EDISON

Raven Property Group

2018 results

Strong operational performance

Real estate

Against a backdrop of a strengthening Russian economy and strong warehouse demand with rising rents, Raven Property Group (Raven) delivered strong operational performance gains in 2018. Occupancy showed a strong improvement and, in rouble terms, rental, income and property values increased. Currency moves continued to negatively affect the reported financials (the rouble weakened 13% versus sterling), but much progress has been made in eliminating the mismatch between increasingly rouble-denominated rents and legacy US dollar debt.

Year end	NOI* (£m)	PAT** (£m)	EPS** (p)	DPS (p)	NAV***/ share (p)	Yield (%)	P/adj NAV (x)
12/17	129.7	43.4	6.54	4.0	59	9.6	0.71
12/18	118.3	20.0	3.12	3.0	48	7.2	0.87
Estimates under review							

Note: *NOI is net operating income. **PAT and EPS are underlying, excluding valuation movements, depreciation, share-based payments and exceptional items, and undiluted. ***NAV is fully diluted.

Occupancy and rents both up

Raven's warehouse occupancy increased from 81% to 89% over the year, and has now reached 90%. Prime rents are firming, and acquisitions are making a significant contribution to income. In rouble terms, the existing warehouse portfolio grew rental income from RUB7.2bn to RUB7.7bn and the portfolio value increased by 8%, but in sterling terms both were lower. Given the transition to a rouble operating model, the presentational currency has changed from US dollars to sterling, in line with the equity and preference capital base. As a result of this and the substantial debt repositioning, we will review our estimates in the coming days. A comparison with our FY18 US dollar forecast is difficult, but we estimate that on an FX-adjusted basis, underlying profits were slightly ahead of our expectation. A final distribution of 1.75p will be made by way of a tender offer buy back of two shares in every 51 at 45p.

Acquisitions increase gearing to market recovery

Acquisitions (two in FY18, yet to fully contribute) are a key element of Raven's strategy to mitigate the loss of income from legacy US dollar-denominated leases that mature over the next two years. These have been significantly funded by convertible preferred share issuance, while the process of migrating secured bank debt out of US dollars is well advanced, with rouble interest rate risk substantially hedged. The capital structure increases the sensitivity of basic NAV to changes in investment property values. The acquisitions appear well timed, and the market improvement is a positive indicator for future income and property values, especially if the rouble shows a more stable performance.

Valuation: Ord. shares offer yield and capital potential

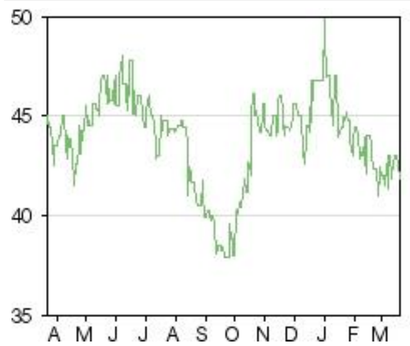
Based on the FY18 distribution, the ordinary share yield is c 7% and shareholders benefit fully from any NAV growth or narrowing of the discount to NAV/share. The preference shares (RAVP) yield 9.0% and convertible preference shares (RAVC) have a cash yield of 5.6% plus a premium at redemption.

20 March 2019

Price	**41.8p**
Market cap	**£261m**

Net debt (£m) at 31 December 2018	873.7
Shares in issue	623.6m
Free float	90.7%
Code	RAV
Primary exchange	LSE
Secondary exchanges	MOEX/JSE

Share price performance



%	1m	3m	12m
Abs	(2.9)	(6.5)	(6.3)
Rel (local)	(4.9)	(13.9)	(9.0)
52-week high/low		49.9p	37.9p

Business description

Raven Property Group (formerly Raven Russia) invests mainly in Class A warehouses in Russia let to large Russian and international companies. It also owns three office buildings in St Petersburg, a third-party logistics company in Russia (RosLogistics) and a residential development

Next events

Tender offer buy-back	Exp. May 2019

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Edison profile page

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Strong operational performance and 'rouble' transition

