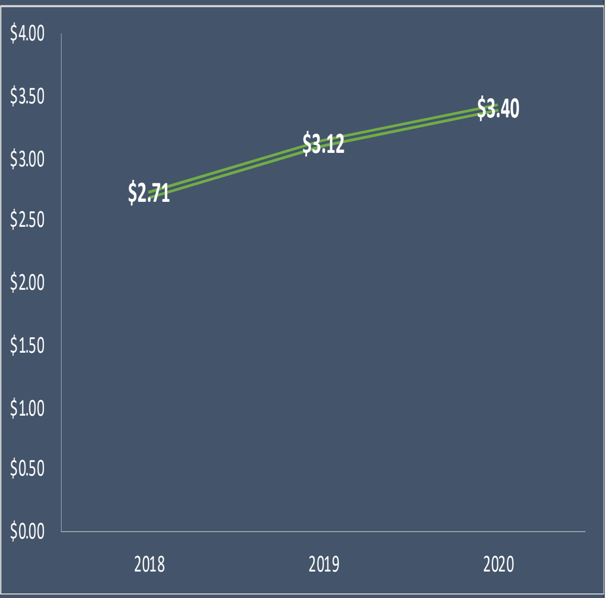
ASX: AQR
DATE: February, 2021

APN Convenience Retail REIT

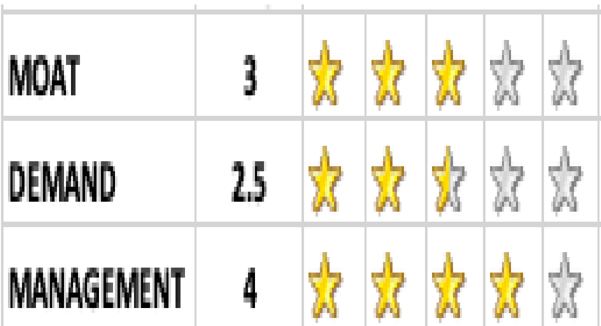
KEY DATA

Current price	$3.51
52-Week High	$4.10
52-Week Low	$2.39
P/E	14.29
ROE	6.09%
DPS	$0.218
EPS	$0.25
Market Cap	$427m
Sector	Real Estate

3 Year Price Chart



Ratings



Company overview

AQR is an Australian REIT, they own 88 service stations and convenience stores. Locations of the properties are skewed to the eastern seaboard of Australia, with around 60% in Queensland and 20% in New south wales.

Total value of the properties owned is $525m AUD. The properties currently have a 100% occupancy rate with a WALE of 10.6 years.

Revenue

AQR generate revenue by receiving rent from the tenants that lease their properties, this revenue stream is locked in as tenants have contracts (10.6 WALE).

Revenues have grown by an annualised rate of 8.95% since 2018. 90% of revenues earnt is directed back to shareholders in the form of quarterly dividends.

Highlights

- 100% Occupancy.
- 2.80% average rental income growth.
- WALE of 10.6 years.
- Dividend stability throughout 2020.

Downsides

- Low natural growth potential.
- Large portion of rental income from 1 tenant.
- Threat of electric vehicles.

ABILITY TO KEEP DEMAND

ECONOMIC MOAT

Switching cost

- WALE of 10.6 years.
- Contract with renters.

The major economic moat we identified for AQR is switching cost that the tenants face and we rate this as a fairly strong switching cost as the time period exceeds 10 years.

AQR has two layer moat, the first layer being in relation to their tenants who act as customers of AQR. All properties have a fixed contract, with the average weighted lease expiry (WALE) for the entire portfolio being 10.6 years. The contracts on average also have an annual rental growth rate of 2.80%, meaning revenues are safe from competition and also growing a rate slightly above the growth rate of the Australian economy.

The next layer is around the businesses that AQR rent their properties to. Petrol stations will not constantly go up next to each until profits are eaten up as it does not make sense from a financial standpoint, at max you will see is one on either side of the road. So the threat of the renters becoming not-profitable and being able to no longer pay rent is substantially low.

THREATS TO MOAT

The moat AQR has does not face any immediate threat or major concerns. As long as contracts are renewed frequently keeping the WALE to a satisfactory level than all threats of renters leaving is safe.

MOAT GROWTH POTENTIAL

The switching cost does have the potential to grow and the potential for the WALE to grow to 15+ years would see the switching cost rated at strong.

There is not noticeable areas for another economic moat to come from for AQR as the businesses activities are fairly small at the present time. We do not believe that is an area of concern though.

ABILITY TO KEEP DEMAND

KEY BUSINESS AND INDUSTRY RISK

BUSINESS RISK

We have identified 3 key business risk in relation to AQR’s operations

- Interest rate risk
- Rental income risk
- 52.6% of income from 1 tenant

1. Interest rate risk: Changing and unpredictable interest rates can become a risk for AQR as it can stall growth and become an issue with repaying outstanding debts. Interest rates are historically low and most likely will stay like this for at least another year, so this is not a major risk.

