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Listed Property

GARDA Diversified Property Fund (ASX Code: GDF)

27 September 2019

Expanding and Internalising

Accumulate

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About Core Property Research

Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research cover sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

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GARDA Diversified Property Fund (ASX: GDF)

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See the end of this document for a description of Core Property's ratings. The rating must be viewed in the context of comparable A-REITs and not across all products.

Forecast Distribution:	6.2%
Forecast 12 Month Capital Return:	7.6%
Total Expected Return:	**13.8%**

Security Information

ASX Code:	GDF
Price:	$1.45
Market Capitalisation:	$229.7M
Securities on Issue:	158.4M
52 Week Range:	$1.21-$1.545

Share price performance

Source: IRESS

Expanding and internalising

- *Acquisition of 2 industrial assets for $410M to be funded by $31.5M institutional capital raising at $1.40 per unit plus increase in debt.*
- *Proposal to internalise the management through the stapling of GDF with the Manager, GARDA Capital Group (ASX: GCM).*
- *Internalisation would see GCM securityholders receive 1.6 units in the new stapled entity GARDA Property Group for every 1.0 units of GCM currently held. New entity will retain the ASX code of GDF.*
- *Internalisation is dependent on securityholder approvals in Oct/Nov before finalisation in late Nov 2019.*
- *Core Property calculates the transactions to be minor dilutive, FY20 FFO per unit estimated at 8.6 cpu (from our prior forecast of 8.7 cpu). Distributions maintained at 9.0 cpu. Minor impact on valuation (est. 1cpu reduction). Our forecasts to be updated once transaction has been approved and finalised.*

GDF announced the acquisition of 2 industrial assets for $41M to be funded via an institutional capital raising of $31.5M, with 22.5M new units of GDF to be issued at $1.40 per unit, a 3.9% discount to the prior traded price before the announcement. The placement is within the current placement capacity and does not require securityholder approval.

GDF also announced its intention to internalise its management structure via a proposal to staple GDF with its manager GARDA Capital Group (ASX: GCM) under a new stapled entity GARDA Property Group, which will retain the ASX code GDF. GCM unitholders will receive 1.6 units in the new GDF for every 1.0 units currently held, with GCM investors estimated to hold 21% of the new stapled security. The transaction is estimated to eliminate Responsible Entity Fees of around $2.6M p.a. on $403M of FUM. Transaction is subject to securityholder approvals at meetings by GDF unitholders (est late October), GCM unitholders (est mid November) and finalised in late November 2019.

Core Property estimates the transactions to be minor dilutive with updated FY20 FFO per unit of 8.6 cpu. Our prior estimate was 8.7 cpu. Management has confirmed FY20 distirbutions to be maintained at 9.0 cpu. Core Property estimates a minor reduction (~1cpu) to our $1.46 valuation and price target (of $1.56), which will be updated once securityholder approvals are received and the transaction is finalised. At current levels, GDF provides a 6.2% distribution yield with upside growth predicated on the leasing up of the Botanicca 9 office in Richmond VIC as well as the completion of industrial developments.

Year Ended 30 June	FY19A	FY20F	FY21F	FY22F
NPAT - Reported - $M	28.8	14.6	16.9	17.1
NPAT - adj - $M	11.8	13.8	16.1	16.2
Price/Earnings Ratio	19.5	16.6	14.3	14.2
FFO - cents	8.7	8.7	10.2	10.2
EPU - Growth		17.2%	16.3%	0.7%
DPU - cents	9.0	9.0	9.5	9.8
Distribution Yield	6.2%	6.2%	6.6%	6.8%
NTA per unit	$1.37	$1.38	$1.40	$1.42
Gearing	33.2%	33.8%	34.1%	34.6%

Source: Core Property estimates
Note: Gearing = (net debt – cash) / (net debt – cash + net assets)

Key Metrics

Strategy
To provide sustainable and growing distributable income derived from commercial and industrial real estate across the east coast of Australia. GDF focuses on a combination of newer and high yielding assets that is diversified across building type, location and tenants. The Fund is relatively defensive as it focuses on maintaining a conservative capital structure.

Board & Management
Board of the RE consists of Executive Chairman (Matthew Madsen) plus an Independent Director (Morgan Parker) and two Non-Executive Directors (Mark Hallett and Philip Lee). **Senior Management** includes Matthew Madsen (Executive Chairman and Managing Director), David Addis (Chief Operating Officer), Paul Brown (Manager, Investor Relations), Paul Lohr (Asset Manager) and Ikram Patel (Financial Controller).

