BlackWall Limited

A high-growth property play

Share Price: A$0.83

Valuation range: A$2.00-2.41

ASX: BWF

Sector: Real Estate Management

31 January 2019

Attractive yields in property management

BlackWall Limited (ASX:BWF) is a Sydney-based property company with a long track record in development and funds management. The group is also growing a flexible office brand; WOTSO Workspace. BWF typically works with urban renewal or distressed property generating recurring fees from development and funds management. These assets are held in SPV investment structures or the group's total return A-REIT (the BlackWall Property Trust ASX:BWR).

Capturing the growth in Coworking office space

BWF operates distinct but complementary businesses. All its operating subsidiaries are mainly fee-earning businesses and are highly scalable. Through WOTSO, BWF is one of the leading operators of shared workspace networks across Australia. Considering the economic strength across Australia and the increasing number of businesses opting for shared office spaces, we believe BWF has substantial growth opportunities. Further, BWF's property management business attracts retail investors through its unique PIPES structures in a business that is traditionally inclined towards institutional capital.

Valuation range of A$2.00–2.41 per share

We value BWF at A$2.00 per share in our base case and A$2.41 per share in an optimistic scenario. Our valuation is based on a blend of DCF and SOTP-based relative valuation, with conservative assumptions regarding the commercial expansion of the business. Our valuation is highly sensitive to volume growth in terms of number of available desks across shared office spaces and BWF's real estate portfolio expansion.

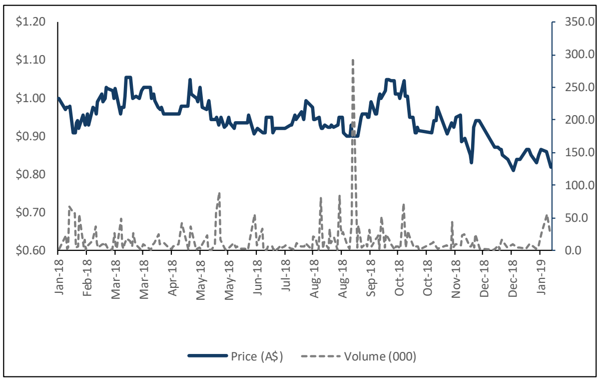
Year to June (A$)	2017A	2018A	2019F	2020F	2021F
Sales (m)	17.4	26.0	29.2	34.9	39.4
EBITDA (m)	6.7	12.8	13.1	15.7	17.7
Net Profit (m)	4.6	9.1	8.8	9.8	11.0
EBITDA Margin (%)	38.4%	49.2%	44.9%	45.0%	44.9%
ROA (%)	13.1%	22.8%	14.4%	20.6%	19.6%
EPS before extr. & amort.	7.84c	14.91c	14.30c	15.87c	17.95c
EPS	6.24c	13.54c	9.68c	15.87c	17.95c
DPS	3.60c	4.00c	2.14c	2.38c	2.69c
EV/Sales	2.4x	1.7x	1.2x	1.0x	0.9x
EV/EBITDA	6.2x	3.4x	2.7x	2.3x	2.0x
P/E	11.5x	6.4x	5.8x	5.2x	4.6x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	51.0
# shares outstanding (m)	61.5
# share fully diluted	67.6
Market Cap Ful. Dil. (A$ m)	56.1
Free Float	53%
12 months high/low (A$)	1.08 / 0.81
1 / 3 / 12-month performance	1.2% / -9.9% / -15.5%
Website	www.blackwall.com.au

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (k, r.h.s.)



Source: Thomson, Pitt Street Research

Valuation metrics	
Fair valuation (A$)	2.00-2.41
WACC	10.74%
Assumed terminal growth rate	2.0%

Source: Pitt Street Research

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Profit & Loss (A$m)	2017A	2018A	2019F	2020F	2021F	2022F	2023F
Sales Revenue	**17.4**	**26.0**	**29.2**	**34.9**	**39.4**	**42.7**	**46.8**
Operating expenses	-10.7	-13.2	-16.1	-19.2	-21.7	-23.6	-25.3
Adjusted EBITDA	**6.7**	**12.8**	**13.1**	**15.7**	**17.7**	**19.1**	**21.5**
Depn & Amort	-0.5	-0.9	-1.0	-2.2	-2.4	-2.7	-2.9
Adjusted EBIT	**6.1**	**11.9**	**12.1**	**13.5**	**15.2**	**16.4**	**18.6**
Net Interest	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Profit before tax (before exceptionals)	**6.0**	**11.8**	**12.0**	**13.4**	**15.2**	**16.3**	**18.5**
Tax expense	-1.4	-2.8	-2.2	-3.7	-4.2	-4.5	-5.1
Abnormals + Minorities	-1.0	-0.9	-3.9	0.0	0.0	-0.1	-0.1
NPAT	**3.6**	**8.1**	**5.9**	**9.8**	**11.0**	**11.8**	**13.3**

Cash Flow (A$m)	2017A	2018A	2019F	2020F	2021F	2022F	2023F
Profit after tax	3.6	7.9	5.9	9.7	11.0	11.8	13.4
Depreciation	0.5	0.9	1.0	2.2	2.4	2.7	2.9
Change in trade and other receivables	-3.5	-0.6	-0.2	-0.3	-0.3	-0.3	-0.3
Change in trade payables	0.5	0.4	0.2	0.3	0.3	0.2	0.2
Other operating activities	0.4	-8.0	-0.4	-4.7	-5.2	-5.7	-6.3
Operating cashflow	**1.5**	**0.7**	**6.4**	**7.1**	**8.2**	**8.8**	**9.9**
Capex (- asset sales)	-1.7	-2.0	-4.4	-7.0	-3.9	-3.4	-3.5
Other investing activities	-1.6	3.1	13.0	1.5	1.8	2.0	2.3
Investing cashflow	**-3.3**	**1.1**	**8.6**	**-5.5**	**-2.2**	**-1.4**	**-1.2**
Dividends	-2.0	-2.2	-1.9	-1.4	-1.6	-1.7	-1.9
Equity raised (repurchased)	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Debt drawdown (repaid)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financing activities	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Net change in cash	-1.3	0.2	13.2	0.3	4.5	5.7	6.9
Cash at End Period	0.7	0.9	14.1	14.3	18.8	24.5	31.4
Net Debt (Cash)	2.8	1.2	-12.0	-12.2	-16.7	-22.4	-29.3

Balance Sheet (A$m)	2017A	2018A	2019F	2020F	2021F	2022F	2023F
Cash	0.7	0.9	14.1	14.3	18.8	24.5	31.4
Total Assets	30.9	38.6	42.8	51.4	61.1	71.4	83.2
Total Debt	3.5	2.1	2.1	2.1	2.1	2.1	2.1
Total Liabilities	7.8	9.1	9.3	9.5	9.8	10.0	10.3
Shareholders' Funds	23.1	29.7	33.7	42.1	51.5	61.6	73.0

Ratios (A$m)	2017A	2018A	2019F	2020F	2021F	2022F	2023F
Net Debt/Equity (%)	12.2%	4.0%	-35.7%	-29.3%	-32.6%	-36.5%	-40.1%
Interest Cover (x)	34.9	91.1	144.2	160.1	181.5	194.8	221.4
Return on Equity (%)	23.0%	34.5%	27.7%	25.7%	23.6%	20.8%	19.8%

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Introducing BlackWall Limited (ASX:BWF)

BlackWall Limited (BWF), is a Sydney-based and ASX-listed, vertically integrated property fund manager. The firm manages, develops and finances income-generating commercial real estate on behalf of retail, High Net Worth, and institutional investors. It operates three separate, but complementary, segments. BlackWall Asset Management is a development and management business that acquires commercial real estate for incremental rentals. Under WOTSO WorkSpace, the company offers office space on short-term leases, shared workspaces and event venues. It provides space for projects, functions, and meetings on hire. The Investment segment (roughly A$30m) holds a strategic stake (A$15m) in BlackWall Property Trust (ASX:BWR) the group's total return REIT. The balance of the segment is actively invested in special positions to secure opportunities for either BlackWall Asset Management or WOTSO.

Current business operations provide flexibility in Australia's sophisticated real estate market

BWF has a capital-light operating model and all its business segments can further scale up the profit without significant capital allocation

In Australia, investment in real estate has been dominated by institutional investment across high-value REITS. BWF brings in distinct investment opportunities for retail investors. With its 20+ years of experience in the market, BWF buys distressed assets for the long term, and allows retail investors to own part of the portfolio. All its segments generate recurring revenue and are 'asset light', hence the model is scalable.

PIPES: Complicated but high-yielding investment structure

Property Income Participating Equity Security (PIPES) is one of BWF's distinctive propositions. It is a unique funding structure effectively bringing in retail participation in real estate investment. Through this arrangement, BWF introduces capital in the property market, without selling it and also simultaneously keeping the institutional gearing minimal. This mezzanine or preferred equity structure is a method to use funds from passive (retail) investors in the real estate market and mitigate risk by mixing it with funds through more aggressive investors, thereby keeping the cost low and liquidity adequate. This allows retail capital to invest in and cash out of unlisted real estate structures without necessitating the sale of the underlying property.

Coworking space — a growing investment opportunity

Increasing demand for shared office space across Australia provides significant growth opportunities for WOTSO

Through WOTSO, BWF provides coworking spaces to growing numbers of start-ups and small and medium-sized enterprises (SMEs). The flexible user-agnostic option allows the tenant to simply pay rent in a short term lease. BWF follows a hub-and-spoke model and has increased its network presence significantly over the past 3–4 years. With the Australian economy booming with start-ups, we believe shared office space provides an ideal investment opportunity for both retail and institutional investors. WOTSO's business proposition is to provide a commercial leasing transaction that is more suited to the needs of small business than conventional long term leases.

Business still highly undervalued

BWF is currently valued at A$50.4m, compared to our base valuation of A$123m. We think that the main reasons for this apparent undervaluation are incomplete understanding on the part of investors of the significant potential of coworking spaces in the Australian market, fear of rental yields stagnating, unfamiliarity with BWF's expansion outside the Australian market, concerns of a crash in the commercial property market, and not fully acknowledging the potential of rental investor participation through the PIPES investment funding structure. We look for a re-rating of BWF based on the company's increased coworking market share with more coworking desks, higher yields from maturing properties under WOTSO, declining vacancy rates and attractive opportunities to buy distressed prime assets that have attractive leasing and revenue profiles.

Top reasons to look at BlackWall Limited

1) BWF is one of the first companies that has been able to attract retail investors to real estate investment. Through large REITS funded by institutional capital, the management challenged the traditional unidirectional process of property investment.
2) BWF has an experienced team that has been at the forefront of property operational management services for the past 10–15 years. Together, management has restructured some distressed assets into highly rewarding real estate, consistently generating superior yields for investors.
3) PIPES is a unique structure in real estate funding, and has been able to introduce a significant number of retail investors into an otherwise niche investment option. PIPES fund provides investors with priority distribution, capital protection, and superior yields.
4) WOTSO is a revolutionary way of providing shared working spaces to small enterprises. It offers a plug-and-play process where tenants have to simply pay the rent by desk, thus removing the burden of long-term commitments required by traditional office leasing. This distinct feature is supported by the flexibility of short-term contracts, which attracts many start-ups, freelancers, and small organizations.
5) Considering WOTSO charges ~50% premium for its flexible system, the average EBITDA margin for a mature WOTSO property is 20–35%. Further, both WOTSO and the asset management business deploy multiple revenue and fees earning structures, providing revenue diversity.
6) Counter cyclical considerations: Management expect WOTSO's 'commitment light' model to be more attractive to potential users in times of economic distress, that is, periods in which office users are less inclined to enter into long term commitments. Further, historically BlackWall Asset Management's activity has increased in times of flat or distress property markets—AuM doubled in 2009 through the acquisition of a number of distressed subscale funds management businesses.
7) All of BWF's operating businesses generate recurring revenues and are scalable. As they are also asset-light, its subsidiaries do not need extensive capital infusions for expansion. Having been in the business for >20 years, the company has developed well-defined philosophies of property investment. It is not looking for deeper penetration in the real estate market but rather aims to build an optimal portfolio that is rewarding over the long term. These well-formulated working principles grant BWF a unique position in an otherwise undifferentiated market.
8) We believe BWF has gained the trust and respect of retail investors. The PIPES funding structure has provided retail investors with the opportunity to invest in quality real estate and earn higher yields compared to other property investments. Similarly, WOTSO's relationship with small enterprises ensures that tenants stay with it long term.

9) The company manages a portfolio of quality, highly rewarding assets, such as 55 Pyrmont Road, Silver at the Exchange and Canberra North. These once distressed assets have all been turned around as a result of better operational management and establishing WOTSO in parts of the building and have now become valuable real estate assets.
10) WOTSO has expanded beyond Australia by partnering with local retail players in Singapore and Malaysia. This is expected to extend their coworking space network and utilize reach to hedge current operations.
11) We believe BWF is currently undervalued. We value the company at A$2.00 per share in our base case scenario, using a blended valuation approach of DCF and relative valuation. We have applied conservative estimates on the increase in coworking desks offered by WOTSO, average price on WOTSO desks, fees earned from asset management, and contribution from the overseas market.

