

# Aged Care Sector

## Different Times Call for Different Measures

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The attraction of NZ's aged care sector centres on its near unique business model of recycling capital while building up an annuity stream; for every 100 dollars invested 100 dollars is recouped through the sale of occupational rights agreements (ORAs). What remains is a growing annuity stream and near "infinite" return on actual invested capital, or so the theory goes. In practice this has become increasingly difficult to achieve. Net debt is building up across the sector and cash conversion of earnings is declining. Is the business model broken? We think not, but believe that recycling capital has become harder and scrutiny of underlying earnings more important. We focus on development of annuity earnings and cash recovery of new business when analysing aged care. We downgrade Ryman Healthcare (RYM) and Arvida (ARV) to NEUTRAL, upgrade Oceania Healthcare (OCA) to OUTPERFORM and reiterate our OUTPERFORM rating on Summerset (SUM).

### Quality of earnings; focus on annuity earnings and cash conversion

The aged care sector is characterised by an unusually innovative approach to underlying earnings, with, at times, only a tenuous link to reported earnings or cash generation. While non-GAAP earnings are common practice in many industries, the aged care sector stands out with un-audited items making up c. 80–90% of underlying earnings. We believe this increases the importance of careful evaluation of these earnings over time and between companies in order to evaluate relative performance. In this report we take a closer look at the composition of earnings with regards to cash conversion, growth and annuity characteristics.

### Imitation is the sincerest form of flattery – the "RYMification" of the NZ aged care sector increases comparability

RYM's focus on continuum of care which is "good enough for mum" and growth through recycling capital has delivered >20% annual Total Shareholder Return (TSR) for over 20 years; the other listed aged care operators have taken note. OCA and ARV are adding a disproportionate amount of Independent Living Units (ILUs) to complement the reliance on care, SUM has increased its care offering and is rather openly following in RYM's footsteps, including over to Victoria. This "RYMification" of the sector reduces the diversity for investors, but also, we believe, increases the earnings comparability. While OCA and ARV are in a different phase, still integrating acquisitions and doing brownfield development, the reliance on traditional care earnings has declined dramatically and the earnings mix is starting to look very similar to RYM.

### SUM and OCA are our preferred names – for very different reasons

SUM has delivered growth in annuity earnings >2x that of the sector over the last 3–5 years and has the best (least bad) cash recovery of expansionary capex. Looking ahead, we see SUM as best positioned to deliver growth from its existing book and, together with OCA, has the highest cash recovery of expansionary capex. Despite this RYM is valued at a ~20% premium to SUM on our preferred valuation metric of EV/Annuity EBITDA and only a modest premium to ARV. OCA, on the other hand, has, by some margin, delivered the worst growth (a decline) in annuity earnings since it listed and has seen cash conversion deteriorate the most. This has been driven by the ongoing transformation from a traditional care operator towards more of a premium continuum of care operator. Looking ahead, we expect 20%+ growth in annuity earnings and cash conversion improving to the sector average; with a starting point as the lowest multiple, we see most upside in OCA – but the path ahead is unlikely to be straight.

**Figure 1. Valuation and rating breakdown**

	Current price (NZ\$)	Target price (NZ\$)	Target price upside	Dividend yield	ETSR*	Rating
SUM	10.00	11.90	19%	1.6%	21%	OUTPERFORM
OCA	1.30	1.65	27%	3.2%	30%	OUTPERFORM
RYM	15.11	14.00	-7%	1.7%	-6%	NEUTRAL
ARV	1.80	1.90	6%	3.4%	9%	NEUTRAL

Source: Forsyth Barr analysis \*12 month Estimated Total Shareholder Return

## Executive summary

### **We remain positive on the aged care sector; the unexpected winner of the COVID crisis...**

Overall we remain positive on the aged care names as a group. The COVID-19 crisis, somewhat unexpectedly, appears to have turned into a double win for the aged care operators. Firstly, and most importantly, the aged care operators collectively did a very good job navigating the direct implications for its residents and the feedback has unequivocally been positive from residents and families. The positive experience, in combination with many vulnerable peoples experience from lockdown at home, has increased demand for aged care. Secondly, early signs are that house prices in New Zealand but more broadly across many parts of the world have not only held up well but have started to increase materially again. A combination of (even) lower interest rates and "nesting" following repeated lockdowns, often including working from home, has increased the demand and affordability for residential houses. We believe this double win for the aged care sector is likely to drive strong earnings growth for several years.

### **...and shift our focus to annuity earnings...**

The aged care operators innovative approach to underlying earnings makes earnings comparisons challenging. Not just between the sector and other sectors but also between the four listed operators. Our preferred approach when evaluating the sector is annuity earnings, i.e. earnings excluding development gains. This approach highlights some diverging fortunes. SUM has continued to grow at a pace of 20%+ p.a. while growth has slowed materially for RYM over the last few years and never really taken off for ARV (organically) or OCA. Looking ahead, we expect growth to improve for the latter three, but expect RYM and ARV to continue to grow slower than SUM while we expect OCA to grow the fastest in the sector as it has reached an inflection point with regards to how it charges for care; we expect annuity earnings to almost double for OCA over the next three years.

### **...along with cash recovery of capex**

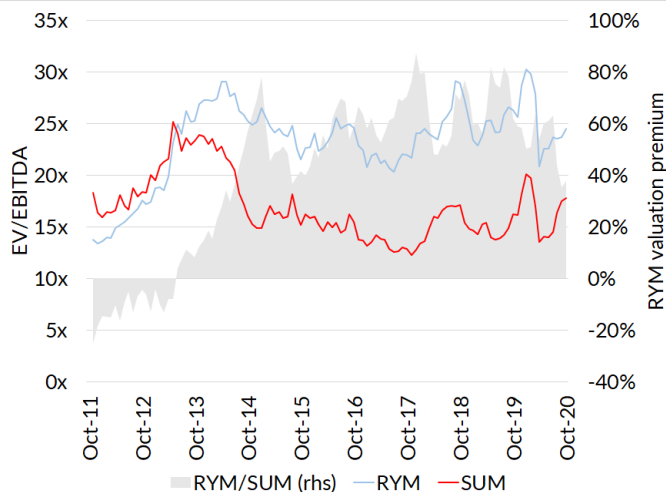
Cash recovery of capex, what proportion of capex that is recovered from new sales, has been trending down for some time with the sector now between 50–70%. Decreasing cash recovery has driven net debt up across the sector and raised questions around the sector's ability to re-cycle capital. We believe the recent house price bounce has bought the sector time and see no near term issue with the increasing debt levels. However, we believe the decline in cash recovery to be partly structural; longer lead times, higher cost of building care as well as higher land prices have all contributed and all are here to stay. As such, we believe the market will reward companies that can show a high degree of cash recovery. We see OCA as best positioned due to its focus on brownfield development and selling care suites under an Occupational Rights Agreement (ORA). ARV is also pursuing care suites which will improve cash recovery, but are earlier in the process and it may continue to be somewhat blurred by repeated acquisitions. We expect RYM to see continued meaningful increase in net debt, predominantly driven by Australia where we believe RYM is still 12–18 months away from cash recovery of the multi year cash outlay. SUM sits in the middle – but its focus on broad acre sites and lower care proportion has been somewhat of a shield.

### **A preference for aged care operators exposed to a buoyant market**

In a buoyant market with strong demand for privately funded care and increasing house prices our preference is for SUM and OCA which we believe can deliver stock quickly to the market and show strong growth in annuity earnings without applying too much balance sheet pressure. OCA has the highest charges which exposes to them to falling demand, but gives leveraged exposure to an up-cycle. SUM has the highest cash recovery of greenfield development, the largest land bank and a focus on fast to develop broad acre sites. While we expect RYM and ARV to also deliver good growth over the coming years, we believe RYM's core competitive advantage of lower fees, more comprehensive care offering and higher occupancy will be less of a differentiator in the near term and view the shares as fully valued. We see some upside in ARV, but believe the market needs to grow comfortable with its ability to deliver on the pivot to care suites as well as a clearer picture on organic growth before ARV will enjoy a re-rating up towards SUM and RYM.

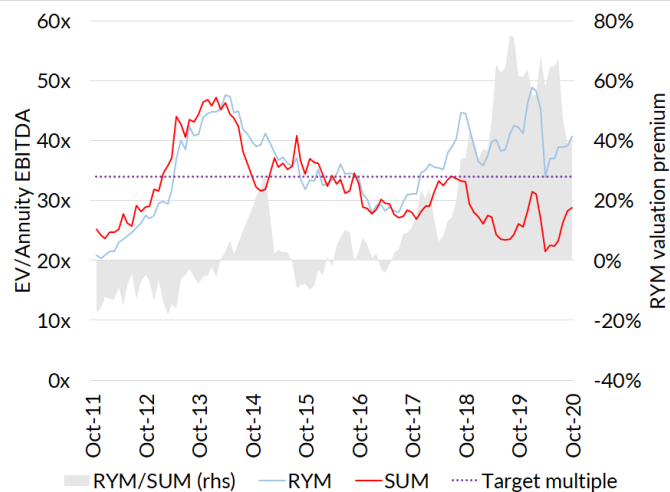
## Our thesis in pictures

Figure 2. EV/EBITDA RYM vs. SUM



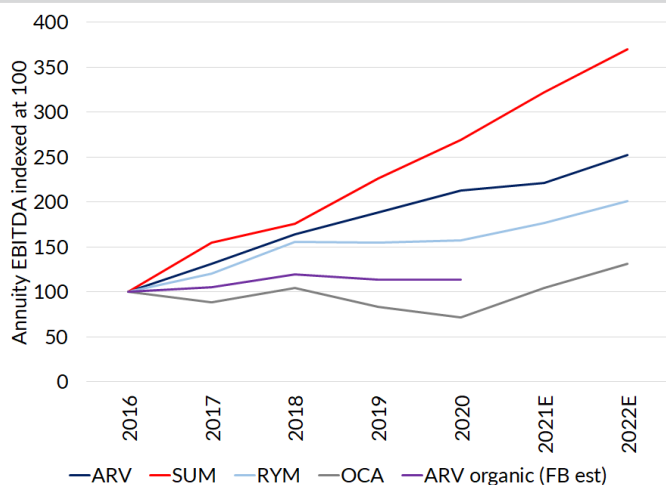
Source: Forsyth Barr analysis

Figure 3. EV/Annuity EBITDA RYM vs. SUM



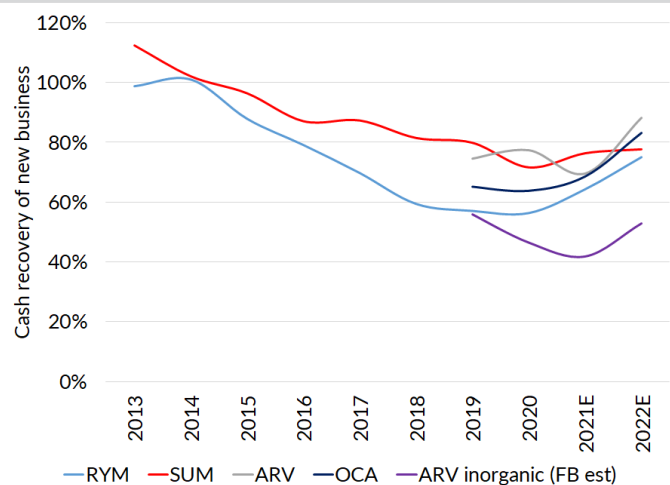
Source: Forsyth Barr analysis

Figure 4. Annuity EBITDA indexed



Source: Forsyth Barr analysis

Figure 5. Cash recovery of capex, 3y average, 1y lag



Source: Forsyth Barr analysis

Figure 6. Implied growth in annuity EBITDA from existing operations

	Implied resale growth	Implied DMF growth (EV resale gain % OA)	Implied resale value (NZ\$m)	Implied DMF value (NZ\$m)	Forecast annuity EBITDA (NZ\$m)	Implied annuity EBITDA growth
RYM	36%	26%	41.3	27.0	205.8	33%
SUM	72%	36%	28.6	21.8	81.2	62%
ARV	11%	26%	3.0	9.3	49.5	25%
OCA	41%	17%	6.5	6.3	42.6	30%

Source: Forsyth Barr analysis, Company reports

Figure 7. Forecast valuation breakdown

	P/E			EV/EBITDA			EV/Annuity EBITDA		
	FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3
RYM	27.0	22.6	20.5	28.0	23.9	21.6	44.0	38.6	34.4
SUM	22.8	17.8	14.5	21.7	17.7	14.7	33.6	28.1	24.4
ARV	17.5	13.7	11.6	19.0	15.6	13.4	25.7	22.5	20.1
OCA	16.2	13.4	11.6	15.5	13.5	12.0	24.9	19.7	16.4

Source: Forsyth Barr analysis

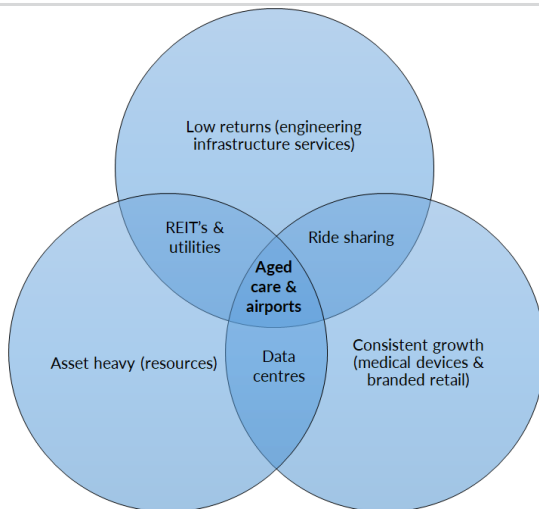
## A sector like no other; in pursuit of firm (valuation) ground

When valuing equity there are, simplistically, three broad approaches; (1) compared to own history; (2) compared to other similar assets; or (3) discounted cash flows. All have merits and shortcomings, and as analysts we often, explicit or not, use a combination of all three to form a view around valuation. With regards to the NZ aged care sector, the ground is quite shaky on all three approaches. Historical multiples show no consistency on any traditional valuation metric, there are no similar assets of significance listed, and they do not generate any FCF to discount. With this report we change our valuation approach from 100% DCF to be based 50% on our target EV/Annuity EBITDA multiple and 50% on our discounted dividend model.

### An eclectic mix of characteristics; Airports (!) are probably the closest peer group

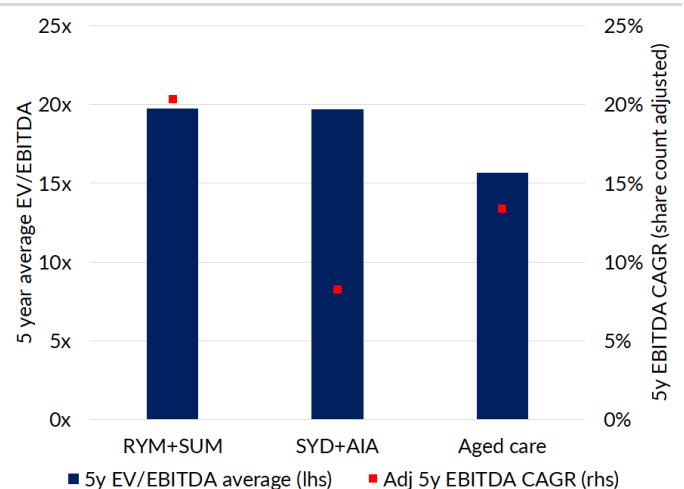
The aged care operators, in a global context, share a highly unusual set of characteristics which makes it difficult to compare to other segments of capital markets, both domestically and internationally. Hence, when trying to compare the valuation of the NZ aged care sector with that of the market we run into some uncharted territory. A significant majority of earnings are non-GAAP, and as a group, FCF hasn't been generated for many years and if our forecasts are correct, likely will not generate any FCF for many years still.

Figure 8. Low returns, asset heavy, fast growing



Source: Forsyth Barr analysis

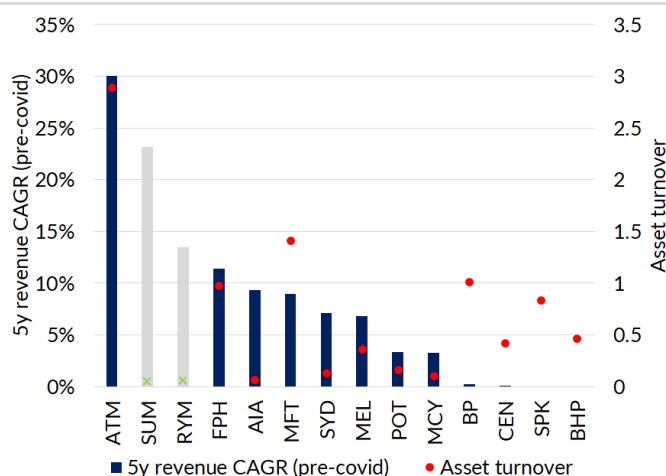
Figure 9. EV/EBITDA valuation and EBITDA growth



Source: Forsyth Barr analysis, Eikon, Company reports

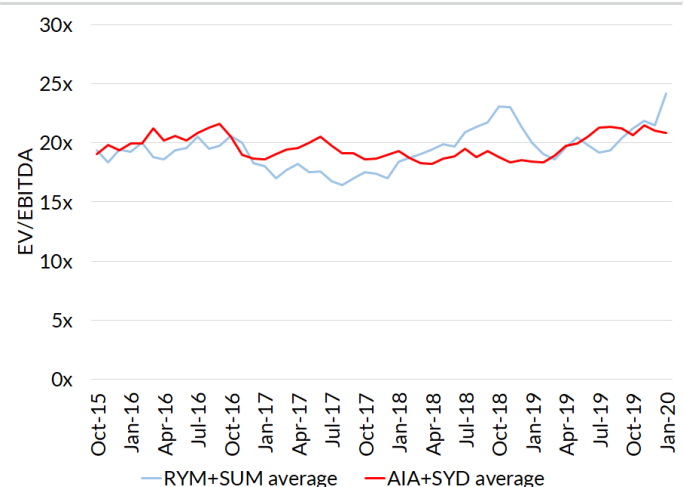
The aged care operators are at the extreme end of asset heavy, with asset turns lower than utilities and mining, yet are growing through cycle earnings and operating cash flow at a similar pace to Nike and Microsoft with a predictability that make them look like a supermarket. The aged care operators return on invested capital is below that of Airlines and REITs and are classified as Healthcare Equipment and Services companies by the MSCI. An eclectic mix of characteristics, to say the least.

