

Primary Health Properties* - 6.0% NAV total return in H1; strong transaction pipeline

- Primary Health Properties (PHP) has reported an EPRA NAV of 90.4p as at 30 June, rising 3.12% since 31 December, boosted by a 1.85% like-for-like increase in portfolio value to £1.2bn, reflecting a 12bps tightening of the Net Initial Yield to 5.2% (from 5.32% at Dec). NAV total return in the period was 6.0%, which compares favourably to an average NAV total return of 2.4% from our high income commercial property peer group. The EPRA cost ratio remained at 11.5%, the lowest in the listed Real Estate sector by a comfortable margin.

PHP - H1 NAV bridge

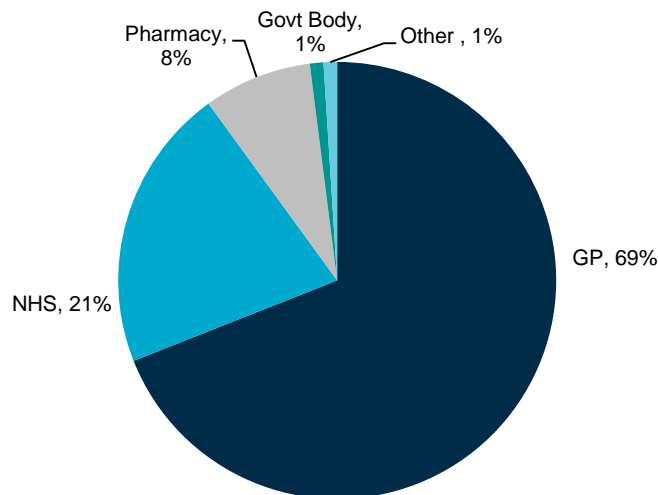
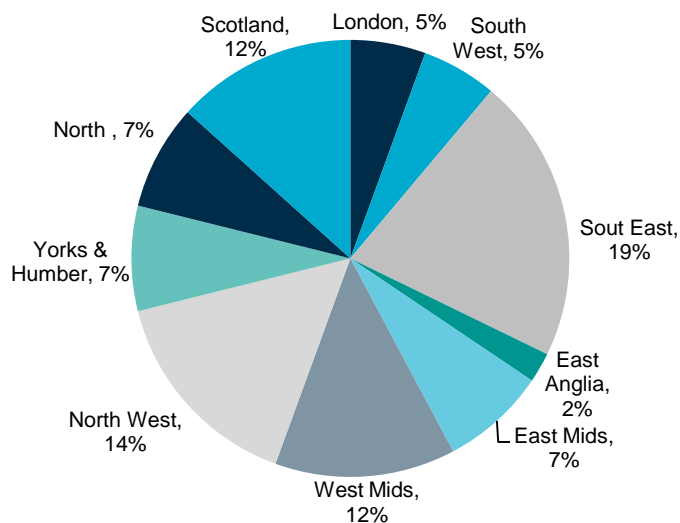


Source: Company & Numis Securities Research

- Strong Earnings Growth:** Net rental income rose 5.2% in the period to £32.2m, reflecting the benefit of acquisitions and developments completed, as well as 1.0% rental growth achieved on reviews. 82 rent reviews were completed in H1, generating additional rent of £0.1m pa. Combined with a reduction in the average cost of debt in the period to 4.49% (from 4.67% at 31 Dec), earnings increased by 27.3% to £12.6m (2.4p), covering the dividends paid of £11.4m.
- Dividend Cover Maintained:** During the period, PHP paid dividends of 2.5p, totalling £11.4m, fully covered by EPRA earnings of £12.6m (2.4p based on weighted average shares in issue). Whilst there is a higher number of shares on which future dividends will be paid, management expects to maintain full cover over the year as a whole, in line with our estimates. The remaining quarterly dividends are expected to be made in August and November.
- Transactions:** During the period, PHP acquired 19 UK assets for a consideration of £54m, adding £3.0m to the rent roll. In addition, the team has completed or initiated a range of asset improvement plans including simple upgrade projects, to major construction and extension works, as well as extending occupational lease durations. Since the period end, PHP has contracted on its first Irish asset for €6.7m. The property is located in the south and is scheduled for completion in August 2016. The building will be fully let for a term of 25 years from completion, with 75% of income received from the Health Service Executive in Ireland (HSE), 22% from a major Irish pharmacy chain and 3% from local GPs. Completion of the contract is conditional upon the HSE executing certain transaction documents.
- Portfolio Summary:** As at 30 June the portfolio comprised 292 assets, of which 289 were rent producing, and three under development. These have an annualised contracted rent roll of £66.9m, up 5% in the period. 75% of rents are subject to an open market review, 19% are index linked and 6.0% have a fixed uplift. The weighted average unexpired lease term is 14.1 years. Assets are spread geographically as follows, with 91% of rental income directly or indirectly from UK government.

