EDISON

Custodian REIT

FY18 results and outlook

Income-driven returns continuing

Real estate

Custodian REIT (CREI) continued to deliver strong returns in FY18, with a NAV total return of 9.6% (FY17: 8.5%), 6.0% from dividends paid and the balance from NAV growth. Barring unforeseen circumstances, the board intends to again increase fully covered DPS in the current year. The manager's ability to source accretive acquisitions, the opportunities to actively manage the existing portfolio, and the prospect of continuing rental growth, all suggest upside in income returns with further potential for capital growth.

Year end	Net rental income (£m)	EPRA EPS* (p)	EPRA NAVPS (p)	DPS (p)	P/NAV (x)	Yield (%)
03/17	25.7	6.59	104	6.35	1.18	5.2
03/18	33.2	6.94	107	6.45	1.14	5.3
03/19e	36.5	7.20	110	6.55	1.11	5.4
03/20e	37.0	7.29	112	6.62	1.09	5.4

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

Income-focused strategy

CREI has built a balanced portfolio of regional UK commercial real estate, diversified by sector, location, tenant and lease term. It is focused on institutional quality assets but with lot sizes of less than £10m, where the investment manager believes it has a competitive advantage. Rental growth is continuing across most of the portfolio, which has low exposure to offices and a relatively high exposure to industrial, retail warehouse and alternative sectors. Management focus is on maintaining high levels of occupancy and growing income through active asset management and accretive acquisitions. Fully covered dividends paid since the IPO in 2014 represent more than 70% of the NAV total return, a compound 7.3% pa.

9.6% NAV total return in FY18

Net rental income grew by 29% (to £33.2m) in FY18, and the investment portfolio by 26% to £529.0m, including £106.3m of acquisitions (before costs) and gross revaluation gains of £11.9m. Cost growth of 20% benefited from the revised management fee structure, effective 1 June 2017. EPRA earnings grew 28% and EPRA EPS by 5.3% to 6.94p after new share issuance to partly fund acquisitions, with the 6.45p DPS declared for the year again fully covered. With demand for the shares remaining high, 47.8m shares were issued under the tap facility at an average 11.1% premium to dividend adjusted NAV. EPRA NAV per share grew 3.4% to 107p and gearing remained conservative with a 21.0% loan to value (LTV).

Valuation: Yield premium supports P/NAV

With an income focus, CREI shares combine one of the highest yields in the sector (FY19e yield 5.4%) with a good level of dividend cover (FY19e 1.1x), and conservative gearing (FY18 LTV 21.0%). This provides support for the P/NAV ratio, which at 1.14x FY18 is above the peer average. The manager's ability to source accretive acquisitions, the opportunities to actively manage the existing portfolio, and the prospect of continuing rental growth all suggest upside in income returns with further potential for capital growth.

27 June 2018

Price	**122p**
Market cap	**£472m**

Net debt (£m) as at 31 March 2018 (gross borrowings less unrestricted cash)	111.3
Net LTV as at 31 March 2018	21.0%
Shares in issue	386.9m
Free float	92%
Code	CREI
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	2.4	8.2	5.2
Rel (local)	4.8	(0.9)	3.1
52-week high/low		122.0p	112.6p

Business description

Custodian REIT (CREI) is a London Main Market listed REIT focused on commercial property in the UK outside London. It is income-focused, with a commitment to pay a high but sustainable and covered dividend.

Next event

AGM	19 July 2018

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Edison profile page

Custodian REIT is a research client of Edison Investment Research Limited

Brief overview of FY18 results

CREI continued to deliver strong returns in FY18, with a NAV total return of 9.6% (FY17: 8.5%), 6.0% from dividends paid and the balance from NAV growth. Barring unforeseen circumstances, the board intends to again increase fully covered DPS in the current year. Portfolio growth continues through selective acquisitions, significantly funded during FY18 by new share issuance, for which investor demand remains high, while maintaining a conservative level of gearing.

Exhibit 1: Summary of results

(£000s)	2018	2017	% change
Net rental income	33,203	25,741	29.0%
Administrative expenses	(4,377)	(3,643)	20.1%
Operating profit before revaluations	28,826	22,098	30.4%
Net interest	(3,659)	(2,405)	52.1%
EPRA earnings	**25,167**	**19,693**	**27.8%**
Revaluation of investment properties	11,859	9,016	
Costs of acquisitions	(6,212)	(6,103)	
Profit on disposal	1,606	1,599	
IFRS earnings	**32,420**	**24,205**	**33.9%**
EPRA EPS (p)	6.94	6.59	5.3%
IFRS EPS (p)	8.95	8.10	10.4%
DPS (declared) (p)	6.45	6.35	1.6%
Dividend cover (EPRA EPS/DPS declared)	1.08	1.04	3.7%
IFRS and EPRA NAV per share (p)	107	104	3.4%
NAV total return	9.6%	8.5%	
Net LTV	21.0%	14.4%	

