

# Vital Healthcare

## FY20 Result — Operation Goes to Plan

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### OUTPERFORM

Vital Healthcare Property (VHP) delivered a solid underlying FY20 result ahead of our expectations, largely due to better than expected COVID-19 abatement outcomes. While no AFFO guidance was given, VHP did provide FY21 dividend guidance of at least 8.75cps, flat on FY20. We believe this reflects management being cautious given the uncertain operating environment. We retain our OUTPERFORM rating underpinned by 1) earnings and dividend growth as developments contribute, and 2) the expectation that VHP's portfolio continues to do its job of providing a very defensive property exposure despite the uncertain economic backdrop. The lift in our FY21-23 earnings forecasts largely reflects reversal of prior COVID-19 abatement assumptions. Our target price increases by +7% to NZ\$2.90.

NZX Code	VHP	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.62	NPAT* (NZ\$m)	46.8	50.3	52.2	56.7	EV/EBITDA	23.9	23.3	22.5	20.9
Target price	NZ\$2.90	EPS* (NZc)	10.4	11.0	11.2	12.1	EV/EBIT	23.9	23.3	22.5	20.9
Risk rating	Low	EPS growth* (%)	7.2	5.8	2.1	7.8	PE	25.4	24.0	23.5	21.8
Issued shares	453.8m	DPS (NZc)	8.8	8.9	9.1	9.4	Price / NTA	1.1	1.1	1.0	1.0
Market cap	NZ\$1,191m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.3	3.4	3.5	3.6
Avg daily turnover	220.0k (NZ\$570k)	*Based on normalised profits					Gross div yld (%)	4.8	4.9	4.9	5.1

### COVID collection highlights defensive qualities

VHP reported a strong FY20 result with NPAT of NZ\$41.7m ahead of our forecast NZ\$39.7m, and up strongly on the pcg due to lower corporate costs. Like-for-like rental growth of +1.6% was slower than seen in previous years, however, this was offset by better than expected COVID-19 related rental abatements. VHP provided rental abatements of just NZ\$0.3m, or 0.3% of its FY20 rental income, highlighting the defensive attributes of its portfolio. That said, VHP has also deferred rent of NZ\$4.5m owing from one of its tenants but it expects this to be largely paid in 1H21. DPS of 8.75cps was flat on the pcg, representing an FY20 AFFO payout ratio of 84% based on VHP's AFFO calculation, or 97% if we adjust for managers fees being paid in units. VHP has guided to dividends of "at least" this amount in FY21.

### Portfolio metrics remain supportive

Headline metrics of VHP's portfolio remain very solid, reporting occupancy of 99.4% and a weighted average lease expiry of 18.1 years. Further revaluation gains saw VHP's NTA lift to NZ\$2.38 (1H20: NZ\$2.36). While its portfolio remains heavily weighted to hospitals (82%), management has outlined its 5 year target portfolio weightings (Figure 5), which suggests it will try to dilute this exposure in favour of aged care and life science/research facilities.

Gearing lifted to 38.7% (from 35.3% in FY19) due to the acquisition of aged care facilities in NSW, Australia, and development costs. While some Australian developments have been put on hold, they are expected to resume in the near term. VHP has ~NZ\$200m of costs required to complete its six committed developments, which will be funded through a mix of bank debt and potential asset sales.

### Revising forecasts up, DPS slightly ahead of guidance

Our earnings forecasts lift by +9%/+8%/+3% in FY21/22/23 due to the increased rental contribution from VHP's recently acquired aged care assets, minor adjustments to our development assumptions, FX movements, and a reversion in our COVID-19 abatement assumptions. We forecast FY21 DPS of 8.90cps or +2% yoy, slightly ahead of guidance.

