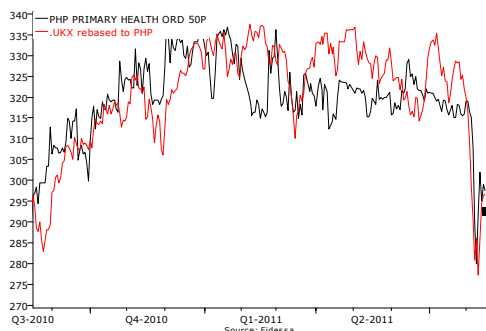


## Primary Health Properties 292p

FLASH: Good Results, Estimates Raised. 6.2% Yield

18 August 2011



**12m High:** 338.25p

**12m Low:** 280p

**Market Cap:** £199m

**Shares in Issue:** 68.2m

**NAV/Share:** 317.8p on EPRA basis

276p allowing for book loss on "Mark to Market"

**Gearing:** LTV 55.6%

**Interest Cover:** 2.5X

**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.

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Interim results released this morning were slightly better than we expected. Key points, from our point of view, are:

- Dividend increased from 8.75p to 9p, strongly suggesting an 18p total for the year, for a current year yield of 6.2%.
- Dividend 0.91X covered, but as some dividend is paid in scrip there is almost total cash cover.
- Expenses, both direct and administrative, down on H2 of 2010. The total cost of running the portfolio is now down to 1.1%, which we find very satisfactory.
- Interest charges slightly lower than we expected.

The yield basis on which the portfolio of GPs' surgeries is valued has been changed slightly from 5.8% to 5.75% (initial yield basis) and this has pushed up the Net Asset Value per share from 311.5p to 317.8p. This ignores the "mark to market" liability on derivatives; if these are taken into account then the NAV is 276p.

Strategically, Primary Health Properties is taking sensible steps to resolve its most important issue, the refinancing of bank debt due January 2013. Some new loans on what we view as good rates have been agreed, to spread future maturities and lessen the importance of the main facility rollover, and an opportunistic £16m equity issue at 305p in April has further strengthened the balance sheet. Loan To Value gearing is currently a modest 55.6%, so PHP is negotiating with the banks from a position of strength. Fortunately the Primary Care Trusts are in a position of lock down while the Government's new NHS Bill is going through Parliament, so the group is not losing any growth opportunities.

We expect a further small dividend increase in 2012, with the dividend fully covered, and for PHP to be able to absorb the additional 2013 borrowing costs and still afford a very modest dividend increase, with the dividend payment only a little short of full cover.

This is a sector driven yield story, and we continue to be enthusiastic about Primary Health Properties and the other large, quality companies in the sector. Where else can you get a rock solid 6.2% yield, in a company that has a 13 year unbroken record of dividend increases?

Y/E	Group Revenue	Adjusted Pre-Tax Profit*	Adjusted EPS #	P/E ratio	Dividend #	Yield
December	£m	£m	p.		p.	%
2009A	21.3	7.3	18.4	15.9	17.00	5.8
2010A	26.9	9.1	14.7	19.9	17.50	6.0
2011E	30.7	11.2	16.8	17.4	18.00	6.2
2012E	31.8	11.3	16.4	17.8	18.50	6.3

\* EPRA basis

# ex-rights adjusted

## Swaps and Mark to Market

Of Primary Health Properties' £269.6m of loans at end-June 2011, just over £200m was covered by various Swap arrangements. Cover on these extends out, for the longest, to 2027. The Swaps gradually reduce in size over that period. The main underlying term loan that PHP's management has swapped out expires in January 2013, but of course the lease agreements with tenants on the properties that were purchased with these loans are long term. The tenancy agreements (almost entirely with GPs or NHS bodies) have a remaining term on average of 16.5 years.

The current low level of interest rates means that Primary Health Properties is carrying a loss on these Swaps in its accounts. These Swaps all trade out over the coming years, however, and would only be of concern if the portfolio of properties were to be sold off. Their presence hampers management slightly in that there are certain actions with regard to debt reorganisation that cannot be undertaken without complications (such as a major bond issue), but we don't see this as a problem in a practical sense. These Swaps have reduced risk. Undoubtedly PHP would have been better off without these Swaps, but it would be irresponsible to run a company of this nature on a totally variable debt book.

## The Debt Refinancing

Debt refinancing of the main RBS/Santander/AIB facility is due January 2013, and negotiations have been taking place with these, and other banks, for over a year. PHP is not short of options. This facility is very cheap by current standards, and will probably cost an extra 1% or so in interest charges to replace. The maximum facility under this agreement is £255m, of which £242m is currently drawn down.

New loans have recently been agreed with Aviva and Clydesdale. These will reduce the amount drawn down on the RBS/Santander/AIB facility to £167m. The company currently has headroom of £102m on its borrowing facilities.

Phasing in the new facilities will cost PHP a little more in interest charges in 2012, and possibly an additional £2.5m a year from 2013. The company has annual rental revenue of ~£30m, and pre-interest profit of ~£25m, which puts the matter in proportion.

