

Vital Healthcare

Upgrade to OUTPERFORM

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OUTPERFORM

In our sector report *Real Estate Reflections* dated 26 March 2020, we looked at sector gearing and provided an update on our preferred LPVs. We also provided some thoughts on how investors should be positioned as uncertainty persists, and a reminder of what happened during the global financial crisis (GFC) and how things may be 'different this cycle'. We upgraded our VHP investment rating from NEUTRAL to OUTPERFORM.

NZX Code	VHP	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.35	NPAT* (NZ\$m)	42.2	44.3	47.8	49.3	EV/EBITDA	21.5	21.3	19.8	18.2
Target price	NZ\$2.76	EPS* (NZc)	9.5	9.8	10.4	10.5	EV/EBIT	21.5	21.3	19.8	18.2
Risk rating	Low	EPS growth* (%)	-10.3	3.0	5.8	1.6	PE	24.8	24.0	22.7	22.4
Issued shares	446.3m	DPS (NZc)	8.8	9.0	9.0	9.0	Price / NTA	1.0	1.0	1.0	1.0
Market cap	NZ\$1,051m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.7	3.8	3.8	3.8
Avg daily turnover	231.5k (NZ\$590k)	*Based on normalised profits					Gross div yld (%)	5.3	5.5	5.5	5.5

Appealing portfolio less exposed to economic cycle

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 — upgraded from NEUTRAL to OUTPERFORM

VHP has strongly defensive portfolio characteristics and is well managed on the ground in NZ and Australia. It is relatively fully geared at ~35% versus a sector average of ~31% but this is offset by the portfolio qualities mentioned above. VHP also has a relatively low dividend pay-out ratio which is helpful. Sentiment towards manager NorthWest remains a risk factor. We have yet to change our forecasts or NZ\$2.76 target price.

Better longer-term structure vs. added complexity

As per our VHP note dated 20 March 2020, we recommend that unitholders approve what is proposed regarding the change in corporate structure and ASX listing. The unitholder meeting is on 31 March 2020 and votes have to be received by 29 March 2020. Our view is centred on the belief that what is being created is a better longer-term structure, given it will potentially widen the appeal to Australian and other international investors.

Vital Healthcare Property Trust (VHP)

Priced as at 26 Mar 2020 (NZ\$)

2.36

12-month target price (NZ\$)*

2.76

Expected share price return

16.9%

Net dividend yield

3.8%

Estimated 12-month return

20.8%

Spot valuations (NZ\$)

1. DCF

2.99

2. NAV

2.36

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.00%

Equity beta

0.68

WACC

5.1%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

2,140

(Net debt)/cash

(728)

