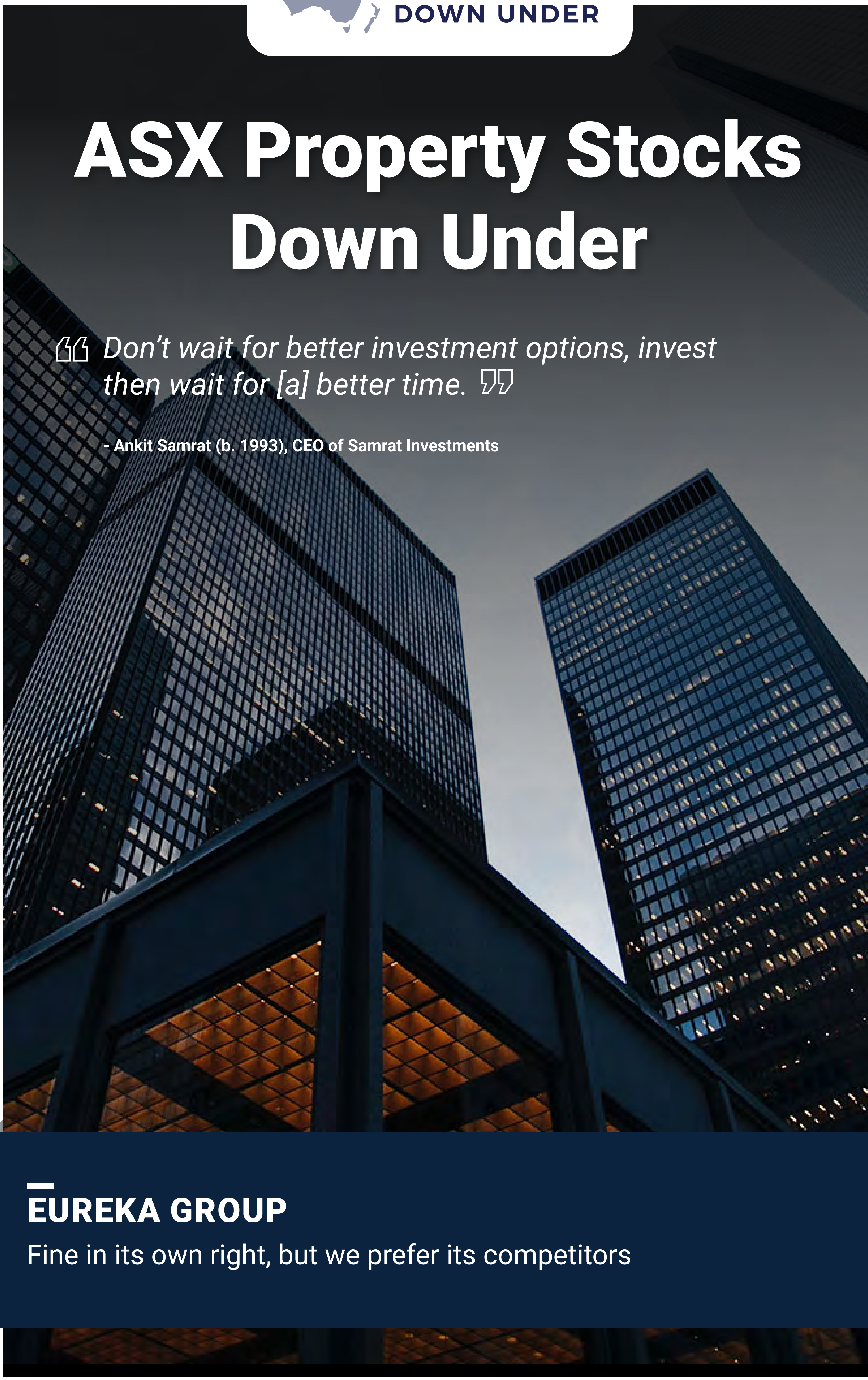
STOCKS DOWN UNDER

5 OCT 2022



ASX Property Stocks Down Under

> *Don't wait for better investment options, invest then wait for [a] better time.*
>
> **- Ankit Samrat (b. 1993), CEO of Samrat Investments**

EUREKA GROUP

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Stocks Down Under rating: ★ ★

ASX: EGH
Market cap: A$135.2M

52-week range: A$0.50 / A$0.72
Share price: A$0.55

After looking at Lifestyle Communities (ASX: LIC), Ingenia (ASX: INA) and Aspen Group (ASX:APZ) earlier this year, we look at the ASX's fourth property stock in the independent living communities space – Eureka Group (ASX:EGH). Eureka hasn't had the best year from a share price perspective, losing 20%, but has still performed better than Lifestyle Communities or Ingenia while trailing Aspen. Why has it performed the way it has and what does the future hold?