Figure 10. NZ and global companies asset turnover and growth



Source: Forsyth Barr analysis, Eikon. Note: ATM revenue has been scaled from 64%

Figure 11. Large cap aged care relative to large cap Airports



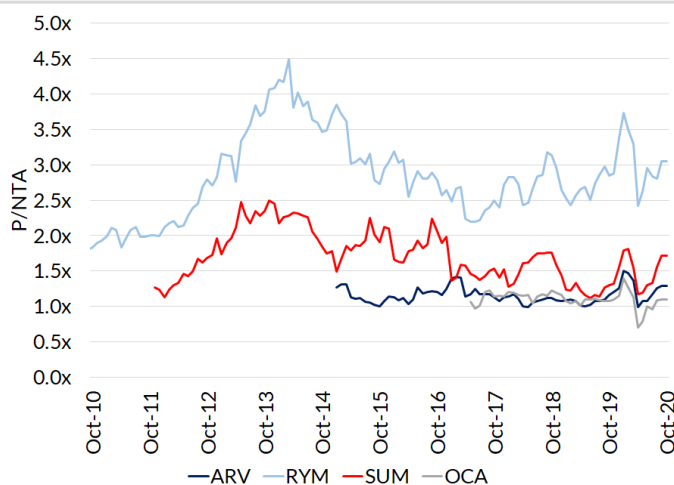
Source: Forsyth Barr analysis, Eikon

Pre COVID-19 airports, somewhat unintuitively, is probably the closest peer group we have found with regards to sharing the aged care sector's eclectic mix of characteristics; extremely asset heavy, (some) stable growth, limited FCF and low returns on invested capital. We will not propose to use this sector as a "peer group" for the aged care sector, however, it does provide some comfort around the (high) multiples of the aged care names in New Zealand; they share a unique set of characteristics which the market values elsewhere as well.

## REITs a poor proxy; focus on NTA motivated – but not for valuation purposes

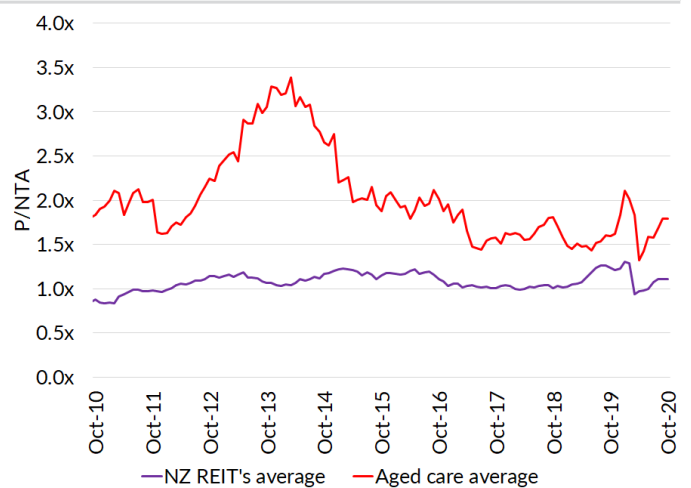
We consider REITs a poor proxy for the aged care sector, and by implication we do not focus on NTA for valuation purposes. We do have some sympathy for comparing the aged care companies to REITs, as it is an asset class that the aged care operators share at least some characteristics with. However, we do not believe that the aged care sector, as an asset class, behave like REITs and consider the differences too large to bridge. Firstly, the divergence in NTA multiples over time and between companies for the aged care sector suggest that, while the market may be focussed on NTA, it is likely to be indirect rather than direct; and secondly, the strong growth, no matter what P&L or balance sheet metric you look at, is one of the key defining features of the listed aged care sector, something that cannot be said for the REITs.

**Figure 12. P/NTA aged care – limited consistency over time or between companies**



Source: Forsyth Barr analysis, Eikon

**Figure 13. P/NTA aged care vs REITs over time**

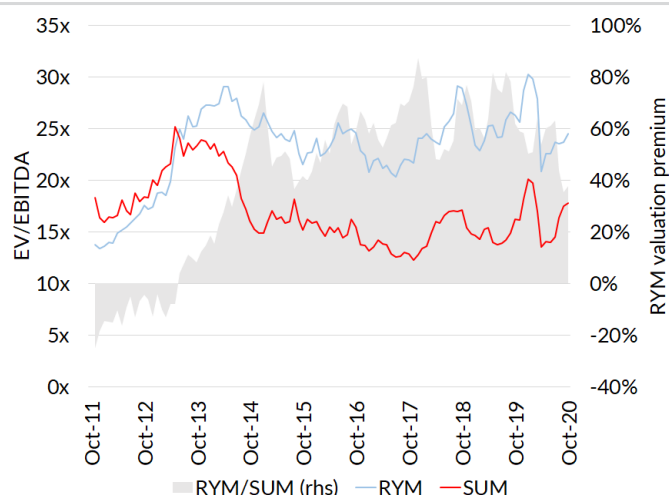


Source: Forsyth Barr analysis, Eikon

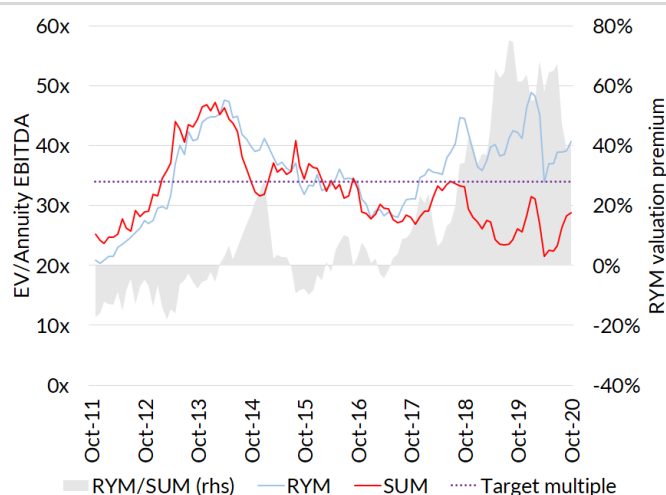
The aged care companies are growing assets (square meterage) at a pace of 10%+ p.a. with almost no equity provided, while the REITs only grow very low single digits despite repeated equity issuance. The valuation differences over time and between the listed aged care names on a P/NTA basis is also vastly higher than for REITs, with earnings based valuation multiples showing more stability over time. This is not surprising, the business cash flow (closest match to the REITs FFO) from SUM and RYM has grown by a CAGR of 15–20% per share over the last decade while many NZ REITs have struggled to get into positive territory.

## EV/annuity earnings; our focus for NZ aged care

When we value the NZ aged care sector we focus on annuity EBITDA (underlying EBITDA less new sales gain). We do this for three reasons; (1) annuity earnings have a clear link to cash generation and accounting earnings, although this at times comes with a multi-year delay; (2) annuity earnings represent the earnings power of current operations while development gains represent potential future earnings, more similar in nature to a new mine or power station for a utility or mining company; and (3) most importantly, we believe this is how the aged care companies are and will be evaluated and valued by the market.

**Figure 14. RYM/SUM EV/EBITDA**


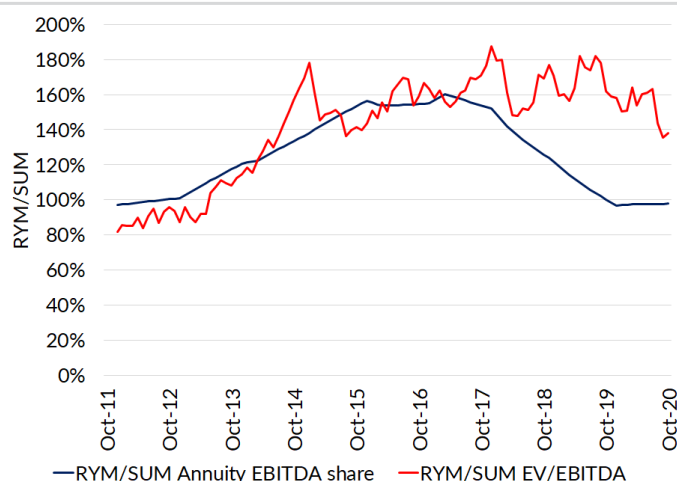
Source: Forsyth Barr analysis, Eikon

**Figure 15. RYM/SUM EV/Annuity EBITDA**


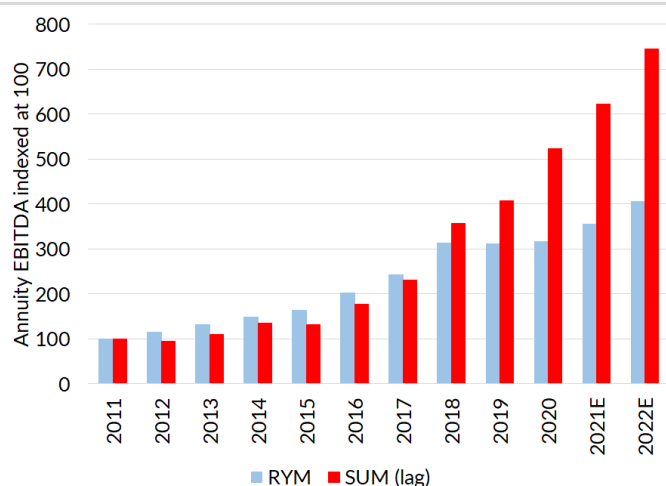
Source: Forsyth Barr analysis, Eikon

### SUM and RYM have traded on a similar EV/Annuity EBITDA multiple

RYM and SUM have, by some margin, the longest trading history of the four main listed operators and we believe trading history can give some guidance with regards to how the market is valuing this unique sector. Looking at EV/EBITDA (Figure 14 above) RYM has traded on a substantial premium of over 50% for most of its history. The same premium can be observed when looking at both P/E and P/NTA. However, during most of this history SUM has derived a substantially higher proportion of earnings from development gains than RYM. If we look at annuity earnings, i.e. excluding development gains, the premium disappears all together for most of the trading history. This suggests to us that the market has been paying a "premium" for RYM not primarily due to superior long term growth prospects and/or rewarding them for longer history of consistent execution, but rather we believe it to be a consequence of RYM's, until recently, superior earnings mix with a higher proportion annuity earnings.

**Figure 16. RYM/SUM Annuity EBITDA and EV/EBITDA**


Source: Forsyth Barr analysis, Company reports

**Figure 17. RYM/SUM annuity EBITDA indexed**


Source: Forsyth Barr analysis, Company reports

### Last two years an anomaly we expect to continue to close

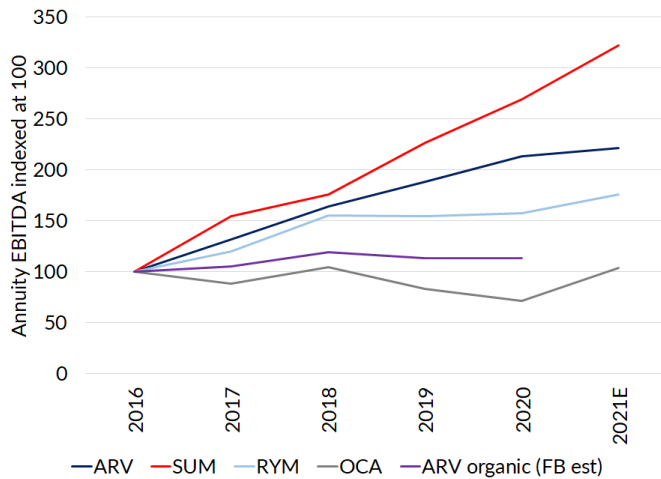
However, over the last 2+ years, RYM has started to be valued at a substantial premium to SUM on EV/Annuity EBITDA as well, why? We believe this to be a consequence of primarily three factors; (1) RYM's growth in annuity EBITDA has slowed materially since 2018 (Figure 17) while SUM's growth has continued, this development has been less visible looking at underlying earnings and development of NTA; (2) historically RYM has been valued at a (in our view) motivated substantial premium on P/NTA and EV/EBITDA due to a higher proportion of annuity earnings, SUM's transformation from c. 45% to over 60% annuity earnings has happened over the last two years; and (3) we are charting forward reported annuity earnings; consensus estimates are not available. The market potentially anticipated growth in-line with history for RYM, and when this growth has not materialised, the (relative) de-rating started, which we have also seen over the last 6 months when SUM has outperformed RYM by ~30%, closing about half the valuation gap.



## Focus on annuity earnings growth and recovery of capex

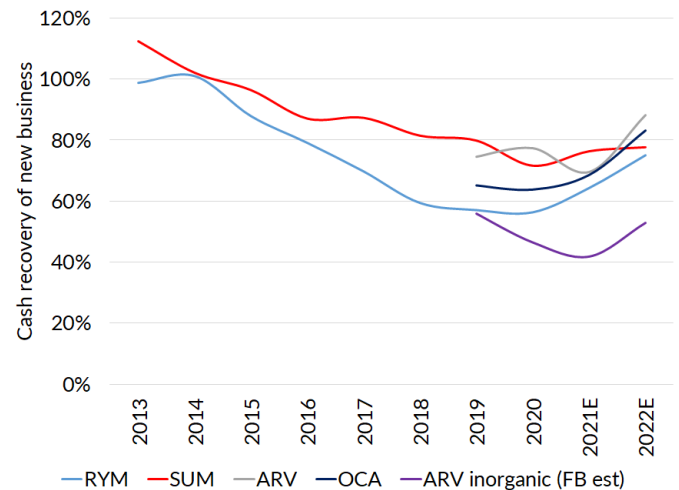
We evaluate the aged care names on two main parameters. Annuity earnings (everything but new-sales) and capex recovery (proportion of capex recovered from new-sales). Faster growth in annuity earnings should intuitively come at the expense of worse cash recovery as more ongoing construction should lead to lower recovery rates, all else equal. However, we find that SUM has, by some margin, grown annuity earnings the fastest despite also having the highest proportion of cash recovered from new sales. While at first this may not appear intuitive, we take the view that a higher proportion of cash being recovered is necessary to achieve fast growth in annuity earnings. This recycling of capital is at the essence of the aged care operators growth engine.

**Figure 18. Sector annuity EBITDA indexed**



Source: Forsyth Barr analysis, Company reports

**Figure 19. Cash recovery of capex, 3y average, 1y lag**

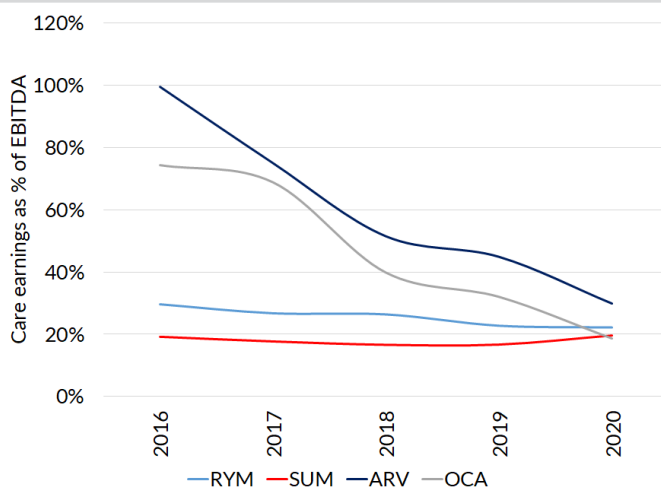


Source: Forsyth Barr analysis, Company reports

## All earnings are not created equal

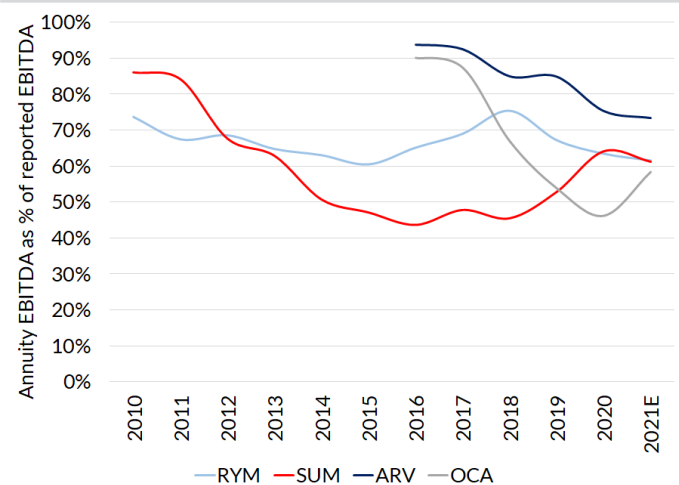
The aged care operators headline EBITDA and underlying earnings include two "non GAAP" or un-audited items; re-sale and new-sale gains. These have increasingly dominated the P&L of the aged care operators and now together make up ~80%+ of reported underlying EBITDA/net income. Much like other sectors where non-GAAP earnings are common, the aged care operators provide these numbers to "better reflect the underlying performance of the business", and overall we agree. However, the consistent dominance of non-gaap earnings is unique amongst listed equities, to our best knowledge. The unique nature of earnings increases the importance of closer scrutiny of the earnings, both in an absolute and relative sense. We are of the view that while re-sale gains are a relatively close proxy to cash generation and reflects a genuine gain (before refurbishment capex) new-sale gains are not. New sale gains does not, and does not aim to, reflect cash generation. Instead, it should, in our view, primarily be analysed from a cash recovery point of view – call it capex efficiency.

**Figure 20. Care earnings as a % of EBITDA**



Source: Forsyth Barr analysis, Company reports

**Figure 21. Annuity EBITDA as % of reported EBITDA**



Source: Forsyth Barr analysis, Company reports

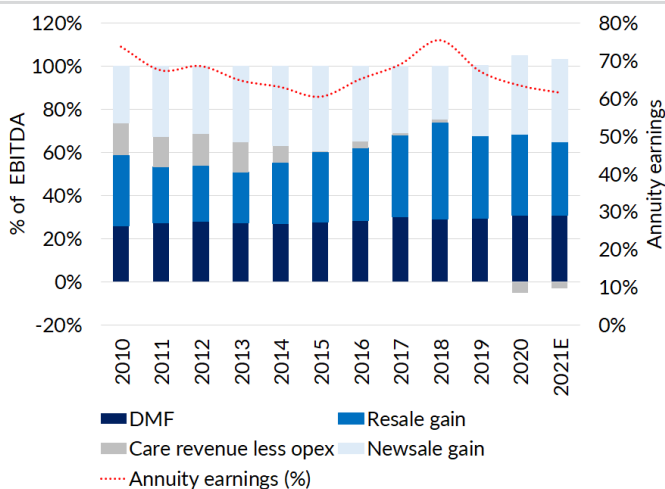
### Earnings mix; less care and more development gains

When looking at the earnings mix of reported earnings for the aged care operators, two trends stand out; the decline of care and the rise of development gains. This has been particularly clear amongst the (previously) care dominated operators; ARV and OCA. In Figure 20 above, we have made an attempt to estimate care contribution for the aged care operators. The result is that when looking at earnings mix the aged care operators are looking increasingly similar to each other. All operators have a small and declining proportion of traditional care earnings and a large and fast growing contribution from ILUs, fuelled by a cash negative development/acquisition business.

