Arvida Group Limited

OUTPERFORM

1H20 Result — Building Well

Arvida Group (ARV) has reported a strong 1H20 result with underlying profit of NZ$23.4m, up +31% with standout EPS growth of +16%. It was ahead of our expectations in terms of key operational metrics highlighting the continued robust demand ahead of our underlying profit forecast of NZ$20.8m. We have not changed our forecast and remain with an OUTPERFORM rating.

What's changed?

- **Earnings:** No changes
- **Target Price:** Up 4 cps to NZ$1.78 due to the time value of money impact on our DCF valuation
- **Rating:** Remains OUTPERFORM

Resales were a key highlight up +10% to 148 units

There were also strong gains in new sales and resales pricing, while margins also lifted versus the pcp. New sales were up strongly at 44 units, although below our forecast of 50 units. These metrics led to realised gains being NZ$17.9m, up +53% and ahead of our forecast of NZ$16.3m. The balance sheet is solid at ~27% geared, operating cash flow was up +17% and the 1H dividend is up +11.5% with the announcement of a 2Q20 dividend of 1.45cps.

Another period of delivery on all fronts

ARV continues to deliver to its strategy and has successfully integrated recent village acquisitions. It continues to lift its development capability and pipeline whilst leveraging its development expertise picked up from Fletchers and Sanderson Group. ARV has indicated it is on track to deliver 200 units in FY20 with 94 units delivered in 1H20 across eight sites. ARV is targeting another step up in FY21 to 250+ units, in line with our forecasts. Existing resales stock at 2% of the portfolio is stable and the 3% vacancy rate for new stock looks manageable given the contracts in place and the ongoing solid demand. The pipeline of 1,693 units implies ~7 years at the FY21 build rate.

A top rated large-scale care operator

ARV's aged care remains very full at 95% average occupancy across its large care operation of 1,590 beds. ARV now has 18 of 26 care facilities with the maximum 4 year DHB certification following recent audits. A further four facilities are being audited in the coming months.

Defensive yield plus growth

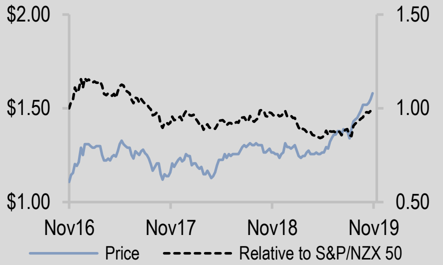
ARV has an attractive blend of a solid dividend yield of ~5% on a 40% pay-out of underlying earnings and a building growth profile given its expanded development expertise, track record and pipeline. Our rating is OUTPERFORM and we continue to view ARV as attractively priced at 1.15x NAV.

Investment View

ARV has future growth prospects centred on brownfield and greenfield expansion. It has a defensive earnings profile given its heavily needs-based portfolio, and has only a modest Auckland exposure. Relative to its listed peers, ARV has an attractive dividend and compares favourably on P/NAV and earnings multiples. Our rating is OUTPERFORM.

NZX Code	ARV
Share price	NZ$1.58
Target price	NZ$1.78
Risk rating	Medium
Issued shares	541.9m
Market cap	NZ$856m
Average daily turnover	393.6k (NZ$531k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ$m)	38.6	54.5	66.6	71.7
EPS* (NZc)	9.3	10.8	12.3	13.2
EPS growth* (%)	4.8	16.1	13.5	7.7
DPS (NZc)	5.4	6.2	6.8	7.3
Imputation (%)	80	80	80	80

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	20.3	15.9	13.5	12.4
EV/EBIT	22.6	17.5	14.8	13.7
PE	16.9	14.6	12.9	11.9
Price / NTA	1.2	1.3	1.3	n/a
Cash dividend yield (%)	3.4	3.9	4.3	4.6
Gross dividend yield (%)	4.4	5.1	5.6	6.0

*Historic and forecast numbers based on underlying profits

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Arvida Group Limited (ARV) Priced as at 19 Nov 2019: NZ$1.58 March year end

Forsyth Barr valuation			
Valuation methodology			DCF
12-month target price (NZ$)*	**1.78**	**Spot valuations (NZ$)**	
Expected share price return	12.7%	1. DCF	1.69
Net dividend yield	4.2%	2. n/a	n/a
Estimated 12-month return	16.8%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.00%	Total firm value	1,109
Equity beta	0.85	(Net debt)/cash	(185)
WACC	7.23%	Value of equity	924
Terminal growth	1.50%	Shares (m)	542

