

Picton Property Income

Consistent outperformance

Initiation of coverage

Real estate

Picton Property Income is an internally managed property company, which has assembled a £624m portfolio diversified by sector, geography and also income concentration. Long-term performance has been strong; its portfolio has outperformed the MSCI quarterly benchmark in the last one, three, five and 10 years. It has also often exceeded its targeted geared IRRs of 10-15%. Last year's property return of 9.9% was more than double the benchmark. Improving occupancy, rental increases and falling interest costs from debt reduction in FY17 should underpin earnings growth in FY18-19, thereby supporting the dividend yield of over 4%. Despite this track record and yield, Picton trades at a discount to the sector average P/NAV, even after the share price recovery we have seen in the last year.

Year end	Revenue (£m)	Adj EPRA EPS* (p)	DPS (p)	EPRA NAV (p)	P/NAV (x)	Yield (%)
03/16	40.8	3.68	3.30	77.2	1.09	3.9
03/17	47.9	3.80	3.30	81.8	1.02	3.9
03/18e	41.8	3.90	3.40	82.3	1.02	4.1
03/19e	42.8	4.03	3.50	82.9	1.01	4.2

Note: *EPS are normalised, excluding exceptional items.

FY17 results: REIT conversion now on the cards

Picton reported a 3% increase in adjusted FY17 EPRA EPS and a 6% rise in EPRA NAV to 81.8p. This was accompanied by an 18% fall in debt to £205m, following the repayment of the zero dividend preference shares and the sale of non-core assets, so net gearing fell to 27%. In its results statement Picton said it is likely to be in the interests of the company to convert to a UK REIT in 2018, which could potentially increase the dividend payout and yield, but we estimate would have little impact on NAV initially. It is currently an offshore investment company, so plans to put a proposal before shareholders in due course.

Forecasts: Steady growth set to continue

As a result of a steady improvement in occupancy, a limited rise in rental rates and lower financing costs following the debt reduction last year, we are forecasting a 3% increase in EPRA EPS in both FY18 and FY19. We forecast dividends to increase 3% in each year, in line with earnings growth, thereby maintaining a comfortable level of cover. NAV growth is expected to be more subdued at 0.6% in both years, as we are not forecasting any fair value gains, or disposal profits.

Valuation: A discount to peers, despite its record

The shares have performed strongly since the post-Brexit sell-off last year and now trade on a 2% premium to our FY18 forecast NAV. Despite Picton's record of outperforming the sector over the past 10 years and its yield being in line with most of its peers, it trades at a slight discount to the average P/NAV for the sector. As Picton is an income-focused company we have valued it using a dividend discount model, which produces a fair value range of 79p to 103p.

26 June 2017

Price **83.75p**
Market cap **£452m**

Net debt (£m) FY17	170.8
Shares in issue	540.1m
Free float	100%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(1.5)	0.3	19.6
Rel (local)	(0.6)	(1.3)	2.5
52-week high/low		86.0p	57.5p

Business description

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

Next events

30 June 2017 NAV July 2017

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Picton Property Income is a research client of Edison Investment Research Limited

Investment summary

Company description: Focused on total returns

Picton is an internally managed investment company, which offers diversified exposure to the UK commercial property market. It targets active management of its assets, focusing on occupiers' needs and the opportunities to enhance value within the portfolio. This has produced consistent outperformance of the IPD benchmark at a portfolio level, partly by using gearing to enhance returns over the long term. Management believes that having an internalised management structure creates alignment with shareholders and generates economies of scale as it grows. These economies of scale are expected to enable it to reach the FTSE 250 within five years.

Financials: Solid FY17 results

Picton reported a 30% increase in FY17 income profit to £25.8m, but reported EPS fell 34% to 7.9p, owing to lower fair value gains (£15m vs £44m). Adjusted EPRA EPS were up 3% at 3.8p and the total return for the year was 10.4%. Net rental income increased 18% to £42.4m, but was boosted by £6m of other income, primarily relating to settlement of a one-off property dispute. The dividend was raised 3% to 3.4p for FY18, which was 115% covered, after adjusting for £5.3m of other income. There was also a significant reduction in net gearing to 27.4%, following debt repayment and the disposal of non-core assets.

Valuation: Trading on a discount to peers

We have compared Picton to the main mid-sized UK REITs and property companies. It trades at a small discount to the sector average, on a 3% premium to the FY17 reported NAV, despite its dividend yield being in line with most sector peers at 4%. Picton has a 10-year track record of sector outperformance, which adds further support to the NAV premium, plus the business model is focused on all sectors of the market and is diversified nationally. Conversion to a REIT could provide the catalyst to close this gap, as it may increase the dividend payout. Our dividend discount model base case uses a discount rate of 7%, a dividend growth rate of 3% and an FY18 dividend estimate of 3.4p. Using a 0.5% sensitivity in the dividend growth rate and cost of equity produces a fair value range of 79p to 103p.

