Primary Health Properties

AGM trading statement

Secure income continuing

Real estate

To accompany its AGM, Primary Health Properties (PHP) issued a trading update covering Q120. With 90% of contracted rental income paid directly or indirectly by the UK or Irish governments and the balance primarily coming from co-located pharmacies, rent collection remained robust through Q120. Reflecting the security and predictability of cash flows, PHP has no change to dividend policy and confirms payment of the recently declared second quarterly DPS of 1.475p as planned.

Year end	Net rental income (£m)	Adj. EPRA earnings* (£m)	Adj. EPRA EPS** (p)	Adj. EPRA*** NAV/share (p)	DPS (p)	P/NAV (x)	Yield (%)
12/18	76.4	36.8	5.2	105.1	5.40	1.46	3.5
12/19	115.7	59.7	5.4	107.9	5.60	1.42	3.7
12/20e	131.3	72.8	5.9	109.7	5.90	1.39	3.9
12/21e	138.6	77.2	6.2	113.7	6.10	1.35	4.0

Note: *Excludes valuation movements, amortisation of fair value adjustment to acquired debt, and other exceptional items. **Fully diluted. ***Adjusts for fair value of derivative interest rate contracts and convertible bond, deferred tax, and fair value adjustment on acquired debt.

Strong tenant covenant delivering income

Q120 rent collection was robust (in line with Q119 and ahead of Q420), in stark contrast to many areas of the commercial property sector. With a proven record of successfully investing in the sector, PHP has delivered 23 years of unbroken dividend growth since it was founded, and it is the security and visibility of its contracted income stream that supports an unchanged dividend policy in Q220. Rental growth continued in the period and the company continued to invest, including in its development assets. Despite a strong pipeline of potential acquisition opportunities and a robust and liquid balance sheet, PHP says that it will continue to have regard to the current market before committing to these. A delay in commitments may have a slight negative impact on our forecasts (unchanged for now) depending on the speed of any catch-up.

Well placed to support health service investment

The COVID-19 pandemic highlights the pressures on health systems around the world and may well lead to increased healthcare spending over the longer term. A broad political consensus already exists in the UK and Ireland to reform healthcare provision, placing more emphasis on primary care to meet the increasing healthcare needs of growing and ageing populations. This requires larger, more flexible, higher-quality premises should provide PHP with significant investment opportunities in the coming years. At end Q220, it had £341m of available funding headroom and an active pipeline of potential acquisitions totalling c £124m, of which £58m was in legal due diligence.

Valuation: Secure income with growth

Income visibility is strong, with long leases and substantially upwards-only rents, 90% backed directly or indirectly by government bodies, with little exposure to the economic cycle, or fluctuations in occupancy. With dividends growing and fully covered by earnings, the FY20e yield is 3.9%, supporting a premium to NAV.

6 April 2020

Price	**153p**
Market cap	**£1,862m**

Net debt (£m) at 31 March 2020	1,086
Net LTV at 31 March 2020	44.8%
Shares in issue	1,217m
Free float	97%
Code	PHP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.5)	(4.0)	16.4
Rel (local)	26.1	37.4	59.6
52-week high/low		165.6p	126.2p

Business description

Primary Health Properties is a long-term investor in primary healthcare property in the UK and the Republic of Ireland. Assets are mainly long-let to GPs and the NHS or HSE, organisations backed by the UK and Irish governments, respectively. The tenant profile and long average lease duration provide an exceptionally secure rental income stream.

Next events

Q220 DPS payment	22 May 2020
Interim results	July 2020

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Forecasts and valuation

Not changing estimates

As PHP has continuing strong collection of contracted rental income, we are not are not at this stage changing the forecasts that we set out in detail in our outlook note following the FY19 results. These assume new investment commitments of £125m in both FY20 and FY21, a mix of fully let completed assets and forward funding commitments in both the UK and Ireland and, while any delay may have a near-term impact on rental income, the longer-term impact will depend on the speed of any catch-up.

During Q120, PHP exchanged contracts for the acquisition of two forward-funded developments (in South Wales and in Surrey) for an aggregate £6.9m. Rental growth, a full period impact from previous acquisitions and the completion of development assets will continue to support rental income growth.

