Panmure Gordon

AND COMPANY

Established 1876

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Equity Research

Companies covered:

Stock	Rec	Price*	Target Price
Assura	Buy	57	61
LondonMetric Property	Hold	191	200
Primary Health Properties	Hold	123	128
Secure Income REIT	Buy	405	435
Tritax Big Box	Buy	142	152

**Priced at 11 March 2019.*

Real Estate Initiations

Feeding a need for yield

Over the past three years the market cap of the long-income REITs has more than doubled to over £10bn as management teams and investment banks have fed a need for yield in a low interest rate environment. Although the companies cover a range of property sub-sectors, their common denominator is a relatively long lease length, with generally a high proportion of fixed/RPI linked review structures, adding to the predictability of the income streams. In this note we look at the attractions but also the risks facing these companies and initiate on five – Assura, Primary Health Properties (PHP), Tritax Big Box (Tritax), Secure Income REIT and LondonMetric.

- **An increasingly rare commodity:** One of the historic attractions of the UK property sector has been its long-term leases. However, these have transitioned from 25 years to settle at c.7 years, with only 6% of new leases granted in 2018 for over 11 years and just 1% over 21 years (source: MSCI). Add to this the introduction of IFRS 16 earlier this year, and we expect a continuation of the trend to the shorter lease. This makes long leases even more valuable.
- **Playing the financial arbitrage:** The financial attraction of enjoying the difference between property yields and low financing rates is well-documented. However, there are some risks, given that the drivers which make the numbers stack up – purchase yields, cost of finance and ability to raise capital – are all outside of the property companies' control.
- **Assets not just an income stream:** Although we recognise that some investors will treat the long-income REIT as a quasi-corporate bond, we would highlight that as leases get shorter the yield demanded should rise. As a result, if the assets are operationally important to a tenant, early renewals are more likely, which is beneficial from a valuation perspective. A long lease is only as good as the tenant's ability to pay, therefore in the event of a tenant defaulting, diversification is important, as is the re-lettability (i.e quality) of the property.
- **Growth driving revenue and cost efficiencies:** The business model of many of the newer long-income REITs relies on acquisitions to drive revenue growth and cost efficiencies, especially those with external management structures. We like those companies that can also generate growth from a development pipeline (LondonMetric, Tritax and Assura), or that are happy to just appreciate the benefits of compounding RPI/fixed uplifts, only buying the right opportunities (Secure Income REIT).
- **Market evaluation of the income streams:** We believe the performance of the long-income REITs are driven by investors' appraisal of the worth of the income streams as opposed to the valuers' assessment. Therefore the NAV is largely irrelevant, the focus being on dividend yields, their growth and their cover.

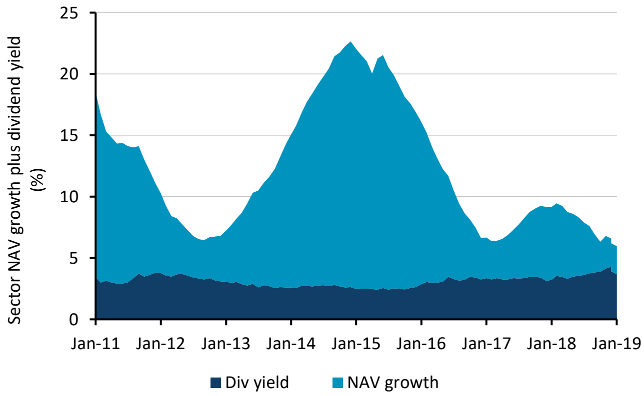
CONTENTS

SUMMARY OF RECOMMENDATIONS

Unusually the direct real estate market is showing a diverse range of sub-sector performances (Figure 1) which is resulting in it being impossible to generalise about the outlook for the UK quoted real estate sector. What we can say is that NAV growth is going to be less of a driver of total return performance over the coming year (Figure 2), whichever sub-sector you consider (retail – negative, office – at best marginally positive, industrial – positive but at a slower rate than 2018). We therefore think it is more useful to look at the companies in relation to their income characteristics and the possibility for growth. Our first group of initiations (5 March 2019 'Operators of space' no longer 'collectors of rent') focused on those companies where efficient operations were the driver of growth. Our second group focuses on those companies offering long-term rental income streams and considers their security and prospects.

Figure 1: Diverse range of direct property performances

Figure 2: NAV growth currently a small part of total returns*



**ignoring change in ratings*
***Source** MSCI, Datastream, Company data, Panmure Gordon*

We understand the appeal of long-term secure property income streams in a low growth, low interest rate, uncertain world but in the following pages we also consider the areas of risk as well as the growth prospects. We then provide 4-page initiation reports on five companies we are picking up coverage in this note. Our recommendations are briefly summarised below (Figure 3):

Figure 3: Summary of ratings, target prices and valuations

	Rating	Share price (p)^	Target price (p)	12-month total return (%)	Forecast div yield (%)	PE (x)	Premium/ (discount) to current NAV (%)	Rationale for rating
LondonMetric Property	Hold	191	200	8.8%	4.3%	22.1	8.5%	Hold for the management team and development pipeline
Assura	Buy	57	61	11.5%	4.6%	21.5	6.2%	Buy given relative underperformance and attractive dividend yield
PHP	Hold	123	128	8.6%	4.6%	21.9	17.2%	Hold for post-merger cost savings and attractive dividend yield
Tritax Big Box	Buy	142	152	11.9%	4.8%	20.0	-6.5%	Buy for good value stock and development pipeline
SecureIncome REIT	Buy	405	435	11.5%	4.1%	24.3	-0.1%	Buy for underlying income growth plus the potential to surprise with acquisitions

^as at close 11 March 2019
***Source** Datastream, Panmure Gordon*

The Attractions of Secure Long-Term Income

As we highlight in Figure 2, the income component of quoted real estate total returns is becoming increasingly important in a slow property market. That income can either come from maximising occupancy for an operational short lease company or from receiving a steady, reliable income stream from a long lease. It is this collection of companies that we consider in our second round of initiations.

We show in Figure 4 how, over the last three years (particularly in the uncertain world created by the EU referendum), investors have preferred those companies with either the potential for income growth through strong operational management or long-term income streams. The sub-sector of long income REITs has experienced low volatility over the past 18 months driven by the fact that a greater proportion of their returns are coming from dividend yields (Figure 5).

Figure 4: Low volatility but still outperforming the sector

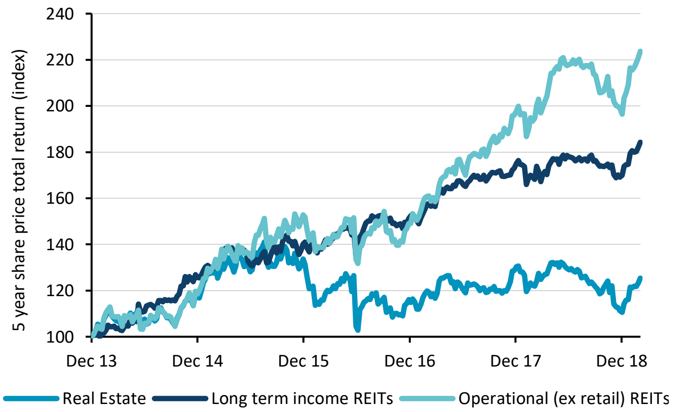
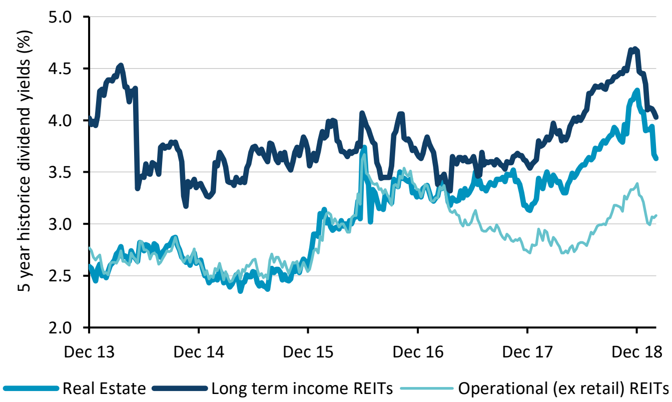


Figure 5: Higher dividend yield component of total returns



Source *Datastream, Panmure Gordon*

Market feeding a need

The demand for income has resulted in a flurry of new real estate IPOs all seeking to provide investors with relatively high sustainable dividend yields backed by property income streams. The market capitalisation of these has risen from £1.5bn in 2014 (Tritax, LondonMetric, Secure Income REIT, Assura, PHP and Target Healthcare) to c.£10bn today (Figure 6), equivalent to c.20% of the market cap of the UK real estate quoted sector as a whole. As we show in Figure 7, the companies that came to the market in 2016/2017 have raised a significant total of £2bn (similar to the current market cap of £2bn, so investors receiving to date a return equivalent to the dividends paid).

Figure 6: Long income REITs account for c.20% of sector

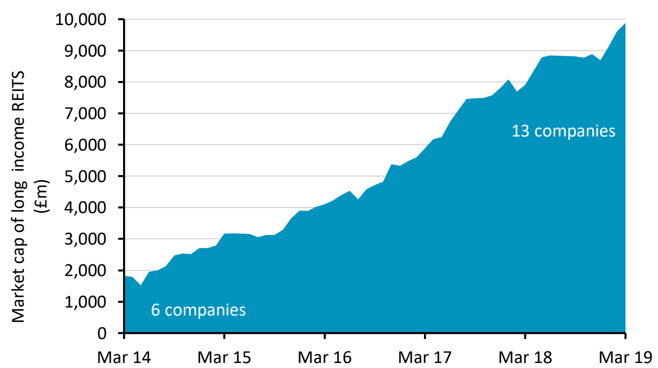


Figure 7: c.£2bn raised by new companies

Company	IPO date	Total gross amount raised to date (£m)	Current market cap (£m)*
Civitas Social Housing	Oct-16	652	610
LXI REIT	Jan-17	373	435
Impact Healthcare REIT	Feb-17	193	199
AEW UK Long Lease REIT	Jun-17	81	73
Residential Secure	Jun-17	180	159
Triple Point Housing	Jul-17	356	358
Supermarket Income REIT	Jul-17	185	192
Total		**2,019**	**2,026**

**as at close 11 March 2019*

Source *Datastream, Company data, Panmure Gordon*

COMMON DENOMINATOR IS LEASE LENGTH & FIXED/RPI UPLIFTS

We detail in Figure 8 the companies that we include in our list of long-income UK REITs together with, in bold, those that we are initiating on in this note. As is clear from the table, they encompass a wide range of property types; traditional and alternative sub-sectors, the common denominators being a relatively long weighted average lease length (WAULT) (Figure 9) and a high proportion of fixed/RPI rent review uplifts (Figure 10).

Figure 8: Panmure's list of long income UK REITs (in bold those companies Panmure is initiating on)

Diversified	Primary Healthcare	Secondary Healthcare	Distribution	Retail	Residential
Secure Income REIT	**Assura**	Target Healthcare	**Tritax**	Supermarket Income REIT	Civitas
LXI REIT	**PHP/MedicX**	Impact Healthcare	**LondonMetric**		Triple Point
AEW Long Income REIT					Residential Secure

Source *Panmure Gordon*

The range of company WAULTs is relatively wide but all are significantly ahead of the quoted real estate sector average of c.8 years (Figure 9), and the wider market average of 7 years for new leases (Figure 11). The rent reviews are dominated by index linked/fixed uplifts, giving attractive visibility of net rental income growth, with only PHP and Assura being driven by open market rent reviews.

Figure 9: WAULT is c.20 years with a range from 11 up to 30

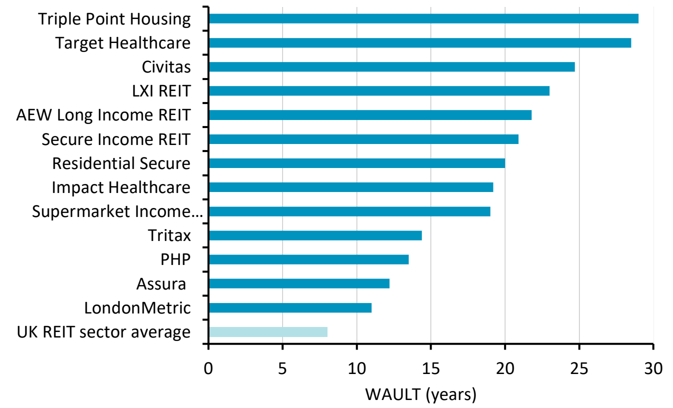
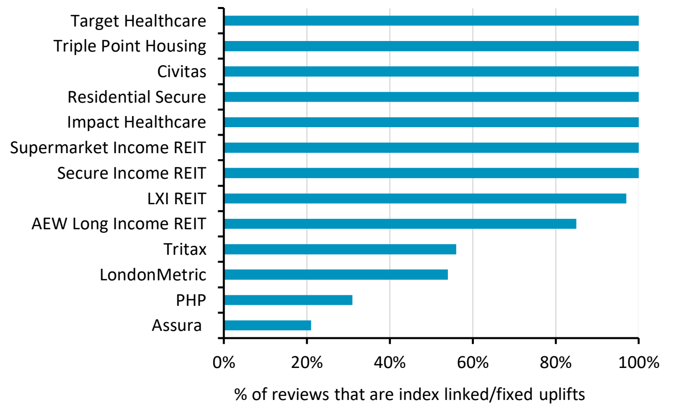


Figure 10: Reviews dominated by index linked/fixed uplifts



Source *Company data*

An increasingly rare commodity in today's property world…

One of the historic attractions of the UK property sector has been its long-term leases. However, these have transitioned from 25 years to settle at c.7 years (on an unweighted basis - Figure 11).

Figure 11: New lease lengths settled at c.7 years

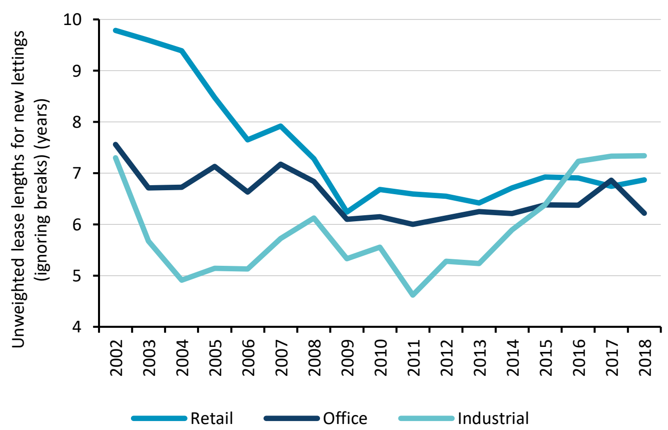
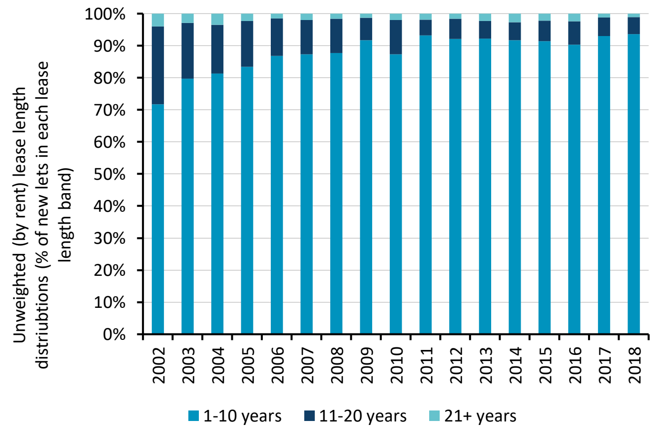


Figure 12: Only 6% of new leases are for >11 years in length



Source *MSCI*

Whilst this is up from c.6 years at the low point in the market in 2009, we believe it is unlikely that leases are likely to trend back upwards significantly, although in the distribution/logistics sub-sector, as a result of rising demand for space and high fit-out costs, there is trend for longer leases (Figure 11).. As Figure 12 shows, only 6% of new leases granted in 2018 were for over 11 years and just 1% over 21 years.

…especially given new IFRS accounting standards

IFRS 16, which replaces current guidance in IAS 17 on lease accounting, came into force earlier this year and will have implications for all companies by forcing them to include all (excluding less than 12 months) lease commitments on-balance sheet. The effect will be to focus investors and management teams on the liabilities side of the balance sheet and in terms of lease lengths, we expect a continuation of the trend to shorter leases. Sale and leasebacks may still be structured but from a business perspective, as opposed to the historic reason of moving assets off balance sheet.

LONGER LEASES – MORE RESILIENT JUSTIFYING LOWER YIELDS

Although much will depend on the tenant covenant strength (a long lease is only as valuable as the quality of the tenant who has signed it) and the rental growth prospects, all other things being equal, there should clearly be a differential in valuation yields between longer and shorter leased properties. However, there is limited market data on this point. CBRE produce a long-income index (two years of information, Figure 13). The latest update suggesting that in 2018 long-income property showed a total return of 9.2%, easily exceeding the 7.5% return for mainstream commercial property (MSCI).

