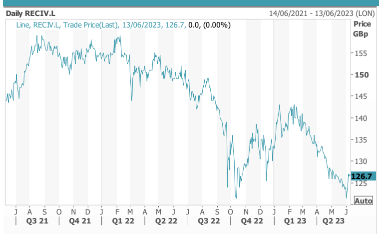
13 June 2023

Diversified Financial Services



Source: Refinitiv

Market data

EPIC/TKR	**RECI**
Price (p)	**127.0**
12m high (p)	159.5
12m low (p)	115.5
Shares (m)	229.3
Mkt cap (£m)	291.2
NAV p/sh (May'22, p)	149.0
Discount to NAV	-15%
Div. yield (FY'21)	9.4%
Country/Ccy of listing	UK/GBP
Market	Premium equity closed-ended inv. funds

Description

Real Estate Credit Investments (RECI) is a closed-ended investment company that originates and invests in real estate debt secured by commercial or residential properties in the United Kingdom and Western Europe.

Company information

Chair	Bob Cowdell
NEDs	Susie Farnon, John Hallam, Colleen McHugh
Inv. Mgr.	Cheyne Capital
Main contact	Richard Lang
	+44 (0)207 968 7328
	www.realestatecreditinvestments.com

Key shareholders (Mar'22)

Close Bros.	8.29%
Bank Leumi	7.96%
Canaccord Genuity	5.89%
Hargreaves Lansdown AM	5.82%
Tilney Smith and Williamson	5.73%
FIL (Aug'22)	5.15%

Diary

End-Jun	Results to Mar
Mid-Jul	Jun NAV

Analysts

Mark Thomas +44 (0)203 693 7075
mt@hardmanandco.com
Mike Foster +44 (0)203 693 7075
mf@hardmanandco.com

REAL ESTATE CREDIT INVESTMENTS

Double tangible security

Our recent notes, in the main, have focused on why RECI should prove resilient in uncertain times, given its credit processes, high-quality security, low exposure to high-risk sectors, diversity and management of problem accounts. Market turbulence has reduced competition, and there is distinct upside, particularly in moderate-risk development loan positions. In this note, our property analyst considers the underlying real estate security, and concludes that i) potentially more difficult asset-classes are well underpinned by appropriate loan-to-value (LTV) ratios, ii) the geography and asset-class profile is good, and iii) there is strong evidence of RECI's value-add, for example, but not exclusively, with its developer loans.

- *May Fact Sheet:* For the third month in a row, the NAV rose 1.1p, owing to recurring interest income. Cash was £29m, gross leverage £88m, and cost of finance 6.1% The book has 47 positions (32 loans, drawn value £298m, and 15 bonds, fair value £34m, unchanged on the month). The weighted average LTV is 60%, and the yield is 10.7%, unchanged.
- *May Investor presentation:* Key themes include i) attractive returns from low LTV credit, backed by UK and European commercial real estate assets, ii) consistent quarterly dividends since October 2013, iii) transparent and conservative leverage, iv) access to a strong pipeline, and v) rotation of market bonds into senior loans.
- **Valuation:** In the five-year, pre-pandemic era, on average, RECI traded at a premium to NAV. In periods of market uncertainty, it has traded at a discount. It now trades at a 15% discount, a level not seen since late 2020. RECI paid its annualised 12p dividend in 2022, which generated a yield of 9.4% – expected to be covered by interest alone.
- **Risks:** Credit cycle and individual loan risk are intrinsic. All security values are currently under pressure. We believe RECI has appropriate policies to reduce the probability of default, and has a good track record in choosing borrowers. Some assets are illiquid. Much of the book is development loans.
- **Investment summary:** RECI generates an above-average dividend yield from well-managed credit assets. Income from its positions covers the dividends. Sentiment to market-wide credit risk is currently difficult, but RECI's strong liquidity and debt restructuring expertise provide extra reassurance. Where needed, to date, borrowers have injected further equity into deals.

Financial summary and valuation

Year-end Mar (£m)	2019	2020	2021	2022	2023E	2024E
Interest income	22.3	26.4	27.0	27.0	36.5	42.7
Operating income	25.3	(10.4)	45.3	32.4	30.3	47.7
Management fee	(3.0)	(4.1)	(4.3)	(4.4)	(4.9)	(5.0)
Performance fee	(0.7)	1.0	-	-	-	-
Operating expenses	(4.8)	(5.6)	(5.8)	(5.8)	(6.5)	(6.8)
Total comp. income	19.2	(17.4)	37.2	24.6	20.6	35.9
EPS (p)	13.1	(8.7)	16.2	10.7	9.0	12.6
NAV per share (p)	165.1	147.0	151.3	150.0	146.9	146.7
S/P prem./disc. (-) to NAV*	2%	-21%	-9%	0%	-14%	-13%
Debt to equity	40%	29%	22%	29%	24%	13%
Dividend (p)	12.0	12.0	12.0	12.0	12.0	12.0
Dividend yield	9.4%	9.4%	9.4%	9.4%	9.4%	9.4%

**2019-22 share price actual, 2023-24 forecast NAV to current share price*
Source: Hardman & Co Research

Important information

The information contained herein and on the pages that follow does not constitute or form part of an offer to sell or issue, or a solicitation of an offer to purchase or subscribe for, any securities to, or for the account or benefit of, US persons as defined in Regulation S under the US Securities Act ("US Persons") or persons within the United States, Australia, Canada, Japan, South Africa or within any other jurisdiction where such offer or solicitation would be unlawful.

The Company's securities have not been and will not be registered under the US Securities Act of 1933, as amended (the "US Securities Act"), or under any securities laws of any state or other jurisdiction of the United States. The Company's securities may not be offered, sold, resold, taken up, exercised, renounced, transferred delivered or distributed, directly or indirectly, into or within the United States or to, or for the account or benefit of, US Persons, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the US Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States. There will be no public offer of the Company's securities in the United States. The Company has not been and will not be registered under the US Investment Company Act of 1940, as amended (the "US Investment Company Act") and, as such, holders of the Company's securities will not be entitled to the benefits of the US Investment Company Act. No offer, purchase, sale, exercise or transfer of the Company's securities may be made except under circumstances which will not result in the Company being required to register as an investment company under the US Investment Company Act.

The offer and sale of the Company's securities have not been and will not be registered under the applicable securities laws of Australia, Canada, Japan or South Africa. The Company's securities may not be offered, sold, resold, transferred, delivered or distributed, directly or indirectly, in Australia, Canada, Japan or South Africa or to any resident or citizen of Australia, Canada, Japan or South Africa. There will be no public offer of the Company's securities in Australia, Canada, Japan or South Africa.

In addition, in the United Kingdom, the information contained herein and on the pages that follow is being directed only at, Qualified Investors (i) who have professional experience in matters relating to investments who fall within the definition of "investment professional" in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "Order"), or (ii) who are high net worth companies, unincorporated associations and partnerships and trustees of high value trusts as described in Article 49(2) of the Order, and (iii) other persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). Any investment or investment activity to which the information contained herein and on the pages that follow relates is available only to and will only be engaged in with such persons. The information contained herein and on the pages that follow must not be acted on or relied on in the United Kingdom, by persons who are not relevant persons.

Potential users of the information contained herein and on the pages that follow are requested to inform themselves about and to observe any such restrictions.

