Raven Property Group

Making headway

28 August, 2018

Today's interims confirmed the progress of strategic initiatives designed to enhance revenue and earnings quality. Portfolio occupancy was 87% at end June (FY17: 81%), and the outlook is backed by improving local property markets, growing tenant demand and tighter investment yields.

Frustratingly, however, the impact of a c 9% fall in RUB/USD meant that headline USD results don't reflect underlying progress. The main culprit was a negative unrealised adjustment to the USD portfolio valuation. Despite an increase in its Rouble value, translation into USD generated a $30.8m deficit, net of tax (H117: $7.0m increase).

That's the motivation for a strategy focused on limiting potential for FX volatility to impact underlying cashflows. Raven is progressively reducing the USD weighting of its lease book and debt portfolio. This process has included significant upfront investment in staffing and fixed costs, now largely complete. That added operational gearing; portfolio growth should leverage a scalable model, so acquisitions and development build profitability without marked increases in overheads.

Interims: underlying progress obscured by forex shifts

H1'18 net operating income was 13% ahead at $79.3m, on higher occupancy and contributions from recently acquired high-yield assets. Net earnings, excluding FX losses were 12.3% up y-o-y at $11.9m. The bottom line absorbed higher overheads associated with the new strategy, finance charges were up in line with convertible prefs. issued last year. The US$41.1m IFRS loss (H117 profit: $9.2m) was principally FX related.

Valuation: scalable model, improving market backdrop

Political risk remains an issue. Recent Rouble weakness followed new US sanctions and contagion from the Turkish Lira crash. Raven's strategy aims to address concerns over operational sensitivity to external factors and capitalise on c $200m of available liquidity, build portfolio scale and reduce underlying exposure to RUB/USD shifts. Portfolio performance is responding to intensive management and better local property markets.

Our forecasts incorporate one acquisition scheduled to complete in September, no other portfolio growth and assume no RUB/USD recovery. At 23% below FY'18e NAV the shares discount potential volatility, underpinned by a substantial 9.5% prospective yield.

Summary forecasts

Year end 31 Dec	2015A	2016A	2017A	2018E	2019E
Net Operating Income, $m	174	152	167	160	157
Adj. Pre-tax, $m	59	48	52	29	24
Adj. diluted EPS, cents	7.9	6.8	7.4	3.4	3.1
Distribution/ord. share (p)*	2.0	2.5	4.0	4.0	4.0
Yield* %	4.8	6.0	9.5	9.5	9.5
Net asset value/ share (p)	56	55	62	55	59

*Source: Group report & accounts and ED estimates, *Distribution paid via tender offer share buy-back*

Company Data

EPIC	**RAV**
Ordinary 1p shares	41.9p
52 week Hi/Lo	52.6-40.5p
Market cap	£277m
Fully diluted market cap	£563m

12% 1p Cumulative Pref	**RAVP**
Share price	145.0p
52 week Hi/Lo	149-143p
Yield %	8.3

6.5% Conv. Red. Pref	**RAVC**
Share price	118.5p
Equivalent ordinary price	55p
52 week Hi/Lo	122-117p
Yield %	5.5

Exchange rates used

GBP/USD		1.29
USD/RUB	Balance Sheet	62.75
	Income Statement	59.35
	28 Aug 2018	67.60

Raven Property Group Ltd (Raven) is a Guernsey registered property investor. Its invests and develops high quality Class A warehouse complexes in major Russian cities let to domestic and international tenants.

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Interims - underlying progress held back by forex shift

The headline $37.1m H118 IFRS pre-tax loss (H117: $26.0m profit) mainly reflects adverse RUB/USD shifts during the period. A 7% y-o-y increase in Rouble portfolio values translated into a US$34.4m deficit, equivalent to a 2.2% unrealised negative adjustment to the value of the group's US$1.57bn portfolio. The other material charge was a $5m amortisation of the cumulative preference share redemption premium (H117: $2.8m).

Underlying measures reveal reassuring progress

A better illustration of underlying investment performance was provided by portfolio occupancy, which grew by six percentage points from 81% to 87% in the first six months and 13% increase in net rent and related income to $75.3m, despite the weaker Rouble.