## Vital Healthcare Property Trust (VHP)

Priced as at 10 Aug 2020 (NZ\$) **2.63**

<b>12-month target price (NZ\$)*</b>	<b>2.90</b>
Expected share price return	10.3%
Net dividend yield	3.4%
Estimated 12-month return	13.7%

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	0.77
WACC	4.3%
Terminal growth	1.5%

<b>Spot valuations (NZ\$)</b>	
1. DCF	3.28
2. NAV	2.38
3. n/a	n/a

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	2,362
(Net debt)/cash	(808)
Less: Capitalised operating leases	0
Value of equity	1,490

<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Sales revenue	97.7	98.8	105.5	111.2	118.5	EV/EBITDA (x)	23.5	23.9	23.3	22.5	21.0
<b>Normalised EBITDA</b>	<b>80.3</b>	<b>82.0</b>	<b>88.2</b>	<b>93.3</b>	<b>100.3</b>	EV/EBIT (x)	23.5	23.9	23.3	22.5	21.0
Depreciation and amortisation	0	0	0	0	0	PE (x)	27.2	25.4	24.0	23.5	21.8
<b>Normalised EBIT</b>	<b>80.3</b>	<b>82.0</b>	<b>88.2</b>	<b>93.3</b>	<b>100.3</b>	Price/NTA (x)	1.1	1.1	1.1	1.0	1.0
Net interest	(29.9)	(28.0)	(28.9)	(31.7)	(33.0)	Free cash flow yield (%)	0.4	-3.3	-5.6	-2.8	4.4
Associate income	0	0	0	0	0	Net dividend yield (%)	3.3	3.3	3.4	3.5	3.6
Tax	(7.6)	(7.2)	(9.0)	(9.5)	(10.5)	Gross dividend yield (%)	4.8	4.8	4.9	4.9	5.1
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>42.9</b>	<b>46.8</b>	<b>50.3</b>	<b>52.2</b>	<b>56.7</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	50.6	11.4	28.2	45.3	34.3	Interest cover EBIT (x)	2.7	2.9	3.1	2.9	3.0
<b>Reported NPAT</b>	<b>93.4</b>	<b>58.1</b>	<b>78.5</b>	<b>97.5</b>	<b>91.0</b>	Interest cover EBITDA (x)	2.7	2.9	3.1	2.9	3.0
Normalised EPS (cps)	9.7	10.4	11.0	11.2	12.1	Net debt/ND+E (%)	41.4	42.5	44.3	43.4	40.4
DPS (cps)	8.8	8.8	8.9	9.1	9.4	Net debt/EBITDA (x)	9.1	9.9	10.3	9.9	8.6
<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Revenue (%)	7.8	1.1	6.8	5.5	6.5	Return on assets (%)	4.2	3.9	3.9	4.0	4.3
EBITDA (%)	5.6	2.1	7.6	5.8	7.5	Return on equity (%)	4.2	4.3	4.4	4.3	4.5
EBIT (%)	5.6	2.1	7.6	5.8	7.5	Return on funds employed (%)	3.9	3.8	3.7	3.7	3.9
Normalised NPAT (%)	-6.9	9.1	7.5	3.7	8.7	EBITDA margin (%)	82.2	83.0	83.6	83.9	84.7
Normalised EPS (%)	-8.9	7.2	5.8	2.1	7.8	EBIT margin (%)	82.2	83.0	83.6	83.9	84.7
Ordinary DPS (%)	2.2	0.0	2.2	1.7	3.5	Capex to sales (%)	36.3	85.2	111.0	76.5	3.7
						Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	Imputation (%)	100	100	100	100	100
<b>EBITDA</b>	<b>80.3</b>	<b>82.0</b>	<b>88.2</b>	<b>93.3</b>	<b>100.3</b>	Pay-out ratio (%)	91	85	82	81	78
Working capital change	(1.9)	(1.3)	0.2	0.3	0.3						
Interest & tax paid	(37.8)	(36.3)	(38.2)	(41.5)	(43.9)						
Other	0	0	0	0	0						
<b>Operating cash flow</b>	<b>40.6</b>	<b>44.4</b>	<b>50.1</b>	<b>52.2</b>	<b>56.7</b>						
Capital expenditure	(35.5)	(84.1)	(117.1)	(85.1)	(4.4)						
(Acquisitions)/divestments	(23.5)	(65.2)	0	53.2	53.8						
Other	(42.2)	79.3	0	0	0						
<b>Funding available/(required)</b>	<b>(60.5)</b>	<b>(25.6)</b>	<b>(66.9)</b>	<b>20.2</b>	<b>106.2</b>						
Dividends paid	(32.7)	(33.5)	(34.3)	(37.1)	(37.9)						
Equity raised/(returned)	0	0	0	0	0						
<b>(Increase)/decrease in net debt</b>	<b>(93.2)</b>	<b>(59.2)</b>	<b>(101.3)</b>	<b>(16.9)</b>	<b>68.3</b>						
<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>						
Working capital	(12.5)	(13.8)	(13.8)	(13.8)	(13.8)						
Fixed assets	1,836.4	2,086.3	2,236.7	2,319.9	2,311.1						
Intangibles	0	0	0	0	0						
Right of use asset	0	0	0	0	0						
Other assets	87.7	8.4	8.4	8.4	8.4						
<b>Total funds employed</b>	<b>1,911.7</b>	<b>2,081.0</b>	<b>2,231.3</b>	<b>2,314.6</b>	<b>2,305.7</b>						
Net debt/(cash)	728.1	808.3	909.5	926.4	858.2						
Lease liability	0	0	0	0	0						
Other liabilities	153.8	179.6	179.6	179.6	179.6						
Shareholder's funds	1,029.7	1,093.1	1,142.2	1,208.5	1,267.9						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>1,911.7</b>	<b>2,081.0</b>	<b>2,231.3</b>	<b>2,314.6</b>	<b>2,305.7</b>						