The information contained herein and on the pages that follow may contain forward-looking statements. Any statement other than a statement of historical fact is a forward-looking statement. Actual results may differ materially from those expressed or implied by any forward-looking statement. The Company does not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You should not place undue reliance on any forward-looking statement, which speaks only as of the date of its issuance.

By reading this report, you represent, warrant and agree that you (1) have read and understood the terms and conditions and other information set out above, (2) agree to be bound by its terms (3) are permitted under applicable laws and regulations to receive the information contained in the pages that follow and (4) agree that you will not transmit or otherwise send any information contained in this report to any person in the United States, to any US Person or to any publication with a general circulation in the United States. If you cannot so certify and agree, you must click the button labelled "Decline" or otherwise exit this.

Executive summary

This note looks at RECI's larger real estate positions.

It provides a snapshot, and positions change over time; however, as our past publications illustrate, this is an evolution not revolution.

RECI has evolved recently towards development loans. We believe this may bring some competitive advantage and, if so, this shifts the risk/reward boundary.

The combination of all the top 10 bilateral positions currently being senior loans, the standing of the sponsors and, in many cases, their past track record with RECI, and the characteristics of individual assets drive an overall positive view on RECI's risk profile. The factors taken together, in our view, are supportive of full capital repayments and dividend servicing in the current, more challenging, real estate environment.

The top 10 positions of £317.6m are 60% pure developments; 64% UK. A further portion of the advances is a mix of yielding assets and developments. There are two notable positions taken in France and, in recent years, France has been a regular feature in the top five or top 10 positions. RECI has a particularly active, experienced and well-connected senior team in France. We also provide some wider analysis of the Eurozone real estate market, the French residential developer market and the French hotels market. Why? Our research has a subsidiary emphasis on trying to provide evidence of competitive advantage. The exposure to development assets, and to France, are two aspects of the exercising of that competitive strength, we believe.

Tangible security analysis

Bilateral loans increasingly dominate, offering more scope for RECI management to add value direct to the borrower

Hardman & Co has undertaken a review of the top 10 bilateral loan positions held by RECI, in conjunction with data and descriptions provided by management. The RECI portfolio comprises bilateral loans/bonds and also market bonds. The latter have market prices and RECI owns a varying share in each bond. This category has progressively become a smaller portion of the portfolio. The latest gross fair value of the market bonds is stated at £33.4m (end-May portfolio factsheet). 15 bonds are held. This compares with a drawn value (net) of £298.5m for the bilaterals. 32 positions are held, all effectively unchanged on the month. The UK predominates, but France has consistently been a notable exposure, the latest proportion remaining at more than 20% of the total. By sector, there is a wide range, the largest of which, marginally, is hotels. These comprise nearly 20% of the bilaterals and a very small amount less in total.

Top 10 positions change over time, but this is an evolution and there are consistent themes

Hardman & Co has provided brief descriptions of the top 10 positions in a number of previous reports, so readers can see that they tend to change relatively slowly. Clearly, positions mature and new ones are taken on, but this is a consistent and stable evolution, so analysis of the current position gives a fair view of the prospects too. Once again, we concentrate, here, on the top 10, as they comprise the large majority of the weight of the exposure.

It can be seen that three of the top 10 positions currently are French, a jurisdiction frequently featuring for RECI. It is a consistent strategy. Local knowledge is paramount. RECI has built strong origination teams abroad, particularly in France.

Development asset loans rest on a RECI competitive advantage and thereby reduce the dangers of competition driving the risk profile upwards

One clear aspect is the high exposure to development asset types, which has increased in the past year. We see this as a positive for several reasons, which we expand on later in the note; principally, however, development allows greater opportunities to achieve a good rate of interest at lower LTVs. On discussion with RECI, we can see the strategy is to optimise control with minimised risk, as opposed to, for example, looking for a much higher interest return compared with core stabilised assets. Bearing in mind RECI's capabilities to assist borrowers operationally, this development exposure reduces competition and hence reduces the risk that the market might force RECI to accept. Nonetheless, certain development assets are leveraged to LTVs up to 80%. Asset-by-asset analysis, therefore, is of interest to those investors seeking a more granular understanding in order to build a representative bigger picture.

RECI portfolio top 10 commitments, end-May 2023

	Deal Description	Commitment	LTV	Investment Strategy	Sector	Country	Asset Type
1	UK mixed use portfolio, predominantly office/residential	£83.0m	48%	Senior Loan	Mixed-Use	United Kingdom	Core+
2	London Student Accommodation	£45.2m	58%	Senior Loan	Student Accommodation	United Kingdom	Development
3	London Residential Led Mixed Use Scheme	£32.7m	67%	Senior Loan	Residential	United Kingdom	Development
4	Office development in Saint Ouen, Paris	£30.9m	58%	Senior Loan	Office	France	Development
5	London Office	£22.8m	44%	Senior Loan	Office	United Kingdom	Core
6	Spanish Villas	£22.4m	49%	Senior Loan	Residential	Spain	Development
7	France Housebuilder Portfolio	£20.6m	36%	Senior Loan	Housebuilder	France	Development
8	Finland Hotel	£20.4m	65%	Senior Loan	Hotel	Finland	Development
9	South of France Hotel	£19.9m	80%	Senior Loan	Hotel	France	Development
10	Luxury Assisting Living Units in London	£19.7m	60%	Senior Loan	Assisted Living	United Kingdom	Core+

Source: Latest factsheets, priced at close May 2023, Hardman & Co Research

Balance and competitive advantage

We seek to show how the real estate class, quality and sponsor contain RECI's risk exposure

Let's take a step back to make clear what this research document seeks to illustrate: to show how the real estate class, quality and sponsor offers RECI the ability to optimise the risk containment. We then try to form a judgment regarding whether the positions illustrate any competitive advantage that RECI may have.

The "big picture": RECI investor proposition

Assessment based on an end-May 2023 snapshot but should give a good indication for the future

Dividend covered by the interest on loans…

This research note provides a real estate snapshot. The RECI business evolves. There is a rollover in the loan book as positions mature. This is a "live", actively managed business. Previous Hardman & Co research may be instructive in confirming there is an evolution as opposed to revolution in RECI's book, over time. Within this, however, it is a recent factor that the market bond portfolio has been significantly reduced in size. The past track record, therefore, gives a good indication of what capabilities and judgments will assist future stability. The current position should give a good indication of the raw material for the future. We also reiterate the important point that the dividend is covered by the interest on loans. Our financial tables on RECI itself, which include forward estimates, show the shape of its own balance sheet. In this document, we look specifically at the tangible assets making up the loan book.

