

Arvida Group

Ageing Well; Upgrade to OUTPERFORM

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OUTPERFORM

The NZ aged care operator's business model demands a lot of patience from investors; cash is spent up front to build villages which can take a decade or more to reach maturity and provide steady annuity earnings streams. Arvida (ARV) is a young company with recent major acquisitions of young villages. The large proportion of young villages with comparatively low annuity earnings have resulted in low organic growth. In our report *"Different Times Call for Different Measures"*, published October 2020, we estimated that ARV has delivered mid single digits organic growth, far below RYM and SUM. Looking ahead, we see an acceleration of organic growth up to over +15% per annum driven by; (1) high end villages approaching maturity and (2) a focus on care suites with faster maturity. In our view, ARV's accelerating organic growth is not reflected in its valuation which is at a relative all time low versus the NZ market and the aged care sector — upgrade to OUTPERFORM.

NZX Code	ARV	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.70	NPAT* (NZ\$m)	51.7	51.2	66.5	80.7	PE	17.8	18.0	13.8	11.4
Target price	NZ\$2.15	EPS* (NZc)	9.5	9.5	12.3	14.9	EV/EBIT	19.9	21.0	16.8	14.0
Risk rating	Medium	EPS growth* (%)	2.2	-0.9	29.9	21.3	EV/EBITDA	18.1	18.7	15.1	12.6
Issued shares	541.9m	DPS (NZc)	5.8	5.8	7.0	9.0	Price / NTA	1.3	1.2	1.2	1.1
Market cap	NZ\$921m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.4	3.4	4.1	5.3
Avg daily turnover	529.2k (NZ\$863k)	*Based on normalised profits					Gross div yld (%)	4.7	4.7	5.7	7.4

What's changed?

- **Earnings:** Minor near-term forecast earnings changes (FY21/22 +1%/+2%), more material changes thereafter.
- **Target price:** Increased to NZ\$2.15 (from NZ\$1.90)
- **Rating:** Upgraded to OUTPERFORM (from NEUTRAL)

Six maturing villages set to underpin an acceleration of organic growth

We have taken a closer look at the maturity profile of six major villages acquired since listing. These six villages comprise of c. 1,000 Independent Living Units (ILUs), making up approximately half of ARV's total ILUs. Half of these acquired ILUs were completed in the period from 2012 to 2017 and are approaching maturity. We estimate the three Sanderson villages acquired in 2019 will add c. NZ\$15m of incremental re-sale gains over the next five years, adding 60% to ARV's current level of re-sale gains.

Attractive valuation on both an absolute and relative basis

After under performing both the aged care sector and the broader market, ARV is currently valued at or close to relative all time lows on P/E. We believe this under performance has primarily been driven by concerns around increasing leverage and slow organic growth. We expect robust FY21 earnings, but believe a sustained re-rating will be driven by the market pricing in the earnings potential from maturing villages and care ORA.

Care ORA relieves pressure on balance sheet and accelerates growth; but a slow burner on the P&L

After a somewhat cautious start, ARV, much like OCA, has fully committed to building out its care offering using the care ORA model whereby care beds are sold using an Occupational Rights Agreement (ORA) rather than a Premium Accommodation Charge (PAC). Over 90% of ARV's planned care units will be built with the intention of selling them under an ORA and will improve cash recovery of capex materially.

Arvida Group Limited (ARV)

Priced as at 13 Apr 2021 (NZ\$) **1.70**

12-month target price (NZ\$)*	2.15
Expected share price return	26.5%
Net dividend yield	4.2%
Estimated 12-month return	30.7%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.88
WACC	5.9%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. EV/Annuity EBITDA	2.20
2. DDM	2.10
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	n/a
(Net debt)/cash	n/a
Less: Capitalised operating leases	n/a
Value of equity	n/a

