Supermarket Income REIT

Equity raise completed

Successful equity issue and strong pipeline

Real estate

With a strong pipeline of investment opportunities that meet Supermarket Income REIT's (SUPR's)strict investment criteria, we anticipate a swift deployment of the proceeds of its just completed £153m (gross) equity raise, as has been the case with previous issues since IPO. The recent H121 results provided evidence of both the financial benefits of increased scale and the key role of omnichannel stores in supermarket distribution strategies.

Year end	Rental income (£m)	EPRA earnings (£m)	EPRA EPS* (p)	EPRA NTA**/ share (p)	DPS (p)	P/NTA (x)	Yield (%)
06/19	17.2	9.9	5.0	97	5.63	1.11	5.3
06/20	26.4	16.8	5.0	101	5.80	1.06	5.4
06/21e	47.6	40.5	6.2	103	5.86	1.04	5.5
06/22e	68.9	58.3	7.2	106	5.98	1.01	5.6

Note: *EPRA EPS is normalised, excluding gains on revaluation. **EPRA net tangible assets.

Growth driving scale and diversification benefits

SUPR's latest equity fund-raising was again well received, with the size of the issue upscaled from £100m to £150m (£153m including the PrimaryBid offering), at 106p per share. The pipeline of investment opportunities is strong, including sales by funds seeking to meet redemption requests or investors seeking to recycle capital. SUPR says this provides an opportunity to deploy capital at attractive prices despite a general tightening in valuation yields; and it believes that tightening has much further to go. Our revised estimates assume deployment of the equity proceeds by end-FY21 with a further £100m of debt-funded deployment by end-Q122. The recent H121 results, already overtaken by continuing portfolio growth, demonstrated the benefits of scale and diversification. Rental income increased 71% to £20.4m, fully collected, and EPRA earnings by 116% to £15.5m; EPRA earnings cover of increased DPS rose to 112%. With the net initial yield on directly owned stores tightening from 5.0% to 4.7%, H121 EPRA NTA per share of 104p positively surprised us and lifts our NTA forecasts, based on unchanged yields.

Visible income and growth potential

The supermarket sector has been a net beneficiary of the pandemic, with all the main operators experiencing strong grocery sales growth, driven by online channels and mainly fulfilled by omnichannel stores (combining in-store and online fulfilment), of the type targeted by SUPR. Upwards-only, predominantly inflation-linked rent uplifts and long leases provide visible income potential, while the strong and improving financial position of the store operators adds income security and is supporting yield tightening, delivering capital growth. Supermarket property has a long record of positive total returns underpinned by stable income returns, and the strength of tenant covenant is reflected in rental income due being collected in advance with no defaults, deferrals or rent reductions.

Valuation: Secure, growing income

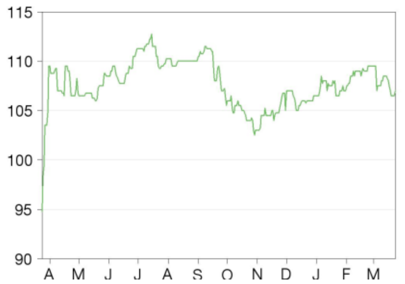
SUPR's FY21 aggregate DPS target of 5.86p represents an attractive prospective dividend yield of 5.5% with visible potential for growth. Compared with a group of other long income-focused REITs, its yield is above average with a similar P/NAV.

24 March 2021

Price	**107p**
Market cap	**£867m**

Net debt (£m) as at 31 December 2020	177.3
Adjusted net LTV as at 31 December 2020	25.3%
Shares in issue	810.4m
Free float	99%
Code	SUPR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.3)	1.4	17.3
Rel (local)	(3.5)	(2.2)	(16.2)
52-week high/low		113p	95p

Business description

Supermarket Income REIT, listed on the special funds segment of the London Stock Exchange, invests in supermarket property, primarily let to leading UK supermarket operators, on long, inflation-linked leases. The investment objective is to provide an attractive level of income, with the potential for capital growth, with a 7–10% pa total shareholder return target over the medium term.

Next events

FY21 period end	30 June 2021

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Edison profile page

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Successful equity raise and strong investment pipeline

Strong investment pipeline

At the time of launching the share issue in early March, the investment adviser had identified a number of attractive acquisition opportunities across the marketplace, including:

- four assets with an aggregate value of approximately £230m (the 'Target Assets') on which the investment advisor has undertaken its own preliminary due diligence and negotiations. It was disclosed that these assets all support physical and online sales channels and benefit from long leases, with a weighted average unexpired lease term of 12 years and expected net initial yields broadly in line with the existing portfolio.
- a further pipeline of nine assets with an aggregate value of approximately £184m that meet SUPR's strict acquisition criteria (the 'Pipeline').

