11 MAY 2022

ASX Property Stocks Down Under

> *I've never cared for what something costs. I care for what it's worth.*
>
> **- Ari Emanuel (b. 1961), American entertainment agent**

360 CAPITAL REIT

Awaiting a pair of takeovers that will represent a makeover

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Stocks Down Under rating: ★★

ASX: TOT
Market cap: A$xxM

52-week range: A$x.xx / A$x.xx
Share price: A$x.xx

Today we look at 360 Capital REIT (ASX: TOT), one of the few ASX REITs that has historically been an investor in other REITs rather than in its own properties. 360 Capital REIT focuses on commercial properties in Australia and New Zealand. In a few months' time, it is set to be a very different entity to what it was at the end of 2020 – divesting one of its major assets and going from a minority owner to majority owner with the other. But how will the transition fare?

Share price chart

Source: Tradingview

The first deal

First of all, we must clarify we are talking about the 360 Capital REIT (360REIT), not the broader group that trades in its own right under the code TGP – although TGP does hold a ~23% stake in 360REIT. Last time we covered 360REIT in September last year, we noted it had two assets – a 12.8% stake in Irongate Group and a 50% investment in PMG Funds. We noted it briefly held a stake in Peet Ltd, but curiously sold only a matter of weeks later.

360REIT first bought into Irongate in early 2021, but since our last report, it and its parent company have fought for full ownership. After rejecting three earlier offers, Irongate consented on 30 March 2022 in an all-cash deal worth $92m. The deal is subject to shareholder approval, but will result in 360REIT acquiring an interest in three properties. A 100% interest in 38 Sydney Avenue in Canberra, a 100% interest in 34 Southgate Avenue and a 50% interest in 510 Church Street, Melbourne. All these properties are office buildings in fringe office markets that have a WALE of 7.1-10.0 years and are 100% occupied.

360REIT has sufficient financial resources to pay the $256.7m for these assets and will not be undertaking a capital raising. TGP will buy Irongate's 50% share in 100 Willis Street in Wellington. This was made possible through a partnership with Charter Hall and Dutch pension fund PGGM, which was entered into during 2021. 360REIT has told shareholders it expects the deal will hike its operating earnings per security by 4.4x from 6c per share to 26.5c per share.

The second deal

Let's turn our attention now to the company's 50% stake in PMG – it is separate to PGGM and holds 47 properties across New Zealand, mostly industrial properties. 360REIT is seeking to sell PMG back to TGP for NZ$21.9m. If shareholders of both companies approve the deal, it will realise a pre-tax IRR of 32.5%.

In making this decision, it cited a desire to become a pure ASX REIT with a simplified portfolio and the chance to crystallise an intangible asset, allowing funds to be deployed into tangible real estate equity. As part of the deal, TGP will be removing the performance fee structure to make 360REIT more competitive with its peers considering their fee structures. However, TGP will retain its existing shareholding.

Looking forward, 360REIT is looking to focus on similar commercial properties – office space, select retail assets and generic warehouse/logistics facilities. It is looking for properties that are securely leased to governments or major corporates and with low capital expenditure requirements. It is targeting properties with a $30m-$200m value range, gearing of 30-45% and interest rate hedging of 50-80%. Post the acquisition, 360REIT will have $154m in cash, which it could use to do its own deals.

How will shareholders fare?

Given the REIT will be a different entity to what it was in FY21 there is little point in considering its past results. But considering the share price has hardly budged, it appears the market has some scepticism about the deal or at least wants to see actual evidence that the company will be better off. However, by mere completion of the deal the company is rectifying some of our biggest criticisms the last time we covered it.

Our biggest criticism was that it was heavily reliant on an investment in another publicly traded company. But once it owns Irongate and its assets outright, that will be less of a concern. We also like that it has given forward guidance for FY23 – something not many other REITs have done – and that it paid below market for the initial three assets.

One thing we dislike about this REIT is that, at least for FY22 and seemingly FY23, it will be paying out a low proportion of its operating earnings, while there are plenty of other REITs paying higher. We acknowledge it pays more regularly than other REITs, but we would rather see payouts higher overall rather than lower payments more frequently.

This said, we think the current discount to its NTA is too excessive and we think there is potential for further acquisitions. Even before any more acquisitions, you are getting a trio of properties leased to high quality tenants for roughly a ~30% discount. Although investors who buy REITS for distributions probably won't be satisfied with this company, we think investors looking for growth will be. On that basis, this one is four stars.

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