Impact Healthcare REIT

Progressive dividends continuing into FY23

Q422 NAV & trading update

Real estate

With its Q422 NAV update, Impact Healthcare REIT (IHR) increased it DPS target for FY23 to 6.77p (+3.5%). With earnings continuing to be driven by inflation-indexed rental growth, significantly protected by fixed costs on 80%, we expect DPS to be fully covered by cash earnings. The Q4 impact of yield widening across the broad property sector was limited by the long-indexed leases, while low gearing mitigated the impact on NAV.

Year end	Net rental income (£m)	EPRA earnings* (£m)	EPRA EPS* (p)	EPRA NTA/ share (p)	DPS (p)	P/NAV (x)**	Yield (%)**
12/21	36.5	27.4	8.1	112.4	6.41	0.89	6.4
12/22e	45.5	32.7	8.4	110.1	6.54	0.91	6.5
12/23e	52.9	35.0	8.4	109.5	6.77	0.91	6.8
12/24e	54.5	36.7	8.8	113.0	6.96	0.88	7.0

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

Q422 data indicates earnings forecast uplift

Despite the decline in property values in Q422, FY22 NAV total return was a positive 3.8%. FY22 DPS was 128% covered by EPRA earnings and 108% covered by adjusted cash earnings, and the FY23 target reflects the past year's achieved rent growth, in line with the clearly stated dividend policy. The Q422 like-for-like decline in property valuations was significantly lower than the c 12% broad market decline indicated by MSCI data and NAV per share was 5.5% lower quarter-on-quarter at 110.18p. We forecast further valuation declines to be limited, as rental growth provides an offset to further yield expansion. For tenants, fee growth and improved occupancy are an offset to inflationary pressures, and rent cover remains strong at c 1.8x. We do not believe that the single tenant in arrears is indicative of wider tenant stress. Based on the Q4 data, and pending the full-year results in March, we have lifted our FY22 adjusted EPS by c 1% and lowered NAV per share.

Predictable cash flow and progressive dividends

Impact operates in a structurally supported market, driven by the demographics of a growing elderly population rather than the economy. There is a shortage of homes with the quality to meet demand sustainably, which is non-discretionary over the medium term. Impact's homes are let on long, triple net leases at affordable initial rents, indexed to inflation. DPS has increased each year since listing in 2017, driving consistently positive accounting returns, averaging 6.9% pa, of which dividend income represents c 75%. Utilising its strong balance sheet position, since end-FY22 Impact has completed an innovatively funded and immediately accretive £56m investment in a six-home portfolio, part-funded by equity. Gross LTV has increased to a comfortable 23.9%, while c £45m of undrawn debt remains.

Valuation: Income-driven, long-term returns

FY23 DPS target represents an attractive yield of 6.8% and despite headwinds we continue to forecast fully covered dividend growth from inflation-indexed rent uplifts and a full contribution from recent investments. The c 9% discount to FY22e NAV already anticipates some further weakening of property values.

3 March 2023

Price	**100p**
Market cap	**£414m**

Gross debt at 31 December 2022	£142.3m
Gross LTV at 31 December 2022	23.9%
Shares in issue	414.4m
Free float	90%
Code	IHR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(6.3)	(2.7)	(9.8)
Rel (local)	(7.0)	(7.1)	(14.0)
52-week high/low		127p	92p

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

FY22 results	Expected March 2023

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Edison profile page

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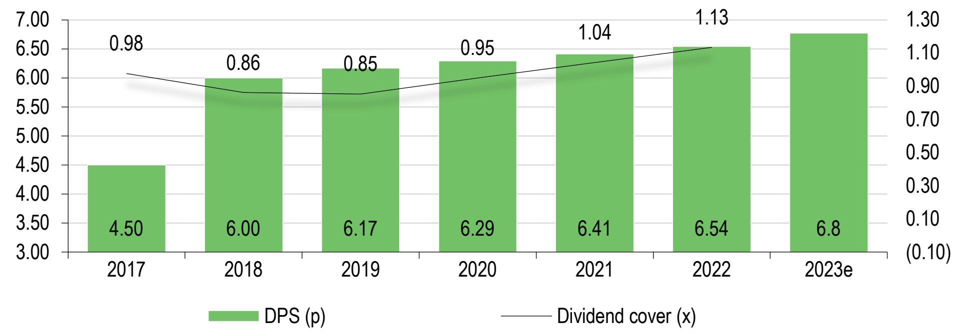
Further details on the Q4 update

