UK retail property investment

Finding better returns in challenging markets

Property sector

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Finding better returns in challenging markets

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We see real value in the current ratings of specialist investors in UK retail property, particularly those focused on better-placed 'secondary' assets. We expect these companies' portfolios to perform better than their current valuations would imply as, despite concerns over the outlook for 'non-prime' retail, recent results show steady occupancy and rents, from assets often less exposed to high profile retailer failures due to affordable rents and solid trading locations. A number of companies have taken advantage of access to low-cost debt to acquire assets at relatively high initial yields and built portfolios on immediately EPS accretive terms. Intensive asset management is already underway to improve tenant quality and revenue sustainability.

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COMPANIES IN THIS REPORT

Capital & Regional
Helical Bar
The Local Shopping REIT
LXB Retail Properties
Metric Property Investments
NewRiver Retail*
Town Centre Securities

*NewRiver Retail is a research client of Edison Investment Research Limited

Asset management returns will be key, if rents stay flat

Retail is the largest component at c 47% of the IPD UK commercial property index. Current consensus leans towards 'prime' retail for its perceived defensive qualities, but that approach has not necessarily produced better returns across prior cycles. We see an effective arbitrage as polarisation of interest in prime assets generates pricing anomalies elsewhere and enables quoted entities to acquire relatively stable assets at initial yields well ahead of all-in debt costs. The potential for such entities to 'sweat' assets to grow rents and values is compelling, when passive strategies may suffer from a lack of market-driven rental growth.

Valuations: Discounts and yields at odds with outlook

There are good prospects for attractive returns from **intensive management** of mid-range retail property over the next two to five years. Equity investors can currently access compelling retail property strategies at attractive yields, backed by sustainable rents (NewRiver Retail, Local Shopping REIT), and potential for asset value enhancement via improved planning and pre-let development and refurbishment (Metric Property Investments, LXB Retail Properties). In some cases these are at material discounts to underlying NAV, without – we believe – equivalent operational risk.

With contribution from Neha Singh

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Investment summary: Seek value in 'secondary' assets

Distinct retail strata and operational challenges

There are currently considerable, but in our opinion not insurmountable, challenges facing the direct investor in UK retail property. Much depends upon specific niche focus.

The market appears polarised between prime and secondary assets, a simplistic distinction which has resulted in a sizeable gap between the equity ratings of the quoted specialists in each category. Although we do not specifically argue against investment in prime retail, we take the view that owners of better-placed 'secondary' assets should outperform their current equity valuations.

Exhibit 1: Retail market sector categories and company exposures

Category	Description and sector relevance	Investment outlook
Uber prime	Retail assets in central London, a leading global retail location. Shaftesbury Capital & Counties Westfield (Australian listed)	These assets eg Covent Garden, Carnaby Street, Bond Street can often still set their own agenda, expect to attract demand from multiple tenants willing to pay record rents per sq. ft. and anticipate growth at rent review. Central London retail has proven highly resilient to recession and pressure on domestic consumers has been offset by strong tourist spending, particularly as sterling has declined.
Other prime	Dominant regional shopping centres popular with domestic and international tenants, and consumers. British Land Capital Shopping Centres Hammerson Land Securities	Properties with defensive qualities that will support occupancy, even during a difficult retail market. The caveat is that some tenants will inevitably now be paying rents agreed three to four years ago, which will be above open market levels. Although lease terms will generally prevent falls in revenues per sq. ft. at rent reviews, that limits potential for market driven rent increases and, moreover, a risk of decline at future breaks/lease expiry. That is particularly true where space needs to be re-let due to tenant failure (Peacocks, Game, Clinton Cards), but also from plans by some stronger retailers – such as Arcadia – to rationalise their portfolios and seek to negotiate better lease terms and lower rents on marginal units. A further possible concern is that, in some instances, these assets are vulnerable to competition from new shopping centres (notably the two Westfield malls opened in London since 2008). They may thus require essential 'defensive' capital investment to protect existing market shares, with limited ROI in the short term.
Well-placed secondary	Good second-tier regional town centres, with access to solid consumer catchments and limited competition from dominant regional Capital & Regional Helical Bar The Local Shopping REIT LXB Retail Properties Metric Property Investment NewRiver Retail Town Centre Securities	1. Provincial UK town centre and edge or out-of-town retail parks. Assets typically characterised by ready access to a solid catchment, affordable occupancy costs, steady trading and modest voids. In addition, recent investment has focused on properties identified as under-represented, but a good fit for the expansion strategies of major food, value and other retailers, which should act as an anchor for other national and on occasion international retailers look to enlarge their UK coverage. 2. Local shopping parades adjacent to residential areas. These typically contain a convenience store, supported by a range of appropriate retailers, ie fast food/takeaway, health & beauty, newsagents. Demand is underpinned by modest rents and other occupancy costs. This category has recently been buoyed by interest from major food retailers to roll out smaller in-town units (Tesco Metro, Little Waitrose etc). This is expected to improve trading for adjacent stores, with a progressive increase in rents and lower voids.

Source: Edison Investment Research

Is a focus on prime assets entirely defensive?

Recent company news flow suggests that many assets in the 'secondary' camp are actually quite well placed to deliver sustainable, growing returns in the current environment. If that's the case, equity investors can lock into attractive and potentially progressive yields, underpinned by the prospect of NAV growth as the operational performance of underlying portfolios are improved by intensive asset management over the next few years.

A tough market inevitably draws investors' attention to the perceived defensive qualities of prime assets and companies with appropriate weightings. However, that may be too simplistic, in part because with few exceptions – notably central London specialist Shaftesbury – there is no historical precedent to suggest that the latter group typically outperforms across the cycle.

Top end assets, such as prime central London shops, are still achieving record sales prices. But fears over the UK retail outlook have created a buyer's market within the second category – by some definition almost everything else – putting downward pressure on sales prices and pushing up initial yields. That apparent distinction has swept up a number of 'secondary' assets which we regard as well placed to outperform over the next few years.

High occupational costs create operational challenges for prime

Although prime retail asset values may continue to benefit if UK and overseas institutions continue to prefer property regarded as dominant, even top UK retail locations face significant operational challenges over the next few years. High occupational costs and rents – many are probably over-rented (at levels ahead of the current market) – will limit the options available to increase revenues. This implies potential for declines in underlying rents as, for example, tenants chose to exercise breaks or negotiate hard for reduced rents at lease expiry.

New tenants will almost always be found for the strongest pitches. Outside of top central London however, the terms will potentially result in a decline in net rental income. In addition, many prime retail assets are proving exposed to major retail failures, including most recently Game, Peacock's and Clinton Cards, as administrators exit the most expensive leases. Capital Shopping Centres Group, which owns a portfolio of prime UK shopping centres recently reported a 2.3% fall in net rents in H112 due to tenant failures.

Finally, longer established prime shopping centres may be vulnerable to increased competition and, in order to maintain their market positioning, may require considerable but largely 'defensive' capital investment. This may be essential, but is unlikely to generate attractive returns in the short term.

The UK retail market is tough, pressure is asset and retailer specific

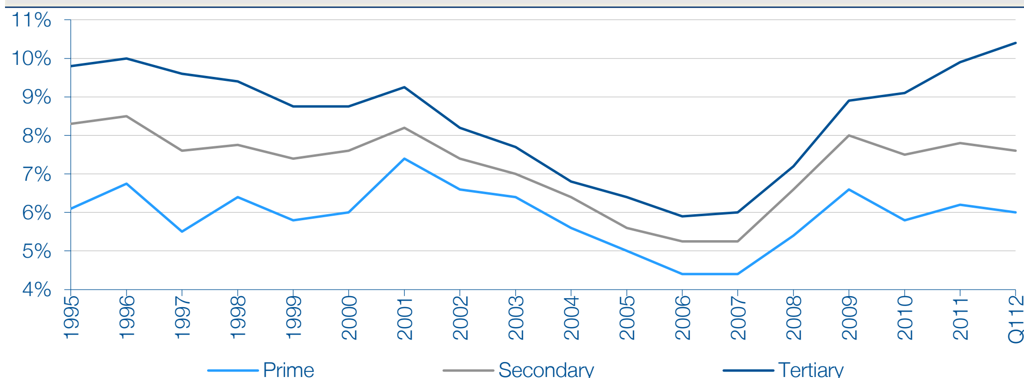
Savills' Q112 Shopping Centre and High Street Bulletin suggests that there is reason for optimism, even outside of resilient super-prime Central London. It sees retailers acquiring selectively and even competition for space, partly due to a lack of quality stock in strong market towns. As a result, some retailers have recently agreed to straight ten-year leases, minimum rent free periods and strong rentals.

This is admittedly town and unit specific, rather than the case for the market generally. Negative press comment – focused on retailer failures, low consumer confidence and store rationalisation – has persuaded many investors that the outlook for non-prime UK high street retail investment represents too high a risk. As a result, valuation yields outside prime locations have softened considerably and the gap between prime and secondary is now its widest since the 1973 oil crisis.

Widest gap between prime and secondary retail yields since 1973

In Savills' view that makes this, potentially, the optimal time to invest in this market, rather than a signal to stay away from the high street. A significant discount in pricing may, in Savills' words, make this "a once in a cycle opportunity to acquire worthwhile opportunities which are attractively priced".

Exhibit 2: UK retail property investment yields – 1995 to Q112



Source: Savills Q112 Shopping Centre and High Street Bulletin

The average initial yield at end Q112 was, unsurprisingly, higher than Q411 at 8.3% vs 7.95%. That reflects market sentiment as well as the nature of the secondary stock traded. In Savills' opinion 2012 will be the turning point of this cycle although generally, retail trading remains tough.

Exhibit 3: Retail property investment yields

	Q411	Q112
Super-prime	5.00%	5.00%
Prime	5.50%	5.50%
Town centre dominant	6.25%	6.50%
Secondary	9.00%	9.00%
Tertiary	12.00%	13.00%

Source: Savills Q112 Shopping Centre and High Street Bulletin

Although the UK retail centre investment market made a slow start to 2012 – 12 shopping centres sold in Q1 for £461.5m capital value vs 17 deals for £609m in Q411 – Savills sees large numbers of equity buyers for shopping centre investments and a wide spread between yields at different ends of the quality spectrum.

Despite the perceived higher risk of secondary relative to prime assets, we see more potential to extract returns via intensive management of high-yielding, well-placed secondary retail assets.

Some locations must be avoided, but those towns whose high street is not threatened by either a dominant out of town retail park or major shopping centre look interesting. Savills predicts that while prime yields may stay where they are in the near future, secondary could have more appeal for active buyers due to an attractive return and, just as important, because risk has been priced in.

It sees the possibility that, by the year end, the gap between prime and secondary could narrow as more investors focus attention on these assets and realise that the spread is now too wide.

Attractions in second tier retail specialists at current values

That view is not necessarily counter cyclical. We just see better potential upside in a difficult market from a focus on assets both regarded and priced as secondary, where a 'flight to quality' has generated pricing anomalies for both real assets and equities.

Exhibit 4 shows the portfolio positioning of the seven companies featured in this report (right hand side component focused upon well-placed secondary retail) as well as the sector majors for comparison, where the retail portfolio weighting is at the prime end.

Exhibit 4: Overview of investment focus of UK listed retail specialists

Source: Edison Investment Research

Better placed 'secondary' assets are performing satisfactorily

We provide more detail on individual companies in the second part of this report, but overall regard the performances of the underlying portfolios as reassuringly stable. Notwithstanding other influences on valuations, companies have reported relatively steady portfolio performances measured in terms of voids, revenues and lettings, despite recent retail failures.

In parallel, pressure on the physical market has provided opportunities to acquire assets at initial rental yields well ahead of underlying financing costs, enhanced by potential for revenue growth post upgrades to attract better tenants and lease terms.

There were some small declines in valuations, although discussions with management point to little broad consensus on the part of external valuers, due largely to a lack of supporting transactional evidence. Planned asset management initiatives to improve property and tenants should help to counter-balance any underlying market-led weakness in asset values.

That leaves a number of steep discounts of 25- 50% due to concerns including the future direction of asset valuations. Our view is that equity ratings are too pessimistic relative to operational characteristics of underlying portfolios, and thus offer a genuinely attractive potential dividend and NAV growth outlook.

Valuations: Growing dividends and NAV backing

We feature seven companies with a broad range of investment strategies, access to distinct sector niches (albeit with a focus on better-placed secondary), experienced management and further capital to finance portfolio growth and intensive asset management initiatives. Metric Property Investments, LXB Retail Properties and NewRiver Retail stand out as candidates for attractive returns, but each of the others has interesting growth characteristics due to their niche strategies (Local Shopping), entrepreneurial approach (Helical Bar) or discounted valuation (Capital & Regional and Town Centre Securities).

