

Picton Property Income

FY18 results & outlook

FY18 builds on successful track record

In a successful FY18, Picton Property Income again outperformed the MSCI IPD Quarterly Benchmark property return, as it has now done over one, three, five and 10 years. Moderate gearing enhanced the EPRA NAV total return to 14.9%. The industrial and office property markets, towards which Picton's portfolio has a strong bias, remain robust with widespread rental growth. In addition, Picton's portfolio continues to offer significant reversionary potential despite an already high level of occupancy. Plans to convert to UK REIT status later in the year should enhance future profitability, with no material impact on investment and portfolio strategy.

Year end	Net rental income (£m)	EPRA EPS* (p)	DPS (p)	EPRA NAV/ share (p)	P/EPRA NAV (x)	Yield (%)
03/17	42.4	3.81	3.35	81.8	1.11	3.7
03/18	38.4	4.19	3.45	90.4	1.01	3.8
03/19e	38.5	4.30	3.57	94.0	0.97	3.9
03/20e	39.1	4.43	3.68	96.6	0.94	4.0

Note: *EPRA EPS excludes revaluation gains/losses and other exceptional items.

Strong delivery in FY18

Adjusting for the exceptional income received in FY17, net rental income grew 3.5% to £38.4m in FY18. Occupancy increased to 96% and the annualised rent roll increased by 3.9%. Costs were little changed, other than for c £300k of REIT conversion expense, with the ongoing charge ratio falling to 1.1%. EPRA EPS grew by 10.1% and the quarterly DPS was increased by 3% during the year to an annualised 3.5p, 1.22x covered by FY18 EPRA EPS. Like-for-like valuation gains of 6.5% contributed to a 10.5% EPRA NAV increase to 90p, taking NAV total return to 14.9%. LTV reduced to 26.7%, with 95% of debt fixed with an average maturity of more than 10 years at a blended cost of 4.1%. We have modestly increased our FY19 EPS and NAV estimates.

Significant reversionary potential

Picton's portfolio continues to be overweight regional industrial and office property, and significantly underweight retail and leisure (with no shopping centre exposure). This served it well in FY18 and consensus expectations remain positive for FY19. The estimated rental value of the portfolio is now £6.5m ahead of the contracted rent roll, of which c £2m represents the upside potential from leasing vacant space, with the balance attributable to rent reviews and lease expiry opportunities. With occupancy at 96% already, continuing active asset management seems likely to be the key driver to unlocking income and value from the existing portfolio.

Valuation: Well covered DPS supports strong returns

While Picton has a strong income focus, it also chooses to reinvest into the portfolio in ways designed to support occupancy and income growth, with the specific goal of enhancing long-term total return. The growing and well covered DPS represents a relatively attractive dividend yield of c 4%, while there are significant opportunities to grow income further from the current portfolio. Despite a strong historic record of relative outperformance, Picton trades at around its EPRA NAV with a P/NAV that is broadly in line with peers.

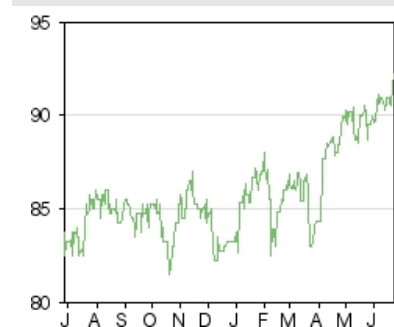
Real estate

25 June 2018

Price 91p
Market cap £491m

Net balance sheet debt (£m) at 31 March 2018	178.3
Net LTV as at 31 March 2018	26.2%
Shares in issue	540.1m
Free float	100%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.9	10.7	9.8
Rel (local)	4.1	0.7	5.6
52-week high/low		92.2p	81.5p

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

Publication of annual report	June 2018
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Picton Property Income is a research client of Edison Investment Research Limited

Brief overview of FY18 results

The year ended 31 March 2018 was a very successful one for Picton. At the portfolio level, it continued to outperform the MSCI IPD Quarterly Benchmark, with a total property return of 13.0% compared with 10.1% for the benchmark. With the benefit of gearing, NAV total return (dividends reinvested during the year) was 14.9%.

Exhibit 1: Results summary			
£000s	2018	2017	Change (%)
Revenue from properties*	48,782	49,148	(0.7)
Property expenses	(10,335)	(12,011)	(14.0)
Net property income	38,447	37,137	3.5
Total operating expenses	(5,566)	(5,249)	6.0
Operating profit	32,881	31,888	3.1
Net finance expense	(9,747)	(10,823)	(9.9)
Tax	(509)	(499)	
EPRA earnings	22,625	20,566	10.0
Exceptional income		5,250	
Profit on disposal of investment property	2,623	1,847	
Investment property valuation movements	38,920	15,087	
IFRS net profit	64,168	42,750	50.1
EPRA EPS (p)	4.2	3.8	10.1
IFRS EPS (p)	11.9	7.9	50.2
DPS declared (p)	3.45	3.35	3.0
Dividend cover (x)	1.22	1.14	
NAV per share, IFRS & EPRA (p)	90	82	10.5
NAV total return (dividends reinvested during the year)	14.9%	10.4%	
Net LTV	26.7%	27.4%	

Source: Picton Property Income. Note: *2017 adjusted for £5.25m of exceptional income.

