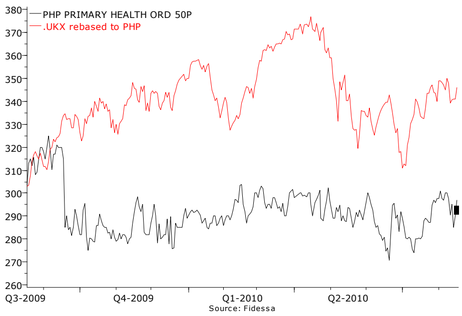
Primary Health Properties 293p

Sound Interim Results. NAV, Profit, Dividend All Higher

19 August 2010

Share Price: 293p



12m High: 320p

12m Low: 271p

Market Cap: £183m

Shares in Issue: 62.6m

NAV/Share: 304p on EPRA basis

Gearing: LTV 58%

Interest Cover: 2.0X

EPIC Code: PHP

Sector: Real Estate

Market: London Full List

Brokers: Numis Securities/Peel Hunt

PR: Pelham Bell Pottinger +44 (0)20 7861 3232

Website: www.phpgroup.co.uk

Description: PHP lets out GP surgeries to GP partnerships on long term leases. The rent GPs pay is reimbursed by the public sector.

Analysts: Roger Hardman

Tel: +44 (0)20 7929 3399

Email: research@hardmanandco.com

Interim results from the owner of GP surgery freeholds, Primary Health Properties, show a familiar picture of growth in rental income, control of expenses, growth in underlying profit, and higher dividend. They also show an increase in net asset value per share because, as we predicted, the independent valuers have shifted the yield basis used for valuing the portfolio from 6.0% to 5.8%.

- Rental and Related Income up from £10.7m to £12.0m, partly through addition of new properties and partly because of 3% p.a. annual equivalent rental growth.
- Expenses once again well controlled at an unchanged £2.2m. This will change once total shareholder returns push through the pre-crash highs and management performance incentives apply again, but that is still some way in the future.
- Finance costs only 9% higher in spite of a 46% increase in the size of the portfolio. The bulk of the investment property additions were financed by last year's equity issue.
- Underlying adjusted profit (rental and related income minus expenses and finance costs) was £4.0m, up from £3.2m. The larger number of shares in issue lead the company announcement to declare lower adjusted eps, but the statement is a little unfair to the company because there is an 'ex rights factor' in part of the capital raising that has not been taken into account.
- Even the IFRS accounting items we prefer to ignore have moved in the company's favour this time. A property revaluation gain of £17.8m goes into the official P & L Account. There is a loss of £5.0m on 'mark to market' of the debt hedging, but this still leaves PHP with a £12.8m net gain in these areas.
- The interim dividend is raised from 8.5p to 8.75p, strongly suggesting our forecast of a total payout for the year of 17.5p is in the right place.

We have slightly reduced our full year eps forecast now we have more clarity following the recent burst of property additions. 2011 will be a good year, as the proportion of properties bought with unhedged debt increases. Every £30m of property additions from now on should add £1m p.a. to the p & l account.

Y/E	Group Revenue	Adjusted Pre-Tax Profit*	Adjusted EPS *#	P/E ratio	Dividend #	Yield
December	£m	£m	p.		p.	%
2007A	15.7	4.2	13.3	22.0	15.18	5.2
2008A	19.7	4.6	14.0	20.9	15.91	5.4
2009A	21.3	7.3	18.4	15.9	17.25	5.9
2010E	26.2	10.3	16.5	17.7	17.50	6.0

