

Precinct Properties NZ

Company Update

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NEUTRAL 

Precinct Properties (PCT) is in a much stronger position this cycle than last; however, the office market is not immune through a recession. The prime location of PCT's portfolio, with some of the best real estate in the country, will hold up relatively well in terms of occupancy, which is crucial, and longer term these assets remain very strategic. We have a NEUTRAL rating, but are watching the Property Sector near-term challenges closely.

NZX Code	PCT	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$1.69	NPAT* (NZ\$m)	77.4	86.7	90.2	95.2	EV/EBITDA	35.3	22.7	21.7	19.8
Target price	NZ\$1.52	EPS* (NZc)	6.2	6.6	6.9	6.6	EV/EBIT	35.3	22.7	21.7	19.8
Risk rating	Medium	EPS growth* (%)	-1.8	6.4	4.0	-3.9	PE	27.2	25.6	24.6	25.6
Issued shares	1211.1m	DPS (NZc)	6.0	6.3	6.3	6.3	Price / NTA	1.2	1.1	1.1	1.1
Market cap	NZ\$2,047m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.6	3.7	3.7	3.7
Avg daily turnover	1,189k (NZ\$2,098k)	*Based on normalised profits					Gross div yld (%)	5.1	5.3	5.3	5.3

Office has historically been very volatile through the cycle

In the NZ LPV sector we only have PCT with close to 100% office, plus KPG, APL, ARG and SPG have less office exposure ranging from around 15% to 45% office in portfolios. WALTs are longer than last cycle and there is a larger amount of structured rents. New major supply has looked manageable and there is little vacant stock which is very helpful, but this dynamic can swing relatively quickly with corporate downsizing. While corporates may still be in business and hence paying rent, many may need less space and this then creates a discounted sub-leasing market (and artificially low official vacancy levels) which ultimately feeds its way into lower market rents and lower asset values. Forced selling could be an issue from private or offshore markets if balance sheets are stretched, which then puts pressure on cap rates. Listed office occupancy dropped to the low 90% level last cycle.

Better positioned than last cycle

While PCT will yet again complete a large development as the cycle turns we believe the business is much better placed than it was in the GFC. Gearing is low at 25.4% (ex. subordinated debt) and 31% after allowing for fully committed project capex. PCT has also just refinanced its bank facilities with the next debt maturity now Dec-21. Portfolio metrics are solid with occupancy at 99% and WALT of 9 years. That said, there is uncertainty around near-term rental payments under earthquake lock out clauses, as well as longer term questions around tenant space requirements, (as well as how firms re-think working from home following the Government lockdown), and the expectation of a recession, offset partially near-term by possible Government rent relief or other corporate support.

Balance position — retain NEUTRAL

As is the case with the wider sector, we have not made material forecast earnings changes at this stage. Balance sheets look generally solid, as is the case with PCT, however, how assets valuations trend in the near-term will be crucial. Our target price is unchanged at NZ\$1.52 and we remain with a NEUTRAL rating. A risk factor is that PCT continues to trade at a large premium to the sector given the quality of its asset base and management execution, but office has never been immune through the cycle. PCT's large development pipeline, which is largely pre-committed, has stalled and will likely be significantly delayed and the feasibility re-assessed. While the back fill from the new Commercial Bay office space was looking to be relatively easily contained, this will be harder now. The retail was fully leased and the tower 92% leased going into the lockdown. One Queen Street project was on track to commence mid-2020, Wynyard Quarter stage 2 is 100% leased, and Bowen Campus stage 2 was set to commence.

Precinct Properties NZ Limited (PCT)

Priced as at 02 Apr 2020 (NZ\$)

1.69
12-month target price (NZ\$)*
1.52

Expected share price return

-9.9%

Net dividend yield

3.7%

Estimated 12-month return

-6.1%

Spot valuations (NZ\$)

1. DCF

1.35

2. NAV

1.60

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.75%

Equity beta

0.69

WACC

5.8%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

2,430

(Net debt)/cash

(752)

