EDISON

Impact Healthcare REIT

On track to meet dividend target

Trading update

Real estate

Impact Healthcare REIT's Q323 total return was 2.6%, or 8.5% over the first nine months of the year (9M23). With rent cover continuing to strengthen, rent collection back to 100% and 98% of drawn debt fixed or hedged, the company is well on track to meet its FY23 DPS target of 6.77p (+3.5%), fully covered by adjusted 'cash' earnings, with a yield of 8.6%.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NTA/ share (p)	DPS (p)	P/NAV (x)**	Yield (%)**
12/22	45.4	30.8	8.4	110.1	6.54	0.72	8.3
12/23e	53.4	33.9	8.2	114.5	6.77	0.69	8.6
12/24e	56.2	34.6	8.3	118.9	6.96	0.66	8.8
12/25e	59.4	38.4	9.3	123.9	7.10	0.64	9.0

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

100% of rents due collected in Q3

The Q323 total return comprised a 1.1% increase in EPRA NTA per share to 114.38p and a quarterly dividend of 1.6925p. The main driver of NTA growth was a 1.3% like-for-like increase in property valuation and some slight yield tightening in certain assets with consistently strong rent cover. Completed rent reviews were at an average uplift of 4.69% per year and added £0.3m to contracted rent (£48.4m). 100% of Q3 rents due were received, as was consistently the case until the beginning of the year, when one of Impact's 13 care home tenants (Silverline) ceased payment. The seven homes that were previously leased to Silverline are now in a process of turnaround under the new operator, during which time no rent is due. Having dipped to 98% in H1, collection year to date is now 99%, with no indications of any wider tenant stress. Our EPRA NTA per share forecasts are each increased by c 2% for FY23–FY25, with no other changes to forecasts.

Continued strengthening of rent cover

Strong fee growth, improved occupancy and easing staff shortages continue to offset inflationary cost pressures on tenants. Underlying rent cover had already reached pre-pandemic levels, at 1.8x in H1 (on a rolling 12-month basis). Currently available tenant reporting data, covering 80% of the portfolio, indicate that it increased further in Q3. Annual underlying fee growth for Impact's tenants was 15% in June, and resident occupancy had increased to 88.2% from 86.6% in December (and a pandemic low of 79%). Occupancy was stable during Q3 and in this respect we note indications across the sector that some operators are increasingly focused on ensuring that fees for new residents are appropriate to the level of required care, as opposed to simply prioritising occupancy. Nevertheless, further progress towards the pre-COVID-19 'norm' of a low 90% level would only reinforce rent cover.

Valuation: Income-driven, long-term returns

The FY23 DPS target represents an attractive yield of 8.6% and we forecast continued growth in adjusted 'cash' earnings. Meanwhile, the shares trade at a c 30% discount to EPRA NTA per share.

26 October 2023

Price	**79p**
Market cap	**£327m**
Gross debt at 30 September 2023	£178.8m
Gross LTV at 30 September 2023	27.0%
Shares in issue	414.4m
Free float	90%
Code	IHR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(5.4)	(13.9)	(21.5)
Rel (local)	(1.8)	(9.5)	(24.6)
52-week high/low		108p	79p

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 event

Q323 DPS paid	24 November 2023

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Edison profile page

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

Additional details

Q323 marked the third consecutive quarter of investment property valuation growth following the significant weakness experienced in Q422, broadly across the property sector. Care home properties have continued to prove more resilient than the wider sector, supported by strong sector fundamentals, long leases (Impact's weighted average unexpired lease term is 21 years) and indexed income growth. Rental income is again driving valuation uplifts, with some additional benefit from slight yield tightening. The Q3 EPRA 'topped-up' net initial yield was 6.91% versus 6.95% in June (December 2022: 6.98%).

