



Market data

EPIC/TKR	PHP
Price (p)	116
12m High (p)	123
12m Low (p)	105
Shares (m)	619
Mkt Cap (£m)	718
EV (£m)	1437
Market	Main, LSE

Description

PHP is a REIT acquiring and owning modern primary medical properties in the UK, and is expanding into the Republic of Ireland (RoI).

Company information

CEO Harry Hyman
 CFO Richard Howell
 Chairman Alun Jones

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Key shareholders

Directors	2.5%
BlackRock	5.5%
Investec Wealth	4.9%
Charles Stanley	4.5%
Unicorn Asset Mgt.	4.2%
Troy	3.9%

Diary

Late April AGM
 August 2018 Interims

Analyst

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Primary Health Properties

Strong 2017 results and prospects

Positive 2017 results (dated 15th February) illustrate continuing good momentum. Currently, UK acquisitions achieve average 4.9% net initial yields and thus generate a 1.4% average yield pick-up after operating and interest costs. Investment in Republic of Ireland (RoI) yields a 3.0% pick-up in the net income yield versus cost of debt. Once again, PHP lowered its cost of debt. Also, one example of several, Aviva renewed a £75m loan facility to November 2028 at a fixed interest rate of 3.1%; this renewal results in interest savings of £675,000 p.a. to PHP (beginning November 2017). PHP has excellent assets and a 'following wind'.

- ▶ **Strategy:** Capital deployment continues well, with 2017 seeing a £77.3m asset investment and a £150m pipeline. For 2019, we estimate Loan to Value (LTV) of 51.4%, leaving plenty of headroom. While rental growth remained modest, at 1% (leases are upwards only, occupancy remains at 99.7%), acceleration is likely.
- ▶ **Capital deployment:** Ten properties were acquired in 2017 for £71.9m – a large average lot size. The 1.4% positive cash return on gross UK investment remains healthy (this calculation is based on all-debt funding). RoI assets yield over 100bps more and debt is 50bps cheaper.
- ▶ **Valuation:** PHP's initial focus remains on steadily growing income, with a good proportion on guaranteed or RPI uplifts. This focus then also steadily enhances capital values. In 2017, PHP's total asset NAV plus dividends returned 16.4% (vs. 9.7% in 2016), and it has had 21 years (since the IPO) of unbroken dividend rises.
- ▶ **Risks:** There is no rental-income or void risk. With debt costs low, the policy is lengthening the debt maturity profile, thereby reducing refinancing risk, while still lowering the cost of debt as some historical higher-rate debt expires. The average debt maturity is 6.3 years and rising – funded from a variety of sources.
- ▶ **Investment summary:** We like the REIT sector's stable, rising income. PHP's leases are all upward-only rents (19% RPI-linked), averaging 13.2 years. It has scope to raise financial gearing modestly, enhancing EPS, particularly with the added RoI yield pick-up. This and falling debt costs generate long-term upside.

Financial summary and valuation

Year-end Dec (£m)	2015	2016	2017	2018E	2019E
Net rental income	62.2	66.6	71.3	76.7	82.8
Finance cost	-33.7	-32.5	-31.6	-34.2	-36.8
Declared profit	56.0	43.7	91.9	52.8	64.6
EPRA PBT (adj. pre-revaluation)	21.7	26.7	31.0	33.4	36.4
EPS reported (p)	12.57	7.78	15.30	8.53	10.00
EPRA EPS (p)	4.87	4.77	5.17	5.40	5.63
DPS (p)	5.000	5.125	5.250	5.400	5.550
Net cash (debt)	-694.7	-663.2	-726.6	-798.2	-822.1
Dividend yield (%)	4.3	4.4	4.5	4.7	4.8
Price/EPRA NAV	1.32	1.27	1.15	1.11	1.06
NAV (p)	77.4	83.5	94.7	97.6	102.8
EPRA NAV (p)	87.5	91.1	100.7	104.7	109.3

NB 2018E EPRA EPS excluding performance fee, non-diluted: 5.49p Source: Hardman & Co Research

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Executive summary

Results announced on 15th February

Key points from the results include the following.

- ▶ Investment expenditure of £75.4m (including certain amounts of capital expenditure on existing assets), which was slightly ahead of our estimates.
- ▶ Net rental income rose 7.1%, including c.1% from inflation, with 1.1% inflation on the tri-annual increases agreed in 2017. We understand this 1.1% figure (up marginally from 0.9% in 2016) includes some tenancies with no increase but which may be increased subsequently on further negotiation. All leases are on the basis of no rent reductions on any tri-annual review.
- ▶ Average cost of debt fell again, from 4.65% in 2016 to 4.26% at the interim results in autumn 2017 and to a 4.09% average in 2017.

