

Primary Health Properties

FY21 results

Continuing strong DPS growth well supported

Income visibility and security continue to be the hallmark of Primary Health Properties (PHP), now in its 26th year of unbroken dividend growth. FY21 showed strong progress despite a competitive market for acquisitions, driven by rent reviews and asset management, and operational and financial savings from management internalisation and debt refinancing.

Year end	Net rental income (£m)	Adjusted EPRA earnings* (£m)	Adjusted EPS** (p)	NAV per share*** (p)	DPS (p)	P/NAV (x)	Yield (%)
12/20	131.2	73.1	5.8	112.9	5.90	1.20	4.4
12/21	136.7	83.2	6.2	116.7	6.20	1.16	4.6
12/22e	140.6	86.2	6.5	120.7	6.50	1.12	4.8
12/23e	144.9	90.2	6.8	126.0	6.80	1.07	5.0

Note: *Excludes valuation movements, amortisation of fair value adjustment to acquired debt and other exceptional items. **Non-diluted. ***Defined as adjusted EPRA net tangible assets (NTA) excluding fair value of derivative interest rate contracts and convertible bond, deferred tax and fair value adjustment on acquired debt.

Management action supports underlying growth

FY21 adjusted EPRA EPS increased 6.9% to 6.2p, fully covering 6.2p of DPS (+5.1%). A Q122 DPS of 1.625p represents an annualised 6.5p (+4.8%). Adjusted EPRA NTA increased to 116.7p with property revaluation gains, driven by yield tightening and rent growth, partly offset by non-recurring items. Including DPS paid, the total return was 8.9%. Including c £4.0m pa of cost savings from management internalisation the EPRA cost ratio fell further to a sector leading 9.3% (FY20: 11.9%). Refinancing of high cost, legacy debt reduced average debt costs to 2.9% (end-FY20: 3.5%), with most of the £5m pa benefit to come in FY22. With 25% of rents index-linked and a positive outlook for open market settlements this should accelerate to at least 2% in FY22. Our forecasts are little changed.

Well placed to meet health service investment needs

The long-term need for primary healthcare facilities is driven by demographic trends and is relatively unaffected by economic conditions. In both the UK and Ireland, populations are growing and ageing, with more complex healthcare needs. There is no sign that the pandemic has reduced the need for primary care facilities, despite the use of online and telephone appointments, particularly for front-line triage. Indeed, the need for modern, integrated, local primary healthcare facilities is becoming yet more pressing to relieve the pressure being placed on hospitals. PHP is well-placed to help meet this need for investment and grow further; it has c £320m of available funding headroom and a strong pipeline of identified potential acquisitions, asset management projects and developments of more than £400m.

Valuation: Securely growing income

PHP's valuation is driven by its income visibility and security, with strong prospects for further growth in income and dividends. Leases are long and substantially upward-only leases, 90% backed directly or indirectly by government bodies, with little exposure to the economic cycle or fluctuations in occupancy. The FY22e DPS of 6.5p fully covered by Adjusted EPRA earnings, represents a yield of 4.8%, while the P/NAV has compressed to c 1.1x.

Real estate

1 March 2022

Price **134p**
Market cap **£1,800m**

Net debt (£m) at 31 December 2021	1,200
Net LTV at 31 December 2021	42.9%
Shares in issue	1,332.9m
Free float	97%
Code	PHP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(5.8)	(9.7)	(10.9)
Rel (local)	(5.0)	(12.6)	(20.7)
52-week high/low		169.6p	131.1p

Business description

Primary Health Properties is a long-term investor in primary healthcare property in the UK and the Republic of Ireland. Assets are mainly let on long leases to GPs and the NHS or HSE, organisations backed by the UK and Irish governments, respectively. The tenant profile and long average lease duration provide an exceptionally secure rental income stream.

Next events

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Continuing strong DPS growth well supported

FY21 was characterised by selective new investment in a competitive market, organic growth from rent reviews and asset management, development completions, and the generation of significant operational and financial savings from internalising the management structure and refinancing high-cost legacy debt. PHP's FY21 EPRA cost ratio of 9.3% is the lowest in the UK REIT sector and, with a competitive funding position (2.9% average cost of debt, all fixed or hedged, with a marginal funding cost of 1.8%), this maintains a positive spread versus property yields (FY21 portfolio net initial yield of 4.64%) and allows most of the growth in rental income to fall to the bottom line. We forecast a continuation of growth based on the following:

- With the loan to value ratio (LTV) at the low end of PHP's target range (42.9% versus a target of 40–50%) and significant debt headroom in place, PHP is well placed to capitalise on an investment pipeline of more than £400m, including standing asset acquisitions, asset management projects, forward fundings and an increasing proportion of higher-return direct development opportunities (c one-third of the total).
- Accelerating growth in rental income and additional gains from asset management projects.
- A full year impact from the FY21 refinancing, with remaining opportunities to further enhance the cost of borrowing.

Firmly embedded in its investment policy are PHP's environmental targets and it has now published its Net Zero Carbon (NZC) Framework, which sets out the five key steps it is taking towards achieving NZC by 2030 for all its operational, development and asset management activities and to help occupiers achieve NZC by 2040.

Management internalisation added further cost efficiency and in-house development skills

On 5 January 2021, PHP completed the internalisation of the group's management structure, with strong shareholder approval (99.95% of votes cast at the extraordinary general meeting in favour), resulting in annualised savings of approximately £4.0m (0.3p per share) compared with the position if the business were still externally managed. The savings represent 25% of the FY20 EPRA cost base and the FY21 EPRA cost ratio fell further to 9.3% (FY20: 11.9%), the lowest in the UK REIT sector by some margin.

Internalisation secured the services of a well-regarded and experienced management team, along with a fully operational platform, including systems, know-how and proprietary knowledge, and allows shareholders to benefit fully from the expected future growth of the portfolio. The acquisition also included the Nexus primary care development business, which has already begun to allow PHP to undertake direct development in addition to its traditional forward funding activity, on a fixed-cost, pre-let basis to add high-quality assets that support its ESG commitments. By utilising its own substantial balance sheet, direct development activity will allow PHP to capture attractive development margins not available on forward funding schemes.

