EDISON

Primary Health Properties

2017 results

Strong 2017 with good growth prospects

Real estate

2017 saw continuing growth in assets, earnings, NAV, dividends and dividend cover. EPRA NAV total return for the year was 16.4%. The prospects for further growth are good, with a strong pipeline of investment opportunities, a reduced LTV and average cost of debt, and substantial undrawn borrowing facilities. While yield tightening has benefited capital growth in recent years, it also increases the cost of acquisitions, and indications of accelerating rent growth are a positive development.

Year end	Revenue (£m)	EPRA earnings* (£m)	EPS* (p)	EPRA** NAV/share (p)	DPS (p)	P/NAV (x)	Yield (%)
12/16	67.4	26.7	4.8	91.1	5.125	1.27	4.4
12/17	72.5	31.0	5.2	100.7	5.250	1.15	4.5
12/18e	76.9	34.1	5.4	105.1	5.400	1.10	4.7
12/19e	82.2	37.5	5.5	109.1	5.500	1.06	4.7

Note: *EPRA basis excludes valuation movements and other exceptional items. We had previously also adjusted for the PIF. **EPRA basis adjusts for fair value of derivative interest rate contracts and convertible bond.

Strong income and capital growth in 2017

Rental income grew 7.1%, driven by acquisitions, funded developments completing and asset management. Asset growth and one-off start-up costs in Ireland increased the cost ratio slightly, but it remains one of the lowest in the sector, and EPRA earnings grew 15.7% (EPRA EPS 8.3%). The increased dividend was substantially covered and PHP is on track for 5.4p of dividends this year, which would be the 22nd year of growth. The net initial yield (NIY) tightened to 4.91%, driving revaluation gains worth 10.4p per share, with EPRA NAV per share increasing 10.5% to 100.7p. In addition, £71.9m was committed to acquisitions, with the portfolio value reaching £1.362bn. Our forecasts are little changed, other than capturing the higher valuation in NAV and assuming full conversion of the convertible bond, reducing gearing (c 5%) and diluting EPS (c 3%) until reinvested.

Strong growth prospects

In both the UK and Ireland, there is broad political will to reform healthcare provision, placing more emphasis on primary care to meet the increasing healthcare needs of growing and ageing populations. The requirement for larger, more flexible, higher-quality premises will provide significant investment opportunities for PHP and others in coming years. It enters 2018 with a healthy £150m targeted pipeline of potential acquisitions and substantial headroom on its debt facilities, extended (in size and duration) and further diversified in 2017, with a 56bp reduction in average cost (to 4.09%).

Valuation: Attractive, secure and growing dividend

We are forecasting a fully covered FY18 prospective 4.7% dividend yield. Revenues are supported by secure, long-term income in a market that is much less sensitive to economic cycles than other commercial real estate subsectors, and therefore shows less volatility in occupancy, rents and valuation.

2 March 2018

Price	**116p**
Market cap	**£720m**

Balance sheet net debt (£m) at 31 December 2017	726.6
Net LTV at 31 December 2017	52.9%
Shares in issue	620.9m
Free float	98%
Code	PHP
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.5	2.5	6.2
Rel (local)	4.7	4.2	7.9
52-week high/low		123.5p	108.0p

Business description

Primary Health Properties is a long-term investor in primary healthcare property in the UK and, more recently, 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

AGM	18 April 2018

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Edison profile page

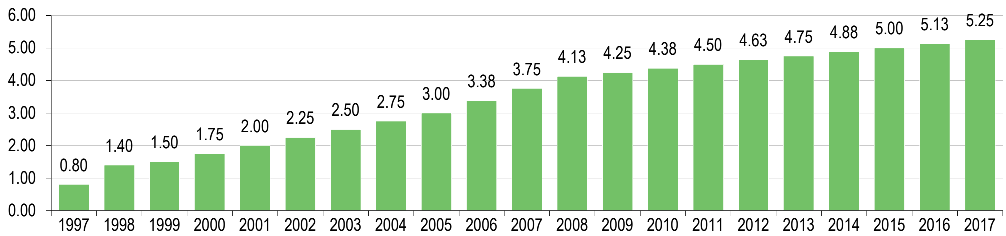
Primary Health Properties is a research client of Edison Investment Research Limited

Company description: Secure and growing income

PHP is a UK real estate investment trust (REIT) and a leading long-term investor in modern, flexible, purpose-built, primary healthcare facilities located across the UK and, more recently, in the Republic of Ireland. The majority of these are leased to general practitioners (GPs), government health service organisations (the UK NHS or Irish HSE) and other associated healthcare providers, such as pharmacies and dentists. Investment is targeted at assets that can generate long-term rental income with scope for capital gains.

The company was founded by the current managing director, Harry Hyman, in 1995. It floated on the AIM market of the London Stock Exchange (LSE) in 1996, moved to the Main Market of the LSE two years later and converted to REIT status in 2007. PHP has a proven record of successfully investing in the sector. The portfolio has reached 306 properties valued at £1.4bn and PHP is now in its 22nd year of unbroken dividend growth since launch, targeting 5.4p for FY18. Dividend cover is high, averaging 98.7% over the past three years (98.6% in FY17 and fully covered, excluding investment adviser performance fees).

Exhibit 1: Twenty-one years of unbroken dividend per share growth



Source: PHP

The primary healthcare property sector is a specialist sector alongside the broader mainstream commercial property subsectors (offices, retail, industrial). As well as having good growth prospects – driven by an ageing population with increasing healthcare needs – that are effectively immune to the economic cycle, the key factors that differentiate it from the broad commercial property sector are as follows:

- Long leases at inception. Typically 20-25 years, with upwards-only rent reviews in the UK.
- A strong tenant covenant. 90% of rent roll is funded directly or indirectly (through cost reimbursement) by the NHS in the UK or the HSE in Ireland.
- No speculative development and minimal vacancy. PHP itself is not a developer and only funds development properties on a pre-let basis. PHP occupancy was 99.7% at end-2017, unchanged on the year.

