Raven Property Group

Full occupancy and strong portfolio outlook

31 August 2021

The interims confirm momentum building behind portfolio values as lower vacancy rates drive growth in RUB rents. Period-end portfolio occupancy at 93% (FY20: 94%) has since increased to 96%, a reflection of a tight underlying market, limited supply, and strong tenant demand.

Underlying earnings were £17.3m (H1 20: £10.4m loss), IFRS profit £41.6m, including unrealised revaluations (H1 20: £31.7m loss). A £29.5m mid-year revaluation surplus (H1 20: £12.5m loss) was a component of 10p growth in diluted NAV/share to 50p since end FY20. RAV has effectively completed a series of initiatives which have stabilised its underlying finances in its functional currency and simplified its equity structure. In H1 21 it repurchased a substantial share overhang at 21.6p (ordinary shares) and 90.8p (prefs).

Stable portfolio outlook, domestic inflation is key sensitivity

In previous updates we've generally reflected on **three factors** which affected the valuation: (a) the complexity of RAV's capital and financial structure, (b) portfolio performance and domestic property market, and (c) a potentially volatile political and economic environment. The main issues related to (a) have been addressed. With regards to (b), an underlying shortage of warehousing and logistics space has shifted dynamics in favour of property owners and plus a minimal development pipeline, encouraged large domestic retailers and e-commerce players to lock in available space for longer terms. Seven to ten years is now typical, often with no breaks, vs a five-year lease with breaks which was the norm three to four years ago. RAV confirmed progressively higher weighting towards longer-term lets and higher quality covenants.

That leaves (c) currently led by rising inflation and efforts by Russia's central bank (CBR) to tackle it. This is the main source of sensitivity in the short to medium term. Although the lack of prolonged lockdowns has limited the pandemic's direct impact on portfolio performance, Russia's decision to close its borders triggered material labour shortages and construction cost inflation, which discourages new development. In response, the CBR has increased its key interest rate from 4.25% (end FY20) to 6.5% which pushes up RUB debt servicing costs. Conversely RUB rents are indexed (typically at the higher of 5% pa or Russian CPI) and although higher interest rates may dent asset values, they could lift RUB/GBP which would boost GBP portfolio values and NAV/share.

An attractive total return outlook is underpinned by the prospect of further underlying NAV growth from a near ideally placed portfolio. Despite that the shares are 46% below end June NAV/share, supported by a 7.4% prospective yield. That discount should narrow if the second half sees some stabilisation of the political backdrop and firmer RUB/GBP. As an alternative, the Cumulative Preference Shares provide exposure to the core property case and an assured 10.7% yield.

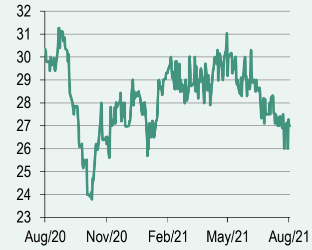
Summary financials				
Year end 31 Dec	2018A	2019A	2020A[1]	2021E
Net Operating Income, £m	118.3	126.5	113.1	105.9
Adj. Pre-tax, £m	25.8	26.2	26.9	24.4
Adj. diluted EPS (p)	4.0	4.7	3.5	2.0
Distribution/ord. share (p)*	3.0	3.5	1.25	2.0
Yield*, %	11.1	13.0	4.6	7.4
Net asset value (p)	48	72	43	52

*Source: Group report & accounts and ED estimates, *Distribution paid via tender offer share buy-back. Adj. EPS is underlying, net of non-cash revaluations and forex. [1] Proforma figures (unaudited)*

Company Data

EPIC (Ords)	**RAV**
Price (last close)	27p
52 weeks Hi/Lo	32p / 23p
Market cap	£153m
12% 1p Cum. Pref	**RAVP**
Price (last close)	112p
52 weeks Hi/Lo	127p / 91p
Market cap	£245m
Yield	10.7%

Share Price Ords, p



Source: ADVFN

Description

Raven Property Group Ltd is a Guernsey registered property company specialising in investment and development of high-quality Grade A warehouse complexes in major Russian cities. It leases to both Russian and international tenants.

