

MedicX Fund

Trading update

Q1 NAV update shows strong valuation gains

The 7.0% prospective yield on MedicX shares is supported by secure cash flows on a broad portfolio of modern primary care properties, on long leases, with quasi-government backing. Existing debt is fixed at c 4.5%, with similarly long duration, and the Fund is negotiating new debt on recently improved terms. Growth prospects for the primary care sector are strong and the spread over funding costs remains attractive despite some yield compression, making acquisitions more expensive, but also driving valuation gains (£9.1m in Q115 alone). Q1 asset and rent growth are consistent with our expectations and the pipeline of new investment opportunities remains strong.

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	6.7	69.4	97.0
09/14	29.5	10.7	3.1	5.8	6.9	65.3	93.4
09/15e	33.4	12.7	3.5	5.9	7.0	61.4	N/A
09/16e	37.6	13.9	3.8	6.0	7.1	61.9	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.

Portfolio growth continuing

MedicX committed £11.8m to new investment in the three months to 31 December, and £5.5m since. Four new forward funding commitments have taken the current portfolio to 141 properties, including nine under construction. The pipeline of new investment opportunities remains strong at c £90m, little changed from the c £100m reported in September 2014. Ahead of the general election, new development approvals remain sluggish, but the NHS is centre stage, with both main parties agreed on the central role of the GP. The NHS five-year plan acknowledges the need for significant change and seeks to deliver additional and more integrated services in the community, with extended opening hours to improve access.

Yield compression deriving up valuations

Q115 valuation gains of £9.1m reflect yield compression from competition for attractively yielding assets, and some rental growth. While this is a positive indicator for NAV, it does make it more expensive to acquire assets. Fortunately funding conditions are similarly positive, and a healthy spread between income and funding costs has been maintained. Q1 open-market reviews (76% of the total portfolio) were up 1.79%, an apparent increase from 1.2% on average for FY14 as a whole, although still behind RPI-linked rent increases (2.82% on average).

Valuation: Attractive portfolio cash yield

The Fund indicates 5.9p in FY15 dividends, barring unforeseen circumstances, a prospective yield of 7.0%. With portfolio growth, we forecast cover to build further, to c 60% in FY15 and c 64% in FY16. The investment adviser's Q115 DCF value per share of the Fund's predictable cash flows remains at 93.4p, unchanged on FY14.

Real estate

20 February 2015

Price 84.50p
Market cap £305m

Net debt (£m) as at 30 September 2014	255.2
Shares in issue	361.4m
Free float	100%
Code	MXF
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.5	0.9	7.6
Rel (local)	(3.1)	(2.9)	5.8
52-week high/low	85.75p	77.50p	

Business description

MedicX Fund is a specialist investor in primary care infrastructure. It holds a portfolio of 141 properties (including those under construction), let mainly to government-funded (NHS) tenants (90%) and pharmacies on GP surgery sites (8%).

Next events

Q2 ex-dividend	14 May 2015
Interim results	22 May 2015

Analyst

Martyn King +44 (0)20 3077 5745

financials@edisongroup.com

[Edison profile page](#)

Q1 as expected, but enhanced by valuation gains

MedicX Fund has reported on its net asset value for 31 December 2014, the end of the first quarter of the current fiscal year to 30 September 2015. It has also given a short update on the Fund's progress during the quarter. Asset acquisition and rental growth appear consistent with our forecasts and we have only adjusted our forecast for the continuing strong valuation gains (stronger than we had allowed for). There is a slight follow-on to property management expense from the higher average asset value. Our PBT and EPS estimates (which exclude revaluation gains) reflect this, as well as recent sales of treasury shares (as described below). Our EPS forecasts decline fractionally due to the higher share count. Adjusted NAV per share is forecast slightly higher as valuation gains offset the additional number of shares. All-in NAV per share, which includes the mark-to-market impact of fixed-rate debt to fair value, declines (as explained below), as a result of a further decline in market rates that has affected the current fair value of fixed-rate debt.

Exhibit 1: Estimate revisions

	Revenue (£m)			PBT (£m)*			EPS (p)*			DPS (p)			Adj. NAV/share (p)			All-in NAV/share (p)		
	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change	Old	New	% change
09/15e	33.4	33.4	0.0%	12.8	12.7	-0.4%	3.58	3.52	-1.7%	5.9	5.9	0.0%	66.1	67.5	2.2%	65.7	61.4	-6.5%
09/16e	37.6	37.6	0.0%	13.9	13.9	-0.1%	3.82	3.78	-0.9%	6.0	6.0	0.0%	66.5	68.0	2.1%	66.1	61.9	-6.4%

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.

