EDISON

Raven Russia

Property acquisition

Growing into an improving market

Real estate

Raven has announced a second significant acquisition for the current year, a large, modern Grade A warehouse complex north of Moscow. The acquisition (maximum consideration c $120m) is initially funded from Raven's existing strong cash position and immediately enhances earnings with the potential for further upside from lettings and higher rents. With the Russian economy continuing to improve, and occupier demand running well in excess of falling new warehouse supply, management comments that it feels increasingly like the bottom of the market. The company remains well positioned for additional accretive acquisitions.

Year end	NOI* ($m)	PAT** ($m)	EPS** (c)	DPS (p)	Adj NAV***/ share (p)	Yield (%)	P/adj NAV (x)
12/15	174.1	54.6	7.94	2.0	55	3.8	0.95
12/16	151.7	47.1	6.81	2.5	52	4.8	1.00
12/17e	145.3	32.0	4.69	2.0	57	3.8	0.92
12/18e	158.6	39.5	5.50	2.0	59	3.8	0.88

Note: *NOI is net operating income. **PAT and EPS (fully diluted) are underlying, excluding valuation movements, depreciation, share-based payments and exceptional items. ***NAV is underlying and fully diluted, excluding goodwill, deferred tax on valuation gains, fair value movements on derivative contracts and cumulative FX movements on preference shares. EPS and NAV assume convertible preference share conversion.

Accretive expansion

With c 195ksqm of lettable space, constructed in stages over 2014-17, the agreed acquisition adds another large, modern warehouse facility to Raven's portfolio. It is being acquired at below replacement cost and at the current 73% occupancy has annualised income of RUB616m ($10.4m). It immediately enhances our fully diluted adjusted EPS by c 8% on a full-year basis. Completion is expected in early December. The consideration includes an initial payment of c $87m with deferred consideration, dependent on letting progress, taking the total to c $112-120m. The full occupancy yield is 11.38% and the reversionary yield is 12.51%.

Significant further acquisition potential

We estimate that current cash resources, geared at a 60% LTV, could potentially fund more than $300m in additional asset acquisitions. At an 11% yield, this aggregate investment, on a full-year basis, could increase our revised FY18 base case estimate for earnings and free cash flow by a further one-third. This provides a useful offset to pressure on existing portfolio income should the market recovery stall and rents fail to recover over the medium term.

Valuation: Improving prospects for ordinary shares

The ordinary shares offer a prospective 3.8% yield, with the potential for distributions to increase materially with acquisitions as well as a market recovery. The ordinary shares would also benefit fully from any NAV growth or narrowing of the 8% discount to FY17e NAV/share. The preference (RUSP) and convertible preference (RUSC) shares yield 8.1% and 5.2%, respectively.

7 November 2017

Price	**52.0p**
Market cap	**£344m**

US$1.31/£, RUB59/$

Net debt ($m) at 30 June 2017	883.5
Shares in issue	660.6m
Free float	91%
Code	RUS
Primary exchange	LSE
Secondary exchange	TISEA

Share price performance

%	1m	3m	12m
Abs	9.5	6.7	33.3
Rel (local)	8.7	5.6	16.8
52-week high/low		55.0p	37.0p

Business description

Raven Russia (RUS) 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 company in the UK (Raven Mount).

Next events

FY17 year end	31 December 2017
Publication of FY17 results	March 2018

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Raven Russia is a research client of Edison Investment Research Limited

Company background

Raven was founded and admitted to AIM in 2005, with the intention of building a portfolio of Class A Russian warehouse assets through acquisition and development. It became self-managed in 2008. The ordinary shares (RUS) and warrants (RUSW) issued in 2009 moved to the main market of the LSE in 2010, followed by the preference shares (RUSP) in 2011. In 2016, Raven issued a first tranche (109m) of convertible preference shares, followed by a second tranche (90m shares) in July 2017. These shares trade on the official list of the International Stock Exchange Authority Limited (TISEA). At 30 June 2017, the investment portfolio comprised c 1.6m sqm of predominantly logistics warehouse property (c 70% in the Moscow region), let 79% to mainly large Russian or international companies, providing strong tenant covenants. Group subsidiaries include Raven Mount, a UK residential development company, and RosLogistics, a third-party logistics business in Russia.

