

Vital Healthcare

1H20 Result – Vital Defensive Play this Season

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NEUTRAL 

Vital Healthcare (VHP) has reported a 1H20 result slightly ahead of our forecasts and it has reaffirmed its steady dividend guidance for FY20. The balance of FY20 will again feature corporate related activity with the Manager's proposal for a capital restructure. Meanwhile, we expect the portfolio to continue to do its job of providing a very defensive property exposure. We have not changed our forecasts but our target price has lifted +2.5% to NZ\$2.76 due to a slight lift in our DCF and NAV valuations. We have pulled our investment rating back from OUTPERFORM to NEUTRAL given the strong share price performance over the last 12 months. VHP remains a key LPV exposure late in the cycle given the defensive nature and quality of its portfolio. NEUTRAL.

NZX Code	VHP	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.91	NPAT* (NZ\$m)	42.2	44.3	47.8	49.3	EV/EBITDA	24.5	24.3	22.6	20.8
Target price	NZ\$2.76	EPS* (NZc)	9.5	9.8	10.4	10.5	EV/EBIT	24.5	24.3	22.6	20.8
Risk rating	Low	EPS growth* (%)	-10.3	3.0	5.8	1.6	PE	30.6	29.7	28.1	27.6
Issued shares	446.3m	DPS (NZc)	8.8	9.0	9.0	9.0	Price / NTA	1.3	1.2	1.2	1.2
Market cap	NZ\$1,299m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.0	3.1	3.1	3.1
Avg daily turnover	228.9k (NZ\$574k)	*Based on normalised profits					Gross div yld (%)	4.3	4.4	4.4	4.4

Slightly ahead of our forecast with FY20 season on track

VHP has reported a solid 1H20 result with net distributable income (and AFFO) of NZ\$22.1m, ahead of our forecast of NZ\$20.2m and up +12.4% on the pcp, helped by a slightly lower interest expense than forecast. Net property income was in line with forecasts at NZ\$49.9m, up +2.1% driven by structured rent reviews and development activity. The like-for-like same currency rental growth was +2.5%. Following an interim revaluation gain of NZ\$42.6m, the NTA is up +2.2% since 30 June 2019, to NZ\$2.36. The revaluation gain was partially offset by new units issued for the management fee. The portfolio cap rate firmed 9bps to 5.52%. Gearing is steady at 35.1%. The 2Q20 dividend was 2.19cpu (record date 12 March/payment date 26 March), providing a flat 1H20 dividend of 4.375cpu. The 1H dividend was 89% of VHP's calculated AFFO per unit.

Portfolio engine room

The portfolio is 99.5% occupied and the long WALT is maintained at 17.9 years. The lease expiry profile remains benign, averaging 1.6% pa over the next 10 years. VHP has commenced NZ\$267m of projects and has spent NZ\$72m to date. The two major projects underway remain Wakefield Hospital in Wellington and Epworth in Melbourne. VHP has previously highlighted an interest in aged care sector acquisitions and it has agreed terms with regard to purchasing three Australian aged care assets from NorthWest (still subject to due diligence). While VHP is still looking to divest some non-core assets, nothing is expected to be completed in FY20.

Outlook and ASX Foreign exempt listing proposal

VHP has reaffirmed its dividend guidance for FY20 as being not less than the 8.75cpu paid in the pcp. Our forecast is 9.0cpu and we have not changed our forecasts. VHP expects to lift its dividend pay-out rate following its foreign exempt listing on the ASX and related capital structure changes. Unitholders should receive notice of meeting documentation to consider over the coming weeks with a Special Unitholder Meeting expected to be held in late March.

Vital Healthcare Property Trust (VHP)

