



27 November 2019

**Market data**

EPIC/TKR	PCA
Price (p)	295
12m High (p)	360
12m Low (p)	265
Shares (m)	45.9
Mkt Cap (£m)	135.0
EV (£m)	236.9
Market	Main, LSE

Description

Palace Capital is a real estate investor, diversified by sector (office, industrial) and location, excluding London, and with minimal exposure to retail. There is an emphasis on city-centre locations. The York development site comprises 10% of assets.

Company information

Chairman	Stanley Davis
CEO	Neil Sinclair
CFO	Stephen Silvester
Executive director	Richard Starr

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www.palacecapitalplc.com**Key shareholders**

AXA	7.7%
Mitton	7.4%
J.O. Hambro	7.3%
Stanley Davis (Chairman)	3.6%

Diary

27 Dec	Div. paid (first as REIT)
Jun'20	Final results
Jul'20	AGM

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PALACE CAPITAL

1H'20 results announced

1H'20 results were announced on 19 November. Seventeen lease events have been completed. Impressively, these were 25% above passing rent and 3% above ERV (i.e. previous estimated valuers' levels). FY19 was struck 14% above passing rent. The total property return was 1.5%, outperforming the MSCI quarterly index. Early progress at the Hudson Quarter mixed-use development inside York city walls is slightly ahead of viability, with sales of 21 units in under 20 weeks (with seven additional under offer). This leads us to upgrade FY21E profits, NAV and cash significantly, but, with a view to the further delays to political certainty, we trim anticipated rental rises slightly.

- **1H'20 results:** These were in line with strong expectations. Macro-politics lead us to trim FY20E PBT by 3%. Regional offices, Palace Capital's largest sector, is resilient. Apartment sales in the mixed-use development, Hudson Quarter, York, saw strong performance. We have brought forward profit estimates into FY21.
- **Results and prospects:** The Chairman stated, "We are well ahead of our business plan at Hudson Quarter. With letting activity brisk on our other refurbishments, we are most encouraged despite the current political uncertainty." We therefore upgrade FY21E reported PBT to £20.25m, including Hudson Quarter profits.
- **Cash paid by a tenant for an early lease surrender is a further positive:** A lease event saw FY20 profit and cash upgraded. The tenant paid a £2.85m cash premium. The most recent valuation of these assets, notably, was only £2.2m. Economic value has been created. A sale of the remaining interest has now been agreed.
- **A track record of outperformance:** In the past three years, Palace Capital has beaten the benchmark each year. This is notwithstanding the cost of holding a development site generating no accounting returns yet. Development returns are not guaranteed but, over two years' timing, add more than 5% to NAV.
- **Risks:** The normal risks of real estate apply. The weighted average length of unexpired lease to break is 5.2 (4.5 in 1H'19) years. Covenants are resilient. Retail exposure (bar Wickes and Booker) is minimal. Gearing, at 34% (34% 1H'19) LTV, is conservative and, although it is rising, as the York development progresses, management has previously stated an intention to keep it below 40%.

Financial summary and valuation

Year-end Mar (£m)	FY17	FY18	FY19	FY20E	FY21E
Net income*	12.2	14.9	16.4	19.0	16.4
Finance cost	-3.0	-3.3	-3.7	-4.0	-4.0
Declared profit	12.6	13.3	6.4	3.6	20.2
EPRA PBT (adj. pre-revaluation)	6.4	7.5	8.6	11.0	8.2
EPS reported (diluted, p)	36.5	35.8	11.3	7.1	44.1
EPRA EPS (p)**	21.2	18.7	16.5	23.2	18.0
DPS (p)	18.5	19.0	19.0	19.0	19.0
Net cash/debt	-68.6	-82.4	-96.5	-108.8	-84.8
Dividend yield	6.3%	6.4%	6.4%	6.4%	6.4%
Price/EPRA NAV	66.6%	71.1%	72.5%	74.3%	69.7%
EPRA NAV (p)	443.0	414.8	406.6	396.8	423.0
LTV (loan-to-value)	37.3%	29.9%	33.8%	37.2%	30.1%

*post direct costs, **diluted, pre-share-based payments; Source: Hardman & Co Research

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1H'20 results

Even stronger on asset management

Good news on asset management...

Palace Capital has continued to add value through active asset management; evidence is the continuing signing of new leases above estimated rental value (ERV). Twelve lease renewals and five rent reviews completed at an average 3% above ERV, with a 25% uplift on previous passing rents. Nine new leases were concluded. This resulted in a total property return of 1.5% for the period, or 3.0% annualised.

