Primary Health Properties

Full Year Results

15 February 2016

Price: 105.75p

Estimated NAV 31 Dec 2016: 92.00p

Market Cap: £469m

Premium: 14.9%

Yield: 4.9%

Ticker: PHP LN

Website: www.phpgroup.co.uk

(Current share price(s) timed at4:30pm on 12 Feb 16)

(NAV as at 31 Dec 16)

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Healthy Growing Income Stream

In 2015, Primary Health Properties (PHP) delivered strong growth in all key metrics. Management action to increase the rent roll and reduce operating and finance costs, culminated in a return to full dividend cover in H2. In addition, EPRA NAV rose 10% over the year, boosted by a £39.8m revaluation surplus. Combined with 5.0p of dividends paid, this resulted in an EPRA NAV total return of 16.3% in 2015. This compares favourably to our high income property peer group which delivered NAV total returns of 14.8% on average. Looking forward, we believe that PHP is well-placed in a niche and growing real estate sector which continues to see structural demand and positive investment market dynamics, underpinning valuations and supporting a fully covered yield of 4.9%, now paid quarterly.

- **Low cost business model:** PHP is an externally managed REIT with a 20-year track record of investing in primary care premises. The company operates with a simple, scalable, relatively low cost business model (EPRA Cost ratio of 11.5%). It does not develop assets itself, but partners with a number of specialist developers in the sector, committing to fund new assets on a pre-let basis and acquire them once they are constructed. It also invests in completed, let properties acquired from a range of investors.

- **Niche and growing real estate sector:** PHP remains one of the few ways to access the growing primary health property market, offering exposure to long leases backed by a government covenant. PHP's portfolio is the largest by value in the listed universe, comprising 273 properties. However, this represents just 5% of the addressable market. The manager is seeing opportunities in both the UK and Ireland and highlights a near-term pipeline of £130m. Importantly, there remains comfortable headroom between acquisition yields and the cost of funding, which bodes well for the revenue account.

- **Defensive property assets:** Since 2007, average investment yields on primary health assets have remained in a relatively tight range of 5.0–6.25% depending on whether the asset is already income producing or under construction. We believe this reflects the lower volatility of primary health assets through the cycle. As demonstrated by All Property yields rising (values falling) by c.330bps from a peak in June 2007 of 4.57% (currently 5.0% in Dec 15) to reach a trough in June 2009 of 7.91%. In comparison, PHP's portfolio saw a more modest 125bps yield adjustment.

- **Attractive return profile:** Our estimates highlight that PHP is well placed to deliver attractive NAV total returns in 2016 and 2017 of 10.7% and 9.0%, respectively. This compares favourably to Investment Property Forum (IPF) consensus forecasts for All Property total returns of 9.3% and 5.4% in the same period. Having returned to full dividend cover, we estimate that PHP can continue to grow distributions (now paid quarterly) by c.2.5% in both 2016 and 2017 and remain fully covered with a prospective yield of 4.9% rising to 5.0%.

Contents

Overview

20-year track record

Primary Health Properties is an externally-managed REIT with a 20 year track record of investing in primary care premises. The company first listed on AIM in 1996, moving to the Main Market of the London SE in 1998, and became the UK's first dedicated healthcare REIT in 2007. The company specialises in the ownership of freeholds or long leasehold interests in purpose-built primary healthcare facilities. The majority of these are GP surgeries, with other properties let to NHS organisations, pharmacies and dentists.

Business model

Simple business model with scope to increase market share

PHP operates with a simple, relatively low cost business model. It does not develop assets itself, but partners with a number of specialist developers in the sector. It commits to fund new assets, on a pre-let basis, and acquires them once constructed. It also invests in completed let properties acquired from a range of investors, provided the underlying occupational leases and other property fundamentals meet its investment criteria.

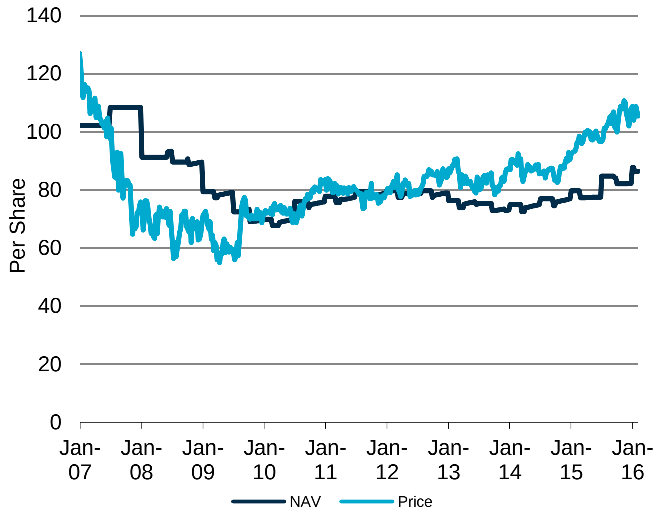
Acquisitions are financed with a mix of equity and debt, the proportions of which are kept under regular review to optimise risk-adjusted returns to shareholders over the long term. Debt facilities are varied, and the company has accessed both traditional bank lenders and debt capital markets in the form of unsecured retail and convertible bonds and secured corporate bonds. Facilities are well spread with a range of providers and maturities.

Attractive Asset Backed Yield

Exposure to long leases backed by government covenant

PHP remains one of the few ways to access the primary health property market, offering exposure to long leases backed by a government covenant. The market continues, rightly in our view, to assign a premium rating to PHP's shares, reflecting the quality of the income stream (WAULT 14.7 years) and defensive nature of the asset base. We would expect this to remain the case, given the favourable market dynamics, flexible balance sheet and attractive dividend yield on offer of 4.8%.

Figure 1: PHP 10-Year Absolute Price & NAV Performance



Source: Company & Numis Securities Research

Figure 2: PHP 10-Year Discount History

Source: Company & Numis Securities Research

Final Results Summary

Strong 2015 performance

In the 12 months to 31 December 2015, PHP delivered strong growth in all key metrics. Management action to grow the rent roll, reduce operating and finance costs, combined with positive momentum in property valuations, resulted in a 16.3% EPRA NAV total return in 2015, and a return to full dividend cover in H2.

19.2% increase in EPRA earnings

Earnings boosted by acquisitions and tight cost control

Net rental income rose 5.1% in the period to £62.3m, reflecting the benefit of acquisitions and developments completed, as well as 0.9% rental growth achieved on reviews. Earnings increased by 19.2% to £21.7m (4.9p), reflecting tight control of admin costs and active management of the debt and hedging portfolio. Fees paid to the manager averaged 0.50% of gross assets in the period, a 9% reduction over the prior year, benefitting from changes to the fee structure in 2014. The EPRA cost ratio was 11.5%, the lowest in the Real Estate sector by a comfortable margin. The tiered management fee means that the rate charged will reduce further from 0.325% to 0.30% on gross assets over £1.25bn.

19th year of DPS growth

Return to full dividend cover

During the year, PHP paid dividends totalling 5.0p, up 2.6% (restated for a 4 for 1 share split in November). This was covered 98% by recurring cash flow. Management notes that earnings generated in H2 2015 covered the second-half dividend by 107% (up from 89% in H1). Having moved to quarterly distributions in January 2016, PHP has subsequently declared a DPS of 1.28125p payable on 26 February 2016 (ex-dividend 14 January), representing an annualised yield of 4.8%. The remaining quarterly dividends are expected to be made in May, August and November.

Enhanced balance sheet flexibility

23% of drawn debt is unsecured giving balance sheet flexibility

PHP has considerably improved its balance sheet flexibility over the past 24 months. In 2014, £500m of debt was refinanced, restructured or procured, diversifying funding sources, lowering interest costs and extending the average maturity. At 31 December 2015, debt totalled £692.7m, with a weighted average maturity of 5.9 years. Net finance costs in the period were £33.7m with an average interest cost of 4.67%, 48bps lower year on year. Consolidated net LTV was 62.7%, although we note that no debt facility has an LTV covenant based on consolidated LTV. Individual debt line LTVs range from 38% to 65% and remain comfortably within covenants. Moreover, 23% of drawn debt is unsecured, giving flexibility in the event that property values fall in the future.

10% increase in EPRA NAV; 16.3% NAV total return

Investor demand driving yield shift

Property values increased by 3.9% or £39.8m (8.9p) in 2015 to £1.1bn including developments, reflecting an initial yield of 5.32% (Dec 14: 5.52%). EPRA NAV rose 10% to 87.7p; basic NAV including the unrealised mark to market of the interest rate swaps was 69.5p up 11% year on year.

Positive outlook for 2016 and beyond

Further dividend and NAV growth expected

We 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 positive, underpinning valuations. Our estimates assume that the company is well-placed to deliver attractive NAV total returns in 2016 and 2017 of 10.7% and 9.0%, respectively. We estimate that PHP can deliver 2.5% annual dividend growth in both 2016 and 2017 and remain fully covered.

PHP Property Performance

Attractive long-term property performance

Whilst PHP's property total return of 9.7% was below the 13.8% return from commercial property in 2015, we believe this reflects the lower volatility of primary health assets through-the-cycle. In particular, All Property yields fell c.330bps from a peak in June 2007 of 4.57% (currently 5.0% in Dec 15) reaching a trough in June 2009 of 7.91%. This compared to a more modest 125bps move for PHP over the same period.