Sensitivities: Mainly macro risks

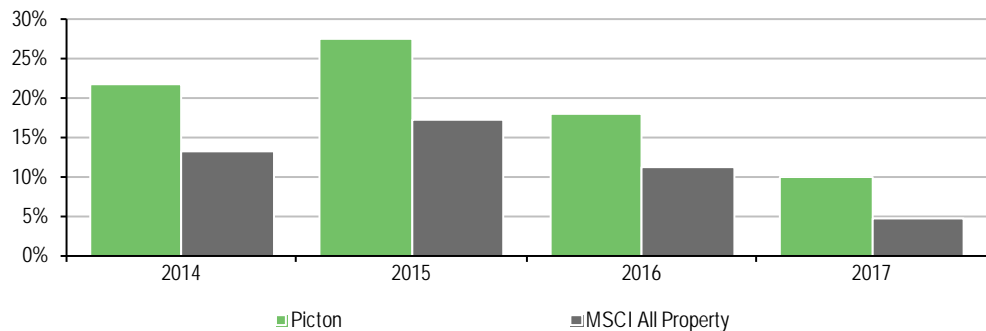
- Sector risk: Property is a cyclical sector, but some of the inherent cyclical risk can be mitigated by building up a large diversified portfolio, with multiple tenants, reducing vacancy risk substantially. At 6% voids were relatively low at year end, and they have already fallen to 4%, supporting an increase in occupancy in FY18-19, as key properties are let.
- Macro risk: The main risk is the wider economy. The macro outlook for the UK has improved recently, with the Bank of England increasing its forecast for GDP growth for 2017 to 2%. A slight slowdown to 1.6% and 1.7% is then expected in 2018 and 2019. The Brexit process could have an impact on these forecasts and thus increase the risks for the sector in 2018-19.
- Inflation and interest rates are a risk for the sector. With inflation already rising, partly due to sterling depreciation and rising oil prices, the prospect of higher interest rates becomes more imminent. Rising interest rates would have little impact on Picton initially, as only the undrawn £51m of its revolving credit facility is on a floating rate, although there would eventually be a knock-on effect on NAV, as yields increased.
- Management risk: As Picton is internally managed there is some management risk. It is a relatively small team, so if a senior director were to leave they would need to be replaced.

Company description: An internally managed company

History and performance

Picton was launched in October 2005 as the ING Real Estate Income Trust in an offshore structure. On 1 June 2011 the name of the company was changed to Picton Property Income Limited and on 1 January 2012 Picton Capital was appointed as the investment manager. Picton Capital is a wholly owned subsidiary company and implements the investment policy, which is determined by the board. The main benefit of this structure is that management costs are not linked to the size of the portfolio, unlike other property investment companies. As a result, the company should benefit from rising economies of scale as it grows, which should in turn improve investor returns. We estimate an effective fee of 0.8% of NAV in FY17 (total cost ratio of c 1.2%), which is lower than companies of a similar size. Indeed, Picton only exceeded the costs under the ING structure in 2017, despite a doubling of NAV five years after taking over. It targets geared IRRs of 10-15%, which it has often exceeded. Performance has been strong, outperforming the MSCI quarterly property index in the last four years and over the past five (1.3%) and 10 years (0.7%), with the same management.

Exhibit 1: Picton's relative performance (total NAV return)

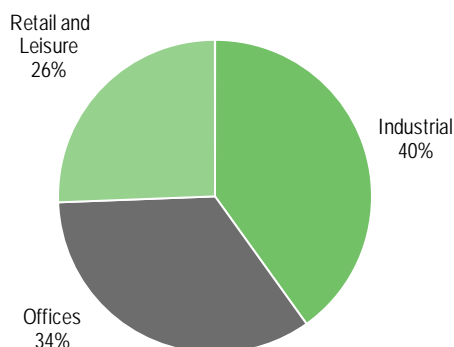


Source: Picton Property Income data, MSCI

Strategy: Occupier focused, opportunity led

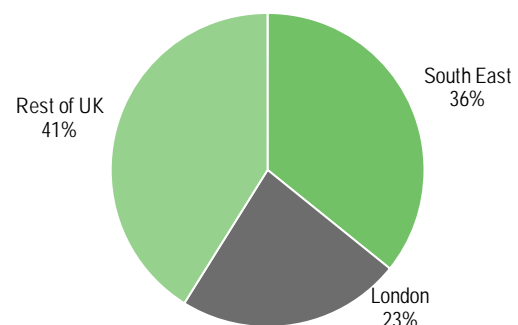
Picton's investment objective is to provide shareholders with an attractive level of income, together with the potential for capital growth, by investing in the main UK commercial property sectors. The strategy enables Picton to create a portfolio that is diversified by sector, geography and by income concentration. Picton can thus invest both directly and indirectly across the UK. As at 31 March 2017 the company had 23% of its portfolio in Greater London, 36% in the South East and the remaining 41% in the rest of the UK. The majority of income, after operating and financing costs, is paid out to investors in quarterly dividends, which could marginally increase on REIT conversion.