Income-driven strategy continuing

Impact aims to provide shareholders with attractive and sustainable returns, primarily in the form of quarterly dividends. DPS has increased each year since listing and, having met its initial DPS targets, in early 2019 the company introduced a clear and progressive dividend policy. Under this policy, Impact targets dividend growth in line with the inflation-linked rental uplifts received in the preceding financial year. Dividends have been covered by EPRA earnings (FY22: 128%) throughout and, as the company has increased in scale, since FY21 dividends have also been fully covered by adjusted 'cash' earnings'[1] (FY22: 108%). We forecast this to continue.

Exhibit 1: Increasing DPS and cover



Source: Impact Healthcare REIT data, Edison Investment Research

FY22 total return remained positive despite property valuation pressure

Dividend returns remained positive during Q422, but this was more than offset by the 5.5% negative capital return, reflecting the property valuation yield widening. Nonetheless, the FY22 total return remained, with the 3.8% total return comprising c 6.5p of dividends paid and a c 2.3% reduction in NAV.

Exhibit 2: Movement in Q421 NAV per share

Pence per share unless stated otherwise	FY22	Q422	Q322	Q222	Q122
Opening NAV	112.4	116.6	116.2	114.9	112.4
Closing NAV	110.2	110.2	116.6	116.2	114.9
Dividends paid	6.5	1.6	1.6	1.6	1.6
Dividend return	5.8%	1.4%	1.4%	1.4%	1.4%
Capital return	-2.0%	-5.5%	0.4%	1.1%	2.2%
Total return	3.8%	-4.1%	1.8%	2.5%	3.7%

Source: Impact Healthcare REIT data

Since listing in 2017, annual returns have been consistently positive, amounting to an aggregate 47.5%, an average annual return of 6.9%. Dividends paid have represented around three-quarters of the total return.

[1] Unlike EPRA earnings, this excludes non-cash IFRS adjustments but does adjust for loan arrangement fee amortisation, licence fees and other non-recurring cash items.

Exhibit 3: NAV total return history

Pence per share unless stated otherwise	2017	2018	2019	2020	2021	2022*	FY17–22
Opening NAV per share	97.9	100.6	103.2	106.8	109.6	112.4	97.9
Closing NAV per share	100.6	103.2	106.8	109.6	112.4	110.2	110.2
Dividends paid	3.0	6.0	6.1	6.3	6.4	6.5	34.3
Dividend return	3.1%	6.0%	5.9%	5.9%	5.8%	5.8%	35.0%
Capital return	2.8%	2.5%	3.5%	2.6%	2.6%	-2.0%	12.5%
Total return	7.2%	8.5%	9.5%	8.5%	8.4%	3.8%	47.5%
Average annualised return							6.9%

Source: Impact Healthcare REIT data. Note: *2022 is unaudited data.

The decline in property values and NAV in Q422 is of little surprise in one of the worst quarters for market-wide capital values in 30 years, driven primarily by increased interest rates. For Impact, the like-for-like reduction in property valuation during the quarter was £21.6m or 4.0%, and the portfolio EPRA topped up net initial yield widened by 30bp to 6.98%. While directionally this mirrored the valuation impact of yield widening experienced across the broad UK commercial sector, the impact was on a much lower scale. MSCI data show a decline in valuations of c 12% across the broad UK sector. There are several factors that mitigated the general decline in values including the relatively higher starting point of care home property yields, indexed rent growth with long leases (Impact's weighted unexpired lease length is 20 years) and, we expect, the robust performance of tenants through the pandemic.

