

Buy

30 October 2018

DATA

Price (close 23/10)	109p
Target price	125p
Market cap	£802m
Index	FTSE 250
Sector	Real Estate

STATS (PRIOR TO CHANGES)

Source: Company accounts, Peel Hunt estimates

Y/E Dec	2017A	2018E	2019E	2020E
Net Op Inc (£m)	71.3	73.7	82.2	90.6
Adj EPS (p)	5.2	5.3	5.8	6.2
EPS growth (%)	9.8	1.3	9.2	6.6
PER (x)	20.9	20.6	18.9	17.7
DPS (p)	5.3	5.4	5.6	5.7
Div yield (%)	4.8	4.9	5.1	5.2
Adj NAV (p)	100.7	105.8	109.9	115.0
NAV/3net (p)	94.7	100.9	105.3	110.3
Disc/Nav (%)	8.7	3.4	(0.5)	(4.8)
Disc/3net (%)	15.5	8.4	3.9	(0.8)

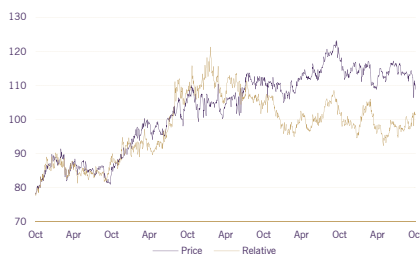
CHANGES TO FORECASTS

Source: Company accounts, Peel Hunt estimates

Y/E Dec	2018E Old	2018E New
Adj NAV (p)	106	nc
Adj EPS (p)	5.3	nc
DPS (p)	5.4	nc

PERFORMANCE

Source: Bloomberg



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Primary Health Properties

PHP

Irish expansion driving growth

The Irish primary care sector has many of the same fundamentals as the UK, as well as higher yields and lower financing costs. A significant development pipeline means Ireland will be a big growth opportunity for PHP over the coming years. The company now owns eight assets and we estimate that each additional purchase will add almost 1% to EPS. The shares currently yield 4.6% and given the 22 year unbroken record of increasing dividends and the robust income characteristics, we retain our Buy recommendation.

- On a recent capital markets day in Dublin, we saw first-hand how PHP's expansion into Ireland is helping to drive both NAV (as values rise) and more importantly EPS (with the spread between property yields and financing costs more than double that of the UK).
- PHP owns eight assets in Ireland including a forward funded asset in Bray currently under construction; this equates to just over €100m or around 6% of the portfolio.
- The company has indicated that Ireland could become around 10% of the portfolio, and given the strong fundamental characteristics, we would support further growth here over the coming years.

The Irish primary care market

Similar market fundamentals

The Irish market has many of the same positive characteristics as the UK market:

- **A growing population** – Population growth is four times the EU average and Ireland has the fourth fastest growing population in the EU.
- **An ageing population** – The average age in Ireland is 37.4 years – up 1.3 years since 2011, and between 2011 and 2016 the number of over 65 year olds increased by 19%.
- **Political support** – As in the UK and much of the Western world, Government policy is encouraging increased care to be provided at the local level in order to reduce the demand on hospitals, save money and enhance patient service.

Some key differences

There are also some key differences at both the property level and across the broader Irish primary care system:

- **Income security** – In the UK the NHS generally pays (directly or indirectly) around 90% of the rent. In Ireland the HSE (the Irish equivalent) typically accounts for around 60-75% of the rent.
- **Not upward only** – Leases are typically 25 years but unlike the UK, rents can rise and fall at reviews (the Irish Government outlawed upward only reviews following the financial crisis).

The average lot size in Ireland is more than double the UK average

- **Inflation linked** – Irish primary care rents are typically linked to CPI inflation compounded over five years (rather than open market reviews). Inflation in Ireland is currently tracking at over 1% per annum and is expected to rise towards 2% over the coming years. There has only been one nine-month period over the past 50 years where five-year inflation has been negative, minimising the risks of rents declining.
- **The buildings** – The HSE typically requires 8k sq ft for each primary care team and there are typically up to three teams in each centre. Therefore, surgeries tend to be much larger than in the UK with PHP's average lot size in Ireland currently around £11m – more than double the UK average of £4.5m.
- **Cost to the individual** – Whilst lower income households are eligible for a medical card (which enables free access), around half of all visits to GP surgeries incur a charge to the individual of around €50-60 per visit.

