

LXi REIT

Acquisitions update

Swift and accretive capital deployment

Less than two months after closing its most recent, c £100m (gross) upsized equity placing, LXi REIT has substantially deployed the equity proceeds in accretive acquisitions. Further assets are in solicitors' hands. Full rent collection underpins the FY22 DPS target, a new high level since listing in February 2017, and we forecast portfolio growth and inflation-protected rents to drive further growth in DPS and net asset value.

Year end	Rental income (£m)	Adjusted earnings* (£m)	Adjusted 'cash' EPS** (p)	EPRA NTA per share (p)	DPS (p)	P/NTA (x)	Yield (%)
03/20	38.5	30.5	5.2	124.3	5.75	1.19	3.9
03/21	42.8	39.2	5.5	125.7	5.55	1.18	3.8
03/22e	61.1	50.9	6.1	136.0	6.00	1.09	4.1
03/23e	68.6	56.6	6.7	141.3	6.20	1.05	4.2

Note: *Adjusted for gain/losses on investment properties, other fair value movements and licence fee income on forward funding extended. **Excludes non-cash IFRS adjustments that are included in adjusted earnings.

Earnings, DPS cover and net asset value enhanced

On 1 July, LXi closed its c £100m (gross) equity placing, upsized from £75m, with c £3m raised in a PrimaryBid offer targeted at retail investors. A substantial portion of the proceeds have been swiftly deployed into acquisitions amounting to £80m, at an accretive average yield of 5.25%. All are let on long leases to strong tenants, in robust sectors, with inflation-linked or fixed uplift rents. The unaudited EPRA NTA per share at 1 June was 130p, up 3.4% since end-FY21. It included valuation gains across the portfolio, particularly industrial assets and recently (pre-placing) acquired assets, reflected in a portfolio net initial yield of 4.7% (end-FY21: 4.9%). Our updated forecasts include our expectation of an additional £80m of deployment funded by existing debt, taking LTV towards 30%. Our FY23e 'cash' EPS increases c 3%, enhancing DPS cover and EPRA NTA per share by c 5%.

Diversified and active long income strategy

With 95% of end-FY21 rents subject to fixed or index-linked, upward-only increases, LXi offers significant income protection against inflation. An end-FY21 average 22-year unexpired lease term and strong tenants add to income visibility and should smooth out volatility in capital values. The company's multi-sector approach differentiates it from many specialist peers, spreads risks and broadens its universe of investment opportunities. The experienced investment advisor continues to demonstrate an ability to source attractively priced assets to enhance income and net asset value – often off-market, smaller lot size, sale and leaseback transactions and forward-funded development schemes. Capital recycling provides firm evidence of this, generating capital gains and allowing redeployment into accretive acquisitions at higher yields.

Valuation: Covered, growing, inflation protected DPS

The FY22e DPS represents an attractive prospective yield of 4.1%, with strong prospects for inflation-protected growth. We forecast DPS to be fully covered by cash earnings and well covered by EPRA earnings, supporting the c 14% premium to unaudited 1 June 2021 EPRA NTA per share.

Real estate

23 August 2021

Price 148p
Market cap £1,036m

Net debt (£m) at 31 March 2021	105.2
Net LTV at 31 March 2021	11.2%
'Pro-forma' net LTV at 31 March 2021	22.8%
Shares in issue	699.8m
Free float	99.3%
Code	LXI
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	3.5	8.4	37.2
Rel (local)	(0.3)	6.3	12.7
52-week high/low		148p	105p

Business description

LXi REIT is an externally managed UK REIT investing in high-quality, smaller lot size (£5–15m) assets, let on long index-linked leases to strong financial covenants across a range of sectors with defensive characteristics. It aims to provide a secure and growing income with capital growth over the medium term, with a total return of at least 8% pa.

