

# Town Centre Securities

Robust performance while delivering strategy

Trading update

Town Centre Securities (TCS) will release its results for the year ending 30 June 2019 (FY19) on 24 September. Despite the tough retail environment, in a trading update the company states that the year ended in line with expectations. We expect a robust recurring earnings performance and an unchanged but fully covered and attractive dividend yield. The year saw continuing progress with the strategy of repositioning the portfolio away from retail and recycling capital into more attractive opportunities, including the group's significant pipeline of development opportunities.

Year end	Net revenue (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NAV/share* (p)	DPS (p)	P/NAV (x)	Yield (%)
06/17	19.4	7.0	13.2	359	11.5	0.57	5.6
06/18	19.3	6.9	13.0	384	11.8	0.53	5.8
06/19e	20.1	6.4	12.1	353	11.8	0.58	5.8
06/20e	20.4	6.6	12.4	354	12.1	0.58	5.9
06/21e	21.3	7.3	13.8	359	12.5	0.57	6.1

Note: \*EPRA EPS is adjusted to exclude revaluation movements, disposal gains/(losses) on investment property and exceptional items.

## FY19 recurring income in line with expectations

The board expects FY19 results in line with its, and we believe the market's, expectations. Like-for-like passing rents increased by 2.6% with overall occupancy at 96%, a similar level to H119 and up from 95% at end-FY18. The car parking operation, CitiPark, continued to grow revenues and profits. With a lack of exposure to the big high street names in its retail portfolio, and a tenant profile that includes a number of strong covenants (including Waitrose and Morrisons), TCS has avoided the worst of the retail sector problems. The fast re-letting of most of the vacated properties, on favourable terms, is a positive indicator for the quality of the portfolio. We leave our recurring earnings forecasts unchanged but trim our NAV by c 3% in line with continued market weakness in retail valuations.

## Active strategy for income and growth

As a family run business, TCS has a strong focus on dividends and has increased or maintained DPS in each of the last 58 years, while investing for growth. To achieve this, it recycles capital and actively manages its assets and in the past two to three years has significantly repositioned the portfolio to reduce income risk, particularly in relation to retail exposure, and unlock value from development opportunities. By H119 retail and leisure assets had fallen to 52% of the total (2016: 70%) and management signals it will continue this process. An extensive pipeline of potential development projects from within the existing portfolio represents a substantial growth opportunity for which the company continues to explore funding options. The estimated gross value, once funded and developed, is now estimated by management at more than £600m.

## Valuation: Strong dividend commitment

TCS has a strong dividend focus while continuing to invest for growth. Our forecast FY19 DPS represents a yield of almost 6%, fully covered by recurring earnings. The share price discount to EPRA NAV is more than 40%.

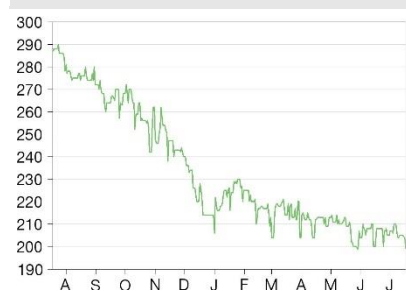
Real estate

18 July 2019

**Price** 204p  
**Market cap** £108m

Net debt (£m) at 31 December 2018 (excluding finance leases)	182.4
Net LTV at 31 December 2018	46.8%
Shares in issue	53.1m
Free float	48%
Code	TOWN
Primary exchange	LSE
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	(4.3)	(6.6)	(30.7)
Rel (local)	(6.5)	(7.0)	(29.2)
52-week high/low		290p	199p

### Business description

Town Centre Securities is a UK real estate investment trust operating across the UK, but with a regional focus, primarily in Leeds, Manchester, Scotland and (mainly suburban) London. It also has a car parking operation (CitiPark). The investment portfolio is intensively managed for income and capital growth.

