PSG Wealth

Redefine Properties Ltd.

Real estate

Company Update Report

Buy

Analyst recommendation

Counter	Share price	Intrinsic value	Difference
RDF-ZA	R4.82	R5.50	14%

November 2024

Executive summary

With the release of FY24's full-year results, we maintain our buy recommendation on Redefine Properties Limited (RDF) and upgrade our intrinsic value from R4.60 to R5.50. In the results, the following was highlighted:

- The South African Real Estate Investment Trust Net Asset Value (SA REIT NAV) increased from 766 to 788 cents per share primarily driven by property valuation uplifts.
- Distributable Income Per Share (DIPS) was down 2.90% to 50.02 cents per share, at the midpoint of FY24's guidance (-7% to +1%). The main driver was funding costs.
- The SA REIT loan-to-value (LTV) increased from 41.1% to 42.3% with the main drivers being capex and acquisitions in the year.
- The interest cover ratio (ICR) decreased from 2.4x to 2.1x and RDF has negotiated to have its covenant decreased from 2x to 1.75x for the next two periods.
- SA occupancies marginally increased primarily driven by the retail segment.
- SA rental reversions improved from -6.7% to -5.9% with office reversions being the main detractor.
- The outlook remains cautiously optimistic as the group looks forward to an upward property cycle in FY25. FY25 improvements are expected to be gradual as the effects of elevated interest rates are worked off in the current interest rate cutting cycle. DIPS are guided to be between 50 to 53 cents per share (flat to 6% growth) with a payout ratio ranging from 80% to 90%.

We maintain our view that RDF should benefit from a decrease in bond yields. Although yields have fallen by almost 130 basis points over the last year, they have yet to normalise to their long-term average. As the interest rate cycle progresses, we anticipate it to be a further driver of yield level depression.

We expect RDF to work off the impacts of higher interest rates as the cutting cycle progresses while distributable income grows. The growth is expected to be driven by improved property metrics, revenue growth and lower interest rates positively impacting finance costs.

Retail should gain from an improving consumer environment, with lowering rates and stable inflation driving occupancy improvement and positive rental reversions with improving demand. Industrial should benefit from GDP growth along with increasing e-commerce, supporting reversions and occupancy levels.

The office segment remains under pressure due to evolving demand dynamics. Although revival efforts may improve occupancies, lease renewals and reversions are likely to stay under pressure given RDF's exposure to the segment and the concentration being in Gauteng. We continue to monitor the segment as a key risk in RDF and the sector.

Valuation

We increase our intrinsic value from R4.60 to R5.50 and we maintain our buy recommendation. We expect distributable income to grow driven by improved performance in property metrics and positive impacts from interest rate cuts on finance costs. We adjust our scenario multiples to reflect continued expansion of the multiple as the RDF benefited from yield compression and improving metrics. We adjust our scenario weights as well to reflect expanded valuation levels closing in on upside potential.

What would change our minds?

- A view change to government bonds increasing, having a potential negative impact on property performance
- A deterioration in property fundamentals:
    - Office occupancies falling below 80%, reversions below -17% (worst levels in last five years)
    - Retail occupancies falling below 90%, reversions below -13% (worst levels in last five years)
    - Industrial occupancies falling below 90%, reversions below -7% (worst levels in last five years)

Table 2: Qualitative summary

Factor review	Rating	Description
Growth		We expect revenue growth of 5% for the FY25 period driven by the improving reversions across its assets. Office remains a highlighted risk. We also forecast an expansion in distribution of 3%, close to the midpoint of management's guidance.
Valuation		We have an intrinsic value of R5.50 with an upside of 14%.
Dividend yield		RDF trades with an 8.95% dividend yield.
Issuance		Share dilution over the last five years has been 24% primarily driven by a capital raise to fund the purchase of the Polish business, EPP.
Catalyst	Bond yield levels decreasing from the current 10.58% towards the long-term average of 9.55%.	
Quality of earnings		We rank RDF's quality of earnings as low primarily because of the impact fair value adjustments have on the bottom line not just in RDF but across the property sector as a whole.
Management and governance		The average tenure for management in the company is seven years. The team has decreased the LTV levels from their highs of 2020, executed the Polish expansion successfully but have had to negotiate a reduction in their covenants for ICR>
Balance sheet		RDF has an interest cover ratio of 2.1x with an LTV of 42.3%. The group has less than 10% of debt maturing in FY25. RDF has negotiated to reduce its ICR covenant from 2x to 1.75x for the next two periods.
Risks	RDF has material ***exposure to Office*** which is a risk because of a structural change in demand for office space. ***Demand indicated by rental reversions*** has remained negative for SA Office and SA Retail with SA Industrial being the only segment in the positive.	
Regulation		RDF complies with REIT regulations and raises no immediate regulatory concerns.
ESG		RDF has a FactSet ESG score of 72/100.
Momentum price		RDF has positive price momentum.
Momentum earnings		RDF has positive earnings momentum.

