Argosy
Steady 2H Revaluation

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NEUTRAL

Argosy Property's (ARG) March 2020 valuations have resulted in an +NZ$61.7m (or +3.6%) increase over book value. This increase (vs. peers who have recently reported declines) reflects large weightings to Industrial (+6.8%) and Office (+2.9%). ARG's NTA increases +2% to NZ$1.30 but gearing increases to c.39% (towards top of its 30–40% range). ARG remains a useful member of an LPV portfolio given its diversified portfolio centred on the industrial segment, and is trading at a large discount to NTA which offsets some near-term uncertainties. Our earnings and target price are unchanged. NEUTRAL.

NZX Code	ARG
Share price	NZ$1.08
Target price	NZ$1.13
Risk rating	Medium
Issued shares	827.0m
Market cap	NZ$893m
Avg daily turnover	657.6k (NZ$848k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	57.4	54.4	56.9	57.1
EPS* (NZc)	6.9	6.6	6.9	6.9
EPS growth* (%)	4.8	-5.2	4.5	0.4
DPS (NZc)	6.3	6.4	4.7	5.6
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	15.9	16.8	15.8	14.8
EV/EBIT	15.9	16.8	15.8	14.8
PE	15.6	16.4	15.7	15.7
Price / NTA	0.9	0.8	0.8	0.8
Cash div yld (%)	5.8	5.9	4.3	5.2
Gross div yld (%)	8.3	8.4	6.2	7.4

Portfolio value increases +3.6% yoy and was flat in 2H20

ARG's March 2020 valuations have resulted in a +$61.7m (+3.6%) lift in asset values over the past 12 months. The desktop valuations reported at ARG's 1H20 result account for +$50.8m of the revaluation, meaning that ARG's portfolio value increased +$10.9m (+0.6%) over the 6 months ending 31 March 2020. As shown in Figure 1, ARG's industrial portfolio saw the largest value uplift in FY20, up +$53.4m (+6.8%). Office held up relatively well, up +$21.3m (+2.9%), while Large Format Retail (LFR) valuations fell -$13.0m (-6.5%). LFR is ARG's smallest segment, making up only ~10% of ARG's total portfolio.

Balance sheet remains tight vs. target

ARG's NTA increased +2% to NZ$1.30 (versus our NAV of NZ$1.02) and gearing increases to 39% (towards the top of its 30–40% target range vs. 50% covenant). While ARG is one of the highest geared in the LPV sector and has committed development expenditure, receipt of NZ Post insurance proceeds and an eventual sale of the Albany Lifestyle Centre will lower gearing in time. Furthermore, its relatively smaller average asset size was a helpful source of liquidity during the last recession.

Read through for other LPVs: Industrial and Office holding up well

ARG's positive valuation movement reflects its portfolio being more weighted to industrial and office vs. peers Kiwi Property Group (KPG, UNDERPERFORM) and Asset Plus (APL, UNDERPERFORM) both of which are more exposed to retail. On each sub-sector, 1) Retail asset valuation decline was in line with our expectations reflecting the mix being LFR vs. the shopping mall heavy portfolios of KPG and APL; **we continue to view Investore's (IPL, OUTPERFORM) supermarket focused LFR portfolio as attractive**, 2) Office held up better than expected particularly given ARG's mix of short and long WALT assets, **we believe this is supportive for Stride's (SPG, NEUTRAL) office portfolio as well as Precinct's (PCT) lower WALT assets**, 3) Industrial was the standout suggesting **Property for Industry (PFI, OUTPERFORM) and Goodman (GMT, NEUTRAL) valuations will remain solid near-term**.

Depending on the extent of the economic slowdown, the office and retail segments in particular remain at risk of further valuation downside over the next 12 months.

