Primary Health Properties

Acquisition of Apollo Medical Partners

Edison investment research

Ahead of FY12 growth forecast

Real estate

Primary Health Properties has acquired Apollo Medical Partners (AMP) in a £10.2m corporate transaction which adds 14 assets valued at £62.3m to its portfolio; it also assumed £49.8m of debt. It paid £4.2m in cash and 1.23m in shares on completion including transaction costs; another £1.8m is due on delivery of assets under construction. That builds on £29.5m of acquisitions and commitments between 1 July and the 15 November IMS. AMP was part of a reported £106m of deals in solicitors' hands at that date and followed a £3.6m asset purchase earlier this month. PHP now holds 183 assets, a total value of £643.3m including forward funding commitments, with a £38.9m contracted annual rent roll. Total available debt post AMP is £508.5m, with c £400m drawn or committed. We have adjusted our forecasts for the new assets, higher FY12 portfolio growth assumptions of £72m – previously £60m – and PHP's expectation that it will refinance AMP's debt at c 4% fixed in early FY13.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	EPRA NAV (p)
12/10	26.9	9.1	14.7	17.5	5.1	311
12/11	30.7	9.7	14.6	18.0	5.3	319
12/12e	33.6	8.0	11.1	18.5	5.4	315
12/13e	41.0	11.2	14.7	19.0	5.6	316

*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

AMP acquisition secures 14 modern assets

AMP's assets were acquired for £64.6m including £0.6m in costs, giving a 5.9% net initial rental yield. As the portfolio was independently valued at £62.3m, the purchase results in a £2.3m or 3p/share NAV reduction. The £49.8m of assumed debt has on average c 18 years to maturity. Of AMP's 11 complete and let assets, 10 were built in the past five years. The three under construction expected to complete between February and August 2013. Total rent roll on the completed portfolio will be £3.8m pa, with a 5.9% net initial yield derived from GPs/PCTs/NHS bodies (c 92% of rents) and pharmacy operators with an 18-year weighted average unexpired lease length.

Valuation: Deal improves FY13 dividend cover

The 5.6% prospective yield is a key attraction, based on another 0.5p/share dividend increase in FY13. Although not fully covered by earnings, the latest deal should help narrow the gap in FY13 and push up cover to 78% from 73%, subject to timing and terms of debt refinance. PHP's ability to continue to secure acquisitions on an EPS enhancing basis is encouraging. Assets remain available at a material positive gap between the net initial rental yield and debt finance cost. PHP will seek to reset the rate on, or refinance assumed debt in early FY13 and expects to achieve an all-in funding cost c 200bps below the 5.9% initial net yield. The purchase price included an allowance for part of any potential cost to reset the debt cost. We have maintained our £50m forecast for FY13 acquisitions, which looks conservative. PHP has a pipeline above that and c £109m of undrawn facilities post this acquisition, although a £27m debt facility, which matures at the end of January 2013, may be refinanced from existing facilities.

21 December 2012

Price	341.25p
Market cap	£255m

Shares in issue	76m
Free float	94%
Code	PHP
Net debt as at 30 Jun 12 (£m)	300
Primary exchange	LSE
Other exchanges	N/A

Share price performance

%	1m	3m	12m
Abs	3.6	(1.2)	9.4
Rel (local)	(0.1)	(1.5)	(2.8)
52-week high/low		350p	310p

Business description

Primary Health Properties invests in primary healthcare property in the UK, principally let to GPs, PCTs and other NHS entities backed by the UK government. This tenant profile provides an exceptionally secure rental outlook.

Next events

February 2013	Final results

Analysts

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Revised forecasts: Improved dividend cover post acquisitions

We set out our amended forecasts below, adjusted for recent acquisitions. Downward adjustment in FY12 profit and earnings reflect the fact that although the scale of portfolio growth is in line with expectations, the timing of commitments is slower than we had built into our previous forecasts.

Of most significance for the valuation is that recent acquisitions result in a better than anticipated improvement in dividend cover during FY13, reflecting the full year impact of larger than expected portfolio growth.

PHP is committed to restoring full cover over the next few years, which will require both material further portfolio growth and access to debt and equity on sufficiently attractive terms to maintain the gap between net initial yields on acquisition (c 5.8-6.0%), cost of debt and equity and incremental management costs.

Exhibit 1: Changes in forecasts – P&L

	Revenue (£m)		%	PBT (£m)		%	EPS (p)		%	Dividend cover (%)		%
	Old	New		Old	New		Old	New		Old	New	
FY11	30.7	-	-	9.7	-	-	14.6	-	-	81%	-	-
FY12e	34.2	33.5	-2%	9.0	8.0	-11%	12.5	11.1	-11%	68%	60%	-11%
FY13e	38.1	41.0	+8%	10.4	12.0	+15%	13.9	14.8	+7%	73%	78%	+7%

Source: Edison Investment Research estimates

We have reduced our NAV/share forecasts by 3p for each for this year and next, reflecting the impact of the AMP acquisition.