2. Rental income risk: Failure of a portion of the tenants to pay their rent will have an adverse effect on AQR’s ability to earn a revenue and repay loans.

3. Large portion of income from 1 tenant: 52.6% of AQR’s rental income comes from Chevron, we considered this a risk as any major complications with Chevron can lead to substantially negative affect on AQR’s rent. This also gives Chevron a large bargaining chip as they are extremely important to AQR.

INDUSTRY RISK

The key risk we have identified for the industry is the ongoing growth of electric vehicles and the continuous search for a cleaner energy. We highlight this as an industry risk due to its unpredictability, however we are aware this may lead to a positive outcome for the industry as well.

As electric vehicles become more dominant the need for a traditional petrol station will become outdated. Most vehicles will be charged at home, however petrol stations may become a location for people to have a quick charge of 30 minutes. This could lead to traditional petrol stations becoming small entertainment complex for people waiting for that quick charge. Alternatively shopping centres may simply just take this role.

Although this may not become the outcome and petrol stations could potentially become irrelevant in the next 15-25 years. Many countries have large growth targets for EV’s in 2030 and beyond.

CURRENT AND POTENTIAL SUBSTITUTES

The main job AQR does it provide a location for petrol stations to rent and the main job of those petrol stations is to give people fuel to drive their vehicles. As it stands there is no other substitutes if you want fuel for your car you simply have to go to a petrol station as it is the only place to fill up your car.

The potential substitutes is the one we spoke about above which is the threat of electric vehicles taking over and becoming what everyone in Australia uses to drive.

CURRENT DEMAND

The fuel retailing itself saw negative growths of 2.70% annualised from 2015-2020.

Petrol stations locations however are becoming fairly attractive investments due to their large WALE and constant need for fuel. It has also been a shining light throughout 2020, even though it faced many difficulties.

The demand for AQR's locations is extremely strong as the 88 sites currently have a 100% occupancy with this expected to last over 10 years (WALE 10.6 years).

FUTURE DEMAND

Growth in rental income is on average expected to grow by 2.80% annually, which is above the growth rate of the Australian economy. The figure is a low one, however the fact that it is locked in growth is great and a nice consistent rate for company with fairly low risk.

DEVELOPMENT PROJECTS

AQR has 3 known development projects remaining for 2021, 2 in Q2 and 1 in Q3 with a total value of $12.2m.

AQR has already seen 9 development projects completed since December 2020 with a total portfolio value around $50m. So we would not be surprised if AQR still had a few more projects to go in Q3 and Q4 2021.

Site	State	Funds deployed	Remaining commitments	Target completion[1]
Port Adelaide	SA	$5.2m		Complete
Pooraka	SA	$5.2m		Complete
Gosnells	WA	$4.8m		Complete
Gepps Cross	SA	$5.1m		Complete
Hampstead Gardens	SA	$4.6m		Complete
Edinburgh	SA	$5.4m		Complete
Grand Junction	SA	$5.4m		Complete
Taperoo	SA	$5.3m		Complete
Sheidow Park	SA	$6.8m		Complete
Paradise[2]	SA	$2.8m	$2.9m	Q2 2021
Lonsdale[2]	SA	$0.1m	$4.4m	Q2 2021
Hillcrest	SA	$3.6m	$4.9m	Q3 2021
Portfolio		**$54.3m**	**$12.2m**	

Source: AQR HY 2021 Presentation

ABILITY TO MANAGE DEMAND

MANAGEMENTS ABILITY

Fund manager

- Chris Brockett is the fund manager and has been at APN since 2016.
- 15 years experience in real estate.

Head of Accounting

- Jessie Chan is head of accounting.
- Prior to APN she worked at deloitte

Senior analyst

- Gordan Korkie is the senior analyst and has been at APN since 2016
- Over 9 years experience in REIT

Senior management involves 3 key figures, which operates slightly different to your normal ASX listed company. This is due to AQR operating as a branch of the overall entity APN.

ROE has grown from 3.47% in FY18 to 7.98% in FY19 a massive 130% growth, 7.98% will most likely be the average ROE for AQR in the future

MANAGEMENTS ABILITY TO INNOVATE

AQR management is not in a position to show massive signs of innovations as they are not dealing with a set product and instead focused on allocating capital in a certain sector. When we look at the capital allocation of AQR we can see a more aggressive past year, which we believe was an outstanding move which will position them well for the future.

- Active during down period in market.
- Strong property growth in portfolio

Management has shown a strong ability to continue growing the portfolio they are managing. Total properties from FY19 to FY20 grew from 70 to 79 and total portfolio value grew by nearly 25%.Properties have since grown to 88 with a total portfolio value of $525m

FINANCIAL ANALYSIS

FINANCIAL STATEMENTS ANALYSIS

BALANACE SHEET

Total equity has seen a total incease in the past 3 years of 58.77%.

Cash in bank has seen a total decrease in the past 3 years of 16.66%.

Total assets have been increase, whilst borrowings have been decreasing.

Overall balance sheet is strong with key areas growing strongly in the past 3 years (Property).

