NEW ZEALAND EQUITY RESEARCH | PROPERTY | DIVERSIFIED PROPERTY
24 JUNE 2020

Stride Property
FY20 Result — Stepping up to OUTPERFORM

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OUTPERFORM

Stride Property (SPG) reported an in line FY20 result, with stronger than expected management fee income offset by higher than expected one-off costs and tax expense. Recent asset sales to Investore (IPL) and the upcoming establishment of Industre will leave SPG in a strong capital position as it continues to execute its asset management growth strategy. We believe the risk reward is favourable with SPG trading at 1) a 13% discount to our NAV vs. the sector at a 3% premium, and 2) a 12-month forward PE of 16.4x vs. the sector at 22.5x. We believe the market is attributing no value to its asset management business. We adjust our earnings to incorporate the establishment of Industre, lift our target price to NZ$1.90, and upgrade our rating to OUTPERFORM.

NZX Code	SPG
Share price	NZ$1.68
Target price	NZ$1.90
Risk rating	Medium
Issued shares	365.2m
Market cap	NZ$614m
Avg daily turnover	344.1k (NZ$678k)

Financials: Mar/	20A	21E	22E	23E
NPAT* (NZ$m)	37.7	38.2	35.2	35.8
EPS* (NZc)	10.3	10.4	9.6	9.8
EPS growth* (%)	-2.8	1.2	-7.7	1.6
DPS (NZc)	9.9	9.9	9.9	9.9
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
EV/EBITDA	15.3	16.7	12.7	12.6
EV/EBIT	15.3	16.7	12.7	12.6
PE	16.3	16.1	17.4	17.2
Price / NTA	0.9	0.9	0.9	0.9
Cash div yld (%)	5.9	5.9	5.9	5.9
Gross div yld (%)	8.4	8.4	8.4	8.4

Value for money

SPG is currently trading at a -12% discount to its net tangible asset (NTA) backing of NZ$1.91 per share (a measure which doesn't consider the value of its asset management business), and at a -13% discount to our NAV which conservatively assumes a further 10% decrease in the value of office and retail properties but includes our valuation of its asset management business of NZ$53m or 15cps. Given this discount to our NAV, we believe the risk reward is favourable at current levels with the market attributing no value to its asset management business. Additionally, SPG trades on the highest cash yield in the sector at 5.9%. While this is a lower quality yield, as it's not covered by underlying cash earnings, SPG's board appears committed to paying it in the near term.

Funds management platform taking shape

SPG continues to grow its asset management platform and expects Industre, its JV with J.P. Morgan Asset Management (JPMAM), to commence operations on 30 June 2020. Industre is SPG's third investment vehicle and will lift assets under management by NZ$398m to NZ$1.8b. While SPG's initial co-investment in Industre is higher than desired at 68%, growth will be funded via additional equity from JPMAM, with a long term objective of reducing SPG's ownership to 25%, but in the process increases the funds asset base and management fees payable. Outside of Industre, Diversified and IPL have available capital of NZ$300m and SPG's balance sheet has undrawn debt facilities of NZ$220m which will likely be used to warehouse assets for the establishment of further funds.

Adjusting forecasts for Industre and FY21 DPS guidance 9.91cps

We adjust our distributable earnings +7.4%/-8.8%/-10.0% in FY21/22/23 which largely reflects 1) lower tenant support in FY21, 2) higher FY21 activity based fees, and 3) dilution from the transfer of industrial assets to Industre. SPG does continue to over pay its underlying cash earnings with an FY20 AFFO payout ratio of 114%. We model flat distributions until earnings catches up, however, this results in an EPS/AFFO payout of 103%/113% in FY22E and 101%/111% in FY23E. We calculate c.NZ$130m of acquisitions would be required to lift FY22 earnings and lower the EPS payout to 95% (the middle of SPG's target band), assuming SPG can acquire assets for a yield of 6.0% with a marginal cost of debt of 2.5%.