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	179.4	203.0	218.0	250.4	283.7	EV/EBITDA (x)	21.2	18.1	18.7	15.1	12.6
Normalised EBITDA	49.6	63.3	65.0	80.6	96.5	EV/EBIT (x)	23.6	19.9	21.0	16.8	14.0
Depreciation and amortisation	(5.0)	(5.8)	(7.1)	(8.1)	(9.2)	PE (x)	18.2	17.8	18.0	13.8	11.4
Normalised EBIT	44.6	57.5	58.0	72.5	87.3	Price/NTA (x)	1.4	1.3	1.2	1.2	1.1
Net interest	(3.6)	(4.1)	(5.7)	(6.0)	(6.6)	Free cash flow yield (%)	-5.7	-13.4	-10.5	-14.2	-16.1
Associate income	0	0	0	0	0	Net dividend yield (%)	3.1	3.4	3.4	4.1	5.3
Tax	(2.3)	(1.7)	(1.0)	0	0	Gross dividend yield (%)	4.4	4.7	4.7	5.7	7.4
Minority interests	0	0	0	0	0						
Normalised NPAT	38.6	51.7	51.2	66.5	80.7	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	20.4	(9.0)	28.1	20.7	12.5	Interest cover EBIT (x)	12.3	14.1	10.1	12.1	13.2
Reported NPAT	59.1	42.6	79.4	87.2	93.1	Interest cover EBITDA (x)	13.7	15.6	11.3	13.5	14.6
Normalised EPS (cps)	9.3	9.5	9.5	12.3	14.9	Net debt/ND+E (%)	24.9	29.7	29.2	29.0	29.0
DPS (cps)	5.4	5.8	5.8	7.0	9.0	Net debt/EBITDA (x)	3.7	4.9	4.9	4.2	3.7

Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	18.0	13.1	7.4	14.9	13.3	Return on assets (%)	3.4	3.0	2.7	3.0	3.2
EBITDA (%)	14.7	27.7	2.7	23.9	19.7	Return on equity (%)	6.9	7.1	6.6	8.0	9.3
EBIT (%)	14.2	29.1	0.8	25.1	20.4	Return on funds employed (%)	5.2	5.0	4.5	5.5	6.3
Normalised NPAT (%)	17.1	33.8	-0.9	29.9	21.3	EBITDA margin (%)	27.6	31.2	29.8	32.2	34.0
Normalised EPS (%)	17.1	2.2	-0.9	29.9	21.3	EBIT margin (%)	24.8	28.3	26.6	29.0	30.8
Ordinary DPS (%)	6.8	8.4	0.0	20.7	28.6	Capex to sales (%)	45.7	74.2	60.2	72.2	72.5
						Capex to depreciation (%)	1,624	2,585	1,850	2,226	2,226
						Imputation (%)	100	100	100	100	100
						Pay-out ratio (%)	57	61	61	57	60

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Operating Performance	2019A	2020A	2021E	2022E	2023E
EBITDA	49.6	63.3	65.0	80.6	96.5	Care fees	125.6	129.5	136.1	146.9	157.1
Working capital change	8.6	24.0	8.0	20.6	18.5	Management fees	21.4	29.0	33.2	40.0	48.8
Interest & tax paid	(5.9)	(5.8)	(6.7)	(6.0)	(6.6)	Resale gains	19.5	23.7	26.2	32.7	43.2
Other	(22.8)	(54.4)	(31.5)	(45.6)	(50.8)	New sale gains	7.5	15.6	17.5	25.5	29.2
Operating cash flow	29.5	27.1	34.8	49.6	57.6	Other	5.4	5.1	5.0	5.3	5.5
Capital expenditure	(82.0)	(150.6)	(131.2)	(180.8)	(205.8)	Total revenue	179.4	203.0	218.0	250.4	283.7
(Acquisitions)/divestments	12.2	(104.1)	113.6	152.3	177.9						
Other	(3.6)	(7.4)	1.0	1.0	1.0						
Funding available/(required)	(43.9)	(235.0)	18.2	22.2	30.7						
Dividends paid	(22.7)	(29.6)	(31.4)	(37.9)	(48.8)						
Equity raised/(returned)	0	141.7	0	0	0						
(Increase)/decrease in net debt	(66.6)	(122.8)	(13.2)	(15.7)	(18.0)						

