Chief executive's review

Michael Morris

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Our focus over the last 12 months has been to ensure we achieve our strategic priorities and prepare for the changes required as Picton becomes a UK REIT.

By way of background, while the UK commercial property market has delivered positive capital growth every month over the financial year, there has been a very obvious variation in returns between sectors. This was particularly evident in the divergence between the strong industrial markets, where we are overweight, and the weaker retail market, where we have an underweight position.

We have delivered growth in both net asset value and at a portfolio level, which has again generated returns ahead of the MSCI IPD Quarterly Benchmark. The Investment Manager's Report provides more detail on the various property transactions completed during the year.

In terms of strategic priorities, I have set out our progress here.

Growing net income

In total, net property income moved from £42.4 million in 2017 to £38.4 million in 2018. However, in 2017 we received £5.3 million of exceptional income in respect of our Luton hotel asset. Excluding this, net property income grew by 3% in 2018.

Working with our occupiers

This is at the heart of our occupier focused, opportunity led approach. We have included several case studies that demonstrate this approach in action and again there is more detail within the Investment Manager's Report.

Working closely with our occupiers to help to expand or contract as their businesses evolve is very much part of what we do and a reflection of this is the increase in occupancy that we have achieved during the year.

We have started to roll out occupier satisfaction surveys to occupiers at our multi-let assets.

We have introduced tougher key performance indicators with our principal service providers, including our managing agents, to continue to improve service delivery. We will make further progress with this initiative in the coming year.

We also encourage the use of our meeting rooms for our occupiers based in the regions who occasionally need meeting room space in London.

Operational efficiency

Over the year our ongoing charges ratio reduced by 5%, from 1.2% to 1.1%.

This reflects our focus on operational efficiency and more importantly the benefits of our internalised management model, meaning that our cost base is not directly linked to the value of the assets.

A significant proportion of the management cost is performance based and aligned with shareholders' interests through both deferred bonus awards and our Long-term Incentive Plan. The management costs this year include a proportion of expected future awards, arising from outperformance to date.

Portfolio and asset management

We continue to have success within the portfolio, in particular with our industrial and office assets, which have shown double digit returns.

Our retail portfolio has not been without its challenges, and seen modest declines reflecting the difficulties faced by a number of high street retailers. As a diversified investment company this element reflects the smallest part of our portfolio and our exposure is significantly lower than the wider market, further contributing to our outperformance against the MSCI IPD Quarterly Benchmark.

Effective use of debt

We have been focused in recent years on the gradual reduction of debt within the Group. Clearly there is a risk/return trade off in this strategy, but we feel it is appropriate as we move through the property cycle.

Tactically, we used one of our revolving credit facilities to partly finance the acquisition in Bristol and we will continue to approach the use of debt on this basis as and when compelling investment opportunities arise.

Notwithstanding the drawdown under our revolving credit facility, our loan to value ratio has reduced slightly to 26.7% at the year end, which is well within the operational headroom afforded by our lending criteria.

TOTAL PROPERTY RETURN

13%

PROPERTY INCOME RETURN

6%

EARNINGS PER SHARE

12p

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Outlook

While we have to be cognisant of macro issues, at Picton our focus is very much at an asset and indeed occupier level. Enhancing space and improving our income profile can have a positive impact and this is where the property market differs from other asset classes; the ability to manage our assets.

Our business model has embedded longevity throughout the various property cycles as we continually reposition the portfolio towards better growth assets. While single digit forecast consensus returns are more pessimistic, more than ever the devil is in the detail. The industrial sector, where we have greatest exposure still looks to be the outperformer and retail where we have very low relative exposure would appear to be the reverse. We are continually having to make value judgements around reward and risk, and to this end we intend to be more cautious in our use of debt in the short-term. We are fortunate to now have in place undrawn debt facilities that we can use tactically if we can secure attractively priced opportunities.

Entering the REIT regime later this year will provide a further operational boost and represents a positive evolution of the Picton business. Recognising our track record, approach and the team's abilities, I believe we are well placed to continue to achieve our aim of being one of the consistently best performing diversified UK focused property companies listed on the main market of the London Stock Exchange.

Michael Morris
Chief Executive,
Picton Capital Limited

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