Economic recovery and structural growth driving demand

The Russian economy returned to growth in 2017, with GDP increasing 1.5% and the official forecast for 2018 is that the rate of growth will have increased to 2.0%. The actual growth rate may have been stronger, with preliminary data indicating growth of 2.3%. The Bank of Russia's benchmark interest rate has fallen a long way from the late 2014 high of 17%, but the decline has recently been interrupted by currency weakness and a desire to limit the inflationary impact of the VAT increase effective from the beginning of 2019. The benchmark rate is now 0.5% above its 2018 low, at 7.75%. Underlying inflation appears well controlled and despite the increase in VAT, policymakers expect the annual inflation rate to be between 5.0% and 5.5% by the end of the year and return to 4% in the first half of 2020. Supported by the stronger economy and structural growth dynamics, the warehouse market has continued to strengthen. Demand in Moscow and the Moscow region, where the majority of Raven's assets are sited, increased to a record level in 2018. With take-up of 1.6m sqm and new supply of 918k sqm, the vacancy rate reduced to c 5% and prime market rents increased. From a range of c RUB3,600–4,000 per sqm for Grade A space at the beginning of the year, the bottom end of the range has moved closer to RUB3,800 with the top of range firming above RUB4,000. Demand was strongest from retail and distribution tenants, while e-commerce is an area of strong growth. 2019 also looks positive, with preliminary estimates of demand of c 1.4m sqm and supply of c 1.0m sqm, of which less than half is speculative development. The rise in construction costs, resulting from rouble weakness feeding through to the cost of specialist imported materials, and rising labour costs, is a positive discipline on developers; if they are to maintain margins, they must build less space or increase rents.

Positive momentum in operational performance

Raven saw a strong lettings and occupancy improvement

Against this more positive economic and market background, Raven's warehouse occupancy improved considerably during the year and was 89% at end-FY18 (FY17: 81%), and has since reached 90%. Existing leases covering 253k sqm of gross lettable area (GLA) were renegotiated or extended and new lettings were 241k, including 11,800 sqm to Accord Post, 16,000 sqm to Mir Instrumenta, 16,200 sqm to Cotton Club, and 18,200 to Perspective, all in Moscow. Since year end, another 31,850 sqm of new lettings have completed, and letters of intent (LOIs) signed in respect of 79,800 sqm of vacant space and renewals and expansions. If the LOIs are signed, vacancy will reduce by a further 24,250 sqm.

Exhibit 1: Summary of 2018 lease activity

000sqm	2018	2019	2020	2021	2022-32	Total
Maturity profile at 1 January 2018	169	264	308	236	495	1,472
Acquisitions	0	4	0	0	107	111
Subtotal	169	268	308	236	602	1,583
Renegotiated & extended	(102)	(64)	(50)	0	(37)	(253)
Maturity profile of lease extensions	0	41	10	84	118	253
Vacated/terminated	(67)	(5)	(4)	0	(16)	(92)
New lettings	0	15	1	39	186	241
Maturity profile at 31 December 2018	**0**	**255**	**265**	**359**	**853**	**1,732**

Source: Raven Property Group

Vacant space at end-FY18 totalled 206,000 sqm. In addition to the maturities shown at the bottom of Exhibit 1, there are 91,600 sqm in potential lease breaks in 2019 and 199,900 sqm in 2020.

Further move towards rouble rents

At end-FY18, the share of warehouse GLA let on US dollar leases was down to 26% compared with 31% at end-FY17, while the share of rouble-denominated leases increased to 61% (end-FY17: 47%). Euro-denominated leases (3%) and vacant space (11%) accounted for the balance.

Exhibit 2: Currency warehouse exposure by area

	US dollar	Rouble	Euro	Vacant	Total
2018					
Currency exposure of warehouse space ('000 sqm)	485	1,149	50	206	1,890
% of total	26%	61%	3%	11%	100%
2017					
Currency exposure of warehouse space ('000 sqm)	551	822	50	343	1,766
% of total	31%	47%	3%	19%	100%

Source: Raven Property Group

The average rental level of the legacy US dollar-denominated leases continues to be higher than the average, such that NOI exposure to the US dollar, calculated using year-end exchange rates, was 51% (FY17: 62%).

