EDISON

Target Healthcare REIT

Continuing DPS and positive total returns

Q420 NAV and business update

Real estate

Target's portfolio of high-quality, purpose-built care homes continued to generate positive returns during Q420, driven by RPI-linked rental uplifts, with quarterly dividend payments maintained. The COVID-19 pandemic has presented a significant challenge to tenant operators; however, it does not change the underlying demographic-driven fundamentals that drive the sector and highlights the critical role that it plays in supporting the NHS.

Year end	Revenue (£m)	Adjusted net earnings** (£m)	Adjusted EPS*(p)	EPRA NAV/ share (p)	DPS (p)	P/NAV/ share (x)	Yield (%)
06/18	28.4	15.7	5.54	105.7	6.45	1.06	5.8
06/19	34.3	20.1	5.45	107.5	6.58	1.04	5.9
06/20e*	43.8	24.9	5.65	108.9	6.68	1.03	6.0
06/21e*	47.6	28.6	6.25	111.9	6.68	1.00	6.0

Note: *Not updated for Q420 data. **EPRA earnings adjusted for development interest under forward fund agreements.

Q420 NAV total return of 1.6%

Q420 EPRA NAV total return, including DPS paid, was 1.6%, taking the FY20 total to 6.8%. A Q420 DPS of 1.67p has been declared, and the FY20 aggregate DPS of 6.68p was 1.5% up on FY19. Across the portfolio of properties, confirmed or suspected cases of COVID-19 have fallen to very low levels and tenants are now seeking to rebuild occupancy. Of rents payable in respect of recent rent quarter dates, 96% has been received after allowing for agreements in respect of a limited proportion of homes to pay monthly in advance, and excluding two immature care homes on which agreements were in place prior to the pandemic. We will review our estimates with the detailed FY20 results in September although the unaudited quarterly data suggest that adjusted earnings were lower than we forecast (c £23.4m vs £24.9m forecast, see page 4) driving a slightly lower (108.1p) EPRA NAV, perhaps including higher non-cash provisioning against rent receivables. Positively, the recent return to acquisitions is not anticipated in our FY21 forecast.

Strong focus on asset quality

The care home sector is driven by demographics rather than the economy, and a growing elderly population, combined with a shortage of quality homes, suggests a strong demand in years to come. Target puts a very strong focus on the quality and location of the assets as well as the operational capabilities and financial performance of tenants. It believes that modern, purpose-built homes with flexible layouts and high-quality residential facilities, including single-occupancy bedrooms complete with en-suite wet rooms, are more likely to provide sustainable, long-duration rental income, appealing to residents and allowing tenants to provide better and more effective care.

Valuation: Indexed, long-term income

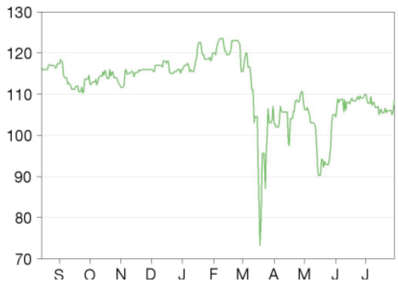
Target's visible, indexed rental growth supports long-term dividend growth. Aggregate DPS of 6.68p for FY20 represents a yield of 6.0% while the shares trade at only a small premium to NAV. Continued robust rent collection and DPS payments through the pandemic indicate the potential for a re-rating.

14 August 2020

Price	**112p**
Market cap	**£512m**

Net debt (£m) at 30 June 2020	115.6
Net LTV (%) at 30 June 2020	18.7
Shares in issue	457.5m
Free float	100%
Code	THRL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	4.3	13.9	(4.0)
Rel (local)	3.6	7.2	10.4
52-week high/low		123.5p	73.2p

Business description

Target Healthcare REIT invests in modern, purpose-built residential care homes in the UK let on long leases to high-quality care providers. It selects assets according to local demographics and intends to pay increasing dividends underpinned by structural growth in demand for care.

