Date: 20th March 2020

URBAN LOGISTICS REIT PLC

Investment recommendation: Buy

Current Price: £1.27 / Target Price Range: £1.74 - £2.49

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We see a long term 37%-96% range of upside in the share price of Urban Logistics REIT. This is due to an underappreciation of earnings power and unpriced structural shifts in last mile warehousing.

Executive Summary

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.

Our valuation of Urban Logistics points squarely towards an intrinsic value that is far above the current market price. This is driven by:

1. Current Income generation of asset base under-priced by market
2. High Potential for upwards rental adjustments
3. High potential for profit margin growth
4. Transition to an investable market cap
5. Covid-19 selling pressure unrelated to fundamentals

The key risks to this investment are:

1. The market fails to realise its mispricing.
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.

These risks are mitigated by using highly conservative forecasts in the valuation of Urban Logistics and having undertaken a thorough due diligence process of the business including interviewing management.

Market Data	
TKR	SHED
Price (£)	1.27
12M High	1.50
12M Low	1.13
Shares (M)	86.5
Mkt Cap (M)	240.49

Major Shareholders	
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%

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 resource 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.

Management & Governance

We believe Richard Moffit and Mark Johnson are competent and have the necessary skill to continue to provide value to shareholders. Richard Moffit is the key actor for the company, utilising his contact list and expertise built up from 25 years within the Industrial and Logistics industry to identify and acquire properties adhering to the company's investment philosophy. Whilst we do see this reliance on Richard Moffit as a potential risk for the company were he unable to fulfil his role, we believe that the close ties of Urban Logistics with Pacific Investments (Chaired by Sir John Beckwith, 8% shareholder, and managed by Urban Logistics director Mark Johnson) would allow for a competent interim manager to quickly be appointed.

Management is aligned with shareholder interests through their 1.05% shareholding of the company and performance structured pay. Moffit and Johnson are remunerated with a low ongoing management fee of 95bps of assets under management, alongside a 10/10 performance fee. Whilst having personal confidence in management to act in the best interest of shareholders, we have reservations over their incentive structure. The 10/10 performance fee may lead to a prioritisation of short-term performance, over long term value creation.

Leadership Team

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 Moffitt. Due to the underlying structural imbalance within last mile warehouse supply and demand, we strongly support management's policy of expansion. As demand begins to outstrip supply there is likely to be upward pressure on the prices of warehouses within the company's investment remit. Thus, making acquisitions sooner rather than later is the best way to grow property yields going forward. Therefore, Urban Logistics; is successfully implementing a sound business strategy.

Expansion, a driver of our investment thesis, is set to continue in the coming years with the company having just raised £136M in an equity placement completed on the 11th March. 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. This purchase will thus 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 there is no compelling reason to make a strong judgement on the effectiveness of these investments, we believe that management is well qualified to operate such a policy.

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. 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.

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. The 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 to 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 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 above.

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 in the coming 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 (64%) 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 does not rely on real growth for a significant upside in the investment. As long as management can maintain the real value of their properties and the market eventually recognises the value of Urban Logistics' asset base and rental income, the share price will increase to the target range

High potential for upwards rent adjustments

Urban Logistics has high potential for future upwards rental adjustments, as 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 straightforward; 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 current market rate, which 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 rent increases, as there isn't a better price available to tenants elsewhere.

High potential for profit margin growth

As Urban Logistics continues to expand its asset base it will benefit from economies of scale, spreading administrative costs over more assets. These costs come primarily from the employment of a small team of full-time staff. The workload of four rent checks per year, and around three tenant meetings per year will not require a significant increase in staff as the company expands. Therefore, administrative costs will not grow proportionally with the asset base and instead the average of 19% of revenue that these costs historically represented will compress as the company grows.

Additionally, we expect that operating expenses will also fall as Urban Logistics matures. The vast majority of historically reported operating expenses have come from the costs associated with letting to new tenants. In 2020 HY, a period in which the company made few acquisitions and had 100% occupancy rate, the nominal operating expense fell by 10 times in comparison to the 2019 HY period. This is because Urban Logistics does not have direct costs associated with the operation of occupied warehouses. Therefore, within the next 5 years, as the company reaches its mature size, we expect that a falling acquisition rate will lead to a fall in operating expenses.

Transition to an investable market cap

It is our belief that the market is potentially 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 investors face constraints on investments into Micro-Caps we believe that demand for Urban Logistics' stock could be artificially subdued.

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, will significantly reduce the constraints of institutional investors and drive the price towards our intrinsic estimation. Conversations that we've had with institutional investors who have come into contact with Urban Logistics convince us of this point.

