S&P Global
Market Intelligence

SEGRO Plc LSE:SGRO

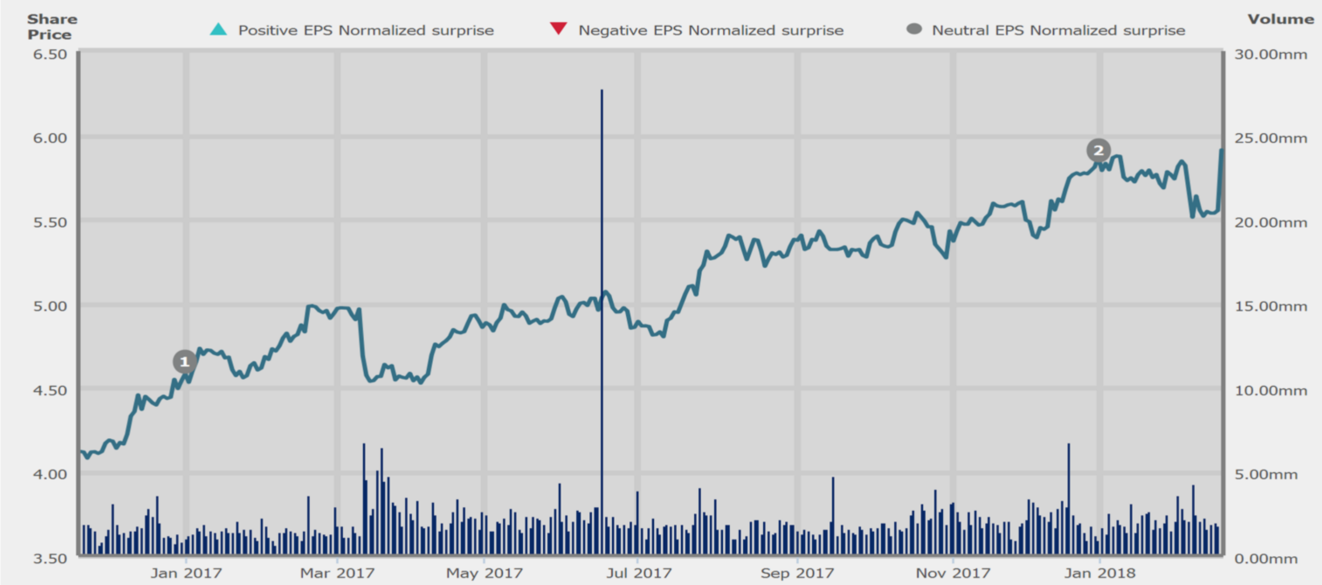
FY 2017 Earnings Call Transcripts

Friday, February 16, 2018 9:00 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.20	0.20	0.00	0.22
Revenue (mm)	265.31	272.90	▲2.86	297.31

Currency: GBP
Consensus as of Feb-16-2018 8:09 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FY 2016	0.20	0.20	1 0.00 %
FY 2017	0.20	0.20	2 0.00 %

Table of Contents

Call Participants

EXECUTIVES

Andrew S. Gulliford
COO & Executive Director

David John Rivers Sleath
CEO & Executive Director

Phil A. Redding
Chief Investment Officer & Executive Director

Soumen Das
CFO & Executive Director

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ATTENDEES

Unknown Attendee

Presentation

David John Rivers Sleath
CEO & Executive Director

Well, good morning, everybody, and welcome to SEGRO's full year results presentation for 2017. I have Soumen here with me, of course. Andy Gulliford, our Chief Operating Officer, is here; and Phil Redding, our Chief Investment Officer, ready to take part in Q&A; and the Chairman, Gerald Corbett, is definitely in the room as well, so he's around too.

As you know, we've been following a very consistent strategy over the last 6 years, which is all around delivering sustainable shareholder returns based upon disciplined capital allocation and operational excellence underpinned by the right capital and corporate structure. And I'm delighted to say that, in 2017, we've delivered exactly what it says on the tin in that regard. Our disciplined approach to capital allocation saw us invest GBP 1.1 billion, a record GBP 414 million of it going into the development program and a further GBP 610 million into some excellent off-market investment purchases. And we generated GBP 525 million from recycling capital out of assets that don't offer the return and defensive qualities that we have elsewhere in our portfolio.

Our operational excellence in what has been the most supportive market backdrop I've seen in my 12 years in the business has enabled us to produce some record data in terms of development completions, leasing activity, the vacancy rate and indeed the rental levels we've achieved. And underpinning our portfolio activities, Soumen, with the help of his finance team, has enjoyed a busy and successful first year by arranging GBP 2.7 billion of debt and equity financing, which have significantly reduced our average cost of borrowings and strengthened our balance sheet. And the output from all of this hard work has been another set of cracking financial results with a total property return of 19%, an NAV increase of 16% and some good uplifts in adjusted earnings per share and dividends.

And as we look to the future, I'm confident that the portfolio of modern, well-located and sustainable assets that we've created over recent years will stand us in good stead. We are, far and away, the largest industrial investor and developer in London and the South East of England, with meaningful and growing positions in Germany, France and Poland. Italy is expanding rapidly. And we are making good progress with some of our smaller positions, most notably in Spain. We're unique in having a portfolio balanced between big box logistics assets as well as high-growth urban or last-mile warehouses. And as we see the structural trends of urbanization, growth of the digital economy and e-commerce penetration continue apace in the U.K. and also now begin to accelerate in continental Europe, SEGRO is well placed to take advantage.

