Whitestone REIT (WSR)

Updated September 8th, 2023 by Kay Ng

Key Metrics

Current Price:	$10	**5 Year CAGR Estimate:**	8.1%	**Market Cap:**	$496M
Fair Value Price:	$10	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date:**	10/02/23
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.5%	**Dividend Payment Date:**	10/12/23
Dividend Yield:	4.9%	**5 Year Price Target**	$12	**Years Of Dividend Growth:**	1
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Whitestone is a retail REIT that owns about 56 properties with about 5.0 million square feet of gross leasable area primarily in top U.S. markets such as Texas and Arizona. Its tenant base is very diversified with about 1,467 tenants with no tenant exceeding 2.2% of total revenue. Its strategy is to prioritize renting to strong tenants and service-oriented businesses, including grocery, restaurant, health and fitness, financial services, logistics services, education and entertainment, etc. in neighborhoods with high disposable income. Whitestone was founded in 1998 and is headquartered in Houston, Texas.

Whitestone reported its second-quarter 2023 results on 8/1/23 for which it witnessed an occupancy rate of 93.3% versus 91.5% in Q2 2022. For the quarter, revenue growth was 4.2% to $36.5 million versus Q2 2022. Funds from operations per share ("FFOPS") was down 16% to $0.21. The decline was primarily from higher litigation and interest expenses. Same-store net operating income ("SSNOI") rose 0.4% to $22.6 million. As well, rental rate growth was 18.7%, up from 17.4% a year ago, driven by a jump in rental rate growth in new leases (to 32.2% vs. 15.6% a year ago). The rental rate growth for renewal leases was 16.2% vs. 17.6% a year ago. There were 27 new leases and 58 renewal leases in the quarter.

Year to date, revenue rose 4.6% to $72.3 million, while FFOPS fell 18% to $0.45 year over year. Whitestone updated its 2023 guidance with SSNOI growth of 2.5%-4.5% and FFOPS of $0.90-0.94. It forecasts an ending occupancy of about 94%. And it anticipates potential bad debt of 0.75%-1.50% of revenue versus 0.83% in 2022. Therefore, we reduced our 2023 FFOPS estimate to $0.92, the midpoint of management's guidance.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
FFOPS	$0.79	$0.96	$1.04	$0.93	$0.95	$0.97	$0.90	$0.83	$0.86	$1.03	***$0.92***	***$1.07***
DPS	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$1.14	$0.42	$0.43	$0.48	***$0.48***	***$0.64***
Shares[1]	21.9	22.8	27.0	29.2	38.5	39.8	40.6	43.3	50.0	50.0	***50.3***	***67.4***

Since Whitestone began reporting FFO, it has seen minimal growth in its FFOPS. This is not a result of decreased FFO but an increase in shares outstanding. The REIT has been issuing shares to fund acquisitions. Between 2016 and 2022, Whitestone issued more than 20 million shares. As a result, there was no dividend growth from 2016 to 2019 and a dividend cut occurred during the pandemic. In February 2021 and 2022, the REIT declared dividend increases. However, it did not declare a dividend increase in February 2023. That said, the REIT has the capacity to improve its dividend in the long run. For now, we use an estimated dividend growth rate of 6% through 2028, which would lead to a sustainable payout ratio of ~60% for a REIT.

Management believes, post-pandemic, investments in acquisitions, re-development, and development projects can drive returns of at least 10%. The continuation of SSNOI growth since Q1 2021 is a good sign. We would like to see it stay that way. For now, we estimate a FFOPS growth rate of 3% through 2028 on a long-term recovery path. We would improve our estimates if/when we see the REITs' investments paying off.

[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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/FFO	16.6	15.8	11.5	15.5	15.2	12.9	14.6	9.2	9.6	10.7	***10.8***	***11.0***
Avg. Yld.	--	7.5%	9.5%	7.9%	7.9%	9.3%	8.7%	5.5%	4.5%	4.2%	***4.9%***	***5.5%***

From 2018 to 2022, Whitestone traded at a price to funds from operations multiple (P/FFO) of 11.4. In a rising interest rate environment, REIT valuations have been pressured. So, we now target a fair P/FFO of 11.0. The stock appears to be fairly valued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

