PEEL HUNT

MARKETING COMMUNICATION

Buy

30 April 2018

Primary Health Properties#

PHP

DATA

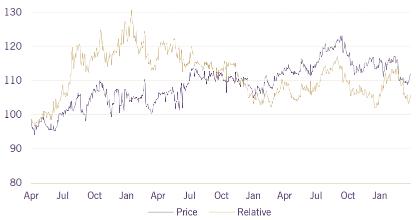
Price (close 25/4)	112p
Target price	125p
Market cap	£818m
Free float	100%
Index	FTSE 250
Sector	Real Estate
Next news	July - Interims
UK portfolio	99%
European portfolio	1%
North American portfolio	0%
Rest of World portfolio	0%

DESCRIPTION

The group is engaged in the generation of rental income and capital growth through investment in primary health care property leased primarily to GPs, Primary Care Trusts, health authorities & other associated health care users

PERFORMANCE

Source: Bloomberg



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#Corporare client of Peel Hunt

£115m equity raise for accretion expansion

Following the recent completion of a successful £115m equity raise, today we publish our new forecasts. The company has a near-term pipeline of opportunities including a significant proportion in Ireland where higher yields combined with low debt costs will lead to earnings accretion and lower leverage. The company has a phenomenal long-term track record and we expect this to continue with forecast total accounting return of over 9% per annum over the next three years. Buy.

Equity raise

PHP announced the successful completion of its equity issue, which raised £115m – more than the initial £100m target – at 108p. The price reflected:

- A 5.3% discount to the closing price (114p) on 22 March 2018.
- A 7% premium to the December 2017 EPRA NAV.

The fundraise attracted a diverse range of quality investors including over 80% take up on the open offer. The increased market cap has led to the company joining the FTSE 250 (as of 24 April), which should further increase liquidity and investor awareness.

Use of the proceeds

Short term, the proceeds can be used to pay-down the company's revolver and therefore minimise the initial cash-drag. PHP will then use the proceeds to grow its portfolio. Given the low cost structure and current cost of debt, this will be accretive to earnings. PHP has identified a pipeline of 15 acquisition opportunities in the UK and Ireland with total anticipated acquisition cost of £151m. These acquisitions are expected to add an additional £8.2m of rent, equating to a net initial yield of 5.1% (after purchasers costs). Of this:

- £57m of acquisitions have pricing agreed and are subject to contract and/or are in solicitor's hands. We understand the majority of this is in Ireland which benefits from an enhanced yield compared to the UK.
- A further £94m is in negotiations and we understand the majority of this is within the UK.

PHP is also on site on five asset management projects and a further seven have been approved. The total cost of the projects is estimated to be around £13.4m.

STATS

Source: Company accounts, Peel Hunt estimates

Y/E Dec	Net Op Inc (£m)	Adj EPS (p)	EPS growth (%)	PER (x)	DPS (p)	Div yield (%)	Adj NAV (p)	NAV/3net (p)	Disc/Nav (%)	Disc/3net (%)
2017A	71.3	5.2	9.8	21.5	5.3	4.7	100.7	94.7	11.8	18.9
2018E	73.7	5.3	1.4	21.2	5.4	4.8	104.8	99.9	7.5	12.7
2019E	82.2	5.8	9.3	19.4	5.6	4.9	108.9	104.3	3.4	8.0
2020E	90.6	6.2	6.6	18.2	5.7	5.1	113.9	109.2	(1.1)	3.1

Impact of equity issue

LTV

Immediately following the issue we estimate that LTV will reduce to c45% from 53% (or c40% from 49% if you assume the convertible bond, which is in the money, converts).

As the £151m pipeline is acquired, this will increase LTV back up towards 50% (or 46% assuming conversion).

EPS

We estimate that once the pipeline is fully invested, the issue will be EPS accretive by around 4% or so. However, alongside this accretion, the leverage will also have fallen as per the below.

