MAILBOX REIT PLC (MBOX:IPSX)

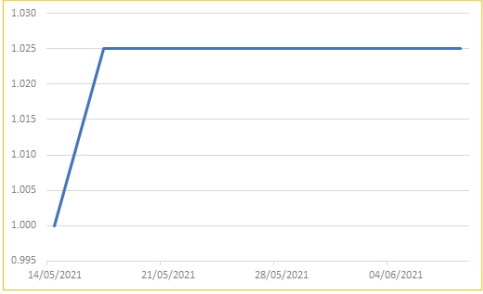
9 June 2021

proactive research

Diversified REITs

PRICE	**£1.04**
MARKET CAP MLN	£88.24

Share Price



Major Shareholders

Shares in issue	84,850,000
Primary Index	

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Mailbox REIT - Income investing with capital upside

A property with secure rental income, and value enhancement potential

Mailbox REIT (MBOX) is a new real estate investment trust (REIT) that began trading on the International Property Securities Exchange (IPSX) Wholesale market on May 14, 2021. MBOX offers investors exposure to a centrally located prime Birmingham commercial property — The Mailbox — that is valued at £181mln. The company is initially targeting an annual dividend of 7p (7% yield at the current price) in year 1, with the potential to increase this in the medium term, as well as offering the potential for capital gains through asset enhancement projects.

The shares trade on the IPSX Wholesale market. IPSX is the world's first regulated exchange for companies owning a single commercial real estate asset. We examine some key attributes of the IPSX as a platform on p3.

The Mailbox is an office-focussed mixed-use commercial real estate asset located in central Birmingham. The property benefits from:

- **A secure income stream from the core tenant base, and upside potential from asset management projects**
- **Exposure to the central Birmingham office market, which benefits from strong demand drivers and significant supply constraints**
- **Excellent transport links, close to Birmingham New Street station, and with good links to the planned HS2 hub**

We present an overview of The Mailbox on p4-6.

Financial outlook

In this report, we provide a detailed analysis of the financial outlook for Mailbox REIT. In particular, we examine the drivers for increased rental income over the 2021-2024e timeframe. These include increasing rental income from the existing tenant base through rent reviews and renewals, and a significant project to convert retail space into offices. MBOX announced an agreement with IWG PLC in February 2021 for a 10-year management contract under the IWG 'Spaces' brand, which delivers a substantial revenue enhancement through the new office space.

We are forecasting a 35% increase in revenue from rent over the period 2021-2024e. Our detailed profit & loss (P&L) forecasts are on p7, and these support an increase in the dividend from the company's initial target level of 7p up to 10p (our forecast) by 2024. This in turn could lead to significant upside for the share price. We consider the total returns potential for MBOX on p9, and highlight a potential internal rate of return (IRR) of 18.4% per year for MBOX through to the end of 2024.

The table below summarises our forecasts. The dividend for 2021 is based on three quarters only.

Year end Dec 31	Current	2022	2023
Revenue from property (£M)	10.1	11.9	13.3
Underlying Op. Profit	9.0	9.9	11.5
Underlying EPS (GBp)	4.3	7.8	9.6
Dividend (GBp)	4.20	9.60	9.70

Richard Croft, executive chairman, M7 Real Estate

Croft is responsible for the strategic direction of M7 real estate and capital raising, and leads the real estate fund management function. He has been involved in over €8 billion of transactions across the UK and Europe during his 26 years of real estate experience.

Tony Edgley, senior independent non-exec, M7 Real Estate

Edgley has 40 years' real estate experience as an advisor and a principal investor. He previously held senior positions at Brockton Capital and Jones Lang LaSalle.

Mailbox REIT

Mailbox REIT (also to be referred to as MBOX) is a single-property REIT offering investors exposure to a prime Birmingham office-led mixed-use asset called The Mailbox, which has a high-quality tenant base, secure long-term rental income stream, and significant value enhancement potential. The shares are listed on the IPSX Wholesale market, which is the world's first regulated exchange for companies owning a single commercial real estate asset.

The asset manager for Mailbox REIT is M7 Real Estate Ltd., a leading specialist in regional, multi-tenanted real estate with over 65mln sq ft under management across Europe. M7 acquired The Mailbox in December 2019 and has initiated a significant programme of property enhancements over the 2021-2024 timeframe that have the potential to increase the net rental income from around £9mln run-rate to £13.6mln. M7 retains a 70% equity interest in MBOX, and is contracted to act as an alternative investment fund manager (AIFM) and asset manager to Mailbox REIT.