Priced as at 19 Feb 2020 (NZ\$)						2.91						
12-month target price (NZ\$)*						2.76	Spot valuations (NZ\$)					
Expected share price return						-5.2%	1. DCF					2.99
Net dividend yield						3.1%	2. NAV					2.36
Estimated 12-month return						-2.1%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					2,130
Equity beta						0.68	(Net debt)/cash					(728)
WACC						5.1%	Less: Capitalised operating leases					0
Terminal growth						1.5%	Value of equity					1,352
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2018A	2019A	2020E	2021E	2022E	115.1	2018A	2019A	2020E	2021E	2022E	20.8
Normalised EBITDA	76.0	81.3	83.2	89.0	96.9	(37.6)	24.1	24.5	24.3	22.6	20.8	20.8
Depreciation and amortisation	0	0	0	0	0	0	27.4	30.6	29.7	28.1	27.6	27.6
Normalised EBIT	76.0	81.3	83.2	89.0	96.9	0	1.3	1.3	1.2	1.2	1.2	1.2
Net interest	(22.8)	(29.9)	(30.3)	(31.7)	(37.6)	0	1.5	0.4	-3.3	-2.2	-2.2	-2.2
Associate income	0	0	0	0	0	0	2.9	3.0	3.1	3.1	3.1	3.1
Tax	(7.2)	(9.3)	(8.6)	(9.5)	(10.0)	0	4.2	4.3	4.4	4.4	4.4	4.4
Minority interests	0	0	0	0	0	0	Capital Structure					
Normalised NPAT	46.0	42.2	44.3	47.8	49.3	0	2018A	2019A	2020E	2021E	2022E	2.6
Abnormals/other	54.0	51.3	22.2	29.6	31.2	0	Interest cover EBIT (x)	3.3	2.7	2.7	2.8	2.6
Reported NPAT	100.1	93.4	66.4	77.3	80.5	0	Interest cover EBITDA (x)	3.3	2.7	2.7	2.8	2.6
Normalised EPS (cps)	10.6	9.5	9.8	10.4	10.5	0	Net debt/ND+E (%)	40.2	41.4	39.9	41.1	42.3
DPS (cps)	8.6	8.8	9.0	9.0	9.0	0	Net debt/EBITDA (x)	8.7	9.0	8.6	8.7	8.7
Growth Rates						Key Ratios						
Revenue (%)	2018A	2019A	2020A	2021A	2022A	8.2	2018A	2019A	2020E	2021E	2022E	4.5
EBITDA (%)	19.5	7.7	2.2	6.7	8.2	8.9	4.3	4.2	4.2	4.3	4.3	4.3
EBIT (%)	15.1	6.9	2.3	6.9	8.9	8.9	4.7	4.1	4.1	4.3	4.3	4.3
Normalised NPAT (%)	15.1	6.9	2.3	6.9	8.9	3.2	4.4	3.9	3.9	4.0	4.1	4.1
Normalised EPS (%)	3.3	-8.4	5.0	7.9	3.2	1.6	83.9	83.2	83.3	83.6	84.1	84.1
Ordinary DPS (%)	0.2	-10.3	3.0	5.8	1.6	0.0	83.9	83.2	83.3	83.6	84.1	84.1
Cash Flow (NZ\$m)						Property Statistics						
EBITDA	2018A	2019A	2020E	2021E	2022E	96.9	2014A	2015A	2016A	2017A	2018A	0
Working capital change	76.0	81.3	83.2	89.0	96.9	0.4	Major Property Values (NZ\$m)					
Interest & tax paid	(2.0)	(2.9)	(3.4)	0.4	0.4	(47.9)	Ascot Hospital & Clinics	0	0	0	0	0
Other	(28.4)	(37.8)	(37.3)	(41.6)	(47.9)	0	Ascot Central	608.2	769.0	929.6	1,372.6	1,729.7
Operating cash flow	45.7	40.6	42.5	47.8	49.3	0	Epworth Eastern	0	0	0	33.9	35.5
Capital expenditure	(26.1)	(35.5)	(85.7)	(76.9)	(77.7)	0	Southport Private Hospital	15.5	18.3	19.8	30.5	38.2
(Acquisitions)/divestments	(187.7)	(23.5)	0	0	0	0	Lingard Private Hospital	47.4	46.6	45.1	42.6	47.6
Other	(46.8)	(37.3)	86.4	0	0	0	Maitland Private Hospital	15.5	18.3	19.8	30.5	38.2
Funding available/(required)	(214.9)	(55.7)	43.2	(29.1)	(28.4)	0	SportsMed Hospital and Clinic	0	0	0	33.0	35.3
Dividends paid	(31.1)	(32.7)	(28.3)	(34.3)	(42.2)	0	Hurstville Private Hospital	0	0	3.6	3.8	4.3
Equity raised/(returned)	0	0	0	0	0	0	Total portfolio	613.0	0	0	0	0
(Increase)/decrease in net debt	(246.0)	(88.3)	14.9	(63.4)	(70.6)	0	Portfolio Summary					
Balance Sheet (NZ\$m)						Investment properties (NZ\$m)						
Working capital	2018A	2019A	2020E	2021E	2022E	(12.5)	613.0	0	0	0	0	0
Fixed assets	1,731.2	1,836.4	1,947.0	2,053.5	2,162.4	(12.5)	(5)	(0)	2	12	0	0
Intangibles	0	0	0	0	0	0	59.5	60.8	70.3	94.8	0	0
Right of use asset	0	0	0	0	0	0	0	0	0	0	0	0
Other assets	49.0	87.7	4.7	4.7	4.7	0	0	0	0	0	0	0
Total funds employed	1,764.5	1,911.7	1,939.2	2,045.7	2,154.6	0	0	0	0	0	0	0
Net debt/(cash)	663.3	728.1	713.3	776.7	847.2	0	0	0	0	0	0	0
Lease liability	0	0	0	0	0	0	0	0	0	0	0	0
Other liabilities	113.2	153.8	153.8	153.8	153.8	0	0	0	0	0	0	0
Shareholder's funds	988.0	1,029.7	1,072.2	1,115.2	1,153.6	0	0	0	0	0	0	0
Minority interests	0	0	0	0	0	0	0	0	0	0	0	0
Total funding sources	1,764.5	1,911.7	1,939.2	2,045.7	2,154.6	0	0	0	0	0	0	0