Russia has a low density of warehouse space, which suggests plenty of room for growth. However, the Russian recession through 2015-16 coincided with cyclical pick-up in new building and saw vacancies increase and rents fall. Market conditions have since improved, with the US$/rouble rate relatively stable, oil prices improving, inflation and interest rates declining, and economic recovery taking hold. Against this background, demand/supply conditions in the warehouse are improving, with declining new supply and good levels of occupier demand for logistics warehouse space. Raven has a strongly liquid balance sheet, ending H117 with a cash balance of $108m, to which it added $102m with the July issue of convertible preference shares, and seeks acquisitions to take advantage of market recovery.

Earnings-enhancing acquisition

Following on from the April 2017 acquisition of a three-asset portfolio (a warehouse and two offices in St Petersburg) for $86.6m, management indicated with the interim results that it hoped to complete a second significant acquisition in the Moscow region before year-end, continuing the investment of proceeds from recent convertible preference share issues. Through one of its operating subsidiaries, it has now conditionally agreed the acquisition of a logistics park in the Moscow region. The property consists of a modern Grade A warehouse complex, built in stages between 2014 and 2017, to the north of Moscow centre. The property is large, with a gross lettable floor area (GLA) of 195,132sqm, similar to Raven's existing properties at Pushkino (c 214,000sqm), Noginsk (204,000sqm) and Istra (206,000sqm), and adds c 18% to Raven's Moscow warehouse GLA and c 12% to overall portfolio GLA. It is currently 73% let to a number of local and international tenants including OBI (Germany-based international DIY retailer), O'KEY Retail Group (large Russian food retailer), Major Logistics Group (Moscow-based logistics services provider), Miratorg (leading Russian meat producer and supplier) and R-Pharm (one of Russia's largest pharmaceuticals producers). Leases are denominated in roubles and the current annualised income is RUB616m ($10.4m) with a current weighted average lease term of four years. Rental income rises to RUB886m ($15.0m) on a fully let ERV basis.

The property is to be acquired from a Russian incorporated company (Industrialniy Park "Sever" Limited Liability Company) for an initial consideration of RUB5.119bn (or a US dollar equivalent of $86.58m using the RUB59.1/$ exchange rate implied in the announcement). Additionally, deferred consideration of between RUB1.51bn ($25.5m) and RUB1.97bn ($33.3m) is due within 18 months of completion, with payments dependent upon and triggered by progress in letting vacant space. The total consideration is equivalent to RUB34,000-36,300 ($600-625) per sqm, which we believe is below replacement cost, including build costs at RUB25,000-30,000 ($400-500) per sqm and land costs at RUB2,000-4,000 ($35-70) per sqm. Raven expects a full occupancy yield of 11.38% on the maximum consideration, with a reversionary yield of 12.51%.

Raven is acquiring the property with cash, although discussions over partial debt funding have commenced. This would boost the return on equity from the acquisition and free up resources for additional investment. Given the increasing share of rouble-denominated rents within Raven's portfolio, we would expect Raven to diversify its existing US dollar-denominated debt funding into roubles as Russian inflation and interest rates reduce. Official lending rates were reduced by a further 25bp on 27 October to 8.25%, but with the central bank forecasting inflation at c 3.0% by year-end there is scope for further reductions.

The acquisition agreement is expected to complete in early December, conditional upon the satisfaction of certain escrow arrangements.

Financials

We have adjusted our estimates, assuming that the agreed transaction completes as planned. The spread between the immediate yield on the assets to be acquired and the loss of interest on the cash invested has a positive impact on our forecast for adjusted earnings. Adjusted earnings after tax increases by just over 11% on a full-year basis in 2018, while the increase in fully diluted adjusted EPS, from a higher base, is c 8%. For now, we have made no changes to our forecast distributions per share, which we raised following the interim results.

Exhibit 1: Estimate revisions

	NOI ($m)			Adj net profit ($m)*			Adj fully diluted EPS ($c)*			Distributions/share (p)			Adj fully diluted NAV/share (p)**		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
2017e	144.4	145.3	0.6%	31.6	32.0	1.2%	4.63	4.69	1.3%	2.0	2.0	0.0%	56	57	0.9%
2018e	148.0	158.6	7.1%	35.6	39.5	11.1%	5.09	5.50	8.1%	2.0	2.0	0.0%	58	59	1.4%

Source: Edison Investment Research. Note: adjusted net profit and EPS are underlying, excluding valuation movements, depreciation, share-based payments and exceptional items. **NAV is underlying and fully diluted, excluding goodwill, deferred tax on valuation gains, fair value movements on derivative contracts and cumulative FX movements on preference shares. EPS and NAV assume convertible preference share conversion.