PHP is externally managed, with the board (biographies on page 14) appointing Nexus Tradeco (Nexus) to provide property advisory and management services, including the services of the managing director and finance director, Harry Hyman and Richard Howell, as well as administrative and accounting services. Nexus receives a property advisory fee payable based on the gross net assets of PHP's portfolio, calculated on a sliding scale, which with incremental asset growth lowers the average fee. In addition, Nexus receives a fixed annual fee for administrative and accounting services, and is entitled to a performance incentive fee (PIF) that gives Nexus 11.25% of the EPRA NAV total return (change in NAV plus dividends paid) above a hurdle rate of 8%, on a cumulative basis, with annual payments subject to caps.

Highlights of the 2017 results

2017 saw continuing growth in assets, earnings, NAV and dividends, generating a 16.4% EPRA NAV total return for the year. The prospects for further growth are good. PHP enters 2018 with a strong pipeline of investment opportunities, a reduced LTV and average cost of debt, and substantial undrawn borrowing facilities. We comment briefly on the results below:

Exhibit 2: Summary of key financials

£m unless otherwise stated	2017	2016	% change
Net rental income	71.3	66.6	7.1
Administrative expenses	(8.2)	(7.3)	12.3
PIF	(0.5)	0.0	
Operating profit before revaluation gain and financing	62.6	59.3	5.6
Net financing costs	(31.6)	(32.5)	(2.8)
EPRA earnings	31.0	26.8	15.7
Net result from property portfolio	64.5	20.7	
Fair value loss on derivatives and convertible bond	(3.6)	(3.8)	
IFRS PBT	91.9	43.7	110.3
EPRA EPS (p)	5.2	4.8	8.3
EPRA NAV (p)	100.7	91.1	10.5
DPS (p)	5.250	5.125	2.4
Investment properties	1,362	1,220	
Net LTV (%)	52.9	53.7	

Source: PHP

- Net rental income grew 7.1% to £71.3m, with acquisitions adding c £3.0m, development completions c £1.0m, and asset management initiatives, including rent growth of 1.1%, c £700k.
- The increase in administrative costs, excluding the PIF, was inflated by c £300k of one-off costs incurred through setting up the Irish portfolio. The main driver of the underlying increase is the management fee. Although the marginal rate is now levied at 0.275% of gross assets, the valuation gains in addition to the acquisition of yielding assets has an impact. The administrative expense ratio remains low, at 60bp of gross assets, excluding the PIF, and the EPRA cost ratio (12.5%) remains one of the lowest in the sector.
- Changes to the terms of the advisory agreement with Nexus were agreed in April and applied from the beginning of the year, incorporating lower fee increments. The PIF was also amended, to be based on EPRA net assets rather than IFRS. With a 16.4% NAV total return for the year, in excess of the 8% hurdle, a £0.5m PIF was recognised in 2017, the first since 2007.
- Despite an increase in average borrowings (to fund portfolio growth), net financing costs fell, reflecting a lower average cost of debt (4.09% at year-end versus 4.65% a year earlier) as well as the cancellation of expensive swap contracts.
- EPRA earnings grew 15.7% to £31.0m and EPRA EPS by 8.3% to 5.2p.
- The 5.25p DPS (+2.4%) was substantially (98.6%) covered by EPRA basis earnings and a first quarterly dividend for the current year (FY18) of 1.35p has subsequently been paid, equivalent to an annualised 5.4p.
- Investor interest in healthcare assets remains strong and the external valuation of the portfolio generated £64.5m in net valuation gains, reflecting an NIY of 4.91% (FY16: 5.17%). The gain supported a 10.5% increase in EPRA NAV per share and contributed to a reduction in LTV to 52.9% (FY16: 53.7%).
- £71.9m was committed to 10 assets; an average lot size of £7.2m compared with £4.5m for the portfolio as a whole.
- The pipeline of targeted acquisitions, in both the UK and in Ireland, remains strong at approximately £150m.

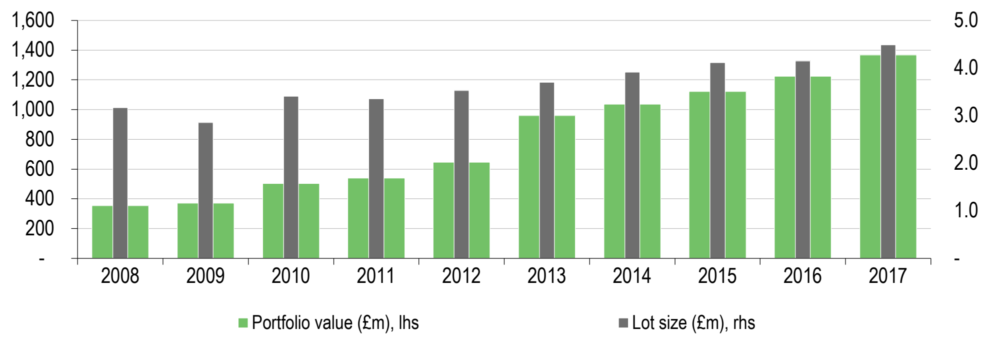
Portfolio update: Selective growth continuing

- The portfolio increased to 306 healthcare centres (FY16: 295), of which 305 were completed and one was under development, funded by PHP, with a commitment to acquire the pre-let asset at completion. There were two assets in Ireland at end-2017, since increased to three, and likely to grow further.
- Ten properties were acquired in 2017 at an aggregate cost of £71.9m, an average lot size of £7.2m compared with the portfolio average £4.5m (FY16: £4.1m).
- The annualised contracted rent roll at the end of 2017 was £72.3m (FY16: £68.0m), with a weighted average unexpired lease term (WAULT) of 13.2 years and a high occupancy rate of 99.7% maintained.
- The portfolio valuation at end-2017 was £1.36bn compared with £1.22bn at end-2016, the growth reflecting investment and the £64.5m net valuation gain for the year.
- The portfolio valuation reflects an NIY of 4.91% with further tightening from 5.17% at end-2016.

