|  |  |  |
| --- | --- | --- |
|   |  | Investment recommendation: Buy |
|  |
|  *Current Price: £1.45 / Target Price: £2.08* |  |

* We see a long term 44% potential upside in the share prices of Urban Logistics REIT.
* This is due to unpriced structural shifts in last mile warehousing.

***Executive*** ***Summary***

Market Data

Our financial analysis leads us to recommend a long position in Urban Logistics REIT with a long-term price target of £2.08. This price target implies a 44% upside, and is based on a set of conservative assumptions for the future performance of the company.

Urban Logistics REIT is a real estate Investment trust managed by Pacific Capital Partners. The company invests in single tenant industrial and logistics properties between 20,000-200,000 square feet that are capable of utilisation by tenants wishing to respond to the rise of e-commerce.

**Rathbone** 10.48%

**Allianz** 10.31%

**Janus Henderson** 9.98%

**Sir John Beckwith** 8.00%

**Premier Fund Managers** 5.01%

**Man Group** 4.63%

**Blankstone Sington** 4.21%

**Management** 1.05%

Major Shareholders

Our valuation of Urban Logistics points squarely towards an intrinsic value that is far above the current market price. Our belief is that this difference exists due an increasing demand/supply imbalance driving up rents, yet a market cap that is not yet large enough for institutional investors to drive the price discovery mechanism towards intrinsic value.

We believe that the key risks to this investment are:

1. The market fails to realise the comparatively high risk adjusted potential returns of Urban Logistics.
2. The market for last mile warehousing is disrupted by technological advances.
3. The UK experiences a prolonged period of economic hardship.
4. Management’s expansionary policy results in a lowered return on assets.

TKR SHED

Price (£) 1.45

12M High 1.50

12M Low 1.13

Shares (M) 86.5

Mkt Cap (M) 127.94



***Company*** ***Overview***

Entering the market in 2017 Urban Logistics REIT (formerly Pacific Industrial & Logistics REIT) is a property investment company with a defined focus on Industrial and Logistics warehouses between 20,000 and 200,000 sqft. The portfolio of 38 warehouses that Urban Logistics has acquired over the past 3 years are located and equipped to assist tenant companies in creating a distribution network capable of dealing with the structural shift towards e-commerce and fast delivery.

These warehouses are overwhelmingly located in the Midlands and South East of the UK. The motivation behind this is a belief that the high rate of conversion of industrial land to higher value uses, such as property development, will lead to these warehouses becoming a scarce resources in the face of increasing demand from potential tenants with time pressure to deliver their goods. The management of Urban Logistics plans to convert this structural imbalance into a strong position to negotiate rent increases with tenants.

The company additionally aims to increase the income it can derive from its portfolio through active asset management programmes, recently initiating a £15.4M development of 6 logistics warehouses on arterial locations of the M6 & M1 motorways.`

Leadership Team

Management & Governance

Director:

Richard Moffit

Director:

Mark Johnson

Non-Executive Chairman:

Nigel Rich CBE

Non-Executive Director:

Jonathan Gray

Non-Executive Director:

Bruce Anderson

***Business*** ***Strategy***

Expansion

Urban Logistics since IPO has pursued an aggressive expansionary policy. This policy of acquisitions has seen the company grow their asset base (at acquisition cost) by around 400% since their 13 asset IPO funded portfolio. A key motivation for Urban Logistics’ fast pace in expansion is due to the relative expense of new build warehouses against acquiring existing sites at current market prices. The company acquires properties at 30%-70% of the cost of building a similar warehouse, a policy that is supported by the experience and contacts of management. Due to the underlying structural imbalance within last mile warehouse supply and demand, we strongly support management’s policy of expansion. We believe that when demand soon begins to outstrip supply there is likely to be upward pressure on the prices of warehouses within the company’s investment remit. We conclude that making acquisitions sooner rather than later is the best way to grow property yields going forward. This support is conditional on management continuing its policy of purchases within the aforementioned 30%-70% range.

Expansion, a driver of our investment thesis, is set to continue in the coming years with the company currently in the midst of a £145M equity placement, which when completed on the 9th March 2020 will near double the company’s market capitalisation. This cash inflow is earmarked to fund the acquisition of the £146M ‘Advanced Portfolio’ which consists of 12 pre-let assets in 3 portfolios which are in late stages of negotiation. Our conclusion is that this purchase will enhance shareholder value with above company average net initial yield (6.8%) and weighted unexpired average lease term (7.8years).