…which is achieved with senior loans and often with prior-known sponsors

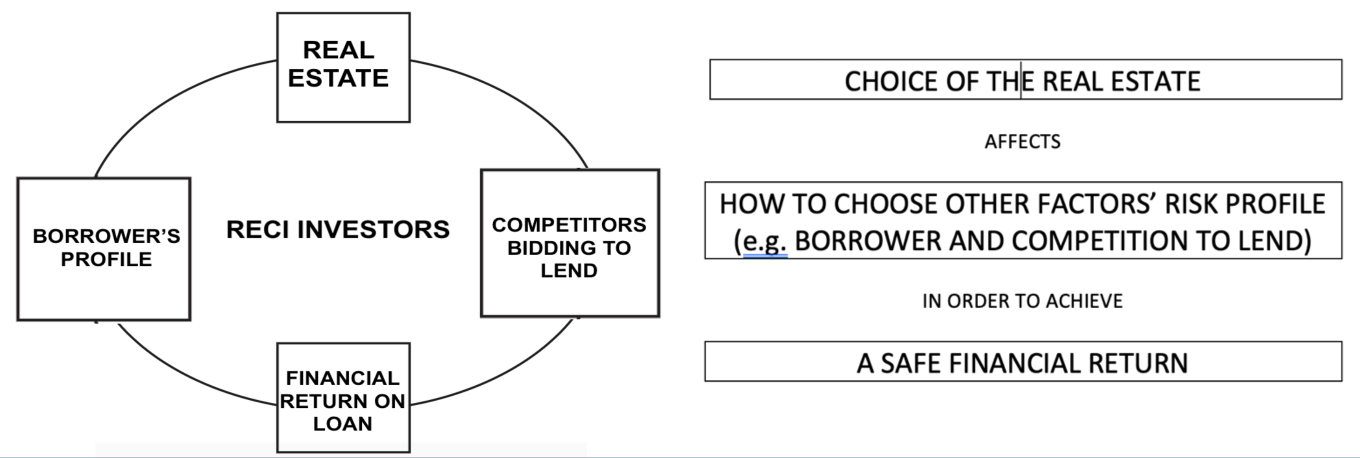
Our overall investor message is threefold. The combination of all top 10 positions currently being senior loans, the standing of the sponsors and, in many cases, their past track record with RECI, and the individual assets' characteristics are, in our view, supportive of full capital repayments and dividend servicing in the current real estate environment.

Importantly, RECI's choice of asset class interacts with the competitiveness of its origination strategy

This can be visualised in terms of how RECI's choice of real estate matches with the borrowers' profiles and how the structure of the loan will tune competition for that business up or down the risk/return profile. RECI's task is to optimise these various factors. Being conservative on one would mean taking a more liberal view on others in order to achieve the required returns to pay the dividends and protect capital.

We also see RECI as holding a competitive advantage in several of its positions.

Inter-related criteria… …translates to RECI "tuning" each input interactively



Source: Hardman & Co Research

Our research emphasises this RECI model being a balance between asset risk and competition. Assets needing more expertise are exposed to less competitive bidding.

This is a question of balance of interaction between the real estate, the sponsor and the loans' terms, which tune the competition to lend up or down.

- Does the management team have the right judgment and connections to achieve strong sourcing of good prospects?
- Does RECI's choice of real estate show some aspect of competitive advantage?
- Is the balance right between, say, ultra-safe asset classes but higher LTVs or lower interest coupons versus maybe a development but with a reliable, well capitalised sponsor, which has a good, safe development project to finance?

RECI has management attributes, which yield competitive advantages…

RECI management expertise brings competitive advantages. These include:

…for example, local knowledge, the wider Cheyne group and hands-on value added to borrowers, especially developers

- local knowledge, for example but not limited to France;
- the wider Cheyne group expertise and monitoring; and
- a hands-on value added to the borrowers, especially developers, as evidenced in the COVID-19 crisis.

This research note does not look at the interest coupon loan-by-loan – it is not stated – but we contend that our assessment of each of the top 10 bilateral positions assists investors to assess that all-important balance. The real estate asset is assessed, coupled with the sponsor and the LTV. Our aim is specifically to provide more detail on the real estate.

The "big picture": bilateral loans as at end-May 2023

Our analysis rests on RECI's end-May 2023 factsheet…

Our research is on the real estate within the bilateral loans. RECI holds positions in market bonds, but their gross fair value of £33.4m (£33.8m end-April 2023) is clearly well below the drawn value (net) of £298.5m (£298.1m end-April) for the bilaterals. We consider it of value, therefore, to look a little more deeply at the largest positions in those bilateral loans. RECI publishes monthly updates (May Fact Sheet), and the latest provides a position as at end-May 2023, published on 12 June. The details in the following section of this research derive from this factsheet and also from discussions with management on further points of detail. While this detail is important in assessing RECI's risk reward, we do not consider any information from our discussions to do any more than provide granularity to overviews that RECI has already provided in public forums.

We have also discussed particular aspects with RECI senior management team

Portfolio overview

Some "top level" categorisations

This research document focuses specifically on the real estate and management of real estate risk. We cannot emphasise too much that this is only one aspect of the overall RECI investor risk/reward proposition. It can only be properly assessed when the loan's financial and legal structure is taken into account.

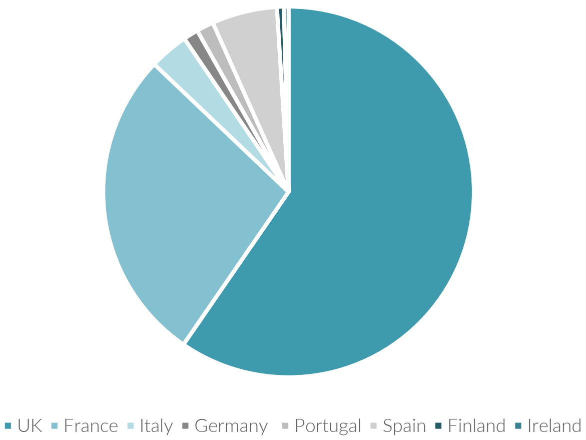
The top 10 positions are 60% developments; 64% UK

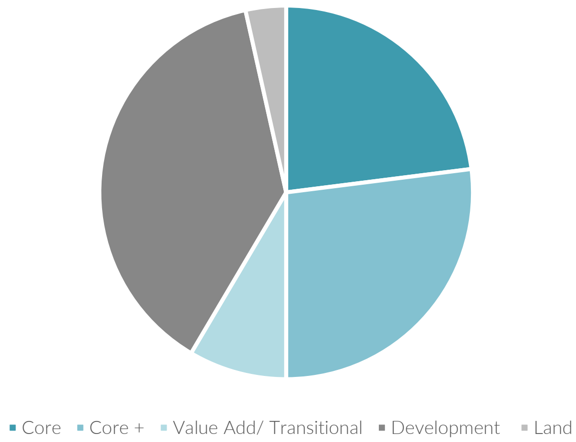
The top 10 positions are 60% developments; 64% UK. Note that, in addition, there are assets designated Core +. These comprise a mixture of yielding assets and development assets. In conjunction with data and background details, which are generally available and provided by RECI, Hardman & Co provides analysis in a little more detail. In the following section, we also provide some wider analysis of the Eurozone real estate market, the French residential developer market and the French hotels market. This is not to over emphasise France, but we consider it important to demonstrate the thinking behind exposure to a couple of dynamic asset classes, namely residential developers and hotels. See our note *Vive la difference,* published 15 February 2022. For reasons we provide below, we conclude this exposure provides an attractive risk/reward balance.

RECI, among other strengths, has expertise in France and in hotel sector

The geographical split and the balance between development and stabilised assets as at end-May 2023 is shown below. The definition of Core is that these are yielding assets. Core+ comprises a mix of yielding and development assets.

Portfolio concentration by geography (%)	Portfolio concentration by asset type (%)





Source: RECI factsheets, Hardman & Co Research

Top 10 bilaterals are a good guide to the group as a whole

The RECI monthly factsheet provides metrics for the wider portfolio and it can be seen that the LTV ranges and the geography and asset classes do indeed broadly match those of the top 10. Even within the top 10, the top five positions comprise 65% of that top 10 total. We would see this as a healthy focus.

