WILSONS

Healthcare A-REITS: Increasing Portfolio Health

Our weekly view on Australian equities.

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A new way to play the Healthcare Mega trend

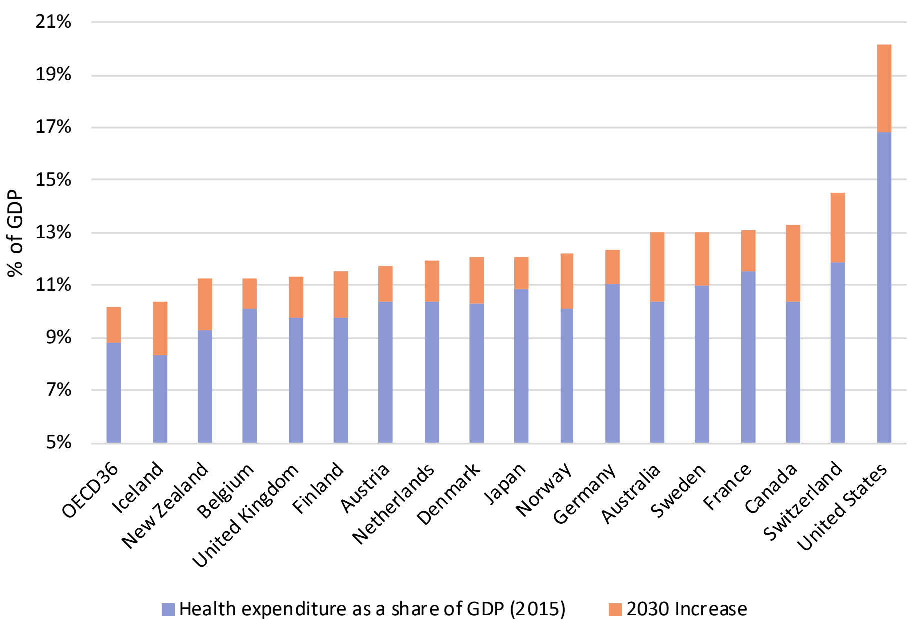
Healthcare A-REITs have two powerful themes behind them. Firstly, the mega trend of growing healthcare expenditure, which is expected to grow at close to double GDP into the foreseeable future - consumer appetite for improved quality of life and ageing populations underpin this trend.

Secondly, the institutional ownership of healthcare property remains low in Australia by global standards. There is a potential shortfall of almost A$100bn of capital required to meet the property healthcare demands over the next two decades. The scale of this required capital to acquire, develop and grow property assets is increasingly likely to involve public market capital. Historically, governments funded the majority of healthcare development.

Healthcare exposed A-REITs, commonplace in the EU and US markets, are almost non-existent in Australia, representing less than 2% of the A-REIT index (yet healthcare spending is 10% of GDP). With only three healthcare exposed REITs on the ASX, all under A$1.5bn in market cap, healthcare-related A-REITs have largely remained undiscovered by institutional investors.

The recently listed HealthCo Healthcare and Wellness REIT (HCW) has been added to the Wilsons Australian Equity Focus List at a 3% weighting. HealthCo is pure-play exposed to the healthcare mega trend and size themes. HealthCo could emerge with one of the sector's lowest costs of capital, fuelling accretive growth in earnings/distributions over the next 3-5 years. A compelling growth story within the A-REITs in our view.

Exhibit 1: Globally health spending is expected to increase relative to GDP



Source: OECD Health Division projections, 2019, Wilsons.

Thematic 1: Rising Healthcare Expenditure

The mega trend of rising healthcare expenditure is a global trend driven by consumers' desire to improve quality of life and increase longevity.