- In FY18, in underlying terms, net property income grew 3.5% compared with FY17, from £37.1m to £38.4m. This adjusts for the £5.25m of exceptional income recognised in FY17 in respect of the settlement of a long-running contractual dispute. Period end occupancy was 96%, up from 94% a year earlier, and ahead of the MSCI IP Quarterly Benchmark at 93%.
- Operating expenses were well controlled, with almost all of the 6.0% increase attributable to the recognition of £307k in non-recurring expenses relating to REIT conversion. Management indicates a further, but smaller charge in the current year, to complete the conversion. The ongoing charge ratio, which excludes the REIT conversion costs (total recurring operating expenses, excluding property operating expenses, as a percentage of average net assets) declined from 1.2% to 1.1%.
- The 9.9% decline in net finance expense reflects lower average debt and a lower average debt cost, following the repayment of the 7.5% zero dividend preference share in H217. From end-FY17 to end-FY18, total debt increased slightly from £204.6m to £210.7m, while the net loan to value ratio (LTV) reduced to 26.7%. The average cost of debt is 4.1% and 95% of borrowing is fixed rate, substantially mitigating interest rate risk.
- EPRA earnings and EPRA EPS both increased by c 10%, the latter to 4.2p per share.
- Including gains on disposal of investment properties (£2.6m) and net revaluation movements (£38.9m, up 6.5% on a like-for-like basis), both higher than in FY17, IFRS earnings increased by 50.1% to £64.2m.
- The quarterly dividend was increased by 3% in February 2018 to an annualised 3.5p per share. Dividends declared in the period of 3.425p were 1.22x covered by EPRA earnings.
- With a 10.5% increase in EPRA NAV per share, including dividends paid, EPRA NAV total return for the year was 14.9%.

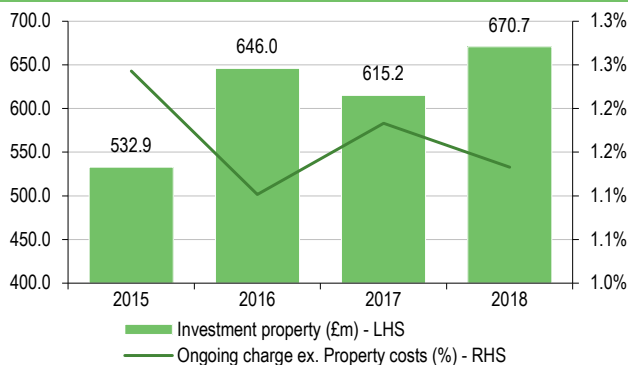
Management provided a positive outlook for the current year, despite the risks associated with current economic conditions and the Brexit transition. Occupational demand for industrial and office property, where the Picton portfolio remains overweighted, has remained robust, with supply tight in many areas. Portfolio occupancy is at a good level, and the company has a number of asset management plans aimed at enhancing the existing asset base and capturing the inherent reversionary potential to grow income and value further.

Focus on income to deliver returns

Background

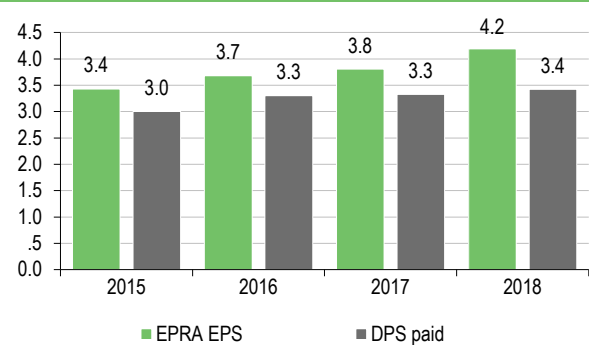
Picton Property Income is an income-focused, internally managed investment company, with an investment objective to provide shareholders with an attractive level of income, together with the potential for capital growth, by investing in the main UK commercial property sectors. As at 31 March 2018 the fair value of the investment portfolio was £670.7m, diversified across 51 assets, let to more than 360 occupiers. Although diversified, the portfolio is actively positioned compared with the MSCI IPD Quarterly Benchmark, with an overweighting in industrial and office properties and an underweight position in retail and leisure property, and in central London.

Exhibit 2: Asset growth and improved efficiency



Source: Picton data

Exhibit 3: Trend in EPRA EPS and DPS

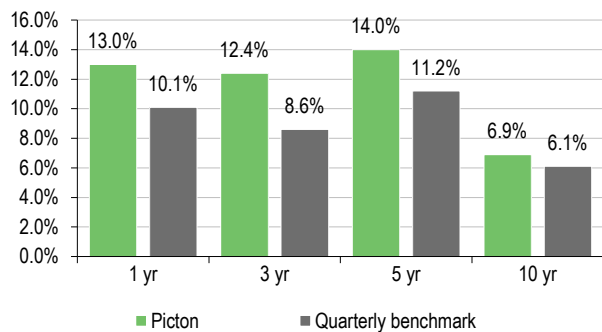


Source: Picton data

Picton was launched in October 2005 as the ING UK Real Estate Income Trust in an offshore structure, and listed on the London Stock Exchange. In 2011, the company name was changed to Picton Property Income and in January 2012 it internalised the investment management function of the company through a newly created, wholly owned subsidiary company, Picton Capital. Picton Capital was substantially created by former employees of the outgoing external manager, ING Real Estate Investment Management. The change in structure was aimed at giving the company greater flexibility to manage costs and benefit fully from the growth in assets and, as the UK economy and commercial property markets have recovered in recent years, Picton has grown assets, earnings and dividends while the ongoing charge ratio (recurring costs excluding property costs as a percentage of average net assets) has trended lower (Exhibits 3 and 4).

