Supermarket Income REIT

Initiation of coverage

Visible, long-term income growth

Real estate

Supermarket Income REIT (SUPR) recently delivered its first set of annual results since listing in July 2017. Capital was deployed rapidly, in a disciplined manner that targets flexible, future-proof assets (all with online fulfilment capability), let on long leases with upwards-only, RPI-linked rent reviews. The 5.5p DPS target was achieved, with income earnings fully covering dividend payments. A full-year contribution from the assets acquired, and indexation of rents, should drive significant progress in the current year.

Consensus estimates

Year end	Revenue (£m)	EPRA EPS* (p)	EPRA NAV/ share (p)	DPS (p)	P/NAV (x)	Yield (%)
06/18	8.9	3.8	96	5.50	1.06	5.4
06/19e	16.3	5.5	100	5.60	1.01	5.5
06/20e	17.2	5.9	106	5.75	0.95	5.7

Source: Supermarket Income REIT data, Thomson Reuters, consensus data calculated from Stifel and Goodbody estimates. Note: *EPRA EPS is normalised, excluding gains on revaluation.

IPO targets met and solid base for growth

SUPR acquired five assets during the year, and a sixth acquisition completed post-year-end takes the total invested to £317m (before acquisition costs), with an annualised rent roll of £16.3m. The proceeds from equity issuance, including £100m from the IPO and £85m from the two follow-on equity raises, were invested rapidly, allowing SUPR to meet its full-year DPS target of 5.5p while fully covering dividends paid in the year. Valuations increased by 4.1% (5.5p per share), primarily reflecting 3.6% average rent indexation, and partly offset portfolio acquisition and IPO costs. Year-end EPRA NAV was 96p. Rent indexation should support income growth and, assuming no change in yields, valuations further in the current year. SUPR is targeting a 3.2% increase in the quarterly dividend from January 2019.

Visible income and growth potential

SUPR is building a diversified portfolio of UK supermarket assets, with long leases and upwards only RPI-linked rents, and high quality tenant covenants. It selectively targets only omnichannel stores (in-store and online fulfilment), in strong locations, with asset management potential. The investment adviser, Atrato Capital, brings a very high level of experience and knowledge of the sector, and its principals have been involved in more than £4.0bn of supermarket transactions over the past decade. The investment advisor believes that secure, long income, supermarket property leases, with index linked rent can, currently, be acquired at attractive investment yields, and that real estate investors are undervaluing the inflation protection characteristics embedded in supermarket leases when compared to other comparable inflation-linked products.

Valuation: Attractive visible yield potential

SUPR offers a prospective FY19 dividend yield of 5.5%, ahead of the c 4.6% sector median, with visible potential for growth. A comparison with a narrower group of long income-focused REITs shows SUPR to offer an above-average yield with a similar P/NAV (page 9).

2 October 2018

Price	**102p**
Market cap	**£187m**
Net debt (£m) at 30 June 2018	85.7
Net LTV as at 30 June 2018	32.4%
Shares in issue	184.4m
Free float	99.7%
Code	SUPR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.5	1.0	4.3
Rel (local)	1.8	1.7	3.2
52-week high/low		104p	99p

Business description

Supermarket Income REIT, listed on the special funds segment of the London Stock Exchange, invests in supermarket property, let to leading UK supermarket operators, on long, RPI-linked leases. The investment objective is to provide an attractive level of income, with the potential for capital growth, with a 7–10% pa total shareholder return target over the medium term.

Next events

Q1 DPS declared	October 2018
Interim results	February 2019

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Edison profile page

Supermarket Income REIT is a research client of Edison Investment Research Limited

EDISON

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The long indexed-linked leases that SUPR targets provide a high degree of visibility to contractual income streams, and strong income returns for supermarket property have underpinned a long record of positive total returns, making this a relatively low risk segment of the UK commercial property market.

UK consumer spending on grocery products has grown each year since 1999, and is forecast by IGD Retail Analysis to grow by a further 15% over the next five years. The supermarket sector has been through a period of intense competition but the incumbent ‘big four’ operators (Tesco, Sainsbury’s, Asda and Morrisons), which SUPR expects will continue to represent the majority of its tenant base, have retained a dominant market share (c 70%) and have recently experienced an improving trend in sales and margins, reflected in share price outperformance of the broader market. The investment adviser believes that their ability to protect market share is in part due to the underlying nature of their store portfolios, which also underpins their online strategies. As incumbents, they tend to have the largest sites in some of the best locations, around which they have built a network of omichannel stores, combining traditional supermarkets (still the dominant channel by far, and growing) with online (with a c 6% share but the fastest-growing channel). As it targets a sustainable and growing income stream, SUPR only invests in omnichannel stores, which the investment adviser estimates account for 74% of all online grocery fulfilment.