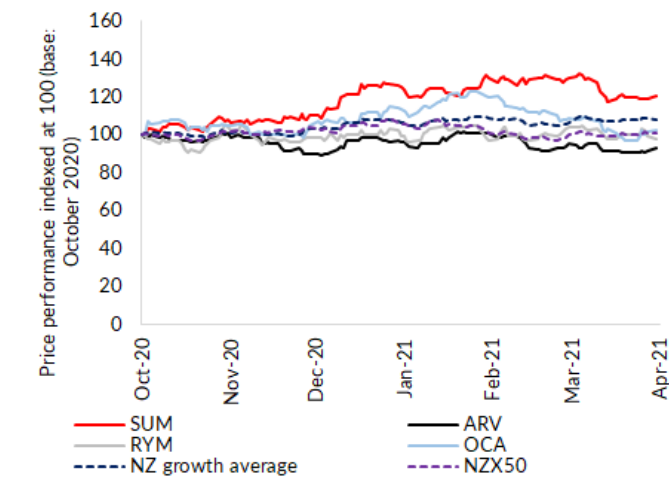
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Key Drivers	2019A	2020A	2021E	2022E	2023E
Working capital	(45.9)	(69.9)	(77.9)	(98.5)	(117.0)	Sales - new units	70	126	145	211	245
Fixed assets	1,190.3	1,804.2	1,997.5	2,247.1	2,526.4	Ave price - new sales (NZ 000's)	633	763	804	746	743
Intangibles	54.0	36.0	36.0	36.0	36.0	Sales - resold units	258	278	263	324	372
Right of use asset	0	0	0	0	0	Ave price - new sales (NZ 000's)	338	377	428	458	482
Other assets	42.8	51.4	52.6	59.6	64.3	Gross development margin	17%	16%	15%	16%	16%
Total funds employed	1,241.2	1,821.8	2,008.2	2,244.2	2,509.7	Gross resales margin	22%	23%	23%	22%	24%
Net debt/(cash)	185.5	308.3	321.5	337.2	355.2	Total portfolio					
Lease liability	0	4.9	4.9	4.9	4.9	Standard care beds	1,722	1,688	1,688	1,688	1,688
Other liabilities	496.8	778.8	904.1	1,075.1	1,278.2	Serviced apartments	664	662	662	662	662
Shareholder's funds	558.8	729.8	777.7	827.0	871.4	ILU's	1,266	1,788	1,894	2,084	2,284
Minority interests	0	0	0	0	0	Care suites (ORA)	25	25	101	136	216
Total funding sources	1,241.2	1,821.8	2,008.2	2,244.2	2,509.7	Care suites (PAC)	0	0	65	75	85
						Total	3,677	4,163	4,410	4,645	4,935

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

Our upgrade in charts

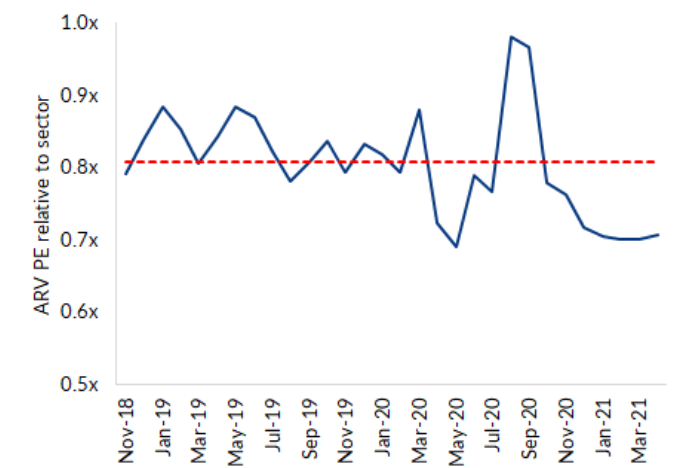
We upgrade ARV to OUTPERFORM (from NEUTRAL) following its relative underperformance against; (1) the aged care sector, (2) NZ growth peers and (3) the NZ market. As a result, we now view valuation as particularly attractive on both an absolute (~14x 12m forward PE and ~20x 12m forward EV/Annuity EBITDA) and relative basis with its relative trading range approaching near all-time lows against both the NZ market median and sector peers.

Figure 1. ARV has underperformed over the past six months...



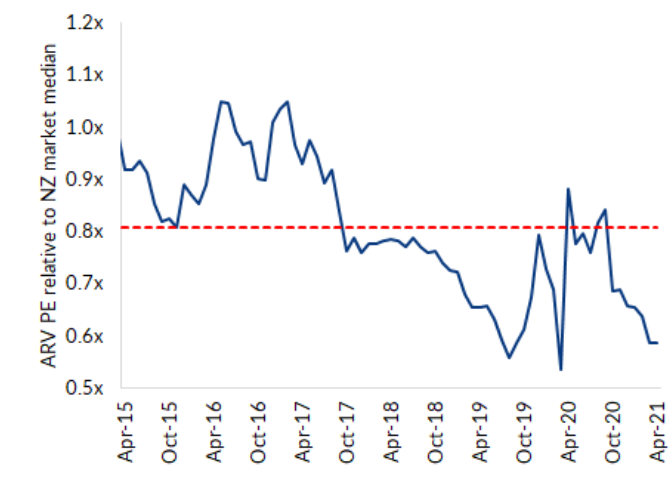
Source: Forsyth Barr analysis, Thomson Reuters

Figure 2. ...and valuation now looks attractive versus the sector...