Next events

Q420 DPS paid	28 August 2020
FY20 results	Sept. 2020

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Edison profile page

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Investment summary

COVID-19 update

Target continues to work closely with tenants and, assisted by the wider availability of COVID-19 testing across the sector, says that just a handful of the 71 operational homes in its portfolio are reporting confirmed or suspected cases. These represent less than 0.3% of the 4,925 beds, down from a peak in the third week of April of 3.2% (162 beds).

In its 6 July trading update Target reported that 96% of the rent payable in respect of the recent quarter dates (24 June in England, Wales and Northern Ireland and 28 May in Scotland) had been collected, after allowing for agreements in respect of a limited proportion of the 71 operational homes to pay monthly in advance, and excluding two immature care homes on which agreements were in place prior to the pandemic. The 4% of rent currently outstanding relates to care homes where active asset management initiatives have been put in place which Target says provides it with strong visibility of value recovery in the near term.

Consistently positive quarterly returns continued in Q420

RPI rental uplifts continued to support growth in the rent roll and increasing property valuations in Q420, as it has throughout the year. The unaudited Q4 EPRA NAV per share increased slightly to 108.1p (Q320: 108.0p) and including the 1.67p Q320 DPS paid the NAV total return in the quarter was 1.6%. A Q420 DPS of 1.67p has been declared for payment on 28 August, bringing the total for the year to 6.68p as expected, up 1.5% compared with FY19.

Exhibit 1: Quarterly NAV total return (unaudited)

	Sep-19	Dec-19	Mar-20	Jun-20	Cumulative
(p)	**Q120**	**Q220**	**Q320**	**Q420**	**Q1–Q420**
Opening EPRA NAV per share	107.5	107.9	108.1	108.0	107.5
Closing EPRA NAV per share	107.9	108.1	108.0	108.1	108.1
DPS paid	1.64475	1.6700	1.6700	1.6700	6.65475
NAV total return (%)	**1.9%**	**1.7%**	**1.5%**	**1.6%**	**6.8%**

Source: Target Healthcare REIT

The quarterly data indicate a full year NAV total return of 6.8%, with a positive return in each period, and takes the cumulative total return since IPO to 55.8% or an annual average compound return (dividends added back but not reinvested) of 6.1%. More than 80% of the total return has been in the form of dividend distributions.

Exhibit 2: NAV total return since IPO

(p)	FY14*	FY15	FY16	FY17	FY18	FY19	FY20	Cumulative
Opening NAV per share	98.0**	94.7	97.9	100.6	101.9	105.7	107.5	98.0
Closing NAV per share	94.7	97.9	100.6	101.9	105.7	107.5	108.1	108.1
DPS paid	6.5	6.1	6.2	6.3	6.4	6.5	6.65	44.6
NAV total return (%)	3.3%	9.7%	9.0%	7.5%	10.1%	7.8%	6.8%	55.8%
Compound annual average return (%)								6.1%

Source: Target Healthcare REIT. Note: **22 January 2013 to 30 June 2014. **Adjusted for IPO costs.

Also consistently positive throughout the quarters were the recurring income returns, shown in the quarterly data and in Exhibit 3 as the 'movement in the revenue reserve', and the capital returns (property revaluation less acquisition costs).

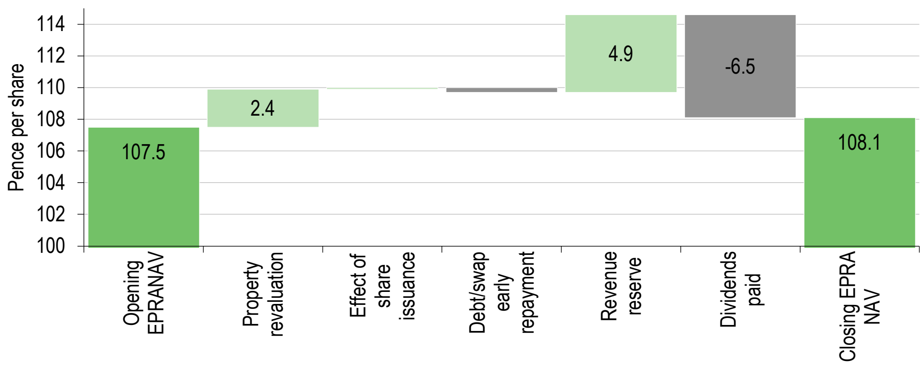
Exhibit 3: Summary of FY20 quarterly data