Figure 13: Long income performance ahead of wider commercial property returns for two years running

	Total return	Income return	Capital growth	ERV growth	NIY
CBRE Long Income index 2017	*13.5%*	*4.9%*	*8.3%*	*1.4%*	*4.4%*
MSCI All Property Monthly Index 2017	*11.2%*	*5.8%*	*5.4%*	*1.9%*	*5.1%*
CBRE Long Income index 2018	*9.2%*	*4.7%*	*4.4%*	*0.7%*	*4.3%*
MSCI All Property Monthly Index 2018	*7.5%*	*5.3%*	*2.1%*	*0.7%*	*4.9%*

***Source** CBRE, MSCI*

Knight Frank produce a useful historic yield series (Figure 14) which shows how valuation yields for some long income sub-sectors, such as foodstores, prime distribution, budget hotels and healthcare, have edged down from c.4.5% in 2015-2017 to closer to 4% now, similar to CBRE's All Long Income NIY of 4.25%.

Figure 14: Yields for long income asset in demand…

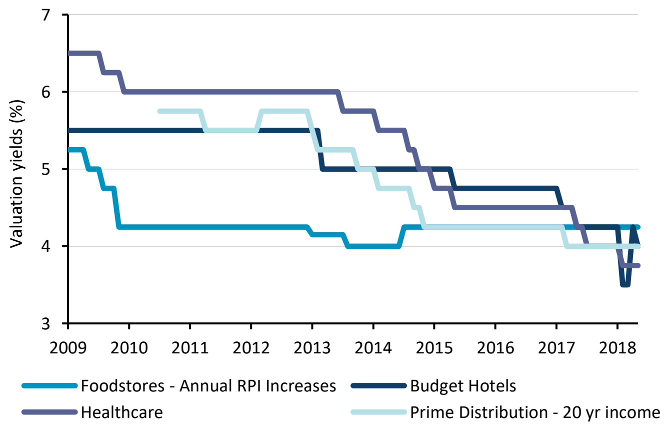
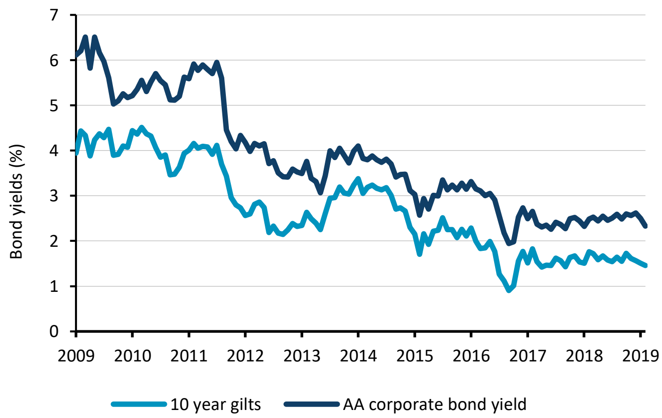


Figure 15: …driven in part by low interest rate environment



***Source** Knight Frank, Datastream*

Clearly the key driver behind this decline in yields is the fall in comparable bond yields to c.2% as illustrated in Figure 15, hence the attractiveness of long-income property yielding 4%+ with growth prospects in a low interest rate environment.

WHAT IS THERE NOT TO LIKE?

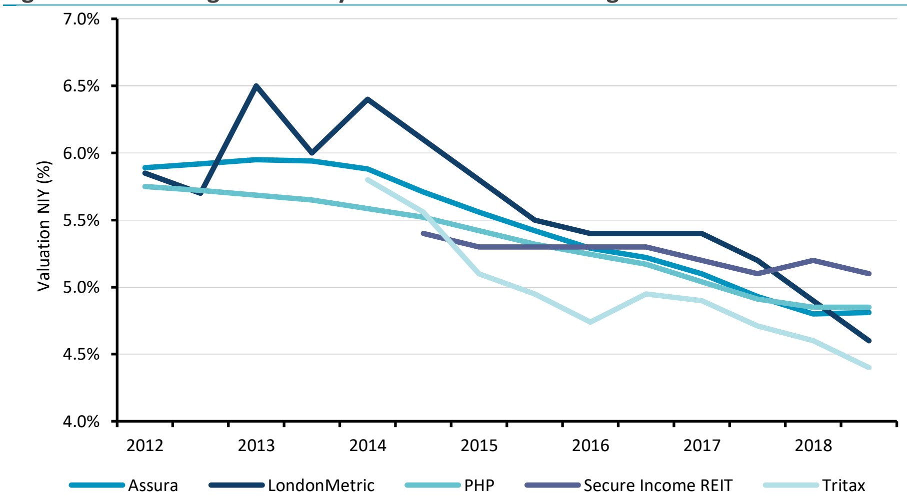
The security of long-term income streams growing at/around inflation is attractive in today's low growth, uncertain economic environment and we understand why investors have invested heavily in this sub-sector. However, there are some risks which tend to be glossed over and which we think investors should be wary of, especially in relation to those companies that are focused on acquisitions to deliver above average returns. In particular, the drivers which make the numbers stack up (market yields on purchase, cost of finance and ability to raise capital), are all outside of the property companies' control.

THE RISKS OF FINANCIAL ENGINEERING

The arbitrage between property yields and financing rates is one of the key attractions of property as an asset class from a debt-backed buyer's perspective and it is the maths behind this that generates the attractive returns. The returns will be dependent upon the company's ability to:

- ***Keep buying*** – not necessarily an issue given many of the alternative real estate markets are fragmented, immature markets with plenty of stock. However, the concern is what price will need to be paid given increased competition and the impact a lower input yield has on returns. We show in Figure 16 how the valuation yields of the companies under our coverage have reduced by around 100bps over the past three years. This is not to say the companies have been buying at these yields (generally the companies we discuss in this note still appear to be buying broadly in line with IPO expectations), but it shows the trend in the market. The temptation is for the companies to increase exposure to risk in order to secure the ever-elusive yield. The best example of this is Tritax. When it came to the market it was purchasing properties off yields of >6% with an investment strategy restricted to long-income assets. Not only have purchase yields reduced but the company is buying shorter income and has now moved into higher risk developments. Helpfully, in the meantime the company's debt costs have come down to 2.4% from 3.8%.

Figure 16: Reducing valuation yields as demand for long income assets increase



Source *Company data*

- ***Keep raising equity*** – as long as the stockmarket values the income streams more highly than the direct property market and the shares trade at a premium to NAV, the companies should be able to raise equity. The issue is when the equity market becomes more cautious about the outlook, or, as has happened recently, becomes replete with long- income stocks.

- ***Keep securing low cost of debt*** - again this is outside the company's control but with interest rates at such low levels it feels, as if the only way is up, even if not by very much and not for a while.

We show in Figure 17 a simplified example where a company raises £60m of equity a year, gears up to 40% LTV and acquires property at gradually decreasing yields, but with no change to the cost of debt. To make the example more realistic, we have allowed for 3% pa rental growth and a reduction in EPRA cost ratio as the portfolio benefits from economies of scale. Not surprisingly given the reduction in purchase yield, this shows the company reporting a gradual reduction in the return on equity (or dividend) which will clearly be exacerbated if the cost of debt increases as shown in Figure 18 (although arguably this is unlikely if property yields are coming down).

Figure 17: Example of the long-income real estate financials

	Year 1	Year 2	Year 3
Assumptions			
LTV of purchases (%)	*40%*	*40%*	*40%*
Cost of debt on purchases (%)	*4.0%*	*4.0%*	*4.0%*
Overall EPRA cost ratio (%)	*20%*	*18%*	*15%*
Yield on purchase (%)	*6.0%*	*5.0%*	*4.0%*
Property acquired (£m)	100	100	100
Annual rental growth (%)	*3%*	*3%*	*3%*

£m	Year 1	Year 2	Year 3
Rent	6.0	11.2	15.5
Costs	-1.2	-2.0	-2.3
Interest	-1.6	-3.2	-4.8
Profit distributed as dividend	3.2	6.0	8.4
Return on equity/Dividend (100% payout)	***5.3%***	***5.0%***	***4.7%***
Overall LTV	*40%*	*40%*	*40%*
Yearly increase in dividend (%)		**86%**	**41%**

Source *Panmure Gordon*

The problem is that many of the new long-income IPOs have committed to distributing a certain level of dividend return to shareholders and are paying out 100% of their profits. So how can a company move the 4.7% return back up to 5.3%?

- Increase the level of gearing (in this example a rise to 60% overall would result in the return rising back to 5.3%).
- Stop acquiring properties (or acquire less so the impact is diluted) and just benefit from the yearly rental growth of 3%, which increases the dividend by 4-5% pa. There is nothing wrong with this and some companies such as Secure Income REIT have remained strict in their acquisition criteria, happy for there to be quiet periods if the market is too competitive. Obviously from the management's point of view (especially external managers driven by growing gross assets) the temptation is to grow.
- Cut the dividend which is what happened to MedicX after years of continuing to distribute a growing dividend (resulting in declining cover) despite the purchase yields coming down.

Figure 18: Sensitising the ROE (dividend yield) in years 1 and 3 depending on purchase yields and cost of debt

		Purchase yield year 1			
		3%	**4%**	**5%**	**6%**
	6%	*0.0%*	*1.3%*	*2.7%*	*4.0%*
Cost of debt	*5%*	*0.7%*	*2.0%*	*3.3%*	*4.7%*
Year 1	*4%*	*1.3%*	*2.7%*	*4.0%*	*5.3%*
	3%	*2.0%*	*3.3%*	*4.7%*	*6.0%*

		Purchase yield year 3			
		3%	**4%**	**5%**	**6%**
	6%	*3.7%*	*4.2%*	*4.7%*	*5.2%*
Cost of debt	*5%*	*4.0%*	*4.4%*	*4.9%*	*5.4%*
Year 3	*4%*	*4.2%*	*4.7%*	*5.1%*	*5.6%*
	3%	*4.4%*	*4.9%*	*5.4%*	*5.8%*

Source *Panmure Gordon*

Therefore, whilst not wishing to distract from the attractions of the financial engineering which is generating returns for shareholders, we think it is worth investors being aware of the drivers that are outside the property companies' control.

TENANT CONCENTRATION OR DIVERSIFICATION?

We show in Figure 19 the range in terms of number of covenants of the long-income stocks from one tenant (effectively government for the primary health care operators) to c.120 for LondonMetric. In general, the number of tenants is relatively limited compared with the operating companies which have 1000s of customers. Whilst a fewer number of tenants means a lower management cost, there is a concentration of risk and so management teams need to undertake extensive due diligence on the covenant strengths and wider market/policy impacts on the tenants.

Figure 19: A range of tenants and covenant strengths

	No of covenants	Key tenants
Assura	1	GPs (government backed)
PHP	1	GPs (government backed)
Supermarket Income REIT	3	Morrisons, Tesco, Sainsbury's
Impact Healthcare	4	Minster (Minster Care and CroftwoodCare), Prestige Care Group, Welford Healthcare Limited and Careport Advisory Services
Secure Income REIT	12	Ramsay Health Care, Merlin Entertainments & Travel Lodge account for c.90%
Triple Point	12	Inclusion Housing (24.7%), My Space Housing Solutions (19.4%) and Falcon Housing Association (16.0%).
Civitas	15	Leased to 15 Housing Associations, involving 140 Local Authorities and 93 care providers.
AEW Long Income REIT	21	Meridian Metal Trading, Prime Life, Mears Group, Juniper Hotels, Motorpoint, Premier Inn Hotels, Volkswagen Group, Travelodge, Hoddesdon Energy, Biffa Waste Services. (These top 10 tenants account for 83% of passing rental income).
Target Healthcare	21	Ideal Carehomes (15%), Care Concern Group (10%), Orchard Care Homes (9%), Aura Care Living (8%)
LXI REIT	29	Travelodge, Student Life, Prime Life, Stobart Energy, QPark, Q Hotels, Priory, Premier Inn, GE UK Group, Aldi, Lidl, B&M
Tritax	39	Amazon (13.7%), Morrisons (6.9%), Howdens (5.4%), M&S (4.2%) and Tesco (4.2%)
LondonMetric	120	Primark, Dixons Carphone, M&S, Argos & Eddie Stobart
Residential Secure	not provided	Larger, well established Housing Associations, Local Authorities, leading private operators or shared equity tenants

***Source** Company Data, Panmure Gordon*

For example, the GP surgeries are government-backed but they are also exposed to changing government policies. Likewise, the social housing REITs may appear to have undoubted covenants in the form of housing associations, but as we have seen recently, these are not watertight. Therefore, the majority of companies are seeking diversification of tenants as part of their growth strategies.

The property assets are more important than you might think

With high occupancy levels (Figure 20) and long leases, there is an argument that the underlying property underpinning these long-term income streams is largely irrelevant. As an investor you are buying exposure to a corporate for a period of time (i.e a quasi-corporate bond) and the residual value of the property is low. Whilst that is theoretically correct, we would highlight the following key points:

- As leases get shorter (and particularly fall below 10 years) valuers tend to take a more cautious approach, putting a higher yield (lower value) on the income streams.
- The approach above assumes that the tenant is strong. If the tenant covenants are questionable (for example in the case of the secondary healthcare tenants and also, in our view, the housing association tenants) then it is important that the properties meet current tenant requirements (for example, including ensuite wet rooms in care homes) to enable them to be re-let swiftly in event of tenant default.
- The assets need to be important/irreplaceable from the tenant's operational perspective. If they are (for example Secure Income REIT's hospitals and theme parks or Assura/PHP's GP surgeries), then the tenants are far more likely to wish to renew the leases earlier to ensure continuity of their businesses. This will benefit both the tenant and landlord.

Growth needed to enable cost efficiencies

Given the high occupancy levels averaging 99% (Figure 20), the low number of tenants discussed previously and the large percentage of reviews with fixed/RPI uplifts, one would expect the management costs to be relatively low and as we show in Figure 21 the EPRA cost ratios of the majority of companies are below the wider sector average. The range is from c.10-15% for the established/internally managed companies compared with 30-40% for the newer companies that are dependent on expansion to bring the cost of management down to an acceptable level. PHP highlights the benefits of scale in its rationale for the merger with MedicX, the expectation being that the EPRA cost ratio will fall to a very low c.11%.

Figure 20: Almost full occupancy for all companies

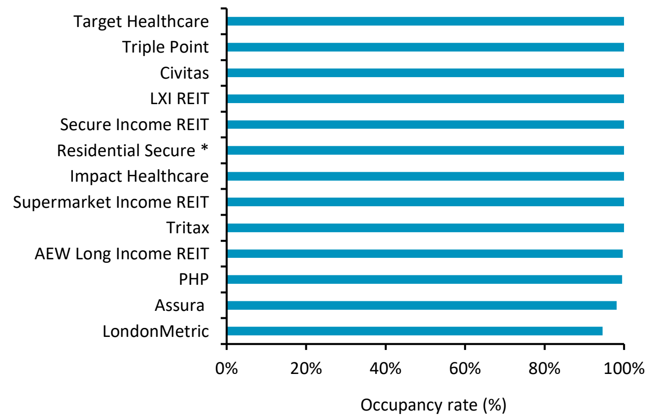
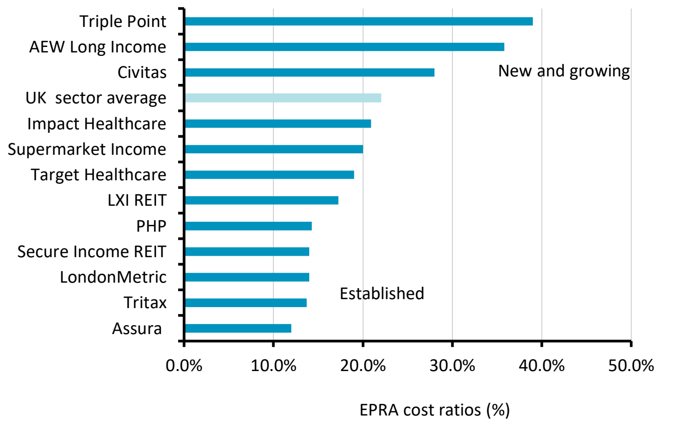


Figure 21: EPRA cost ratios reducing as companies growing*



**Residential Secure provides very limited information*
***Source** Company data, Panmure Gordon*

All of the companies considered, other than LondonMetric and Assura (interestingly both with very low EPRA cost ratios) are externally managed. Most newer agreements are fairly standard (1% of net assets ratcheting down) with just a few having performance incentives (PHP, Target Healthcare and Secure Income REIT). We show in Figure 22, as an example, the improvement of the EPRA cost ratio as a company (using the external management agreement of one of the social housing REITs) makes acquisitions.

Figure 22: The cost benefits of the external management agreements

	Up to £250m (1% of net assets)	Up to £500m (0.9% of net assets)	Up to £1bn (0.8% of net assets)	Over £1bn (0.7% of net assets)
EPRA cost ratio (%)*	*13.0%*	*12.4%*	*11.2%*	*10.4%*

**allowing for an element of fixed company costs*
***Source** Panmure Gordon*

USING LEVERAGE WISELY

Not surprisingly long-term income streams can justify higher balance sheet gearing levels than short-term operationally geared companies. This works in rising real estate markets, but when values are falling across the board, as happened in 2008/2009, irrespective of the lease length gearing can very quickly rise to unacceptable levels.

