

Property For Industry

1H20 Result: Rock Solid Despite Virus

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NEUTRAL

Property for Industry (PFI) reported an in-line interim result, with lower than expected abatements, tax, and interest offsetting higher than expected maintenance capex and leasing incentives. PFI reinstated FY20 dividend guidance (originally provided in February) of 7.65–7.70cps. While we expect industrial property to remain relatively robust vs. other sub-sectors, we believe this is largely priced into PFI's current share price with the stock trading at a 31% premium to its net tangible asset (NTA) backing, an FY21 Adjusted Funds From Operations (AFFO) multiple of 34.5x, and a gross yield of 4.0%. We retain our NEUTRAL rating.

NZX Code	PFI	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.69	NPAT* (NZ\$m)	42.5	43.9	44.8	45.8	PE	31.5	30.6	30.2	29.5
Target price	NZ\$2.64	EPS* (NZc)	8.5	8.8	8.9	9.1	EV/EBIT	23.4	24.3	24.5	24.3
Risk rating	Low	EPS growth* (%)	1.8	2.9	1.4	2.4	EV/EBITDA	23.4	24.3	24.5	24.3
Issued shares	499.0m	DPS (NZc)	7.6	7.7	7.8	7.9	Price / NTA	1.3	1.3	1.3	1.3
Market cap	NZ\$1,340m	Imputation (%)	100	100	100	100	Cash div yld (%)	2.8	2.8	2.9	2.9
Avg daily turnover	287.9k (NZ\$676k)	*Based on normalised profits					Gross div yld (%)	4.0	4.1	4.1	4.2

Property for Investment

PFI delivered a solid result, ahead of our expectations at the top line due to lower than expected COVID-19 rental abatements, but a touch lower at the AFFO line due to higher than expected maintenance capex and leasing incentives (from the timing of new leases). Of the ~140 tenants in PFI's portfolio, there has only been a couple of failures and cash collection of rent has been high, >95% in recent months. Portfolio fundamentals remain strong with 99.0% occupancy, WALT of 5.3 years, and gearing at 29%, comfortably below its 35% target.

The focus turns to leasing and recycling

Leasing progress in 1H20 was solid, with 4.6% of the rent roll leased on an average term of 6.4 years. While 1H20 leasing saw incentives remain low at about 2 weeks rent-free, incentives are expected to tick up across the market in the short/medium term as landlords look to secure tenants in a softer market. PFI has 19.1% of rent expiring or vacant over the next three years.

PFI has NZ\$128m of debt headroom and NZ\$69m of capital commitments. PFI is working to divest its remaining non-core properties which account for 9% of portfolio value including the c.NZ\$100m Carlaw Park office complex. Low interest rates and earnings certainty in a post COVID-19 world has seen direct industrial assets well bid, and as such it may be challenging to manage earnings dilution from any capital recycling.

Earnings forecasts and target price up, valuation still full

We have lifted our FY20/21/22 AFFO by 3.9%/3.5%/0.9% which largely reflects lower COVID-19 rent abatements partially offset by higher tenant incentives. Our revised earnings profile and lifted payout ratio (now 100% of AFFO) lifts our distribution forecasts c. 10%. We lift our target price to NZ\$2.64 due to 1) revised WACC assumptions lifting our DCF to NZ\$2.78, and 2) 12bp of cap rate compression and PFI's sector low management expense ratio (MER) lifting our NAV to NZ\$2.42. We remain NEUTRAL rated on PFI on valuation grounds with the stock trading at a 31% premium to its NTA which implies +21% increase in asset values, which equates to 102bp of cap rate compression.