Cost of debt keeps reducing

Prospects

Good pipeline

- ▶ The pipeline of acquisitions is a healthy £150m.
- ▶ Over time, we anticipate RoI investment to comprise over 5% of total assets, rising towards 10%. As a working assumption, we model 25% group investment being directed to RoI. Both the UK and RoI should yield an EPS enhancement, but RoI currently generates almost twice as much incremental EPS as the UK.

RoI important

- ▶ Thus, illustratively, a £25m acquisition in a 'typical' year in RoI would add £1.43m operating profit and cost £0.68m interest – a £0.75m increment to PBT and, on its own, representing 2.4% of the historical EPRA PBT, strongly supporting dividend growth.

Re-gearing enhanced post 2019

EPS

- ▶ Overall, existing banking facilities and the conversion of the 2019 Convertible, give many years' potential of 're-gearing' the balance sheet beyond the horizon of our financial estimates. With net initial yields of 4.91% currently and recent debt secured at 2.3%, this is significantly EPS-enhancing.
- ▶ Average cost of debt is set to fall this year and next. Our estimates assume a broadly sideways movement in cost of debt in 2019, despite the 'baked-in' cost reductions from actions already taken. They allow for a potentially significant lengthening of the debt term and an element of conservatism in the numbers.

Dividend cover rising....

- ▶ Rates achieved for rent rises are increasing slowly, but there are significant pressures for this to accelerate (in a measured way).
- ▶ Our 2018 estimates conclude that the dividend will be fully covered (before diluting for the 2019 Convertible and post an estimated £0.5m Performance Incentive Fee (PIF)). For 2019, we estimate a rise in diluted EPS in excess of 5%, despite the effect of the conversion of the £63.2m outstanding of the 4.25% Convertible and another £0.5m PIF; this generates a 2019 DPS fully covered on a basic and diluted basis.

.... hence scope for moderate increases in rates of DPS growth

As PHP confirms the continuing acceleration of rent inflation and gives confidence that it is investing in assets (thereby re-gearing its balance sheet), long-term EPS growth is highly visible. Even taking on board a rise in the interest rate environment, we see scope for the recent 2.4% growth rate in DPS accelerating gently.

Prospects

Pipeline strength

- ▶ Management has indicated that a pipeline of acquisitions totalling some £150m is currently being worked on. Our estimates take a conservative view that this will take over 18 months to deploy. In addition, half a dozen existing assets are set to benefit from asset management projects (e.g. extensions). We assume this will predominantly complete in 2018 but assume £80m 2018E (and £95m 2019E) in our estimates, as some of the pipeline is visibility into 2019E.

RoI estimates quantified

- ▶ In due course, we anticipate over 5% and towards 10% of the total group portfolio to be in RoI. We use, as a working assumption, a figure of 25% RoI vs. 75% UK for the next few years' expenditure. We take no material account of this factor in our EPS estimates, but RoI enhances EPS growth ahead of that generated by UK investment. RoI NIY is currently c.3.0% greater than the 10-year cost of money in RoI, versus 1.4% for the UK (note these figures are post the incremental management fee of 0.3% p.a). Further, RoI investment is funded 100% in € debt.

RoI alone would drive good DPS rises

- ▶ Thus, were 25% of total net property investment to be RoI, all funded by debt, illustratively, a £25m acquisition in a 'typical' year would add £1.43m operating profit and cost £0.68m interest. This represents a £0.75m increment to PBT, or 2.4% of the historical £31.0m EPRA PBT figure. This 2.4% growth, looking just at a £25m investment, should be compared with 2018E DPS growth of 2.9%.

Convertible set to convert, reducing average cost of debt; equity-dilutive in short term, but masses of 'firepower' through 2019, 2020 and beyond.

- ▶ PHP shares currently stand at a 19% price premium to the conversion strike price. Given this premium and noting that £19.3m had already been converted late in 2017, conversion is virtually a given. This reduces LTV in our model to 51.4% at end-2019 (52.9% end-2017 and 54.0% 2018E before the benefit from conversion).
- ▶ Longer term, our model, taking into account the major firepower from the Convertible, leaves major scope for earnings-enhancing investments funded solely by incremental debt for many years, based on the figures above. PHP has an internal ceiling towards 60% LTV.
- ▶ This – and the existing banking facilities' headroom – gives plenty of scope to fund rates of acquisition at or significantly ahead of our estimates. With net initial yields of 4.91% currently and recent debt secured at 2.3%, this ongoing 're-gearing' of the balance sheet beyond 2019E is usefully EPRA EPS-enhancing.
- ▶ Rates on rent rises are increasing slowly, but there are significant pressures for this to accelerate (in a measured way).

Debt profile lengthening...

- ▶ We anticipate a steady lengthening of the debt maturity profile (currently the average duration is 6.3 years – up from 5.1 years).