In the absence of a destabilising event, leaving the company no longer being able to source funding or negotiate new acquisitions, it is highly likely that the value of Urban Logistics portfolio will exceed £500M within the next 3 years as they pursue a £300M pipeline.

Active Asset Management

The experienced management team aims to build shareholder value through active asset management of portfolio properties. This management consists of developing the capabilities of properties so that they provide the maximum value, and thus the maximum rental price, to clients. Whilst we do not make a strong judgement on the effectiveness of these investments, we believe that management is well qualified to operate such a policy.

Property Management

Day to day management of Urban Logistics’ portfolio is outsourced to Savills plc. Savills have a strong track record in property management and have similar arrangements with comparable companies such as Warehouse REIT. We are confident in the ability of Savills to meet tenant requirements. Where did we get this from? I can’t find any mention of savills on their reports.Doesn’t savills handle finding tenants and pacific partners the management?

***Market*** ***Environment***

Industry Overview

The warehousing and storage industry is comprised mainly of businesses which own and lease storage facilities which they operate in order to provide storage services for a diverse range of goods. Their main clients typically range from clothing and food retail stores, to manufacturing and third-party logistics (3PL) firms. Over the past few years, however, the main driving force behind industry growth has been the sharp increase in revenue of online retail, which is often logistically based in warehouses. Even though it is currently a relatively small piece in the overall makeup of the industry, online retail sales have played a growing role in the increased demand for storage space within the last 10 years, with e-commerce related take up increasing from 3% in 2012 to 28% in 2018. Demand has also been augmented by the exceptional circumstance of precautionary over-stocking by many pharmaceutical and manufacturing companies due to Brexit related uncertainty (primarily in 2016). As for the distribution of warehouses, most storage facilities are located around populated areas and especially within what is known as the “Golden Triangle” at the centre of the country. This area is particularly sought after due to the fact that goods stored in warehouses within it can be distributed to 90% of the U.K population within 4 hours.

In the 5 years through to 2020, The warehousing and storage industry grew by a compound annual growth rate (CAGR) of 5.7%. The biggest spike during this time was in 2016, again, mainly relating to a response by many firms to Brexit uncertainty. This trend of over-stocking hasn’t necessarily gone away and might persist until the U. K’s position on trade with the E.U becomes clearer. For example, The Department of Health and Social Care have currently asked pharmaceutical companies to maintain a further 6 weeks supply.

Outlook

Overall the warehousing industry is expected to continue growing in the next 5 years, although at a slightly slower pace than in the previous 5. Some analysts predict a steady and consistent CAGR of 3.8% through to 2025. Contribution of the sector to the overall economy is also expected to grow within the next 10 years and outperform the general economy on a value-added basis.

The main driver for this growth will likely be a further increase in online expenditure, with companies such as Urban Logistics forecasting online retail to account for up 25% of their storage capacity by 2022. Factors that might impact the other users of storage space, such as interest rates, consumer confidence, and trade fluctuations are somewhat mitigated by a trend towards longer term contracts which provide certainty for industry revenue.

The increasing importance of so called “last-mile” warehousing is a trend which is also likely to continue into the future for several reasons. While many of the companies who own these warehouses and storage facilities aren’t directly responsible for the distribution of the goods stored within them (although an increasing amount are), the distance between storage facility and delivery location is of prime concern for many of their clients. In a recent survey of senior UK Supply chain professionals, rising fuel costs were identified as one of the industry’s biggest challenges and 72% of these said that demand for shorter delivery times will continue to go up in the future. Additionally, in a 2017 manifesto, the U.K warehousing association released the following statement: “The exponential growth of online retailing coupled with the grocers

refocus on convenience food retail, especially in urban locations, means more warehouse space will be required in and around conurbations to replenish stock in the time frames required”. Combining this with the increase in demand for same day and next-day delivery services, the importance of “last mile” warehouses, with their close proximity to urban areas, becomes apparent.