We started 2018 with good momentum. Occupational demand is encouraging across the piece. And we've already had some good leasing successes with low vacancy rates in all markets, limited speculative supply and constraints to new supply being brought through, there are good prospects for further rental growth. And whilst there are plenty of macro risks out there that may affect the broader economy, the attractive fundamentals benefiting our sector, which are structural in nature, are unlikely to change anytime soon. Not surprisingly, therefore, investor appetite for good industrial stock remains unsated, meaning current valuations are well supported. And I wouldn't be at all surprised if we see further inward yield shift this year. Meanwhile, our land bank and our strong balance sheet has put us in a great position to be able to capture further growth.

So I continue to feel positive about our prospects. And I'll return to some of these thoughts later on, but before that, let me hand you over to Soumen to take you through the numbers.

Soumen Das
CFO & Executive Director

Great. Well, thank you, David. Good morning, everyone.

So I'm going to take you through the financials for 2017, go into a bit of detail on the valuations and I'll take you through some of the activities that we've been undertaking in terms of reshaping the balance sheet.

So starting with what I think are a really great set of figures. So we saw strong growth in earnings through 2017. The main drivers were higher rental income and lower finance costs, and I'll come on to expand on both shortly. Adjusted profit before tax is up 26%, while earnings per share is up 6% to 19.9p. The different growth rates reflect the increased number of shares that are in issue following the rights issue and the 2016 placing. The balance sheet is in great shape, thanks to all of the financing activity over the past year. NAV is up 16% to 556p per share, and loan-to-value remains at the lower end of our target range at just [30%.]

We're announcing a 6% increase in the dividend -- the final dividend, to 11.35p per share, which takes the full year dividend to 16.6p per share, which is also up 6%. You should just note that all the historic per share figures that we've quoted have been adjusted for the rights issue bonus adjustment factor, just as described at the bottom of the page.

So just looking at net rental income growth a little bit more closely on this slide. As you can see, the impact of acquisitions and disposal roughly net each other out, whilst development completions add about GBP 20 million to the top line. Like-for-like growth was 2.6%, which added GBP 4.5 million of new rent. Now the different movements in the U.K. and in Europe reflect the under and the over rented positions that have been built up from recent years. And we anticipate the European over rented position reducing as ERV growth there picks up. The vacancy rate at 4% is, I think, the lowest we've ever reported. And if we can maintain it at around these levels, the prospect for continued like-for-like rental growth should be good.

And just to help with your forecasts going forward. The blue bar on the right-hand side just shows the pro forma run rate for net rent, which adjusts for one-offs and the timing of acquisitions, disposals and the completions of developments. And this would be about GBP 5 million higher than the actual 2017 figure. And Slide 35 in the back sets out the detail.

Turning now to the rest of the income statement. This slide just shows you the components of adjusted earnings. Top line rental growth improved strongly, but earnings also benefited from the lower financing costs, which reflects a reduction of debt post the rights issue and also the lower costs of debt from the refinancing activity. The full impact of this should really be felt in 2018. As I mentioned at the half year, the JV fee income was boosted by an acceleration in performance fees, which crystallized on the acquisition of APP. And that took our JV fees to GBP 24 million versus the recurring level of nearer GBP 16 million. On the third box in the right-hand side, you can see the cost ratio's increased from 23% to 24.6%. As you read down to the cost of our share schemes, which have gone up, which are -- underline and reflect the outperformance of the property portfolio, which clearly you can see in our total return metrics, you can see it in NAV, but obviously it doesn't factor into the income statement as yet. Excluding the share schemes, the cost ratio would have risen much more modestly by 0.7% to 21.7%, which mainly reflects higher staff costs.

Finally, just as a reminder, the average number of shares for 2018 -- for 2017, rather, was 967 million, but for 2018 it'll be just over 1 billion. And that increase has the impact of knocking about 0.8p off EPS.

Turning now to NAV. So EPRA NAV per share has risen from 478p to 556p. The valuation gain increased NAV by 96p, of which the development surplus comprised a significant piece at 17p. The gain was offset by about 20p of costs which relate to the various financing activities.

So Slide 10, we're just going to look at the -- looking at the valuation increase in a little bit more detail. The valuation gain totaled just under GBP 1 billion, reflecting mainly a 13% increase in the like-for-like portfolio. The U.K. was the major driver of this growth, particularly London and Slough, but as you can see, there's also a very healthy contribution from the French, the German and the Italian assets as well. Now we don't yet have comparables for Continental Europe, but on the U.K. side, the U.K. portfolio generated a capital value uplift of 15.8%. And that compares very favorably to the IPD all industrial quarterly index, which grew 13.9%.

So on Slide 11. The valuation increase is really the increase -- is really the result of the asset management activities, yield shift and of rental growth. Yields tightened about 40 basis points across the portfolio but continue to offer a healthy margin to the risk-free rate as well as rental growth. And you can see that in the 3.1% ERV growth during the year. In London, the portfolio equivalent yield was 4.8%, whilst the ERV growth was 4.6%, with particularly strong performance in Park Royal and in the North and the East London portfolios. We've also seen ERV growth in Continental Europe. You can see on the right-hand side of the slide that the growth was especially concentrated in the wholly owned estates, which as you know, mainly comprise the warehousing in Paris, in Warsaw and in Germany's main cities. Poland continues to offer the highest cash yield. And marketing conditions have stabilized, with ERVs actually nudging up during the course of 2017.

