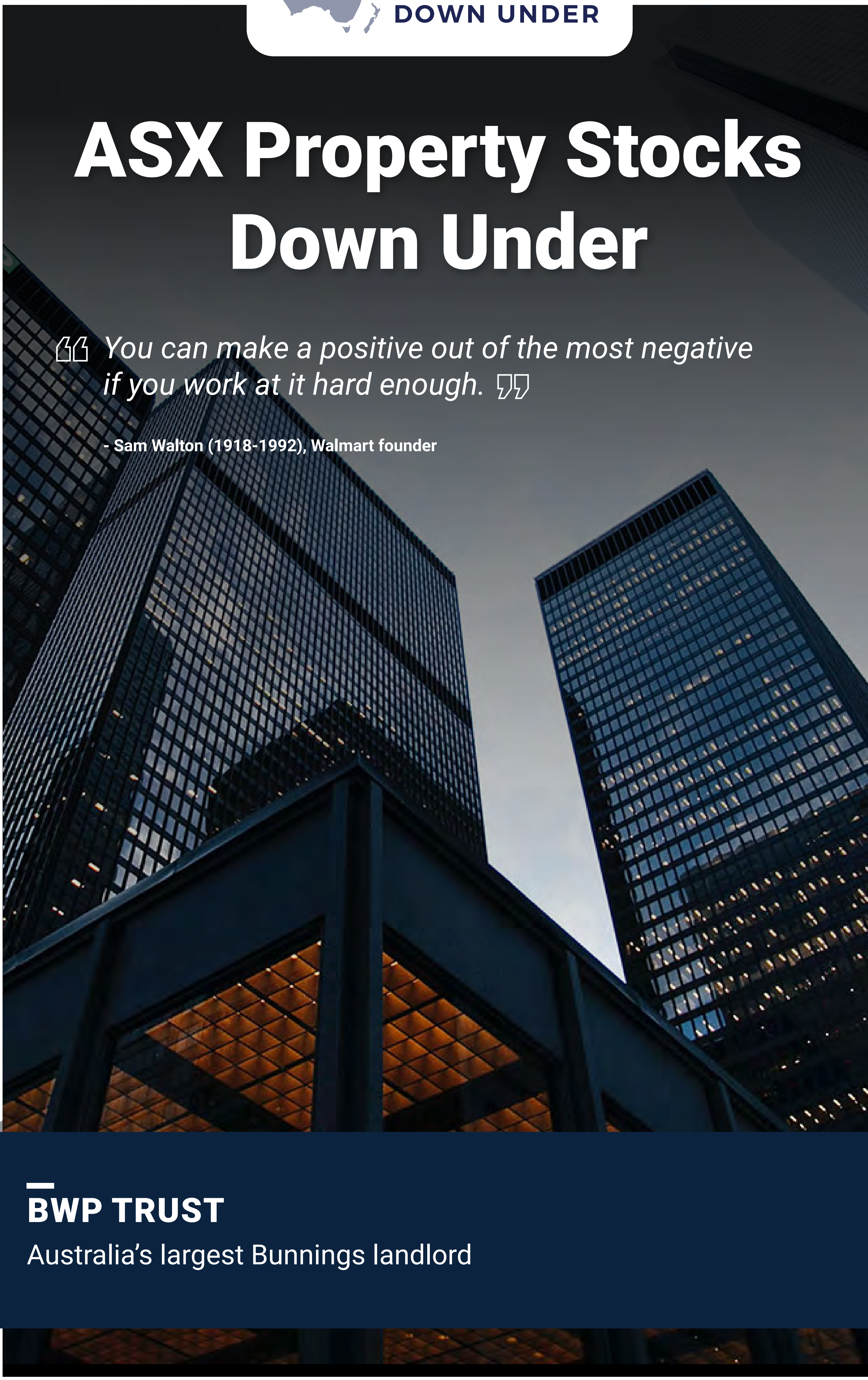

ASX Property Stocks Down Under

"You can make a positive out of the most negative if you work at it hard enough."

- Sam Walton (1918-1992), Walmart founder

BWP TRUST

Australia's largest Bunnings landlord

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Australia's largest Bunnings landlord

Stocks Down Under rating: ★★★★

ASX: BWP
Market cap: A$2.7BN

52-week range: A$3.66 / A$4.33
Share price: A$4.23

After last week's look into a REIT with exposure a uniquely American staple (the college system), we turn our attention to a REIT offering exposure to a uniquely Australian staple – Bunnings. And this REIT, BWP Trust (ASX: BWP), is actually holding up well this year, with a loss of just 2% (a fraction of the ASX 200 REIT Index's 20% loss), not to mention a 40% gain on a 5-year basis. Why has it held up so far and can shareholders expect its outperformance to continue (if not perform even better)?