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	152	179	209	242	258
Normalised EBITDA	**44**	**50**	**69**	**85**	**92**
Depreciation and amortisation	(4)	(5)	(6)	(8)	(9)
Normalised EBIT	**40**	**45**	**63**	**77**	**84**
Net interest	(2)	(4)	(4)	(5)	(6)
Associate income	-	-	-	-	-
Tax	(4)	(2)	(4)	(5)	(6)
Minority interests	-	-	-	-	-
Normalised NPAT	**33**	**39**	**54**	**67**	**72**
Abnormals/other	25	21	-	-	-
Reported NPAT	**58**	**59**	**54**	**67**	**72**
Normalised EPS (cps)	8.9	9.3	10.8	12.3	13.2
DPS (cps)	5.0	5.4	6.2	6.8	7.3

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	n/a	17.9	16.5	15.6	6.6
EBITDA (%)	n/a	13.1	38.4	23.5	8.8
EBIT (%)	n/a	12.6	40.3	23.4	8.4
Normalised NPAT (%)	n/a	16.9	41.0	22.3	7.7
Normalised EPS (%)	n/a	4.8	16.1	13.5	7.7
DPS (%)	n/a	6.8	15.4	9.5	7.7

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**44**	**50**	**69**	**85**	**92**
Working capital change	17	27	48	92	101
Interest & tax paid	(7)	(7)	(8)	(11)	(12)
Other	-	-	-	-	-
Operating cash flow	**54**	**69**	**108**	**166**	**181**
Capital expenditure	-	(5)	(6)	(8)	(9)
(Acquisitions)/divestments	(136)	(113)	(318)	(152)	(168)
Other	-	-	-	-	-
Funding available/(required)	**(82)**	**(49)**	**(216)**	**6**	**5**
Dividends paid	(17)	(23)	(33)	(37)	(39)
Equity raised/(returned)	77	-	152	-	-
Increase/(decrease) in net debt	**26**	**72**	**102**	**31**	**35**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(8)	(14)	(2)	(3)	(3)
Fixed assets	1,053	1,215	1,574	1,785	2,014
Intangibles	56	54	54	54	54
Other assets	13	19	19	19	19
Total funds employed	**1,114**	**1,273**	**1,645**	**1,855**	**2,084**
Net debt/(cash)	119	185	287	318	353
Other non current liabilities	484	538	689	863	1,055
Shareholder's funds	511	550	669	674	676
Minority interests	-	-	-	-	-
Total funding sources	**1,114**	**1,273**	**1,645**	**1,855**	**2,084**

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	n/a	20.3	15.9	13.5	12.4
EV/EBIT (x)	n/a	22.6	17.5	14.8	13.7
PE (x)	n/a	16.9	14.6	12.9	11.9
Price/NTA (x)	n/a	1.2	1.3	1.3	1.3
Free cash flow yield (%)	n/a	7.5	11.9	18.5	20.1
Net dividend yield (%)	n/a	3.4	3.9	4.3	4.6
Gross dividend yield (%)	n/a	4.4	5.1	5.6	6.0
Imputation (%)	n/a	80	80	80	80
Pay-out ratio (%)	n/a	57	57	55	55

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	18.0	12.3	14.7	15.0	14.7
Interest cover EBITDA (x)	19.9	13.7	16.1	16.5	16.2
Net debt/ND+E (%)	18.9	25.2	30.1	32.1	34.3
Net debt/EBITDA (x)	2.7	3.7	4.2	3.8	3.8

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	3.5	3.4	3.8	4.1	4.0
Return on equity (%)	6.5	7.0	8.1	9.9	10.6
Return on funds employed (%)	6.4	6.0	13.8	16.6	17.5
EBITDA margin (%)	28.8	27.6	32.8	35.1	35.8
EBIT margin (%)	26.0	24.8	29.9	31.9	32.5
Capex to sales (%)	0.0	2.8	2.9	3.2	3.4
Capex to depreciation (%)	0	100	100	100	100

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (NZ$m)*					
Care fees	109.9	125.6	132.7	141.8	149.6
Management fees	18.1	21.4	29.1	35.5	39.9
Other	4.3	5.4	6.0	6.5	6.9
Changes in fair value					
Operating rights	0.0	0.0	0.0	0.0	0.0
Invest. property (total gains)	19.8	27.0	41.4	58.0	61.3
Total revenue	152.1	179.4	209.1	241.8	257.7