Somewhat simplistically the aged care sector has three sources of annuity EBITDA from which we deduct corporate and village costs;

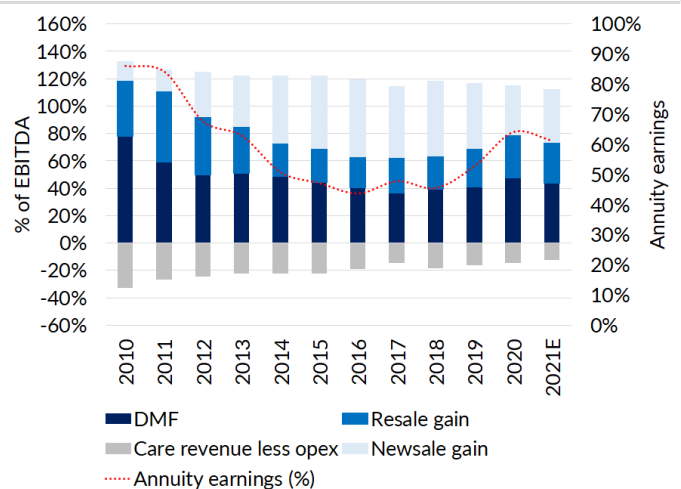
- **Deferred management fees (DMF):** Cash conversion is poor but "annuity" characteristics and growth is high. Reported DMF largely represents cash DMF in the future, with an average lag of 5–7 years.
- **Re-sale gain:** Cash conversion is mediocre (we estimate that about 25% is consumed by refurbishment capex), annuity characteristic is good and growth (so far) has been very strong, driven through cycle house price inflation as well as premiumisation.
- **Estimated care earnings:** Cash conversion is high (we estimate around 100%) and annuity characteristics are also high. However, aged care earnings have been under pressure over the last few years driven primarily by increased costs but also by a deliberate shift to monetise care through an ORA.

Figure 22. RYM: mix of EBITDA



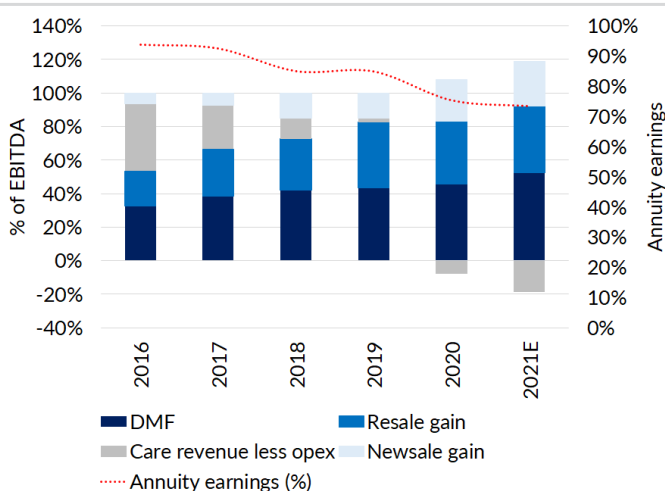
Source: Forsyth Barr analysis, Company reports

Figure 23. SUM: mix of EBITDA



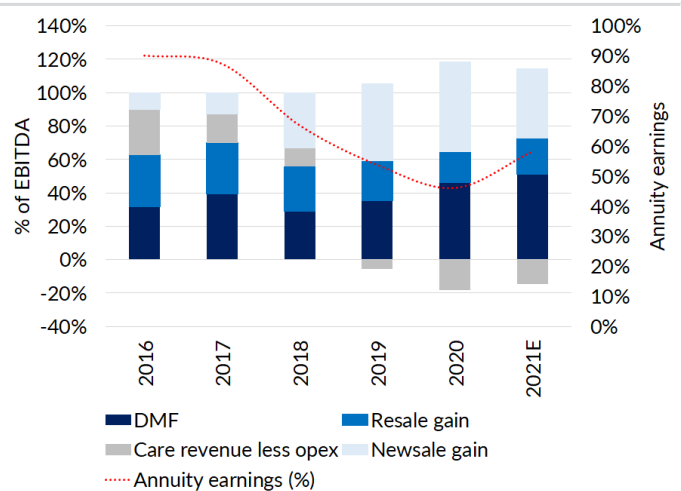
Source: Forsyth Barr analysis, Company reports

Figure 24. ARV: mix of EBITDA



Source: Forsyth Barr analysis, Company reports

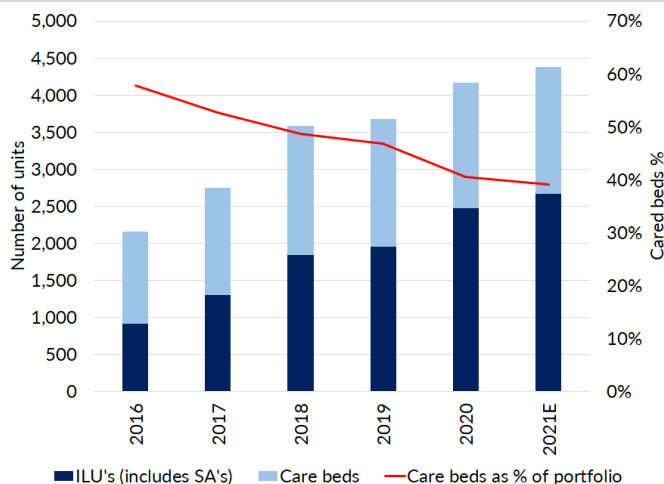
Figure 25. OCA: mix of EBITDA



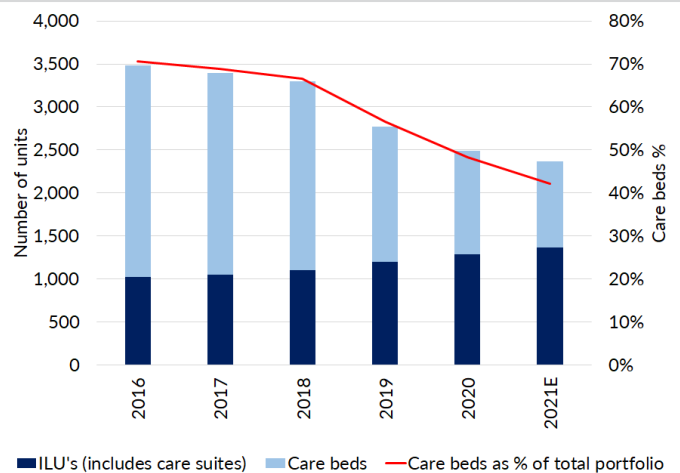
Source: Forsyth Barr analysis, Company reports

We estimate that "stand alone" care earnings have become an increasingly small proportion of earnings, around 20% for all operators. Care earnings now do not cover corporate costs for any of the operators, on our estimates. Secondly, new sales gain, which we do not include in annuity earnings, has grown substantially as a proportion of reported underlying earnings. This has been particularly prominent for ARV and OCA, but up until recently also for SUM. RYM is the only company that has showed relative consistency.



**Figure 26. ARV: portfolio composition**


Source: Forsyth Barr analysis

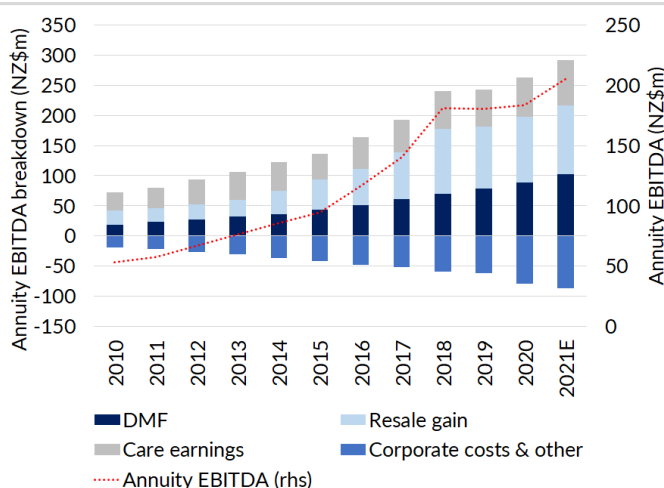
**Figure 27. OCA: portfolio composition**


Source: Forsyth Barr analysis

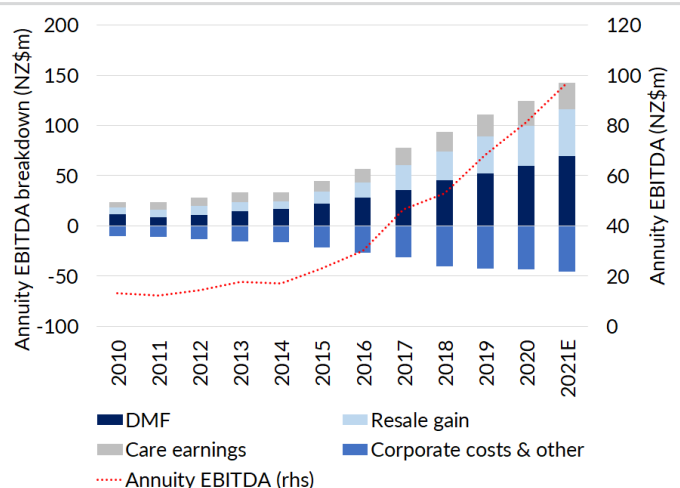
The re-shaping of the earnings mix has been partly deliberate. All aged care operators, ARV and OCA in particular, have directed growth almost exclusively towards what we refer to as "village" earnings; earnings derived from DMF and re-sale gains. This has been primarily a question of building and acquiring (ARV) ILUs, but also about a shift in business model towards charging for care through DMF and re-sale gain. However, it has also been a consequence of declining profitability of care as increased costs have outstripped revenue growth, not least due to the equal pay settlement.

## "RYMification" – can the success of RYM be replicated?

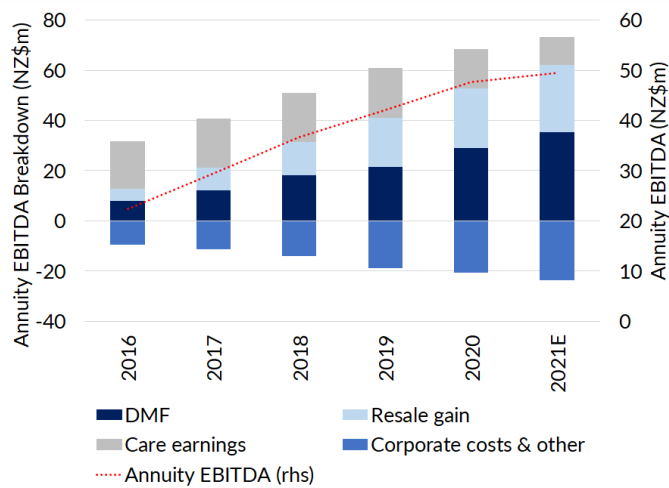
RYM has a 20 year track-record of delivering 20% TSR and 10–15% growth in annuity earnings – can the others replicate the success? We believe that SUM has proven it can. With a slightly less care focussed strategy and higher fees, the risks are higher for SUM should demand fall off, but the opportunity is also greater. Less care and more broad acre sites means faster recycling of capital, while higher DMF charges drives better cash returns. For ARV and OCA we believe the jury is still out. ARV has embarked on a slightly different strategy, with significant acquisitions. Growth has been high, but it has come at the cost of higher share count and higher leverage. We estimate that ARV's organic growth has been mid-single digits. OCA has been focussed on brownfield development, tearing down old care homes and re-placing them with ILUs and care suites. So far this has resulted in a dramatic drop in annuity earnings, but on our forecasts annuity earnings are set to double over the next four years.

**Figure 28. RYM: annuity EBITDA summary**


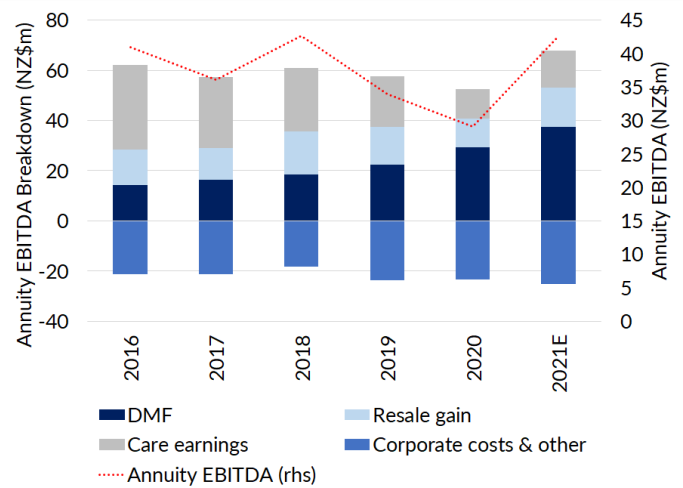
Source: Forsyth Barr analysis, Company reports

**Figure 29. SUM: annuity EBITDA summary**


Source: Forsyth Barr analysis, Company reports

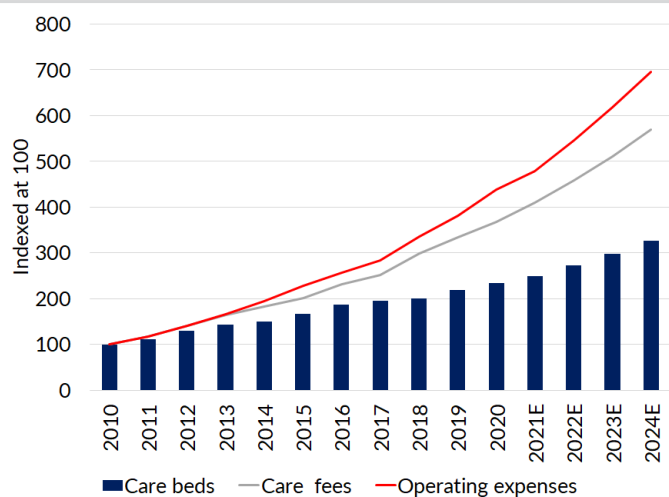
**Figure 30. ARV: annuity EBITDA summary**


Source: Forsyth Barr analysis, Company reports

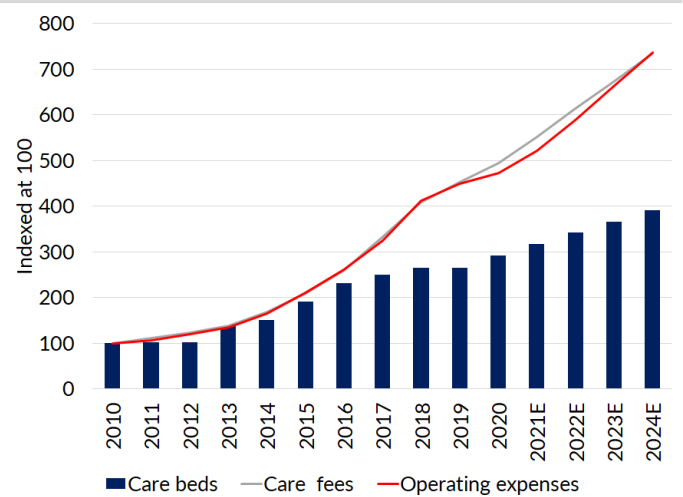
**Figure 31. OCA: annuity EBITDA summary**


Source: Forsyth Barr analysis, Company reports

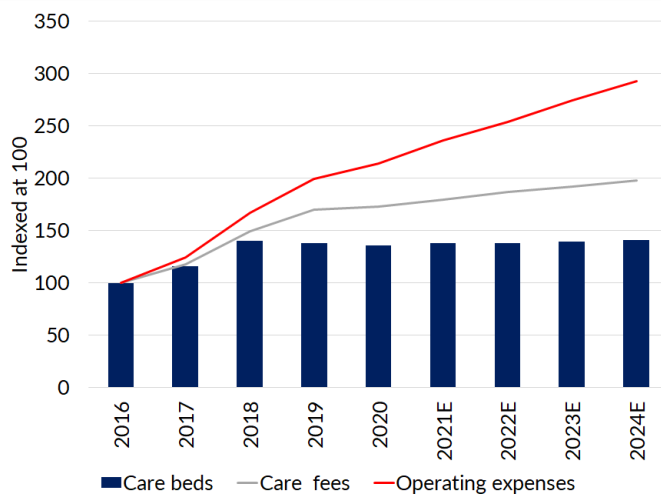
In absolute terms, the declining profitability in care has had the most profound impact on OCA followed by ARV and RYM, with the least impact on SUM. OCA is a bit of a "special case" as a meaningful proportion of its old care facilities have been (literally) torn down in order to make room for ILUs and care suites charged for under ORAs. However, annuity EBITDA has decreased materially. With regards to ARV it is difficult to assess exactly, given acquisitions have been a substantial driver of current operations over the last few years, but we estimate that ARV has "only" grown organically around mid-single digits since listing compared to 10–15% for RYM during the same period and SUM at ~30%.

