

MedicX Fund

Quarterly NAV
announcement

Strong valuation gains continue in Q2

Real estate

6 August 2015

Price **81.25p**
Market cap **£297m**

Net debt (£m) at 31 March 2015	265.6
Shares in issue (excluding treasury)	365.0m
Free float	100%
Code	MXF
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(0.3)	(2.1)	(1.2)
Rel (local)	(2.4)	(0.4)	(4.5)
52-week high/low	85.8p	78.8p	

Business description

MedicX Fund is a specialist investor in primary care infrastructure. It holds a portfolio of 143 properties (including those under construction), let mainly to government-funded (NHS) tenants (90%) and pharmacies on GP surgery sites (8%).

Next events

Q3 ex-dividend	13 August 2015
Q4 ex-dividend	12 November 2015
Full year results	9 December 2015

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Strong valuation gains, primarily the result of further yield contraction, have continued in Q2. Adjusted NAV has increased despite continuing dividend distributions. Asset growth appears consistent with our estimates and our underlying forecasts (excluding valuation gains) are unchanged. NHS planning suggests good growth prospects for the primary care property sector, and MedicX Fund offers a low-risk approach; it is neither developer nor operator but a long-term investor. A broad portfolio of modern primary care properties, long, quasi government-backed leases, and similar duration fixed-rate debt with modest (c 50%) gearing, provide secure cash flows to support the greater than 7% prospective yield.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	Yield (%)	All-in NAV/ share (p) ¹	DCF/share (p) ²
09/13	25.5	9.7	3.7	5.7	7.0	69.4	97.0
09/14	29.5	10.7	3.1	5.8	7.1	65.3	93.4
09/15e	33.7	13.0	3.6	5.9	7.3	66.4	N/A
09/16e	37.2	13.7	3.7	6.0	7.4	66.8	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, asset revaluations, performance fees, exceptional items and share-based payments. ¹Including adjustment for mark-to-market valuation of long-term, fixed-rate debt. ²Investment Adviser's DCF.

Further yield compression driving up valuations

The quarterly (Q3) valuation of the portfolio by JLL as at 30 June reflects a net initial yield of 5.50%, down from 5.57% at the end of March and 5.68% at the end of September 2014. This continuing yield compression, resulting from competition for attractively-yielding assets, and some rental growth, generated a Q3 valuation gain of £6.7m. While positive for NAV, yield compression makes it more expensive to acquire assets, largely mitigated by supportive funding conditions. Q3 rent reviews covering rents of £1.7m generated an average 1.73% increase.

Portfolio growth continuing

During Q3, MedicX committed £10.1m to new investment. Of particular note is the first acquisition in Ireland, which followed a period of significant due diligence. The Investment Adviser believes that the market offers an attractive balance of yield and investment quality, and expects further investments. The pipeline of new investment opportunities remains strong at c £100m. A second (£25m) tranche of the £50m private placement of loan notes arranged in May is expected to be drawn in September, while the duration of an existing (£50m) loan note facility has recently been extended to more than 13 years at a slightly increased all-in cost. Across all facilities, the average unexpired term is 15 years at a fixed cost of 4.45%.

Valuation: Attractive portfolio cash yield

The Fund offers an attractive prospective yield of more than 7%. With portfolio growth, we forecast cover to build further, to c 60% in FY15 and c 64% in FY16. The Investment Adviser's Q315 DCF value per share of the Fund's predictable cash flows increased to 94.5p (March 2015: 93.5p), using unchanged assumptions (weighted average discount rate 7.08%).

MedicX Fund is a research client of Edison Investment Research Limited

Continuing asset growth and further valuation gains

MedicX Fund has reported on its net asset value for 30 June 2015 – the end of the third quarter (Q3) of the current fiscal year to 30 September 2015. Full-year results are scheduled for release on 9 December 2015. The Q3 statement also gives a short update on the Fund's progress during the quarter. Previously disclosed asset acquisition and rental growth appear consistent with our forecasts and the only adjustments that we have made to our forecasts are to incorporate the continuing strong valuation gains (stronger in Q3 than we had allowed for during H2 as a whole), and to reduce the negative mark-to-market adjustment on fixed-rate debt in line with the 30 June value. This benefited from higher gilt yields during the quarter. Within the P&L, there is a slight follow-on to forecast property management expense from the higher average asset value.

