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Picton Property Income

Company update

Positive leasing events and refinancing

Real estate

A recent update by Picton Property Income provided details of key leasing events across all sectors. This was followed by a debt refinancing that enhances the maturity profile, provides additional long-term, fixed-rate funding and reduces the average cost of debt. These are both positive indicators for financial performance but, with results for the year to March 2022 due for release next month, we will review our estimates at that time.

Year end	Net property income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	DPS (p)**	NAV*** per share (p)	P/NAV*** (x)	Yield (%)
03/20	33.6	19.9	3.7	3.25	93	1.05	3.3%
03/21	33.5	20.1	3.7	2.93	97	1.02	3.0%
03/22e	35.0	21.5	3.9	3.45	114	0.86	3.5%
03/23e	35.8	21.9	4.0	3.60	117	0.84	3.7%

Note: *EPRA earnings exclude revaluation gains/losses and other exceptional items. **Declared basis. ***NAV measure is net tangible assets (NTA).

Positive indicators for performance

Details of the leasing events and refinancing can be found in this report. The former includes new lettings and lease extensions, all at above estimated rental value (ERV), contributing to an increase in occupancy to 92% (91% at end-Q322) and reduction in void costs. Picton anticipates a positive valuation impact. Meanwhile, rent collection remains strong and for the December quarter now stands above 99%. The additional long-term, fixed-rate debt provided by the refinancing will initially repay substantially all floating rate borrowings that were drawn from the revolving credit facility (RCF) to fund recent acquisitions, and provide additional resources to fund identified acquisitions and capital projects. Undrawn funds under the RCF will provide flexibility to take advantage of further growth opportunities when identified. The average cost of drawn debt is reduced from 4.1% to 3.7%, with a modest reduction of 0.8p in Q322 NAV per share to a pro forma 112.0p.

Organic and acquisition-led opportunities

Picton's strong multi-year financial and operational performance has benefited from active asset management, including investment in the portfolio and sector positioning. Capex aims to enhance the quality, sustainability and occupier appeal of assets, born out by progress with leasing available space. Despite this progress, a strong organic growth opportunity remains, reflected in the c £9m H122 gap between passing rent and ERV. Low gearing (pro forma LTV of c 22% following the refinancing) and now £65m available for investment provides an opportunity for further accretive acquisitions. Picton has also expressed its interest in exploiting its strong performance record and scalable internalised structure to engage in sector consolidation, where there is an opportunity to create additional value.

Valuation: Good yield with growth potential

At 0.875p per quarter, the annualised rate of DPS of 3.5p represents a prospective yield of 3.6% with a good potential for further DPS growth. Meanwhile, the shares trade at a c 12% discount to the pro forma end-Q322 EPRA NAV of 112.0p, wider than the five-year average discount of c 3% and a peak premium of c 10%.

4 April 2022

Price	**98.3p**
Market cap	**£545m**

Net debt (£m) at 31 December 2021	164.5
Net LTV at 31 December 2021	20.8%
Shares in issue	547.6m
Free float	100%
Code	PCTN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.6	(3.6)	13.3
Rel (local)	(1.3)	(3.4)	3.8
52-week high/low		106.00p	79.80p

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

FY22 results	26 May 2022

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Edison profile page

Further details

Refinancing adds to debt capacity at lower average cost and with increased duration

Of the two long-term, fixed-rate facilities (with Canada Life and Aviva), the Canada Life facility has been extended from £80m to £129m. The new £49m tranche is priced at 3.25% and the cost of the original £80m tranche has been reduced to a similar level from 4.1%, a reduction of c 20%. The new tranche has a maturity date of July 2031 and the maturity of the original tranche has been extended by four years to the same date. Out of the proceeds, the £31m[1] that had been recently drawn from the shorter-term, floating rate NatWest RCF has been substantially repaid, although the entire £50m facility remains available to the company. As a result, total debt facilities have increased to £264m, with £219m drawn, of which £214m is fixed for an average 10 years. The weighted average cost of the drawn debt is 3.7% compared with 4.1% previously.