**Figure 32. RYM: care operations breakdown**


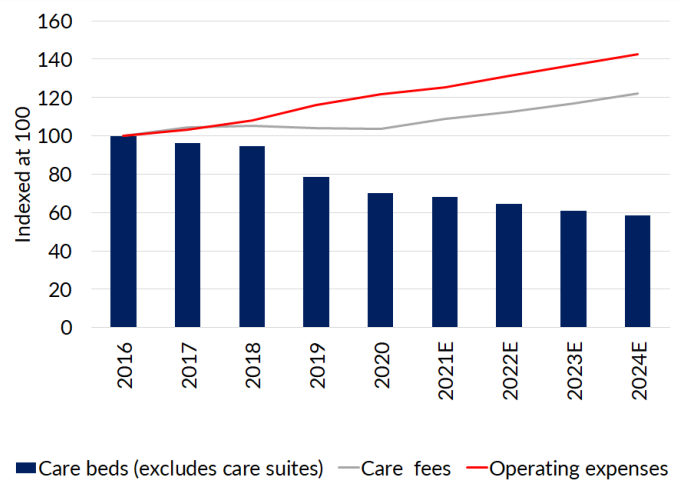
Source: Forsyth Barr analysis, Company reports

**Figure 33. SUM: care operations breakdown**


Source: Forsyth Barr analysis, Company reports

**Figure 34. ARV: care operations breakdown**


Source: Forsyth Barr analysis, Company reports

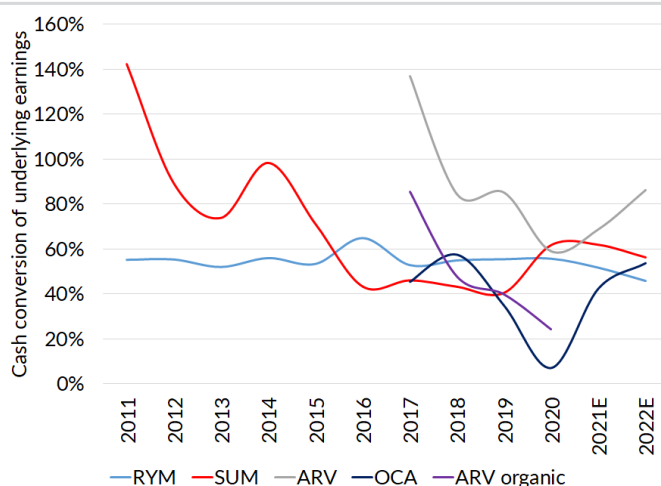
**Figure 35. OCA: care operations breakdown**


Source: Forsyth Barr analysis, Company reports

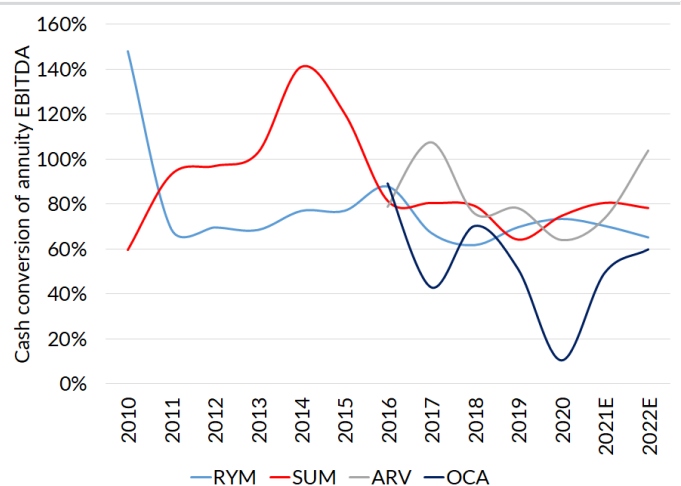
We do not expect this "gap" between care revenues and operating expenses to close. However, neither do we expect it to expand significantly, and thus see this care headwind as largely behind us. Care profitability has declined to a level where, on our estimates, stand alone care is not covering cost of capital; it only "works" if it is seen as part of an integrated offering together with village earnings. While existing stand alone care facilities could be considered "sunk cost" with limited alternative use, as OCA has shown, the risk is that more care facilities are being re-purposed to integrated villages, or indeed residential development, driving a shortage of care beds in New Zealand.

#### With less care earnings, focus on cash conversion increases

We estimate cash conversion within the care component of EBITDA to be near 100% while cash conversion within the ILU proportion of EBITDA (DMF and re-sale gain) is likely around 50%. Thus, the shift in earning mix away from care has also lead to a deterioration of cash conversion, this is most acute for OCA but can be seen across the sector. However, going forward we also see the biggest improvement for OCA, and within three years we expect cash conversion to be similar across the sector.

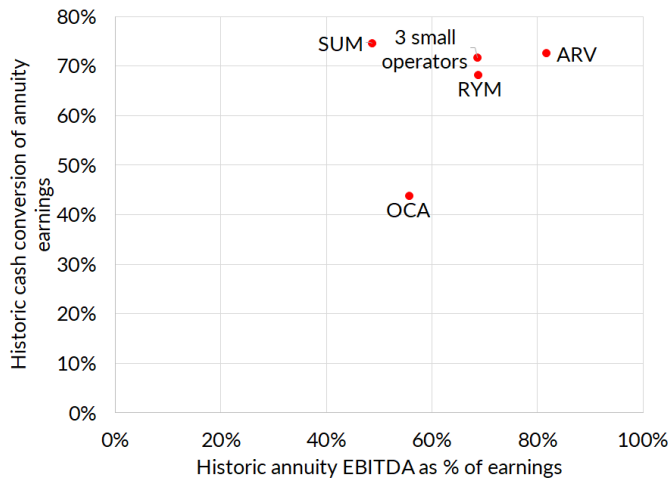
**Figure 36. Cash conversion of underlying earnings**


Source: Forsyth Barr analysis, Company reports

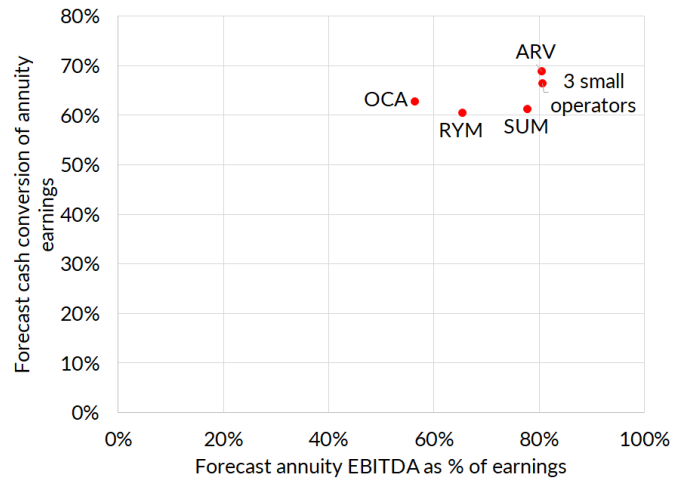
**Figure 37. Cash conversion of annuity EBITDA**


Source: Forsyth Barr analysis, Company reports

Figures 36 and 37 above do not factor in maintenance capex, which further reduces the cash conversion of "ILU" earnings. We believe that one important aspect of the aged care earnings is that the low cash conversion is structural/built in rather than a consequence of various cyclical or "random" factors. With regards to DMF, which is a GAAP revenue item, they represent cash in the future with a blended average pre-booking of cash of 3+years. The cash realised from DMF relates to ORAs signed an average of 7 or so years ago. As long as the aged care companies grow, DMF cash conversion will always be low.

**Figure 38. Historic sector earnings quality (3y average)**


Source: Forsyth Barr analysis, Company reports

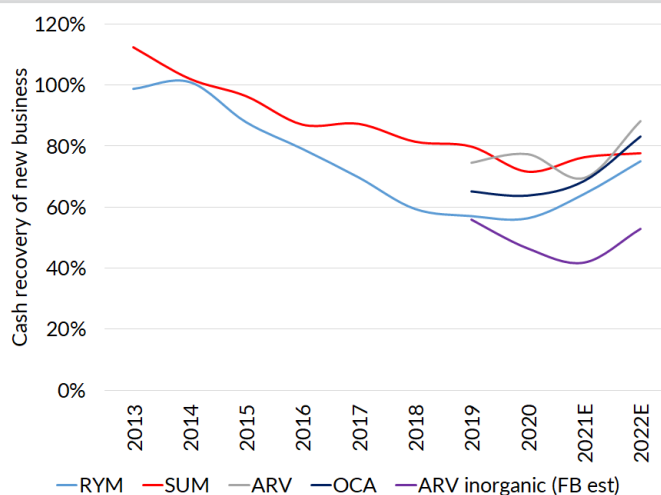
**Figure 39. Forecast sector earnings quality**


Source: Forsyth Barr analysis, Company reports

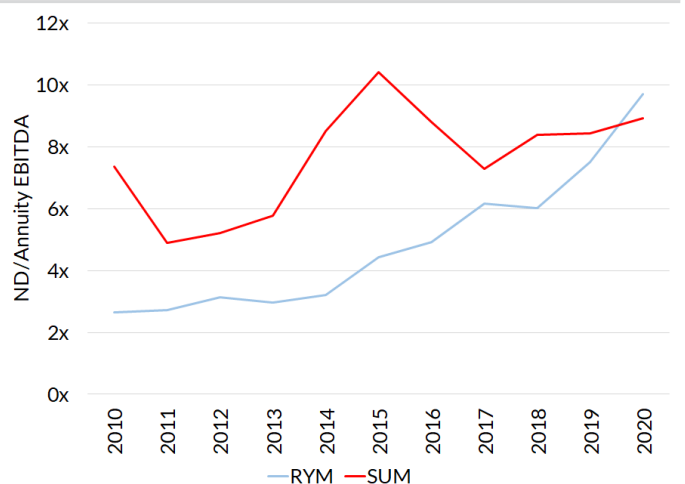
Overall, ARV scores the best and OCA the worst for what we call earnings quality; mix of annuity proportion of EBITDA and cash conversion of annuity earnings. However, our main take away is that the large historical differences looks to be slowly eliminated. OCA, again, stands out negatively in the above figures, but are also likely to see the most significant improvement; by FY23 we estimate that OCA will almost close the gap on the rest of the group.

## Capital recycling under pressure from increased lead times

Cash recovery of development capex has deteriorated markedly across the sector, but it has been an uneven experience. RYM has gone from recovering almost 100% of capex spent in "year 1" to now recovering only ~50%. For SUM this has been a lot less dramatic, but still a deterioration. ARV has seen the worst if we include acquisitions and the best if we exclude them. The truth is probably something in-between, much like for OCA. The consequence of deteriorating cash recovery should not be underestimated, in our view. On one hand, should the weak recovery be a sign of built up soon to be delivered units, we should expect an influx of cash over the coming 2-3 years. On the other hand, net debt is building up across the sector, and without an improvement in the near term, growth may have to be slowed down or significant equity raised. We believe a bit of both, but we think we are closer to seeing the cash come through for OCA, where we expect a sharp improvement over the coming years, than it is for RYM, where we expect a slower recovery as Australia matures.

**Figure 40. Cash recovery of new business**


Source: Forsyth Barr analysis, Company reports

**Figure 41. RYM and SUM ND/Annuity EBITDA**


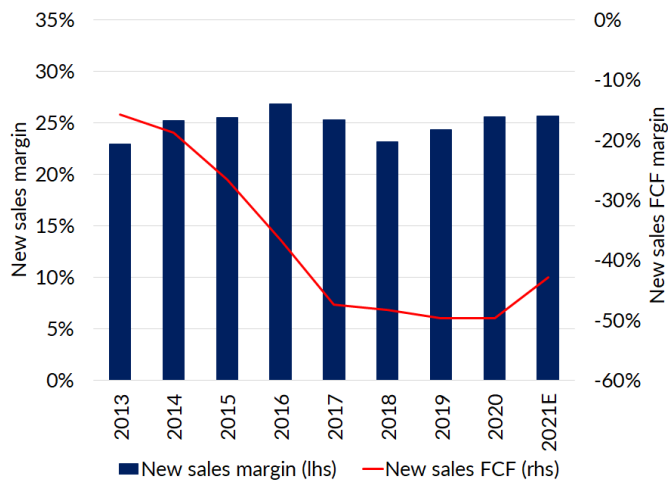
Source: Forsyth Barr analysis, Company reports

## We do not ignore development gains just because we do not consider them earnings

Development gains clearly represent something; we view increasing development gains as positive and decreasing gains to be negative, all else equal. And for clarity, we do not doubt that the aged care companies have a stringent method for calculating

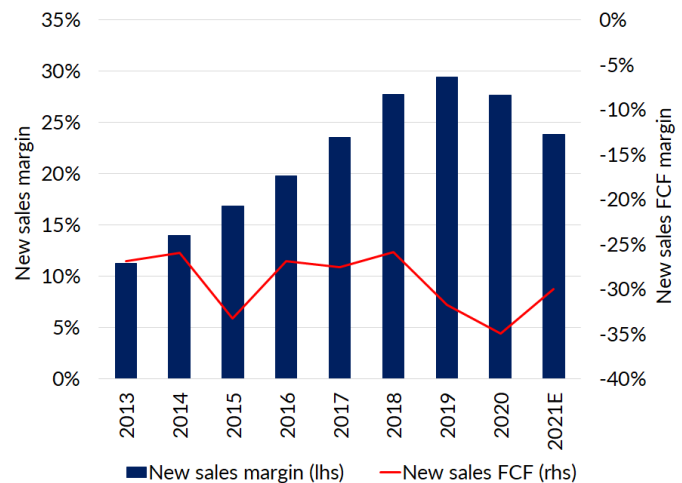
development gains which is audited for consistency over time. We do not treat them as traditional earnings because do not believe that the value add is comparable over time or between companies.

**Figure 42. RYM: new sales margins**



Source: Forsyth Barr analysis, Company reports

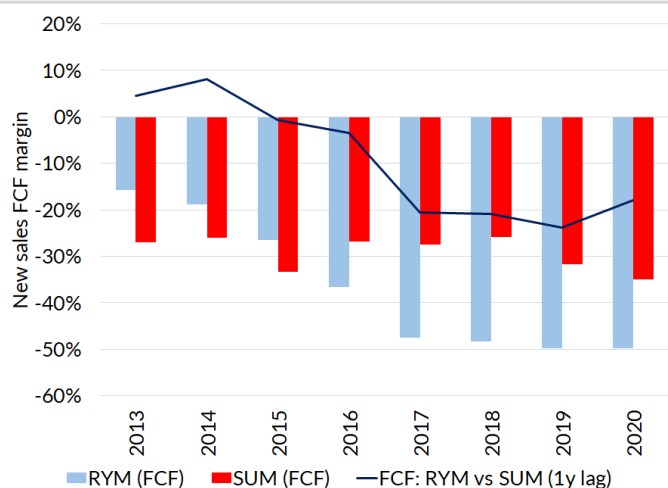
**Figure 43. SUM: new sales margins**



Source: Forsyth Barr analysis, Company reports

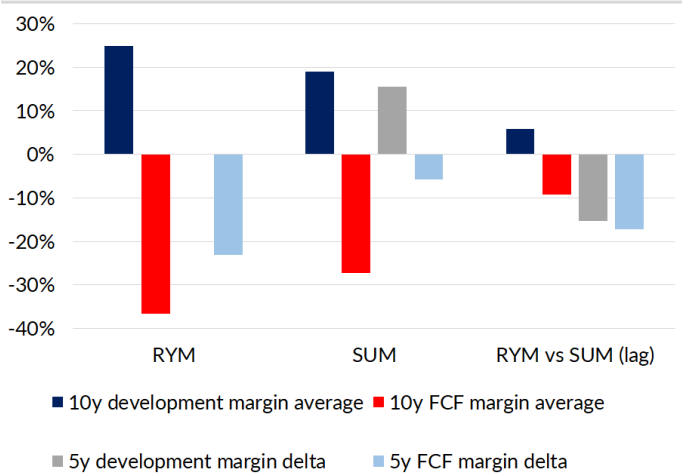
To illustrate this point. In Figures 42 & 43 above we have plotted RYM's and SUM's new sales margin on a three year rolling (aggregate) basis as well as total development cash margin (development FCF margin); i.e. for every 100 dollars spent how much is recovered through new sales. RYM's FCF margin started the decade at around zero, but RYM has now for 6 years reported development FCF margins of around -50%, i.e. RYM have recovered ~50% of capex in new sales vs 100% a decade ago, meanwhile development margins have been stable at just over +20%. SUM looks very similar to RYM, with the exception that reported development margins have increased materially, while development FCF margins have remained stable (and negative) around -30%. Accordingly, RYM has also experienced a relatively substantial increase in net debt/annuity EBITDA, which has increased from 6x to almost 10x in the last three years, while SUM's has been stable (and high). However, and importantly, while the build-up in debt for RYM has been more visible and pronounced over the last three years, it is the continuation of a near decade long trend of falling cash recovery of new business, likely primarily driven by the ambitious entry into Australia.

**Figure 44. RYM vs SUM new sales margins**



Source: Forsyth Barr analysis, Company reports

**Figure 45. RYM/SUM new sales transition**



Source: Forsyth Barr analysis, Company reports

There are perfectly rational explanations for the low cash recovery of new business; (1) the cost of building care in relation to building ILUs has increased, (2) it takes longer and longer to build villages, and (3) historical land appreciation contributes meaningfully to development margins. However, while satisfactory explanations to the observed phenomena, it does not support the notion that these non-GAAP earnings will eventually turn into cash.

In summary, while we do not think that today's development margins are comparable to those 10 years ago, or that RYM's 25% margins tell the same story as SUM's 25% development margins, we do believe that SUM's consistent improvement in development margins relative to RYM's stable margins matters. SUM has gone from a c. 5% development FCF margin disadvantage vs RYM 10 years ago to a near 20% advantage today.

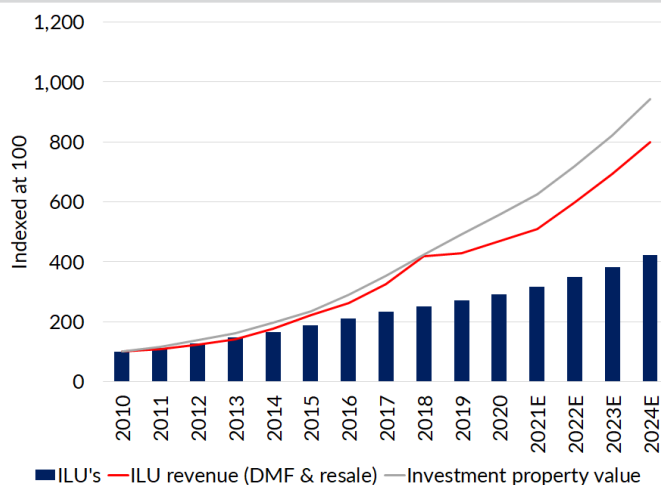
## All eyes on investment properties – driver of annuity earnings

As illustrated above, the four listed aged care operators earnings mix are starting to look increasingly similar; all the operators have put their eggs in the ILU annuity basket; today, and in our view going forward, the development of DMF and re-sales is likely to dominate earnings, cash generation and share price performance. Re-sales gains and DMF (village earnings) are both directly linked to the value of investment properties. From an equity holders perspective, one other aspect is also important; the development of net debt. We find that despite RYM's superior house price inflation (HPI) capture, SUM is growing the value of investment properties equally fast, and if we deduct net funding, faster.