Distinct structure for property asset management

Australia has always been an evolved, sophisticated and knowledgeable property market. Traditionally, investment in real estate has been dominated by large institutional investors, through REITs. BWF changed that through its unique participatory and long-term philosophy. Its uniquely designed funding structure enables retail investors to own a piece of a real estate portfolio, thereby increasing the number of investors, and removing the overreliance on large funds.

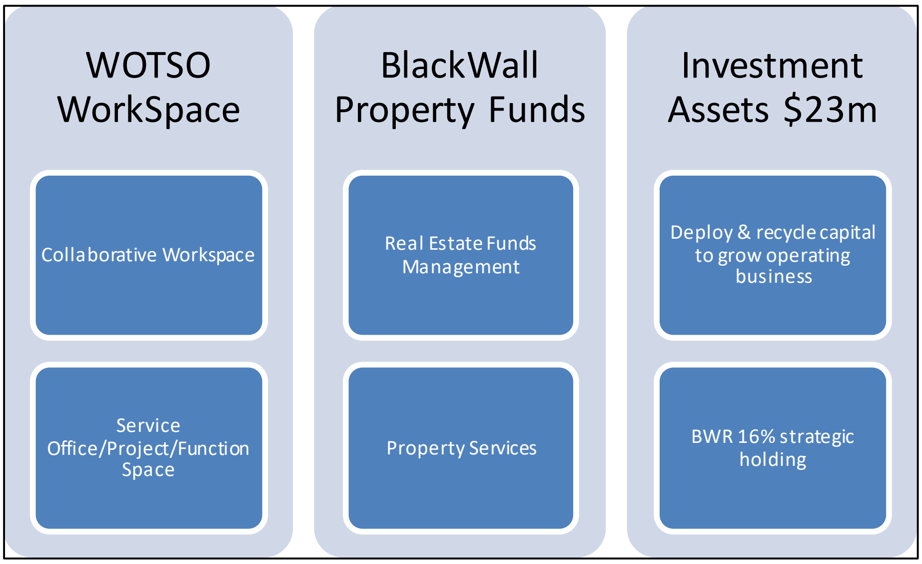
A well-positioned property with amenities will attract and retain users and over time command a premium

BWF has a patient property investment philosophy. It acquires real estate at a discount, with the intention of holding on to it for the long term. The company strives to increase rent by creating leasing opportunities through adaptive reuse and development. BWF is not involved in residential real estate and is fully focused on the commercial property market. Its WOTSO operating segment focuses on the niche coworking office rental space for SMEs.

As a business rule, BWF only buys active assets where it can add value. Management invests in distressed (financial or real estate distress) assets with adaptive reuse opportunities, so that it can provide healthy cash flow over a long-term period. This has helped BWF keep debt levels manageable and deliver consistently high returns (Figure 1).

Management structures the funding in such a way that passive/retail investors can exit a project without selling the underlying asset. Furthermore, an asset is only sold when all the growth opportunities in that asset have been exhausted or the after-tax capital gains are higher than the future returns.

Figure 1: BlackWall structure of operations



Source: Company, Pitt Street Research

1. WOTSO: Unique proposition in coworking space

WOTSO is a fast-growing, dynamic, and relatively new business line for BWF. It is disruptive for the traditional office renting business, where only a desk or a part of the entire space can be leased out. WOTSO offers a user-agnostic, flexible way of renting office space. The user/company does not face a real estate cost/risk and can use it as per requirement. Cost related to refurbishing, network connectivity, maintenance, security, concierge, etc., are all managed by WOTSO. Users only pay a monthly rent. The most unique proposition is that there are no long-term lease contracts.

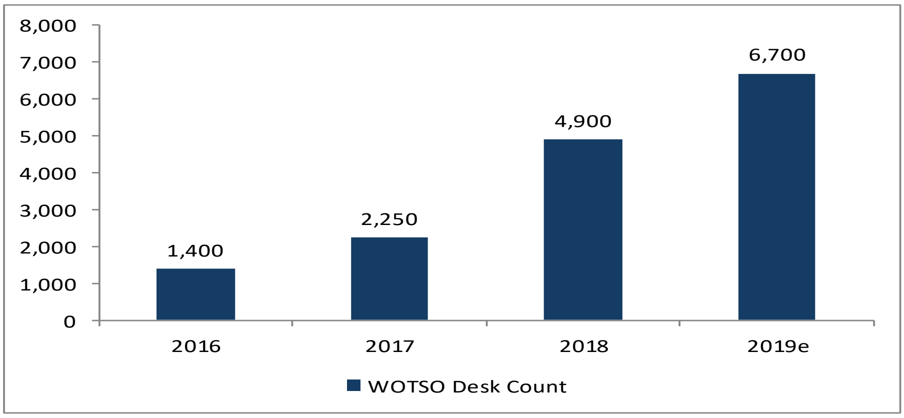
Under WOTSO, BWF takes office space and adds amenities and design and offers flexible terms to drive a higher margin than conventional leasing arrangements

Based on a similar policy of offering a good office environment and developing a long-term relationship with the lessees, WOTSO works on short-term contracts, builds long-term relationships and works on retaining tenants. The company carries out small transactions with many customers, thus hedging risk, rather than conducting large transactions for a few companies. A typical WOTSO space is between 1,000 and 2,000 square meters.

BWF has historically invested in real estate outside the central business district (CBD) and this has been WOTSO's approach as well. The company follows the hub-and-spoke network model where limited CBD locations provide amenities for WOTSO's regional and suburban network. This helps maintain higher operating profitability. As WOTSO's network grows, BWF can generate better margins because it charges a hefty premium for providing good quality real estate at highly flexible lease terms.

WOTSO's inventory is the desks it rents in open plan areas on a non-exclusive (hot desk) or exclusive (permanent desk) basis (Figure 2). It also offers private desks in offices. Its potential revenue is therefore a function of desks at each location. A mature site can generate A$700–900 per square meter of gross floor area (GFA) per annum. According to management, WOTSO locations usually have a 5% average vacancy rate. Considering that it expects to supply 6,700 desks by 2019E, it will have the capacity to generate a gross revenue of just over A$30m. A mature network has the possibility to earn an EBITDA margin of 20–35%. This makes the business highly lucrative. Unlike traditional leasing arrangements, WOTSO's growth is not limited by inflation. Where demand is high, its margins grows quickly because costs are essentially fixed.

Figure 2: Number of desks available under WOTSO

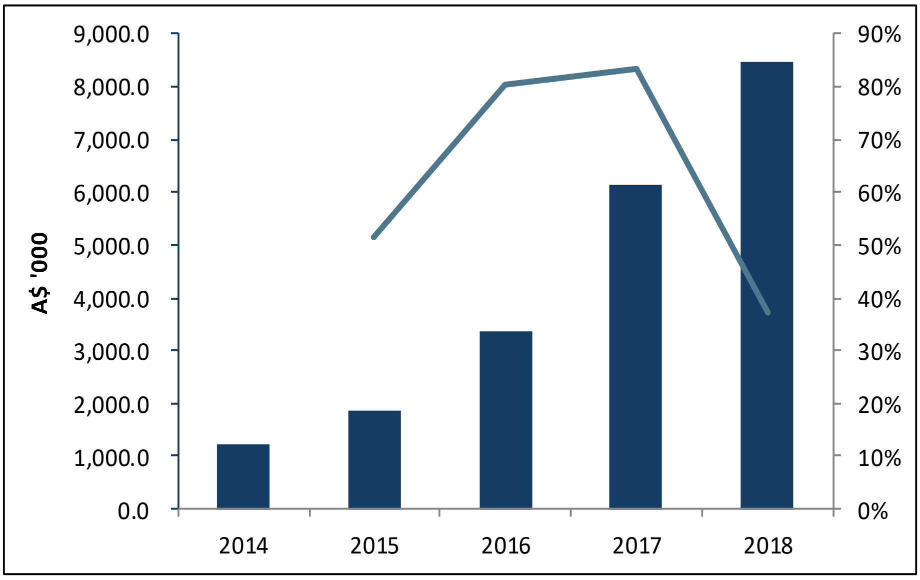


Source: Company, Pitt Street Research

Initially, WOTSO was typically housed in property controlled by BWF, but now its operations and potential go beyond that. In 2016, WOTSO collaborated with a local partner, Springboard, to launch its services in the fast-growing Singapore market. Similarly, BWF recently formed a Joint Venture (JV) with UEM Sunrise Berhad in Malaysia, a large local real estate player to operate its coworking rental business in the country.

With the scope of operations going beyond the traditional market of Australia, and beyond the property controlled by the group subsidiaries, WOTSO's business has come of age (Figure 3). As the gig economy of freelancers, experts, and independent consultants grows, we believe the requirements of flexible and shared working space will expand tremendously.

Figure 3: WOTSO's revenue and revenue growth (r.h.s.)



Source: Company, Pitt Street Research

2. BlackWall Asset Management

BlackWall Asset Management is the group's traditional property management and funds business. It has been operational for over 20 years and generates consistent fee income from a portfolio of real estate held in investment structures capitalized by wholesale and retail investors. It acquires income-generating property, enhances rental returns and through this, increases distributions for investors. The business has a long and proven track record of generating consistent recurring revenue and periodically generates significant transaction/performance fees.

BlackWall Asset Management generates fees from real estate investment structures – the largest of these is ASX listed REIT, BlackWall Property Trust (ASX:BWR)

Through this operating subsidiary, BWF structures boutique property investment offers for HighNet Worth individuals and its retail investor network. Under this subsidiary, BWF has structured debt, equity, and hybrid investment offers with respect to over a billion dollars of income-generating real estate. Management structures ways for individual investors to exit a project without actually selling the project. All investment structures created by the group have generated returns of at least 8% per annum for investors. Additionally, management has a long track record in turnaround, distressed debt, and urban renewal projects that are all carried out under this operating business.

BWF manages debt levels for each fund to reflect the asset's cash flow rather than the amount a financier is willing to lend. It usually sells an asset only when it has exhausted growth opportunities or the after-tax capital gains are higher than the returns that can be generated by continuing to hold the asset. This discipline is ingrained in all aspects of the operations.

Over the years, BWF has managed many property funds, distributing uninterrupted returns to the investors. Some of the current active funds are as the following:

1) **BlackWall Penrith Fund No. 3** – The fund promises a return of 9% per annum paid quarterly. At maturity (7 years), investors' capital is expected to be returned along with a bonus equal to 20% of the capital gain (based on the increase in the value of the property over the term). The fund manages a 'big-box' retail complex at 12 Mulgoa Road, which was developed in 1996. Its tenants include Toys 'R' Us, Barbeques Galore, and Boating Camping Fishing. The property was valued at A$16.5m on a 9.5% capitalization rate by Landmark White in December 2013.
2) **Pyrmont Bridge Trust** – It holds the property at 55 Pyrmont Bridge, which is a single-asset wholesale unit trust. The property on the western end of Sydney's CBD is 15,000 sq m. It housed FOX Sports earlier, and is now occupied by media and technology tenants, including Verizon, Fairfax Media, and Digital Pacific. It also houses WOTSO WorkSpace. The building's lobby was refurbished and the building was upgraded to add a childcare center to accommodate 140 children on Level 1, which significantly uplifted its value.
3) **Woods Pipes fund** – It is a capital protection and priority distribution PIPES fund that returns 8% per annum, paid quarterly. The special feature is that the fund management fee is only paid if investors' quarterly returns are paid. Its units have an asset backing of 100 cents on the dollar on commencement. It is a stable property fund with rising returns. Under the fund, BWF manages multiple tenants, including AMF Bowling, M9 Laser Skirmish, Kartatak Raceway, Sydney Indoor Climbing Gym, and Chipmunks Playland.
4) **Bakehouse Quarter** – This is a special-purpose trust that controls the development of a large-scale real estate development known as the Bakehouse Quarter, located at North Strathfield, Sydney. It is a large-scale, mixed-use property. The property is owned by Kirela Development Unit Trust and managed by BlackWall. The trust was formed in 1997, when the property was purchased from Arnott's Biscuits. Since then, BlackWall has steered the development of the project from an abandoned 60,000 sq m factory to a busy mixed-use precinct. BlackWall Property Trust (BWR) owns a 14.4% stake in Bakehouse Quarter. In 2017, BlackWall negotiated a call option with Yuhu to buy-out specific parts of Bakehouse Quarter for A$380m, of which A$38m is nonrefundable. In July 2018, after holding Bakehouse Quarter for 21 years and generating an IRR of 15% through strategic leasing transactions, Kirela agreed to the sale for A$380m, to be concluded in February 2019. The investors in the Bakehouse

investment structure have earned an IRR over a 22-year period of well above 15% per annum.

