

Picton Property Income

NAV update

Progress continues

Picton Property Income's 25 July NAV update showed that asset management initiatives have continued to add value through a series of new and renewed leases, as well as two asset disposals at 37% above their March 2017 valuations. Like-for-like valuations in the office and industrial sectors, representing 75% of the portfolio, rose over 2% and earnings of £5.3m gave 1.16x dividend cover, also contributing to NAV gains. Management continues to execute the strategy of investing in and actively managing a regional property portfolio to provide rising income and increasing capital value.

Year end	Revenue (£m)	Adj. EPRA EPS* (p)	DPS (p)	EPRA NAV/share (p)	P/EPRA NAV (x)	Yield (%)
03/16	40.8	3.68	3.30	77.2	1.11	3.8
03/17	47.9	3.80	3.30	81.8	1.05	3.8
03/18e	41.8	3.90	3.40	84.2	1.02	4.0
03/19e	42.8	4.03	3.50	84.7	1.01	4.1

Note: *EPS are normalised, excluding exceptional items.

NAV update

Picton's announcement showed that NAV rose to £452.5m or 83.8p per share in the quarter to 30 June 2017 (31 March 2017: £441.9m and 81.8p), in part due to a 1.8% like-for-like revaluation gain on the portfolio, but also with increased dividend cover (116% from 106% at 31 March 2017) from higher earnings (£5.3m vs £4.9m). A 0.85p quarterly dividend was paid and another declared, equivalent to an annual dividend of 3.4p, a 4% yield on the current share price; the quarterly total NAV return was 3.4%. The rise in NAV helped reduce net LTV to 27.0% (March 2017: 27.4%) and £51m of funds remain undrawn from the two revolving credit facilities. Combined with proceeds from two recent disposals, these provide capital for meaningful further portfolio and earnings growth.

Asset management adding value

The property portfolio increased 1.8% in value on a like-for-like basis with five lettings completed at an average of 2% above March 2017 estimated rental value (ERV), adding £0.9m to the rent roll. In addition, four re-gears and lease renewals were negotiated, adding £0.3m pa at 5% above March ERV. Occupancy was flat quarter-on-quarter at 94%, but the sales of two non-income producing assets were agreed for £9.86m, 6% above the June valuation. These were completed in the current quarter, increasing occupancy to 96%.

Valuation: Attractive dividend and capital growth

The shares have continued to perform well, gaining 2p since our initiation in June, in line with NAV growth and maintaining the c 2% premium to NAV. This remains below the peer group average of c 9%. The 4% prospective dividend yield is below the group average of 5%, which may explain some of the difference, but there may be scope for the premium to rise closer to the average. With no changes to the assumptions in our dividend discount model (see our [initiation note](#)), which we use as a sense check, the fair value range produced by our model remains 79p to 103p.

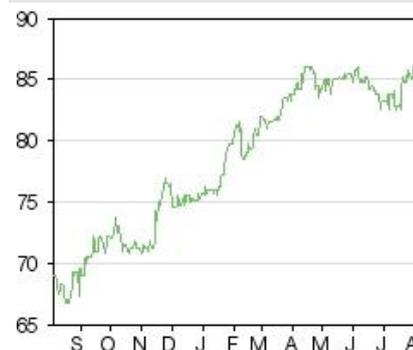
Real estate

3 August 2017

Price 86p
Market cap £462m

Net debt (£m) at 30 June 2017	171.5
Shares in issue	540.1m
Free float	100%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.8	0.9	23.9
Rel (local)	0.9	(1.0)	10.1
52-week high/low		86.0p	66.8p

Business description

Picton Property Income is an internally managed investment company that invests in commercial property across the UK. The investment objective is to provide investors with an attractive level of income and the potential for capital growth.

Next events

September 2017 NAV	October 2017
2017 half year results	November 2017

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Summary of announcement and estimate changes

In this section we give a synopsis of the NAV update before explaining the small changes to our estimates that result from it. Essentially, continued focus on occupiers and active asset management contributed to reductions in vacancy and increases in rental income at several assets that were already let, feeding through to higher valuations. Our estimates have changed slightly to take account of these, but our dividend assumption remains the same.

- A 1.8% like-for-like portfolio valuation increase, the disposal of two assets for £9.86m, or £2.7m (37%) above their previous valuation, and an increase in retained earnings all contributed to a 2p increase in NAV per share, as shown in Exhibit 1.