Less: Capitalised operating leases

0

Value of equity

1,655

Profit and Loss Account (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Sales revenue	95.3	95.0	139.1	151.7	164.9
Normalised EBITDA	85.1	79.2	126.3	135.5	148.0
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	85.1	79.2	126.3	135.5	148.0
Net interest	(2.2)	(1.8)	(32.8)	(35.0)	(37.9)
Associate income	0	0	0	0	0
Tax	(6.3)	0	(6.7)	(10.2)	(14.9)
Minority interests	0	0	0	0	0
Normalised NPAT	76.6	77.4	86.7	90.2	95.2
Abnormals/other	178.3	110.5	86.0	53.0	78.9
Reported NPAT	254.9	187.9	172.8	143.3	174.1
Normalised EPS (cps)	6.3	6.2	6.6	6.9	6.6
DPS (cps)	5.8	6.0	6.3	6.3	6.3

Growth Rates

	2018A	2019A	2020A	2021A	2022A
Revenue (%)	5.4	-0.3	46.4	9.1	8.7
EBITDA (%)	5.6	-6.9	59.5	7.3	9.3
EBIT (%)	5.6	-6.9	59.5	7.3	9.3
Normalised NPAT (%)	2.5	1.0	12.1	4.0	5.5
Normalised EPS (%)	2.5	-1.8	6.4	4.0	-3.9
Ordinary DPS (%)	3.6	3.4	4.2	0.8	0.0

Cash Flow (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
EBITDA	85.1	79.2	126.3	135.5	148.0
Working capital change	(2.6)	(7.8)	15.4	4.4	4.6
Interest & tax paid	(7.6)	(7.3)	(39.5)	(45.2)	(52.8)
Other	0	0	0	0	0
Operating cash flow	74.9	64.1	102.1	94.6	99.9
Capital expenditure	(294.4)	(271.9)	(160.6)	(128.5)	(62.9)
(Acquisitions)/divestments	0	180.8	0	0	0
Other	(11.5)	(2.4)	0	0	0
Funding available/(required)	(231.0)	(29.4)	(58.5)	(33.9)	36.9
Dividends paid	(69.6)	(75.1)	(81.3)	(82.6)	(90.9)
Equity raised/(returned)	0	149.3	0	0	0
(Increase)/decrease in net debt	(300.6)	44.8	(139.7)	(116.5)	(54.0)

Balance Sheet (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Working capital	(6.0)	(33.2)	(48.6)	(53.0)	(57.6)
Fixed assets	2,325.7	2,793.7	3,040.3	3,221.9	3,363.7
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	225.7	44.2	44.2	44.2	44.2
Total funds employed	2,545.4	2,804.7	3,035.9	3,213.1	3,350.3
Net debt/(cash)	758.8	751.5	891.2	1,007.7	908.7
Lease liability	0	0	0	0	0
Other liabilities	95.9	129.4	129.4	129.4	129.4
Shareholder's funds	1,690.7	1,923.8	2,015.3	2,076.0	2,312.2
Minority interests	0	0	0	0	0
Total funding sources	2,545.4	2,804.7	3,035.9	3,213.1	3,350.3

* 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)	31.1	35.3	22.7	21.7	19.8
EV/EBIT (x)	31.1	35.3	22.7	21.7	19.8
PE (x)	26.7	27.2	25.6	24.6	25.6
Price/NTA (x)	1.2	1.2	1.1	1.1	1.1
Free cash flow yield (%)	-10.7	-10.2	-2.9	-1.7	1.8
Net dividend yield (%)	3.4	3.6	3.7	3.7	3.7
Gross dividend yield (%)	4.9	5.1	5.3	5.3	5.3

Capital Structure

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	38.7	44.0	3.8	3.9	3.9
Interest cover EBITDA (x)	38.7	44.0	3.8	3.9	3.9
Net debt/ND+E (%)	31.0	28.1	30.7	32.7	28.2
Net debt/EBITDA (x)	8.9	9.5	7.1	7.4	6.1

Key Ratios

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	3.3	2.8	4.1	4.1	4.3
Return on equity (%)	4.5	4.0	4.3	4.3	4.1
Return on funds employed (%)	3.1	2.7	3.9	3.8	3.8
EBITDA margin (%)	89.3	83.4	90.8	89.3	89.7
EBIT margin (%)	89.3	83.4	90.8	89.3	89.7
Capex to sales (%)	308.9	286.2	115.5	84.7	38.2
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	92	97	95	92	95

