

Target Healthcare REIT

Income growth and growing NAV

NAV & dividend update

Real estate

9 November 2017

Price **117.25p**
Market cap **£296m**

Net debt (£m) at 30 June 2017	28.9
Net LTV at 30 June 2017	10.5%
Shares in issue	252.2m
Free float	90%
Code	THRL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.5	(3.9)	5.4
Rel (local)	1.3	(4.1)	(5.4)
52-week high/low		123.0p	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

Q2 NAV and portfolio update	Expected January 2018
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Target has published its quarterly NAV and dividend update. NAV total return was 3.0% in the quarter including dividends paid of 1.570p. With investor interest in modern, purpose-built care homes remaining strong the portfolio valuation increased further. While this is positive for NAV, it also highlights the strong competition for quality assets in the market. Despite the competitive market conditions, as previously indicated the managers have identified a number of acquisition opportunities that meet its qualitative and financial hurdles on which due diligence is progressing.

Year end	Revenue (£m)	EPRA net earnings* (£m)	EPRA EPS* (p)	EPRA NAV/share (p)	DPS (p)	Price/EPRA NAV/share (x)	Yield (%)
06/16	16.9	8.1	4.7	100.6	6.18	1.17	5.3
06/17	23.6	12.2	4.8	101.9	6.28	1.15	5.4
06/18e	28.0	15.8	6.3	104.1	6.45	1.13	5.5
06/19e	30.5	17.5	6.9	106.5	6.58	1.10	5.6

Note: *EPRA earnings exclude revaluation movements, non-cash income arising from the accounting treatment of lease incentives and guaranteed rent review uplifts, and the costs of acquisitions.

Income in line; lifting NAV forecast

In the three months to 30 September 2017, Target's EPRA NAV per share increased by 1.4p to 103.3p per share after the payment of 1.570p per share in dividends during the period. A 1.6125p DPS has been declared for the quarter under review. Passing rent increased 3.7%: 3.1% from previously disclosed acquisitions and 0.6% from rent reviews. The external portfolio valuation saw the EPRA net initial yield (NIY) tighten to 6.69% from 6.75% in June, combining with rent increases to generate 1.8p per share in property revaluation gains. Our only forecast change is to increase our assumed revaluation gains for the year from £6.0m to £9.0m with the balance of the year benefitting from an assumed 2% pa increase in rents and no further change in NIY. This adds 1.2p to our EPRA NAV per share forecasts.

Strong pipeline of growth opportunities

As discussed at length in our recent [update note](#), Target seeks further portfolio growth, capturing the positive spread between rental income and funding costs, generating operational efficiencies, and further diversifying the portfolio. The investment manager continues to perform due diligence on a strong pipeline of opportunities and while it is not certain that all of these will proceed in aggregate they are higher than we have forecast. The scale of the opportunities is such that additional equity and debt capital support, not in our forecasts, may be required.

Valuation: Long-term income visibility

The mid-teens premium to EPRA NAV is supported by an attractive 5.5% prospective dividend yield, with our estimated cover increasing to 97% in FY18 and 106% in FY19. The long-term need for care home provision is clear, providing a strong opportunity for investors in modern, purpose-built facilities, such as Target, in combination with efficient, well managed, and financially sound operators.

