STOCKS DOWN UNDER

24 AUG 2022

ASX Property Stocks Down Under

> *We believe there is a high correlation between long-term performance and error avoidance.*
>
> **- Robert Olstein (b. 1941), Chairman of Olstein Funds**

NEWMARK PROPERTY REIT

Another landlord of Bunnings – and more

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Stocks Down Under rating: ★ ★

ASX: NPR
Market cap: A$307.4M

52-week range: A$1.20 / A$1.95
Share price: A$1.66

A few weeks ago, we looked at Australia's largest Bunnings landlord, BWP Trust (ASX: BWP). For over 20 years, BWP was the only pureplay Bunnings landlord on the ASX, but Newmark joined it late last year. After listing at $1.89, it has lagged for much of the year, but has rebounded in the last few weeks. Is it just moving with the market, or was there something in its recent results that investors liked?

Share price chart

Source: Tradingview

Another landlord of Bunnings

While BWP has a portfolio of over 60 stores across Australia, Newmark has just eight properties across Australia that are worth a total of $563.3m - although it is in the process of acquiring a ninth. Five of these are freestanding Bunnings Warehouses – including one under construction - and the remaining three properties are large-format retail centers with Bunnings as an anchor tenant. There's one advantage it has over BWP, in diversification.

We think Bunnings needs no introduction – Brand Finance Australia recently rated the hardware chain as Australia's strongest brand. Other property tenants include discount retailer Kmart and pet retailer PETstock. Four Newmark properties are in Victoria, in a 100km radius from Melbourne, with two in New South Wales as well as one in Queensland and one in Tasmania.

Newmark tenants have been COVID beneficiaries

While COVID-19 hit many Australian retailers, Bunnings and other Household Goods retailers were beneficiaries, as people stuck at home during lockdowns spent their time and money on home improvement projects. In the 12 months to 30 June 2021, the household sector grew by 14.2% and Bunnings grew its EBTDA by 21.3% to $2.2bn.

Other Newmark tenants have also performed well during COVID-19. K-Mart for example - which is also owned by Wesfarmers - grew its EBTDA by 19% in a shift Wesfarmers credited to higher demand for home and activewear. While PETstock is not obliged to disclose its own figures being a private company (despite being partly owned by ASX listed investment company Auctus (ASX:AVC)), the pet care market has been another to boom in conjunction with the rise of pet adoption during COVID-19. Morgan Stanley estimated that global pet ownership tripled in the first twelve months of the pandemic.

Of course, things have changed in 2022 and the consumer discretionary sector is being hit by rising inflation and interest rates. As we outlined when we covered BWP, Bunnings provides items for important maintenance and repair jobs, not discretionary or one-off items such as sofas and electronics required to work from home. We looked to trends in the USA where inflation has been rampant for longer and the closest comparable company, Home Depot, managed to grow its sales by 3% in 1QCY22 and is expecting a similar growth figure for the entire year.

But it remains to be seen what will happen to other discretionary retailers Newmark hosts, such as K-Mart and PETstock. We note that US outlets Ross Stores and Burlington, which are similar to K-Mart, have been feeling the pinch from inflation (in the form of lower sales) just as their lower to middle class customers have.

A post-IPO laggard despite good results

Newmark released its results for FY22 on 11 August. It delivered a statutory net profit of $51.8m, Funds from Operations (FFO) of $13.3m (equating to 7.3c per security given its 181.6m shares on issue) and it declared a distribution of 5.5c per share. All of these were in line with its prospectus forecasts. For FY23, it has guided to a distribution of 8.9-9.1c per unit, which would represent a yield of 5.6%.

If we assume it pays out 75% of its FFO in FY23, as it did in FY22, this equates to 12c per security, which implies a P/FFO multiple of 13.6x. This is on the lower side among ASX REITs. Looking to its NTA, it was $1.77 at its IPO and the deal was priced at a 7% premium to its NTA, but it is now trading at a 13% discount because of the share price decline on one hand and the uplift in NTA to $1.97 on the other. When REITs are trading at a discount to NTA you might think you're getting it at a bargain. But are you?

We'd rather be invested in BWP

There are some things in Newmark's favour, especially the nature of its tenants and the long-term leases. Newmark's portfolio has a WALE of 7.2 years, which is more than BWP that is only 4.2 years, but way off other REITs that have WALEs of over 10 years.

But you might argue WALE is irrelevant for BWP and Newmark because, although lease terms are short, Bunnings keeps renewing the leases. Over 90% of Newmark's leases won't expire until FY26 at the earliest and over 40% are set to last until FY30 or FY31. Furthermore, Newmark's rents typically increase between 2.5% and 3% per year.

Counting against Newmark is its higher gearing of 25.1% whereas BWP is at just 15%, although many other REITs we have observed are over 30%. Also weighing against Newmark is the fact that it pays a lower proportion of its FFO compared to other ASX REITs – well, at least it did in FY22.

We think Newmark could have sparked more investor enthusiasm by announcing more concrete acquisition plans or targets at the time it listed. A valuation uplift of $43.7m was announced in May, which did nothing to stop the share price decline. It eventually bottomed out in June. In July, the company told shareholders a development at Preston would be complete by year's end and it was buying a ninth LFR property in Brisbane, at 1-17 Compton Rd in Underwood, Queensland for $57m. There won't be a Bunnings here (for now), but it will include tenants like Officeworks, Supercheap Auto and Sydney Tools.

We like Newmark's promises of regular, healthy payouts and capital growth in the underlying assets over the longer term. We also think it is likely that Newmark will continue to expand its portfolio in the future and this will likely diversify its tenant base and increase distributions further. But we prefer BWP given the latter's longer-term track record, broader portfolio and higher distributions – not just the raw per security figure, but the higher proportion of earnings. It also appears investors do too given BWP's P/NTA premium and outperformance compared to its peers. So, Newmark gets two stars from us.

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