

16 January 2020

Real Estate Services

52-WEEK HIGH	121.80p
52-WEEK LOW	111.00p
PRICE	113.80p
MARKET CAP MLN	£466.47
NET DEBT (MLN)	£112.00

Share Price



Major Shareholders

Shares in issue	412,503,344
Primary Index	FTSE AS

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Custodian REIT - Diverse portfolio still paying dividends

Dividend remains fully covered

Custodian REIT (LON:CREI) remains one of the best dividend/yield plays in the UK market going into the calendar year 2020, in our view. The company has recently released its interim report for the half-year period ending September 2019, confirming continued solid progress. During the period Custodian delivered a +0.5% net asset value (NAV) total return (NAV TR is an industry-standard measure of underlying property portfolio performance) with good performance in the industrial property portfolio offsetting negative revaluations in retail properties. The strategy of maintaining sectoral diversification (see chart p2) is an important risk limiter for Custodian.

Importantly the company delivered EPRA (European Public Real Estate) earnings per share (EPS) of 3.4p during the period, providing steady dividend cover for the 3.325p payout for the period. A definition of EPRA EPS can be found at EPRA.com, but essentially it is net rental income (no capital gains). We are confident in our forecast of continued dividend growth in the full-years (FY) to March 2020 and 2021, fully covered by EPRA EPS (see chart p2).

Additionally, Custodian extended its revolving credit facility from £35m to £50m with the interest rate margin above three-month London interbank offered rate (LIBOR) reduced from 2.45% to between 1.5% and 1.8%. This low funding cost is partly a reflection of Custodian's prudent level of balance sheet gearing. Gearing stood at 20.5% at 30 September and is now at 23% (by our estimate) following the acquisition of the warehouse portfolio from Menzies in October.

Strong rent-yielding portfolio sustains dividends

Custodian's strategy focuses on maintaining a diverse portfolio of properties with strong rental yields to sustain growing dividends to shareholders. Portfolio characteristics which support this strategy include:

- Commercial properties in high yielding sectors, with a focus on the regions (see chart p2).
- Small lot sizes – Custodian targets properties in the £2-10m range, which tend to offer better rental yields compared with larger lots, which are more sought-after by institutional investors.
- Targeting good-condition buildings with quality sitting tenants, minimising expenditure on refurbishment and re-letting.

Also, Custodian maintains a low level of central costs, meaning that a high proportion of rental income drops through to distributable net income.

Finally, we note that Custodian is a closed-ended real estate investment trust (REIT), meaning that it is not exposed to the selling pressure which has had an impact on some of the open-ended funds in the sector that have received negative publicity in recent months.

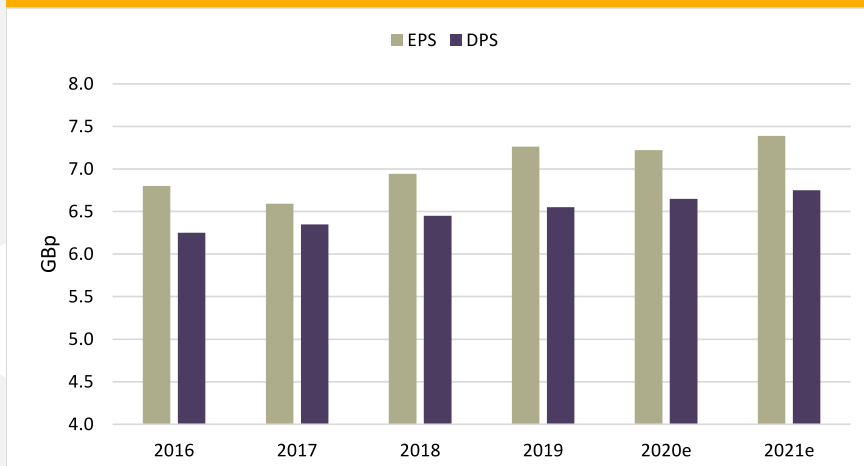
Year end Mar 31	2018	2019	Current	2021
Value of investment properties	528.9	572.7	584.2	604.2
Revenue from property (£M)	34.8	40.0	40.9	43.0
EPRA EPS (GBP)	6.9	7.3	7.2	7.4
DPS (GBP)	6.45	6.60	6.65	6.75
Dividend yield	5.68%	5.77%	5.85%	5.94%

Richard Shepherd-Cross, fund manager.

Shepherd-Cross is a chartered surveyor. He joined Mattioli Woods in 2009, and established Custodian Capital as a property fund management subsidiary to the group. In 2014 he led the business through its flotation as Custodian REIT PLC.

Alex Nix, assistant fund manager.

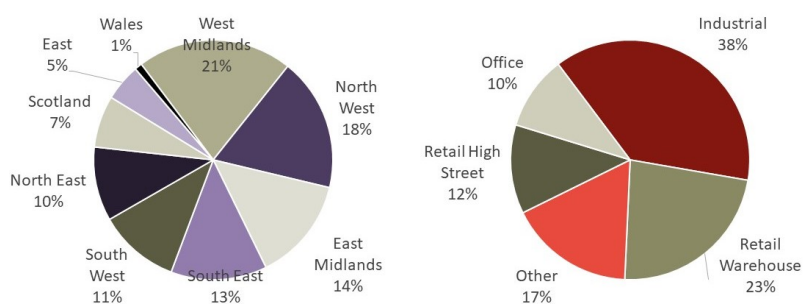
Nix joined Custodian Capital in 2012, having spent eight years with Lambert Smith Hampton. He holds a degree in real estate management, and qualified as a chartered surveyor in 2006.

Custodian dividends fully covered by EPRA EPS

Source: Proactive Research

The chart above shows Custodian's EPRA EPS and dividend payment, including our forecasts for 2020 and 2021. We argue that investors seeking dividend yield within the UK REIT space should be cautious of REITs that regularly pay their dividend out of capital, not fully covered by net rental income. Custodian has delivered steady dividend growth while maintaining full EPRA EPS (rental earnings) cover of the dividend.

The charts below show the breakdown of Custodian's rental income by region and by property sector. We note that the UK REIT space overall is overweight of London property and underweight of industrial property. In this sense, Custodian offers a good diversifier for investors in the UK REIT space.

Rental income by region and by property sector

Source: Custodian interim report to Sep 2019

Diverse property portfolio maintains strong returns and limits risk

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