

**Buy**  
12 April 2011

## Primary Health Properties (PHP)

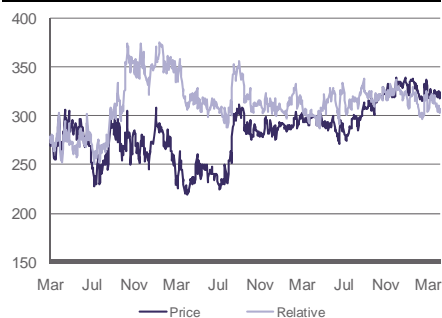
Data	
Price	322p
Target price	345p
Market cap	£202.5m
Free float	100.0%
Index	FTSE SmallCap
Sector	Real Estate
Next news	Aug - Interims
UK sales	100.0%
European sales	0.0%
North American sales	0.0%
Rest of World sales	0.0%

**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



### Analysts

Keith Crawford	+44 (0) 20 7418 8973
Matthew Churstain	+44 (0) 20 7418 8895
Matthew.Churstain@peelhunt.com	
James Carswell	+44 (0) 20 7418 8903
James.Carswell@peelhunt.com	

### Cashbox fundraising and quarterly update

PHP announces an 8.4% placing of equity, raising a net £15.6m. The small cashbox fundraising, along with further banking support, increases the company's potential investment reach and provides additional flexibility within the current funding structure as well as firepower to target further acquisitions.

### Key highlights

- **Primary Health Properties (PHP) has announced it is to raise £16.1m (net £15.6m) via a small placing, equal to 8.4% of issued shares.** The issue price of 305.0p represents a discount of 5.3% to yesterday's closing price and a discount of 2.1% to EPRA NAV/share of 311.5p, as reported at end-Dec 2010.

**The issue proceeds are expected to be used to target further opportunistic acquisitions, as well as providing additional flexibility within PHP's current funding arrangements.**

In addition, the company has provided an update for the first quarter (period from 1 January 2011 to 12 April 2011), **the main detail of which contains:**

- Completed acquisitions and commitments totalling £16.6m
- Annualised rental growth from rent reviews completed tracking at 3.27% versus 3.22% in the prior year
- Annualised rent roll increased by +3.2% (or £0.9m) to £28.9m as result of acquisition activity and continued rent review process
- Approval of new £50m debt facility with Clydesdale Bank
- Health and Social Care Bill proposals ongoing by the government, but expected to lead to medium-term demand for modern primary healthcare facilities
- Net mark-to-market liability on derivative portfolio reduced from £31m to £22m, principally because of rises in wholesale interest rates

### Forecasts for 2011 post funding

- **Adjusted NAV per share** reduces by 1.2% from 334p to **330p**. **The discount to the TERP of 321p is -2.7%.**
- **Adjusted EPS** down from 18.4p to 17.9p. **DPS unchanged at 18.0p, for 5.6% yield.**

### 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 (%)	NAV/H'line (x)	NAV/3net (x)	Prem/H'line (%)	Prem/3net (%)
2010A	21.9	9.1	14.7	(20.1)	17.5	21.9	5.4	311.0	261.9	3.5	22.9
2011E	24.5	11.9	17.9	21.5	18.0	18.0	5.6	330.1	284.9	(2.5)	13.0
2012E	26.9	12.4	18.2	1.6	18.5	17.7	5.7	343.8	298.5	(6.3)	7.9
2013E	28.9	13.0	19.1	5.0	19.0	16.9	5.9	358.2	312.9	(10.1)	2.9

## Comment

- The company intends to use proceeds of the issue to build upon the £12.3m of acquisitions already completed since the start of the year. Management believes a significant pipeline of attractive properties remains in the market and aims to capitalise on the positive yield differential of +1.2% between its finance costs and the average portfolio yield. In addition to completed acquisitions, the company has a commitment to purchase a £4.3m property in Newark, Nottinghamshire, increasing total commitments to £22.4m.
- PHP is also in the process of finalising a £50m bullet loan from Clydesdale Bank. Total undrawn commitments as of December 2010 were £53.2m. When combined with the new facility, cash resources and new equity, this means the company now has over £77m for future acquisitions (after accounting for recent acquisitions and future commitments). Gearing (net debt to equity) following the issue is expected to reduce to approximately 139%, versus 160% at December 2010.
- The issue price of 305p corresponds to a discount of 5.0% to the TERP of 321p and, subsequent to the issue, PHP will have a total of 68.2m ordinary shares in issue. The pro forma historical adjusted NAV per share reduces marginally to 310p, for a premium of 3.6%

