Investors' Chronicle

Warehouse REIT offers ecommerce exposure at a bargain price

INVESTMENT IDEAS

December 30, 2020

By Emma Powell

The logistics landlord stands to benefit from increasing demand for online delivery, but its shares trade at a discount to peers

- Shares trade at a discount to peers and forecast NAV
- Dividend maintained in the wake of the pandemic and forecast to grow next year
- **Tip style**
  - INCOME
- **Risk rating**
  - MEDIUM
- **Timescale**
  - LONG TERM
- **Bull points**
  - **Rising rental income**
  - **Growing portfolio valuation**
  - **Dividend forecast to rise**
  - **High rent collection rates**
  - **Bear points**
- **Potential pressure on retail tenants**
- **Manufacturing could come under strain**

Logistics landlords proved themselves to be among the most resilient within the real estate sector in 2020. The post-pandemic acceleration towards ecommerce and efforts to strengthen supply chains ahead of the UK's exit from the EU drove demand for warehouse space – those forces are unlikely to dissipate in 2021.

UK sector leaders Segro (SGRO), now the largest property group listed in London, and LondonMetric (LMP) have stolen much of the attention gained by the rapidly ascending corner of the real estate market. Yet we think Aim constituent Warehouse REIT (WHR) is equally deserving of consideration.

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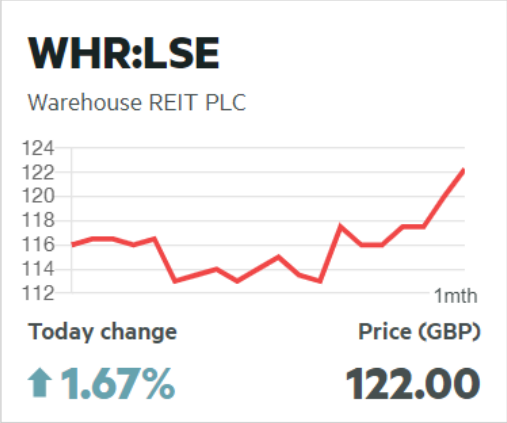


Warehouse Reit's portfolio is focused on multi-let industrial estates across England, with all assets within 2.5 miles of a town centre or major transport infrastructure hub. Admittedly, the scale of the portfolio is much smaller than main market peers, but that is more than accounted for by the lower valuation attached to the shares. Despite the group delivering the sixth highest total returns of any UK REIT since the start of 2020, according to FactSet data, the company is still valued at a 5 per cent discount to forecast net asset value (NAV) at the end of March. That compares with double-digit premiums baked into the shares of Segro and LondonMetric.

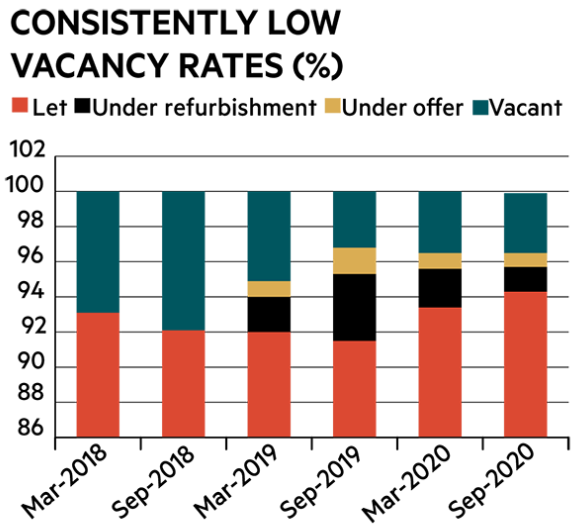
	Prem./Disc. to Fwd NAV (+12mths)	Prem./Disc. to Fwd NAV (+24mths)
Warehouse Reit	-8.8%	-15%
Urban Logistics Reit	-9.8%	-14%
Tritax Big Box	-5.4%	-9.0%
Segro	+15%	+9.5%
Londonmetric	+21%	+17%

Source: FactSet, consensus forecasts

No room at the warehouse

Consumers increasingly expect speedy delivery of goods purchased online, and that has driven demand for warehouse space from businesses – a trend accelerated by the pandemic. Take-up for distribution warehouses topped 34m square feet (sq ft) during the first three quarters of2020, according to data from real estate services group Colliers International, 11 per cent ahead of the figure for the whole of 2019. It expects annual occupational demand to reach a new record around the 45m sq ft mark.