During Q120, the forward-funded development at Athy, County Kildare, in Ireland was completed on time and on budget with a development cost of £11.4m (€12.9m). A further seven developments are currently on-site, at various stages of completion, with a net development cost of £56m. Given the important contribution that the development assets will make to health services in the UK and Ireland, work is continuing on the majority (five of the seven) of the sites (with the exception of Banagher in Ireland and Epsom in Surrey, where construction has not yet commenced). In particular, the Irish government is keen that the sites in Bray (net development cost £19.8m/€22.4m) and Rialto (net development cost £11.5m/€13.0m) are completed as soon as possible and this is expected during April 2020.

Rent growth continued in Q120 with 56 rent reviews settled, increasing rent by £0.4m, with a weighted average increase of 2.4%. Five completed asset management projects added a further £0.9m to rents and a strong pipeline of similar projects is being progressed.

Strong financing position

PHP was active in terms of refinancing initiatives following the merger with MedicX and during FY19 increased its available capital, both debt and equity, while reducing the average cost of borrowing from 4.0% to 3.5% (with a marginal cost of debt of 2.5%), and extending average debt maturity to more than seven years.

As at 31 March 2020 (end-Q120) net debt was £1.086m (31 December 2019: £1067.3m), with the slight increase since end-FY19 primarily reflecting investment in the development assets. The loan to value ratio (LTV) was 44.8% (end FY19: 44.2%). After capital commitments, PHP had undrawn loan facilities and cash on deposit totalling £341.1m at end Q120, providing significant liquidity headroom. Cash on deposit was £137.0m. Interest cover was 2.8x at end Q120 and the company estimates that the group's portfolio would need to fall in value by around £1.0bn or 42% for the LTV covenants in its borrowing arrangements to come within risk of being breached.

Valuation

Historical returns on primary healthcare assets have been higher than other sectors of the UK commercial property market, with a lower level of volatility. This has been a function of strong healthcare fundamentals, secure and more resilient income, and more muted yield shifts through the property cycle.

The shares have re-rated since the transformational merger with MedicX such that our forecast full year FY20 DPS of 5.90p now represents a prospective 3.9% dividend yield. A comparison with the broader property sector is for now made difficult by the uncertainty attached to cash flows and near-term dividend prospects across the sector. Many companies have already announced the temporary suspension of dividend payments. Our unchanged forecasts show dividends to be fully covered by forecast cash earnings, with good potential for further growth and, most importantly, backed by a secure, upwards-only rent profile, c 90% funded directly or indirectly by the NHS in the UK or HSE in Ireland. Although a delay in new investment could slightly reduce income and dividend cover from the level we forecast, we do not expect a material impact. Given the nature of this income stream, it is tempting to draw comparison with the generic yield on 10-year gilts at around 0.3%. This secure dividend return provides the basis for the valuation and in turn provides support for a continuing valuation premium to EPRA NAV (currently 1.4x).

