

MedicX Fund

A year of solid progress

FY16 results

Real estate

MedicX Fund's (MXF) FY16 results show progress on several key measures including adjusted EPS, EPRA NAV, DPS and dividend cover: EPRA NAV total return for the year was 11.8%. The portfolio was expanded while the cost of debt remained unchanged and its maturity is still closely matched to unexpired lease lengths. A change of the advisory agreement will reduce future incremental fees and the board is examining the benefits of converting the fund to a REIT. We have slightly adjusted our FY17 estimates to take account of better-than-expected performance in FY16 and expected future yield compression, and extended these into FY18.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	Yield (%)	EPRA NAV/ share (p)	DCF/share (p)**
09/15	33.7	13.4	3.7	5.90	6.7	70.8	94.9
09/16	35.5	14.2	3.8	5.95	6.7	73.2	96.6
09/17e	39.4	15.4	3.9	6.00	6.8	73.7	N/A
09/18e	42.7	15.7	3.9	6.05	6.8	74.1	N/A

Note: *PBT and EPS are normalised, excluding deferred taxation, revaluation gains and performance fees. **Investment adviser's DCF value/share.

Disciplined acquisitions

A tightening yield environment (contributing to £15.5m of valuation gains) and the adviser's price discipline in acquiring new assets meant modest portfolio growth although, encouragingly, a cash yield on new commitments of above 6% was achieved. The cost of debt was flat and gearing rose only fractionally to 50.8% vs the board's 50% target, helped by block listing and the issue of treasury shares, which raised £19m during the year. As a result, adjusting for the £1.55m performance fee earned by the adviser, EPS was 3.8p (FY16 EPRA EPS: 3.4p) against 3.7p in FY15; dividend cover on the same basis was 64.0% (FY15: 63.3%).

Market drivers remain positive

Demand for primary care property in the UK and the Republic of Ireland (ROI) is driven by growing and ageing populations, which will need more medical attention outside hospital in future. This trend is causing a greater volume and variety of healthcare needs to be met in a primary care setting. Central government policy and funding in both countries is being applied to improve the provision of primary care, and we expect little impact from the UK's decision to leave the EU. With the tenant covenant in ROI similarly strong to that in the UK and with a healthy pipeline of opportunities, we expect the portfolio of secure income streams to grow further.

Valuation: Security of income supports NAV premium

The combination of long leases, government-backed tenants, full occupancy and consistent demand underpinning the dividend, continues to attract investors. Uncertainty since the EU referendum has contributed to a 13% decline in the EPRA/NAREIT UK Index since 23 June, while MXF's shares have gained c 3% and trade at around a 20% premium to NAV. Even at that premium, the board's indicated prospective dividend of 6p equates to a yield of 6.8% and we forecast that dividend cover will increase to c 65% in FY17.

15 December 2016

Price 88.50p
Market cap £351m

Net debt (£m) at 30 September 2016	315.3
Shares in issue	397.0m
Free float	100%
Code	MXF
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(1.7)	(2.2)	2.9
Rel (local)	(4.2)	(5.5)	(11.2)
52-week high/low	92.00p	80.00p	

Business description

MedicX Fund is a specialist investor in primary care infrastructure in the UK and Republic of Ireland. It holds a portfolio of 147 completed premises let mainly to government-funded tenants (89.2%) and pharmacies (8.6%) on long leases. Its three assets in the Republic of Ireland and another three in the UK are under development.

Next events

Q117 NAV update	February 2017
AGM	February 2017
Interim results	May 2017

Analysts

Julian Roberts	+44 (0)20 3077 5748
Andrew Mitchell	+44 (0)20 3681 2500

financials@edisongroup.com

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Investment summary

MedicX's portfolio of modern, purpose-built primary healthcare assets is let on long leases at effectively zero vacancy with the large majority of rents underpinned by the UK and Irish governments, providing a strong tenant covenant. This secure and growing income stream helps support a high dividend yield as well as historically more stable capital value than some other commercial property sub-sectors. Management continues to increase dividend cover from EPRA earnings (which exclude valuation increases) as well as growing the portfolio by investing in large, modern facilities suited to the changing and increasing demands placed on the primary care sector in the UK and ROI. Debt funding is raised at fixed rates and for durations matching the assets' leases, locking in a spread between property yields and costs of debt. As rents rise (rent reviews are effectively upwards only in the UK) and economies of scale (such as the declining rate of marginal advisory fees) take effect, we expect dividend cover to continue to grow. The fund has a strong pipeline of investment opportunities, broad access to debt funding and has seen high demand for shares from its block listing programme at prices well above EPRA NAV per share.

Valuation: Reliable income and stable capital

MedicX's prospective dividend yield of c 6.8% is the highest among its immediate peers and is over 8% of EPRA NAV per share. Although covered 1.2x by net attributable profit, the exclusion of revaluation gains reduces this to 63.8% in 2016 (ahead of our forecast of 61.5%). Nonetheless, the nature of its income streams gives confidence that the board will maintain a progressive dividend policy and makes the underlying assets attractive, particularly at a time of considerable uncertainty. In line with other listed property investors specialising in long leases, MedicX trades at a premium to EPRA NAV, showing the highest premium as well as paying the highest yield.