For Warehouse REIT, that has allowed it to let space ahead of estimated rental values (ERV), which themselves have been growing. Since the company's IPO in 2017, lettings have been completed at an average 8.5 per cent ahead of ERV. During the six months to the end of March, new lettings were also completed at 8.5 per cent ahead of ERV and renewals at 28 per cent above passing rent. The acute shortage of supply in urban warehouse space also contributed to a tenant retention rate at lease break of 92 per cent during the same period.



Source: FactSet

That demand for space endured despite manufacturing output suffering in the immediate aftermath of the pandemic. Manufacturing activity has since recovered – the manufacturing output index recording a reading of 55.3 in December, with any reading above 50 indicating expansion.

In the wake of the pandemic outbreak rent collection has remained robust. During both the second and third quarters, rent collection stood at just over 97 per cent of the amount due and almost 93 per cent for fourth-quarter rent by the end of October. That could partly be attributable to the diverse and defensive tenant base. Occupiers in the wholesale and trade distribution sectors account for the largest proportion of contracted rent at 36 per cent of the total, followed by food and general manufacturing at 21 per cent.

The top tenant is Amazon (US:AMZN), which during the first half of the year accounted for 11 per cent of contracted rent. The group does, however, also have considerable exposure to retailers – John Lewis and DFS (DFS) are the third and fourth biggest contributors to rental income – which could come under strain as lockdown restrictions impact trading.

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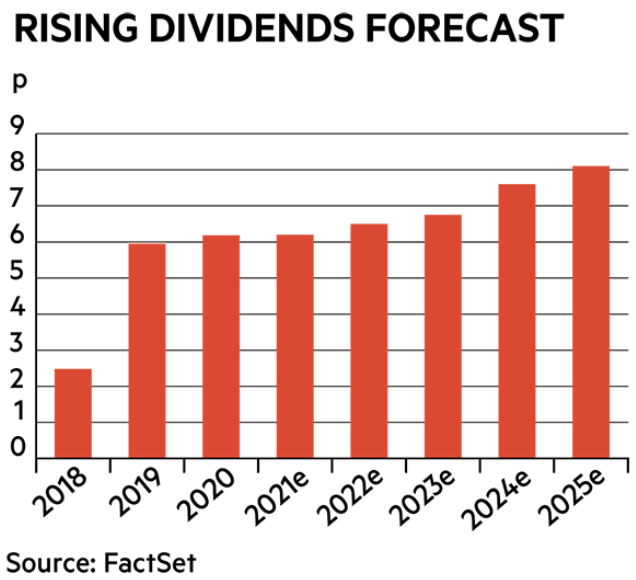
A shed fit for an e-commerce king

In addition to growing rental income via the existing portfolio, the company also seeks to acquire sites with low average rents, carry out refurbishment and re-let the space at a higher rent. It also carries out small-scale redevelopment on space either adjacent to existing industrial estates. However, it does not start building without first achieving a pre-let on at least some of the proposed new space. Expansion plans were partially funded via a £153m share placing and open offer in July at 110p.



Rising rental income has backed generous dividend payments, paid quarterly, since the Reit's IPO. For the year to March 2021 management is targeting a payment of 6.2p a share, in line with the pay-out for the prior financial year. This is forecast to rise to 6.3p the following year. At the current price, that leaves the shares offering a yield of 5.4 per cent, rising to 5.5 per cent. A solid financial position gives extra confidence in the sustainability of shareholder returns. The loan-to-value ratio stands at a conservative 20.2 per cent, it has cash and available debt facilities of £106m and no debt is due to mature before 2025.

Warehouse REIT offers exposure to the rapid shift towards ecommerce, at a substantial discount to larger sector peers and its own NAV. However, a shortage of warehouse space, solid rent collection rates and the prospect of impressive annual dividends means a premium rating could emerge in 2021.

Last IC view: Buy, 111p, 3 Nov 2020

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WAREHOUSE REIT (WHR)				
ORD PRICE:	114p	MARKET VALUE:	£441m	
TOUCH:	113.5-114.5p	12-MONTH HIGH:	123p	LOW: 69p
FORWARD DIVIDEND YIELD:	5.5%	TRADING PROPERTIES:	nil	
FORWARD DISCOUNT TO NAV:	11%	NET DEBT:	27%	
INVESTMENT PROPERTIES:	£572m			

Year to 31 Mar	Net asset value (p)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2018	102	5.7	2.0	2.5
2019	110	18.6	6.4	6.0
2020	110	26.1	6.5	6.2
2021*	120	27.9	4.8	6.2
2022*	128	38.8	6.6	6.3
% change	+7	+39	+38	+2
Normal market size:				
Beta:	0.66			

*Peel Hunt forecasts, adjusted NAV, PTP and EPS figures