### Value of investment properties a good proxy for "village earnings"

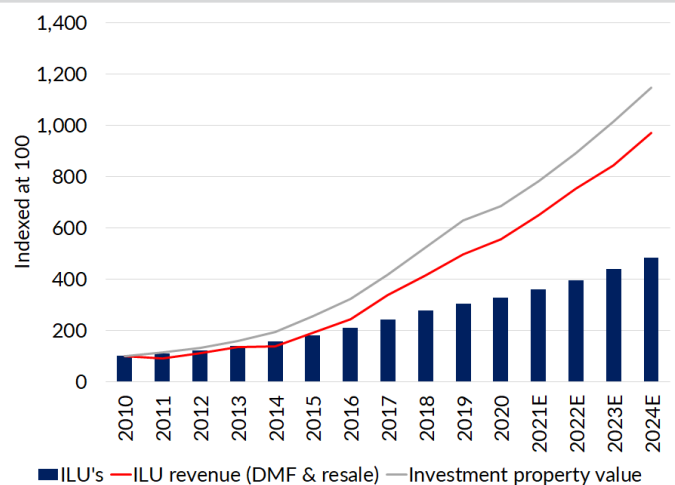
DMF and re-sale gains are both tightly linked to the value of investment properties, and should in theory track the development of the value of investment properties with a lag. And despite the, at times, somewhat opaque area of property re-valuations, we find that the relationship is quite strong. It is "too early to tell" for ARV and OCA, but RYM and SUM, with a good decade of comparable data show similar performance.

**Figure 46. RYM: village operations breakdown**



Source: Forsyth Barr analysis, Company reports

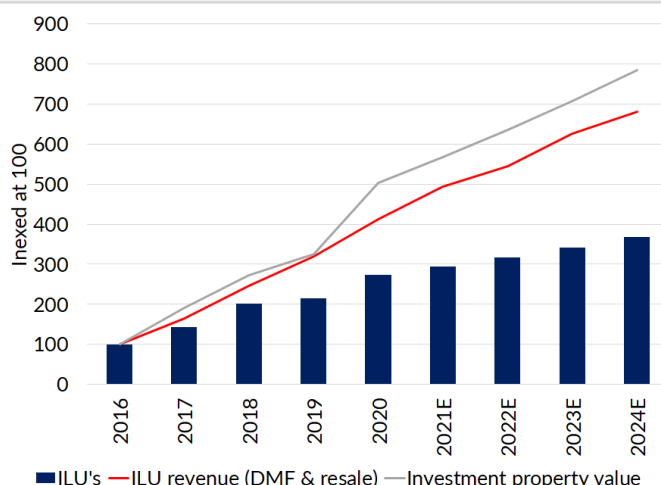
**Figure 47. SUM: village operations breakdown**



Source: Forsyth Barr analysis, Company reports

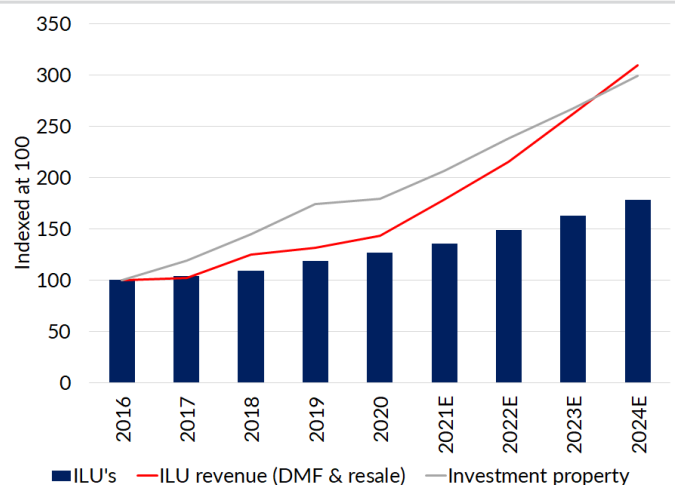
Over the last decade, RYM and SUM have both increased the number of ILUs by a factor of 3x, premiumisation and house price inflation has resulted in the value of investment properties increasing by a factor of around 6x. ILU revenues (re-sale gains and DMF) have largely tracked the development value of investment properties, and the slight edge RYM displayed in the past has all but been eroded over the last two years. The substantial NTA premium the market is willing to pay for RYM vs the other three is difficult to motivate from this perspective.

**Figure 48. ARV: village operations breakdown**



Source: Forsyth Barr analysis, Company reports

**Figure 49. OCA: village operations breakdown**

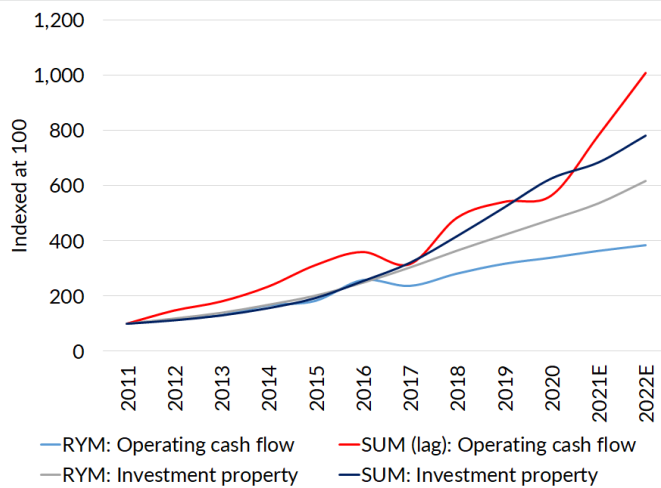


Source: Forsyth Barr analysis, Company reports



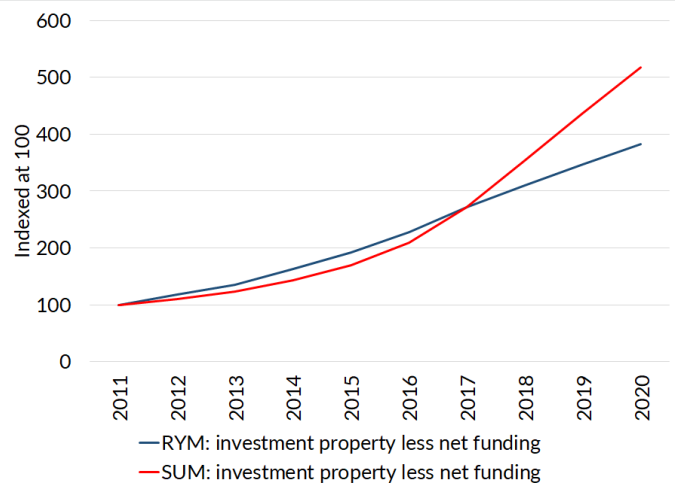
ARV and OCA are both in the midst of business transformations; ARV through acquisitions and OCA through re-developing older aged care facilities and sites to modern retirement villages with ILUs and "care suites", i.e. care beds under an ORA. ARV has delivered very strong absolute growth over the last four years. However, we caution that ARV's revenues are to a large degree acquired, and we estimate that organic annuity EBITDA growth has been mid single digits. OCA, however, has displayed very weak development, with minimal growth in either ILUs or ILU associated revenues. However, going forward we expect OCA to deliver, by some margin, the fastest growth in annuity earnings, driven primarily by fast realisation of care suite DMFs. The wide gap that has opened up between ILU revenues and investment property values suggest an element of "untapped" revenue opportunity.

**Figure 50. RYM/SUM operating cash flow**



Source: Forsyth Barr analysis, Company reports

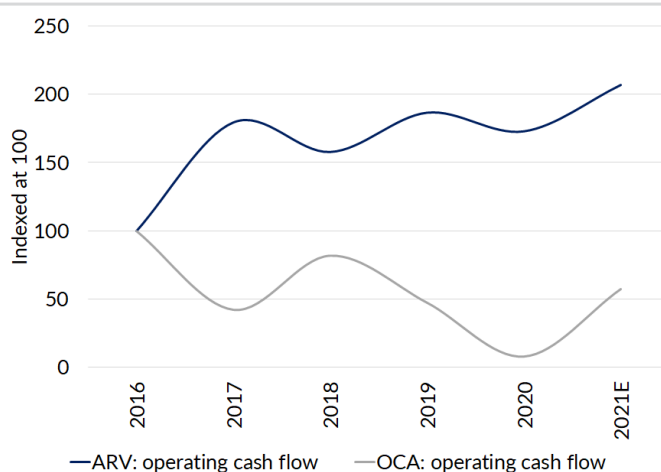
**Figure 51. RYM vs SUM investment property less net funding**



Source: Forsyth Barr analysis, Company reports

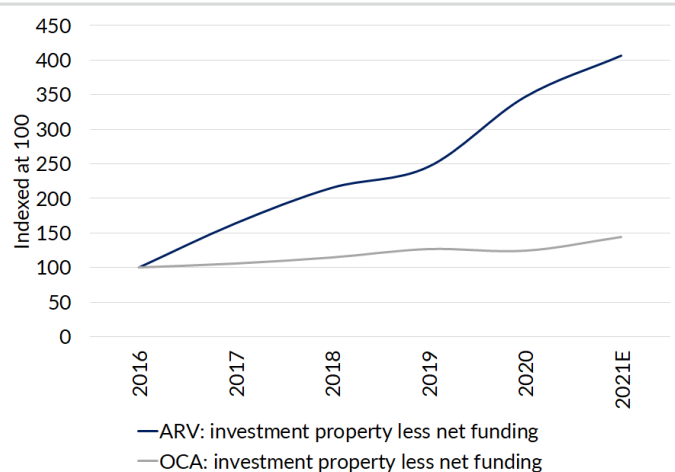
In Figure 51 above we have deducted net cash commitment (cash spent on capex less cash received from new sales), and the result is still impressive; 16% CAGR for RYM and 20% CAGR for SUM over the last decade. This is particularly impressive in light of our estimate of revaluation gains of "only" c. 5–6% per year. Over the last four years, however, it is notable that SUM has grown faster than RYM, this despite RYM having experienced higher revaluation gains; the difference is SUM's more efficient recycling of capital.

**Figure 52. ARV/OCA operating cash flow**



Source: Forsyth Barr analysis, Company reports

**Figure 53. ARV vs OCA investment property less net funding**



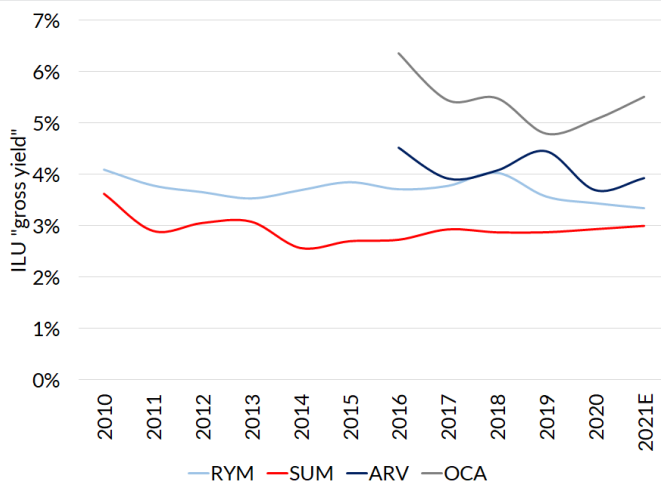
Source: Forsyth Barr analysis, Company reports

Figures 52 and 53 above showcase the notable differing fortunes between OCA and ARV reflecting the diverging strategies in recent years. ARV has transitioned its portfolio to become more ILU focussed by acquiring sites with a large and predominant ILU presence whilst OCA has invested to move from a traditional care operator to a premium care operator through the development and conversion of care suites. OCA's recent investment has likely neared the point of inflection with operating cash flow set to improve materially as the annuity streams of earnings from care suite development through quick DMF and resale gains realisation begin to flow through. Note that OCA's investment property values aren't fully comparable given care suites are classified as PP&E rather than investment properties.

## Aged care an integrated part of village offering – and the numbers agree

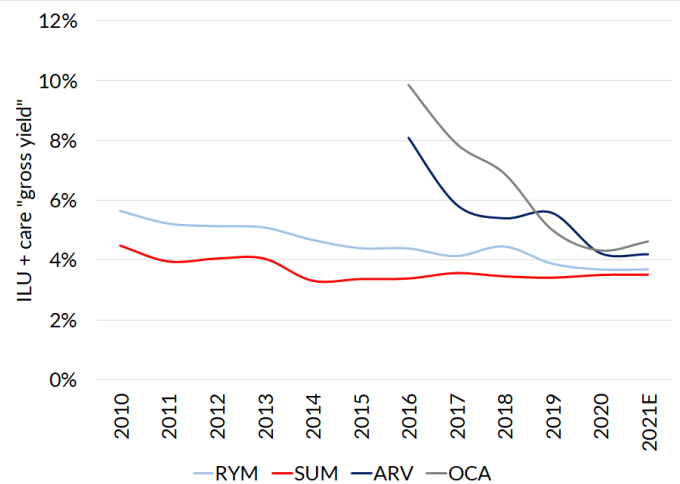
Investment properties dominate the balance sheet of the aged care operators, making up c. 85% of invested capital including ORA liabilities. For SUM investment properties make up ~100% and for OCA ~60%; with RYM and ARV in between. We have focussed on investment properties as they are the key driver of ILU earnings, however, the ability to extract revenues out of investment properties is closely related to the size and quality of the care offering.

**Figure 54. ILU gross yield**



Source: Forsyth Barr analysis, Company reports

**Figure 55. ILU + care gross yield**



Source: Forsyth Barr analysis, Company reports

In Figures 54 and 55 we have charted gross yield with and without aged care assets and earnings. Gross yield is an attempt to look at the aged care operators using similar metrics to the REITs' space; we have divided DMF and re-sale gain by the value of investment properties in the balance sheet, in Figure 55 we have added our estimate of care earnings and reported Property, Plant and Equipment (PP&E).

SUM has the lowest gross "yield" on its investment properties, around 3%, and RYM is not much higher with 3.5%. Adding aged care earnings and aged care assets increase it to around 4% for both, with ARV and OCA are only slightly higher around 4.5%. Importantly, the difference in yield almost completely disappears when you add care to the village operations; i.e. higher proportion of care appears to result in higher investment yield, but it comes at the cost of higher assets. This is one of the key reasons why we focus on total capex spend rather than development margins. It also illustrates the declining return on care assets – while ILU earnings have been relatively stable over time, there has been an overall decline which has almost exclusively been driven by the aged care part of the operations. Going forward, we believe this decline is unlikely to continue as it will be untenable for the care operators that do not combine care with village operations. However, we also do not see a turn-around in the near future, hence, our focus on village earnings as the key driver of earnings.

## Outlook for annuity growth remains strong

Below we have made an attempt to look at the outlook for annuity EBITDA from existing village operations, i.e. disregarding new development. We use company provided as well as estimated tenure, embedded value disclosed by the companies and pricing structure. Our analysis suggests that there is c. 40% annuity EBITDA growth purely from the villages maturing. The two drivers of this is higher turnover and realisation of embedded re-sale gains. This is only approximate, and assumes, for instance, that re-sale gains remain stable. However, it gives us confidence, in particular in light of recent accelerated house price inflation, that we should see continued strong growth from the aged care sector overall.

**Figure 56. Derived embedded growth**

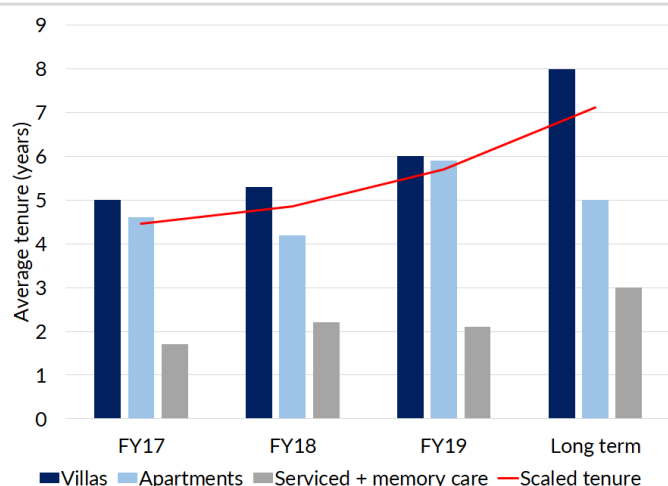
	Implied resale growth	Implied DMF growth (EV resale gain % OA)	Implied resale value (NZ\$m)	Implied DMF value (NZ\$m)	Forecast annuity EBITDA (NZ\$m)	Implied annuity EBITDA growth
RYM	36%	26%	41.3	27.0	205.8	33%
SUM	72%	36%	28.6	21.8	81.2	62%
ARV	11%	26%	3.0	9.3	49.5	25%
OCA	41%	17%	6.5	6.3	42.6	30%

Source: Forsyth Barr analysis, Company reports

## The all important tenure – what they say is what you get

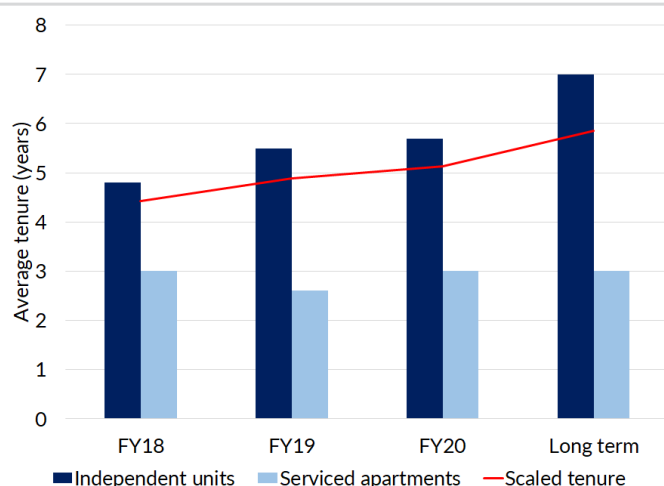
The four aged care operators are all either in transformation or growing very fast. Additionally, all the operators implement different DMF pricing mechanisms and have differing village mixes. This makes it difficult to assess a steady state tenure and therefore steady state profitability. Tenure is of crucial importance for re-sale gains but also for DMF, as residents will be charged the same absolute DMF if residents stay for 15 years or 5. Our analysis suggests that, encouragingly, the tenure guided to by the aged care operators of ~7 years for villas and apartments, and 3–4 years for serviced apartments is likely to be realistic. While this may not come across as revolutionary, it implies that re-sale growth within the existing business is material; we estimate 70% growth in re-sale gains for SUM and 10–40% for the other three. SUM and RYM both give average tenure at exit and ARV gives average expected tenure for valuation purposes. ARV's number is an estimated average tenure disclosed on a village by village basis which we estimate has a weighted average of ~8 years.

**Figure 57. SUM: average tenure**



Source: Forsyth Barr analysis, Company reports

**Figure 58. RYM: average tenure**



Source: Forsyth Barr analysis, Company reports

In Figures 57 and 58 above we have plotted the reported tenure at exit by RYM and SUM. The average tenure at exit will underestimate the tenure as exits from relatively new villages will have low tenure by definition. The company guided "long term" tenure is the guidance given by the companies with regards to actual tenure by living unit. We have weighted the tenure by the number of residents in the different living forms as well as our estimate of the average value of them. The net result is what we refer to as "scaled" tenure.