Covid-19 selling pressures unrelated to fundamentals

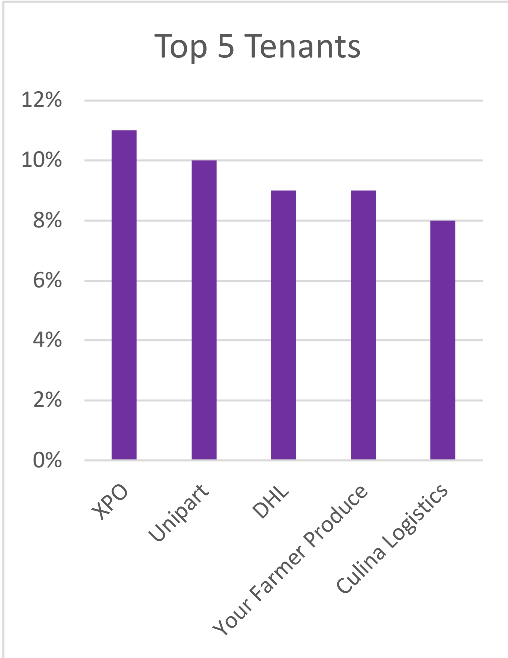
Over the past three weeks we have observed the share price of Urban Logistics decline by 12.5% in response to the broader market sell off. Whilst this fall has been less extreme than the FTSE100 (-25%), it is likely unrelated to a decline in the intrinsic value of Urban Logistics. By virtue of long tenant contracts (5.1 year WAULT) and high switching cost (50-80 months' rent to relocate) the company's portfolio is insulated from this kind of shock. Unless the market is predicting that the tenant portfolio, of which 89% is rate low-moderate risk, will begin to default then the sell-off indicates that investors are scared, rather than the company has reduced earnings potential. As we expect the share price to tend towards its intrinsic value in the long run, this behavioural drop in price represent an opportunity to realise greater upside on our investment.

Financial Analysis

Revenue

Urban Logistics' revenue has followed a healthy growth pattern, largely in line with the acquisition of assets. 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 lease 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). 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.

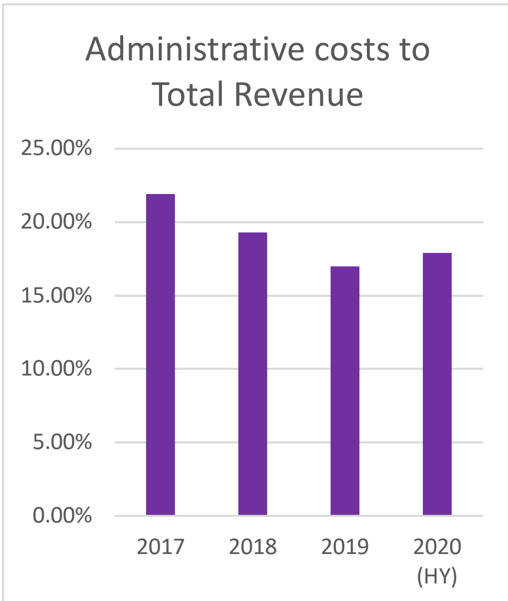


Source: 2020 Interim Report

Costs

Administrative costs:
Administrative cost, in nominal terms, have grown year on year to £1.8M in 2019. However, as a percentage of revenue, they have consistently fallen. This supports the thesis that Urban Logistics is nearing its maximum administrative size and therefore, as the asset base expands, will benefit from economies of scale resulting in higher profit margins.

Operating costs:
Operating costs, whilst historically volatile, are primarily derived from the costs associated with letting out warehouses. There are no direct operating expenses paid by Urban Logistics whilst a property is occupied. The extent of this can be seen in the fully let HY 2020 operating cost of only 0.7% of revenue, compared with the average of 8% over the rest of the company's history. When the availability of acquisitions fall, as management expects it to in around 5 years, we foresee a consistent operating expense of around 1.5% of revenue (accounting for the possibility of unoccupied warehouses).

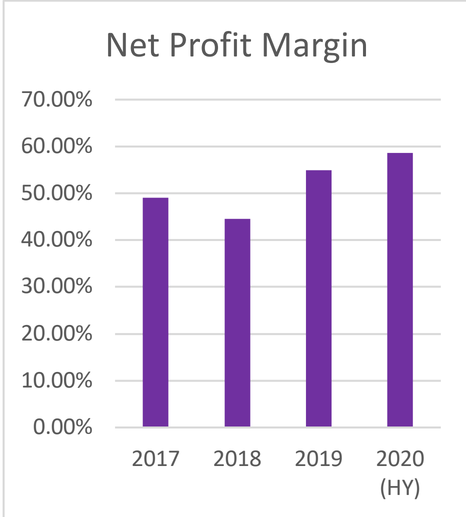


Source: 2017-2020 Annual Reports

Profit margin

Urban Logistics benefits from wide profit margins. 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.