**Table 1: Pro forma balance sheet**

Source: Company accounts, Peel Hunt estimates

(£m)	Dec 2010	Placing	Apr 2011
Investment properties	469.3		469.3
Net borrowings	-267.1	15.6	-251.5
Other net assets	-6.6		-6.6
<b>Adjusted net assets</b>	<b>195.6</b>		<b>211.2</b>
Number of shares (m)	62.8	5.3	68.2
<b>Adjusted NAV per share (p)</b>	<b>311.5</b>		<b>309.8</b>

Peel Hunt's 2011E NAV forecast prior to the issue was 334p; subsequent to the issue this falls marginally to 330p, offering a discount of -2.7% to the TERP.

- The company's portfolio is amongst the most reliable and secure in the sector; 100%-let, 17-year average lease length, PCT/GP tenants account for 90% of the rent roll and are therefore quasi-government guaranteed and 86.5% of rents are subject to upwards-only rent reviews.
- PHP has offered consistent, progressive dividend growth to investors over the past 10 years. Although the 2010 dividend was uncovered, additional contracted rent, future commitments and uplifts in rental values over the next three years will bridge the gap between earnings and dividends. Furthermore, this takes account of continued stepped increases to the dividend, which is assumed to average 0.5p per share per annum. Our base assumptions for DPS and the dividend yield of PHP are forecast to rise over the next three years from 18.0p and 5.6% in 2011 to 19.0p and 5.9% in 2013.

- Rental progress has remained strong, with annualised growth of 3.3% since the turn of the year versus 2.4% during the same period last year. Contracted rent increased by 3.2% to £28.9m, as a result of rent reviews as well as acquisitions. In addition, the company highlights that 13% of the portfolio is inflation-indexed and is therefore likely to benefit further if UK inflation persists at higher levels.
- Since the last significant capital raise in September 2009, PHP has acquired c40 health centres for a total cost of £117m. Combined with valuation growth of approximately +6.6% through 2010, the portfolio rose 37% from 31 December 2009 to 31 December 2010, demonstrating another year of significant growth for the company.
- Long-term implications of the NHS Health and Social Care Bill are expected to be positive for PHP – GPs will be responsible for allocating up to 80% of the NHS budget and increased responsibilities will be placed on the role of GPs and local health centres. However, short-term uncertainty remains on the availability and logistics for financing of Primary Health Centres, and this is expected to delay commitments to future developments.
- **Conclusion:** PHP continues to build upon the progress made in 2010, with acquisitions and rent reviews adding additional strength to earnings and support for further rises to future dividends. The small cashbox fundraising, along with further banking support, increases the company's potential investment reach and ensures PHP has the necessary firepower to act on opportunities within this niche investment class.

