EDISON

Town Centre Securities

Trading update

Adding resilience and recycling for growth

Real estate

As a family run business, Town Centre Securities (TCS) has a strong focus on dividend returns and has increased or maintained DPS in each of the last 58 years, while investing for growth. H119 saw further progress with ongoing portfolio repositioning, targeting increased income resilience while recycling capital to unlock the sizeable future growth and diversification opportunity in the development pipeline. Retail & leisure assets have reduced to 52% of the total from 70% in 2016. We will review our estimates with the interim results in February, but note that a handful of retail tenant failures are likely to have a modest negative impact on near-term income while retail capital values appear to be softening.

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	0.63	5.0
06/18	19.3	6.9	13.0	384	11.8	0.59	5.2
06/19e	20.5	6.8	12.9	392	11.8	0.58	5.2
06/20e	20.9	7.2	13.5	399	12.1	0.57	5.3
06/21e	21.2	7.6	14.3	418	12.5	0.55	5.5

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

Progress with strategy

H119 saw TCS continue to unlock the value of its development pipeline, particularly focused on offices and residential assets, manage a challenging retail environment, and grow car parking profits. Occupancy increased to 96% (FY18: 95%), with passing rent up 0.9% y-o-y on a l-f-l basis, supported by the updated long let to Leeds City Council of Merrion House, also the subject of an innovative refinancing. The £13.2m sale of a Rochdale retail park further reduced retail & leisure exposure, resulting in a greater focus on more resilient supermarket and convenience retailing. Retail & leisure CVAs and insolvencies have affected 2.5% of the rent roll in the past 12 months, but the majority of affected units have already been re-let at higher rents to quality tenants.

We will review estimates with interim results

H119 progress on capital recycling and with the development pipeline is consistent with our medium-term forecasts, which capture only a small element of the larger opportunity. Compared with our existing current year forecast, the Rochdale disposal will crystallise a small (c £0.8m) loss on disposal, while retail tenant turnover is likely to be a modest drag (c £250k) on income through temporary voids and related costs, despite the re-letting at higher rents. The valuation impact is uncertain and sector-wide retail values have softened, particularly for secondary high street assets and shopping centres, while Brexit remains a more general cause of uncertainty. We estimate that based on market consensus data, softening yields may affect our forecast FY19e NAV per share by c 19p (see page 4).

Valuation: Strong dividend track record

TCS yields a prospective 5.2% and shares trade at a significant discount to FY18 EPRA NAV of c 40%. A combination of income and capital growth is reflected in five-year annual average NAV total return (to end-FY18) of a compound 10.4%.

25 January 2019

Price	**228p**
Market cap	**£121m**

Net debt (£m) at 30 June 2018 (excluding finance leases)	192.6
Net LTV at 30 June 2018	47.5%
Shares in issue	53.2m
Free float	48%
Code	TOWN
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.6	(10.9)	(21.9)
Rel (local)	6.5	(9.5)	(12.7)
52-week high/low		296p	206p

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

Interim results	26 February 2018

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Edison profile page

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Further details and analysis

Rebalancing progress

Capital recycling is a key element of the TCS strategy and we estimate that since the beginning of FY17, the company has disposed of c 10% of the portfolio. This has freed capital from mature assets for strategic repurchases and investment in the development pipeline, while broadly maintaining profitability and increasing capital values. During this process, the portfolio (c £400m at end-FY18) has undergone a significant sector repositioning, becoming increasingly diversified and mixed use, and that process is continuing. Retail and leisure remains the single largest sector weight, but with the most recent purchase and sales activity, including the £13.2m disposal of the Rochdale Central Retail Park, it has been actively reduced to 52% (by value) compared with 55% at end-FY17 and 70% two years before that.