...lower risk, but also lower cost...

- ▶ Average cost of debt is set to fall this year and next, simply on the basis of replacing historically more expensive bonds and loans. It fell again in 2017, to 4.09%, and we note that, from November 2017, the £75m Aviva loan facility renews at a lower rate of 3.1% (11 years), saving £0.7m p.a. from that date. In 2019, the £75m 5.375% retail bond matures, as does the 4.25% Convertible (with £63.2m remaining). Note that our estimates assume a broadly sideways movement in cost of debt in 2019, despite the benefits outlined above. This is to allow for a potential significant lengthening of the debt term, which is quite

...quantifying drivers of falling cost of debt

possible (and the rising yield curve steepening further – which we deem unlikely). We consider our 2019 estimate for interest cost to be particularly conservative.

Rents accelerating, debt cost falling

The rising rental inflation

The major investment case, beyond the low risk pertaining to this asset class, is that an acceleration in tri-annually reviewed rental growth is happening now, while the average cost of debt is falling. Although the rent rate rise is still modest, it points to an ongoing acceleration in rental inflation. PHP announced rent inflation of 1.1% for 2017 as a whole. The figure was 0.9% in 2016, so the pace is modestly accelerating.

With money starting to be invested into the new build by NHS England, we see a supportive environment. We anticipate further acceleration in rent rises (as does PHP in its stated DCF valuation modelling). The driver is the effective demand of the NHS for the development of more, new facilities. Developers require a return, and rents drive this. Building costs are rising. That said, Britain's exit from the EU cuts both ways, reducing supply of labour and also cutting forecasts for demand. A falling exchange rate increases the costs of some materials, while falling confidence may reduce land costs. Industry analysts Gardiner & Theobald stated recently: "Headline rates of tender price inflation for 2018 are down to 1% for the UK average...., with more prospect of downside than upside pricing. 2019 headlines remain unchanged at 1.5% UK average whilst forecasts for 2020 and 2021 have reduced by 0.5%." We still see upward momentum.

Rent rises of 1.6% in the pipeline, and greater rises likely

There are lags, so this benefits 2018E and particularly 2019E onwards, giving good forward visibility to cash-backed profit drivers to dividend growth

Past cost rises still have not been fully reflected in rent rises, we consider. In the table below, we initiate 2019 estimates; we have maintained 2018 estimates. The second line in the table is the 'lead' indicator, i.e. the agreed rents. This gives confidence as to the rising momentum behind the future achieved rents.

Income y-o-y growth components per annum (%)				
	2016	2017	2018E	2019E
Growth of portfolio (time-weighted)	5.0	6.5	6.0	6.5
Headline uplift on agreed rent reviews	0.9	1.1	1.5	2.0
Achieved rental increases, average	1.8	1.0	1.5	1.5
Total income increase (driven by achieved rents)	6.8	7.5	7.5	8.0

Source: PHP, Hardman & Co Research

As a point of comparison, on 9th February, MedicX Fund announced that, since 1st October 2017, 30 leases had been reviewed and the equivalent of a 1.89% p.a. increase had been achieved. This was up from 1.02% in the year to 30th September 2017. Of these reviews, an uplift of 1.14% p.a. was achieved through open market reviews. We understand there may be modest scope for some PHP reviews to eventually agree at slightly higher levels than reported.

Drivers for rent income growth beyond 2018E

The drivers for rent income growth beyond 2019E include the following:

- ▶ Continuing expansion of the portfolio, re-gearing LTV (which enhances EPS).
- ▶ Accelerating rises in rent on new leases agreed.
- ▶ Increasing investment in the (somewhat) higher-yielding Republic of Ireland (RoI) market. 2017 acquisitions in RoI averaged more than 100 basis points over those achieved in the UK.

Cost of debt reducing – with more to come

Current cost of debt has fallen to 4.1% and will fall further in 2018E

The average cost of debt currently is 4.1%. Despite the rising market environment and likely lengthening of debt maturity profile, we estimate ongoing, but only modest, falls in the rates PHP is set to pay (see p. 10). Current PHP cost compares with 4.26% at the previous results announcement (August 2017). End 2016 average cost was 4.65%.

5.375% interest bond set to mature, as will other relatively expensive debt

Interest cost will fall further as the more expensive debt falls due. The £75m 5.375% unsecured retail bond matures in July 2019 and new facilities – at current market rates – are available usefully below the current average interest rate. There are also benefits from the selective unwinding of some older ‘swaps’ put in place to synthetically fix interest rate costs. More specifically, a £20m, 4.76% fixed-rate swap was cancelled some months ago. This has ongoing £0.8m p.a. benefits, effective for very few months in 2017 and for the full 2018 year. Our new 2018 estimates forecast debt up some 10%.