## The Property Portfolio

Rental growth, on rent reviews, picked up during the period, from 3.22% to 3.42%. This reflects the increase in the inflation rate; rent review of GPs' properties tend to track the inflation rate, and indeed 11% of the portfolio is directly linked to RPI. District Valuers take account of new build costs when negotiating rent reviews with GP surgery property owners, and these have been rising, in part due to rising specifications. We look for a faster rate of growth in rents in the existing portfolio over the coming two years. On a geared balance sheet, of course, this should have a favourable impact on the bottom line.

As far as new properties are concerned, Primary Health Properties added £0.9m of new annualised rental income (including rental uplift) to its portfolio in Q1, but only £0.1m in Q2. The company puts this down to delayed completions on some new properties. Commitments of £21m complete in H2 – these are not included in the June 30 rent roll. Primary Care Trusts are not authorising many new build GP Surgery projects at present, and will not until the new NHS Bill has passed through Parliament. There are currently an additional £43m of projects in the hands of solicitors, which will increase the portfolio size by approximately 10%.

## Sub-Sector Performance

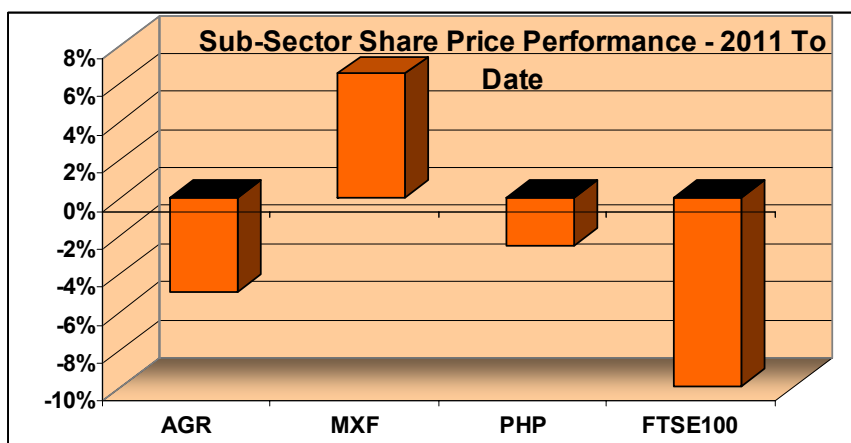
The three main quoted companies owning the freeholds of GP surgeries have all beaten the FTSE Index so far during 2011. This has been a solid, safe, defensive sector to be in. Primary Health Properties shares have been particularly stable, and the price fall since August (see chart on Front Page) almost precisely mirrors, though in a less extreme fashion, the drop in the FTSE Index.

Primary Health Properties

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To date in 2011 the performance of the three main quoted companies matches their dividend payment policies. The biggest distributor, MedicX Fund, has performed the most strongly. MedicX Fund has a policy of over-distributing its earnings, in effect distributing part of its capital along with its p & I surplus every year, and its historic yield is 7.0%. The worst performer, Assura Group, also has the worst yield, of 2.3% on its historic payout, although on the current forecast for 2011 from its own broker this will rise to 5.0%. Primary Health Properties, which has a policy of total distribution, yields a historic 6.0%.

This suggests to us that the stock market has totally accepted the argument that this class of share should be rated on a yield basis, rather than in relation to its Net Asset Value.



