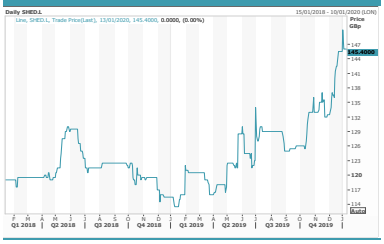
Real Estate



Source: Refinitiv

Market data

EPIC/TKR	**SHED**
Price (p)	145
12m High (p)	145
12m Low (p)	113
Shares (m)	87.8
Mkt Cap (£m)	127
EV (£m)	189
Market	AIM

**As defined by AIM Rule 26*

Description

This REIT focuses on strategically located (e.g. urban 'last mile'), smaller (typically ca.70,000 sq. ft.) single-let industrial and logistics properties, servicing high-quality tenants. The market is in strategic under-supply.

Company information

CEO	Richard Moffitt
Chairman	Nigel Rich

+44 (0)20 7591 1600
www.urbanlogisticsreit.com/

Key shareholders

Directors	1.1%
Allianz	11.6%
Janus Henderson	10.7%
Rathbone I M	10.5%
Sir John Beckwith	8.0%
Premier	7.9%

Diary

May'20	Final results
Jul'20	AGM

Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

URBAN LOGISTICS

The staff of life

Urban Logistics invests in 'mid-box', 'last-stage' distribution warehouses. Latest interim results indicate further strong progress, with EPRA NAV per share up 12% in 12 months and EPS and dividends up 25%. Positive market demand for this asset class is broadly based, including e-commerce fulfilment. Management has proved asset values in the market via a series of asset disposals, achieving blended 58% average total property returns since IPO. Supply of such assets is limited. Also, Urban Logistics' assets contain essential staff of life for the conurbations they service. Thus, we argue that the asset values are particularly conservatively stated.

- **Acquisition pipeline:** The pipeline update, provided 6 January, indicates £146m assets in advanced stages of negotiation with a similar amount for the medium term. The former comprises three portfolios plus 12 individual assets, on a 6.8% net initial yield and average 7.8-year leases.
- **Growth strategy: Management has** a deep specialist knowledge and has delivered strong consistent returns as a result. To fund a potential pipeline, an equity fund raise is being considered. Liquidity (percentage of shares traded over a given period of time) tends to be enhanced by greater market capitalisation.
- **Valuation:** On a 5.3% dividend yield (2H'19 plus 1H'20) and with momentum behind earnings and NAV, and compared with other yields in the peer group, the rating is attractive. We contend there is insufficient appreciation of the investor benefits of this last step logistics supply chain into growing conurbations.
- **Risks:** A 6.1-year (5.4 to tenant break option) WAULT (weighted average unexpired lease term) means reversionary rent rises are set to come, but also that new leases must be secured. In the past ca.20 years, aggregate rent rises have been minimal. Physical reduction in supply and strong demand mitigate risk.
- **Investment track record:** Urban Logistics owns a £195m warehouse portfolio. Since listing on the AIM in April 2016, it has generated annual NAV and dividend returns of 16.1%. The experienced management team has bought well. Market rents are ca.9% above the REIT's current levels as evidenced by two recent reviews. Market vacancies are only ca.5% and Urban Logistics' vacancy is nil.

Financial summary and valuation

Year-end Mar (£m)	2017	2018	2019	2020E	2021E	2022E
Rental Income	2.28	5.56	10.80	12.20	13.40	13.90
Finance costs	-0.60	-0.93	-2.20	-2.60	-2.90	-2.90
EPRA operating profit	1.76	3.40	8.18	9.90	11.00	11.40
Declared profit	4.89	9.86	18.88	18.40	14.18	14.86
EPS reported (p)	46.80	19.54	22.12	20.97	16.16	16.94
EPRA EPS (dil., post LTIP, p)	7.82	4.91	7.01	8.32	9.23	9.69
DPS (p)	6.23	6.32	7.00	7.80	8.60	9.20
Net debt	16.52	44.39	61.64	66.12	71.23	73.13
Dividend yield (%)	4.29	4.36	4.82	5.37	5.93	6.34
Price/EPRA NAV (x)	1.25	1.18	1.05	0.98	0.91	0.87
NAV per share (p)	118.26	123.62	137.39	148.47	158.24	166.74
EPRA NAV per share (p)	116.11	122.49	137.96	148.47	158.24	166.74

Source: Hardman & Co Research

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Executive summary

A successful track record in a strong market segment…

Urban Logistics is entirely focused on one asset class, mid-sized logistics warehouses in urban locations. These are the 'last mile' components of the ever-growing delivery chain fulfilment requirements of third-party logistics businesses, e-commerce and other mainstream users. Being in an urban environment, competing uses for this space are high and the supply of such assets is falling – overall in the UK. This is most unusual in the context of any UK commercial real estate asset class and so it is unsurprising that rents have been rising and are set fair to continue to outperform the broader UK real estate market. Urban Logistics management is highly experienced and specialised so it is unsurprising that the team has achieved the strong results not only in the past half year but since flotation. This puts the company in a strong position to make a robust case for further expansion, with a proven ability to deploy capital and generate returns above a high-end target of 15% compound return. For example, 58% average total property return uplift has been achieved on all (seven) disposals since flotation (see page 5).

…ready for ongoing expansion

Business

Tenants in this asset class are predominantly there for the long term

Urban Logistics owns logistics assets – urban warehouses – which are mission critical to their tenants, nearly all of whom have been *in situ* for more than a decade. Specifically, it does not invest in 'industrial' assets or the mammoth, motorway-junction monolithic sheds ('big-box'). It is focused on storage for logistics providers for their last-mile operations. Its warehouses are typically in the 50-100,000 sq. ft. range.

Competing uses for this specific type of urban land result in tight supply/demand…

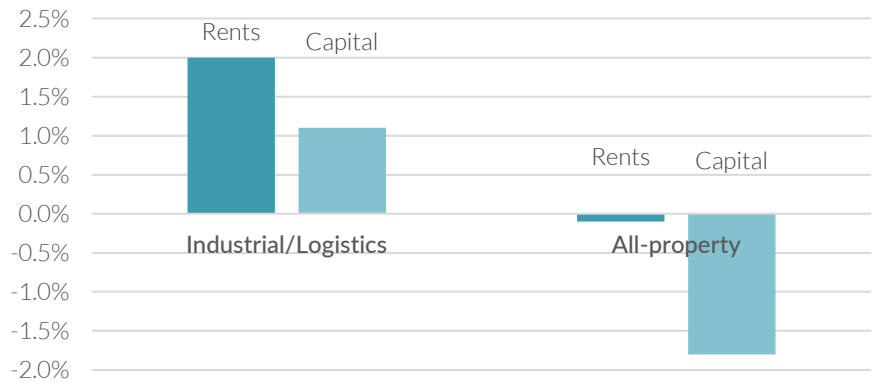
Logistics assets are in short supply due to competing land use for these urban locations, in particular residential development. Demand is strong due to the continuing growth in e-fulfilment logistics as well as a broad range of other tenant types. e-fulfilment turbo charges tenant demand, but it is more broadly based, with half the customers coming from third-party logistics ('3PL'). Much of the business is B2B, delivering, for example, food or pharmaceuticals.

Urban Logistics' tenants are employers within the assets. The quality and modernity of the assets and the convenience of their locations for employees, tenants as well as logistics operators delivering to the site are all crucial factors. These benefit the tenants who are employers looking to attract and retain their employees and who are looking to achieve efficient operation. They are underestimated qualities, in our view.

Rental outlook

…which continues to underpin premium rent and capital performance

Consensus rental and capital value growth 2020



Source: Investment Property Forum

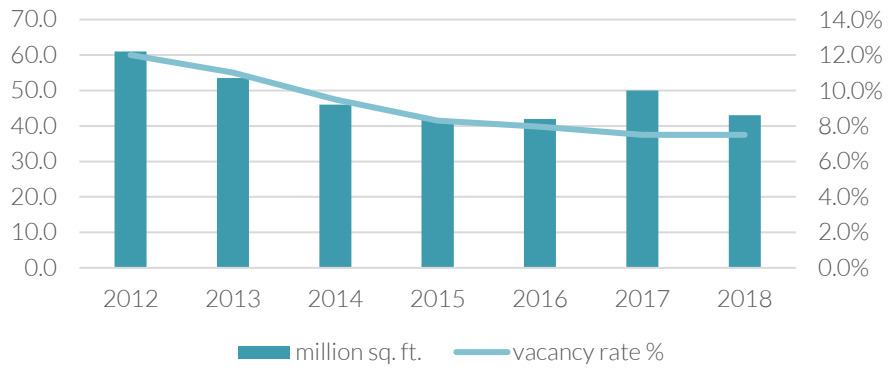
This specialist segment has shown premium rental growth in the recent past and its prospects are attractive. Savills is projecting 10% annualised total returns for the next five years – the highest returns among all the sectors it analyses.

A number of forecasts indicate rental growth in this sector of up to 3.0% p.a. for 2020 and 2021. The strong, if not overwhelming, likelihood is that the logistics asset class outperforms all 'mainstream' sectors.

Cumulative capital growth for 2019 to 2021 (inclusive) is estimated by IPF at 1.6% p.a. for the sector, which compares with -0.6% for offices and -1.9% average for All-property.

What development there is of new stock tends to be focused on the 'big-box' assets. Within logistics assets (in this case defined as 20-200,000 sq. ft.) supply has fallen from ca.60m sq. ft. in 2012 to just over 40m sq. ft. in 2018. Consequently, vacancy rates have also tumbled from 12% to below 8%. Urban Logistics' vacancy rate is 0%.

Supply (sq. ft., m) and vacancy rate %



Data for logistics assets sub-200,000 sq. ft. Source: Savills

In addition to reduction in supply and vacancies….

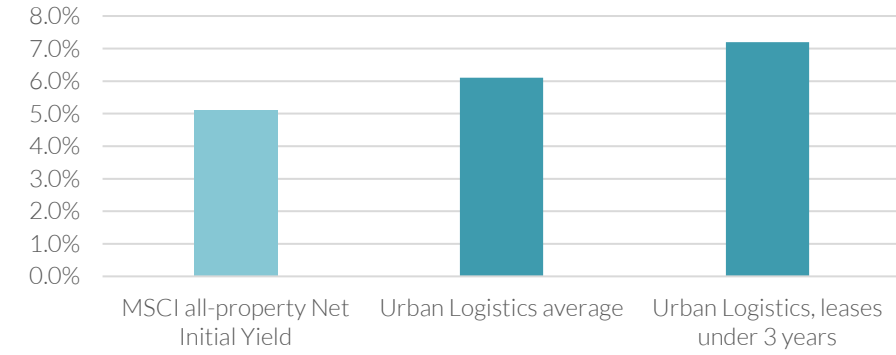
Valuation

The logistics sector is valued lower than the property market as a whole. The current net initial yield (NIY) is 6.0% compared with 5.1% for the MSCI UK Index. Urban Logistics' average NIY is 6.2%, which rises to 7.3% for its assets with leases of less than three years remaining.

Net yield valuation is on a premium to the market

….the assets trade at a yield valuation premium to the market

With shorter lease assets on an even greater yield premium, re-gearing of leases adds value



Source: Urban Logistics, MSCI

We do not expect the yield premium to disappear but it provides a useful valuation cushion and a possible boost to total returns.

We contend there is insufficient appreciation of the investor benefits of this last-step logistics supply chain into growing conurbations.

Reversions

Positive reversions

Urban Logistics' average tenant has stayed for more than 10 years; however, its weighted average unexpired lease term (WAULT) is 4.4 years (excluding one 20-year lease asset). In an over-rented market, this can be seen as a weakness with rents likely to fall when leases are renewed. However Urban Logistics' portfolio is under-rented. We estimate there is a 9% reversionary upside on the current rent of £4.90 sq. ft. as demonstrated by its ability to sell assets at premiums to their current valuations.

Furthermore, the shorter leased assets tend to be valued lower than the longer leased assets. So, a lengthening of leases as terms are renegotiated should see a valuation uplift as well as a rent uplift.

Management adding value

Within this attractive sub-sector, Urban Logistics' management has created considerable additional value. Since its IPO in 2016, it has generated a 16% p.a. accounting return. The average NIY on its assets was 7.1% when bought (on assets held) and is now 6.2% – a 14% value uplift. The total return includes the dividends paid as well as the NAV uplift.

A record in the top 10% of the UK sector

Urban Logistics total accounting returns

Year-end Mar	Annual return
FY'17	19.1%
FY'18	10.9%
FY'19	17.7%
1H'20	16.4%*

** Annualised return* *Source: Urban Logistics accounts*

It has not achieved this by standing still. More than 14% of the initial portfolio has been sold and the capital reinvested. There have been seven asset sales, including three in the first half of FY'20. They were all at a significant uplift in value and a 5% premium to most recent book value. The disposals generated a total property return including income of 58% in a little more than two years, excluding one non-core sale.

Estimated 75% of value added has derived from asset management – on top of market moves

Management estimates that 75% of the value added has derived from its asset management as opposed to underlying market moves.

