

# Target Healthcare REIT

Interims confirm portfolio growth and performance

Interim results

Real estate

7 March 2019

Target Healthcare REIT has published interim results for the six months ended 31 December 2018 (H119), providing the detail behind the Q4 NAV update published in January. This showed the portfolio performing well (H119 EPRA NAV total return 4.2%) and good progress being made with deployment of the November placing proceeds. The attractive dividend yield is backed by very long leases, mostly RPI linked, and supported by careful asset and operator selection. We continue to forecast a fully covered dividend in FY20.

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	1.13	5.4
06/18	28.4	15.7	5.54	105.7	6.45	1.09	5.6
06/19e	34.4	21.0	5.68	106.5	6.58	1.08	5.7
06/20e	43.1	25.8	6.71	110.6	6.71	1.04	5.8
06/21e	44.4	26.6	6.91	115.1	6.84	1.00	5.9

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

## 4.2% six-month EPRA NAV return

As discussed in detail in [our recent update](#), the 4.2% H119 EPRA NAV total return comprised a 1.1% increase in NAV to 106.9p versus 105.7p in June 2018 (end-FY18) and dividends paid. Quarterly DPS has increased 2.0% to 1.64475p in H119, an annualised c 6.58p, or a current yield of 5.7%. The portfolio continues to grow strongly (£464m at end-H119 versus £386m at end-FY18) and is performing well, delivering 1.3% rental growth and 2.8% valuation growth on a like-for-like basis. With an end-H119 net LTV of 9.1% and borrowing facilities increased by £40m since period end, Target is well placed meet investment commitments and make further acquisitions from a strong pipeline of near-term opportunities.

## 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.

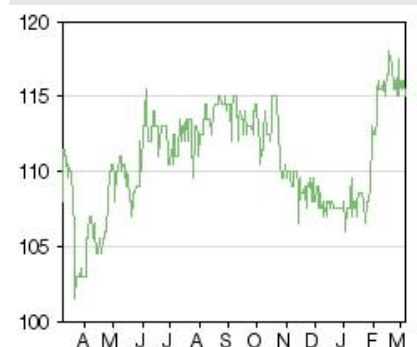
## Visible income growth supports premium to NAV

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 (5.7%) that supports the continuing c 8% premium to Q219 NAV.

**Price** 115.5p  
**Market cap** £445m

Net debt (£m) at 31 December 2018	42.2
Gross LTV at 31 December 2018	15.3%
Shares in issue	385.1m
Free float	96.7%
Code	THRL
Primary exchange	LSE
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	(0.9)	6.0	7.5
Rel (local)	(1.4)	(1.4)	7.4
52-week high/low	118.0p	101.5p	

### 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

Q3 NAV update	Ext. April 2018
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### Analysts

Martyn King	+44 (0)20 3077 5745
Andrew Mitchell	+44 (0)20 3681 2500

[financials@edisongroup.com](mailto:financials@edisongroup.com)

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## Summary of the interim results

The H119 results show continuing strong portfolio growth and recurring income earnings. During the period, £81.8m (including costs) was committed to new investment, a mix of operational homes and forward-funded developments. Good progress has been made in deploying the £50m (gross) proceeds from the November share placement, although this is yet to fully contribute, dampening adjusted EPS in the period. With gearing remaining moderate and debt facilities increased by £40m since the H119 period end, Target is well placed for further acquisitions from a strong acquisition pipeline, including a number of well-advanced projects.