Main challenges facing the Industry

One of the key issues currently facing the warehousing industry is the lack of available warehouse space and land for further development. Supply of existing warehouse space dropped by 71% from 2009 to 2016, as the economic downturn saw the financing and development of these properties sharply decrease. As a consequence of this, stock was not replenished once occupiers were found. In general, warehousing supply tends to lag behind demand. Industry expert Savills predicts that based on current supply levels and long-term average take up levels, most regions in the U.K have less than a year’s worth of supply left. This situation seems to be aggravated by the U. K’s rising population which Is forcing the government to develop an increasing number of homes around urban areas (their goal is 240,000 homes per year), and which leads them to designate an increasing amount of land around urban areas to residential zoning. This indicates a clear need for increased government support for the industry, not only in the form of logistics-friendly Brexit terms, but especially in the insurance of a continued supply of warehousing units and land available for warehouse development schemes. High quality and affordable warehouse space is becoming increasingly rare, with “last-mile” warehousing space being especially limited due to the compounding effect of all the factors mentioned previously.

Final Remarks

Overall, the U. K’s warehousing industry, propped up by the rapidly increasing demand for online retail sales, will seemingly continue to grow for the next several years. Despite the potential negative impacts of Brexit on the manufacturing and logistics sector, the solvency and profitability of the warehousing industry will likely remain intact thanks to growing demand and longer-term tenancy agreements which are common in the industry. The issue of limited and deficient supply will likely play a key role in the coming years if steps aren’t taken by the U.K government to ensure the availability of further land for development of warehouses surrounding urban areas. However, this lack of supply will likely put upward pressure on rents and present a competitive advantage for those firms who have already positioned their warehouses in locations which are key distribution points into local urban areas, and especially those which fall under the category of “last-mile” warehouses.

***Investment*** ***Thesis***

Current income generation of asset base under-priced by market

Urban logistics’ asset base, notwithstanding of the potential upwards rent adjustments, generates a level of income that is not fully priced by the market. Without accounting for value accretive acquisitions, or for any rental growth above inflation, we find a significant difference (44%) between the implied value of the income generated by the company and the market’s pricing of the company. As value investors we are particularly attracted to this situation as it allows us to buy Urban Logistics stock at a price that necessitates no real growth to imply a significant upside. As long as management can maintain the real value of their properties and the market eventually realises this inefficiency, we believe Urban Logistics’ share price will appreciate towards its implied value.

High potential for upwards rent adjustments

Urban Logistics has high potential for future upwards rental adjustments. As discussed previously, in the market environment section, last mile warehousing is facing serious structural imbalances which most likely will result in a significant increase in warehouse owner’s ability to increase tenant rents. The economic justification for future rent increases is simple; developers are unable, and usually unwilling, to increase the supply of last mile warehouses, yet potential tenants driven by e-commerce are consistently increasing their demand for warehouse space. Therefore ownership of these scarce warehouses, and thus the ability to profit from rental uplifts, is the key competitive advantage of Urban logistics.

Additionally, Urban Logistics’ is currently charging rents that are around 9% lower than the market rate they would achieve if they were to re-let all of their properties today. This reversionary potential puts management in a strong position to negotiate increased rents, as there isn’t a better price available to tenants elsewhere.

For conservatism, our valuation model takes into account no real rental growth, however factoring in only a 1% yield increase (4% to 5%) the implied margin of safety increases to 80%. With convincing economic justifications for this level of growth, we have strong conviction in this thesis.



High potential for profit margin growth

A benefit to shareholders of Urban Logistics’ expansionary path is that it spreads the administrative costs associated with running the company over more assets. The business model of Urban Logistics has high fixed costs, brought about through the sheer cost of operating a functional property company. However, once the company reaches its mature administrative size, as we believe it likely has, these costs will not grow proportionally with the asset base. As expenses related directly to property operation have consistently represented a small proportion of revenue (average 8%) in comparison to administrative costs (average 19%), we expect a widening profit margin as administrative expenses are spread across more revenue. This trend is already reflected in the sustained growth of adjusted (excluding revaluations) net margin since 2018.

Transition to an investable market cap

It is our belief that the market is not truly recognising the future earnings potential of Urban Logistics due to its status as a Micro-Cap company. As a substantial proportion of institutional managers face constraints in regards to investments into Micro-Caps we believe that demand for Urban Logistics’ stock is artificially subdued. We believe that this is the majority of the reason as to why the market is significantly under-pricing Urban Logistics’ stock.

However, as previously described, Urban Logistics has a well-defined plan to grow and will likely pass the threshold for consideration as a small, rather than micro, cap stock. This reclassification alone, which will likely occur within the next 3 years, we believe will significantly reduce the constraints of institutional managers and drive the price towards our intrinsic estimation.