York site's early performance ahead of "viability" budget

...and on important (10% of REIT assets)
York development

It is worth noting that 10% of the assets are invested in the ongoing Hudson Quarter, York, development. During the period, no revaluation gains (or income) were taken on this asset.

With a positive update regarding Hudson Quarter, York, we anticipate it to be strongly accretive to NAV for FY21 – a quicker timetable than earlier assumed – so we have brought some of the profit we anticipated for the half year to September 2021 into the full year ended March 2021. The positive update is clearly good news so far, and encouraging momentum has been established right from the start.

Development at Hudson Quarter, York

Operational progress at Hudson Quarter a
major, positive issue

We previously referred to the progress being "not discouraging", but the update accompanying the results has encouraged us that full delivery of profits from the site will be more rapid than earlier expected. Palace Capital has announced that, since launch in June, well over one apartment a week has been sold or is in legal conveyancing. This is important, positive news. The confirmation that costs and timing for physical construction are on time and on budget is as expected, but is still a reassuring factor. No mention is made of sales prices, but, with such strong sales rates "ahead of budget" on timing, we see no reason for any disappointment on gross development value.

We have brought forward our estimates
of at least £10m scheme profit

This has led us to move forward the anticipated benefits from our recent expectations of 1H'22 (i.e. the period ending September 2021). We now see the dominant part of the development being completed and cash-in by end-March 2021. Even so, to be conservative, we assume that ca.25% of the development's profits will not come through until early FY22.

Chairman states, "We are well ahead of
our business plan at Hudson Quarter"

Palace Capital has owned this site for over five years and worked towards optimising the saleability, reducing risk and optimising returns. It was bought as a mainly vacant office block as part of a portfolio sold by a vendor focusing on reducing debt. This is a mixed commercial and residential site, with minimal competing stock in either category. Construction started in February of this year, and the marketing launch was at the end of June. As stated by the Chairman, "At the end of June, we placed 20 apartments at Hudson Quarter, York, on the market and demand has been such that we have now sold 21 apartments with a further seven apartments under offer. We are well ahead of our business plan at Hudson Quarter."

Good property returns

New leases at above ERV – again

- ▶ As noted, 12 lease renewals and five rent reviews completed at an average 3% above ERV and with a 25% uplift on previous passing rents, creating £0.4m additional annual rental income. Nine new leases were concluded. These were significant, and totalled £0.5m of additional annual income. The last full year saw

The EPRA EPS rose at the headline level and also if a one-off beneficial event is excluded

Property returns modestly beat the benchmark – in part held back by refurbishment value-added not being recognised (rightly) until proven by new, enhanced leases

Leases lengthened

Dull markets, NAV modest reduction – better than many in sector

Two major assets seeking tenants have seen good legal commitments and new leases

Plenty of fire power

Clarity of earnings enhancements covering future dividend pay-outs

37 new leases completed, at 14% above ERV. It is reassuring that this past half year, which saw the baleful effects of Brexit on tenant decision-making, has witnessed Palace Capital's momentum maintained so well. We do, however, take note of the effect this may have as an ongoing feature for a number of future half years.

- ▶ The rent roll fell just under 1% to £16.3m p.a., with, for example, the early lease surrender at Priory House, Birmingham. All rent due on the entire length of the lease was remitted to Palace Capital, but this property is now off-rent. Net income post property costs stands at £14.8m p.a.
- ▶ EPRA EPS doubled to 14.5p, vs. 7.7p in the comparable six months to September 2018.
- ▶ Excluding the benefit of the lease surrender, adjusted EPRA EPS rose to 8.5p, from 8.0p in the comparable six months to September 2018. We are adjusting headline results downwards.
- ▶ The total property return was 1.5% over the half year, ahead of the MSCI UK Quarterly Index figure of 0.8%. The last full year's total property return was 7.1%, well ahead of the MSCI Index (the standard benchmark) figure of 4.6%. The total accounting return in the six months shows -1.5%.
- ▶ The weighted average unexpired lease term at end-September (year-end March 2019) was 5.2 years (4.5 years 1H'19) to first break and 6.6 years to expiry. Occupancy was down to 84%, from 87%; the fall was because of a deliberate policy of investment to drive long-term rent benefits.

Progress in the top 10 assets

Most of the largest assets are from occupancy usefully above 90%, but two are in the process of value-maximisation, which means balancing the filling of space (having been purchased with significant vacancies) with maximising rent. These two also benefit from a certain level of investment – funded in part by Palace Capital, and in part, properly, by dilapidations.

In the results announcement, there was a fuller update on most of the larger assets. The message is selective investment and also rental momentum. We highlight two where there is a plan in place to enhance income to a fairly substantial measure.