Share price chart

Source: Tradingview

Substantial growth since listing

BWP (which stands for Bunnings Warehouse Property) Trust is the largest owner of Bunnings Warehouse sites in Australia, with a portfolio of 65 stores. It also has three vacant properties and six large retail format show rooms. BWP listed in 1998 with a portfolio of 20 properties worth $170m. Now it collects nearly that same amount in annual rent ($151.4m) and has a portfolio value of just over $2.9bn. It is 24% owned by Bunnings' parent company, Wesfarmers (ASX: WES).

Some ASX REITs have diversified or gone on M&A sprees since COVID-19. BWP has just stuck to what it does best and that strategy has been paying off. In FY21, BWP generated $152.2m in revenue, $114m in net profits and it distributed 18.3c per share. In 1HY22, it has made a $56.5m profit before gains in fair value of investment properties and $348.3m in post-valuation gains (up from $144m in the prior corresponding period). Obviously, property prices have grown during COVID-19 thanks to record low interest rates. The COVID-19 boom in hardware arguably helped too. BWP has an NTA of $3.75, which implies an 11% premium to its NTA given the current share price. It is one of only a handful of REITs trading at a P/NTA premium, but it is far from the highest. Lastly, BWP has a low gearing of 15.5%.

BWP will be releasing its FY22 results in a few days' time, on 3 August. The company has only given general guidance, stating that the distribution would be 'similar' to the previous year. For the record, BWP paid 18.3c per share in FY21 as well as in FY20. Consensus estimates for FY23 expect ~18c again in FY23, followed by ~19c for FY24-26. Both signify yields of over 4%.

Turning to multiples, we observe that BWP is trading at a P/E of 22.3x for FY23. We observe that BWP doesn't utilize FFO, meaning we cannot use our beloved P/FFO metric. But, BWP has historically paid out 100% of its earnings and has had lower capex, making P/E all but the same as P/FFO.

Could the unravelling of the DIY home renovation boom hurt?

The most obvious investment risk for BWP is that it is reliant on one tenant – Bunnings. However, if you had to rely on a single tenant, there are few others that you'd want to rely on given its footprint and market position. Another risk is the impact of inflation and rising interest rates, which could be compounded by the unexpected boom retailers like Bunnings had during the pandemic. This may be accepted, but bear in mind that Bunnings is a hardware store. It provides items for maintenance and repair jobs, not sofas and electronics to make working from home more appealing.

To get an idea of how Bunnings might be impacted, let's look to the USA, which has seen inflation surging for a longer period, and to hardware chain Home Depot specifically. Even though inflation has been surging in the USA for longer, Home Depot still grew its sales by 3% in 1QCY22 compared to 12 months ago and is expecting a similar growth figure for the entire year. Admittedly, its peer Lowe's saw a 4% fall in its sales because it is pivoted more to consumers doing DIY jobs rather than tradies. Still, Lowe's is expecting modest growth (~1%) for CY22. Unfortunately, we can't look at American hardware store REITs, because both companies own the bulk of their stores outright.

Turning back to Australia, we accept the falling property market could reduce the number of people doing home improvements and renovations for the purpose of adding value to properties. You could also argue that supply chain issues might hit the construction industry. But with the majority of Bunnings' supplies locally sourced, the latter should be less of an issue. And while value-adding work may potentially be pushed out in a falling property market, there are some repair jobs that simply cannot be put off, such as roof leaks and drainage repairs.

Ultimately with BWP, you have to remember that you are investing in a landlord of these outlets and not the outlets themselves. Many REITs suffered during the Corona Crash just because of perception cash would stop coming through the door due to lockdowns. But ultimately most of those REITs survived relatively unscathed, having to provide minimal rental relief.

Just sticking to what it's good at helps

In our view, the biggest downside of BWP is that you don't hear much from the company, other than at results time. Now, of course, management are there to run the business and not to constantly promote themselves to shareholders, so you could argue this is a good thing. But shareholders can be attracted to companies that update them more often and there are other REITs that updated shareholders outside reporting season and have recorded multiple valuation upgrades in the last two years. This is particularly so with the niche Charter Hall REITs.

We observe that BWP also has a lower WALE than you might expect, at 4.2 years. With Bunnings renewing leases fairly often, this clearly isn't a problem for the Trust's overall viability. And there are some sites where leases are locked in longer term, but nearly 30% of leases will expire in FY26. This means you have to watch rent reviews more often than you would for REITs with longer WALEs.

Weighing all these factors, we've given BWP four stars and think it deserves to be one of the few REITs at a P/NTA premium. Even if there is a modest decline in Bunnings' sales, we don't expect it to affect lease negotiations or renewals substantially, if at all. We also take courage in its low gearing, resilience to the underperformance in the ASX REIT sector and track record of delivering distributions and growth to shareholders.

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