Regional REIT

Q3 trading update

Letting progress; trading in line

Real estate

Regional REIT (RGL) is trading in line with management's expectations, is seeing a good level of interest in both its office and industrial properties, and has continued to be active in letting since 30 June. As a result, it expects occupancy rates to increase across the portfolio in the near term, supporting income from the growing portfolio (c £650m in assets). Lettings since the end of September indicate progress towards the 85% occupancy rate that we target for end-2017 and then towards 90% by the end of 2018. On this basis, RGL's highly attractive and growing dividend is fully covered by forecast earnings, while its regional focus should prove more resilient to macroeconomic headwinds than London real estate.

Year end	Net rental income (£m)	EPRA EPS* (p)	EPRA NAV/ share (p)	DPS (p)	P/EPRA NAV (x)	Yield (%)
12/15**	4.6	0.9	107.8	1.00	0.97	1.0
12/16	38.1	7.8	106.9	7.65	0.98	7.3
12/17e	44.7	7.9	108.8	7.85	0.96	7.5
12/18e	49.8	8.9	118.8	8.35	0.88	8.0

Note: *EPRA EPS is adjusted to exclude exceptional expenses and estimated performance fees. **56-day trading period only.

Letting progress towards targets

RGL says that it continues to see good performance in regional UK industrial and office occupancy markets and that it remains confident of its growth prospects, with active asset management underpinning income. Although occupancy (by value) was actually slightly lower at 30 September than at mid-year (82.8% versus 83.3%), subsequent lettings already agreed represent, we estimate, c 1.4% in occupancy improvement towards the 85% we target by year-end. While H217 will benefit from a full-period contribution from earlier acquisitions, the successful letting of major refurbishment projects expected to complete promises to be a significant driver of rental income growth.

Slight increase in our forecast NAV

Portfolio activity (sales/purchases) since 30 June has been relatively modest compared with earlier periods, although a recently agreed sale of a development site in Leeds is expected to release a profit of c £9.0m and generate a c 2% uplift in forecast 2018 fully diluted NAV per share. Otherwise, our estimates are unchanged. RGL notes that it continues to explore opportunities to enhance the organic growth that it expects by further, opportunistic acquisitions. We provided a sensitivity analysis of the potential impact in our October note.

Valuation: Sector-leading yield, fully covered

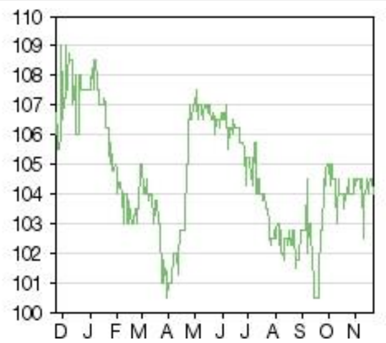
RGL's prospective dividend yield of 7.5% is the highest of all UK REITs, while its price/EPRA NAV of 0.96% sits within the middle of the range despite a strong focus on asset management with potential for capital gains. The geographic spread of its non-London portfolio, its sector and tenant diversity, and high asset yield all mitigate macroeconomic risks. The successful launch and letting of major refurbishment projects during H217/H118 is an important near-term catalyst.

21 November 2017

Price	**104p**
Market cap	**£313m**

Net debt (£m) as at 30 September 2017	313.3
Shares in issue	300.5m
Free float	80%
Code	RGL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.0	1.7	(1.9)
Rel (local)	1.7	0.7	(10.7)
52-week high/low		109.0p	100.2p

Business description

Regional REIT (RGL) owns a commercial property portfolio of predominantly offices and light industrial units located in the regional centres of the UK. It is actively managed and targets a total shareholder return of 10-15% with a strong focus on income.

Next events

Full year results	22 March 2017

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Edison profile page

Regional REIT is a research client of Edison Investment Research Limited

Company description: Regional focus

Regional REIT (RGL) is a UK-based real estate investment trust (incorporated in Guernsey) that was admitted to the premium segment of the Official List and to trading on the Main Market of the London Stock Exchange in November 2015. The shares became a constituent of the FTSE All-Share Index in March 2016 and the FTSE EPRA NARIT Index in June 2016. RGL was formed by the combination of two UK commercial property investment funds previously created by the external managers, London & Scottish Investments (LSI), the asset manager, and Toscafund Asset Management (Toscafund), the investment manager. LSI advises the RGL board on the acquisition, management and disposal of the real estate assets and is also responsible for debt funding negotiations, while Toscafund is responsible for the management functions of the company. LSI is a privately owned RGL property investment manager, established in 2012, with an experienced team that will be further strengthened by the appointment of Simon Marriott to the position of investment director, working closely with Stephen Inglis, LSI group property director, chief investment officer, and RGL board member. Through investments in UK commercial property (predominantly office and industrial property) in the main regional centres of the UK, effectively outside the M25 motorway, RGL aims to deliver an attractive total return to investors. It targets a 10-15% total return pa with a strong focus on income in addition to capital growth.

