Wealth Generation and Generation Healthcare

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It can be difficult saying goodbye to things you really don't want to part with. But that's the situation APN's analytical team found themselves in recently, saying 'farewell' to Generation Healthcare REIT (GHC) which was recently acquired by Canadian healthcare specialist Northwest.

It's an instructive story, one that shows the value of buying assets at attractive prices and moving them on at the right time, even if the parting is difficult.

Initially known as ING Real Estate Healthcare Fund (IHF), Generation Healthcare listed in May 2006. It was the first and only property trust focused on the Australian healthcare sector. At that time, IHF was priced at $1.00 offering investors an 8.4% distribution yield.

APN's securities team conducted initial due diligence. We liked what we saw in the management team and the underlying portfolio of assets. The weighted average lease terms was greater than 10 years; tenants like Epworth Hospital were of a high quality; and there seemed plenty of scope for sustainable rental growth.

Back then, our team was still learning about the healthcare market but we were well aware that the growth in health expenditure and services required to sustain Australia's ageing population was beginning to gain momentum.

Nevertheless, we did not build an initial stake until February 2007 when what was to become GHC had its first post-listing public offer under the IHF moniker. Conservative investors like us like to allow some time for management to start to prove their worth, and to appreciate their grasp of the business.

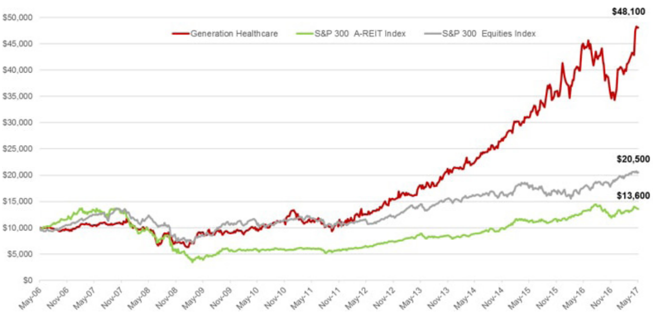
GHC didn't disappoint on either score. Since then the stock has become a core non-index holding across APN's funds, providing high and sustainable income growth with lower-than-market volatility. Really, it's all we could ever hope for from a commercial property holding.

Since our initial investment at $1.08, the share price has increased a staggering 116% or 14.7% p.a. But best of all for our income-focused investors, GHC has delivered an average distribution yield of 7.5% p.a.

We don't often talk of total returns because it can draw the investor's eye from where it should be focused. But with GHC now out of our portfolio it seems safe to do so. Total returns on the fund's initial investment have been in excess of 22% p.a.

The chart below shows the impact of this return on an initial investment of $10,000 since GHC's IPO in May 2006 compared with the S&P/ASX 300 AREIT Index and the S&P/ASX 300 Equities Index.

$10,000 Invested: GHC vs AREITs and Equities Indexes (dividends reinvested)



Source: APN, Bloomber - May 2017

What a cracker. GHC's capital growth has been driven by a significant repricing of the healthcare asset class over the past five years which has supercharged returns. As they say in this industry, good things tend to happen to good businesses.

APNs flagship AREIT Fund established a position in GHC in September 2009 at $0.74. A placement in October 2009 at $0.68 allowed the Fund to increase its exposure significantly and, over the next seven years, we continued to accumulate stock until exiting as part of the Northwest buyout offer in May 2017.

According to Bloomberg's Total Return calculator, the initial investment returned 25% p.a. with the placement stock returning 26% p.a.

APN Group had such a positive view of IHF and its management team that it became the responsible entity in August 2011 as ING wound down its Australian real estate operations. It also acquired 3.4% of the company's stock, which prompted the name change to GHC.

What can we take from the experience, apart from happy faces?

Well, firstly that the biggest determinant of future returns on an asset is the price you pay for it. Generation Healthcare was an exceedingly well-managed, high quality trust. Given this and the tailwinds in the sector, we were able to acquire it at a very attractive price.

Then we let time do its work. The Global Financial Crisis may have panicked many investors out but the business was strong enough to survive and then prosper. The value of that 7-10 year time frame we like investors in our funds to adopt is endorsed by the GHC experience.

And finally, the experience shows you can't buy cheaply and have the courage to ride out the inevitable choppy periods without confidence in your own analytical assessments of a business.

These, then, are the lessons retail investors can take from our investments in GHC and apply to their own investing lives. As for us, we're sad to see GHC go. But we look forward to uncovering the next opportunity and hope to see another healthcare stock in the AREIT universe soon.

APN Property Group
A specialist real estate investment manager

We actively invest in, develop and manage real estate and real estate securities on behalf of institutional and retail investors. APN's approach to real estate investment is based on a 'property for income' philosophy.

Established in 1996, APN's listed on the ASX and manages $2.4 billion (as at 31 December 2016) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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