Raven Russia Limited

Tenacity winning through

28 March, 2018

Recent FY17 results and the distribution to ordinary shareholders were both ahead of market expectations, and continuing stabilisation of group finances coincides with increasingly positive economic and property market data.

That should shift the investment focus back on the group's core business and Raven's competitive positioning as a market leading provider of Russian warehousing and 3rd party logistics. It has capacity to grow, and the potential to capitalise upon Russia's determination to modernise its economy, supply chain and infrastructure.

FY17 result: stabilising finances, leveraging a competitive portfolio

The results featured 10% y-o-y NOI growth, 19% in underlying EPS, and a 50% increase in the final distribution to 3p/share. Diluted NAV/share was also 13% ahead at 80c (57.5p), backed by the first uplift in appraised asset values for five years.

Raven has capitalised on £211m raised via two convertible preference share issues to build the sustainability of its financial base. The proceeds funded (a) $209m of high-yield acquisitions, which have added c $24m to the rent roll, and (b) debt reduction and renegotiation of facility terms, including reduced annual amortisation rates.

The key ongoing task is to manage the impact, as leases expire, of a fundamental market shift from US dollar pegged to rouble denominated rents. In parallel, the group plans to refinance USD borrowings with new Rouble facilities, which would match operational income and expenses, and reduce sensitivity to potential USD/RUB volatility.

Valuation: yield, 22% NAV discount, competitive positioning

The shares are underpinned by earnings growth and an attractive yield (paid via a tender offer to buy back shares) and the positive NAV outlook.

The group's financial footing has been assisted by the improved macro and domestic real estate market backdrops. Key economic data (GDP, inflation, interest rates) are stabilising, core lettings and investment markets are operating more conventionally.

Our forecasts are conservative i.e. absorb the impact of the transition to Rouble rents **but assume no further acquisitions despite $267m of year-end cash, which could clearly have a material positive impact on NOI and EPS.**

Summary forecasts

Year end 31 Dec	2015A	2016A	2017A	2018E	2019E
Net Operating Income, $m	174	152	167	155	150
Adj. Pre-tax, $m	59	48	52	38	33
Adj. diluted EPS, cents	7.9	6.8	7.4	5.1	4.9
Distribution/ord. share (p)*	2.0	2.5	4.0	4.0	4.0
Yield*, %	4.6	5.8	9.3	9.3	9.3
Net asset value (p)	51	50	56	58	60

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

Company Data

EPIC	RUS
Ordinary 1p shares, p	43p
52 week Hi/Lo	55-43p
Market cap	£284m
Fully diluted market cap	£581m

12% 1p Cumulative Pref	RUSP
Share price p	136p
52 week Hi/Lo	156-132p
Yield %	8.9

6.5% Convertible Red Pref	RUSC
Share price p	117p
Equivalent ordinary price	64p
52 week Hi/Lo	125-113p
Yield %	5.6

Exchange rates used	
GBP/USD	1.42
USD/RUB	57.23

Company description

Raven Russia is a Guernsey registered property investment company specialising in Russian commercial real estate. The portfolio focus is investment and development of high quality Class A warehouse complexes in major cities let to Russian and international tenants.

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FY17 results

Portfolio management boosted by acquisitions

FY17 results showed key KPIs moving in a positive direction. NOI was 10% up y-o-y at $166.7m, backed by an initial $10m rental contribution from $209m of acquisitions ($24m full year impact). Raven seeks further acquisitions, with US$267m cash at the year-end.

IFRS profit after tax was $57.7m (FY16: $7.7m), underlying post tax earnings $56.8m (FY16: $47.1m) and basic underlying EPS 8.56 cents (FY16: 7.17c).

A $38.2m (FY16: $43.3m loss) revaluation gain was the first since 2013 and contributed to an increase in diluted NAV to 80c/share (FY17: 71c/share).

Raven proposed a 3p/share final distribution, to be paid by way of a tender offer buy back of 1 share in every 17 at 52p.

Summary results

Year end 31 Dec, $m	2016	2017
Net rent and related income	151.7	166.7
IFRS Pre-tax profit	22.2	90.6
Revaluation surplus deficit	(43.4)	38.2
Underlying EPS (c)	6.81	7.41
Basic EPS (c)	1.17	8.69
Distribution per share (p)	2.50	4.00
Investment portfolio	1,324	1,593
Adj. fully diluted NAV/share (c)	68	77
IFRS fully diluted NAV/share (c)	71	80

Source: Company

The existing portfolio's performance was underpinned by lease renewals and enhanced valuations.