Exhibit 2: Portfolio sector split Q417



Source: Picton Property Income data

Exhibit 3: Geographical split (Q417)



Source: Picton Property Income data

Picton says its strategy is to be occupier focused and opportunity led, as the occupiers provide the cash flow and Picton is focused on income. However, the focus is not just on its own occupiers, but the whole occupier market. The opportunity-led part relates to being commercial when buying, managing and selling. For example, in FY17 four non-core assets were sold 41% above the March 2016 valuation. Picton also attempts to recycle capital where opportunities exist for better risk-adjusted returns. To achieve this two-pronged strategy it targets five strategic priorities:

- **Hands-on asset management:** Picton is always trying to improve its asset base via refurbishment, higher value uses or lease restructuring. It has recently reduced the number of assets, as the complexity of its portfolio determines how many staff it needs. It believes a lot size of £10-30m produces economies of scale and means it can own most UK property assets, although it does see competition in all lot sizes. It will acquire new assets that offer income and value potential and will dispose of assets where the gains have been achieved.
- **Working with occupiers:** The asset management team maintains direct relationships with occupiers. The idea is to invest in the space to reflect what tenants want, which it believes is the way to maintain occupancy, reduce voids and achieve rental growth. The initiatives include the 'Picton Promise', which includes eight commitments to quality and the tenant experience intended to raise retention rates.
- **Growth of recurring income:** The target is to increase rental income and to secure market rent rises via active portfolio management, adding additional income from new lettings, lease renewals and re-gears. A diverse tenant base means that the rental income is relatively stable, allowing the company to cover its dividend and invest surplus cash flow in the portfolio.
- **Operational efficiency and expertise:** Picton is an internally managed investment company. The management team of 12 permanent employees has an average of over 12 years' experience in the commercial property sector. With just 53 assets, the asset managers can visit the properties regularly and develop strong relationships with their occupiers. Management believes this operating model has enabled it to consistently outperform the sector and should allow Picton to benefit from economies of scale as it grows.
- **Effective use of debt:** The use of gearing increases returns to shareholders over the long term. When gearing is appropriate in the cycle, the portfolio's income return can be improved by low, long-term fixed interest rates.

Portfolio: Overweight industrial, warehouse and logistics

Picton invests in a portfolio of UK assets, diversified by sector, geography and tenant, where it believes it can improve either income or value. It sees hundreds of millions of pounds worth of stock each quarter and is constantly reviewing opportunities in the market, but will only acquire where the property and financial fundamentals are compelling. In 2016 the company made no acquisitions. However, it undertook some portfolio restructuring, largely reducing Central London exposure and continuing to sell non-core assets. It is sector agnostic, investing in all segments of the market, but is currently underweight retail and double the benchmark in industrial. It also has to take a long-term view, as stamp duty on acquisitions is 5%.

The property portfolio, which was valued at £615m (£624m before lease incentives) at the end of March 2017, consisted of 53 assets, with approximately 350 occupiers, providing a diversified income stream, from a wide range of businesses and an average lot size of £11.8m. The largest tenant accounts for 4% of the rent roll. As discussed 40% of the portfolio is allocated to the industrial, warehouse and logistics sector, where Picton is seeing good performance and which has been resilient during recent economic and political volatility. The top 10 assets below represent 48% of the portfolio by capital value. They show Picton's diversified national exposure and half of them are in the industrial or retail warehouse segment.