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

1H20 Result Summary

Figure 1. 1H20 Results Summary (NZ\$m)

Financial period	1H19	1H20	% Chg	Forbar	% Var
Net property income	48.8	49.9	2.2%	50.4	-1.0%
Corporate costs	(8.4)	(8.8)	4.5%	(8.1)	7.9%
EBITDA	40.4	41.1	1.7%	42.3	-2.7%
Interest expense	(15.0)	(14.3)	-4.6%	(15.4)	-7.4%
PBT	25.4	26.8	5.4%	26.8	-0.0%
Current tax - reported	(5.0)	(5.0)	-1.1%	(5.6)	-11.2%
Tax shield on performance fees	(1.4)	(0.9)	-37.2%	(1.0)	-9.2%
NPAT (net distributable income) - Forbar presentation	19.0	20.9	10.4%	20.2	3.5%
Tax shield on performance fees	1.4	0.9	-37.2%	1.0	-9.2%
One-off strategic transaction costs	-	-	-	-	-
NPAT (net distributable income) - Reported	20.4	21.8	7.0%	21.2	3.0%
Amortisation of deferred financing charges	0.2	0.3	33.8%	0.3	
Amortisation of leasing costs and tenant inducements	0.5	0.5	16.0%	0.5	
Funds from operations - FFO	21.1	22.6	7.5%	22.0	
Strategic transaction costs	1.9	-	-100.0%	-	
Actual capex & leasing from continuing operations	(1.5)	(0.8)	-43.5%		
Adjusted funds from operations	21.4	21.8	1.7%		
Distributable income (cpu) - Forbar presentation	4.29	4.65	8.3%	4.56	2.0%
AFFO (cpu) - reported	4.13	4.63	11.9%		
1H cash dividend (cpu)	4.38	4.38	-	4.38	-
Operating cash flow	19.8	21.4	8.0%		
Gearing (debt to gross assets)	36.8%	35.1%	-1.7ppts		
NTA	2.24	2.36	5.4%		
NTA (as at 30 June 2018)	2.31		2.2%		

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 outperformed its peers over the past 12 months and we have pulled our rating back from OUTPERFORM to NEUTRAL. VHP is a key LPV exposure given its defensive qualities.

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 99.5%.

Earnings and cashflow 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.

Risk factors

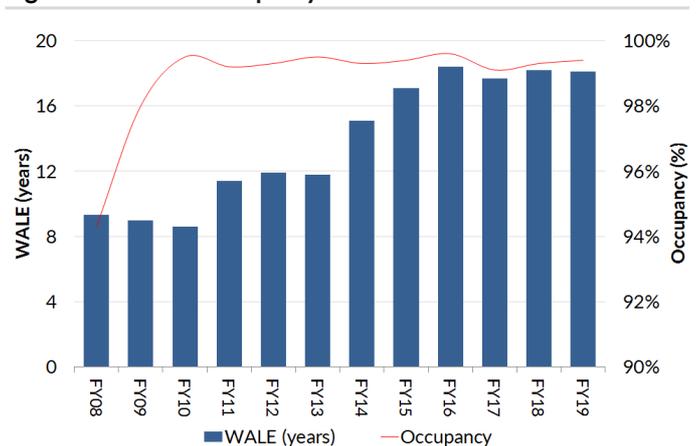
- **Rising interest rates:** Interest is VHP's largest expense. Changes to wholesale rates or margins can have a material impact on earnings.
- **Currency:** ~75% of VHP's assets are located in Australia thus currency movements can impact VHP's earnings and the value of its AUD assets. This is mitigated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