Figure 23: The importance of maintaining LTV headroom

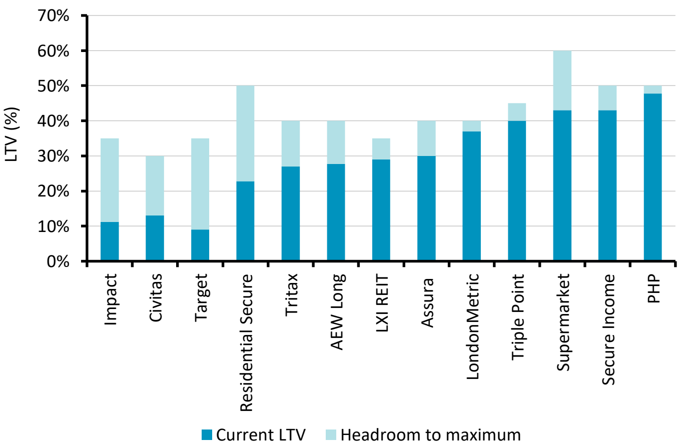
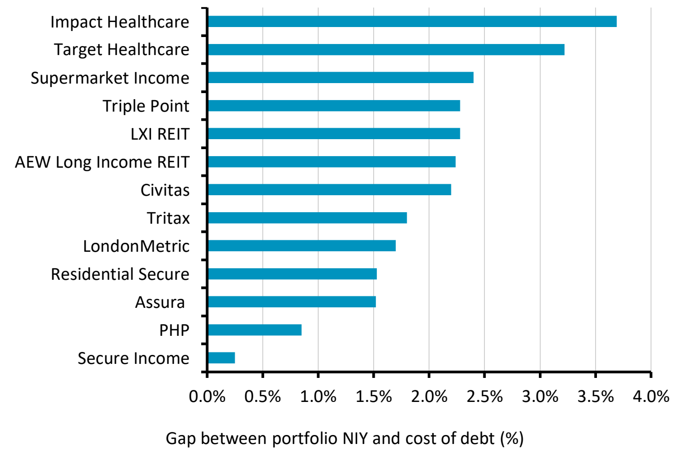


Figure 24: Benefiting from a low interest rate environment



***Source** Company data, Panmure Gordon*

For example, the cornerstone assets of Secure Income REIT were previously held in a highly levered private vehicle by Prestbury. In the downturn the LTV rocketed towards 100% and the company has been focused on bringing it back down ever since (currently 43%). Likewise, Assura suffered with its LTV rising to 77% in 2009.

Therefore, whilst we show in Figure 23 there is plenty of headroom to the maximum LTVs allowing for further acquisitions, assuming that values will keep rising is dangerous (especially given that valuations will start to reduce as the leases shorten). Ideally the management teams need to be disciplined maintaining some headroom irrespective of the market conditions.

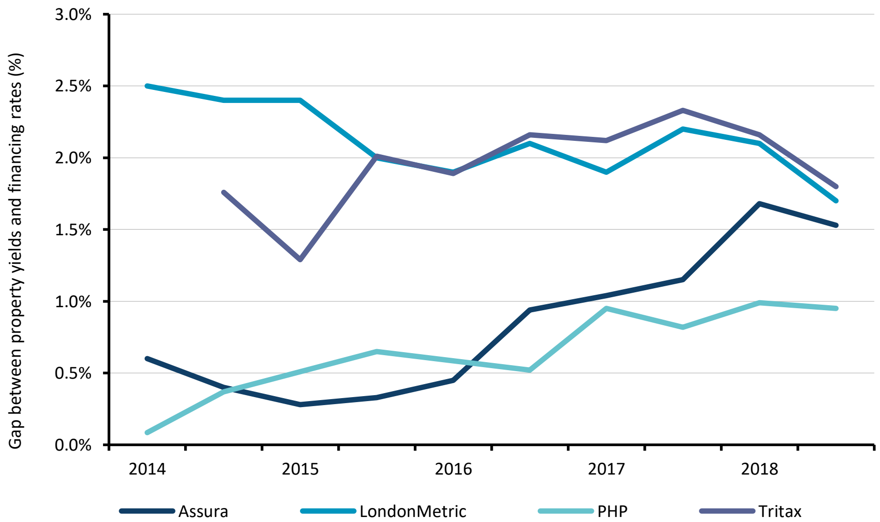
NEED A LOW COST OF DEBT TO DRIVE RETURNS ON EQUITY

Although the properties may be relatively similar in terms of lease length and rent review structure, the all-in cost of debt averages 3.25%, with a range from 2.5% for Supermarket Income REIT, up to 4% for PHP and 4.8% for Secure Income REIT. This reflects two things; firstly, the timing of securing the debt (for example, PHP has some historically expensive debt) and secondly the LTV and flexibility required (for example, Secure Income REIT).

From a financial engineering perspective, the key is the difference between the income yield on the property and the financing rate. In this respect we show in Figure 24 the relatively high gap of the secondary healthcare companies which are still benefiting (rightly in our view given the relatively weak tenant covenant strengths) from higher valuation yields. The gap is relatively low for Assura and PHP (although PHP's cost of debt should come down over the next few years) reducing the return on equity and meaning that a low cost of management is ever important. It is also another reason why both companies are seeking exposure to higher yielding assets (development – Assura and Ireland – PHP). That said, it has increased over the past five years as outlined in Figure 25. This has been driven by the impressive reduction in the cost of debt for Assura and PHP of c.200bps over the last seven years, versus the reduction in valuation yields of 100bps. As a result, whilst the gap is lower than for some of the other long-income companies, it has widened.

LondonMetric's gap has reduced, but this only looks at the standing investment portfolio and does not reflect the difference in yield on cost of its developments versus its cost of debt. Tritax's gap has also reduced more recently, which will be one of the reasons why it has widened its investment policy to allow for developments (and has recently acquired db symmetry, a strategic land owner).

Figure 25: Reducing valuation yields as demand for long income assets increases



***Source** Company data*

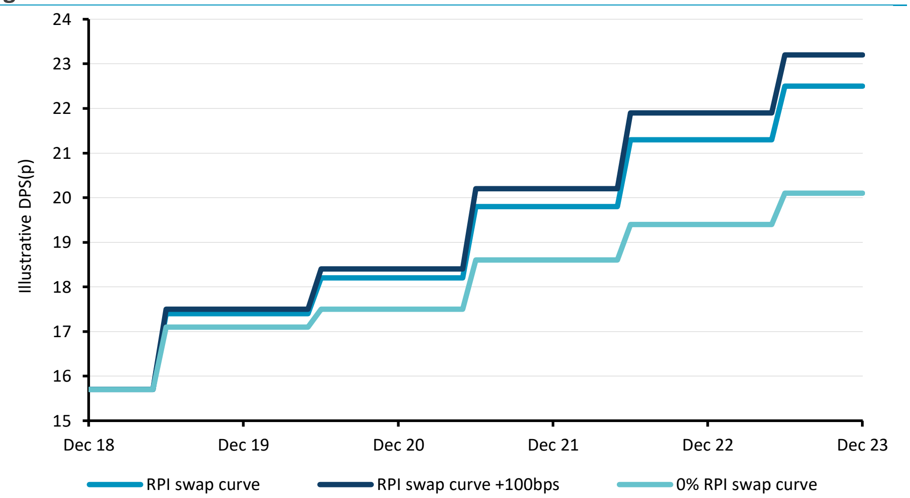
Secure Income REIT is the one where financing rates and property yields are almost identical and where we expect debt refinancing to occur, as the LTV continues on its downwards trajectory.

INCOME GROWTH DRIVERS

We highlight earlier in this note that the driver of revenue growth will continue to be acquisitions for the majority of companies discussed, supplemented by fixed/RPI uplifts. However, LondonMetric and Tritax (following its recent acquisition) as well as to a lesser extent, Assura, have an additional source of growth via their developments. This is a way of improving the quality and longevity of income in their portfolios.

Having considered the drivers and issues behind the long-income business model, we focus on the income growth prospects for the companies that we are covering. As Figure 10 shows, for the majority of the companies, the driver of income growth will be solely fixed/RPI uplifts, which in themselves can drive steady attractive income returns, as is always illustrated very clearly by Secure Income REIT (Figure 26 – shows its dividend projection just based upon the fixed/RPI uplifts with no further acquisitions). The biggest issue is whether market rental growth keeps up with inflation and whether by the end of the lease the properties are over-rented or not.

Figure 26: Secure Income REIT illustrative dividend distribution outlook



Source *Company data*

Tritax and LondonMetric both have c.50% RPI/fixed uplifts. Given the strength of the underlying industrial occupational property market the open market reviews are likely to provide above inflation uplifts which will drive net rental income growth. In addition, LondonMetric's growth is supplemented by earnings accretive development projects and post Tritax's recent development acquisition we expect this to be a source of growth as well (Figure 28). As we highlight in the individual notes, we expect open market reviews to continue showing only low growth for Assura and PHP, the key driver being acquisitions as well as direct development for Assura (Figure 27).

Figure 27: Driver expected to be acquisitions

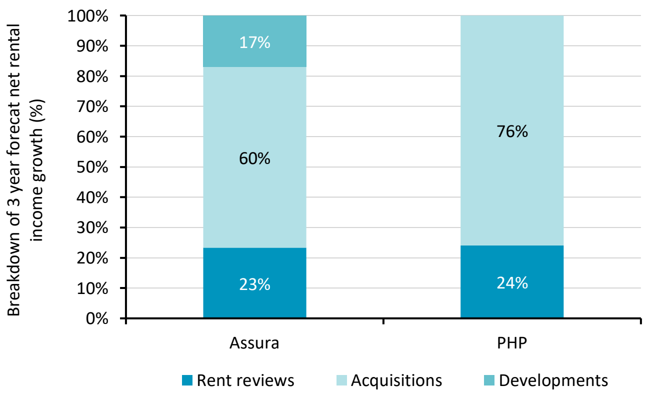
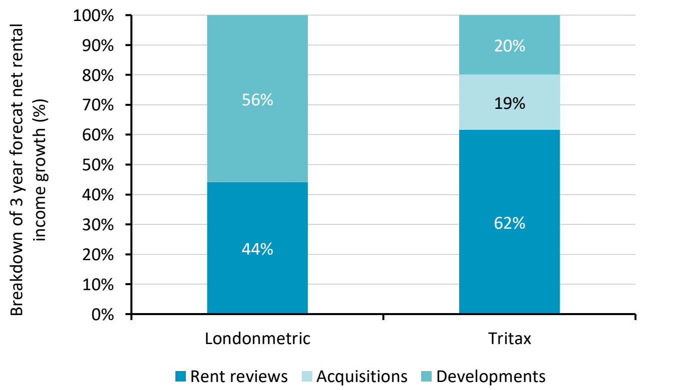


Figure 28: A combination of drivers



Source *Company data, Panmure Gordon*

VALUING THE INCOME STREAMS

We show in Figure 29 the current dividend yields vs NAV ratings for the whole long-income universe (based upon reported figures). The range is from +17% premium to -12% discount, with dividends of between 4% and 6%, most companies distributing full dividend payouts. We would suggest that the NAVs are broadly irrelevant; the market is valuing the security and longevity of the income streams and deciding the appropriate yield required. In this regard investors appear to prefer the more diversified portfolios of Secure Income REIT or LXI REIT (suggesting that AEW Long Lease is too cheap but maybe reflecting low liquidity) and are happy with a lower yield from PHP and Assura given the security of the underlying income stream, despite lower growth prospects. LondonMetric's exposure to a favoured sub-sector (and higher NAV growth – Figure 31) also appears to be valued by investors. In contrast, Tritax's shares are cheaper (Figure 30 and 32), maybe reflecting concern over the company's move up the risk curve with its recent strategic land acquisition and reflecting the more concentrated big box portfolio? We think Tritax's rating will improve as the upside potential from the db symmetry acquisition becomes more visible.

Figure 29: Dividend yields can be justified

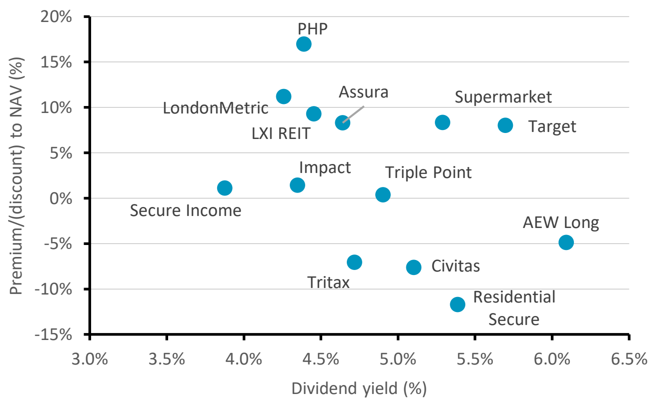
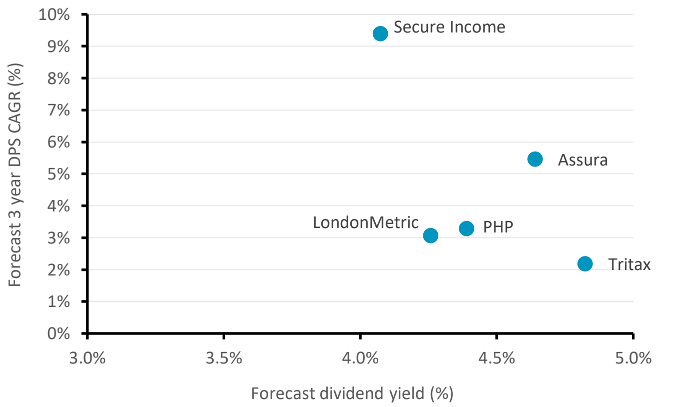


Figure 30: Tritax looks relatively good value



Source *Thomson Reuters, Company Data, Panmure Gordon, Datastream*

Turning to the other companies that we are picking up coverage of, we show in Figure 30 the forecast dividend yield versus 3-year DPS CAGR and in Figure 32 the PE ratings versus 3-year EPS CAGR. This highlights that other than Secure Income REIT (driven by the prior year acquisition feeding into FY2019E forecasts, thereafter 5% pa growth), the companies all have fairly similar dividend growth prospects, averaging c.3%. The outlook for PHP and Assura is similar, with Assura being marginally cheaper both from a PE and a dividend yield perspective.

Figure 31: Dividends a significant contributor to total returns

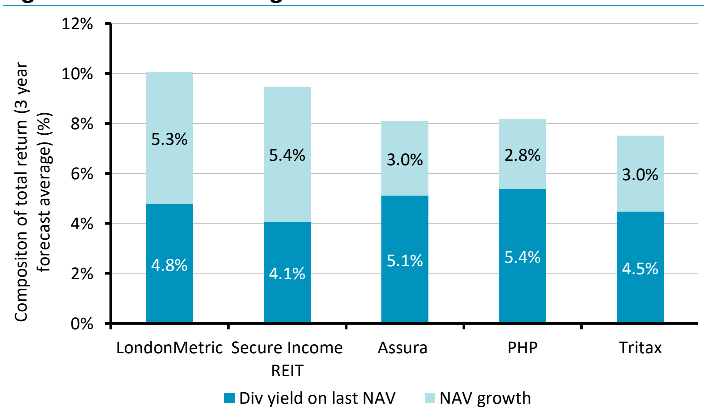
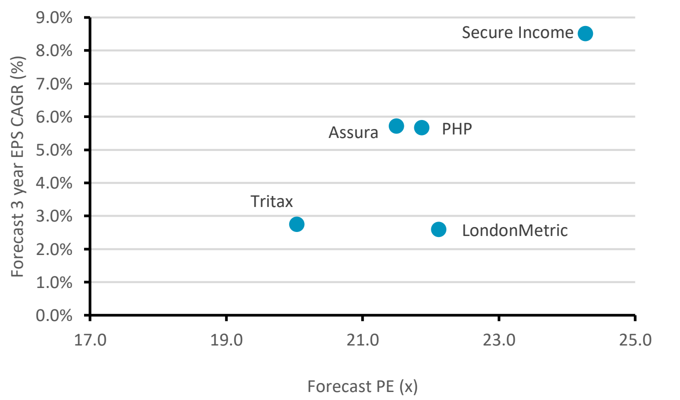


Figure 32: Secure Income REIT is an outlier this year



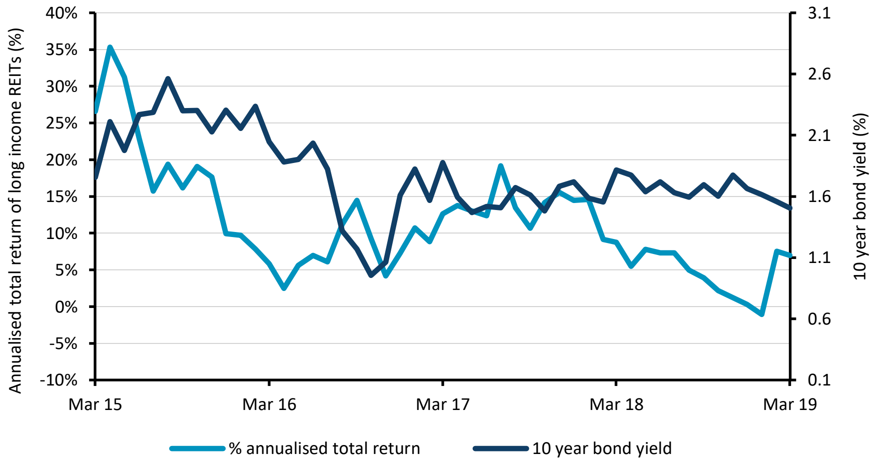
Source *Company Data, Panmure Gordon, Datastream*

Sector & Company Risks

Having considered the quality, longevity and growth of the long-income REITs, it is worth highlighting that each sub-sector has its own specific risks (Figure 34). Many of these risks relate to wider macro-economic issues or government policies, over which the companies have no control. One key economic risk to all of the stocks is a rise in interest rates, which means that investors could demand a higher income return from the companies. It could also potentially mean a higher interest cost (depending on hedging) and lower earnings.