This profit margin is expected to increase in coming years as an increased operating margin drags up net margin.

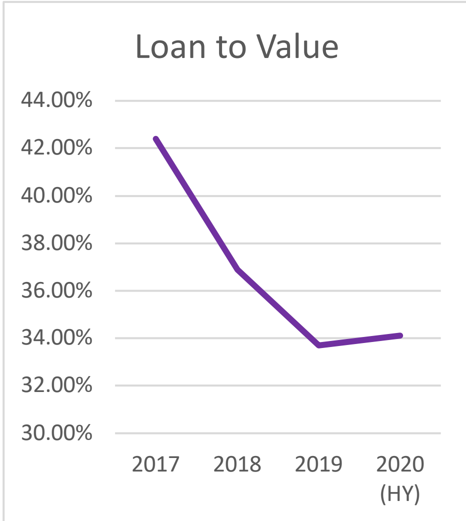


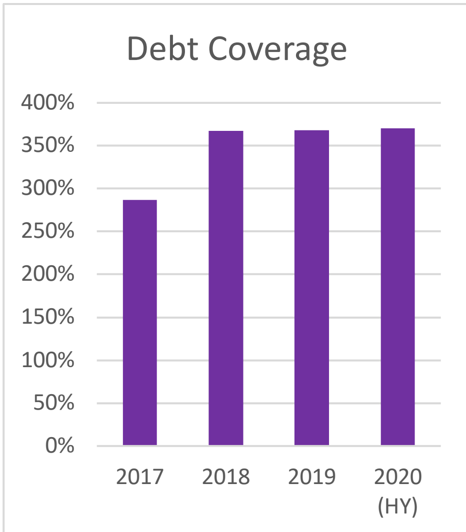
Debt Position

Urban logistics has up to this point used debt sparingly to fund its expansions, instead preferring to raise 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%.

Financing expenses have 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 it is not expected to significantly increase in coming years.

There is very little risk of the company becoming unable to manage debt payments as lease payments are non-discretionary and operating profit consistently represents around 370% of finance expense.





Sources: 2017-2020 Annual Reports

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 are not accurately predictive of the company's future. To resolve this issue, a unique dividend discount model is designed to value the company. This model assumes, metaphorically, that the company is a machine that every year translates a proportion of its asset base (at acquisition cost) into income distributable to shareholders. The REIT is thus valued entirely from income generation, without factoring in any potential gains from property disposals

Our base case model conservatively assumes that:

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

The future cash flows from rental income are discounted with a rate obtained by accounting for the risk associated with an equity investment into Urban Logistics:

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 portfolio)

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 the fact that, although 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 the model.

<u>Discussion of discount rate</u>

The discount rate chosen for our model is based upon the return that an investor would require to invest in a similarly risky security. To find this we split the risk of the company into two key sections:

1) The risk the company will become insolvent and thus unable to pay equity holders. This risk is proxied by Urban Logistics' cost of debt, which is approximately 2.1%+£L.
2) Tenants' credit risk, namely the risk of individual tenants defaulting on their rental obligations to Urban Logistics', is proxied by the individual tenants cost of debt. Accounting for the diversification benefit of having multiple tenants, the required return for an investor taking on this risk is likely equivalent to that of a AA corporate bond. In our model, however, this risk is taken to be 10 standard deviations away from the average AA default risk, by using the 2.16% yield to maturity of a portfolio of BBB corporate bonds.

This yields a 5.26% discount rate

Comparing this discount rate to a simple CAPM model further shows how conservative this methodology is. As CAPM (with a beta = 0.3075) returns a discount rate of only 3.34%.

Base Case Assumptions

The starting point of our quantitative analysis is strongly conservative. The assumptions made in the base case scenario are explained in detail as follows:

Net income 4% of Asset Value: After subtracting all costs associated with the operation of the company. 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 implying 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, the demand/supply imbalance driven by secular demand shifts and a 9% reversionary buffer suggests that assuming 4% is not only reasonable but highly conservative.

1.75% asset value growth until 2024: A 1.75% annual growth of asset value implies that assets will not grow in real terms as the current inflation rate is also 1.75%. Urban logistics, instead, has written up the value of its portfolio by an average of 16.4% in the past 2 years. These write-ups are excluded from our analysis as all asset values are taken at acquisition costs. Therefore, assuming no real growth in the base case scenario is a highly conservative assumption as it would require a significant reversal in the economic conditions of the last mile industry.

