

Buy (from Hold) 13 June 2013

Primary Health Properties[#] (PHP)

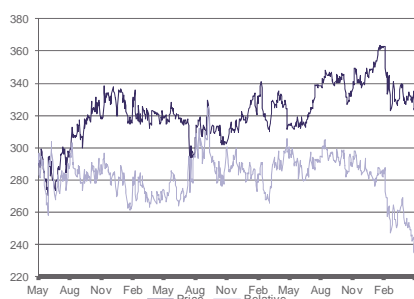
Data	
Price	315p
Target price	350p
Market cap post raising	£340m
Dec'13 EPRA NAV (PHe)	306p
Net Debt (Dec'12)	£381m
Free float	100%
Index	FTSE SmallCap
Sector	Real Estate
Next news	August - Interims
UK sales	100.0%
Rest of World sales	0.0%

Description

Engaged in the generation of rental income and capital growth through investment in UK primary health care property, leased primarily to GPs, Primary Care Trusts, health authorities and associated health care users

Performance

Source: Bloomberg



Analyst

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Large and accretive £68.5m equity raising completes

PHP has today completed a c£66.1m (net of costs) equity issue which is EPS accretive in later years – we lower our 2013 EPS but we upgrade our 2015 forecasts. Although dependent upon the acquisition rate (£93m currently in solicitors hands), we now expect the equity injection to boost earnings to almost fully cover the dividend in 2015. With the shares close to the 12-month low, a quasi-bond income stream and a progressive dividend yield of 6.0% we upgrade our recommendation to Buy (from Hold).

Summary: Excluding the 'false spike' that embraced all equities in 2006, PHP's shares have provided a remarkably progressive tripling in price over two decades (starting 1996). The sizeable, for PHP, £68.5m share issue at 315p confirmed today tops a year of issuance embracing a £75m retail bond, a smaller £19m share placing and institutional debt arrangement – now all invested in £110m of acquisitions last year. The financial structure has become far less dependent on banks, and leverage is usefully reduced, from 2.0x to 1.7x (assuming the equity is invested alongside £40m debt). PHP's total firepower now reaches £200m for acquisitions (c£75m of unrestricted cash and c£125m of debt) and we assume this is invested over the next two years by June'15.

Dividend cover: We envisage that today's raising (more significant for payouts than any stability question) will reduce dividend cover initially (due to dilution). However, once invested we expect our previously forecasted cover to be maintained in 2014 (0.8x) and importantly, even assuming a continued progressive dividend payout strategy from the 6.0% starting base, we expect the dividend to reach near full cover in 2015. See page 3 for our forecast assumptions.

Bond-like income: In terms of tenant lease commitment (16-year average lease lengths), continuous near-100% occupancy rate and 90% government funded rent roll, PHP has the most reliant income stream in the sector. The issue was a good opportunity to add.

Stable property values: On the valuation side, the yields are far less cyclical than generic commercial property while the primary care sector offers long-term growth potential through new builds/refurbishments considering 60% of GPs work from unsuitable premises and the 2012 Health & Social Care Act supports the move to providing an increasing number of services at local surgeries.

Stats

Source: Company accounts, Peel Hunt estimates

Y/E Dec	Net Op Inc (£m)	Adj PBT (£m)	Adj EPS (p)	EPS growth (%)	DPS (p)	PER (x)	Div yield (%)	Adj. NAV (p)	NAV/3net (p)	Premium NAV (%)	Premium 3net (%)
2012A	32.2	11.9	10.2	(30.1)	18.5	31	5.9	305	236	3.3	33.8
2013E	38.6	14.1	10.8	5.9	19.0	29	6.0	305	252	3.3	25.2
2014E	46.3	20.0	15.1	40.3	19.5	21	6.2	303	249	3.8	26.3
2015E	52.4	24.3	19.0	25.6	20.0	17	6.3	309	255	1.9	23.5

Equity Issue

Key Stats

- The equity issue totals 21.75m shares (29% of prior issued share capital of 76.1m shares) at 315p, raising gross proceeds of £68.5m.
- Total costs are expected to be approx. £2.4m with net proceeds of £66.1m.
- Admission of the new shares to trading starts at 8am today (Thurs, 13 June)

Issue Structure – a three part raising

- 1 **Firm Placing:** 7.3m shares raised gross proceeds of £23.0m
- 2 **Open Offer:** 1 share for every 10 existing shares raised £16.4m (5.2m shares).
- 3 **Offer for subscription/placing:** 9.2m shares raised gross proceeds of £29.1m.