Exhibit 1: NAV changes in the quarter to 30 June 2017			
	Total (£m)	% change	Per share (p)
NAV at 31 March 2017	441.9		81.8
Movement in property value	9.6	2.2	1.8
Net income for the quarter	5.3	1.2	1.0
Dividends paid	(4.6)	(1.0)	(0.8)
Other	0.3	0.0	0.0
NAV at 30 June 2017	452.5	2.4	83.8

Source: Picton Property Income data

- Net LTV fell from 27.4% to 27.0%. Debt remains 100% fixed, with an average term of 11.5 years and average cost of 4.2%. The revolving credit facility due to expire in 2018 has been extended to June 2021, initially for £24m at 190bp above three-month Libor. Together the two revolving credit facilities give the company £51m of undrawn debt finance.
- The portfolio consisted of 53 assets valued at £626.5m with an average lot size of £12m at 30 June (now 51 assets worth c £617.5m or £12.1m on average). The top 10 assets by value comprised 48% (now 49%) of the portfolio and the sectoral and geographic breakdown as at 30 June is shown in Exhibit 2. Valuation growth in the quarter came from the office and industrial sectors with like-for-like increases of 2.9% and 2.1%, respectively, while the retail and leisure assets had the same valuation quarter-on-quarter. The portfolio had a net initial yield based on contracted rent of 5.8%, with a reversionary yield of 6.8% and a weighted unexpired lease term of 5.5 years.

Exhibit 2: Portfolio composition					
Sector	Value (£m)	% of portfolio		Value (£m)	Location
Industrial	251.9	40.2%	27.2%	170.4	South East
			13.0%	81.4	Rest of UK
			4.3%	26.9	London City + West End
Office	216.8	34.6%	9.1%	57.0	Inner and Outer London
			12.3%	77.1	South East
			8.9%	55.8	Rest of UK
			10.3%	64.5	Retail warehouse
Retail and Leisure	157.9	25.2%	7.2%	45.1	High Street – rest of UK
			5.5%	34.5	High Street – South East
			2.2%	13.8	Leisure

Source: Picton Property Income data

- Asset management initiatives in the quarter included the disposal of two vacant office buildings in Bracknell for a total of £9.86m, 37% above the March valuation and 6% above the June one, which have now completed.
- The largest office vacancy in the portfolio at 50 Farringdon Road was reduced with two suites totalling 11,900 sqft let for rent of £0.62m pa, 2% above March ERV and taking the building to 75% occupancy.

- A lease was renewed at Angel Gate in Islington, securing a 28% increase in passing rent to £58,000 pa, in line with ERV. Two other suites in the same building are under offer and two more are being refurbished for re-leasing.
- A lease to Standard Life at 180 West George Street in Glasgow, where a full refurbishment is underway, was renewed 4% above March ERV for £0.19m pa.
- In the industrial portfolio the largest vacancy was let at River Way in Harlow following planning consent for change of use. The new lease has a 10-year term for £0.2m per year with RPI-linked uplifts collared and capped at 2% and 4%. Two other industrial rent reviews were settled at £0.16m pa, a 16% increase and 5% ahead of March ERV.
- Finally, in the retail and leisure portfolio, the 152 bed Strathmore Hotel in Luton reopened after the incoming occupier, Thistle, completed a comprehensive refurbishment.

Minor changes to estimates

We have adjusted our previous estimates to include the revaluation gains reported in the quarter and for the subsequent disposals. The increase in occupancy and rental income is within the scope of our previous assumptions and because the disposals were of non-income producing assets, we have not changed our rental income estimates. Our dividend estimates are also unchanged.

Exhibit 3: Estimate changes												
	Revenue (£m)			Adj. EPRA EPS (p)			NAV/share (p)			DPS (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
FY18e	41.8	41.8	0%	3.90	3.90	0%	82.3	84.2	2%	3.40	3.40	0%
FY19e	42.8	42.8	0%	4.03	4.03	0%	82.9	84.7	2%	3.50	3.50	0%

Source: Edison Investment Research

Valuation

Picton's 4% dividend yield and strong performance history support a c 2% premium to EPRA NAV, while the peer group trades at an average premium of 8%. We would argue that Picton's earnings performance and rebalancing of the portfolio towards sectors that may be more resilient to the effects of Brexit warrant a valuation closer to the average. As mentioned above, our dividend discount model still gives a valuation range of 79p to 103p using a 7% cost of equity, 3% dividend growth and a 50bp sensitivity to each.