Costs, even for a management-intensive portfolio – are below the sector average.

Pipeline

With an exciting pipeline, an equity plus debt funding strategy is in place

We provide further detail in this document in the section entitled 'Pipeline'. On 6 January, Urban Logistics provided an update. It indicates that £146m assets are in advanced stages of negotiation, with a similar further amount for the medium term. Management stated on 6 January: "the Company is now considering an equity fundraising." The former comprises three portfolios plus 12 individual assets. As a combined average, this shorter-term pipeline offers a 6.8% NIY on average 7.8-year leases. These are all subject to ongoing negotiation and due diligence by the Manager. Hardman & Co's view is that the Manager's track record both in terms of acquisition execution and subsequent asset performance commends their judgement in securing assets which are strategically attractive as well as attractively priced.

Many previous acquisitions have also enabled the Managers to secure lease re-gears, which created further value uplifts.

Half-year results

In the top 10% of all UK REITS

Urban Logistics' reported a total accounting return of 8.1% for the six months to September 2019, putting it again in the top 10% of all REITS.

With a strong set of lease renewals, other asset events, good capital recycling and execution of delivery of the acquisitions pipeline, 1H'20 was a successfully busy time. Importantly, in a period where much of the real estate sector has been struggling or marking time, dividends and earnings increased strongly.

Like-for-like capital growth for 1H'20 was 4% and total property return was 7%. Total accounting return – NAV plus dividend – was 8.2%; the dividend was raised 25% to 3.75p.

Asset sales amounted to £18.4m – 5% ahead of net book value with NOY at disposal of 4.9% compared with 7.0% on acquisition.

There were £15.2m of acquisitions, all off-market and towards the period end, so with minimal impact on 1H income. Blended NIY was 6.7% with 80% by value based in the South East or Midlands.

Risks

Urban Logistics' gearing is modest. Debt maturity is 3.2 years and all debt is secured. The loan-to-value (LTV) is 34% and interest cover stands at 4.2 times.

There is £15.4m of future development but the funding is in place and there is no development risk.

The WAULT is relatively low at 6.1 years, or 5.1 years excluding the 20-year lease property. This falls to 4.4 years at first tenant break. We are reassured both by the rents being below current market levels and by the average length of occupancy exceeding the lease lengths.

The economy in general and Brexit specifically pose inevitable risks. These are mitigated, in our view, by the quality of the tenants and their limited exposure to fashion or other non-durable retail. The growth in online retail has been a driver of the sector's recent rent performance. Were this to slow, we estimate that the difference in demand would not be particularly material, although it might remove some of the gloss.

The risk of new competing supply is low, especially as the current valuations typically are below the cost of build (let alone the land element).

Investment case

Summary

'Last-mile' logistics assets

A tight focus – it's all about last-step logistics assets, a market with strong secular growth

Urban Logistics owns logistics assets – warehouses – which are mission critical to its tenants, nearly all of whom have been in situ for more than a decade. Typically, these warehouses are between 50,000 sq. ft. and 100,000 sq. ft. The company specifically does not invest in industrial assets, as it seeks to have a strong focus on the 'last-stage' type of logistics provider. At anywhere near the current share price rating, we think the market is ignoring the major benefits of this strong logistics focus. Not only this, but the assets are overwhelmingly in the urban envelope. This is a crucial further element to the focus as such assets are in particularly limited supply. Competing land uses are reducing the physical supply of the assets Urban Logistics invests in – at the same time as its assets are in ever-more demand, due to the rise in e-fulfilment logistics. Tight supply/demand results in like-for-like rental trends exceeding 3% p.a. consistently – a more robust level than the broader market. The Urban Logistics portfolio is highly reversionary (market level rents above rents applicable to the current leases), so earnings and dividend momentum is strong. In addition, management has exhibited skills through proven capital appreciation.

1H'20: EPRA earnings increase 31%; per share 25%; EPRA NAV 12% rise

58% cumulative total property return since 2016 float

Results consistently strong since 2016 IPO

In this document, we comment on the recent interim results – released 14 November – and place them in the context of an attractive total accounting returns (income plus capital) track record, achieving 16% CAGR since flotation. We believe this is a strong management team executing well in an asset class with investment prospects superior to the broader market. The asset class has generated higher income yields and historically (2007-present) exhibited a lower volatility (annual standard deviation) of returns compared with the total UK real estate market, as per MSCI data. Management has brought these fundamentals and its skills to bear, achieving 58% cumulative total property returns on the portion of the assets that it has disposed since IPO. Note, this excludes one disposal of a non-core asset purchased as part of a portfolio. Including this, the figure is 50%. Since the 2016 float, 14% of the company's assets have been disposed of to recycle capital. The average premium to book value for the seven assets sold was 8%. This 'proves up' the validity of the NAV.

This document seeks to inform on four overarching themes:

- quantify and also prove the market-tested validity of the returns;
- verify their repeatability, based on current reversions, market dynamics and asset management opportunities within management's track record;
- provide detailed assessment of the assets themselves and asset management – a particularly important aspect of the Urban Logistics proposition; and
- assess the strategic model, management record and valuations.

SHED's strategy has been and is being deployed to strong benefit of shareholders and occupiers

The individual assets and the asset class are strong. Experienced management has proven validity of its market-beating NAV rises through capital recycling. Urban Logistics invests in modern, well laid-out assets whose tenants typically have been in situ for more than a decade. The tenants' covenants are strongly rated and both they and Urban Logistics benefit from robust market dynamics.

This specific asset class lends itself to several value-adding asset management strategies

The market segment offers premium rental growth recent history and prospects, allied to a discount valuation (see overleaf). Supply/demand is tight and market rents growing well. At current values, Urban Logistics assets are valued at 6.2% NIYs – an All-property MSCI (the benchmark performance institution) market premium. This

attracts, with regards to valuation, supply/demand, but also lends itself to several value-adding asset management strategies.

This management team is achieving 16% annual returns, market-tested and verifiable

Urban Logistics' strategy is proven by the combination of its total accounting returns, at 16% p.a., and a successful recycling of capital. All disposals have been completed at above the (upward) revalued book cost at the time.

Investor attraction of the asset class

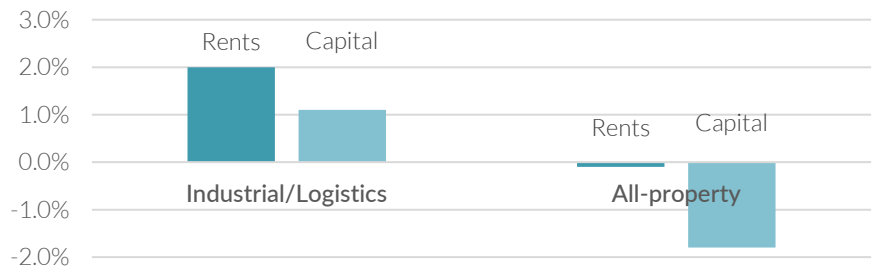
Savills (2019) projects 10% annualised total returns from the asset class over the next five years. This is the highest projected rise among the sectors it analyses.

Consensus premium rental growth for 2020, but also 2021

2021 IPF figures are 1.7% rental growth Industrial vs. 0.6% All-property

2021 IPF figures are 1.5% capital growth Industrial vs. -0.2% All-property

Consensus rental and capital value growth 2020



Source: Investment Property Forum

A number of forecasts indicate rental growth in this sector of up to 3.0% for this coming year and next (2021). Whatever the final outcome, the strong if not overwhelming likelihood is that the logistics asset class outperforms all 'mainstream' sectors (although IPF sees offices as a close second at 0.6%, then a stronger 1.3% in 2021E).

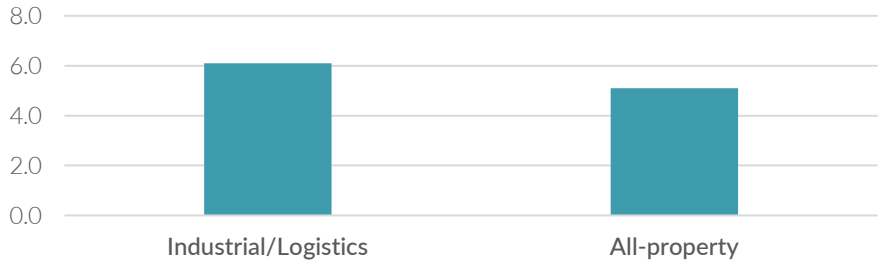
Capital: take your pick at +1.6% logistics; -0.6% offices; -1.9% All-property

Cumulative capital growth 2019 to 2021 (inclusive) is estimated by IPF at 1.6% p.a. for the sector, which compares with -0.6% for offices and -1.9% average annually for All-property. We refer in this document to the potential confusion which arises from labelling this (broad) sector as 'Industrial'. The sector is dominated by logistics assets. Later in this document (*Asset class supply and demand* section), we provide further details of market prospects.

The strong demand for the asset class has led to some development of new stock, naturally. This development is principally in 'big-box' assets – a class where Urban Logistics has only marginal presence (its one asset let out to Culina). The whole sector's development pipeline stands at 16.5m sq. ft. (3Q'19, source CBRE), down from 22.5m sq. ft. a year previously.

Yield pick-up

Net initial yields on asset class



Source: MSCI

The asset class still stands at a valuation discount (i.e. a NIY premium) to the broader market. While we do not expect this yield premium to disappear, it does provide a useful component to total returns and 'cushion' to valuations.

A most important point is that the tenants are employers within these logistics assets. With low employment vacancies generally in the UK, attractiveness of assets for workforce and employers is a significant factor. JLL estimates that the past three years have seen 100,000 new warehouse jobs created across Europe. In this document, we provide some insight into the assets' attributes, their attractiveness to tenant occupiers, to their flow of goods, but also – importantly – the attractiveness to the operatives in the buildings.

Structural under supply…

- **The assets are mission critical.** They are in a structurally expanding market for supply-chain logistics 'last-mile' delivery to urban customers. Tenants remain in place for many years. Supply is falling (down 30% since 2012 – Savills) as competing uses erode the total stock of such assets. The build cost (excluding land cost) alone equates to the typical valuation of such an asset.

…in a market with strong demand…

- **The sector demand is well-spread.** 28% of 'UK industrial' take-up in 2018 was online retail, a large number and much larger than the 3% figure for 2013 (Savills). Nevertheless, 51% came from 3PL (third-party logistics), manufacturing, grocery and high street. Online fulfilment is important but not the end-all factor.

…inexpensively priced

- **Rents are rising**. Urban Logistics achieved like-for-like rental growth of 3.1% to September 2019 (includes two reviews settled post period-end) and 3.2% average over the prior three years. We – and market consensus – see growth levels in the 2.0% to 3.0% range projected for years to come, given the supply/demand.

- **The attractive valuation basis** (net initial yield) remains typically 80-100 bps cheaper than the MSCI All-property market and is cheaper than 'big-box' assets.

What Urban Logistics does

Mid-sized logistics depots, mission critical to customers' urban supply chain

'Mid-box' assets – typically 100,000 sq. ft. or smaller – is the segment in which Urban Logistics has invested. The prime support to tenant demand is the strong need to be near the end-customer, delivering a wide range of SKUs (stock keeping units) rapidly.

An acute squeeze on supply and a structural rise in demand

Urban Logistics invests in 'last-mile' warehousing and parcel depots for business-to-business delivery of domestic goods such as food or pharmaceuticals – not the historically volatile area of fashion retail. It invests 100% in a specialist sector 'mid-box' logistics, with 'structural tailwinds'. There is a structural rise in demand and an acute squeeze on supply as redevelopment has changed sites to other uses, such as residential. Assets are all well within the urban envelope. They have to be, in order to be effective 'last-mile' logistics assets. There is reduced land availability inside the urban envelope for warehouse space and such space is disappearing through change of use. Population growth is continuing, boosting occupier demand and exacerbating competition for land in Urban Logistics locations.

'Mid-box' has markedly different characteristics to the better-understood big-box market

Across the market, nationwide, 'mid-box' vacancies are low, ca.5% (and Urban Logistics nil), and development of new assets is low. Being a pure-play in 'mid-box' logistics, this differentiates the asset class from 'big-box', which typically are ca.500,000 sq. ft. The average size of Urban Logistics assets is 54,000 sq. ft. The assets are located in the urban environment so, unlike 'big-box', space for expansion is rare.

Assets' average £86 sq. ft. is below replacement cost

Yet 'mid-box' assets trade on lower valuations (based on net initial yields) than the UK All-property market, than 'big-box', or than newbuild cost. It is notable that the average Urban Logistics asset, at £86 sq. ft., is valued below replacement cost. Market rents have risen faster than All-property for some years. They stand at ca.9% above Urban Logistics' current £4.90 sq. ft., so there are years of 'baked-in' growth, yet to come.

The fundamental positives for the asset class are broadly based – for the right assets in the right locations. We have referred to demand being driven by ecommerce 'last-step' fulfilment and that this is far from the only driver to demand.