The shares have a number of attractive qualities from an investor's perspective:

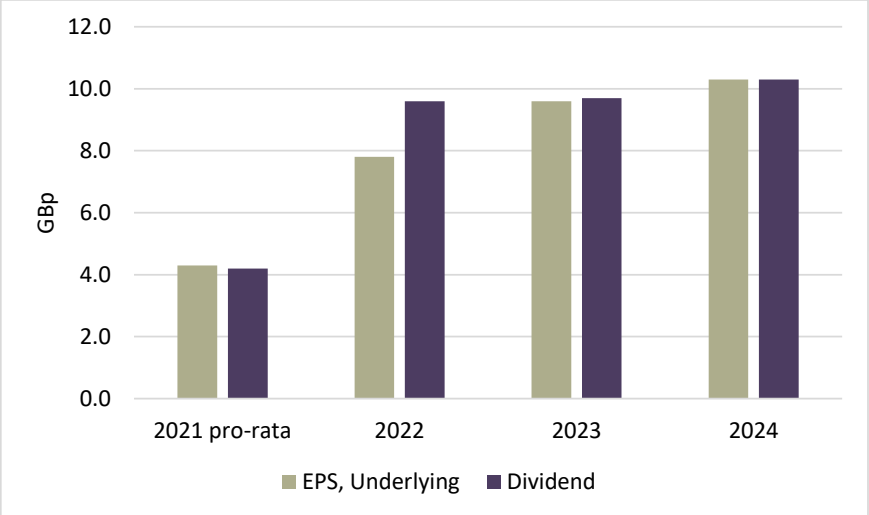
- Upside potential from asset management projects
- Targeted dividend yield of 7% from year 1, with potential to increase to 10% in the medium term
- Exposure to the central Birmingham office market, which benefits from strong demand drivers and significant supply constraint

In this report, we provide an overview of the property and the financial outlook for MBOX.

To summarise the financial outlook, we believe that Mailbox REIT will cover its cost of financing and generate surplus cash from year one, enabling the company to pay a dividend. The initial dividend target is 7p which represents a 7% yield for investors. We believe there is scope to begin increasing this dividend in the next few years. The following chart shows our forecasts for earnings per share and dividend.

Initial target dividend of 7p (annual basis). We forecast 10p by 2024

Proactive Research forecasts - underlying earnings per share and dividend



Source: Proactive Research

Dividend increases could in turn drive significant upside for the share price. We examine the financial outlook and the potential returns for shareholders on p7-9.

The single property REIT allows investors to build their own diversified portfolio, with cost efficiency and transparency

The IPSX and the concept of a single property REIT

IPSX is the world's first regulated securities exchange dedicated to companies owning single institutional-grade real estate assets or multiple assets with commonality. IPSX is a fully regulated exchange and is recognised by the Financial Conduct Authority as a Recognised Investment Exchange.

The single-asset REIT is a new asset class to the UK market although following the same structure and regulatory regime as the existing REIT market.

We compare certain characteristics of a single property REIT against the more familiar multi-property REIT:

- Lack of diversification. The idea here is that the investor can diversify their own portfolio instead of paying a portfolio manager to do it for them. Currently investors would diversify by holding Mailbox REIT alongside some multi-property REITs. As the market for single property REITs expands in future investors will have the opportunity to build their own portfolio of single property REITs.
- Cost effectiveness. Multi-property REITs have the ability to defray their central operating costs over a large number of properties; however, Mailbox REIT will use an external property manager and pay as a percentage of net asset value (NAV), which is actually what many multi-property REITs already do. The cost ratio for MBOX actually compares favourably with the UK REIT sector.
- Transparency. Another advantage is that having a single property makes it possible to have far greater transparency and granularity about the tenants and income streams that would be possible with a REIT invested in numerous properties. This makes it easier to understand what is being invested in and gives greater confidence in the valuation.

In addition to having the same attributes as a regulated exchange like the London Stock Exchange (LSE) in terms of regulation, transparency, liquidity, the IPSX also has some specific advantages as a specialist property exchange. In particular the IPSX valuation requirements create potential for share prices to be more closely aligned with NAVs. This should mean that there is less equity market "noise" around share prices and less volatility — effectively returns for investors should be more like property returns.

Furthermore, investing in Mailbox REIT allows shareholders to avoid some of the issues that have caused concern in the UK listed property space in recent years. Specifically many investors in the space have concerns about the possibility of gating (suspending withdrawal of funds from a unit trust), concerned about the IFA proposed 180 day redemption period on open-ended funds. Mailbox REIT is not an open-ended fund. There is no prospect of gating and no redemption period.