Financials: Portfolio growth to build on a steady 2016

Maintaining its disciplined approach to acquisitions, the fund committed less investment in FY16 than we had forecast, therefore increasing rental income less than expected, but also incurring less financing cost. Adjusted EPS was ahead of our forecasts and yield tightening led to revaluation gains, which increased EPRA NAV above our estimates too. These points and changes to our forecasts are dealt with in more detail on page 6. We expect investment to pick up in FY17 as the UK and ROI pipelines complete and as government policies to enhance primary care infrastructure in both countries take effect. This should drive earnings, NAV and dividend cover growth.

Sensitivities: Yields and investment

MedicX's portfolio has a low-risk profile and relatively predictable income. 90% of rents in the UK are government backed, as are c 75% in the ROI. Key sensitivities include:

- MedicX's ability to find and execute new investments, which is supported by a strong existing pipeline, access to the adviser's development arm and agreements with other developers.
- The rate of UK approvals of new developments is expected to rise as regional healthcare estate plans are carried out, unlocking demand and providing new investment opportunities.
- Competition for secure income has squeezed primary care yields in recent years (currently c 5% in the UK and 7.00% in ROI), increasing capital values and the cost of new investment.
- Rent reviews are typically every three years and upwards only in the UK. Most of MedicX's portfolio is subject to open-market reviews with reference to the rent and cost of a new building. More approvals and successful discussions with district valuers in South Eastern England (see page 6) are expected to lead to higher rents for existing assets.

2016 results

FY16 adjusted EPS and EPRA NAV per share were ahead of our estimates at 3.8p and 73.2p respectively (we had forecast 3.6p and 71.9p). The EPRA EPS figure was lower at 3.4p as a result of the performance fee earned by the adviser by virtue of the total shareholder return exceeding 10% per annum since 2009. We have moderately increased our EPS and NAV estimates for FY17 and introduced a FY18 forecast (see page 6). The main points from the results are below:

- Rents receivable of £35.1m were 7.0% ahead of 2015. The annualised rent roll increased from £34.8m to £37.2m. Of this, £2.2m came from newly acquired assets and £0.2m from rental uplifts. The latter increased by 1.2% on average. 89.2% of rents receivable come directly from or are reimbursed by the National Health Service (NHS), Irish general practitioners (GPs) or the Health Service Executive (HSE).
- New committed investments amounting to £35.0m were made in the year at an average cash yield of 6.02%. These included the acquisitions of six modern, operational and fully let premises in the UK for £18m. MedicX also committed £3.0m to fund the development of a property near Swansea due to be completed in January 2017, as well as €16.6m for two primary care centres in the outskirts of Dublin, which are due to be completed in May 2017 and April 2018. The Irish assets are mainly leased to the HSE with GPs and pharmacies also occupying space. The HSE and GP leases are for 25 years on CPI-linked, five-yearly rent reviews. The medical centre in Swansea will be let for 20 years to a GP practice, the NHS and a pharmacist.
- Portfolio valuation increased 10.6% to £612.3m. £43.3m of capital was invested and £15.5m of the increase came from valuation gains.
- The investment pipeline contained c £108m of opportunities as at 7 December.
- Drawn debt of £336.3m at an unchanged all-in average cost of 4.45% has an average unexpired term of 14 years, similar to the weighted average unexpired lease term of 15.5 years. Net gearing of 50.8% remains well within the fund's self-imposed limit of 65% and was slightly ahead of last year's 50.2%.
- The board declared dividends totalling 5.95p per share in respect of FY16, up from 5.9p in FY15. Dividend cover adjusted for the performance fee earned by the adviser and for properties under development rose from 63.3% to 64.0%. Quarterly dividends totalling 6.0p are expected to be paid in respect of FY17.
- The board is considering converting to a real estate investment trust and believes that doing so would be advantageous. A conversion date of 1 October 2017 has been suggested but no final decision has been made to seek shareholder approval.

Company description: Major player in niche sector

MedicX Fund is a leading investor in modern, purpose-built primary care assets with long leases in the UK and the ROI. Its tenants are mainly GPs, the NHS or the HSE, other healthcare providers such as dentists or physiotherapists and associated businesses such as pharmacies. Leases are typically for 25 years with three-yearly upwards-only rent reviews (in the UK) or five-yearly reviews (in the ROI). Funding comes from a combination of equity and debt, the latter being fixed-term and closely matched to the unexpired lease lengths of the portfolio, locking in the spread between the property yield and the debt cost.

The fund's objective is to achieve rising rental income and capital growth, which it seeks to achieve by investing in high-quality assets with long, secure income streams. Assets must be purpose-built

and therefore fit for purpose beyond their existing lease term, and may have potential for enhancement. New investments come from a variety of sources:

- tenders in the open market
- Octopus Healthcare's own development pipeline
- General Practice Investment Corporation (GPI), a leading developer in the sector with which MedicX has a framework agreement
- other developers with which the fund either has an agreement or a working relationship; this is often the case in the ROI, where the fund made its first investment in 2015

Other criteria for investment include that in any financial year at least 80% of rental income will come from the NHS, the HSE and Irish GPs; no more than 20% of assets by value will be in the ROI; and borrowings shall not exceed 75% of the adjusted total assets excluding goodwill. In practice the board does not expect assets in ROI to exceed 15% of the portfolio and targets LTV of 50% with a self-imposed limit of 65% (it was 50.8% at 30 September).