** EPRA basis* *# ex-rights adjusted*

The Interim Results

6m to end June	2010	2009	Change
	£m	£m	%
Rental Income	11.8	10.6	+11%
Finance Lease Income	0.2	0.1	+100%
Total Income	**12.0**	**10.7**	**+12%**
Direct Property Expenses	0.2	0.1	+100%
Administrative Expenses	2.0	2.1	-5%
Total Expenses	2.2	2.2	unch
Operating Profit	**9.8**	**8.5**	**+15%**
Net Finance Costs	5.8	5.3	+9%
Adjusted Pre- Tax Profit	**4.0**	**3.2**	**+25%**
Tax Charge	1.6	0	
After Tax Profit	**2.4**	**3.2**	**-25%**
No. Shares In Issue, m	62.6	35.3	+77%
Adjusted Earnings Per Share Ignoring Tax Charge p.	**6.4p**	**9.2p**	**-32%**
Valuation Gain/Loss On Portfolio	+17.8	-8.0	
Fair Value (Loss)/Gain On Debt Hedging Instruments	-5.0	+3.0	
Annual REIT Conversion Charge	-1.6	0	
Declared Pre-Tax Profit	**16.7**	**-1.8**	
Declared Earnings Per Share p.	**24.7p**	**-5.4p**	
Investment Properties	460.8	315.7	+46%
Net Debt	257.7	221.4	+12%
Shareholders' Equity	157.3	85.9	+83%
Declared Net Asset Value Per Share	251p	243p	+3%
NAV Per Share on EPRA Basis (excludes fair value adjustments for debt and related derivatives) Before 'Ex Rights' Factor Adjustment	**304p**	**290p**	+5%
% of Debt at Fixed Rate (approx)	88%	100%	
Loan To Value Ratio (max permitted 70%)	**58%**		
Interest Cover (min permitted 1.3X)	**2.0X**		

We, and the auditors, have ignored the tax charge in adjusted eps calculations, because this is levied on the IFRS property valuation gain, and is in any case a non-cash item.

The Future

Primary Health Properties is in an interesting situation strategically. It is by some way the largest freehold owner of GP surgeries in the country (though with only a 1% market share by number). It has significant headroom for acquisitions on its banking covenants. But on the other hand has limited headroom from existing facilities (new ones are being negotiated). Also existing facilities expire in 2013. We expect an extended (or a replacement) facility to be in place by the end of the year.

We also expect new development approvals by Primary Care Trusts to come to a grinding halt short term – Primary Care Trusts are to be abolished by the Government, the Health White Paper posed more questions than it answered and there will be no clarity on this front until October on November. As the PCTs currently reimburse rent to GPs, one good thing likely from the changes is reimbursement from a central body, arguable strengthening covenants.

There remains a major requirement to upgrade GP facilities and to continue the move towards larger, more sophisticated buildings, housing more doctors and in some cases multiple practices.

Financial Outlook

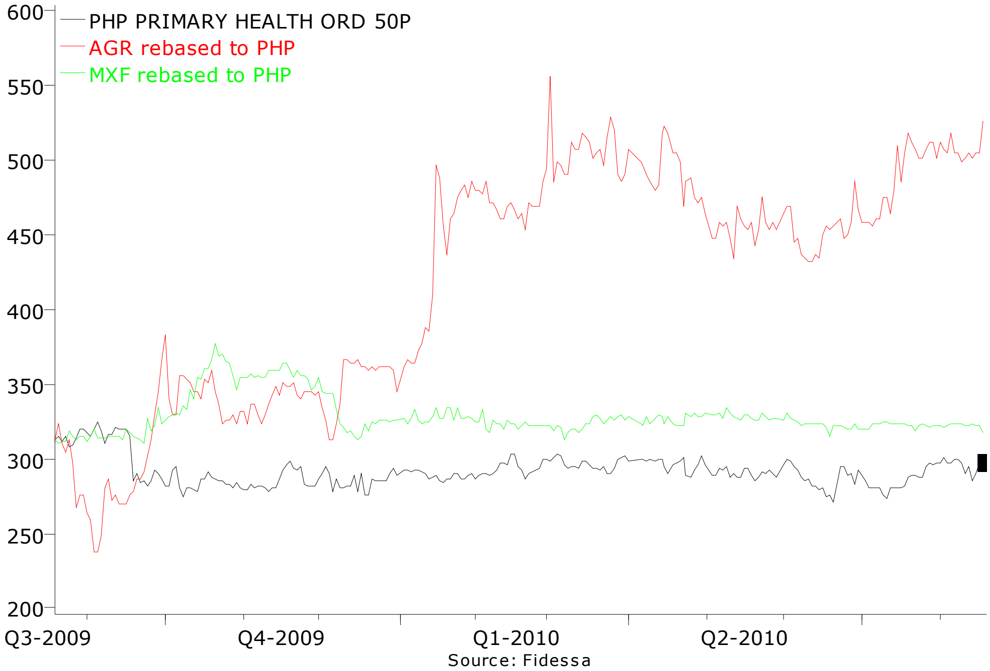
The additional debt being taken on to finance new properties and acquisitions is for the most part floating rate, enabling PHP to take advantage short term of the very low interest rate environment before entering into more term fixes. For the present, we estimate that PHP will probably make an additional £1m profit for every £30m of new property acquisitions it adds to its portfolio.

