

# Westpac Office Trust (WOT)

Structural issues resolved

## Recommendation

# Accumulate

## Price

# \$0.785

## Target (12 months)

# \$0.81

Following approval by unit holders of the Instalment Receipt Restructure Proposal we adjust our valuation and PT to reflect the fully paid basis with which WOT now trades. Our valuation is unchanged at \$0.81 (was \$0.31 partly paid), while our PT has lifted to \$0.81 (from \$0.78 or \$0.28 partly paid), given we've removed the 10% discount to our partly paid valuation with the Trust's structural issues now resolved.

## Expected Return

Capital growth **3.2%**

Dividend yield **8.5%**

Total expected return **11.7%**

## Company Data & Ratios

Enterprise value **\$1,090**

Market cap **\$378m**

Issued capital **482.2m**

Free float **100%**

12 month price range  
**\$0.72 - \$0.89**

GICS sector

**Real Estate**

## Structural issues removed

We see the move for the Trust to being traded on a fully paid basis as an important step in the evolution and growth of the Trust. With these issues now behind it, combined with the resultant increase to market cap and high quality domestic only portfolio we expect WOT's relevance within the REIT sector to strengthen. This in the future should also help to attract additional institutional investor support.

## Investment view - price up rating down (to Accumulate)

Following the strong recent share price performance we've reduced our rating from Buy to Accumulate with a target price of \$0.81 (from \$0.78 or \$0.28 partly paid). The stable FY10 DPU yield (8.5%) and discount to NTA (now 8.7%), no longer appear quite as compelling, however we continue to be attracted to the quality portfolio and strong tenant covenant.

## Valuation

Our 3-stage DDM derived valuation of \$0.81 applies a 9.8% discount rate and 7.7% terminal yield. From a NAV perspective our \$0.81 valuation implies an un-gearred asset cap rate of 7.5%.

### Earnings Forecast

Year end 30 June	2008a	2009a	2010f	2011f
NPAT (reported) (A\$m)	-4	-159	41	67
NPAT (adjusted) (A\$m)*	32	34	33	36
EPS (adjusted) (cps)	6.6	7.0	6.9	7.3
EPS growth (%)	16%	5%	-1%	6%
PER (x)	11.9	11.2	11.4	10.8
NTA (\$)	1.24	0.86	0.85	0.90
EV/EBITDA (x)	15.4	13.5	13.4	13.0
Dividend (¢ps)	7.3	6.7	6.7	7.1
Yield (%)	9.2%	8.5%	8.5%	9.0%
ROE (%)	5.3%	8.1%	8.1%	8.1%

## Absolute Price - partly paid basis



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

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# Structural issues resolved

On 10 September 2009, investors approved by clear majority the Instalment Receipt Restructure Proposal, with the cessation of (“WOTCA”) Instalment Receipts from close of trade on 11 September 2009, with fully paid units (“WOT”) to commence trading from 14 September 2009.

As previously indicated the removal of the partly paid structure should be seen as a positive for the Trust moving forward, given it:

- provides investors with increased flexibility to continue to hold Instalment Receipts for an extended period (if already held prior to close of trade on 11 September 2009) or convert to units;
- remove any negative perceptions from retail investors that the Trust may have faced in light of the well publicised issues that other partly paid groups such as BrisConnections (ASX: BCSCA) and Multiplex Prime Property Fund (ASX: MAFCA) have faced in recent times; and
- increase the market capitalisation of the Trust by c.\$240m (based on part payment of \$0.50 x number of Instalment receipts on issue) which should support improved liquidity, investor relevance and potential for index inclusion.

## COMPANY DESCRIPTION

Westpac Office Trust invests in securely leased commercial properties in Australia.