Argosy Property Limited (ARG)

Priced as at 23 Apr 2020 (NZ$)	1.08

12-month target price (NZ$)*	1.13
Expected share price return	4.6%
Net dividend yield	4.4%
Estimated 12-month return	9.0%

Spot valuations (NZ$)	
1. DCF	1.35
2. NAV	1.02
n/a	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.77
WACC	5.5%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	1,808
(Net debt)/cash	(591)
Less: Capitalised operating leases	0
Value of equity	1,176

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	101.0	102.5	100.5	108.0	115.0
Normalised EBITDA	**91.1**	**91.5**	**89.6**	**96.7**	**103.1**
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	**91.1**	**91.5**	**89.6**	**96.7**	**103.1**
Net interest	(25.5)	(24.2)	(25.7)	(27.9)	(32.0)
Associate income	0	0	0	0	0
Tax	(11.0)	(10.0)	(9.5)	(11.9)	(14.1)
Minority interests	0	0	0	0	0
Normalised NPAT	**54.6**	**57.4**	**54.4**	**56.9**	**57.1**
Abnormals/other	(43.6)	(76.3)	(68.7)	(51.4)	(26.7)
Reported NPAT	**98.2**	**133.7**	**123.1**	**108.3**	**83.8**
Normalised EPS (cps)	6.6	6.9	6.6	6.9	6.9
DPS (cps)	6.2	6.3	6.4	4.7	5.6

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	15.5	15.9	16.8	15.8	14.8
EV/EBIT (x)	15.5	15.9	16.8	15.8	14.8
PE (x)	16.3	15.6	16.4	15.7	15.7
Price/NTA (x)	1.0	0.9	0.8	0.8	0.8
Free cash flow yield (%)	-0.1	-3.1	-5.0	2.2	5.8
Net dividend yield (%)	5.7	5.8	5.9	4.3	5.2
Gross dividend yield (%)	8.0	8.1	8.2	6.0	7.2

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	3.6	3.8	3.5	3.5	3.2
Interest cover EBITDA (x)	3.6	3.8	3.5	3.5	3.2
Net debt/ND+E (%)	37.3	37.0	40.2	38.7	37.6
Net debt/EBITDA (x)	6.1	6.5	8.1	7.5	6.9

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	0.2	1.5	-1.9	7.5	6.4
EBITDA (%)	-0.4	0.5	-2.1	7.9	6.7
EBIT (%)	-0.4	0.5	-2.1	7.9	6.7
Normalised NPAT (%)	2.0	5.0	-5.2	4.6	0.4
Normalised EPS (%)	1.0	4.8	-5.2	4.5	0.4
Ordinary DPS (%)	1.6	1.2	1.2	-26.6	20.2

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	5.9	5.5	4.8	5.0	5.2
Return on equity (%)	5.9	5.7	5.0	5.0	4.8
Return on funds employed (%)	5.1	4.9	4.3	4.2	4.3
EBITDA margin (%)	90.2	89.3	89.1	89.5	89.7
EBIT margin (%)	90.2	89.3	89.1	89.5	89.7
Capex to sales (%)	62.5	92.5	98.1	34.7	4.9
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	94	90	97	68	81

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**91.1**	**91.5**	**89.6**	**96.7**	**103.1**
Working capital change	6.6	9.2	0	0	0.0
Interest & tax paid	(35.4)	(33.8)	(35.2)	(39.8)	(46.1)
Other	0	0	0	0	0
Operating cash flow	**62.3**	**66.9**	**54.4**	**56.9**	**57.1**
Capital expenditure	(63.1)	(94.8)	(98.6)	(37.4)	(5.6)
(Acquisitions)/divestments	24.8	40.7	(44.4)	0	0
Other	(0.7)	(1.6)	7.0	25.7	0
Funding available/(required)	**23.3**	**11.3**	**(81.6)**	**45.1**	**51.5**
Dividends paid	(47.3)	(52.4)	(51.9)	(42.7)	(44.4)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**(24.0)**	**(41.1)**	**(133.5)**	**2.4**	**7.1**

