

Vital Healthcare

OUTPERFORM

FY19 Result — Healthy and Strong

Vital Healthcare (VHP) remains with a very healthy outlook, given its strongly defensive medical asset portfolio that has high appeal in a world of falling interest rates and economic uncertainty. The FY19 result was close to expectations, with the major surprise a slightly higher effective tax rate going forward. **OUTPERFORM.**

What's changed?

- **Earnings:** Only minor reflecting a higher tax rate with FY20 EPU -2%, FY21 -2% and FY22 -2%
- **Target Price:** Up slightly to NZ\$2.30
- **Rating:** Remains **OUTPERFORM**

Little in the way of surprises apart from a lift in tax

Net property income was in line with forecasts at NZ\$97.7m, up +7.7% driven by acquisitions and development activity. In terms of underlying like-for-like same currency rental growth this was a solid +2.3%. NTA lifted +2% to NZ\$2.31 on the back of the revaluation gain that was partially offset by negative net movement in interest rate derivatives and unrealised currency movements. Gearing has fallen slightly to 35.3%. This does not include the A\$80.3m loan to NorthWest that was repaid post balance date on 2 August 2019. FY19 distributable profit was impacted by higher tax than forecast given a change in NZ tax regulations; a slightly higher effective tax rate is expected going forward.

Steady dividends backed by a strong portfolio

The FY19 dividend was as per guidance and our forecast at 8.75cpu, up +2.2%. This is 77% of VHP's calculated AFFO per unit. The 4Q19 dividend was 2.19cpu. FY20 dividend guidance is flat at not less than 8.75cpu. The portfolio remains full at 99.4% and the WALT is maintained at 18.1 years. The lease expiry profile remains benign averaging 1.7% pa over the next 10 years.

Key project focus with governance and CEO changes later in the year

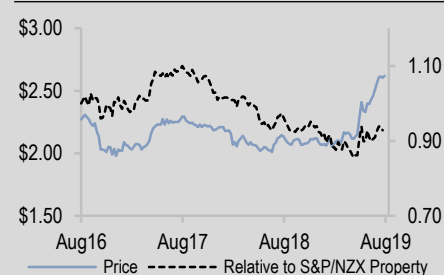
VHP has commenced NZ\$218m of development projects and has acquired NZ\$25m of strategic land for future development activity. Two major projects, being Wakefield Hospital in Wellington and Epworth in Melbourne, are the key portfolio activities underway. VHP has again highlighted an interest in aged care sector acquisitions and will also look to divest some non-core assets. The proposed new fee structure will be put to unitholders for approval at the AGM which is expected to be in October, and VHP is also looking to increase the number of independent directors. A permanent CEO is expected to be appointed by the end of CY19.

Investment View

VHP remains one of our preferred LPV exposures given (1) it has a defensive portfolio underpinned by a sector-leading WALT (18.1 years), a high proportion of structured rental reviews (~90%) and no major near-term expiries, (2) has an attractive long-term macro outlook with an ageing population and improving healthcare technology. Governance issues have overhung VHP and it is now, hopefully, time for back to basics and for VHP's high quality portfolio to do the talking. Our rating is **OUTPERFORM**.

NZX Code	VHP
Share price	NZ\$2.62
Target price	NZ\$2.30
Risk rating	Low
Issued shares	446.3m
Market cap	NZ\$1,169m
Average daily turnover	284.5k (NZ\$623k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	42.2	44.3	47.8	49.3
EPS* (NZc)	9.5	9.8	10.4	10.5
EPS growth* (%)	-10.3	3.0	5.8	1.6
DPS (NZc)	8.8	9.0	9.0	9.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	22.9	22.7	21.2	19.4
EV/EBIT	22.9	22.7	21.2	19.4
PE	27.6	26.7	25.3	24.9
Price / NTA	1.1	1.1	1.1	1.1
Cash dividend yield (%)	3.3	3.4	3.4	3.4
Gross dividend yield (%)	4.8	4.9	4.9	4.9

*Historic and forecast numbers based on underlying profits

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Vital Healthcare Property Trust (VHP)

