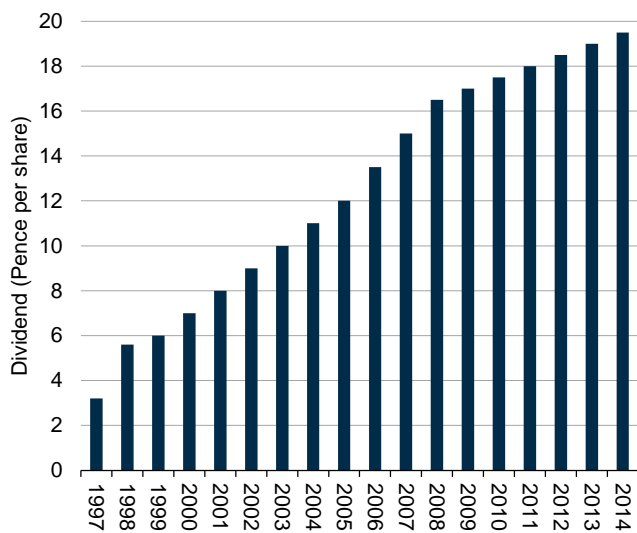


Primary Health Properties*

A Year of Growth: Portfolio over £1bn and dividend cover rises to 84%

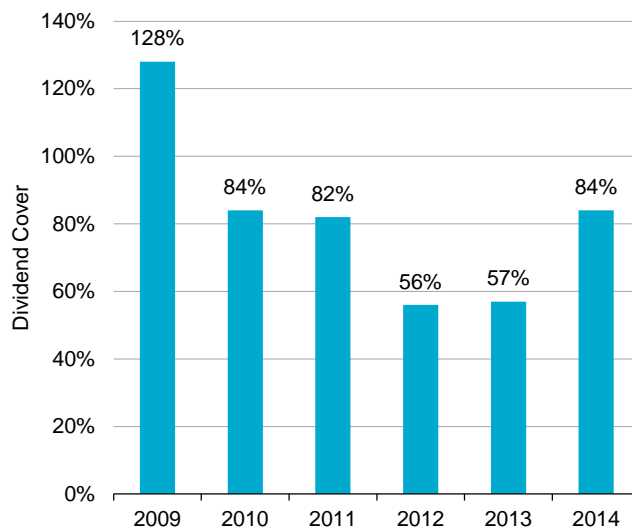
- PHP's results for the year to 31 December 2014 highlight another year of progress. Gross assets increased by 9% to a record £1.03bn, and the company benefitted from a full contribution from the scale-changing Prime Public Partnerships (PPP) acquisition in December 2013, resulting in strong net rental income growth of 42.5%. The dividend rose by 2.6% to 19.5p per share, representing a yield of 5.1% and the 18th successive year of dividend growth. Importantly, there was a significant improvement in the dividend cover, which increased to 84% from 57% reflecting both revenue accretive acquisitions and reduced costs. The EPRA NAV rose by 6.3% to 319p, representing a NAV total return over the year of 12.8%. The share price total return during 2014 was 10.9%, and the share price has risen a further 4.1% (15p) in 2015 YtD to 385p which represents a market cap of £428m and premium to EPRA NAV of 20.7%. We believe that this rating will continue to be supported by the sustainability of PHP's yield, as well as its progress towards a target of reaching full dividend cover.**
- Dividend:** The total dividend total paid in 2014 was 19.5p (2013: 19.0p), representing the 18th successive year of dividend growth. Dividend cover improved significantly to 84% from 58%, with EPRA earnings per share increasing by 116% to 16.4p (2013: 7.6p). This reflected the benefits of cost savings following changes to management fee structure, refinancing of the debt acquired as part of the PPP portfolio, and a full year impact of acquisitions completed in 2013. The Board has declared a second interim dividend of 10.0p to be paid on 1 April (ex-date 26 February), up from 9.75p. It is "committed to maintaining its progressive dividend policy whilst growing dividend cover".