We have conservatively assumed only the current annualised rental income on the newly acquired assets at this stage, making no assumptions about the potential for occupancy improvement or rent reversion and will reassess this, along with the existing portfolio, with future earnings releases. We do not anticipate any impact on recurring administrative costs and only an insignificant one-off expense in relation to transaction-related professional fees. Our existing forecasts assume a c 5% rouble-based return on cash assets and our interest income forecast is reduced accordingly. We have allowed for an $87.78m initial payment at completion (assumed 1 December, with a one-month impact on the current year) and have assumed payment of the minimum deferred consideration in three equal instalments over the following 18 months (with the effect that c $105m of the minimum total consideration of c $112m is reflected in our published forecasts to end-2018). If letting progress is made, then our income forecasts are likely to rise to more than compensate for the additional deferred consideration that may be triggered.

We have not assumed any new debt funding in our forecasts, but even without this our forecast end-2018 cash balance, adjusted to take account of deferred consideration, remains a little above $100m.

Significant additional acquisition upside remains

In the note that we published after the interim results, we explored in depth the potential upside to our base case forecasts from the deployment of cash balances in the acquisition of yielding investment properties. We update that analysis below, taking account of the Sever acquisition and its impact on our forecasts.

Our starting point remains our revised estimate for end-2018 cash, adjusted for the remaining deferred consideration on the Sever acquisition at that time, and assumes a gearing of both the Sever acquisition and the cash acquisitions made in April 2017. We would not expect management to commit all of the available cash resources to investment and assume that it will continue to prudently hold c $100m. Allowing for this, we estimated that post-completion of the Sever acquisition Raven will still have capacity to invest c $128m over the next 18 months, most likely in further initially un-geared acquisitions, which are then geared to recycle equity into further projects. Assuming a 60% LTV again this implies a remaining potential for cash-generating asset additions of more than $300m.

Exhibit 2: Potential for asset acquisition

	FY18e
FY18 forecast cash and equivalents	109,214
Remaining deferred consideration (Sever)	(8,600)
Add cash released from re-gearing April acquisitions/Sever acquisition	128.000
Adjusted FY18 cash	228,614
Assumed cash reserve	100,000
Cash available for investment	**128,614**
Assumed gearing/LTV	60%
Potential asset purchases	**321,535**

Source: Edison Investment Research

The additional potential upside to our base case forecasts remains substantial as we show in Exhibit 3. Noting that JLL recently put prime yields in the Moscow warehouse market at 11-12.5% (*Russian Warehouse Markets*, dated 26 July 2017), we show the outcome based on a range of property yields. We assume no significant acquisition or additional administrative costs and have applied a 7.8% interest cost to additional borrowings, similar to the existing average cost of secured debt – although management hopes to be able to lower this.

Exhibit 3: Potential accretion from asset acquisitions

Forecast earnings	**2018e**		
Underlying earnings – basic	39,491		
Underlying earnings (fully diluted basis)	55,805		
Total net operating income after interest	38,967		
Add back convertible preference dividend	16,314		
Total net operating income after interest (adj. for conv. pref. div.)	55,281		
Potential acquisition impact (full year basis)		**2018e**	
Potential asset investment	321,535	321,535	321,535
Assumed net initial yield	10%	11%	12%
Additional NOI	32,153	35,369	38,584
Interest income adjustment	-16,545	-16,545	-16,545
Net earnings uplift	15,608	18,823	22,039
Tax	25%	25%	25%
Net earnings uplift	11,706	14,118	16,529
Adjusted earnings			
Underlying earnings – basic	51,197	53,608	56,020
Underlying earnings (fully diluted basis)	67,511	69,922	72,334
Total net operating income after interest	50,673	53,084	55,496
Total net operating income after interest (adj. for conv. pref. div.)	66,987	69,398	71,810
Potential accretion to base case forecast			
Underlying earnings – basic	**30%**	**36%**	**42%**
Underlying earnings (fully diluted basis)	**21%**	**25%**	**30%**
Total net operating income after interest	**30%**	**36%**	**42%**
Total net operating income after interest (adj. for conv. pref. div.)	**21%**	**26%**	**30%**