Portfolio	
Metric	**June 19**
No of Properties	12
Valuation	$332.8M
Portfolio Capitalisation Rate	6.79%
Locations	Australia
Sector	Office, Industrial
Occupancy	83%[1]
WALE	5.3 years
Note 1: Occupancy is 98% excluding Botanicca 9	

Key Properties	
June 19	**% Portfolio**
588 Swan St, Richmond	18.9%
7-19 Lake St, Cairns	17.1%
572 Swan St, Richmond	15.9%
41 Bivouac Pl, Wacol	10.6%
436 Elgar Rd, Box Hill	9.5%
Top 5	**72.0%**

Key Tenants	
June 19	**% income**
J Blackwoods & Sons	10.1%
Volvo Group	9.5%
Qld Gov (DTMR)	8.0%
Golder Associates	7.2%
Planet Innovation	7.2%
Top 5	**42.0%**

Geography	
June 19	**% Portfolio**
NSW	-
VIC	44.4%
QLD	55.6%
ACT	-
WA	-
SA	-
Total	**100%**

Debt	Jun 2019
Gearing	32.5%
Target LVR	30-35%
Drawn Debt	$139.7M
Facility limit	$162.3M
Weighted Expiry	1.15 years
All in cost of debt	3.16%
% Hedged	37%
LVR	38.5%
LVR Covenant	50%

Expenses	Jun 2019
RE Fee	0.65% of GAV
Outgoings	17.8% of rental income

Historical	FY17	FY18	FY19
EPU – FFO per Unit	10.3	8.7	8.7
DPU – Distributions per Unit	9.4	9.0	9.0
Payout Ratio	94.4%	100.7%	104.7%
Distribution Frequency	Qtrly	Qtrly	Qtrly
NTA per Unit	$1.21	$1.28	$1.37

Expanding and Internalising

On 20 September 2019 GDF announced the acquisition of two industrial properties, an equity raising and an internalisation proposal to create a new stapled entity with its manager, GARDA Capital Group (ASX: GCM).

- **Acquisition of 326 and 340 Thynne Road, Morningside QLD** – GDF will acquire the two warehousing and distribution facilities which sit on a 4-hectare site, located 4.5kms east of the Brisbane CBD. The industrial properties will be acquired for $41.0M, representing a 5.75% capitalisation rate and an initial yield of 6.57%. The properties are fully occupied with a Weighted Average Lease Expiry (WALE) of 3.35 years with key tenants Komatsu fully occupying the site at 326 Thynne Road and Wallace International at 340 Thynne Road. The site at 326 Thynne Road has 7,500sqm of surplus land with a development approval in place, which GDF intends to develop in the future.

  The acquisitions will increase the industrial component of the portfolio to 46% (from 40%), providing a more even weighting with the office assets. Portfolio capitalisaiton rate is expected to reduce to 6.68% (from 6.79%) and portfolio WALE will reduce to 5.1 years (from 5.3 years).

- **Equity raising of $31.5M** – The acquisition will be funded by an additional $12.5M in debt as well as an institutional equity raising of $31.5M through the placement of 22.5M units in GDF at $1.40 per unit. The placement price represents a 3.9% discount to the last close price of $1.46 per unit prior to the announcement. The new units are issued under GDF's available placement capacity and will not be entitled to the distribution for the September 2019 quarter.

- **Internalisation Proposal** - GDF proposes to internalise its management structure by acquiring its Manager, GARDA Capital Group (ASX: GCM), via a Scheme of Arrangement and Trust Scheme. GDF intends to establish a new stapled structure to combined GDF and GCM, with GCM unitholders being offered 1.6 units in the new GDF stapled security for each GCN security held. GDF securityholder will own approximately 79% of the new entity, GARDA Property Group and GCM unitholders will own 21%. The independent directors of GDF have unanimously recommended that GDF unitholders vote in favour of the internalisation and the proposal will require approval from GDF unitholders (with a meeting expected to be held in late October 2019), GCM unitholders (with a meeting expected to be held in mid-November 2019) and a final implementation expected in late November 2019.

  GDF has confirmed that all management and staff will continue in the new structure.

  The stapling of the units will eliminates all Responsible Entity Fees that GDF currently pays GCM. The Responsible Entity Fee is 0.65% of Gross Asset Value of the Fund. In FY19 this amounted to $2.1M, however is estimated to increase to around $2.6M p.a., based on a forecast FUM of $403M.

  The transaction also eliminates all related party transactions including property management fees and facility management fees (estimated at $4.0M in total) as well as capex fees and leasing fees (estimated at $2.8M in total), which adds the value proposition.