Source: PSG Wealth

RDF FY24 results

RDF's FY24 results showcased performance within management's guidance. Group property revenue was up by 8% for the period driven by retail, industrial, specialised and the performance of Poland. The only detractor was office which was down about 1% for the period. FFO was down 5% for the period with distributable income per share down 3%, at the midpoint of management guidance of between 1% growth and a 7% decline. Dividends followed suit to FFO, also down 3% with a payout ratio of 85% for the year maintained.

The ICR was down from 2.4x to 2.1x over the period. RDF has also negotiated to reduce its covenant from and ICR of 2x to 1.75x from 31 August 2024 to 31 August 2026. Management anticipates pressure on the multiple and the negotiation lends them headroom. The LTV increased from 41.1% to 42.3% primarily driven by capex as well as acquisitions throughout the year. The bulk of the acquisition impact was from the Mall of the South transaction.

Occupancies in the SA portfolio were up by 20 basis points. Improvement was noted in both retail and office, though marginal in office, with industrial occupancies falling by 70 basis points over the period. Reversions in the SA portfolio improved from -6.7% to -5.9% with retail pivoting to positive territory, industrial continuing to see improvements in the metric and office faltering from -12.1% to 13.9% in the period. The office segment remains one of the main areas of concern for RDF despite being primarily exposed to P- and A-grade assets. The Polish portfolio continues to perform well with occupancies at high levels and rental reversions in the current period being positive.

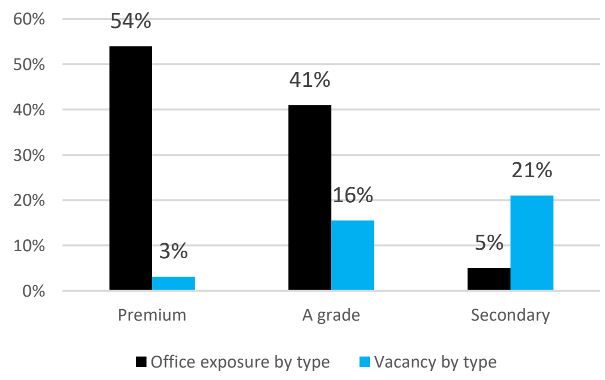
Guidance for FY25 has pivoted to positive with DIPS expected to be flat to up 6% versus prior year's guidance of a DIPS expected to be up 1% or down 7%. RDF's outlook for FY25 is positive, expecting the year to showcase an upward cycle in property as the negative impacts of elevated interest rates on finance costs and distributions are worked off.

Table 3: Results summary

	FY23	*FY24*
Property revenue (R'm)	9 908	10 656
SA REIT FFO (R'm)	3 629	3 465
Distributable income per share	51.53	50.02
Dividends per share	43.8	42.52
Payout ratio	85%	85%
Interest cover ratio	2.4x	2.1x
Loan-to-value	41.1%	42.3%
SA portfolio:	FY23	FY24
Occupancies:		
Portfolio	93.0%	93.2%
Retail	93.6%	95.0%
Office	88.6%	88.8%
Industrial	95.2%	94.5%
Rental reversions:	FY23	FY24
Portfolio	-6.7%	-5.9%
Retail	-4.1%	0.2%
Office	-12.1%	-13.9%
Industrial	2.1%	5.5%
Polish portfolio	FY23	FY24
Occupancies		
Core EPP	98.4%	99.1%
ELI	92.5%	93.4%
Rental reversions	FY23	FY24
Core EPP	-7.2%	0.2%
ELI	6.0%	0.9%

