EDISON

Regional REIT

Completion of acquisitions

Asset growth and refinancing completed

Real estate

RGL's acquisition of two property portfolios, first announced in early December, for an aggregate consideration of £93.4m including costs, completed just before Christmas. This followed the closing of a capital issue that raised £73m (gross) in new equity at 101p per share. The group has also completed a major refinancing programme, simplifying the debt structure and extending maturity, at no additional cost. We reinstate our estimates, including the acquisitions, which add immediately to earnings, and the capital increase. We also take a slightly more cautious approach to 2018 and have trimmed our previously above consensus position.

Year end	Net rental income (£m)	EPRA EPS* (p)	EPRA NAV/ share (p)	DPS (p)	P/EPRA NAV (x)	Yield (%)
12/16	38.1	7.8	106.9	7.65	0.95	7.6
12/17e	44.7	7.9	104.4	7.85	0.97	7.8
12/18e	56.3	8.4	112.2	8.05	0.90	8.0
12/19e	59.2	9.1	117.9	8.25	0.86	8.2

Note: *EPRA EPS is adjusted to exclude exceptional expenses and estimated performance fees.

Further portfolio growth and diversification

The two portfolios acquired are significant in scale and bring an immediate £7.8m uplift to the gross contracted rent roll (end-September 2017: £55.9m), offer significant asset management potential, and further diversify the portfolio. RGL estimates an ungeared 8.6% net initial yield off an overall 87% occupancy, with a reversionary yield above 10%. We have also assumed that the additional "pipeline investment", an office property in Portsmouth included in the December announcement, proceeds to completion by end Q118, adding a further £400k to gross rent roll for a £4.9m investment.

Acquisition benefit offset by underlying revision

Assuming no uplift from asset management, the acquisitions have a broadly neutral impact on FY18e EPRA EPS. The refinancing significantly extends the debt profile (from 2.5 years to 6.2 years) with no material impact on cost. While the demand-supply balance in regional commercial property remains generally positive, we sense some caution among tenants regarding making longer-term commitments amid continuing Brexit uncertainty. We now assume a slower rate of occupancy improvement, reducing our above consensus estimates accordingly: FY18e EPRA EPS by 5%, EPRA NAV per share by 6%, and DPS by 4%. More positively, our forecast end-FY18 net LTV reduces to 44.1% from 45.5%, moving closer to management's preferred medium-term level of around 40%.

Valuation: Sector-leading yield, fully covered

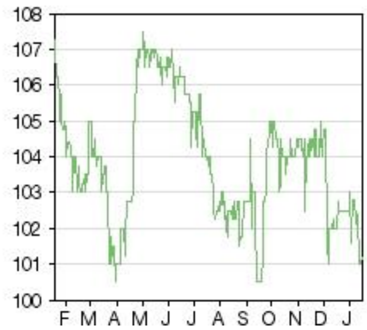
RGL's prospective dividend yield of 7.8% is the highest of all UK REITs, while its price/EPRA NAV sits within the middle of the range despite a strong focus on asset management and the potential for capital gains. The geographic spread of its non-London portfolio, its sector and tenant diversity, and high asset yield all mitigate macroeconomic risks.

16 January 2018

Price	**101.2p**
Market cap	**£377m**

Net debt (£m) at 30 September 2017	313.3
Shares in issue	372.8m
Free float	97%
Code	RGL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.2)	(2.4)	(5.2)
Rel (local)	(5.8)	(5.3)	(11.7)
52-week high/low		107.2p	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 DPS/valuation announcement	22 February 2018
Full year results	22 March 2018

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Forecasts reinstated

We temporarily suspended our estimates during the capital raise in December but are now able to reinstate these, including adjustment for the acquisitions, share issuance and refinancing. Looked at in isolation, these have a broadly neutral impact on FY18e EPS and slightly reduce EPRA NAV per share (largely as a result of property acquisition costs), while reducing LTV. We have also taken the opportunity to review our underlying forecast for FY18, and introduce an FY19 forecast for the first time. While occupier demand for regional property appears to be robust, and new supply continues to be constrained, we sense that amid ongoing macroeconomic uncertainty, particularly related to Brexit, some tenants are cautious with respect to entering into long-term commitments. While H217 will benefit from a full-period contribution from earlier acquisitions, and with the successful letting of major refurbishment projects representing a significant driver of rental income growth, we have taken a slightly more cautious view as to the pace at which occupancy may increase over the next 12 months. Not reflected in our forecasts is the possibility of additional acquisition-led growth.

