STOCKS DOWN UNDER

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ASX Property Stocks Down Under

> *If investing is entertaining, you're probably not making any money. Good investing is boring.*
>
> **- George Soros (b. 1930), Chairman of Soros Fund Management & Open Society Foundations**

WAYPOINT REIT

Profiting from the pump

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Stocks Down Under rating: ★★★★

ASX: WPR
Market cap: A$1.8BN

52-week range: A$2.15 / A$3.06
Share price: A$2.49

There are few ASX REITs offering exposure to service stations, but Waypoint REIT (ASX: WPR) is one of them. Since its listing in 2016, it has consistently traded above its offer price, offering an inflation and interest rate beating dividend. Will this continue to be the case going forward?

Share price chart

Source: Tradingview

Servicing the service stations

Pardon the above pun, but that is literally true. Waypoint has a $3.1bn portfolio consisting of 404 fuel and convenience retail properties, over 90% of which are in metropolitan and major highway locations. These are leased to top-tier tenants such as 7-Eleven, Liberty and the Shell-Coles express convenient chains. The property has a 9.5-year WALE, 99.9% occupancy and a Weighted Average Rental Review of 3.2% across its portfolio. Pro forma liquidity of $99.6m and pro forma gearing is 29.3%.

It is active in its own capital management, regularly buying back shares ($100m throughout 1HY22) and divesting assets as well as purchasing new ones. Last year, it sold 31assets to Melbourne-based property investor Fawkner Property for $113.9m and a further 29 earlier this year for $141.8m (also to Fawkner). Although this deal reduces the number of sites owned, Waypoint's average fuel volume, gross fuel margin and asset value all rose by 7% to 9%. And the assets were sold at a healthy premium to its book value.

Reliant on one tenant

Despite the separate brands, Waypoint's primary tenant is Viva Energy (ASX: VEA), accounting for 96.4% of total income. It is always a risk with any REIT when rental income is dominated by one tenant. Yes, this is less of a risk when the tenant is a large one. Viva has the exclusive license to sell Shell fuels and lubricants in Australia. If it lost this right, this would spell trouble for Viva and therefore Waypoint. However, we believe the Viva/Shell relationship is a strong one.

Until 2020, Viva was a major shareholder in this REIT as well as being a tenant, but it has now sold its entire stake. Investors may recall Viva's acquisition of Coles Express, announced barely three weeks ago. These related to non-Waypoint managed properties. Still, Waypoint management felt the need to comment to investors about this, noting existing lease agreements remain in place.

Dealing with debt

Waypoint hasn't fared as badly as its peers in 2022, but has still dropped by more than 15% so far this year. Investors fear the impact of inflation (both generally and specifically petrol prices) as well as interest rates. The latter is feared to slow down the rapid property valuation increases witnessed during the pandemic and eat into individual REIT earnings as debt servicing costs increase. You could also argue that investors fear the rise of electric vehicles (EV) and the possibility that petrol stations may have to 'adapt or die'.

Have any of trends shown up in Waypoint's accounts just yet? Interest rates arguably have, at least in respect of valuation impacts. Turning briefly to FY21, which for Waypoint is the calendar year, the company made distributable Earnings Per Security (EPS) of 15.8c (up 4.25%) and a net profit of $443.6m (up 59%).

In the first half of FY22, it made a $213.8m net profit (down 15%) and Distributable Earnings of $61.4m (up 0.2%). It blamed the lower net valuation gains on its investment properties relative to the prior corresponding period, although this was somewhat offset by higher net valuation gains on derivatives. The company did not mention the guidance it had previously given for the full year but did not withdraw it either – it was 16.44c per security, which would represent 4% growth, an inflation-beating yield of 6.6% and a P/E multiple of 15x (it does not report FFO, which Stocks Down Under typically prefers to use). It currently has an NTA of $3.18, placing it at a 28% discount.

But what about the debt issue? Goldman Sachs predicts each 1% increase in interest rates could cut Waypoint's earnings by 2.1%. This is below the 2.6% average of its coverage universe, but slightly above its closest peer, Charter Hall Convenience REIT (ASX: CQR), at 2.0%. Still, this was assuming 73% of its debt was hedged and now that number is up to 90% after the company entered into forward interest rate swaps after 30 June, worth $63m and with an average rate of 3.55%. These have a pro forma weighted average hedge maturity of 3.5 years.

Why we're backing this one

You will recall that earlier this year, we covered Charter Hall Retail REIT (ASX: CQR) and gave it two stars on the basis of its relatively short WALE (7.3 years) as well as concerns over its debt levels and the rise in EVs. But we are giving Waypoint 4 stars, because we like its longer WALE and how it has immunised itself against interest rate hikes in the immediate term. We also like that the company's distribution guidance will exceed inflation (barring an unexpected hike from current levels) and its prudent portfolio management.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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