Source: Custodian REIT

- During FY18, £103.8m (before acquisition costs) was invested in 20 acquisitions, one ongoing pre-let development and one significant refurbishment. Five properties with an aggregate book value of £9.3m were disposed of, generating a £1.6m profit. Including a revaluation gain of £11.9m and other adjustments, the investment portfolio increased by 26.4% to £528.9m (FY17: £418.5m), reflecting a net initial yield (NIY) of 6.6% (FY17: 6.7%).
- Net rental income increased by 29.0% to £33.2m.
- The ongoing charge ratio (excluding direct property costs) reduced further, from 1.20% to 1.15%. Administrative expenses grew at a slower pace than income, by 20.1% to £4.4m, including a 17.0% increase in investment management fees, already benefiting from revised fee schedules from 1 June 2017.
- The growth in net interest expense reflects the increase in borrowing during the year, although net LTV remained conservative at 21.0% (FY17: 14.5%). Drawn borrowings increased from £65m to £115m, all fixed rate. The weighted average cost of CREI's agreed debt facilities, which also included the £35m floating rate revolving credit facility (RCF), undrawn at year-end, was 3.1% with a weighted average maturity of 9.1 years.
- EPRA earnings grew by 27.8% to £25.2m and EPRA EPS by 5.3% to 6.94p. During the year, CREI issued 47.8m new shares, 14.1% of the opening number, at an average 11.1% (2017: 5.1%) premium to dividend adjusted NAV via an ongoing programme of tap issuance.
- EPRA NAV per share increased by 3.4% to 107p per share.

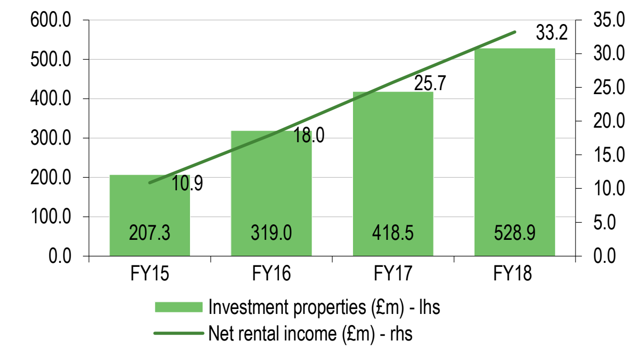
In a confident outlook statement, CREI points to the continuing strength of the regional occupier market, giving confidence in its ability to maintain occupancy levels and achieve rental growth at lease renewals and through proactive asset management. Although the commercial property market is cyclical, the company believes that its strategy of securing sustainable income will support future dividends through any medium-term market volatility and deliver capital growth for shareholders over the long term, despite the potential for cyclical impacts on NAV along the way.

Barring unforeseen circumstances, the board anticipates an increase in quarterly dividends per share for the current year to an aggregate 6.55p (FY18: 6.45p), fully covered by earnings.

Income-oriented, targeting quality smaller lot sizes

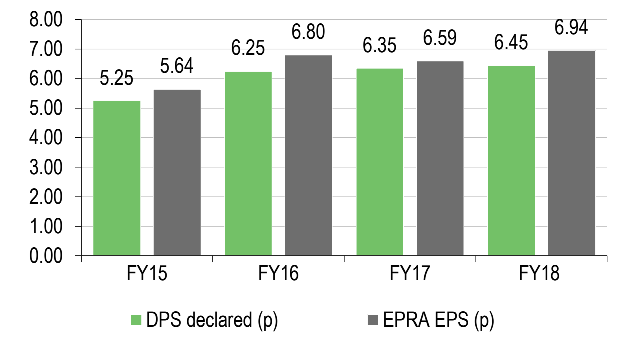
CREI is a UK real estate investment trust (REIT) listed on the Main Market of the London Stock Exchange. Its diversified portfolio comprises regional commercial properties, predominantly let to institutional grade tenants throughout the UK, differentiated by a principal focus on properties with smaller individual values ('lot sizes') of less than £10m at acquisition. CREI is externally managed by Custodian Capital, a property management and investment business, regulated by the FCA. Custodian Capital is a subsidiary of Mattioli Woods, the specialist wealth management and employee benefits consultants, with £8.3bn of assets under management or advice.

Exhibit 2: Growth in investment property value and net rental income



Source: Custodian REIT data

Exhibit 3: Dividends per share declared fully covered by EPRA EPS



Source: Custodian REIT data

The company seeks to provide investors with an attractive level of income as well as potential for capital growth. It aims to appeal to both retail and institutional investors in the UK REIT sector by providing high and stable dividends from a well-diversified portfolio of UK commercial real estate with conservative levels of gearing. At 31 March 2018, the portfolio, consisting of 147 assets spread across all of the main commercial real estate sectors as well as alternatives (eg car showrooms, trade counters and nurseries), was valued at £528.9m, reflecting a NIY of 6.6%. The net LTV was 21.0%, still below the medium-term target of c 25%.