The structure of the loan exposure

Choice of real estate directly affects how much risk needs to be taken on as regards loan characteristics:

Senior loans dominate; LTVs are relatively high

- all top 10 loans are senior risk-rank loans; and
- four out of the top 10 have LTV of 60% or more.

Taking on slightly higher LTVs enables RECI to be selective in other metrics – it is the balance that is crucial

It might appear incongruous to reach the conclusion that LTVs of over 60% constitute strength; but, what is the bigger picture? All four have strong sponsors and are in strong asset classes. Balance is essential. For example, position 4's micro-market is strong, even though apartment sales might be considered a less strong asset class. The sponsor – we give further detail when we describe this position, below – is a long-standing RECI counterpart. Taking on slightly higher LTVs enables RECI to be selective in other metrics.

This is exactly why this document takes a closer look, position by position.

The real estate exposure

The analysis is specifically on the real estate. Certain features stand out, in our view.

- Exposure to the UK is high.
- The exposure to development loans is high, with nine out of the top 10 fully or partly developer-led.
- There is a wide asset-class spread, including offices, but no retail malls or logistics.
- The largest single position by far comprises a portfolio, so a detailed assessment of real estate risk is not possible here. This is an actively managed portfolio; we assess the overall character and note the long track record RECI has with the sponsor.

The portfolio should be assessed "in the round", by which we mean the balance of risks on sponsors' servicing debt and, even more importantly, paying off the capital.

Loan-by-loan observations on real estate exposure

RECI's prospects for preserving capital while paying a strong sustainable dividend

We seek to determine RECI's prospects in preserving capital while paying a strong sustainable dividend. This is all based on the real estate profile and it assesses how this interacts with the loan structures to optimise reward and minimise risk.

Our research is based on the real estate profile and it assesses how this interacts with the loan structures to optimise reward and minimise risk. The interaction is a crucial element in reaching investment conclusions on RECI.

Senior debt

- All top 10 loans are senior ranking. This is listed first in the RECI-stated investment case. While some others may not be senior, it is an important RECI characteristic. There are trade-offs and the real estate characteristics should be taken as part of a risk/reward continuum.

Various LTVs analysed

- The LTVs on position 3 have a fluctuating balance, with periodic cash-refresh. Apartment sales drive the real estate fundamentals and deposits are built up, held on escrow. Apartment sales are subject to market fluctuations so this, allied to current interest rate rises, may be a risk. We consider all other factors on this position to reduce the risk, to acceptable levels. See our more detailed description of the position in the following section.
- LTV on position 8 is high, at 65%, but we consider the particular developer and development asset-class brings the risk down.
- LTV stands at 80% on position 9, which is in the strong market of French hotels. There are two underlying assets, one of which is being marketed for sale and which appears to be an attractive business.
- LTV of 60% for position 10 appears a modest risk, as this is a strong asset class.

High but not exclusively UK exposure

- High UK exposure is a normal response to the mandate of being a UK-based fund, paying dividends in Sterling and with a balance sheet in Sterling. It is natural, therefore, that the dominant core should be UK.

Development loans now comprise the large majority…

- Development loans need to be assessed individually and the range of fundamentals includes a variety of asset classes, LTVs and locations. By their nature, through their construction phase, developments absorb and do not generate cash. The financial standing of the sponsor is very important, therefore. Servicing the dent interest is reliant on the sponsor, so our analysis ultimately can only truly be as regards the end-repayment on the position. We assess each in the segment below. The mix of end-sponsor, LTVs and asset class fundamentals is supportive, although positions 4, 8 and 9 are the ones we consider merit deeper analysis. Number 4 is a Paris office. The LTV reassures us that, while this admittedly difficult market may make marketing the underlying asset slow, there is reasonably sufficient leeway between real estate value and the RECI loan position, especially as it is a senior loan. We have listed positions 8 and 9 above and the end-market of hotels does appear supportive.

…which we consider to be one aspect of RECI's competitive advantage

- Competitive advantage is important and development loans are one of several fields in which this competitive advantage can be deployed.
- The office assets positions 4 and 5 are possibly the more exposed in terms of current market prospects for particular asset classes. We review number 4 in brief just above. Position 5 has a low LTV, providing plenty of leeway for any realistically possible down-valuation of the real estate.
- The largest position comprises a portfolio and this includes offices, which may be seen as a weak market. We assess this specific position below. The LTV is capped at 60% but is well below that level currently.

What this research note analyses and what it does not

We emphasise that this research note focuses on the bilateral positions and how they come together to constitute the overall RECI risk, rewards and opportunities. This coming together of real estate and senior management expertise – the balance of knowing how to manage assets where there might be less competition to lend – is what this research document is about. We do not assess in this note the reinvestment style – e.g. the loan durations – or the RECI balance sheet.

Top 10 bilateral loans

1: UK mixed-use Core +

Long track record with the sponsor, a portfolio with positions maturing and being refreshed, competitive advantage and value-add to the sponsor

We consider the RECI position to be significantly enhanced by its benefitting from a positive track record with the sponsor. From the sponsor's point of view, the flexibility of the advance no doubt is a major convenience and we would expect there is also a rapid appraisal, understanding and potential approval for new collateral as it is presented from time to time.

This is a Core+ holding, indicating a combination of yielding asset and development asset. The sponsor has been in fruitful commercial relationships with Cheyne/RECI for over a decade. Locations are carefully selected across the UK with the sponsor securing planning and taking the position through to stabilised income, upon which it can eventually refinance.

Turning to the specific RECI position, we understand there is a 60% LTV cap, with a series of deals being financed, then maturing within the wrapper. Each new advance within the position is taken on its merit, with RECI's approval required for new collateral to be put in. The leeway for fresh advances within the facility is created by the sponsor refinancing stabilised, income-producing assets with a third party and paying the cash to reduce the outstanding debt to RECI. There is thus a healthy refreshing of the collateral in the position, based on the strategic *modus operandi*, which combines holding development land through to the yielding assets. It is also healthy for RECI cash management and underlying visibility of liquidity that the exposure has income-yielding assets as well as development land.

2: London student accommodation

Some market and political risk in this development loan, but the market is significantly undersupplied. A balance of risk/reward/competition.

This commitment was taken in November 2022, so is priced post the worst of the market turbulence. It comprises UK (London) student accommodation at an early stage of development, to be completed in 3Q'25. Less than half to date has been funded out of a £45.2m commitment. Student assets are dependent on a number of factors, which may move for or against the risk. The underlying point here is undersupply. However, the asset class is somewhat dependent on overseas students paying the higher rent levels, which impart upward momentum to the sector's rents. This may be open to political risks/changes, and the cost-of-living crisis affects domestic students' willingness to pay rising rents. This is an important position, and, overall, we consider the risk to be more than acceptable, given the undersupply.

3: London (Wembley) residential-led, mixed use

Again, a balance of risk/reward/competition much assisted by being a strong project and a sponsor well known to RECI

We consider the RECI position to be significantly enhanced by its benefitting from a positive track record with this sponsor. From the sponsor's point of view, the LTV is without doubt attractive, while this is risk-minimised for both parties by the transactions with the local authority.