(pence per share)	Q120	Q220	Q320	Q420	Q1–Q420
Opening EPRA NAV per share	**107.5**	**107.9**	**108.1**	**108**	**107.5**
Property revaluation	0.6	1.3	0.7	0.6	3.2
Property acquisition costs & other capital items	(0.1)	(0.6)	(0.1)	0.0	(0.8)
Net gains/(losses) on investment property revaluation	**0.5**	**0.7**	**0.6**	**0.6**	**2.4**
Net effect of early repayment of debt facilities/swap	0.1	0.0	0.0	0.0	0.1
Cost of corporate restructure	0.0	0.0	(0.3)	0.0	(0.0)
Movement in revenue reserve	1.2	1.2	1.3	1.2	4.9
Dividend paid	(1.4)	(1.7)	(1.7)	(1.7)	(6.5)
Closing EPRA NAV per share	**107.9**	**108.1**	**108.0**	**108.1**	**108.1**

Source: Target Healthcare REIT data

Exhibit 4 shows a bridge of the unaudited EPRA NAV movement during the year with dividend payments exceeding recurring income and the difference made up by net positive capital movements (net property revaluation less refinance costs).

Exhibit 4: Unaudited FY20 EPRA NAV per share bridge



Source: Target Healthcare REIT data

Target's last equity fund-raising was in September 2019 (Q120) when it raised £80m (gross) in an oversubscribed issue of 72.4m shares. The equity proceeds were quickly deployed in Q220 and acquisitions continued into Q320. However, the COVID-19 pandemic then slowed further deployment of available debt capital, with two potential acquisitions postponed at a late stage of negotiation, until a clearer picture of the impact of the pandemic could be assessed. As a result, the balance sheet remained liquid with modest gearing (loan to value or LTV) through Q420. The relatively modest growth in the portfolio valuation during the quarter reflected positive revaluation (driven by RPI-linked rental growth), as has been the case throughout the year, and continuing investment in forward funded pre-let development assets.

Exhibit 5: Summary of quarterly balance sheet development

	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
(£m)	**Q419**	**Q120**	**Q220**	**Q320**	**Q420**
Investment properties at market value	500.9	511.4	589.9	613.4	617.6
Cash	26.9	116.4	31.8	31.1	36.4
Net current assets/(liabilities)	(6.0)	(4.1)	7.9	(8.3)	(7.7)
Bank loan	(108.0)	(130.0)	(135.0)	(142.0)	(152.0)
Net assets	**413.8**	**493.7**	**494.6**	**494.2**	**494.3**
Net debt	(81.1)	(13.6)	(103.2)	(110.9)	(115.6)
Gross LTV (%)	21.6%	25.4%	22.9%	23.1%	24.6%
Net LTV (%)	**16.2%**	**2.7%**	**17.5%**	**18.1%**	**18.7%**

Source: Target Healthcare REIT

Target has £180m of committed banking facilities comprising £80m of fully drawn fixed rate term loan facilities and £100m of more flexible variable rate revolving credit facilities £72m drawn). Adjusting the drawn debt of £152m for £36.4m of cash, the Q420 net LTV was 18.7%. The weighted average cost of the drawn debt, including amortisation of loan arrangement fees, was 2.87% with a weighted average term to expiry of 4.24 years.