The Irish assets will be particularly accretive to EPS given the higher starting yields (c5.5-6.0%) and the lower cost of debt – as demonstrated in the charts below.

The initial cash-drag will be partially offset by paying down short-term debt facilities and the majority of the most advanced purchases are also in Ireland where yields are higher, and this should further mitigate the immediate dilution.

NAV

The equity is being raised at 108p versus a previously reported NAV of 101p. The small accretion will be offset by the small c2% issue costs and effectively, we believe the pro-forma NAV is largely unchanged.

Chart 1: Accretion of UK acquisitions

Source: Company accounts, Peel Hunt estimates

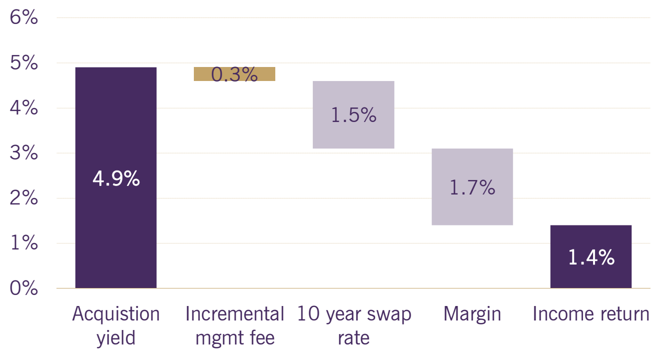
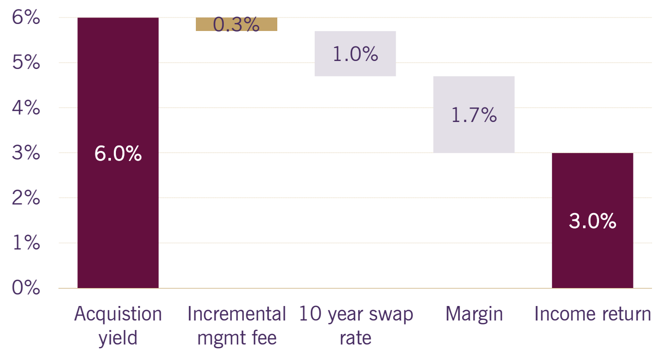


Chart 2: Accretion of Ireland acquisitions

Source: Company accounts, Peel Hunt estimates



Investment case

Growth sector
Around half of the 8,000 GP surgeries in England and Wales are considered unfit for purpose and the Government continues to shift more care away from hospitals and into GP surgeries. Combined with an age-ing population, demand for GP surgeries is set to continue to rise.

Undemanding property valuation
Despite yield compression, initial yields of c4.9% remain conservative compared with other parts of the real estate market and even on the current NAV premium, this merely implies a property yield of around 4.6% - still good value given other long income assets (supermarkets trade as low as 4.25%).

Robust income stream
Furthermore PHP's 13-year WAULT provides robust income security especially with 90% of the rent roll indirectly or directly paid by the Government and a long track-record of near 100% occupancy (currently 99.7%).

Improving rental growth
74% of the rent reviews are open market with 19% RPI-linked and 7% fixed.

For open market rent reviews, market rental evidence is typically from newly constructed properties. Land price and construction price inflation over the past five years or so means new developments require materially higher rents to justify construction.

Encouragingly, demand for new premises is now being supported by NHS initiatives to modernise the primary care estate. As these new developments start to complete, this "will eventually result in further rental growth in the future".

We now forecast rental growth picking up towards current inflation levels over the next two to three years.

New Peel Hunt forecasts

Today we publish our new forecasts following the equity issue.

December 2018 forecasts

- We reduce our EPS forecast from 5.7p to 5.3p to reflect the increased number of shares in issue and the timing of the proceeds' deployment. We assume around £100m of acquisitions, weighted towards H2. We also assume that half the outstanding convertible bond converts mid-way through the financial year.
- We retain our DPS forecast of 5.4p for a 4.8% dividend yield.
- NAV remains unchanged at 105p for a small 8% premium. The costs of the equity raise were offset by the 7% premium to December 2017 NAV, at which the shares were issued.