The table below sets out the valuations of the seven second tier UK retail property investors that we feature in this report. This illustrates that the five expected to pay dividends currently offer prospective yields of 2.8% to 10.5% (4.9% to 10.5% for the UK-REITs), fully covered by recurring rental income.

Exhibit 5: Company valuations

		Code	Share Price (p)	Market Value (£m)	NAV/ share (p)	NAV/ share+1 (p)	Discount to NAV+1 (%)	Dividend (p)	Div +1 (p)	Yield (%)	Yield +1 (%)
Capital & Regional		CAL	24	85	56	55	(56%)	0	0	0.0%	0.0%
Helical Bar		HLCL	191	226	250	249	(23%)	5.2	5.4	2.8%	2.9%
The Local Shopping REIT	UK-REIT	LSR	40	33	76	72	(44%)	4.0	4.2	10.0%	10.5%
LXB Retail Properties		LXB	110	280	108	118	(7%)	0	0	0.0%	0.0%
Metric Property Investments	UK-REIT	METP	81	154	107	111	(27%)	3.3	4.0	4.1%	4.9%
NewRiver Retail	UK-REIT	NRR	181	58	258	252	(28%)	15.0	16.5	8.3%	9.1%
Town Centre Securities	UK-REIT	TCS	162	86	288	275	(41%)	10.4	10.4	6.4%	6.4%
Average							**(33%)**			**4.5%**	**4.8%**
Capital Shopping Centres	UK-REIT	CSC	325	2,774	391	375	(13%)	7.5	7.6	2.3%	2.3%
Hammerson	UK-REIT	HMSO	459	3,271	530	530	(13%)	16.6	16.8	3.6%	3.7%
Shaftesbury	UK-REIT	SHB	539	1,358	421	478	13%	11.3	12.0	2.1%	2.2%
Average							**(1%)**			**3.4%**	**3.6%**

Source: Consensus forecasts (Thomson One)

Recent results confirmed the underlying resilience of group revenues. As might be expected, the three leading sector retail specialists are higher rated, both in terms of lower average discounts to NAV and dividends. Shaftesbury, which has an exclusively prime London West End portfolio, is a deserved outlier, the only group whose shares are currently valued above prospective NAV/share.

Although 'prime' assets may appear - and indeed be - best-placed to resist pressure on consumers and to replace retailers lost due to failure, lease expiry or break, we feel that with the exception of Shaftesbury, owners of prime assets could struggle to generate material growth from portfolios let at high rents agreed in better markets. Even if revenues are sustainable there could be limited capacity for rent or indeed, dividend growth.

We set out a brief overview of the strong secondary investors below. It is important to distinguish between these and a third group – owners of weak-secondary/tertiary retail located on the UK's weakest high-streets, where high and increased void rates are becoming the norm. None of the companies below fall into that category.

Although we see clear distinctions between the performance characteristics of prime, strong secondary, weak secondary and tertiary retail, we believe that a broad brush has been applied to assets regarded as 'non-prime', which has swept up properties and companies fully capable of outperformance in the right hands.

Recommendations: Overview of individual stocks

The table below sets out our overview of the attractions of the seven companies we identify for their exposure to what we regard as better-placed secondary UK retail assets. This sets out the investment case briefly, with a few issues for investors to consider. We would put the emphasis firmly on the ability to distinguish between cyclical and structural pressure on retailers and identify likely outperformers in a tough trading environment.

Exhibit 6: Company overviews – themes and outlook

Recent IPOs – direct investment in better placed secondary retail property, no legacy assets	
LXB Retail Properties	Upside from NAV growth in short term. The investment focus is development of out-of-town and edge-of town retail centres, to generate growth in valuations and rents in the medium term. Cash will be retained to cover capex requirement.
Metric Property Invs.	Investment case is predicated upon potential for NAV and yield growth. IPO has invested in existing out-of-town retail on EPS accretive terms, since supplemented by active management of tenants and leases and asset refurbishment/upgrade. We expect this to drive NAV/share and dividend growth even in difficult markets. Joint venture asset management partnerships in place.
NewRiver Retail	Attractive existing yield and growth outlook. Has invested since IPO in existing, high-yielding well-placed secondary town centre retail, on EPS accretive terms. Assets are selected for revenue sustainability supported by a tenant focus on food and value retail, and the potential to ratchet returns from intensive management of property and tenants. JV AM partnerships in place.
Niche investment	
The Local Shopping REIT	Attractive yield supported by commitment to distribute 100% of recurring revenues, revenue sustainability comes from a diversified tenant base paying affordable rents. Outlook backed by focus on the neighbourhood retail niche increasingly targeted by major food retailers. Substantial JV AM partnerships in place. The broad portfolio and tenant base requires intensive management.
Established town centre retail	
Town Centre Securities	We see a mismatch between a rating which combines an attractive yield and NAV discount, and the underlying operational stability of the group's substantial and well-established provincial retail assets.
Direct and fund exposure to UK retail assets	
Capital & Regional	There should be potential for the current 56% discount to NAV to narrow as it sweats a portfolio of direct holdings and stakes in external funds, which it also manages. This process has cut gearing and improved individual asset performance. Issues relate to the lack of a dividend and the complexity of the group structure, with potential for some of its managed funds to be wound-up over the next few years, although the sale of these or their assets should return cash to the group.
Entrepreneurial – increased retail weighting over last two years	
Helical Bar	Not a pure UK or retail investor, the group has substantial other commercial property development interests. It is however interesting that one of the sector's proven entrepreneurs decided to substantially increase its weighting to better placed secondary UK retail assets to over 50% of the portfolio at this stage in the cycle. A range of proposed asset management initiatives will drive growth in revenues and valuations.

Source: Edison Investment Research

UK REITs: Brief recap on investment advantages

Four of the seven companies featured in this report are UK REITs. These entities are tax efficient, not liable for corporation tax or capital gains tax and obliged to distribute 90% of their recurring property income, ie rents via dividends to shareholders. By nature, they are primarily engaged in property investment rather than development, a generation of income to support dividend growth.

Exhibit 7: Retail focused UK-REITs

Company	Market value (£m)	Portfolio focus
Local Shopping REIT	33	Retail (Neighbourhood shops)
Metric Property Investments	154	Retail (Out-of-town)
NewRiver	58	Retail (Town Centre)
Town Centre Securities	86	Retail (Provincial UK)

Source: REITA website

Newer groups to benefit from lack of legacy assets

Looking at the broad investment strategies pursued by the above companies, relatively recent IPOs, such as **Metric Property Investments**, **NewRiver Retail** and **LXB Retail Properties**, (all within the last three years) makes them stand-out candidates for outperformance as they lack the 'legacy' assets from portfolios purchased in pre-recession property markets. Each acquisition was assessed for its potential to outperform in a harsher retail environment as these companies hold substantial retail property portfolios acquired to fit specific yield, asset management and development targets.

Their management intends to leverage an understanding of UK retail, well-established relationships with key anchors and occupiers for proposed schemes. None proposes to build speculatively.

Neighbourhood retail: Key target area for new food retail concepts

The Local Shopping REIT is interesting as the leading investor in a substantial, £20bn property 'niche' UK neighbourhood retail, typically overlooked by traditional institutional investors and, until recently, national retailers. Its portfolio 'sweet-spot' is shopping parades within easy access of residential areas, typically occupied by newsagents, convenience stores, take-away providers, beauty parlours/hairdressers etc, but also a wide range of other tenants. Units are let at relatively low rents which represent a modest proportion – c 7% on average – of a tenant's turnover vs a UK 15% retail average. LSR also occupies territory of increasing interest to supermarkets seeking to roll out convenience store concepts, eg Tesco Metro, Sainsbury's Extra and Little Waitrose. These seek to capitalise on the changing shopping habits of an ageing population, and a consumer pressed by higher fuel costs for more regular, lower cost shopping trips, to benefit conveniently placed neighbourhood stores within walking distance of residential areas. The ongoing roll out of compact formats by supermarkets should benefit footfall, spending, revenues and valuations of local shops.

Provincial retail continues to perform resiliently

Town Centre Securities and **Capital & Regional** hold portfolios purchased over the medium to longer terms across earlier cycles. Both performed resiliently over the last year and thus appear better placed than current equity valuations imply. Both shares are significantly below NAV despite recent management driven asset performance. Town Centre has a £279m portfolio predominantly based in the North of England (Leeds, Manchester) and Scotland (Edinburgh, Glasgow), with revenues derived from town centre and out-of-town retail (58%), offices and car parking.

Capital & Regional holds retail, leisure and trade park investments in the UK and Germany, directly on its balance sheet, via investment in UK retail funds, a joint venture with a German retail property portfolio and interests in leisure and trade park properties. Direct investments are supplemented by fees from management of the two funds and joint ventures. If decisions were taken not to extend the life of these funds, C&R would benefit from any sales as it is also a significant shareholder.

Niche has also attracted traditional active managers

Finally, we include **Helical Bar** in this report to reflect its materially increased retail property weighting over the last two years. Although its management does not have a strong association with retail property per se, it has a deserved reputation for well-timed investment in undervalued segments of the property industry at appropriate points in the cycle.

Brief company overviews – portfolio and strategy

Exhibit 8: Company descriptions in brief

Company	Description
Capital & Regional	Established investor with a portfolio focused on retail investment in UK and Germany. Has £2.7bn of assets under management, ie two well established UK retail funds, a JV in a German retail portfolio and other interests in trade park and leisure properties. The business model combines direct investment in retail and leisure property and funds, and the provision of management services (The Mall and The Junction funds and other JVs). Also owns stakes in the management companies which operate The X-Leisure Fund and its German portfolio and receives profits from SNO!zone operating business.
Helical Bar	Not traditionally regarded as a retail property investor, but Helical has a broad sector track record and a strong reputation for entrepreneurial and intensive asset management, as well as timing investment across the cycle. We have included Helical in this report as it increased the UK retail weighting of its investment portfolio from 15% to 61% over the last 18 months, with a specific focus on higher yielding secondary property. These were acquired on terms that provide a broad income base, with potential for material growth through tenant and lease management, refurbishment and development over the next two to three years.
LXB Retail Properties	Closed-end (Jersey) investor in out-of-town and edge-of-town retail property, which listed in 2009. Has since acquired 10 properties in England and Scotland, which include income-generating assets with some vacant units and development sites. LXB's strategy is to seek to capitalise on structural changes occurring in the out-of-town UK retail sector. It acquires retail parks and drives returns through hands-on management of existing tenancies, letting vacant space and, where possible, development. These are all designed to enhance revenues and capital value of acquired assets.
Metric Property Investments UK-REIT	Established in 2010, it has acquired a £242m portfolio of 24 multi-let retail assets located across the UK. This provides opportunities to reconfigure existing space and development over the longer term. Experienced management leverages relationships with retailers to direct strategy, increase rent via reviews, re-let vacant space and re-gear leases. Other income growth comes from short-cycle development, refurbishment, reconfiguration, extension, addition of 'pods' and new units. This improves the retail environment, attracts new consumers, retailers and uses. A better tenant mix, revenue profile and longevity will be reflected in higher valuations. When asset management is complete it plans to sell assets and recycle proceeds into new investments.
NewRiver Retail UK-REIT	Retail focused UK-REIT was established in 2009. Highly focused on income growth, it has acquired a diversified, balanced portfolio of eight income-producing retail assets that already generates significant surplus cashflow that should be further enhanced via asset management initiatives. It owns eight shopping centres (c 350 tenants across 1.3m sq ft). It is currently undertaking risk-controlled development and refurbishment over approximately 0.5m sq ft of space, including jointly-owned and managed shopping centres. Tenant profile is weighted toward value (45% of rents) and food retail (22%); the latter includes major high quality retailers such as Sainsbury's, Tesco and The Co-op. Some 86% of overall income is derived from national multiple retailers.
The Local Shopping REIT UK-REIT	Invests principally in local parades and neighbourhood venues for 'top-up' shopping, a substantial niche in which it has established a leading position since its formation in January 2005. The market is highly fragmented, which enables LSR to exploit pricing inefficiencies and apply asset management to generate above average returns. The market value of this 'local shopping' sub-sector is c £20bn ie c 15% of the overall UK retail market. A key characteristic is rent affordability – ie on average below 7% of tenant turnover (Colliers CRE), which compares with typical high street rents in an 8-15% range. The average shop rent for LSR's portfolio is £12,129 pa (or £233 per week), under £11.30 psf.
Town Centre Securities UK-REIT	Long established provincial (Leeds, Manchester, Glasgow and Edinburgh) UK property investor and developer. At end FY11, retail (individual shops, shopping centres, retail warehouses and food stores) comprised 73% of the portfolio by value, 77% of rent. Its main asset (42% of total portfolio value) is the Merrion Centre in Leeds. Portfolio performance has been steady recently – voids down from 8.4% to 3.2% in the last two years, and rent collection consistently strong. It recently refinanced £65m of facilities, extended to 2015-16.

