

Primary Health Properties (PHP LN) Management to Sales: Top Dollar Assets

Key Takeaway

Harry Hyman (MD) & Richard Howell (FD) gave a fulsome update of PHP's strategy to the Jefferies sales desk. They are wary that in a property bull market, lower quality assets are re-priced beyond their fundamentals. PHP's acquisition strategy is focused on acquiring high quality, larger lot size assets even if that means paying 'top dollar' whilst diversification in The Republic of Ireland gives more income accretive market relative to the UK.

Disciplined approach to scaling up. At their FY17 results, PHP reported a portfolio value of £1.4bn which has scalability as PHP continues invest in a £150m pipeline with undrawn £100m debt facilities and the remaining £63m of the convertible bond expiring in 2019 (LTV 52.9%). PHP has identified the need for £5bn of new primary care assets the HMG needs to deliver the NHS's 5yr forward plan of moving some treatment performed in expensive hospitals into Primary Care assets. Although size isn't everything, 'future proofed' GP surgeries will generally be dominant centres in their catchment areas with modern facilities. The investment market remains strong with the portfolio's NIY shifting from 5.92% (FY13) to 4.91% (FY17), -26bps in FY17. Given the attractive, NHS-backed income profile of the leases, the market has re-priced lower quality assets to a level that PHP is not comfortable with and continues to be disciplined in buying top quality assets even if they come at a premium price. This has been demonstrated by acquisitions (and some disposals) increasing the average lot size of the portfolio by £1m over 5yrs to £4.5m in FY17, with £7.1m the average acquisition price for the 10 assets acquired in FY17. PHP also forward funds a limited number of developments and these opportunities have increased vs. 12mths ago.

Primary Care is not without risks but volatility is low compared with other CRE sectors and PHP continues to diversify its portfolio through further acquisition in the Republic of Ireland. During the GFC, yields on GP surgeries moved from 5% to 6.25% which compares to the wider market which saw movements of c.4.5% to 8%. Valuation yields will be sensitive to rising interest rates but given higher yields are broadly a sign of inflation mean yield rises are mitigated by rental growth which rise with construction inflation (i.e. the replacement cost). 26% of portfolio has in-built rental growth through leases linked to inflation or with fixed uplifts and with further investment in Ireland with leases there linked to CPI. Rising interest rates could mean further opportunity to buy assets in the UK as the vast majority of debt in the sector is from Aviva which tends to be very long-term. Aviva have been unwilling to provide discounts or waivers to break costs (N.B. AGR's c. £55m break cost to refinance £212m long-term Aviva Loan) when refinancing means the MTM to FV on facilities arranged pre-GFC make assets with secured debt sales uneconomical. With rising interest rates, the MTM should naturally reduce meaning the potential for opportunistic buys.

Primary Care is a 'nitty gritty' sector but PHP have the right people and management expertise. Despite the attractive income profile of the sector (PHP WAULT 13.2yrs) for institutional investors, there are barriers to entry which restricts most to owning a handful of assets. The NHS moves slowly and knowledge of the system is vital given the issues such as a lack of commercial timing in the NHS and its inefficient finance functions. Asset management is therefore key, especially given the short review cycle (every 3yrs) for open market rent reviewed leases. Additionally PHP is responsible for the external maintenance of the building for 40% of its leases which is unattractive for most investors. The company receives c. 5% extra rent for this and through their asset management team based in Stratford, it can cover such maintenance for less than the extra 5% rental provision. Asset management is also required to keep the portfolio relevant with a property, Woolston Lodge Surgery, Southampton a good example of this. The asset was acquired when PHP was listed in 1995 and through an extension project in 2017 (inc. £0.6m capex resulting in a rental uplift), the lease was re-gear up to 24yrs.