***Financial*** ***Analysis***

Revenue

Urban Logistics’ revenue has followed a healthy growth pattern, largely in line with its assets acquisitions. Revenue is overwhelmingly derived from warehouse rental income. This revenue is bond like in that it is tied to legally binding contracts with a weighted average unexpired lease term of 6.1 years (5.1 excl long leases). This term is in line with direct competitor Warehouse REIT (5.1 years), however is below the average of competitors with more diversified portfolios such as SEGRO (8.9 years) and London Metric (12.5 years). We believe that this is not a cause for concern as the WAULT is within the company’s target range, and strong demand conditions make it likely that at the end of contracts management will be able to secure rental uplifts.

The tenant portfolio is sufficiently diversified, with a wide variety of tenants occupying the Urban Logistics’ warehouses. Companies with strong balance sheets, operating within non-cyclical industries have been selected by management as tenants. 89% of these tenants have been classed, by Dun & Bradstreet, as low/moderate risk.

Costs

**Operating costs:**

Operating costs, whilst historically volatile, we expect to settle in the long run at around 8% of revenue. There is little scope for a decrease in these costs as there is a relatively fixed cost associated with running each warehouse annually.

**Administrative costs:**

Administrative cost, in nominal terms, have grown year on year to £1.8M in 2019. However, as a percentage of revenue, there has been a consistent annual fall in these costs. This supports our thesis that Urban Logistics is nearing its maximum administrative size and therefore, as the asset base expands, this cost will be spread across more £s of revenue.

Source: 2020 Interim Report

Source: 2017-2020 Annual Reports

***Financial*** ***Analysis***

Source: 2017-2020 Annual Reports

Profit margin

Urban Logistics is an extremely profitable company. Excluding revaluations the company had a 2019 net profit margin of 54.9%. Broken down; 93.6% of revenue made it to gross margin, 75.4% then made it to operating margin, and finally after financing expenses 54.9% finally made it to net margin.

As previously stated, we expect this profit margin to increase in coming years as an increased operating margin drags up net margin.

Debt Position

Urban logistics has up to this point used debt sparingly to fund its expansions, instead preferring to issue equity. This has resulted in a strong balance sheet with a long term debt to equity ratio of only 0.62 in 2020(HY). Long term debt, including lease liabilities, now stands at £77.7M, representing a Loan to Value (book) of 34.1%. This gearing is on the low end of its peer group, and below management’s own target of 35%-40%. This allows Urban Logistics optimise financing in their coming expansion.

Financing expense has grown in line with the asset base and subsequent revenue. This cost has on average represented an annual payment of around 3% on outstanding debt. This is in line with our expectation of Urban Logistics’ cost of debt, and we don’t expect it to substantially increase in coming years.

There is very little risk of the company becoming unable to manage debt payments, with operating profit consistently representing around 370% of finance expense.

***Valuation:*** ***Methodology***

As Urban Logistics has only 3 years of financial statements, a period in which it has grown its asset base by over 400%, the financial results of the past aren’t accurately predictive of the company’s future. To combat this problem we have built a customised dividend discount model. This model works by viewing the company as a machine that every year translates a proportion of its asset base (at acquisition cost) into income distributable to shareholders. We view the REIT as purely for income generation and therefore do not factor in any potential gains from property disposals.

In our base case model we make assumptions we believe to be conservative:

1. Annually net income will represent 4% of asset value. We exclude revaluations.
2. 90% of net income will be paid as a dividend each year, as this is the legal minimum for a REIT.
3. Asset value will grow in line with inflation (1.75%) until 2024.
4. Past 2024 asset value will grow at the Bank of England’s 2% target.

Rather than use a WACC or CAPM discount rate, we take the discount rate to be the expected return of a similarly risky security. We believe that risk in Urban Logistics is derived from two sources:

1. The company’s own credit risk (proxied by their cost of debt)
2. The risk of tenant defaults (proxied quantitatively to be in the worst case equal to a BBB rated bond)

An implicit assumption of this model is that future asset growth through acquisitions will neither create nor destroy shareholder value per share. This assumption is based on doubt of our own prophetic ability. Whilst we are confident in management’s ability to create value going forward, we cannot accurately quantify how much value management can add in perpetuity and therefore do not include it in our model.

