

# Vital Healthcare

OUTPERFORM

## 1Q20 — Vital Signs

Vital Healthcare (VHP) provided its 1Q20 update, highlighting modest property income growth and continued strength in its very defensive portfolio. Following the recently approved management fee structure, VHP delivered a key direction change in its management fees with a material reduction in incentive fees (c.-46%) in 1Q20. Our rating remains OUTPERFORM and we have not changed our forecasts.

### Portfolio continues to perform

As at 30 September 2019 (1Q20), VHP had 99.9% occupancy and a 17.9 year WALT, generating underlying net operating income growth of +2.6% for the three months to 30 September 2019. The 50 bps increase in occupancy was a result of a newly secured 1,000 sqm lease at Gold Coast Surgery Centre.

### Development updates

VHP detailed that it currently has five fully debt funded projects under construction with a total cost of NZ\$284m. The majority of the spend is apportioned to stage one of the Wakefield hospital project in Wellington, expected to be completed by early 2021 at a cost of NZ\$37m, whilst the 14 level East Wing tower project at VHP's Epworth Eastern campus in Melbourne is entering its next phase. Upon completion, Epworth Eastern campus is expected to have a value of c.A\$350m. At a 3% cost of debt and expected blended return on cost of 6.1%, these projects are expected to be return and earnings accretive by FY21.

Figure 1. Development Progress

Development	Project cost (NZD\$m)	Spend to date (NZD\$m)	Forecast completion date
Lingard Day Surgery (NSW)	28	18.9	Mid 2020
Epworth Eastern Tower Expansion (VIC)	136.1	14.7	Late 2021
The Hills Clinic (NSW)	9	1.9	Mid 2020
Wakefield Hospital - Stage 1, NZD\$37m (WLG)	98	11.8	Staged 2021-23
Royston (Hawkes Bay)	13	4	Mid 2021
<b>Total Projects</b>	<b>284.1</b>	<b>51.3</b>	

Source: Forsyth Barr analysis, Company Reports

### Annual Meeting results — Trust Deed and Management Fee Alterations

At the annual meeting held 31 October 2019, unitholders unanimously approved amendments to the trust deed including long awaited changes to VHP's management fee structure.

Additionally, in line with the FY20 dividend guidance reiteration of 8.75 cpu, VHP declared its 1Q20 dividend of 2.1875 cpu to be paid on 19 December 2019.

### Investment View

VHP remains one of our preferred LPV exposures given (1) it has a defensive portfolio underpinned by a sector-leading WALT (17.9 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\$2.60
Target price	NZ\$2.69
Risk rating	Low
Issued shares	446.3m
Market cap	NZ\$1,160m
Average daily turnover	245.6k (NZ\$575k)