The adviser, Octopus Healthcare, takes a disciplined approach to acquisitions, preferring to adhere to investment criteria focusing on healthcare facilities that are or can become dominant in their catchment areas. It uses a proprietary database and analysis of GP practices, associated services and local demography to identify sites and works with prospective tenants and developers to optimise their design.

The sector

Primary healthcare is a subsector of commercial property characterised by long leases, strong tenant covenants, no speculative development and little volatility in rents and capital values. Here we give a brief overview of the UK and ROI primary healthcare sectors and their corresponding property markets.

In both countries primary care, or general practice, is the foundation of national medical care with GPs being the first point of contact most people have with the health system. As the populations of the UK and ROI age and live longer with more conditions requiring treatment, the burden on those systems is increasing; a trend that is set to continue for decades. The Office for National Statistics forecasts that the UK population will grow 15% from 64.6 million in 2014 to 74.3 million in 2039. At the same time the population over 65 years old is expected rise from 11.4 million to 18.0 million (24.3% of the total population), an increase of 58%. In Ireland the Central Statistics Office has forecast total population growth of 13.4% from 4.6 million to 5.2 million between 2011 and 2031 and for the proportion of over 65s to rise from 11.6% to 19.1%. Not only will larger populations require more care, but the requirement for locally-delivered services such as traditional GP appointments as well as other non-acute ones will too. Both the NHS and the HSE have responded with strategies to deliver more services outside hospitals in local hubs. In the larger and more complex UK healthcare environment, a wider variety of care models will be used, but governments in both countries have recognised the requirement for modern, purpose-built facilities to accommodate services which are fit for purpose. There is broad political commitment to more effective healthcare, and the fund's investment policy is in line with national efforts to modernise and make primary care facilities more efficient and sustainable.

The United Kingdom

Most GP practices remain independent partnerships, although in some cities larger commercial groupings, known as super practices, have emerged. Smaller practices' premises were often converted residential buildings. As more services are being delivered in a primary care setting, converted houses are becoming less and less suitable: a 2014 survey by the British Medical Association (BMA) found that 70% of GPs described their premises as too small to deliver enhanced or additional services; 52% said they had seen no investment or refurbishment for 10

years and a majority said their premises were unsuitable for the delivery of training and education. The NHS does incentivise GPs to enhance their premises by offering payments for additional services they provide and funds for refurbishment or redevelopment. The NHS also reimburses rent and rates for practices providing General Medical Services. The strength of the UK property market in recent years means that as older GPs retire, it is more expensive for their successors to buy the practice premises, and converted houses are not attractive as premises in which to run the practice. As a result, there is a growing requirement for modern, purpose-built premises to accommodate single or multiple practices, as well as other service providers such as dentists and pharmacists. With medical service providers being reimbursed by the NHS for rent, the tenant covenant is effectively with the UK government. Non-NHS-reimbursed rents are typically from associated businesses such as pharmacies which are by default well-situated to trade successfully.

The trend towards more healthcare services being delivered in a primary care setting is backed by NHS England's strategy for healthcare as a whole and general practice in particular: in 2013 the NHS trusts were replaced with clinical commissioning groups (CCGs), led by GPs, with responsibility for delivery of primary care in their regions. CCGs have greater control of NHS budgets and are able to spend any savings they make in one field in others of their choosing. Also in 2013 NHS Property Services was created to manage, maintain and improve the NHS estate, increasing the focus on making it fit for purpose. In 2014 NHS England published its Five-Year Forward View (NHS Review). This confirmed that "the foundation of NHS care will remain list-based primary care" and described plans to deliver more services in that context. It also announced the setting aside of £1bn over five years for enhancing primary care infrastructure. The plans have since been set out in greater detail in the General Practice Forward View (April 2016) and in individual CCGs' sustainability and transformation plans (STPs). The publication of STPs is an important milestone because it brings closer the implementation of policies which have been discussed for several years. This is expected to have two effects:

- More new primary care premises will be approved: now that clear plans exist and budgets have been allocated, the longstanding demographic pressure and political will should translate into action. This would provide more opportunities for MedicX to invest and to add value with its proprietary database and analytical tools to help providers and developers optimise additions to the primary care estate.
- Rents on existing premises may increase: around 75% of MedicX's assets have market review rent uplifts every three years (as opposed to fixed or index-linked ones). In these cases, to ensure that the NHS does not overpay, a reasonable market rent is agreed with the district valuer, with reference to any similar properties in the vicinity. The lack of new, purpose-built surgeries has meant rents have changed little in recent years. More approvals should lead to more high-quality comparable premises with new rental evidence, which may facilitate higher rents.

The Republic of Ireland

The HSE launched a new strategy in 2012, which aims eventually to provide a single-tier primary care service that is free and universal. To date only those under six (with a plan to increase to twelve) and over 70 years old are guaranteed free access, although the aim remains to make this available to all by 2019 (c 464,000 GP visitors' cards have been issued so far and they remain means tested). Currently, the majority of GP services are paid for directly by the patient (or their insurer) and the GPs' costs are not reimbursed by any government agency. This has previously inhibited private investment in primary care.

