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Start of Transcript

Operator: Thank you for standing by and welcome to the HealthCo Healthcare and Wellness REIT FY22 half-year results briefing. All participants are in a listen-only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Sam Morris, Senior Portfolio Manager. Please go ahead.

Sam Morris: Good morning, everyone, and thanks for joining us today. I am Sam Morris, Senior Portfolio Manager of HealthCo Healthcare and Wellness REIT. Joining me on the call today is Christian Soberg, CFO of the Healthcare REIT, and Sid Sharma, Home Consortium COO. Before we commence, we acknowledge the traditional custodians of country throughout Australia. We celebrate their diverse culture and connections to the land, sea and community. We pay our respects to their Elders past, present and emerging and extend that respect to all Aboriginal and Torres Strait Island people today.

Let's turn to slide 4 to begin our commentary for you this morning. We are very pleased to deliver our first half-year result since listing in September last year. It's been a very busy four months. We are excited to update you on our Camden Health and Innovation Precinct development, with progress made on stages 2 and 3 of the project. Of particular note is that we have received EOIs from leading national private hospital operators to partner with you. These developments will increase our active development pipeline to over $500 million providing unitholders with future earnings and valuation growth.

We remain on track to meet our upgraded FY22 FFO guidance per unit of $0.05. That is an increase of 16% over the PDS forecast. Our PDS forecast distribution per unit guidance of $0.074 remains on track. Driving FFO growth are $200 million in committed acquisitions in the period since IPO, including a pipeline of 13 new fit-for-purpose Melbourne Metro-located childcare assets. We have also increased HealthCo's exposure to our exciting developments at Proxima and Camden.

Our acquisitions were secured at attractive valuations and improved our portfolio WALE from 9.4 to 10 years. NTA per unit increased by 4.3% from IPO to $1.94 per unit. From an operations perspective, we have achieved 100% cash collection and an improvement in portfolio occupancy from 96% to 98%. This is a testament to the portfolio strategy which is designed to provide strong downside protection through high-quality tenants and target subsectors. This manages risk through diversification across geography, subsector and tenant. Lastly, we have maintained a strong and flexible balance sheet with a current net cash position to fund our accretive development pipeline and acquisition.

Turning to slide 5, we provide an overview of our strategy driving these outcomes. As part of our IPO, we outline the objective to provide unitholders with exposure to a diversified portfolio of healthcare real assets underpinned by attractive megatrends. The portfolio is targeting stable and growing distributions, long-term capital growth and positive environmental and social impact. Our strategy to achieve this objective remains unchanged. This covers four key actions.

First, maintain a diversified exposure across geography, tenant and target subsectors of healthcare and wellness. Second, target stable income characteristics, including long leases, contracted rental escalations at CPI or better,

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sustainable rents and strong tenant covenants. Third, pursue accretive acquisition and development opportunities to scale the portfolio and enhance returns and finally maintain and appropriate capital structure with a target gearing range of 30% to 40%. Delivering on these four key elements will position us to deliver attractive total returns.

Now, moving to slide 6. We have significant growth opportunity embedded in the existing portfolio, as well as latent capacity to pursue further accretive acquisitions and developments. From the IPO FY22 net operating income forecast, the portfolio has over 90% NOI growth potential. This is based on the remaining lease up in the portfolio and completion of the committed acquisitions and developments outlined in this presentation. There is further growth upside in our pipeline of uncommitted developments and acquisitions, namely Camden stages 2 and 3, which Christian will touch on in more detail later in this presentation.

Clearly, there is strong demand and competition for healthcare property from institutional investors. However, that demand needs to be seen in the context of the addressable Australian market across our targeted subsectors, which is in excess of $200 billion. We have been and will continue to actively pursue future acquisition and development opportunities; however we remain highly selective.