### 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	22.8	22.6	21.1	19.3
EV/EBIT	22.8	22.6	21.1	19.3
PE	27.3	26.5	25.1	24.7
Price / NTA	1.1	1.1	1.1	n/a
Cash dividend yield (%)	3.4	3.5	3.5	3.5
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 12 Nov 2019: NZ\$2.60					June year end				
<b>Forsyth Barr valuation</b>						<b>Valuation Ratios</b>					
Valuation methodology						Blended DCF (50%) and NAV (50%)					
12-month target price (NZ\$)*						2.69					
Expected share price return						3.5%					
Net dividend yield						3.5%					
Estimated 12-month return						6.9%					
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						2.0%					
Equity beta						0.68					
WACC						5.1%					
Terminal growth						1.5%					
Sales revenue						90.7					
<b>Normalised EBITDA</b>						<b>76.0</b>					
Depreciation and amortisation						-					
<b>Normalised EBIT</b>						<b>76.0</b>					
Net interest						(22.8)					
Associate income						-					
Tax						(7.2)					
Minority interests						-					
<b>Normalised NPAT</b>						<b>46.0</b>					
Abnormals/other						54.0					
<b>Reported NPAT</b>						<b>100.1</b>					
Normalised EPS (cps)						10.6					
DPS (cps)						8.6					
<b>Growth Rates</b>						<b>2018A</b>					
Revenue (%)						19.5					
EBITDA (%)						15.1					
EBIT (%)						15.1					
Normalised NPAT (%)						3.3					
Normalised EPS (%)						0.2					
DPS (%)						0.7					
<b>Cash Flow (NZ\$m)</b>						<b>2018A</b>					
<b>EBITDA</b>						<b>76.0</b>					
Working capital change						(2.0)					
Interest & tax paid						(28.4)					
Other						-					
<b>Operating cash flow</b>						<b>45.7</b>					
Capital expenditure						(26.1)					
(Acquisitions)/divestments						(187.7)					
Other						(46.8)					
<b>Funding available/(required)</b>						<b>(214.9)</b>					
Dividends paid						(31.1)					
Equity raised/(returned)						-					
<b>Increase/(decrease) in net debt</b>						<b>246.0</b>					
<b>Balance Sheet (NZ\$m)</b>						<b>2018A</b>					
Working capital						(15.8)					
Fixed assets						1,731.2					
Intangibles						-					
Other assets						49.0					
<b>Total funds employed</b>						<b>1,764.5</b>					
Net debt/(cash)						663.3					
Other non current liabilities						113.2					
Shareholder's funds						988.0					
Minority interests						-					
<b>Total funding sources</b>						<b>1,764.5</b>					
<b>Profit and Loss Account (NZ\$m)</b>						<b>2018A</b>					
Sales revenue						90.7					
<b>Normalised EBITDA</b>						<b>76.0</b>					
Depreciation and amortisation						-					
<b>Normalised EBIT</b>						<b>76.0</b>					
Net interest						(22.8)					
Associate income						-					
Tax						(7.2)					
Minority interests						-					
<b>Normalised NPAT</b>						<b>46.0</b>					
Abnormals/other						54.0					
<b>Reported NPAT</b>						<b>100.1</b>					
Normalised EPS (cps)						10.6					
DPS (cps)						8.6					
<b>Key Ratios</b>						<b>2018A</b>					
Return on assets (%)						4.3					
Return on equity (%)						4.7					
Return on funds employed (%)						4.4					
EBITDA margin (%)						83.9					
EBIT margin (%)						83.9					
Capex to sales (%)						28.8					
Capex to depreciation (%)						n/a					
<b>Capital Structure</b>						<b>2018A</b>					
Interest cover EBIT (x)						3.3					
Net debt/ tangible assets (%)						37.6					
Net debt/ND+E (%)						40.2					
Net debt/EBITDA (x)						8.7					
<b>Property Statistics</b>						<b>2014A</b>					
<b>Major Property Values (NZ\$m)</b>						<b>2015A</b>					
Ascot Hospital & Clinics						85.0					
Ascot Central						23.9					
Epworth Eastern						68.2					
Southport Private Hospital						47.4					
Lingard Private Hospital						54.2					
Maitland Private Hospital						35.2					
SportsMed Hospital and Clinic						33.4					
Hurstville Private Hospital						25.2					
Total portfolio						613.0					
<b>Portfolio Summary</b>						<b>2016A</b>					
Investment properties (NZ\$m)						613.0					
Number of properties - yielding only						25					
Weighted average lease term (yrs)						15.1					
Occupancy rate (%)						99.3					
M'tment/Admin cost % of assets (%)						1.29					
NTA per share (NZ\$)						1.03					
Average portfolio cap rate (%)						8.95					
<b>2017A</b>						<b>2018A</b>					
Investment properties (NZ\$m)						781.9					
Number of properties - yielding only						25					
Weighted average lease term (yrs)						17.1					
Occupancy rate (%)						99.4					
M'tment/Admin cost % of assets (%)						1.69					
NTA per share (NZ\$)						1.26					
Average portfolio cap rate (%)						7.99					
Investment properties (NZ\$m)						951.9					
Number of properties - yielding only						30					
Weighted average lease term (yrs)						18.4					
Occupancy rate (%)						99.6					
M'tment/Admin cost % of assets (%)						1.76					
NTA per share (NZ\$)						1.51					
Average portfolio cap rate (%)						7.24					
Investment properties (NZ\$m)						1,376.2					
Number of properties - yielding only						37					
Weighted average lease term (yrs)						17.7					
Occupancy rate (%)						99.1					
M'tment/Admin cost % of assets (%)						2.05					
NTA per share (NZ\$)						2.05					
Average portfolio cap rate (%)						6.12					
Investment properties (NZ\$m)						1,731.2					
Number of properties - yielding only						42					
Weighted average lease term (yrs)						18.2					
Occupancy rate (%)						99.3					
M'tment/Admin cost % of assets (%)						1.76					
NTA per share (NZ\$)						2.26					
Average portfolio cap rate (%)						5.76					

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

## 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. In our report 'Real Estate Reflections' dated 5 September we adopted our new Research team risk free rate of 2% and market risk premium of 7.5% which increased the VHP target price by +17%. 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 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.

### 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 17.9 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.

### Company description

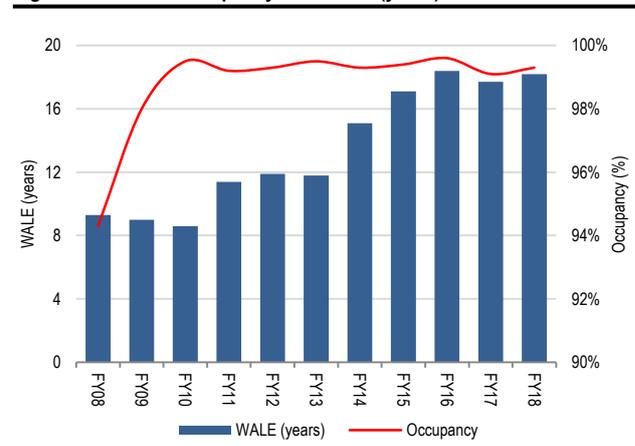
Vital Healthcare Property Trust (VHP) is a major owner of healthcare focussed commercial property in Australasia. VHP's NZ\$1.67bn portfolio comprises private hospitals, medical office buildings and aged care facilities, and has a ~75% weighting to Australia. The portfolio expanded significantly in December 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.

