

Impact Healthcare REIT

Portfolio investment

Attractive growing income, innovatively funded

Impact Healthcare REIT (IHR) has invested £56m, on an accretive basis, in a portfolio of six quality care homes, to be operated by existing tenant Welford Healthcare. The transaction is innovatively funded by a blend of new equity issued to the vendors, attractively priced at the last published NAV, and cash/newly hedged debt, managing near-term interest rate risks.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NTA/share (p)	DPS (p)	P/NAV (x)**	Yield (%)**
12/20	30.8	23.1	7.3	109.6	6.29	0.96	6.0
12/21	36.4	27.4	8.1	112.4	6.41	0.94	6.1
12/22e	41.6	31.5	8.2	115.7	6.54	0.91	6.2
12/23e	49.2	32.9	8.1	115.5	6.76	0.91	6.4

Note: *EPRA earnings exclude fair value movements on properties and interest rate derivatives. **P/NAV and yield are based on the current share price.

No equity dilution and additional funding capacity

Full details of the investment can be found on the company's [website](#). The portfolio comprises more than 400 beds, mostly with en-suite bathrooms, EPC ratings for the homes are good, and each has an established track record of delivering strong operational performance. Of the £56m consideration, £44.8m (or 80%) is in cash with the balance in new shares issued to the vendors and priced at 116.62p per share, the Q322 NAV, a significant premium to the current price. The debt drawn to fund the cash element has been hedged through a new £50m interest rate cap at a cost of £1.5m, which caps SONIA at 3.0% for two years. The group has now hedged the interest rates on 80% (£150m) of its current drawn debt of £187m with a gross LTV after this transaction of 27.6%. A further £54m of undrawn debt facilities remain available.

Immediately income generating and accretive

In line with similar recent transactions, IHR's investment is initially funded by way of a loan to Welford, enabling it to take immediate operational control of the homes, avoiding a potentially lengthy transition period while regulatory approvals are sought. Once these approvals are received, IHR has the option to acquire the property assets, and we expect it will do so. IHR receives interest at 8.4% on the loan, generating immediate income, and has pre-agreed a new 35-year lease with Welford, assuming it acquires the properties. The agreed initial rent is £3.9m, subject to annual Retail Price Index reviews (capped and collared), reflecting a gross initial yield of 7.0%. On page 2 we provide an analysis of the estimated immediate accretion to earnings and the prospects for this to increase over time.

No changes to forecasts ahead of Q422 update

We will review our [forecasts](#) following the Q422 trading update later in January, which we expect to include a new FY23 DPS target. We anticipate this to be consistent with IHR's clear and progressive policy, which seeks dividend growth in line with the inflation-linked rental uplifts received in the preceding financial year. Market expectations remain for a softening of property yields across all real estate sectors as interest rates rise, at least in part reflected in the current share price.

Real estate

13 January 2023

Price 105.2p
Market cap £436m

Gross debt (£m) at 30 September 2022	130.6
Gross LTV at 30 September 2022	21.4%
Shares in issue including 9.6m shares newly listed	414.4m
Free float	90%
Code	IHR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	3.3	14.1	(10.1)
Rel (local)	(1.4)	(0.7)	(10.0)
52-week high/low		127.0p	92.2p

Business description

Impact Healthcare REIT, traded on the Main Market of the London Stock Exchange, invests in a diversified portfolio of UK healthcare assets, primarily residential and nursing care homes, let on long leases to high-quality operators. It aims to provide shareholders with attractive and sustainable returns, primarily in the form of dividends, underpinned by structural growth in demand for care.

Next events

Q422 trading update	Exp. late January 2023
---------------------	------------------------

Analyst

Martyn King +44 (0)20 3077 5700

financials@edisongroup.com

[Edison profile page](#)

Impact Healthcare REIT is a research client of Edison Investment Research Limited

Analysis of estimated accretion to earnings from day 1

The portfolio investment is significant, at £56m compared with a Q322 portfolio total value of £543m. Importantly, we expect a positive net earnings impact on day 1 and for this contribution to increase for as long as RPI-indexed rental growth exceeds any rise in debt funding costs. In Exhibit 1, we show this effect for the first two years, during which the debt funding costs are known with certainty. Based on the increased number of shares in issue and assuming 4% pa rental growth (in line with the RPI cap), we expect a 0.2p enhancement to adjusted EPS in the first year and for this enhancement to increase to 0.3p in the second year. Assuming no change in borrowing costs after expiry of the SONIA cap, and continued 4% pa rental growth, the total enhancement would be 0.4p at the end of the fifth year. While borrowing costs may increase beyond the period covered by the SONIA cap, it is also possible they may fall. The three-month SONIA curve is currently indicating less than 4% pa for early 2025 which, including the 200bp loan margin, would represent an all-in-cost of less than 6% pa compared with the 6.5% pa we expect for the next two years.

