

# Picton Property Income

NAV update

Positive income-driven returns continuing

Picton property delivered a solid performance in the three months to December 2018 (Q319), generating an NAV total return of 1.2% (or a compound annual 4.9%). A good level of dividend cover was maintained and the company progressed a number of asset management initiatives targeted at capturing reversionary income potential and enhancing long-term total return.

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	3.33	82	1.03	3.9
03/18	38.4	4.19	3.43	90	0.93	4.1
03/19e	38.5	4.26	3.57	93	0.91	4.2
03/20e	37.0	4.22	3.68	95	0.89	4.4

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

## Solid Q319 returns and active management

The 0.875p quarterly DPS, annualising at 3.5p per share, and Picton's first payment under the REIT regime, was 123% covered by income earnings. The portfolio value and net asset value both edged up, with NAV per share increasing 0.3% to 92.5p. There were no portfolio transactions during the period but active asset management continued, aimed at capturing the significant reversionary income potential contained in the portfolio (£6.4m at H119; £2.9m related to vacant space and the remainder represented the potential uplift from lease renewals, rent reviews and contracted uplifts). Lease renewals/re-gears and new lets, covering c £3m of annual rents were completed or agreed, at levels above ERV. Six lease surrenders were also completed/agreed, with the aim of re-letting at higher market rents (on average 23.2% above the passing rent level).

## Reversionary potential supports growth prospects

Portfolio performance continues to benefit from an overweight in industrial and regional office property, where market rents and valuations have continued to grow, and a significant underweighting of retail and leisure (with no shopping centre exposure), where rents and values are under pressure. Income earnings prospects benefit from the significant reversionary potential, and a positive market supply-demand balance in the industrial and regional office sectors, with limited new development and occupational demand continuing to drive market rental growth, despite signs of leasing decisions taking longer to complete. With increased economic and market uncertainties, not least Brexit related, capital values are more difficult to call. However, with moderate (c 25%) gearing and £26m of undrawn debt facilities, Picton is well placed to seize any opportunities that may emerge.

## Income focus, with an eye to sustainable growth

Picton offers a current yield of 4.1% and trades at a 9% discount to the Q319 NAV. Although it has a strong income focus its yield is lower than the peer average (c 5.7%), reflecting strong cover (Q319: 1.23x). This cover provides scope to reinvest into the portfolio in ways designed to support occupancy and income growth with the specific goal of enhancing long-term total return.

Real estate

29 January 2019

**Price** **84.50p**
**Market cap** **£456m**

Net debt (£m) as at 31 December 2018 171.1

Net LTV as at 31 December 2019 25.0%

Shares in issue 539.0m

Free float 100%

Code PCTN

Primary exchange LSE

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 0.4 (1.2) (2.7)

Rel (local) (0.9) 1.0 10.2

52-week high/low 93.4p 79.4p

### Business description

Picton Property Income is an internally managed UK REIT that invests in a diversified portfolio of 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 event

FY19 results May 2019

### Analysts

Martyn King +44 (0)20 3077 5745

Andrew Mitchell +44 (0)20 3681 2500

[financials@edisongroup.com](mailto:financials@edisongroup.com)
[Edison profile page](#)

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

## Management for income generating solid returns

Picton delivered a solid performance in the three months to December 2018 (Q319), generating an NAV total return of 1.2% (or a compound annual 4.9%), maintaining a good level of dividend cover, and progressing a number of asset management initiatives targeted at capturing reversionary income potential.

- Net asset value edged up to £498.1m (30 September: £497.1m). In per share terms, the increase was 0.3%, from 92.2p to 92.5p. A 0.875p dividend per share paid during the quarter in respect of Q219, with dividend cover remaining strong at 123% (Q219: 129%). A dividend of 0.875p per share has been declared for Q319 and will be paid on 28 February, the first payment under the REIT regime. The quarterly DPS is equivalent to an annualised 3.5p, representing a yield of 4.1%.

<b>Exhibit 1: Summary of quarterly NAV movement</b>		
	£m	Per share (p)*
NAV at 30 September 2018	497.1	92.2
Movement in property values	0.1	
Income earnings, net of tax	5.8	1.1
Dividends paid	(4.7)	(0.8)
Other	(0.2)	
<b>NAV at 31 December 2018</b>	<b>498.1</b>	<b>92.5</b>

Source: Picton Property Income. Note: \* Per share values are rounded.

