

Company focus: Primary Health Properties

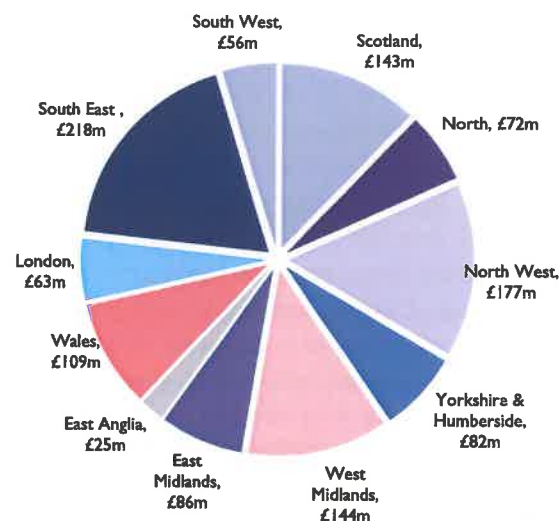
Primary Health Properties (PHP) was a top quartile performer amongst the sector in 2016, delivering a TSR of 8.2%, outperforming the sector average total return (-9.5%), but not the wider equity market (16.8%). Similar to the other outperformers in the sector it delivered an attractive income return last year, and at 4.8% offers one of the most attractive, covered, prospective dividend yields amongst the property stocks.

We believe the dividend yield and PE metrics are more relevant valuation tools than the NAV premium/(discount) for a REIT business like PHP focused on earnings and dividend growth. Based upon our own revised forecasts (presented in the tables below and on pages 7 and 10), which for DPS and NAVs are in line with consensus, we anticipate a total return over the next two years of c8% per annum. This assumes a two year forward dividend yield of 4.6%, PE multiple of 22x, and an implied NAV premium at that time of 20%. The group has delivered 20 consecutive years of dividend growth (CAGR of 9.9%).

We draw investors attention to the following observations:

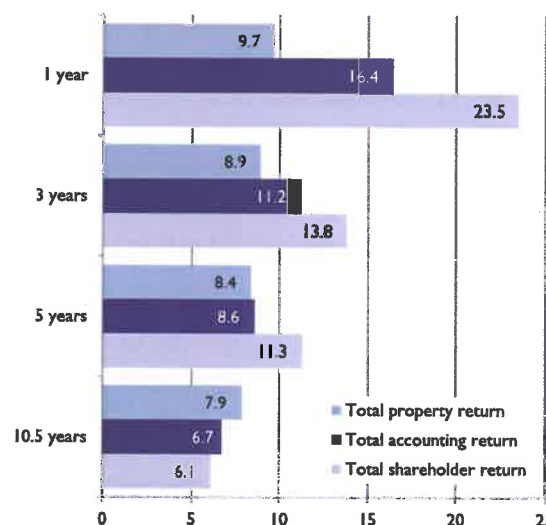
- PHP has delivered a positive annual total property return (TPR) each year FY06-FY15. Its CAGR TPR of 8% over the past decade has largely been translated into similar positive CAGR total accounting and total shareholder returns over the period of 7% and 6% respectively. The group, externally managed, is a very efficient REIT structure, operating with one of the lowest gross to net rental leakages, and with one of the lowest Total Costs/Gross rental income and Total Costs/Investment Property (average) ratios.
- The performance of PHP's portfolio and that of the wider primary care properties (PCP) sector (to which it is solely invested in) over the past decade or so has been superior, and achieved with lower volatility to that of the All Property average. Our upgraded CAGR forecast for total returns for the PCP sector FY16-FY20 is 6.7%, significantly above the IPF consensus All Property total return of 4.2% over the same period.
- PHP's portfolio currently comprises 295 assets (including its maiden purchase for €6.7m in the Republic of Ireland in October 2016) and is valued at c£1.2bn. As at 30 June 2016 the portfolio's annual contracted rent roll was £66.9m, the occupancy was 99.7%, the average unexpired lease term was 14.1 years, and around a quarter of the rent roll is reviewed to RPI or with fixed uplifts. The 75% reviewed to OMR is expected to see increased growth over the next few years as the NHS authorises increased new development, and where construction cost inflation over the past few years is captured in higher rental levels, and which is used as evidence for rent reviews.
- PHP has been a long term net investor, financing its portfolio expansion through regular issues of new equity and additional debt. It, like the wider sector, has adopted a lower leverage strategy over recent years, but continues to operate with an above sector average LTV, supported by the strong covenant and long leases, and low volatility in its underlying property returns.
- PCP investment yields are likely to remain firm/stable for the next several years. All three of the quoted specialists, attracted by the positive long term investment case for PCP, seek to grow their portfolios significantly through continued acquisitions.
- In November Phil Holland, Finance Director announced he will leave the company in March 2017. A replacement will be announced in due course.

