

Impact Healthcare REIT

Quarterly update

Strong cash flow underpins further DPS growth

Impact Healthcare REIT's Q423 update shows a continued strengthening in operational and financial tenant performance, reflected in a record level of rent cover and 100% rent collection. With cash flow remaining strong, we expect the FY23 DPS of 6.77p (+3.5%) was fully covered by adjusted 'cash' earnings and the FY24 DPS target has been set at 6.95p (+2.7%). We will review our forecasts with the full year results in late March.

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	32.6	8.4	110.1	6.54	0.79	7.5
12/23e	53.4	33.9	8.2	114.5	6.77	0.76	7.8
12/24e	56.2	34.6	8.3	118.9	6.95	0.73	8.0
12/25e	59.4	38.4	9.3	123.9	7.10	0.70	8.2

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% rent collection and rent cover at record level

Although FY23 earnings and NAV are not yet available, Impact does say that the FY23 DPS, and its target for FY24, are both in line with its aims of paying a growing dividend, fully covered by adjusted earnings. Contracted rents increased 13% y-o-y to £49m, driven by inflation-linked rent reviews and a significant and accretive acquisition. Tenant operators have benefited from the continuing post-pandemic recovery in occupancy (to 88.2% versus 87.4% a year earlier) and strong fee growth (c 14%). With rent increases capped at c 4%, rent cover of 2.2x is at its highest since Impact listed in 2017. Rent collection was 100% in Q4 and more than 99% for the year, and the seven homes that were previously leased to Silverline are showing improved performance under the new operator. During the turnaround, no rents are due (but are included in contracted rent roll), but the progress made gives us confidence in our expectation of a full resumption of rental payments in FY25.

Structurally supported and affordable

Providing a strong tailwind, Impact operates in a structurally supported market, where care demand is driven by the demographics of a growing elderly population rather than the economy. Leases are long term (Impact has a 21-year weighted average unexpired lease term) and inflation indexed, while caps at c 4% manage the risks for landlord and tenant alike. Based on an affordable level of rents for tenants, the Q3 portfolio EPRA 'topped-up' net initial yield of 6.9% generates strong cash flow, underpinning returns. DPS has increased each year since listing in 2017, driving consistently positive accounting returns, averaging 7.1% per year. High asset yields, combined with stable, long-term cash flows, have mitigated the impact of rising capital costs on care home properties and rental growth drove valuation uplifts in Impact's portfolio in each of the first three quarters of 2023.

Valuation: Income-driven, long-term returns

The FY24 DPS target represents an attractive yield of 8% and we forecast this to be fully covered by growth in adjusted 'cash' earnings. Meanwhile, the shares trade at a 24% discount to the last published (September) EPRA NTA per share.

Real estate

31 January 2024

Price **87p**

Market cap **£359m**

Gross debt (£m) at 31 December 2023 184.8

Gross LTV at 31 December 2023* 27.7%

*Based on 30 Sept. portfolio valuation

Shares in issue 414.4m

Free float 91.9%

Code IHR

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (3.8) 6.5 (18.4)

Rel (local) (2.8) 0.6 (16.9)

52-week high/low 108p 79p

Business description

Impact Healthcare REIT invests in a diversified portfolio of UK 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

FY23 results Late March 2024

Analyst

Martyn King +44 (0)20 3077 5700

financials@edisongroup.com

[Edison profile page](#)

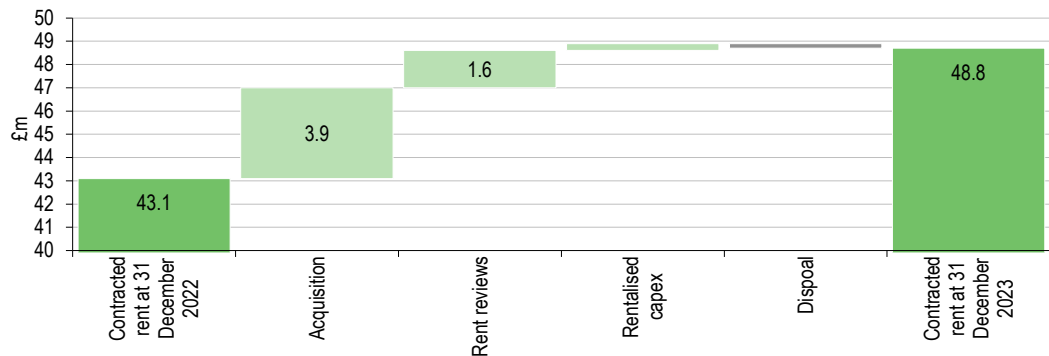
Impact Healthcare REIT is a research client of Edison Investment Research Limited

Further details from the trading update

Rent growth driven by reviews and acquisition

The acquisition of a six-home portfolio of homes in January 2023 and annual rent reviews were the main drivers of contracted rent growth, adding £3.9m and £1.6m respectively (an average 4.1% pa uplift).

