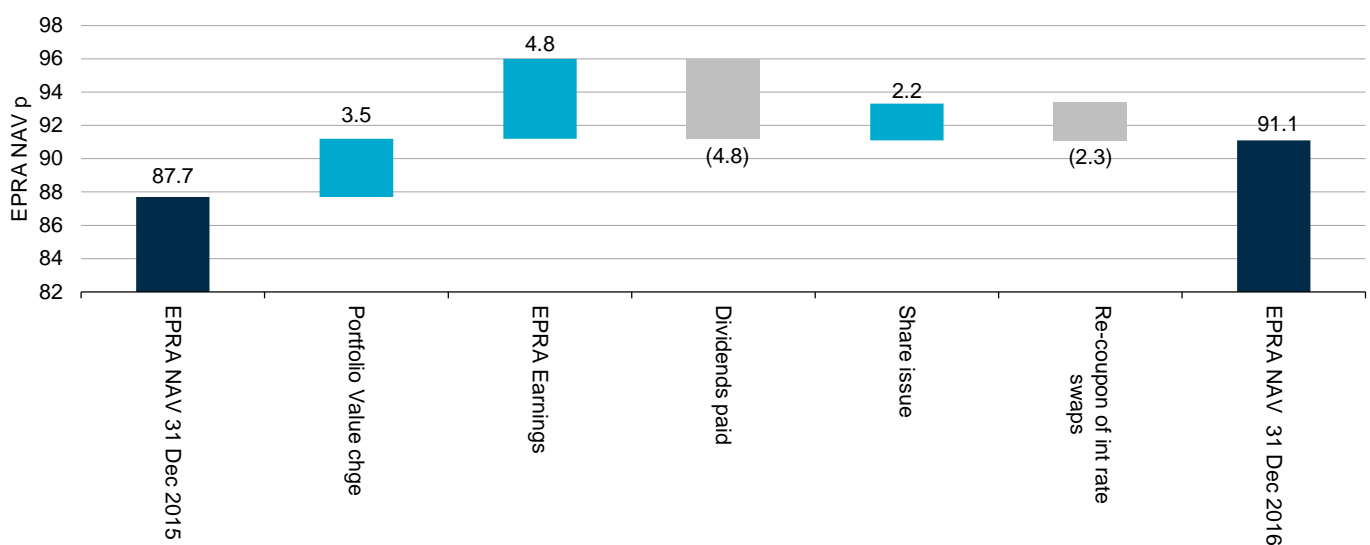


**Primary Health Properties\* - 9.7% NAV total return in 2016; Strong H1, steady H2**

- Primary Health Properties (PHP) has reported final results to 31 December 2016, characterised by a strong H1, augmented by a solid H2. EPRA NAV of 91.1p as at 31 December was broadly in line with our 92p estimate, and represents a 3.9% increase over the year. Key drivers included a 2.3% like-for-like increase in portfolio value to £1.2bn, adding 3.5p to EPRA NAV. This reflected a 15bps tightening of the Net Initial Yield to 5.17%, most of which was recorded in H1 (H1 12bps; H2 3bps). Including dividends, EPRA NAV total return over the year was 9.7%, which compares favourably to an average NAV total return of 2.6% from the IPD monthly Index, and an average 2016 NAV total return for the high income commercial property peer group of 4.8%. Notwithstanding portfolio growth in excess of 10%, EPRA cost ratio remained at 11.5%, the lowest in the listed Real Estate sector by a comfortable margin.