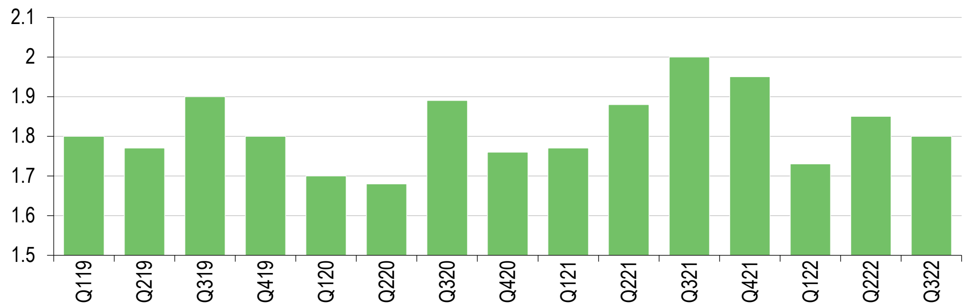
In addition to the like-for-like valuation movement, the Q422 change in the property value included £1.0m of asset management investment, £13.6m from acquisitions and a £2.65m reduction from the sale of a non-core home at 4% above its H122 book value.

In addition to the investment property valuation movement, Impact's investment in a portfolio of 12 care homes by way of a loan was independently valued at £36.3m versus £38.1m at end-Q322, a 4.7% reduction, or £1.8m, similarly reflecting the upward shift in valuation yields across the sector.

Rent cover has remained strong

Rent cover[2] across Impact's portfolio has remained strong. The latest available data collected from tenants shows 1.9x cover for Q322 compared with a little over 1.7x for Q223. The 12-month average rate through the end of September 2022 was c 1.8x, broadly in line with the 12-month rate ending 30 June 2022 (1.85x).

Exhibit 4: Trend in 12-month average tenant rent cover



Source: Impact Healthcare REIT

[2] Rent cover is a key metric Impact uses in monitoring and assessing the ability of individual homes and operators to sustainably support the rents it expects from its portfolio. The ratio tracks operational cash earnings at the home level (before rent) with the agreed rent on a quarterly basis.

Most tenants continue to perform well, managing the challenge of inflation, with increased occupancy and strong fee growth. Having reached a pandemic-driven low point of c 79% in March 2021, occupancy has been steadily recovering towards pre-pandemic levels of c 90%. End-Q422 occupancy was slightly down on end-Q322 (86.6% versus 87.3%), which Impact attributes to expected seasonal fluctuations over the Christmas and New Year holiday period. Occupancy has started to recover in January 2023.

Having consistently collected all rent due, with no variation in lease terms, throughout the pandemic, one single tenant has fallen behind with its rent payments for Q123.[3] As at 31 January 2023, 97% of rent due for the quarter ending 31 March 2023 had been received, including 1% from rent deposits. The overdue rent was £0.4m, all attributable to this one tenant, with whom the investment manager is in active discussions regarding rental payments. We believe that all other tenants are trading as expected and that the issues with this one tenant do not represent more general issues.

Estimate revisions

We have updated our forecasts for the data contained within the Q422 update and the early FY23 investment via a loan in a six-care home portfolio for £56m.[4] The investment, part-financed by equity issued to the vendor at the prevailing NAV, has already been discussed. We have also included an FY24 forecast for the first time. The Q422 data is unaudited and only provides a guide to full-year performance and so further, minor revisions are likely when the FY22 results are published in March.

We have adjusted FY22 earnings in line with those implied by the disclosed dividend cover and NAV.

The increase in FY23e adjusted earnings includes the investment in the portfolio, with EPS further reflecting the vendor shares issued.

FY23e NAV per share, very slightly down on FY22, assumes, and we stress that it is an assumption, a further increase in the EPRA topped-up net initial yield of c 10bp to c 7.10%. This is substantially offset by indexed rent growth, just as rent growth mitigated Q422 market-wide yield expansion.

