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Listed Property

Centuria Industrial REIT
(ASX Code: CIP)

11 February 2021

Catching the industrial sector tailwinds

Centuria Industrial REIT (ASX: CIP)

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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.

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ACCUMULATE

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:	5.5%
Forecast 12 Month Capital Return:	6.2%
Total Expected Return:	**11.7%**

Company Data	
ASX Code:	CIP
Price:	$3.06
Market Capitalisation:	$1,685M
Securities on Issue:	550.7M
52 Week Range:	$2.11 - $3.795

- *Strong start to FY21 with transformational acquisitions improving portfolio metrics.*
- *Achieved 98% of total rent collection through the COVID period.*
- *FY21 forecast distributions of 17.0cpu, backed by FFO guidance of no less than 17.6cpu.*
- *Industrial sub-sector thematics remain attractive for institutional investors.*
- *FY21F distribution yield of 5.5% and trading at a small premium to NTA.*

Transformational acquisitions – CIP has executed close to $700M of acquisitions since the start of FY21. Assets acquired have very good metrics and improves the quality of the portfolio. Occupancy is around 97%, Weighted Average Lease Expiry (WALE) is close to 10 years, and the tenancy quality has improved post the acquisitions. Core Property believes these metrics jettison CIP into a leading pure play Australian industrial and logistics A-REIT exposure for investors. Upcoming lease expiries over the next two financial years is less than 10% of the portfolio thereby underpinning a view of predictable and sustainable earnings.

Robust financial metrics: Despite a flurry of activity, CIP has a conservative balance sheet with gearing of 29.6% and interest cover of 5.8x. This should allow some flexibility for future acquisitions or development opportunities.

The industrial sector remains in high demand as investors continue to position their capital to take advantage of a renewed focus on logistics and distribution centres. CIP reported capitalisation rates compression of 36 bps on its existing properties during the six-month period resulting in revaluation gains just over $100M.

Outlook and FY21 Guidance: Management continues to focus on active leasing and asset management to ensure existing income streams are protected and enhanced. FY21 earnings guidance has been upgraded to be no less than 17.6 cpu (previously 17.4 cpu). We expect this will be achievable on the basis: 1) half the amount, 8.8 cpu, has already been delivered in the first half, 2) rent collections have ticked up to 98% (from 97%), and 3) prior acquisitions contributing to second half earnings. FY21 distributions of 17.0 cpu was reiterated.

At current price levels CIP is trading at around a small premium of 2.3% to its NTA of $2.99 per unit, with a forecast distribution yield of 5.5% for FY21. Core Property has a 12-month price target for CIP of $3.25 per unit based on our DCF valuation. Any weakness as a result of broader market volatility presents investors with a good opportunity to get set in CIP. The broader thematic of strong demand for industrial property from offshore and investors also supports our view of the industrial property sector outperforming the office and retail sectors.

Share price performance

Source: IRESS

Year Ended 30 June	FY20A	FY21F	FY22F	FY23F
NPAT - Reported - $M	75.3	83.5	97.5	100.5
NPAT – FFO basis - $M	62.5	83.5	97.5	100.5
Price/Earnings Ratio	16.4	17.4	17.3	16.8
FFO per unit - cents	18.6	17.6	17.7	18.3
FFO per unit - Growth	6.1%	5.5%	5.6%	5.6%
DPU - cents	18.7	16.9	17.0	17.2
Distribution Yield	6.1%	5.5%	5.6%	5.6%
NTA per unit	2.8	2.9	2.9	2.9
Gearing	28%	32%	33%	33%

Source: Core Property estimates

Key Metrics

Strategy
Deliver income and capital growth to investors from a portfolio of high quality Australian industrial assets; by - Focusing on 'fit for purpose' assets that are relevant to a quality customer base - Anticipating and meeting the needs of customers to ensure high retention and occupancy - Re-positioning assets to maximise value to unitholders.

