

Primary Health Properties (PHP LN)

1h18: Buying High Yielding Irish assets

Key Takeaway

PHP posted good results with NAV +3.4% to 104.2p with valuation +1.5%. Earnings increased +11% with EPS -3.8% after April's £115m equity placing. PHP has been disciplined with its capital, buying assets which will be relevant for 21st Century healthcare and with higher yields in Ireland 6.0% (4.9% UK), PHP has found better value with 3 assets acquired in 2018 and £35m in legals aiming at 10% of gross assets in Ireland.

PHP's NAV was +3.4% to 104.2p with valuation +1.5% as yield compression slowed to -6bps with portfolio NIY 4.85%. EPS decreased -3.8% with dilution coming from the £115m equity placing with EPRA earnings +11% to £17.1m whilst DPS increased +3% to 2.7p. LTV reduced to 44.6% after the equity placing, down from 52.9% and would reduce to a proforma 40.5% once the convertible bond has converted. PHP has £37m of potential asset purchases in legals (£35m in Ireland) with a further £175m pipeline in negotiation highlighting further external growth potential from the equity placing. Rent reviews saw growth of 1.7%, up 1.1% meaning a modest acceleration in organic growth. There has been further financial management with a £70m 4.52% swap cancelled and a further £5.4m of the convertible bond converted, saving a total of £2.7m of interest and the cost of debt reduced to 3.8% (1h17 4.65%) with a 2.4% marginal kd.

Rental growth is on an upward trend with PHP's rent reviews seeing +1.7% but most of that growth is still coming from leases that are indexed-linked or with fixed uplifts. Open market reviews achieved 0.5% pa (1.6% pa excluding nil increases) whilst a further 25 reviews post period end agreed in principle equate to 1.0% pa. Anecdotal evidence in the market, particularly an asset owned by Medicx in Clapham which saw its rent increase +35% on review, have shown signs that valuers are acknowledging construction and land inflation. This will still be on a localised basis however PHP believe that rental growth should reach 2% pa over the next couple of years.

PHP's increased scale is benefitting the company at both the equity and portfolio levels. Around the end of 1q18, PHP entered the FTSE 250 and the company shares are seeing increased liquidity. This can add to the volatility in the share price, since competitor AGR joined the FTSE 250 (Dec 2015), the av. monthly absolute movement of its share price has been 3.7%, 170bps higher than PHP however for PHP we think the benefits (e.g. holdings and liquidity from trackers) significantly outweigh this. The £115m equity raise means that PHP has significant capacity to invest in new assets with £37m in legals and £175m pipeline and although we wouldn't expect the company to complete on all of this, the £201m of current undrawn facilities means PHP has the liquidity to acquire. Additionally, the 4.35% Convertible bond is due to convert at the latest by May 2019 and with a pro-forma LTV of c. 40%, there is further capacity for additional unsecured debt.

FY19 should be a stand-out year for PHP from an operational perspective, with rental income and the removal of legacy debt from when the company was unable to access cheaper capital. We expect disciplined acquisitions in 2h18 and into 2019 which will see top-line growth with assets acquired post period end and legals in Ireland, once completed, should add >£3m of rental income (assuming 6% NIY). The Irish acquisitions also provide scale to the Irish investment vehicle (ICAV) which is tax efficient but expensive to run for 2 assets but its ongoing cost will be spread over a larger portfolio. The debt will, we think, support significant cashflow accretion with the convertible and retail bond (£75m @ 5.3%) due to convert or be redeemed in May and July 2019 respectively. In the near term, the retail bond will likely be replaced with secured debt which we expect to be 200+bps below the current rate whilst further Irish acquisitions should allow PHP to secure EUR debt, which will likely come at a lower rate than the UK providing further capacity for dividend growth.

BUY

Bloomberg LSE: PHP LN
Price target 126.00p
Price 116.40p^

^Prior trading day's closing price unless otherwise noted.

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Company Description

Primary Health Properties

PHP is a UK REIT which specializes in investing in primary health care premises which are leased back to providers of primary health care, such as GPs and other associated healthcare users. Ninety percent of its tenant base is either directly or indirectly backed by the UK Government on rents which broadly track inflation. The portfolio consists of both investment properties and forward-funded developments.

Company Valuation/Risks

Primary Health Properties

PT based on adj. NAV. Risks: slower valuation growth.

Assura plc

PT based on adj. NAV. AGR trades +11% vs Spot NAV & DY 4.4% vs. PHP on +7% & 4.8% resp. Risks: disappointing rental growth.