Exhibit 1: Estimated accretion to earnings over the first two years

	Year 1	Year 2
Debt drawn to fund cash consideration (£m)	44.8	44.8
Loan margin	2.0%	2.0%
Capped SONIA rate	3.0%	3.0%
Amortisation of cap fee	1.5%	1.5%
Total cost of drawn debt	6.5%	6.5%
Additional debt cost (£m)	(2.9)	(2.9)
Annualised rent income (£m)	3.9	4.1
Indexation		4%
Annualised rental income net of finance costs (£m)	1.0	1.1
Existing number of shares (m)	404.8	404.8
Vendor shares issued (m)	9.6	9.6
Enlarged number of shares (m)	414.4	414.4
Additional rental income less finance costs per share (p)	0.24	0.28

Source: Edison Investment Research

Exhibit 2: Financial summary

Year to 31 December (£m)	2017	2018	2019	2020	2021	2022e	2023e
INCOME STATEMENT							
Cash rental income	9.5	13.9	19.1	25.9	30.5	36.0	42.8
Rental income arising from recognising rental premiums, fixed rent uplifts & lease incentives	(0.1)	3.4	4.9	4.9	5.9	5.6	6.5
Net rental income	9.4	17.3	24.0	30.8	36.4	41.6	49.2
Administrative & other expenses	(2.3)	(4.3)	(4.6)	(5.3)	(5.8)	(6.6)	(7.0)
Realised gain on disposal	0.0	0.0	0.0	0.2	0.3	0.0	0.0
Operating profit before change in fair value of investment properties	7.1	13.0	19.4	25.7	30.9	34.9	42.3
Unrealised change in fair value of investment properties	2.4	4.1	9.1	5.6	4.2	7.1	(6.5)
Operating profit	9.5	17.2	28.5	31.3	35.2	42.0	35.8
Loan related interest	0.0	0.0	0.0	0.0	0.1	2.6	0.0
Other net finance cost	0.0	(0.7)	(2.1)	(2.5)	(3.3)	(5.9)	(9.4)
Profit before taxation	9.5	16.5	26.3	28.8	32.0	38.8	26.4
Tax	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0
Profit for the year (IFRS)	9.5	16.5	26.3	28.8	32.0	38.8	26.4
Adjust for:							
Change in fair value of investment properties	(2.4)	(4.1)	(9.1)	(5.6)	(4.2)	(7.1)	6.5
Gain on disposal	0.0	0.0	0.0	(0.2)	(0.3)	0.0	0.0
Change in fair value of interest rate derivatives	0.0	0.1	0.4	0.1	(0.1)	(0.2)	0.0
EPRA earnings	7.1	12.4	17.6	23.1	27.4	31.5	32.9
Rental income arising from recognising rental premiums & fixed rent uplifts	0.1	(3.4)	(4.9)	(4.9)	(6.0)	(5.6)	(6.5)
Amortisation of loan arrangement fees	0.0	0.2	0.4	0.7	1.0	1.2	1.2
Amortisation of lease incentive					0.1	0.0	0.0
Non-recurring costs	0.0	0.7	0.2	0.0	0.0	0.0	0.0
Gain on disposal	0.0	0.0	0.0	0.2	0.3	0.0	0.0
Adjusted earnings	7.1	9.9	13.4	19.1	22.7	27.0	27.6
Average number of shares in issue (m)	162.6	192.2	254.0	319.0	339.8	385.5	404.8
Basic & diluted IFRS EPS (p)	5.82	8.57	10.37	9.02	9.41	10.06	6.53
EPRA EPS (p)	4.35	6.47	6.95	7.25	8.05	8.16	8.12
Adjusted EPS (p)	4.39	5.17	5.26	5.98	6.68	7.01	6.82
Dividend per share (declared)	4.50	6.00	6.17	6.29	6.41	6.54	6.76
EPRA earnings dividend cover	97%	108%	113%	115%	126%	125%	120%
Adjusted earnings dividend cover	98%	86%	85%	95%	104%	107%	101%
NAV total return	5.9%	8.5%	9.5%	8.5%	8.4%	8.7%	5.6%
BALANCE SHEET							
Investment properties	156.2	220.5	310.5	405.7	437.6	581.3	586.9