At certain times in history there has been a relationship between the UK quoted real estate sector and 5-year swap rates or 10-year benchmark bond yields. However, it tends to be fairly inconsistent and as we show in Figure 33, during 2018 whilst bond yields have been relatively steady, the annualised total return has weakened, although it has rebound as bond yields have fallen year to date.

Figure 33: Little relationship between long-income REITs total return performance and bond yields



Source *Datastream*

Company specific risks generally relate to company structures, asset location and quality or management strengths and weaknesses.

Figure 34: Sub-sector Risks

Sector	Company	Sector/company risks
Diversified	Secure Income REIT	Risks to income will comprise a combination of the risks outlined for the individual sub-sectors
		Relative concentration of tenant risk means importance of monitoring individual tenants
		Ensuring no over reliance on weaker sub-sectors
Primary Healthcare	PHP	Change to government NHS policies
	Assura	Need an increase in development of new surgeries to provide evidence of cost inflation to trigger rental growth
		Any change to the reimbursement mechanism could change the risk profile of the GPs as a tenant
Industrial/ workspace	LondonMetric	General industrial rental growth tends to be linked to wider economic growth
	Tritax	The rapidly changing logistics market means management teams need to be hands on and react to changing trends
		Distribution properties have concentrated tenant risk

Source *Panmure Gordon*

COMPANY NOTES

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BUY

Target Price: 61p

Share Price: 57p

(Price at close 11 March 2019)

Stock Codes	AGRP.L / AGR LN
Market Cap	£1369m
Sector	Real Estate
Last Published Research:	n/a

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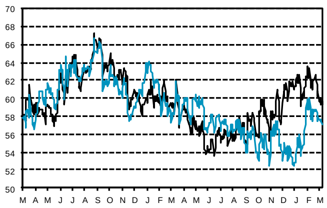
Absolute & Relative Performance



— *Absolute*

— *Relative to DS Real Estate*

***Source** Datastream*

Investment Research

INITIATING

Assura

The low risk option

The need for better quality primary healthcare in the UK is well-documented and Assura provides investors with exposure to this sector in a low-risk wrapper (limited leverage and internal management). The company has firepower for further acquisitions which together with development capex, is driving earnings growth, rather than underlying market uplifts. The shares have rallied since their recent low, but have underperformed PHP over the past 12 months by 7%. At 57p the shares are trading on an undemanding 6% premium to NAV (vs PHP on a 17% premium) and provide investors with an attractive prospective dividend yield of 4.6% We therefore initiate with a Buy rating and a target price of 61p.

- **A business model meeting growing healthcare demand in the UK:** There is cross-party political consensus on the need for increased investment in primary healthcare and Assura is well placed to help provide that, especially given the recent increase in its development capability. At present there are c.9000 medical centres of which Assura own c.6%. The market is fragmented with c.45% of centres being owned by individual GPs and 9% owned by NHS, but more importantly c.30% of the centres are not fit-for-purpose. This is the opportunity. Assura undertakes direct developments in addition to forward fundings (unlike PHP), but only on a 100% prelet basis with fixed-price contracts, the result being an upgrading of its portfolio quality together with an attractive yield on cost.

- **Differentiating itself from the competition:** Post PHP's merger with MedicX, Assura will no longer be the largest and most liquid primary healthcare REIT. Given the assets are broadly similar (other than PHP/MedicX's foray into Ireland), the key differences relate to the capital structures and management. Firstly, Assura is internally versus PHP externally managed. Whilst PHP has highlighted that its EPRA cost ratio will be 11% post-merger, compared with Assura at 12%, there is little to choose between them and we prefer the internal management structure (less driven by expansion and more by shareholder value). Secondly, Assura's leverage is currently 30% rising towards 40% on full investment, compared with PHP at a relatively high 47%. As a result, we see Assura as the least risky option for investors.

- **Acquisitions to remain the key driver to earnings growth (for now):** Whilst we expect Assura's acquisition programme to drive growth (our 3-year EPS CAGR is 6%) near term, we expect its development pipeline to have a growing impact on the top-line. For example, we forecast the on-site and immediate developments to generate c.£3m pa of rent over the next three years. The area that we remain cautious about is the prospect for underlying market growth. There has been plenty of discussion about the emergence of growth but there has been little evidence to date.

- **Reducing WAULTs – an opportunity:** Assura's average WAULT of 12.2 years is, not surprisingly, reducing year on year (it was 15 years five years ago). Whilst 12.2 years is still long in the context of the wider real estate sector, we would highlight that c.25% of leases expire between 0-8 years providing Assura with an opportunity for lease renewal and valuation uplifts.

Year End	NAV	Premium/(discount) to NAV	NAV Growth	DPS ord	Yield	EPS	P/E
Mar	p	%	%	p	%	p	x
2018A	52.4	8.9	6.4	2.5	4.3	2.5	22.4
2019E	53.9	6.0	2.8	2.7	4.6	2.7	21.5
2020E	55.7	2.6	3.3	2.8	4.8	2.9	19.9
2021E	57.2	(0.2)	2.8	2.9	5.0	3.0	19.0

Source Company Data, Panmure Gordon

INVESTMENT CASE

COMPANY PROFILE

Assura is one of the UK's leading primary care real estate investors and developers. It was formed and floated in November 2003 as a Primary Care Real Estate Investment Fund. However, over-expansion and valuation declines led to lower profitability and growing shareholder discontent. The company started to streamline the business, but the real transformation occurred when Graham Roberts was appointed Chief Executive in March 2012. He focused the company on becoming more shareholder friendly, with a simple business model looking to leverage its expertise in the sector (for example, it has a unique database which details every GP surgery in the UK) and generate superior risk adjusted returns. As part of the strategy, Assura has raised c.£870m of equity since FY2015, in part used to stabilise the balance sheet, but mostly spent on doubling the portfolio from £925m in FY2015 to £1.8bn today.

Figure 1: The portfolio by location, lot size and tenant

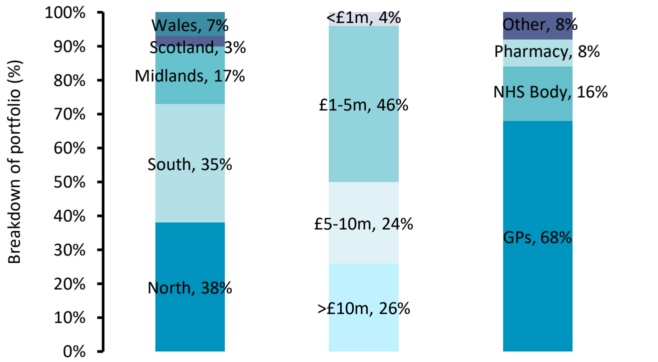
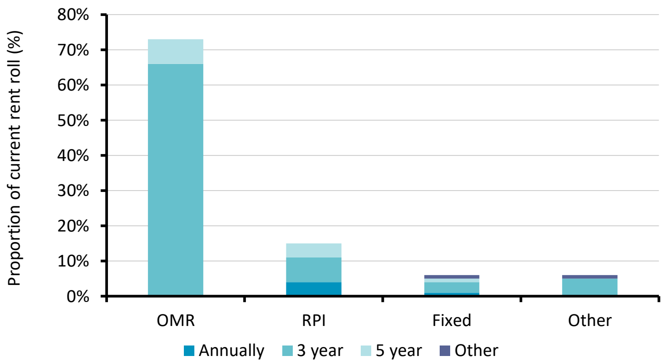


Figure 2: Majority of rent reviews are 3 yearly open market



Source *Company Data*

PORTFOLIO CHARACTERISTICS – INCOME SECURITY BUT LIMITED GROWTH

The £1.8bn portfolio comprises 556 GP surgeries located across the UK. 84% of the income is funded (directly or indirectly) by government bodies and the portfolio is currently 98% occupied with a WAULT of 12.2 years. As Figure 1 shows, the lot sizes of the properties are generally fairly small, averaging £3.3m and given portfolios are relatively rare, it has taken market knowledge and time to secure the assets.

Figure 3: Avg OMR growth is 0.9% but the trend is improving

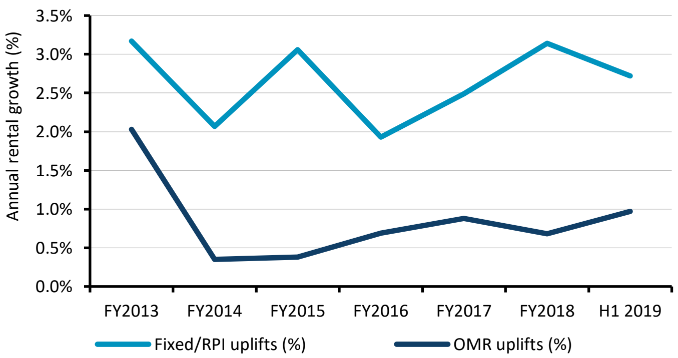
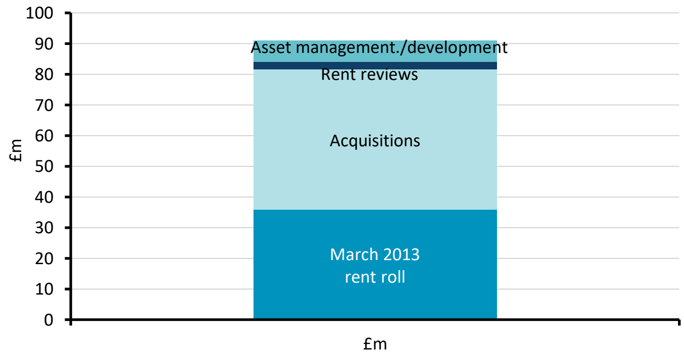


Figure 4: Growth has been driven by acquisitions



Source *Company Data, Panmure Gordon*

A key area of focus is the rent review mechanism. Figure 2 shows that 73% of the rent roll is based upon open market rent reviews (75% upwards only). However there has been limited rental growth as outlined in Figure 3 (average 1.5% pa overall). New developments capture increased rents, but given the lack of government investment, there has been a paucity of evidence for use at rent reviews. As a result, although there has been plenty of discussion about a turning point, there is limited numerical evidence to date. This is clear in Figure 4 which shows the growth in Assura's rent roll since 2013, the clear key driver being acquisitions and we expect this to remain the case near term.

Direct development is a differentiator

Assura has always had a direct development capability but in recent years it has grown the development team, because it sees it as an opportunity of securing quality new assets (thus upgrading its portfolio) at higher yields on cost than standard acquisitions (see Figure 6 which shows valuation yields have decreased by 100bps to 4.8% over 4/5 years).

Figure 5: A growing development pipeline

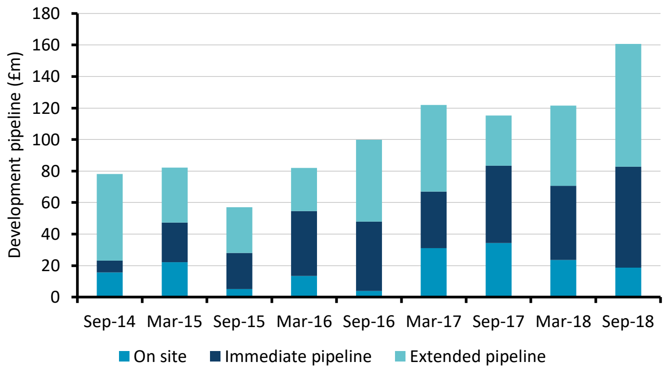
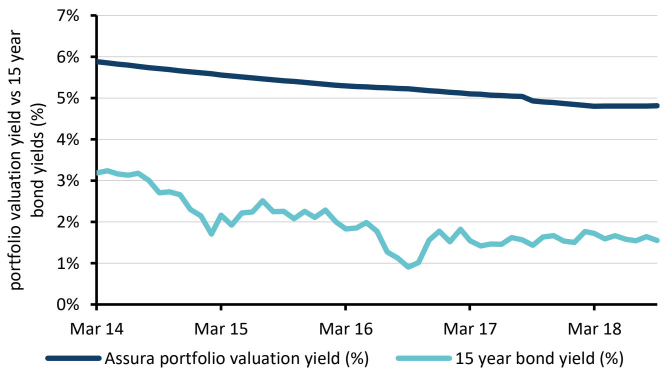


Figure 6: Valuation yields reduced as bond yields declined



Source *Datastream, Company Data:*

MANAGEMENT – A TRUSTED TEAM

Jonathan Murphy – Chief Executive Officer

Jayne Cottam – Chief Financial Officer

Jonathan was appointed CEO in 2017 having been Finance Director since 2013 and Jayne joined later that year as the new Finance Director. The team have continued the strategy that Graham Roberts put in place focusing on growing a portfolio of primary healthcare properties by acquisition and development.

SHARE PRICE PERFORMANCE, VALUATION & RATING

Assura's share price has performed relatively well over the past five years, although as Figure 7 shows it has started to underperform over the past year. We think this was in part a correction following 2016/2017 when the equity market consistently valued Assura's income streams too aggressively, the premium to NAV being 20-25% with a dividend yield of below 3.5%. We recognise the security and longevity of the income streams but do not believe the market fully understood the limited underlying rental growth prospects explained above. Following a year of over-issuance (£400m in 2017), this view reversed in 2018 and the shares moved back to trade at NAV with a dividend yield of >4%. This feels like an over-reaction and we think the shares look relatively good value trading on a 6% premium to NAV offering a 4.6% dividend yield. Our 61p target price assumes a 4.5% dividend yield a year out (and a 10% premium to NAV+1).

Figure 7: Strong 5 year, but weaker 12-month, performance

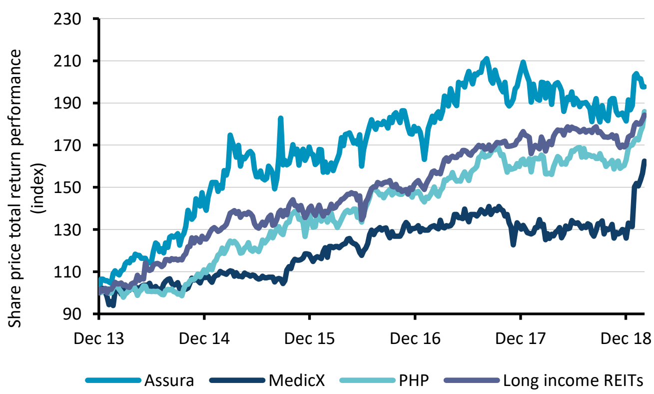
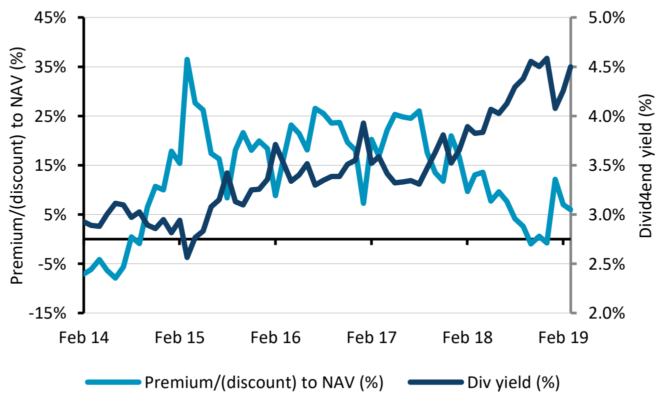


Figure 8: Shares providing investors with a 4%+ dividend yield



Source *Datastream, Company Data, Panmure Gordon:*

The Numbers

We assume only limited underlying rental growth of 1-2% pa going forward. Therefore the growth is coming from acquisitions, together with completion of developments (we estimate c.£3m from the current and immediate pipeline) and some active management. We expect dividend growth to slow to c.4% pa as the pace of acquisitions slows, although any improvement in underlying rental growth could offset this.

We think it unlikely that valuation yields (currently 4.8%) will fall much further given the flat to rising interest rate environment. Having said that, demand for the asset class remains strong, so we assume 3bps pa of yield compression over the next two years. The dominant driver of NAV growth will be underlying income growth along with some development surpluses.

We expect Assura to continue being a net investor over the next few years (resulting in the LTV edging towards its target of 40%), although there is the possibility that there might be some disposals as well.