We have assumed £81.3 m of portfolio acquisitions this year, and £50m during FY13. With undrawn facilities available no further equity issues are currently built into the FY13 forecast.

Exhibit 2: Changes in forecast – net asset value

	Net assets (£m)		%	EPRA NAV/share (p)		%
	Old	New	Change	Old	New	Change
FY11	168.1			319		
FY12e	187.8	191.1	+2%	318	315	-1%
FY13e	189.7	194.2	+2%	319	316	-1%

Source: Edison Investment Research estimates

Exhibit 3: Financial summary

£'000s	2008	2009	2010	2011	2012e	2013e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	19,691	21,332	26,915	30,676	34,325	41,493
Cost of Sales	0	0	0	0	0	0
Gross Profit	19,691	21,332	26,915	30,676	34,325	41,493
EBITDA	15,125	18,034	21,871	25,117	28,418	35,178
Operating Profit (before GW and except.)	15,125	18,034	21,871	25,117	28,418	35,178
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0
Other	0	0	0	312	0	0
Operating Profit	15,125	18,034	21,871	25,429	28,418	35,178
Net valuation gain on property portfolio	(17,707)	1,615	22,790	10,584	1,500	5,000
Mark to market loss on derivatives	(10,655)	1,318	(4,714)	(7,947)	(600)	0
Net Interest	(10,502)	(10,181)	(12,722)	(15,417)	(19,389)	(23,036)
Profit Before Tax (norm)	4,623	7,853	9,149	9,700	9,029	12,142
Profit Before Tax (FRS 3)	(23,739)	10,786	27,225	12,337	9,929	17,142
Tax	(160)	0	(1,550)	5	0	0
Profit After Tax (norm)	4,463	7,853	7,599	9,705	9,029	12,142
Profit After Tax (FRS 3)	(23,899)	10,786	25,675	12,342	9,929	17,142
Average Number of Shares Outstanding (m)	33.6	40.6	62.2	66.6	72.2	76.2
EPS - normalised (p)	13.3	18.4	14.7	14.6	12.5	15.9
EPS - FRS 3 (p)	(71.2)	26.6	41.3	18.5	13.7	22.5
Dividend per share (p)	16.5	17.0	17.5	18.0	18.5	19.0
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Gross Margin (%)	100.0	100.0	100.0	100.0	100.0	100.0
EBITDA Margin (%)	76.8	84.5	81.3	81.9	82.8	84.8
Operating Margin (before GW and except.) (%)	76.8	84.5	81.3	81.9	82.8	84.8
BALANCE SHEET						
Fixed Assets	320,133	349,786	472,739	528,679	611,486	666,486
Investment properties	316,862	341,890	469,290	525,586	608,386	663,386
Development properties	282	3,496	0	0	0	0
Net inv. in fin leases/ deriv. int. Rate swaps	2,989	4,400	3,449	3,093	3,100	3,100
Current Assets	2,987	2,263	3,555	2,740	4,525	6,025
Other	454	63	555	0	0	0
Debtors	1,808	1,939	2,582	2,633	3,000	4,000
Cash	675	212	370	77	1,500	2,000
Current Liabilities	(23,597)	(20,321)	(33,241)	(36,913)	(50,700)	(24,100)
Creditors	(23,597)	(20,321)	(29,684)	(36,321)	(23,100)	(24,100)
Short term borrowings	0	0	(3,557)	(592)	(27,600)	0
Long Term Liabilities	(221,237)	(176,317)	(278,307)	(326,386)	(374,200)	(454,200)
Long term borrowings	(204,088)	(166,139)	(263,888)	(300,747)	(332,000)	(412,000)
Other long term liabilities	(17,149)	(10,178)	(14,419)	(25,639)	(42,200)	(42,200)
Net Assets	78,286	155,411	164,746	168,120	191,111	194,211
CASH FLOW						
Operating Cash Flow	15,799	15,951	22,801	24,025	14,730	35,178
Net Interest	(9,883)	(3,346)	(12,722)	(15,417)	(19,389)	(23,036)
Tax	0	0	0	0	0	0
Capex	0	0	0	0	0	0
Acquisitions/disposals	(49,311)	(23,413)	(70,761)	(44,589)	(81,300)	(50,000)
Financing	0	60,748	0	15,605	22,475	0
Dividends	(5,542)	(5,562)	(9,825)	(11,199)	(12,941)	(13,356)
Other	0	(6,541)	0	(2,880)	(413)	(686)
Net Cash Flow	(48,937)	37,837	(70,507)	(34,455)	(76,838)	(51,900)
Opening net debt/(cash)	155,357	203,413	165,927	267,075	301,262	358,100
HP finance leases initiated	0	0	0	0	0	0
Other - including adjustment for corporate transactions	881	(351)	(30,641)	268	20,000	0
Closing net debt/(cash)	203,413	165,927	267,075	301,262	358,100	410,000

Source: Company accounts/Edison Investment Research

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