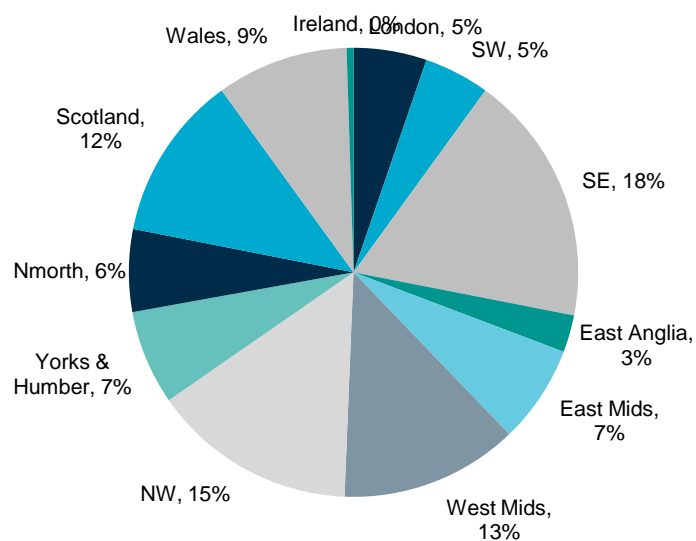
**PHP - 2016 EPRA NAV bridge**



Source: Company & Numis Securities Research

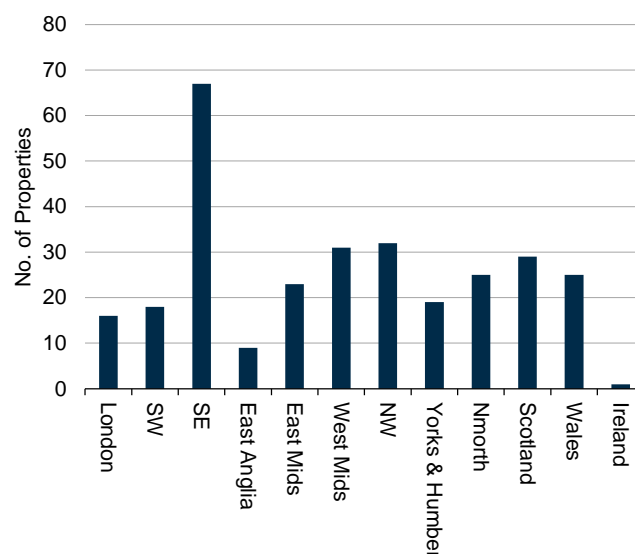
- Solid Earnings Growth Underpins Dividend:** Net rental income rose 6.9% in the period to £66.6m, reflecting the benefit of acquisitions, the impact of completed developments, and 0.9% rental growth achieved on reviews. 166 rent reviews were completed over the year, generating additional rent of £0.3m pa. Whilst new development evidence for rent reviews remains limited, there is an expectation this will start to improve in the next 24 months. In the meantime, c.20% of PHP's leases have inflation linkage and 6% with fixed uplifts. Combined with a 4.4% reduction in net financing costs, EPRA earnings rose 23.5% to £26.8m, representing 4.8p per share, fully covering the total dividends paid in the period of £26.8m. Following the issue of shares earlier in 2016, there is a higher number of shares on which future dividends will be paid, however we expect this to remain fully covered.
- Transactions:** During the period, PHP acquired 23 UK assets, as well as its first Irish property, for a total consideration of £74m, adding £4.2m to rents. In addition, the team has completed or initiated a range of asset improvement plans including simple upgrade projects, to major construction and extension works, as well as extending occupational lease durations, adding £0.2m to rents. Following the period end, PHP has added a further two properties for £7.2m increasing the portfolio to 298.
- Portfolio Summary:** As at 31 December, the portfolio comprised 296 assets, of which 295 were rent producing, and one under development, with an annualised contracted rent roll of £68m. 74% of rents are subject to an open market review, 20% are index linked and 6.0% have a fixed uplift. The weighted average unexpired lease term is 13.7 years. Assets are spread geographically as shown below, with c.90% of rental income directly or indirectly from UK government.