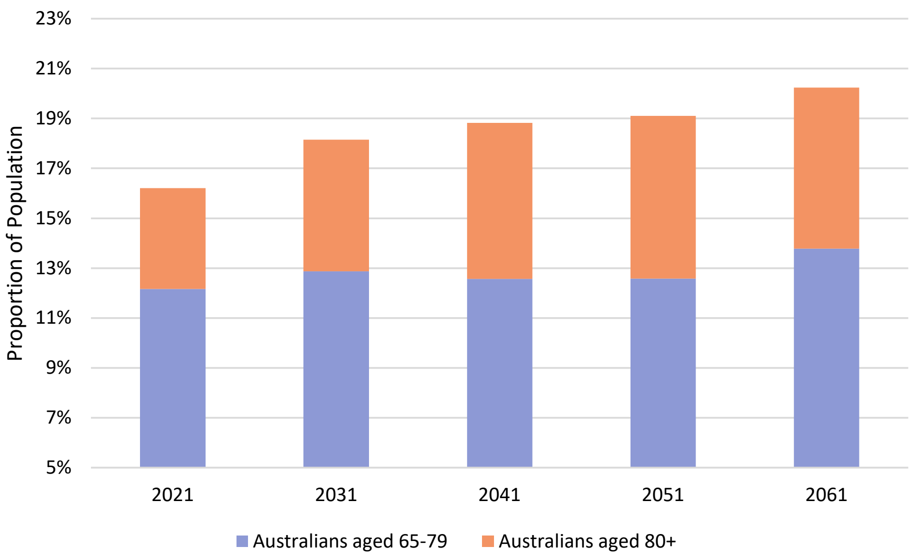
In the five years pre-COVID, Australian spending on healthcare grew at +4.3%pa[1], double the rate of GDP growth. The ABS estimated household consumption relating to health and wellness as a proportion of total household consumption increased by ~50% between 1986 and 2016[2].

An ageing population is one of the underlying drivers for this acceleration in health spending. Over 65s as a proportion of the population is forecast to grow at +2.0% p.a. between 2020-2060[3]. This is almost double the natural population growth of between 0.8-1.4% p.a. estimated by the ABS. Additionally, this cohort spends 3-5x more on healthcare spending vs <65yrs[4].

Rising healthcare expenditure will have flow-on impacts for services and facilities to meet this demand. The installed asset base across healthcare is estimated to be currently valued at >A$200bn[5]. In order to meet forecast demand, spending of almost A$100bn could be required over the next 20 years[5].

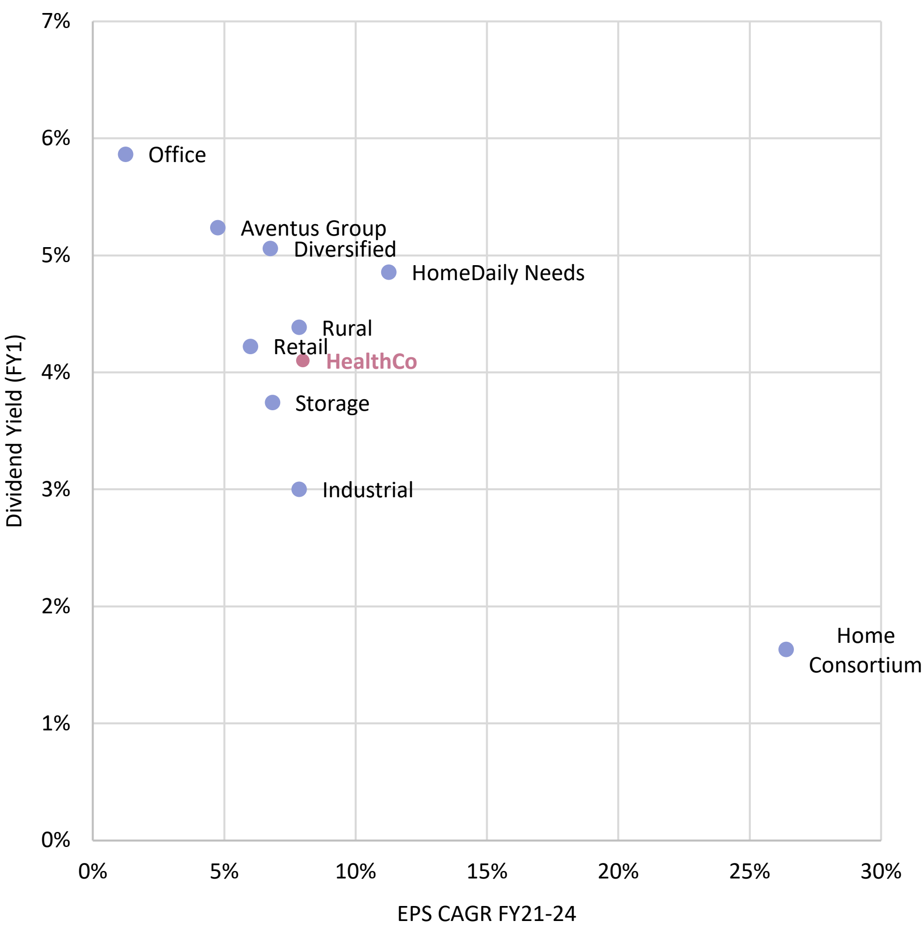
Increasingly governments are looking to the private sector to help fund this growth. Even private operators from hospitals through to childcare are increasingly separating the property/asset ownership from the operational assets. In our view, ASX listed players can play a role here given the large pools of money that the A-REIT sector can attract.

