STOCKS DOWN UNDER

1 JUNE 2022

ASX Property Stocks Down Under

"We don't rebuild, we renovate."

- John Elliot (1941-2021), Australian business magnate, Carlton FC executive

DEXUS

Your best bet in the office space

DEXUS

Your best bet in the office space

Stocks Down Under rating: ★★★★

ASX: DXS
Market cap: A$11.3BN

52-week range: A$9.86 / A$11.50
Share price: A$10.55

Since we began Property Stocks Down Under in February 2022, we've haven't been too keen on REITs with exposure to office space and neither have investors. But Dexus, Australia's biggest owner of office towers has been a standout performer, sitting over 25% ahead of its 2020 lows. And we think investors have been right to send the company's share price higher. It owns an impressive portfolio of office assets along with a funds management business that includes two other ASX-listed REITs. And it's about to boost its portfolio with a substantial development pipeline (including a majority stake in the Atlassian Tower) and the addition of Collimate Capital.

Share price chart

Source: Tradingview

Australia's biggest office landlord

For clarity's sake, we are talking about Dexus' parent company, not about Dexus Convenience Retail REIT (ASX: DXC) or Dexus Industria REIT (ASX: DXI) – we covered the latter a few weeks ago. Dexus (ASX: DXS) listed in 2004 as part of the stapling of three listed property trusts, two of which listed on the ASX in 1984 with the other in 1998.

Dexus has a portfolio worth $42.5bn (inclusive of its independently listed REITs) that exclusively consists of Australian properties. $17.5bn of this is directly owned with $25bn being part of its funds management business. It has a further development pipeline of $14.6bn. Its total funds under management consists of 182 properties and office properties making up $26bn (61%). The next biggest segments are industrial ($7.8bn), retail ($6.2bn) and healthcare ($1.2bn).

Its office properties have traditional spaces with long term leases, but also more flexible spaces, including some that can be hired by the hour. Some of its most notable spaces include Australia Square in Sydney, 240 St. George's Terrace in Perth, 1 Eagle Street in Brisbane and Rialto Towers in Melbourne. Dexus' development pipeline is headlined by a <60% stake in the 40-storey Atlassian building near Central station in Sydney, which it paid $1.4bn for last year, plus Waterfront Brisbane, which is a major redevelopment of the Eagle Street Pier site, which will host two office towers.

In Dexus' existing office portfolio, no customer accounts for over 3.6% of income, with the biggest being the Victorian State Government and the top 10 account for under 18%. Furthermore, no office customer segment accounts for over 15% although the top five (financial and insurance services; legal services; public administration and safety; professional scientific and technical services; and rental, hiring and real estate services) account for roughly 53%. Readers interested in Dexus' industrial properties should check out our March 2022 report on Dexus Industria REIT (ASX: DXI).

Getting back off the ground by M&A

During the Corona Crash, Dexus shed a third of its value and continued to lag for several months thereafter – in fact, by February 2021 it was slightly lower than it was in late March 2020. As with its office peers, its share price lagged as people worked from home. It wasn't the case that it lost tenants and it didn't even have to grant that much rent relief. But it's post-tax profit in FY20 was down 23% from FY19, at $983m, due to net revaluation gains of investment properties being lower than in FY19.

But since then, Dexus has gained nearly 25% and a lot of it has to do with its M&A activity, both in individual properties and other property investment entities. Its deal for a majority stake in the Atlassian tower was arguably the most significant among individual properties. As for property groups, Dexus bought APN Property Group (ASX: APN) in June 2021 and is currently closing a deal to buy AMP's funds management platform Collimate Capital.

It is true that Dexus' results improved in FY21 and 1HY22. It's FY21 net profit was back in the billions – at $1.1bn, which was up 17% - and its Adjusted Funds from Operations (AFFO) was 51.8c per security, up 3%. In 1HY22 it made an $803.2m net profit after tax, which was up 82%, although FFO was 2.8% down from 1HY21 at 28c per security. The company's most recent financial update was its 3Q22 update, delivered on 3 May. It transacted $2.1bn in properties across the group, completed 84 leasing transactions across its office and industrial portfolios and collected 98.1% of rents.

Collimate & Co. set to contribute

Looking to Dexus' FY22 results, due in August, the only guidance the company has given is to deliver distribution per security growth of no less than 2.5%. Assuming Dexus pays out 100% of its AFFO in FY22, just as it did in FY21, this would equate to 53.1c and represent a P/FFO ratio of 20x. This would be above the ASX average, but not excessively so.

Looking to FY23, consensus estimates are slightly more optimistic about Dexus. Consensus estimates forecast 3.7% EBITDA growth from $868.4m to $901.3, meaning it's FY23 P/E ratio is 14.9x. We think its P/E and P/AFFO multiples are reasonable considering its portfolio, development pipeline and cash flows. And we also note that it is trading at a discount to its NTA of nearly 10%.

ESG investors will find more positives than negatives when examining the company. It is the only real estate company to achieve a Gold Class distinction in the S&P Global Sustainability Yearbook 2022. Additionally, it scored an A- in the CDP Climate Change survey, achieved carbon neutrality across its corporate operations, NPS scores with industrial and office customers and employees of +46 and +4, respectively, and is targeting net zero emissions by 30 June 2022. However, one thing ESG investors may not like is that females in senior and executive management roles slightly declined in FY21 from 36% to 35%.

While we have been sceptical about most ASX property stocks with substantial exposure to offices, we are prepared to get behind Dexus. This is because it is trading at a reasonable price, has a robust portfolio with solid cash slows and a substantial development pipeline. So, it's four stars from us.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!

Stocks Down Under (Pitt Street Research AFSL 1265112) provides actionable investment ideas on ASX-listed stocks. The Content is financial advice but is not (and cannot be construed or relied upon as) personal financial advice. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content. Please make sure that investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of unpredictable market and economic factors.

Stocks Down Under/Pitt Street Research directors and staff may own shares in the companies mentioned in our articles, videos, reports and analyses.