BlackWall Limited

Wotso's rapid expansion

Share Price: A$0.97

Valuation range: A$2.10-2.39

ASX: BWF

Sector: Diversified Financials

24 September 2019

BlackWall Limited (ASX:BWF) announced on 2 August 2019 that it was spinning out its Wotso flexible workspace business into a separate listed company. We see this development as a positive, allowing the BlackWall group to capitalize on increasing investor awareness of flexible workspace as a growing segment of the commercial property stock in Australia. The move comes at a time when BlackWall has substantial cash resources to invest advantageously should distressed assets become available.

BlackWall's enviable cash position

When we initiated on BWF in late January 2019, the company was about to complete the sale of its flagship Bakehouse Quarter project for A$380m. That transaction finally settled on 18 April 2019. In our view, the story of the Bakehouse Quarter deal demonstrates what we call the 'BlackWall Way' of creating value for property investors.

Base case valuation $2.10 per share

Hence, we value BWF at A$2.10 per share (base case) by providing equal weights to the DCF calculation of A$2.55 and a SOTP relative valuation of A$1.64 per share. This is slight upgrade to our initial valuation from January 2019.

Cashed up and ready to create value

A demonstrated core competence of BlackWall is the ability to acquire distressed property assets, imaginatively re-profile those assets, and then grow substantial value for its investors over subsequent property investment cycles. BWF now has, for the first time, substantial cash resources to anchor any new projects being structured.

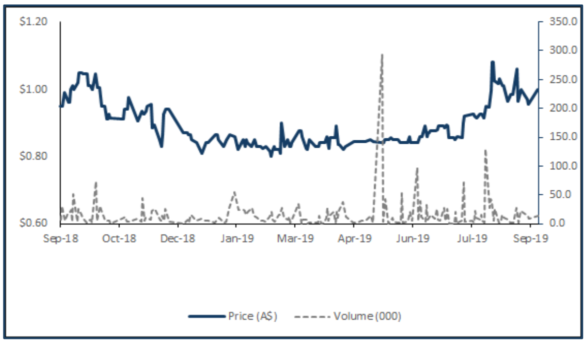
Year to June (AUD)	2017A	2018A	2019A	2020f	2021f
Sales (m)	17.4	26.0	20.3	29.6	32.9
EBITDA (m)	6.7	12.8	5.7	13.1	14.6
Net Profit (m)	4.6	9.1	3.3	8.3	9.2
Adj. EBITDA Margin (%)	38.4%	49.2%	27.9%	44.2%	44.5%
ROA (%)	13.1%	22.8%	8.2%	20.4%	19.3%
EPS before extr. & amort.	7.84c	14.91c	5.24c	13.15c	14.54c
EPS	6.24c	13.54c	5.20c	13.15c	14.54c
DPS	3.60c	4.00c	4.10c	1.97c	2.18c
EV/Sales	2.4x	1.6x	2.3x	1.6x	1.4x
EV/EBITDA before extra	6.2x	3.4x	8.1x	3.5x	3.2x
P/E before extra	11.5x	6.4x	18.5x	7.4x	6.7x
Dividend yield %	4.0%	4.2%	4.2%	2.0%	2.2%

Source: Company, Pitt Street Research

Market Cap. (A$ m)	61.2
# shares outstanding (m)	63.1
# share fully diluted	67.6
Market Cap Ful. Dil. (A$ m)	65.6
Free Float	100%
12 months high/low (A$)	1.08 / 0.80
1 / 3 / 12-month performance	-4% / 7% / -8%
Website	blackwall.com.au

Source: Company, Pitt Street Research

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



Source: Thomson Reuters, Pitt Street Research

Valuation metrics	
Fair valuation (A$)	2.10-2.39
WACC	10.95%
Assumed terminal growth rate	2.0%

Source: Pitt Street Research

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Table of Contents

Wotso to carve out its piece of the flexible workspace cake as a separate company

BlackWall announced on 2 August 2019 that it was spinning out its Wotso flexible workspace business into a separate listed company. We see this development as a positive, allowing the BlackWall group to capitalize on increasing investor awareness of flexible workspace as a growing segment of the commercial property stock in Australia. BlackWall CEO Stuart Brown will move over to the Wotso business to focus on this major opportunity while at BlackWall, founder Seph Glew will move up to Executive Chairman.