Turning now to the liability side of the balance sheet. We raised GBP 2.7 billion of fresh capital in 2017, which is an extraordinary level of activity and has transformed our capital structure. Firstly, we significantly strengthened the financial position with the GBP 573 million rights issue back in March to fund the acquisition of APP and future development CapEx. And we've used this additional equity to increase the pace of development through 2017. Less than a year on, we've already spent or committed 70% of the capital on projects highlighted at the time of the rights issue.

On the debt side, we've raised GBP 2.1 billion. The U.S. private placement in May, which was our first debt issue in euros, improved the natural currency hedge for our euro-denominated assets. The sterling's bond tender in September, which we -- it was alongside the new issue, locked in low coupons and long maturities; and we retired a big piece of our legacy high-coupon debt.

And a new bond for SELP, the second one it issued, affirmed its move into unsecured financing with a new 8-year bond with a coupon of just 1.5%, which largely removed secured financing out of the joint venture. And finally, at the end of the year, we added to our credit facilities, which means we now have over GBP 1 billion of undrawn liquidity.

Now as you'd expect, all this activity has had a very positive effect. We've extended the debt maturity by 4.6 years to just under 11 years. And the cost of debt has fallen from 3.4% to just 2.1%. Loan-to-value is now 30%, which as you can see is a huge -- a significant improvement over the last 5 years. Now looking forward, when you're thinking about your forecasts, we expect to maintain a high rate of CapEx, so in excess of GBP 350 million a year on development, with -- in the order of another GBP 50 million related to infrastructure, mainly at East Midlands Gateway. That's in line with the GBP 414 million we spent in total in 2017.

We continue to recycle capital. And we estimate selling around GBP 200 million of assets this year, which equates to a run rate of around 2% to 3% of the portfolio.

So just to finish from me. I'm very happy to be reporting very strong earnings growth; a balance sheet that is in great shape; and a dividend increase of 6%, which reflects the performance in 2017 but also the very strong momentum that we see going into 2018.

With that, I'll hand you back to David.

David John Rivers Sleath
CEO & Executive Director

Very good. Thank you, Soumen.

So what's behind those impressive numbers is, of course, a supportive market backdrop, but also a lot of hard work by our property teams and indeed the rest of the group in terms of executing our strategy. Disciplined capital allocation, as you know, is one of the key elements. And that's all about creating the right portfolio shape for long-term performance and making capital allocation decisions which will enable us to deliver attractive property-level returns.

We took the decision about 2 years ago to switch our emphasis from what had been an acquisition-led approach to capital allocation towards one that favored development given the increasingly crowded investment market. And so we've been consciously adding to the land bank. And we did so again in 2017, although interestingly we generated a similar amount of proceeds from land sales to residential developers as we invested in new land, but we've materially increased our development expenditure, with GBP 414 million going into this channel, more about which I'll say later. But notwithstanding the development focus, we've remained alert to acquisition opportunities of off-market and other special situations. In 2017, we completed 2 other property swaps, 1 in France and 1 in the U.K., through which we acquired 2 prime logistics assets. However, the biggest acquisition of the year was to buy out our joint venture partner's interest in APP, which as you know, we executed in March, acquiring in the process another GBP 550 million of unique airport assets at Heathrow, Gatwick and Stansted. Heathrow's cargo volumes jumped 10% last year to a new all-time high, and space has been in demand across the portfolio. So the assets have performed well since acquisition, and there's a slide in your appendix with some of the details that you might want to look at.

Finally, despite having completed over GBP 3 billion worth of disposals in the previous 5 years, we continued to take a disciplined approach to managing and reviewing the existing portfolio, constantly looking for opportunities to recycle capital out of assets which offer less upside or are not as defensive as the rest of our portfolio. And we also continued to recycle capital by selling assets that we've created on balance sheet into our SELP joint venture in Continental Europe.

So in aggregate, as you can see, we sold over GBP 500 million of assets in 2017, including GBP 150 million that we sold as part consideration for the purchase of Aviva's share in APP.

Another important element of our investment strategy though, has been to focus on achieving scale in all our chosen markets. The benefits of scale, which we clearly have in London and South East England, are not just to do with cost efficiency, but it's also about access to opportunities through relationships with customers, with agents, with local authorities and other local stakeholders that you simply can't develop if you don't have a really meaningful scale position and seen as a serious, committed player in those markets. As I mentioned earlier, we're in pretty good shape now in Germany, France and Central Europe, with over GBP 1 billion of assets under management in each of those. And in Italy, we're growing fast on the back of the excellent Vailog acquisition 2.5 years ago. We now already have a reasonable scale there of EUR 0.5 billion of AUM and with an excellent pipeline of further opportunities coming through over the next year or 2. In Spain, a lack of suitable corporate acquisition targets means that our growth has had to follow a much more organic approach, but we're making very good progress there, having started only 2 years ago, through a combination of acquiring land sites and undertaking our own development, through funding -- forward funding local partners' projects and also buying some income-producing assets largely through customer relationships that we've got elsewhere in the group. We now own 9 assets, and we're well on track to have AUM in Spain of in excess of EUR 300 million in the near future.