Taken as a whole, the Target Assets and the Pipeline provide visibility on current market pricing and multiple investment opportunities for capital deployment. Moreover, the investment adviser continues to exploit its market knowledge to explore additional potential investments. In current market conditions this is likely to include sales by investment funds to meet redemption requests or investors seeking to recycle capital, and this is providing SUPR with the opportunity to deploy capital at yields that are in many cases above prevailing market averages, continuing to meet its investment objectives. The company's decision to increase the size of the equity raise recognised the investment advisor's confidence in executing on the pipeline as well as the strong level of support from investors. Indeed, the investment advisor has commented that during the roadshow period it saw an increase in attractive investment opportunities and therefore expects to be able to deploy the equity proceeds efficiently. The £200m (gross) proceeds of the October 2020 equity raise were deployed by January 2021, continuing a strong track record of deployment since IPO.

Forecast update

When we last published, in February 2021, we note that SUPR had substantially committed its available equity and debt funding headroom based on its medium-term loan to value ratio (LTV) target of 30–40%; although there remained significant flexibility within the expanded debt portfolio to fund further investment should SUPR choose to. SUPR subsequently completed the acquisition of a Tesco supermarket in Prestatyn, North Wales, for £26.5m (before acquisition costs) taking aggregate acquisition spending thus far in H221 to £146.1m (before acquisition costs) at a blended net initial yield of just more than 5% (H121 store portfolio blended average net initial yield 4.7% or 4.8% including ancillary assets).

Our revised forecasts include the equity raise and deployment of the proceeds including associated gearing. We have also adjusted for the interim results, primarily in respect of the portfolio yield compression, driving stronger valuation gains and NAV growth than we had allowed for.

On top of the disclosed acquisitions above we assume:

- £150m (before costs) is invested by end FY21 (ie end-June 2021), swiftly deploying the proceeds of the equity raise;
- an additional £100m is invested by the end of Q122 (ie end-September 2021) as the additional equity is geared up to 40%; and
- an average net initial yield on acquisitions of 4.9%.

A summary of our revised estimates is shown in Exhibit 1 and can be seen in detail in the Financial summary (Exhibit 3). We have made no change to our DPS growth forecasts with post-deployment EPRA dividend cover remaining strong at c 120% in FY22e and FY23e. Adjusted dividend cover, which conservatively strips out the non-cash JV earnings contribution, increases as a result of the larger share of directly owned assets. On this basis we now expect effectively full cover by FY23 (99% versus 94% previously). Increased EPRA NTA per share reflects the portfolio valuation gains reported in H121. Our forecasts are based on unchanged yields although we note that the investment advisor anticipates that the yield shift apparent in H121 is likely to continue.

Exhibit 1: Key forecast changes

	Rental income (£m)			EPRA earnings (£m)			EPRA EPS (p)			EPRA NTA/share (p)			DPS (p)		
	New	Old	Chg.	New	Old	Chg.	New	Old	Chg.	New	Old	Chg.	New	Old	Chg.
06/21e	47.6	46.7	2%	40.5	39.6	2%	6.2	6.4	-4%	103	98	5%	5.86	5.86	0%
06/22e	68.9	54.9	25%	58.3	48.3	21%	7.2	7.2	-1%	106	102	4%	5.98	5.98	0%
06/23e	71.7	56.0	28%	59.9	49.1	22%	7.4	7.4	0%	110	106	4%	6.10	6.10	0%

Source: Edison Investment Research

Brief overview of interim results

Although the H121 results were dominated by the continuing strong growth in the portfolio (discussed at length in our February Outlook note), the underlying performance of the portfolio remained strong, including upwards-only, predominantly inflation-indexed rent uplifts, full rent collection and a strong increase in property valuation, sufficient to more than offset property acquisition costs. Valuation growth was driven by yield tightening, reflecting strong investor interest in supermarket properties and the strengthening tenant covenant. The supermarket sector has been a net beneficiary of the pandemic, and has seen a strong increase in grocery sales volumes, particularly online and through omnichannel stores, on which SUPR focuses, in particular.