Less: Capitalised operating leases

0

Value of equity

1,362

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	90.7	97.7	99.8	106.5	115.1	EV/EBITDA (x)	20.8	21.5	21.3	19.9	18.2
Normalised EBITDA	76.0	81.3	83.2	89.0	96.9	EV/EBIT (x)	20.8	21.5	21.3	19.9	18.2
Depreciation and amortisation	0	0	0	0	0	PE (x)	22.3	24.8	24.1	22.8	22.4
Normalised EBIT	76.0	81.3	83.2	89.0	96.9	Price/NTA (x)	1.0	1.0	1.0	1.0	1.0
Net interest	(22.8)	(29.9)	(30.3)	(31.7)	(37.6)	Free cash flow yield (%)	1.9	0.5	-4.1	-2.8	-2.7
Associate income	0	0	0	0	0	Net dividend yield (%)	3.6	3.7	3.8	3.8	3.8
Tax	(7.2)	(9.3)	(8.6)	(9.5)	(10.0)	Gross dividend yield (%)	5.2	5.3	5.4	5.4	5.4
Minority interests	0	0	0	0	0						
Normalised NPAT	46.0	42.2	44.3	47.8	49.3	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	54.0	51.3	22.2	29.6	31.2	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	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	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	Net debt/EBITDA (x)	8.7	9.0	8.6	8.7	8.7
Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	19.5	7.7	2.2	6.7	8.2	Return on assets (%)	4.3	4.2	4.2	4.3	4.5
EBITDA (%)	15.1	6.9	2.3	6.9	8.9	Return on equity (%)	4.7	4.1	4.1	4.3	4.3
EBIT (%)	15.1	6.9	2.3	6.9	8.9	Return on funds employed (%)	4.4	3.9	3.9	4.0	4.1
Normalised NPAT (%)	3.3	-8.4	5.0	7.9	3.2	EBITDA margin (%)	83.9	83.2	83.3	83.6	84.1
Normalised EPS (%)	0.2	-10.3	3.0	5.8	1.6	EBIT margin (%)	83.9	83.2	83.3	83.6	84.1
Ordinary DPS (%)	0.7	2.2	2.9	0.0	0.0	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
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Imputation (%)	100	100	100	100	100
EBITDA	76.0	81.3	83.2	89.0	96.9	Pay-out ratio (%)	81	92	92	87	86
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)	Property Statistics	2014A	2015A	2016A	2017A	2018A
Other	0	0	0	0	0	Major Property Values (NZ\$m)					
Operating cash flow	45.7	40.6	42.5	47.8	49.3	Ascot Hospital & Clinics	0	0	0	0	0
Capital expenditure	(26.1)	(35.5)	(85.7)	(76.9)	(77.7)	Ascot Central	608.2	769.0	929.6	1,372.6	1,729.7
(Acquisitions)/divestments	(187.7)	(23.5)	0	0	0	Epworth Eastern	0	0	0	33.9	35.5
Other	(46.8)	(37.3)	86.4	0	0	Southport 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)	Lingard Private Hospital	47.4	46.6	45.1	42.6	47.6
Dividends paid	(31.1)	(32.7)	(28.3)	(34.3)	(42.2)	Maitland Private Hospital	15.5	18.3	19.8	30.5	38.2
Equity raised/(returned)	0	0	0	0	0	SportsMed Hospital and Clinic	0	0	0	33.0	35.3
(Increase)/decrease in net debt	(246.0)	(88.3)	14.9	(63.4)	(70.6)	Hurstville Private Hospital	0	0	3.6	3.8	4.3
						Total portfolio	613.0	0	0	0	0
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Portfolio Summary					
Working capital	(15.8)	(12.5)	(12.5)	(12.5)	(12.5)	Investment properties (NZ\$m)	613.0	0	0	0	0
Fixed assets	1,731.2	1,836.4	1,947.0	2,053.5	2,162.4	Number of properties - yielding only	(5)	(0)	2	12	0
Intangibles	0	0	0	0	0	Weighted average lease term (yrs)	59.5	60.8	70.3	94.8	0
Right of use asset	0	0	0	0	0	Occupancy rate (%)	0	0	0	0	0
Other assets	49.0	87.7	4.7	4.7	4.7	M'ment/Admin cost % of assets (%)	0	0	0	0	0
Total funds employed	1,764.5	1,911.7	1,939.2	2,045.7	2,154.6	NTA per share (NZ\$)	0	0	0	0	0
Net debt/(cash)	663.3	728.1	713.3	776.7	847.2	Average portfolio cap rate (%)	0	0	0	0	0
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						
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