Source: Edison Investment Research

Smart purchase and investment strategies drive returns

We see the acquisition and intensive asset management strategies of smaller UK-REITs and property investors as interesting, even in this environment. Initial purchase prices look attractive as shortages of buyers for non-prime assets able to secure bank debt has resulted in mispricing of some assets within this broad category. The key issue for equity investors must be to assess how effectively management teams will be able to leverage their experience and knowledge of specific property/retailing niches and local markets to their benefit in a tough market. We have reviewed acquisition strategies which deliberately steer clear of badly placed, underperforming high street retail. CBRE defined a credible investment approach set out in a recent report. We set out our view on this basis below, to put the valuation data in context.

Exhibit 9: Investment criteria

	Retail property focus	Strategic clarity	Limited legacy portfolio	Experienced operational team	Balance of stabilised and opportunity assets	Efficient capital structure and allocation
Capital & Regional	●			●		
Helical Bar	◖	●		●	●	●
The Local Shopping REIT	●	●		●	●	●
LXB Retail Properties	●	●	●	●	●	●
Metric Property Inv.	●	●	●	●	●	●
NewRiver Retail	●	●	●	●	●	●
Town Centre Securities	◖	●		●		●

Source: CBRE, Edison Investment Research

Retail mix also likely to be crucial for revenue sustainability

The retail balance of investment portfolios reflects shifts in consumer behaviour that, for example, benefit food and 'value' retailing – both of which are holding up well in a more austere economic environment – and neighbourhood and convenience stores, which address shoppers' desires to avoid fuel and parking charges. Demographics are another important influence, eg a number of strategies are designed to fit the shopping habits of an aging population.

Risks are managed by acquisition of better properties, tenants in outperforming sectors (food, value, health & beauty) or stores within tenants' national chains. The latter seek to:

- reduce potential that these units will be closed during any proposed store rationalisation, such as announced by Arcadia and Dixons Retail;
- be readily re-lettable on similar terms, should tenants decide to vacate; and
- if there is retailer failure (Peacock's, Game, Clinton Cards), be among units retained as administrators or via a 'prepack' focus on better-performing stores.

Consumer polarisation continued towards each end of the retail spectrum to the benefit of value retailers or selected highly regarded brands. With respect to new lettings, Savills reports instances where substantial premiums have been paid by new tenants, at higher rents in some cases.

Active management: Key to performance in a flat market

If there is, as expected, little underlying market-led retail rental growth in the next few years, there may be few opportunities to push up returns from prime assets. Secondary looks better placed to benefit from intensive management of tenants, leases or physical property to drive revenue growth.

Any asset attracting a modest proportion of its core consumer catchment may benefit from improvements to the built environment, a more compelling retail mix (including food & beverage), leisure and marketing initiatives via social media, websites and free Wi-Fi. Some suggestions are relatively cosmetic, others entail new planning consents and significant capex to extend existing stores, to add space suitable for better anchor tenants, attract supportive retailers and improve the consumer offer.

The table below sets out actions available to owners of retail property, the application of which can ratchet up net revenues or underpin the sustainability of existing rental income.

Exhibit 10: Ratcheting up revenues and asset values

Action	Examples	Benefit
Re-let empty units		Reduced voids
Rent reviews		Rental growth
Re-gear leases	Extend term of existing leases	Improve revenue sustainability
	Remove breaks	
Replace/upgrade tenants	Improve tenant mix	Yield shift/valuation uplift
Retailer partnering	Improve consumer footfall	Yield shift/valuation uplift
	Broaden demographic appeal	
	Expand local catchment	
	Increase visit frequency/time spent	
Extend existing units	Attract new tenants	Improve revenue sustainability
	Leverage anchors to attract other retail	Yield shift/valuation uplift
	Add new units within site	
	Pods for coffee shops	
Enlarge food retail	Attract stronger tenant (Tesco/Waitrose etc)	Improve revenue sustainability Yield shift/valuation uplift
Redevelopment	Reconfigure space	Yield shift/valuation uplift
	Sub-divide large units	
	Improve calibre of anchor tenants	
Marketing initiatives	Social networking	Yield shift/valuation uplift
	Free Wi-Fi	
Improve planning consents		Yield shift/valuation uplift

Source: Edison Investment Research

In the short term, market volatility will influence portfolio appraisals, even if other criteria provide evidence of progress. We would judge performance on occupancy and revenue sustainability; improvement in tenant quality, lease terms, firm pre-lets and planning consents for asset refurbishment and enlargement, which will be reflected in NAV growth over time.

UK retail property market backdrop

With cyclical recovery in its early stages we see limited potential for **passive** retail property investment over the next few years, outside perhaps of prime London west end. General market rental growth relies on confident consumers and, in that respect, the traditional impetus for retailer expansion is missing. Overall, UK retail asset values fell by 1.1% in the three months to end March 2012, relative to falls of 0.5% and 0.6% for offices and industrial property respectively (IPD data). That contrasts with outperformance by the retail property segment over longer periods.

Exhibit 11: Total returns (capital and income) from property investment – period to end June 2012

	Retail	Offices	Industrial	All property	Equities	Gilts
3 months	0.5%	1.1%	1.2%	0.9%	6.1%	(0.3%)
12 months	5.2%	8.2%	6.7%	6.6%	1.4%	16.1%
3 years (% pa)	11.5%	11.0%	10.0%	11.2%	18.8%	7.1%
10 years (% pa)	7.0%	5.5%	6.6%	6.5%	5.2%	7.1%

Source: IPD

Sector investors must anticipate a few hits from a tough market

A positive outlook for UK retail property, backed by sustainable growth in revenues and valuations, would require a mix of the following, most of which we see as missing in the current market:

- Consumer confidence in future employment status and earnings potential.
- Potential for real rental growth on the back of steady demand for space from new and existing occupiers seeking to evolve their retail offerings and expand into new markets.
- A planning regime which supports delivery of new retail schemes, yet limits over development to provide potential for a satisfactory return on investment.
- An active secondary market comprising institutional buyers, owner-occupiers and other investors with ambitions to build revenue-generating portfolios and, conceivably, forward fund development of new retail property on a speculative or part-let basis.
- Ready access to investment and/or debt finance for construction of retail units and large shopping centres on a speculative and pre-let basis.

Putting the above into context, the key operational sensitivity would appear to be the risk that initial revenues do not prove sustainable. No portfolio can be fully insulated from the difficult retail environment and thus revenues may take a few hits as retailers fail or rationalise their portfolios. Companies do, however, try to factor this risk into acquisition prices and carry out considerable due diligence into locations, tenant profiles and future opportunities to add value.

Efforts are made to diversify risk and reduce dependence upon single tenants or weaker sectors. Acquisitions target an individual tenant's better performing units, which should be among those retained in the event of an administration. In general, occupational costs for the portfolios owned by companies in this report will be well below prime retail space. That will help to attract retailers which seek to expand their branch networks, assisted by a nearly empty pipeline of new retail development over the next few years. This reduced risk should progressively be reflected in equity ratings.

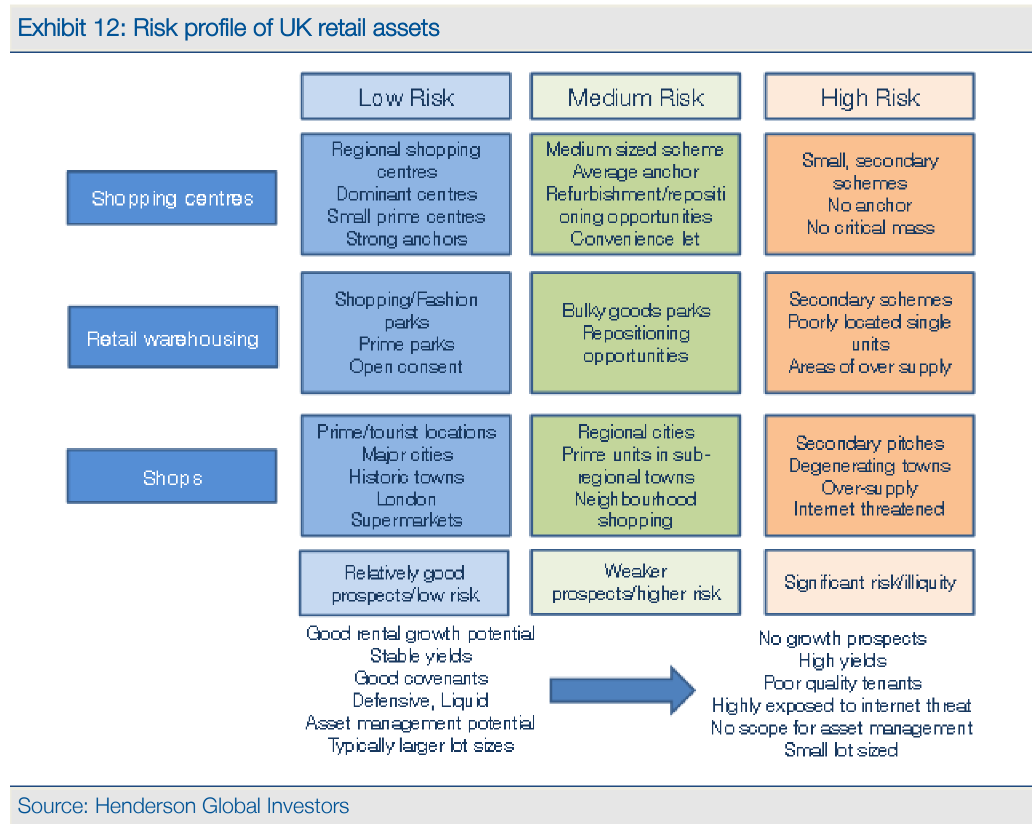
Our discussions with company management, as well as retail and property sector specialists have revealed similar views on the outlook for UK retail in 2012 and the next few years. Overall, this reflects the progressive influence of a more austere environment on consumers:

- Minimal nominal, ie 1.2% growth in overall retail spending this year, the third-lowest rate for over four decades (Verdict Research). Total food sales to grow y-o-y in line with floor space expansion, but to fall on a like-for-like basis.

- Home-related sectors are under the most pressure, ie DIY, electrical, furnishing, floor coverings, due to the difficult housing market.
- Another tough year for entertainment, ie music, video and books, due to online sales; c 75% of all such expenditure is now online.
- Further retailer consolidation and store chain rationalisation is probably inevitable. The retailer failure rate will be above the last three years, but better than 2008.
- Higher vacancies reflect pressure on consumer spending, online/mobile purchases and competition from supermarkets (CBRE data).

The current risk profile of UK retail assets is set out below.

Exhibit 12: Risk profile of UK retail assets



Source: Henderson Global Investors

Why are retailers failing?

Debt is, inevitably, a recurrent theme. A recent casualty such as value fashion retailer Peacocks, reported profits at the operating level and encouraging like-for-like growth over Christmas. It however, it lacked a strategy to cope with a £240m debt loaded post its purchase by private equity in 2006. Peacocks' collapse, together with those of Game and Clinton's Cards, provides a test for the investment rationale outlined by the second tier investor, whose broad UK coverage inevitably means some exposure to a national chain. Peacocks had 563 stores, between 0.5% and 3% of total rent roll of the companies featured in this report. Risk that an indebted retailer may fail is factored into acquisition prices, with better placed units (a) retained by a new owner/buyer; (b) among better performing stores in the portfolio, so retained by an administrator pending sale; or finally (c) rapidly re-let in the event of the worst-case scenario, ie closure of the entire chain.

The above also applies for retailers with too much space, which seek to reconfigure their portfolios and close underperforming stores as leases expire. Another value fashion chain, New Look (also private equity owned) revealed an intention to close around 60 stores of 100 leases due to expire over the next three years and may increase this to 100 if it cannot negotiate better deals with landlords. Arcadia, Mothercare and Dixons Retail are similarly minded.

More resilience from food and 'value' retail tenants

Recent UK retail sector updates have included record results from Harrods and Poundland, which shows retailers at each end of the spectrum can still make headway as the middle is squeezed. Additionally, 2012 updates have included solid news from both food and other retailers.