Long-term strategy to grow the portfolio and income

PHP has a long-term strategy to grow its portfolio through asset management of the existing assets and selected acquisitions, at all times ensuring that the portfolio remains fit for purpose and suitable for satisfying evolving healthcare needs over time. Acquisitions include a mix of let standing properties as well as new developments, generally providing funding to the developer with an agreement to acquire the pre-let assets at completion. PHP itself is not a developer, but works with a range of experienced development partners, healthcare bodies and health professionals to source and procure newly built premises. Over the past 10 years, the portfolio value, including investment commitments, has increased from £354m to £1,362m, with the number of properties increasing from 112 to 306 and the average value per property from £3.2m to £4.5m (Exhibit 3). Over the same period, the annualised rent roll has increased from £19.6m to £72.3m.

Exhibit 3: The portfolio has grown strongly, with increasing lot size

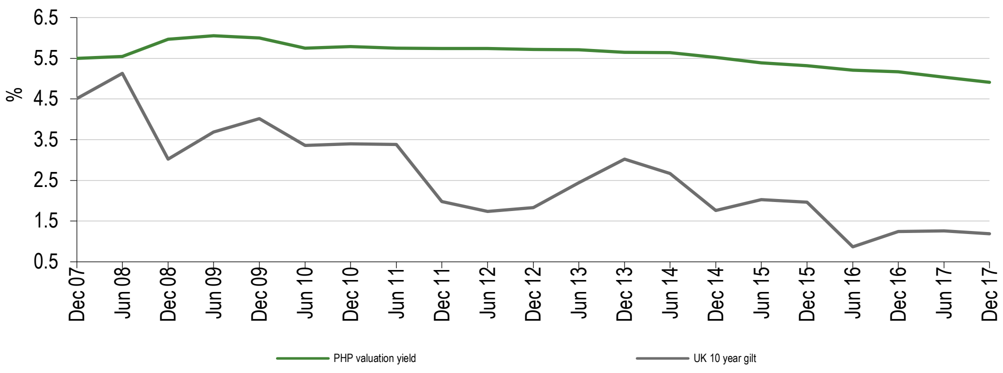


Source: PHP

The market is competitive and calls for selective investment

With investor interest in the secure long-term income provided by primary healthcare assets remaining strong, prices have increased and valuation yields have tightened across the sector. Exhibit 4 tracks the NIY reflected in PHP's portfolio, along with the 10-year UK gilt yield. Yields in the healthcare sector have historically shown much less volatility than has the general commercial property sector, but from a recent high of c 6.0% in 2009, PHP's NIY, in common with the market and quoted peers, has steadily tightened to 4.91% as of December 2017.

Exhibit 4: PHP's NIY and 10-year UK gilt yield



Source: PHP, Bloomberg

In such an environment, it is necessary to remained disciplined in selecting investments. Management believes that it has achieved this and notes that, in its view, the market in general is not differentiating sufficiently on the quality of the assets and their ability to generate growing rents and attractive returns over the long term and not just in the immediate future. It is not easy for investors to assess the quality of the assets in the portfolio, but we would suggest that larger, more modern assets, and assets with the flexibility to adapt and change over time, are more likely to provide superior long-term rental growth.

Exhibit 5 shows a summary of the 10 assets acquired during the year. At the time of acquisition, eight of the assets were completed and let, and two were pre-let development assets for which PHP provided pre-acquisition funding. The asset in Carrigaline completed in August 2017 and opened to patients in September, while the Churchdown asset remains on-site and is due to complete in March 2018. The rent roll at completion added by these 10 assets was £3.7m (or c 5.1% of the acquisition price before costs), adding 5.4% to the total rent roll. The average lot size is large, at £7.2m, and well ahead of the portfolio average of £4.5m, although this is skewed somewhat by the Low Grange asset with an acquisition cost of £25.4m. That said, eight of the 10 have a lot size of more than £3m. Low Grange is a high-quality asset, serving four GP practices (12 doctors) in addition to NHS property services, a pharmacy, and optician. It benefits from a fixed 3% pa rental uplift and a WAULT of 17.3 years. In February 2018, PHP completed the acquisition of a third Irish asset: a large, modern 6,500sqm healthcare facility in County Cork, at a cost of €20m.

Exhibit 5: Summary of 2017 acquisitions

Asset	Type	Area (sqm)	Acquisition price (£m)	WAULT	GP patients	Other services
Cove Bay, Aberdeen	Investment	983	4.6	15.3	12,500	
Pitmedden, Aberdeen	Investment	710	2.6	13.0	5,300	
Carrigaline, County Cork, Ireland*	Development	2,985	6.4	25.0	20,000	HSE, pharmacy
Churchdown, Gloucestershire	Development	1,184	5.0	20.0	13,500	Pharmacy
Low Grange, Middlesbrough	Investment	5,800	25.4	17.3	22,000	NHS, pharmacy, optician
Evenwood, Bishops Auckland	Investment	465	1.7	13.0	2,500	
Syston Medical Centre, Leicestershire	Investment	2,575	8.4	16.1	23,000	NHS, pharmacy
Croft Medical Centre, Birmingham	Investment	1,175	4.7	23.5	11,000	
Stenhousemuir Medical Centre, Falkirk	Investment	2,450	8.7	17.5	19,000	
Wincanton Medical Centre, Somerset	Investment	983	4.4	19.5	8,800	Pharmacy
Total		**19,310**	**71.9**			
Average		1,931	7.2	18.0	13,760	

Source: PHP. Note *Sterling equivalent (€7.3m).