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

## Result summary and earnings changes

Figure 1. Result summary

Financial period	FY19	FY20	% Chg	Forbar	% Var
Net property income	97.7	100.1	2.5%	97.0	3.2%
Corporate costs	(29.5)	(23.3)	-21.1%	(23.3)	-0.1%
<b>EBITDA</b>	<b>68.2</b>	<b>76.9</b>	<b>12.8%</b>	<b>73.7</b>	<b>4.2%</b>
Interest expense	(29.9)	(28.0)	-6.3%	(27.6)	1.6%
<b>PBT</b>	<b>38.3</b>	<b>48.9</b>	<b>27.6%</b>	<b>46.2</b>	<b>5.8%</b>
Current tax - reported	(7.6)	(7.2)	-4.4%	(6.5)	12.0%
<b>NPAT</b>	<b>30.7</b>	<b>41.7</b>	<b>35.5%</b>	<b>39.7</b>	<b>4.8%</b>
<b>Add:</b>					
Management incentive fees paid as units	12.1	6.5	-46.4%	6.7	-3.0%
Current tax expense/(benefit) on translation of borrowings	.0	(1.2)	n/m	-	-
Amortisation of borrowing costs	.5	.6	30.0%	.5	27.5%
Amortisation of leasing costs and tenant inducements	.9	1.1	16.4%	-	-
IFRS 16 operating lease accounting	-	(.1)	-	-	-
<b>VHP reported FFO</b>	<b>44.3</b>	<b>48.5</b>	<b>9.5%</b>	<b>46.9</b>	<b>3.3%</b>
<b>Add:</b>					
Non-recurring corporate costs	1.1	.3	-69.2%	-	-
Actual capex & leasing from continuing operations	(1.4)	(1.6)	11.2%	(4.8)	-67.5%
<b>VHP reported AFFO</b>	<b>43.9</b>	<b>47.2</b>	<b>7.5%</b>	<b>42.1</b>	<b>12.2%</b>
<b>Less:</b>					
Management incentive fees paid as units	(12.1)	(6.5)	-46%	(6.7)	-3%
<b>Forbar AFFO</b>	<b>31.8</b>	<b>40.7</b>	<b>28%</b>	<b>35.4</b>	<b>15%</b>
EPU	6.93	9.23	33.1%	8.79	4.9%
VHP FFO per unit	9.98	10.73	7.5%	10.38	3.4%
VHP AFFO per unit	9.90	10.46	5.6%	9.31	12.3%
Forbar AFFO per unit	7.18	9.02	25.7%	7.83	15.2%
DPU	8.75	8.75	-	8.56	2.2%