## PHP - Portfolio Value by Region



Source: Company & Numis Securities Research

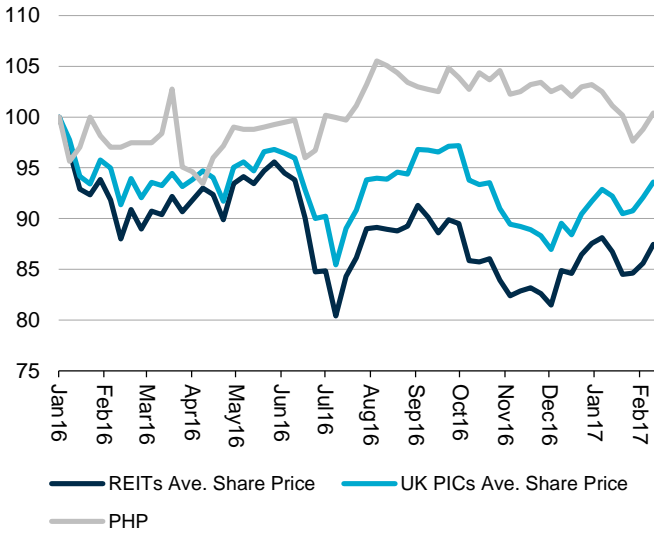
## PHP – Number of properties by region



Source: Company & Numis Securities Research

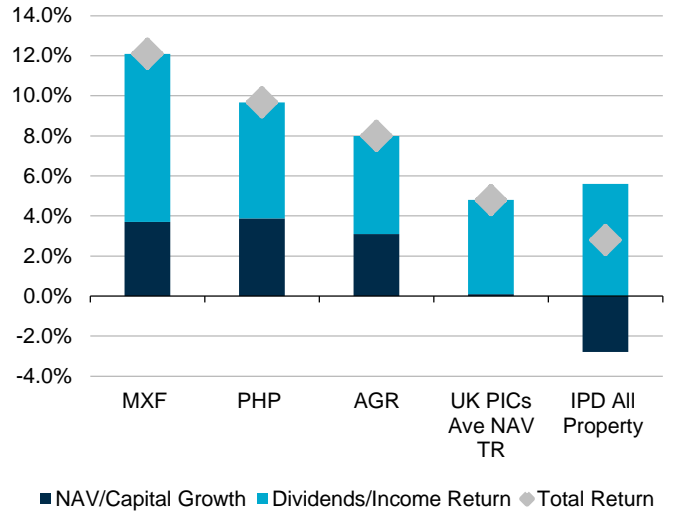
- Prudent Debt Management:** PHP continued to improve its balance sheet flexibility during 2016, with most actions concluded in H1. Notably, having raised equity in H1 at a 14% premium to NAV, PHP used some proceeds to temporarily repay its revolving credit facility (RCF), and re-coupon two interest rate swaps from 4.79% to 0.87% effective Nov 2016 which is expected to save total interest of c.£16.4m to August 2021. As at 31 December, cash balances were £5.1m and the drawn balance across PHP's debt facilities was c.£661m (c.24% unsecured), representing a Net LTV of 53.7%, with a weighted average cost of 4.65% and maturity of 5.1 years. Management notes that it is in positive discussions to secure additional, long-term secured debt facilities.
- Investment Firepower and Pipeline:** PHP currently has c.£90.5m of headroom on its existing facilities to fund its growing pipeline, comprising c.£120m of UK and Irish opportunities.
- Manager Outlook:** Management retains a positive outlook for the business. In particular, it continues to see development opportunities emerging in the UK, and a growing opportunity set in Ireland. Importantly, there remains a positive pricing arbitrage between acquisition yields and funding costs, which combined with a simple low cost structure, should provide potential for further earnings accretive growth.
- Management Changes:** PHP has announced the appointment of Richard Howell to replace Phil Holland as Finance Director, effective 31 March 2017. Richard joins from LondonMetric Property where he has been finance director of its Joint Ventures and Brixton plc where he was financial controller and company secretary.
- Numis View:** PHP's final results were broadly in line with expectations, reflecting the stable returns on offer from the sector. We continue to believe that PHP is well placed in a niche, growing real estate sector. Occupier dynamics are firmly underpinned by both demographics and increased demand for health services. Moreover, investment market dynamics remain broadly favourable, underpinning a stable outlook for valuations.
- Despite the impact of stamp-duty changes in H1, which reduced values by c.£7m, the robust income characteristics of the portfolio underpinned valuations, resulting in a solid property return of 7.9% and an attractive EPRA NAV total return of 9.7%. This compares favourably to the commercial real estate high income peer group (4.8% average NAV TR in 2016). The steady performance continues to translate favourably to PHP's share price. Against a backdrop of more volatile equity markets and low interest rates, we would expect this to remain the case.