Exhibit 1: Growth in FY23 contracted rents



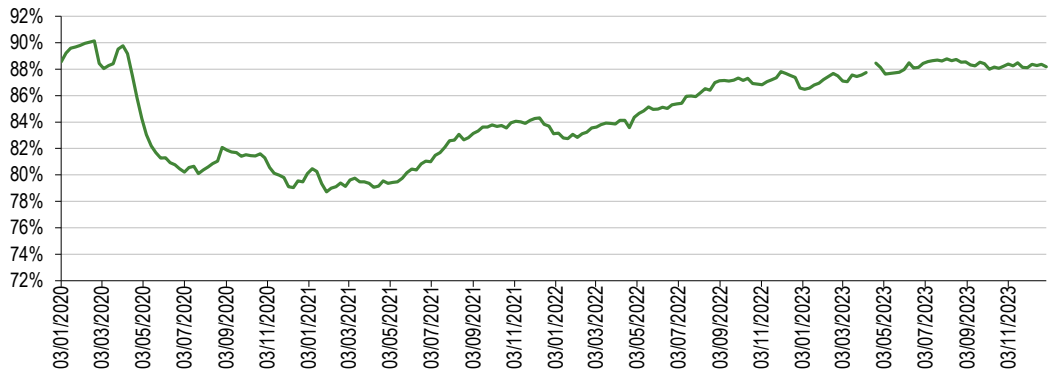
Source: Impact Healthcare REIT

As discussed in a [previous note](#), the acquired homes, each with good Energy Performance Certificate ratings and an established track record of delivering strong operational performance, added more than 400 beds to Impact's portfolio, mostly with ensuite bathrooms. They are let to existing tenant, Welford, on 35-year leases with annual RPI-linked uplift (capped and collared). Despite the increased cost of capital, the acquisition gross initial yield of 7.0%, combined with an innovative financing structure, was immediately accretive. The £56m funding comprised new equity issued to the vendors, attractively priced at the last published NAV despite the prevailing share price discount, and cash/newly drawn debt, hedged for two years at a total all-in cost of 6.5%. By the time the debt cost hedging matures, contracted rent is expected to have increased with indexation, while the market consensus is for interest rates to be falling.

Tenant performance remains strong

The average home-level occupancy achieved by Impact's tenants increased to 88.2% during the year from 87.4% at end FY22, with upside remaining to the c 90% pre-pandemic level. The level of increase has levelled out in recent months, 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. Average weekly fees have grown strongly, up 12% in the 12 months to September, with the preliminary data indicating faster growth in the final quarter of the year, to 14% in the 12 months December.

Exhibit 2: Tenant home-level resident occupancy

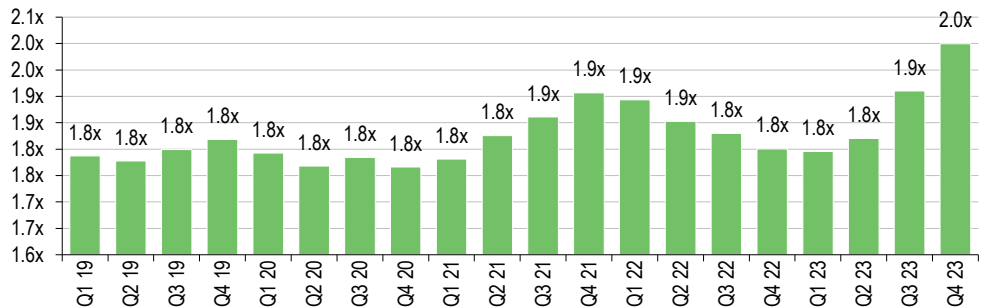


Source: Impact Healthcare REIT

In addition to higher occupancy and strong fee growth, the caps on rent increases have also protected tenants against the pressures of elevated inflation, just as they are designed to do. Similarly, over previous periods of low inflation, the floors on rent increases (typically c 2%) have worked to the company's advantage.

Average rent cover¹ during the three months to end-September (Q3 rent cover) was 2.2x (1.9x in Q322) and was the strongest quarterly tenant performance since Impact listed in 2017. Based on the December data thus far received, Q4 was maintained at this high level despite operators typically reporting lower seasonal profitability in the period, reflecting the timing of increases in fees and staff costs. Impact estimates that on a rolling 12-month basis, average rent cover for 2023, as a whole, was 2.0x compared with 1.8x in 2022.