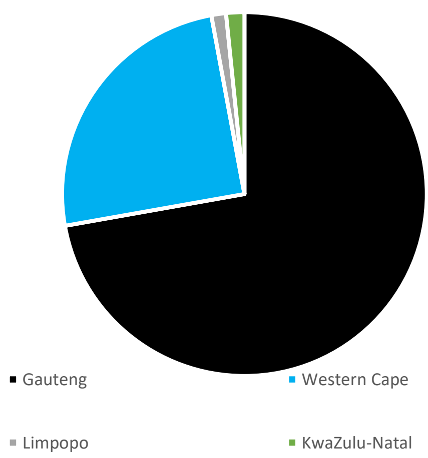
Source: company AFS

Graph 1: Office exposure & vacancies by type



Source: Company AFS

Graph 2: Office exposure per province by GLA



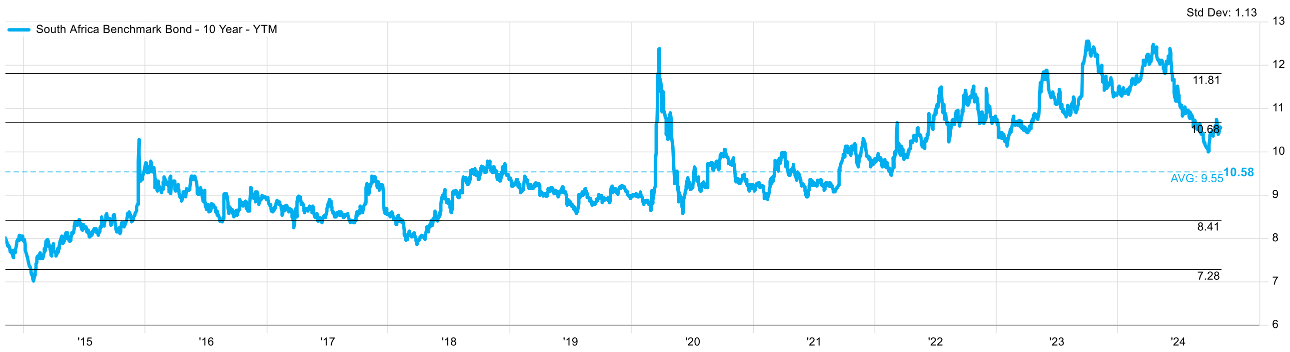
Source: Company AFS

Outlook

Our outlook on bond yields has not changed since the last report. Since then, yield levels have marginally depressed. We saw yields move from 10.60% at the end of August, to as low as 10.03 at the end of September to its current level of 10.58%. RDF's share price in the same period has only increased by 1.26%. We remain positive on the sector and RDF as we expect a normalisation of yield levels to their long-term average catalysed by the interest rate cutting cycle we have recently entered.

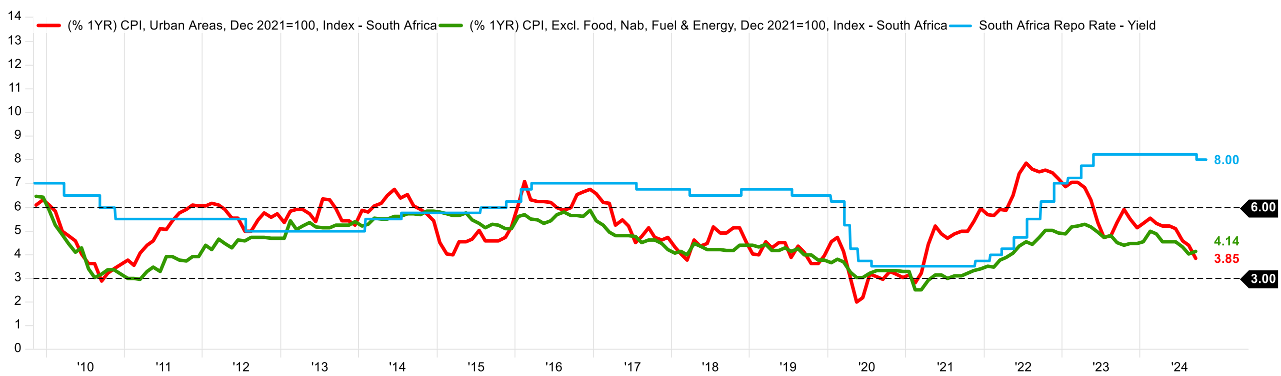
We acknowledge that there is a narrowing of yield levels relative to their long-term average, however due to our expectation of a further depression- we remain positive on RDF. The runway for growth in distribution is further bolstered by the cutting cycle and the cycling out of the negative impact on finance costs and distribution that high interest rates have had thus far. Our optimism is supported by RDF's view of an upcycle in FY25 for the property sector along with guidance in distributions indicative of a positive turnaround.

