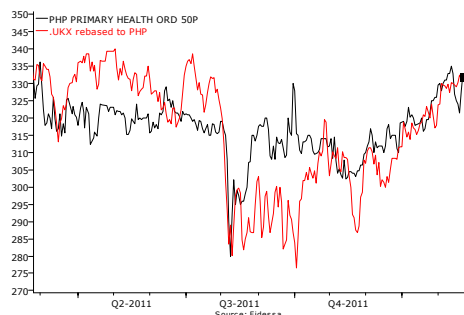


Primary Health Properties 331p

Higher Dividend, More To Come Despite Tighter Loan Terms. New Estimates

23 February 2012



12m High: 336p

12m Low: 280p

Market Cap: £218m

Shares in Issue: 68.3m

NAV/Share: 319p on EPRA basis

246p allowing for book loss on "Derivatives Mark to Market"

Gearing: LTV 57.8%

Rent/Interest Cover: 2.0X

EPIC Code: PHP

Sector: Real Estate

Market: London Full List

Brokers: Numis Securities/Peel Hunt

PR: Pelham Bell Pottinger +44 (0)20 7861 3232

Website: www.phpgroup.co.uk

Description: PHP lets out GP surgeries to GP partnerships on long term leases. The rent GPs pay is reimbursed by the public sector.

Analysts: Roger Hardman//Mike Foster

Tel: +44 (0)20 7929 3399

Email: research@hardmanandco.com

Full year results came in below our (and market) estimates, as higher H2 finance costs impacted on an otherwise healthy trading position. Overall, though, the announcement has been viewed by the stock market as good news. The full year dividend is confirmed as increased, and an Interim Dividend for 2012 has been announced that sets down a very clear marker for a further payout increase in 2012.

The final loan renegotiations – for £175m, equivalent to 45% of total facilities and 58% of the drawn down total – have been concluded. Even though the terms agreed have not been released, it is clear to us that this will push up interest costs by £1m in H1 2012, £3m for FY 2012, and £4m for FY 2013 onwards. This will push down profits and eps, and lead to dividend cover dropping to 0.72X. Even with a modest level of additions to the portfolio, however, we expect 2013 eps to be slightly higher than those for 2012.

Primary Health Properties finished 2011 with £89m headroom on its borrowing facilities. The only unrefinanced loan remaining is £30m with Allied Irish Banks; this will be allowed to expire in 2013, and in terms of the size of this company, and its headroom, this is not important.

The company aims to add £50m of new properties to its portfolio in 2012. This compares to £45m in 2011, and is not only quite achievable but will still leave it within its current facilities, even if the Allied Irish Banks loan is not replaced from another source. From 2014 onwards, more loans will be necessary if the company is to continue to expand, but at the current growth rate it will be many years before PHP bumps up against its 65% Loan-To-Value Limit.

An opportunistic equity raising is possible if the terms are right. Assura recently concluded a fundraising, and MedixFund is currently in the middle of one.

Every property added to the portfolio produces rents that immediately more than cover its interest charge. The faster PHP can grow its portfolio, the quicker it will return to full dividend cover and the less significant its theoretical mark-to-market liabilities will be.

It is worth pointing out that for 2012 and 2013, the cost of the uncovered part of the dividend will still be less than the likely annual increase in value of the property portfolio, so we do not expect the NAV to fall over this period.

The yield is the attraction.

Y/E	Group Revenue	Adjusted Pre-Tax Profit*	Adjusted EPS	P/E ratio	Dividend #	Yield
December	£m	£m	p.		p.	%
2010A	26.9	9.1	14.7	22.5	17.50	5.3
2011A	30.7	9.7	14.6	22.7	18.0	5.4
2012E	34.3	8.6	12.6	26.3	18.5	5.6
2013E	38.2	9.2	13.4	24.7	18.75	5.7

* EPRA basis

The New Loan Arrangements

Primary Health Properties hasn't quite got what it, or we, wanted out of the banks during its loan roll-over negotiations. However, we would be surprised if any other REIT does better in 2012. The overall impact is to push up the average margin on the total loan book from the 3 month LIBOR +70 basis points paid in 2010 to +230 basis points from Q2 2012 onwards. Even before the precise terms of the £175m of lending from RBS and Santander are released, it is clear that Primary Health Properties has opted for a shorter loan length in order to keep down interest rates, rather than going longer at a higher price. The new loan is for a 4 year term, when its preference, all other things being equal, would have been for longer. PHP's new facilities now have a weighted maturity of 4.6 years, so banking renegotiations and changes to the loan package will be a regular feature from now on. However, Primary Health Properties has achieved one important thing, and that is a spread of maturities, so that in future each individual negotiation will be less important.