Turning to slide 8, portfolio overview and update. We have continued to grow a high quality, diversified healthcare portfolio and enhance key portfolio metrics. There are four key highlights: (1) a 26% increase in the value since IPO to $700 million and an as-complete value of $880 million, (2) an improvement in occupancy from 96% to 98% with a clear line of sight to 100%, (3) an increase in the WALE from 9.4 to 10 years; and (4) 100% cash collection. Our current target subsector weightings are a function of where we've seen accretive acquisition opportunities. We will target a balanced exposure to these subsectors over the longer term. Importantly, our portfolio is predominately located in Australia's major metropolitan centres.

On slide 9, we have provided a collection of key portfolio statistics. Long-term leases to high-quality operators with contracted rental growth are key mitigants against rising inflation and interest rates. The portfolio consists of a diverse range of quality tenants with national tenants representing 70%. The tenants are spread across resilient health and wellness subsectors, which are underpinned by attractive megatrends. These include an aging population, growing government expenditure and an increasing consumption of health services per capita.

Importantly, our leases have contracted rental escalations across 100% of the portfolio with a weighted average rent review of 3% per annum for leases with fixed-escalations accounting for 70% of the portfolio. The 30% balance benefits from CPI or better escalations which are attractive in the current environment.

Now turning to slide 10, portfolio valuation summary. At IPO, the value of the portfolio was $555 million and over the four months to 31 December that portfolio has increased to $700 million in value. That growth of $145 million includes $113 million of announced acquisitions, $14 million of capitalised development costs and $18 million of gains from property revaluations. Pleasingly, these revaluation gains are driven by both cap rate compression and net operating income growth.

The infrastructure-like nature of our health assets, having stable CPI or better-linked cash flows and long-term leases will continue to underpin the value of our portfolio.

In summary, we are delivering against or ahead of our projections at IPO and are confident about the strength and embedded growth opportunity in the current portfolio and the options for future growth. I will now hand over to Christian to take us through our investments to date.

Christian Soberg: Many thanks, Sam. Let's move on to slide 12 to look in more detail at investments we're making to enhance our returns and the quality of our portfolio. We announced $200 million of investments in our trading update in October. These investments are consistent with three key aspects of our investment strategy: (1) they substantially

increase the scale of our portfolio, (2) they are earnings accretive and led to a 16% upgrade to FFO guidance for FY22, and, third, they enhance key portfolio metrics, including our WALE.

Proxima and Camden stage 1 were acquired on de-risked and attractive terms from HomeCo, the external manager of HealthCo. This demonstrate the strong strategic alignment between HealthCo and HomeCo. As Sam mentioned earlier, we are continuing to review accretive acquisition opportunities on an ongoing basis. I now want to provide more details about our exciting development pipeline on page 13.

Our development pipeline is a valuable source of growth with strong incremental returns. We have $140 million of committed development projects currently underway, including Camden stage, which is a 78-bed paediatrician private hospital, and Proxima, a health club in a new health precinct adjacent to the Gold Coast University Hospital and Gold Coast Private Hospital. As set out on the next slide, both these projects are on track, they're on budget and set to open next year.

I now want to move on to page 15 to talk more broadly about the Camden precinct and provide more details about stage 2, which represents an attractive opportunity for HealthCo.The Camden precinct has an ideal location in Sydney's southwest growth corridor. It's 20 kilometres away from the new airport being built at Badgerys Creek and Camden is the fastest growing LGA in Australia. From a demand perspective, there is significant undersupply of clinical services in the local catchment area and it's also worth highlighting that the private health insurance coverage in the area is greater than the New South Wales average.

Let's move on slide 16 to provide more detail about the three stages we are developing at Camden. Stage 1 is The George Private Hospital. It's on track and will open in the first half of Calendar '23 and is on budget. Stage 2 will be a significant new private hospital. As Sam mentioned earlier, we have received EOIs from national private hospital operators and we are targeting the appointment of a preferred partner towards the middle of the year. We expect that the hospital could be valued at more than $250 million and we will target an investment return in excess of 7%.

For stage 3, we are targeting a 10,000 square metre facility which will complement the service profiles of the two private hospitals. Overall, the three stages will provide an integrated healthcare hub for the local catchment area. We are very excited about this precinct.

