.0	21.3	23.1	23.2	23.0
PE (x)	28.4	27.9	28.3	27.6	27.0
Price/NTA (x)	1.3	1.2	1.2	1.2	1.2
Free cash flow yield (%)	3.3	2.7	3.0	3.2	3.3
Net dividend yield (%)	3.2	3.2	2.9	2.9	2.9
Gross dividend yield (%)	4.5	4.6	4.2	4.2	4.2

**Capital Structure**

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	3.8	3.9	3.9	4.2	4.5
Interest cover EBITDA (x)	3.8	3.9	3.9	4.2	4.5
Net debt/ND+E (%)	30.3	28.2	28.3	28.2	27.7
Net debt/EBITDA (x)	5.6	5.5	6.0	6.0	5.8

**Key Ratios**

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	5.3	4.9	4.6	4.6	4.6
Return on equity (%)	4.6	4.1	4.0	4.1	4.2
Return on funds employed (%)	4.4	4.1	3.8	3.8	3.8
EBITDA margin (%)	93.9	93.6	92.5	91.8	91.8
EBIT margin (%)	93.9	93.6	92.5	91.8	91.8
Capex to sales (%)	19.5	20.1	6.9	6.8	6.8
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	90	89	83	81	80

**Property Statistics**

	2015A	2016A	2017A	2018A	2019A
<b>Major Prop. Values - PFI (NZ\$m)</b>					
7-9 Niall Burgess Rd, Mt Wellington	27.3	28.9	31.0	32.0	43.5
54 Carbine Rd, Mt Wellington	22.4	25.8	26.4	28.6	33.0
6 Donner Place, Mt Wellington	14.5	15.0	15.1	15.1	24.8
686 Rosebank Rd, Avondale	32.2	33.4	35.0	40.0	44.5
212 Cavendish Drive, Manukau	17.1	19.1	22.4	29.7	29.7
3-5 Niall Burgess Rd, Mt Wellington	15.7	17.3	17.7	20.0	21.0
30-32 Bowden Rd, Mt Wellington	20.7	21.4	25.4	27.0	27.8

**Major Prop. Values - DPF (NZ\$m)**

	2015A	2016A	2017A	2018A	2019A
Carlaw Commercial, Parnell	60.8	61.8	62.1	63.8	72.0
Carlaw Gateway, Parnell	33.8	35.0	35.0	35.5	34.4
78 Springs Road, East Tamaki	72.0	78.5	82.8	83.0	95.0
229 Dairy Flat Highway, Albany	22.9	24.7	27.0	28.0	
15 Jomac Place, Avondale	21.0	23.6	24.0	24.5	25.1

**Portfolio Summary**

	2015A	2016A	2017A	2018A	2019A
Investment properties (NZ\$m)	987	1,083	1,211	1,322	1,476
Weighted average lease term (yrs)	5.2	4.8	5.3	5.4	5.4
Occupancy rate (%)	99.6	99.6	99.9	99.3	99.0
Number of properties	84	83	92	94	94
NTA per share (NZ\$)	1.41	1.61	1.63	1.78	2.06