December 2019 forecasts

- We leave our EPS forecast for December 2019 unchanged at 5.8p. This assumes a further £100m of acquisitions and includes the remainder of the convertible bond converting.
- Our 2019 DPS forecast is unchanged 5.6p which equates to a fully covered dividend yield of 5.0%.
- Our NAV forecasts for remains unchanged at 109p.

December 2020 forecasts

- Our December 2020 EPS forecast increases c3% to 6.2p to account for accretion from the deployment of the capital raised.
- 2020 DPS is unchanged at 5.7p which equates to dividend yields of 5.1% which is 1.1x covered by recurring EPS.
- Our NAV forecasts for remains unchanged at 114p.

Total accounting return

Even with potential cash drag from what is a substantial equity raise we forecast a compound total accounting return of over 9% to December 2020 and expect FY19 to be PHP's 23rd successive year of dividend growth.

Table 1: Peel Hunt forecast changes

Source: Peel Hunt

	Dec-17	Dec-18		Dec-19		Dec-20	
	Actual	New	Old	New	Old	New	Old
Adj EPS	5.2p	5.3p	5.7p	5.8p	5.8p	6.2p	6.0p
EPS yield	4.6%	4.7%		5.2%		5.5%	
DPS	5.3p	5.40p	5.40p	5.55p	5.55p	5.7p	5.70p
Dividend cover	99%	98%		105%		109%	
Dividend yield	4.7%	4.8%		5.0%		5.1%	
NAV	101p	105p	105p	109p	109p	114p	114p
Discount/premium	11%	7%		3%		-2%	
Total accounting return	17%	9%		9%		10%	

Recommendation structure and distribution

	Recommendation distribution at 26 April 2018				All research published in the last 90 days	
	Corporate No	Corporate %	No	%	Corporate %	%
Buy	75	77	185	54	78	58
Add	12	12	53	15	11	16
Hold	8	8	78	23	6	20
Reduce	0	0	16	5	0	5
Sell	0	0	3	1	0	1
Under Review	6	6	8	2	4	1

Peel Hunt's Recommendation Structure is as follows:

Buy, > +15% expected absolute price performance over 12 months
Add, +5-15% range expected absolute price performance over 12 months
Hold, +/-5% range expected absolute price performance over 12 months
Reduce, -5-15% range expected absolute price performance over 12 months
Sell, > -15% expected absolute price performance over 12 months
Under Review (UR), Recommendation, Target Price and/or Forecasts suspended pending market events/regulation

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

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Number	Disclosure
1	Company is a corporate client of Peel Hunt
2	The Analyst has a shareholding in this Company
3	The Company holds >3% in Peel Hunt
4	Peel Hunt makes a market in this Company
5	Peel Hunt is Broker to this Company and therefore provides investment services to the Company
6	During the last 12 months Peel Hunt has received compensation from this company for the provision of investment banking services
7	During the last 12 months Peel Hunt has acted as a sponsor/broker/ NOMAD/ financial advisor for an offer of securities from this company
8	Peel Hunt holds >5% in Company (calculated under Market Abuse Regulation (EU) 596/2014)
9	1% beneficial ownership (calculated for purposes of FINRA under Section 13(d)/(g) of the Securities Exchange Act of 1934 and IIROC Rule 3400)
10	Peel Hunt holds a net long position that exceeds 0.5% in the Company (calculated under Market Abuse Regulation (EU) 596/2014).
11	Peel Hunt holds a net short position that exceeds 0.5% in the Company (calculated under Market Abuse Regulation (EU) 596/2014).

Recommendation history

Company	Disclosures	Date	Rec	Price	Target Price
Primary Health Properties	1, 4,7	20 Apr 17	Buy	113p	125p

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