Source: Edison Investment Research

On this basis, full deployment of resources in the way described (at an 11% net initial yield) has the potential to lift underlying earnings and net operating income after interest costs by an additional 36%, compared with our revised FY18 base case forecast. On a fully diluted basis (allowing for preference share conversion) the increases, from a higher base, are 25% and 26%, respectively. In both cases, the percentages are the same in per-share terms. To the extent that market conditions continue to improve, as management anticipates, this would be a strong contributor to earnings growth. Alternatively, should market conditions remain weak for an extended period, it is a useful offset to medium-term NOI attrition, which is likely on the current portfolio as rents gradually revert to the lower levels recently established. Full reversion of warehouse portfolio rents to current market levels would require several years with no market improvement, which seems an unlikely scenario but would represent an eventual reduction in NOI of $35-40m pa.

Valuation

With the company well placed to benefit from a stabilising economy, the potential for cash flow and distributions will continue to be the underlying driver of investment in Raven. Over the longer term we believe there is room for valuation yields (c 11-12.5%) in the Russian market to decline, but there is no immediate prospect of any material shift.

Based on our distribution per share forecast of 2p, the prospective yield on the ordinary shares is 3.8%. The Sever acquisition is accretive to earnings and cash flow without assuming the occupancy and rental income improvements that management expects. Although we have not revised our distribution forecast at this stage, earnings cover is improved and the positive potential from further acquisitions is material. As noted above, a full deployment of cash resources on cash-generative acquisitions has the potential to further lift cash flow (net operating income after interest) substantially above the revised forecast levels. At an 11% net initial yield on acquisitions, net operating income after interest and after a full deduction for annual debt amortisation (estimated $30m) would still leave distributable cash per share of more than 3p pa. This would represent a potential yield on the ordinary shares in excess of 6%, with the ability to benefit fully from any growth in NAV or discount narrowing.

Giving up some of the potential for upside benefit in return for a higher yield, an investment in Raven may also be made through non-convertible or convertible preferred shares.

The convertible preference shares (RUSC) rank ahead of other share classes in terms of dividend payments and receive a cumulative 6.5% preferential dividend on the subscription amount of 100p; a yield of 5.2% on the current price of 124p. The convertible preference shares can be converted into ordinary shares at any time up to July 2026, currently at a rate of 1.759 (equivalent to 70.5p per ordinary share at the current price). The (non-convertible) preference shares (RUSP) 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 148p, the yield is 8.1%.