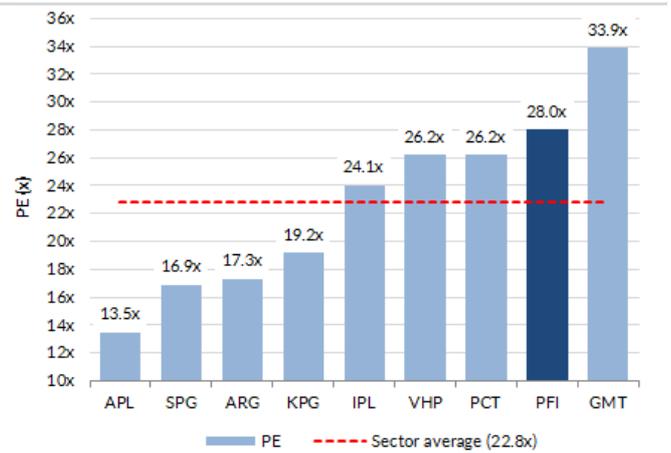
## Key tables and charts

Figure 1. Rent collection rates vs industry feedback

	Office	Industrial	Retail	LFR	Total
KPG					<b>63%</b>
GMT		90%			<b>90%</b>
ARG	93%	89%		53%	<b>72%</b>
PFI		90%			<b>90%</b>
IPL				90%	<b>90%</b>
Industry feedback (retail)				65%	
CBRE (April data)	81%	98%	63%		
Re-released (May data)	67%	76%	42%		

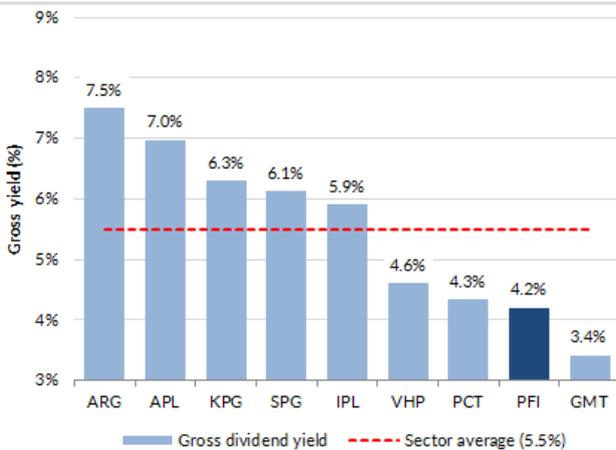
Source: Forsyth Barr analysis, Company reports, CBRE, Re-released

Figure 2. Sector P/E ratio



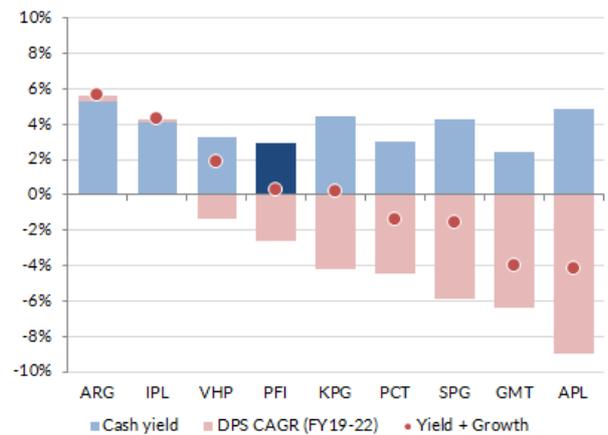
Source: Forsyth Barr analysis, Company reports

