Target Healthcare REIT

Rental growth and development progress

Quarterly NAV update

Real estate

Target's portfolio continued to perform well during the three months ended 31 March (Q319), with RPI-driven rental growth, increased property valuations and progress with the forward-funded development of pre-let, high-quality, purpose-built homes. Due diligence on potential further acquisition opportunities continues, in aggregate sufficient to fully deploy remaining debt capital resources.

Year end	Revenue (£m)	Adj. net earnings* (£m)	Adjusted EPS* (p)	EPRA NAV/ share (p)	DPS (p)	P/NAV per share (x)	Yield (%)
06/17	23.6	13.2	5.23	101.9	6.28	1.14	5.4
06/18	28.4	15.7	5.54	105.7	6.45	1.10	5.5
06/19e	34.4	21.0	5.68	106.5	6.58	1.10	5.6
06/20e	43.1	25.8	6.71	110.6	6.71	1.05	5.8
06/21e	44.4	26.6	6.91	115.1	6.84	1.01	5.9

Note: *Adjusted earnings exclude revaluation movements, non-cash income arising from the accounting treatment of lease incentives and guaranteed rent review uplifts and acquisition costs, and include development interest under forward fund agreements.

2.0% quarterly EPRA NAV total return

EPRA NAV per share increased c 0.4% during Q319 to 107.3p versus 106.9p at end-Q219. Including dividends paid during the quarter, the EPRA NAV total return was 2.0%, taking the cumulative return in the first nine months of the year to 6.1%. A third quarterly DPS of 1.64475p per share has been declared and will be paid 31 May 2019. The portfolio value increased to £477.1m during the period, with growth driven by continuing investment in the forward-funded developments (two completed in the period and five under construction) and underlying valuation gains. The latter were supported by rental growth on the mainly RPI-linked leases, with modest yield tightening in the period. Although there were no acquisitions completed in Q319, £6.9m has since been deployed and the pipeline remains strong. Our forecasts, including a fully covered FY20 DPS, are unchanged.

Demographics support long-term growth

Demographics should support growing care-home demand for years to come, while there is an undersupply of the modern, well-designed homes, fully equipped with en-suite wet rooms and suitable communal spaces that differentiate Target's investment strategy. Investors continue to be attracted by long lease lengths and upwards-only RPI-linked rental growth, with strong competition for assets. Although increasing asset prices have a positive impact on the NAV, they make Target's disciplined approach to acquisitions, targeting 'future-proof assets', an essential ingredient in delivering attractive and sustainable long-term returns.

Visible income growth supports premium to NAV

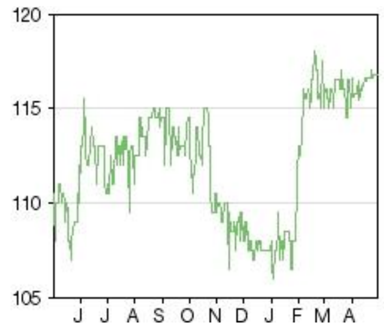
Target offers a growing dividend with visible inflation-linked potential for growth, which we expect to be fully covered by adjusted earnings in FY20. The dividend represents a highly attractive yield (FY19e: 5.6%) that supports the continuing c 10% premium to Q219 NAV.

30 April 2019

Price	**116.6p**
Market cap	**£449m**

Net debt (£m) at 31 March 2019	62.9
Gross LTV as at 31 March 2019	17.6%
Shares in issue	385.1m
Free float	97%
Code	THRL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.6	6.2	6.2
Rel (local)	(1.0)	(2.0)	7.3
52-week high/low		118p	106p

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

Q319 ex-dividend	2 May 2019
Q319 DPS paid	31 May 2019

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Further details

We provide more details on the quarterly progress below. Despite Q319 EPRA NAV of 107.3p being slightly ahead of our full-year forecast of 106.5p, we have left our estimates unchanged for now. We anticipate an acceleration in acquisition activity, which is likely to generate future additional acquisition costs that will act as a drag on NAV, while the Q3 development completions occurred faster than we had allowed for, positively releasing the discount applied to funds invested during the construction phase. The quarterly movement in the revenue reserve (effectively EPRA earnings), appears consistent with our full-year forecast, that will benefit from a larger rent-generating asset base during Q419.