INCOME STATEMENT

Income from rent has seen a total increase in the past 3 years of 17.56%.

Operating expenses have been outgrowing revenue. They have increase by 19.73% annualised over the past 3 years.

Net profit has seen a total increase in the past 3 years of 45.30%

Overall the income statement has been stable with a consistent growth in profit.

CASH FLOW STATEMENT

- Receipts from customers has shown strong growth with a total increase of 19.98%.
- Cash at end of period has seen negative flucations.
- 2020 saw a large increase in cash of 707%.
- AQR has a fairly different cash flow statement to other companies, however it is fairly stable and in line with other A-REIT

PROFITABILITY ANALYSIS

Profitability	2018	2019	2020
Return on equity (%)	3.47	7.98	6.09
Return on assets (%)	2.75	6.21	5.56
ROIC (%)	N/A	N/A	N/A
Net profit margin (%)	N/A	N/A	N/A

NPM have not been included, due to the difference in operations compared to a normal companies.

- Both ROE and ROA so overall increased in the past 3 years, however both experienced drops in 2020.
- Both figures are on similar level to industry average, with ROE slightly below and ROA slightly better.
- All figures are in average position, which are stable and will be able to strongly generate healthy returns in the future.

DEBT MANAGEMENT ANALYSIS

Debt Management	2018	2019	2020
Net interest cover	4.49	4.61	5.79
Current ratio	0.41	0.05	0.24
Quick ratio	0.41	0.05	0.24
Debt-to-equity (%)	47.25	49.24	20.45

- Net interest cover has seen the biggest growth with a total increase of 28.85%, ability to keep up with loan repayments for AQR is vital so this is a positive figure.
- Current and quick ratio are both extremely low to normal standards, however for REIT they are quite normal as they do not need a lot of cash on hand.
- Compared to the most similar A-REIT VVR, both have similar debt management ability with no clear standout. So AQR is at industry average.
- All debt management figures are in a stable position and not areas for concern, AQR has shown strong ability to handle debt.

OTHER METRICS

Other Metrics	2018	2019	2020
EPS (cents)	19.26	23.64	24.56
P/E	14.07	13.20	13.84
P/BV	0.95	1.05	1.04
End of year share price	$ 2.71	$ 3.12	$ 3.40

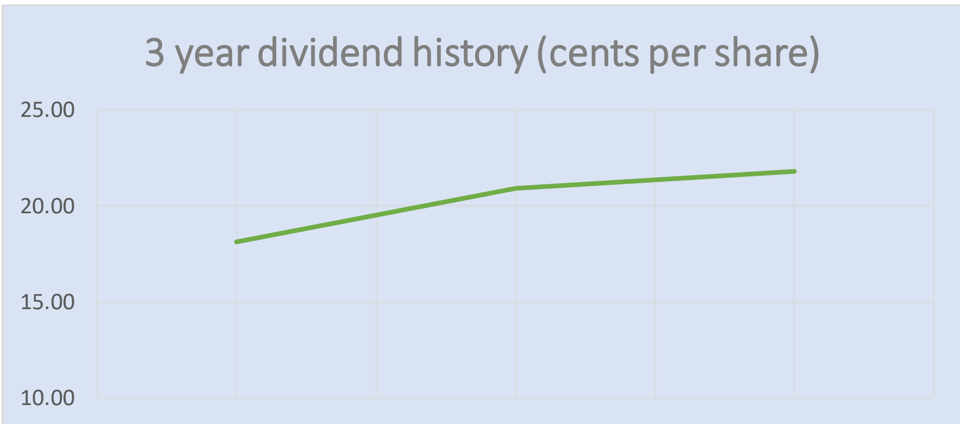
- EPS has shown strong growth in the past 3 years with a total growth of 27.52%, with more properties being purchased this figure is likely to keep growing.
- AQR does have a higher P/E compared to VVR (10.58), however this is most likely due to the aggressive expansion AQR has undertaken. Therefore we believe the higher P/E is warranted.
- Share price has grown in the past 3 years by an annualised rate of 8.49%, which is impressive for a REIT.

FAIR VALUE

Discounted cash flow model has shown a fair value of $3.99 for 1 AQR share.

DIVIDEND HISTORY

Dividends in cents per share (AUD).



- Dividends have seen a positive trend in the past 3 years, with a total increase of 20.24%
- Dividend increase from 2019 to 2020 was smaller than the previous year's increase, with a small jump of 4.31%
- AQR has had an average payout ratio of 90.43% in the past 3 years.
- Dividend yield in 2020 was 6.41%.
- AQR has strong dividends with good stability.

SWOT ANALYSIS

Strengths

- WALE 10.6+ with growth potential.
- Set growth of around 2.8% P.A.
- Stable income, generating stable dividends.

Weaknesses

- Growth comes from inorganic growth.
- Inability to pivot and innovate.

AQR

Opportunities

- More sites are in development phases.
- Becoming a future hub for charging of EV's.

Threats

- Unknown future of EV's from 2030 and beyond.
- Large portion of rental income from 1 tenant (52.6% Chevron).