**Exhibit 1: Summary of interim results**

	H119			H118			H119/H118	FY18		
£m unless stated otherwise	IFRS	Adjustments	Adj. Earnings	IFRS	Adjustments	Adj. Earnings	Adj. Earnings	IFRS	Adjustments	Adj. Earnings
Rent revenue	13.3		13.3	10.7		10.7	24%	22.0		22.0
Income from guaranteed rent reviews & lease incentives	2.9	(2.9)	0.0	3.2	(3.2)	0.0		6.3	(6.3)	0.0
Development interest*	0.0	0.8	0.8	0.0		0.0		0.0	0.3	0.3
<b>Total income</b>	<b>16.2</b>	<b>(2.1)</b>	<b>14.1</b>	<b>13.9</b>	<b>(3.2)</b>	<b>10.7</b>	<b>32%</b>	<b>28.4</b>	<b>(6.1)</b>	<b>22.3</b>
Base investment manager fee	(2.4)		(2.4)	(1.4)		(1.4)	68%	(3.2)		(3.2)
Performance fee*	0.0		0.0	(0.4)	0.4	0.0		(0.6)	0.6	0.0
Other expenses	(0.8)		(0.8)	(0.7)		(0.7)	3%	(1.5)		(1.5)
<b>Operating profit before property gains/(losses)</b>	<b>13.0</b>	<b>(2.1)</b>	<b>10.9</b>	<b>11.3</b>	<b>(2.8)</b>	<b>8.5</b>	<b>28%</b>	<b>23.2</b>	<b>(5.5)</b>	<b>17.7</b>
Revaluation of investment properties	3.3	(3.3)	0.0	4.3	(4.3)	0.0		6.4	(6.4)	0.0
Cost of corporate acquisitions	0.0	0.0	0.0	(0.4)	0.4	0.0		0.0	0.0	0.0
<b>Operating profit</b>	<b>16.4</b>	<b>(5.5)</b>	<b>10.9</b>	<b>15.1</b>	<b>(6.6)</b>	<b>8.5</b>	<b>28%</b>	<b>29.6</b>	<b>(12.0)</b>	<b>17.7</b>
Net finance cost	(1.4)		(1.4)	(0.7)		(0.7)		(2.0)		(2.0)
Tax	0.0		0.0	(0.0)		(0.0)		0.0		0.0
<b>Net earnings</b>	<b>14.9</b>	<b>(5.5)</b>	<b>9.5</b>	<b>14.4</b>	<b>(6.6)</b>	<b>7.8</b>	<b>22%</b>	<b>27.6</b>	<b>(12.0)</b>	<b>15.7</b>
<b>Other data:</b>			<b>H119</b>			<b>H118</b>	<b>FY18/FY17</b>			<b>FY18</b>
IFRS EPS (p)			4.24			5.71	-26%			9.77
Adjusted EPS (p)			2.69			3.08	-12.7%			5.54
EPRA EPS (p)*			2.47			2.92	-16%			5.25
DPS declared (p)			3.29			3.23	2%			6.45
Dividend cover			0.80			0.95				0.82
NAV per share, IFRS & EPRA (p)			106.9			104.4	2%			105.7
Investment properties			438.4			315.4				362.9
Gross LTV			15.3%			24.2%				17.1%

Source: Company data, Edison Investment Research. Note: \*EPRA earnings excludes development interest under forward fund agreements and includes investment manager performance fees. Performance fees discontinued from start of FY19.

The key financial and operational features of the interim results were:

- The total portfolio value increased to £464m (FY18: £386m) comprising 61 assets (54 operational and seven under development). Alongside continuing investment, valuations increased by 2.8% on a like-for-like basis during the period, driven by rental growth and continued yield tightening. The portfolio valuation reflected an EPRA topped up net initial yield of 6.32% (end-FY18: 6.44%).
- The contracted rent roll increased 7.9% to £28.0m including a 1.3% increase in like-for-like rents. The seven homes under development and the forward purchase asset will provide an additional £5.3m in rental income upon completion later in FY19. Target says the acquisition yields on the new investments are representative of assets of a similar standard and location within the existing portfolio.
- Adjusted (underlying income) earnings increased by 22% but, reflecting share issuance, adjusted EPS was lower at 2.69p (H118: 3.08p).

- Quarterly dividends have increased by 2.0%, amounting to c 3.29p during the period. Dividend cover was 80% but we continue to expect full cover as capital resources are deployed and developments complete.
- EPRA NAV per share increased by 1.1% to 106.9p (end-FY18: 105.7p). Including DPS paid, the H119 EPRA NAV total return was 4.2%.
- With £71m of drawn debt at period end and cash balances of £28.8m, gross loan to value (LTV) was 15.3% and net LTV was 9.1%. Since end-H119 Target has doubled the size of its revolving credit facility with HSBC, adding an additional £40m of flexible debt facilities, and increasing total debt facilities to £170m.