Refinancing lowered borrowing costs with further opportunities

In October 2021, PHP arranged a new £200m 15-year debt facility with Aviva Investors at a fixed rate of 2.52%, using the proceeds to repay legacy facilities, also with Aviva, amounting to £177m, with a blended fixed rate of 5.0% and remaining term of a little under six years. At the same time,

PHP renewed its £100m revolving credit facility with NatWest for a further three-year term, with extension options. Both facilities incorporate sustainability KPIs which, if met, will reduce loan margins. Before these potential additional savings, the new arrangements reduce PHP's current average cost of debt from 3.4% to 2.9% (with a marginal cost of debt of 1.8%). The annualised interest expense saving is c £5.0m with a positive impact on weighted average debt maturity. One-off early termination costs were £24.6m. PHP still has £386m of legacy loans, acquired with the merger of MedicX in 2019, at a blended fixed rate of 4.2% and a weighted average maturity of 9.7 years. Excluding these facilities, the average cost of debt is 2.3% and the company continues to look at further opportunities to reduce the average cost of debt and deliver further finance cost-saving synergies. We have not allowed for this in our forecasts

Investment pipeline increasing and broadening

PHP's pipeline of external investment opportunities has increased to £377m (H121: £216m), comprising standing assets, direct and forward-funded development opportunities, across the UK and Ireland, of which £152m is in legal due diligence (£72m in the UK and £80m in Ireland). Additionally, it has a strong pipeline of more than 100 identified asset management projects with an aggregate value of £67m (FY20: £46m), providing opportunities to improve the quality of assets, organically increase rental income, extend (re-gear) leases and enhance capital values.

Exhibit 1: Investment pipeline

Type of investment	Number of assets	UK	Ireland
Standing asset investment	11	£87m	£18m (€22m)
Direct development	21	£163m	
Forward-funded development	12	£20m	£89m (€105m)
Total external investment pipeline	44	£270m	£107m
Asset management	100+	£67m	
Total pipeline	143+	£337m	£107m (€127m)

Source: PHP

The external investment pipeline includes 11 standing assets with an expected acquisition value of £105m (£87m in the UK and £18m in Ireland). However, most of the external opportunity comprises direct and forwarded-funded developments. PHP and its recently acquired direct development team have many years of experience in successfully delivering development projects and we see little incremental risk. All developments are pre-let and prices are fixed with contractors. Contractors are liable for penalties in the case of delays of more than six months for reasons that are within their control.

The **direct development** programme, all in the UK, now consists of 21 assets with an expected gross development value (GDV) of £163m, an increase from £80m in January 2021 when Nexus Developments was acquired. Two projects that will commence imminently, in Lincoln and West Sussex, have an expected combined GDV of £10.8m, reflecting a blended valuation yield of c 4.6% and an attractive c 11% development profit for PHP on the cost of development reported as a capital gain. A further five projects with a GDV of £42m are at a significantly advanced stage, which will be progressed during this year together with a wider medium-term pipeline at various stages of progress across 14 projects with a GDV of £110m.

During FY21, four existing **forward-funded development** projects, all in the UK, completed on time and on budget with a net development cost of £20.1m. Two forward-funded developments remain on site, both in Ireland, and both are expected to reach practical completion in Q122 with a combined net development cost of £25.7m (c £9.0m of which remained to be invested at end-FY21). The advanced pipeline of future potential projects includes nine projects in Ireland (GDV of £89m) and three in the UK (GDV of £20m).

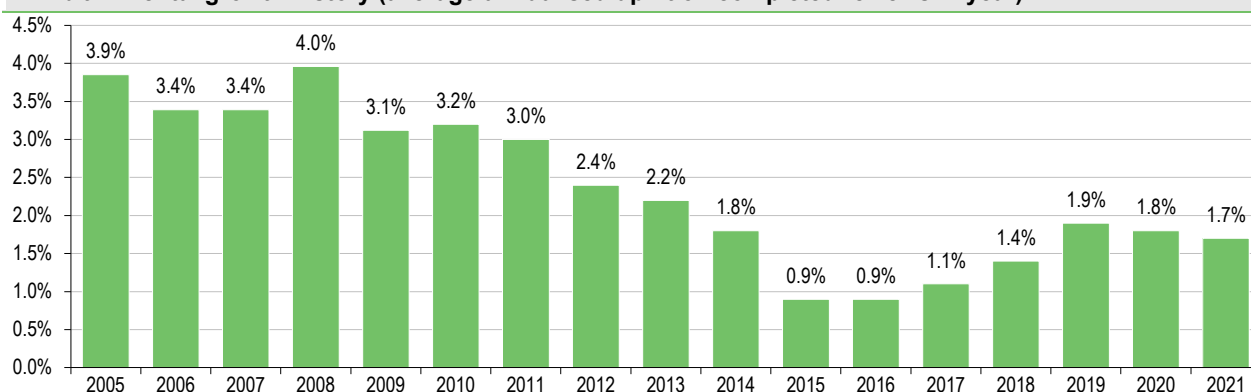
Asset management projects such as property extensions and refurbishments provide an opportunity to enhance the quality of the portfolio, including its environmental credentials, avoid obsolescence and support the tenants in improving their healthcare delivery. These generate additional rents for PHP but, just as importantly, support lease extensions that extend the weighted average unexpired lease term (WAULT) and visibility of income, enhancing capital values. During FY21, 30 asset management projects were completed and a further nine are on site. These will increase rental income by a further £0.4m pa for an aggregate investment of c £15.0m. More than 100 additional projects have been identified (of which 24 are board approved) with an estimated investment requirement of c £67m over the next three years. PHP expects these projects to add an additional c £1.3m to rental income and extend the average WAULT on those assets back to an average c 20 years.

Positive outlook for rental growth

Rent reviews in the UK are typically on a three-year revolving basis and effectively upward only, at the option of the landlord. Irish rents (c 8% of the total) are linked to CPI and, in theory, may decrease as well as increase, although this seems a remote prospect.¹ Rental growth continued in FY21, adding £2.0m pa to contracted rent roll (FY20: £1.7m) or 4.0% (FY20: 4.3%). This equates to an average 1.7% pa uplift on completed rent reviews, slightly lower than in FY20 (1.8%), but we see good prospects for this to accelerate. Of total rents, 25% are indexed to RPI and recently increased inflation will progressively feed into rent reviews. Another 6% of rents provide fixed uplifts at c 2.7% pa. However, the key opportunity lies in open market rent reviews, 69% of the total, which have shown relatively muted growth in recent years, in contrast to land and building cost inflation, an important input into the rent review process for existing assets. As the NHS long-term healthcare planning takes shape, development activity has begun to increase creating rent benchmarks that provide evidence for upward rent reviews for existing assets. Rents on newly developed assets must be set at levels that justify the investment that is needed to support modernisation of the primary healthcare estate and PHP anticipates that this will increasingly be reflected in market rent levels across the estate. In many cases, it has held off from settling open market reviews, awaiting the market evidence that will provide support. There are 635 open reviews that remain outstanding and under negotiation, with the large number reflecting the requirement for all reviews to be agreed with the district valuer.² These represent £84.9m of passing rent, £2.1m lower than the estimated rental value (ERV), a significant upside potential.