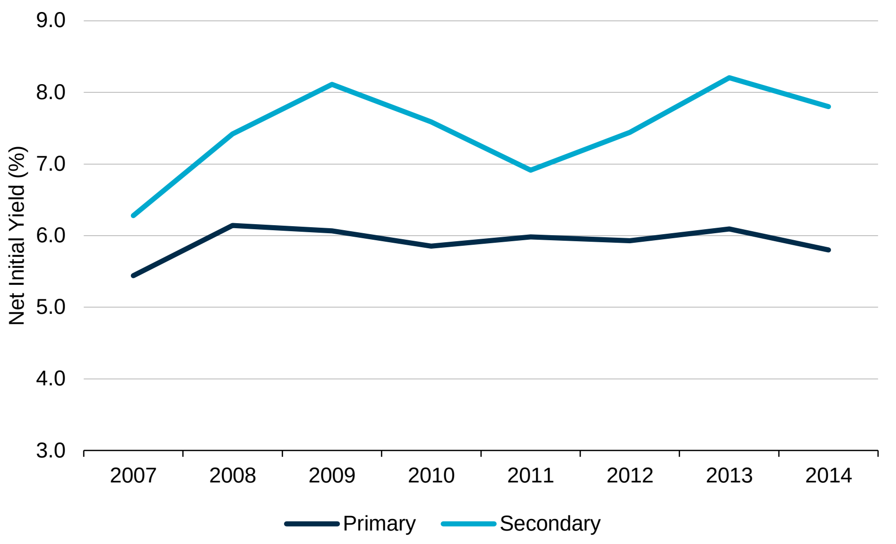
Table 1: Total Property Return pa to 31 Dec 2015

(%)	1 Year	3 Years	5 Years
PHP	9.7	8.2	7.7
IPD All Property Index	13.8	14.6	10.8

Source: Company data/IPD

The annual IPD healthcare index for 2015 will not be published until March. This index records performance across a range of health sub-sectors, including primary care (doctors surgeries, dentists etc.) and secondary care (care homes, hospitals etc.). Since 2007, average investment yields on primary health assets have remained in a relatively tight spread of 5.0– 6.25% depending on whether the asset is already income producing or under construction. However, we are aware of keener pricing, sub-5%, for certain larger assets that have attracted institutional investors looking for long-term RPI linked yield.

Figure 3: Primary Healthcare & Secondary Healthcare Net Initial Yields

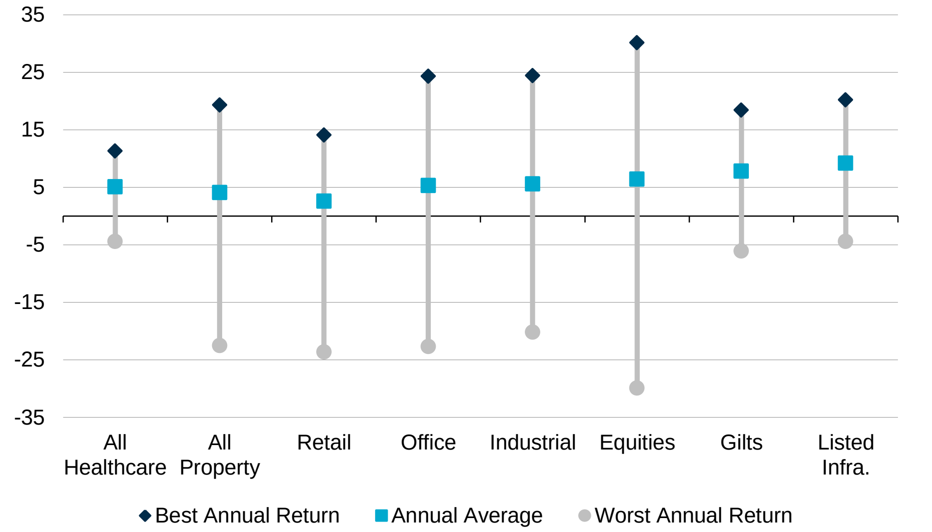


Source: Numis Securities Research/IPD

Low volatility of asset values vs other property sectors

The lower volatility of primary health assets is further demonstrated in the following chart, which illustrates the best and worst annual return as well as the annual average compared with other property sectors and yielding asset classes.

Figure 4: Total Returns by Asset Class 2007–14 inclusive



*** Listed Infra based on NAV total return*
Source: IPD/Datastream/Numis Securities Research

High Degree of Income Visibility

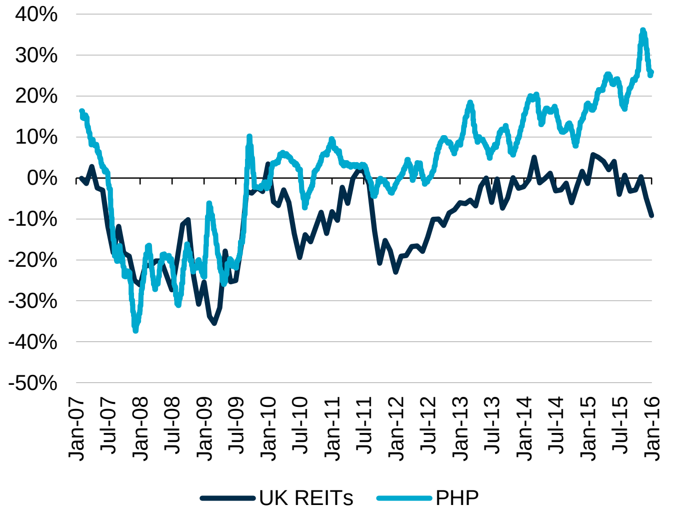
A key driver of PHP's solid long-term property performance is the high degree of income visibility, strong covenants and generally matching supply and demand of assets. As at 31 December 2015, PHP was contracted to receive minimum lease payments of £899m over the next 15 or more years from a strong tenant covenant (predominantly NHS).

PHP Share Price Performance

PHP's attractive income characteristics have translated favourably to share price performance. Whilst the discount ballooned out to almost 40% at the end of 2007, in line with the general REIT sector, the shares have been trading at a healthy premium to NAV in more recent years. A key driver of this has been a greater understanding of the primary health property market drivers, and the quality of income stream that it produces.

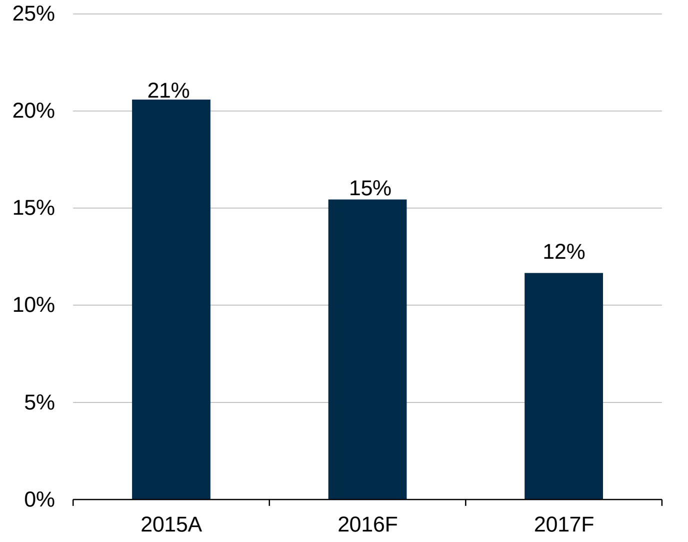
PHP shares are currently trading on a 21% premium to the December 15 EPRA NAV in line with the weighted average premium for the listed primary healthcare peer group. **The premium falls to 15% based on our 31 December 2016 EPRA NAV estimate of 91.6p and 12% based on our 31 December 2017 EPRA NAV of 94.7p.**

Figure 5: PHP Discount/Premium vs UK REITs



Source: Datastream/Numis Securities Research

Figure 6: PHP Implied premium to NAV estimates



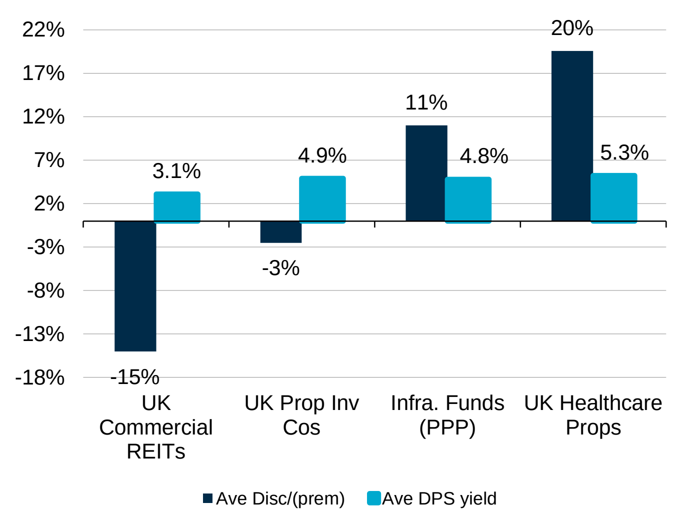
Source: Numis Securities Research

PHP Rating in Context

Premium rating for high quality income plays

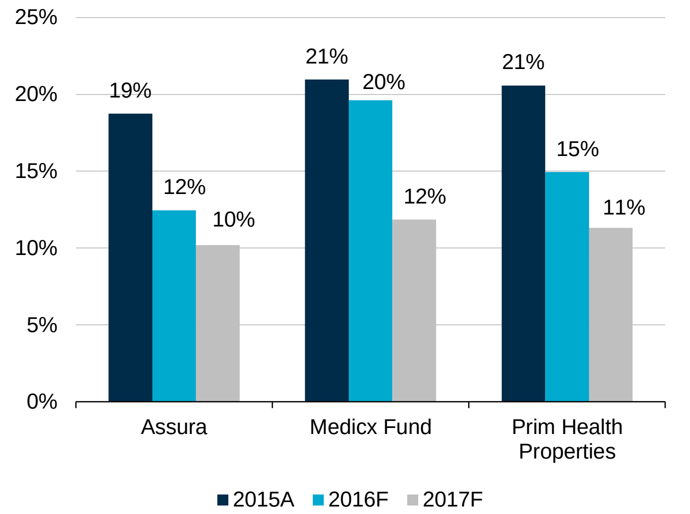
As the following charts suggest, the market continues to assign a premium to the sector primary health sector given the strong income characteristics and relatively defensive asset base. In particular where there is a government covenant such as listed infrastructure or primary health. We expect this to remain the case in the current low interest rate environment.

