



Market data	
EPIC/TKR	LMP
Price (p)	179
12m High (p)	188
12m Low (p)	147
Shares (m)	697
Mkt Cap (£m)	1247
EV (£m)	1930
Market	Main, LSE

Description

LMP's business is real estate for retail – principally large, long-lease retail warehouses, and it now has an 18% presence in urban logistics warehouses (in strong demand for 'last-mile' retail delivery execution).

Company information

CEO Andrew Jones
 CFO Martin McGann
 Chairman Patrick Vaughan

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Key shareholders	
Directors	3.5%
Blackrock	7.3%
Rathbones	7.1%
Troy	5.0%
Standard Life	4.0%
Threadneedle	3.8%

Diary

End-May Full-year results
 Mid-Jul AGM

Analyst

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LondonMetric Property

Income compounder: the logistical investor

LondonMetric's (LMP) five-year total shareholder return is 122% (FTSE 350 Real Estate sector 69%). Remaining retail-focused, it has raised Distribution investment assets from 28% (2014) to 69% currently (with developments), reducing its retail parks greatly, to 8%. Income is the driver. Management has achieved reliable and predictable results here. The focus is on structurally supported sectors and strong-covenant long leases. 48% have a contractual income uplift. Development and asset management add 'alpha', including re-gearing leases and adding new tenants. The last two years saw significant expansion into Urban Distribution.

- ▶ **Strategic focus on income:** The average REIT dividend yield is ca. 3.5%, whereas LMP delivers 4.4%. We consider this premium payout involves low risk. LMP's assets are priced at 5.3% net initial yield (NIY), and financial gearing of 34% loan to value of assets (LTV) takes the cash-on-cash return to 6.7% historical.
- ▶ **An early mover:** LMP invested and built distribution assets ahead of others' weight of money. 28% of net income derives from seven 'mega' assets, let on average £5.30/sq. ft. (£5.60 for all Distribution assets). Lease length (WAULT) for these is 13.7 years; the total across this REIT is 12.4 years.
- ▶ **Retail supply chain:** LMP includes 'urban' logistics, with a good breadth of exposure to retail distribution. Online retail growth drives all such LMP assets. Distribution assets comprise >60% of the contracted rent roll and are growing.
- ▶ **Risks:** Some development (generating 6%-7% yield on cost) is undertaken; a portion is not pre-let. LTV of 34% (last interims) is conservative, given 99.4% occupancy and only 3.5% of leases expire in three years. Modern retail Distribution assets form a robust sector. LMP has honed its retail parks down to just five attractive assets (from 23 four years ago).
- ▶ **Investment case: income plus NAV.** NAV is still relevant, but a greater focus is on the cash-backed profits, and thus the ability to grow dividends. REITs have to pay 90%+ of such profits as a dividend. LMP's strategy supports growth and security, based on the cash returns of the portfolio. Thus, the valuation should not focus overly on price to NAV, but more on the sustainable, progressive dividend.

Financial summary and valuation				
Year-end March (£m)	2016	2017	2018E	2019E
Gross income plus share JV profit	72.4	77.5	90.5	94.5
Total expenses*	(12.5)	(12.5)	(13.5)	(14.0)
Finance costs	(30.6)	(19.6)	(17.0)	(18.0)
Revaluation, disposal profits	53.4	17.7	75.0	50.0
Declared profit	82.7	63.0	135.0	112.5
EPRA PBT (adj. pre. revn., hedging, etc.)	48.5	51.0	60.0	62.5
EPRA EPS (p)	7.8	8.2	8.5	8.8
DPS (p)	7.25	7.50	7.80	8.10
Net assets (EPRA)	922.1	1030.5	1118.0	1208.0
Net cash (debt) incl. share of JV	(591.2)	(481.6)	(680.0)	(720.0)
Dividend yield (%)	4.0	4.2	4.3	4.5
EPRA NAV (p)	147.7	149.8	160.0	168.0

* Net of advisory fee income ongoing forward ~£1.5m pa

Source: Hardman & Co Research, LMP

Investment case

Strong covenants within UK retail logistics...a relatively early investor

Repositioning since FY14 has been successfully executed

Occupancy 99.4%, lease lengths 11.5 years to average first break

Fair amount of transactions last year – fewer anticipated going forward

Modest level of short-cycle development adds value. Estimated £120m spend commitments in developments....

