28 September 2018

Palace Capital

Initiation of coverage

Palace Capital (PCA) has almost doubled NAV since the initial investment in October 2013. Good income generation is evidenced by the EPRA EPS and the DPS track record, whilst undertaking incremental refurbishments and development. The investment portfolio is 90% occupied and generates strong cashflows: with a focus on regional city centres, offering occupiers value for money. Development opportunities are optimised. 6% of the portfolio value is in a recently demolished and cleared two-acre site in the heart of York, due to be redeveloped, which will generate a step rise in NAV and in group income, once completed end 2020.

- ► **Selective assets:** PCA makes opportunistic acquisitions of regional real estate, enhancing income through active asset management. Average rents of £14 sq. foot (in the largest sector, offices) underpin the sustainability of cashflows. There is one major development, in York, commencing early 2019.
- ► **Capital recycling:** Selected property disposals (typically small portions of portfolios acquired) provide liquidity. Further, the York development is set to enhance cashflows, once completed, as is the sale of the residential portfolio currently available for sale. This latter was part of a portfolio acquisition.
- ► **Risks:** The £70m equity raise, funding the £68m RT Warren portfolio acquisition (October 2017), reduced LTV to a conservative 30% (37% prior year). WAULT of 5.3 years is a mix, with some void risk balanced by asset management potential. While the office element at York is being developed speculatively, the local residential market is strong, with the northern market currently outperforming the south.
- ► **Investment case:** The existing income portfolio produces 6.6% NIY, providing a good risk/reward. Importantly, the York development's anticipated completion by December 2020 will result in a step-rise in Palace Capital's ongoing income as capital is redeployed. We estimate this could add £1.5m p.a. or more, equating to post tax 2.7p on EPRA EPS, 16% of the 2019E level.
- ► **Valuation:** The valuation appears below that of comparables even before the potential from York is taken in to consideration. There is also a 16% income uplift potential on ERV vs. contracted rent, thus adding to the momentum.

Financial summary and valuation

Year-end March (£m)	2016	2017	2018	2019E	2020E
Income	14.6	14.3	16.7	18.3	19.9
Finance cost	-2.3	-3.0	-3.4	-4.0	-4.3
Declared profit	11.8	12.6	13.3	14.0	10.5
EPRA PBT (adj. pre-revaluation)	8.7	6.3	7.3	9.4	10.5
EPS reported (p)	43.9	36.4	35.9	27.3	19.7
EPRA EPS (p) [note]	31.3	12.0	18.7	17.2	19.6
DPS (p)	16.0	18.5	19.0	19.2	19.5
Net debt	-65.4	-68.6	-82.4	-84.7	-126.7
Dividend yield	5.1%	5.9%	6.0%	6.1%	6.2%
Price/EPRA NAV	76.1%	71.1%	75.9%	74.2%	74.2%
NAV (p)	414.3	434.2	400.2	409.6	409.7
EPRA NAV (p)	414.3	443.0	414.8	424.2	424.3

EPRA EPS is stated pre share-based payments *Hardman & Co Research estimates*

Real Estate

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**PCA**
Price (p)	315
12m High (p)	380
12m Low (p)	310
Shares (m)	45.8
Mkt Cap (£m)	143
EV (£m)	225
Market	Main, LSE

Description

A real estate investor, diversified by sector (office, industrial predominate) and location, but not in London and minimal exposure to retail. There is an emphasis on city centres. The York development site comprises 6% of assets.

Company/ Advisor information

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

+44 20 3301 8330
www.palacecapitalplc.com

Key ordinary shareholders

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

Diary

Q1 div paid	October 2018
Interim results	November 2018
Q2 div paid	December 2018
Q3 div paid	April 2019
Final results	June 2019
Q4 div paid	July 2019

Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

Table of contents

Executive summary

Tight acquisition criteria

Palace Capital acquires properties in strong locations where it can add value in its preferred market sectors. Regional town-centre offices make a significant portion. This market is increasingly undersupplied, in part through conversion of stock to residential through permitted development and in part due to lack of speculative development in recent years. Assets are favoured if they offer scope to add value by optimising the attractiveness to current and prospective tenants. Preferably, acquisition is via portfolios and corporate vehicles, optimising the entry-cost.

The £68m RT Warren portfolio is the most recent acquisition (October 2017) and while some early upside has been captured, we see more to come. The UK real estate sector features a very large number of portfolio transactions where the vendor wishes to divest of assets which might need a little work. This work may be in terms of leases or (in a minor way) asset refurbishment. Palace Capital, to date, has acquired the bulk of its assets through such portfolio acquisitions.

Patience has been rewarded with a value-accretive planning success…

The 2013 portfolio acquisition from Quintain comprised, among a series of assets, a near-vacant office block one minute's walk from York station, built in the 1960s, located inside the city walls. Optimal planning permission has been received – after dialogue. The site is being cleared for a mixed residential-commercial scheme. Construction (managed by external project management specialists) is expected to commence early 2019. This attractive opportunity in the shorter term will absorb construction capital and yield no income. It will result in a step-rise in Palace Capital's ongoing income as capital is redeployed from the York asset. We estimate £1.5m p.a. or more, equating to post tax 2.7p on EPRA EPS, 16% of the 2019E level.

… capital is being committed, which depressed PBT short term but creates significant medium- and long-term value uplift….

We question whether the market has taken these York development implications properly into consideration. This redeployment (lifting EPS) leaves loan to value (LTV) at under 30%. This conservative level would enable re-gearing towards a 40% target LTV. The RT Warren portfolio was funded fully from equity, thus raising ammunition for subsequent portfolio expansion, as well as the York development.

… plus 'straight-forward working up' of assets to secure reversionary value

The prospects are, we consider, underpinned by:

- rent reversions of the existing portfolio and void reduction, with end-March 2018 contracted rental income of £17.9m p.a., ERV of £20.8m p.a.;

Bias to a sector we see positively

- strong fundamentals in the predominant sector exposure. As an example, the largest exposure (48.5% by value) comprises offices in regional locations with strong local economies. Supply has reduced (primarily due to permitted development planning legislation) and demand is strong, creating a continuing supply-demand imbalance and opportunity for rental growth;

Asset enhancement

- Targeted and inexpensive refurbishment opportunities, which will have a positive impact (and high returns of capital) on rents and valuations. We illustrate this via a limited number of examples in this document.

In summary on valuation

Dividend growth potential accelerates significantly post the York development completion

Dividends are secured on reliable income from strong assets and growth can accelerate significantly once the York development comes to fuller fruition. On a dividend yield of 6.0%, investors are looking at the reduced cover this year. 100% is estimated in 2020, a period before the York asset's development enhances group income. The NAV discount highlights the lack of attention to the York development.