The new strategy has established a number of state-funded primary care teams responsible for specific geographical areas and made up of a range of service providers including (but not limited to) community and public health nursing, home helps, mental health services, social workers and dental care. They are not currently all co-located, but where this would improve efficiency it is

planned that they will be. To that end the Department of Health is planning the construction of c 90 new primary care centres (PCCs). In each the HSE is, or will be, the anchor tenant with around 75% of the building on a 25-year lease with five-yearly index-linked reviews. The remaining space will be let to GPs, pharmacies and other care providers. At the start of 2016 the HSE had sought expressions of interest for 73 PCCs in addition to the 90 already operating, and expected 15 to be completed in 2016. Irish PCCs tend to be larger than most assets in MedicX's UK portfolio because the HSE requires at least 800sqm per primary care team, before space for GPs and other tenants, and plans to have more than one primary care team per PCC in most cases. As a result, the average PCC is expected to be around 2,300sqm. We note that the tenant mix means the rental covenant will not be as strong as in the UK, where the NHS underpins 90% of rents, but it will still provide secure income streams.

Financials and estimate revisions

Since the publication of FY16 results, which were ahead of our expectations of EPS and EPRA NAV per share, we have raised our FY17 forecasts slightly and also introduced them for FY18.

Management's ability to increase earnings by investing in new assets with a good yield spread above the cost of financing is key to raising dividend cover. In the past, proceeds from major equity issues have taken time to deploy, increasing the quantum of distributions but acting as a cash drag until they have been spent. In September 2016 MedicX established a block listing of c 24m shares which has enabled the fund to manage demand for shares as well as providing a source of funds for investment without creating a cash drag. This and a strong pipeline place MedicX well for further asset growth, which we forecast will increase earnings and dividend cover over the next two years. After lower investment than expected in 2016 we have reduced our assumption for committed investments for 2017 from £80m to £75m and introduced a 2018 forecast assuming that £95m of funds are invested that year. An overview of our new forecasts is in Exhibit 1 below.

Exhibit 1: Changes to estimates and comparison with results

	Revenue (£m)			EPS (p)			DPS (p)			Dividend cover (%)			Adj. NAVPS (p)		
	Old	New	%	Old	New	%	Old	New	%	Old	New	pp chg	Old	New	%
09/16a	35.9	35.5	-1.1%	3.60	3.79	5.2%	5.95	5.95	0.0%	61.5%	63.8%	2.3	71.9	73.2	1.8%
09/17e	39.9	39.4	-1.5%	3.90	3.89	-0.3%	6.00	6.00	0.0%	64.5%	64.4%	-0.1	72.3	73.7	1.9%
09/18e		42.7			3.92			6.05			64.9%			74.1	

Source: Edison Investment Research

Although revenues were below forecasts as a result of lower investment, finance costs were reduced too and careful control of administrative costs meant that adjusted EPS (excluding the performance fee earned) was above our forecast, as was dividend cover and NAV per share. We forecast that marginal administrative costs will continue to fall as the incremental advisory fees diminish and the fund's existing debt is at fixed rates. In the current environment we do not forecast any increase in the cost of debt. We have reduced our assumptions of yields on new commitments from 7% on Irish assets to 6.75% reflecting yield compression trends described by the fund and kept our UK assumption at 5%, below the current portfolio valuation yield of 5.25%. Importantly, we have not reduced our future valuation yield assumption and therefore have not forecast valuation increases other than those driven by rental growth. If we assume a valuation yield compression of five basis points, to 5.2%, our FY17 and FY18 NAV per share estimates rise by 1p each. We therefore expect that the fund will continue to be able to lock in the spread between debt costs and property yields.

Modest future rental growth is assumed at 1.5% in FY17 and FY18. This is above the level seen in FY16 (1.2%) but below 2015 (1.8%) and the 10-year average of c 2%. We note that rental growth by market review may accelerate following a rise in inflation. The latter effect would be magnified if the portfolio continues to have a growing proportion of rents linked to RPI. We also note that the

fund is challenging the rent increases suggested by district valuers in some cases in South East England. In that region especially, management states that recent build costs and rental prices in the wider real estate market have risen in the order of 30% in the last three years, whereas rent increases suggested by district valuers for primary care properties are considerably less than that implied by the level of growth. Although a detailed review process is required, if MedicX Fund succeeds, not only would we expect to see rental increases on existing assets but we would expect a rise in new developments as well.