Wotso is growing quickly. Currently there are 13 Wotso flexible workspace locations around Australia but a potential doubling of that is envisaged in the near term. Three new sites are slated to open soon. Wotso workspaces are characterized by an attractive and modern look and feel, ease of access to transport options, and location outside of CBDs. We are confident that Wotso's management team can execute well on the expansion plans given the speed with which the business has grown to date in the midst of a diversified property investment and development company with multiple projects in the go. In order to get a sense of valuation of BWF's high-growth gem, Wotso, we have conducted a standalone valuation of this business within BWF.

What sets Wotso apart from the majors? We see three factors at work in helping Wotso carve out a competitive niche in the flexible office space

1) **The focus on the suburbs rather than the CBD or CBD fringe**. It's reasonable to expect better deals on space outside the CBD from landlords, while demand from tenants will likely be as strong as in the CBDs given that many companies do not need a CBD presence.
2) **A focus on all serving all kinds of SMEs, not just 'tech' companies**. Wotso prides itself on being a provider of choice for businesses as diverse as accounting practices and lawn maintenance operators. This tends to mean that 'traditional' businesses looking for flexible workspace are more likely to find Wotso before they find more 'tech-oriented' operators like WeWork.
3) **The ease with which users can enter and exit, and the ease of billing**. At Wotso all tenants are on month-to-month arrangements and the billing is straightforward. This contrasts with arrangements with more established providers.

Victory Offices may provide a precedent for Wotso

The recent listing of Victory Offices suggests investor appetite for businesses like Wotso. Victory Offices (ASX:VOL) went public on ASX in mid-June 2019. This Melbourne-based company[1], which started up in 2013, currently provides serviced office accommodation at 21 locations in Melbourne, Sydney, Brisbane and Perth. Like Wotso, Victory Offices is in rapid expansion mode, with eight new sites planned for FY20. Also, like Wotso, it enjoys high occupancy near 90%. Unlike Wotso it has tended to favour CBD locations although it is now expansion to the suburbs, as evidenced by sites in the Melbourne suburbs of Box Hill, Dandenong and Sunshine. Also, sites at Melbourne's iconic Chadstone shopping centre indicates it is exploring the use of this kind of real estate, as has Wotso with Westfield Chermside in Brisbane. However, we believe that Victory Offices' IPO was priced to provide considerable upside – at the offer price the company was valued at an EV/EBITDA multiple of 1.7 times FY19 forecast earnings[2]. This contrasts with

[1] victoryofficeslimited.com
[2] See Victory Office's 20 May 2019 prospectus, page 7.

a multiple above 4 for the one other ASX-listed listed comparable, Servcorp (ASX:SRV)[3].

We have been conservative in modeling Wotso. In our January 2019 initiation piece on BlackWall we modeled, for Wotso, a business growing from A$8.6m revenue in FY18 to A$24.6m in FY23. Our basic assumptions from that time are shown in Figure 1 below:

Figure 1: Our Wotso assumptions, estimated in January 2019

	2018	2019E	2020E	2021E	2022E	2023E
Revenue ($ 000)	8,599	11,977	13,830	16,484	19,891	24,649
EBITDA ($ 000)	958	1,111	1,508	2,731	3,603	5,479
EBITDA margin	11.1%	9.3%	10.9%	16.6%	18.1%	22.2%
Average desks over the year	3575	5,200	6,256	7,784	9,379	11,100
Revenue per occupied desk per month	$401	$400	$400	$401	$402	$402
Occupancy	50%	48%	46%	44%	44%	46%

Source: Pitt Street Research

Figure 2: Wotso with reported FY19 numbers and subsequent forecasts on a more rapid growth curve