Property Statistics

	2014A	2015A	2016A	2017A	2018A
Key metrics					
No. properties	17	15	13	12	12
Net lettable area (000sqm)	322	304	226	224	225
Average lease term (years)	5.4	5.0	6.3	8.7	6.9
Occupancy rate (%)	98	98	98	100	99
Cap rate (%)	7.3	7.0	6.5	6.2	5.8
Initial yield (%)	7.5	7.0	6.7	6.5	5.8
Over / (under) renting (%)	0	(1.8)	(3.6)	(4.7)	(6.4)

Total portfolio (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Investment properties	1,633	1,612	1,514	1,535	1,488
Properties held for sale	96	76	0	0	191
Development properties	0	0	190	509	838
Total	1,728	1,688	1,704	2,045	2,517
NTA per share (NZ\$)	1.04	1.11	1.17	1.24	1.40

Figure 1. LPV Balance sheet overview

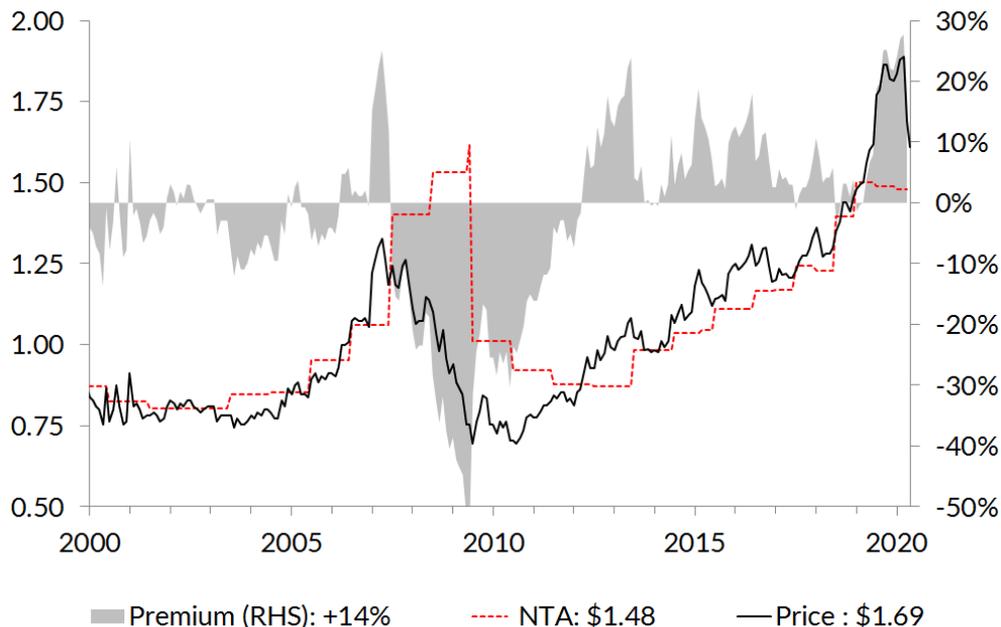
	As at	Reported gearing	Target gearing	Bank covenant	Bank facilities (NZ\$m)	Issued Bonds (NZ\$m)	Facility capacity (NZ\$m)	Term - bank (years)	Term - bonds (years)	Term - weighted (years)
APL	Mar-20	30.2%	35-40%	50%	75	-	27	2.2	-	2.2
ARG	Sep-19	36.2%	30-40%	50%	585	200	135	2.7	6.3	3.6
GMT	Sep-19	17.9%	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%	4,335	2,117	1,628	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. PCT long run P/NTA


Source: Forsyth Barr analysis

Figure 4. LPV compco

LPV	Code	Rating	Price 2-Apr	Target price	Gross yield	AFFO yield	P/NAV	P/NTA
Asset Plus	APL	UNDERPERFORM	\$0.38	\$0.65	13.5%	8.3%	58%	54%
Argosy Property	ARG	NEUTRAL	\$0.88	\$1.13	10.2%	7.1%	86%	69%
Augusta Capital	AUG	NEUTRAL	\$0.81	\$1.38	11.1%	8.8%	58%	109%
Goodman Property	GMT	NEUTRAL	\$2.14	\$1.92	4.4%	2.9%	113%	124%
Investore	IPL	OUTPERFORM	\$1.64	\$1.85	6.6%	4.7%	99%	96%
Kiwi Property Group	KPG	NEUTRAL	\$0.89	\$1.29	11.5%	7.3%	78%	63%
Precinct Properties	PCT	NEUTRAL	\$1.69	\$1.52	5.3%	3.6%	106%	115%
Property for Industry	PFI	OUTPERFORM	\$2.05	\$2.15	5.4%	3.8%	100%	103%
Stride Property	SPG	NEUTRAL	\$1.35	\$1.75	10.5%	6.8%	84%	69%
Vital Healthcare	VHP	OUTPERFORM	\$2.20	\$2.76	5.8%	4.0%	93%	95%
Core simple average					7.5%	5.0%	95%	92%