Graph 3: SA 10-year bond yield



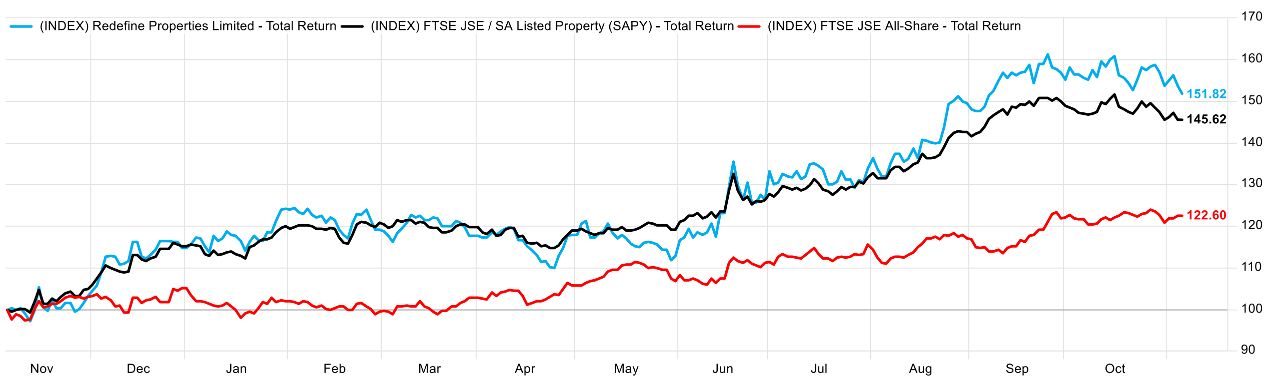
Source: FactSet

Graph 4: Inflation and repo rate



Source: FactSet

Graph 5: RDF, SAPY and ALSI indexed 1-year total returns



Source: FactSet

Valuation

We value RDF using a product of our forecasted FY26 FFO/s and an expected range of P/FFO multiples discounted to compute our intrinsic value. Since the last report, we have updated our model to include FY24's results. The impact has been an increase in our intrinsic value driven by:

- An expectation of further uplift in valuation multiples off the back of continued yield level depression
- A work off of the negative impacts of elevated interest rates on finance costs and distributions
- The continued disposal of non-core assets to focus on core revenue generating assets

We acknowledge the following risks as ongoing items of concern that are included in our assumptions and continually assess for material change that could impact our view:

- ICR decreased from 2.4x to 2.1x along with the covenant being relaxed from 2x to 1.75x
- Office reversions have not taken a turn as of yet and are expected to be worse in FY25 given a large upcoming renewal

Our initial investment thesis focused on an expectation of outperformance as a combination of a positive inflection point in property metrics and a depression in bond yield levels. We have seen yields depressing over the last 12 months along with inflection points in property metrics with the exception of office. Office remains a risk with RDF's exposure primarily in Gauteng. Reaching the inflection point is taking longer than anticipated from a renewals point of view but the rest of the business gives us confidence.

We expect revenue in FY25 to grow between 4% and 6% driven by growth across segments with the exception of Office. Although exposed to mostly P- and A-grade office space, it is primarily in Gauteng within the main areas of concern. We forecast distributable income to grow 3%, in the midpoint of management's guidance for the period.