### Next events

Final results	24 September 2019
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### Analysts

Martyn King	+44 (0)20 3077 5745
Andrew Mitchell	+44 (0)20 3681 2500

[financials@edisongroup.com](mailto:financials@edisongroup.com)

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## Further details from the trading update

### Like-for-like rental growth of 2.6%

The re-letting of the retail asset on Main Street at Milngavie is the main driver of the improvement. Previously occupied by Homebase, which gave notice to vacate in late 2017, the unit was sub-divided and has been let to Aldi and Home Bargains. The rent of c £0.6m pa has been increased by 8% and the valuation has increased by 23% on its end-FY18 level.

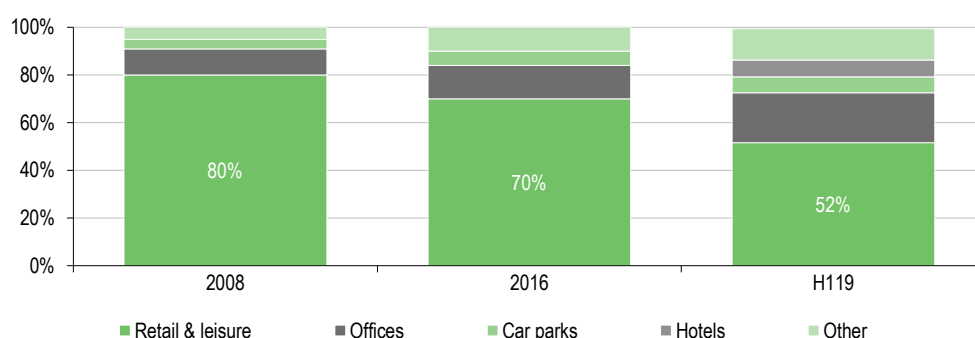
### Relatively modest impact from retail sector stress

Over the past year, eight tenants have gone into administration or launched a CVA, a similar number to the trailing 12-month total reported with the interim results, indicating the continuing but manageable effect of the tough retail environment. Three of the eight units affected over the past 12 months have been re-let to new tenants and a further three have seen the incumbent retailer choose to remain at the same rent. The two remaining void units, accounting for c 0.5% of the total rent roll, are in the process of being re-let. Those properties that have been re-let, or where the incumbent retailer has remained, have actually seen a small (1%) increase in base rent. Including temporary voids and lease incentives and other letting costs we would expect a similar negative income statement impact in H219 to the £0.25m impact reported in H1.

### Portfolio repositioning

Management has actively recycled capital in the past three years to significantly reposition and diversify the portfolio. The portfolio weighting to regional offices, hotels, and residential property has increased with a corresponding reduction in retail and leisure exposure to 52% by value at end-H119 compared with 70% at end-FY16.

**Exhibit 1: Increasing portfolio diversification**



Source: Town Centre Securities

Significant developments in FY19 included the previously reported sale of the Rochdale Retail Park for £13.2m in January 2019 and the acquisition of the Cube, a mixed use asset opposite the Merrion Centre in Leeds, for £12.0m in October 2018. Since the interims, TCS has achieved practical completion of its private residential sector (PRS) development at Burlington House in Manchester. The company says the scheme has been well received and was more than 50% rented within a month of completion.

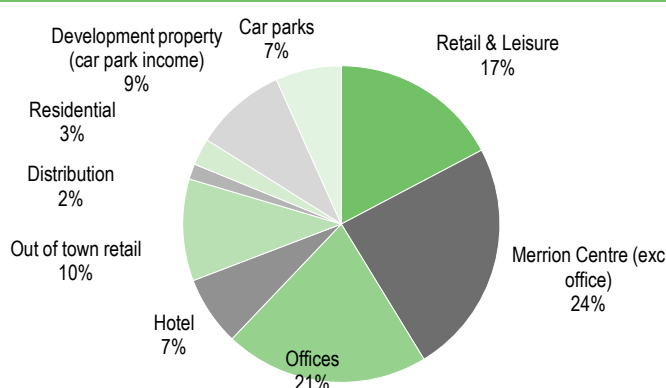
Although TCS is managing the stress in the retail sector well, it sees no early change in market conditions and plans further retail sector divestment and portfolio repositioning. We believe that reinvestment may take the form of acquisitions with greater expected growth and value-add potential, further diversifying the portfolio, or further investment in the group's pipeline of

development opportunities where the estimated gross development value has now increased to more than £600m.

