STOCKS DOWN UNDER

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ASX Property Stocks Down Under

> *Successful investment is a battle for financial survival.*
>
> **- Gerald Loeb (1899-1974), 20th century Wall Street trader**

STOCKLAND

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Stocks Down Under rating: ★★★★

ASX: SGP
Market cap: A$8BN

52-week range: A$3.12 / A$4.83
Share price: A$3.33

The property market downturn has left few (if any) REITs untouched. Even 70-year-old Stockland has not been able to escape, with its shares down roughly 25% this year and the company trading at roughly the same percentage discount to its NTA. Stockland is one of the most diversified property stocks consisting of master-planned communities, town centres, workplaces, logistics properties and land lease communities, all of which finished 2022 lower than what they began the year at. But with a relatively healthier debt position, positive underlying market trends in its portfolio and trading at cheap multiples, Stockland could be set to bounce back ahead of its peers.

Share price chart

Source: Tradingview

A diversified property stock

Stockland began in 1952, founded by Ervin Graf. The company's vision then was 'to not only achieve growth and profits, but to make a worthwhile contribution to the development of our cities and great country'. The company boasts $10.7bn in trust net funds employed . 40% of its portfolio is weighted to town centres (shopping malls), 24% to logistics, 16% each to workplaces and master-planned communities with the balance to land lease communities.

The pandemic has affected all of these segments in several different ways. Town centres have been facing increasing competition from eCommerce, while workplaces saw occupancy levels fall as people worked from home. Conversely, logistics properties were in higher demand than ever due to eCommerce and master-planned communities benefited as people made tree changes.

Thriving through the pandemic, only to see more headwinds

But overall, Stockland has experienced more good than bad during the pandemic and it has shown in its results. In FY21, it made a statutory profit of $1.1bn (up from a $21m loss in FY20) and FFO (Funds from Operations) of $788m (down 4.6%). In FY22, it made a statutory profit of $1.4bn (up 25%), FFO of $851m (up

8%), which is 35.7c per security and it paid a distribution of 26.6c (also up 8%). It has an NTA of $4.31, rent collection of 99.7% and a ROIC (Return on Invested Capital) of 10% from its recurring revenue base and 16% from its developments.

But part of the demand for the properties outlined above sprung from the expectation that interest rates would not rise until 2024. Obviously, this has not proven to be the case, with interest rates increased by the RBA for 6 months in a row. But no one knows at what point they will stop going up. Yes, in one sense we do know, when inflation returns to 2-3%. Yet, how much more interest rate hikes this will take is anyone's guess. It is also anyone's guess how individual REITs will be impacted, but investors have speculated that most (if not all) will be negatively hit.

Stockland still expects to perform (mostly)

expects its WACD (Weighted Average Cost of Debt) to rise to 4.4% over FY23. And the company anticipates impacts in a number of regards, particularly on demand for its communities segment and completion of deals. Current, the residential default rate is 1.2%, but the company has made a provision for a 10% default rate in the June quarter of next year.

A number of negative developments in relation to its office portfolio haven't helped, such as IBM cutting its footprint at Stockland's 601 Pacific Highway at St Leonards' Sydney by 62%. The company also parted ways with its retirement living business, which it had tried to make work for roughly two decades but just couldn't. Admitting failure is tough, but doing so allowed Stockland to reap $987m to put into its construction projects, in particular a $765m science and technology park at Macquarie Park in Sydney (named M_Park).

Nevertheless, Stockland appears to be expecting business as usual for FY23. It has issued FFO guidance of 36.4-37.4c per share on a pre-tax basis. 75-85% of Stockland's FFO will be distributed to shareholders as per company policy. The mid-point represents a very low P/FFO multiple of just 8.9x and 4% growth from FY23. The latter figure isn't significant in isolation, but appears bigger when you consider so many other ASX property stocks expect to go backwards in FY23. Stockland is trading at a P/NTA discount of 24%, a figure you would expect of an illiquid REIT rather than a multibillion-dollar property developer.

Still some hardship to come, but better times are ahead

Looking forward, our biggest concern is that the bulk of Stockland's recurring FFO is from commercial property. This is expected to decline in the medium term as it completes more master-planned communities (these account for another 36% of FFO). We can understand investor concerns about construction supply chain issues, but these do not appear to have impacted Stockland. Neither have increased interest rates impacted on its ambitions and we think it is unlikely given the company's healthy debt position. We observe that it has available liquidity of $1bn, investment grade ratings from S&P and Moody's, capital partnerships with Mitsubishi Estate Asia and Ivanhoe Cambridge and an interest cover of 6.94x.

Although Stockland shares are unlikely to rebound without the property market and ASX property stocks recovering, we think Stockland will be one of the companies to lead the rebound given the renewal of its portfolio and FFO growth that is forecast to occur in FY23. Four stars.

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