STOCKS DOWN UNDER

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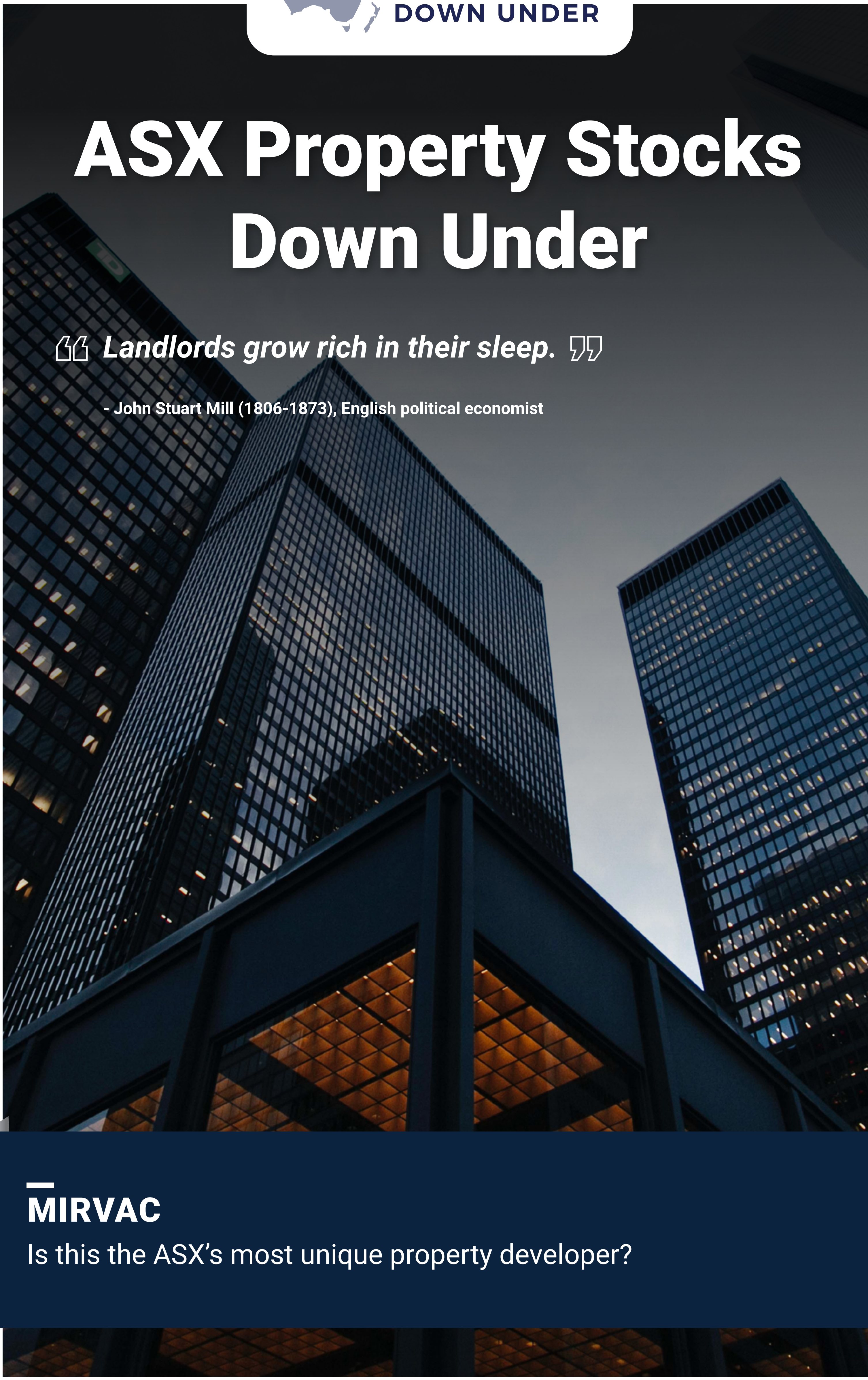
ASX Property Stocks Down Under

Landlords grow rich in their sleep.

- John Stuart Mill (1806-1873), English political economist



MIRVAC

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Stocks Down Under rating: ★★★★

ASX: MGR
Market cap: A$xxM

52-week range: A$x.xx / A$x.xx
Share price: A$x.xx

Today we look at Mirvac, founded in 1972 and today Australia's largest listed developer of residential, commercial and industrial property. Arguably, it is one of the most unique, being the first in Australia to be "carbon positive" and the first on the ASX to offer Built to Rent (BTR) apartments. Mirvac's share price remains below pre-COVID highs with investors seemingly bearish on the office and apartment markets. Is this concern justified?

Share price chart

Source: Tradingview

A bumpy ride, but positive times

Mirvac has assets totalling over $26bn, including office, industrial, retail, residential and built to rent properties across Australia – mostly in Australia's major cities. It also builds master planned communities. Mirvac's business model is to develop properties and subsequently either retain them and lease them out or sell them once completed. The bulk of properties are in NSW (63%), and its biggest sector is office space (61%).