CREI was listed in March 2014 with an initial portfolio of assets that had previously been held and managed on behalf of clients of Mattioli Woods, the specialist wealth management and employee benefits consultants, with £8.3bn of assets under management or advice. It is externally managed by Custodian Capital, a property management and investment business, wholly owned by Mattioli Woods and regulated by the FCA.

Investment objectives target sustainable income

CREI's income-focused strategy targets good quality properties but with smaller lot sizes (less than £10m at the point of investment) and differentiates it from a number of peers that also focus on regional commercial property. Properties of this size may be too small for larger institutional buyers, yet too large for many private investors, and management believes that it can continue to benefit from less competitive pricing, sufficient to offset the additional administrative complexity of a broader portfolio. Other elements of CREI's strategy for meeting its investment objective include:

- A preference for single-let properties to high-quality tenants.
- No tenant to represent more than 10% of the rent roll, unless it is a government body.

- A maximum weighting to any one property sector, or any geographic region, of 50%.
- Focus on areas with high residual values, strong local economies and favourable demand–supply characteristics.
- No speculative development, except for refurbishing of existing assets or forward funding of pre-let schemes.
- A conservative gearing ratio, limited to a maximum LTV of 35%, with an expected long-term average of 25%.
- A high payout ratio and a fully covered dividend.

The investment objectives also currently state that CREI will seek to maintain a weighted average unexpired lease term (WAULT) of over five years across the portfolio but the AGM, to be held on 19 July 2018, will be asked to approve an amendment, giving the investment manager greater flexibility with acquisitions policy. The proposed new WAULT policy reads:

The company will seek to minimise rental voids and enhance the WAULT of the portfolio by managing lease expiries and targeting property acquisitions, which will in aggregate be accretive to WAULT at the point of acquisition, on a rolling 12-month basis.

Behind the proposal is the investment manager's view that investor focus on WAULT as a proxy for income risk has actually contributed towards an inflation in prices for longer lease assets that in many cases under-prices risk. Given the strength of the occupational market, the investment manager believes that risk is better managed by acquiring shorter-lease, good-quality properties that are likely to be re-let, even if this reduces the overall WAULT of the portfolio.

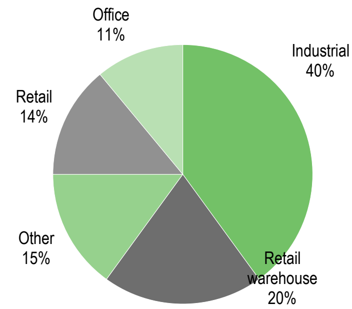
The investment manager has a long-term approach to investment, with a focus on properties with low obsolescence and low capital expenditure requirements. It also prefers properties with high residual values, rather than just focusing on the terms of the lease contracts.

Gearing is deliberately kept at relatively low levels, such that management's sensitivity analysis suggests it would not exceed a 40% LTV in a property sector downturn similar to that of 2008.

The portfolio is well diversified

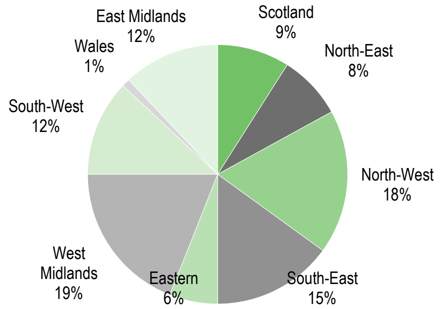
Portfolio diversification, by property, sector, geography and tenant mix is a key element of managing the cyclicality inherent in the sector, but the investment objectives allow sufficient flexibility for CREI to be contra-cyclical where the investment manager believes this to be appropriate. The EPRA occupancy rate at end-FY18 was 96.5% (end-FY17: 98.6%), and as noted above, the investment manager is confident about maintaining a high level of occupancy in the current year. CREI's nationwide portfolio of 147 properties covers the main commercial sectors: industrial, office and retail, but also a number of the alternative sectors as mentioned above, mainly restaurants, leisure, car showrooms and trade counters. The portfolio has a relatively low exposure to office property (11% as at 4 May 2018), which the investment manager regards as having more obsolescence risk and so requiring more capital expenditure, and has a relatively high exposure to industrial, retail warehouse and alternative sectors. Industrial property is a good fit with CREI's strategy, with higher residual values (ie the vacant possession value is closer to the investment value than in other sectors) with less exposure to obsolescence. The portfolio is also well diversified geographically, with minimal exposure to London, but exposure to every other region.

