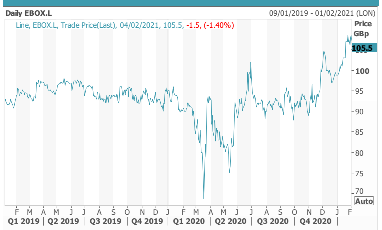
Real estate



Source: Refinitiv

Market data

EPIC/TKR	**EBOX**
Price (p)	**107**
12m High (p)	108
12m Low (p)	70
Shares (m)	422.7
Mkt Cap (£m)	453
EV (£m)	807
Free Float	99%
Market	Main market

Description

EBOX invests in large, modern logistics assets in several Continental European countries. It also undertakes new development. Continental European markets focus on larger assets (vs. the UK).

Company information

CEO (Manager)	Nick Preston
CFO (Manager)	Mehdi Bourassi
Chairman	Robert Orr

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Key shareholders

Timbercreek	8.3%
Aviva	8.3%
CCLA	6.2%
East Riding Yorks	4.7%
Primonial	4.6%

Diary

9 Feb	AGM
May'21	Interim results
Dec'21	Full-year results

Analyst

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TRITAX EUROBOX

Premium growth still offering premium yield

Growth in demand for large, modern logistics real estate is accelerating. 12% of Continental European retail was via internet shopping in 2020. Savills quotes data projecting 15.3% this year. Onshoring and lengthening of supply chains add to the trend. Tritax EuroBox (EBOX) invests entirely in this sector. It capitalises on Tritax Group's extensive expertise in the sector (£5bn assets, including the eight year-old Tritax Big Box in the UK). Its prospective dividend yield is 4.2%. We calculate the dividend yield on the largest UK real estate stocks to be 3.9%, while the largest logistics real estate REIT, Segro, offers a historical dividend yield of 1.9%.

- **Strategy:** EBOX is an investment trust, launched and floated in mid-2018, with a further €135m equity raised in May 2019. It is dedicated to investing in the structurally undersupplied Continental European logistics market. Rents grew 2.9% like-for-like last year, and there is every indication this should accelerate.

- **New development:** EBOX projects 7.0% rent returns on its three developments (one under way). There is thus a latent revaluation uplift of as much as €20m, or more, in total to be delivered over the next three years. Further developments are planned. Supply/demand is attractive, so modest, judicious new development is low-risk.

- **Valuation:** Tenant demand strength indicates a steady NAV rise as rents rise. Furthermore, value generated by new development is clear, and this may indicate a premium to NAV being warranted. It is worth noting this company has achieved critical mass, but a greater capital base may enhance the valuation.

- **Risks:** This asset class's valuation basis is almost exactly in line with the total market but, in the past, logistics assets have been valued at higher yields. Growth in logistics and internet fulfilment is a long-standing driver. New development is never without some risk. There are taxes payable, and the quantum may vary.

- **Investment summary:** Growth in demand has been accelerated by COVID-19, and this is set to continue. In many of EBOX's markets, this has taken market vacancies down to near zero. Value rises tend to lag such events, and this – added to the developments – gives high visibility to NAV growth. Income has now risen to the target indicated at IPO. There is a €2bn acquisition pipeline.

Financial summary and valuation (NB share price is in pence)

Year-end Sep (€m)	2019*	2020	2021E	2022E
Net rental income	24.5	35.5	41.7	43.5
Revaluation and disposal profit	17.8	39.4	30.0	40.0
Administrative costs	-8.5	-10.7	-11.4	-11.6
Finance (incl. fair value, translation)	-7.5	-10.6	-8.6	-8.6
Reported PBT	26.3	53.6	51.7	63.3
Profit EPRA basis	9.8	13.8	21.7	23.3
EPS EPRA basis (c)	3.0	3.3	5.1	5.5
EPS adjusted basis (cash-based, c)	3.3	4.2	5.1	5.5
DPS (c)	3.4	4.4	5.0	5.3
IFRS EPRA (c)	113.0	119.0	125.4	134.8
Dividend yield	2.8%	3.6%	4.2%	4.4%
Price/NAV (x)	1.07	1.01	0.97	0.90

** Period from 1 July 2018. Source: Hardman & Co Research*

Executive summary

95% income has escalation clauses built in

The company invests in four asset categories in the logistics sector. On a long-term, fully-invested basis, EBOX expects ca.50% of its gross assets to be invested in Foundation Assets, which have long, escalating leases. 20% of the assets are to be invested in Value-Add Assets, which have development options or shorter leases, and scope to add value. Another 20% are to be invested in Growth Covenant Assets, where tenant covenant quality is rising. The remaining 10% are to be invested in Strategic Land.

