

Buy

4 February 2016

Primary Health Properties[#]

PHP

DATA

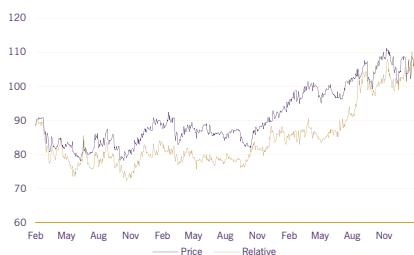
Price	107p
Target price	125p
Market cap	£478m
Dec '15 EPRA NAV	88p
Free float	100%
Index	FTSE SmallCap
Sector	Real Estate
Next news	Aug - Interims
UK portfolio	100%
European portfolio	0%
North American portfolio	0%
Rest of World portfolio	0%

DESCRIPTION

PHP owns GP surgeries let on long leases with the income largely directly/indirectly from the UK Government.

PERFORMANCE

Source: Bloomberg



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Finals: dividend back to full cover

PHP delivered a 4.7% dividend yield, which combined with 20bps of yield shift, led to a 16% total return in 2015. A 20% increase in EPS means the dividend is back to full cover for the first time since 2009. The property yield of 5.3% looks set for further yield compression and, with the shares around 20-25% cheaper than its closest peers, PHP is currently one of our top picks, particular in these volatile markets. [Click here for our detailed note on PHP, Assura, MedicX published 14 Jan.](#)

Highlights

- **Adj EPS +20% to 4.9p** – marginally above our estimate (4.8p) and this means the **dividend was fully covered 1.1x in H2** – the first time in several years.
- The **5.0p dividend equates to a 4.7% yield** and this is the 19th consecutive increase. PHP will now pay quarterly dividends, with 1.28125p in Feb '16.
- **Adj NAV increased +10% to 88p** –marginally ahead of our 87p forecast. The **total accounting return for the year was 16%**.
- The **property increased +3.9%** with 20bps of yield compression to 5.3% net initial - we expect to see further compression, given the yield is still around 2.5x higher than gilts, and this more than offset the additional risk.
- The EPRA cost ratio (effectively the EBITDA margin) reduces further to 11.5% and **PHP remains the most efficient company in our coverage**.
- **LTV falls marginally to 62.7%** (from 64.1%), but this would decline to c55% upon conversion of the convertible bond (matures 2019).
- The company made **£44m of purchases in 2015** and management reports a **“strong pipeline of transactions across both the UK and Ireland in solicitors hands and being documented”**. We assume £75m of purchases per annum.
- Ireland is seeing similar demographic changes to the UK and management, like MedicX, intends to enter the market. Leases are typically 25 years, have CPI-linked uplifts and around 60-75% of the income will be from the Irish HSE, which has a similar funding structure/covenant to the NHS. Yields however are around 200-250bps higher at c7.0-7.5%.

Rental growth slowed to 0.9% (from 1.8%) but the rate of NHS development approvals is slowly increasing and given construction and land price inflation we expect medium-term rental growth to maintain development viability.

STATS

Source: Company accounts, Peel Hunt estimates

Y/E Dec	Net Op Inc (£m)	Adj EPS (p)	EPS growth (%)	PER (x)	DPS (p)	Div yield (%)	Adj NAV (p)	NAV/3net (p)	Disc/Nav (%)	Disc/3net (%)
2015A	62.3	4.9	19.0	21.9	5.0	4.7	88	77	22	38
2016E	65.4	5.7	16.1	18.9	5.1	4.8	95	85	12	26
2017E	70.1	6.0	5.1	17.9	5.3	4.9	103	93	4	15
2018E	75.1	6.1	2.6	17.5	5.4	5.0	112	102	(5)	5

Investment case

- **Secure, growing and high dividend** - PHP's yield of 4.7% is now fully covered and the dividend is expected to continue to grow at c2-3% per annum. This is backed by one of the most secure income streams, with 90% of rent direct/indirectly secured from the government, 15-year average lease length, 99.7% occupancy, upward-only rent reviews and no tenant default in its history.
- **Growing sector** – There are around 1.3m visits to GP surgeries every day in the UK and, with an ageing and increasing population, the government has declared primary care the “*bedrock*” of the NHS, with a 24/7 service targeted by 2020. Currently around 40% of GPs believe their existing properties are not fit for purpose and 70% believe their property is inadequate for the range of services they would like to deliver. In November 2015 the government confirmed a further £6bn of funding for primary care by the end of 2016/17, and spending is then expected to increase by 4-5% per annum.
- **High total returns** – We see potential for significant yield compression given the conservative property yield of 5.3%; if a large portfolio of say £300m of assets were put on the market, it would attract significant institutional interest and almost certainly trade well below 5%. Our forecasts assume just 20bps of further yield compression and this equates to a three-year accounting total return of 46%, or 14% per annum – in line with the 14% compounded annual shareholder return since IPO, one of the best track records in the property sector.
- **Super-efficient** – External management structures are often associated with high running costs, but PHP is not only the most efficient of the medical property companies, but the most efficient of all UK real estate companies, with an EPRA cost ratio of 11.5% (down from 12.0% last year).
- **Cheaper than its peers** – PHP is around 20% cheaper than Assura and MedicX on a P/E basis, around 20% cheaper on an EV/EBIT basis and around 5-10% cheaper on a NAV basis.