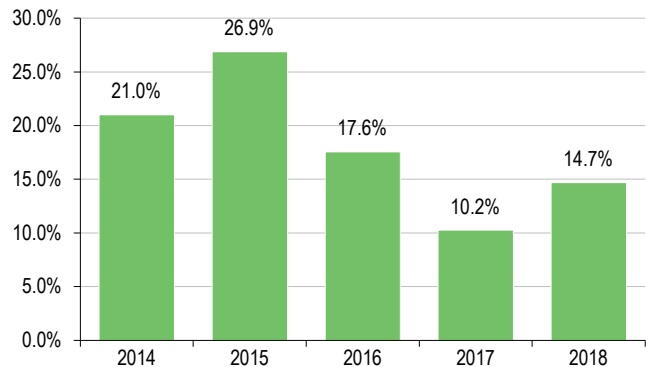
Management's aim is for Picton to be one of the consistently best-performing, diversified, UK-focused property companies listed on the Main Market of the London Stock Exchange. In the five years to end-FY18, positive property returns have combined with effective use of debt and efficient operation to generate an EPRA NAV per share total return of 117%, or a compound annual return of 16.8% pa (see Exhibit 15).

Exhibit 4: Picton property performance vs MSCI IPD Quarterly Benchmark (annualised, to 30 March 2018)



Source: Picton Property Income, MSCI

Exhibit 5: Picton NAV total return (change in NAV per share plus dividends paid in the period)



Source: Picton data, Edison Investment Research

Strategy: Occupier focused, opportunity led

Picton describes its strategy as occupier focused and opportunity led. Occupier focused refers to working closely with its own tenants, to understand their needs, enhance occupancy, improve retention and maximise income, but it also applies to the occupier market as a whole, helping to drive portfolio strategy and asset selection. The opportunity led part relates to being commercial when buying, managing and selling. During FY18, Picton acquired one office asset in Bristol city centre, with significant reversionary potential for £23.2m and sold three non-core assets for an aggregate £10.4m, 37% ahead of the start-of-year valuation. By year-end, occupancy at the acquired Bristol asset had increased from 65% to 91%, contributing to a 15% uplift in valuation in the four months since completion. 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 also been steadily increasing the average lot size of the portfolio, which increased by a further 14% in FY18 to £13.4m. A larger lot size reduces the complexity of managing the portfolio and supports efficiency, and management targets a lot size of £10-30m, believing this provides a good balance between efficiency and the added competition that is common for larger assets. Picton also looks to recycle capital where opportunities exist to achieve improved risk-adjusted returns, and is able to invest anywhere across the UK to do this.
- Working with occupiers:** Picton believes in working closely with its occupiers so as to better understand their needs and be able to respond to their requirements in a timely manner. The goal is enhance occupancy and tenant retention rates, and increase income. Recent initiatives include the roll-out of occupier satisfaction surveys, and continuing to provide meeting room space in London for occasional use by regional-based occupiers.
- 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 reduces income risk and supports the aim of generating sufficient cash to meet growing dividends while continuing to reinvest in the portfolio.
- Operational efficiency and expertise:** as an internally managed investment company, Picton has direct control over its costs base. All staff are incentivised by a long-term incentive share plan (LTIP), linked to shareholder total return, which closely aligns their interest with the interests of shareholders and encourages a focus on efficiency. This operating model should allow Picton to benefit further 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.

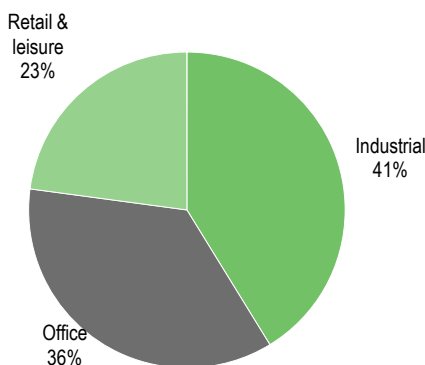
Property portfolio: Significant reversionary potential

The externally appraised value of the portfolio as at 31 March 2018 was £683.8m (FY17: £624.2m) with a balance sheet fair value, after lease and other adjustments, of £670.7m. The valuation reflects a net initial yield of 5.5% and a reversionary yield of 6.6%, and increased by 6.5% on a like-for-like basis. In addition, purchases less sales of properties added a net £12.8m and £3.6m were invested into refurbishment projects to enhance the portfolio.

The rent roll at year end was £41.4m and increased by 3.9% during the year on a like-for-like basis. The estimated rental value (ERV) of £47.9m, up by 2.4% during the year, indicates a significant opportunity to increase rental income from the existing portfolio, as discussed below. Occupancy improved from 94% to 96% with a weighted average unexpired lease term of 5.2 years.

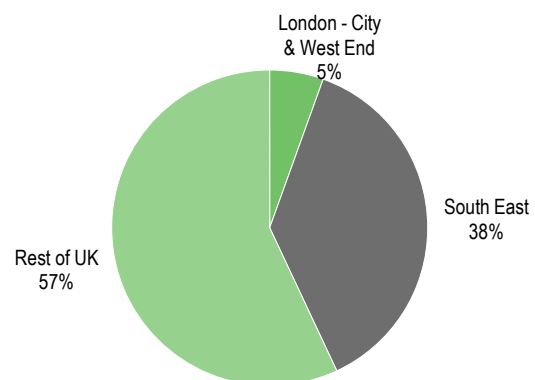
Exhibits 6 and 7 show the sector and regional positioning of the portfolio. The bias towards industrial and office assets was very beneficial to performance during the year, and the low exposure to central London (reduced significantly in FY17) was also beneficial.