Exhibit 2: Annualised rental increases by type of review

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Open market	3.00%	1.8%	2.0%	2.2%	1.5%	1.0%	1.0%	1.3%	0.4%	
RPI	3.80%	3.9%	1.4%	2.6%	4.6%	3.4%	3.5%	2.7%	2.1%	1.7%
Fixed uplift		2.5%	2.5%	0.0%	2.5%	2.5%		2.7%	2.7%	2.0%
Average annualised	3.1%	2.4%	2.0%	2.3%	1.9%	1.8%	1.6%	1.9%	1.8%	1.80%

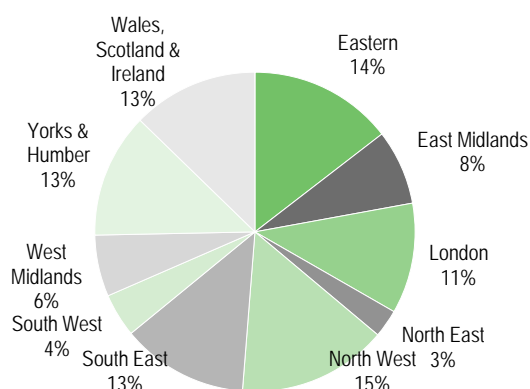
Source: MedicX Fund

MedicX continues to have access to debt finance, with the possibility of extending an existing facility by £10m with lender consent at a margin of 2% over Libor, allowing the fund to react quickly if attractive opportunities arise. Adjusted gearing, as noted earlier, remains close to the target 50% and well within the limit of 65%. We do not forecast any equity issue, but do note that the company has treasury shares and a block listing capacity totalling 21.3m shares. Given the current premium to EPRA NAV at which the shares trade, these are an immediately NAV-accretive potential source of funds for acquisitions. 10.9m block listing shares have been issued in recent weeks at an average price of c 88p, or a 19% premium to 30 September EPRA NAV, increasing balance sheet strength. In FY 2016 a total of £18.96m (net) was raised through the sale of shares out of Treasury and a small amount of block listing prior to the year end.

The portfolio

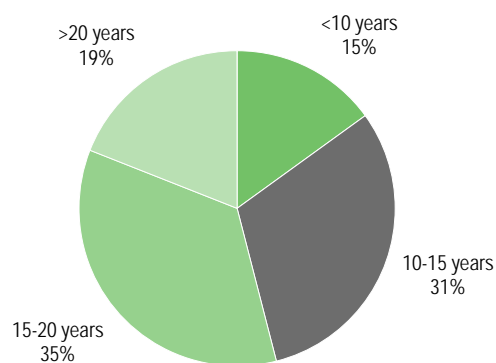
At 30 September MedicX's portfolio comprised 152 properties, with 146 operational and fully let and six were under development, these were valued at £612m after construction costs to complete the development assets and net of purchaser's costs of 6.1%. The portfolio had passing rent of £35.2m at 30 September, for a net initial yield of 5.25%; we note that the Irish development assets have been acquired at yields over 7%. Since the period end the company has contracted to forward-fund another primary healthcare centre in Wales. Three of the six development assets are in the Republic of Ireland. The portfolio is geographically diverse (Exhibit 3) and the largest asset comprises only 2.9% of the portfolio value (down from 3.1% at 30 September 2015). The top 10 assets account for 18.2%, down from 19.6%. The averaged unexpired lease length is 15.5 years.

Exhibit 3: Portfolio distribution by rent region



Source: MedicX Fund

Exhibit 4: Portfolio by lease length to expiry



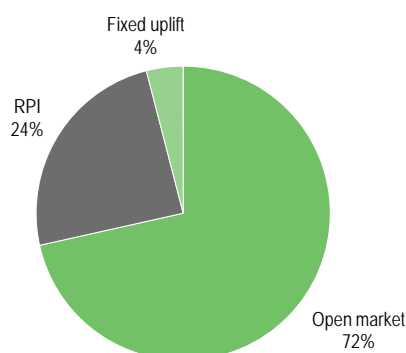
Source: MedicX Fund

Apart from the lease length, yield and method of rent review, significant characteristics of MedicX's healthcare property assets are their future longevity, average size and tenant mix. We examine these in more detail below.

Leases and rent reviews

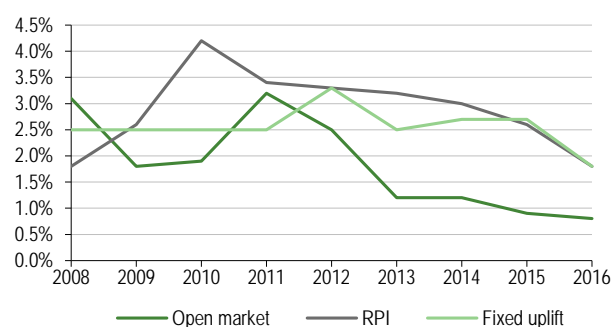
The weighted average unexpired lease term (WAULT) across the fund's portfolio is 15.5 years and combined with the strength of the tenant covenants, provides a secure and predictable income stream comparable to that of a bond. New leases are typically for 20 or 25 years and the majority of rents change by market review although a significant minority (24.5% at 30 September 2016, up from 22.6% a year earlier) are linked to RPI or CPI, including all rents in the ROI. In the UK, rent reviews are triggered by the landlord and can typically be as often as every three years. As a result they are effectively upwards only. Rents in the ROI are reviewed every five years and may fall as well as rise. A smaller number of rents rise on fixed increments throughout the lease term. Exhibit 5 shows the rental portfolio divided by method of rent review. In recent years, rents reviewed by open market comparison have risen less than those assessed using other methods, partly as a result of the slower rate of approvals for new developments, as discussed above. It is possible that an acceleration of primary care construction will help increase rental uplifts.