The Mailbox Birmingham

The Mailbox is an office-focussed mixed-use asset located in central Birmingham, located five minutes' walk from New Street Station. The property houses Grade A office space, retail, leisure and a car park operated under a long-let by Q-Parks Ltd.

A prime mixed-use asset in central Birmingham with office focus

The Mailbox

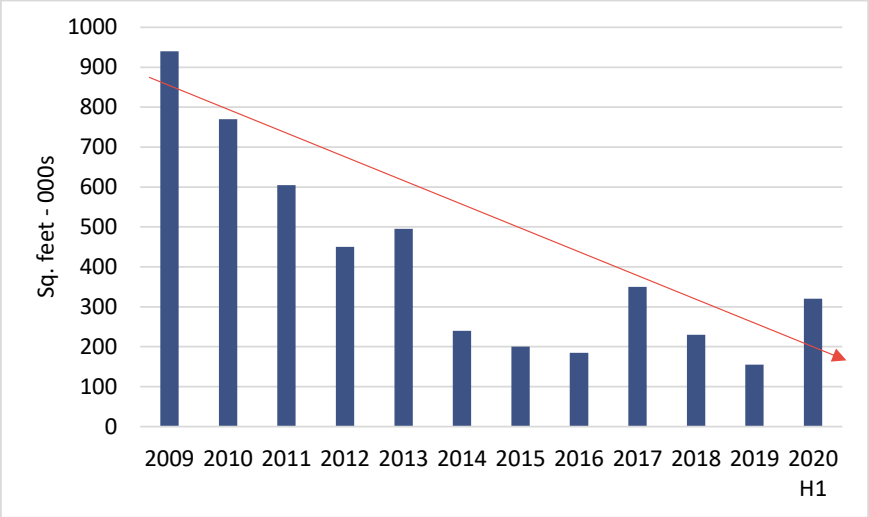
Source: Mailbox REIT

The property benefits from a prime location in central Birmingham. The city is at the heart of the UK's second largest urban region, the West Midlands, which has a growing population of 4.2 million, excellent transport links, and a growing economy.

Supply constraints supportive of office rent levels

The market for office space in Birmingham also benefits from supply constraints, which are supportive for rents. This is important for Mailbox REIT because office space accounts for 50% of the current rent roll, and this will increase over the next few years as asset management projects are implemented to convert more of the floor space into offices. The following chart shows the available office space in Birmingham over the last decade.

Birmingham city centre Grade A office space availability



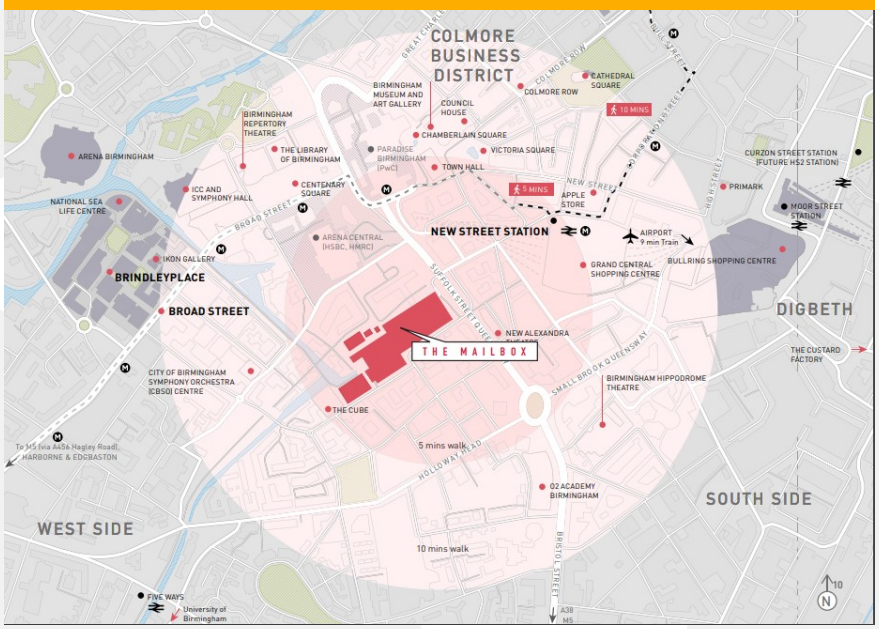
Source: Avison Young 2020 and JLL 2020

Furthermore, The Mailbox is well-located for transport links, being close to New Street station, the main railway hub for the city. This position will be further enhanced by the implementation of the HS2 rail system over the next decade,

which has been approved by the UK government. The map shows the location of The Mailbox.