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Primary Health Properties

18-Aug-11

P & L Account

Six Months To	£m	6/09A	12/09A	6/10A	12/10A	6/11A	12/11E	6/12E	12/12E
Investment Properties - Start of Period		316.8	315.7	341.9	460.8	469.3	489.5	522.8	542.2
Additions to Portfolio - Purchases		6.9	26.2	101.1	3.5	14.9	25.0	10.0	10.0
Revaluations (rent increases and yield shift)		-8.0	9.6	17.8	5.0	5.3	8.3	9.4	9.8
Investment Properties - End of Period		315.7	341.9	460.8	469.3	489.5	522.8	542.2	562.0
Average Amount Invested		316.3	328.8	401.4	465.0	479.4	506.2	532.5	552.1
Portfolio Yield - Actual		6.65%	6.37%	5.90%	6.34%	6.29%	6.00%	5.75%	5.75%
Portfolio Yield - Quoted by co.					5.80%				
Closing Annualised Rent Roll		20.1	21.3	27.6	28.0	29.0	31.4	31.2	32.3
Rent Reversions, % p.a.		3.8%	3.3%	3.3%	3.2%	3.4%	3.4%	3.6%	3.6%
Base Rent			10.1	10.7	13.8	14.8	14.7	15.0	15.6
Rent Increase Through Reversions				0.2	0.2	0.2	0.2	0.3	0.3
Rent Increase Through Portfolio Additions				0.9	0.7	0.1	0.4	0.1	0.1
Rental Income For the Period		10.51	10.48	11.83	14.74	15.08	15.31	15.46	16.01
Finance Lease Income		0.15	0.17	0.17	0.171	0.17	0.18	0.18	0.18
<b>Total Income</b>		<b>10.66</b>	<b>10.65</b>	<b>12.00</b>	<b>14.92</b>	<b>15.25</b>	<b>15.49</b>	<b>15.64</b>	<b>16.19</b>
Direct Property Expenses		0.10	0.11	0.20	0.20	0.18	0.20	0.20	0.20
Administrative Expenses - a		2.07	1.39	2.04	2.61	2.45	2.50	2.50	2.50
Total Expenses		2.17	1.50	2.24	2.80	2.63	2.70	2.70	2.70
Operating Profit		8.49	9.15	9.76	12.11	12.62	12.79	12.94	13.49
Net Finance Costs		5.30	4.90	5.80	6.92	7.20	6.99	7.38	7.79
Average Interest Rate		5.2%	6.0%	4.4%	5.2%	5.0%	5.0%	5.1%	5.2%
<b>Adjusted Pre-tax Profit</b>		<b>3.19</b>	<b>4.25</b>	<b>3.96</b>	<b>5.19</b>	<b>5.42</b>	<b>5.80</b>	<b>5.55</b>	<b>5.70</b>
Tax Charge <sup>b</sup>		0.00	0.00	0.00	1.51	0.00	0.00	0.00	0.00
Tax Charge %		0%	0%	0%	0%	0%	0%	0%	0%
After Tax Profit		3.19	4.25	3.96	3.68	5.42	5.80	5.55	5.70
Dividend Cost, Cash		2.71	2.85	5.06	4.76	5.40	4.59	3.90	3.32
Dividend Cost, Scrip		0.00	0.28	0.32	0.71	0.30	0.92	0.95	0.96
Dividend Cost, <sup>c</sup>		2.71	3.13	5.38	5.48	5.86	6.17	6.36	6.39
Retained Earnings		0.48	1.12	-1.42	-1.80	-0.44	-0.37	-0.81	-0.69
Retained Cash		0.48	1.40	-1.10	-1.09	0.02	1.21	1.65	2.39
Shares in Issue, No., Avge,		34.49	40.62	62.6	62.6	65.16	68.5	68.8	69.1
<b>Adjusted EPS</b>		<b>9.2</b>	<b>10.5</b>	<b>6.3</b>	<b>8.3</b>	<b>8.3</b>	<b>8.5</b>	<b>8.1</b>	<b>8.3</b>
Dividend Per Share, p.		8.25	8.5	8.75	8.75	9.00	9.00	9.25	9.25

Primary Health Properties

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Management	Major Shareholders										
<p><b>Chairman:</b> Graeme Elliott</p> <p><b>Managing Director:</b> Harry Hyman</p> <p><b>Finance Director &amp; Deputy Managing Director:</b> Phil Holland</p> <p><b>Property Management:</b> A team of eight based in Woking.</p>	<table border="0"> <tr> <td data-bbox="770 367 1182 427">Harry Hyman (inc. Nexus Group)</td> <td data-bbox="1182 367 1410 427">5.9%</td> </tr> <tr> <td data-bbox="770 427 1182 488">Blackrock</td> <td data-bbox="1182 427 1410 488">4.0%</td> </tr> <tr> <td data-bbox="770 488 1182 548">Legal &amp; General</td> <td data-bbox="1182 488 1410 548">3.9%</td> </tr> <tr> <td data-bbox="770 548 1182 609">Aberdeen Asset Management</td> <td data-bbox="1182 548 1410 609">3.5%</td> </tr> <tr> <td data-bbox="770 609 1182 669">BT Pension Scheme Trustees</td> <td data-bbox="1182 609 1410 669">3.2%</td> </tr> </table>	Harry Hyman (inc. Nexus Group)	5.9%	Blackrock	4.0%	Legal & General	3.9%	Aberdeen Asset Management	3.5%	BT Pension Scheme Trustees	3.2%
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BT Pension Scheme Trustees	3.2%										
Key Dates	Key Milestones										
<p><b>AGM:</b> April 2011</p> <p><b>Interim Results:</b> August 2011</p>	<p><b>1994</b> Business model put forward by Harry Hyman</p> <p><b>1995</b> Purchase of small portfolio and incorporation</p> <p><b>1996</b> Floated on AIM, shortly afterwards upgrading to the Official List.</p> <p><b>2002</b> Wanless Review proposing reforms in the NHS</p> <p><b>2007</b> PHP converts to REIT status Darzi Interim Report launching the reform of public primary care</p> <p><b>2008</b> (May) Largest single acquisition, Port Talbot (£15.6m) (June) Darzi Review expanding on initial reform</p> <p><b>2009</b> (March) £3m capital raising at 220p  (September) £60m equity capital raising at 230p, comprising placing and 1-for-5 rights issue.</p> <p><b>2010</b> Purchase of CareCapital property portfolio for £24m. Purchase of Health Investments Ltd £39m portfolio - £3m placing at 290p as part consideration</p>										

## Primary Health Properties

18 August 2011

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