MAS PLC a publicly traded real estate investor listed in both the Netherlands and South Africa, with a focus on income-generating commercial properties across Central and Eastern Europe (CEE). Their strategy revolves around acquiring, developing, and managing income generating properties to deliver consistent and growing returns for their shareholders .

The real estate company's pivotal strategy revolved around shifting capital previously employed in Western Europe to Central and Eastern Europe. CEE countries are a fertile investment ground, particularly for property, as they have been experiencing rapid economic growth demonstrated by a burgeoning middle class. This translates into material potential for property value appreciations and more importantly attractive yields with rental income often outperforming the average cost of funding. This is particularly true when one contrasts yields and valuations with Western European counterparts. Demonstrably, CEE properties yield 9% with underlying rental growth bolstered by strong demand.

Additionally, they aim to reach a target of €2 billion in gross assets by 2026, which would grant them investment grade status, this would greatly expand their investor base, increase their liquidity as well and most importantly lower their borrowing costs. Set against the 4%-5% yields of London, the potential for higher returns strengthens the investment proposition. This shift in strategy, led by Martin Slabbert (legendary South African real estate mogul) and his team, resulted in a record sale of mixed property portfolios valued on schedule and above net asset value (NAV). This sale brought in over €400 million in disposal proceeds over five years, strengthening MAS's balance sheet.

The improved balance sheet allowed MAS to pursue its development ambitions in CEE while also considering dividends and buying back stocks. This bolstered MAS's share price from a low of R8 during the COVID-19 pandemic to a high of R23 in 2023. However, a prolonged cycle of interest rate tightening by central banks created a new risk for MAS in terms of liquidity, invoking fears about funding and liquidity risks at a DJV and PK level. In response, MAS management made the decision to halt non-mandatory dividends to conserve liquidity as funding risks increased throughout Europe. Unfortunately, this abrupt decision to halt non-statutory dividends was met with a record sell-off by dividend -seeking investors.

DJV set up with PKM, commitments and benefits

Upon the inception of the joint venture (JV) with Prime Kapital, Mr. Martin Slabbert held a 21% effective interest in MAS equity and owned 100% of Prime Kapital, an astute European commercial property developer. Under various agreements, MAS committed funding in the form of preferred capital to Prime Kapital to finance development projects, earning a bi-annual preferred dividend in return. Additionally, MAS and Prime Kapital agreed that the latter would oversee property development exclusively for the JV until 2026, recently extended to dissolve in 2030 with an additional €50 million in committed preferred capital, on top of the initial €419 million.

To ensure fair risk and benefit distribution within the JV, crossholdings were permitted between MAS and Prime Kapital, albeit without direct property ownership arrangements unless approved by shareholders. However, Prime Kapital's influence in MAS appeared to outweigh minority shareholders' ability to benefit significantly from MAS's ambitions. Prime Kapital's recent stance on positioning the JV for its own benefits, with less emphasis on minority interests, further highlighted this imbalance.

To address interest misalignment with Prime Kapital, shareholders proposed that MAS acquire a 60% stake in the JV from Prime Kapital. However, Prime Kapital responded with value-destructive options, requiring MAS to issue 250 million shares at R26/share and fund the purchase with a €325 million third-party loan, amounting to approximately 57% of its current market capitalization. This disproportionality between potential returns and risk exposure raised uncertainties about Prime Kapital's influence on MAS minority shareholders and the likelihood of promised returns being realized without overpayment.

Overall, these complexities underscore the challenges stemming from the JV arrangement, contrasting with the initial investment case built on strong fundamentals in CEE property, earnings growth, and deleveraging.

Results

MAS reported a solid 12% growth in net operating income for the six months, driven by above-inflation rental growth in Romania. The loan-to-value (LTV) ratio stood at 24% and 28% on net and gross bases, respectively, affirming the group's strong solvency position. Despite concerns about liquidity following the announcement of dividend cuts a year ago, Prime Kapital's liquidity situation was not as dire as initially feared, as it managed to meet preference share interest obligations for the six months ended. Additionally, MAS's asset base reached €1.5 billion, approaching a quarter of the €2 billion target expected to be achieved by early 2026 upon completion of remaining developments. Achieving an asset base of €2 billion will secure an investment grade rating for MAS, aligning its cost of funding with peers and providing positive financial leverage to earnings.

Furthermore, MAS management demonstrated prudent capital allocation, repurchasing over €80 million worth of bonds to capitalize on higher yields in Romania, where bonds were trading at a significant discount to par. This strategy offered MAS a better return profile than investing in properties yielding 9% after a prolonged period. While this showcased management's effective capital allocation, a dividend yield of 10% would have been preferable. However, management still faces shareholder pressure to reinstate dividends.

Conclusion

While we've grown increasingly concerned about Prime Kapital's influence on the DJV arrangement, prioritising its own benefits over those of MAS minorities, we take solace in MAS's past achievements. Their disciplined capital allocation strategy allows them to seize market opportunities despite challenging trading environments.

MAS remains the most poised property company to achieve double-digit earnings growth. Its valuation offers protection against downside risks, with the opportunity to buy back shares at lower prices rather than risky investments promising delayed returns.

Our investment case in MAS remains intact, despite expectations of reduced returns in the long term due to governance concerns between MAS and PK. However, there's a notable margin of safety and upside potential given the company's undervaluation.