Exhibit 6: Summary of debt portfolio

Lender	Facility type	Facility	Maturity	Margin
RBS	Term loan and revolving credit facility	£50m**	September 2021*	Libor + 1.5%
HSBC	Revolving credit facility	£80m	January 2022***	Libor + 1.7%
ReAssure	Term loan	£50m	January 2032	Fixed 3.28%

Source: Target Healthcare REIT data. Note: *RBS facility includes the option of two one-year extensions subject to RBS approval. **The RBS facility comprises a £30m term loan and £20m revolving credit facility. ***HSBC facility includes the option of a one-year extension subject to HSBC approval.

With visibility improving, acquisitions have now resumed

With continuing robust rent collection (see below), falling infection rates reported at properties within the portfolio, and a generally improving operational environment for the tenant operators, in early July Target resumed its portfolio growth with the acquisition of a new-build care home in Bicester, Oxfordshire for a consideration of £15m (including the costs of acquisition), funded from existing cash resources. The high quality 66-bed, purpose-built home is let to Ideal Carehomes, Target's largest existing tenant, and increases the number of homes leased by it to 12. With the 6 July announcement of the acquisition, Target reported that the financial position of the group remained robust with remaining uncommitted capital resources of £26m and a still modest LTV of 20.6%.

The investment manager is analysing and performing due diligence on a number of investment opportunities, both near-term and early stage, but notes that any decision on future acquisitions will take into account both market conditions and the funds available to the group.

Also since end-Q420, practical completion has been reached on the forward funded development of an 80-bed home in Burscough, Lancashire. The home is pre-let to existing tenant, Athena, and opened to tenants in July 2020. The currently remaining forward funded development is at Rudheath, Cheshire, acquired for £9.7m (including transaction costs) in Q320. The home is pre-let at completion to an existing tenant of the group, L&M Healthcare. Planning consent was received in October 2019 with the development phase expected to take 16 months.

Financials and valuation

We expect Target to report audited full-year results in mid-September and we will reassess our financial forecasts at that time with the detail that will become available. Our analysis of the quarterly data suggests that EPRA and adjusted earnings are likely to be lower than our current forecasts, which explains the unaudited end-Q420 EPRA NAV per share of 108.1p being slightly below our forecast 108.9p.

Applied to the average shares in issue, the unaudited quarterly data suggest EPRA earnings, excluding the non-cash IFRS adjustment for fixed or guaranteed rent uplifts (recognised as income on a straight line basis over the length of the lease), of around £22m, compared with our forecast £23.6m on this same basis. Reported EPRA earnings includes the non-cash IFRS adjustments and will be closer to £30m. Given recent bank debt drawings to maintain a liquid balance sheet while continuing investment in the forward funding assets, net interest expense may be slightly higher than we have allowed for. However, we suspect that the main difference with our forecasts is likely to be related to prudential non-cash provisioning against the rent receivables, both COVID-19 related and other, and in part related to IFRS accounting rules. H120 included c £0.3m of provisioning, relating to recently established homes rather than COVID-19, and in our forecasts we had allowed c £0.5m in H220.

Adjusted earnings, on which dividend decisions are made and against which dividend cover is measured, also includes the coupon accrued under forward funding agreements, and we also add back the non-recurring net refinancing costs that we estimate at £0.4m. Our £24.9m forecast for Adjusted earnings includes £0.8m accrued forward funding coupon but the slight delay in completions during the pandemic suggest this may be higher, at perhaps £1.0m. This suggests that adjusted earnings are likely to be c £23.4m for the year compared with dividends paid of c £29.4m (cover of c 80%).

Positively, in FY21 we would expect the provisioning to fall away, in part or in full, while our existing forecasts do not yet allow for Target's return to acquisitions which we expect to have a positive impact.

Based on the FY20 aggregate annual DPS of 6.68p, the shares trade with a yield of 6.0% and a slight premium to NAV.