Exhibit 1: Summary of increased debt portfolio

	Canada Life	Aviva	NatWest RCF
Amount drawn	£129m	£85m	£50m
Undrawn	Fully drawn	Fully drawn	£5m
Maturity	Jul-31	Jul-32	01/05/2024
Interest rate	3.25%	4.38%	Libor +1.5%
Commitment fee	N/A	N/A	0.60%

Source: Picton Property Income, Edison Investment Research

The interest saving on the original £80m tranche of the Canada life facility is £0.7m pa. Allowing for the additional £49m of fixed-rate borrowing, RCF repayment and RCF commitment fees, annualised finance costs increase by c £0.4m. Reflecting the still relatively low level of market rates, at H122 the fair value of Picton's £165m fixed-rate debt at the time was c £200m, although this will have narrowed since as market rates have begun to increase. The redemption fee to reset the interest rate on the £80m tranche is £4m, equivalent to a modest 0.8p reduction in the end-Q322 EPRA NTA per share of 112.8p.

Positive leasing activity

At the extensively refurbished Stanford Building in Long Acre in Covent Garden, where the office accommodation had already been let, the ground and basement retail units have been let to an international fashion retailer for 10 years, subject to break, commencing in May. The rent of £0.5m pa is 22% ahead of the March 2021 ERV[2] and the incentive package is less than one year's rent. This was Picton's largest retail sector void and we estimate that its retail sector assets are now very close to being fully occupied (H122: 91%).

Within the industrial sector, the Swiftbox distribution centre in Rugby has been let for 10 years, subject to break. Following an extensive refurbishment, the unit was let on a short lease at the height of the pandemic and Picton was able to commence the new long-term lease the day after the previous occupant vacated. The new agreed rent of £0.7m pa is 11% ahead of both the previous passing rent and the March 2021 ERV.

At the 180 West George Street, Glasgow office building, one of the two vacant floors has been let to an engineering consultancy, subject to break, at an agreed rent of £0.2m pa, 28% of the March

[1] The RCF has been used to fund recent investments including the October 2021 acquisition of Madleaze Trading Estate in central Gloucester for £13.1m and in February 2022 the adjacent Mill Place Trading Estate for £10.4m. The acquisition prices of each reflected a net initial yield of 6.1% with significant reversionary potential.

[2] Externally assessed estimated rental value.

2021 ERV. Also in the office sector, at 50 Farringdon Road, EC1, following a heating and cooling system upgrade that increased the energy performance certificate (EPC) rating from D to B, a lease due to expire later this year has been extended, retaining £0.6m pa of rental income at 2% ahead of the March 2021 ERV.

