EDISON

Primary Health Properties

Debt refinancing

Refinancing enhances earnings/dividend outlook

Real estate

Primary Health Properties (PHP) has announced refinancing measures that enhance debt duration and significantly reduce the running cost of debt. Our forecasts for earnings and fully covered dividend growth are increased. Sustainability linked terms in the new debt facilities are a first for PHP and will potentially further reduce debt costs over time.

Year end	Net rental income (£m)	Adjusted earnings* (£m)	Adjusted EPS** (p)	Adj. EPRA*** NATA/share (p)	DPS (p)	P/NTA (x)	Yield (%)
12/19	115.7	59.7	5.5	107.9	5.60	1.42	3.6
12/20	131.2	73.1	5.8	112.9	5.90	1.36	3.8
12/21e	136.1	83.1	6.2	115.3	6.20	1.33	4.0
12/22e	140.5	90.8	6.8	119.0	6.50	1.29	4.2

Note: *Excludes valuation movements, amortisation of fair value adjustment to acquired debt and other exceptional items. **Non-diluted. ***Net tangible assets; adjusts for fair value of derivative interest rate contracts and convertible bond, deferred tax and fair value adjustment on acquired debt.

Asset management supporting liability management

PHP has secured 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. The early termination costs for the legacy loans are £24m. At the same time, PHP has 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%, while the marginal cost of debt remains 1.7%. The annualised interest expense saving is c £5.0m and the weighted average debt maturity of seven years is similar to H121 despite the passage of time.

FY22 EPS forecast increases by 5.5%

We have adjusted our forecasts to reflect the refinancing transactions with no other changes. There is a modest uplift to FY21 adjusted earnings and EPS, while on a full-year basis our FY22e adjusted EPS increases by 5.5%. Further interest savings are possible as PHP implements its ESG initiatives published earlier in the year. We have increased our FY22 DPS forecast from 6.4p to 6.6p with cover of 103%. EPRA NTA reduces by c 1.8p due to the early repayment cost. As anticipated, acquisition activity has stepped up in H221, but post the financing significant funding headroom remains with uncommitted cash and undrawn loan facilities of £237m.

Valuation: Securely growing income

PHP's valuation is driven by strong income visibility with good prospects for growth: 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 FY21 DPS of 6.2p represents a yield of 4.0%, with good prospects for DPS growth, fully covered by adjusted earnings, and supports the premium to NAV.

1 November 2021

Price	**153.6p**
Market cap	**£2,046m**

Net debt (£m) at 30 June 2021	1,085
Net LTV at 30 June 2021	40.9%
Shares in issue	1,332.3m
Free float	97%
Code	PHP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.4	(5.8)	7.4
Rel (local)	0.0	(7.5)	(18.0)
52-week high/low		170p	139p

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 long-let 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

Q4 DPS paid	26 November 2021
FY21 year end	31 December 2021

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Edison profile page

Primary Health Properties is a research client of Edison Investment Research Limited

Further details

Forecast changes

Our forecast changes are summarised in Exhibit 1. FY21e reflects around two months of the annualised borrowing cost reduction with the full impact felt in FY22. The Q421 DPS of 1.55p was declared on 7 October for payment on 26 November, bringing the FY21 total to the targeted 6.2p. We have increased our FY22 DPS target to 6.5p with projected dividend cover of 105% providing scope to smooth dividend growth over the next couple of years.

Exhibit 1: Summary of estimate changes

	Net rental income (£m)			Adjusted earnings (£m)			Adjusted EPS (p)			DPS (p)			Adj. EPRA NTAPS (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
12/21e	136.1	136.1	0.0	82.3	83.1	1.0	6.2	6.2	0.8	6.2	6.2	0.0	117.0	115.3	-1.7
12/22e	140.5	140.5	0.0	85.8	90.8	5.9	6.5	6.8	5.5	6.4	6.5	1.6	120.5	119.0	-1.5

Source: Edison Investment Research

Sustainability KPIs aligned with PHP's ESG targets

The new Aviva facility and the renewed revolving credit facility both incorporate sustainability KPIs that are based around PHP's existing environmental targets. In each case, PHP will benefit from additional interest savings if the KPIs are successfully met. Core to PHP's environmental targets is an improvement in the EPC ratings[1] of portfolio assets to B or better by 2030, as well as achieving a BREEAM[2] rating on new developments of 'excellent' or better.

