Core Property
Fund Research & Ratings
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Listed Property

GARDA Property Group
(ASX Code: GDF)

13 March 2020

1H20 Results: Steadying the ship

GARDA Property Group (GDF)

Contents

About Core Property Research

Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research cover sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

IMPORTANT NOTICE

13 March 2020

GARDA Property Group (ASX: GDF)

Hold

See the end of this document for a description of Core Property's ratings. The rating must be viewed in the context of comparable A-REITs and not across all products.

Forecast Distribution:	7.5%
Forecast 12 Month Capital Return:	20.8%
Total Expected Return:	**28.3%**

Security Information

ASX Code:	GDF
Price:	$1.20
Market Capitalisation:	$273.2M
Securities on Issue:	227.6M
52 Week Range:	$1.17 - $1.545

Share price performance

Source: IRESS

1H20 Results: Steadying the ship

- *1H20 results saw FFO per security declining 1.1%. Growth from acquisitions offset by issue of new securities.*
- *Industrial acquisitions and developments continue to fuel growth.*
- *Botanicca 9 remains vacant, we now expect this to be progressively leased up by July 2021.*
- *Management guidance implies FY20 FFO of 8.2 cps (from 8.7 cps in FY19). FY20 distributions to be maintained at 9.0 cps or 110% payout ratio.*
- *Recommendation reduced to Hold (previously Accumulate) as a result of the uncertainty in the current economic climate and temporarily high payout ratio.*

GDF's 1H20 results delivered a strong 19.3% growth in Funds From Operations (FFO), benefitting from recent acquisitions. However, FFO per security declined 1.1% due to the issue of new securities to fund the acquisitions and the internalisation of the manager with the fund. GDF now comprises the stapling of securities of the GARDA Diversified Property Fund with GARDA Holdings Limited.

The portfolio has increased its weighting to the industrial sector, due to recent acquisitions. Industrial properties now represent 47% of the portfolio (previously 40%). Portfolio occupancy has remained stable at 83%. The newly constructed Botanicca 9 office building at 588A Swan St, Richmond VIC remains unoccupied following its completion in June 2019, which accounts for 14% of the portfolio vacancy. Core Property now expects the building to be gradually leased up from December 2020 until June 2021 (we previously expected to be fully leased by July 2020).

Management guidance is for FY20 distributions of 9.0 cps, the same as in FY19. GDF expects the payout ratio to be around 110%, implying FFO of 8.2 cps.

Core Property has reduced its 12-month price target to $1.45 per unit (previously $1.56 per unit) which includes the updated 1H20 results and management guidance, recent acquisitions, the issue of new securities and stapling structure as well as updated leasing assumptions. Whilst this represents a 20.8% capital upside at current prices, we do not see any near term catalyst for the security price in the current economic climate. We expect that any leasing success at Botanicca 9 may provide an opportunity for a rerating.

Year Ended 30 June	FY19A	FY20F	FY21F	FY22F
NPAT - Reported - $M	28.8	7.1	17.7	19.4
NPAT - adj - $M	11.8	14.8	17.7	19.4
Price/Earnings Ratio	20.5	16.3	13.7	12.5
FFO - cents	8.7	8.2	8.8	9.6
EPU - Growth		10.5%	6.5%	9.5%
DPU - cents	9.0	9.0	9.0	9.0
Distribution Yield	7.5%	7.5%	7.5%	7.5%
NTA per unit	$1.37	$1.33	$1.39	$1.46
Gearing	33.2%	37.3%	36.8%	36.0%

Source: Core Property estimates
Note: Gearing = (net debt – cash) / (net debt – cash + net assets)

Core Property
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Key Metrics

Strategy
To provide sustainable and growing distributable income derived from commercial and industrial real estate across the east coast of Australia. GDF focuses on a combination of newer and high yielding assets that is diversified across building type, location and tenants. The Fund is relatively defensive as it focuses on maintaining a conservative capital structure.

