

6 April 2018

Folkestone Education Trust (FET) BUY Share Price: \$2.75

Finds an avenue to acquire assets

Target Price: \$2.94

Folkestone Education Trust (FET) has announced the acquisition of nine established childcare centres for a total value of \$63.16 million, which will all settle by mid-April 2018. Management have said both transactions will be immediately accretive to distributable income which we estimate to be roughly 1% per annum. The transaction is surprising given how tight market transactions have been in recent years, but ultimately works given the ability of both groups to work together going forward to build a steady development pipeline. We maintain our BUY recommendation for FET.

Investment Highlights

- Distribution yield – 5.8% in FY19.
- Long leases (WALE) – 9.9 years average.
- Triple net leases.
- High occupancy – 100%.
- Market rent reviews – ~11% of portfolio in FY18.

Transaction Highlights

- The transactions will be funded through a combination of bank debt and asset sales, which will leave FET with a gearing level of ~32%, within its gearing policy of between 30 to 40%.
- All centres operate on very high occupancy (~97%) and are located within Brisbane and are leased to Avenues Childcare.
- Lease terms are 20 years with 3.0% annual increases.
- Avenues Childcare were established in 2003 and charge mid-market fees – and therefore align with FET's recent strategy tweak of focusing more on mid-market fee operators, with locations which are still metro based and have a high land value.
- The transaction also brings new development opportunities to FET as it partners with the growth in Avenue Childcare.
- The portfolio delivers an overall lift in portfolio WALE from 9.2 year to 9.9 years and reduces the proportion of CPI linked leases from ~72% to 66%.

Earnings Revisions and Valuation

- We estimate the impact of this transaction increases earnings by ~1.0% p.a. based on an acquisition yield of 6.0-6.5% and asset disposals at ~6.5%.
- We increase our price target to \$2.94 (was \$2.84) based on our NAV valuation which uses a 6.1% average cap rate (previously 6.2%), based on recent evidence of FET independent valuations.

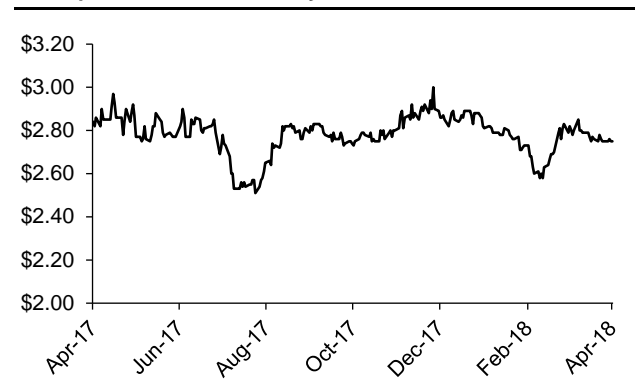
Company Data

| | |
|--------------------------------|-------------|
| Shares – ordinary (M) | 255.2 |
| Dilution (M) | 0.0 |
| Total (fully diluted) (M) | 255.2 |
| Market capitalisation (\$M) | 701.8 |
| 12 month low/high (\$) | 2.50 / 3.00 |
| Average monthly turnover (\$M) | 13.1 |
| Index | ASX 300 |
| GICS Industry | Real Estate |

Financial Summary (fully diluted/normalised)