Exhibit 1: Estimate revisions

	Revenue (£m)			EPS (p)			DPS (p)			Adj. NAVPS (p)			All-in NAVPS (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
09/15e	33.7	33.7	0.0	3.6	3.6	0.0	5.90	5.90	0.0%	68.3	69.7	2.0	63.5	66.4	4.5
0916e	37.2	37.2	0.0	3.7	3.7	0.0	6.00	6.00	0.0%	68.7	70.0	1.9	63.9	66.8	4.5

Source: Company date, Edison Investment Research. Note: *PBT and EPS are normalised, excluding intangible amortisation, asset revaluations, performance fees, exceptional items and share-based payments.

Based on the quarterly valuation of the portfolio by Jones Lang LaSalle LLP at 30 June 2015, Q3 valuation gains were £6.7m. Including the gain of £12.8m reported at the half year, this brings the total gain year to date to £19.5m. The gains are substantially driven by a further decline in the net initial yield used to value the portfolio, to 5.50% at 30 September from 5.57% at 31 March and 5.68% at 30 September 2014. Portfolio properties were valued at £556.0m at 30 June 2015 on the basis that all are complete. We had been assuming a valuation increase of £2.6m for H215 as a whole, based on our estimate of the impact of rental growth and explicitly making no assumption about valuation yields. We have increased the H215 estimate to £8.0m (an additional £1.3m in Q4), reflecting rental growth for the balance of the year, but no further yield changes.

Adjusted NAV (NAV adjusted mainly for deferred taxes and fair value adjustments to reset loans) increased to £255.9m (70.1p per share) from £250.6m (68.8p) at 31 March. The Fund also reports NAV with fixed-rate debt marked-to-market (the fair value of the debt increases as market interest rates decline, increasing the size of the fair value liability on the balance sheet). Gilt yields increased during the quarter (the 20-year gilt yield from 2.29% at 31 March to 2.75% at 30 June) with a positive impact on the mark-to-market value of fixed-rate debt, taking the all-in NAV on this basis to £244.0m (66.8p per share vs 61.5p at 31 March). With no change in the assumptions, the Investment Adviser's DCF valuation increased to £344.9m (94.5p per share) from £340.6m (93.5p) at 31 March.

Average rent increases have continued at a similar pace to the first half of the year. In the financial year to date, 14 leases and rents of £1.7m have been reviewed and the equivalent of a 1.73% per year increase was achieved. Open market reviews (74% of the total) showed an average uplift of 1.21% pa and are yet to show any sign of the acceleration that the Investment Adviser expects over time. This is expected to follow a pick-up in new development schemes, which should set new, higher, rental evidence to reflect underlying increases in building and land costs.

£10.1m was invested in two new forward-funding commitments during the quarter, including a first investment in Ireland. The portfolio now consists of 143 properties (of which nine are under construction) with an annualised rent roll of £34.4m. The pipeline of new investment opportunities remains strong, at c £100m in value when fully developed. Year to date the fund has committed £27.3m to new investment, including £17.2 m in H1. Our forecasts are based on £38m of new investment for the year to 30 September 2015.

Financing activity during the quarter has been focused on optimising the Fund's existing debt. In April, the Fund agreed the issue of £50m of new long-term loan notes to a single investor, maturing in 2028, with no amortisation, at an all-in rate of 3.838%, reducing the average weighted fixed-rate cost of debt. £25m was drawn at issue and a second £25m tranche will be drawn in September. Since June, another previously existing loan note facility (also £50m) has been renegotiated so as to extend the term from an original five years (of which a little over four years was remaining) to 13 years and five months. The all-in interest rate increased from 3.80% to 3.99%, but given the decline in benchmark gilt yields between August 2014, when the note was issued, and the May 2015 renegotiation, this represents an effective interest saving compared with the rate that could have originally been expected on the longer maturity. We estimate that c £0.3m pa has been saved on each of the remaining (more than 13) years, by comparing the notional 15-year gilt yield at the end of August 2014 (c 2.70%) with the equivalent yield at the end of May 2015 (c 2.22%) as provided by Bloomberg. Across all the Fund's facilities, other than the revolving credit facility, the weighted unexpired term is 15 years with an average weighted fixed cost of 4.45%. At H1, the comparables were 14.2 years and 4.52%.

