

Property For Industry

Pulling Guidance but not Pulling the Dividend

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OUTPERFORM

Property for Industry (PFI) has announced that it is pulling its FY20 dividend guidance of 7.65 to 7.7cps given the near-term operating uncertainties but still intends to pay quarterly dividends in FY20. We have not changed our recently revised FY20 dividend forecast of 5.8cps. PFI remains one of our preferred LPVs given its defensive attributes, internal management structure and the track record of the business through a number of cycles. OUTPERFORM.

NZX Code	PFI	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.01	NPAT* (NZ\$m)	42.6	43.8	44.0	44.9	EV/EBITDA	18.8	18.9	18.7	18.4
Target price	NZ\$2.15	EPS* (NZc)	8.5	8.8	8.8	9.0	EV/EBIT	18.8	18.9	18.7	18.4
Risk rating	Low	EPS growth* (%)	1.9	3.0	0.3	2.2	PE	23.5	22.9	22.8	22.3
Issued shares	498.7m	DPS (NZc)	7.6	5.8	7.0	7.1	Price / NTA	1.0	1.0	0.9	0.9
Market cap	NZ\$1,002m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.8	2.9	3.5	3.6
Avg daily turnover	281.9k (NZ\$641k)	*Based on normalised profits					Gross div yld (%)	5.4	4.1	5.0	5.1

Withdrawing guidance

PFI has announced that it is pulling its FY20 dividend guidance of 7.65 to 7.7cps given the near-term operating uncertainties and also because it is only a quarter through FY20. PFI intends to update the market regarding 1Q20 on 8 May. It is important to note it is PFI's intention to still pay quarterly dividends. Our revised forecast in our recent *Real Estate Reflections April 2020 Keeping it Real*, dated 9 April, was 5.8cps for FY20 dividend, a 25% cut to our previous forecast. PFI has very few tenants that have a lock out or red zone type lease clause but this announcement is an acknowledgement that PFI will need to negotiate with some tenants with regard to near-term rent and to ensure its portfolio remains well positioned when this event passes. The vast bulk of its tenants are operational at level 3. A typical arrangement may be that PFI waives the rent or part of the rent for a short period and then claws all or some of this back at a later date. PFI noted that it is in a strong financial position with 28% gearing, a 3.7 year weighted average debt term and borrowings that are 65% bank debt/36% bonds.

Industrial attributes

Good, well located, industrial property has proven to be fairly resilient through the cycle, typically with a lower level of vacancy than office, but it has had a massive re-rating in terms of asset values over the last eight years. PFI is ~90% weighted to Auckland prime and secondary industrial property, and has 99% occupancy with a WALT of 5.4 years. Quality listed industrial occupancy only dropped to around the ~95% level last cycle. A deep occupier market and change of use optionality over the medium term provides defensive attributes for the industrial market, and vacancy was at record lows going into COVID-19 with modest new supply on the horizon.

We recently lowered near-term sector wide dividend pay-out ratios to capture uncertainties

There is considerable near-term revenue uncertainty given the unknowns around rent relief, government support and bankruptcy. We are yet to make material changes to forecast EPS or AFFO per share across the NZ LPV sector, however, we have adopted lower dividend pay-out ratios near-term to attempt to adjust for this uncertainty and present dividend yields that capture an element of near-term earnings downside and board conservatism around dividend payments. To date, only KPG has cancelled an upcoming dividend and is not paying its 2H20 dividend for the six months to 31 March. We remain with a defensive focus with preferred LPVs being IPL, PFI and VHP. See Figure 1 for a summary of our recent sector wide DPS changes.

Property for Industry Ltd (PFI)