We model on the assumption of costs rising towards 4.0% in the medium term

The most recent debt line has cost 2.83%. Marginal costs stand at 2.3%. In our strategic review of September 2017, we based our modelling assumptions on 10-year swaps doubling from 1.3% to 2.5%. Since then, UK 10-year swaps have risen to 1.55%. We note that, over the past month, 10-year ‘risk-free’ UK bond yields have risen from 1.34% to 1.61%. We also note that 20-year rates have risen, but less so.

Despite a rising market rate environment, we maintain our ‘target’ of a 2.5% rate for UK 10-year swaps. Thus (adding on the lenders’ margins), long-term debt might cost PHP 4% maximum in its current investment/refinancing cycle.

Having read the cycle correctly as rates fell, PHP is now lengthening its debt book...

PHP’s average debt to maturity is 6.3 years, up from 5.1. It is lengthening the debt maturity profile (having correctly kept it shorter in an era of falling rates). There is plenty of scope to lengthen it, progressively, while keeping dividends well covered. We anticipate a modest rise in the (currently very small) quantum of € debt.

...maturity profile: lengthening and thus reducing risk

For our initiated 2019 estimates, we forecast average debt up only 3%. This is a direct result of the conversion of over £63m of Convertible. We model the 2019E interest rate conservatively, see page 12, to allow for market risk and a lengthening of the debt profile further. With £75m 5.375% debt maturing in 2019, there is every chance that the 2020E interest cost will average a rate at or below 2019E, even in a rising interest rate environment. Further, the growing RoI assets are funded by € debt.

Fee rises are well below asset growth

Fees

In 2017, investment assets grew 11.6%, advisory fees 6.9% (pre PIF, performance fee of £0.5m). In the past two years, investment assets grew 23.7%, advisory fees 17.0% (pre PIF, performance fee of £0.5m). Advisory fees totalled £5.3m in 2015, £5.8m in 2016 and £6.2m in 2017. Service charge management fees paid to Nexus in the year in connection with the Group’s properties totalled £0.3m (2016: £0.1m). We estimate a small reduction in this element (a series of one-off projects) in 2018E.

The advisor reduced its fee structure in 2017

In April 2017, Nexus revised its investment advisory fee structure, backdating reduced fees to start 2017. At the same time, the PIF was revised, to be based on an EPRA NAV basis, as opposed to IFRS. IFRS includes, for example, mark-to-market of interest rate swaps and the convertible bond. The PIF entitles Nexus to 11.25% of EPRA NAV total return above an 8.0% hurdle rate. No PIF was payable prior to 2017. All our figures are stated **post** the PIF. We estimate a run-rate of some £0.5m p.a.

All our estimates are POST PIF

Between £1bn and £1.25bn, fees are 0.3250% of gross investment property assets, to £1.5bn, 0.3%, to £1.75bn, 0.275%, and to over £1.75bn, 0.25%.

Convertible bond: fuel for expansion

The 2019 Convertible has started to convert (November and December 2017)

The loan to value overall gives scope to buy more assets for debt

Purchase of assets, utilising this new headroom, would have a material, positive EPS impact

Fully-diluted EPS 2018E is 3% below undiluted. PHP will look to reinvest the debt 'headroom' generated by conversion.

There is a 4.25% Convertible bond remaining outstanding, maturing in May 2019.

A maximum theoretical 3.2% EPS initial dilution will occur upon full conversion. We made the point before, and make it again now, that re-investment of the debt reduction resulting from conversion would be accretive to earnings – so the effect of the Convertible is to provide seed-corn/fuel for the next two or three years' expansion.

£63.2m out of £82.5m originally issued remains outstanding. 23% of the bond (£19.3m) was converted in November and December 2017. When the whole converts, shares in issue will rise and interest cost will fall, naturally, but, with LTV being a guide to debt appetite, conversion gives scope to take on more debt. Recent borrowing costs are well below the 4.25% bond coupon.

At end-2019, total shares in issue will equate to an estimated 684m shares. As conversion is assumed to take place upon maturity in May 2019 (it might happen before), average shares in issue equate to 646m in 2019E (which has part of the year pre-conversion) and 684m in 2020E.

Our-end 2018E LTV ratio is 54.0%, with £798m net debt (including small, positive fair-value adjustments) on £1461m investment properties. Pro-forma, were the full Convertible to be converted as at end-2018, debt would reduce to £735m (this ignores fair value issues – so, actually, the debt would reduce to a slightly lower figure). On £1461m assets, this equates to 50.3% LTV pro-forma. PHP has stated its desire to keep below 60%, but the likely target is to approach this 60% level. This illustrates that the Convertible gives plenty of fire power to purchase additional investment property assets funded by debt.