Exhibit 1: Financial summary

Year to 30 June (£000s)	2014	2015	2016	2017	2018e	2019e
INCOME STATEMENT						
Rent revenue	3,817	9,898	12,677	17,760	22,449	24,940
Movement in lease incentive or rent review	1,547	3,760	4,136	5,127	5,414	5,414
Rental income	5,364	13,658	16,813	22,887	27,863	30,354
Other income	0	66	61	671	100	100
Total revenue	5,364	13,724	16,874	23,558	27,963	30,454
Gains/(losses) on revaluation	(2,233)	(839)	425	2,211	1,279	(271)
Cost of corporate acquisitions	0	(174)	(998)	(626)	(688)	(63)
Total income	3,131	12,711	16,301	25,143	28,555	30,120
Management fee	(648)	(1,524)	(2,654)	(3,758)	(3,739)	(3,796)
Other expenses	(780)	(880)	(992)	(1,236)	(1,400)	(1,600)
Total expenditure	(1,428)	(2,404)	(3,646)	(4,994)	(5,139)	(5,396)
Profit before finance and tax	1,703	10,307	12,655	20,149	23,416	24,724
Net finance cost	190	(716)	(929)	(808)	(1,622)	(2,125)
Profit before taxation	1,893	9,591	11,726	19,341	21,794	22,599
Tax	(4)	(39)	(24)	(219)	0	0
Profit for the year	1,889	9,552	11,702	19,122	21,794	22,599
Average number of shares in issue (m)	105.2	119.2	171.7	252.2	252.2	252.2
IFRS earnings	1,889	9,552	11,702	19,122	21,794	22,599
Adjusted for rent arising from recognising guaranteed rent review uplifts + lease incentives	(1,547)	(3,760)	(4,136)	(5,127)	(5,414)	(5,414)
Adjusted for valuation changes	2,233	839	(425)	(2,211)	(1,279)	271
Adjusted for corporate acquisitions	0	174	998	420	688	63
EPRA earnings	2,575	6,805	8,139	12,204	15,788	17,518
Adjustment for performance fee	150	466	871	997	935	949
Group adjusted EPRA earnings	2,725	7,271	9,010	13,201	16,723	18,467
IFRS EPS (p)	1.80	8.02	6.81	7.58	8.64	8.96
EPRA EPS (p)	2.45	5.71	4.74	4.84	6.26	6.95
Adjusted EPS (p)	2.59	6.10	5.25	5.23	6.63	7.32
Dividend per share (declared)	6.00	6.12	6.18	6.28	6.45	6.58
BALANCE SHEET						
Investment properties	81,422	138,164	200,720	266,219	324,093	328,967
Trade and other receivables	0	2,530	3,742	3,988	4,495	4,753
Non-current assets	81,422	140,694	204,462	270,207	328,588	333,720
Trade and other receivables	6,524	6,457	13,222	25,629	24,261	29,675
Cash and equivalents	17,125	29,159	65,107	10,410	4,186	4,884
Current assets	23,649	35,616	78,329	36,039	28,447	34,559
Bank loan	(11,764)	(30,865)	(20,449)	(39,331)	(84,487)	(89,643)
Other non-current liabilities	0	(2,530)	(4,058)	(3,997)	(3,997)	(3,997)
Non-current liabilities	(11,764)	(33,395)	(24,507)	(43,328)	(88,484)	(93,640)
Trade and other payables	(3,089)	(3,623)	(5,002)	(5,981)	(5,981)	(5,981)
Current Liabilities	(3,089)	(3,623)	(5,002)	(5,981)	(5,981)	(5,981)
Net assets	90,218	139,292	253,282	256,937	262,570	268,657
Period end shares (m)	95.2	142.3	252.2	252.2	252.2	252.2
IFRS NAV per ordinary share	94.7	97.9	100.4	101.9	104.1	106.5
EPRA NAV per share	94.7	97.9	100.6	101.9	104.1	106.5
CASH FLOW						
Profit before tax	1,893	9,591	11,726	19,341	21,794	22,599
Adjusted for						
Net interest payable	(190)	716	929	808	1,622	2,125
Revaluation gains on property portfolio	686	(2,921)	(4,787)	(7,339)	(6,695)	(5,145)
Cost of corporate acquisitions				626	688	63
Change in receivables/payables	783	695	1,038	(9,042)	6,275	(258)
Net interest paid	161	(514)	(681)	(615)	(1,466)	(1,969)
Tax paid	0	(47)	(164)	(543)	0	0
Net cash flow from operating activities	3,333	7,520	8,061	3,236	22,217	17,414
Purchase of investment properties	(51,894)	(51,736)	(34,833)	(37,698)	(29,095)	(2,645)
Acquisition of subsidiaries	0	(5,845)	(27,091)	(25,552)	(28,188)	(2,563)
Net cash flow from investing activities	(51,894)	(57,581)	(61,924)	(63,250)	(57,283)	(5,208)
Issue of ordinary share capital (net of expenses)	44,520	46,644	97,501	0	0	0
Sale of shares from treasury	0	0	14,799	0	0	0
(Repayment)/drawdown of loans	8,646	22,525	(12,808)	20,906	45,000	5,000
Dividends paid	(4,364)	(7,074)	(9,681)	(15,589)	(16,158)	(16,510)
Net cash flow from financing activities	48,802	62,095	89,811	5,317	28,842	(11,510)
Net change in cash and equivalents	241	12,034	35,948	(54,697)	(6,224)	697
Opening cash and equivalents	16,884	17,125	29,159	65,107	10,410	4,186
Closing cash and equivalents	17,125	29,159	65,107	10,410	4,186	4,884
Debt	(11,764)	(30,865)	(20,449)	(39,331)	(84,487)	(89,643)
Net cash/(debt)	5,361	(1,706)	44,658	(28,921)	(80,301)	(84,759)
Net LTV	0.0%	0.0%	0.0%	10.5%	23.4%	23.8%

Source: Company data, Edison Investment Research

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