BUY

Bloomberg LSE: PHP LN

Price target 126.00p

Price 116.00p[^][^]Prior trading day's closing price unless otherwise noted.**Andrew Gill** *

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Real Estate Sector Valuation Sheet

	Priced at CoB 19/02/18	Rec	Last y/end	Market cap (£m)	Share price (p)	Price target (p)	Upside to PT (%)	Div yield (%)	eTSR (%)	Disc to NAV		EV/EBITDA		PE ratio	
										Spot (%)	Spot+1 (%)	Next (x)	Next+1 (x)	Last (x)	Next (x)
Mature diversifieds	BLND	Unpf	Mar-17	6335	644	475	-26%	4.7%	-22%	-25%	-24%	21.7	23.1	17.1	17.4
	LAND	Hold	Mar-17	6929	935	860	-8%	4.5%	-3%	-30%	-29%	19.7	18.6	18.1	17.1
	GFC FP (€)	Hold	Dec-16	11342	151	146	-3%	3.5%	0%	1%	-4%	37.3	36.2	28.0	30.0
Shopping Centres	UL NA (€)	R ²	Dec-16	18713	187	N/A	R ²	5.8%	R ²	R ²	R ²	R ²	R ²	16.7	R ²
	LI FP (€)	Hold	Dec-16	10569	34	32	-5%	5.8%	1%	-9%	-15%	17.6	17.2	15.1	14.1
	HMSO	Unpf	Dec-16	3653	460	440	-4%	5.5%	1%	-37%	-28%	19.5	19.6	15.7	14.9
Logistics	INTU	Unpf	Dec-16	2824	208	195	-6%	6.7%	0%	-46%	-39%	19.5	19.5	13.9	13.8
	BBOX*	Buy	Dec-16	1950	143	167	17%	4.5%	21%	3%	0%	28.0	24.2	22.0	22.5
Industrial	LMP	Hold	Mar-17	1235	177	190	7%	4.4%	12%	10%	6%	24.9	22.7	21.7	18.9
	HSTN	Hold	Dec-16	560	136	130	-4%	4.6%	1%	6%	4%	14.0	20.2	20.2	22.1
London office	SGRO	Hold	Dec-17	5815	580	615	6%	3.1%	9%	3%	-4%	32.4	30.2	29.1	26.5
	DLN	Unpf	Dec-16	3234	2901	2450	-16%	2.0%	-14%	-10%	-6%	30.8	27.9	37.7	32.6
Other London	GPOR	Unpf	Mar-17	2096	642	525	-18%	1.7%	-16%	-17%	-14%	37.6	38.0	37.1	34.4
	WKP	Unpf	Mar-17	1580	965	750	-22%	2.7%	-19%	9%	15%	40.5	36.0	31.5	28.1
Self storage	CAPC [^]	Unpf	Dec-16	2340	276	186	-33%	0.5%	-32%	10%	16%	125.4	121.2	197.2	611.2
	SHB	Hold	Sep-17	2993	974	953	-2%	1.8%	0%	1%	-1%	47.8	43.7	60.3	52.0
Primary Care	BYG	Hold	Mar-17	1327	837	835	0%	3.7%	3%	38%	31%	23.0	21.4	24.3	21.6
	SAFE	Hold	Oct-17	1084	518	515	0%	3.1%	3%	53%	40%	20.8	19.6	22.2	19.4
Other	AGR	Buy	Mar-17	1418	60	70	18%	4.1%	22%	10%	2%	26.4	25.0	24.4	21.9
	PHP	Buy	Dec-17	712	115	126	10%	4.7%	14%	12%	2%	23.0	23.8	22.7	20.2
UK Majors Sector (UK)	ESP* ¹	Buy	Jun-16	513	85	110	29%	6.5%	36%	-22%	-26%	42.5	23.0	-	33.1
	GRI [^]	Hold	Sep-17	1155	277	282	2%	1.9%	4%	-10%	-14%	20.3	20.6	19.4	18.8
	UTG [^]	Hold	Dec-16	1867	775	815	5%	2.7%	8%	10%	6%	27.5	25.6	28.0	25.9
EU Stocks	RESI* ³	Buy	n/a ³	178	99	116	17%	3.0%	20%	-4%	-8%	n/a	n/a	n/a	n/a
							-17%	5.1%	-8%	-32%	-29%	20.3	20.4	16.7	16.3
							-7%	3.7%	-3%	-10%	-10%	31.5	30.0	33.3	51.3
							-2%	5.1%	0%	-2%	-5%	15.0	14.6	19.4	12.0

