



Whitestone REIT (WSR)

Updated September 13rd, 2019 by Kay Ng

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	4.7%	Volatility Percentile:	58.7%
Fair Value Price:	\$12	5 Year Growth Estimate:	0.0%	Momentum Percentile:	60.5%
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.6%	Growth Percentile:	2.0%
Dividend Yield:	8.3%	5 Year Price Target	\$12	Valuation Percentile:	40.2%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	27.1%

Overview & Current Events

Whitestone is a retail REIT that owns about 57 properties with about 4.9 million square feet of gross leasable area in six top U.S. markets in Texas (29 properties) and Arizona (27 properties). It has roughly 85% service-based tenants in the areas of services & entertainment (32%), dining (23%), specialty retail (15%), health & wellness (13%), grocery (12%), and education (5%), which are meant to be e-commerce resistant. Additionally, its tenant base is very diversified with only two tenants that contribute more than 2% of the annualized base rent. It also has equity interests in and manages 11 properties containing 1.3 million square feet of gross leasable area. Whitestone was founded in 1998 and headquartered in Houston, Texas. It has a market cap of \$554.8 million.

Whitestone reported its second-quarter results on 07/31/19. Year over year, the portfolio occupancy declined 1.9% to 89.4%. However, the funds from operations per share increased 14.3% to \$0.24. This is thanks to Whitestone increasing its rental rates on new and renewal leases by 7.5% for the trailing 12-month period, resulting in the annualized base rent per square foot rising by 4.0% year over year to \$19.53.

Whitestone finished building the Anthem Marketplace Pad Site in Arizona, which is 100% leased and is expected to generate an annual unlevered return on total cost of 10.5%, with tenant lease terms averaging 7.5 years.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
FFOPS	N/A	N/A	N/A	N/A	\$0.79	\$0.96	\$1.04	\$0.93	\$0.95	\$0.97	\$0.96	\$0.96
DPS	\$0.45	\$1.19	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$0.86
Shares¹	N/A	2.20	8.83	16.84	21.94	22.83	26.99	29.25	38.49	39.77	40.83	58.77

Since Whitestone began reporting FFO, they have seen minimal growth in their funds-from-operations-per-share (FFOPS). This is not a result of decreased FFO but an increase in shares outstanding. The reason why the REIT has been issuing shares is because it has been using them to fund acquisitions. With the issuance of these shares, it has put a hold on dividend growth. Between 2016 and 2019, Whitestone issued over 10.52 million shares. Given the past and current dividend per share (DPS) of \$1.14, this equates to approximately 12 million dollars per year that must be issued as dividends on the additional shares. On the plus side, Whitestone has been able to acquire \$283 million worth of property since 2016, but it has only grown its revenue by \$18 million since 2016. Fortunately, Whitestone has been able to increase its net income from continuing operations by almost \$14 million but on a per-share basis, it has decreased. Whitecap plans to issue up to 3,433,931 common shares under the Long-Term Equity Incentive Ownership Plan. The company can issue up to 5,000,000 common shares and historically has issued approximately 3,500,000 shares per year in the last 5 years. Given the increase in shares outstanding, it is unlikely that even as revenue increases the FFOPS will increase as well. Assuming the FFOPS remained stable, the current payout ratio is still unsustainable. A dividend cut down the road can occur, especially if FFOPS doesn't improve.

1. Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/FFO	N/A	N/A	N/A	N/A	16.6	15.8	11.5	15.5	15.2	12.9	14.4	12.0
Avg. Yld.	N/A	N/A	N/A	N/A	N/A	7.5%	9.5%	7.9%	7.9%	9.3%	8.3%	7.5%

Whitestone has traded at a price to funds from operations multiple of 14.7 over the past 5 years, which aligns with the current multiple it's trading at. However, for the time being, we estimate the FFOPS to remain stagnant. So, a lower multiple of 12 is more appropriate. If the REIT were to cut its dividend down the road, the stock can drop significantly.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	N/A	N/A	N/A	N/A	144%	119%	110%	123%	120%	118%	119%	89.6%

