

Target Healthcare REIT

Nearing full investment

NAV update

Real estate

Target has provided a NAV and portfolio update as at 30 June. The previously announced acquisition of a newly-built home in Leicestershire and the forward funding of one in Merseyside bring the portfolio to a total of 47 properties and closer to management's target of a 20% loan-to-value (LTV) ratio (14.2% at 30 June). We have adjusted our estimates for the NAV update and to account for the timing of the new investments. Target has the longest lease portfolio of any UK REIT, producing stable income streams from high-quality and purpose-built modern care homes. These support a prospective dividend yield of 5.2%.

Year end	Revenue (£m)	EPRA EPS (p)	EPRA NAV/share (p)	Price/EPRA NAV/share (x)	DPS (p)	Yield (%)
06/15	12.7	5.71	97.9	1.23	6.12	5.1
06/16	16.3	4.56	100.6	1.20	6.18	5.1
06/17e	21.3	4.81	101.9	1.18	6.28	5.2
06/18e	26.5	6.47	103.5	1.16	6.34	5.3

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

NAV and pipeline update

At 30 June 2017 EPRA NAV stood at £256.9m, or 101.9p per share, from 101.5p at 31 March. The Q3 dividend of 1.57p was covered by 2p of IFRS earnings, but not yet by EPRA EPS, which excludes 0.5p of revaluation. Passing rent was £20.3m, up 2.8% in the quarter, representing a 6.75% net initial yield. 70bp of the rental increase were due to rent reviews and the rest from acquisitions. The portfolio was valued at £282.0m at 30 June, after a like-for-like increase of c 0.5% (£1.3m), broadly in line with rental growth, and a £6.1m acquisition. Subsequent purchases have taken the portfolio to £298.6m. This steady performance shows the team's success in delivering stable, predictable income from a growing portfolio of long leases (the weighted average unexpired lease term was 29.5 years at 30 June).

Two new properties

The Amwell in Melton Mowbray was acquired in early July for £8.4m and let for 35 years to Melton Care, a joint venture between Care Concern and local operator Magnum Care. The £8.2m forward funding agreement is for a land acquisition and the development of a high-quality care home in Birkdale, which will be carried out with Athena Healthcare. Athena will lease the completed property for 35 years from completion, expected by March 2019. The investments represent a yield in line with the rest of the portfolio (c 7%).

Valuation: Long leases support dividend

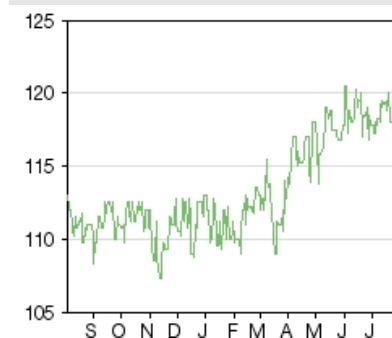
Target's premium to EPRA NAV remains in the mid-teens, supported by the attractive 5.2% prospective dividend, paid from a growing portfolio of leases with the longest average unexpired term of any UK REIT. The company remains conservatively geared at 14.2% LTV, with a target of 20% at full investment. The care home market enjoys long-term secular demand, which is likely to provide further investment opportunities for Target to participate in this growth.

1 August 2017

Price 120.25p
Market cap £303m

Net debt (£m) at 30 June 2017	29.6
Shares in issue	252.2m
Free float	90%
Code	THRL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	2.1	1.9	7.1
Rel (local)	1.0	(0.2)	(3.3)
52-week high/low	120.5p	107.2p	

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

Final results	September 2017
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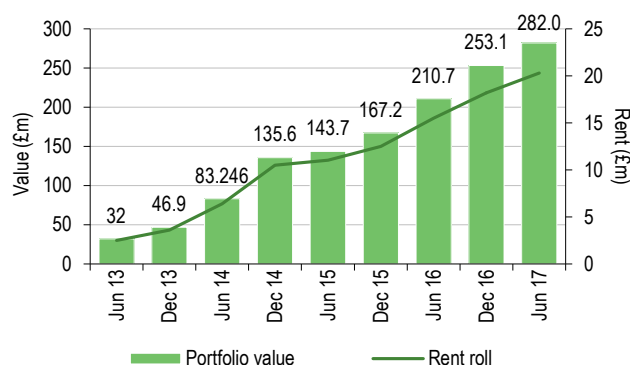
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Summary of NAV update

The full year results will be published in September, but the NAV update gave a brief overview of the balance sheet, which we have used to update our model. The update contains no surprises and Target continues to execute management's strategy of investing in purpose-built homes in areas with a supportive local economy and demographics. The main points are summarised below:

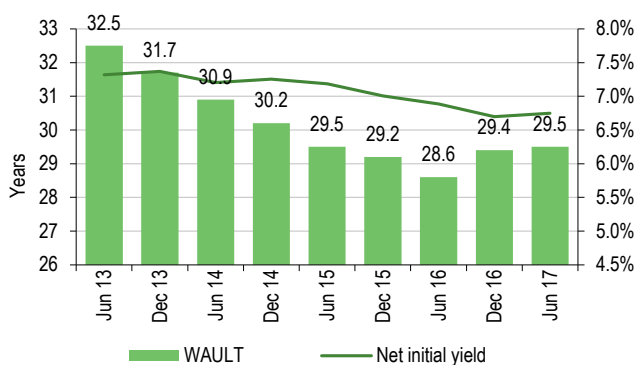
- At 30 June 2017 the portfolio of 45 assets was valued at £282.0m (31 March: 44 and £274.6m). Of the increase, £6.1m was from the acquisition of a care home in Dover and £1.3m from valuation increases. The latter were equivalent to c 0.5% of the existing portfolio value, broadly in line with the like-for-like rental growth.
- The rent roll stood at £20.3m, up 2.8% from £19.8m at 31 March. Of the increase, c £0.14m, or 0.7%, was due to rent increases and the rest was from new leases on acquired properties. Portfolio net initial yield was up slightly at 6.75% (31 March: 6.7%) and WAULT rose to 29.5 years over the period due to the addition of new 35-year leases.

Exhibit 1: Portfolio value and rent roll progression



Source: Company data

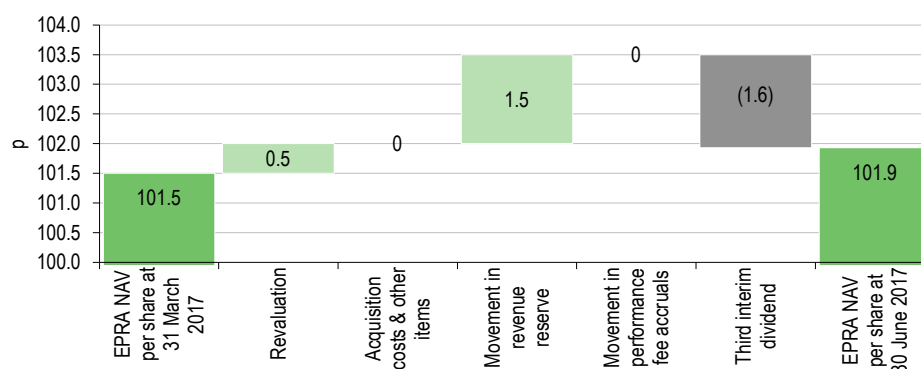
Exhibit 2: WAULT and yield progression



Source: Company data

- Total borrowings were £40.0m, for an LTV ratio of 14.2%, excluding a cash balance of £10.4m. At 30 June, Target had £10m of capital available from its revolving credit facility. The company is close to agreeing a new debt facility with a new lender, replenishing its debt resources following the post-year end acquisitions.
- EPRA NAV increased to £256.9m at 30 June from £256.1m at 31 March, equivalent to 101.9p per share.

Exhibit 3: EPRA NAV per share changes in the quarter



Source: Company data

New investments

The two acquisitions were announced on 12 July 2017 and are outlined below. Both new assets are in relatively prosperous areas with populations of potential residents. Once the forward-funded asset is built, both will fulfil Target's criteria of having a long useful life ahead of them with less refurbishment and alteration required than older stock.

The Amwell in Melton Mowbray has 88 beds and welcomed its first residents in March 2017. The development was carried out by Melton Care to its own design and has excellent public spaces, large bedrooms with wet rooms en suite, a cinema, coffee shop and gym as well as a good location near the town centre, next to a park on the River Eye. The joint venture partners in Melton Care are Care Concern, a national operator with which Target works at several other homes, and local operator Magnum Care, which runs two other homes in Leicestershire. The 35-year lease has capped and collared RPI uplifts and the total acquisition cost was £8.4m.

The site in Birkdale, Merseyside, received planning permission in February 2017 for a 55-bed home, again with excellent amenities. The site acquisition and forward funding agreement have a total capped cost of £8.2m, with completion scheduled for March 2019, when the home will be let to Athena Healthcare for 35 years, again with capped and collared RPI uplifts. Athena has three operational homes and several under development; the Birkdale development will be the third Athena home owned by Target. This home will target the premium market and is located in an affluent suburb of Southport, an area with high demand for care homes.

Changes to estimates

We had previously assumed that Target would invest £40m in H217 (to 30 June 2017) and £20m in H118. The timing of the acquisitions announced on 12 July means that we have trimmed our H217 assumption to £35m but leave our H118 assumption unchanged. We have assumed that the forward funding will be disbursed as follows: £2.5m each in H118, H218 and H119, with the remaining £0.7m in the last quarter before the Birkdale home is completed by March 2019. We also assume that the funding will attract interest at the same rate as our assumed property yield of 7%.