Delivering sustainable returns also isn't just about building or buying modern warehouses in strong locations. It's also important to own very generic buildings that are highly flexible and appeal to a wide range of occupier types, which is something that we've been very focused on. And it's about future-proofing them in line with our customers' present and likely requirements and taking a responsible approach towards sustainability. In 2017, we've continued to focus on reducing our carbon footprint, mainly by further investing in renewable energy, in particular rooftop solar panels, including our largest-ever array in a single building where we installed 3.4 megawatts of capacity at Tesla's facility in Tilburg. And we're also seeking to minimize carbon consumption through the development process, firstly by minimizing waste and reusing as much of an existing building as we can but also by using more sustainable materials, as we did in Paris where we made the roof beams out of laminated wood.

With customers often investing massively now in automated systems and tech inside the buildings, we've been future-proofing our developments with power upgrades. So for example, at our development site in East Midlands we spent GBP 7 million extra in order to provide a lot more capacity than a traditional logistics team would need because we're just sure that our customers are going to want it. All of our new developments as well now have electrical charging points. So you'll increasingly hear us talking a lot more about these things in the future. And during 2018, we are going to be setting out new long-term targets for the business that we'll be sharing with you later in the year.

Now let's turn to operational excellence. When I get out and about and I visit our assets and meet customers, I never cease to be impressed with the knowledge that the SEGRO team has on the ground, the relationship they have with the customers, their intimacy with the businesses of our customers. And how those excellent relationships have -- and knowledge have translated into results are very much demonstrated in these 3 charts. You can see that, in 2017, we generated over GBP 50 million of new annualized rent from lettings of standing assets and development, which is the highest ever we've achieved. Our vacancy rate is, again, the lowest it's ever been at just 4%, or in fact 3.4% if you strip out recently completed spec developments. Our customer retention rate is one of the highest we've ever reported. And the uplift in rent reviews -- in rents from reviews and renewals is almost 10%, capturing some of the reversion that we've been building up in recent years. We're now consistently generating growth in net income from our existing, standing assets. In fact, we've achieved positive rent roll growth from our existing portfolio every reporting period since the beginning of 2014. And as you can see from the bars on the first chart, most of that revenue growth is coming from development, so let me provide a little more color on that.

Last year, we completed 35 developments, producing 650,000 square meters of space, which is again by some margin a record in terms of volume. The overall development yields on total costs including the land was over 8%. 93% of that income has already been leased or secured.

As always, we provide space to a very diverse range of customers spread across lots of geographies and with big boxes and urban. Amazon, though, has been featuring very heavily over the last year or 2. And in 2017, we delivered buildings for them in Rome, in the Midlands, Barcelona, London and Munich. And you'll be seeing us doing more business with them this year. But we've also been doing business with other e-commerce players such as Yoox Net-a-Porter. The parcel delivery partners of these online retailers have also continued to be very active, particularly now as the battle for last-mile delivery hops up. And we've seen good demand from discount grocers and from traditional retailers seeking to respond to the online challenge and also from data center operators as the demand for cloud computing services continues to [boon.]

You can see on this slide just how much the scale of development has ramped up over the last few years and what a major source of new income it is for us. In fact, it's more than tripled in terms of space development and CapEx spent. And you can see that it's contributed over GBP 110 million of new annualized rents, mostly secured now, which is equivalent to about 1/3 of our existing rent roll. Looking ahead, we see plenty of opportunity for further income growth, especially against a continuing supportive market backdrop.

The low-growth, low interest rate environment that we've become accustomed to is just fine from our perspective. Whilst the general trajectory of interest rates is upwards from here and there are clearly wider concerns about the effects of Brexit, I don't believe that these will significantly impact demand for our type of space. That's because the e-commerce revolution is well established and ongoing. It -- and it remains a powerful driver of demand both for big box warehouses and urban warehouses both here in the U.K. and increasingly now on the continent, there's definitely been a pickup in sentiment. Meanwhile, as these charts show you, the supply situation remains relatively constrained. In the U.K., big box speculative development completions slowed sharply in 2017, and they show little sign of increasing dramatically in 2018. And despite an apparent decline in take-up from the record levels seen in 2016, this masks the fact that there are approximately 7 million square feet of space in solicitors' hands at year-end, equivalent to about half the total take-up in 2017 itself; 2 million feet of which, by the way, were our own pre-lets at our East Midlands Gateway site. So I think 2018 looks like being a good year in the U.K. for take-up.

And in terms of development and construction right across Europe, you can see from the charts at the bottom, there's still only a modest amount of spec development in the U.K. And elsewhere across Europe, volumes of build are similar to a year ago, but again and particularly emphasized by the red part of those bars, it's mostly preleased. Of course, these charts don't include any data about urban warehouses, where frankly a reliable supply of data is very hard to get hold of, but we know from our experience in all the markets we're operating in the availability of land there is even more constrained than it is for big boxes. In these urban locations, a meaningful supply response just isn't possible in most of them.

So the culmination of all of that is that we remain confident about the rental growth prospects from our portfolio over the next couple of years. In the U.K., growth rates to 2% to 5% seem eminently achievable, with parts of London certainly exceeding that and perhaps areas outside of London a little bit lower. In Continental Europe, we're particularly pleased to see some positive momentum in rental growth in the urban estates, in the urban markets that we're operating in, but we're also seeing pockets of rental growth in big boxes too, even in Poland, as Soumen alluded to, at least the markets we're operating in. The market rates have stabilized. And if anything, incented packages are now starting to come back in, which is a good sign, but regardless of future ERV growth across the portfolio, even at today's market rents, our portfolio is now GBP 25 million under rented, so the prospects for growing income and value from our standing assets are good. But that said, it's the development pipeline that remains the real differentiator for SEGRO. And despite the very large volume of space delivered in 2017, our current on-site program of development remains very substantial indeed, about 50% higher than a year ago.