Scale of the opportunity

The HSE is targeting 200 modern Primary Care Centres throughout Ireland and whilst data is limited, PHP believe there are currently only a handful of modern facilities that are fit for purpose.

The HSE is expected to:

- Open 12 surgeries in 2018;
- Open one surgery in 2019;
- A further 31 are currently under construction or at an advanced stage of planning and a further 44 are at an early stage of planning.

We estimate that the 75 centres in the pipeline will be valued in the region of €750m, offering a vast pipeline for PHP to aim at.

To date, the company has acquired seven centres and is funding the development of an eighth; the company believes it is the largest owner of primary health centres in Ireland (MedicX is also active in Ireland and currently owns £52.5m of assets here).

Superior earnings accretion

Despite recent yield compression (Irish yield were c7% when PHP entered the market) net initial yields in Ireland are around 6% – around a 100bps premium over yields available in the UK market.

Furthermore, the company will borrow debt in Euros and current 10 year Euribor rates (90bps) are around 55bps lower than the equivalent 10 year GBP swap rate (145bps), which further increases the yield differential (see Charts 1 and 2 below).

We estimate that:

- for every €15m spent in Ireland and funded through debt, the company will see at least a c1% accretion to EPS (initially it will be higher as the company's marginal cost of debt is lower due to undrawn facilities etc).
- For comparison, we estimate that the equivalent spend on UK assets will approximately equal a 0.4% increase to EPS.

Every €15m spent in Ireland boosts EPS by c1%

Our forecasts assume that PHP spends around £100m per annum at an average blended yield of around 5.5% – approximately equal to PHP spending £50m in the UK and €55m in Ireland. This compares to its most recently disclosed pipeline of £37m in legals and over £175m in negotiations, of which around one-third is in Ireland.

Chart 1: Irish yield differential

Source: Company accounts, Peel Hunt estimates

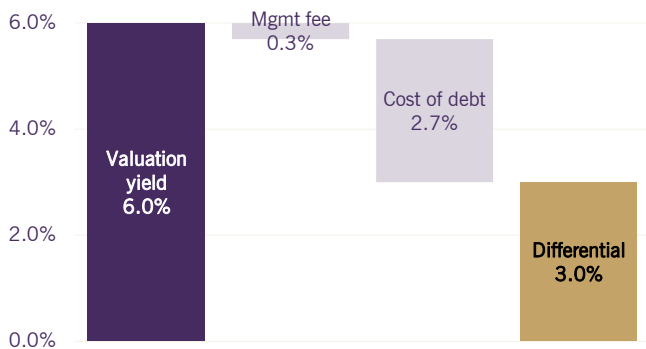
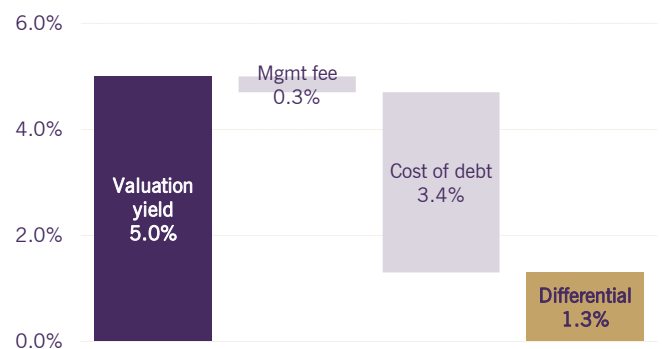


Chart 2: UK yield differential

Source: Company accounts, Peel Hunt estimates



The assets visited

We visited three assets, all within close proximity of Dublin.

Navan Road Primary Care Centre, Dublin

- Purchased in September 2018 for €12.2m, the centre comprises five GPs (all working for Centric – a large, private equity backed GP company), a pharmacy, a coffee shop and the HSE who account for 60% of the rent.
- The HSE offers various services (see margin photo) including speech therapy, physiotherapy, psychology, mental health care and various meeting and office spaces.
- The lease has 22 years to run and is subject to CPI uplifts (except the coffee shop which is subject to open market rent reviews).

Celbridge Primary Care Centre, Kildare

- Also purchased in September 2018, the 3,500 sq m centre is let to the HSE, the Child & Family Agency (another Government organisation), Centric and a Mangan Pharmacies – one of Ireland’s largest pharmacy companies.
- The centre cost €13m and was purchased in a portfolio alongside Navan and a centre in Newbridge – combined, the HSE and other Government agencies comprise 67% of the rent roll.