Figure 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%
Total	82%	15%	4%	100%

Source: Forsyth Barr analysis

Figure 3. Portfolio Occupancy and WALE



Source: Forsyth Barr analysis

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

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

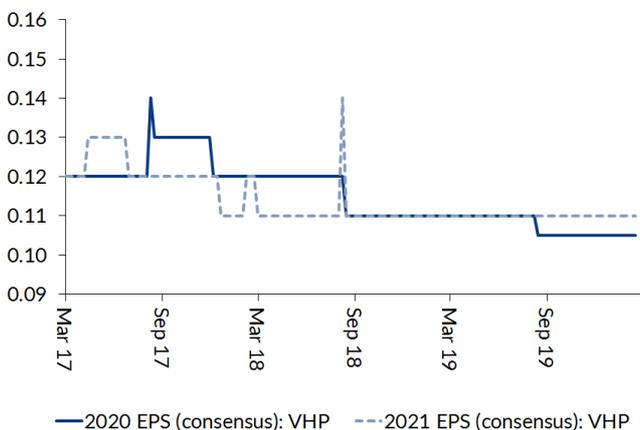
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

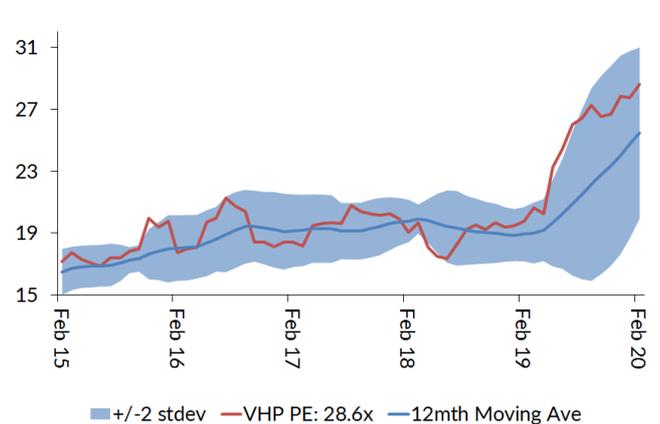
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Vital Healthcare	VHP NZ	NZ\$2.91	NZ\$1,299	29.7x	28.1x	24.4x	22.8x	24.4x	22.8x	3.1%
Argosy Property *	ARG NZ	NZ\$1.44	NZ\$1,191	21.6x	20.9x	19.7x	18.4x	19.7x	18.4x	4.4%
Goodman Property Trust *	GMT NZ	NZ\$2.36	NZ\$3,264	34.7x	33.9x	29.4x	27.0x	29.4x	27.0x	2.8%
Investore *	IPL NZ	NZ\$1.83	NZ\$557	22.5x	22.1x	21.4x	21.1x	21.4x	21.1x	4.2%
Kiwi Property Group *	KPG NZ	NZ\$1.56	NZ\$2,448	21.9x	21.6x	20.5x	19.3x	20.5x	19.3x	4.6%
Asset Plus *	APL NZ	NZ\$0.59	NZ\$96	15.5x	16.5x	11.6x	12.3x	11.6x	12.3x	6.1%
Precinct Properties NZ *	PCT NZ	NZ\$1.88	NZ\$2,463	28.4x	27.3x	25.5x	23.7x	25.5x	23.7x	3.4%
Property For Industry *	PFI NZ	NZ\$2.54	NZ\$1,267	29.4x	29.0x	22.5x	22.4x	22.5x	22.4x	3.1%
Stride Property *	SPG NZ	NZ\$2.38	NZ\$870	22.4x	21.3x	20.8x	19.2x	20.8x	19.2x	4.3%
Compcpo Average:				24.5x	24.1x	21.4x	20.4x	21.4x	20.4x	4.1%
VHP Relative:				21%	17%	14%	11%	14%	11%	-24%

EV = Current Market Cap + Actual Net Debt

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

Figure 7. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)


Source: Forsyth Barr analysis

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