¹ The Irish central bank forecasts CPI will increase by 4.5% in 2022.

² Open market reviews aim to set the rent at the current market level, defined as what would be paid by a free and willing tenant to a landlord in that area. The decision is that of the district surveyor, allowing for a range of factors including the size, condition, amenity and location of the premises as well as the terms of the lease itself.

Exhibit 2: Rental growth history (average annualised uplift on completed reviews in year)


Source: PHP data

During FY21, 375 UK rent reviews were concluded and documented, with a combined value of £49.5m. Average uplifts of 2.8% and 2.7% were achieved on index-linked (25% of the total) and fixed uplift (6% of the total) reviews. For open market reviews (69% of the total), an average of 1.5% pa (FY20: 1.3% pa) was achieved on 159 positive reviews. Including 74 reviews concluded with no uplift, the average increase was 1.1% pa. In addition, a further 236 open market rent reviews were agreed in principle, which will add £1.7m to the contracted rent roll when concluded, representing an uplift of 1.6% pa.

Portfolio update

At 31 December 2021 (end-FY21), the portfolio consisted of 521 assets, externally valued at £2.80bn, and with a contracted rent roll of £140.7m, reflecting a net initial yield of 4.64% (FY20: 4.81%). During the year, nine assets were acquired for an aggregate £86.6m (mostly in H2) and one asset was sold for £2.3m (generating a net gain of £0.3m). The £5.5m (or 4.1%) increase in contracted rent roll during the period included acquisitions of £4.1m, like-for-like rental growth of £2.0m, and asset management projects £0.5m, partly offset by FX translation in respect of the Irish assets.

Exhibit 3: Portfolio summary

	31-Dec-21	31-Dec-20	31-Dec-19
	FY21	FY20	FY19
Total number of properties	521	513	488
Of which properties in Ireland	20	18	16
Of which under development	2	6	6
Investment portfolio value	£2.80 billion	£2.58 billion	£2.41 billion
Contracted rent roll	£140.7 million	£135.2 million	£127.7 million
Net initial yield	4.64%	4.81%	4.86%
Average lot size	£5.4m	£5.0m	£4.9 million
Average WAULT	11.6 years	12.1 years	12.8 years
Occupancy	99.7%	99.6%	99.5%

Source: PHP

With 90% of contracted rental income paid directly or indirectly by the UK and Irish governments, and the balance primarily by co-located pharmacies, covenant strength is exceptionally strong and, given the nature of the assets, vacancy is minimal.

Only 6% of the annualised rent roll expires in the next three years and 13% in the next five years. Terms have been agreed to renew leases or for asset management projects in respect of almost 70% of this rent.

Exhibit 4: Income expiry profile

	£m	% total
< 3 years	8.9	6.3%
4–5 years	9.3	6.6%
5–10 years	49.4	35.1%
10–15 years	39.2	27.9%
15–20 years	17.3	12.3%
> 20 years	16.6	11.8%
Total	140.7	100.0%

Source: PHP

The continued increase in average lot size reflects investment in larger, purpose-built, multi-disciplinary medical centre hubs as well as capital value growth. In this respect, increasing lot size may be viewed as a proxy for enhanced portfolio quality.

Exhibit 5: Capital value profile

Capital value	Number of properties	Value (£m)	% total
> £10m	59	893	32.0%
£5–10m	131	910	32.6%
£3–5m	155	615	22.0%
£1–3m	171	369	13.2%
< £1m (including land of £1.5m)	5	4	0.1%
Total	521	2,791	100%

Source: PHP

There are now 20 properties in Ireland with an aggregate valuation of £213m (FY20: £198m), making PHP the largest primary healthcare investor in the country. Including the c £9.0m cost to complete the two forward funding assets, the fully developed valuation of £222.1m represents just under 8% of the portfolio total. The end-FY21 Irish rent roll was €14.6m, 75% let directly to the Health Service Executive (the Irish equivalent of the NHS) or government agencies, with a long WAULT of 21 years. Reflecting a focus on primary healthcare hubs, the average lot size of the Irish assets is around double the £5.4m portfolio average. Yields remain higher in Ireland, although the premium has narrowed, with the valuation of PHP's Irish assets reflecting a net initial yield of 5.1%. As is reflected in the investment pipeline statistics, PHP plans further growth in its Irish assets to a portfolio value of c €500m, around 15% of the current portfolio value.

Financials

Further details on FY21 financial performance

Exhibit 6 provides a summary of the FY21 financial performance, starting with adjusted EPRA earnings with a reconciliation to EPRA earnings and the IFRS result.

Exhibit 6: Summary of FY21 financial performance

£m unless stated otherwise	FY21	FY20	FY21/FY20
Net rental income	136.7	131.2	4.2%
Administrative expenses	(10.5)	(13.2)	-20.5%
Net finance expense	(43.0)	(44.9)	-4.0%
Adjusted EPRA earnings*	83.2	73.1	13.8%
Amortisation of fair value adjustment on acquired debt	8.0	3.1	
Costs/charges relating to acquisition of Nexus	(29.0)		
EPRA earnings	62.0	76.2	-18.6%
Property revaluation	110.2	51.3	
Profit on sale of properties	0.3	0.1	
Fair value loss on derivatives	(1.8)	(12.9)	
Fair value gain/(loss) on convertible bond	3.4	(2.3)	
Costs/charges relating to acquisition of Nexus	(8.0)		
Exceptional early loan redemption cost	(24.6)		
Tax charge	(1.4)	(0.4)	
IFRS earnings	140.1	112.0	25.1%
Basic IFRS EPS (p)	10.5	8.8	
Basic EPRA EPS (p)	4.7	6.0	
Basic adjusted EPRA EPS (p)	6.2	5.8	6.9%
DPS declared and paid (p)	6.2	5.9	5.1%
Dividend cover (%)**	1.01	1.00	1.0%
Adjusted EPRA NAV per share (p)***	116.7	112.9	3.4%
EPRA NAV total return	8.9%	10.1%	
Investment portfolio (bn)	2.80	2.58	8.5%
Portfolio net initial yield (NIY)	4.64%	4.86%	
Net LTV	42.9%	41.0%	
EPRA cost ratio	9.3%	11.9%	

Source: PHP data, Edison Investment Research. Note: *Adjusted EPRA earnings excludes valuation movements, amortisation of acquired fixed-rate debt revaluation and other exceptional items. **Dividend cover is based on adjusted EPRA EPS. ***Adjusted EPRA net tangible assets (NTA) excludes fair value movements in derivative interest rate contracts and convertible bonds, acquired fixed rate debt revaluation and deferred tax.

