

Primary Health Properties

FY14 results

Asset growth on track

Real estate

A trading update to coincide with its AGM, covering the period from 1 January to 22 April 2015, confirms the group to be on track for the asset and profit growth we forecast following the FY14 results in March. We have made no changes to our underlying estimates. Primary Health Properties (PHP) provides growing dividends and an attractive 5.0% prospective yield. Cash flows are generated from a broad portfolio of government-backed healthcare facilities on long leases. Portfolio growth, lower funding costs and a lower expense ratio drove FY14 growth and we expect a full contribution from funding and expense benefits in 2015, while portfolio growth is ongoing. With profit growth, we expect full dividend cover by H216, despite a progressive dividend.

Year end	Revenue (US\$m)	PTP* (US\$m)	EPADR (c)	DPADR (c)	Gross yield (%)	EPRA NAV/ share (\$)
12/13	63.0	10.2	22.8	57.0	4.8	8.99
12/14	90.0	27.3	49.2	58.5	4.8	9.56
12/15e	94.6	30.4	54.2	60.0	5.0	9.85
12/16e	102.3	33.5	59.7	61.5	5.1	10.25

Note: Converted at £1/US\$1.50 Dividend yield excludes withholding tax. Investors should consult their tax advisor regarding the application of any domestic and foreign tax laws.

FY15 on track

During the period covered by the trading update, three new acquisitions with an aggregate value of £15.7m were funded from existing facilities, with £95m of headroom remaining. The pipeline of investment opportunities remains strong and a fourth acquisition has subsequently been announced, taking the year-to-date total to £22.4m, consistent with our full-year forecasts published in our [update note](#) following the FY14 results in March. 1.9% rental growth was achieved on lease renewals in the period, although management cautiously expects the full-year increase to be slightly down on FY14 (1.8%).

Attractive growth market

The primary healthcare property market has good medium-term growth prospects, and PHP's leading position and good developer relationships leave it well placed to benefit. Leases are long and with upwards-only rent revisions, and tenant quality is excellent, being largely government risk or pharmacies. While the outcome of the general election remains finely balanced, there is general consensus among all parties that the NHS requires additional funding. The NHS England five-year plan seeks to deliver additional and more integrated services in the community, based around the GP. Additional modern, purpose-built and flexible premises of the kind provided by long-term investors like PHP will be required to achieve this.

Valuation: Growing dividends and cover

PHP's assets deliver secure cash flows from mainly government-backed revenues, supporting a high payout and growing dividends. Healthcare property values (and PHP NAV) are also benefiting from mild yield compression, but historical performance has shown much less volatility than the broad commercial sector.

24 April 2015

Price **\$12.0***
Market cap **\$668m**

ADR/Ord conversion ratio 1:2

*underlying GBP price converted at US\$1.5

Net debt (\$m) at 31 March 2015 993.3m

ADRs in issue 55.65m

ADR Code PYHPY

ADR exchange OTC

Underlying exchange LSE

Depository BNY

Business description

Primary Health Properties is a long-term investor in primary healthcare property in the UK, principally let long term to GPs and NHS organisations backed by the UK government. The tenant profile and long average lease duration provide an exceptionally secure rental outlook.

Next event

H115 results July/August 2015

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Summary of trading update

The trading update, timed to coincide with the company's AGM, covers the period from 1 January 2015 to 22 April 2015.

With its FY14 results, management indicated a strong pipeline of acquisition opportunities, and that a number of transactions were nearing completion. Since then it has contracted to fund the development of three new properties (two included in the trading update and one subsequently announced) and additionally to acquire one new standing property, all on long leases. The acquisitions take the number of properties in the portfolio to 269 (262 completed), with an aggregate value of c £1.06bn. The most recent announcement covers the agreement to forward fund the development and acquire at completion a modern, purpose-built medical center in East Anglia for £6.7m. It will be let to a GP practice and pharmacy operator on lease terms of 25 years at completion, expected by Q216. This asset originates from the pipeline agreement entered into with Apollo when PHP acquired its portfolio in December 2012. Other pipeline opportunities, already in solicitors' hands, being appraised or under negotiations, remain strong, covering a mix of completed, immediately income-producing assets, as well as forward-funding commitments. £22.4m of investment commitment year to date is consistent with our assumption of £60m in FY15 (FY14 £43m).

