

# MedicX Fund

## More Irish expansion

Q3 NAV update

Continuing yield compression generated additional valuation gains in Q3, while selective acquisitions continue at MedicX. The EU referendum result has no impact on the fundamental drivers of primary care and we doubt that the political will to deliver healthcare reforms will be dented. As a long-term investor in a broad portfolio of modern primary care properties, MedicX Fund has very secure, long-term cash flows to support the c 6.7% progressive dividend yield, while portfolio growth is increasing dividend cover. Lease duration is long and quasi-government backed, while debt is of similar duration with the cost fixed (gearing of 52.3% at 31 March 2016).

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	EPRA NAV/ share (p)	Yield (%)	DCF/share** (p)
09/14	29.5	10.7	3.1	5.80	65.4	6.6	93.4
09/15	33.7	13.5	3.7	5.90	70.8	6.7	94.9
09/16e	35.9	13.6	3.6	5.95	71.9	6.7	95.6
09/17e	39.9	14.8	3.9	6.00	72.3	6.8	-

Note: \*PBT and EPS are normalised, excluding asset revaluations, performance fees and exceptional items. \*\*Investment adviser's DCF value/share. 09/16e DCF value is as last reported at 30 June 2016.

## Portfolio growth and valuation gain in Q316

A further contraction in UK valuation yields during the quarter (to 5.28% at 30 June from 5.36% at the end of March) contributed to a net valuation gain of £7.4m. The unaudited EPRA NAV was £275.1m at the end of the period, or 72.8p per share, up from 71.2p at 31 March and after 1.4875p of dividends. The investment pipeline is strong and selective investment continues, but at a slower pace in the quarter than we had allowed for, leading us to defer some expected investment to FY17. We have slightly increased our NAV estimate as a result of valuation gains and slightly delayed revenue growth as a result of the investment deferral (see Exhibit 1).

## Secure income and growth

The underlying drivers of primary care property demand in both the UK and the Republic of Ireland (RoI) are a combination of demographics, medical advances, the need to upgrade the existing estate and the importance of generating efficiencies in the overall provision of healthcare (for a detailed explanation see our [note](#) of 7 June). With broad political consensus for NHS planning, we see no impact from the Brexit vote. NHS planning should lead to an acceleration of new development opportunities in the UK, while investment in RoI offers attractive additional rental yield premium, with no material tenant covenant weakening.

## Valuation: Secure cash flows support premium to NAV

The security of income that results from long leases and effective full occupancy with strong tenant covenants has been recognised by the market since the EU referendum, with a 7% rise in the share price amid a generally weak broad commercial real estate sector. The price to NAV has increased to 1.24x, but the yield remains highly attractive at 6.7% and we forecast dividend cover to be on an improving trend in FY17 (to c 65%) as assets under construction in RoI complete.

### Real estate

11 August 2016

**Price** 89.32p  
**Market cap** £340m

Net debt (£m) at end FY15	281.4
Shares in issue	381.4m
Free float	100%
Code	MXF
Primary exchange	LSE
Secondary exchange	N/A

### Share price performance



%	1m	3m	12m
Abs	5.1	(1.9)	8.6
Rel (local)	(0.1)	(11.2)	6.9
52-week high/low	91.75p	77.25p	

### Business description

MedicX Fund is a specialist investor in primary care infrastructure. It holds a portfolio of properties let mainly to government-funded (NHS) tenants (87% of rent) and pharmacies on GP surgery sites (8%). It now has three properties under development in the Republic of Ireland, where the lead tenant (60-75%) will be the Health Service Executive (HSE).

### Next event

Year end results	December 2016
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## Continued asset growth and changes to forecasts

MedicX has issued its quarterly NAV update for the nine months ended 30 June 2016. The unaudited EPRA NAV at that date was £275.1m or 72.8p per share compared with £267.2m (71.2p per share) at 31 March 2016. As expected, a quarterly dividend of 1.4875p per share was paid at the end of the quarter.

Investor appetite for existing let properties has remained strong, alongside solid market fundamentals. A shortage of available modern properties and a continuing slow pace of new development approvals have seen yields fall further during the quarter. The quarterly external valuation of MedicX's UK portfolio at 30 June 2016, on the basis that all properties were complete, reflects a net initial yield of 5.28%, down from 5.36% at 31 March. This represents a 1.25% uplift on a like-for-like basis or a net valuation gain of £7.4m. We have adjusted our forecasts for this gain but, as usual, make no assumption about future yield movements, allowing only for the valuation impact of assumed rent growth.

During the first six months of the current financial year (to 31 March), MedicX committed £27.4m to investment in new properties, including the acquisition of six completed and let UK properties, and agreed to forward-fund two other properties, one in the UK and one in RoI. Given the competition for assets and changing primary care environment, MedicX has indicated a selective approach to investment opportunities, with a focus on sustainable, modern, purpose-built development assets in both the UK (where a gradual increase in NHS approvals is expected) and the RoI. There is currently a strong pipeline of c £95m of assets either in solicitors' hands or under negotiation (a narrower, more immediate definition of the opportunity than the £144m quoted at the interim stage). There were no new commitments in the most recent quarter, but in July MedicX committed €8.6m to fund a Primary Care Centre (PCC), its third Irish investment. The portfolio now comprises 152 properties of which seven are under construction, of which six were due to be finished within a year. The annualised rent roll for all the properties is now £37.1m.