The publication of a summary balance sheet has enabled us to make some assumptions about cash flow movements, but the FY17 financials overleaf remain estimates, pending final results to be announced in September. The changes to our estimates are summarised below. The slight increase in revenue is a result of the resilient net initial yield. That flows through to higher EPS and contributes to the increased EPRA NAV forecasts. We have not increased our dividend assumption.

Exhibit 4: Estimate changes

	Revenue			EPRA EPS			EPRA NAV/share			DPS		
	Old (£m)	New (£m)	Change (%)	Old (p)	New (p)	Change (%)	Old (p)	New (p)	Change (%)	Old (p)	New (p)	Change (%)
2017e	23.4	23.4	0%	4.8	4.8	1%	100.7	101.9	2%	6.28	6.28	0%
2018e	27.9	28.1	1%	6.3	6.5	2%	102.3	103.5	2%	6.34	6.34	0%
2019e	28.7	29.2	2%	6.6	6.9	4%	105.2	106.5	2%	6.34	6.34	0%

Source: Edison Investment Research

Valuation: Long-term income

The 5.2% prospective yield is supported by 47 leases with 17 different tenants that have the longest WAULT of any UK REIT. Earnings will increase as Target becomes fully invested and approaches its planned LTV ratio of 20%, which we expect in FY18 as management deploys more debt capital, and we continue to expect the dividend to be fully covered in FY18. The c 18% premium to EPRA NAV is below the level of other REITs investing in healthcare assets, which trade at more than 20% above EPRA NAV, and shows the attraction of Target's long-term, stable income streams to investors. Target's valuation may continue to converge with peers as its track record and scale increase.