'Sticky' tenants whose rents drive high cashflow

Tenants, on average, have been in situ for more than 10 years – albeit WAULT of 4.4 years

The average tenant has stayed for more than 10 years. It is important to be aware (see Risks section) that the WAULT to first tenant break is, however, 4.4 years (for the 95% of the portfolio in logistics, excluding one 20 year-lease asset). In an undersupplied market with rent reversion built in and tenants who seek to stay long term, this relatively low figure is not a concern to us. Indeed, it is a positive, opening the way sooner rather than later for dialogue with the tenant on new rents on lease renewals. In addition to Urban Logistics being in the attractive subsector of 'mid-box' assets, it has – at a micro asset-optimisation level – acquired assets, which clearly fulfil tenants' evolving requirements.

Modern, high-quality assets; good tenants

Assets are modern, typically with low (sub-25%) site cover and tenants are 89% rated low or low-moderate risk by Dun & Bradstreet. 67% of the portfolio is B or C EPC rated. A high-quality REIT such as Primary Health Properties in the particularly sensitive sector of primary medical assets has an 82% split in A, B or C rated EPC assets. Urban Logistics' 67% is an important, positive ratio. We consider it beneficial in this sector to appreciate in some detail the quality of the assets and tenants. Urban Logistics' style of management is to acquire assets that are invariably single-let, not multi-let. This is an important differentiator vs the predominantly multi-let peer group, as it usefully reduces landlord operating costs (including service charge costs).

Single-let, unlike the majority of the peer group: this significantly enhances the tenancy rent pass-through to the landlord

The 'big picture' of the 'mid-box' market is attractive, but we consider the assets themselves to be misunderstood by potential investors, so we illustrate the portfolio. The nature of the sites and the buildings, as well as knowledge of the tenant characteristics is explored in this document.

Hinkley – XPO Supply Chain (XPO Logistics)

Yards from A5/A47 junction

Source: Urban Logistics

Management has invested in a portfolio with strong financial returns

Strong investment fundamentals

- 16.1% average accounting return since flotation, with a 29% average like-for-like income growth achieved on rent reviews since IPO: 12 rent reviews.
- 0% current voids.
- 2% average voids since flotation, excluding the first few months on assets newly acquired, with voids in place.
- The average period tenants have occupied the asset exceeds 10 years.

The 16.1% average accounting return figure illustrates to us that management has selected attractive assets and is adding value. This is shown also by the fact that the average NIY on assets was 7.1% when bought (on assets held) and 6.2% valuation now.

- This is a management-intensive model, yet the Urban Logistics EPRA cost ratio is (slightly) below the UK sector average. It should be noted that Urban Logistics' £195m portfolio size – growing – is below the mean for the UK sector.

Quantifying and market-testing the returns

How are the accounting returns proven by actual disposals? The profitable disposal of ca.14% of the assets (by purchase price) underlines the validity of asset valuations.

Income with reversion upside and scope for good capital uplifts

7% 2019 dividend yield on initial capital…

The strong income is rising significantly. Urban Logistics is an income-based REIT, with a record of strong NAV progression. The 7.0p historical full-year (March) 2019 dividend was 100% covered. The latest interim dividend, for 1H'20, has declared 3.75p, a 25% rise on the previous interim and closely in-line with the EPRA EPS rise achieved.

…total property returns of 58%

The historical asset-value performance is strongly evidenced by the fact that more than 14% of the initial portfolio has been sold and the capital reinvested. There have been seven asset sales, with three in 1H'20. Not only were all those at a significant uplift in value but the average disposal price vs. most recent book value was at a 5% premium. Disposals gave a total property return of 58%, comprising total income plus capital return over a holding period of a little more than two years. This excludes one non-core sale. The overall figure is 50%.

The following table is based on dividend payments made plus the rise in NAV. While this is impressively above the stated range of 10% to 15% for target returns sought, even more impressive – we consider – is the 'proving up' of the asset value by the disposals associated with capital recycling.

Total accounting returns of 11%-19% are set to continue to perform well

Urban Logistics total accounting returns

Year-end Mar	Annual return
FY'17	19.1%
FY'18	10.9%
FY'19	17.7%
1H'20	16.4%*

** Annualised return* — *Source: Urban Logistics accounts*

Recycling: adding further value and proving the NAV's validity

Since flotation, management has added value and also proven the asset valuations by subjecting the company's assets to the ultimate test of validity: finding willing buyers.

It has sold at above the (upward revalued) stated asset NAVs. This is the first set of evidence that valuers are assessing the asset values conservatively. Other indicators comprise low vacancies, above-market rental trends and the capital values still being typically at below replacement cost.

Adding value, with only 25% of the value-add relying on market-wide movements

- The metrics specific to Urban Logistics itself are the best proof of value. Management states 75% value-added derives from asset management initiatives and transaction value-capture, as opposed to simple market moves.

- A 50% return was achieved on the £18m of asset sales in the latest half year to September 2019 (1H'20). Since float, all assets have been sold above the (upwardly revalued) book value. The latest half year's disposals were at an average of 5% above the then book value.

1H'20 achievements

- 58% average total property return uplift on all (seven) disposals since flotation. This includes a 50% return on the £18m of asset sales in the latest half year to September 2019 (1H'20).

- 1H'20: three disposals at respectively 23.3%; 73.1% and (a small asset) 126.3% total property returns over their holding period.

- 1H'20 disposals at, respectively, 1.3%; 8.2% and (small asset) 14.3% above book value. All disposals since float have been at above book value.

Average acquired at 7.1% yield basis and disposed at 5.7%

- Average disposal yield of 5.9% (excluding one non-core sale) vs. 7.1% average acquisition net initial yield.

- 1H'20 disposals are indicative of market appetite in that they were at 4.7%; 4.7% and 5.3% net initial yields. These are interesting yields as they compare with acquisition net initial yields of 7.1% across the 45 assets acquired into the portfolio, historically. This is not strictly like-for-like, but we consider it builds the picture of an undervalued asset class until it comes to Urban Logistics seeking and achieving buyers.

Returns are repeatable:

There is upside in the rents, going from current leases to the higher current market levels

Strong current reversions, asset management, strong market dynamics

Reverting to the statistics above, the low voids confirm tenants' appreciation of the property characteristics, as these are not ultra-long leases. Tenants choose to renew.

Positive reversions: built-in upside still to go for

Is there more to go for?

- 9% reversionary upside on the current rent of £4.90 sq. ft.

This is on top of a strong momentum of rent rises achieved, which we have referred to:

- Urban Logistics' like-for-like rent growth stands at 3.1% (September 2019) and averages 3.2% since March 2017 year-end.

In the segment below, we look at the scope for Urban Logistics to benefit from the asset-class yield curve, which we believe undervalues quality assets on short leases. We will turn in more detail to the sector asset valuation basis vs. the broader market. In summary, however, the 'mid-box' (i.e. ca.50,000 sq. ft. to 100,000 sq. ft.) logistics sector is seeing subdued new development pipeline, continued asset redevelopment to non-logistics use, supporting strong rental growth. Note, a mere 1.8% of assets are

currently rented at higher than valuer's assessment of market rent (total over-rent only ca. £10,000 p.a.).

Asset management potential – an apparent valuation anomaly

The sector retains its premium NIY vs. the broader market.

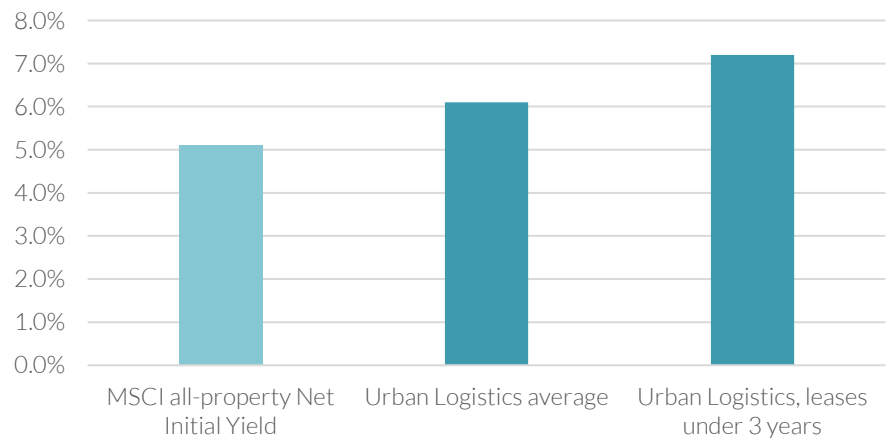
- 5.1% NIY MSCI UK index (4.9% to 5.5% range over the past five years)
- 6.2% average NIY across all Urban Logistics assets (broadly in line with the 'mid-box' logistics sector)
- 7.3% average NIY on Urban Logistics assets with lease length below three years

Yield premium to the market …

…and scope to add value simply by lengthening term to lease break

The sector is inexpensively rated and assets on shorter leases are cheaper yet

Net yield valuation is on a premium to the market



Source: Urban Logistics, MSCI

Given tenants move so infrequently, we consider the high NIY on short WAULT leases to be anomalous

There is asset management upside from the optimising of lease lengths. Given that the average occupancy of the tenants exceeds 10 years, we consider the rationale for any discount valuation for leases under three years is tenuous. It is valuation inefficiencies such as these that offer experienced management opportunities to add value.

Market valuations present an attractive opportunity to add to NAV through lengthening leases. The statistics quoted above (from Urban Logistics accounts) show the disparity: a 7.2% NIY on short lease assets vs. 6.2% on the whole portfolio.

Multiple drivers to total return…

- There is in-built asset value appreciation from the simple lengthening of the lease.

Strong market dynamics

Asset value growth stems from the combination of the asset class, the selection process of this long-experienced team and the active asset-management. There are, therefore, multiple drivers to total returns. This is an attractive segment within the logistics market. Indeed, in a number of ways, it appears more attractive than the 'big-box' segment where there is currently a greater development pipeline and where valuation bases (specifically net initial yields) are significantly more forward looking.

Rents have risen 20% (MSCI) or 35% (Savills) from the lows of 2014. Momentum is strong, with supply down 30% (Savills) since 2012. RICS surveys class this as the

sector with the strongest capital and rent growth prospects. E-fulfilment is particularly supportive to 'last-step' logistics assets.

...management decisions each year drive 69%-78% of capital growth

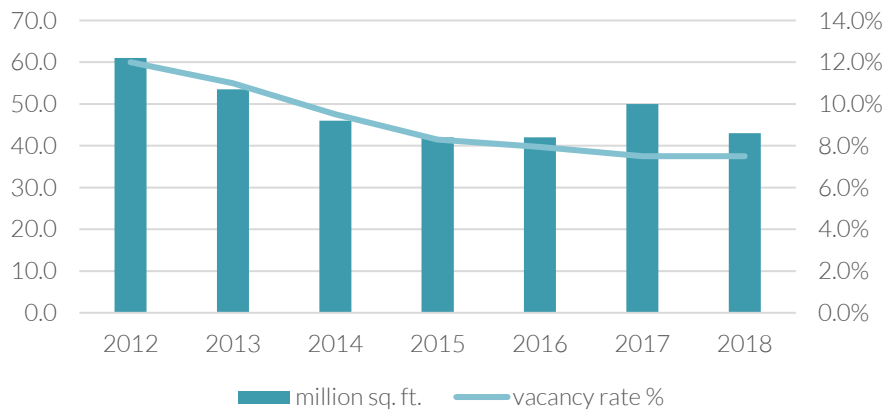
Urban Logistics has witnessed management creating strong, growing income enhanced by asset management initiatives. The company states that market movement generated only 22%-0% of capital growth in the years 2017, 2018 and 2019, with 16% in 1H'20.

Restricted, falling supply

- Supply in the 20,000 sq. ft. to 200,000 sq. ft. logistics asset class has reduced by 30% since 2012.
- Vacancy rates have fallen significantly and remain stable at low levels, despite recent modest rises in new supply (engendered by wider economic recovery and confidence). See the later section in this report: *Asset class supply and demand*.

30% reduction in market supply

Supply (sq. ft., m) and vacancy rate %



Data for logistics assets sub-200,000 sq. ft. Source: Savills

Supply-demand balance is attractive for this asset class. The supply is falling because of competing land uses in the urban locations this sub-200,000 sq. ft. asset class typically occupies. The cheapness of the assets in itself restricts their supply.

Assets average £86 sq. ft. capital value, significantly lower than replacement cost

Urban Logistics' assets are valued on average at £86 sq. ft., significantly lower than replacement cost. This is not dissimilar to other investors in the space. Quality assets can be purchased in good urban locations – by an experienced management team – at levels below replacement cost. The Urban Logistics management team has clearly demonstrated its skills, evidenced by its capital recycling returns. However, this is a specific asset class where a number of opportunities are repeatedly available, albeit often off market.

The average purchase capital; value stands at £71 sq. ft., we understand. This is data applicable to assets owned as of end September 2019. Again, therefore, this is well below replacement cost.

Typically, a year's supply, which is low

Robust ratio of take-up to stock available

Comparing average take-up between 2014 and 2018 with the current availability, the size category of up to 100,000 sq. ft has a modest 1.03 years' supply (and not necessarily in the right location). It is worth noting that demand generated specifically by e-fulfilment is – we estimate – less than a third of the total.