Exhibit 1: Quarterly movement in NAV/NTA

Pence per share	EPRA NTA	IFRS NAV
Opening value	**113.08**	**113.64**
Revaluation gains on investment properties	1.30	1.30
Purchase of interest rate caps	(0.42)	
Revaluation loss on interest rate cap		(0.28)
Net remaining contribution to reserves	2.11	2.11
Q223 dividend paid	(1.69)	(1.69)
Closing value	**114.38**	**115.08**
Percentage quarterly change	1.1%	1.3%

Source: Impact Healthcare REIT data, Edison Investment Research

The positive valuation performance has driven positive total accounting returns in each quarter year to date.

Exhibit 2: Quarterly EPRA NTA total return

Pence per share	Q123	Q223	Q323	9M23
Opening NAV	110.1	112.2	113.1	110.1
Closing NAV	112.2	113.1	114.4	114.4
Dividends paid	1.6	1.7	1.7	5.0
Annualised NAV total return	**3.4%**	**2.3%**	**2.6%**	**8.5%**
Of which dividends paid	1.5%	1.5%	1.5%	4.6%
Of which change in NAV	2.0%	0.7%	1.1%	3.9%

Source: Impact Healthcare REIT data, Edison Investment Research

The year-to-date return continues a strong track record of positive NAV/accounting total returns since listing in March 2017, with an average of 7.1% pa. Even in 2022, IHR's robust cash flows enabled the company to report a dividend-driven total return of 3.7%. Since listing, progressive dividends have generated 70% of returns.

Exhibit 3: Strong long-term track record of EPRA NTA total returns

Pence per share	2017	2018	2019	2020	2021	2022	9M23	FY17-9M23
Opening NAV	97.9	100.6	102.9	106.8	109.6	112.4	110.08	97.9
Closing NAV	100.6	102.9	106.8	109.6	112.4	110.1	114.5	114.5
Dividends paid	3.0	6.0	6.1	6.3	6.4	6.5	5.0	39.3
Annualised NAV total return	**7.2%**	**8.2%**	**9.7%**	**8.5%**	**8.4%**	**3.7%**	**8.6%**	**57.1%**
Of which dividends paid	3.1%	6.0%	6.0%	5.9%	5.8%	5.8%	4.6%	40.1%
Of which change in NAV	2.8%	2.3%	3.7%	2.6%	2.6%	-2.1%	4.0%	17.0%
Average annualised return								7.1%

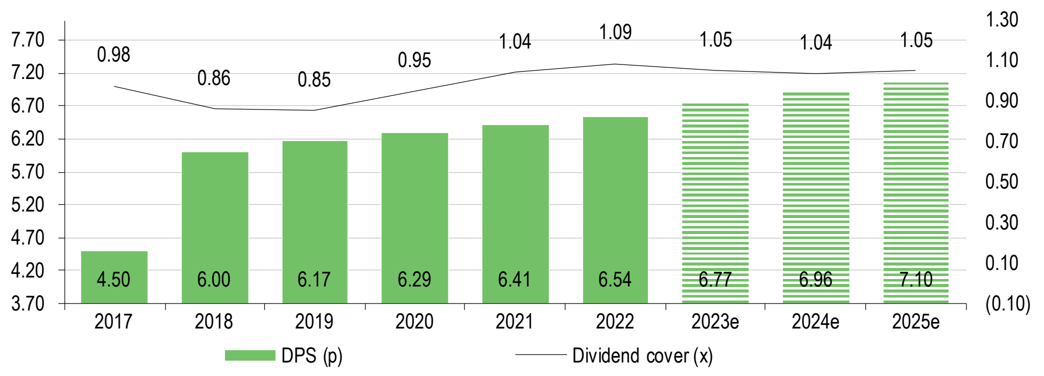
Source: Impact Healthcare REIT data, Edison Investment Research

Dividends have been fully covered by EPRA earnings in each year since listing and, as cash rents have continued to increase, have been well covered on an adjusted 'cash' basis. We expect Impact to continue to target progressive dividends and, despite the increased cost of borrowing, we forecast a fully covered dividend in both this year and next, albeit with cash cover slightly lower than in previous years.