Board & Management
Board of the RE consists of Executive Chairman (Matthew Madsen), an Executive Director (Mark Hallett), an Independent Director (Morgan Parker) and one Non-Executive Director (Philip Lee). **Senior Management** includes Matthew Madsen (Executive Chairman and Managing Director), David Addis (Chief Operating Officer), Paul Brown (Manager, Investor Relations), Paul Lohr (Asset Manager) and Ikram Patel (Financial Controller).

Portfolio	
Metric	**Dec 19**
No of Properties	17
Valuation	$405.1M
Capitalisation Rate	6.60%
Locations	Australia
Sector	Office, Industrial
Occupancy	84%[1]
WALE	5.6 years
Note 1: Occupancy is 97% excluding Botanicca 9	

Key Properties	
Dec 19	**% Portfolio**
588A Swan St, Richmond	14.6%
7-19 Lake St, Cairns	14.3%
572 Swan St, Richmond	13.2%
326 & 340 Thynne Rd, Morningside QLD	10.1%
41 Bivouac Place Wacol QLD	9.6%
Top 5	**61.8%**

Key Tenants	
Dec 19	**% income**
Planet Innovation	10.3%
J Blackwood & Sons	9.9%
Volvo Group	9.6%
QLD Gov (DTMR)	7.8%
Golder Associates	6.8%
Top 5	**44.4%**

Geography	
Dec 19	**% Portfolio**
NSW	-
VIC	35.7%
QLD	64.3%
ACT	-
WA	-
SA	-
Total	**100%**

Debt	Dec 2019
Gearing	36.0%
Target LVR	30-35%
Drawn Debt	$178.1M[1]
Facility limit	$200.0M[1]
Weighted Expiry	3.0 years[1]
All in cost of debt	2.5%[1]
% Hedged	50%[1]
LVR	44.0%[1]
LVR Covenant	50%
Note 1: As at 4 March 2020	

Expenses	Dec 2019
RE Fee	NA[1]
Property Outgoings	23.6% of rental income
Note 1: The RE forms part of GDF as a stapled security. All fees to the RE are eliminated on consolidation.	

Historical	FY17	FY18	FY19
EPU – FFO per unit	10.3	8.7	8.7
DPU – Distributions per Unit	9.4	9.0	9.0
Payout Ratio	94.4%	100.7%	104.7%
Distribution Frequency	Qtrly	Qtrly	Qtrly
NTA per Unit	$1.21	$1.28	$1.37

Investment Overview

GDF reported its 1H20 result on 20 February 2020, delivering a 19.3% increase in Funds From Operations (FFO). The result was boosted by acquisitions undertaken. FFO per security declined by 1.1% after adjusting for the issue of new securities to fund the acquisition as well as the issue of new securities as part of the internalisation of the management of GDF. The internalisation effectively stapled the securities of GDF with its Manager and was completed in November 2019.

GDF's occupancy has remained at 83%, primarily due to Botanicca 9, at 588A Swan St, Richmond VIC, remaining vacant since the office building was completed in July 2019. The property accounts for 14% of the portfolio vacancy and we now expect the building to be gradually leased up, starting around December 2020 through to June 2021 (previously we expected the building to be fully leased by July 2020). The lack of rental income from Botanicca 9 has impacted management guidance, with expectations that the payout ratio will increase to 110% (from 100% - 105% previously) in order to maintain distributions at 9.0 cps for FY20.

Core Property has reduced its recommendation to Hold (from Accumulate) in the absence of any near term catalyst for the security price in the current economic climate. The impact of the coronavirus (Covid – 19) on the real estate sector and more broadly, the Australian economy remains uncertain. GDF has also maintained its FY20 distribution guidance which implies that it is temporarily using retained earnings to top up forecast FY20 operating earnings. We expect that any leasing success at Botanicca 9 may provide a boost, potentially increasing earnings to over 9.0 cps. and would provide an opportunity for a rerating.