Despite some softening of UK economic growth expectations, both occupier and investment demand for regional property remain positive, especially for industrial property. In addition to the focus on regional property assets, predominantly quality offices and light industrial units, a key element of the RGL investment strategy is to acquire undermanaged and unloved properties and create value through active asset management.

Details of the trading update

RGL continued to be active in lettings during the three months to 30 September. The update provides details on a number of its asset management initiatives, which support existing income through lease renewals and re-gears, and generating additional income through new lettings. The number of new leases to new tenants exchanged since 30 June is now 22, totalling 391,459sq ft of space, and providing c £2.9m of gross rental income when fully occupied. There were also a number of re-gears completed, which provided an average 3.8% uplift in headline rents. Including those tenants who hold-over at the expiry of a lease, 70% of the headline rent has been retained at a lease event.

Measured on a rental value basis, occupancy was overall slightly lower during the period on both a headline basis (82.8% versus 83.3% at 30 June) and like-for-like basis (81.4% versus 82.0%); however, we estimate that some significant new lettings since the period end represent c 1.4% of occupancy. Our forecast for 2017 year-end occupancy remains the same at 85% and reaching 89% at year-end 2018, consistent with management's target of c 90%.

During the period under review, RGL completed two acquisitions and one disposal, and has exchanged contracts on two further sales since 30 September. The two acquisitions (Woodlands Court and Equinox North) are both freehold office buildings in the Almondsbury area of North Bristol, with an aggregate purchase value of c £11.4m and providing a net initial yield of more than 8%. Asset sales are generally directed at crystallising the value that has been created by asset management initiatives. St James House, an office building in Bath, was sold for £4.6m, 44% ahead of the December 2016 valuation, reflecting an initial yield of 5.75%. One of the recently agreed sales is 18 industrial units on the Thames Trading Estate in Irlam for £2.2m, 40% above the

December 2016 valuation, reflecting a net initial yield of 6%. The other agreed sale, for £10.5m on a subject-to-planning basis, to Unite Students, the manager and developer of student accommodation, is a development site in Leeds that was acquired as part of the Wing portfolio in 2016. RGL has said that it expects to generate a profit upon completion, probably in early 2018, of c £9m on the original acquisition price, and we would also expect a significant uplift to the current carried value of the asset. We have assumed a £6.5m realisation gain in our 2018 forecast.

The contracted rent roll ended the period at c £55.9m, an increase from c £54.6m at the last-year, substantially reflecting the net balance of acquisitions versus sales completed in the period. The portfolio value was c £651m at 30 September (30 June c £640m) with the uplift similarly reflecting investment activity, including refurbishment capex that we estimate at c £3.9m during the period and which is intended to support future rental income and property values. RGL does not undertake a quarterly revaluation of the portfolio. Gross debt was slightly increased on H117, from £331.8m to £335.4m, not reflecting the most recent agreed sales, and with the cash balance at £22.1m the net loan to value ratio was c 48.1%.

RGL continues to be in advanced discussions on replacing five of its existing debt facilities, representing c £164m of the c £296m outstanding at H117 with a new 10-year facility, and has reached agreement, subject to documentation, to refinance another. Overall, the refinancing is expected to extend average debt maturity to 6.3 years from 2.0 years and will simplify the debt structure, with no increase in costs expected by management.

We have made no changes to our EPRA earnings but have adjusted our balance sheet for both the completed and agreed transactions, assuming that the latter will complete. We have included an assumed gain on disposal of the Leeds development site as stated above, but have not assumed any material uplift versus the mid-2017 carried values in respect of the other sales. As a result of the assumed disposal gain, our fully diluted 2018 EPRA NAV per share estimate increases 2% to 118.8p from 116.6p. Our end-2018 estimated net LTV reduces to 45.5% from 46.4%.

RGL will pay a third quarterly dividend per share (DPS) of 1.80p for the three months ending 30 September 2017 on 22 December 2017 to shareholders on the register as at 24 November 2017. The ex-dividend date is 23 November 2017. This represents an increase of c 3% on the prior year DPS and is in line with RGL's intention to pay three similar quarterly dividends during the year with a fourth, potentially higher, dividend for the fourth quarter that will ensure it meets the REIT distribution requirement to pay out at least 90% of taxable income. We forecast a fourth quarter dividend of 2.45p, making a total of 7.85p for the year.