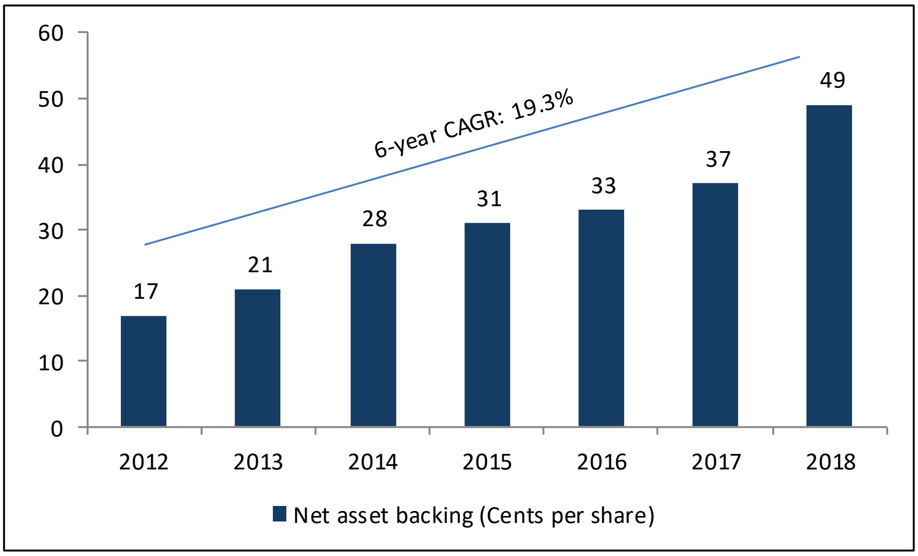
3. Investment: Portfolio management vehicle

Subject to relevant investor approvals, BWF will sell its position in the Pyrmont Bridge Trust to BlackWall Property Trust. The transactions will generate ~A$10m of cash. This cash will be deployed in acquiring additional assets and for fit-out costs across new WOTSO locations

Investments is one of BWF's most straightforward business segments. It manages the transactions that BWF conducts and does not run an operational business. The main scope of work under this segment is to deploy and recycle the capital to grow the other operating businesses.

Through this segment, BWF invests in deep value or opportunistic positions with strategic or operational benefits for WOTSO or BlackWall Asset Management. Currently, the segment manages BWF's 16% strategic position in the groups listed REIT. As at 30 June 2018, the business of investment has a net asset backing of 49 cents per share (Figure 4). Often these positions are traded to generate cash for new opportunities. In 2017, WOTSO Adelaide was moved off balance sheet and it is expected WOTSO Fortitude Valley to follow within 6 months.

Figure 4: Investments — Net Asset growth run rate



Source: Company, Pitt Street Research

BWF used capital to secure opportunity with the other two operating business of the group. In the last 4 years, BWF had bought two properties using the balance sheet liquidity of the company to shore up the profits. The segment helps BWF to align its interest with those of its investors. Excess capital is used to manage a mechanism for generating recurring revenue through asset management and WOTSO's operations.

PIPES: A distinctive but rewarding investment structure

PIPES are mezzanine funding structures that provide capital protection investment vehicles to retail investors. BWF provides unique funding structures where third-party funds are used to sponsor the property acquisition, and in return the investors earn periodic returns. Under PIPES, BWF allows participating equity security to passive retail investors. They are treated as preferred debt investors in the fund and are paid before anyone else. They are also considered equivalent to preferred equity investors as in a direct real estate asset transaction.

PIPES is a funding structure that mixes high-reward, risk-oriented funds with return-oriented passive funds, i.e. equity capital market investments with PE, Venture Capital funds, etc.

BWF, which manages such funds, receives fund management fees (usually over a 7-year period), and whatever is left (after selling the property and paying the investors) is paid back to the owner. This structure of incumbent participation in investment, with property being the security, addresses the key issue of multiple investors for BWF. It is through PIPES that BWF has been able to make a mark for itself in a market that had traditionally been dominated by high-value REITS and institutional money.

A key feature of the structure is that it allows passive retail investment capital to participate in commercial real estate without the necessity of selling the underlying property. This is significant to the longevity of the recurring funds management fees BlackWall can generate from a particular asset. By way of example the BlackWall Penrith PIPES Fund is the third iteration on that particular assets. At each “renewal” retail capital has been given the opportunity to cash out or reinvest in the new investment term. As such BlackWall has managed this structure for 18 years.

How PIPES work

Under the structure, PIPES Capital investors are allocated units in a trust. The trust makes an investment in real estate secured by a PIPES Mortgage. PIPES Capital ranks higher in priority to the property owner’s equity but is subordinate to PIPES Mortgage. The PIPES Mortgage also gives control of the Property and its cash flow to the responsible Entity on behalf of the Fund. (Figure 5).

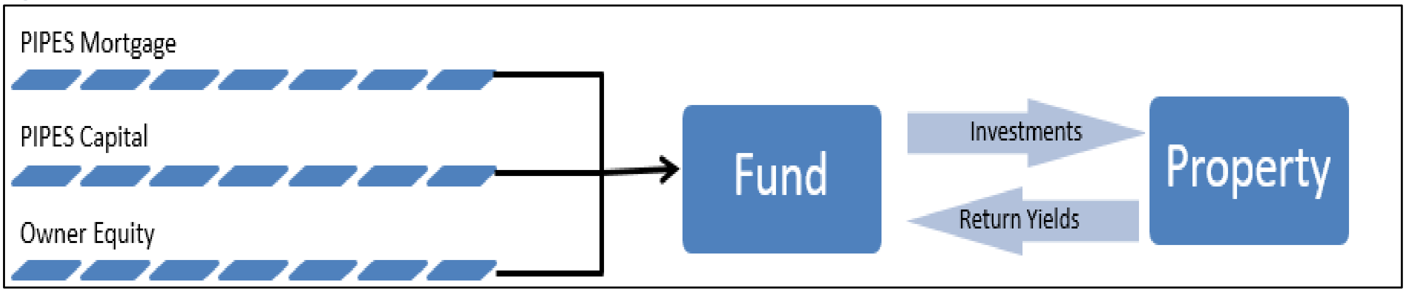
PIPES structure has a downside — they are usually not liquid and investors have no right to withdraw their investment during the term (~7-years)

For example, if a property investment requires A$6m, BWF will initiate the PIPES fund and collect ~A$4m from passive retail investors, treat them as preferred partners – who are promised a better yield compared to similar investments elsewhere, mix the PIPES funds with funds from other professional investors as well as debt. This way it gets a significant amount of money from investors that are happy to be part of a high yield returning asset, and introduces capital into the market without unnecessarily selling an asset, keeping gearing at a manageable level and also mitigating the risk by mixing funds from risk-taking experienced investors.

The key benefits of the PIPES structure are:

- Acquisition costs associated with direct or syndicated property ownership are not paid by dipping into the investor’s funds. On origination, an investment in the PIPES Fund has asset backing of 100 cents in the dollar.
- The PIPES capital has a downside protection from the onset as the owner’s equity acts as a buffer. PIPES Capital will suffer in the scenario where the property value declines significantly to wipe out the owner’s capital.

Figure 5: PIPES investment structure



Source: Company, Pitt Street Research

PIPES exhibit characteristics of debt as well as equity. Investors' capital is invested in the Property and secured by a second-ranking (after debt) mortgage registered on the title of the Property. The Fund has control over the property, its cash flow and improvements during the Term. Investors receive PIPES Interest (periodic payment) and a PIPES Bonus (one-time payoff at the end depending on the capital gain from the property).

BWF has been offering such investments since 2000 when it first launched a PIPES fund. All PIPES structures generated quarterly returns of at least 8.75% per annum and income distributions have never been suspended. These payments are dependent on the income and capital appreciation of the property. Both the investments (and any returns on them) are subordinate to the amounts owed to and the rights of the first mortgagee. The BlackWall Storage Fund (a PIPES structure) matured in September 2013, generating a 7-year IRR of 14.6%.

BlackWall Property Trust (A-REIT)

As of June 2018, BWR has gross assets of A$273m with ~44% gearing levels. It has issued a total of 66.6m units, of which ~16% are directly owned by BWF

BlackWall Property Trust (BWR) is an ASX-listed (ASX: BWR) total return real estate investment trust (A-REIT) managed by BWF. Total return means that the trust generates recurring, tax-effective distributions from a stable property portfolio and net asset value growth through development, turn-around, and opportunistic investments. BWR generates and distributes income returns from assets held in its income portfolio. It also takes on special situations or development properties to generate above-average gains through the growth portfolio. Once assets in the growth portfolio stabilize or mature, they move to the income portfolio to increase distributions. The trust either purchases real estate directly or holds positions in property JVs. BWR has interests in commercial, retail, and industrial property (Figure 6). BlackWall Asset Management earns property and funds management fees from the trust, as well as leasing and transactional fees.

Figure 6: Property Investment Portfolio of BWR

Property Investment Portfolio (A$' 000)	Ownership	Passing Yield	Fully Let Yield	2018	2017
Commercial					
Canberra North, ACT	100%	5.70%	9.70%	30,000	25,000
Varsity Lakes, QLD	100%	6.10%	7.60%	18,200	18,000
Pyrmont Bridge Road, NSW*	32%	6.50%	6.60%	117,000	13,677
Hobart, TAS	100%	7.70%	8.00%	8,800	8,400
Canberra South, ACT	100%	2.60%	7.20%	8,250	8,100
Mixed Use					
Bakehouse Quarter, NSW	14%	6.50%	6.60%	36,133	28,216
Sippy Downs, QLD	100%	6.10%	7.10%	26,400	26,200
Industrial					
Yandina, QLD	100%	13.60%	13.60%	20,100	22,200
Toowoomba, QLD	100%	2.20%	7.40%	6,600	6,500
Total property investment portfolio				271,483	156,293

Source: Company, Pitt Street Research

Real estate investment structures in which BWR has invested will have carry forward tax losses (often derived from the development process). Where this is the case, distributions are received as returns of capital. To account for this, distributions are applied against the carrying value of the position on the balance sheet and then shown in the Profit and Loss column as an unrealized gain.

Over the years, BWR has undertaken many complex property transactions, added value by face-lifting them and increased the cash flow. Two such examples are:

- **55 Pyrmont Bridge Road** (BWR owns ~32% in the property)

  In 2014, the company structured the acquisition of the then half-empty office building. That transaction was a complex distressed debt purchase in a JV with NAB at a value of A$80m. Since then the asset has been repositioned, is fully tenanted, and NAB's investment has been purchased out. Management successfully completed negotiations with the property's largest tenant, Verizon, which has committed a further term of 5 years through November 2023, with two additional options of 5 years each. The property was independently valued at A$111m in June 2017, which is ~40% incremental value growth over three years.
- **Canberra North** (BWR owns 100% in the property)
  Earlier, it was completely occupied by Telstra and was called Telstra House. The property is located in the Northbourne Avenue commercial zone, next to the Dickson retail precinct. It also houses a WOTSO work space. Since June 2016, the property has been generating an annualized gross revenue of A$1.5m, which has grown by 47% to A$2.2m. Since June 2017, the demand for WOTSO's flexible office space has grown. To meet this demand, Canberra North has been repositioned to house WOTSO's tenants. This change has led to a restructuring of the arrangement between WOTSO and BWR, as the building owner. The conventional lease structure has been replaced with a management arrangement, wherein all revenues go to the

property owner and all operating costs are covered using said revenue, with WOTSO earning a fee based on turnover. The current annualized gross revenue is A$2.8m and fully let gross revenues should reach A$4m, ~82% more than what was projected as the maximum pay out.

Figure 7: Reconciliation of Property Investment Portfolio of BWR

	2018	2017
Opening Balance	156,293	136,197
Pyrmont net acquisition / consolidation	99,319	5,461
Revaluation of Bakehouse Quarter	8,679	8,680
Revaluation of Pyrmont	6,240	6,258
Revaluation of Canberra North	4,761	110
Revaluation of Other property investments	2,346	694
Capital improvements	1,998	593
Straight-line rental income	850	622
Depreciation	-4,421	-2,626
Revaluation of Yandina	-1,921	-2,054
Returns of capital – Pyrmont	-1,900	-190
Returns of capital – Bakehouse Quarter	-743	-1,473
Other disposal	-18	-
Hobart acquisition	-	7,800
Bakehouse Quarter net acquisition	-	909
Coolum property sale	-	-3,400
Other property investment sales	-	-1,288
Closing Balance	**271,483**	**156,293**

Source: Company, Pitt Street Research

Bakehouse Quarter Transaction

After a 22-year investment period, BWF recently announced a deal to sell off its Bakehouse Quarter property. The deal is expected to be completed in February 2019 and BWF is structuring a proposal that, subject to unit holder and regulatory approval, will see up to A$100m added the BWR balance sheet. With this transaction, BWR (~14% ownership) can expand its opportunistic total return investment strategy and can expect gross assets to grow to over A$750m over the next 5 years. The Bakehouse investment has generated over 15% IRR per annum for the past 22 years. As part of this transaction, BWF will also seek approval to make the following investments:

- The acquisition of BWF's position in the Pyrmont Bridge Trust.
- The acquisition of the properties: WOTSO Adelaide and WOTSO Fortitude Valley.

Following these transactions, BWF's balance sheet is expected to have roughly A$100m in cash, which provides the company with a large cash reserve for future opportunities.

Diversified business model facilitates growth

BWF's business operations revolve around its wholly-owned operating subsidiaries. All of them have distinct operations but the underlying set-up is similar. All follow the 'capital light' principle and generate recurring revenues. For BWF, this translates into the capacity to scale-up without significant capital allocation.