1H20 Results

1H20 Results to 31 December 2019

1H20 results	1H20	1H19	Change
Earnings			
Statutory Net Profit after tax *	**$0.16M**	$12.9M	-98.8%
Funds From Operations	**$7.7M**	$6.5M	+19.3%
FFO per security (on weighted units)	**4.35 cps**	4.4 cps	-1.1%
Distributions Paid	**$8.0M**	$6.7M	+19.6%
Distribution per security	**4.5 cps**	4.5 cps	No Change
Payout ratio	**103.8%**	103.5%	+0.3%
Movement over 6 months	**As at Dec 2019**	**As at Jun 2019**	**Change**
Balance Sheet			
NTA per security	**$1.19**	$1.37	-9.1%
Gearing	**34.6%**	32.5%	+2.1%
Weighted average cost of debt	**3.0%**[1]	3.16%	-0.16%
Weighted average debt maturity	**0.6 years**	1.15 years	-0.55 years
Borrowings – on balance sheet	**$168.1M**	$139.7M	+20.3%
Portfolio			
Property Valuation	**$407.6M**	$332.8M	+22.5%
Occupancy rate	**83%**	83%	No Change
Number of properties	**17**	16	+1 property
Weighted Average Capitalisation Rate	**6.60%**	6.79%	-19bps
WALE (Weighted Average Lease Expiry)	**5.6 years**	5.3 years	+0.3 years

Note 1: Debt metrics as at 31 December 2019. The debt facility was subsequently refinanced on 4 March 2020. Source: GDF, Core Property *Statutory Net Profit after Tax includes non-cash items which distorts operating income. Operating Earnings or Funds From Operation (FFO) is a more appropriate measure to assess changes.

Commentary on 1H20 Results

Portfolio metrics remained stable during the period with the portfolio value increasing by 22.5% primarily through industrial acquisitions. The Botanicca 9 office building in Richmond VIC remains unleased and remains a key focus for GDF to lease up, accounting for 14% portfolio vacancy.

FY20 guidance was maintained with management looking to maintain distributions flat at 9.0cps. The payout ratio is expected to be 110%, implying FFO of 8.2 cps for FY20, which is 5.7% below the 8.7 cps delivered in FY19. The earnings and distribution guidance assumes Botanicca 9 remains vacant for FY20.

- **Funds From Operations (FFO)** of $7.7M increased by 19.3% over the prior corresponding period, driven by net acquisitions, completed projects and strong leasing activity. FFO per security fell slightly after taking into account an increase in securities on issue. Units on issue increased through the internalisation of GDF's management function as well as equity raisings to fund acquisitions over the period.
- **Portfolio metrics:**
  - **Occupancy levels** remained at 83%, primarily due to the vacancy at Botanicca 9 (588A Swan St, Richmond VIC), which management hope to lease up over the coming period. Excluding Botanicca, GDF would see occupancy levels of 97% on the remainder of the portfolio.
  - **Portfolio WALE** of 5.6 years was up on the previous corresponding period (of 5.3 years), reflecting the strong leasing activity carried out by GDF over the period. In particular, 21,997 sqm of portfolio NLA (or 15%) was leased with 11,404 sqm under negotiation/discussion. As such, GDF sees only 8% of lease expiries (excl. current vacancies), due before FY22.
  - **The investment portfolio** increased to $407.6M (from $332.8M at June 2019). Key movements during the period included:
    - **Acquisitions of 326 & 340 Thynne Road, Morningside** for $41.0M in September 2019. The portfolio comprises two warehousing and distribution facilities which include surplus land of 7,500 sqm (valued at $4.5M). The initial yield was 5.85% on total purchase price and 6.57% excluding the surplus land value. The larger asset is able to be expanded by 5,872 sqm, with a development approval in place. The assets were acquired with a 3.35-year WALE, however, one tenant has exercised a 3-year option post-balance date, extending the WALE to 5 years.
    - **Acquisition of four industrial properties in Acacia Ridge and Archerfield** for $31.0M (plus costs). The transaction was funded through debt facilities, a placement to vendors of 4.4M fully paid units at $1.36 per unit and $17.3M of proceeds from the sale of a commercial asset in Murarrie. GDF have advised they are well advanced with development plans for potential tenants at these locations.
    - **GDF's development pipeline progressed** with the construction of a new industrial facility in Berrinba QLD. The facility will provide approximately 5,500 sqm of warehouse and office space, totaling $6.5M and due for completion in mid-2020. Further projects are expected to commence in 2H20, including Stage 1 of Acacia Ridge and developments in Wacol QLD. These projects are due for completion in mid to late 2020.
- **Gearing** increased to 34.6% (from 32.5%) during the period, at the top end of GDF's target range of 30% - 35%. The increase is a result of debt funding used to complete the acquisitions of the Acacia Ridge and Morningside portfolio. Subsequent to the results GDF advised that its has restructured its debt facilities, increasing the debt facility limit to $200M (from $180.7M) with a new weighted average debt duration improve of 3.0 years. Drawn debt at 31 December 2019 was $168.1M, which has since increased to $178.1M (at 4 March 2020) to facilitate the repayment of a syndicate loan acquired as part of the stapling with the Manager. A total of $100M of the loan is hedged.
- **During the half year period, GDF internalised its management function**, through the stapling of GARDA Diversified Property Fund and GARDA Holdings Limited to form a new entity GARDA Property Group (ASX: GDF was retained). This had the effect of eliminating management fees and reducing