What Palace Capital does

Palace Capital is a regional UK real estate investment company. It seeks secure yield and value enhancement through active asset management. The achievement to date has been sector-leading, enhancing NAV 90% from its re-admission, following the portfolio acquisition in October 2013, to last year end. The strategic focus is to:

Good communication-hub locations

- acquire in city-centre locations, typically in locations with good communication hubs and higher gross value-added local economies;

Asset management and moderate-risk developments

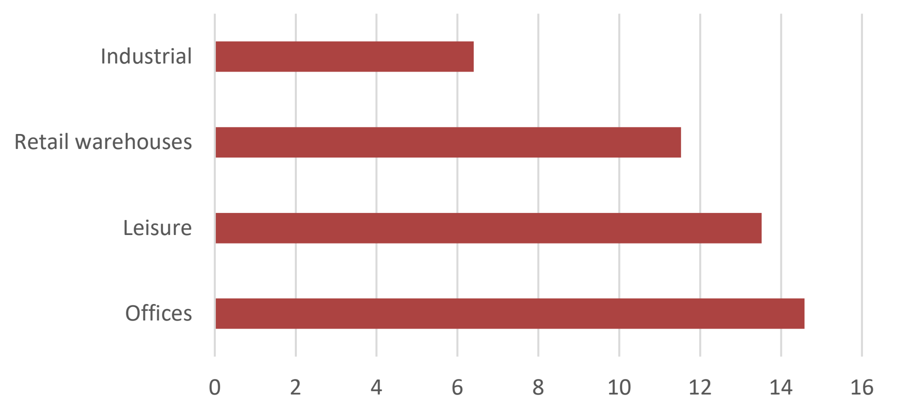
- create alpha in a low risk way by optimising the assets' attractions for existing and new tenants;
- undertake low-risk (albeit not pre-let) development, by virtue of location strength;
- capture ongoing, secure income yield by focusing on assets where supply/demand is positive and where tenant satisfaction can be optimised;
- be mindful of locations which might be improving. One example might be seen as Northampton, where rail communication has been upgraded and where a substantial higher education campus has now moved into the town centre, which is where the Palace Capital multi-tenant leisure asset is located.
- Palace Capital's latest balance sheet at 31 March 2018 comprises £19m gross cash and £14.5m unutilised debt facilities. Loan to value (LTV) is 30%. Illustratively, were these to be fully invested in yielding assets, we expect ERV would rise by ca.10%. As capital is deployed to a large development site (York) and then re-deployed, the group-wide income enhancement would be much more material than 10%.
- Palace Capital's focus is on good assets whose cost of occupancy is attractive in absolute terms and also in comparison with local alternatives.

Value for money to occupiers; well located

Nearly half the portfolio by value is in regional offices (none owned in Greater London)

Palace Capital offers occupiers attractive workspace at value for money

ERV £ per sq. foot. average (as at end-March 2018)



Source: Palace Capital

The chart above illustrates the ERV (estimated current rental value at current market rates on 100% occupancy) by sector. In our view, these levels illustrate that the portfolio, at average rents, is offering occupants relatively attractive price points.

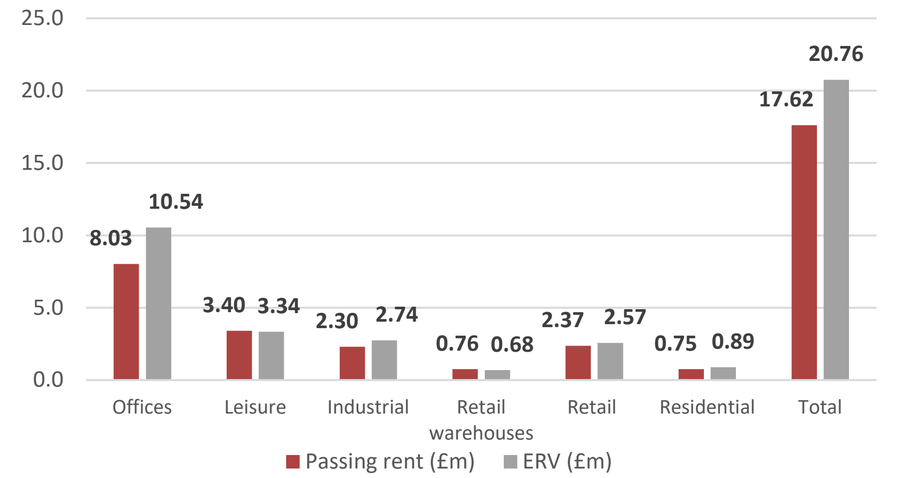
Not only are assets offering value-for-money to occupants, but they have reversionary potential.

The ERV shows a 17.8%, or £3.1m, uplift on current passing rent (£20.8m vs. £17.6m), as of end-March. 81% of this (£2.5m) is to be found within the regional office segment.

81% of ERV uplift vs. current passing rent is in office segment

Reversionary potential

Passing rent and ERV (as at end-March 2018)



Source: Palace Capital

In addition, assets are further enhanced

There is a clear strategy for each asset in the portfolio. The top 10 are as below.

30.6% assets in North East (principally a central Newcastle office and Halifax city centre multi-let leisure)

Halifax and Northampton are the two multi-let leisure assets, on average leases of good duration. These are prime examples of strong income-earners with potential active asset management opportunities to enhance both the income and capital values, with significantly more rent upside potential than downside risk. The cashflow, in the meantime prior to reaping benefits from further asset management, is underpinned by NIY of 6.15% and 7.45%, respectively, with modest voids.

St James Gate, a large office block purchased last year, is at the edge of Newcastle's CBD. Serco has extended its lease at 10% higher rent – helping guide the market to a new benchmark for further re-lets.

Hudson House, York's £16m asset-value generates no income, as it has been demolished prior to imminent re-development. See below.

Boulton House, Manchester, is a city centre, multi-let office of 75,000 sq. ft., with 19,340 vacant. Since purchase in August 2016, 6,500 sq. ft. has been let at £17.25/sq. ft. plus 2,120 at £18.95/sq. ft. This illustrates the benefit of careful marketing (i.e. steadily filling on rising new rental levels) and refurbishment of the reception area.

8.0% median reversionary yield and 5.3% net initial yield on top 10 assets

50.0% assets in South East, principally medium and smaller sized

Nil assets inner London

Largest assets

	Market value (£m)	NIY (%)	Reversionary yield (%)	WAULT to break
Broad Street Plaza, Halifax	23.2	6.15	7.11	13.2
2&3 St James Gate, Newcastle	20.0	8.05	8.10	3.9
Sol Central, Mare Fair, Northampton	18.9	7.45	7.69	7.9
Hudson House, York	16.0	0.00	N/A	N/A
Boulton House, 17-21 Chorlton Street, Manchester	14.3	2.87	8.04	1.3
Bank House, 27 King Street, Leeds	10.9	5.26	9.34	2.3
Kiln Farm, 2-4 Pitfield, Milton Keynes	8.4	3.73	8.39	8.7
Units A & B, Imberhorne Lane, East Grinstead	8.1	5.95	5.62	9.3
249 Midsummer Boulevard, Milton Keynes	8.0	5.32	8.06	1.5
Point Four Industrial Estate, Avonmouth, Bristol	7.0	4.73	6.54	4.2

Source: Palace Capital

Diversified rental covenant

Largest tenants

	Rent p.a. (£m)
Vue (leisure)	0.91
National Lottery (charity)	0.60
Walker Morris (legal)	0.57
Accor (hotels)	0.51
Eldon (insurance)	0.41
Wickes (retail)	0.40
Rockwell Automation (auto)	0.40
Blake Morgan (legal)	0.36
Apcoa (car parking)	0.34
Brose (auto)	0.32

Source: Palace Capital

48% regional offices

15% leisure

Retail exposure low

Sectoral split

	Market value March 2018 (£m)	Number of properties	Number of leases	Area ('000s sq. ft.)	Current passing rent (£m)
Offices	134.2	32	110	723	8.0
Leisure	42.1	2	22	247	3.4
Industrial	36.4	13	44	428	2.3
Residential (for sale)	22.3	62	60	40	0.8
Retail	30.3	11	64	148	2.4
Retail warehouses	11.4	2	3	59	0.8
Total	276.7	122	303	1645	17.6

Source: Palace Capital (31 March 2018 Annual Report)

Note, retail exposure represents assets where the majority is retail, so the total actually in retail is slightly overstated here on that basis. Palace Capital has been and remains cautious on retail, specifically the high street sector, in the medium term.

