

# Vital Healthcare

## Recommend APPROVE

JEREMY SIMPSON CFA

jeremy.simpson@forsythbarr.co.nz  
 +64 9 368 0022

NEUTRAL 

Vital Healthcare Property Trust (VHP) has proposed a restructure to shareholders which would alter its operating structure and facilitate a foreign exempt listing on the Australian Securities Exchange (ASX). VHP is pursuing this restructure as it believes it will result in (1) higher distributions to unitholders, (2) a potential increase in the value and liquidity of units, (3) access to a broader range of capital, and (4) better competitive positioning. We recommend that unitholders approve VHP's restructure and ASX listing proposal. The Special Meeting is on 31 March 2020, and the last day for proxy votes to be received is 29 March 2020. VHP remains a key NZ LPV investment given its defensive qualities. NEUTRAL.

NZX Code	VHP	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.07	NPAT* (NZ\$m)	42.2	44.3	47.8	49.3	EV/EBITDA	19.9	19.8	18.4	16.9
Target price	NZ\$2.76	EPS* (NZc)	9.5	9.8	10.4	10.5	EV/EBIT	19.9	19.8	18.4	16.9
Risk rating	Low	EPS growth* (%)	-10.3	3.0	5.8	1.6	PE	21.8	21.1	20.0	19.7
Issued shares	446.3m	DPS (NZc)	8.8	9.0	9.0	9.0	Price / NTA	0.9	0.9	0.9	0.8
Market cap	NZ\$924m	Imputation (%)	100	100	100	100	Cash div yld (%)	4.2	4.3	4.3	4.3
Avg daily turnover	227.0k (NZ\$581k)	*Based on normalised profits					Gross div yld (%)	6.0	6.2	6.2	6.2

### Better longer-term structure vs. added complexity

We recommend that unitholders approved what is proposed. This is centred on, what being created is a better longer-term structure for VHP, given it will potentially widen the appeal to Australian and other international investors. Some sort of restructure was inevitable given the heavy Australian weighting of its asset base and earnings. The trade-off for NZ investors is a more complex corporate structure and a different tax return treatment. The after tax position is relatively neutral for most NZ investors, with lower tax paying investors slightly better off, but it is complex from a tax perspective. It is a more tax efficient structure for offshore investors. The governance regulatory regime also becomes more complex but we don't expect any weakening in the corporate governance framework. Gearing increases slightly and this needs to be watched given the deteriorating economic environment. Improving debt term is a key consideration.

### Manager benefits but the manager remains on notice

The proposal increases the after tax returns for NorthWest. NorthWest remains with the big job of improving investor confidence, given high profile disputes with investors and the loss of a well-regarded Chair and CEO. What is crucial is VHP gets back to basics, improves manager visibility, and that investors get confident that its growth strategy is centred on growing returns not just size. Given the economic change occurring, VHP will likely have increased acquisition opportunities and what is helpful for VHP is NorthWest's global healthcare expertise.

### Appealing portfolio

VHP remains with a very appealing portfolio given its spread of healthcare assets, with many resilient to the traditional economic cycle, long WALT of 17.9 years, 99.5% occupancy. Only an average of 1.6% of the leases expire per annum over the next 10 years. VHP has been successful in adding value via brownfield developments, but this will be more challenging near term.

**Vital Healthcare Property Trust (VHP)**

 Priced as at 20 Mar 2020 (NZ\$) **2.07**

<b>12-month target price (NZ\$)*</b>	<b>2.76</b>
Expected share price return	33.3%
Net dividend yield	4.3%
Estimated 12-month return	37.7%

<b>Key WACC assumptions</b>	
Risk free rate	2.00%
Equity beta	0.68
WACC	5.1%
Terminal growth	1.5%

<b>Profit and Loss Account (NZ\$m)</b>	2018A	2019A	2020E	2021E	2022E
Sales revenue	90.7	97.7	99.8	106.5	115.1
<b>Normalised EBITDA</b>	<b>76.0</b>	<b>81.3</b>	<b>83.2</b>	<b>89.0</b>	<b>96.9</b>
Depreciation and amortisation	0	0	0	0	0
<b>Normalised EBIT</b>	<b>76.0</b>	<b>81.3</b>	<b>83.2</b>	<b>89.0</b>	<b>96.9</b>
Net interest	(22.8)	(29.9)	(30.3)	(31.7)	(37.6)
Associate income	0	0	0	0	0
Tax	(7.2)	(9.3)	(8.6)	(9.5)	(10.0)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>46.0</b>	<b>42.2</b>	<b>44.3</b>	<b>47.8</b>	<b>49.3</b>
Abnormals/other	54.0	51.3	22.2	29.6	31.2
<b>Reported NPAT</b>	<b>100.1</b>	<b>93.4</b>	<b>66.4</b>	<b>77.3</b>	<b>80.5</b>
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