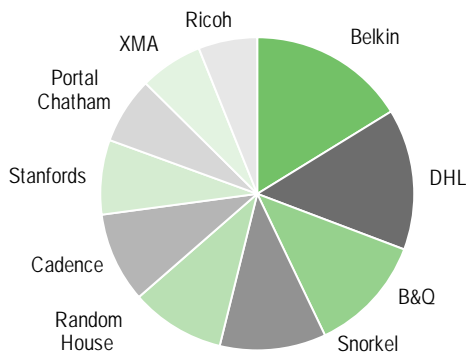
Exhibit 4: Top 10 assets as at 31 March 2017

Property	Sector	Location
Parkbury Industrial Estate, Radlett	Industrial	South East
River Way Industrial Estate, Harlow	Industrial	South East
Angel Gate Office Village, City Road, EC1	Office	London
Stanford House, Long Acre, WC2	Retail	London
50 Farringdon Road, EC1	Office	London
Shipton Way, Rushden, Northamptonshire	Industrial	East Midlands
Pembroke Court, Chatham	Office	South East
Queens Road, Sheffield	Retail Warehouse	Yorkshire & Humberside
Phase II Parc Tawe, Swansea	Retail Warehouse	Wales
Metro, Manchester	Office	North West

Source: Picton Property Income data

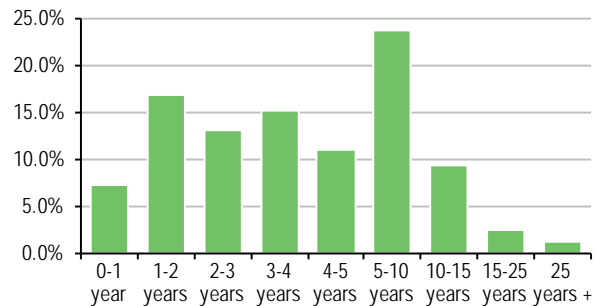
Picton's top 10 occupiers come from a range of businesses and account for less than 25% of the annual rent roll. Its tenants are active in all the main UK industries from retail and manufacturing to financial services and public administration. The portfolio's lease expiry profile shows the length of some of the leases. Half have over four years to expiry and nearly 13% are above 10 years. The average is 5.7 years to the first termination and 6.6 years to expiry.

Exhibit 5: Top 10 occupiers as at 31 March 2017



Source: Picton Property Income data

Exhibit 6: Lease expiry profile as at 31 March 2017



Source: Picton Property Income data

Management: Internalised structure

Unlike many investment companies, Picton is unusual in that it has internalised its investment management function. It has created a wholly owned investment management subsidiary, Picton Capital, which is authorised and regulated by the Financial Conduct Authority. Picton Capital operates the group's investment objectives, subject to the overall supervision of the board. Picton Property Income itself is managed and controlled by its board, which is based in Guernsey. The investment management team comprises 12 permanent employees and includes six real estate professionals, three qualified accountants and three support employees. The staff are incentivised by a long-term incentive share plan (LTIP), linked to total return, which creates a way of locking-in staff and alignment with shareholders.

Michael Morris, chief executive of Picton Capital Limited

Michael Morris is responsible for devising and overseeing the implementation of all aspects of the company's investment strategy. He is also a non-executive director of Picton Property Income Limited. He has over 22 years' experience in the UK commercial property sector, working initially in private practice, becoming a fund manager at ING Real Estate Investment Management. He was appointed to the board in October 2015, having worked with the group since launch in 2005.

Nicholas Thompson, chairman

Nicholas Thompson was formerly director and head of fund and investment management at Prudential Property Investment Management. He has served on the board as chairman since 2005. He is currently chairman of MSCI/IPD's UK & Ireland Consultative Group, a director of the Lend Lease Retail Partnership and an independent director of the Association of Real Estate Funds. He is a fellow of the Royal Institution of Chartered Surveyors and a member of the Property Forum of the Association of Investment Companies.

Andrew Dewhirst, finance director

Andrew Dewhirst joined Picton Capital Limited as finance director in March 2011. Previously he was director of client accounting at ING Real Estate Investment Management (UK) Limited from January 2006. Prior to ING he was director of securities and property accounting at Hermes Pensions Management Limited. He has over 25 years' experience in the real estate and financial services sector. He is an associate member of the Institute of Chartered Accountants in England and Wales and a member of the Investment Property Forum.

Property sector outlook

Investment volumes have fallen since the 2015 peak

UK commercial property recovered well after the 2008-09 crisis and recession, despite a dip in 2011, but the regions were slower to recover than London and secondary property recovered slower than prime. Indeed, total investment volumes in 2014-15 exceeded the peak years of 2004-07, with Cushman & Wakefield reporting investment of £61.5bn in 2015. Foreign investment has accounted for 45% of the total on average since 2009. Regional property investment held up well at £22.7bn in 2016, due to the higher yields on offer. Although the EU referendum increased uncertainty in the market, even before the vote, there remains opportunity in the asset class outside London.

