STOCKS DOWN UNDER

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ASX Property Stocks Down Under

> *If a job has been correctly done when a stock is purchased, the time to sell is almost never.*

- Philip Fisher (1907-2004), 'Common Stocks and Uncommon Profits' author

MIRVAC

At the forefront of Build to Rent

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Stocks Down Under rating: ★ ★ ★ ★

ASX: MGR
Market cap: A$8.4BN

52-week range: A$1.06 / A$3.02
Share price: A$2.12

It has been 10 months since we last looked at Mirvac (ASX: MGR), Australia's largest listed developer of residential, commercial and industrial properties. We were, and still are, bullish on the company, because it is the best chance for ASX investors to gain exposure to the growing 'Build to Rent' (BTR) sector. Despite the promising long-term outlook, Mirvac shares fell 25% in 2022 due to adverse conditions in the property market.

Share price chart

Source: Tradingview

The Jack of all trades

Mirvac has ~$25.6bn in Assets Under Management (AUM), a figure split across offices, industrial properties, retail, Build to Rent and Funds Management. The company's property portfolio makes up $15.4bn, with $1.9bn being properties under development (most of which consists of residential properties) and the balance being 'passive invested capital'. The latter alludes to properties Mirvac holds and takes rent from. $8.4bn of Mirvac's property portfolio is invested in office properties, retail properties make up $2.9bn, industrial properties $1.6bn and Build to Rent (BTR) $0.6bn.

As you can see, Mirvac has heavy exposure to the office space, accounting for 62% of passive capital. Long-term readers of Stocks Down Under would observe we have been bearish on property stocks with exposure to the office space. Mirvac is an exception, however, because of its BTR diversification.

At the forefront of a once in a generation innovation

Last March, we said that BTR could be the most significant innovation to the property space since the innovation of strata in the 1960s. Although BTR is at an early stage in Australia, we think there is significant potential here based on the sector's growth in North America and Europe. More importantly, we also think that Mirvac is in a prime position to capture the upside because it is one of the first movers. The company has big ambitions in the BTR space, targeting 3,300 residents by 2024.

Yet judging by its share price, investors have not given Mirvac credit for its ambitions. In investors' defence, it has taken more than 6 years for the company to get its ambitions off the ground. Investors had every right to be disappointed, but not anymore.

Mirvac has leased almost all of its flats at the first site, in Sydney's Olympic Park, and just opened its second BTR property in Melbourne. We expect BTR apartments to be popular with tenants, specifically because of the tight rental market, but also because of the amenities Mirvac provides. Its property in Melbourne has an on-site gym, is right across the road from the Queen Victoria Market, close to public transport and is well suited to Working from Home. We also think BTR will be lucrative for investors, given it is an inflation-safe hedge because rents increase annually irrespective of inflation. Additionally, Mirvac is reporting an 8% unlevered Internal Rate of Return (IRR), ahead of the current inflation rate.

Legacy projects dominate earnings for now

Despite Mirvac's future potential, investors have to judge the company on its legacy operations at the moment. It recorded a strong result in FY22 (the 12 months to 30 June) with a $906m statutory profit (flat compared to FY21), 15.1c EPS (up 8%) and it paid out 10.2cps (up 3%). It closed the year with an NTA of $2.79 (up 4%), representing a 22% P/NTA discount.

Among operational highlights, the company settled 2,523 residential lots (beating its 2,500 target), successfully integrated the $8bn AMP Wholesale Office Fund into its platform, maintained an average occupancy of 97.3% across the portfolio and achieved net positive carbon emissions nine years ahead of schedule.

Mirvac has issued EPS guidance of 15.5c for FY23, indicating a P/E multiple of 14.1x. It expects to pay 10.5c per share to investors, representing a 4.8% yield. Consensus estimates expect revenue to grow 12% from $786m to $884m, although EPS is expected to be flat at 0.15c for FY23 as well as for FY24. This places the company at a 14.5x P/E and 3.2x PEG. Although a company with a PEG multiple above 1x is typically considered overvalued relative to its growth, the long-term growth used is just 4.5%. The average target price among the 14 analysts covering the company is $2.41, which implies 11% upside.

The company's most recent update was its report for 1Q23. It observed a slowdown in residential settlements given rising interest rates and inflation. Nevertheless, Mirvac stuck by its full year guidance. It forecasts sales to be skewed towards 2HY23 and has not been significantly impacted by construction or supply chain issues. Mirvac also observed strong leasing at its office and industrial properties.

Short-term headwinds possible, but long-term looks compelling

The biggest risk with Mirvac is that the property downturn is prolonged and it substantially impacts the company's FY23 results. The company and analysts covering the stock evidently do not think this will occur, although this is a realistic possibility that investors should still be wary of. Another risk is that Mirvac takes its time in getting its new BTR properties off the ground, as happened at Sydney Olympic Park. Judging by the quicker completion of its Melbourne property, we think this risk has lessened.

In the end, we don't expect a prolonged slowdown in residential development sales to impact Mirvac's financials too significantly, given that this is a small portion of the company's portfolio. And again, we express our excitement over the rise of the BTR sector and how Mirvac is positioned to capitalise on it as one of the first movers. Four stars.

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