Currently 80% of PHP's portfolio has an EPC rating of A–C and PHP is well-advanced with asset management plans that will lead to EPC rating improvements. Environmental performance is a key consideration in new investment and 92% of newly completed assets delivered in 2020 held an EPC with a rating of B or better.

Asset management projects, such as property extensions, upgrades and refurbishments, including improvements to environmental performance, are an attractive way of enhancing the quality of the portfolio and avoiding obsolescence. In addition, as well as supporting tenants to improve their healthcare delivery, these programmes create shareholder value by generating additional rents and supporting lease extensions/regears, increasing the visibility and duration of income and enhancing asset valuations. With the H121 results, PHP reported on 17 projects that had either completed or were on site with an aggregate investment requirement of £10.8m. These will generate c £0.3m of additional rental income but, just as importantly, will extend the WAULT on those properties back to 21 years. A further c 100 projects had either been approved by the PHP board or were in advanced negotiations, requiring an investment of c £46m, potentially generating an additional £1.4m of rental income and similarly extending WAULT on those premises back to an average of 22 years.

[1] Energy Performance Certificate.

[2] Building Research Establishment's Environmental Assessment Method

Exhibit 2: Financial summary

Year end 31 December (£m)	2018	2019	2020	2021e	2022e
PROFIT & LOSS					
Net rental income	76.4	115.7	131.2	136.1	140.5
Administrative expenses	(9.9)	(12.3)	(13.2)	(9.6)	(9.8)
EBITDA	66.5	103.4	118.0	126.5	130.7
Net result on property portfolio	36.1	49.8	51.4	88.0	45.1
Exceptional items related to corporate acquisition	0.0	(148.6)	0.0	(37.0)	0.0
Operating profit before financing costs	102.6	4.6	169.4	177.5	175.8
Finance income	0.1	1.4	1.2	0.8	1.0
Finance expense	(29.8)	(42.6)	(43.0)	(41.0)	(37.8)
Net finance expense	(29.7)	(41.2)	(41.8)	(40.2)	(36.7)
Net other income/expense	1.4	(33.6)	(15.2)	(24.2)	0.0
Profit Before Tax	74.3	(70.2)	112.4	113.1	139.1
Tax	0.0	(1.1)	(0.4)	(0.6)	0.0
Profit After Tax (FRS 3)	74.3	(71.3)	112.0	112.5	139.1
Adjusted for the following:					
Net gain/(loss) on revaluation	(36.0)	(48.4)	(51.3)	(88.0)	(45.1)
Profit on disposal	(0.1)	(1.4)	(0.1)	0.0	0.0
Fair value gain/(loss) on derivatives & convertible bond	(1.4)	33.6	15.2	0.2	0.0
Exceptional items related to corporate acquisition	0.0	138.4	0.0	8.0	0.0
Other adjustments	0.0	1.1	0.4	24.6	0.0
EPRA earnings	36.8	52.0	76.2	57.3	94.0
Exceptional item		10.2	0.0	29.0	0.0
Amortisation of fair value adjustment to acquired debt		(2.5)	(3.1)	(3.2)	(3.2)