Including the acquisition completed in July, the investment portfolio now comprises six supermarket assets, each combining in-store and online fulfilment, with a value of c £317m. The annualised rent roll is c £16.3m and each of the leases is RPI-linked with a weighted average unexpired lease term of more than 19 years. SUPR continues to see opportunities in the market to further grow the portfolio while meeting its investment objectives.

The company has an independent board of non-executive directors and has appointed Atrato Capital as investment adviser.

The investment adviser: Atrato Capital

The external investment adviser appointed by the board is Atrato Capital, established in 2016 by Ben Green and Steve Windsor (biographies on page 12). The Atrato management team brings a very high level of experience and knowledge of the UK real estate sector, having advised on, structured and executed more than £4.0bn of supermarket transactions over the past decade. This sector knowledge and the strength of Atrato’s industry contacts have been key factors behind the fast deployment of investment capital. The fees paid to the investment adviser are on a sliding scale, from 0.95% of net assets up to £500m and reducing to 0.45% of net assets above £1.5bn, and compare favourably with the peer group average, especially for higher NAV levels. The fee is payable 75% in cash and 25% in shares with a 12-month lock-up.

Supermarket real estate

Long, indexed income

Supermarket lease agreements are often long-dated (typically 20–30 years at inception without break options), fully repairing and insuring, and subject to upwards-only rent review linked to inflation. Such lease terms, provide a high degree of visibility to contractual income streams, and strong income returns for supermarket property have underpinned a long record of positive total returns, making this a relatively low risk segment of the UK commercial property market. The investment advisor believes that secure, long income, supermarket property leases, with index linked rent can, currently, be acquired at attractive investment yields, and that real estate investors are undervaluing the inflation protection characteristics embedded in supermarket leases when compared to other comparable inflation-linked products. With UK index-linked gilts trading at negative real yields since 2013, the investment manager believes that the implied risk premium attached to large supermarket group tenants has the potential to narrow in line with improved operator performance.

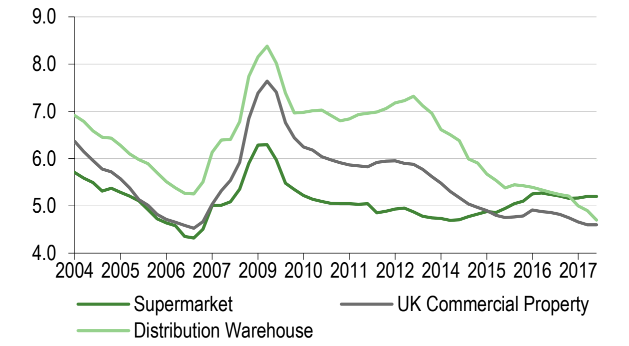
The operator market

UK consumer spending on grocery products has grown each year since 1999 and is forecast by IGD Retail Analysis to grow by a further 15% over the next five years, from £190bn in 2018 to £218bn in 2023. According to IGD, hypermarket and supermarket stores account for c 55% of sales, and although sales are expected to grow, it is convenience and discount formats – and above all for online sales – that are expected to show the fastest five-year growth. Although growing strongly, online sales are currently only c 6% of the total, with consumers showing a preference for selecting fresh produce in person. The majority of online grocery orders are fulfilled from within supermarkets (the investment adviser estimates 74%) rather than dedicated online fulfilment centres, with the major operators operating a network of omnichannel stores, combining traditional supermarkets (still the dominant channel by far, and growing) with online (the fastest-growing channel). Around 90% of Tesco fulfilment is from supermarket stores, and it is five years since the last of their six online-only fulfilment centres was built. The investment adviser believes that because of the capex required, dedicated online-only facilities are only really viable in areas of high population density, such as London, which are under-serviced by supermarket space relative to the rest of the country. Outside of London, existing, relatively larger, full-range stores, in close proximity to population centres makes the omnichannel store model well suited for fulfilling ‘the last mile’ of online grocery distribution.

The sector has been fiercely competitive for many years and remains so. Low-price operators such as Aldi and Lidl have experienced strong sales growth, driven by new store openings and price competition, primarily taking market share from the smaller independent operators. The ‘big four’ (Tesco, Asda, Sainsbury’s and Morrisons) still have a combined share of c 70%, and together operate more than 9,000 stores. The investment adviser believes that their ability to protect market share is in part due to the underlying nature of their store portfolios. As incumbents, they tend to have the largest sites in some of the best locations.