We have undertaken a theoretical pro-forma exercise and calculate that 2018 pro-forma EPRA EPS would rise 12% were the LTV to stand at 58%, as opposed to the 50.3% pro-forma for full conversion of the Convertible.

Looking at it the other way – i.e. the dilutive effect of the Convertible – the following pro-forma metrics are generated for 2018. Currently, we assume the remaining convertible bond converts in May 2019. If it had all converted at the start of 2018 and no incremental property purchases had been made, £2.7m interest would be saved, but there would be 64.8m more shares in issue. Our 5.40p 2018E EPRA EPS (pre-dilution) reduces to 5.29ps on 684m fully-diluted shares. The reduction to 5.29p EPRA EPS is effectively like 'changing down a gear to accelerate', with the lowered LTV offering the headroom to grow substantially – as outlined and illustratively quantified above.

Risks

Upward-only rents, 99%+ occupancy, A1 covenant

There is no rental income or void risk. The average lease length is 13.3 years, with a minimal amount ending within five years. Now that the debt cost is so low (five-year swaps are well under 1%, 10-year swaps are ca. 1.2%), the policy is to lengthen the debt profile, we understand, thereby reducing risk, while still lowering cost of debt.

Modest re-finance risk

There is market risk with regard to interest rate exposure. Interest rate 'swaps' are in place, which are all risk-reducing, covered positions. The average length of the debt facilities is 6.3 years end December 2017 (5.8 years June 2017), and the large majority of this is fixed-rate (including the swaps contracts). Bearing in mind the long leases, clearly, with hindsight, PHP has been entirely correct to wait for market rates to fall, in order to lengthen its fixed-rate exposure. As facilities mature, they need to be replaced, and there is risk as to the cost of funds. This risk relates to fluctuations in market interest rates. With LTV at 54.4% and leases' weighted length to expiry some 13.3 years, we consider the availability of funding at attractive rates to be high.

A shrewd call to have started lengthening maturity only recently – excellent timing

Good cashflow

The assets' net initial yield (NIY) at end-2017 was assessed by LSH (the external valuers) at 4.91% (5.17% at end-2016). NIYs on assets are usefully ahead of costs of debt and, with an efficient cost base (under 12% EPRA cost ratio), acquisitions are cash-flow-positive, even if fully debt-funded. The current loan to value (LTV) stands at 52.9%, with an internally imposed ceiling of around 60%. PHP can re-gear its balance sheet on a conservative LTV, with 2018E interest cover at exactly 2.0x being no constraint either.

Dividend cover considerations

Dividend cover has been below 100% recently, but this has been a function principally of the dilutive effects of a large (£150m) oversubscribed 2016 equity issue. This issue was solely to accelerate growth.

Interest cover considerations. Note 1.3x is the group covenant.

Interest cover (operating profits as multiple of total finance costs) fell to 1.7x in 2009, illustrating the strength of a business invested in rental streams that are upwards-only. The cover fell to a low point of 1.3x in 2012, but this was a function of a 19% expansion in the portfolio that year, funded by debt, itself a function of a well-placed commitment to growth on attractive NIYs on the assets.

Stress-test on interest rates and costs – all robust

As with any real estate investment – funded by debt – there is a combination of risks based on levels of financial gearing and due diligence on assets acquired. Even if the average cost of PHP's debt were to rise to 5.0% five years from now, its dividend would be over 100% covered (and this would be without re-gearing the balance sheet). With PHP borrowing recently at 2.83%, we consider this risk to be distinctly modest. PHP has access to many varied sources of financing. Note that the trend is still for PHP's specific costs to reduce as older debt matures. PHP's ability to secure finance through a range of different markets (banks, institutions, private placement, retail bonds, etc.) and its particular attraction in bear markets reassure us that the right level of risk is being taken on.

PHP has access to many varied sources of financing

Brexit is seen by us, on balance, as a positive for PHP. Any changes to labour availability are likely to be in the nature of tightening. We are seeing a reduction in confidence and a likely construction slowdown, but immigration of skilled labour is a material issue. Currency falls would, on balance, lead to materials and energy cost rises. Construction tender prices are rising. Occupancy (as in GP surgery usage) is not, in any way, GDP- or confidence-related and, of course, the leases are long-term. Rental growth rates under these circumstances are unlikely to slow. The attractions of full tenancy occupation on long-term A1 covenant leases are all the stronger.

Calculation of forward estimates

We summarise our estimates below: (See also financial analysis tables.)