- ▶ 23,500 sq. ft. at Sol, Northampton, to Gravity Fitness for a minimum term of 10 years at a 17% premium to ERV. This takes occupancy at the scheme to 90%.
- ▶ 14,665 sq. ft. of space let at Boulton House, Manchester, bringing the asset to 82% occupancy, with 13,170 sq. ft. remaining to be let.

Balance sheet and cashflow

- ▶ EPRA NAV of 391p (407p March 2019).
- ▶ There was a loss on revaluation, of £6.2m on investment properties and net £0.5m on other investment assets.
- ▶ Cash available for investment stands at £34m, including £14m cash and the £20m revolving credit facility.
- ▶ LTV stood at 34%.



- ▶ The average cost of debt declined to 3.2% (3.3% at year-end March 2019). An increased revolving credit facility with NatWest was secured. This now stands at a facility of £40m and was extended for a further five years at a lower margin.
- ▶ Dividend cover was 150%, but this was with the benefit of a cash-backed lease surrender premium. Excluding the premium, cover was 90%. This ratio is set to rise towards above 100%.

Recycling capital

Palace Capital adds value to assets it owns through a combination of asset management and development. This combines to add cash from crystallising capital projects to the cash from EPRA income. This is the net rent income post all costs, including financing and administration overheads.

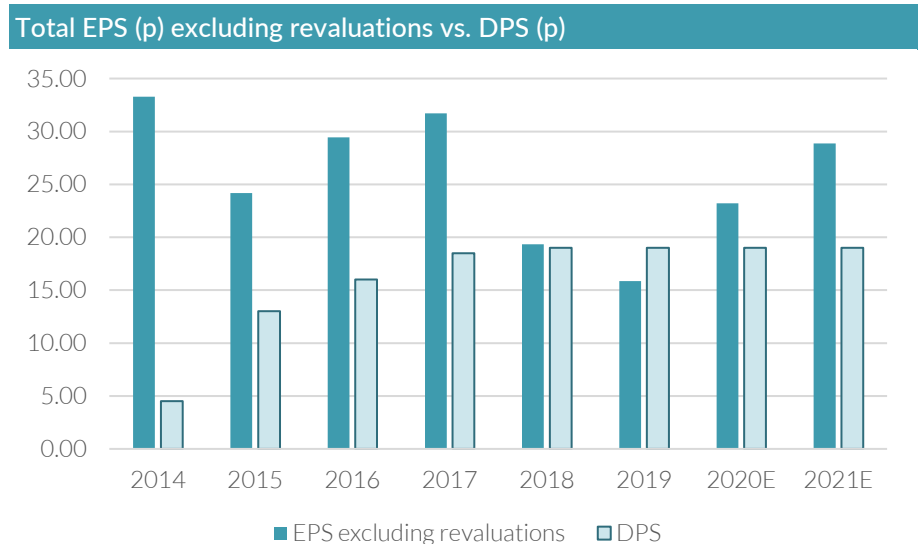
The true driver to dividend progression

We consider this combination to be the true driver to medium-term dividend prospects. In the chart below, we compare this annual “topped-up” hybrid cash earnings stream with the annual dividends.

Earnings stated on the chart are all cash-backed.

We look here at cash profits

Financial “fire power” for DPS progression clearly building now



*Note: tax rates are assumed pro-forma; ongoing tax is zero
Source: Palace Capital accounts, Hardman & Co estimates*

- ▶ There were £13.2m of disposals during the period, including remaining non-core residential units from the RT Warren Portfolio. Palace Capital has a policy of purchasing portfolios that fit its criteria and disposing of the minority segments that do not fit.
- ▶ There have been no material acquisitions for 11 months, and the focus is on securing the right redevelopment schemes on assets already held, as well as enhancing the rental stream on new or renewed leases.
- ▶ The policy is to maximise value, not maximise current-year rents. A good example might be the redevelopment at High Street, Weybridge, Surrey, listed below.

Successful policy is to maximise value, not maximise this year's income...

The RT Warren acquisition included some London residential assets. These have virtually all been sold – some in FY19 and some since year-end. There was a budgeted minor loss on the part-disposal of the RT Warren portfolio. As confirmed by Palace Capital with the results announcement: “We have achieved 98% of book value so far, which is well ahead of the business plan on acquisition.”

FY19 saw the acquisition of One Derby Square, Liverpool, for £14.0m, and Palace Capital states this comes “with considerable asset management opportunities.”

Palace Capital assesses its own assets to determine where the most appropriate capital deployment lies. 249 Midsummer Boulevard, Milton Keynes, is one of several where the risk of investment is reduced significantly by already being in possession of a good, yielding asset, but one that can also be “worked-up”.