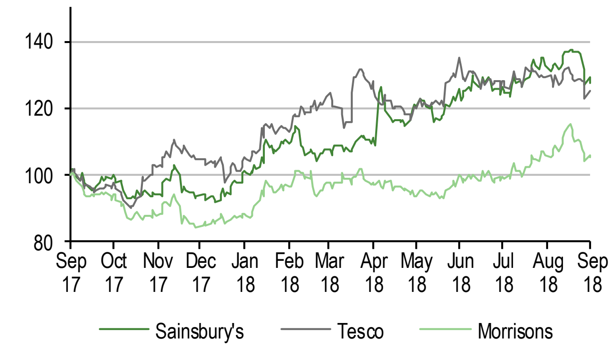
Supermarket property has historically been priced at yields below UK all-property sector; however, this has not been the case since c 2015 (see Exhibit 1). Supermarket property yields have increased in recent years, even as the broader UK commercial property market and the distribution warehouse subsector has seen yields decline. The period of yield widening for supermarket property corresponded to a period of intense competition among the supermarket operators, against a background of continuing growth in online retail and its transformational impact on traditional retail distribution.

Exhibit 1: Supermarket property net initial yields



Source: SUPR, MSCI

Exhibit 2: Relative share price performance*



Source: Thomson Datastream as at 25 September 2018. Note: *Relative to FTSE 100 Index.

A more positive trading environment has recently been evident, with the big four showing improved sales trends and margins as they have focused more closely on customer service, diversification of product offering and cost structures. This has been reflected both in positive credit rating changes and improved share price performance. Relative to the FTSE 100 Index, the share prices of Tesco and Sainsbury's have increased by more than 25% over the past 12 months and that of Morrisons by c 5%.

The investment manager believes that Sainsbury's proposed acquisition of Asda, currently the subject of a Competition and Markets Authority enquiry, is a positive development, and that consolidation within the operator sector has the potential to further support tenant covenants. It does not anticipate any competition issues with its Sainsbury's Ashford store, and given that Sainsbury's and Asda will continue to target a different customer segment, the combined group is expected to retain stores from both brands wherever possible.

Noting the improving performance of the main supermarket operators, the investment manager believes that supermarket property yields offer value and have the potential to tighten (property values increase) relative to other property classes.

Positive demand–supply conditions in the investment market

One element of the strategic refocus of the big four operators has been a slowdown in large store expansion plans and a consolidation in store numbers, with an effective end to sale and leaseback transactions and a decline in the number of assets being offered to the investment market. Tesco became a net buyer of stores in 2015 and for the first time in many years, there were no new sale and leaseback transactions in 2016 across the market as a whole. Accounting changes (IFRS 16) have encouraged this trend of operator repurchases, often making it advantageous for operators to strengthen their balance sheets by repurchasing property assets and reducing lease commitments. At the same time, some institutional owners of property assets have become more willing sellers, sometimes as a result of more onerous regulatory capital rules that reduce the attraction of their investing in real estate assets, and sometimes as part of an effort to reduce retail property exposure more broadly. Colliers International estimates that investment demand for supermarket assets grew by 18% in 2017, to £1.4bn, driven by operators' store repurchases and financial investment demand, including overseas investors, perhaps encouraged by the weakness of sterling, and domestic investors, including SUPR. The investment adviser expects this positive investment market to continue, providing scope for yields to tighten and valuations outpace rental growth.

SUPR has a selective investment policy

SUPR plans to continue building a diversified portfolio of mainly freehold and long leasehold operational properties, let to UK supermarket operators, and likely to benefit from long-term growing income streams with high-quality tenant covenants. The investment adviser estimates that from a pool of c £20bn of supermarket properties that are not owned directly by operators, c £10bn meet SUPR's strict selection criteria aimed at assets that can deliver sustainable value in a shifting retail environment. SUPR believes that a portfolio value of c £1bn is a reasonable objective over the long term, or a c 10% share of its target asset pool, compared with c £320m currently. The key elements of SUPR's investment policy are:

- A focus on **long unexpired lease terms**, typically more than 15 years to first break (currently over 19 years), with **index-linked or fixed rental uplifts** to provide income visibility and inflation protection.
- SUPR targets **institutional grade tenants** with multi-billion pound revenues and strong consumer brands. As a result, it expects that the majority of its tenants will continue to consist of the big four supermarket operators, Tesco, Sainsbury's, Asda and Morrisons, as is the case today, although it will also invest in assets let to other operators and retailers where these meet its investment criteria and objectives.
- The portfolio will **be geographically diversified** across UK cities, towns, and regions, and will also include different-sized assets, ranging from larger convenience store formats through to large superstore formats, likely to appeal to a range of different consumer types.
- SUPR targets assets that the investment adviser believes may benefit from future **asset management opportunities** and which may offer good potential for alternative use over the longer term.

Capital rapidly deployed in growing portfolio

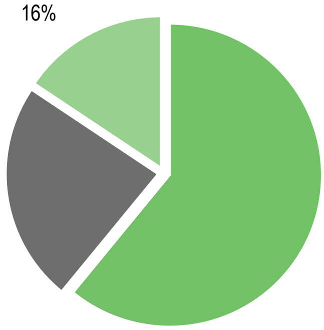
SUPR was able to deploy capital rapidly during FY18, while adhering to its strict investment criteria, and minimising cash drag so as to be able to meet its targets for dividends and dividend cover. The investment adviser's strong knowledge of the sector and extensive industry contacts were key to achieving this, and all of the acquisitions to date have been off-market transactions. The proceeds from equity issuance, including £100m from the IPO and £85m from the two follow-on equity raises, were invested, alongside leverage, within four weeks or less. Capital deployment, including debt, was achieved in six weeks or less.

