

# Joint Report by the Chief Executive Officer and Managing Director



Spear successfully listed on the JSE (JSE:SEA) on 11 November 2016 and remains the only regionally-specialised REIT in Southern Africa. The company invests only in high-quality real estate in the Western Cape. At year end, Spear had a market capitalisation in excess of R1.0 billion and assets under ownership of nearly R1.5 billion.

Spear shares started trading at R9.00 per share on the listing date and have continued to perform strongly, with the share price trading up to levels of R10.40 per share (up 15.5% from the listing date). The company has traded strongly for its first partial year and, as a result, its distributable profits are more than 15% higher than the 20.14 cents per share forecast per the Spear pre-listing statement ("PLS") issued on 21 October 2016.

We actively manage all our properties internally, with all asset management, property management and financial management performed in-house. This allows us to be more responsive to our tenants' needs and demands, which translates into much higher than average tenant retention rates.

Our aim is to build the business through careful selection, acquisition and management of secure income-producing properties and portfolios. The regional specialisation plays to all these strengths – with management never more than one hour's drive away from any of its assets.

The company obtains its diversification through investment across the commercial, retail, industrial, hospitality and residential sectors. Spear's key focus areas are creating shareholder value by growing income for all stakeholders and continuously acquiring high-quality assets within the Western Cape. This is done whilst maintaining a high-quality core portfolio with a high percentage of occupancy.

It is notable that management remains heavily invested in Spear, further reinforcing strong management and shareholder alignment.

Mike Naftali Flax  
Chief Executive Officer

## Local economic landscape

The South African economy is facing uncertain times and political events like the recent cabinet reshuffles created further economic uncertainty. As a result, the interest rate, inflation and GDP outlook has to be revisited on a macro-economic level. Given the challenges facing the South African economy, this may have a negative impact on the South African real estate sector. The Western Cape has showed greater resilience than the rest of South Africa and demonstrates positive growth rates across sectors.

The Spear board has diligently contemplated the possible impact of the current economic climate on Spear and a number of strategies have been put in place to mitigate the sovereign and sectoral risk.

In response to the economic headwinds, the Spear board has implemented appropriate risk management tools to ensure that the business continues as a going concern with a strong balance sheet, low levels of debt, strong lease covenants and an exceptionally skilled asset and property management team.

## Financial performance

The Board approved and declared a maiden distribution of 23.51 cents per share on 11 May 2017. The distribution declared is an increase of 16.75% over the forecast distribution of 20.14 cents per share as per the PLS dated 21 October 2016. The increase in the forecast distribution was linked to higher than budgeted hotel occupancies which led to higher than budgeted hotel revenue and rentals; savings generated on finance costs due to lower than forecast interest rates and savings generated on certain group overheads contributed marginally.

The tangible net asset value per share increased by 7.01% from the pro forma R9.37 per share as per the PLS to R10.03 per share. The increase was driven by an increase of 3.79% in the fair value of investment property and reducing debt levels by 8.36%.

After the November listing date, the company has raised an additional R119 million through a share-for-cash issue on 28 February 2017 by placing 12.8 million shares at a price of R9.30 per share. Spear has attracted strong support from the institutional investor market as demand for Spear stock has grown from the listing date. Over the last four months, the company has welcomed a number of new institutional investors that participated in the Spear share-for-cash placement and have identified Spear as a long-term investment opportunity. In order for Spear to access an even greater pool of institutional investors, the board resolved to move across to the Main Board of the JSE on 22 May 2017.

The Group's gearing level at 28 February 2017 was 33.09% and the company had fixed borrowings of 59% of total borrowings at an average fixed rate of 9.78% and

group average cost of funding of 9.65%. Total borrowings for the group amounted to R478 million at year end.

## Focused strategy

As the only regionally-focused REIT, Spear continues to ply its trade in a focused manner. The Western Cape real estate market has fortuitously delivered excellent results compared to the rest of South Africa and has performed exceptionally well as a provincial economy, benefiting from good provincial governance, continued demand for real estate, strong growth in tourism numbers and continued construction activity driving additional economic growth.

Given the regionally-focused strategy, Spear's proximity to assets is excellent and allows the company to understand the macro- and micro-economic factors that influence the day-to-day operations of the business. Spear will remain focused on investing in high-quality assets in the Western Cape, with a Cape Town bias. It is expected that the Western Cape real estate sector will continue to outperform the rest of the South African real estate sector as the effects of semigration are starting to have a positive impact on the Western Cape and in particular the general Cape Town market.

## Property portfolio

The company has a current portfolio of 172 503m<sup>2</sup>, consisting of a regionally-focused but sectorally-spread real estate portfolio of 25 high-quality assets with an average value per property of R57.8 million. Portfolio occupancies remain high as management continuous its focus on strong tenant retention and active asset management. The average escalation rate across the portfolio on income is 8% per annum, with the average rental rate per square metre at R91.00 per m<sup>2</sup>.

The sectoral spread by GLA of the portfolio is 42.7% in the industrial sector, 23.5% in the office sector, 22.2% in the retail sector, 7.0% in the hospitality sector and 4.6% in the residential sector. As part of the growth strategy of the company, management would look to continuously increase sectoral assets and aims to increase both the Hospitality and Residential percentages over the short to medium term into double-digit percentages, as and when suitable and value-adding investment opportunities present themselves.

One of the critical strengths of management is its hands-on and direct approach to asset and property management. The company takes pride in its current and historically low portfolio vacancies which never exceeded 1% of the total portfolio under ownership.

