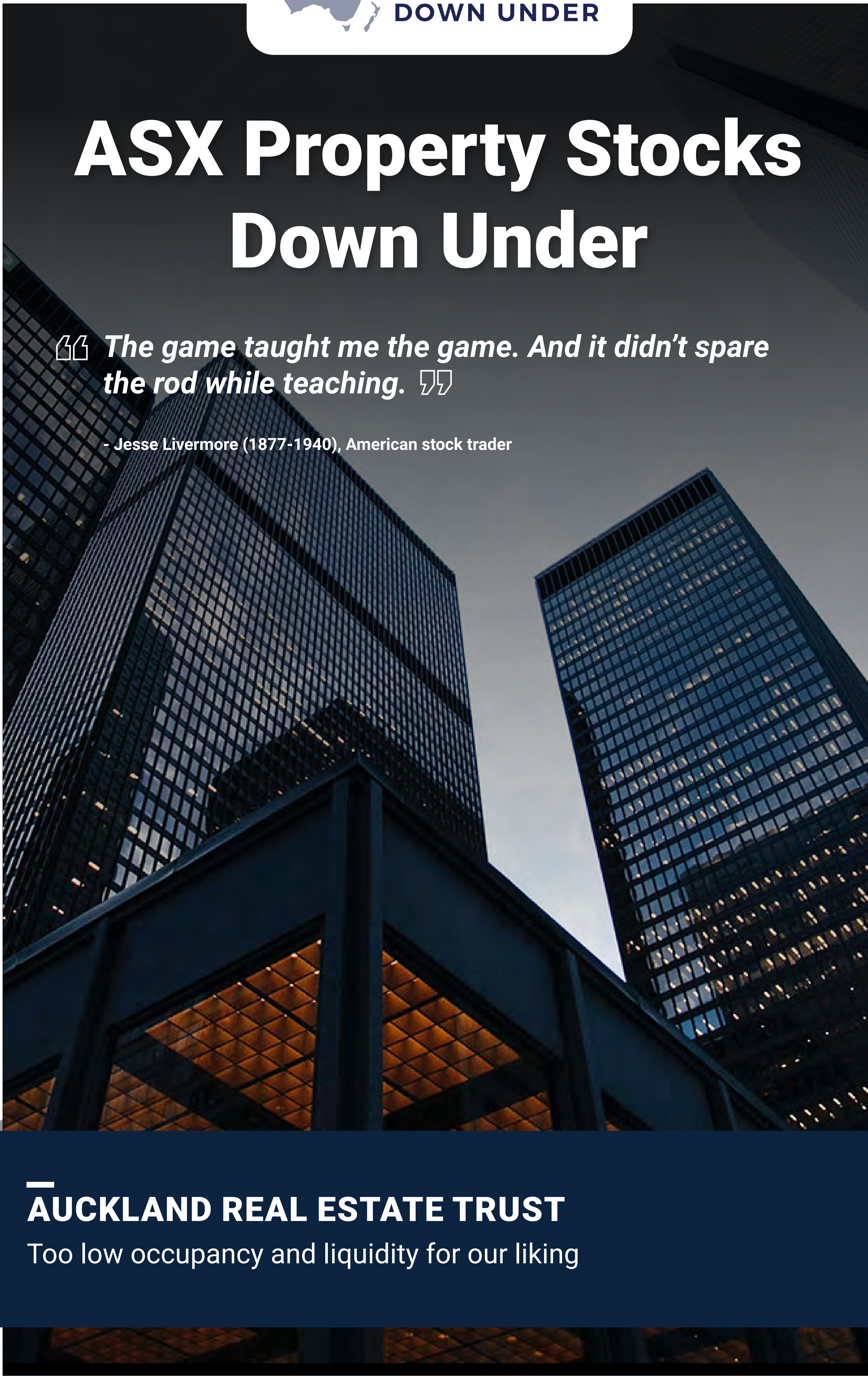
STOCKS DOWN UNDER

24 MAY 2022



ASX Property Stocks Down Under

> *The game taught me the game. And it didn't spare the rod while teaching.*
>
> - Jesse Livermore (1877-1940), American stock trader

AUCKLAND REAL ESTATE TRUST

Too low occupancy and liquidity for our liking

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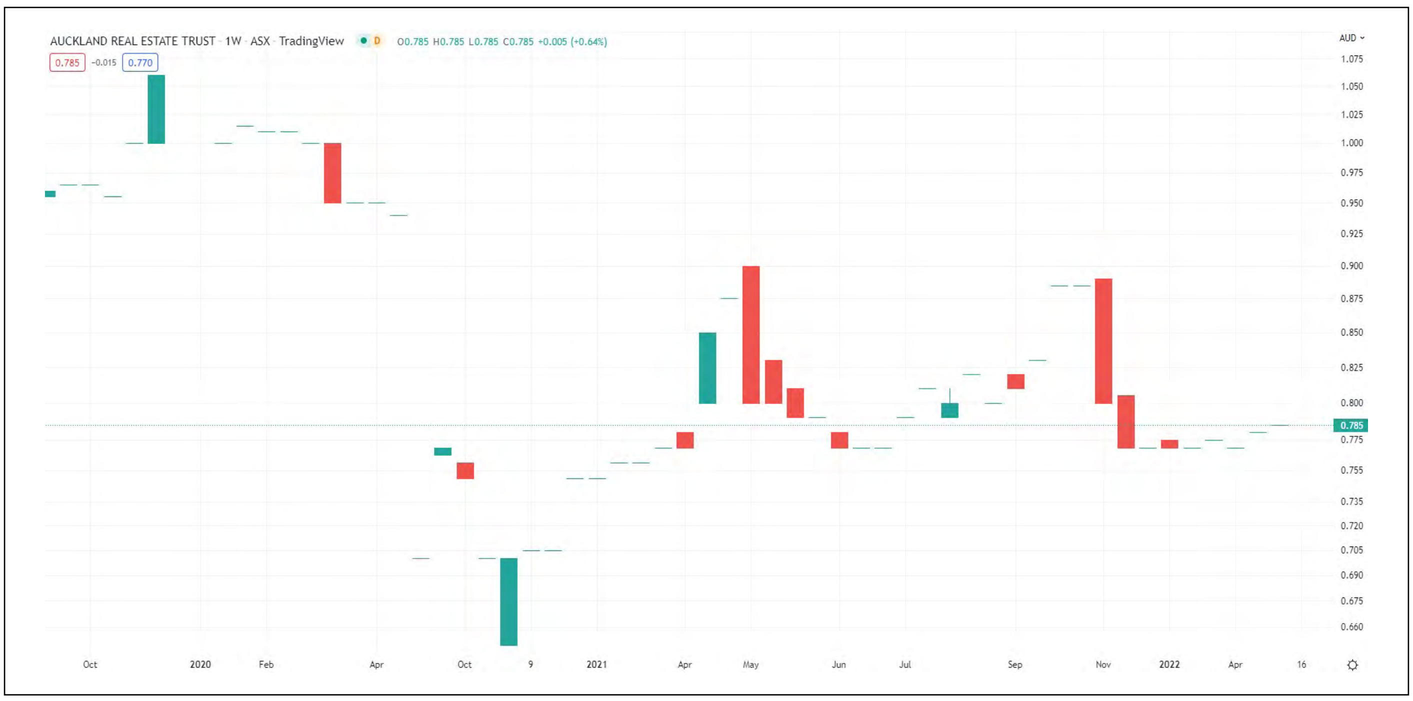
Stocks Down Under rating: ★★

ASX: AKL
Market cap: A$63.1M

52-week range: A0.60 / A$0.89
Share price: A$0.79

There are few ASX-listed REITs with no exposure to Australia whatsoever, but Auckland Real Estate Trust (ASX: AKL) is one of them. It specialises in the Auckland commercial property market and is dually listed on both sides of the Ditch. Unfortunately, the one thing that drags this company down is its lack of liquidity.