		NAV				Adj EPS			DPS			3yr CAGR (%pa)	LTV Next (%)	Seethru yield (%)	3yr TSR CAGR (%pa)
		Last (p)	Next (p)	Next+1 (p)	Next+2 (p)	Last (p)	Next (p)	Next+1 (p)	Last (p)	Next (p)	Next+1 (p)				
Mature diversifieds	BLND	915	851	842	832	37.8	37.1	37.0	29.2	30.1	30.1	1.0%	28%	5.7%	0.3%
	LAND	1511	1324	1318	1308	51.5	54.8	57.6	41.1	42.4	44.5	4.3%	24%	6.0%	-1.6%
	GFC FP (€)	130	147	156	162	5.4	5.0	5.8	5.1	5.2	5.5	4.3%	47%	5.0%	11.1%
Shopping Centres	LI FP (€)	37	39	41	42	2.2	2.4	2.4	1.8	2.0	2.1	5.7%	36%	5.0%	9.2%
	HMSO	739	730	653	648	29.2	30.9	32.1	24.0	25.4	25.4	2.0%	39%	6.8%	-0.7%
Logistics	INTU	404	386	346	314	15.0	15.0	15.3	14.0	14.0	14.0	0.0%	50%	7.9%	-4.1%
	BBOX*	129	137	142	146	6.5	6.4	7.2	6.2	6.4	6.6	3.3%	27%	4.2%	8.8%
Industrial	LMP	150	162	167	171	8.2	8.6	9.5	7.5	7.8	8.0	3.2%	37%	4.0%	9.2%
	HSTN	129	128	130	137	6.7	6.1	7.7	5.9	6.2	6.5	5.0%	-38%	7.5%	6.7%
London office	SGRO	556	598	621	636	19.9	21.9	23.8	16.6	18.0	19.5	7.3%	38%	4.6%	7.6%
	DLN	3551	3275	3121	2973	77.0	89.0	100.6	52.6	57.8	63.6	10.0%	18%	3.8%	-3.8%
Other London	GPOR	799	772	743	718	17.3	18.6	19.2	10.6	11.0	11.0	1.1%	10%	3.9%	-2.1%
	WKP	953	873	836	800	30.6	34.4	35.3	21.1	26.4	27.1	9.5%	21%	4.9%	-2.6%
Self storage	CAPC [^]	340	261	241	240	1.4	0.5	0.5	1.5	1.5	1.5	0.0%	23%	n/a	-10.3%
	SHB	952	978	1005	1031	16.2	18.7	20.6	16.0	17.4	18.7	7.0%	27%	3.0%	4.5%
Primary Care	BYG	564	614	640	667	34.5	38.7	41.8	27.6	31.0	33.5	9.3%	23%	4.9%	10.8%
	SAFE	327	362	384	407	23.3	26.6	28.2	14.0	16.0	17.0	8.0%	31%	4.9%	11.9%
Other	AGR	49	55	59	61	2.4	2.7	2.9	2.3	2.5	2.6	7.6%	27%	4.5%	12.0%
	PHP	101	111	120	128	5.1	5.7	6.2	5.3	5.4	5.7	3.7%	55%	4.4%	12.9%
UK Majors Sector (UK)	ESP* ¹	105	108	114	120	1.3	2.6	4.6	6.1	5.6	5.0	-6.2%	31%	7.4%	10.1%
	GRI [^]	303	316	328	339	14.3	14.8	15.7	4.9	5.3	6.3	15.2%	39%	4.2%	5.7%
	UTG [^]	646	699	726	754	27.7	29.9	33.2	18.0	21.1	24.2	15.9%	34%	5.0%	8.6%
EU Stocks	RESI* ³	98	102	106	110	n/a	4.0	5.4	n/a	3.0	5.0	n/a	51%	n/a	n/a