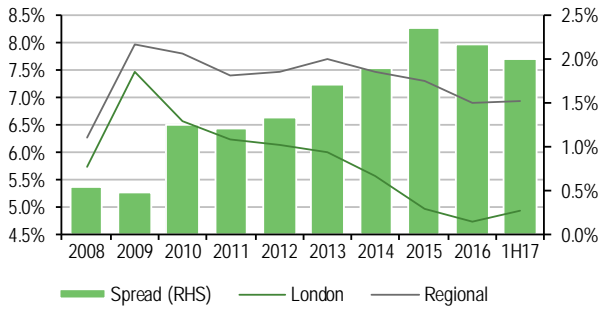
Relative yields favour the regions

There are several ways to look at the relative attractions of regional real estate. The first is the yield gap between the regions and London. The spread remains wide on a historical basis at c 2%. At the peak of the market in 2008 it was just c 0.5%. Although this seems likely to narrow, it is not a driver of Picton's strategy. The higher income return means that total returns do not need to be driven by capital growth, although there is the potential to see valuation gains if yields do compress.

Secondly, as the chart below shows, yield movements generally follow the London market, but they are significantly less volatile. So the regions could outperform London as the cycle turns and either way could see less of a correction. Also, regional assets, especially in smaller lot sizes, generally attract less attention from institutional and overseas investors, so there is less competition for assets and the yields have not been driven down. Finally, the regions are less negatively exposed to rising business rates and are less affected by international factors like secondary investment, the fate of financial services and the direct effects of the Brexit vote.

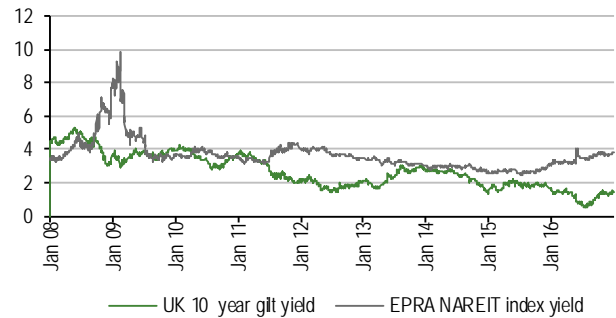
Exhibit 8 shows the effect of this higher return on the sector's dividend yields, which are one of the main drivers for owning the majority of these stocks. This shows the yield spread over the 10-year gilt for the sector as a whole, and clearly the spread is wider again for the regional property sector as illustrated in Exhibit 7.

Exhibit 7: Equivalent yields – regional vs London



Source: Edison Investment Research, Palace Capital

Exhibit 8: UK 10-year gilt and NAREIT index yields



Source: Bloomberg

Regional occupier demand remains strong

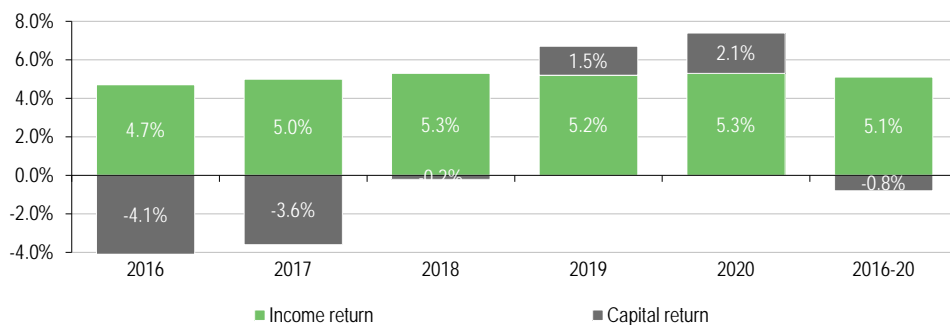
The second factor to cover is the relative attraction of the regions to occupiers and investors. Because of limited new supply in the regions, the strength of the economic recovery, growth in employment and business relocation away from London, tenant demand has been strong. This has helped to improve rents for regional office and industrial sites. Brexit has increased uncertainty, especially in London, and appears to have led to delayed business decisions in general. However, there is a view that sterling weakness could turn out to be positive for industrial exporters and in turn support economic activity outside London, with a positive knock-on effect on regional industrial property.

CBRE predicts that records for the take-up of regional space may be broken in 2017, due to government related entities taking pre-lets in the regions, which can often exceed the normal annual demand in a city. Additionally business confidence generally is looking robust, as evidenced by manufacturing PMI data earlier in the year, which surprised on the upside. This showed all regions other than Scotland exhibiting growth.

As well as occupational demand being good, supply is very tight. There has been very little new building, especially of industrial space. For example, one estimate suggests that in order to be economically viable new mid-sized logistics and industrial developments would require rentals 15% above current levels, which is adding to pressure for rental growth.

Regional markets are thus expected to deliver higher returns in the latter stages of the cycle than London, as income is expected to drive the majority of total returns from 2017 to 2020. Also, offices and industrial property outside London should be less exposed to the knock-on effects of the Brexit vote than London or the wider retail sector.