Palace Capital is uniquely positioned for steady, rising net income and benefits from its regional focus. It has plenty of 'fuel in the tank'. £33.5m cash and debt facilities are available for further funding. Asset enhancement is progressing well, which will generate new income streams once occupation is secured.

The central York development is of central importance to creating value and will generate income uplift once the project is completed and capital recycled.

Central York – Hudson House development

- Planning consent achieved for 127 apartments, 34,000 sq. ft. offices, 5,000 sq. ft. of commercial and car parking.
- Demolition commenced in February 2018, expected to be completed September 2018.
- Marketing anticipated to commence during Summer 2019.
- Hardman estimates first cash returns as from early 2021.
- Demand for residential & Grade A office space in York is strong.

York voted by the Sunday Times as the Best Place to Live 2018

Plans to commence construction in early 2019

Hudson House, York

Source: Palace Capital

Four drivers to shareholder value

The four drivers

Palace Capital has a strong record, putting together a reversionary portfolio on an NIY we calculate at 6.6%; created significant value through the planning consent achieved at Hudson House, York; expects to achieve further upside through its imminent development at York and scope to exit and reinvest cash, thereby increasing group-wide profits by some 20%. Finally, its largest asset class is regional city centre offices which is expected to generate stronger growth than the majority of other sectors.

Strong record

- 1. Palace Capital NAV growth has been sector-leading and clarity of future potential is high. It has acquired portfolios with inherent opportunities for value-creation. It has delivered significant and progressive dividends, incremental revaluations, with continuing reversionary potential being steadily secured. ERV is 16% ahead of contracted rent.

York development potential in a strong market

- 2. As significant – and something we consider the market has missed – is the planning permission secured on a centrally located asset in York, being a strong market for such a mixed residential and commercial scheme. The York asset was acquired as part of a portfolio, without planning permissions in place and no material premium paid for the 'hope-value',

Development ties up and also creates capital, during which process the results do not reflect any of the value

- 3. Optimisation of the York development upside requires tying up of an asset valued at £16m yielding nil. Further, there are progressive development construction costs of more than £30m. This leads to significant capital allocation in both elements – the asset and the construction cost. This capital is earning nil reported profits in the timeframe of our model, so there is a major step up in ongoing profits once that capital is put to work into yielding assets post completion. So, pre-completion, York ties up capital; post completion, it adds capital enhancing future group-wide rental income streams.

A balanced portfolio with the largest segment in an asset type that we consider to have strong underlying fundamentals

- 4. The largest weight of asset allocation (48% of total, the largest segment by far) is in well located large town/city centre offices. Supply here has been depleted by the planning regime's permitted development conversion to residential. In our view, this segment has a positive medium-term investment case – even before individual asset enhancement programmes.

Below, we outline more detail on each of these four aspects in turn.

Strong record

Since the equity raise and re-admission in 2013 and Quintain portfolio acquisition, Palace Capital has performed with sector-leading NAV growth

The financial results are that, since re-admission in 2013, total dividends have been more than fully covered by EPRA earnings (i.e. excluding revaluations) and regular positive property revaluations have been achieved. Palace Capital's modus operandi is to acquire well located real estate, for income enhancement via active management. It also acquires a more modest quantum of assets for development. Much of the asset base has been acquired through portfolio transactions, to maximise value for money.

16% reversion uplift potential

- Recent contracted rent is £17.9m p.a. ERV is stated at £20.8m p.a. In addition, Palace Capital management has an active value-creation plan on all its assets, some of which have scope to reduce voids, others to upgrade asset quality and 'presentation' or create new income streams.

Steady revaluations

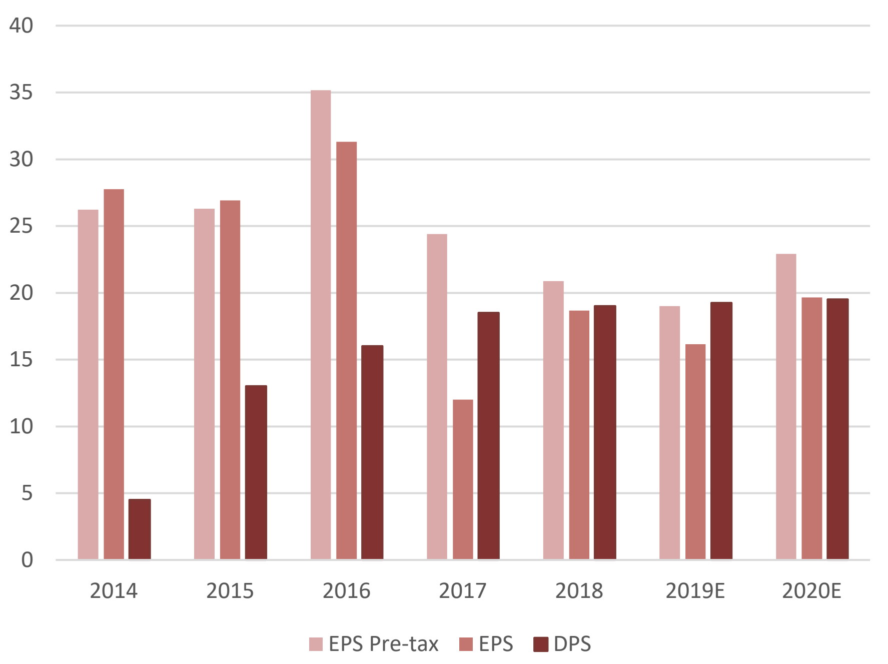
- Past four years' property revaluation gains range between £3.1m and £9.8m, an average of £5.5m. Revaluation as a percentage of start-year investment properties equates to, respectively, 16.4%, 3.5%, 1.8%, 3.1% p.a.
- The largest portion of assets is in large town/city centre offices, a market where supply has been depleted by permitted development conversion to residential.

York planning uplift took a great deal of work: several iterations

- Achievement of significant planning permission in York, which, we estimate, could yield a significant value uplift on an asset with a £16m current book valuation. This illustrates that management has an eye on development uplift as well as yielding assets.

Dividend cover and dividend growth slow in 2019 and 2020 for a very good reason – the temporary capital allocation to the York development

DPS; EPS including revaluation and EPRA EPS (pence)



Source: Palace Capital historical figures, Hardman & Co estimates

Dividend cover of 84% 2019, 100% 2020 estimated

Dividend cover and growth is forecast to slow in 2019 and 2020 for good reasons. In those years, Palace Capital funds its York development, which yields no profits during the development phase. Note, Palace Capital is an investment company, not a REIT. We state EPRA EPS (i.e. excluding revaluation and disposal profits) post-tax. Were REIT conversion to occur, tax would not be paid, providing greater earnings enhancing dividend cover. 2017 saw a material tax, which investors should note versus REIT valuations.

2019 vs. 2018 bears a £0.5m rent reduction from various voids plus £0.3m reduction prelude to a small re-development project

There is upside; however, 2019 vs. 2018 we do estimate bears a £0.5m rent reduction from various lease expiries and voids, and a further £0.3m reduction for vacancy, which could be a precursor to re-development. We estimate gross 2019 (year to March) rent rises at a token £0.1m. With recent letting rate rises at Solaris House, Milton Keynes, likely to yield positive results on the adjacent assets, 2020 should see a more positive progression. See pages 16, 18 for fuller details.

A major development uplift being secured – current numbers solely reflect its costs

More detail on the second element of the investment proposition….