Source: Forsyth Barr analysis, Company reports

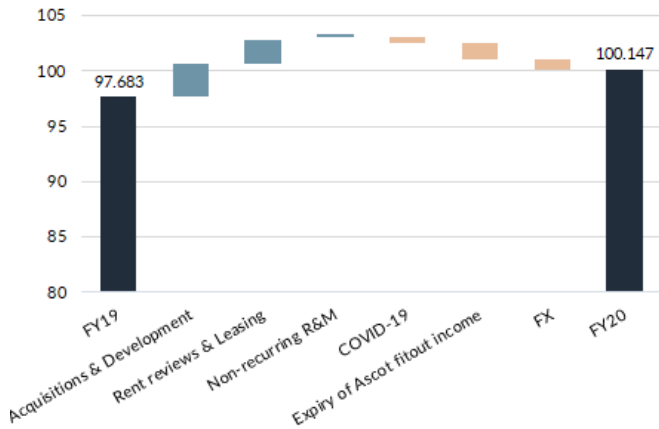
Figure 2. Earnings changes

	2021E			2022E			2023E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Net income	98.5	105.5	7.1%	105.9	111.2	5.0%	115.3	118.5	2.7%
Corporate costs	(17.3)	(17.3)	0.2%	(17.8)	(17.9)	0.7%	(18.5)	(18.2)	-1.6%
<b>EBITDA</b>	<b>81.2</b>	<b>88.2</b>	<b>8.5%</b>	<b>88.1</b>	<b>93.3</b>	<b>5.9%</b>	<b>96.9</b>	<b>100.3</b>	<b>3.5%</b>
Net interest	(27.3)	(28.9)	5.9%	(31.1)	(31.7)	1.9%	(31.7)	(33.0)	4.1%
Current tax	(8.0)	(9.0)	12.4%	(8.6)	(9.5)	10.2%	(10.1)	(10.5)	4.5%
<b>NPAT (underlying)</b>	<b>46.0</b>	<b>50.3</b>	<b>9.4%</b>	<b>48.5</b>	<b>52.2</b>	<b>7.6%</b>	<b>55.1</b>	<b>56.7</b>	<b>3.0%</b>
Maintenance capex	(4.9)	(1.0)	-80.0%	(5.1)	(1.1)	-78.9%	(5.3)	(1.1)	-78.4%
<b>AFFO</b>	<b>38.4</b>	<b>44.5</b>	<b>15.8%</b>	<b>42.9</b>	<b>45.4</b>	<b>5.9%</b>	<b>49.8</b>	<b>49.6</b>	<b>-0.4%</b>
EPS (cps)	9.97	10.95	9.8%	10.36	11.18	8.0%	11.68	12.06	3.3%
AFFO (cps)	8.33	9.82	17.9%	9.17	9.88	7.8%	10.56	10.69	1.2%
DPS (cps)	8.40	8.94	6.4%	8.40	9.09	8.2%	9.00	9.41	4.5%
Payout - EPS	84%	82%	-3.1%	81%	81%	0.2%	77%	78%	1.2%
Payout - AFFO	101%	91%	-9.7%	92%	92%	0.4%	85%	88%	3.3%

Source: Forsyth Barr analysis

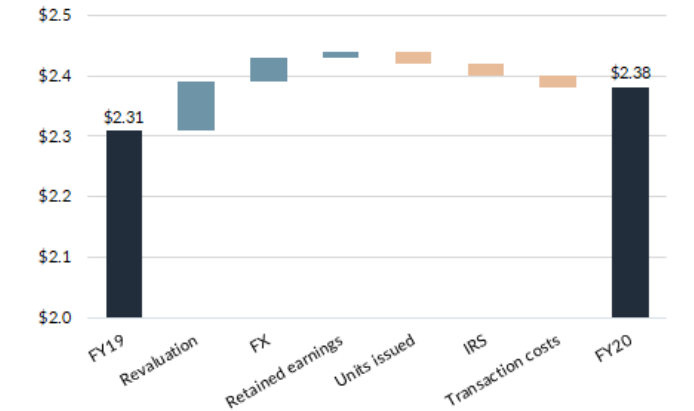
## FY20 in 6 charts

Figure 3. Net property income (NZ\$m)