Figure 1: PHP - Dividend History



Source: Company data

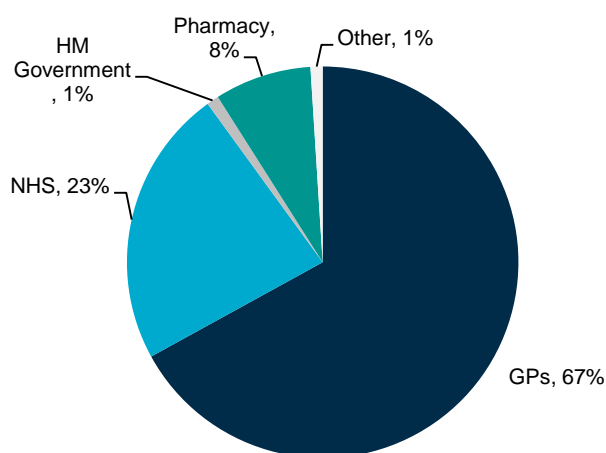
Figure 2: PHP - Dividend Cover



Source: Company data

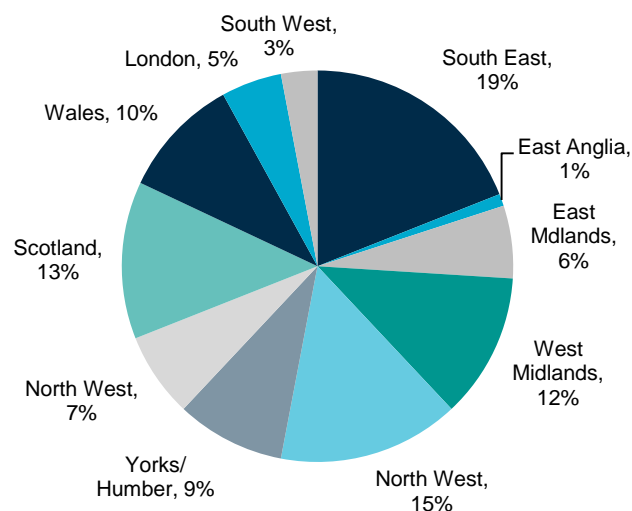
- NAV:** The EPRA NAV increased by 6.3% to 319p from 300p at the start of the year (and by 3.6% from 308p at 30 June). Allowing for acquisition costs, there was a valuation surplus of £29.2m for the year, with underlying like-for-like growth of 3.2% reflecting a reduction in the net portfolio initial valuation yield to 5.52% from 5.65%.
- Portfolio:** The investment property portfolio value increased to £1,026m at 31 December, up from £942m. There are now 265 primary care facilities, of which 260 are completed and five committed and under development. The average lot size is £3.9m, with an average age of building of nine years. There is a 99.8% occupancy rate, and an average unexpired lease term of 15.3 years. 91% of rental income comes directly or indirectly from the UK government, and there is a broad spread by geography across the UK.