- The balance sheet showed only modest changes during the period and gearing remains modest at 25.0% (30 September: 25.5%). The debt had a maturity of 10.1 years at 31 December, and was 87% fixed rate. The average interest cost is c 4.0%. Picton has £26m available from its undrawn revolving credit facilities, providing the flexibility to take advantage of investment opportunities that may arise.
- With no portfolio transactions during the quarter, the portfolio value increased by 0.1% or £1.0m to £684m (the balance sheet value above is stated net of lease incentives), with the industrial sector, strongly represented in the portfolio, continuing to drive growth, up 2.3%. The office sector saw a slight (0.4%) decline, in part due to asset management driven surrender activity. In the retail and leisure sector the main driver of the 3.2% reduction in value was weaker sentiment in the regional retail and warehouse sectors. Although modest, the 0.1% total valuation increase was ahead of the 0.2% quarterly decline registered by the MSCI Monthly Digest. Based on contracted net income, the net initial yield (NIY) at 31 December was 5.4%, similar to the level at 30 September, with a reversionary yield of 6.5% (30 September: 6.4%).

**Exhibit 2: Portfolio summary**

Sector	Portfolio weighting		Like for like change in value
	December 2018	September 2018	
<b>Industrial</b>	<b>44.7%</b>	<b>43.7%</b>	<b>2.3%</b>
South East	31.5%	30.6%	
Rest of UK	13.2%	13.1%	
<b>Offices</b>	<b>34.3%</b>	<b>34.5%</b>	<b>-0.4%</b>
London City & West End	4.2%	4.1%	
Inner and Outer London	8.3%	8.3%	
South East	11.0%	11.0%	
Rest of UK	10.8%	11.1%	
<b>Retail &amp; Leisure</b>	<b>21.0%</b>	<b>21.8%</b>	<b>-3.2%</b>
Retail warehouse	8.3%	8.6%	
High Street - rest of UK	5.1%	5.6%	
High Street - South East	5.7%	5.7%	
Leisure	1.9%	1.9%	
<b>Total portfolio</b>	<b>100.0%</b>	<b>100.0%</b>	<b>0.1%</b>

Source: Picton Property Income

- With the interim results (H119) Picton provided details of the £6.4m reversionary income potential, at that date, in the existing portfolio. Of this, £2.9m reflected the opportunity to let additional space, with the remainder representing the potential uplift from lease renewals, rent reviews and contracted uplifts. During Q319, Picton completed six lease renewals/re-gears and secured eight rent reviews, at an average 9.9% ahead of the September 2018 ERV, with a combined rent of £2.1m. In addition, six new lettings were completed and one agreed, with a combined rent of £0.9m, on average 2.1% below the September ERV. At the same time, the company completed five surrenders and one agreement to surrender as part of its ongoing asset management. Although in some cases this will have a short-term impact on income, the intention is to re-let the properties at higher rents. On average the market rents are 23.2% ahead of the passing rent, while the surrender payments received were in excess of £0.3m. At Parc Tawe in North Swansea, Picton has completed an agreement with Lidl to lease the former Homebase unit, the subject of a CVA in H119, moving Lidl from its existing smaller premises on the site and making it the anchor occupier. Lidl will pay an annual £0.39m rent on the space previously occupied by Homebase, on a 20-year lease, with a break after 15 years, and subject to five-yearly RPI-based rent reviews capped at 2%. Homebase had been paying rent of £0.44m on a lease expiring in 2022, but had sought a 90% reduction under its CVA.

## Forecasts and valuation

### No change to forecasts

We are making no changes to the estimates that we set out in our [update](#) published following the interim results to 30 September. These reflect an expectation of continuing growth in like-for-like rental income in the industrial portfolio and to a lesser extent, within the office portfolio. For industrial assets, we assume 2% growth in H219 and a further 2% for FY20 as a whole. For office, we assume 1% growth in H219 and 1% growth for FY20 as a whole. In retail and leisure, we assume no rental growth and look for the asset management driven vacation of Stanford House to temporarily reduce end-FY19 contracted rents by an additional c £1m (in addition to the c £0.5m H119 impact). This will more than offset any positive impact from re-letting space affected by retail failures in H119. We have prudently assumed that only around £1m of the c £1.5m contracted income forgone is recovered by end FY20, with no material impact on revenue in the period. For the group as a whole, our forecasts reflect an end FY19 contracted rent roll of £39.8m (H119: £40.3m), with £41.5m at end FY20.

Our forecasts include modest revaluation gains driven by expected rental growth, focused on the industrial sector where Picton is strongly weighted, with no assumption of a change in market yields, either up or down. However, there has clearly been an increase in market uncertainty, most obviously with respect to the effects of Brexit. With a NIY of 5.4%, we estimate that a 0.25% increase in market yields would reduce FY20 NAV per share by c 5p per share, while a 0.25% reduction would increase it by c 7p per share.

## Income focus supporting share price

Picton has a strong focus on income and pays fully covered quarterly dividends that currently annualise at 3.5p per share (a prospective yield of 4.1% at the current share price) while continuing to invest in the portfolio to support future income growth. In Exhibit 3 we show the trend in EPRA NAV per share during the past almost six years ended December 2018. During this period, Picton has generated an aggregate NAV total return of 126.5%, or a compound annual average 15.3%.