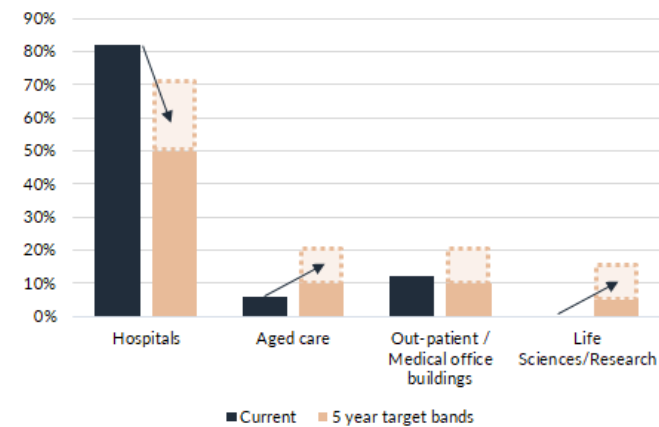
Source: Forsyth Barr analysis, Company reports

Figure 4. NTA per share



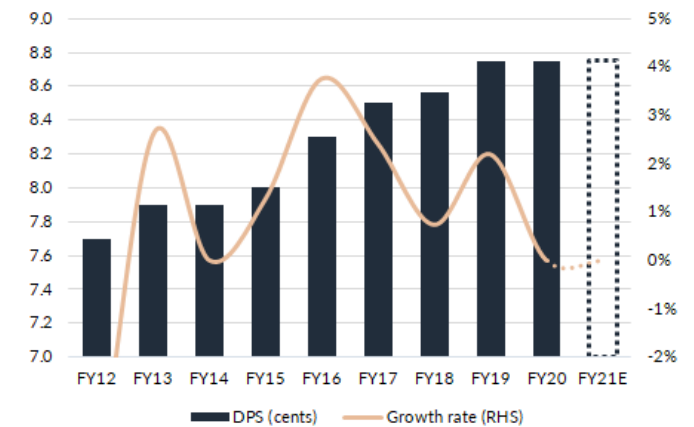
Source: Forsyth Barr analysis, Company reports

Figure 5. Asset allocation target bands



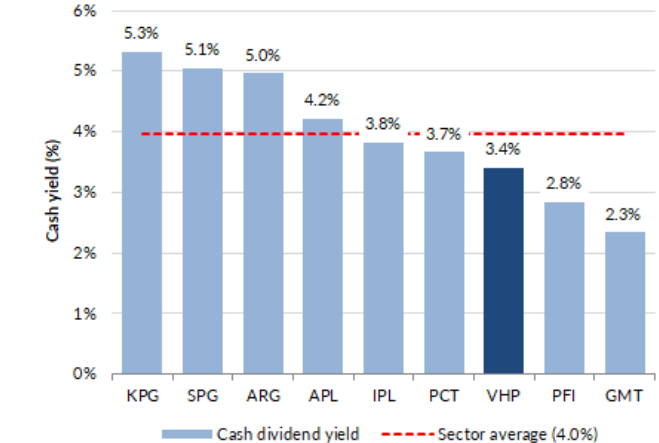
Source: Forsyth Barr analysis, Company reports

Figure 6. DPS growth



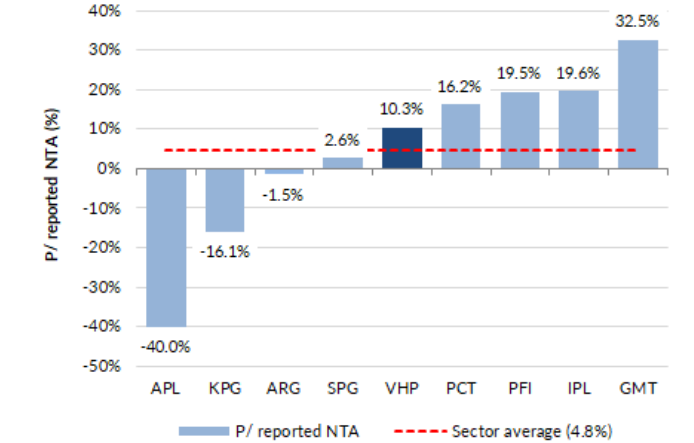
Source: Forsyth Barr analysis, Company reports

Figure 7. Sector cash yield



Source: Forsyth Barr analysis, Eikon

Figure 8. Sector P/NTA



Source: Forsyth Barr analysis, Eikon

## 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 the COVID-19 pandemic presents a difficult operating environment for most businesses, VHP's lease structures and the essential nature of its tenants businesses should provide some support. **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 18.1 years and strong portfolio occupancy of 99.4%.