The various size categories between 100,000 sq. ft. and 400,000 sq. ft are all at between 1.4- and 1.65-years' supply. The ratio of current availability to average take-up in the big-box market is more attractive than mid-box (sub-100,000 sq. ft.). However, this 'snapshot' has been noticed and the development pipeline in big-box is relatively high whereas in mid-box it is low and constrained by the fact that (to use Urban Logistics assets as an example) assets are typically valued at 30%-70% of replacement cost.

Pipeline update, potential equity raise

On 6 January, Urban Logistics updated as follows:

The pipeline would be funded potentially with new equity and debt

"The total pipeline is in excess of £300m. This pipeline includes units for an aggregate consideration of £146m where the Manager is in advanced negotiations (the "Advanced Portfolio") and further properties with an aggregate consideration of more than £150m where the Manager is in preliminary stage discussions." The net initial yield would be 6.8%. "The pipeline assets referred to are subject to ongoing negotiation and due diligence by the Manager and no contractually binding obligations have been entered into for their sale and purchase. Urban Logistics has a stated strategy of utilising the platform of its Manager to grow the Company and deliver attractive income and capital returns to its shareholders."

Equity fundraising being considered, alongside debt finance where appropriate

Urban Logistics is "now considering an equity fundraising… …and will commence a period of engagement with existing and potential new investors."

A strong, deliverable pipeline is key to the investment case

On the following basis, we have every confidence that the Managers will be able to continue to secure attractive acquisition opportunities.

Excellent specialist knowledge has translated to strong, consistent returns

- Management's deep specialist knowledge has delivered high, consistent returns.
- Since IPO (to the accounting period ended September 2019), Urban Logistics achieved a cumulative total accounting return of 55.9%, or 16.1% p.a.

Still a growing participant

- In a market of ca.40m sq. ft., the current 2.2m sq. ft. Urban Logistics portfolio represents only ca.5% of the total supply in any one of the recent years.

Potential equity raise

To fund a potential pipeline, an equity fund raise is being considered.

Attractive pricing

A potential equity raise would be based on a strong NAV rise post IPO

A potential equity raise would be on a strong record of EPRA NAV per share up 45.2% between IPO and end-September 2019, 75% of which came from management's value added (as opposed to the market itself) allied to a current share price below prospective NAV.

See also our *Relative rating attractions* section in this document, below.

Relative rating anomaly

We suspect a lengthening track record and a greater liquidity, which would stem from a greater market capitalisation, are important reasons why other longer-established, larger peer group trade off lower dividend yields.

Equity would be substantially invested within three months

Management indicates substantial deployment within three months

The 6 January announcement stated deployment within three months of a raise.

Liquidity benefits

Liquidity in the shares

Liquidity (percentage of shares traded over a given period of time) is enhanced by greater market capitalisation. See Hardman & Co real estate sector research, *https://www.hardmanandco.com/companies/ipsx/, dated June 2019.*

Operational model

Strong, growing demand

Valuation is ca.20% below the MSCI All-property net initial yield, despite strong rent prospects

The third of the four categories our research document assesses – the operations themselves – is an important one. Urban Logistics owns logistics assets. Its remit is tight. It does not invest in industrial assets and the type of logistics asset it buys is specifically attuned to the strongly growing 'last-step' logistics fulfilment market, where assets are in reducing supply. Despite this, the asset class' net initial yields are higher than the wider market. We illustrate the high quality of such assets.

Why these assets are in a market category sometimes called 'industrials' is a surprise to us

Urban Logistics' target asset class is tightly defined, but the categorised sector is diverse. It ranges from industrial to the small local-business SME multi-let, through corporate tenants, 3PL 'last-mile' depots and giant 'big-box' 200,000 sq. ft. to 400,000 sq. ft. distribution hub warehouses. The different subcategories have varied characteristics and are driven by different supply/demand characteristics and radically different business models within the tenants. We have outlined that the Urban Logistics' focus 'mid-box' has the optimal supply/demand characteristics in the broad sector.

When providing data from the asset class, valuers typically classify it under the misnomer 'industrial'. In our view, this does not enhance detailed understanding.

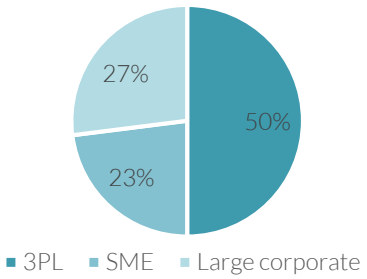
- The Urban Logistics tenant is specifically distribution-based.
- Given the locations, the typical Urban Logistics tenant is focused on keeping as many SKUs as close to the end-customer as logistically possible.

Half is third-party logistics, but effectively these are buildings on large urban sites: lorries in, vans out

The chart below states the tenant types. 50% are third-party logistics (3PL), mostly global such as XPO, DHL, which comprise 11% and 9% (up from 8%) of the rent roll, respectively. These are global businesses and Urban Logistics assets are the crucial 'last-step' interface between logistics service provider and end-customer.

Urban Logistics' tenant diversity

The operational driver is the tenants' growing need for space in a sector shrinking in size. There is a broad base of tenants, all of good quality.



Source: Urban Logistics

The financial driver is to benefit from good supply/demand and also capitalise on pricing inefficiencies…

The assets

Capitalising on inefficient pricing

We contend that:

- We have demonstrated the valuation basis for quality assets let on short (under three-year) leases is too low. Management has captured upside, in part through buying such assets and lengthening leases (or filling voids).

- In this large market, management has the ability to secure a wide selection of such assets.

...re-gearing (lengthening) leases enhances value

- Urban Logistics has on average acquired assets at over 7% net initial yields and sold at ca.5% or sub-5%.

We do not believe valuers have properly factored in the new demand dynamics for this subsector. Valuers take comfort in stating asset prices conservatively and also from many years' evidence of new trends before fully reflecting their impact. For example, 'big-box' is valued at a net initial yield of well under 5% (i.e. is more expensive than the MSCI All-property UK asset). The rollout and new development of such an asset class was earlier than the 'last-mile' assets. Re-evaluation takes time. Urban Logistics' average acquisition was on 7.1% NIY.

Urban Logistics assets are 'mid-box' in size. The definition is typically in the range of 50,000 sq. ft. to 150,000 sq. ft. Supply of 'mid-box' is significantly below that of 'big-box'. We expand on this in the next segment of this document: Supply and Demand. Part of the constraint on supply is a physical one. Many (not all) Urban Logistics sites are within the urban envelope and are therefore subject to competing land uses. Despite the rarity of urban land, asset valuations are still typically only around the physical build cost.

Commercial property has been built...
...not for this sector: it's being redeveloped for other uses

Data (IPF) indicate the past decade has seen significant expansion in office and even retail stock, whereas industrial (here we return to the confusion between logistics and industrial) has fallen. The long-term reduction is admittedly less than 1% p.a. in the total sector, but the divergence is marked. Urban assets have disappeared – through redevelopment – more rapidly. With growth in both e-commerce and the land-hungry expansion of major conurbations, supply problems are set to continue.

A closer look at the assets – coverage, car parking, etc.

It is important that the site coverage is not too high, allowing efficient handling of inwards and outwards goods movements. It is also important that the floorplan is attractive. This maximises internal manoeuvrability and optimises loading bays.

Only four miles from M1 but right inside the conurbation in Nottingham

Glaisdale Parkway – Hilary's Blinds

In addition to the flow of goods in and out, there is good parking for tenant employees

Later in this document, we show an interior shot

Source: Urban Logistics

Hilary's Blinds is Urban Logistics' seventh-largest tenant. Here is a 170,000 sq. ft. asset, one of the larger ones in the Urban Logistics portfolio. This site is on the edge of Nottingham, four miles from the M1.

The assets comprise the "shed" but also crucially, the loading bays, employee (sometimes customer) car parks, turning circles and so on. Management is the best judge of the optimal configuration, but aspects such as the ones listed are just as important as the location, lease, tenant in situ and so forth.

Look out for the attractiveness of the asset for the employee

A most important point is that the tenants are employers within these logistics assets. This brings us to the crucial aspect – and sometimes overlooked by some landlords – the tenants and their employees. With low employment vacancies generally in the UK, attractiveness of assets for workforce and employers is a significant factor. JLL estimates that the past three years have seen 100,000 new warehouse jobs created across Europe. The UK will have seen a disproportionately large number of these, as a function of e-commerce and economic expansion. These are places of employment for people who have the choice of where to work – just as much as might apply to offices or other buildings. Indeed, many of the assets have office facilities attached to the logistics asset itself. It is important that these are buildings and layouts which are attractive and that the locations – in the context of logistics (B1 or B8 planning use) – are parks with a modern, open, feel to them, attractive to employees. These are overwhelmingly well within the urban envelope while also being 'uncluttered' and landscaped.

The Urban Logistics tenants

3PL is a significant element – 50% of the total rent roll, we estimate

Top tenants (no traditional retailers)	
Tenant	**% of total roll**
XPO Logistics	11
Unipart	10
DHL	9
Your Farmer Produce	9
Culina Logistics	8
Connect (Tuffnells Parcels Express)	7
Hilary's Blinds	5
OTC Direct (Boots)	4
Manitowoc Crane	4
Strata Products	4

Source: Urban Logistics accounts

All assets are supplying tenants' logistics requirements: these are not industrial assets

All assets are supplying tenants' logistics requirements: these are not industrial assets. As mentioned above, of the rent roll: 50% are third-party logistics businesses; 27% large corporates; and 23% SMEs. The key point is that the last-step urban logistics market place is both profitable and essential to the tenants' operations.

Urban Logistics' largest tenant is XPO Logistics, a $17bn revenue company and a top 10 global provider of transport and logistics services.

Urban Logistics focuses on efficient management, including a near 100% 'drop through' of rental income as there are no service charges payable by Urban Logistics on 100%-occupied, single-tenanted assets. It has close contact with all tenants, with proactive operational support given.

The reasons why they stay

- Profitable tenants, with the operations in the asset being crucial. This is a key part of the tenant value chain.
- Rent is a low proportion of the assets' operating costs (wages being an important factor).

- Removal costs would equate to many, many years' rent, typically (and labour force relocation would be a major factor). Moving is disruptive, not only in cost but in the disruption. To move a 100,000 sq. ft. site may cost up to £4m. Disruption includes the retention of the workforce in attractive buildings. The cost of moving varies but is typically 50 to 80 months' rent.

- Significant competition for labour in many of Urban Logistics' locations and the asset itself is often an important workplace-amenity factor.

- 'Proof of the pudding': low rates of tenant churn.

The investor returns are predicated on the quality of the tenants and the quality of the assets – the two of course go hand in hand. Location is of high importance of course, but we fear the market has overlooked the reasons why tenants are attracted in the first place and the reasons they stay – even when leases are renewed on raised rents.

We structure our analysis around four segments

We structure our analysis into these four segments:

- The larger tenants include global players such as XPO and DHL.

- All sites are an essential part of the 'last link' in logistics fulfilment to the end-customer.

- Certain sites have larger (geographical) regional/strategic significance – such as Haverhill and Runcorn.

- In conclusion, the sites (i.e. the estates where Urban Logistics' assets are situated) are modern and efficient – we illustrate this.

The larger tenants and how they make use of Urban Logistics in their business plans

2.2m sq. ft., £12.2m contracted rent roll

Of the 38 assets, 2.2m sq. ft., £12.2m contracted rent roll, XPO and DHL (principally DHL Supply Chain) comprise nine. XPO is a global top 10 global logistics provider. DHL Supply Chain has a global revenue of more than €60bn.

All sites are an essential part of the 'last link' in logistics fulfilment to the end-customer

All assets are supplying tenants' logistics requirements: these are not industrial assets

The chief operating officer of XPO Logistics, Troy Cooper, succinctly stated how the physical requirements are evolving. "Consumers are buying more large items online, including furniture and appliances. These are home deliveries that often require white glove services, such as assembly, installation and testing." (Source: cilt.org.uk, February 2018). The workforce interaction with the last-step link to consumers is becoming increasingly skilled and orientated to how they present themselves to the end-consumer.

The only exceptions to 'last link' are ones where prospects for tenant and tenancy longevity are high.

- Haverhill – a 200,000 sq. ft. distribution hub of national significance to the tenant, Culina; tenant in situ for more than 10 years

- Hoddesdon Travis Perkins – a Travis Perkins builder merchant supplier to retail and trade

- Hoddesdon Sainsbury's – a large multiple grocery store between Ware and Cheshunt north east of London

Sites of regional importance

The Urban Logistics site with the highest value is at Haverhill, occupied by Culina. As a corporate, Culina dates back to 1994 and this ambient and chilled food logistics business expanded significantly in 2008 after merging with Bayliss Transport. In that year, it opened its 200,000 sq. ft. Haverhill site – crucial to the business as evidenced by it being highlighted on the Culina website.

One noteworthy site is Runcorn, the fifth most highly valued asset. This is let to DHL Supply Chain. It is regionally essential.