Our forecasts are adjusted for underlying portfolio performance, occupancy and NOI, as well as the currency mix and expiry profile of underlying leases. These provide visibility regarding how group income could change over the medium term, and specific pressures on rent.

Roslogistics: interesting medium-term potential

Over the longer term we see potential for the group's substantial third-party logistics operator Roslogistics, to benefit from central, government driven efforts to modernise and upgrade Russia's domestic transport infrastructure.

A core strategy to improve the country's self-sufficiency will require a more efficient logistics supply chain to help significantly reduce wastage.

The group has a joint venture with the Russian Co-op at the early planning stage of a pilot project. This has potential both for property level returns and management of its sites.

One-offs: profitable sale of non-core, legacy UK land holdings

FY17 results benefited from one-offs. The group completed the profitable disposal of most of its non-core UK strategic land holdings for a $20.2m profit and $21.6m cash. These assets were acquired for $0.7m as part of the purchase of Raven Mount in 2008.

Two acquisitions added $24m to full year rent roll

The two acquisitions completed last year added $10m to FY17 revenues, but $24m pa to the rent roll which will be reflected from FY18 onwards. The plan is to seek further high-quality income producing assets, primarily Grade A warehouses and logistics, but Raven will consider alternative asset classes where the property and financial metrics are attractive.

Details of the four properties in Moscow and St Petersburg acquired in FY17 are set out below.

Raven paid aggregate consideration of RUR11.989bn ($209m), which secured 11.38-16.0% initial rental yields at attractive prices relative to replacement cost. The two acquisitions were part funded by a second, $126m issue of convertible preference shares in July 2017.

These assets comprised an office portfolio and warehouse in St Petersburg, and a large Moscow logistics complex. They are high-quality, income producing assets, available at attractive prices at this stage of the property cycle. The transactions also begin to diversify the portfolio beyond logistics warehousing.

Assets acquired

Location	Description	Consideration & Initial yield
St Petersburg **Apr 2017**	Three separate properties - 87,000 sqm of Grade A warehousing - 33,000 sqm of offices 98% leased at acquisition; 68 tenants include Otis, Oracle, YIT, Schenker and Maersk	RUR4.9bn ($86m) total consideration 16% initial yield
Moscow **Nov 2017**	New Grade A warehouse complex 195,000 sqm lettable 73% leased at acquisition; major tenants include Obi, Okey, Major Logistics and Miratorg 83% let currently	RUR7.089bn ($123m) total consideration based on letting vacant space over next 18-months 11.38% yield 12.5% reversionary yield

Source: Company

Cash available to finance further portfolio growth

The statement points to further acquisitions this year, financed from a $266.7m year-end cash balance and potential new debt secured against new and unencumbered assets.

The strategy is to continue to build the scale and resilience of portfolio returns, cash flow and finances. The business model combines high yielding (typically c 12% on cost) warehouse assets, financed by debt at a c 7% all-in cost, subject to 55% aggregate portfolio LTV.

Raven may retain a c $120m cash buffer while it navigates the transition of its lease book and refinances its debt on a similar basis. **No further acquisitions are included in our forecasts.**

Valuation & sensitivities

The 9% prospective yield, based on an assumed 4p/share distribution (which will continue to be paid via a tender offer to buy-back shares) is covered by earnings and substantial year end cash. We expect c $120m to be held as a cash buffer. The shares are also underpinned by 80c/57.5p NAV per share.

The statement confirmed that distributions paid to ordinary shareholders will be covered by underlying operating cash earnings after interest.