Exhibit 6: Portfolio sector split



Source: Picton data at 31 March 2018

Exhibit 7: Portfolio regional split



Source: Picton data at 31 March 2018

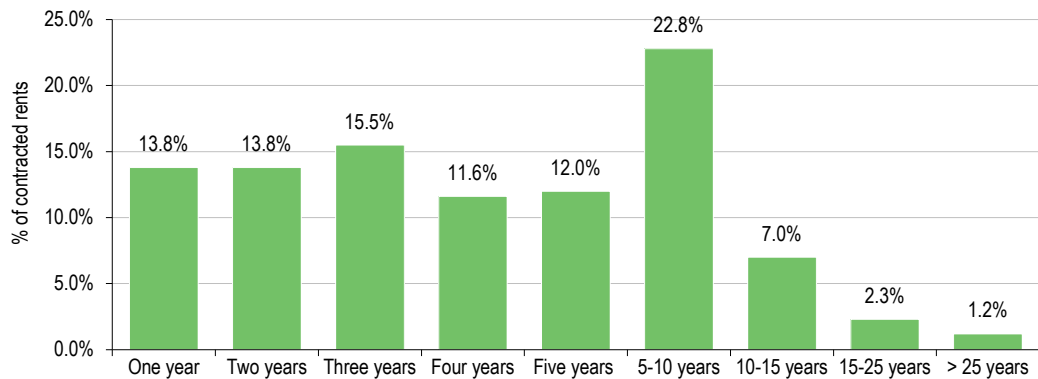
The 13.0% total property return generated by Picton during FY18 compares with a 10.1% return on the MSCI IPD Quarterly Benchmark over the same period, around half of which is attributable to income and the rest to capital growth. Picton is c 41% weighted to the industrial sector (MSCI IPD c 22%) and its industrial assets saw 12.6% like-for-like valuation growth. Like-for-like valuation growth in Picton's office assets (c 36% weight versus MSCI IPD at c 27%) was 6.5%. Retail and leisure values declined by 2.3% despite a high level of occupancy (97%) being maintained.

Significant potential from existing assets

Of the £6.5m pa gap between end-FY18 contracted rents and ERV, c £2m represents the upside potential from leasing vacant space, with the balance attributable to asset management opportunities. With occupancy at 96% already, active asset management is likely to be the key to unlocking income and value from the existing portfolio.

The weighted average unexpired lease length (to first break) was 5.2 years as at 31 March 2018, and the maturity profile is shown below in Exhibit 8.

Exhibit 8: Lease maturity schedule (to first break)



Source: Picton data

Over one year, lease maturities to first break represent just under 14% of contracted rent, or c £5.7m. Exhibit 9 provides a summary of some of the key asset management opportunities for FY19 and the potential upside from reversion to ERV.

Exhibit 9: Summary of key FY19 asset management opportunities

Sector	Occupancy	Opportunity
Industrial	99.3%	24 lease events to March 2019 with ERV 19% ahead of passing rent
Retail	97.0%	14 lease events to March 2019 with ERV 7% ahead of passing rent. Key voids: Angouleme Retail Park, Bury (£0.2m pa ERV)
Office	91.9%	30 lease events to March 2019 with ERV 12% ahead of passing rent. Key voids: Glasgow (£0.4m pa ERV), Bristol (£0.2m pa ERV), Angel Gate EC1 (£0.2m pa ERV), Farringdon Rd EC1 (£0.2m pa ERV).

Source: Picton

Market backdrop

Despite some slowing of UK economic growth, continuing Brexit uncertainty and a significant retracement of the boost to export competitiveness that resulted from post-EU referendum sterling weakness, with much regional variation, property markets have remained robust over recent months. Industrial occupier demand has been robust across the UK, driving rents higher, and this seems likely to continue with little sign of material new supply. Sentiment towards London offices has weakened somewhat, and the large financial services sector is viewed as being particularly vulnerable to Brexit uncertainty. Regional markets continue to benefit from structural factors such as business relocation away from London, office conversion to residential use and a relative lack of new development in the years following the financial crisis. The retail sector continues to struggle, negatively affected by consumer income pressure, internet competition and cost pressures including business rates. The impact on Picton is mitigated by its relatively low weighting, a good level of occupancy and a high yield on assets. Management sees opportunities to create value through active asset management.

The Investment Property Forum (IPF) UK Consensus Forecasts survey gathers independent forecasts for UK commercial property from 26 leading consultants and fund/investment managers. We show a summary of the latest quarterly results, generated between the latter part of February and mid-May 2018, in Exhibit 10. For some time, the consensus has been for income to become the driver of continuing positive overall sector returns, with capital growth waning or even becoming mildly negative. Participants remain most positive about industrial property. City of London and West End office rental growth is expected to be negative over the next couple of years, which implies positive expectations for the regional contribution.