The efficiency and modernity of the sites

Currently, many occupiers place the EPC rating low down on the list of requirements. We think this is changing. 67% of assets (by number) are EPC C or better – as stated in our summary, above. Environmental performance is a criterion that Urban Logistics assesses closely.

This aerial view shows a site, which is modern and efficient – as regards loading bays, extra storage, employee and visitor car parking. We do not propose to give visual descriptions of all sites, but we do highlight that Urban Logistics selects assets whose physical attributes and site-configurations attract strong tenants.

Point of view is directly above M1/M69 junction

Immediately beyond the greenery (top right) are residential streets, part of Leicester

Leicester, Meridian South – DHL Supply Chain

Source: Urban Logistics

Leicester - DHL

Source: Urban Logistics

The location can be viewed on the link here: https://binged.it/2rJ4GSx

This site is within yards of the M1/M69 junction and within yards of residential roads on the outskirts of Leicester. There are two restaurants, a hotel and a Sainsbury's store within yards. We point to the juxta-positioning of communication access and the amenities, which might be of some appeal to employees and operatives on-site.

All sites have to be 'future proof' to gain premium valuations. The trade organisation relevant to this sector is the global Chartered Institute of Logistics and Transport. In August 2018, its article (cilt.org.uk) stated: "If autonomous drones and self-driving delivery vehicles are becoming part of the delivery process, in the not-too-distant future, we may have forgotten all about the 'last mile'. The more pressing questions will be centred around, speed, efficiency and the 'last 30 feet'." We point to the disconnect on asset valuation between this assessment by the users of Urban Logistics *type* sites and the valuers whose mind-set is focused on real estate specifications. We have not visited all Urban Logistics sites. We are not stating a view as to drones or the future proofing. We are, however, clearly of the view that the Urban Logistics management sets its investment criteria by the acquisition of assets that do have those future proof characteristics, that are founded on appeal to tenants and appeal to all users of the facilities. Valuers – as we understand it – place no premium on assets with such characteristics.

A small number of Urban Logistics sites are regional hubs based outside the urban area. One example is the distribution hub for Culina, a major food and drink 3PL. We have referred to this 200,000 sq. ft. site in our list of tenants above, with emphasis on the sites of regional significance to their supply chain.

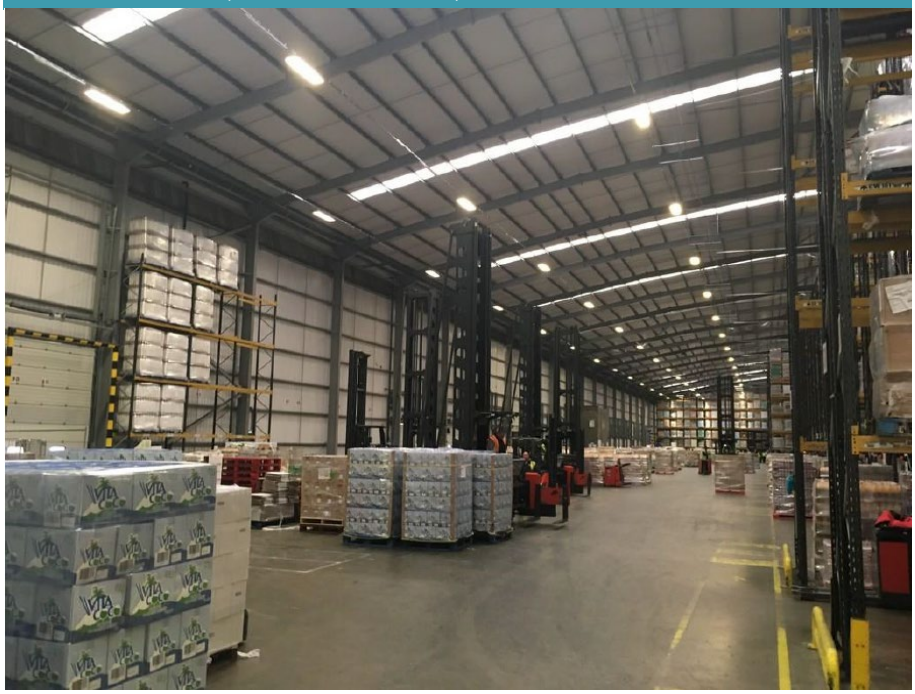
Haverhill, Suffolk, Culina food and drink third-party logistics

Haverhill – Culina

Source: Urban Logistics

The Culina asset, which is just over 10 years old, is at the larger-scale end of Urban Logistics' portfolio, both in footprint and in eves height.

Haverhill – Culina (food and drink 3PL)

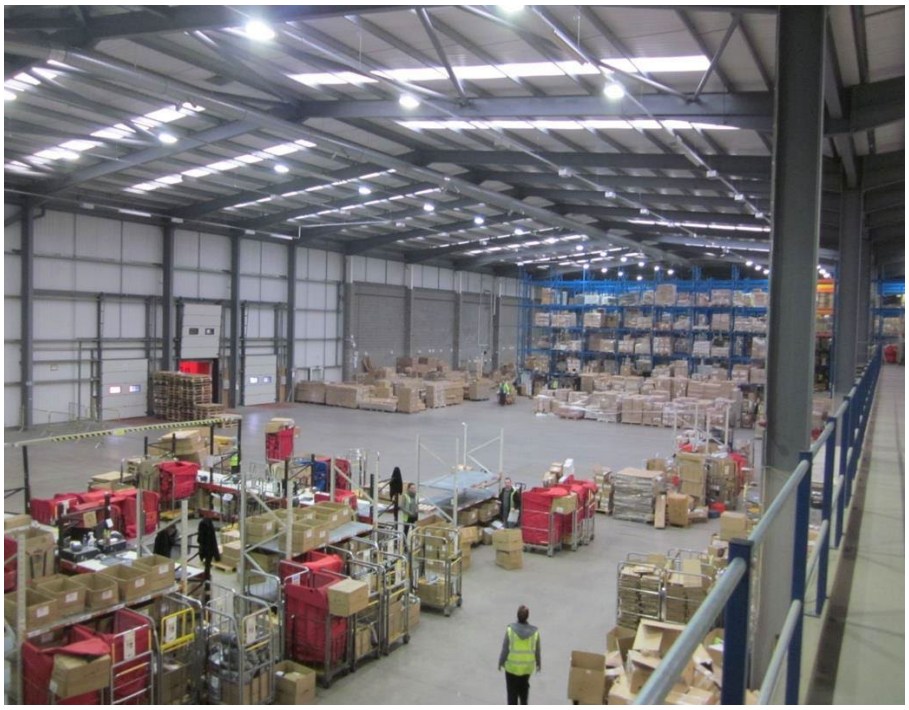


Source: Urban Logistics

There are numerous types of assets, a number with high eves, but all are selected on the strict criteria of future-proofing and being the right asset to suit the needs of the (usually long-standing) tenant and its operatives.

Winit provides supply chain management solutions for cross-border e-commerce companies

Interlink Way, Bardon – Winit



Source: Urban Logistics

Asset class supply and demand

The sector assets

Investor activity in the logistics subsector of the UK real estate market has been robust. 1H'19 investment volumes stood at £1.5bn, which is 5% higher than the corresponding period last year (Savills briefing July 2019).

Supply of 'mid-box' is significantly below that of 'big-box'.

Availability hovers at around a year

Comparing average take-up between 2014 and 2018 with the current availability, the size category of up to 100,000 sq. ft. has 1.03 years' supply. We have summarised the position in the Investment Case, but provide further detail here. The size ranges of 100,000 sq. ft. to 200,000 sq. ft. and of 200,000 sq. ft. to 300,000 sq. ft. and of 300,000 sq. ft. to 400,000 sq. ft are all at between 1.4 and 1.65 years of supply. Speculative building is particularly in the 'big-box' space of over 400,000 sq. ft. Newbuild space also remains popular for occupiers with 'design and build' in particular driving take-up due to their increasingly complex requirements. The distribution chain in the somewhat smaller-footprint 'last step' has not seen significant new assets being developed, not least as a result of difficulty in securing large sites in urban areas. Urban Logistics is funding three developments, with an average size of 58,000 sq. ft.

Take-up is steady...

...availability is now well down

In the sub-100,000 sq. ft. size category, annual average take-up between 2014 and 2018 was 11.0m sq. ft. At the other end, the 'big-box' assets have seen strong demand and strong supply. There has been 8.5m sq. ft. annual average take-up between 2014 and 2018.

Rents are well up in % terms, but these are still inexpensive assets to rent

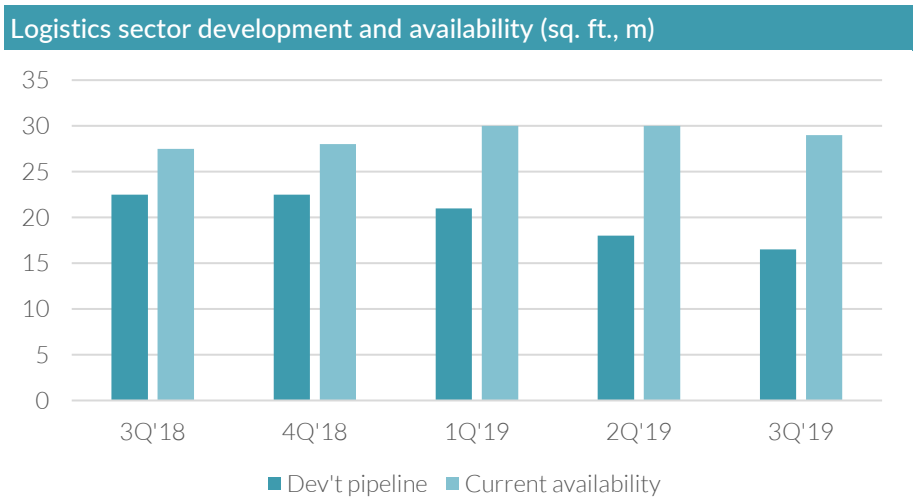
Cross-referencing with other data sources indicates that sector take-up is running at 45m sq. ft. p.a. for 'secondary UK industrial' (Savills) and 85m sq. ft. for all industrial (including logistics). Since 2012, 'secondary UK industrial' (Savills) has been steady at 45-50m sq. ft. p.a. It is availability that has plummeted – to 75m sq. ft. This looks like an inflection point upwards for rents – or at the very least, continuing growth building on past rises.

Sector average rents in 2018 stood at 580p sq. ft. (Savills) vs. 410p sq. ft. end-1Q'12. It is clear that current reinstatement cost of the buildings (at ca.£100 sq. ft – source CBRE) is well above the valuation on Urban Logistics and peer group's assets, so new supply should prove modest and patchily location-specific. So, the rise in rents is justified. Vacancy rates stand at 5.5%, down from 13% in 1Q'12. Further, the 2012 rental lows were well down on previous highs and, at current levels, rents are still broadly similar to levels of two decades ago.

The average land value, we understand, in Urban Logistics' balance sheet (albeit the costs of land and of the building are not stated separately) stands are ca.£1m per acre. In Urban Logistics' latest presentation, it cites figures from Colliers. Current land values stand within a range of £650,000 to £950,000 per acre for northern conurbations to Leicester, with Reading at £2.0m. These are urban sites. Demand for urban sites with planning is high. This (estimated) land value appears modest, to us, given the urban locations and is, we contend, a strong support to valuations.

Data below is from the CBRE 3Q'19 Logistics Snapshot. It aggregates data across all asset-sizes and there has been extensive commentary that the developments have been skewed to the larger 'big-box' style of assets in 2019. We have referred several times to the physical constraints in many urban locations – the types of location where Urban Logistics' portfolio is located.

The sector development pipeline is modest and has been working through, reducing



Source: CBRE

The sector tenants

SKUs increasingly need to be physically held near the end-user

A crucial factor for 'mid-box' assets – those of typically 100,000 sq. ft. or smaller, where Urban Logistics concentrates its investment – is the strong need to be near the end-customer. The dynamics of the sector have been strong for a number of years, with the permanent change in the need for SKUs to be held near the end-customer. This situation boosts 'mid-box' directly, but 'big-box' only indirectly.

This is not a fashion clothing story

However, prior to this new growth source, the supply/demand story was not particularly supportive. The growth of 'last-mile' or 'last-link' internet fulfilment logistics is a major driver to the sector. It is easy to overstate, but is a significant factor. There are many sources of tenant demand – many being nothing to do with the internet. 3PL is as large a component as online retail.

Online e-fulfilment is important but only one of several drivers

- 28% 2018 take-up from online retail, source Savills
- 25% 3Q'19 take-up from online retail, source CBRE

The undoubted growth in e-fulfilment over the past three years or so has permanently changed the supply chain logistics and the Urban Logistics assets thrive in this environment. It embeds the break of bulk and the requirement to stock a large range of SKUs near to the end-customer location. Further, there are no fashion-related tenants, be they internet-oriented or not.

Online retail is considered to be driving the 'story'. Online omni-channel fashion and other broad segments of retail are growing strongly but they are not driving logistics real estate. We have outlined in our Investment Case, above, that internet fulfilment is a major, but not the only, driver. Savills states UK industrial take-up from this element rose from 3% in 2013 to 28% in 2018. Half still is from 3PL, manufacturing, grocery and high street.