Figure 7: Valuations in Context



Source: Company & Numis Securities Research

Figure 8: Primary Health Peers - Prem to EPRA NAV



Assura & Medicx consensus forecasts from Factset
Source: Company & Numis Securities Research

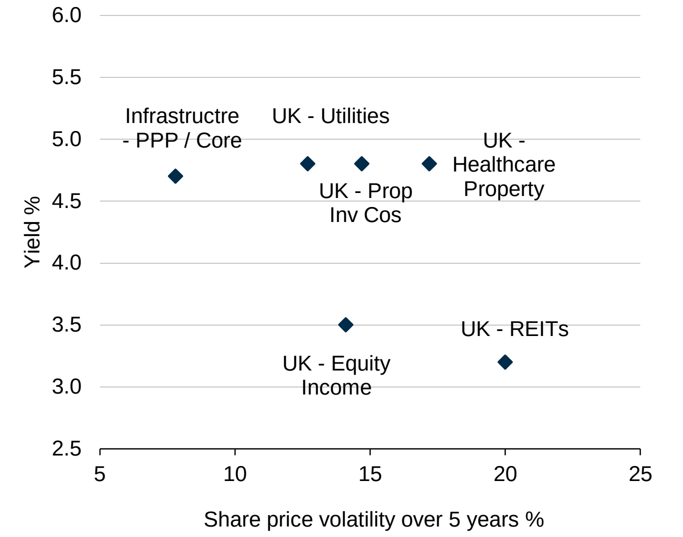
Greater NAV growth potential versus PPP funds

Compared with listed Infrastructure funds, the wider premium for healthcare property can generally be justified by an expectation of greater near-term NAV growth, as well as asset ownership (PPP funds invest in finite life concessions where the asset reverts to government ownership at the end of the contract). In our view, the higher premium versus commercial property can be justified by the lower volatility of asset values and relatively high dividend yields on offer.

Lower correlation with general equities

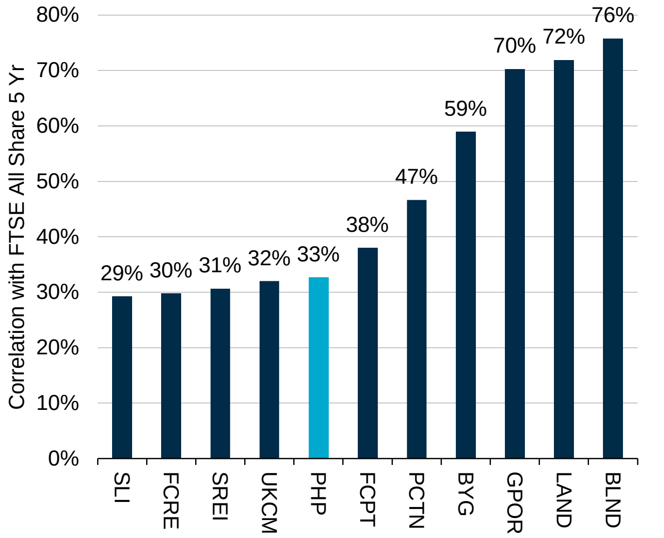
It is also interesting to note that over a five-year period, PHP’s share price has shown lower correlation with the All Share compared with other listed property plays. This is particularly stark compared with commercial REITs that have much higher correlation to general equities compared with UK high income property investment fund peers and PHP. We believe this a key attraction for investors looking for income diversification from a relatively low volatility asset base.

Figure 9: 5-Year share price volatility & Yield



Source: Company & Numis Securities Research

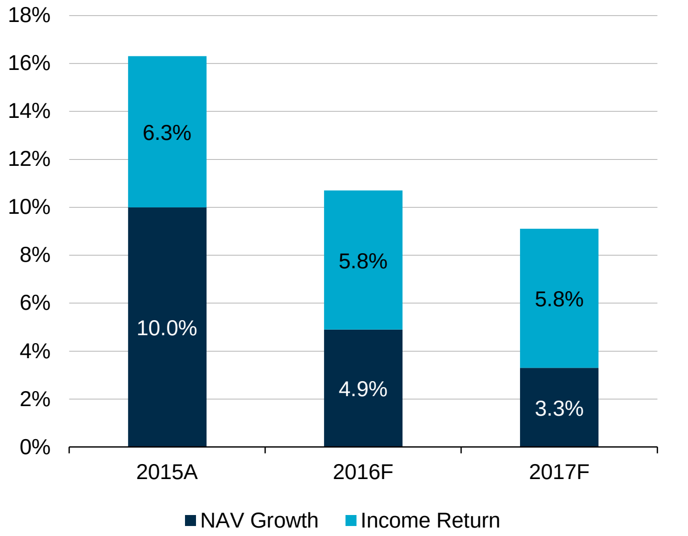
Figure 10: Share Price Correlation with FTSE All Share – 5yrs



Source: Numis Securities Research/Datastream

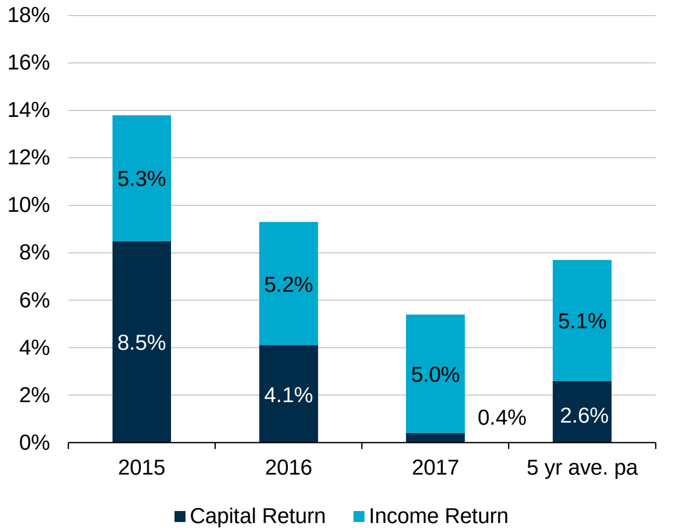
The following charts illustrate our NAV total return expectations for PHP. We believe these compare favourably with total return forecasts for general commercial property, as published by the Investment Property Forum (IPF). Contributors to IPF forecasts include a mix of property advisors and fund managers.

Figure 11: PHP NAV Total Return Expectations



Source: Numis Securities Research

Figure 12: IPF Consensus Total Return - All Property Est.



Source: IPF November 2015 Forecast

Market Backdrop

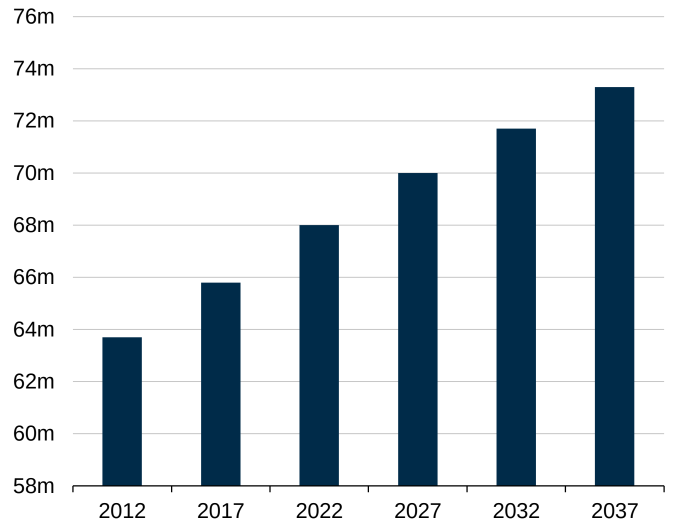
In its research report entitled *Specialist Property: The Core Markets*, Knight Frank highlights three key differences between specialist and traditional property assets (Retail, Industrial & Offices) as follows:

- Lease duration
- Risk profile and
- Structure of rental uplifts.

In our view, the primary health property market looks attractive on all three counts. Leases have significantly longer duration and feature more regular, effectively upwards-only rent reviews, when compared with general commercial leases. In addition, tenants have a low risk profile given the dominant government covenant.

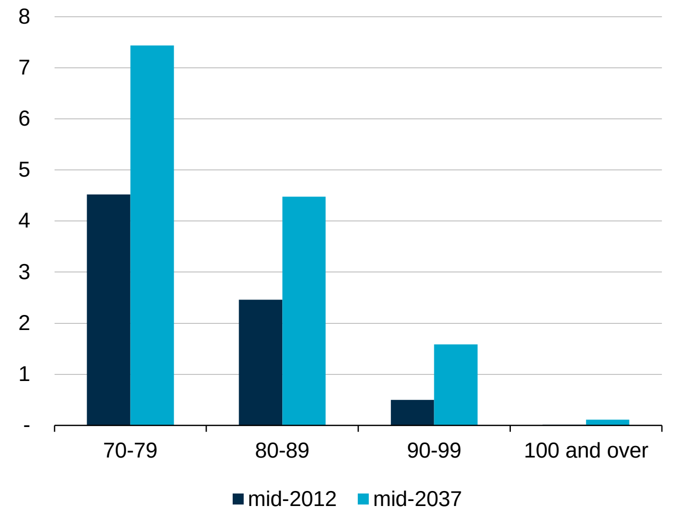
Moreover, we believe the sector offers some of the most attractive supply and demand dynamics, driven by structural rather than cyclical changes. Most notably, there is a growing demand for primary healthcare services as the UK population ages the incidence of chronic disease increases.