In Exhibit 7 we show a comparison of Target with its nearest competitors. With investors attracted by secure, long-term yield, the group has performed relatively well over the past 12 months. However, compared with the primary healthcare investors and the social housing investors, the share price performance of the care home investors has lagged the peer group average. We believe this is because rents for primary healthcare and social housing are ultimately funded by government, representing a strong covenant, while the care home sector has inevitably been more challenged by the COVID-19 pandemic. With rent collection to support dividends remaining robust, while benefitting from similar positive demographic trends compared with the peer group, there is good potential for Target's yield differential to narrow versus the peer group average of 4.6%.

Exhibit 7: Peer group comparison

	Price (p)	Market cap. (£m)	P/NAV (x)	Yield (%)	Share price performance			
					1 month	3 months	12 months	From 12M high
Assura	81	2156	1.50	3.5	6%	12%	23%	-8%
Civitas Social Housing	111	688	1.03	4.8	0%	12%	33%	-4%
Impact Healthcare	103	327	0.96	6.1	5%	16%	-8%	-10%
Primary Health Properties	152	1992	1.39	3.8	2%	1%	17%	-10%
Triple Point Social Housing	104	363	0.98	4.9	0%	7%	30%	-5%
Average			**1.17**	**4.6**	**2%**	**10%**	**19%**	**-7%**
Target Healthcare	**112**	**513**	**1.04**	**6.0**	**7%**	**23%**	**-4%**	**-10%**
UK property index	1,484			8.6	1%	14%	-5%	-25%
FTSE All-Share Index	3,380			3.4	-1%	7%	-13%	-21%

Source: Historical company data, Refinitiv. Note: *Based on last published EPRA NAV per share. **Based on trailing 12-month DPS declared. Refinitiv price data at 14 August 2020.