Summary Interim Results

6m to 30 June, $m	**H1'17**	**H1'18**
Net rent and related income	**69.9**	**79.3**
Admin expenses	(13.2)	(19.2)
JV share	0.3	0.2
Share based payments/other LT incentives	(2.2)	(2.5)
Forex profit/(loss)	4.9	(8.7)
Underlying operating profit	**59.6**	**49.1**
Revaluation surplus/(deficit)	11.6	(34.4)
Operating profit	**71.3**	**14.7**
Net finance charge	(45.3)	(51.8)
Pre-tax profit	**26.0**	**(37.1)**
Underlying EPS (c)	**2.33**	**0.49**
Basic EPS (c)	**1.38**	**(6.30)**
Distribution per share (p)	1.00	1.25

Source: Company

Our forecasts are adjusted for recent RUB/USD weakness i.e. RUB 67.5 currently vs 62.7 at end June 2018. Forex volatility will continue to have implications for reported results and provided the motivation for Raven's concerted efforts to reposition its balance sheet, property holdings and debt facilities, and move away from a US dollar based financial model, purchase/develop new assets, push up portfolio occupancy and shift existing tenants from USD onto RUB leases.

While this will remain a work in progress, for at least the forecast period, Rouble income is already growing in real terms and as a proportion of the leased portfolio. At the end of June 2018 54% of the group's warehouse portfolio (FY17: 47%) was secured by RUB leases and 46% of NOI (32% as at end FY17).

Balance sheet – Rouble financing and portfolio growth

Raven also plans to progressively increase the RUB weighting of its debt portfolio, to reduce potential for currency mismatches. That weighting was 5.7% at end June 2018 – it drew down its first Rouble debt facility in H1 – and the balance USD (77.4%) and Euro (16.9%). Six of seventeen projects used as security for group debt are currently financed in Euros or Roubles.

Total secured and unsecured debt was $824.3m at end June 2018 (FY17: $847.2m or $784.9m adjusted). Loan-to-value on secured debt at end June 2018 was 52% (FY17: 53%). The weighted average cost of debt at the half-year was 7.4% (FY17: 7.6%), with a 4.4 year weighted average term to maturity (FY17: 4.5 years). Restructuring in 2016/2017 created a buffer - against forex volatility - for covenant headroom on secured debt.

The increase in secured debt at end H118 reflects the final €11m tranche re 2017 acquisitions in St Petersburg and refinance of the Sever acquisition, completed in November 2017, its first Euro/Rouble mix facility. Raven drew €9.7m and RUB2.96bn on 8 June 2018 under a five-year facility. It also refinanced its only unsecured loan, a $15m facility, reducing the margin from 7.9% to 2.5%.

Cash is on hand to finance growth: US$198.1m at end June 2018 (FY17: $266.7m). Use of cash in H118 was more modest than that implies. End FY17 debt included a project refinancing facility which straddled the year end and added $62.3m to cash balances and bank debt. That debt was repaid on 9 January 2018.

The latest acquisition was the recently signed RUB2.45bn ($36.5m) addition of a 58,851sqm Moscow warehouse at a 11.3% yield. Further purchases are expected to be announced in Q4.

Summary Balance Sheet ($m)

As at end	Dec 2017	June 2018
Investment property	1,568	1,532
Investment property under construction	38	37
Other non-current assets	63	83
Current Assets		
Cash	267	198
Trade/other debtors	80	59
Current liabilities		
Trade/other payabes	(107)	(94)
Debt – current	(107)	(43)
Debt – non-current	(741)	(781)
Preference shares	(146)	(143)
Convertible preference shares	(269)	(267)
Other non-current liabilities	(116)	(103)
Net assets	**530**	**478**
Adj. fully diluted NAV/share (c)	77	71
IFRS fully diluted NAV/share (c)	81	76

Source: Company

Valuation: multiple inputs, but underlying progress

Efforts to let vacant space and secure high-yield acquisitions have borne fruit and remain the core strategy. Recent investment has improved operational gearing and scalability and should be reflected in profit margins as new lettings and acquisitions boost rental revenues. The underlying performance will become less sensitive to external newsflow as Raven progressively shifts its leases, debt and other costs from USD into Rouble denomination, reducing exposure to the impact of weaker RUB/USD on its local tenant base.

The Russian economy is growing slowly, interest rates are declining (Russian Central Bank rate at 7.25% vs 9.0% end H1'17). Recent elections provide better medium-term political stability and the World Cup presented a positive side of Russia's economy.