With an additional £50m of hedging acquired during Q3[1], the interest costs on 98% of drawn debt (£179m) are now fixed or hedged, removing the primary risk to our earnings forecasts. The current average cost of drawn debt, including hedging and fixed-rate borrowings, is 4.47% and although the hedging is of relatively short duration (£50m matures at end-2024 and £50m in August 2025), we note that:

- this provides Impact with the flexibility to review its longer-term financing at a point when a decline in interest rates is implied by the current market yield curve; and
- the completion of development and asset management projects, a restoration of rents from the properties in turnaround, as well as continuing indexed rental growth that we forecast will provide an additional offsetting uplift in revenues.

Exhibit 4: Progressive dividends and cash cover



Source: Impact Healthcare REIT data, Edison Investment Research

[1] A further £50m interest rate cap at a cost of £1.76m, which caps SONIA at 4.0% for two years.

Exhibit 5: Financial summary

Year to 31 December (£m)	2020	2021	2022	2023e	2024e	2025e
Cash rental income*	25.9	30.5	39.1	46.3	47.6	50.0
IFRS adjustments for guaranteed uplifts and lease incentives	4.9	5.9	6.4	7.4	8.6	9.4
Gross rental income	30.8	36.5	45.4	53.7	56.2	59.4
Net other income/(expense)	(0.0)	0.0	0.0	0.0	0.0	0.0
Bad debt charge				(0.4)		
Net rental income	30.8	36.5	45.4	53.4	56.2	59.4
Administrative & other expenses	(5.3)	(5.8)	(7.0)	(7.6)	(7.7)	(7.8)
Realised gain on disposal	0.2	0.3	0.1	(0.0)	0.0	0.0
Operating profit before change in fair value of investment properties	25.7	31.0	38.6	45.7	48.5	51.6
Unrealised change in fair value of investment properties	5.6	4.2	(16.3)	12.9	10.0	10.4
Operating profit	31.3	35.2	22.3	58.6	58.5	62.0
Net finance cost	(2.5)	(3.3)	(5.4)	(10.8)	(13.9)	(13.9)
Profit before taxation	28.8	32.0	16.9	47.9	44.5	48.1
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Profit for the year (IFRS)	28.8	32.0	16.9	47.9	44.5	48.1
Adjust for:						
Realised and unrealised gain/(loss) on investment properties	(5.7)	(4.5)	14.3	(12.9)	(10.0)	(10.4)
Change in fair value of interest rate derivatives	0.1	(0.1)	(0.4)	(1.1)	0.0	0.7
EPRA earnings	23.1	27.4	30.8	33.9	34.6	38.4
Rental income arising from recognising rental premiums & fixed rent uplifts	(4.9)	(6.0)	(6.5)	(7.5)	(8.6)	(9.4)
Amortisation of loan arrangement fees	0.7	1.0	1.2	1.5	1.5	1.5
Interest received on rate cap	0.0	0.0	0.1	1.5	2.5	0.4
Other adjustments	0.2	0.4	2.1	0.1	0.0	0.0
Adjusted earnings	19.1	22.7	27.7	29.5	29.9	30.9
Average number of shares in issue (m)	319.0	339.8	390.1	414.2	414.4	414.4
Basic & diluted IFRS EPS (p)	9.02	9.41	4.33	11.56	10.75	11.60
EPRA EPS (p)	7.25	8.05	8.37	8.19	8.34	9.26