Share price chart

Source: Tradingview

Serving the masses

Firstly, it is important to note that, Eureka is not a REIT. It operates similar to the bulk of non-property businesses on the ASX and, consequently, conventional reporting metrics such as EBITDA are relevant in a way they are not with REITs. As with its peers, Eureka makes money from renting out retirement communities and these are not aged care facilities. It is for seniors who want an independent lifestyle with social engagement, quality nutrition and security in a caring environment. One important difference is that the company's entire business model is predicated on renting out the units, it does not sell them directly to residents.

Eureka has 2,507 units under management across 44 villages. These are mostly on the East Coast, but with a handful in South Australia, Tasmania and inland (in the Eastern States). 1,392 of its units are owned with a further 861 not owned, but managed and 254 are partly owned as part of a joint venture.

Eureka is hoping to capitalise on several trends, including an aging population, a shift away from home ownership and increased demand on low-cost quality rental accommodation. And it has a big market, with 2.15m Australians aged 70 or over and receiving the Age Pension. Looking more broadly, 3.9m Australians are retirees and a further 0.5m people are intending to retire in the next five years. Still, it is a difficult thing to balance the needs of the population for affordable housing, but to provide it in a way that is profitable for developers, owners and operators.

Overcoming market challenges

Judging by its FY22, Eureka does appear to be walking the tightrope. The company generated $29.7m in revenue from operations (up 8%), $10.5m in EBITDA (flat compared to FY21) and made a net profit of $8.2m (up 30%). Its EPS was 3.48c per share and it paid a dividend of 1.26c per share – a yield of 2.3% at the current share price. Despite the rise in property prices, its valuation uplift was modest at only $2.8m (after a $7.2m loss in fair value of its Lismore village because of the floods).

The Lismore floods did lead to a $1m insurance payout, but caused $360,000 in costs and a further $300,000 estimated loss of earnings. Its total assets grew by 15% to $183m. Borrowings, however, rose by 23% to $70m and its gearing was 40.8% (up from 37.8%).

Unusually for property companies, there has not been formal guidance given for FY23. Consensus estimates suggest $32.1m in revenue and $11.9m in EBITDA, representing modest growth of 7% and 12% respectively. For FY23 the stock is trading at a P/E of 18.3x, an EV/EBITDA of 17.1x and, consequently, at 1.3x EV/EBITDA-to-EBITDA growth, which implies a significant premium, i.e. this stock is expensive relative to its growth. We also note that with an NTA of 38.2c, it is also trading at a premium of nearly 50%.

The good things about Eureka

The company is not afraid to dispose of assets, having parted ways with 360 units in the last five years while acquiring 955. Even though it had acquired more properties than it has disposed of, it is encouraging to see a property investment company unafraid to part ways with assets that it thinks aren't worth having just for the sake of propping up the balance sheet.

There are some things in Eureka's favour relative to competitors. First, it has exposure skewed to northern states that were not as affected by the pandemic. Second, it has not been predicated on building more units, only to have them disrupted by supply chain issues – as happened to Ingenia. Third, its business model being purely a rental model means that the current market downturn will have less of an impact.

We prefer Aspen

Similar to last week's edition on Shopping Centres Australasia (ASX: SCP), we do not think Eureka is a bad company in its own right, but we prefer its competitor, specifically Aspen Group (ASX: APZ), which we covered back in June. As a consequence, Eureka gets two stars from us.

First, we like that Aspen has exposure to multiple markets with exposure to student accommodation, short-term holiday accommodation and built to rent apartments. This takes its addressable market to roughly 40% of Australian households. Second, we like its track record of growth, in tripling its portfolio in five years. Third, we like the higher growth forecast in FY23 judging by consensus estimates (revenue and EBITDA up 80% and 50% respectively). The company aims to grow EPS and/or NAV by at least 10% per annum.

We also take heart that Aspen was able to raise $36.3m just a few weeks ago, something that can't be said of many ASX property stocks in 2022. This also helped it reduce its gearing to roughly 20%, only half of Eureka's. Although Aspen does have a business model partly based around the building and selling of properties, these tend to be less than $400,000. You cannot discount the prospect of it being plagued by supply chain issues, but (as we noted in June) its development pipeline and refurbishment program is only a quarter of its total dwellings, so it wouldn't have a significant impact on the viability of the business and its cash flows.

And although Aspen is trading at a premium to Eureka, at a 20.4x EV/EBITDA and a 15x P/E for FY23, it is hardly excessive. Further, we think its higher growth justifies this – it is just 0.8x EV/EBITDA-to-EBITDA growth.

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