Property Statistics	2015A	2016A	2017A	2018A	2019A
Industrial					
Value (NZ$m)	510	507	583	638	738
No. buildings	40	39	38	36	37
WALT (years)	5.72	5.99	6.40	7.35	7.22
Occupancy	99.7%	99.9%	98.3%	99.9%	97.8%
Contract yield	7.6%	7.7%	6.9%	6.7%	6.2%
Market yield	7.6%	7.7%	7.1%	6.7%	6.5%
Office					
Value (NZ$m)	484	549	548	577	627
No. buildings	17	17	17	17	16
WALT (years)	5.60	4.82	4.87	4.99	4.94
Occupancy	98.8%	99.1%	98.4%	97.2%	96.8%
Contract yield	7.6%	7.6%	7.3%	7.0%	6.9%
Market yield	7.6%	7.6%	7.6%	7.4%	7.1%
Retail					
Value (NZ$m)	312	312	311	298	303
No. buildings	11	10	9	8	7
WALT (years)	5.15	4.78	5.46	5.69	5.96
Occupancy	98.9%	99.2%	99.4%	100.0%	100.0%
Contract yield	7.5%	7.4%	7.4%	7.1%	6.2%
Market yield	7.4%	7.1%	7.3%	6.8%	6.3%

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(10.6)	(13.9)	(13.9)	(13.9)	(13.9)
Fixed assets	1,513.1	1,667.0	1,784.1	1,847.3	1,879.7
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	28.8	4.4	92.0	92.0	92.0
Total funds employed	**1,531.3**	**1,657.5**	**1,862.2**	**1,925.4**	**1,957.7**
Net debt/(cash)	551.5	591.3	724.9	722.5	715.4
Lease liability	0	0	0	0	0
Other liabilities	52.9	57.1	57.1	57.1	57.1
Shareholder's funds	926.9	1,009.0	1,080.2	1,145.8	1,185.2
Minority interests	0	0	0	0	0
Total funding sources	**1,531.3**	**1,657.5**	**1,862.2**	**1,925.4**	**1,957.7**

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

Valuation update

Figure 1. ARG valuation update — 31 March 2020

Segment	Book Value as at 31 March ($m)	New Valuation ($m)	chg ($)	chg (%)	Portfolio weighting (new)
Industrial	789.5	842.8	53.4	6.8%	47.2%
Office	734.6	756	21.3	2.9%	42.4%
Large Format Retail	198.3	185.4	-13.0	-6.5%	10.4%
Total	**1722.4**	**1784.1**	**61.7**	**3.6%**	

Source: Forsyth Barr analysis

Investment Summary

Argosy Property (ARG) has recycled non-core assets and worked through incremental development opportunities to improve portfolio quality. Fundamentals have been very strong but as we enter a downturn there are risks for retail and secondary office assets in particular. NEUTRAL.

Business quality

- **Revaluation gains:** ARG reported an FY20 revaluation gain of +NZ$61.7m (or +3.6%) increase over book value, lifting the NTA to NZ$1.30.
- **Industrial assets underpin portfolio:** ARG's portfolio WALT was steady in 1H20 at 6yrs. ARG's WALT is underpinned by its NZ $750m+ industrial portfolio (7.2yrs), which is sector-leading versus industrial peers.

Earnings and cashflow outlook

- **Rental growth:** ARG achieved robust rental growth of +3.2% (annualised) across rent reviews in 1H20 with the industrial portfolio particularly strong.
- **Development activity:** Developments include office at 107 Carlton Gore Road (12 year lease to Housing NZ) and 8–14 Willis Street (leased to Statistics NZ for 15 years), and retail at Stewart Dawsons corner in Wellington.

