

Key metrics moving ahead

28 August 2019

Raven is understandably pleased with these strong first half results. The business has responded well to efforts to stabilise the portfolio and de-risk its finances. A 40% increase in NAV/share to 67p during the period was driven by both uplifts in property valuations and Rouble/GDP strength. Another 5p was added in August (post the period end) via the repurchase and cancellation of c 14% of its ordinary shares at around half underlying NAV.

Valuation: 45% NAV discount, risk factors being addressed

The shares are currently 45% below NAV, at odds with an investment case that pivots on (a) steady performance of high-quality mainly Moscow-based warehouses, (b) improving local real estate markets, (c) a proactive approach to insulate operations from politically driven external factors and (d) post the half-year, actions taken to deal head-on with issues weighing on its equity value.

Key metrics all moved ahead. Underlying earnings were £13.4m before forex effects (H1 2018: £8.6m). That progress was primarily driven by higher portfolio occupancy; 90% at end June 2019 vs 84% a year earlier and initial rents from lettings and acquisitions completed in H2 2018. NOI was £64.3m (H1 2018: £57.6m).

Outlook: well set for H219 and beyond

- Higher portfolio occupancy and acquisitions have built RUB scale and reduced the potential impact of external factors/forex shifts. Over the last two years Raven has strategically shifted its financial base to better match its core, functional currency. A much higher proportion of its leases and debt facilities are now Rouble denominated, and all USD debt is on track to be refinanced by end December.
- Portfolio metrics are moving in the right direction. Occupancy is underpinned by further lettings (2% of vacancy) under negotiation and steady lease renewals. The portfolio valuation was also higher, in line with a stronger local warehouse market.
- Market dynamics improved again. Availability of vacant space in Moscow fell during the period and estimated rental values (ERVs) pulled ahead.
- Raven has a strong position in a market seeing many of the same factors - online retail driving demand for warehouse and logistics space - as Western markets.

Summary forecasts

Year end 31 Dec	2017A	2018A	2019E	2020E
Net Operating Income, £m	129.7	118.3	130.1	125.1
Adj. Pre-tax, £m	55.9	24.9	31.5	25.5
Adj. diluted EPS (p)	5.7	3.1	4.3	4.0
Distribution/ord. share (p)*	4.0	3.0	3.0	3.0
Yield*, %	10.1	7.6	7.6	7.6
Net asset value (p)	59	48	72	74

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

Company Data

EPIC	RAV
Ordinary 1p shares, p	39.5p
52 week Hi/Lo	49p -37p
Market cap £m	£202m

12% 1p Cumulative Pref	RAVP
Share price p	132p
52 week Hi/Lo	144.5p -130p
Issued share cap m	99.6
Market cap	£131.5m
Yield %	9.1%

6.5% Convertible Red Pref	RAVC
Share price p	110p
Issued share cap m	198
Market cap	£218m
Yield %	5.9%

Exchange rates (RUB/GBP) used:

	B/S	P&L
H119	79.91	84.51
FY18	88.35	83.69
FY17	77.80	75.19

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. Its portfolio is let to both Russian and international tenants.

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Interim results

With group NOI and expenses increasingly moving onto a Rouble basis, year-on-year comparison of GBP results is skewed by forex shifts. There has nonetheless been genuine progress in underlying (incl. forex, excl. portfolio revaluations) revenues and profit.

NOI (net rent and related income) was £64.3m in H1 19 (H1 18: £57.6m). Higher underlying earnings reflects improved average portfolio occupancy; 90% at the end of June 2019 vs 84% a year earlier, with another 2% of vacant space subject to letters of intent. The result also included initial rent from acquisitions completed in H2 2018.

Summary Income Statement

Six months ended 30 June	2019	2018
Net Rent & Related Income (£)	64.3	57.6
Underlying Earnings after tax (£)	32.4	4.4
Underlying Basic EPS (pence)	5.31	0.67
Revaluation surplus/(deficit) (£m)	18.2	(26.1)
IFRS Earnings/(loss) after tax (£m)	26.2	(28.8)
Distribution per share (pence)	1.25	1.25

Source: Raven Property Group interim results statement

Progressive shift to Rouble financial model paying dividends

Reducing exposure to external factors has been and will remain a core strategy. Raven has deliberately transitioned a higher proportion of its leases and debt servicing costs from USD, mainly into Roubles, over the last few years. The intention has been to reduce underlying, operational exposure to sudden shifts in forex rates i.e. minimise any potential currency mismatch between portfolio income and finance costs.