NAV Impact

- The issue price of 315p is a 3% premium to the last reported EPRA NAV (305p) but issue costs of c£2.4m will offset this small premium. The issue will therefore effectively be neutral on EPRA NAV.
- Our NAV forecast in later years is marginally reduced due higher acquisition costs associated with increased acquisition assumptions (page 3).

The issue price of 315p represents:

- A 6% discount to the closing share price of 336.3p on 21 May 2013 – the date prior to announcement.
- A 5% discount to the theoretical ex-close of 331p.
- A 0% discount to yesterday's closing price of 315p.

A comparison with other recent real estate issues:

Table 1: Recent equity issues

Source: Company accounts, Peel Hunt estimates

Company	Date Announced	Gross Issue Size (£m)	Issue Size (% share capital)	Discount to prior close	Discount to EPRA NAV	Use of proceeds
Redefine	Sep '12	127.5	84.6%	-22.4%	-44.4%	Debt restructure and acquisitions
Cap&Co	Sep '12	149.1	10.0%	-1.0%	+23.0%	Expansion of Covent Garden
Great Portland	Nov '12	141	9.99%	-7.4%	+6.1%	Acquisition opportunities
Big Yellow	Jan '13	37	7.00%	-3.1%	-13.6%	Reduce leverage and developments
St. Modwen	Feb '13	49	9.99%	-12.0%	-10.0%	Development at New Covent Garden
Intu (CSCG)	Feb '13	279.5	9.99%	-5.0%	-17.0%	MidSummer Place acquisition
British Land	Mar '13	493	9.99%	-5.3%	-7.7%	Acquisition opportunities
PHP	May '13	68.5	29%	-6.1%	+3.4%	Acquisition opportunities

Use of proceeds

Since the last £19m equity issue in May '12 and the £75m retail bond (July '12) the company has invested £109m across 22 investment assets.

We understand PHP firepower totals c£200m and we assume the resources are invested over the next three years. Firepower is comprised of the following:

- c£75m of unrestricted cash
- c£70m of available debt
- credit approval to extend their Barclays facility by £20m
- additional leverage on today's equity issue of c£35m

As of 15 April 2013 the company had £82m of acquisitions in solicitor's hands and this has increased to £92.5m by May '13 as shows below:

Table 2: Acquisition pipeline - terms agreed

Source: Company accounts, Peel Hunt estimates

Geographical Region	No. of assets	Acquisition Cost (£m)	Rent Roll (£m)	Implied gross yield
North	3	30.7	1.8	5.9%
Midlands	3	7.6	0.5	6.6%
South East	7	22.7	1.4	6.2%
South West	2	5.5	0.3	5.5%
Wales	4	14.2	0.9	6.3%
Scotland	3	11.7	0.7	6.0%
TOTAL	22	92.5	5.6	6.1%

We understand that approximately half of the pipeline consists of standing investment and approximately half is forward funded development agreements – therefore, even though we expect £50m to be invested by September this year, perhaps only half will receive the benefit of income immediately (see our forecast assumptions below).

New forecasts

Following the equity issue we amend our forecasts as follows:

Table 3: Full year forecasts

Source: Company accounts, Peel Hunt estimates

Y/end Dec	2013E			2014E			2015E		
	Old	New	Change	Old	New	Change	Old	New	Change
Recurring PBT (£m)	10.0	9.4	-6%	11.6	14.8	+28%	13.1	18.5	+41%
Adj. EPS (p)	13.1	10.8	-18%	15.3	15.1	-1%	17.2	19.0	+11%
DPS (p)	19.0	nc		19.5	nc		20.0	nc	
Dividend cover	69%	57%		79%	77%		86%	95%	
Adj. NAV (p)	306	305	-0.3%	310	303*	-2%	317	309	-3%