PHP – Share Price performance



Source: Datastream

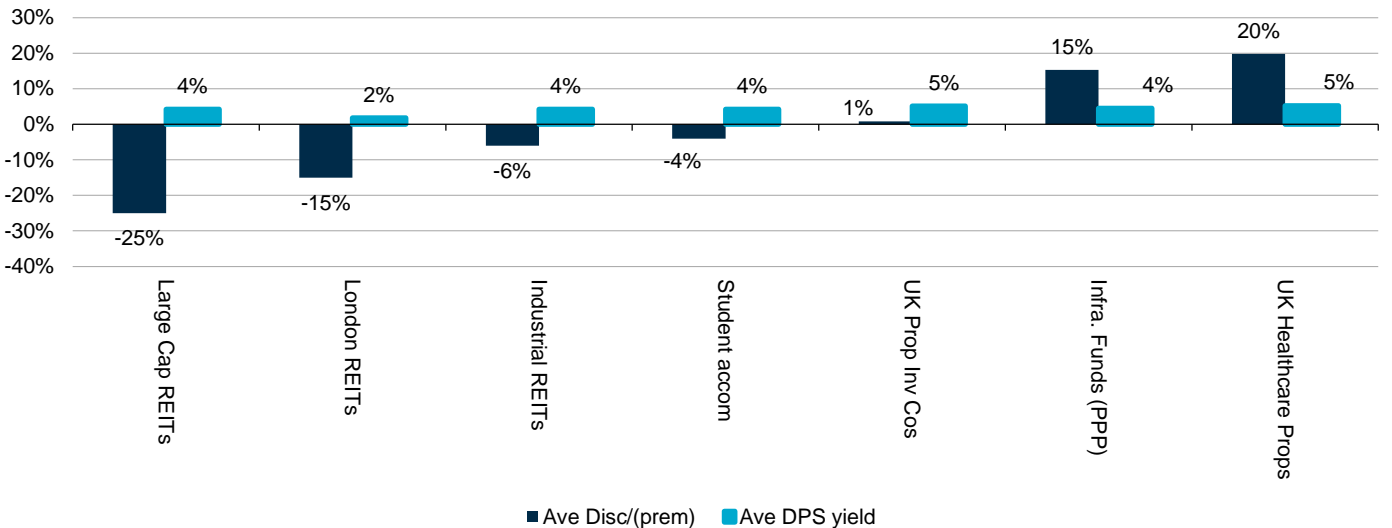
2016 NAV Total Returns – Healthcare Peers; UK PICs; IPD



Source: Numis Securities Research

- Whilst the premium to NAV of PHP, and its wider primary health peer group, contrasts to discounts assigned to general commercial REITs, we believe this is justified based on the lower volatility of asset values, and relatively high, predictable dividend yields on offer. In addition, we note the inflation linkage on c.20% of PHP’s leases will also be viewed positively in the current macro backdrop. With this in mind, it is logical that the shares trade more in line with the listed infrastructure peers, in our view, which also offer exposure to government-backed cashflow streams. It is worth noting, that the infrastructure vehicles do not typically own their property assets, but invest in finite life concessions where the asset reverts to government ownership at the end of the contract.

Primary Healthcare Valuation in Context



Source: Company & Numis Securities Research

- **Numis Estimates:** Assuming stable valuation yields, we may tweak down our 2017 December EPRA NAV estimate by from c.94.9p to c.92p, and maintain our dividend of 5.25p, which implies a NAV total return of c.7% in 2017. In our view, this continues to look relatively attractive compared with general commercial real estate companies. PHP’s shares are currently trading at 107.75p, representing an 18% premium to the latest NAV and yield of 4.9%. This compares with the weighted average premium for Medix Fund and Assura Group of 20.6% and yield of 5.4%.

\* Denotes that this company is a corporate broking client of Numis Securities.

*Note: all prices, NAVs and discounts as at close of business at 15 February 2017 unless otherwise stated.*

*The research analyst who prepared this report was Colette Ord*

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