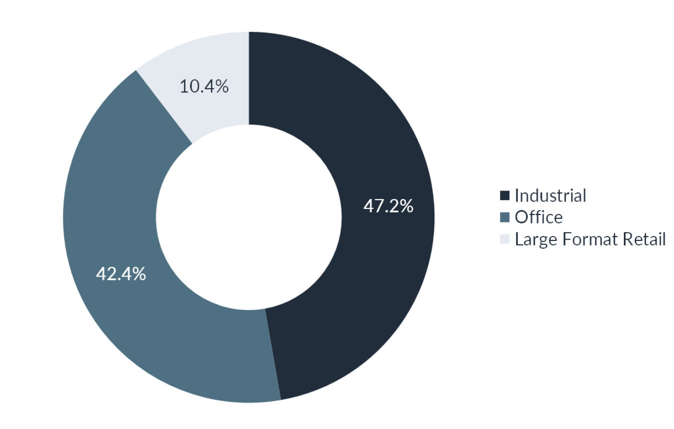
Financial structure

- **Balance sheet:** Gearing is above sector average levels at ~39%.
- **Dividends:** ARG has guided to a modest dividend growth in FY20 and it pays out around AFFO, providing an attractive dividend yield.

Risk factors

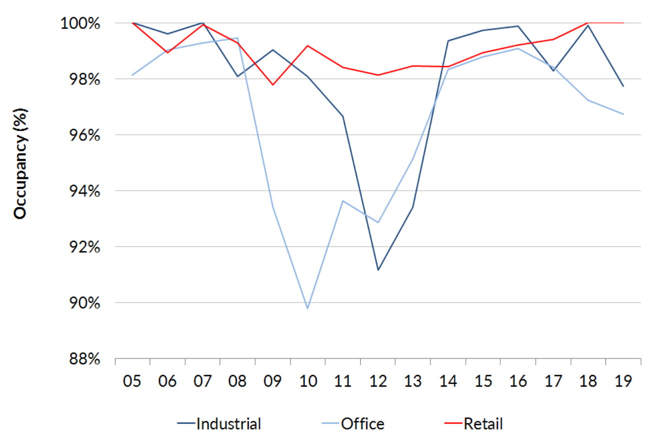
- **Auckland office conditions:** Auckland office is vulnerable from increasing supply and the drive for space efficiency, however, recently this has been offset by assets leaving the market and increased government space, and now a slower economic outlook.
- **Retail Exposure:** The retail sector is facing considerable headwinds and uncertainties at present, helpful for ARG is that most of its retail is large format and more defensive than traditional specialty retail.

Figure 2. Sector portfolio exposure



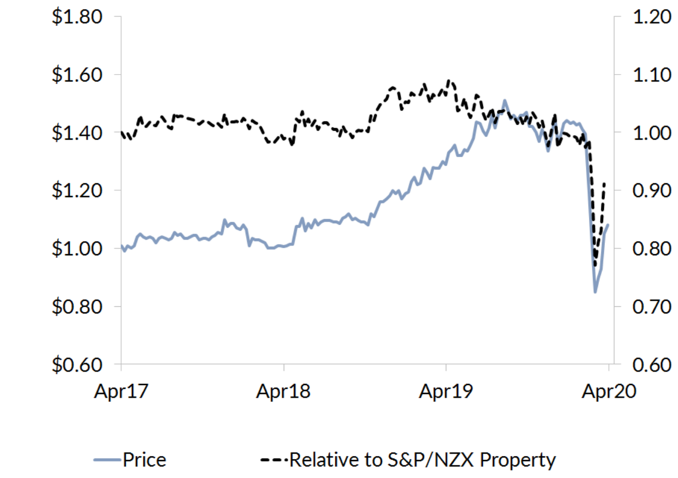
Source: Forsyth Barr analysis, Company Reports. Note: Data is based on FY20 revaluations

Figure 3. ARG occupancy by sector



Source: Forsyth Barr analysis, Company Reports

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
ACC	5.2%
The Vanguard Group	5.1%
Milford Asset Management	5.0%