Revenue arrangement for WOTSO

For BWF, the WOTSO segment follows the operating model of a hotel, where the revenue is earned from customers'/members' real estate-linked operation. Consequently, WOTSO deploys a number of structures with property owners and earns in different ways through them:

1) **Leased and Owned Sites**

   WOTSO takes control of the property either through a lease or direct ownership, refurbishes them, and leases it out to the tenants. The revenue from these sites is shown in the income statement. The cost of occupancy in a leased site is shown in WOTSO's rent line. These sites incur operating expenses, such as electricity, staff, consumables, marketing, and other costs.

2) **Management Agreement**

   WOTSO applies its branding, systems, and network to generate revenue on behalf of the property owner. The risk for WOTSO is mitigated in this case as it does not pay set-up costs. WOTSO Bondi is an example of set-up costs funded by the company. Management charges 20% of WOTSO's revenue as fee and this is entered into the company's income statement.

3) **Joint Ventures**

   In some cases, the company creates a separate entity to operate from. For example, in Malaysia, BWF has partnered with UEM Sunrise Berhad, a large real estate player, to operate its coworking business. Here, WOTSO licenses its brand, intellectual property, and systems to the JV. As with other JVs, this too will be equity accounted and only the licensing fee and WOTSO's profits will count as revenues in the income statement.

Regardless of the type of structure leveraged at a particular site, WOTSO's revenue is a function of receipts from its members. The company terms these receipts as WOTSO's turnover and tracks it to analyze its performance.

Fees from Asset Management

Asset management has a track record of generating a consistent recurring fee income and periodically accounts for significant transaction performance fees.

Income under the three segments is earned in a number of ways:

1) **Management fees**

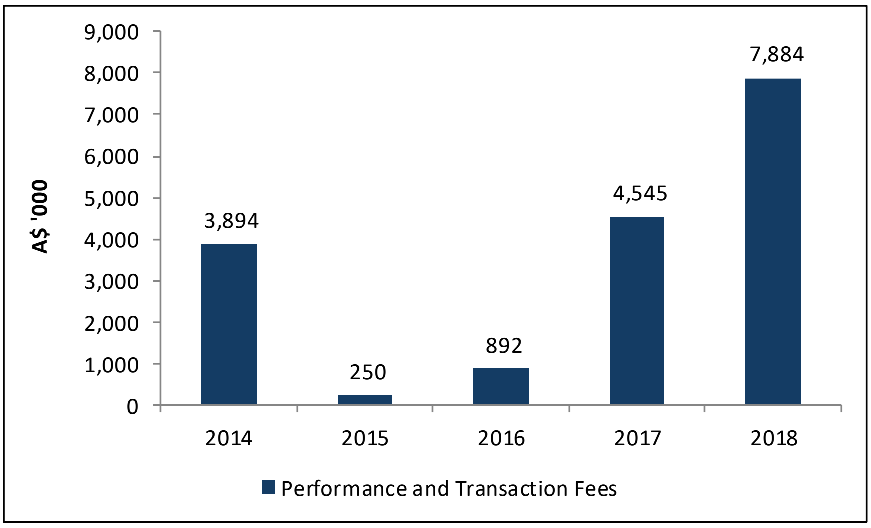
   - **Property Management Fees:** The fee is calculated as a percentage of gross revenue generated by the property. It is 1–4% of the gross revenue, depending on the complexity of the property. For example, Bakehouse Quarter, a complex site, contributes ~3% of gross rentals as a management fee.

- **Fund Management Fees:** This fee is collected for the management of the investment structure of real estate. In this case, the fee is calculated as a percentage of the gross asset value. It is 0.25–0.65% of the gross asset value per annum. For example, the funds management fee charged to the BlackWall Property Trust is 0.65% per annum of the gross asset value, while that from Bakehouse Quarter was 0.25% of the anticipated sale value of A$270m.
- **Leasing and Project Management Fees**: This is collected by event-driven leasing opportunities due to the acquisition of new assets, development, or tenant revenue. When the company finds new tenants or manages construction, it earns a one-time fee. For example, it got an extension on the Verizon lease at 55 Pyrmont Bridge Road, which fetched the company a fee of ~A$300K.

2) Performance and Transaction Fees

These fees are contingent on certain events, and hence are irregular (Figure 8). The company earns a one-off fee when a project outperforms or when a transaction is completed. The payment is upfront or interest in the investment structure. For example, in 2018, BWF received A$7.9m for outperformance at 55 Pyrmont Bridge Road. The fee was awarded for exceeding a reference IRR earned by the investors.

Figure 8: Performance & Transaction Fees are irregular



Source: Company, Pitt Street Research

WOTSO's duration mismatch isn't actually a mismatch

Prominence, Profile, and Location are WOTSO's Unique Selling Points (USPs)

WOTSO signs long-term leases for properties that it then leases out to clients that prefer flexible short-term leases. Investors sometimes question this duration mismatch. To avoid any knee-jerk reactions, management actively structures WOTSO's operations to mitigate any possible rent-period-related risk.

1) **Location**: One of WOTSO's single largest advantages is location. WOTSO offices are often located in suburban locations, where customers have limited choice, availability of pristine real estate is restricted, and thus the barriers to entry for competition is high. The risk profile of WOTSO offices in these areas is limited.

2) **Profile**: The second differentiating factor for BWF is management's ability to structure land deals in a way that the risk profile of the group is limited. Management often negotiates the land deal (Figure 9) such that they do not commit a lot of capital and mostly reward the land owner through value-add from its products, i.e. the WOTSO facility.

Figure 9: Case examples of WOTSO's highly beneficial structured land deals

- WOTSO structured a deal where it took management control without committing to any major capital infusion. The 20:80 structure of the deal favors BWF that infused only 20% of the fit-out costs (the owner is responsible for the rest) while it retains the same proportion of the revenue. The property is managed by WOTSO, and the land owner benefits from diversification of the client profiles, value-add of the property and better long-term visibility.

- WOTSO is negotiating a land deal by following the principle of progressive rent. Rather than committing to a long-term rent payout, WOTSO is proposing lower rent to the owner in initial period of the lease. As the location gains traction for WOSTO's operations, the land owner is expected to realize higher rental income. This deal is expected to support land owners with progressive rent, and ensure a marginal risk for WOTSO (by not committing to a large rent figure); thus WOTSO manages its margin without infusing big capital and the land owner mitigates rent-risk across many clients.

Source: Company, Pitt Street Research

3) **Prominence**: In times of economic downturns, clients often find WOTSO's flexibility highly valuable, as they do not have to commit to any long-term commitment. This is why clients often prefer WOTSO to rigid CBD-based shared office space operators.

Since WOTSO is not usually present in CBD areas and its operations are not limited to commoditized markets, it has the flexibility to add value to the real estate itself. Average occupancy is the Key Performance Indicator (KPI) for WOTSO, and not the average length of tenancy of its client. WOTSO's prime responsibility is to maintain flexibility for its clients, and hence it can charge premium fees.

Due to structured deals and high entry barriers for specific locations, the underlying risk profile of the WOTSO business remains low. We believe, it is also less sensitive to most of the common real estate related operational risks.

Key addressable markets

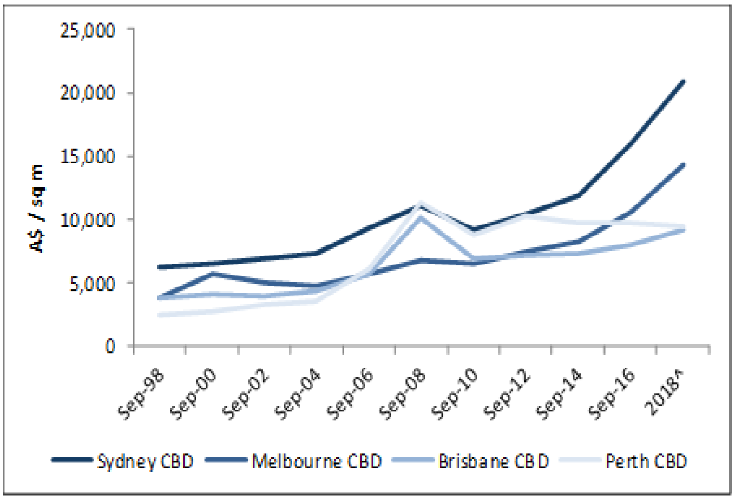
Commercial Real Estate in Australia

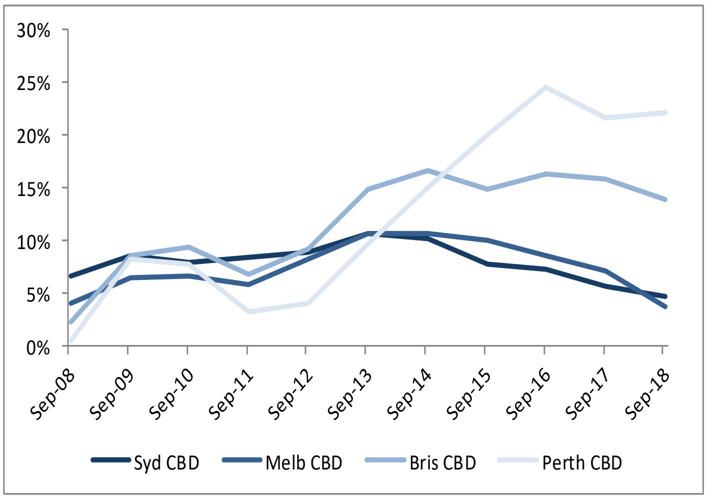
Commercial real estate in Australia has grown at a rapid pace in the past five years due to strong business confidence. With two decades of consecutive economic growth, and commodity prices firming up, vacancy rates have dropped to multi-year lows in some commercial property markets of Australia. Further, low interest rates have reduced the cost of servicing a loan, thereby boosting activity in the commercial property market.

Steady demand, low supply, higher employment and buoyant business confidence have all converged to uplift Australia's CBD office market

According to Savills, one of the world's leading property agents, Sydney and Melbourne are witnessing multi-year low vacancy rates in the respective CBD areas (Figure 10). While Melbourne is witnessing a consistent increase in CBD rental rates, the Perth and Brisbane CBD markets are showing signs of life after the mining downturn. As per CBRE, Sydney's current CBD office rental growth is at an all-time peak. Accordingly, market experts (Savills Australia) are forecasting vacancy rates to fall "much faster than the market anticipates" in the coming years.

Figure 10: Prime office values and vacancy rates in Australia





Note: ^ September 2018

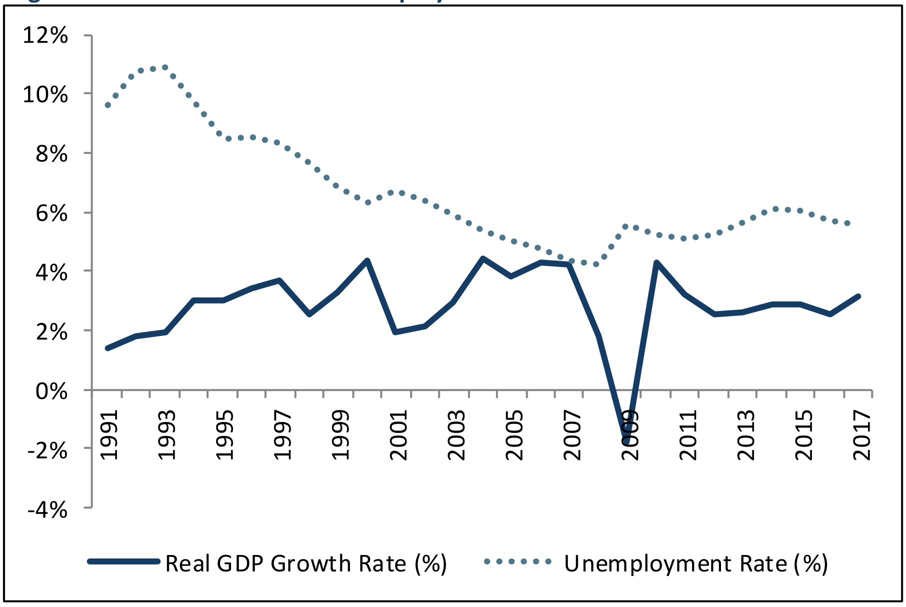
Source: JLL, Dexus, Pitt Street Research

Favorable Macroeconomic Conditions

The Australian economy has witnessed 26 years of consecutive growth. Strong global growth, led by Asian economies, has led to stronger employment growth in Australia. The outlook for white-collar employment growth in Australia, which directly affects the office property market, is improving. Australia's unemployment rate (5% in September 2018) has fallen faster than expected (5.3% in August 2018). The unemployment rate is down to its lowest level since April 2012 (Figure 11). Consequently, tightening of the labor market is expected to result in a rise in wages, which may further spruce up the retail property market.