Figure 3. Sector gross dividend yield



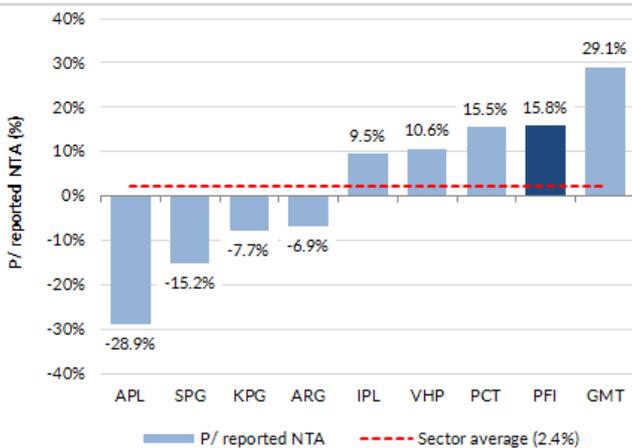
Source: Forsyth Barr analysis

Figure 4. Sector cash yield plus growth



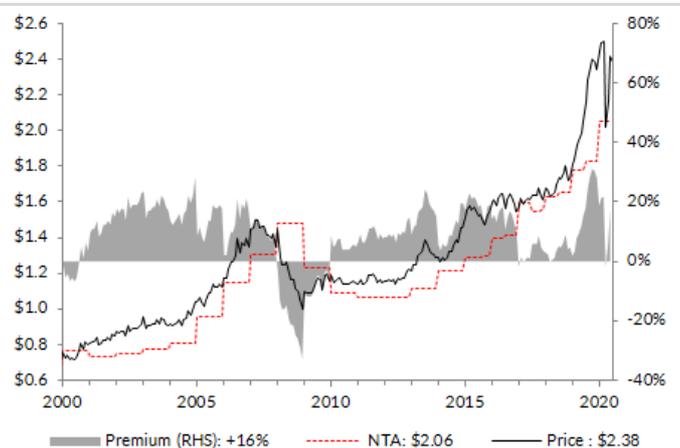
Source: Forsyth Barr analysis

Figure 5. Sector P/NTA ratio



Source: Forsyth Barr analysis

Figure 6. Long run price and NTA



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. **NEUTRAL.**

### 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

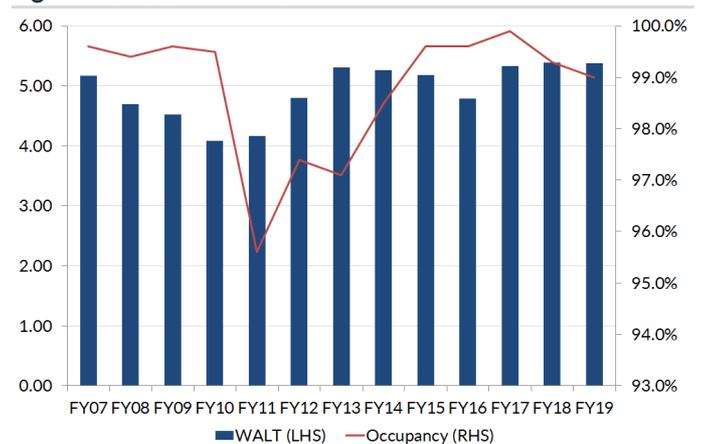
- **Rising interest rates:** Higher interest rates make other yield investments more attractive relative to listed property dividend yields.

Figure 7. Sector and regional portfolio exposure

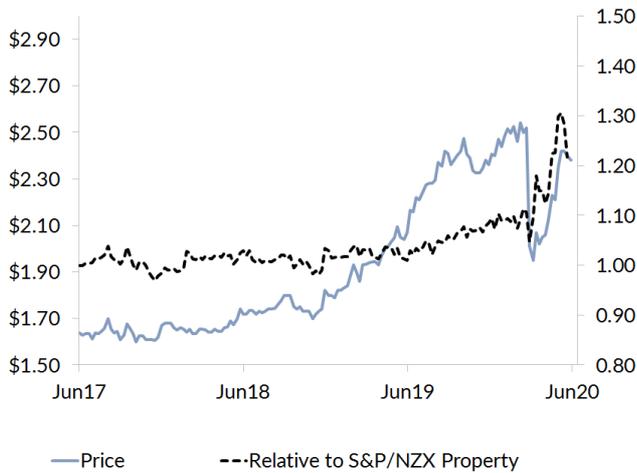
	Auckland	Other North Island	South Island	Total
Industrial	70%	12%	5%	<b>87%</b>
Office	7%	0%	0%	<b>7%</b>
Mixed use	5%	1%	0%	<b>6%</b>
<b>Total</b>	<b>83%</b>	<b>13%</b>	<b>5%</b>	<b>100%</b>