Exhibit 4: Peer comparison						
Company	Price (p)	Market cap (£m)	EPRA NAV/share (p)	P/NAV (x)	DPS (p)	Yield (%)
Picton	86.00	464.4	83.8	1.03	3.40	4.0%
A&J Mucklow	508.50	321.9	448.0	1.14	22.10	4.3%
Custodian REIT	114.50	402.3	104.3	1.10	6.50	5.7%
F&C Commercial Property	148.00	1,183.1	139.4	1.06	6.00	4.1%
Regional REIT	102.75	308.8	101.9	1.01	8.00	7.8%
Schroders REIT	62.00	321.5	64.8	0.96	2.48	4.0%
Strd Life Invst Ppty Trust	92.50	359.7	83.9	1.10	4.76	5.1%
UK Commercial Ppty Trust	91.15	1,184.4	87.4	1.04	3.68	4.0%
Average	159.91	583.1	147.1	1.09	7.65	5.0%

Source: Bloomberg data as at 2 August 2017, Edison Investment Research

Exhibit 5: Financial summary

Year end 31 March	£000s	2014	2015	2016	2017	2018e	2019e
PROFIT & LOSS		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Revenue		31,967	35,151	40,770	47,911	41,829	42,798
Service charge income		4,782	4,511	5,153	6,487	6,374	6,522
Total revenue		36,749	39,662	45,923	54,398	48,203	49,320
Gross property expenses		(8,992)	(9,320)	(10,001)	(12,011)	(11,792)	(12,054)
Net rental income		27,757	30,342	35,922	42,387	36,411	37,266
Administrative expenses		(1,139)	(1,194)	(1,510)	(1,613)	(1,634)	(1,672)
Operating Profit before revaluations		26,618	29,148	34,412	40,774	34,778	35,594
Revaluation of investment properties		18,422	53,163	44,171	15,087	9,600	0
Profit on disposals		5,660	412	799	1,847	558	0
Management expenses		(2,127)	(2,591)	(2,901)	(3,636)	(3,664)	(3,740)
Operating Profit		48,573	80,132	76,481	54,072	41,272	31,854
Net Interest		(10,868)	(10,930)	(11,417)	(10,823)	(9,578)	(9,564)
Profit Before Tax		37,705	69,202	65,064	43,249	31,693	22,289
Taxation		(357)	(347)	(216)	(499)	(731)	(514)
Profit After Tax		37,348	68,855	64,848	42,750	30,962	21,775
Profit After Tax (EPRA)		13,266	15,280	19,878	20,516	21,038	21,775
Average Number of Shares Outstanding (m)		359.9	445.3	540.1	540.1	540.1	540.1
EPS (p)		10.38	15.46	12.01	7.92	5.73	4.03
Adj EPRA EPS (p)		3.69	3.43	3.68	3.80	3.90	4.03
Dividend per share (p)		3.00	3.00	3.30	3.30	3.40	3.50
Dividend cover (x)		1.23	1.14	1.12	1.15	1.15	1.15
BALANCE SHEET							
Fixed Assets		421,393	536,898	649,406	618,391	619,831	623,331
Investment properties		417,207	532,926	646,018	615,170	616,610	620,110
Other non-current assets		4,186	3,972	3,388	3,221	3,221	3,221
Current Assets		42,879	84,111	37,408	49,960	61,043	60,853
Debtors		10,527	14,019	14,649	16,077	14,246	14,576
Cash		32,352	70,092	22,759	33,883	46,796	46,276
Current Liabilities		(17,369)	(17,480)	(47,521)	(21,171)	(20,867)	(21,309)
Creditors/Deferred income		(14,434)	(16,468)	(18,430)	(20,067)	(19,763)	(20,205)
Short term borrowings		(2,935)	(1,012)	(29,091)	(1,104)	(1,104)	(1,104)
Long Term Liabilities		(232,807)	(233,559)	(222,161)	(205,255)	(205,477)	(205,477)
Long term borrowings		(231,081)	(231,834)	(220,444)	(203,540)	(203,540)	(203,540)
Other long term liabilities		(1,726)	(1,725)	(1,717)	(1,715)	(1,937)	(1,937)
Net Assets		214,096	369,970	417,132	441,925	454,530	457,398
Net Assets excluding goodwill and deferred tax		214,096	369,970	417,132	441,925	454,530	457,398
NAV/share (p)		56.4	68.5	77.2	81.8	84.2	84.7
EPRA NAV/share (p)		56.4	68.5	77.2	81.8	84.2	84.7
CASH FLOW							
Operating Cash Flow		23,145	24,705	33,283	36,283	32,688	31,451
Net Interest		(8,768)	(8,695)	(8,836)	(9,211)	(9,578)	(9,564)
Tax		(394)	(369)	(426)	(232)	0	0
Net cash from investing activities		(10,838)	(61,729)	(68,123)	48,691	8,160	(3,500)
Ordinary dividends paid		(10,711)	(13,102)	(17,822)	(17,957)	(18,356)	(18,907)
Debt drawn/(repaid)		(1,031)	(3,191)	14,591	(46,450)	0	0
Proceeds from shares issued		18,043	100,121	0	0	0	0
Other cash flow from financing activities							
Net Cash Flow		9,446	37,740	(47,333)	11,124	12,913	(520)
Opening cash		22,906	32,352	70,092	22,759	33,883	46,796
Closing cash		32,352	70,092	22,759	33,883	46,796	46,276

Source: Picton Property Income data, Edison Investment Research

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