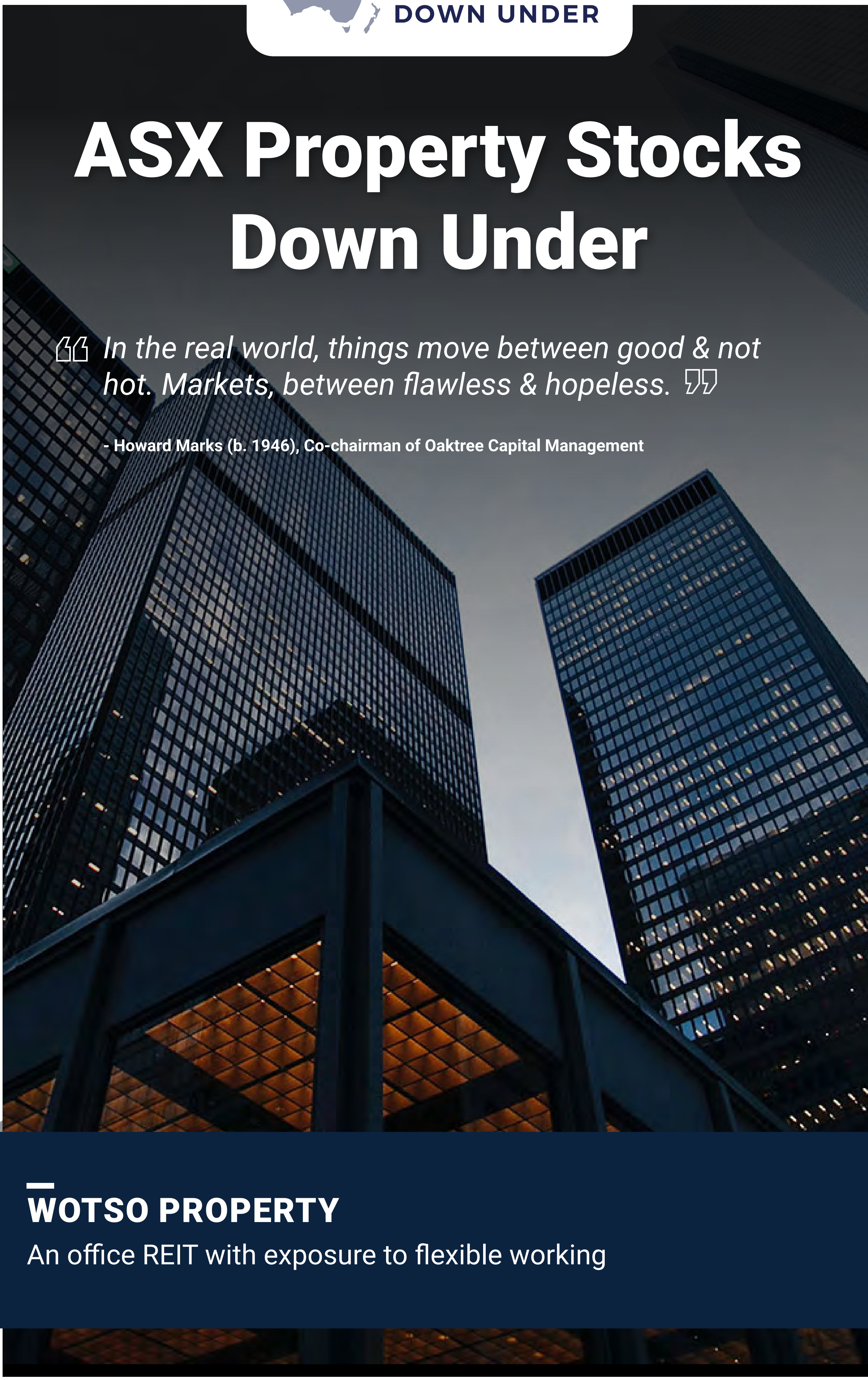

ASX Property Stocks Down Under

> *In the real world, things move between good & not hot. Markets, between flawless & hopeless.*

- Howard Marks (b. 1946), Co-chairman of Oaktree Capital Management

WOTSO PROPERTY

An office REIT with exposure to flexible working

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An office REIT with exposure to flexible working

Stocks Down Under rating: ★★★★

ASX: WOT
Market cap: A$215.6M

52-week range: A$1.20 / A$1.48
Share price: A$1.32

The bulk of office REITs have never recovered from the Corona Crash as 'flexible working' becomes the norm. But WOTSO Property (ASX:WOT) just might be on the right side of the equation here. It is the first (and currently only) ASX REIT to offer flexible office to its tenants. On a 6-month basis, Wotso's shareprice is actually in positive territory (by 3%), while the ASX 200 REIT Index is down 8%. Even if we assume flexible working is here to stay, is WOTSO really capturing market share, or are investors just buying in due to FOMO?