Close proximity to major rail links

Location in Birmingham city centre



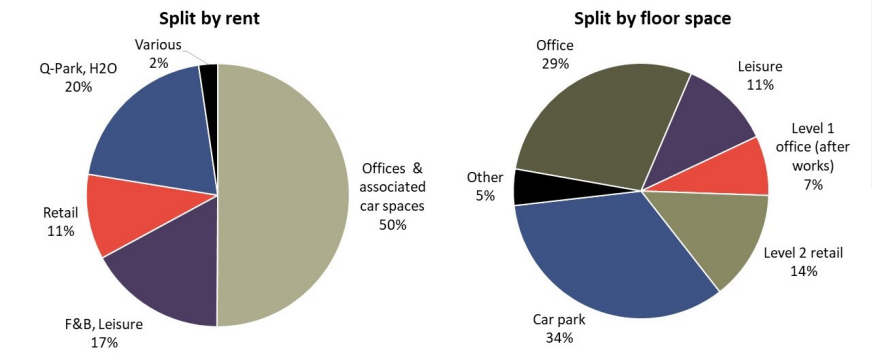
Source: Mailbox REIT

The tenant base consists of office, retail and leisure tenants as well as a car park which is let to Q-Parks Ltd.

As an aside, we note that The Mailbox buildings also contain some residential and hotel properties, which have been sold off under leasehold agreements and which do not form part of the revenue base for MBOX.

The following charts show the breakdown of Mailbox REIT's tenant base by sector, in terms of rental income and floor space.

Types of tenant - by sq. feet and by rental income



Source: Mailbox REIT

Plans to convert more retail space into offices

The retail tenancies generate a lower income per square foot than offices, and one of the major projects for Mailbox REIT to enhance asset value is the conversion of retail space on Level 1, currently unoccupied, into office space. We examine this on p7.

Another attractive quality of Mailbox REIT is the long lease time attached to the current tenant base. MBOX has an overall weighted average unexpired lease term (WAULT) of 14 years. WAULT is an industry-standard measure for lease duration,

and at 14 years Mailbox REIT compares favourably with the UK-listed commercial property space.

The tenant base consists of 39 enterprises, of which the largest 10 account for 90% of the rent roll. The following table shows the top 10 tenants.

The company has undertaken Creditsafe rating checks for these tenants, all of which rated as "very low risk" with the exceptions of The BBC (not rated, but as a government-backed broadcaster surely low risk in our view), Everyman Media (rated "moderate risk"), and individuals (not rated).

A high quality tenant base

Top 10 tenants

Tenant	% of Total Current Gross Rent	Contracted Rent
British Broadcasting Corporation	24.25%	£2,143,004
Q-Park Limited	19.85%	£1,754,434
Advanced Business Software and Solutions Limited – trading as Advanced	14.99%	£1,325,039
WSP UK Limited	12.86%	£1,136,482
Harvey Nichols and Company Limited (Guarantor) – trading as Harvey Nichols	6.30%	£556,973
Vodafone Enterprise UK	2.95%	£260,339
Everyman Media Group plc (Guarantor) – trading as Everyman	2.30%	£203,105
Washington Green Retail Ltd	2.23%	£197,500
Ha Ha Bar & Grill Limited	2.19%	£193,741
Cotswold Inns and Hotels Limited – trading as Churchills	2.16%	£190,500

Source: Mailbox REIT

We argue that Mailbox REIT compares favourably with listed multi-property REITs in terms of tenant mix, WAULT, and tenant quality.

Financial outlook

The following table shows our P&L forecasts for 2021-2024. Here we define underlying operating profit, net profit, and earnings per share (EPS) to mean earnings before property revaluations and one-off charges. In this sense, we are measuring rental income rather than non-cash gains or losses. It makes sense for us to look at this measure because rental income is the driver of dividend payments.