Key challenge: offset NOI impact of switch from US$ to RUB rents

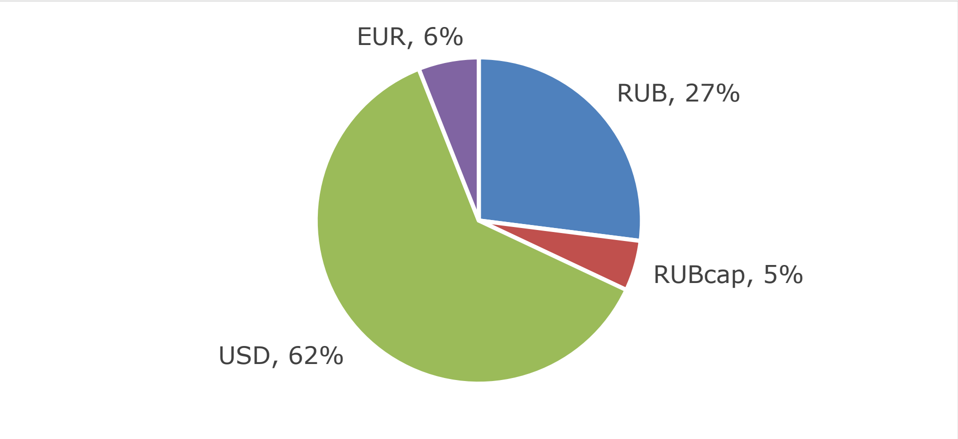
The key short-term challenge is to improve portfolio returns and attempt to offset the impact of an inevitable switch from US dollar to Rouble denominated rents. As the group renews existing leases or secures new tenants at expiry or break, this will have a material negative impact on NOI reported in USD. The implications of this are set out below.

- As at end FY17 31% (FY16: 50%) of warehouse GLA was US dollar pegged with a weighted average unexpired term of three years at average rents of $143 psm (FY16: $125 psm), equivalent to c RUB 8,150 per sqm.
- The Russian warehouse market is now almost entirely Rouble denominated, at rents between RUB 3,600-4,000 per sqm for Grade A space for Moscow, St Petersburg and two regional hubs, Rostov and Novosibirsk. That reflects a relative lack of completion and tighter letting dynamics outside of the capital.
- New leases are being signed at an average RUB 3,870 psm rent and renewals at RUB 5,250 psm. We have thus assumed a 50% fall in reported USD income, which is equivalent to a potential c $11m pa drop in income in each of the next three years (based on an average three-year unexpired lease term).

More positively, Rouble denominated leases are being secured for longer terms i.e. average unexpired period of 3.6 years for group RUB leases. Those Rouble leases were subject to an average minimum indexation of 6.8% pa last year (FY16: 7.7%).

Within the office portfolio, 54% of income is Rouble denominated, 35% Euro and 11% US Dollar.

Currency exposure - Percentage of total group portfolio net operating income:



Strategy: build NOI by acquisitions and active management

Acquisitions would help offset the potential shortfall. Purchases in FY17 added $10m to NOI in FY17 and we estimate, at least $24m pa in future years.

- We anticipate that acquisitions could potentially add $25-27m pa to NOI, net of debt service. That assumes investment of c $150m of $267m end FY17 cash, plus debt (target 60% LTV) i.e. c $350m in new assets at c 12% initial rental yields.
- Further reduction in 19% end FY17 portfolio vacancy towards a 10-12% near term target will also help maintain portfolio returns.

  The c 340,000 sqm of vacant lettable space at the year-end could hypothetically be let at 3,500-4,000 Rouble psm. Raven let c 180,000 sqm last year and has a 200,000 sqm FY18 target (net of tenant exits).

  So far this year it has secured tenants for 30,000 sqm and holds Letters of Intent for another 40,000 sqm.

NAV: 28% above current share price, modestly upward trajectory

Diluted NAV/share increased from 71c to 80c, equivalent to 57.5p/share c 28% above the current share price.

That growth reflects an underlying improvement in asset values, confirmed by the first uplift in the period end external appraisal for five years. **That incorporated lower valuation yields in a recovering investment market.**

The NAV outlook is also indirectly supported by the distribution policy which (a) ensures that the cost of distributions is fully covered by cash earnings and (b) is paid by way of a tender offer (1 for 17 shares at 52p).

That represents a share repurchase at below NAV/share and subject to take up would progressively shrink the equity base.

Director purchase March 2018: 1m shares at 46.15p each

The group's Executive Deputy Chairman, Anton Bilton, purchased 1m ordinary shares at 46.15p. That increases his and his immediate family's beneficial interest to c 42.37m Ordinary Shares (6.41% of total issue).