Exhibit 4: Financial summary

Key financial data (US$000s)					
PROFIT & LOSS	**2014**	**2015**	**2016**	**2017e**	**2018e**
Gross revenue	257,596	219,704	195,294	195,172	210,032
Property operating expenditure & cost of sales	(65,288)	(45,581)	(43,553)	(49,914)	(51,454)
Net rental and related income	192,308	174,123	151,741	145,258	158,578
Administrative expenses	(34,630)	(30,494)	(25,344)	(26,781)	(27,178)
Share based payments and other long term incentives	(2,354)	(3,594)	(9,077)	(3,726)	(3,000)
FX losses	(15,471)	1,223	18,079	4,911	0
Share of profit of joint ventures	955	2,518	1,780	785	1,000
Operating profit/(loss) before realised/unrealised property gains (EBIT)	140,808	143,776	137,179	120,447	129,400
Realised/unrealised gains on investment property	(145,404)	(256,548)	(39,517)	11,613	0
Operating profit	(4,596)	(112,772)	97,662	132,060	129,400
Net finance expense	(93,448)	(92,284)	(75,416)	(93,449)	(95,448)
Charge on preference share conversion	0	0	0	0	0
Profit before tax	(98,044)	(205,056)	22,246	38,611	33,952
Tax	9,855	12,697	(14,527)	(22,281)	(13,164)
Profit after tax	(88,189)	(192,359)	7,719	16,330	20,789
Company underlying earnings	66,652	54,559	47,122	32,000	39,491
Reported EPS - fully diluted (c)	(11.83)	(27.99)	1.16	2.38	3.08
Company underlying EPS - fully diluted (c)	8.94	7.94	6.81	4.69	5.50
Distributions per ordinary share (p)	6.00	2.00	2.50	2.00	2.00
Period end number of shares exc own held (m)	688.5	644.1	661.5	654.8	654.8
Average number of shares (m) - basic	715.0	666.8	657.3	665.8	654.8
Average number of shares (m) - fully diluted	745.5	687.2	667.7	685.7	675.5
BALANCE SHEET					
Investment property	1,593,684	1,333,987	1,300,643	1,521,034	1,524,034
Other non-current assets	151,840	96,735	92,097	95,932	95,932
Total non-current assets	1,745,524	1,430,722	1,392,740	1,616,966	1,619,966
Cash & equivalents	171,383	202,291	198,621	137,743	109,214
Other current assets	54,444	51,878	53,798	59,498	59,498
Total current assets	225,827	254,169	252,419	197,241	168,712
Total assets	1,971,351	1,684,891	1,645,159	1,814,207	1,788,678
Interest bearing loans & borrowings	55,252	104,724	40,787	50,000	50,000
Other current liabilities	86,215	55,481	66,351	103,567	86,367
Total current liabilities	141,467	160,205	107,138	153,567	136,367
Interest bearing loans & borrowings	837,429	814,021	699,038	657,476	627,476
Preference shares	164,300	156,556	131,703	139,181	139,181
Convertible preference shares	0	0	119,859	270,016	284,016
Other non-current liabilities	130,866	89,066	87,195	96,162	96,162
Total non-current liabilities	1,132,595	1,059,643	1,037,795	1,162,835	1,146,835
Total liabilities	1,274,062	1,219,848	1,144,933	1,316,402	1,283,202
Net assets (and shareholders' equity)	697,289	465,043	500,226	497,806	505,476
NAV adjustments					
Goodwill	(7,806)	(5,134)	(6,187)	(6,504)	(6,504)
Deferred tax on revaluation gains	55,250	0	0	0	0
Cumulative FX loss on preference shares	13,955	4,956	(20,362)	(13,606)	(13,606)
Fair value of derivatives	(5,322)	(5,159)	(5,041)	(3,941)	(3,941)
Adjusted NAV	753,366	459,706	468,636	473,755	481,425
Fully diluted NAV per share (c)	110	72	71	72	74
Adjusted fully diluted NAV (c)	106	70	68	74	77
Fully diluted NAV per share (p)	85	55	55	56	57
Adjusted fully diluted NAV (p)	81	54	52	57	59
CASH FLOW					
Net cash generated from operating activity	168,794	136,151	118,012	131,955	103,215
Payments for investment property under construction	(105,582)	(20,028)	(9,163)	(121,745)	(3,000)
Acquisition of subsidiary undertakings, net of cash acquired	(12,873)	0	0	(84,214)	0
Other investing activity	19,561	32,895	8,171	4,962	4,988
Net cash generated from investing activity	(98,894)	12,867	(992)	(200,997)	1,988
Bank borrowing costs paid	(70,979)	(69,465)	(66,808)	(61,155)	(54,598)
Ordinary dividends paid in cash	0	0	0	0	(16,118)
Preference/convertible preference share dividends paid	(18,225)	(17,156)	(19,437)	(28,128)	(33,016)
Net own shares (acquired)/disposed	(68,928)	(41,906)	6,624	(14,512)	0
Issue of preference/convertible preference shares	0	0	128,327	133,049	0
Debt drawn/(repaid)	89,447	23,157	(164,493)	(32,343)	(30,000)
Other investing activity	(3,086)	(4,930)	(4,972)	3,734	0
Cash flow from financing activity	(71,771)	(110,300)	(120,759)	645	(133,732)
Change in cash	(1,871)	38,718	(3,739)	(68,397)	(28,529)
Opening cash	201,324	171,383	202,291	198,621	137,744
FX/other	(28,073)	(7,812)	69	7,520	0
Closing cash	171,383	202,291	198,621	137,744	109,215
Debt	(1,056,981)	(1,075,301)	(991,387)	(1,116,673)	(1,100,673)
Net (debt)/cash	(885,598)	(873,010)	(792,766)	(978,928)	(991,458)

Source: Company data, Edison Investment Research

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