

Caledonian Trust

I need help with this one. It has a market capitalisation of £7.7m and investment properties (long term lets) of £8.1m. In addition it has a portfolio of properties (something like two dozen sites) described as for 'trading'. These are valued at the lower of cost or net realisable value, which is very significant as the open market value may be much more. The balance sheet values of the trading properties are £11.6m. Total liabilities are £3.2m. There are a few small items, leaving NAV at £16.9m and net current asset value at £8.8m. It seems to pass the first test of Benjamin Graham's net current asset value investing.

This reported balance sheet looks nice enough, but also consider the achievement of the management over the past five years. They might not have reported profit but they have created value by obtaining planning permissions on the properties. Here are some examples:

- St Margaret's House, Edinburgh. Currently 92,000 ft² office building occupied by a charity on low rent and sublet to 250 artists. Parking spaces (120) let separately. In Sept 2011 permission was granted for 231,000ft² of residential and/or student + hotel + offices + 225 parking spaces.
- Brunston Home Farm, East Edinburgh. 3 Georgian Cottages for sale + consent to convert Georgian steading and reconstruct cottage + 10 houses + detached farmhouse + 2 acres of land
- Belford Road, Edinburgh. Cul-de-sac 500m from Charlotte Sq and the West end of Princes St. Consent for 22,500 ft² office + 14 car spaces or 20 flats + cars
- Wallyford, Muselburgh. Building 5 detached + 4 terrace
- Tamperion, Comrie. Smallholding. Consent for 12 detached houses
- Chance Inn. Consent for 10 houses + upgrade of house
- Strathray. 2 large detached + mansion
- Fife. Cottage + 8 houses
- Gartshare, 7 miles from central Glasgow. 120 acres of farmland, 80 acres of policies and tree-lined parks. Georgian pigeonier + Victorian cottages and other buildings
- Ardpatrick. 'prospects for residential property extremely good'. Consent to change the use of 'keepers' and bothy. Being marketed. Plus 'secluded sites – applying for planning'
- Shore Road. Consent for house + 2 others
- Frithfield. Applying for 12 houses
- Many other sites without planning permission. YET.

As a property developer myself, I'm aware that it often makes sense to delay the realisation of value. This can create reported losses in the short run as you have to cover expenses with little cash coming in. Delay might be sensible because the depressed housing and/or commercial property market means that you will not cover your infrastructure costs, build costs and local authority demand costs. It might make sense because you want to modify the development plans to gain even greater value. Delay could also be wise if you anticipate that the property market will be much healthier two-three years down the line.

Quotes related to this idea of delay:

“Heavy infrastructure investment would result in an illiquid investment with very limited or nil profit margin. Accordingly, we continue to delay any major

investment but to start, or prepare to start, on small low investment, low infrastructural projects.” (Chairman, 2012 annual report)

“Unfortunately other potential new sites and many of the conversion sites are commercially difficult to realise. Current market conditions are unhelpful, but major continuing constraints are the high cost of conversion and the overall cost of upgrading the inadequate infrastructure, partially due to the required enhancement of the public services. Considerable effort has been expended on minimising the costs of reinstatement and development by operational efficiencies, but the current burdens and restrictions will curtail earlier plans, unless some relaxations become available or other development opportunities emerge.” (Chairman, 2012 annual report)

Thus, for many of the sites it is not economically viable to build the properties which have planning permission due to high costs and an illiquid property market. This means that a valuation of the company hinges on the potential of the sites in a normal property market. There is good reason for hope:

“Our development portfolio contains a very high proportion of sites with excellent planning consents, many of these gained in the last few years. Our several strategic land sites have been extensively promoted for inclusion in Local Plans and we have secured bridgeheads there. The investment in these long planning processes has been considerable and will be further reduced next year.” (Chairman, 2012 annual report)

The only debt is £2.7m loan stock granted by Chairman’s other company. Interest is only 3% over base. Chairman has continued to roll over the debt for many years.

Note the tax losses that have accumulated over the years.

Quality of management

Overall: Decades of experience in the property game plus high quality degrees plus a lot of skin in the game plus no sign (so far as I can tell) of poor sense of decency with respect to minority shareholders. The Chairman’s letters with the annual report show both awareness and analytical understanding of the macro and micro economic environment and a high degree of openness about the company’s strategy and individual projects.

Douglas Lowe, Chairman and Chief Executive, Date of Birth 24/03/1937

Mr Lowe is a graduate of Clare College Cambridge University (MA Hons in Natural Science and Diploma in Agriculture) and Harvard Graduate School of Business Administration (MBA and Certificate in Advanced Agricultural Economics). Until 1977 he was Chief Executive of his family business, David Lowe and Sons of Musselburgh, property owners, farmers and market growers established in 1860, which farmed intensively 2,000 acres and employed over 200 people.

In 1978 and 1979 Mr Lowe was Deputy Managing Director of Bruntons (Musselburgh) Limited, a listed company which manufactured mainly wire and wire rope and employed approximately 1,000 people. He was a significant shareholder and, from 1986 until shortly after joining the Company, Executive Deputy Chairman of Randsworth Trust PLC, a property company with a dealing facility on the Unlisted Securities Market. The market capitalisation of Randsworth Trust PLC increased from £886,000 to over £250 million between April 1986 and sale of the company in 1989.

Mr Lowe purchased shares in the Caledonian Trust PLC in August 1987, at which time he became Chief Executive. Owns 78.47% of shares of the company.

Michael J Baynham, Executive Director, Date of Birth 09/10/1956

Mr Baynham graduated in law (LLB Hons) from Aberdeen University in 1978. Prior to joining the Company in 1989, he worked as a solicitor in a private practice specialising in commercial property and corporate law. He was a founding partner of Orr MacQueen WS in 1981 and from 1987 to 1989 was an associate with Dundas & Wilson CS.

Roderick J Pearson, FRICS, Non-Executive Director, Date of Birth 27/10/1954

Mr Pearson is a graduate of Queens' College Cambridge (MA Modern Languages and Land Economy) and is a Fellow of the Royal Institution of Chartered Surveyors. He has held senior positions in Ryden and Colliers International, practising in Edinburgh, Aberdeen and Glasgow, and now runs his own consultancy, RJ Pearson Property Consultants.

The directors have complete control with 86% of the shares in their hands. Less than 1m shares are in free float (out of 11.9m), so these are very illiquid.

Eight employees. Modest director remuneration: Total employees (with pension payments) cost under £0.5m. I D Lowe £142,000 and MJ Baynham £152,000

So the questions are:

WHAT AM I MISSING? WHAT IS THE CATCH?

Possible answers, if I was to play devil's advocate and assume the worst:

- As a minority shareholder you'll never get a dividend, or you'll get a paltry figure
- The planning permissions are mostly worthless because the revenue from the completed schemes will not cover the costs, even over a five year horizon. This would call into question the capabilities of the directors and so would go against the evidence on knowledge and experience
- The directors are simply not interested in generating wealth for minority shareholders. Any wealth produced will be siphoned off. To answer this one we need to know the characters of the main people. Can anyone help?
- The economy and therefore the property market remains in the doldrums for the next 5-10 years. Caledonian keeps spending but the value declines.