Net Asset Value: 23% discount to forecast FY2018 NAV/share

The shares currently stand at a c 23% discount to FY18e NAV, which is adjusted for further RUB/USD weakness since the end of June. That discount reflects the perceived risk of further externally-driven hits to reported financials. Efforts to underpin underlying performance should over the next 12-18 months deliver incremental improvements in (RUB) portfolio returns from a better positioned, more resilient revenue base.

Diluted NAV/share was 76c at end H1'18 (31 Dec 2017: 80c) which, post recent GBP/USD weakness, translates to 60p/share (FY17: 59p/share). The IFRS first half loss and final FY17 distribution reduced NAV from $529.8m (FY17) to $478.8m. Prospective FY18e NAV of 71c (55p) is also indirectly supported by a distribution policy which (a) ensures that distributions are fully covered by cash earnings and (b) is paid by way of a tender offer. Although our current forecast does not provide full cover, we have taken a conservative view of contributions from recent - and assume no further - acquisitions and recent lettings.

Sentiment vulnerable to external factors, offset by investment strategy

There is clearly potential for events outside its control, particularly politically driven FX shifts to dent headline returns. The shares fell in August as they tracked a recent c 6.5% fall in RUB/USD. Our forecasts assume current (end August) FX rates, but presentation of results in US dollars means that components such as accumulated Rouble cash balances remain vulnerable to currency volatility. In H1'18 forex movements generated an $8.7m forex loss (H117: $4.9m profit), an unrealised US$13.6m profit swing.

Like-for-like, local currency valuations of the portfolio should respond to improved rental revenue quality as the strategic repositioning rolls out and local market dynamics, particularly the small declines in investment yields noted by real estate advisers over the last 12 months.

Prospective 9.5% yield provides further support

Underlying cash generation supports a 25% y-o-y increased in the interim distribution to an effective 1.25p/share, delivered as in previous periods via a tender offer buy back of 1 in 44 shares at 55p (H1'17: 1p / 1 in 52 shares at 52p). We have held the full year at 4.0p. Cash flow from operating activities at $55.8m (H117: $48.9m) tracked NOI and cash generation ($7.5m) post net interest and preference share coupon was in line with the prior year.

The group seeks a broader investor audience and intends to list its ordinary shares on both the Moscow and Johannesburg Stock Exchanges. This process is already underway, and Raven will make a further announcement shortly when the process is finalised.

Portfolio update

Total portfolio occupancy was 87% at the mid-year, from 81% six months earlier, and the trend continued into the current half. Raven's warehouse portfolio is 86% occupied and its much smaller office portfolio (0.05m sqm vs 1.77m sqm of warehouse space) fully let. The weighted average warehouse lease length is 3.5 years and annual indexation on Rouble leases provides contracted growth.

The warehouse portfolio reported an increase in Rouble denominated leases from 47% to 54% over the first six months; US Dollar leases fell marginally to 29% (FY17: 31%). Rouble denominated leases had a 3.6 year weighted average term to maturity (31 Dec 2017: 3.6 years). The figure for US Dollar leases was 2.6 years (31 Dec 2017: 3.0 years).

Raven secured 0.153m sqm of new warehouse lettings in the first half, and another 0.116m sqm of existing leases were renegotiated and extended. Some 54,000sqm was vacated by tenants. Another 38,000sqm of vacant space has been let since the end of June, and 23,000sqm of maturing leases renegotiated and extended.

We have incorporated 132,000sqm of leases maturities in H218 into our figures, and 62,000sqm potential lease breaks. Management expects tenants to vacate 39,000sqm and breaks related to 15,000sqm to be exercised before the year end.

Local property markets: improving trends support growth strategy

Raven's confidence in its core property markets is reflected in its plans to speculatively build around 70,000sqm at its Nova Riga site, which at current construction costs and rents should generate a c 12% return on the marginal cost of investment from 2020.

Moscow Warehouse Market Indicators in H1 2018

	2016	2017	H1 2018	2018F
Supply/Demand				
Total modern warehouse stock (sqm m)	16.4	16.9	17.1	18.2
Completions (sqm m)	1.06	0.53	0.22	1.31
Availability (sqm)	1.56	1.39	1.04	1.24
Vacancy rate - existing projects	9.5%	8.3%	6.1%	6.8%
Take up (sqm)	1.43	1.18	0.66	1.38
Commercial terms				
Prime asking rents (RUB/sqm/year)	4,000	4,000	4,000	4,000
Average base asking rent (RUB/sqm/year)	3,600	3,600	3,600	3,650
Prime yields (%)	11-12.5	11-12.5	10.75-12.25	10.75-12.25

Source: JLL

The latest market research confirms management's argument that local property market dynamics back a more expansive growth strategy. That is entirely focused on reducing operational sensitivity and shifting investor focus back towards the core business's competitive positioning as a market leading provider of Russian warehousing and 3rd party logistics.

