What to watch this reporting season

FEBRUARY 2017

For investors and analysts alike, this is a frantic time of year. Amid the flurry of results and management commentary, it's easy for ordinary investors to lose focus on what's important. Here the three AREIT metrics that really deserve your attention this reporting season. One of the many attractive features of the sector is its simplicity. By focusing on net operating income growth, occupancy and valuation you'll get a snapshot of the health of your property trust investments. Think of these three metrics as the heartbeat, blood pressure and body temperature of the sector.

1. Net Operating Income

The jargon is unavoidable I'm afraid but the concept is straightforward: Add up all the revenue generated from a property and subtract all the operating expenses required to maintain and run it. The resultant figure is the net operating income (NOI). Remember, this is an operational measure so it excludes things like taxes, interest expenses and depreciation. Whilst it's an important measure of operational profitability, we're more interested in the changes in the figure over time, which is why we've included this table from Three big themes from reporting season, published in April last year.

Metric	1H15	1H16
Earnings Per Share (EPS) growth	5.4%	5.3%
Net Tangible Asset (NTA) growth	4.5%	5.3%
Net Operating Income (NOI) growth		
Office	1.5%	1.9%
Retail	2.7%	3.0%
Industrial	2.3%	0.7%
Occupancy	97.1%	97.2%
Vacancy rate	2.9%	2.8%
Cap rate	7.1%	6.5%
Cap rate movement	(44bps)	(58bps)
Gearing	29.5%	28.5%
Index Return (total – last 6 months)	12.7%	7.1%

Source: JP Morgan Armed with this information, you'll be able to see the change in NOI for office, retail and industrial property over the last half compared with the previous two halves. NOI is essential to commercial real estate investment and is used in the determination of capitalisation rates and other metrics. And just to be clear, the higher the figure the better.

2. Vacancy Rate

Unlike NOI, we're looking for low vacancy rates because if an office tower, industrial estate or shopping centre has a vacancy rate of 1% (occupancy 99%) rather than, say, 10%, rental income will be greater. That will lead to higher NOI, which pushes up earnings per share. So, a big thumbs up for low and falling vacancy rates. Again, the comparative figures for the past two halves are in the table. There's one obvious question though: if vacancy rates feed into NOI, why not just stick with that measure and ignore this one. It's a fair question with a simple answer. Whereas NOI is a profitability measure, vacancy rate is an indicator of market supply and demand and management ability to lease their building(s). Low vacancy rates across a sector, for example, indicate the potential for rent rises in a way that NOI cannot. This makes vacancy rates a broader indicator of the overall economic health of a sector and physical assets.

3. Net Tangible Asset Value Growth

Having covered profitability and demand and supply, the final metric to examine is asset value. AREIT investors seek regular, reliable distributions that can be used to fund day-to-day living expenses, which is why APN Property pays distributions each month. But there's another component – capital growth – which over the long term derives from property revaluations. The most common valuation metric in commercial real estate is net tangible asset value (NTA), which is again shown in the table. But there's a problem with it. Big AREIT sector stocks like Goodman Group and Westfield generate substantial profits from their funds management and property development divisions, which distort NTA – that is, these components of their business are not 'tangible assets' (see Reporting season defies critics and delivers on income). That's why it's better to examine the trajectory of NTA growth rather than any absolute measure. Last financial year, AREIT sector NTA growth rose 11%[1]. That should be your benchmark for this reporting season. So there you have it – three metrics to help you understand what's really going on this reporting season, without the need to wade through mind-numbing reports and excruciating management presentations, which is our job after all. And on that score we'll be getting back to you in a few weeks with our major takeaways and insights.

1 Source: UBS

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