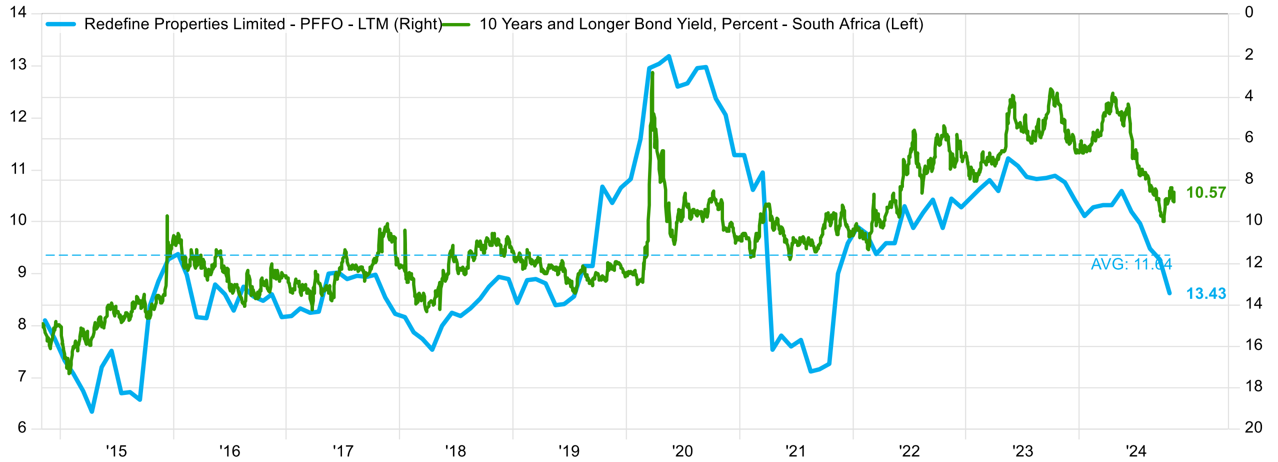
We increase our intrinsic value from R4.60 to R5.50 and maintain our buy recommendation. We adjust our scenarios to 30%, 50% and 20% for the bear, base and bull case, respectively. The adjustment takes into account that RDF's P/FFO multiple has moved materially from its 5-year average along with bond yield depression. However, the spread from current yield levels and the long-term average has narrowed, limiting the potential upside but we acknowledge that the multiple can further increase as high as 15x given the interest rate cutting cycle into which we have entered.

Table 4: Valuation

	Bear	Base	Bull	Weighted
FFO FY26 estimate	3 785	3 822	3 859	3 818
FFO/share	0.6	0.6	0.6	0.6
Price/FFO multiple	9.0x	11.0x	15.0x	11.2x
Intrinsic value	4.38	5.40	7.44	5.50
Upside/(downside)	-9%	12%	54%	14%
Scenario	30%	50%	20%	-

Source: PSG Wealth Research

Graph 6: P/FFO (Inversed) and SA 10-year bond yield



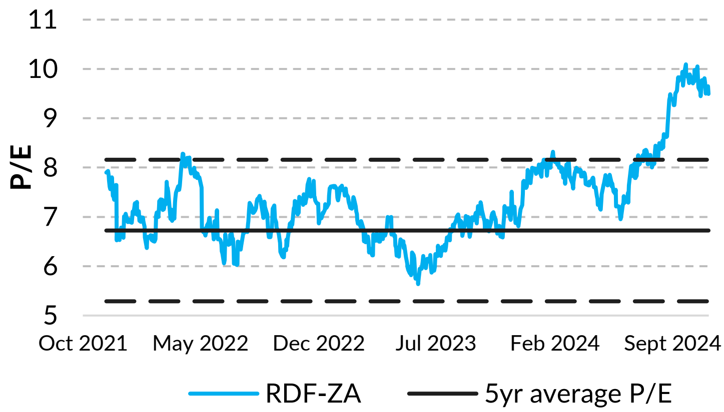
Source: FactSet

Table 5: Company data

52-week high	R5.22
52-week low	R3.26
Market value (bn)	R43.5
Price momentum	Positive
3m earnings revision	11%
Fiscal year end	2025/08/31
Beta (3Y, daily)	0.66