Adjusted EPS (p)	5.98	6.68	7.11	7.11	7.22	7.45
Dividend per share (declared)	6.29	6.41	6.54	6.77	6.96	7.10
EPRA earnings dividend cover	115%	126%	128%	121%	120%	130%
Adjusted earnings dividend cover	95%	104%	109%	105%	104%	105%
NAV total return	8.5%	8.4%	3.8%	10.7%	9.3%	9.7%
EPRA cost ratio	17.1%	15.8%	16.6%	15.2%	13.7%	13.1%
BALANCE SHEET						
Investment properties	405.7	437.6	504.3	616.7	640.6	659.0
Other non-current assets	15.9	62.0	68.1	38.0	46.6	56.0
Non-current assets	421.6	499.7	572.4	654.6	687.2	715.0
Cash and equivalents	8.0	13.3	22.5	17.1	15.6	10.2
Other current assets	0.1	1.6	1.5	5.3	2.2	1.3
Current assets	8.1	14.8	24.1	22.4	17.8	11.4
Borrowings	(74.2)	(110.9)	(122.4)	(186.1)	(197.6)	(199.1)
Other non-current liabilities	(2.8)	(2.6)	(4.3)	(2.4)	(2.4)	(2.4)
Non-current liabilities	(77.0)	(113.5)	(126.7)	(188.5)	(200.0)	(201.5)
Borrowings	0.0	0.0	(14.8)	0.0	0.0	0.0
Other current liabilities	(3.1)	(6.7)	(9.1)	(10.8)	(11.4)	(12.1)
Current Liabilities	(3.1)	(6.7)	(23.9)	(10.8)	(11.4)	(12.1)
Net assets	349.5	394.2	445.9	477.7	493.6	512.9
Adjust for derivative financial liability/(asset)	(0.0)	(0.1)	(0.4)	(3.2)	(0.8)	0.3
EPRA net tangible assets (NTA)	349.5	394.2	445.6	474.5	492.9	513.2
Period end shares (m)	319.0	350.6	404.8	414.4	414.4	414.4
IFRS NAV per ordinary share	109.6	112.4	110.2	115.3	119.1	123.8
EPRA net tangible assets (NTA) per share	109.6	112.4	110.1	114.5	118.9	123.9
CASH FLOW						
Net cash flow from operating activities	21.0	(13.9)	29.5	38.2	41.1	42.8
Purchase of investment properties (including acquisition costs)	(88.5)	(28.1)	(71.9)	(48.6)	(6.0)	0.0
Capital improvements	(1.7)	(1.1)	(11.2)	(4.5)	(8.0)	(8.0)
Other cash flow from investing activities	0.9	1.6	5.4	2.2	0.0	0.0
Net cash flow from investing activities	(89.3)	(27.6)	(77.7)	(50.8)	(14.0)	(8.0)
Issue of ordinary share capital (net of expenses)	0.0	34.6	60.5	(0.0)	0.0	0.0
(Repayment)/drawdown of loans	51.2	38.2	27.7	48.5	10.0	0.0
Dividends paid	(20.0)	(21.9)	(25.7)	(27.8)	(28.6)	(28.8)
Other cash flow from financing activities	(2.8)	(4.1)	(5.1)	(13.5)	(10.0)	(11.3)
Net cash flow from financing activities	28.5	46.8	57.4	7.2	(28.6)	(40.2)
Net change in cash and equivalents	(39.8)	5.3	9.3	(5.5)	(1.5)	(5.4)
Opening cash and equivalents	47.8	8.0	13.3	22.5	17.1	15.6
Closing cash and equivalents	8.0	13.3	22.5	17.1	15.6	10.2
Balance sheet debt	(74.2)	(110.9)	(137.2)	(186.1)	(197.6)	(199.1)
Unamortised loan arrangement costs	(2.2)	(3.6)	(5.1)	(4.7)	(3.2)	(1.6)
Net cash/(debt)	(68.4)	(101.3)	(119.7)	(173.7)	(185.2)	(190.6)
Gross LTV (net debt as % gross assets)	17.8%	22.3%	23.8%	28.2%	28.5%	27.6%

Source: Impact Healthcare REIT historical data, Edison Investment Research. Note: *Including interest on investments via loans.