New lettings are progressively being secured via indexed Rouble denominated leases, which provides protection and helps to ensure that rent affordability for tenants is not impaired by the kind of shifts in RUB/USD experienced over the last few years.

Lease Currency Mix, % of total as at end June

	USD	RUB	EUR	Vacant
2018	26%	61%	3%	11%
2019	19%	67%	3%	11%

Source: Raven Property Group interim results statement

The group also continued to transition its secured debt portfolio from USD to a Rouble/Euro blend. As at 30 June 2019, 37% of its secured debt was RUB denominated (31% at end FY18), 52% Euro (35%) and 11% USD (34%).

Secured debt currency portfolio, % of total debt at end June

	USD	RUB	EUR	Total
2018	34%	31%	35%	100%
2019	11%	37%	52%	100%

Source: Raven Property Group interim results statement

During H1 19 the impact of that higher RUB weighting was positive i.e. a £18.9m forex gain (H1 18: £4.3m loss). That is admittedly a difficult contribution to forecast, which we ignore in our estimates. However, for reference, GBP/RUB was 79 at end June 2019 vs 88 at the last year-end, close to its three-year average.

A comparison which strips out forex effects sees underlying earnings (GBP) up 56% at £13.4m (H1 2018: £8.6m), vs £32.4m inclusive of currency effects (H1 2018: £4.4m).

Balance sheet: revaluations drive NAV growth

IFRS profit at £26.2m (H1 2018: £28.8m) includes an £18.2m portfolio revaluation (H1 2018: £26.1m loss) in line with ongoing, investment market shifts in ERVs/yields. That added £129.3m to the equivalent GBP portfolio valuation.

That was offset by £13.9m of mark-to-market losses on interest caps (H1 2018: £2.3m profit), principally related to CBR caps taken out in 2018. That reflects anticipated CBR cuts.

Diluted NAV/share grew by 40% to 67p during the first six months (FY18: 48p), buoyed by higher portfolio valuations and Rouble strength.

The secured debt loan to value ratio at 30 June 2019 was 50.1% (31 December 2018: 54.1%). The blended cost of the secured debt portfolio is 7.39% (FY18: 7.69%), with a 3.6 year weighted average term to maturity (FY18: 4.0 years). Underlying operating profit, excluding forex, covered net interest expense 1.46x in H1 2019 (H1 2018: 1.33x).

Raven currently seeks to extend another £122m of facilities, including its short-term maturities, and convert a further 8% into Rouble facilities. It expects to have repaid all USD denominated debt by end FY19.

Forecasts

We have adjusted our forecasts for the above dividend and the share buy-back in August and dividend, recent and prospective lettings and a slightly ahead of forecast refinance of USD debt facilities.

There is inevitably some sensitivity related to forex and timing of leases and initial rental contributions, but our projections support the group's ability to cover its operational costs including debt finance (assuming successful refinance of USD facilities), and the proposed and our forecast distributions.

Cash balances improved during the period to £83m (FY18: £73m), with a small cash inflow in the six months before the effect of the strengthening Rouble. Approx. £32m of that was used to finance a share buy-back (described below) completed on 20 August, via which Raven purchased 89.145m of its ordinary shares (14.8% of shares in issue) at 36p/share.

The proposed distribution could consume a further c £6.4m. The group plans to distribute the equivalent of 1.25p per ordinary share, as previously by way of tender offer buy back; one in 44 shares at 55p (H1 18: 1.25p, one in 44 shares at 55p).

Valuation

Despite the risks implicit in a near 45% discount to NAV and 7.6% effective yield, the fundamentals look appealing. They combine strong portfolio performance and improved underlying finances. Asset values are underpinned by an improving local real estate market and economy, plus the positive impact on sterling NAV/share of recent Rouble appreciation.

The Rouble’s recovery to its near three-year average of 80 RUB/GBP is equivalent to **a 17p boost to NAV/share**. Local property market conditions have improved, backed by the current rate cutting posture of the Russian Central Bank.