PHP - Portfolio Value by Region

PHP - Portfolio Income by Covenant

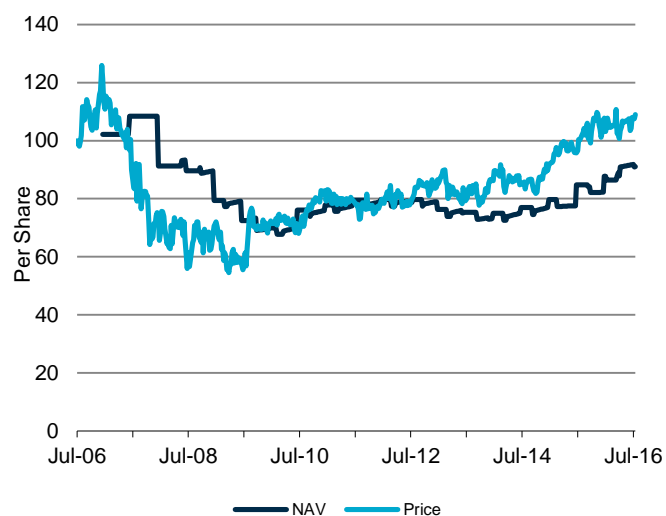


Source: Company & Numis Securities Research

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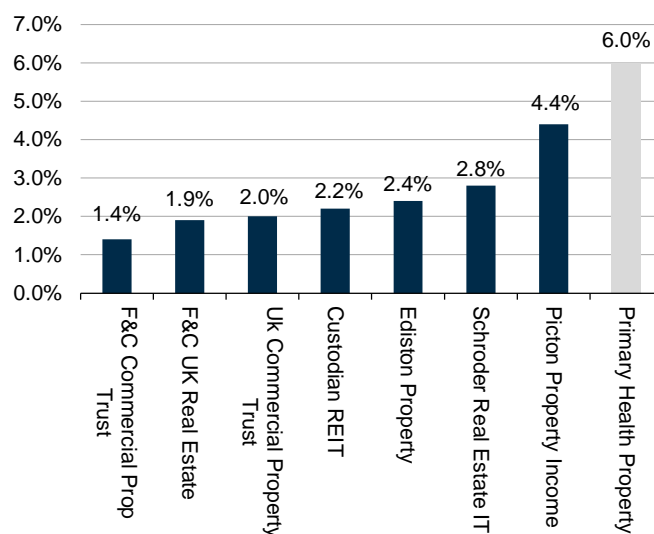
- Investment Firepower and Pipeline:** Following the recent £150m capital raise, £54m of proceeds were used towards acquisitions, c.£12.5m earmarked for development commitments, with the remainder temporarily paying down debt, avoiding cash drag. As at 30 June, cash balances were £6.0m and the drawn balance across PHP's debt facilities totalled c.£635m, resulting in Group LTV of 53% (from 63% in Dec). The weighted average debt maturity is 5.6 years and 26% of debt is unsecured. This reduces to c.46% excluding the 'in the money' convertible bond. PHP can redraw c.£110m of facilities to fund its growing pipeline, comprising c.£150m of UK and Irish opportunities.
- Outlook:** Management retains a positive outlook for the business. In particular, it continues to see development opportunities emerging in the UK, and a growing opportunity set in Ireland. Importantly, there remains a positive pricing arbitrage between acquisition yields and funding costs, which combined with a simple cost structure, should provide potential for further earnings accretive growth. Management also makes an encouraging comment that *"post-vote activity in the primary care market has not suggested any immediate change to trading conditions or valuations"*.
- Numis View:** PHP's interim results were in line with expectations, reflecting the stable returns on offer from the sector. We continue to believe that PHP is well placed in a niche, growing real estate sector. Occupier dynamics are firmly underpinned by both demographics and increased demand for health services. Moreover, investment market dynamics remain broadly positive, underpinning valuations.
- Despite the impact of stamp-duty changes in the period, which reduced values by c.£7m, the robust income characteristics of the portfolio underpinned valuations, resulting in an attractive EPRA NAV total return of 6.0%. This compares favourably to the commercial real estate high income peer group with H1 NAV total returns illustrated in the following chart. The steady performance has also translated favourably to PHP's share price, which continues to trade at a premium to asset value. Against a backdrop of more volatile equity markets and low interest rates, we would expect this to remain the case.