		2018	2019	2020E	2021E	2022E	2023E
Revenue ($ 000)		8,599	10,197	18,899	27,637	39,139	54,444
EBITDA ($ 000)		958	1,262	2,646	4,809	7,280	10,290
EBITDA margin		11.1%	12.4%	14.0%	17.4%	18.6%	18.9%
Average desks over the year		3575	4,950	5,688	7,076	8,526	10,091
Revenue per occupied desk per month		$401	$419	$438	$457	$478	$500
Occupancy		50%	56%	63%	71%	80%	90%
Annual rent increse	5%						
Occupancy by FY23	90%						
FY21 EBITDA multiple	4.3						
Valuation ($m)	20.7						

Source: Pitt Street Research

What if Wotso's growth is faster? Assume, instead of the above, a more rapid growth in revenue per desk and in occupancy, based on the same number of desks but at relatively moderate revenue growth. Blackwall thinks the 'natural' EBITDA margin of its business is in the order of 25-35%, which is reasonable given that much of its costs would relate to lease agreements with the landlords. Put a Servcorp multiple on this faster growth horizon and Wotso on this scenario would potentially be worth A$21m (see Figure 2). Obviously as rapid a growth as this would suggest a high multiple.

Why Wotso would warrant a higher EBITDA multiple. An important aspect of Wotso is likely to be the dependability of its growth profile. It has a large

[3] Source: Thomson Reuters.

range of small customers and depends very much on local economies for its growth. This not makes it less likely that occupancy rates on established properties will go down after the centre has filled out, unlike, say, a CBD-located A Grade office building that depends on the fortunes of large companies with more options in terms of where to locate its people. Once it becomes apparent to investors that BlackWall is leveraged to this dynamic, we anticipate that the EBITDA multiple could go into double digits to reflect this growth.

Why Wotso could be on a faster growth curve

Currently less than 3% of office space in Australia is 'flexible'

We argue that the market dynamic in which Wotso is playing could allow the business to reach the kind of upside we have described above. In Victory Office's 2019 prospectus the company argues that, by 2030, some 30% of commercial real estate globally could be defined as 'flexible', while in Sydney and Melbourne at present less than 3% of office space sits in that category[4]. This suggests a huge shift towards flexible office space in the next decade or so, driven by:

- The rise of the Millennials, who are comfortable in flexible office environments, as a major factor in the workforce.
- The rise in the 'gig economy' characterised by contract and temporary work and freelancing.
- The openness of medium and large companies to flexible office space, as they grapple with the rapidly changing nature of their workforce needs.

We expect the serviced office space in Australia will grow strongly over the next few years, thanks to a robust economic environment combined the secular trend towards adoption of co-working spaces. Overall, industry revenue could reasonably grow at ~8% over the period to 2023-24 to exceed >$600m p.a[5] . The main demand driver for serviced office space is the shortage of top-quality properties in Sydney and Melbourne at a time when significant numbers of companies will be looking to improve workforce flexibility, in prestigious office locations, without committing to longer lease arrangements. One key research finding has been that approximately 12% of all commercial office space in Australia will be used for flexible workspaces by 2030, including serviced offices and co-working space. The value will be mostly driven by lower operating costs, as companies using flexible space require less office space and improved personnel productivity.[6]

Low commercial property vacancy rates in the CBD are driving flexible office space growth

The biggest markets for flexible office space in Australia will continue to be Sydney and Melbourne, with current concentration of coworking spaces of 49% in Melbourne and 38% in Sydney[7] . Demand for office accommodation under 1000sqm and between 1000 to 3000sqm increased by 7% and 66% in the last quarter. Vacancy rates in Sydney CBD office market will continue to move downwards towards 3%[8] by end of 2020 as many of the developments are achieving strong pre-commitment levels along with large proportion of refurbished space being committed prior the completion. In the Melbourne CBD, strong rental growth is being recorded with vacancy rates just above 3%

[4] See page 33 of that prospectus.
[5] McGegor William, "Serviced Office Leasing in Australia", *IBISWorld Industry Report* (Aug 2018)
[6] Regus, "Places to work for everyone, worldwide", *Regus plc Annual Report and Accounts* (2017)
[7] Property Council of Australia, "The future is flexible", *Propery Council of Australia* (Apr 2018)
[8] Colliers International, "CBD Office: First Half 2019", *Colliers International Research and Forecast Report* (2019)

and strong population rise, better infrastructure investment and emergence of new market participants, including education and co-working sectors

There are a number of major participants in the Australian flexible office space, beginning with Regus at 83 locations, Servcorp at 23 locations and Victory Offices at 21 locations. Also growing strongly are WeWork with 11 locations[9] and The Executive Centre with 9 locations. Global operators like Regus and Servcorp are better positioned than the rivals, as shareholders equity allows them to enter lease arrangements for prime locations with multinational clients that other operators would not be able to afford.