Exhibit 1: Composition of NAV changes

	Sep-18	Dec-18	Mar-19
	Q119	Q219	Q319
Opening EPRA NAV per share (p)	105.7	106.1	106.9
Net gains/(losses) on investment property revaluation, acquisition costs, construction cost discounting	0.7	1.0	0.9
Net effect of equity issuance	0.0	0.1	0.0
Movement in revenue reserve (excluding performance fee accruals)	1.3	1.1	1.1
Dividend paid	(1.6)	(1.4)	(1.6)
Closing EPRA NAV per share (p)	**106.1**	**106.9**	**107.3**

Source: Target Healthcare REIT

- The portfolio value increased by 2.8% during the quarter, to £477.1m. The number of assets was unchanged at 61 but the number of operational assets increased to 56 as two forward-funded developments completed. Continuing investment into the forward-funded developments accounted for most of the portfolio growth, but like-for-like valuation movements also added 0.5%, driven mostly by rental growth and modest yield tightening. The end-Q319 EPRA topped-up net initial yield was 6.29% compared with 6.32% at end-Q219.
- The two completed pre-let developments contributed 5.5pp of the overall 6.0% increase in contracted rents, to £29.7m, while like-for-like rent increases on the mostly RPI-linked leases added 0.5pp. The completed developments, at Earl Shilton in Leicestershire and Cumnor Hill in Oxfordshire, provide 140 bedrooms with full en-suite wet-room facilities and are let to operators with an established record of managing high-quality homes. Both are new to the group and contribute to an increasingly diverse tenant base that now numbers 23.
- Development work continues on five additional pre-let forward-funded assets, all expected to complete in late FY19/early FY20. Completion of these assets, as well as the further forward purchase home that Target has contracted to acquire on completion, is expected to add an additional £3.7m to annual contracted rent and further diversify the tenant base to 26.
- Since the end of the quarter, Target has acquired a 40-bedroom home in Formby, Merseyside, for £6.9m including acquisition costs. In line with Target's strict investment criteria, the home, which opened in late 2017, provides high-quality facilities including full en-suite wet rooms. It is let on a 35-year RPI-linked lease, with cap and collar, to Athena Healthcare, a long-standing tenant of the group.
- At the end of Q319 Target had drawn £84.0m of its £170m debt facilities, giving a gross loan to value ratio (LTV) of 17.6% or a net LTV 13.2% after adjusting for cash.
- A number of near-term acquisition opportunities are in due diligence and the group says that if they all complete as anticipated, it would be able to fully deploy all available debt capital in the 2019 summer months. This suggests that although the current run-rate of acquisitions in H219 is a little below that reflected in our forecasts, there are good prospects for acquisitions to accelerate and even exceed our expectations.

- Our forecasts, unchanged from our last update note, include £55m of additional investment commitment by the end of FY19, a level that we believe is consistent with re-gearing the balance sheet to a c 25% LTV, generating full dividend cover in FY20. We estimate that full-deployment of existing debt facilities would provide room for an additional c £24m of acquisitions, temporarily lifting LTV to c 28%, but increasing EPRA earnings.

Exhibit 2: Continuing positive EPRA NAV total return

	Q319	FY19 YTD
Opening EPRA NAV per share (p)	106.9	105.7
Closing EPRA NAV per share (p)	107.3	107.3
Dividends paid (p)	1.6	4.9
NAV total return	2.0%	6.1%