Priced as at 15 Apr 2020 (NZ\$)						2.01						
12-month target price (NZ\$)*						2.15	Spot valuations (NZ\$)					
Expected share price return						7.0%	1. DCF					1.99
Net dividend yield						3.1%	2. NAV					2.06
Estimated 12-month return						10.0%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					1,484
Equity beta						0.70	(Net debt)/cash					(412)
WACC						5.3%	Less: Capitalised operating leases					0
Terminal growth						1.5%	Value of equity					1,066
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2018A	2019A	2020E	2021E	2022E	82.9	EV/EBITDA (x)	2018A	2019A	2020E	2021E	2022E
Normalised EBITDA	71.4	74.7	74.8	75.3	76.6	76.6	EV/EBIT (x)	19.4	18.8	18.9	18.7	18.4
Depreciation and amortisation	0	0	0	0	0	0	PE (x)	24.0	23.5	22.9	22.8	22.3
Normalised EBIT	71.4	74.7	74.8	75.3	76.6	76.6	Price/NTA (x)	1.1	1.0	1.0	0.9	0.9
Net interest	(18.8)	(19.0)	(18.9)	(19.0)	(18.9)	(18.9)	Free cash flow yield (%)	3.9	3.2	3.9	3.9	4.0
Associate income	0	0	0	0	0	0	Net dividend yield (%)	3.8	3.8	2.9	3.5	3.6
Tax	(10.9)	(13.1)	(12.1)	(12.3)	(12.9)	(12.9)	Gross dividend yield (%)	5.4	5.4	4.1	5.0	5.1
Minority interests	0	0	0	0	0	0	Capital Structure					
Normalised NPAT	41.8	42.6	43.8	44.0	44.9	44.9	Interest cover EBIT (x)	2018A	2019A	2020E	2021E	2022E
Abnormals/other	68.3	133.7	20.4	18.5	18.8	18.8	Interest cover EBITDA (x)	3.8	3.9	4.0	4.0	4.1
Reported NPAT	110.1	176.3	64.2	62.5	63.8	63.8	Net debt/ND+E (%)	30.3	28.2	27.4	26.6	25.9
Normalised EPS (cps)	8.4	8.5	8.8	8.8	9.0	9.0	Net debt/EBITDA (x)	5.6	5.5	5.4	5.3	5.2
DPS (cps)	7.6	7.6	5.8	7.0	7.1	7.1	Key Ratios					
Growth Rates						2018A						
Revenue (%)	2018A	2019A	2020E	2021E	2022E	1.7	Return on assets (%)	2018A	2019A	2020E	2021E	2022E
EBITDA (%)	7.7	4.9	0.8	1.3	1.7	1.8	Return on equity (%)	5.3	4.9	4.9	4.8	4.8
EBIT (%)	10.1	4.6	0.2	0.7	1.8	1.8	Return on funds employed (%)	4.4	4.1	4.1	4.0	4.0
Normalised NPAT (%)	12.5	1.9	3.0	0.3	2.2	2.2	EBITDA margin (%)	93.9	93.6	93.0	92.5	92.5
Normalised EPS (%)	3.7	1.9	3.0	0.3	2.2	2.2	EBIT margin (%)	93.9	93.6	93.0	92.5	92.5
Ordinary DPS (%)	1.3	0.7	-23.6	20.1	2.3	2.3	Capex to sales (%)	19.5	20.1	6.5	6.5	6.5
Cash Flow (NZ\$m)						2018A						
EBITDA	2018A	2019A	2020E	2021E	2022E	76.6	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Working capital change	71.4	74.7	74.8	75.3	76.6	76.6	Imputation (%)	100	100	100	100	100
Interest & tax paid	1.6	1.7	0.2	0.3	0.4	0.4	Pay-out ratio (%)	90	89	66	79	79
Other	(19.2)	(28.1)	(31.0)	(31.4)	(31.7)	(31.7)	Property Statistics					
Operating cash flow	53.7	48.4	44.0	44.2	45.3	45.3	Major Prop. Values - PFI (NZ\$m)					
Capital expenditure	(14.8)	(16.1)	(5.2)	(5.3)	(5.4)	(5.4)	7-9 Niall Burgess Rd, Mt Wellington	2015A	2016A	2017A	2018A	2019A
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0	0	54 Carbine Rd, Mt Wellington	27.3	28.9	31.0	32.0	43.5
Other	(0.1)	0.7	0	0	0	0	6 Donner Place, Mt Wellington	22.4	25.8	26.4	28.6	33.0
Funding available/(required)	10.6	22.8	38.8	38.9	39.9	39.9	686 Rosebank Rd, Avondale	14.5	15.0	15.1	15.1	24.8
Dividends paid	(37.9)	(37.7)	(32.5)	(33.3)	(35.4)	(35.4)	212 Cavendish Drive, Manukau	32.2	33.4	35.0	40.0	44.5
Equity raised/(returned)	0	0	0	0	0	0	3-5 Niall Burgess Rd, Mt Wellington	17.1	19.1	22.4	29.7	29.7
(Increase)/decrease in net debt	(27.3)	(14.9)	6.3	5.6	4.5	4.5	30-32 Bowden Rd, Mt Wellington	15.7	17.3	17.7	20.0	21.0
Balance Sheet (NZ\$m)						2018A						
Working capital	2018A	2019A	2020E	2021E	2022E	(7.5)	Major Prop. Values - DPF (NZ\$m)					
Fixed assets	1,318.7	1,469.3	1,489.0	1,512.9	1,537.1	1,537.1	Carlaw Commerical, Parnell	2015A	2016A	2017A	2018A	2019A
Intangibles	29.1	29.1	29.1	29.1	29.1	29.1	Carlaw Gateway, Parnell	60.8	61.8	62.1	63.8	72.0
Right of use asset	0	0	0	0	0	0	78 Springs Road, East Tamaki	33.8	35.0	35.0	35.5	34.4
Other assets	5.0	13.8	13.8	13.8	13.8	13.8	229 Dairy Flat Highway, Albany	72.0	78.5	82.8	83.0	95.0
Total funds employed	1,343.5	1,505.0	1,524.7	1,548.4	1,572.5	1,572.5	15 Jomac Place, Avondale	22.9	24.7	27.0	28.0	25.1
Net debt/(cash)	396.6	411.8	405.4	399.8	395.3	395.3	Portfolio Summary					
Lease liability	0	0	0	0	0	0	Investment properties (NZ\$m)	987	1,083	1,211	1,322	1,476
Other liabilities	35.1	46.1	46.2	46.4	46.6	46.6	Weighted average lease term (yrs)	5.2	4.8	5.3	5.4	5.4
Shareholder's funds	911.8	1,047.1	1,073.1	1,102.2	1,130.6	1,130.6	Occupancy rate (%)	99.6	99.6	99.9	99.3	99.0
Minority interests	0	0	0	0	0	0	Number of properties	84	83	92	94	94
Total funding sources	1,343.5	1,505.0	1,524.7	1,548.4	1,572.5	1,572.5	NTA per share (NZ\$)	1.41	1.61	1.63	1.78	2.06