Exhibit 1: Financial summary

Year end 31 December	£000s	2015	2016	2017e	2018e
PROFIT & LOSS		IFRS	IFRS	IFRS	IFRS
Gross rental income		5,361	42,994	51,042	55,388
Non-recoverable property costs		(754)	(4,866)	(6,370)	(5,580)
Revenue		4,608	38,128	44,672	49,808
Administrative expenses (excluding performance fees)		(1,353)	(7,968)	(8,586)	(9,465)
EBITDA		3,255	30,160	36,086	40,344
Gain on disposal of investment properties		87	518	(41)	6,500
Change in fair value of investment properties		23,784	(6,751)	9,938	22,839
Operating profit before financing costs		27,126	23,927	45,982	69,683
Performance fees		0	(249)	(1,986)	(1,632)
Exceptional items		(5,296)	0	0	0
Finance income		177	193	207	120
Finance expense		(997)	(8,822)	(12,687)	(13,661)
Net movement in the fair value of derivative financial investments and impairment of goodwill		115	(1,654)	168	0
Profit Before Tax		21,124	13,395	31,684	54,510
Tax		0	23	(11)	0
Profit After Tax (FRS 3)		21,124	13,418	31,673	54,510
Adjusted for the following:					
Performance fees		0	249	1,986	1,632
Exceptional items		5,296	0	0	0
Net gain/(loss) on revaluation		(23,784)	6,751	(9,938)	(22,839)
Net movement in the fair value of derivative financial investments		(180)	865	(447)	0
Gain on disposal of investment properties		(86)	(518)	41	(6,500)
Profit before Tax (norm)		2,371	20,765	23,315	26,802
Period end number of shares (m)		274.2	274.2	300.5	300.5
Average Number of Shares Outstanding (m)		274.2	274.4	294.6	300.5
Fully diluted average number of shares outstanding (m)		274.2	274.4	294.6	300.5
IFRS EPS - fully diluted (p)		7.7	4.9	10.8	18.1
EPRA EPS - adjusted (p)		0.9	7.8	7.9	8.9
EPRA EPS		(1.1)	7.7	7.2	8.4
Dividend per share (p) - declared basis		1.00	7.65	7.85	8.35
Dividend cover		n.a.	102%	101%	107%
BALANCE SHEET					
Non-current assets		407,492	506,401	663,395	690,234
Investment properties		403,703	502,425	659,928	686,767
Other non-current assets		3,790	3,976	3,467	3,467
Current Assets		35,803	27,574	32,445	40,437
Trade and other receivables		11,848	11,375	14,039	14,573
Cash and equivalents		23,954	16,199	18,406	25,864
Current Liabilities		(21,485)	(23,285)	(34,360)	(35,317)
Trade and other payables		(12,576)	(14,601)	(20,736)	(21,218)
Bank and loan borrowings - current		(200)	0	0	0
Other current liabilities		(8,709)	(8,684)	(13,623)	(14,100)
Non-current liabilities		(126,469)	(218,955)	(334,803)	(338,661)
Bank borrowings		(126,469)	(217,442)	(296,448)	(297,686)
Zero divident preference shares (ZDP)		0	0	(37,320)	(39,940)
Other non-current libilities		0	(1,513)	(1,035)	(1,035)
Net Assets		295,341	291,735	326,677	356,693
Derivative interest rate swaps		416	1,513	963	963
EPRA net assets		295,757	293,248	327,640	357,656
IFRS NAV per share (p)		107.7	106.4	108.7	118.7
Fully diluted EPRA NAV per share (p)		107.8	106.9	108.8	118.8
LTV		-5.9%	40.6%	48.1%	45.5%
CASH FLOW					
Cash (used in)/generated from operations		(2,232)	31,434	37,794	39,136
Net finance expense		(424)	(6,626)	(8,892)	(9,683)
Tax paid		0	(1,715)	51	0
Net cash flow from operations		(2,656)	23,093	28,953	29,453
Net investment in investment properties		1,157	(99,286)	(17,990)	2,500
Acquisition of subsidiaries, net of cash acquired		26,659	(5,573)	209	0
Other investing activity		13	60	8	0
Net cash flow from investing activities		27,828	(104,799)	(17,773)	2,500
Equity dividends paid		0	(15,723)	(17,834)	(24,494)
Bank debt drawn/(repaid)		(1,217)	91,417	9,265	0
Other financing activity		0	(1,744)	(404)	0
Net cash flow from financing activity		(1,217)	73,950	(8,973)	(24,494)
Net Cash Flow		23,955	(7,756)	2,207	7,459
Opening cash		0	23,955	16,199	18,406
Closing cash		**23,955**	**16,199**	**18,406**	**25,864**
Closing debt		(126,669)	(217,442)	(333,768)	(337,626)
Closing net debt		(102,714)	(201,243)	(315,362)	(311,762)

Source: Company date, Edison Investment Research

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