Raven has resources available to fund growth, and potential to capitalise upon the modernisation of Russia's economy, supply chain and infrastructure. The strategy is to build the scale and resilience of portfolio returns, cash flow and finances.

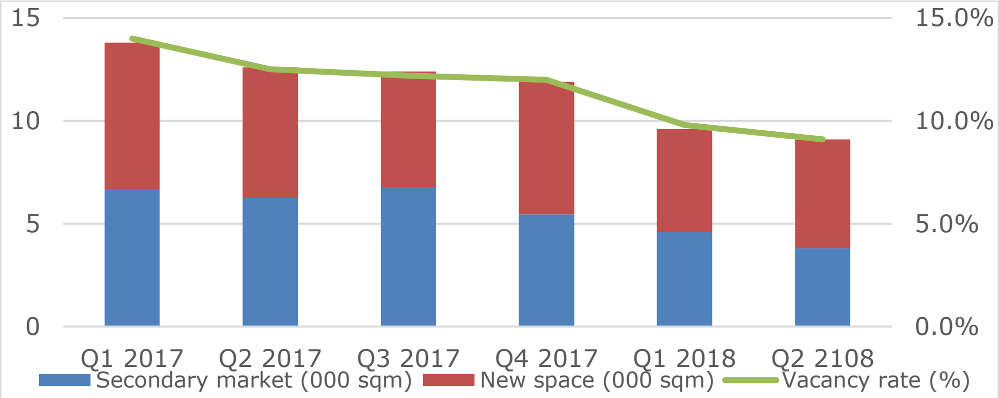
The business model combines high yielding (c 12% on cost) warehouse assets, financed by debt at a c 7% all-in cost, subject to 55% aggregate portfolio LTV. It may retain a c $120m cash buffer until it transitions its lease book and refinances its debt on a similar basis.

It plans to acquire further high-quality income producing assets, primarily Grade A warehouses and logistics, but consider other asset classes if property and financial metrics are attractive. It recently signed contracts to acquire a RUB2.45bn ($36.5m) asset at an average 11.3% initial investment yield. That will contribute RUB272m pa ($4.0m) to NOI when fully let. Other acquisitions are under consideration for the remainder of this year. Two acquisitions completed last year added $10m to FY17 revenues, but $24m pa to the rent roll.

Occupational demand data, underlying (RUB) rental rates and prime investment yields reflect a more active market, and support the case for investment in warehouse acquisition and development.

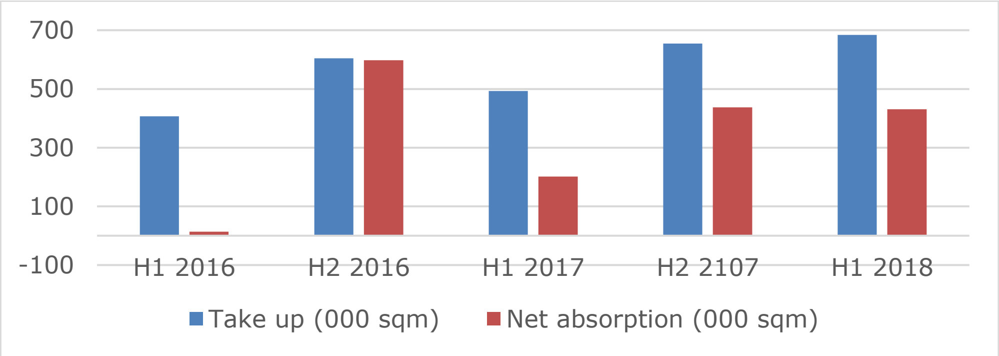
Other third-party market research (CBRE) confirms that Moscow's industrial property market has exhibited the kind of trends which provide the group with more certainty regarding its investment decisions, and underpin our projections, which assume further underlying performance at the operational, portfolio level.