Australia remains at the upper end of developed economies with respect to projected growth, supported by population growth and its links to Asia, but constrained by high household debt

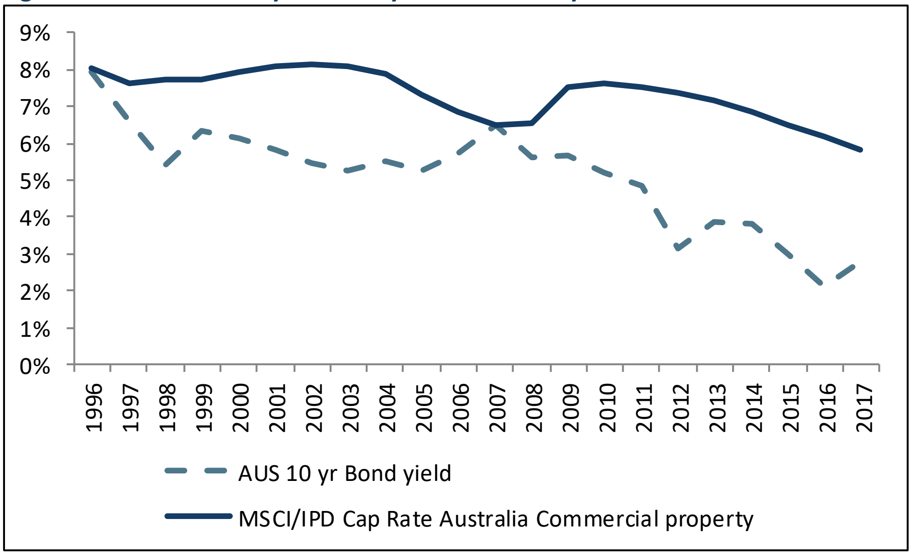
Figure 11: Australia GDP and Unemployment Rate



Source: World Bank, Pitt Street Research

With higher growth, the investment outlook has also improved while interest rates in Australia are at record lows, which is a booster for the real estate segment. Over the past decade, the spread between the commercial property rent yield and the 10-year bond yield has widened (Figure 12), resulting in improving margins from commercial property.

Figure 12: Australian 10-year bond yield and rental yields



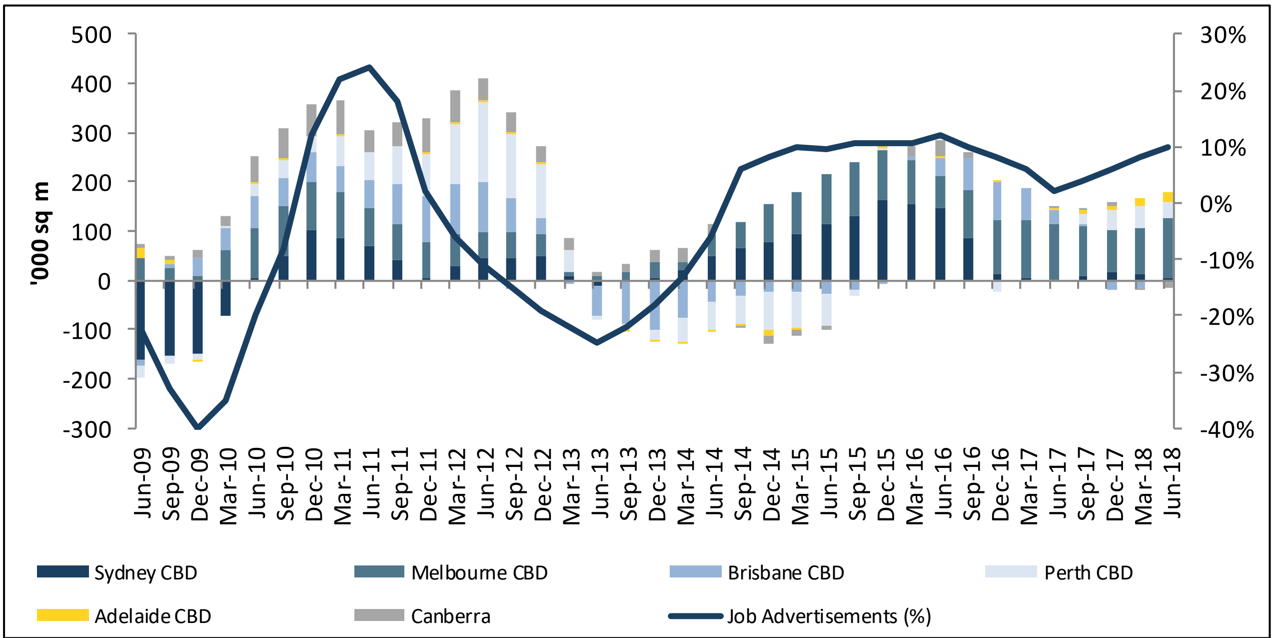
Source: Reserve Bank of Australia, MSCI, Pitt Street Research

Demand outlook to remain strong

Geographically, demand has been robust in Sydney and Melbourne. Vacancy rates in both cities have reduced continually due to positive net demand in CBD markets and withdrawals in non-CBD markets. Vacancy rates have been lower than their 10-year average in the two cities for quite some time now.

According to Colliers, the 10-year average vacancy rates in Sydney and Melbourne have been 7.3% and 6.6%, respectively. Moreover, the 3-year average growth in prime-grade property in these two cities is more than the 10-year growth. In Sydney, the 10-year growth rate is at 4.7%, while the 3-year growth rate is at 8.8%. Similarly, the 10-year growth rate in Melbourne is 4.3% and the 3-year growth rate is at 8.6%. Brisbane had faced an extended period of weakness but is now catching up with other capital cities. Vacancy rates are expected to be low in the coming years, as limited supply and a strong population and job growth will boost the commercial real estate market (Figure 13).

Figure 13: Quarterly absorption rate of office space by market



Source: JLL, Dexus, Pitt Street Research

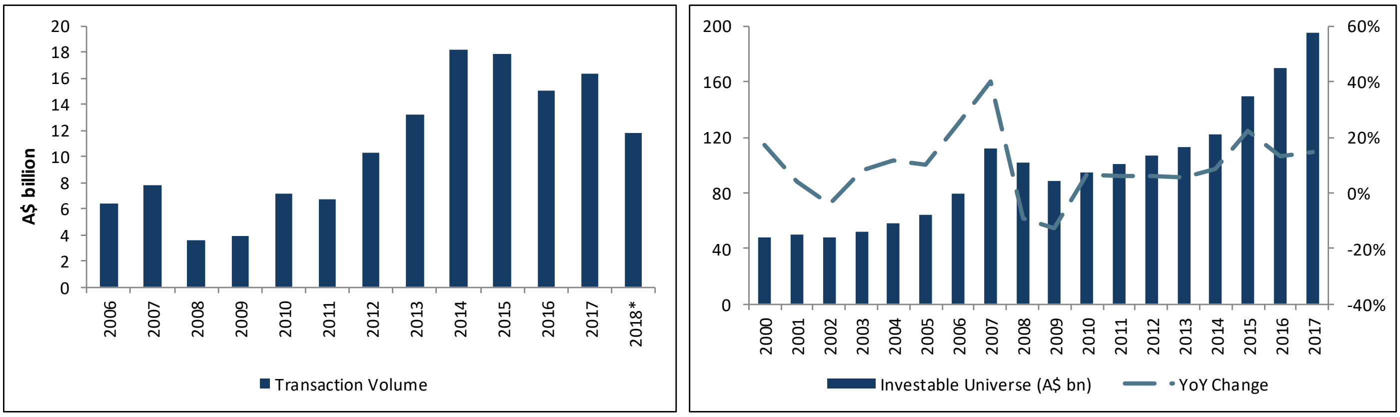
Slow supply growth to drive rental yields

Commercial construction has lagged-behind demand over the past few years. According to Preston Rowe Patterson, total office stock in the beginning of 2018 stood at 25.2m sq m. Most of the space additions in the past decade have taken place in CBD's, which makes up ~71% of total office space in Australia. Lack of supply in the coming years in Sydney and Melbourne portend a rise in rental income. Development of commercial real estate in Sydney was slow as stock availability declined due to the metro rail project and residential conversions. Low supply and strong demand have led to low vacancy rates. Overall, building approvals started to pick up by mid-2016. By the end of 2017, there were office projects worth A$20bn under construction in Australia and projects worth A$8bn are slated to start soon.

High liquidity in Australian commercial property market

Transaction volumes have always been used as a proxy for liquidity in the commercial property sector. Based on this parameter, the Australian CBD office market is very active, with transaction volumes hitting the third-highest level on record in 2017. According to Jones Lang LaSalle (JLL), transaction volumes imply high levels of liquidity across the Australian office sector, with volumes increasing from the lows of A$3.9bn in 2009 (at the height of the financial crisis cycle, to A$16.3bn in 2017 and A$11.7bn over 9M2018 (Figure 14). As per JLL, Australia is a beneficiary of higher allocations to real estate assets, which is partly due to an increased appreciation of the role real estate can play in a diversified portfolio. This also indicates the positive contribution real estate can make to risk-adjusted performance in Australia.

Figure 14: Transaction Volume and CBD Office Market Investable Universe



*Note: *For 9M 2018*

Source: JLL, Pitt Street Research

The problem of plenty

According to the *Emerging Trends in Real Estate Asia Pacific* survey 2019, jointly published by the Urban Land Institute (ULI) and PwC, Melbourne and Sydney occupy two of the top three places in the best property investment prospects across the region. For the past 3–4 years, Australia has been the single most popular investment destination in APAC mainly due to strong fundamentals, with deep and liquid markets offering investors a relatively safe haven.

However, therein lies the problem of getting domestic money into the market. According to the same report, foreign buyers currently account for ~40% of all prime asset transactions in Australia. The crux of the problem is that domestic REITs and funds are unable to compete on the cost of capital, resulting in foreign capital displacing local capital. Australian superannuation funds and other institutions with large holdings of local property are compelled to sell if capital value increases.

With so much capital targeting core assets in Sydney and Melbourne, other cities are also getting more attention. This has resulted in more supply, more availability, but more vacancy – Perth and Brisbane currently have high vacancy rates. The influx of capital is forcing money into these markets because these foreign funds can't find other, better places to put their money. These funds may not necessarily be looking for better returns, just a place to invest their capital. This makes the market unstable and volatile as these funds are more cyclical and short-term in nature, leading to inflated real estate prices, which is not conducive for higher long-term return yields.

The Way Forward

Business conditions in Australia are positive, helped by subdued wage costs, low financing costs, and an improving growth outlook. Consequently, businesses are hiring again. These trends are expected to support occupier demand in FY2019, particularly for the office and industrial sectors. The strategic theme is that the office and industrial sectors will be relatively stronger than the retail sectors. Further, contrary to historical evidence, commercial properties are fast becoming a better instrument for investment in Australia. This is due to their binding nature and long-term lease.

In a nutshell, steady demand, low supply, higher employment, and buoyant business confidence are expected to keep Australia's commercial property market of an attractive destination for investment dollars (Figure 15).

Figure 15: Australia Commercial Property trends for next 12 months

Market	Comments	Direction of trend for next 12 months	
Melbourne	**Strongest quarterly net absorption in over 10 years**. Melbourne recorded its strongest quarterly net absorption figure in more than a decade at +79,800sqm as the market continued to benefit from strong economic fundamentals. The vacancy rate also fell further and is now at 4.0%. Rental growth is strong with prime net effective rents increasing by 10.3% over the year. While new supply will come online in the near term, the majority of new projects are pre-committed and strong demand will continue to keep pressure on vacancy and rents over the next 6-12 months.	Vacancy	→
		Rents	↑
		Incentives	↓
		Yields	→
Brisbane	**Steady recovery**. After recording negative net absorption last quarter, net absorption rebounded to +15,400sqm in Q3 2018, largely supported by mid-sized occupiers. The vacancy rate reduced slightly to 13.9%, and net effective rent growth improved further (+1.8%p.a). Incentives are likely to remain elevated in the near term while the vacancy rate is still high. Demand is projected to continue to improve over the next year or two which will support rental growth, particuarly for prime stock supported by a flight to quality.	Vacancy	↓
		Rents	↑
		Incentives	→
		Yields	↓
Perth	**Market improves on steady demand**. Perth continued to rebound recording +17,600sqm of positive net absorption in Q3 2018. The vacancy rate increased to 22.0% as Woodside's new headquarters at Capital Square completed and their backfill space became available. Prime net effective rents have experienced further growth of +4.1%p.a. while market net incentives are stable at 48%. Rental growth is expected improve mildly as market conditions slowly recover in the absence of major new supply.	Vacancy	→
		Rents	↑
		Incentives	↓
		Yields	→
Sydney	**Limited stock availability restricting absorption**. The Sydney office market recorded negative net absorption in Q3 2018 as a lack of large, contiguous space options impacted activity despite solid levels of enquiry. The vacancy rate increased slightly to 4.7% but is expected to fall further. Rental growth remains strong at +10.1% p.a. (prime gross effective) as incentives continue to fall. The majority of new supply is still not expected to come online until FY22-24 and the demand backdrop remains supportive. The pace of rent growth is tapering and we forecast another two years of rent growth in this cycle.	Vacancy	↓
		Rents	↑
		Incentives	↓
		Yields	→
Canberra	**Office demand improves**. Canberra recorded positive net absorption of +35,700sqm in Q3 2018, which was the first positive recording this year, supported by expansion of the Department of Home Affairs. The demand outlook is expected to remain mild given Federal Government budget constraints. Limited availability of prime space (prime vacancy is currently 6.2%) is helping to support rental growth for prime assets (+3.4% p.a. net effective). Positive demand for prime assets should support an uplift in rents over the next 12 months.	Vacancy	→
		Rents	↑
		Incentives	→
		Yields	→

Source: Dexus report on Australian Real Estate Quarterly Review, Q4 2018

Coworking space in Australia

Coworking offices offer functionality and flexibility to their users and have seen a strong uptake in recent years. Many start-ups and SMEs are unsure of the duration of their stay in a particular office and of future office space requirements. Hence, signing long-term leases poses significant risks for them. A shared office space provides scalability without long-term financial commitments.