Source: Forsyth Barr analysis, Eikon

Investment Summary

Precinct Properties (PCT) NZ\$1.5bn development pipeline is both improving the quality of its portfolio and growing EPS. We are positive on the value PCT is creating through its developments. Its portfolio is also in very good shape with occupancy of 99%. Conditions for the Auckland CBD office market have been very firm and vacancy low which is helpful for dealing with new supply, the slower economy, and expected increased drive for space efficiency by corporate occupiers. NEUTRAL.

Business quality

- **Portfolio fundamentals:** PCT has 99% occupancy and a high portfolio WALT of 9 years including developments as at 30 June 2019.
- **Prime location:** PCT is well positioned given its key precincts in Auckland and Wellington. We are positive about rental upside in Auckland and rental diversification from its retail, hotel, and Generator business, plus stable cash flow from its Wellington government leases. PCT is in a stronger position than last cycle.

Earnings and cashflow outlook

- **Development milestones:** Commercial Bay retail component was set to open fully leased in late March and the office tower in April but will be delayed due to the COVID-19 outbreak. The retail was fully leased and the tower 92% leased going into the lockdown. One Queen Street project was on track to commence mid-2020, Wynyard Quarter stage 2 is 100% leased, and Bowen Campus stage 2 was set to commence.
- **Development margins:** Commercial Bay and Bowen Campus are expected to generate a yield on cost of 7.5% and ~7.0% respectively, as well as substantial development margins.
- **Revaluation gains:** PCT posted a revaluation gain of NZ\$162m fro FY19 which boosted NTA per share +11cps from NZ\$1.38 to NZ\$1.49.

Financial structure

- **Balance sheet:** 1H20 gearing is 22% and committed gearing is ~32% when the sale of Pastoral House in Wellington for NZ\$77m, settles in 2H20.

Risk factors

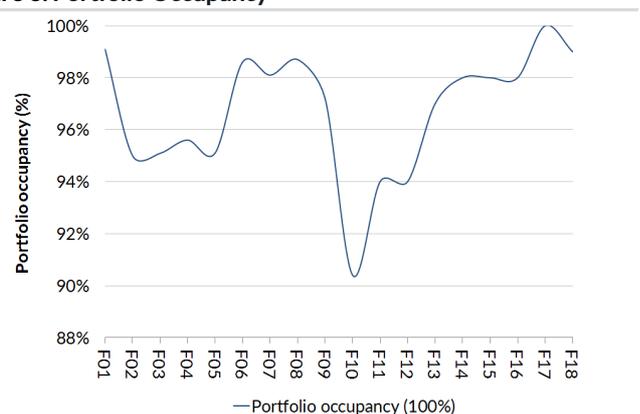
- **CBD office supply:** Auckland and Wellington have office supply planned in coming years, which could impact vacancy and rents.
- **Economic slowdown:** Traditionally the office market is relatively volatile through a downturn in terms of rental levels, vacancy and values.

Figure 5. Sector and regional portfolio exposure

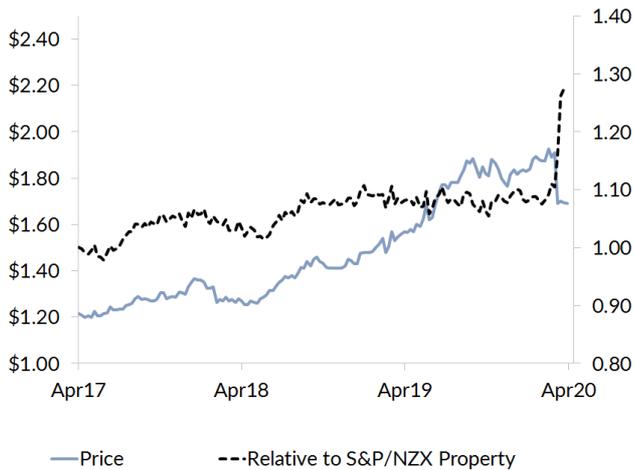
	Auckland	Other North Island	South	Island	Total
Industrial	-	-	-	-	-
Office	74%	26%	-	-	100%
Mixed use	-	-	-	-	-
Total	74%	26%	-	-	100%