Exhibit 3: Currency exposure of NOI

	US dollar	Rouble	Euro	Total
2018	51%	42%	7%	100%
2017	62%	32%	6%	100%

Source: Raven Property Group

The average US dollar-denominated rental level at end-FY18 was US$148 per sqm (End-FY17: US$143 per sqm), with weighted average term to maturity of 2.1 years (end-FY17: 3.0 years). The average rental level on rouble-denominated leases was RUB4,900 (end-FY17: RUB5,200) per sqm, with a weighted average term to maturity of 4.5 years (end-FY17: 3.6 years). In US dollar terms, the rouble-denominated rents are around US$75 per sqm, but benefit from minimum annual indexation of 5.9% (FY17: 6.8%).

The reduced US dollar share in NOI exposure in the year is substantially due to the increase in rouble-denominated rents resulting from increased occupancy and the significant acquisition activity of the past two years. Acquisitions are a key element of the company's strategy to mitigate the loss of income from legacy US dollar-denominated leases as these mature over the next two years. Raven says that it is continuing to see a number of new acquisition opportunities, but its current preference is to be selective, focusing on newly completed or recently let properties with the best long-term prospects for sustainable cash flow and value appreciation.

Acquisitions supporting income

Two acquisitions of Grade A warehouse complexes were completed during the year, for an aggregate consideration of RUB5.3bn, adding 123,200 sqm of space (c 7% of the opening stock), with expected annualised income of RUB580m. That takes the total acquisition investment since April 2017 to RUB14.6bn. In September 2018, Raven completed the acquisition of a c 59k sqm Grade A warehouse complex, immediately adjacent to the c 195k sqm Sever logistics park in Moscow, which it acquired in November 2017. It was acquired 78% let, with an unexpired weighted average lease term of nine years and annual rent indexation of 6%. The current annualised lease income, before indexation, was c RUB230m at acquisition, rising to an expected c RUB270m when fully let. The initial consideration was c RUB2.5bn, with RUB160.0m deferred for six to eight months.

In December 2018 Raven closed the acquisition of a completed warehouse in Nizhny Novgorod, a city 400km east of Moscow, together with 21.5ha of adjacent land. The 64,375sqm warehouse complex was acquired fully let with a weighted average unexpired lease term (WAULT) of 8.4 years.

Consideration for the acquisition was RUB2.8bn with expected annual income of c RUB350m, giving an initial yield of 13.7%.

Stripping out last year's exceptional £16.4m gain from sales of legacy UK land assets, net rental and related income (NOI) was ahead of 2017, supported by acquisitions and occupancy growth. The reduction in NOI from the existing investment portfolio reflects the movement of the average rouble/sterling exchange rate over the year, from 75.2 roubles to the pound in 2017 to 83.7 in 2018. Underlying rouble-denominated income from the existing investment portfolio increased from RUB7.2bn to RUB7.7bn. The FY18 acquisitions will contribute for a full year in FY19, which we estimate will add c RUB380m to rental income (more than £4m at the year-end exchange rate).

Exhibit 4: Net rental and related income

£m	2018	2017	
Acquisitions	18.2	8.3	119%
Existing Investment Portfolio	91.6	95.4	-4%
RosLogistics	8.1	9.6	-15%
UK land sales (Raven Mount)	0.4	16.4	-98%
Total net rental and related income	**118.3**	**129.7**	**-9%**
Average rouble/sterling	83.7	75.2	

Source: Raven Property Group

FX movements mask operational progress

Exhibit 5 shows a summary of the FY18 income statement, on a reported and underlying basis, as well as a comparison with FY17. The FY18 results (with an FY17 restatement) are reported for the first time in sterling rather than US dollars. Sterling has been and remains the functional currency of the group, but the presentation currency has switched from US dollars to sterling, matching the denomination of the equity capital and preference capital base, and in recognition of the declining significance of US dollars in terms of group revenues and borrowings. At the level of the investment property owning subsidiaries, the functional currencies are all now rouble, having previously included some US dollar denominations, and the group financial statements are translated into sterling at the group level at the appropriate rates.

