



For What It's Worth

A Montgomery White Paper
JUNE 2014

National Storage well-placed to capitalise on rising storage demand

Long-term population growth in cities bodes well for self-storage providers.

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Barely a day passes without commentary on the ageing population. Less considered is another vital demographic and social trend – the impending urbanisation and emergence of mega-cities in Australia – and the long-term implication for investors.

Our population is forecast to swell from 23 million to 40 million by 2060, according to the Australian Bureau of Statistics. Sydney and Melbourne will each have more than 8 million residents, Perth's population will more than double to 5.5 million, and Brisbane's will rise to 4.8 million.

That means tens of millions of Australians will crowd into capital cities; most of which are already struggling with traffic congestion. Space will be at a premium as increasingly more people live in city units rather than traditional homes or "McMansions" on urban fringes.

This urbanisation of Australian cities is a powerful trend for National Storage REIT. The third-largest self-storage provider in the Australian market, it has 62 centres in six states storing goods for 23,000 residential and commercial customers, and it ranks behind market leaders Storage King and Kennards.

Demand for self-storage will surely rise in coming years as cities become more crowded, and those living in smaller accommodation need to rent extra storage space. More people renting (as opposed to buying) properties, and changing addresses more often, also favours self-storage providers.

National Storage is Australia's first listed self-storage REIT. It raised \$183 million through an initial public offering in December at 98 cents per stapled security. Those securities rallied to \$1.23 and some newspapers have been quick to label the IPO as a "runaway success".

This is premature. Although National Storage's market has favourable long-term dynamics, key questions for prospective investors are: is it a high-quality REIT, and does its intrinsic value provide a sufficient margin of safety – relative to the market price – to buy now?

National Storage is rated as a C3 for quality and performance – well outside the preferred quality range. Our valuation estimate also suggests National Storage is overvalued at the current price.

But there may well be enough in National Storage to suggest it warrants a spot on portfolio watch-lists in anticipation of improving quality and performance over the next three years. There is also potential for its intrinsic value to rise; however, it is already trading at a significant premium to asset backing.

National Storage resides within an attractive industry. The self-storage market has grown steadily in the past five years owing to more people relocating to major cities for work or study purposes, where there is a lack of substitute self-storage services. Those who wanted to store personal belongings, furniture, white goods or cars for later use, have had little choice but to turn to self-storage providers.

Rising demand for removal services and an increase in property transfers due to buoyant capital-city property markets have also helped self-storage operators. The industry had estimated revenue of \$741 million in FY14, and annual revenue growth of 1.8 per cent in the past five years, according to business forecaster IBISWorld.

More encouraging is the industry's combined estimated profit of \$143 million in FY14 on IBISWorld's numbers,





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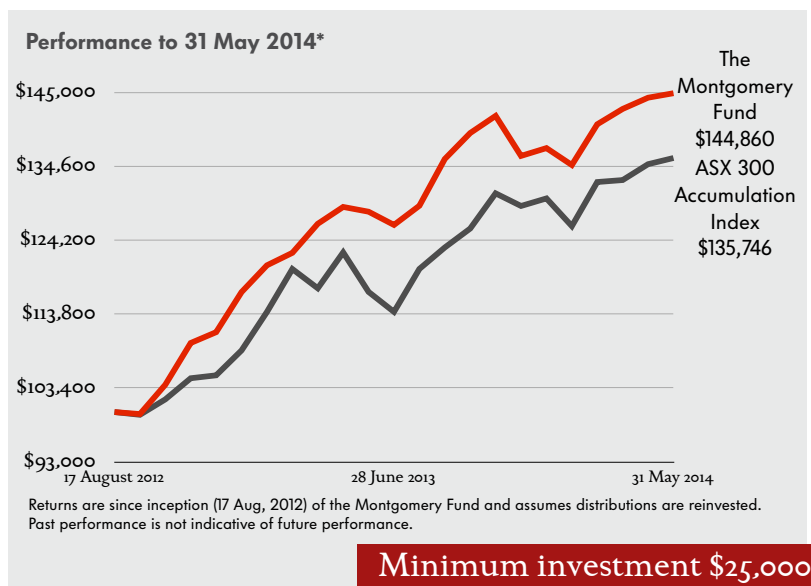
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giving solid margins and returns per square metre in self-storage assets. Profitability has grown as self-storage operators have reduced costs and added higher-priced services such as storage for wine, firearms and high-value items, as well as the selling of boxes, locks and other packaging materials.

