

# Custodian Property Income REIT

Strong leasing has delivered targeted dividends

Q423 trading update

Custodian Property Income REIT (CREI) has met its 5.5p DPS target for the year to 31 March 2023 and, with property yields stabilising, the Q423 NAV total return was an income-driven 0.9%. Average rental values have continued to increase and this, combined with asset management opportunities and a strong balance sheet, provides strong ongoing support for the company's high-income strategy.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	NAV**/ share (p)	DPS (p)	P/NAV** (x)	Yield (%)
03/21	33.1	23.7	5.6	97.6	5.00	0.94	5.5
03/22	35.6	25.3	5.9	119.7	5.25	0.76	5.7
03/23e	37.8	24.8	5.6	99.3	5.50	0.92	6.0
03/24e	38.3	24.4	5.5	99.3	5.50	0.92	6.0

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

\*\*Defined as EPRA net tangible assets per share (EPRA NTA).

## Progress and opportunities but economic caution

Successful leasing activity, at an average 5% ahead of estimated rental value (ERV), supported income and valuations during Q423. EPRA occupancy improved to 90.3% (Q3: 89.9%). ERV increased by a like-for-like 1.4% during the period and now exceeds passing rent by 16%, providing a wide range of opportunities to further grow income and add value. Income is substantially protected from rising interest rates, with 81% of debt fixed cost with an average maturity of seven years, while Q4 loan to value (LTV) was a moderate 27.4%. Q4 EPRA EPS of 1.4p took the FY23 total to 5.6p, covering DPS by 1.02x. For FY24 the company targets aggregate DPS of a minimum 5.5p. Property market valuations showed an improving trend through the first quarter of 2023, reflected in CREI's moderate 0.7% like-for-like valuation decline. NAV per share fell marginally to 99.3p (Q3: 99.8p). Despite the Q4 progress we have moderated our FY24 expectations, reflecting broad economic pressures, with FY24e EPRA EPS of 5.5p (previously 5.9p), fully covering DPS of 5.5p (previously 5.6p).

## Income at the core of the strategy

CREI is focused on delivering attractive and stable dividend returns from an actively managed, well-diversified portfolio of UK commercial real estate. Within this, it is differentiated by a principal focus on properties with smaller individual values ('lot sizes') of less than £15m at the point of investment. These typically provide a yield premium over larger assets, partly the result of a broader range of potential occupiers, while attracting less competition from larger institutional investors. Average NAV total return since the company listed in 2014 is 4.9% pa, with unbroken dividend payments accounting for 98% of the total.

## Valuation: Consistent income returns

The FY23 fully covered DPS of 5.5p represents an attractive yield of 6.0%. The discount to NAV has closed to 7%, versus c 25% for close peers, but is still below the average 3% premium since listing.

Real estate

24 May 2023

**Price** **91.5p**

**Market cap** **£403m**

Net debt (£m) at 31 March 2023 (excluding restricted cash) 168.1

Net LTV at 31 March 2023 27.4%

Shares in issue 440.9m

Free float 91.8%

Code CREI

Primary exchange LSE

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (0.5) (0.5) (7.6)

Rel (local) 1.1 1.5 (9.3)

52-week high/low 110p 83p

### Business description

Custodian Property Income REIT is a London Main Market-listed REIT focused on smaller lot-size (<£15m) commercial properties across the UK regions outside London. It is income focused, with a commitment to pay a high but sustainable and covered dividend, with the potential for capital growth.

### Next events

FY23 results announcement Expected June 2023

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## The relative stability of income return has been significantly boosted by capital growth in FY22

With some optimism returning to the UK commercial property market during the first quarter of CY23, following the sharp and fast re-pricing to higher interest rate expectations in the second half of 2022, income returns more than offset a moderate reduction in NAV during CREI's Q4.