Next events

H122 period end	30 September 2021
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Swift and accretive capital deployment

Substantial progress made with deployment of equity proceeds

In June 2021, LXi announced its intention to raise additional equity under its existing placing programme. Reflecting the strength of investor interest and scale of suitable acquisition opportunities identified by the company, the issue was upsized from c £75m to £100m and closed in early July, with c 75.2m new placing shares issued at 133p per share. An additional c 2.8m shares were issued in a PrimaryBid offering, aimed at retail investors and on similar terms. In aggregate, c 78.0m new shares were issued, c 12.5% of the number previously outstanding, raising gross proceeds of c £104m. Including the new c 100.4m shares issued in March 2021 (at 124.5p), LXi has now issued c 221.6m of the 400m shares authorised by shareholders to be issued between 16 March 2021 and 17 February 2022.

LXi has a strong track record of quickly deploying additional equity resources into predominantly off-market investments that have been identified in advance. The proceeds of the March equity raise were deployed swiftly within eight weeks and, leading up to the most recent placing, increased debt facilities had also been substantially deployed. The c £80m of acquisitions just announced substantially deploys the recently raised equity, continuing this pattern, and with additional pre-let forward funding and sale and leaseback transactions in solicitors' hands we expect full deployment to be quickly achieved.

The acquired assets in detail

The acquisitions are all let on long leases to strong tenants that operate in defensive sectors. Starting rents are low and inflation-linked or subject to fixed uplifts, and in each case the assets benefit from being 'mission critical' for the tenant and/or having a favourable investment to vacant possession value ratio. Full details of the acquired assets are available on the company's website (www.lxireit.com) and in summary they comprise:

- **Life Science and Biotech campus in York:** this substantial and internationally renowned facility is let to Capita on a long lease, with 25 years unexpired until first break. The low starting rent increases five-yearly in line with RPI (capped at 3.5%). Capita derives 75% of its income from UK government agencies, with the remainder from high-growth SMEs.
- **Media studios and corporate HQ in Glasgow:** the facilities, well-located in Glasgow's media and tech hub, were acquired through an off-market transaction and are let to STV, Scotland's equivalent of England's ITV and listed on the London Stock Exchange. The asset is a 'mission-critical' site for STV, reflected in a recently agreed 20-year unbroken lease. The low starting rent increases five-yearly at a fixed 1.5% pa.
- **Waste recycling and storage facility in Aberdeen:** the facility is let to Biffa with an unbroken 14-year remaining lease length and rents that increase annually in line with CPI (collared at 2% and capped at 4%). This is Biffa's only facility in Aberdeen and LXi has already commenced discussions with it about increasing the lease length.

Attractive capital recycling

Alongside the acquisitions, LXi reported the disposal of a Lidl food store, acquired through a forward funding transaction in 2017, following an unsolicited approach. The sale price of £7.75m reflected a low exit yield of 3.8%, a 38% premium to the acquisition price, which reflected a net initial yield of 5.5%. The sale proceeds will be recycled into higher-yielding opportunities within the continuing pipeline.

Estimates increased

We have updated our estimates to include the £104m (gross) of equity recently raised and our expectations for its deployment, on a geared basis, including the acquisitions detailed in this note. A summary is provided in Exhibit 1. Our DPS forecasts are unchanged, although we note the increasing level of cover by 'cash' earnings in FY23 (1.08x), which raises the possibility that FY23 DPS growth may be faster than we assume.

Exhibit 1: Summary of forecast revisions

	Rental income (£m)			Adjusted earnings (£m)*			Adjusted 'cash' EPS (p)**			EPRA NTA per share (p)			DPS (p)		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
03/22e	61.1	57.6	6.1	50.9	47.9	6.3	6.1	6.1	0.0	136.0	130.1	4.6	6.0	6.0	0.0
03/23e	68.6	59.4	15.5	56.6	50.1	13.0	6.7	6.5	3.2	141.3	134.4	5.2	6.2	6.2	0.0

Source: Edison Investment Research. Notes: *Adjusted for gain/losses on investment properties, other fair value movements and licence fee income on forward funding extended. **Excludes non-cash IFRS adjustments that are included in adjusted earnings.