Portfolio split by region (£m), 30 June 2016



Source: Company data, Lazarus

Compound total returns (% per annum, to 31 Dec 15*)



Source: Company data, Lazarus

*PHP reports FY2016 in Feb17

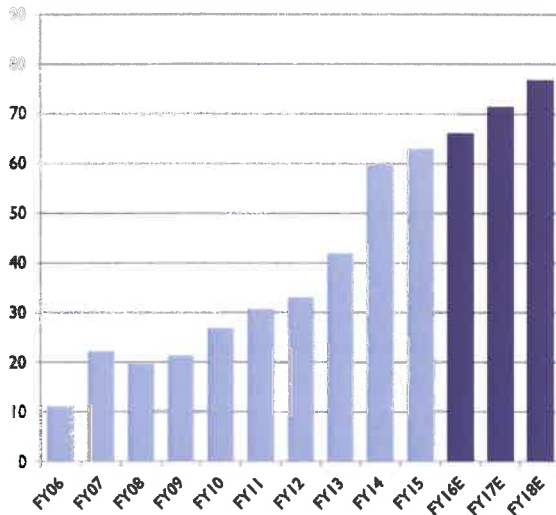
Income statement, including Lazarus forecasts (£m)

	FY10	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Gross rental income	26.9	30.7	33.2	42.0	60.0	63.1	66.2	71.5	76.9
Operating expenses	(0.4)	(0.4)	(0.4)	(0.4)	(0.7)	(0.9)	(0.8)	(0.9)	(1.0)
Net rental income	26.5	30.2	32.7	41.6	59.3	62.3	65.3	70.6	75.9
Other income	0.0	0.0	0.0	(2.7)	0.0	0.0	0.0	0.0	0.0
Administrative expenses	(4.6)	(5.1)	(5.1)	(6.1)	(6.8)	(6.8)	(7.0)	(7.4)	(7.8)
Net interest	(12.7)	(15.4)	(20.2)	(26.0)	(34.3)	(33.7)	(33.1)	(31.8)	(35.7)
Recurring profit before tax	9.1	9.7	7.4	6.8	18.2	21.7	25.2	31.4	32.5
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recurring earnings	9.1	9.7	7.4	6.8	18.2	21.7	25.2	31.4	32.5
Earnings per share (p)	3.7	3.6	2.5	1.9	4.1	4.9	5.2	5.3	5.4
Dividends per share (p)	4.4	4.6	4.7	4.8	4.9	5.0	5.1	5.3	5.4
No of shares (m, weighted)	249.3	267.5	291.5	356.5	444.2	445.6	483.8	596.2	596.2

Source: Company data, Lazarus

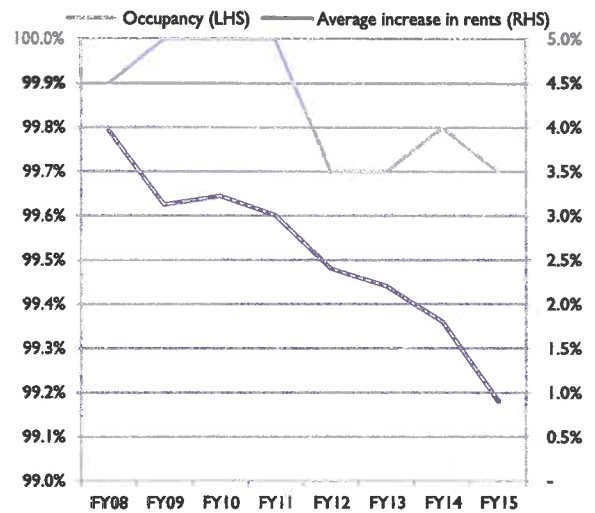
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Evolution of passing rent FY06-FY15, and Lazarus forecast FY16-FY18 (£m)