Online e-fulfilment has been a real positive but demand would have grown without it

However, if take-up has been steady since 2012 and online has grown from 3% of take-up to 28%, were online to slow, surely that would weigh on the sector take-up? Take-up, ex the expansion in online, would be lower. Certainly, yes. Mathematically, the ca.45m sq. ft take-up over that period would be ca.90% of that level (i.e. over 41m sq. ft.) ex the online. The difference is there, but not particularly material.

Property business model

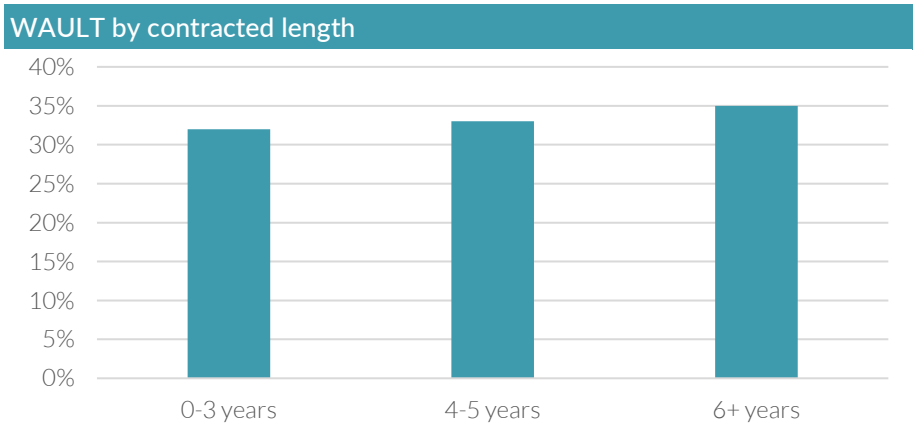
Re-gear leases, recycle capital

The model is to focus 100% on logistics assets and to:

Buy good quality assets housing contented tenants – re-gear the lease

- acquire attractive assets, which have long standing, high covenant tenants or have the scope to be leased to such tenants;
- take the opportunity to re-gear (lengthen) leases thereby serving the dual purpose of raising rents and raising the valuation as a function of valuers' lowered NIYs on longer leases; [Note that part of the expertise is to communicate with tenants – a skill often overlooked in this sector.]

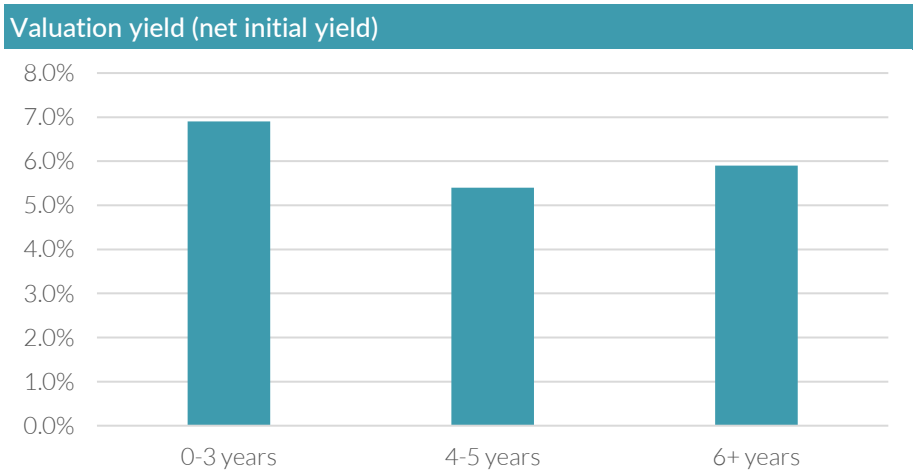
Deliberately oriented to a significant % of leases under three years. This gives the scope to lengthen…



Source: Urban Logistics

It is an anomaly – we consider – that shorter leases to break are valued at significantly lower levels. This is evidenced in these data from Urban Logistics showing the sub-three-year WAULTs (nearly a third of the portfolio) are valued on 6.9% net initial yields on average and well above the longer WAULT leases. The average WAULT across the portfolio is 6.1 years. Note, the 6+ years segment yield includes a high yield long lease asset. Ex-this, the longer-lease segment yields similar levels to 4-5 years.

…and once lengthened, the valuation yield tends to fall (price goes up)



Source: Urban Logistics

- recycle capital – within REIT regime parameters – where appropriate value-capture can be attained.

Disposals in FY'19 totalled £11.3m, all at or above book value, representing average total (ungeared) property return of 25.2%.

£18m good disposals – at yields of 4.9% vs. the 7.0% acquisition cost

£18m asset sales were effected in 1H'20 (six months to September 2019). These were at a 5% premium to net book value and generated a total property return of 50% (as summarised earlier in this document). The average NIY at disposal was 4.9% vs. 7.0% at acquisition. It is important to note that the acquisition net initial yields were in effect exactly at the average Urban Logistics has achieved over its whole portfolio. These assets were bought well, but the yields were not exceptional outliers. Turning to the disposals, the market has moved up (yields falling) but nowhere near to the 4.9% achieved. Asset management was a combination of lengthening leases much more than expenditure on buildings, which were already of good quality. It is an art of finding the right buyer and presenting well in a very asset-specific market for assets, which individually are of relatively modest size. See overleaf.

Management has shown that it can spot opportunities to acquire well.

Buying good assets at 6.7% yields, well above the wider-portfolio average

- 1H'20 saw acquisitions totalling £15.2m, all off-market and on an impressive 6.7% blended average net initial yield. This 6.7% is higher than the portfolio's average valuation net initial yield of 6.2%. With the assets being modern, 100% occupied by tenants of good standing and 80% located in the Midlands and south east of England, we see no reason why the acquired assets should not soon be achieving similar valuation bases compared with the rest of the portfolio. In part, this is a function of their long-term expertise. See the section on *Management*.

- Smaller lot sizes are sometimes particularly under-priced and many Urban Logistics acquisitions have been £5m or less capital valuation.

- In part, it is a function of the problem (indeed, the opportunity) that valuers do not differentiate enough – we consider – between different subsectors of industrial and logistics.

- Nor do they differentiate sufficiently between assets which are clearly attractive to tenants (longevity being the proof) and those which have risks of obsolescence or being less attractive to employees of the tenants or other users.

Lot size considerations

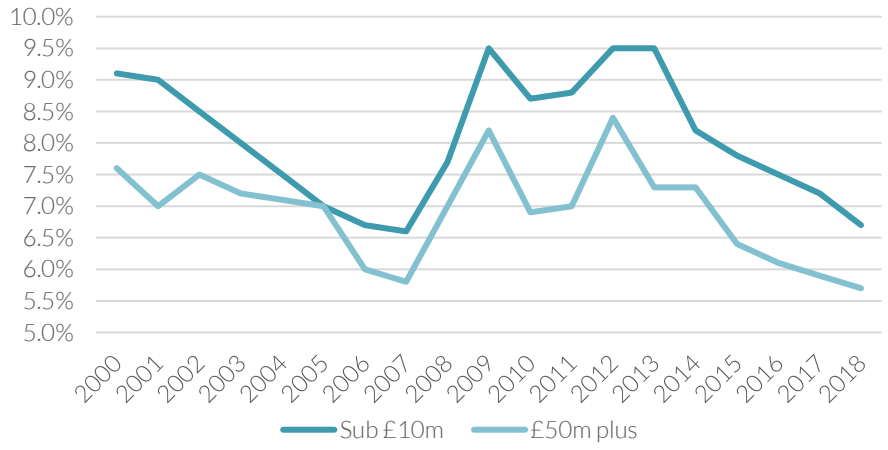
Urban Logistics tends to buy lots at the smaller end of the market; off market…

We have referred above to the typical relatively modest size of many acquisitions in the context of institutional investment. Work has been done by Savills quantifying price (net initial yield) differentials between larger lots-sizes, namely £50m plus, compared with smaller, namely sub-£10m lot size. The results, which speak for themselves, are illustrated below.

… – a price advantage

Urban Logistics sources through a variety of methods, but one avenue open to it is to buy well through the discrepancies outlined by the trends in the chart below. It can take the best timing open to it for the disposal to redeploy the capital.

Net initial yield at transaction price for different size categories over time



Source: Savills

The sector has the wrong name and investors mix up different classes

Market confusion – an opportunity, but education needed

The sector in agency parlance is called 'Industrial and Logistics' and indeed CBRE (Urban Logistics' professional valuer), like nearly all other valuers, refers to the sector as 'Industrial'. Savills, for example, prided itself as being Industrial Agency (i.e. not 'logistics') of the year last year. These are not industrial assets; they are buildings that tenants use as hub-centres for their distribution chains. They and the grounds surrounding are purpose-built to be configured to optimise tenant satisfaction. Tenants range from global distributors who use Urban Logistics for the last step to urban customers, to building products businesses, food or houseware retailers and mission-critical suppliers to public bodies and others.

Beating (17.7%) and ambitious target (10%-15%)

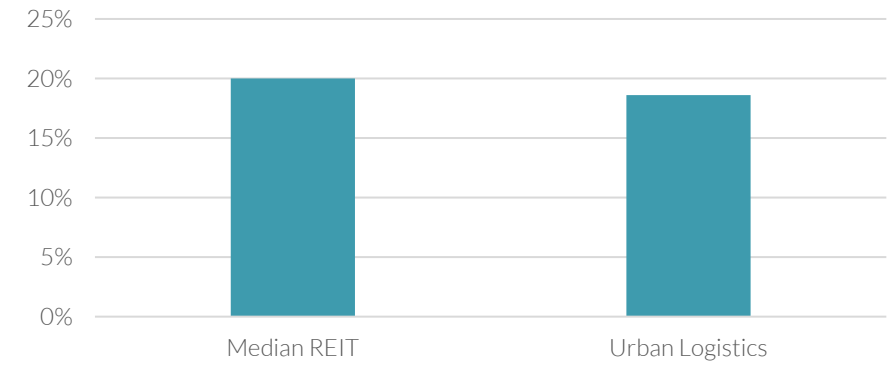
Growth in shareholder value

The accounting return (growth in NAV plus dividends) totalled 17.7% in the last full year and a fraction less in the recent half year (annualised). Note, the medium-term target is 10%-15% growth p.a. We estimate a return potential of over 15% p.a.

- This is a management-intensive model, yet the Urban Logistics EPRA cost ratio is (slightly) below the UK sector average. It should be noted that Urban Logistics' £195m portfolio size – growing – is below the mean for the UK sector.

Urban Logistics is smaller than the average UK REIT but holds its own on a (falling) EPRA cost ratio

EPRA cost ratio



Source: Urban Logistics accounts/Peel Hunt/PHP

Development pipeline

Gross development value of £15.4m

We have pointed to the low amount of new development in the subsector. Urban Logistics does undertake forward funding of third-party trusted developer partners. It undertakes no development, nor does it expose itself to development risk other than the forward funding. Urban Logistics exchanged contracts on 25 February 2019 with Carbide Properties Ltd., for the forward funding of two assets at Staffordshire's Stone Business Park and Leicestershire's Lime Kilns Business Park in Hinckley. The forward acquisition is conditional on receipt of planning permission. The gross development value is £15.4m, financed from the Urban Logistics' cash resources.

All developments will generate a 6.0% yield on cost.

The three assets under development

Stone: total cost £8.5m

- Stone/M6: Yield on cost, 6.0%. The site will provide a flexible gross internal floor area of 86,000 sq. ft. Stone Business Park is in an established logistics location and benefits from direct access to junctions 14 and 15 of the M6.

Hinkley cost £6.9m

- Hinckley/M1: Yield on cost, 6.0%. The site will comprise two units with a total gross internal floor area of 63,500 sq. ft. Lime Kilns Business Park has direct access to the A5 and is close to junction 1 of the M69, enabling access to both the M1 and M6.

Southwater cost £4.6m

- Southwater, Horsham: Yield on cost, 6.0%. This development of 24,000 sq. ft. is located in a prime location in the South East and will comprise one unit.

Construction across all three sites is expected to commence shortly with completion expected in the second quarter of calendar year 2020. A number of pre-lets are at an advanced stage.

Half-year results

Announced 14 November

Achieving a total accounting return of 8.1% in just six months to September 2019 puts Urban Logistics well in the top 10% of REITs' current results.

Expansion through a variety of funding routes

1H'20 results continued the strong trend. The chairman states: "The strong results reflect our specialist focus which is underpinned by a shift in retailing to e-commerce. We maintain a healthy acquisition pipeline which we expect to fund through equity raising and bank debt when we have the opportunity to do so." There is a strong pipeline of acquisitions and forward funding development for three modest-sized assets – with no development risk – is in place. The portfolio remains 100%-occupied.

The interim dividend increased 25% to 3.75p, matching EPS, driven by rent reviews, new letting and acquisitions. 1H'20 showed strong total accounting returns (NAV plus dividend) at 16.4% annualised. Asset disposals in the period made total (ungeared) property returns of 50.0%, again all above book.