Sensitivities

More stable macro-economic and local market outlook

The group navigates two major, interconnected external influences; Russia's macro-economic backdrop and local property market dynamics. **Both look far more supportive than 12 months ago.**

- GDP grew last year as oil prices recovered, inflation and interest rates fell. GDP growth was 1.5% in 2017, while inflation fell from 5.4% to 2.5%.
- The central bank interest rate is currently 7.25% vs 10% at end FY16.
- The RUB/USD rate traded within a 57-60 range last year, and the oil price recovered to c $63/barrel. We have assumed relatively stable RUB/USD, but this does pivot on an ongoing recovery.

The impact of geo-political events on Russia's economy will however remain a source of sensitivity. However, a more positive outlook for domestic GDP growth, inflation and interest rates should give tenants more confidence when considering investment decisions, including committing to new leases and additional space.

A stronger active occupier market should assist group efforts to improve/stabilise portfolio occupancy. Resources are focused on letting vacant space and actively managing and optimising returns from its existing assets, leases and tenant relationships.

Recent lettings and reported enquiries from prospective tenants should mean that the impact on group NOI over the next three years can be modelled with a reasonable degree of accuracy.

Balance sheet

Core KPIs focus on stability of cash flow, net of debt service costs (interest and amortisation). This identifies the need to restructure existing bank facilities, which in turn influenced the decision to issue new convertible preference shares.

Pref issues finance portfolio/NOI growth, debt renegotiation

Over the last two years £211m cash has been raised via convertible preference share issues. These have backed strategies devised to improve ongoing net cash generation, revenue stability and profit margins. This cash has had two main applications:

a) To reduce outstanding loan balances and LTVs, as part of a renegotiation of facility terms including reduced annual amortisation rates.

   Although group banking facilities currently remain predominately US Dollar denominated, Raven has over the last two years reduced and restructured its facilities and increased covenant headroom. That provides a safety margin with respect to debt service, against any adverse movements in exchange rates.

   As at end FY17, the aggregate LTV on asset specific debt was 53% (FY16: 55%).

b) Acquisition of $209m of high yielding well-let properties. This improved portfolio (including sector and tenant) diversification and grew the rental base.

   These acquisitions will help offset the impact of the ongoing move from USD to Rouble rents.

Debt structure: USD debt to be refinanced by new rouble facilities

Another component of the medium-term stabilisation strategy is to change how the portfolio is financed. Switching into Rouble denominated debt would remove a potential forex mismatch between an increasingly Rouble-based revenue base and debt service costs.

Raven plans to refinance its USD banking facilities with a Rouble/currency mix, assuming further small declines in Russian Central Bank rates as facilities approach maturity, if not before. The table below sets out outstanding debt and other significant non-Rouble liabilities related to recent fundraisings, as at the end of FY17.

Debt				
($m)	**Current**	**Non-current**	**Total**	**Proportion**
USD	103.9	680.6	784.5	62%
Euro	2.8	59.9	62.7	5%
Sterling - Preference Shares		146.5	146.5	12%
Sterling - Convertible Pref Shares		269.0	269.0	21%
Total	**106.7**	**1,156**	**1,262.7**	

Source: Company

The group seeks terms (c 7.5% all service cost) which provide it with a material positive return from an underlying rented portfolio yielding 11-12%. Recent declines in market interest rates suggest that it will be possible to secure ten-year fixed rate Rouble facilities this year. Management is in open dialogue with its banking partners on this transition process.

Outlook: asset management led returns

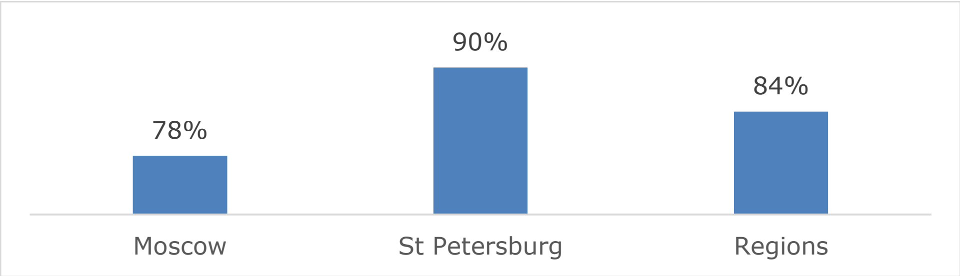
Target: reduce 19% end FY17 portfolio vacancy to stabilise NOI

Portfolio occupancy was stable in FY17 on a like for like basis. Set against a more vibrant letting market, the ability to cut vacancies represents a clear potential opportunity to significantly enhance ongoing rent.