Figure 3: PHP - Strong Rental Covenant



Source: Company data

Figure 4: PHP - Wide Geographic Spread

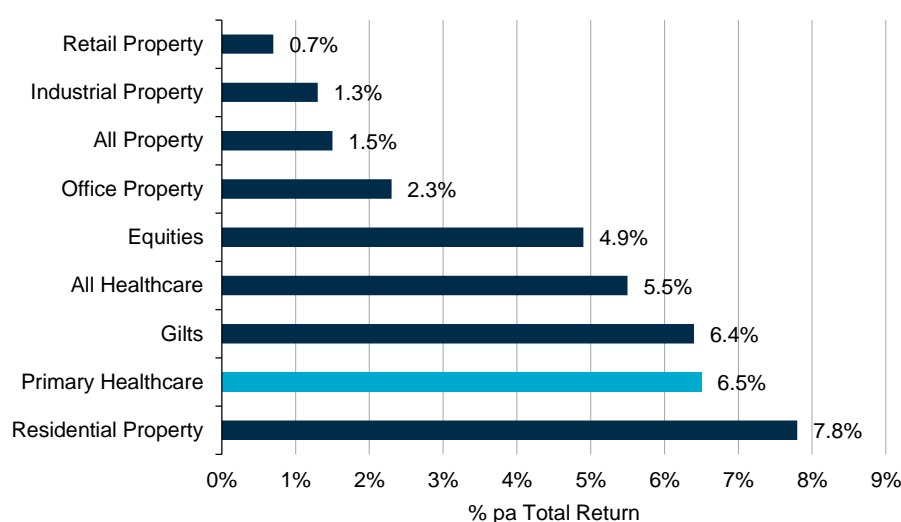


Source: Company data

- Portfolio Activity:** It was a relatively quiet year for new investment, with the addition of further assets totalling £43m in 2014. However, this followed the acquisition of the PPP portfolio in December 2013 which comprised 54 fully let primary care assets with a value of £233m. As a result, net rental income in the year rose 42.5% to £59.3m (2013: £41.6m). A number of asset management projects were also completed, with £4.4m capex invested, securing £0.3m pa additional income and lengthening applicable leases. PHP currently has firepower of £116.7m (after development commitments), and stated that it has a “*strong acquisition pipeline in solicitors’ hands or agreed*” in order to provide further growth.
- Rental Growth:** 135 reviews were completed in 2014 resulting in an average increase of 1.8% pa (versus 2.2% in 2013). The additional rent from reviews completed in 2014 was £0.6m pa, and the total contracted rent roll at the end of the year was £60.9m. Historically, rental increases have broadly tracked RPI increases, with 4% of the rent roll having fixed uplifts, 19% formally index linked and 77% reviewed to open market.
- Reduced Debt Costs:** Net debt at 31 December 2014 was £658.1m, representing an LTV of 64.1% (61.6%: 2013). £178m of debt acquired with the PPP portfolio in December 2013 was fully refinanced as planned, reducing rates by 100bps. In addition, a £82.5m five year 4.25% Convertible Bond was issued in May 2014, with a conversion price of 390p per share. In August, £235m of bank facilities were restructured, with lending margins reduced by an average of 55bps. As a result of these refinancings, PHP now has lower marginal borrowing costs, a wider spread of debt providers (including 24% on an unsecured basis) and longer average maturity of facilities (the average duration has increased to 6.2 years from 5.8 years). 87% of the debt is fixed or hedged.
- Reduced Management Costs:** The consolidation of advisory services under Nexus was effective from May 2014. This has reduced administrative costs, with the group’s total expense ratio falling to 69 basis points (2013: 88 bps).
- Supportive Political Climate:** In the results, PHP’s Chairman highlights that “*the upcoming General Election dominates the political and fiscal landscape but the unwavering cross party support for the NHS is already evident. Each of the major political parties made specific statements in the autumn of 2014 on their commitment to the future of the NHS, its funding and its importance to British society. These included continued ring-fencing of the NHS budget with annual increases in expenditure in real terms, targeting increases in GP numbers and improved access to GP services*”. This was boosted in the Chancellor’s Autumn Statement with the provision of an additional £2bn of funding for front-line NHS services in 2015/2016 and a further pool of more than £1bn to be provided over a four year period to directly enhance GP premises.

- **Peer Group Valuations:** PHP's 21% premium to the December EPRA NAV (5.1% yield), compares with a 19% premium for Assura (3.7% yield, fully covered) and a 23% premium for MedicX (7.0% yield, 67% covered). These premiums reflect the market's preference for strong income characteristics and a defensive asset base.
- **Outlook:** We believe that the market backdrop for PHP remains positive. The company has a proven strategy of investing in modern, purpose built primary care premises in order to generate an attractive yield that is underpinned by long term, secure income streams. It has a healthy investment pipeline and Harry Hyman, PHP's MD, stated that he expects the rate of approval of new premises will increase, having slowed since 2013. At present, there is also a supportive funding environment, enabling the company to make revenue accretive acquisitions which should continue to increase the dividend cover. Acquisitions made at a market yield of c.5.6% currently represent a margin of 190 bps over incremental costs. As a result, we continue to believe that PHP is an attractive, asset backed yield play. The chart below highlights the strong performance of primary healthcare assets in recent years.

Figure 5: Asset Class Returns



Since IPD established Healthcare Property Index in 2007
Source: Company data, IPD

* Primary Health Properties is a corporate broking client of Numis Securities.

Note: all prices, NAVs and discounts as at close of business at 18 February 2015 unless otherwise stated.

The research analyst who prepared this report was Charles Cade

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