Share buyback in August adds 5p to NAV/share

NAV/share was further enhanced post the period end via the repurchase of 14.8% of the group’s ordinary shares for 36p/share. The price agreed was an 11.1% discount to the relevant closing price and a c 48% discount to end June 2019 NAV/share

Those shares were held by funds managed by Raven’s two largest institutional shareholders; the Woodford Funds (72.145m, 12% of total issued ordinary share capital), and the balance by IAM/Invesco Funds (which in aggregate, held 31% of the ordinary shares). Raven ultimately purchased WIM’s entire holding for c £25.97m, and 17m shares from Invesco, for which it paid £6.12m; in total 89.145m shares. Post the buybacks, the Invesco Funds hold 33.1% of the reduced ordinary share capital.

Fund Manager	No. of shares	Holding
Invesco Perpetual Asset Management	169,234,493	33.1%
JO Hambro Capital Management	64,656,720	12.7%
Raven Property Group Directors and EBT	54,276,074	10.6%
Schroder Investment Management	53,771,167	10.5%
Quilter Investors	32,091,029	6.3%
Progressive Capital Partners	16,569,506	3.2%
Norges Bank Investment Management	8,606,116	1.7%
Legal & General Investment Management	7,780,738	1.5%
BlackRock Investment Management	7,105,235	1.4%
		81.4%

Source: Company

This was an opportunistic use of available cash. Recent newsflow concerning one of the group’s major shareholders would suggest that Raven dealt promptly with a potential large potential overhang which would otherwise have weighed on its share price, on terms which materially benefitted remaining shareholders.

The shares were cancelled on 21 August 2019 which, on a proforma basis, will add around 5p to NAV/share.

In addition, the proposed a 1.25p/share distribution, as previously by way of a tender offer buy back (1 in 44 shares at 55p), will further enhance that 72p/share NAV calculation. There are good prospects for further uplifts in portfolio valuations, but we have not included these in our forecasts.

Portfolio performance in an improving market

The first half outcome reflects management's efforts to drive portfolio performance and where practicable, insulate group finances from the kind of external and political factors which have previously prompted sudden shifts in forex rates.

The portfolio is at the core of the investment case and occupancy arguably the key metric, plus average ERVs. The table below illustrates activity during the first half, with occupancy rates maintained and a positive shift towards longer lease maturities.

Warehouse Portfolio Maturities						
'000s sqm	2019	2020	2021	2022	2023 - 2032	Total
Maturity profile at 1 Jan 2019	244	259	358	222	602	1,685
Renegotiated and extended	(38)	(3)	(18)	0	(33)	(92)
Maturity profile lease extensions	21	12	0	11	48	92
Vacated/terminated	(117)	0	(3)	0	0	(120)
New Lettings	31	1	4	3	76	115
Maturity profile at 30 Jun 2019	140	269	341	236	693	1,679
Maturity profile with breaks	212	438	462	137	430	1679

Source: Raven interim results

Raven reported 115,002 sqm of new warehouse lettings at steadily improving rents during the first six months, plus 91,584 sqm of lease extensions and renegotiations. That was offset by 119,812 sqm of vacated space, 91,284 sqm of which related to one major tenant.

Letting outlook: current demand outstrips expected tenant exits

A total of 140,114 sqm of warehouse leases is due to mature during H2 19, with another 56,254 sqm of potential lease breaks. Raven's forecasts suggest that respectively, 41,227 sqm (29%) and 7,373 sqm (13%) of these will vacate before the year end.

Post the end of June it has let 19,562 sqm of vacant warehouse space and renegotiated and extended 31,818 sqm of maturing leases. Another 38,713 sqm of vacant space and 109,383 sqm of negotiations on currently let space is subject to letters of intent.

Prime Moscow warehouse rents are currently RUB 3,800-4,100 per sqm vs RUB 3,600 to 4,000 per sqm at end 2018.

Market recovery maintaining momentum

Colliers International’s H1 2019 Moscow Warehouse and Industrial Market reinforces the group’s view regarding recovery in the local warehouse market dynamics, tenant and investor demand.