Source: FactSet

Graph 7: Price to earnings



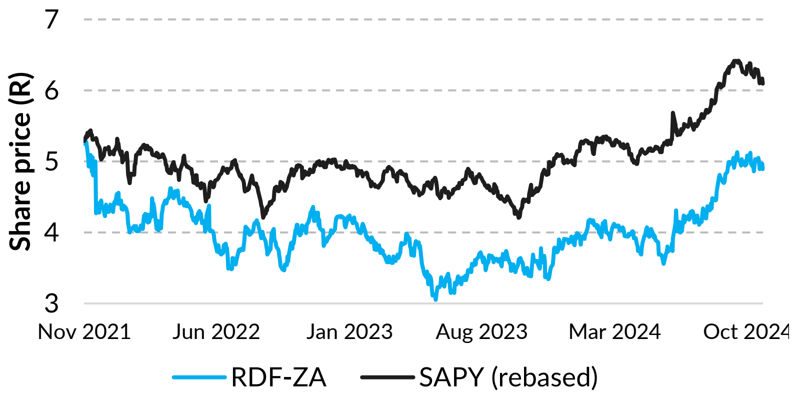
Source: FactSet

Table 6: Valuation multiples

Multiple	*Latest:* Nov-2024	*Last note:* Aug-2024
P/E	9.5x	8.5x
P/S	6.6x	6.0x
EV/EBITDA	15.5x	12.0x
EV/EBIT	-	12.0x
EV/SALES	14.6x	14.4x
Dividend yield	9.0%	9.9%
FCF yield	-	-

Source: FactSet

Graph 8: Share price history versus benchmark



Source: FactSet

Table 7: Performance versus benchmark

Period	YTD	MTD	3M	6M	1Y	2Y	3Y	5Y	10Y
Redefine Properties Limited	27.0%	0.0%	16.4%	20.1%	35.1%	19.0%	2.1%	-40.9%	-50.9%
SAPY	20.1%	0.0%	8.6%	18.5%	36.5%	31.3%	20.8%	-15.6%	-31.5%

Source: FactSet

Table 8: Key competitors

Code	Price (local)	Market Cap (Rbn)	Sales FY0 (Rbn)	EBIT FY0 (Rbn)	Net Income FY0 (Rbn)	EV/EBIT	P/E	Price % (3mo)	Price % (1YR)
RDF-ZA	4.9	34	4 925	7.1	3	10.6x	9.5x	16.4%	35.1%
GRT-ZA	13.0	44	7 960	7.3	5	17.7x	9.0x	3.3%	22.7%
BTN-ZA	9.4	8	1 857	0.9	1	19.7x	-	21.7%	22.2%
SAC-ZA	2.8	7	1 284	1.2	1	11.4x	10.3x	2.6%	40.2%

Source: FactSet

Table 9: Key financials and ratios

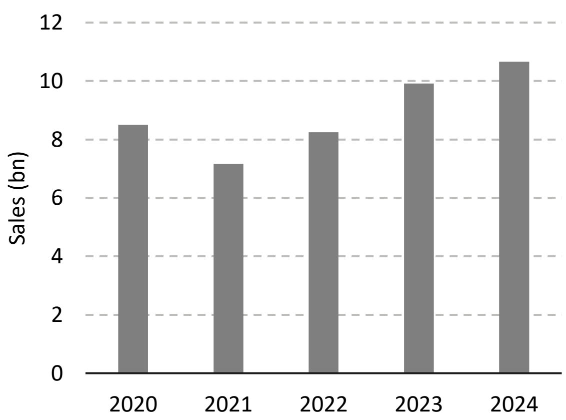
Income Statement (ZAR bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Revenue	9.2	8.5	7.2	8.2	9.9	10.7	2.90%	5.2	5.4
Y/Y growth (%)	-	*-8.0*	*-15.7*	*15.1*	*20.2*	*7.5*		*-51.4*	*4.1*
Gross Income	6.1	5.3	4.1	4.9	5.9	6.3	0.64%	-	-
Y/Y growth (%)	-	*-12.8*	*-22.6*	*17.4*	*21.1*	*7.6*		-	-
EBITDA	5.3	4.3	4.6	4.5	5.0	4.6	-2.52%	4.9	5.0
Y/Y growth (%)	-	*-18.5*	*8.2*	*-3.0*	*11.2*	*-7.6*		5.5	*3.6*
EBIT	4.6	1.7	5.7	6.5	4.9	7.1	9.19%	-	-
Y/Y growth (%)	-	*-63.0*	*234.5*	*14.3*	*-24.5*	*45.1*		-	-
Net Income	3.3	-16.2	2.9	8.7	1.4	4.0	3.50%	3.5	3.6
Y/Y growth (%)	-	*-586.1*	*-118.0*	*198.4*	*-83.4*	*174.4*		*-12.3*	*3.4*
EPS	0.6	-3.1	0.5	1.4	0.2	0.6	-0.98%	0.5	0.5
Y/Y growth (%)	-	*-595.6*	*-116.4*	*181.4*	*-84.9*	*174.4*		*-13.0*	*3.8*