We have some terrific pre-lets under construction, including 2 on sites acquired through our partnership with the Greater London Authority in East London, 2 data centers, 4 warehouses for online retailers and 3 high-value uses in the form of budget hotels. But 20 of those schemes are speculative, concentrated in and around major urban centers where we're very confident that the demand-supply dynamics will see that space taken up quickly as it has done in each of the last 5 years. In fact, we've already achieved some considerable success since the year-end, including leasing the entirety of our 2-story scheme in Paris to IKEA and Leroy Merlin some 11 months ahead of practical completion.

So pulling together the entire development program, this slide gives you the full picture. The current projects that I just ran through are shown in the first line of the table. As always, though, we have a large number of further pre-lets in solicitors' hands; or in some cases already signed and agreed, subject to a planning consent. So we're expecting to start those projects very soon. That's the second line in the table. And it includes the first pre-let we've now signed at East Midlands Gateway, which is a 1.3 million square foot deal with Amazon. It also includes another sizable pre-let at EMG that we hope to sign very soon and a 1.2 million square foot deal for Zalando in Northern Italy. Beyond this, we have over 3 million square meters of potential developments under our control from our land bank and from land held under option. We have many excellent development sites across all our target markets, and you can see the general location of them on the map. You can also see the estimated breakdown of the annualized rent by geography, which is shown in the bar across the bottom of the page. And that excludes land under options, which if you added the land under options, it would make the U.K. closer to 50%. But the great news is that the average development yield on these sites remains attractive at around 7.5%. And of course, the yield on incremental capital from here on land that we already own is well north of 10%. And although 1 or 2 of the sites, as you can see from the final column of the table, 1 or 2 of the sites, could keep us busy for the best part of a decade, the current rate of progress of our overall development program could see us work through most of this land bank in a 4- or 5-year period.

So pulling it all together. We've got the potential to increase cash-passing rents by over GBP 300 million, almost double our current rent roll. There's around GBP 140 million of additional rent available from our current portfolio and the development projects which are either underway or in advanced discussions. And there's another GBP 160 million available from projects associated with our land bank and options. And whilst this chart doesn't allow for the fact that we expect to continue disposing of assets around the edges of our core portfolio, it equally doesn't include any indexation or further market-driven rental growth.

So to conclude. We've already started well in 2018. Occupational demand is encouraging across the piece, and we've had some good early successes. With low vacancy rates in all markets, limited speculative supply and significant constraints to new sites being brought through, there are good prospects for further rental growth. Whilst we're alert to the broader macro risks, the attractive fundamentals benefiting our sector are structural in nature and unlikely to change in the near future. The unsatisfied investor demand for good industrial stock is providing strong support for current valuations. And our land bank and our strong balance sheet have put us in a great position to be able to drive some further growth. So in summary, I remain confident about our prospects for further performance.
And with that, we are happy to take your questions.

Question and Answer

David John Rivers Sleath
CEO & Executive Director

We will start in the room first. You -- if you -- welcome to Mike. If you put your hand up, you'll find a microphone in front of you. It's best if you don't put your microphone up until you know you've got the floor, as it were. So Mike, go ahead.

Michael Anthony Bessell
BofA Merrill Lynch, Research Division

Mike Bessell from Bank of America. Three for me, please. The first, given the GBP 400 million of CapEx spend, I can't see anything in here that tells us what the marginal cost on the GBP 1.2 billion of undrawn facilities is. How should we think about your incremental costs of financing to fund developments and acquisitions? The second would be just an update on the cargo center, update on rent capture through the year, also how you're thinking about redeveloping that within sort of in context of a 10% jump in the cargo volumes at Heathrow. And the third was just very interested in the rooftop solar. Was interested, do you get the benefit of any fees from that, or does the tenant? And also, does that give you -- and does that give an economic return? Or is that almost more of a marketing ploy?

David John Rivers Sleath
CEO & Executive Director

Good questions, right. And particularly good because I'm going to be able to very easily pass one of them to Soumen and then the other two to Andy. So I like those tough questions. Soumen, do you want to deal with the first one?

Soumen Das
CFO & Executive Director

Sure. And it's -- well, it's the easy one. So on the GBP 1 billion of sort of undrawn facilities we have, the marginal cost of debt is around 1%. And it depends whether we draw in euros or sterling.

David John Rivers Sleath
CEO & Executive Director

And cargo center and APP update generally, Andy? You've got a mic there.

Andrew S. Gulliford
COO & Executive Director

Yes, good, yes. Cargo center. So there's a significant kind of reversion there of GBP 10 million, GBP 11 million from the peppercorns. And we're basically about 30% achieved on that stroke, very advanced discussion; about 60% in discussion; and probably about 10% we know we won't get from those current occupiers, but of course, that presents a good opportunity for us. So the growth in cargo volume has been good, Mike. And we have got our Sandringham estate, which is the second part of the cargo center, full for the first time actually, so we had a couple of really good deals this year. So all going pretty well. On the PV, I think, was the second one. Not a marketing gimmick. It's something that customers really enjoy. What we try and do is get them a more economic power supply back into their building from the solar. So it does have a reasonable return, but it's a really nice way of helping customers with their sustainability credentials as well as our own. So that's the usual form.