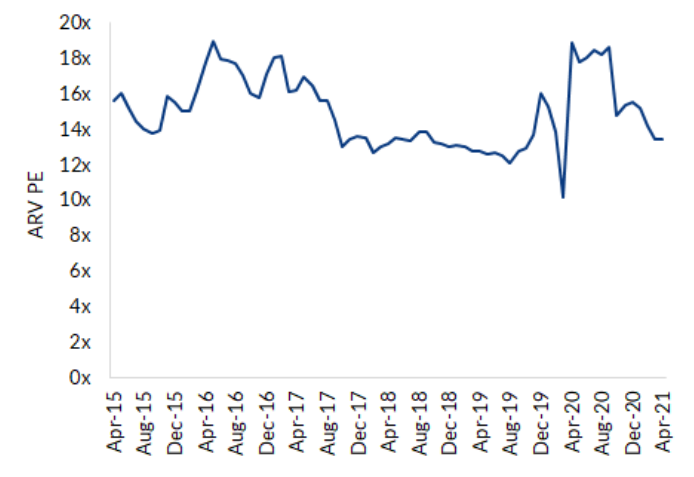
Source: Forsyth Barr analysis

Figure 3. ...and the NZ market



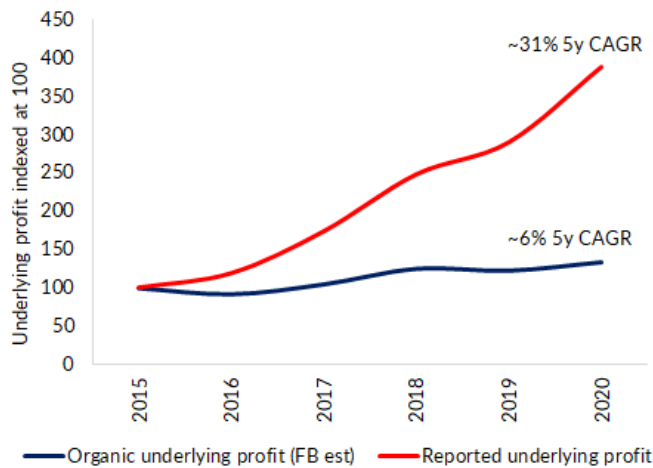
Source: Forsyth Barr analysis

Figure 4. ...with no multiple expansion through time



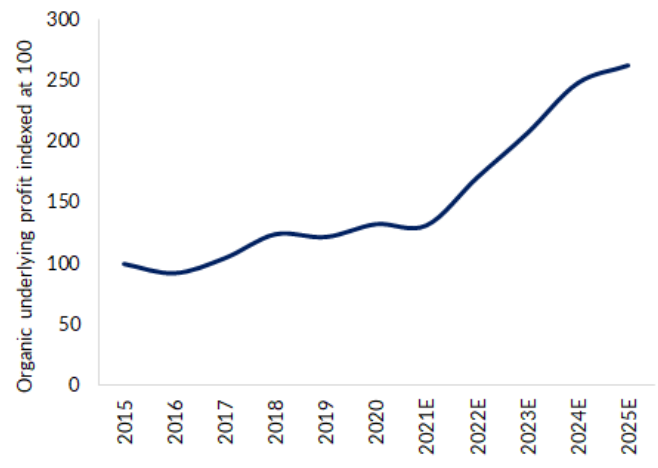
Source: Forsyth Barr analysis

Figure 5. Organic underlying growth has been subdued to date...



