

Westpac Office Trust (WOT)

Asset sale to prove up NTA

Recommendation

Buy

Price

\$0.75

Target (12 months)

\$0.80

WOT has sold its Kensington, NSW office asset (3.1% of portfolio) for \$35.5m in line with book value (\$36m). With greater transaction evidence emerging in recent weeks at pricing levels consistent with valuations we continue to believe the devaluation cycle for stabilised institutional grade assets in Australia has passed. Hence we expect domestically focussed passive REITs such as WOT are unlikely to see further material downward NTA pressure.

Expected Return

Capital growth	6.7%
Dividend yield	8.9%
Total expected return	15.5%

Company Data & Ratios

Enterprise value	\$1,073m
Market cap	\$362m
Issued capital	482m
Free float	100%
12 month price range	\$0.69 - \$0.835

GICS sector

Real Estate

Minimal financial impact, but a positive signal

The transaction has minimal impact on financial metrics for WOT. Based on our estimates the transaction is mildly dilutive to EPU (0.3% in FY10 & 0.7% in FY11 given the full year impact). Covenant gearing reduces c.11% to 61.5% all else being equal vs. covenant of 70%, while NTA is reduced by <1¢pu to ~\$0.85. More importantly, the transaction provides evidence that current book values are a fair reflection on reality.

Buy rating with \$0.80 target price

Our target price of \$0.80 is based on our 3-stage DDM derived valuation (previously \$0.81), which has reduced due to our minor forecast adjustments following today's sale and movements in the risk free rate. Due to recent price performance we've lifted our rating to Buy (from Accumulate). We believe that the current price is implying a cap rate of ~7.7%, with every 10bps movement impacting NTA by ~3¢pu.

Absolute Price (fully paid basis)



SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Earnings Forecast

Year end 30 June	2008a	2009a	2010f	2011f
NPAT (reported) (A\$m)	-4	-159	41	66
NPAT (adjusted) (A\$m)*	32	34	33	35
EPS (adjusted) (cps)	6.6	7.0	6.9	7.2
EPS growth (%)	16%	5%	-2%	5%
PER (x)	11.3	10.7	10.9	10.4
NTA (\$)	1.24	0.86	0.85	0.90
EV/EBITDA (x)	15.2	13.3	13.4	13.2
Dividend (¢ps)	7.3	6.7	6.7	7.0
Yield (%)	9.7%	8.9%	8.9%	9.3%
ROE (%)	5.3%	8.1%	8.1%	8.1%

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

COMPANY DESCRIPTION

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

The Trust currently owns a portfolio of seven office assets valued at \$1.1bn with 93% 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

Given the recent unit price pullback from levels in line with our valuation we've upgraded our rating to Buy (from Accumulate) with a target price of \$0.80 (from \$0.81).

We continue to be attracted to the quality portfolio with strong tenant covenant, stable FY10 DPU yield (8.9%) and discount to NTA (now 8.7%), which in our view may close over a 12 month period, given continuing evidence that asset values are stabilising.

VALUATION

Our 3-stage DDM derived valuation of \$0.80 is in line with our target price.

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 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).

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 24 November 2009

Recommendation

Buy

Price

\$0.75

Target (12 months)

\$0.80

Table 1 - Financial summary

Westpac Office Trust (WOT)					Share Price (A\$)				\$0.75
As at 24 Nov-09					Market Cap (A\$M)				362
PROFIT AND LOSS					VALUATION DATA				
Y/e June 30 (\$m)	2008a	2009a	2010f	2011f	Y/e June 30	2008a	2009a	2010f	2011f
Net property income	78	86	88	88	Net profit adj (\$m)	32.0	33.7	33.1	35.5
Other income	(1)	0	0	0	Operating EPS (c)*	6.6	7.0	6.9	7.2
Total operating revenue	76	86	88	88	EPS growth	16.3%	5.4%	-16%	5.2%
Management fee/ Trust expenses	(6)	(5)	(8)	(7)	P/E ratio (x)	11.3	10.7	10.9	10.4
EBITDA	71	81	80	81	CFPS (c)	5.4	6.6	6.9	7.2
Depreciation	-	-	-	-	NTA (\$)	1.26	0.86	0.85	0.90
EBIT	71	81	80	81	DPS (c)	7.3	6.7	6.7	7.0
Net interest	(39)	(47)	(47)	(46)	Distribution yield (%)	9.7%	8.9%	8.9%	9.3%
Pre-tax profit	32	34	33	35	Payout ratio	110%	95%	97%	97%
Tax (expense) / benefit	-	-	-	-	Tax deferred	100%	100%	100%	100%
Net Profit	32	34	33	35	EV/EBIT	14.9	13.3	13.0	13.0
SCEQ adj profit	32	34	33	35	LEVERAGE RATIOS				
ALFRS items***	(36)	(193)	8	31	Y/e June 30	2008a	2009a	2010f	2011f
Reported net profit	(4)	(159)	41	66	Net debt/ equity (%)	114.4	172.0	167.0	156.9
CASHFLOW					Net debt/ net debt + equity (%)	53.4	63.2	62.5	61.1
Y/e June 30 (\$m)	2008a	2009a	2010f	2011f	Net interest cover (x)	1.8	1.7	1.7	1.8
EBITDA	77	77	80	81	PROFITABILITY RATIOS				
Net interest expense	(51)	(46)	(47)	(46)	Y/e June 30	2008a	2009a	2010f	2011f
Other	-	-	-	-	Return on assets (%)	5.3%	6.7%	6.9%	6.8%
Operating cashflow	26	32	33	36	Return on equity (%)	5.3%	8.1%	8.1%	8.1%
Capex	-	-	(1)	(11)	Return on funds empl'd (%)	5.3%	7.0%	7.2%	7.0%
Asset (acquisition)/disposal	(168)	(16)	36	-	Dividend cover (x)	0.9	1.0	1.0	1.0
Other	-	-	-	-	PORTFOLIO BY INCOME				
Investing cashflow	(168)	(16)	34	(11)		2008a	2009a	2010f	2011f
Debt increase/(reduce)	170	(1)	(30)	11	Westpac PI	48	49	50	52
Equity raised	1	-	-	-	Woolworths NSO	18	18	19	19
Dividends paid	(35)	(33)	(32)	(33)	IBM Centre	6	10	10	10
Other	-	-	(6)	-	Other assets	6	9	10	10
Financing cashflow	137	(33)	(67)	(23)	Total	79	87	89	91
Net change in cash	(6)	(18)	1	1	Dividend Discount Model Assumptions				
BALANCE SHEET					Risk free rate	5.4%			
Y/e June 30 (\$m)	2008a	2009a	2010f	2011f	Risk premium	5.5%			
Cash	46	28	28	30	Beta	0.80			
Investments	1,281	1,172	1,138	1,171	Terminal risk free rate	6.5%			
Other	4	2	2	2	DPU growth years 5-10	2.0%			
Total assets	1,331	1,202	1,167	1,203	Terminal growth	2.0%			
Debt	739	739	710	720					
Other liabilities	(14)	49	49	42					
Total liabilities	725	788	759	763					
Shareholders' equity	606	414	408	440					
Minorities	-	-	-	-					
Total shareholders funds	606	414	408	440					
W/A diluted shares on issue	482	482	482	491					

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 NIL shares in WOT as at the date of this report. This position is subject to change without notice.



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