## Financial statements

**Table 2: Financial Statements**

Source: Company accounts, Peel Hunt estimates

Y/end December (£m)	2009	2010	2011E	2012E	2013E
<b>Per share data (p)</b>					
NNNAV	247.2	261.9	284.9	298.5	312.9
Adjusted NAV	279.9	311.0	330.1	343.8	358.2
Basic EPS	26.6	41.3	38.7	32.2	33.4
<b>Adjusted EPS</b>	<b>18.4</b>	<b>14.7</b>	<b>17.9</b>	<b>18.2</b>	<b>19.1</b>
Dividend	17.0	17.5	18.0	18.5	19.0
Number of shares (m)	61.5	62.9	68.2	68.2	68.2
<b>Key ratios (%)</b>					
NNNAV discount	31%	23%	13%	8%	3%
Adjusted NAV discount	15%	4%	(2%)	(6%)	(10%)
<b>Dividend yield</b>	<b>5.3%</b>	<b>5.4%</b>	<b>5.6%</b>	<b>5.7%</b>	<b>5.9%</b>
Gearing	109%	160%	143%	157%	159%
Interest cover (x)	1.8x	1.7x	1.9x	1.9x	1.8x
Dividend cover (x)	1.1x	0.8x	1.0x	1.0x	1.0x
<b>Income statement</b>					
<b>Net rental income</b>	<b>21.3</b>	<b>26.9</b>	<b>29.8</b>	<b>32.8</b>	<b>35.2</b>
Admin costs	(3.3)	(5.0)	(5.3)	(6.0)	(6.3)
<b>Recurring EBITDA</b>	<b>18.0</b>	<b>21.9</b>	<b>24.5</b>	<b>26.9</b>	<b>28.9</b>
Depreciation	-	-	-	-	-
Finance income	0.1	0.2	0.0	0.0	0.0
Finance expense	(10.3)	(12.9)	(12.5)	(14.5)	(15.9)
<b>Recurring pre-tax profits</b>	<b>7.9</b>	<b>9.1</b>	<b>11.9</b>	<b>12.4</b>	<b>13.0</b>
Exceptional items	1.3	(6.3)	-	-	-
Revaluation gain/(loss) on property	1.6	22.8	13.9	9.6	9.7
Tax	-	0.0	-	-	-
<b>Net profit</b>	<b>10.8</b>	<b>25.7</b>	<b>25.8</b>	<b>21.9</b>	<b>22.8</b>
<b>Balance sheet</b>					
Investment properties	341.9	469.3	513.2	562.7	592.5
Cash	0.2	0.4	0.3	0.1	0.1
<b>Total assets</b>	<b>348.6</b>	<b>476.3</b>	<b>520.1</b>	<b>569.4</b>	<b>599.2</b>
Total debt	(166.1)	(264.4)	(278.8)	(318.8)	(338.8)
<b>Total liabilities</b>	<b>(196.6)</b>	<b>(311.5)</b>	<b>(325.9)</b>	<b>(365.9)</b>	<b>(385.9)</b>
<b>Shareholders' equity</b>	<b>151.9</b>	<b>164.7</b>	<b>194.2</b>	<b>203.6</b>	<b>213.4</b>
<b>Cash flow statement</b>					
<b>Operating cash flow</b>	<b>16.0</b>	<b>22.8</b>	<b>11.9</b>	<b>12.4</b>	<b>13.0</b>
Net working capital	(0.5)	3.1	-	-	-
Tax	-	(0.2)	-	-	-
<b>Investing cash flow</b>	<b>(23.4)</b>	<b>(70.8)</b>	<b>(30.0)</b>	<b>(40.0)</b>	<b>(20.0)</b>
Acquisitions/disposals	(23.4)	(25.2)	(30.0)	(40.0)	(20.0)
Capital expenditure	-	-	-	-	-
<b>Financing cash flow</b>	<b>6.9</b>	<b>48.1</b>	<b>18.0</b>	<b>27.4</b>	<b>7.0</b>
Net borrowings	(38.3)	69.6	14.3	40.0	20.0
Dividends paid	(5.5)	(9.8)	(12.0)	(12.6)	(13.0)
<b>Net cash</b>	<b>(0.5)</b>	<b>0.2</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>0.1</b>

**Recommendation structure and distribution as at 11 April 2011**

		No	%
Buy	> +10% expected absolute price performance over 12 months	137	54
Hold	+/-10% range expected absolute price performance over 12 months	93	37
Sell	> -10% expected absolute price performance over 12 months	24	9

**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	x

**Recommendation history**

Company	Date	Rec	Date	Rec	Date	Rec	Date	Rec
Primary Health Properties	20 Nov 09	Buy						

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Peel Hunt LLP  
 111 Old Broad Street  
 London EC2N 1PH  
 T: +44 (0) 20 7418 8900  
 F: +44 (0) 20 7417 4646