Also, every year, rental income will rise because of the three year rent reviews on each property, while, the borrowing costs against most of those properties is fixed.

Future income flows, and dividends, therefore continue to look very secure indeed.

Sector Comparisons

Ownership of GP and medical freeholds is a stable, defensive business, where no fireworks are expected. Of the three main companies in this sub-sector, Primary Health Properties has the longest track record, is the largest, and has been the steady one. The Assura Group share price has shown the most variation as it recovers from difficulties in 2008 and 2009. MedicX Fund shares have exhibited the same pattern of low volatility as Primary Health Properties.



Source: Fidessa

Disclaimer

The conclusions and opinions expressed in the investment research accurately reflect the views of the first named analyst. Hardman & Co provides professional independent research services and the companies researched pay a set fee in order for this research to be made available. While the information in the research is believed to be correct, this cannot be guaranteed. There are no other conflicts of interest.

Neither Hardman & Co nor the analysts responsible for this research own shares in the companies analysed in this research note. Neither do they hold any other securities or derivatives (including options and warrants) in the companies concerned. Hardman & Co does not transact corporate finance and therefore does not earn corporate finance fees. It does not buy or sell shares, and does not undertake investment business either in the UK or elsewhere.

Hardman & Co does not make recommendations. Accordingly we do not publish records of our past recommendations. Where a Fair Value price is given in a research note this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price.

Our research is issued in good faith but without legal responsibility and is subject to change or withdrawal without notice. Members of the professional investment community are encouraged to contact the analyst concerned.

This research is provided for the use of the professional investment community, market counterparties and sophisticated and high net worth investors as defined in the rules of the regulatory bodies. It is not intended to be made available to unsophisticated individuals. In the UK, any such individual who comes into possession of this research should consult their properly authorized professional adviser, or undertake one of the 'self certified' sophisticated investor tests that are available.

This research is not an offer to buy or sell any security.

Past performance is not necessarily a guide to the future and the price of shares, and the income derived from them, may fall as well as rise and the amount realised may be less than the original sum invested. For AIM and PLUS shares, it is the opinion of the regulator that risks are higher. Furthermore the marketability of these shares is often restricted.

This document must not be accessed or used in any way that would be illegal in any jurisdiction.

In some cases research is only issued electronically and in some cases printed research will be received by those on our distribution lists later than those receiving research electronically.

The report may be reproduced either whole or in part on condition that attribution is given to Hardman & Co, and on condition that Hardman & Co accepts no liability whatsoever for the actions of third parties in this respect.

Hardman & Co is not regulated by the Financial Services Authority (FSA).

Hardman & Co

4-5 Castle Court
London
EC3V 9DL
United Kingdom

Tel: +44(0)20 7929 3399
Fax: +44(0)20 7929 3377

www.hardmanandco.com