3 Group charges rent quarterly or monthly in advance.

4 A small non-core asset has also been sold for £1.25m, in line with the 31 December 2022 valuation.

Exhibit 5: Estimate revisions*

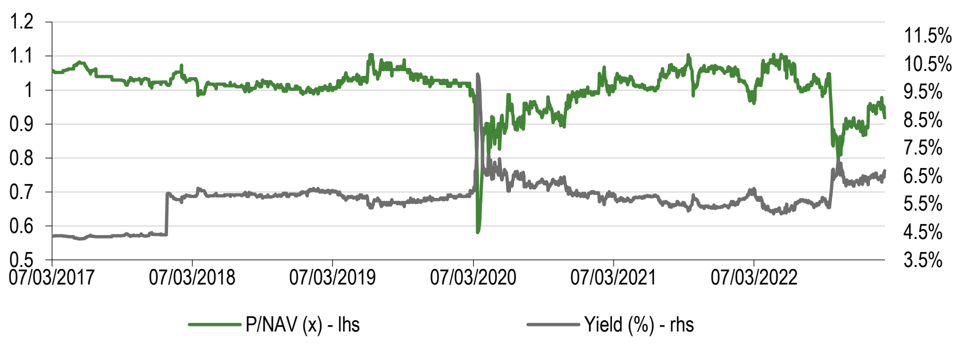
				Last published		Change	
£m unless stated otherwise	**2022e**	**2023e**	**2024e**	**2022e**	**2023e**	**2022e**	**2023e**
Cash rental income plus loan interest*	39.0	45.4	46.8	38.7	42.8	0.4	2.7
IFRS adjustments	6.5	7.4	7.7	5.6	6.5	0.9	1.0
Administrative expenses	(7.1)	(8.1)	(8.4)	(6.6)	(7.0)	(0.4)	(1.2)
Net finance expense,	(5.8)	(9.7)	(9.5)	(6.1)	(9.4)	0.3	(0.3)
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EPRA earnings	**32.7**	**35.0**	**36.7**	**31.5**	**32.9**	**1.2**	**2.1**
IFRS adjustments	(6.5)	(7.4)	(7.7)	(5.6)	(6.5)	(0.9)	(1.0)
Other non-cash adjustments	1.4	1.2	1.2	1.1	1.2	0.3	0.0
Adjusted earnings	**27.6**	**28.7**	**30.2**	**27.0**	**27.6**	**0.6**	**1.1**
Average number of shares (m)	390.1	414.1	414.4	385.5	404.8	4.6	9.3
EPRA EPS (p)	8.4	8.4	8.8	8.2	8.1	0.2	0.3
Adjusted EPS (p)	7.1	6.9	7.3	7.0	6.8	0.1	0.1
DPS (p)	6.54	6.77	6.96	6.54	6.76	0.00	0.01
EPRA dividend cover	128%	125%	127%	125%	120%	300bps	400bps
Adjusted 'cash' dividend cover	108%	103%	105%	107%	101%	100bps	200pbs
EPRA NTA per share (p)	110.1	109.5	113.0	115.7	115.5	(5.6)	(6.0)
NAV total return*	3.7%	5.7%	9.3%	8.7%	5.6%	-500bps	100bps

Source: Edison Investment Research. Note: *Cash rental income includes interest on loan investments.

Valuation update

For FY23, Impact is targeting a DPS of 6.77p (+3.5%), fully covered by adjusted 'cash' earnings. This represents an attractive yield of 6.6%. Meanwhile the shares trade at a c 0.92x the unaudited end-Q422/FY22 EPRA NTA (NAV) per share of 110.17p. This discount appears to already anticipate some further weakening of property valuations. With the shares trailing the growth in dividends, the yield is at the upper end of its range (excluding the peak of pandemic uncertainty) and the P/NAV is below its average since listing of c 1.0x and the peak of c 1.2x.

Exhibit 6: Price to NAV and dividend yield history since listing



Source: Refinitiv prices as at 10 February 2023. Note: Company published NAV and DPS data.

Exhibit 7 shows a summary of the performance and valuation of a group of real estate investment trusts (REITs) that we consider to be Impact's closest peers within the broad and diverse commercial property sector. The group is invested in the primary healthcare, supported housing and care home sectors, all targeting stable, long-term income growth derived from long-lease exposures.

