

Primary Health Properties

Improving rental growth

BUY

Target price 125p | Published price 116p

PHP delivered a good first half with NAV +3.5% to 104.2p, 2% ahead of our expectation due to stronger than expected yield compression and rental growth. EPRA EPS +4% and the DPS +3% were in line with our expectation. Positively, rent reviews have shown further improvement with annualised growth of 1.7% and continue to be enhanced by acquisitions with associated scale benefits. We expect PHP's portfolio to continue to benefit from long-term structural growth, driven by a growing and ageing UK population, coupled with efforts to improve the efficiency and cost effectiveness of the NHS by expanding the scope of services provided by GPs. The shares trade on a CY18E P/NAV of 1.12x vs. the sector 0.87x and offer a DPS yield of 4.6%.

Good start to FY18: NAV 2% ahead

H1 EPRA NAV +3.5% to 104.2p was 2% ahead of our 102p forecast primarily due to stronger than anticipated yield compression and rental growth.

EPRA EPS +4% to 2.5p was in line with our 2.5p expectation and the DPS +3% to 2.7p was similarly in line with our 2.7p expectation.

Improving rental growth

Positively annualised rental growth has shown further signs of improvement +1.7% vs. +1.1% in FY17 and narrowing the gap to peer Assura (1.7% as at March 18). Comparable new build evidence, used to price open market reviews, is now beginning to be reflected in lease renewals.

The outcome of an independent expert determination of an outstanding rent review in Clapham for peer MedicX could further support this expectation. The determination resulted in a 35% increase in contractual rent from March 2015 (equating to 10.54% per annum). As of December 2017 PHP's London rent roll stood at £3.9m, representing 5.4% of the total rent roll.

The portfolio remains well let at 99.7%, in line with FY17 (99.7%), with a weighted average unexpired lease length of 12.9yrs (13.2yrs FY17). The EPRA cost ratio increased marginally to 14.2% (13.2% FY17), but remains one of the lowest in the sector.

1.5% valuation gain, progress deploying equity proceeds into acquisitions

A +1.5% LFL increase in the property portfolio was ahead of our expectation, driven by -6bps of yield compression to a net initial yield of 4.85% (Assura 4.8% as at March) and continued rental growth improvement.

Proceeds from the £115m equity placing (at 108p) have helped support £23.8m (£48.6m including post period end transactions) of spend in H1, with PHP and peer MedicX continuing to focus on larger lot sizes differentiating their growth strategy vs. peer Assura. We believe this strategy will drive superior value in the long term. PHP also contracted to forward fund its 5th asset in Ireland; a substantial €22.3m centre in Bray, County Wicklow (with practical completion anticipated in Q4 2019), let on a 25 year lease. PHP cites a current pipeline of £175m across the UK and Ireland (vs. £155m identified at the placing). A further four properties are currently in solicitors' hands for £37m.

Aided by the equity raise, LTV reduced to 44.6% (vs. 55.0% in FY17), with interest cover at 2.4x (covenant 1.3x).

Taking share in a low-risk, growth market

We expect PHP's portfolio to benefit from long-term structural growth, driven by a growing and ageing UK population coupled with efforts to improve the efficiency and cost effectiveness of the NHS by expanding the scope of services provided by GPs. The majority of the existing primary care estate is considered unfit for purpose to meet this growing demand. Leases are long-dated and contain upward only rent review provisions. The shares trade on a CY18E P/NAV of 1.12x, with a P/E of 22.5x and DPS yield of 4.6%.

Figure 1: Summary Financials & Valuation (not updated for H1 results)

Valuation Summary (CY)	2017A	2018E	2019E	2020E
P/NAV (x)	1.16	1.12	1.12	1.10
P/E (x)	22.6	22.5	20.7	19.4
Div Yield (%)	4.5%	4.6%	4.8%	4.9%
EV/Sales (x)	19.8	20.1	20.3	19.8
EV/EBITDA (x)	22.9	22.9	23.2	22.4
EV/EBIT (x)	22.9	22.9	23.2	22.4
FCF Yield (%)	3.2%	4.3%	4.7%	5.0%
Financials (FY - Dec y/e)	2017A	2018E	2019E	2020E
Gross rental income (£m)	72.5	76.4	82.6	89.8
Net rental income (£m)	71.3	75.3	81.3	88.4
Gross to net (%)	98.3%	98.5%	98.5%	98.4%
Adj. EBITDA (£m)	62.6	67.0	72.3	79.4
EBITDA margin (%)	86.3%	87.7%	87.5%	88.4%
Adj. EBIT (£m)	62.6	67.0	72.3	79.4
EBIT margin (%)	86.3%	87.7%	87.5%	88.4%
Adj. net Interest (£m)	-31.6	-31.0	-27.7	-31.8
Adj. PBT (£m)	31.0	36.0	44.6	47.7
Adj. EPRA EPS - diluted (p)	5.2	5.2	5.6	6.0
DPS (p)	5.3	5.4	5.6	5.7
Cover (x)	1.0	1.0	1.0	1.1
Diluted EPRA NAV (p)	100.7	103.5	104.4	105.7
Net cash/(debt) (£m)	-732.7	-723.5	-755.6	-857.4
LTV (%)	53%	49%	47%	50%

Source: Liberum

Research



David Brockton
+44 (0)20 3100 2243
David.Brockton@liberum.com



James Ashley
+44 (0)20 3100 2167
James.Ashley@liberum.com

Specialist Sales