Share price chart

Source: Tradingview

Exposure to co-working

WOTSO owns 15 properties worth $385.2m and leases a further 9 properties from third party landlords. At all these properties, it offers space for businesses to operate, promising to meet any business need ranging from large corporates to healthcare professionals, chefs or designers. It offers individual suites, open plan workspaces or even virtual spaces. Wotso offers flexible options, allowing clients to rent a desk for a day or on a month-to-month basis.

Wotso was formerly owned by BlackWall but was consolidated into the new entity in FY21. Blackwall retains a 10% stake in the current entity. It is true that there are other companies offering exposure to flexible working, such as Victory Offices (ASX: VOL) and ServCorp (ASX: SRV). But unlike those companies (not to mention the infamous WeWork), Wotso is structured as a REIT, meaning its primary purpose is to own income producing assets and generate a return for investors from those assets.

Flexible working here to stay

Properties tend to lie in suburban areas that cater to small and medium-sized enterprises that want workspaces that are flexible and close to come. For instance, it owns properties at Manly and Penrith in Sydney as well as the northern Brisbane suburb of Chermside. Next month, it is entering New Zealand, setting up shop at Takapuna on Auckland's North Shore. It tends to acquire and repurpose distressed buildings, finding a new purpose for them as co-working spaces.

The company timed its run perfectly with the rise of coworking or flexible working. It had been on the rise prior to the pandemic, but was typically focused on startups. Since COVID-19 forced businesses to work remotely, it made flexible working mainstream and helped everyone see the positives as well as the negatives – yes there are some including isolation and concerns over worker productivity. JLL's Global Flex Space Report found that 41% of commercial office tenants expected to increase their use of flex space as part of a post-pandemic strategy.

Solid financials

In FY22, Wotso delivered $40.2m in revenue and a $36.7m profit before tax, which were up 32% and 214% respectively. These numbers suggest Wotso has a margin of over 90% but it is more complicated than that. The company recorded $19.2m in direct costs with a net rental income of $19.2m. To derive the NPAT figure, it deducts non-core expenses than adds back the net gain on assets which is $32m.

Wotso's annualised turnover reached $23.7m, which was roughly 50% above pre-pandemic levels of $16m. It paid a distribution of 6c per security, which was unchanged from the previous year. Wotso's Net Asset Value (NAV) is $1.66 per security on an underlying basis and $1.56 on a statutory basis (meaning after adjustments the company has to make due to accounting regulations but don't in practice impact the underlying value). Occupancy at WOTSO properties was only 73%, but up from 68% a year ago.

Wotso's companywide Funds from Operations (FFO) was $11.2m, down from $12.1m. Its FFO from individual properties rose from $15.6m to $18.7m (a 20% gain), overheads grew from $4.5m to $7m and cancelled out the FFO increase.

Given that Wotso has ~163.4m shares on issue, its FFO on a per security basis is 7.2c per share thereby providing a trailing P/FFO multiple of 18.8x at the current share price of $1.35. There are no consensus estimates for the years ahead as the stock is not covered by analysts. Wotso's yield is 4.4% and on a P/NAV basis is the stock trades at a 15% discount. But it is faring better than its office peers, which on average are trading at a 36% discount and a trailing P/FFO multiple of 11x.

Not for everyone, but we like it

We think WOTSO is in a good space and has done well to stand out to investors in spite of the WeWork horror story. This may not be a company for all investors, though, for a few reasons. First, Wotso is still exposed to the office space and investors' skepticism about the sector remains high. Second, because it explicitly disowns itself from having a long WALE. There is no shortage of REITs with high WALEs in the office sector and other sectors on the ASX. Third, we observe that it does not pay an inflation-busting distribution, at least not at the moment. But this is because inflation is at 40-year highs.

For our part, we are backing Wotso. We think that as flexible working becomes more entrenched, Wotso can continue to grab more market share, more revenues and more profits. Four stars.

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