With regard to 249 Midsummer Boulevard, Milton Keynes, Palace Capital states it is “currently evaluating a major development of this site and we intend to make appointments to move forward with a planning application in the near future. We have already received a preliminary report indicating that the site is capable of a scheme with a floor area of more than double the existing property.”

...Weybridge an excellent example of this

Another example among several would be 41-45 High Street, Weybridge, Surrey. Planning consent was secured in July 2019 for 4,000 sq. ft. of retail space and 28 apartments, and Palace Capital anticipates starting the development late next year. Here we have a prime site, but one that is now off-rent ahead of the value-creating redevelopment.

Forward estimates

Reversionary upside

End-1H'20 (end-FY19) ERV was unchanged, at £21.5m, usefully ahead of passing rent of £17.6m (£17.7m 1H'19). These figures exclude £0.9m rent potential from the Hudson Quarter, York, commercial assets. We estimate that ca.82% of the reversionary potential is in the office portfolio. With the strong fundamentals of this asset class, we are confident that the reversions will be achieved. We understand that well over half this upside is from reducing voids.

Strong regional office overweight

Fundamentals are driven by:

- ▶ Under-supply of regional offices (48% of the portfolio total). In the three years to 2017, between 1% and 2% of total office space was converted to residential in most cities in the north of England: Manchester, Leeds, Newcastle, for example. In the south of England, percentages typically were 2% to 5%, or higher still, as capital values justify the conversion costs (Source: Centre for Cities).
- ▶ Underlying positive market trends in its geographical areas of major exposure. Palace Capital has no central London exposure. No Palace Capital assets are on the high street or in out-of-town retail, apart from modest assets included as part of mixed-use assets.
- ▶ Execution of the broad range of specific asset management business plans. These are not pro-cyclical and are all designed expressly to raise returns. They also reduce the risks of future voids. They include small and larger projects, such as the rolling upgrade floor-by-floor at the Boulton House, Manchester, offices.

Asset management programmes

York: NAV uplift – we had anticipated not until FY22, but have now brought the majority into FY21

- ▶ Execution of the Hudson Quarter, York, development, which, we estimate, will add 20p to NAV. The anticipated total capital employed at peak (early 2021) is estimated at £55.8m. We anticipate the mixed commercial and residential sales proceeds to generate over £10m development profits in this robust location.
- ▶ Execution of redevelopment or significant additional space at sites held, such as Weybridge and Milton Keynes.

And more asset enhancement plans

- ▶ Recycling capital (from Hudson Quarter and other optimised assets). The Hudson Quarter site value is in the books at £24.2m, on top of which we anticipate £28.8m further build costs (£35m total build cost) and up to £4m other costs, comprising professional fees and capitalised interest cost. Cash generated will be available to reduce debt and/or invest in assets. It should be borne in mind that the commercial assets, which comprise part of the development, may be seen as attractive to either dispose of or retain.

Revenue account

FY20E

One Derby Square, Liverpool...

Palace Capital purchased One Derby Square, Liverpool, in December 2018, generating £0.9m annual rent. This will lead to an incremental £0.6m rental income in FY20E vs. FY19. Since 2014, Liverpool has lost over 1 million sq. ft. of office space, which has been converted to either residential or student accommodation

...welcome value uplift from lease surrender

The May 2019 early lease termination at Priory House, Birmingham, led to a £2.85m surrender premium, which is added to FY20E income. This early surrender has created economic value for Palace Capital; however, in our assuming nil income and void costs for FY20, we have reduced our forward estimates appropriately. Apart from this, we see overall ca.3% negative like-for-like rental income, reflecting the current

Some simple technical background

Set to be bumper year, with strong NAV uplift from York and new income from capital released

Negative revaluation of assets – we assume flat 2H'20 and slight FY21 uplift from asset management programmes

relatively difficult macroeconomic background. This, naturally, includes a mix of relatively small positives and negatives across the portfolio.

FY21E

The “headline” fall of £2.90m in total income allows for the absence of a £2.85m one-off income from Priory House in FY20E. The Priory House tenant paid for a lease surrender. We assume nil investment property acquisitions or disposals in this year, and assume no rise in underlying rental income. Our assumption is for headline rental levels in FY21 to rise minimally. The Investment Property Forum consensus estimates a 0.8% rise to March 2021. We assume no re-let for the Birmingham asset, Priory House, as the remaining lease is under offer to be sold and the benefits from refurbished space, such as (potentially) Manchester Boulton House, are continuing to see take-up. However, Weybridge is now yielding no income pending its development.

