STOCKS DOWN UNDER

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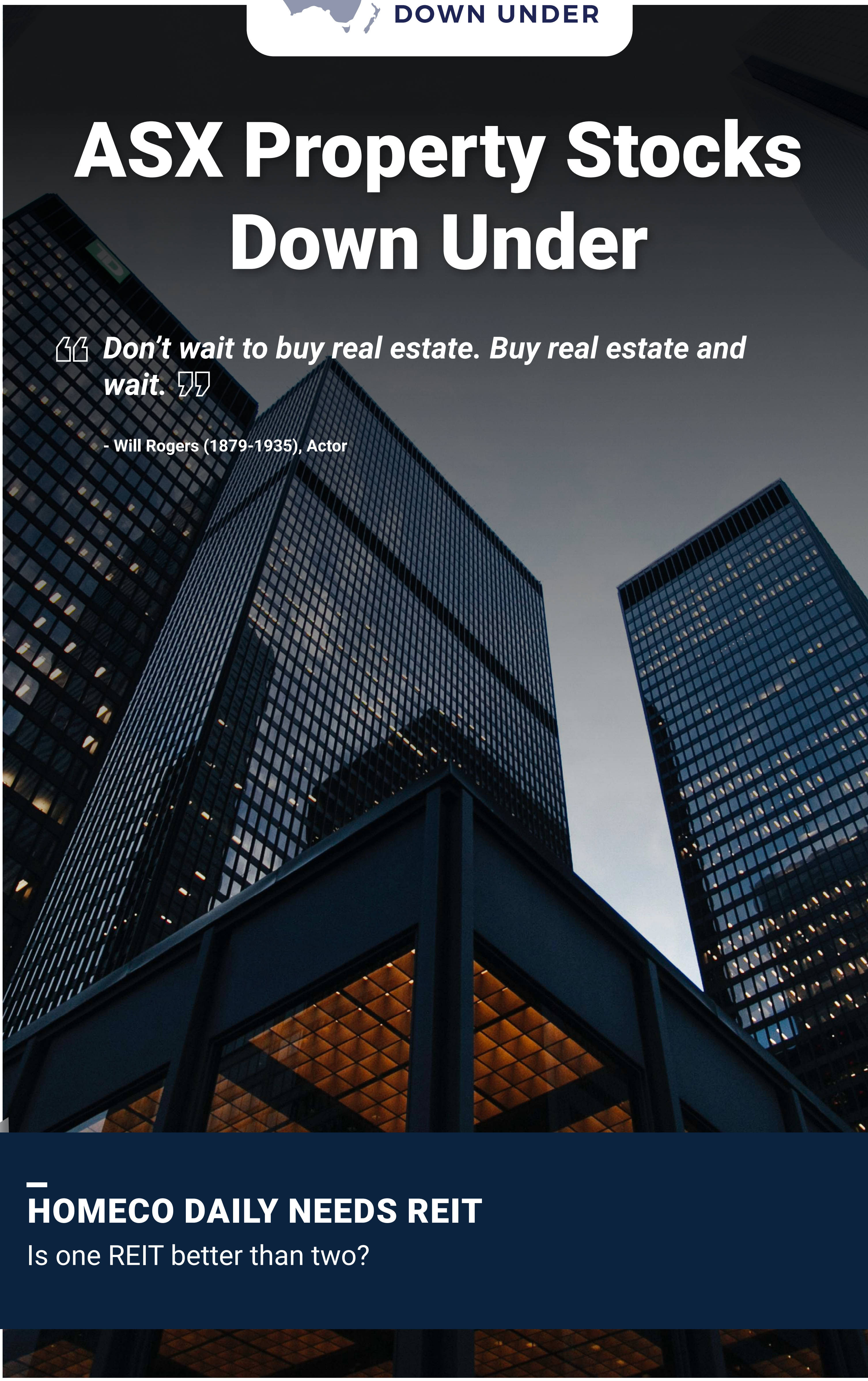
ASX Property Stocks Down Under



> *Don't wait to buy real estate. Buy real estate and wait.*
>
> - Will Rogers (1879-1935), Actor

HOMECO DAILY NEEDS REIT

Is one REIT better than two?

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Stocks Down Under rating: ★★★★

ASX: HDN
Market cap: A$2.7BN

52-week range: A$1.17 / A$1.70
Share price: A$1.31

The ASX REIT sector hasn't seen as much M&A activity as other sectors, but HomeCo Daily Needs REIT (ASX: HDN) was one company that's been involved in the action. Barely a year since HDN listed on the ASX, it made a bid for Aventus Group and the deal became effective earlier this month. The merged entity has a $4bn+ portfolio focused on consumer staple retailers in metropolitan markets with high population growth and has identified a $500m+ development pipeline. Will the deal live up to expectations?