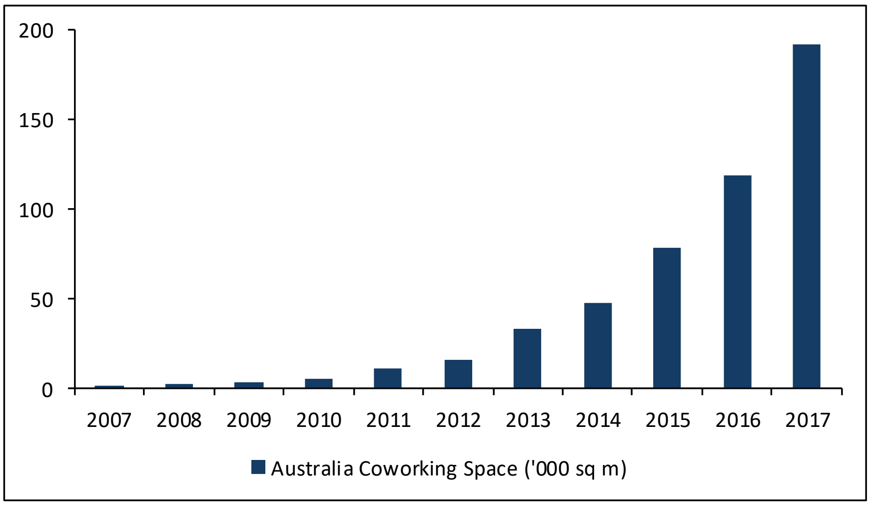
Latest trends in Australian coworking office space

According to the Australian coworking market report 2017–18, published by Office Hub, the sector is witnessing several new trends:

1) **Supply is expanding rapidly**

   As numerous private businesses are renting out spare desks, more coworking space providers are entering the Australian market, resulting in ~26% increase in coworking locations in 2017, compared with the previous year, totaling ~190,000 sq m (Figure 16). Further, according to Knight Frank, commercial buildings used for coworking purposes have increased ~300% between 2013 and 2017 to 309. Additionally, more organized operators are expanding and making the office hubs bigger, i.e. in less than one year of entering the market in October 2016, WeWork, one of the largest operators, has taken up ~26,000 sq m of space across five locations in Sydney and Melbourne.

Figure 16: Development of Coworking space in Australia

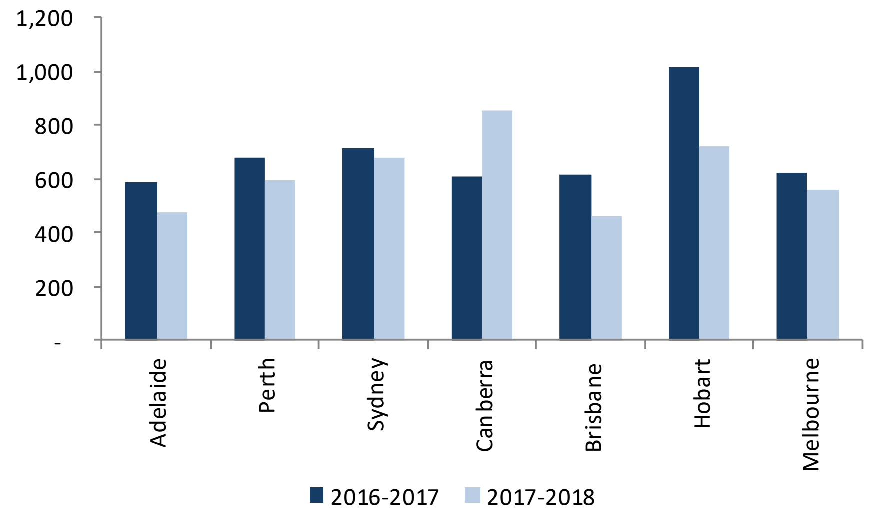


Source: Knight Frank, Pitt Street Research

2) **Competition is intensifying**

   The segment is characterized by intensified competition and there is a palpable fight to avoid any increase in vacancy rates. This has resulted in a decline in rental prices in Sydney, Melbourne, Brisbane, Adelaide, Perth, and Hobart (Figure 17). As per Office Hub, just 3% more Australian businesses moved to a flexible office space in 2017, compared with ~19% more providers operating in the market. Consequently, tenants enjoy an abundance of choice, and more competitive rental rates.

Figure 17: Average monthly rent per desk (A$)



Source: Office Hub, Pitt Street Research

3) Larger businesses are experimenting with hybrid models

In the past 1–2 years, demand for shared space has risen among larger businesses. According to Office Hub, in 2017, the number of businesses with 15 or more people, looking for shared office space, increased 105% YoY. The average size of rented space in 2017–2018 was 3.2 desks (compared with 2.4 desks in the previous year). To cater to larger businesses, desk providers are offering hybrid offices, which include private suites and shared spaces. Accordingly, ~20% of the enquiry base for shared space was made up of large corporations, compared to just 2% in 2014. This clearly reflects that shared offices are now attracting larger clients.

Coworking spaces are more densely fitted

Occupancy ratios vary from operator to operator in the coworking space sector. On average, there is one workstation for every 5–6 sq m. However, most buildings in Australia are designed to accommodate one workstation every 10 sq m. This implies that when a facility is leased, working conditions, such as fire solutions, air conditioning, and emergency exits have to be upgraded.

Figure 18: Monthly work station rates (A$)

CBD Locations	Sydney	Melbourne	Brisbane
Open plan workpoint	900	650	650
Private office, single workpoint	1,050	750	750
Fringe Locations			
Open plan workpoint	650	550	500
Private office, single workpoint	700	650	600

Source: Knight Frank, Pitt Street Research

Price structure

Coworking operators provide workstations at various price points, depending on fixed inclusions, optional extras, and location. Pricing structures differ across the spectrum and direct comparison is difficult.

Figure 19: Traditional Lease vs Coworking Comparison

Location	Traditional Lease, 600 sqm 'A' Grade, No Services	Traditional Lease, 600 sqm 'A' Grade, $100k for Services	Fully Serviced Co-Working Facility, CBD Location, Private Office
Sydney (gross rent A$1,100/sqm)	660,000	760,000	630,000
Melbourne (gross rent A$700/sqm)	420,000	520,000	450,000
Brisbane (gross rent A$750/sqm)	450,000	550,000	450,000

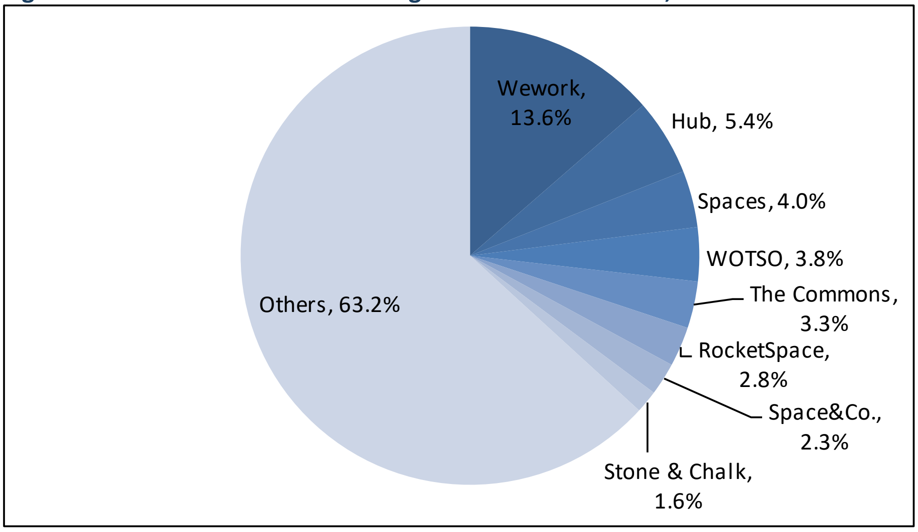
Source: Knight Frank, Pitt Street Research

Assuming that the average density in the Sydney CBD is one person per 12 sq m, a business with 50 employees would need 600 sq m of space. Gross rent in Sydney CBD for an 'A' grade office is A$1,100 per sq m. This translates to an annual cost of A$660,000, which excludes any fit-out costs. Whereas, a coworking facility would cost A$630,000, resulting in savings of ~A$30,000, as well as other cost reductions such as reduced management costs, and shared miscellaneous administrative costs, without compromising on the space density (Figure 19).

Consolidation opportunity among Coworking providers

According to a report by Knight Frank (2017), WeWork is the Australian market leader, with ~13.6% share, followed by Hub Australia – 5.4% share (Figure 20). WOTSO is among the top 5 shared office space providers. It is imperative to note that a majority of the market share is still in the hands of unorganized and small operators, which provides a consolidation opportunity for bigger players such as WOTSO.

Figure 20: Market Share of Coworking Providers in Australia, 2017



Source: Knight Frank, Pitt Street Research

Geographical profiles of Coworking office space

Sydney – The average rent per month for a desk stood at A$677 in 2017–18. Demand for office space was driven by proximity to transportation hubs such as Central Station. Managed offices in North Sydney and Chatswood did well. The CBD witnessed robust commercial construction and is likely to see quite a few global operators in next few years.

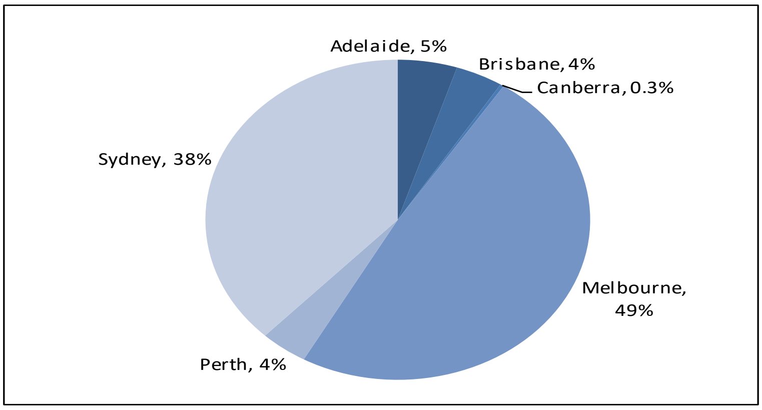
Adelaide – According to Office Hub, Adelaide witnessed 4% growth in shared space over the previous year. Most of these offices are serviced offices, while shared spaces are limited. Most demand is limited to the Central Business District (CBD). Though demand in suburban locations is lower, the conversion from enquiry to lease is higher. High commercial lease expiry, continued job growth, and lower commercial supply will buoy the coworking space for the next two years.

Brisbane – Its shared space market has progressed at a slower pace than peers, and most of the demand is restricted to the CBD. As regards to utilization, coworking space is attracting law and finance firms as well as professional services. In the inner suburbs, the customer base is dominated by one-person companies as tenants. These tenants are looking for an alternative to home offices. Tenants in smaller locations focus on internet speeds, meeting rooms, and presence of sunlight, while city-based clients look for quality office space.

Perth – Perth's local economy depends on the mining sector, which witnessed a downturn this year. Local demand was focused on shared and flexible spaces to mitigate cost-side pressures. As per Office Hub, the average rent per month stood at A$596 in 2017, down 12% from the previous year. Businesses opted for working spaces in metro areas rather than Perth CBD.

Canberra – According to Office Hub, average monthly rent per desk in Canberra stood at A$858 this year, up ~40% from the previous year. This increase was driven by limited supply of and robust demand for workspace. Demand was concentrated around the CBD and suburbs such as Kingston and Barton. Office enquiries indicated preference for working closer to home. Additionally, meeting rooms and business services are in great demand.

Figure 21: Distribution of Coworking Space (sq m)



Note: Total is more than 100% as numbers have been rounded off

Source: Knight Frank, Pitt Street Research

Coworking space in Singapore is getting more competitive

As per Colliers, the total area devoted for coworking space increased from 1m sq ft in 2015 to 2.1m sq ft in 2017, accounting for 2.5% of the total working space. It is expected to grow to 3.9% by end-2018 and 20% by 2020. The operators have taken advantage of soft rental environment and the influx of new supply. More players from overseas are looking to enter the Singaporean market and there are currently more than 70 operators in the shared office space domain in Singapore. Coworking space operator Justco opened its first center in Singapore in 2018. In 2017, WeWork acquired Singaporean company Spacemob and intends to invest further. Other prominent players include The Hive, The Great Room, The Working Capital, Collective Works, District 6, and ClubCo. The Government of Singapore is also proactively promoting flexible workspaces. It has supported the development of flexible locations such as the JTC LaunchPad, which is home to a number of tech start-ups. Though Singapore – through its growing requirements for shared working spaces – provides significant growth opportunity, WOTSO will have to counter stringent competition and the risk of exponentially growing supply.