- Regus has the biggest market share in Australia, taking ~19% of the market. This global company operates almost 3100 flexible working spaces in over 110 countries and provides workplace solutions under multiple brands including Spaces, Signature, Open Office, Basepoint and No18. Due to rapid expansion and investment in business centres its Australian operations have performed well over the past 5 years. However, in recent years its expansion has eased due to higher focus on Asian markets.
- Servcorp is the second largest participant, taking 16% of the market share in Australia and also operating in close to 20 other countries. Servcorp has strong focus on expansion and during 1990s it had started operations across Malaysia, Japan and Hong Kong. It had strong revenue growth over the last 5 years, mainly lead by Sydney high market sales and occupancy rates. However, Servcorp is currently challenged with oversupply and lack of demand for its serviced offices in Perth.
- Apart from the largest participants in the industry, serviced office leasing is highly fragmented with small players that claim more personalised solutions. Smaller businesses will tend to focus on smaller geographic markets rather than operating on global scale. One of those is Christie Offices, with 4.5% market share. This company operates along Australia`s eastern seaboard and offers more than 900 serviced offices in 6 locations across Brisbane, Sydney and Melbourne. Another smaller player is Deague Group Holdings, which operates through APSO and has serviced offices in Melbourne, Brisbane and Adelaide.

You could tell flexible workspaces were mainstreaming when GPT got in the game

The market's growth is attracting new participants. In the next 2 years 55%[10] of all tenants occupying 30000 sq. m or more intend to reduce traditional leased offices and increase co-working space. That larger, established property companies are taking note of this trend is evidenced by GPT's 2014 move into the space with the launch of Space&Co. Space&Co currently has venues in 4 locations with more than half members being existing GPT tenants who searched for more flexible space. Australia`s largest owner of office space, Dexus, followed suit in 2018 with a flexible workspace offering called 'SuiteX'[11].

[9] WeWork plan is to grow further and recently it signed a deal to lease entire 6 floors at Lendlease`s Daramu House office building at Barangaroo South that will be available early next year – see The Urban Developer, "WeWork Takes Out Entire Lease of Barangaroo Office Building", *The Urban Developer* (Jul 2018)
[10] CBRE, "Australiaa Real Estate Market Outlook 2019", *CBRE Research Report* (2019)
[11] Cummins Carolyn, "It will become the norm: Co-working office space tipped to rise", *The Sydney Morning Herald* (Jun 2019)

The Bakehouse Quarter demonstrated that the 'BlackWall Way' works

What is the 'BlackWall Way'? Every property group in Australia has a slightly different way of seeking to create shareholder value. Lendlease, for example, focuses on major urbanisation projects in key 24-hour cities around the world, where the company has capability to add value at every stage of the development. Mirvac focuses on creating the best possible buildings and has brought this ethic to all classes of Australian real estate. And so on. For the 'BlackWall Way', we see three major components.

– Buying distressed commercial or industrial assets where there is too much debt and/or too little vacancy, and re-profiling those assets for better returns.
– Using innovative funding structures (such as PIPES) to lower the cost of capital on projects and allow wholesale/retail investors to move in and out without significant transaction costs.
– Investing patiently for the upside and actively adding value.

The 'BlackWall Way' has its origins in the approach that founding director Seph Glew took to building value in real estate coming out of the early 1990s recession[12]. This philosophy was put into action with BlackWall's signature project, the Bakehouse Quarter, from 1997 onwards.