A total of five supermarket assets, each combining in-store and online fulfilment, were acquired during the year, and a sixth asset was acquired soon after year-end. The five assets owned at 30 June 2018 were valued at £265m, a 4.1% increase on the aggregate acquisition price (before acquisition costs), with an annualised passing rent of £13.6m, and weighted average unexpired lease term (WAULT) of 19 years. The valuation reflected a net initial yield of 4.9%. The post year-end acquisition of Morrisons, Hillsborough for £51.7m took the annualised passing rent to £16.3m.

Exhibit 3: Portfolio summary as at 30 June 2018	
Number of assets*	5
Valuation	£265m
Valuation yield	4.9%
Valuation increase over acquisition price	4.1%
WAULT**	19 years
Annualised passing rent***	£13.6m
Rent reviews	All RPI linked
Average rent increase in period	3.6%

Source: Source: SUPR. Note: *Sixth asset acquired post year-end. **WAULT = weighted average unexpired lease term. ***Annualised passing rent £16.3m including sixth asset.

Exhibit 4: Tenant mix (by income)*



Source: SUPR data. Note: *Includes Morrisons, Hillsborough acquired post end-FY18.

All of the acquired assets are subject to RPI-linked rent reviews, in most cases annually, but in the case of Morrisons, Hillsborough, every five years. A summary of the current portfolio is shown in Exhibit 5.

Exhibit 5: Portfolio overview

Tenant	Tesco	Tesco	Sainsbury's	Tesco	Tesco	Morrisons*
Location	Thetford, Norwich	Lime Trees, Bristol	Ashford, Kent	Cumbernauld, North Lanarkshire	Gallagher Retail Park, Scunthorpe	Hillsborough, Sheffield
Acquisition date	August 2017	August 2017	August 2017	December 2017	May 2018	July 2018
Purchase price	£43.2m	£28.5m	£79.8m	£50.0m	£53.0m	£51.7m
Valuation at 30 June 2018	£43.8m	£29.1m	£83.4m	£54.5m	£54.1m	N/A
Passing rent	£2.56m	£1.53m	£3.82m	£2.94m	£2.88m	£2.54m
Size (sq ft)	78,000	55,000	125,000	117,000	98,000	113,000
Rent review basis	Annual RPI	Annual RPI	Annual RPI	Annual RPI	Annual RPI	5 yearly RPI
Lease expiry	December 2029	March 2031	September 2038	August 2040	August 2040	October 2039
Tenure	Virtual freehold**	Virtual freehold	Freehold	Virtual freehold	Virtual freehold	Virtual freehold

Source: SUPR. Note: *Acquired post FY18 year-end. **Virtual freehold represents a very long freehold, typically longer than 999 years, or a lease containing a purchase option for a nominal sum at expiry.

SUPR has developed comprehensive plans for potential asset management projects across all of its sites, aimed at increasing cash yields and, where appropriate, development gains from selective larger projects. Many of the initiatives are relatively small-scale changes and improvements to buildings, requiring limited additional capital spending and/or planning approval, such as investing in green energy schemes that help tenants in meeting their strategic objectives in areas such as sustainability targets. Larger schemes are likely to include repurposing of peripheral space, such as underutilised car parking space, to provide new customer offerings or facilities, potentially enhancing footfall and generating additional income, while enabling the supermarket operators to maximise the value of their buildings.

Many of the potential projects are long term, although the investment adviser expects to proceed with the first larger repurposing schemes over the next couple of years, expecting to invest less than £10m on additional pre-let space to generate a return on development cost of 10-15%.

Debt funding at attractive margins

SUPR will utilise debt in order to enhance returns and target a loan to value ratio (LTV) of 30–40% over the medium term. To part-fund acquisitions, it arranged a £100m revolving credit facility with HSBC in August 2017. The facility has a three-year term with two one-year extension options and pays interest at 1.6% over three-month Libor. To protect against the possibility of interest rate increases, £65m has been hedged with SUPR’s exposure to increases in Libor, on the £65m of hedged debt, capped at a maximum Libor of 1.75% (c 0.80% currently). Above Libor, 1.75% the cost of the hedged amount of debt is effectively fixed at 3.35%. The end-FY18 LTV was 32.4% and SUPR had significant headroom on its debt covenants with an LTV threshold of 60% and 200% interest cover ratio for each asset in the portfolio. The investment adviser calculated that as at 30 June 2018, SUPR could afford to suffer a 30% fall in property values before breaching its LTV covenants and, including its hedging arrangements, had significant interest cover headroom.