Other non-current assets	1.7	5.7	10.1	15.9	62.0	30.3	36.7
Non-current assets	157.9	226.2	320.7	421.6	499.7	611.6	623.6
Cash and equivalents	38.4	1.5	47.8	8.0	13.3	13.1	2.4
Other current assets	0.1	0.6	0.6	0.1	1.6	1.8	1.8
Current assets	38.5	2.1	48.3	8.1	14.8	14.9	4.3
Borrowings	0.0	(24.7)	(23.5)	(74.2)	(110.9)	(148.8)	(150.0)
Other non-current liabilities	(1.7)	(1.9)	(1.8)	(2.8)	(2.6)	(2.6)	(2.6)
Non-current liabilities	(1.7)	(26.6)	(25.2)	(77.0)	(113.5)	(151.4)	(152.6)
Borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other current liabilities	(1.2)	(3.3)	(3.1)	(3.1)	(6.7)	(6.6)	(7.5)
Current Liabilities	(1.2)	(3.3)	(3.1)	(3.1)	(6.7)	(6.6)	(7.5)
Net assets	193.5	198.3	340.7	349.5	394.2	468.5	467.8
Adjust for derivative financial liability/(asset)	0.0	(0.5)	(0.1)	(0.0)	(0.1)	(0.3)	(0.3)
EPRA net tangible assets (NTA)	193.5	197.9	340.6	349.5	394.2	468.2	467.5
Period end shares (m)	192.2	192.2	319.0	319.0	350.6	404.8	404.8
IFRS NAV per ordinary share	100.6	103.2	106.8	109.6	112.4	115.8	115.6
EPRA net tangible assets (NTA) per share	100.6	102.9	106.8	109.6	112.4	115.7	115.5
CASH FLOW							
Net cash flow from operating activities	8.2	10.0	14.9	21.0	23.6	24.8	36.7
Purchase of investment properties (including acquisition costs)	(153.3)	(55.1)	(73.4)	(88.5)	(28.1)	(125.0)	(8.0)
Capital improvements	(0.5)	(3.9)	(8.2)	(1.7)	(1.1)	(6.7)	(4.0)
Other cash flow from investing activities	0.0	0.0	0.1	0.9	(35.9)	39.6	0.0
Net cash flow from investing activities	(153.8)	(58.9)	(81.5)	(89.3)	(65.1)	(92.1)	(12.0)
Issue of ordinary share capital (net of expenses)	189.3	(0.1)	132.2	0.0	34.6	60.9	0.0
(Repayment)/drawdown of loans	0.0	26.0	(0.9)	51.2	38.2	37.1	0.0
Dividends paid	(5.3)	(11.6)	(16.1)	(20.0)	(21.9)	(25.4)	(27.1)
Other cash flow from financing activities	0.0	(2.3)	(2.2)	(2.8)	(4.1)	(5.4)	(8.2)
Net cash flow from financing activities	184.0	12.0	112.9	28.5	46.8	67.1	(35.4)
Net change in cash and equivalents	38.4	(36.9)	46.3	(39.8)	5.3	(0.2)	(10.6)
Opening cash and equivalents	0.0	38.4	1.5	47.8	8.0	13.3	13.1
Closing cash and equivalents	38.4	1.5	47.8	8.0	13.3	13.1	2.4
Balance sheet debt	0.0	(24.7)	(23.5)	(74.2)	(110.9)	(148.8)	(150.0)
Unamortised loan arrangement costs	0.0	(1.3)	(1.7)	(2.2)	(3.6)	(2.8)	(1.6)
Net cash/(debt)	38.4	(24.5)	22.7	(68.4)	(101.3)	(138.5)	(149.2)
Gross LTV (net debt as % gross assets)	0.0%	11.4%	6.8%	17.8%	22.3%	24.2%	24.1%

Source: Impact Healthcare REIT historical data, Edison Investment Research forecasts

General disclaimer and copyright

This report has been commissioned by Impact Healthcare REIT and prepared and issued by Edison, in consideration of a fee payable by Impact Healthcare REIT. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Copyright: Copyright 2023 Edison Investment Research Limited (Edison).

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia