Regional REIT

Significant proposed growth and funding

Acquisition and capital raising

Real estate

We have previously commented on the fact that regional commercial property markets, especially for industrial and office properties, have remained firm despite Brexit uncertainties. Steady occupier demand, combined with a general tightness of supply, is supporting rental growth in many areas. Against this background, Regional REIT (RGL) continues to see a wide range of acquisition and asset enhancement opportunities, which meet its investment criteria, giving rise to a strong pipeline of capital deployment opportunities. RGL has conditionally agreed the acquisition of two portfolios and is seeking to raise up to £100m gross from the issue of new shares.

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	0.96	1.0
12/16	38.1	7.8	106.9	7.65	0.96	7.4

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

Significant acquisition pipeline

In its recent Q3 trading update, RGL reiterated that it was continuing to explore specific acquisition opportunities to further grow the business and enhance income and earnings. It has now reached conditional agreement to acquire two real estate portfolios representing an aggregate investment of £93.4m and with an expected net initial yield of 8.6%. This is a significant potential increase in its existing portfolio, valued at c £651m at 30 September 2017. To finance its plans it has proposed a capital increase seeking to raise gross proceeds of up to £100m (£97m net of expenses). The capital increase proposes the issue of up to approximately 99m new shares, a c 32% increase on the existing number of shares. It is conditional on, among other things, certain resolutions being passed at an EGM, which is expected to take place on 19 December 2017. The new shares are to be issued at an offer price of 101p, slightly below the closing price on 4 December of 103.5p and the fully diluted EPRA NAV per share of 107.3 as at 30 June 2017.

Raising capital for funding

It is proposed that c £50 will be raised from the issue of new ordinary shares in a firm placing and up to a further £50m by way of a placing, open offer and offer for subscription. The firm placing has already been carried out by way of an accelerated book building and, subject to certain resolutions being passed at the extraordinary EGM to be held on 19 December 2017, will see the issue of c 49.5m new shares. The placing, open offer and offer for subscription will see up to a further 49.5m shares issued and shareholders qualifying for the open offer will be able to subscribe for new shares on the basis of one new ordinary share for every eight existing shares held. Full details can be found in the prospectus available on the company website, www.regionalreit.com. Our forecasts are suspended pending completion of the transaction.

6 December 2017

Price	**103.0p**
Market cap	**£310m**

Net debt (£m) 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	(1.2)	0.5	(5.3)
Rel (local)	1.9	0.9	(13.7)
52-week high/low		108.5p	100.0p

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

Q4 dividend announcement and portfolio valuation	22 February 2018
Publication of 2017 results	22 March 2018

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Summary of the acquisitions and use of proceeds

RGL says that it continues to see a wide range of acquisition and development opportunities that meet its investment criteria, giving rise to a strong pipeline of capital deployment opportunities. These include the following:

- Up to £45.8m (including acquisition costs) to finance the agreed acquisitions, which RGL describes as the First New Portfolio Acquisition. This a portfolio of three office properties located in Woking, Cheshunt, and Edinburgh with 25 lettable units and 18 individual tenants. The properties are 88% let (by area) on a weighted average lease term (WAULT) of 6.4 years with 3.3 years to first break. The contracted rent roll is £3.6m and the portfolio has been valued at £43.5m, reflecting a yield of 8%.
- Up to £4.9m to finance a pipeline investment, which is in advanced negotiations and which RGL expects to complete in March 2018. This is an office property in Portsmouth which, combined with the First New Portfolio Acquisition, would result in a portfolio of 26 lettable units and 19 individual tenants, occupied 90% by area. RGL estimates the combined rent roll at £4.0m, reflecting a yield of 8.1% on a WAULT of 6.6 years (3.4 years to first break).
- Up to £47.6m to finance the Second New Portfolio Acquisition comprising 17 office properties with 210 lettable units and 136 individual tenants. The properties are 75% let (by area) with a WAULT of 3.1 years or 2.1 years to first break. The contracted rent roll is £4.2m and the portfolio has been valued at £44.8m, reflecting a yield of 9.2%.

The potential acquisitions listed above are significant in terms of the current portfolio, which has already grown strongly since IPO. As at 30 September 2017 the portfolio comprised 151 properties, with 1,113 units and 838 tenants, an aggregate value of c £651m and a contracted rental income of c £55.9m pa.

In addition, approximately £4.0m of the capital raise proceeds will be absorbed by the costs of the previously announced refinancing of certain of the group's debt facilities. With its Q3 trading update RGL confirmed that discussions were at an advanced stage 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. It said that the refinancing is expected to extend average debt maturity to 6.3 years from 2.0 years and it will also simplify the debt structure. The total cost of the refinanced debt is expected to be 3.3-3.4% fixed.