**Figure 59. DMF breakdown**

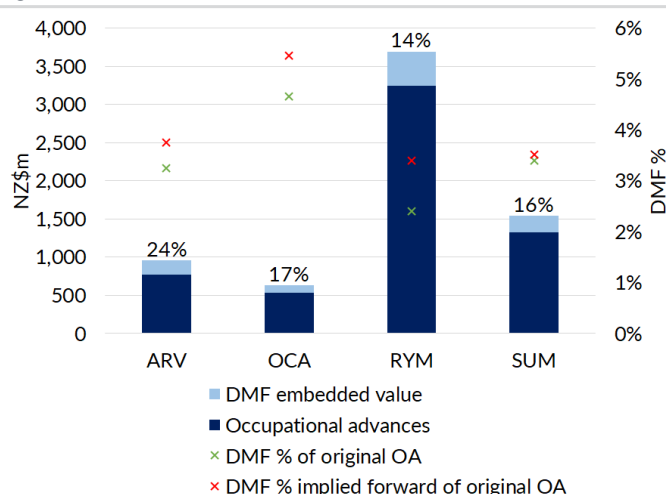
	RYM	SUM	ARV	OCA
DMF, % of ORA	20%	25%	30%	30%
DMF derived economic tenure	7.3	6.4	7.9	5.5
Average Tenure Reported, FB est	5.1	5.7	8.0	5.6
Average Tenure, implied forward, scaled	5.9	7.1	8.0	5.5
DMF % of Original OA	2.4%	3.4%	3.2%	4.7%
DMF % of Balance sheet OA	2.7%	3.9%	3.8%	5.5%
DMF %, implied forward of original OA	3.4%	3.5%	3.8%	5.5%

Source: Forsyth Barr analysis, Company reports

In Figure 59 above we have made an attempt at utilising the reported DMF as a way of "sense checking" the guided expected tenure. The tenure at exit and at guided does not measure total tenure, but tenure in that specific living form; someone moving from an ILU to a serviced apartment at RYM, for instance, will be able to carry forward its DMF, and if it is fully amortised the SA will not carry any DMF. SUM and ARV also implement DMF discounts for people moving within the village, which will have some impact, but our analysis suggest that this is smaller. We calculate the "economic" tenure in three steps:

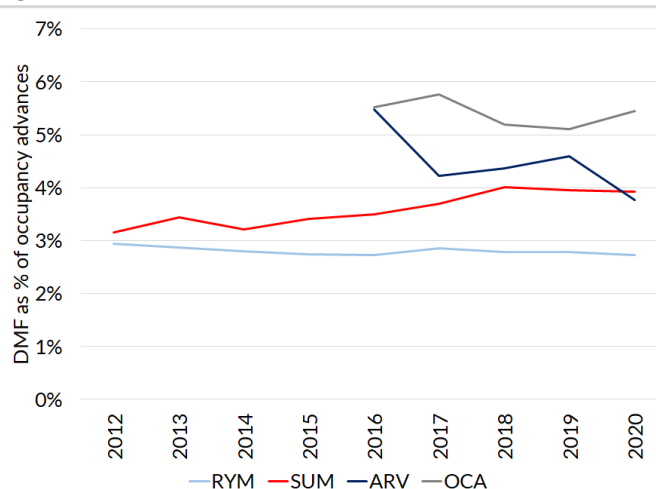
- **Step 1:** Calculate occupational advances that DMF is based off, i.e. "original OA". We do this by adding the embedded value of DMF to the reported occupational advances
- **Step 2:** Divide reported P&L DMF with original OA
- **Step 3:** Divide the list price DMF% (20–30%) with the % DMF calculated in Step 2.

**Figure 60. DMF embedded value and occupational advances**



Source: Forsyth Barr analysis, Company reports

**Figure 61. DMF as % of occupational advances**



Source: Forsyth Barr analysis, Company reports

Overall, our impression is that company guided tenure appears realistic. The reason why RYM's economic tenure is over two years higher than its forward guided is not, we believe, because the guidance is wrong, but is more likely to be driven by RYM's favourable pricing when moving within the village in combination with this being a common feature. Many independent living residents in a RYM village are likely to first live 6 years in a villa/apartment and then 3–4 years in a serviced apartment.

Looking over a longer time period, it also appears as if RYM's realised DMF has tracked the "implied forward guidance" closely, suggesting to us that this is realistic and "accurate" guidance from RYM. SUM, however, has undershot its potential until recently, but now appears to have closed the gap. This could potentially be a consequence of increased focus on care. However, again, we believe SUM's guided average tenure of c. 7 years appears realistic.

Our broad conclusion is that the forward guidance looks realistic, and that the main reason for RYM's lower DMF percentage is a natural consequence of its more generous pricing structure.

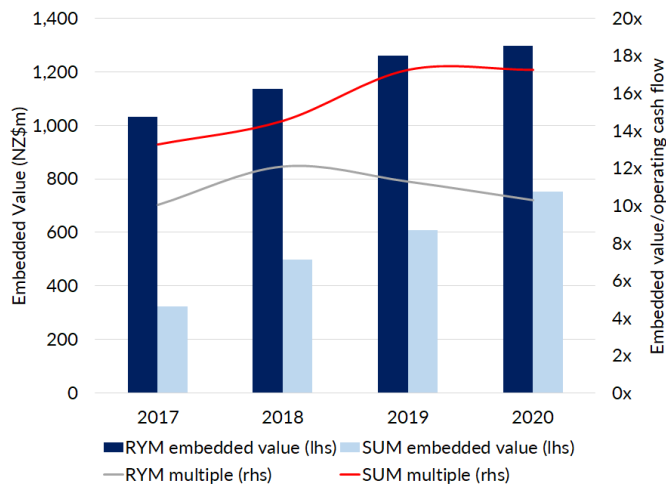
## Embedded value, tenure and now house price inflation; the holy trinity of re-sale gains

We believe the combination of high embedded value reported by the companies and a maturing book supports the notion that there are several years of double digit growth in annuity earnings within the existing business ahead of them. To this we can add re-sale house price inflation. Again SUM comes out looking strongest, with total reported embedded value representing 18 years of operating cash flow.

### Embedded value provides a cushion for future growth in cash flow and annuity earnings

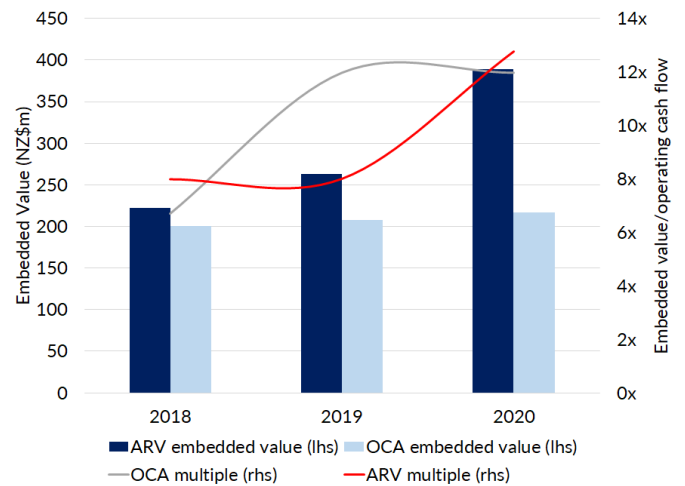
All aged care companies report "embedded value" split by DMF and re-sale gain. The DMF component represents revenues booked but not yet received (in the form of cash) while the re-sale component represents revaluations not yet realised (revenues or cash). Despite three years of largely stagnant house-prices, EV as proportion of cash flow or annuity earnings has remained stable or increased.

**Figure 62. RYM embedded value**



Source: Forsyth Barr analysis, Company reports

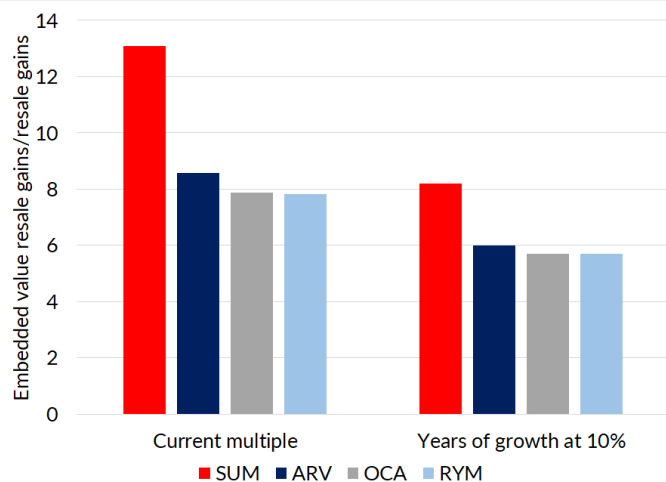
**Figure 63. SUM embedded value**



Source: Forsyth Barr analysis, Company reports

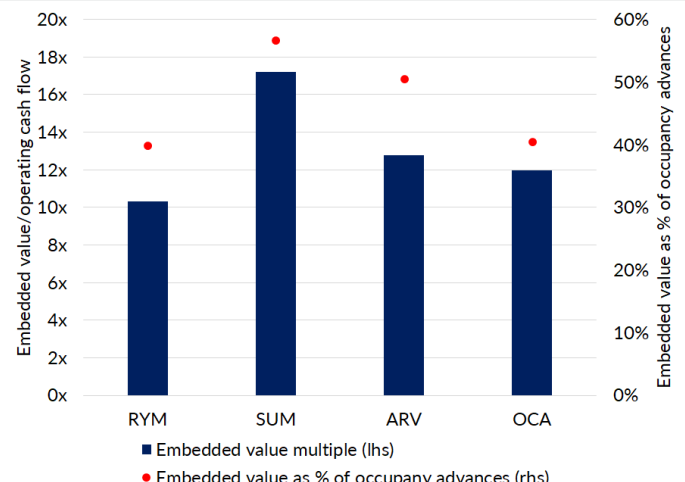
The most important component of the embedded value, in our view, is the re-sale gain component. SUM has embedded re-sale gains equivalent to 13 years of most recently reported re-sale gains. A different way of looking at it is number of years at 10% growth; SUM could grow re-sale gains by 10% p.a. for 8 years without running out of embedded gains, the other aged care operators also have an impressive 6 years of growth at 10%. This suggest to us that even with a period of flat or very low single digit HPI the aged care operators could deliver growth in re-sale gains for several years.

**Figure 64. Embedded re-sales value multiple**



Source: Forsyth Barr analysis, Company reports

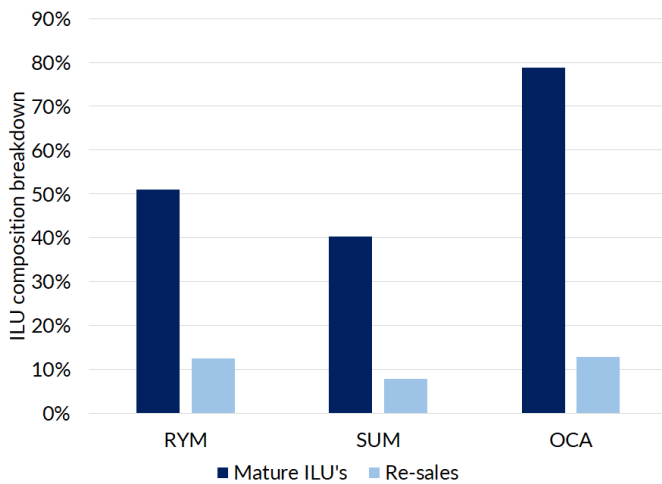
**Figure 65. Embedded value breakdown**



Source: Forsyth Barr analysis, Company reports

### Applying guided tenure to re-sale turnover suggests material upside

The aged care operators only turnover on average ~11% of ORA units (ILUs and care suites) per year, which, if the aged care operators were in a steady state, would suggest an average tenure of 9 years, an unrealistic number, in our view.

**Figure 66. ILU maturity composition**


Source: Forsyth Barr analysis, Company reports

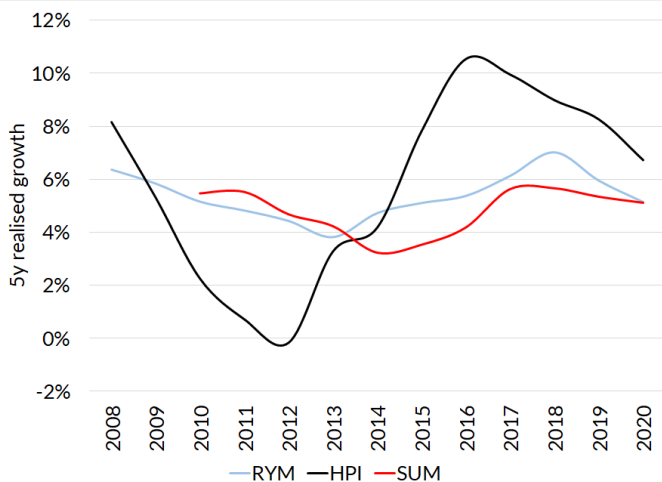
The reason for the low turnover, assuming corporate communication around tenure at exit is approximately correct, is the fast pace of growth in recent years. Both SUM and RYM have more than doubled ILUs over the last 7 years, exclusively through new construction, suggesting that about half (RYM) and only 40% of SUM's villages are fully mature.

If we apply our estimated actual weighted tenure using company guidance and our analysis of tenure above, we arrive at an untapped average growth potential of ~40%. This may seem unrealistic. However, we only need to exclude villages that have come on-line over the last four years (not sold, but being delivered) to arrive at a turnover very similar to our steady state estimate. This suggests that while only approximate – it is not entirely unrealistic.

#### Still living off the house price cushion built up in 2015/2016 – and we may be about to build a new one

We will not go into detail on long term price realisation and outlook for house prices in the report. However, we believe the medium term outlook for re-sale gains looks ok for three reasons;

1. Our analysis of RYM and SUM suggest that realised HPI through re-sale gains works its way through the P&L with a certain slowness; we understand that due to village dynamics as well as consistency in pricing, the aged care operators are unwilling to increase prices by more than mid single digits per annum.
2. The record HPI achieved in 2015/2016 built up a “buffer” (reflected in the above mentioned embedded value) that the aged care operators can eat through for another few years, although a significant proportion of that has been eaten up over the last three years.
3. Most recent REINZ data points to a broad acceleration of house prices, September data was up 11.1% yoy, the highest since February 2017 and all (current) signs are that house prices will continue to be strong for the near future.

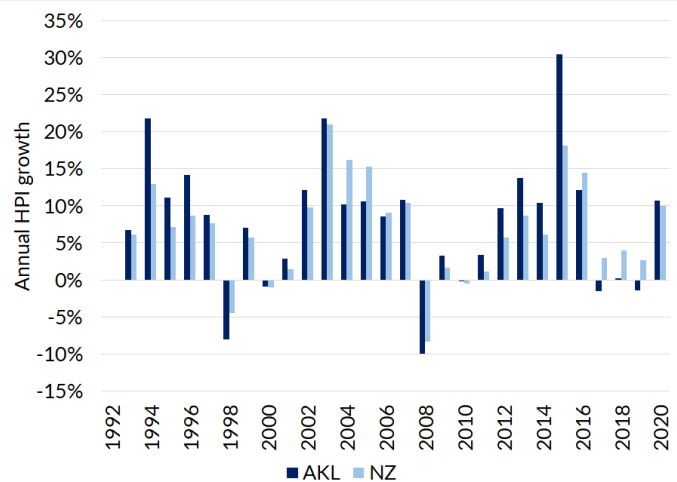
**Figure 68. RYM & SUM unit pricing vs HPI**


Source: Forsyth Barr analysis, Company reports, REINZ

**Figure 67. Re-sales and tenure breakdown**

	Re-sale	Steady state	Growth	Actual Weighted Tenure
RYM	12%	17%	36%	5.9
SUM	8%	14%	72%	7.1
ARV	11%	13%	11%	8.0
OCA	13%	18%	41%	5.5

Source: Forsyth Barr analysis, Company reports

**Figure 69. Auckland and New Zealand HPI**


Source: Forsyth Barr analysis, REINZ



## Valuation and price target: History best guide; DDM complement

Our preferred valuation metric is EV/Annuity EBITDA, but we acknowledge that this is not an established metric looking at the aged care operators. The history of EV/EBITDA vs EV/Annuity EBITDA looks similar, the average overlap is ~75%, but we consider the distinction between annuity EBITDA and reported EBITDA to be important, and believe that the market is recognising this when valuing the companies. We are complementing our EV/Annuity EBITDA approach with a Dividend Discount Model (DDM), which we find more suitable than DCF as we do not forecast any meaningful free cash flow for the foreseeable future.

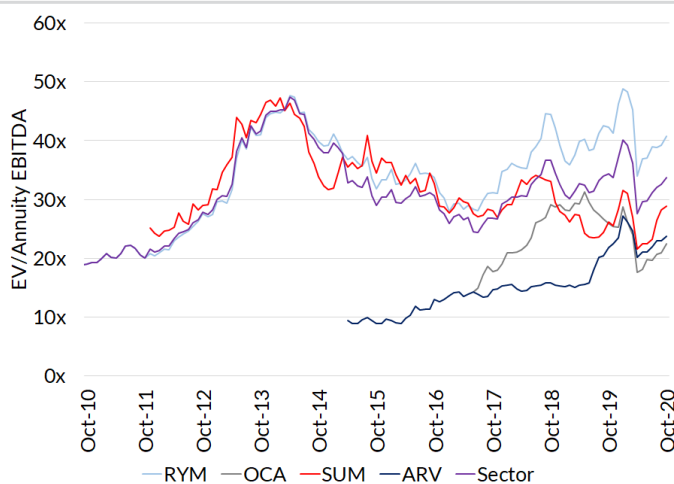
**SUM vs RYM – reasons for higher and lower multiples vs history balanced; but we expect RYM's premium to continue to shrink...**

RYM and SUM have a reasonably long history and a relatively consistent business mix and growth over the last 8–10 years. RYM and SUM have traded in a relatively wide range between 30x and 40x EV/Annuity EBITDA over the last decade, with a median combined forward multiple of 34x, we note four key differences relative to history;

1. The NZ market weighted forward EV/EBITDA multiple today is ~50% higher than the average over the last 10 years, suggesting that we should apply a higher multiple today than historically.
2. The track record of delivering growth and the acceptance of the business model is substantially higher today than 10 years ago.
3. However, as discussed extensively above, the cash recovery of capex is worse than historically which may dampen ability to continue to grow.
4. Penetration for aged care in NZ is higher today and the runway for growth is therefore likely to be shorter.

