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NEW ZEALAND EQUITY RESEARCH | PROPERTY | INDUSTRIAL PROPERTY
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Property For Industry
1Q20 Update — Dividend Confirmed

JEREMY SIMPSON CFA
jeremy.simpson@forsythbarr.co.nz
+64 9 368 0022

OUTPERFORM

Property for Industry (PFI) has delivered a 1Q20 update, confirming its 1Q20 dividend and providing some detail of the ongoing impact of COVID-19 on its business. PFI is providing some relief to tenants on a case by case basis, which could potentially be entirely offset by benefits from lower floating interest rates and higher building depreciation allowances. As such, we see potential upside risk to our FY20 DPS of 5.8cps. PFI remains one of our preferred exposures in the listed property vehicle (LPV) sector given its defensive attributes, internal management structure, and strong track record throughout a number of cycles. OUTPERFORM.

NZX Code	PFI
Share price	NZ$2.21
Target price	NZ$2.15
Risk rating	Low
Issued shares	498.7m
Market cap	NZ$1,102m
Avg daily turnover	288.7k (NZ$658k)

Financials: Dec/	19A	20E	21E	22E
NPAT* (NZ$m)	42.6	43.8	44.0	44.9
EPS* (NZc)	8.5	8.8	8.8	9.0
EPS growth* (%)	1.9	3.0	0.3	2.2
DPS (NZc)	7.6	5.8	7.0	7.1
Imputation (%)	100	100	100	100

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	20.2	20.2	20.0	19.7
EV/EBIT	20.2	20.2	20.0	19.7
PE	25.9	25.1	25.1	24.5
Price / NTA	1.1	1.1	1.0	1.0
Cash div yld (%)	3.4	2.6	3.2	3.2
Gross div yld (%)	4.9	3.8	4.5	4.6

PFI providing relief

In the release, PFI highlighted that it is working with tenants on a case by case basis, providing a mixture of rent abatements and deferrals. Additionally, PFI noted that approximately 6% of tenants were contractually entitled to rent relief under clause 27.5 of the ADLS 6th edition lease. We estimate this equates to c.0.5% of gross rent over Level 4. It is unlikely we will know the full impact of COVID-19 on PFI's FY20 rent collection for a while, and PFI expects discussions with tenants to continue throughout 2020.

1Q20 dividend confirmed

PFI has confirmed its 1Q20 dividend of 1.8cps, in line with its 1Q19 dividend. Dividends are being considered on a quarterly basis, with PFI assessing 1) its performance over the period, and 2) its financial position. Its performance over the period (Jan–Mar) would have been only marginally impacted by the government enforced lockdown which began on 26 March, and its balance sheet remains in a strong position.

What is the risk to FY20 dividends?

Reintroduction of building depreciation will provide PFI with an NZ$1.9m FY20 AFFO benefit. Additionally, we estimate lower floating debt costs will provide a net benefit of c.NZ$0.7m to FY20 AFFO. The combined AFFO benefit of NZ$2.5m would require a 4.5% reduction in PFI's gross rent, or c.2.3 weeks rent free for every tenant. With only a "small number" of tenants requiring rent relief the net impact vs. PFI's prior FY20 distribution guidance of 7.65–7.70cps (since withdrawn) may be limited. As such, we see upside risk to our current FY20 DPS estimate of 5.8cps. That said, with rent relief largely impacting 2Q cash flows we see particular risk to this quarterly dividend payment. Furthermore, PFI may still elect to be conservative given the highly uncertain economic outlook.

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Property for Industry Ltd (PFI)

Priced as at 08 May 2020 (NZ$)	**2.21**

12-month target price (NZ$)*	**2.15**
Expected share price return	-2.7%
Net dividend yield	2.8%
Estimated 12-month return	0.1%

Spot valuations (NZ$)	
1. DCF	1.99
2. NAV	2.06
3. n/a	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.70
WACC	5.3%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	1,489
(Net debt)/cash	(412)
Less: Capitalised operating leases	0
Value of equity	1,071

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	76.1	79.8	80.4	81.5	82.9
Normalised EBITDA	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Depreciation and amortisation	0	0	0	0	0
Normalised EBIT	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Net interest	(18.8)	(19.0)	(18.9)	(19.0)	(18.9)
Associate income	0	0	0	0	0
Tax	(10.9)	(13.1)	(12.1)	(12.3)	(12.9)
Minority interests	0	0	0	0	0
Normalised NPAT	**41.8**	**42.6**	**43.8**	**44.0**	**44.9**
Abnormals/other	68.3	133.7	20.4	18.5	18.8
Reported NPAT	**110.1**	**176.3**	**64.2**	**62.5**	**63.8**
Normalised EPS (cps)	8.4	8.5	8.8	8.8	9.0
DPS (cps)	7.6	7.6	5.8	7.0	7.1

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	20.8	20.2	20.2	20.0	19.7
EV/EBIT (x)	20.8	20.2	20.2	20.0	19.7
PE (x)	26.4	25.9	25.1	25.1	24.5
Price/NTA (x)	1.2	1.1	1.1	1.0	1.0
Free cash flow yield (%)	3.5	2.9	3.5	3.5	3.6
Net dividend yield (%)	3.4	3.4	2.6	3.2	3.2
Gross dividend yield (%)	4.9	4.9	3.8	4.5	4.6

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	3.8	3.9	4.0	4.0	4.1
Interest cover EBITDA (x)	3.8	3.9	4.0	4.0	4.1
Net debt/ND+E (%)	30.3	28.2	27.4	26.6	25.9
Net debt/EBITDA (x)	5.6	5.5	5.4	5.3	5.2

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	7.7	4.9	0.8	1.3	1.7
EBITDA (%)	10.1	4.6	0.2	0.7	1.8
EBIT (%)	10.1	4.6	0.2	0.7	1.8
Normalised NPAT (%)	12.5	1.9	3.0	0.3	2.2
Normalised EPS (%)	3.7	1.9	3.0	0.3	2.2
Ordinary DPS (%)	1.3	0.7	-23.6	20.1	2.3

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	5.3	4.9	4.9	4.8	4.8
Return on equity (%)	4.6	4.1	4.1	4.0	4.0
Return on funds employed (%)	4.4	4.1	3.9	3.9	3.9
EBITDA margin (%)	93.9	93.6	93.0	92.5	92.5
EBIT margin (%)	93.9	93.6	93.0	92.5	92.5
Capex to sales (%)	19.5	20.1	6.5	6.5	6.5
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	90	89	66	79	79

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**71.4**	**74.7**	**74.8**	**75.3**	**76.6**
Working capital change	1.6	1.7	0.2	0.3	0.4
Interest & tax paid	(19.2)	(28.1)	(31.0)	(31.4)	(31.7)
Other	0	0	0	0	0
Operating cash flow	**53.7**	**48.4**	**44.0**	**44.2**	**45.3**
Capital expenditure	(14.8)	(16.1)	(5.2)	(5.3)	(5.4)
(Acquisitions)/divestments	(28.3)	(10.3)	0	0	0
Other	(0.1)	0.7	0	0	0
Funding available/(required)	**10.6**	**22.8**	**38.8**	**38.9**	**39.9**
Dividends paid	(37.9)	(37.7)	(32.5)	(33.3)	(35.4)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**(27.3)**	**(14.9)**	**6.3**	**5.6**	**4.5**