2% growth after 2024: Implies that the real value of assets will see no growth in the long run as the BoE's long-term inflation target is 2%. There is no compelling reasons on either side of the argument to predict that inflation will be anywhere but target in the long run. However, 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. Therefore, the long-term assumption results in a very, perhaps overly, conservative valuation for our base case. Nonetheless, starting with a very conservative valuation is one of the key strategies we employ to minimise downside risk.

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, not relying on management's above average skill in our base case scenario implies that our approach is once again conservative.

Valuation Results

Base Case:
The aforementioned assumptions lead to an indicative valuation in the base case of £2.08, suggesting a potential upside of 64% compared to the current market price.

A sensitivity analysis is performed on the results of the base case by adjusting our assumptions to replicate the effects of a severe and protracted economic downturn or a bull market.

<u>Worst Case Scenario:</u>

The super bear scenario assumes that annual net income will fall to 3% of asset value annually, and the value of assets will remain at their current level in perpetuity. The potential loss in this scenario is 24%.

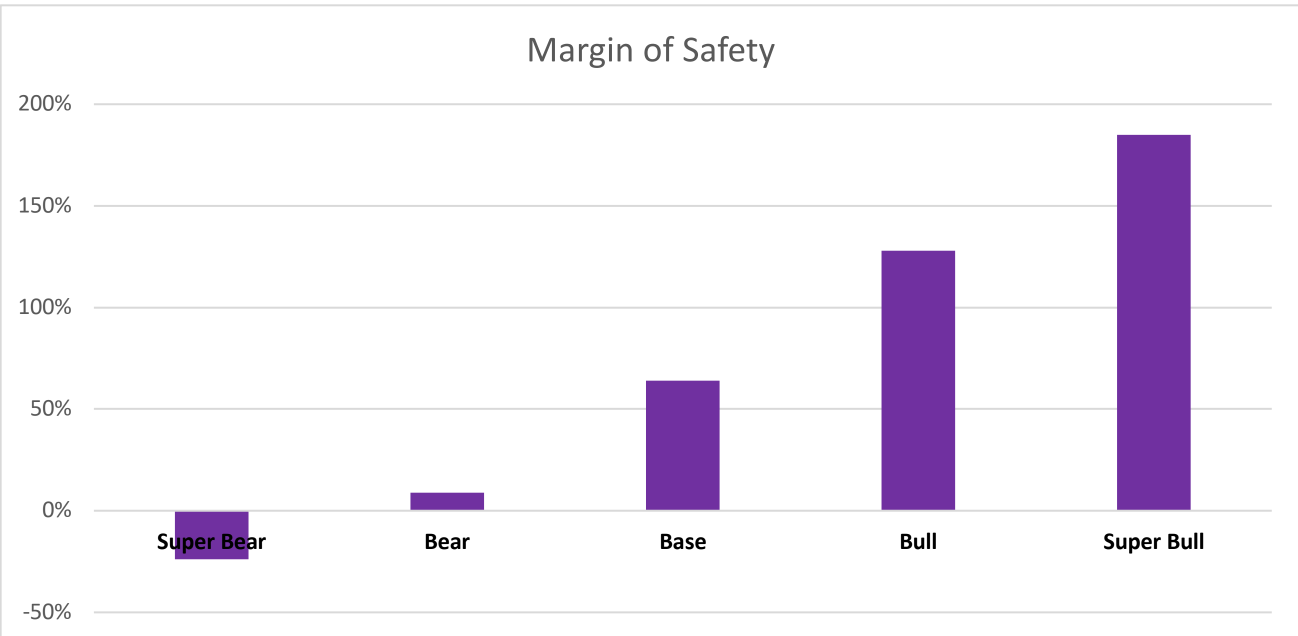
Bear:
The bear scenario assumes that annual net income remains at 4% of asset value, 1.75% asset base growth until 2024, and no nominal growth at all after 2024. The potential gain in this scenario is 9%.

Bull:
The bull scenario assumes annual net income remains at 4% of asset value, 1.75% asset base growth until 2024, and 3% growth after 2024. The potential gain in this scenario is 128%. The long run growth rate is estimated to be 1% above the UK's long-term inflation target.

Super Bull:
This is a best-case scenario which assumes annual net income increases to 5% of asset value, 1.75% asset base growth until 2024, and 3% growth after 2024. The potential gain in this scenario is 185%.