Exhibit 5: Rental value by type of review



Source: MedicX Fund

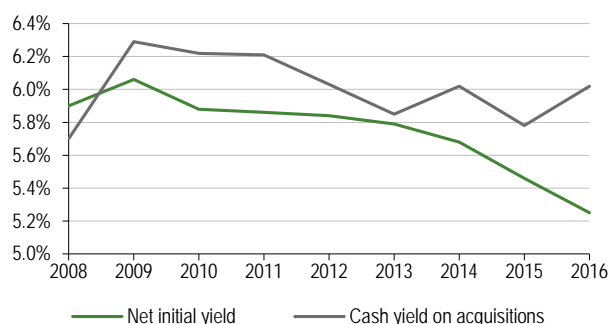
Exhibit 6: Rental uplift by type of review



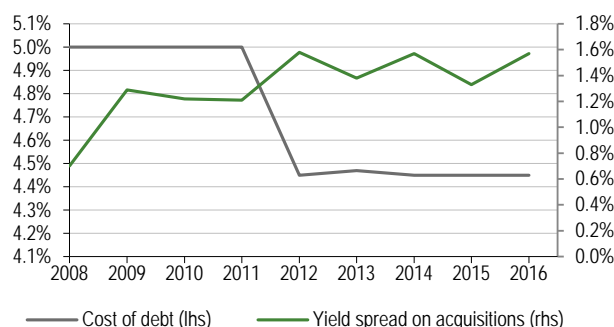
Source: MedicX Fund annual reports.

Yields

In the UK, valuation yields have reduced steadily in recent years (Exhibit 7), driven by demand for income-generating assets from institutional and private investors alike. While this has driven asset values up, it could potentially have made new acquisitions at attractive yields harder to find. MedicX's investment adviser has exercised discipline in only selecting modern, high-quality assets available at net initial yields around 5% in the UK and one of the attractions of the Irish market is that yields there are in excess of 7%. As a result, the adviser has been able to continue to find assets to buy at cash yields above the portfolio average (6.02% in FY16). In combination with the fixed cost of debt (including a drop in the cost in 2012), the spread between the average cost of debt and the cash yield on acquisitions has remained relatively wide, currently at 1.6%.

Exhibit 7: Portfolio net initial yield and acquisition cash yields


Source: MedicX Fund

Exhibit 8: Average cost of debt and the spread over cash yield on new acquisitions


Source: MedicX Fund

Asset age and size

More modern and larger premises are able to accommodate a broader range of services, allowing GPs and other tenants to offer a wider range of care, in line with the future healthcare policies of the UK and ROI. Such assets are therefore in greater demand, command higher rents and will have longer useful lives than older (particularly converted residential) surgeries. Larger premises are particularly suited to the trend in the UK of co-locating more than one GP practice as well as other services. The adviser's proprietary database and analysis of population and medical service distribution in the UK allows the identification of sites which are best placed to optimise the catchment area for particular services; to identify where certain services might find greater demand; and to help design better premises to meet healthcare demands in a particular area. In the UK as a whole, Savills estimated in 2015 that 50% of the primary healthcare estate was over 30 years old and as noted earlier, most GPs surveyed by the BMA in 2014 said their premises were inadequate. MedicX Fund's high-quality portfolio has an average age of eight years, average value of £4m and an average size of 1,410sqm.

Management

The fund has a board of four non-executive directors: John Hearle, Steve Le Page and Shelagh Mason, and a non-executive chairman, David Staples, whose biographies are on page 13. It has been indicated that, after 10 years' service, Mrs Mason will step down in this financial year once a suitable successor has been identified.

The investment adviser, Octopus Healthcare Adviser, was an original part of MedicX Group (now Octopus Healthcare) and has extensive experience in this specialist area of commercial property. The Octopus group also includes an in-house development arm and invests in other areas of healthcare property including secondary and retirement care. The investment adviser is remunerated according to the formulae below, which when implemented effectively froze the investment advisory fee until the portfolio reaches £782m. The formulae cover four types of fees:

- **Investment advisory:** 0.5% on healthcare property assets up to £750m, 0.4% on assets from £750m to £1bn, and 0.3% on assets over £1bn, subject to a minimum fee of £3.878m.
- **Property management:** 3% of gross rental income up to £25m and 1.5% above £25m.
- **Corporate transaction:** 1% of the gross asset value of any property-owning subsidiary company acquired.
- **Performance:** 15% of the amount by which total shareholder return exceeds a compound hurdle rate of 10% from the 69p issue price at 8 April 2009. A high water mark is recorded in

years in which a performance fee is earned and the deficit in any years in which the hurdle is not reached must be recouped in subsequent periods before a performance fee can be earned. A performance fee of £1.553m was earned in FY16 and the current high water mark is 89.6p, being the average share price over the month of September 2016.

Total fees payable to the adviser in FY16 amounted to £6.362m, including £3.852m of advisory fees, £889k for property management and £68k arising on the acquisition of a new subsidiary. Octopus Healthcare Adviser owns c 2.15m shares of the fund.