<b>Growth Rates</b>	2018A	2019A	2020A	2021A	2022A
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
Ordinary DPS (%)	0.7	2.2	2.9	0.0	0.0

<b>Cash Flow (NZ\$m)</b>	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>76.0</b>	<b>81.3</b>	<b>83.2</b>	<b>89.0</b>	<b>96.9</b>
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	0	0	0	0	0
<b>Operating cash flow</b>	<b>45.7</b>	<b>40.6</b>	<b>42.5</b>	<b>47.8</b>	<b>49.3</b>
Capital expenditure	(26.1)	(35.5)	(85.7)	(76.9)	(77.7)
(Acquisitions)/divestments	(187.7)	(23.5)	0	0	0
Other	(46.8)	(37.3)	86.4	0	0
<b>Funding available/(required)</b>	<b>(214.9)</b>	<b>(55.7)</b>	<b>43.2</b>	<b>(29.1)</b>	<b>(28.4)</b>
Dividends paid	(31.1)	(32.7)	(28.3)	(34.3)	(42.2)
Equity raised/(returned)	0	0	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(246.0)</b>	<b>(88.3)</b>	<b>14.9</b>	<b>(63.4)</b>	<b>(70.6)</b>

<b>Balance Sheet (NZ\$m)</b>	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	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	49.0	87.7	4.7	4.7	4.7
<b>Total funds employed</b>	<b>1,764.5</b>	<b>1,911.7</b>	<b>1,939.2</b>	<b>2,045.7</b>	<b>2,154.6</b>
Net debt/(cash)	663.3	728.1	713.3	776.7	847.2
Lease liability	0	0	0	0	0
Other 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	0	0	0	0	0
<b>Total funding sources</b>	<b>1,764.5</b>	<b>1,911.7</b>	<b>1,939.2</b>	<b>2,045.7</b>	<b>2,154.6</b>

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

<b>Spot valuations (NZ\$)</b>	
1. DCF	2.99
2. NAV	2.36
3. n/a	n/a

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	2,139
(Net debt)/cash	(728)
Less: Capitalised operating leases	0
Value of equity	1,361

<b>Valuation Ratios</b>	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	19.1	19.9	19.8	18.4	16.9
EV/EBIT (x)	19.1	19.9	19.8	18.4	16.9
PE (x)	19.5	21.8	21.1	20.0	19.7
Price/NTA (x)	0.9	0.9	0.9	0.9	0.8
Free cash flow yield (%)	2.1	0.6	-4.7	-3.2	-3.1
Net dividend yield (%)	4.1	4.2	4.3	4.3	4.3
Gross dividend yield (%)	5.9	6.0	6.2	6.2	6.2

<b>Capital Structure</b>	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	3.3	2.7	2.7	2.8	2.6
Interest cover EBITDA (x)	3.3	2.7	2.7	2.8	2.6
Net debt/ND+E (%)	40.2	41.4	39.9	41.1	42.3
Net debt/EBITDA (x)	8.7	9.0	8.6	8.7	8.7

<b>Key Ratios</b>	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.3	4.2	4.2	4.3	4.5
Return on equity (%)	4.7	4.1	4.1	4.3	4.3
Return on funds employed (%)	4.4	3.9	3.9	4.0	4.1
EBITDA margin (%)	83.9	83.2	83.3	83.6	84.1
EBIT margin (%)	83.9	83.2	83.3	83.6	84.1
Capex to sales (%)	28.8	36.3	85.8	72.2	67.5
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	81	92	92	87	86

<b>Property Statistics</b>	2014A	2015A	2016A	2017A	2018A
<b>Major Property Values (NZ\$m)</b>					
Ascot Hospital & Clinics	0	0	0	0	0
Ascot Central	608.2	769.0	929.6	1,372.6	1,729.7
Epworth Eastern	0	0	0	33.9	35.5
Southport Private Hospital	15.5	18.3	19.8	30.5	38.2
Lingard Private Hospital	47.4	46.6	45.1	42.6	47.6
Maitland Private Hospital	15.5	18.3	19.8	30.5	38.2
SportsMed Hospital and Clinic	0	0	0	33.0	35.3
Hurstville Private Hospital	0	0	3.6	3.8	4.3
Total portfolio	613.0	0	0	0	0