This year will benefit from Hudson Quarter, from disposals of residential units developed, and from a £2.5m revaluation of the site based on progress on the commercial segment of the asset, and there is also a strong possibility of a revaluation of residential stock not completed. The whole project is on schedule to complete physically by January 2021 but, at this stage, we hold back our anticipated full, final residential profit until FY22.

- ▶ We estimate £5.0m residential profits from units disposed in FY21.
- ▶ We estimate a £2.5m revaluation on commercial assets that we anticipate being physically completed (but may not be let) as of March 2021.

FY22E

We are not currently forecasting to FY22. It is also important to note that the development of Hudson Quarter, York, is ongoing and that we fully expect first profits to be taken in FY21. Hudson Quarter will generate free cash for investment. Note that the York development cost is capitalised in Palace Capital's accounts.

- ▶ We estimate £2.5m residential profits from units completing in FY22. Strong sales to date, and the project delivery being on time and to budget, bode well for this last element to come in time fully to benefit FY21 results.

Capital account

There is a modest negative revaluation of assets 1H'20. We assume no change in 2H'20 and a 1.5% positive revaluation (ex the Hudson Quarter, York, development uplift) in FY21, from a broadly unchanged rental position, but with benefits being recognised from refurbishment investment projects.

Palace Capital is investing in these major refurbishment projects (particularly Hudson Quarter) with an aim to enhance the REIT's cash generation and NAV. It is also investing in small asset management plans designed to make residual values robust, even before taking into account the reversionary potential that the valuers assess in the existing leases. As stated by the Chairman: “significant capital expenditure we have deployed across a number of different properties has not yet fully resulted in a corresponding uplift in property valuations due to the time lag between completing capital works and letting the refurbished space.” We illustrate Weybridge as one of several such projects that is material in the context of the size of the REIT. While the investment is supportive of robust residual values, the main aspect we look out for is rising cash-backed rental income. The company's statement backing the prospective results from such investment indicates good scope here.



Palace Capital

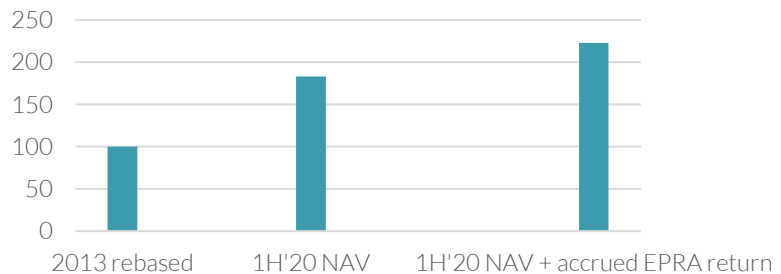
Hudson Quarter, York: uplift in FY21 and FY22 (mostly FY21), with estimated 75% being cash-backed profits on residential sales

With regard to Hudson Quarter, York, by 2022, the NAV uplift is estimated to total 20p per share from here. With the majority of the development being residential, this uplift (and working capital unwind) comes in the form of cash on the residential element.

Longer-term record

Palace Capital floated (reverse takeover, placing and £39.25m portfolio acquisition from Quintain) in 2013, and NAV has risen 83% to date

Returns since initial portfolio acquisition (rebased to 100)



Source: Palace Capital accounts

Mean EPRA total returns of 123% (annualised 14.6%) have been registered since the October 2013 initial major acquisition.

The total property return beat the MSCI Quarterly Benchmark again, and last year's result was 2.5% points ahead. This represents three successive years of outperformance.

Strategy

Conversion to REIT in August 2019

Investing and dedicating meaningful portion of assets to enhance future NAV growth

York an important element for long term

Its progress boosts NAV growth and also indicates strategic "second front" for further NAV acceleration on future projects

- ▶ Palace Capital's commitment to progressive dividends is supported even further by the conversion to a REIT.
- ▶ The company is investing to grow the NAV, as evidenced by the Hudson Quarter, York, development.
- ▶ Unwinding of the significant capital employed in York, allied to conservative LTV ratios, offers significant scope for capital recycling.
- ▶ Asset management is an important component of Palace Capital's total return, and the current portfolio offers a useful opportunity in this respect. It has positioned itself in an attractive mix of sectors.

The development at Hudson Quarter, York, is important – generating future liquidity through successful forward sales and underpinning significantly positive expectations for NAV in FY22 (or FY21) as the scheme completes. The initial sales bode particularly well, and so, while clearly nothing is guaranteed, the launch has demonstrated that in one and a half years' time, a useful step-jump in NAV is increasingly likely. As sales progress, the visibility of the NAV rise will continue steadily to build. In the meantime, the strong geographical and asset-class positioning, and the running yield above market levels, indicate a positive period up to the completion at Hudson Quarter.