For FY16 we are assuming an increase to £97m, anticipating a thawing of the logjam of new development approvals by the NHS, particularly after the general election. For FY15 we assume that the majority of new commitments are to forward-fund properties under development (£38m), with the balance to immediately income-producing assets. Additionally, we assume £40m of development assets transfer to income-producing assets during the year. All the development assets are pre-let and PHP does not undertake speculative development. During the period, Fountains Medical Centre in Chester was completed, triggering rents of £1.13m pa. 16 completed rent reviews in the period generated average annualized increases of 1.9%. This is slightly ahead of FY14 (1.8%), although management continues to expect growth for the year as a whole to be slightly lower. The total contracted rent roll (including all developments that are on-site) increased to £61.7m from £60.9m at FY14 period end with an average unexpired lease term of 15.2 years (FY14 15.3 years).

While the outcome of the general election remains finely balanced, there is a general consensus among all parties that additional funding needs to be made available to the NHS in support of the strategy laid out in Simon Stevens' five-year plan for NHS England. That plan acknowledges the need for significant change, and seeks to deliver additional and more integrated services in the community, based around the GP. Additional modern, purpose-built and flexible premises of the kind provided by long-term investors like PHP will be required to achieve this. Management says it has seen the first awards made from the £1bn Primary Care Infrastructure Fund established in the November autumn statement. This is aimed at facilities enhancement and 12 PHP properties have been allocated funding.

After a busy period of refinancing in 2014, there were minimal changes in funding in the period. The new acquisitions were funded under existing facilities. Net debt at 31 March was £662.3m with available headroom of £95m. The group LTV of 63.9% is slightly down on 64.1% at FY14 end.

Portfolio valuation gains, especially driven by yield contraction, were a feature of FY14. Our forecasts include additional gains in FY15 (£12.7m) and FY16 (£15.4m), driven by rent growth with an unchanged valuation yield. With expectations of interest rate increases continuing to fall, a further decline in valuation yield remains possible. The next external valuation will be at mid-year. This interest rate environment has increased the total mark-to-market liability of the derivative portfolio to £42.4m as at 31 March 2015 (FY14 £41.0m), but there is no cash impact or impact on EPRA NAV.

Exhibit 1: Financial summary (as reported in sterling)

