

# Primary Health Properties

Funded for growth

With a successfully completed £115m (gross) equity raise behind it, PHP is well funded for continuing growth in its investment portfolio, targeting returns that are supportive the progressive dividend policy, now in its 22<sup>nd</sup> year. The prospects for cash deployment look positive, with a c £151m pipeline of investment prospects, of which more than a third are at a highly advanced stage of negotiation. Reduced gearing leaves Primary Health Properties (PHP) well placed to seize additional opportunities that may arise, with the NHS commissioning of primary healthcare investment finally showing signs of acceleration, and the Republic of Ireland (RoI) operation becoming established, with a fourth asset recently added.

Year end	Revenue (£m)	EPRA earnings* (£m)	EPS* (p)	DPS (p)	EPRA** NAV/share (p)	P/NAV (x)	Yield (%)
12/16	67.4	26.7	4.7	5.125	91.1	1.25	4.5
12/17	72.5	31.0	5.1	5.250	100.7	1.13	4.6
12/18e	77.1	36.4	5.1	5.400	105.0	1.08	4.7
12/19e	82.6	42.2	5.4	5.500	108.4	1.05	4.8

Note: \*Diluted EPRA basis, excludes valuation movements and other exceptional items.

\*\*EPRA basis adjusts for fair value of derivative interest rate contracts and convertible bond.

## Strong pipeline for deployment of funds

PHP has raised £115m (gross), issuing 106.5m new shares (a 17% increase) at 108p, a premium to the end-FY17 EPRA NAV per share of 100.7p. The proceeds will be used to selectively grow the investment portfolio. Of the £151m investment pipeline, £57m is agreed subject to contract. We have not changed our assumption of £100m a year of investment commitments in each of FY18 and FY19, but the size of the pipeline and reduced LTV offer the potential for more investment and higher earnings than we forecast. Our FY19 EPRA earnings forecast increases c 13% but EPS is c 2% lower. Our DPS forecasts are unchanged (FY19 cover 101%) while LTV falls to 45.0% from 51.9%.

## Strong growth prospects in UK and RoI

In both the UK and RoI, there is broad political will to reform healthcare provision, placing more emphasis on primary care to meet the increasing healthcare needs of growing and ageing populations. The requirement for larger, more flexible, higher-quality premises will provide significant investment opportunities for PHP and others in coming years, and there are signs in the UK that NHS new build commissioning is finally beginning to accelerate as new structures and strategies bed down.

## Valuation: Secure, dividend growth underpinned

Our DPS estimates are unchanged despite the increase in share count, and our forecasts show the FY18 DPS substantially (99%) covered for a yield of 4.7%. Revenues are supported by secure, long-term income, substantially subject to upwards-only review, with little exposure to the economic cycle, or fluctuations in occupancy. The reduction in gearing makes faster asset and income growth possible, should opportunities arise.

Capital increase completed

Real estate

14 May 2018

**Price** 113.8p  
**Market cap** £832m

Balance sheet net debt (£m) at 31 December 2017	726.6
Net LTV at 31 December 2017	52.9%
Shares in issue	730.7m
Free float	98%
Code	PHP
Primary exchange	LSE
Secondary exchange	N/A

## Share price performance



%	1m	3m	12m
Abs	3.8	1.2	0.5
Rel (local)	(2.3)	(6.9)	(4.0)
52-week high/low	123.14p		108.8p

## Business description

Primary Health Properties is a long-term investor in primary healthcare property in the UK and, more recently, Ireland. Assets are mainly long-let to GPs and the NHS or HSE, organisations backed by the UK and Irish governments, respectively. The tenant profile and long average lease duration provide an exceptionally secure rental income stream.

## Next events

Interim results July 2018

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## Funded for growth

### Successful £115m capital raise, ahead of target

PHP first announced its proposed capital increase to fund ongoing acquisitions on 23 March 2017. It said it would seek to raise £100m (gross), at 108p per share, with the ability to increase the size of the issue by up to 25% depending upon the strength of investor demand. The firm placing and placing, open offer and offer for subscription duly received shareholder approval and closed on 18 April with valid applications and commitments amounting to £115m, representing the issue of 106.5m new shares, a 17% increase, taking the total number of issued shares to 730.7m. Over the medium term, the proceeds are intended to be selectively applied alongside existing and future debt facilities, to enable PHP to continue its strategy of portfolio growth while targeting returns capable of supporting the progressive dividend policy. PHP has a strong pipeline of investment opportunities, discussed below, but will initially pay down some of the debt drawn on its revolving debt facilities totalling £129m, as a matter of financial efficiency and saving on debt costs.

### Strong pipeline of investment opportunities

In the issue prospectus, PHP provided some more details of its pipeline of investment opportunities, amounting to £151m, of which c 54% is in the UK (£81.8m) and the balance in RoI (€79.0m). Around 40% (five opportunities with an anticipated total acquisition cost of £57m) of the pipeline represents potential transactions at an advanced stage of negotiation, with terms agreed subject to contract and matters in the hands of solicitors for documenting and completion. Another 10 opportunities with an anticipated total acquisition cost of £94m are nearing that state or are at the stage where PHP is in the course of agreeing terms with the sellers. As noted below, PHP has subsequently completed a €5.8m acquisition in the RoI.