Since year-end, SUPR has broadened its banking relationships, adding a £52.1m five-year secured facility with Bayerische Landesbank, at a competitive cost of 1.25% above three-month Libor, secured against the new Morrisons supermarket in Sheffield and the Sainsbury's supermarket in Ashford. The Libor exposure has been fixed at 1.3% for the five years.

Including this facility and taking account of the recent acquisition, net LTV is currently c 43% and the average cost of debt is c 2.4%.

Financial results summary and outlook

In its first year of trading post-IPO in July 2017, SUPR moved quickly to establish its initial portfolio and a stream of rental income capable of delivering on its dividend targets.

Exhibit 6: Summary of FY18

£000s	2018	H118	H218
Total rental income	**8,942**	**3,151**	5,791
Administrative and other expenses	(2,097)	(965)	(1,132)
Operating profit before investment property change in fair value	**6,845**	**2,186**	**4,659**
Net finance expense	(1,917)	(649)	(1,268)
EPRA earnings before tax	**4,928**	**1,537**	**3,391**
Tax	(227)	(231)	4
EPRA earnings after tax	**4,701**	**1,306**	**3,395**
Change in fair value of investment properties	(4,081)	(4,859)	778
IFRS earnings	**620**	**(3,553)**	**4,173**
Basic and diluted IFRS EPS (p)	0.50		
EPRA and diluted EPS (p)	3.78		
DPS (p)	5.50		
Dividend cover*	1.03		
Investment properties	**264,900**		
Net assets	**176,746**		
EPRA NAV per share (p)	96		
Net debt	(85,860)		
LTV	32.4%		

Source: SUPR. Note: *Dividend cover calculated as EPRA earnings/dividends paid.

- Rental income of £8.9m during the year is yet to reflect the contracted annualised passing rent, £13.7m at year-end but increased to £16.3m with the acquisition of Morrisons, Hillsborough, Sheffield in July.
- Administrative costs of £2.1m included c £260k of non-recurring costs related to the IPO. Recurring costs of c £1.8m comprise investment management fees of c £1.1m and other corporate costs. On an underlying basis, the EPRA cost ratio was 20.5% and the company expects this to fall towards 16% as the existing assets fully contribute.
- Net finance expense followed the drawing of debt to part-finance asset growth. At year-end, £88.8m of the £100m revolving credit facility had been drawn, and post year-end a new £52.1m loan was entered into in July 2018.
- Earnings on an EPRA basis (with IPO costs included) were £4.7m or 3.78p per average share outstanding. IFRS earnings of £0.6m (or 0.50p per share) included a net negative revaluation movement of £4.1m. The small tax charge during the year relates to the period between IPO and entering the REIT regime upon establishing the required portfolio.

- The net revaluation movement included a positive movement in property valuations of £10.4m, c 4.1% of the aggregate acquisition price (before acquisition costs). This was primarily driven by the 3.6% average increase in rents in the period (c £7.0m) and a positive yield shift (c £3.4m). The positive movement in valuations was offset in the income statement by written-off costs of acquisition of £14.1m, c 5.5% of the amount invested, mainly representing land transfer tax.

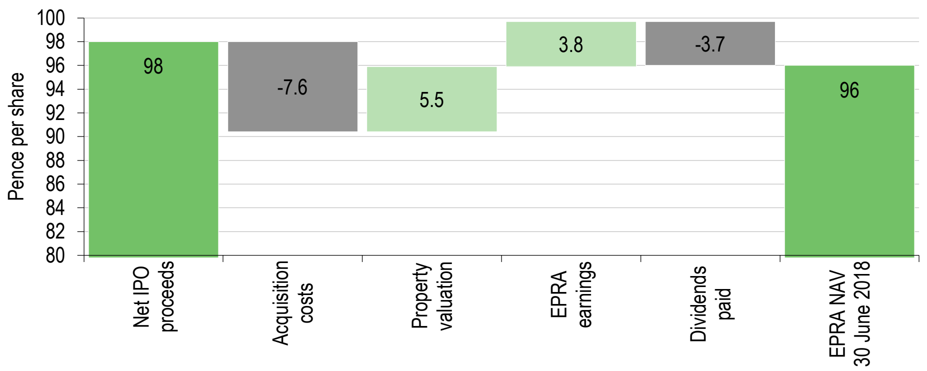
Exhibit 7: Breakdown of net revaluation movement

	£000s
Gross revaluation	10,360
Acquisition costs written off	(14,113)
Net revaluation	**(3,753)**
Rent smoothing adjustment	(328)
Fair value movement recognised in P&L	**(4,081)**

