STOCKS DOWN UNDER

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ASX Property Stocks Down Under

Buying stocks is like buying groceries, you want to go where the value is.

- Ralph Wagner (b. 1933), Wagner Asset Management founder

GOODMAN GROUP

The price is right this time

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Stocks Down Under rating: ★★★★

ASX: GMG
Market cap: A$33.5BN

52-week range: A$15.57 / A$25.24
Share price: A$17.82

Last time we looked at Goodman Group (ASX:GMG), back in February last year, we titled the article 'Good assets, but at a bad price'. As a company that owns and leases industrial properties, particularly logistics facilities and warehouses, Goodman was a beneficiary from the eCommerce boom during the pandemic. We were not keen on the company, however, simply on valuation grounds – Goodman's share price nearly triple its NTA. Nearly a year on, the company's shares have fallen by a third. Is now a more appropriate time to get in? Or will the shares decline further?

Share price chart

Source: Tradingview

A world leader

Goodman Group is the world's leading developer, owner and manager of industrial properties. It has $73bn in Assets Under Management (AUM), spread across 410 properties in 14 countries. More than half of its properties are outside Australia, with 132 in Europe and the UK, and 71 in Asia. It leases a total of 4.5m square metres (sqm) globally, with 99% of this space occupied. Goodman's properties are actually owned by partnerships that Goodman manages and retains an equity stake in.

Its largest customer is Amazon, which accounts for 12.5% of net income. You may have heard that Goodman is Amazon's landlords at the latter's new warehouses in Australia. That is indeed correct, but the relationship between Goodman and Amazon goes back nearly two decades, with Goodman having developed its first Amazon logistics warehouse during 2006 in Leipzig, Germany. Goodman's next largest customer, Deutsche Post, only accounts for 1.7% of net income.

Industrial properties are good assets to own right now

The growth in eCommerce has resulted in higher demand for industrial properties. With an inability to bring new industrial properties online at such a rapid speed, companies like Goodman have been able charge higher rents for their properties. According to research from JLL, industrial rents in Australia grew at their fastest annual rate in over three decades during CY22, by just under 15%. Beyond generating short-term cash, increased rents also increase the underlying valuation of the properties. Record low-interest rates played their part too.

In FY22 (the 12 months to 30 June 2022), Goodman recorded a statutory accounting profit of $3.4bn, up 48% from FY21. Although this figure includes the property valuation gains, the company's operating profit grew too, by 25% to $1.5bn. Although it recorded EPS of 81.3c per share (also up 25%), it paid out only 30c per share - the same as the year before and a yield of barely 1.5%.

Turning to the balance sheet, Goodman has $2.8bn in liquidity - $1.1bn in cash and $1.7bn in available credit. It claims gearing, which it calculates as total interest bearing liabilities over total assets, is just 8.5%. This figure rises to nearly 20% if you use net debt over net assets, although this is still below many of its peers that we have covered recently.

Goodman's weighted average debt maturity profile is 6.2 years and it has an Interest Cover Ratio (ICR) of 36.7x. As interest rates rise, these figures illustrate that Goodman is in better shape to handle the hikes relative to many of its peers. This may explain why consensus estimates expect growth, something that can't be said for many of Goodman's peers.

Set to generate solid results, even with interest rate hikes

Consensus estimates for FY23 call for $2.3bn in revenue and 93c normalised EPS, representing 13% and 15% growth respectively. The current share price of $17.82 consequently values the company at 18.7x P/E, 2.1x PEG (assuming 8.9% long term growth) and at a 113% P/NTA premium, considering its $8.37 NTA. Consensus estimates for FY24 call for $2.5bn in revenue and $1.01 EPS (both up 9%), implying valuation multiples of 17.1x P/E and 1.9x PEG.

Goodman's last update was its report for the three months to 30 September 2022, released to investors in early November. In our view, it was a solid result, with occupancy at 99% and like-for-like Net Property Income (NPI) growth of 4%. Perhaps most importantly, given rising interest rates and construction supply chain issues, Goodman reported that development Work In Progress (WIP) rose to $13.8bn. It gave FY23 EPS guidance of 90.3c (which would be 11% higher than FY22).

Not a stock for dividends, but a good one for growth

We think dividend investors should avoid Goodman Group, given it has had a low payout ratio and a yield of just 1.5%. This is unlikely to grow anytime soon, given high capex requirements. Although Goodman's investments will likely pay off in the longer term, this makes it less appealing to dividend investors in the shorter term. After all, there is no shortage of REITs that increase shareholder distributions almost every year and distribute almost 100% of EPS.

But for growth-oriented investors, we think this one is now four stars. We are optimistic about Goodman's prospects given the continuing rise in demand for industrial properties, which will be reflected in property rents and, consequently, in Goodman's profit and valuation. Although this was true when we covered Goodman last year, the difference this time is Goodman's lower valuation, providing a better entry point for investors, in our view. That's why we are changing our rating from two stars to four stars.

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