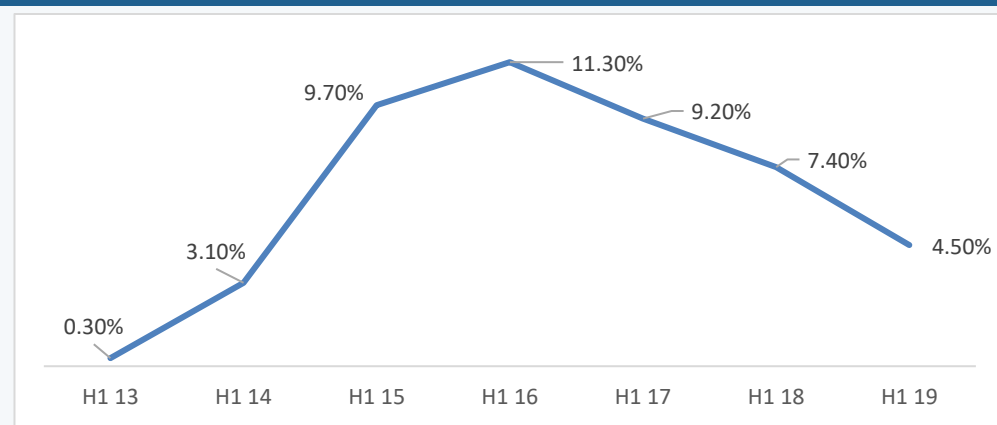
Moscow – warehouse and industrial market

	H1 2017	H1 2018	H1 2019
Total warehouse stock, million sqm	12.9	14.0	15.8
Completions (000 sqm)	203	267	279
Total take-up (000 sqm)	534	568	762
Volume of lease deals (000 sqm)	534	445	597
Volume of sale deals (000 sqm)	0	123	165
Vacancy %	9.2	7.4	4.5
Average rental rate, RUB/sq/m/year	3,800	3,800	3,850

Source: Colliers International

Despite some steady increases in total warehouse stock, vacancy rates have fallen from 9.2% to 4.5% during the two years to end June 2019.

Vacancy rate, H1 2013 to H1 2019



Source: Colliers International

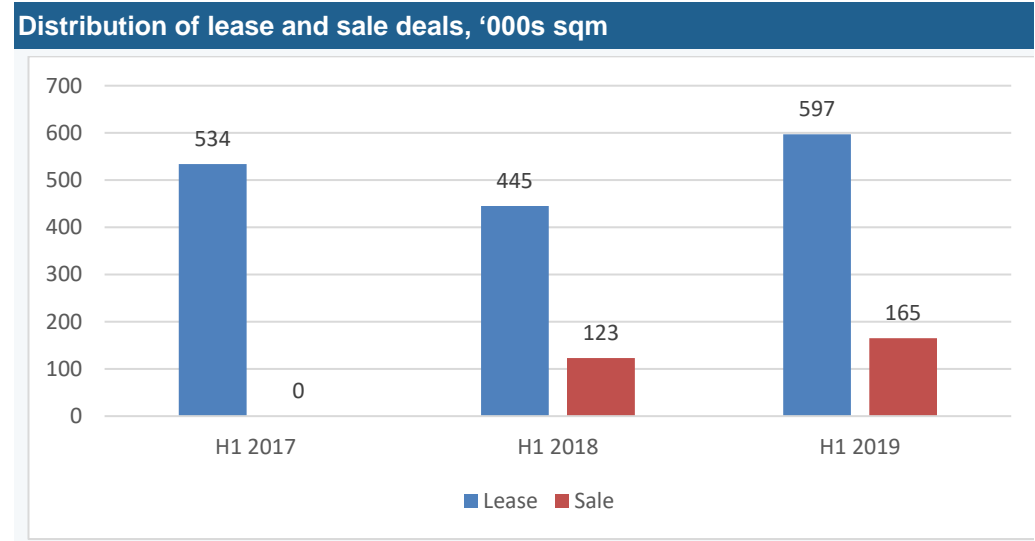
At end H1 2019 the total supply of new high-quality warehouse space in the Moscow market was 15,802,000 sqm. New build added another 279,000 sqm in the first six months, 4% above the comparable period in 2018. Speculative construction of new warehouse space was 10% below last year, projects commissioned by end users up c 250%. Over 190,000 sqm is at the final stage of commissioning.

Retailers were the most active takers of warehouse space in H119 - off and online retailers accounting for 44% vs 35% H118. Logistics companies were also busy, with a c 22% share (10%). Colliers data points to a broad supply and demand balance but anticipates declining availability of vacant units above 20,000 sqm.

The vacancy rate will be affected by high speculative construction on the one side, and high take-up on the other. As the level of vacant units of 20,000 sqm and more decreases warehouse premises of 10,000–20,000 sqm will form the largest share. The forecast vacancy level is 4–4.5%.