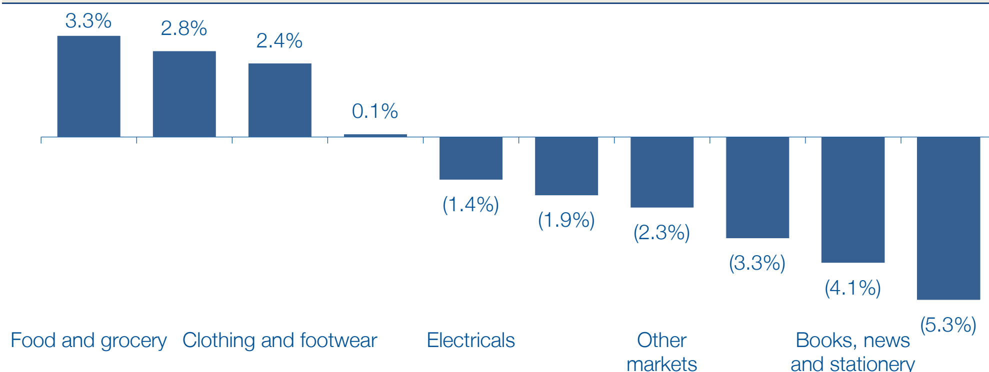
Although Tesco produced its first profit warning for 20 years at the start of the year, followed by a 1% fall in UK trading profits to £2.5bn for the year to end February, the culprit may be poor strategy – its price cutting campaign – and over expansion into non-food. In contrast, competitors appeared to get their acts together. Sainsbury's reported a 6.8% increase in sales to £24.5bn, 2.1% growth at stores open for at least a year, and added 1.4m sq ft of space – including 19 new supermarkets, 73 convenience stores and 28 extensions. New space is expected to fall to c 1m sq ft pa, still a significant commitment well within the sweet spot for the investors in this report.

In particular, the convenience store category grew by c 25%, both in new space and like-for-like sales growth. It is a core component of the investment plans of the property companies we feature, providing opportunities for food retailers to enlarge networks. Tesco still plans to invest £1bn in its UK portfolio this year, despite a refocus on online sales of non-food and a reduced number of new 100,000 sq ft plus stores. That points to a renewed shift to smaller, food-focused units as a potential opportunity for retail property portfolios. There is already substantial investment in the pipeline for the next few years. Sainsbury's, Morrisons, Waitrose and others appear committed to expanding their networks. For the second tier property companies, we expect further growth as food retailers rationalise their portfolios. They represent one of the strongest tenant covenants and an important 'anchor' to attract other retailers to planned refurbishments over the next few years. Any slowdown in new supermarket development may shift focus to existing, proven locations.

Austerity regime is affecting consumer trends

The outlook above fits with forecasts for spending on its category for the current year, with essential purchases to further gain ground. Austerity measures and inflation have put disposable incomes under pressure. Consumers have responded by spending more on food & grocery (trend towards more eating at home, rather than at restaurants), attracted by value promotions but also the roll out of compact, neighbourhood, food-focused stores by the major supermarket operators. These appealed to shopper preference for more frequent, lower cost visits – the 'just in time shopping basket' phenomenon, which involve minimal car or parking expense. That scenario fits with the forecasts for shifts in consumer spending set out in Exhibit 13 below.

Exhibit 13: 2012 forecasts



Source: Verdict Research

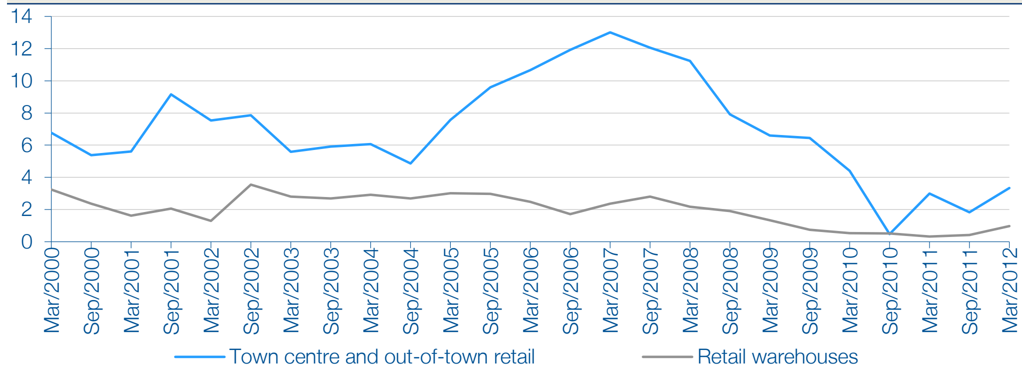
Tertiary retail space: not void, but obsolete

It is important that investors appreciate the distinction between weak secondary/tertiary assets and well-placed secondary – which is the focus on investment by the companies in this report. According to JLL estimates, up to 30% of retail space in developed markets is potentially obsolete in its current form. This space was built for a retailing model relevant over 30-40 years ago. Many units are simply too small and inflexible to accommodate modern retailers.

That has been compounded over the last few decades by a significant shift in retail's 'location hierarchy', post focused investment in regional retail centres, out-of-town and edge-of-town retail parks. Much of this was deliberately designed to attract contemporary consumers and draw them away from congested town centres. As a result, the weakest local high streets and non-dominant secondary shopping centres are now particularly exposed. The valuations of that category may indeed have peaked in 2007 and will never regain its former level. Many vacancies should be considered permanent and large numbers of units reclassified not as void, but obsolete.

Weak development pipeline will help to restore balance

Exhibit 14: UK retail space under construction



Source: CBRE

There has been a sharp fall in shopping centre development, both town centre and out-of-town schemes, in the last few years. With a two to three year lead time there is effectively just one major development, Land Securities' Trinity Leeds, in the pipeline: 1m sq ft of new/reconfigured floor space due in 2013. Another c 50m sq ft is theoretically on hold, but much of this is unfunded and very unlikely to be developed speculatively until market conditions improve.

CBRE's data encapsulates the extent of development pipeline shrinkage. Excluding the recent surge in grocery store development which may itself be undergoing a rethink, shopping centre and retail park pipeline levels have declined by 3.98m sq ft (6.3%) and 3.14m sq ft (13.9%) respectively since September 2007. That sounds relatively modest, but developers are actively deferring schemes and actual construction activity has plummeted, as illustrated in Exhibit 14 above.

There are clearly two sensitivities to take into account when interpreting the above figures. First, that online shopping may reduce retailer demand for new space, although the impact of this may be lower than anticipated. Second, that lower development may be required post recent rapid growth in supermarket development, particularly non-food space. The decline will, however, help to maintain occupancy in better placed properties, and drive retailers towards the refurbished and upgraded assets owned by the companies featured in this report.

Despite pressure on consumer spending, some major retailers still seek to enlarge or rationalise their UK portfolios, replace underperforming stores and fill gaps in geographical coverage. That requires larger, modern units, but low development and relatively high occupancy within better placed existing centres could frustrate their search for the kind of space they require.

Over the next few years, we expect such retailers to consider existing retail centres and help to underpin returns from planned refurbishments and extensions. The scale of these activities, which are less risky and capital intensive activities than pure development, is unlikely to deliver sufficient new space to meet demand. Owners' plans to extend existing assets may be the initial phase of development recovery.

Retail warehouses under construction at lowest level since 1980s

Investment dynamics are further illustrated in the retail warehouse segment, where new space under construction is at its lowest recorded level since the early 1980s. CBRE sees retail park

investment, increasingly, as a one-way bet. With much held by institutional investors, little quality stock ever comes onto the market, debt levels are low and vacancies for decent stock are sharply down. CBRE has also commented that tenant mix on retail parks has become so much broader in the last few years that the risks attached to any single sector, eg electrical, are much lower.

With an effective ban on out-of-town shopping centre development due to ‘town centre first’ planning policies, typical occupiers have focused interest on what is available in retail parks and existing stock, and forced traditional shopping centre anchors to consider entirely new trading formats suitable for retail parks. CBRE reports pent-up demand for additional A1 space in parks.

Primary stock availability for retailers is well below the cyclical low point in the early 1990s. The big difference now is that all the major schemes coming onstream during 2012 are near fully let at completion. With genuinely interesting space in increasingly short supply we may see much faster recovery in development activity when the economy begins to recover. In the meantime, however, all this is good news for better-placed existing retail centres.

Sensitivities: Cyclical and structural influences

To put the risks and opportunities in context, we set out below some of the current influences on UK retail, with specific focus upon retail property investment, occupancy and revenue sustainability. These are specifically considerations for company, rather than equity investment.

Exhibit 15: Sensitivities

Positives	Negatives
Retail trading & growth strategy	
Retailer expansion plans	Retailer woes
Despite the economic backdrop (and Tesco's recent announcement) a number of retailers – particularly food and value – remain committed to material floorspace expansion over the next few years, significant branch rationalisation (shift to newer centres) and the roll-out of new retail concepts.	Retailers will accentuate their difficulties in an era during which they want to put landlords under pressure. At the end of 2011 Arcadia (which operates high street brands such as Top Shop, Burton and BHS) revealed plans to close 260 stores over the next two years. It and others can be expected to negotiate hard on rents and lease terms.
Rental outlook	
Revenue sustainability	Flat underlying rental growth outlook
A focus on key retailers in better locations, let on affordable terms, will still represent a strong revenue profile. Investment strategies that seek assets with potential to ratchet up returns via active property and tenant management will still see opportunities to push up income and values over two to four years.	This market does not fit a passive investment strategy. Capital growth will follow income growth and there is, arguably, near zero probability that rents will get any assistance from the general economy in the near future. It is likely income growth will only be achieved from letting voids, securing extensions to leases and units, and general upgrade and refurbishment of space acquired.
Debt	
Funding characteristics	Lower appetite for gearing
Despite pressure on banks, most listed entities confirm ready access to debt. More importantly, the terms are exceptionally low, ie all-in cost for five-year fixed to c 3.5-4.0% pa. Portfolios available on initial yields of c 7.5-8.0% pa make acquisitions potentially very attractive, assuming continuity of rents.	Debt terms have become increasingly conservative over the last two to three years. Where banks were once comfortable with 75% loan-to-value, 60% is now more normal. There is similarly pressure on companies to maintain more modest balance sheet gearing in uncertain times. A shortage (and investor mistrust) of clever finance shifts emphasis to 'sweating assets' to generate returns.
Asset management	
Development pipeline	Defensive capex
The pipeline of new retail developments isn't quiet, it's empty. Almost nothing is due in the next two to three years. Although schemes may be dusted off, it's unlikely that much will get funded speculatively. That puts the onus on refurbishment, upgrade and extension of existing schemes to meet demand for space (see below). These represent more modest capex, shorter construction timeframes and if based upon pre-lets, more certain return on capital invested.	Investors may be drawn towards prime assets for income security. Dominant regional centres may remain attractive for tenants and consumers. These assets' competitive advantages must also be considered. High occupancy costs and peak rental values may leave limited scope for rental growth. Some, particularly older centres, are in need of upgrade and face competition from newer assets, eg Westfield's new centres in London and Stratford. Capex to defend market share may generate limited, if any return on investment.
Valuations	
Asset mispricing	Values falling for first time since 2009
There appear to be relatively indiscriminate pricing of assets regarded as below prime quality, ie the polar opposite of the 'yield compression' which characterised the market peak. A broad category of secondary retail is being priced as high risk. But there is a real difference between failing, or failed high streets and well located, strong secondary assets in need or active management or capex. If they're priced identically, for whatever reason, that's potentially interesting for buyers.	UK commercial property values suffered their first reversal in November 2011 after 27 months of steady growth, during which they retrieved 18% of the 44% lost during the property crash to early 2009. Retail assets, particularly outside of London and the south-east, have been amongst the weakest components of the sector during 2012.
Pressure on the consumer, internet shopping	
Ignore the averages and the extremes	Struggling high streets
Despite the media coverage, trading in many UK high town centres remains robust. These benefit from their proximity to more affluent, growing population centres, without severe competition from out-of-town retail or large shopping malls. A number of these are older properties, which could potentially benefit from investment to improve the retailer profile, grow footfall and capture a higher proportion of local spending. Refurbished centres would fit the growth strategies of food and value retailers, plus other categories not yet represented.	Mary Portas recently published her report into the decline of the UK high street. It investigated the causes and sought to identify remedies, but for large components of the UK high street retail estate there simply aren't any. Economic pressure is only part of the story. Serious structural issues are derived from new retailer strategies evolved over the last couple of decades, consumer habits, threat posed by out of and edge-of-town development, dominant malls and online retail.