Priced as at 08 Aug 2019: NZ\$2.62

June year end

Forsyth Barr valuation						Valuation Ratios					
Valuation methodology		Blended DCF (50%) and NAV (50%)				EV/EBITDA (x)	2018A	2019A	2020E	2021E	2022E
						EV/EBIT (x)	22.4	22.9	22.7	21.2	19.4
12-month target price (NZ\$)*		2.30	Spot valuations (NZ\$)				PE (x)	22.4	22.9	22.7	21.2
Expected share price return		-12.1%	1. DCF	2.16		Price/NTA (x)	24.7	27.6	26.7	25.3	24.9
Net dividend yield		3.4%	2. NAV	2.30		Free cash flow yield (%)	1.16	1.14	1.11	1.09	1.07
Estimated 12-month return		-8.7%	3. n/a	n/a		Net dividend yield (%)	1.7	0.4	-3.7	-2.5	-2.4
						Gross dividend yield (%)	3.3	3.3	3.4	3.4	3.4
						Imputation (%)	4.7	4.8	4.9	4.9	4.9
Key WACC assumptions			DCF valuation summary (NZ\$m)				100	100	100	100	100
Risk free rate		2.8%	Total firm value		1,741	Pay-out ratio (%)	81	92	92	87	86
Equity beta		0.68	(Net debt)/cash		(728)						
WACC		5.8%	Value of equity		963	Capital Structure	2018A	2019A	2020E	2021E	2022E
Terminal growth		1.5%	Shares (m)		446	Interest cover EBIT (x)	3.3	2.7	2.7	2.8	2.6
						Net debt/ tangible assets (%)	37.6	38.1	36.8	38.0	39.3
Profit and Loss Account (NZ\$m)						2018A	2019A	2020E	2021E	2022E	
Sales revenue						90.7	97.7	99.8	106.5	115.1	
Normalised EBITDA						76.0	81.3	83.2	89.0	96.9	
Depreciation and amortisation						-	-	-	-	-	
Normalised EBIT						76.0	81.3	83.2	89.0	96.9	
Net interest						(22.8)	(29.9)	(30.3)	(31.7)	(37.6)	
Associate income						-	-	-	-	-	
Tax						(7.2)	(9.3)	(8.6)	(9.5)	(10.0)	
Minority interests						-	-	-	-	-	
Normalised NPAT						46.0	42.2	44.3	47.8	49.3	
Abnormals/other						54.0	51.3	22.2	29.6	31.2	
Reported NPAT						100.1	93.4	66.4	77.3	80.5	
Normalised EPS (cps)						10.6	9.5	9.8	10.4	10.5	
DPS (cps)						8.6	8.8	9.0	9.0	9.0	
Growth Rates						2018A	2019A	2020E	2021E	2022E	
Revenue (%)						19.5	7.7	2.2	6.7	8.2	
EBITDA (%)						15.1	6.9	2.3	6.9	8.9	
EBIT (%)						15.1	6.9	2.3	6.9	8.9	
Normalised NPAT (%)						3.3	-8.4	5.0	7.9	3.2	
Normalised EPS (%)						0.2	-10.3	3.0	5.8	1.6	
DPS (%)						0.7	2.2	2.9	0.0	0.0	
Cash Flow (NZ\$m)						2018A	2019A	2020E	2021E	2022E	
EBITDA						76.0	81.3	83.2	89.0	96.9	
Working capital change						(2.0)	(2.9)	(3.4)	0.4	0.4	
Interest & tax paid						(28.4)	(37.8)	(37.3)	(41.6)	(47.9)	
Other						-	-	-	-	-	
Operating cash flow						45.7	40.6	42.5	47.8	49.3	
Capital expenditure						(26.1)	(35.5)	(85.7)	(76.9)	(77.7)	
(Acquisitions)/divestments						(187.7)	(23.5)	-	-	-	
Other						(46.8)	(37.3)	86.4	-	-	
Funding available/(required)						(214.9)	(55.7)	43.2	(29.1)	(28.4)	
Dividends paid						(31.1)	(32.7)	(28.3)	(34.3)	(42.2)	
Equity raised/(returned)						-	-	-	-	-	
Increase/(decrease) in net debt						246.0	88.3	(14.9)	63.4	70.6	
Balance Sheet (NZ\$m)						2018A	2019A	2020E	2021E	2022E	
Working capital						(15.8)	(12.5)	(12.5)	(12.5)	(12.5)	
Fixed assets						1,731.2	1,836.4	1,947.0	2,053.5	2,162.4	
Intangibles						-	-	-	-	-	
Other assets						49.0	87.7	4.7	4.7	4.7	
Total funds employed						1,764.5	1,911.7	1,939.2	2,045.7	2,154.6	
Net debt/(cash)						663.3	728.1	713.3	776.7	847.2	
Other non current liabilities						113.2	153.8	153.8	153.8	153.8	
Shareholder's funds						988.0	1,029.7	1,072.2	1,115.2	1,153.6	
Minority interests						-	-	-	-	-	
Total funding sources						1,764.5	1,911.7	1,939.2	2,045.7	2,154.6	

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

FY19 key points of interest

Steady result and a well-positioned portfolio

VHP has reported a steady FY19 result with like-for-like same currency rental growth up a solid +2.3%. Net property income was in line with forecasts at NZ\$97.7m, up +7.7%, driven by a full year of rent from acquisitions in FY18 and recent development activity.