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

Our recent dividend changes

Below is a summary of the dividend changes we made in our recent sector report *Real Estate Reflections* dated 9 April 2020.

Figure 1. Dividend cuts

		Old Forecast			New Forecast			DPS chg
		AFFO payout	NPAT payout	DPS (cps)	AFFO payout	NPAT payout	DPS (cps)	
APL	FY20	109%	93%	3.60	82%	70%	2.70	-25%
	FY21	115%	100%	3.60	63%	55%	1.99	-45%
	FY22	120%	104%	3.60	90%	78%	2.73	-24%
ARG	FY20	105%	95%	6.275	105%	95%	6.28	0%
	FY21	101%	91%	6.275	75%	68%	4.68	-25%
	FY22	101%	91%	6.275	90%	81%	5.62	-10%
GMT	FY20	109%	99%	6.65	109%	99%	6.65	0%
	FY21	105%	97%	6.65	85%	78%	5.37	-19%
	FY22	100%	93%	6.65	90%	84%	6.01	-10%
IPL	FY20	107%	97%	7.63	107%	97%	7.63	0%
	FY21	100%	92%	7.63	90%	83%	6.88	-10%
	FY22	99%	91%	7.80	90%	82%	7.11	-9%
KPG	FY20	55%	46%	3.53	55%	46%	3.53	0%
	FY21	75%	64%	4.96	75%	64%	4.96	0%
	FY22	100%	85%	6.74	90%	76%	6.07	-10%
PCT	FY20	105%	95%	6.25	105%	95%	6.25	0%
	FY21	104%	92%	6.30	75%	66%	4.55	-28%
	FY22	108%	95%	6.30	90%	79%	5.29	-16%
PFI	FY20	100%	88%	7.70	75%	66%	5.81	-25%
	FY21	101%	89%	7.80	90%	79%	6.98	-11%
	FY22	100%	88%	7.85	90%	79%	7.14	-9%
SPG	FY20	113%	81%	9.91	113%	81%	9.91	0%
	FY21	108%	82%	9.91	75%	57%	6.90	-30%
	FY22	109%	85%	10.38	90%	71%	8.65	-17%
VHP	FY20	118%	92%	9.00	115%	89%	8.75	-3%
	FY21	97%	87%	9.00	90%	81%	8.37	-7%
	FY22	96%	86%	9.00	90%	80%	8.50	-6%

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. **OUTPERFORM.**

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 2. Sector and regional portfolio exposure