Source: Edison Investment Research

Investment rationale: Positive cash flow and growth

Recent sector investment in retail property fits the main themes of this report. Discussions with management define the rationale for this strategy as follows:

Exhibit 16: Investment case

Cash is king	A shortage of bank debt for commercial property purchase generally has reduced competition for assets. Buyers with cash are thus particularly well-placed to negotiate and weak vendors in correspondingly poor positions to hold out for better prices.
Low cost of debt	Those with access to debt – which includes the entities covered in this report – can currently borrow at historically low UK interest rates and generate an immediate cash return from acquisitions. That's due to an unusually attractive gap (for the UK market) between all-in borrowing costs at c 3.5-4% and initial rental yields of 7-9% plus on retail property. Sceptics may regard the latter as unsustainable, due to potential for retailer failures and prolonged voids as national chains are rationalised. So far however, revenues for quality assets are proving quite resilient.
Yield expansion in secondary retail category reflects lack of distinction between strong and weak assets in this class	Institutional and overseas buyers still typically focus on 'prime' property, located in central London or the south east. There are fewer buyers for assets regarded as non-prime, a broad category which ranges from stronger secondary to a structurally impaired town centre. That lack of distinction (between stronger and weaker secondary retail assets) has resulted in a broad brush approach to valuations and presents buyers with attractive opportunities to build revenues. Ironically, these currently 'enlarged' valuation yields contrast with the 'yield compression' which characterised the market peak. At that point buyers did not distinguish sufficiently between good and inferior assets and often overpaid.
Conservative financing structures shift emphasis to ability to buy well and intensively manage assets	Where finance is available, the terms are generally far more conservative than was the case a few years ago. If the new industry norm is lower balance sheet gearing and available loan-to-value, this shifts the emphasis from clever finance structures to finding ways to ratchet returns from active portfolio management. The ability of each company to 'sweat' its assets will be a function of the profile of property acquired, price paid, the terms of underlying leases and relevant management experience and skills.
Dry development pipeline of new retail malls	Due to the near zero availability of development finance the pipeline of potential new retail centres has fallen to an all-time low. That should progressively increase demand for space in prime and better placed secondary locations.

Source: Edison Investment Research

Company reviews

The current UK retail market has generated asset pricing anomalies in better-placed secondary assets, on which companies will seek to capitalise. These assets remain a core component of UK retail and will provide opportunities for improved revenues and valuations over the next few years via intensive asset management. Equity investors can currently access substantial discounts to NAV and attractive dividends. We believe that, for this discrete group, the risks are more than discounted. To varying degrees, each has a supportive shareholder base, access to undrawn debt and JV funding for further acquisitions, refurbishment and developments. Any distinctions in this mix are generally reflected in their relative equity ratings.

The 'strong secondary' category is most material from the perspective of this report. It is the target investment for the second tier of quoted retail investors. It provides retailers with less expensive space, access to a solid consumer catchment and local consumer population with easy access.

Focus on management experience, sector, asset and tenants' niches

To recap, the components of the investment case, which we explore in this note, are that:

- Rather than prime vs secondary, effective analysis of prospects for UK retail property must differentiate between distinct strata, and focus upon better placed secondary.
- Pressure on net asset values can be counter-balanced by effective asset management. The seven companies in this report concentrate on specific niches such as sustainable income, out-of town development, town centres, local shopping, a focus on 'value' retail and intensive management of mature assets. This mixes defensive attributes with growth potential, has capacity to generate better returns and provides useful diversification.
- Management experience is particularly valuable in a challenging UK retail environment. These teams have proven track records, strong relationships and understanding of the challenges which leading retailers face.
- Financing structures are important. We identify which companies have further access to equity and undrawn debt at historically attractive terms. That provides them with opportunities to secure earnings and NAV/share enhancing growth in the short to medium term. It provides them with an important competitive advantage in a market in which banks continue to retrench; many of their traditional competitors for these kinds of assets are starved of capital.
- Company structures, eg UK-REITs, put emphasis upon maximising income and dividend growth, which should appeal to investors seeking income.

Imponderables include bank deleveraging and indeed, threats to retailers such as the internet, which were not around 20 years ago. Taking the above into account, however, we have set out brief overviews of the featured companies' distinct portfolio investment and growth strategies, which seek to capture the essence of each company's strategy in the short to medium term. What they have in common is experienced management teams with detailed knowledge of their particular investment niches.

Company profiles

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Capital & Regional

Year end	Revenue (£m)	Recuring PBT (£m)	EPRA EPS* (p)	DPS (p)	Yield (%)	NAV/ share (p)	Disc. to NAV (%)
12/10	30.7	14.9	4.0	0.0	0.0	50	52
12/11	28.9	16.4	5.0	0.0	0.0	56	56
12/12e	N/A	15.9	4.4	0.0	0.0	55	56
12/13e	N/A	17.0	4.8	0.9	3.5	59	59

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: NAV discount draws eye

We see potential for the 56% discount to NAV to narrow as C&R sweats a portfolio of direct holdings and external funds. This has already cut gearing and driven individual asset performances. Issues relate to a complex group structure and the potential for some managed funds to be wound-up over the next few years, although sales should return cash for other purposes. The portfolio generates rent, fund distributions and asset management fees. Around 57% of FY11 NAV was stakes in three external UK funds, 28% in Germany and the remainder JVs/associates, wholly owned assets and cash. All three UK funds outperformed their IPD index on a 12 month rolling basis.

Asset sales & management improve financial stability

The FY11 revenue decline following £370m of asset sales, mainly within The Mall and The Junction funds. Assets under management fell 12% y-o-y to c £2.5bn and the consensus forecast anticipates further portfolio sales this year. Interest costs and gearing fell (to 24% from 29% at FY10 year end) and see-through net FY11 LTV – including C&R's economic exposure to the portfolios for the three UK funds – was 64% (FY10: 66%). Tenant interest is illustrated by 15 new lettings, seven renewals and 29 rent reviews achieved in Q1 at above ERV or previous passing rents.

Valuation: 56% discount to end FY11 NAV/share

The shares are well below NAV, unmoved by recent operational recovery. A complex structure makes it difficult to put newsflow into context across the portfolio, but the projected EPS fall principally reflects asset sales that may cut debt and free cash for reinvestment. The Q1 IMS confirmed broadly stable performance by the combined UK funds. Despite an 'uptick' in tenant insolvencies rent collection rates remain strong. A recent CMBS default in Germany applies to the weakest asset in that portfolio - all others are ring-fenced - and may knock 1p off NAV/share. In part, the strategic agenda and returns will be driven by impending continuation votes and terminations of UK funds, and debt maturities and the next two years may see material sales of stakes in funds or assets. The Junction Fund (property value £287m at end March 2012), 13.4% owned by C&R has an imminent continuation vote and is reported by the media as being prepared for sale. Disposals could corroborate external valuations, provide a catalyst for a re-rating and release cashflow for capex, debt redemption or, potentially, restoration of dividends. Major institutional investors hold c 64% of the equity.

Price*	24p
Market cap	£84m

*As at 25 July 2012

Share price graph

Share details

Code	CAL
Listing	LSE
Sector	Real Estate
Shares in issue	350.6m

Price

52 week	High	Low
	39.0p	24.0p

Balance sheet as at 31 December 2011

Debt/Equity (%) – excl. fund shares	24
NAV per share (p)	56
EPRA NAV/share (p)	63
Net debt (£m)	47

Business

Capital & Regional is a specialist property company with a focus on retail investments in the UK and Germany. It has two investments in well-established UK retail funds; a joint venture with a German retail property portfolio; and a number of interests in leisure and trade park properties.

Major shareholders

Parkdev Intl AM	29.2%
Laxey Partners	9.8%
Standard Life	9.2%
Free float	68%

Revenues by geography

UK	Europe	US	Other
75%	25%	0%	0%

Analysts

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Company description: Portfolio actions to address NAV gap

C&R is split into **asset** businesses (The Mall, The Junction, X-Leisure, German JV), which earn revenues from rents, and **earnings** businesses, which manage property funds/JVs and operate the SNO!zone indoor ski slope. The strategic focus is retail property in the UK and Germany. C&R intends to realise its investment in X-Leisure (c 12% stake valued at £30.5m) and concentrate on asset management initiatives to unlock income and capital value growth from its existing retail portfolio, particularly The Mall and The Junction. Options are under review to secure the long-term future of The Mall ahead of a CMBS refinancing in 2015.

Trading benefiting from new lettings, renewals and rent reviews

Portfolio performance has responded to active asset management over the past 18 months. Negotiations with retailers for new space take longer to complete, but there were 101 new lettings (£8.8m rent, 2.2% above ERV), 57 lease renewals (£1.8m/+0.2%) and 156 rent reviews (£20.5m, 4.7% above previous rents, +6.1% vs ERV) across the funds during FY11. Momentum has continued this year, with values of combined UK funds broadly stable in Q1 and progress on new lettings, lease renewals and rent reviews.

Financials: Asset sales cut debt and add strategic flexibility

C&R is likely to remain a net seller of assets short term which should benefit group finances. Group net debt to equity was 24% at end FY11 and six assets sold by The Mall and The Junction in FY11 raised £370m at or above valuation. These have cut gearing and recycled cash, funding asset management initiatives within existing businesses. These included, in May, the £130m acquisition with a partner (C&R share £10.6m for 20% stake) of a shopping centre in Redditch at an 8% net intial yield. Its large retail centres have been affected by retail woes such as the failures of Peacock's and Game, but units are generally being re-let relatively promptly. Clinton Cards's administration post end Q1 affects £1.4m of The Mall's passing rent. C&R believes that the majority of these units trade profitably.

Exhibit 17: Financials (£m, December year end)

Income statement (£m)	FY09	FY10	FY11	FY12e	FY13e
Revenue - Asset businesses	7.8	7.6	7.4	N/A	N/A
Revenue - Earnings businesses	29.4	23.1	21.5	N/A	N/A
Share of profit in associates & JVs	(106.8)	45.2	22.3	N/A	N/A
Recurring pre-tax profit	**17.5**	**14.9**	**16.4**	N/A	N/A
Net finance cost	(8.3)	(6.2)	(3.5)	N/A	N/A
Pre-tax profit	**(113.4)**	**46.4**	**23.4**	N/A	N/A
Revaluation surplus	(2.8)	(0.2)	(1.5)	N/A	N/A
Per share data					
EPRA EPS (p)	1.0	4.0	5.0	4.4	4.8
Dividend per share (p)	0.0	0.0	0.0	0.0	0.9
Balance sheet (£m)					
Investment portfolio	10.2	10.0	8.5	N/A	N/A
Associates	76.4	110.8	120.2	N/A	N/A
Joint ventures	30.3	25.7	27.2	N/A	N/A
Trading properties/held for sale	84.2	70.8	71.5	N/A	N/A
Net (debt) - C&R balance sheet	(61.3)	(43.7)	(46.6)	N/A	N/A
Net asset value	**129.8**	**174.5**	**196.0**	**175.0**	**179.0**
Per share data					
NAV/share (p)	37.0	50.0	56.0	54.8	59.5
EPRA NAV/share (p)	47.0	57.0	63.0	61.3	63.5
Valuation data					
Discount to NAV	(35%)	(52%)	(56%)	(56%)	(60%)
Dividend yield	0.0%	0.0%	0.0%	0.0%	3.5%

Source: Company data, Thomson consensus estimates

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Year end	Gross rent (£m)	PBT (£m)*	EPRA EPS (p)*	DPS (p)	Yield (%)	EPRA NAV/ share (p)	Disc. to NAV (%)
03/11	18.6	(6.3)	(6.4)	4.90	2.6	253	25
03/12	23.1	7.4	3.4	5.15	2.7	250	24
03/13e	25.0	6.8	9.5	5.37	2.8	249	23
03/14e	27.6	10.3	18.8	5.61	2.9	270	29

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Rebalance towards retail

Neither pure UK nor retail, Helical invests broadly across real estate sectors in the UK and also has two developments in Poland nearing completion. We are however drawn by this leading sector entrepreneur's decision to push up its investment portfolio's UK retail weighting from c 26% to 61% (share of equity) over the past three years, although that is likely to be the limit of its exposure in this area, as its investment focus switches to investment development in central London. It has also sought to acquire better placed secondary locations, mainly town centre retail assets which it believes are likely to respond to its brand of hands-on asset management. Despite recent NAV/share declines, recent results saw no material writedowns.

Portfolio strategy

Helical's portfolio has seen a thorough transformation since January 2010, in line with a strategy to access sustainable cash flow to support development over the medium term. Substantial disposals of largely non-income producing development assets has funded over £250m of investment property acquisitions and portfolio value, including shares of JV assets, has increased from £494m to c £573m. The ratio of investment to trading/development assets has shifted positively, from c 45:55 to 69:31 at end March 2012, with 75:25 the target. Helical acquired c £103m of investment assets during FY12, including in October the £70m purchase of land and buildings in Corby Town Centre at an 8% net initial yield. It has since completed 15 lease renewals or new leases, with another eight lettings and six lease re-gears in the pipeline. Planned asset management initiatives, including development, should drive returns from recent acquisitions of undervalued areas of UK retail property. These have improved returns and helped offset the impact of administrations of Priceless Shoes and Peacock's.