Board & Management
Board of the RE consists of independent Chairman (Roger Dobson) plus three independent directors with extensive property and financial services experience (Nicholas Collishaw, Peter Done, Natalie Collins). **Senior Management** includes Jason Huljich (Joint CEO), Ross Lees (Head of Funds Management) and Jesse Curtis (Fund Manager).

Portfolio

Metric	Dec 20
No of Properties	59
Valuation	$2,399M
Portfolio Capitalisation Rate	5.42%
Locations	Australia
Sector	Industrial (100%)
WALE (by income)	9.8 years

Key Properties (by value)

Dec 20	% Portfolio
Telstra Data Centre Complex Clayton VIC	17.3%
46 Robinson Road East Virginia QLD	10.2%
2 Woolworths Way, Warnervale NSW	3.8%
67-69 Mandoon Road, Girraween	3.0%
10-12 Williamson Rd, Ingleburn NSW	2.4%
Top 5	**36.7%**

Tenant Composition (by income)

Dec 20	% Portfolio
ASX listed	28%
Multinational	25%
National	32%
Govt.	1%
Other	14%
Total	**100%**

Geography

Dec 20	% Portfolio
NSW	24%
Queensland	28%
Victoria	37%
SA & ACT	4%
WA	7%
Total	**100%**

Debt	Dec 2020
Gearing	29.6%
Target Gearing	<40%
Drawn Debt	$734M
Facility limit	$880.0M
Weighted Average Cost of Debt	2.73%
Weighted Average Debt Maturity	3.3 years
% Hedged	55.9%
LVR (on drawn debt)	30.6%
ICR	5.8x

Expenses	Dec 2020
RE Remuneration Fee	0.60% of GAV[1]
Direct Property Expenses	17.5% of gross income
Management & Other Expenses	1.6% of gross income

Note 1: The Manager is entitled to a Management Fee of 0.65% p.a. of GAV, but has elected to charge 0.60% p.a.

Historical	FY18	FY19	FY20
EPU – FFO per Unit	19.5	19.3	18.9
DPU – Distributions per Unit	19.4	18.4	18.7
Payout Ratio	99%	95%	99%
Distribution Frequency	Qtrly	Qtrly	Qtrly
NTA per Unit	$2.56	$2.73	$2.82

Key Points from the 1H21 result and operating update

COVID-19 Impact: Over the period, the industrial sector has continued to accelerate due to the growth of online sales (32% over last 12 months) and the direct correlation of businesses requiring more fulfillment centres, logistics and cold storage units. Faster delivery expectations from consumers have driven acquisitions of high value, key metropolitan sites capable of meeting these expectations. The transaction volumes of Sale and Leasebacks have increased because of businesses looking to free capital, presenting opportunities of high valued, strong tenanted properties becoming available. As a result, CIP has performed strongly despite challenging conditions, collecting 98% of rents in 1H21, (up from 97% in the June 2020 quarter). Total rental waivers of $0.8M were provided in 1H21, a reduction from the $1.0M provided in the June 2020 quarter.

Funds from Operations (FFO) reduced to 8.8 cpu for 1H21, a decline of 11.1% on the prior corresponding period. The decline was largely due to acquisitions undertaken by CIP to diversify and strengthen the portfolio. New units were issued in September and December 2020 to fund the acquisitions, which are dilutive to earnings in the short term, until the full year earnings benefit of the acquisitions are included.