- ▶ Total **income** increase of 7.0% in 2018 and 8.0% in 2019.
- ▶ Total **operating cost** (including PIF) increase of 4.5% in 2018 and 5.5% in 2019.
- ▶ Total **finance cost** increase (including the assumed £0.5m, rising to £0.6m income from developers on forward funding) of 8.2% in 2018 and 7.6% in 2019.
- ▶ We assume a rise in average shares in issue, entirely as a result of the Convertible bond converting to equity. Average shares in issue were 601m in 2017; we estimate 619m in 2018 and 646m in 2019. In 2020, the Convertible will have converted to equity for the whole year. We estimate 2019 year-end and also 2020 average shares in issue of 684m.
- ▶ Our EPRA EPS and DPS estimates are shown in the table below. Note that we also show estimates for fully-diluted EPRA EPS **post** a £0.5m PIF fee.

EPRA EPS and DPS

Earnings and dividends per share (pence)				
	2016	2017	2018E	2019E
EPRA EPS 'headline', i.e. not diluted	4.770	5.170	5.400	5.630
EPRA EPS fully-diluted for Convertible	4.690	5.020	5.290	5.570
EPRA EPS fully-diluted for Convertible and excluding PIF	4.690	5.100	5.370	5.650
DPS	5.125	5.250	5.400	5.550
DPS (fully-diluted) cover % [1]	91.5	95.6	98.0	100.4

Source: PHP historical figures, Hardman & Co Research estimates

[1] Cash cover is higher in 2016 and 2019E as a result of share issuance events; on a cash basis, 2016 was fully covered. In addition, there is an element of scrip dividends.

Income

Income y-o-y growth components per annum (%)				
	2016	2017	2018E	2019E
Growth of portfolio (time-weighted)	5.0	6.0	6.0	6.5
Headline uplift on agreed reviews	0.9	1.1	1.5	2.0
Achieved rental increases, average	1.8	1.0	1.5	1.5
Total income increase	6.8	7.0	7.5	8.0

Source: PHP historical figures; Hardman & Co Research estimates

Excluding the direct property expenses, ca. 75% of costs comprise advisory and (as of 2017) performance fees (PIF). Advisory is driven by the external management (Nexus) fee structure. Between £1bn and £1.25bn gross assets, fees are 0.3250%, to £1.5bn, 0.3%, to £1.75bn, 0.275%, and to over £1.75bn, 0.25%.

Costs

Costs, components per annum (£m)				
	2016	2017	2018E	2019E
Total costs [1]	8.2	9.9	10.3	11.0
PIF included above	0.0	0.5	0.5	0.5
Rises y-o-y:				
Rise in admin expenses vs. prior year (incl. PIF, etc)	0.5	1.4	0.4	0.4
Rise in costs vs. prior year, as driven by advisory fee agreement on incremental additional property managed	0.5	0.4	0.3	0.3

Source: PHP historical figures, Hardman & Co Research estimates

[1] Advisory, direct property, PIF, remuneration of directors, auditors, etc.

Note: 1H'17 vs. 1H'16 direct property costs rose by £0.1m, total administrative costs by £0.4m (or 11%).

No PIF is payable at the interim stage

Interest

Components of rise in interest costs (£m)				
	2016	2017	2018E	2019E
Year-end debt	663.2	726.6	798.2	822.1
Average interest rate (%)	4.65	4.09	4.00	4.00
Finance cost excl. all developer income and fees	28.0	26.2	28.3	30.0
Fees	2.7	2.3	3.0	4.0
Swap interest cost	5.1	3.4	3.4	3.4

Source: PHP historical figures, Hardman & Co Research estimates

- ▶ Note that there is income from developers received relating to forward funding. This is excluded in the table above. From time to time, there are break fees, but there are none in the years above.
- ▶ A 5.375% £75m unsecured retail bond matures July 2019.
- ▶ A £20m, 4.76% fixed-rate swap was cancelled some months ago. This has ongoing £0.8m p.a. benefits, effective very few months in 2017 and for the full 2018 year. Our 2018E allows for additional swaps.
- ▶ Aviva refinance started in November 2017, saving nearly £0.7m p.a. post that date.
- ▶ Our model works on unchanged average rate of interest cost 2019E vs. 2018E. This reflects a significant underlying fall for the reasons set out above. It also assumes a lengthening of the debt maturity and that the yield curve slopes upwards. In addition, we allow for a rise in market rates of interest. We see 4.0% as a conservative number for average cost of debt for 2019E and indeed 2020E.
- ▶ We estimate incremental debt of £24m at year-end 2019 vs. 2018. However, Convertible maturity in May will distort this, so our average net debt assumption for 2019 is £50m higher than for 2018 (including the part year for the Convertible). We estimate a £0.6m saving in 2018 vs. 2017 in respect of Aviva, so our average interest rate calculated in the table above should prove conservative. We assume gentle market rate rises, but the 2019 £75m retail bond debt is set to be refinanced at usefully below 5.375%. This factor alone saves more than £0.5m in 2019 and approaching £1m in 2020. Our 2019E rate, table above, therefore allows for modestly rising interest costs excluding the retail bond.