***Base Case Assumptions***

Our base case valuation attempts to make strongly conservative assumptions as a starting point for quantitative analysis. Below explain each one of these assumptions, clarifying the justification for each and why we believe they are conservative. Are assumptions are as follows:

**Net income 4% of Asset Value**: This assumes that Urban Logistics’ assets will earn 4% of their value each year, after subtracting all costs associated with the operation of the company. We believe that this is a reasonable assumption as we have observed that in 2019, a year in which the asset base (at acquisition cost) expanded by 34% and thus a third of assets weren’t earning for the full 12 months, Urban Logistics was able to generate 3.65% of net income as a percentage of asset value . Additionally with a demand/supply imbalance driven by secular demand shifts and a 9% reversionary buffer, we believe this 4% figure to be suitably conservative.

**1.75% growth until 2024**: Urban logistics has written up the value of its portfolio by an average of 16.4% in the past 2 years. Whilst we exclude these write ups from our analysis, if the true increase in asset value is only a quarter of what has been recorded, we are still underestimating by about 2.5%.

**2% growth after 2024:** This assumption implies that the real value of assets will see no growth. Without a radical disruption of the logistics industry, it seems likely that supply will continue to face physical and administrative constraints that stop it from matching e-commerce driven demand. This is an issue of a fixed maximum supply that simply can’t expand fast enough to meet the unlimited potential growth of demand. Therefore we conclude that it is highly likely that our base case assumption is too conservative and the asset base will in fact see real appreciation in value.

**Future acquisitions are value neutral**: Management have to this point been able to leverage their industry experience and contacts to acquire properties at well below replacement cost. These acquisitions have continually been well executed and value accretive to shareholders. Therefore we believe it is particularly conservative to assume that, from this point onwards, management will be incapable of adding value to shareholders

***Valuation Results***

**Base Case:**

We believe that our base case is a conservative starting point. As previously explained it assumes net income will represent 4% of asset value annually, 1.75% asset base growth until 2024, and 2% growth after 2024. The gain in this scenario is 44%.

**Super Bear:**

This is a worst case scenario which assumes net income will fall to 3% of asset value annually, 1.75% asset base growth until 2024, and no nominal growth after 2024. The loss in this scenario is 28%.

**Bear:**

The bear scenario assumes that net income remains at 4% of asset value, 1.75% asset base growth until 2024, and no growth at all after 2024. The loss in this scenario is 4%.

**Bull:**

The bull scenario assumes net income remains at 4% of asset value, 1.75% asset base growth until 2024, and 3% growth after 2024. The gain in this scenario is 100%.

**Super Bull:**

This is a best case scenario which assumes net income increases to 5% of asset value, 1.75% asset base growth until 2024, and 3% growth after 2024. The gain in this scenario is 150%.

|  |  |  |
| --- | --- | --- |
| **Case** | **Implied Value** | **Margin of Safety** |
| Super Bear | £1.04 | -28% |
| Bear | £1.39 | -4% |
| Base | £2.08 | 44% |
| Bull | £2.90 | 100% |
| Super Bull | £3.62 | 150% |

**Discount rate = 5.26%**

***Discussion*** ***of*** ***Results***

Downside Scenarios

We believe that our bear cases are unlikely and require some form of disruption to Urban Logistics business model and the last mile warehouse industry as a whole.

 A fall in earnings yield, as occurs in the super bear case, is likely only if the industry faces serious disruption. This is most likely to occur if there is technological advances that render the warehousing model obsolete, however may also occur in a host of other scenarios such as a change to zoning laws that allows for supply to begin to outstrip demand.

No nominal growth after 2024 effectively assumes that management, or industry conditions, become incapable of increasing the value of assets. With a trailing 5 year CAGR of 5.7% to 2020, and analyst predicting a further 3.8% CAGR up to 2025, it seems unlikely that growth in the industry will entirely stop after 2024. Again the cases in which this assumption will occur are extreme. Without significant disruption from either the demand or supply side of the industry, the natural imbalance between these two forces will continue to push up asset values at least in line with inflation.

Conclusion

From our analysis of Urban logistics we conclude that the upside potential of Urban Logistics heavily outweighs the downside. As discussed above we believe that our bear case scenarios are likely only to occur in the face of exogenous shocks to the industry that we can’t predict or foresee. Whereas we believe our upside scenarios are the results of strongly evidenced secular shifts.

From a value investment perspective the company exhibits highly attractive characteristics:

1. It has an easily quantifiable asset base and revenue stream.
2. It operates in an industry that is insulated from economic shocks.
3. Its product is unlikely to ever become obsolete.
4. It serves an expanding market in which supply faces hard constraints.
5. Management is experienced and well aligned.
6. It is significantly under-priced.