Exhibit 6 provides an analysis of the overall portfolio by lot size. 78.9% of the total portfolio has a lot size of £3m or more and there are just two assets (excluding £1.3m in land assets) that have a value of less than £1m.

Exhibit 6: Analysis of portfolio lot size (at 31 December 2017)

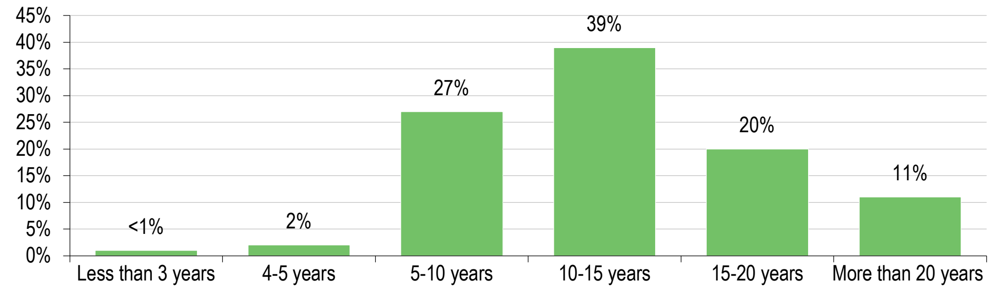
Capital value (£m)	Number of properties	Value (£m)	% of total portfolio
10+	20	316.9	23.3
5-10	55	380.6	27.9
3-5	98.0	376.3	27.6
1-3	131	285.2	20.9
0-1 (including land of £1.3m)	2	2.9	0.2
Total	**306**	**1,361.9**	**100**

Source: PHP

Leases are long and secure

Lease terms are long in the primary healthcare sector, typically 20-25 years at inception, providing considerable durability of income. PHP has an average unexpired term of 13.2 years across its portfolio, with less than 1% of rent roll coming from 12 properties where the remaining lease length is less than three years. In each case, the company is in advanced negotiation to renew the lease, in some cases as part of an asset management programme.

Exhibit 7: Analysis of unexpired rent roll



Source: PHP

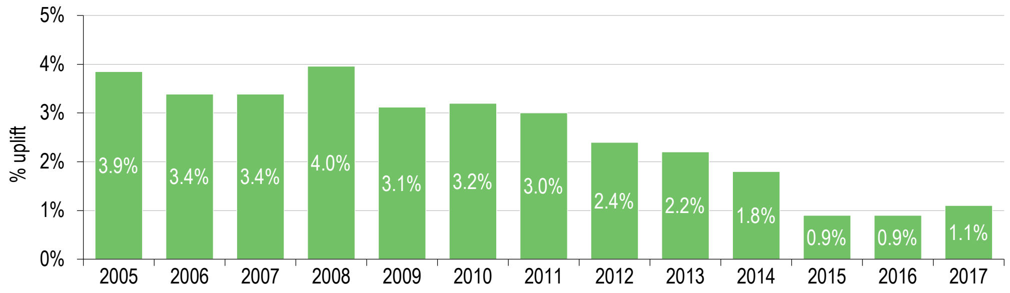
Asset management initiatives that enhance and extend the existing assets are a useful way to continue to meet the evolving needs of tenants, increase rents, extend/re-gear leases and increase the property valuation. In 2017, PHP committed to nine asset management projects, investing £4.4m and re-gearing leases back to 20 years. It has seven further projects approved by the NHS and a pipeline of 16 further projects that are being progressed.

Positive indications for faster rental growth

UK rental agreements can only be instigated by the landlord and are effectively upwards-only, based on lease terms that may include fixed uplifts (c 7% of PHP rents), RPI-linked (c 19%) and open market (at the option of the landlord, c 74%). The majority of reviews (more than three-quarters) are on a three-year basis, with the balance on either one- or five-year cycles. In Ireland, the HSE leases are also of 20- to 25-year durations, with five-yearly reviews that are all set by reference to CPI, and rents may go down as well as up.

Low rates of RPI inflation (in contrast to land and building cost inflation) and low open-market rent review increases in recent years have resulted in low overall levels of rent growth. Although the total weighted average rent increase on completed rent reviews in 2017 increased on 2016, it was still just 1.1% pa.

Exhibit 8: Rental growth history



Source: Company data, Edison Investment Research

The weighted average increase on fixed uplift lease reviews completed in 2017 was 3.4% pa, while RPI-linked uplifts averaged 2.3% pa. Open market reviews saw an average 0.3% pa uplift but this included a number of instances where there was no increase at all; excluding these the increase was an average 1.3% pa. In addition, a further 10 open market reviews were agreed in principle, which will add another £0.1m to the contracted rent roll and represent an uplift of 1.4% per annum.

Open-market reviews aim to set the rent at current market level, defined as what would be paid by a free and willing tenant to a landlord in that area. As a result of the NHS rent reimbursement mechanism, the decision is that of the district surveyor, seeking to allow for a range of factors including the size, condition, amenity and location of the premises as well as terms of the lease itself. However, across the market there is evidence that open-market rent reviews have failed to sufficiently capture the strong rise in land and build costs in recent years, in part the result of financial pressures and reorganisation within the NHS that has slowed decision-making of the commissioning of the development of new primary healthcare facilities. This dearth of new developments has restricted the opportunities for increased land and building costs to be adequately reflected in the rent reviews for existing assets and threatens to restrict the flow of much-needed private investment to support modernisation of the primary healthcare estate. There is a growing optimism that this is beginning to change, with developers reporting that they expect increased levels of activity.