We note the following key points from the results:

- Net rental income increased by 4.2% or c £5.5m to £136.7m, reflecting rent uplifts, development completions and asset management initiatives.
- Administrative expenses reduced by £2.7m to £10.5m, reflecting the savings from management internalisation, partly offset by business growth. The EPRA cost ratio reduced to 9.3%.
- On an underlying basis, net finance expenses reduced slightly, driven by a lower average cost of debt.
- Adjusted EPRA earnings increased c 14% to £83.2m and adjusted EPRA EPS increased 6.9% to 6.2p.
- IFRS earnings increased by c 25% to £140.1m including a number of items that are excluded from adjusted EPRA earnings, the most significant of which were:
 - Net property revaluation gains of £110.5m, driven by valuation yield tightening and like-for-like rent growth.
 - Costs and charges relating to the acquisition of Nexus, comprising an exceptional payment and impairment of goodwill arising on the acquisition of £35.3m and acquisition costs of £1.7m.
 - An exceptional charge of £24.6m reflecting the early termination cost on refinancing legacy loans.
- Adjusted EPRA NTA per share increased by 3.8p or 3.4% to 116.7p. Revaluation gains added 8.3p, partly offset by early loan termination costs equivalent to 1.9p, and costs and charges relating to the Nexus acquisition of 2.4p and other items. Including dividends paid in the year, the adjusted EPRA NTA total return was 8.9%.

FY21 results as expected

FY21 results were in line with our forecasts and our FY22 expectations are little changed overall. Our FY22 net rental income is increased slightly (in line with end-FY21 rent roll), but is offset by slightly higher costs, while NAV per share increases in line with FY21.

We have introduced FY23 and FY24 forecasts, which anticipate further growth in earnings and DPS driven by portfolio growth and like-for-like rent growth. The latter drives NAV growth, assuming no change in property valuation yields. Our forecasts are explained below and shown in detail in Exhibit 13 at the back of this report.

Exhibit 7: Summary of FY21 performance versus forecast and revised forecasts

	Net rental income (£m)			Adjusted EPRA earnings* (£m)			Adjusted EPRA EPS** (p)			DPS (p)			NAV per share*** (p)		
	Est.	Act.	% diff.	Est.	Act.	% diff.	Est.	Act.	% diff.	Est.	Act.	% diff.	Est.	Act.	% diff.
12/21	136.1	136.7	0.5	83.1	83.2	0.0	6.2	6.2	0.0	6.2	6.2	0.0	115.3	116.7	1.4
	Old	New	Chg	Old	New	Chg	Old	New	Chg	Old	New	Chg	Old	New	Chg
12/22e	140.5	140.6	0.0	90.8	86.2	-5.1	6.8	6.5	-5.1	6.5	6.5	0.0	119.0	120.7	1.7
12/23e	N/A	144.9	N/A	N/A	90.2	N/A	N/A	6.8	N/A	N/A	6.8	N/A	N/A	126.0	N/A
12/24e	N/A	150.9	N/A	N/A	93.0	N/A	N/A	7.0	N/A	N/A	7.0	N/A	N/A	131.7	N/A

Source: PHP FY21 actual data, Edison Investment Research. *Excludes valuation movements, amortisation of fair value adjustment to acquired debt and other exceptional items. **Non-diluted. ***Defined as Adjusted EPRA net tangible assets (NTA) excluding fair value of derivative interest rate contracts and convertible bond, deferred tax and fair value adjustment on acquired debt.

Further details on our forecasts

The key underlying assumptions driving our FY22–24 forecasts include:

- New external investment commitments of £120–130m pa, a mix of fully let standing assets, forward funding commitments and direct developments. The blended yield on our assumed new commitments is c 4.5%, similar to the current portfolio average net initial yield. We also assume c £20m pa in asset management investment.
- We assume a blended average 2.0 % pa like-for-like rental growth in FY22, increasing to 2.5% in FY23–24.
- Investment commitments are financed by debt drawdown, immediately in the case of standing assets and on a phased basis for developments up to the point of practical completion. FY22 finance costs benefit from the FY21 refinancing and over the forecast period, blended average debt costs benefit from drawing on low marginal cost debt facilities. We have not assumed further refinancing activity
- We make no assumption of changes in market valuation yields (either up or down) and reflect the assumed rental growth in gross revaluation gains, partly offset by assumed acquisition costs. We estimate that a 0.1% decrease in the portfolio net initial yield would increase FY22e EPRA NAV per share by c 5p, with a 0.1% increase in net initial yield having a similar negative impact.

Significant funding headroom and flexibility

With a progressive dividend policy that sees recurring earnings effectively fully distributed, portfolio growth is funded by a balance of new equity and debt, locking in a positive spread between investment yields and funding costs. and generating operational and financial economies of scale.

PHP last issued equity for cash in July 2020, raising £140m (£136.9m net of issue expenses) to provide funding for the continuing strong pipeline of investment opportunities, while maintaining LTV within its target gearing range of between 40% and 50%. During FY21, c 11.5m shares were issued

for part consideration of the Nexus acquisition (management internalisation), c 0.6m shares for the part consideration of one property acquisition³ and 5.2m shares in lieu of cash dividends.

The target LTV range is higher than is typical across the mainstream commercial property sector, recognising the visibility and security of cash flows, reflected in an FY21 interest cover ratio of 3.2x (FY20: 2.9x). The end-FY21 LTV of 42.9% is at the lower end of the target range, providing ample room to deploy available debt capital resources to fund the investment pipeline, with a low marginal cost of debt of 1.8%. Assuming conversion of outstanding convertible bonds, the LTV would fall to 37.5%.⁴ Undrawn debt headroom after all capital commitments⁵ was £321m on a pro forma basis at end-FY21, allowing for subsequently arranged debt facilities.

