EDISON

Picton Property Income

Trading update

COVID-19 punctuated a positive Q420

Real estate

Picton Property Income has provided an update on its further progress in the three months ended 31 March 2020 (Q420), as well as the impact of COVID-19 and its response to this. The company enters a period of acute economic and sector uncertainty with a strong and liquid balance sheet, and material internal asset management opportunities to support income and capital values.

Year end	Net property income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	DPS (p)	EPRA NAV/ share (p)	P/NAV (x)	Yield (%)
03/18	38.4	22.6	4.2	3.43	90	0.83	4.6
03/19	38.3	22.9	4.3	3.50	93	0.81	4.7
03/20e	34.5	20.6	3.8	3.50	93	0.81	4.7

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

Little change to our FY20 expectations

Q420 began well with positive leasing activity driving achieved rental growth, refurbishment completions, and opportunistic disposals locking in valuation gains. The COVID-19-induced lockdown came too late to materially affect Q420 rent collection but, in common with peers, Picton has seen a subsequent slowdown as tenants seek to protect their cash flows. Collection performance to date is robust and the company is working closely with its occupiers to optimise rent collection and provide support where this is appropriate. The balance sheet is strong with modest 22% gearing, good liquidity and undrawn debt. We have made no material change to our FY20 underlying earnings forecast but have slightly trimmed forecast EPRA NAV per share from 95p to 93p. In line with the normal timetable, the board will consider the Q420 DPS towards the end of April and says it will assess the prevailing circumstances at that time in making its decision. We assume an unchanged Q420 DPS of 0.875p per share, fully covered by our forecast EPRA earnings. Reflecting economic and sector uncertainty, we have temporarily withdrawn our FY21 estimates.

Positive sector positioning and reversionary potential

Although the portfolio is diversified to manage income risks, an overweight position in industrial and regional office property, where fundamentals are stronger, and a significant underweighting of the more challenging retail and leisure sectors (with no shopping centre exposure) continued to support portfolio performance in Q420. In combination with asset management-driven gains, the external property valuation declined only modestly. The gap between estimated rental value at full occupancy (ERV) and the current level of passing rent, substantially the result of refurbishment projects, continues to represent a significant opportunity to support future income and capital values irrespective of future market conditions.

Valuation: Total return with sustainable income focus

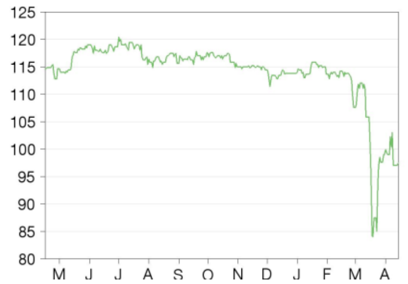
Based on our unchanged forecast for the FY20 DPS, which we expect to be fully covered by EPRA earnings, Picton's shares now yield almost 5% and a significant discount to FY20e EPRA NAV per share (c 20%) has opened up.

16 April 2020

Price	**75p**
Market cap	**£411m**

Net debt (£m) at 31 December 2019	153.4
Net LTV at 31 December 2019	22.4%
Shares in issue	547.6m
Free float	99%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(9.2)	(23.6)	(17.9)
Rel (local)	(11.9)	4.9	8.4
52-week high/low		103.0p	52.0p

Business description

Picton Property Income is an internally managed UK REIT that invests in a diversified portfolio of commercial property across the UK. It is total return driven with an income focus and aims to generate attractive returns through proactive management of the portfolio.

Next events

FY20 results	Expected June 2020

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Edison profile page

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

Further details on the Q420 update

Picton owns and actively manages a £665m diversified portfolio of commercial property across the UK comprising 47 assets let to c 350 occupiers. The portfolio is managed for total returns but with a strong income focus and through its occupier-focused, opportunity-led approach, the company aims to be one of the consistently best-performing diversified UK-focused property companies listed on the London Stock Exchange (LSE). A strong weighting to industrial and regional office assets (82% by value) and significant underweighting of retail and leisure assets (no shopping centre exposure) continues to support property returns, maintaining the long-term track record of outperformance versus the MSCI Quarterly Property Index on an ungeared basis, over one, three, five and 10 years to 30 September 2019.

Refurbishment and leasing activity continued in Q420

A total of nine new lettings were completed in Q420 at an average 3.5% above the December 2019 ERV, three leases were renewed/extended (at an average 7.1% above ERV) and four rent reviews were concluded (at an average 12.6% above ERV).

The main transactions included the three regional office lettings that were announced in March 2020, adding £0.9m of annual rental income, at or above ERV. Despite a challenging retail sector, Picton re-let the former Lidl unit in Swansea to Farmfoods and extended its lease with Pets at Home by five years. In Greater London, an industrial unit was let post-refurbishment work at 9.5% ahead of ERV.