Case	Implied Value	Margin of Safety
Super Bear	£0.96	-24%
Bear	£1.39	9%
Base	£2.08	64%
Bull	£2.90	128%
Super Bull	£3.62	185%

Discount rate = 5.26%



Downside Scenarios

As the base case scenario is designed to be highly conservative, it follows that the bear cases are unlikely and would require some form of large and unforeseeable disruption not only to Urban Logistics‘ business model and the last-mile warehouse industry, but the entire economy.

A fall in earnings yield, as assumed in the worst case scenario, is conceivable only in the event of a serious technological disruptions to the industry, which would make the Urban Logistics’ business model obsolete, or in light of new regulations and zoning laws which would allow for an increase in supply.

While assuming no nominal growth after 2024 implies that that management becomes incapable of increasing the real value of assets, either due to internal or external limitation to the firm. However, 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. Hence, the downside scenarios model cases in which the investment is subject to severely adverse circumstances. Without significant disruption from either the demand or supply side of the industry, the natural imbalance between these two forces will continue to increase asset values at least in line with inflation. Therefore, the downside scenarios are deemed to be rare albeit possible.

Conclusion

The bottom line of the quantitative analysis is that the upside scenarios of Urban Logistics outweighs the downside cases. Only unpredictable exogenous shocks to the industry or company would trigger downside scenarios, whereas the potential upside is a result of evident structural increase in demand combined with a supply shortage.

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 largely insulated from economic shocks.
3) Its product is highly relevant in today’s digitalised economy and for the foreseeable future.
4) It serves an expanding market in which supply faces hard constraints.
5) Management is experienced and well aligned.
6) The market fails to price the above 5 points.

Risks to Thesis

Threats to sector:

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. Additionally, it is possible that e-commerce retail is highly sensitive to economic downturns.

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. However, this would require a vast expansion of Amazon's current ownership of warehouses.

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:

Tenants default on rental contracts
Urban Logistics income depends on the ability of its tenants to meet their contractual obligations to pay rent. If tenants become insolvent, and thus unable to pay rent then Urban Logistics income stream will be substantially threatened. The key risk is not that individual tenants become insolvent in isolated incidents, the portfolio is sufficiently diversified to absorb this, but that an exogenous event renders multiple tenants unable to pay simultaneously.

Substantial 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.

Management continues to acquire as 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 that of replacement costs, there is the threat that management will continue 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.

Risk Mitigation

We have attempted to mitigate the exposure of our thesis to the above risk factors through a conservative approach to modelling. This provides a level of protection from risk factors that would result in a fall in rental income growth. Additionally, in in our valuation model we have not factored in the unquantifiable potential of future acquisitions, nor have we included the likely expansion of margins going forward. These form a significant proportion of our conviction in future price appreciation of Urban Logistics' share price, however DUSIF's core philosophy of not paying for hope means that we do not include these growth factors in our model. Therefore, when we give our target price range it is from a value perspective that does not include these likely, yet unknowable, factors.

Our analysis may be affected by exogenous shocks such as our current experience of Covid-19. However, we believe that the risk of shocks such as this are mitigated by management's selection of low credit risk tenants. With a weighted average unexpired lease term of 5.1 years and tenant moving costs between 50-80 months' worth of rent, the income Urban Logistics is largely resilient to the business cycle. The fundamentals of Urban Logistics remain unchanged by Covid-19 and therefore the falling price represents panic selling, rather than a deterioration of future earnings prospects.

Disclaimer:

The Durham University Student Investment Fund is not a professional investment organisation and therefore the content of this document is intended for EDUCATIONAL PURPOSE ONLY. It does not constitute legal, accounting, financial or tax advice for any individual or corporation. Many contingencies could affect the validity of the statements and views expressed in this document. The Durham University Student Investment Fund, including all of its members, under no circumstances will be liable for losses or damages of any nature resulting from the reliance and/or application of the information in this document.

Appendix A

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 U.K. 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.

