
Primary Health Properties

Healthy start

HOLD

Target price 120p | Published price 114p

H1 results were ahead of our expectations with NAV +5.5% to 96.1p, 5% ahead of forecast, primarily driven by yield compression. EPRA EPS +8% and the DPS +2% were also just expectation. Positively, rent reviews are beginning to increase with annualised growth of 1.6%, up from 0.9%. We expect PHP's portfolio to continue to benefit from long-term structural growth, driven by a growing and ageing UK population coupled with efforts to improve the efficiency and cost effectiveness of the NHS by expanding the scope of services provided by GPs. The shares trade on a CY17E P/NAV of 1.24x vs sector 0.89x but offer a DPS yield of 4.5%

Good start to FY17: NAV and EPS ahead

H1 EPRA NAV +5% to 96.1p was 5% ahead of our 91.3p forecast primarily due to 13bps of yield compression.

EPRA EPS +8% to 2.6p was 4% ahead of our 2.5p expectation. The DPS +2.2% to 2.62p was also 2% ahead of our 2.58p expectation.

Rental growth improving

Positively, rent reviews are beginning to increase with annualised growth of 1.6%, up from 0.9% in FY16. Comparable new build evidence, used to price open market reviews, is now beginning to be reflected in lease renewals with management expects to result in further rental growth in the future. This level of growth matches peer Assura who reported 1.6% growth in rents for the year to Mar-17.

The portfolio remains well let at 99.7%, in line with FY16, with a weighted average unexpired lease length of 13.3yrs (13.7yrs FY16). The EPRA cost ratio increased marginally to 11.9% (11.5% H1 16), but remains one of the lowest in the sector.

+2.4% LFL valuation gain, with further portfolio expansion

A +2.4% LFL increase in the property portfolio was principally driven by -13bps of yield compression to a net initial yield of 5.04% (Assura 5.10% as at March).

PHP continues to make acquisition progress with £18.6m of spend including 2 developments currently on site. This has been partly offset by +2.4% underlying like for like growth on the property portfolio, reducing LTV immaterially to 53.0% (53.7% FY16), with interest cover at 2.25x (covenant 1.3x). Three further properties have also been acquired for £35.5m post year end taking total portfolio rent roll to £71m.

Taking share in a low-risk, growth market

We expect PHP's portfolio to benefit from long-term structural growth, driven by a growing and ageing UK population coupled with efforts to improve the efficiency and cost effectiveness of the NHS by expanding the scope of services provided by GPs. The majority of the existing primary care estate is considered unfit for purpose to meet this growing demand. Development activity has been hampered by NHS reforms which has depressed rental growth in recent years, although there are signs that activity is returning. Leases are long-dated and contain upward only rent review provisions. The shares trade on a CY17E P/NAV of 1.24x vs sector 0.89x, but offer a DPS yield of 4.5%.

Figure 1: Summary Financials & Valuation (not updated for H1 results)

Valuation Summary (CY)	2016A	2017E	2018E	2019E
P/NAV (x)	1.25	1.24	1.23	1.21
P/E (x)	23.8	22.8	21.2	19.5
Div Yield (%)	4.5%	4.5%	4.6%	4.7%
EV/EBITDA (x)	22.8	23.2	22.4	21.7
FCF Yield (%)	1.6%	4.1%	4.5%	5.0%
Financials (FY - Dec y/e)	2016A	2017E	2018E	2019E
Gross rental income (£m)	67.4	71.8	78.1	82.4
Net rental income (£m)	66.6	70.8	77.0	81.2
Gross to net (%)	98.7%	98.7%	98.6%	98.6%
Adj. EBITDA (£m)	59.2	63.1	68.9	72.9
EBITDA margin (%)	87.8%	87.9%	88.2%	88.4%
Adj. net Interest (£m)	-32.5	-33.1	-36.7	-37.7
Adj. PBT (£m)	26.7	30.0	32.2	35.2
Adj. EPRA EPS - diluted (p)	4.8	5.0	5.4	5.9
DPS (p)	5.1	5.2	5.3	5.4
Cover (x)	0.9	1.0	1.0	1.1
Diluted EPRA NAV (p)	91.1	91.8	92.8	94.5
Net cash/(debt) (£m)	-668.2	-782.1	-861.6	-898.9
LTV (%)	55%	58%	60%	60%

Source: Liberum

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