



Whitestone REIT (WSR)

Updated March 4th, 2019 by Kay Ng

Key Metrics

Current Price:	\$13	5 Year CAGR Estimate:	3.1%	Market Cap:	\$553M
Fair Value Price:	\$11	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	03/02/20
% Fair Value:	123%	5 Year Valuation Multiple Estimate:	-4.1%	Dividend Payment Date:	03/13/20
Dividend Yield:	8.7%	5 Year Price Target	\$11	Years Of Dividend Growth:	0
Dividend Risk Score:	F	Retirement Suitability Score:	C	Last Dividend Increase:	0%

Overview & Current Events

Whitestone is a retail REIT that owns about 58 properties with about 5.0 million square feet of gross leasable area in six top U.S. markets in Texas (30 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 8 properties containing 0.9 million square feet of gross leasable area. Whitestone was founded in 1998 and headquartered in Houston, Texas.

Whitestone reported its fourth-quarter and full-year 2019 results on 02/26/20. In Q4, the funds from operations per share fell 3.7% to \$0.26 compared to the same quarter a year ago. For the quarter, the occupancy was 90.3%, same-store property net operating income (NOI) growth was 4.7%, and the total rental rate growth was 14.4%. In the quarter, it also realized gains of about \$14 million (net proceeds of \$12.3 million) in the sale of 3 Houston non-core assets (announced in October 2019) owned in a joint venture.

In 2019, funds from operations fell 4.3% to \$0.90 per share against 2018. For the year, the occupancy was stable at 90.3%, same-store property NOI rose by 2.4%, and the total rental rate growth was 10.1%. During the year, Whitestone completed new leases and renewal leases of \$28.2 million and \$59.8 million in annualized revenue. The annualized base rent per leased square foot rose to \$19.77 from \$19.35;

In November 2019, Whitestone announced the completion of the redevelopment of Williams Trace Plaza, which is 93% occupied. In December 2019, Whitestone acquired Las Colinas Village for \$34.8 million as an off-market purchase in a high-growth market of Texas, following Microsoft's recent announcement to expand in the neighborhood. The company guides funds from operations in the range of \$0.87-\$0.91 for the year. We use the mid-point of \$0.89 for our estimates in the following table.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FFOPS	N/A	N/A	N/A	\$0.79	\$0.96	\$1.04	\$0.93	\$0.95	\$0.97	\$0.90	\$0.89	\$0.89
DPS	\$1.19	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$1.14	\$0.80
Shares¹	2.2	8.8	16.8	21.9	22.8	27.0	29.2	38.5	39.8	40.6	41.4	45.7

Since Whitestone began reporting FFO, it has 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 REIT has been issuing shares because it has been using them to fund acquisitions. The share issuance has put a hold on dividend growth. Between 2016 and 2019, Whitestone issued more than 11 million shares. Given the past and current dividend per share (DPS) of \$1.14, this equates to approximately 13 million dollars per year that must be issued as dividends on the additional shares. On the plus side, since 2016, Whitestone has been able to acquire \$318 million worth of property, but it has only grown its revenue by \$15 million. Given the increase in shares outstanding, it is unlikely that even as revenue increases the FFOPS

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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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.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/FFO	--	--	--	16.6	15.8	11.5	15.5	15.2	12.9	14.6	14.8	12.0
Avg. Yld.	--	--	--	--	7.5%	9.5%	7.9%	7.9%	9.3%	8.7%	8.7%	7.5%

Whitestone has traded at a price to funds from operations multiple of 13.9 over the past 5 years. The stock is expensive at the current P/FFO of 14.8, especially since we estimate the FFOPS to remain stagnant. We think 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	--	--	--	144%	119%	110%	123%	120%	118%	127%	128%	90%