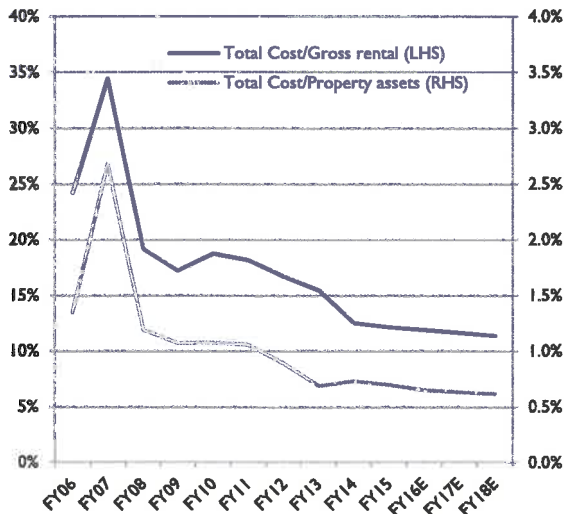
Source: Company data, Lazarus

Portfolio occupancy and average increase in rents (% of passing) over 3 year review (% per annum)



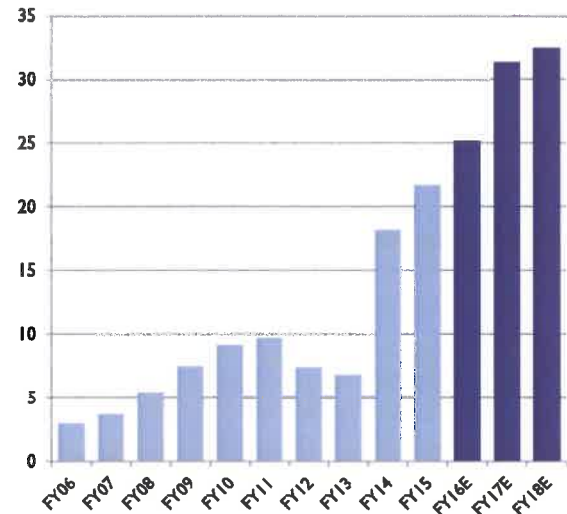
Source: Company data, Lazarus

Evolution of Total Costs/Gross Rental Income and Total Costs/Property Assets (%)



Source: Company data, Lazarus

Evolution of Recurring Profit Before Tax (PBT) FY06-FY15, and Lazarus forecasts FY16-FY18 (£m)



Source: Company data, Lazarus

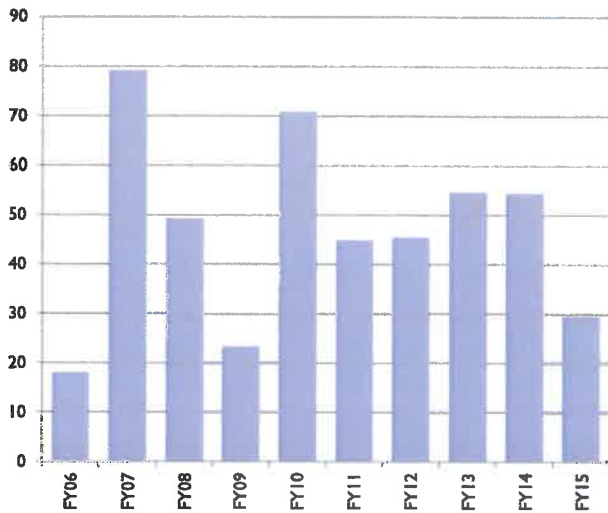
Balance sheet, including Lazarus forecasts (£m)

	FY10	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Property assets	469	526	622	942	1,026	1,101	1,211	1,318	1,419
Net debt	(267)	(301)	(376)	(587)	(655)	(695)	(648)	(733)	(818)
Other net assets	(37)	(56)	(67)	(52)	(62)	(60)	(60)	(60)	(60)
MTM of debt/other adjustments	31	49	53	29	45	46	46	46	46
Adjusted Net Assets	196	218	232	331	355	392	549	571	587
Adjusted NAV per share (p)	78	79	76	75	80	88	92	96	98
No of shares (m, period end)	251.9	273.8	305.0	441.9	445.1	446.3	596.2	596.2	596.2
Loan to value (%)	57	57	60	62	64	63	54	56	58