Large potential for rental income growth 2021e to 2024e

P&L forecasts, £-000

	2021	Pro rata 2021	2022	2023	2024
Revenue	**10,121**	**6,433**	**11,870**	**13,350**	**13,622**
Other property costs	-3,011	-1,914	-1,864	-2,255	-2,295
Gross Profit	**7,110**	**4,519**	**10,007**	**11,095**	**11,327**
Non cash adj: Amortisation of lease incentive	908	577	782	1,321	1,670
Non cash adj: Bad debt prov	2,040	1,296	268	74	0
Adj Cash Gross Profit	**10,058**	**6,393**	**11,057**	**12,490**	**12,997**
Admin	-1,019	-647	-1,128	-1,037	-974
Op profit	**9,039**	**5,745**	**9,929**	**11,453**	**12,023**
Finance costs	-3,297	-2,095	-3,297	-3,297	-3,297
Net profit, underlying	**5,743**	**3,650**	**6,633**	**8,156**	**8,726**
Share Count (mln)		84.85	84.85	84.85	84.85
Underlying adjusted EPS (pence)		**4.3**	**7.8**	**9.6**	**10.3**
Forecast Div, £-000s		3,559	8,163	8,267	8,736
Forecast DPS (pence)		**4.2**	**9.6**	**9.7**	**10.3**

Source: Proactive Research

Revenue growth drops through to strong earnings growth

Our dividend forecast for 2021 is based on the partial year since market listing and would equate to 7.0p on a full annualised basis.

For the period 2022-24e we are forecasting significant increases in revenue from improved asset utilisation, and this drives significant increases in net income.

Our expectation for increasing revenue from rents arises due to two effects:

- Improved rental yield from the existing footprint and the expiry of rent incentives
- Conversion of more of the retail space into offices

The following table summarises these effects:

Gross Rent	£8.8mln
Market rent, excluding Level 1 conversion	£11.3mln
Market rent, including Level 1 conversion	£15.1mln

Increases in rental income from the current footprint are expected to arise due to rent reviews on existing tenancies, re-letting of a few vacant properties, and the expiration of rent incentives that currently apply to some tenants.

The rental uplift from repurposing is attributable to a project already underway to convert retail space to office use on a large portion of the level 1 current retail space:

A major asset enhancement project underway from 2021

Conversion of retail space and the agreement with IWG

In May 2020 M7 Real Estate secured planning consent to convert Level 1 from retail to offices.

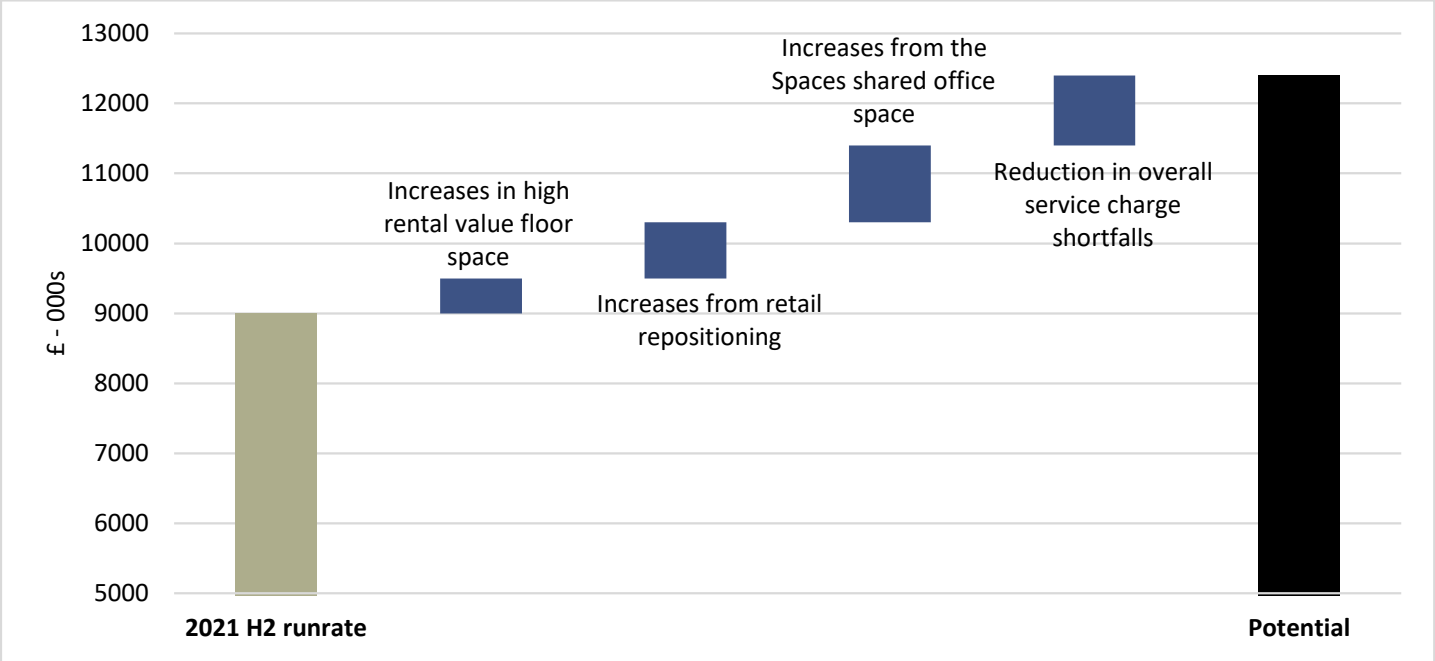
In February 2021 Mailbox REIT announced it has agreed with IWG a 10-year management contract under its Spaces coworking brand over the entire 50,000 sq ft of new office space on Level 1 of the Mailbox. Occupiers of the Spaces offices will pay rent directly to Mailbox REIT, and IWG's management fees will be based on a percentage of rent received.