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Stride Property Group (SPG)

Priced as at 23 Jun 2020 (NZ$)	1.68

12-month target price (NZ$)*	1.90
Expected share price return	13.1%
Net dividend yield	5.9%
Estimated 12-month return	19.0%

Spot valuations (NZ$)	
1. SOTP	1.84
2. NAV	1.92
n/a	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.80
WACC	5.6%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	644
(Net debt)/cash	(85)
Less: Capitalised operating leases	0
Value of equity	558

Profit and Loss Account (NZ$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	74.0	77.9	57.0	52.9	54.1
Normalised EBITDA	**55.7**	**56.8**	**38.9**	**32.8**	**33.2**
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	**55.7**	**56.8**	**38.9**	**32.8**	**33.2**
Net interest	(14.1)	(13.2)	(5.3)	(4.0)	(3.6)
Associate income	4.2	4.1	9.8	11.7	11.7
Tax	(7.0)	(10.0)	(5.2)	(5.3)	(5.5)
Minority interests	0	0	0	0	0
Normalised NPAT	**38.8**	**37.7**	**38.2**	**35.2**	**35.8**
Abnormals/other	2.5	4.0	0	0	0
Reported NPAT	**72.8**	**29.9**	**33.7**	**31.9**	**47.5**
Normalised EPS (cps)	10.6	10.3	10.4	9.6	9.8
DPS (cps)	9.9	9.9	9.9	9.9	9.9

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	-4.0	5.3	-26.8	-7.2	2.3
EBITDA (%)	-7.5	2.0	-31.5	-15.6	1.1
EBIT (%)	-7.5	2.0	-31.5	-15.6	1.1
Normalised NPAT (%)	0.0	-2.8	1.2	-7.7	1.6
Normalised EPS (%)	-0.1	-2.8	1.2	-7.7	1.6
Ordinary DPS (%)	0.0	0.0	0.0	0.0	0.0

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	**55.7**	**56.8**	**38.9**	**32.8**	**33.2**
Working capital change	(2.5)	(5.4)	2.5	0.0	(0.0)
Interest & tax paid	(20.7)	(22.5)	(9.0)	(7.7)	(7.5)
Other	0.6	0.2	0	0	0
Operating cash flow	**33.2**	**29.1**	**32.4**	**25.1**	**25.7**
Capital expenditure	(24.5)	(44.7)	(37.5)	(3.3)	(3.2)
(Acquisitions)/divestments	0	16.9	508.2	0	0
Other	2.1	(11.7)	(178.5)	9.3	9.3
Funding available/(required)	**10.7**	**(10.3)**	**324.7**	**31.2**	**31.9**
Dividends paid	(36.2)	(36.2)	(36.2)	(36.2)	(36.2)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**(25.4)**	**(46.5)**	**288.5**	**(5.0)**	**(4.3)**

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(14.9)	(14.0)	(16.4)	(16.5)	(16.4)
Fixed assets	882.8	892.7	549.7	549.7	564.6
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	135.1	110.2	286.7	286.7	286.7
Total funds employed	**1,003.0**	**989.0**	**820.0**	**820.0**	**834.8**
Net debt/(cash)	327.0	373.8	85.3	90.3	94.6
Lease liability	0	0	0	0	0
Other liabilities	21.9	21.8	21.8	21.8	21.8
Shareholder's funds	704.2	698.2	712.9	707.9	718.5
Minority interests	0	0	0	0	0
Total funding sources	**1,053.1**	**1,093.7**	**820.0**	**820.0**	**834.8**

* 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)	15.0	15.3	16.7	12.7	12.6
EV/EBIT (x)	15.0	15.3	16.7	12.7	12.6
PE (x)	15.8	16.3	16.1	17.4	17.2
Price/NTA (x)	0.9	0.9	0.9	0.9	0.9
Free cash flow yield (%)	1.4	-8.0	-0.8	3.6	3.7
Net dividend yield (%)	5.9	5.9	5.9	5.9	5.9
Gross dividend yield (%)	8.4	8.4	8.4	8.4	8.4

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	3.9	4.3	7.4	8.2	9.1
Interest cover EBITDA (x)	3.9	4.3	7.4	8.2	9.1
Net debt/ND+E (%)	31.7	34.9	10.7	11.3	11.6
Net debt/EBITDA (x)	5.9	6.6	2.2	2.7	2.9