RGL intends to put in place a £19.4m debt facility as soon as possible following completion of the First New Portfolio Acquisition, of which £17.4m will be in respect of the assets acquired and £2.0m to part-finance the pipeline investment. Terms have been agreed at a cost of Libor plus 2.0%.

A second new debt facility is planned on completion of the Second New Portfolio Acquisition, for which a fixed cost of 2.15% has been agreed.

Exhibit 1: Historical financial summary

Year end 31 December	£'000s	2015	2016	H117
PROFIT & LOSS		**IFRS**	**IFRS**	**IFRS**
Gross rental income		5,361	42,994	22,964
Non-recoverable property costs		(754)	(4,866)	(3,480)
Revenue		4,608	38,128	19,484
Administrative expenses (excluding performance fees)		(1,353)	(7,968)	(4,261)
EBITDA		3,255	30,160	15,223
Gain on disposal of investment properties		87	518	(41)
Change in fair value of investment properties		23,784	(6,751)	7,504
Operating profit before financing costs		27,126	23,927	22,686
Performance fees		0	(249)	(905)
Exceptional items		(5,296)	0	0
Finance income		177	193	107
Finance expense		(997)	(8,822)	(5,872)
Net movement in the fair value of derivative financial investments and impairment of goodwill		115	(1,654)	168
Profit Before Tax		21,124	13,395	16,184
Tax		0	23	(11)
Profit After Tax (FRS 3)		21,124	13,418	16,173
Adjusted for the following:				
Performance fees		0	249	905
Exceptional items		5,296	0	0
Net gain/(loss) on revaluation		(23,784)	6,751	(22,839)
Net movement in the fair value of derivative financial investments		(180)	865	(447)
Gain on disposal of investment properties		(86)	(518)	41
Profit before Tax (norm)		2,371	20,765	(-6,167)
Period end number of shares (m)		274.2	274.2	300.5
Average Number of Shares Outstanding (m)		274.2	274.4	288.5
Fully diluted average number of shares outstanding (m)		274.2	274.4	300.5
IFRS EPS - fully diluted (p)		7.7	4.9	5.6
EPRA EPS - adjusted (p)		0.9	7.8	3.2
EPRA EPS		(1.1)	7.7	2.9
Dividend per share (p) - declared basis		1.00	7.65	3.60
Dividend cover		N/A	102%	88%
BALANCE SHEET				
Non-current assets		407,492	506,401	643,872
Investment properties		403,703	502,425	640,405
Other non-current assets		3,790	3,976	3,467
Current Assets		35,803	27,574	46,871
Trade and other receivables		11,848	11,375	14,642
Cash and equivalents		23,954	16,199	32,229
Current Liabilities		(21,485)	(23,285)	(36,271)
Trade and other payables		(12,576)	(14,601)	(24,529)
Bank and loan borrowings - current		(200)	0	(400)
Other current liabilities		(8,709)	(8,684)	(11,342)
Non-current liabilities		(126,469)	(218,955)	(332,474)
Bank borrowings		(126,469)	(217,442)	(295,429)
Zero dividend preference shares (ZDP)		0	0	(36,010)
Other non-current liabilities		0	(1,513)	(1,035)
Net Assets		295,341	291,735	321,998
Derivative interest rate swaps		416	1,513	963
EPRA net assets		295,757	293,248	322,961
IFRS NAV per share (p)		107.7	106.4	107.1
Fully diluted EPRA NAV per share (p)		107.8	106.9	107.3
LTV		-5.9%	40.6%	47.3%
CASH FLOW				
Cash (used in)/generated from operations		(2,232)	31,434	18,921
Net finance expense		(424)	(6,626)	(4,106)
Tax paid		0	(1,715)	51
Net cash flow from operations		(2,656)	23,093	14,866
Net investment in investment properties		1,157	(99,286)	(900)
Acquisition of subsidiaries, net of cash acquired		26,659	(5,573)	209
Other investing activity		13	60	8
Net cash flow from investing activities		27,828	(104,799)	(683)
Equity dividends paid		0	(15,723)	(7,014)
Bank debt drawn/(repaid)		(1,217)	91,417	9,265
Other financing activity		0	(1,744)	(404)
Net cash flow from financing activity		(1,217)	73,950	1,847
Net Cash Flow		23,955	(7,756)	16,030
Opening cash		0	23,955	16,199
Closing cash		23,955	16,199	32,229
Closing debt		(126,669)	(217,442)	(331,839)
Closing net debt		(102,714)	(201,243)	(299,610)

Source: Company accounts, Edison Investment Research

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