

CUSTODIAN REIT PLC (LON:CREI)

Safety Pays

QUARTERLY VALUATION UPDATE

Custodian REIT PLC (LON:CREI) issued its quarterly NAV (net asset value) update for the three months ended September 30, on October 23. The company reported a NAV total return per share of 2.3% for the period (NAV increase plus dividend approved), and a reduction in net gearing to 20.5% loan-to-value, from 21.0% on June 30. Custodian acquired five new properties during the period with net initial yields of between 6.38% and 9.79%. More details are on p2.

DIVERSE AND RESILIENT PROPERTY PORTFOLIO

In pence-per-share terms, the NAV increased by 0.8p during the quarter. This represents an increase of 3.7p or 3.5% over the 12 months from September 2017. Furthermore, the company has maintained a target dividend per share of 6.55p to March 2019 up from 6.45p delivered in FY March 2018.

This has been achieved in spite of some macro pressures during the quarter, notably in the retail space where CVAs (company voluntary agreements) have affected many landlords, including some impact to Custodian; however, the resilient performance of the portfolio overall highlights some of the key strengths of Custodian's strategy – diversity in terms of geography and property type, and low tenant concentration with the top five tenants representing only 11.5% of income.

A SECURE DIVIDEND

We believe that Custodian REIT offers one of the most secure dividends in the sector. This is underpinned by low balance sheet gearing, a high weighted average unexpired lease term (WAULT) of 5.6 years, and a dividend consistently fully covered by earnings from rental income. We presented further details of these attributes in our report "Custodian REIT – Strong returns, strong foundations, May 29 2018".

The shares currently offer a forward-looking dividend yield of 5.4% and have exhibited impressive low volatility in recent months. We believe that Custodian REIT represents a haven in volatile market conditions due to its stable cash generation and distribution to shareholders.

Yr end March (£mln)	2017a	2018	2019e	2020e
Value of investment properties	415.8	528.9	579.5	631.1
Revenue from property	27.6	34.8	39.0	42.5
Underlying op. profit	22.1	28.8	32.3	35.2
EPRA EPS* (GBp)	6.59	6.94	7.10	7.36
DPS (GBp)	6.35	6.45	6.55	6.7
Dividend yield	5.3%	5.4%	5.4%	5.6%
Price/Book	1.08	1.12	1.06	1.03
Source: Capital Network				

DIVERSIFIED REITS

25/10/2018

SHARE PRICE	52 WEEK LOW
▲ 120.4p	▲ 103.0p
MARKET CAP	52 WEEK HIGH
▲ £471.0mln	▲ 120.6p
NET DEBT	NAV
▲ £108.3mln	▲ £427.5mln

MAJOR SHAREHOLDERS

- 1) Societe Generale Gestion 4.48%
- 2) Thames River Capital LLP 3.92%
- 3) Canaccord Genuity Wealth Ltd 3.72%

Shares in Issue	393.9mln
Avg Volume	492,796
Primary index	FTSE All Share
EPIC	LON:CREI
Next Key Announcement	November 2018: FY results to September 2018
Sector	Diversified REITs

SHARE PRICE CHART



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	Per share (p)	£-mln
Net asset value (NAV) at 30 June 2018	107.8	416.9
Issue of equity (net of costs)	0.2	8.3
Valuation movements relating to:		
Profit on property disposals	1.1	4.3
Asset management activity	0.5	2.2
Other valuation movements	-0.9	-3.7
	0.7	2.8
Acquisition costs	-0.3	-1.1
Net valuation movement	0.4	1.7
Income earned for the period	2.5	9.7
Expenses and net finance costs	-0.7	-2.8
Dividends paid	-1.6	-6.3
NAV at 30 September 2018	108.6	427.5

Source: Custodian REIT data

The table above summarises the NAV movement during the quarter.

The company reported an impact from CVA arrangements in the retail warehouse space, which contributed £3.2mln of the total £3.7mln negative move in “other valuation movements”. The line item “Asset management activity” includes rent reviews, new lettings, lease extensions and the retention of tenants beyond their contractual break clauses, and contributed a £2.2mln positive. In addition, the company generated £9.7mln in property income and £4.3m in capital gains on disposals, leading to an overall NAV increase of £10.6m or 0.8p per share.

The next table summarises the property acquisitions during the three months.

Location	Shrewsbury	Stafford + Shrewsbury	Derby	Sheffield
Property type	Car dealership	Car dealership	Industrial distribution	Office
Tenant	TJ Vickers (car dealer)	VW Group UK (car dealer)	Daher Aerospace	Government
Price (£-mln)	1.68	7.38	5.59	3.56
Net initial yield	6.75	6.38	6.72	9.79
Weighted average unexpired lease (years)	7	6	13	4

Source: Custodian REIT data

Net initial yield (NIY) is a measure of rental returns on investment, and the high level of NIY on the new acquisitions is an important indicator that Custodian is still able to identify investments with suitably high returns. The typical portfolio NIY for UK commercial property real estate investment trusts (REITs) is around 4-6%, whereas Custodian has a portfolio NIY of 6.6%, and the recent acquisitions actually have an even higher NIY.

In our report “Custodian REIT – Strong returns, strong foundations, May 29, 2018” we demonstrated that Custodian benefits from a focus on high yielding segments of the commercial property market, and in particular from a focus on small lot sizes, meaning principally below £10mln. These properties are overlooked by many REITs and institutional investors, and typically achieve a 20% yield premium according to industry data, i.e. if big units are delivering 5.5% rental yields then equivalent smaller units can achieve 6.6%, for example. We argue that the high rental yields are the key driver of Custodian’s ability to deliver a strong dividend yield without taking on higher risks such as higher balance sheet leverage.

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