Figure 13: UK Population growth



Source: ONS/Numis Securities Research

Figure 14: Ageing Population Trends



Source: ONS/Numis Securities Research

90% of PHPs rental income is derived from GP and NHS tenants

GPs form the largest tenant group in the sector, with >60% being owner/occupiers of their own premises. According to the Nuffied Trust, 90% of all NHS contact takes place in the primary care setting with the average member of the public visiting a GP six times a year. However, many existing practices have been deemed too small or inadequate in the face of changing demographics (growing and ageing population), supporting demand for new premises. According to a survey of GPs by the British Medical Association, 70% stated their premises are too small to deliver extra/additional services, whilst 52% said that their premises had seen no investment or refurbishment in the last 10 years. Meanwhile, the UK population is expected to rise by 10% in 15 years, with the percentage of people aged 70 or more expected to rise by 45%.

Tightly Controlled Supply

Against a backdrop of growing demand, supply remains constrained. The primary care premises market is controlled by the NHS in the UK and largely influenced by the HSE in the Republic of Ireland, meaning there is little or no speculative development of new facilities. Buildings are often located within residential areas which can lead to restricted alternative use potential. Against this, initial lease terms are longer than in general commercial markets, averaging more than 20 years.

In the UK, rent reviews are triggered by the landlord, typically on a three yearly, upwards-only basis. GPs receive reimbursement for rent, maintenance and insurance costs from the NHS, a practice set out in legislation. Together with leases direct to the NHS, the sector benefits from a very strong underlying rental covenant.

In Ireland, whilst there is no rental reimbursement of GP rents, the HSE makes a commitment to each primary care centre in order to create an integrated healthcare system alongside GP services. The HSE presence, representing 60-75% of rent received at a centre, will underpin the long term secure income to be received from Irish properties.

Overall, these factors combine to create a long-term, low risk income environment where over the medium-term, through a mix of indexed linked and open market reviews, rental growth has broadly tracked inflation. Whilst rental growth remains muted (ranging between 0.9-1.4%), the rate of development approvals in starting to pick up in the UK. This should see an improving trend in rental growth in the medium term. When settling rent reviews, new developments provide rental evidence for valuers.

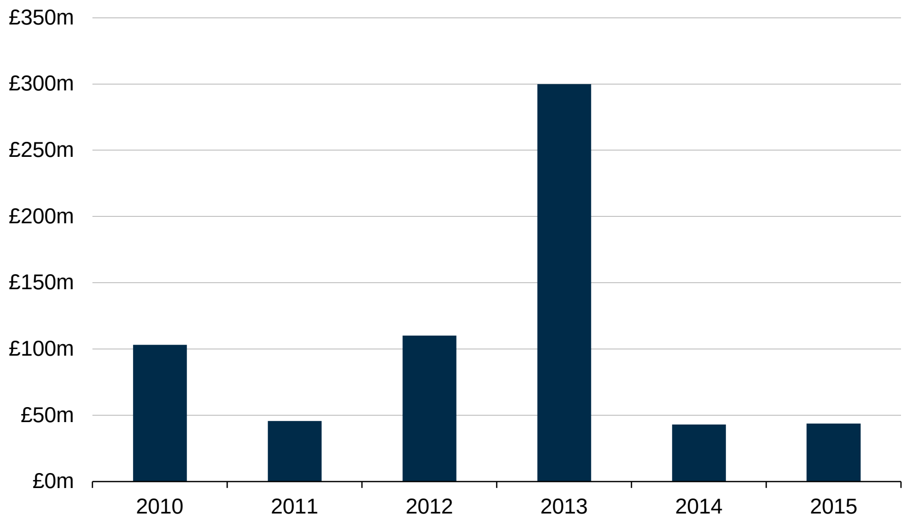
In addition, investment market dynamics remain buoyant with scope for yields to edge modestly lower, supported by rental growth (albeit lower than historic levels) and demand from investors for high quality, long-term government-backed income streams.

Acquisitions and Pipeline

£50m of acquisitions in a typical year

The chart below illustrates PHP's recent acquisition profile. Management seeks to add £50-100m of new assets per annum. In 2015, PHP acquired eight properties for a combined consideration of £44m, increasing the rent roll by £2.4m. These comprised a mix of forward-funded projects that are expected to be completed in the next 12 or so months and will be let for an average term of 21 years.

Figure 15: Acquisition profile since 2010

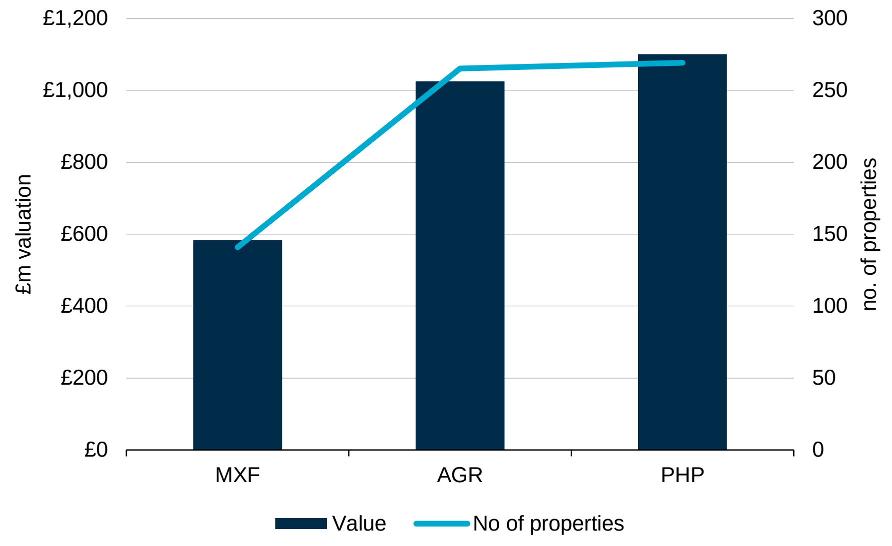


Source: Company & Numis Securities Research

The most notable transaction in the past 24 months was the acquisition of Prime in December 2013. The deal added 54 properties (valued at £233m) and £14.3m to the annual rent roll. As well as boosting dividend cover significantly, it also increased the inflation linkage of the portfolio (from 11% to 18%), enhanced the longevity of income and increased the average lot size.

Of the three listed health property peers, PHP has the largest portfolio by value, comprising 273 health centres. However, this compares with 9,800 GP practices that exist in the UK (British Medical Association). Whilst many of these would not be suitable as a result of size, quality and growth potential, we believe it indicates the further scalability of PHP's business model, providing it continues to have access to attractively priced capital.

Figure 16: Primary Health Peer Group – Portfolio Value and No. of Properties



Source: Company & Numis Securities Research

The near term pipeline includes £28m of UK assets in solicitors hands and €14m of property in Ireland, a new market for PHP and the peer group. Transactions under offer and progressing total £70m in the UK and €40m in Ireland.

Ireland

The Irish market has attracted interest from the London listed primary health peers more recently. This has been driven by a commitment from the department of Health in Ireland to widen access to primary care including free provision for over 70's and under 6's. This may be extended to children under 12.

PHP is seeing a growing number of opportunities in the region, and highlights the following key characteristics that are expected to complement the UK portfolio.

- Target assets include large, modern integrated primary care centres
- HSE typically represents 60-75% of income for 20-25 year lease terms
- Residual space let to GPs, pharmacy and associated healthcare users
- Five-yearly rent reviews linked to CPI (upward and downwards)
- Supportive demographics
- Higher initial yields compared with UK assets
- Supportive banking market at accretive rates.

Whilst there are clearly differences compare with the UK primary health property market, PHP is comfortable that any perceived risks can be sufficiently mitigated. Moreover, we would not expect Ireland to be a substantial percentage of the portfolio with management suggesting it may invest up to €150m over time. This would represent c.10% of the current portfolio. Medicx Fund is currently seeking shareholder approval to invest up to 20% outside of the UK.

Funding Growth

PHP has funded its portfolio growth using a combination of equity and debt capital markets, as well as traditional bank and insurance funding. The following table summarises the most recent significant capital raise events completed by the company.

Table 2: PHP - Recent Funding from Capital Markets

Date	Gross Proceeds (£m)	Method
18 Sept 2009	60	Firm Placing, Placing & Open Offer issue of 26.1m shares at 230p
11 July 2012	75	5.375% Retail Bond
22 May 2013	60	Firm Placing, Placing & Open Offer issue of 19m shares at 315p
16 Dec 2013	70	Secured bond, floating rate 2025
03 Dec 2013	41	Issued 12.57m shares at 320p as part consideration for Prime Portfolio
13 May 2014	82.5	Convertible, senior unsecured 4.25% bond

Source: Company & Numis Securities Research

The last equity raise occurred in 2013 when PHP issued 19m shares at 315p (78.75p restated for the four for one share split in November 2015).