costs. The internalisation was formally completed on 29 November 2019. Net Tangible Assets (NTA) decreased 9.1% to $1.19 per unit, as a result of the internalisation of management.

- **Management has advised that its focus for FY20** will be on: 1) Completing the leasing of Botanicca 9, expected to deliver approximately $4.0M p.a. in net income on a fully leased basis, and 2) Advance the development pipeline through progressions at Berrinba (construction to be completed), Wacol Building C (achieve development approval and commence construction) and Acacia Ridge Stage 1 (progress re-development options and leasing outcomes)
- **FY20 Guidance** was reaffirmed with distributions maintained at 9.0 cps. The FY20 payout ratio is expected to increase to 110% of earnings on the basis that Botanicca 9 remains unleased for the full year. This implies FFO per security of 8.2 cps.

Financial Forecasts

We have updated our financial forecasts for GDF to include:

- 1H20 reported results and updated management guidance.
- Recent acquisitions and development.
- We are now forecasting Botanicca 9 to be gradually leased up from December 2020 until June 2021. Our previous assumption was for the building to be fully leased by July 2020.
- We have updated our forecasts to include the impact of the internalisation of GDF's Responsible Entity and Manager.

Our DCF valuation has reduced to $1.39 per unit (previously $1.46 per unit). Our 12-month target is $1.45 per unit (previously $1.56 per unit).

Portfolio Metrics

The following table is a summary of GDF's portfolio at 31 December 2019.

