

# Picton Property Income

Q119 NAV report

## Capital and income returns continuing

The Q119 NAV total return was 2.5%, with a high level of occupancy maintained and successful progress made with lease events. Picton's portfolio has a strong bias towards industrial and regional office property markets, which remain robust with widespread rental growth. In addition, Picton's portfolio continues to offer significant reversionary potential. Shareholders have approved conversion to REIT status, which is expected to take effect from 1 October 2018 and 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	1.00	3.8
03/19e	37.8	4.27	3.57	93.5	0.97	3.9
03/20e	38.1	4.43	3.68	96.1	0.94	4.1

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

## Good progress; no material changes to forecasts

Income earnings during the quarter covered dividends per share of 0.875p by 121%. Like-for-like revaluation gains of 0.8% and gains on the disposal of two properties for £11.8m, 8.4% ahead of the March valuation, contributed to NAV growth of 1.5% to 91.8p. The NAV total return for the quarter was 2.5%. Lease events with a combined annual rent of £0.9m were completed in the period at an average 6.2% uplift to the March estimated rental value (ERV). Occupancy was maintained at a high 95%, dipping slightly from March (96%) due to asset management actions. A £33.7m debt repayment since the end of Q119 will save c £1m pa in interest costs, broadly matching the income impact of the disposals, while LTV has fallen to 25.5% (March: 26.2%). We have made only very minor adjustments to our forecasts for EPS and NAV, and no change to DPS.

## 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 positioning had a positive impact on returns in FY18 and Q119 and consensus expectations remain positive for FY19. As discussed in our [recent outlook note](#), there is significant reversionary potential within the portfolio. At the end of FY18, the ERV was c £6.5m ahead of the contracted rent roll, representing the opportunity to lift income from existing assets further, through leasing vacant space, rent reviews and lease expiry opportunities.

## Valuation: Well-covered DPS supports strong returns

Picton offers well-covered and growing dividends, providing a yield of c 4.0%, and trades at around its EPRA NAV broadly in line with peers. The current yield is below the median c 5% on a group of immediate peers as despite having a strong income focus, Picton 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. Continuing this approach, it has significant opportunities to grow income and value further from the current portfolio.

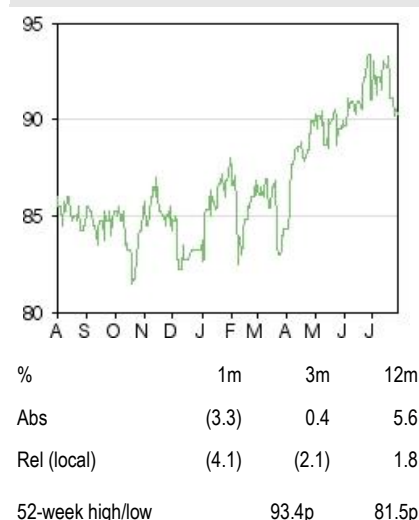
Real estate

30 July 2018

**Price** 90.50p  
**Market cap** £486m

Net debt (£m) as at 30 June 2018	169.8
Net LTV as at 30 June 2018	25.5%
Shares in issue	539.0m
Free float	100%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

### Share price performance



### 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

Payment of Q119 DPS	31 August 2018
REIT conversion expected	1 October 2018

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## Further details from the update

A summary of the NAV progression during the three months to 30 June 2018 (Q119) is shown in Exhibit 1. The c £6.0m movement in property values includes a £5.4m, or 0.8% like-for-like, portfolio revaluation movement and a c £0.6m gain on disposals after costs. Income earnings after tax of c £5.7m covered dividends for the quarter by 121%. In aggregate, net assets grew 1.5% and net asset value per share by a similar amount to 91.8p. As discussed below, the early retirement of £33.7m of debt, due to mature in July 2022, that has taken place since the end of Q119, will have a negative impact on Q219 NAV per share of c 0.7p but will reduce recurring interest expenses.