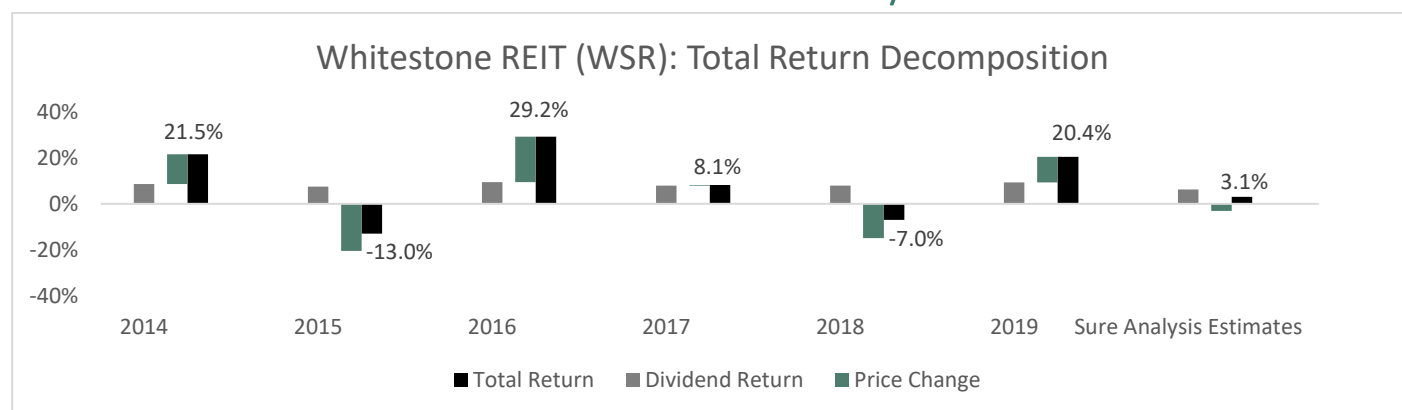
Whitestone had some financial troubles during the last recession in 2008. From 2007 to 2008 rental income dropped by \$5.8 million, and it took until 2012 for the rental income to return to the 2007 highs. Also, the payout ratio is above 100%, which means that the dividend is only sustainable by adding 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 85% of its \$630 million real estate debt subject to fixed interest rates. The recent weighted average interest rate was 4.1% with a weighted average remaining term of 5.3 years. Its net-debt-to-EBITDA ratio was 8.6 at the end of 2019, a small improvement from 8.7 at the end of 2018, but this is still high debt levels. Its goal is to decrease this multiple to six to seven times by 2023. At quarter end, it had \$15.5 million of cash on its balance sheet, which is small compared to its debt levels.

Final Thoughts & Recommendation

Whitestone has an expected annualized total return of 3.1% over the next five years, coming from an 8.7% dividend yield, 0% growth, and -4.1% 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 return ideas with lower risks in the Sure Dividend coverage universe.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	32	35	45	60	72	93	104	126	120	119
Gross Profit	19	22	28	38	47	62	70	84	82	82
Gross Margin	61.0%	61.8%	62.6%	62.5%	65.3%	66.5%	67.4%	66.6%	68.8%	69.1%
SG&A Exp.	5	7	8	11	15	20	24	24	23	22
D&A Exp.	7	8	10	13	16	20	22	27	26	27
Operating Profit	7	7	11	14	16	22	24	33	33	34
Operating Margin	23.6%	20.6%	23.7%	22.8%	22.4%	23.6%	22.9%	25.9%	27.9%	28.5%
Net Profit	1	1	0	4	8	7	8	8	21	24
Net Margin	3.5%	3.2%	0.1%	6.3%	10.5%	7.2%	7.6%	6.6%	17.9%	19.9%
Free Cash Flow	10	8	11	24	26	36	41	41	40	48
Income Tax										

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	196	273	385	508	634	782	855	1070	1029	1056
Cash & Equivalents	18	6	7	6	4	3	4	5	14	16
Accounts Receivable	5	6	8	10	12	15	20	21	21	23
Total Liabilities	112	143	212	287	421	535	588	712	670	703
Accounts Payable	7	9	14	13	16	24	29	36	34	39
Long-Term Debt	101	128	191	261	394	498	544	659	618	645
Shareholder's Equity	63	116	166	216	210	243	256	348	350	345
D/E Ratio	1.61	1.10	1.15	1.21	1.88	2.05	2.13	1.90	1.76	1.87

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.6%	0.5%	0.0%	0.8%	1.3%	1.0%	1.0%	0.9%	2.0%	2.3%
Return on Equity	2.1%	1.3%	0.0%	2.0%	3.6%	3.0%	3.2%	2.8%	6.1%	6.8%
ROIC	0.6%	0.5%	0.0%	0.9%	1.4%	1.0%	1.0%	0.9%	2.1%	2.4%
Shares Out.	4.04	9.04	13.61	18.27	22.79	25.68	28.38	36.26	40.61	41.46
Revenue/Share	7.80	3.86	3.31	3.31	3.18	3.64	3.68	3.47	2.95	2.88
FCF/Share	2.57	0.93	0.82	1.31	1.13	1.41	1.43	1.14	0.97	1.15

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

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