Financial analysis

Revenue account (£m)							
Year-end December	2013	2014	2015	2016	2017	2018E	2019E
Rental income total received	41.9	60.0	63.1	67.4	72.5	78.0	84.2
Finance lease income	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total income	42.0	60.0	63.1	67.4	72.5	78.0	84.2
Direct property expenses	0.4	0.7	0.9	0.9	1.2	1.3	1.4
Administrative expenses	6.1	6.8	6.8	7.3	8.7	9.1	9.6
Total expenses	6.5	7.5	7.7	8.2	9.9	10.3	11.0
Operating profit	35.5	52.5	55.4	59.2	62.6	67.6	73.2
Operating margin (%)	84.7	87.5	87.8	87.8	86.3	86.8	86.9
Devt. loan interest, other income	0.2	1.0	0.7	0.5	0.3	0.5	0.6
Swap interest paid	-7.7	-7.6	-6.0	-5.0	-3.4	-3.4	-3.4
Bank, bond loan interest, fees	-18.5	-27.7	-28.4	-28.0	-28.5	-31.3	-34.0
Break fees [1]	-0.9	-1.2	0.0	0.0	0.0	0.0	0.0
Net finance costs	-26.9	-35.5	-33.7	-32.5	-31.6	-34.2	-36.8
EPRA pre-tax profit	9.5	18.2	21.7	26.7	31.0	33.4	36.4
Net revaluation on portfolio	2.9	29.2	39.8	20.7	64.5	19.4	28.2
Fair value gain on derivatives	11.4	-2.5	1.0	-2.2	-0.3	0.0	0.0
Fair value on Convertible	n.a.	-4.5	-6.5	-1.5	-3.3	0.0	0.0
Non-recurring expenses	-2.7	-2.4	0.0	0.0	0.0	0.0	0.0
Reported pre-tax profit	20.2	36.9	56.0	43.7	91.9	52.8	64.6
Tax charge	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EPRA EPS (p) basic [2]	2.67	4.10	4.87	4.77	5.17	5.40	5.63
EPRA EPS (p) diluted for Convertible	2.67	4.10	4.77	4.69	5.06	5.28	5.55
Reported EPS (p)	5.67	8.30	12.57	7.80	15.30	8.53	10.00
Dividend per share (p)	4.750	4.875	5.000	5.125	5.250	5.400	5.550
Avg. no. of shares in issue (m)	356.4	444.4	445.6	560.1	600.7	619.4	646.4
Fully-diluted shares (Convertible) (m)		496.0	530.8	644.7	665.5	684.2	684.2

Source: PHP historical figures, Hardman & Co Research estimates

[1] Such break fees excluded from Hardman adjusted EPS figures

[2] EPRA EPS excludes revaluations among other more minor factors

PHP's historical performance returns

In 2017, PHP total asset NAV plus dividends returned 16.4% (vs. 9.7% 2016).

In 2017, PHP's Total Shareholder Return (TSR) accelerated to 9.6%. In 2016, the TSR was 7.3%, and in 2015 23.5%. In the past 10 years, UK primary healthcare assets have returned a CAGR of just over 7%, which compares with all property at some 4.5%. PHP has fully kept up with this rise.

