

Listed Property

Australian Unity Office Fund (ASX Code: AOF)

20 March 2020

Starwood withdraws takeover offer

Australian Unity Office Fund (AOF)

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Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research cover sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

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20 March 2020

Australian Unity Office Fund (AOF)

Hold

See the end of this document for a description of Core Property's ratings process. The rating must be viewed in the context of comparable A-REITs and not across all products.

Forecast Distribution	9.0%
Forecast Capital Return (12mths)	53.2%
Total Expected Return	61.4%

Security Information

ASX Code:	AOF
Price:	\$1.97
Market Capitalisation:	\$320.8M
Securities on Issue:	162.8M
52 Week Range:	\$1.82 - \$3.04

Based on last traded price 20 March 2020

Starwood withdraws takeover offer

- ◆ *Starwood effectively withdraws its intended takeover offer for AOF of \$2.98 per security announced back on 29 January 2020.*
- ◆ *Offer was unlikely to have succeeded, given a number of conditions, including a minimum 90% acceptance. Hume Partners hold 14.6% of AOF and have publicly stated they would not accept the offer. AU's total stake is 14.9%.*
- ◆ *AOF trades well below recent valuations, impacted by market uncertainty and volatility. In the absence of a short-term catalyst, maintain Hold recommendation.*

Starwood Capital Group has announced that it will effectively allow its latest takeover offer for AOF to lapse. The Offer was announced on 29 January 2020 and priced at \$2.98 per unit for AOF and was subject to a number of conditions. Starwood has advised that it will not free the Offer of the conditions, which means the Offer cannot succeed and will lapse. As a result, Starwood does not intend to dispatch its Bidders Statement to AOF unitholders.

Core Property considered the Offer had a low probability of success (see our note from 29 January 2020), given that it required a 90% acceptance as well as a number of conditions.

AOF's planned development at Valentine Ave, Parramatta NSW has also recently had site specific planning gazetted and is now law, allowing an increase in the Floor-Space-Ratio to 13.25:1 (from 6.1:1) as well as additional height limits. This provides the Parramatta Council with the pathway to approve AOF's development application for the site to build a ~28,000 sqm commercial office building. Once a DA is approved, AOF will look to revalue the property.

At this stage, it is too early to assess the impact that the Coronavirus (Covid-19) might have on AOF's earnings. AOF's property portfolio consists of corporate tenants with the top 5 tenants accounting for 60% of Gross Property Income. The top 5 tenants are Telstra (22%), the NSW State government (13%), Boeing Defence Australia (13%), GE Capital Finance (75) and the Commonwealth government (5%).

At current price levels, AOF is trading at well below its December 2019 NTA of \$2.85 per unit and our 12-month price target of \$3.02 per unit. Whilst this represents a 53.2% capital upside at current prices, we do not see any near term catalyst for the security in the current economic climate. We recommend that existing investors Hold.

Price performance (12 mths)



Source: IRESS

Year Ended 30 June	FY19A	FY20F	FY21F	FY22F
NPAT - Reported - \$M	44.8	25.6	26.4	26.7
NPAT - adj - \$M	28.2	28.8	29.4	29.8
Price/Earnings Ratio	11.4	11.1	10.9	10.8
EPU - adj - cents	17.3	17.7	18.1	18.3
EPU - Growth		2.2%	2.2%	1.2%
DPU - cents	15.8	16.0	16.5	16.7
Distribution Yield	8.0%	8.2%	8.4%	8.5%
NTA per unit	\$2.79	\$2.79	\$2.88	\$2.93
Gearing	29.3%	28.9%	28.1%	27.7%

Note: Gearing = (net debt) / (net debt + net assets), Source: Core Property estimates

Key Metrics

Strategy

AOF's strategy is to provide sustainable income and capital growth potential through a diversified office portfolio in Australia. The office assets are located in CBD and metropolitan locations.

Board & Management

Board of the RE consists of Independent Chairmen (Peter Day), two Independent Non- Executive Directors (Don Marples and Eve Crestani), a Non-Executive Director (Greg Willcock) and an Executive Director (Kristy Dullahide).