The improved operational performance described above is obscured by the non-repeat of the £16.4m FY17 exceptional land sales gains as well as a negative swing year-on-year of £8.6m in unrealised foreign exchange movements. Adjusting for these two factors, on a comparable basis, the FY18 underlying profit before tax would have been £28.7m (actual £26.2m) compared with £33.4m in FY17 (actual £55.9m). Higher staff incentive payments in respect of the 2017 performance and a full year interest cost on the 2017 issue of convertible preference shares are the main factors contributing to the decline. In calculating underling earnings, the most significant adjustment to IFRS earnings is the movement in unrealised revaluation on property assets. In FY17 this was a positive £28.2m but in FY18 was a negative £121.0m. In roubles, the property valuation increased by 8%, reflecting an unchanged range of valuation yields of 11–12.5% on the year. The sterling loss reflects the movement in the period-end rouble/sterling exchange rate, from 77.9 at end-FY17 to 88.3 at end-FY18. Although market demand-supply dynamics have improved and rents are firming, the valuations have been set amid a slow year for the Russian commercial property investment market, with the volume of transactions falling by c 40%. Raven expects yields to be driven by interest rates and the strength of investor appetite for the time being, with the potential to adjust downwards if rents begin to grow, reflecting the potential for rental growth from under-rented leases expiring.

Exhibit 5: Summary of income statement

	FY18			FY17			FY18/FY17
£m unless stated otherwise	**Underlying**	**Adj.**	**Reported IFRS**	**Underlying**	**Adj.**	**Reported IFRS**	**Underlying**
Net rental and related income	118.3	0.0	118.3	129.7	0.0	129.7	-9%
Administrative expenses	(22.7)	(2.4)	(25.2)	(19.7)	(2.4)	(22.1)	16%
Share based payments and other long term incentives	0.0	(2.9)	(2.9)	(1.3)	(2.3)	(3.5)	
Share of profit of joint ventures	1.6		1.6	1.6		1.6	
Operating profit before FX losses and property valuation movements	**97.2**	**(5.3)**	**91.9**	**110.4**	**(4.7)**	**105.7**	**-12%**
FX losses	(2.5)		(2.5)	6.1		6.1	
Property revaluation movements	0.0	(121.0)	(121.0)		28.2	28.2	
Operating profit	**94.7**	**(126.3)**	**(31.6)**	**116.5**	**23.6**	**140.1**	**-19%**
Net finance expense	(68.5)	(14.8)	(83.3)	(60.6)	(11.1)	(71.7)	13%
Profit before tax	**26.2**	**(141.1)**	**(114.9)**	**55.9**	**12.4**	**68.3**	**-53%**
Tax	(6.2)	0.4	(5.8)	(12.5)	(12.7)	(25.2)	
Profit after tax	**20.0**	**(140.7)**	**(120.7)**	**43.4**	**(0.2)**	**43.1**	**-54%**
Basic IFRS EPS (p)			(18.81)			6.50	
Diluted IFRS EPS (p)			(18.81)			6.27	
Basic underlying EPS (p)	3.12			6.54			-53%
Diluted underlying EPS (p)	3.08			5.68			-46%
Distribution per share (p)	3.00		3.00	4.00		4.00	-25%

Source: Raven Property Group

Given the change in presentational currency, it is difficult to make a direct comparison with our previously published forecasts in US dollars. However, we note that our FY18 adjusted PBT forecast of US$26.7m excluding forecast FX impacts was US$35.4mm, based on 88% year-end occupancy. Translated into sterling at the year average US$/sterling rate of 1.33 this is £26.6m compared with the FX adjusted £28.7m reported.

Balance sheet and cash flow

Period-end cash was £73.5m, providing resources for further accretive acquisitions.

Significant progress was made during the year in migrating the secured debt facilities out of US dollars and into roubles and euros, to better match the evolving income profile and de-risking cash flows. Raven has also invested £19m in rouble interest rate hedging, capping the rouble cost of debt at 8.25% for periods of five to seven years. Around 84% of the end-FY18 secured bank debt was hedged.

At end-FY18 US dollar debt had reduced to 34% of total secured debt excluding unamortised loan arrangement costs and accrued interest of £643m from 92% at end-FY17 (rouble debt 31% and euro debt 35%) and management expects that much of the remaining US dollar debt will be gone by the end of the current year. By using a blend of rouble and euro debt, Raven has limited the impact on the average cost of secured debt, which increased from 7.62% at end-FY17 to 7.69% at end-FY18. The average term to maturity was 4.0 years. The gross secured debt, making no allowance for cash, represented 54.7% of the investment portfolio value at end-FY18.

