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Full EIS Report

Titan Storage EIS

Ducalian Capital / Enterprise Investment Partners

The Titan Storage EIS is a discretionary service which will invest into up to 3 underlying companies. Each will either purchase a property and convert it into, or buy a site and build, a storage facility, which will then be operated under the Titan Storage brand.

	Positives	Issues
Why Invest?	**Strategy:** Exposure to storage businesses with experienced management and some asset backing.	**Concentration:** Three companies with almost identical business plans so limited diversification.
The Investment Manager	**Team:** The managers have an experienced team and have been running storage properties since 2012.	**Track Record:** Have operated 4 smaller properties, of which only two have reached some sort of maturity.

Nuts & Bolts

- **Investing:** Closing date of 31 March 2016 though new money can be invested in either 2015/16 or 2016/17 tax years. New projects in next tax year.
- **Diversification**: Up to 3 companies, though all will be in the same business.
- **Valuation:** Companies will be unquoted. To keep costs down properties will be valued at towards the end of the investment term.

Specific Issues

- **Fees:** All charged via the company. Performance fee uses A Shares and is 25% on returns over £1.20 calculated on a per company basis.
- **Investment Process:** Focussing on the south of England in areas with high potential demand. Established business plan.

Manager Information	
Scheme assets	£5m
Scheme target	£15m
Current EIS assets	£45m
Total FUM	£45m
Launch date	2015

Risks

- **Target return:** Target is to double the investor's gross investment over a five year period, i.e. an IRR of around 15%, suggesting medium to high risk.
- **Operational targets:** Occupancy target of 80% is better than industry average of 70% and aimed for after 5 years of operation. Planned rental levels look reasonable compared to available data.

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Investment Process

Portfolio Service Aims

The Titan Storage EIS is a discretionary service that will invest into up to 3 specific underlying companies. Each of these will buy / build and operate a freehold industrial property as a self storage facility. The return target is to double the gross amount invested, after fees, over a period of five years. There is no income target. The intention is to exit after five years, probably by selling the companies.

There are two parties involved in managing the EIS:

- **Ducalian Capital**: Will be the asset manager and bring the property and operational expertise. Titan Storage Solutions is a wholly owned division of Ducalian.
- **Enterprise Investment Partners (EIP)**: Are the promoters of the EIS.

Deeper dig into process

The storage market is well established in the UK. The typical property used is an industrial unit, though other types of properties have been converted. Each is subdivided into much smaller self-contained individual units of various sizes. These units are very basic, usually just being a large box with a light and a lockable door.

At the last survey (about 12 months ago) there were 1,022 units in the UK, which has a higher density than continental Europe, but is well behind the USA or Australia. Historically the main customers have been individuals, but businesses have been an increasing proportion. The latter are now estimated to be 40% of the market and, importantly, tend to take longer lets than domestic customers.

The market experienced a slowing of growth in the early years of this decade, averaging less than 10 openings per year from 2011-2014 compared to nearly 40 per year prior to that. In 2015 there was a slight pickup again and this new EIS will feed into that growth.

Despite the growth, various surveyors[1] believe that there is a shortage of facilities, particularly in certain areas. The new projects will be in the South East, South West or Midlands, where the managers believe this gap is the strongest. They are also encouraged by near term economic growth looking stronger in these areas too.

Properties

The fund will purchase freehold properties, with the intention of either buying existing properties to convert or building new properties. The first property has already been bought, and will be a conversion, though the indication is that the other two are most likely to be new builds. Each site will be around one acre and will have 35-50,000sq ft of lettable space.

Like most property investors, the manager sees location as the key element. They are looking for sufficient population within a ten minute drive, with a mix of business & residential. The desired site requires easy access, preferably close to other facilities such as retail parks or car showrooms.

[1] The managers cite both CBRE and Jones Lang LaSalle.

Each company will have £5m of initial capital, with the target properties costing £3.3-3.9m to bring to the point of opening. The balance will be used for working capital. According to the business plan each property should reach break even in the second year after opening, hopefully at around 18 months. Until then the company will need to fund its expenses internally. According to the business plans we have seen, £1m plus of working capital should provide a more than adequate buffer.

Each property will be branded and managed by Titan Storage Solutions, a subsidiary of Ducalian. Founded in 2012, Titan currently manages four existing locations with a fifth under construction.

Each company will bear the direct costs of the site, with the management fee covering use of the brand, and there will be no head office charges.

Titan has a three stage growth strategy:

- **Stage 1**: Occupancy led growth – using heavy discounts for 12-18 months.
- **Stage 2**: Once store roughly reaches 40% occupancy use a more blended approach. Will still try to grow occupancy, but gradually reduce incentives.
- **Stage 3**: At 70-80% occupancy will focus on raising prices and reducing incentives.