BlackWall's ability to transform a vacant factory into a busy commercial and entertainment district creates value for investors

The 'BlackWall Way' in action - how BlackWall and its precursors made >15% p.a. over >20 years for its property investor group. The Bakehouse Quarter[13] is a 60,000 sq m commercial and retail precinct in the inner-western Sydney suburb of North Strathfield. The precinct is called the Bakehouse Quarter because the site originally housed a biscuit factory[14]. In 1997 a high net worth syndicate led by Seph Glew and Paul Tresidder acquired the vacant factory site by tender. At the time this was considered a minor coup in Australian commercial property circles because a site that large located only 14 km west of downtown Sydney was hard to come by. Through their Kirela Development Unit Trust, finally managed by BlackWall, Glew et. al. proceeded to turn the site into a busy commercial and entertainment district which was eventually sold to China's Yuhu Group for A$380m. This represented an Internal Rate of Return (IRR) of 15.4% compounded quarterly for the original investors, not bad given that the time horizon was in excess of two decades[15].

We see four main reasons for the outstanding success of the Bakehouse Quarter

- **Location**. A characteristic of valuable property investments of the last few decades globally has been investments in '24-hour cities', where people work, play, eat and sleep in the same urban area[16]. The Bakehouse Quarter with its mix of commercial, retail dining and entertainment tenants fits this model, given its location in a part of Sydney where apartment living is now predominant.
- **Creative use**. From the beginning Glew et. al. envisaged a mixed-use precinct in an area where other developers may have sought single use. The resulting diversity of tenants at the Bakehouse Quarter - from Aldi to AMF Bowling to Subway to NRMA to BlackWall's own Wotso business -

[12] With a company he founded called Jagar Property, which morphed into Pelorus Property and finally into BlackWall. In the 1980s Glew had been an Executive Director with New Zealand based property group Chase Corporation, which famously crashed in 1989 as the commercial property sector turned down. In the years following, commercial property prices in Australia's big cities many instances fell by 50% or more.
[13] See bakehouseqtr.com.au
[14] Owned by Arnotts, an iconic Australia biscuit maker that became majority-owned by America's Campbell Soup Company in 1993. Arnotts moved the factory to Huntingwood, around 20 km west of North Strathfield, in 1997, the year Campbell took full control.
[15] See the ASX market release dated 18 August 2017 and headlined *'2017 results – growth across all businesses'*.
[16] For background here see *24 Hour Cities* by Hugh Kelly (New York, Routledge, 2016).

meant that the site was not vulnerable to a downturn in any one class of consumer spending.

- **Long development pipeline**. The Bakehouse Quarter was developed gradually over the 22 years of the project's life. This meant that the resources that went into developing the precinct did not become stretched, and there was no issue of property oversupply that could result from too-hasty development.
- **Transport-friendly**. The Bakehouse Quarter was already close to public transport – North Strathfield has its own train station, on Sydney's Northern Line – but the initiation of the NSW government's WestConnex project[17] suggested that access would become considerably easier over time.

Innovative financial structuring

The Bakehouse Quarter shows that BlackWall's financial structuring works. Glew et. al., and, finally, BlackWall, developed their PIPES investment model as a way of tapping cost-effective sources of capital that would mitigate the risk of excessive bank covenants. Obviously, the Bakehouse Quarter project also benefited from a rising Sydney market for commercial, industrial and retail property. However, we estimate that this was only about 5-6% p.a. at best. The BlackWall model that was perfected here resulted in well more than double that level of performance for the 1997 investors.

BlackWall's innovative financial structuring model, which is structured and managed internally with no input from outside corporate advisors, is a testament to the management's proficiency

An innovation for a smaller property company. It is important not to understate the significance of what we have termed 'innovative financial structuring'. The concept of using different classes of securities in a particular investment structure is not unique. What is unique is for them to be structured, managed and executed internally by a relatively small organisation and in the unlisted managed investment space. For larger and more established companies in Australian real estate sector, millions of dollars are paid to investment banks and corporate advisors to achieve what this group has done by itself.

Structuring was important for BlackWall in thriving post-GFC. Often the term 'financial structuring' has a negative connotation, however, this philosophy allowed the group to sail through the GFC as one of the few listed property businesses not forced into panicked assets sales or a deeply discounted rights issue. Proof of this is the fact that the funds management operations doubled in size in 2009 through the acquisition of two distressed funds management platforms.