The impact is to reduce our underlying (pre-acquisition) FY18e net rental income by c 3% with a somewhat more geared impact on adjusted EPRA EPS (-5%). Our revised estimates continue to show 7% growth in EPS versus FY17 and 3% growth in DPS, with cover increasing to 105%. Our newly introduced FY19 forecast assumes a continuation of recent trends, with EPS, DPS and dividend cover increasing further.

Exhibit 1: Forecast revisions

	Net rental income (£m)			EPRA EPS* (p)			EPRA NAV (p)			DPS (p)		
	New	Old	% chg.	New	Old	% chg.	New	Old	% chg.	New	Old	% chg.
12/17e	44.7	44.7	0%	7.9	7.9	0%	104.4	108.8	-4%	7.85	7.85	0%
12/18e	56.3	49.8	13%	8.4	8.9	-5%	112.2	118.8	-6%	8.05	8.35	-4%
12/18e	59.2	N/A	N/A	9.1	N/A	N/A	117.9	N/A	N/A	8.25	N/A	N/A

Source: Edison Investment Research. Note: *EPRA EPS is adjusted to exclude exceptional expenses and estimated performance fees.

The two portfolios acquired consist of 20 properties, all UK regional offices with a relatively high weighting to the south-east. They came too late in FY17 to have any impact on rental income but are included in our revised FY18 forecast from the beginning of the year. These add £7.8m in gross rental income, to which we add an additional £400k from end-Q118, assuming completion of the pipeline asset, an office property in Portsmouth.

We have included the new £19.4m debt facility in respect of the First New Portfolio acquired (the office properties in Woking, Cheshunt and Edinburgh) that management has indicated it intends to put in place soon after completion. This will be provided by RBS at 2% above Libor, with £2.0m of the proceeds directed towards the acquisition of the Portsmouth pipeline property. We have not yet included the additional new facility that management expects to agree in respect of the Second New Portfolio acquired, with Santander, at a fixed rate of 2.15%. To add this to our forecasts at this stage would create an unlikely cash drag on earnings as we have not assumed any ongoing acquisition activity.

The end-FY17 NAV is negatively affected by the estimated £5.1m costs of acquisition (reflected in the net revaluation line of the P&L) related to the two portfolios as well as by the costs related to the refinancing that management has guided to. Reflecting our slightly more cautious assumptions for operational improvement in FY18, we have slightly reduced our projected revaluation gain. The net effect of all of the changes that we have made is to increase FY18e investment property assets by c 14%, adjusted earnings by c 17% and EPRA net assets by c 17%. The capital raising saw 77.3m new shares issued at 101p, taking the total number of outstanding shares to 372.8m.

Gross debt as at 30 September was £335.4m. Of the total, the zero dividend preference (ZDP) shares acquired with the Conygar acquisition represent c £36m. These carry a yield of 6.5% until their maturity in January 2019. Of the remaining c £300m in bank debt, a £47.8m secured facility with Santander, due to mature in December 2018, was refinanced in November 2017 with a new five-year secured Santander facility. On 12 December, the larger refinancing of five secured facilities with a new £165m secured 10-year facility was completed. The new facility with Scottish Widows and Aviva Real Estate Finance was arranged by RBS. The fixed rate on the new facility will be set at drawdown and will be between 3.3% and 3.4%. The average maturity of all of the group's debt facilities increases from 2.5 years to 6.2 years as a result of the refinancing with no significant impact on the cost of debt, which remains at c 3.80% on average.