This is a residential-led, mixed-use development in Wembley, north west London. The sponsor is a joint venture between LaSalle and Regal London, with the latter well known to RECI. This risk-profile is mitigated by the expertise of the sponsor, the fact the Wembley site has a strong anchor and momentum and that the performance of the in-house building contractor is very strong. It has proved itself in managing rising costs. Indeed, it was strong over the difficult COVID-19 period too. We are told the sales rates continue at levels which give comfort as to the sponsor performing on its loan. There is also an encouraging flow of funds through the life of this position. Cash liquidity encourages us to anticipate repayment upon scheduled maturity. Cheyne/RECI and Regal London have a track record together on previous advances, we believe. This one appears very well founded, even in potentially more difficult times for residential developers worldwide.

Regal London has a strong pedigree of high-quality London apartment development within larger schemes such as this one. It offers owners well-appointed, quality-finish apartments with access to facilities. This attracts buyers globally, and Regal itself has sales offices in the Middle East and Far East, where it can point to an element of loyal brand-following. The development is phased, so there is a build-up of sales, with deposits held in escrow, followed by the phase completion releasing cash, which is then reinvested in further phases. It is a positive aspect that there is a fluctuating balance, with periodic cash-refresh. In addition, the development is entering a pre-selling phase of social housing to Brent Council, added to which the council is purchasing some private development apartments, we understand. The developer, therefore, holds in escrow a useful quantum of deposits, a figure which is growing.

4: Office Saint Ouen, Paris

An acceptable risk, which should come out successfully, but not an easy market and LTV nudging 60% with valuation risk on the downside

RECI's track record with developments, and in France, no doubt encouraged attractive terms to be put forward. While the market has changed somewhat further since 2020, particularly driven by interest rates, the timing of the opening of this position was already one where conservative valuations were being put forward, we would expect.

This office development is in Paris, near the main ring road. This development at Saint Ouen is near fully built. The loan was instigated in 2020 and the build has proceeded well, to plan. The leasing risk does remain, though, and the market is relatively slow compared with the good central Paris market. The latter's rents are up and supply is low, so there are indications that a firmer position may spread. At the moment, this is conjecture, however. The sponsor is private equity and interest is currently being paid. Once a tenant is in place, a refinance event can take place and the LTV for RECI would be covered. We expect it should be. The valuation is historical and based on the gross development value, i.e. the position as completed. There are some challenges to this position, therefore; but, as a modern, well-located – near transport – value-for-money proposition, the risk is to timing rather than ultimate rental potential, we believe. As a final point to bear in mind, Paris and the wider French economy have experienced a relatively robust position in recent years.

5: London office

This is a London office investment let to WeWork. With a modest LTV, there is plenty of "wiggle room" in a difficult market.

This London office investment is in Hoxton. The asset is let to WeWork on a long lease. Given further concerns about WeWork as recently as May 2023, we would consider the position and layout of the building to be just as important as the lease. Both of these are strong and the sub-let occupancy is above 70%, we are informed. That said, WeWork's 1Q'23 occupancy was stated at 73%, so this building's level is in line but below the aspiration expressed by WeWork for the group, namely 76%. We note the LTV is at an encouragingly conservative level. This, we understand, is based on levels assessed a year ago. Given the tech sector's woes the valuation risk appears on the downside. Looking at "stress-test" scenarios, nonetheless, the leasing risk should prove manageable, even were WeWork to somehow be released from its commitment. Were this position an equity investment, its value might be in question. The LTV is usefully a level that we consider modest, at 44%, an important figure. Even were the value to slip, as yields move out, a refinance should be achievable, with LTVs up to, say, around 60%. This indicates a wide margin for asset down-valuation – in this case some 25%. We would consider this a conservative illustration, a reassuring cushion.

RECI understands development risk and timings and much of the sales risk has gone via pre-sales

6: Spanish villas

We consider the RECI position to be significantly enhanced by its benefitting from understanding development risk and timings while it has been made clear much of the sales risk had already been removed.

The villas are under development as a further phase on a well-established community, with good existing on-site facilities. This is a new phase and is marketed to high-net-worth, second-home owners. The majority of the villas are pre-sold, so the risk is on the construction and this is proceeding on time to budget, we understand. While a discretionary purchase, this mid-higher-end market is less affected by interest rate fluctuations than some other segments of the market and it appears other Spanish mid-higher-end second-home markets are resilient too. We reiterate that, crucially, these villas are pre-sold thus we consider this position to be low risk.

The villas are pre-sold and the mainstream market trends are therefore only of broader interest to place this position in some context. Spanish house price inflation started 2022 at 10%, rising to 12% in March and ended the year at 1%. This took the two-year increase to 10% at that point, 20% above the 2014 low and 15% below the 2007 high. Madrid and the Balearics are the stronger regions in the long and short term. The Spanish government is discussing excluding foreign buyers from the Balearics (Source: Spanish Property Insight).

Effectively a low LTV company loan in a market sector that – as well as upside – has some intrinsic risks but is performing reasonably after a year of difficult market background

7: French housebuilder portfolio

We consider the RECI position to be enhanced by its understanding not only of the French market but also of developers. This is a loan to a developer company rather than a position with a specific development, but, no doubt, RECI's expertise was a factor in it securing this position. We are not sure if that was under public competitive positions, but we expect that Lone Star would have been able to select from a list of potential lenders at this modest LTV. From the sponsor's point of view, many on the list of potential candidates might not have had the hands-on expertise, particularly expertise in France, which Lone Star might feel to be a benefit.

This is a company loan to finance the purchase of a French housebuilder. In 2021, the experienced global residential developer investor Lone Star purchased a mid-market regional French residential developer operating primarily out of Toulouse, GreenCity Immobilier. The latter was founded in 2011 and, since 2018, has delivered over 1,000 apartments p.a. Under Lone Star, it has expanded, including geographical expansion, although it is important to specify that expansion into Paris and other regions commenced well before Lone Star.

RECI financed 35% of the purchase price, so, even with recent headwinds in the sector globally, the collateral would be well underpinned. That stated, it is important to be aware that the business model, common in its chosen market, is to own a land option, not the full land title. Residential developers in this market have real estate and work-in-progress assets, but it is a more asset-light model than, for example, the UK.

There is construction and sales price risk and also risk from slowing sales rates. There is a structure in place to cap GreenCity Immobilier's balance sheet gearing. The loan is amortising at 5% p.a. and has three years left on a five-year loan. Lone Star is a well-resourced, globally diversified player. We provide broader analysis of French residential developers' positions later in this report.

8: Finland (Helsinki) hotel

LTV is perhaps surprisingly high, but RECI has high expertise and a very good track record in hotels, so it is justified in backing its judgment

RECI has deep understanding of the hotel developer market and exited pre-COVID-19 positions with poise, after becoming more involved in the progress of the relevant projects during the COVID-19 turbulence. This stands RECI in good stead to assess risk. However, it may have also proven an attraction when the sponsor decided on lender and this may be reflected in returns, although it should be noted that this is conjecture on our part.

The asset is a Helsinki airport hotel, Finland. It is a development loan and the large, experienced contractor retained is under a fixed price contract. The development is progressing on schedule. Development started in the latter part of 2022, with expected completion for June 2024 – so cash exposure is modest currently.

The location, specification and the local market conditions are positive, offering the strong prospect of a sale or a refinancing once the project is completed.