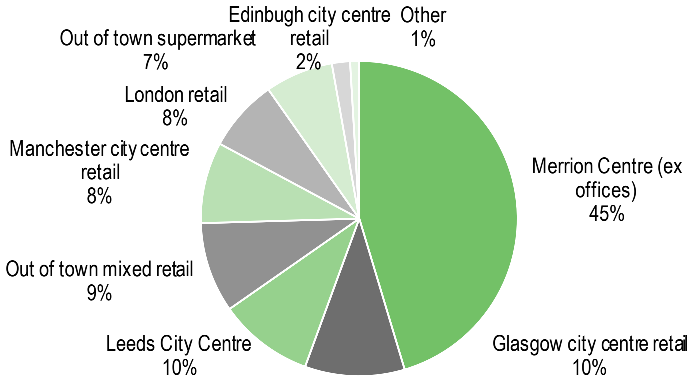
Reinvestment has included standing asset acquisitions and development projects from the significant pipeline of opportunities available to the company from its already owned asset base. These include delivery of the Merrion House office development (February 2018), the Premier Inn in Leeds (February 2017), and the ibis Styles hotel with restaurant (April 2017). Included in our medium-term forecasting, the Burlington House residential scheme is on track for practical completion in May 2019, to be followed by a second private residential sector (PRS) development, Eider House, where ground works are expected to commence this year, while the George St JV with Leeds City Council (aparthotel with ground floor units) has received detailed planning consent, with work also expected to commence this year.

In addition to the development projects captured by our forecasts, the further development opportunities that TCS has identified within its existing asset base represent a gross development value of well over £500m, with significant potential to further enhance earnings and NAV beyond that which we have forecast. Management continues to consider how quickly to proceed and how best to fund these, most likely to involve ongoing capital recycling and potential access to new capital resources. For a more detailed description and analysis, see our update note published on 12 October 2018.

Retail & leisure exposure more targeted as well as smaller

The retail and leisure portfolio itself has also become increasingly targeted by format and location. Exhibit 1 shows the end-FY18 position, which will have changed subsequently with the Rochdale sale and some other smaller transactions. The retail & leisure tenant base has retained its diversification, and although at end-FY18 the top 10 retail tenants represent 29% of the retail & leisure property income, almost half of this was accounted for by Waitrose and Morrisons, along with many other good-quality covenants. The proportion of more resilient supermarket and convenience retailing has increased with the Rochdale sale. The Merrion Centre is the largest individual retail & leisure destination, which in addition includes office and car parking space. It is well-placed in the centre of Leeds, and has been transformed over the past 10 years from a classical shopping centre to a truly mixed-use destination. Delivery of the Merrion House office development (February 2018) and the ibis Styles hotel with restaurant (April 2017) has continued the process, with reliance on traditional 'mall' retail falling to less than 25%. The 'mall' assets have a focus on convenience and discount formats, which has proved a successful positioning for the location, which includes a significant student population.

Exhibit 1: Spread of retail & leisure assets at 30 June 2018



Source: TCS. Note: Retail & leisure assets only, by value.

The Rochdale disposal will have no material impact on our existing income forecasts, which already assumed asset disposals and an annualised £1.1m rent roll impact (Rochdale: £1.15m). Similarly, our forecasts capture the previously announced acquisitions of The Cube in Leeds for £12.8m, a retail unit in Gordon Street, Glasgow, for £2.6m, and a retail/residential unit on Chiswick High Road, London for £1.7m. TCS says that in total these acquisitions will generate ongoing annual income of more than £1.4m, which allows for 2019 and 2020 lease expiries at The Cube.

Modest income impact from retail stress

TCS has seen some disruption from the recent wave of retail and leisure administrations, but says that active asset management will actually result in a rise in ongoing rents due to an enhanced mix of replacement tenants. It has been affected by eight CVAs or insolvencies from tenants in the past 12 months, involving eight units representing c 2.5% of the rent roll. By December 2018, six of these units had already been re-let to tenants including Iceland and The Works, at rents ahead of the previous levels. The two units most recently vacated, accounting for just c 0.5% of rent roll, are currently being actively marketed. The ability of TCS to re-let vacated space at a premium to previous rents is consistent with our medium-term forecasts, although in the near term, temporary void periods and related costs are likely to have a negative impact on income earnings, albeit relatively small. Based on a total rent roll of £23.4m at 30 June, the 2.5% of affected rents represents annualised rents of almost £600k. Allowing for a relatively fast re-letting of four months, the void period would represent rental income foregone of c £200k. Allowing for the loss of rechargeable property expenses, the total negative impact may well be c £250k.

More generally, across the entire portfolio, rent collection remains strong. Rents are mostly collected a quarter in advance and across the portfolio, and for H119 99% of rents were collected within a week of the quarter commencing.