Exhibit 2: Financial summary

Year end 31 December	£000s	2015	2016	2017e	2018e	2019e
PROFIT & LOSS		**IFRS**	**IFRS**	**IFRS**	**IFRS**	**IFRS**
Gross rental income		5,361	42,994	51,042	62,844	65,506
Non-recoverable property costs		(754)	(4,866)	(6,370)	(6,569)	(6,348)
Revenue		4,608	38,128	44,672	56,276	59,159
Administrative expenses (excluding performance fees)		(1,353)	(7,968)	(8,557)	(10,702)	(10,965)
EBITDA		3,255	30,160	36,115	45,573	48,194
Gain on disposal of investment properties		87	518	(41)	6,500	0
Change in fair value of investment properties		23,784	(6,751)	4,838	22,410	15,709
Operating profit before financing costs		27,126	23,927	40,912	74,483	63,903
Performance fees		0	(249)	(1,986)	(1,632)	0
Exceptional items		(5,296)	0	0	0	0
Finance income		177	193	207	120	123
Finance expense		(997)	(8,822)	(15,328)	(14,263)	(14,304)
Net movement in the fair value of derivative financial investments and impairment of goodwill		115	(1,654)	168	0	0
Profit Before Tax		21,124	13,395	23,972	58,708	49,721
Tax		0	23	(11)	0	0
Profit After Tax (FRS 3)		21,124	13,418	23,961	58,708	49,721
Adjusted for the following:						
Performance fees		0	249	1,986	1,632	0
Exceptional items		5,296	0	0	0	0
Net gain/(loss) on revaluation		(23,784)	6,751	(4,838)	(22,410)	(15,709)
Net movement in the fair value of derivative financial investments		(180)	865	(447)	0	0
Gain on disposal of investment properties		(86)	(518)	41	(6,500)	0
Profit before Tax (norm)		2,371	20,765	20,703	31,430	34,013
Period end number of shares (m)		274.2	274.2	372.8	372.8	372.8
Average Number of Shares Outstanding (m)		274.2	274.4	294.5	372.8	372.8
Fully diluted average number of shares outstanding (m)		274.2	274.4	294.5	372.8	372.8
IFRS EPS - fully diluted (p)		7.7	4.9	8.1	15.7	13.3
EPRA EPS - adjusted (p)		0.9	7.8	7.9	8.4	9.1
EPRA EPS (p)		(1.1)	7.7	6.4	8.0	9.1
Dividend per share (p) - declared basis		1.00	7.65	7.85	8.05	8.25
Dividend cover		N/A	102%	100%	105%	111%
BALANCE SHEET						
Non-current assets		407,492	506,401	751,696	783,005	806,714
Investment properties		403,703	502,425	748,229	779,538	803,247
Other non-current assets		3,790	3,976	3,467	3,467	3,467
Current Assets		35,803	27,574	25,814	32,479	34,505
Trade and other receivables		11,848	11,375	14,039	16,455	17,042
Cash and equivalents		23,954	16,199	11,775	16,024	17,464
Current Liabilities		(21,485)	(23,285)	(34,360)	(39,632)	(40,158)
Trade and other payables		(12,576)	(14,601)	(20,736)	(23,853)	(23,858)
Bank and loan borrowings - current		(200)	0	0	0	0
Other current liabilities		(8,709)	(8,684)	(13,623)	(15,779)	(16,300)
Non-current liabilities		(126,469)	(218,955)	(354,184)	(358,004)	(361,824)
Bank borrowings		(126,469)	(217,442)	(315,829)	(317,029)	(318,229)
Zero dividedn preference shares (ZDP)		0	0	(37,320)	(39,940)	(42,560)
Other non-current liabilities		0	(1,513)	(1,035)	(1,035)	(1,035)
Net Assets		295,341	291,735	388,966	417,848	439,237
Derivative interest rate swaps		416	1,513	963	963	961
EPRA net assets		295,757	293,248	389,929	418,811	440,198
IFRS NAV per share (p)		107.7	106.4	104.3	112.1	117.8
Fully diluted EPRA NAV per share (p)		107.8	106.9	104.4	112.2	117.9
LTV		-5.9%	40.6%	46.1%	44.1%	42.6%
CASH FLOW						
Cash (used in)/generated from operations		(2,232)	31,434	37,823	46,798	48,136
Net finance expense		(424)	(6,626)	(9,052)	(10,323)	(10,361)
Tax paid		0	(1,715)	51	0	0
Net cash flow from operations		(2,656)	23,093	28,822	36,475	37,774
Net investment in investment properties		1,157	(99,286)	(111,390)	(2,400)	(8,000)
Acquisition of subsidiaries, net of cash acquired		26,659	(5,573)	209	0	0
Other investing activity		13	60	8	0	0
Net cash flow from investing activities		27,828	(104,799)	(111,173)	(2,400)	(8,000)
Equity dividends paid		0	(15,723)	(17,834)	(29,826)	(28,334)
Bank debt drawn/(repaid)		(1,217)	91,417	28,665	0	0
Other financing activity		0	(1,744)	67,096	0	0
Net cash flow from financing activity		(1,217)	73,950	77,927	(29,826)	(28,334)
Net Cash Flow		23,955	(7,756)	(4,424)	4,249	1,440
Opening cash		0	23,955	16,199	11,775	16,024
Closing cash		23,955	16,199	11,775	16,024	17,464
Closing debt		(126,669)	(217,442)	(353,149)	(356,969)	(360,789)
Closing net debt		(102,714)	(201,243)	(341,374)	(340,945)	(343,325)

Source: Regional REIT accounts, Edison Investment Research

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