Turning to broader market analysis, the number of tourists visiting Finland in 2022 was only 5.4% less than in 2019. The absence of Russian and Asian tourists was compensated for by the increased share of visitors from Germany and the United Kingdom, which became the highest-spending tourist nations. Sweden, France, and the US complete the list of top-five feeder markets. The seasonality in 2022 repeated the trends of 2019, with the year usually starting slowly. Driven by the gradual resurgence of international travel, strong domestic demand, and rising inflation, the country-wide average room rate in 2022 (€106) has surpassed the 2019 level (€99), thus setting a new record. 2023 is continuing trends but in the face of global economic slowdown, so there is an evolving situation (Source: Christie & Co February 2023).

9: French hotels (Paris and Nice)

RECI well positioned in competition with other lenders due to deep understanding of hotel developer market it gained in recent turbulent years

Here, too, the deep understanding of the hotel developer market that RECI gained in recent years amid COVID-19 turbulence must be seen as a competitive advantage.

The asset comprises two French hotels, one yielding asset, one development. The majority of the exposure is to the development position, in the old town in Nice. This is a construction management arrangement, not a fixed price. Construction is progressing well. Upon completion, the asset could be sold or could be refinanced. The loan matures in approximately two years' time. Upon maturity, an equity participation remains held by RECI, giving some element of potential upside at no risk. The yielding asset is well located in the vibrant Pigalle area of central Paris, the asset comprising a strong food and beverage income as well as rooms. This four-star hotel has an ADR (average daily rate) of €216, up 20% YoY. It averages 75% occupied, we understand. We understand that this asset is currently being marketed for sale.

As to indications of the French hotel investment market, we provide further analysis later in this document, based on Cushman Wakefield March 2023 and other data. Looking at the dominant market, Greater Paris, hotel transaction volumes reached a robust €1.9bn during 2022. This was 300% above 2021 but also 7% above 2019 level. A part of the attraction is the Olympics, but this is a wide and encouraging market background albeit, naturally, the headwinds of 2023 for the global economy and global real estate may take some of the shine off.

10: Luxury assisted senior living, London

High-quality project in an under-served market

This is a high-quality project in Kensington, London. The capital advanced was deployed in the acquisition of a 190-unit complex, complete with 20,000 sq. ft. of communal facilities, which include a concierge, chauffeur service, swimming pool, spa, screening room, restaurants and bars. The residence retains a third-party care provider, appropriate to the premium nature of the scheme. Exit is expected through the sale of units, as opposed to looking for disposal of the complex in its entirety.

This appears to be a straightforward position, with a granular exit not reliant on other investors needing to discount cashflows from an entire scheme.

Residential and hotel sectors in France

RECI has a position in a Paris office, French hotels and a French housebuilder. See our previous Hardman & Co research note, focusing on France, *Looking at the current opportunities*, published on 15 February 2022

Notwithstanding the risks of investing overseas, RECI in France is considered a local company with international reach

RECI is a UK-quoted stock so it is natural that investors will look to reassure themselves of risks of investing overseas. Importantly, RECI in France is a local company with a strong base there. It has a commitment of £40m to these two sectors, through two positions, so we do not wish to over-emphasise their importance. Further, the housebuilder has a modest LTV of 36%. Hardman & Co's reasons for ascribing a low risk to these positions should be expanded upon, we believe. Investors need to understand the steps leading us to our positive conclusions as to the modest risk of position number 7, the French residential developer and position 9, the French hotels. We summarise from two recent financial and commercial updates from two leading French residential developers.

In our view, a message of cautious stability comes across. Cautious optimism may follow, but this would be premature. It is crucial at all times for investors to bear in mind that RECI is a provider of loans not equity, so stability is the main commodity being sought.

French residential development market update

Residential development is not asset-rich and is exposed to rapid fluctuations in buyer-demand. Both of these factors, undoubtedly, affect the risk characteristics. Residential development, too, should be viewed as granular and the beneficiary of regular cash "refresh" as apartments are purchased and subsequently handed over. The French residential loan profile, therefore, has complex aspects both raising and lowering the risk profile. We have provided specific analysis of the position in the segment of this research document above. The market as a whole will inform investors as to the fast-changing profile of demand, which is an important factor for the underlying cashflow dynamics servicing the position.

2022 sales volumes were down on 2021, but still 20% above the 10-year average. 2023 has weakened, globally.

In 2022 as a whole, the market was rising. Of course, as global economic headwinds sharpened in 2H'22, matters deteriorated. For 2023, we look at the two largest developers, but first, a general market assessment is of relevance. Second-hand residential volumes and prices are strong, albeit 2022 sales volumes were down on 2021. Nonetheless, they are still 20% above the 10-year average, and further above the 20-year average. House prices increased by 8.6% in 2022, apartment prices 5%. Ile-de-France saw a slight relative cooling, but house prices still rose 5.7% there in 2022. Across France, house prices are up 23% in the three years to 2022 and 18% in the two years to 2022, (Source: Association les Notaires de France).

Kaufman & Broad 1Q'23 results were acceptable and it did not change guidance

Kaufman & Broad's 1Q'23 results and dividend were announced on 13 April 2023 "in line with our expectations." EBIT margin was 8.4% while the full-year 2023 revenue estimate was reiterated at €1.5bn. Housing orders fell in 1Q'23 to €234m vs. €278m, down 15.8%, while units were down 17.5%. The programme take-up period rose to 6.9 months from 4.5 months. 98% of the offering and 88% of the land bank is in "tight areas" A, ABIS and B1. First-time buyers fell to 5% of revenue from 12%. Kaufman & Broad's long-term Fitch rating is BBB-, outlook stable, last updated September 2022. Previously, it was BB-, so the rating upgrade brings it to investment grade. The balance sheet holds net cash.

Nexity 1Q'23 results were acceptable and it did not change guidance

On 26 April, Nexity announced its 1Q'23 results, including an unchanged dividend. Its 2023 outlook was unchanged and the 19 months' revenue backlog was highlighted. French home reservations were down 19% in unit terms, 25% in value. Development revenue showed a 2% increase. Public and private landlord sales rose, particularly social housing, and monetary value of sales to individuals fell 33%. Take-up periods fell slightly to 6.5 months. The Outlook statement included: "Traditionally, the first quarter is not representative of expected activity over the course of the year. The French market for new homes is set to continue to decline in the first half of 2023, in line with the trend seen in the fourth quarter of 2022, before stabilising in the second half of 2023."

French hotel market update

Paris hotel transaction volume in 2022 was €1.9bn, 300% above 2021 and 7% above the 2019 level

Hotel transaction volume in Greater Paris reached €1.9bn during 2022. This was 300% above 2021 but also 7% above 2019 levels. The key driver was several major transactions in prime locations, with price per room exceeding €1m. Examples of landmark deals in 2022 include The Hoxton, and the Locke Paris.

Hotels recorded an outstanding performance in 2022, with RevPAR at €154 in Paris and €98 in Greater Paris (+14% and +8%, respectively, above 2019). As previously experienced in 1H'22, performances were driven by strong ADR (€205 in Paris and €142 in Greater Paris). In the meantime, occupancy reached 75% and 69%, slightly below 2019 levels, due to still weaker demand from the corporate segment and long-haul source markets, especially China.