Distributable profit was back -8% and impacted by increased tax and corporate costs. VHP has presented a normalised profit of NZ\$51m, up +3.8% on a comparable pcpc number that adds back some non-recurring costs and the impact of higher current tax this period. The current tax rate will lift slightly going forward.

NTA lifted +2% to NZ\$2.31 on the back of the previously released revaluation gain of NZ\$103.6m, that was partially offset by negative net movement in interest rate derivatives and unrealised currency movements.

Gearing has fallen slightly to 35.3%. This does not include the A\$80.3m loan to NorthWest that was repaid post balance date on 2 August 2019.

Dividend holds true

VHP announced a 4Q19 dividend of 2.19cpu, bringing the final dividend for FY19 to 8.75cpu. Management provided FY20 dividend guidance of "at least" 8.75cpu, with VHP to reassess this figure periodically. The record date is 12 September 2019, and the payment date is 26 September. The dividend is a 76% pay-out of VHP's calculated normalised net distributable profit of 11.5cpu and VHP's calculated AFFO of 11.50cpu.

Figure 1. FY19 results summary (NZ\$m)

Year ending 30 June	FY18	FY19	% Chg	Forbar
Net property income	90.7	97.7	7.7%	97.3
Operating costs	14.6	16.4	12.0%	15.7
EBITDA	76.0	81.3	6.9%	81.6
Depreciation and amortisation	0.0	0.0		0.0
EBIT	76.0	81.3	6.9%	81.6
Net interest	(22.8)	(29.9)	31.1%	(30.3)
EBT	53.3	51.4	-3.4%	51.3
Current tax	3.5	5.9		
Tax shield on performance fees	3.7	3.4		
Current tax underlying	7.2	9.3	28.7%	8.8
Distributable profit - Forbar presentation	46.0	42.2	-8.4%	42.5
Revaluation gains	85.5	103.6		
Other	(31.4)	(52.3)		
Reported profit	100.1	93.4	-6.6%	
Distributable profit (cpu) - Forbar presentation	10.6	9.5	-10.3%	9.6
AFFO (cpu) - reported	11.4	11.5	1.0%	
FY cash dividend (cpu)	8.56	8.75	2.2%	8.75
Operating cash flow	45.7	40.6	-11.2%	45.3
Debt to gross assets	37.5%	35.3%		
NTA	2.26	2.31	2.2%	

Source: Forsyth Barr analysis, Company reports

Leasing keeps on rolling on

VHP outlined progress made on securing lease agreements across a number of properties in its portfolio, exemplifying the strength of its tenant relationships. VHP successfully negotiated a 30 year lease term, reset upon completion of the new A\$126m Epworth Eastern expansion. This security in occupancy is coupled with management securing an A\$0.576m increase in rent for FY20, scaling up +3% pa thereafter.

The near-by Ekeru medical building will similarly enjoy stable occupancy rates in future with VHP entering into a new 10 year lease with Epworth and its new IVF partner.

Lastly, Gold Coast Surgical Centre, which has had occupancy levels of only 63% since late 2016 due to a vacant day surgery floor, will now effectively become 100% occupied after recent leasing.

Defensive characteristics supported by portfolio metrics

With a WALT of 18.1 years, occupancy at 99.4% and an average 10 year lease expiry of 1.7%, VHP unquestionably has the most defensively positioned cashflows in the broader listed property sector. Annualised rental growth reached +2.2% across the portfolio during FY19 with no singular property disproportionately impacting these results.

Development Update

Epworth Eastern Hospital expansion

Construction is underway on the Epworth Eastern Hospital expansion, which is 80% preleased to Epworth and will be host to five additional operating theatres along with 63 beds, an ED department and seven levels of specialist consultation practises. The development will cost A\$126m and yield circa 6% when tenanted. Completion of the expansion is expected in late CY21.

Wakefield Hospital development

In July, Hawkins Construction broke dirt for stage 1 of the Wakefield Hospital development, with the initial stage set to equate to NZ\$37m of the total NZ\$98m investment. VHP and its hospital operating partner Acurity Health Group have agreed a 30 year lease term and 6.3% yield on the site, due to be completed by 2023. It's expected the hospital, once complete, will provide some of most advance medical services the country has to offer.