Each of Mirvac's sectors went through different conditions in the past few years. For example, offices and retail have suffered from people working and shopping from home due to COVID-19 restrictions. Meanwhile, industrial properties have benefited from the rapid expansion of eCommerce and residential properties, especially stand-alone houses, have boomed due to record low interest rates.

The experience has been varied but, overall, Mirvac's portfolio has delivered the goods. In FY21, Mirvac made a statutory profit of $901m, up 61% from the year before, and distributed $390m, up 9% from FY20. In H1 FY22, it recorded a statutory profit of $565m, up 44%, and distributed $202m, up 6%. It has a development pipeline of ~$28bn and a healthy balance sheet with $750m in cash and undrawn facilities, and just 22.3% gearing, with – get this – less than 6% of total debt maturing before FY24. Consensus estimates forecast $894m revenue and $767.2m EBIT in FY22. If replicated this would be up 14% and down 1% from FY21, but its EBIT in H1 of FY22 was 8% up from H1 FY21, at $391m. In FY23, $953.6m revenue and $821.0m EBIT are expected, which would both be 7% higher than FY22 forecasts.

ESG investors would be pleased to know that this company recently achieved carbon positivity, nine years ahead of its original 2030 target, becoming the first Aussie property company to be able to say it was 'carbon positive'. To be carbon positive is better than being 'carbon neutral' because then you eliminate more carbon than you emit. For Mirvac this has been done by relying on renewable energy and optimising asset performance. We reckon the people who work at Mirvac must like their company being carbon positive, because Mirvac also boasts an 80% employee engagement rate (placing Mirvac in the top quartile of Australian companies) and, despite the Great Resignation, it has retained 93% of its key talent.

Office and apartment markets slowing

Mirvac currently has Net Tangible Assets (NTA) of $2.76, up 8% in the past two years. In early 2020, it was trading at a hefty premium, but it is currently at a 13% discount to its NTA. Mirvac fell from $3.48 in January 2020 to $1.97 in mid-March 2020 as the Corona Crash hit the market. Afterwards, the shares recovered, and traded above $3 for a couple of months in 2021, but the Omicron strain has sent shares to below $2.50, and the company's results failed to excite investors.

We would attribute this to investor scepticism surrounding offices and apartments (the latter being a prominent part of its residential business). The apartment market has been through a tough few years. It all began with the Mascot Tower fiasco and subsequent investor scepticism over new apartments. Although COVID-19 has boosted the property market, apartments haven't seen the same benefit as standalone houses. This can be put down to a lack of international arrivals due to COVID-19 border restrictions and people opting to move to regional areas for more space.

Mirvac has also been championing so-called Built to Rent (BTR) apartments, recently opening its first such complex in Sydney's Olympic Park. If you live in a Built to Rent apartment, Mirvac is your landlord, but you have more flexible lease terms, capped rental increases and shared amenities. We don't want to get ahead of ourselves but in a space that has seen little innovation since the early 1960s when the concept of strata was born, we think BTR could have a similar impact on the market. Mirvac's recent milestone was a long time coming, with the company first exploring the concept in 2016 and securing initial investors in 2018. Mirvac was delayed by market conditions for apartments as well as supply chain issues – including the individual white goods it opted to put into each apartment.

But things are gradually coming together. As of February, it has leased 93% of LIV Indigo at Olympic Park, and it has another $1bn of BTR assets under construction, with more recent developments having been located in Brisbane and Melbourne. We think apartments will recover as international arrivals return, apartment vacancies fall and the affordability gap between apartments and houses widens. And if Mirvac can deliver further developments in the medium term, investors will inevitably warm to the concept, which is still relatively foreign to Australia. We also think there is some concern that rising interest rates will impact property market demand. Although rates will rise, we think central banks will be cautious in raising rates to ensure that demand doesn't fall exponentially.

Deserves a premium

We last covered Mirvac in July 2020 and gave it four stars. Shares are up 15% since then, but it is still trading at a discount to its NTA. It is also trading at a reasonable trailing Price to FFO ratio of ~18, FFO standing for 'Funds From Operations'. Comparison between other companies is difficult because many of Mirvac's peers specialise in specific sectors – for instance, **GPT Group (ASX: GPT)** is retail-focused, while **Dexus (ASX: DXS)** specialises in office space. On a P/FFO basis, it is trading roughly in line with GPT and Dexus, but on a P/NTA basis, it trades at a smaller discount.

We think Mirvac deserves a premium, based on the firm's track record, its healthy pipeline, high ESG credentials, capital discipline and sector diversification. We cannot blame investors for scepticism about the apartment market, but we believe things will turn a corner as conditions in the sector and broader economy normalise. So, it's four stars from us.

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