Property valuation gains in the quarter were £9.1m (full year FY14 was £11.6m, of which £6.8m was reported in H2), substantially driven by a further decline in the net initial yield applied by the external valuers, Jones Lang LaSalle LLP. Portfolio properties were valued at £542m at 31 December 2014 (30 September 2014: £517.1m) on the basis that all properties are complete, using an initial yield of 5.59% (30 September 2014: 5.68%). We had been assuming a valuation increase of £8.4m for FY15 as a whole (FY16: £8.8m) based on our estimate of the impact of rental growth and explicitly making no assumption about valuation yields. We have increased the FY15 estimate to £13.8m, reflecting rental growth for the balance of the year, but no further yield changes.

The Investment Adviser indicated the possibility of further yield compression driven valuation gains when reporting the FY14 results, describing market conditions as "very warm". Given still attractive yields, institutional interest (particularly for larger properties, valued at £10m or more) has been strengthening against the backdrop of still muted new development.

Valuation gains are positive for NAV, but yield compression is making it more expensive to acquire assets and income while maintaining a disciplined investment strategy.

Adjusted NAV (NAV adjusted mainly for deferred taxes and fair value adjustments to reset loans) was up from £233.1m at 30 September 2014 (65.8p per share) to £243.6m (68.0p per share). 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). On this basis, NAV declined to £221.3m (61.8p per share) from £231.6m (65.3p) at 30 September 2014. It is worth noting that the Fund has the option of holding this debt to maturity, when the nominal value (and not the currently higher fair value) is repayable, while the decrease in rates also provides an opportunity to take out new, low-cost debt facilities, about which it is in discussion with lenders. The Investment Adviser's DCF valuation was unchanged in per share terms during the quarter (at 93.4p per share) on unchanged assumptions; there was a small increase in nominal terms (from £331.1m to £334.3m).

13 leases were reviewed in the quarter (rents of £1.6m), generating an average uplift of 2.08% (full year 2014 was 1.8%). RPI-linked rents continue to show the largest gains (2.82%) compared with open-market reviews (76% of the total, and up 1.79% on average in the quarter, an apparent increase from 1.2% on average for FY14 as a whole).

With the FY14 results, the Investment Adviser expressed comfort with the current mix of open-market versus RPI/fixed-level rents in the portfolio, believing an acceleration in the former to be likely. Open-market rent increases have trailed RPI increases for a number of years, which more recently seems to reflect the subdued level of newly approved construction projects post NHS reform. This has provided little precedent for a general uplift in market rents. As the new NHS Property Services procurement system is bedded down, supported by pledges of additional funding for primary care new development, there should be more available evidence of the rent levels required to stimulate private investment, reflecting material recent building and land cost inflation.

£11.8m was invested in two new forward funding commitments during the quarter, and £5.5m has been committed to two further properties since. The portfolio now consists of 141 properties (of which nine are under construction) with an annualised rent roll of £33.8m. The pipeline of new investment opportunities remains strong, at £90m in value when fully developed, little changed from the £100m reported in September. For now we will leave our full year estimate of £45m in new portfolio investment unchanged.

Financing activity during the quarter was modest. The second and final drawdown (£35m) of the £50m private placement of five-year loan notes at a fixed 3.8% went ahead as previously disclosed. This allowed the repayment of the GE Capital loan (£31.2m) that was due in April 2015, while making only temporary use of the £25m revolving loan facility that has now been repaid and provides headroom for further investment.

Early in the FY14 financial year, MedicX raised £48.75m gross (£47.6m net) in additional equity by issuing 85m new shares at a price of 75p. 20m of the shares were immediately repurchased for treasury, to be reissued to satisfy investor demand, including scrip dividend. By the end of FY14, 10.5m treasury shares had been reissued for cash, and the tap issue has now been completed, with all shares issued at a premium to NAV. The staggered reissue of shares as investments was made to limit the dilutive effects of the equity issuance. On 18 February 2015, 32.8m new ordinary shares were similarly issued and immediately repurchased at the issue price of 83.5p, to be held in treasury. Our forecasts allow for these shares to be used to satisfy scrip dividend demand at an estimated 12% of dividends. On this basis, 27.3m shares will remain available between now and the end of 2016 to be sold into the market in an efficient and cost-effective manner.