Capital values have become more uncertain

Our forecasts typically make no assumption about yield shifts, but we do include a benefit from the assumed 1% pa rental growth across the portfolio, as well as expected development gains. With pressures on the broad retail sector increasing, and as already reported by a range of companies across the sector, we think it has become increasingly likely that the end-H119 (December 2018) valuations will have softened, at least for the TCS retail and leisure assets. For the wider portfolio, it is less easy to call, although increased Brexit and economic uncertainty presents an unhelpful backdrop. Exhibit 2 shows a summary of the last published Investment Property Forum consensus forecasts for autumn 2018. While continuing to predict positive all-property total returns through 2020, this is driven by income returns, with weaker capital values in all sectors but industrial properties (not an area in which TCS is active). The consensus was particularly negative on both rental value growth and capital value growth for the retail subsectors. For the three months ended December 2018, MSCI IPD reported all-property rental growth of negative 0.1% and capital growth of negative 0.2%. The weakness was driven by retail, negative 1.5% and 3.3% respectively.

Exhibit 2: Summary of Investment Property Forum UK consensus forecasts, autumn 2018

	Rental value growth (%)				Capital value growth (%)				Total return (%)			
	2018	2019	2020	2018/22	2018	2019	2020	2018/22	2018	2019	2020	2018/22
Office	0.8%	-0.3%	0.3%	0.8%	1.8%	-2.3%	-1.8%	-0.5%	6.0%	1.9%	2.5%	3.8%
Industrial	4.1%	2.6%	2.2%	2.6%	10.2%	2.7%	0.6%	2.8%	15.2%	7.4%	5.2%	7.5%
Standard retail	-0.6%	-0.8%	-0.2%	0.0%	-2.0%	-3.3%	-1.9%	-1.5%	2.1%	0.9%	2.4%	2.9%
Shopping centre	-1.3%	-1.5%	-0.9%	-0.8%	-6.6%	-5.4%	-3.2%	-3.6%	-2.2%	-0.6%	1.6%	1.3%
Retail warehouse	-1.1%	-1.1%	-0.4%	-0.4%	-3.7%	-3.9%	-1.9%	-2.0%	1.8%	1.6%	3.4%	3.6%
All property	**0.8%**	**0.2%**	**0.5%**	**0.8%**	**1.5%**	**-1.7%**	**-1.2%**	**-0.3%**	**6.2%**	**3.0%**	**3.5%**	**4.5%**

Source: IPF

Clearly, it is difficult to read across these observations directly to the TCS asset base, and the position will become clearer with the interim results. However, by way of indication of the potential impact of softening values, if we were to apply the 2018 consensus capital value growth forecasts to the core TCS portfolio (excluding development assets and car parks) of £331m at 30 June 2018, the negative impact would be £8.3m, reducing our end-FY19 NAV per share estimate of 392p by c 19p.

Exhibit 3: Illustrative valuation sensitivity

Sector	30 June 2018 valuation (£m)	Valuation movement (%)	Valuation movement (£m)
Retail & Leisure	67.6	-2%	(1.4)
Merrion Centre (exc office)	97.7	-7%	(6.4)
Offices	70.1	2%	1.3
Hotel	27.2	0%	0.0
Out of town retail	52.1	-4%	(2.1)
Distribution	5.8	5%	0.3
Residential	10.9	0%	0.0
Total investment properties	**331.4**	**3%**	**(8.3)**

Source: Edison Investment Research

Valuation update

The performance of the broad UK property sector has continued to track the overall market closely. Narrowing this down a little, Exhibit 4 compares the TCS valuation and share price performance with a group of companies focused on regional property investment and/or the retail sector. Two trends that stand out are:

- The continuing signs of investor preference for companies targeting recurring income (eg Picton and Custodian, both REITs), historically a less volatile component of total property return, compared with the sharp swings in property valuations observed across the cycle.
- The weakness of investor sentiment in respect of the retail sector, driving retail-focused stocks such as Capital & Regional, Hammerson, Intu and NewRiver to significant P/NAV discounts and very high yields, metrics that indicate a lack of confidence in current asset values and income/dividend sustainability.

