

**Buy**  
18 May 2012

## Primary Health Properties<sup>#</sup> (PHP)

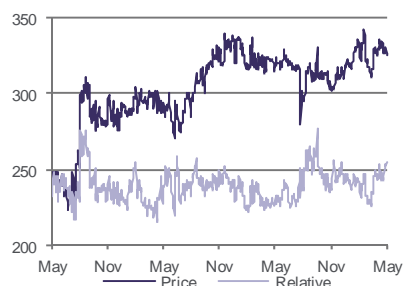
Data	
Price	325p
Target price	345p
Market cap	£223.6m
No. shares (prior to placing)	68.4m
Free float	100%
Index	FTSE SmallCap
Sector	Real Estate
Next news	Aug - Interims
UK sales	100.0%

**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



**Analyst**

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### £19m equity fundraising for further acquisitions

PHP completes a £19m placing at a tight discount in order to expand the portfolio with earnings accretive acquisitions. The company outlines £67m of potential acquisitions – we assume £55m (incl. commitments and capex) is actually spent this year (previously £50m). We reduce our FY12 forecasts very marginally (largely due to dilution from 6.2m new shares issued today) but upgrade our FY13 and FY14 forecasts (due to a higher acquisition rate). Over the medium to long term, today's placing should help bridge the uncovered dividend and, with the shares yielding a high 5.7% dividend, we retain our Buy recommendation on one of the best long-term performing stocks in the sector.

#### Key Highlights

- **£19m raised** (c£18.4m net of costs) as a cashbox placing approximately 9.1% of the shares currently in issue. The issue price of 305p represents:
  - a tight 6.2% discount to yesterday's closing price (325p);
  - a 4.3% discount to the EPRA NAV per share of 319p, as reported Dec'11.
  - a 5.7% discount to the theoretical ex-rights price (TERP) of 324p.
- **Dilution is minimal** due to the tight discount between the issue price and NAV.
- **£79m firepower**: comprised £60m available debt and today's £19m equity.
- **Use of proceeds**: a clear and strong pipeline of opportunities is in place, with approximately £25m of assets with heads of terms agreed and PHP are bidding for, or are in negotiations on, a further £42m of acquisitions.
- The short-term **cash drag should be minimal** as the proceeds can be used to reduce the revolving credit facility until proceeds are spent on acquisitions. See page 2 for our acquisition assumptions.

#### FY12 forecasts reduced marginally but FY13 and FY14 forecasts upgraded

- We slightly reduce our FY12 **Adj. NAV** forecast by 0.9% **from 329p to 326p** accounting for the small dilution and associated costs of the equity fundraise.
- Our **FY 12 Adj. EPS** forecast reduces very marginally to **14.5p (from 14.7p)**, largely for the dilution and adjustments to our acquisition rate (see page 2).
- The fund raising and subsequent acquisitions will be **accretive to 2013 and 2014 EPS** numbers and we upgrade by 2.4% and 5.8% respectively.

#### 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 (p)	NAV/3net (p)	Prem/H'line (%)	Prem/3net (%)
2011A	25.1	9.7	14.5	n/a	18.0	22.5	5.5%	319	246	2.6%	32.8%
2012E	27.2	10.5	14.5	n/a	18.5	22.5	5.7%	326	259	0.3%	26.0%
2013E	31.2	12.7	17.0	17.2%	19.0	19.2	5.8%	338	272	-3.3%	20.4%
2014E	33.9	13.6	18.3	7.7%	19.5	17.9	6.0%	351	285	-7.0%	14.7%

## PHP discloses a £67m acquisition pipeline

Like last year's small cashbox fund raising (also raised at 305p) of £15.6m (net), today's funds will be used for earnings-enhancing acquisitions. In addition to the £67m in potential acquisitions outlined in the announcement, we understand further assets are available for purchase and are in various stages of being identified or appraised.