Exhibit 2: Financial summary

Year end 31 March (£m)	2018	2019	2020	2021	2022e	2023e
	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Rents receivable, adjusted for lease incentives	41.4	40.9	37.8	36.6	39.2	40.2
Other income	1.4	1.1	1.2	1.5	0.3	0.3
Service charge income	5.9	5.7	6.7	5.3	5.5	5.6
Revenue from properties	48.8	47.7	45.7	43.3	45.0	46.1
Property operating costs	(2.6)	(2.3)	(2.3)	(2.4)	(2.5)	(2.7)
Property void costs	(1.8)	(1.4)	(3.0)	(2.2)	(1.9)	(2.0)
Recoverable service charge costs	(5.9)	(5.7)	(6.7)	(5.3)	(5.5)	(5.6)
Property expenses	(10.3)	(9.4)	(12.0)	(9.9)	(10.0)	(10.3)
Net property income	38.4	38.3	33.6	33.5	35.0	35.8
Administrative expenses	(5.6)	(5.8)	(5.6)	(5.4)	(5.6)	(6.0)
Operating Profit before revaluations	32.9	32.5	28.1	28.1	29.4	29.9
Revaluation of investment properties	38.9	10.9	(0.9)	12.9	92.0	12.7
Profit on disposals	2.6	0.4	3.5	0.9	0.0	0.0
Operating Profit	74.4	43.7	30.7	41.8	121.5	42.6
Net finance expense	(9.7)	(9.1)	(8.3)	(8.0)	(8.0)	(8.0)
Debt repayment fee	0.0	(3.2)				
Profit Before Tax	64.7	31.4	22.4	33.8	113.5	34.6
Taxation	(0.5)	(0.5)	0.1	0.0	0.0	0.0
Profit After Tax (IFRS)	64.2	31.0	22.5	33.8	113.5	34.6
Adjust for:						
Investment property valuation movement	(38.9)	(10.9)	0.9	(12.9)	(92.0)	(12.7)
Profit on disposal of investment properties	(2.6)	(0.4)	(3.5)	(0.9)	(0.0)	0.0
Exceptional income /expenses	0.0	3.2	0.0	0.0	0.0	0.0
Profit After Tax (EPRA)	22.6	22.9	19.9	20.1	21.5	21.9
Fully diluted average Number of Shares Outstanding (m)	539.7	541.0	546.2	546.8	546.8	546.3
EPS (p)	11.89	5.75	4.14	6.20	20.80	6.34
EPRA EPS (p)	4.19	4.25	3.66	3.68	3.94	4.01
Dividend declared per share (p)	3.43	3.50	3.25	2.93	3.45	3.60
Dividends paid per share (p)	3.400	3.500	3.500	2.750	3.375	3.575
Dividend cover (x) EPRA EPS/DPS declared	122%	121%	113%	126%	114%	111%
Dividend cover (x) - paid dividends	122%	121%	105%	134%	117%	112%
EPRA cost ratio including direct vacancy costs)	23.7%	22.9%	28.3%	26.9%	25.3%	26.0%
BALANCE SHEET						
Fixed Assets	670.7	676.1	654.5	669.5	782.5	802.9
Investment properties	670.7	676.1	654.5	665.4	778.0	798.4
Other non-current assets	0.0	0.0	0.0	4.1	4.5	4.5
Current Assets	50.6	39.5	41.2	42.9	39.6	35.3
Debtors	19.1	14.3	17.6	19.6	19.0	18.0
Cash	31.5	25.2	23.6	23.4	20.6	17.3
Current Liabilities	(22.3)	(23.3)	(20.4)	(19.9)	(20.0)	(20.0)
Creditors/Deferred income	(21.6)	(22.5)	(19.5)	(18.9)	(19.1)	(19.1)
Short term borrowings	(0.7)	(0.8)	(0.9)	(0.9)	(1.0)	(1.0)
Long Term Liabilities	(211.7)	(192.8)	(166.0)	(164.4)	(178.1)	(178.5)
Long term borrowings	(210.0)	(191.1)	(164.2)	(162.7)	(176.4)	(176.8)
Other long-term liabilities	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)	(1.7)
Net Assets	487.4	499.4	509.3	528.2	623.9	639.7
NAV/share (p)	90	93	93	97	114	117
Fully diluted EPRA NTA/share (p)	90	93	93	97	114	117
CASH FLOW						
Operating Cash Flow	35.1	34.8	21.4	26.0	30.9	31.6
Net Interest	(9.1)	(8.6)	(7.9)	(7.5)	(7.5)	(7.6)
Tax	(0.3)	(0.8)	0.1	0.1	0.0	0.0
Net cash from investing activities	(17.8)	10.3	25.0	(1.3)	(20.5)	(7.8)
Ordinary dividends paid	(18.5)	(18.9)	(19.0)	(15.0)	(18.4)	(19.5)
Debt drawn/(repaid)	9.2	(22.6)	(27.2)	(1.8)	13.3	0.0
Net proceeds from shares issued/repurchased	(0.9)	(0.4)	6.1	(0.6)	(0.5)	0.0
Other cash flow from financing activities						
Net Cash Flow	(2.4)	(6.3)	(1.6)	(0.2)	(2.7)	(3.3)
Opening cash	33.9	31.5	25.2	23.6	23.4	20.6
Closing cash	31.5	25.2	23.6	23.4	20.6	17.3
Debt as per balance sheet	(210.7)	(192.0)	(165.1)	(163.7)	(177.4)	(177.7)
Un-amortised loan arrangement fees	(3.4)	(2.7)	(2.3)	(2.6)	(2.2)	(1.8)
Closing net (debt)/cash	(182.5)	(169.5)	(143.9)	(142.8)	(158.9)	(162.3)
Net LTV	26.7%	24.7%	21.7%	20.9%	20.1%	20.0%

Source: Picton Property Income historical data, Edison Investment Research forecasts

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