Figure 9: Financial Statements – Year end March

Income statement (£m)

Year End March	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Net rental income	**57.6**	**67.2**	**79.4**	**94.1**	**104.2**	**111.4**
Other income	0.8	0.7	0.8	0.0	0.0	0.0
Administrative expenses	-8.0	-7.1	-8.2	-9.0	-9.5	-9.9
EBIT	50.4	60.8	72.0	85.1	94.8	101.4
Net interest	-24.5	-21.0	-22.7	-22.2	-27.1	-30.6
Recurring PBT	**26.4**	**40.2**	**50.0**	**63.4**	**68.6**	**71.8**
Revaluations	36.4	56.5	79.4	28.1	39.8	34.2
Profit on the sale of inv properties	0.1	-0.1	-0.3	0.0	0.0	0.0
Exceptionals	-34.1	-1.4	-57.3	0.0	0.0	0.0
PBT	28.8	95.2	71.8	91.5	108.4	106.0
Tax	-0.9	0.1	0.0	0.0	0.0	0.0
Profit/loss after taxation	27.9	95.3	71.8	91.5	108.4	106.0
Adjusted diluted EPS (p)	**2.0**	**2.4**	**2.5**	**2.7**	**2.9**	**3.0**
Earnings growth (%)	*-0.8%*	*21.0%*	*4.5%*	*4.3%*	*8.2%*	*4.7%*
DPS (p)	**2.1**	**2.3**	**2.5**	**2.7**	**2.8**	**2.9**
Dividend growth (%)	*11%*	*10%*	*9%*	*8%*	*4%*	*4%*
Dividend cover (x)	1.0x	1.1x	1.0x	1.0x	1.0x	1.0x
Interest cover (x)	2.1x	2.9x	3.2x	3.8x	3.5x	3.3x

Balance Sheet (£m)

Year End March	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Investment properties	1109.4	1344.9	1732.7	1985.1	2154.8	2264.0
Other fixed assets	0.6	0.9	0.9	0.8	0.8	0.8
Other net current assets	-21.8	-22.4	-17.1	-18.7	-18.7	-18.7
Net debt	-324.9	-496.6	-457.6	-669.3	-796.5	-868.0
Other liabilities	-9.4	-8.8	-8.5	-8.2	-8.2	-8.2
Fair value of derivatives	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5
Adjusted NAV	**754.5**	**817.5**	**1249.9**	**1289.2**	**1331.8**	**1369.4**
NAV per share (p)	**45.8**	**49.3**	**52.4**	**53.9**	**55.7**	**57.2**
NAV growth (%)	*3.9%*	*7.7%*	*6.4%*	*2.8%*	*3.3%*	*2.8%*
LTV (%)	*29%*	*37%*	*26%*	*34%*	*37%*	*38%*

Cash flow (£m)

Year End March	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Operating cash flow	**48.8**	**58.2**	**72.6**	**85.1**	**94.8**	**101.4**
Funds available for distribution FAD	22.9	39.0	49.9	62.9	67.6	70.8
Free cash flow (pre-investment)	**-3.4**	**7.1**	**13.2**	**5.5**	**2.8**	**3.5**
Property acquisitions	-122.5	-157.9	-282.3	-196.6	-100.0	-50.0
Development capex	-17.7	-19.9	-31.7	-26.8	-30.0	-25.0
Property disposals	1.3	1.1	0.9	0.1	0.0	0.0
Net cash from share issues	299.1	0.0	397.1	0.0	0.0	0.0
Other	-34.1	0.0	-58.2	0.0	0.0	0.0
Net cash flow	**122.7**	**-169.6**	**39.0**	**-217.8**	**-127.2**	**-71.5**

Source *Company Data, Panmure Gordon*

INITIATING

LondonMetric Property

In tune with the retailers

HOLD

Target Price: 200p

Share Price: 191p

(Price at close 11 March 2019)

Stock Codes	LMPL.L / LMP LN
Market Cap	£1337m
Sector	Real Estate
Last Published Research:	n/a

Analyst
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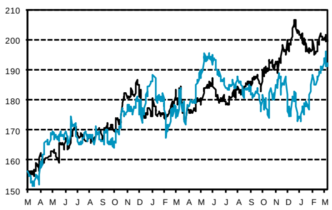
Absolute & Relative Performance



— *Absolute*

— *Relative to DS Real Estate*

Source *Datastream*

Investment Research

LondonMetric's key strength is its retailer relationships which gives it a unique insight into the ongoing structural changes occurring in the retailing/logistics industry and how retailers are adapting. As a result, we expect management to continue churning the portfolio, taking advantage of the weight of money seeking industrial exposure and reducing its retail portfolio. Dividend growth will be driven by the compounding effect of RPI/fixed uplifts together with market rental growth, although we are cognisant of an increasing supply of new logistics property in the UK which may dampen ERV growth in some locations. The shares are trading back at a premium to NAV again (9% in line with the five-year average) and offering a dividend yield of 4.3%. Whilst we expect LondonMetric to outperform its peers in a slower market, we struggle to justify a higher premium rating (given our expectation of a slowdown in NAV growth to 3-5% p.a. in FY2020E/FY2021E from 7-10% in FY2018/FY2019E) and so initiate with a Hold rating and 200p target price, which implies a 9% 12-month total return.

- **Not just an asset collector:** Whilst LondonMetric has similarities with other long-income focused companies (WAULT of 11 years, large proportion of fixed/RPI uplifts) there are distinct differences; the key being that management is constantly fine-tuning the portfolio and recycling assets taking into consideration market pricing and occupier trends, not just focused on growing the portfolio. Management is always conscious of the impact that disposals have on earnings, but the overriding decision has, in its view, got to be taken from a property perspective. The company is also happy to take on an element of risk with its development pipeline providing some much-needed yield on cost (c.6.5%), versus a current distribution valuation yield of just 4.3% and a competitive market for standing investments.

- **A range of distribution assets:** LondonMetric splits its distribution portfolio into three (urban logistics, mega and regional sheds), the most recent area of focus being on increasing its exposure to urban logistics, a sub-sector which a year or so ago it believed to look good value with rental growth potential. This stance has been validated over the past 12 months. The yield on this part of the portfolio reduced from 5.4% at H1 2018 to 4.7% by H1 2019. In addition, ERV growth has been more than double that of regional or mega distribution sheds over the past year. With a lower percentage of contractual uplifts, management is able to capture this growth at rent reviews (the urban logistic portfolio is 12% reversionary versus the mega sheds which are rack rented).

- **Income in a low growth environment:** LondonMetric's 'repetitive and reliable' income stream is a key attraction for investors. The average lease length is 11.1 years (to first break) and occupancy remains high at 94.4% (although down over H1 2019 due to the completion of several developments). In addition, there is certainty of compounding income growth with 54% of income having fixed or inflation linked rental uplifts. Contracted rent is currently £93.4m and we forecast it to grow by c.8% to c.£101m by FY2021E. The result is a 3-year EPS and DPS CAGR of c.3%. Low but secure.

Year End	NAV	Premium/(discount) to NAV	NAV Growth	DPS ord	Yield	EPS	P/E
Mar	p	%	%	p	%	p	x
2018A	165	15.8	10.3	7.9	4.1	8.5	22.4
2019E	177	8.2	7.1	8.2	4.3	8.7	22.1
2020E	186	2.8	5.3	8.4	4.4	8.9	21.5
2021E	193	(0.7)	3.5	8.7	4.5	9.2	20.7

Source Company Data, Panmure Gordon

INVESTMENT CASE

COMPANY PROFILE

LondonMetric was formed in early 2013 following the merger between London & Stamford and Metric Property. Almost immediately management refocused the strategy and the company disposed of its London office and residential assets. In 2015 the strategy evolved further, and management proposed to reduce its large retail warehouse exposure, concentrating instead on retailer-led distribution. The change was driven by management's close relationships with retailers and the property strategy continues to adapt today using management's market intelligence. LondonMetric's business model is to provide investors with long-term income streams but also, by actively managing the assets and undertaking short-cycle developments, report above average NAV growth. The company is one of the most active in the sector recycling assets, constantly fine-tuning the portfolio and taking advantage of current market pricing.

Figure 1: 72% of the portfolio comprises distribution

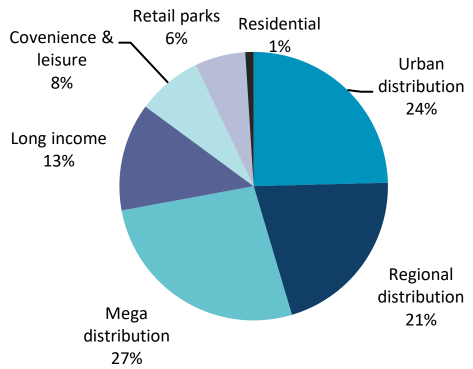
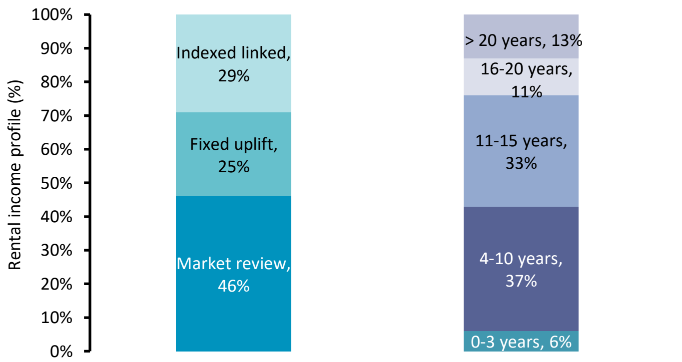


Figure 2: 54% of income fixed or index linked



Source *Company Data*

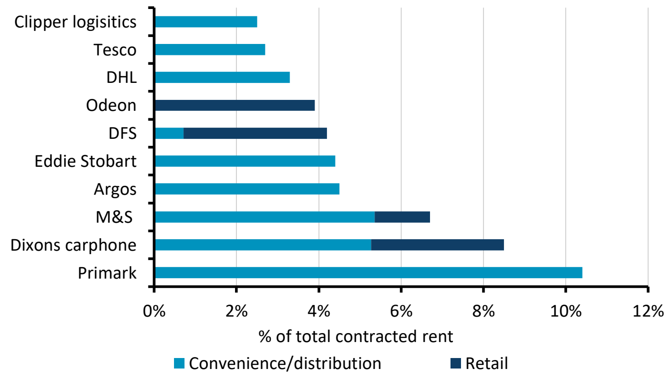
PORTFOLIO CHARACTERISTICS – DIVERSE DISTRIBUTION

The £1.9bn portfolio is split as outlined in Figure 1, with over 70% comprising distribution properties. The remaining retail exposure is focused on long-income, although the retail parks are likely to be sold. The distribution portfolio is relatively uniquely split into three distinct sub-sectors with different characteristics (Figure 3). Most recently LondonMetric's focus has been on urban logistics given its rental growth prospects (H1 ERV growth of 3.1% versus 1.4% for mega and 0.3% for regional distribution). However, valuation yields have contracted quite dramatically reflecting increased investor demand.

Figure 3: Different characteristics of the distribution portfolio

	Mega	Regional	Urban logistics
No of assets	7	13	54
Sq ft (m)	4.7	3	3.4
Average sq ft per asset	671,429	230,769	62,963
Rent roll (£m pa)	22.7	17.1	21.6
Average rent (£psf)	5.40	6.15	6.60
Average topped up NIY (%)	*4.50%*	*4.50%*	*4.70%*
WAULT (years)	13	14	10
Capital value (£psf)	109	125	136
Contractual uplifts (%)	*71.0%*	*74.0%*	*37.0%*

Figure 4: Retailer exposure but distribution focused



Source *Company Data*

One of the key attractions of the portfolio is its income profile, with over 50% fixed/RPI uplifts and a WAULT (to break) of 11 years (Figures 2/3). If there is an area of concern it is the company's exposure to retailers (Figure 4). Clearly these retailers are mostly letting from LondonMetric distribution, rather than traditional retail space, but obviously if the retailer goes into administration all forms of its property tenancies are impacted.

An example is the loss in September 2018 of Poundworld, Wakefield (a 4 year old, c.500,000 sq ft shed let off £4.85psf) where the rent was £2.6m pa (c.2.5% of rent roll). This property is still available to let.

Up until recently one of the key differentiators between LondonMetric and Tritax was its development pipeline. This pipeline has seen LondonMetric move up the risk curve in search of higher yields, although generally a large proportion is pre-let prior to start on site. For example, the current five developments detailed in Figure 5 were c.80% pre-let/under offer as at H1 2019.

Figure 5: A largely prelet development pipeline

Project	Sq ft	Costs to complete	Estimated completion	Letting	Expected or agreed rent roll (£m pa)	Panmure estimated end value (£m)	Panmure forecast development surpluses (£m)
Durham	58,000	11	FY2020E	Prelet to Lidl and The Range	0.7	14.6	0.6
Bedford	680,000	42	FY2019E*	100k under offer	4.6	90.7	8.7
Weymouth	27,000	5	FY2020E	19k prelet Aldi	0.6	10.7	1.2
Ringwood	35,000	2	FY2019E	Prelet to Premier Inn	0.2	4.4	0.4
Telford	7,000	1	FY2019E	Prelet to 3 convenience occupiers	0.1	2.1	0.1
Total	**807,000**	**61**			**6.2**	**122.5**	**11.0**

**phase 1 of 180,000 sq ft*

***Source** Company Data, Panmure Gordon*

Management – forward thinking and outspoken

Andrew Jones – Chief Executive Officer

Martin McGann – Finance Director

Andrew was co-founder and CEO of Metric and post the merger with London & Stamford, became CEO of LondonMetric. Martin has been Finance Director of LondonMetric (and London & Stamford before) since 2008. The team (including Mark Stirling, Valentine Beresford and Chairman Patrick Vaughan) have worked together for years and are renowned for their outspoken views on the retail sector and ability to call the market cycle, hence their appetite for recycling. The team is the only one who actually acted upon the structural changes occurring in the retail sector and the share price performance (Figure 6) has reflected this switch. We show what could have been (for example, Hammerson) if its portfolio had remained dominated by retail properties.

Share price performance, valuation & rating

Whilst income generation is at the heart of LondonMetric's returns, the capital growth reported by its industrial portfolio has meant that NAV growth has been above average. As a result, over the past four years (Figure 7) the shares have been trading at a premium to NAV (average 9%) with a dividend yield averaging 4.5%. At present the shares are trading on a similar 9% premium to NAV but offering a slightly lower 4.3% dividend yield. We think this looks fair, but not good, value and initiate with a Hold rating.

Figure 6: What could have been – Hammerson vs LondonMetric

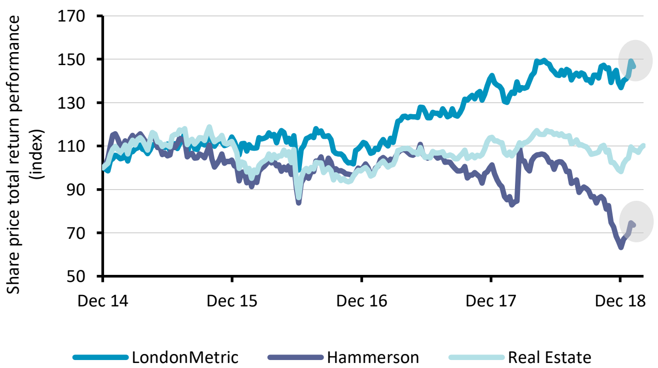
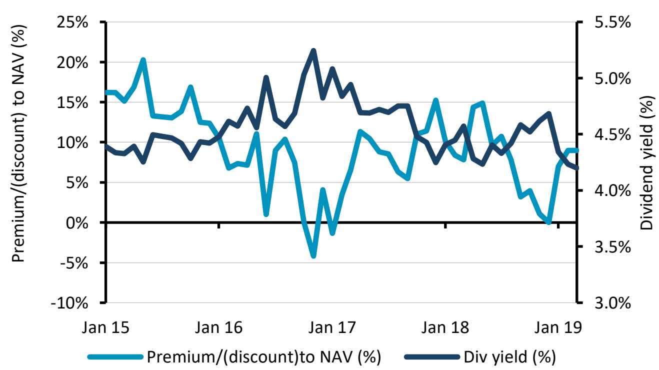


Figure 7: Shares trading in line with their average rating



***Source** Datastream, Company Data, Panmure Gordon*

The Numbers

The driver of net rental income growth is a combination of fixed/RPI uplifts together with market rental growth and rent from the development pipeline (we allow for £5.5m pa extra by FY2021E). We see low single-digit earnings growth flowing through into dividend growth of c.3% pa, although recognise that asset recycling can have an impact on our forecasts in any particular year.