Since the end of FY21, PHP has issued a new €75m secured private placement loan note to MetLife for a 12-year term at a fixed rate of 1.64%, with an option to increase to €150m over the next three years at the lenders discretion. The proceeds will be used to finance the continuing investment in Ireland. Also post year-end, an existing revolving credit facility with Santander (£50m) has been renewed for an initial three years with options to extend by a further year at both the first and second anniversaries. Including the post-year end financing, PHP's debt portfolio stands at £1.55bn, 90% secured and 10% unsecured (the outstanding convertible bonds), broadly diversified across a range of lenders with a weighted average term to maturity of 7.3 years (8.2 years for just the drawn debt facilities). The average cost of the debt facilities of 2.7% (FY20: 3.1%) is below the average cost of drawn debt of 2.9% (FY20: 3.5%) due to low cost (1.8% undrawn marginal funding).

Interest rate risk is well managed, with 100% either fixed rate or hedged for an average maturity of 7.3 years. Unfettered assets of £88.4m at end-FY20 provide significant flexibility in the utilisation of the debt facilities.

Exhibit 8: Key debt metrics*

	31-Dec-21	31-Dec-20
	FY21	FY22
Average cost of drawn debt*	2.9%	3.5%
Average cost of debt - fully drawn*	2.7%	3.1%
Loan to value (LTV)	42.9%	41.0%
LTV excluding convertible bond	37.5%	35.2%
Interest cover	3.2 times	2.9 times
Weighted average debt maturity	7.3 years	7.6 years
Total debt facilities*	£1,550.5m	£1,456.8m
Total drawn debt	£1,232.9m	£1,159.3m
o/w drawn secured debt	£1,082.9m	£1,009.3m
o/w drawn unsecured debt	£150.0m	£150.0m
Total undrawn facilities and cash available*	£321.2m	£361.5m
Unfettered assets	£104.9m	£88.4m

Source: PHP. Note: *Pro forma basis including debt facilities secured post year-end.

³ The shares, with a value of c £1m were issued on 23 September 2021 to the vendor for the £5.5m corporate acquisition of Sarak Group whose sole asset was the Crwys Medical Centre in Cathays, Cardiff.

⁴ The unsecured convertible bonds, with a nominal value of £150m and fixed coupon of 2.875% pa, were issued in July 2019 and mature in July 2025.

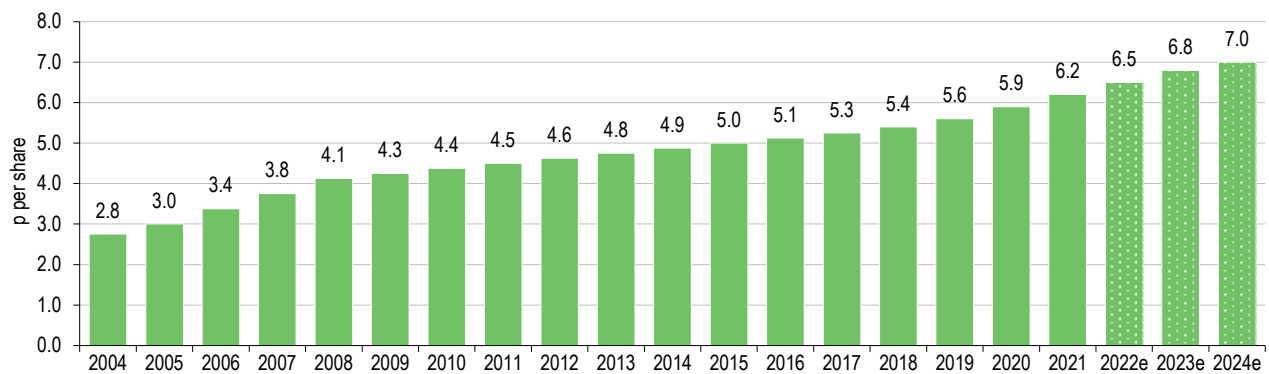
⁵ A total of £29.8m at end-FY21, comprising investment expenditure of £10.7m, outstanding forward funding commitments of £9.0m and asset management projects on site of £10.1m. The initial exchange price was set at 153.25p per ordinary share but is subject to adjustment if DPS exceeds 2.8p pa (FY21: 6.2p). The current adjusted conversion price is 142.29p. Full conversion would result in 104.4m new shares being issued.

Valuation

Historical returns on primary healthcare assets have been higher than other sectors of the UK commercial property market, with a lower level of volatility. This has been a function of strong healthcare fundamentals, secure and more resilient income and less pronounced yield shifts through the property cycle.

PHP is in its 26th year of unbroken dividend growth, having already declared a Q122 DPS of 1.625p, 4.8% ahead of the FY21 quarterly rate. The annualised rate of 6.5p represents a prospective 4.8% dividend yield and we expect further growth in fully covered DPS (Exhibit 9).

Exhibit 9: PHP is in its 26th year of unbroken DPS growth



Source: PHP data

DPS paid represents 52% of the cumulative NAV total return generated over the past five years, with capital returns contributing the balance, including the impact of asset management, rental growth and yield tightening. In the five years to end-FY21, the aggregate NAV total return was 59.3% or a compound annual average return of 9.8%. With valuation yields for primary healthcare having tightened over a number of years, we would expect income returns to represent a greater share of total returns in the coming years.