Exhibit 10: Consensus forecasts for UK commercial property

	Rental value growth (%)				Capital value growth (%)				Total return (%)			
	2018	2019	2020	2018/22	2018	2019	2020	2018/22	2018	2019	2020	2018/22
West End office	(0.7)	(0.8)	0.8	1.0	(2.1)	(3.0)	(0.6)	(0.5)	1.3	0.6	3.1	3.2
City office	(1.3)	(1.6)	0.7	0.5	(2.5)	(3.4)	(0.6)	(0.8)	1.3	0.5	3.5	3.3
Office (all)	(0.1)	(0.5)	0.8	0.9	(0.8)	(2.7)	(0.9)	(0.6)	3.3	1.6	3.4	3.8
Industrial	3.6	2.4	2.0	2.4	5.4	1.0	(0.1)	1.3	10.2	5.8	4.8	6.3
Standard retail	0.6	0.5	0.8	1.0	(0.3)	1.2	(0.8)	(0.2)	4.2	3.2	3.7	4.3
Shopping centre	0.1	(0.1)	0.4	0.4	(3.0)	(2.9)	(1.6)	(1.5)	1.9	2.0	3.5	3.6
Retail warehouse	0.3	0.3	0.7	0.7	(1.0)	(1.7)	(0.8)	(0.6)	4.5	4.0	5.0	5.2
All property	1.0	0.6	1.0	1.2	0.4	(1.4)	(0.7)	(0.1)	5.2	3.4	4.2	4.8

Source: Investment Property Forum UK Consensus Forecasts, Spring 2018

Management and REIT conversion

Picton has to date been listed as an investment company, managed and controlled by a board, based in Guernsey, with its own UK-based investment management subsidiary, Picton Capital, authorised and regulated by the Financial Conduct Authority. Picton Capital operates the group's investment objectives, subject to the overall supervision of the board. As has been flagged by the company for some time, this corporate structure will change later this year, when Picton converts to REIT status, subject to shareholder approval. A key requirement for conversion is that management and control of Picton shifts to the UK, and in order to satisfy this requirement a number of changes to the board composition and internal management structures will take effect. At the same time, Picton will seek shareholder approval to change its technical listing status from that of an investment company to that of a commercial company, a change that would bring it more in line with other internally managed property company peers. A circular to shareholders will be released with the annual report later in June and an EGM will be held in July, when shareholders will be asked to approve the changes, planned to take effect from 1 October 2018.

Tax-efficient REIT conversion will not change strategy

The conversion to REIT status is a logical response to changes in UK tax legislation, to become effective over the next couple of years, which would otherwise be expected to materially increase the company's tax burden. From 1 April 2020, non-resident landlord companies, as Picton currently is, will be brought into the scope of UK taxation, while additionally, from 1 April 2019, its capital gains from the disposal of commercial property would become subject to UK tax. In addition to tax efficiencies, management also anticipates potential administrative cost savings.

The changes are not expected to have any impact on Picton's investment or portfolio strategy and there are no plans to change the quarterly dividend and reporting cycle. A condition of REIT status is that 90% or more of its tax-exempt income profits (not capital gains) are distributed, and the board intends to review the level of dividends post-conversion. However, although the FY18 dividend was 1.22x covered by earnings on an EPRA basis, management indicates that it does not believe the current distribution policy is materially out of line with REIT distribution conditions. Our forecasts indicate continuing DPS growth, but with dividend cover maintained at a similar level to FY18.

Board changes will underline shift to UK control

Nicholas Thompson is the non-executive chairman of the board, which also includes Robert Sinclair, Roger Lewis, Vic Holmes, Mark Batten and Michael Morris. Robert Sinclair and Vic Holmes will both retire after the AGM in September 2018, providing an opportunity for the board composition to adapt to Picton's new status as a UK-managed and controlled REIT. Michael Morris currently serves on the board as a non-executive director, although he is chief executive of Picton

Capital, the group's property management subsidiary. He will become chief executive of the group, Picton Property Income, from 1 October, remaining on the board as an executive director. Andrew Dewhirst, currently finance director of Picton Capital, will also join the board as group finance director and executive director. From 1 October 2018 it is intended that the board will comprise six members, four of whom (including the chairman) will be non-executive, and two executive. From next year, the AGM will shift from Guernsey to the UK, with the potential to strengthen links between the company and its shareholders.

No change to operational management

The investment management team that is responsible for the day-to-day implementation of Picton's investment strategy and management of its assets will not change. In addition to Michael Morris and Andrew Dewhirst, the senior management team of Picton Capital includes the head of asset management, Jay Cable, and investment director, Fraser D'Arcy, and in total comprises 10 permanent employees and includes five real estate professionals, three qualified accountants and two support employees. The interests of all staff are aligned with shareholders through a deferred bonus structure linked to shareholder total return, and long-term incentive share plan (LTIP), additionally linked to growth in EPRA earnings and total property return relative to the MSCI IPD Quarterly Benchmark.

Financials

As noted earlier in this report, in the financial year ended 31 March 2018 (FY18) Picton produced strong results, with an EPRA NAV total return for the year of almost 15%. Net rental income, EPRA earnings and EPRA NAV were all slightly ahead of our expectations.

In our forecasts we assume an unchanged portfolio. Management says that it remains alert for new investment opportunities, but equally may make selective asset sales over the coming months, reducing gearing further.

Our rental income forecasts reflect a blended increase in the annualised rent roll of 1.3% in FY19 and 1.1% in FY20, driven by the industrial assets. We do not assume any change in occupancy across the portfolio given the already high level. In view of the £6.5m reversionary potential inherent in the portfolio, the £1.0m increase in our forecast for annualised contracted rents by end FY20 may well prove conservative. We have assumed modest increases in property valuation, in line with rental growth, maintaining the implied net initial yield at around 5.5%. The gains add 3p to NAV in FY19 and 2p in FY20.