*Full year pro-forma for 2015A

Key Drivers					
Sales - new units	79	70	125	169	183
Ave unit price - new sales (NZ$m)	0.53	0.63	0.74	0.87	0.89
Sales - resold units	216	258	288	313	345
Ave unit price - resales (NZ$m)	0.31	0.34	0.37	0.40	0.42
Ave resold unit price inflation (%)	13.2	8.8	5.0	8.0	4.0
Gross development margin (%)	19.0	18.0	19.7	21.0	19.0
Gross resales margin (%)	19.9	23.0	21.4	21.5	21.0

Development and acquisitions:					
New units/care suites built	101	113	200	258	250
New beds built	-	-	-	-	-
Acquisitions - beds	351		326	-	-
Acquisitions - units	479	-	-	-	-
Total portfolio:					
Apartments/units	**1,850**	**1,955**	**2,481**	**2,739**	**2,989**
Beds	**1,743**	**1,722**	**1,722**	**1,722**	**1,722**

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

1H19 result — key points of interest

Taking care of business

ARV has reported a strong 1H20 result with underlying profit of NZ$23.4m, up +31% and ahead of our expectations of NZ$20.8m with standout EPS growth of +16%. As expected growth was solid across the board given the successful integration of acquired villages and ARV's building development capability. Operating cash flow was up +17%.

ARV continues to deliver to its strategy and has successfully integrated recent village's acquisitions and continues to lift its development capability and pipeline.

Building on track for development step up in FY20 and again in FY21

ARV delivered 94 units in 1H20 across eight locations and it has indicated it is on track to deliver 200 units in FY20 and 250 units in FY21.

Numerous operational highlights indicate robust demand

Resales volumes were up +10% to 148 units and new sales were also up strongly at 44 units (up +46%), although below our forecast of 50 units, and there was a strong gain in new sales and resales pricing while margins also lifted versus the pcp.

Strong new sales pricing at NZ$779k was up +35% on the pcp, underpinning a 19% development margin (NZ$5.2m). Resales were 148 units, up +10%, and resales pricing was NZ$364k, both were ahead of our expectations. These metrics led to realised gains being NZ$17.9m, up +53% and ahead of our forecast of NZ$16.3m as detailed in Figure 2. Resales inventory has remained steady at 2%.

Figure 1. 1H20 result summary (NZ$m)

Six months ending 30 September	1H19	1H20	% chg	Forbar
Revenue				
Care fees	62.7	64.1	2.2%	63.7
Management fees + other	10.4	12.9	24.6%	12.8
Other	2.6	2.6	-1.6%	2.9
Realised fair value movement of investment properties	11.7	17.9	53.3%	16.3
Total revenue	**87.4**	**97.5**	**11.6%**	**95.7**
Total costs	(63.9)	(68.4)	7.0%	(68.8)
Total EBITDA	**23.5**	**29.1**	**24.0%**	**26.9**
Depreciation	(2.4)	(2.8)	14.4%	(2.9)
EBIT	**21.0**	**26.3**	**25.1%**	**24.0**
Net interest	(1.7)	(2.3)	34.2%	(1.7)
EBT	**19.3**	**24.0**	**24.3%**	**22.3**
Tax	(1.4)	(0.6)	-58.4%	(1.5)
Normalised or underlying profit	**17.9**	**23.4**	**30.9%**	**20.8**
Unrealised value movement	13.3	18.2	**36.8%**	
Tax (deferred) + other	(0.7)	3.4		
Reported profit (NZ IFRS)	**30.5**	**45.0**	**47.7%**	
Operating cash flow	26.0	0.0	-100.0%	
EPS (cps)	4.32	4.98	15.3%	4.55
DPS (cps)	2.60	2.90	11.5%	2.85
NTA	1.15	1.25	8.7%	
NAV	1.32	1.39	5.3%	

Source: Forsyth Barr analysis, Company Reports

Attractive yield plus growth

ARV has announced a 1.45cps 2Q20 dividend (record date 3 December 2019 / payment date 11 December 2019), bringing the 1H20 dividend to 2.90cps, up +12% versus the pcp.

Care segment challenges but a quality operation

Care revenues only had modest growth given a number of beds were taken offline during the period for redevelopment (Aria Bay, Auckland) or closure as a result of historic earthquake damage (Wendover, Christchurch). ARV noted it had an increase in premium accommodation charges, but is still feeling the impact of higher registered nurse pay levels, without the commensurate funding increase, and general cost inflation, that continues to put downward pressure on margins.