In 2013, Palace Capital acquired a 1960s office block inside the city walls at York – an excellent location, but a poor physical asset. Since that date income has been minimal as Palace Capital has been in the process of working the planning, initially through a conversion to residential via permitted development, and now to the optimal, which is redevelopment of new build. Over some years, Palace Capital has worked to achieve a significant planning gain in one particular asset in central York. This asset has not yielded material income for Palace Capital to date, and is currently being demolished. At its book value (£16m) plus peak construction outlay in excess of £30m, ca.14% of the total group real estate assets will be tied up in the (clearly, non-yielding) development.

…illustratively, this creates £1.5m p.a. income stream by investing the York book cost plus conservatively stated profits

Below, we outline some illustrations. These indicate the re-investment of a conservatively calculated cash exit from the York development would permanently raise PBT by £1.5m p.a.

Re-deployment would also take LTV (with York developed and sold) back down below 30%. Given Palace Capital's reversionary potential, strength of assets, history and management, such a level would indicate the potential to take on somewhat further gearing.

Re-investing an illustrated York development surplus adds 16% to current level of profits

- Our £1.5m p.a. income illustration of the York 'surplus reinvestment' clearly is some years off, but it is worth bearing strongly in mind that this is more than 16% of current year estimated EPRA profit – a significant figure.

Then, LTV might be increased from 30% levels, which are conservative

- The figure is even more significant as it is only part of the potential profit rise – over a number of years. Palace Capital has an LTV of 30%, whereas a more typical level in recent years has been 37%. The reduction is to provide capacity to develop the York asset.

The LTV of 30% brings potential to re-gear

Yields

NIY 6.6% (excluding the development site)

The net initial yield (NIY) of Palace Capital assets is 6.6%. This includes residential, classed as assets for sale but is stated (a Hardman estimate) excluding Hudson House, which is being developed. We consider this income to be secure, with initiatives to raise it being under way, through modest asset expenditure accompanied by investment and marketing plans specific to each asset.

Reversionary potential

The portfolio is, we consider, secure and reversionary. The most recently stated reversionary potential is evidenced by an ERV (estimated rental value potential) of £20.8m per annum and a current passing income of £17.6m (contracted is £17.9m). This gives good visibility to an upward bias to rent income from the like-for-like portfolio in the coming years of almost £3.0m – with the York development benefit on top.

RT Warren portfolio cost £68m funded entirely with new share issuance

The most recent balance sheet loan to value (LTV) ratio is 29.9% (and a very similar ratio currently), which, we consider, offers some opportunity to re-gear (modestly and conservatively) the portfolio and balance sheet.

Gearing ratios

The LTV stepped down in 2018 as Palace Capital raised £70m through equity issuance. It has maintained a conservative balance sheet gearing and raising effectively the entire cost of RT Warren as equity means Palace Capital's LTV on its total balance sheet reduced, as outlined below. The RT Warren portfolio cost £68m. The step down in LTV provides a significant opportunity for Palace Capital to develop out its Hudson House, York asset.

Equity raise also supports securing funds for the York development – which will raise group-wide income potential

To maximise value-capture, Palace Capital will undertake and fund the entire development, tying up a sum over £30m for the total project construction cost. Its current balance sheet valuation is £16m. To fund this, it aims to keep its LTV conservative and will likely put some development funding in place for the construction period. At the temporary peak cash-out (and even assuming Palace Capital acquires £20m yielding assets out of debt) we model, maximum 45% LTV. For a period of two years, this leads to a significant capital tie-up in non-yielding assets. Development results in a mix of residential and commercial assets, which can be sold, or indeed the commercial assets may be retained. By definition, the capital deployment is not revenue producing during the course of development. LTV rises as a result of this expenditure, but remains at conservative levels. Our table, below, estimates LTV at 39.1% end fiscal 2020, after additional asset purchases of £22m. The full construction cost at York would take LTV to ca.44% if debt funded.

As with any developer – the development ties up non income-producing capital

Asset acquisitions and balance sheet gearing

Cashflow and ratios, March year-end (£m)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019E	FY 2020E
Asset revaluation	19.5	9.8	3.6	3.1	5.7	4.6	0.0
Net asset purchase	39.9	33.8	67.9	6.3	85.9	2.0	22.0
Cash into Hudson House development	0.0	0.0	0.0	0.0	0.0	0.0	20.0
LTV %	24.7%	24.0%	37.5%	37.3%	29.9%	30.0%	39.1%

Source: Palace Capital accounts; Hardman & Co Research

The table above illustrates a conservative range of LTVs but still with upside on the current 30%

Palace Capital's equity raise ensures a conservative level of debt but, during York construction work, the income potential is not in the equation.

Assets weighted to regional offices

48.5% of assets are regional offices, in 32 properties

48.5% of assets are in the regional offices segment, in 32 assets. The office market sees minimal new supply being developed in any material way outside London and inner Home Counties. Net supply is decreasing as a result of Permitted Development converting into residential – a planning framework implemented nationally post the global financial crisis. This means rents rise as supply contracts.

There is a supply shortage as a result of the planning regime

A good example is the Palace Capital office asset of Regency House in Winchester. This is a city centre property dating from the early nineteenth century. There is planning consent to convert the upper parts (second floor) to residential, but "residential conversion is not now in shareholder interest." This is due to the improved rental opportunities in the office market in Winchester.

Regional focus remains attractive because the yield pick-up versus London and inner Home Counties is strong but also because economic conditions mean corporate tenants still seek value for money but realise that poorly located or specified stock is a false economy as regards staff churn and ability to do business efficiently. The sweet spot logically is therefore where Palace Capital locates, near the centre of strong regional cities and large towns.

Operational detail for value creation

We see the four main drivers to 'alpha' value creation as follows.

1. Savvy stock selection.

2. Optimising the assets' desirability for existing and new tenants.

3. To own a good ongoing, secure income yield by focusing on assets where supply/demand is positive and where tenant satisfaction can be optimised through relatively inexpensive investments enhancing the properties.

4. Palace Capital maintains strong focus on good, centrally located assets whose cost of occupancy is attractive in absolute terms and compared with local comparable alternatives.

Stock selection

60% assets came as part of portfolios

As the majority are purchased in portfolios (four purchased, in 2011, 2013, 2014 and 2017, comprising 60% of total acquisition consideration), a limited number of assets not fitting the criteria have been disposed of. With many portfolio opportunities to choose from, Palace Capital has optimised the balance between core assets with strong long-term tenants and those where there are asset management initiatives to raise rental levels and reduce voids. The total valuation uplift since 2013 to March 2018 is £41.7m along with substantial income returns generated. Combined an average total property return of over 13% p.a. has been achieved.

Tenant-focused refurbishments

Hands-on decisions regarding presentation of the properties

The active asset management comprises light asset refurbishment either ahead of tenancy breaks, or at the break. It also comprises active discussion with tenants who might welcome expansion or reduction in the floorspace and thereby working with them to provide a tailored configuration to them, which optimises the rent for the building as a whole.

A recent example is Solaris House in Milton Keynes. This saw a refurbishment enabling a re-let at £16.55 sq. foot (with a period at reduced rent), which is £6 sq. ft more than the current rent on the 38,000 sq. ft Palace Capital owned adjacent building. This other building undergoes a rent review this December. Solaris House is a 14,500 sq. ft office building and was acquired as part of the 2013 Sequel portfolio. We note the significant, positive, lease agreement took place after the year end.

Good, ongoing, secure income yield

Use-category is one determinant of the decision to acquire

The attraction of the regional office sector is touched on, on page 8 and 11. We give more detail on the following section, Market focus, page 13.