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Interims: strong portfolio driving income

The H1 21 results provide further confirmation of a robust underlying (local currency) operational outlook, underpinned by an inherently resilient and stable asset base. Property values rose on the back of higher rents and continuing demand for a diminishing pool of available vacant space. That momentum is arguably building, with vacant space at a premium and a limited pipeline as development is discouraged by the risks associated with escalating construction costs.

Financial Summary

Income Statement for the six months ended:	**30 Jun 21**	**30 Jun 20**
Net rental and related income (£m)	51.9	59.6
Underlying earnings / (loss) (£m)	17.3	(10.4)
Revaluation surplus / (deficit) (£m)	29.5	(12.5)
IFRS profit / (loss) (£m)	41.2	(31.7)
Balance Sheet at:	**30 Jun 21**	**31 Dec 20**
Investment Property Market Value (£m)	1,161	1,129
Diluted NAV per share	50p	40p

Source: Raven interim results

Sterling results are less representative of like-for-like performance as average RUB/GBP of 103.1 during the period vs the 87.3 comparable dampened the sterling equivalent. The first half was positive on an operational, local currency basis. Underlying RUB net rent was ahead of the first half last year at RUB5.4bn (H120: RUB5.2bn). Tenants have met all rental obligations in the six months and there are no material rental deferrals remaining from the outset of the pandemic in 2020.

Underlying GBP earnings were £17.3m (H120: £10.4m loss). Basic EPS was 3.08p (H1 20: 2.16p loss), affected by unrealised forex and property revaluations; and Basic IFRS EPS 7.32p (H1 20: 6.59p loss).

A more stable RUB on the back of higher interest rates and relatively strong oil prices generated an £8.9m unrealised forex profit on RAV's Euro debt balances (H120: £23.8m loss). IFRS profit revealed a similar swing, a £41.2m profit compared with a £31.7m loss for the first half of 2020. The components were (all unrealised) forex gains, a £29.5m investment portfolio revaluation (H120: £12.5m unrealised loss); and mark to market adjustments to interest derivatives and other related adjustments.

Reported net finance costs fell from £40.4m in H120 to £33.2m in H121. However, RAV's weighted average interest cost was 6.37% during the period, a step up from 5.48% in FY20, as Russia moved from a low inflationary environment with a 4.25% key central bank intervention rate, into one where rising inflation prompted the CBR to push its interest rate up to 6.5% currently. That will have a full impact on H2 unless there is some easing of the policy. It did however prompt a positive adjustment to the mark to market value of interest rate derivatives i.e., a £2.2m valuation gain (H120: £1.5m loss).

Administrative expenses were in line with the comparable period, after adjusting for one-off transactions and £1.25m of expenses related to the purchase of IAM's stake. Excluding these, both underlying and IFRS administrative expenses were below 2020, despite bonus payments which pushed up employment costs slightly. RAV deferred bonus decisions in 2020 due to the pandemic, so there was no comparable charge in H120. It redesignated its convertible preference shares in September 2020, so there is no repetition of the £3.6m charge in H120, related to the need to account for the premium on redemption.

Net cash from operations of £37.2m covered debt costs and the £32.6m preference share coupon. Other net financing drawdowns totalled £18.9m. That covered £12.3m loan amortisation £3.1m capital expenditure, and a £5.1m final tender offer for FY20.

Balance Sheet buoyed by uplift in asset valuations

There was a 3% uplift in Investment property valuations in the first six months to RUB113.7bn. The sterling equivalent was a market value of £1.13bn (FY20: £1.10bn). Investment property under construction was broadly unchanged at £27.1m.

Period end net assets were £264.5m (FY20: £233.7m) and includes £27.7m property revaluations (net of deferred tax), improved underlying profitability and £11.5m of positive unrealised currency movements taken through the income statement and reserves. H2 will also benefit from the release of a RUB255m provision in respect of a legal claim dismissed by Russia's Supreme Court in August.