Key forecasting assumptions

Our previous forecasts assumed £185m of capital deployment after the March £125m gross capital raise. Following a string of transactions up to and including the £19.0m forward funding of a Dobbies garden centre announced on 10 June, c £15m of this assumed deployment remained ahead of the equity raise announced in June. We estimate that the net proceeds of this equity raising, geared (at an LTV of c 30%) utilising existing debt facilities, will support an additional c £145m of investment. Allowing for the £80m of deployment announced, our forecasts include future assumed deployment of £80m, £35m by end-September 2021 (end-H122) and the balance in H222. The £35m that we assume by end-H122 is equivalent to deployment of the £15m 'brought forward' and the full net equity proceeds of the July placing.

We also allow for capital recycling, assuming c 10% of the completed asset portfolio is sold each year (at book value and reflecting the existing portfolio yield) with the proceeds redeployed into new opportunities. We include the disposal of the Lidl food store in Chard within this.

For all future deployment, including recycled capital, we assume a c 50:50 split between completed assets and forward funding commitments at an average 5.5% yield on invested/committed capital (before acquisition costs). This implies an acquisition net initial yield of between 5.15% and 5.4% depending on whether the assets are completed properties (we assume standard acquisition costs of 6.8%) or forward-funded developments (we assume acquisition costs of 2%).

Based on the lease structure (95% of leases index-linked or fixed uplift at end-FY21) and inflation expectations (see section below), we assume a blended average uplift in rents of 2.6% pa through FY22 and FY23.

With its recent equity raise, LXi disclosed an unaudited EPRA NTA per share as at 1 June 2021 of 130p, up 3.4% since 31 March 2021 (end-FY21), substantially driven by portfolio revaluation gains, with an independent third-party portfolio valuation of £1.08bn reflecting a 4.7% net initial yield (end-FY21: 4.9%). Since end-FY21, each of the real estate subsectors within the portfolio had experienced like-for-like gains in valuation, with the largest contributor being the industrial and logistics assets, benefiting from continued strong investment markets, good covenants, and attractive supply and demand fundamentals. Recently purchased assets, those acquired since end-FY21, also showed increased valuations, on average 9% compared with the acquisition cost. Our capital value forecasts reflect the 1 June position and anticipate further valuation uplifts driven by rental growth and post-acquisition revaluation gains, which derive from LXi's ability to source off-market properties and forward funding opportunities at attractive valuations.

Returns and valuation

Despite the pandemic, since listing LXi has achieved its aim of providing shareholders with secure and growing income, fully covered by adjusted earnings along with capital growth over the medium term. For FY22, LXi targets DPS of 6.0p, a new high since IPO. Including capital growth, EPRA NTA total return from IPO to end-FY21 was 48.0%, or an annual average increase of 10.1%, well ahead of the medium-term target of at least 8%.

Exhibit 2: 10.1% pa average EPRA NTA total return since IPO

	FY18	FY19	FY20	FY21	IPO to FY21
Opening EPRA NTA per share (p)	98.0	107.7	114.6	124.3	98.0
Closing EPRA NTA per share (p)	107.7	114.6	124.3	125.7	125.7
Dividends paid (p) – differs from declared	2.00	6.13	5.69	5.53	19.34
NTA total return	11.9%	12.1%	13.4%	5.6%	48.0%
Average annual return					10.1%

Source: LXi REIT data

LXi shares offer a 4.1% FY22 prospective yield and we expect further DPS growth in FY23, fully covered by ‘cash’ earnings. With capital growth underpinned by the strong start to FY22, our forecasts also imply an above-target EPRA NTA total return over the next two years (13.0% in FY22 and 8.4% in FY23).