**Exhibit 1: FY23 quarterly NAV returns**

Pence per share (p) unless stated otherwise	Q123	Q223	Q323	Q423	FY23*
	Jun-22	Sep-22	Dec-22	Mar-23	Mar-23
Opening NAV per share	119.7	122.2	113.7	99.8	119.7
Closing NAV per share	122.2	113.7	99.8	99.3	99.3
Dividends paid per share	1.4	1.4	1.4	1.4	5.5
<b>Dividend return</b>	<b>1.1%</b>	<b>1.1%</b>	<b>1.2%</b>	<b>1.4%</b>	<b>4.6%</b>
Capital return	2.1%	-7.0%	-12.2%	-0.5%	-17.1%
<b>NAV total return</b>	<b>3.2%</b>	<b>-5.8%</b>	<b>-11.0%</b>	<b>0.9%</b>	<b>-12.5%</b>

Source: Custodian Income REIT data, Edison Investment Research. Note: \*FY23 unaudited.

The unaudited quarterly data indicate an FY23 return from dividends paid of 4.6% but an NAV total return of -12.5% after NAV reduction resulting from property revaluation losses. This was the only year of negative NAV total return since listing, despite the COVID-19 pandemic.

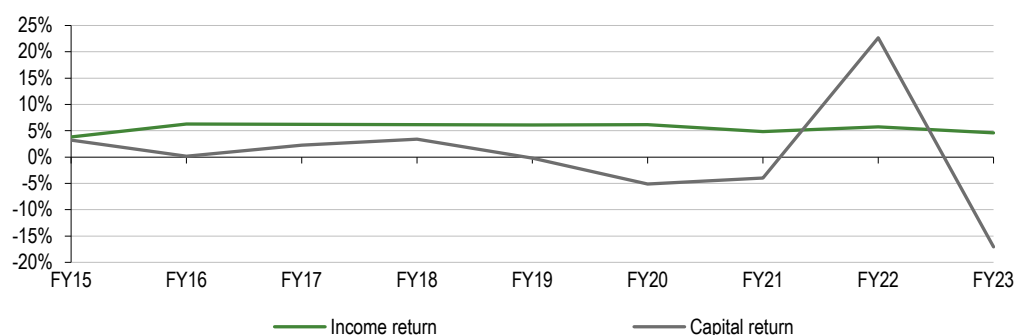
**Exhibit 2: NAV total returns since listing**

Pence per share (p) unless stated otherwise	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	March-14 to March-23
	2015	2016	2017	2018	2019	2020	2021	2022	2023*	
Opening NAV per share	98.2	101.3	101.5	103.8	107.3	107.1	101.6	97.6	119.7	98.2
Closing NAV per share	101.3	101.5	103.8	107.3	107.1	101.6	97.6	119.7	99.3	99.3
Dividends paid per share	3.750	6.350	6.350	6.425	6.525	6.625	4.913	5.625	5.500	52.1
Dividend return	3.8%	6.3%	6.3%	6.2%	6.1%	6.2%	4.8%	5.8%	4.6%	53.0%
Capital return	3.2%	0.2%	2.2%	3.4%	-0.2%	-5.2%	-4.0%	22.7%	-17.1%	1.1%
<b>NAV total return</b>	<b>7.0%</b>	<b>6.4%</b>	<b>8.5%</b>	<b>9.6%</b>	<b>5.9%</b>	<b>1.0%</b>	<b>0.9%</b>	<b>28.4%</b>	<b>-12.5%</b>	<b>54.1%</b>
<b>Average annual return</b>										<b>4.9%</b>

Source: Custodian Income REIT data, Edison Investment Research. Note: \*FY23 unaudited.

Dividend returns have accounted for 98% of CREI's NAV total return since listing and the relative stability versus more volatile capital returns can be seen clearly in Exhibit 2. Across the broad UK commercial property market, income returns have historically accounted for c 70% of property returns through the cycle.

**Exhibit 3: Relative stability of income returns**



Source: Custodian Income REIT data, Edison Investment Research

Exhibit 4 shows a reconciliation of the quarterly movements in NAV. Both NAV and NAV per share were slightly (0.5%) lower in Q423. For the year, NAV was 17.1% lower. With dividends fully covered by EPRA earnings, the decline in NAV resulted from property valuation movements.