Exhibit 2: Over 65yrs cohort is expected to grow at +2% p.a. into 2060



Source: ABS, Wilsons.

Exhibit 3: A-REIT dividend yield vs EPS growth. HealthCo looks well placed vs peers



Source: Refintitiv, Wilsons estimates of HCW EPS growth. HDN estimates have adjusted given partial FY21 impact due to IPO.

Thematic 2: Low Levels of Institutional Ownership

Despite the asset class attracting strong institutional support in overseas markets, public market institutional ownership of healthcare-related property assets across Australia remains low. We believe there is an emerging opportunity for this asset class to become a much larger component of the A-REIT index over time. This has the potential to improve growth rates for small healthcare-related A-REITs and lead to a re-rate in valuations.

We have shown in previous notes that small, well-run REITs that can typically grow faster than the sector can generate significant outperformance vs larger-cap REITs (total return basis).

Read Alternative A-REITs: From Little Things Big Things Grow

An important attribute of A-REITs is the higher following of passive or index aware institutional money. As market cap of an A-REIT increases and index entry is granted or index weighting increased, the passive following can assist in keeping equity prices well supported, providing deeper pools of money to tap into for accretive acquisitions.

Read Tech and Base Metals Drive Gains

HealthCo Healthcare and Wellness REIT (HCW)

We have added HealthCo to the Focus List at a 3% weighting. Combined with Goodman Group (GMG), the Focus List is marketweight the A-REITs sector.

HealthCo is an externally managed A-REIT by Home Consortium (HMC), a relatively new listed property group that was established to purchase the now-defunct Master's hardware sites from Woolworths (WOW).

HealthCo has been established with a A$500m portfolio focused on health and wellness properties and plans to take an active approach in the development and management of property assets. Five sub-sectors will be the initial focus of HealthCo:

- Hospitals
- Primary care and wellness
- Life sciences and research
- Aged care
- Childcare

Around 5% (by value) of the initial portfolio is exposed to development opportunities. HealthCo sees a gap in the market for the development of 'health precincts'– where tenants are integrated via location and property. This could include a mixture of primary medical and wellness tenants, childcare, and other ancillary health services. In much the same way that office business parks or industrial business parks benefit the consumer/tenant via co-location – HealthCo sees a real opportunity to drive value via co-location.