Senior Management includes James Freeman (Fund Manager), Simon Beake (Portfolio Manager) and Giovanna Reale (Senior Asset Manager).

Portfolio		Key Properties		Key Tenants		Geography	
Metric	Dec 19	Dec 19	% Portfolio	Dec 19	% Portfolio	Dec 19	% Portfolio
No of Properties	9	30 Pirie Street, Adelaide SA	18%	Telstra	22%	NSW	39%
Valuation	\$685.8M	10 Valentine Ave Parramatta NSW	18%	NSW State Government	13%	VIC	9%
Capitalisation Rate	6.13%	150 Charlotte St, Brisbane QLD	15%	Boeing Defence Australia	13%	QLD	26%
Locations	Australia	468 St Kilda Rd, Melbourne VIC	12%	GE Capital Finance	7%	ACT	4%
Sector	Office	5 Eden Park Dr, Nth Ryde NSW	10%	Commonwealth of Australia	5%	SA	22%
Occupancy	95.2%	Top 5	73%	Top 5	60%	Total	100%
WALE	3.3 years						

Debt	Dec 2019	Expenses	Dec 2019	Historical	FY17	FY18	FY19
Gearing	29.9%	RE Fee	0.60% p.a. of GAV	EPU – FFO per Unit	17.1	17.2	17.3
Target Gearing	<40%	Outgoings	36.0% of rental income	DPU – Distributions per Unit	15.6	15.6	15.8
Drawn Debt	\$210.8M	Other Exp	8.6% of rental income	Payout Ratio	87.7%	90.7%	91.3%
Facility limit	\$220.0M			Distribution Frequency	Qtrly	Qtrly	Qtrly
All in cost of debt	3.6%			NTA per Unit	\$2.23	\$2.67	\$2.79
Weighted Maturity	2.6 years						
% Hedged	81%						
LVR	30.7%						
LVR Covenant	50%						
ICR	4.41x						
ICR Covenant	2.0x						

Appendix: Financial Summary

Profit & Loss	FY19A	FY20F	FY21F	FY22F	Summary	FY19A	FY20F	FY21F	FY22F
Operating Revenue	60.5	61.8	63.1	63.7	NPAT - adj	28.2	28.8	29.4	29.8
Property Expenses	-19.5	-20.5	-21.0	-21.2	Price Earnings Multiple	11.4	11.1	10.9	10.8
Net Property Income	40.9	41.3	42.0	42.5	Revenue Growth	NA	2.2%	2.1%	1.0%
Other Income & Expenses	-1.0	-1.2	-1.2	-1.3	EBIT Growth	NA	0.6%	1.8%	0.9%
RE Fees	-3.9	-3.9	-4.0	-4.0	Value of Properties	668.4	664.9	678.0	685.1
EBITDA	36.0	36.2	36.9	37.2	Net Assets	454.0	454.5	468.6	476.9
Deprn & Amort	0.0	0.0	0.0	0.0	NTA per Unit	\$2.79	\$2.79	\$2.88	\$2.93
EBIT	36.0	36.2	36.9	37.2	Prem(Disc) to NTA per unit (based on current price)	-29.3%	-29.4%	-31.5%	-32.7%
Net Interest	-7.8	-7.4	-7.4	-7.4	DPU	15.8	16.0	16.5	16.7
Pre Tax Profit	28.2	28.8	29.4	29.8	Payout Ratio	91.9%	91.2%	91.2%	91.2%
Tax	0.0	0.0	0.0	0.0	DPU Growth		2.1%	2.2%	1.2%
Minorities	0.0	0.0	0.0	0.0	Yield	8.0%	8.1%	8.4%	8.5%
NPAT - adj	28.2	28.8	29.4	29.8					
Non Recurring Items	16.7	-3.2	-3.0	-3.1					
NPAT - Statutory	44.8	25.6	26.4	26.7					