Source: Forsyth Barr analysis, Company Reports. Note: Data is based on reported portfolio as at 30/06/2018

Figure 6. Portfolio Occupancy



Source: Forsyth Barr analysis, Company Reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

Shareholder	Latest Holding
Haumi	17.7%
ANZ NZ Investments	10.9%

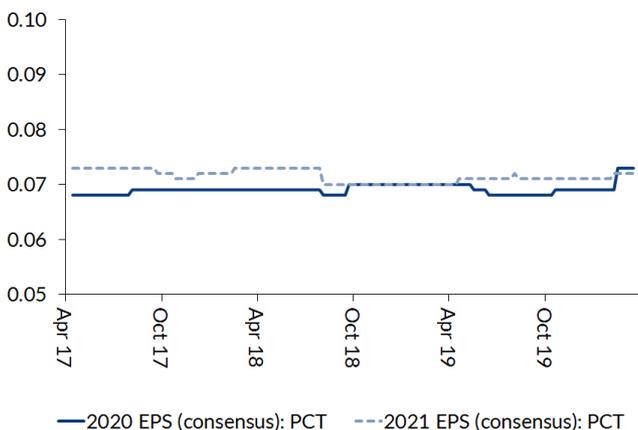
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 9. International valuation comparisons

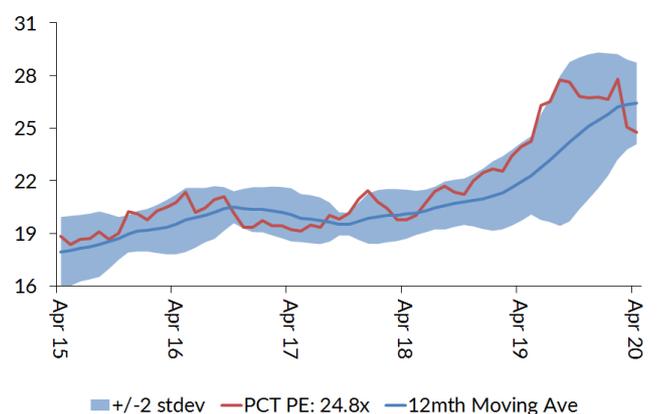
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Precinct Properties NZ	PCT NZ	NZ\$1.69	NZ\$2,047	25.6x	24.6x	22.2x	20.7x	22.2x	20.7x	3.7%
Argosy Property *	ARG NZ	NZ\$0.84	NZ\$695	12.6x	12.2x	14.2x	13.3x	14.2x	13.3x	7.5%
Goodman Property Trust *	GMT NZ	NZ\$2.05	NZ\$2,841	30.2x	29.5x	26.2x	24.1x	26.2x	24.1x	3.2%
Investore *	IPL NZ	NZ\$1.41	NZ\$429	17.7x	16.8x	17.6x	15.4x	17.6x	15.4x	5.4%
Kiwi Property Group *	KPG NZ	NZ\$0.84	NZ\$1,318	11.8x	11.6x	13.8x	13.0x	13.8x	13.0x	8.5%
Asset Plus *	APL NZ	NZ\$0.42	NZ\$68	11.1x	11.8x	8.6x	9.1x	8.6x	9.1x	8.6%
Property For Industry *	PFI NZ	NZ\$1.76	NZ\$878	20.3x	20.1x	17.3x	17.2x	17.3x	17.2x	4.4%
Stride Property *	SPG NZ	NZ\$1.30	NZ\$475	12.3x	12.1x	14.2x	14.1x	14.2x	14.1x	7.7%
Vital Healthcare *	VHP NZ	NZ\$2.05	NZ\$928	20.9x	19.8x	19.9x	18.6x	19.9x	18.6x	4.4%
Compcpo Average:				17.1x	16.7x	16.5x	15.6x	16.5x	15.6x	6.2%
PCT Relative:				49%	47%	35%	33%	35%	33%	-40%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcpo metrics re-weighted to reflect headline (PCT) 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

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