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	5.2	4.9	4.6	3.9	3.8
Return on equity (%)	5.5	5.4	5.4	5.0	5.0
Return on funds employed (%)	4.5	4.1	3.4	3.3	3.3
EBITDA margin (%)	75.3	72.9	68.2	62.1	61.4
EBIT margin (%)	75.3	72.9	68.2	62.1	61.4
Capex to sales (%)	33.1	57.3	65.7	6.2	5.9
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	93	96	95	103	101

Operating Performance	2016A	2017A	2018A	2019A	2020A
Portfolio Summary					
Investment properties (NZ$m)	1,275	895	902	966	996
Weighted average lease term (yrs)	7.9	4.9	5.1	4.8	5.8
Occupancy rate (%)	99.6	96.8	96.7	97.6	98.1
NTA per share (NZ$)	1.97	1.67	1.82	1.92	1.91
Average portfolio cap rate (%)	7.0	7.0	6.6	6.4	6.1
Adjusted Fund From Operations					
AFFO (cps)	10.3	8.0	9.1	8.9	8.7
AFFO payout ratio (%)	96	124	109	112	114

Other take outs from the result

- **Flat FY20 result:** SPG reported FY20 distributable profit of NZ$37.7, down -2.8% on pcp and slightly below our expectations (NZ $38.2m), with improved operating earnings due to higher management fees more than offset by increased tax.
- **Flat dividend of 9.91cps in FY21:** SPG has guided to an FY21 dividend of 9.91cps. The impact of COVID-19 rent abatements on FY21 earnings will be offset by higher one-off activity based fees as well as tax benefits.
- **COVID-19 impact:** SPG is providing rent abatements and deferrals to assist tenants with the financial impact of COVID-19. This tenant support is expected to impact FY21 distributable earnings by NZ$2.9–5.1m, or around half SPG's prior expectations of NZ $5.8–8.0m.
- **Activity based income:** SPG expects one-off activity based income to lift FY21 distributable earnings by NZ$2.2–3.6m. This income is from Investore performance fees and establishment fees from Industre. Establishment of Industre will grow SPG's external asset under management from NZ$1.2bn to NZ$1.8bn with capital available for acquisitions of NZ$300m.
- **Gearing low:** SPG's FY20 year-end balance sheet gearing of 39.1% reduces to 17.8% on a pro forma basis (25.3% on a look-through basis) after adjusting for the sale of 3 large format retail assets to Investore and the establishment of Industre being partially offset by swap break payments. SPG is well positioned to warehouse assets on its balance sheet for the establishment of further funds. SPG has suggested an office fund is its next likely product.
- **Portfolio metrics solid but will deteriorate with divestments:** FY20 WALT of 5.8 years and occupancy of 98.1%; these reduce to 4.4 years and 95.9% following FY21 divestments. FY20 leasing outcomes were solid with 50% of the portfolio reviewed resulting in a +3.1% annualised increase in rents with market rents +6.8%.

Figure 1. FY20 result summary (NZ$m)

	FY19	FY20	Chg %	FBe FY20	Var %
Net rental income	57.2	57.5	0.5%	58.3	-1.3%
Management fee income	16.8	20.4	21.3%	16.8	21.3%
Total revenue	**74.0**	**77.9**	**5.3%**	**75.1**	**3.8%**
Corporate overhead	(18.3)	(21.1)	15.2%	(18.8)	12.5%
EBITDA	**55.7**	**56.8**	**2.0%**	**56.3**	**0.9%**
Net interest	(14.1)	(13.2)	-7.0%	(14.8)	-11.3%
PBT	**41.6**	**43.7**	**5.0%**	**41.5**	**5.2%**
Current tax	(7.0)	(10.0)	43.4%	(7.5)	34.5%
NPAT (distributable) - pre associates	**34.6**	**33.6**	**-2.8%**	**34.0**	**-1.2%**
Dividends from associates	4.2	4.1	-3.2%	4.2	-3.2%
NPAT (distributable) - post associates	**38.8**	**37.7**	**-2.8%**	**38.2**	**-1.4%**
Maintenance capex	(6.4)	(5.9)	-7.9%	(6.1)	-3.3%
AFFO	**32.4**	**31.8**	**-1.8%**	**32.1**	**-1.0%**