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(Article 3(1)e and Article 7 of MAR)

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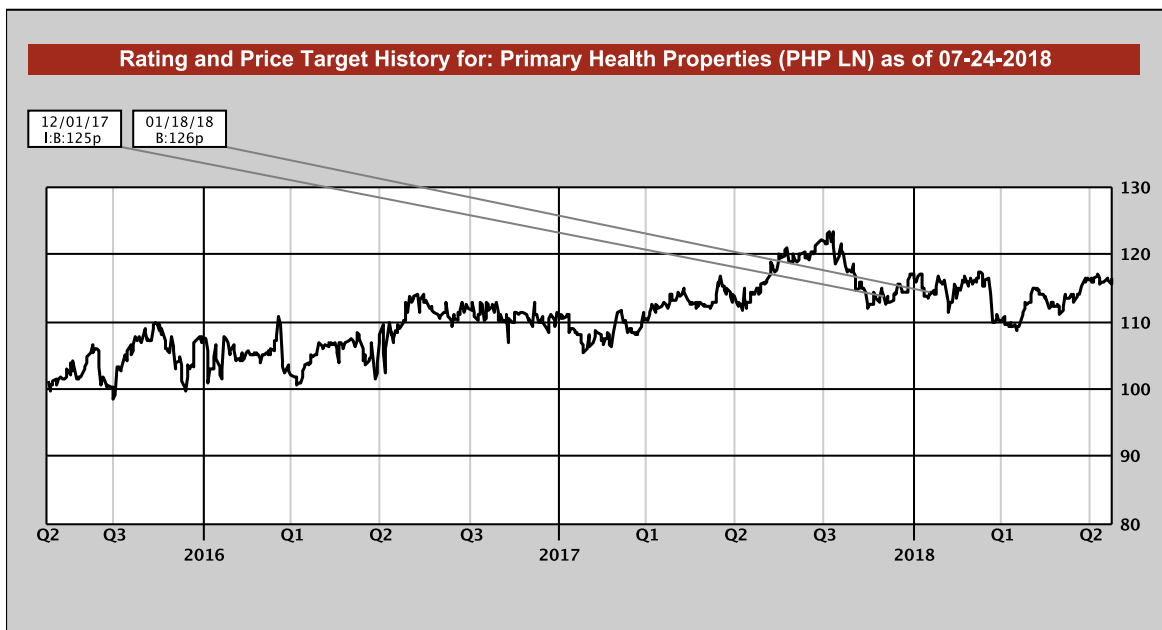
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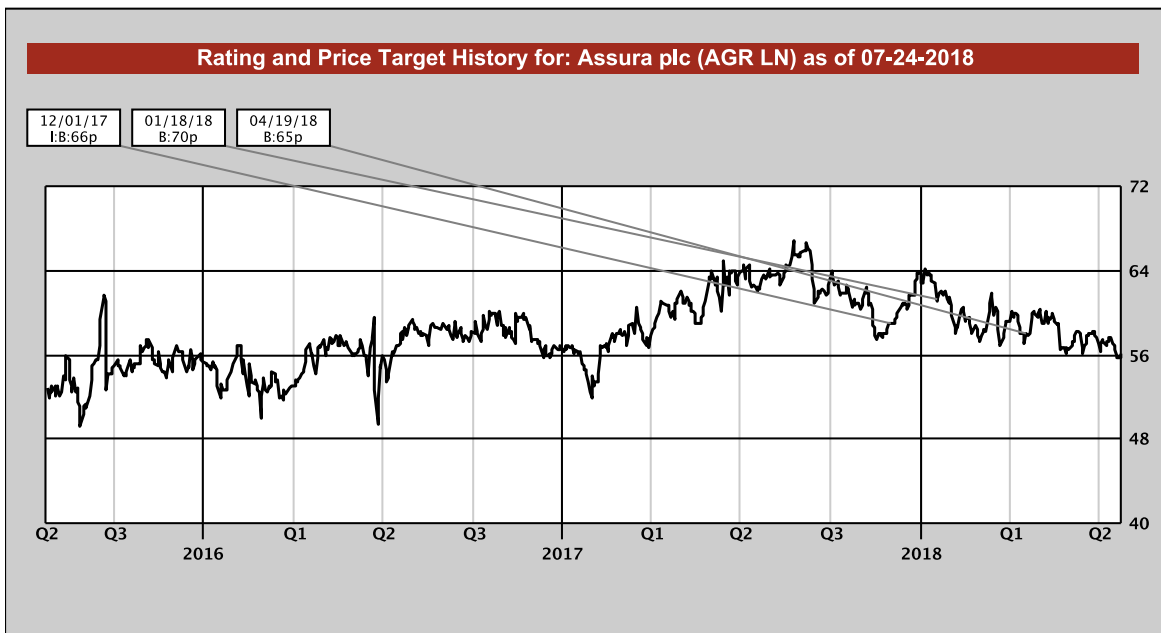
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Other Companies Mentioned in This Report

- Assura plc (AGR LN: p56.10, BUY)





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