Exhibit 3: Rent cover on a rolling 12-month basis



Source: Impact Healthcare REIT

Turnaround of Silverline assets progressing well

The strength of rent cover across the portfolio provides a strong indication that the problems encountered by Silverline stemmed from its inability to respond effectively to industry challenges and were not indicative of wider stresses among Impact's 13 tenants. The portfolio of seven homes that were previously tenanted and operated by Silverline continues to show improved performance under the management of Melrose, an affiliate of the Minster Group, since June 2023.

¹ Rent cover is a key metric used by Impact in monitoring and assessing the ability of individual homes and operators to support the rents that it expects from its portfolio sustainably. The ratio tracks home-level earnings before interest, tax, depreciation, amortisation, rent and group management overheads (EBITDARM), or operational cash earnings, on a rolling 12-month basis divided by rents over the same period. It excludes 'turnaround' and 'immature' homes. Immature homes are defined as homes that are newly opened or are undergoing major capital improvement requiring partial closure.

Impact says that portfolio of four homes in Scotland has an average occupancy of 88% and is now cash flow positive. Negotiations are well advanced to transfer these homes back to rent generating operational leases.²

The portfolio of three homes in Bradford is expected to be cash flow positive by the end of the first quarter of 2024, with discussions underway on a proposed change to the management of the properties.

Our current forecasts do not assume rental income from the seven properties until the start of FY25, with positive cash flow meanwhile used to repay inter-company borrowing. From the beginning of FY25, we assume rental income of £1.6m pa, in line with previous rent paid by Silverline.

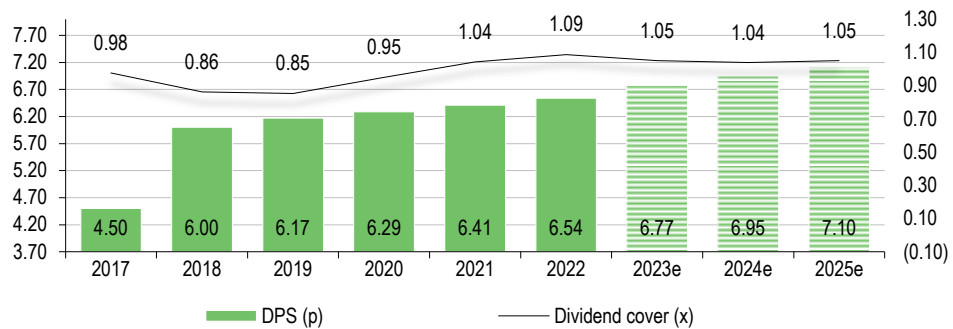
DPS has increased each year since listing in 2017

DPS has increased each year since listing in 2017, driving consistently positive accounting returns, averaging 7.1% per year up to 30 September 2023. Distributions have been fully covered by EPRA earnings throughout and since 2019, as the portfolio increased in scale, by adjusted 'cash' earnings. In H123, DPS was 109% covered by cash earnings and, including non-cash IFRS rent smoothing adjustments, 123% by EPRA earnings.

The trading statement indicates that the FY23 DPS of 6.77p was fully covered by adjusted earnings, in line with dividend policy. Ahead of the FY23 annual results being published, our current forecasts show FY23 DPS covered by 1.05x and the increased FY24 DPS target by 1.04x.

With the interest costs on 95% of the £185m end-2023 debt fixed or hedged, interest rate fluctuations pose little risk to our FY24 forecasts. Although the interest rate hedges that are in place are of relatively short duration (£50m matures at end 2024 and £50m in August 2025), 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.

Exhibit 4: Progressive dividends and cash cover



Source: Impact Healthcare REIT data, Edison Investment Research

² During the turnaround period, no rent is due from Melrose, with surplus cash flows directed initially at the repayment of inter-company borrowings. See our June [update note](#).