Source: Company data, Lazarus

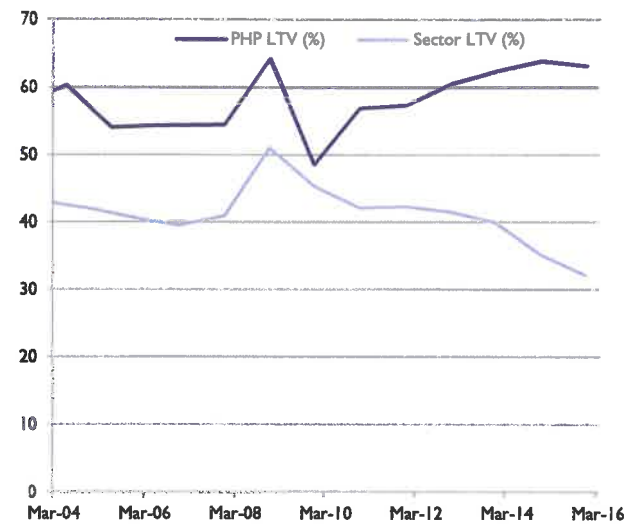
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PHP annual net investment FY06-FY15 (£m)



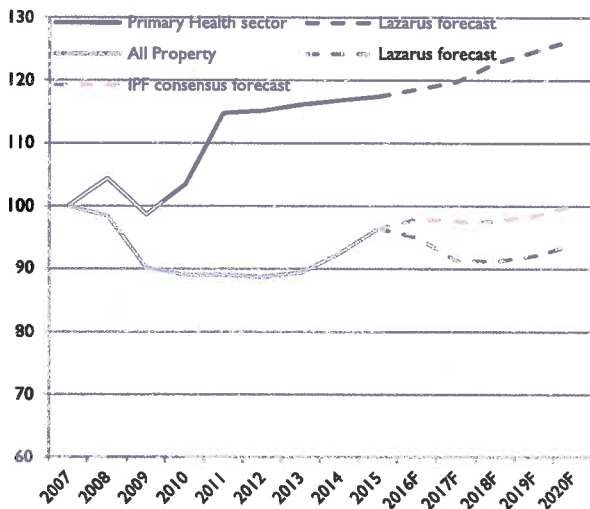
Source: Company data, Lazarus

PHP and Sector average LTV FY06-FY15 (%)



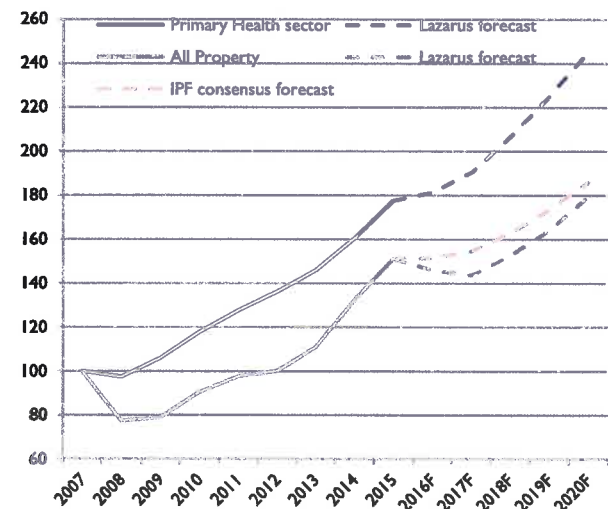
Source: Company data, Lazarus

Annual total property returns (Dec07 = 100) FY06-FY15, and Lazarus/IPF consensus forecasts FY16-FY20