The first half increase in NAV/share was primarily driven by positive portfolio fundamentals and underlying market dynamics, rather than forex. There was also a reduction in the number shares in issue post the transaction in May and the final FY20 distribution via a tender offer.

Completion of the transaction to purchase of the majority of IAM's holding of ordinary and preference shares was a key event during the first half. A new joint venture vehicle, Raven Holdings Limited, 50:50 owned by RAV and six of its executive directors and senior management bought in 100m ordinary / 32.5m preference shares at 21.6p and 90.8p/share respectively. Another 46.8m ordinary / 31.1m prefs) were placed with existing shareholders at that price, and 9.85m ordinaries bought in and cancelled.

RAV paid £15.4m for 50% of the equity in RH and lent the JV £35.7m at 6.65% pa. That was funded by a €60m loan with a five-year term, interest only at 5.65% pa. The JV is equity accounted in the group accounts, with RAV's share of its profits shown in the income statement and the carrying value of its 50% holding net of the group's share of its net assets and any distributions received. At end June 2021 this investment's carrying value was £7.0m and share of the income in H1 21 was £2.0m. The group balance sheet also includes (non-current assets) the £35.7m loan due from the JV.

All income received by RAV to service the JV loan or via ordinary share distributions must be used to service/repay the VTB loan. While the VTB loan remains outstanding, any surplus income generated by the JV is unavailable for distribution.

Completion of proposed conversion into RUB leases and debt

Total debt was £673.0m at end June 2021 (FY20: £627.5). Cash balances were flat at £53.1m. RAV drew net £71.1m of debt , including a new €60m (£52.2m) facility related to the IAM share buy-back, which funded a £35.7m loan and £15.4m invested into the JV and the repurchase of £2.1m of existing shares. A medium-term initiative to match debt service and rent in functional currencies is near completion. Just 3% of remaining rent is USD denominated vs 17% USD/EUR at end June 2020.

Lease Currency Mix

	USD	RUB	Vacant	Total
Sqm	3%	90%	7%	100%

Source: Raven interim results

At end June 62% of group debt was RUB denominated, 38% EUR. RAV may retain EUR facilities hedged at materially lower interest rates, particularly when domestic rates are rising. The group's RUB debt is hedged via interest rate caps at a weighted average 7.6% strike vs Euro debt at 0.9%. The loan book had a 3.8 year weighted average maturity term (FY20: 4.1 years), 6.37% debt cost (FY20: 5.48%).

Secured debt currency profile

	RUB	EUR	Total
Debt portfolio	62%	38%	100%

Source: Raven interim results

Portfolio characteristics underpinned by limited supply and rising ERVs

The first half portfolio performance is characteristic of a market with very limited supply and a portfolio which is effectively fully occupied. The statement is line with independent market data which shows Russia's large e-commerce leaders and retailers urgently seeking additional space. Any vacant space in RAV's portfolio has quickly been let at rents ahead of expectation. It reports advanced negotiations to extend larger maturities due in 2022 and is on track to reach effective full occupancy by the end of the current year.

The Covid-19 pandemic has, ironically, spurred demand for warehouse and logistics space and in a market in very short supply, rents have risen as vacant space is mopped up. This has driven a cyclical shift from a tenant to a landlord ascendant market, which RAV has taken advantage of and moved a higher proportion of its portfolio onto to longer term leases. Strong covenants, including larger domestic e-commerce players such as Ozon and Yandex Market, have actively sought more space to support their growth plans.