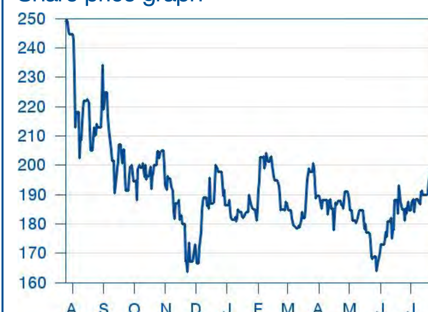
Valuation

The shares stand c 25% below the 250p end March 2012 EPRA NAV/share. Investment is effectively a call on the team's ability to ratchet returns via active management of its high-yielding assets and to generate returns from the development of a broad portfolio of commercial property schemes over the medium term. The group looks far better placed to navigate and moreover, capitalise, upon challenging markets post recent asset disposals with a portfolio weighted towards high yield investments.

Price*	191p
Market cap	£226m

*As at 25 July 2012

Share price graph



Share details

Code	HLCL
Listing	LSE
Sector	Real Estate
Shares in issue	118m

Price

52 week	High	Low
	250.0p	163.0p

Balance sheet as at 31 March 2012

Debt/Equity (%)	90
EPRA NAV per share (p)	250
Net debt (£m)	228

Business

Helical Bar is a property developer and investor which seeks to add value via active asset management activities. Property investment is the core activity and provides a stable income stream to cover all overheads and interest costs. The strategy is to deploy capital rapidly, with a focus on whatever opportunities offer the best returns at different points of the property cycle.

Major shareholders

Mike Slade (CEO)	11.4%
Baillie Gifford	8.4%
Aberdeen AM	8.2%
Blackrock Advisors	4.6%
Free float	83%

Net assets by geography

UK	Poland	US	Other
89%	11%	0%	0%

Analysts

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Company description: Refocus on stable rents and retail

Helical targets the middle retail tier, 'good secondary' with tenant demand the key acquisition driver. It seeks multi-let assets, active management opportunities and net initial yields of 7.5-10% (lower in London). In a 'no growth' economic environment it expects a majority of returns to come from income and seeks day one cash-on-cash returns of 10-15% pa after gearing. It sees the UK retail property market as follows:

- Prime/trophy 'institutional' assets enjoying reasonable demand from buyers, especially foreign investors seeking a 'safe haven', but with limited opportunities to add value. **Helical develops and sells into this market.**
- Well located, good quality assets in need of active management and/or capex. Often off institutional radar screens/hard to finance without a strong balance sheet. **The group's preferred area of buying.**
- Weak secondary/tertiary assets. Severe danger of falling rents/higher voids. **Avoid.**

£103m of acquisitions in FY12 characterise the strategy. Broadway House, Hammersmith was acquired in February 2012 for £14.1m, funded by new debt (65% LTV) from a UK bank at an all-in rate fixed below 4% for four years. The NIY was 5.7%, with an 8.7% target reversionary yield; 70% of passing rent is derived from retail tenants, ie Dolland & Aitchison, Lloyds TSB, Café Nero, Ladbrokes. It spent £11.1m in Basildon in July 2011 for an 8% NIY and has since agreed terms to re-gear three retail leases and secure tenants for vacant office suites.

Financials

FY12 profit reflects growth in net rent and a first contribution from development profits since H108. Year end net debt was £228m (£264m including share of JVs) at an effective 4.1% pa and 2.7 years average maturity. Balance sheet gearing, including the group's share of JV debt, was 104% at the year end (FY11: 94%), comfortable relative to interest cover and development plans. Approximately £43m of assets – 21% of the trading property – comes from two schemes in Poland approaching completion and potential sale this year.

Exhibit 18: Financials (£m, March year end)

Income statement (£m)	FY09	FY10	FY11	FY12	FY13e	FY14e
Gross rental income	20.8	18.9	18.6	23.1	25.0	27.6
Development income	54.1	47.8	84.3	19.7	N/A	N/A
Trading sales & other	6.9	0.7	16.2	10.2	N/A	N/A
Revenue	**81.8**	**67.4**	**119.1**	**53.0**	**25.0**	**27.6**
Finance cost	(7.6)	(8.3)	(8.1)	(10.0)	N/A	N/A
Pre-tax profit on ordinary activities	(71.9)	7.9	(6.3)	7.4	6.8	10.3
Gain on sale/revaluation of inv. properties	(66.7)	8.2	8.3	3.9	N/A	N/A
Per share data						
EPRA EPS (p)	9.0	2.9	(6.4)	3.4	9.5	18.8
Dividend per share (p)	4.5	4.5	4.9	5.2	5.4	5.6
Balance sheet (£m)						
Investment properties	241.3	219.9	271.9	326.9	N/A	N/A
Trading & dev. Stock	210.4	182.6	180.0	132.8	N/A	N/A
Group share of assets held in joint ventures	7.9	26.4	80.3	112.9	N/A	N/A
Group share of total net debt	(230.3)	(228.8)	(241.3)	(264.2)	(235.0)	(186.0)
Net assets	**237.1**	**242.6**	**255.4**	**253.7**	**254.5**	**281.0**
Per share data						
NAV/share (p)	242.0	241.0	225.0	221.0	241.0	260.0
Diluted EPRA NAV/share (p)	286.0	272.0	253.0	250.0	249.0	270.0
Valuation data						
Discount to EPRA NAV	(33%)	(30%)	(25%)	(24%)	(23%)	(29%)
Dividend yield	2.4%	2.4%	2.6%	2.7%	2.8%	2.9%

Source: Company data, Thomson consensus estimates

Edison investment research

The Local Shopping REIT

Year End	Net Rent (£m)	PBT (£m)	EPRA EPS (p) [1]	DPS (p)	Yield (%)	EPRA NAV/ share (p)	Disc. to NAV (%)
09/10	12.9	2.9	3.6	3.6	9.0	81	51
09/11	13.5	3.2	4.0	4.0	10.0	76	47
09/12e	14.3	3.3	4.2	4.2	10.5	72	44
09/13e	14.3	3.7	4.4	4.4	10.9	62	35

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Neighbourly niche

Local Shopping REIT combines a high dividend yield with a commitment to distribute 100% of recurring revenues from a diversified tenant base. Its strategic focus is neighbourhood retail parades, a £20bn value 'niche' broadly overlooked by institutional investors. We see LSR well-placed to capitalise upon attractive market fundamentals, eg as UK food retailers roll out more compact convenience store formats (Tesco Metro, Sainsbury's Extra) to fit more regular, lower-cost shopping trips. LSR is the leader in this discrete segment and invests both directly and on behalf of substantial JV partners (Pramerica, Schroders) and advises banks seeking to work-out/unwind their exposure. NAV may remain under pressure short term in line with secondary retail values, but the risks are offset by asset management and the current discount.

Portfolio: Steady demand from broad tenant sources

As at end March LSR held a £183m portfolio (645 assets, 2,026 letting units) with broad UK geographical spread and tenant diversification. The portfolio has a highly affordable letting profile; average rent per shop is £12,002 pa (£11.21/sq ft), estimated below 7% of tenant turnover. During the first half 103 rent reviews were completed at 3.6% average uplifts, 6% above market rents, in line with portfolio performance over the last 12 months. Another £0.6m pa of rent was secured as 62 vacant units were let. Although the portfolio fell in value by 2.8% in the first six months, operational performance was stable and voids steady for the period at 10.6% overall (March 2011: 11.1%). Yields moved out (from 8.16% to 8.21% NIY), reflecting valuer caution over the investment market in less economically active parts of the UK.

Valuation: Attractive yield and portfolio growth outlook

LSR is committed to distribute 100% of recurring profits earned over its full year, with a stated objective to pay a progressive dividend assuming it grows profits. Consensus forecasts put the shares on a 10.5% prospective yield, with earnings underpinned by a broad revenue base and assets well diversified by tenant and geography. The group has substantial funds for acquisitions, both directly and via JVs. We expect near-term growth to be driven by LSR's proven ability to grow rents and add value via active asset management such as relettings, lease regears and refurbishment.

Price*	40.0p
Market cap	£33m

*As at 25 July 2012

Share price graph

Share details

Code	LSR
Listing	LSE (UK-REIT)
Sector	Real Estate
Shares in issue	82.5m

Price

52 week	High	Low
	61.0p	40.0p

Balance Sheet as at 31 March 2012

Debt/Equity (%)	260
NAV per share (p)	65
EPRA NAV/share (p)	76
Net debt (£m)	127

Business

LSR holds a substantial UK retail portfolio. This comprises local shops in urban and suburban areas, typically local retail parades and neighbourhood venues for convenience or "top-up" shopping. It also manages third-party assets and JVs.

Major shareholders

Schroder IM	11.0%
TR Prop. Inv. Trust	10.2%
AXA Framlington	9.5%
JG Whateley	9.3%
Free float	66%

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Retail for the ‘just in time shopper’

LSR leverages in-house market intelligence and an established introducer network to acquire better-placed assets, often ‘off-market’, while intensive asset management ratchets up income and capital values. Stock picking is key to asset management angles; advantages are derived from auction market and private treaty activity, and direct approaches to local authorities and housing associations with capital tied up in retail parades. The strategy includes creation of JV/funds in aligned sectors. It has three management contracts with banks and secured three new JVs, which add acquisition/management fees and promote fees subject to agreed targets.

- LSR has a 20% stake in a £100m (£37.5m capital, plus debt) JV with Pramerica, which had acquired/committed to purchase 13 properties for over £37.3m by end March. The target return is a minimum 15% geared IRR. Debt is provided by HSBC; at end March £11.1m was drawn at an all-in cost of 3.4% (44% hedged).
- In March 2012 it set up a £60m JV with Schroders, which has made initial purchases.
- A “work-out” JV was established at the end of September 2011, in partnership with an undisclosed, established UK financial institution. This vehicle will acquire commercial properties across the UK, with a focus on local shopping assets. The structure is a 50:50 split, each partner committing £5m.

Financials: IMS confirms letting and revenue growth

Group loan to value as at end March 2012 was 71.9% (September 2011: 68.5%), reflecting £3.3m of drawdowns and the decline in asset values. There are no LTV provisions on £117m of facilities, with a 85% LTV covenant applicable to £17m (£45.5m facility provided by HSBC). Interest cover at end September 2011 was 215% vs covenants of 110-120%. There are no loan maturities before 2016. LSR sold four properties and two flats in the first half for £1.7m, 16.1% above valuation (FY11: 17 for £3.6m at 8.5% above book value). It has not made any purchases for the wholly-owned portfolio since the year end, but expected to be more active in H2 and beyond, as lenders seek solutions via loan book disposals, continue to put pressure on borrowers and reports that auction volumes picked up in the first half.

Exhibit 19: Financials (£m, September year end)

Income statement (£m)	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net rental income	12.4	12.9	13.5	14.3	14.3	14.3
Operating profit (underlying)	9.9	10.3	10.8	10.9	11.0	12.0
Finance cost	(7.1)	(7.4)	(7.5)	(7.6)	(7.3)	(8.3)
Recurring pre-tax profit	2.9	2.9	3.2	3.3	3.7	3.7
Revaluation surplus	(28.3)	2.7	(3.8)	N/A	N/A	N/A
Per share data						
EPRA EPS (p)	3.5p	3.6p	4.0p	4.2p	4.4p	4.5p
Dividend per share (p)	3.5p	3.6p	4.0p	4.2p	4.4p	4.5p
Balance sheet (£m)						
Investment portfolio	174.2	194.1	190.1	N/A	N/A	N/A
Net (debt)	(116.1)	(131.7)	(126.2)	N/A	N/A	N/A
Net asset value	58.6	57.6	53.8	51.3	48.6	50.0
Per share data						
NAV/share (p)	71.0	70.0	65.0	59.1	59.9	60.4
EPRA NAV/share (p)	77.0	81.0	76.0	71.5	61.5	61.9
Valuation data						
Discount to NAV	(48%)	(51%)	(47%)	(44%)	(35%)	(35%)
Dividend yield	8.8%	9.0%	10.0%	10.5%	10.9%	11.1%

Source: Company data, Thomson consensus estimates

Edison investment research

LXB Retail Properties

Year End	Gross Rent (£m)	PBT (£m)	EPRA EPS (p) [1]	DPS (p)	Yield (%)	EPRA NAV/ share (p)	Disc. to NAV (%)
09/10	1.4	(1.9)	(0.6)	0.0	0.0	95	(16)
09/11	5.0	0.1	0.0	0.0	0.0	108	(1)
09/12e	6.9	0.0	(0.2)	0.0	0.0	118	7
09/13e	8.9	(1.3)	(0.5)	0.0	0.0	147	25

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Well set for medium term

We see LXB's attractions in prospects for short-term NAV growth on the back of asset improvement and development, underpinned by its 2009 formation, which means that there are no legacy assets acquired at the market peak to drag back performance. The focus is out-of-town and edge-of-town retail parks and the strategy is to develop high quality investments capable of generating substantial, secure and growing rents. In the past two years LXB has built a £224m portfolio of investment and development opportunities. It has so far signed agreements for lease at several locations and secured planning or resolutions to grant permissions at six sites which, with two others expected shortly, would comprise in total c 2.1m sq ft of new space.

