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Palace Capital

Real estate

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Income and capital growth outside London

Palace Capital seeks commercial real estate investments in towns and cities outside London that present the opportunity to grow rental income and capital value. It achieves this through active asset management to increase value, as evidenced by Hudson House in York where value has increased from £3.8m to £14.9m since acquisition in October 2013. EPRA NAV grew 1.2% in H117 to £107.6m and the shares trade at a considerable discount to the 419p NAV per share value.

Interim results

In H117 Palace acquired Boulton House in central Manchester for a consideration of £10.6m, bringing the total portfolio value to £184.8m with net rents of £11.7m and NAV per share of 419p, up 1.2% from 414p at 31 March. Rental income grew from £5.4m in H116 to £7.0m as acquisitions and asset management initiatives added to the rent roll, maintaining 89% occupancy despite Boulton House being 18% void. The absence of the one-off £3m surrender premium received in H116 and lower revaluation and disposal gains were the main reasons for the reduction in net profit from £7.1m to £3.4m. The interim dividend was increased from 7p to 9p and covered 1.5x by reported earnings. Net LTV of 39% is within Management's target range and the company's debt has an average maturity of 5.1 years and cost of 2.9%, among the lowest in the sector.

Selective acquisitions and asset management

Palace buys assets in central locations in regional cities with the aim of increasing value and income through asset management efforts to reduce vacancy and improve the assets. Hudson House near York station was acquired in October 2013 for £3.8m and is now valued at £14.9m following planning approval for conversion to mixed residential and office use. Further value could be added if a redevelopment proposal succeeds. Palace plans to enhance the value of Boulton House by refurbishing two floors, reducing void space and raising rents: occupied space is currently let at c £12.5-13.0/sqft vs a market rate of £15/sqft. Management sees potential for the net initial yield of 5.5% to revert to 8.5%.

Valuation: Conservative

The c 15% discount to 30 September NAV (vs 9% peer average) appears to allow for considerable risk, which we would expect to be mitigated by the diverse portfolio and lack of exposure to London, where the property cycle may be more advanced. Given that and the asset management initiatives already underway, which are likely to enhance income and capital value, the current discount appears conservative.

Consensus estimates

Year end	Net revenue (£m)	PBT* (£m)	EPRA EPS (p)	NAV/share (p)	DPS (p)	Yield (%)
03/15	7.4	13.9	27.7	375	13.0	3.6
03/16	13.0	11.8	31.3	414	16.0	4.4
03/17e	11.9	6.5	21.7	420	18.0	5.0
03/18e	12.7	7.0	22.6	423	18.0	5.0

Source: Bloomberg, Palace Capital. * PBT forecasts exclude fair value movements on properties and share-based payments, profits on disposals and other non-recurring items.

Price 360p

Market cap £93m

Share price graph

Share details

Code	PCA
Listing	AIM
Shares in issue	25.71m

Business description

Palace Capital invests in UK commercial property outside London, typically in prime locations in major regional cities and is sector agnostic. It seeks to enhance capital value and long-term income potential through asset management. The existing portfolio is valued at £184.8m, with contracted rents of £13.7m.

Bull

- Exposure to resilient ex-London commercial property market likely to benefit from improved national infrastructure.
- Not being a REIT means Palace is able to recycle capital and use income to enhance capital returns.
- Undemanding valuation vs regional property peers and well-covered dividend.

Bear

- Pays corporation tax on profits as a non-REIT.
- Relatively high administrative costs as a result of detailed asset management.
- Susceptible to UK property cycle.

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