STOCKS DOWN UNDER

20 APRIL 2022

ASX Property Stocks Down Under

"In the real world, ninety-nine cents will not get you into New York City. You will need the full dollar."

- Bruce Springsteen (b.1949), American songwriter and musician

US MASTERS RESIDENTIAL FUND

Selling itself at a heavy discount

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Stocks Down Under rating: ★★

ASX: URF
Market cap: A$96.2M

52-week range: A$0.18 / A$0.39
Share price: A$0.235

The US Masters Residential Property Fund (ASX: URF) is the only ASX REIT exclusively focused on United States property. It specialises in freestanding and multi-tenant properties in the New York City and New Jersey metropolitan area. While most ASX REITs lack controversy, this one is an exception after agreeing to sell itself in a deal that heavily discounted its ASX shares.

Share price chart

Source: Tradingview

A decade of growth, but responsible for the downfall of Dixon

URF was established in 2011 by Dixon Advisory and listed on the ASX in 2012. It aims to give Australian investors, particularly Dixon clients, exposure to residential property in the New York metropolitan area. As with other ASX REITs, the company buys and sells properties, but also manages them with the hope of portfolio growth in the long term. Since 2011 its portfolio has grown to 888 housing units across 483 freestanding properties. It has a gross asset value of ~$1.01bn, up from $69m a decade ago.

The New York metropolitan area is one of the world's most expansive markets, particularly for so-called 'freestanding property', which URF specialises in. Freestanding properties are not attached to anything else so they exclude apartments and terrace houses. URF listed at the end of the 2006-11 downturn in the property market and has reaped the benefits from a property valuation perspective. Valuations rose not just because of the property market and the long period of low interest rates, but also because the bulk of properties were renovated by Dixon affiliated companies. Initially it intended to buy distressed homes in New Jersey, but from 2014 shifted to buying premium properties, renovating them and renting them out.

However, URF has a market capitalisation of just A$100m and trades at a hefty discount to its NAV, which is $0.71 per security before tax and $0.62 after tax. As we articulated the last time we covered it, the company has two problems: debt and earnings yield. Compared to its peers, URF's debt is higher and its yield is lower. It has cut its debt through US$188m in asset sales since 2019, but its debt was still US$349.9m as of 31 December 2021. It also doesn't help that its Funds from Operations (FFO) was in negative territory by

US$17.4m. The company has positive EBITDA of US$4.2m - US$11.5m excluding disposal costs and one-off items – but FFO is a more reliable indicator because it excludes non-cash items such as forex movements, changes in asset values and capitalised expenses thereby giving a clearer idea of its operational performance.

We also note URF caused significant problems for Dixon, which lost its clients' money through the fund and was one of the key reasons why Dixon entered administration.

Throwing it all away?

On 25 March 2022, URF dropped a bombshell by announcing it entered into a traditional agreement to sell to a joint venture led by real estate investor Brooksville. To the company's credit it had foreshadowed a deal late last year, telling shareholders it was looking for 'capital market opportunities'. It had decided a portfolio sale was a more attractive outcome than going on or undertaking further asset sales. But the US$507m deal was at an 11% discount to its book value and a 38% discount to the previous' days trading price. Why the discount? Because ASX shareholders would be second in line after URF Convertible Preference Units holders and the latter would be getting a 23% premium to their trading price. On top of all this, the deal was a 22% discount to its recent valuation at US$645m.

The deal is conditional to Brooksville assuming its debt, a 60-day due diligence period and the approval of URF shareholders. Typically, when M&A deals are presented to shareholders, it's a foregone conclusion whether you're Uniti (ASX: UWL) and have gone up nearly 20 times in 3 years or you're Cashrewards (ASX: CRW) and accepting a deal at a 33% discount to the price you listed at just a year ago.

Could there be a better outcome?

On the day this deal was announced, URF shares sunk, but have since regained some of the lost ground. There has been media speculation that shareholders may ultimately strike the deal down when it comes to a vote, which is expected in July. It remains to be seen what would happen thereafter – if management would try and get a better deal, or if they would resign and hand the reigns to a new team. Shareholders would likely prefer either of those scenarios over accepting the present offer. In contrast, by soliciting for the deal and conditionally agreeing to it, management evidently lack confidence in their ability to grow URF going forward.

But even if URF was not to accept the current bid, there would still be a large debt problem and interest rates are moving upwards after several years of going down. With the uncertainty surrounding the company and the implicit lack of confidence by the management, URF is two stars from us.

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