Moscow Industrial Property Market – Take Up and Vacancy Rate



Source: CBRE Q2 2018

Moscow Industrial Property Market – Take Up and Net Absorption



Source: CBRE Q2 2018

FINANCIALS

Income statement					
Year to end Dec, $m	**2015**	**2016**	**2017**	**2018e**	**2019e**
Group					
Gross revenue	220	195	228	214	208
Opex/cost of sales	(46)	(44)	(61)	(54)	(51)
Net operating income	174	152	167	160	157
Running general and admin expenses	(30)	(24)	(25)	(31)	(29)
Share based pyts & LT incentives	0	(9)	(5)	(4)	(3)
Forex profit / (loss)	1	18	9	(9)	0
Depreciation	(2)	(1)	(1)	(1)	(1)
Goodwill impairment	0	0	(2)	0	0
	140	**135**	**143**	**116**	**125**
Share of profit of JV	3	2	2	2	2
Underlying profit before interest	**142**	**137**	**145**	**118**	**127**
Unrealised loss on reval. of Inv Prop under construction	(5)	(3)	(4)	1	0
Unrealised profit on revaluation of inv. Property	(251)	(40)	42	(35)	0
Profit before interest	**(114)**	**94**	**183**	**84**	**127**
Finance income	3	3	8	10	5
Finance expense	(67)	(69)	(65)	(67)	(65)
Preference dividend cost	(19)	(24)	(36)	(42)	(42)
Profit before tax	**(197)**	**5**	**91**	**(15)**	**24**
Adj. profit before tax	**59**	**48**	**52**	**29**	**24**
Tax	(10)	(15)	(33)	(7)	(6)
Net profit / (loss)	(208)	(10)	58	(22)	18
Adj. net profit	49	33	20	22	18
Earnings per share					
Underlying - fully diluted cents	7.9	6.8	7.4	3.4	3.1
Underlying - fully diluted (GBP p)	6.2	5.3	5.7	2.6	2.4
Ord distributions per share p	**2.0**	**2.0**	**4.0**	**4.0**	**4.0**

Source: Company historic data, ED estimates

Group balance sheet

Year to end Dec, $m	2015	2016	2017	2018e	2019e
Investment property	1,334	1,301	1,568	1,520	1,490
Investment property under construction	39	41	38	38	50
Other non-current assets	58	51	62	67	66
	1,431	**1,393**	**1,669**	**1,625**	**1,606**
Current assets					
Inventory	1	1	0	0	0
Trade and other debtors	50	53	79	60	60
Cash etc	202	199	267	175	180
	254	**252**	**346**	**235**	**240**
Total assets	**1,685**	**1,645**	**2,015**	**1,861**	**1,846**
Current liabilities					
Debt	(105)	(41)	(107)	(43)	(43)
Other current liabilities	(55)	(66)	(107)	(93)	(93)
	(160)	**(107)**	**(214)**	**(136)**	**(136)**
Non-current liabilities					
Debt	(814)	(699)	(740)	(781)	(781)
Other non-current liabilities	(89)	(87)	(116)	(94)	(94)
	(903)	**(786)**	**(856)**	**(875)**	**(875)**
Total liabilities	**(1,063)**	**(893)**	**(1,070)**	**(1,011)**	**(1,011)**
Net assets	**622**	**752**	**945**	849	**835**
Conv red pref		(120)	(269)	(267)	(267)
Preference capital	(157)	(132)	(146)	(144)	(144)
Ordinary shareholders' funds	**465**	**500**	**530**	438	**424**
Goodwill	(7)	(6)	(5)	(5)	(5)
Unrealised forex loss on Pref	5	(20)	(8)	(10)	(10)
Excess liabilities on non-recourse secured debt					
Fair value interest derivatives	(2)	(5)	(8)	(4)	(4)
Fair value embedded derivatives	3	1	0	0	0
Fair value forex derivatives	(3)	(0)	0	0	0
Undiluted NAV	461	469	509	420	406
Red conv pref		120	269	283	297
Warrants	9	8	4	4	4
Employee schemes	2	3	2	4	4
Diluted NAV	476	631	805	729	729
Undiluted NAV per share US cents	72.2c	75.6c	80.8c	71.3c	73.3c
Diluted NAV per share US cents	**70.3c**	**71.0c**	**79.6c**	**70.8c**	**75.6c**
Undiluted NAV per share pence	52.2p	54.6p	58.4p	55.2p	56.8p
Diluted NAV per share pence	**50.8p**	**51.3p**	**57.5p**	**54.9p**	**58.6p**

Source: Company historic data, ED estimates

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