| Year end June | 2016A | 2017A | 2018F | 2019F | 2020F |
|------------------------|-------|-------|--------|--------|--------|
| Property NOI (\$M) | 48.6 | 52.9 | 58.1 | 65.1 | 66.7 |
| EBITDA (\$M) | 44.4 | 48.2 | 52.8 | 58.6 | 60.0 |
| NPAT (adj.)(\$M) | 34.5 | 37.8 | 41.3 | 43.0 | 44.6 |
| EPS (¢ps) | 14.0 | 15.2 | 16.3 | 16.9 | 17.5 |
| EPS Growth (%) | 5.4 | 8.6 | 7.6 | 3.3 | 3.7 |
| PER (x) | 19.7 | 18.1 | 16.9 | 16.3 | 15.7 |
| AFFO (\$M) | 34.9 | 39.7 | 43.2 | 43.0 | 44.6 |
| AFFOPS (¢ps) | 14.1 | 15.9 | 17.1 | 16.9 | 17.5 |
| Enterprise Value (\$M) | 899.3 | 946.7 | 1026.0 | 1058.9 | 1055.9 |
| NTA (cps) | 2.14 | 2.51 | 2.66 | 2.68 | 2.69 |
| Price to NTA (%) | 28.3 | 9.4 | 3.2 | 2.7 | 2.3 |
| Dividends (¢ps) | 13.4 | 14.2 | 15.1 | 16.0 | 16.6 |
| Payout ratio (%) | 95.9 | 93.7 | 92.5 | 95.0 | 95.0 |
| Yield (%) | 4.9 | 5.2 | 5.5 | 5.8 | 6.0 |

FET – performance over one year



Analysis

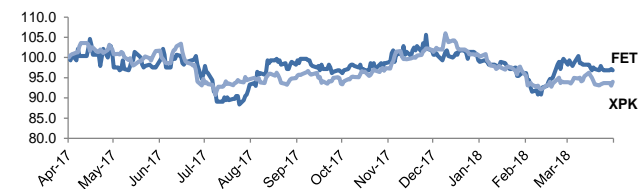
Folkestone Education Trust (FET)

Year end 30 June

MARKET DATA

| | | |
|---------------------------|-----|-------------|
| Recommendation | | BUY |
| Price | \$ | 2.75 |
| Price target (12-month) | \$ | 2.94 |
| 52 week high / low | \$ | 2.50 / 3.00 |
| Market capitalisation | \$m | 701.8 |
| Shares on issue (basic) | no. | 255.2 |
| Options / rights | no. | 0.0 |
| Other equity | no. | 0.0 |
| Shares on issue (diluted) | no. | 255.2 |

12-MONTH SHARE PRICE PERFORMANCE



PROFIT AND LOSS

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|--------------------------------|-----------------|-------------|-------------|-------------|-------------|
| Property NOI | \$m 48.6 | 52.9 | 58.1 | 65.1 | 66.7 |
| Other Income | \$m 1.7 | 1.7 | 2.2 | 2.1 | 2.1 |
| Operating Expenses | \$m (5.8) | (6.4) | (7.5) | (8.6) | (8.8) |
| EBITDA | \$m 44.4 | 48.2 | 52.8 | 58.6 | 60.0 |
| Depreciation & amortisation | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | \$m 44.4 | 48.2 | 52.8 | 58.6 | 60.0 |
| Net interest | \$m (10.0) | (10.4) | (11.6) | (15.7) | (15.5) |
| Non-operating income | \$m 72.4 | 84.6 | 34.5 | 0.0 | 0.0 |
| Pretax Profit | \$m 106.8 | 122.3 | 75.6 | 42.9 | 44.5 |
| Tax expense | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Minorities/Preference dividend | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported NPAT | \$m 106.8 | 122.3 | 75.6 | 42.9 | 44.5 |
| Significant items | \$m (72.3) | (84.5) | (34.4) | 0.1 | 0.1 |
| Operating NPAT | \$m 34.5 | 37.8 | 41.3 | 43.0 | 44.6 |

INTERIM SUMMARY

| | 2H16 | 1H17 | 2H17 | 1H18 | 2H18 |
|--------------------------------|-----------------|-------------|-------------|-------------|-------------|
| Property NOI | \$m 24.8 | 26.1 | 26.8 | 27.8 | 30.3 |
| EBITDA | \$m 22.6 | 23.7 | 24.5 | 25.5 | 27.3 |
| Depreciation & amortisation | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | \$m 22.6 | 23.7 | 24.5 | 25.5 | 27.3 |
| Net interest | \$m (5.1) | (5.1) | (5.4) | (4.6) | (7.1) |
| Non operating revenue | \$m 29.7 | 50.5 | 34.1 | 34.5 | 0.0 |
| Pretax Profit | \$m 47.3 | 69.1 | 53.2 | 55.4 | 20.3 |
| Tax expense | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Minorities/Preference dividend | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported NPAT | \$m 47.3 | 69.1 | 53.2 | 55.4 | 20.3 |
| Significant items | \$m 29.7 | 50.4 | 34.0 | 34.4 | (0.1) |
| Operating NPAT | \$m 17.6 | 18.7 | 19.1 | 20.9 | 20.3 |
| Reported EPS (diluted) | ¢ 19.1 | 27.8 | 21.3 | 22.0 | 7.9 |
| Normalised EPS | ¢ 7.1 | 7.5 | 7.6 | 8.3 | 8.0 |

BALANCE SHEET

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|-----------------------------|------------------|--------------|----------------|----------------|----------------|
| Cash | \$m 0.8 | 2.4 | 2.4 | 1.5 | 4.5 |
| Receivables | \$m 0.5 | 1.2 | 0.7 | 0.7 | 0.7 |
| Inventory | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investment Properties | \$m 719.5 | 861.2 | 979.7 | 1,015.9 | 1,015.9 |
| Investments | \$m 31.3 | 36.0 | 40.0 | 40.0 | 40.0 |
| Derivatives | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$m 1.4 | 2.4 | 3.9 | 3.9 | 3.9 |
| Total assets | \$m 753.6 | 903.3 | 1,026.7 | 1,062.0 | 1,065.0 |
| Payables | \$m 15.3 | 21.2 | 15.0 | 15.0 | 15.0 |
| Borrowings | \$m 198.3 | 247.3 | 326.6 | 358.6 | 358.6 |
| Derivatives | \$m 8.2 | 5.2 | 5.2 | 5.2 | 5.2 |
| Other | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total liabilities | \$m 221.8 | 273.6 | 346.8 | 378.8 | 378.8 |
| Net assets | \$m 531.8 | 629.7 | 679.8 | 683.2 | 686.1 |
| Equity | \$m 531.8 | 629.7 | 679.8 | 683.2 | 686.1 |
| Minorities | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Shareholder's equity | \$m 531.8 | 629.7 | 679.8 | 683.2 | 686.1 |
| Shares on issue | m 248.1 | 250.6 | 255.2 | 255.2 | 255.2 |

PER SHARE DATA

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|----------------------------------|---------------|-------------|-------------|-------------|-------------|
| Reported EPS (diluted) | ¢ 43.3 | 49.0 | 29.9 | 16.8 | 17.4 |
| Normalised EPS (diluted) | ¢ 14.0 | 15.2 | 16.3 | 16.9 | 17.5 |
|Growth | % 5.4 | 8.6 | 7.6 | 3.3 | 3.7 |
| Funds From Operations (FFO) | ¢ 14.0 | 15.2 | 16.3 | 16.9 | 17.5 |
| Adj Funds From Operations (AFFO) | ¢ 14.1 | 15.9 | 17.1 | 16.9 | 17.5 |
| AFFO yield | % 5.1 | 5.8 | 6.2 | 6.1 | 6.4 |
| Dividend | ¢ 13.4 | 14.2 | 15.1 | 16.0 | 16.6 |
| Payout | % 95.9 | 93.7 | 92.5 | 95.0 | 95.0 |
| Yield | % 4.9 | 5.2 | 5.5 | 5.8 | 6.0 |
| Tax deferred | % na | na | na | na | na |
| NTA (\$/share) | \$ 2.14 | 2.51 | 2.66 | 2.68 | 2.69 |