Exhibit 9: All property total return forecasts



Source: Investment Property Forum consensus forecasts

Valuation: A small discount to peers

Sector outperformance not reflected in comparative valuations

Picton trades at a premium of 2% to our forecast FY18 NAV, which is a slight discount to the more income-orientated listed sector peers. It has traded at a discount to NAV in the past, but this was when the company's gearing was much higher and also briefly last year following the Brexit vote. Picton also has a 10-year track record of sector outperformance, as discussed above, which adds further support to the NAV premium. This has been achieved by a variety of factors including: the experienced team, the internal management structure, the intensive asset management, a manageable portfolio and a sector-diversified portfolio. As the business model is focused on all sectors of the market and is diversified nationally, with a wide tenant base, Picton's risk profile is reduced. In our view, this also supports the current premium to NAV.

We have compared Picton to the main mid-sized UK REITs and property companies. Picton trades at a small discount to the sector average on a 3% premium to the FY17 reported NAV, despite its dividend yield being in line with most of the sector at 4%. However, its yield could increase if it converts to REIT status. The sector's average dividend yield is also boosted by Regional REIT, which has a yield of over 7%, without which the average would be 4.5%.

As Picton is an income focused company we have valued the company on a dividend discount model, using a cost of equity of 7%, a dividend growth rate of 3% and the declared FY18 dividend of 3.4p. Using a 0.5% sensitivity in the dividend growth rate and cost of equity this produces a fair value range of 79p to 103p, implying upside of up to 20% at the top end of the range.

Exhibit 10: Comparative valuations, FY17e

	Price (p)	Market cap (£m)	NAV (p)	P/NAV (x)	DPS (p)	Dividend yield
Custodian REIT	117.5	407	104	1.13	6.5	5.5%
F&C Commercial Prop	148.4	1,190	137	1.08	6.0	4.0%
A&J Mucklow	502.0	407	444	1.13	22.0	4.4%
Standard Life Inv Prop	88.8	345	81	1.09	4.8	5.4%
Regional REIT	106.3	319	97	1.09	7.7	7.2%
Schroders REIT	64.8	336	64	1.01	2.5	3.9%
UK Commercial Property Trust	88.0	1,140	87	1.01	3.7	4.2%
Average		4,143		1.08		4.9%
Picton Property Income	84.3	455	81.8	1.03	3.4	4.0%

Source: Bloomberg, Edison Investment Research forecasts. Note: Prices as at 20 June 2017.

Financials

Earnings: FY17 boosted by one-off income

Picton reported a 30% increase in income profit to £25.8m in its FY17 results. Reported EPS fell 34% to 7.9p, owing to lower fair value gains (£15m vs £44m). Adjusted EPRA EPS were up 3% at 3.8p and the total return for the year was 10.4%. The total return for the fourth quarter alone was 2.8%. Net rental income increased 18% to £42.4m boosted by £6m of other income relating to a one-off property dispute that was settled. The dividend was raised 3% to 3.4p for FY18 in February, which was 144% covered, or 115% when adjusted for the £5.3m of other income.

Occupancy was 94%, but this improved to 96% post period end, as Picton completed a letting of its largest industrial void. It has also made further progress at 50 Farringdon Road, EC1, where it has now let 75% of the space, having relaunched the building in March. 96% occupancy matches the recent peak level in FY16. The best performing sector in the portfolio in the second half of FY17 was industrial, which saw robust occupational demand. Annual passing rent is currently £40m (up

4.4% like for like) and reversionary income is c £46m at 100% occupancy. This is broken down as follows: a third vacancy, a third stepped rents and a third market rent resets.

We have made the following assumptions in our forecasts:

- An average 2% rental growth in industrial and 1% growth across the rest of the portfolio, which is in line with management expectations and below market inflation forecasts.
- We have not assumed any acquisitions, so the portfolio size remains unchanged in FY17-18.
- An improvement in occupancy to 97% in FY18-19, as the office segment's occupancy recovers.
- A slight erosion in the net rental margin, as gross rental income falls, following the disposals in FY17.
- We are not assuming any fair value gains, or disposal profits.

As a result of these factors and lower financing costs after the debt reduction in FY17, we are forecasting a 3% increase in EPRA EPS in both FY18 and FY19 and a 0.6% increase in NAV/share to 82.3p and 82.9p, respectively.