<b>Exhibit 1: Q119 NAV movement</b>			
	<b>Total (£m)</b>	<b>Movement %</b>	<b>Per share (p)</b>
NAV at 31 March 2018	487.4		90.4
Movement in property values	6.0	1.3	1.2
Net income after tax	5.7	1.2	1.1
Dividends paid	(4.7)	(1.0)	(.9)
Other	0.2	-	-
<b>NAV at 30 June 2018</b>	<b>494.6</b>	<b>1.5</b>	<b>91.8</b>
<b>Pro-forma NAV at 30 June 2018*</b>	<b>491.1</b>	<b>0.8</b>	<b>91.1</b>

Source: Picton. Note: Pro-forma for impact of post period-end early debt repayment.

The composition of the Q119 net asset value can be seen in Exhibit 2. The reduction in the value of investment properties (stated net of lease incentives) in the quarter reflects the completed sales of two office assets for an aggregate £11.8m, 8.4% ahead of the March valuation, partly offset by the positive revaluation movement. As at 30 June 2018, the portfolio had a net initial yield of 5.4%, allowing for void holding costs (March: 5.5%). The increase in the cash balance broadly corresponds to the properties sold. Picton has also helpfully provided a pro-forma position that shows the end-Q119 position adjusted for the subsequent debt repayment.

<b>Exhibit 2: NAV breakdown</b>				
	<b>Pro-forma</b>			
	<b>30 June 2018</b>	<b>30 June 2018</b>	<b>31 March 2018</b>	<b>31 December 2018</b>
Investment properties	669.4	669.4	674.5	665.3
Other assets	16.3	16.6	17.9	18.1
Cash	21.6	44.0	31.5	31.7
Other liabilities	(21.6)	(21.6)	(22.5)	(21.4)
Borrowings	(194.6)	(213.8)	(214.0)	(216.3)
<b>Net assets</b>	<b>491.1</b>	<b>494.6</b>	<b>487.4</b>	<b>477.4</b>
<b>Net asset value per share (p)</b>	<b>91.1</b>	<b>91.8</b>	<b>90.4</b>	<b>88.6</b>

Source: Picton. Note: Pro-forma for impact of post period-end early debt repayment.

On 20 July, Picton completed the early repayment of £33.7m of debt, due July 2022, reducing its total debt outstanding to £194.6m. The debt that was repaid was not due to mature until July 2022 and carried a fixed interest rate of 4.08%. It was repaid using £23m of cash resources, with the balance coming from one of the group's revolving credit facilities, at a cost of 1.75% above Libor, or c 2.5% currently. The vast majority of the remaining debt (87%) is now fixed under long-term facilities, with the rest at variable rates. Average maturity extends to c 10.6 years and the weighted average cost of debt falls to 4.0%. In addition, Picton has secured other amendments to the loan documentation covering the c £80m debt balance with the lender involved, which will increase operational flexibility. We have adjusted our estimates (shown below) for the repayment, which results in an annualised interest saving of c £1.0m while incurring a one-off repayment fee of £3.2m and crystallising un-amortised loan arrangement fees of c £300k. The impact on NAV, to be recognised in Q219, will be a c 0.7p reduction.

Picton's industrial portfolio (43% of the total) continued to drive the valuation performance, with a like-for-like gain of 3.4% in the quarter, supported by continuing rental growth. The office portfolio

(34.5% of the total) saw a small 0.1% overall like-for-like valuation decline within which regional office performance was positive, with occupier demand remaining strong, while London offices, where Picton is underweight, saw a value decline reflecting a weaker rental outlook. Retail and leisure (22.5% of the portfolio), another area where the portfolio is underweighted, saw a 2.5% like-for-like value decline driven by high street retail property.

During the period, seven lettings, six lease renewals/re-gears and two rent reviews were completed, with a combined annual rent of £0.9m, on average 6.2% ahead of the March ERV. Occupancy remained high at 95% but was slightly lower than March (96%). The reduction reflects the surrender of two leases at business parks within the industrial portfolio, reflecting ongoing active management, where management expects to be able to re-let the units at rents significantly ahead of the previous passing rent.

## Estimate revisions

Our revised estimates allow for the year-to-date property sales and debt repayment, which broadly offset each other at the level of EPRA earnings. The Q119 revaluation movement was consistent with our existing forecasts and EPRA NAV reduces slightly, with the Q119 disposal gain partly offsetting the upfront cost of the debt repayment.

<b>Exhibit 3: Estimates revision</b>												
	Net rental income (£m)			EPRA EPS (p)			EPRA NAV/share (p)			DPS (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
FY19e	38.5	37.8	(1.8)	4.30	4.27	(0.8)	94.0	93.5	(0.6)	3.57	3.57	0.0
FY20e	39.1	38.1	(2.3)	4.43	4.43	0.1	96.6	96.1	(0.5)	3.68	3.68	0.0

Source: Picton Property, Edison Investment Research

**Exhibit 4: Financial summary**

Year end 31 March	£'000s	2014	2015	2016	2017	2018	2019e	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>								
Revenue		31,967	35,151	40,770	47,911	42,855	42,134	42,448
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	48,134	48,448
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	37,834	38,148
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	36,234	36,498
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	900	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	48,390	42,662
Net finance expense		(10,868)	(10,930)	(11,417)	(10,823)	(9,747)	(12,497)	(8,762)
Profit Before Tax		37,705	69,202	65,064	43,249	64,677	35,894	33,899
Taxation		(357)	(347)	(216)	(499)	(609)	(205)	0
Profit After Tax		37,348	68,855	64,848	42,750	64,168	35,689	33,899
Profit After Tax (EPRA)		13,266	15,280	19,878	20,566	22,625	22,989	23,899
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	6.62	6.29
EPRA EPS (p)		3.69	3.43	3.68	3.81	4.19	4.27	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	1.19	1.20
Ongoing charges ratio (excluding property expenses)		1.7%	1.2%	1.1%	1.2%	1.1%	1.1%	1.1%
<b>BALANCE SHEET</b>								
Fixed Assets		421,393	536,898	649,406	615,187	670,679	682,129	695,632
Investment properties		417,207	532,926	646,018	615,170	670,674	682,124	695,627
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	37,747	38,638
Debtors		10,527	14,019	14,649	15,541	19,123	15,105	15,306
Cash		32,352	70,092	22,759	33,883	31,510	22,642	23,332
Current Liabilities		(17,369)	(17,480)	(47,521)	(20,635)	(22,292)	(20,458)	(20,719)
Creditors/Deferred income		(14,434)	(16,468)	(18,430)	(20,067)	(21,580)	(19,746)	(20,007)
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)	(195,467)	(195,467)
Long term borrowings		(231,081)	(231,834)	(220,444)	(200,336)	(209,952)	(193,752)	(193,752)
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	503,951	518,084
Net Assets excluding goodwill and deferred tax		214,096	369,970	417,132	441,925	487,355	503,951	518,084
NAV/share (p)		56.4	68.5	77.2	81.8	90.4	93.5	96.1
EPRA NAV/share (p)		56.4	68.5	77.2	81.8	90.4	93.5	96.1
<b>CASH FLOW</b>								
Operating Cash Flow		23,145	24,705	33,283	36,283	35,088	30,848	32,746
Net Interest		(8,768)	(8,695)	(8,836)	(9,211)	(9,125)	(12,497)	(8,762)
Tax		(394)	(369)	(426)	(232)	(328)	(205)	0
Net cash from investing activities		(10,838)	(61,729)	(68,123)	48,691	(17,811)	8,276	(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	(16,200)	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)	(8,868)	690
Opening cash		22,906	32,352	70,092	22,759	33,883	32,403	23,535
Closing cash		32,352	70,092	22,759	33,883	32,403	23,535	24,225
Closing debt		(234,016)	(232,846)	(249,535)	(200,904)	(210,664)	(194,464)	(194,464)
Closing net (debt)/cash		(201,664)	(162,754)	(226,776)	(167,021)	(178,261)	(170,929)	(170,239)
Net LTV				34.6%	27.4%	26.7%	24.9%	24.3%

Source: Picton Property Income, Edison Investment Research

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