I will now move on to talk about sustainability on page 18. As you will know, HomeCo, the external manager of HealthCo recently released its inaugural sustainability report. This report sets out six sustainability commitments towards creating healthy communities. Importantly, this also includes our commitment to achieving net zero emissions by 2028. HomeCo strongly believes that these commitments will help drive long-term value creation across all the assets managed for HomeCo.

On the next slide, we'll provide some more colour on how we are creating healthy communities at HealthCo. Three points to note. First, a pathway to achieving our sustainability targets is focused on utilising energy efficient systems and technologies, as well as renewable energy. Second and importantly, healthy communities require a focus on social impact and providing access to healthcare services. Third, we have developed a social impact framework that we have incorporated into our investment processes.

I will now move on to provide an overview of the financial results for the half year period on page 21. Starting with the earnings summary. Three highlights are as follows. First, FFO of $5.8 million. This was underpinned by strong operating performance and is consistent with the updated guidance that we gave in our trading update in October. Second, statutory profit was $10.8 million for the period. This was impacted by a positive fair value movement of $6.8 million, which comprised a positive revaluation of $23 million net of transaction costs in relation to property acquisitions. Third, we declared our first distribution of $0.03 per unit for the half-year period.

Now turning to the balance sheet on the next page. HealthCo has a strong balance sheet and I would like to highlight the following three points: (1) NTA increased from $1.86 per unit at the time of the IPO to $1.94 per unit. This represents an increase of $0.08 per unit in just under four months. Second, our investment property portfolio increased to $568 million, inclusive of our stake in Camden. Third, HealthCo had net cash of $56 million as at the end of the half-year period.

Now, we move on to capital management on the next slide. HealthCo has a strong capital and liquidity position. At the end of the half-year, we had $456 million of cash in undrawn debt facilities. In terms of our capital structure going forward, we will target gearing in the 30% to 40% range in line with the strategy set out in the PDF. So, in summary, we have delivered a strong set of financial results for the first half of FY22.

I will now turn to page 25 to summarise our guidance for the full financial year. We are pleased to reaffirm the following guidance for FY22: FFO of $0.05 per unit and DPU guidance of $0.074 per unit. The FFO guidance is consistent with our trading update and the DPU guidance is consistent with the PDS. Going forward, we will target a distribution payout ratio of 90% to 100% FFO once our portfolio is fully stabilised and gearing is within the 30% to 40% target range. I'll now hand you back to Sam for concluding remarks.

Sam Morris: Thanks, Christian. We are excited to deliver a strong inaugural first-half result following the listing in September last year. HealthCo's high quality and diversified portfolio is delivering against our core objective to provide unitholders with consistent and growing distributions. We are making good progress, unlocking the significant growth opportunity embedded in our current portfolio. HealthCare is well positioned to take advantage of growth opportunities in the market with a strong balance sheet and gearing capacity. In closing, Christian and I would like to thank our entire team and our tenant partners for contributing to these results. I will now hand back to the operator to take questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two, and if you're on speakerphone, please pick up the handset to ask your question. Your first question comes from Simon Chan from Morgan Stanley. Please go ahead.

Simon Chan: (Morgan Stanley, Analyst) Hi. Good morning, guys. Hey, I just noticed on slide 25 you guys talked about the intention to kick off a DRP program going forward. Can you perhaps describe the reason for that, given your balance sheet gearing's still net cash and even if you spend the CapEx that you have committed to, it's still barely 20% gearing.

Christian Soberg: Yes, sure. Sure. I'll answer that. It's Christian here. So for the DRP, it's being established primarily for the benefit of our retail shareholder base. It's not a capital management decision and the DRP will not be underwritten there will be no discount.

Simon Chan: (Morgan Stanley, Analyst) Okay. So it's retail focused, is it? Because I mean it's a little bit counterintuitive, isn't it, because you're paying above FFO and then you're raising equity on the other side via a DRP, so it just sounds a little bit, yes, confusing for me.

Christian Soberg: Yes, look, just to reiterate the point, it's established for our retailer shareholder base and it's not the capital management decision.