Figure 2. 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%
<b>Total</b>	<b>82%</b>	<b>15%</b>	<b>4%</b>	<b>100%</b>

Source: Forsyth Barr analysis, Company Reports

Figure 3. Portfolio occupancy and WALE (years)



Source: Forsyth Barr analysis, Company Reports

**Figure 4. Substantial Shareholders**

Shareholder	Latest Holding
Northwest	25.0%
Forsyth Barr Investment Management	7.1%
ACC	5.0%

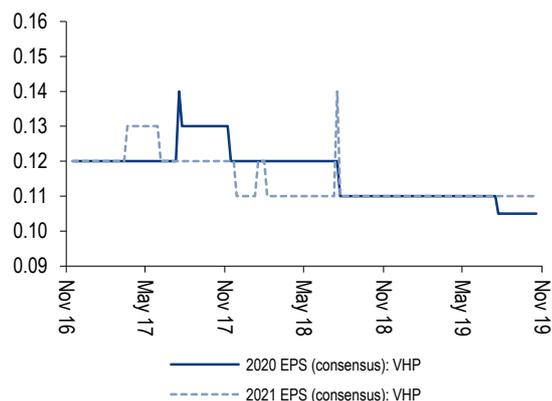
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 5. International Compco's**

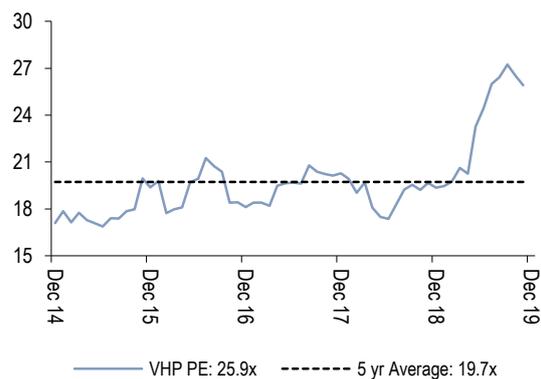
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect VHP's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
<b>Vital Healthcare</b>	<b>VHP NZ</b>	<b>NZ\$2.60</b>	<b>NZ\$1,160</b>	<b>26.5x</b>	<b>25.1x</b>	<b>22.7x</b>	<b>21.2x</b>	<b>22.7x</b>	<b>21.2x</b>	<b>3.5%</b>
Argosy Property *	ARG NZ	NZ\$1.41	NZ\$1,166	21.2x	20.5x	19.4x	18.2x	19.4x	18.2x	4.5%
Goodman Property Trust *	GMT NZ	NZ\$2.10	NZ\$2,903	30.9x	30.2x	26.6x	24.5x	26.6x	24.5x	3.2%
Investore *	IPL NZ	NZ\$1.89	NZ\$492	23.1x	22.6x	19.7x	19.5x	19.7x	19.5x	4.0%
Kiwi Property Group *	KPG NZ	NZ\$1.57	NZ\$2,439	21.8x	21.0x	20.5x	19.3x	20.5x	19.3x	4.5%
Asset Plus *	APL NZ	NZ\$0.64	NZ\$104	16.9x	17.9x	12.5x	13.2x	12.5x	13.2x	5.6%
Precinct Properties NZ *	PCT NZ	NZ\$1.80	NZ\$2,365	27.2x	25.6x	24.1x	22.4x	24.1x	22.4x	3.6%
Property For Industry *	PFI NZ	NZ\$2.35	NZ\$1,172	27.2x	26.9x	21.0x	20.7x	21.0x	20.7x	3.3%
Stride Property *	SPG NZ	NZ\$2.28	NZ\$833	21.4x	20.4x	20.1x	18.7x	20.1x	18.7x	4.4%
<b>Compco Average:</b>				<b>23.7x</b>	<b>23.1x</b>	<b>20.5x</b>	<b>19.6x</b>	<b>20.5x</b>	<b>19.6x</b>	<b>4.1%</b>
<b>VHP Relative:</b>				<b>+12%</b>	<b>+8%</b>	<b>+11%</b>	<b>+9%</b>	<b>+11%</b>	<b>+9%</b>	<b>-16%</b>

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 6. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 7. 12 Month Forward PE**


Source: Forsyth Barr analysis

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