1H21 Results to 31 December 2020

1H21 results	1H21	1H20	Change
Earnings			
Statutory Net Profit after tax[1]	**$99.6M**	$31.5M	+216.2%
Funds from Operations (FFO)	**$42.8M**	$30.0M	+42.7%
Distribution	**$45.0M**	$30.3M	+48.5%
FFO per unit	**8.8 cpu**	9.9 cps	-11.1%
Distribution per unit	**8.5 cpu**	9.4 cps	-9.6%
Payout ratio	**96.9%**	94.9%	+2.0%
Movement over 6 months	**As at Dec 2020**	**As at Jun 2020**	**Change**
Balance Sheet			
NTA per unit	**$2.99**	$2.82	+6.0%
Gearing %	**29.6%**	27.2%	+2.4%
Cost of debt[2]	**2.7%**	3.4%	-0.7%
Weighted average debt maturity	**2.8 years**	3.3 years	-0.5 years
Borrowings	**$733.5M**	$454.4M	+61.4%
Portfolio			
Property Valuation	**$2,399M**	$1,602M	+49.7%
Occupancy rate	**97.7%**	97.8%	-0.1%
Number of properties	**59**	50	+9 properties
Weighted Average Capitalisation Rate	**5.42%**	6.05%	-63 bps
WALE (Weighted Average Lease Expiry)	**9.8 years**	7.2 years	+2.6 years

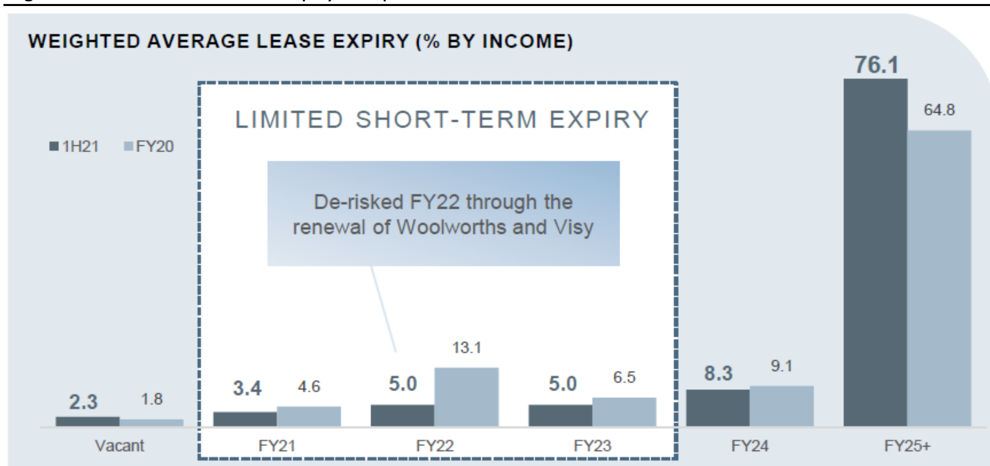
Source: CIP, Core Property Note 1: Statutory Net Profit after Tax includes mon-cash items which distorts operating income
Note 2: Including weighted average swap rate, facility establishment and all-in margins (base & line fees).

The Property portfolio metrics are robust:

- **Occupancy levels** marginally decreased to 97.7% from 97.8%, with 140,074 sqm of lease terms agreed during the half year period (representing 13% of the portfolio). CIP has around 8.5% of the portfolio expiring in the 18 months to FY22.
- **Portfolio WALE** increased to 9.8 years, a 2.6-year increase from June 2020. The portfolio benefitted from 9 acquisitions which were undertaken on an average WALE of 19-years including the Telstra Data Centre Complex, Clayton VIC with a WALE of 29.7 years.