Source: SUPR

- SUPR met the dividend target that it set at IPO, declaring four quarterly dividends of 5.5p in aggregate, of which 4.125p per share was paid during the year and a fourth quarterly dividend of 1.375p declared and paid post-year-end on 17 July. In cash terms, dividends paid during the year were covered 103% by EPRA earnings. The company is targeting a 3.2% increase in quarterly dividends from the January 2019 dividend payment. As a result, the dividend target for FY19 has been raised to 5.63p per share and dividends are again expected to be fully covered by EPRA earnings.
- EPRA NAV per share ended the year at 96p, a small reduction in the IPO proceeds (net of costs) of 98p, substantially reflecting the impact of the written-off acquisition costs to build the portfolio (predominantly Stamp Duty Land Tax, SDLT, at 5%), offset by positive property revaluation. The property valuations carried within NAV reflect an assumption that if the properties were to be sold by SUPR, the buyer would similarly be required to pay SDLT. However, each has been placed in a separate company structure, wholly owned by SUPR, which would enable it to be sold as a corporate entity, significantly reducing the SDLT that would be paid by the buyer (to c 0.5% currently). This would potentially increase the sales value of the properties and enhance reported NAV.

Exhibit 8: Movement in EPRA NAV per share



Source: SUPR

Positive outlook for earnings, dividends and NAV

Leaving aside portfolio growth through acquisition, SUPR's rental income can be expected to increase with RPI, supporting dividend growth and, to the extent that property valuation yields do not change, NAV growth. This is the basis for the company's medium-term target of 7–10% NAV total return, and is also reflected in near-term earnings consensus, which makes no assumption of further acquisitions although these may be expected. SUPR says that it continues to see multiple opportunities in the market that meet its investment objectives, with the potential to further diversify the portfolio geographically and by tenant covenant.

Exhibit 9: Consensus forecast summary

£m unless stated otherwise	FY18	FY19e	FY20e
Revenue/rental income	8.9	16.3	17.2
EPRA earnings	4.7	10.2	10.9
EPRA EPS (p)	3.8	5.5	5.9
DPS (p)	5.50	5.60	5.75
EPRA NAV (p)	96	100	106

Source: Company data, Thomson Reuters, consensus data calculated from Stifel and Goodbody estimates.

Current year earnings will benefit from a full-period contribution from the properties acquired during FY18, an almost full-year contribution from the Sheffield store let to Morrisons in July 2018, and annual indexation of rents. FY20 will benefit from ongoing rent indexation.

Administrative costs in the current year will benefit from non-recurring IPO-related costs dropping out, while investment advisor fees will track the growth in average NAV. Interest costs will increase with a full-period impact from the FY18 borrowing, as well as the new £52.1m loan arranged in July 2018, although the average cost of debt will benefit from the attractive pricing on the new loan.

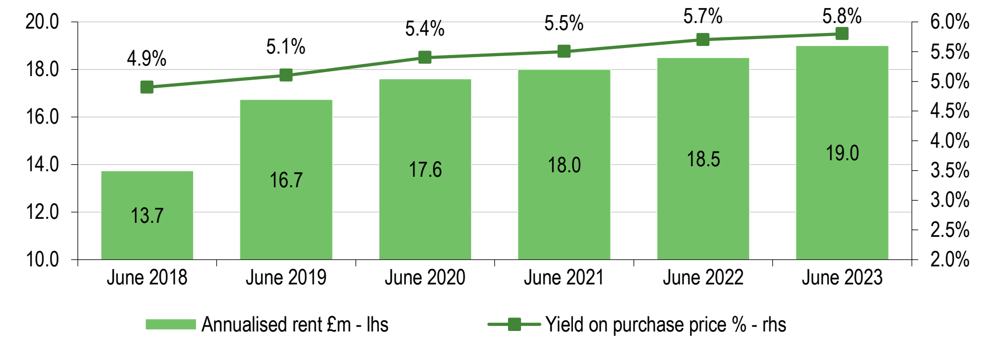
The consensus is for EPRA earnings to increase to £10.2m in FY19 and £10.9m in FY20, with EPRA EPS increasing to 5.5p and then 5.9p.

Consensus forecasts look for EPRA NAV to increase to 100p by end-FY19 and 106p by end FY20. The NAV total return implied by the consensus is 10% in FY19 and 11.9% in FY20.

Contractual RPI rent increases provide visibility

To better illustrate the potential impact of contractual RPI rent uplifts on rental income growth, SUPR has provided the data in Exhibit 10. The illustrated growth in rental income in FY19 includes the £2.54m July 2018 addition of the Sheffield asset let to Morrisons. Otherwise, the rental growth reflects RPI growth of 3.2%.