CASH FLOW

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|-------------------------------------|-------------------|---------------|---------------|---------------|---------------|
| EBITDA | \$m 44.4 | 48.2 | 52.8 | 58.6 | 60.0 |
| Net interest | \$m (9.6) | (10.6) | (12.7) | (15.7) | (15.5) |
| Tax paid | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$m 0.1 | 2.1 | 3.2 | 0.1 | 0.1 |
| Operating cash flow | \$m 34.9 | 39.7 | 43.2 | 43.0 | 44.6 |
| Capital expenditure | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acquisitions/divestment/other | \$m (15.9) | (58.9) | (94.8) | (36.2) | 0.0 |
| Investing cash flow | \$m (15.9) | (58.9) | (94.8) | (36.2) | 0.0 |
| Equity | \$m 0.0 | 0.0 | 7.4 | 0.0 | 0.0 |
| Increase / (decrease) in borrowings | \$m 7.3 | 49.4 | 78.9 | 32.0 | 0.0 |
| Other Financing | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends | \$m (26.4) | (28.5) | (34.7) | (39.7) | (41.6) |
| Financing cash flow | \$m (19.2) | 20.9 | 51.6 | (7.7) | (41.6) |
| Net cash flow | \$m (0.2) | 1.6 | (0.0) | (0.9) | 3.0 |
| Free cash flow | \$m 34.9 | 39.7 | 43.2 | 43.0 | 44.6 |

VALUATION DATA

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|---------------------|-----------|-------|---------|---------|---------|
| P/E (operating EPS) | x 19.7 | 18.1 | 16.9 | 16.3 | 15.7 |
| Prem/(Disc) to NTA | % 28.3 | 9.4 | 3.2 | 2.7 | 2.3 |
| Price to book | x 1.3 | 1.1 | 1.0 | 1.0 | 1.0 |
| Enterprise value | \$m 899.3 | 946.7 | 1,026.0 | 1,058.9 | 1,055.9 |
| EV/EBITDA | x 20.3 | 19.7 | 19.4 | 18.1 | 17.6 |
| EV/EBIT | x 20.3 | 19.7 | 19.4 | 18.1 | 17.6 |

GROWTH PROFILE

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|----------------|--------|------|-------|-------|-------|
| Property NOI | % 12.0 | 8.9 | 9.9 | 12.0 | 2.4 |
| EBITDA | % 13.8 | 8.6 | 9.5 | 11.1 | 2.4 |
| EBIT | % 13.8 | 8.6 | 9.5 | 11.1 | 2.4 |
| Operating NPAT | % 16.0 | 9.7 | 9.1 | 4.3 | 3.7 |
| Operating EPS | % 5.4 | 8.6 | 7.6 | 3.3 | 3.7 |
| DPS | % 4.7 | 6.0 | 6.3 | 6.1 | 3.7 |

LEVERAGE

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|--------------------------------------|-----------|-------|-------|-------|-------|
| Net debt | \$m 197.5 | 244.9 | 324.2 | 357.1 | 354.1 |
| Gearing (net debt / EBITDA) | x 4.4 | 5.1 | 6.1 | 6.1 | 5.9 |
| Leverage (net debt / equity) | % 27.1 | 28.0 | 32.3 | 34.3 | 34.0 |
| LVR (net debt / assets) | % 26.2 | 27.1 | 31.6 | 33.6 | 33.2 |
| Interest cover (EBIT / net interest) | x 4.6 | 4.5 | 4.1 | 3.7 | 3.8 |

DUPONT ANALYSIS

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|-------------------------|---------------|-------------|-------------|-------------|-------------|
| Net Profit Margin | % 71.0% | 71.6% | 71.0% | 66.1% | 66.9% |
| Asset Turnover | x 0.1x | 0.1x | 0.1x | 0.1x | 0.1x |
| Return on Assets | % 4.6% | 4.2% | 4.0% | 4.1% | 4.2% |
| Financial Leverage | x 1.4x | 1.4x | 1.5x | 1.6x | 1.6x |
| Return on Equity | % 6.5% | 6.0% | 6.1% | 6.3% | 6.5% |