**Exhibit 4: FY23 quarterly NAV development**

	Q123	Q223	Q323	Q423	FY23e
£m unless stated otherwise	Jun-22	Sep-22	Dec-22	Mar-23	Mar-23*
<b>Opening NAV</b>	<b>527.6</b>	<b>538.7</b>	<b>501.4</b>	<b>440.0</b>	<b>527.6</b>
Movement in property values	11.4	(39.2)	(61.5)	(2.2)	(91.5)
o/w asset management	6.9	1.4	3.0	2.6	13.9
o/w other valuation movement	4.5	(40.6)	(64.5)	(4.8)	(105.4)
Profit/(loss) on disposal	1.3	3.4	(0.1)	(0.2)	4.4
Acquisition costs	(1.6)	(1.8)	0.0	0.0	(3.4)
EPRA earnings	6.1	6.4	6.3	6.1	24.9
Dividends paid	(6.1)	(6.1)	(6.1)	(6.1)	(24.4)
<b>Closing NAV</b>	<b>538.7</b>	<b>501.4</b>	<b>440.0</b>	<b>437.6</b>	<b>437.6</b>
NAV per share (p)	122.2	113.7	99.8	99.3	99.3
EPRA EPS (p)	1.4	1.4	1.5	1.4	5.6

Source: Custodian Income REIT data, Edison Investment Research. Note: \*FY23 unaudited.

Compared with Q323, when the main UK commercial property indices showed the largest quarterly decline on record, Q423 showed considerable stabilisation with asset management/leasing continuing to make a positive impact. The £2.2m or 0.7% like-for-like decline in values was net of a £2.6m or 0.4% increase from asset management. During Q423, new leases, lease renewals and rental uplifts added £2.5m pa of income.

During the year to end-FY23, CREI experienced an 11.8% decline in property values, which compares favourably with c 17% for the broad UK market. Factors highlighted by the company are its focus on smaller regional assets, leaving it less exposed to some of the 'hot' sectors in 2022 (eg prime logistics), and the diversified nature of its portfolio.

Including £5.8m invested in the development and refurbishment of existing assets and a small (c £0.5m) disposal, the portfolio value increased modestly in Q423, by £0.8m.

The end-FY23 portfolio EPRA net initial yield was 5.8% and an equivalent yield was 7.3%, demonstrating the further opportunity to increase rental income and enhance value.

**Exhibit 5: Quarterly movements in property valuation**

	Q123	Q223	Q323	Q423	Q123	Q223	Q323	Q423	Q123	Q223	Q323	Q423
	Jun-22	Sep-22	Dec-22	Mar-23	Jun-22	Sep-22	Dec-22	Mar-23	Jun-22	Sep-22	Dec-22	Mar-23
	Sector position (£m)				Valuation movement (£m)				Like-for-like valuation movement (%)			
Industrial	339.6	327.3	291.6	295.1	6.2	(22.6)	(36.0)	1.4	1.9%	-7.1%	-11.0%	1.0%
Retail warehouse	144.8	147.3	135	131.8	4.8	(7.5)	(11.5)	(0.3)	3.8%	-6.0%	-8.0%	0.0%
Other*	87.8	77.2	74.3	78.6	0.9	(2.7)	(4.6)	0.9	1.4%	-3.5%	-6.0%	1.0%
Office	74.5	83.4	73.9	71.7	(0.4)	(5.0)	(7.1)	(3.3)	-0.4%	-5.7%	-9.0%	-4.0%
High street retail	53.1	50.2	38	36.4	(0.1)	(1.4)	(2.3)	(0.9)	-0.5%	-2.8%	-6.0%	-3.0%
<b>Portfolio total</b>	<b>699.8</b>	<b>685.4</b>	<b>612.8</b>	<b>613.6</b>	<b>11.4</b>	<b>(39.2)</b>	<b>(61.5)</b>	<b>(2.2)</b>	<b>1.7%</b>	<b>-5.4%</b>	<b>-9.1%</b>	<b>-0.7%</b>

Source: Custodian Income REIT data. Note: \*Other comprises drive-through restaurants, car showrooms, trade counters, gymnasiums, restaurants and leisure units.