## Little change to our forecasts

Much of the financial and operational progress made in H119 had previously been disclosed in outline and was reflected in the forecasts we published in our [February update note](#), along with our expectations for future portfolio growth. We have updated our forecasts for this detail but adjusted earnings, NAV and DPS show little or no change.

### Exhibit 2: Forecast update

	Revenue (£m)			Adjusted EPS (p)			EPRA NAV/share (p)			DPS (p)		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
06/19e	34.9	34.4	-1.6	5.71	5.68	-0.6	106.3	106.5	0.2	6.58	6.58	0.0
06/20e	43.4	43.1	-0.8	6.72	6.71	-0.2	110.0	110.6	0.5	6.71	6.71	0.0
06/21e	44.7	44.4	-0.7	6.92	6.91	-0.2	114.2	115.1	0.7	6.84	6.84	0.0

Source: Edison Investment Research

## Our forecasts assume £55m of further investment commitment

With portfolio growth, Target should benefit from scale economies and further portfolio diversification by asset (currently 61) and tenant (currently 21 but increasing to 26 upon completion of developments and commitments to acquire properties). The revised management fee structure in place from the start of FY19 introduced a tiered base fee structure with reducing rates at higher NAV levels, allowing shareholders to benefit from the increasing economies of scale that a larger portfolio provides. Performance fees were discontinued.

Our forecasts include £55m of additional investment commitment by the end of FY19. We believe this level is consistent with re-gearing the balance sheet to a c 25% LTV, although given Target's comments about the strength of its acquisition pipeline, we believe it may be exceeded. Full drawdown of the increased debt facilities, for deployment in investment properties, would take the LTV to c 28% and provide scope for perhaps £85m of future commitment, rather than the £55m we model. This increases our confidence in the dividend cover that we forecast in FY20, even if acquisition yields were to continue to tighten. Although higher than the c 25% medium term LTV of which Target has previously spoken, we believe this would still be a comfortable level of gearing given the security of the rental income.

## Future-proof asset selection supports income visibility

The security of Target's contractual income benefits from long leases (weighted average lease term of 28.5 years), mostly RPI rent uplifts, and an increasingly diversified portfolio and tenant base. Strong demand demographics and an undersupply of the modern, well-designed homes that are fully equipped with en-suite wet rooms and suitable communal spaces, of the type in which Target is invested, are also highly supportive. As well as a strong focus on the quality of the physical assets it acquires and their location, the operational capabilities and financial performance of the tenant are also carefully assessed before and after investment. In a challenging operational environment where regulation is high, government funding in short supply and labour costs rising,

even strong operators can experience problems. As the portfolio grows so does the chance of potential trading challenges to operators, which is where pro-active asset management plays a role. During the first six months of the current year, the vast majority of assets in the portfolio have continued to perform well and each has seen its value maintained or increased. Target has been pro-actively involved and has:

- re-tenanted a challenging home to a new, regional operator, with the lease length significantly extended and now supported by a parent company guarantee;
- transferred the pre-agreed lease at one of the assets under development to a new, stronger tenant;
- engaged with an existing tenant that had decided to close a home following compliance challenges while it considers how best to reposition the home, meanwhile continuing to collect the rent in full; and
- extended the lease at a well-performing home by a further eight years.

**Exhibit 3: Financial summary**

<b>INCOME STATEMENT</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019e</b>	<b>2020e</b>	<b>2021e</b>
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
<b>BALANCE SHEET</b>								
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
<b>CASH FLOW</b>								
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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Frankfurt +49 (0)69 78 8076 960  
Schumannstrasse 34b  
60325 Frankfurt  
Germany

London +44 (0)20 3077 5700  
280 High Holborn  
London, WC1V 7EE  
United Kingdom

New York +1 646 653 7026  
1,185 Avenue of the Americas  
3rd Floor, New York, NY 10036  
United States of America

Sydney +61 (0)2 8249 8342  
Level 4, Office 1205  
95 Pitt Street, Sydney  
NSW 2000, Australia