Figure 1. Balance Sheet summary

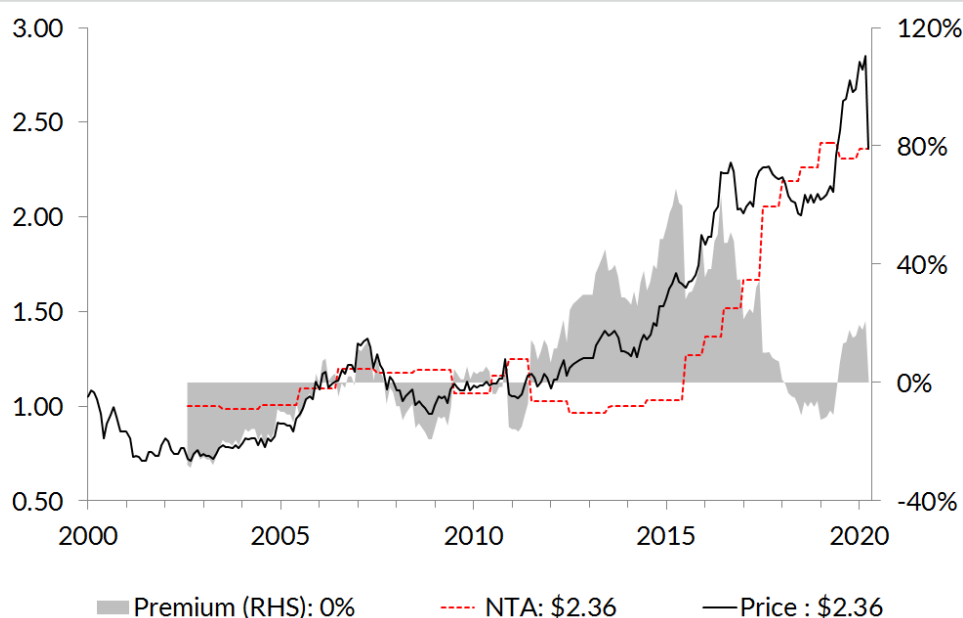
	As at	Reported gearing	Target gearing	Bank covenant	Bank facilities (NZ\$m)	Issued Bonds (NZ\$m)	Facility capacity (NZ\$m)	Term - bank (years)	Term - bonds (years)	Term - weighted (years)
APL	Mar-20	30.2%	35-40%	50%	75	-	27	2.2	-	2.2
ARG	Sep-19	36.2%	30-40%	50%	535	200	85	2.7	6.3	3.7
GMT	Sep-19	17.9%	25-35%	50%	400	556	400	2.6	4.6	3.8
IPL	Sep-19	40.6%	<48%	65%	270	100	65	1.5	4.1	2.2
KPG	Sep-19	27.4%	25-35%	45%	825	475	303	3.5	3.7	3.6
PCT	Dec-19	25.4%	<37.5%	50%	610	586	322	3.3	5.1	4.2
PFI	Dec-19	28.2%	<40%	50%	300	200	84	3.1	5.1	3.9
SPG	Sep-19	34.4%	38-42%	50%	400	-	67	1.8	-	1.8
VHP	Dec-19	35.1%	na	50%	870	-	225	2.0	-	2.0
Average/total		30.6%		51.1%	4,285	2,117	1,479	2.5	3.2	3.0

Source: Forsyth Barr analysis, company reports

Figure 2. Hypothetical asset value declines required to breach banking covenant

	Reported Gearing	Bank Covenant	Approx Debt Drawn	Approx Asset Value	Minimum Asset Value	Asset Value Decline
APL	30.2%	50%	50.0	160.0	100.0	-40%
ARG	36.2%	50%	650.0	1,790.0	1,300.0	-28%
GMT	17.9%	50%	530.0	2,960.0	1,060.0	-64%
IPL	40.6%	65%	300.0	750.0	470.0	-38%
KPG	27.4%	45%	930.0	3,400.0	2,070.0	-39%
PCT	25.4%	50%	870.0	3,440.0	1,750.0	-49%
PFI	28.2%	50%	430.0	1,520.0	860.0	-44%
SPG	34.4%	50%	300.0	880.0	610.0	-31%
VHP	35.1%	50%	680.0	1,940.0	1,360.0	-30%