Exhibit 3: EPRA NAV total return							
	Year ending 31 March					9 months 2019	Cumulative 2014–19
	2014	2015	2016	2017	2018		
Opening EPRA NAV per share (p)	49	56	69	77	82	90	49
Closing EPRA NAV per share (p)	56	69	77	82	90	93	93
DPS paid (p)	3.00	3.00	3.30	3.30	3.40	2.63	19
<b>EPRA NAV total return</b>	<b>21.0%</b>	<b>26.9%</b>	<b>17.6%</b>	<b>10.2%</b>	<b>14.7%</b>	<b>5.2%</b>	<b>126.5%</b>
<b>Compound annual total return</b>							<b>15.3%</b>

Source: Company data, Edison Investment Research. Note: Annual data differ slightly from Picton's published data which assume dividend reinvestment during the year.

In Exhibit 4 we show a summary performance and valuation comparison of Picton and what we consider to be its closest income-oriented peers. Over the past year Picton shares have performed more strongly than the peer group average as well as the broader UK property sector and the FTSE All-Share Index. The valuation comparison is based on last reported EPRA NAV per share and trailing 12-month DPS declared – on this basis, the Picton yield is below the peer average and the P/NAV slightly above. We believe that the shares continue to benefit from the company's income focus, a less volatile element of property returns across the cycle compared with capital values, its good level of dividend cover and relatively modest gearing.

Exhibit 4: Peer comparison								
	Price (p)	Market cap (£m)	P/NAV* (x)	Yield* (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
Ediston Property	101	213	0.88	5.7	-2%	-3%	-9%	-12%
F&C UK Real Est Inv	88	211	0.82	5.7	-3%	-7%	-16%	-20%
F&C Com Prop	126	1007	0.89	4.8	-1%	-6%	-12%	-19%
Custodian REIT	115	452	1.06	5.7	-1%	-3%	0%	-7%
Regional REIT	97	360	0.85	8.2	4%	-3%	-4%	-6%
Schroder REIT	54	282	0.79	4.6	-3%	-8%	-15%	-19%
Standard Life Inv Prop	88	358	0.96	5.4	8%	-2%	-7%	-9%
<b>Average</b>			<b>0.89</b>	<b>5.7</b>	<b>0%</b>	<b>-5%</b>	<b>-9%</b>	<b>-13%</b>
<b>Picton</b>	<b>84</b>	<b>453</b>	<b>0.91</b>	<b>4.2</b>	<b>0%</b>	<b>-3%</b>	<b>-3%</b>	<b>-10%</b>
UK property index	1,662			5.2	7%	-2%	-8%	-12%
FTSE All-Share Index	3,720			4.8	1%	-3%	-12%	-14%

Source: Company data, Edison Investment Research. Prices as at 28 January 2019. Note: \*Last reported EPRA NAV per share and trailing 12-month DPS declared.