Management is extremely satisfied with the robust and defensive lease expiry profile, underpinned by a WALE of 46 months. Maintaining our current vacancy rate of 1% and continuous rental growth as leases expire and are successfully renewed, will be a critical focus area of

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Quintin Michael Rossi  
Managing Director

the company. We believe that our proximity to our assets plays a key role in the low vacancy percentage across the portfolio as it allows quick turnaround times on lease negotiations, renewals and problem solving.

## Capital management

Spear actively manages its capital and market risk. Its current average cost of funding is 9.64%, with a current hedged position of 59% and a debt and hedge maturity of two years and three years respectively. Management is satisfied with its capital management policy and will ensure strict oversight over capital management and risk management on a continuous basis.

Furthermore, management continuously assesses its capital allocation to assets and, in turn, will look at recycling assets that are not expected to deliver long-term value to the company. The capital will be redeployed into larger yield-enhancing acquisitions.

## Outlook

The portfolio is well-placed to deliver sustainable cash flow for the 2018 year and continued growth beyond. Spear has a well-diversified and defensive core portfolio of assets, a quality tenant base and a long dated WALE, which provides clear visibility of income going forward. The latter, together with management's active asset, property and financial management, will further reinforce the company's ability to be resolute in what currently is a challenging economic and political landscape.

- Management will focus on the integration and stabilisation of the three large acquisitions (in excess of R1 billion) concluded after year end onto the company's sophisticated management platform.
- Management will continue to focus on prudent capital management and will continue to position itself for the impact of any major fiscal policy changes and/or increased interest rates and the impact it may have on the real estate sector.
- The company is focused on ensuring optimisation of long-term shareholder value through actively managing the underlying portfolio so as to ensure assets perform consistently over a long-term period.
- Management is of the opinion that the company is well-placed to continue with its growth objectives, both in the form of assets and human capital. The company has continued to invest in people by growing the team in both capacity and skills during the year. The company has a very experienced board that is always available for guidance and a strong, passionate team driving growth going forward.

**“The Western Cape has shown greater resilience than the rest of South Africa and demonstrates positive growth rates across sectors.”**

- Quintin Rossi, Managing Director

- The company will continue its tenant-centric approach which has helped to create customer loyalty and which is mutually beneficial to the company and its tenants.

## Prospects and guidance

The continued strong performance of the Western Cape property sector and the regional specialisation of Spear insulate the company to a degree from the current weak economic climate. The Western Cape focus of the company and management's proximity to assets will continue to stand the company in good stead well into the future, given the continued and successful implementation of the company strategy to only invest in high-quality assets within the Western Cape (with a Cape Town bias). Its healthy pipeline of greenfield and brownfield development opportunities will further drive organic growth from within the core portfolio, without placing unnecessary income drag on the company. The board is confident that demand for quality rental properties across the various sectors within the Western Cape will continue as the effects of semigration will create additional demand for rental properties. Along with strong property fundamentals and in line with the pre-listing statement issued on 21 October 2016, management's distribution forecast for the year ending 28 February 2018 was 74 cents per share. In the light of the recent acquisitions, improved cost of debt and other operational efficiencies created within the company, management advises that distribution per share for the year ending 28 February 2018 is now anticipated to be higher than the original forecast of 74 cents per share by 3 cents to 4 cents. The latter revision is premised upon the following assumptions:

- That a relatively stable macro-economic environment will prevail.
- That lease renewals are concluded as per the company forecast.
- That no major tenant failures will take place.
- That tenants will successfully absorb rising costs associated with utility consumption charges and municipal rates.
- That all acquisitions successfully transfer to Spear as announced recently on SENS.

The information and opinions contained above are recorded and expressed in good faith and are based upon reliable information provided to management. No representation, warranty, undertaking or guarantee of whatsoever nature is made or given with regard to the accuracy and/or completeness of such information and/or the correctness of such opinions.

## Governance

Spear is committed to the highest standard of corporate governance. The board regularly reviews the company's

structures and systems to ensure all of the latter stay in line with the guiding principles of a strong corporate governance culture within Spear.

## Sustainability

Sustainability is about building Spear to ensure we have a positive impact on the economic and social progress of communities and on the environment, while growing and preserving our tenant business and stakeholders' interests based on strong relationships of trust. Spear acknowledges its responsibility to its stakeholders, the environment and the community at large and consistently focuses on continual improvement of our business and environmental sustainability.

Spear is committed to broad-based black economic empowerment (“BBBEE”) and its approach continues to involve a strong focus on the procurement of our property managers and socio-economic development initiatives. Spear has kickstarted the process to roll out PV solar solutions and water conservation solutions across the property portfolio in a bid to introduce energy and water efficiency initiatives in its buildings with a view to reduce the “total cost of occupation” across the property portfolio.

## Acknowledgements

Spear's management is very proud of the maiden results delivered by the company and the focus will remain on delivering on the key strategic objectives – consistently growing the distribution per share, acquiring high-quality assets within the Western Cape and focusing on yield-enhancing transactions, together with active and hands-on asset management to ensure sustainable income generation across the portfolio.

We would like to acknowledge each and every one of our tenants, our investors, our suppliers and all our stakeholders without whom the company could not operate or succeed.

We would like to thank our board of directors and the respective committees for their ongoing support and guidance. A special acknowledgement is due to the full team for their dedication, hard work, innovation and contribution to our achievements in this short space of time.

MN Flax  
Chief Executive Officer

QM Rossi  
Managing Director

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