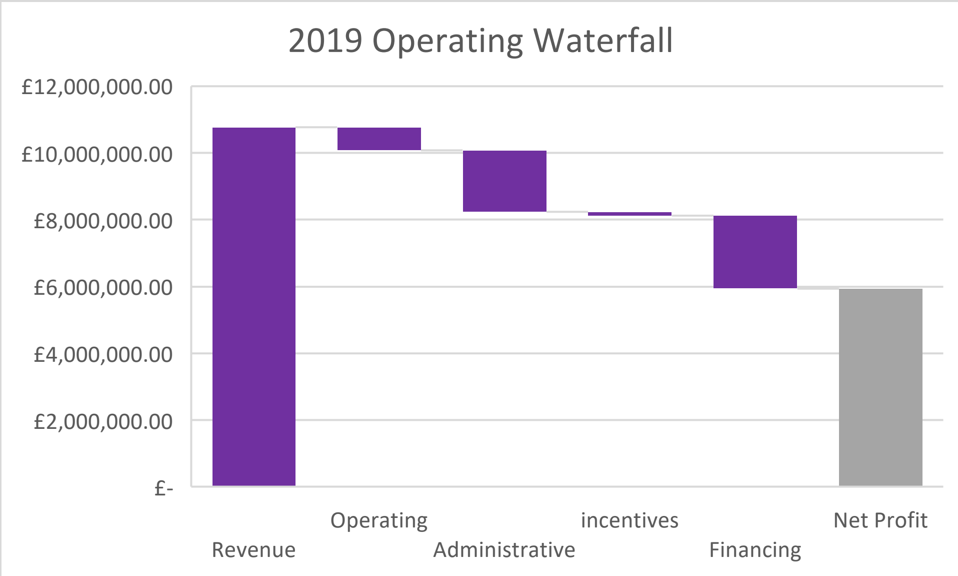
3PL

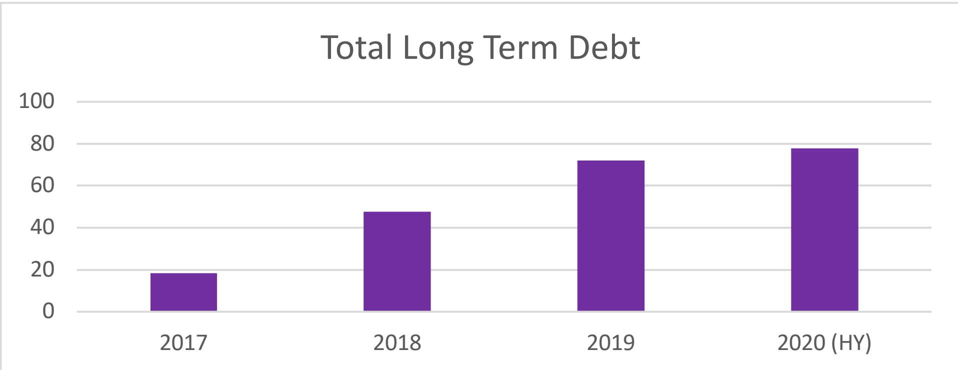
Third party logistics companies such as Amazon, DHL, XPO etc. have been buying properties at an increasing rate, typically with a growth rate higher than that of which they are increasing leased properties. No exact numbers could be sourced for the pace of this growth, but it represents only a small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

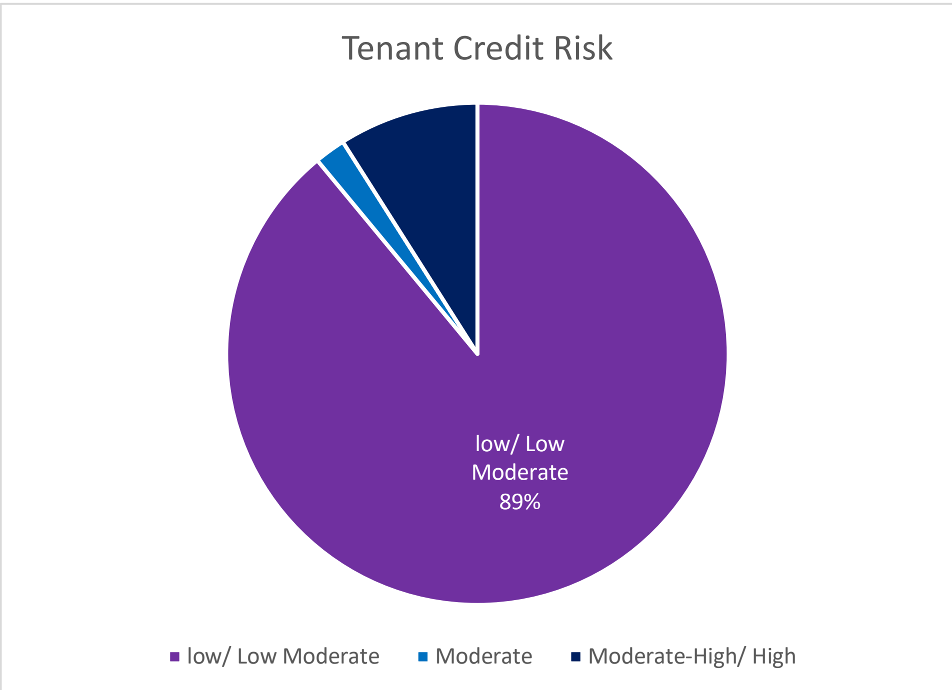
Blackstone

Blackstone have entered the UK last mile logistics space recently through their acquisition of Hansteen, a director competitor of Urban Logistics. Management at Urban Logistics claim that due to the size of transactions that Blackstone must make, they are not a direct competitor as they can't make purchases of individual assets. We agree with the sentiment of management, whilst the warehouses that Blackstone own are direct substitutes to Urban Logistics, due to the fact that they can't acquire individual properties they do not pose a threat to future expansion. On balance we feel that due to the potential for acquisition Blackstone's interest in the market is a positive for Urban Logistics.