	£'000s	2012	2013	2014	2015e	2016e
		IFRS	IFRS	IFRS	IFRS	IFRS
Year end 31 December						
PROFIT & LOSS						
Revenue		33,151	41,982	59,985	63,061	68,202
Cost of Sales		(402)	(398)	(723)	(877)	(949)
Gross Profit		32,749	41,584	59,262	62,184	67,254
Administrative expenses		(5,124)	(6,080)	(6,782)	(6,450)	(6,892)
EBITDA		27,625	35,504	52,480	55,734	60,362
Other income and expenses		0	638	0	0	0
Non-recurring items		0	(2,702)	(2,426)	0	0
Net valuation gain on property portfolio		(1,768)	2,313	29,204	12,718	15,360
Operating profit before financing costs		25,857	35,753	79,258	68,451	75,721
Net Interest		(20,242)	(26,016)	(34,275)	(35,496)	(38,004)
Non-recurring finance income/expense		0	0	0	0	0
Early loan repayment fees		(1,564)	(950)	(1,187)	0	0
Fair value gain/(loss) on interest rate derivatives and convertible bond, and swap amortization		(2,922)	11,432	(6,916)	0	0
Profit Before Tax (FRS 3)		1,129	20,219	36,880	32,956	37,717
Tax		1	1	0	0	0
Profit After Tax (FRS 3)		1,130	20,220	36,880	32,956	37,717
Adjusted for the following:						
Net gain/(loss) on revaluation		1,768	(2,313)	(29,204)	(12,718)	(15,360)
Fair value gain/(loss) on derivatives & convertible bond		2,922	(11,432)	6,916	0	0
Profit on termination of finance lease		0	(-638)	0	0	0
Early loan repayment fees		1,564	950	1,187	0	0
Issue costs of convertible bond		0	0	2,426	0	0
EPRA basic earnings		7,384	6,787	18,205	20,238	22,358
Period end number of shares (m)		76.0	110.5	111.3	111.4	111.6
Average Number of Shares Outstanding (m)		72.7	89.1	111.0	112.1	112.3
Fully diluted average number of shares outstanding (m)		72.7	89.1	124.1	117.0	117.2
EPS - basic (p)		1.6	22.7	33.2	29.4	33.6
EPS - fully diluted (p)		1.6	22.7	31.5	31.2	35.2
EPRA EPS (p)		10.2	7.6	16.4	18.1	19.9
Dividend per share (p)		18.5	19.0	19.5	20.0	20.5
Dividend cover		56%	41%	84%	90%	97%
BALANCE SHEET						
Fixed Assets		625,547	942,020	1,026,232	1,098,950	1,211,309
Investment properties		622,447	941,548	1,026,207	1,098,925	1,211,284
Net investment in finance leases		3,100	0	0	0	0
Derivative interest rate swaps		0	472	25	25	25
Current Assets		28,033	14,052	17,740	13,125	13,597
Trade & other receivables		2,916	4,764	5,668	5,125	5,597
Net investment in finance leases		21	0	0	0	0
Cash & equivalents		25,096	9,288	12,072	8,000	8,000
Current Liabilities		(107,519)	(39,635)	(33,065)	(37,637)	(39,113)
Term loans		(79,934)	(3,843)	(711)	(3,513)	(3,513)
Trade & other payables		(10,687)	(16,269)	(14,244)	(16,014)	(17,490)
Derivative interest rate swaps		(7,523)	(7,566)	(5,802)	(5,802)	(5,802)
Deferred rental income		(7,811)	(11,934)	(12,308)	(12,308)	(12,308)
Other		(1,564)	(23)	0	0	0
Long Term Liabilities		(366,971)	(614,052)	(701,777)	(754,090)	(850,045)
Term loans		(247,905)	(460,185)	(437,022)	(489,335)	(585,290)
Bonds		(73,755)	(132,408)	(229,543)	(229,543)	(229,543)
Derivative interest rate swaps		(45,311)	(21,459)	(35,212)	(35,212)	(35,212)
Net Assets		179,090	302,385	309,130	320,347	335,748
Derivative interest rate swaps		52,834	28,553	40,989	40,989	40,989
Change in fair value of convertible bond		0	0	4,462	4,462	4,462
EPRA net assets		231,924	330,938	354,581	365,798	381,199
IFRS NAV per share (p)		236	274	278	287	301
EPRA NAV per share (p)		305	300	319	328	341
CASH FLOW						
Operating Cash Flow		35,432	36,682	49,020	58,047	61,365
Net Interest & other financing charges		(20,339)	(30,430)	(49,633)	(35,496)	(38,004)
Tax		0	0	(23)	0	0
Acquisitions/disposals		(45,519)	(54,731)	(54,396)	(60,000)	(97,000)
Net proceeds from issue of shares		18,399	65,232	17	0	0
Equity dividends paid (net of scrip)		(12,209)	(16,130)	(20,688)	(21,738)	(22,316)
Other (including debt assumed on acquisition)		(51,000)	(211,273)	7,647	0	0
Net Cash Flow		(75,236)	(210,650)	(68,056)	(59,187)	(95,955)
Opening net debt/(cash)		(301,262)	(376,498)	(587,148)	(655,204)	(714,391)
Closing net debt/(cash)		(376,498)	(587,148)	(655,204)	(714,391)	(810,346)

Source: Company data, Edison Investment Research

Exhibit 2: Financial summary (translated to US\$ at £1=US\$1.50)