<b>Portfolio Summary</b>	2018A	2019A	2020E	2021E	2022E
Investment properties (NZ\$m)	613.0	0	0	0	0
Number of properties - yielding only	(5)	(0)	2	12	0
Weighted average lease term (yrs)	59.5	60.8	70.3	94.8	0
Occupancy rate (%)	0	0	0	0	0
M'ment/Admin cost % of assets (%)	0	0	0	0	0
NTA per share (NZ\$)	0	0	0	0	0
Average portfolio cap rate (%)	0	0	0	0	0

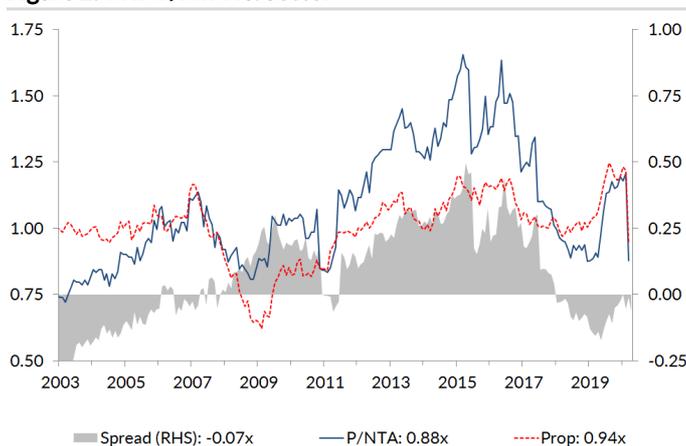
**Figure 1. Key dates**

Date	Event
Friday, 28 February 2020	Notice of Meeting published
Sunday, 29 March 2020	Last time for receipt by the Registrar of proxy forms
Sunday, 29 March 2020	Last time for completion of online proxy appointment
Tuesday, 31 March 2020	Special Meeting of Unitholders to consider the Proposal
Thursday, 23 April 2020	Trading begins on a cum entitlement basis
Friday, 24 April 2020	Stapling and Distribution Record Date
Monday, 27 April 2020	Distribution of Vital NZ Units to Unitholders and Stapling to VHPT Units. Trading on the NZX Main Board continues, but of Stapled Units
Early May	Stapled Units commence trading on the ASX, as well as the NZX Main Board

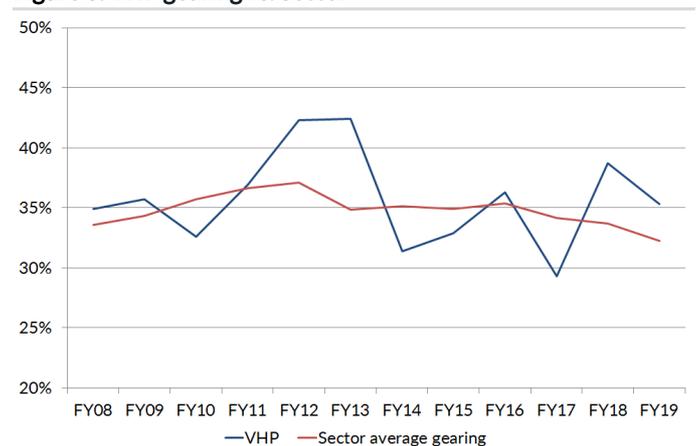
Source: Forsyth Barr analysis

**Some issues for investors:**

- Complexity increases but it is a better structure for the longer term:** While VHP is already a complex structure given its large Australian asset base, the tax and currency management implications of this and because it is externally managed, what is proposed increases the complexity. With VHP having a predominantly Australian asset base, it was only a question of time before a corporate restructure was contemplated. The portfolio does not change.
- Dividend increases:** The bulk of this is a lift in the dividend pay-out rate, however, most NZ investors appear to be slightly better off in terms of post-tax returns under what is proposed everything else being equal. But from a taxation perspective it is complex.
- Better structure for Australian and other international investors:** VHP has an appealing asset base given the very defensive nature of its cash flows and is a unique REIT in Australasia. The proposed structure will reduce a tax barrier for international investors. This will be helpful as the vehicle increases in size over the longer term and if 25% shareholder NorthWest decides to sell its position. Longer term this should improve liquidity in VHP units, access to capital and the possibility of Australian index inclusion.
- Change in governance structure:** While this adds to the complexity, we don't expect overall governance regime and protections for investors to weaken.
- Gearing and banking:** Gearing sits around 40% and is one of the highest in the NZ LPV sector and it is expected to slightly increase with what is proposed. This remains well below banking covenants given the nature of its asset base, but it does increase the risk profile in a recession/credit crunch which will see asset values reduce. VHP operationally and financially proved to be very resilient through the GFC, which is comforting for investors. VHP has a relatively short debt term and has been holding off renegotiating facilities until this proposal is finalised. We expect VHP will continue to be very well supported by its bankers, however, as is the case for the whole market, it will be harder to get term on facilities at present. Other avenues such as the USPP market and the NZ corporate bond market look difficult as well near-term. We expect VHP will slow development activity going forward and divest some non-core assets if possible.