Market developments

We have previously written at length about the strong medium- to long-term growth outlook for investment in primary care health facilities in both the UK and Ireland, as governments and health authorities strive to meet the challenge of ageing populations with growing healthcare needs. In both, there is a general acceptance of the critical role of primary healthcare in meeting growing demands, but also of the advantages for healthcare services to be more integrated within the community as the NHS and HSE strive to improve levels of care and efficiency. To make this happen, the under-invested healthcare estate needs significant resources and requires modern, purpose-built, flexible premises of the type in which PHP invests. The direction of travel has been clear for some time now, but progress in getting needed developments underway has been painfully slow in the UK. Signs of acceleration are apparent, however, and PHP notes that every one of the developers with which it works expects to have more developments on site this year than next.

NHS plans for primary care provision were set out in broad terms in the NHS Five-Year Forward View (FYFV) in late 2014. In late 2016, sustainability and transformation plans (STPs), which include plans for the primary care premises that will be required to deliver care objectives, were published by all 44 STP areas in England. This was followed in March 2017 by publication of the independent report on NHS Property and Estates by Sir Robert Naylor. The report highlighted the importance of primary care premises and of the recently created NHS Property Board in supporting the visions of the FYFV and STPs, and in helping to create affordable and efficient estates, as well as the role of the private sector in delivering these objectives. The UK government's spring and autumn budgets both announced additional funding for the NHS, to provide support for the 15 strongest STPs, increase funding for frontline NHS services and upgrade NHS buildings and facilities. An additional £6.3bn, including £3.5bn for capital investment, will be made available to the NHS by 2020-21.

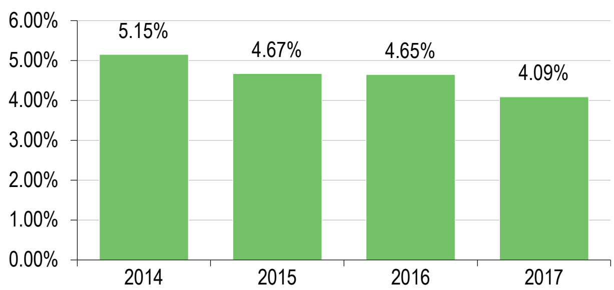
Early this year, the government published a response to the Naylor Review that acknowledges the importance of land and property to the transformation of NHS health services and how the NHS will be able to supplement public capital with finance from the private sector, which has provided a source of valuable investment and innovation in primary and community care in the past.

PHP, like all of the main investors, continues to work closely with GPs, stakeholders and key influencers within the NHS, HSE and governments in both the UK and Ireland, to demonstrate the benefits of the third-party development model and its differences to private finance initiatives.

Financing drives value, as well as the assets

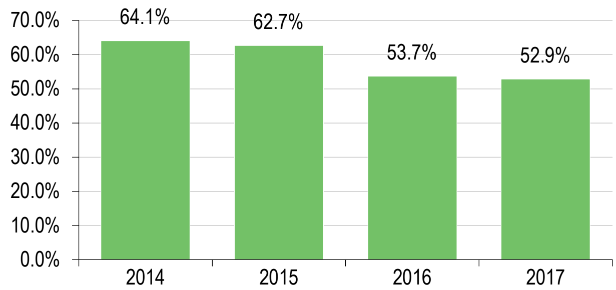
As primary healthcare property prices have increased in recent years, reducing the amount of income immediately available on new acquisitions, PHP has continued to work hard on the liability side of its balance sheet; reducing the average cost of borrowing while maintaining a broad range of funding options, and managing duration and interest rate risk.

Exhibit 9: Average cost of debt (%)



Source: PHP

Exhibit 10: Loan to value ratio (x)



Source: PHP

The weighted average cost of debt fell by an additional 56bp to 4.09% in 2017, while the weighted average maturity of the debt facilities increased to 6.3 years from 5.1 years, above the four-year average of 5.9 years. The marginal cost of debt, reflecting the current cost of utilising the floating rate revolving debt facilities is c 2.3%. There were 10 secured debt facilities in place at end-2017, from a range of lenders, and two unsecured debt facilities, issues of convertible and retail bonds. Total available loan facilities amounted to £844m (2016: £749m), of which £724m had been drawn. After allowing for cash balances and committed investment, £101m of undrawn facilities remained available to the group to fund ongoing investment. 90% of the drawn debt is either fixed rate or hedged using interest rate swaps.

PHP continued to extend and diversify its sources of funding in 2017, including its first private placement (to a range of insurance companies) of £100m in 10-year senior secured notes at an attractive fixed coupon of 2.83%. The proceeds were partially used to refinance drawings on its

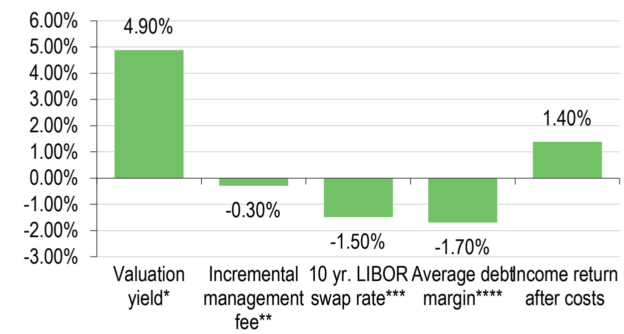
£115m revolving 'club facility' with RBS and Santander, which was due to mature in August 2017. The club facility itself has been replaced with a bilateral loan for £50m from RBS, which was extended in November to £100m, while early in 2018 the initial four-year term was extended to five years. In December 2017, PHP agreed another long-term (11-year) secured loan facility with Aviva; the £75m loan at a fixed rate of 3.1% replaced a similar facility (at a fixed 4.0%) due to mature in late 2018, saving £0.7m pa in interest.

PHP also cancelled a relatively expensive 4.76% fixed-rate swap with a nominal value of £20m during the year, in return for a one-off payment of £6.2m. The swap would have become effective from H217 and cancellation resulted in an annualised interest saving of c £800k pa.