In 2022, the hotel supply increased by 75 properties, adding approximately 10,000 rooms, most of which opened in the first half of the year. This included primarily midscale and upper midscale hotels in central Paris and the periphery, but also highly expected, high-end assets such as the TOO Hotel and the SO/Paris Hotel. More high-profile openings were expected for the first quarter of 2023 (and this has taken place), such as the Hotel Dames des Arts. After two difficult years, demand for hotels in Paris has bounced back thanks to strong demand from international tourists in 2022. While leisure tourism has picked up, business tourism is to take longer to return to pre-COVID-19 levels. Data from Cushman & Wakefield, March 2023.

Eurozone real estate market update

Investment into European real estate market totalled €305bn in 2022, down 18% as a consequence of the slowdown experienced in the final quarter, which continued in 2023. The market is going through a period of repricing.

The French market represents RECI's second-largest geographical exposure, although it is well behind the UK. A strategic decision was taken some years ago to develop expertise and deal-sourcing ability in France. On a macro basis, this decision is paying off usefully. French macroeconomic data is well documented and its recent performance and prospects are as good as or better than the Eurozone as a whole and better than the UK. Turning to the more specific Eurozone real estate investment volumes, these had performed robustly in 2021 and rose early in 2022. Investment into the European real estate market totalled €305bn in 2022, down 18% as a consequence of the slowdown experienced in the final quarter. The market is going through a period of repricing. 2021 had been 2% above the five-year average, which included the low 2020 figure. 2021 also stood above the average achieved in the period since 2015. Data from CBRE reports.

Balance of risk in top 10 positions: conclusions

RECI strategy and investment style

Our conclusions are opinion, but our aim has been to provide investors and potential investors with data and facts for use to draw their own conclusions on a better-informed basis. The facts of the developments point to clear competitive advantages, worth highlighting. Certain themes emerge, and consistently so.

Much of the strategic analysis boils down to RECI exploiting its competitive advantage and building up trusted borrowers

- In seven cases out of the top 10, a strong case can be made that RECI's expertise was a competitive advantage in securing the transaction.
- Strong counterparts are a feature in several and, no doubt, the others have been selected on robust criteria too.
- Senior loans currently comprise 100% of the top 10 positions.
- RECI has the ability to be hands-on where needed and, given most of the top 10 positions are development projects, this is a competitive advantage.
- It can be concluded that RECI has been seeking out areas where lending competition is lower yet where it has something to add, such as development loans.

Sponsors (counterparts) are not made known across the board, for commercial confidentiality. Clearly, though, RECI has a backbone of repeat borrowers.

One very important risk/reward driver we have touched on but not provided full detail on is the quality of the sponsors (counterparts) of the positions. There is an element of commercial confidentiality and so we point to the track record, which points to a robust outcome through the COVID-19 turbulence. As mentioned, this included a hands-on working with the sponsors to manage some of the problems promptly as they arose.

Senior loans have predominated; indeed, currently, the top 10 bilateral positions are all senior debt. It is worth reiterating that this, in part, is made more achievable by the raising of exposure to development loans. Here, competition is less acute and broad-brush less-experienced non-bank lenders will be wary, simply due to the nature of the risks of construction and development. We do not reiterate the position-by-position exposition of how these risks are managed by RECI. We do urge investors, however, to take into account the fact they are senior loans.

If well positioned, development advances do the opposite of raising risk

Development advances do not raise risk because they take RECI into areas where lenders are less competitive and, further, RECI has shown, throughout COVID-19, its ability to help its position and the sponsor by being hands-on where this helps.

The detail and tactics: summarising the top 10 positions

Each of the positions must be taken on its own merits; that said, RECI has specific areas of expertise

Taking the positions in order of commitment, the largest rests on the throughflow of cash as older positions mature into yielding assets for refinancing and newer ones are taken on. This cashflow is very useful ammunition were the commitment to be reviewed by RECI. The new positions each have to be approved by RECI. We have not analysed the sponsor, but Cheyne/RECI has a track record of joint success lasting more than 10 years. The level of the LTV, below 50%, is a further reassurance.

The second position, in our view, is underpinned by undersupply in London for student accommodation. It is a market open to political changes and anecdotally (so far) rents for students are rising at a much slower pace than the broader market.

They are, nonetheless, rising, which is in contrast to many sectors. The Unite share price might be considered an imprecise but relevant proxy and this is broadly reassuring. The key point is that this – like all RECI – is a loan, not an equity position. We do have some reservations about purpose-built student accommodation values but not in any way significant enough to give us concern on this LTV, given the undersupply.

The third position, Wembley, has a sponsor that clearly knows what it is doing and that is operating in a good location and in a good sector of residential. The fourth, Saint Ouen position, is a bit of a contrast. We have some reservations as to end value, certainly until a suitable tenant(s) is found. Nonetheless, Paris is a relatively strong market and the LTV is acceptable. The fifth, the Hoxton office, we would place in the middle of the risk ranking. The LTV is usefully a little below 50%, an important figure. Even were the value to slip as yields move out, a refinance should be achievable with LTVs up to, say, around 60%.

Position six, the Spanish villas, is one we are relaxed about. The villas are ore-sold and the LTV below 50%. We are also relaxed about position seven. Given how French residential developer share prices have been as weak as those in the UK, for example, this might seem an overly unconcerned conclusion, but only if all the multiple risk-limiting factors we have outlined are ignored. In addition to these, the LTV is low. The next two positions in hotels have fairly high LTVs but are senior loans and our detailed analysis points to acceptable risks. The French hotel market appears robust in terms of RevPAR and investor demand too. The final top 10 position is in a decent sector and undersupply is the main quantifiable positive, in addition to this being a senior loan.

Valuation

Absolute

Current NAV likely to be on conservative side

We have, in previous reports, considered how the NAV is assessed (see pages 23-24 of our initiation report, *7%+ yield from well-secured property debt portfolio,* published on 28 August 2019). The critical issues are how conservative the culture of the organisation is, and the independent checks and controls that are in place to review the process. As we noted in that report, RECI's approach to both issues appears to be in line with best practice. Writedowns and subsequent recoveries in the bond book, and the limited writeup of the housebuilder mezzanine loan, demonstrate a conservative approach.

Yield

12p annual dividend expected

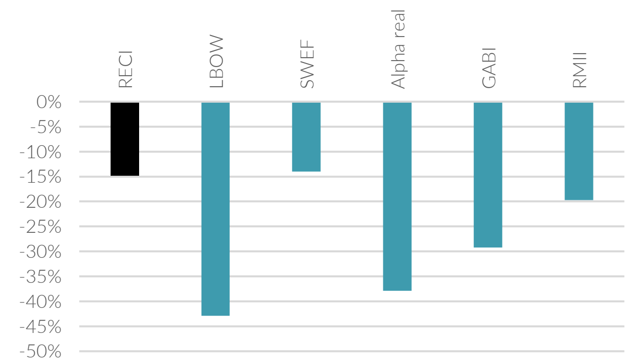
Through the COVID-19 crisis, when RECI took large, early MTM hits in 2020, and then steadily released them through the rest of the year, it maintained a consistent 3p quarterly dividend. The yield was covered largely by stable monthly interest income, and the bond MTM saw capital gains/losses feeding through to NAV noise. With the recent market recession uncertainty, and the hiatus in the gilt and bond markets, following the UK mini-budget, we have seen the same happening, and we expect RECI to follow the same, consistent policy: a stable 3p quarterly dividend, covered largely by interest income, and MTM losses and gains seeing some NAV noise.