Attractive cost of occupancy

See the chart on page 4. Rents are generally affordable; within the office sector this is well located but not premium Grade A space (the whole concept of Grade A, Hardman considers, is losing traction). This gives the opportunity to increase rents through refurbishment towards Grade A, but is also attractive to tenants in the meantime. Rents across the sector categories will make up a smaller proportion of tenants' total costs, bringing obvious benefits to tenant and landlord.

Market focus

Unique planning situation removes supply permanently

Palace Capital invests opportunistically, but with a strong framework of guiding fundamentals. As an example, the largest exposure is offices in regional locations with strong local economies. Regional offices have good demand fundamentals, if central and at a small rent discount to top-rent prime. They also benefit from a unique planning situation, which reduces supply through conversion of use.

The office market – 48.5% of portfolio, 32 properties

Knight Frank's regional office market report for 2018 stated "occupier demand for office space defied wavering confidence, with take-up reaching a 15 year high supported by headcount growth…"

Larger Palace Capital office assets

Among the top five assets are two large offices, each with an asset-management upside

Among the top five assets are two offices (plus the Hudson House former office, now a development site). St James Gate, Newcastle was bought in August 2017 for £20.0m and valued at latest balance sheet at £20.0m, or £204 per sq. foot. Serco recently extended its lease at 10% higher rent. This is a multi-let, modern city centre office, fully let. The NIY is 8.1%. WAULT is 3.9 years and valuers see the reversionary yield as 8.1%, indicating that the current rent level is likely to be achievable on re-letting under current conditions.

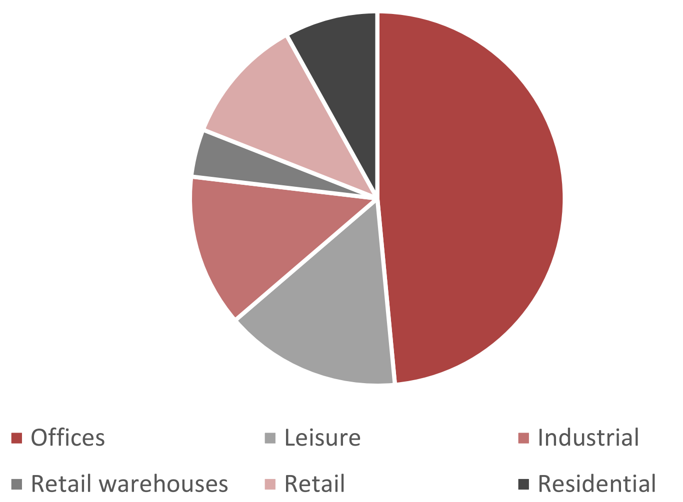
Last valued at 2.9% NIY with major letting opportunities

Boulton House, Chorlton Street, Manchester M1 was last valued at 2.9% NIY but is very significantly under-rented. It is good, therefore, that it is on a 1.3-year WAULT. The reversionary yield is at 8.0%; valuation of £14.3m is £191 per sq. ft. For a location right in the centre but not quite prime (between Piccadilly and the art gallery, through Chinatown and the Canal Street cultural area), this valuation seems the least justifiable and likely to prove conservative. Acquisition cost in August 2016 was £10.6m, since when 24% of the space has been refurbished and there have been significant lettings at rising prices (latest being at £18.95 sq. ft).

Other sectors, 28 commercial properties, 62 residential

Market value split (as at end-March 2018)

Nearly half the portfolio by value is in regional offices



Source: Palace Capital

Halifax consumes management time to 'work-up' the occupancy profile but is repaying the commitment

The same is the case in Northampton, with a 7.4% NIY in the meantime

The mix of assets brings a selection each with an active asset-management plan

Leisure – 15.2% of portfolio, 2 properties

The two leisure assets comprise 22 tenants, paying £3.4m rent, valued on aggregate at 6.7% NIY. For the two combined, we see rents going sideways with the benefit of some vacant units potentially being let. The Broad Street Plaza asset in Halifax (13.2 years WAULT to break) benefits from significant local cultural regeneration initiatives with strong anchor tenants and new marketing initiatives to fill an element of voids. Two tenants entered administration in the year to March 2018, but others saw positive rent reviews and "remaining tenants trade well." (Palace Capital 2018 Report and Accounts). The highest valued asset in the portfolio, it is valued on 6.15% NIY and 7.11% reversionary.

Northampton's Sol Central was purchased in 2015 for £20.7m and – like Halifax – has Vue as a major anchor. The weighted average length of lease to break (WAULT) is 7.9 years. This asset includes a 151-room hotel, gym, etc. and "has not been trading at its optimum level for a number of years'' (Palace Capital 2018 Report and Accounts). £1.0m external upgrades have been invested out of a £4.0m surrender premium from Gala while a specialist car park operator has commenced. 2018 valuation increased just under 1.9% and we await further investment, but likely only once a certain level of new tenants has been secured. There certainly is scope for active asset management; however, for commitment, the balance of risk and reward must be weighed. It is valued on 7.45% NIY, 7.69% reversionary, the third-highest capital valuation in the portfolio.

Industrial – 13.2% of portfolio, 13 properties

A mix of multi-let and single let assets has been acquired. Many properties have relatively shortly expiring leases and imminent rent reviews. The regional industrial market is strong, so rental uplifts are highly likely. The average valuation across 13 properties is £85 per sq. ft. The top three properties are valued at £7.1m, £6.9m and £4.6m, respectively, but the average valuation for the next 10 is a modest £1.8m.

Retail – 11.0% of portfolio, 11 properties

Here, Palace Capital is in strong locations, albeit the sector does have its well-publicised challenges. Average valuation is £205 per sq. ft., which is reassuringly value-oriented. We note that the sector allocation is based on the predominant use-category. Thus, for example, by square foot or income, a reasonably notable part of the retail segment for Palace Capital is in uses other than retail – such as the 13 residential units let to Dartford Council for 10 years.

Residential – 8.1% of portfolio, 62 properties

The £22.3m portfolio is non-core based in outer zone London and valued at an average £562 per sq. ft, £360,000 per property. It was acquired via the RT Warren portfolio and is an opportunity for capital recycling.

Retail warehouse – 4.1% of portfolio, 2 properties

The three tenants include Wickes, Pets at Home and Booker, located in East Grinstead and Salisbury with good scope for modest rental growth medium term.

Portfolio acquisitions

60% of all acquisitions have been as part of a portfolio of assets

Palace Capital favours acquisition via the portfolio route because this enables it to secure a series of asset management opportunities which are not priced into the cost. As a bonus, it of course saves significant stamp duty but this is not the motivating factor. It should be noted that many single assets (e.g. the recent Newcastle purchase) are acquired as corporate entities, minimising SDLT (stamp duty land tax) and often with latent tax benefits.

Capital recycling

Capital recycling

During the 2018 fiscal period, 10 properties were sold for £9.0m, releasing funds out of low growth assets, purchased as part of the portfolios acquired. Many are good assets, but with modest management 'angles'. As a major example, £3.3m was paid by Travis Perkins (for own occupation) for an asset in an Exeter industrial estate business park. The former tenant had entered administration and the asset, which could have benefitted from capital expenditure, was sold for a 10% premium to September 2017 valuation.

We have referred above to the residential assets, valued at £22.3m, at 31 March 2018, acquired via the RT Warren portfolio, as being non-core. They are classed as assets for sale. The yield (not stated in detail) is some way below the 6.2% overall NIY for Palace Capital valuations.

Recycling capital is a major adjunct to the Palace Capital philosophy. Core assets, which comprise a large majority of the total, are likely to remain in the portfolio long term.