David John Rivers Sleath
CEO & Executive Director

It's on a single building. It's quite a lot, but then probably Tesla is a bigger consumer of electric power than most people would be. Just to add on the cargo center: I mean, Andy mentioned Sandringham Road, the cargo center there being full. I think Gatwick is full for the first time in a long time as well. And

Stansted is also very full. I mean, all the cargo facilities are pretty well chockablock on the back of some good export volumes. Marc?

Marc Louis Baptiste Mozzi
Societe Generale Cross Asset Research

Marc Mozzi from SocGen. And 3 question from my side as well. The first one is about the massive slowdown in rental growth you experienced in H2 compared to H1 if I'm correct. And I'd like also to -- some color on the negative rental growth on the Continental European market you've been experiencing. The second one is, out of the GBP 630 million targeted rental income, what would be the net amount if you include disposals you have targeted -- you are targeting to fund your development pipeline? So if we can have just a kind of size of order of this GBP 630 million net of disposals. And the final one -- I know it's a tricky one, but I think it's one everyone would like to have a view on. Brexit will have the potential impact on export from the U.K. to Europe. How much of your tenant base is, I would say, associated, linked to European trade?

David John Rivers Sleath
CEO & Executive Director

I'll have a go at dealing with some of those. The rental growth, second half versus the first half. I think it's the other way around actually. Maybe just the way the table was set up, but second half rental growth generally was much stronger than the first half, particularly in the U.K. I think it was quite modest, the ERV growth that we had in H1. And it was triple that in H2, so we had some very good uplifts in rental levels in the second half. Continental Europe was more balanced first half and second half. In Continental Europe, what we -- what you're seeing, and it depends whether you're looking at like-for-likes, so whether you're looking at ERV. So I'm talking about ERVs. And ERVs, the encouraging thing is we have now got over 2% growth -- ERV growth, coming through in the urban warehouses; and a little bit of growth, 0.5% just over, in big boxes. Now your question is, so why doesn't that flow through into the like-for-likes. It doesn't flow through into the like-for-likes because in Continental Europe there's this -- you'll be aware of this, that leases are indexed in Continental Europe. So they're indexed according to some kind of inflational construction cost metric. So what you have is, every year, the lease -- the rents automatically go up. And then when you have a break or expiry, the tenant has an opportunity to renegotiate. And if the market rent hasn't driven their rebates back down. And so if you look at the data in the property book, you'll see we've now got a very positive reversion in the U.K., but in Continental Europe we're still about GBP 5 million worth over-rented. So what will happen over the next couple of periods is that, that over-renting will continue to unwind. But the good news is that with strong growth, I think, in the U.K. adding to that reversion and then Continental Europe now in positive territory, you should start to see that reverse, anyway. So I hope that answers the question.

The GBP 630 million of additional rent -- or total rent we're shooting for in terms of the big growth side, how much of that -- what's it going to net back to? I don't know. But the guidance we've given is, we're around about GBP 200 million of disposals as a normal annual run rate that we would expect. We did all the big disposal programs, all the big reshaping of the portfolio. We're now in around about sort of GBP 200 million or thereabouts annual recycling chunk. And so you'll have to do the math from there.

And then, in terms of Brexit and whether there's an impact on our tenant base, our customer base, I'd say the answer is, not really, because the vast majority of occupiers in our portfolio are to do with inward consumption. There's a little bit of manufacturing in Slough. Mars make chocolate bars. I'm sure those get shipped all over the country and into Continental Europe as well, but the vast majority of our portfolio is to do with inward consumption. It's serving major population centers, whether it's big boxes in the middle of the country or urban warehouses in and around the South East. So it's all around consumption. It's all around urban population growth in particular. And it's all around digital data streaming, which is placing demand for data centers; and of course, last-mile delivery for Internet purchases. So I don't -- we have this phrase, "Internet trumps Brexit." I think, as far as our portfolio is concerned, we think the forces, the structural drivers are much more important than any broad concerns around Brexit. Mike?

Unknown Attendee

Still on the land bank. I mean it looks like there's been quite a lot of inflation in land, particularly in the second half of the year. You've talked about basically your existing land bank, including options, giving you about 4 to 5 years of visibility. Should we think about that as your target size of land bank going forward? Or is there any intention to look to expand that?

David John Rivers Sleath
CEO & Executive Director

Happy with the land bank that we've got now. We're about in the range -- we don't set hard targets, but we've got a broad range. We'd like to be in that sort of 5% to 7% of GAV is land available for development. We'll flex that according to how we see the development cycle and the risk profile, et cetera. So at this point, with a very strong occupational demand, we're very happy to have a bit more land, but land prices are getting more expensive. And I think it's very important that, for us as a business, we remain as disciplined over land as we have done over buying investment products. The great news is that, even if we don't buy another piece of land from here, and I'm sure we will find something that makes sense, but even if we don't buy any, we've got 4 or 5 years of really good development-led growth to work through the current land bank. And we're running -- we are burning through land at about 20%, 25% per annum, so that's consistent with that.

Unknown Attendee

Just had one more on disposals, please. You talked about the GBP 200 million per annum run rate. I mean, what is it you're looking to sell? I mean, I guess, recently you've been selling some things for change of use. You've been selling probably dregs of noncore. Are you at all tempted to come to the market with prime product given the strength of the bid that we see out there?

David John Rivers Sleath
CEO & Executive Director

I'll let Phil answer, tell you whether he's tempted.