Bray Primary Care Centre, Wicklow (under construction)

- This forward funding development will comprise 4,800 sq m, including a large GP practice (11 doctors), the HSE, a pharmacy and a coffee shop.
- The centre will cost €22.3m and the lease length is 25 years. The HSE comprises 70% of the rent and completion is expected in August next year.

Navan Road Primary Care

Source: Company accounts



Chart 3: Cellridge

Source: Company accounts, Peel Hunt estimates



Chart 4: Bray forward funding

Source: Company accounts, Peel Hunt estimates



Valuation

Given the strong income characteristics of the sector, we increasingly value PHP, MedicX and Assura on earnings metrics rather than a traditional NAV discount/premium.

We continue to prefer PHP over its immediate peers

On our forecasts, PHP continues to look good value and we continue to prefer PHP to its immediate peers given:

- The Irish expansion which looks set to be very earnings accretive (MedicX will also benefit here);
- The low cost base with an EPRA cost ratio of just 12% (alongside Assura, this is significantly below MedicX's ratio of c20%);
- The strong track-record with a 21 year unbroken record of increasing dividends and compound total shareholder return of 14% since IPO in 1994;
- Strong management alignment who own (directly or indirectly) around £13m in PHP.

Chart 5: P/E ratios

Source: Company accounts, Peel Hunt estimates

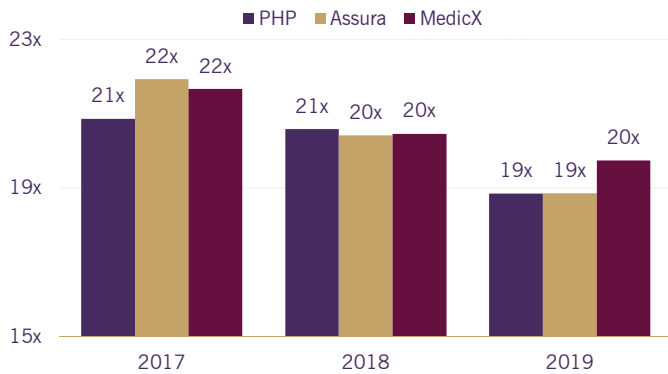
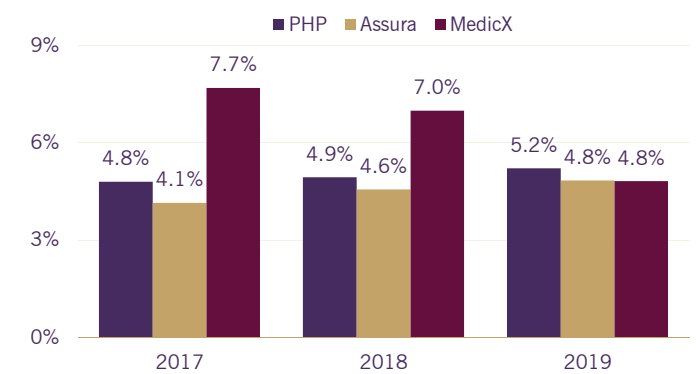


Chart 6: Dividend yields

Source: Company accounts, Peel Hunt estimates



Recommendation structure and distribution

	Recommendation distribution at 29 October 2018				All research published in the last 90 days	
	Corporate No	Corporate %	No	%	Corporate %	%
Buy	81	89	195	56	82	58
Add	9	10	49	14	10	15
Hold	8	9	77	22	9	22
Reduce	0	0	14	4	0	3
Sell	0	0	5	1	0	2
Under Review	2	2	6	2	0	1

Peel Hunt's Recommendation Structure is as follows:

Buy, > +15% expected absolute price performance over 12 months

Add, +5-15% range expected absolute price performance over 12 months

Hold, +/-5% range expected absolute price performance over 12 months

Reduce, -5-15% range expected absolute price performance over 12 months

Sell, > -15% expected absolute price performance over 12 months

Under Review (UR), Recommendation, Target Price and/or Forecasts suspended pending market events/regulation

NB The recommendation is the primary driver for analyst views. The target price may vary from the structure due to market conditions, risk profile of the company and capital returns

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Recommendation history

Company	Disclosures	Date	Rec	Price	Target Price
Primary Health Properties	1,4,5,7	27 Jul 17	Buy	114p	125p

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