New Peel Hunt forecasts

Following recent upgrades in our January 2015 note, we today make further small upgrades:

Earnings

- We maintain our 2016E and 2017E EPS forecasts at 5.7p and 6.0p respectively and publish our new 2018E forecast (6.1p). These forecasts assume around £75m of purchases per annum, and the company has £39m in solicitors hands and a further £100m identified and in progress. Dividend cover over the next three years is expected to be 111%, 113% and 114%.

These forecast do not include the potential dilution from the convertible bond, which matures in 2019. Were this to convert, our EPS forecasts would be 5.4p, 5.7p and 5.8p respectively (still fully covering the dividend).

Dividend

- We maintain our 2016E and 2017E dividend forecasts at 5.125p and 5.25p and today publish our 2018E forecast (5.375p). This represents **dividend yields of 4.8%, 4.9% and 5.0%** respectively.

NAV

- We increase our NAV forecasts over 2016 and 2017 by 1p to account for today's higher than expected NAV. The shares trade on a 13% premium to our Dec 2016E NAV forecast (95p), reducing to a 5% discount by Dec 2018E (112p forecast).

Table 1: New Peel Hunt forecasts

Source: Company accounts, Peel Hunt estimates

Y/end December (£m)	2015	2016E		2017E		2018E	
	Actual	NEW	Old	NEW	Old	NEW	Old
PBT	£21.7m	£25.5m	£25.5m	£26.9m	£26.9m	£27.3m	n/a
Adjusted EPS (p)	4.9p	5.7p	5.7p	6.0p	6.0p	6.1p	n/a
Adjusted EPS (post convertible)	4.8p	5.5p	n/a	5.7p	n/a	5.8p	n/a
P/E ratio	22x	20x		19x		18x	
DPS (p)	5.000p	5.125p	5.125p	5.250p	5.250p	5.375p	n/a
Dividend yield (%)	4.7%	4.8%		4.9%		5.0%	
Cover (%)	98%	111%		113%		114%	
NAV (p)	88p	95p	94p	103p	102p	112p	n/a
Total return (%)	16%	14%		14%		14%	
Discount/Premium (%)	22%	13%		4%		-5%	

Recommendation structure and distribution

Recommendation distribution at 4 February 2016

	Corporate No	Corporate %	No	%
Buy	76	84%	152	52%
Add	8	9%	41	14%
Hold	6	7%	82	28%
Reduce	1	1%	9	3%
Sell	0	0%	6	2%
Under Review	0	0%	1	0%

Until 7 September 2015, Peel Hunt's Recommendation Structure was as follows: Since 7 September 2015, Peel Hunt's Recommendation Structure is as follows:

Buy, > +10% expected absolute price performance over 12 months	Buy, > +15% expected absolute price performance over 12 months
Hold, +/-10% range expected absolute price performance over 12 months	Add, +5-15% range expected absolute price performance over 12 months
Sell, > -10% expected absolute price performance over 12 months	Hold, +/-5% range expected absolute price performance over 12 months
	Reduce, -5-15% range expected absolute price performance over 12 months
	Sell, > -15% expected absolute price performance over 12 months
	Under Review (UR), Recommendation, Target Price and/or Forecasts suspended pending market events/regulation

NB The recommendation is the primary driver for analyst views. The target price may vary from the structure due to market conditions, risk profile of the company and capital returns

Peel Hunt...

Company	Shareholding (%) held by				during the last 12 months		
	Analyst	Company in PH (>3%)	PH in Company (>3%)	makes a market in this company	is broker to this company	has received compensation from this company for the provision of investment banking services	has acted as a sponsor/broker/NOMAD/financial advisor for an offer of securities from this company
Primary Health Properties				x	x	x	

Recommendation history

Company	Date	Rec	Date	Rec	Date	Rec	Date	Rec
Primary Health Properties	13 Jun 13	Buy						

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