Source: Forsyth Barr analysis, Company reports

Figure 6. ...however, we expect this to change



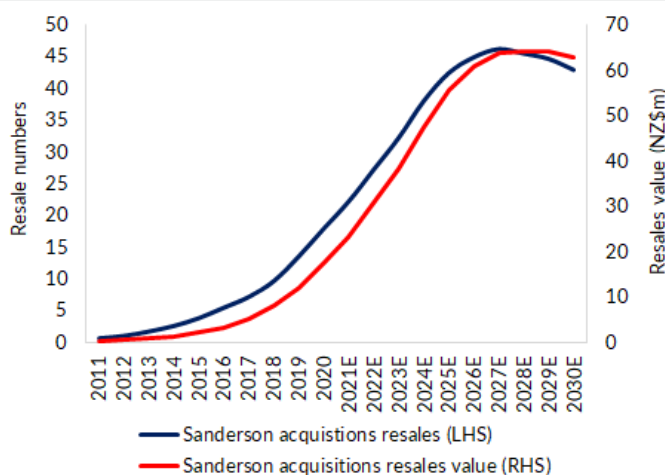
Source: Forsyth Barr analysis, Company reports

We believe the main reason for ARV's relatively low valuation relates to its historically modest organic growth. While the headline growth has been sector leading at 30% per annum, this has primarily been achieved through acquisitions, partly funded by multiple equity raisings. Organic growth as well as per share earnings growth have been modest, we estimate around mid-single digits.

A closer look at recent acquisitions points to substantial acceleration in re-sale gains and associated DMF

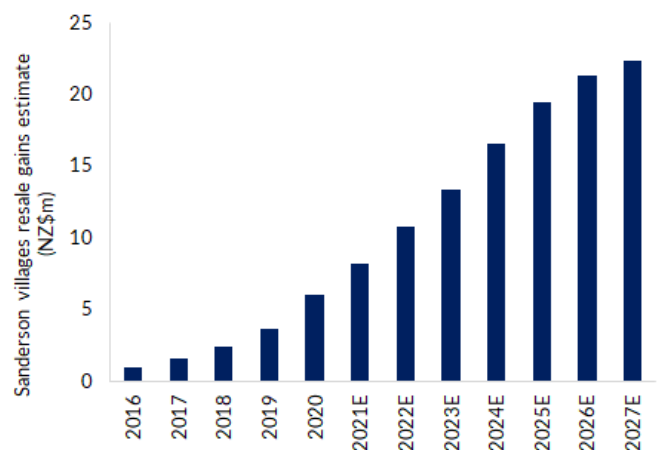
ARV's acquisitions have been focussed on relatively young villages, particularly in the case of the most recent high-end Sanderson acquisitions. This has introduced a level of uncertainty around the steady state earnings potential from these villages. As an illustrative point, Bethlehem Shores, with 146 ILUs, had less than five re-sales in FY20 while the equally large but more mature Bethlehem Country Club had 10-15. More broadly, our analysis of the timing of first occupant for the three Sanderson villages acquired points to the number of re-sales doubling over the next five years.

Figure 7. Annuity growth phase only just approaching (Sanderson case study)...



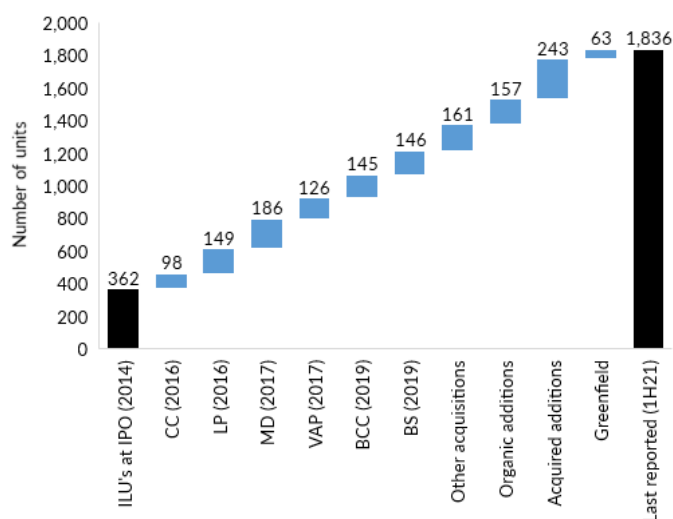
Source: Forsyth Barr analysis, NB; Sanderson case study represents Bethlehem Shores, Bethlehem Country Club and Queenstown Country Club