PHP - Ten Year Absolute NAV and price performance



Source: Datastream

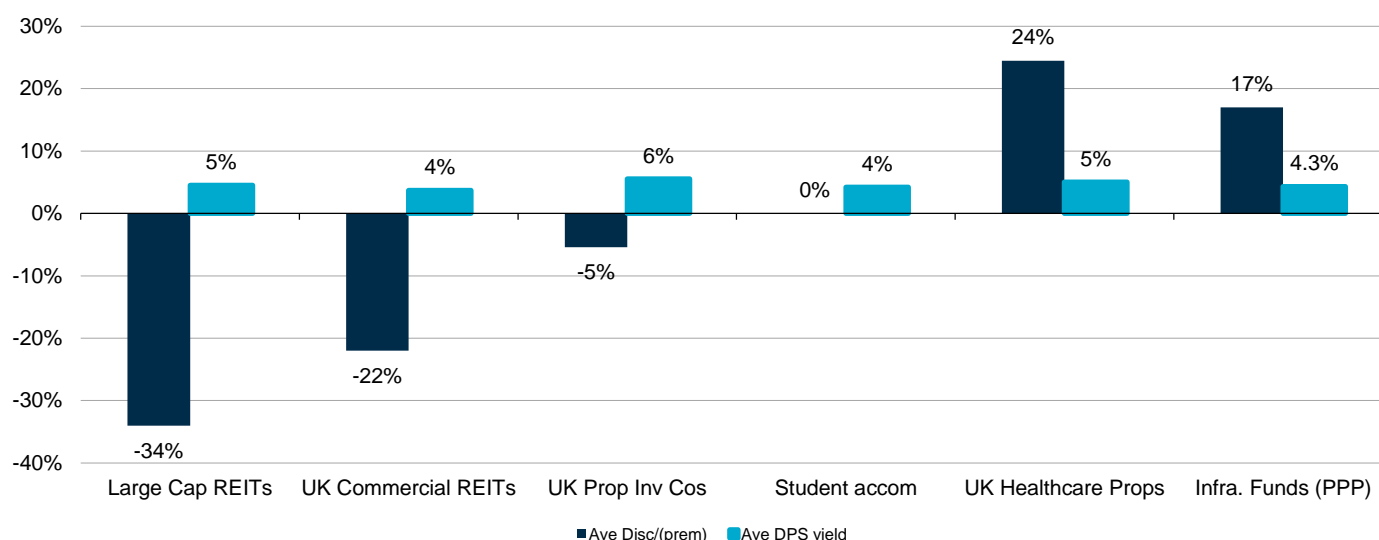
H1 NAV Total Returns - High Income Property Peers



Source: Numis Securities Research

- Whilst the premium to NAV of PHP, and its wider primary health peer group, contrasts to discounts assigned to general commercial REITs, we believe this is justified based on the lower volatility of asset values, and relatively high, predictable dividend yields on offer. With this in mind, it is logical that the shares trade more in line with the listed infrastructure peers, in our view, which also offer exposure to government-backed cashflow streams. It is worth noting, that the infrastructure vehicles do not typically own their property assets, but invest in finite life concessions where the asset reverts to government ownership at the end of the contract.

Primary Healthcare Valuation in Context



Source: Company & Numis Securities Research

- **Numis Estimates:** Given the progress made in H1, we see no reason to change our full year estimates of Dec 2016 EPRA NAV of 92p and dividend of 5.125p. This rises to 95p in Dec 2017, dividend of 5.25p (4.8% yield) implying that PHP can deliver attractive NAV total returns in the next two years. PHP's shares are currently trading at 110.375p, representing a 22% premium to the latest NAV, falling to 16% based on our December 2017 NAV estimate. This compares with the weighted average premium for Medix Fund and Assura Group of 27% and yield of 5.1%.

** Denotes that this company is a corporate broking client of Numis Securities.*

Note: all prices, NAVs and discounts as at close of business at 26 July 2016 unless otherwise stated.

The research analyst who prepared this report was Colette Ord

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