STOCKS DOWN UNDER

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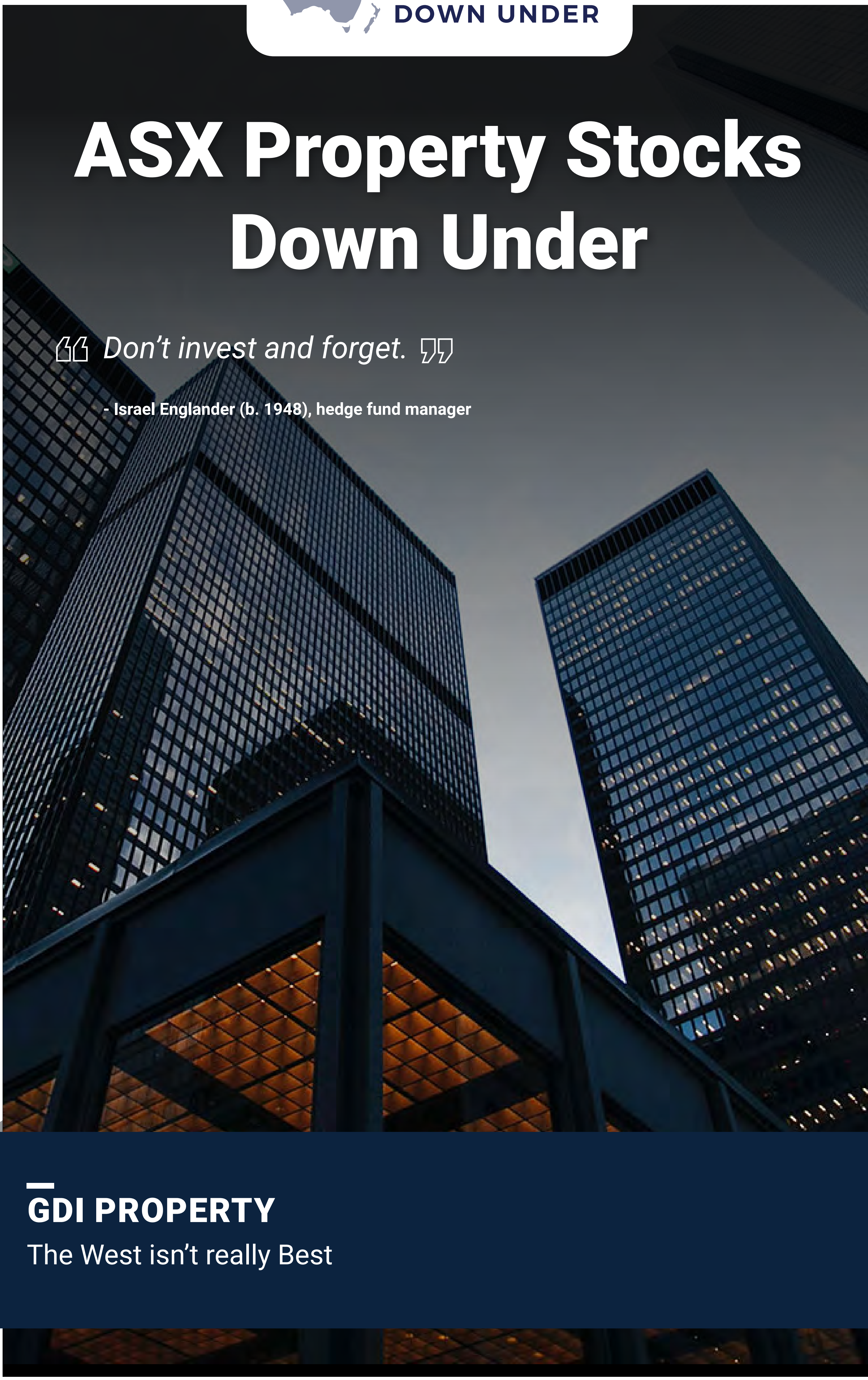
ASX Property Stocks Down Under

“Don’t invest and forget.”