....which achieve 6%-7% on cost

Urban logistics saw the greatest increase in exposure in 2017, LMP having been a relatively early mover in the mega 'sheds'

LMP's assets benefit from long leases on strong covenants, focused on UK retail logistics. With investors seeking secure income, allied to the changes in retail supply-chain, asset prices have risen in this segment. Positive momentum nonetheless remains. Distribution exposure rises progressively, and is now up to 69% of the total portfolio (steadily rising from 28% in FY14 and with a target of 75%+. This includes 18% of the portfolio that is Urban Logistics, a growing proportion. NIYs of Distribution assets stand at a blended 4.9%, with strong rental growth prospects. Retail parks were formerly a much greater proportion, and are now down to 8%.

The assets' simplicity adds to attractions. The large majority are single-tenant assets with low (1.3%) income leakage. Occupancy is 99.4% (excl. the 2% historical residential assets being worked out profitably). WAULT is 12.4 years, (and to first break is 11.5 years). This comprises a low-risk income stream. LMP undertakes development, which, in most, but not all, cases is pre-let. This development, however, is in the core, well-understood, asset types and is in locations of strong demand. 30th September 2017 forward contracted income stood at £93.8m pa. Once fully let, the development pipeline (principally at Bedford) will raise this to £98.9m.

As with other income-driven, long-lease REITs, we see ample scope for the rating to reflect income distribution more than NAV. As a result, there is scope to trade at a premium to NAV. Fiscal year to date, LMP disposed of £226m and bought £278m. Having repositioned within retail (reducing retail parks, raising distribution), the asset-type mix is now more 'steady-state'. This indicates a desire and ability to undertake lower-risk development and pursue a modest level of acquisitions in a stable portfolio. This could, perhaps as recently, comprise acquiring specialist portfolios, particularly with an eye to urban distribution. We do not see development aspirations raised much beyond the current £45m we estimate required to complete developments in build, plus £75m to be spent on the three in the pipeline.

Short-cycle development reduces risks, as opposed to raising them. It adds income yield, quickly converting 'pipeline' to investment. None is undertaken with a view to short-term disposal. Modest development is a means to diversify growth (not relying entirely on acquisitions). It achieves premium returns, namely a 6.2% income yield on developments in build and 7.0% on those to be commenced; the latter amount is principally the Bedford development, at a 7.3% yield on anticipated £4.4m pa rents.

With investors seeking reliable, growing income in preference to growth contingent on yield shift, large-scale development or rapid trading of assets, LMP is well placed. Management's relationships, expertise and track record are supportive.

- ▶ LMP's portfolio chimes well with structural demand for large, regional and urban retail logistics. Supply (especially urban and regional) will remain constrained.
- ▶ LMP has expanded in the strong 'urban logistics' sub-class, increasing to £293m at last period-end (September 2017) vs £82m a year earlier. Recent acquisitions are on 5.9% yields. To an extent, the intrinsic (other-use) value within a location is even more important than WAULT, tenant or even initial rent.
- ▶ LMP's success in short-cycle (under 12 months) development adds value. Within a total of £177m, across 11 projects, Bedford's anticipated cost is £60m. Here, land cost was fixed three years ago. Note: in 1H, no land acquisition valuation uplift was taken. Uplift may occur on pre-letting and construction completion.

28% leases on automatic fixed annual rises, 20% inflation indexed

▶ LMP has an efficient structure, with 3.0% finance costs (down from 3.5% and a 1.8% marginal cost) and a competitive 15% EPRA cost ratio (also recently falling).

▶ Like-for-like (LFL) income grew usefully above RPI in each of the past four years. LFL grew 4.6% in FY17 (3.1% average prior three years).

Disposals include a large asset sold on 5.0% NIY

The bigger picture – LMP has been a proactive early mover

Accelerated by, but not solely reliant on, internet shopping, a more efficient distribution platform is required by the retail industry. Ahead of more high-profile ‘big box’ specialists, LMP favoured that sector, investing proactively over the past five years. Transactions have proceeded well. In the last half year, £171m of Distribution asset acquisitions were made. LMP has still found good acquisition yields: 6.1% NIY was achieved, with a focus on urban retail logistics (£125m was acquired in 1H’18). Total acquisitions in the half- year period were £236m.

Note the high and growing dividend cover

Good results have been achieved

FY17 registered 5.3% EPRA EPS growth, with 3.4% DPS growth. The FY17 total shareholder return was 4.4%, with 18.7% and 5.9% achieved in FY15 and FY16, respectively. In FY17, a return of 6.4% was achieved from dividends, plus EPRA NAV rises. Similarly, its total property return comfortably beat the market in FY17.