Exhibit 1: Financial summary

£m	2017	2018	2019	2020e	2021e
Year end 31 December					
PROFIT & LOSS					
Net rental income	71.3	76.4	115.7	131.3	138.6
Administrative expenses	(8.7)	(9.9)	(12.3)	(13.2)	(13.8)
EBITDA	62.6	66.5	103.4	118.2	124.7
Net result on property portfolio	64.5	36.1	49.8	42.8	46.1
Other acquisition related value adjustment	0.0	0.0	(148.6)	0.0	0.0
Operating profit before financing costs	127.1	102.6	4.6	161.0	170.8
Finance income	0.3	0.1	1.4	0.7	1.1
Finance expense	(31.9)	(29.8)	(42.6)	(42.9)	(45.5)
Net finance expense	(31.6)	(29.7)	(41.2)	(42.2)	(44.4)
Net other income/expense	(3.6)	1.4	(33.6)	0.0	0.0
Profit Before Tax	91.9	74.3	(70.2)	118.8	126.4
Tax	0.0	0.0	(1.1)	0.0	0.0
Profit After Tax (FRS 3)	91.9	74.3	(71.3)	118.8	126.4
Adjusted for the following:					
Net gain/(loss) on revaluation	(64.5)	(36.0)	(48.4)	(42.8)	(46.1)
Profit on disposal	0.0	(0.1)	(1.4)	0.0	0.0
Fair value gain/(loss) on derivatives & convertible bond	3.6	(1.4)	33.6	0.0	0.0
Exceptional revaluation related to MedicX acquisition	0.0	0.0	138.4	0.0	0.0
Deferred tax	0.0	0.0	1.1	0.0	0.0
EPRA earnings	31.0	36.8	52.0	76.0	80.4
Exceptional item			10.2	0.0	0.0
Amortisation of fair value adjustment to acquired debt			(2.5)	(3.2)	(3.2)
Adjusted EPRA earnings	31.0	36.8	59.7	72.8	77.2
Period end number of shares (m)	619.4	769.1	1,216.3	1,217.0	1,217.0
Average Number of Shares Outstanding (m)	600.7	708.6	1,092.0	1,216.9	1,217.0
Fully diluted average number of shares outstanding (m)	665.5	732.7	1,138.5	1,317.3	1,317.4
Basic IFRS EPS (p)	15.3	10.5	(6.53)	9.8	10.4
Basic adjusted EPRA EPS (p)	5.2	5.2	5.5	6.0	6.3
Diluted adjusted EPRA EPS (p)	5.1	5.2	5.4	5.9	6.2
Dividend per share (p)	5.250	5.400	5.600	5.900	6.100
Dividend cover (Adj. EPRA earnings/dividends paid)	100%	101%	101%	101%	104%
EPRA cost ratio	13.2%	14.3%	12.0%	11.5%	11.4%
BALANCE SHEET					
Non-current assets	1,361.9	1,503.5	2,413.6	2,573.9	2,744.0
Investment properties	1,361.9	1,502.9	2,413.1	2,573.4	2,743.5
Other non-current assets	0.0	0.6	0.5	0.5	0.5
Current Assets	10.5	10.5	159.8	45.3	26.3
Cash & equivalents	3.8	5.9	143.1	28.6	9.6
Other current assets	6.7	4.6	16.7	16.7	16.7
Current Liabilities	(33.9)	(134.5)	(66.0)	(59.9)	(59.9)
Current borrowing	(0.8)	(102.4)	(6.1)	0.0	0.0
Other current liabilities	(33.1)	(32.1)	(59.9)	(59.9)	(59.9)
Non-current liabilities	(751.7)	(591.5)	(1,278.9)	(1,283.8)	(1,382.6)
Non-current borrowings	(729.6)	(573.7)	(1,257.8)	(1,262.7)	(1,361.5)
Other non-current liabilities	(22.1)	(17.8)	(21.1)	(21.1)	(21.1)
Net Assets	586.8	788.0	1,228.5	1,275.5	1,327.8
Derivative interest rate swaps	24.5	17.2	13.0	13.0	13.0
Change in fair value of convertible bond	12.3	3.4	22.7	0.0	0.0
Other EPRA adjustments	0.0	0.0	48.6	45.3	42.1
Adjusted EPRA net assets	623.6	808.6	1,312.8	1,333.8	1,382.9
IFRS NAV per share (p)	94.7	102.5	101.0	104.9	109.2
Adjusted EPRA NAV per share (p)	100.7	105.1	107.9	109.7	113.7
CASH FLOW					
Operating Cash Flow	60.1	68.5	94.0	116.4	122.9
Net Interest & other financing charges	(37.8)	(35.1)	(52.9)	(43.4)	(45.6)
Tax	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals	(75.4)	(101.9)	(47.4)	(115.7)	(122.2)
Net proceeds from issue of shares	(0.1)	111.0	97.6	0.0	0.0
Debt drawn/(repaid)	82.3	(5.6)	110.5	0.0	100.0
Equity dividends paid (net of scrip)	(29.8)	(34.7)	(54.4)	(70.8)	(74.2)
Other cash movements and FX	(0.1)	0.6	(11.9)	(0.0)	0.0
Net change in cash	(1.3)	2.1	137.2	(113.5)	(19.1)
Opening cash & equivalents	5.1	3.8	5.9	143.1	29.6
Closing net cash & equivalents	3.8	5.9	143.1	29.6	10.6
Debt as per balance sheet	(730.4)	(676.1)	(1,263.9)	(1,262.7)	(1,361.5)
Convertible bond fair value adjustment	12.3	3.4	22.7	22.7	22.7
Unamortised borrowing costs	(6.1)	(6.4)	(14.6)	(12.6)	(10.6)
Acquired debt fair value a		0.0	45.4	42.2	39.0
Net cash/(debt)	(720.4)	(673.2)	(1,067.3)	(1,180.8)	(1,299.8)
Net LTV	52.9%	44.8%	44.2%	45.9%	47.4%

Source: PHP data, Edison Investment Research forecasts

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