Exhibit 11: Net rental income (£m)						
	2014	2015	2016	2017	2018e	2019e
Gross rental income	32.0	35.2	40.8	47.9	41.8	42.8
Net rental income	27.8	30.3	35.9	42.4	36.4	37.3
Net rental margin	87%	86%	88%	88%	87%	87%

Source: Picton Property Income data, Edison Investment Research forecasts

Cash flow: Comfortable dividend cover

Now the zero dividend preference shares have been paid off, the company has the scope to increase the dividend, due to the positive effect on earnings of the lower interest costs. The dividend was reduced in 2012 to reset it to be fully covered. It has been increased twice since, in 2016 and 2017, and will be reviewed regularly. We have assumed a steady increase to 3.5p in FY19 and expect it to increase as cash is deployed in additional assets. The cover target is 110-120% of EPRA EPS. Any surplus cash can therefore be reinvested in the portfolio.

Exhibit 12: Dividends and cover (£m)					
	2015	2016	2017	2018e	2019e
Free cash flow before investing and financing	15.6	24.0	26.8	22.7	22.1
Dividends paid	(13.1)	(17.8)	(18.0)	(18.4)	(18.9)
Cash cover	1.19	1.35	1.49	1.23	1.16

Source: Picton Property Income data, Edison Investment Research forecasts

Balance sheet: Falling debt strengthens capital structure

Picton reported an NAV of £441.9m for Q417, equating to 81.8p per share, an increase of 1.7% over Q3 and 6% for the year. This does not include a provision for the dividend. There was a 3% like-for-like increase in the property portfolio valuation to £615m, producing a valuation gain of £15m. Based on contracted net income the portfolio had a net initial yield of 5.9% (allowing for void costs) and a reversionary net yield of 6.9%.

Picton sold two central London assets in FY17 for £45m, on average 4% above the March 2016 valuation. It also sold four other non-core assets for £7m, at an average of 41% above the March valuation. The disposals were thus NAV enhancing, but partly as a result, occupancy was slightly down at 94%. The portfolio now has 53 assets with an average lot size of £11.8m. In the final quarter Picton sold a property in Bath for £2.75m and Drury Lane in Oldham for £2.2m after significant asset management. The combined transaction value of these assets was 10% ahead of the December 2016 valuation. Picton exchanged on the disposal of another two properties after year end.

Total debt was reduced 18% to £205m, following the repayment of £29m of zero dividend preference shares, saving up to £1.9m in interest charges. Net gearing was reduced to 27% from close to 35% in FY16. This is a significant change from 2013-14 when Picton had high gearing levels of over 50% and traded at a discount to NAV as a result. Rather than sell assets at the wrong point in the cycle, the company decided to reduce debt steadily over time. No further disposals are currently planned.

Exhibit 13: Debt structure (£m)

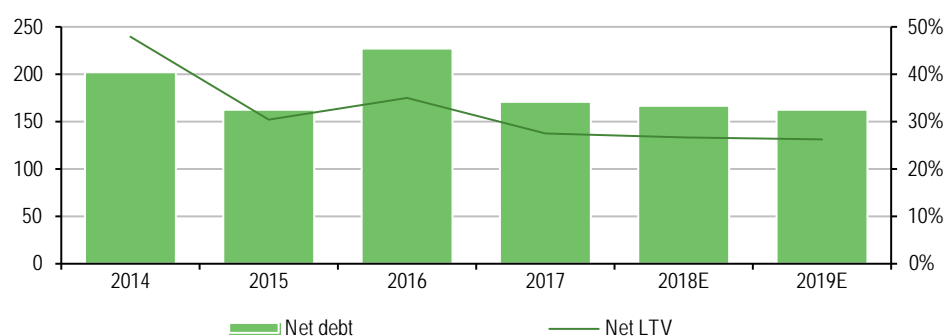
	2014	2015	2016	2017	2018e	2019e
Short-term borrowings	3	1	29	1	1	1
Long-term borrowings	231	232	220	204	204	204
Total debt	234	233	250	205	205	205
Cash	32	70	23	34	28	20
Net debt	202	163	227	171	177	184
LTV	56%	43%	38%	33%	33%	32%
Net LTV	48%	30%	35%	28%	28%	29%

Source: Picton Property Income data, Edison Investment Research forecasts

Total borrowings at 31 March were £204.6m, with a weighted average interest rate of 4.2% (100% fixed) and a weighted average debt maturity profile of approximately 11.7 years. Picton now has long-term debt from Aviva and Canada Life and uses revolving credit facilities to reduce cash drag when making acquisitions. There is thus no short-term refinancing risk and no exposure to interest rate risk. The mid-cycle gearing target is 35%, but Picton feels 27-28% is a comfortable level currently. The limit is 65%, but the peak was 55% in 2013. Management's view is that the benefits of high gearing do not offset the negative impact in a downturn.