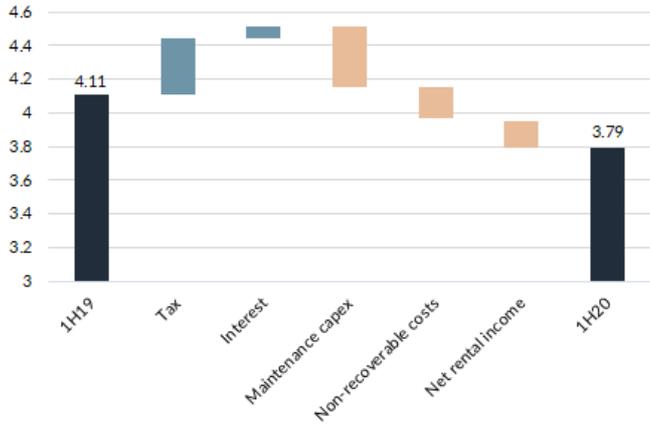
Property for Industry Ltd (PFI)

Priced as at 04 Sep 2020 (NZ\$)						2.69										
12-month target price (NZ\$)*						2.64	Spot valuations (NZ\$)									
Expected share price return						-1.9%	1. DCF					2.78				
Net dividend yield						2.9%	2. NAV					2.42				
Estimated 12-month return						1.0%	3. n/a					n/a				
Key WACC assumptions						DCF valuation summary (NZ\$m)										
Risk free rate						1.30%	Total firm value					1,781				
Equity beta						0.71	(Net debt)/cash					(412)				
WACC						4.4%	Less: Capitalised operating leases					0				
Terminal growth						1.5%	Value of equity					1,362				
Profit and Loss Account (NZ\$m)						Valuation Ratios										
Sales revenue	2018A	2019A	2020E	2021E	2022E	76.1	79.7	77.5	77.0	77.8	EV/EBITDA (x)	2018A	2019A	2020E	2021E	2022E
Normalised EBITDA	71.4	74.6	71.8	70.9	71.6	24.2	23.4	24.3	24.6	24.3	EV/EBIT (x)	24.2	23.4	24.3	24.6	24.3
Depreciation and amortisation	0	0	0	0	0	32.1	31.5	30.7	30.2	29.5	PE (x)	1.5	1.3	1.3	1.3	1.3
Normalised EBIT	71.4	74.6	71.8	70.9	71.6	2.9	2.4	3.0	2.9	3.0	Price/NTA (x)	2.9	2.4	3.0	2.9	3.0
Net interest	(18.8)	(19.0)	(17.8)	(16.1)	(15.1)	2.8	2.8	2.8	2.9	2.9	Free cash flow yield (%)	4.0	4.0	4.1	4.1	4.2
Associate income	0	0	0	0	0	4.0	4.0	4.1	4.1	4.2	Net dividend yield (%)					
Tax	(10.9)	(13.1)	(10.1)	(10.0)	(10.7)						Gross dividend yield (%)					
Minority interests	0	0	0	0	0											
Normalised NPAT	41.8	42.5	43.9	44.8	45.8						Capital Structure					
Abnormals/other	68.3	133.7	(3.0)	(5.1)	6.6	3.8	3.9	4.0	4.4	4.7	Interest cover EBIT (x)	2018A	2019A	2020E	2021E	2022E
Reported NPAT	110.1	176.2	40.9	39.6	52.4	3.8	3.9	4.0	4.4	4.7	Interest cover EBITDA (x)	30.3	28.2	27.4	27.5	27.2
Normalised EPS (cps)	8.4	8.5	8.8	8.9	9.1	5.6	5.5	5.6	5.6	5.6	Net debt/ND+E (%)					
DPS (cps)	7.6	7.6	7.7	7.8	7.9						Net debt/EBITDA (x)					
Growth Rates						Key Ratios										
Revenue (%)	2018A	2019A	2020E	2021E	2022E	7.7	4.8	-2.9	-0.5	1.0	5.3	4.9	4.8	4.7	4.7	4.7