Exhibit 10: Illustrated impact of contracted RPI uplifts on rental growth



Source: SUPR

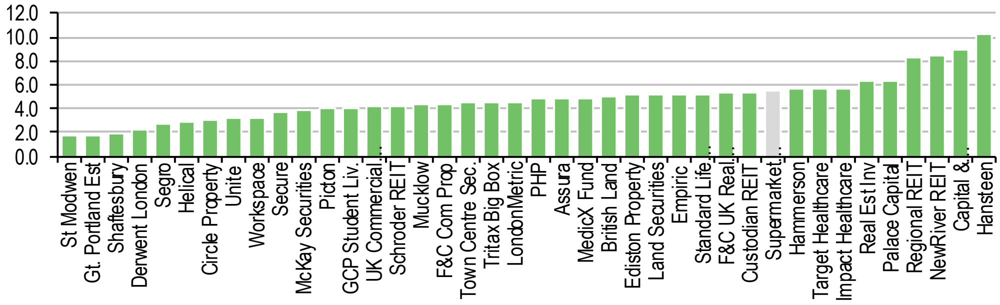
With the illustrated growth in rents, the yield on property purchase values also increases. However, if we assume no change in property valuation yields, the external market valuations of the properties would be expected to increase further. We estimate that applying an unchanged 4.9% valuation yield to the illustrated FY23 rental income implies c £58m potential upside to the £330 historical purchase price, or c 31p per share.

As noted above, the investment adviser believes that there is scope for supermarket property yields to reduce, relative to other classes of commercial property potentially in absolute terms, with a positive effect on supermarket property valuations.

Valuation

SUPR's long-term leases and RPI-linked rent growth provide investors with considerably visibility over a growing stream of contracted rental income, and offer considerable protection against inflation. The company's current-year target of fully covered dividends of 5.63p puts the shares on a prospective FY19 dividend yield of 5.5%, ahead of the median 4.6% yield on the broad range of property companies and REITs shown in Exhibit 11, and with visible potential for dividend growth.

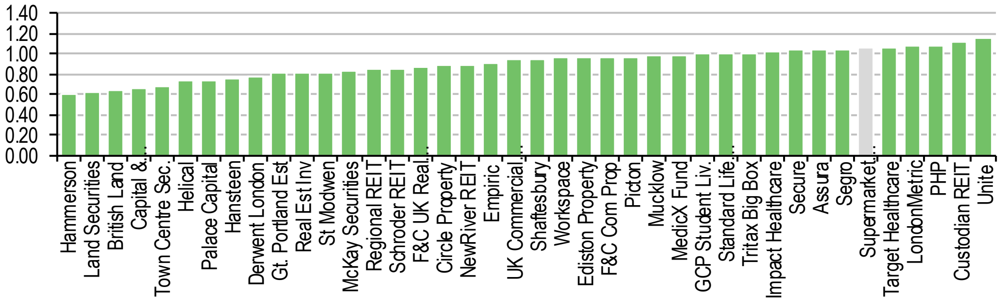
Exhibit 11: Sector prospective dividend yield



Source: Company data, Edison Investment Research, Bloomberg data as at 25 September 2018.

Reflecting investor demand for companies that offer secure long-term income, within a range of UK commercial property stocks, SUPR trades at a c 10% premium to the median P/NAV which is c 0.95x (Exhibit 12).

Exhibit 12: Sector price to historical NAV



Source: Company data, Edison Investment Research, Bloomberg data as at 25 September 2018.

Despite the above median P/NAV, the prospective dividend yield is also above median, reflecting SUPR's strong income focus.

In Exhibit 13, we show the key valuation and performance metrics for SUPR and a more focused group of companies that similarly target long-lease exposures across a range of property types including healthcare property, 'big box' distribution centres and leisure assets. Compared with this group, SUPR offers a yield that is above the median for a broadly similar P/NAV.

Exhibit 13: Summary of long lease REITS								
	Price (p)	Market cap (£m)	P/NAV (x)	Yield (%)	Share price performance			
					One month	Three months	12 months	From 12-month high
Assura	54	1299	1.04	4.8	-4%	-7%	-12%	-15%
Impact Healthcare	105	201	1.02	5.7	0%	1%	2%	-3%
MedicX Fund	80	355	0.99	4.9	1%	-2%	-11%	-13%
PHP	113	832	1.08	4.8	-1%	-3%	-7%	-8%
Secure	396	1273	1.04	3.7	4%	3%	7%	-2%
Target Healthcare	113	383	1.07	5.7	-1%	0%	-5%	-6%
Tritax Big Box	147	2166	1.01	4.6	-2%	-5%	3%	-7%
Median			**1.04**	**4.8**	**-1%**	**-2%**	**-5%**	**-7%**
Supermarket Income REIT	**102**	**187**	**1.06**	**5.5**	**0%**	**-1%**	**1%**	**-2%**
UK property index	1,748			4.2	-2%	-6%	0%	-8%
FTSE All-Share Index	4,132			4.1	-1%	0%	3%	-5%

Source: SUPR data, Edison Investment Research, Bloomberg data as at 25 September 2018.