We estimate a £20m full-year FY20 cash investment (funded from existing banking facilities) for the York development. FY21E includes a further £14m to the peak total intra-year outflow. We estimate the large majority of the anticipated total capital employed, £55.8m at its peak, to be returned in cash before March 2021. Profits will accrue in cash on top of this, and we estimate £10m, with 75% of the profits coming from residential apartment sales. Palace Capital has ample financial capacity to retain the commercial assets, which it intends to do. The assets should prove attractive to a long-term holder such as Palace Capital – and others. Medium term, we anticipate further development profits to contribute to overall profits.

Risks and mitigation – sector exposure

Palace Capital's exposure to offices stands at 48% (MSCI index weight 29.5%).

No individual tenant exceeds 6% of the total. The largest retail tenants comprise Wickes, Bravissimo, Aldi, Booker and Tesco. No shopping centres are owned.

We consider all of Palace Capital's major retail tenants to be solid. In terms of background, Bravissimo (an office tenant, albeit with a retail business) currently has 29 stores across the UK, and also sells via mail order, online and via a US website.

LTV ratios stood at 34% at the end of fiscal 2019. We believe the broad target LTV is 30%-40%, but assuming that York's Hudson Quarter proceeds to plan, the LTV on completion and exit of the York development will be under 30%. During the development of Hudson Quarter, LTV is expected to rise to manageable levels (40%), and it will ultimately reduce, through the value uplift and residential sales.

Hudson Quarter York's mixed-use developments, the majority of which are apartments, were commenced without residential pre-sales or pre-letting of the relatively modest commercial element. To date, sales are strong. The residential market here is also currently strong, and marketing is under way. Construction is being undertaken at a fixed-price contract, and it is running to time and budget. The greater risks tend to be "in the ground" – so the risks are now much reduced; however, construction is not complete.

All real estate sector investment brings location risk. Palace Capital mitigates this. It excludes London and chooses central, accessible locations with good underlying demand. We view these as assets with robust residual values – not simply good leases.

The assets owned offer value-for-money to occupiers and, as such, there is often a tight emphasis by the tenant on the rental levels. Mitigating this is the fact that the rent level will be a more modest part of total operating costs (whether offices or leisure, etc.) than would be the case for prime assets.

Assets purchased sometimes require areas of refurbishment (e.g. reception areas). This is the nature of the value-adding asset management policy. To fund this, however, the group requires either dilapidations to be deployed, or an element of Palace Capital "maintenance" capital – or a mix of both. Our cashflow and asset forecasts include an element of this, itemised.

A number of leases are of short duration. The overall WAULT – weighted average unexpired lease term – is not particularly relevant, as this is a granular investment portfolio. Assets that have reversionary potential, indeed, by definition, benefit from shorter WAULTs. Palace Capital's WAULT happens to be 5.2 years to tenant break option (at period-end).

Leisure might be considered a sector under pressure, and here the leases are mostly of long duration (see our analysis of top 10 assets in our previous research documents), thus anticipating and helping mitigating that risk. In order to support potential income increases, the Northampton asset, in particular, has asset enhancement programme plans, to widen the catchment area. Its WAULT is longer than the group average. There have been two significant new lets: in February, a 15-year lease was signed by a new yoga and fitness tenant; and a 10-year lease was agreed to Gravity Fitness. These take occupancy at the scheme to 90%.

Dividend cover has reduced but will return to being fully covered next year, according to Hardman & Co estimates. DPS growth will be constrained, we estimate, until the NAV and, importantly, income see an uplift upon completion of the York development.

The following Hardman & Co research documents have particular focus on certain assets within Palace Capital's top 10 holdings.

<https://www.hardmanandco.com/wp-content/uploads/2018/09/Palace-Capital-Initiation-of-coverage-28-September-2018-1.pdf>

<https://www.hardmanandco.com/wp-content/uploads/2018/11/Palace-Capital-Newcastle-November-2018.pdf>

<https://www.hardmanandco.com/wp-content/uploads/2019/03/Palace-Capital-21-March-2019.pdf>

<https://www.hardmanandco.com/wp-content/uploads/2019/05/Palace-Capital-Portfolio-and-trading-update-May-2019-1.pdf>