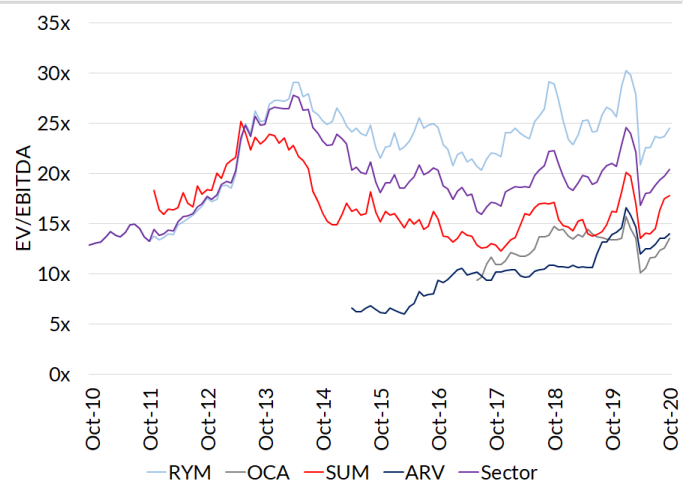
Overall we believe history to be the best guide. An attempt to quantify the above four factors is unlikely, in our view, to get us closer to how these stocks are valued. However, we are of the view that there is no reason why we should apply a higher multiple to RYM than to SUM, indeed, the market has applied the same multiple on the two for most of history.

**Figure 70. Sector EV/Annuity EBITDA**



Source: Forsyth Barr analysis, Eikon

**Figure 71. Sector EV/EBITDA**



Source: Forsyth Barr analysis, Eikon

SUM has outgrown RYM over the last few years and has managed to do so without increasing leverage meaningfully. SUM also have, in our view, better medium term growth prospects with a less mature book and higher fees, this suggests a premium to RYM. However, we want to acknowledge that RYM has, in our view, lower risks. This is partly due to fundamental factors; more care focussed operations, lower fees and higher brand recognition, and partly due to its MSCI inclusion and more global ownership; these factors should reduce COE.

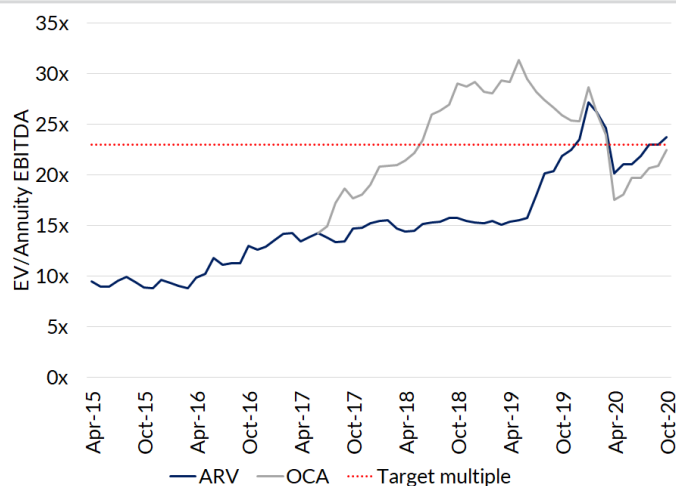
For price target purposes we apply the historical 34x EV/Annuity EBITDA multiple to RYM and SUM. This may appear high; very few companies trade on a 34x EBITDA multiple, however, we believe RYM and SUM are unlikely to deviate from the last five years 30–40x range for three reasons;

1. As outlined above, we estimate that earnings from current assets, ignoring any new development, will increase by 25–60% over the next 5–7 years.
2. Underlying earnings, the established focal point for the sector, has on average been c. 30–40% higher than annuity earnings; 34x annuity EBITDA is equal to high 20's P/E using underlying earnings.
3. This is a relatively unique asset class – if the recycling of capital improves and international expansion proves to be successful the runway for growth is very long without having to add more equity.

### ...OCA and ARV on a different path, for now

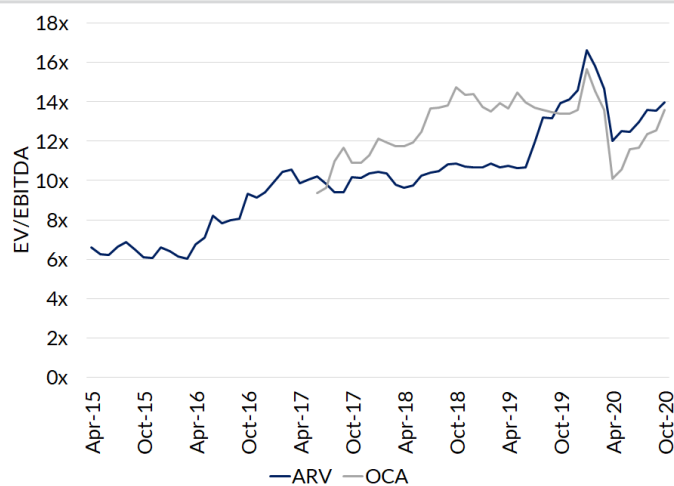
OCA and ARV have a short and chequered trading history, but over the last two years they have started to stabilise around 22–23x EV/annuity EBITDA. We think that the market will be focussed on the development of annuity EBITDA over the coming 12–24 months. A re-rating up towards SUM/RYM multiples are unlikely, in our view.

**Figure 72. ARV and OCA EV/Annuity EBITDA**



Source: Forsyth Barr analysis, Eikon

**Figure 73. ARV and OCA EV/EBITDA**



Source: Forsyth Barr analysis, Eikon

For a re-rating to occur, we believe three things needs to be in place;

1. Proofing the care suite business model, the early signs are encouraging, but this is still a relatively new product.
2. Track record of delivering double digit organic growth. While our forecasts suggest that they will, we would not expect a re-rating until several years of delivery.
3. Most importantly; a capex efficient greenfield development operations. While we expect strong growth over the coming years, in order to re-rate up towards SUM/RYM the market needs to grow confident that there is a runway beyond.

**Figure 74. Historic valuation breakdown**

	Current 12m Fwd EV/ Annuity EBITDA	5y average P/E	5y average EV/ Annuity EBITDA	5y average P/NTA	5y average EV/ EBITDA	Rating
RYM	40.7	23.8	36.3	2.8	24.1	NEUTRAL
SUM	28.9	14.3	29.3	1.6	15.1	OUTPERFORM
ARV	23.7	14.0	15.7	1.2	10.5	NEUTRAL
OCA	22.5	13.6	23.6	1.1	12.7	OUTPERFORM

Source: Forsyth Barr analysis

**Figure 75. Forecast valuation breakdown**

	P/E			EV/EBITDA			EV/Annuity EBITDA		
	FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3
RYM	27.0	22.6	20.5	28.0	23.9	21.6	44.0	38.6	34.4
SUM	22.8	17.8	14.5	21.7	17.7	14.7	33.6	28.1	24.4
ARV	17.5	13.7	11.6	19.0	15.6	13.4	25.7	22.5	20.1
OCA	16.2	13.4	11.6	15.5	13.5	12.0	24.9	19.7	16.4

Source: Forsyth Barr analysis

### DDM provides some comfort around multiples based valuation

Our long term DDM is based around the following assumptions; (1) for OCA and to some degree ARV, that only the current development pipeline is built out, for SUM and RYM we run current target development until 2035 and then tail it off until our terminal year, (2) that maintenance capex slowly increases to 1/asset life but that cash conversion elsewhere improves as the villages mature, (3) steady state net debt/investment properties will be relatively stable at around 15–20%. Additionally, we have applied a slightly lower COE for RYM than for SUM (6.2% vs 6.35%), and a c. 1% higher COE for OCA and ARV (7.3%).

# Summerset Group

## More to Come; Reiterate OUTPERFORM

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### OUTPERFORM

We reiterate our OUTPERFORM rating on Summerset (SUM) and increase our price target to NZ\$11.90 (from NZ\$9.15). SUM has outperformed RYM by ~30% over the last six months, but on our preferred metric of EV/Annuity EBITDA RYM is still valued at a ~20% premium. SUM has delivered by some margin the fastest organic growth in annuity EBITDA of all listed aged care operators over the last 3, 5 and 10 years, experienced the best cash recovery of capex, and seen the strongest organic growth in investment property values. Going forward we see SUM as best positioned to deliver predictable growth due to a low proportion of mature villages and high levels of embedded value equal to 13 years of re-sale gains, by far the highest in the sector.

NZX Code	SUM	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$10.00	NPAT* (NZ\$m)	107.9	98.1	126.2	154.7	PE	20.6	22.8	17.8	14.5
Target price	NZ\$11.90	EPS* (NZc)	48.6	43.8	56.1	68.8	EV/EBIT	21.7	23.4	19.0	15.7
Risk rating	Medium	EPS growth* (%)	11.5	-10.0	28.1	22.6	EV/EBITDA	20.4	21.7	17.7	14.7
Issued shares	224.9m	DPS (NZc)	14.1	14.2	16.0	20.0	Price / NTA	2.2	2.0	2.0	1.8
Market cap	NZ\$2,249m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.4	1.4	1.6	2.0
Avg daily turnover	317.6k (NZ\$2,279k)	*Based on normalised profits					Gross div yld (%)	2.0	2.0	2.2	2.8

### Ability to gear up and slow down as the market dynamic changes puts SUM in a good position

SUM has built up by some margin the largest land bank in the sector and currently has ~10 years worth of development. Despite this build up, SUM has delivered the best recovery of total capex at around 70% and kept net debt in relation to annuity EBITDA largely stable (and high). Going forward, we believe SUM will benefit from its ability to accelerate development, should demand allow, and relatively defensive characteristics in the form of high unrealised embedded value, relatively low fees and low execution risk, at least within New Zealand. We believe the key company specific risk going forward relates to Australia, which we believe will start to be the focus for SUM in FY22/FY23.

**Figure 1. Forecast earnings changes (NZ\$m)**

	FY20E			FY21E			FY22E		
	Old	New	Change	Old	New	Change	Old	New	Change
Total Revenue	252.0	255.8	1%	293.9	301.1	2%	340.7	351.8	3%
Total Costs	129.2	129.2	0%	142.5	142.5	0%	158.5	160.9	1%
EBITDA	122.9	126.6	3%	151.4	158.6	5%	182.2	190.9	5%
Depreciation & Amortisation	8.8	9.5	7%	9.6	10.3	7%	11.0	11.8	8%
EBIT	114.1	117.2	3%	141.7	148.3	5%	171.2	179.1	5%
Net interest	19.1	19.1	0%	22.1	22.1	0%	24.4	24.4	0%
Underlying profit	95.0	98.1	3%	119.6	126.2	5%	146.8	154.7	5%
EPS (cents)	42.2	43.6	3%	53.2	56.1	5%	65.3	68.8	5%
DPS (cents)	14.2	14.2	0%	16.0	16.0	0%	20.0	20.0	0%
Sales - new units	320	350	9%	435	435	0%	500	500	0%
New sales margin (%)	22.0%	21.0%	-1.0%	22.0%	22.0%	0.0%	24.0%	24.0%	0.0%
Sales - resold units	348	361	4%	370	393	6%	408	438	8%
Resales margin (%)	24.0%	24.0%	0.0%	23.0%	25.0%	2.0%	22.0%	25.0%	3.0%

Source: Forsyth Barr analysis, Company reports

## Summerset Group Limited (SUM)

Priced as at 14 Oct 2020 (NZ\$) **10.00**

<b>12-month target price (NZ\$)*</b>	<b>11.90</b>
Expected share price return	19.0%
Net dividend yield	1.6%
Estimated 12-month return	20.6%

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	0.84
WACC	5.7%
Terminal growth	2.0%

<b>Spot valuations (NZ\$)</b>	
1. EV/Annuity EBITDA	13.20
2. DDM	10.65
3. n/a	n/a

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

<b>Profit and Loss Account (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Sales revenue	229.2	251.6	255.8	301.1	351.8
<b>Normalised EBITDA</b>	<b>116.7</b>	<b>129.2</b>	<b>126.6</b>	<b>158.6</b>	<b>190.9</b>
Depreciation and amortisation	(6.7)	(7.8)	(9.5)	(10.3)	(11.8)
<b>Normalised EBIT</b>	<b>110.1</b>	<b>121.4</b>	<b>117.2</b>	<b>148.3</b>	<b>179.1</b>
Net interest	(11.4)	(15.2)	(19.1)	(22.1)	(24.4)
Associate income	0	0	0	0	0
Tax	(1.7)	1.7	0	0	0
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>97.0</b>	<b>107.9</b>	<b>98.1</b>	<b>126.2</b>	<b>154.7</b>
Abnormals/other	117.5	67.4	(85.2)	52.3	38.7
<b>Reported NPAT</b>	<b>214.5</b>	<b>175.3</b>	<b>12.9</b>	<b>178.5</b>	<b>193.5</b>
Normalised EPS (cps)	43.6	48.6	43.8	56.1	68.8
DPS (cps)	13.2	14.1	14.2	16.0	20.0

<b>Growth Rates</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Revenue (%)	23.1	9.8	1.7	17.7	16.8
EBITDA (%)	19.6	10.7	-2.0	25.3	20.4
EBIT (%)	18.4	10.3	-3.5	26.5	20.8
Normalised NPAT (%)	19.2	11.3	-9.1	28.7	22.6
Normalised EPS (%)	19.3	11.5	-10.0	28.1	22.6
Ordinary DPS (%)	20.0	6.8	0.7	12.7	25.0

<b>Cash Flow (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>EBITDA</b>	<b>116.7</b>	<b>129.2</b>	<b>126.6</b>	<b>158.6</b>	<b>190.9</b>
Working capital change	29.8	54.3	62.7	6.8	2.1
Interest & tax paid	(13.1)	(13.5)	(19.1)	(22.1)	(24.4)
Other	84.3	67.9	87.7	192.4	225.2
<b>Operating cash flow</b>	<b>217.8</b>	<b>237.9</b>	<b>257.9</b>	<b>335.7</b>	<b>393.8</b>
Capital expenditure	(209.2)	(240.0)	(228.8)	(255.4)	(297.7)
(Acquisitions)/divestments	(54.7)	(57.3)	(60.0)	(65.0)	(70.0)
Other	75.4	106.1	95.6	51.4	50.3
<b>Funding available/(required)</b>	<b>29.3</b>	<b>46.7</b>	<b>64.7</b>	<b>66.6</b>	<b>76.4</b>
Dividends paid	(19.7)	(19.5)	(31.9)	(36.0)	(45.0)
Equity raised/(returned)	0	1.9	2.2	0	0
<b>(Increase)/decrease in net debt</b>	<b>9.7</b>	<b>29.1</b>	<b>35.0</b>	<b>30.7</b>	<b>31.4</b>

<b>Balance Sheet (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Working capital	(83.7)	(137.9)	(200.6)	(207.4)	(209.4)
Fixed assets	2,193.1	2,717.8	3,261.0	3,567.8	4,065.2
Intangibles	5.6	6.6	6.1	8.1	10.1
Right of use asset	0	0	0	0	0
Other assets	4.6	12.6	12.6	12.6	12.6
<b>Total funds employed</b>	<b>2,119.6</b>	<b>2,599.1</b>	<b>3,079.2</b>	<b>3,381.1</b>	<b>3,878.5</b>
Net debt/(cash)	339.7	431.3	562.0	678.5	751.5
Lease liability	0	0	10.5	10.5	10.5
Other liabilities	990.8	1,167.0	1,361.2	1,570.8	1,854.2
Shareholder's funds	789.1	1,000.8	1,145.5	1,121.4	1,262.3
Minority interests	0	0	0	0	0
<b>Total funding sources</b>	<b>2,119.6</b>	<b>2,599.1</b>	<b>3,079.2</b>	<b>3,381.1</b>	<b>3,878.5</b>

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

<b>Valuation Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
EV/EBITDA (x)	21.9	20.4	21.7	17.7	14.7
EV/EBIT (x)	23.2	21.7	23.4	19.0	15.7
PE (x)	22.9	20.6	22.8	17.8	14.5
Price/NTA (x)	2.8	2.2	2.0	2.0	1.8
Free cash flow yield (%)	0.4	-0.1	1.3	3.6	4.3
Net dividend yield (%)	1.3	1.4	1.4	1.6	2.0
Gross dividend yield (%)	1.8	2.0	2.0	2.2	2.8

<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Interest cover EBIT (x)	9.6	8.0	6.1	6.7	7.3
Interest cover EBITDA (x)	10.2	8.5	6.6	7.2	7.8
Net debt/ND+E (%)	30.1	30.1	32.9	37.7	37.3
Net debt/EBITDA (x)	2.9	3.3	4.4	4.3	3.9

<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Return on assets (%)	4.9	4.4	3.5	4.0	4.3
Return on equity (%)	12.3	10.8	8.6	11.3	12.3
Return on funds employed (%)	8.5	7.4	5.6	6.8	7.5
EBITDA margin (%)	50.9	51.4	49.5	52.7	54.3
EBIT margin (%)	48.0	48.2	45.8	49.2	50.9
Capex to sales (%)	91.3	95.4	89.4	84.8	84.6
Capex to depreciation (%)	3,129	3,064	2,419	2,469	2,525
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	30	29	32	29	29

<b>Operating Performance</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>Revenue (NZ\$m)</b>					
Care fees	91.2	101.3	110.6	123.2	137.2
Management fees	45.6	52.5	60.1	69.5	80.8
Gain on resales	28.7	36.9	39.7	46.9	54.3
Gain on new sales	63.7	61.0	45.4	61.5	79.5
<b>Total revenue</b>	<b>229.2</b>	<b>251.6</b>	<b>255.8</b>	<b>301.1</b>	<b>351.8</b>

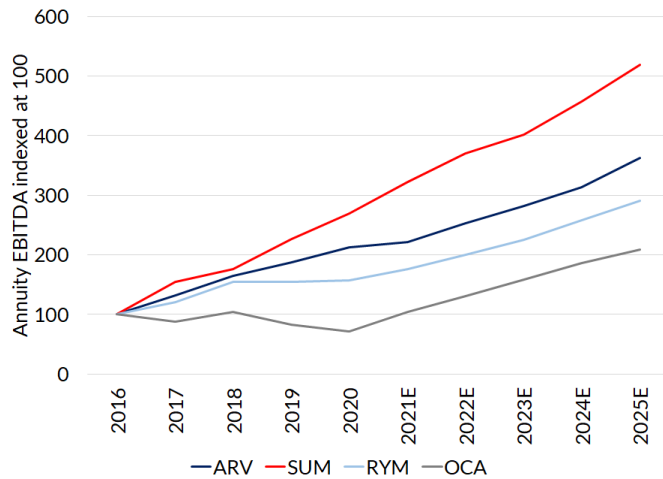
<b>Key Drivers</b>					
Sales - new units	339	329	350	435	500
Ave unit price - new sales (NZ\$000s)	566	665	618	643	662
Sales - resold units	301	323	361	393	438
Ave unit price - resales (NZ\$000s)	406	445	458	477	496
Gross development margin (%)	33.2%	27.9%	21.0%	22.0%	24.0%
Gross resales margin (%)	23.5%	25.7%	24.0%	25.0%	25.0%