KEY RATIOS

| | FY16 | FY17 | FY18e | FY19e | FY20e |
|---------------|--------|------|-------|-------|-------|
| EBITDA margin | % 91.4 | 91.1 | 90.8 | 90.1 | 90.0 |
| EBIT margin | % 91.4 | 91.1 | 90.8 | 90.1 | 90.0 |
| NPAT margin | % 71.0 | 71.6 | 71.0 | 66.1 | 66.9 |
| ROE | % 6.5 | 6.0 | 6.1 | 6.3 | 6.5 |
| ROA | % 4.6 | 4.2 | 4.0 | 4.1 | 4.2 |

Source: Petra Capital

Petra Capital
 Level 17, 14 Martin Place, Sydney NSW 2000

ABN 95 110 952 782
 ACN 110 952 782
 AFSL 317 944

| | | | |
|-------------------------|----------------------|--------------------|----------------------------------|
| Director: | George Marias | +61 (0)2 9239 9601 | gmarias@petracapital.com.au |
| Research (Industrials): | Killian Murphy | +61 (0)2 9239 9607 | kmurphy@petracapital.com.au |
| Research (Industrials): | James Lennon | +61 (0)2 9239 9618 | jlennon@petracapital.com.au |
| Research (Industrials): | Mark Tomlins | +61 (0)2 9239 9625 | mtomlins@petracapital.com.au |
| Research (Property): | Jonathan Kriska | +61 (0)2 9239 9633 | jkriska@petracapital.com.au |
| Research (Resources): | Brett McKay | +61 (0)2 9239 9605 | bmckay@petracapital.com.au |
| Research (Resources): | Matthew Schembri | +61 (0)2 9239 9630 | mschembri@petracapital.com.au |
| Research (Resources): | Craig Brown | +61 (0)2 9239 9629 | cbrown@petracapital.com.au |
| Research (Resources): | Peter Chilton | +61 (0)2 9239 9634 | pchilton@petracapital.com.au |
| Sales: | Frank Barila | +61 (0)2 9239 9603 | fbarila@petracapital.com.au |
| Sales: | Neil Watson | +61 (0)2 9239 9602 | nwatson@petracapital.com.au |
| Sales: | Vincent Pisani | +61 (0)2 9239 9617 | vpisani@petracapital.com.au |
| Sales: | Jamie Campbell | +61 (0)2 9239 9620 | jcampbell@petracapital.com.au |
| Sales: | Peter Veldhuizen | +61 (0)2 9239 9609 | pveldhuizen@petracapital.com.au |
| Sales: | Colin Redmond | +61 (0)2 9239 9613 | credmond@petracapital.com.au |
| Sales: | Vince Barila | +61 (0)2 9239 9627 | vbarila@petracapital.com.au |
| Sales: | Michael Casey | +61 (0)2 9239 9608 | mcasey@petracapital.com.au |
| Sales: | Richard Macphillamy | +61 (0)2 9239 9604 | rmacphillamy@petracapital.com.au |
| Corporate (ECM): | Conrad Anderson | +61 (0)2 9239 9610 | canderson@petracapital.com.au |
| Administration: | Krystle Garven | +61 (0)2 9239 9635 | kgarven@petracapital.com.au |
| Administration: | Samantha Tingley | +61 (0)2 9239 9636 | stingley@petracapital.com.au |
| Administration: | Silvia Fratta Pasini | +61 (0)2 9239 9621 | spasini@petracapital.com.au |
| Administration: | Larissa Falvo | +61 (0)2 9239 9611 | lfalvo@petracapital.com.au |
| Legal & Compliance: | Stephen Newton | +61 (0)2 9239 9612 | snewton@petracapital.com.au |
| Financials: | Tony Christelis | +61 (0)2 9239 9615 | tchristelis@petracapital.com.au |

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