Phil A. Redding
Chief Investment Officer & Executive Director

I'll do the first one: what sort of stuff are we looking to sell in 2018? It is very much the same sort of things. So in SELP, we sold in 2017 some stuff in France that was -- that we thought was a little bit less core, wasn't going to perform as much. We're going to be probably doing that again maybe out of Germany and Poland, so out of SELP. And again, the other big bucket really will be the transfers from Italy into the SELP portfolio as well, so very similar to 2017; and as you say, a few noncores around the edges. And then, on the good question about are we tempted to sell some of our prime products? Well, when we're seeing where the yields currently get to, I must admit tempted is probably

[Audio Gap]

yes. I mean, particularly some of the latest deals. And I've got to say, I mean, 2018 has started pretty strongly in the capital markets in industrial sector, so we're certainly expecting some good evidence to come through. But for our really prime stuff, I mean, it's -- we're not really looking to sort of trade out of that stuff and sort of take advantage. We see these as really long-term anchors for us, mainly because they're irreplaceable. Some of our assets now are really so good that we would struggle to reinvest when we felt the time was right to do it. And also, they're still performing very strongly because the rental growth that they're generating is higher than we're getting on -- in other parts of the market. So tempted, yes, but probably not tempted enough.

David John Rivers Sleath
CEO & Executive Director

I mean, I'm really pleased that we got rid of all the stuff that would have been problematic, would be problematic. And it's really -- we're being very picky now, but it is a great market, as Phil mentioned. It's a great market to be selling anything that's got any kind of a doubt or concern around its future performance, so we'll be thinking hard about that. Any more questions? Yes, Hemant?

Hemant Kumar Kotak
Green Street Advisors, LLC, Research Division

So from Green Street. I guess, just picking up some of the comments there about the capital markets; and an earlier comment that you made, David, about you wouldn't be surprised to see further yield compression. Just trying to understand the background for that comment. Is that based on what you're seeing with the start of the year, or is there something more to that? And then perhaps, are there pockets where you expect greater yield compression, more strength than others?

David John Rivers Sleath
CEO & Executive Director

Answer that, Phil?

Phil A. Redding
Chief Investment Officer & Executive Director

I mean, as I said, I think it's been a very strong start to the year. And what's that based on? Well, mainly it's based on the very strong fundamentals that are in the market. So all the market dynamics that were driving the performance in 2017 are all still around now that will probably drive the market in 2018. I mean, I think -- reading the press in 2017, I don't think a month went by without some new vehicle being set up targeting to get into the industrial markets. So there's still plenty of money looking to deploy into the sector. So I mean, if you're being very conservative, that's a lot of support for current pricing that that'll probably mean in certain markets we're going to see some further yield compression. So I think 2018 will still be pretty good, but I -- maybe not quite as strong as 2017. I mean, there were some -- the big platform deals that happened in 2017 that sort of put the yields down, obviously not going to be happening again in 2018. But it's going to be pretty good, I would have thought, yes. I mean -- and generally across-the-board, that's where we're finding it. There isn't -- well, I think, some areas that, where the supply is very low, I mean, might be slightly different. There might be some differentiation in yield compression, but I think it's going to be generally positive across-the-board.

David John Rivers Sleath
CEO & Executive Director

Is the -- I'm asking the question now, is the Continental Europe different to the U.K.?

Phil A. Redding
Chief Investment Officer & Executive Director

Yes. I mean I think there are slight differences. I mean some markets in Continental Europe that you could argue are slightly behind where the U.K. has got to. So Germany is pretty low, almost in line with where we are in the U.K. Those markets, I mean, there might be a little bit more but maybe focused more in the urban areas rather than in logistics. But France, for instance; Spain; Italy, they've probably still got some further to go. So Continental Europe might be a little bit better than the U.K.

David John Rivers Sleath
CEO & Executive Director

I think there's a sort of the -- there's a broader, if you like, a -- contextual point here, Hemant, which is I think the investment world has been relatively slow to realize that industrial isn’t what it used to be. In other words, it's not old manufacturing on the wrong end of the decline of Western European manufacturing. It's actually around Internet retailing and data centers and last-mile delivery; and the whole change -- societal change that's happening is having a massive positive impact. And slowly but surely, as Phil talked about, every month, there's some new investor or fund that's been announced. Capital all around the world, slowly but surely, is waking up to that. Now some people got there very early and did really well out of it, but there are still people that are waking up, saying, "You know what, as an investment strategy, we're underweight. We need to get into this space." And that's driving a lot of demand.

Hemant Kumar Kotak

Green Street Advisors, LLC, Research Division

That brings me nicely on to my last question. Your portfolio is already weighted 55% to urban logistics. What kind of tilt can we expect? Now I know you've already done the major restructuring of your portfolio, but in terms of when you talk about data centers, urban logistics, some of the strengths that you -- I think it was Slide 25, that you point to. If you're expecting that in the medium term, can we see a progression in the portfolio?