Figure 8: Income statement (£m) – Year end March

Year End March	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Net rental income	**67.1**	**73.1**	**81.2**	**84.0**	**87.1**	**90.4**
Other income	2.2	1.7	1.7	1.7	1.7	1.7
Administrative expenses	-13.6	-13.3	-13.8	-14.0	-14.3	-14.4
JV EBIT	9.5	7.9	8.5	9.6	9.7	9.7
EBIT	64.8	69.2	77.6	81.2	84.2	87.4
Capitalised interest	2.7	1.9	1.7	1.5	1.0	0.0
Net interest	-15.9	-18.1	-18.2	-20.4	-21.2	-21.1
JV interest	-2.9	-2.2	-2.0	-2.1	-2.2	-2.2
Recurring PBT	**48.7**	**50.8**	**59.1**	**60.2**	**61.9**	**64.2**
Change in fair value of derivatives	-16.8	0.3	26.4	-0.4	0.0	0.0
Revaluations	51.1	22.2	114.7	86.9	62.9	40.4
JV revaluations	-1.3	-1.2	6.8	-5.5	-1.0	0.2
Profit on the sale of inv properties	2.4	-4.5	-2.1	-0.9	0.0	0.0
Profit on the sale of JV inv properties	-0.3	-1.0	0.1	-1.4	0.0	0.0
Exceptionals	-0.8	-3.6	-19.1	0.0	0.0	0.0
PBT	82.9	63.0	186.1	138.9	123.8	104.8
Tax (deferred and income)	-0.2	0.0	0.0	-0.1	-0.1	-0.1
Profit/loss after taxation	82.8	63.0	186.0	138.9	123.7	104.7
Adjusted diluted EPS (p)	**7.8**	**8.2**	**8.5**	**8.7**	**8.9**	**9.2**
Earnings growth (%)	*19.6%*	*4.9%*	*4.8%*	*1.3%*	*2.7%*	*3.8%*
DPS (p)	**7.3**	**7.5**	**7.9**	**8.2**	**8.4**	**8.7**
Dividend growth (%)	*3.6%*	*3.4%*	*5.3%*	*3.2%*	*3.1%*	*3.0%*
Dividend cover (x)	1.1	1.1	1.1	1.1	1.1	1.1
Interest cover (x)	3.4	3.4	3.9	3.6	3.6	3.8

Our NAV growth forecasts are being driven by the expectation of ongoing growth from the distribution portfolio (income growth not yield compression) offset by continuing declines in the retail park portfolio and a broadly flat performance from the long income/convenience properties. To this we allow for c.2p of development surpluses.

Balance Sheet (£m)

Year End March	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Investment properties	1346.1	1373.4	1677.6	1816.5	1926.4	1966.8
Investments	119.7	107.6	117.6	107.7	106.7	106.9
Other fixed assets	0.6	0.3	2.9	2.5	2.5	2.5
Other net current assets	-19.3	-27.6	-31.2	-22.9	-22.9	-22.9
Net debt	-525.3	-423.4	-617.4	-671.6	-715.8	-711.4
Provisions/fair value on derivatives	-23.6	-23.4	0.0	0.0	0.0	0.0
Adjustments	23.9	23.6	-2.9	-2.5	-2.5	-2.5
Adjusted NAV	**922.1**	**1030.5**	**1146.6**	**1229.7**	**1294.5**	**1339.4**
NAV per share (p)	**148**	**150**	**165**	**177**	**186**	**193**
NAV growth (%)	*5%*	*1%*	*10%*	7%	5%	3%
LTV (%)	*38.6%*	*31.6%*	*36.5%*	36.9%	37.1%	36.5%

It is difficult to estimate the level of recycling in any one year. What is more certain is the level of capex on its development pipeline. Overall we estimate leverage will remain broadly flat at around 36% LTV.

Cash flow (£m)

Year End march	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Operating cash flow	**54.3**	**74.3**	**68.4**	**80.4**	**84.2**	**87.4**
Funds available for distribution FAD	37.8	50.8	52.0	57.8	60.8	64.1
Free cash flow (pre-investment)	**-18.3**	**7.1**	**8.7**	**3.3**	**2.8**	**4.4**
Property acquisitions	-79.1	-147.8	-322.0	-178.5	-50.0	-50.0
Development capex	-69.6	-25.9	-56.2	-40.3	-47.0	0.0
Property disposals	156.6	181.1	200.0	170.6	50.0	50.0
Net cash from share issues	0.0	92.8	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Net cash flow	**-10.4**	**107.3**	**-169.5**	**-44.8**	**-44.2**	**4.4**

Source *Company Data, Panmure Gordon*

HOLD

Target Price: 128p

Share Price: 123p

(Price at close 11 March 2019)

Stock Codes	PHP.L / PHP LN
Market Cap	£971m
Sector	Real Estate
Last Published Research:	n/a

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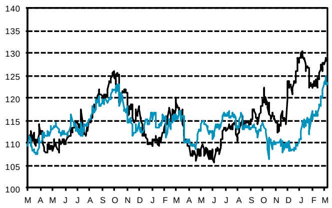
Absolute & Relative Performance



— *Absolute*

— *Relative to DS Real Estate*

Source *Datastream*

Investment Research

INITIATING

Primary Health Properties

Everyone's a winner

In our view both PHP and MedicX shareholders benefit from the merger. PHP grows its portfolio by c.50% overnight giving it access to good quality assets with similar characteristics, in a very competitive market where it is difficult to acquire in bulk. MedicX shareholders exit on premium terms, a company structure that got into a mess through overdistribution (although to be fair it was sorting itself out). The end result is a company with greater liquidity which we believe will benefit from economies of scale. Both MedicX and PHP's shares have reacted positively and rightly so in our view. However, PHP's shares are now trading on a demanding premium of 17% to NAV (vs 6% for Assura) and offer a dividend yield of 4.6% (in line with Assura). Whilst we do not expect much underlying capital or rental growth over the next year, we think the fact that the primary healthcare sector is driven by demographics, not economics, should mean both companies will continue to appeal to investors in 2019. However, given recent share price relative performance, we have a marginal preference for Assura at present and so initiate on PHP with a Hold rating and a 128p target price.

- **Benefits of a large company:** In theory a larger company should have improved access to debt and equity markets. PHP already has a track record of tapping the equity markets in order to make acquisitions, but we can see that it is likely to benefit from greater accessibility in terms of the debt markets. For example, Assura's cost of debt is 3.3% versus post-merger PHP's cost of c.4.0%, although PHP would need to reduce leverage in our view to secure a similar level to Assura. There will also be cost benefits with PHP highlighting that it believes its EPRA cost ratio will be amongst the lowest in the sector post-merger (we estimate 11.5%).

- **Giving investors a difficult decision to make:** Post-merger the estimated market cap of PHP will be broadly in line with Assura. This will give investors a more difficult choice given liquidity in PHP should be improved. We highlight in our initiation note on Assura the key differences between the companies; PHP's higher leverage, its external management structure and its exposure to Ireland versus Assura's direct development capability. Although our preference is for internal management and lower leverage, we like PHP's growing Irish exposure (and its CPI linkage) which we believe will have an increasingly positive impact on earnings.

- **A low growth sector:** Given we think underlying rental growth will remain low for primary healthcare for the foreseeable future, the focus is going to remain on acquisitions for earnings growth. PHP highlights the appeal of the yield arbitrage in Ireland and we see further emphasis placed on that location, especially given that post-merger the company will start to gain critical mass there (although still only c.6% of the total portfolio). This, together with the cost improvements highlighted above, results in a 3-year EPS CAGR of c.6%. We assume that management will seek to grow dividend cover so our 3-year DPS CAGR estimate is slightly lower at c.3%.

Year End	NAV	Premium/(discount) to NAV	NAV Growth	DPS ord	Yield	EPS	P/E
Dec	p	%	%	p	%	p	x
2018A	105	17.0	4.4	5.4	4.4	5.2	23.7
2019E	106	15.7	1.2	5.6	4.6	5.6	21.9
2020E	110	12.0	3.3	5.8	4.7	5.9	20.9
2021E	114	7.7	4.0	6.0	4.8	6.1	20.0

Source Company Data, Panmure Gordon

INVESTMENT CASE

COMPANY PROFILE

Primary Health Properties plc ('PHP') was founded by Harry Hyman in 1994 and floated on AIM in 1996, converting to REIT status in 2007. The company is externally managed by the adviser Nexus Tradeco Ltd. The business model is to invest in modern purpose-built healthcare facilities in the UK and Ireland. It aims to create progressive returns to shareholders through a combination of earnings growth and capital appreciation. As with Assura, the focus has been on growing the portfolio, benefiting from economies of scale and distributing a growing dividend (22 successive years of dividend growth). Over the past four years the company has raised c.£250m of equity to fund this growth and the portfolio has increased in size from £1.1bn in 2015 to £1.5bn in 2018. Early in 2019 the company announced a transformational all-share merger with MedicX which, assuming it completes later this month, will result in a portfolio of more than 470 properties and a combined value of £2.3bn (compared with Assura at £1.8bn). The enlarged group will have a market cap of over £1bn providing shareholders with improved liquidity.

Figure 1: Merging the portfolios

	MedicX	PHP	Combined
No of properties	313	166	479
Value (£m)	1503	800	2300
Contracted rent roll (£m)	79	44	123
Average NIY (%)	*4.85%*	*4.85%*	*4.85%*
Average lot size (£m)	4.8	4.8	4.8
WAULT (years)	14.2	13.1	13.5
Government backed income (%)	*90%*	*91%*	*91%*
% in Ireland	*7%*	*6%*	*6.5%*
Occupancy (%)	*99.0%*	*99.8%*	*99.5%*
% fixed/index uplifts	*30%*	*31%*	*31%*
% OMV rent reviews	*70%*	*69%*	*69%*
Cost of debt (%)	*4.3%*	*3.9%*	*c.4.1%*
LTV (%)	*52.6%*	*44.8%*	*47.8%*
Avg debt maturity years	12.3 years	8 years	c 10 years

***Source** Company Data, Panmure Gordon*

PORTFOLIO CHARACTERISTICS – COMBINING TWO SIMILAR PORTFOLIOS

Figure 1 shows how the characteristics of the individual portfolios are almost identical, so the combined group is just a larger version of PHP, the benefit on acquisition being that no stamp duty will be incurred (c.£40m versus merger costs of £25m). Management plans to continue with its growth strategy of acquiring properties in both the UK and Ireland, but we would also expect some selective assets sales following the merger.

PHP is largely dependent on open market value (OMV) rent reviews but little growth has been reported, just 0.4% over the past year. MedicX similarly reported limited growth of 0.8% in the year to September 2018 (Figure 2). Both companies (and Assura) have been suggesting that there are signs of rental growth through increased development activity (build cost inflation), but to date there have been little evidence as outlined in Figure 2.

Figure 2: OMV rent review uplifts showing limited growth

% annual OMV rent review uplifts	MedicX	PHP	Assura
Last financial year	*0.8%*	*0.4%*	*0.7%*
-1	*0.5%*	*0.3%*	*0.9%*
-2	*0.8%*	*0.9%*	*0.7%*

***Source** Company Data, Panmure Gordon*

Rationale for Irish acquisitions

Over the past few years both PHP and MedicX have sought exposure in Ireland. To date PHP owns eight properties and MedicX five (the strategy being for Irish exposure to account for a maximum of 10% of the portfolio, currently c.6%). The key attraction, other than portfolio diversification, is the higher valuation yields of c.6% giving an income return of 3% after costs, compared to the UK where the yields are lower and the cost of debt higher, resulting in an income return of 1.2% after costs. The Irish Government accounts for an average 67% of the rent roll; less than in the UK, a slight reduction in covenant strength. The properties being purchased are a mix of forward fundings and new properties, so the WAULT is a relatively high 22 years overall, which will help the portfolio WAULT. Another difference is that the rent reviews are linked to Irish CPI, so moving away from the open market review that is dominant in the UK.

MANAGEMENT – SECTOR EXPERIENCE

Harry Hyman – Managing Director of Nexus Group

Richard Howell – Finance Director of Nexus Group

Harry Hyman was the founder of Nexus and PHP in 1996. He has extensive experience of investing in the primary healthcare sector, having overseen the growth of the company over the past 20+ years. Richard Howell joined in 2017 having previously been at LondonMetric and before that, Brixton. Post-merger management will remain, with some changes amongst the independent directors.

The management fee structure has changed several times over the years. The MedicX portfolio at acquisition will be charged at a flat rate of 0.225% pa for a period of 5 years. Separately PHP's current marginal property fee of 0.275% will apply until it reaches £1.75bn at which point it will ratchet down. There is no change to the performance incentive fee (11.25% of the total NAV return above 8% subject to various restrictions).

SHARE PRICE PERFORMANCE, VALUATION & RATING

We show in Figure 3 the divergence in share price performance between MedicX and PHP during 2018 driven by MedicX's problems with dividend cover and its subsequent decision to cut the dividend. With hindsight buying MedicX shares in 2018 was the correct strategy, this merger clearly being beneficial for MedicX shareholders.

PHP's shares have consistently traded at a premium to NAV (3-year average 16% ranging from 23% down to 5%, currently 17%, just above average), the focus clearly being on the dividend (irrespective of the lack of dividend cover for periods of time post equity raises). Figure 4 shows how the dividend yield has ranged from 4.3% up to 4.9%, currently at 4.6%. We don't expect the shares to trade much differently post the merger and therefore initiate with a Hold rating and 128p target price (4.5% forecast+1 dividend yield and a 20% premium to NAV+1) suggesting a 12-month share price total return of 9%.

Figure 3: Divergence in performance before merging together

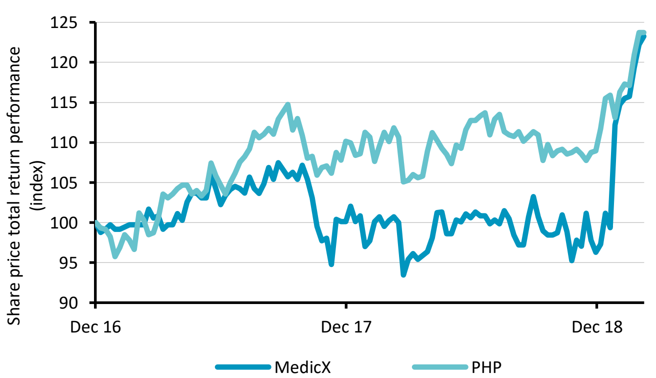
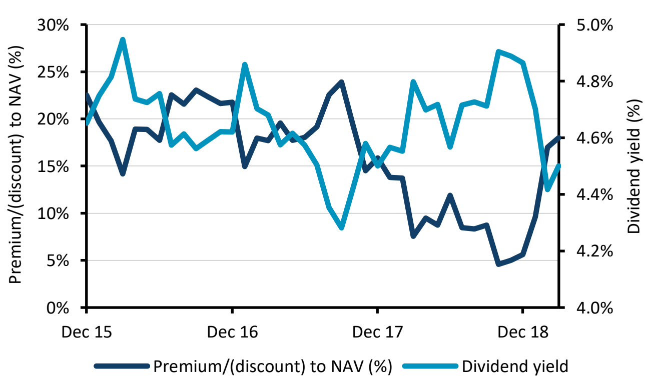


Figure 4: Shares trading at a 3-year average rating



***Source** Datastream, Company Data, Panmure Gordon:*

THE NUMBERS

We have allowed for the merger with MedicX in our forecasts (having a 75% impact in FY2019E) as well as the cost savings in terms of the management fee structure. This boosts earnings in FY2019E. Thereafter we expect underlying rental growth of 1-2% pa driving dividend growth of c.3% pa. Our FY2020E and FY2021E estimates allow for c.£1m pa of performance fees as we believe the company could report a total return of just over 8% pa.

We expect broadly flat valuation yields in the UK but a little compression in Ireland. Together with income growth this suggests NAV growth of c.3% pa. The LTV is expected to edge up a little to c.52% by FY2021E.

We allow for further acquisitions of £100-150m pa together with an element of disposals over the next couple of years, as management fine-tunes the portfolio post the MedicX acquisition.