The Trust currently owns a portfolio of eight office assets valued at \$1.2bn with 90% by value of the portfolio derived from the Trust’s largest three assets:

- Westpac Place, Sydney, NSW (\$730m);
- Woolworths NSO, Baulkham Hills, NSW (\$234m); and
- IBM, West Pennant Hills, NSW (\$93m)

The Trust’s income is derived purely from passive rental income and should remain resilient even during uncertain economic times due to:

- the strong tenant covenant with 92% being derived from Westpac, Woolworths and IBM Australia;
- only 7% of the portfolio’s leases expiring prior to 2014; and
- the strong weighted average lease expiry (WALE) of 9.2yrs

## INVESTMENT STRATEGY

Following the strong share price performance we’ve reduced our rating from Buy to Accumulate with a target price of \$0.81 (from \$0.78 or \$0.28 partly paid). The stable FY10 DPU yield (8.5%) and discount to NTA (now 8.7%), no longer appear quite as compelling, however we continue to be attracted to the quality portfolio and strong tenant covenant.

## VALUATION

Our 3-stage DDM derived valuation of \$0.81 (\$0.31 partly paid) is unchanged, while our price target has lifted so as to be in line with our valuation given we’ve removed the 10% discount to valuation previously applied.

In deriving our valuation we've employed a discount rate of 9.8% (5.4% 10yr bond, 0.80 beta & 5.5% market risk premium) and terminal yield of 7.7%.

From a NAV perspective, we also value WOT at \$0.81 which implies a weighted average cap rate for the portfolio of 7.5% vs. NTA at Jun'09 of \$0.86 which applies a weighted average cap rate of 7.32% (6.85% at Dec'08).

The following table highlights the premium/discount to NTA and FY10 DPU yield of some of WOT's peers, while also showing the domestic exposure %.

**Table 1 - Comparables**

	Market cap (\$m)	Unit price (\$)	NTA (\$)	Prem/(disc) to NTA (%)	FY10 DPU yield (%)	Domestic exposure (%)
<b>WOT</b>	<b>\$378</b>	<b>\$0.785</b>	<b>\$0.86</b>	<b>-8.7%</b>	<b>8.5%</b>	<b>100%</b>
MOF	\$1,310	\$0.285	\$0.49	-41.8%	8.7%	40%
IOF	\$1,657	\$0.590	\$0.80	-26.3%	6.6%	54%
DXS	\$3,479	\$0.755	\$1.01	-25.2%	7.0%	75%
BWP	\$571	\$1.800	\$1.79	0.6%	6.6%	100%
CPA	\$1,681	\$0.885	\$1.15	-23.0%	6.2%	100%
CFX	\$3,902	\$1.905	\$2.02	-5.7%	6.7%	100%

SOURCE: COMPANY DATA & IRESS

## RISKS

Risks facing WOT include but are not limited to:

- Rising bond yields;
- Availability of debt and refinancing risk;
- Capital raising risk; and
- Tenant default and property leasing risk

Should the impact of these factors be greater than anticipated, the stock may have difficulty achieving our target price. Likewise, if any of these factors proves to have less of an effect than we expect, the stock could materially outperform our target

# Westpac Office Trust

as at 15 September 2009

Recommendation **Accumulate**  
 Price **\$0.785**  
 Target (12 months) **\$0.81**