Income protection against increasing inflation expectations

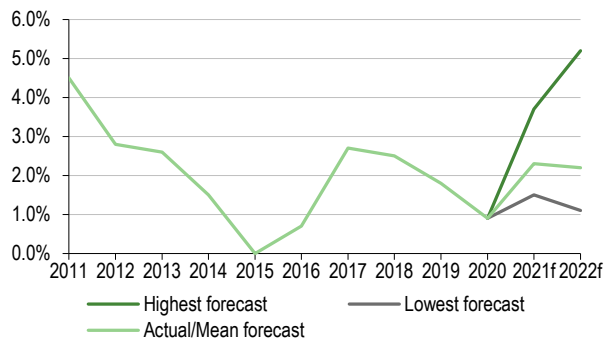
Rising levels of inflation are an increasing cause of concern for investors, although forecasters are sharply divided about whether this will prove to be enduring or a transitory phenomenon, with inflation subsequently declining. LXi’s index-linked leases (mostly capped and collared) and fixed uplift leases provide significant income protection against inflation,¹ while conversely, fixed rents and rent collars (minimum uplifts to indexed rents) ensure continuing rent growth if inflation falls to low levels.

Of the 95% of rents that were indexed or fixed at end-FY21, 74% were indexed to inflation (57% indexed to RPI and 17% indexed to the consumer price index (CPI)). The 21% of rents that provided fixed uplifts did so at an average of 2.4% pa. Taken together, the fixed and collared income amounts to 67% of the total at an average minimum uplift of c 2.0% pa regardless of how low inflation may fall. Rent reviews concluded in FY21 generated average uplifts of 2.1% pa.

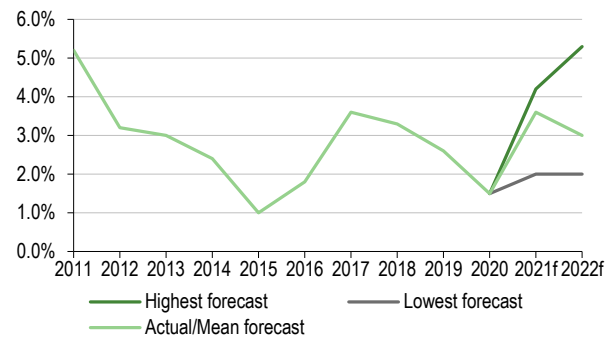
As economies begin to recover from the pandemic, CPI inflation has risen markedly, to above the Bank of England (BoE) monetary policy committee’s target of 2% and is projected to rise temporarily to 4% in the near term. This is attributed to higher energy and goods prices, which in turn reflect rising commodity prices, transportation bottlenecks, constraints on production and strong global demand for goods. As such, the BoE expects above-target inflation to be transitory, as commodity prices stabilise, supply shortages ease and global demand rebalances.

The most recent UK inflation data for July 2021 showed some moderation compared with recent strong increases, with the 12-month change in the CPI falling to 2.1% compared with 2.5% in June, while the 12-month change in RPI was 3.8%, compared with 3.9% in June. The Treasury comparison of independent forecasters for June 2021 shows a mean expectation that CPI will be increasing at a 2.3% rate by Q421 and at a similar rate in Q422, but there is a high level of uncertainty reflected in a wide range of expectations, from 1.5% to 3.7% for 2021, and from 1.1% to 5.2% for FY22. A similar trend is apparent for RPI, with a mean expectation of 3.2% in Q421 and 2.9% in Q422.

¹ Only if inflation rises above c 4% will rent growth lag in real terms, and we would expect this to be a considerably stronger performance than for the broad UK commercial property sector.

Exhibit 3: CPI* historical trend and forecasts


Source: ONS historical data, Treasury Forecasts for the UK economy: a comparison of independent forecasts, June 2021. Note: *UK consumer price index.

Exhibit 4: RPI* historical trend and forecast


Source: ONS historical data, Treasury Forecasts for the UK economy: a comparison of independent forecasts, June 2021. Note: *UK retail price index.

Peer comparison

Compared with its peer group of long-income peers (mostly comprising subsector specialist investors but also diversified investment peers such as Secure Income REIT and, to a lesser extent, LondonMetric), LXi has an above average WAULT and trades with a trailing P/NTA and yield that are both slightly lower than the average. For comparative purposes, the DPS and NTA/NAV data are shown on a trailing basis, taking the last 12 months DPS declared and last reported NTA/NAV. Prospectively, we forecast a good level of growth in LXi's NTA per share and DPS over FY22 and FY23. LXi's share price performance is well ahead of the peer group over the past 12 months and is also ahead of the UK market and broad property sector despite both benefiting from a recovery in the prices of stocks that were hard hit by the pandemic.