Figure 5: Financial Statements – Year end December

Income statement (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Net rental income	66.6	71.3	76.4	113.6	130.3	137.4
Administrative expenses	-7.3	-8.7	-9.9	-11.3	-12.7	-13.5
EBIT	59.2	62.6	66.5	102.4	117.5	123.9
Net interest	-32.5	-31.6	-29.7	-43.3	-50.3	-53.8
Recurring PBT	**26.8**	**31.0**	**36.8**	**59.0**	**67.3**	**70.1**
Revaluations	20.7	64.5	36.0	36.5	36.4	45.0
Profit on the sale of inv properties	0.0	0.0	0.1	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	-10.0	0.0	0.0
PBT	43.7	91.9	74.3	85.5	103.7	115.2
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Profit/loss after taxation	43.7	91.9	74.3	85.5	103.7	115.2
Adjusted diluted EPS (p)	**4.8**	**5.2**	**5.2**	**5.6**	**5.9**	**6.1**
Earnings growth (%)	*-2.0%*	*8.3%*	*0.0%*	*8.2%*	*4.6%*	*4.3%*
DPS (p)	**5.1**	**5.3**	**5.4**	**5.6**	**5.8**	**6.0**
Dividend growth (%)	*2%*	*2%*	*3%*	*4%*	*3%*	*3%*
Dividend cover (x)	0.9x	1.0x	1.0x	1.0x	1.0x	1.0x
Interest cover (x)	1.8x	2.0x	2.2x	2.4x	2.3x	2.3x

Balance Sheet (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Investment properties	1220.2	1361.9	1502.9	2456.8	2573.2	2718.3
Other fixed assets	0.0	0.0	0.6	1.7	1.7	1.7
Other current assets	-28.1	-26.7	-27.5	-42.3	-42.3	-42.3
Net debt	-663.3	-726.3	-670.2	-1235.0	-1312.9	-1409.6
Other liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Fair value of derivatives	-29.5	-22.1	-17.8	-21.2	-21.2	-21.2
Adjustments	45.8	36.8	20.6	20.6	20.6	20.6
Adjusted NAV	**545.0**	**623.6**	**808.6**	**1180.6**	**1219.1**	**1267.4**
NAV per share (p)	**91.1**	**100.7**	**105.1**	**106.3**	**109.8**	**114.2**
NAV growth (%)	*3.8%*	*10.5%*	*4.4%*	*1.2%*	*3.3%*	*4.0%*
LTV (%)	*54%*	*53%*	*45%*	*50%*	*51%*	*52%*

Cash flow (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Operating cash flow	**56.8**	**60.1**	**68.5**	**92.4**	**117.5**	**123.9**
Funds available for distribution	27.1	30.5	40.9	49.0	67.3	70.1
Free cash flow (pre-investment)	**2.4**	**0.7**	**6.2**	**-12.9**	**2.1**	**3.3**
Property acquisitions	-97.4	-75.4	-101.9	-125.0	-100.0	-100.0
Development capex	0.0	0.0	0.0	0.0	0.0	0.0
Property disposals	0.0	0.0	0.0	30.0	20.0	0.0
Net cash from share issues	145.2	0.0	111.0	0.0	0.0	0.0
Other	-48.1	72.9	-13.9	0.0	0.0	0.0
Net cash flow	**2.2**	**-1.8**	**1.4**	**-107.9**	**-77.9**	**-96.7**

Source *Company Data, Panmure Gordon*

BUY

Target Price: 435p

Share Price: 405p

(Price at close 11 March 2019)

Stock Codes	SIRE.L / SIR LN
Market Cap	£1302m
Sector	Real Estate
Last Published Research:	n/a

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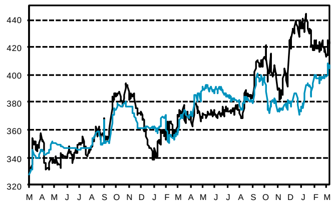
Absolute & Relative Performance



— *Absolute*

— *Relative to DS Real Estate*

***Source** Datastream*

Investment Research

INITIATING

Secure Income REIT

Defensive income in an uncertain world

There are many aspects of Secure Income REIT to like; the manager's alignment with shareholders, the security and predictability of the income streams resulting in steady dividend growth and a conservatively (in our view) valued portfolio giving protection against interest rate rises. The shares have performed well over the past couple of years and are currently trading at NAV and offering a 4.1% dividend yield. This looks fair and assuming a similar rating a year out we initiate with a Buy rating and a 435p target price.

- **Predictable income returns…:** Given the longevity of income streams (WAULT 20.9 years), strength of covenants and fixed/RPI uplifts, Secure Income REIT is providing investors with a very stable upward-only income stream, secured from assets across a diverse range of sectors.

- **…with an entrepreneurial slant:** The manager of Secure Income REIT, Prestbury Holdings, is not your typical property fund manager. The team is entrepreneurial, having a track record of taking advantage of market cycles and trends and not afraid to sell when they perceive the time to be right. Their expansion of Secure Income has played perfectly to the need for steady, growing income returns in a low interest rate, and increasingly uncertain, world. Whilst the assets may appear dry on paper, the most recent acquisitions earlier in 2018 provide some interesting opportunities, in particular its purchase of Manchester Arena which, in addition to a long-income stream (26 years to SMG) includes 8 acres in Central Manchester, located on top of Manchester Victoria railway and Metrolink stations.

- **Conservative valuations give comfort:** Given the demand for 'alternative' property sectors and long-term income streams, we are surprised that Secure Income's valuation yield at 5.1% is still higher than primary health care (c.4.8%) and social housing (c.5%) assets, having moved only modestly over the past few years. We understand that this is largely due to a lack of comparable transactions (other than hotels which have experienced some yield compression).

- **Only raising equity when it has portfolio acquisition:** Management has made it clear from the outset that it does not want its earnings to be diluted by cash drag. Therefore, it is only raising equity when it has a sizeable portfolio acquisition ready to go. Another important differentiator is that it is focused on real estate that is integral to the operations of the occupiers, providing investors with reassurance that the tenants are committed to the properties (for example, it is not easy to relocate a theme park) and assisting in renewal negotiations.

- **Aligned with shareholders:** Management has continued to invest alongside shareholders as it has raised equity, currently owning 13.4% of Secure Income REIT worth over £170m. This underpins its backing of the company's strategy and is in contrast to many of the other externally managed REITs. As a result, the strategy from the manager's perspective is not just about benefiting from the fees from an expanding portfolio, but more about creating value for the company as a whole.

Year End	NAV	Premium/(discount) to NAV	NAV Growth	DPS ord	Yield	EPS	P/E
Dec	p	%	%	p	%	p	x
2018A	400.5	1.1	8.1	13.9	3.4	14.7	27.5
2019E	427.3	(5.2)	6.7	16.5	4.1	16.7	24.3
2020E	447.9	(9.6)	4.8	17.2	4.2	17.4	23.2
2021E	468.9	(13.6)	4.7	18.2	4.5	18.4	22.0

Source Company Data, Panmure Gordon

Investment Case

COMPANY PROFILE

Secure Income REIT was admitted to AIM in June 2014 and in March 2016 expanded its shareholder base by undertaking a secondary placing. The company is externally managed by Prestbury Investments LLP. Secure Income's business model is to invest in long term (> 15 year unexpired at the time of acquisition) income streams, generated from a range of real estate sub-sectors. At IPO the portfolio was quite concentrated but over the following years Secure Income made some key acquisitions (a Travelodge portfolio followed by two further portfolios in early 2018, including additional Travelodges, Manchester Arena, The Brewery in Chiswell Street and some Stonegate pubs) financed by two equity raises of c.£104m and £309m. Secure Income REIT's priority is to seek out new off-market portfolios, but management won't compromise on its criteria and so acquisitions tend to be sporadic and opportunistic.

PORTFOLIO CHARACTERISTICS – SECURITY & LONGEVITY OF INCOME

Secure Income's portfolio can be split into three broad sectors as outlined in Figure 1, although it should be recognised that the 'leisure' sub-sector encompasses a broad range of types of property (theme parks, pubs, Manchester Arena). Although the portfolio has a long weighted average unexpired lease term of 20.9 years, it is only valuable if the tenants' covenants are strong (Figure 2). The two dominant tenants are Ramsay Health Care Ltd, one of the top five private hospital operators in the world (ASX 50 company with a market cap of £6.9bn) and Merlin Entertainments plc, the second largest visitor attractions company in the world and largest in Europe (c.£3.7bn market cap). One of the areas of focus for the company has been to diversify the tenant base, seeking high quality operators with defensive qualities and ideally global spread.

Figure 1: Broadly split between three sub sectors

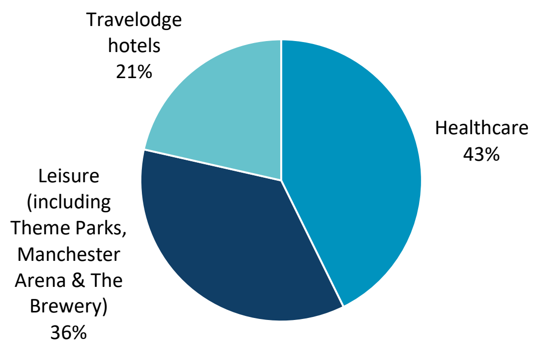
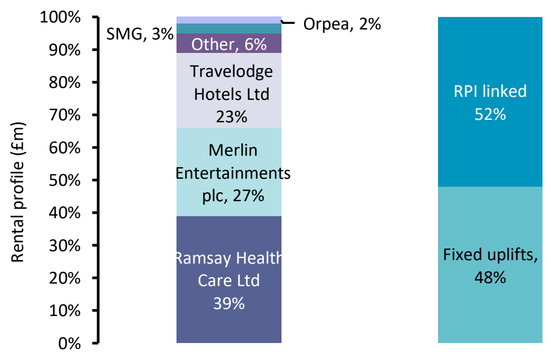


Figure 2: Strong covenants and RPI/fixed uplifts.



***Source** Company Data*

One of the differentiating factors between Secure Income REIT and some of the other long-income REITs is management's focus on acquiring assets that are vital to tenants' operations and difficult to replace. This means that the tenants are far more likely to renew the leases as they approach lease expiry.

Affordability and visibility of growth

It is important that the tenants can afford the yearly increases. As Figure 2 highlights the leases are broadly split between fixed uplifts (for example the Ramsay group has a 2.75% increase each year together with some open market reviews, the most recent resulting in a positive increase) and RPI linked leases (for example the Merlin leases are uncapped RPI - revised each year). Management believes that whilst it is difficult to gauge what is the true market rent for some of the assets, given their specialist nature and the volatile nature of operating profits, overall the portfolio is rack rented.

MANAGEMENT – SEASONED OPERATORS WITH SKIN IN THE GAME

Nick Leslau – Chairman of Prestbury Investments LLP (external manager)

Mike Brown – Chief Executive Officer of Prestbury

Sandy Gumm – Chief Operating Officer of Prestbury

Secure Income REIT is managed by Prestbury Investments plc; the team that successfully set up, invested, managed and sold Max Property Group over the period 2009 to 2014. It is run by experienced Nick Leslau (ex-Burford Holdings) and Mike Brown (ex-Helical Bar) with Sandy Gumm overseeing the numbers. This team has a substantial equity commitment in Secure Income REIT worth c.£170m/13.4%. The four independent non-exec directors of Secure Income REIT include Martin Moore as Chairman and Ian Marcus.

The management fee structure is fairly straightforward although has been altered a little over the last year as part of an extension to the management contract to 2025. The base fee equates to 1.25% for the first £500m of NAV reducing to 1% for £500-1bn, 0.75% up to £1.5bn and 0.5% thereafter. There is also a performance fee payable of 20% of the total NAV return above 10% subject to a high watermark and capped now at 5% of EPRA NAV. This is paid in shares and subject to a 3-year lock-in.

SHARE PRICE PERFORMANCE, VALUATION & RATING

The timing of management's entry into the long-income area of the market has been spot on, resulting in strong outperformance of both its peers and the wider real estate sector over the past three years (Figure 3). This has been driven by NAV total returns averaging c.13% pa over the last three years. Whilst the portfolio valuation yields have edged down (for example healthcare assets from 5.2% in Dec 2015 to 4.8% in Dec 2018), the moves have not been dramatic and much of the capital growth has been driven by the income growth of c.3% pa together with leverage (currently 43% down from 61% in 2015). As a result, we think that the portfolio valuation yield of 5.1% is relatively conservative.

Whilst the earnings are extremely predictable there is one area which could result in earnings upside – the cost of debt - which is currently 4.8%. Now that the LTV has come down to a more palatable level, a lower cost of debt could be achievable. The first maturity is in October 2022 (Merlin debt £381m at a c.5.7% rate). If this was replaced with debt at 3%, then the savings of £10m pa would equate to an uplift of 3p of earnings (20% uplift on the last reported EPS). We are not expecting this near-term, given it is fixed rate debt with a penalty for early repayment, but it is something for the future.

Figure 3: Outperformance versus its peers

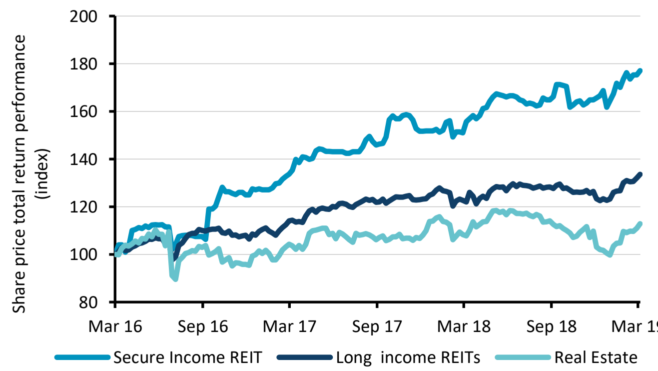
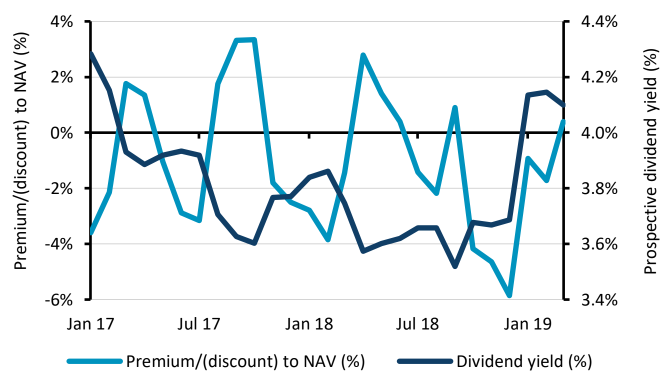


Figure 4: Stable rating (dividend or NAV basis) over 2 years



***Source** Datastream, Company Data, Panmure Gordon:*

Looking forward, we forecast Secure Income REIT to generate a c.10% total return, driven c.50% from the dividend and c.50% from NAV growth. We see little reason why the company's valuation ratings should change much, the shares trading on average at NAV over the past two years offering a c.3.8% dividend yield (Figure 4). We therefore initiate with a target price of 435p and a Buy rating assuming consistent ratings.

The Numbers

Net rental income growth is being driven by a combination of RPI and fixed uplifts – we expect an average of 2-3% pa. Interest costs are relatively high given the higher cost of debt of 4.8% (due to higher leverage and flexibility of the facilities) although we expect this to be addressed over the coming years. Management is committed to a full pay-out of c.100% of earnings.

We assume just 5bps of yield compression in FY2019E (from 5.1%) and nothing thereafter, although we would highlight that we believe the yield to be relatively conservative given the quality and longevity of the income streams. The driver of NAV is therefore income growth which drives a reduction in leverage to below 40% on our base case forecasts for FY2021E.

We do not allow for any acquisitions because if the company does purchase any portfolios we believe they are likely to be large and acquired with equity.

Figure 5: Financial statements – Year end December

Income statement (£m)

Year end December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Net rental income*	**80.3**	**95.2**	**114.4**	**126.5**	**129.6**	**133.3**
Other income	0.0	0.2	0.0	0.0	0.0	0.0
Administrative expenses	-9.1	-11.9	-15.3	-17.4	-18.1	-18.7
EBIT	71.2	83.5	99.2	109.1	111.5	114.6
Net interest	-49.7	-51.8	-54.5	-54.9	-54.9	-54.9
Recurring PBT	**21.6**	**31.6**	**44.6**	**54.2**	**56.6**	**59.8**
Revaluations	72.2	113.4	98.2	84.4	63.7	65.5
Profit on the sale of inv properties	0.0	0.0	0.2	0.0	0.0	0.0
Incentive fee/exceptional costs	-12.5	-17.6	-5.3	0.0	0.0	0.0
PBT	81.3	127.5	137.7	138.6	120.4	125.2
Tax	-1.7	-1.7	-1.1	-0.3	-0.3	-0.3
Profit/loss after taxation	79.5	125.7	136.6	138.3	120.0	124.9
Adjusted diluted EPS (p)	**11.1**	**13.6**	**14.7**	**16.7**	**17.4**	**18.4**
Earnings growth (%)	*320%*	*23%*	*8%*	*13%*	*5%*	*6%*
DPS (p)	**5.8**	**13.6**	**13.9**	**16.5**	**17.2**	**18.2**
Dividend growth (%)	0%	134%	*2%*	*19%*	*4%*	*6%*
Dividend cover (x)	1.9	1.0	1.1	1.0	1.0	1.0
Interest cover (x)	1.4	1.5	1.9	2.0	2.0	2.1

Balance Sheet (£m)

Year end December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Investment properties	1655.2	1783.6	2338.0	2422.4	2486.1	2551.6
Other current assets	-33.6	-34.5	-38.3	-38.3	-38.3	-38.3
Net debt	-863.9	-866.6	-978.5	-976.1	-973.5	-971.1
Provisions/fair value on derivatives	-20.3	-22.0	-39.9	-39.9	-39.9	-39.9
Adjustments	8.5	10.2	11.1	11.1	11.1	11.1
Adjusted NAV	**745.9**	**870.8**	**1292.9**	**1379.9**	**1446.0**	**1513.9**
NAV per share (p)	**324**	**370**	**400**	**427**	**448**	**469**
NAV growth (%)	*14%*	*14%*	*8%*	*7%*	*5%*	*5%*
LTV (%)	*53%*	*50%*	*43%*	*41%*	*40%*	*39%*

Cash flow (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Operating cash flow	**73.2**	**82.9**	**110.9**	**109.1**	**111.5**	**114.6**
Funds available for distribution FAD	23.4	32.4	59.1	55.7	58.1	61.2
Free cash flow (pre-investment)	**11.5**	**1.2**	**17.6**	**2.4**	**2.6**	**2.5**
Property acquisitions	-195.9	0.0	-436.8	0.0	0.0	0.0
Property disposals	0.0	0.0	0.4	0.0	0.0	0.0
Net cash from share issues	140.3	0.0	309.8	0.0	0.0	0.0
Net cash flow	**-44.2**	**1.2**	**-108.9**	**2.4**	**2.6**	**2.5**

**ignoring rent smoothing*

***Source** Company Data, Panmure Gordon*

INITIATING

Tritax Big Box

In the right place at the right time

BUY

Target Price: 152p

Share Price: 142p

(Price at close 11 March 2019)

Stock Codes	BBOXT.L / BBOX LN
Market Cap	£2424m
Sector	Real Estate
Last Published Research:	n/a

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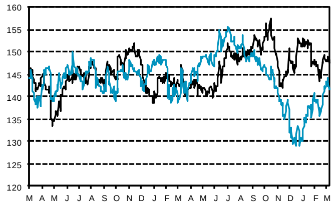
Absolute & Relative Performance



— *Absolute*

— *Relative to DS Real Estate*

Source *Datastream*

Investment Research

Over the past five years Tritax has pieced together a unique £3.4bn logistics warehouse portfolio, at a time of voracious investment appetite for industrial assets. Whilst its underlying portfolio has benefited from yield shift, competition has meant it is increasingly tough for management to buy at the yields required to sustain the relatively high dividend. As a result, management first started to consider shorter-term leases and then moved into forward funding developments, which gave an extra kicker to yields. Following this, it acquired the Littlebrook site in Dartford in order to undertake direct development and now it has gone the whole way and acquired a portfolio of strategic land options (38m sq ft), which could more than double the existing portfolio (30m sq ft) over a 10-year period. Whilst it has clearly had to move up the risk curve, the opportunity looks attractive, giving a c.7-8% yield on cost (assuming planning is received and there is demand for the developments). Therefore, although we recognise the impact on near-term earnings, our model suggests continued dividend cover at 2% pa dividend growth and we initiate with a Buy rating and a 152p target price believing the recent share price correction to be overdone and the 4.8% dividend yield to look attractive.