The Fund expects to pay 5.9p in dividends in the current year (FY14: 5.8p), barring unforeseen circumstances. The directors have approved a quarterly dividend of 1.475p per ordinary share for the period 1 April 2015 to 30 June 2015, which will be paid on 30 September 2015 to ordinary shareholders on the register as at 14 August 2015. The ex-dividend date is 13 August 2015. Shareholders elected to take 10.1% of the Q215 dividend (1.475p per share), covering the period 1 January 2015 to 31 March 2015, in scrip.

Exhibit 2: Financial summary

Year end 30 September	£'000s	2013	2014	2015e	2016e
PROFIT & LOSS					
Revenue		25,537	29,488	33,723	37,199
Cost of Sales		(413)	(666)	(845)	(823)
Gross Profit		25,124	28,822	32,878	36,376
EBITDA		20,616	23,664	27,162	30,283
Operating Profit (before GW and except.)		20,616	23,664	27,162	30,283
Intangible Amortisation		0	0	0	0
Revaluation of investment properties		248	11,649	20,477	9,215
Investment advisory performance fee / loss on disposal of property		(240)	(1,888)	0	0
Operating Profit		20,624	33,425	47,639	39,498
Net Interest		(10,959)	(12,989)	(14,149)	(16,621)
Profit Before Tax (norm)		9,657	10,675	13,012	13,661
Profit Before Tax (FRS 3)		9,665	20,436	33,489	22,876
Deferred tax on fair value movements in property values		(299)	(264)	(1,130)	0
Profit After Tax (norm)		9,656	10,675	13,013	13,663
Profit After Tax (FRS 3)		9,366	20,172	32,359	22,876
Average Number of Shares Outstanding (m)		263.4	341.4	356.9	367.2
EPS - normalised (p)		3.7	3.1	3.6	3.7
EPS - FRS 3 (p)		3.6	5.9	9.1	6.2
Dividend per share (p)		5.70	5.80	5.90	6.00
Gross Margin (%)		98.4	97.7	97.5	97.8
EBITDA Margin (%)		80.7	80.2	80.5	81.4
Operating Margin (before GW and except.) (%)		80.7	80.2	80.5	81.4
BALANCE SHEET					
Fixed Assets		426,649	502,906	562,646	651,861
Intangible Assets		0	0	0	0
Tangible Assets		399,502	492,252	536,618	630,833
Properties under construction		27,147	10,654	26,028	21,028
Current Assets		38,067	39,306	31,676	39,881
Stocks		0	0	0	1
Debtors		11,004	8,181	6,676	14,879
Cash		27,063	31,125	25,000	25,000
Current Liabilities		(19,994)	(56,714)	(20,027)	(27,898)
Creditors		(18,865)	(23,866)	(20,027)	(27,898)
Short term borrowings		(1,129)	(32,822)	0	0
Financial derivatives		0	(26)	0	0
Long Term Liabilities		(273,732)	(254,798)	(321,677)	(407,643)
Long term borrowings		(272,615)	(253,485)	(319,449)	(405,415)
Other long term liabilities		(1,117)	(1,313)	(2,228)	(2,228)
Net Assets		170,990	230,700	252,618	256,202
Net Assets excluding goodwill and deferred tax		171,832	231,764	253,367	256,948
NAV/share (p)		62.5	65.4	69.3	69.6
Adjusted NAV per share		63.1	65.8	69.7	70.0
Est. value/share of Fund's long-term fixed rate debt (p)		6.3	-0.5	-3.3	-3.3
NAV/share including benefit of long-term debt (p)		69.4	65.3	66.4	66.8
CASH FLOW					
Operating Cash Flow		18,515	35,578	24,684	29,951
Net Interest		(11,495)	(11,342)	(13,721)	(16,621)
Tax		0	0	0	0
Capex		0	0	0	0
Acquisitions/disposals		(30,428)	(42,161)	(37,938)	(80,000)
Financing		(1,757)	55,577	6,669	0
Dividends		(13,610)	(16,759)	(17,585)	(19,295)
Net Cash Flow		(38,775)	20,893	(37,891)	(85,965)
Opening net debt/(cash)		189,206	246,681	255,182	294,449
HP finance leases initiated		0	0	0	0
Other items (including debt assumed on acquisition)		(18,700)	(29,394)	(1,376)	(0)
Closing net debt/(cash)		246,681	255,182	294,449	380,415

Source: Company data, Edison Investment Research

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