Non-recurring REIT conversion costs of £307k were taken in FY18. Some further costs are likely, but we have made no specific allowance for this. Finance costs are based on the current 4.1% average cost of debt (95% fixed) and no change in drawn debt. Given the growth in portfolio value and modest positive net cash flow, we expect net LTV to drift lower, below 25% by end-FY20.

The changes to our FY19 forecasts, shown in Exhibit 11, are modest (the small reduction in net rental income relates to a slightly reduced assumption for dilapidation receipts) and we have introduced an FY20 forecast for the first time. Our FY20 forecast looks for EPRA earnings and DPS to grow further, by c 3%.

Exhibit 11: Performance versus forecasts and forecast revisions

	Net rental income (£m)			EPRA EPS (p)			EPRA NAV/share (p)			DPS (p)		
	Forecast	Actual	% diff.	Forecast	Actual	% diff.	Forecast	Actual	% diff.	Forecast	Actual	% diff.
FY18	37.9	38.4	1.5%	4.11	4.19	2.0%	89.0	90.4	1.6%	3.45	3.45	0.0%
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
FY19e	39.2	38.5	-1.8%	4.29	4.30	0.3%	91.7	94.0	2.4%	3.57	3.57	0.3%
FY20e	N/A	39.1	N/A	N/A	4.43	N/A	N/A	96.6	N/A	N/A	3.68	N/A

Source: Edison Investment Research

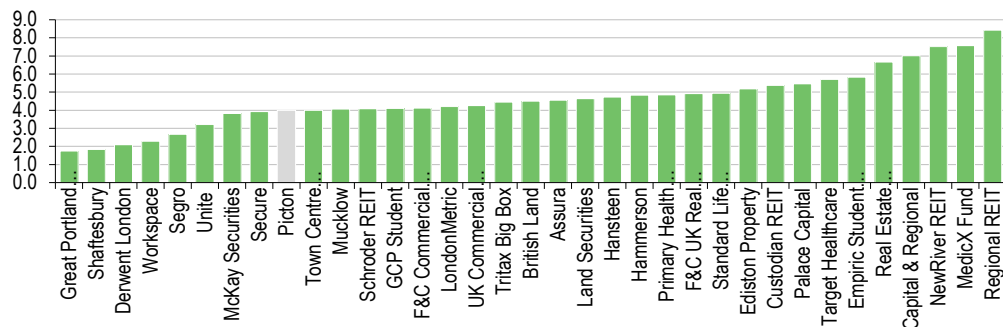
Taking our forecasts for changes in EPRA NAV and DPS together, the implied EPRANAV total return is 7.8% in FY19 and 6.7% in FY20.

Valuation

With its strong income focus, Picton pays quarterly dividends that currently annualise at 3.5p per share, a yield of c 4% at the current share price. With dividend cover of 1.22x in FY18 (and our forward-looking estimates show a similar level of cover with growing DPS), the payout could be higher, but management chooses to reinvest into the portfolio in ways designed to support occupancy and income growth, with the specific goal of enhancing total return over the long run. As noted above, its goal is to be one of the consistently best performing, diversified, UK-focused property companies listed on the Main Market of the London Stock Exchange.

A comparison of Picton with a broad range of listed property companies shows that its yield is below the median, albeit it is very well covered in a sector context.

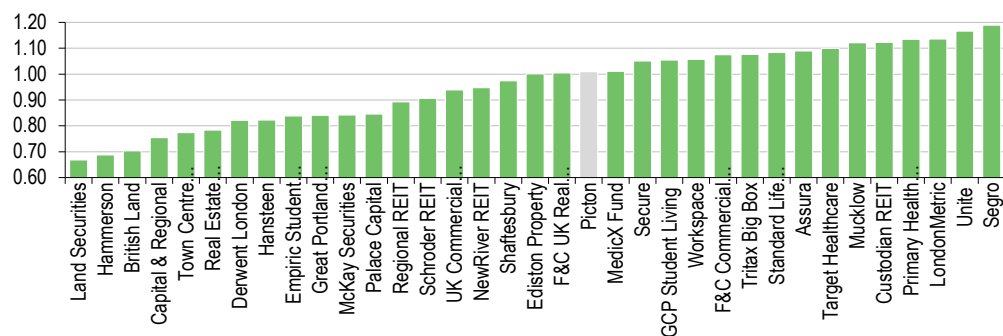
Exhibit 12: Sector prospective yield comparison



Source: Company data, Edison Investment Research, Bloomberg data as at 20 June 2018

A similar comparison of P/NAV shows Picton, which trades at around its EPRA NAV per share, positioned around the median position.

Exhibit 13: Sector historic P/NAV comparison



Source: Company data, Edison Investment Research, Bloomberg data as at 20 June 2018

This broad peer group contains a wide variety of property companies, REITs and non-REITs, and specialist vehicles (healthcare property, student accommodation), and covers a wide range of strategies, from a pure focus on income and collecting rents to varying degrees of asset management and capital growth, extending to property development. In Exhibit 14 we show a summary valuation comparison of Picton and what we consider to be its closest peers.