The second portfolio acquisition: Sequel, 2013

Among other matters, the 2013 portfolio brought the York asset – virtually vacant at the time

The Sequel portfolio, consisting of 24 properties across office, industrial and retail sectors was acquired in 2013 for £39.25m. Circa a third of the properties (by number not value) have since been sold.

Value enhancements created by Palace Capital

- The Hudson House, York planning enhancement created a significant valuation uplift from the original purchase price of £3.8m. Clearly, post development, there is further substantial uplift to be captured.
- Kiln Farm, Milton Keynes, refurbished assets were let for 10- and 12-year leases at substantial rent increases, creating a value uplift from the original purchase price of £2.3m to the most recent valuation of £8.4m.
- Dartford, £2m was spent converting vacant office space into residential and let for 10 years to the local authority. A value uplift from the original purchase price of £1.1m to the most recent value of £4.7m was achieved.

NAV prospects

The portfolio offers plenty of scope to work up value.

- Hudson House, York development is value creative and in at a level not yet reflecting the full potential.
- Recycling of capital in assets acquired in portfolios with lesser growth potential, plus utilisation of funding lines both will add to the running income and to value.
- Were the Estimated Rental Value (ERV) to be achieved, the portfolio's current valuation yield of 7.8% should tighten – that is to say, be revalued upwards. These things take time, but there is plenty of scope to work up value as well as the earnings per share and hence dividend paying capacity.

ERV is the open market rental value that a property can be reasonably expected to attain given current market and property conditions.

March 2018 net initial yield was stated as 6.2%; reversionary yield 6.9%; ERV (equivalent) yield 7.2%, with York current income nil

March 2018 net initial yield was stated as 6.2%; reversionary yield 6.9%; ERV (equivalent) yield 7.2%. These figures exclude the residential assets held for sale but include York, Hudson House valued at £16.0m. This is non-income generating, nearing completion of demolition, with planning permission for development.

£m March 2018 data, excluding residential (which is for sale)

Passing rent income	16.9
ERV of voids	2.1
ERV total	19.9
Market value	254.4
ERV as % market value excluding residential (for sale)	7.8%

Source: Palace Capita historical figures, Hardman & Co estimates

With 244 leases (March 2018, excluding the 60 residential properties which are classified as being held for disposal), there remains considerable scope.

Useful upside momentum should begin to be achieved in many assets, including the two of highest value – Broad Street Plaza leisure asset in Halifax (valued at 8.4% of total portfolio) and St James Gate, Newcastle (7.2% of total portfolio market value). The Broad Street Plaza asset benefits from significant local cultural regeneration initiatives with new Palace Capital marketing initiatives to fill an element of voids. Serco recently renewed its lease at St James Gate, Newcastle on 10% higher rent.

Some Hardman illustrations on NAV prospects

Solaris House Milton Keynes

Refurbishment and rent rise

Since year end, the 14,500 sq. ft Solaris House offices re-let at 40% uplift and, as we understand it, the prior year-end valuation did not reflect significant potential for uplift. The 38,000 sq. ft adjacent and similar office asset would on this rent basis of £6 per sq. ft higher, see a more than 50% rent rise. While this number is conjecture and the headline rent on the 14,500 sq. ft building will not be achieved until 2021, there is clear upside in the smaller building valuation this year and larger potential, later, for the larger asset. Illustratively, even an extra £3 per sq. ft (half of what might appear to be the potential) at a yield equivalent of, conservatively, 7%, would be £1.6m valuation uplift. This illustration is 3.5p NAV per share potential over the next short number of years (on the 45.8m shares in issue excluding treasury shares) on this one office building. To put this in context, 38,000 sq. ft is 5.0% of Palace Capital's office space by area. Office comprises (latest year end) 48.5% of the Palace Capital portfolio.

Hudson House, York

Hudson House, as a development asset, is non-income generating and absorbs capital….

Hudson House was a 103,000 sq. foot former office building, let at modest rent and 30% occupied, for an ageing, 1960s building. The two-acre, location is immediately overlooking and within the medieval city walls. York was voted the best place to live by the Sunday Times in 2018. Residential values continue to rise consistently. The plans are to commence development in early 2019; 127 apartments with 34,000 sq. foot of offices and 5,000 sq. foot commercial, plus car parking. We would anticipate pre-sales commencing Summer 2019. Planning approval in August last year was unanimous. The current valuation is £16.0m (with no debt secured on it). The office plans would be the first speculative office development in York for many years.http://www.fuse-studios.com/wp-content/uploads/2017/03/large-1500x600-SketchUp-view-from-City-Wall-02.jpg

….at the exit of the project, there is scope for significant step move upwards in NAV….

So, the £16m York value currently in the books and a construction cost in excess of £30m, tie up capital in order to crystallise the value created by the planning gain Palace capital has achieved.

This affects current accounting ratios, as EPS would be higher if this capital were released sooner. However, that would not maximise value to shareholders.

….and the potential to raise group-wide income upon the recycling of capital

Palace Capital will have the choice as to retaining part of the development (e.g. the commercial assets will be well-located in a growing local economy) or recycling into new portfolio asset purchases. Given the capital upside from York, we see scope for both. Clearly, this capital redeployment would raise the group-wide income earnt from the yielding assets acquired. This is a significant component in the valuation criteria for palace capital equity.

While Hudson House is currently the largest of the speculative developments, there might be others latent within the portfolio, and we would anticipate that development of commercial assets would be balanced against the core income-producing portfolio, supporting both the progressive dividend policy and also the drive to grow net asset value.

Income prospects

Some 2019 like for like erosion….

…2020 advance

£m rental income projections

2018 actual achieved	**16.7**
2019 full year effect Newcastle office	0.5
2019 full year effect RT Warren	1.8
2019 new vacancies	-0.4
2019 vacancy for redevelopment	-0.3
2019 rent loss from disposal	-0.2
2019 rent rises achieved	0.2
2019 Hardman forecast to be achieved	18.3
2020 deployment of £20m capital on 6% NIY	1.2
2020 other net increases (ca.2%), including Milton Keynes adjacent Solaris	0.4
2020 Hardman forecast to be achieved	**19.9**

Source: Palace Capital historical figures, Hardman & Co estimates

[1] EPRA EPS pence per share, illustrative on certain assumptions including redeployment of major development asset

2020 may see, additionally, some yield pickup on the progressive redeployment of residential assets purchased through the RT warren portfolio, but this might more fully impact 2021 positively.

£m rental income run rate March 2018

Passing rent income	17.6
ERV of voids and uplift to ERV from current passing rent	3.2
ERV total	20.8

Source: Palace Capital historical figures, Hardman & Co estimates

Risks

The assets offer value-for-money to occupiers and as such there is often 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 (be it offices or leisure, etc.) than would be the case for prime assets.

Assets purchased sometimes need refurbishment of parts (e.g. reception area or external). This 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.

LTV ratios stand at 30%, down from a sustainable historical level of 37%. We believe the broad target LTV is 40%.

The other asset type is the development assets class. Currently this comprises one asset, Hudson House, 6% of the total portfolio value. We expect this type will always comprise a modest portion. This is because development in itself brings inherent risks and because it creates a drag on income stream related cash income.

During development of Hudson House, LTV is expected to rise to manageable levels and will ultimately reduce LTV through the value uplift and residential sales.

York's mixed-use development (the majority of which is apartments) is being developed without pre-letting, including on the relatively modest commercial element. The residential market here is currently strong.

All real estate is at risk as regards location. Palace Capital mitigates this by excluding London and choosing central, accessible locations with good underlying demand.