In addition to the secured debt, Raven is funded by sterling-denominated, fixed-rate, unsecured preference (£109.3m nominal value) and convertible preference shares (£99.6m nominal excluding own held shares). The capital structure makes basic NAV per share quite sensitive to movements in the portfolio value. The improvement in the Russian economy and warehouse market, if translated into further property valuation gains, not offset by FX moves, has the potential to be quite material. We estimate that a 1% increase in portfolio value would increase basic NAV per share by c 4%.

For an investor, the ordinary shares provide full exposure to distributions and NAV per share movements. For distributions, the convertible preference shares rank ahead of other share classes, and the cumulative 6.5% preferential dividend on the subscription amount of 100p represents a cash yield of 5.6% on the current price of 115.5p. They are redeemable by the company on 26 July 2026 at 1.35p, and can be converted into ordinary shares at the holder's request at any time prior to redemption, currently at a rate of 1.617 (equivalent to c 71p per ordinary share at the current price), a premium of c 67%.

The (non-convertible) preference shares earn a cumulative 12% dividend on the fixed issue amount per share of 100p, ranking ahead of the ordinary shares. At a current price of 134p, the yield is 9.0%.

Exhibit 6: Financial summary

Period ending 31 December. (£m)	2017	2018
INCOME STATEMENT	**IFRS**	**IFRS**
Gross revenue	177.0	162.6
Property operating expenditure & cost of sales	(47.3)	(44.4)
Net rental and related income	129.7	118.3
Administrative expenses	(22.1)	(25.2)
Share based payments and other long term incentives	(3.5)	(2.9)
FX gains/(losses)	6.1	(2.5)
Share of profit of joint ventures	1.6	1.6
Operating profit/(loss) before realised/unrealised property gains (EBIT)	111.8	89.4
Realised/unrealised gains on investment property	28.2	(121.0)
Operating profit	140.1	(31.6)
Net finance expense	(71.7)	(83.3)
Profit before tax	68.3	(114.9)
Tax	(25.2)	(5.8)
Profit after tax	43.1	(120.7)
Company underlying earnings	43.4	20.0
Basic IFRS EPS (p)	6.50	(18.81)
Fully diluted IFRS EPS (p)	6.27	(18.81)
Basic company underlying EPS(p)	6.54	3.12
Fully diluted company underlying EPS(p)	5.68	3.08
Distributions per ordinary share (p)	4.00	3.00
Period end number of shares exc own held (m)	655.4	608.9
Average number of shares (m) - basic	663.5	641.6
Average number of shares (m) - fully diluted	936.4	641.6
BALANCE SHEET		
Investment property	1,159.2	1,175.4
Other non-current assets	74.7	102.6
Total non-current assets	1,233.9	1,278.0
Cash & equivalents	197.1	73.5
Other current assets	59.0	44.4
Total current assets	256.2	117.8
Total assets	1,490.1	1,395.8
Interest bearing loans & borrowings	78.9	75.6
Other current liabilities	79.5	66.2
Total current liabilities	158.3	141.8
Interest bearing loans & borrowings	547.4	567.9
Preference shares	1,082.6	1,092.7
Convertible preference shares	198.9	206.1
Other non-current liabilities	-889.0	-908.2
Total non-current liabilities	939.9	958.4
Total liabilities	1,098.2	1,100.2
Net assets (and shareholders' equity)	391.8	295.6
IFRS NAV per share (p)	60	48
Fully diluted IFRS NAV per share (p)	59	48
CASH FLOW		
Net cash generated from operating activity	98.0	96.1
Payments for investment property under construction	0.0	0.0
Acquisition of subsidiary undertakings, net of cash acquired	(65.7)	(32.6)
Other investing activity	(88.4)	(39.6)
Net cash generated from investing activity	(154.0)	(72.2)
Bank borrowing costs paid	(49.5)	(50.0)
Ordinary dividends paid in cash	0.0	0.0
Preference/convertible preference share dividends paid	(21.0)	(24.0)
Net own shares (acquired)/disposed	(11.3)	(28.3)
Issue of preference/convertible preference shares	97.8	0.0
Debt drawn/(repaid)	78.8	(20.8)
Other investing activity	(0.3)	(16.7)
Cash flow from financing activity	94.5	(139.8)
Change in cash	38.5	(115.9)
Opening cash	160.6	197.1
FX/other	(2.0)	(7.7)
Closing cash	197.1	73.5
Debt	(933)	(959)
Net (debt)/cash	(736.2)	(885.3)

Source: Raven Property Group

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