Low borrowing rates maintaining positive yield gap

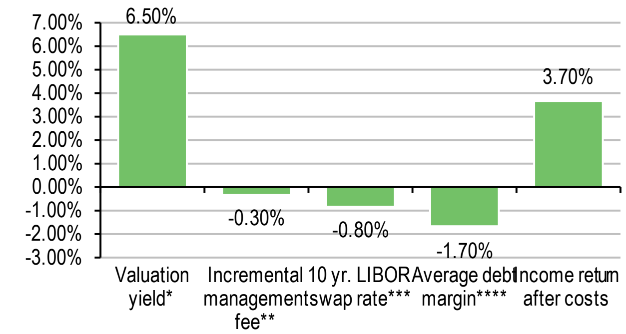
Continuing favourable borrowing conditions are maintaining a positive spread between marginal income on acquired assets less costs and marginal borrowing costs, although the gap has narrowed. In the UK, the 1.4% positive spread shown in Exhibit 11 compares with 1.86% at H117, since when the 10-year LIOBOR swap rate has increased. In Ireland (Exhibit 12), the spread remains much wider, but there too it has tightened, to 3.0% from 3.70% at H117, as a result of asset yield contraction (increasing competition for Irish assets) and an increase in the 10-year EURIBOR swap rate. The Irish spread remains particularly attractive and we expect Irish assets to represent a significant share of portfolio growth in the next couple of years. Our estimates assume 30% of all commitments. Over the medium term, we would anticipate that accelerating rental growth should mitigate the impacts of a turn in the interest rate cycle. Meanwhile, PHP has an opportunity to further reduce its average cost of borrowing over the next two years.

Exhibit 11: Indicative net margin over funding cost (UK)



Source: PHP. Note: *30 June 2017 valuation yield. **Per management contract. ***Source: JC Rathbone. ****PHP incremental margin on debt facilities.

Exhibit 12: Indicative net margin over funding cost (Republic of Ireland)

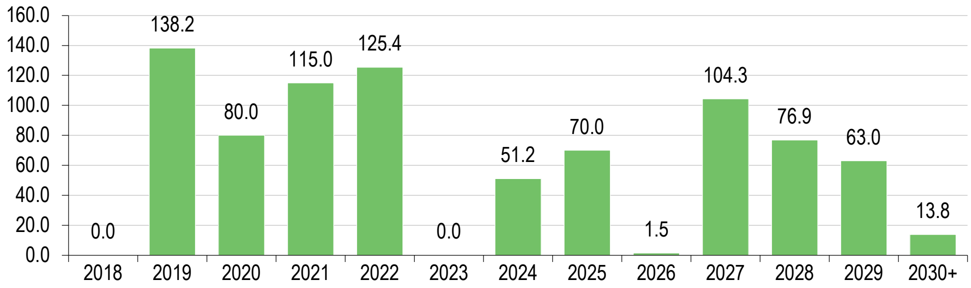


Source: PHP. Note: *PHP est. based on pipeline. **Per management contract. ***Source: JC Rathbone. ****PHP incremental margin on debt facilities.

Maturities provide opportunities to further reduce borrowing cost

There are no debt maturities during 2018, but in 2019 the £75m retail bond issue and the outstanding convertible bonds will mature. The unsecured retail bonds pay a coupon of 5.375%, which appears high in current market conditions, providing an opportunity for refinancing at lower cost. The convertible bonds may be converted at 97.5p per share, below the EPRA NAV per share and well below the current share price, at any time up to May 2019. We now assume full conversion in our forecasts. The immediate effect is to slightly dilute EPS per share (c 3%) but the conversion of debt to equity will reduce LTV (c 5%) and provide an opportunity to re-gear the balance sheet, most likely utilising debt at lower cost. We have not assumed lower borrowing cost in our forecasts.

Exhibit 13: Summary of debt maturities (£m)



Source: PHP

Financials and estimate revisions

The 2017 results were closely in line with our expectations, apart from the gain on revaluation of investment properties. We include an allowance for the impact of rent increases in our forecast but not for changes in the valuation yield, which continued to tighten in H217. EPRA NAV per share was 4.2% above our forecast as a result.

Exhibit 14: Performance versus estimate and estimate revisions

	Revenue (£m)			EPRA earnings			EPRA EPS (p*)			DPS (p)			Dividend cover*			EPRA NAVPS (p)		
	F'cast	Actual	% diff	F'cast	Actual	% diff	F'cast	Actual	% diff	F'cast	Actual	% diff	F'cast	Actual	% diff	F'cast	Actual	% diff
12/17a	71.9	72.5	0.9%	31.3	31.0	-1.0%	5.2	5.2	-1.1%	5.250	5.250	0.0%	100%	99%	-1.0%	96.6	100.7	4.2%
	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff	Old	New	% diff
12/18e	77.9	76.9	-1.3%	34.1	34.1	0.0%	5.6	5.4	-3.7%	5.360	5.40	0.7%	104%	100%	-3.8%	99.2	105.1	5.9%
12/19e	N/A	82.2	N/A	N/A	37.5	N/A	N/A	5.5	N/A	N/A	5.50	N/A	N/A	104%	N/A	N/A	109.1	N/A

Source: Edison Investment Research. Note: *In Decembe0,r we showed EPRA EPS and dividend cover adjusted for the PIF. PHP has not adjusted for this, and we have reverted to unadjusted EPRA earnings.

Our forecasts for 2018 and (new) 2019 continue to be driven off the following key assumptions:

- Investment commitments in both years of c £100m, comprising c 50% UK standing assets (at a 4.9% cash yield on investment), c 30% Irish development assets (6.0% yield) and 20% UK development assets (5.1% yield).
- Average annualised rent growth of 2.0% pa.
- Revaluation gains in line with rent growth.
- Full conversion of the outstanding convertible bonds by May 2019.
- No change in the average cost of debt.
- No additional equity issuance other than scrip dividends at an assumed 5% of dividend entitlement.