## Progress and opportunities but economic caution reflected in our forecasts

Despite the consistent leasing progress through the year, the unaudited FY23 EPRA earnings are slightly (1.4%) below our forecast. Ahead of the FY23 results, which we expect will be published in June (FY22: 17 June 2022), we have provisionally reduced our FY24 earnings forecast by £1.7m or 6.5%, reflecting a range of factors including property disposals, slower underlying rent-roll growth in what remains a challenging market environment, inflationary cost growth and slightly higher costs on the floating rate borrowings. On this basis, we expect a flat but fully covered DPS of 5.5p (previously 5.6p).

**Exhibit 6: Forecast update**

£m unless stated otherwise	Forecast		Previous forecast		Change			
	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
Gross rental income	40.9	42.3	41.9	43.4	(0.9)	(1.2)	-2.2%	-2.7%
Non-recoverable property costs	(3.1)	(4.0)	(4.0)	(4.1)	0.9	0.1		
Net rental income	37.8	38.3	37.9	39.3	(0.1)	(1.1)	-0.2%	-2.8%
Administrative expenses	(6.3)	(6.3)	(6.2)	(5.8)	(0.2)	(0.4)	2.6%	7.3%
Net Interest	(6.6)	(7.6)	(6.5)	(7.4)	(0.1)	(0.2)	2.0%	2.5%
<b>EPRA earnings</b>	<b>24.8</b>	<b>24.4</b>	<b>25.2</b>	<b>26.1</b>	<b>(0.4)</b>	<b>(1.7)</b>	<b>-1.4%</b>	<b>-6.5%</b>
Realised & unrealised property gain/(losses)	(89.9)	0.0	(93.8)	0.0	4.0	0.0		
IFRS earnings	(65.0)	24.4	(68.6)	26.1	3.6	(1.7)		
<b>EPRA EPS (p)</b>	<b>5.6</b>	<b>5.5</b>	<b>5.7</b>	<b>5.9</b>	<b>(0.1)</b>	<b>(0.4)</b>	<b>-1.4%</b>	<b>-6.5%</b>
IFRS EPS (p)	(14.7)	5.5	(15.6)	5.9	0.8	(0.4)		
<b>DPS declared (p)</b>	<b>5.50</b>	<b>5.50</b>	<b>5.50</b>	<b>5.60</b>	<b>0.0</b>	<b>(0.1)</b>	<b>0.0%</b>	<b>-1.8%</b>
<b>Dividend cover (x)</b>	<b>1.02</b>	<b>1.01</b>	<b>1.04</b>	<b>1.06</b>				
EPRA NTA (p)	99.3	99.3	98.5	98.9	0.8	0.5	0.8%	0.5%
EPRA NTA total return	-12.5%	5.6%	-13.1%	6.0%				
LTV	27.4%	28.4%	28.9%	29.8%				