55 Pyrmont Bridge Road showed that the Bakehouse Quarter was not a one-off

The 2014 acquisition by BlackWall of 55 Pyrmont Bridge Road in Ultimo near the Sydney CBD showed that the same kind of approach that had created the Bakehouse Quarter could be repeated in other transactions.

55 Pyrmont Bridge Road was a distressed asset when BlackWall acquired it. 55 Pyrmont Bridge Road lies on the rim of the CBD in an area that is mixed commercial and residential. The area has traditionally featured a number of media operations, and the 14,500 sq m commercial property which BlackWall acquired had been occupied by a small number of large corporate tenants – one of these went into insolvency and the other (Fox Sports) vacated. The

[17] A 33 km predominately underground motorway project currently under construction in Sydney- see westconnex.com.au.

building also had less parking than it required and more significantly carried too much debt. All these problems created an opportunity for BlackWall.

The 'BlackWall Way' turned 55 Pyrmont Bridge Road around. We argue that the turnaround at 55 Pyrmont Bridge Road, in which BlackWall had had a management role since 2009, reflected four main factors.

Management's innovative financial structuring and diversification of portfolio of tenants underpins the success of the 'BlackWall Way'

- **The transition from single use to mixed use**. BlackWall refurbished the building to make it suitable for multiple tenants, lowering the risk of one tenant being difficult to replace. Current tenants include the phone company Verizon, an IAG subsidiary, the web hosting company Digital Pacific and two childcare facilities.
- **The use of Wotso as an anchor tenant**. 55 Pyrmont Bridge Road became the location for BlackWall's second Wotso site after the success of the initial Wotso at 50 Yeo Street in Neutral Bay on Sydney's Lower North Shore. Having Wotso as an anchor tenant, and one that filled up fairly quickly after launch, ensured that space in 55 Pyrmont Bridge Road was utilised very efficiently.
- **Creative financing**. This project was conducted collaboratively with the National Australia Bank, but PIPES and the BlackWall Property Trust were used to gain a favourable cost of capital. As with the Bakehouse Quarter, this was a 'big end of town' approach, but executed by a small, hands-on team without the assistance of high-priced corporate advisers.
- **A rising commercial property market**. 2009 was a good time to be active in commercial property in Australia, as sentiment towards the sector was impacted by the GFC of the previous year. Declining ten-year bond rates over the subsequent years have consequently pushed strong returns from property investment.

BlackWall is now well positioned should a crunch emerge in Australian property

There are currently several indications that the Australian property markets may be set for a slowdown.

Current macro indicators all hint at an impending recession

- **The economy appears to be slowing**, with GDP growth for the year to JUne 2019 a mere 1.4%, its slowest rate in ten years[18].
- **Residential property is down**. The decline in residential property values in Australia from their 2017 peak has been widely reported and may be affecting sentiment towards other property sectors[19].
- **Tough times for the retail sector are impacting expected property values here**, with the Royal Institute of Chartered Surveyors noting the expectation among contributors to its Australian property monitor reports that capital and rental values will drop heavily over the next 12 months[20].
- **Bond yields may prove to be unsustainably low**, with the currently low 10-year bond rate of just 1.2% way below the average since 1999 of 4.6%. It is worth noting that the 10-year bond rate is quite close to the cash rate of 1.0% which indicates a gradual shift towards an inverted yield curve, indicative of a potential recession ahead.

[18] Source: ABS, *5206.0 - Australian National Accounts: National Income, Expenditure and Product, Jun 2019*, released 4 September 2019.
[19] *With residential property prices declining, is it time to invest in commercial real estate?* by Eliza Owen, Domain, 19 December 2018.
[20] Source: RICS Q1 2019: Australia Commercial Property Monitor.