Strong average occupancy was maintained at 95% and ARV now has 18 (72%) of its care facilities with the maximum 4 year DHB certification. We consider this business to be very defensive given the quality of the facilities, and ARV's growing care brand and strong offer, including dementia expertise, is very supportive of its retirement village operation.

Figure 2. Sale of occupation right agreements (ORAs) — price, volume and margins

Year ending 31 March	1H18	2H18	1H19	2H19	1H20	Chg pcp	Chg seq	Forbar
New Sales (Units)	3	76	30	40	44	47%	10.0%	50
Resales (Units)	98	118	135	123	148	10%	20.3%	137
Total	**101**	**194**	**165**	**163**	**192**	**16%**	**17.8%**	**187**
New Sales $m	1.2	40.5	17.3	27.1	34.3	99%	26.7%	32.0
Resales $m	27.9	39.1	42.1	45.0	53.9	28%	19.7%	48.6
Total	**29.1**	**79.6**	**59.4**	**72.1**	**88.1**	**49%**	**22.3%**	**80.6**
Ave new sales $000	392	533	577	675	779	35%	15.4%	640
Ave resales $000	285	331	312	366	364	17%	-0.5%	355
Operating margins								
New sales (development margins)	43%	15%	16%	18%	15%	-2%	-14.9%	18%
Resales margins	19%	21%	22%	23%	24%	10%	1.6%	22%
New sales margin ($m)	0.5	6.0	2.7	4.8	5.2	94%	7.8%	5.8
Resales margin $m	5.2	8.1	9.1	10.4	12.7	40%	21.6%	10.4
Total realised gain ($m)	**5.7**	**14.1**	**11.7**	**15.3**	**17.9**	**53%**	**17.3%**	**16.3**

Source: Forsyth Barr analysis, Company Reports

Steady NAV at NZ$1.39

Net asset value (NAV) has lifted to NZ$1.39 (NZ$1.32 1H19) but was only marginally up from FY19 and reflects the recent acquisitions at valuation and the closure of Wendover in Christchurch. Gearing is at 27%, slightly up on the pcp as detailed in Figure 3.

Figure 3. Balance Sheet Summary (NZ$m)

As at 30 September	1H19	1H20	% chg
Total Assets	1,300	1,842	41.7%
Net Debt	186	268	44.6%
Shareholders Equity	549.7	729.7	32.7%
NAV	$1.32	$1.39	5.3%
Net Debt/Total Assets	14%	15%	
Net Debt / (Net Debt + Equity)	25%	27%	

Source: Forsyth Barr analysis, Company Reports

Updated near-term development pipeline

Figure 4 below looks at an indicative near-term development pipeline for ARV and details the 94 units delivered in 1H19 and the balance expected in 2H19 to hit its target of 200 units in FY20.

We have also highlighted an indicative delivery programme for FY21 that is supportive of 250+ units. Our forecast remains a build rate of 250 in FY20 and 258 in FY21.

Figure 4. 1H20 development pipeline and near-term pipeline

	FY19A	1H20A	2H20E	FY20E	FY21E	FY22+E
Independent Units and Serviced Apartments						
Kerikeri- villas					15	265
Copper Crest - villas	27				29	2
Bethlehem country club - villas		2	4	6	10	6
Bethlehem Shores - villas		4	5	9	15	173
Queenstown Country Club - villas		7	8	15	20	250
Glenbrae - villas			10	10	8	4
Oakwoods						30
Aria Park						95
Aria Bay	25					58
Cascades						90
Park Lane - SAs	29		49	49		
Rhodes on Cashmere	18					
St Albans - SAs		4	21	25		
Lauriston - villas		12		12		90
Mary Doyle - villas	14	3	9	12	9	
Village at the Park - SAs		24		24		
Village at the Park - villas					10	6
Waimea Plains, Richmond - villas		38		38	25	212
Total units	**113**	**94**	**106**	**200**	**141**	**1281**
Care suites						
Aria Bay					59	
Rhodes on Cashmere					10	21
St Albans					20	
Copper Crest					55	
Total Care Suites	**0**	**0**	**0**	**0**	**144**	**21**
Total units and beds	**113**	**94**	**106**	**200**	**285**	**1302**

Source: Forsyth Barr analysis, Company Reports

The majority of the 1H20 delivery was from Village at the Park, Wellington (24 SAs) and Waimea Plains, Richmond (38 Villas). 2H20 will be weighted largely to the end of the period with the completion of 49 apartments at Park Lane, Christchurch, expected in March 2020 and another 21 apartments at St Albans due for completion by December 2019. Given the delivery of these units are weighted late in 2H20, there is downside risk that settlement of sales is pushed into FY21, albeit ARV has indicated presale interest has been solid to date.