Exhibit 4: Portfolio split by income



Source: Custodian REIT data as at 4 May 2018

Exhibit 5: Regional Split by income

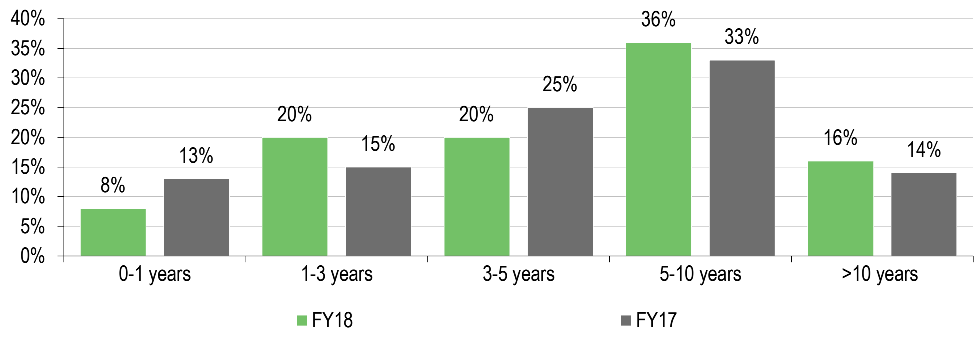


Source: Custodian REIT data as at 4 May 2018

The properties are let to more than 200 individual tenants, the largest of which represents just over 3% of total rental income, with the top 10 tenants accounting for less than 20% of the total.

As at end-FY18, the WAULT to first break was 5.9 years, unchanged on the previous year. Within this, the proportion of income due within the next 12 months has reduced.

Exhibit 6: Income profile



Source: Custodian REIT data

Exhibit 7 shows how the portfolio weightings by sector have shifted over the FY18 year (data to 31 March rather than 4 May as above), driven primarily by the acquisition of new assets (20 assets) rather than by sales (five assets). Each sector saw an increase in value.

Exhibit 7: Portfolio weightings, FY18 vs FY17

	Valuation (£m)		Weighting by income		
31 March	**FY18**	**FY17**	**FY18**	**FY17**	**FY18 vs FY17**
Industrial	209.8	188.4	39%	45%	(6%)
Retail warehouse	107.5	48.8	20%	11%	9%
Other	80.4	56.7	15%	13%	2%
Retail	75.3	72.2	14%	17%	(3%)
Office	55.9	52.4	12%	14%	(2%)
Total	**528.9**	**418.5**	**100%**	**100%**	**0%**

Source: Custodian REIT data

Although the share of the total portfolio has reduced, the strong existing exposure to industrial properties was very beneficial to performance during FY18. However, the retail warehouse sector saw the largest share of new investment, taking its weight in the overall portfolio from 11% to 20%. The investment manager notes that retail warehousing vacancy rates are close to historical lows, with development activity constrained by restricted planning policy among other factors, while retailers continue to target larger format stores, easy parking, and ‘click and collect’ capability.

CREI acquired 20 properties in FY18 with an aggregate agreed purchase price of £105.8m, before netting off rent-free top-ups (c £1.9m) and allowing for acquisition costs of £6.2m. The aggregate annual passing rent on these properties, disclosed at the time of acquisition, was c £7.6m and the blended NIY was c 6.7%. So far in FY19, two properties have been acquired for an aggregate £8.0m before costs, adding passing rent of c £625k with a blended NIY of 7.32%. Although investing for the long term, properties are disposed of when they no longer meet the long-term investment strategy, or when they can be disposed of significantly ahead of the expected valuation. Five properties were sold during FY18 for a total of £11.3m, realising a profit on disposal of £1.6m (net of costs of £0.1m), 20% ahead of the aggregate valuation. The NIY on disposals was a blended 5.7%. The sales included two industrial properties, with an aggregate disposal value of £5.2m, at £1.1m above valuation, benefiting from the current strong demand for regional industrial units. A further property has been sold in FY19, a five-unit retail development in Stourbridge, for £2.25m, in line with the end-FY18 valuation.

Market backdrop

Despite some slowing of UK economic growth, continuing Brexit uncertainty and a significant retracement of the boost to export competiveness that resulted from post EU-referendum sterling weakness, regional property markets have remained in good health over recent months. In general, across the regional markets, a positive occupational demand–supply balance continues, although some participants have indicated that in some instances letting decisions are taking longer to execute. 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.

Regional industrial and office rents are growing, but from affordable levels following a number of years of decline in real terms, and in many cases remain below the threshold necessary to bring forward new development. Much of the retail sector, particularly secondary retail, remains a weak spot, but yields are above average and CREI has seen little impact from the aggressive use of company voluntary arrangements, which are being used to allow tenants to step away from their lease obligations or reduce rents.

From an investment point of view, CREI sees the market as characterised by a restricted supply of investment opportunities and a significant level of demand from a range of investors. Within this, investor demand has polarised, moving away from high-street retail and focusing on industrial/logistics assets and properties on long leases, especially when combined with inflation-indexed rents. CREI believes the market is over-pricing some of these assets and has taken a cautious approach to acquisitions. However, it does not believe that the sector is at risk from a significant cyclical correction, as witnessed in 2007/8, noting the relative lack of new regional supply, affordable rents, low interest rates and a stronger banking system that is less exposed to real estate lending.