**Exhibit 5: Financial summary**

Year end 31 March	£'000s	2016	2017	2018	2019e	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Rents receivable, adjusted for lease incentives		39,663	40,555	41,412	40,842	40,480
Surrender premiums		339	263	200	442	200
Dilapidation receipts		108	1,090	1,111	530	600
Other income		660	6,003	132	79	0
Revenue		40,770	47,911	42,855	41,893	41,280
Service charge income		5,153	6,487	5,927	6,061	6,000
Total revenue		45,923	54,398	48,782	47,954	47,280
Gross property expenses		(10,001)	(12,011)	(10,335)	(9,447)	(10,300)
Net rental income		35,922	42,387	38,447	38,507	36,980
Administrative expenses		(1,510)	(1,613)	(1,914)	(1,812)	(1,500)
Operating Profit before revaluations		34,412	40,774	36,533	36,695	35,480
Revaluation of investment properties		44,171	15,087	38,920	12,461	10,000
Profit on disposals		799	1,847	2,623	379	0
Management expenses		(2,901)	(3,636)	(3,652)	(4,006)	(4,000)
Operating Profit		76,481	54,072	74,424	45,529	41,480
Net finance expense		(11,417)	(10,823)	(9,747)	(9,283)	(8,726)
Profit Before Tax		65,064	43,249	64,677	36,246	32,755
Taxation		(216)	(499)	(509)	(445)	0
Profit After Tax		64,848	42,750	64,168	35,801	32,755
Profit After Tax (EPRA)		19,878	20,566	22,625	22,961	22,755
Average Number of Shares Outstanding (m)		540.1	540.1	539.7	539.0	539.0
EPS (p)		12.01	7.92	11.89	6.04	6.08
EPRA EPS (p)		3.68	3.81	4.19	4.26	4.22
Dividends declared per share (p)		3.300	3.325	3.425	3.570	3.680
Dividend cover (x)		1.12	1.15	1.22	1.19	1.15
Ongoing charges ratio (excluding property expenses)		1.1%	1.2%	1.1%	1.0%	1.0%
<b>BALANCE SHEET</b>						
Fixed Assets		649,406	615,187	670,679	678,145	691,645
Investment properties		646,018	615,170	670,674	678,120	691,620
Other non-current assets		3,388	17	5	25	25
Current Assets		37,408	49,424	50,633	35,688	36,240
Debtors		14,649	15,541	19,123	14,614	14,970
Cash		22,759	33,883	31,510	21,074	21,270
Current Liabilities		(47,521)	(20,635)	(22,292)	(19,915)	(20,378)
Creditors/Deferred income		(18,430)	(20,067)	(21,580)	(19,107)	(19,570)
Short term borrowings		(29,091)	(568)	(712)	(808)	(808)
Long Term Liabilities		(222,161)	(202,051)	(211,665)	(192,274)	(192,274)
Long term borrowings		(220,444)	(200,336)	(209,952)	(190,559)	(190,559)
Other long term liabilities		(1,717)	(1,715)	(1,713)	(1,715)	(1,715)
Net Assets		417,132	441,925	487,355	501,644	515,233
Net Assets excluding goodwill and deferred tax		417,132	441,925	487,355	501,644	515,233
NAV/share (p)		77	82	90	93	96
Fully diluted EPRA NAV/share (p)		77	82	90	93	95
<b>CASH FLOW</b>						
Operating Cash Flow		33,283	36,283	35,088	30,733	32,211
Net Interest		(8,836)	(9,211)	(9,125)	(8,950)	(8,726)
Tax		(426)	(232)	(328)	(80)	0
Net cash from investing activities		(68,123)	48,691	(17,811)	9,777	(3,524)
Ordinary dividends paid		(17,822)	(17,957)	(18,487)	(18,883)	(19,766)
Debt drawn/(repaid)		14,591	(46,450)	9,183	(23,033)	0
Net proceeds from shares issued/repurchased		0	0	(893)	0	0
Other cash flow from financing activities						
Net Cash Flow		(47,333)	11,124	(2,373)	(10,436)	196
Opening cash		70,092	22,759	33,883	31,510	21,074
Closing cash		22,759	33,883	31,510	21,074	21,270
Debt as per balance sheet		(249,535)	(200,904)	(210,664)	(191,367)	(191,367)
Un-amortised loan arrangement fees		0	(3,740)	(3,376)	(2,885)	(2,885)
Closing net (debt)/cash		(226,776)	(170,761)	(182,530)	(173,178)	(172,982)
Net LTV		34.6%	27.3%	26.7%	25.2%	24.7%

Source: Company data, Edison Investment Research

---

## General disclaimer and copyright

This report has been commissioned by Picton Property Income and prepared and issued by Edison, in consideration of a fee payable by Picton Property Income. Edison Investment Research standard fees are £49,500 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

**Accuracy of content:** All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the Edison analyst at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

**Exclusion of Liability:** To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained on this note.

**No personalised advice:** The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

**Investment in securities mentioned:** Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

**Copyright:** Copyright 2019 Edison Investment Research Limited (Edison). All rights reserved FTSE International Limited ("FTSE") © FTSE 2019. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.

---

## Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd who holds an Australian Financial Services Licence (Number: 427484). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

---

## New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

---

## United Kingdom

Neither this document and associated email (together, the "Communication") constitutes or form part of any offer for sale or subscription of, or solicitation of any offer to buy or subscribe for, any securities, nor shall it or any part of it form the basis of, or be relied on in connection with, any contract or commitment whatsoever. Any decision to purchase shares in the Company in the proposed placing should be made solely on the basis of the information to be contained in the admission document to be published in connection therewith.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document (nor will such persons be able to purchase shares in the placing).

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

---

## United States

The Investment Research is a publication distributed in the United States by Edison Investment Research, Inc. Edison Investment Research, Inc. is registered as an investment adviser with the Securities and Exchange Commission. Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a) (11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

---

Frankfurt +49 (0)69 78 8076 960  
Schumannstrasse 34b  
60325 Frankfurt  
Germany

London +44 (0)20 3077 5700  
280 High Holborn  
London, WC1V 7EE  
United Kingdom

New York +1 646 653 7026  
1,185 Avenue of the Americas  
3rd Floor, New York, NY 10036  
United States of America

Sydney +61 (0)2 8249 8342  
Level 4, Office 1205  
95 Pitt Street, Sydney  
NSW 2000, Australia