<b>Exhibit 1: Pipeline summary</b>		
	Number of opportunities	Anticipated total acquisition cost
Subject to contract	5	£57m
Other opportunities	10	£94m

Source: PHP. Note: All figures unaudited. As at date of prospectus

PHP says that if all of the opportunities shown in Exhibit 1 were to reach the stage of completion, for which there is no guarantee, the estimated annual rent they would generate is £8.2m (or a blended yield of 5.4–5.5% on cost). We would expect the RoI opportunities to represent a higher yield than UK opportunities, and for development opportunities to provide a higher yield than for standing assets in the same territory.

We note that the average lot size of this pipeline is c £10m, roughly twice that of the existing portfolio, and a favourable indicator of the quality of the assets. As we noted in our recent company [study](#), in an environment in which investor interest in primary healthcare assets remains strong, causing yields to tighten, a selective and disciplined approach to acquisitions is required. Larger, more modern assets and those with the flexibility to adapt and change are more likely to provide superior long-term rental growth and sustained value creation.

Having completed the €20m acquisition of a large, modern 6,500 sqm healthcare facility in Mallow, County Cork in February 2018, subsequent to the capital increase, PHP has acquired a fourth asset in the RoI. The Mountmellick Primary Healthcare Centre, acquired for €5.8m, has a floor area of 1,600 sqm and comes with a separate c 230 sqm pharmacy, with both elements fully let. The Irish Health Service Executive (HSE) accounts for 65% of the total rent roll and the unexpired lease term is more than 18 years. There are now 308 assets in the PHP portfolio, with a gross value of more than £1.375bn and a contracted rent roll of £73.5m. Within this, the value of the Irish portfolio has

now reached more than €40m (c 3%) but should increase further given the share of RoI assets in the pipeline and the overall RoI opportunity.

In addition to the investment pipeline, PHP has ongoing asset management initiatives, enhancing and extending existing assets to meet the evolving needs of tenants, increase rents, extend/re-gear leases and increase property valuations. Outstanding commitments totalled £5.7m at end FY17 and with the prospectus, the adviser disclosed it is working on additional asset management projects that will potentially commit £11.3m of capital if approved.

## Estimate revisions

Our revised estimates reflect the increased number of shares and new capital raised, with relatively little change in our underlying assumptions.

- Share count increased by 106.5m with gross proceeds of £115m and net proceeds assumed at £111.6m after issuance costs.
- We continue to assume full conversion of the remaining convertible bonds (conversion price 97.5p) by end May 2019, and our share count also increases with the assumption that 5% of dividends are paid in scrip.
- We have not adjusted our assumption of £100m of new investment commitments in each of FY18 and FY19, although there is clearly room for this to be exceeded, given the current pipeline of opportunities. We have made modest changes to the assumed profile of investment, with a slightly increased share of completed RoI assets in the mix, consistent with the H118 trend.
- Our model assumes the use of excess cash to reduce borrowings near-term, which in turn reduces interest costs.
- Our forecast for end FY19 net debt reduces to £714m from £824m previously, and the net LTV reduces to 45.0% from 51.9%.

### Exhibit 2: Estimate summary

	Revenue (£m)			EPRA earnings			Diluted EPRA EPS (p)			DPS (p)			Dividend cover			EPRA NAVPS (p)		
	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff
12/18e	76.9	77.1	0.2%	34.1	36.4	6.9%	5.4	5.1	-6.0%	5.400	5.400	0.0%	100%	99%	-1.4%	105.1	105.0	-0.1%
12/19e	82.2	82.6	0.5%	37.5	42.2	12.7%	5.5	5.4	-1.9%	5.500	5.500	0.0%	105%	101%	N/A	109.1	108.4	-0.7%

Source: Edison Investment Research

Our forecast revenues increase modestly due to the changes in our assumed investment mix, while interest costs decline and EPRA earnings increase, 6.9% in FY18 and 12.7% in FY19. The increase in our forecast EPRA earnings does not fully offset the increase in share count, such that diluted EPRA EPS reduces by 6% in FY18 and 1.9% in FY19. We make no change to our forecast DPS growth, although dividend cover is slightly reduced. With the new shares issued at 108p, a premium to the end-FY17 EPRA NAV per share of 100.7p, the issue of shares had no dilutive impact on NAV per share, even allowing for issuance costs. Our new forecasts show a slightly reduced NAV per share as a result of lower retained earnings after dividends.