The Investment Property Forum UK Consensus Forecasts survey gathers independent forecasts for UK commercial property, including London, 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 8. 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 and retail warehouse property. City of London and West End office rental growth is forecast to be negative over the next couple of years, which implies positive expectations for the regional contribution.

Exhibit 8: 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 board

CREI's board of directors comprises four members, all of whom are non-executive, responsible for the overall management of the company's activities. The board has appointed Custodian Capital (www.custodiancapital.com), a wholly owned subsidiary of Mattioli Woods (www.mattioliwoods.com), as investment manager to provide investment and property management, and administrative services to the company.

Three of the board members are independent of the investment manager, including the non-executive chairman, David Hunter, a professional strategic adviser focused principally on UK and international real estate, who sits on the boards of a number of listed and unlisted companies, as well as holding corporate advisory roles. The independent non-executive directors are Matthew Thorne, an experienced former finance director in the UK quoted sector and non-executive director of Bankers Investment Trust, and Barry Gilbertson, an international consultant with a focus on real estate, strategy and risk, and with more than 40 years' experience advising on property. Ian Mattioli, chief executive officer of Mattioli Woods, and a board member of the investment manager, is the fourth CREI non-executive director.

Custodian Capital was appointed investment manager at the IPO, with performance reviewed annually. It was reappointed for a further three years from 1 June 2017, with the board noting in particular the investment manager's timely deployment of investment funds, the quality of its asset selection, and its success in generating earnings to fully cover the targeted dividend growth. At the same time, the property management and administrative fees payable to the investment manager were reduced such that further growth in CREI's NAV will support further reduction in the ongoing charge ratio and increase the dividend paying capacity of the company. This is particularly the case when net assets increase above £500m (end-FY18: £415.2m) as shown in the fee schedule below, applied from 1 June 2017:

- **Property management fees**: these continue to be charged at 0.90% pa on average net assets of up to £200m and at 0.75% pa on average net assets between £200m and £500m. However, on average net assets above £500m the fee was reduced from 0.75% to 0.65%.
- **Administrative fees**: these continue to be charged at 0.125% pa on average net assets up to £200m but reduced to 0.08% on average net assets of £200–500m and to 0.05% on average net assets of above £500m.

Richard Shepherd-Cross is the managing director of Custodian Capital and the fund manager of CREI. He is a former director of Jones Lang LaSalle in London, where he led the portfolio investment team before joining Mattioli Woods in 2009, with responsibility for its syndicated property initiative, the precursor to Custodian. In total, the Custodian Capital team that is dedicated to the management of CREI's assets consists of 16 members, including eight property professionals, supported by a compliance officer and an investment committee.

Financials

Compared with our forecasts published after the interim results, FY18 net rental income, EPRA earnings and EPRA NAV were all slightly ahead of our expectations (Exhibit 9), generating an EPRA NAV total return for the year of 9.6%.

In our forecasts, we have only included the two acquisitions (c £8m consideration) and one sale (c £2.25m proceeds) that have been announced in the period since end-FY18 but we have not assumed further portfolio additions, given the obvious forecasting uncertainty in doing so, even though these are highly likely. Our forecast end-FY19 LTV is 22.4%, below the 25% that CREI targets over time, and by way of illustration, we estimate that an additional c £20m of property acquisitions, fully funded by cash/debt, with no equity issuance, would take the LTV to 25%. Furthermore, if the NIY on such acquisitions were to be in line with the blended FY18 average of 6.7%, on an annualised basis, it would increase our forecast FY19 EPRA EPS by c 2.5%.

In addition to factoring in the known acquisition/disposals, we have assumed c 1.5% pa rental growth in FY19 and c 1.0% in FY20, with unchanged occupancy, both of which seem consistent with the management outlook statement.

We have assumed increases in property valuation, in line with rental growth, maintaining the implied NIY on the portfolio at around 6.5%. The assumed gains add 2.1p to NAV in FY19 and 1.4p in FY20.

Our forecasts assume £10m of additional debt drawn since end-FY18 as part-consideration for acquisitions, with finance costs based on the 3.1% average cost of CREI's overall debt facilities. All £115m of CREI's existing long-term, fixed-rate borrowing facilities were drawn at end-FY18, but there is also a £35m RCF, attracting variable interest at a rate of 2.45% above three-month LIBOR, none of which was drawn at year-end. The RCF, on which advances may be drawn from time to time, provides tactical flexibility over debt funding for acquisitions and helps to reduce the cash drag of forward funding with equity issuance.

The changes to our FY19 forecasts, shown in Exhibit 9, are modest. The small reduction in EPRA EPS shown in the table reflects a similar reduction in forecast EPA earnings driven by an upwards adjustment to our administrative expense assumption, in part related to the higher net asset value, that is only partly offset by the small increase in net rental income. We nevertheless forecast a further small reduction in the ongoing cost ratio. We have introduced an FY20 forecast for the first time. Our FY20 forecast looks for EPRA EPS and DPS to grow modestly, with full dividend cover maintained throughout the period.

