STOCKS DOWN UNDER

31 AUG 2022

ASX Property Stocks Down Under

It is an important and popular fact that things are not always what they seem.

- Douglas Adams (1952-2001), Author of 'Hitchhiker's Guide to the Galaxy'

GROWTHPOINT PROPERTIES

Can it live up to its name?

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Stocks Down Under rating: ★★

ASX: GOZ
Market cap: A$2.7BN

52-week range: A$3.31/ A$4.48
Share price: A$3.52

Many ASX REITs that Stocks Down Under has covered in recent weeks have been able to outperform the market. This is not the case with Growthpoint Properties (ASX: GOZ), which has traded roughly in line with the ASX 200 REIT Index, losing ~20% in 2022. Growthpoint is heavily exposed to offices, which have fallen out of favor with investors. But have investors taken things too far in selling it off to the point where it trades at a 25% discount to its NTA?

Share price chart

Source: Tradingview

A reasonable niche

Growthpoint joined the ASX in mid-2007 and over its listed-life has grown its portfolio to 59 properties, valued at $5.3bn. It is in two sectors, office and industrial, with 27 office properties and 31 industrial properties. 84% of properties are on the Eastern seaboard, with 8% each in SA and WA. Growthpoint's portfolio occupancy is 97%, its WACR (Weighted average capitalization rate) is 5% and WALE is 6.3 years (although some clients are locked into deals with long terms). Growthpoint is also in the process of acquiring private real estate fund manager Fortius Funds Management, in a deal which will add $1.9bn in third party Funds Under Management and, over time, maybe, 10-20% to Growthpoint's EBIT. The purchase will cost $45m in upfront cash with a net asset adjustment, along with an additional $10m earnout component and ongoing performance fees from existing funds received by the group – but GOZ will not have to pay anything for new funds.

Growthpoint's top 10 tenants by portfolio income only make up 47% and the biggest, Woolworths only makes up 12%. The NSW Police Force makes up 8%, while big banks ANZ, BOQ and CBA account for 13% between them. Other tenants include Country Road, Lion and Samsung. But office accounts of 66% by value and 65% by income. Less than 4% of income is represented by SMEs, with the balance being government entities, listed companies or large private companies. Growthpoint does not own any properties in CBDs but in 'secondary CBDs' such as Parramatta and Olympic Park in Sydney, Newstead in Brisbane and Richmond in Melbourne. Workers living closer to these secondary CBDs might just be more willing to commute there – although

others may find it a longer journey than the CBD. Looking to industrials, Growthpoint also owns warehousing facilities with on-site offices and quick access to major motorways including Woolworths distribution centers in Adelaide, Brisbane and Perth, Linfox facilities in Sydney and the Australia Post facility in Perth.

In a wrong space at the wrong time...maybe?

Now, as we've noted in multiple Property Stocks Down Under editions of late, both sectors haven't had the best run of late. Office REITs have been unloved by investors ever since the pandemic began because of people working from home. Even as Australia has adjusted to living with COVID, people aren't coming back 5 days a week like they used to. Industrial properties have been in hot demand since the pandemic began, but investor interest has tapered off. While low vacancy rates are a sign demand is hot, it also means it is difficult for investors to see just how in demand it is. Now, investor perceptions are one thing, and they can sometimes be incorrect. But Growthpoint's FY22 results showed they just might be right, or close enough to right.

In FY22 it made a $459.2m profit after tax, down 17% from FY21, FFO of 27.7cps up 7.8%, and paid a distribution of 20.8cps, up 4%. For FY23 it is anticipating 25-26cps FFO and 21.4cps distribution guidance – representing a yield of 5.7% at the share price on the day this guidance was issued but a 6.2% yield now. It's NTA is $4.56, placing it at a 24% discount to NTA and its forward P/FFO ratio is a cheap 13.6x. Bear in mind, Growthpoint has assumed an average floating cash rate of 2.8%, so results could be worse if rates rise higher than that. The RBA's own predictions expect a peak of only 2.5%, but we all remember the RBA promised no rate hikes until 2024. And the average call among economists is 3.1%, with some predicting as high as 4% (specifically Vanguard).

We'll pass on it for now

ESG investors would be pleased with this one, as it is targeting net zero by 2025, earlier than many other REITs we have covered of late. One of the key ways it is doing this is with renewable energy and it has won positive ratings for its properties including four with the maximum 6-star NABERS energy rating. It also boasts high employee engagement and alignment.

To return to the portfolio, we argue you wouldn't buy it on the basis of its forward guidance even Growthpoint's management deserves brownie points for honesty. In our view, since Growthpoint expects decreased FFO, it deserves two stars. We would back up this view with two other observations. First, that Growthpoint is targeting increased gearing in the year ahead, with 31.6% now but a target of 35-45%. Second, that it has higher than typical turnover for offices, with only 72% retention in the year just past. For comparison's sake, it has 98% retention amongst industrial properties. New leasings for office space might make for news flow outside reporting season, but it isn't a good sign when it comes to the office property market, since it suggests that it's hard for Growthpoint to retain good tenants.

A big discount to NTA notwithstanding, we'll leave this one alone for the time being.

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