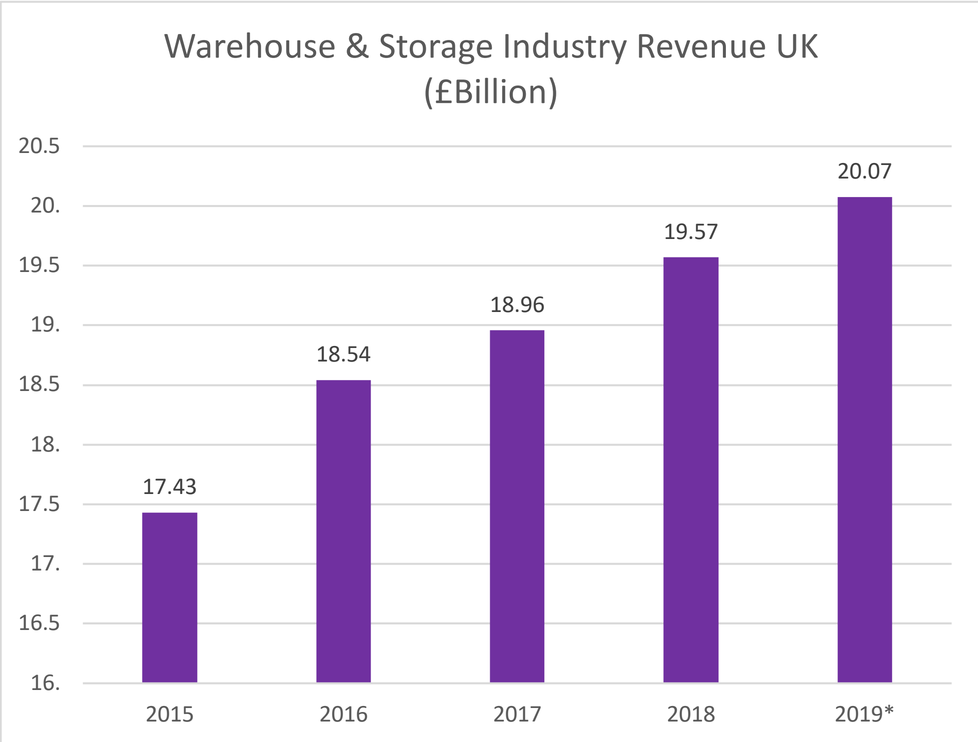
Appendix B


2019 Operating Waterfall
£12,000,000.00
£10,000,000.00
£8,000,000.00
£6,000,000.00
£4,000,000.00
£2,000,000.00
£-
Revenue
Operating
Administrative
incentives
Financing
Net Profit