**Risk to Thesis**

**Threats to sector:**

*Consolidation of the market by major players, e.g. Amazon*

There is the potential for a fall in demand for Urban Logistics’ warehouse space brought about by consolidation of the retail market by a major player, most likely Amazon. In the future it is possible that retailers, that currently make up Urban Logistics’ tenant bases, are attracted to Amazon’s retail portal and a network of warehouses owned by Amazon. This would require a vast expansion of Amazon’s current ownership of warehouses.

*Overestimating impact of e-commerce on growth*

There is the possibility that we are misinterpreting the demand derived from the business cycle/ Brexit stockpiling as proof of a growth in ecommerce related demand. If this is the case then our assumptions on future growth and rental yields are misleading.

*e-commerce related demand sensitive to economic downturns*

At this stage it is difficult to predict how sensitive e-commerce retail is to economic downturns. If demand is sensitive and in future the proportion of tenants reliant on e-commerce represents a majority of Urban Logistics income, then our assumption of future tenant risk is likely wrong.

*Generic recession/Brexit threat*

Falling Vacancy rates and rising rents may, instead of representing a secular shift, be the symptoms of an overheating market. If we have misinterpreted these signs and last mile warehousing is indeed headed towards recession, then our conviction in rising rents is misplaced.

*A paradigm shift away from last-mile-friendly business models*

An example of this would be increasing environmentalism leading to a fall in the acceptability of one/same day delivery. This would significantly reduce demand for last mile warehousing space and significantly disrupt the business model of companies such as Urban Logistics.

**Threats to Urban Logistics:**

*Massive increase in zoning allocated to last mile warehousing, oversupply that bigger players are more able to take advantage of:*

As predicted by UKWA, if there was an increase in last mile zoning there would likely be a proliferation of acquisition activity. As a relatively small company, without the ability to raise as much debt as larger competitors such as SEGRO, Urban Logistics would be at a significant disadvantage relative to its competitors as it would be forced to instead go through the slower process of raising equity.

*Short WAULT relative to competitors*

The Weighted average unexpired lease term of Urban Logistics (5.1 years to first break & 4.4 years excluding a single long lease non last mile asset) is significantly lower than many competitors. Almost a third of leases expire within three years, and therefore if management is not able to negotiate rental uplifts as expected, Urban Logistics will quickly face a falling occupancy rate.

*Capital Values near replacement costs*

Capital values are currently around £80 per sqft, whilst replacement cost is around £120 sqft. This differential allows management to operate its investment policy of pursuing acquisitions at 30%-70% of replacement cost. As the market adjusts to raise capital values to around replacement costs, there is the threat that management continues its expansionary policy outside of the 30%-70% range. If management does pursue an empire building approach to expansion, rather than attempting to maximise shareholder value, the ability of Urban Logistics to generate returns for shareholders will significantly diminish.

*Management Leave their roles*

The ability of Urban Logistics to acquire properties at 30%-70% of their replacement cost, and engage in value accretive asset management, relies heavily on the capability and experience of management. If the current management team were to leave for any reason this could significantly reduce the company’s ability to continue to generate returns for shareholders.

**Potential of analysis error**

It is additionally possible that we have come to the wrong conclusions on Urban Logistics. This may have occurred due to our misinterpreting or lack of discovery of crucial piece of information. Whilst we strongly believe in the validity of our analysis, and conclusions reached, there is always the possibility for research errors.

***Appendix***

**Competitors**:

**Warehouse Reit**

Warehouse REIT, along with Urban Logistics, is the UK company most exposed to last mile warehousing. It owns 6.2 million sqft of last mile warehouses and is well diversified across the uk with two thirds of asset split between the Midlands and South East, and the rest split between North England, Scotland and Northern Ireland.

**Segro**

Segro is the biggest player in the UK warehousing space, with ownership of both big box and last mile warehouses. It owns 84 million sqft of total space, with 16.6 million sqft urban warehousing in UK, 11.3million sqft of urban warehousing in Europe. The majority of the remaining space is big box warehousing. Segro is heavily exposed to London (>50% exposure by value), with almost no representation in the rest of UK.

**LondonMetric**

London Metric is actively transitioning from a retail and big box focus, to a higher exposure of last mile warehousing. It owns 3.3 million sqft urban warehousing, and 13 million sqft of total space.