**Exhibit 3: Financial summary**

	£'000s	2015	2016	2017	2018e	2019e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		63.1	67.4	72.5	77.1	82.6
Cost of Sales		(0.9)	(0.9)	(1.2)	(1.2)	(1.3)
Gross Profit		62.3	66.6	71.3	75.9	81.4
Administrative expenses		(6.8)	(7.3)	(8.7)	(9.2)	(9.5)
EBITDA		55.5	59.2	62.6	66.7	71.8
Other income and expenses		0.0	0.0	0.0	0.0	0.0
Non-recurring items		0.0	0.0	0.0	0.0	0.0
Net valuation gain on property portfolio		39.8	20.7	64.5	21.8	24.0
Operating profit before financing costs		95.2	79.9	127.1	88.5	95.8
Net Interest		(33.7)	(32.5)	(31.6)	(30.3)	(29.6)
Non-recurring finance income/expense		0.0	0.0	0.0	0.0	0.0
Early loan repayment fees		0.0	(0.0)	0.0	0.0	0.0
Fair value gain/(loss) on interest rate derivatives and convertible bond, and swap amortisation		(5.5)	(3.7)	(3.6)	0.0	0.0
Profit Before Tax		56.0	43.7	91.9	58.2	66.2
Tax		0.0	0.0	0.0	0.0	0.0
Profit After Tax (FRS 3)		56.0	43.7	91.9	58.2	66.2
Adjusted for the following:						
Net gain/(loss) on revaluation		(39.8)	(20.7)	(64.5)	(21.8)	(24.0)
Fair value gain/(loss) on derivatives & convertible bond		5.5	3.7	3.6	0.0	0.0
Profit on termination of finance lease		0.0	0.0	0.0	0.0	0.0
Early loan repayment fees		0.0	0.0	0.0	0.0	0.0
Issue costs of convertible bond		0.0	0.0	0.0	0.0	0.0
EPRA basic earnings		21.7	26.7	31.0	36.4	42.2
Period end number of shares (m)		446.3	598.2	619.4	768.5	794.2
Average Number of Shares Outstanding (m)		445.6	560.0	600.7	709.4	783.2
Fully diluted average number of shares outstanding (m)		530.2	644.6	665.5	753.7	793.2
EPS - fully diluted (p)		11.2	7.3	14.7	8.0	8.5
EPRA EPS (p)		4.9	4.8	5.2	5.1	5.4
Diluted EPRA EPS (p)			4.7	5.1	5.1	5.4
Dividend per share (p)		5.000	5.125	5.250	5.400	5.500
Dividend cover		97.6%	100.0%	98.6%	98.7%	101.2%
<b>BALANCE SHEET</b>						
Non-current assets		1,100.6	1,220.2	1,361.9	1,471.6	1,589.2
Investment properties		1,100.6	1,220.2	1,361.9	1,471.6	1,589.2
Other non-current assets		0.0	0.0	0.0	0.0	0.0
Current Assets		7.0	8.4	10.5	9.3	13.7
Cash & equivalents		2.9	5.1	3.8	4.3	8.3
Other current assets		4.2	3.3	6.7	5.0	5.4
Current Liabilities		(34.9)	(32.3)	(33.9)	(34.8)	(35.9)
Current borrowing		(0.9)	(0.8)	(0.8)	(0.8)	(0.8)
Other current liabilities		(34.0)	(31.5)	(33.1)	(34.0)	(35.1)
Non-current liabilities		(727.4)	(697.1)	(751.7)	(676.3)	(743.4)
Non-current borrowings		(696.9)	(667.6)	(729.6)	(654.2)	(721.3)
Other non-current liabilities		(30.6)	(29.5)	(22.1)	(22.1)	(22.1)
Net Assets		345.4	499.2	586.8	769.8	823.5
Derivative interest rate swaps		35.3	33.3	24.5	24.8	24.8
Change in fair value of convertible bond		10.9	12.5	12.3	12.3	12.3
EPRA net assets		391.6	545.0	623.6	806.9	860.6
IFRS NAV per share (p)		77.4	83.5	94.7	100.2	103.7
EPRA NAV per share (p)		87.7	91.1	100.7	105.0	108.4
<b>CASH FLOW</b>						
Operating Cash Flow		57.1	56.8	60.1	69.2	72.7
Net Interest & other financing charges		(35.6)	(45.9)	(37.8)	(27.3)	(27.4)
Tax		0.0	(0.1)	0.0	0.0	0.0
Acquisitions/disposals		(29.5)	(97.4)	(75.4)	(87.9)	(93.6)
Net proceeds from issue of shares		(0.1)	145.2	(0.1)	111.6	0.0
Debt drawn/(repaid)		20.0	(31.8)	82.3	(30.0)	92.0
Equity dividends paid (net of scrip)		(21.1)	(24.7)	(29.8)	(35.1)	(39.6)
Other		0.0	0.0	(0.6)	0.0	0.0
Net change in cash		(9.2)	2.2	(1.3)	0.5	4.1
Opening cash & equivalents		12.1	2.9	5.1	3.8	4.3
Closing net cash & equivalents		2.9	5.1	3.8	4.3	8.3
Debt		(697.7)	(668.4)	(730.4)	(655.0)	(722.1)
Net debt		(694.9)	(663.3)	(726.6)	(650.8)	(713.8)
Net LTV		62.7%	53.7%	52.9%	44.2%	45.0%

Source: Company data, Edison Investment Research

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