Balance Sheet Flexibility

Diverse range of lenders; 23% of loans unsecured

PHP has a diverse range of debt providers including traditional bank and insurance lenders, as well as a mixture of secured and unsecured bonds. This includes an unsecured convertible bond with an initial conversion price of 97.5p and semi-annual coupon of 4.25% pa until maturity in May 2019. This is expected to be redeemed at par, although the bond can be converted at any time by bondholders or from June 2017 by the company. PHP can settle entirely in shares, in cash or with a combination of both. The initial conversion price represents an 11% premium to the 31 Dec 15 NAV and a 7.8% discount to the current 105.75p share price.

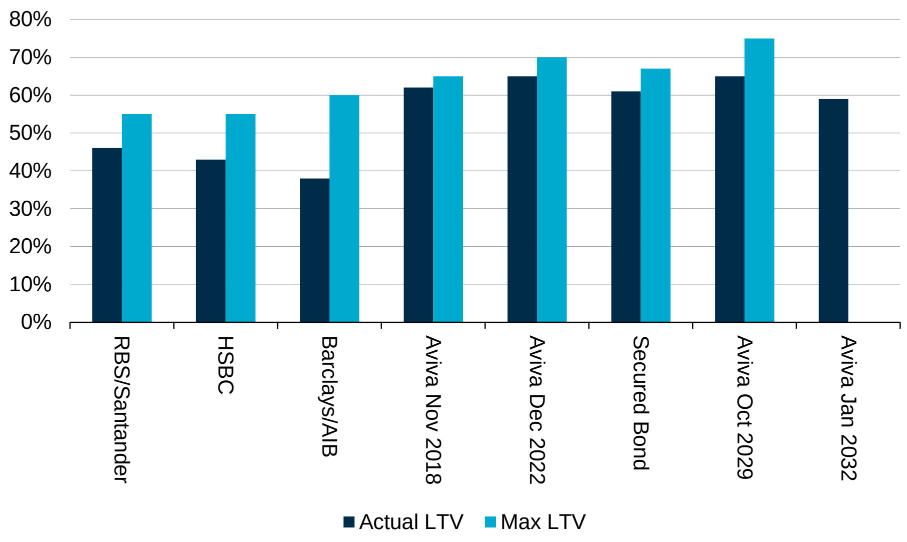
Convertible bond in the money

As at 31 December 2015, PHP had drawn £690m out of £802.7m available under its existing debt facilities. Allowing for the cost of development projects on site at the year-end of £21.8m, PHP has £91.1m of headroom for future investment. Group level Net LTV was 62.7% at 31 December 2015, including the convertible. However, given that the convertible is currently in the money, we believe it is correct to exclude it from LTV, which reduces group level LTV to 55.8%.

Comfortable headroom on covenants

It is also worth noting that there is no group level LTV covenant in any debt facility. Each of PHP's eight secured debt facilities has its own covenant level against which PHP is comfortably placed. LTVs on individual debt lines range from 38% to 65% and covenant levels ranging from 55% to 100% as well as strong levels of interest cover.

Figure 17: Individual LTVs vs Covenant Levels

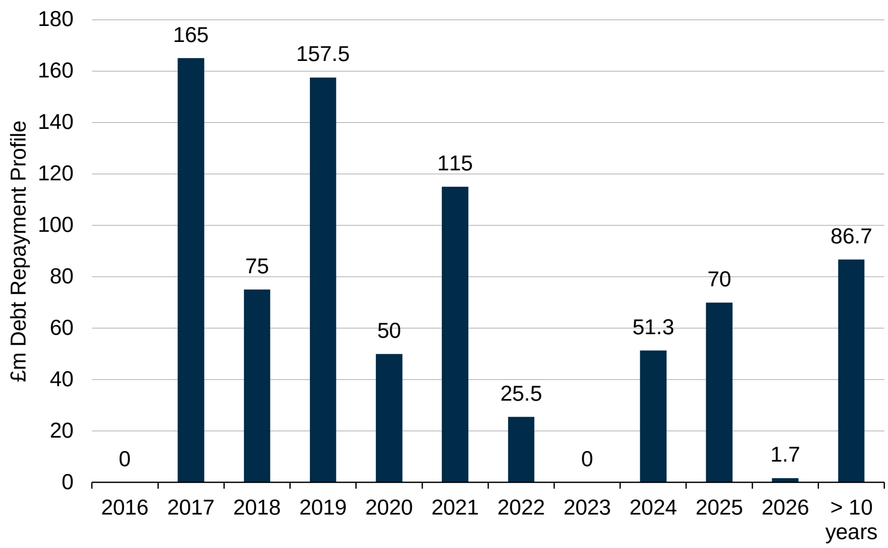


Source: Company & Numis Securities Research

Weighted average debt maturity of 5.9 years

The weighted average maturity is currently 5.9 years, with the next refinancing event expected in 2017 when PHP will need to refinance £165m relating to its club facility. Management note that discussions are currently ongoing in this regard.

Figure 18: Maturity of Debt

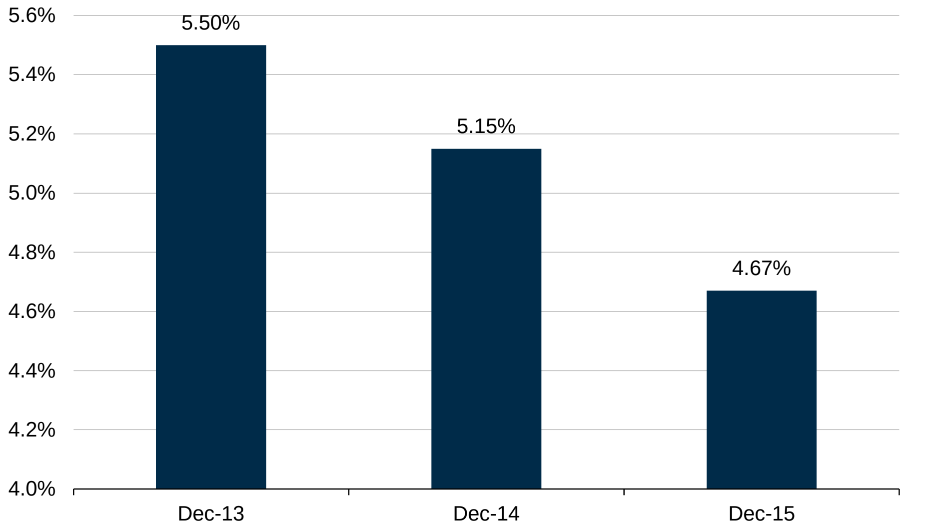


Source: Company & Numis Securities Research

Active debt and hedge book management

Over the past 24 months, PHP has refinanced, restructured or procured c.£500m of debt. Most notably, the manager has improved balance sheet flexibility, with the addition of two unsecured bonds totalling £157.5m, representing c.23% of drawn facilities, providing a buffer in the event that property valuations fall in the future. In addition, it has also reduced the average interest rate paid in 2015 to 4.67%, down from 5.15% a year earlier. This has been driven by the addition of new lower cost facilities and also the termination of a shorter dated, relatively expensive £80m notional swap contract that was due to expire to July 2016. Whist this crystallised a £3.2m (0.8p) break cost, it was a £250,000 discount to the inherent interest cost and reduced average debt costs in the period by 43bps.

Figure 19: Average Cost of Debt

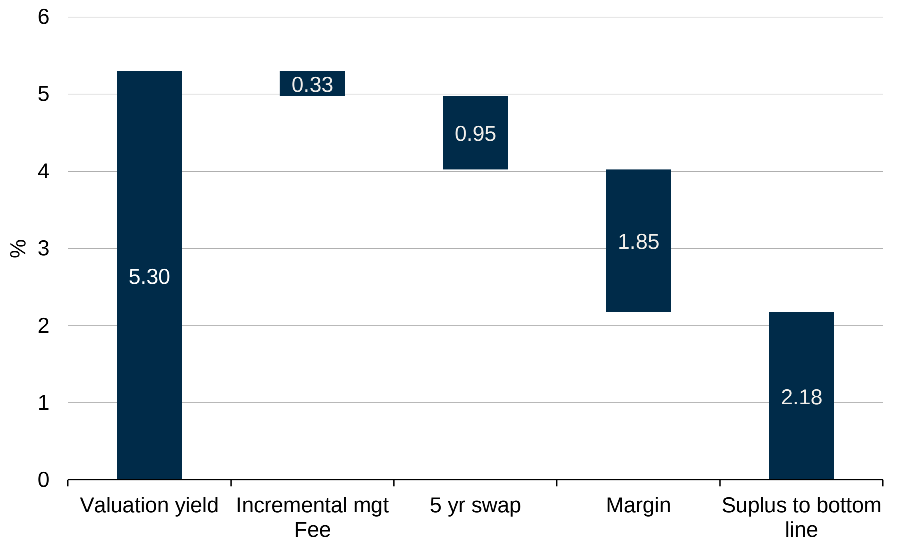


Source: Company & Numis Securities Research

Accretive margin on new investments

Importantly, in our view, there remains a comfortable margin over the incremental cost of acquiring new assets. Purchases should therefore be earnings-accretive and underpin further growth in the dividend over time.