Other features of the new loan are a modest reduction in covenants, with the Loan To Value covenant being reduced from 70% to 65% and the minimum ICR covenant being increased from 1.3X to 1.4X.

So, the terms are not ideal, but they reflect the current environment, and they still leave PHP with a good profit from day 1 of any new property entering the portfolio (on a c. 5.75% - 6% yield) and with ample headroom on its covenants.

The next loan to fall due is the relatively small £30m Allied Irish Banks facility, which is fully drawn down and matures in January 2013. Allied Irish Banks is not in a position to extend or renegotiate this facility. PHP may allow it to lapse without direct replacement. It will have ample headroom for this by our calculations.

We believe the decisions of the commercial banks are still being dictated by their 2008 problems, and we will watch with interest the terms other property companies obtain in their negotiations over the remainder of the year – if indeed they are able to obtain any terms at all. Hindsight will show that PHP has dealt well.

We think future loans are likely to be provided by the life insurance companies, such as Aviva which is already prominent in this sector, and Legal & General. We think a bond issue by PHP may also be possible. If used as part of the expansion of the property portfolio, such as the funding of the acquisition of a large portfolio, this could be done totally independent of the "mark to market" position.

Rental Increases

Primary Health Properties achieved rent increases equivalent to 3.0% p.a. last year. Rent increases broadly track the RPI, so we expect average rental growth to be slightly reduced during the coming two years.

Portfolio Additions

£45m of new property was added to the portfolio last year. The company's 2012 target is for £50m. PHP states that it is being held back by uncertainty over Andrew Lansley's Health and Social Care Bill, currently progressing through Parliament. The faster PHP is able to expand its portfolio, the quicker it will return eps to their previous levels and once again have a fully covered dividend.

Primary Health Properties

23 February 2012

Primary Health Properties

23.2.2012

P & L Account

Six Months To	£m	6/09A	12/09A	6/10A	12/10A	6/11A	12/11A	6/12E	12/12E	6/13E	12/13E
Investment Properties - Start of Period		316.8	315.7	341.9	460.8	469.3	489.5	525.6	553.0	590.4	627.8
Additions to Portfolio - Purchases		6.9	26.2	101.1	3.5	14.9	30.8	20.0	30.0	30.0	30.0
Revaluations (rent increases and yield shift)		-8.0	9.6	17.8	5.0	5.3	5.3	7.4	7.5	7.4	6.9
Investment Properties - End of Period		315.7	341.9	460.8	469.3	489.5	525.6	553.0	590.4	627.8	664.7
Average Amount Invested		316.3	328.8	401.4	465.0	479.4	507.6	539.3	571.7	609.1	646.3
Portfolio Yield - Actual		6.65%	6.37%	5.90%	6.34%	6.29%	6.14%	6.00%	6.00%	6.00%	6.00%
Portfolio Yield - Quoted by co.					5.80%						
Closing Annualised Rent Roll		20.1	21.3	27.6	28.0	29.0	32.3	33.2	35.4	37.7	39.9
Rent Reversions, % p.a.		3.8%	3.3%	3.3%	3.2%	3.4%	3.0%	2.8%	2.7%	2.5%	2.2%
Base Rent			10.1	10.7	13.8	14.0	14.5	16.2	16.6	17.7	18.8
Rent Increase Through Reviews				0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Rent Increase Through Portfolio Additions				0.9	0.7	0.9	0.6	0.3	0.5	0.5	0.5
Rental Income For the Period		10.51	10.48	11.83	14.74	15.08	15.25	16.68	17.26	18.38	19.49
Finance Lease Income		0.15	0.17	0.17	0.171	0.17	0.17	0.18	0.18	0.18	0.18
Total Income		10.66	10.65	12.00	14.92	15.25	15.42	16.86	17.44	18.56	19.67
Direct Property Expenses		0.10	0.11	0.20	0.20	0.18	0.24	0.26	0.28	0.30	0.32
Administrative Expenses ^a		2.07	1.39	2.04	2.61	2.45	2.67	2.60	2.70	2.85	3.00
Total Expenses		2.17	1.50	2.24	2.80	2.63	2.91	2.86	2.98	3.15	3.32
Operating Profit		8.49	9.15	9.76	12.11	12.62	12.51	14.00	14.46	15.41	16.35
Net Finance Costs		5.30	4.90	5.80	6.92	7.20	8.22	9.22	10.62	11.08	11.53
Adjusted Pre-tax Profit		3.19	4.25	3.96	5.19	5.42	4.29	4.78	3.84	4.33	4.82
Tax Charge ^b		0.00	0.00	0.00	1.51	0.00	0.00	0.00	0.00	0.00	0.00
Tax Charge %		0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
After Tax Profit		3.19	4.25	3.96	3.68	5.42	4.29	4.78	3.84	4.33	4.82
Dividend Cost, Cash		2.71	2.85	5.41	5.33	5.63	5.80	6.00	6.00	6.08	6.08
Dividend Cost, Scrip		0.00	0.28	0.15	0.15	0.15	0.15	0.32	0.32	0.32	0.32
Dividend Cost, ^c		2.71	3.13	5.48	5.48	5.86	6.15	6.32	6.32	6.40	6.40
Retained Earnings		0.48	1.12	-1.52	-1.80	-0.44	-1.86	-1.54	-2.48	-2.07	-1.58
Retained Cash		0.48	1.40	-1.45	-1.66	-0.21	-1.51	-1.23	-2.16	-1.75	-1.26
Shares in Issue, No., Avge,		34.49	40.62	62.6	62.6	65.16	68.3	68.3	68.3	68.3	68.3
Adjusted EPS		9.2	10.5	6.3	8.3	8.3	6.2	7.0	5.6	6.3	7.1
Dividend Per Share, p.		8.25	8.5	8.75	8.75	9.00	9.00	9.25	9.25	9.37	9.37
Dividend Cover X		1.1	1.2	0.7	0.9	0.9	0.7	0.8	0.6	0.7	0.8