Exhibit 7: Peer group comparison

	WAULT* (years)	Price (p)	Market cap (£m)	P/NTA** (x)	Yield*** (%)	Share price performance			
						1 month	3 months	1 year	3 years
Assura	12	51	1495	0.84	6.0	-12%	-9%	-18%	-33%
Civitas Social Housing	22	62	376	0.56	9.1	2%	2%	-29%	-36%
Primary Health Properties	12	106	1422	0.91	6.0	-9%	-6%	-22%	-29%
Target Healthcare	27	77	478	0.75	8.8	-12%	-3%	-29%	-34%
Triple Point Social Housing	26	52	209	0.46	10.4	2%	-26%	-41%	-44%
Average	**20**			**0.70**	**8.1**	**-6%**	**-8%**	**-28%**	**-35%**
Impact Healthcare	20	100	415	0.91	6.5	-7%	-3%	-11%	-5%
UK property index		1,371				-9%	1%	-26%	-21%
FTSE All-Share Index		4,321				0%	4%	5%	17%

Source: Historical company data, Refinitiv. Note: *Weighted average unexpired lease term. **Based on last published EPRA NTA/NAV per share. ***Based on trailing 12-month DPS declared. Refinitiv price data at 2 March 2023.

Impact's shares have substantially outperformed the peer group and the broad UK property market over the past one and three years. Average yields and P/NAV multiples for our selected peer group have been notably affected by the weakness of the social housing sector investment REITs. As a result, Impact's trailing yield is now below the average of the peer group but remains above that of the primary healthcare REITs. The latter have significant exposure to open market rent reviews and, although this is accelerating, we do not expect it to reach 4% in the near term (the average level at which Impact's indexed rents are capped). Despite having a higher yield and, we expect, faster rent growth, Impact shares trade at a similar P/NAV to the primary healthcare REITs. The primary healthcare REITs benefit from an exceptionally strong tenant covenant, with c 90% of rents coming directly or indirectly from government, but we note Impact's robust tenant performance through, and emerging from, the pandemic.