A strong set of results

With a strong set of lease renewals, other asset events, good capital recycling and execution of delivery of the acquisitions pipeline, 1H'20 was a successfully busy time. There was also progress on the three forward-funded newbuild assets. Importantly, in a period where much of the real estate sector has been struggling or marking time, the total property return has stood firm. Dividends and earnings have increased strongly from an already strong base.

Financial highlights – announced 14 November

Substantial advances from an already high base

- Like-for-like capital growth for 1H'20 4%; year to March 2019, 11%
- 1H'20 total property return stood at 7% (9% 1H'19 and 7% 2H'19)
- Total accounting return (NAV plus dividend) in the half year: 8.2% (8.1%)
- EPRA NAV/share +12.4%
- EPRA EPS 3.92p, +25.0%
- Dividend per share 3.75p, +25%

Asset management

Occupancy remains 100%

Ratings for the UK logistics REITs on historical data

Transaction in 1H'20	Rent uplift	LFL rental growth
3 lettings transactions	£0.2m	N.A.
1 fixed uplift rent review	£0.1m	20%
3 open market value rent reviews [1]	£0.3m	44%
7 total asset management transactions	£0.6m	38%

[1] Includes two reviews post period-end, settled at 9% above ERV *Source: Urban Logistics*

- WAULT 6.1 years (5.5 years). As a point of detail, the average time to first break is 4.4 years if the 20 year-lease parcels depot is excluded from the calculation.

Disposals

Capital recycling:

- £18.4m asset sales in three lots, 5% ahead of net book value (range 1.3% over to 14.3% over)
- Average NIY at disposal: 4.9% vs. 7.0% at acquisition
- Total property return (not annualised) 50%

Buying at near 7% yields and selling at 5%

In summary, Urban Logistics is buying still at near 7% yields and selling at ca.5% yields.

Acquisitions

- £15.2m during 1H'20, all off-market near period-end, so no meaningful impact on 1H'20 income
- Blended NIY 6.7%. 80% by value south east of England and midlands

Tuffnells: good name, 7% NIY, low site coverage is a useful benefit

On 20 September, Urban Logistics exchanged contracts to acquire a portfolio of six parcel distribution depots from Connect Group plc.

Average site cover for the portfolio is 18%

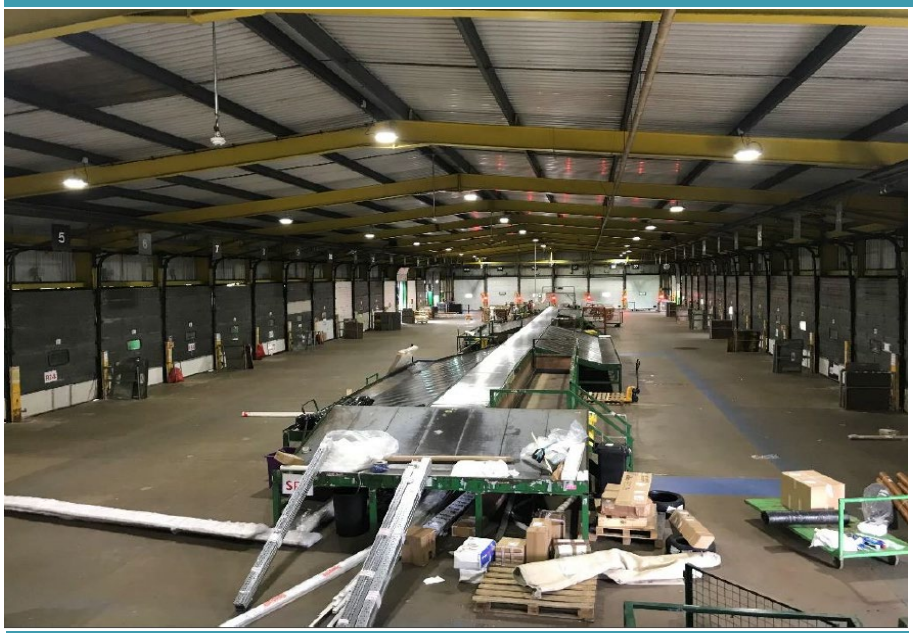
By a trunk A road in a small but well laid-out business park…

…note the good configuration

Coventry/ Nuneaton – Tufnells

Source: Urban Logistics

Coventry – Tufnells



Source: Urban Logistics

The Tuffnells acquisition was achieved for a total consideration of £9.9m at a 7.04% net initial yield. Completion took place shortly afterwards. This is a mix of freehold and long leasehold properties; the depots are located in Coventry, Newport, Plymouth, Leighton Buzzard, Andover and Perth. Assets were all leased back to a subsidiary of Connect Group plc, Tuffnells Parcels Express Limited, for 20 years on a fixed rental uplift (minimum of 1.0% to a maximum of 4.0% per annum, cap and collar, linked to RPI). Connect Group acts as guarantor. Tuffnells is a business-to-business distributor specialising in irregular dimensions and weights, serving small and medium-sized companies. The portfolio comprises 84,872 sq. ft. of warehousing, with a low average site cover of ca.18%.

At the same time as the Tufnells acquisition, Urban Logistics announced the purchase of two logistics properties in Sittingbourne and Thatcham for £5.3m at a 5.9% blended net initial yield. The warehouses are let to DHL Parcel UK.

Rent and prospects

The contracted rent for the portfolio as a whole stands at £12.2m (£10.7m), as stated in the results announcement.

Calculation of our forward estimates…

….0.46p EPRA EPS rise annually before any impact from rises in market levels

32% of the leases are with less than three years to expiry, as stated. We estimate ERV at some 9% ahead of current rents and typical uplifts to date have been ca.30% at the time of lease renewals. Three years from now – with zero additional benefit from market rises – we estimate a rise in rental income of £12m x 32% x 30% = £1.15m. This equates to an average rise in the top line of ca.£0.4m p.a. This, in turn, equates to 0.46p EPRA EPS rise annually before any impact from rises in market levels. We expect market rates to rise at ca.3% p.a. Adding 3% rises to the 0.46p calculated above, the increase would be 0.87p. In this context, we think our 2021 EPRA EPS is a conservative estimate, with the 2022E figure being particularly conservative.

Evidence for continuing strong returns

Only two months in to FY'20 and disposals enhance FY'20 shareholder returns by more than 4%

Disposals to date for FY'20 comprise an £18.8m redeployment and £5.1m profit on disposals, which enhances FY'20 shareholder returns by 4%. Although we see scope for these returns to continue, especially as the 4% is just from activity in a part of the year, let us use 2% as the figure in the table below – just to be conservative. This also ignores the benefit of financial gearing.

Figures from MSCI show 2018 growth in secondary (i.e. not Grade A or newbuild) rents of 6.5%. In this definition, secondary is the best fit to smaller- and medium-sized assets, which Urban Logistics owns. Although we see scope for these increases to continue, let us use 4% as the figure – just to be conservative.

Net initial yields are 6.2%. Post EPRA costs, this takes the yield to ca.4.8%.

Exceptionally difficult to see FY'20 ungeared returns below 10.5%...

Hardman & Co illustration of potential shareholder returns – ungeared

	Annual illustrative return
Asset yield net of all property and corporate administrative costs	4.5%
Assumed enhancement through capital redeployment	2.0%
Assumed conservative market rent growth	4.0%
Total – on Hardman & Co's conservative estimates (see above)	10.5%

Source: Urban Logistics accounts and Hardman & Co illustrations and estimates

Hardman & Co illustration of potential shareholder returns – geared

	Annual illustrative return
Total – on Hardman & Co's conservative estimates (see above)	10.5%
Total with benefit of 40% LTV, at current finance costs	15.0%

Source: Urban Logistics accounts and Hardman & Co illustrations and estimates

10.5% ungeared equates to 15.0% geared return. This assumes market rental growth of 4.0% p.a. On an assumption (which we consider too low, long term) of 2.0% market rental growth, the geared return equates to 11.7% p.a. On a larger asset base, the return rises (with administrative costs spread over a greater capital deployed).

The current rate is running at a significantly higher level to the illustration, above. Note, this figure is also conservative as the 4% assumed gain from recycling capital is just from activity already booked in this relatively short part of the fiscal year to date.

...Hardman & Co estimates shareholder (geared) returns of 17.5% as plausible – but it's early days

Current run rates of Urban Logistics shareholder returns FY'20E

	Annual return
Asset yield net of all property and corporate administrative costs	4.5%
Enhancement through capital redeployment (see text above)	4.0%
Estimated market rent growth	5.0%
Effect of financial gearing on the above	4.0%
Total – on Hardman & Co's conservative estimates (see text above)	17.5%

Source: Urban Logistics accounts and Hardman & Co illustrations and estimates

Relative rating attractions

The share price appears to be at the lower end of the range in terms of dividend yields and particularly so, given the growth rate.

Anomaly based on both a dividend yield and NAV. Particular anomaly given dividend growth achieved

Ratings for the UK logistics REITs on historical data

	Dividend growth past year [1]	Dividend yield
London Metric (LMP) 233p	3.7%	3.5%
Segro (SGRO) 888p	13.5%	2.2% [2]
Tritax Big Box (BBOX) 145p	2.2%	4.7% [2]
Urban Logistics (SHED) 145p	25.0%	5.3% [2]
Warehouse REIT (WHR) 112p	0.0%	5.4% [2]

[1] Latest dividend compared to equivalent one year prior
[2] Based on last two announced half years
Source: Bloomberg, priced 7 January 2020

The consistent record of adding value through capital disposal and reinvestment is a positive. Evidence of recent transactions is stated in this document. The spread between NIY at acquisition and NIY of current valuation shows a strong past performance. The future is indicated by our research on the dynamics of the market. Therefore, we think the fact that the share price being at a discount to NAV is noteworthy. We note the significant premium to NAV at which London Metric and Segro shares stand. These, in the comparables, above, have longer track records and more capital invested. This may be the main rationale.

We also note London Metric, Segro and Tritax all possess significantly longer WAULTs than the mean levels (an average of 11.5 years) with the first two registering significantly higher rents, too.

Performance record

The Urban Logistics (SHED) shares have performed well, in absolute terms and compared with the sector. The low rating reflects the fact that the share price has not kept pace with the NAV and dividends achieved rather than being an investment where investors have not done well.

Total (share price + dividends) returns on 100 invested in SHED vs. sector

April 2016 (flotation) to date	Current value of 100 at start
Urban Logistics	170
Real Estate sector (UK)	111

Source: Bloomberg, priced 7 January 2020

Management

Nigel Rich - Independent non-executive Chairman

Nigel brings a wealth of Board experience, having operated across the globe in senior positions, most recently at Segro plc where he was Chairman for 10 years.

Richard Moffitt - CEO

Former head of UK Distribution sector, CBRE, Richard has More than 25 years' experience of UK Industrial and Logistics markets.

Transaction history includes:

- Goodman acquisition of Rosemound for £650m +
- Scaling up and subsequent disposal by London & Stamford Plc for in excess of £350m
- Disposal of £300m of assets to Logicor by Anglesea
- Founding partner of M3 Agency LLP (logistics property consultancy).
- Ran CBRE Logistics business 2010-15

Christopher Turner - Asset manager

A qualified Chartered Surveyor, Christopher has 25 years of experience in acquisition, performance and disposal of investments.

Experience includes:

- Acquired, managed and traded £175m asset portfolio
- Acquired and repositioned €135m industrial portfolio in Germany

Independent non-executive directors

Jonathan Gray

Financial services expertise, having held senior roles at HSBC, UBS and NCB.

Mark Johnson

Co-founded Pacific Investments with Sir John Beckwith.

Bruce Anderson

Has held senior roles at Green REIT, Lloyds, HBoS and Bank of Scotland.

Management Agreement

The Investment Management Agreement runs to April 2024.

Annual management fee:

0.95% EPRA NAV p.a., paid in cash quarterly in arrears

Long-term incentive plan ("LTIP"):

The LTIP has an NAV element and a share price element. It is assessed on: i) 30 September 2020 (the "First Calculation Date"); and ii) 30 September 2023 (the "Second Calculation Date").

NAV element:

10% of excess of NAV per share return over an annualised 9% hurdle, multiplied by the number of shares in issue at the relevant calculation date.

Share price element:

10% of excess of share price element (including dividends) over an annualised 9% hurdle, multiplied by the number of shares in issue at the relevant calculation date.

First calculation date:

Share price element and NAV element calculated by reference to the capital raise placing price in August 2017 – 115p

Second calculation date:

If a payment is made at the first calculation date under either element, the hurdle for that element at the second calculation date shall be re-set to the prevailing EPRA NAV per share/share price as at the first calculation date (as applicable). If no payment is made under an element, then that element shall continue to be calculated by reference to the capital raise placing price.

The LTIP will be paid, at the plc Board's discretion, in shares or cash.

Risks and mitigation

Urban Logistics

Debt maturity is 3.2 years. All debt is secured and LTV is a modest 34% and interest cover stands at 4.2 times. The average cost of debt is 3.1%, 72% hedged.