EBITDA (%)	10.1	4.5	-3.7	-1.3	1.0	10.1	4.5	-3.7	-1.3	1.0	4.6	4.1	4.2	4.2	4.3	4.3
EBIT (%)	10.1	4.5	-3.7	-1.3	1.0	12.5	1.8	3.2	2.0	2.4	4.4	4.1	3.9	3.9	3.9	3.9
Normalised NPAT (%)	12.5	1.8	3.2	2.0	2.4	93.9	93.6	92.8	92.0	92.1	93.9	93.6	92.8	92.0	92.1	92.1
Normalised EPS (%)	3.7	1.8	2.9	1.4	2.4	93.9	93.6	92.8	92.0	92.1	19.5	20.2	6.6	6.6	6.6	6.6
Ordinary DPS (%)	1.3	0.7	0.7	1.6	1.0	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	100	100	100	100	100
Cash Flow (NZ\$m)						Portfolio Summary										
EBITDA	2018A	2019A	2020E	2021E	2022E	71.4	74.6	71.8	70.9	71.6	987	1,083	1,211	1,322	1,476	1,476
Working capital change	1.6	1.8	1.6	(0.1)	0.2	(19.2)	(28.1)	(28.0)	(26.2)	(25.8)	5.2	4.8	5.3	5.4	5.4	5.4
Interest & tax paid	(19.2)	(28.1)	(28.0)	(26.2)	(25.8)	53.7	48.4	45.5	44.7	46.0	99.6	99.6	99.9	99.3	99.0	99.0
Other	0	0	0	0	0	(14.8)	(16.1)	(5.1)	(5.1)	(5.1)	84	83	92	94	94	94
Operating cash flow	53.7	48.4	45.5	44.7	46.0	(28.3)	(10.3)	0	0	0	1.41	1.61	1.63	1.78	2.06	2.06
Capital expenditure	(14.8)	(16.1)	(5.1)	(5.1)	(5.1)	10.6	22.8	40.4	39.5	40.9						
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0	(37.9)	(37.7)	(27.4)	(40.4)	(39.4)						
Other	(0.1)	0.7	0	0	0	0	0	0	0	0						
Funding available/(required)	10.6	22.8	40.4	39.5	40.9	(27.3)	(14.9)	13.0	(0.9)	1.5						
Dividends paid	(37.9)	(37.7)	(27.4)	(40.4)	(39.4)											
Equity raised/(returned)	0	0	0	0	0											
(Increase)/decrease in net debt	(27.3)	(14.9)	13.0	(0.9)	1.5											
Balance Sheet (NZ\$m)																
Working capital	2018A	2019A	2020E	2021E	2022E	(9.2)	(7.2)	(7.0)	(6.9)	(7.0)						
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											
Total funds employed	1,343.5	1,505.0	1,499.4	1,499.4	1,511.0											
Net debt/(cash)	396.6	411.8	398.8	399.7	398.1											
Lease liability	0	0	0	0	0											
Other liabilities	35.1	45.9	45.5	45.4	45.6											
Shareholder's funds	911.8	1,047.4	1,055.1	1,054.3	1,067.3											
Minority interests	0	0	0	0	0											
Total funding sources	1,343.5	1,505.0	1,499.4	1,499.4	1,511.0											