Sensitivities

As noted above, the key sensitivity is that the fund is able to invest in new assets at favourable yields, which is reflected in its decision to expand its ambit to include the ROI. The investment adviser exercises discipline in selecting new assets, not growing the portfolio for the sake of scale alone. Investor demand for yield-producing assets has helped reduce valuation yields in the UK in recent years, but the adviser has consistently been able to find new investments at cash yields over 5.8% and there is scope for acceleration of rent increases. Other sensitivities include:

- Demographic pressure and policy responses maintaining demand for primary care premises and supporting both new approvals and rental growth.
- If bond yields increase, investor competition for assets may abate. This may also soften property yields.
- Foreign exchange: given that MXF only has three Irish assets so far, this is currently minor and will be effectively partially hedged by borrowing in euros against euro-denominated investments.
- The funding climate has rarely been more favourable. Interest rates are at historic lows and currently MedicX can raise equity funds at considerably above NAV, making any equity-funded investments immediately NAV-accretive while de-gearing the balance sheet.

Valuation

Yield

MedicX's key attraction is its access to sources of secure, long-term income that underpins its dividend payments. The company, barring unforeseen circumstances, expects to pay dividends of 6.0p per share in FY17, 1% above FY16, a yield of 6.8% on the current share price. We expect this to be 64.4% covered by EPRA earnings, the highest level since 2009. Portfolio growth would allow cover to continue to grow, and the use of block listing above NAV to finance acquisitions may allow acceleration of dividend cover growth. The prospective dividend yield is the highest among the peer group of property companies specialising in long-let assets, despite the considerable (c 20%) premium to NAV at which the shares trade. In fact, MedicX has recently had the highest dividend yield on EPRA NAV of the group as well as the highest premium to NAV, implying investor appetite for yield even when this is in part paid from capital. Notably, the three primary care property companies with mainly government-funded income trade on higher premiums than the other three, indicating that the market may place more importance on the tenant covenant than the unexpired lease term of the portfolio, or dividend cover. We note that the shares trade at a discount to the investment adviser's DCF valuation as explained below.

Exhibit 9: Yield and valuation comparison

Company	Yield	NAV yield	Premium to EPRA NAV	WAULT (years)
MedicX	6.8%	8.2%	20.9%	15.5
PHP	4.7%	5.7%	21.7%	14.1
Assura	4.2%	5.1%	21.4%	13.5
Target	5.8%	6.4%	10.8%	28.6
Secure Income	4.4%	4.6%	6.0%	25.0
Tritax	4.8%	4.9%	3.7%	16.3
Average	5.1%	5.8%	14.1%	18.8

Source: Bloomberg, Edison Investment Research. Note: EPRA NAV is as last reported by each company.

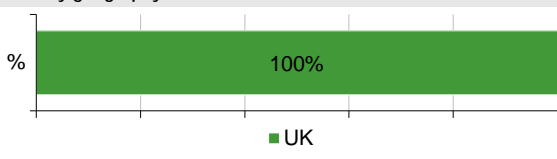
Net asset value and adviser's discounted cash flow

EPRA NAV per share of 73.8p at 30 September as calculated by the company's valuers, JLL, means the shares currently trade at a c 20% premium. The investment adviser also carries out a discounted cash flow valuation of the assets annually using assumptions that are consistent each year: discount rates of 7% for completed and occupied assets, and 8% for developments (a weighted average of 7.06%); an average 2.5% annual increase in rents and residual values based on 1% capital growth from current value to lease expiry. This gives an NAV of 96.6p per share for 2016. The adviser reports that for DCF NAV to match the 30 September share price of 88.75p, it would have to assume separately either a 7.9% discount rate, a 1.1% increase in rents per year or 0.1% capital growth.