Balance sheet and cash flow (ZAR bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Capex (ZAR Mn)	9.3	14.6	28.6	10.3	9.1	24.5	21.32%	-	-
Cash from operations	4.6	2.7	2.3	2.6	2.6	2.9	-8.73%	3.5	3.6
Cash and ST investments	0.4	0.4	1.5	1.8	0.8	0.5	5.46%	0.6	0.7
Total assets	102.7	82.2	75.6	92.4	99.4	101.9	-0.16%	105.0	107.1
ST debt	4.5	1.9	2.3	4.3	5.8	1.8	-16.51%	-	-
LT debt	36.7	34.9	28.5	33.5	34.9	41.5	2.48%	-	-

Ratios (ZAR bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Gross margin (%)	66.4	62.9	57.8	58.9	59.4	59.4	59.7	-	-
EBIT margin (%)	49.8	20.0	79.5	79.0	49.7	67.0	59.0	-	-
Net income margin (%)	36.2	-191.2	40.8	105.8	14.6	37.2	1.4	67.2	66.8
Total debt to equity	73.6	96.1	78.7	77.6	78.2	81.8	82.5	-	-
Total debt to assets	40.1	44.8	40.8	40.9	40.8	42.5	42.0	-	-
ROA (%)	3.3	-17.6	3.7	10.4	1.5	3.9	0.4	-	-
ROE (%)	5.9	-34.5	7.5	19.9	2.9	7.6	0.7	-	-