Source: Forsyth Barr analysis, Company reports

Figure 3. VHP long-run P/NTA


Source: Forsyth Barr analysis

Figure 4. LPV compco table

LPV	Code	Rating	Price 26-Mar	Target price	Gross yield	AFFO yield	P/NAV	P/NTA
Asset Plus	APL	UNDERPERFORM	\$0.42	\$0.65	12.4%	7.6%	63%	58%
Argosy Property	ARG	NEUTRAL	\$0.86	\$1.38	10.4%	7.2%	65%	67%
Augusta Capital	AUG	NEUTRAL	\$0.98	\$1.38	9.3%	7.3%	70%	132%
Goodman Property	GMT	NEUTRAL	\$2.19	\$1.92	4.3%	2.9%	115%	127%
Investore	IPL	OUTPERFORM	\$1.50	\$1.85	7.3%	5.0%	90%	88%
Kiwi Property Group	KPG	NEUTRAL	\$0.87	\$1.29	11.7%	7.5%	76%	61%
Precinct Properties	PCT	NEUTRAL	\$1.66	\$1.52	5.4%	3.6%	103%	113%
Property for Industry	PFI	OUTPERFORM	\$2.06	\$2.15	5.4%	3.7%	100%	104%
Stride Property	SPG	NEUTRAL	\$1.35	\$2.18	10.5%	7.0%	66%	69%
Vital Healthcare	VHP	OUTPERFORM	\$2.36	\$2.76	5.5%	3.8%	100%	102%
Core simple average					7.6%	5.1%	90%	91%

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 is a key LPV exposure given its defensive qualities. **OUTPERFORM**

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

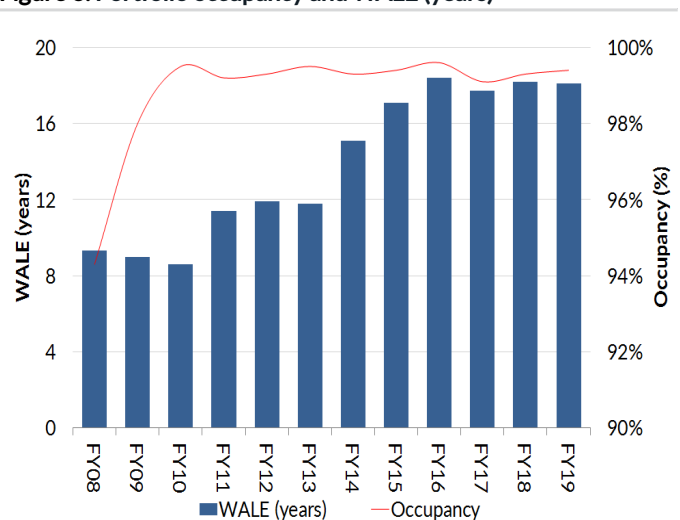
- **Rising interest rates:** Interest is VHP's largest expense. Changes to wholesale rates or margins can have a material impact on earnings.
- **Currency:** ~75% of VHP's assets are located in Australia, thus, currency movements can impact VHP's earnings and the value of its AUD assets. This is mitigated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

Figure 5. Sector and regional portfolio exposure

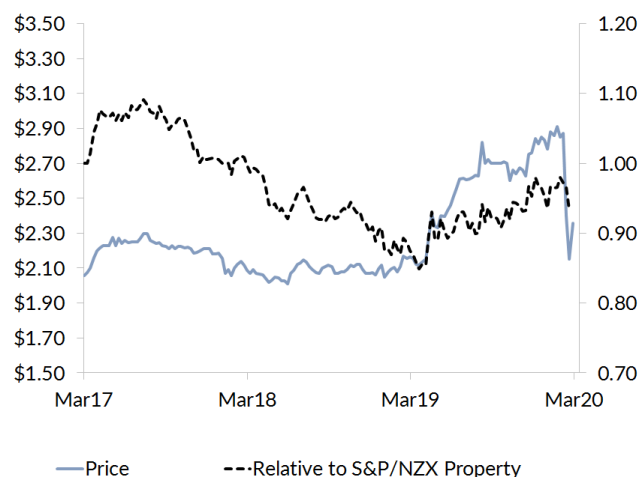
	Hospitals	MOBs	Aged care	Total
NSW	28%	2%	3%	33%
NZ	17%	5%	0%	22%
QLD	13%	1%	0%	14%
VIC	15%	4%	0%	20%
Other AU	8%	3%	1%	12%
Total	82%	15%	4%	100%