Property Statistics	**2015A**	**2016A**	**2017A**	**2018A**	**2019A**
Major Prop. Values - PFI (NZ$m)					
7-9 Niall Burgess Rd, Mt Wellington	27.3	28.9	31.0	32.0	43.5
54 Carbine Rd, Mt Wellington	22.4	25.8	26.4	28.6	33.0
6 Donner Place, Mt Wellington	14.5	15.0	15.1	15.1	24.8
686 Rosebank Rd, Avondale	32.2	33.4	35.0	40.0	44.5
212 Cavendish Drive, Manukau	17.1	19.1	22.4	29.7	29.7
3-5 Niall Burgess Rd, Mt Wellington	15.7	17.3	17.7	20.0	21.0
30-32 Bowden Rd, Mt Wellington	20.7	21.4	25.4	27.0	27.8
Major Prop. Values - DPF (NZ$m)					
Carlaw Commerical, Parnell	60.8	61.8	62.1	63.8	72.0
Carlaw Gateway, Parnell	33.8	35.0	35.0	35.5	34.4
78 Springs Road, East Tamaki	72.0	78.5	82.8	83.0	95.0
229 Dairy Flat Highway, Albany	22.9	24.7	27.0	28.0	
15 Jomac Place, Avondale	21.0	23.6	24.0	24.5	25.1
Portfolio Summary					
Investment properties (NZ$m)	987	1,083	1,211	1,322	1,476
Weighted average lease term (yrs)	5.2	4.8	5.3	5.4	5.4
Occupancy rate (%)	99.6	99.6	99.9	99.3	99.0
Number of properties	84	83	92	94	94
NTA per share (NZ$)	1.41	1.61	1.63	1.78	2.06

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(9.2)	(7.2)	(7.2)	(7.3)	(7.5)
Fixed assets	1,318.7	1,469.3	1,489.0	1,512.9	1,537.1
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**	**1,524.7**	**1,548.4**	**1,572.5**
Net debt/(cash)	396.6	411.8	405.4	399.8	395.3
Lease liability	0	0	0	0	0
Other liabilities	35.1	46.1	46.2	46.4	46.6
Shareholder's funds	911.8	1,047.1	1,073.1	1,102.2	1,130.6
Minority interests	0	0	0	0	0
Total funding sources	**1,343.5**	**1,505.0**	**1,524.7**	**1,548.4**	**1,572.5**

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

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

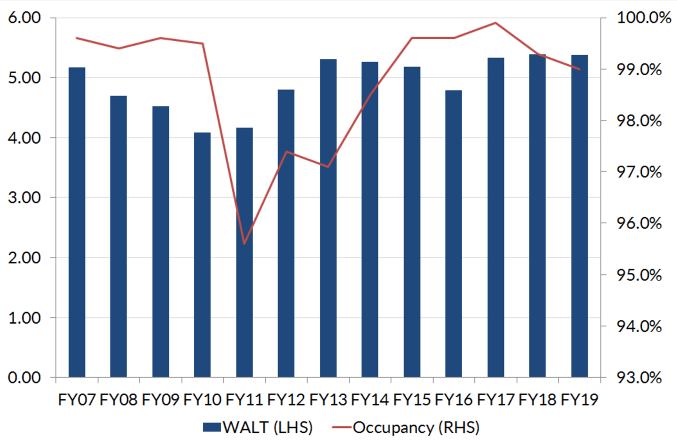
- **Rising interest rates:** Higher interest rates make other yield investments more attractive relative to listed property dividend yields.

Figure 1. 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%**

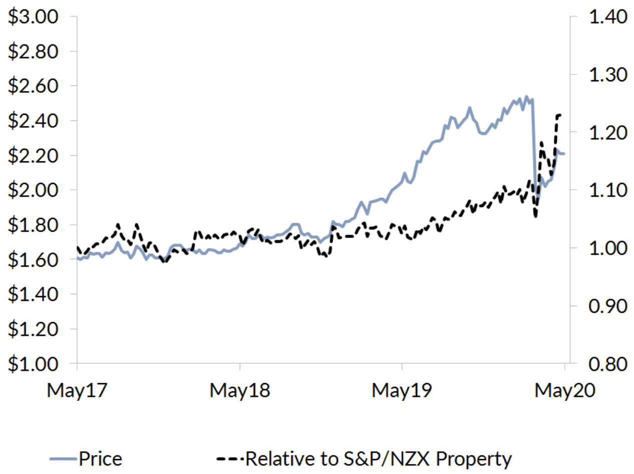
Source: Forsyth Barr analysis, Company Reports