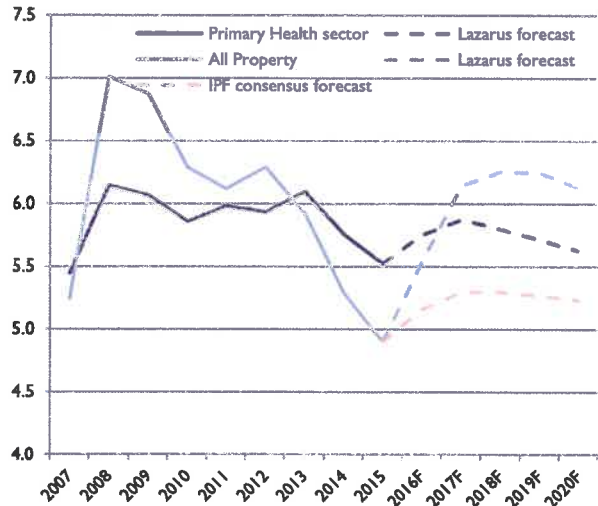
Source: MSCI/IPD, IPF, Lazarus

Annual rental growth (Dec07 = 100), and Lazarus/IPF consensus forecasts FY16-FY20



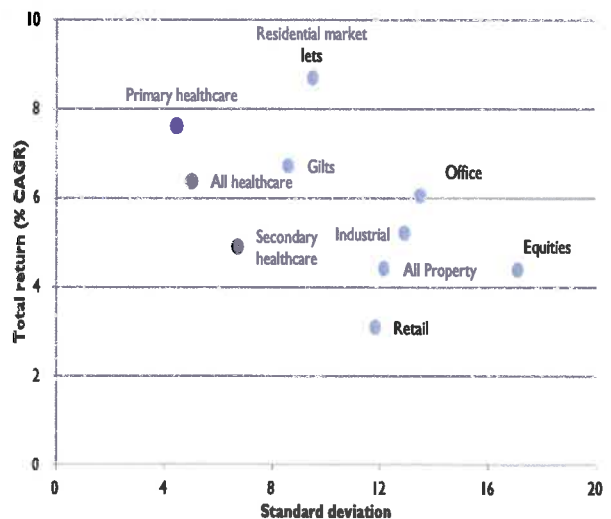
Source: MSCI/IPD, IPF, Lazarus

Initial yield comparisons FY07-FY15, Lazarus/IPF consensus forecasts FY16-FY20



Source: MSCI/IPD, IPF, Lazarus

Volatility of total return and other sectors/asset classes 2007-2015



Source: MSCI/IPD, Lazarus

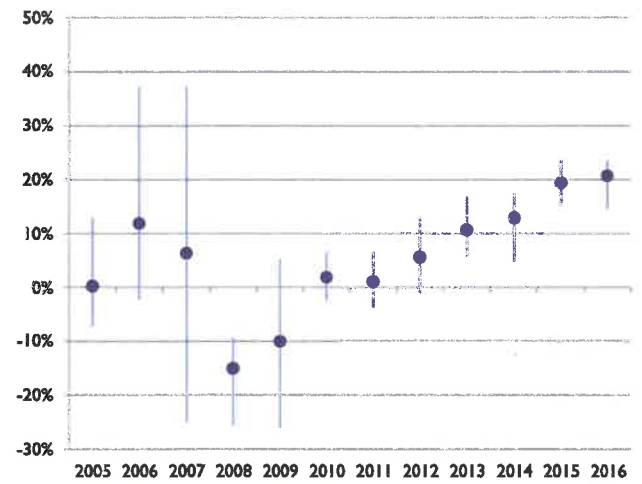
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Historic PE (x) 2007-2016