Source: Edison Investment Research

**Exhibit 7: Financial summary**

Year end 31 March, £m	2020	2021	2022	2023e	2024e
<b>PROFIT &amp; LOSS</b>					
Gross rental income	40.0	38.7	39.0	40.9	42.3
Non-recoverable property costs	(1.9)	(5.6)	(3.4)	(3.1)	(4.0)
Net rental income	38.1	33.1	35.6	37.8	38.3
Administrative expenses	(4.8)	(4.6)	(5.5)	(6.3)	(6.3)
Operating Profit before revaluations	33.4	28.5	30.1	31.5	32.0
Revaluation of investment properties	(25.9)	(19.6)	94.0	(91.5)	0.0
Costs of acquisitions	(0.6)	(0.7)	(2.3)	(3.4)	0.0
Profit/(loss) on disposal	(0.1)	0.4	5.4	5.1	0.0
Operating Profit	6.8	8.6	127.2	(58.4)	32.0
Net Interest	(4.7)	(4.8)	(4.8)	(6.6)	(7.6)
Profit Before Tax	2.1	3.7	122.3	(65.0)	24.4
Taxation	0.0	0.0	0.0	0.0	0.0
Profit After Tax	2.1	3.7	122.3	(65.0)	24.4
Net revaluation of investment property/costs of acquisition	26.4	20.3	(91.7)	94.9	0.0
Gains/(losses) on disposal	0.1	(0.4)	(5.4)	(5.1)	0.0
EPRA earnings	28.7	23.7	25.3	24.8	24.4
Average Number of Shares Outstanding (m)	409.7	420.1	428.7	440.9	440.9
IFRS EPS (p)	0.5	0.9	28.5	(14.7)	5.5
EPRA EPS (p)	7.0	5.6	5.9	5.6	5.5
Dividend per share (p)	6.65	5.00	5.25	5.50	5.5
Dividend cover (x)	1.04	1.13	1.10	1.02	1.01
Ongoing charges ratio (excluding property expenses)	1.12%	1.12%	1.20%	1.29%	1.38%
NAV total return	1.1%	0.9%	28.4%	-12.5%	5.6%
<b>BALANCE SHEET</b>					
Fixed Assets	559.8	551.9	665.2	613.6	624.4
Investment properties	559.8	551.9	665.2	613.6	624.4
Other non-current assets	0.0	0.0	0.0	0.0	0.0
Current Assets	30.7	9.9	16.8	14.8	10.4
Debtors	5.3	6.0	5.2	8.6	7.6
Cash	25.4	3.9	11.6	6.3	2.8
Current Liabilities	(14.9)	(12.8)	(39.9)	(17.9)	(17.8)
Creditors/Deferred income	(14.9)	(12.8)	(17.2)	(17.9)	(17.8)
Short term borrowings	0.0	0.0	(22.7)	0.0	0.0
Non-current Liabilities	(148.9)	(139.2)	(114.5)	(172.8)	(179.2)
Long term borrowings	(148.3)	(138.6)	(113.9)	(172.3)	(178.6)
Other long term liabilities	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)
Net Assets	426.8	409.9	527.6	437.6	437.8
NAV/share (p)	101.6	97.6	119.7	99.3	99.3
EPRA NTA/share (p)	101.6	97.6	119.7	99.3	99.3
NAV total return	1.1%	0.9%	28.4%	-12.5%	5.6%
<b>CASH FLOW</b>					
Operating Cash Flow	31.0	23.8	32.6	27.6	32.0
Net Interest	(4.4)	(4.5)	(4.5)	(6.3)	(7.2)
Tax	0.0	0.0	0.0	0.0	0.0
Net additions to investment property	(12.2)	(10.1)	26.6	(37.0)	(10.0)
Ordinary dividends paid	(27.0)	(20.6)	(24.2)	(24.3)	(24.2)
Debt drawn/(repaid)	10.5	(10.1)	(25.1)	35.3	6.0
Proceeds from shares issued (net of costs)	25.0	0.0	0.5	0.0	0.0
Other cash flow from financing activities	0.0	0.0	1.7	0.0	0.0
Net Cash Flow	22.9	(21.5)	7.7	(4.6)	(3.4)
Opening cash	2.5	25.4	3.9	11.6	7.0
Closing cash	25.4	3.9	11.6	7.0	3.6
Debt as per balance sheet	(148.3)	(138.6)	(136.6)	(172.3)	(178.6)
Unamortised loan arrangement fees	(1.7)	(1.4)	(1.2)	(1.2)	(0.9)
Total debt	(150.0)	(140.0)	(137.8)	(173.5)	(179.5)
Restricted cash	(0.9)	(1.2)	(1.1)	(1.7)	(1.7)
Closing net debt	(125.5)	(137.3)	(127.3)	(168.2)	(177.6)
Net LTV	22.4%	24.9%	19.1%	27.4%	28.4%

Source: Custodian Income REIT historical data, Edison Investment Research forecasts

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