- Our £55m assumption on acquisition/capex *includes* forward commitments for this year (£11m), acquisitions which the company has already completed (£7m) and £5m of capex projects.
- In FY11, PHP acquired £48m of properties, and with PHP's strong pipeline, **we believe our assumption for a further £32m acquisitions this year to be very attainable** (although dependent on market conditions).
- From these acquisitions and forward commitments, we expect additional rental income of £1.2m and a further £400k from organic rental growth (2.5%). This should offset the higher finance expenses (following the comprehensive refinancing announced last month) and today's small dilution.

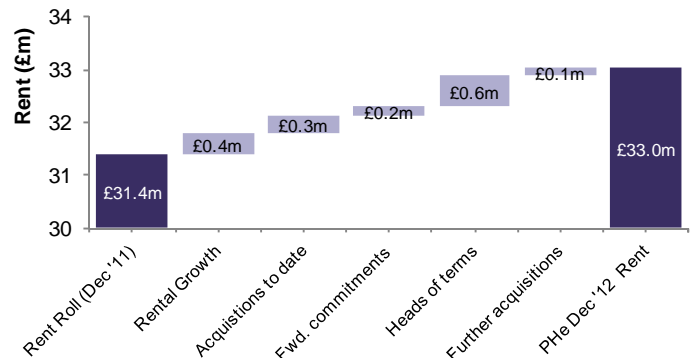
**Table 1: Rent Roll Bridge**

Source: Company documents, Peel Hunt estimates

	Rent	Assumption
<b>Rent Roll (Dec '11)</b>	<b>£31.4m</b>	
Organic Rental Growth	+£0.4m	2.5% growth
£7m acquisitions to date	+£0.3m	6.0% yield
£11m forward commitments in 2012	+£0.2m	Sept '12 completion, 6.0% yield
£25m heads of terms agreed	+£0.6m	Aug '12 completion, 6.0% yield
£12m further acquisitions	+£0.1m	Sept '12 completion, 6.0% yield
<b>TOTAL rent for 2012 (PHe):</b>	<b>£33.0m</b>	

**Chart 1: Rent Roll Bridge**

Source: Company documents, Peel Hunt estimates



## Impact on the NAV

The dilution from the additional shares raised is as follows:

- The pro-forma Adj. NAV (Dec '11) is reduced by just -0.6% to 317p.
- The basic balance sheet NAV (including derivative liabilities) is actually enhanced by +1.7% due to the premium the shares currently trade on to the basic NAV (due to the derivative liability).
- Our Adj. NAV FY12 forecast is also reduced marginally to 326p (from 329p) once £55m of acquisitions, capex and commitments are assumed within the year.

**Table 2: Pro forma historic balance sheet – as at Dec 2011**

Source: Company accounts, Peel Hunt estimates

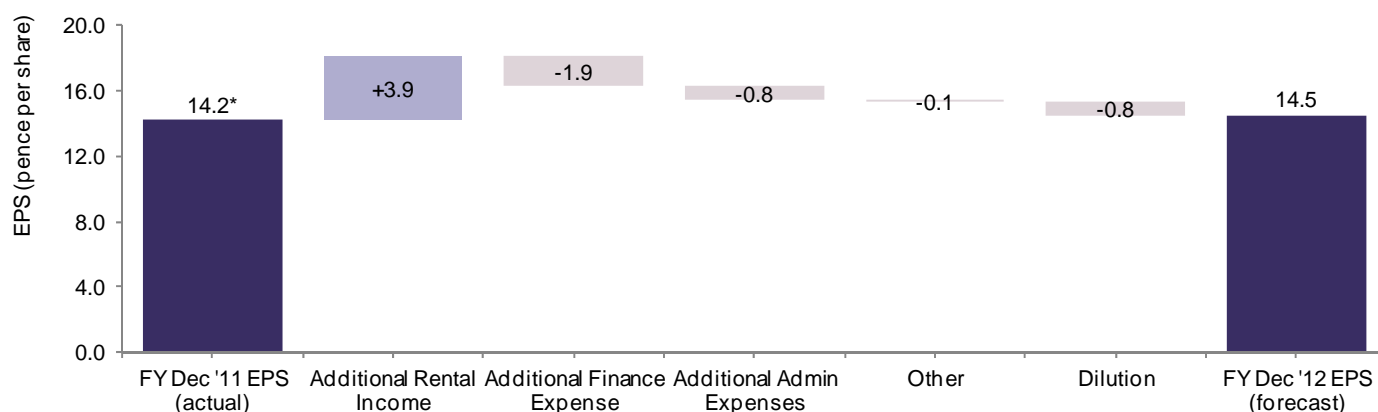
£m	Dec '11	Placing	Dec '11 adjusted	
Investment properties	525.6		525.6	
Net borrowings	-301.3	18.4	-282.8	
Other net assets	-56.2		-56.2	
Basic net assets	168.1		186.5	
Adjust for derivative liability	49.5		49.5	
<b>Adjusted Net Assets</b>	<b>217.6</b>		<b>236.0</b>	
Number of shares (millions)	68.3m	6.2m	74.5m	
Basic NAV per share (p)	246.2p		250.4p	+1.7%
<b>Adj. NAV per share (p)</b>	<b>318.7p</b>		<b>316.8p</b>	<b>-0.6%</b>