The majority of the administrative cost is accounted for by the investment adviser fees that are determined by a set, scaled schedule, with a marginal rate of 0.30% of gross portfolio value up to £1.5bn and 0.275% thereafter. The assumption of full conversion of the convertible bonds is slightly dilutive of EPS in 2018 and 2019, as we have made no change to the forecast rate of investment; the LTV falls by c 5 percentage points as a result. We look for further growth in DPS and for this to be broadly covered by EPRA earnings.

Valuation: Secure and attractive dividends

In an environment of continuing low interest rates and in a sector where income returns represent a substantial share of long-term total returns, the security and length of PHP's lease portfolio are attractive to investors. Our forecast FY18 dividend of 5.40p represents a 4.7% dividend yield on the current share price, with growth potential, and is covered by forecast cash earnings off a secure, long-term income stream. With 90% of the rent roll funded directly or indirectly by the NHS in the UK or HSE in Ireland, it is tempting to draw comparison with the c 1.6% yield on 10-year gilts. This secure and growing dividend return on PHP shares provides support for the continuing premium to EPRA NAV.

Exhibit 15: Five-year NAV total return of 13.3% pa compound

(p)	2013	2014	2015	2016	2017	2013-2017
Opening EPRA NAV	76.3	74.9	79.7	87.7	91.1	76.3
Closing EPRA NAV	74.9	79.7	87.7	91.1	100.7	100.7
Dividends paid in period	4.75	4.88	5.00	5.13	5.25	25.00
NAV total return (%)	4.4	12.9	16.4	9.7	16.4	64.8

Source: Edison Investment Research

Between the end of 2012 and the end of 2017, PHP generated an EPRA NAV total return of 64.8% or a compound 13.3% pa. Dividends paid have accounted for 50% of the return, with capital values benefiting from yield tightening and modest rental growth.

At some point, we are likely to enter a market environment in which valuation yields stop tightening, and may even increase again, although this is only likely in the context of a broad property market yield shift. This would have no impact on the rental income from existing assets and would have no material impact on funding costs. It would increase the cash yield available on acquisitions, but whether this would be a net benefit would depend on marginal funding costs at the time. However, with the prospects for rental growth improving, it seems likely that in such an environment, the balance of total return contribution would shift further in favour of income returns and away from capital returns. In our near-term estimates, by assuming capital value growth in line with 2.0% assumed rent growth over the next two years, our forecast EPRA NAV total returns are 9.7% and 9.1% respectively, with dividends contributing 5.1% and 5.0% respectively, or c 55%.

Sensitivities

As a long-term investor (not developer) operating in a sector with long leases, predominantly government-backed, with minimal vacancy and (in the UK) upwards-only lease adjustments, supported by predominantly fixed-cost debt, we view PHP as relatively low operational risk. 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, general economic and monetary conditions, and operational performance.

- Market environment:
  - As discussed above, the demand for healthcare in both the UK and the Republic of Ireland seems set for further growth, while government and health service planning in both countries puts primary healthcare at the centre of measures to both improve delivery and generate overall efficiencies. Primary healthcare estates are in need of substantial modernisation and upgrading to meet this demand.
  - Attractive risk adjusted yields have attracted new investors to the sector and are causing valuation yields to tighten. Competition is greatest for larger let properties as these attract a wider pool of potential investors, although PHP management believes that, selectively, these are likely to provide the best potential for longer-term rental growth and returns. PHP

has a strong reputation and track record in the market and has continued to successfully acquire let properties in the UK. Its formal and informal developer relationships leave it well placed to benefit from the gradual increase in development activity that is expected. Entry into the Irish market provides additional access to attractively priced properties.

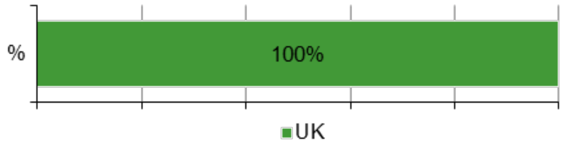
- Government policy: while changes cannot be ruled out over the longer term, the UK government and all major parties are in support of NHS five-year planning, which includes a larger, community-based role for primary care, with 24/7 access to GP services and supported by increased funding. The Irish government is similarly restructuring its primary care provision.
- General economic and monetary conditions:
  - The non-cyclical nature of the sector reduces the impact of the wider economy and we would include the impact of Brexit in this statement.
  - The average maturity of the debt facilities is 6.3 years, with 87% fixed rate or protected by interest rate swaps. The WAULT of the portfolio was 13.2 years at end-2017. There is a risk that interest rates, particularly real interest rates, may be higher as debt facilities mature; however, this is some way off and PHP has already begun to lengthen its average debt maturity, and near-term (2019) maturities cover its existing higher-cost facilities.