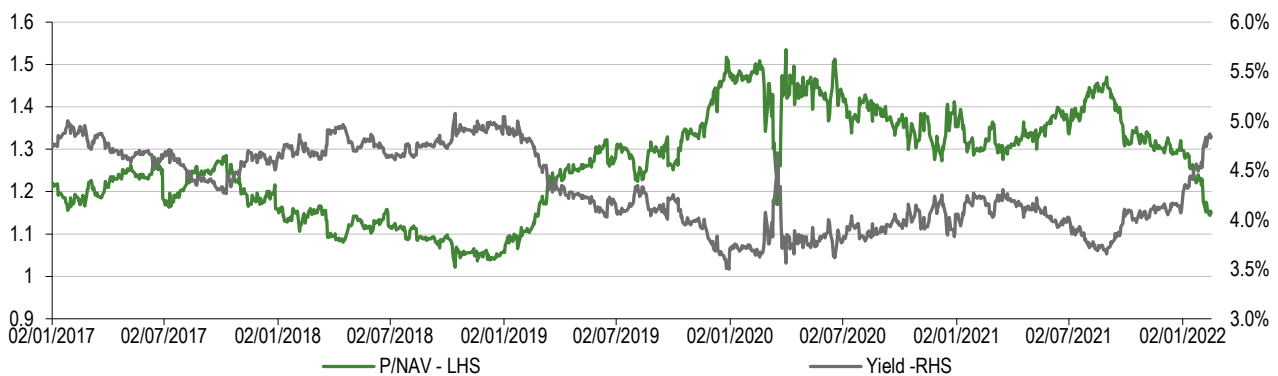
Exhibit 10: Five-year adjusted EPRA NAV total return history

	2017	2018	2019	2020	2021	Five years to end-FY21
Opening adjusted EPRA NTA (p)	91.1	100.7	105.1	107.9	112.9	91.1
Closing adjusted EPRA NTA (p)	100.7	105.1	107.9	112.9	116.7	116.7
Dividends paid in period (p)	5.25	5.40	5.60	5.90	6.20	28.4
Income return	5.8%	5.4%	5.3%	5.5%	5.5%	31.1%
Capital return	10.5%	4.4%	2.7%	4.6%	3.4%	28.1%
NTA total return	16.3%	9.8%	8.0%	10.1%	8.9%	59.3%
Annual average return						9.8%

Source: PHP data, Edison Investment Research

The valuation of the PHP shares is very much driven by the security and predictability of its income. In turn, this provides support for a continuing valuation premium to EPRA NAV. However, as DPS has grown strongly, the yield has increased and the P/NAV ratio has compressed from a peak of c 1.5x in 2020 to c 1.1x currently, below the five-year average (c 1.27x) and the 10-year average (c 1.21x). Given that we expect DPS to grow slightly more than 4% on average over FY22–24, the current valuation appears attractive.

Exhibit 11: Prospective dividend yield has recently increased and P/NAV has contracted



Source: Refinitiv

In Exhibit 12, we show the key valuation and performance metrics for PHP and a group of its closest peers, including Assura, another investor in primary healthcare assets, care home investors (Impact and Target) and social housing investors (Civitas, Secure Residential Income and Triple Point).

Over three years, PHP's price performance is well ahead of the peer group average (in fact it is the strongest performer in the group), the broader UK property sector and the UK equity market. However, during the past 12 months, the share price performance for the whole peer group has been below that of the broad UK property sector and UK share index. During this period, share price performance has been led by the recovery of those companies that suffered most during the pandemic, as well as those focused on the industrial sector⁶ and, as inflation has increased, many of those companies with predominantly long, index-linked leases. Some of the latter appear in the Exhibit 12 peer group but there are many in other subsectors that do not.⁷

PHP shares trade at a lower yield than the peer group average, which in our view reflects the strength of the tenant covenant and the strength of free cash flow, supported by a low cost ratio.

Exhibit 12: Peer comparison

	Price (p)	Market cap (£m)	P/NAV* (x)	Yield** (%)	Share price performance			
					One month	Three months	12 months	Three years
Assura	62	1,821	1.06	4.7	-6%	-9%	-18%	9%
Civitas Social Housing	88	541	0.81	6.2	-8%	-5%	-17%	-14%
Impact Healthcare	109	420	0.97	5.9	-6%	-9%	-2%	6%
Residential Secure Income	101	187	0.96	5.0	-7%	-2%	13%	7%
Target Healthcare	109	675	0.98	6.2	-5%	-5%	-2%	-5%
Triple Point Social Housing	87	351	0.82	6.0	-6%	-9%	-19%	-18%
Average			0.93	5.7	-6%	-6%	-7%	-2%
Primary Health Properties	135	1,805	1.16	4.6	-5%	-10%	-12%	17%
UK property sector index	1,873				-3%	-4%	15%	3%
UK equity market index	4,158				-2%	2%	11%	-1%

Source: Company data, Edison Investment Research, Refinitiv. Note: *Based on last reported EPRA NAV. **Based on 12-month trailing dividends declared. Prices as at 28 February 2022.

⁶ Particularly industrial logistics, where demand for space has benefited from the trend towards online distribution, accelerated during the pandemic, amid limited supply.

⁷ This includes the care home investors, Impact and Target, where price performance has been above the peer average over 12 months, but in our opinion is yet to reflect robust performance during the pandemic. It also includes the social housing investors, Civitas and Triple Point, where performance has been impeded by investor concerns about the sustainability of the sector model, misplaced in our opinion.

Strong ESG credentials

PHP's social benefit is clear. Private capital has a key role in the modernisation of primary health infrastructure and service provision in both the UK and Ireland, resulting in better patient experiences with a positive impact on health and wellbeing. The company has a strong commitment to acting responsibly with integrity and transparency and is overseen by an experience board of directors. Recent focus has been focused on enhancing performance. The goal of NZC by 2030 for all PHP's operational, development and asset management activities is embedded in its investment process. All developments completed during the year achieved BREEAM⁸ ratings of Excellent or Very Good, while all asset management projects completed met EPC⁹ ratings of B or better. PHP's first two direct investment schemes (discussed below) are both designed to be NZC. PHP indicates that the additional development and capex costs related to environmental enhancement will not have a material impact on returns and financial performance.

The goal of helping occupiers achieve NZC by 2040 is ahead of that set by the NHS for becoming the world's first NZC national health system by 2045 and 10 years ahead of the 2050 target set by the UK and Irish governments.

The board

The board of directors currently has seven members (normally six),¹⁰ consisting of five (normally four) independent non-executive directors and two executive directors. The two executive directors are Harry Hyman, chief executive of PHP (having served on the board prior to managements internalisation as managing director of Nexus), and Richard Howell, chief financial officer (who previously served in the role of finance director of Nexus). Mr Hyman was the founder of PHP in 1996 and with the management internalisation he confirmed his continuing commitment to the group for at least five years from the MedicX merger in March 2019. The independent non-executive directors are Steven Owen (chair), Laure Duhot, Ivonne Cantu, Ian Krieger and, until April 2022, Peter Cole. Biographies of the key members of the leadership team can be found at the back of this report, with further details available on the [company website](#).