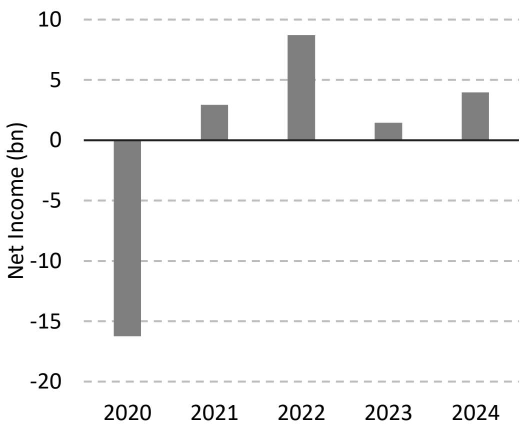
Source: FactSet

Graph 9: Annual sales



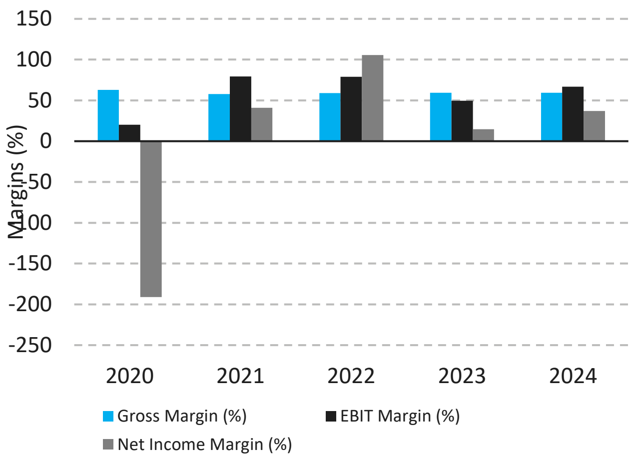
Source: FactSet

Graph 10: Annual net income



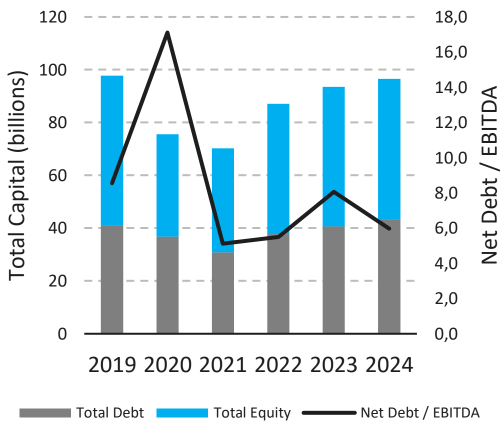
Source: FactSet

Graph 11: Gross, EBIT, net margins



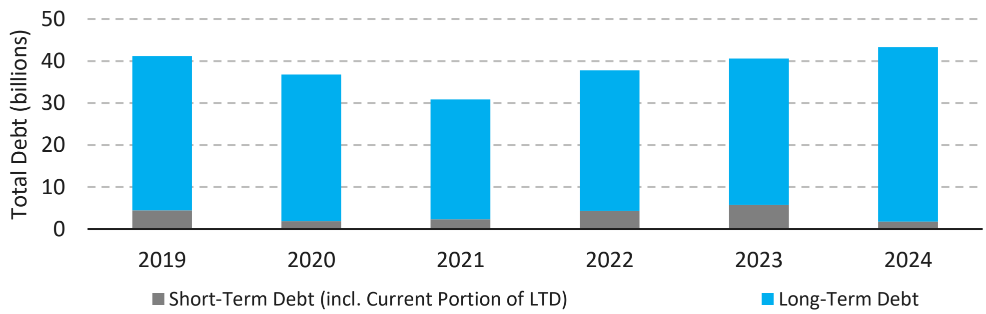
Source: FactSet

Graph 12: Capital structure & net debt / EBITDA



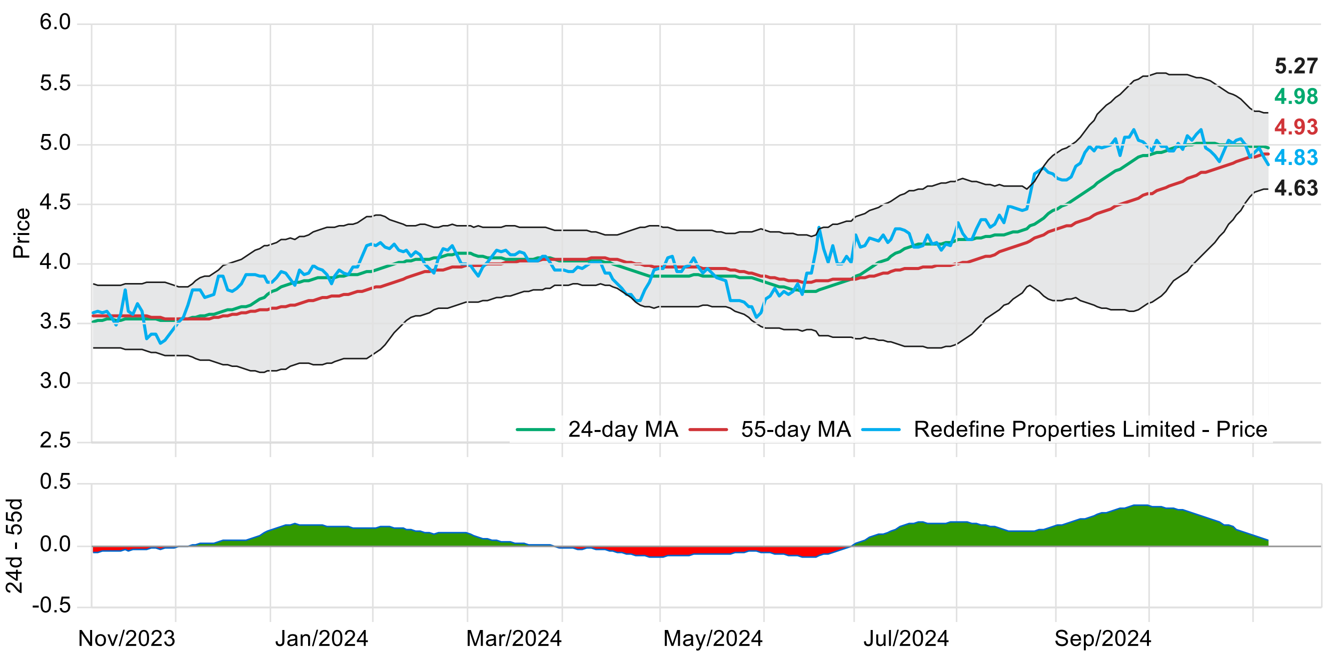
Source: FactSet

Graph 13: Short-term and long-term debt



Source: FactSet

Graph 14: Price momentum



Source: FactSet

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Date and share price: The date the report was reviewed and approved by the portfolio committee is likely to precede the release date and price on the report.

*Share price as at closing.

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