GDF Property Portfolio - as at 31 Dec 2019

Property	Valuation $M		Capitalisation Rate %		Occupancy %		WALE (years)	
	Dec19	Jun19	Dec19	Jun19	Dec19	Jun19	Dec19	Jun19
7-19 Lake Street, Cairns QLD (including land at 26-30 Grafton St, Cairns QLD)	$58.0M	$57.0M	8.25%	8.25%	93%	97%	3.2	3.6
154 Varsity Parade, Varsity Lakes QLD	$12.5M	$12.8M	8.25%	8.25%	82%	83%	2.4	2.6
142-150 Benjamin Place, Lytton QLD	$9.8M	$9.5M	7.00%	7.00%	100%	100%	1.4	1.9
436 Elgar Road, Box Hill VIC	$32.0M	$31.5M	6.25%	6.25%	100%	100%	7.9	3.4
572-576 Swan Street, Richmond VIC	$53.5M	$53.0M	5.75%	5.75%	100%	100%	3.9	4.4
69-79 Diesel Drive, Mackay QLD	$30.0M	$30.0M	7.50%	7.50%	100%	100%	9.0	9.5
41 Bivouac Place, Wacol QLD	$39.0M	$35.3M	5.75%	6.25%	100%	100%	8.5	9.0
70-82 Main Beach Road, Pinkenba QLD	$20.0M	$20.0M	6.75%	7.00%	100%	100%	13.6	14.1
588A Swan Street, Richmond VIC (Botanicca 9)	$59.0M	$62.8M	5.75%	5.75%	0%	0%	NA	NA
67 Noosa Street, Heathwood QLD	$11.25M	$10.5M	6.75%	7.25%	100%	100%	8.2	8.8
1-9 Huntress Road, Berrinba QLD	$3.1M	$3.0M	NA	NA	NA	NA	NA	NA
498 Progress Road, Wacol QLD	$6.3M	$6.5M	NA	NA	NA	NA	NA	NA
326 & 340 Thynne Rd, Morningside QLD	$41.0M		5.75%		100%		5.0	
38 Peterkin St, Acacia Ridge QLD	$6.0M		7.50%		100%		0.7	
56 Peterkin St, Acacia Ridge QLD	$6.7M		7.25%		NA		NA	
69 Peterkin St, Acacia Ridge QLD	$10.9M		7.25%		NA		NA	
839 Beaudesert Rd, Archerfield QLD	$6.0M		7.50%		92%		1.5	
Capital Expenditure post valuation	$1.0M	$1.0M	NA	NA	NA	NA	NA	NA
Total Portfolio	**$405.1M**	**$332.8M**	**6.60%**	**6.79%**	**84%**	**97.8%**	**5.6**	**6.4**

Source: GDF

Appendix: Financial Summary

GARDA Property Group (ASX: GDF)

Profit & Loss	FY19A	FY20F	FY21F	FY22F
Operating Revenue	25.0	28.6	34.1	36.6
Property Expenses	-5.9	-7.1	-8.5	-9.2
Net Property Income	**19.0**	**21.5**	**25.6**	**27.5**
Other Income & Expenses	-2.3	-3.3	-4.1	-4.3
RE Fees	-2.1	0.0	0.0	0.0
EBITDA	**14.6**	**18.2**	**21.4**	**23.1**
Depn & Amort	0.0	0.0	0.0	0.0
EBIT	**14.6**	**18.2**	**21.4**	**23.1**
Net Interest	-2.8	-3.4	-3.7	-3.7
Pre Tax Profit	**11.8**	**14.8**	**17.7**	**19.4**
Tax	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
NPAT - adj	**11.8**	**14.8**	**17.7**	**19.4**
Non Recurring Items	17.0	-7.7	0.0	0.0
NPAT - Statutory	**28.8**	**7.1**	**17.7**	**19.4**

Summary	FY19A	FY20F	FY21F	FY22F
NPAT - adj	11.8	14.8	17.7	19.4
Price Earnings Multiple	20.5	16.3	13.7	12.5
Revenue Growth	27.2%	16.7%	16.4%	7.4%
EBIT Growth	22.2%	24.5%	17.6%	7.9%
Value of Properties	332.8	437.9	453.8	470.2
Net Assets	217.1	268.7	280.3	294.6
NTA per Unit	$1.37	$1.33	$1.39	$1.46
Prem(Disc) to NTA per unit	-12.4%	-9.8%	-13.6%	-17.8%
DPU	9.0	9.0	9.0	9.0
Payout Ratio		109.2%	102.5%	94.0%
DPU Growth		0.0%	0.0%	0.4%
Yield	7.5%	7.5%	7.5%	7.5%