Coworking space in Malaysia gaining popularity

The flexibility provided by coworking spaces has led to its acceptance among the mobile workers of Malaysia. By the end of 2018, there were over 70 operators and 100 outlets in Klang Valley. Out of these, 53% were operating from office buildings, while the rest worked out of retail podiums and shopping centers. Regus and Common Ground have more than 10 outlets. Local operators are also starting to emerge in urban areas such as Georgetown and Seberang Perai. The growth of coworking space is driven by strong demand from freelancers and capital expenditure contribution by landlords. Currently, WOTSO has two centers in Malaysia (Kuala Lumpur and Johor). In Johor, the coworking space arena is dominated by small local operators. They operate in shop-offices and start-ups are their main clients; hence, price volatility is high.

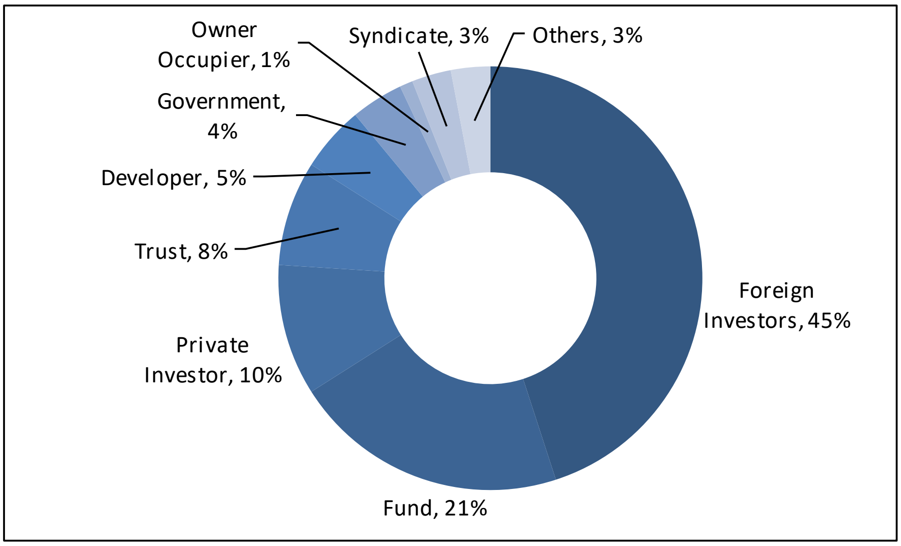
Competitive landscape

Australian real estate market attracts funds from across the globe

Traditionally, Australia has been a very sophisticated property market led by large institutional capital and with listed-REITs the only investment platform. However, strong economic growth since 1992 has helped build Australia's real estate funds business. Consequently, the advent of foreign capital has powered the uptick in the Australian property market. According to the Willis Towers Watsons Global Alternatives Survey 2016, Australian real estate funds had a total of ~A$64bn in Assets Under Management (AUM).

Domestic investors in real estate compete with foreign investors from China, Hong Kong, the US, the UK, Malaysia, and Germany, and as the cost of capital of some foreign investors is lower than that for Australian investors, they are willing to settle for lower yields with higher related risk. This has resulted in increasing ownership of real estate by foreign investors in Australia (Figure 22).

Figure 22: Office property buyer profile, 2016



Source: Savills Research, Pitt Street Research

However, in a bid to arrest the increase in investment by foreign investors, the government raised charges on foreign purchases, made the tax treatment less favorable, and introduced a cap on new development sales. The introduction of application fees for foreign investors in the latter part of 2015 led to a plunge in the number of applications by foreign buyers 2016–17. China, which is the largest foreign investor in the Australian market, cut its investment by ~50% YoY in 2016–17. However, it was still the highest at A$15bn, followed by Canada with A$7.2bn and the US with A$6.8bn.

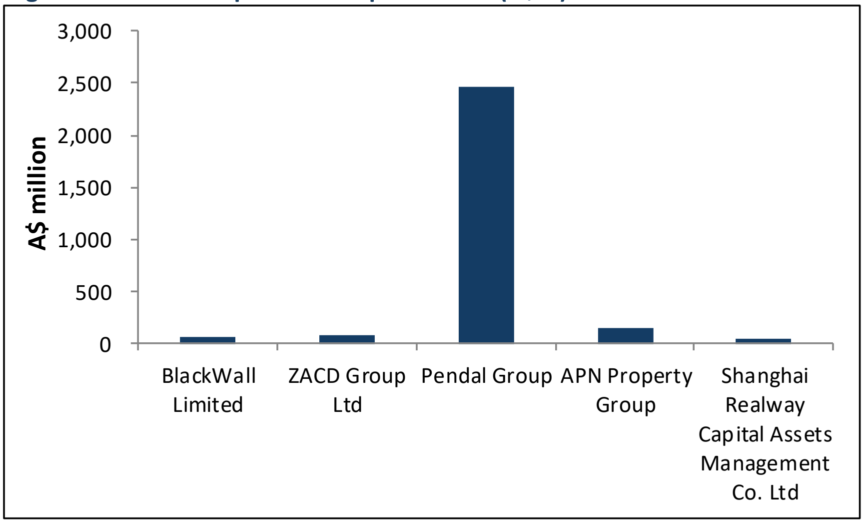
Institutional investors are increasingly co-investing directly alongside fund managers in an effort to prevent fee leakage and gain more transparency and control over opportunities. This is being led by the larger superannuation funds that have been investing in real estate for a considerable time now.

Companies to keep an eye on in the property space

We believe the following companies are good comparable for BWF (Figure 23):

- **APN Property Group** (ASX: APD) is a real estate investment manager that actively manages property funds on behalf of institutional and retail investors. It also owns industrial, technology, and business park assets. It manages both real estate securities funds and direct real estate funds
- **Pendal Group Limited** (ASX: PDL), is engaged in the provision of investment management services. The Company offers investment services in Australian equities, global equities, property, ethical, income and fixed interest and diversified strategies. The Pendal Property Securities Fund invests primarily in Australian listed property-related investments including listed property trusts, developers and infrastructure investments, both directly and indirectly. In addition, up to 15% of the Fund can be invested in international listed property-related investments and around 5% of the Fund will generally be invested in unlisted property investments.
- **ZACD Group Ltd** (HKG: 8313) in Hong Kong is a holding company mainly involved in the asset management business in the real estate sector. Through its subsidiaries, the group operates across the value chain, from identifying real estate investment opportunities and marketing them to investors to property and tenancy management, deal evaluation, and consultancy. Asia Pacific, specifically Singapore, is the main region covered by the company. ZACD also has a proven track record in structuring and managing numerous real estate investments.
- **Shanghai Realway Capital Assets Management Co. Ltd** (HKG: 1835) is a Chinese asset management company mainly focused on real estate assets. The funds cover commercial real estate, distressed assets, and urbanization and redevelopment projects. The operating area is mainly China.

Figure 23: Peer Group Market Capitalization (A$m)



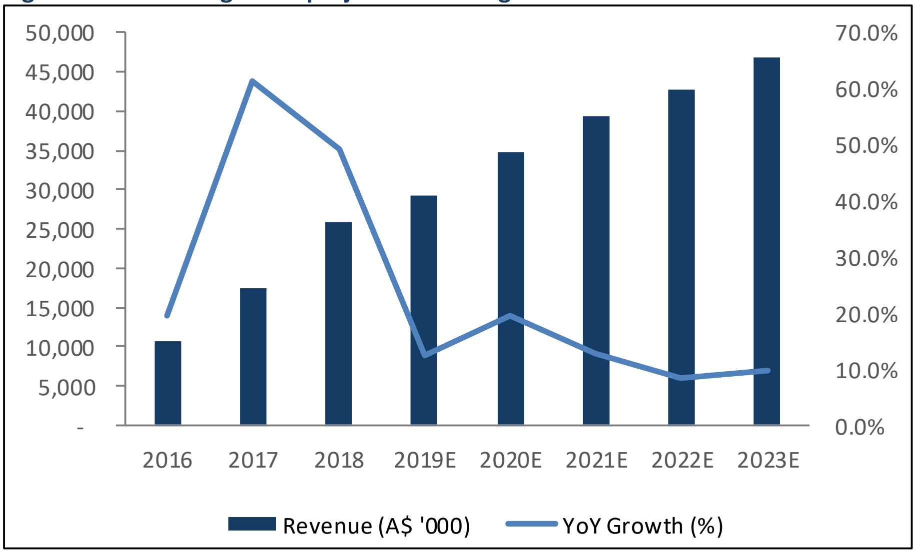
Source: Thomson Reuters, Pitt Street Research

Financial performance driven by WOTSO

Accelerating revenue through WOTSO expansion

BWF has a steady and recurring income stream through its traditional property fund management business. To accelerate growth and counter any impact from competition in fund management, BWF has decided to expand its shared office business aggressively. This is expected to accelerate revenue growth over the next few years (Figure 24). The company has also ventured outside Australia to Singapore and Malaysia, through JVs with local players.

Figure 24: Revenue growth projections through 2023



Source: Pitt Street Research

WOTSO expected to be the key long-term revenue driver

We expect WOTSO's business to continue its high growth trajectory aided by new properties, expansion in the number of available desks resulting in a higher market share, and operational maturity of some of the older assets. Consequently, WOTSO's contribution to BWF's total revenue is expected to increase from ~35% in 2017 to >50% by FY2023E (Figure 25).

Figure 25: Percentage Revenue Breakdown

Revenue Contribution (%)	2017	2018	2019E	2020E	2021E	2022E	2023E
WOTSO	35.4%	33.1%	45.7%	47.7%	49.6%	51.9%	52.6%
Asset Management	54.8%	52.5%	37.6%	37.3%	35.8%	33.3%	32.5%
Investments	9.8%	15.0%	16.7%	15.0%	14.6%	14.9%	14.9%

Source: Pitt Street Research

We expect revenue from WOTSO's operations to grow at 23.4% CAGR and reach A$24.6m by FY2023E (vs. A$8.6m in FY2018), aided by multiple drivers (Figure 26):

– Growth in the average number of new desks through aggressive network expansion and consolidation of its client base that is complimented by an overall increase in industry demand.

As competition intensifies, Australia's coworking market will become more organized as single operators will find it difficult to meet client expectations

Due to a more organized network operation, businesses are expected to prefer WOTSO over other providers

- Market share expansion of WOTSO as industry moves towards consolidation. With organized players expanding aggressively, single space operators are expected to face tough competition forcing industry to become more organized.
- We expect that over the long-term single operators may find it difficult to survive and consistently meet increasing expectations. Consequently, there will be scope for bolt-on acquisitions by well-established players such as WOTSO.

Considering that a higher number of desks are available to be leased out, with significant expansion by organized operators, average growth of rent per desk is expected to decelerate. As supply is increasing faster than demand, and end clients have more choice, it will not be easy for BWF to just survive on the back of value addition to the property and charging significant premiums. Hence, we have assumed a consistent decline in average revenue per desk for WOTSO over the next 5 years.

Operational maturity of older properties is expected to improve the profitability of WOTSO's business. Further, as the network grows, we expect operational expenses will be consolidated, driving EBITDA margins towards ~23% in FY2023E, from ~11% in FY2018.

Figure 26: WOTSO Revenue Model and Assumptions

Revenue Model (AUD '000, Year end June)	2017	2018	2019E	2020E	2021E	2022E	2023E
Revenue	6,175	8,599	13,359	16,663	19,510	22,126	24,627
External revenue	6,175	8,449					
Revenue from leased and owned sites	6,175	8,074					
Management agreements	-	375					
Intersegment revenue	-	150					
Desks	2,250	4,900	6,700	8,375	10,050	11,809	13,698
YoY growth	*60.7%*	*117.8%*	*36.7%*	*25.0%*	*20.0%*	*17.5%*	*16.0%*
Average desks	1,825	3,575	5,800	7,538	9,213	10,929	12,753
Occupancy	70%	50%	48%	46%	44%	42%	40%
Revenue per desk	4.83	4.81	4.80	4.81	4.81	4.82	4.83
YoY growth		*-0.5%*	*-0.25%*	*0.15%*	*0.15%*	*0.15%*	*0.15%*

Source: Pitt Street Research

Asset Management to remain steady and Investments business to grow consistently

We expect the Asset Management business to remain steady, while the Investments segment will get a boost after BWF makes fresh investments from the upcoming pool of cash.

In the absence of any major transaction fees, the Asset Management business is expected to grow at 2.2% CAGR over FY2018–23E (Figure 27):

Figure 27: Australia revenue model and assumptions for Asset Management

Revenue Model (AUD '000, Year end June)	2017	2018	2019E	2020E	2021E	2022E	2023E
Revenue	9,549	13,640	11,002	13,005	14,103	14,200	15,211
Management fees	5,004	5,756	6,562	7,382	8,120	8,851	9,559
Performance and transaction fees	4,545	7,884	4,440	5,623	5,982	5,349	5,651
Performance fee – Pyrmont	2,615	7,884					
Performance fee - Penrith	433	-					
Transaction fees	1,497	-					
Assets	5,039	1,985					
Liabilities	(1,621)	(696)					
Net assets	3,418	1,289					
YoY growth (management fees)		*15.0%*	*14.0%*	*12.5%*	*10.0%*	*9.0%*	*8.0%*

Source: Pitt Street Research

The Investments segment is likely to grow at 12.3% CAGR and reach A$7.0m by FY2023E, from A$4.0m in FY2018 (Figure 28).