Source: Target Healthcare REIT, Edison Investment Research

Exhibit 3: Financial summary

Year to 30 June (£000s)	2014	2015	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT								
Rent revenue	3,817	9,898	12,677	17,760	22,029	28,450	37,060	38,362
Movement in lease incentive/fixed rent review adjustment	1,547	3,760	4,136	5,127	6,334	5,903	6,000	6,000
Rental income	5,364	13,658	16,813	22,887	28,363	34,353	43,060	44,362
Other income	0	66	61	671	3	0	0	0
Total revenue	5,364	13,724	16,874	23,558	28,366	34,353	43,060	44,362
Gains/(losses) on revaluation	(2,233)	(839)	425	2,211	6,434	1,819	9,714	10,996
Cost of corporate acquisitions	0	(174)	(998)	(626)	0	0	0	0
Total income	3,131	12,711	16,301	25,143	34,800	36,172	52,774	55,358
Management fee	(648)	(1,524)	(2,654)	(3,758)	(3,734)	(4,983)	(5,255)	(5,453)
Other expenses	(780)	(880)	(992)	(1,236)	(1,458)	(1,520)	(1,600)	(1,600)
Total expenditure	(1,428)	(2,404)	(3,646)	(4,994)	(5,192)	(6,503)	(6,855)	(7,053)
Profit before finance and tax	1,703	10,307	12,655	20,149	29,608	29,669	45,918	48,304
Net finance cost	190	(716)	(929)	(808)	(2,010)	(3,179)	(4,512)	(4,576)
Profit before taxation	1,893	9,591	11,726	19,341	27,598	26,490	41,406	43,728
Tax	(4)	(39)	(24)	(219)	11	0	0	0
Profit for the year	1,889	9,552	11,702	19,122	27,609	26,490	41,406	43,728
Average number of shares in issue (m)	105.2	119.2	171.7	252.2	282.5	369.8	385.1	385.1
IFRS earnings	1,889	9,552	11,702	19,122	27,609	26,490	41,406	43,728
Adjust for rent arising from recognising guaranteed rent review uplifts + lease incentives	(1,547)	(3,760)	(4,136)	(5,127)	(6,334)	(5,903)	(6,000)	(6,000)
Adjust for valuation changes	2,233	839	(425)	(2,211)	(6,434)	(1,819)	(9,714)	(10,996)
Adjust for corporate acquisitions	0	174	998	420	0	0	0	0
EPRA earnings	2,575	6,805	8,139	12,204	14,841	18,768	25,692	26,733
Adjust for development interest under forward fund agreements					261	2237	141	-138
Adjust for performance fee	150	466	871	997	550	0	0	0
Group adjusted earnings	2,725	7,271	9,010	13,201	15,652	21,005	25,833	26,595
IFRS EPS (p)	1.80	8.02	6.81	7.58	9.77	7.16	10.75	11.36
Adjusted EPS (p)	2.59	6.10	5.25	5.23	5.54	5.68	6.71	6.91
EPRA EPS (p)	2.45	5.71	4.74	4.84	5.25	5.08	6.67	6.94
Dividend per share (declared)	6.00	6.12	6.18	6.28	6.45	6.58	6.71	6.84
BALANCE SHEET								
Investment properties	81,422	138,164	200,720	266,219	362,918	513,043	530,028	540,823
Other non-current assets	0	2,530	3,742	3,988	27,139	34,544	42,004	48,233
Non-current assets	81,422	140,694	204,462	270,207	390,057	547,587	572,032	589,056
Cash and equivalents	17,125	29,159	65,107	10,410	41,400	5,217	6,964	7,738
Other current assets	6,524	6,457	13,222	25,629	3,365	6,093	6,093	6,093
Current assets	23,649	35,616	78,329	36,039	44,765	11,310	13,057	13,831
Bank loan	(11,764)	(30,865)	(20,449)	(39,331)	(64,182)	(134,716)	(145,216)	(145,716)
Other non-current liabilities	0	(2,530)	(4,058)	(3,997)	(4,673)	(5,131)	(5,131)	(5,131)
Non-current liabilities	(11,764)	(33,395)	(24,507)	(43,328)	(68,855)	(139,847)	(150,347)	(150,847)
Trade and other payables	(3,089)	(3,623)	(5,002)	(5,981)	(7,360)	(9,108)	(9,108)	(9,108)
Current Liabilities	(3,089)	(3,623)	(5,002)	(5,981)	(7,360)	(9,108)	(9,108)	(9,108)
Net assets	90,218	139,292	253,282	256,937	358,607	409,943	425,634	442,933
Period end shares (m)	95.2	142.3	252.2	252.2	339.2	385.1	385.1	385.1
IFRS NAV per ordinary share	94.7	97.9	100.4	101.9	105.7	106.5	110.5	115.0
EPRA NAV per share	94.7	97.9	100.6	101.9	105.7	106.5	110.6	115.1
CASH FLOW								
Cash flow from operations	3,172	8,081	8,906	4,394	23,627	19,373	28,745	31,080
Net interest paid	161	(514)	(681)	(615)	(1,366)	(2,531)	(4,012)	(4,076)
Tax paid	0	(47)	(164)	(543)	(122)	14	0	0
Net cash flow from operating activities	3,333	7,520	8,061	3,236	22,139	16,856	24,733	27,004
Purchase of investment properties	(51,894)	(51,736)	(34,833)	(37,698)	(89,981)	(148,379)	(7,271)	0
Acquisition of subsidiaries	0	(5,845)	(27,091)	(25,552)	0	0	0	0
Net cash flow from investing activities	(51,894)	(57,581)	(61,924)	(63,250)	(89,981)	(148,379)	(7,271)	0
Issue of ordinary share capital (net of expenses)	44,520	46,644	97,501	0	91,729	49,049	0	0
(Repayment)/drawdown of loans	8,646	22,525	(12,808)	20,906	24,456	70,000	10,000	0
Dividends paid	(4,364)	(7,074)	(9,681)	(15,589)	(17,353)	(23,709)	(25,715)	(26,229)
Other	0	0	14,799	0	0	0	0	0
Net cash flow from financing activities	48,802	62,095	89,811	5,317	98,832	95,340	(15,715)	(26,229)
Net change in cash and equivalents	241	12,034	35,948	(54,697)	30,990	(36,183)	1,747	774
Opening cash and equivalents	16,884	17,125	29,159	65,107	10,410	41,400	5,217	6,964
Closing cash and equivalents	17,125	29,159	65,107	10,410	41,400	5,217	6,964	7,738
Balance sheet debt	(11,764)	(30,865)	(20,449)	(39,331)	(64,182)	(134,716)	(145,216)	(145,716)
Unamortised loan arrangement costs	(497)	(645)	(551)	(669)	(1,818)	(1,284)	(784)	(284)
Net cash/(debt)	4,864	(2,351)	44,107	(29,590)	(24,600)	(130,783)	(139,036)	(138,262)
Gross LTV	15.1%	22.8%	10.5%	14.2%	17.1%	25.1%	25.8%	25.1%
Net LTV	0.0%	1.7%	0.0%	10.5%	6.4%	24.1%	24.6%	23.8%

Source: Company data, Edison Investment Research

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