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ASX Property Stocks Down Under

> *Inflation takes from the ignorant and gives to the well informed.*
>
> - Venita Van Caspel (b. 1922), financial author

CHARTER HALL SOCIAL INFRASTRUCTURE REIT

One for the long-term, but maybe not the short-term

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Stocks Down Under rating: ★★★★

ASX: CQE
Market cap: A$1.2BN

52-week range: A$3.07 / A$4.20
Share price: A$3.23

Australian REIT investors haven't been very spoiled for choice, with little choice beyond office, retail, residential and industrial property trusts. Charter Hall Social Infrastructure REIT (ASX: CQE) is one of the few niche REITs, offering exposure to social infrastructure. Social infrastructure refers to properties that enable social and community services, with prominent examples including childcare centres, university buildings, police stations and court houses. The REIT more than halved during the Corona Crash and still hasn't fully recovered despite solid financial results achieved since the onset of the pandemic.

Share price chart

Source: Tradingview

Long WALE & Occupancy

CQE has been listed since 2003 but has only been known by its current name since late 2019. It spent the first fifteen years of its listed life operated by the Folkestone Group before Charter Hall took it over in 2018. Its name became Charter Hall Childcare Trust for roughly a year before adopting its current name. The name change occurred as CQE moved on from being exclusively focused on childcare centres and began to diversify into 'social infrastructure' properties generally.

As of 31 December 2021, it had a portfolio of 364 properties that was valued at $1.8bn and had 100% occupancy, a 14.6 year Weighted Average Lease Expiry (WALE) and a 4.9% passing yield. Passing yield alludes to yield from 'Net Passing Income' which is essentially gross rent less outgoings. Ironically, CQE has a longer WALE than Charter Hall's Long WALE REIT (ASX:CLW), which has a 12.2-year WALE. 75% of CQE's leases are on fixed rent reviews and lease expiries in the next five years are only 3.9% of its income. Childcare assets still make up 85% of its income, but there is significant geographical and tenant diversification.

Its biggest tenants are two of the largest childcare operators in Australia, Goodstart and G8, which account for 40% and 10% of income respectively and no other tenant accounts for over 10%. 36% of properties are in Queensland, 24% in Victoria, 19% in NSW, 11% in WA and the balance in South Australia, Tasmania and the Northern Territory. The company's childcare centres are targeted at metropolitan locations, where there is higher demand for childcare services.

A diversification without abandoning its roots

Although CQE is no longer exclusively a childcare REIT, it still has a significant exposure to it and therefore plunged during the Corona Crash, sinking by over 55% in little over a month. The childcare industry was affected by COVID-19 as parents withdrew their children from childcare. But gradually the children came back and operators were able to keep paying rent due to government support. CQE raised $115m in May 2020 to strengthen its balance sheet and provide it the flexibility to purchase attractive properties. This enabled the purchase of 18 new childcare properties in Perth for $100m and, in 2021, the purchase of new non-childcare assets.

These assets include the South Australia Emergency Services Centre, a Victorian Healthcare asset leased to pathology company Healius (ASX: HLS) and a Queensland health asset that is the headquarters and training facility for not-for-profit operator Mater. Even if you didn't believe that the childcare sector was recovering from COVID, healthcare assets and emergency services have been unaffected by COVID-19 being essential services. These assets are leased long term and are unlikely to require rental relief.

Time to snap up a bargain?

CQE's diversification was evidently well received by investors. The REIT recovered ground lost in 2020 and spent much of 1Q22 above its pre-pandemic high. It has also delivered solid financial results. In FY21, CQE made a profit of $174.1m, up 103.4% on the year before and operating earnings of $58m. In 1HY22, made a profit of $207.7m, which was up over 250% from the prior corresponding period. As of 31 December 2022, CQE has a balance sheet gearing of 30% with investment capacity of $200m.

The recent market crash has sent it below the peak once again. But we think this could present a good buying opportunity for investors, especially those with a specific mindset for distributions. It's currently trading at a 13% discount to NTA ($3.78), a 18.9x P/FFO for FY23 and, given it expects to pay its investors 17.2c per unit, at a dividend yield of over 5%. These look favourable compared to its industry peer Arena REIT (ASX:ARF). ARF trades at a 34% NTA premium, a 25.9x P/FFO for FY23 and is expecting to pay 16c per unit, which is a yield of above 4%. We also observe that Arena REIT has a smaller portfolio with 256 properties valued at just over $1.4bn, although it's WALE is 19.8 years.

Stock market conditions likely to remain tough

We think the biggest problems CQE will face in the months ahead won't be internal issues, but the market conditions generally. REITs have not been able to escape the recent market crunch. Arguably investors fear the property market will crash as interest rates rise. It is inevitable that FY22 will not see property revaluations and the consequential high profits that we saw in FY21. Nor are we likely to see the massive M&A sprees that some REITs, including CQE, engaged in. And while REITs can often escape market downturns, being considered bond proxies, many have failed to escape the downturn in recent months, considering the factors above. But we still should expect to see REITs to pay distributions to investors, CQE included, although this should be true for most ASX REITs.

CQE is also one to look at for ESG-minded investors. Most notably, CQE is investing in solar energy across its portfolio ($8.6m) and is targeting 100% net zero carbon emissions by 2025. It is undertaking a diagnostic assessment of its response to human rights and modern slavery and has partnered with Goodstart to provide at least 55 vulnerable families and their children access to its services.

Ultimately, we think CQE is a four-star stock given its high exposure to defensive sectors, its long WALE, attractive valuation, ESG credentials and lack of exposure to assets under construction. Nevertheless, we concede now might not be the right time to buy in, but the problem is with the broader market rather than CQE as an individual REIT.

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