Elizabeth Vale project

VHP settled on an A\$7.1m strategic land acquisition in Elizabeth Vale, North Adelaide in November of last year; a 50% JV with NorthWest. Located directly opposite Adelaide's third largest hospital, Lyell McEwin Hospital, VHP hopes to develop a private hospital, carpark, and medical centre on the site over the next 5–10 years, with estimated cost of ~AUD\$50m for VHP. In the interim, holding costs will be covered by existing retail assets which currently occupy a section of the site.

Only minor forecast changes

We have made little in the way of changes to our operational forecasts. We have lowered forecast interest costs slightly and this has been offset by increased tax with VHP guiding to a slightly higher effective tax rate going forward.

Our price target increased to NZ\$2.30 due to a slight lift in our NAV valuation from NZ\$2.24 to NZ\$2.30.

Figure 2. Forecast changes (NZ\$m)

	2020E			2021E			2022E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	99.8	99.8	-	106.5	106.5	-	115.1	115.1	-
Corporate costs	(16.6)	(16.6)	0.1%	(17.5)	(17.5)	-	(18.3)	(18.3)	-
EBITDA	83.2	83.2	-0.0%	89.0	89.0	-	96.9	96.9	-
Net interest	(30.7)	(30.3)	-1.3%	(32.2)	(31.8)	-1.2%	(38.2)	(37.8)	-1.1%
PBT	52.5	52.9	0.7%	56.7	57.1	0.7%	58.6	59.1	0.7%
Current tax	(7.2)	(8.6)	19.4%	(8.0)	(9.5)	18.8%	(8.3)	(9.9)	19.6%
NPAT (underlying)	45.3	44.2	-2.3%	48.8	47.7	-2.2%	50.3	49.1	-2.4%
EPU	10.02	9.79	-2.4%	10.59	10.34	-2.3%	10.77	10.49	-2.6%
DPU	9.00	9.00	-	9.00	9.00	-	9.00	9.00	-

Source: Forsyth Barr analysis

Investment summary

Vital Healthcare's (VHP) portfolio of medical properties has strong defensive characteristics such as long lease terms, inflation-linked rental growth, and exposure to the structural growth in demand for healthcare services. While there is some evidence that the Australian operating environment for tenants is slowing, VHP's lease structures mean this will have little impact on rents in the near-to-medium term. VHP has underperformed a number of peers over the past 12 months and offers attractive risk/reward on relative basis. Our rating is **OUTPERFORM**, which reflects our view on VHP relative to other NZX-listed property vehicles.

Earnings and cash flow outlook

- **Increasing healthcare demand:** A growing and ageing population in Australia and New Zealand is driving demand for healthcare services.
- **Healthscope deal off the table:** VHP's manager NorthWest Healthcare (TSX.NWH) has entered into an A\$1.2bn sale-and-lease back agreement with Brookfield in a proposed takeover offer for Healthscope. However, following extensive consideration, VHP has declined to participate in the deal.
- **Development activity:** VHP currently has over NZ\$200m of committed brownfield developments underway. Key developments include major redevelopments for Wakefield, Bowen and Royston Hospitals' which have recently been purchased as well as the large Epworth Eastern expansion in Melbourne'.
- **Acquisitions:** VHP's portfolio has expanded dramatically in recent periods with acquisitions totalling ~NZ\$350m over FY17 and FY18; albeit, we note acquisition activity has slowed over the past six months.

Company description

Vital Healthcare Property Trust (VHP) is a major owner of healthcare focussed commercial property in Australasia. VHP's NZ\$1.67bn portfolio comprises private hospitals, medical office buildings and aged care facilities, and has a ~75% weighting to Australia. The portfolio expanded significantly in December 2010 when VHP acquired a large Australian portfolio. It continues to undertake strategic acquisitions. VHP has significant brownfield development opportunities across its portfolio and currently has a number of developments underway. VHP is externally managed by NorthWest Healthcare Properties, which also owns 25% of the units in VHP.

Business quality

- **Property fundamentals:** VHP has sector leading portfolio metrics which continue to underpin the defensive qualities of the stock. VHP has a very long WALT of 18.1 years and strong portfolio occupancy of 99.4%.