Figure 20: Illustrative Yield Gap on New Investments as at 31 Dec 2015

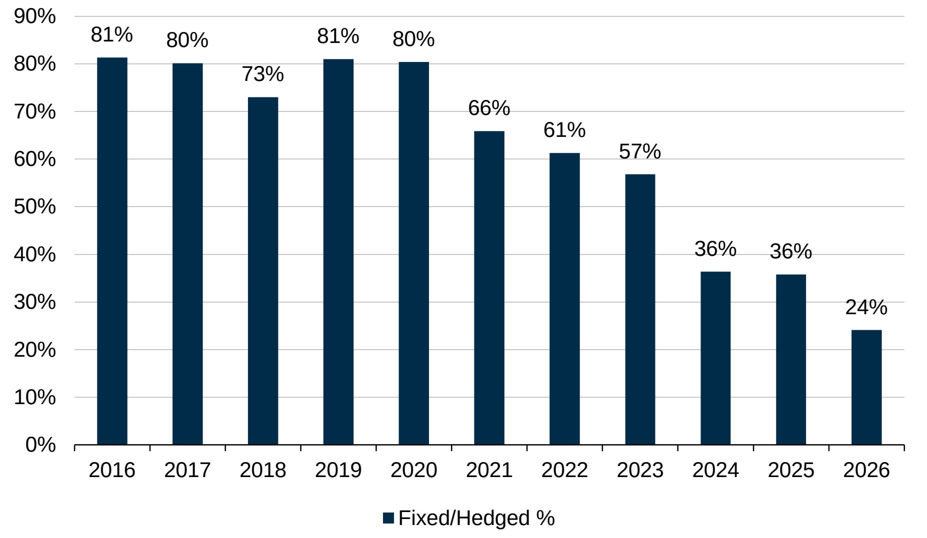


Source: Company & Numis Securities Research

80% of debt fixed or hedged

Given the long average lease length of the portfolio, PHP uses interest rate swaps to mitigate exposure to variable interest-rate risk. Its policy is to maintain the proportion of floating rate interest exposure at between 20-40% of total interest rate cost. Currently, c.80% of debt is fixed or hedged to 2020, with a longer term hedging profile as follows:

Figure 21: PHP Debt Hedging Profile



Source: Company & Numis Securities Research

The portfolio of interest rate swaps are with RBS, AIB, HSBC and Barclays and were put in place at various dates. As at 31 December, floating to fixed interest rate swaps with a contract value of £126m were in effect at a weighted average interest rate of 3.9%. Some of these will be replaced by forward starting swaps that will fix the interest rate on £180m of debt from H2 2016 onwards. In addition, PHP has one £15m interest rate cap at 2%. As at 31 December 2015, the mark-to-market valuation of the swap portfolio was an unrealised liability of £35.3m.

Will break swaps on an opportunistic basis only

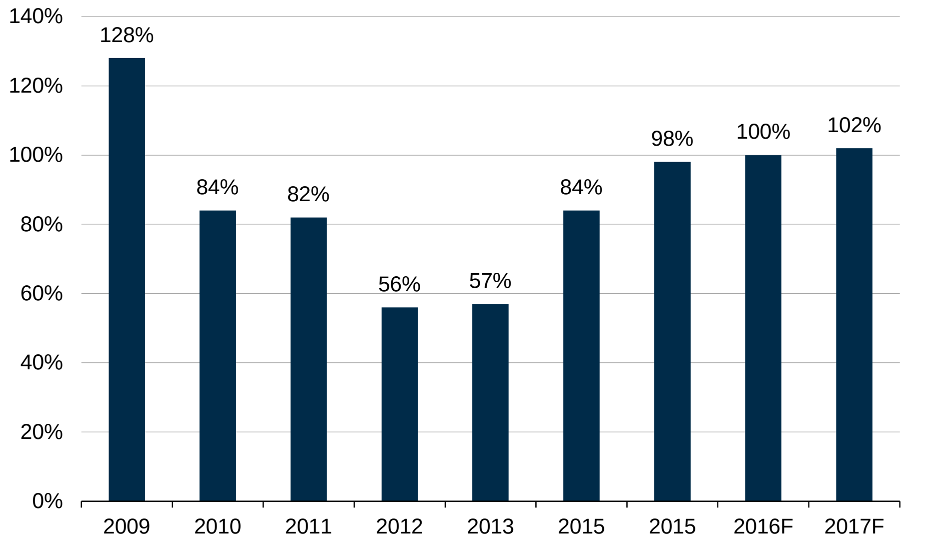
This is an accounting adjustment which continues to be volatile in a low interest rate environment, although it does not impact the company's cash flows. In theory, the liability could crystallise if PHP were to repay the related debt or cancel its swaps. Management opportunistically repaid c.£80m of shorter-dated swaps in 2015, crystallising a break cost of £3.2m (0.8p). However, these were replaced by attractively priced forward starting swaps and generated a £250,000 pa interest cost saving, reducing the average interest cost by c.48bps in the period. We believe that management will only cancel swaps where they can see value and not on a wholesale basis.

Impressive dividend growth record

19 years of dividend growth

Given the visibility of its income, and tight control on costs, PHP has built an impressive track record of growing dividends over the past 19 years. Historically, the company has maintained a high level of dividend cover from recurring cash flows. However, rising debt costs in 2012 (refinance of bi-laterals and issue of retail bond) resulted in a temporary fall in dividend cover below historic levels. Through a combination of acquisitions, rental growth and management action to reduce operating and debt costs, PHP returned to a fully covered dividend position in H2 2015. Our forecasts assume that PHP can continue to grow its dividends (now paid quarterly) by c.2.5% in both 2016 and 2017, whilst remaining fully covered.

Figure 22: Dividend Cover Progression



Source: Company & Numis Securities Research

The following tables highlight our summary income statement and balance sheet forecasts for the next two years.

Financial Summary

Table 3: Summary Income Statement

(£m)	2015A	2016F	2017F
Net rental income	62.3	65.5	68.0
Admin costs	(6.8)	(7.3)	(7.5)
Net finance costs	(33.7)	(35.2)	(36.7)
Recurring PBT	21.7	23.0	23.8
Recurring EPS	4.9	5.1	5.3
Growth		*5.7%*	*3.8%*
DPS	5.00	5.125	5.25
Growth		*2.5%*	*2.4%*
Dividend Cover	*98%*	*100%*	*102%*
Shares in issue	446	446	446

Source: Company & Numis Securities Research

Rental growth: We assume modest rental growth of 1% on one-third of the portfolio each year. This will be bolstered by c.£50m of acquisitions in 2016, and 2017. Risks to these forecasts include a better or worse rental growth result or the addition of fewer or greater value of new assets than we currently estimate.

Finance Costs/Debt: Assumes current agreed facilities only with a blended cost of c.4.8% in 2016 and 4.7% in 2017.

Admin Costs: As gross assets grow the fee will ratchet down as follows:

Table 4: Adviser and Fee base

Gross Asset Value	Fee rate
First £250m	0.50%
Between £250-£500m	0.48%
Between £500-£750m	0.40%
Between £750- £1bn	0.38%
Between £1- £1.25bn	0.32%
Above £1.25bn	0.30%

Source: Company & Numis Securities Research

Our summary balance sheet assumptions are as follows:

Table 5: Summary Balance Sheet

	2015A	2016F	2017F
Property (£m)	1,101	1,179	1,243
Total Assets (£m)	**1,108**	**1,186**	**1,250**
Debt (£m)	(698)	(748)	(798)
Total Liabilities (£m)	**(762)**	**(812)**	**(862)**
Basic NAV	345	374	387
Basic NAV (p)	77	84	87
EPRA NAV (£m)	392	409	423
EPRA NAV (p)	88	92	95
LTV (%)	*63%*	*63%*	*64%*

Source: Company & Numis Securities Research

Total Assets: We forecast the addition of £50m new assets in both 2016 and 2017. We also assume further valuation uplifts of c.£28m in 2016 and £14m in 2017, reflecting the revaluation of construction assets as well as modest yield compression on the existing fully completed portfolio.

Debt: We assume that PHP draws down on its existing debt facilities to fund portfolio growth. We have not assumed that any new significant facilities are signed.

Risks to our estimates include upwards or downwards yield shift in excess of our current forecasts, a significant difference in the quantum and pricing of new debt.

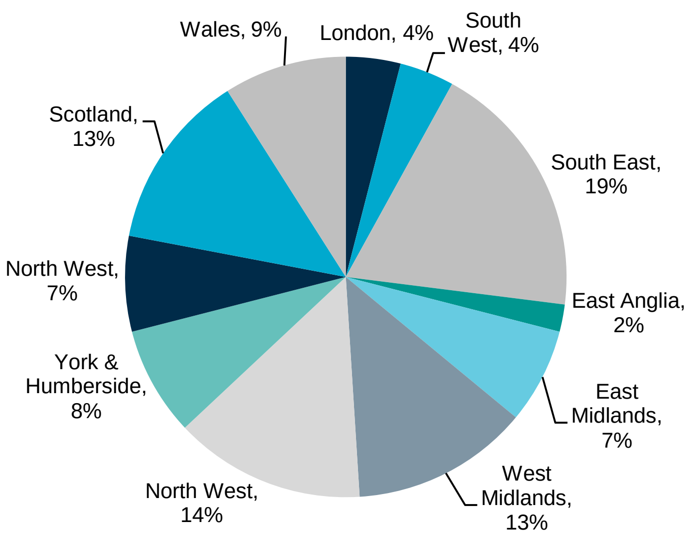
Appendix

PHP Portfolio Overview

Long leases with growth potential

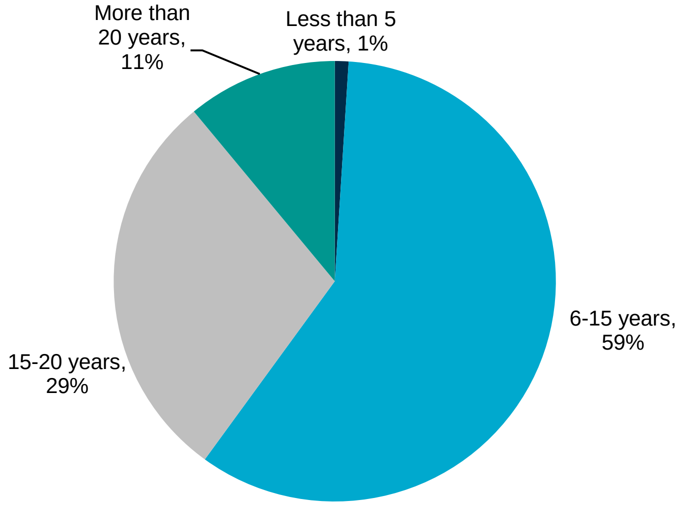
As at 31 December 2015, the portfolio comprised 273 assets (of which six are under construction). The number of tenancies on completed assets totalled 583, generating £61.8m of rent. The assets are well diversified by location, with a weighted-average unexpired lease term of 14.7 years.

