Chairman's Report

Abubaker Varachhia
Chairman

Spear seized the opportunity best described as the "Goldilocks opportunity" in a market management knew and understood well. The opportunity existed to buy many mid-sized properties that have value enhancement potential and were crying out for improvement. They were too small to matter for the large property companies and too large for smaller companies to access.

Operationally, the period since listing, while short, has been a successful one. Mike, Quintin, Christiaan and the team beat their own forecast set just a few months ago and they must be commended for this.

Spear improved on its forecast distribution per share of 20c for the four months to 28 February 2017 by 16.75%, resulting in an actual per share distribution of 23.51 cents. The assets under ownership at period end was R1.4 billion, with a market capitalisation of R1.0 billion. The growth in distribution had been achieved in combination with an increase in tangible net asset value per share by 7.01%, from R9.37 on the listing date to R10.03 at 28 February 2017.

As an asset class, property has historically generated returns well above inflation over long periods of time. However, in the short term, returns are cyclical and more dependent on the economy. We'd thus like to remind our shareholders that our actions and decisions can only truly be judged over the long term.

The world is changing quickly: Demographics and technology lie at the heart of this

In the West, the falling birth rate over the past half a century is ageing the population. Older people produce, earn and spend less. This reduces the state's revenue from tax. At the same time, they demand more of the state's budget in the form of health and welfare benefits.

> "This maiden integrated report celebrates the first four months of excellent financial performance of Spear REIT Limited since its successful listing on 11 November 2016. This report will give the reader access to a variety of insights and strategic information that clearly outlines the strategic objective of the company"
>
> – Abu Varachhia, Chairman

The world has also reached its debt limits. Incremental borrowing is having a diminishing effect on growth. With few other options to grow their economies, central banks have embarked on unprecedented fiscal and monetary stimulus. They are in unchartered waters and there are no lifeboats on board.

This cheap capital has elevated asset prices at a time when incomes are not growing. This has raised the level of inequality and is exacerbating tensions arising from low economic growth. Political and social instability is thus high. Leaders who promise people radical solutions have become popular.

Compounding this, technological change is accelerating and disrupting the order of the world. The cycle is virtuous as cheap capital is a willing funder, being desperate for returns.

Property is not exempt from these changes. E-commerce is changing the way we shop and questioning the viability of malls. Online classified businesses, such as AirBnB and Booking.com, are winning market share from hotels and gaining bargaining power. Ride-sharing technologies like Uber and developments in autonomous vehicles will change the need for parking space in office buildings. Easier access to connectivity is reducing the demand for office space and new building methods are changing the cost and value of buildings. We cannot be oblivious to these changes.

Hope now turns to Africa and the East, home to five billion people. In these countries, deepening democracy, strong institutions, increased inclusivity and equality and a strong middle class are needed to create sustainable economic growth.

We all need to act to ensure a better future for our children

In South Africa, we have come far since our young democracy began. Our country grew faster than ever in its history in the post-apartheid period. Prudent budgeting and policies helped us to fix our balance sheet, while still expanding our infrastructure to offer services such as education, electricity and healthcare to so many more. A strong black middle class has emerged and poverty rates have fallen.

However, we still have far to go. We are in a race against technology and must take steps to address unemployment and create sustainable opportunities for our children. We should focus on improving:

- the standards of education
- the ease of starting a new business
- general access to communications
- our infrastructure
- our relationships with other countries in Africa.

We produce some of the best engineers, accountants, doctors and actuaries in the world and should leverage these skills.

We also need to remain investor-friendly to ensure our borrowing costs are reasonable.

Most importantly, we have to protect our democracy by guarding the independence of our judiciary, our financial system, our open media and our levels of corporate governance.

We live in one of the most beautiful countries in the world, abound with potential. We must do more to create a better future for our children and fulfil the dreams of our founding fathers.

Property in the Western Cape has structural advantages

The Western Cape economy is bucking the national trend and continues to grow. This is due to increased tourism, migration from other parts of the country and industrialisation along the West Coast. There is also growth in niche industries such as asset management and technology. The city of Cape Town expects a further one million people to move into the region by 2020 and this will continue to drive growth over the medium term.

However, this is also having adverse consequences. Foremost is the stress being placed on our natural resources. The Cape is already a water-scarce region and we are likely to experience shortages in the coming years. This will hurt our economy. Residential property prices are rising quickly and congestion is increasing. The poor bears the brunt of these effects. Strong leadership and good planning are needed to avoid this.

We have much within our control to create value over the long term

As a company, we cannot escape from our dependence on the economy. Low growth affects our tenants and, in turn, our return on capital. We have to remain close to our tenants and manage our tenant profile carefully. At the same time, a local debt downgrade seems inevitable. This will raise our borrowing costs. While 59% of our debt is fixed, we have to be guarded about our gearing.

However, we also have much within our control. We have experienced in-house development and asset management teams which are not short of opportunities. We have a low-cost structure, an entrepreneurial mindset and a good track-record of taking advantage of value-enhancing opportunities.

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Our acquisitions after period end prove this. They are in sectors and areas with strong demand, where we have experience and where we see the potential for operational improvement.

We will continue to take actions that will prioritise our long-term growth over our short-term growth. These actions will increase the quality of our portfolio over time, giving us the power to sustainably grow our rentals and keep vacancy levels low. This will allow us to create value for shareholders by earning returns on our capital greater than our cost of capital.

A thank you to all our stakeholders

Our journey so far has only been possible with the dedication of our employees and management team. As a board, we would like to thank them for their sacrifices and hard work. We would also like to thank our tenants, lenders and shareholders for their continued support and understanding.

Finally, as chairman, I would like to thank our directors for their ongoing assistance, insight and guidance.

Abubaker Varachhia
Chairman

27 June 2017

Sable Square Shopping Centre