PRIMARY HEALTH PROPERTIES PLC (LON: PHP)

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20 February 2020

Real Estate

52-WEEK HIGH	**£163.40**
52-WEEK LOW	**£116.20**
PRICE	**£161.80**
MARKET CAP MLN	£1,946.08

Share Price

Major Shareholders

Blackrock inc 5.0%	
Investec Wealth & Investment 5.0%	
CCLA Investment Management 4.9%	
Shares in issue	1,216,321,774
Avg Three-month trading volume	3,013,559
Primary Index	MAIN
Next Key Announcement	FY result Feb 2020

Company Information

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Primary Health Properties - Winning returns, lowest costs

Strong results for 2019, well positioned for 2020

Primary Health Properties PLC (LON:PHP) recently announced its full-year results to December 2019. These were in line with our forecast and confirmed a strong year for the company. Earnings per share as measured by the adjusted EPRA EPS (see footnotes to the table) grew by 5.8%, and the dividend (full-year total) was increased to 5.6p.

Following the transformational merger with MedicX (another primary healthcare real estate investment trust, or REIT) in March 2019, the company has fully delivered on the key merger objectives – integrating the companies, a reduction of £4mln in the cost base, and financing cost reduced by half a percentage point to 3.5%. The success of the merger was a significant contributor to the strong share performance in the year, in our view.

Drivers for 2020

With the merger objectives largely complete, we believe that the focus for 2020 returns to the more organic value drivers. The company has six new developments on site for completion in 2020, and a pipeline of property acquisition targets. Furthermore, we expect to see more asset management projects to increase the value of the existing portfolio. In addition, we believe that there will be a continuation of the improved trend in rental uplifts in the UK market. We provide an overview of these drivers on p2.

Positive developments in the last few months

The last 12 months have been another period of strong returns for PHP shareholders; in fact, PHP has outperformed (in total returns) versus the FTSE 350 and versus the EPRA UK REIT index (UK property fund index) over the last one year, three years, and five years. Some factors underpinning this performance include:

- Dividend growth every year since inception — 23 years.
- 90% of rents covered by government national health bodies of the UK and Ireland. This supports 99.5% occupancy rates and minimal tenant defaults or similar unplanned costs.
- The lowest cost ratio (costs / rental income) in the entire UK REIT space.
- Headroom to continue growing the portfolio of health centres in the UK and Ireland.

We believe that the conditions remain in place for continued strong returns to shareholders in the coming years.

Year end Dec 31	2018	Current	2020	2021
Portfolio value (£mln)	1,502.9	2,413.0	2,575.0	2,745.0
Net rental income (£mln)	76.4	115.7	130.5	138.6
EPRA earnings (£mln)	36.8	59.7	73.5	77.4
EPRA EPS (GBp)	5.2	5.4	5.9	6.2
DPS (GBp)	5.40	5.60	5.90	6.10
EPRA NAV / share (GPp)	105.1	107.9	109.9	113.4
Gearing (LTV%)	44.8	44.2	47.2	49.0

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* EPRA is the European Public Real Estate Association

* EPRA definitions of earnings per share (EPS) and net asset value (NAV) are industry standards. Definitions can be found at www.epra.com

Harry Hyman, managing director. Hyman has extensive experience in investing in the primary healthcare sector, having developed PHP's business from inception more than 20 years ago. He is a graduate of Cambridge University and a fellow of the Institute of Chartered Accountants in England & Wales.

Richard Howell, finance director. Howell is a chartered accountant and has more than 20 years' experience working with London-listed commercial property companies, including Brixton PLC and LondonMetric Property PLC.

Drivers for 2020

The strong share price performance in 2019 — a total return of 43.4% — was partly a reflection of the success of the merger of PHP with MedicX. The merger synergies have now been largely realised. For 2020, we believe that the company will focus its attention on organic measures to drive value. These include:

1. Property developments. The company has six ongoing health centre developments that are due to complete in 2020, with an area of 16,397 square metres. This compares with completions totalling 4,695 square metres during 2019.
2. The company has a pipeline of property acquisition targets totalling £160mln. With the current gearing ratio at 44.2% (38% excluding a convertible bond) and headroom in the available debt facilities, we believe that additional debt can be used to finance acquisitions, leading to earnings accretion.
3. The company sees opportunities to spend on upgrades to existing facilities. These initiatives usually generate a positive return in terms of rental income uplift, and also drive extensions to lease durations.

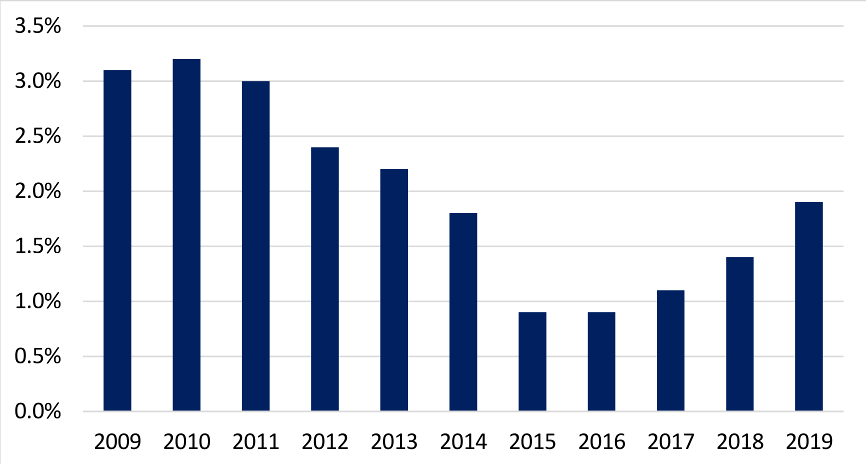
Finally, we note that the environment for rent reviews improved in 2019. Various mechanisms are used to review the level of rent receivable on PHP's healthcare properties. Some 69% of the portfolio is covered by open market value reviews, under which a government agency determines any rent increase (no decreases generally allowed).

In our view, the UK government was taking a very conservative view during the period 2015-2018; however, we believe that it has become clear that maintaining world-class healthcare infrastructure requires private sector investment. In 2018, and more so in 2019, we believe that the government agencies have taken a more realistic view of rents in order to encourage investment.

The following chart shows the levels of rental uplift that PHP has realised from its property portfolio. Our own view is that rent increases will remain at healthy levels in the 1.5-2.5% corridor in the coming years.

Rents escalations have improved in 2018 and 2019, following a softer period 2015-2017

Rental growth history



Source: Primary Health Properties

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