- **Concentrated risk:** In contrast to LondonMetric and SEGRO, Tritax is focused solely on the big box warehouse sub-sector of the logistics market. This sub-sector has experienced significant yield compression (given the long leases) but there are concerns that increasing supply will dampen the outlook for ERV growth (Tritax reported ERV growth of just 0.6% in 2018). Given the large proportion of fixed/RPI uplifts, management forecast c.2.8% pa income growth over the next few years. Therefore, whilst the portfolio is 5.4% reversionary at present, we highlight that if ERV growth slows, then it could become overrented. The tenant base is also quite concentrated with five tenants accounting for 34% of the rent roll. Admittedly we have little issue with Amazon being the largest at 13.7%, but it is heavily exposed to retailers (in industrial not retail space, but if a tenant goes into administration it needs neither its shops nor its distribution warehouse).

- **Moving up the risk curve:** We highlight above how Tritax has moved up the risk curve in order to seek out extra yield. Whilst this may be a change in its investment strategy, as long as investors understand the risks and these are managed correctly, we do not see this as an issue. In fact, we think the db symmetry transaction provides an opportunity to upgrade its existing portfolio (we expect some disposals) and continue being at the forefront of the evolution of the supply chain. The potential yield on cost of 7-8% provides enough room for Tritax to generate attractive profits and income, even if valuation yields move out a little and build costs rise. However, management will clearly need to raise more equity in order to develop the sites out and at present the shares are trading at an unusual discount to NAV (currently 6%).

Year End	NAV	Premium/(discount) to NAV	NAV Growth	DPS ord	Yield	EPS	P/E
Dec	p	%	%	p	%	p	x
2018A	152.8	(7.1)	7.4	6.7	4.7	6.9	20.6
2019E	155.3	(8.6)	1.6	6.9	4.8	7.1	20.0
2020E	161.5	(12.1)	4.0	7.0	4.9	7.0	20.2
2021E	167.2	(15.1)	3.5	7.2	5.0	7.5	19.0

Source Company Data, Panmure Gordon

INVESTMENT CASE

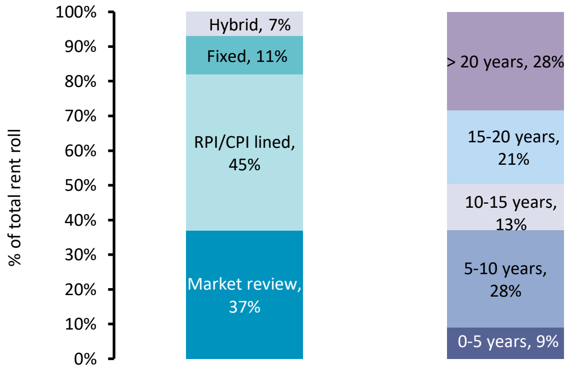
COMPANY PROFILE

Tritax Big Box was floated at the end of 2013, raising £200m of equity for the purpose of acquiring well located, modern Big Box assets let to institutional-grade tenants. Given strong investor appetite for exposure to this market, the company has grown rapidly raising c.£1.7bn of equity over the past 5 years. In the first 6 months the average purchase yield was 5.9%. Whilst this has reduced to 5.5% on average over the past five years, it compares favourably to the current valuation yield of just 4.4% and reflects management's strong market contacts, with 86% of all properties being purchased off market. However, in order for Tritax to be able to continue growing the dividend, it has had to be more inventive and is increasing its exposure to developments. It now has shareholder approval for a maximum exposure to land and options to 15% of gross asset value (GAV), of which 5% can be invested in speculative developments.

Figure 1: Current forward funding agreements

	Sq ft *	Price (£m)	NIY (%)	PC
Eddie Stobart, Corby	847,643	82	5%	Feb-19
BSH Home Appliances, Corby	945,375	89	5.20%	Aug-19
Howdens II & III, Northamptonshire	957,000	104	5%	Sep-19
Amazon, Darlington	1,508,367	120	5%	Sep-19
Amzon, Haydock, Merseyside	361,092	69	4.90%	Jul-19
Amazon, Durham	1,992,061	142	5.25%	Jul-20
Total	**6,611,538**	**605**		

Figure 2: Over two thirds of reviews are fixed or index linked



**including mezzanine*
***Source** Company Data*

PORTFOLIO CHARACTERISTICS – MOVING WITH THE TIMES

Over the past five years Tritax Big Box has acquired a unique portfolio of 54 assets, totalling 29.8m sq ft with a current value of £3.42bn (of which £525m is revaluation gains). The assets are large (average >500,000 sq ft), generally single-let, 100% occupied with a WAULT of 14.4 years. They are located in the key distribution hot spots in the SE (19%), Midlands (42%), NW (12%) and NE (26%). Around 30% of all the assets acquired have been forward funding transactions (especially more recently – see Figure 1 for current forward funded developments which have a rent roll of c.£31m pa). Two thirds of leases have some form of fixed or index-linked reviews, the remaining being open market rent reviews (Figure 2). Management highlight that over the next five years rental growth, given consensus inflation forecasts, should average 2.8% pa.

db symmetry - A transformational deal

In February Tritax completed the complex acquisition of an 87% economic interest in db symmetry, the owner of one of the UK's largest strategic land portfolios for £372.75m (paid c.£270m in cash, funded by equity of £245m and the remainder in shares). The 26 sites (1,950 acres) are split into 7 consented developments (of which 5 are under construction speculatively but are expected to secure tenants prior to completion at the end of 2019) and 19 options (of up to 13 years) which will be drawndown once planning and tenants are secured, although management highlights that it might undertake an element of smaller speculative developments, where beneficial to the overall scheme. The company has a 10-year business plan and believes the total capex requirement (including fees) will be c.£2.1bn (Figure 3) although assuming an element of disposals, the guidance is that Tritax will need around £1.3bn over the period or c.£130m pa which will be funded by a mixture of equity, disposals and debt.

We show in Figure 3 a simplified development appraisal on a per square foot (psf) basis which suggests a yield on cost of c.7.7% on average. Clearly this is not without risk, both in terms of planning, cost inflation and continued appetite for the end product, but we believe the 7-8% yield on cost or 50%+ profit on cost potential allows for this.

Figure 3: The simple maths behind the db transaction

Cost	£psf	£m on 38m sq ft	Cost	£psf	£m on 38m sq ft
Option cost	9	342	Average rent	6	228
Acquisition cost	9	346	Yield on cost	7.7%	
Average construction	38	1444	Assumed end value yield	5%	
Other fees	15	570	**Assumed end value**	**120**	**4560**
dbs pay out	3	114	Profit	42	1592
Finance/management fees	4	152	Over 10 years		159
Total costs	**78**	**2968**	Profit on cost	54%	

Source *Company Data, Panmure Gordon*

MANAGEMENT – HAVING THE RIGHT IDEA AT THE RIGHT TIME

James Dunlop – Partner, Fund Manager, Tritax Management LLP

Colin Godfrey – Partner, Fund Manager, Tritax Management LLP

Colin Godfrey and James Dunlop are the founding partners of Tritax Management and were responsible for creation of Tritax Big Box. The wider Tritax Group has acquired and developed commercial property assets of over £4bn since 1995 on behalf of property unit trusts, limited partnerships and syndicates. The management team spotted the opportunity in 2013 to create a logistics focused REIT, given the increasing interest in the industrial asset class and the structural changes occurring within the retail industry. Sir Richard Jewson (previously Chairman of Savills amongst other roles) is the independent Chairman of Tritax Big Box.

SHARE PRICE PERFORMANCE, VALUATION & RATING

Since flotation in December 2013 Tritax shareholders have enjoyed a c.80% total return (12% CAGR), broadly in line with LondonMetric, but below that of SEGRO which has benefited from its London/SE and development focus (Figure 4). Until recently the shares have traded at a consistent premium to NAV (enabling equity raising), but in December 2018 this moved out to a wide 15% discount (Figure 5) reflecting, in our view, a combination of factors including concern about increasing supply of logistics warehouses, low valuation yields and ongoing equity issuance. As a result of the rerating, the hitherto steady c.4.4% dividend yield peaked at 5.1%. The shares have recovered to a degree with a dividend yield of 4.6% and a discount to NAV of 7%, but we think this still offers value for shareholders and initiate with a Buy rating and a 152p target price.

Figure 4: c.80% total return for investors since flotation

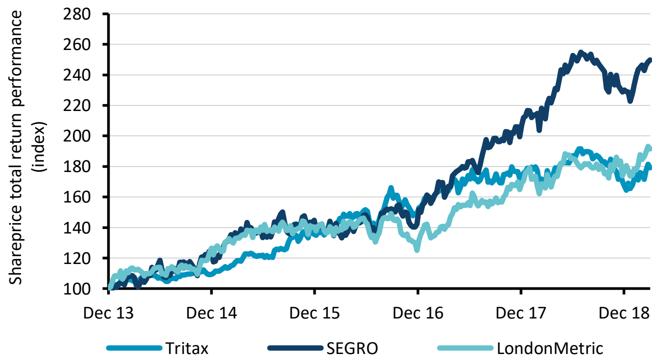
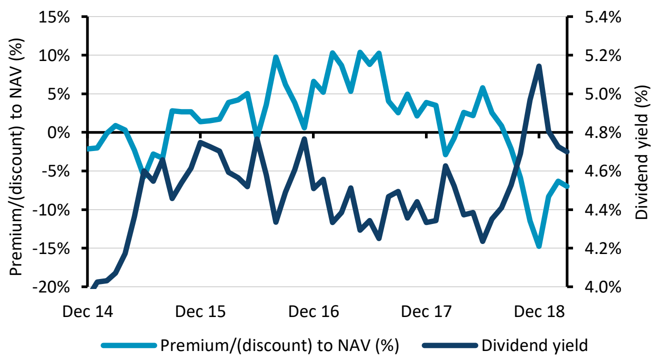


Figure 5: Recent derating of the shares



Source *Datastream, Company Data, Panmure Gordon*

THE NUMBERS

The driver of net rental income growth is a combination of fixed/RPI uplifts together with market rental growth, rent from the db development pipeline (we allow for £8m pa extra by FY2021E) and an assumed letting at Littlebrook. We see low single-digit earnings growth flowing through into dividend growth of c.2% pa, the equity raise and non-income yielding sites having an impact on our FY2019E and FY2020E forecasts.

The company has a fairly standard management fee of 1% on NAV up to £500m, ratcheting down to 0.5% above £1.5bn (excluding cash balances). 25% of total fees are payable in shares. There is no performance fee but the EPRA cost ratio is a low 13.7%.

Our NAV growth forecasts are driven by the expectation of a very small amount of yield compression (5bps in FY2019E), together with average rental growth of 2.8% pa (as guided to by management). To this, we allow for c.2p of development surpluses.

The NAV forecast for FY2019E is impacted by the dilution of the equity raise associated with the db symmetry acquisition.

We assume the company spends capex on its forward funding commitments and the current db developments that are under construction. For now we do not assume any further capex. We start to allow for some disposals from FY2020E.

Figure 6: Financial statements – Year end December

Income statement (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Net rental income	**71.0**	**103.3**	**128.4**	**131.6**	**158.1**	**177.9**
Licence fee/management fees	8.9	6.9	11.6	30.0	11.4	2.0
Administrative expenses	-11.7	-14.2	-18.1	-20.1	-21.1	-21.8
EBIT	68.2	96.0	122.0	141.4	148.4	158.2
Capitalised interest	0.0	0.0	0.0	1.0	1.0	1.0
Net interest	-11.3	-15.2	-22.9	-24.0	-28.7	-31.0
Recurring PBT	**56.9**	**80.8**	**99.1**	**118.5**	**120.6**	**128.2**
Change in fair value of derivatives	-7.2	-2.0	-1.2	0.0	0.0	0.0
Revaluations	47.5	176.0	163.0	150.4	112.4	98.4
Exceptionals	-7.2	-6.8	-0.3	0.0	0.0	0.0
PBT	90.1	248.0	260.5	268.8	233.1	226.6
Tax (deferred and income)	0.0	0.0	0.0	0.0	0.0	0.0
Profit/loss after taxation	90.1	248.0	260.5	268.8	233.1	226.6
Adjusted diluted EPS (p)	**6.5**	**6.4**	**6.9**	**7.1**	**7.0**	**7.5**
Earnings growth (%)	*6.4%*	*-2.2%*	*8.0%*	*3.0%*	*-0.7%*	*6.0%*
DPS (p)	**6.2**	**6.4**	**6.7**	**6.9**	**7.0**	**7.2**
Dividend growth (%)	*3%*	*3%*	*5%*	*2%*	*2%*	*2%*
Dividend cover (x)	1.0x	1.0x	1.0x	1.0x	1.0x	1.0x
Interest cover (x)	6.0x	6.3x	5.3x	5.9x	5.2x	5.1x

Balance Sheet (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Investment properties	1803.1	2599.2	3038.3	3788.7	4086.1	4209.5
Other fixed assets	3.2	2.0	5.2	5.2	5.2	5.2
Other net current assets	-28.9	-40.8	-30.5	-30.5	-30.5	-30.5
Net debt	-362.8	-630.9	-772.1	-1117.6	-1301.7	-1321.1
Adjustments	11.6	11.0	12.2	12.2	12.2	12.2
Adjusted NAV	**1426.2**	**1940.4**	**2253.1**	**2657.9**	**2771.3**	**2875.3**
NAV per share (p)	**129**	**142**	**153**	**155**	**162**	**167**
NAV growth (%)	*3%*	*10%*	*7%*	*2%*	*4%*	*3%*
LTV (%)	*29.6%*	*27.3%*	*27.0%*	*30.9%*	*32.9%*	*32.3%*

Cash flow (£m)

Year End December	FY2016	FY2017	FY2018	FY2019E	FY2020E	FY2021E
Operating cash flow	**70.3**	**87.1**	**110.9**	**141.4**	**148.4**	**158.2**
Funds available for distribution FAD	60.5	73.0	83.2	117.5	119.6	127.2
Free cash flow (pre-investment)	**2.7**	**-4.3**	**-12.3**	**9.5**	**0.9**	**5.6**
Property acquisitions	-600.8	-607.9	-283.2	-270.0	-75.0	-75.0
Development capex	0.0	-103.7	-103.7	-330.0	-110.0	-25.0
Property disposals	0.0	0.0	0.0	0.0	0.0	75.0
Net cash from share issues	551.1	351.4	154.7	245.0	0.0	0.0
Other	-58.9	271.4	0.0	0.0	0.0	0.0
Net cash flow	**-105.8**	**-93.1**	**-244.4**	**-345.5**	**-184.1**	**-19.4**

Source *Company Data, Panmure Gordon*

Distribution of investment ratings for equity research (as of 3 Jan 18)			Rating: GUIDELINE (return targets may be modified by risk or liquidity issues)	
Overall Global Distribution (Banking Client*)			**Buy**	Total return of >10% in next 12 months
Buy	**Hold**	**Sell**	**Hold**	Total return >-10% and <+10% in next 12 months
66% (47%)	27% (8%)	7% (0%)	**Sell**	Total return <-10% in next 12 months
* Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients				

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