Exhibit 8: Financial summary

Year to 30 June (£000s)	2016	2017	2018	2019	2020e*	2021e
INCOME STATEMENT						
Rent revenue	12,677	17,760	22,029	27,923	36,097	39,883
Movement in lease incentive/fixed rent review adjustment	4,136	5,127	6,334	6,354	7,710	7,710
Rental income	16,813	22,887	28,363	34,277	43,807	47,593
Other income	61	671	3	0	10	0
Total revenue	16,874	23,558	28,366	34,277	43,817	47,593
Gains/(losses) on revaluation	(573)	1,585	6,434	6,155	3,876	7,843
Realised gains/(losses) on disposal	0	0	0	0	642	0
Total income	16,301	25,143	34,800	40,432	48,335	55,437
Management fee	(2,654)	(3,758)	(3,734)	(4,702)	(5,261)	(5,522)
Other expenses	(992)	(1,236)	(1,458)	(2,742)	(2,783)	(1,523)
Total expenditure	(3,646)	(4,994)	(5,192)	(7,444)	(8,044)	(7,045)
Profit before finance and tax	12,655	20,149	29,608	32,988	40,291	48,391
Net finance cost	(929)	(808)	(2,010)	(3,104)	(4,496)	(4,240)
Profit before taxation	11,726	19,341	27,598	29,884	35,796	44,151
Tax	(24)	(219)	11	0	3	0
Profit for the year	11,702	19,122	27,609	29,884	35,799	44,151
Average number of shares in issue (m)	171.7	252.2	282.5	368.8	440.4	457.5
IFRS earnings	11,702	19,122	27,609	29,884	35,799	44,151
Adjust for valuation changes	(425)	(2,211)	(6,434)	(6,155)	(3,013)	(7,843)
Other EPRA adjustments	998	420	1	729	(1,458)	0
EPRA earnings	12,275	17,331	21,176	24,458	31,328	36,308
Adjust for fixed/guaranteed rent reviews	(4,136)	(5,127)	(6,334)	(6,354)	(7,710)	(7,710)
Adjust for development interest under forward fund agreements			261	2011	849	0
Adjust for performance fee	871	997	550	0	0	0
Adjust for debt early repayment fee	0	0	0	0	400	0
Group adjusted earnings	9,010	13,201	15,653	20,115	24,866	28,598
IFRS EPS (p)	6.81	7.58	9.77	8.10	8.13	9.65
Adjusted EPS (p)	5.25	5.23	5.54	5.45	5.65	6.25
EPRA EPS (p)	7.15	6.87	7.50	6.63	7.11	7.94
Dividend per share (declared) (p)	6.18	6.28	6.45	6.58	6.68	6.68
Dividend cover	1.08	0.83	0.82	0.82	0.81	0.94
BALANCE SHEET						
Investment properties	200,720	266,219	362,918	469,596	572,995	586,992
Other non-current assets	3,742	3,988	27,139	37,573	45,504	53,509
Non-current assets	204,462	270,207	390,057	507,169	618,498	640,501
Cash and equivalents	65,107	10,410	41,400	26,946	31,783	25,111
Other current assets	13,222	25,629	3,365	4,264	9,957	9,957
Current assets	78,329	36,039	44,765	31,210	41,740	35,068
Bank loan	(20,449)	(39,331)	(64,182)	(106,420)	(140,684)	(141,484)
Other non-current liabilities	(4,058)	(3,997)	(4,673)	(7,068)	(7,940)	(8,316)
Non-current liabilities	(24,507)	(43,328)	(68,855)	(113,488)	(148,624)	(149,800)
Trade and other payables	(5,002)	(5,981)	(7,360)	(11,802)	(13,788)	(14,352)
Current Liabilities	(5,002)	(5,981)	(7,360)	(11,802)	(13,788)	(14,352)
Net assets	253,282	256,937	358,607	413,089	497,826	511,417
Adjust for derivative financial liability	316	9	115	707	290	290
EPRA net assets	253,598	256,946	358,722	413,796	498,116	511,707
Period end shares (m)	252.2	252.2	339.2	385.1	457.5	457.5
IFRS NAV per ordinary share (p)	100.4	101.9	105.7	107.3	108.8	111.8
EPRA NAV per share (p)	100.6	101.9	105.7	107.5	108.9	111.9
CASH FLOW						
Cash flow from operations	8,906	4,394	23,627	20,476	31,199	33,483
Net interest paid	(681)	(615)	(1,366)	(2,313)	(3,130)	(3,440)
Tax paid	(164)	(543)	(122)	1	(73)	0
Net cash flow from operating activities	8,061	3,236	22,139	18,164	27,997	30,043
Purchase of investment properties	(61,924)	(63,250)	(89,981)	(99,615)	(120,104)	(6,154)
Disposal of investment properties	0	0	0	0	14,402	0
Net cash flow from investing activities	(61,924)	(63,250)	(89,981)	(99,615)	(105,702)	(6,154)
Issue of ordinary share capital (net of expenses)	97,501	0	91,729	48,925	78,176	0
(Repayment)/drawdown of loans	(12,808)	20,906	26,000	42,000	34,000	0
Dividends paid	(9,681)	(15,589)	(17,353)	(23,628)	(29,117)	(30,560)
Other	14,799	0	(1,544)	(300)	(117)	0
Net cash flow from financing activities	89,811	5,317	98,832	66,997	82,942	(30,560)
Net change in cash and equivalents	35,948	(54,697)	30,990	(14,454)	5,237	(6,671)
Opening cash and equivalents	29,159	65,107	10,410	41,400	26,946	32,183
Closing cash and equivalents	65,107	10,410	41,400	26,946	32,183	25,511
Balance sheet debt	(20,449)	(39,331)	(64,182)	(106,420)	(140,684)	(141,484)
Unamortised loan arrangement costs	(551)	(669)	(1,818)	(1,580)	(1,316)	(516)
Net cash/(debt)	44,107	(29,590)	(24,600)	(81,054)	(109,817)	(116,489)
Gross LTV	10.5%	14.2%	17.1%	21.6%	23.2%	22.4%
Net LTV	0.0%	10.5%	6.4%	16.2%	18.0%	18.4%

Source: Target Healthcare REIT historical data, Edison Investment Research forecasts. Note: *Not updated for unaudited Q420 data.

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