Adjusted EPRA earnings	36.8	59.7	73.1	83.1	90.8
Period end number of shares (m)	769.1	1,216.3	1,315.6	1,331.7	1,331.7
Average Number of Shares Outstanding (m)	708.6	1,092.0	1,266.4	1,330.1	1,331.9
Fully diluted average number of shares outstanding (m)	732.7	1,138.5	1,368.4	1,432.7	1,433.9
Basic IFRS EPS (p)	10.5	(6.53)	8.8	8.5	10.4
Basic adjusted EPRA EPS (p)	5.2	5.5	5.8	6.2	6.8
Diluted adjusted EPRA EPS (p)	5.2	5.4	5.7	6.1	6.6
Dividend per share (p)	5.400	5.600	5.900	6.200	6.500
Dividend cover (adjusted EPRA earnings/dividends paid)	101%	101%	100%	101%	105%
EPRA cost ratio	14.3%	12.0%	11.9%	8.7%	8.7%
BALANCE SHEET					
Non-current assets	1,503.5	2,413.6	2,576.1	2,737.1	2,886.7
Investment properties	1,502.9	2,413.1	2,576.1	2,735.7	2,885.3
Other non-current assets	0.6	0.5	0.0	1.4	1.4
Current Assets	10.5	159.8	121.0	32.1	34.6
Cash & equivalents	5.9	143.1	103.6	17.2	19.7
Other current assets	4.6	16.7	17.4	14.9	14.9
Current Liabilities	(134.5)	(66.0)	(68.1)	(59.0)	(59.0)
Current borrowing	(102.4)	(6.1)	(6.4)	0.0	0.0
Other current liabilities	(32.1)	(59.9)	(61.7)	(59.0)	(59.0)
Non-current liabilities	(591.5)	(1,278.9)	(1,214.6)	(1,240.9)	(1,340.5)
Non-current borrowings	(573.7)	(1,257.8)	(1,206.5)	(1,232.5)	(1,332.1)
Other non-current liabilities	(17.8)	(21.1)	(8.1)	(8.4)	(8.4)
Net Assets	788.0	1,228.5	1,414.4	1,469.3	1,521.8
Derivative interest rate swaps	17.2	13.0	0.1	(1.3)	(1.3)
Change in fair value of convertible bond	3.4	22.7	25.0	24.5	24.5
Other EPRA adjustments	0.0	48.6	45.8	43.0	39.8
Adjusted EPRA net tangible assets (NTA)	808.6	1,312.8	1,485.3	1,535.5	1,584.8
IFRS NAV per share (p)	102.5	101.0	107.5	110.3	114.3
Adjusted EPRA NTA per share (p)	105.1	107.9	112.9	115.3	119.0
CASH FLOW					
Operating Cash Flow	68.5	94.0	118.9	103.6	129.3
Net Interest & other financing charges	(35.1)	(52.9)	(65.9)	(41.3)	(37.1)
Tax	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals	(101.9)	(47.4)	(102.8)	(82.3)	(103.1)
Net proceeds from issue of shares	111.0	97.6	136.8	(0.1)	0.0
Debt drawn/(repaid)	(5.6)	110.5	(58.4)	27.6	100.0
Equity dividends paid (net of scrip)	(34.7)	(54.4)	(69.1)	(75.3)	(86.6)
Other cash movements and FX	0.6	(11.9)	1.6	(19.2)	(0.0)
Net change in cash	2.1	137.2	(39.5)	(86.5)	2.5
Opening cash & equivalents	3.8	5.9	143.1	103.6	17.1
Closing net cash & equivalents	5.9	143.1	103.6	17.1	19.6
Debt as per balance sheet	(676.1)	(1,263.9)	(1,212.9)	(1,232.5)	(1,332.1)
Convertible bond fair value adjustment	3.4	22.7	25.0	24.4	24.4
Unamortised borrowing costs	(6.4)	(14.6)	(13.8)	(11.8)	(9.0)
Acquired debt fair value a	0.0	45.4	42.4	39.2	36.0
Net debt	(673.2)	(1,067.3)	(1,055.7)	(1,163.6)	(1,261.1)
Net LTV	44.8%	44.2%	41.0%	42.4%	43.6%

Source: PHP historical data, Edison Investment Research forecasts

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