KILLIK & Co

25 January 2012

Large Cap Update

.COMPANY:	EPIC:	MARKET CAP:	RECOMMENDATION:	RISK RATING:	PRICE:
Land Securities	LAND.L	£5.4bn	Buy Initiated on 01/07/2011	6 CATEGORY: UNRESTRICTED (see bottom of note for risk categories)	687p

Land Securities is the largest UK REIT by market cap, focusing on property assets in two areas: Retail focuses on shopping centres and retail parks, and London focuses on both office and retail assets in the capital. The group has a healthy exposure to London offices (43% of the portfolio) and a strong development pipeline, with £1.6bn of current projects.

Investment Case

- Strong exposure to London property, which continues to outperform the UK market.
- Significant development pipeline, which was further de-risked over the third quarter.
- Recent trading highlights the resilience of its business model.
- Strong balance sheet at a time when deleveraging becomes a key issue for REITs.

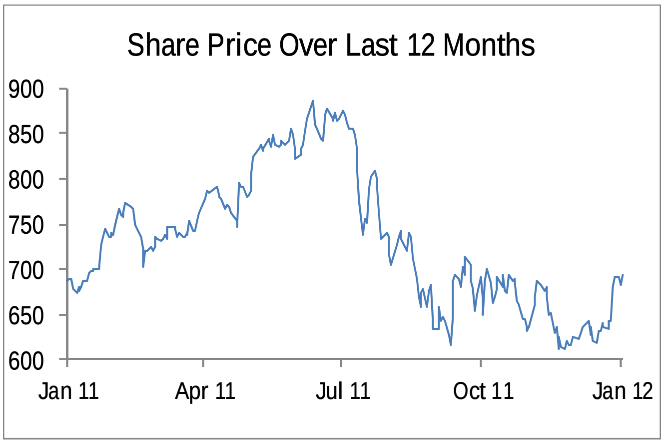
The group's third-quarter trading update illustrated how it has repositioned itself to take advantage of any downturn, with further progress with lettings in its development portfolio and like-for-like portfolio voids down quarter-on-quarter.

Although the change in management is a surprise, new CEO Robert Noel is highly regarded within the industry, having had a strong track record in London property, and was widely seen as Francis Salway's likely successor.

Given its strong exposure to London property, which continues to outperform the UK market, and its significant development pipeline – which has been further de-risked over the quarter – we believe that a 20% discount to net asset value remains an attractive level to gain exposure.

52 Week High	894p
52 Week Low	608p
NAV Discount / Premium	20%
Dividend Yield	4.2%
Dividend Cover	4.3x
Loan To Value	37.2%
Net Debt	£3.3bn
Portfolio Focus on London	61%
Portfolio Focus on Offices	43%
Next announcement	18 May 2012

Source: Company Data and Bloomberg Consensus



Note: UK REITs may pay their dividends as a mixture of Property Income Distributions ("PIDs") and ordinary dividends ("Non-PIDs"). PIDs are taxable as property letting income in the hands of shareholders, and are generally paid out after the deduction of withholding tax at the basic rate. Ordinary dividends are declared in a similar fashion to those of other UK companies – with the 10% UK withholding tax credit already deducted.

Year End	Sales (£m)	PBT (£m)	EPS (p)	PE (x)	DPS (p)	Yield (%)
Mar 2011	702	275	36.31	18.9	28.2	4.1
Mar 2012	589	293	37.50	18.3	29.0	4.2
Mar 2013	593	290	37.10	18.5	30.0	4.4
Mar 2014	639	313	40.70	16.9	31.5	4.6

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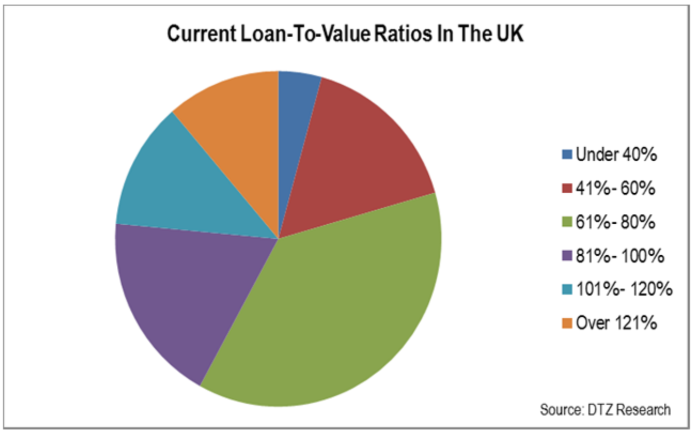
Land Securities' third-quarter trading update was in line with expectations, with further progress with lettings in its development portfolio and voids in the like-for-like portfolio down quarter-on-quarter, illustrating how the group has become much better positioned to take advantage of any downturn. More significantly, CEO Francis Salway is to step down on 31 March after eight years in charge and will be succeeded by the Robert Noel, the highly rated head of the group's London portfolio.

Land Securities is the largest UK real estate investment trust (REIT) by market cap, focusing on property assets in two areas: Retail (39% of portfolio) focuses on shopping centres and retail parks; and London (61%) focuses on both office and retail assets in the capital. The group has a healthy exposure to London offices (43% of the portfolio) and a strong development pipeline, with £1.6bn of current projects.