Source: Forsyth Barr analysis, Company Reports

Figure 8. Portfolio metrics



Source: Forsyth Barr analysis, Company Reports

**Figure 9. Price performance**


Source: Forsyth Barr analysis

**Figure 10. Substantial shareholders**

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

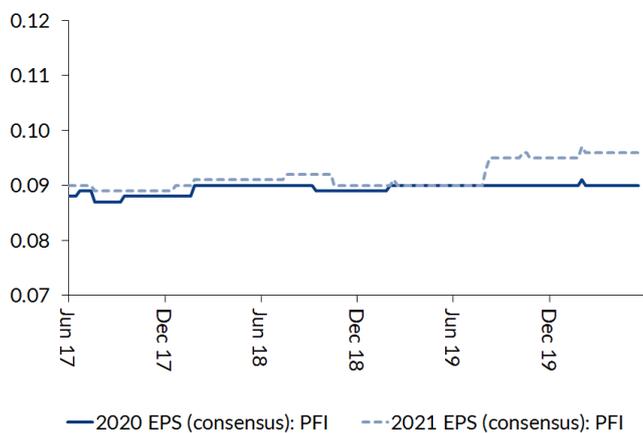
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 11. International valuation comparisons**

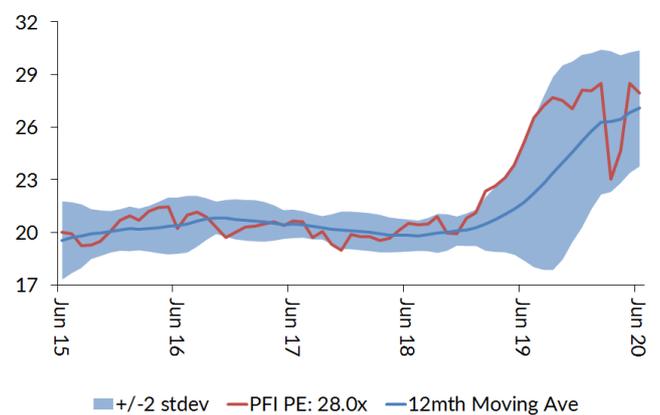
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Property For Industry</b>	<b>PFI NZ</b>	<b>NZ\$2.38</b>	<b>NZ\$1,187</b>	<b>28.3x</b>	<b>27.6x</b>	<b>23.1x</b>	<b>23.2x</b>	<b>23.1x</b>	<b>23.2x</b>	<b>2.9%</b>
Argosy Property *	ARG NZ	NZ\$1.23	NZ\$1,017	17.5x	17.6x	19.4x	18.9x	19.4x	18.9x	5.2%
Goodman Property Trust *	GMT NZ	NZ\$2.28	NZ\$3,153	34.5x	34.1x	28.9x	28.0x	28.9x	28.0x	2.4%
Investore *	IPL NZ	NZ\$1.85	NZ\$681	24.4x	23.3x	20.9x	19.5x	20.9x	19.5x	4.1%
Kiwi Property Group *	KPG NZ	NZ\$1.17	NZ\$1,836	19.3x	17.9x	19.8x	17.7x	19.8x	17.7x	4.9%
Asset Plus *	APL NZ	NZ\$0.39	NZ\$63	10.6x	11.0x	8.4x	8.6x	8.4x	8.6x	6.5%
Precinct Properties NZ *	PCT NZ	NZ\$1.75	NZ\$2,299	26.0x	25.8x	23.3x	21.6x	23.3x	21.6x	2.8%
Stride Property *	SPG NZ	NZ\$1.66	NZ\$606	16.7x	15.6x	18.1x	17.1x	18.1x	17.1x	4.9%
Vital Healthcare *	VHP NZ	NZ\$2.63	NZ\$1,190	26.5x	25.8x	23.7x	22.7x	23.7x	22.7x	3.2%
<b>Compcop Average:</b>				<b>21.9x</b>	<b>21.4x</b>	<b>20.3x</b>	<b>19.2x</b>	<b>20.3x</b>	<b>19.2x</b>	<b>4.3%</b>
<b>PFI Relative:</b>				<b>29%</b>	<b>29%</b>	<b>14%</b>	<b>21%</b>	<b>14%</b>	<b>21%</b>	<b>-31%</b>

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compcop metrics re-weighted to reflect headline (PFI) 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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