Risk Factors

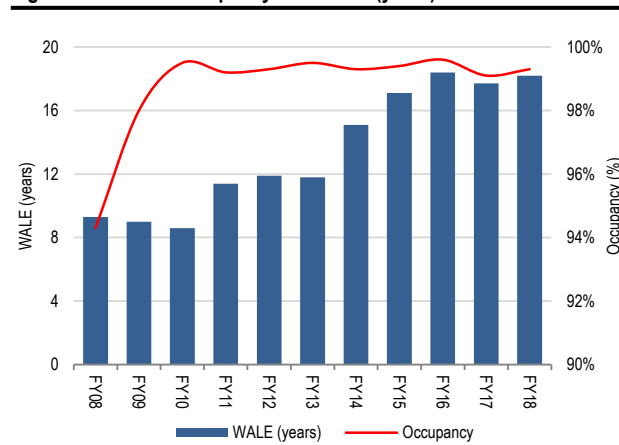
- **Rising interest rates:** Interest is VHP's largest expense. Changes to wholesale rates or margins can have a material impact on earnings.
- **Currency:** ~75% of VHP's assets are located in Australia thus currency movements can impact VHP's earnings and the value of its AUD assets. This is mitigated by hedging policies.

Figure 3. Sector and regional portfolio exposure

	Hospitals	MOBs	Aged care	Total
NSW	28%	2%	3%	33%
NZ	17%	5%	0%	22%
QLD	13%	1%	0%	14%
VIC	15%	4%	0%	20%
Other AU	8%	3%	1%	12%
Total	82%	15%	4%	100%

Source: Company Reports, Forsyth Barr analysis

Figure 4. Portfolio occupancy and WALE (years)



Source: Company Reports, Forsyth Barr analysis

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
Northwest	24.1%
Forsyth Barr Investment Management	7.1%
ACC	5.0%

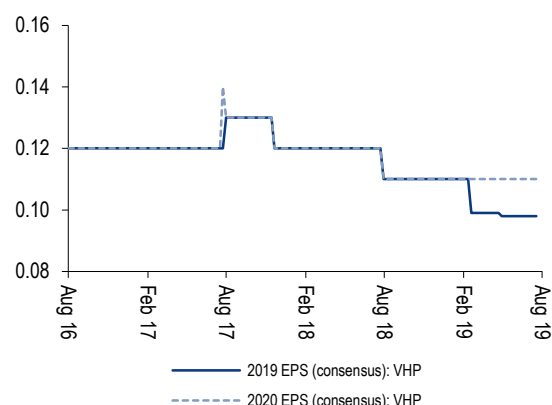
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International Compco's

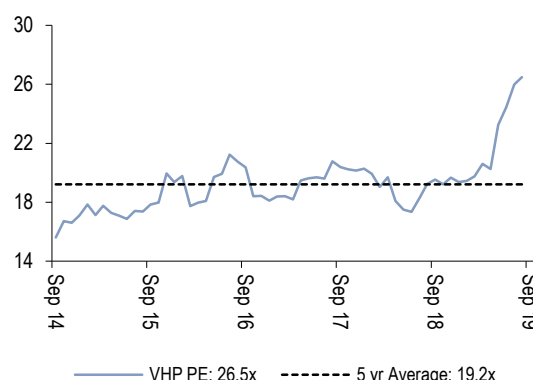
Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash D/Yld
<i>(metrics re-weighted to reflect VHP's balance date - June)</i>				2020E	2021E	2020E	2021E
Vital Healthcare	VHP NZ	NZ\$2.62	NZ\$1,169	26.7x	25.3x	22.8x	21.3x
Argosy Property *	ARG NZ	NZ\$1.41	NZ\$1,166	21.2x	20.5x	19.4x	18.2x
Goodman Property Trust *	GMT NZ	NZ\$2.08	NZ\$2,709	30.3x	29.3x	25.5x	23.6x
Investore *	IPL NZ	NZ\$1.90	NZ\$494	23.2x	22.8x	19.8x	19.6x
Kiwi Property Group *	KPG NZ	NZ\$1.63	NZ\$2,354	22.7x	21.9x	20.0x	18.8x
Asset Plus *	APL NZ	NZ\$0.64	NZ\$103	16.7x	17.8x	12.4x	13.1x
Precinct Properties NZ *	PCT NZ	NZ\$1.80	NZ\$2,358	27.2x	26.9x	36.5x	24.5x
Property For Industry *	PFI NZ	NZ\$2.29	NZ\$1,142	26.7x	26.4x	20.8x	20.8x
Stride Property *	SPG NZ	NZ\$2.28	NZ\$833	21.4x	20.4x	20.1x	18.7x
Compco Average:				23.7x	23.2x	21.8x	19.6x
VHP Relative:				+13%	+9%	+5%	+9%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (VHP) companies fiscal year end

Figure 7. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE


Source: Forsyth Barr analysis

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