A number of leases are of short duration. The overall WAULT number is not relevant as this is a granular investment portfolio. Leisure might be considered a sector under pressure and here the leases are mostly of long duration (see our analysis of top 10 assets), anticipating and mitigating that risk.

Sector exposure is weighted to regional offices – a segment we consider to be robust, with good supply/demand balance favouring the investor.

The dividend cover reduces this year (100% covered next, by Hardman estimates). This will constrain DPS growth, we estimate, until the NAV and, importantly, income step-uplift upon completion of the development. So, the DPS is 'cake today', 'cake and jam' shortly, post the highly visible York development delivery. DPS thus remains progressive but the cover will rise substantially 'post York', giving opportunities for DPS growth acceleration.

Corporate matters

Palace Capital is a real estate investment company. It has chosen not to convert to REIT status at present time.

This is an LSE main market (official list) premium quoted stock (graduated from AIM in March 2018).

The most recent equity fund raising was for £70m gross at 340p per share. 20.588m New Ordinary Shares were issued on 9 October 2017, raising £70.0m gross (including £3.76m via an open offer to shareholders 87.9% subscribed).

Palace Capital Board

Stanley Davis – Non-Executive Chairman

Stanley is a successful serial entrepreneur who has been involved in the City of London since 1977. His founding company was company registration agent Stanley Davis Company Services Limited, which he sold in 1988. In 1990, he became Chief Executive of a small share registration company, which became known as IRG plc and acquired a number of businesses including Barclays Bank Registrars and was sold for a substantial sum to The Capita Group plc. He is Chairman of Stanley Davis Group Limited specialising in company formations, property and company searches, Chairman of the Nominations Committee and member of the Audit and Renumeration Committees.

Neil Sinclair –- Chief Executive

Neil has more than 50 years' experience in the property sector. He was a founder of Sinclair Goldsmith Chartered Surveyors, which was admitted to the Official List in 1987 and subsequently merged with Conrad Ritblat in 1993, when he became Executive Deputy Chairman. Neil has been on the board of several publicly quoted companies since, including as a Non-Executive Director of Tops Estates plc, in 2003. He remained so until it was sold to Land Securities plc in 2005.

Stephen Silvester – Finance Director

Stephen Silvester, a Chartered Accountant with over 15 years in finance, joined Palace Capital in 2015 as Finance Director and brings more than 10 years' experience working in real estate. Prior to joining Palace Capital, he served for three years as Group Financial Controller at NewRiver REIT, which specialises in the UK retail sector.

Stephen joined the Australian St Hilliers Pty Ltd, a large real estate company with construction, fund management and property development operations in both the residential and commercial sectors. During his four years at St Hilliers, he became Group Financial Controller and oversaw the finance team.

Richard Starr –- Executive Director

Richard has extensive experience of sourcing and managing commercial investments throughout the UK. After qualifying as a Chartered Surveyor in 2000, he developed his experience working as a fundamental team member of four Central London property firms including the corporate real estate division of what is now CBRE Global Investors. In 2011, Richard established his own boutique property consultancy, successfully negotiating sales and acquisitions on behalf of a wide variety of institutional & private clients before joining the board of Palace Capital in October 2013.

Anthony Dove – Non-executive Director

30 years' experience in the corporate sector includes a partner role at the international law firm Simmons & Simmons from 1977 until 1999.

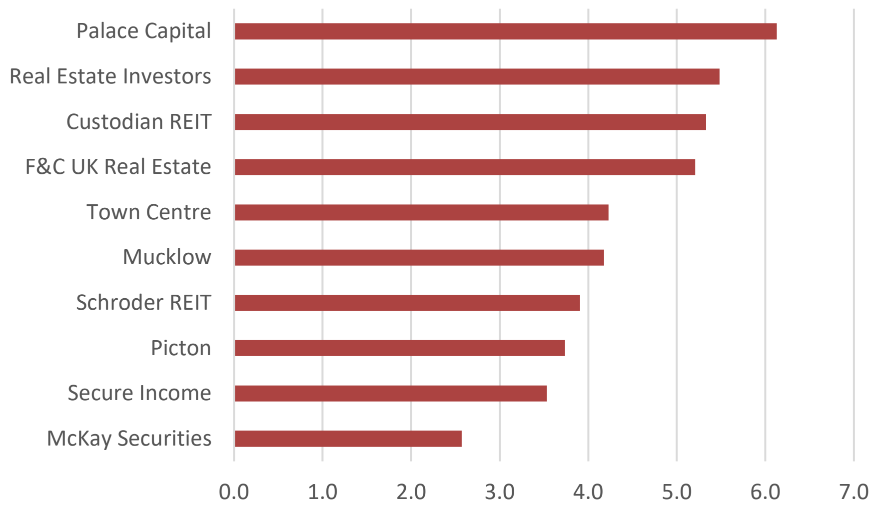
Kim Taylor-Smith – Non-executive Director

Kim, a Chartered Accountant, brings to Palace Capital more than 30 years' experience as a company director for a range of businesses, with a particular background in property management, investment and development. He was Finance Director and latterly Chief Executive of Birkby plc.

Valuation

Management has re-affirmed its commitment to a progressive dividend policy.

Historical dividend yields (%)



Source: Eikon Thomson Reuters

Past returns comprise a 119% total NAV return from 2014 to 2018 (March year-end), the period since the Sequel portfolio acquisition. Current returns reflect that £16m of assets (by book value) are non-yielding development assets in York (Hudson House).

We estimate DPS to be 87% covered by EPRA EPS this year (96% prior year) and we estimate 100% in 2020E. However, illustratively, were the £16m book value at York development site to be invested in assets yielding 6%, the current year EPRA EPS would be enhanced 11% and 2020E's greater EPRA EPS by more than 9%, yielding to pro forma DPS cover of 97% this year and 108% 2020E. This illustration simply substitutes yielding assets for the non-income yielding York site. It takes no account of projected profits from the development.

Portfolio performance

Annual % returns vs. benchmark

	March 2017	March 2018
Palace Capital portfolio total return	**7.8**	**9.8**
MSCI/IPD Benchmark total return	3.7	10.7
Palace Capital portfolio income return	**6.8**	**6.5**
MSCI/IPD Benchmark income return	4.9	4.8

Source: Palace capital and MSCI/ IPD

Financial analysis

Revenue account

Revenues, March year-end (£m)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019E	FY 2020E
Rental, other income	3.25	8.64	14.59	14.27	16.73	18.30	19.90
Direct property costs	-0.65	-1.20	-1.62	-2.06	-1.82	-1.60	-1.60
Net income	2.60	7.44	12.97	12.21	14.91	16.70	18.30
Administrative expenses	-0.65	-1.44	-2.05	-2.92	-4.18	-3.30	-3.50
EPRA operating profit	**1.95**	**6.00**	**10.92**	**9.29**	**10.73**	**13.40**	**14.80**
Property revaluation	19.50	9.77	3.62	3.10	5.74	4.60	0.00
Profit on disposal, transaction costs	0.27	-0.46	-0.52	3.19	0.27	0.00	0.00
Share based payments	-0.01	-0.11	-0.11	-0.24	-0.17	-0.20	-0.20
Operating profit	**21.71**	**15.20**	**13.91**	**15.34**	**16.57**	**17.80**	**14.60**
Interest	-0.57	-1.40	-2.26	-3.01	-3.43	-4.00	-4.30
EPRA PBT (pre-revaluation, etc.)	**1.38**	**4.60**	**8.66**	**6.28**	**7.30**	**9.40**	**10.50**
PBT as declared (pre share-based)	**21.15**	**13.91**	**11.76**	**12.57**	**13.31**	**14.00**	**10.50**
Tax	0.08	0.11	-0.95	-3.19	-0.77	-1.50	-1.50
EPRA PAT	**1.46**	**4.71**	**7.71**	**3.09**	**6.53**	**7.40**	**9.00**
Company adjusted EPS (p)	n/a	28.30	18.90	22.20	21.20	17.20	19.65
EPRA EPS (post share-based) (p)	**27.76**	**26.30**	**30.90**	**11.10**	**18.18**	**16.81**	**19.21**
EPS (p) Reported	403.61	80.16	43.91	36.44	35.85	27.29	19.65
DPS (p)	**4.50**	**13.00**	**16.00**	**18.50**	**19.00**	**19.25**	**19.50**
Average shares issue (m)	5.29	17.49	24.62	25.74	34.98	45.80	45.80
Year-end shares issue (m)	12.44	20.23	25.78	25.15	45.80	45.80	45.80