In FY17 a second revolving credit facility was agreed with Santander, which provides future operational flexibility. The first facility has been extended and will now expire at the same time as the second, in June 2021. Picton currently has access to £51m of undrawn facilities. If drawn, interest will be charged at 175 basis points over three-month Libor, which is currently equivalent to 2.1% a year. We are not forecasting much change in debt or gearing levels in FY18-19, but management has said it would raise equity if needed for a major acquisition, to help drive growth.

Exhibit 14: Net debt and gearing (£m)



Source: Picton Property Income data, Edison Investment Research forecasts

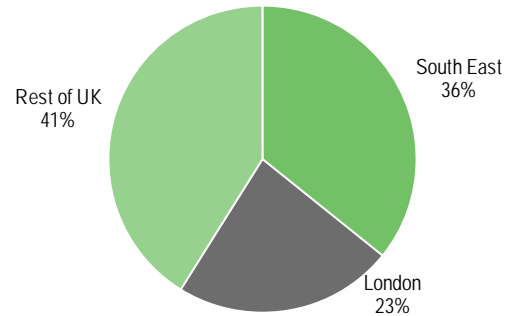
Exhibit 15: Financial summary

Year end 31 March	£000s	2014	2015	2016	2017	2018e	2019e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Gross rental income		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	0	0
Profit on disposals		5,660	412	799	1,847	0	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	31,114	31,854
Net Interest		(10,868)	(10,930)	(11,417)	(10,823)	(9,578)	(9,578)
Profit Before Tax		37,705	69,202	65,064	43,249	21,535	22,276
Taxation		(357)	(347)	(216)	(499)	(497)	(514)
Profit After Tax		37,348	68,855	64,848	42,750	21,038	21,762
Profit After Tax (EPRA)		13,266	15,280	19,878	20,516	21,038	21,762
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	3.90	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	621,891	625,391
Investment properties		417,207	532,926	646,018	615,170	618,670	622,170
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	48,838	48,634
Debtors		10,527	14,019	14,649	16,077	14,246	14,576
Cash		32,352	70,092	22,759	33,883	34,591	34,058
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)	(205,255)	(205,255)
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)	(1,715)	(1,715)
Net Assets		214,096	369,970	417,132	441,925	444,607	447,462
Net Assets excluding goodwill and deferred tax		214,096	369,970	417,132	441,925	444,607	447,462
NAV/share (p)		56.4	68.5	77.2	81.8	82.3	82.9
EPRA NAV/share (p)		56.4	68.5	77.2	81.8	82.3	82.9
CASH FLOW							
Operating Cash Flow		23,145	24,705	33,283	36,283	32,143	31,452
Net Interest		(8,768)	(8,695)	(8,836)	(9,211)	(9,578)	(9,578)
Tax		(394)	(369)	(426)	(232)	0	0
Net cash from investing activities		(10,838)	(61,729)	(68,123)	48,691	(3,500)	(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
Net Cash Flow		9,446	37,740	(47,333)	11,124	708	(533)
Opening cash		22,906	32,352	70,092	22,759	33,883	34,591
Closing cash		32,352	70,092	22,759	33,883	34,591	34,058

Source: Picton Property Income data, Edison Investment Research

Contact details	Revenue by geography (FY17)
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Management team of Picton Capital Ltd

Chief Executive: Michael Morris
 Michael Morris is responsible for devising and overseeing the implementation of all aspects of the company's investment strategy. He is also a non-executive director of Picton Property Income Limited.

Finance Director: Andrew Dewhirst
 Andrew Dewhirst joined Picton Capital Limited as finance director in March 2011. He has over 25 years' experience in the real estate and financial services sector. He is an associate member of the Institute of Chartered Accountants in England and Wales and a member of the Investment Property Forum.

Chairman of Picton Property Income: Nicholas Thompson

Nicholas Thompson was formerly director and head of fund and investment management at Prudential Property Investment Management. He has served on the board as chairman since 2005. He is currently chairman of MSC/MPD's UK & Ireland Consultative Group, a director of the Lend Lease Retail Partnership and an independent director of the Association of Real Estate Funds. He is a fellow of the Royal Institution of Chartered Surveyors and a member of the Property Forum of the Association of Investment Companies.

Principal shareholders	(%)
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Investec	18.5
Blackrock	6.2
Canaccord Genuity	4.5
Integrated Financial Arrangement	4.4
Bank of Montreal	4.3
Alliance Trust	4.2
Brewin Dolphin	3.3

Companies named in this report

Custodian REIT, F&C Commercial Property, A&J Mucklow, Standard Life Investment Property, Regional REIT, Schroders REIT, UK Commercial property Trust

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