Exhibit 14: Picton peer group comparison

	Price (p)	Market cap (£m)	P/NAV (x)	Yield (%)	Share price performance			
					One month	Three months	12 months	From 12M high
EPIC	113	237	1.00	5.1	2%	3%	0%	-2%
F&C Commercial Property	152	1,213	1.08	4.0	5%	8%	5%	0%
F&C UK Real Estate Investments	101	242	1.00	5.0	-4%	-3%	-4%	-7%
Custodian REIT	120	466	1.12	5.4	2%	6%	3%	0%
Regional REIT	95	352	0.89	8.5	-5%	-4%	-10%	-11%
Schroders REIT	62	320	0.91	4.0	1%	-2%	-4%	-5%
Standard Life Investment Property	96	386	1.08	5.0	0%	3%	7%	-1%
Median			1.00	5.0	1%	3%	0%	-2%
Picton Property Income	91	490	1.01	3.9	1%	6%	8%	0%
UK Property Index	1,840			3.8	0%	3%	4%	-1%
FTSE All-Share Index	4,190			4.0	-1%	8%	3%	-3%

Source: Company data, Edison Investment Research, Bloomberg data as at 20 June 2018

As a result of its strong dividend cover, Picton's prospective yield is below the median yield for the group of 5.0% (which includes Regional REIT at 8.5%), while its P/NAV per share is similar to the median. Picton has showed a stronger share price performance than the peer group median and the FTSE All-Share Index over the past 12 months. However, the market valuation that investors appear to be giving Picton for its track record of returns in recent years is relatively modest.

Bringing together dividend distributions and the impact of reinvesting for growth, in Exhibit 15 we show the trend in EPRA NAV per share in the five years ended FY18. Total return has been 117% over the period or a compound annual return of 16.8% pa.

Exhibit 15: EPRA NAV total return

	2014	2015	2016	2017	2018	2014-18
Opening EPRA NAV	49	56	69	77	82	49
Closing EPRA NAV	56	69	77	82	90	90
DPS paid	3.00	3.00	3.30	3.33	3.43	16
EPRA NAV total return	21.0%	26.9%	17.6%	10.2%	14.7%	117.0%
Compound annual total return						16.8%

Source: Company data, Edison Investment Research. Note: Annual data differs slightly from Picton published data which assumes dividend reinvestment during the year.

Sensitivities

The commercial property market is cyclical, historically exhibiting substantial swings in valuation through cycles. Income returns are significantly more stable, but fluctuating with tenant demand and rent terms. From a sector point of view, we would also highlight the increased risks and uncertainties that attach to development activity, including planning consents, timing, construction risks and the long lead times to completion and eventual occupation. With its income focus, Picton is not a developer and avoids such risks, but does actively invest in improvements to existing assets with the aim of enhancing long term income growth and returns. We consider that the main sensitivities include:

- Sector risk: some of the inherent cyclical risk to vacancy in commercial property can be mitigated by portfolio diversification. As noted above, Picton invests across the main UK commercial property sectors, with a portfolio that is well diversified by property and by individual occupiers. As noted above, the largest tenant accounts for less than 4% of the total portfolio income, while a number of government entities collectively represent the second largest tenant. Picton has a strong record of occupancy, 96% at end-FY17.
- Macro risk:
 - Although growing by c 1.8% in 2017, UK GDP growth was weak in Q4, and into early 2018, although poor weather is likely to have had a temporary impact. The Bank of England

continues to forecast a similar rate of growth in 2018 compared with 2017, although Brexit uncertainty remains high.

- Having risen, partly due to sterling depreciation after the EU referendum and rising oil prices, inflation has recently moderated again, relieving some of the pressure for higher interest rates. Around 95% of Picton's debt is fixed rate with an average duration of 10.3 years, providing substantial pressure from any increase. An eventual increase in longer-term rates is likely to have a knock-on effect on NAV over time, through increased property yields.
- 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.