Exhibit 2: Summary of H121 financial performance

£m unless stated otherwise	H121	H120	H120/H1/19	FY20
Total rental income	20.4	11.9	71%	26.4
Administrative & other expenses	(4.1)	(2.3)	80%	(5.2)
Operating profit before investment property change in fair value	16.3	9.6	69%	21.2
Net finance expense	(3.7)	(2.5)		(4.9)
Adjusted EPRA earnings	**12.6**	**7.2**	**75%**	**16.3**
Share of income from joint venture (exc. revaluation gains)	2.9	0.0		0.5
EPRA earnings	**15.5**	**7.2**	**116%**	**16.8**
Negative goodwill	0.0	0.0		3.0
Change in fair value of investment properties	15.5	0.6		13.1
Change in fair value of investment properties within JV	2.0	0.0		0.0
IFRS earnings	**33.0**	**7.8**	**325%**	**32.8**
Period end number of shares	665.9	337.9	97%	473.6
Average number of shares	561.4	285.4	97%	334.2
Basic & diluted IFRS EPS (p)	5.9	2.7		9.8
EPRA & diluted EPS (p)	**2.8**	**2.5**	**10%**	**5.0**
DPS (p)	**2.93**	**2.88**	**2%**	**5.80**
Dividend cover	**112%**	**90%**		**85%**
Adjusted dividend cover	**91%**	**90%**		**83%**
Gross assets	1,011.6	504.2		617.5
Investment properties	885.3	490.4		539.4
Net assets	691.8	328.0		477.2
EPRA NTA per share (p)	104	97		101
Net balance sheet debt	(239.2)	(158.7)		(106.4)
Adj. LTV (includes JV equity)	25.3%	32.4%		17.9%

Source: Supermarket Income REIT data

Given the continuing rapid growth of the portfolio, both in the period since end-H121 but also prospectively as the equity raise proceeds are deployed, we do not intend to dwell on the H121 results in detail. We note however:

- £315m of capital deployment, taking gross assets above £1bn.
- Growth in annualised passing roll to £46.0m from £28.8m at end-FY20.
- Despite the annualised impact of this growth in rent roll not being fully captured in H121, total rental income earned during the period increased 71% y-o-y and was at 77% of the full year FY20 level.
- Operational gearing was demonstrated by the more than doubling of EPRA earnings to £15.5m, more than 90% of the full-year FY20 level. Excluding the non-distributed profits from the Sainsbury's Reversion Portfolio joint venture, adjusted EPRA earnings increased 75%.
- Dividends continued to increase with RPI-inflation, as they have done each year since IPO, and dividend cover increased on both an EPRA earnings basis (112% cover) and an adjusted EPRA earnings basis (91%).
- A like-for-like portfolio valuation increase of 5.5% added 5.1p to NTA per share, more than double to the 2.4p cost of acquisitions, and overall NTA per share increased to 104p (FY20: 101p). Including DPS paid the six-month EPRA NTA total return was 5.9%.

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Exhibit 3: Financial summary