Financial Forecasts

Assuming the internalisation is successful and the acquisitions are completed, we estimate the transactions to be slightly dilutive to earnings per unit, with our FY20 Funds From Operations per unit (FFO per unit) reducing to 8.6 cpu (from 8.7 cpu previously). We calculate this would have a minor impact on our valuation and 12-month price target (~1 cpu). At this stage we have not updated our forecasts for the transactions until the securityholder meetings are held and the transactions are finalised.

Our updated FFO per unit for FY20 of 8.6 cpu is at the lower end of GDF's prior guidance, which indicated 8.6 – 9.0 cpu based on a 100% - 105% payout ratio for a 9.0 cpu distribution. GDF have confirmed that FY20 distributions are expected to be maintained at 9.0 cpu for FY20.

Portfolio Metrics

The following table is a summary of GDF's portfolio at 30 June 2019.

GDF Property Portfolio - as at 30 June 2019

Property	Valuation $M		Capitalisation Rate %		Occupancy %		WALE (years)	
	Jun19	Dec18	Jun19	Dec18	Jun19	Dec18	Jun19	Dec18
7-19 Lake Street, Cairns QLD (including land at 26-30 Grafton St, Cairns QLD)	$57M	$51.0M	8.25%	8.25%	97%	98%	3.6	3.2
154 Varsity Parade, Varsity Lakes QLD	$12.8M	$14.0M	8.25%	8.25%	83%	90%	2.6	2.9
142-150 Benjamin Place, Lytton QLD	$9.5M	$9.7M	7.00%	7.00%	100%	100%	1.9	1.2
B2, 747 Lytton Road, Murarrie QLD	-	$14.3M	-	8.00%	-	100%	-	3.6
436 Elgar Road, Box Hill VIC	$31.5M	$29.0M	6.25%	6.25%	100%	100%	3.4	3.9
572-576 Swan Street, Richmond VIC	$53.0M	$52.5M	5.75%	5.75%	100%	100%	4.4	4.9
69-79 Diesel Drive, Mackay QLD	$30.0M	$30.2M	7.50%	7.50%	100%	100%	9.5	10.0
41 Bivouac Place, Wacol QLD	$35.3M	$35.3M	6.25%	6.25%	100%	100%	9.0	9.5
70-82 Main Beach Road, PinkenbaQLD	$20.0M	$19.0M	7.00%	7.37%	100%	100%	14.1	14.6
588A Swan Street, Richmond VIC (Botanicca 9)	$62.8M	$33.9M	5.75%	5.75%	0%	NA	NA	NA
67 Noosa Street, Heathwood QLD	$10.5M	$9.8M	7.25%	7.40%	100%	100%	8.8	9.2
1-9 Huntress Road, Berrinba QLD	$3.0M	$3.0M	NA	NA	NA	NA	NA	NA
498 Progress Road, Wacol QLD	$6.5M	-	NA	-	NA	-	NA	-
Capital Expenditure post valuation	$1.0M	$4.5M	NA	NA	NA	NA	NA	NA
Total Portfolio	**$332.8M**	**$306.3M**	**6.79%**	**6.78%**	**97.8%**	**99.0%**	**6.4**	**5.7**

Source: GDF

Appendix: Financial Summary

GARDA Diversified Property Fund (ASX: GDF)

Profit & Loss	FY19A	FY20F	FY21F	FY22F
Operating Revenue	25.0	29.6	33.7	33.6
Property Expenses	-5.9	-7.2	-8.7	-8.4
Net Property Income	**19.0**	**22.4**	**25.0**	**25.2**
Other Income & Expenses	-2.3	-2.1	-2.2	-2.2
RE Fees	-2.1	-2.4	-2.6	-2.7
EBITDA	**14.6**	**17.9**	**20.1**	**20.3**
Depn & Amort	0.0	0.0	0.0	0.0
EBIT	**14.6**	**17.9**	**20.1**	**20.3**
Net Interest	-2.8	-4.0	-4.0	-4.0
Pre Tax Profit	**11.8**	**13.8**	**16.1**	**16.2**
Tax	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
NPAT - adj	**11.8**	**13.8**	**16.1**	**16.2**
Non Recurring Items	17.0	0.8	0.8	0.9
NPAT - Statutory	**28.8**	**14.6**	**16.9**	**17.1**