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

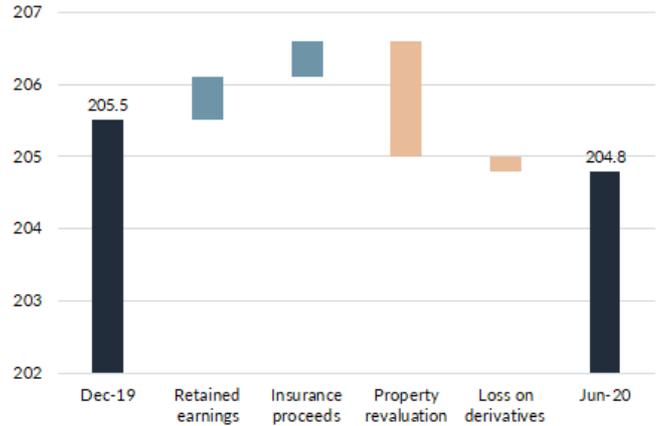
1H20 in 6 charts

Figure 1. AFFO bridge (\$ p/s)



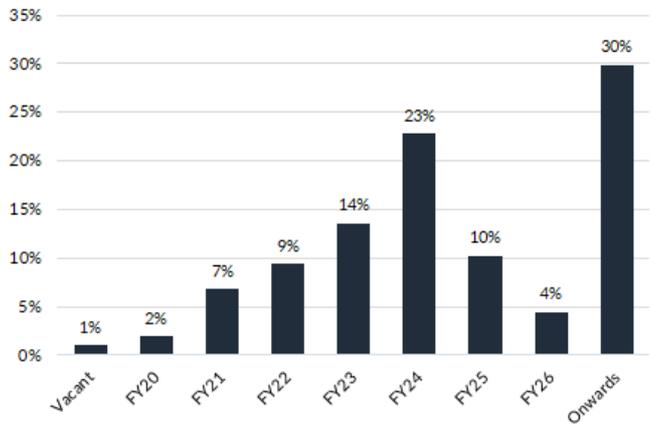
Source: Forsyth Barr analysis, Company reports

Figure 2. NTA per share bridge (cents)



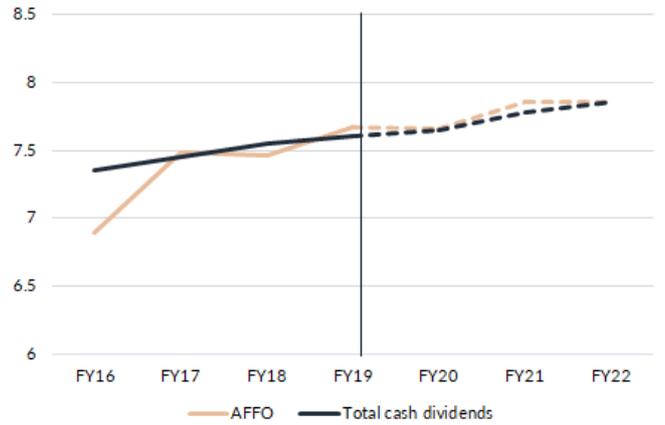
Source: Forsyth Barr analysis, Company reports

Figure 3. Lease expiry profile



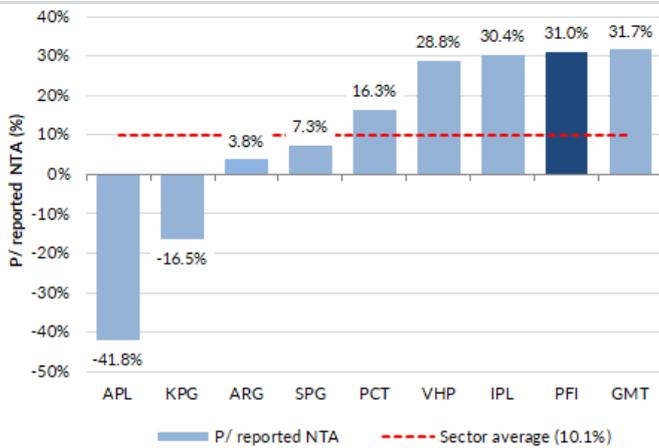
Source: Forsyth Barr analysis, Company reports

Figure 4. DPS vs AFFO (historics and forecast)