Exhibit 9: Performance versus forecast, and forecast revisions

	Net rental income (£m)			EPRA EPS (p)			DPS (p)			EPRA NAV/share (p)			Net LTV		
	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)	F'cast	Actual	Diff (%)
03/18	32.7	33.2	1.6	6.90	6.94	0.6	6.45	6.45	0.0	106	107	0.9	22.1%	21.0%	N/A
	Net rental income (£m)			EPRA EPS (p)			DPS (p)			EPRA NAV/share (p)			Net LTV		
	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)	Old	New	Chg (%)
03/19e	36.5	36.5	0.0	7.29	7.20	(1.2)	6.55	6.55	0.0	110	110	0.0	20.8%	22.4%	N/A
03/20e	N/A	37.0	N/A	N/A	7.29	N/A	N/A	6.62	N/A	N/A	112	N/A	N/A	22.3%	N/A

Source: Edison Investment Research

Taking our forecasts for changes in EPRA NAV and DPS together, the implied EPRA NAV total return is 8.5% in FY19 and 7.9% in FY20, with dividends representing a return on NAV of 6.1% and 6.0%, respectively.

Valuation

CREI is an income-oriented REIT and management's focus is on generating secure income over the long term. The shares combine one of the highest yields in the sector (FY19e yield 5.4%) with a good level of dividend cover (FY19e 1.1x), and conservative gearing (FY18 LTV 21.0%). Growth in EPRA NAV per share has also contributed to historical returns, contributing 2.2% pa to the compound annual EPRA NAV total return of 7.3% pa from the beginning of FY15 to the end of FY18.

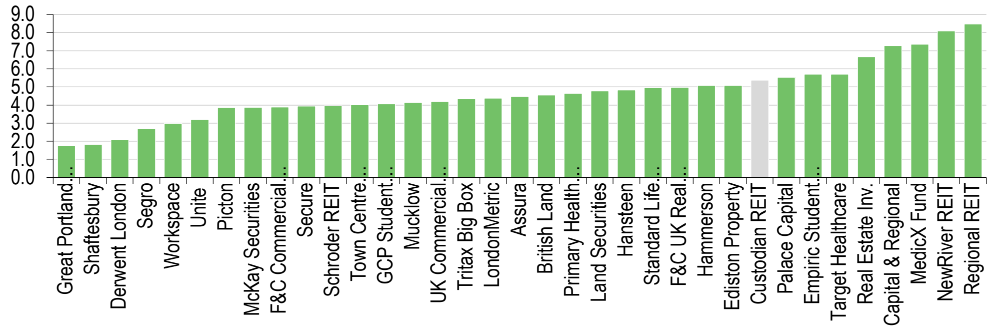
Exhibit 10: EPRA NAV total return

Year ending 31 March	2015	2016	2017	2018	2015–18
Opening EPRA NAV per share (p)	98.2	101.3	101.5	103.8	98.2
Closing EPRA NAV per share (p)	101.3	101.5	103.8	107.3	107.3
Dividends paid per share (p)	3.750	6.350	6.350	6.425	22.875
EPRA NAV total return	**7.0%**	**6.4%**	**8.5%**	**9.6%**	**32.6%**
Compound annual total return					**7.3%**

Source: Custodian REIT data, Edison Investment Research

Exhibit 11 shows a prospective yield comparison of CREI with a broad range of listed property companies, and this combination of dividend cover and conservative gearing positions it well among those that offer the highest yields.

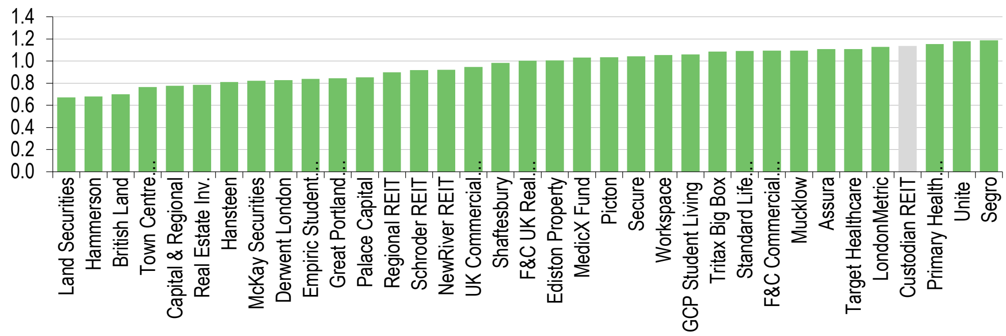
Exhibit 11: Sector prospective yield comparison



Source: Custodian REIT data, Edison Investment Research, Bloomberg data as at 26 June 2018.

Exhibit 12 shows a comparison of the same group, based on historical P/NAV per share, which shows that CREI's above-average income profile has been rewarded with an above-average P/NAV.