Simon Chan: (Morgan Stanley, Analyst) Okay, fair enough. My second question, so since IPO you guys have done some acquisitions. Obviously the biggest bucket was the childcare one of the Metro portfolio from memory back in October. Can you perhaps talk a bit more broadly about the transaction market, what you're seeing outside of the childcare subsector?

Sam Morris: Yes, sure. Sam Morris here. There's no doubt that investor appetites for quality Australian healthcare property remains strong. Quality healthcare assets certainly do remain tightly held and highly sought after by an increasing pool of domestic and global buyers. Our focus has been on identifying operating and development partners in our target subsector and we've certainly created a number of off-market opportunities this way to acquire quality access, however have declined to proceed on a lot of them based on the prevailing pricing on offer.

A key priority for the fund in this market is really to realise the embedded growth that exists in the current portfolio through development and lease-up. Developments is certainly offering more attractive total returns and I think noticing that forecast value creation at Camden Precinct, we certainly do have a number of development opportunities in diligence.

Simon Chan: (Morgan Stanley, Analyst) So would you say future acquisitions are more likely to be development projects then rather than mature assets?

Sid Sharma: I might take that one, guys. It's Sid here. So, no, we're not saying that at all. We're assessing opportunities every day. We pretty much see everything that's transacting in the market. At any given moment as we're diligence-ing an acquisition versus a development, we'll just look at what the right decision is per asset. But what we're steadfastly focused on is the model portfolio construction and we're steadfastly focused on underlying cash flows that are growing.

Simon Chan: (Morgan Stanley, Analyst) That's very clear, Sid. Thanks, guys.

Sam Morris: Thank you.

Operator: Thank you. Your next question comes from Jeff Pehl from Goldman Sachs. Please go ahead.

Jeff Pehl: (Goldman Sachs, Analyst) Good morning, guys. Just to your…

Sam Morris: Good morning.

Jeff Pehl: (Goldman Sachs, Analyst)] Just to come back to, I guess, the recent acquisitions in childcare, but also just for aged, I'm just wondering about just the health of the operators, just across your childcare and then in aged care portfolios. Just we're hearing just obviously rising labour and staffing costs. Just any concerns in the portfolio just given we are going to potentially a much higher inflation environment?

Sam Morris: I think the key thing to note here, Jeff, - thanks for the question - is that we have 100% rent collection across our portfolio and in terms of our tenant base, over [70%] of our tenant base across our portfolio are national tenants. So we are feeling confident in terms of where we are at this moment in time.

Sid Sharma: I might just add to that - sorry, Sid again. So [unclear] childcare portfolio, but we've also seen post the Omicron wave is that occupancy levels across our network within the childcare portfolio are north of 70% to 80%. So they're trading really well. Most of our tenants actually have a waiting list for people. But, again, if we come back to the model portfolio, the diversification across the five subsectors allow us to deal with these waves in a particular subsector at any moment in time and 30% of our tenants already are rental escalations pegged to inflation, CPI. As we do more and more new transactions, a lot of our newer transactions are also pegged to CPI. So then we're protecting ourselves onto the inflation risk moving forward.

Jeff Pehl: (Goldman Sachs Analyst) Thanks for that. My second question is just along the - just Springfield. You opened December '21. Just curious just how that asset's been performing and then just how are discussions going for the remaining leasing on that asset?

Sid Sharma: Yes, Sid again. Thank you for that. No. Springfield's trading - well, really exciting. We're very close to making an announcement on Springfield, but we're not quite there yet. We're already - we're close to completing the

childcare, which will commence trading shortly. The practical completion has occurred. The medical centre and the health and wellness phases are also currently fitting out - so is the chemist - and then we'll be making an announcement on the balance of the facility in the very near future. We're in advanced discussions with a tier 1 hospital operator for part of that space.

Jeff Pehl: (Goldman Sachs Analyst) Thanks. Thanks for that. That's all my questions. Thank you.

Sam Morris: Thanks, Jeff.

Operator: Thank you. Your next question comes from Stuart McLean from Macquarie. Please go ahead.

Stuart McLean: (Macquarie, Analyst) Good morning. Just following up some - maybe Simon's questions. In regard to the pace of acquisitions and the use of the balance sheet, when would you expect to reach full deployment of 30% to 40% and have a stabilised portfolio that covers the divi.