Financial performance

Revenue account							
Year-end Mar (£m)	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Rental, other income	8.64	14.59	14.27	16.73	18.75	20.80	18.30
Direct property costs	-1.20	-1.62	-2.06	-1.82	-2.32	-1.85	-1.95
Net income	7.44	12.97	12.21	14.91	16.43	18.95	16.35
Administrative expenses	-1.44	-2.05	-2.91	-4.18	-4.08	-4.00	-4.10
EPRA operating profit	6.00	10.92	9.30	10.73	12.35	14.95	12.25
Property revaluation	9.77	3.62	3.10	5.74	-0.89	-6.70	7.00
Profit on disposal, transaction costs	-0.46	-0.52	3.19	0.27	-0.36	0.00	5.00
Share-based payments	-0.11	-0.11	-0.24	-0.17	-0.33	-0.20	-0.20
Other income/costs	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Operating profit	15.20	13.91	15.35	16.57	10.77	8.05	24.05
Finance	-1.40	-2.26	-3.01	-3.26	-3.74	-4.00	-4.00
EPRA PBT (pre-revaluation, etc.)	4.60	8.66	6.45	7.47	8.61	10.95	8.25
Financial derivatives: change in fair value	0.00	0.00	0.00	-0.18	-0.93	-0.70	0.00
PBT as declared (pre-share-based)	13.91	11.76	12.58	13.31	6.43	3.55	20.25
Tax	0.00	-0.95	-3.19	-0.77	-1.26	-0.30	0.00
Deferred tax revaluations, capital allowances	0.10	0.00	2.20	0.00	0.00	0.00	0.00
EPRA PAT	4.70	7.71	5.46	6.53	7.35	10.65	8.25
EPRA EPS (p)	26.87	31.32	21.21	18.67	16.54	23.20	17.97
EPRA EPS (p, adj. post share-based payments)	26.24	30.87	20.28	18.18	15.82	22.77	17.54
EPRA plus cash profit on disposals: EPS (p)*	24.19	29.44	31.70	19.34	15.84	23.20	28.87
EPS (p, diluted, reported)	80.00	43.90	36.50	35.85	11.26	7.08	44.12
DPS (p)	13.00	16.00	18.50	19.00	19.00	19.00	19.00
Average shares issue (m)	17.49	24.62	25.74	34.98	45.90	45.90	45.90
Year-end shares issue (m)	20.23	25.78	25.23	45.80	45.90	45.90	45.90

All EPS figures are on diluted shares

**This figure is a Hardman & Co calculation and assumes the same tax rate on disposals as on the rest of the business – which is not necessarily reflecting actual tax splits. This figure also is stated pre-share-based payments.*

Source: Palace Capital accounts, Hardman & Co Research estimates

We highlight that Palace Capital's strategy is to enhance income streams by selecting the right assets, engaging in asset management programmes, and also devoting capital from time to time to developments. On this basis, we consider the management strategy – within the parameters of the REIT regime – to include development for profit. We therefore add a financial ratio, namely the EPS reflecting EPRA income plus cash-based disposal profits (excluding revaluations, therefore).

FY20E

No acquisitions assumed – disposals made since year-end

Note that the £11.0m disposal cash inflow has been largely achieved already – namely the balance of the RT Warren residential asset disposals. Headroom is available for acquisitions. We estimate a £20m full-year FY20 construction working capital investment for the York development. £6.2m was expended in 1H'20 (to end-September 2019).

FY21E

Positive considerations regarding Hudson Quarter, York...

...residential...

Note, with regard our cashflow estimates, that FY21 assumes significant further investment into the development at the Hudson Quarter, York, site. Most residential sales are estimated to complete (and cash received) shortly before March 2021 year-end. We estimate £5.0m residential profits to be secured in FY21. We had been anticipating full completion in early FY22, but it appears completion may likely be achieved in FY21. Our estimates still assume some completions in FY22.

FY21E includes £14m peak total *intra-year* outflow for the York development, and we estimate this will be the total (gross) outflow on this project to completion. The project

is progressing well in the construction phase, and sales have proven positive to date. The commercial phase is now being marketed to tenants.

...and commercial

As at end-March 2021, therefore, we assume Palace Capital will hold on its balance sheet ca.£15m of Hudson Quarter commercial property (physically complete), plus ca.£15m residential assets (physically recently completed, and awaiting finalisation of conveyancing).

Our estimates that some profits will be taken in FY22 may be too conservative as regards timescale

For FY21, we estimate a revaluation on the commercial portfolio averaging 10 basis points, or 1.5%. In addition, we anticipate a £2.5m revaluation for the commercial assets at Hudson Quarter, York.

FY22E

We plan to initiate FY22 estimates early in 2020. Our FY22 estimates will include an element of profit from final residential sales at Hudson Quarter, York. At this stage, we anticipate total residential profits from the development to amount to £7.5m – thus we would anticipate a figure of £2.5m for FY22.