[^]Non-REIT - GRI's valuation based on a NNNNAV

*Jefferies Hoare Govett act as brokers

¹ ESP's year-end changing from June to Dec

² Jefferies is currently restricted on Unibail-Rodamco

³RESI Last NAV take as 100p per share IPO less estimated 2% transaction charges. N.B. No prior financial year-end

Source: Thomson Reuters, Company Data, Jefferies Estimates

Company Description

PHP is a UK REIT which specializes in investing in primary health care premises which are leased back to providers of primary health care, such as GPs and other associated healthcare users. Ninety percent of its tenant base is either directly or indirectly backed by the UK Government on rents which broadly track inflation. The portfolio consists of both investment properties and forward-funded developments.

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(Article 3(1)e and Article 7 of MAR)

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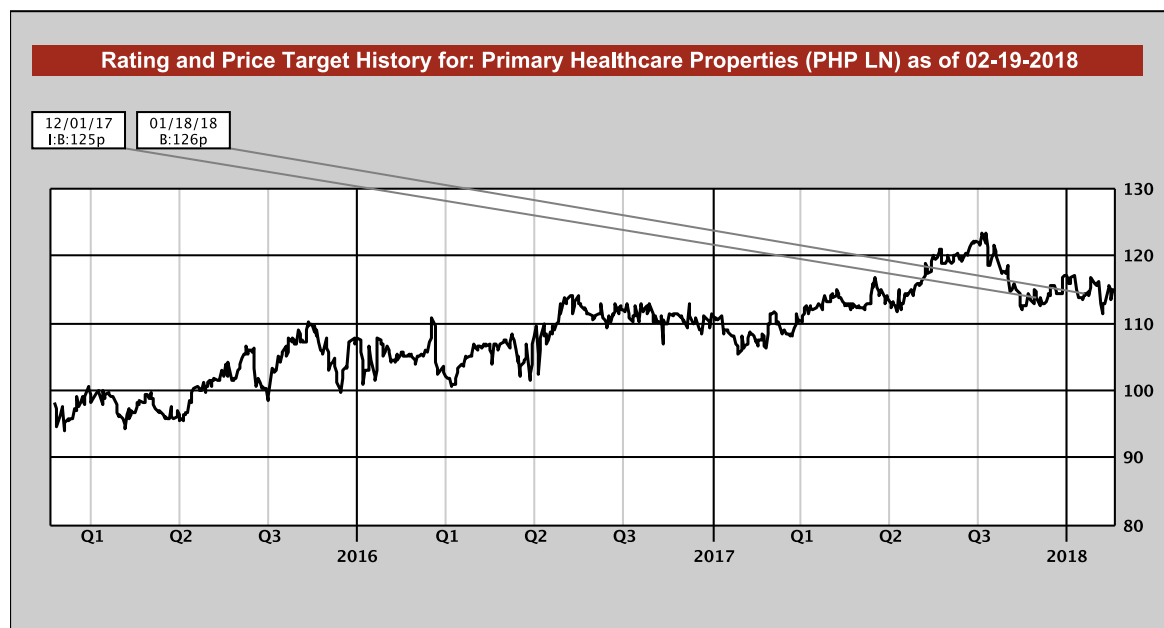
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- Big Yellow Plc (BYG LN: p841.50, HOLD)
- British Land (BLND LN: p647.60, UNDERPERFORM)
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- Hansteen (HSTN LN: p136.00, HOLD)
- Intu Properties plc (INTU LN: p213.20, UNDERPERFORM)
- Klepierre (LI FP: €33.67, HOLD)
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