Churn rates are important through this process – the industry average occupancy length is about 10 months, so marketing is a continual cost. Ducalian/Titan acknowledges that the removal/reduction of incentives can boost churn and expect longer tenancies in Stage 3 than earlier.

The first property has already been purchased in Woking, Surrey. As indicated above, this is an existing site that will be converted to storage use. The site is close to a major supermarket and the location is densely populated and affluent. Cost of the facility and its conversion will be around £3.85m.

EIS investors will be co-investing with Ducalian's direct clients. For the Woking acquisition EIS investors will supplied around 70% of the total equity and we'd expect a similar proportion in the other companies. The co-investors will get the same terms as EIS investors and should have similar aims and interests.

The scheme does have the right to use gearing within each company. We are told that it is not planned to gear any of the companies for normal operations, though there may be some short term financing used at the outset to bridge cash flows.

Financial Targets

Each company will have significant operational gearing. The cost base in each is largely fixed, with almost 40% being property costs and the balance staff, administrative and marketing costs. None of these will change much with as occupancy grows.

The key drivers of profitability will be the occupancy and the rents achieved, with some ancillary income too. The projections for the EIS are based on an occupancy level after four years of 70% and 80% in five years. We note that this final figure is above the industry average of around 70%, with the managers believing that by choosing prime locations the higher figure is achievable. We note that some of the listed companies in this market have seen improved occupancy over the last year too and Titan has reached over 80% occupancy in its (smaller) Bracknell site after only 2.5 years.

We also note that the time it takes to open the store after acquiring it will have an affect too. A conversion should take around 6 months to open, a new build a little over a year. These suggest that 80% occupancy could be a challenging target, but not an impossible one. Using the manager's projections, the IRR before tax relief is 16.6% with a 7.5% exit yield. Using 70% occupancy rather than 80% would reduce that to 13.6% (using the manager's tax after tax basis those IRRs are 21% going to 18%). We note also that the listed companies do trade at a premium to net assets, suggested that profitability multiples may also be relevant when the time to exit arrives.

It is difficult to comment in detail on rental levels as they are to some extent location specific. Broadly those assumed in the manager's models are comparable with those on Titan's existing properties. They are above the average for the market as a whole, but we would expect that if they are achieving prime locations in the south of England.

Decision Making

For each purchase a property will be recommended by Ducalian, but the final decision will lie with EIP. Given each company only requires one investment decision we'd expect that EIP would be involved from the early stages.

Governance and Monitoring

The first company has received Advance Assurance from HMRC. The intention is to get this for all of the companies before investing.

Investors will receive reports quarterly, though the managers will review more frequently. As full property valuations have a cost the intention is to have one full valuation, probably towards the end of the investment term. Subsequently this will be updated as necessary rather than being repeated.

The directors of each investee company will initially be James Hancock, James McCulloch, Robert Cherry (all Ducalian) and Christian Elmes (EIP). We note that there are no external or independent directors for each company, though the latter is non-executive from an operational perspective.

Investors should note that the cost base for each company contains few discretionary elements and should be regarded as largely fixed. This means each has a high degree of operational gearing and the occupancy rate, together with the rental rate, are the key metrics for investors.

Although the EIS does not have a track record, Ducalian and Titan Storage Solutions have been managing storage properties since October 2012. There are four properties in their existing portfolio. Each is smaller than those currently targeted in the EIS, being around 15-20,000 sq ft. The best performing, in Bracknell, has reached 83% occupancy in just under 2.5 years from opening. The oldest property, in Littlehampton, is at 51% after three years, which is still broadly in line with the business plans for the EIS projects.

The effects of the different phases of growth can be seen in the rental prices. At the two high occupancy properties incentives are reducing rents by less than 10%, but for the lower occupancy ones the reductions are 26-36%. Overall the track record gives support to credibility of the business plans for the new properties though, with only four properties and less than four years of trading, it is not conclusive. In particular the larger size of the EIS properties may make it harder to replicate the success achieved in Bracknell.

Fees

All the fees are charged via the companies and can be divided into initial, ongoing and exit fees. Note that the external investors (direct to Ducalian) are subject to the same charges as EIS investors so the benefit is tax efficiency rather than dilution. Payments to advisors can be facilitated, but will come out of the pre-investment payment and will not be tax exempt.

Initial Fees

There will be an initial charge of 2.5% plus VAT (where appropriate).

Ongoing Fees

There is an annual management fee of 1.5% plus VAT of capital invested. Of this 1% this will be payable to Ducalian and 0.5% to EIP. There are no additional administrator charges.

There is also the right to charge the companies a "pro-rata proportion of expenses reasonably incurred by the Manager". We understand that this is intended to be in respect of the costs of selling the companies at the time of exit.