The TCS share price performance significantly reflects the weaker trend of the purer retail plays but less acutely, particularly over the past three months. That still leaves the valuation (0.59x P/NAV and historical dividend yield of 5.2%) at a modest level relative to peers facing similar market-level uncertainties, with the share price performance not obviously reflecting some of the specific characteristics of TCS. We would highlight:

- The consistent track record of dividend payments, which at least in part we attribute to the family-controlled nature of TCS.
- The significant shift in portfolio positioning that should represent a material de-risking of future income.

- The significant reduction in LTV over the past year and through July, combined with increased financial flexibility to fund selected development projects.
- The scale of the opportunity contained in the group's already owned development pipeline which, subject to funding, has the potential to substantially lift the earnings and net asset position from that modelled. As the company considers how quickly to proceed with developments and how best to fund them, continued capital recycling and JVs will doubtless have a role to play, while additional equity is also an option. The latter may require family shareholders to reassess their position, but could benefit all shareholders if it brings a welcome increase in liquidity to the shares.

Exhibit 4: Peer comparison table

	Price (p)	Market cap (£m)	P/NAV* (x)	Yield** (%)	Share price performance			
					One month	Three months	12 months	From 12-month high
Capital & Regional	27	196	0.42	13.8	-10%	-35%	-52%	-53%
Circle Property	193	54	0.69	2.9	0%	-3%	17%	-25%
Custodian REIT	113	446	1.05	5.8	-3%	-6%	-4%	-8%
Hammerson	353	2705	0.45	7.3	5%	-17%	-29%	-39%
Helical	330	394	0.70	2.9	4%	7%	-6%	-17%
Intu	107	1447	0.31	13.1	-8%	-46%	-54%	-54%
McKay Securities	258	242	0.79	3.9	8%	-8%	8%	-11%
Mucklow	501	317	0.90	4.5	1%	-6%	-2%	-13%
NewRiver REIT	207	629	0.73	10.3	-1%	-20%	-35%	-35%
Palace Capital	303	139	0.72	6.3	-2%	-3%	-9%	-17%
Picton	84	455	0.92	4.1	-1%	-2%	-3%	-10%
Real Est Inv	52	96	0.73	6.8	0%	-5%	-6%	-17%
Regional REIT	98	365	0.86	8.1	7%	-3%	-4%	-4%
St Modwen	413	919	0.87	1.8	5%	12%	-1%	-4%
Schroder REIT	54	277	0.78	4.7	-4%	-11%	-17%	-21%
Average			**0.73**	**6.4**	**0%**	**-10%**	**-13%**	**-22%**
Town Centre Securities	228	121	0.59	5.2	10%	-11%	-22%	-23%
UK property index	1,643			5.3	5%	-3%	-9%	-13%
FTSE All-Share Index	3,759			4.7	3%	-1%	-10%	-13%

Source: Company data, Edison Investment Research. Note: *Last reported EPRA NAV per share. **Trailing 12-month DPS declared. Prices as at 24 January 2019.