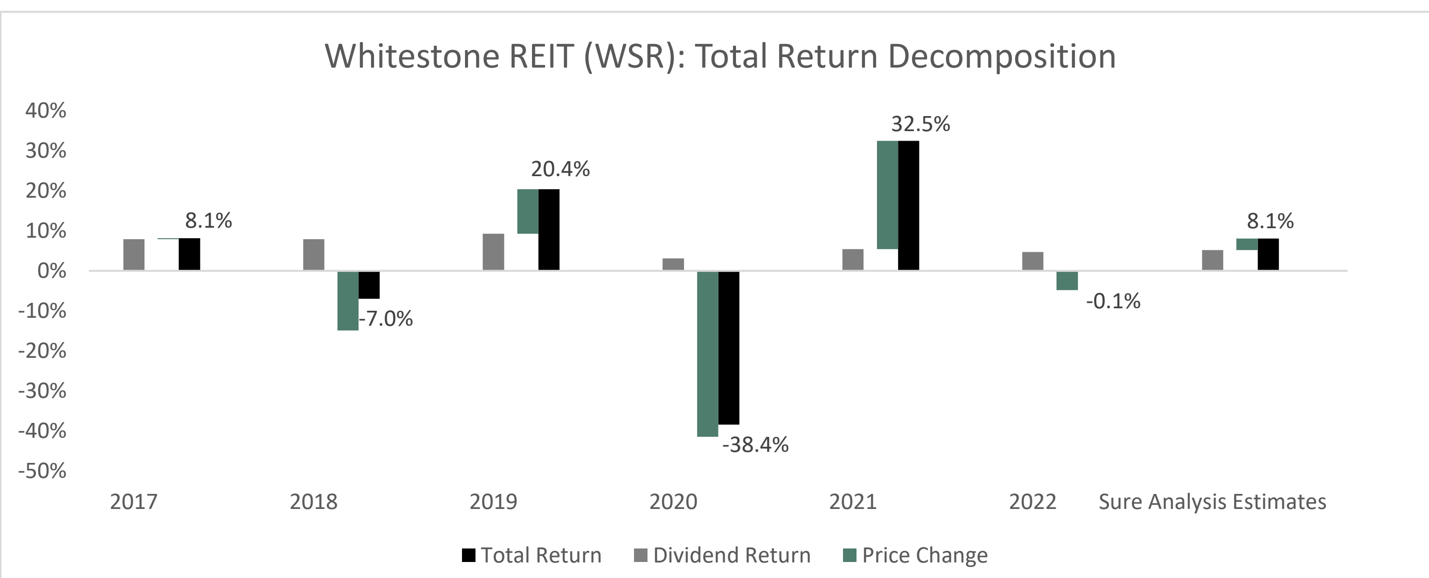
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	144%	119%	110%	123%	120%	118%	127%	51%	50%	47%	***52%***	***60%***

Whitestone had some financial troubles during the previous recession in 2008. From 2007 to 2008, its rental income dropped by $5.8 million, and it took until 2012 for the rental income to return to the 2007 highs. Whitestone cut its dividend by 63% in 2020. It looked like it was ready to steadily increase its dividend to the pre-pandemic levels starting with a cautious increase of 2.4% in February 2021 followed by another dividend hike in February 2022. Currently, the payout ratio of about 50% is sustainable. However, the REIT did not declare a dividend increase in February 2023.
At the end of Q2 2023, Whitestone had a debt-to-equity ratio of 1.62 times. At quarter end, the REIT had $2.9 million in cash and cash equivalents. Moreover, its payout ratio is much more sustainable than pre-pandemic levels because of a lower dividend.

Final Thoughts & Recommendation

Whitestone has an expected annualized total return of 8.1% over the next five years, coming from a 4.9% dividend yield, 3% growth, and 0.5% valuation expansion. Concerns surrounding this REIT include rising interest rates, what is its normal growth rate in the normalized environment post-pandemic, and it's an unfavorable environment for share issuances to fund acquisitions. So, it has less levers to pull to drive growth. We rate the stock as a "hold".

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	60	72	93	104	126	120	119	118	125	139
Gross Profit	38	47	62	70	84	82	82	79	86	96
Gross Margin	62.5%	65.3%	66.5%	67.4%	66.6%	68.8%	69.1%	67.3%	68.6%	68.9%
SG&A Exp.	11	15	20	24	24	23	22	21	23	18
D&A Exp.	13	16	20	22	27	26	27	28	29	32
Operating Profit	14	16	22	24	33	33	34	30	34	46
Operating Margin	22.8%	22.4%	23.6%	22.9%	25.9%	27.9%	28.5%	25.2%	27.5%	33.2%
Net Profit	4	8	7	8	8	21	24	6	12	35
Net Margin	6.3%	10.5%	7.2%	7.6%	6.6%	17.9%	19.9%	5.1%	9.6%	25.3%
Free Cash Flow	24	26	36	41	41	40	48	43	47	44
Income Tax	0	0	0	0	0	0	0	0	0	0

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	508	634	782	855	1070	1029	1056	1045	1102	1103
Cash & Equivalents	6	4	3	4	5	14	16	26	16	6
Accounts Receivable	10	12	15	20	21	21	23	23	22	25
Total Liabilities	287	421	535	588	712	670	703	707	703	678
Accounts Payable	13	16	24	29	36	34	39	51	46	36
Long-Term Debt	261	394	498	544	659	618	645	644	643	625
Shareholder's Equity	216	210	243	256	348	350	345	332	393	418
LTD/E Ratio	1.21	1.88	2.05	2.13	1.90	1.76	1.87	1.94	1.64	1.49

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.8%	1.3%	1.0%	1.0%	0.9%	2.0%	2.3%	0.6%	1.1%	3.2%
Return on Equity	2.0%	3.6%	3.0%	3.2%	2.8%	6.1%	6.8%	1.8%	3.3%	8.7%
ROIC	0.9%	1.4%	1.0%	1.0%	0.9%	2.1%	2.4%	0.6%	1.2%	3.4%
Shares Out.	21.9	22.8	27.0	29.2	38.5	39.8	40.6	43.3	50.0	50.0
Revenue/Share	3.31	3.18	3.64	3.68	3.47	2.95	2.88	2.74	2.71	2.79
FCF/Share	1.31	1.13	1.41	1.43	1.14	0.97	1.15	1.00	1.02	0.89

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