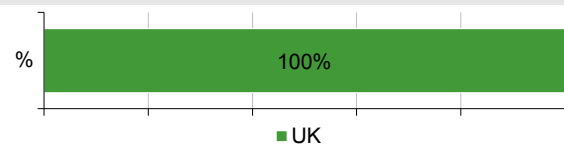
Exhibit 16: Financial summary

Year end 31 March	£'000s	2014	2015	2016	2017	2018	2019e	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue		31,967	35,151	40,770	47,911	42,855	42,810	43,357
Service charge income		4,782	4,511	5,153	6,487	5,927	6,000	6,000
Total revenue		36,749	39,662	45,923	54,398	48,782	48,810	49,357
Gross property expenses		(8,992)	(9,320)	(10,001)	(12,011)	(10,335)	(10,300)	(10,300)
Net rental income		27,757	30,342	35,922	42,387	38,447	38,510	39,057
Administrative expenses		(1,139)	(1,194)	(1,510)	(1,613)	(1,914)	(1,600)	(1,650)
Operating Profit before revaluations		26,618	29,148	34,412	40,774	36,533	36,910	37,407
Revaluation of investment properties		18,422	53,163	44,171	15,087	38,920	15,000	10,000
Profit on disposals		5,660	412	799	1,847	2,623	0	0
Management expenses		(2,127)	(2,591)	(2,901)	(3,636)	(3,652)	(3,743)	(3,837)
Operating Profit		48,573	80,132	76,481	54,072	74,424	48,166	43,571
Net Interest		(10,868)	(10,930)	(11,417)	(10,823)	(9,747)	(9,689)	(9,689)
Profit Before Tax		37,705	69,202	65,064	43,249	64,677	38,477	33,881
Taxation		(357)	(347)	(216)	(499)	(509)	(292)	0
Profit After Tax		37,348	68,855	64,848	42,750	64,168	38,185	33,881
Profit After Tax (EPRA)		13,266	15,280	19,878	20,566	22,625	23,185	23,881
Average Number of Shares Outstanding (m)		359.9	445.3	540.1	540.1	539.7	539.0	539.0
EPS (p)		10.38	15.46	12.01	7.92	11.89	7.08	6.29
EPRA EPS (p)		3.69	3.43	3.68	3.81	4.19	4.30	4.43
Dividends declared per share (p)		3.000	3.000	3.300	3.350	3.450	3.570	3.680
Dividend cover (x)		1.23	1.14	1.12	1.14	1.22	1.20	1.20
Ongoing charges ratio (excluding property expenses)		1.7%	1.2%	1.1%	1.2%	1.1%	1.1%	1.1%
BALANCE SHEET								
Fixed Assets		421,393	536,898	649,406	615,187	670,679	689,179	702,682
Investment properties		417,207	532,926	646,018	615,170	670,674	689,174	702,677
Other non-current assets		4,186	3,972	3,388	17	5	5	5
Current Assets		42,879	84,111	37,408	49,424	50,633	49,862	50,740
Debtors		10,527	14,019	14,649	15,541	19,123	15,466	15,670
Cash		32,352	70,092	22,759	33,883	31,510	34,396	35,070
Current Liabilities		(17,369)	(17,480)	(47,521)	(20,635)	(22,292)	(20,927)	(21,192)
Creditors/Deferred income		(14,434)	(16,468)	(18,430)	(20,067)	(21,580)	(20,215)	(20,480)
Short term borrowings		(2,935)	(1,012)	(29,091)	(568)	(712)	(712)	(712)
Long Term Liabilities		(232,807)	(233,559)	(222,161)	(202,051)	(211,665)	(211,667)	(211,667)
Long term borrowings		(231,081)	(231,834)	(220,444)	(200,336)	(209,952)	(209,952)	(209,952)
Other long term liabilities		(1,726)	(1,725)	(1,717)	(1,715)	(1,713)	(1,715)	(1,715)
Net Assets		214,096	369,970	417,132	441,925	487,355	506,447	520,562
Net Assets excluding goodwill and deferred tax		214,096	369,970	417,132	441,925	487,355	506,447	520,562
NAV/share (p)		56.4	68.5	77.2	81.8	90.4	94.0	96.6
EPRA NAV/share (p)		56.4	68.5	77.2	81.8	90.4	94.0	96.6
CASH FLOW								
Operating Cash Flow		23,145	24,705	33,283	36,283	35,088	31,632	33,656
Net Interest		(8,768)	(8,695)	(8,836)	(9,211)	(9,125)	(9,689)	(9,689)
Tax		(394)	(369)	(426)	(232)	(328)	(292)	0
Net cash from investing activities		(10,838)	(61,729)	(68,123)	48,691	(17,811)	326	(3,527)
Ordinary dividends paid		(10,711)	(13,102)	(17,822)	(17,957)	(18,487)	(19,091)	(19,766)
Debt drawn/(repaid)		(1,031)	(3,191)	14,591	(46,450)	9,183	0	0
Proceeds from shares issued		18,043	100,121	0	0	0	0	0
Other cash flow from financing activities								
Net Cash Flow		9,446	37,740	(47,333)	11,124	(1,480)	2,886	674
Opening cash		22,906	32,352	70,092	22,759	33,883	32,403	35,289
Closing cash		32,352	70,092	22,759	33,883	32,403	35,289	35,963
Closing debt		(234,016)	(232,846)	(249,535)	(200,904)	(210,664)	(210,664)	(210,664)
Closing net (debt)/cash		(201,664)	(162,754)	(226,776)	(167,021)	(178,261)	(175,375)	(174,701)
Net LTV				34.6%	27.4%	26.7%	25.2%	24.7%

Source: Picton Property Income, Edison Investment Research

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Revenue by geography

Management team
Chief Executive of Picton Capital: Michael Morris

Michael Morris is currently chief executive of Picton Capital, the group's UK investment management subsidiary. He has more than 23 years' experience in the UK commercial property sector and has worked for the group since launch in 2005, becoming a non-executive director of the group in 2015. It is intended that he will become group chief executive post REIT conversion on 1 October. In his current role he is responsible for devising and overseeing the implementation of all aspects of the company's investment strategy.

Finance Director of Picton Capital: Andrew Dewhirst

Andrew Dewhirst joined the group as finance director of Picton Capital in March 2011 and it is intended that he will join the board as group finance director post REIT conversion on 1 October 2018. He has over 25 years' experience in the real estate and financial services sector, is an associate member of the Institute of Chartered Accountants in England and Wales and a member of the Investment Property Forum

Head of asset management of Picton Capital: Jay Cable

Jay Cable is a director of Picton Capital and head of asset management. In this role he is responsible for overseeing all asset management activities in respect of the group's property portfolio. Formerly he was director at ING Real Estate Investment Management (UK), and has worked with the group since it launched in 2005. He has over 17 years of real estate experience and is a member of the Royal Institution of Chartered Surveyors and of the Investment Property Forum.

Investment Director, Picton Capital: Fraser D'Arcy

Fraser D'Arcy joined Picton Capital as investment director in January 2013 and is primarily responsible for transactional activity in the portfolio to manage effective recycling of capital. Previously he was an investment surveyor at Threadneedle Property Investments from 2006. He has 17 years of investment experience in UK real estate, is a member of the Royal Institution of Chartered Surveyors, has obtained the Investment Management Certificate and is a member of the Investment Property Forum.

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	(%)
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Mattoli Woods	5.0%
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Brew in Dolphin	3.5%
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