Year-end portfolio vacancy was 342,900 sqm or 19% of GLA and the short-term target is to reduce that to 12/13%. Reported market optimism has been verified by higher tenant inquiries against a stronger macro backdrop i.e. GDP growth, higher oil prices and lower inflation. Raven signed 187,100 sqm of new leases last year and renegotiated another 198,100 sqm.

Current portfolio vacancy is however, above the market generally, particularly in Moscow, as space exited on lease expiry has outstripped new lettings. Management attributes this disparity to a willingness by its competitors to let space at below market rents. It has already seen improved portfolio letting activity since the year end.

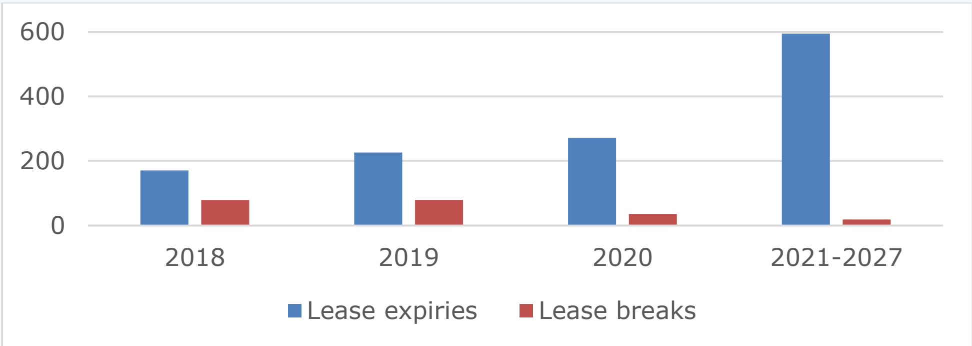
Portfolio occupancy by geographical component:



Lease expiry and potential breaks

The table below illustrates the timing of lease expiry. The continuing task, as leases expire or as breaks are exercised, is to smoothly transition tenants with US dollar denominated leases onto rouble-based rents.

Lease duration



Source: Company

This is set out in more detail below. There was a broad balance between space exited and extended/let in FY17. Leases expiries related to 233,000 sqm of warehouse space; c 69% of that (161,000 sqm) was vacated or terminated, and another 18,600 sqm due to early terminations of leases expiring in 2018-19 and weaker covenants.

Tenancies for GLA of 72,000 sqm were renegotiated and extended, another 186,000 sqm let on new leases. Around two-thirds of those new lettings were for periods to 2021-27, pushing out the term of average leases and potentially improving income visibility. New lettings were exclusively Rouble denominated.

Lease maturities

	2017	2018	2019	2020	2021-2027	Total
Warehouses						
Maturity profile 1 Jan 17	199	165	252	179	392	1,187
Acquisitions	34	27	8	13	147	229
Subtotal	**233**	**192**	**260**	**192**	**539**	**1,416**
Renegotiated and extended	(72)	(79)	(22)	0	0	(173)
Maturity profile of negotiations	0	46	0	78	49	173
Vacated/terminated	(161)	(14)	(4)	0	0	(179)
New lettings	0	15	17	32	122	186
Maturity profile 31 Dec 17	**0**	**160**	**251**	**302**	**710**	**1,423**
Offices						
Maturity profile 1 Jan 2017	16	0	0	0	0	16
Maturity profile 31 Dec 2017	0	9	13	6	21	49
Total Group Portfolio	**0**	**169**	**264**	**308**	**731**	**1,472**

Source: Company

Although 78,300 sqm of space is subject to potential break clauses this year and 79,000 sqm in 2019, Raven has already completed 53,000 sqm of renewals since the year end, 8,400 sqm of lease extension and 21,000 sqm of new lettings. In addition, letters of intent have been signed for another 38,000 sqm.

Amongst recent lettings were 30,000 sqm to Makita (Moscow), 8,000 sqm to Mars (Rostov) and the decision by Wildberries, one of Russia's largest internet retailers, to double its space to 10,000sqm (Novosibirsk).

The average letting size by tenant is 8,410sqm (2016: 11,240sqm); no tenant accounts for more than 11% (FY16: 11%) of portfolio GLA. Raven's top ten tenants contribute 45% (2016: 46%) of portfolio GLA and 50% (2016: 58%) of income generated.