Exhibit 8: Financial summary

Year to 31 December (£m)	2019	2020	2021	2022e	2023e	2024e
PROFIT & LOSS						
Cash rental income	19.1	25.9	30.5	39.0	45.4	46.8
Rental income arising from recognising rental premiums, fixed rent uplifts & lease incentives	4.9	4.9	5.9	6.5	7.4	7.7
Net rental income	24.0	30.8	36.5	45.5	52.9	54.5
Administrative & other expenses	(4.6)	(5.3)	(5.8)	(7.1)	(8.148)	(8.355)
Realised gain on disposal	0.0	0.2	0.3	0.1	0.0	0.0
Operating profit before change in fair value of investment properties	19.4	25.7	31.0	38.6	44.7	46.1
Unrealised change in fair value of investment properties	9.1	5.6	4.2	(15.4)	(8.8)	6.5
Change in fair value of loan asset call option				(1.2)	0.0	0.0
Operating profit	28.5	31.3	35.2	21.9	35.9	52.6
Loan related interest	0.0	0.0	0.0	0.0	0.0	0.0
Other net finance cost	(2.1)	(2.5)	(3.3)	(5.8)	(10.5)	(10.2)
Profit before taxation	26.3	28.8	32.0	16.1	25.4	42.4
Tax	0.0	0.0	0.0	0.0	0.0	0.0
Profit for the year (IFRS)	26.3	28.8	32.0	16.1	25.4	42.4
Adjust for:						
Change in fair value of investment properties Including loan assets)	(9.1)	(5.6)	(4.2)	16.7	8.8	(6.5)
Gain on disposal	0.0	(0.2)	(0.3)	(0.1)	0.0	0.0
Change in fair value of interest rate derivatives	0.4	0.1	(0.1)	0.0	0.8	0.8
EPRA earnings	17.6	23.1	27.4	32.7	35.0	36.7
Rental income arising from recognising rental premiums & fixed rent uplifts	(4.9)	(4.9)	(6.0)	(6.6)	(7.4)	(7.7)
Amortisation of loan arrangement fees	0.4	0.7	1.0	1.3	1.2	1.2
Amortisation of lease incentive			0.1	0.1	0.0	0.0
Non-recurring costs	0.2	0.0	0.0	0.0	0.0	0.0
Gain on disposal	0.0	0.2	0.3	0.1	0.0	0.0
Adjusted earnings	13.4	19.1	22.7	27.6	28.7	30.2
Average number of shares in issue (m)	254.0	319.0	339.8	390.1	414.1	414.4
Basic & diluted IFRS EPS (p)	10.37	9.02	9.41	4.13	6.14	10.22
EPRA EPS (p)	6.95	7.25	8.05	8.38	8.45	8.85
Adjusted EPS (p)	5.26	5.98	6.68	7.07	6.94	7.28
Dividend per share (declared)	6.17	6.29	6.41	6.54	6.77	6.96
EPRA earnings dividend cover	113%	115%	126%	128%	125%	127%
Adjusted earnings dividend cover	85%	95%	104%	108%	103%	105%
NAV total return	9.5%	8.5%	8.4%	3.7%	5.7%	9.3%
EPRA cost ratio		17.1%	15.8%	15.5%	15.4%	15.3%
BALANCE SHEET						
Investment properties	310.5	405.7	437.6	540.5	600.0	614.4
Other non-current assets	10.1	15.9	62.0	30.9	39.1	46.0
Non-current assets	320.7	421.6	499.7	571.4	639.0	660.4
Cash and equivalents	47.8	8.0	13.3	22.0	5.1	8.9
Other current assets	0.6	0.1	1.6	1.8	1.8	1.8
Current assets	48.3	8.1	14.8	23.8	7.0	10.7
Borrowings	(23.5)	(74.2)	(110.9)	(139.6)	(180.8)	(192.0)
Other non-current liabilities	(1.8)	(2.8)	(2.6)	(2.6)	(2.6)	(2.6)
Non-current liabilities	(25.2)	(77.0)	(113.5)	(142.2)	(183.4)	(194.6)
Borrowings	0.0	0.0	0.0	0.0	0.0	0.0
Other current liabilities	(3.1)	(3.1)	(6.7)	(7.4)	(8.0)	(8.2)
Current Liabilities	(3.1)	(3.1)	(6.7)	(7.4)	(8.0)	(8.2)
Net assets	340.7	349.5	394.2	445.6	454.6	468.3
Adjust for derivative financial liability/(asset)	(0.1)	(0.0)	(0.1)	(0.1)	(0.8)	(0.1)
EPRA net tangible assets (NTA)	340.6	349.5	394.2	445.5	453.8	468.2
Period end shares (m)	319.0	319.0	350.6	404.8	414.4	414.4
IFRS NAV per ordinary share	106.8	109.6	112.4	110.1	109.7	113.0
EPRA net tangible assets (NTA) per share	106.8	109.6	112.4	110.1	109.5	113.0
CASH FLOW						
Net cash flow from operating activities	14.9	21.0	23.6	25.2	37.9	38.6
Purchase of investment properties (including acquisition costs)	(73.4)	(88.5)	(28.1)	(70.8)	(10.3)	0.0
Capital improvements	(8.2)	(1.7)	(1.1)	(7.6)	(12.0)	(8.0)
Other cash flow from investing activities	0.1	0.9	(35.9)	3.9	(46.0)	0.0
Net cash flow from investing activities	(81.5)	(89.3)	(65.1)	(74.5)	(68.3)	(8.0)
Issue of ordinary share capital (net of expenses)	132.2	0.0	34.6	60.7	11.2	0.0
(Repayment)/drawdown of loans	(0.9)	51.2	38.2	27.8	40.0	10.0
Dividends paid	(16.1)	(20.0)	(21.9)	(25.4)	(27.7)	(28.6)
Other cash flow from financing activities	(2.2)	(2.8)	(4.1)	(5.0)	(10.0)	(8.3)
Net cash flow from financing activities	112.9	28.5	46.8	58.1	13.5	(26.9)
Net change in cash and equivalents	46.3	(39.8)	5.3	8.7	(16.9)	3.7
Opening cash and equivalents	1.5	47.8	8.0	13.3	22.0	5.1
Closing cash and equivalents	47.8	8.0	13.3	22.0	5.1	8.9
Balance sheet debt	(23.5)	(74.2)	(110.9)	(139.6)	(180.8)	(192.0)
Unamortised loan arrangement costs	(1.7)	(2.2)	(3.6)	(2.7)	(1.5)	(0.3)
Net cash/(debt)	22.7	(68.4)	(101.3)	(120.3)	(177.2)	(183.5)
Gross LTV (net debt as % gross assets)	6.8%	17.8%	22.3%	23.9%	28.2%	28.7%

Source: Impact Healthcare REIT historical data, Edison Investment Research

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