Exhibit 5: Financial summary

Year ending 30 June (£000's)	2015	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT							
Gross revenue	22,714	26,265	27,540	30,178	31,687	32,388	33,056
Total property expenses	(5,248)	(7,661)	(8,148)	(10,896)	(11,233)	(11,477)	(11,846)
Net revenue	17,466	18,604	19,392	19,282	20,454	20,911	21,210
Administrative expenses	(5,321)	(5,493)	(6,295)	(6,574)	(6,865)	(7,022)	(7,183)
Other income	1,468	599	707	888	400	400	400
Valuation movement on investment properties	14,791	3,018	(2,085)	5,932	1,875	2,901	2,970
Reversal of impairment of car parking assets	0	500	1,000	1,300	0	0	0
Profit on disposal of investment property	236	1,140	303	1,677	0	0	0
Share of post-tax profits from joint venture	2,621	1,400	1,342	3,757	3,000	1,050	7,475
Operating profit	31,261	19,768	14,364	26,262	18,864	18,240	24,872
Net finance costs	(7,258)	(7,847)	(7,639)	(7,887)	(8,150)	(8,180)	(8,385)
PBT	24,003	11,921	6,725	18,375	10,714	10,060	16,487
Tax	0	0	0	0	0	0	0
Net profit	24,003	11,921	6,725	18,375	10,714	10,060	16,487
Adjustments to EPRA:							
Valuation movement on investment properties	(14,791)	(3,018)	2,085	(5,932)	(1,875)	(2,901)	(2,970)
Reversal of impairment of car parking assets	(5,013)	(500)	(1,000)	(1,300)	0	0	0
Valuation movement on properties held in joint ventures	0	(668)	(471)	(2,561)	(2,000)	0	(5,900)
Profit on disposal of investment/development properties	(236)	(1,140)	(303)	(1,677)	0	0	0
(Profit)/Loss on disposal of investment properties held in joint ventures	2,488	0	0	0	0	0	0
Refi costs					0	0	0
EPRA earnings	6,451	6,595	7,036	6,905	6,839	7,159	7,617
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	20.2	18.9	31.0
Basic & fully diluted EPRA EPS	12.1	12.4	13.2	13.0	12.9	13.5	14.3
DPS declared (p)	10.44	11.00	11.50	11.75	11.75	12.10	12.45
BALANCE SHEET							
Investment properties	336,982	346,388	349,266	359,734	368,671	377,571	392,541
Investment in joint ventures	19,344	25,093	27,852	39,742	18,842	28,842	37,342
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	3,669	3,669	3,669
Total non-current assets	361,564	377,656	385,064	407,169	395,206	414,106	437,576
Investments (listed equities)	1,962	2,070	2,394	3,530	3,530	3,530	3,530
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	3,525	3,625	3,640
Cash & equivalents	1,515	0	3,124	5,473	17,206	7,329	3,902
Total current assets	13,798	9,458	8,829	15,291	24,260	14,484	11,073
Total assets	375,362	387,114	393,893	422,460	419,466	428,590	448,649
Trade & other payables	(11,857)	(11,496)	(10,846)	(20,278)	(12,817)	(13,180)	(13,238)
Financial liabilities	(38,668)	(887)	0	0	0	0	0
Total current liabilities	(50,525)	(12,383)	(10,846)	(20,278)	(12,817)	(13,180)	(13,238)
Non-current financial liabilities	(141,959)	(184,874)	(191,969)	(198,057)	(198,057)	(203,057)	(213,057)
Total liabilities	(192,484)	(197,257)	(202,815)	(218,335)	(210,874)	(216,237)	(226,295)
Net assets	182,878	189,857	191,078	204,125	208,592	212,353	222,354
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	392	399	418
CASH FLOW							
Net cash flow from operating activity	2,191	5,656	10,108	6,348	8,318	7,273	6,984
Investment in investment properties	(37,045)	(17,014)	(23,246)	(2,859)	(29,415)	(6,000)	(12,000)
Proceeds for disposal of investment property	26,821	16,050	21,574	7,534	16,076	0	0
Purchase of fixtures, equipment and motor vehicles	(532)	(1,496)	(586)	(340)	(900)	(900)	(900)
Proceeds from sale of fixed assets	0	54	61	0	0	0	0
Investments and loans to JV	0	(4,916)	(4,250)	(8,809)	(3,500)	(10,000)	(2,600)
Distributions received from joint ventures	0	567	1,031	676	27,400	1,050	1,575
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)	0	0	0
Cash flow from investing activity	(10,756)	(6,755)	(7,366)	(3,973)	9,661	(15,850)	(13,925)
Proceeds from borrowing	17,475	4,247	7,197	6,088	0	5,000	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)	(6,247)	(1,300)	3,514
Change in cash	3,360	(2,402)	4,011	2,349	11,733	(9,877)	(3,427)
Opening cash	(1,845)	1,515	(887)	3,124	5,473	17,206	7,329
Closing cash	1,515	(887)	3,124	5,473	17,206	7,329	3,902
Bank overdraft	0	887	0	0	0	0	0
Cash as per balance sheet	1,515	0	3,124	5,473	17,206	7,329	3,902
Financial liabilities	(176,147)	(181,281)	(191,969)	(198,057)	(198,057)	(203,057)	(213,057)
Net debt	(174,632)	(181,281)	(188,845)	(192,584)	(180,851)	(195,728)	(209,155)
Net LTV	49.7%	49.5%	49.3%	47.5%	45.9%	47.4%	48.0%

Source: Company accounts, Edison Investment Research

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