## Forecasts and valuation

We are making no changes to our recurring income forecasts, set out in detail [here](#) but we will review these when FY19 results are published in September. With those results we would expect management to provide more detail on its intentions to further reposition the portfolio away from retail. Given the higher yields attaching to retail assets and the potential for disposals ahead of reinvestment it is likely that near-term (ie FY20 onwards) income will be negatively affected but the aim will be to reinvest in areas with stronger rental growth and total return prospects.

**Exhibit 2: Portfolio split by value at 31 December 2018**



Source: Town Centre Securities

Our previously published forecasts explicitly excluded any assumption of property revaluation movements given the uncertainty of doing so. Our last published FY19 NAV forecast of £193m (363p per share) compares with the Bloomberg consensus of £187m (353p per share). Given management's comments that the performance is in line with expectations, and in light of the further evidence of continuing weakness in retail sector valuations, we have trimmed our FY19 NAV forecast by £5m and NAV per share to 353p. The £5m equates to a c 1.4% reduction in the H119 portfolio value or a c 2.5% reduction in the value of the retail and leisure assets (52% of the total portfolio, comprising the retail and leisure, out of town retail, and Merrion Centre retail and leisure segments shown in Exhibit 2).

For FY20 and FY21 we continue to make no assumption regarding further revaluation movements.

**Exhibit 3: Forecast revisions**

	Net revenue (£m)			EPRA EPS (p)			DPS declared (p)			EPRA NAV/share (p)			LTV (%)		
	New	Old	% change	New	Old	% change	New	Old	% change	New	Old	% change	New	Old	% change
06/19e	20.1	20.1	0.0	12.1	12.1	0.0	11.8	11.8	0.0	353	363	(2.6)	48.2	47.6	1.4
06/20e	20.4	20.4	0.0	12.4	12.4	0.0	12.1	12.1	0.0	354	363	(2.6)	50.4	49.8	1.3
06/21e	21.3	21.3	0.0	13.8	13.8	0.0	12.5	12.5	0.0	359	369	(2.5)	51.8	51.2	1.2

Source: Edison Investment Research

In Exhibit 4 we show a share price performance and valuation summary of companies that we consider to be a group of peers to TCS, taken from within the broad property sector. The group includes companies focused on regional property as well as those with retail exposure.

Over the past 12 months the TCS share price performance has been weaker than the group average, which we ascribe to poor investor sentiment towards retail exposure. In the past three months it has more closely tracked the average despite a continuing poor performance from the purer retail plays, with significant shopping centre exposure, such as Capital & Counties, Hammerson and Intu.

In terms of valuation TCS provides an attractive yield, with a strong management commitment to dividends and an alignment of interest between management and shareholders. Additionally, its regional focus (Leeds and Manchester), increasingly diversified portfolio and significant development opportunities for further growth are all potential catalysts for a re-rating, in our view.

