Chief executive's review

MICHAEL MORRIS

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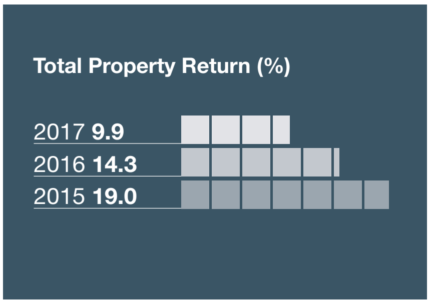

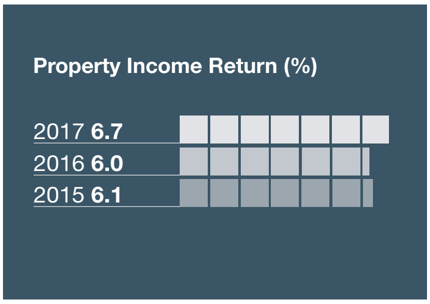

Total Return

10.4%

Total Property Return

9.9%

Earnings per Share

7.9p

The last 12 months have not been without their challenges. The uncertainty caused by the EU referendum and consequent nervousness within the investment and occupier markets undoubtedly impacted performance.

We have made progress on many fronts and have delivered strong relative property performance, which has further been enhanced by our use of debt.

Our entrepreneurial approach has enabled us to react quickly as market conditions have changed. We have put ourselves in a strong position, through our strategy of realising profits from low yielding London assets and using proceeds to repay debt.

Portfolio and asset management

Our outperformance against MSCI IPD is significant and we cover this in more detail further on. As I have said in previous years, there is always a balance to be struck between income and capital returns. A pure focus on income, and a lack of investment into assets, is likely to be at the expense of future capital returns and income sustainability.

We have retained our overweight position to the industrial, warehouse and logistics sector and this has again had a positive impact on our relative performance.

We have reshaped the portfolio through the sales of two central London office buildings and four smaller non-core assets. This has reduced the number of assets in the portfolio and increased the average lot size to £11.8 million.

The work of the asset management team in adding value across the portfolio is covered in more detail within the Investment Manager's Report.

Operational efficiency

An increase in performance related remuneration across the team has contributed to a small increase in Picton's Ongoing Charges ratio for the year. It is worth noting that in 2012 Picton moved to an internalised management structure as part of a process to reduce ongoing costs and become more aligned with its shareholders. Since then, total management costs have averaged £2.6 million per annum, compared to £4.2 million per annum in the preceding five years under the old external management model.

Effective use of debt

In common with other asset classes, commercial property has experienced more volatility this year and therefore the impact of gearing on returns has been both positive and negative over time. Despite an uncertain summer last year, the property market has now returned to a more stable position.

The key event for us in 2016 was the maturity of our zero dividend preference shares. Given current market conditions we believed that it was appropriate to operate with a lower level of gearing and used the proceeds from asset sales to repay these shares in full, rather than re-financing. Consequently, we have also simplified our corporate structure.

We also put in place a second revolving credit facility, which matures in 2021, and can be drawn down when required to provide the Group with additional operational flexibility.

Our net gearing now stands at 27%, with a maturity profile of 11.7 years and an average interest rate of 4.2%.

Outlook

We remain positive about the prospects for commercial property as an asset class and investment opportunity for three key reasons:

- Firstly, income drives returns. Income from real estate remains a key component of total return and is supportive of the underlying investment case relative to other asset classes;
- Secondly, although our occupiers' businesses are naturally changing which creates different real estate requirements, we believe that most businesses will continue to need premises to operate from over the longer term. By having a well managed diversified portfolio of assets Picton can also adapt and change with these requirements; and
- Thirdly, there is the potential for a competent owner to add value in an imperfect and illiquid market when no two assets are identical, through clever buying, good management and well timed disposals.

The defensive qualities of the asset class reinforce why real estate has performed so well in recent years, even off significantly repriced levels. With most assets, there is a high residual value, which can be unlocked by pursuing alternative uses either from the buildings, or from the land itself.

One of our strengths as a team is the focus we put on getting to know our occupiers, where possible building relationships that help us to understand their businesses and property needs.

We maintain regular communication with our occupiers, keeping them up to date with matters that may affect their occupation. For example, earlier this year we provided guidance on how the changes to business rates might impact their business. Our asset managers are always available to deal with any issues relating to their properties and resolve problems. on hand to advise, sort out a problem or help where possible. This remains very much at the heart of our Picton Promise and is something that a dedicated team can genuinely deliver.

We will continue to adopt a long-term approach, with our closed ended structure, enabling us to control the timings of both acquisitions and disposals. Against a backdrop of forecast lower returns, we believe there will be subsectors of the market that continue to perform more strongly. Our role is to identify and secure these opportunities on the back of a strong balance sheet and execution track record.

Michael Morris
Chief Executive, Picton Capital Limited

6 June 2017