Another notable industry characteristic is low competition. Storage King leads the market with about 110 facilities, followed by Kennards with almost 80 facilities, and National Storage with 62 facilities (at March 2014). The top three players have a combined 35 per cent market share – and there is a big gap to small rivals. For example, the fourth player, Fort Knox Queensland, has just over 20 facilities.

The market is highly fragmented, with 879 self-storage providers in FY14, according to IBISWorld. Big players, and especially the listed National Storage, which has the scope to consolidate the industry, grow by acquisition and benefit from economies of scale by reducing costs and lifting operating margins.

National Storage was formed in 2000 after the merger of Stowaway Self Storage, National Mini Storage and Premier Self Storage, and has had eight acquisitions since then. In its latest investor presentation, the company said its platform had “significant scalability with potential to take advantage of a highly fragmented (self-storage) industry”.

National Storage acquired a self-storage facility based in the industrial town of Townsville for \$17 million in April – its first standalone acquisition, and a sign that it's starting to acquire larger properties. The Townsville property will be the largest by lettable area in National Storage's portfolio. The acquisition of a Melbourne self-storage asset was announced in May.

Its balance sheet can support further acquisitions. Gearing of 16.1 per cent in the first half of FY14 is well below the targeted gearing range of 25-35 per cent.

The self-storage market is also characterised by lower competition because industry operators tend to deal with local markets. Typically, their self-storage facilities are located away from inner-city areas, for cost reasons, but close enough for their customers to access. This explains why there are so many small self-storage operators providing a service to their local market.

Moreover, self-storage providers have traditionally competed on price. But as cities become more congested and demand for inner-city storage facilities rises, pricing power should start to rise in coming years. The cost of acquiring or building inner-city facilities could constrain new supply for self-storage services.

National Storage will lease properties from third-party owners rather than buy them, meaning less upfront working capital is required. It then provides central management for self-storage facilities and is offering this service to other third-party owners.

It is targeting yields of 8-10 per cent from its self-storage assets as it improves efficiencies in its existing portfolio and adds new assets that can leverage its national centre management platform.

National Storage has an interesting business model: rather than be a traditional self-storage property owner, it is positioning itself as a service provider and leveraging its intellectual property to other providers, which in turn creates extra revenue streams that do not rely heavily on capital investment or weigh on working capital.

There is scope to make existing assets more efficient. National Storage believes it can increase the average rent per square metre and drive the current occupancy rate from 72.5 per cent to 83 per cent.