Forward commitments and forward momentum – resilient position

The gross development value of the forward funded asset is £15.4m, readily covered by the current balance sheet. No development risk is taken. Such a commitment is a good way of broadening the forward pipeline of portfolio acquisitions. We see no reason why management should not be able to execute off-market transactions in the foreseeable future. As to disposals, none is required other than as part of the capital recycling strategy successfully adopted to date.

We understand ERV is ca9% ahead of passing rent on the Urban Logistics portfolio.

Reversionary, so short leases are a positive

WAULT of 4.4 years to first break

WAULT stands at 6.1 years, a relatively quite low number. Indeed, the Urban Logistics portfolio can be divided into two: 95% of its value is 'last-mile logistics', the rest is a parcel depot let out on a 20-year lease to expiry (and break option). For the 95% of the portfolio, the WAULT stands at 5.1 years. The WAULT to first tenant break is, however, 4.4 years. Is this a risk? Yes: it is a near certain risk of rental increases as units fall vacant and all at below current market rents. This conclusion is the only one possible, given the preceding paragraph. Furthermore, leases are one thing, occupancy another. We understand the average length of occupancy for Urban Logistics tenants is well over 10 years.

Robust regards Brexit…

Brexit, as yet, is not leading to recession. However, Urban Logistics has successfully sought tenants that provide consumer staples and a range of essential goods – the 'staff of life'. Exposure to fashion retail (or other non-durables retail) is minimal. Its tenants are weighted to large 3PL operators and others, which are more resilient to a downturn. This diverse tenant base is resilient. In several sectors, Brexit has led to uncertainty.

…rent reviews looking solid

Rent reviews are progressing well, as normal. Since the 2016 IPO, there have been 12 rent reviews and 14 new lettings/lease re-gears. Since the 1H'20 period-end (September 2019), rent reviews have raised the portfolio income by £0.3m p.a. or 2.5% – encouraging. The rent reviews post period-end have been settled at 9% ahead of estimated rental value (ERV). ERV is the external valuers' opinion of the open market rent which, on the date of valuation, could reasonably be expected to be obtained on a new letting or rent review of a property.

Were the take-up growth to halt, *and* newbuild come onstream (which for reasons outlined above, it will not) and, say, *and* Brexit were to cause a collapse in demand, the rating of the sector might come under pressure. We do not expect items one and three to be likely and, if item two seems logically impossible under current strong markets, in a weaker market, that would be all the more so.

All assets are let to a single tenant. They are all good covenants. 89% of tenants are low risk or low/medium risk entities (Dun & Bradstreet, Experian ratings data).

A top 10 asset is at Elms Farm industrial estate Bedford. This asset was purchased as a vacant building and immediately let. The tenant is Your Farmer Produce. Within the terms of the lease, Your Farmer Produce has sub-let and the sub-letting tenants pay rent into an escrow account for the benefit of Urban Logistics. Urban Logistics from time to time as appropriate passes monies to Your Farmer Produce, as sub-tenant inflow more than covers the rent and charges due.

Sector

Sector average rents in 2018 stood at 580p sq. ft. (Savills) vs. 410p sq. ft. end-1Q'12. As new supply should prove modest and patchily location-specific, the rise in rents is justified. However, should demand reverse, a prop is removed. Supply remains short. Vacancy rates stand at 5.5%, down from 13% in 1Q'12. Further, the 2012 rental lows were well down on previous highs and rents have gone nowhere for two decades. The dynamics of the sector have been strong for a number of years, but prior to that the supply/demand story was not supportive.

Rents have risen but, of course, given vacancy rates stand at 5.5%, down from 13% in 1Q'12

Since 2012, 'secondary UK industrial' demand has been steady at 45m-50m sq. ft. p. a. It is availability that has plummeted – by 67% to 75m sq. ft

Are low vacancy rates and a 67% fall in availability 2012-19 a sign of over-heating? We believe not. Take-up is running at 45m sq. ft. p.a. for 'secondary UK industrial' (Savills) and 85m sq. ft. for all industrial (all is including logistics). Since 2012, 'secondary UK industrial' (Savills) has been steady at 45m-50m sq. ft. p.a. It is availability that has plummeted – to 75m sq. ft. This looks like an inflection point upwards for rents – or at the very least, continuing growth building on past rises.

Online retail is helpful to the sector but is only ca.5% of annual take-up, we estimate

Online retail is considered to be driving the 'story'. Online omni-channel fashion and other broad segments of retail are growing strongly but they are not driving logistics real estate. Of UK industrial take-up in 2018, 28% was online retail, a large number and much larger than the 3% figure for 2013 (Savills). Nevertheless, still 51% came from 3PL (third-party logistics), manufacturing, grocery and high street.

However, if take-up has been steady since 2012 and online has grown from 3% of take-up to 28%, were online to slow, surely that would weigh on the sector take-up? Take-up, ex the expansion in online, would be lower. Certainly, yes. Mathematically, the ca.45m sq. ft take-up would be ca.95% of that level (i.e. 43m sq. ft.) ex the online. The difference is there, but not particularly material.

By historical logistics market standards, the current NIY of the sector, including Urban Logistics, is low. The NIY adjusted for current ERVs (reversionary uplift) makes the rating look much more in line with the higher yields in the past.

Glossary

3PL, third-party logistics. Distribution businesses – parcels, typically, but smaller or larger items. Comprises 50% of Urban Logistics' tenant base.

EPRA is the European Public Real Estate Association, the industry body for European REITs.

EPRA cost ratio is a proportionally consolidated measure of the ratio of net overheads and operating expenses against gross rental income (with both amounts excluding ground rents payable). Net overheads and operating expenses relate to all administrative and operating expenses, net of any service fees, recharges or other income, specifically intended to cover overhead and property expenses.

EPRA cost ratio sometimes is stated as including direct vacancy costs, or conversely, excluding direct vacancy costs. Nearly all REITs have some level of vacancies as part of the business model, so we focus little on EPRA costs excluding voids.

EPRA operating profit principally excludes revaluations gains/losses on investing and trading property. It also excludes changes in the fair value of financial instruments. It includes items such as early lease surrender premiums.

EPRA net asset value (EPRA NAV) is a proportionally consolidated measure, representing the IFRS net assets excluding the mark-to-market on derivatives and related debt adjustments (this is the adjustment of net assets and EPRA net assets in our spreadsheet), as well as deferred taxation. It is adjusted for the dilutive impact of share options.

EPRA net initial yield is the annualised rents generated by the portfolio, after the deduction of an estimate of annual recurring irrecoverable property outgoings, expressed as a percentage of the portfolio valuation (adding notional purchaser's costs), excluding development and residential properties.

EPRA NNNAV is the EPRA NAV adjusted to reflect the fair value of debt and derivatives and to include deferred taxation on revaluations.

Estimated rental value (ERV) is the external valuers' opinion of the open market rent which, on the date of valuation, could reasonably be expected to be obtained on a new letting or rent review of a property.

Direct property costs are fairly self-explanatory; this usually is a low figure as leases are fully repairing. However, the figure may include (amortisation of pre-paid) lettings fees. It will not include capitalised capital expenditure, some of which may be prompted by refurbishment when tenants vacate. As an aside, we understand that, over the medium term, this figure may be ca.0.75% of gross assets for Urban Logistics, although this may change over time as the portfolio is constantly evolving.

LTV loan to value: the ratio of debt to total value of investment assets. It is sometimes sated as gross debt ignoring cash but we use net debt, which includes cash held.

LTIP is a long-term incentive plan for senior management and Urban Logistics had an A, B and C share scheme. A shares crystallised in FY'18 and some B and C shares are likely to crystallise in FY'21. There are fair value movements in the year. These are excluded from EPRA profits.

Net current assets are often modestly negative for REITs, including rent payable (end-March being a 'quarter day' when rent usually falls to be invoiced).

Other income may, for example, include payments from tenants for dilapidations (when they vacate) over and above the monies spent to refurbish the asset which the dilapidation deposit covered.

Revenue can include early lease surrender premiums (we would highlight this) and it can 'gross up' small figures for some of the service charge, which includes insurance, for example.

SME, small, medium-sized enterprises.

WAULT, weighted average unexpired lease term. We specify in this document where this refers to time to the first break.

Financial analysis

Revenue account

Year-end Mar (£m)	2017	2018	2019	2020E	2021E	2022E
Rental income	2.28	5.56	10.80	12.20	13.40	13.90
Vacant property costs	0.00	-0.49	-0.60	-0.10	-0.10	-0.10
Direct property costs	-0.02	-0.07	-0.10	-0.20	-0.20	-0.20
Net income	2.26	5.00	10.10	11.90	13.10	13.60
Administrative expenses	-0.50	-1.07	-1.80	-1.90	-2.00	-2.10
LTIP charge	-0.03	-0.66	-0.12	-0.10	-0.10	-0.10
Other income/costs	0.00	0.13	0.00	0.00	0.00	0.00
EPRA operating profit	1.73	3.40	8.18	9.90	11.00	11.40
Property Revaluation	3.88	7.19	13.40	6.00	6.08	6.36
Profit on disposal, transaction costs	0.00	0.06	0.20	5.10	0.00	0.00
Other income/costs	0.00	0.00	0.00	0.00	0.00	0.00
Operating profit	5.60	10.65	21.78	21.00	17.08	17.76
Finance	-0.60	-0.93	-2.20	-2.60	-2.90	-2.90
EPRA PBT (pre LTIP, etc.)	1.32	3.13	6.10	7.40	8.20	8.60
EPRA PBT (post LTIP)	1.29	2.47	5.98	7.30	8.10	8.50
Fair value changes	-0.11	0.13	-0.70	0.00	0.00	0.00
PBT as declared	4.89	9.86	18.88	18.40	14.18	14.86
Tax	0.00	0.00	0.00	0.00	0.00	0.00
EPRA PAT	1.32	3.13	6.10	7.40	8.20	8.60
EPRA EPS (p) (adj. pre LTIP, diluted)	7.89	6.12	7.20	8.43	9.34	9.80
EPRA EPS (p) (post LTIP, diluted)	7.82	4.91	7.01	8.32	9.23	9.69
EPS (p) (diluted) reported	46.80	19.54	22.12	20.97	16.16	16.94
DPS (p)	6.23	6.32	7.00	7.80	8.60	9.20
Average shares issue (diluted, m)	14.33	50.56	84.70	87.75	87.75	87.75
Year-end shares in issue (m)	21.45	68.11	87.69	87.75	87.75	87.75

Source: Urban Logistics report and accounts; estimates: Hardman & Co Research

Balance sheet

@ 31 Mar (£m)	2017	2018	2019	2020E	2021E	2022E
Investment properties	43.42	131.85	186.40	199.40	212.08	221.45
Derivatives	0.00	0.02	0.00	0.00	0.00	0.00
Long term liabilities (deposits, derivatives)	-0.76	-0.67	-1.64	0.00	0.00	0.00
Long-term debt	-18.20	-47.67	-71.40	-71.40	-73.00	-75.00
Net current assets excluding financial	-0.78	-2.60	-2.66	-3.00	-2.00	-2.00
Cash, deposits, short-term debt	1.68	3.28	9.76	5.28	1.77	1.87
Net cash (debt)	-16.52	-44.39	-61.64	-66.12	-71.23	-73.13
Net assets	25.36	84.21	120.46	130.28	138.85	146.32
EPRA net assets	24.91	83.43	121.17	130.28	138.85	146.32
NAV/share (p)	118.26	123.62	137.39	148.47	158.24	166.74
EPRA NAV/share (p)	116.11	122.49	137.96	148.47	158.24	166.74
Asset revaluation	3.88	7.19	13.40	6.00	6.08	6.36
LTV (net debt)	38.0%	33.7%	33.1%	33.2%	33.6%	33.0%
LTV (gross debt)	41.9%	36.2%	38.3%	35.7%	36.9%	36.8%

Source: Urban Logistics report and accounts; estimates: Hardman & Co Research

Cashflow						
Year-end Mar (£m)	2017	2018	2019	2020E	2021E	2022E
Cash from operations	3.29	4.80	8.35	9.90	11.00	11.40
LTIP	0.03	0.66	0.12	0.12	0.10	0.00
Net cashflow from op. activities	3.32	5.46	8.47	10.02	11.10	11.40
Investing activities	-23.11	-51.40	-18.22	-7.00	-5.00	-1.00
Finance	-0.52	-0.78	-1.83	-2.20	-2.90	-2.90
Free cashflow operation and investment	-20.31	-46.72	-11.58	0.82	3.20	7.50
Share issue	20.68	51.23	22.80	0.10	0.00	0.00
Dividends	-0.31	-2.91	-4.76	-5.40	-6.71	-7.40
Other	0.00	0.00	0.00	0.00	0.00	0.00
Net cash change	0.06	1.60	6.46	-4.48	-3.51	0.10
Net cash (short-term)	1.68	3.28	9.64	5.16	1.65	1.75
Net cash/(debt)	-16.52	-44.39	-61.64	-66.12	-71.23	-73.13

Source: Urban Logistics report and accounts; estimates: Hardman & Co Research

The gross development value of the three assets being developed totals £15.4m. Within the forward projections above, we assume disposals as well as acquisitions and developments.

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