Exhibit 12: Sector historical P/NAV comparison



Source: Custodian REIT data, Edison Investment Research, Bloomberg data as at 26 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 13 we show a summary valuation comparison of CREI with what we consider to be its closest peers.

Exhibit 13: Peer group comparison

	Price (p)	Market cap (£m)	P/NAV (x)	Yield (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
EPIC	113	239	1.12	5.1	4%	7%	1%	(2%)
F&C Commercial Property	154	1234	1.09	3.9	7%	12%	6%	0%
F&C UK Real Estate Investments	101	242	1.00	5.0	(3%)	2%	(4%)	(7%)
Picton Property Income	93	502	1.03	3.8	4%	12%	11%	0%
Regional REIT	95	354	0.90	8.5	(5%)	0%	(10%)	(11%)
Schroders REIT	63	325	0.92	4.0	3%	5%	(2%)	(4%)
Standard Life Investment Property	96	389	1.09	4.9	4%	9%	8%	0%
UK Commercial Property Trust	88	1143	0.95	4.2	1%	(1%)	(4%)	(5%)
Median			**1.02**	**4.6**	**4%**	**6%**	**(1%)**	**(3%)**
Custodian	**122**	**446**	**1.14**	**5.4**	**2%**	**8%**	**5%**	**0%**
UK Property Index	1,838			3.9	(1%)	5%	4%	(2%)
FTSE All-Share Index	4,146			4.0	(2%)	9%	2%	(4%)

Source: Custodian REIT data, Edison Investment Research, Bloomberg data as at 26 June 2018.

Custodian's prospective yield of 5.4% is also above the median for the narrower peer group of 4.6%, and its P/NAV at a similar premium.

In terms of price performance, Custodian has slightly outperformed the broad property sector and has more clearly outperformed the FTSE All Share Index over the past 12 months, a stronger performance than the narrow peer group.

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, CREI 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. During FY18, CREI also agreed to acquire development land and fund the pre-let development of a drive through coffee shop with parking space. 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, CREI has a balanced portfolio of UK regional commercial property assets, diversified by property and by individual occupiers.
- Macro risk:
  - Although expanding 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. Other than the tactical RCF, all of CREI's structural debt is fixed rate with an average duration of 9.1 years, mitigating the risk of 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 CREI is externally managed, any management risk is indirect. The management agreement with Custodian Capital was renewed on 1 June 2017 and runs for three years. Custodian Capital operates with a relatively small team, and if a senior member of that team were to leave they would need to be replaced.

Stock issuance: the ability to regularly issue new equity on attractive terms has enabled CREI to grow its portfolio while maintaining a conservative level of gearing. The sustained P/NAV premium is evidence that issuance is in response to investor demand and rather than representing a share overhang is driven by the availability of attractive investment opportunities.

