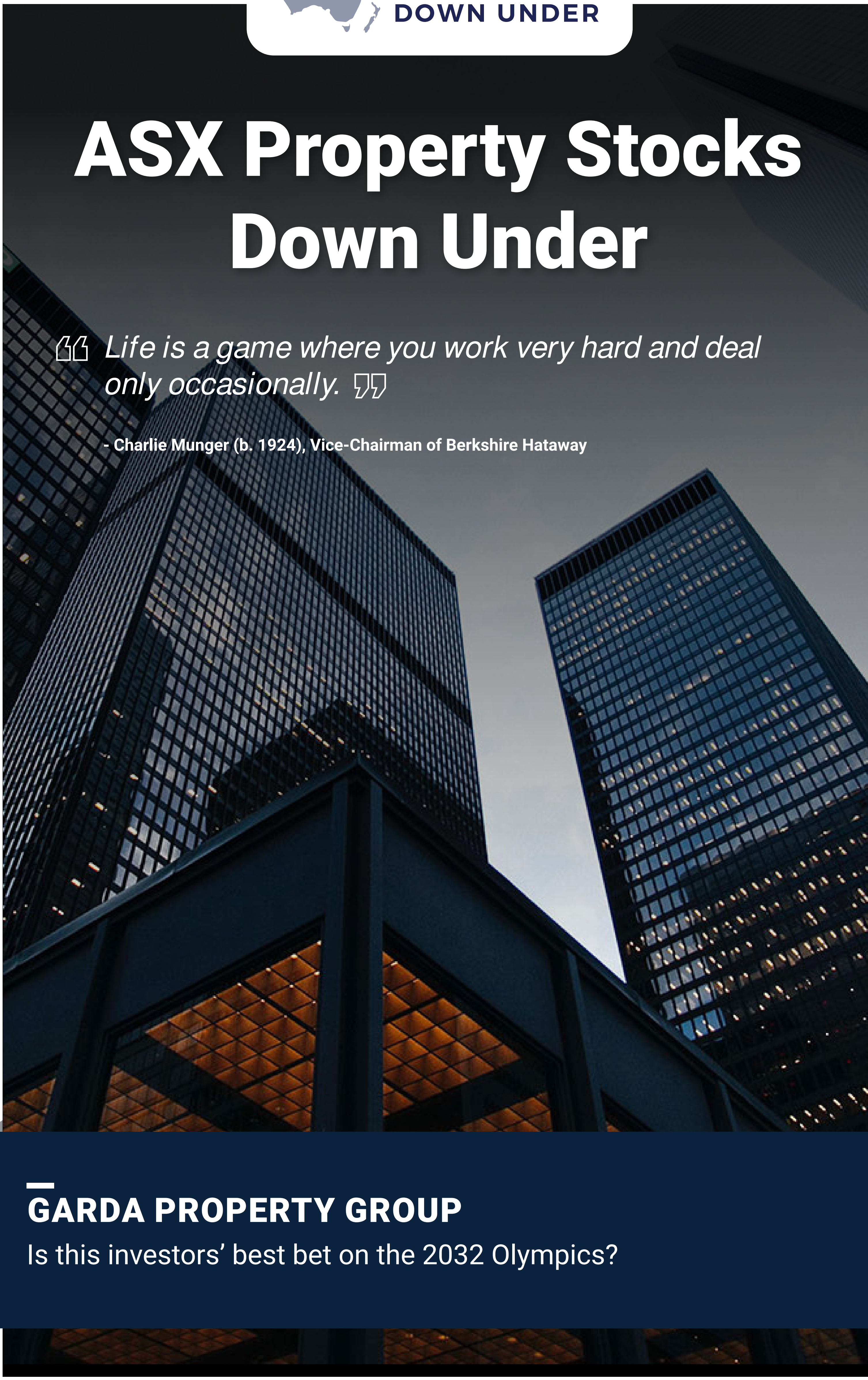
STOCKS DOWN UNDER

13 JULY 2022

ASX Property Stocks Down Under

Life is a game where you work very hard and deal only occasionally.

- Charlie Munger (b. 1924), Vice-Chairman of Berkshire Hataway



GARDA PROPERTY GROUP

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Stocks Down Under rating: ★★★★

ASX: GDF
Market cap: A$354M

52-week range: A$1.26 / A$1.77
Share price: A$1.54

In a decade's time, the Summer Olympics will be coming to Australia for the third time and Brisbane will be hosting. Garda (ASX: GDF) is a property fund with exposure to industrial properties in inner Brisbane. It has had short-term challenges and is not the highest yielding property stock by any means. But we think investors looking for long-term portfolio growth will not be disappointed.