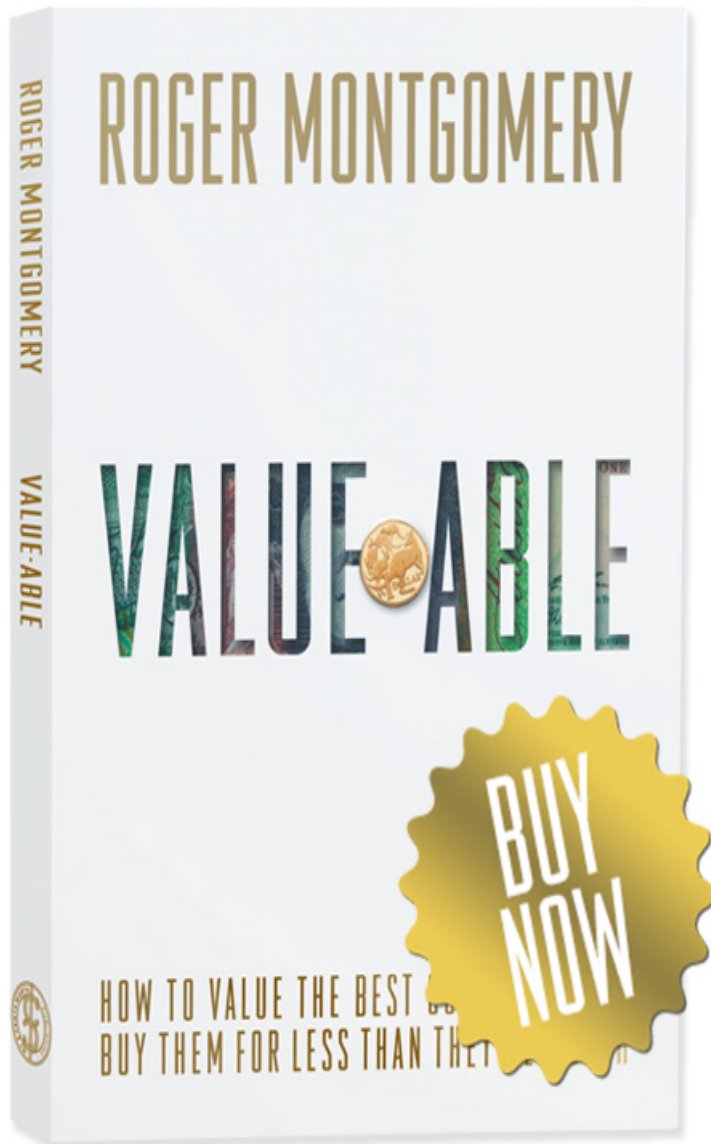
The market liked National Storage's maiden half-year result: profit after tax was \$7.89 million or 7.67 cents per stapled security, and it reaffirmed its earnings and distribution guidance of 7.8 cents per stapled security for CY14. National Storage has rallied about 14 per cent since the result.

The main question, of course, is how much of this outlook is already factored into its valuation. National Storage is a difficult REIT to value: it has had a short life as a listed company and a merged entity.

Moreover, performance comparisons with prior periods are problematic because National Storage REIT, in its current form, only came into existence in December 2013, and the stapling of separate entities in its structure includes several one-off transactions related to the IPO, and the internalisation of some costs that were previously external.

At \$1.23, National Storage has a market capitalisation of

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\$301 million. Its latest reported Net Tangible Assets (NTA) figure was 93 cents a share – in line with forecasts. At current prices, investors are paying a 32 per cent premium to NTA for National Storage, presumably because they believe it has strong growth prospects. That puts it in the upper echelon of REIT valuations.

Some premium to NTA is warranted given the self-storage industry's long-term prospects, fragmentation, and National Storage's position and business model.

But as so often happens with IPOs, a strong post-listing performance can build on itself as investors, confused by price and value, and are seduced by hype.

Still, National Storage is among the more interesting small-cap REITs to keep an eye on this year and next. Look for its net asset value to rise at a faster rate as more assets are acquired and efficiency gains realised.





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Code		Change	Outperformance
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XNAJI	ASX 200 Industrials Accumulation Index	25.57%	24.43%
XTOAI	ASX 100 Accumulation Index	37.20%	12.80%
XJOAI	ASX 200 Accumulation Index	33.75%	16.25%
XAOAI	All Ordinaries Accumulation Index	30.07%	19.92%
XK0AI	ASX 300 Accumulation Index	31.75%	18.25%
XTLAI	ASX 20 Accumulation Index	42.55%	7.44%
XMDAI	ASX Midcap 50 Accumulation Index	17.97%	32.02%
XSOAI	ASX Small Ordinaries Accumulation Index	-16.21%	66.21%

Benchmarked returns are since inception (23 Dec, 2010) of the Montgomery [Private] Fund and assumes distributions are reinvested. Past performance is not indicative of future performance.

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