Exhibit 14: Financial summary

Year-end 31 March	£000s	2014	2015	2016	2017	2018	2019e	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Gross rental income			11,228	18,561	26,980	34,055	37,798	38,326
Re-charge income			342	451	630	758	871	885
Total revenue			11,570	19,012	27,610	34,813	38,670	39,211
Gross property expenses			(715)	(1,023)	(1,869)	(1,610)	(2,194)	(2,227)
Net rental income			10,855	17,989	25,741	33,203	36,475	36,985
Administrative expenses			(2,327)	(2,828)	(3,643)	(4,377)	(4,714)	(4,886)
Operating Profit before revaluations			8,528	15,161	22,098	28,826	31,761	32,099
Revaluation of investment properties			6,083	3,031	9,016	11,859	8,095	5,548
Costs of acquisitions			(5,844)	(5,768)	(6,103)	(6,212)	(524)	0
Profit on disposal			269	56	1,599	1,606	0	0
Operating Profit			9,036	12,480	26,610	36,079	39,332	37,647
Net Interest			(289)	(1,273)	(2,405)	(3,659)	(3,900)	(3,900)
Profit Before Tax			8,747	11,207	24,205	32,420	35,432	33,747
Taxation			(2)	0	0	0	0	0
Profit After Tax			8,745	11,207	24,205	32,420	35,432	33,747
Net revaluation of investment property/costs of acquisition			(239)	2,737	(2,913)	(5,647)	(7,572)	(5,548)
Gains/(losses) on disposal			(269)	(56)	(1,599)	(1,606)	0	0
EPRA earnings			8,237	13,888	19,693	25,167	27,861	28,199
Average Number of Shares Outstanding (m)			146.1	204.2	298.7	362.4	386.9	386.9
IFRS EPS (p)			5.99	5.49	8.10	8.95	9.16	8.72
EPRA EPS (p)			5.64	6.80	6.59	6.94	7.20	7.29
Dividend per share (p)			5.25	6.25	6.35	6.45	6.55	6.62
Dividend cover (x)			1.07	1.09	1.04	1.08	1.10	1.10
Ongoing charges ratio (excluding property expenses)			0.00%	1.33%	1.20%	1.15%	1.12%	1.12%
BALANCE SHEET								
Fixed Assets			207,287	318,966	418,548	528,943	551,650	561,540
Investment properties			207,287	318,966	418,548	528,943	551,650	561,540
Other non-current assets			0	0	0	0	0	0
Current Assets			1,921	9,973	10,260	12,942	12,509	11,036
Debtors			1,072	4,518	4,453	7,883	9,567	9,675
Cash			849	5,455	5,807	5,059	2,942	1,361
Current Liabilities			(5,411)	(8,165)	(12,572)	(12,755)	(14,539)	(14,625)
Creditors/Deferred income			(5,411)	(8,165)	(12,572)	(12,755)	(14,539)	(14,625)
Short term borrowings			0	0	0	0	0	0
Long Term Liabilities			(23,811)	(65,714)	(64,359)	(113,928)	(124,228)	(124,528)
Long term borrowings			(23,811)	(65,143)	(63,788)	(113,357)	(123,657)	(123,957)
Other long term liabilities			0	(571)	(571)	(571)	(571)	(571)
Net Assets			179,986	255,060	351,877	415,202	425,392	433,423
NAV/share (p)			101	102	104	107	110	112
EPRA NAV/share (p)			101	102	104	107	110	112
CASH FLOW								
Operating Cash Flow			12,780	13,945	23,066	28,388	30,518	30,735
Net Interest			(204)	(1,285)	(2,200)	(3,521)	(3,600)	(3,600)
Tax			0	0	0	0	0	0
Net additions to investment property			(129,788)	(113,621)	(92,126)	(105,884)	(13,794)	(3,000)
Ordinary dividends paid			(5,546)	(12,220)	(18,493)	(23,007)	(25,242)	(25,716)
Debt drawn/(repaid)			23,811	41,700	(1,000)	49,364	10,000	0
Proceeds from shares issued (net of costs)			99,796	76,087	91,105	53,912	0	0
Other cash flow from financing activities				0	0	0	0	0
Net Cash Flow			849	4,606	352	(748)	(2,117)	(1,581)
Opening cash			0	849	5,455	5,807	5,059	2,942
Closing cash			849	5,455	5,807	5,059	2,942	1,361
Debt			(23,811)	(65,143)	(63,788)	(113,357)	(123,657)	(123,957)
Closing net debt			(22,962)	(59,688)	(57,981)	(108,298)	(120,715)	(122,596)
Net LTV			11.4%	19.1%	14.4%	21.0%	22.4%	22.3%

Source: Custodian REIT data, Edison Investment Research

Contact details	Revenue by geography
Penman Way Grove Park Enderby Leicester LE19 1SY 0116 240 8740 www.custodianreit.com	100% UK

Leadership team

Chairman of Custodian REIT: David Hunter	Managing director of Custodian Capital: Richard Shepherd-Cross
David Hunter is an international property consultant, specialising in supporting the creation, operation and liquidation of property funds and companies. He is chairman of a UK-based real estate debt fund manager and also has corporate advisory roles in the UK and France. He was managing director of Aberdeen Asset Management's £6.5bn UK and international property fund business from 2001–04. He was president of the British Property Federation in 2004	Richard Shepherd-Cross is the managing director of Custodian Capital and the fund manager of Custodian REIT. He is a chartered surveyor, and a former director of Jones Lang LaSalle in London, where he led the portfolio investment team before joining Mattioli Woods in 2009, where he was responsible for the syndicated property initiative, which was the precursor to CREI. He was instrumental in establishing CREI and raising £55m at IPO.
Non-executive director: Ian Mattioli	**Company secretary: Nathan Imlach**
Ian Mattioli is the founder director of Custodian REIT and, together with Bob Woods, founded Mattioli Woods, the AIM-listed wealth management and employee benefits business, which is the parent company of Custodian Capital, external fund manager of Custodian REIT. He has more than 30 years' experience in the financial services industry. Ian is responsible for the vision and operational management of Mattioli Woods and instigated the development of its investment proposition. This included the syndicated property initiative that developed into the seed portfolio for the launch of Custodian REIT.	Nathan Imlach qualified as a chartered accountant with Ernst & Young, specialising in providing mergers and acquisitions advice to a broad range of quoted and unquoted clients in the UK and abroad, latterly as a director and associate of Johnston Carmichael. He is a fellow of the Chartered Institute for Securities & Investment and a member of the Institute of Chartered Accountants in Scotland.

Principal shareholders*	(%)
Mattioli Woods	7.3
BlackRock	3.4

*As disclosed in the 2018 Annual Report. Shareholdings of more than 3%. Ownership incorporates the control of voting rights through acting as a discretionary investment manager on behalf of retail investors holding the beneficial interest.

Companies named in this report

Ediston Real Estate (EPIC), F&C Commercial Property Trust (FCPT), F&C UK Real Estate Investments (FCRE), Picton Property Income (PCTN), Regional REIT (RGL), Schroder REIT (SREI), Standard Life Investment Property Trust (SLI), UK Commercial Property Trust (UKCM)