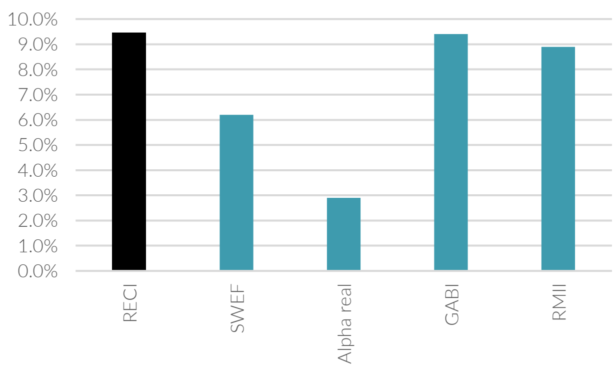
Relative

NAV rating and dividend yield among highest among ongoing peers

Comparisons of RECI with a close and broad peer group are given in the charts below. The RECI NAV rating is among the highest in the close peer group. Having returned to trade at a premium, the recent market uncertainty has, once again, meant that RECI is now trading at a discount. The dividend yield is the among the highest among RECI's closest peers (LBOW in wind-down). For investors who view the risk controls and procedures in RECI as robust, such a valuation appears anomalous.

Premium/discount to NAV (LHS, %), and dividend yield for RECI and selected peers (RHS, %)





Source: Latest factsheets, priced at close 12 June 2023, Hardman & Co Research

Financials

Profit and loss

Year-end Mar (£m)	2016	2017	2018	2019	2020	2021	2022	2023E	2024E
Interest income bonds	4.7	2.6	5.4	6.9	11.5	12.9	15.6	13.8	2.6
Interest income loans	12.9	12.5	12.8	15.2	14.9	14.1	11.3	22.7	40.0
Other interest income	0.1	0.2	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Interest income	**17.7**	**15.3**	**18.4**	**22.3**	**26.4**	**27.0**	**27.0**	**36.5**	**42.7**
Net (losses)/gains on investments	4.7	4.6	2.8	(0.1)	(35.9)	18.2	5.4	(6.2)	5.0
Net losses on options	(1.6)	(2.4)	(0.9)	-	-	-	-	-	-
Net gains on foreign exchange instruments	(5.6)	(1.8)	0.2	3.1	-	0.1	0.0	-	-
Total net gains on fin. assets at FV through P&L	(2.6)	0.5	2.2	3.0	(36.8)	18.3	5.4	(6.2)	5.0
Operating income	**15.1**	**15.7**	**20.6**	**25.3**	**(10.4)**	**45.3**	**32.4**	**30.3**	**47.7**
Management fee	(2.0)	(2.0)	(2.6)	(3.0)	(4.1)	(4.3)	(4.4)	(4.9)	(5.0)
Performance fee	(0.2)	(0.1)	(0.3)	(0.7)	1.0	-	-	-	-
Other operating expenses	(0.9)	(1.1)	(0.8)	(1.1)	(2.4)	(1.6)	(1.5)	(1.6)	(1.8)
Operating expenses	(3.1)	(3.2)	(3.7)	(4.8)	(5.6)	(5.8)	(5.8)	(6.5)	(6.8)
Profit before finance costs	**12.0**	**12.5**	**16.8**	**20.4**	**(15.9)**	**39.5**	**26.5**	**23.8**	**40.9**
Finance costs	(3.5)	(3.4)	(1.9)	(1.2)	(1.5)	(2.2)	(2.0)	(3.3)	(5.0)
Net profit	**8.5**	**9.1**	**14.9**	**19.2**	**(17.4)**	**37.2**	**24.6**	**20.6**	**35.9**

Source: RECI Report and Accounts, Hardman & Co Research

Hardman & Co adjusted profit & loss

Year-end Mar (£m)	2016	2017	2018	2019	2020	2021	2022	2023E	2024E
Statutory profit	8.5	9.1	14.9	19.2	(17.4)	37.2	24.6	20.6	35.9
Capital gains & FX movements	(2.6)	0.5	2.2	3.0	(36.8)	18.3	5.4	(6.2)	5.0
Profit excl. capital gains & FX	**11.1**	**8.6**	**12.8**	**16.3**	**19.4**	**18.9**	**19.2**	**26.8**	**30.9**
Adjustment to performance fee	0.2	0.1	0.3	0.1	(0.3)	0.9	1.0	(0.5)	(1.3)
Adjusted profit	**11.3**	**8.7**	**13.1**	**16.3**	**19.0**	**19.9**	**20.2**	**26.3**	**29.6**
Cost of dividend	(7.9)	(8.4)	(13.7)	(17.6)	(25.1)	(27.5)	(27.5)	(27.5)	(27.5)
Statutory cover	1.1	1.1	1.1	1.1	(0.7)	1.4	0.9	1.3	1.3
– excluding capital gains cover	1.4	1.0	0.9	0.9	0.8	0.7	0.7	1.1	1.1

Source: RECI Report and Accounts, Hardman & Co Research

Balance sheet

@ 31 Mar (£m)	2016	2017	2018	2019	2020	2021	2022	2023E	2024E
Bonds	39.6	49.8	97.3	163.1	237.6	254.3	284.5	49.2	15.0
Loans	113.2	109.3	148.1	139.4	137.6	136.1	109.8	354.0	463.2
Financial assets at FV through P&L	**152.8**	**159.0**	**245.4**	**302.5**	**375.2**	**390.4**	**394.3**	**403.2**	**478.2**
Cash and cash equivalents	5.3	24.9	7.2	38.6	27.0	21.2	47.4	12.0	5.4
Cash collateral at broker	0.0	0.0	2.4	1.4	25.0	0.9	5.2	5.2	5.2
Derivatives	3.2	0.9	0.2	0.7	0.0	2.3	0.0	0.0	0.0
Other assets	2.5	4.4	4.9	12.0	14.6	11.4	0.0	0.0	0.0
Receivables for investments sold	0.0	0.0	48.1	0.0	0.0	0.0	0.0	0.0	0.0
Total current assets	11.0	30.2	62.8	52.7	66.6	35.8	52.6	17.2	10.7
Total assets	**163.8**	**189.3**	**308.2**	**355.2**	**441.8**	**426.2**	**447.0**	**420.4**	**488.9**
Current liabilities									
Derivatives	0.5	0.0	0.0	0.0	6.2	0.0	1.1	0.4	0.4
Financing	0.0	0.0	78.3	100.1	97.0	77.8	100.4	81.4	55.0
Cash collateral due to broker	0.0	0.4	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Preference shares	41.8	41.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	2.7	2.7	1.3	1.7	1.5	1.5	1.6	1.6	1.6
Total liabilities	45.0	45.0	79.6	102.0	104.6	79.4	103.0	83.4	57.0
Net assets	**118.8**	**144.3**	**228.5**	**253.2**	**337.2**	**346.9**	**343.9**	**337.0**	**431.8**
No shares (m)	72.8	88.4	139.4	153.3	229.3	229.3	229.3	229.3	294.3
NAV per share (p)	**163.2**	**163.2**	**164.0**	**165.1**	**147.0**	**151.3**	**150.0**	**146.9**	**146.7**

Source: RECI Report and Accounts, Hardman & Co Research

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).

(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 2018, 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: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.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.

research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44 (0)203 693 7075

www.hardmanandco.com