Exhibit 5: Peer comparison

	Recent WAULT (years)	Price (p)	Market cap (£m)	P/NAV* (x)	Yield** (%)	Share price performance			
						One month	Three months	12 months	From 12-month high
Assura	11	78	2,076	1.36	3.7	0%	6%	-5%	-6%
Civitas Social Housing	23	110	687	1.02	4.9	-5%	-3%	0%	-9%
Impact Healthcare	20	115	366	1.04	5.5	0%	3%	14%	-4%
LondonMetric	11	260	2,367	1.37	3.3	5%	14%	8%	-2%
Primary Health Properties	12	167	2,362	1.45	3.6	3%	10%	9%	-1%
Secure Income	20	398	1,288	1.05	3.7	-2%	5%	39%	-4%
Supermarket Income	16	122	578	1.17	4.8	4%	7%	11%	-2%
Target Healthcare	29	124	566	1.12	5.4	3%	9%	13%	-2%
Triple Point Social Housing	26	110	445	1.04	4.7	7%	6%	5%	-3%
Tritax Big Box	13	236	4,050	1.21	2.7	13%	21%	49%	-1%
Average	18	148	1,036	1.16	4.3	3%	8%	16%	-3%
LXi REIT	22	148	1,036	1.18	3.9	2%	8%	36%	-1%
UK property sector index		1,944				5%	12%	29%	-1%
UK equity market index		4,083				1%	2%	22%	-2%

Source: Company data, Edison Investment Research, Refinitiv prices as at 23 August 2021. Note: *Based on last reported EPRA NAV/NTA. **Based on 12-month trailing dividends declared.

