6 JULY 2022

ASX Property Stocks Down Under

"The best investors adeptly engage in both value and activist strategies, based on changing circumstances."

- Phillip Goldstein (b. 1945), Bulldog Investors manager, civil engineer

CROMWELL PROPERTY GROUP

Facing a different future, but will it be better?

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Stocks Down Under rating: ★ ★

ASX: CMW
Market cap: A$2.2BN

52-week range: A$0.68 / A$0.92
Share price: A$0.78

We last covered Cromwell Property Group (ASX: CMW) in March 2021 and its share price is only slightly ahead of where it was back then. You'd imagine little has happened, but it's been the opposite. It has overhauled its board and management, spun off certain non-core assets and is looking to list its office assets into its own REIT, rather than being part of the current funds management business.

Share price chart

Source: Tradingview

A diverse portfolio, but not entirely owned outright

Unlike most companies we have covered in Property Stocks Down Under, Cromwell is a fund and asset management business, although it also has property investments in their own division. It has 18 properties owned outright that are predominantly Australian office properties. This portfolio has a valuation of $3.1bn, a 54% Weighted Average Capital Return, a 6.1-year WALE and 94.7% occupancy – see our 1 March 2021 edition to find out more. There are a further 7 assets owned by the Cromwell Urban Logistics Fund (CULF), which comprises of 7 assets leased to DHL in Italy worth $86m collectively and 6 owned by the Cromwell Polish Retail Fund (CPRF), which consists of 6 shopping centres in Poland valued at $708m.

There is a further $621m in European properties owned by the Cromwell European Real Estate Investment Trust (CEREIT). Despite being the investment manager, Cromwell only has a ~28% stake in CEREIT because CEREIT is actually listed in its own right on the Singapore Exchange. REITs are a particularly popular investment option in Asia, but particularly in Singapore. Turning to Cromwell's fund management business, it has $7.6bn in Funds Under Management, $5.2bn of which is in Europe and a further $2.4bn in Australia. It also has a 50% stake in New Zealand property investor Oyster Property Group.

Cromwell is chaired by Gary Weiss, whose name probably would ring a bell to ASX investors. He has served on the boards of several companies ranging from Ardent Leisure to Westfield and has served a stint as an Australian Rugby League Commissioner. The company has hired Jonathan Callaghan as CEO, who previously was CEO of Investa. The pair are undertaking a restructure of the company, including divesting non-core assets and spinning out core assets into a new, externally managed REIT, leaving Cromwell as a property funds management business.

Profitable, but not perfect or immune from market conditions

Cromwell made a $308.2m profit in FY21, equivalent to 11.78c per share and up 73% from the year prior. Although part of this was due to an increase in the fair value of investment properties, it still made an operating profit of $192.2m, equivalent to 7.35c per security. Cromwell's Australian assets benefited from having government and ASX-listed tenants, whilst its Italian assets benefited from the eCommerce boom. The Polish shopping centres, however, saw discretionary retail tenant-customers significant impacted, leading to a number of leases being renegotiated.

Cromwell has not issued guidance for FY22. But its 1HY22 results showed some worrying signs with its statutory profit falling by 9% to $132.5m and its operating profit falling by 3% to $96.4m. We observe that Cromwell's gearing is 39.8%, thereby placing it on the higher side among REITs we have covered recently. However, it has a strong Interest Coverage Ratio (ICR) of 6.6x and has an average interest rate of just 2.3%. It's NTA is $1.03, placing it at a discount of over 20%.

But the share price has failed to reach that levels since before the Corona Crash, hence the company restructure. Its most recent update came on 7 June, when it revealed that its plans to spin off its Australian office assets into their own REIT would be delayed due to market conditions. It also revealed divestments during the quarter would free up $160m in capital. These included the Village Cinema Centre in Geelong and 200 Mary Street in Brisbane. The latter is ironically Cromwell's own headquarters, although its current lease runs until March 2024.

How will it go as a pure play funds management company?

Let's assume that the spin-off REIT goes ahead. We would be open to considering the REIT of office assets on its own merits, but let's just look at Cromwell's fund and asset management assets for the purpose of this article. We cannot do so without observing it's been a tough time to be an ASX-listed fund manager in any sector, with Magellan and Pinnacle suffering spectacular share price falls in the last year. Such companies were overpriced to begin with, although investors disregarded it when the market was performing well. But this is not so in 2022 when market conditions are more adverse.

Nevertheless, it is worth recalling that Cromwell is in property while the other two are in equities. The record of property fund manager platforms is more mixed with Charter Hall (ASX: CHC) more than doubling in five years, but companies like 360 Capital Group (ASX: TGP) failing to fire. We also recall that AMP Capital pulled plans to list its real estate funds management platform Collmate on the ASX due to market conditions. In Cromwell's favour is that it is has solid FUM and a future development pipeline of 34 projects across ten different countries. It is a profitable division with a $22.7m profit in 1HY22. This is slightly down from $22.8m in the prior corresponding period, but the latter figure included a one-off rollover fee of $9.8m, so exclusive of that, the profit was actually up 44%.

But ultimately, we are two stars on this one for the following four reasons. First, we are concerned about the potential for the crisis in the construction industry to impact any or all of its projects. Secondly, we don't think ASX investors are currently fond of companies in the fund management space. Third, that distributions will inevitably be lower than if it had remained a REIT with the sole purpose of paying distributions to its shareholders. Even now, it's payout ratio of 88.3% is quite low among property stocks. And fourth, the lack of forward guidance provided by the management about how it's funds management platform will perform as a standalone entity. So, we'll leave this one alone for now.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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