Cashflow	FY19A	FY20F	FY21F	FY22F	Key Ratios	FY19A	FY20F	FY21F	FY22F
Operating Activities	36.5	38.1	39.0	39.4	EPU (adj)	17.2	17.7	18.1	18.3
Net Interest	-7.6	-7.4	-7.4	-7.4	EPU - Reported	27.5	15.7	16.2	16.4
Tax Paid	0.0	0.0	0.0	0.0	EPU (adj) - Growth		2.8%	2.2%	1.2%
Other	0.0	0.0	0.0	0.0	LVR	30.5%	30.3%	29.7%	29.4%
Operating Cashflow	28.9	30.7	31.6	32.0	Gearing	29.3%	28.9%	28.1%	27.7%
Capex	-10.1	0.0	0.0	0.0	Net interest Cover	4.6	4.9	5.0	5.0
Maintainable Operating CF	18.8	30.7	31.6	32.0	Distn / Maintainable CF	136.6%	85.7%	83.9%	84.4%
Distributions	-25.6	-26.3	-26.5	-27.0	ROE	6.3%	6.3%	6.3%	6.3%
Acquisitions	0.0	0.0	0.0	0.0					
Disposals	0.0	0.0	0.0	0.0					
Other	0.0	0.0	0.0	0.0					
Free Cashflow	-6.9	4.4	5.1	5.0					
Change in Debt	6.5	2.5	2.5	2.6					
Change in Equity	0.0	0.0	0.0	0.0					
Net Cashflow	-0.4	6.9	7.6	7.6					

Balance Sheet	FY19A	FY20F	FY21F	FY22F	Valuation	
Cash	7.5	8.8	10.1	11.4	Discount Rate	9.0%
Debtors	1.1	1.1	1.1	1.2	Terminal Growth Rate	2.5%
Investments	0.0	0.0	0.0	0.0	DCF Valuation per Share	\$2.86
Other Assets	668.9	665.4	678.5	685.6	12 Month Target Price	\$3.02 DCF rolled forward 12 mths
Total Assets	677.5	675.3	689.7	698.2	12 month Dividend Yield	8.2%
Creditors	6.9	6.9	7.1	7.1	12 month Target Price	53.2%
Borrowings	203.9	201.3	201.3	201.3	Total Est. 12 mth return	61.4%
Provisions	0.0	0.0	0.0	0.0		
Other Liabilities	12.6	12.6	12.7	12.8		
Total Liabilities	223.4	220.8	221.1	221.3		
Net Assets	454.0	454.5	468.6	476.9		

Note: FY18 EPU of 17.2cpu is calculated on quarterly basis.
When calculated on a daily basis EPU is 17.4cpu.

Source: Core Property estimates,
Note: Gearing = (net debt – cash) / (net debt – cash + net assets)

Ratings Process for A - REITs

Core Property Research evaluates recommendations on listed A-REITs continuously, based on a range of qualitative and quantitative criteria ranging from management, appropriateness of the A-REIT's capital structure and the property portfolio metrics. From a quantitative perspective, Core Property's recommendations are based on Total Expected Returns (forecast distribution yield plus forecast capital gain or loss) for a 12-month time horizon, using a range of valuation methodologies. The two most commonly used valuation techniques are Discounted Cash Flow (DCF), which uses an A-REIT's expected free cash flow, and the Net Asset Valuation (NAV) approach.

The 12-month Total Return is compared with set total return bands and assigned a 12-month recommendation based on the Recommendation Definitions below.

Recommendation Definitions

Recommendation	Definition
Buy	If the 12-month Total Expected Return is forecast to be 15% or more.
Accumulate	If the 12-month Total Expected Return is forecast to be at least 10% and less than 15%.
Hold	If the 12-month Total Expected Return is forecast to be at least 5% and less than 10%.
Reduce	If the 12-month Total Expected Return is forecast to be at least 0% and less than 5%.
Sell	If the 12-month Total Expected Return is forecast to be less than 0%.

At times of extreme volatility, it is quite possible that the recommendations will swing between each of our bands. During such times, Core Property will adopt a more flexible approach to recommending stocks, based on a slightly longer duration, and as such, recommendations may appear to be inconsistent when compared with the bands. This is to avoid clouding value judgments with short-termism.

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