Russian warehouse and logistics markets picking up

The market in FY17 was characterised by higher take up and enquiry levels, with values underpinned by falling levels of new warehouse sector development in the Moscow region.

Post c 1.2m sqm take up in 2017 market vacancy fell to 9% and new supply virtually halved to just over 500,000 sqm. Demand is being driven by retail (39% of take-up) and distribution businesses (19%).

The market consensus view sees modest improvement across the board in 2018, with the outlook for rents, yields and occupancy supported by a pick-up in the wider economy, lower central bank rates and investment. FY17 investment volumes were $4.6bn, of which Moscow accounted for 79% and the warehouse sector just 8% at $370m. According to JLL prime yields for Moscow warehouses currently range between 11-12.5%.

FINANCIALS

Income statement					
Year to end Dec, $m	**2015**	**2016**	**2017**	**2018e**	**2019e**
Group					
Gross revenue	220	195	228	212	206
Opex/cost of sales	(46)	(44)	(61)	(55)	(54)
Net operating income	174	152	167	157	152
Running general and admin expenses	(30)	(24)	(25)	(27)	(27)
Share based pyts & LT incentives	0	(9)	(5)	0	0
Forex profit / (loss)	1	18	9	0	0
Depreciation	(2)	(1)	(1)	(1)	(1)
Goodwill impairment	0	0	(2)	0	0
	140	**135**	**143**	**129**	**124**
Share of profit of JV	3	2	2	2	2
Underlying profit before interest	**142**	**137**	**145**	**131**	**126**
Unrealised loss on reval. of Inv Prop under construction	(5)	(3)	(4)	0	0
Unrealised profit on revaluation of inv. Property	(251)	(40)	42	0	0
Profit before interest	**(114)**	**94**	**183**	**131**	**126**
Finance income	3	3	8	8	8
Finance expense	(67)	(69)	(65)	(60)	(60)
Preference dividend cost	(19)	(24)	(36)	(42)	(42)
Profit before tax	**(197)**	**5**	**91**	**38**	**33**
Adj. profit before tax	**59**	**48**	**52**	**38**	**33**
Tax	(10)	(15)	(33)	(10)	(9)
Net profit / (loss)	(208)	(10)	58	28	24
Adj. net profit	49	33	20	28	24
Earnings per share					
Underlying - fully diluted cents	7.9	6.8	7.4	5.1	4.9
Underlying - fully diluted (GBP p)	5.6	4.8	5.2	3.6	3.4
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	1,575	1,575
Investment property under construction	39	41	38	38	38
Other non-current assets	58	51	62	62	62
	1,431	**1,393**	**1,669**	**1,675**	**1,675**
Current assets					
Inventory	1	1	0	0	0
Trade and other debtors	50	53	79	60	60
Cash etc	202	199	267	240	220
	254	**252**	**346**	**300**	**280**
Total assets	**1,685**	**1,645**	**2,015**	**1,975**	**1,955**
Current liabilities					
Debt	(105)	(41)	(107)	(75)	(60)
Other current liabilities	(55)	(66)	(107)	(100)	(100)
	(160)	**(107)**	**(214)**	**(175)**	**(160)**
Non-current liabilities					
Debt	(814)	(699)	(740)	(740)	(730)
Other non-current liabilities	(89)	(87)	(116)	(116)	(116)
	(903)	**(786)**	**(856)**	**(856)**	**(846)**
Total liabilities	**(1,063)**	**(893)**	**(1,070)**	**(1,031)**	**(1,006)**
Net assets	**622**	**752**	**945**	**944**	**950**
Conv red pref		(120)	(269)	(283)	(297)
Preference capital	(157)	(132)	(146)	(146)	(146)
Ordinary shareholders' funds	**465**	**500**	**530**	**515**	**506**
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	496	488
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	805	811
Undiluted NAV per share US cents	72.2c	75.6c	80.8c	82.3c	84.4c
Diluted NAV per share US cents	**70.3c**	**71.0c**	**79.6c**	**81.4c**	**82.8c**
Undiluted NAV per share pence	52.2p	54.6p	58.4p	59.5p	60.9p
Diluted NAV per share pence	**50.8p**	**51.3p**	**57.5p**	**58.8p**	**59.9p**

Source: Company historic data, ED estimates

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