EBOX's investment case is supply/demand imbalance, which results in decent yield returns…

The sheer size of the sites, the need for proximity to transport nodes and the strong "green" anti-development movement in Europe make the securing of sites and planning difficult for developers. Existing modern assets therefore are valued relatively highly, and also attract good tenants. The typical lease is index-linked. It is important to highlight that, although yields for such assets have modestly come in (prices have risen), the average net initial yield of 4.6% still enables strong dividend payouts. Further market-related value rises are very likely.

…growth in demand…

We estimate a 5.0c dividend payout for FY'21, on an NAV that most recently stood at 119c per share – an attractive 4.2% dividend yield on asset value. This return is set to rise in FY'22, with rent from the low-risk developments we refer to below.

Internet retail is not the only driver to growth. Parcel delivery and logistics fulfilment businesses (B2B and B2C), as well as individual retailers, are all in long-term growth mode. Modern assets are increasingly sought, as they are good environments for the rising fitout requirements (increasing spend on fitout is well-established) and workplace attractiveness (for employee retention).

…and ability to add value by modest-risk development

With this supply/demand balance and the difficulty in securing planning, EBOX's industry knowledge, developer connections and capital put the company in a strong position to add value. With certain sites meeting its exacting risk/reward requirements, the company has found it possible to confidently project rental yield returns of ca.7% on developments in mainstream markets, either pre-let or in micro locations of proven extremely tight supply/demand. Taking a modest risk on a minority of the portfolio is set to boost cash and investment valuation benchmarks, particularly in FY'22. Three such sites are currently on the books, the first completing this summer.

Most recent acquisition

Source: Tritax EuroBox

The assets

EBOX owns large assets near population centres and transport hubs. At end-September 2020, 12 assets were owned: in prime locations, with a large average size of nearly 73,000 sq. m. Nivelles, with a size of 34,119 sq. m., represented the 13th asset. At fiscal year-end, there was a strong, well-diversified base of 21 tenant partners, 80% of which are multi-billion-Euro turnover businesses. 100% of assets are income-producing, and 95% of rental income is subject to an element of indexation each year. The weighted average unexpired lease term (WAULT) at the fiscal year-end was 9.1 years (30 September 2019: 11.0 years).

The group has a country spread. Total income (including service charges, etc.) stood at €42.88m in the year to September 2020. Note that Germany has a 10% minority held by the vendor. One effect of this is to minimise taxation.

Annual income (€m)

Period-end September 2020	Belgium	Germany	Spain	Italy	Poland	Netherlands
Rent	6.07	13.84	8.14	7.07	6.72	1.04

Source: Tritax EuroBox

Strategic positioning

Expected to deliver 4.2% dividend yield in 2021

EBOX is forecasting a further dividend progression, to 1.25c per share for 1Q'21, equivalent to 5.0c p.a., which equates to a 4.2% yield on the current share price.

Slight change of emphasis due to greater size, resources and proven track record

As stated at the last results: "we have always looked favourably on assets with value creation potential and although we will continue to acquire fully let standing assets, we will increasingly tilt our activity towards value-add opportunities. Our overall investment policy and acquisition criteria will not change but we will aim to acquire assets at an earlier point in the development cycle to enable us to control more effectively the value-add opportunity. While the dividend will remain a substantial driver of our Total Return, this strategy will enable us to supplement that with increased capital growth." (EBOX Chairman December 2020)

Mango: 19% EBOX income; Amazon: 15%

Typical asset

Source: Tritax EuroBox

Both logistics and retail company fulfilment

The largest tenant is Mango, a fashion retailer. Most tenants are logistics operators. Unlike in the UK, fewer Continental European markets focus on smaller "last-touch" depots.

Active asset management

Examples of active management last year included the agreement on an option to fund a ca.88,000 sq. m. extension to the Mango property in Barcelona and selling a 16,400 sq. m. plot of non-core development land at Bornem, Belgium, for €2.3m, 53% ahead of the latest valuation, and realising a profit of €0.8m. This profit is excluded from the EPRA and adjusted profits (being a capital event). We anticipate a string of such modest disposals or the development of parts of sites held.

Judicious value-adding new development

In addition, EBOX is delivering three new assets: in Belgium (a new building on an unused plot of land), Spain and Poland. The Belgian asset is under construction, with completion due this summer. EBOX undertook this as a speculative development (with a rent guarantee), as local vacancy rates are sub-1%. Others will look to pre-let. Respective costs are €7m, €31m and €15m, and our September 2021 year-end assumes €12m development spend in Belgium and Barcelona. With rent returns of 7.0% on these costs, there is a latent revaluation uplift of as much as €20m, or more, in these three assets – spread from this year to 2023.

Investment conclusion

Average total returns of 10.4% in last two years

Efficiencies of scale achieved in 2020. EPRA cost ratio stood at 31.3% for year to September 2020.