Exhibit 16: Financial summary

£'000s	2015	2016	2017	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	63.1	67.4	72.5	76.9	82.2
Cost of Sales	(0.9)	(0.9)	(1.2)	(1.2)	(1.3)
Gross Profit	62.3	66.6	71.3	75.7	80.9
Administrative expenses	(6.8)	(7.3)	(8.7)	(9.2)	(9.5)
EBITDA	55.5	59.2	62.6	66.5	71.4
Other income and expenses	0.0	0.0	0.0	0.0	0.0
Non-recurring items	0.0	0.0	0.0	0.0	0.0
Net valuation gain on property portfolio	39.8	20.7	64.5	21.8	24.0
Operating profit before financing costs	95.2	79.9	127.1	88.3	95.4
Net Interest	(33.7)	(32.5)	(31.6)	(32.5)	(33.9)
Non-recurring finance income/expense	0.0	0.0	0.0	0.0	0.0
Early loan repayment fees	0.0	(0.0)	0.0	0.0	0.0
Fair value gain/(loss) on interest rate derivatives and convertible bond, and swap amortisation	(5.5)	(3.7)	(3.6)	0.0	0.0
Profit Before Tax	56.0	43.7	91.9	55.8	61.5
Tax	0.0	0.0	0.0	0.0	0.0
Profit After Tax (FRS 3)	56.0	43.7	91.9	55.8	61.5
Adjusted for the following:					
Net gain/(loss) on revaluation	(39.8)	(20.7)	(64.5)	(21.8)	(24.0)
Fair value gain/(loss) on derivatives & convertible bond	5.5	3.7	3.6	0.0	0.0
Profit on termination of finance lease	0.0	0.0	0.0	0.0	0.0
Early loan repayment fees	0.0	0.0	0.0	0.0	0.0
Issue costs of convertible bond	0.0	0.0	0.0	0.0	0.0
EPRA basic earnings	21.7	26.7	31.0	34.1	37.5
Period end number of shares (m)	446.3	598.2	619.4	662.0	687.4
Average Number of Shares Outstanding (m)	445.6	560.0	600.7	634.3	676.6
Fully diluted average number of shares outstanding (m)	530.2	644.6	665.5	678.6	686.5
EPS - fully diluted (p)	11.2	7.3	14.7	8.5	9.1
EPRA EPS (p)	4.9	4.8	5.2	5.4	5.5
Dividend per share (p)	5.000	5.125	5.250	5.400	5.500
Dividend cover	97.6%	100.0%	98.6%	100.1%	104.5%
BALANCE SHEET					
Non-current assets	1,100.6	1,220.2	1,361.9	1,469.4	1,588.9
Investment properties	1,100.6	1,220.2	1,361.9	1,469.4	1,588.9
Other non-current assets	0.0	0.0	0.0	0.0	0.0
Current Assets	7.0	8.4	10.5	10.0	10.2
Cash & equivalents	2.9	5.1	3.8	5.3	5.2
Other current assets	4.2	3.3	6.7	4.7	5.0
Current Liabilities	-34.9	-32.3	-33.9	-34.7	-35.9
Current borrowing	-0.9	-0.8	-0.8	-0.8	-0.8
Other current liabilities	-34.0	-31.5	-33.1	-33.9	-35.1
Non-current liabilities	-727.4	-697.1	-751.7	-786.3	-850.4
Non-current borrowings	-696.9	-667.6	-729.6	-764.2	-828.3
Other non-current liabilities	-30.6	-29.5	-22.1	-22.1	-22.1
Net Assets	345.4	499.2	586.8	658.4	712.9
Derivative interest rate swaps	35.3	33.3	24.5	24.8	24.8
Change in fair value of convertible bond	10.9	12.5	12.3	12.3	12.3
EPRA net assets	391.6	545.0	623.6	695.5	750.0
IFRS NAV per share (p)	77.4	83.5	94.7	99.5	103.7
EPRA NAV per share (p)	87.7	91.1	100.7	105.1	109.1
CASH FLOW					
Operating Cash Flow	57.1	56.8	60.1	69.0	72.2
Net Interest & other financing charges	(35.6)	(45.9)	(37.8)	(29.5)	(31.7)
Tax	0.0	(0.1)	0.0	0.0	0.0
Acquisitions/disposals	(29.5)	(97.4)	(75.4)	(85.7)	(95.5)
Net proceeds from issue of shares	(0.1)	145.2	(0.1)	0.0	0.0
Debt drawn/(repaid)	20.0	(31.8)	82.3	80.0	89.0
Equity dividends paid (net of scrip)	(21.1)	(24.7)	(29.8)	(32.3)	(34.1)
Other	0.0	0.0	(0.6)	0.0	0.0
Net change in cash	(9.2)	2.2	(1.3)	1.5	(0.1)
Opening cash & equivalents	12.1	2.9	5.1	3.8	5.3
Closing net cash & equivalents	2.9	5.1	3.8	5.3	5.2
Debt	(697.7)	(668.4)	(730.4)	(765.0)	(829.1)
Net debt	(694.9)	(663.3)	(726.6)	(759.7)	(823.9)
Net LTV	62.7%	53.7%	52.9%	51.6%	51.9%

Source: Edison Investment Research

EDISON

Contact details	Revenue by geography
5th Floor Greener House 66-68 Haymarket London SW1Y 4RF 0207 104 5599 www.phpgroup.co.uk	

Leadership team

Alun Jones: Chairman

Mr Jones was appointed to the board in 2007 and has served as non-executive chairman since 2014. He will retire from the board at the 2018 AGM, to be replaced by Steven Owen. Mr Jones is a chartered accountant who was a partner at PricewaterhouseCoopers until he retired in 2006. He had previously been a member of PwC's UK and global supervisory boards and served on the financial reporting review panel.

Steven Owen : Chairman-elect

Mr Owen was appointed to the board in 2014 and, subject to shareholder approval, will become chairman after the 2018 AGM. He is a chartered accountant, starting his career at Brixton plc where he was finance director and subsequently deputy CEO. He is currently CEO and founding partner of Wye Valley Partners LLP, a commercial real estate and asset management business,

Harry Hyman: Managing Director

Mr Hyman founded PHP and its property adviser Nexus in 1994 and is the managing director of both, representing Nexus on the board. He is a chartered accountant. In addition to his roles at PHP and Nexus, he is a director of several private companies as well as being the non-executive chairman of Summit Germany, an AIM quoted company that invests in German commercial property.

Richard Howell: Finance Director

Mr Howell joined Nexus, the property adviser to PHP, in March 2017 and joined the board of PHP in the same month. He is a chartered accountant with more than 20 years' experience working with London listed commercial property companies, including LondonMetric Property plc and Brixton plc.

Principal shareholders	(%)
Investec	8.7
Hargreaves Lansdown Asset Management	4.8
Blackrock	4.7
Charles Stanley	4.5
Unicorn Asset Management	3.9
Troy Asset Management	3.7
CCLA Investment Management	3.4

Companies named in this report