### 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 and Royston Hospitals, as well as the Epworth Eastern expansion in Melbourne.

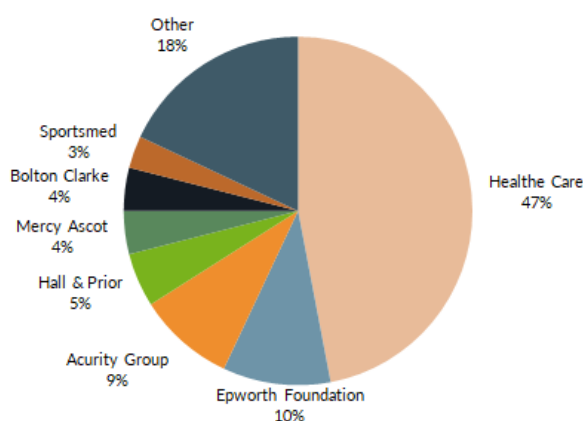
### Financial structure

- **Gearing sits at 38.7%:** As at 30 June 2020, VHP was geared at 38.7%. This represents a lift from 35.3% in FY19 due to development costs and the acquisition of aged care facilities in NSW, Australia. VHP's LVR bank covenant is 50%.
- **Diversifying debt:** VHP indicated that it wishes to diversify the tenor of its debt, most likely through either a USPP or bond issue.

### Risk factors

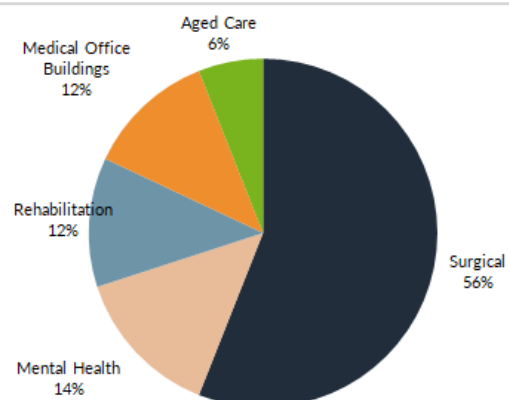
- **Currency:** ~75% of VHP's assets are located in Australia, thus, currency movements can impact VHP's earnings and the value of its AUD assets. This is mitigated by hedging policies.
- **Economic uncertainty:** In periods of economic uncertainty tenants are more likely to default and new leasing becomes more competitive. This could result in increased vacancy, downward pressure on rents, and negative asset revaluations.

Figure 9. Tenant diversification by % of rent (FY20)

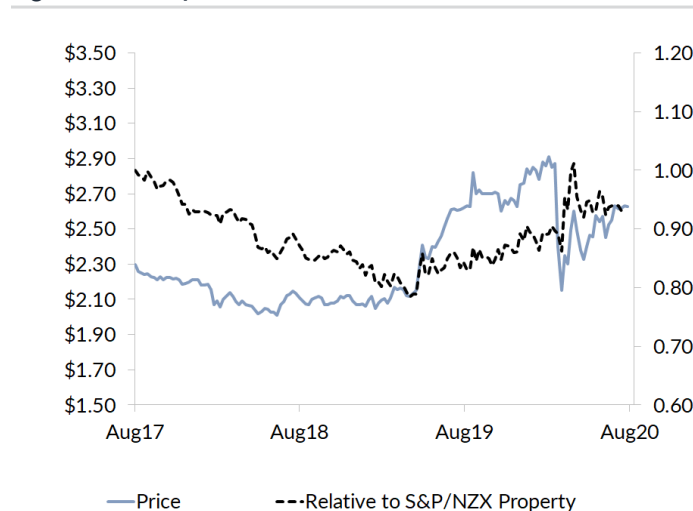


Source: Forsyth Barr analysis

Figure 10. Subsector diversity



Source: Forsyth Barr analysis

**Figure 11. Price performance**


Source: Forsyth Barr analysis

**Figure 12. Substantial shareholders**

Shareholder	Latest Holding
Northwest	25.0%
Forsyth Barr Investment Management	8.1%
ACC	5.0%