*Reduced due to acquisition costs from new investments (assumed to be 5.8%) – see table below

Forecast assumptions

We make the following key assumptions within our forecasts above:

Table 4: Assumptions

Source: Peel Hunt estimates

Y/end Dec	2013E	2014E	2015E
Acquisition rate at average 6.0% yield	£50m by September (half developments)	£100m by June 2014	£50m by June 2015
Rental growth across the portfolio	2%	2%	2%
Valuation growth across the portfolio*	1.5%	1.5%	1.5%
Marginal cost of drawing new debt	2.8%	3.2%	3.5%
Acquisition costs	£1.4m	£7.0m	£2.8m

* Primarily due to rental growth - assumes relatively flat yields.

Investment case

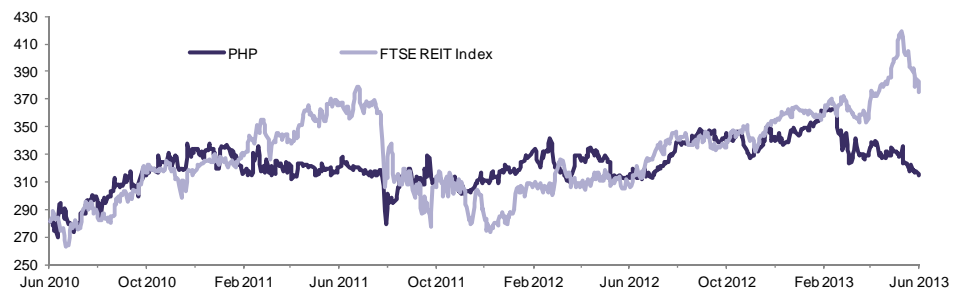
A rare-safe haven

Share price (315p) at lowest point since July 2012:

- The share price has underperformed over the past four months – falling from 365p in February 2013 to a low of 315p today – a fall of -15% against a relatively flat market.
- Today's share price has not been seen since July 2012, while the £68.5m equity raise has enhanced company's position – bigger, greater economies of scale from a larger portfolio with improving dividend cover.

Chart 1: PHP Share Price relative to the real estate sector

Source: Company accounts, Peel Hunt estimates



PHP offers a quasi-bond income stream due to several factors:

- Contracted lease lengths are long at **16 years** on average: 60% of the current rent roll has more than 15 years remaining, with just 2% of the rent roll expiring within the next five years. New leases are typically 20-25 years long.
- The income is highly secure – **90% is government backed** (72% GPs, 17% NHS and 1% HM Govt).
- The continuous near-100% **occupancy** provides a rare safe haven for the real estate sector.
- **Rent reviews** are effectively upwards-only as they are either contracted to fixed uplifts (5% of the rent roll), are index-linked (11%) or subject to open-market rent reviews (84%) which can only be initiated by PHP. The track record is strong, achieving c2-3% rental growth pa, although has recently slowed towards +2%.

Furthermore, on the property side, primary health care values are typically less volatile and cyclical than other commercial property classes:

- Since 2005, PHP's portfolio valuation yield has moved only between a low of c5.3% and a high of 6.3% – a small variance of just 100bps over a highly volatile period. This is attributable to the supply-demand balance, long leases, strong covenants and a lack of defaults.
- PHP's assets are currently valued at a 5.72% yield. This yield is conservative in our opinion when compared with other property types and the low 10-year gilt rate of 2.2% – the yield does not fully factor in the security of the income stream.

The sector also offers long-term potential:

- PHP provides purpose-built high-grade properties and there is significant room for expansion in the primary care sector as many GPs require new premises (60% work from unsuitable premises. Source: GVA Grimley 2010).
- Growing demand for local services requires new builds/ extensions/ refurbishments: the number of GP visits has been growing at 2.5% pa, the population is ageing and more services are likely to be delivered via GP surgeries following the 2012 Health & Social Care Act (GPs will be managing £80bn of the £120bn annual healthcare budget). Meanwhile 75% of the c35,000 GPs in the UK believe their premises are not suitable for future needs.
- GP premises will also be regulated for the first time this year – a third of GPs believe their premises would not be capable of complying with the Disability Discrimination Act and a quarter of premises are believed to pose a risk to staff/patients.