Source: Forsyth Barr analysis, company reports

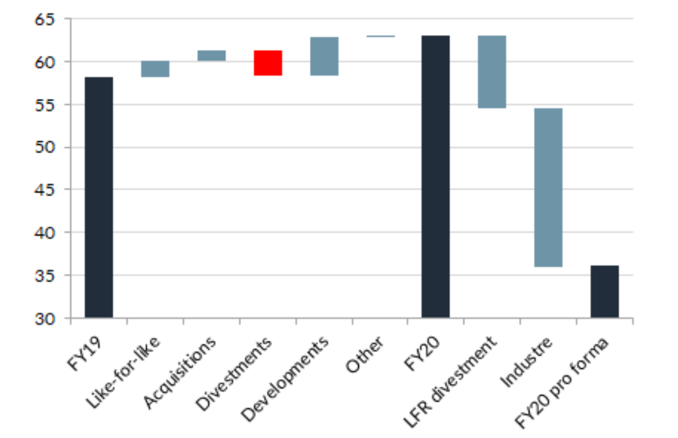
Figure 2. Earnings changes

	2021E			2022E			2023E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	**65.4**	**57.0**	**-12.8%**	**71.4**	**52.9**	**-25.9%**	**72.7**	**54.1**	**-25.6%**
Corporate costs	(16.2)	(18.1)	11.6%	(18.1)	(20.1)	10.7%	(18.5)	(20.9)	13.3%
EBITDA	**49.2**	**38.9**	**-20.8%**	**53.3**	**32.8**	**-38.3%**	**54.3**	**33.2**	**-38.8%**
Net interest	(12.2)	(5.3)	-56.5%	(11.2)	(4.0)	-64.4%	(10.8)	(3.6)	-66.3%
Current tax	(5.8)	(5.2)	-9.1%	(7.8)	(5.3)	-31.4%	(8.0)	(5.5)	-32.0%
NPAT (underlying)	**35.6**	**38.2**	**7.4%**	**38.6**	**35.2**	**-8.8%**	**39.8**	**35.8**	**-10.0%**
Maintenance capex	(5.5)	(4.5)	-19.1%	(5.1)	(3.3)	-35.0%	(4.9)	(3.2)	-34.7%
AFFO	**30.0**	**33.7**	**12.2%**	**33.6**	**31.9**	**-4.9%**	**34.9**	**32.6**	**-6.6%**
EPS (cps)	9.73	10.45	7.4%	10.58	9.64	-8.9%	10.89	9.79	-10.0%
AFFO (cps)	8.22	9.22	12.2%	9.19	8.74	-4.9%	9.56	8.93	-6.6%
DPS (cps)	6.90	9.91	43.6%	8.27	9.91	19.9%	8.60	9.91	15.2%
Payout - EPS	71%	95%	33.8%	78%	103%	31.5%	79%	101%	28.1%
Payout - AFFO	84%	107%	28.0%	90%	113%	26.0%	90%	111%	23.4%

Source: Forsyth Barr analysis

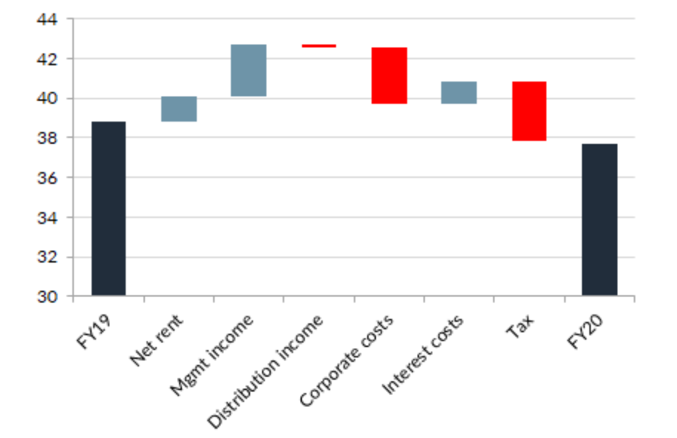
Key charts

Figure 3. Net contract rent (NZ$m)