Primary Health Properties

23.2.2012

P & L Account

Full Year to Dec	£m	2009A	20010A	2011A	2012E	2013E
Investment Properties - Start of Period		316.80	341.90	469.28	525.60	590.42
Additions to Portfolio - Purchases		33.10	104.61	45.70	50.00	60.00
Revaluations		1.60	22.80	10.60	14.82	14.29
Investment Properties - End of Period		341.90	469.28	525.60	590.42	664.71
Average Amount Invested		329.35	405.59	497.44	558.01	627.57
Portfolio Yield - Actual			0.12	0.12	0.12	0.12
Portfolio Yield - Quoted by co.		0.00	0.06	0.00	0.00	0.00
Closing Annualised Rent Roll		21.30	28.00	32.30	35.43	39.88
Rent Reversions, % p.a.			3.3%	3.3%	3.2%	2.8%
Base Rent		10.05	24.45	28.50	32.74	36.55
Rent Increase Through Reversions		0.00	0.40	0.40	0.45	0.43
Rent Increase Through Portfolio Additions		0.00	1.60	1.50	0.75	0.90
Rental Income For the Period		20.99	26.57	30.33	33.94	37.88
Finance Lease Income		0.32	0.34	0.34	0.36	0.36
Total Income		21.31	26.92	30.67	34.30	38.24
		0.00	0.00	0.00	0.00	0.00
Direct Property Expenses		0.21	0.40	0.42	0.54	0.62
Administrative Expenses a		3.46	4.65	5.12	5.30	5.85
Total Expenses		3.67	5.04	5.54	5.84	6.47
Operating Profit		17.64	21.87	25.13	28.46	31.77
		0.00	0.00	0.00	0.00	0.00
Net Finance Costs d		10.20	12.72	15.42	19.84	22.61
Adjusted Pre-tax Profit		7.44	9.15	9.71	8.62	9.16
Tax Charge b		0.00	1.51	0.00	0.00	0.00
Tax Charge %		0.00	0.00	0.00	0.00	0.00
After Tax Profit		7.44	7.64	9.71	8.62	9.16
Dividend Cost, Cash		5.56	10.74	11.43	12.00	12.16
Dividend Cost, Scrip		0.28	0.30	0.30	0.63	0.64
Dividend Cost, c		5.84	10.96	12.01	12.64	12.80
Retained Earnings		1.60	-3.32	-2.30	-4.02	-3.64
Retained Cash		1.88	-3.11	-1.72	-3.38	-3.00
Shares in Issue, No., Avge,		75.11	62.60	66.73	68.30	68.30
Adjusted EPS		19.71	14.62	14.54	12.62	13.40
Dividend Per Share		17.00	17.50	18.00	18.50	18.74

a A non-recurring Administrative Charge of £0.37m was levied in the 12/09 period.