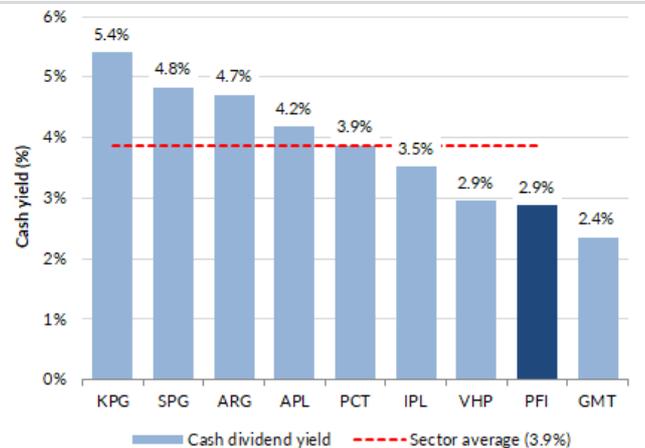
Source: Forsyth Barr analysis

Figure 5. Sector P/NTA



Source: Forsyth Barr analysis

Figure 6. Sector cash yield



Source: Forsyth Barr analysis

Result summary and earnings changes

Figure 7. 1H20 result summary

Financial period	1H19	1H20	Change	Forecast	Var
6 months ending	06/19	06/20	pcp		
Net income	39,406	39,117	-0.7%	36,626	6.8%
Base corporate costs	(2,597)	(2,873)	10.6%	(2,780)	3.3%
EBITDA	36,974	36,419	-1.5%	34,021	7.0%
Net interest	(9,582)	(9,248)	-3.5%	(8,948)	3.4%
PBT	27,392	27,171	-0.8%	25,073	8.4%
Current tax	(6,322)	(4,696)	-25.7%	(4,675)	0.4%
NPAT (underlying)	21,070	22,475	6.7%	20,398	10.2%
Amortisation of incentives and other	1,346	1,373	2.0%	1,181	16.3%
Funds from operations (FFO)	22,416	23,848	6.4%	21,579	10.5%
Maintenance capex	(374)	(2,169)	479.9%	(1,000)	116.9%
Tenant incentives, leasing fees and other	(1,556)	(2,770)	78.0%	(1,181)	134.5%
Adjusted funds from operations	20,486	18,909	-7.7%	19,398	-2.5%
NPAT underlying	21,070	22,475	6.7%	20,398	10.2%
Investment property revaluations	23,449	(7,803)	-133.3%	(2,561)	204.7%
Other non-operating adjustments	1,879	977	-48.0%	1,000	-2.3%
NPAT (reported)	46,398	15,649	-66.3%	18,837	-16.9%
NPAT (Forbar) per share (cps)	4.22	4.50	6.6%	4.09	10.1%
FFO per share (cps)	4.49	4.78	6.3%	4.33	10.5%
AFFO per share (cps)	4.11	3.79	-7.7%	3.89	-2.6%
Dividends (cps)	3.60	3.60	-	3.10	16.1%

Source: Forsyth Barr analysis

Figure 8. Earnings changes

NZ\$m	FY20			FY21			FY22		
	Old	New	%	Old	New	%	Old	New	%
Net income	77.4	80.0	3.3%	77.6	79.8	2.8%	78.4	80.6	2.7%
Base corporate costs	(8.3)	(8.1)	-1.7%	(8.8)	(8.9)	0.9%	(8.8)	(8.9)	0.9%
EBITDA	69.1	71.9	3.9%	68.8	70.9	3.0%	69.6	71.6	3.0%
Net interest	(17.9)	(17.8)	-0.6%	(16.5)	(16.1)	-2.3%	(15.7)	(15.1)	-3.7%
Current tax	(9.3)	(10.1)	8.5%	(9.4)	(10.0)	7.4%	(10.0)	(10.7)	7.4%
NPAT (underlying)	41.9	43.9	4.9%	43.0	44.8	4.1%	43.9	45.8	4.3%
Amortisation of incentives and other	2.4	2.6	11.9%	2.4	2.7	12.4%	2.4	2.7	12.4%
Funds from operations (FFO)	44.2	46.5	5.2%	45.4	47.4	4.6%	46.3	48.5	4.7%
Maintenance capex	(5.1)	(5.1)	0.0%	(5.1)	(5.1)	0.0%	(5.1)	(5.1)	0.0%
Tenant incentives, leasing fees and other	(2.4)	(3.1)	31.6%	(2.4)	(2.8)	18.0%	(2.4)	(3.9)	63.0%
Adjusted funds from operations	36.7	38.3	4.3%	37.9	39.5	4.3%	38.8	39.5	1.8%
FFO PS	8.87	9.30	4.9%	9.09	9.43	3.7%	9.29	9.65	3.9%
AFFO PS	7.37	7.66	3.9%	7.59	7.85	3.5%	7.78	7.85	0.9%
DPS	7.00	7.65	9.3%	6.98	7.77	11.3%	7.01	7.85	12.1%