Sam Morris: I think in terms of the dividend coverage - so we obviously - it's an objective of ours to do that and we're targeting, as you well know, a dividend payout ratio of 90% to 100% of FFO. As to when that happens, it's really a function of when - as you've identified, when we deploy that capital that we have on our balance sheet. As Sid's alluded to, that we're continuing to evaluate acquisition opportunities. We are continuing to evaluate development opportunities, so - but, I mean, in answer to your question, if we deploy spare capital today on projects that are above our cost of capital, that could be next year, but that's a theoretical, forward-looking point, so we're just continuing to evaluate how we can deploy our balance sheet.

Stuart McLean: (Macquarie, Analyst) Okay, thank you. Then my second question is just around the ownership structure of Camden stage 2, stage 3 and do you think does [HCW] anticipates exercising first rights on HMC's interest in that asset or can you just talk to the potential structure of ownership on stage 2, stage 3?

Sam Morris: Yes, I think it's the intention for HealthCo to be the owner of those - of stage 2 and 3 and not HomeCo, but that will be a process that we'll develop over time.

Stuart McLean: (Macquarie, Analyst) Okay, thank you. That's all questions from me. Appreciate the time.

Sam Morris: Thank you.

Operator: Thank you. Once again, if you wish to ask a question, please press star-one on your telephone and wait for your name to be announced. Your next question comes from Sky Walker from Alder & Partners PWM. Please go ahead.

Sky Walker: (Alder & Partners PWM, Analyst) Hello. Thanks for taking my questions. I just wondered if you could expand on your comment about expressions of interest from hospital operators. Is - do you have expressions beyond your current projects and do they have a potential pipeline of new precincts that you are targeting?

Sid Sharma: Yes. The short answer is yes. Again, we were looking at opportunities not just within our current network, but beyond that. So at the right time we'll make some further announcements in relation to it.

Sam Morris: Just by way of an update on Camden stages 2 and 3, we're really pleased with the level of response in regard to that EOI process. We will look to appoint a preferred operator over the next couple of months and work with them on the service profile of the hospital final design and ancillary tenant mix required. We envisage stage 3, the research facility, and that'll be complementary to both those hospital facilities. Therefore, once we appoint a preferred operator for stage 2, we will work with both of those private hospital operators on the potential design and tenant mix. So we will look to progress stages 2 and 3 concurrently.

Sky Walker: (Alder & Partners PWM, Analyst) Okay. This research facility sector, is that more of a sale-and-leaseback opportunity or is it [unclear] property or is it a development sector too?

Sam Morris: That's a development, so, yes, that's right. It'll be done on a sale-and-leaseback basis, as in we will develop it and lease it.

Sky Walker: (Alder & Partners PWM, Analyst) Sorry. I'm talking about more broadly for further opportunities beyond this one.

Sam Morris: Absolutely. We're diligence-ing a number of Camden-style development opportunities that do include life sciences and research opportunities as we see that as an emerging sector in Australia and very much following the US and Europe experience.

Sky Walker: (Alder & Partners PWM, Analyst) Just one last question, just the Camden stage 2, you've indicated a return of 7% plus potentially. To be honest, that doesn't look that exciting given the size of the project and development risk. Is this reflective of tightness in the market? Is that what we should kind of expect for these projects going forward?

Christian Soberg: Hi. It's Christian here now. We believe that's an attractive return to profile for our REIT and it's over and above where we see other projects currently in the market at this moment in time.

[Over speaking]

Sky Walker: (Alder & Partners PWM, Analyst) …an ungeared return or is it geared?

Sid Sharma: Ungeared.

Christian Soberg: That's ungeared. That's on a [unclear] basis.

Sky Walker: (Alder & Partners PWM, Analyst) Yes, okay. All right. Thank you.

Operator: Thank you. Once again, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced. We will pause for a moment while we wait for questions to register. There are no further questions at this time and that does conclude our conference for today. Thank you for participating. You may now disconnect.

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