Table 2 - Financial summary

Westpac Office Trust (WOT)					Share Price (A\$)				\$0.785
As at 15-Sep-09					Market Cap (A\$M)				378
<b>PROFIT AND LOSS</b>					<b>VALUATION DATA</b>				
<b>Y/e June 30 (\$m)</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>	<b>Y/e June 30</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>
Net property income	78	86	89	91	Net profit adj (\$m)	32.0	33.7	33.2	31.6
Other income	(1)	0	0	0	Operating EPS (c)*	6.6	7.0	6.9	7.3
<b>Total operating revenue</b>	<b>76</b>	<b>86</b>	<b>89</b>	<b>91</b>	EPS growth	16.3%	5.4%	-1.2%	5.6%
Management fee/ Trust expenses	(6)	(5)	(8)	(7)	P/E ratio (x)	11.9	11.2	11.4	10.8
EBITDA	71	81	81	84	CFPS (c)	5.4	6.6	6.9	7.3
Depreciation	-	-	-	-	NTA (\$)	1.26	0.86	0.85	0.90
<b>EBIT</b>	<b>71</b>	<b>81</b>	<b>81</b>	<b>84</b>	DPS (c)	7.3	6.7	6.7	7.1
Net interest	(39)	(47)	(48)	(48)	Distribution yield (%)	9.2%	8.5%	8.5%	9.0%
<b>Pre-tax profit</b>	<b>32</b>	<b>34</b>	<b>33</b>	<b>36</b>	Payout ratio	110%	95%	97%	97%
Tax (expense) / benefit	-	-	-	-	Tax deferred	100%	100%	100%	100%
<b>Net Profit</b>	<b>32</b>	<b>34</b>	<b>33</b>	<b>36</b>	EV/EBIT	15.2	13.5	13.5	13.2
<b>SCEQ adj profit</b>	<b>32</b>	<b>34</b>	<b>33</b>	<b>36</b>	<b>LEVERAGE RATIOS</b>				
AIFRS items***	(36)	(193)	8	32	<b>Y/e June 30</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>
<b>Reported net profit</b>	<b>(4)</b>	<b>(159)</b>	<b>41</b>	<b>67</b>	Net debt/ equity (%)	114.4	172.0	175.1	164.3
<b>CASHFLOW</b>					Net debt/ net debt + equity (%)	53.4	63.2	63.6	62.2
<b>Y/e June 30 (\$m)</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>	Net interest cover (x)	1.8	1.7	1.7	1.7
EBITDA	77	77	82	84	<b>PROFITABILITY RATIOS</b>				
Net interest expense	(51)	(46)	(48)	(48)	<b>Y/e June 30</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>
Other	-	-	-	-	Return on assets (%)	5.3%	6.7%	6.7%	6.8%
<b>Operating cashflow</b>	<b>26</b>	<b>32</b>	<b>34</b>	<b>36</b>	Return on equity (%)	5.3%	8.1%	8.1%	8.1%
Capex	-	-	(1)	(11)	Return on funds empl'd (%)	5.3%	7.0%	7.0%	7.0%
Asset (acquisition)/disposal	(168)	(16)	-	-	Dividend cover (x)	0.9	1.0	1.0	1.0
Other	-	-	-	-	<b>PORTFOLIO BY INCOME</b>				
<b>Investing cashflow</b>	<b>(168)</b>	<b>(16)</b>	<b>(1)</b>	<b>(11)</b>		<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>
Debt increase/(reduce)	170	(1)	6	11	Westpac PI	48	49	50	52
Equity raised	1	-	-	-	Woolworths NSO	18	18	19	19
Dividends paid	(35)	(33)	(32)	(34)	IBM Centre	6	10	10	10
Other	-	-	(6)	-	Other assets	6	9	10	10
<b>Financing cashflow</b>	<b>137</b>	<b>(33)</b>	<b>(32)</b>	<b>(23)</b>	Total	79	87	89	91
<b>Net change in cash</b>	<b>(6)</b>	<b>(18)</b>	<b>1</b>	<b>1</b>	<b>Dividend Discount Model Assumptions</b>				
<b>BALANCE SHEET</b>					Risk free rate	5.4%			
<b>Y/e June 30 (\$m)</b>	<b>2008a</b>	<b>2009a</b>	<b>2010f</b>	<b>2011f</b>	Risk premium	5.5%			
Cash	46	28	28	30	Beta	0.80			
Investments	1,281	1,172	1,174	1,208	Terminal risk free rate	6.5%			
Other	4	2	2	2	DPU growth years 5-10	2.0%			
<b>Total assets</b>	<b>1,331</b>	<b>1,202</b>	<b>1,204</b>	<b>1,240</b>	Terminal growth	2.0%			
Debt	739	739	745	755					
Other liabilities	(14)	49	50	42					
<b>Total liabilities</b>	<b>725</b>	<b>788</b>	<b>794</b>	<b>798</b>					
Shareholders' equity	606	414	409	442					
Minorities	-	-	-	-					
<b>Total shareholders funds</b>	<b>606</b>	<b>414</b>	<b>409</b>	<b>442</b>					
<b>W/A diluted shares on issue</b>	<b>482</b>	<b>482</b>	<b>482</b>	<b>491</b>					

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

**Recommendation structure**

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 0% and +15% on a 12 month view

Reduce: Expect -15% and 0% total return on a 12 month view

Sell: Expect <-15% total return on a 12 month view

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Southern Cross Equities Ltd and its associates hold 1,299,529 shares in WOT as at the date of this report. This position is subject to change without notice.



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