Exhibit 10: Financial summary

Year end 30 September	£'000s	2013	2014	2015	2016	2017e	2018e
		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		25,537	29,488	33,669	35,517	39,363	42,702
Cost of Sales		(413)	(666)	(902)	(1,195)	(965)	(1,045)
Gross Profit		25,124	28,822	32,767	34,322	38,398	41,657
EBITDA		20,616	23,664	27,255	28,566	32,456	36,646
Operating Profit (before GW and except.)		20,616	23,664	27,255	28,566	32,456	36,646
Intangible Amortisation		0	0	0	0	0	0
Revaluation of investment properties		248	11,649	25,603	15,523	9,183	9,776
Investment advisory performance fee / loss on disposal of property		(240)	(1,888)	0	(1,522)	0	0
Operating Profit		20,624	33,425	52,858	42,567	41,639	46,422
Net Interest		(10,959)	(12,989)	(13,736)	(14,380)	(17,084)	(20,956)
Profit Before Tax (norm)		9,657	10,675	13,519	14,186	15,372	15,690
Profit Before Tax (FRS 3)		9,665	20,436	39,122	28,187	24,555	25,466
Deferred tax on fair value movements in property values		(299)	(264)	(3,293)	(1,556)	0	0
Profit After Tax (norm)		9,657	10,675	13,519	14,186	15,372	15,690
Profit After Tax (FRS 3)		9,366	20,172	35,829	26,631	24,555	25,466
Average Number of Shares Outstanding (m)		263.4	341.4	361.3	374.5	395.5	400.6
EPS - normalised (p)		3.7	3.1	3.7	3.8	3.9	3.9
EPS - FRS 3 (p)		3.6	5.9	9.9	7.1	6.2	6.4
Dividend per share (p)		5.70	5.80	5.90	5.95	6.00	6.05
Dividend cover		63.8%	53.6%	63.3%	63.8%	64.4%	64.9%
BALANCE SHEET							
Fixed Assets		426,649	502,906	553,479	612,264	699,147	801,423
Intangible Assets		0	0	0	0	0	0
Tangible Assets		399,502	492,252	544,490	597,410	684,147	781,423
Properties under construction		27,147	10,654	8,989	14,854	15,000	20,000
Current Assets		38,067	39,306	63,688	29,487	28,031	28,735
Stocks		0	0	0	0	0	0
Debtors		11,004	8,181	6,778	8,519	8,031	8,735
Cash		27,063	31,125	56,910	20,968	20,000	20,000
Current Liabilities		(19,994)	(56,714)	(20,862)	(21,906)	(20,077)	(21,838)
Creditors		(18,865)	(23,866)	(18,966)	(19,923)	(20,077)	(21,838)
Short term borrowings		(1,129)	(32,822)	(1,896)	(1,983)	0	0
Financial derivatives		0	(26)	0	0	0	0
Long Term Liabilities		(273,732)	(254,798)	(342,208)	(341,684)	(418,630)	(516,143)
Long term borrowings		(272,615)	(253,485)	(336,412)	(334,307)	(411,253)	(508,766)
Other long term liabilities		(1,117)	(1,313)	(5,796)	(7,377)	(7,377)	(7,377)
Net Assets		170,990	230,700	254,097	278,161	288,470	292,178
Net Assets excluding goodwill and deferred tax		171,832	231,764	258,428	284,048	294,357	298,065
NAV/share (p)		62.2	65.1	69.6	71.7	72.2	72.7
EPRA NAV/share (p)		62.5	65.4	70.8	73.2	73.7	74.1
Est. value/share of Fund's long-term fixed rate debt (p)		6.3	(0.4)	(6.9)	(15.2)	(14.8)	(14.7)
EPRA NNNAV/share including benefit of long-term debt (p)		68.5	64.7	62.7	56.4	57.4	57.9
CASH FLOW							
Operating Cash Flow		18,515	23,639	23,362	25,949	33,099	37,702
Net Interest		(11,495)	(11,342)	(13,210)	(14,541)	(17,084)	(20,956)
Tax		0	0	0	0	0	0
Capex		0	0	0	0	0	0
Acquisitions/disposals		(30,428)	(42,161)	(23,316)	(36,281)	(77,700)	(92,500)
Financing		(1,757)	55,577	6,119	12,408	7,822	0
Dividends		(13,610)	(16,759)	(19,247)	(21,582)	(22,067)	(21,759)
Net Cash Flow		(38,775)	8,954	(26,292)	(34,047)	(75,931)	(97,513)
Opening net debt/(cash)		189,206	246,681	255,182	281,398	315,322	391,253
HP finance leases initiated		0	0	0	0	0	0
Other items (including debt assumed on acquisition)		(18,700)	(17,455)	76	123	0	(0)
Closing net debt/(cash)		246,681	255,182	281,398	315,322	391,253	488,766

Source: Company data, Edison Investment Research. Note: 2016 financing shown above of £12.4m includes £6.0m repayment of acquired loans. The company reports 2015 adjusted PBT of £13.431m.

Contact details	Revenue by geography
Regency Court Glatigny Esplanade St Peter Port Guernsey, GY1 1WW +44 (0) 1481 723 450 www.medicxfund.com	 <p>100% ■ UK</p>
Management team	
Non-executive chairman: David Staples Mr Staples is a Fellow Chartered Accountant and Chartered Tax Adviser. He was a partner at PwC for 13 years, running that company's tax practice in South-East England. He is a non-executive director of five other listed companies, HSBC Private Bank and certain private equity funds run by Apax Partners. He is resident in Guernsey.	Non-executive director: John Hearle Mr Hearle is a Fellow of the Royal Institution of Chartered Surveyors and a member of the Chartered Institute of Arbitrators. Until October 2015 he ran the healthcare division of Aitchison Raffety and was group chairman. He runs a company called Medical Premises Consultants, which continues to do work for Aitchison Raffety. He has previously worked for the District Valuer's Office, and TSB Property Services. He is resident in the UK.
Non-executive director: Shelagh Mason Mrs Mason is a solicitor with 30 years' experience in commercial property. She is a consultant to Collas Crill and was previously a partner in Spicer and Partners, Edge and Ellison. She is a non-executive director of the Renewables Infrastructure Group, listed on the London Stock Exchange, and of the Channel Islands Property Fund, listed in the Channel Islands. She holds several other non-executive positions. She is resident in Guernsey.	Non-executive director: Steve Le Page Mr Le Page is a Chartered Accountant and Chartered Tax Adviser, having been a partner at PwC from 1994 until 2013. He is a non-executive director of two listed funds. He is resident in Guernsey.
Principal shareholders	(%)
Investec Wealth & Investment Limited	8.8
Architas Multi-Manager Limited	8.7
CCLA Investment Management Limited	8.4
Brewin Dolphin Securities	6.7
East Riding of Yorkshire Council	4.6
Premier Fund Managers Limited	3.7
Companies named in this report	
Assura Group (AGR), Primary Health Properties (PHP), Secure Income REIT (SIR), Target Healthcare REIT (THRL), Tritax Big Box (BBOX).	

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