Despite strong pricing momentum in 1H20, given management's identification of softness in the Christchurch market (sentiment consistent across the industry) there is some pricing risk on deliveries at Park Lane. Although this is a modern and well established village with a strong brand.

ARV indicated that it was hopeful of securing consents for its second greenfield site that is located in Kerikeri during the period and there should be more news on this near-term. ARV is planning around 200 ILUs, 80 SAs and an 80 care bed facility on the large 18ha site with first deliveries now expected in FY21 (15 ILUs). ARV has also indicated it will lift its annual unit delivery rate to 250+ units in FY21, with development likely to be derived from existing brownfield sites, whilst management aims to also acquire c.1–2 greenfield sites p.a. to help fuel such expansion. The pipeline of 1,693 units implies ~7 years at the FY21 build rate.

Investment summary

Arvida Group (ARV) provides exposure to the positive industry dynamics at play for retirement and aged care sector operators centred on a rapidly aging population. ARV has future growth prospects focussed on brownfield expansion and the acquisition of care-focussed retirement facilities. A strong needs-based portfolio gives ARV a defensive earnings profile.

Earnings and cash flow outlook

- **Unique acquisition strategy:** With ARV now having a significant land bank we expect its focus will be more on the existing opportunities within its portfolio and additional greenfield developments, although further acquisition opportunities will be considered.
- **Brownfield development:** ARV has over 1,700 units, care suites and beds in its pipeline, including over 300 underway.
- **Recycling capital:** The occupational right agreement (ORA) structure allows ARV to self-fund development and recycle capital into new developments.

Business quality

- **A market leader:** ARV is a market leader in aged care with consistently high occupancy rates and the majority of its aged care facilities being four-year Ministry of Health certified — the highest rating achievable.
- **Defensive income streams:** ARV has a strong focus on continuum of care with over 60% of its portfolio needs-based. Care fees are supported by government subsidies and the growing demand for aged care services.

Balance sheet

- **Attractive dividend yield:** ARV has an attractive yield at ~4.5%, amongst the highest in the sector, backed by a defensive care earnings stream.
- **Balance sheet robust:** ARV's gearing at ~27% remains at comfortable levels, providing ample room to work through its development pipeline.

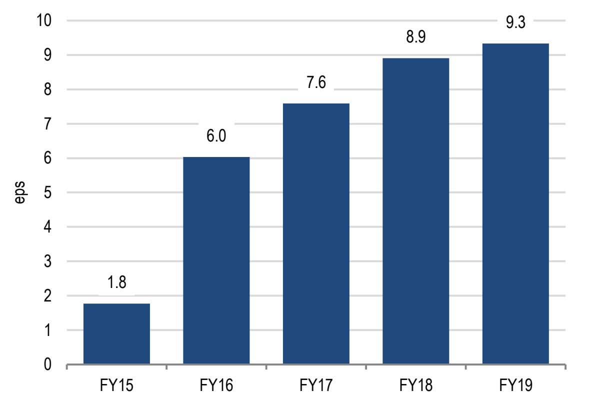
Risks factors

- **Care occupancy:** Competition with quality beds and a focus on home-based support are providing headwinds for near-term occupancy, while cost pressures are building. ARV's 95% occupancy is strong compared to the sector's ~89%.
- **Retirement unit oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term.

Company description

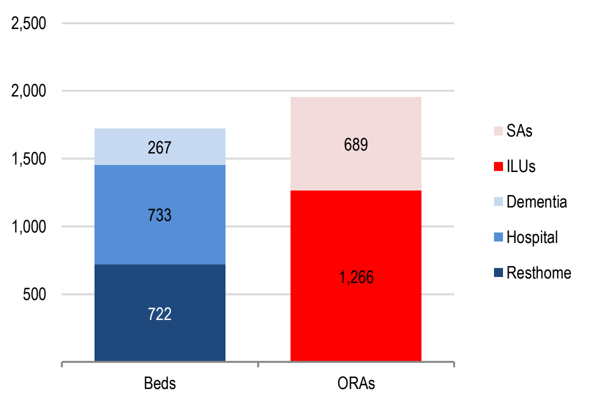
Arvida Group is an aged care and retirement sector operator with a 'needs based' portfolio providing a full continuum of care. It has 33 villages with 1,682 aged care beds and 2,359 units, with the majority of these villages offering both independent living and aged care options. Although the portfolio is predominantly older villages, they are well established, well maintained and are generating solid cash flows. It has 16 facilities located in the South Island (including 7 in Christchurch), which provides regional diversification to its listed peers. ARV's strategy is focussed on brownfield developments and acquisitions which enhance and diversify its earnings.