**Exhibit 4: Peer comparison table**

	Price (p)	Market cap. (£m)	P/NAV (x)	Yield (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
Capital & Regional	18	131	0.31	13.4	22%	-26%	-64%	-64%
Custodian	119	486	1.11	5.5	1%	3%	-3%	-3%
Hammerson	279	2135	0.38	9.3	-1%	-17%	-48%	-48%
Helical	378	453	0.78	2.7	-3%	9%	9%	-7%
Intu	75	1014	0.26	6.1	-13%	-28%	-58%	-63%
McKay Securities	230	217	0.71	4.3	-6%	-5%	-12%	-19%
Mucklow	645	408	1.13	3.6	-1%	24%	16%	-2%
NewRiver	170	521	0.60	12.6	-10%	-30%	-38%	-41%
Palace Capital	285	131	0.68	6.7	-3%	0%	-18%	-21%
Picton	94	516	1.02	3.7	-1%	3%	1%	-6%
Real Est Inv	57	105	0.82	6.4	4%	5%	5%	-9%
Regional REIT	107	399	0.93	7.5	-2%	1%	13%	-3%
St Modwen	428	951	0.88	1.7	0%	5%	6%	-5%
Schroder REIT	57	297	0.83	4.5	2%	-3%	-8%	-15%
<b>Average</b>			<b>0.74</b>	<b>6.3</b>	<b>-1%</b>	<b>-4%</b>	<b>-14%</b>	<b>-22%</b>
<b>Town Centre Securities</b>	<b>205</b>	<b>109</b>	<b>0.57</b>	<b>5.7</b>	<b>2%</b>	<b>-3%</b>	<b>-29%</b>	<b>-30%</b>
UK property index	1,691			4.0	1%	-2%	-8%	-8%
FTSE All-Share Index	4,098			4.5	2%	1%	-3%	-4%

Source: Company data, Edison Investment Research. Note: Based on last reported EPRA NAV and trailing 12-month DPS declared. Prices as at 17 July 2019.