Year ended 30 June	2018	2019	2020	2021e	2022e	2023e
£m						
INCOME STATEMENT						
Rent receivable	8.5	16.9	25.5	45.8	66.3	69.0
Rent smoothing adjustment	0.5	0.4	0.9	1.8	2.6	2.7
Total rental income	8.9	17.2	26.4	47.6	68.9	71.7
Administrative & other expenses	(2.1)	(3.1)	(5.2)	(8.7)	(9.7)	(10.1)
Operating profit before investment property change in fair value	6.8	14.1	21.2	38.9	59.2	61.5
Change in fair value of investment properties	(4.1)	0.6	13.1	1.1	16.2	23.6
Share of profit of jv	0.0	0.0	0.5	9.7	11.0	11.0
Negative goodwill	0.0	0.0	3.0	0.0	0.0	0.0
Operating profit/(loss)	2.8	14.8	37.7	49.6	86.5	96.2
Net finance expense	(1.9)	(4.2)	(4.9)	(8.0)	(11.9)	(12.6)
Profit/(loss) before tax	0.8	10.6	32.8	41.6	74.6	83.5
Tax	(0.2)	(0.0)	0.0	0.0	0.0	0.0
Profit/(loss) for the period	0.6	10.6	32.8	41.6	74.6	83.5
Adjust for:						
Changes in fair value of investment property	4.1	(0.6)	(13.1)	(1.1)	(16.2)	(23.6)
Negative goodwill	0.0	0.0	(3.0)	0.0	0.0	0.0
EPRA earnings	4.7	9.9	16.8	40.5	58.3	59.9
Share of profit of jv	0.0	0.0	(0.5)	(9.7)	(11.0)	(11.0)
Adjusted earnings	4.7	9.9	16.3	30.9	47.3	48.9
Closing number of shares (m)	184.4	239.8	473.6	810.4	810.4	810.4
Average number of shares in issue (m)	124.2	198.1	334.2	653.0	810.4	810.4
IFRS EPS (p)	0.5	5.3	9.8	6.4	9.2	10.3
EPRA EPS (p)	3.8	5.0	5.0	6.2	7.2	7.4
Adj EPS (p)	3.8	5.0	4.9	4.7	5.8	6.0
DPS declared (p)	5.50	5.63	5.80	5.86	5.98	6.10
EPRA earnings/dividends paid	103%	92%	85%	115%	121%	122%
Adj. earnings/dividends paid	103%	92%	83%	87.3%	98.2%	99.4%
BALANCE SHEET						
Investment property	264.9	368.2	539.4	1,185.9	1,310.7	1,337.0
Associate	0.0	0.0	56.1	123.4	134.4	145.4
Other non-current assets	0.0	0.0	56.1	123.4	134.4	145.4
Total non-current assets	264.9	368.2	595.5	1,309.3	1,445.1	1,482.4
Trade & other receivables	1.0	3.5	1.7	2.7	3.5	3.6
Cash & equivalents	2.2	9.9	20.4	(23.4)	19.3	17.0
Other current assets	0.0	0.0	(0.0)	0.5	0.5	0.5
Total current assets	3.3	13.4	22.1	(20.2)	23.3	21.1
Deferred rental income	(1.7)	(3.5)	(5.2)	(9.4)	(9.4)	(9.4)
Current tax liabilities	(0.2)	(0.2)	0.0	0.0	0.0	0.0
Trade &other payables	(1.5)	(2.6)	(6.4)	(8.1)	(10.6)	(10.8)
Total current liabilities	(3.4)	(6.4)	(11.6)	(17.6)	(20.0)	(20.2)
Bank borrowings	(88.1)	(143.7)	(126.8)	(440.4)	(590.9)	(591.4)
Interest rate derivatives	0.0	(1.1)	(2.0)	(2.2)	(2.3)	(2.3)
Total non-current liabilities	(88.1)	(144.8)	(128.8)	(442.6)	(593.2)	(593.7)
Net assets	176.7	230.5	477.2	828.9	855.2	889.6
IFRS NAV per share (p)	96	96	101	102	106	110
EPRA NAV per share (p)	96	97	101	103	106	110
CASH FLOW						
Net cash from operations	8.1	13.9	26.9	41.4	58.3	59.0
Acquisition & investment in investment property	(268.7)	(91.1)	(157.3)	(643.6)	(106.0)	0.0
Investment in associate	0.0	0.0	(52.6)	(57.6)	0.0	0.0
Other investing activity	0.0	0.0	0.0	(0.5)	0.0	0.0
Net cash from investing activity	(268.7)	(91.1)	(209.9)	(701.7)	(106.0)	0.0
Share issuance (net of costs)	180.9	43.9	234.8	345.6	0.0	0.0
Debt drawn/(repaid)	88.8	56.1	(16.2)	314.8	150.0	0.0
Interest paid and other financing costs	(2.3)	(4.3)	(5.6)	(8.6)	(11.4)	(12.1)
Dividends paid	(4.6)	(10.9)	(19.6)	(35.3)	(48.2)	(49.2)
Net cash from financing activity	262.8	84.8	193.4	616.5	90.4	(61.3)
Change in cash	2.2	7.7	10.5	(43.7)	42.7	(2.3)
Opening cash	0.0	2.2	9.9	20.4	(23.4)	19.3
Closing cash	2.2	9.9	20.4	(23.4)	19.3	17.0
Debt as per balance sheet	(88.1)	(143.7)	(126.8)	(440.4)	(590.9)	(591.4)
Net debt	(85.9)	(133.8)	(106.4)	(463.8)	(571.6)	(574.4)
Adjusted LTV (including JV equity)	32.4%	36.3%	17.9%	35.4%	39.6%	38.7%

Source: Supermarket Income REIT historical data, Edison Investment Research forecasts

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