Share price chart

Source: Tradingview

Perfect timing

HomeCo Daily Needs REIT is managed by Home Consortium (ASX: HMC), which is ASX-listed in its own right - entering the bourse in 2019 – and also runs the Healthcare and Wellness REIT (ASX: HCW), which listed in 2021. HDN was listed in 2020 at $1.33 per share after being spun out of its parent company, although HMC retains a shareholding and two board seats.

As its name implies, HDN leases properties to retailers servicing every-day needs such Coles, Woolworths, Baby Bunting and Chemist Warehouse as well as childcare centres. Many of these retailers were not forced to close during lockdowns, but even if they had to close, could stay open to fulfil click and collect orders. This meant the company's share price remained stable in a way that REITs focused on discretionary retail did not.

HDN also benefited from the boom in the property market, spurred by record low interest rates. This triggered uplifts in its portfolio value – 82% in FY21 – and the ability for HDN to borrow money cheaply to acquire further properties. And it was active on the M&A front, going back to equity investors twice more in 2021 to fund six additional assets. After treading water for the first few weeks of listed life, the company has been above its IPO price for much of the last 12 months, spurred by its M&A activity as well as its resilient operating performance and earnings growth.

In FY21, it achieved FFO (funds from operations) of $21.4m, 14% higher than its pre-IPO forecast. FY22 has been even stronger for HDN, which recorded $30.4m FFO in the first half of the year, up 121% versus the prior corresponding period.

One head better than two

On 18 October last year, HDN announced the tie-up with Aventus. Aventus was listed on the ASX in 2015 and has focused on homemaker and bulky-goods shopping centres – examples including Bunnings and Harvey Norman. At the time of listing, it was backed by retail king Brett Blundy, but he has since departed from the board although he remains a shareholder. The deal was priced at a premium of over 90% to Aventus' IPO price.

Although it did not excite investors as much as earlier asset acquisitions, we believe this was the most exciting of all. The pair will have a combined portfolio size of $4.1bn with 51 properties spanning 2.5m square metres across Australia. The portfolio has a 5.3-year Weighted Average Lease Expiry (WALE), $331/sqm average gross rent and 99% occupancy. It will have a significant mix of tenants, with no one tenant accounting for over 4%. 34% of the portfolio will be Daily Needs retailers (such as fast food and supermarkets), 50% Large Format Retail (furniture and sports stores) and 16% health and services (including government services). It will have a heavy focus on fast-growing metropolitan markets, with 74% of properties located in Greater Sydney, Greater Melbourne and Greater Brisbane. 12 million people live within a 10km radius of one of HDN's properties.

The company will inevitably be admitted to the ASX 200 when the next rebalance occurs, given its substantially higher market capitalisation. This may seem an afterthought to retail investors, but it will allow more fund managers to buy into the company that otherwise wouldn't be able to because of their individual mandates. It should also lead to more analyst coverage and both developments are likely to boost the company's share price. HDN's status as Australia's largest Daily Needs REIT will also enhance its ability to source debt finance for future M&A activity.

But now it's unfairly valued

HDN trades at a near 8% discount to its Net Tangible Assets (NTAs) and at 13.9x its forecast FFO for FY22 (9.3 cents). We note that HDN has been trading at a premium to its NTA for much of the last year but has retreated into discount territory in the last fortnight's sell off, triggered by Russia invading Ukraine. We have compared HDN to its five major peers, Charter Hall Retail REIT (ASX: CQR), Shopping Centres Australasia (ASX: SCP), BWP Trust (ASX: BWP), Waypoint REIT (ASX: WPR) and Newmark (ASX: NPR). HDN is discounted on a P/NTA basis and a P/FFO basis, with the industry average being a 4.35% P/NTA discount and 16.9x P/FFO. We believe a premium for HDN justified given its strong financial performance to date, its concentration in higher growth metropolitan areas and its development pipeline, which is by far the largest of any of its peers. Its pipeline is set at $500m and is expected to generate 7.0%+ cash returns.

We first covered HDN on 27 November 2020 – just days after its IPO – and we gave it three stars. We liked its 5.5% dividend yield, but thought it was overvalued because it was one of the few REITs trading at a premium to its NTA when most others traded at a discount. But that was a time when many REITs had been unfairly sold off in the Corona Crash because of investor perceptions that their tenants' cash flows would stop and as a result, so would their distributions.

Now that many ASX REITs have returned to normality from their 2020 lows, but HDN is now at a discount; we think HDN's price is more reasonable, especially after its M&A activity in the past twelve months. So, this time it's four stars from us.

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