Exhibit 6: Financial summary

Year to 31 March (£m)	2018	2019	2020	2021	2022e	2023e
INCOME STATEMENT						
Cash rental income	7.7	18.6	33.1	34.4	51.3	58.8
IFRS rental adjustments	1.7	3.0	5.4	8.4	9.8	9.8
Total rental income	9.3	21.6	38.5	42.8	61.1	68.6
Administrative & other expenses	(2.4)	(3.5)	(6.6)	(5.9)	(8.6)	(9.1)
Operating profit before property & other valuation movements	6.9	18.0	31.9	36.9	52.6	59.5
Change in value of investment property	15.1	15.9	45.4	0.1	64.5	27.4
Gain/(loss) on disposal of investment property	0.1	3.3	1.2	6.3	0.0	0.0
Change in fair value of financial instruments	0.0	0.0	(0.1)	0.0	0.0	0.0
Operating profit	22.1	37.3	78.4	43.3	117.0	86.9
Net interest expense	(1.1)	(3.2)	(4.8)	(5.3)	(5.6)	(7.0)
Gain on refinancing				1.9		
Profit before tax	21.0	34.1	73.6	39.9	111.4	79.9
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Net income	21.0	34.1	73.6	39.9	111.4	79.9
Adjust for:						
Change in value of investment property	(15.1)	(15.9)	(45.4)	(0.1)	(64.5)	(27.4)
Gain/(loss) on disposal of investment property	(0.1)	(3.3)	(1.2)	(6.3)	0.0	0.0
Change in fair value of financial instruments	0.0	0.0	0.1	0.0	0.0	0.0
EPRA earnings	5.8	14.9	27.1	33.5	46.9	52.6
License fee receivable	1.2	1.5	2.1	3.5	4.0	4.1
Amortisation of cash-backed rental top ups and rent frees	0.0	0.0	1.3	2.2	0.0	0.0
Adjusted earnings	7.0	16.4	30.5	39.2	50.9	56.6
Period-end number of shares (m)	196.9	352.3	521.4	621.8	699.8	699.8
Weighted average number of shares (m)	138.6	267.6	485.4	525.9	679.2	699.8
IFRS EPS (p)	15.1	12.8	15.2	7.6	16.4	11.4
EPRA EPS (p)	4.2	5.6	5.6	6.4	6.9	7.5
Adjusted EPS (p)	5.1	6.1	6.3	7.5	7.5	8.1
Cash EPS (p)	3.8	5.0	5.2	5.5	6.1	6.7
DPS declared (p)	4.0	5.5	5.8	5.6	6.0	6.2
Dividend cover (cash earnings basis)	0.68	0.89	0.91	0.95	1.01	1.08
BALANCE SHEET						
Investment property	255.2	511.5	809.7	887.5	1,257.4	1,333.0
Other non-current assets	0.0	0.0	0.0	0.4	0.0	(0.0)
Total non-current assets	255.2	511.5	809.7	887.9	1,257.4	1,333.0
Cash (unrestricted)	30.8	19.4	13.4	87.1	12.9	1.2
Restricted cash	17.9	43.2	0.0	0.0	0.0	0.0
Other current assets	6.9	5.9	10.6	15.1	20.6	22.3
Total current assets	55.6	68.5	24.0	102.2	33.5	23.5
Trade & other payables	(5.2)	(9.0)	(16.1)	(18.3)	(33.0)	(35.9)
Other non-current liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Total current liabilities	(5.2)	(9.0)	(16.1)	(18.3)	(33.0)	(35.9)
Bank borrowings	(93.5)	(167.3)	(166.1)	(186.6)	(302.4)	(328.2)
Other non-current liabilities	0.0	0.0	(3.5)	(3.8)	(3.5)	(3.5)
Total non-current liabilities	(93.5)	(167.3)	(169.6)	(190.4)	(305.9)	(331.7)
Net assets	212.0	403.7	648.0	781.4	952.0	988.9
Adjust for:						
Mark to market derivative adjustment	0.0	0.0	0.1	0.0	0.0	0.0
EPRA net tangible assets (NTA)	212.0	403.7	648.1	781.4	952.0	988.9
EPRA NTA per share (p)	107.7	114.6	124.3	125.7	136.0	141.3
CASH FLOW						
Net cash flow from operating activity	2.7	19.5	25.8	28.9	49.2	50.9
Acquisition of investment property	(238.5)	(288.0)	(260.1)	(160.5)	(387.6)	(154.4)
Proceeds from sale of investment property	0.7	54.7	20.9	96.0	93.2	117.2
Other investment activity	0.0	0.1	0.4	0.0	0.0	0.0
Net cash flow from investing activity	(237.7)	(233.2)	(238.8)	(64.5)	(294.4)	(37.2)
Net proceeds from equity issuance	195.0	171.8	195.7	122.3	101.4	0.0
Dividends paid	(3.5)	(14.2)	(25.0)	(28.8)	(39.4)	(43.0)
Interest paid	(1.3)	(3.6)	(4.7)	(5.9)	(6.0)	(7.4)
Net debt drawn/(repaid)	77.1	49.7	43.2	22.3	115.0	25.0
Other cash flow from financing activity	(4.3)	(21.0)	(28.0)	(29.5)	(49.2)	(50.9)
Net cash flow from financing activity	265.8	202.3	207.0	109.3	171.0	(25.4)
Change in cash	30.8	(11.4)	(6.0)	73.7	(74.2)	(11.7)
Opening cash	0.0	30.8	19.4	13.4	87.1	12.9
Closing cash	30.8	19.4	13.4	87.1	12.9	1.2
Balance sheet debt	(93.5)	(167.3)	(166.1)	(186.6)	(302.4)	(328.2)
Unamortised loan costs	(1.5)	(2.7)	(3.9)	(5.7)	(4.9)	(4.1)
Net debt	(64.2)	(150.6)	(156.6)	(105.2)	(294.4)	(331.1)
Net LTV	23.0%	28.0%	17.1%	11.2%	22.4%	24.5%
'Pro-forma' net LTV*	30.8%	41.9%	29.5%	22.8%	27.0%	26.2%

Source: LXI REIT historical data, Edison Investment Research forecasts. Note: *Net gearing on a fully developed basis.

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