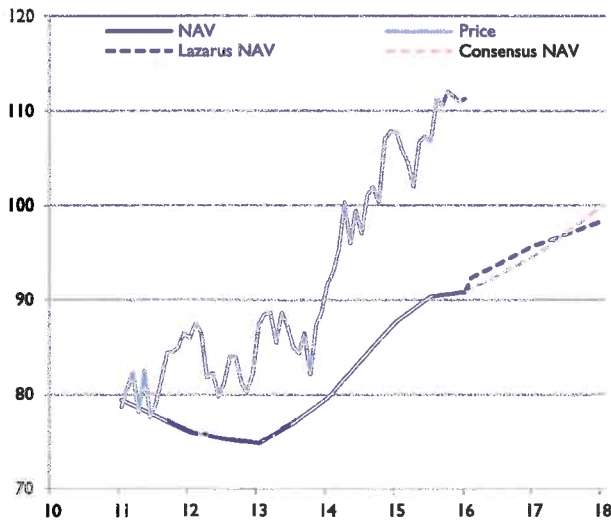
Source: FactSet, Lazarus

The spread of annual NAV premium/(discounts) (%), high, low and average



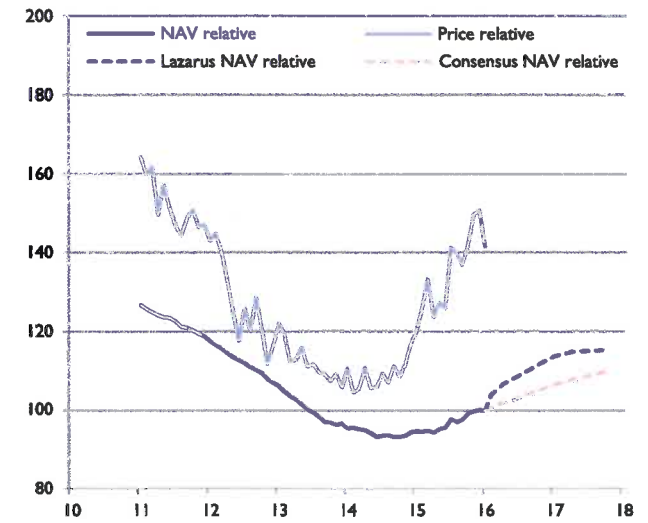
Source: Company data, FactSet, Lazarus

Five year historic and two year forecast NAV per share and share price (p)



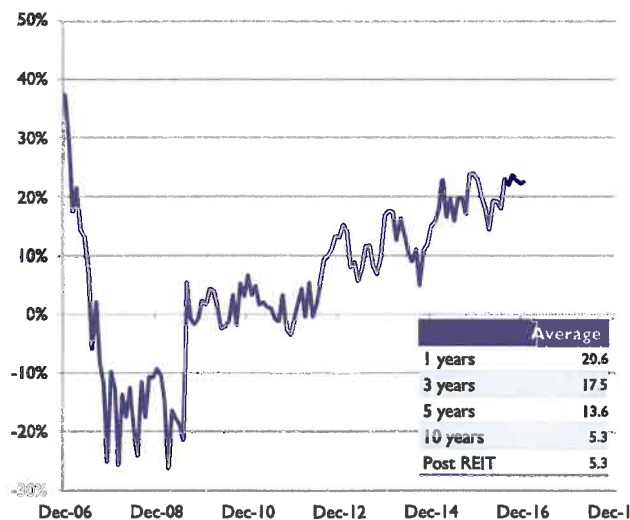
Source: Company data, FactSet, Lazarus

Five year historic and two year forecast NAV per share and share price relatives (Dec16 NAV relative = 100)



Source: Company data, FactSet, Lazarus

Ten year historic absolute NAV premium/(discount)



Source: Company data, FactSet, Lazarus

Ten year historic relative NAV premium/(discount)



Source: Company data, FactSet, Lazarus

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Lazarus two year forecast total return matrix (% per annum)

		NAV premium/(discount) (%)				
		(20)	(10)	0	10	20
NAV delta (%)	(30)	(16.5)	(12.1)	(8.0)	(4.0)	(0.1)
	(20)	(14.4)	(9.9)	(5.6)	(1.5)	2.5
	(10)	(12.4)	(7.7)	(3.3)	1.0	5.1
	0	(10.4)	(5.6)	(1.0)	3.4	7.6
	10	(8.4)	(3.5)	1.2	5.7	10.0
	20	(6.5)	(1.5)	3.4	8.0	12.4
	30	(4.7)	0.5	5.5	10.2	14.7

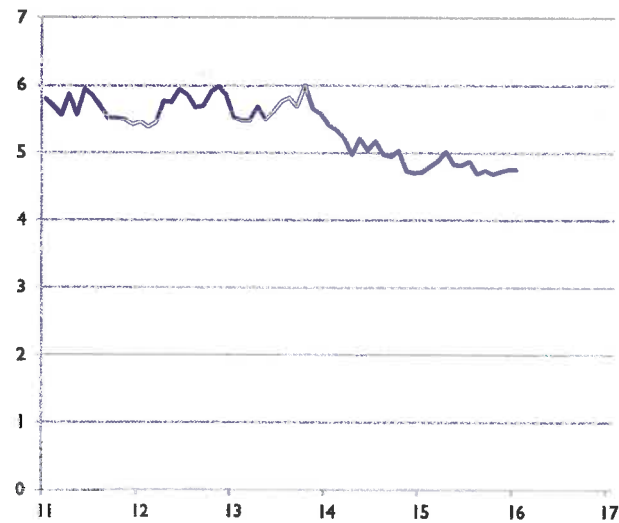
Source: Company data, Lazarus

Lazarus two year forecast dividend yield matrix (%)