Summary	FY19A	FY20F	FY21F	FY22F
NPAT - adj	11.8	13.8	16.1	16.2
Price Earnings Multiple	19.5	16.6	14.3	14.2
Revenue Growth	27.2%	18.1%	13.7%	-0.3%
EBIT Growth	22.2%	22.0%	12.7%	0.6%
Value of Properties	332.8	341.7	347.7	353.2
Net Assets	217.1	219.2	222.6	224.5
NTA per Unit	$1.37	$1.38	$1.40	$1.42
Prem(Disc) to NTA per unit	5.8%	4.8%	3.2%	2.3%
DPU	9.0	9.0	9.5	9.8
Payout Ratio	113.9%	103.5%	93.5%	96.0%
DPU Growth		0.5%	5.0%	3.4%
Yield	6.2%	6.2%	6.6%	6.8%

Cashflow	FY19A	FY20F	FY21F	FY22F
Operating Activities	24.6	24.2	26.9	27.2
Net Interest	-4.0	-4.0	-4.0	-4.0
Tax Paid	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Operating Cashflow	**20.6**	**20.2**	**22.9**	**23.2**
Capex	-9.1	-7.0	-7.7	-7.7
Maintainable Operating CF	**11.5**	**13.2**	**15.2**	**15.5**
Distributions	-13.4	-14.3	-15.1	-15.6
Acquisitions	-45.9	0.0	0.0	0.0
Disposals	16.4	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Free Cashflow	**-31.4**	**-1.1**	**0.1**	**-0.1**
Change in Debt	22.8	7.4	7.4	6.8
Change in Equity	24.2	0.0	0.0	0.0
Net Cashflow	15.7	6.2	7.5	6.8

Key Ratios	FY19A	FY20F	FY21F	FY22F
EPU (adj)	7.5	8.7	10.2	10.2
EPU - Reported	18.2	9.2	10.7	10.8
EPU (adj) - Growth		17.2%	16.3%	0.7%
LVR	38.5%	37.5%	36.9%	36.3%
Net Debt/(Net Debt + Equity)	33.2%	33.8%	34.1%	34.6%
Net interest Cover	5.2	4.4	5.0	5.0
Distn / Maintainable CF	116.3%	108.5%	99.1%	100.3%
ROE	5.6%	6.4%	7.2%	7.2%

Balance Sheet	FY19A	FY20F	FY21F	FY22F
Cash	20.2	16.5	13.3	9.8
Debtors	1.4	2.0	2.0	2.0
Investments	0.0	0.0	0.0	0.0
Other Assets	334.7	341.7	347.7	353.2
Total Assets	**356.3**	**360.2**	**362.9**	**364.9**
Creditors	4.2	5.8	5.8	5.8
Borrowings	128.3	128.3	128.3	128.3
Provisions	0.0	0.0	0.0	0.0
Other Liabilities	6.7	6.9	6.3	6.4
Total Liabilities	**139.2**	**141.0**	**140.3**	**140.5**
Net Assets	**217.1**	**219.2**	**222.6**	**224.5**

Valuation		
Discount Rate	9.0%	
Terminal Growth Rate	2.5%	
DCF Valuation per Share	$1.46	
12 Month Target Price	**$1.56**	DCF rolled forward 12 mths
12 month Dividend Yield	6.2%	
12 month Target Price	7.6%	
Total Est. 12 mth return	**13.8%**	

Source: Core Property forecasts
Note: Gearing = (net debt – cash) / (net debt – cash + net assets)

Ratings Process for A- REITs

Core Property Research evaluates recommendations on listed A-REITs continuously, based on a range of qualitative and quantitative criteria ranging from management, appropriateness of the A-REIT's capital structure and the property portfolio metrics. From a quantitative perspective, Core Property's recommendations are based on Total Expected Returns (forecast distribution yield plus forecast capital gain or loss) for a 12-month time horizon, using a range of valuation methodologies. The two most commonly used valuation techniques are Discounted Cash Flow (DCF), which uses an A-REI's expected free cash flow, and the net Asset Valuation (NAV) approach.

The 12-month Total Return is compared with set total return bands and assigned a 12-month recommendation based on the Recommendation Definitions below.

Recommendation Definitions

Recommendation	Definition
Buy	If the 12-month Total Expected Return is forecast to be 15% or more.
Accumulate	If the 12-month Total Expected Return is forecast to be at least 10% and less than 15%.
Hold	If the 12-month Total Expected Return is forecast to be at least 5% and less than 10%.
Reduce	If the 12-month Total Expected Return is forecast to be at least 0% and less than 5%.
Sell	If the 12-month Total Expected Return is forecast to be less than 0%.

At times of extreme volatility, it is quite possible that the recommendations will swing between each of our bands. During such times, Core Property will adopt a more flexible approach to recommending stocks, based on a slightly longer duration, and as such, recommendations may appear to be inconsistent when compared with the bands. This is to avoid clouding value judgments with short-termism.

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