£116m out of the £262m Urban logistics segment was acquired since March 2017

Urban logistics – ‘last mile’

These are typically 50-100,000 sq. ft. in area, providing ‘spoke’ operations for larger ‘hubs’. Intrinsically high-value sites are selected. They are well located to facilitate same- and next-day delivery, which now comprise 40% of all deliveries. Although currently – at 17% of the total portfolio – this is smaller than the mega and regional segments, it is a strong focus of investment. For example, a £116.6m portfolio acquisition was made (Cabot), within which ‘urban’ comprises 11 (out of 14) assets and 65% by value of the total acquired. The portfolio offers “strong prospects for income growth and lease extensions.” (LMP).

Strong organic reversionary potential

These are valued on slightly higher NIY’s (5.9% for the 1H’18 acquisitions), primarily because of the shorter WAULTs (8.3 years for the historical 1H’18 acquisitions). They represent a strong and growing part of the supply chain, so should represent good value to an experienced investment manager. The ‘urban logistics’ sub-sector has an average rent of £6.10 per sq. ft. at LMP, but with a reversion to £6.70 per sq. ft.

Highly visible and moderate-risk EPS growth, with some added alpha

Investment conclusion and risk mitigation

LMP generates highly visible earnings growth, with an efficient structure, owning simple (i.e. a preponderance of single-tenant) assets. This and the modest (34% LTV) financial gearing create a low-risk proposition. There is focus on an area of long-term growth, i.e. retail distribution, particularly in urban centres. Added to this is ‘alpha’ created by an element of development and asset management.

48% of the leases benefit from annual increments. Income momentum is therefore good, and risk is modest, with 11.5 years, on average, to the first break clause. Debt is fixed for over five years’ duration, at 3%.

See page 1 and SWOT analysis on page 4 for risks. If macroeconomic conditions result in significant rises in yields, valuations (not rents) may fall. Property trading is significantly reducing and is not a required part of delivering the strategy. Note that, in FY18 to date, £126.7m assets (six in total) have been disposed of and that these sold, on average, at a 6.4% yield. In mega centres, where yields are more modest, location is crucial. For LMP, 51% is in the southeast of England.

Financial summary

- ▶ 69% of the portfolio by value is invested in Distribution assets. Of these, 43% are 'mega', 32% 'regional' and 25% 'urban'. Thus, 30% of the total portfolio is in 'mega' distribution centres, comprising 670,000 sq. ft. of floorspace, on average.
- ▶ Completion of developments raises this to 71% (estimate). 75% is the 'target'.
- ▶ The balance sheet is not stretched, readily funding the developments. We estimate LTV of <40%, post all the developments being completed (pre-revaluation).
- ▶ £93.8m total contracted rent, including £0.5m Residential, £2.9m Development.
- ▶ Residential down now to 2% of assets – a residual exposure, sold down.
- ▶ Note the recent disposal at 4.8% NIY of Hull 'long income' asset.

Current portfolio (by segment, including JV share)

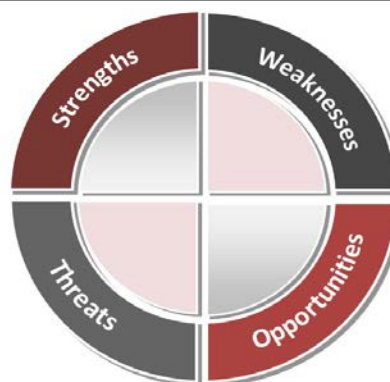
Asset sector	WAULT years*	NIY%*	£m Rent*	£m valuation
Distribution	11.9	4.9	57.1	1074
Convenience, leisure	17.2	5.2	10.4	185
Long income retail	11.4	6.2	14.5	220
Retail parks	11.5	5.6	8.4	136
Residential	na	na	0.5 [1]	35
Development	na	na	2.9 [1]	55
TOTAL *	12.4	5.2	90.4	1705

* Total excludes developments, residential

Source: Hardman & Co Research, LondonMetric PLC

SWOT analysis

- Added Alpha by early repositioning to distribution
- Well executed short-cycle development record
- Long leases on single let assets
- Medium term occupier demand in logistics
- Covenants generally first rate but some Urban Logistics less so
- Competing asset buyers



- Residual exposure to residential
- Certain logistics sectors' pricing has risen significantly
- Own Retail Parks – but reduced from 23 to 5 assets
- Half income has contractual uplift
- Organic rental growth
- Developments create assets yielding up to 7%
- Ability to execute acquisitions in strong Urban Logistics sector

Source: Hardman & Co Research

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