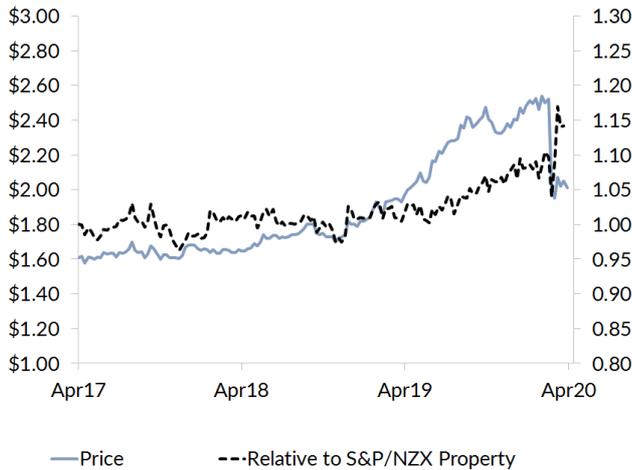
	Auckland	Other North Island	South Island	Total
Industrial	70%	12%	5%	87%
Office	7%	0%	0%	7%
Mixed use	5%	1%	0%	6%
Total	83%	13%	5%	100%

Source: Forsyth Barr analysis, Company Reports

Figure 3. Portfolio metrics



Source: Forsyth Barr analysis, Company Reports

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

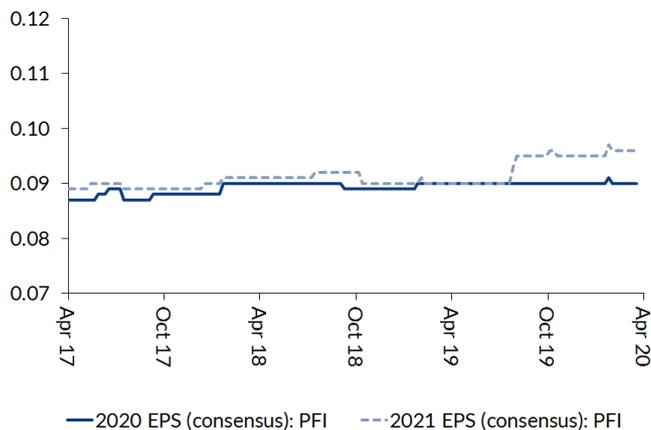
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

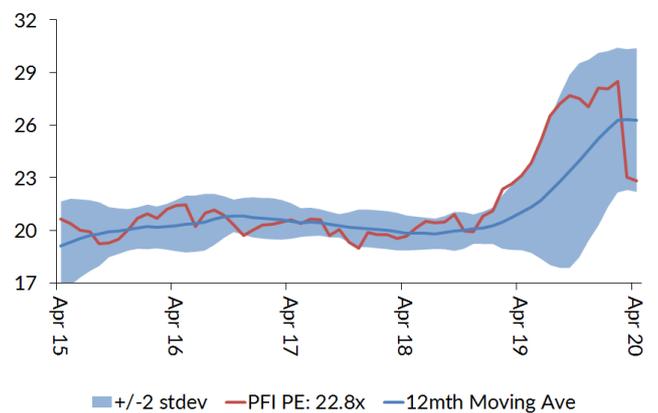
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Property For Industry	PFI NZ	NZ\$2.01	NZ\$1,002	22.9x	22.8x	18.9x	18.8x	18.9x	18.8x	3.5%
Argosy Property *	ARG NZ	NZ\$0.84	NZ\$695	12.3x	12.2x	13.7x	12.9x	13.7x	12.9x	6.4%
Goodman Property Trust *	GMT NZ	NZ\$2.05	NZ\$2,841	29.9x	28.9x	25.0x	23.4x	25.0x	23.4x	2.9%
Investore *	IPL NZ	NZ\$1.41	NZ\$429	17.2x	16.5x	16.2x	15.1x	16.2x	15.1x	5.0%
Kiwi Property Group *	KPG NZ	NZ\$0.84	NZ\$1,318	11.6x	11.4x	13.3x	12.7x	13.3x	12.7x	6.9%
Asset Plus *	APL NZ	NZ\$0.42	NZ\$68	11.3x	11.9x	8.9x	9.0x	8.9x	9.0x	6.1%
Precinct Properties NZ *	PCT NZ	NZ\$1.47	NZ\$1,931	21.8x	21.7x	20.5x	19.0x	20.5x	19.0x	3.3%
Stride Property *	SPG NZ	NZ\$1.30	NZ\$475	12.2x	11.9x	14.2x	14.0x	14.2x	14.0x	6.3%
Vital Healthcare *	VHP NZ	NZ\$2.05	NZ\$928	20.3x	19.6x	19.3x	17.9x	19.3x	17.9x	4.1%
Compcop Average:				17.1x	16.7x	16.4x	15.5x	16.4x	15.5x	5.1%
PFI Relative:				34%	36%	15%	21%	15%	21%	-32%

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 7. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)


Source: Forsyth Barr analysis

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