Shareholders elected to take 11.6% of the Q414 dividend (1.45p per share) in scrip, paid on 31 December. The Fund expects to pay 5.9p in dividends in respect of the current year (FY14: 5.8p), barring unforeseen circumstances. A Q114 dividend of 1.475p per share has been approved for payment in 31 March 2015.

Exhibit 2: Financial summary

Year end 30 September	£'000s	2013	2014	2015e	2016e
PROFIT & LOSS					
Revenue		25,537	29,488	33,388	37,646
Cost of Sales		(413)	(666)	(714)	(801)
Gross Profit		25,124	28,822	32,674	36,845
EBITDA		20,616	23,664	27,032	30,658
Operating Profit (before GW and except.)		20,616	23,664	27,032	30,658
Intangible Amortisation		0	0	0	0
Revaluation of investment properties		248	11,649	13,790	8,897
Investment advisory performance fee / loss on disposal of property		(240)	(1,888)	0	0
Operating Profit		20,624	33,425	40,822	39,555
Net Interest		(10,959)	(12,989)	(14,291)	(16,766)
Profit Before Tax (norm)		9,657	10,675	12,741	13,892
Profit Before Tax (FRS 3)		9,665	20,436	26,531	22,789
Deferred tax on fair value movements in property values		(161)	(264)	0	0
Profit After Tax (norm)		9,656	10,675	12,742	13,894
Profit After Tax (FRS 3)		9,504	20,172	26,531	22,789
Average Number of Shares Outstanding (m)		263.4	341.4	360.9	365.1
EPS - normalised (p)		3.7	3.1	3.5	3.8
EPS - normalised fully diluted (p)		3.7	3.1	3.5	3.8
EPS - FRS 3 (p)		3.6	5.9	7.4	6.2
Dividend per share (p)		5.70	5.80	5.90	6.00
Gross Margin (%)		98.4	97.7	97.9	97.9
EBITDA Margin (%)		80.7	80.2	81.0	81.4
Operating Margin (before GW and except.) (%)		80.7	80.2	81.0	81.4
BALANCE SHEET					
Fixed Assets		426,649	502,906	561,696	650,593
Intangible Assets		0	0	0	0
Tangible Assets		399,502	492,252	541,042	629,939
Properties under construction		27,147	10,654	20,654	20,654
Current Assets		38,067	39,306	41,686	43,178
Stocks		0	0	0	1
Debtors		11,004	8,181	11,686	13,176
Cash		27,063	31,125	30,000	30,000
Current Liabilities		(19,994)	(56,688)	(26,241)	(29,433)
Creditors		(18,865)	(23,866)	(25,041)	(28,234)
Short term borrowings		(1,129)	(32,822)	(1,200)	(1,199)
Long Term Liabilities		(273,732)	(254,798)	(333,788)	(417,382)
Long term borrowings		(272,615)	(253,485)	(332,475)	(416,069)
Other long term liabilities		(1,117)	(1,313)	(1,313)	(1,313)
Net Assets		170,990	230,726	243,353	246,957
Net Assets excluding goodwill and deferred tax		171,832	231,764	244,339	247,940
NAV/share (p)		62.5	65.4	67.2	67.6
Adjusted NAV per share		63.1	65.8	67.5	68.0
Est. value/share of Fund's long-term fixed rate debt (p)		6.3	-0.5	-6.1	-6.1
NAV/share including benefit of long-term debt (p)		69.4	65.3	61.4	61.9
CASH FLOW					
Operating Cash Flow		18,515	23,639	24,702	32,361
Net Interest		(11,495)	(11,342)	(14,291)	(16,766)
Tax		0	0	0	0
Capex		0	0	0	0
Acquisitions/disposals		(30,428)	(42,161)	(45,000)	(80,000)
Financing		(1,757)	55,577	4,697	0
Dividends		(13,610)	(16,759)	(18,601)	(19,188)
Net Cash Flow		(38,775)	8,954	(48,493)	(83,593)
Opening net debt/(cash)		189,206	246,681	255,182	303,675
HP finance leases initiated		0	0	0	0
Other items (including debt assumed on acquisition)		(18,700)	(17,455)	(0)	(0)
Closing net debt/(cash)		246,681	255,182	303,675	387,268

Source: Company data, Edison Investment Research

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