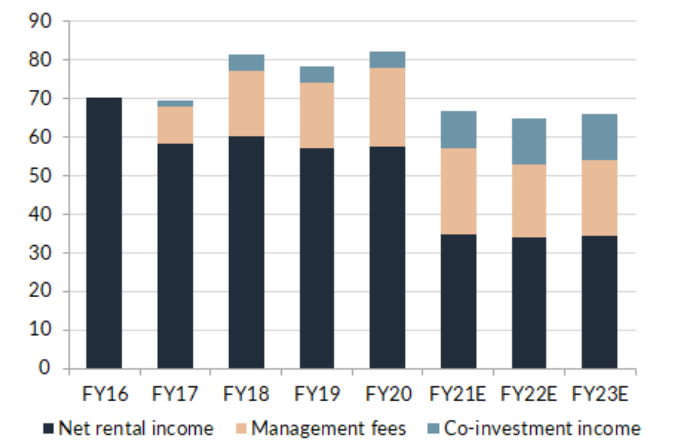
Source: Forsyth Barr analysis, Company reports

Figure 4. Distributable profit (NZ$m)



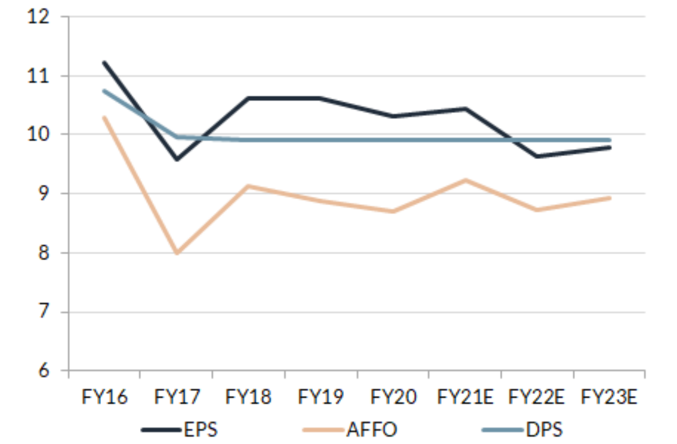
Source: Forsyth Barr analysis, Company reports

Figure 5. Income mix (NZ$m)



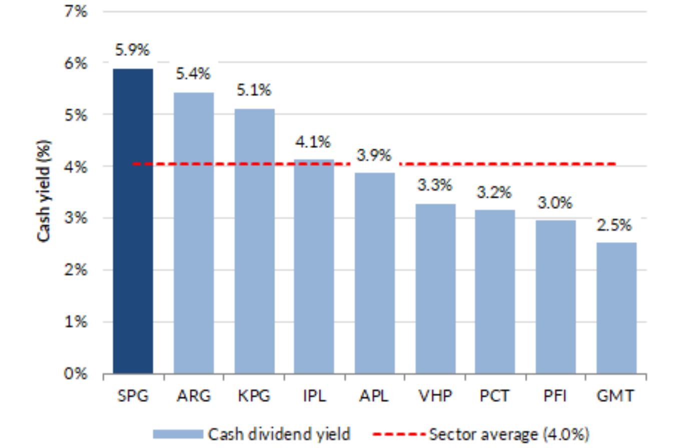
Source: Forsyth Barr analysis, Company reports

Figure 6. CPS earnings forecast



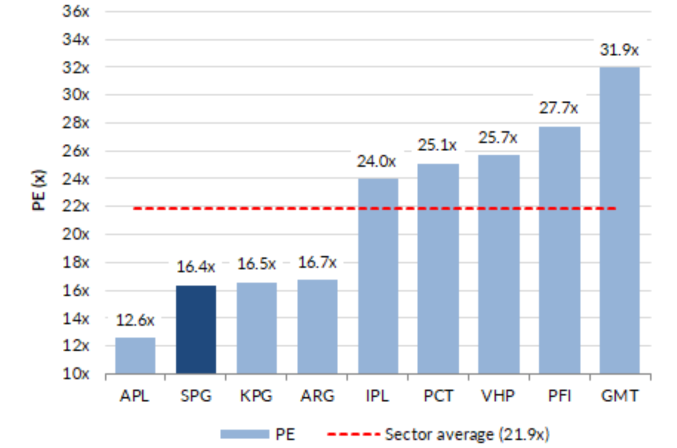
Source: Forsyth Barr analysis, Company reports

Figure 7. Cash yield



Source: Forsyth Barr analysis

Figure 8. Price to earnings



Source: Forsyth Barr analysis

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Investment Summary

Stride Property Groups (SPG) funds management platform is beginning to take shape. The establishment of Industre, a JV with JP Morgan Asset Management (JPMAM), and further growth of Investore (IPL) and Diversified should see assets under management (AUM) grow to c.NZ$2bn over the coming year. While the growth of these funds has diluted the quality of SPG's directly owned portfolio, we believe this is more than factored into the current share price. Our rating is OUTPERFORM.