Cashflow	FY19A	FY20F	FY21F	FY22F
Operating Activities	24.6	21.9	26.6	28.5
Net Interest	-4.0	-4.6	-3.7	-3.7
Tax Paid	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Operating Cashflow	**20.6**	**17.3**	**22.9**	**24.8**
Capex	-9.1	-6.7	-6.1	-6.1
Maintainable Operating CF	**11.5**	**10.5**	**16.8**	**18.7**
Distributions	-13.4	-20.1	-18.2	-18.3
Acquisitions	-45.9	-68.0	0.0	0.0
Disposals	16.4	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Free Cashflow	**-31.4**	**-77.6**	**-1.4**	**0.4**
Change in Debt	22.8	39.0	8.4	5.8
Change in Equity	24.2	30.9	0.0	0.0
Net Cashflow	15.7	-7.7	7.0	6.2

Key Ratios	FY19A	FY20F	FY21F	FY22F
EPU (adj)	7.5	8.2	8.8	9.6
EPU - Reported	18.2	4.0	8.8	9.6
EPU (adj) - Growth		10.5%	6.5%	9.5%
LVR	38.5%	40.4%	39.0%	37.6%
Net Debt/(Net Debt + Equity)	33.2%	37.3%	36.8%	36.0%
Net interest Cover	5.2	5.4	5.8	6.2
Distn / Maintainable CF	116.3%	190.6%	108.5%	97.7%
ROE	5.6%	5.5%	6.7%	6.6%

Balance Sheet	FY19A	FY20F	FY21F	FY22F
Cash	20.2	17.1	13.8	11.3
Debtors	1.4	1.5	1.9	1.9
Investments	0.0	0.0	0.0	0.0
Other Assets	334.7	437.9	453.8	470.2
Total Assets	**356.3**	**456.5**	**469.5**	**483.4**
Creditors	4.2	3.8	4.7	4.7
Borrowings	128.3	176.9	176.9	176.9
Provisions	0.0	0.0	0.0	0.0
Other Liabilities	6.7	7.0	7.5	7.1
Total Liabilities	**139.2**	**187.8**	**189.2**	**188.8**
Net Assets	**217.1**	**268.7**	**280.3**	**294.6**

Valuation		
Discount Rate	9.0%	
Terminal Growth Rate	2.5%	
DCF Valuation per Share	$1.39	
12 Month Target Price	**$1.45**	DCF rolled forward 12 mths
12 month Dividend Yield	7.5%	
12 month Target Price	20.8%	
Total Est. 12 mth return	**28.3%**	

Note: GDF became a stapled security on 29 November 2019. The results for FY19 reflect the listed trust only.
Gearing = (net debt – cash) / (net debt – cash + net assets). Source: Core Property forecasts

Ratings Process for A- REITs

Core Property Research evaluates recommendations on listed A-REITs continuously, based on a range of qualitative and quantitative criteria ranging from management, appropriateness of the A-REIT's capital structure and the property portfolio metrics. From a quantitative perspective, Core Property's recommendations are based on Total Expected Returns (forecast distribution yield plus forecast capital gain or loss) for a 12-month time horizon, using a range of valuation methodologies. The two most commonly used valuation techniques are Discounted Cash Flow (DCF), which uses an A-REI's expected free cash flow, and the net Asset Valuation (NAV) approach.

The 12-month Total Return is compared with set total return bands and assigned a 12-month recommendation based on the Recommendation Definitions below.

Recommendation Definitions

Recommendation	Definition
Buy	If the 12-month Total Expected Return is forecast to be 15% or more.
Accumulate	If the 12-month Total Expected Return is forecast to be at least 10% and less than 15%.
Hold	If the 12-month Total Expected Return is forecast to be at least 5% and less than 10%.
Reduce	If the 12-month Total Expected Return is forecast to be at least 0% and less than 5%.
Sell	If the 12-month Total Expected Return is forecast to be less than 0%.

At times of extreme volatility, it is quite possible that the recommendations will swing between each of our bands. During such times, Core Property will adopt a more flexible approach to recommending stocks, based on a slightly longer duration, and as such, recommendations may appear to be inconsistent when compared with the bands. This is to avoid clouding value judgments with short-termism.

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