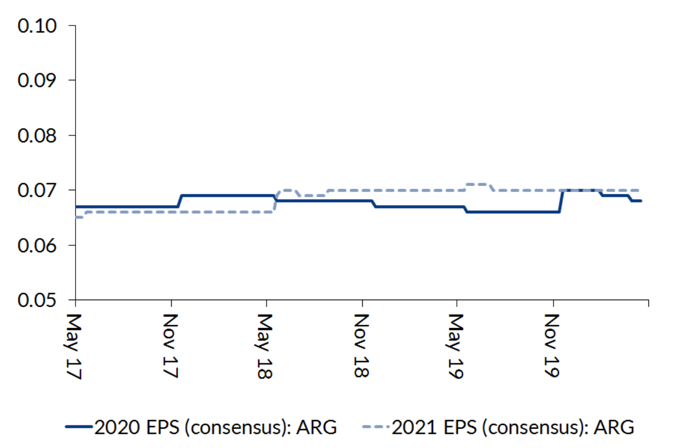
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect ARG's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Argosy Property	**ARG NZ**	**NZ$1.08**	**NZ$893**	**16.4x**	**15.7x**	**16.6x**	**15.4x**	**16.6x**	**15.4x**	**4.3%**
Goodman Property Trust *	GMT NZ	NZ$2.05	NZ$2,841	30.4x	29.7x	26.8x	24.4x	26.8x	24.4x	2.6%
Investore *	IPL NZ	NZ$1.41	NZ$429	18.0x	16.9x	18.3x	15.5x	18.3x	15.5x	4.9%
Kiwi Property Group *	KPG NZ	NZ$0.84	NZ$1,318	11.8x	11.5x	14.0x	13.0x	14.0x	13.0x	6.0%
Asset Plus *	APL NZ	NZ$0.42	NZ$68	10.9x	11.5x	8.6x	9.1x	8.6x	9.1x	4.7%
Precinct Properties NZ *	PCT NZ	NZ$1.47	NZ$1,931	22.6x	21.6x	24.4x	20.2x	24.4x	20.2x	3.4%
Property For Industry *	PFI NZ	NZ$1.76	NZ$878	20.5x	20.0x	17.3x	17.2x	17.3x	17.2x	3.5%
Stride Property *	SPG NZ	NZ$1.30	NZ$475	12.4x	12.1x	14.2x	14.2x	14.2x	14.2x	5.3%
Vital Healthcare *	VHP NZ	NZ$2.05	NZ$928	21.1x	20.0x	20.0x	18.9x	20.0x	18.9x	4.1%
			Compco Average:	**18.5x**	**17.9x**	**17.9x**	**16.6x**	**17.9x**	**16.6x**	**4.3%**
EV = Current Market Cap + Actual Net Debt			**ARG Relative:**	**-11%**	**-12%**	**-8%**	**-7%**	**-8%**	**-7%**	**0%**

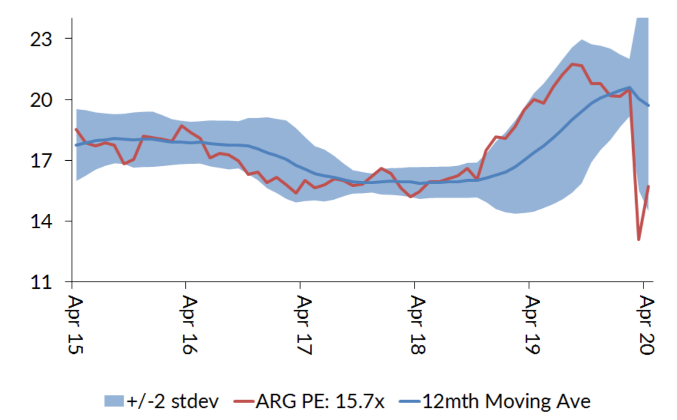
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ARG) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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