The company previously set out a target increase in net operating income on Level 1 from the current £1 per sq ft average for retail at the property to about £21.75 per sq ft for offices within three years. To achieve this the new Spaces at the Mailbox would need to achieve occupancy of around 75%. Based on comparable IWG locations in central Birmingham and other similar sites we believe that this could be achieved in 18 months.

The conversion work is budgeted at around £10.2mln, to be financed by Mailbox REIT from its existing balance sheet resources.

Our forecasts assume that the Level 1 office space achieves its 75% occupancy rate during the course of 2022. Taking this together with our other revenue uplift drivers, we arrive at our forecast for significant revenue growth in the next few years. The following chart illustrates.

Rental income bridge - Proactive Research forecasts



Source: Proactive Research

These revenue expectations underpin our forecast for dividend growth over the period and could also lead to capital gains in the appraised value of the property.

Balance sheet

Following the initial public offering (IPO), the company has enough capital available to finance its development plans and to keep the loan-to-value ratio below 60%, by our forecasts. The following table summarises our balance sheet forecast for MBOX.

Balance sheet leverage remains below 60% going forward, our forecast

Balance sheet forecasts

£-mln	Dec-21	Dec-22	Dec-23	Dec-24
Investment Properties	189	190	190	194
Non-current assets	**189**	**190**	**190**	**194**
Receivables	4.4	3.9	3.9	3.9
Cash	3.8	1.2	1.2	1.2
Current assets	**8.2**	**5.1**	**5.1**	**5.1**
Total Assets	**197.2**	**195.1**	**195.1**	**199.1**
Loans	109	109	109	109
Capitalised costs/other				0
Non-current liabilities	**109**	**109**	**109**	**109**
Payables/other	5.3	7	8	7
Inter-company loan				
Current liabilities	**5.3**	**7**	**8**	**7**
Total liabilities	**114.3**	**116**	**117**	**116**
Net Assets	**82.9**	**79.1**	**78.1**	**83.1**

Source: Proactive Research

We believe that a leverage ratio of around 60% provides a nice level of enhancement to return on equity while maintaining enough flexibility to ensure that Mailbox is able to support its capital expenditure (capex) programmes and its dividend payments.

Total returns model and conclusions:

We argue that a growing dividend can potentially reward shareholders, not only in terms of cash income but in driving the share price higher. As a simple assumption, if we suppose that the shares continue to trade on a 7% dividend yield, with the dividend increasing to 10% by 2024, then the following table illustrates the total shareholder return, and the implied internal rate of return (IRR) on the investment.

Our total returns model suggests an IRR to investors of 18.4% p.a. over the next four years

Total returns potential

Total returns model	
Starting share price	100p
Dividends paid 2021, 2022, 2023, 2024	4.2p, 9.6p, 9.7p, 10.3p
Ending share price, Dec 2024, at 7% dividend yield on 10.3p dividend	147.1p
Shareholders' total gain	= 147.1 + 4.2 + 9.6 + 9.7 + 10.3 - 100 =80.9p
IRR over 3.5 years	18.4% p.a.

Source: Proactive Research

We conclude that Mailbox REIT offers investors:

- Targeted dividend yield of 7% from year 1, with scope to increase to 10% over the next 3-4 years
- Upside potential from asset management projects
- A sound balance sheet structure with a low cost of debt
- A low operating cost structure, even when compared with multi-property REITs
- Exposure to the central Birmingham office market, which benefits from strong demand drivers and significant supply constraint

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