Take up

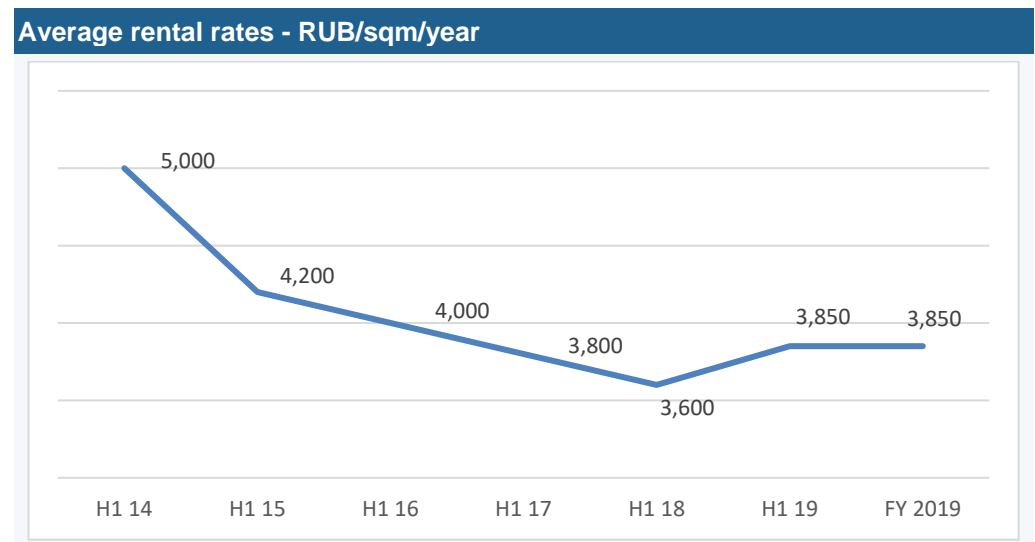
The last two years have seen a material increase in warehouse take-up in the Moscow region. Total lease and sale transactions were 762,000sqm in the first six months, 34% ahead of the comparable for H118.



Source: Colliers International

Rental rates

Rental rates in A and B class warehouses in the Moscow region in H1 2019 reached 3,850 RUB/sqm/year.



Source: Colliers International

The gradual increase in rental rates has been due to a decline in the volume of vacant space and the increase in the average lease deal size.

Income statement (£m)				
12 months to end December	2017	2018	2019e	2020e
Net rent and related income	129.7	118.3	130.1	125.1
Administrative expenses	(19.7)	(22.7)	(24.5)	(25.5)
Adj. EBIT	110.0	95.6	105.6	99.6
Long term incentives	(1.3)	0.0	(2.0)	(2.0)
Share of profit of JVs	1.6	1.6	1.6	1.6
Adj. Op. profit (excl. revaluations)	110.4	97.2	105.2	99.2
Net finance charge	(60.6)	(68.5)	(73.7)	(73.7)
Underlying PBT	49.8	28.7	31.5	25.5
Tax	(12.5)	(6.2)	(6.0)	(5.5)
Underlying profit after tax	43.4	20.0	25.5	20.0
Other		(13.9)	(11.0)	0.0
Unrealised profit/(loss) on revaluation	28.2	(121.0)	18.2	0.0
IFRS Reported pre-tax profit	68.3	(114.9)	32.5	20.0
Tax	(25.2)	(5.8)	(6.0)	(5.5)
Reported profit after tax	43.1	(120.7)	26.5	14.5
Forex (losses)/gains	6.1	(2.5)	18.9	0.0
Underlying EPS (p)	5.7	3.1	4.3	4.0
Distribution per share (p)	4.0	3.0	3.0	3.0
Balance sheet (£m)				
As at 31 December 2018	2017	2018	2019e	2020e
Non-current assets				
Investment property	1,159	1,175	1,335	1,340
Investment property under construction	29	31	30	30
Other - incl. JVs	11	32	21	21
Other receivables	4	4	4	4
	1,202	1,242	1,390	1,395
Net cash/(debt)	(429)	(558)	(631)	(632)
Pref/Conv. Pref	(307)	(315)	(324)	(324)
	(736)	(874)	(955)	(956)
Deferred tax	(34)	(33)	(23)	(22)
Other adjustments - incl. net payables	(40)	(39)	(28)	(28)
	(811)	(946)	(1,005)	(1,006)
Net equity	392	296	384	388

Source: Group results, Equity Development forecasts



Investor Access

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