Sensitivities

In our view, PHP has low operational risk in the context of the UK property sector. This reflects its position as a long-term investor in a specialist sector of the commercial property market characterised by long leases, predominantly government backed, with minimal vacancy and (in the UK) upward-only lease adjustments supported by long-term fixed or hedged debt. Occupational demand in the primary healthcare sector is driven by demographics (ageing, growing and sicker populations) and the need to upgrade the existing primary care estate rather than general economic conditions. There are nevertheless a range of factors that could affect the business, especially over the longer term, including structural changes in the markets in which the group operates, changes to government health and fiscal policies, funding conditions and operational performance. In terms of our forecasts we note:

- Enhancing organic rental growth and continuing property acquisitions are a significant driver of the growth that we forecast, requiring PHP to maintain a suitable pipeline of investment

⁸ BREEAM is a leading provider of sustainability assessments.

⁹ Energy performance certificate.

¹⁰ Ivonne Cantu joined the board in January 2022 and Peter Cole will retire from the board in April 2022.

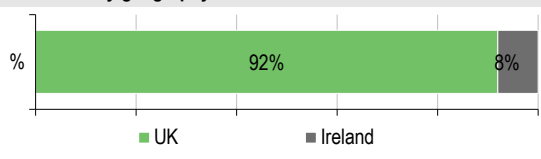
opportunities on favourable terms and conditions. The current pipeline is strong, across standing assets, direct and indirect developments, and identified asset management schemes.

- Development risk: we believe that pre-let, fixed-cost development schemes, both indirect and direct, are low risk. All developments are pre-let and prices are fixed with contractors. Contractors are liable for penalties in the case of delays of more than six months for reasons that are within their control.
- Market environment:
 - While the demand for healthcare in both the UK and Ireland seems set for further growth, changes in government and health service planning policy cannot be fully ruled out in both countries. We believe this is unlikely as primary healthcare is at the centre of long-term planning to improve delivery and generate overall efficiencies, including substantial modernisation and upgrading of existing healthcare estates.
 - In an environment of low interest rates, attractive risk-adjusted yields have attracted new investors to the sector, resulting in a tightening of yields over several years. Competition is greatest for the larger, purpose-built properties that are expected to provide the best potential for longer-term rental growth and returns. Favourable funding conditions have maintained a positive spread between acquisition yields and costs, including funding costs, while the spread in Ireland, where PHP has a strong and growing presence, remains above that in the UK. We expect the spread on direct development to be above average and the upward trend in rental growth is a positive factor.
- General economic and monetary conditions: the non-cyclical nature of the sector reduces the impact of fluctuations in the wider economy and property market. We expect such fluctuations to have no material direct impact on PHP's income and, as has been the case historically, we would expect variations in property valuations to be less pronounced than for the broad commercial property sector.
- PHP is well protected against potential increases in market interest rates in the short to medium term. The average maturity of the debt facilities is a long 7.3 years, although it remains shorter than the WAULT (11.6 years) and is 100% fixed/hedged. In the long term, without assuming further management action, there is a risk that funding costs may increase relative to rental growth.