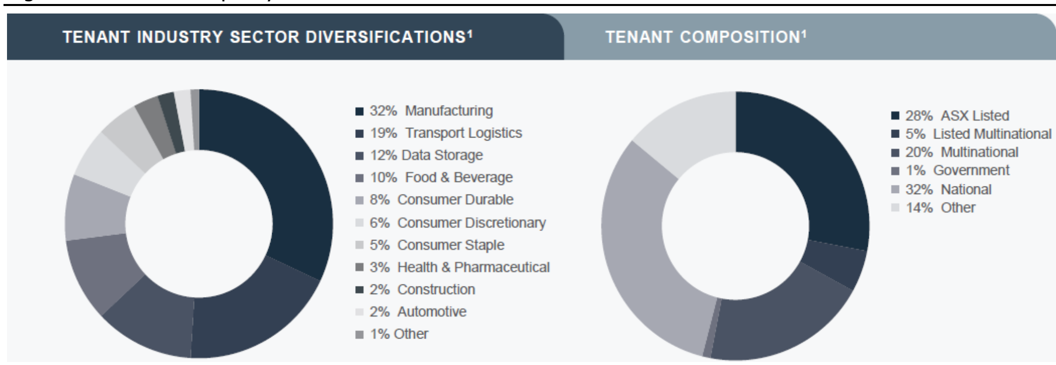
- **Portfolio valuation** increased to $2,399M (up 49.7% from $1,602M at June FY20) uplifted by the $694.0M of acquisitions and divestments of $40.0M. The portfolio capitalisation rate reduced by a significant 63 bps to 5.42%. Around 36 bps was attributable to valuation movements as the demand for industrial properties continued to increase throughout 2020. The remaining 27 bps movement was due to acquisitions impacting the overall portfolio capitalisation rate. 29 of the 59 assets were externally valued at December 2020.
- **Major leasing** activity included the renewed lease to Visy at Warwick Farm, NSW creating a 20% increase in value following the 10-year lease extension, and the 17% value increase in the Arnott's properties in QLD and SA.
- **Diversification:** CIP's acquisitions have provided strong diversification across key-sub sectors of the industrial sector. Most notably, the acquisitions of the Telstra Data Centre Complex in Clayton, VIC as well cold storage facilities in NSW, QLD and VIC have provided improved diversification into highly sought after sectors with strong tenant covenants.

Figure 2: Limited short-term expiry is a positive



Source: Company reports

Figure 3: diversified quality tenant base



Source: Company reports

Financial Forecasts

We have updated our financial forecasts to include the 1H21 results, asset transactions, and securities on issue. This also includes:

- Management guidance for FY21 earnings of no less than 17.6 cents per unit, and distributions of 17.0 cents per unit, representing a 97% payout ratio;
- Earnings and distributions are calculated on the weighted average units on issue; and
- Our forecasts are based on an "as is" portfolio and assumes around $50M of acquisitions on an ongoing basis.

Figure 4: Earnings Summary and forecasts

Financial Forecasts - $M	**FY20A**	**FY21F**	**FY22F**	**FY23F**
Net Property income	**90.6**	126.5	144.3	148.0
Management fees	**-8.7**	-13.4	-14.6	-14.7
Other recurring income and expenses	**-2.5**	-3.3	-4.9	-4.9
EBIT	**79.4**	**109.8**	**124.8**	**128.4**
Net interest	**(16.9)**	(26.3)	(27.3)	(27.8)
Operating NPAT	**62.5**	83.5	97.5	100.5
Weighted average units on issue (M)	**335.6**	475.5	550.8	550.8
Operating EPS (cents)	**18.6**	17.6	17.7	18.3
DPS cents	**18.7**	16.9	17.0	17.2

Source: Core Property forecasts

Valuation

Core Property has a 12-month price target for CIP of $3.25 per unit based on a DCF Valuation rolled forward by 12 months. We calculate our DCF valuation using a Discount Rate of 7% and terminal growth rate of 2.5%. Relative to current trading price, Core Property believes CIP presents as a good opportunity to **ACCUMULATE**. The recent history of acquisitions, significant improvements to the portfolio metrics, the persistence of a low for longer interest rate environment, and the strong demand for industrial assets supports our thesis.