After the first half we were forecasting H216 commitments of £33m: £10m in completed UK assets, £10m of development in the UK and £13m of development assets in Ireland. Despite the robust pipeline, we now think it is prudent to reduce this to £23m of commitments in H216, deferring £5m of the reduction to FY17, where our forecast commitments increase from £75m to £80m. We have focused the H216 commitment reduction on completed assets where pricing is particularly competitive, taking this to nil in H216, but increasing it by an additional £5m (to £20m) in FY17.

Following the EU referendum, the broad commercial real estate market has been volatile due to increased uncertainty, and transaction activity has slowed. This appears not to have been the case for transactions in primary care real estate, with management and valuers reporting continued activity with no change in market sentiment and no adverse effect on valuations.

Exhibit 1 summarises the small changes to our estimates. The changes to our investment commitment assumptions have a slight negative effect on revenue, while the yield-driven valuation gain increases EPRA NAV.

### Exhibit 1: Estimate changes

	Revenue (£m)			PBT (£m)			EPS (p)			EPRA NAV/share (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
09/16e	36.1	35.9	(0.5)	13.8	13.6	(1.2)	3.7	3.6	(1.2)	71.1	71.9	2.0
09/17e	40.4	39.9	(1.1)	15.2	14.8	(2.7)	4.0	3.9	(2.7)	71.7	72.3	1.9

Source: Edison Investment Research

**Exhibit 2: Financial summary**

Year end 30 September	£'000s	2013	2014	2015	2016e	2017e
<b>PROFIT &amp; LOSS</b>						
Revenue		25,537	29,488	33,669	35,916	39,946
Cost of Sales		(413)	(666)	(902)	(952)	(980)
Gross Profit		25,124	28,822	32,767	34,964	38,966
EBITDA		20,616	23,664	27,255	29,080	33,099
Operating Profit (before GW and except.)		20,616	23,664	27,255	29,080	33,099
Intangible Amortisation		0	0	0	0	0
Revaluation of investment properties		248	11,649	25,603	13,219	9,467
Performance fee / gains or losses on disposal		(240)	(1,888)	0	31	0
Operating Profit		20,624	33,425	52,858	42,330	42,566
Net Interest		(10,959)	(12,989)	(13,736)	(15,439)	(18,341)
Profit Before Tax (norm)		9,657	10,675	13,519	13,641	14,759
Profit Before Tax (FRS 3)		9,665	20,436	39,122	26,891	24,226
Deferred tax on fair value movements in property values		(299)	(264)	(3,293)	(151)	0
Profit After Tax (norm)		9,656	10,675	13,520	13,643	14,762
Profit After Tax (FRS 3)		9,366	20,172	35,829	26,740	24,226
Average Number of Shares Outstanding (m)		263.4	341.4	361.3	376.2	382.0
EPS - normalised (p)		3.7	3.1	3.7	3.6	3.9
EPS - FRS 3 (p)		3.6	5.9	9.9	7.1	6.3
Dividend per share (p)		5.70	5.80	5.90	5.95	6.00
Dividend cover		63.8%	53.6%	63.3%	61.5%	64.5%
<b>BALANCE SHEET</b>						
Fixed Assets		426,649	502,906	553,479	618,175	712,422
Intangible Assets		0	0	0	0	0
Tangible Assets		399,502	492,252	544,490	607,269	697,422
Properties under construction		27,147	10,654	8,989	10,906	15,000
Current Assets		38,067	39,306	63,688	37,210	38,169
Stocks		0	0	0	0	0
Debtors		11,004	8,181	6,778	7,209	8,167
Cash		27,063	31,125	56,910	30,000	30,000
Current Liabilities		(19,994)	(56,714)	(20,862)	(18,022)	(20,416)
Creditors		(18,865)	(23,866)	(18,966)	(18,022)	(20,416)
Short term borrowings		(1,129)	(32,822)	(1,896)	0	0
Financial derivatives		0	(26)	0	0	0
Long Term Liabilities		(273,732)	(254,798)	(342,208)	(367,529)	(457,836)
Long term borrowings		(272,615)	(253,485)	(336,412)	(361,599)	(451,906)
Other long term liabilities		(1,117)	(1,313)	(5,796)	(5,930)	(5,930)
Net Assets		170,990	230,700	254,097	269,835	272,339
Net Assets excluding goodwill and deferred tax		171,832	231,764	258,428	274,316	276,819
NAV/share (p)		62.2	65.1	69.6	70.7	71.2
EPRA NAV/share (p)		62.5	65.4	70.8	71.9	72.3
Est. value/share of Fund's long-term fixed rate debt (p)		6.3	-0.4	-6.9	-9.5	-9.5
EPRA NNAV/share including benefit of long-term debt (p)		68.5	64.7	62.7	61.2	61.7
<b>CASH FLOW</b>						
Operating Cash Flow		18,515	23,639	23,362	27,325	34,536
Net Interest		(11,495)	(11,342)	(13,210)	(15,288)	(18,341)
Tax		0	0	0	0	0
Capex		0	0	0	0	0
Acquisitions/disposals		(30,428)	(42,161)	(23,316)	(51,022)	(84,780)
Financing		(1,757)	55,577	6,119	10,349	0
Dividends		(13,610)	(16,759)	(19,247)	(21,552)	(21,722)
Net Cash Flow		(38,775)	8,954	(26,292)	(50,189)	(90,307)
Opening net debt/(cash)		189,206	246,681	255,182	281,398	331,599
HP finance leases initiated		0	0	0	0	0
Other items (including debt assumed on acquisition)		(18,700)	(17,455)	76	(12)	0
Closing net debt/(cash)		246,681	255,182	281,398	331,599	421,906

Source: Company accounts, Edison Investment Research

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