Exhibit 5: Financial summary

Year to 31 December (£m)	2021	2022	2023e	2024e	2025e
Cash rental income*	30.5	39.1	46.3	47.6	50.0
IFRS adjustments for guaranteed uplifts and lease incentives	5.9	6.4	7.4	8.6	9.4
Gross rental income	36.5	45.4	53.7	56.2	59.4
Net other income/(expense)	0.0	0.0	0.0	0.0	0.0
Bad debt charge	0.0	0.0	(0.4)	0.0	0.0
Net rental income	36.5	45.4	53.4	56.2	59.4
Administrative & other expenses	(5.8)	(7.0)	(7.6)	(7.7)	(7.8)
Realised gain on disposal	0.3	0.1	(0.0)	0.0	0.0
Operating profit before change in fair value of investment properties	31.0	38.6	45.7	48.5	51.6
Unrealised change in fair value of investment properties	4.2	(16.3)	12.9	10.0	10.4
Operating profit	35.2	22.3	58.6	58.5	62.0
Net finance cost	(3.3)	(5.4)	(10.8)	(13.9)	(13.9)
Profit before taxation	32.0	16.9	47.9	44.5	48.1
Tax	0.0	0.0	0.0	0.0	0.0
Profit for the year (IFRS)	32.0	16.9	47.9	44.5	48.1
Adjust for:					
Realised and unrealised gain/(loss) on investment properties	(4.5)	16.1	(12.9)	(10.0)	(10.4)
Change in fair value of interest rate derivatives	(0.1)	(0.4)	(1.1)	0.0	0.7
EPRA earnings	27.4	32.6	33.9	34.6	38.4
Rental income arising from recognising rental premiums & fixed rent uplifts	(6.0)	(6.5)	(7.5)	(8.6)	(9.4)
Amortisation of loan arrangement fees	1.0	1.2	1.5	1.5	1.5
Interest received on rate cap	0.0	0.1	1.5	2.5	0.4
Other adjustments	0.4	0.3	0.1	0.0	0.0
Adjusted earnings	22.7	27.7	29.5	29.9	30.9
Average number of shares in issue (m)	339.8	390.1	414.2	414.4	414.4
Basic & diluted IFRS EPS (p)	9.41	4.33	11.56	10.75	11.60
EPRA EPS (p)	8.05	8.37	8.19	8.34	9.26
Adjusted EPS (p)	6.68	7.11	7.11	7.22	7.45
Dividend per share (declared)	6.41	6.54	6.77	6.95	7.10
EPRA earnings dividend cover	126%	128%	121%	120%	130%
Adjusted earnings dividend cover	104%	109%	105%	104%	105%
NAV total return	8.4%	3.8%	10.7%	9.3%	9.7%
EPRA cost ratio	15.8%	16.6%	15.2%	13.7%	13.1%
BALANCE SHEET					
Investment properties	437.6	504.3	616.7	640.6	659.0
Other non-current assets	62.0	68.1	38.0	46.6	56.0
Non-current assets	499.7	572.4	654.6	687.2	715.0
Cash and equivalents	13.3	22.5	17.1	15.6	10.2
Other current assets	1.6	1.5	5.3	2.2	1.3
Current assets	14.8	24.1	22.4	17.8	11.4
Borrowings	(110.9)	(122.4)	(186.1)	(197.6)	(199.1)
Other non-current liabilities	(2.6)	(4.3)	(2.4)	(2.4)	(2.4)
Non-current liabilities	(113.5)	(126.7)	(188.5)	(200.0)	(201.5)
Borrowings	0.0	(14.8)	0.0	0.0	0.0
Other current liabilities	(6.7)	(9.1)	(10.8)	(11.4)	(12.1)
Current Liabilities	(6.7)	(23.9)	(10.8)	(11.4)	(12.1)
Net assets	394.2	445.9	477.7	493.6	512.9
Adjust for derivative financial liability/(asset)	(0.1)	(0.4)	(3.2)	(0.8)	0.3
EPRA net tangible assets (NTA)	394.2	445.6	474.5	492.9	513.2
Period end shares (m)	350.6	404.8	414.4	414.4	414.4
IFRS NAV per ordinary share	112.4	110.2	115.3	119.1	123.8
EPRA net tangible assets (NTA) per share	112.4	110.1	114.5	118.9	123.9
CASH FLOW					
Net cash flow from operating activities	(13.9)	29.5	38.2	41.1	42.8
Purchase of investment properties (including acquisition costs)	(28.1)	(71.9)	(48.6)	(6.0)	0.0
Capital improvements	(1.1)	(11.2)	(4.5)	(8.0)	(8.0)
Other cash flow from investing activities	1.6	5.4	2.2	0.0	0.0
Net cash flow from investing activities	(27.6)	(77.7)	(50.8)	(14.0)	(8.0)
Issue of ordinary share capital (net of expenses)	34.6	60.5	(0.0)	0.0	0.0
(Repayment)/drawdown of loans	38.2	27.7	48.5	10.0	0.0
Dividends paid	(21.9)	(25.7)	(27.8)	(28.6)	(28.8)
Other cash flow from financing activities	(4.1)	(5.1)	(13.5)	(10.0)	(11.3)
Net cash flow from financing activities	46.8	57.4	7.2	(28.6)	(40.2)
Net change in cash and equivalents	5.3	9.3	(5.5)	(1.5)	(5.4)
Opening cash and equivalents	8.0	13.3	22.5	17.1	15.6
Closing cash and equivalents	13.3	22.5	17.1	15.6	10.2
Balance sheet debt	(110.9)	(137.2)	(186.1)	(197.6)	(199.1)
Unamortised loan arrangement costs	(3.6)	(5.1)	(4.7)	(3.2)	(1.6)
Net cash/(debt)	(101.3)	(119.7)	(173.7)	(185.2)	(190.6)
Gross LTV (net debt as % gross assets)	22.3%	23.8%	28.2%	28.5%	27.6%

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 2024 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.