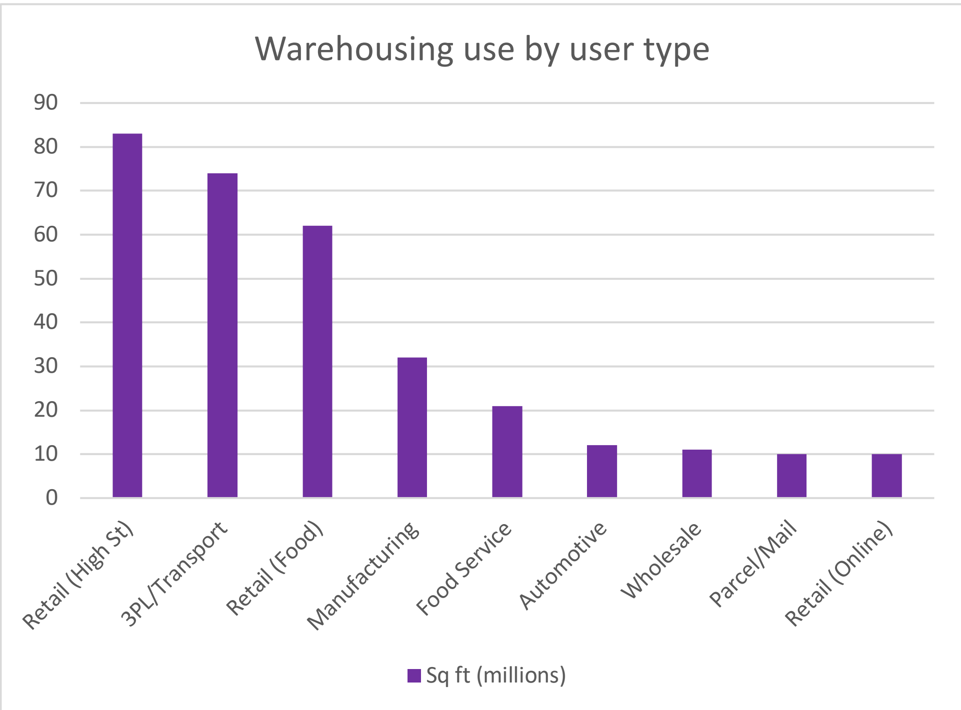

Total Long Term Debt
100
80
60
40
20
0
2017
2018
2019
2020 (HY)


Tenant Credit Risk
low/ Low Moderate 89%
low/ Low Moderate
Moderate
Moderate-High/ High

Appendix C



Warehouse & Storage Industry Revenue UK
(£Billion)
20.5
20.
19.5
19.
18.5
18.
17.5
17.
16.5
16.
17.43
18.54
18.96
19.57
20.07
2015
2016
2017
2018
2019*



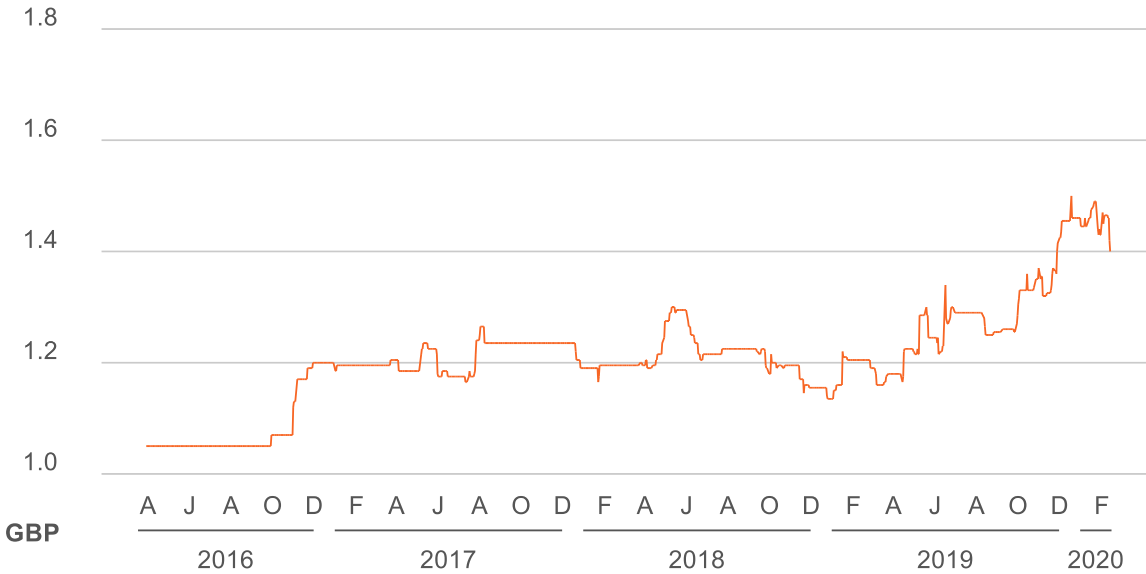
Warehousing use by user type
90
80
70
60
50
40
30
20
10
0
Retail (High St)
3PL/Transport
Retail (Food)
Manufacturing
Food Service
Automotive
Wholesale
Parcel/Mail
Retail (Online)
Sq ft (millions)

Appendix D

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 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

Directors' shareholdings

The beneficial interest in the Ordinary Shares of the Company held by the Directors who were in office during the year are set out below.

Director	Number of Ordinary Shares held	Percentage of issued share capital at 31 March 2019
Nigel Rich - Chairman	225,536	0.26%
Bruce Anderson	45,554	0.05%
Jonathan Gray	60,000	0.07%
Mark Johnson	193,478	0.22%
Richard Moffitt	398,362	0.45%

Directors' remuneration

The fees paid to the current Directors in the year to 31 March 2019 are set out below.

Director	
Nigel Rich – Chairman	£75,000
Bruce Anderson	£35,000
Jonathan Gray	£35,000
Mark Johnson*	–
Richard Moffitt*	–
Total	**£145,000**

* Mark Johnson and Richard Moffitt do not receive any remuneration as directors of the Company.

Source: 2019 Annual Report