Total returns of 9.5% and 11.3% in the years to September 2019 and 2020, respectively, may well rise further in the coming three years, as profits accrue from new asset development. Further equity was raised in 2019. The medium-term aim is to raise additional equity, we believe, as the equity is fully invested and now registers a 44% loan to value – LTV (assuming the development expenditure mentioned above), which equates to the target rate. We see significant scope for expansion, which would benefit returns, as part of this expansion could continue to be through development. With or without further equity, the strategy is to undertake active capital management – for example, utilising vacant land.

Risks

Some development but market intelligence extensive and positive

Development has some risks, and some is undertaken without being pre-let – in a market with under 1% market vacancy. Mango's credit risk is low, and the company performed well in 2020.

We have no concerns over a very strong tenant base, with 2020 rent paid 95% on time

WAULT is 9.1 years (September 2020). Credit facilities had a weighted average maturity of 3.8 years at 30 September 2020, with no facilities maturing before 2023.

Drivers to investment returns

2.9% historical rental growth, but great interest in value from development

The prime driver is organic rental growth. In addition, EBOX is enhancing its assets and certain tenant covenants. It is also delivering three new assets. New developments yield ca.7.0%-plus. With valuation yields of ca.4.6%, there is a significant valuation uplift. A small amount of the September 2021 revaluation is from the Belgian extension. Much more development revaluation will come in September 2022 and the 2023 fiscal period.

Our assumptions of minimal reductions in capitalisation may well prove overly conservative

Our asset valuation progression makes no assumption on changes in capitalisation rates. It does assume values rise in line with rent rises, and we take account of the revaluation on newly developed assets.

LTV set to rise to 43% in FY'22– medium-term target level

New acquisitions and development are paid for out of debt. LTV for September 2021 and 2022 stands at just under 42% and 43%, respectively, in our model (note, gross cash as a ratio of assets including cash), which is near the target.

Cash cost of debt is 2.3%; in addition, there have been arrangement and commitment fees. Were rates to rise, there would be derivates capping the cost, and it is worth noting that lenders do not pass on the benefit of negative Euribor rates.

This company pays some overseas taxes

German assets are 90%-owned – the vendor retained 10%, and is a minority on the balance sheet. The accounting is through the medium of a Put that the original owner has for the retained 10%. Changes in value in the investment affect the Put value, and this is accounted in the Finance line. As we assume no changes in capitalisation rates, we make no change to the Put, but if valuations were to rise markedly, there would be an impact to the Finance line. It may be that strong markets would impact profits, but the Put value change (being non-cash) does not affect adjusted profits.

Local taxes are paid and not refundable. Long term, a ca.4%-5% tax rate is expected.

EBOX targets cash-backed "adjusted" profits

The analysis below shows reported, EPRA and adjusted profits. Adjusted is broadly cash-based reporting. Thus ca.€1.6m deferred 2020 rents payable over the first nine months of calendar 2021 are reflected in adjusted earnings.

Financial analysis (NB, for reference, share price quoted in pence]

Period-end (€m)	Sep'19*	Mar'20**	Sep'20	Mar'21**	Sep'21	Sep'22
Revenue account	15 months	Interim	Full-year	Interim	Full-year	Full-year
Total rental income net of direct costs	24.5	17.2	35.5	20.5	41.7	43.5
Administrative costs	-8.5	-5.0	-10.7	-5.7	-11.4	-11.6
Revaluation and disposal profit	17.8	20.1	39.4	20.0	30.0	40.0
Finance (incl. fair value, translation)	-7.5	-4.5	-10.6	-4.3	-8.6	-8.6
Profit EPRA basis	9.8	7.5	13.8	10.5	21.7	23.3
PBT reported	26.3	27.8	53.6	30.5	51.7	63.3
PAT reported	20.7	22.5	44.8	26.5	44.7	59.3
EPS EPRA basis (c)	3.0	1.8	3.3	2.5	5.1	5.5
EPS adjusted basis (cash-based, c)	3.3	2.2	4.2	2.5	5.1	5.5
EPS IFRS basis (includes revaluations, c)	6.3	5.3	10.6	6.3	10.6	14.0
DPS (c)	3.4	2.2	4.4	2.5	5.0	5.3
Balance sheet						
Investment properties	689.1	889.1	837.9	889.0	906.0	992.0
Other net assets, excl. net debt	2.3	-15.0	-17.8	-15.0	-15.0	-15.0
Net debt	-214.1	-354.1	-316.2	-354.0	-361.0	-407.0
Shareholders' funds	477.3	520.0	503.9	520.0	530.0	570.0
IFRS NAV (c)	113.0	123.0	119.0	123.0	125.4	134.8
Ratios						
LTV	33.3%	41.8%	39.9%	42.0%	41.8%	43.0%

**Period from July 2018, **six-month period. Source: Tritax EuroBox accounts, Hardman & Co Research estimates*

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