Exhibit 13: Financial summary

Year end 31 December (£m)	2019	2020	2021	2022e	2023e	2024e
PROFIT & LOSS						
Net rental income	115.7	131.2	136.7	140.6	144.9	150.9
Administrative expenses	(12.3)	(13.2)	(10.5)	(10.8)	(11.3)	(11.9)
EBITDA	103.4	118.0	126.2	129.8	133.6	139.0
Net result on property portfolio	49.8	51.4	110.5	53.9	70.8	75.6
Exceptional items related to corporate acquisition	(148.6)	0.0	(37.0)	0.0	0.0	0.0
Operating profit before financing costs	4.6	169.4	199.7	183.7	204.4	214.6
Finance income	1.4	1.2	0.8	0.6	2.0	2.0
Finance expense	(42.6)	(43.0)	(35.9)	(41.3)	(42.3)	(45.0)
Net finance expense	(41.2)	(41.8)	(35.1)	(40.6)	(40.3)	(43.0)
Net other income/expense	(33.6)	(15.2)	(23.0)	0.0	0.0	0.0
Profit Before Tax	(70.2)	112.4	141.6	143.0	164.0	171.6
Tax	(1.1)	(0.4)	(1.5)	0.0	0.0	0.0
Profit After Tax (FRS 3)	(71.3)	112.0	140.1	143.0	164.0	171.6
Adjusted for the following:						
Net gain/(loss) on revaluation	(48.4)	(51.3)	(110.2)	(53.9)	(70.8)	(75.6)
Profit on disposal	(1.4)	(0.1)	(0.3)	0.0	0.0	0.0
Fair value gain/(loss) on derivatives & convertible bond	33.6	15.2	(1.6)	0.0	0.0	0.0
Exceptional items related to corporate acquisition	138.4	0.0	8.0	0.0	0.0	0.0
Other adjustments	1.1	0.4	26.0	0.0	0.0	0.0
EPRA earnings	52.0	76.2	62.0	89.1	93.2	96.0
Exceptional item	10.2	0.0	29.0	0.0	0.0	0.0
Amortisation of fair value adjustment to acquired debt	(2.5)	(3.1)	(3.2)	(2.9)	(3.0)	(3.0)
MTM write off on early termination of bank debt	0.0	0.0	(4.7)	0.0		
Adjusted EPRA earnings	59.7	73.1	83.2	86.2	90.2	93.0
Period end number of shares (m)	1,216.3	1,315.6	1,332.9	1,332.9	1,332.9	1,332.9
Average Number of Shares Outstanding (m)	1,092.0	1,266.4	1,330.4	1,332.9	1,332.9	1,332.9
Fully diluted average number of shares outstanding (m)	1,138.5	1,368.4	1,434.9	1,438.3	1,438.3	1,438.3
Basic IFRS EPS (p)	(6.53)	8.8	10.5	10.7	12.3	12.9
Basic Adjusted EPRA EPS (p)	5.5	5.8	6.2	6.5	6.8	7.0
Diluted Adjusted EPRA EPS (p)	5.4	5.7	6.1	6.3	6.6	6.8
Dividend per share (p)	5.6	5.9	6.2	6.5	6.8	7.0
Dividend cover (Adj. EPRA earnings/dividends paid)	101%	100%	101%	100%	100%	100%
Adjusted EPRA NTA total return	8.0%	10.1%	8.9%	9.0%	10.0%	10.1%
EPRA cost ratio	12.0%	11.9%	9.3%	9.3%	9.4%	9.4%
BALANCE SHEET						
Non-current assets	2,413.6	2,576.1	2,801.4	2,951.4	3,157.6	3,379.8
Investment properties	2,413.1	2,576.1	2,795.9	2,945.9	3,152.1	3,374.3
Other non-current assets	0.5	0.0	5.5	5.5	5.5	5.5
Current Assets	159.8	121.0	51.7	37.5	34.7	40.7
Cash & equivalents	143.1	103.6	33.4	19.9	17.1	23.1
Other current assets	16.7	17.4	18.3	17.6	17.6	17.6
Current Liabilities	(66.0)	(68.1)	(70.5)	(68.3)	(68.3)	(68.3)
Current borrowing	(6.1)	(6.4)	(2.2)	0.0	0.0	0.0
Other current liabilities	(59.9)	(61.7)	(68.3)	(68.3)	(68.3)	(68.3)
Non-current liabilities	(1,278.9)	(1,214.6)	(1,282.7)	(1,364.6)	(1,494.2)	(1,643.8)
Non-current borrowings	(1,257.8)	(1,206.5)	(1,273.0)	(1,354.9)	(1,484.5)	(1,634.1)
Other non-current liabilities	(21.1)	(8.1)	(9.7)	(9.7)	(9.7)	(9.7)
Net Assets	1,228.5	1,414.4	1,499.9	1,556.0	1,629.8	1,708.4
Derivative interest rate swaps	13.0	0.1	(4.4)	(4.4)	(4.4)	(4.4)
Change in fair value of convertible bond	22.7	25.0	21.6	21.6	21.6	21.6
Other EPRA adjustments	48.6	45.8	38.8	35.9	32.9	29.9
Adjusted EPRA net tangible assets (NTA)	1,312.8	1,485.3	1,555.9	1,609.1	1,679.9	1,755.5
IFRS NAV per share (p)	101.0	107.5	112.5	116.7	122.3	128.2
Adjusted EPRA NTA per share (p)	107.9	112.9	116.7	120.7	126.0	131.7
CASH FLOW						
Operating Cash Flow	94.0	118.9	140.4	130.2	134.0	139.4
Net Interest & other financing charges	(52.9)	(65.9)	(46.6)	(40.9)	(40.7)	(43.4)
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals	(47.4)	(102.8)	(129.3)	(96.1)	(135.4)	(146.7)
Net proceeds from issue of shares	97.6	136.8	(0.1)	0.0	0.0	0.0
Debt drawn/(repaid)	110.5	(58.4)	82.8	80.0	130.0	150.0
Equity dividends paid (net of scrip)	(54.4)	(69.1)	(74.4)	(86.6)	(90.6)	(93.3)
Other cash movements and FX	(11.9)	1.6	(43.6)	(0.2)	0.0	(0.0)
Net change in cash	137.2	(39.5)	(70.2)	(13.6)	(2.8)	6.0
Opening cash & equivalents	5.9	143.1	103.6	33.4	19.8	17.0
Closing net cash & equivalents	143.1	103.6	33.4	19.8	17.0	23.0
Debt as per balance sheet	(1,263.9)	(1,212.9)	(1,275.2)	(1,354.9)	(1,484.5)	(1,634.1)
Convertible bond fair value adjustment	22.7	25.0	21.6	21.6	21.6	21.6
Unamortised borrowing costs	(14.6)	(13.8)	(13.7)	(11.1)	(8.5)	(5.9)
Acquired debt fair value a	45.4	42.4	34.4	31.5	28.5	25.5
Net debt	(1,067.3)	(1,055.7)	(1,199.5)	(1,293.1)	(1,425.9)	(1,569.9)
Net LTV	44.2%	41.0%	42.9%	43.9%	45.2%	46.5%

Source: PHP historical data, Edison Investment Research forecasts

Contact details 5th Floor Greener House 66-68 Haymarket London SW1Y 4RF +44 (0)20 7104 5599 www.phpgroup.co.uk	Portfolio value by geography  <table border="1"> <thead> <tr> <th>Geography</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>UK</td> <td>92%</td> </tr> <tr> <td>Ireland</td> <td>8%</td> </tr> </tbody> </table>	Geography	Percentage	UK	92%	Ireland	8%
Geography	Percentage						
UK	92%						
Ireland	8%						
Leadership team							
Non-executive chairman: Steven Owen Steven Owen joined the board in 2013 and has been non-executive chairman since 18 April 2018 when he also became chairman of the nomination committee. He is a chartered accountant with extensive expertise in investment and development in commercial property in a listed company environment. He began his career with KPMG before moving into property with Brixton, where he was finance director and subsequently deputy CEO. He was CEO and founding partner of Wye Valley Partners, a commercial real estate and asset management business.	Chief executive: Harry Hyman Harry Hyman founded PHP in 1996 and has served on the board since. He became chief executive of PHP following management internalisation, having previously served on the board as managing director of the former external property adviser, Nexus, which he founded. He is a chartered accountant and in addition to his roles at PHP and Nexus TradeCo, he has established a number of private companies and is non-executive chairman of two LSE-listed companies, BioPharma Credit, which invests in the fast-growing science industry, and TMT Acquisition, an acquisition shell company.						
Chief financial officer: Richard Howell Richard Howell joined the board of PHP in 2017 and became chief financial officer of PHP following management internalisation. He previously served on the board as finance director of Nexus, the former external property adviser to PHP, which he joined in March 2017. He is a chartered accountant with more than 20 years' experience working with London-listed commercial property companies, gained principally with LondonMetric Property and Brixton. Richard was part of the senior management team that led the merger of Metric Property Investments and London & Stamford Property in 2013 to create LondonMetric Property with a combined property portfolio of £1.4bn.	Chief investment officer: Chris Santer Chris Santer joined PHP/Nexus in October 2017 and has over 20 years of real estate investment and development experience in the UK and continental Europe in both listed and private equity funds. He was a director of portfolio management at PGIM Real Estate, the asset management arm of Prudential Financial, and previously at MGPA, the real estate fund management arm of Macquarie Bank. He has been responsible for a number of funds making or managing direct and indirect real estate investments, across a range of sectors including healthcare. He is a non-executive director of Impact Healthcare REIT.						
Principal shareholders as at 31 January 2022 (Source: PHP)							
BlackRock Investment Management Vanguard Group Hargreaves Lansdown (EO) SSGA SSGA Investec Wealth & Investment Legal & General Investment Management	(%) 7.1 4.9 3.9 3.9 3.9 3.1						

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