Figure 5. ARV eps trajectory



Source: Forsyth Barr analysis, Company Reports

Figure 6. ARV portfolio as at 31 March 2019



Source: Forsyth Barr analysis, Company Reports

Figure 7. Substantial Shareholders

Shareholder	Latest Holding
Forsyth Barr Investment Management	9.4%
Generate Investment Management	5.1%

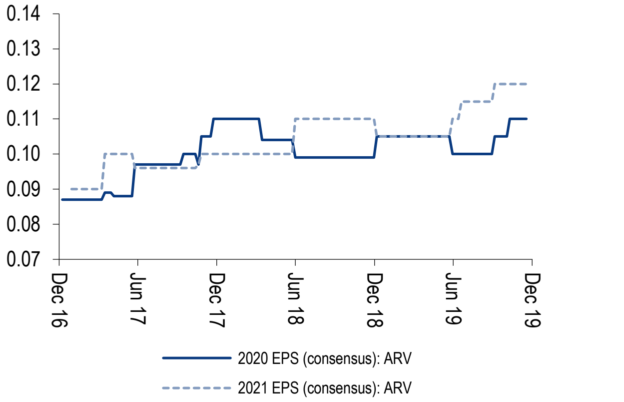
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 8. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect ARV's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Arvida Group Limited	**ARV NZ**	**NZ$1.58**	**NZ$856**	**14.6x**	**12.9x**	**15.2x**	**12.3x**	**16.7x**	**13.5x**	**4.3%**
Ryman Healthcare *	RYM NZ	NZ$14.30	NZ$7,150	27.6x	23.9x	27.2x	23.6x	29.7x	25.7x	2.1%
Summerset Group *	SUM NZ	NZ$7.25	NZ$1,645	15.5x	13.5x	16.6x	14.5x	17.6x	15.3x	2.2%
Metlifecare *	MET NZ	NZ$5.18	NZ$1,105	12.2x	11.5x	14.0x	13.2x	14.9x	14.1x	2.2%
Oceania Healthcare *	OCA NZ	NZ$1.08	NZ$658	11.7x	10.8x	12.8x	11.9x	15.0x	13.9x	5.1%
Regis Healthcare	REG AT	A$3.05	A$917	22.5x	21.6x	11.4x	10.2x	15.6x	14.6x	4.6%
Japara Healthcare	JHC AT	A$1.13	A$301	23.3x	21.6x	10.3x	9.6x	19.4x	18.0x	4.9%
Estia Health	EHE AT	A$2.77	A$723	19.9x	20.0x	9.4x	9.1x	14.1x	13.8x	4.6%
			Compco Average:	**19.0x**	**17.6x**	**14.5x**	**13.2x**	**18.0x**	**16.5x**	**3.7%**
EV = Current Market Cap + Actual Net Debt			**ARV Relative:**	**-23%**	**-27%**	**+5%**	**-7%**	**-8%**	**-18%**	**+16%**

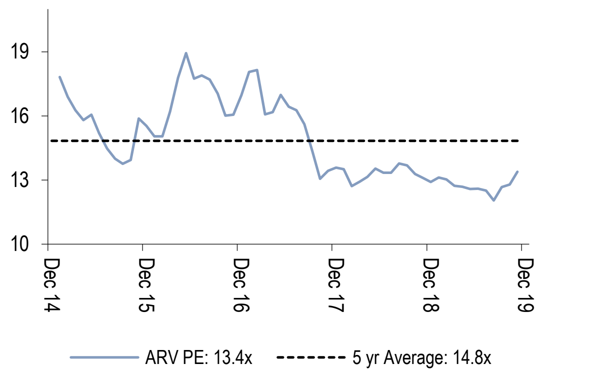
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ARV) companies fiscal year end

Figure 9. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 10. 12 Month Forward PE



Source: Forsyth Barr analysis