Share price chart

Source: Tradingview

A magnificent seven years of portfolio growth

Garda listed on the ASX in mid-2015, named after a Swiss mountain-climbing knot that locks a rope so that it can only move in one direction. It listed with ~$140m worth of office and industrial buildings under management, a WALE of just 3.6 years and with top five tenants making up 52% of income. Its NTA was $1.02 per security and the offer price was $1 per unit.

Fast forward seven years and it has a portfolio of $639m, which has a greater focus on industrial uses – 54% to be exact, including land held for development. Looking at Garda's portfolio, 12 properties are in Brisbane, 1 is in Mackay (a warehouse and distribution facility), 1 in Cairns (an office building leased to government and financial tenants) and 3 in Melbourne (offices in inner-east Melbourne). The Brisbane properties are industrial properties, warehouses or business parks, with access to major transport routes.

Garda has an NTA of $2.03 per security but is trading at a discount of nearly 30% to this. This is a significant discount among ASX REITs, but the share price is only down 9% so far in 2022 and up 35% in the last five years. Meanwhile, the ASX 200 REIT Index is down 24% in 2022 and only up 5% in five years. And although the ASX 200 REIT Index has failed to pass its pre-Corona Crash levels, Garda has fully recovered.

After its FY22 results, Garda plans to make a 7.2c per security distribution, spread quarterly across FY23 and representing a yield of 4.6%. If you take the company's word that this will represent an FFO payout ratio of 90%, Garda is trading at 19.3x P/FFO. The forecast distribution is the same as in FY21, but the forecast FFO is up 3.8% on a per security basis (it was 7.7 cents in FY21).

As of 31 December 2021, Garda had $20.1m in cash, along with $270m in total debt facilities with a 2.2% weighted average cost of debt. Looking to its debt position, roughly $100m is hedged and it has a 36.1% gearing rate across the group as well as a 4.6x interest cover ratio. The latter is a measure to determine the capacity of a company to pay interest on its outstanding debt, and Garda's figure is safe.

An industrial boom and a (forthcoming) Olympic boom

Industrial properties are increasingly in demand due to the rise in eCommerce. Yes, we know some of the heat has come out of the sector, evidenced by the share prices of companies such as Kogan (ASX: KGN) and Redbubble (ASX: RBL). But let's just look at Australia's industrial property market, heavily tied to the sector. It has the lowest industrial vacancy in the world at just 0.8%. This is well below the global average of 2.7% as at the end of June 2022. The demand for properties is so extreme that deals are being signed before properties are even being built. This was the case with Garda's flagship development at Wacol, which secured tenants across the whole complex even though two of the four buildings have yet to begin construction.

All up, 956,000 square metres is planned for the East Coast and Brisbane is expected to account for a large proportion of this (Bris Vegas and Melbourne will make up 88% of that stock). The demand will also mean higher rents for tenants. And keep in mind that all this is occurring with eCommerce representing just 9% of all retail trade in Australia – we think there is some growth that is still to be unlocked.

Another reason we are excited about Garda is that being significantly exposed to Brisbane, it has a chance to benefit from the Olympics Games in 2032. The games themselves may be a decade away, but, just as it was for Sydney and Melbourne when they hosted the games, we think a real estate renaissance is coming. There has been consensus that residential properties will rise, but little has been said about commercial properties.

Although industrial and commercial properties may not experience the same price hikes as residential property, we think the population growth that will occur over the next decade as well as investment in venues and infrastructure will flow through to industrial properties. Brisbane will grow by 1.9% each year for the next decade and by the time of the Olympics, will be home to 530,000 more people than it is today. This will mean logistics companies will need to set up shop in the Sunshine State. Even now, industrial property in Brisbane is a hot commodity with vacancy rates at all-time lows, and there were 650,000 square metres of leasing deals across Brisbane (roughly 50% higher than a usual year).

Not without risk, but a good long-term bet

As with all investments Garda is not without risk. We see two, namely potential construction issues and higher interest rates. We also accept that property isn't a particularly popular sector with investors at the moment. Investors are particularly cool on office REITs because of the perception that, since COVID, offices are out of favour with businesses. Garda is still significantly exposed to offices – 46% of its income is derived from its offices. However, as we observed above, it is less risky than its peers because it leases its properties to governments and major financial entities that are more reluctant to embrace working from home.

As more of Garda's industrial properties come online, its offices should become less important. We think if Garda wanted to divest its office properties, it would have little trouble doing so in light of its existing tenants. But even industrial properties aren't immune to negative sentiment. Rising interest rates are tipped to soften yields in industrial properties from highs of 11-12% per annum over the last two years.

But ultimately, we think Garda deserves four stars based on how well it held up relative to its peers in the current conditions, its long-term growth record and prospects over the next decade. We also think that rental increases can help offset lower yields from rising interest rates.

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