Figure 28: Australia revenue model and assumptions

Revenue Model (AUD '000, Year end June)	2017	2018	2019E	2020E	2021E	2022E	2023E
Revenue	1,700	3,905	4,869	5,237	5,761	6,337	6,970
Unrealised gains	1,723	3,007					
Realised gain - WOTSO Adelaide	(117)	572					
Rental income		66					
Other income	94	260					
Assets	22,585	31,667	33,250	36,575	40,233	44,256	48,682
Liabilities	(5,587)	(4,312)					
Net assets	16,998	27,355					
YoY growth (assets)	*88.0%*	*40.2%*	*5.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
Revenue as % of average assets	*9.8%*	*14.4%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*

Source: Pitt Street Research

Short-term impact on group profitability as WOTSO ramps up

As older WOTSO properties mature and as the anticipated operating leverage kicks in, we believe BWF will witness a steady expansion in profitability. However, as the company expands its new portfolio in the next 1–2 years using the extra available cash, and simultaneously indulges in aggressive expansion of the WOTSO network, we anticipate the benefits of operating leverage will be curtailed, though only for a relatively short period of time. Traditionally, BWF's operations have achieved high operating margins (e.g. ~50% in 2018); the EBITDA margins are expected to reach the same levels in the next 4–5 years, but with a higher revenue base (Figure 29).

Figure 29: Growth and profitability

Growth & Margins (%)	2017	2018	2019E	2020E	2021E	2022E	2023E
Revenue Growth YoY	61.4%	49.2%	12.5%	19.4%	12.8%	8.4%	9.7%
EBITDA margin	38.4%	49.2%	44.9%	45.0%	44.9%	44.8%	45.9%
EBIT Margin	35.3%	45.9%	41.4%	38.5%	38.7%	38.3%	39.7%
Net Profit Margin	26.6%	35.0%	30.1%	27.9%	28.0%	27.6%	28.4%

Source: Pitt Street Research

Cash-rich balance sheet to support significant expansion

BWF will have cash available from related-party transactions, which will be utilized to expand its real estate portfolio

BWF's management team has decided to release some assets from the balance sheet and transfer them to BWR, including WOTSO Fortitude Valley and the position in the Pyrmont Bridge Trust. This is expected to provide ~A$10m in cash to the company, thereby giving it the required leverage for further scaling up the asset portfolio. Consequently, the company will become cash-heavy and could even venture into bolt-on acquisitions within the shared working space. In FY2017–18, the operating cash flow stood at ~15% of EBIT and is expected to jump to an average of ~55% in FY2019–23E.

Abundant availability of cash and consistent cash generation through the mature funds management business are expected to help BWF expand its WOTSO franchise network further. As BWF makes fresh investments, RoE and RoA will remain subdued in near future, but over the long-term period they are expedted to remain high. Average RoA for FY2017–18 was ~18% and is expected to remain relatively high going forward as well (Figure 30).

Figure 30: Balance sheet strength and return ratios

Balance Sheet Ratios (%)	2017	2018	2019E	2020E	2021E	2022E	2023E
Net Debt (Cash) to EBITDA	42.0%	9.2%	-91.1%	-78.0%	-94.6%	-117.3%	-136.4%
Operating Cash Flow / EBIT	24.3%	5.8%	53.0%	53.0%	53.8%	53.5%	53.4%
Total Cash / Total Assets	2.2%	2.4%	32.9%	27.9%	30.8%	34.3%	37.7%
ROA	13.1%	22.8%	14.4%	20.6%	19.6%	17.8%	17.4%

Source: Pitt Street Research

It is imperative to acknowledge that once the Bakehouse transaction is concluded, BWR will have an additional capital of A$100m to be deployed. This is expected to have a far greater effect on the recurring fee and WOTSO income and should also result in higher profitability.

Valuation

To derive BWF's long-term value, we have used a weighted average valuation methodology, assigning equal weight to a peer-group-based sum-of-the-parts (SOTP) valuation and discounted cash flow (DCF) calculation.

Currently, we have considered ASX-listed and HK-listed peers for business valuation (Figure 31). BWF has been benchmarked against bigger ASX-listed competitors – APN Group (ASX: APD), and Pendal Group Ltd (ASX: PDL) and HK-listed ZACD Group Ltd (8313.HK) and Shanghai Realway Capital Assets Management Co Ltd (1835.HK).

Figure 31: Peer group valuation

Company Name	Ticker	FY-end	EV / EBITDA				
			LTM	FY18	FY19	FY20	FY21
Pendal Group Limited	PDL.AX	September	8.9x	7.3x	9.8x	8.7x	7.6x
APN Property Group Ltd	APD.AX	June	12.1x	NA	12.1x	12.1x	12.1x
ZACD Group Ltd	8313.HK	December	9.0x	NA	9.0x	9.0x	9.0x
Shanghai Realway Capital Assets Mar	1835.HK	December	1.7x	NA	1.7x	1.7x	1.7x
AVERAGE				**7.3x**	**8.1x**	**7.9x**	**7.6x**

Source: Thomson Reuters, Pitt Street Research

The company's peer group is valued at an average EV/EBITDA multiple of 7.9x for FY2020E. We have applied the same methodology to evaluate the WOTSO and Asset Management businesses, while Investments has been valued at 1.0x book value, resulting in an implied EV of A$101.2m for BWF or an equity value of A$1.65 per share (Figure 32).

Figure 32: Relative Valuation Per Share

Equity Value (A$ '000; except share price)	
Implied EV	102,334
Net debt (cash)	1,177
Minority interest	(207)
Provisions	165
Equity value	**101,199**
ShareS outstanding	61.5
Implied price (A$ cents)	**164.67**
Adjusted Current price (A$ cents)	82.00
Upside (%)	*100.8%*

Source: Pitt Street Research

Considering that BWF is still a growing business, looking to further expand its WOTSO franchise network, entering new geographies, and leveraging portfolio realignment for future investment, we think a discount to the sector average multiples should be applied. Additionally, as most competitors are larger, more mature, and well-established, we believe a discount is justified from that perspective as well. We have applied a discount of 20% to the peer group average. The effective EV/EBITDA multiple applied to WOTSO and Asset Management business is 6.3x.

DCF calculation suggests substantial long-term upside

Our DCF model yields a 10.8% WACC for BWF (risk-free rate of 2.7%, a beta of 1.1, and an equity risk premium of 7.7%). Applying this discount rate to our free cash flow projections through FY2028 and using a terminal growth rate of 2%, BWF yields a value of A$2.36 per share (Figure 33).

Execution risk is associated with BWF's expansion into the Singaporean and Malaysian markets, and WOTSO's underlying industry is reaching excess supply. We believe that there will be room for higher growth in NOPAT in case WOTSO's market share expands further, the average rent rate per desk improves and the new properties start yielding higher returns, even as the commercial activity continues to boom in Australia. This would translate into higher values over time.

Figure 33: DCF using various WACCs

Sensitivity Analysis										
WACC		**10.74%**								
Terminal Growth Rate		**2.00%**	**Change in WACC**							
Implied Price (AUD cents)		**236**	*10.0%*	*10.2%*	*10.5%*	*10.7%*	*11.0%*	*11.2%*	*11.5%*	*11.7%*
Change in Terminal Growth Rate		*1.25%*	245.0	238.7	232.5	226.7	221.1	215.9	210.8	206.1
		1.50%	248.5	242.0	235.6	229.5	223.7	218.3	213.1	208.2
		1.75%	252.2	245.4	238.7	232.4	226.5	220.8	215.5	210.4
		2.00%	256.2	249.1	242.1	**235.6**	229.4	223.5	218.0	212.8
		3.00%	274.7	266.2	257.9	250.1	242.8	236.0	229.5	223.5
		3.50%	286.2	276.6	267.4	258.8	250.8	243.4	236.4	229.8
		4.00%	299.5	288.8	278.5	268.9	260.0	251.8	244.1	236.9

Source: Pitt Street Research

Fair value of A$2.00 per share

Our fair value of A$2.00 per share has been derived from a weighted average valuation methodology, which assigns equal weight to our SOTP-based relative valuation and our DCF calculation (Figure 34). This implies a substantial upside from the current share price.

Figure 34: Weighted Average Valuation

Methodology	Weightage (%)	Share price (A$ cents)
DCF	50.0%	235.6
Relative valuation	50.0%	164.7
Composite		**200.1**
Adjusted Current Price		82.0
Upside/ Downside (%)		**144.1%**

Source: Pitt Street Research

In a more optimistic scenario in which our long term projections for top line growth, and hence operating margins are higher due to stronger growth at WOTSO in particular, we see a fair value for BWF of A$ 2.41 per share.

Re-rating BlackWall Limited

BWF's stock is currently trading below our base case valuation. We have outlined a number of factors that may result in a rerating of BWF going forward:

– Asset-light model, scalable operating structure of all business subsidiaries, a unique funding structure attracting retail investors; growth opportunity offered by expansion in the commercial real estate market.

– Aggressive evolution into the niche but exponentially growing shared working office space through flexible but highly profitable leasing arrangements.

– Successful entry into Singaporean and Malaysian coworking office space.

Further, we believe BWF has an experienced management team (Figure 35), capable of taking the company through to the next growth stage. Stuart Brown, BWF's CEO, has been managing property structures and funding vehicles for over 15 years. Tim Brown, CFO, has been instrumental in the financial management of the group for the past 10 years. COO Jessie Glew has substantial operational experience in handling property management matters.

Figure 35: BWF's Proficient Management Team

	Name and Designation	**Profile**
	Stuart Brown **Director & CEO**	• Mr. Brown has worked in the field of property development, management, and funding for over 18 years. • He has raised debt and equity worth >A$500m for listed and unlisted real estate structures. Before this, Mr. Brown practiced as a solicitor in the areas of real estate, M&As, and corporate advisory. • He is also on the board of Coogee Boys Preparatory School and Randwick Rugby Club as an Independent Director.
	Tim Brown **Director and CFO**	• Mr. Brown is responsible for all aspects of these entities' financial reporting, debt management, and accounting operations. • He joined the formerly listed Pelorus Property Group Limited in 2008 as Group Financial Controller and became CFO in 2009. • He has a Bachelor's in Commerce from the University of New South Wales, is a member of the Institute of Chartered Accountants of Australia, and has a Graduate Diploma from the Financial Services Institute of Australasia.
	Jessie Glew **COO**	• Jessie has been with BlackWall from early 2011 and took over as COO in March 2018. She oversees the management and operations of the property portfolio. • She has a Bachelor's in International Communication from Macquarie University and a Bachelor's in Property Economics from the University of Technology Sydney.

Source: Company, Pitt Street Research

Risks

We see four main risks related to BWF's investment thesis:

1) Rising interest rates: Rising interest rates could push retail investors to look for higher return from PIPES investment vehicles. This has the potential to restrict yields for BWF. Also, interest rate increases would raise the borrowing cost, and thus the payback period for any new property acquisition could increase substantially.
2) Cyclical risk: In the past 2–3 years, the commercial property market across Australian cities has witnessed an uptick. This has significantly reduced the number of distressed assets, and prices of available real estate have surged. This could result in expensive acquisitions, which may cause lower capital gains.
3) Overcapacity risk: As the coworking space is gaining traction across Australia, more players are expanding into this market. The increase in supply could result in downward pressure on average rent per desk.
4) Collaboration risk: As BWF expands into new geographies, the country-specific partner it chooses will be highly critical. Any slippage or error of judgment may result in a decline in the company's valuation.

Conclusion: Abundant growth opportunities

BWF has a scalable business operation, generates recurring revenues, and has an experienced management team and a solid investment strategy. It has also initiated a process to aggressively widen its high-growth shared office space network and expanded into the similar but untapped geographies of Singapore and Malaysia. Sustained ventures into new geographies, consistently increasing market share in the unorganized coworking space, and better operational efficiencies as a result of maturing of past investments are expected to contribute to a potential re-rating of the stock. Based on a peer group valuation and a DCF calculation, we have set a valuation range of A$2.00–2.41.

SWOT Analysis

Strengths:

- A well-established business with consistently expanding revenues in the coworking space.
- Good track record of buying distressed assets and adding value to them through adaptive reuse opportunities.
- Flexibility to tailor lease duration according to tenant's needs; long-term relationships on short-term contracts.
- Ability to generate high IRR on real estate investments. E.g. Bakehouse Quarter generated an IRR of ~15% over a period of 22 years.
- Willingness to return gains to shareholders through reinvesting and distributing earnings as dividends.

Weaknesses:

- Limited experience of working in geographies other than Australia.
- Difficult to regularly find active assets to which the company can add value.

Opportunities:

- Expansion in coworking space in Australia. In 2018, the coworking space constituted 2–3% of the total office space, and it is expected to hold a 12% share by 2030.
- Sale of Bakehouse to provide A$100m cash on the balance sheet, which can be used to make other investments.

Threats:

- Potentially rising interest rates to dampen property prices.
- With many global coworking players starting operations in various Australian cities, increase in supply of such coworking spaces can possibly result in downward pressure on rent/desk.

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