	US\$000s	2012	2013	2014	2015e	2016e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		49,727	62,973	89,978	94,592	102,303
Cost of Sales		(603)	(597)	(1,085)	(1,316)	(1,423)
Gross Profit		49,124	62,376	88,893	93,276	100,881
Administrative expenses		(7,686)	(9,120)	(10,173)	(9,676)	(10,338)
EBITDA		41,438	53,256	78,720	83,601	90,542
Other income and expenses		0	957	0	0	0
Non-recurring items		0	(4,053)	(3,639)	0	0
Net valuation gain on property portfolio		(2,652)	3,470	43,806	19,076	23,040
Operating profit before financing costs		38,786	53,630	118,887	102,677	113,582
Net Interest		(30,363)	(39,024)	(51,413)	(53,244)	(57,006)
Non-recurring finance income/expense		0	0	0	0	0
Early loan repayment fees		(2,346)	(1,425)	(1,781)	0	0
Fair value gain/(loss) on interest rate derivatives and convertible bond, and swap amortization		(4,383)	17,148	(10,374)	0	0
Pre Tax Profit (FRS 3)		1,694	30,329	55,320	49,433	56,576
Tax		2	2	0	0	0
Profit After Tax (FRS 3)		1,695	30,330	55,320	49,433	56,576
Adjusted for the following:		0	0	0	0	0
Net gain/(loss) on revaluation		2,652	(3,470)	(43,806)	(19,076)	(23,040)
Fair value gain/(loss) on derivatives & convertible bond		4,383	(17,148)	10,374	0	0
Profit on termination of finance lease		0	(957)	0	0	0
Early loan repayment fees		2,346	1,425	1,781	0	0
Issue costs of convertible bond		0	0	3,639	0	0
EPRA basic earnings		11,076	10,181	27,308	30,357	33,536
Period end number of ADRs (m)		38.0	55.2	55.6	55.7	55.8
Average Number of ADRs Outstanding (m)		36.3	44.6	55.5	56.0	56.1
Fully diluted average number of ADR outstanding (m)		36.3	44.6	62.1	58.5	58.6
EPADR - basic (\$c)		4.7	68.1	99.6	88.2	100.8
EPADR - fully diluted (\$c)		4.7	68.1	94.4	93.6	105.6
EPRA basis EPADR (\$c)		30.5	22.8	49.2	54.2	59.7
Dividend per ADR (\$c)		55.5	57.0	58.5	60.0	61.5
Dividend cover		56%	41%	84%	90%	97%
BALANCE SHEET						
Fixed Assets		938,321	1,413,030	1,539,348	1,648,424	1,816,964
Investment properties		933,671	1,412,322	1,539,311	1,648,387	1,816,927
Net investment in finance leases		4,650	0	0	0	0
Derivative interest rate swaps		0	708	38	38	38
Current Assets		42,050	21,078	26,610	19,687	20,395
Trade & other receivables		4,374	7,146	8,502	7,687	8,395
Net investment in finance leases		32	0	0	0	0
Cash & equivalents		37,644	13,932	18,108	12,000	12,000
Current Liabilities		(161,279)	(59,453)	(49,598)	(56,456)	(58,670)
Term loans		(119,901)	(5,765)	(1,067)	(5,270)	(5,270)
Trade & other payables		(16,031)	(24,404)	(21,366)	(24,021)	(26,236)
Derivative interest rate swaps		(11,285)	(11,349)	(8,703)	(8,703)	(8,703)
Deferred rental income		(11,717)	(17,901)	(18,462)	(18,462)	(18,462)
Other		(2,346)	(35)	0	0	0
Long Term Liabilities		(550,457)	(921,078)	(1,052,666)	(1,131,135)	(1,275,067)
Term loans		(371,858)	(690,278)	(655,533)	(734,002)	(877,935)
Bonds		(110,633)	(198,612)	(344,315)	(344,315)	(344,315)
Derivative interest rate swaps		(67,967)	(32,189)	(52,818)	(52,818)	(52,818)
Net Assets		268,635	453,578	463,695	480,521	503,622
Derivative interest rate swaps		79,251	42,830	61,484	61,484	61,484
Change in fair value of convertible bond		0	0	6,693	6,693	6,693
EPRA net assets		347,886	496,407	531,872	548,697	571,799
IFRS NAV per ADR (\$c)		707	821	833	862	902
EPRA NAV per ADR (\$c)		915	899	956	985	1,024
CASH FLOW						
Operating Cash Flow		53,148	55,023	73,530	87,071	92,048
Net Interest & other financing charges		(30,509)	(45,645)	(74,450)	(53,244)	(57,006)
Tax		0	0	(35)	0	0
Acquisitions/disposals		(68,279)	(82,097)	(81,594)	(90,000)	(145,500)
Net proceeds from issue of shares		27,599	97,848	26	0	0
Equity dividends paid (net of scrip)		(18,314)	(24,195)	(31,032)	(32,608)	(33,475)
Other (including debt assumed on acquisition)		(76,500)	(316,910)	11,471	0	0
Net Cash Flow		(112,854)	(315,975)	(102,084)	(88,780)	(143,932)
Opening net debt/(cash)		(451,893)	(564,747)	(880,722)	(982,806)	(1,071,586)
Closing net debt/(cash)		(564,747)	(880,722)	(982,806)	(1,071,586)	(1,215,519)

Source: Company accounts, Edison Investment Research

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