Business quality

- **Restructure:** In 2016 SPG separated its funds management business, Stride Investment Management Limited (SIML), and Stride Property Limited, its direct portfolio. The stapled entities trade as one security.
- **Position in IPL:** SPG owns 18.8% of Investore, which represents all of SPG's large format retail (LFR) exposure after recent asset transfers.
- **Quality JV partner:** SPG is in the process of establishing an industrial property vehicle with JPMAM. This high quality capital partner has committed equity to grow the vehicle and SPG's AUM.

Earnings and cashflow outlook

- **Funds management income:** On a pro-forma basis, SPG has grown its external funds under management to c.NZ$1.8bn, reflecting growth from Investore and the establishment of Industre. SPG intends to grow its three funds over time and has indicated that the next fund under consideration is an office vehicle.
- **Johnsonville redevelopment:** SPG has noted it is reconsidering its development plans at Johnsonville due to the uncertain economic environment. For now, works have been stopped.

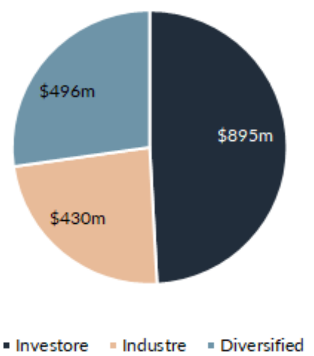
Financial structure

- **Balance sheet:** SPG's gearing is 17.8% on a pro-forma basis, accounting for the asset divestments to IPL and Industre.
- **WALT covenant:** SPG has a banking covenant requiring WALT to be above 3.0 years. At FY20, SPG's WALT was 4.3 years.

Risk factors

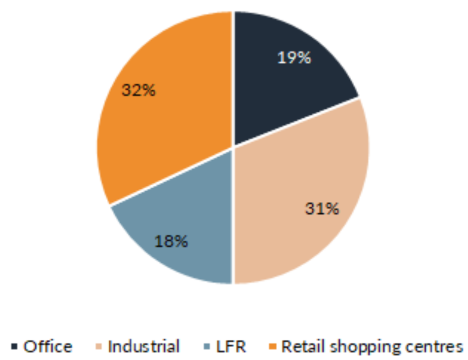
- **Economic uncertainty:** In periods of economic uncertainty tenants are more likely to default and new leasing becomes more competitive. This could result in increased vacancy, downward pressure on rents, and negative asset revaluations.
- **Asset valuations:** Given uncertain economic outlook the risk of further downward asset revaluations is heightened.

Figure 9. SIML pro forma external AUM



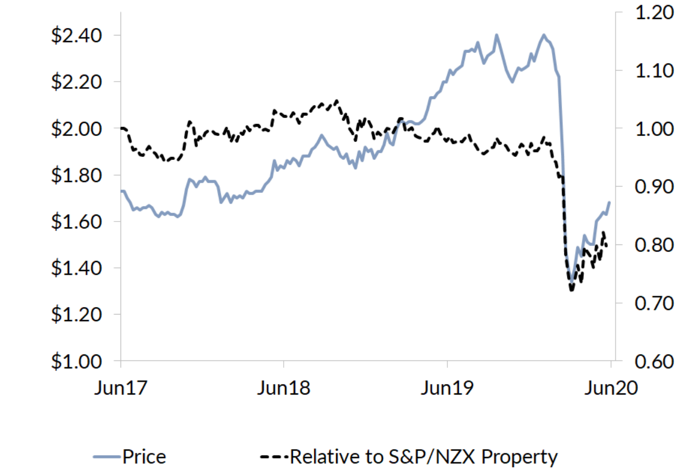
Source: Forsyth Barr analysis, Company Reports