Extended Warehouse Portfolio Lease Maturities

	2021	2022	2023	2024	2025-2032	Total
Maturity profile at 1 January 2021	**357**	**204**	**275**	**262**	**677**	**1,775**
Breaks exercised	27	(15)	0	(4)	(8)	0
Renegotiated and extended	(48)	(18)	(5)	(9)	(8)	(88)
Maturity profile of renegotations	0	6	1	8	73	88
Vacated/terminated	(229)	0	0	0	0	(229)
New lettings	22	3	1	23	160	209
Maturity profile at 30 June 2021	**129**	**180**	**272**	**280**	**894**	**1,755**
Maturity profile with breaks	**161**	**249**	**394**	**373**	**578**	**1,755**

Source: Raven interim results

In the first RAV secured 209,000sqm of new lettings, 89,000sqm of lease extensions and portfolio occupancy was 93% at end June 2021, rising to 96% post the period end.

- The largest portfolio maturity was at the start of H1 21, when Wildberries released its short term lets at Krekshino (29,000sqm) and Pushkino (44,000sqm). This space was quickly absorbed.
  - Home Market took 21,000sqm at Krekshino, the balance by smaller lets.
  - DNS took 21,600sqm at Pushkino, Ozon 22,700sqm.
- Other lettings this year include 18,000sqm at Klimovsk, 4,500sqm in Rostov to Yandex Market, and 16,000sqm at Klimovsk to Sladkaya Zhizn. Ozon has taken a further 8,000sqm in Rostov. All other new lets were for blocks of below 10,000sqm.
- The other large maturity in the first half related to DSV's exit from 59,000sqm at Istra in May. This was the largest single space available on the Moscow market at that time. RAV expanded its relationship with Russian e-commerce giant, Ozon, which has taken 52,000sqm of available space post the period end. Beluga has leased the remaining 8,400sqm.

Of 130,000sqm of H2 lease expiries 72,000sqm has already been extended or re-let. The balance includes 44,000sqm within the RosLogistics portfolio, where underlying clients' needs are expected to drop to 36,200sqm. Negotiations for all remaining maturities and vacant space are at advanced stages.

It is also considering how to generate returns from the remaining 'trapped' - often unneeded office and mezzanine space - that may remain at high occupancy levels. The office portfolio has performed in line with expectations. There are no large breaks or expiries due in H2 and occupancy is 98%. All office rent is up to date.

Outlook: strong asset performance driving NAV/share

From an operational perspective, RAV will continue to work its assets to extract higher returns and grow EBITDA. With a near fully occupied portfolio, it will focus upon securing longer-term lettings and higher quality covenants, which we expect will be reflected in asset values and assist its strategy to rationalise its debt portfolio, extend or refinance existing facilities, and seek to reduce debt service costs.

Higher inflation and interest rates are a key sensitivity

A near fully let portfolio and rising ERVs underpins prospects, but as ever, a more stable political and economic environment would help reduce uncertainty.

The interim statement refers to the potential for higher interest rates to affect the H2 result. Russia's official inflation rate is currently (June 2021) 6.5%, well above the CBR's 4% target. In response, the CBR raised rates by 1% to 6.5% (4.25% at start of 2021) at its 23 July meeting, the highest single increase since late 2014. Another hike, probably 50 bp is expected at its next meeting on 10 September, subject to the August inflation report.

This will increase the cost of servicing RAV's variable rate RUB debt although index linked RUB rents will part of offset the impact on profitability. Russia's determination to prioritise its economic performance is not expected to change, and it has recorded a strong recovery since the 2020 lockdown. Covid-19 remains an issue, with recent steep rise in weekly death rates and slowdown in the vaccination programme.

Strong growth outlook for economy in 2021, limited consensus thereafter

Forecasts for Q2 21 growth are still above 10% y-o-y, and GDP growth for calendar 2021 above 4% (source: Higher School of Economics). The government's reluctance to lock down meant that the pandemic had limited direct impact on RAV's trading. All rent due in the period was collected and the group finished the half with no material outstanding debtors or rent deferrals.

There is limited market consensus regarding GDP growth in 2022 and beyond. This reflects debate over Russia's future economic direction, headline performances and individual sectors. Growth forecasts for 2021 reflect a low base, pent-up demand from last year, and increased budget spending on higher oil receipts from a faster than expected recovery in oil production and better global demand for commodities. That has been accompanied by improved business confidence and consumer activity, and higher budget spending.