Share price chart



Source: Tradingview

A Kiwi company taking a different path

AKL listed on the ASX in 2005 and listed on the NZX in late 2020. Compared to the ASX, the NZX has fewer companies and liquidity so some New Zealand companies either go straight to Australia or list on the NZX first and move to Australia later (Xero being the most prominent example of a company taking the latter route). AKL chose a different path in listing on the NZX after listing Australia and when it debuted it was just the fourth IPO of 2020 on the Kiwi bourse. That figure is considerably lower compared to the 66 ASX IPOs in 2020, but impressive when you consider that there have been some calendar years (most recently 2018) without any new NZX listings at all.

AKL only has a handful of properties but the vast majority are in the Auckland CBD. It owns 1 Albert Street, a major skyscraper at the waterfront, the Harbour Collection, comprising of three properties at the Viaduct Harbour – namely 10 and 12 Viaduct Harbour Avenue along with 110 Customs Street West, and the Fusion Project, comprising of 16 Kingston Street, 60 Federal Street and 87 Albert Street. Additionally, the company owns an office in Chicago (near O'Hare Airport), but it has unsuccessfully been trying to dispose of this asset for several months.

Year 1 of COVID was OK, Year 2 not so much

The Auckland office market is the biggest in New Zealand, but it would be unfamiliar to many ASX investors. For the first year of the pandemic, it didn't suffer as much as Sydney and Melbourne, because the virus was kept at bay. A number of companies that had offices outside the CBD opted to move in, with one example being Genesis Energy.

But the second year took its toll. The Delta lockdowns in Auckland between August and November 2021, supply chain issues, inflationary pressures and higher interest rates have had an impact. In the 2HCY21 only one CBD office property was transacted and office investment volumes were at the lowest levels for several years according to Kiwi realtor Bayleys. Long term construction works, particularly for the new railway line and associated stations, also haven't helped, but it is hoped that it will increase the value of properties once it is completed.

In FY21, AKL generated revenues of $NZ12m, up a modest 2.7% from FY20. It's profit, however, jumped 468.5%, from NZ$9.5m to NZ$54.2m. No, that's not a typo – AKL's profit was greater than its revenue. REITs can include revaluations in their profits, but these do not represent revenues and this was the case with AKL. It recorded an increase in the total fair value of its portfolio of $59.9m compared with just $10.9m in the prior corresponding period. However, in 1HY22 it made an interim loss of NZ$12.6m, driven by higher costs. We also note that its cash position was just NZ$850,000, although it has A$16.6m in financing facilities available – enough to last roughly 90 quarters.

It's trading at a hefty NTA discount

AKL's property portfolio as at 31 December 2021 was NZ$296m and its NTA is $1.63 per share. The NTA is a figure that actually declined in 1HY22 due to ongoing investment in developments, funded by increased borrowings. And the current share price implies a more than a 50% discount to NTA. At first glance, you might think you're picking up a bargain. But we don't think that is the case.

First, putting the specific dynamics of Auckland to one side, it is exposed to the office market exclusively. Office REITs have fallen out of favour with ASX investors due to perceptions that occupancy will never return to pre-COVID levels and owners will need to slash their leases to encourage tenants to maintain their tenancy and that they won't be as value accretive as industrial properties will be. Indeed, many ASX-listed REITs that historically focused on the office space have tried to diversify with GPT (ASX:GPT) being one example.

Second, lower occupancy rates. Most ASX-listed REITs have occupancy rates of over 95% - including those in the office space - but this isn't the case with many of AKL's properties. 12 Viaduct Harbour Avenue is 100% occupied, but all other properties are lower – with 87 Albert Street being only 34% leased and 60 Federal Street being 48% leased, according to the company's own website. Admittedly it has made some progress with the broader Harbour Collection, increasing occupancy at the collection to over 85%. Indeed, low occupancy rates are why it has been having trouble selling its Chicago asset, with the company admitting recent discussions with one buyer fell through and it will have a more realistic chance of selling the property when it reaches 90%.

The final reason why we don't think AKL is a bargain is low liquidity. In the past month there have been just 3 trades of only 66,000 shares collectively, worth just $52k. Even if you wanted to buy this company you might not be able to get in and if you can, you may find it difficult to get out. In light of these three factors, it's two stars from us.

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