Figure 10. SPL's weighted look through portfolio value



Source: Forsyth Barr analysis, Company Reports

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	12.4%
ACC	11.2%

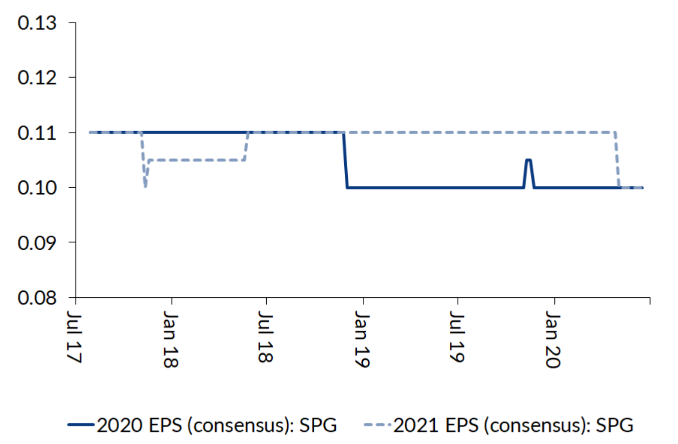
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 13. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SPG's balance date - March)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Stride Property	**SPG NZ**	**NZ$1.68**	**NZ$614**	**16.1x**	**17.4x**	**25.4x**	**30.1x**	**25.4x**	**30.1x**	**5.9%**
ARGOSY PROPERTY *	ARG NZ	NZ$1.18	NZ$976	16.9x	16.8x	18.9x	18.3x	18.9x	18.3x	5.4%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ$2.12	NZ$2,938	32.4x	31.5x	27.3x	26.1x	27.3x	26.1x	2.6%
INVESTORE *	IPL NZ	NZ$1.84	NZ$677	24.4x	22.8x	20.1x	19.2x	20.1x	19.2x	4.2%
KIWI PROPERTY GROUP *	KPG NZ	NZ$1.07	NZ$1,679	17.2x	15.6x	18.2x	15.8x	18.2x	15.8x	5.7%
ASSET PLUS *	APL NZ	NZ$0.37	NZ$60	12.6x	13.2x	16.5x	17.1x	16.5x	17.1x	6.2%
PRECINCT PROPERTIES NZ *	PCT NZ	NZ$1.63	NZ$2,141	23.9x	24.3x	21.7x	20.0x	21.7x	20.0x	3.1%
PROPERTY FOR INDUSTRY *	PFI NZ	NZ$2.36	NZ$1,180	27.9x	27.2x	23.0x	23.1x	23.0x	23.1x	3.0%
VITAL HEALTHCARE *	VHP NZ	NZ$2.58	NZ$1,167	25.9x	25.1x	23.4x	22.0x	23.4x	22.0x	3.3%
			Compco Average:	**22.6x**	**22.1x**	**21.1x**	**20.2x**	**21.1x**	**20.2x**	**4.2%**
EV = Current Market Cap + Actual Net Debt			**SPG Relative:**	**-29%**	**-21%**	**20%**	**49%**	**20%**	**49%**	**41%**

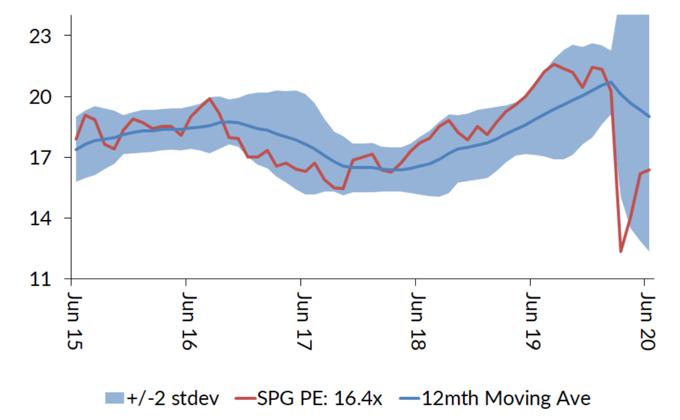
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SPG) companies fiscal year end

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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