STOCKS DOWN UNDER

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ASX Property Stocks Down Under

> *Train yourself to let go of everything you fear to lose.*
>
> **- Yoda, Jedi Master**

DESANE

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Stocks Down Under rating: ★ ★

ASX: DGH
Market cap: A$36.6M

52-week range: A$0.87 / A$1.25
Share price: A$0.895

There are only a handful of ASX property stocks that trade at a premium to their Net Tangible Assets (NTA) or Net Asset Value (NAV). In 2022, the majority of companies have borne the brunt of the cooling property market. However, only a handful of property stocks are trading at discounts of over 40%. Many of them are asset-scarce and illiquid companies, such as Auckland Real Estate Trust (ASX:AKL) and US Residential Fund (ASX:URF). Then there's Desane Group, an Australian property developer that has been listed since 1987. Does this company deserve to be in the same basket and is there a way out?

Share price chart

Source: Tradingview

A long-term property developer

Desane is both a property developer and an owner, specialising in commercial properties. One of its first ever properties was a redevelopment of the former heritage listed Grace Brothers building in the Sydney inner suburb of Camperdown. It has remained true to its roots with the bulk of its properties remaining in Sydney's Inner West. It has two properties under development at Leichhardt: 159 Allen Street and 322 Norton Street, both of which will be boutique apartment buildings. The Inner West Council has approved both properties.

Then it has five other properties that it retains as investments. These include the Villa Rosa building at Leichhardt that Desane wants to redevelop as apartments, two properties at Lane Cove, which offer both industrial and commercial space, a site on Thornton Street in Penrith that it wants to use as an industrial property, but is awaiting council approval, and lastly an industrial property in the Brisbane suburb of Wacol, which is leased to a local government tenant on a medium term basis.

A good FY22, aided by the property market

As at 30 June 2022, Desane held $97.6m in total assets, equating to $1.55 per share. 46% of assets are industrial and commercial properties, 37% approved Sydney Inner West residential properties and 17% are other assets, including cash and other financial assets. It recorded $6.8m in EBIT and a $4.6m NPAT, up from $2.7m and $1.8m respectively. Desane boasted that this was the eleventh consecutive yearly profit.

Revenues from ordinary activities were only $1.8m, down from $2.1m, but the $7.2m gain on revaluation of investment properties ensured the EBIT and NPAT lines remained in the green. This was nearly triple the $2.5m gain made in FY22. Nevertheless, it did not pay a dividend despite doing so just one year earlier. The company said it wanted to preserve cash to leave the option open to undertake further investment opportunities.

Headwinds in FY23

FY23 is not expected to see the same momentum that occurred in FY22. We won't see the revaluation gains we saw in FY22 due to the property market falling as interest rates rise. The company's CEO, Phil Montrone, said in the FY22 results that Desane's assets fall into a highly sought-after asset class – industrial and commercial assets – and provide stability of income. He also claimed his company's balance sheet left the door open to acquire further properties with medium to long-term benefit. Most of this may be accepted. And it could endure more upside than it otherwise would if property prices were rising.

However, we note three things. First, as goes without saying, it will depend on what specific properties are acquired. Some properties will provide more upside than others. Second, it could face supply chain issues and red tape delaying its developments and ambitions for its properties. Thirdly, there's the issue of interest rates. Desane has a $13.3m loan portfolio, secured by first registered mortgages against quality property assets. However, the rates are variable and only at 2.4% currently. It remains to be seen if these will go higher and what the impact will be on the company's cash flow statement.

Good ambitions, but seeing is believing

The company has big ambitions with its properties. It has told shareholders an additional facility to its Brisbane site would ultimately have a value of ~$20m and generate over $1.1m per annum in net rental income. The combined Norton and Allen Street apartments could yield revenues of $70-$75m for the group.

But, the company has not given indication of when we will start to see money flowing in and it may be some time. The company is generating income in the meantime, but it is relatively modest. On the topic of modest numbers, we also observe that the stock has low liquidity on the ASX. In the month of November there have been just four trades of Desane's ASX shares with less than $5,000 worth of shares changing hands. This depicts that even if you wanted to get in, it would be no easy feat. And getting out of the company would be another story altogether.

Ultimately, we think investors should leave this company until liquidity, sentiment towards property stocks and the broader property market improve as we see little upside for the company otherwise. Two stars.

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