Appendix: Financial Summary

Current price	$3.06

Year to June	2020A	2021F	2022F	2023F
Net Property income	90.6	126.5	144.3	148.0
Mangement fees/ admin costs	(11.2)	(16.7)	(19.5)	(19.7)
EBIT	79.4	109.8	124.8	128.4
Net Interest	(16.9)	(26.3)	(27.3)	(27.8)
Pre-tax profit	62.5	83.5	97.5	100.5
Tax expense	-	-	-	-
Minorities	-	-	-	-
NPAT (adj)	**62.5**	**83.5**	**97.5**	**100.5**
Non recurring items	12.9	-	-	-
Reported profit	**75.3**	**83.5**	**97.5**	**100.5**
EPS (adj) (cents)	18.6	17.6	17.7	18.3
DPS (cents)	18.7	16.9	17.0	17.2

Cashflow summary	2020A	2021F	2022F	2023F
Operating cashflow pre-interes	86.2	99.3	125.3	128.5
Interest and tax	(20.9)	(26.3)	(27.3)	(27.8)
Operating cashflow	**65.3**	**73.0**	**97.9**	**100.6**
Required capex	-	(11.9)	(18.0)	(18.1)
Maintainable cashflow	**65.3**	**61.1**	**80.0**	**82.6**
Dividends	(54.1)	(81.0)	(94.6)	(97.5)
Growth capex/disposals	(361.6)	(791.4)	-	-
Other Investing items	-	-	-	-
Free cashflow	(350.3)	(811.3)	(14.6)	(15.0)
Equity	374.6	471.0	0.3	0.4
Debt increase/(reduction)	(16.5)	340.3	14.3	14.6

Balance Sheet Summary	2020A	2021F	2022F	2023F
Cash & short term deposits	17.1	17.1	17.1	17.1
Inventories (ST)	-	-	-	-
Trade debtors (ST)	6	5	6	6
PPE, investments	1,591	2,394	2,412	2,430
Intangibles	11	11	11	11
Other assets	11	11	11	11
Total assets	**1,636**	**2,439**	**2,458**	**2,476**
Borrowings	452	793	807	822
Trade creditors	20	9	10	10
Other liabilities	25	25	25	25
Total liabilities	**497**	**826**	**842**	**857**
Minorities / Convertibles	-	-	-	-
Total shareholders equity	**1,139**	**1,613**	**1,616**	**1,619**
NTA ($)	2.82	2.91	2.91	2.92
Net debt	435	776	790	805
Ordinary Securities on issue	400	551	551	551

Key ratios	2020A	2021F	2022F	2023F
Growth:				
EBITDA growth (%)	23.3	39.7	14.1	2.6
EPS growth (%)	(0.0)	(0.1)	0.0	0.0
Liquidity and leverage:				
Net debt/equity (%)	38%	48%	49%	50%
Net debt/(net debt + equity	28%	32%	33%	33%
Net interest cover (x)	4.7	4.2	4.6	4.6
Dividend cover:				
EPS / DPS (x)	1.00	1.00	1.00	1.00
Maint cashflow / div paid (	1.21	0.75	0.85	0.85
Payout ratio (%)	100.0	100.0	100.0	100.0
Forecast return on capital:				
Return on assets (x)	4.3%	4.1%	4.0%	4.1%
Return on equity (x)	6.6%	6.1%	6.0%	6.2%
Pricing:				
Earnings yield (%)	6.1%	5.7%	5.8%	6.0%
Enterprise value/EBIT (x)	30.2	21.8	19.2	-
Capitalisation:				
Current Market cap ($M)				
FY20 Net debt ($M)				

Summary	2020A	2021F	2022F	2023F
NPAT (AIFRS) (A$M)	75.3	83.5	97.5	100.5
NPAT (FFO basis) (A$M)	62.5	83.5	97.5	100.5
EPS (adj) (cents)	18.6	17.6	17.7	18.3
EPS change (%)	6.1%	5.5%	5.6%	5.6%
Price/earnings ratio (x)	16.4	17.4	17.3	16.8
Earnings yield (%)	6.1%	5.7%	5.8%	6.0%
DPS (cents)	18.7	16.9	17.0	17.2
Dividend yield (%)	6.1%	5.5%	5.6%	5.6%
Maintainable CF/share (ce	19.5	12.8	14.5	15.0
Maintainable CF yield (%)	6.4%	4.2%	4.7%	4.9%

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

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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