Note: 2014 comprises a 14 month reporting period *Source: Palace Capital accounts; Hardman & Co Research estimates*

Rental income

The rental line, it should be noted, currently receives nil from Hudson House at York, in the books at £16m and – since March 2018 – being demolished and redeveloped. No development profits are assumed in the model's time horizon.

Note that – as is normal for real estate – some new leases offer initial rent-free periods. The impact of these, for accounting purposes, is spread across the lease.

Direct property costs

Direct property costs include an element of uncovered expenses such as the rates bills or service charges on void assets. This is a normal function of the investment strategy, with reduction in these costs a material part of adding value to acquisitions.

Admin expenses

Administrative expenses in 2018 included £0.7m one-off costs of Palace Capital moving to the main market (from AIM).

Revaluation

We expect modest like-for-like rent inflation, which would lead to a small positive revaluation each year, assuming stable valuation yields. This element of revaluation is excluded from our 2020 estimates. Some assets are seeing significant rent rises per square foot (e.g. Milton Keynes and others). We consider this and certain void reductions would impart upwards pressure on 2019 valuations. The new Hudson House development sees construction commencing early calendar 2019. We model significant development surplus but make no assumption of revaluation in 2020.

Finance costs

We estimate interest costs of 3.4% with £0.4m p.a. amortisation of fees. Interest costs on development of Hudson House are capitalised. Development debt is on balance sheet. Finance costs include ca.£0.1m head lease costs.

Tax

Tax: Palace Capital chooses not to convert to a REIT so allows for a £6.5m deferred tax liability.

Balance sheet

@ March year-end (£m)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019E	FY 2020E
Investment properties	59.4	103.0	174.5	183.9	253.9	260.5	312.5
Long-term liabilities (Deferred tax)	-1.2	1.5	1.2	-2.1	-6.6	-6.6	-6.6
Long-term debt	-18.6	-36.6	-71.8	-77.7	-98.8	-98.8	-138.8
Net current assets, excluding financial	0.8	0.3	-3.5	-3.7	-3.3	-3.3	-3.3
Assets held for sale	0.0	0.0	0.0	0.0	21.7	21.7	11.7
Cash, deposits, short-term debt	3.9	11.9	6.3	9.1	16.3	14.0	12.1
Net cash (debt/finance lease)	-14.7	-24.7	-65.4	-68.6	-82.4	-84.7	-126.7
Net assets (NNNAV)	44.4	80.0	106.8	109.6	183.3	187.6	187.6
EPRA net assets	44.4	80.0	106.8	111.8	190.0	194.3	194.3
NAV/share (p)	356.6	395.6	414.3	434.2	400.2	409.6	409.7
EPRA NAV/share (p)	356.6	395.6	414.3	443.0	414.8	424.2	424.3

Source: Palace Capital accounts; Hardman & Co Research estimates

The assets held for sale comprise residential acquired as part of the RT Warren portfolio. Note Hardman estimate of £10m disposals of such assets during 2020.

Cashflow

Revenues, March year-end (£m)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019E	FY 2020E
Cash from operations	1.3	4.4	12.3	10.3	9.9	12.7	14.7
Finance	-0.4	-1.6	-3.4	-2.5	-2.7	-4.0	-4.2
Tax	0.0	0.0	-0.2	-1.1	-0.4	-1.0	-1.5
Net cash flow from op. activities	0.9	2.8	8.7	6.7	6.8	7.7	9.0
Acquisitions/disposals	-2.7	-0.4	-48.4	1.2	-65.0	0.0	-20.0
Refurbishment (capitalised)	0.0	-2.5	-1.2	-4.6	-2.8	-2.0	-2.0
Major development (Hudson)	0.0	0.0	0.0	0.0	0.0	0.0	-20.0
Free cashflow operation and investment	-1.8	-0.1	-40.9	3.4	-60.9	5.7	-33.0
Share issue	23.0	19.7	19.1	-2.2	67.7	0.0	0.0
Shares to fund asset purchases	0.0	-29.0	-15.7	0.2	-13.7	0.0	0.0
Dividends	0.0	-1.8	-3.2	-4.6	-6.7	-8.0	-9.0
Other	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net cash change	21.1	-11.2	-40.7	-3.3	-13.7	-2.3	-42.0
Net financial position	-13.5	-24.7	-65.4	-68.6	-82.4	-84.8	-126.7

Source: Palace Capital accounts; Hardman & Co Research estimates

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/legals/research-disclosures. Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. . No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission from Hardman & Co. By accepting this document, the recipient agrees to be bound by the limitations set out in this notice. This notice shall be governed and construed in accordance with English law. Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the FCA under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259.

(Disclaimer Version 8 – Effective from August 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

Hardman & co team

Management Team

+44 (0)20 7194 7622			
John Holmes	jh@hardmanandco.com	+44 (0)207 194 7629	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)207 194 7630	CEO

Marketing / Investor Engagement

+44 (0)20 7194 7622		
Richard Angus	ra@hardmanandco.com	+44 (0)207 194 7635
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)207 194 7637
Gavin Laidlaw	gl@hardmanandco.com	+44 (0)207 194 7627
David Banks	db@hardmanandco.com	+44 (0)207 194 7622
Ann Hall	ah@hardmanandco.com	+44 (0)207 194 7622
Max Davey	md@hardmanandco.com	+44 (0)207 194 7622
Antony Gifford	ag@hardmanandco.com	+44 (0)207 194 7622

Analysts

+44 (0)20 7194 7622

Agriculture		**Bonds**	
Doug Hawkins	dh@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com	Mark Thomas	mt@hardmanandco.com
Building & Construction		**Consumer & Leisure**	
Tony Williams	tw@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
Mike Foster	mf@hardmanandco.com	Jason Streets	js@hardmanandco.com
Financials		**Life Sciences**	
Brian Moretta	bm@hardmanandco.com	Martin Hall	mh@hardmanandco.com
Mark Thomas	mt@hardmanandco.com	Gregoire Pave	gp@hardmanandco.com
		Dorothea Hill	dmh@hardmanandco.com
Media		**Mining**	
Derek Terrington	dt@hardmanandco.com	Paul Mylchreest	pm@hardmanandco.com
Oil & Gas		**Property & Services**	
Angus McPhail	am@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Special Situations		**Tax Enhanced Services**	
Steve Clapham	sc@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Paul Singer	ps@hardmanandco.com		
Yingheng Chen	yc@hardmanandco.com		
Technology		**Utilities**	
Milan Radia	mr@hardmanandco.com	Nigel Hawkins	nh@hardmanandco.com

Hardman & Co

35 New Broad Street
London
EC2M 1NH

Tel: +44(0)20 7194 7622

www.hardmanandco.com