They are Exposed to the South East (45%), Midlands(30%) and evenly distributed across rest of UK

**Tritax Big Box**

Tritax Big Box own both warehousing and land assets. It is purely focused on big box warehouses and owns some of the only big box last mile warehouses in the UK. If its land assets are fully developed they have potential for growth that is not priced by the market, however without inside knowledge it is difficult to quantify the value of their land holdings. It owns 1.5mm sqft of last mile warehousing out of its 30.9 million sqft portfolio. They are relatively evenly distributed across the UK, with the most exposure to the Midlands. We wouldn’t classify them as a direct competitor to Urban Logistics, due to their primary ownership of big box assets.

**3PL**

Third party logistics companies such as Amazon, DHL, XPO etc. have been buying properties at an increasing rate, typically with a growth rate higher than that of which they are increasing leased properties. No exact numbers could be sourced for the pace of this growth, but it represent only a small proportion of the overall last mile warehousing space in the UK.

***Appendix***



***Appendix***

# Historical Performance, Strategy & Management

## Historical Performance

***Stock Price Performance***



*Source: Orbis*

The share price has increased by 35% since the IPO in April 2016, which corresponds to an annualised return[[1]](#footnote-1) of approximately 11.8%.

***Dividends***

|  |  |  |  |
| --- | --- | --- | --- |
| *In £ pence* | *Year ending 31/03/19* | *Year ending 31/03/18* | *Year ending 31/03/18* |
| *Dividends paid* | 7.0 | 6.32 | 6.0 |
| *Growth rate* | 10.8% | 5.33% | - |

*Source: 2019 and 2017 Annual Reports*

Both stock price and dividends have steadily increased in the last 3 years, suggesting a good – although brief – overall performance of Urban Logistics REIT. Given that DUSIF’s investment horizon is significantly longer than 3 years, this performance should not be considered to be a proof of Urban Logistics’ value, but rather a sensitivity test on its overall stability.

## Strategy

Urban Logistics aims to find well located single-let “last mile” and “middle box” logistics properties and to actively manage these assets to create value for both investors and tenants.

As part of their strategy Urban Logistics also buy and sell real estate assets. Recently Urban Logistics has disposed of 3 properties with an average profit over cost of 57%, which added with the income return during the ownership of the property implies a total property return of 50%.

Nuneaton

*“The building was purchased as part of a portfolio in September 2017 for £6.7 million. The unit was acquired with vacant possession and was subject to a rent guarantee until September 2019. The property was sold to an owner occupier, Cofresh Limited, in April 2019 and realised a Total Property Return of 23%.”* Interim report September 2019

Postley Road, Bedford

*“This property was purchased at IPO in 2016 for £5.6 million and comprises four industrial units with a piece of development land. After extensive asset management, increasing rents and lease terms, the fully occupied site was sold in May 2019 for £9.1 million and realised a Total Property Return of 73%. The land element has been retained and the purchaser has an option to acquire it for £0.5m if planning for redevelopment is granted.”* Interim report September 2019

***Going forward***

Urban Logistics is forward funding, along with a developer, three sites in the Midlands to turn them into six urban logistics warehouses.

“*The Company has received strong interest from prospective tenants and expects that both sites will be fully pre-let by the time of practical completion […] The intention is for the sites to be built and let the second quarter of 2020. They are both well-located and near key arterial routes.*” 2019 Annual Report and Interim report September 2019

Urban Logistics has recently acquired eight new properties which present opportunities to add value by efficiently managing the assets:

Tuffnells portfolio

*“On 27 September 2019, a portfolio of parcel depots was acquired for £9.9 million. The acquisition was sourced at a net initial yield of 7.0%. The properties are close to established regional transport hubs in last-mile locations. These well specified parcel delivery hubs are leased to Tuffnells Parcel Express Limited, a business-to-business distributor specialising in irregular dimensions and weights, on fully repairing and insuring leases.”* Interim report September 2019

Thatcham and Sittingbourne

“*The Group acquired two logistics properties in Sittingbourne and Thatcham for a combined consideration of 5.3 million at a 5.9% blended net initial yield. The acquisitions further extend our portfolio’s weighting across the South East of England where there is a chronic shortage of logistics properties in our size range. Both properties are let to DHL’s UK Mail business.”* Interim report September 2019

Pipeline

*“We seek to identify markets with high performance characteristics. For example, the East of England has just 3 months of supply in the 100-200,000 sq. ft. range. We note that 70% of 2018 take up was within this size range and we have a number of assets in our pipeline located in this region. Through our track record and experience, we are well-placed to continue sourcing attractive new opportunities and have a strong pipeline of similar product to our current portfolio.”* Interim report September 2019

Therefore, Urban Logistics appears well positioned to exploit the lack of supply in the industrial warehousing market as well as continue to manage assets to add value to shareholders.