In total, seven refurbishment projects were completed in the quarter, representing an investment of £3.7m, with the main project completion at the Rugby distribution centre.

Robust portfolio valuation

Adjusting for the January 2020 disposal of a distribution warehouse in Lutterworth, Leicestershire, for £15.9m (1% ahead of the December 2019 valuation and reflecting a 5.8% net initial yield), the overall portfolio valuation decreased by 0.8% in the quarter to £665m. Allowing for capex in the period, the decline was 1.3%. As has become industry-wide practice, the independent valuation is subject to a material uncertainty clause reflecting the difficulty in assessing the impact of the COVID-19 pandemic in the absence of a representative level of market transactions. On a sector basis, the robust portfolio performance reflects the continued overweighting of industrial and office properties and underweighting of retail & leisure, as well the positive impact of asset management initiatives in the period. It is our expectation that this outcome will compare favourably with the MSCI Quarterly Property Index when this becomes available later this month.

Exhibit 1: Summary of valuation move in three months to 31 March 2020 (Q420)

	Valuation movement	Portfolio weighting
Industrial, warehouse & logistics	-0.3%	47.9%
Office	-0.2%	33.8%
Retail & leisure	-2.9%	18.3%

Source: Picton Property Income

Rental collection

The COVID-19-induced lockdown came too late to materially affect Q420 but, in common with peers, Picton has seen a subsequent slowdown in rent collection. Around 95% of Picton's rents are billed in England and Wales and following the most recent rent quarter (due) day on 25 March 2020, the company had received 71% of the rent due by 7 April 2020. Including some rent deposit offset, this rate increased to 72% and increased further to 80% including short-term monthly payment plans agreed with a number of tenants. Rent in Scotland and Northern Ireland is next due in May 2020.

Picton is working closely with its occupiers to optimise rent collection and provide support where this is appropriate to assist them through the current uncertainties, while minimising the impact on the company's cash flows and capital values.

Strong balance sheet position with good liquidity

Following the January 2020 disposal, Picton repaid all of its drawings under its flexible revolving credit facility, or RCF (£19.0m drawn at H120). We estimate end-Q420 drawn debt (including unamortised loan arrangement fees) of £167.5m and, allowing for the £23m of cash indicated by the company, the LTV is a modest c 22%. The remaining drawn debt is all fixed rate with the first maturity in 2027. Picton estimates that on average rental income or asset values would need to fall by more than 40% for there to be any impact on covenants and that it is in any case in constant dialogue with its lenders, who remain fully supportive of the company. With none of the RCF drawn, Picton has access to £49.0m of undrawn borrowing facilities in addition to the positive cash balance.

Most current capital projects have been suspended until site access can be obtained, including at the Stanford Building in Covent Garden where the refurbishment is nearing completion (H120 ERV £1.6m). The company anticipates that it will take a further eight weeks to reach practical completion once work recommences.

Financials and valuation

We expect results for the year ended 31 March 2020 (FY20) to be published in June. We have made no material adjustments to our FY20 underlying earnings forecast other than to factor in the January disposal. However, although the Q420 portfolio valuation was robust, as a result of the COVID-19 impact it was below (c £9m) our expectations that were set following the interim results and supported by the Q320 NAV update. This feeds through into a modestly lower forecast FY20 fully diluted EPRA NAV per share of 95p (previously 94p).

Given the high level of economic and sector uncertainty, we have temporarily removed our FY21 forecasts.

Dividend decision yet to be taken

Picton has declared and paid three quarterly dividends of 0.875p per share. A decision on the Q4 DPS is normally taken towards the end of April and Picton says that it will assess the prevailing circumstances at that time before making a further announcement.

Our FY20 forecast assumes payment of the Q420 DPS at an unchanged 0.875p per share at a cash cost of £4.8m and this is fully covered by our forecast FY20 EPRA earnings.

Valuation

Picton shares now yield almost 5% and trade at a significant discount to FY20e EPRA NAV per share (0.81x). Uncertainty as to the extent and duration of the economic impacts of the COVID-19 pandemic makes it difficult to predict the level of near-term income earnings and capital values on both a company and sector level. Picton benefits from a well-positioned but diversified portfolio, a strong balance sheet and liquidity position, and an experienced management team with a strong track record of property-level returns versus the sector benchmark.