- Israel Englander (b. 1948), hedge fund manager



GDI PROPERTY

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Stocks Down Under rating: ★ ★

ASX: GDI
Market cap: A$418.9M

52-week range: A$0.78 / A$1.20
Share price: A$0.785

This week we look at GDI Property (ASX:GDI). GDI is another property stock that has an exclusive focus on the Perth market. However, it has not always been exclusively focused on Perth, shifting its focus there in 2017 seeing opportunities after the end of the early 2010s resources boom and noting that Perth had the lowest supply of office buildings in Australia. Just how has that choice fared out?

Share price chart

Source: Tradingview

Nearly a decade on the bourse

GDI (which originally stood for Grosvenor Direct Investments) was established in 1993 and listed on the ASX in 2013. The company's philosophy has always been to buy well-located properties with four sides of natural light, easily divisible floor plates, opportunities to add value and at a reasonable price.

It manages 48 properties with a total value in excess of $2.5bn and an average internal rate of return of over 20%, with no single property having delivered a negative return ever. It does not just buy and hold the properties, it has the intention of re-developing properties. Having re-developed properties, it can either secure higher leases or can part ways with the assets at a premium to what it bought the buildings at.

Looking West

GDI has unlisted properties that are outside WA, but its listed properties are all West Australian with the exemption of 235 Stanley Place in Townsville. Until last year, it owned a skyscraper in the Gold Coast (50 Cavill Avenue), but cashed out for $113.5m, five and a half years after buying it for $48.8m. It owns a handful of properties in Perth, including IODM dealerships, two car parks on Wellington Street and 5 office properties. The flagship office property is Westralia Square, which is 50% occupied by the Works Ministry of WA.

As with its West Australian peers, staying COVID-free for so long did more good than bad, at least as far as CBD office and car park occupancy levels are concerned. However, the timing around the border re-opening led to a hesitation of tenants to commit to long-term leases. And when the border opened there was a major COVID wave that impacted occupancy levels. They also caused labour shortages in the resources sector, the main driver of Perth's economy. Nevertheless, GDI's shares have never recovered to pre-Corona Crash levels and have declined further in 2022 (down by more than 30%).

A large NTA discount

In FY22 the company achieved AFFO (Adjusted Funds from Operations) of 5.29c ($28.5m), down 2% from the year before, and paid a distribution of 7.75c per security. AFFO adjusts FFO for incentives paid during the period and maintenance capital whilst FFO adjusts net profit for certain non-cash changes, including impairments of goodwill and unrealised one-off items. GDI's dividend represented an impressive yield of nearly 10%, but this was over and above AFFO, after parting ways with the Gold Coast property. And of course, the yield would have been lower if shares were more in sync with the company's NTA, which was $1.27. The Gold Coast transaction also inflated its net profit from $22.5m to $68.1m.

At the current share price of 78.5 cents the shares are trading at a discount of 39% to NTA. Its NTA actually declined slightly, from $1.28 in FY21, due to the company paying a distribution ahead of its AFFO. GDI's goal is to deliver a consistent 10% total return on equity measured annually and on a three-year rolling basis. It measures total return as NTA growth per security plus distributions per security. This says nothing as to the mix between the two or what FFO might be, especially as it aims to pay a consistent distribution regardless of its earnings. Keep in mind, though, that a REIT with such a prominent buying strategy will not have consistent earnings compared to a REIT that just sits back and collects the rent.

Conditional earnings

GDI has not provided formal guidance, but aims to pay a distribution at levels similar to previous years. It admitted that to be able to do that, it would need stronger leasing outcomes and/or significant capital transactions. In relation to the first, we presume that it is alluding to higher occupancy, because its occupancy rates are not the highest in the industry. It has not published an average figure across the portfolio, but it is 61% at 197 Saint Georges Terrace and 78% at Westralia Square.

We don't think the company has significant capacity for additional M&A without selling further assets. It has just $12.5m in its own cash and while it has $106.1m in undrawn debt, of which it has drawn down $206.8m already. It is more realistic that it would sell properties, as it has done in the past. But in the current market it will not realise high returns, as it would have a year ago or if occupancy was 90% or higher. And bear in mind that taking on more debt would be a significant turnoff for property investors.

There are too many other REITs with similar earnings, even in this current market, that are not conditional. In a better market for property and interest rates (from a borrower's perspective), we might be prepared to give this REIT the benefit of the doubt, but not in this market. Two stars.

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