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Vukile reports strong financial results and an appetite for growth

Vukile Property Fund (JSE: VKE), the specialist retail REIT invested in South Africa and Spain, has increased earnings (funds from operations or FFO) by 9.5% for its financial year to 31 March 2022 and declared a total dividend of 105.8 cents per share, retaining R308m to fund growth. Its earnings and dividend are ahead of its previously raised guidance.

Vukile's excellent set of results reflects a business in a powerful position operationally and financially with a sound base for future growth and a healthy pipeline of opportunities.

Laurence Rapp, CEO of Vukile Property Fund, comments, "We're very upbeat with the performance Vukile has delivered in the past year. We produced strong results from our South African portfolio and even better performance in Spain. Property valuations have started to rise in both countries, which shows the excellent quality of the cash flows emanating from the assets. Our balance sheet is robust, and we delivered exceptionally well on our capital rotation strategy, jump-started our growth, and returned to business as usual, paying dividends and providing market guidance. Vukile really proved its mettle this year."

Vukile is a focused retail REIT with assets of R33bn held 46% in South Africa and 54% in Spain through its 89.6% held Madrid-listed subsidiary Castellana Properties Socimi. The fundamentals of both businesses are strong, with highly diversified income streams across different macroeconomies provided by blue-chip retail tenants. Tenants in Spain and South Africa in all product categories are reporting good performance, with trading trending upward across the board.

The SA portfolio delivered a strong showing, with vacancies reducing to 2.6%, a 93% tenant retention rate and 100% of billings collected. Retail reversions rallied and shifted to positive growth in the value (+4.9%), rural (+3.2%) and township (+0.7%) markets. Turnovers have surpassed pre-Covid levels, with like-for-like trading density increasing by 6.1%. The rent-to-sales ratio is 6.1%.

On the back of positive trading, there is keen demand from retailers for space at Vukile's centres, and they are competing for position. As a result, the reversionary rental cycle has turned, and Vukile's South African property values increased by 4.6%.

"We operate in the sweet spot in the SA market, with significant exposure to brilliantly performing township and rural shopping centres, where trading densities are up 10.2% and 6.9%, and footfalls are up 106% and 104%, respectively. These assets, with a high percentage of essential services tenants, fortify the defensiveness of our portfolio," notes Rapp.

Castellana delivered a market-leading performance with reduced vacancies of 1.6%, positive rental reversions of 3.1% and a rental collection rate of 98.7%. Retail sales exceeded 2019 levels. Footfalls finally breached the pre-Covid level in April, a month after year-end.

As part of Vukile's active asset rotation, it sold R800m of non-core assets in SA at or above book value. Vukile also received R700m in cash proceeds from selling 64% of its shareholding in its Namibian property portfolio and sold around R500m of Fairvest shares following the Arrowhead merger. Castellana also sold non-core office assets for €26m in Spain, also ahead of book value. The combined proceeds were largely rotated into Castellana's acquisition of a 21.7% shareholding in Lar España for some €100m.

"This is a great investment that provides strategic optionality to further grow our market share in Spain," says Rapp about Lar España. Its portfolio complements Castellana's and represents an outstanding investment return. They are both specialist retail property investors with high-quality, low-risk assets, but in different areas of the country giving Castellana exposure to the entire Spanish peninsula.

Since year-end Castellana has increased its stake in Lar España to 23%, further enhancing optionality and taking advantage of the excellent value in the share price. "Vukile is engaging with Lar España to understand their strategies and explore ways to reduce its discount to net asset value," says Rapp.

All Vukile's balance sheet metrics are strong. Its interest cover ratio (ICR) of 3.4 times highlights strong cash flow from its assets. It has a stable loan-to-value ratio of 43%. Vukile has a diversified funding base and has already repaid or extended 66% of debt expiring in FY23, and has increased its undrawn debt facilities to R3.1bn.

Fitch Ratings assigned Castellana a first-time investment-grade credit rating complementing Vukile's investment-grade rating in SA. Castellana also significantly de-risked its debt expiry profile by refinancing a syndicated loan into a new seven-year €185m facility, which extended its average debt maturity to five years. Castellana's balance sheet improvements added to Vukile's strong financial position. The group is more than 75% hedged for interest rate risk and well-positioned for the rising interest rate cycle.

This year Vukile concluded its first use-of-proceeds green loan with Nedbank CIB – a significant milestone in its sustainability journey. It will fund 19 solar energy projects and energy-efficiency initiatives in SA, supporting Vukile's positive environmental action, energy-efficient and cost-efficient operations, and reducing climate impact. To date, Vukile has installed 14.2 MWp in solar photovoltaic (PV) power systems through 21 different projects, substituting 9% of fossil-fuelled energy consumed across Vukile's portfolio with power from renewable resources and decreasing Vukile's carbon footprint by about 20,500 tons of CO_2. It plans to install another 7.4 MWp of solar by end-March 2023 and to increase its sustainable energy consumption by at least 50% over the next three years. Castellana is also preparing to add PV capacity across its portfolio.

"Our investment in solar energy is a key focus of our ESG strategy, for which we set the foundation this year," reports Rapp. "We will strive to maintain the high ethical standards assessed through our participation in the GIBS Ethics Barometer as part of our continued good governance."

The nature of Vukile's shopping centres places them at the heart of their SA communities. Equally in Spain, Castellana's proven strategy of owning dominant shopping centres in secondary cities makes them key community resources. With this in mind, Vukile's decentralised corporate social investment strategy adds value to its communities and customers through its centres, which are best positioned to know their communities, understand unique challenges, support specific needs, showcase their achievements and celebrate their people.

The Vukile Academy funded 66 bursary students in property disciplines for the 2021 academic year and placed all job-seeking interns in formal employment, with a positive social impact on education and job creation. The Vukile Retail Academy is ready to launch with nine small retail businesses incubated in 1,000sqm of free retail space within Vukile's shopping centres. By de-risking their entry into formal retail spaces, Vukile helps develop emerging retailers' enterprises.

With limited new retail centres recently added in both Vukile's markets, and a low likelihood of this happening – especially in Spain, Vukile's dominant market positions auger well for good income growth and the roll-out of its healthy growth pipeline of asset purchases in South Africa and Spain.

"Our strong operational results have proven that we can navigate through headwinds to deliver our clear strategy of driving operational excellence, keeping our balance sheet strong and recycling capital to deepen our core investment strategies. They show a business that is well-positioned to pursue future growth to support long-term sustainability. With good growth opportunities in our pipeline, it makes sense for Vukile to be investment-ready. Keeping cash on our balance sheet supports the ability to grow and create value for all our stakeholders," concludes Rapp.

At a similar payout ratio to FY22, and based on current forecasts, Vukile expects to pay both an interim and final dividend in FY23, with growth in FFO and dividend per share of 5% to 7%, and a full-year dividend per share of between 111 and 113 cents.

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