		NAV premium/(discount) (%)				
		(20)	(10)	0	10	20
NAV delta (%)	(30)	8.0	7.2	6.4	5.9	5.4
	(20)	7.6	6.8	6.1	5.5	5.1
	(10)	7.2	6.4	5.8	5.2	4.8
	0	6.8	6.1	5.5	5.0	4.6
	10	6.5	5.8	5.2	4.7	4.3
	20	6.2	5.5	5.0	4.5	4.1
	30	5.9	5.3	4.8	4.3	4.0

Source: FactSet, Lazarus

Dividend yield (%)



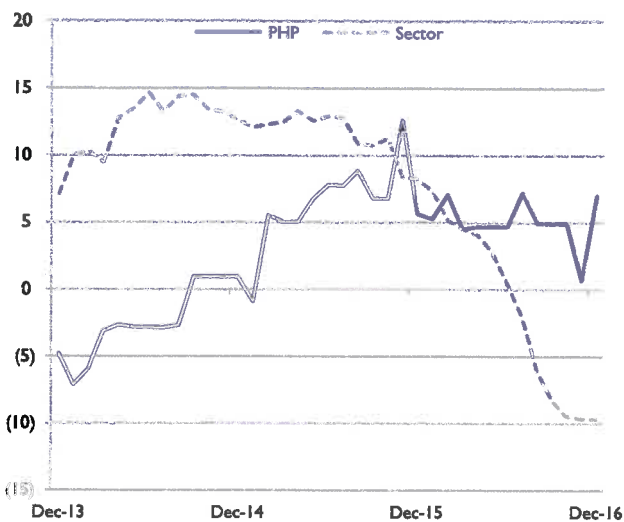
Source: FactSet, Lazarus

Lazarus and Consensus forecasts (pence per share)

	Dec-15	Dec-16	Dec-17	Dec-18	CAGR
EPS					
Lazarus	4.9	5.2	5.3	5.4	3.7
Consensus	4.9	5.2	5.6	6.1	7.9
		0.1	(6.1)	(10.8)	
DPS					
Lazarus	5.0	5.1	5.3	5.4	2.5
Consensus	5.0	5.1	5.3	5.4	2.9
		0.2	(0.7)	(0.3)	
NAVps					
Lazarus	88	92	96	98	4
Consensus	87	91	95	100	5
		1.3	1.2	(1.6)	

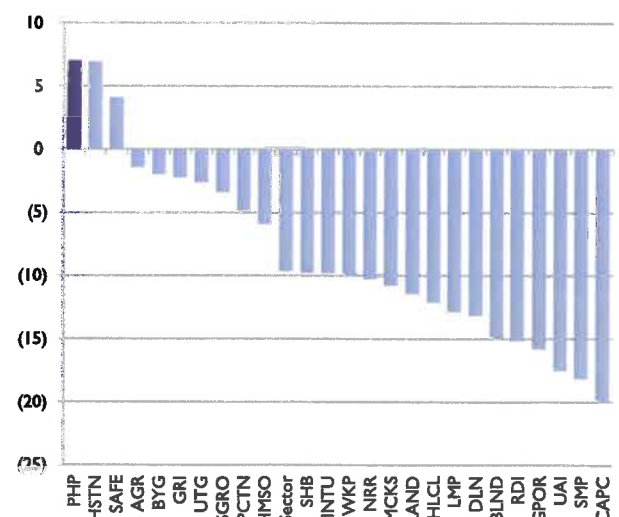
Source: FactSet, Lazarus

Momentum in consensus NAV per share ranked (YoY, %)



Source: FactSet, Lazarus

NAV momentum^ (%)



Source: FactSet, Lazarus

^Change over 12 months of next FY consensus NAV forecast