Figure 8. ...with strong resales gains set to be realised

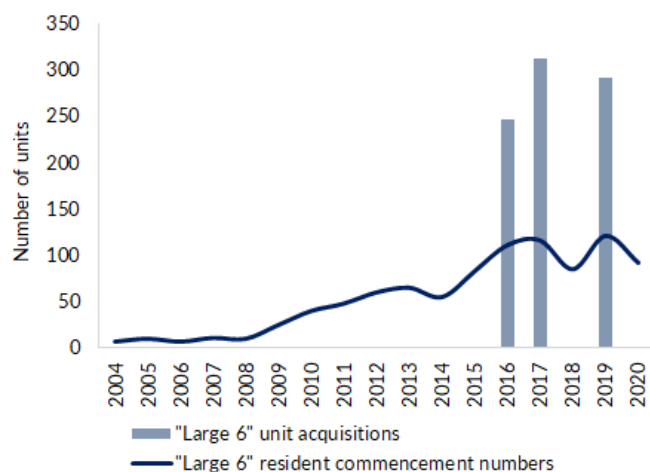


Source: Forsyth Barr analysis

The impact on re-sale gains is likely to be significantly larger due to the compounding effect of higher house prices. By 2025, using a 35% re-sale margin (which we believe to be conservative) we estimate that the three Sanderson villages alone will deliver close to NZ\$20m of re-sale gains, up from around NZ\$4m today. To put this into context; in FY20 ARV reported total re-sale gains of NZ\$24m.

Figure 9. Strong history of acquisitions since listing


Source: Forsyth Barr analysis, Company reports, NB; BCC=Bethlehem Country Club, BS=Bethlehem Shores, CC=Copper Crest, MD=Mary Doyle, LP=Lauriston Park, VAP=Village at the Park

Figure 10. Maturity is now approaching for ARV's large recent acquisitions


Source: Forsyth Barr analysis, Company reports, NB; "Large 6" represents Bethlehem Country Club, Bethlehem Shores, Copper Crest, Mary Doyle, Lauriston Park, Village at the Park

DMF is effectively a function of new and re-sales. The combination of higher re-sale gains and DMF should drive an acceleration of organic growth in annuity earnings from mid single digits to over 15% p.a.

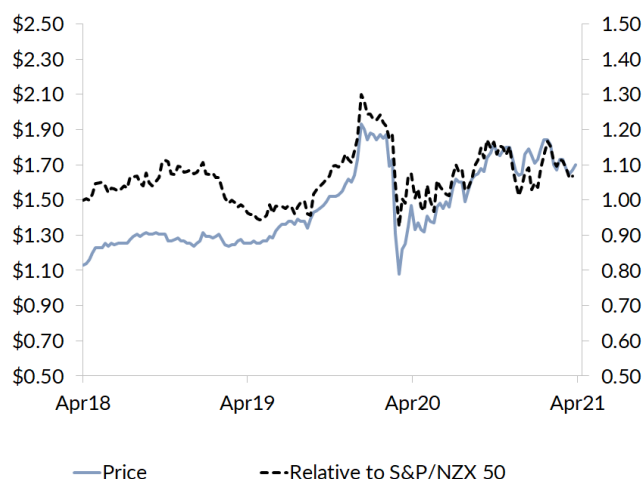
Earnings changes

We make minor near-term forecast earnings changes (FY21/22 +1%/+2%), more material changes are made thereafter as we incorporate the full benefits of ARV's transition into care suites. Albeit, this will take time to reach maturity given ARV is still very much in the early days of its care portfolio transformation.

Figure 11. Forecast earnings changes (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care fees	133.5	136.1	2%	141.4	146.9	4%	149.7	157.1	5%
DMF	33.1	33.2	0%	40.2	40.0	-1%	48.8	48.8	0%
Resale gains	25.1	26.2	4%	31.7	32.7	3%	36.7	43.2	17%
Newsale gains	17.9	17.5	-2%	26.5	25.5	-4%	30.1	29.2	-3%
Other	5.0	5.0	0%	5.3	5.3	0%	5.5	5.5	0%
Total revenue	214.6	218.0	2%	245.0	250.4	2%	270.9	283.7	5%
Total costs	149.5	152.9	2%	164.3	169.8	3%	178.5	187.2	5%
EBITDA	65.2	65.1	0%	80.7	80.6	0%	92.5	96.5	4%
Depreciation & amortisation	7.3	7.1	-2%	8.2	8.1	0%	9.3	9.3	-1%
EBIT	57.9	58.1	0%	72.6	72.5	0%	83.1	87.2	5%
Net interest & tax	6.7	6.7	0%	6.2	6.0	-4%	6.7	6.6	-2%
Underlying profit	51.2	51.3	0%	66.3	66.5	0%	76.5	80.7	6%
 Annuity EBITDA	 47.3	 47.6	 1%	 54.2	 55.1	 2%	 62.3	 67.3	 8%
EPS (cents)	9.4	9.5	0%	12.2	12.3	0%	14.1	14.9	6%
DPS (cents)	5.8	5.8	0%	7.0	7.0	0%	7.5	9.0	20%