Valuation at current 315p share price

Table 5: Valuation

Source: Company accounts, Peel Hunt estimates

Y/end Dec	2012 (A)	2013E	2014E	2015E
Dividend yield	5.9%	6.0%	6.2%	6.3%
NAV premium	+3%	+3%	+4%	+2%

Financial statements

Table 6: PHP forecasts

Source: Company accounts, Peel Hunt estimates

Year ended 31 December	FY011A	FY012A	FY13E	FY14E	FY15E
Per share data (p)					
NNNAV	246	236	251	249	255
Adjusted NAV	319	305	305	303	309
Basic EPS	19.0	1.6	19.5	17.4	25.7
Adjusted EPS	14.5	10.2	10.8	15.1	18.9
DPS	18.0	18.5	19.0	19.5	20.0
Number of shares (m)	68.3	76.0	97.8	97.8	97.8
Key ratios					
NNNAV premium	28%	34%	25%	26%	24%
Adjusted NAV premium	(1%)	3%	3%	4%	2%
Dividend yield	5.7%	5.9%	6.0%	6.2%	6.3%
Gearing	179%	196%	134%	192%	211%
Interest cover	1.6x	1.3x	1.4x	1.5x	1.6x
Dividend cover	0.8x	0.5x	0.6x	0.8x	0.9x
Income Statement (£m)					
Net rental income	30.7	33.1	39.6	47.3	53.4
Admin/ management costs	(5.6)	(5.5)	(5.7)	(6.3)	(6.8)
Recurring EBITDA	25.1	27.6	33.9	41.1	46.7
Finance income	0.4	0.5	0.5	0.5	0.5
Finance expense	(15.8)	(20.8)	(25.0)	(26.8)	(28.6)
Recurring pre tax profits	9.7	7.4	9.4	14.7	18.5
Exceptional items	(7.6)	(4.5)	-	-	-
Revaluation gain/(loss) on property	10.6	(1.8)	7.7	2.2	6.6
Tax (REIT vehicle – no tax)	-	-	-	-	-
Net Profit	12.7	1.1	17.1	17.0	25.1
Balance Sheet (£m)					
Investment properties	525.6	622.4	660.1	792.4	854.0
Cash	0.1	25.1	17.9	13.5	12.5
Total assets	531.4	653.6	684.0	812.0	872.5
Total debt	(300.7)	(321.7)	(285.6)	(415.6)	(470.6)
Total liabilities	(363.3)	(474.5)	(438.4)	(568.4)	(623.4)
Shareholders equity	168.1	179.0	245.6	243.5	249.1
Cash Flow Statement (£m)					
Operating cash flow	24.0	35.4	9.4	14.7	18.5
Net working capital	0.9	7.8	-	-	-
Investing cash flow	(44.6)	(45.1)	(30.0)	(130.0)	(55.0)
Acquisitions/disposals	(45.7)	(42.2)	(30.0)	(130.0)	(55.0)
Capital expenditure	-	-	5.0	5.0	5.0
Financing cash flow	20.3	34.7	13.3	110.9	35.4
Net borrowings	146.0	75.7	(36.1)	130.0	55.0
Dividends paid	(11.2)	(12.2)	(16.7)	(19.1)	(19.6)
Net cash increase/(decrease)	(0.3)	25.0	(7.2)	(4.3)	(1.0)

Recommendation structure and distribution as at 13 June 2013

		Corporate No	Corporate %	Total No	Total %
Buy	> +10% expected absolute price performance over 12 months	53	83%	152	52%
Hold	+/-10% range expected absolute price performance over 12 months	11	17%	121	41%
Sell	> -10% expected absolute price performance over 12 months	0	0%	20	7%

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	Analyst	Shareholding (%) held by				during the last 12 months	
		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
Primary Health Properties	28 Feb 13	Hold	20 Nov 09	Buy		

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