Figure 23: Portfolio by Region



Source: Company & Numis Securities Research

Figure 24: Lease Length



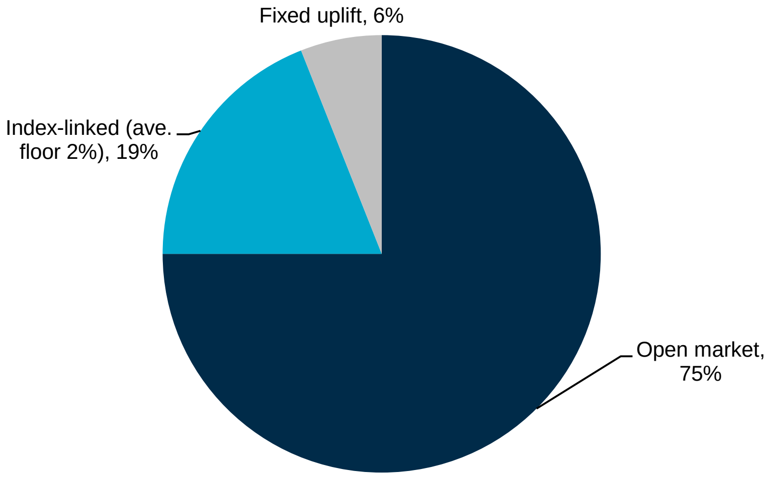
Source: Company & Numis Securities Research

More than 40% of the rent roll has more than 15 years remaining, but where leases are shorter than average, management undertakes asset management initiatives to enhance longevity of income. PHP invested £2.5m of capital across seven projects in 2015, generating £0.3m of additional rental income and securing an average of 19.4 additional years of lease terms. Two further projects are currently in progress, for a total capital cost of £1.5m, generating additional rent of £0.1m pa and an average additional term of 12 years.

Regular Upward-Only Rent Reviews

Typically 10% of leases are reviewed annually, 77% on a three yearly basis and 13% every five years. 19% of leases are linked to RPI with an average floor of 2.0% pa and 6% of leases have a fixed uplift of 2.65% pa on average. The balance is subject to effective upwards-only open market reviews, agreed with the District Valuer's Office, a government agency. Key inputs into deciding a fair rent include the replacement cost of the asset, as well as general inflation and market evidence. In particular, replacement costs continue to rise, driven by tighter building regulation, higher specification requirements and increasing raw material prices. This should support rental growth across the portfolio over the medium-term.

Figure 25: Lease Review Profile



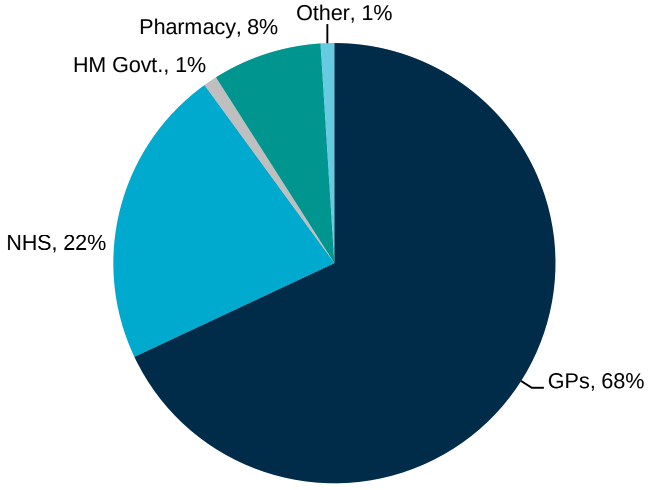
Source: Company & Numis Securities Research

The regular upward-only rent review profile gives management high visibility of cash flow, particularly compared with general commercial real estate operators. PHP can expect to receive minimum future lease payments of at least £899m from its existing asset base, excluding any future rental growth.

Strong Tenant Covenant

Another comfort factor for dividends is the strength of the underlying tenant covenant. Of the total income, 91% is paid either directly or indirectly by the UK government.

Figure 26: Strong Tenant Covenant



Source: Company & Numis Securities Research

Government reimburses GP rent costs

In the case of GP tenants, the typical payment structure is quarterly. The most common lease in the portfolio provides that the relevant government body (NHS or PCT) pays GPs the current market rent for their premises, plus an allowance of 5% for any repairs. In turn, GPs pay the current market rent to PHP and accept responsibility for all repairs and maintenance. 8% of rent comes from pharmacy operators including national players such as Lloyds, Rowlands and Boots. Their premises are usually next to GP surgeries, have co-terminus leases and command a higher rent per sq ft.

Peer Group Summary

There are three London listed players investing solely in primary health assets. The following tables and charts provide a summary of peer group portfolios and property strategies.

Table 6: Portfolio Summary

Company	Completed	Committed	Total	Ave. age	Ave. lot size	Ave. lease	Portfolio value	Valuation yield	Valuers
	Assets	Assets	Assets	Yrs	%	Yrs	£m	NIY/True Equiv %	
Primary Health Props (Dec 15)	267	6	273	9	4.1	14.7	1100	5.32/5.52	Lambert Smith Hampton
Assura Group (Sept 15)	301	4	305	11	3.2	14.1	1025	5.42/5.81	Savills/Jones Lang La Salle
Medicx Fund (Dec 15)	143	6	150	7.2	4.0	15.8	583	5.40/not published	Jones Lang LaSalle

Source: Company & Numis Securities Research

PHP has the largest portfolio by value, comprising 273 assets. Assets are modern with an increasingly growing lot size, as the market continues to move towards the delivery of larger primary health facilities. PHP sources new build assets from a variety of developers and has a number of exclusivity arrangements in place to access new stock. Assura develops its own new build assets as well as acquiring from third parties. MXF sources properties from both third parties and the development arm of the investment adviser to the fund.

As the table below illustrates, the sector receives a large portfolio of its rental income either directly or indirectly (through rent reimbursement) from the UK government.

Table 7: Lease Summary

		Annual Rent Analysis			Rent Reviews	
Company	Rent Roll Fully Built	NHS/GPs	Pharmacies	Other	RPI/Fixed	Open market
	£m	%	%	%	%	%
Primary Health Props (Dec 15)	63.7	91	8	1	25	75
Assura Group (Sept 15)	59.6	87	8	5	20	75
Medicx Fund (Dec 15)	36.4	90	8	0	28	72

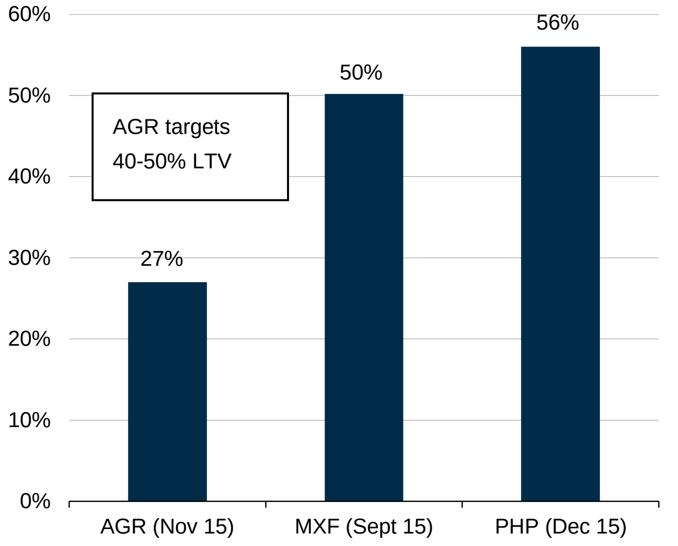
Source: Company & Numis Securities Research

Reflecting the predictability of revenue streams and the deep debt market for healthcare assets, the peer group operate with higher overall levels of leverage compared with the general commercial property market.

PHP currently has the highest overall LTV at 55% (excluding the convertible which is in the money). However, we believe it is important to note that no individual debt line contains a group level LTV covenant. Individual debt lines have their own covenant levels and remain comfortably within these.