Over the quarter, the group achieved further lettings at One New Change, which is now 82.0% let following the 25,200 square foot (sqft) let to CBRE Global Investors. Trinity Leeds has moved from 54.0% pre-let to 57.8%, with a further 7.9% in solicitors' hands, and the Buchanan Street development in Glasgow is now 90.7% pre-let. In total, the group achieved £7.1m lettings, 0.5% ahead of estimated rental value (ERV), and voids in the like-for-like portfolio were down 30bps, to 3.1%. Units in administration were up 20bps over the quarter, to 0.6%, primarily due to Barratt's and Officer's Club going to administration, and since quarter-end administrations such as La Senza, The Outdoor Group and Peacocks have added a further 40bps, although the group has noted that over 75% of these units continue to trade.

Net property receipts over the quarter were £104m as a result of disposals in the Retail portfolio, 1.9% below March 2011 valuations. Total disposals in the Retail portfolio stand at £205.8m year-to-date, 1.8% above March 2011 valuations and at an average yield of 6.4%. In the London portfolio, the recent sale of the 253,000 sqft Eland House for £171m took year-to-date disposals to £299.4m. This is 3.1% below March 2011 valuations, due to the low price achieved for Eland House, which was let at £49 per sqft to the UK Government, who had a break option in 2016 which was expected to be exercised. At a sale price of £676 per sqft, the upside to estimated rental value after taking into account the roughly £200 per sqft refurbishment required on a building more than 15 years old would be limited, and management clearly believe that this capital can be redeployed more effectively elsewhere.

The group's substantial development pipeline was further de-risked over the quarter, with key milestones reached on a number of projects. Kingsgate House, a 336,000 sqft mixed use development in Victoria, achieved resolution to grant planning consent in November, while at Victoria Circle planning consent to reposition a listed building has been obtained. The existing buildings at Victoria Circle remain substantially let until September, after which demolition can begin. Management's belief is that Victoria offers a real long-term opportunity as a central West End location, with rents well below Mayfair and St James. Elsewhere, demolition at 30 Old Bailey and 60 Ludgate Hill, a proposed 377,000 sqft office scheme, is nearing completion. In Retail, the group continues to make progress on edge-of-town and out-of-town developments, which will be significantly pre-let before construction begins.



The group believes that balance sheet strength will be a key issue for REITs in 2012, and signed a new £1,050m revolving credit facility over the quarter, at a headline margin of 120bps over Libor, which will replace the existing £1,500m facility. Group LTV has reduced by 50bps, to 37.2%, and its debt now has an average duration of 11.2 years at a weighted average cost of 5.0%. Although the size of the new facility is lower, it is more flexible, and the group's AA credit rating means that bond market financing is another avenue that can be explored.

Land Securities' balance sheet strength remains a key component of the investment case. DTZ recently reported that a funding gap of £28bn existed in UK commercial property, At a time when many market participants remain highly geared, difficulties in deleveraging have arisen as they clamour to sell assets. Given the group's low LTV relative to the sector, in addition to its superior ability to refinance, it remains much better placed than its peers.

A third quarterly dividend of 7.2p has been declared, in line with the group's long-standing policy of paying three equal interim dividends and growing the payout through a variable fourth-quarter payment. Based on consensus expectations of a fourth-quarter dividend of 7.4p, the shares are currently trading on a yield of 4.2%.

Although the change in CEO is a surprise, the sector has seen many leadership changes following the financial crisis, including those of the other top-five UK REITs. Additionally, Robert Noel is highly regarded within the industry, having had a strong track record as Portfolio Director at Great Portland Securities and since joining Land Securities in 2010, and was widely seen as Francis Salway's likely successor. Given his strong expertise in London property, this management change should be positive as the group positions itself ahead of what is expected to be a tough quarter.

Given the group's balance sheet strength, Land Securities is expected to supplement its development pipeline with further acquisitions, and on the analyst call, Robert Noel confirmed that the group does not intend to make any large acquisitions, maintaining its discipline in identifying suitable opportunities. A de-merger of the business into three units – previously proposed in 2007 – was ruled out.

Management expect the group to make further progress this quarter, although given the weak economic environment lettings are expected to take longer to execute. Given its strong exposure to London property, which continues to outperform the UK market and its significant development pipeline, we believe that a 20% discount to net asset value remains an attractive level to gain exposure.

Risks with this recommendation

- A delayed economic recovery could negatively impact demand for offices and rental values.
- A sharp increase Gilt yields could negatively affect property.
- Delays in receiving planning permission could reduce any near-term uplift in the value of development pipelines.

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Large Cap Update

KILLIK & Co RESEARCH RECOMMENDATIONS					
Equity Research			Fund Research		
Large Cap	Mid Cap	Global	Absolute Return	Income	Growth
Investment ideas in the FTSE 100 which we believe will generate returns ahead of the All-Share index.	Investment ideas in the FTSE 250 which we believe will generate returns ahead of the All-Share index.	Global investment ideas which we believe will generate returns ahead of the FTSE World (ex UK) index over the long term.	Funds that aim to generate an absolute return over the medium to long term, i.e. a positive return irrespective of equity or bond market direction.	Income producing funds, which are attractive in the context of the yield available from cash, gilts and UK equities.	Funds which we believe have the potential to generate a high level of capital growth over the long term.

KILLIK & Co RESEARCH PERIODIC PUBLICATIONS		
Daily Note	ETFs Bulletin	Thematic
A summary of the day's newsflow and an update of opinion on covered stocks.	Focusing on London-listed Exchange Traded Funds (ETFs) and Exchange Traded Commodities (ETCs).	A number of direct equity and fund ideas that are well positioned to exploit a key investment theme.

The Killik & Co Research Policy and recommendation definitions can be found at www.killik.com/research

The Killik & Co Risk Rating system uses categories which are intended as guidelines to the specific risks involved, as follows: Restricted Lower Risk (1), Restricted Medium Risk (2-3) and Unrestricted (4-9).
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