Balance sheet

Balance sheet							
@ 31 March (£m)	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Investment properties	103.0	174.5	183.9	253.9	273.4	292.7	281.2
Long-term liabilities (deferred tax)	1.5	1.2	-2.1	-6.6	-5.6	0.0	0.0
Long-term debt	-36.6	-71.8	-77.7	-98.8	-119.4	-125.5	-100.4
Net current assets, excluding financial	0.3	-3.5	-3.7	-3.3	-2.7	-3.0	-3.5
Assets held for sale	0.0	0.0	0.0	21.7	11.7	0.0	0.0
Cash, deposits, short-term debt	11.9	6.3	9.1	16.3	22.9	16.7	15.7
Net cash (debt/finance lease)	-24.7	-65.4	-68.6	-82.4	-96.5	-108.8	-84.8
Net assets (NNNAV)	80.0	106.8	109.6	183.3	180.3	180.9	193.0
EPRA net assets	80.0	106.8	111.8	190.0	187.1	182.1	194.2
NAV/share (p)	395.6	414.3	434.2	400.2	392.8	394.2	420.4
EPRA NAV/share (p)	395.6	414.3	443.0	414.8	406.6	396.8	423.0
LTV	24.0%	37.5%	37.3%	29.9%	33.8%	37.2%	30.1%

Source: Palace Capital accounts, Hardman & Co Research estimates

Potential, deferred corporation tax liabilities for potential capital gains tax have now effectively been extinguished under the REIT regime status.

Note that the FY21E NAV is enhanced by profits and the commercial revaluation at Hudson Quarter, York. We assume a further ca.£15m (residential) cash and £2.5m (residential) profit for FY22, or 5.5p per share of profit and accrual to NAV. Were the commercial assets to be leased to tenants and retained (the outcome is still open to maximising value through retention or disposal), the FY22 income line would benefit.

Cashflow

Cashflow							
Year-end Mar (£m)	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Cash from operations	4.4	12.3	10.3	9.9	13.6	15.0	18.3
Finance	-1.6	-3.4	-2.5	-2.7	-4.6	-4.0	-4.0
Tax	0.0	-0.2	-1.1	-0.4	-2.0	-2.0	0.0
Net cash flow from op. activities	2.8	8.7	6.7	6.8	6.9	9.0	14.3
Acquisitions/disposals/lease break premiums	-0.4	-48.4	1.2	-65.0	-4.6	13.0	0.0
Refurbishment (capitalised)	-2.5	-1.2	-4.6	-2.8	-3.0	-5.5	-0.5
Major development (Hudson)	0.0	0.0	0.0	0.0	-1.9	-20.0	19.0
Free cashflow operation and investment	-0.1	-40.9	3.4	-60.9	-2.6	-3.6	32.8
Share issue	19.7	19.1	-2.2	67.7	0.0	0.0	0.0
Shares to fund asset purchases	-29.0	-15.7	0.2	-13.7	0.0	0.0	0.0
Dividends	-1.8	-3.2	-4.6	-6.7	-8.7	-8.7	-8.7
Other	0.0	0.0	0.0	0.0	-2.8	0.0	0.0
Net cash change	-11.2	-40.7	-3.3	-13.7	-14.1	-12.3	24.0
Net financial position	-24.7	-65.4	-68.6	-82.4	-96.5	-108.8	-84.8

Source: Palace Capital accounts, Hardman & Co Research estimates

Cashflow and balance sheet reconciliation summary				
£m	Net debt	Cashflow	Investment property assets	Change in asset valuation
End-March 2020	109.0	-	293.0	-
Period to peak cash out, York	-	-14.0	-	14.0
Position at peak cash out, York	123.0	-	307.0	-
York cashflow peak to end-March 2021	-	38.0	-	-38.0
Revaluation of commercial assets, York	-	-	-	2.5
Revaluation of other commercial assets	-	-	-	4.5
Profit residential portion, York	-	-	-	5.0
End-March 2021 financial position	85.0	-	281.0	-

Note: fraction £m reconciliation with balance sheet table due to roundings

Source:
Hardman & Co Research estimates

We summarise cash and asset flows at York in the table above. The Hardman & Co estimates assume that, as at end-March 2021, the commercial assets are retained (strategy is yet to be optimised, with market conditions determining the value maximisation) and ca.£15m of residential assets are about to be, but not yet, completed at end-March 2021 (with £2.5m realistic profit potential).

On this basis, LTV at end-March 2021 stands at 30.1%, as per our estimates.

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