Experienced management team and substantial cash would allow BlackWall to not only survive the slowdown in the economy but also take advantage of the rise in availability of distressed assets

- **Leasing markets are currently slow**, with only moderate growth having been enjoyed recently in Sydney and Melbourne, and modest growth in other capitals around the country[21].
- **Given its history, BlackWall can do well**. Unsurprisingly given the above, The National Australia Bank's Commercial Property Index fell 11 points in the first quarter of 2019, its first negative reading since mid-2016[22]. However, given its history, BlackWall can do well in what could be a potentially bearish climate ahead. For one thing, the group is led by a director and senior executive team that are all invested in its projects and the head stock. This cohort has an impressive track record of over 20 years and a proven ability to be disciplined and, above all, patient. Consider as well:
  - There will be more and more distressed assets available as the slowdown becomes more pronounced;
  - The group now has the cash to act quickly should assets become available;
  - The group will likely be able to continue relying on PIPES investors given that these have traditionally made good returns with BlackWall;
  - The Wotso business has shown the creativity of the group in terms of carving out new property niches.

The size of the BlackWall war chest coming into this potential crunch is significant:

- The BlackWall Property Trust now holds A$317m in gross assets and gearing in the trust is only 18%.
- BlackWall Ltd itself is debt-free and is currently investing the cash not invested in the BlackWall Property Trust in growing the Wotso business.

What the Bakehouse Quarter sale means for BlackWall's long-run valuation?

Often on the ASX smaller, less well-known property groups tend to trade at a discount to their reasonable valuation based on Sum-of-the-Parts or DCF. We noted in our January 2019 initiation note on BlackWall that the company could reasonably be valued at between $1.65 (SoTP) and $2.36 (DCF) without any optimistic case, compared to the 83-cent share price at the time. We think the undervaluation of BlackWall and many of its peers is partly due to the belief by equity investors that the property market is 'efficient', reducing the chances that property managers and developers can earn outsize returns without taking on more risk.

How BlackWall can close the gap. We argue that the Bakehouse Quarter provides evidence of outsize returns for investors from BlackWall. We see the share price re-rating from here based on following two factors:

- Continued growth in Wotso, allowing a more generous multiple to be placed on this business.
- A significant property transaction, allowing BlackWall to argue that the capital is now being deployed to secure the 'Next 55 Pyrmont Bridge Road' or, indeed, the 'Next Bakehouse Quarter'.

Potentially, Wotso is available for 'free' at current prices, and BlackWall Asset Management for not very much. As at June 2019 BlackWall held

[21] See the BIS Oxford Economics report headlined *Australian Property Outlook* from late 2018.
[22] Source: NAB, 2 May 2019.

A$25.3m in net investments on its balance sheet. The Bakehouse Quarter transaction added A$10m to BlackWall Ltd's cash balance, with the intention that this cash would help build out the Wotso business. This suggests, if we put no value on Wotso, that the market is currently valuing BlackWall Asset Management at only 1.7 times our forecast FY20 EBITDA, rather than the 6.3 times we used. As we have asserted above, Wotso is potentially worth a lot more than nothing.

Cashed-up balance sheet provide significant upside potential

Following the Bakehouse quarter sale, the company now has A$100m in cash at the BlackWall Property Trust. In our view, this is a substantial advantage for BlackWall as it provides the company the ability to quickly acquire a distressed asset should it become available, a high probability in the currently stagnated Australian property market. As mentioned above, the company has a proven track-record for creating value for investors through its acquired properties, which we believe provides significant upside potential for revaluation.

We believe that the market is currently valuing the company only on the basis of its cash and properties at hand, and not taking into account the considerable war-chest present in the form of A$100m with BWR. Consequently, in our opinion, this calls for a re-rating of the BWF stock from the A$2.00 per share (base case) reported at the time of our initiation of coverage in January 2019, to A$2.10 per share.

Re-rating Blackwall to target range of A$2.10-2.39

We believe that the scalability of the Wotso business would continue to benefit BlackWall even after the spin-off as the synergies between the businesses continue to flow in. Currently, 10 operations of Wotso are housed in a property controlled by BlackWall. In our view, this provides stability in tenancy to BlackWall, an important hedge in the lease market. Additionally, the recurring revenues in the asset management business, the experienced management team, and the substantial war-chest, all provide significant upside potential to the BlackWall stock.

Hence, we value BlackWall at A$2.10 per share (base case) by providing equal weights to the DCF calculation of A$2.55 and a SOTP relative valuation of A$1.64 per share. This is slight upgrade to our initial valuation.