Exhibit 4: How HealthCo REIT is expected to grow shareholder value

	Components of return	Wilsons Comments
	Distribution Yield	FY22E 4.1% distribution yield
A	Income Growth	Majority of portfolio has 3% annual rent escalators
B	Accretive Developments	Pipeline of development opportunities in conjunction with HMC
C	Accretive Acquisitions	Target asset base is >$200bn in size
	Prospective total return	**4.1% + A + B + C**

Source: Company Data, Wilsons

HealthCo earnings are likely to accelerate

HealthCo is in a unique position in that it is both small (A$750m market cap), net cash balance sheet (highly unusual for an A-REIT), and has a high degree of visibility on its future growth pipeline. The balance sheet is unlikely to remain under-geared for long. The company has a policy of being 30-40% geared, which implies debt capacity in the range of A$150-250m.

We estimate that deployment of debt capacity could lift earnings between 15-30% on a full-year basis, on the assumption that acquired assets can generate an earnings spread of 2% p.a. This provides a pathway for a material step-up in the growth rate of HealthCo.

We believe HealthCo could emerge with one of the highest growth rates amongst externally managed A-REITs over the next 3 years. We anticipate HealthCo will also raise equity to grow earnings and distributions. HomeCo Daily Needs REIT (HDT) has raised equity twice since IPO in 4Q20 and follows a similar strategy to HealthCo in large format retail. At current prices, HealthCo is trading on PDS period forecast of ~4.1%, offering 3 year CAGR EPS growth in the range of 8-10% on our estimates.

Exhibit 5: Potential earnings upside from regearing the balance sheet at different earnings spreads

	1.50%	2.00%	2.50%	3.00%
$150m | 24% Gearing	13%	17%	22%	26%
$200m | 33% Gearing	17%	23%	29%	35%
$250m | 42% Gearing	22%	29%	36%	43%

Source: Company Data, Wilsons estimates. Earnings = Funds From Operations (FFO). Earnings Spread = FFO – cost of debt. Assumes cost of debt at 1.9%, as per HealthCo PDS.

Focus List Changes

Aventus Group (AVN)

We have removed AVN from the Focus List, 4% weighting. We see AVN as now trading closer to fair value, on a P/NTA multiple of 1.1x. AVN has performed strongly for the Focus List, delivering a total return of ~30% since November 2020. This compares to the broader market at 18% and the A-REITs index at 13%.

CSL (CSL)

Increased weighting to CSL by 1%, now 8%. We remain overweight healthcare. We expect CSL will be able to show a return to momentum in the core blood plasma business in FY22/23. New product launches are also expected to feature.

Exhibit 6: Key metrics: HealthCo vs. peer REITs

Company	Sub-Sector	Price $	MCAP ($b)	EPS CAGR FY21-24	Dividend Yield (FY1)
National Storage REIT	Storage	2.36	2.8	7%	3.8%
Cromwell Property Group	Office	0.88	2.3	5%	8.5%
Centuria Capital Group	Diversified REIT	3.44	2.7	9%	3.2%
Ingenia Communities Group	Lifestyle/holiday	6.38	2.1	12%	1.9%
Aventus Group	Large Format Retail	3.36	1.9	5%	5.2%
Home Consortium	Large Format Retail	7.70	2.2	26%	1.6%
Charter Hall Social Infrastructure	Social Infrastructure	3.72	1.4	5%	4.5%
Arena REIT No 1	Social Infrastructure	4.20	1.5	4%	3.8%
Rural Funds Group	Rural	2.66	1.0	8%	4.4%
GDI Property Group	Hotels	1.16	0.6	23%	6.7%
Hotel Property Investments	Hotels	3.54	0.6	6%	5.8%
HomeCo Daily Needs REIT	Large Format Retail	1.60	1.2	11%	5.1%
HealthCo*	Healthcare	2.26	0.7	8%	4.1%

*HealthCo EPS and Div. Yield are based off Wilsons estimates.

Source: Refinitiv, Wilsons.

[1] 2014-2019. AIHW, Health Expenditure Australia 2018-19.

[2] Household Expenditure Survey (latest available – FY16, released 13 September 2017).

[3] Australian Institute of Health and Welfare, ABS.

[4] Admitted Patient Care 2018-19: Australian hospital statistics

[5] L.E.K. Consulting, HealthCo.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

Disclaimer

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