David John Rivers Sleath
CEO & Executive Director

I think you will see over time that we will be looking to increase our deployment of capital into urban warehousing in a lot more cities than we're currently in -- or sorry, a lot more scale than we currently have in a number of those, about 12 or 15 cities across Europe that we'd like to do this in. The difficulty is, it takes a long time because when we look at all those markets, it's very hard to find good-quality existing assets that we can go and buy. So generally we're having to buy brownfield land. We've done a lot in the U.K. and Paris; demolish it; build something new. And that takes time relative to big boxes where there's more stock around and you can deploy larger chunks of capital quite quickly. One of the great things despite all we say about shortage of land and the issues in the U.K. is that we've been around here in scale for a very long time building this portfolio. And actually, the U.K. does have planning laws, particularly London. It actually strategically protects industrial land. So if a site becomes available, if it's designated as industrial -- strategic industrial land, it's very risky for a residential developer to buy it thinking that they can convert it to residential. There are some around the edges where you can, but it's difficult. Most of Continental Europe isn't like that. Most of Continental Europe, this is the same thing happening, urban population growth needing -- fueling the need for more housing, and so the residential developers go in and buy because there are very few places where industrial land is strategically protected as industrial. It's something that we're very much trying to engage with local authorities with -- on and to say that, "You're going to create a problem for yourselves if you don't provide local jobs and space to make the city work," but it means it's a long, hard process. So we're very committed to it. We think it's a great product, but it's going to be a gradual rather than a very rapid switch in terms of portfolio weighting. Any more questions in the room? Alan?

Alan Carter

Yes, Alan Carter, Stifel. This is probably for Andy. Just intrigued, a very high lease retention rate at the moment. Obviously, the expiry profile historically has been pretty rapid in distribution space. I'm wondering if you can just give a flavor of sort of the uplift you're being able to drive, at least expiry, when you've got 80% plus of your tenants remaining in situ. I presume that's driven by a lack of alternatives, so you kind of got them across a barrel. So I'm wondering if you can give a few examples if it's not commercially insensitive.

Andrew S. Gulliford
COO & Executive Director

We never have our customers across a barrel, Alan. We're always working with them, but yes, it's pretty good for us at the moment because, as you saw from the slides, the lack of supply is clearly, frankly, making people sticky. We like to think we are doing pretty well with customers as well. Just mention our sort of customer satisfaction, which has gone up considerably to 87%. So we do work very closely with our customers, but yes, the dynamic is in our favor at the moment. So we are seeing -- on regears, renewals and reviews, you saw from David's stats some really significant uplifts in London over the period. That's been in the sort of 5% to 10% mark, a little bit less elsewhere.

What?

I've clearly ruined a relationship with one of our customers there. So sorry about that. But so we are seeing progression. And sort of generally we are -- in our leasing and our activities, we are using sort of vacancy and regears, renewals. We're looking for value, as opposed to, in the past, we've been, particularly on the vacancy side, letting to fill up. That's not the case now. So we're happy on the vacancy side too to wait our time for deals. When you've got 3% vacancy on the trading estate, 3% vacancy in Park Royal, you can push ahead a little bit. So we're definitely seeing that coming through.

David John Rivers Sleath
CEO & Executive Director

So Marc. Marc is coming for a return. If you could get your hand up first, and then you get the mic.

Marc Louis Baptiste Mozzi
Societe Generale Cross Asset Research

Yes, just a follow -- it's not a follow-up actually. It's just on the Sofibus acquisition. If we can have a kind of an explanation why, rationale. Is it an industrial or a financial movement? What is the final aim on that? What sort of dividend yield are you going to get from that?

David John Rivers Sleath
CEO & Executive Director

Stake we've acquired in a French-listed company whose principal asset is a -- it's like many Slough Trading Estates in South of Paris. I mean, because it's a listed company, Marc, you'll appreciate we're quite limited in what we can say, but we're very pleased we've bought a stake in the company. We like the asset. We like the terms that it throws off, and we'll see what happens from here. Keith?

Keith Crawford
Peel Hunt LLP, Research Division

[indiscernible]

David John Rivers Sleath
CEO & Executive Director

No, you must use the mic now, if you don't mind.

Unknown Executive

Press the button.

Keith Crawford
Peel Hunt LLP, Research Division

Can you hear me?

David John Rivers Sleath
CEO & Executive Director

Yes, we can. Go on.

Keith Crawford
Peel Hunt LLP, Research Division

Good, okay. I've just been looking through this presentation. It answers any question I could conceivably ask. It does seem that all the capital has been...

David John Rivers Sleath
CEO & Executive Director

[indiscernible], not one.

Keith Crawford
Peel Hunt LLP, Research Division

I mean really right down to looking into the Europe and the balance of all the territories. Everything looks perfectly excellent and justifies the capital that's been put in by shareholders in recent years, so I'll ask a saucy question. Amazon, what type of leases do you get -- you as a company, get from Amazon? Do you get an inc tenancy? Do you get a local tenancy? Do you get a U.K. tenancy? What sort of thing do they do? Because they've been fighting landlords for years, of course.

David John Rivers Sleath
CEO & Executive Director

Well, Amazon are very protective about what they allow their landlords to say. So just in case I put my foot wrong, I'm going to pass over to our Amazon key account director, who is Andy Gulliford. And he will answer the question as diplomatically as he can.

Andrew S. Gulliford
COO & Executive Director

I was really hopeful that, as you were taking that, you were going to stay with it. I've got to be really careful on that because that is commercially sensitive. And I certainly wouldn't want to upset what is now our second largest customer and growing rapidly. But we are, Keith, very aware of the covenant strength, not just with Amazon but generally. They tend to have a structure which provides a European covenant which is extremely good. So that's what we do.

David John Rivers Sleath
CEO & Executive Director
Okay, any more from you all? If not, then thank you all very much for your questions and for coming on this morning. And have a good day.