Please see www.pittstreetresearch.com for our initiating coverage, including risk factors for BWF.

Profit & Loss (A$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F	2024F
Sales Revenue	**17.4**	**26.0**	**20.3**	**29.6**	**32.9**	**37.9**	**44.9**	**51.1**
Operating expenses	-10.7	-13.2	-14.7	-16.5	-18.3	-21.4	-25.8	-29.5
Adjusted EBITDA	**6.7**	**12.8**	**5.7**	**13.1**	**14.6**	**16.5**	**19.1**	**21.6**
Depn & Amort	-0.5	-0.9	-0.8	-1.6	-2.0	-2.2	-2.4	-2.6
Adjusted EBIT	**6.1**	**11.9**	**4.8**	**11.4**	**12.7**	**14.3**	**16.7**	**19.0**
Net Interest	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Profit before tax (before exceptionals)	**6.0**	**11.8**	**4.7**	**11.4**	**12.6**	**14.3**	**16.7**	**19.0**
Tax expense	-1.4	-2.8	-1.2	-3.1	-3.5	-3.9	-4.6	-5.2
Abnormals + Minorities	-1.0	-0.9	-0.1	0.0	0.0	-0.1	-0.1	-0.2
NPAT	**3.6**	**8.1**	**3.2**	**8.3**	**9.2**	**10.3**	**12.0**	**13.6**

Cash Flow (A$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F	2024F
Profit after tax	3.6	7.9	3.1	8.3	9.2	10.3	12.1	13.8
Depreciation	0.5	0.9	0.8	1.6	2.0	2.2	2.4	2.6
Change in trade and other receivables	-3.5	-0.6	-2.8	2.1	-0.2	-0.4	-0.5	-0.5
Change in trade payables	0.5	0.4	-0.2	-0.2	0.2	0.3	0.4	0.4
Other operating activities	0.4	-8.0	-2.3	-4.1	-4.5	-5.0	-5.5	-6.0
Operating cashflow	**1.5**	**0.7**	**-1.4**	**7.7**	**6.5**	**7.5**	**8.9**	**10.2**
Capex (- asset sales)	-1.7	-2.0	-2.3	-5.9	-3.3	-3.0	-3.4	-3.6
Other investing activities	-1.6	3.1	17.7	1.3	1.3	1.5	1.8	2.0
Investing cashflow	**-3.3**	**1.1**	**15.3**	**-4.6**	**-2.0**	**-1.5**	**-1.6**	**-1.5**
Dividends	-2.0	-2.2	-2.5	-1.9	-1.3	-1.5	-1.7	-1.9
Equity raised (repurchased)	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt drawdown (repaid)	0.0	0.0	-2.1	0.0	0.0	0.0	0.0	0.0
Other financing activities	0.0	0.7	1.2	0.0	0.0	0.0	0.0	0.0
Net change in cash	-1.3	0.2	10.6	1.2	3.3	4.6	5.7	6.8
Cash at End Period	0.7	0.9	11.5	12.6	15.9	20.5	26.2	32.9
Net Debt (Cash)	2.8	1.2	-10.4	-11.6	-14.8	-19.4	-25.1	-31.9

Balance Sheet (A$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F	2024F
Cash	0.7	0.9	11.5	12.6	15.9	20.5	26.2	32.9
Total Assets	30.9	38.6	37.4	43.5	51.6	60.7	71.6	83.8
Total Debt	3.5	2.1	1.1	1.1	1.1	1.1	1.1	1.1
Total Liabilities	7.8	9.1	5.9	5.7	5.9	6.2	6.6	7.0
Shareholders' Funds	23.1	29.7	31.5	37.9	45.7	54.6	64.9	76.5

Ratios (A$m)	2017A	2018A	2019A	2020F	2021F	2022F	2023F	2024F
Net Debt/Equity (%)	12.2%	4.0%	-33.1%	-30.6%	-32.5%	-35.6%	-38.6%	-41.5%
Interest Cover (x)	34.9	91.1	39.7	268.4	297.6	335.5	392.5	446.9
Return on Equity (%)	23.0%	34.5%	10.8%	23.9%	22.0%	20.5%	20.0%	19.2%

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