Balance sheet (£m)							
Year-end December	2013	2014	2015	2016	2017	2018E	2019E
Investment properties, start of period	622.4	941.5	1026.2	1100.6	1220.1	1361.9	1461.3
Currency translation effect	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additions to portfolio	316.2	55.5	34.6	98.8	77.3	80.0	95.0
Revaluations	2.9	29.2	39.8	20.7	64.5	19.4	28.2
Non-current assets							
Investment properties, end of period	941.5	1026.2	1100.6	1220.1	1361.9	1461.3	1584.5
Finance leases	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Interest rate swaps	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sub-total: non-current assets	942.0	1026.2	1100.6	1220.1	1361.9	1461.3	1584.5
Current assets							
Receivables	4.8	5.7	4.1	3.3	6.4	4.4	4.4
Finance leases, etc.	0.0	0.0	0.0	0.0	0.3	0.0	0.0
Net cash + short-term investments	5.5	12.1	2.9	5.1	3.8	11.7	10.3
Sub-total: current assets	10.3	17.8	7.0	8.4	10.5	16.1	14.8
Total assets	952.3	1044.0	1107.6	1228.5	1372.4	1477.4	1599.3
Current liabilities							
Deferred rental income	11.9	12.3	13.2	14.1	15.0	15.0	15.0
Trade and other payables	16.3	14.2	16.1	13.6	15.4	16.0	16.0
Term loans	1.9	0.7	0.9	0.8	0.8	1.0	1.0
Interest rate swaps	7.6	5.8	4.7	3.8	2.7	2.7	2.7
Sub-total: current liabilities	37.7	33.0	34.9	32.3	33.9	34.7	34.7
Non-current liabilities							
Term loan over 1 year, bond	592.6	666.6	696.7	667.5	729.6	808.9	831.4
Interest rate swaps	21.5	35.2	30.6	29.5	22.1	29.5	29.5
Sub-total: non-current liabilities	614.1	701.8	727.3	697.0	751.7	838.4	860.9
Total liabilities	651.8	734.8	762.2	729.3	785.6	873.1	895.6
Shareholders' funds	300.5	309.2	345.4	499.2	586.8	604.3	703.7
EPRA shareholders' funds	329.1	354.2	391.6	545.0	623.6	648.5	747.8
Shares in Issue at period-end, No. (m)	444.4	445.1	446.3	598.2	619.4	619.4	684.2
NAV per share (p)	69.6	69.5	77.4	83.5	94.7	97.6	102.8
EPRA NAV per share (p)	76.1	79.6	87.5	91.1	100.7	104.7	109.3
Net debt	589.0	655.2	694.7	663.2	726.6	798.2	822.1
Debt % NAV	196.0	211.9	201.1	132.8	123.8	132.1	116.8
Change in term loan	269.5	74.0	30.1	-29.2	62.2	79.4	22.5
Loan to value ratio	61.8%	62.8%	62.7%	53.7%	52.9%	54.0%	51.4%
Net debt [1]	579.7	658.0	694.7	663.2	726.6	798.2	822.1

Source: PHP historical figures, Hardman & Co Research estimates

[1] Measure of net debt including fair value, carrying value, unamortised borrowing costs

Investment and development properties (£m)			
At December 2017	UK	RoI	Total
Investment	1347.1	13.7	1360.8
Development	1.1	0.0	1.1
Total	1348.2	13.7	1361.9

Source: PHP accounts: historical figures

Cashflow (£m)							
Year-end December	2013	2014	2015	2016	2017	2018E	2019E
Operating activities							
Profit before taxation (adjusted for fair value)	6.0	38.2	49.9	43.1	91.9	52.8	64.6
Adjustments for:							
Net valuation changes on investment property	-2.9	-29.2	-39.8	-20.7	-64.5	-19.4	-28.2
Early repayment fees and bond issue	0.0	3.6	0.0	0.0	0.0	0.0	0.0
Profit on disposal of investment property	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial income receivable	0.0	-1.0	0.0	0.0	0.0	0.0	0.0
Finance costs payable	23.3	35.3	33.7	32.5	32.2	34.2	36.8
Sub-total	26.4	46.9	43.8	54.9	59.6	67.6	73.2
Increase in trade and other receivables	4.4	-0.5	1.0	0.6	-3.1	0.7	0.8
Increase in trade and other payables	0.4	-2.0	2.1	-1.5	2.0	0.0	0.0
Interest, fees paid	-26.9	-35.9	-37.0	-46.0	-35.9	-32.2	-34.8
Interest received	0.0	0.5	1.3	0.5	0.0	0.0	0.0
Taxation (& REIT) paid	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
Net cash inflow from operating activities	4.3	9.0	11.2	8.4	22.6	36.0	39.1
Investing activities							
Acquisitions net of cash acquired, other	-232.5	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from sale of investment properties	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additions to investment properties	-58.6	-54.5	-29.5	-97.4	-75.4	-80.0	-95.0
Net cashflow operating and investing	-286.8	-45.5	-18.3	-89.0	-52.8	-44.0	-55.9
Financing activities							
Net proceeds from issue of share capital/ conversion	91.8	0.0	-0.1	145.2	19.3	0.0	64.8
Dividends paid	-16.1	-20.7	-21.1	-24.7	-29.8	-27.6	-32.9
Net cashflow (change in debt)	-211.1	-66.2	-39.5	31.5	-63.3	-71.6	-23.9
Net proceeds of long-term borrowings	-16.3	69.0	30.3	-29.3	62.1	79.5	22.6
Net cash inflow from financing activities	59.4	48.3	9.1	91.2	51.6	51.9	62.5
Net debt	589.0	655.2	694.7	663.2	726.6	798.2	822.1
Increase in cash and cash equivalents	-15.8	1.6	-9.4	2.2	-1.2	7.9	-1.4
Opening cash and cash equivalents	25.1	9.3	12.1	2.9	5.0	3.8	11.7
Closing cash and cash equivalents	9.3	12.1	2.9	5.1	3.8	11.7	10.3

Source: PHP historical figures, Hardman & Co Research estimates

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The full detail is on page 26 of the full directive, which can be accessed here: <http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf>

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