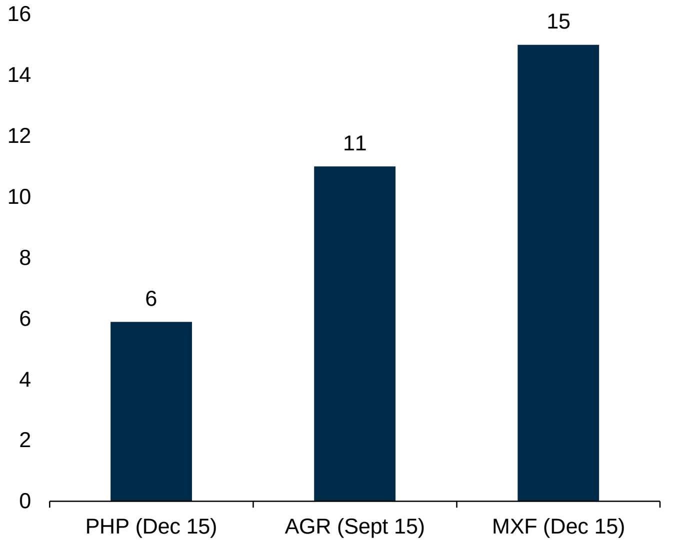
Following a sizeable equity raise, AGR recently reset a portion of its more expensive debt and reduced its overall borrowings, reducing LTV to 27%. This is expected to increase to c.35% on completion of the pipeline. Thereafter, AGR management has an LTV target of 40-50%.

Figure 27: Peer Group LTV (%)



Source: Company & Numis Securities Research

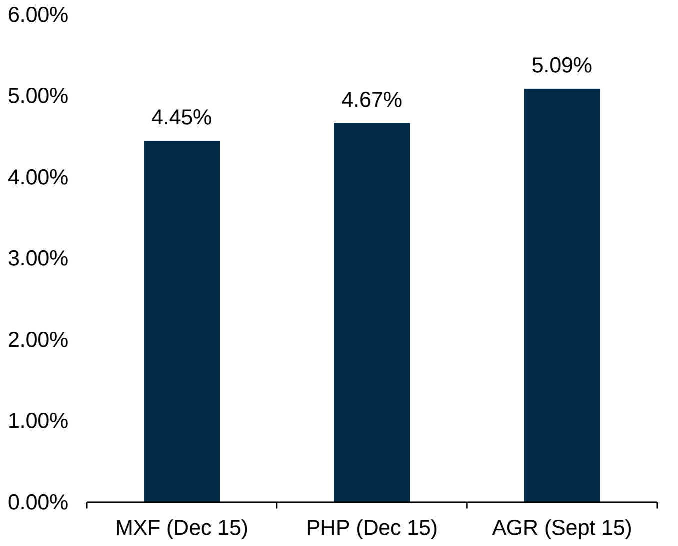
Figure 28: Average Debt Maturity (years)



Source: Company & Numis Securities Research

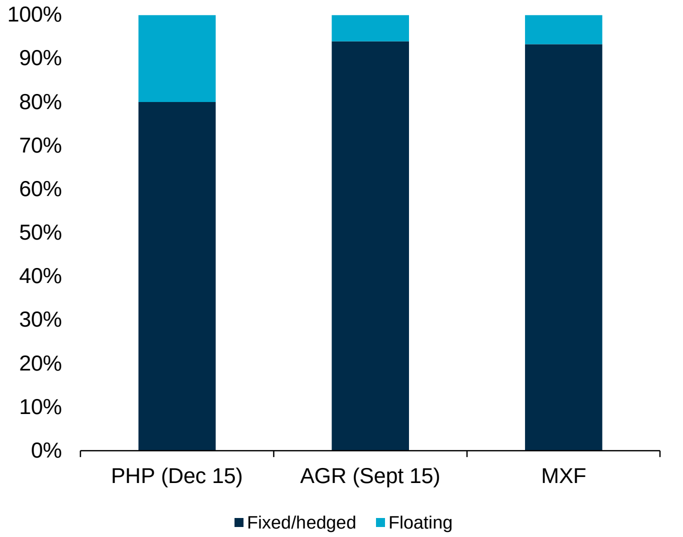
Medicx Fund has the longest average maturity of debt, closely matching the average lease length of the portfolio. In addition, overall facilities attract a lower average cost compared with the peer group. PHP has the shortest average maturity. As opportunity arises to refinance facilities and/or the swap book, PHP will seek to maintain or extend longevity whilst seeking to reduce the blended cost of debt.

Figure 29: Average Cost of Debt



Source: Company & Numis Securities Research

Figure 30: Interest Rate Exposure

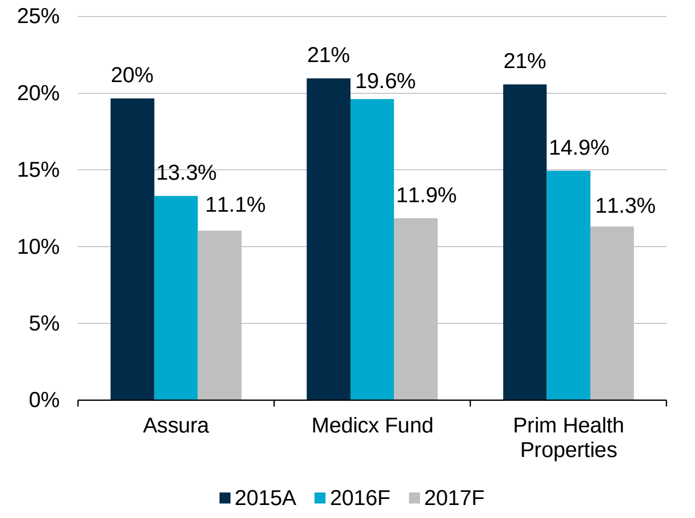


Source: Company & Numis Securities Research

Trading Statistics

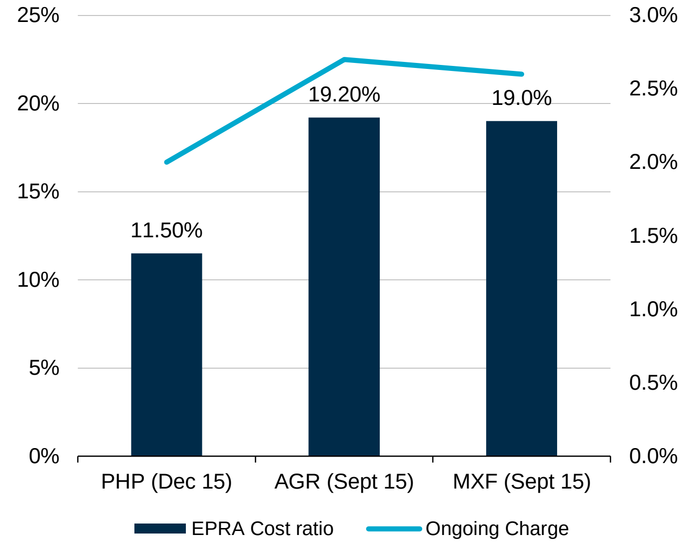
The following charts illustrate the current valuations across the peer group. The market continues to assign a premium to companies with strong income characteristics and a defensive asset base. In particular where there is a government covenant such as listed infrastructure or primary health. We expect this to remain the case in the current low interest rate environment.

Figure 31: Premium to EPRA NAV (Hist. and Forecast)



Source: Company & Numis Securities Research; Factset Consensus AGR and MXF

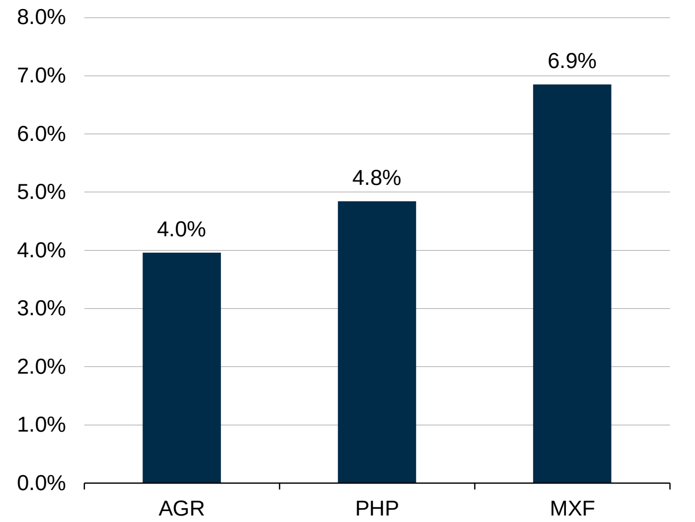
Figure 32: EPRA Cost Ratio/Ongoing Chare Ratio



Source: Numis Securities Research

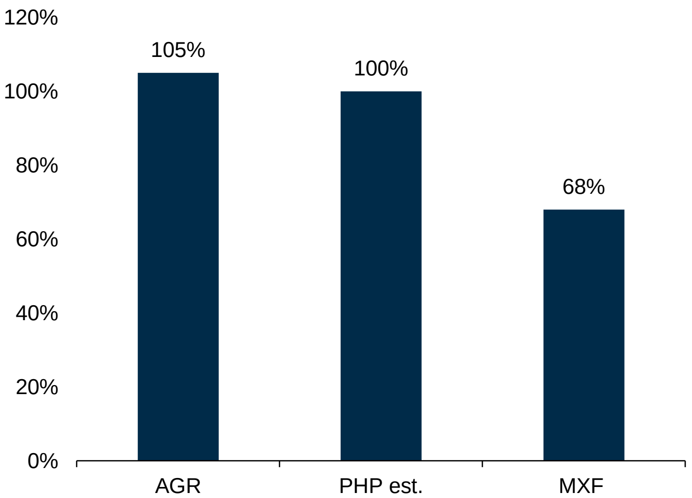
Compared with listed infrastructure funds, the wider premium for healthcare property can generally be justified by an expectation of greater near term NAV growth as well as asset ownership (PPP funds invest in finite life concessions where the asset reverts to government ownership at the end of the contract). In our view, the wider premium versus commercial property can be justified by the lower volatility of asset values and relatively high dividend yields on offer.

Figure 33: Dividend Yield



Source: Company & Numis Securities Research

Figure 34: Dividend Cover



Source: Company & Numis Securities Research

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