Exhibit 5: Financial summary

Year end 30 June	2013	2014	2015	2016	2017e	2018e	2019e
£000s	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Rent revenue	2,291	3,817	9,898	12,677	18,084	22,625	23,721
Movement in lease incentive or rent review	860	1,547	3,760	4,136	5,143	5,446	5,446
Rental income	3,151	5,364	13,658	16,813	23,227	28,071	29,167
Other income	0	0	66	61	195	0	0
Total revenue	3,151	5,364	13,724	16,874	23,422	28,071	29,167
Gains/(losses) on revaluation	(3,225)	(2,233)	(839)	425	804	(200)	971
Cost of corporate acquisitions	0	0	(174)	(998)	(2,941)	(1,363)	(194)
Total income	(74)	3,131	12,711	16,301	21,286	26,507	29,944
Management fee	(808)	(648)	(1,524)	(2,654)	(3,447)	(3,114)	(3,150)
Other expenses	0	(780)	(880)	(992)	(1,436)	(1,937)	(2,013)
Total expenditure	(808)	(1,428)	(2,404)	(3,646)	(4,883)	(5,051)	(5,163)
Profit before finance and tax	(882)	1,703	10,307	12,655	16,403	21,456	24,780
Net finance cost	93	190	(716)	(929)	(965)	(1,254)	(1,241)
Profit before taxation	(789)	1,893	9,591	11,726	15,438	20,202	23,540
Tax	(14)	(4)	(39)	(24)	(533)	0	0
Profit for the year	(803)	1,889	9,552	11,702	14,905	20,202	23,540
Movement in valuation of interest rate swap	0	0	0	(316)	223	0	0
Total comprehensive income for the year	(803)	1,889	9,552	11,386	15,128	20,202	23,540
Average number of shares in issue	58,618,032	105,231,661	119,160,560	171,734,587	252,180,851	252,180,851	252,180,851
IFRS earnings	(803)	1,889	9,552	11,386	15,128	20,202	23,540
Adjusted for rent arising from recognising guaranteed rent review uplifts + lease incentives	(860)	(1,547)	(3,760)	(4,136)	(5,143)	(5,446)	(5,446)
Adjusted for valuation changes	3,225	2,233	839	(425)	(804)	200	(971)
Adjusted for corporate acquisitions	0	0	174	998	2,941	1,363	194
EPRA earnings	1,562	2,575	6,805	7,823	12,122	16,320	17,317
Adjusted for performance fee	0	150	466	871	745	800	800
Group adjusted EPRA earnings	1,562	2,725	7,271	8,694	12,867	17,120	18,117
IFRS EPS (p)	(1.37)	1.80	8.02	6.63	6.00	8.01	9.33
EPRA EPS (p)	2.66	2.45	5.71	4.56	4.81	6.47	6.87
Adjusted EPS (p)	2.66	2.59	6.10	5.06	5.10	6.79	7.18
Dividend per share (declared)	0.00	6.12	6.12	6.18	6.28	6.34	6.34
BALANCE SHEET							
Investment properties	46,004	81,422	138,164	200,720	281,952	305,152	309,451
Trade and other receivables	0	0	2,530	3,742	3,763	3,763	3,763
Non-current assets	46,004	81,422	140,694	204,462	285,715	308,915	313,214
Trade and other receivables	1,300	6,524	6,457	13,222	11,000	11,000	11,000
Cash and equivalents	45,354	17,125	29,159	65,107	10,400	8,452	11,704
Current assets	46,654	23,649	35,616	78,329	21,400	19,452	22,704
Total assets	92,658	105,071	176,310	282,791	307,115	328,366	335,918
Bank loan	0	(11,764)	(30,865)	(20,449)	(40,000)	(57,000)	(57,000)
Interest rate swap	0	0	0	(316)	0	0	0
Trade and other payables	0	0	(2,530)	(3,742)	(3,763)	(3,763)	(3,763)
Non-current liabilities	0	(11,764)	(33,395)	(24,507)	(43,763)	(60,763)	(60,763)
Trade and other payables	(1,363)	(3,089)	(3,623)	(5,002)	(6,497)	(6,497)	(6,497)
Current Liabilities	(1,363)	(3,089)	(3,623)	(5,002)	(6,497)	(6,497)	(6,497)
Total liabilities	(1,363)	(14,853)	(37,018)	(29,509)	(50,260)	(67,260)	(67,260)
Net assets	91,295	90,218	139,292	253,282	256,855	261,106	268,658
Period end shares	95,221,629	95,221,629	142,298,226	252,180,851	252,180,851	252,180,851	252,180,851
NAV per ordinary share	95.9	94.7	97.9	100.4	101.9	103.5	106.5
EPRA NAV per share	95.9	94.7	97.9	100.6	101.9	103.5	106.5
Earnings yield on EPRA NAV	2.8%	2.6%	5.8%	4.5%	4.7%	6.3%	6.4%
Dividend yield on EPRA NAV	0.0%	6.5%	6.3%	6.1%	6.2%	6.1%	6.0%
CASH FLOW							
Profit before tax	(789)	1,893	9,591	11,726	15,438	20,202	23,540
Adjusted for							
Interest receivable	(93)	(201)	(99)	(173)	(138)	(80)	(80)
Interest payable	0	11	815	1,102	1,103	1,334	1,321
Revaluation gains on property portfolio	2,365	686	(2,921)	(4,787)	(4,943)	(700)	(1,099)
Cost of corporate acquisitions					2,941	1,363	194
(Increase)/decrease in trade and other receivables	(440)	(558)	(308)	(233)	4,543	0	0
Increase/(decrease) in trade and other payables	1,300	1,341	1,003	1,271	19	0	0
Total working capital adjustments	3,132	1,279	(1,510)	(2,820)	3,524	1,918	336
Interest paid	0	0	(613)	(854)	(892)	(1,334)	(1,321)
Interest received	93	161	99	173	138	80	80
Tax paid	0	0	(47)	(164)	(25)	0	0
Total other adjustments	93	161	(561)	(845)	(779)	(1,254)	(1,241)
Net cash flow from operating activities	2,436	3,333	7,520	8,061	18,184	20,866	22,635
Purchase of investment properties	(49,229)	(51,894)	(51,736)	(34,833)	(49,069)	(22,500)	(3,200)
Acquisition of subsidiaries	0	0	(5,845)	(27,091)	(27,867)	(1,363)	(194)
Net cash flow from investing activities	(49,229)	(51,894)	(57,581)	(61,924)	(76,936)	(23,863)	(3,394)
Issue of ordinary share capital	95,740	45,450	47,802	100,279	0	0	0
Expenses of issue	(1,882)	(930)	(1,158)	(2,778)	0	0	0
Sale of shares from treasury	0	0	0	14,799	0	0	0
(Repayment)/drawdown of bank loan	0	11,946	19,225	(10,638)	19,744	17,000	0
(Grant)/repayment of development loan and cost of bank facility	0	(3,300)	3,300	(2,170)	(185)	0	0
Dividends paid	(1,711)	(4,364)	(7,074)	(9,681)	(15,514)	(15,950)	(15,988)
Net cash flow from financing activities	92,147	48,802	62,095	89,811	4,045	1,050	(15,988)
Net change in cash and equivalents	45,354	241	12,034	35,948	(54,707)	(1,948)	3,253
Opening cash and equivalents	0	16,884	17,125	29,159	65,107	10,400	8,452
Closing cash and equivalents	45,354	17,125	29,159	65,107	10,400	8,452	11,704
Net debt (cash)	0	(17,125)	(17,395)	(44,658)	29,600	36,548	45,296

Source: Company data, Edison Investment Research

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