**Exhibit 5: Financial summary**

Year ending 30 June (£000's)	2015	2016	2017	2018	2019e	2020e	2021e
<b>INCOME STATEMENT</b>							
Gross revenue	22,714	26,265	27,540	30,178	31,479	31,922	33,077
Total property expenses	(5,248)	(7,661)	(8,148)	(10,896)	(11,403)	(11,497)	(11,794)
Net revenue	17,466	18,604	19,392	19,282	20,076	20,425	21,283
Administrative expenses	(5,321)	(5,493)	(6,295)	(6,574)	(7,302)	(7,219)	(7,385)
Other income	1,468	599	707	888	625	400	400
Valuation movement on investment properties	14,791	3,018	(2,085)	5,932	(16,227)	0	0
Reversal of impairment of car parking assets	0	500	1,000	1,300	(300)	0	0
Profit on disposal of investment property	236	1,140	303	1,677	(856)	0	0
Share of post-tax profits from joint venture	2,621	1,400	1,342	3,757	1,025	1,045	3,445
Operating profit	31,261	19,768	14,364	26,262	(2,960)	14,650	17,743
Net finance costs	(7,258)	(7,847)	(7,639)	(7,887)	(7,984)	(8,068)	(8,333)
PBT	24,003	11,921	6,725	18,375	(10,944)	6,582	9,410
Tax	0	0	0	0	0	0	0
Net profit	24,003	11,921	6,725	18,375	(10,944)	6,582	9,410
Adjustments to EPRA:							
Valuation movement on investment properties	(14,791)	(3,018)	2,085	(5,932)	16,227	0	0
Reversal of impairment of car parking assets	(5,013)	(500)	(1,000)	(1,300)	300	0	0
Valuation movement on properties held in joint ventures	0	(668)	(471)	(2,561)	0	0	(2,100)
Profit on disposal of investment/development properties	(236)	(1,140)	(303)	(1,677)	856	0	0
(Profit)/Loss on disposal of investment properties held in joint ventures	2,488	0	0	0	0	0	0
EPRA earnings	6,451	6,595	7,036	6,905	6,439	6,582	7,310
Average number of shares (m)	53.2	53.2	53.2	53.2	53.2	53.2	53.2
Basic & fully diluted IFRS EPS (p)	45.2	22.4	12.7	34.6	(20.6)	12.4	17.7
Basic & fully diluted EPRA EPS (p)	12.1	12.4	13.2	13.0	12.1	12.4	13.8
DPS declared (p)	10.44	11.00	11.50	11.75	11.75	12.10	12.45
<b>BALANCE SHEET</b>							
Investment properties	336,982	346,388	349,266	359,734	349,055	355,055	362,055
Investment in joint ventures	19,344	25,093	27,852	39,742	12,833	24,108	34,883
Goodwill	4,024	4,024	4,024	4,024	4,024	4,024	4,024
Other non-current assets	1,214	2,151	3,922	3,669	4,025	4,025	4,025
Total non-current assets	361,564	377,656	385,064	407,169	369,937	387,212	404,987
Investments (listed equities)	1,962	2,070	2,394	3,530	4,478	4,478	4,478
Non-current assets held for sale	3,450	0	0	0	0	0	0
Trade & other receivables	6,871	7,388	3,311	6,288	3,760	3,900	3,937
Cash & equivalents	1,515	0	3,124	5,473	9,340	7,676	2,910
Total current assets	13,798	9,458	8,829	15,291	17,578	16,054	11,325
Total assets	375,362	387,114	393,893	422,460	387,514	403,266	416,311
Trade & other payables	(11,857)	(11,496)	(10,846)	(20,278)	(12,532)	(13,001)	(13,122)
Financial liabilities	(38,668)	(887)	0	0	0	0	0
Total current liabilities	(50,525)	(12,383)	(10,846)	(20,278)	(12,532)	(13,001)	(13,122)
Non-current financial liabilities	(141,959)	(184,874)	(191,969)	(198,057)	(187,100)	(202,100)	(212,100)
Total liabilities	(192,484)	(197,257)	(202,815)	(218,335)	(199,632)	(215,101)	(225,222)
Net assets	182,878	189,857	191,078	204,125	187,882	188,164	191,089
Period end shares in issue (m)	53.2	53.2	53.2	53.2	53.2	53.2	53.2
NAV per share (p)	344	357	359	384	353	354	359
<b>CASH FLOW</b>							
Net cash flow from operating activity	2,191	5,656	10,108	6,348	6,487	6,765	6,950
Investment in investment properties	(37,045)	(17,014)	(23,246)	(2,859)	(29,398)	(6,000)	(7,000)
Proceeds from disposal of investment property	26,821	16,050	21,574	7,534	17,204	0	0
Purchase of fixtures, equipment and motor vehicles	(532)	(1,496)	(586)	(340)	(794)	(900)	(900)
Proceeds from sale of fixed assets	0	54	61	0	23	0	0
Investments and loans to JV	0	(4,916)	(4,250)	(8,809)	(211)	(10,500)	(7,900)
Distributions received from joint ventures	0	567	1,031	676	28,145	270	570
Proceeds from sale of joint ventures	0	0	0	0	0	0	0
Payment for the acquisition of non-listed investments	0	0	(1,950)	(175)	(385)	0	0
Cash flow from investing activity	(10,756)	(6,755)	(7,366)	(3,973)	14,584	(17,130)	(15,230)
Proceeds from borrowing	17,475	4,247	7,197	6,088	(10,957)	15,000	10,000
Dividends paid	(5,550)	(5,550)	(5,928)	(6,114)	(6,247)	(6,300)	(6,486)
Cash flow from financing activity	11,925	(1,303)	1,269	(26)	(17,204)	8,700	3,514
Change in cash	3,360	(2,402)	4,011	2,349	3,867	(1,664)	(4,765)
Opening cash	(1,845)	1,515	(887)	3,124	5,473	9,340	7,676
Closing cash	1,515	(887)	3,124	5,473	9,340	7,676	2,910
Bank overdraft	0	887	0	0	0	0	0
Cash as per balance sheet	1,515	0	3,124	5,473	9,340	7,676	2,910
Financial liabilities excluding finance leases	(176,147)	(181,281)	(187,507)	(193,595)	(182,656)	(197,656)	(207,656)
Net debt	(174,632)	(181,281)	(184,383)	(188,122)	(173,316)	(189,980)	(204,746)
Net LTV	49.7%	49.5%	49.3%	47.5%	48.2%	50.4%	51.8%

Source: Town Centre Securities, Edison Investment Research

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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