Source: Forsyth Barr analysis, Company Reports

Figure 6. Portfolio occupancy and WALE (years)



Source: Forsyth Barr analysis, Company Reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

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

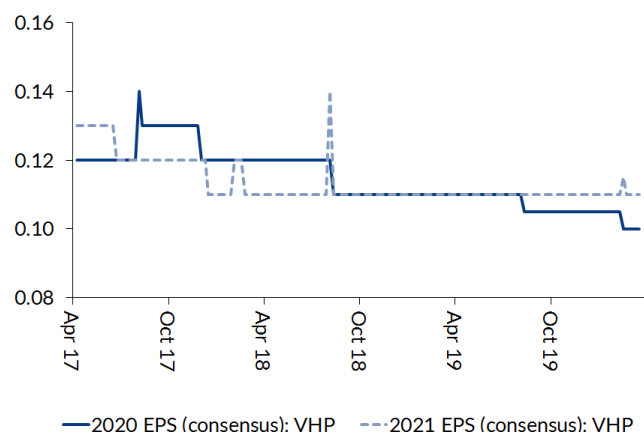
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 9. International valuation comparisons

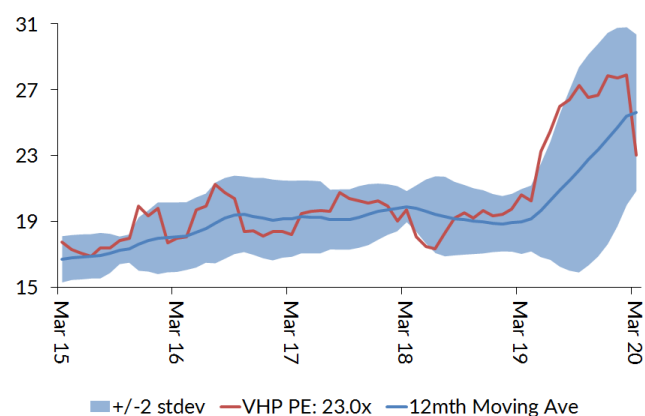
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect VHP's balance date - June)				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Vital Healthcare	VHP NZ	NZ\$2.36	NZ\$1,051	24.0x	22.7x	21.4x	20.0x	21.4x	20.0x	3.8%
Argosy Property *	ARG NZ	NZ\$0.84	NZ\$695	12.6x	12.2x	14.2x	13.3x	14.2x	13.3x	7.5%
Goodman Property Trust *	GMT NZ	NZ\$2.05	NZ\$2,841	30.2x	29.5x	26.2x	24.1x	26.2x	24.1x	3.2%
Investore *	IPL NZ	NZ\$1.41	NZ\$429	17.3x	17.0x	18.3x	18.0x	18.3x	18.0x	5.4%
Kiwi Property Group *	KPG NZ	NZ\$0.84	NZ\$1,318	11.8x	11.6x	13.8x	13.0x	13.8x	13.0x	8.5%
Asset Plus *	APL NZ	NZ\$0.42	NZ\$68	11.1x	11.8x	8.6x	9.1x	8.6x	9.1x	8.6%
Precinct Properties NZ *	PCT NZ	NZ\$1.47	NZ\$1,931	22.3x	21.4x	21.2x	19.8x	21.2x	19.8x	4.3%
Property For Industry *	PFI NZ	NZ\$1.76	NZ\$878	20.3x	20.1x	17.3x	17.2x	17.3x	17.2x	4.4%
Stride Property *	SPG NZ	NZ\$1.30	NZ\$475	12.2x	11.7x	13.9x	12.9x	13.9x	12.9x	7.8%
Compco Average:				17.2x	16.9x	16.7x	15.9x	16.7x	15.9x	6.2%
VHP Relative:				40%	34%	28%	26%	28%	26%	-38%

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 10. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 11. One year forward PE (x)


Source: Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
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