Planning, pre-lets to add value ahead of development

As at 31 March LXB's portfolio included six foodstore led and three fashion-park led projects, plus leisure and residential opportunities. The momentum achieved in FY11 has been maintained. In November it announced four pre-lets to Marks & Spencer, has since agreed terms with a 'household name' tenant for 100,000 sq ft in three stores and advanced discussions are under way for pre-lets on other sites. In FY11 it raised £110m net via equity issues (99.2m shares at 114p) and 31 March had cash and other liquid resources of £97.1m, all allocated to existing projects or its pipeline. Construction will be funded by development debt, currently under negotiation with lenders. The business plan incorporates modest gearing and, in anticipation of future borrowing needs, LXB has fixed the LIBOR element of finance costs via a forward swap at 1.6675%: £100m of debt from 31 March 2013 to 30 September 2015.

Valuation: Planning, letting & schemes milestones

The core return is portfolio value growth as assets are progressed through planning, pre-lets and development. This has already generated material uplifts and illustrates an ability to drive returns despite an unhelpful UK retail backdrop. LXB's investment portfolio was valued by Jones Lang LaSalle as at end March 2012 at £222.4m (Sep 2011: £182.8m), which contributed to further growth in EPRA NAV/share to 111.6p. Each project milestone is typically reflected in asset values at external appraisals, although a conservative approach to value recognition means that there should still be further material upside as investments approach practical completion.

Price*	110p
Market cap	£280m

*As at 25 July 2012

Share price graph

Share details

Code	LXB
Listing	LSE
Sector	Real Estate
Shares in issue	254m

Price

52 week	High	Low
	122.0p	91.5p

Balance sheet as at 31 March 2012

Debt/Equity (%)	N/A
NAV per share (p)	111
Net cash (£m)	71

Business

LXB Retail Properties is a Jersey incorporated closed-ended real estate investment company, founded in 2009 by a well-regarded and experienced team. The strategy is to invest in out-of-town and edge-of-town retail assets and develop a portfolio of high quality retail assets over the medium term.

Major shareholders

Invesco AM	17.0%
BlackRock Inc.	13.0%
Jupiter AM	9.3%
Morgan Stanley IM	9.0%
Scottish Widows Inv. Ptrship.	8.5%
Free float	85%

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Development driven growth strategy

The group's relatively recent foundation means it has built a portfolio to supports its focus on creation of space to fit current trading formats, in preferred locations, at sustainable rental levels. In the period since October 2010 it has acquired sites and secured planning consent at Sheppey, Banbury, Biggleswade, Gloucester, Stafford and a hotel scheme at Greenwich, and awaits planning committee decisions at Rushden, and for a new Sainsbury's Marks & Spencer scheme at Greenwich. Assuming that these are granted, LXB will have secured consent for c 2.1m sq ft of new space, including 0.3m sq ft for other employment uses.

As the group will not develop speculatively it has, in addition to securing its planning position, negotiated lease terms with key occupiers for new investments. As at the last year-end these include Agreements for Lease with major food retailers including Morrisons and Sainsbury's and four pre-lets with Marks & Spencer. Including the latter, it had secured tenants for approaching 800,000 sq ft of its portfolio and reported advanced discussions on pre-lets for another 500,000 sq ft as well as two 120-bed hotels. Construction is underway at Greenwich and Stafford, Sheppey and Gloucester are due to commence this year, with stores due to open for trading during 2013.

Financials: Equity in place to fund existing investment plans

In FY11, £74.3m (2010: £92.7m) of cash was used in acquisition capex on investment properties, with another £17.6m in H112. At end FY11 LXB projected that it would require c £82m of equity to fund all of its existing investments through to practical completion. That projected expenditure is however, largely discretionary, as very little is subject to legally binding obligations. At the half year it held £97.1m of cash and equivalents, all allocated to existing schemes or the pipeline. Cashflow improved in FY11 as additions to the portfolio pushed up net rental income, but from FY12 annualised overheads are forecast to exceed rental income. The latter will fall as vacant possession is achieved ahead of proposed development.

LXB will secure further bank facilities to support construction and reports that, despite the economic backdrop, there remains lender appetite to provide finance.

Exhibit 20: Financials (£m, September year end)

Income statement (£m)	FY10	FY11	FY12e	FY13e
Gross rents	1.4	5.0	6.9	8.9
Operating profit (underlying)	(0.9)	0.5	0.4	1.2
Finance cost	(1.0)	(0.4)	(0.6)	(1.5)
Pre-tax profit	(1.9)	0.1	0.0	(1.3)
Revaluation surplus	0.3	19.1	28.0	79.0
Per share data				
EPRA EPS (p)	(0.6)	0.0	(0.2)	(0.5)
Dividend per share (p)	0.0	0.0	0.0	0.0
Balance sheet (£m)				
Investment portfolio	93.0	194.8	N/A	N/A
Net cash/(debt)	52.1	87.2	N/A	N/A
Net asset value	145.9	274.4	300.0	347.9
Per share data				
NAV/share (p)	94.2	108.0	118.1	137.3
EPRA NAV/share (p)	95.2	108.2	118.3	147.4
Valuation data				
Discount to NAV	16%	2%	(7%)	(25%)
Dividend yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Thomson consensus estimates

Edison investment research

Metric Property Investments

Year end	Gross rent (£m)	EPRA PBT (£m)*	EPRA EPS (p)*	DPS (p)	Yield (%)	EPRA NAV/ share (p)	Disc. to NAV (%)
03/11	4.7	1.1	0.5	0.6	0.7	101	20
03/12	12.8	6.6	3.5	3.3	4.1	107	24
03/13e	18.1	8.6	4.3	4.0	4.9	111	27
03/14e	20.8	9.7	5.1	4.6	5.6	117	31

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Out-of-town retail focus

METP is a specialist retail UK-REIT, formed in 2010 to pursue a strategy to create value at each stage of property ownership, from acquisition to exit. The investment case is predicated upon potential for NAV and dividend yield growth and the group's relatively recent formation, which means it has no legacy assets purchased at the peak of the market. It has acquired existing out-of-town retail on EPS accretive terms. An experienced team identifies retail properties with sustainable revenue profiles at attractive prices, then applies intensive asset management strategies to enhance existing rent, ie improving leases, letting void and refurbished space, with progress already reflected in valuations. When asset management is complete it expects to sell upgraded assets and reinvest/recycle cash into similar opportunities.

Portfolio: Progress building portfolio since 2009 IPO

The strategic focus is the ownershp and delivery of new out-of-town retail space in short supply. Since IPO it has built a £242m portfolio of 24 assets including JV shares. It acquired eight assets in FY12 – retail schemes, parks and foodstores let to tenants with broad sector exposure: food (18%), general merchandise (18%), DIY (14%), electrical (15%), home furnishings (12%), furniture (12%) and other retail (11%). Some £24m of capex was allocated to asset management initiatives in FY12. Risks are managed via partnerships with leading retailers which seek to expand, reposition and rebalance networks to fit changing consumer habits and retail models. The portfolio has performed well operationally (19 new lettings, £3.4m pa of new rent) and planning gains will contribute to rent and dividend growth over the medium term.

Valuation: Range of EPS accretive options available

End FY12 EPRA NAV/share was 107p, after 9p/share of IPO and accumulated acquisition costs. The period to end March 2012 saw a 3.5% increase in the portfolio valuation, or a 4.4% growth excluding acquisition costs. A total 10.7% portfolio return after costs was well ahead of the 5.0% IPD All Retail index, two-thirds derived from the development portfolio. Planning gains and pre-lets on four schemes offset a 20bp outward movement in valuation yields. The growth strategy assumes no underlying rental growth at the macro level. METP remains in the relatively early stages of building its portfolio and expects to see a material increase in investment opportunities this year as debt refinancing, fund redemptions and corporate pressure improve pricing terms.

Price*	81.0p
Market cap	£154m

*As at 25 July 2012

Share price graph

Share details

Code	METP
Listing	LSE (UK-REIT)
Sector	Real Estate
Shares in issue	190m

Price

52 week	High	Low
	111.0p	82.0p

Balance sheet as at 31 March 2012

Debt/Equity (%)	13
NAV per share (p)	104
Net debt (£m)	22

Business

Metric Property Investments is a specialist UK retail property investment company which seeks to grow rents and values via intensive asset management, ie leasing, rent reviews, lease renewals, extensions and redevelopment.

Shareholders

APG Asset Management	9.2%
University Superannuation Sch.	8.6%
Kames Capital Group	5.4%
Taube Hodson Stonex Ptnrs	5.3%
Free float	96%

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Focus on robust out-of-town assets

The strategy is to acquire operationally strong retail assets that provide an immediate cashflow contribution. Average initial property yields are 260bp above finance costs and intensive asset management initiatives should help drive revenue growth. Due to its recent formation, assets have been bought for their ability to perform in the current retail environment, with no legacy assets acquired earlier in the cycle. It has also established a £150m JV with USS (MIPP), which at end May 2012 had acquired five properties for £52m. Metric has a third share in this fund and receives a management fee of 0.4% pa of gross assets. The fund has a 6.9% pa running yield and 40% of its income is subject to RPI/fixed uplifts. The portfolio is fully occupied with an unexpired lease term of 17.7 years. Including anticipated debt facilities and committed and earmarked capex, Metric and MIPP have respectively c £85m/£113m of further firepower.

Portfolio performance: Above average sector returns

The end March 2012 investment portfolio was 98% let (97% end Sep. 2011) with another 2% in detailed negotiations. Like-for-like rental growth was 3.1% in FY12, with 19 new lettings to M&S, Next, Boots, Costa, Carphone Warehouse, Hobbycraft and others. Capex of £20.4m, including commitments, is expected to deliver a 14% return on capital, 8.4% yield on total cost. Six units were vacated due to administrations; five have since been relet at 5% above previous passing rents and advanced discussions are underway potential occupiers for the other unit. The development pipeline includes retail parks at Bishop Auckland (82% pre-let), Cannock (87% pre-let) and Berkhamsted (84% pre-let to M&S Simply Food).

Finances

The annualised rent roll is c £15.3m, up 28.7% y-o-y (3.1% lfl), including £3.4m of additional income secured from 19 new lettings during FY12. Revenue visibility and sustainability is underpinned by an 11.8-year average unexpired lease length (10.9 year to first break) and £14.5/sqft average passing rents, with significant reversionary potential. The group's weighted average cost of debt is 3.9%, 260bp below the average yield on cost of its investment property portfolio. Group LTV was 13% at the year end, including MIPP, rising to 25% on a pro-forma basis – assuming completion of its committed developments and equity investment in MIPP.

Exhibit 21: Financials (£m, March year end)

Income statement (£m)	FY11	FY12	FY13e	FY14e
Gross rental income	4.7	12.8	18.1	20.8
EBITDA	0.2	8.4	13.1	15.7
Finance cost	0.9	(1.3)	N/A	N/A
Pre-tax profit	1.1	6.6	8.6	9.7
Revaluation surplus	7.6	7.7	9.6	14.5
Per share data				
EPRA EPS (p)	0.5	3.5	4.3	5.1
Dividend per share (p)	0.6	3.3	4.0	4.6
Balance sheet (£m)				
Investment portfolio	192.4	225.9	N/A	N/A
Net (debt)/cash	28.0	(29.3)	(85.0)	(110.0)
Net asset value	191.1	201.3	184.0	194.2
Per share data				
NAV/share (p)	101.0	105.9	108.5	115.0
EPRA NAV/share (p)	101.0	107.0	111.3	117.4
Valuation data				
Discount to NAV	(20%)	(24%)	(27%)	(31%)
Dividend yield	0.7%	4.1%	4.9%	5.6%

Source: Company data, Thomson consensus estimates

NewRiver Retail

Edison investment research

Year End	NPI (£m)	PBT (£m)*	EPRA EPS (p)*	DPS (p)	Yield (%)	EPRA NAV/ share (p)	Disc. to NAV (%)
03/11	4.4	0.8	6.3	5.5	3.0	273	34
03/12	12.8	4.4	16.9	15.0	8.3	258	30
03/13e	14.9	5.9	18.1	16.5	9.1	252	28
03/14e	16.3	6.1	18.8	17.5	9.7	257	30

Note: Edison estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Focused value-creation

An attractive yield and growth outlook is derived from NewRiver's strategy to invest in existing high-yielding, well-placed secondary town centre retail on EPS accretive terms. The group was launched in 2009, so has no legacy assets acquired at the top of the cycle. It has focused upon assets with sustainable revenues, potential to respond to intensive asset management and a tenant weighting towards food, value clothing and health & beauty sectors, regarded as relatively robust in a period when consumer budgets are under pressure. Management's track record provides a compelling template for above-average returns. The investment model combines careful selection of in-town retail assets, implementation of value creation – tenant/lease management, development, refurbishment – and well-timed exits.