b A non-recurring 'conversion to REIT' charge of £1.58m was levied in the 6/10 period.

c. Approx. 5% of dividends are scrip rather than cash

Primary Health Properties

23 February 2012

Management	Major Shareholders										
<p>Chairman: Graeme Elliott</p> <p>Managing Director: Harry Hyman</p> <p>Finance Director & Deputy Managing Director: Phil Holland</p> <p>Property Management: A team of eight based in Woking.</p>	<table> <tr> <td>Harry Hyman (inc. Nexus Group)</td> <td>5.9%</td> </tr> <tr> <td>Blackrock</td> <td>4.0%</td> </tr> <tr> <td>Legal & General</td> <td>3.9%</td> </tr> <tr> <td>Aberdeen Asset Management</td> <td>3.5%</td> </tr> <tr> <td>BT Pension Scheme Trustees</td> <td>3.2%</td> </tr> </table>	Harry Hyman (inc. Nexus Group)	5.9%	Blackrock	4.0%	Legal & General	3.9%	Aberdeen Asset Management	3.5%	BT Pension Scheme Trustees	3.2%
Harry Hyman (inc. Nexus Group)	5.9%										
Blackrock	4.0%										
Legal & General	3.9%										
Aberdeen Asset Management	3.5%										
BT Pension Scheme Trustees	3.2%										
Key Dates	Key Milestones										
<p>AGM: April 2012</p>	<p>1994 Business model put forward by Harry Hyman</p> <p>1995 Purchase of small portfolio and incorporation</p> <p>1996 Floated on AIM, shortly afterwards upgrading to the Official List.</p> <p>2002 Wanless Review proposing reforms in the NHS</p> <p>2007 PHP converts to REIT status Darzi Interim Report launching the reform of public primary care</p> <p>2008 (May) Largest single acquisition, Port Talbot (£15.6m) (June) Darzi Review expanding on initial reform</p> <p>2009 (March) £3m capital raising at 220p (September) £60m equity capital raising at 230p, comprising placing and 1-for-5 rights issue.</p> <p>2010 Purchase of CareCapital property portfolio for £24m. Purchase of Health Investments Ltd £39m portfolio - £3m placing at 290p as part consideration</p> <p>2011/12 Refinancing of loan book</p>										

Primary Health Properties

23 February 2012

Disclaimer

The conclusions and opinions expressed in the investment research accurately reflect the views of the first named analyst. Hardman & Co provides professional independent research services and the companies researched pay a set fee in order for this research to be made available. While the information in the research is believed to be correct, this cannot be guaranteed. There are no other conflicts of interest.

Neither Hardman & Co nor the analysts responsible for this research own shares in the companies analysed in this research note. Neither do they hold any other securities or derivatives (including options and warrants) in the companies concerned. Hardman & Co does not transact corporate finance and therefore does not earn corporate finance fees. It does not buy or sell shares, and does not undertake investment business either in the UK or elsewhere.

Hardman & Co does not make recommendations. Accordingly we do not publish records of our past recommendations. Where a Fair Value price is given in a research note this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price.

Our research is issued in good faith but without legal responsibility and is subject to change or withdrawal without notice. Members of the professional investment community are encouraged to contact the analyst concerned.

This research is provided for the use of the professional investment community, market counterparties and sophisticated and high net worth investors as defined in the rules of the regulatory bodies. It is not intended to be made available to unsophisticated individuals. In the UK, any such individual who comes into possession of this research should consult their properly authorized professional adviser, or undertake one of the 'self certified' sophisticated investor tests that are available.

This research is not an offer to buy or sell any security.

Past performance is not necessarily a guide to the future and the price of shares, and the income derived from them, may fall as well as rise and the amount realised may be less than the original sum invested. For AIM and PLUS shares, it is the opinion of the regulator that risks are higher. Furthermore the marketability of these shares is often restricted.

This document must not be accessed or used in any way that would be illegal in any jurisdiction.

In some cases research is only issued electronically and in some cases printed research will be received by those on our distribution lists later than those receiving research electronically.

The report may be reproduced either whole or in part on condition that attribution is given to Hardman & Co, and on condition that Hardman & Co accepts no liability whatsoever for the actions of third parties in this respect.

Hardman & Co is not regulated by the Financial Services Authority (FSA).

© Hardman & Co.

Hardman & Co

4-5 Castle Court
London
EC3V 9DL
United Kingdom

Tel: +44(0)20 7929 3399
Fax: +44(0)20 7929 3377

www.hardmanandco.com