Although all of the companies listed in Exhibit 13 have WAULTs that are above the average of the broad property sector, there remains a considerable variation within the group. Among these, the WAULTs for the primary care asset investors are on average shorter, and although upwards-only, a significant share of the leases are subject to open market review rather than being indexed. However, the vast majority of leases benefit from significant direct or indirect (through general practitioner reimbursement) government backing. Lease terms for the other companies are predominantly index-linked, with tenant exposures being mostly corporate, across a range of sectors. As noted above, the investment adviser believes the implied risk premium attached to large supermarket group tenants is attractively wide compared with negative real yields on UK-index linked gilts, and that there is potential for this to narrow in line with improved supermarket operator performance.

Exhibit 14: Last published WAULT

Company	Recent WAULT	Date
Target Healthcare	28.5	June 2018
Secure Income REIT	21.4	June 2018
Impact Healthcare	19.2	June 2018
Supermarket Income REIT	19.0	June 2018
Tritax Big Box	14.1	June 2018
MedicX Fund	14.0	June 2018
PHP	13.2	June 2018
Assura	12.6	December 2017

Source: Company data

Sensitivities

The visibility to SUPR's contractual income is provided by long leases and RPI-linked rent increases. Additionally, the company plans further accretive acquisition of assets. We see the key sensitivities as relating to the following:

- The failure of any of the tenants could negatively affect contractual incomes if this involved a void period or a need to re-let the space on less advantageous terms. SUPR seeks to mitigate this risk by targeting institutional grade tenants with multi-billion pound revenues and strong consumer brands.
- In recent years, supermarket rents linked to RPI have risen faster than open market rents, such that they are in many circumstances above market rent levels. If this were to remain the case, as lease expiry approaches it is likely that property valuations would be negatively affected, reflecting the possibility that rental income would decline at lease expiry. SUPR believes that the long WAULT on its assets protects against any negative valuation impact for many years to come, whilst asset management potential provides a means to increase rental income and

potentially extend lease length further. Valuations may be further protected by carefully selecting stores with good potential for alternative use over the longer term.

- RPI-linked rent increases provide good income protection against inflation, providing inflation does not rise too far. The RPI-linked increases SUPR's assets are capped, at an average level of 4.2%, which means that should inflation increase significantly the growth income could lag the growth in expenses and funding costs. Given the relative security of the tenant base, such conditions may be expected to generate more significant challenges to the mainstream commercial property market.
- As noted above, debt is currently c £140m with an average term to maturity of c three years. The average cost is 2.4%, all floating rate, but with £65m protected against an increase in three- month Libor above 1.75%. Assuming no change in the differential between Libor and RPI, the impact on funding costs arising from any increase in Libor should be matched by increases in rental income, providing that RPI does not rise above the cap on rent increases of 4.2%.

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Leadership team	
Chairman, Supermarket Income REIT: Nick Hewson	**Principal, Atrato Capital: Ben Green**
Nick Hewson was co-founder, CEO and chairman of Grantchester Holdings, where he worked from 1990 until 2012. Nick currently serves as a non-executive director and chair of the audit committee at Redrow, a FTSE 250 company and one of the UK's leading housebuilders. Prior to this, Nick was chair of the executive committee of Pradera AM, a European retail property fund management business. Nick was also a founding partner of City Centre Partners.	Ben has over 20 years' of experience structuring and executing real estate transactions and has completed £4bn of supermarket sale and leaseback transactions over the course of his career. Ben qualified as a lawyer in 1997 and worked at Wilde Sapte and Linklaters. He left law in 2000 and has since spent his career at Barclays, Lloyds and Goldman Sachs where he was a managing director and European head of structured finance.
Principal, Atrato: Steve Windsor	**Partner, Atrato Capital: Steven Noble**
Steve spent 16 years at Goldman Sachs, specialising in finance and risk management. Steve became a partner at Goldman Sachs in 2008 and headed Goldman Sachs' European, Middle East and African Debt Capital Markets and Risk Management businesses from 2010 until 2016. Steve has helped and advised a number of FTSE 100 companies on how to finance their business and manage risk. Steve was a member of the Goldman Sachs Investment Banking Risk Committee.	Steven spent nine years at Lloyds in origination and risk management with a focus on commercial real estate. Steven has negotiated and executed over £240m of Supermarket Property transactions. Prior to Lloyds, Steven was at KPMG where he qualified as a chartered accountant. Steven is a fellow of the Institute of Chartered Accountants Ireland and holds the Chartered Financial Analyst designation.

Principal shareholders	(%)
Quilter Cheviot Investment Management	14.22
Premier Fund Management	8.83
Miton Asset Management	7.83
BMO Global Asset Management	7.28
Smith & Williamson Investment Management	7.27
West Yorkshire Pension Fund	6.55
Cannacord Genuity Wealth	5.96
River & Mercantile Asset Management	5.30

Companies named in this report

Assura (AGR), Impact Healthcare (IHR), MedicX Fund (MXF), Primary Health Properties (PHP), Secure Income REIT, Target Healthcare (THRL), Tritax Big Box REIT (BBOX).