**Figure 2. VHP P/NTA vs. Sector**


Source: Forsyth Barr analysis, Company Reports, Thomson Reuters

**Figure 3. VHP gearing vs. Sector**


Source: Forsyth Barr analysis, Company reports

## 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.
- **Development activity:** VHP currently has over NZ\$200m of committed brownfield developments underway. Key developments include Wakefield, Bowen and Royston Hospitals, as well as the 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

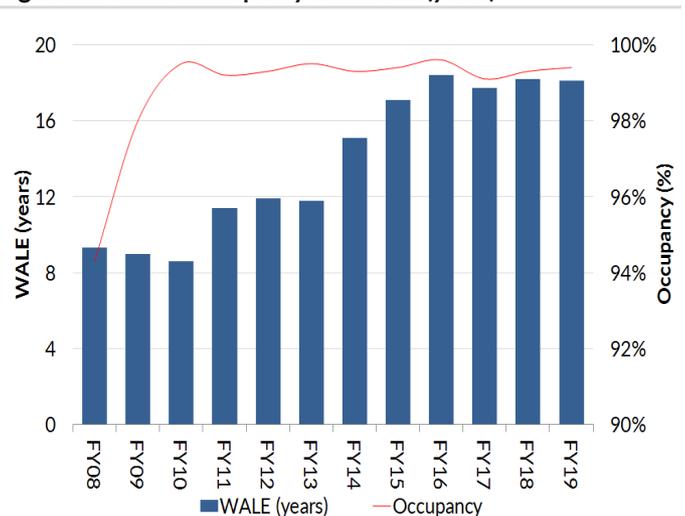
- **Rising interest rates:** Interest is VHP's largest expense. Changes to wholesale rates or margins can have a material impact on earnings.
- **Currency:** ~75% of VHP's assets are located in Australia, thus, currency movements can impact VHP's earnings and the value of its AUD assets. This is mitigated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

**Figure 4. Sector and regional portfolio exposure**

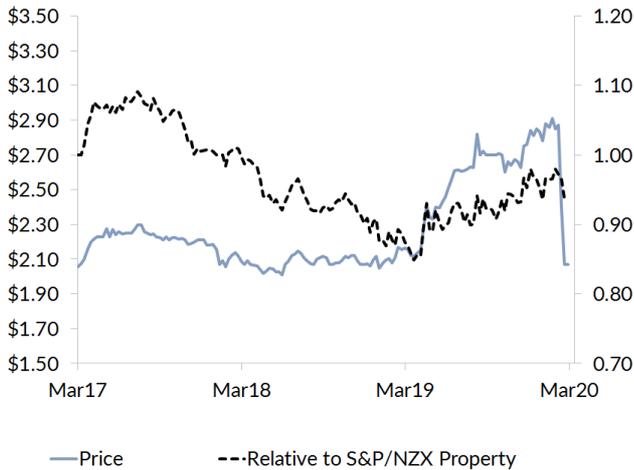
	Hospitals	MOBs	Aged care	Total
NSW	28%	2%	3%	<b>33%</b>
NZ	17%	5%	0%	<b>22%</b>
QLD	13%	1%	0%	<b>14%</b>
VIC	15%	4%	0%	<b>20%</b>
Other AU	8%	3%	1%	<b>12%</b>
<b>Total</b>	<b>82%</b>	<b>15%</b>	<b>4%</b>	<b>100%</b>