Source: Forsyth Barr analysis

Figure 12. Price performance


Source: Forsyth Barr analysis

Figure 13. Substantial shareholders

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

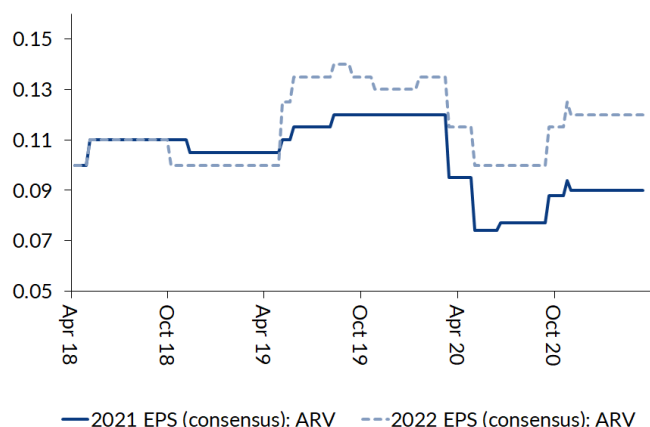
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 14. International valuation comparisons

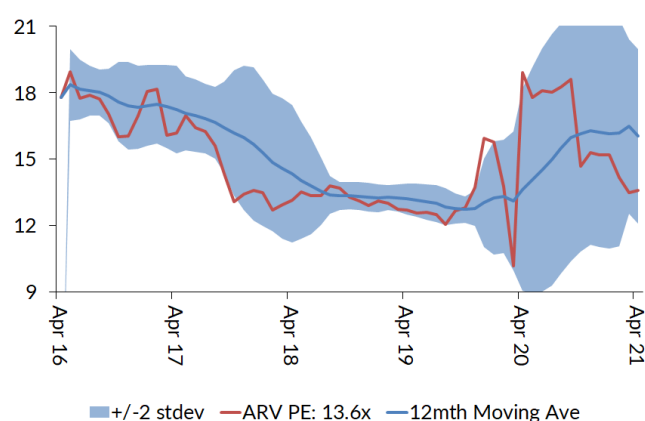
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect ARV's balance date - March)										
Arvida Group Limited	ARV NZ	NZ\$1.70	NZ\$921	18.0x	13.8x	18.9x	15.3x	21.2x	17.0x	4.1%
RYMAN HEALTHCARE *	RYM NZ	NZ\$14.87	NZ\$7,435	30.9x	24.4x	31.1x	24.9x	35.0x	27.7x	2.1%
SUMMERSET GROUP LIMITED *	SUM NZ	NZ\$12.00	NZ\$2,753	25.5x	19.2x	26.0x	19.7x	27.8x	20.9x	1.6%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.33	NZ\$913	17.9x	13.8x	17.8x	13.2x	22.2x	16.2x	3.4%
REGIS HEALTHCARE	REG AT	A\$2.29	A\$689	69.0x	26.2x	6.4x	6.3x	10.3x	9.5x	3.5%
JAPARA HEALTHCARE	JHC AT	A\$0.77	A\$204	<0x	58.6x	13.0x	13.0x	<0x	<0x	1.5%
ESTIA HEALTH	EHE AT	A\$2.34	A\$611	75.0x	48.2x	<0x	7.8x	9.0x	11.3x	2.3%
Compco Average:				43.7x	31.7x	18.9x	14.2x	20.9x	17.1x	2.4%
ARV Relative:				-59%	-56%	0%	8%	2%	-1%	73%

EV = Current Market Cap + Actual Net Debt

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

Figure 15. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 16. One year forward PE (x)


Source: Forsyth Barr analysis

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