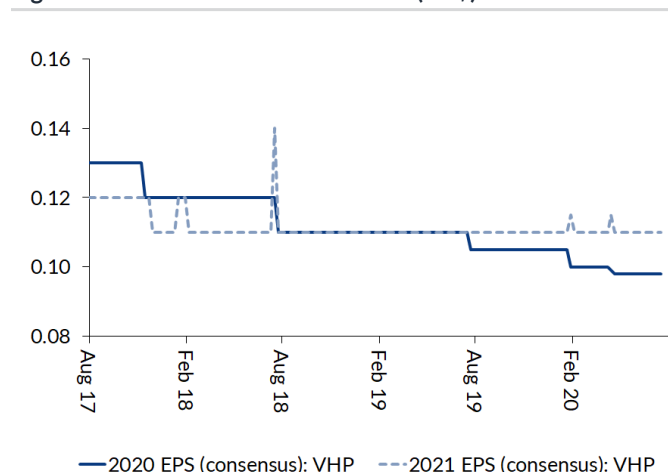
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 13. International valuation comparisons**

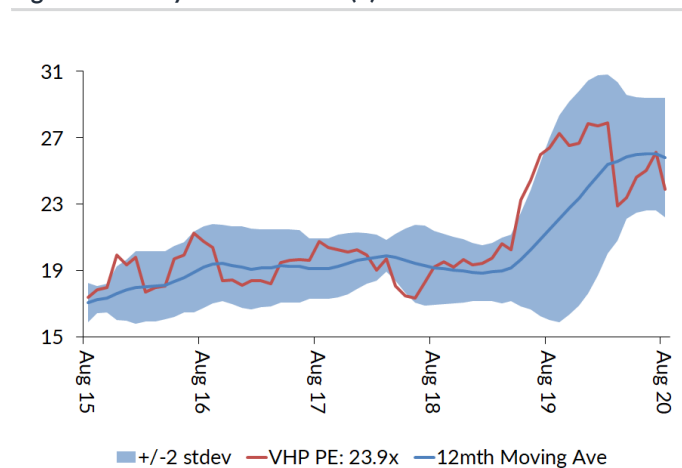
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect VHP's balance date - June)										
Vital Healthcare	VHP NZ	NZ\$2.63	NZ\$1,191	24.0x	23.5x	22.7x	21.4x	22.7x	21.4x	3.5%
ARGOSY PROPERTY *	ARG NZ	NZ\$1.26	NZ\$1,047	18.0x	17.9x	19.5x	18.9x	19.5x	18.9x	5.0%
GOODMAN PROPERTY TRUST *	GMT NZ	NZ\$2.28	NZ\$3,172	34.6x	33.7x	28.8x	27.6x	28.8x	27.6x	2.4%
INVESTORE *	IPL NZ	NZ\$2.02	NZ\$744	25.7x	23.8x	20.5x	19.4x	20.5x	19.4x	3.9%
KIWI PROPERTY GROUP *	KPG NZ	NZ\$1.05	NZ\$1,648	16.5x	15.1x	17.4x	15.5x	17.4x	15.5x	5.9%
ASSET PLUS *	APL NZ	NZ\$0.36	NZ\$57	12.7x	14.1x	16.8x	18.2x	16.8x	18.2x	5.7%
PRECINCT PROPERTIES NZ *	PCT NZ	NZ\$1.70	NZ\$2,233	25.5x	25.4x	32.8x	23.7x	32.8x	23.7x	3.7%
PROPERTY FOR INDUSTRY *	PFI NZ	NZ\$2.46	NZ\$1,230	28.9x	28.2x	23.8x	23.7x	23.8x	23.7x	2.8%
STRIDE PROPERTY *	SPG NZ	NZ\$1.96	NZ\$716	19.2x	20.3x	29.3x	33.1x	29.3x	33.1x	5.1%
Compco Average:				22.6x	22.3x	23.6x	22.5x	23.6x	22.5x	4.3%
VHP Relative:				6%	5%	-4%	-5%	-4%	-5%	-20%

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 14. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 15. One year forward PE (x)**


Source: Forsyth Barr analysis

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