### Impact on EPS

We have marginally reduced our FY12 EPS forecast from 14.7p to 14.5p. This is to account for today's dilution, adjustments to our acquisition assumptions and other small adjustments in our model (rent roll and finance expense). The following chart demonstrates the EPS bridge between last year's EPS (restated for the April 2011 equity issue) and our FY Dec '12 forecast. Included in the +3.9p/£2.7m additional rental income is the £1.6m rental income outline in Chart 1 and the remaining £1.1m comprises the full year effect of acquisitions completed last year.

**Chart 2: EPS Bridge post equity fundraise**

Source: Company accounts, Peel Hunt estimates (\* FY Dec '11 EPS restated to account for the April 2011 fund raising)



We upgrade our FY13 EPS forecast by +2.4% and FY14 by +5.8%.

- The **-0.8p of dilution** to the Adj. EPS is partially offset by the £55m of acquisitions, commitments and capex assumed for this year (was £50m previously). Our full acquisition assumptions are shown in Table 1 and Chart 1 on page 2.
- Our **EPS forecasts for later years are boosted** once earnings-accretive acquisitions are complete and the full year effect is recognised.
- Our dividend forecast increases by 0.5p each year (from 18.5p in 2012) for the next three years and becomes 94% covered by Dec '14.

**Table 3: Our New Forecasts**

Source: Company accounts, Peel Hunt estimates

	2011A	2012E		2013E		2014E	
	Actual	New	Old	New	Old	New	Old
Recurring PTP (£m)	9.7	<b>10.5</b>	10.0	<b>12.7</b>	11.4	<b>13.6</b>	11.8
Adj. EPS (p)	14.5	<b>14.5</b>	14.7	<b>17.0</b>	16.6	<b>18.3</b>	17.3
EPRA NAV (p)	319	<b>326</b>	329	<b>338</b>	341	<b>351</b>	354

## The investment case for PHP remains unchanged

The income stream remains very stable and secure:

PHP is a high dividend yielding stock underwritten by very long leases and a strong underlying rental covenant. It is also, in our opinion, one of the best and most stable long-term performers in the real estate sector. Furthermore:

- Today's placing (18 May) follows the successful refinancing of PHP's debt facilities. The company now has just £30m of debt maturing before 2014 and £60m remains undrawn and available from other facilities for acquisitions (after commitments).
- Today's placing is notable for its very tight discount to EPRA NAV (4.3%), emphasising the very secure income stream, as detailed below:

### 1 The income stream remains very stable and secure:

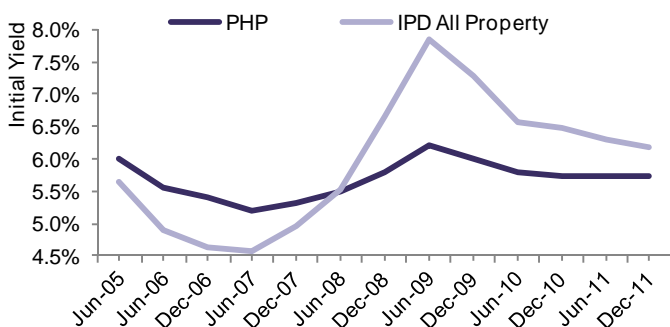
- Near 100% occupancy
- 90% of rental income backed by Government funding
- Very long average lease length of 16 years
- 67% of rent expires in over 15 years and just 2% expires within five years
- Strong track record of between 2.5-3.5% rental growth per annum.
- High quality and modern buildings
- PHP owns centres covering just c2.5% of the UK population – significant room for expansion.

Yields are conservative and stable compared with other assets classes

2 **Yields** on medical centres, as well as being less volatile than other sectors, are in our opinion conservative when compared to other real estate asset classes and do not fully factor in the security of the income stream.

**Chart 3: PHP yields less volatile than general real estate**

Source: Company accounts, IPD, Peel Hunt estimates



**Table 4: PHP yields are conservative in our opinion**

Source: Company accounts, IPD, Peel Hunt estimates

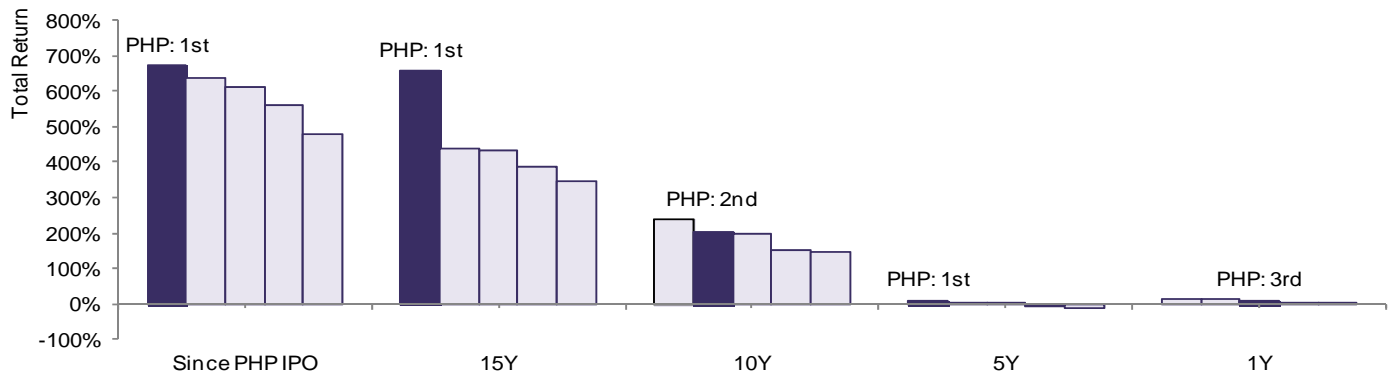
Asset Class	Initial Yield
<b>PHP Property Portfolio</b>	<b>5.74%</b>
IPD All Property	6.19%
IPD All Retail	6.01%
IPD All Office	5.97%
IPD City Office	5.11%
IPD Retail Warehouse	5.79%

Historically, PHP outperforms the general real estate market

3 Whilst past performance is not necessarily a guide to future performance, it is worth noting that **PHP has been one of the best performers** (total return) in the sector on almost any time frame:

#### Chart 4: Total Return Performance

Source: DataStream, Peel Hunt estimates



**Recommendation structure and distribution as at 18 May 2012**

		No	%
Buy	> +10% expected absolute price performance over 12 months	158	53
Hold	+/-10% range expected absolute price performance over 12 months	101	34
Sell	> -10% expected absolute price performance over 12 months	37	12

**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	
PHP				x	x	x		

**Recommendation history**

Company	Date	Rec	Date	Rec	Date	Rec	Date	Rec
PHP	20 Nov 09	Buy						

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