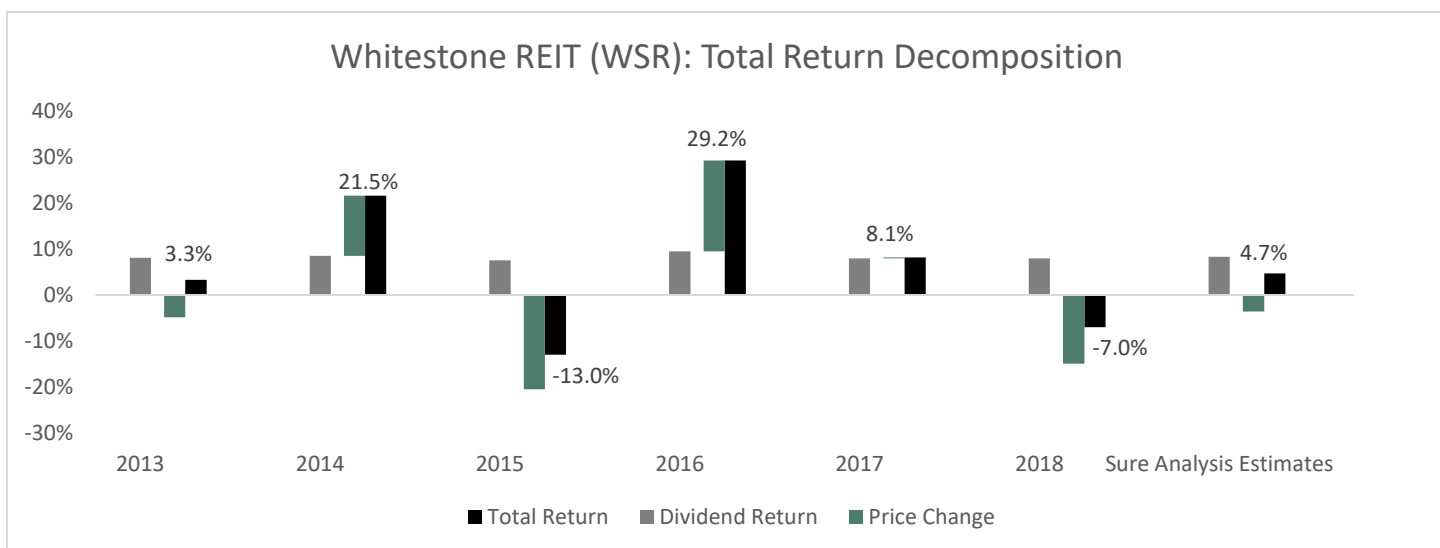
Whitestone had some financial troubles during the last recession in 2008. From 2007 to 2008 rental income dropped by 5.8 million, and it took until 2012 for the rental income to return to the 2007 highs. Also, the payout ratio is above 100% which means that the dividend is only sustainable by adding debt. Therefore, we don't expect the company to be resilient to recessions, and in fact, a dividend cut is likely during harsh economic times.

The company has about 87% of its \$623 million real estate debt subject to fixed interest rates. The recent weighted average interest rate was 4.08% with a weighted average remaining term of 5.8 years. It had also decreased its debt-to-EBITDA ratio from 8.95 in 2015 to 8.4 in 2018, but this is still high debt levels. Its goal is to decrease this multiple to six to seven times by 2023.

Final Thoughts & Recommendation

Whitestone has an expected annualized total return of 4.7% over the next five years, coming from an 8.3% dividend yield, 0% growth, and -3.6% valuation compression. Concerns surrounding this REIT include significant share issuances, a high debt load, and an unsustainable payout ratio. The possibility of multiples contraction and a dividend cut leading to unattractive total returns make the REIT a sell today. There are better income and total returns ideas with lower risks in the Sure Dividend coverage universe.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	33	32	35	45	60	72	93	104	126	120
Gross Profit	20	19	22	28	38	47	62	70	84	82
Gross Margin	60.3%	61.0%	61.8%	62.6%	62.5%	65.3%	66.5%	67.4%	66.6%	68.8%
SG&A Exp.	6	5	7	8	11	15	20	24	24	23
D&A Exp.	7	7	8	10	13	16	20	22	27	26
Operating Profit	7	7	7	11	14	16	22	24	33	33
Operating Margin	20.4%	23.6%	20.6%	23.7%	22.8%	22.4%	23.6%	22.9%	25.9%	27.9%
Net Profit	1	1	1	0	4	8	7	8	8	21
Net Margin	4.1%	3.5%	3.2%	0.1%	6.3%	10.5%	7.2%	7.6%	6.6%	17.9%
Free Cash Flow	0	10	8	11	24	26	36	41	41	40

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	182	196	273	385	508	634	782	855	1070	1029
Total Liabilities	115	112	143	212	287	421	535	588	712	670
Accounts Payable	10	7	9	14	13	16	24	29	36	34
Long-Term Debt	102	101	128	191	261	394	498	544	659	618
Shareholder's Equity	44	63	116	166	216	210	243	256	348	350
D/E Ratio	2.34	1.61	1.10	1.15	1.21	1.88	2.05	2.13	1.90	1.76

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.7%	0.6%	0.5%	0.0%	0.8%	1.3%	1.0%	1.0%	0.9%	2.0%
Return on Equity	3.0%	2.1%	1.3%	0.0%	2.0%	3.6%	3.0%	3.2%	2.8%	6.1%
ROIC	0.8%	0.6%	0.5%	0.0%	0.9%	1.4%	1.0%	1.0%	0.9%	2.1%
Shares Out.	N/A	2.20	8.83	16.84	21.94	22.83	26.99	29.25	38.49	39.77
Revenue/Share	9.90	7.80	3.86	3.31	3.31	3.18	3.64	3.68	3.47	2.95
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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