## Management

***Governance Structure***

“The Board is responsible for determining strategy, investment policy and overseeing the Company’s performance and business conduct. The Board is also responsible for supervising our Manager, Pacific Capital Partners Limited. […] The Board has delegated day-to-day responsibility for running the Company to the Manager who deals with all the property transactions including ongoing asset management. A report is received from the Manager at each Board meeting. The Management Engagement Committee formally reviews the Manager’s performance each year, to allow the Board to state, if appropriate, that the Manager’s continued appointment is in the shareholders’ interests. […] Under the Investment Management Agreement, the Board has delegated day-to-day responsibility for running the Company to the Manager who deal with all the property transactions. They are supported administratively by appropriate people from the Manager’s professional staff. Richard Moffitt and Christopher Turner are the principle members of the team and report to the Board at each meeting and other members of the management team attend as required. The Manager regularly uses for its purchase and sales of assets, M1 Agency LLP, a limited liability partnership in which Richard Moffitt has an interest. The fees for each transaction are reviewed by the Board and Manager excluding Richard Moffitt to ensure that the fees payable are in line with market fees and practice. The total fees paid in the year amounted to £1.1 million. The Board formally reviews the Manager’s performance each year, to allow the Board to state, if appropriate, that the Manager’s continued appointment is in shareholders’ interests. The Investment Management Agreement was extended in July 2018 so that it now runs through to April 2024. This ensures continuity of the relationship with the Manager.

All other key terms of the agreement remain unchanged.” 2019 Annual Report

***The Board***

|  |  |  |  |
| --- | --- | --- | --- |
| **Board Member** | **Role** | **Experience** | **Education** |
| *Nigel Rich CBE* | *Non-executive Chairman* | * *Group Chief Executive of Trafalgar House plc from 1994 to 1996.*
* *20 years at the Jardine Matheson Group in Asia*
* *Chairman of the Board of Segro plc, from October 2006 until April 2016*
 | NA |
| *Richard Moffitt* | *Director* | * *Previously Head of Industrial and Logistics at CBRE. 25 years’ experience of the UK Industrial and Logistics markets*
 | NA |
| *Jonathan Gray* | *Non-executive Director* | * *Worked in senior roles at HSBC, UBS and NCB*
* *Non-Executive Chairman of PGF II SA, a London based £200 million private property fund*
* *Currently works as a financial advisor/ consultant to a variety of international companies*
 | NA |
| *Bruce Anderson* | *Non-executive Director* | * *Worked in senior roles at Lloyds, HBoS and Bank of Scotland, with 15 years of investment-led boardroom positions*
* *Currently a Non-Executive Director at Green Property Limited.*
 | Abertay University, BA in Accountancy |
| *Mark Johnson* | *Director* | * *Co-founded Pacific Investments Management Limited (“Pacific Investments”) with Sir John Beckwith*
* *Previously CEO of the Riverside Group*
* *Founding partner and shareholder/Director of Pacific’s investment portfolio and private equity companies*

*(including Barbican Healthcare Plc, Sports & Outdoor Media International Plc, Liontrust Asset Management Plc, Thames River Capital LLP, River and Mercantile Group Plc, Argentex LLP and Pacific Asset Management LLP.)* | NA |

*Source: 2019 Annual Report*

***Executive Pay***



*Source: 2019 Annual Report*

The remuneration appears to, by and large, align the interests of the Board of Directors with those of the Shareholders. However, the compensation of two directors remains unclear.

Richard Moffitt has an interest in M1 Agency LLP, which is a company used for the purchase and sale of assets, thus it is unclear whether Moffitt’s salary is paid through M1 Agency LLP. The economic agreement between M1 Agency LLP and Urban Logistics is also unclear as only the total amount of fees, and not the precise fee arrangement, is stated in the annual reports. Suspicions thus arise for Mark Johnson’s remuneration package as it might also not be fully disclosed in the annual reports.

In light of the above due diligence screening a thorough enquiry into Urban Logistics’ governance structure is suggested to fully understand the interests of the directors as well as shed light on to whom is responsible for the day to day running of the firm besides Moffitt and Johnson (the only people on the board which appear to have executive roles).

1. Annualised returns are calculated as follows: Annualised return = (1 + cumulative return)365/days held – 1 [↑](#footnote-ref-1)