Source: Forsyth Barr analysis, Company Reports

**Figure 5. Portfolio occupancy and WALE (years)**



Source: Forsyth Barr analysis, Company Reports

**Figure 6. Price performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

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

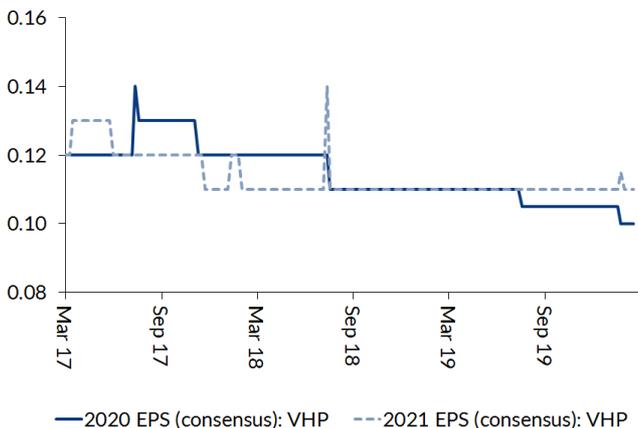
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 8. International valuation comparisons**

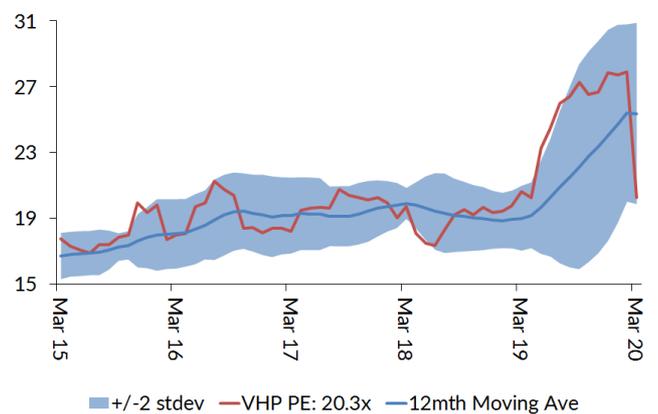
Company (metrics re-weighted to reflect VHP's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Vital Healthcare</b>	<b>VHP NZ</b>	<b>NZ\$2.07</b>	<b>NZ\$924</b>	<b>21.1x</b>	<b>20.0x</b>	<b>19.9x</b>	<b>18.6x</b>	<b>19.9x</b>	<b>18.6x</b>	<b>4.3%</b>
Argosy Property *	ARG NZ	NZ\$0.95	NZ\$786	14.3x	13.8x	15.2x	14.2x	15.2x	14.2x	6.6%
Goodman Property Trust *	GMT NZ	NZ\$1.93	NZ\$2,668	28.4x	27.7x	24.8x	22.9x	24.8x	22.9x	3.5%
Investore *	IPL NZ	NZ\$1.45	NZ\$442	17.8x	17.5x	18.6x	18.3x	18.6x	18.3x	5.3%
Kiwi Property Group *	KPG NZ	NZ\$0.98	NZ\$1,538	13.7x	13.6x	15.1x	14.2x	15.1x	14.2x	7.3%
Asset Plus *	APL NZ	NZ\$0.44	NZ\$71	11.6x	12.3x	8.9x	9.4x	8.9x	9.4x	8.2%
Precinct Properties NZ *	PCT NZ	NZ\$1.63	NZ\$2,141	24.7x	23.7x	22.9x	21.4x	22.9x	21.4x	3.9%
Property For Industry *	PFI NZ	NZ\$1.85	NZ\$923	21.4x	21.1x	17.9x	17.8x	17.9x	17.8x	4.2%
Stride Property *	SPG NZ	NZ\$1.55	NZ\$566	14.6x	13.9x	15.5x	14.4x	15.5x	14.4x	6.5%
<b>Compco Average:</b>				<b>18.3x</b>	<b>18.0x</b>	<b>17.4x</b>	<b>16.6x</b>	<b>17.4x</b>	<b>16.6x</b>	<b>5.7%</b>
<b>VHP Relative:</b>				<b>15%</b>	<b>11%</b>	<b>14%</b>	<b>12%</b>	<b>14%</b>	<b>12%</b>	<b>-23%</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 9. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**


Source: Forsyth Barr analysis

**Analyst certification:** The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

**Analyst holdings:** The following Analyst(s) have a threshold interest in the financial products referred to in this publication: Jeremy Simpson. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

**Ratings distributions:** As at 19 Mar 2020, Forsyth Barr's research ratings were distributed as follows:

<b>OUTPERFORM</b>	<b>NEUTRAL</b>	<b>UNDERPERFORM</b>
<b>33.3%</b>	<b>51.0%</b>	<b>15.7%</b>

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

**Disclosure:** Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

**Investment banking engagements:** Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the following issuers that are the subject of this publication: ARG

**Not personalised financial advice:** The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

**Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

**Terms of use:** Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.