Portfolio: £275m assets under management

In the 33 months since its IPO NRR has built a £275m (assets under management) retail property portfolio and secured diversified revenue streams, ie rent, JV income and asset management fees. It was profitable within six months of IPO and paid its maiden dividend within 16 months. Its strategy is to seek assets able to generate a 15% pa geared return on invested cash, via the use of equity, debt and co-investment funds. It achieved underlying growth in NAV/share of c 7% at the property level in FY12. The 5.5%% EPRA NAV fall over the period reflected 33.5p/share of expenses related to fund-raisings and one-off acquisition costs.

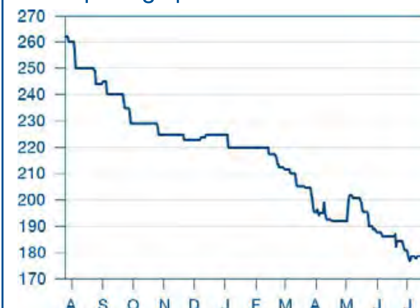
Valuation: 9% fully covered forward yield, NAV cover

NRR is managed as a traditional UK REIT, with rental growth the key driver of portfolio returns. Assets are chosen principally for sustainable rental yields, then their potential to respond to pro-active asset management initiatives in the next few years and achieve the return target without any underlying market growth or significant new development. The latter is assisted by access to debt at c 4% pa all-in vs c 8-9% pa net initial yields from acquisitions. The FY12 distribution was a fully-covered 15p/share, an 8.3% yield (9.1% for FY13) and we see potential for further growth over the next two years. There is also considerable asset backing. The shares are currently 28% below prospective FY13 NAV/share and active asset management initiatives are likely to provide the key drivers of income and capital growth over the next few years.

Price*	181p
Market cap	£58m

*As at 25 July 2012

Share price graph



Share details

Code	NRR
Listing	LSE (UK-REIT)
Sector	Real Estate
Shares in issue	31.8m

Price

	High	Low
52 week	256.0p	177.0p

Balance Sheet as at 31 March 2012

Debt/Equity (%)	157
Net debt (£m)	124*

*Incl. Conv. Unsecured Loan Stock

Business

NewRiver Retail is a specialist REIT, established in 2009 with to capitalise upon the next cycle of the UK retail property sector. It targets food and value sub-sectors as an opportunistic acquirer of high-yielding assets, to which it adds value via active asset management, refurbishment and development.

Major shareholders

Asset Value Investors	9.2%
Forum European Realty Inc.	8.8%
Directors & related holdings	7.2%
Spearpoint	6.8%
Free float	93%

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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NewRiver Retail is a research client of Edison Investment Research Limited

Company description: Ratchet returns via asset management

The group seeks to leverage competitive advantages such as access to deals, finance and equity capital, and established relationships with tenants in its chosen niches – food and value retail – to maximise returns from assets in the first few years under ownership. Neither the strategy nor our forecasts anticipate any underlying market growth. The core strategy is predicated on achieving its target 15% pa geared IRR return, without any development.

Management has identified schemes suitable for risk-controlled development in the next few years. These include basic refurbishment of vacant units and pre-let development for new food/ department stores. Recent portfolio updates illustrates how NRR secures its target returns.

- A sale in Great Yarmouth for £3.38m at a 8.25% NIY. The group bought this property in August 2011, replaced the tenant with Poundland via a new 10-year lease and increased rent from £0.2m pa to c £0.3m pa, resulting in an effective 11.2% NIY on purchase. The ungeared IRR on disposal is 43.2%.
- A new ground lease for 125 years on a property in Newcastle upon Tyne, acquired in June 2010 for £4.2m, ie a c 9.6% NIY. It simultaneously let the property to a fashion retailer (part of JD Sports) and further enhanced the valuation via renewal of a short-term letting to H Samuel with a 10-year lease, with no break clauses.
- Acquisition of a long leasehold interest of an existing freehold asset in Skegness from the Co-op (CWS) for £2.9m, ie a 9.5% NIY, generating an immediate uplift in value. The property is let to Home Bargains with a seven-year unexpired lease and CWS.

Financials

FY12 results showed that the strategy can build sustainable revenue growth in a challenging UK retail environment. Returns were derived from 70 positive 'leasing events' (new lettings, lease renewals and re-gears), 92% at or ahead of business plan at average rents 1% ahead of market rates. NRR completed £93m (net) of acquisitions at average 8.5% pa initial yields, and grew assets under management to £275m (2011: £166m). The focus on resilient food and retail sub-sectors kept retailer administrations to 1.6% of gross rents.

Exhibit 22: Financials (£m, March year end)

Income statement (£m)	FY10	FY11	FY12	FY13e	FY14e
Net property income	0.3	4.4	12.8	14.9	16.3
Operating profit (underlying)	(0.8)	2.5	9.7	11.7	12.0
Finance cost	(0.0)	(1.7)	(5.3)	(5.8)	(5.9
Pre-tax profit	(0.8)	0.8	4.4	5.9	6.[illegible]
Revaluation surplus	1.3	3.6	0.1	0.5	1.0
Per share data					
EPRA EPS (p)	(8.2)	6.3	16.9	18.1	18.8
Dividend per share (p)	0.0	5.5	15.0	16.5	17.5
Balance sheet (£m)					
Investment portfolio & JVs	25.1	117.7	209.4	223.0	225.0
Net (debt)	1.4	(74.2)	(123.9)	(141.5)	(142.5
Net asset value	26.1	38.8	79.1	77.0	77.5
Per share data					
EPRA NAV/share (p)	261.0	273.0	258.0	252.0	257.0
Valuation data					
Discount to NAV	(31%)	(34%)	(30%)	(28%)	(30%
Dividend yield	0.0%	3.0%	8.3%	9.1%	9.7%

Source: Thomson consensus estimates, Edison Investment Research

Edison investment research

Town Centre Securities

Year End	Net Property Rent (£m)	PBT (£m)*	EPRA EPS (p)*	DPS (p)	Yield (%)	NAV/ share (p)	Disc. to NAV (%)
06/10	18.7	7.6	14.8	10.36	6.4	269	40
06/11	18.4	8.2	15.1	10.44	6.4	288	44
06/12e	N/A	N/A	14.1	10.44	6.4	275	41
06/13e	N/A	N/A	14.1	10.54	6.5	278	42

Note: Consensus estimates; *EPRA EPS excludes revaluations and other adjustments.

Investment summary: Solid provincial asset base

We see a mismatch between a rating at an attractive yield and NAV discount, and the underlying operational stability of TCS's established retail assets. The group is a long-term investor and developer with a provincial UK – Leeds, Manchester, Glasgow and Edinburgh – focus. As at end December 2011 its retail assets (individual shop units, shopping centres, retail warehouses and food stores) generated 58% of rental income, with 21% from car parks and the remaining 21% offices and residential. Although management is cautious regarding prospects for underlying markets, overall portfolio occupancy was 96.8% at mid-May (97.2%: end Dec 2011) post administrations of Bon Marche, Peacock's and Game, with only one unit still vacant with tenant interest being pursued. It reported solid trading at its key asset, the Merrion Centre in Leeds; footfall was 7.6% ahead in December 2011, 5.3% in the first four months of H2. All revolving debt has been refinanced, with maturities extended to four or five years.

Sweating assets to improve revenue performance

In a tough market the focus is to sweat assets to improve revenue stability, cut voids and deal with any issues with financialy weak tenants before they occur. The interims illustrated an ability to maintain solid portfolio performance and confirmed that well-located retail assets in major cities such as Leeds, Manchester, Glasgow and Edinburgh can trade successfully in a more austere period. Over 100 new leases and renewals were completed in 2010/11, to generate 3.8% rental growth in the Merrion Centre, 1.6% for the portfolio overall. The investment portfolio was valued at £281.8m at the mid-year - a £2.2m valuation deficit - at a 7.1% initial yield (June 2011: 7.0%).

Valuation: 6.6% prospective yield, NAV underpinning

The shares, at a discount of c 43% to 288p FY11 year-end NAV/share are well cushioned against challenging markets, backed by a 6.4% prospective dividend yield. Recent extension of short-term debt removed a possible source of concern. We see benefits in the strong emphasis on risk management, in line with a family managed and owned (54% of shares in issue) business. The strategic focus is tenant/asset management. The group anticipates little help from the market in H1 and pressure on occupancy rates in H2; however 96.8% is close to full occupancy allowing for tenant churn in a broad portfolio.

Price*	162p
Market cap	£86m

*As at 25 July 2012

Share price graph

Share details

Code	TCSC
Listing	LSE
Sector	Real Estate
Shares in issue	53.2m

Price

	High	Low
52 week	190.0p	130.0p

Balance Sheet as at 31 December 2011

Debt/Equity (%)	94
NAV per share (p)	284
Net debt (£m)	143

Business

Town Centre Securities is a long-established UK property investment and development company. It holds a c £282m portfolio of mixed-use developments located close to transport hubs in major cities across the UK, principally Leeds, Manchester, Glasgow and Edinburgh.

Major shareholders

Ziff family (concert party)	54.1%
Free float	52%

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Long-term town centre investment

TCS's business model is to work existing assets and tenants, invest and develop to improve revenue sustainability. The portfolio was valued at c £282m portfolio at the mid-year with the main asset (42% of the total), the Merrion Centre in Leeds. The focus is long-term ownership of assets in locations that management regards as good and improving. Over the medium term it will add assets where management sees opportunities to add value and seek planning concent to improve existing holdings. Recent examples of this are (a) the consent obtained for a new Merrion Centre frontage in late 2011 and redevelopment of the multi-storey car park; (b) the £3.5m reconfiguration of Urban Exchange as a retail destination, since let to Go Outdoors, Marks & Spencer, Aldi and Pure Gym and (c) the acquisition of 6/7 Park Row, a central Leeds office building occupied by Lloyds Banking Group.

Finances

The group generated £17.7m of net rent in FY11 and £4.8m income from car parks. Underlying pre-tax profit was £8.1m, net of a £6.8m interest charge and it paid £5.6m in dividends. Interim H112 pre-tax profit was £4.0m (H111: £4.4m) and underlying EPS 7.6p (H111: 8.3p). Headline pre-tax profit fell to £1.8m (H111: £7.8m), due to the £2.2m fall in portfolio value (H111: £3.2m increase). Rents were steady at £8.8m (H111: £8.9m), ie a positive performance adjusted for asset sales last year. Intensive asset management resulted in 1% like-for-like growth, as income from new letting at Urban Exchange in Manchester offset reductions elsewhere. Rents from the Merrion Centre were stable.

Total borrowings at end December 2012 were £142.5m, with all short-term debt refinanced in H112. TCS now has access to £106m of 5.375% First Mortgage Debenture Stock that matures in 2031, and drawings under a £90m revolving credit/£5m overdraft facility from RBS, Lloyds and Handelsbanken, which expires in 2015 and 2016. Mid-year balance-sheet gearing was 94% (FY11: 92%) and total debt 48% of property assets (FY11: 47%). The portfolio has experienced ten administrations so far this year, the majority of which continue to trade. Rent collection was strong; over 98% of rents were collected within five days of the due date at both the September, December and March quarters.

Exhibit 23: Financials (£m, June year end)

Income statement (£m)	FY10	FY11	FY12e	FY13e	FY14e
Rents from inv. properties & car parks	23.0	22.5	N/A	N/A	N/A
Operating profit (underlying)	14.4	14.4	N/A	N/A	N/A
Finance cost	(7.6)	(6.8)	N/A	N/A	N/A
Underlying pre-tax profit	7.6	8.2	N/A	N/A	N/A
Revaluation surplus	25.4	6.8	N/A	N/A	N/A
Per share data					
EPRA EPS (p)	14.8	15.1	14.1	14.1	14.0
Dividend per share (p)	10.36	10.44	10.44	10.54	10.65
Balance sheet (£m)					
Investment portfolio	276.8	283.1	N/A	N/A	N/A
Development portfolio	13.3	13.3	N/A	N/A	N/A
Net (debt)	(141.3)	(140.2)	N/A	N/A	N/A
Net asset value	142.9	152.9	N/A	N/A	N/A
Per share data					
NAV/share (p)	269.0	288.0	275.0	278.0	N/A
Valuation data					
Discount to NAV	(40%)	(44%)	(41%)	(42%)	N/A
Dividend yield	6.4%	6.4%	6.4%	6.5%	6.6%

Source: Company data, Thomson consensus estimates

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