Exhibit 2: Financial summary

Year end 31 March	£'000s	2016	2017	2018	2019	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Rents receivable, adjusted for lease incentives		39,663	40,555	41,412	40,942	38,550
Other income		1,107	7,356	1,443	1,073	1,658
Service charge income		5,153	6,487	5,927	5,718	6,172
Revenue from properties		45,923	54,398	48,782	47,733	46,380
Property operating costs		(3,308)	(3,501)	(2,578)	(2,342)	(2,592)
Property void costs		(1,540)	(2,023)	(1,830)	(1,373)	(3,076)
Recoverable service charge costs		(5,153)	(6,487)	(5,927)	(5,718)	(6,172)
Property expenses		(10,001)	(12,011)	(10,335)	(9,433)	(11,840)
Net property income		35,922	42,387	38,447	38,300	34,540
Administrative expenses		(4,411)	(5,249)	(5,566)	(5,842)	(5,800)
Operating Profit before revaluations		31,511	37,138	32,881	32,458	28,739
Revaluation of investment properties		44,171	15,087	38,920	10,909	2,841
Profit on disposals		799	1,847	2,623	379	373
Operating Profit		76,481	54,072	74,424	43,746	31,953
Net finance expense		(11,417)	(10,823)	(9,747)	(9,088)	(8,239)
Debt repayment fee					(3,245)	
Profit Before Tax		65,064	43,249	64,677	31,413	23,714
Taxation		(216)	(499)	(509)	(458)	68
Profit After Tax (IFRS)		64,848	42,750	64,168	30,955	23,782
Adjust for:						
Investment property valuation movement		(44,171)	(15,087)	(38,920)	(10,909)	(2,841)
Profit on disposal of investment properties		(799)	(1,847)	(2,623)	(379)	(373)
Exceptional income /expenses		0	(5,250)	0	3,245	0
Profit After Tax (EPRA)		19,878	20,566	22,625	22,912	20,568
Fully diluted average Number of Shares Outstanding (m)		540.1	540.1	539.7	541.0	546.3
EPS (p)		12.01	7.92	11.89	5.75	4.37
EPRA EPS (p)		3.68	3.81	4.19	4.25	3.78
Dividends declared per share (p)		3.300	3.325	3.425	3.500	3.500
Dividend cover (x)		112%	115%	122%	121%	108%
EPRA cost ratio including direct vacancy costs)		22.8%	26.1%	23.7%	22.9%	29.4%
BALANCE SHEET						
Fixed Assets		649,406	615,187	670,679	676,127	655,004
Investment properties		646,018	615,170	670,674	676,102	654,981
Other non-current assets		3,388	17	5	25	23
Current Assets		37,408	49,424	50,633	39,477	42,537
Debtors		14,649	15,541	19,123	14,309	19,583
Cash		22,759	33,883	31,510	25,168	22,953
Current Liabilities		(47,521)	(20,635)	(22,292)	(23,342)	(21,392)
Creditors/Deferred income		(18,430)	(20,067)	(21,580)	(22,509)	(20,559)
Short term borrowings		(29,091)	(568)	(712)	(833)	(833)
Long Term Liabilities		(222,161)	(202,051)	(211,665)	(192,847)	(166,031)
Long term borrowings		(220,444)	(200,336)	(209,952)	(191,136)	(164,316)
Other long term liabilities		(1,717)	(1,715)	(1,713)	(1,711)	(1,715)
Net Assets		417,132	441,925	487,355	499,415	510,118
Net Assets excluding goodwill and deferred tax		417,132	441,925	487,355	499,415	510,118
NAV/share (p)		77	82	90	93	94
Fully diluted EPRA NAV/share (p)		77	82	90	93	93
CASH FLOW						
Operating Cash Flow		33,283	36,283	35,088	34,756	21,497
Net Interest		(8,836)	(9,211)	(9,125)	(8,630)	(7,892)
Tax		(426)	(232)	(328)	(845)	11
Net cash from investing activities		(68,123)	48,691	(17,811)	10,251	24,329
Ordinary dividends paid		(17,822)	(17,957)	(18,487)	(18,860)	(19,076)
Debt drawn/(repaid)		14,591	(46,450)	9,183	(22,616)	(27,190)
Net proceeds from shares issued/repurchased		0	0	(893)	(398)	6,107
Other cash flow from financing activities						
Net Cash Flow		(47,333)	11,124	(2,373)	(6,342)	(2,215)
Opening cash		70,092	22,759	33,883	31,510	25,168
Closing cash		22,759	33,883	31,510	25,168	22,953
Debt as per balance sheet		(249,535)	(200,904)	(210,664)	(191,969)	(165,149)
Un-amortised loan arrangement fees		0	(3,740)	(3,376)	(2,700)	(2,330)
Closing net (debt)/cash		(226,776)	(170,761)	(182,530)	(169,501)	(144,526)
Net LTV		34.6%	27.3%	26.7%	24.7%	21.8%

Source: Picton Property Income data, Edison Investment Research forecasts

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