There are a number of drivers for inflation. Although Russia didn't impose a prolonged lock down it effectively closed its borders and choked off the flow of cheaper labour and that, with a weak Rouble, materially increased construction costs for logistics' developments. Food inflation was 7.9% in June vs 7.4% in May. Producer price inflation may however have peaked i.e., 31.1% in June vs 35.3% in May.

The prospect of higher borrowing costs remains an issue, but a stronger Rouble would be net positive for sterling NAV/share. Expectations are for modest RUB recovery this year on the back of higher interest rates, a firmer oil price (despite recent wobbles), and some easing of sanctions in line with a more pragmatic relationship between Moscow and Washington.

The oil price is expected to make further gains in the autumn and winter. Risk factors include a new geopolitical conflict or other event which results in new sanctions, or a collapse in the oil price to low USD60s per barrel (currently c USD71).

Financials

Income statement					
12 months to end December, £m	**2017**	**2018**	**2019**	**2020[1]**	**2021e**
Net rent and related income	129.7	118.3	126.5	113.1	105.9
Administrative expenses	(19.7)	(25.2)	(25.4)	(24.7)	(22.7)
	110.0	**93.1**	**101.1**	**88.4**	**83.2**
Long term incentives	(3.5)	(2.9)	(5.5)	(1.2)	(2.0)
Share of profit of JVs	1.6	1.6	1.3	1.1	4.0
Profit on disposal of JV					0.2
Adj. Operating profit (excl. revaluations)	**108.1**	**91.9**	**96.9**	**88.3**	**85.4**
Net finance charge	(71.7)	(83.3)	(107.6)	(73.6)	(61.0)
Profit on redesignation of convertible prefs.				45.7	
One-off transaction costs				(1.1)	
Underlying PBT	**36.4**	**8.6**	**(10.7)**	**14.7**	**24.4**
Adj. PBT	**41.4**	**25.8**	**26.2**	**26.9**	**24.4**
Tax	(25.2)	(5.8)	(19.0)	(15.1)	(14.0)
Underlying profit after tax	**11.2**	**2.8**	**(29.7)**	**(0.4)**	**10.4**
Forex (losses)/gains	(2.5)	(2.5)	27.5	(53.7)	8.9
Unrealised profit/(loss) on revaluation	28.2	(121.0)	48.3	(5.6)	29.5
IFRS Reported pre-tax profit	**68.3**	**(114.9)**	**65.1**	**1.3**	**62.8**
Tax	(25.2)	(5.8)	(19.0)	(15.1)	(14.0)
Reported profit after tax	**43.1**	**(120.7)**	**46.0**	**(13.9)**	**48.8**
Adjusted EPS (p)	6.2	4.0	4.7	3.5	2.00
Distribution per share (p)	**4.0**	**3.0**	**3.5**	**1.25**	**2.00**

Balance sheet					
As at end December, £m	**2017**	**2018**	**2019**	**2020[1]**	**2021e**
Non-current assets					
Investment property	1,159	1,175	1,338	1,090	1,150
Investment property under construction	29	31	34	27	27
Other - incl. JVs	11	32	9	12	53
Trade and other receivables	4	16	3	69	100
	1,202	**1,254**	**1,384**	**1,198**	**1,330**
Net cash/(debt)	(429)	(570)	(615)	(628)	(683)
Pref/Conv. Pref	(307)	(315)	(328)	(252)	(252)
	(736)	**(885)**	**(943)**	**(880)**	**(935)**
Deferred tax	(34)	(33)	(47)	(44)	(70)
Other adjustments - incl. net payables	(40)	(39)	(28)	(54)	(25)
	(811)	**(957)**	**(1,018)**	**(978)**	**(1,030)**
Net equity	392	296	366	220	300
NAV/share (p)	**59**	**48**	**71**	**43**	**53**

Source: Group results/ED forecasts [1]2020 proforma (unaudited)

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