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. We remain NEUTRAL rated on valuation grounds with the stock trading at a 31% premium to its net tangible asset (NTA) backing, an FY21 Adjusted Funds From Operations (AFFO) multiple of 34.5x, and a gross yield of 4.0%.

Business quality

- **Property fundamentals:** PFI has occupancy of 99% and a WALT of 5.3 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. 84% of PFI's portfolio is weighted to Auckland with record low vacancy and strong tenant demand.

Earnings and cashflow outlook

- **Transactional activity:** PFI will look to divest its non-core properties through FY20–21 which accounts for 9% of its total portfolio. PFI has NZ\$130m of debt capacity to fund acquisitions that can bridge any earnings gap from its asset recycling program.
- **Increased incentives expected:** Given the softer economic outlook, tenant incentives are expected to increase in the coming years which may have an impact on PFI's underlying cash earnings.

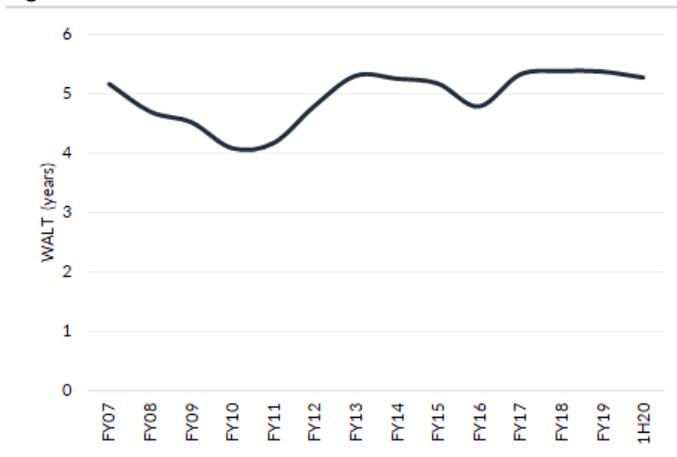
Financial structure

- **Balance sheet provides flexibility:** PFI's balance sheet is solid at 28% geared, well below the 50% banking covenant limit and its self-imposed 40% maximum. While PFI targets 35% gearing, it is comfortable at current levels given the economic outlook.

Risk factors

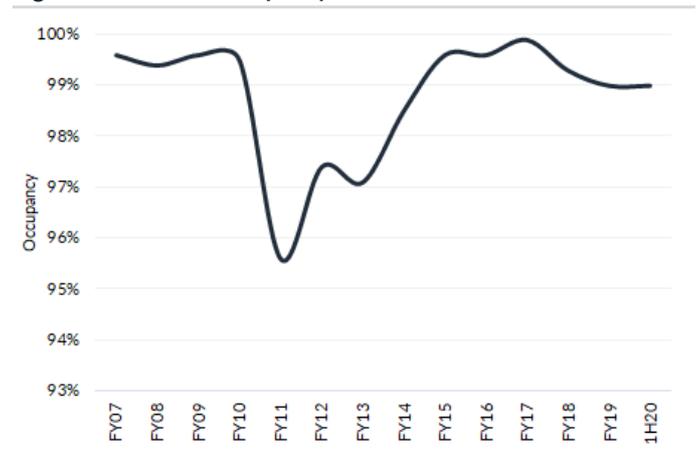
- **Tenant default:** With COVID-19 leading to widespread financial distress across many business sectors, all LPVs face a higher than usual risk of tenant default.