Figure 2. Portfolio metrics



Source: Forsyth Barr analysis, Company Reports

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.3%
ACC	5.3%

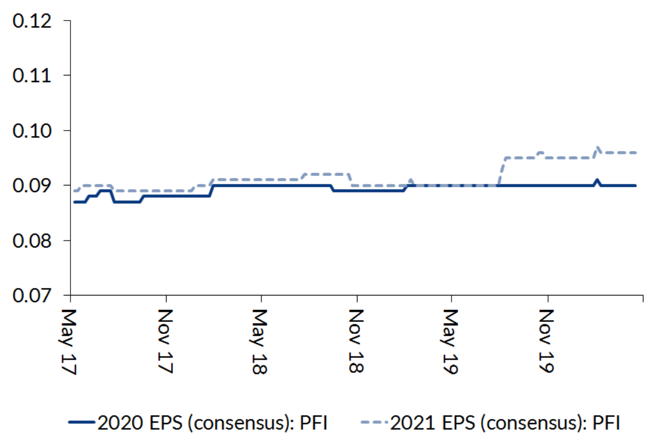
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect PFI's balance date - December)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Property For Industry	**PFI NZ**	**NZ$2.21**	**NZ$1,102**	**25.1x**	**25.1x**	**20.2x**	**20.1x**	**20.2x**	**20.1x**	**3.2%**
Argosy Property *	ARG NZ	NZ$1.08	NZ$893	15.9x	15.7x	15.7x	14.6x	15.7x	14.6x	5.0%
Goodman Property Trust *	GMT NZ	NZ$2.29	NZ$3,173	33.4x	32.3x	27.4x	25.7x	27.4x	25.7x	2.6%
Investore *	IPL NZ	NZ$1.77	NZ$539	22.6x	21.8x	18.9x	17.5x	18.9x	17.5x	4.3%
Kiwi Property Group *	KPG NZ	NZ$0.98	NZ$1,538	13.5x	13.3x	14.5x	13.9x	14.5x	13.9x	6.0%
Asset Plus *	APL NZ	NZ$0.40	NZ$64	10.7x	11.1x	8.5x	8.7x	8.5x	8.7x	6.4%
Precinct Properties NZ *	PCT NZ	NZ$1.58	NZ$2,069	23.4x	23.3x	21.6x	19.9x	21.6x	19.9x	3.1%
Stride Property *	SPG NZ	NZ$1.50	NZ$548	15.1x	14.1x	17.0x	16.0x	17.0x	16.0x	5.5%
Vital Healthcare *	VHP NZ	NZ$2.45	NZ$1,110	24.3x	23.4x	21.4x	19.8x	21.4x	19.8x	3.4%
			Compco Average:	**19.9x**	**19.4x**	**18.1x**	**17.0x**	**18.1x**	**17.0x**	**4.5%**
EV = Current Market Cap + Actual Net Debt			**PFI Relative:**	**27%**	**29%**	**12%**	**18%**	**12%**	**18%**	**-30%**

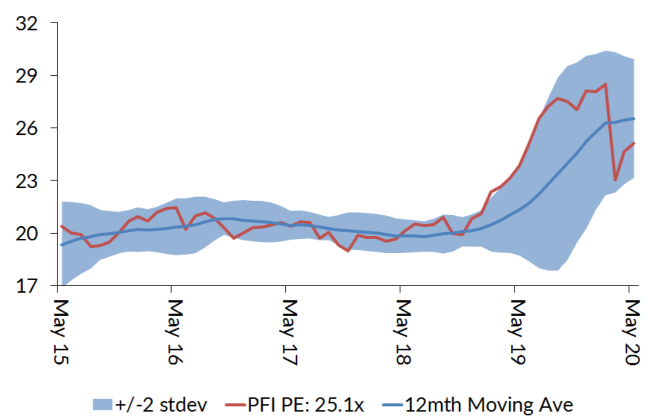
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (PFI) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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