Exit Fees

On exit a performance fee of 25% is payable. This is subject to investors receiving £1.20 gross for every £1 invested and the fee is payable on gains above this amount. This is structured using A Shares. These are issued to Ducalian and EIP at no cost, and translate into the equivalent shareholding at the time of exit. The split is 80% to Ducalian and 20% to EIP.

Investors should note that the performance fee is effectively charged on a per company rather than a portfolio basis. If any investee companies make a loss then the effective performance fee on the portfolio as a whole will be higher than 25%, and a performance fee may be payable on some investments even if the portfolio as a whole does not make a net gain.

Fundraising targets

EIP aim to raise £15m for the Titan Storage EIS, with £5m for each company. As each company requires a certain amount of capital a lower fund raise than £15m could mean fewer properties and less diversification for investors. There is a minimum amount of £4m, but that has already been exceeded. At the time of writing the first company is already in place.

The Titan Storage EIS is intended to be evergreen, and with further, similar, companies being started in the future.

The minimum investment is usually £10,000, though for investors using the Kuber platform it is £5,000.

Risk Analysis/ Commentary

Note that there are generic risks from investing in EIS or unquoted companies in addition to the specific ones commented on below. Comments on relative risk refer to other EIS investments and not to wider investments.

Shares and client money are held by the custodian, Woodside Corporate Services Limited (FCA registered – number 467652). Cash is held in a separate client account. No interest is payable on funds held. For direct clients, administration is handled internally by EIP and Woodside.

The targeted return of doubling the gross investment over five years would suggest that the EIS is medium to high risk. With only three properties, each in the same business, there is limited diversification within the EIS. A smaller than targeted fundraising may reduce the number of companies.

The macro background to the business appears helpful at the moment, though we note that domestic storage business has some correlation with housing and may be affected by any downturns in that market. The targeting of prime locations should help to reduce economic sensitivity.

The value of the property within each company does provide significant asset backing, though its value is related to the success of the operational side. We also note that each company will have no financial gearing, but will have significant operational gearing as the cost base is largely fixed. Additionally low occupancy will probably mean lower rent per square foot.

There does seem to be a reasonable pipeline of deals available and cash should be able to be invested promptly. The secondary market in storage properties is reasonably active and under normal circumstances achieving a sale to exit should be straightforward.

Ducalian/Titan have reasonable experience in the area. While their track record is limited, it does support their business plans. With all the company Directors being drawn from Ducalian and EIP we note that there is only one non-executive and none that are completely independent.

Overall this looks like a sensible business opportunity in the current economic environment. The operating targets are a little challenging, but investor returns will still be reasonable if the company reaches industry average performance.

Investment Manager

Regulation

Ducalian Capital Limited

Ducalian Capital Limited is a limited company incorporated in 2011, though the business was first formed in 2007. It is FCA Registered (number 656531) with a limited list of permissions. The latest accounts are as of 31 December 2014 and are submitted under the micro-entity provisions. Capital at that date was £107,000. Since then there has been an issue of equity for £40,000, suggesting the balance sheet is more than adequate.

The ownership of Ducalian Capital Limited is split almost equally between Robert Cherry, James Hancock and James McCulloch.

Titan Storage Solutions is a wholly owned subsidiary of Ducalian Capital Limited.

Enterprise Investment Partners LLP

Enterprise Investment Partners LLP is a limited liability partnership incorporated in 2010. It is FCA Registered (number 604439) with appropriate permissions. The latest accounts are as of 31 March 2015 and as it is a small company are abbreviated. Capital at that date was £54,000. The balance sheet has improved since then, with EIP telling us that capital is now over £90,000 above the requirement of £40,000.

EIP has three partners: Christian Elmes, Matthew Lenzie and Martin Sherwood.

People

James Hancock – Operations Director, Ducalian
Having graduated with a degree in Aerospace, he began his career at Rolls Royce plc focussing on project management. For Titan Storage he provides operational oversight and performance management functions.

James McCulloch – Investment Director, Ducalian
Has spent most of his career providing real estate solutions – residential and commercial – to the wealth management market. His responsibility is to source and analyse investment opportunities.

Robert Cherry – Director of Private Equity, Ducalian
His career has mostly involved providing financial advice to high net worth individuals. He is in charge of the capital raising team and advises Titan on their sales processes.

Christian Elmes – Partner, EIP
A qualified accountant, he spent a time in investment banking before getting involved in tax efficient investment at Smith & Williamson. He left his role as deputy head of the team to join EIP in 2011.

The above will comprise the board of each investee company. Both Ducalian and EIP have other individuals with appropriate experience as part of their teams. Although neither team is very large, there does seem to be a good spread of skills across the two.

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