Figure 9. Historic WALT



Source: Forsyth Barr analysis, Company reports

Figure 10. Historic occupancy



Source: Forsyth Barr analysis, Company reports

Figure 11. Price performance


Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

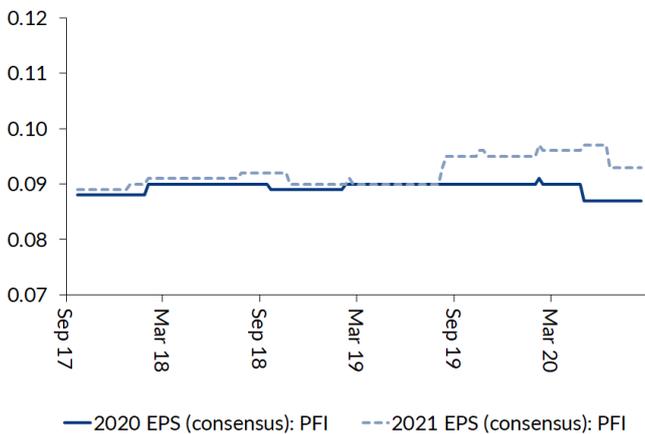
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 13. International valuation comparisons

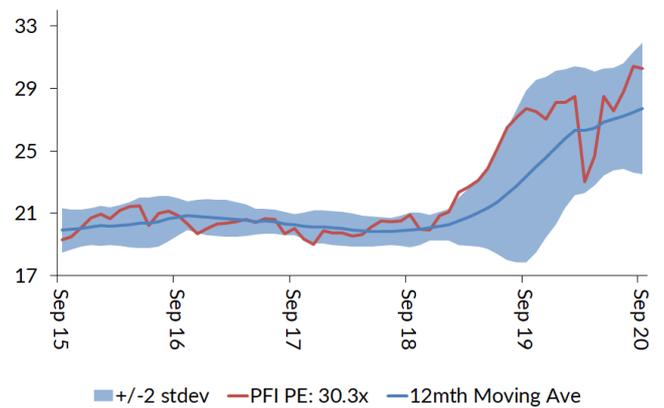
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Property For Industry	PFI NZ	NZ\$2.69	NZ\$1,340	30.6x	30.2x	24.4x	24.7x	24.4x	24.7x	2.9%
ARGOSY PROPERTY *	ARG NZ	NZ\$1.36	NZ\$1,125	19.3x	19.4x	20.6x	20.0x	20.6x	20.0x	4.7%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ\$2.29	NZ\$3,179	34.7x	34.2x	29.1x	28.2x	29.1x	28.2x	2.4%
INVESTORE *	IPL NZ	NZ\$2.17	NZ\$799	28.3x	26.4x	23.1x	20.9x	23.1x	20.9x	3.6%
KIWI PROPERTY GROUP *	KPG NZ	NZ\$1.04	NZ\$1,632	16.2x	15.5x	17.3x	16.1x	17.3x	16.1x	5.7%
ASSET PLUS *	APL NZ	NZ\$0.36	NZ\$57	11.9x	13.9x	15.4x	18.2x	15.4x	18.2x	4.9%
PRECINCT PROPERTIES NZ *	PCT NZ	NZ\$1.68	NZ\$2,207	26.5x	26.2x	31.0x	26.6x	31.0x	26.6x	3.9%
STRIDE PROPERTY *	SPG NZ	NZ\$2.04	NZ\$745	19.6x	20.8x	26.5x	32.7x	26.5x	32.7x	4.9%
VITAL HEALTHCARE *	VHP NZ	NZ\$3.03	NZ\$1,373	28.4x	27.3x	25.7x	24.1x	25.7x	24.1x	3.0%
Compco Average:				23.1x	23.0x	23.6x	23.4x	23.6x	23.4x	4.1%
PFI Relative:				33%	31%	3%	6%	3%	6%	-30%

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 14. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)


Source: Forsyth Barr analysis

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