<b>New apartments/units</b>	<b>454</b>	<b>354</b>	<b>325</b>	<b>425</b>	<b>480</b>
<b>New beds</b>	<b>52</b>	<b>0</b>	<b>86</b>	<b>80</b>	<b>80</b>
<b>Total</b>	<b>506</b>	<b>354</b>	<b>411</b>	<b>505</b>	<b>560</b>

<b>Portfolio</b>					
Apartments/units	3,732	4,086	4,411	4,846	5,346
Beds	858	858	944	1,024	1,104
<b>Total Portfolio</b>	<b>4,590</b>	<b>4,944</b>	<b>5,355</b>	<b>5,870</b>	<b>6,450</b>

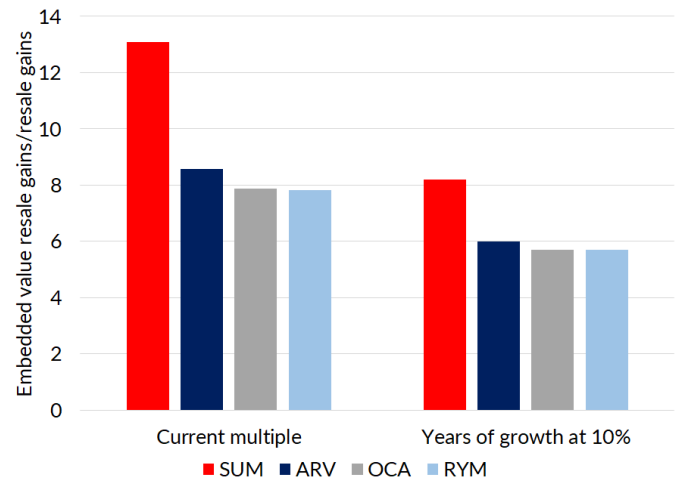
## Our thesis in pictures

**Figure 2. Fastest annuity EBITDA growth in the sector...**



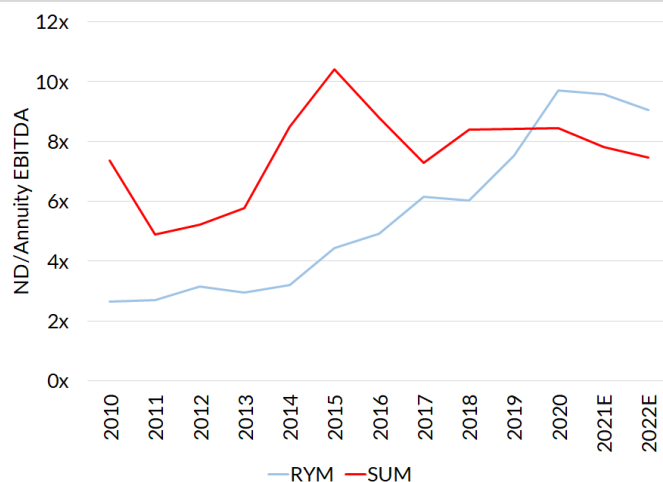
Source: Forsyth Barr analysis, Company reports

**Figure 3. ...and a decent cushion in the form of embedded value..**



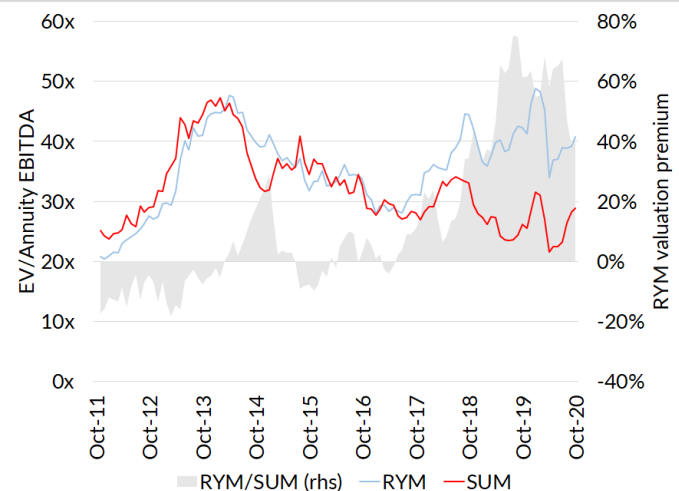
Source: Forsyth Barr analysis, Company reports

**Figure 4. ...and net debt/annuity EBITDA has been relatively stable...**



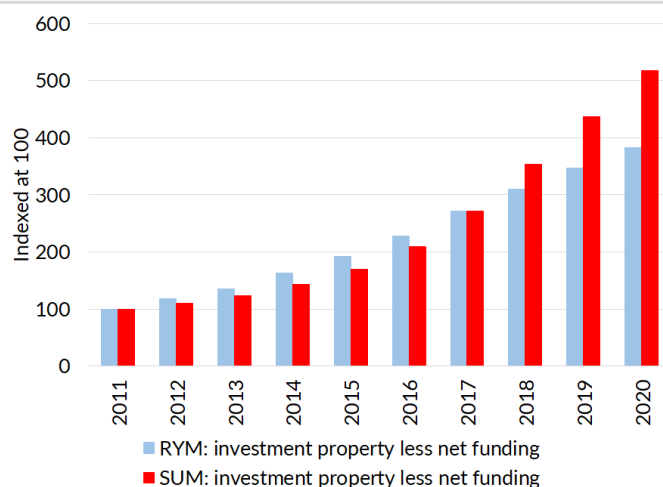
Source: Forsyth Barr analysis, Company reports

**Figure 5. ...yet still at a discount to RYM despite recent performance**



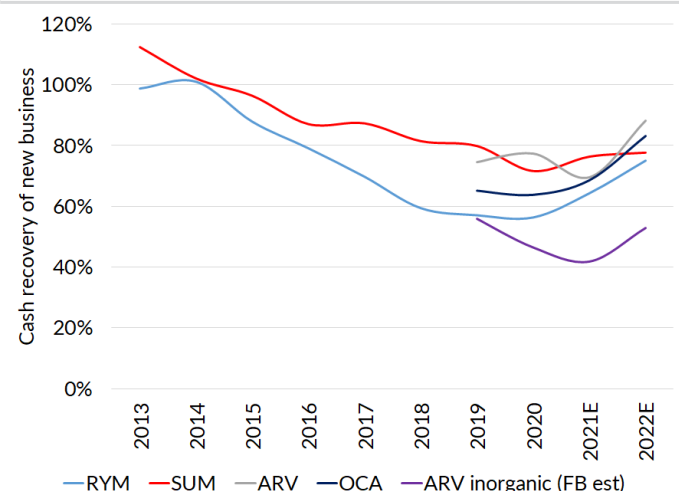
Source: Forsyth Barr analysis

**Figure 6. Fast growth in investment property less net funding...**

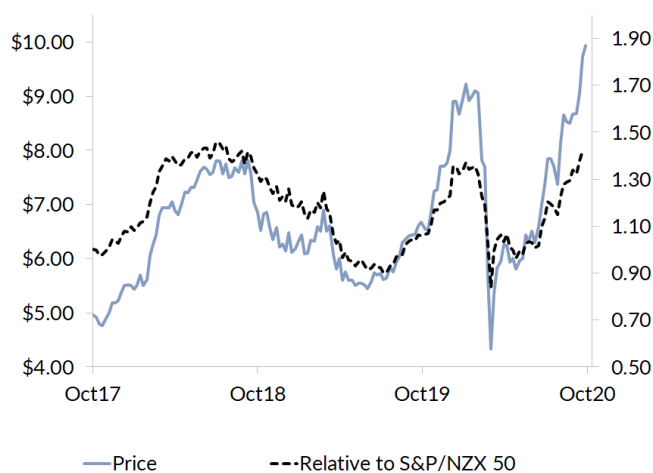


Source: Forsyth Barr analysis, Company reports

**Figure 7. ...driven by higher cash recovery of new business**



Source: Forsyth Barr analysis, Company reports

**Figure 8. Price performance**


Source: Forsyth Barr analysis

**Figure 9. Substantial shareholders**

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	8.3%
Fisher Funds Management	6.2%
Milford Asset Management	5.3%

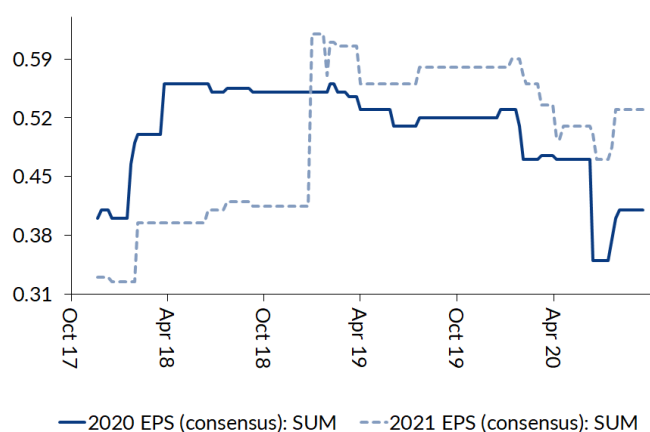
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 10. International valuation comparisons**

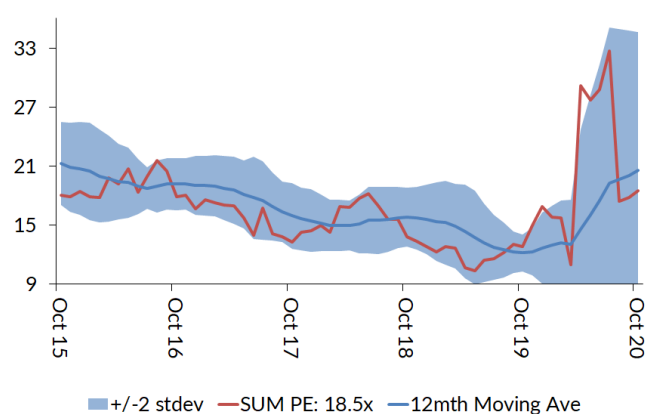
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect SUM's balance date - December)											
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E	
Summerset Group Limited	SUM NZ	NZ\$10.00	NZ\$2,249	22.8x	17.8x	21.2x	16.9x	22.9x	18.1x	1.6%	
METLIFECARE *	MET NZ	NZ\$5.95	NZ\$1,269	17.8x	16.5x	19.4x	18.0x	21.0x	19.5x	1.3%	
RYMAN HEALTHCARE *	RYM NZ	NZ\$14.84	NZ\$7,420	25.4x	23.3x	28.4x	24.2x	31.1x	26.3x	1.8%	
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.30	NZ\$810	17.3x	14.6x	16.3x	14.0x	21.0x	17.7x	3.3%	
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.78	NZ\$966	16.9x	14.5x	19.2x	16.2x	21.6x	18.2x	3.4%	
Compco Average:				19.4x	17.2x	20.8x	18.1x	23.7x	20.4x	2.4%	
EV = Current Market Cap + Actual Net Debt				SUM Relative:	18%	3%	2%	-7%	-3%	-11%	-34%

EV = Current Market Cap + Actual Net Debt

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

**Figure 11. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 12. One year forward PE (x)**


Source: Forsyth Barr analysis



# Oceania Healthcare

## V Shaped Recovery; Upgrade to OUTPERFORM

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### OUTPERFORM

We upgrade Oceania Healthcare (OCA) to OUTPERFORM with a target price of NZ\$1.65 (from NZ\$1.10). We believe OCA's higher average charges and focus on care suites over traditional care is a key beneficiary of the current buoyant market environment for residential homes and high demand for care. We believe OCA to be at an inflection point with its transition from traditional care operator towards a premium operator charging through deferred management fees (DMF) and re-sale gains. We expect OCA to almost double annuity earnings over the coming three years and deliver the highest cash recovery of new capex in the sector. Should OCA deliver on our expectations and the buoyant market continue, we see substantial further upside medium term.

NZX Code	OCA	Financials: May/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.30	NPAT* (NZ\$m)	42.5	49.5	59.8	69.0	PE	18.8	16.2	13.4	11.6
Target price	NZ\$1.65	EPS* (NZc)	6.9	8.0	9.7	11.2	EV/EBIT	22.2	19.8	16.8	14.8
Risk rating	Medium	EPS growth* (%)	-15.8	15.9	20.7	15.4	EV/EBITDA	17.1	15.5	13.5	12.0
Issued shares	618.1m	DPS (NZc)	3.5	4.0	4.5	5.0	Price / NTA	1.5	1.4	1.4	1.3
Market cap	NZ\$804m	Imputation (%)	0	0	0	0	Cash div yld (%)	2.7	3.1	3.5	3.8
Avg daily turnover	2,542k (NZ\$2,603k)	*Based on normalised profits					Gross div yld (%)	2.7	3.1	3.5	3.8

### The worst is behind us, time to look ahead

OCA has had, by some margin, the worst development of all the aged care operators over the last four years; annuity earnings have declined by almost 30% and only 50% of capex has been recovered in the form of new sales. This has been a deliberate strategy by OCA to de-commission one third of its existing care beds to replace them with (fewer) care suites and ILUs. This has, in our view, been a high risk, high reward, strategy that looks to be paying off. The care suite model substantially improves capex recovery, cash conversion of annuity earnings and DMF. The risk primarily relates to demand; will the product work? We are of the view that the "use case" for care suites is strong, however, it is a relatively untested product in New Zealand. The early signs are positive, but OCA is, in our view, a high risk, high reward stock.

**Figure 1. Forecast earnings changes (NZ\$m)**

	FY20A		FY21E		FY22E		FY23E		
	Actual	Old	New	Change	Old	New	Change	Old	New
Total revenue	241.7	253.9	256.7	1.1%	276.8	277.9	0.4%	297.6	297.0
Total costs	178.6	182.6	183.8	0.6%	193.6	192.5	-0.6%	205.2	200.7
EBITDA	63.1	71.3	72.9	2.3%	83.2	85.4	2.6%	92.3	96.3
Depreciation & amortisation	14.5	15.7	15.7	-0.1%	17.0	17.0	-0.2%	18.2	18.2
EBIT	48.6	55.6	57.2	3.0%	66.3	68.4	3.2%	74.1	78.0
Net interest	6.2	7.7	7.7	0.1%	8.3	8.6	4.0%	8.3	9.0
Underlying profit	42.5	47.9	49.5	3.4%	58.0	59.8	3.1%	65.8	69.0
EPS (cps)	6.9	7.7	8.0	3.4%	9.4	9.7	3.1%	11.2	11.2
DPS (cps)	3.5	4.0	4.0	0.0%	4.6	4.5	-2.2%	5.0	5.0
Sales - new units	189.0	225	235	4.4%	255	255	0.0%	270	270
New sales margin (%)	33%	26%	26%	0.0%	22%	22%	0.0%	20%	20%
Sales - resold units	166.0	212	234	10.5%	261	286	9.6%	315	348
Resales margin (%)	20%	18%	18%	0.0%	18%	18%	0.1%	18%	17%

Source: Forsyth Barr analysis, Company reports

## Oceania Healthcare Limited (OCA)

Priced as at 14 Oct 2020 (NZ\$) **1.30**

<b>12-month target price (NZ\$)*</b>	<b>1.65</b>
Expected share price return	26.9%
Net dividend yield	3.2%
Estimated 12-month return	30.2%

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	0.88
WACC	6.4%
Terminal growth	1.5%

<b>Spot valuations (NZ\$)</b>	
1. EV/Annuity EBITDA	1.65
2. DDM	1.65
3. n/a	n/a

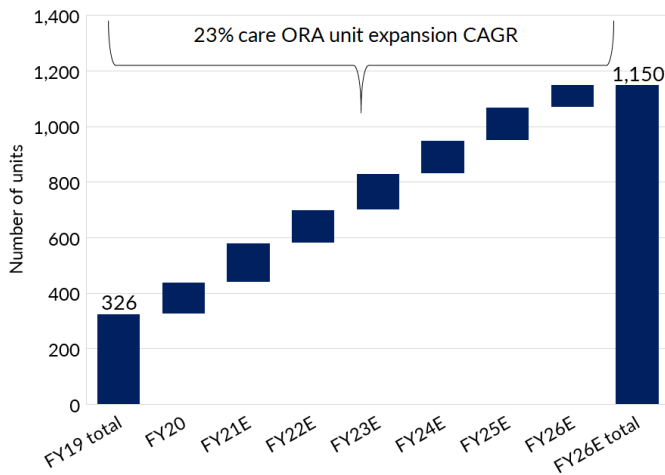
<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	n/a
(Net debt)/cash	n/a
Less: Capitalised operating leases	n/a
Value of equity	n/a

<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Sales revenue	233.5	241.7	256.7	277.9	297.0	EV/EBITDA (x)	15.9	17.1	15.5	13.5	12.0
<b>Normalised EBITDA</b>	<b>63.1</b>	<b>63.1</b>	<b>72.9</b>	<b>85.4</b>	<b>96.3</b>	EV/EBIT (x)	18.7	22.2	19.8	16.8	14.8
Depreciation and amortisation	(9.5)	(14.5)	(15.7)	(17.0)	(18.2)	PE (x)	15.8	18.8	16.2	13.4	11.6
<b>Normalised EBIT</b>	<b>53.6</b>	<b>48.6</b>	<b>57.2</b>	<b>68.4</b>	<b>78.0</b>	Price/NTA (x)	1.3	1.5	1.4	1.4	1.3
Net interest	(3.5)	(6.2)	(7.7)	(8.6)	(9.0)	Free cash flow yield (%)	30.9	29.3	32.8	38.3	40.7
Associate income	0	0	0	0	0	Net dividend yield (%)	3.6	2.7	3.1	3.5	3.8
Tax	0	0	0	0	0	Gross dividend yield (%)	3.6	2.7	3.1	3.5	3.8
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>50.1</b>	<b>42.5</b>	<b>49.5</b>	<b>59.8</b>	<b>69.0</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	(4.7)	(56.1)	(7.7)	(1.4)	(5.1)	Interest cover EBIT (x)	15.3	7.9	7.4	7.9	8.7
<b>Reported NPAT</b>	<b>45.4</b>	<b>(13.6)</b>	<b>41.8</b>	<b>58.4</b>	<b>63.9</b>	Interest cover EBITDA (x)	18.1	10.2	9.5	9.9	10.7
Normalised EPS (cps)	8.2	6.9	8.0	9.7	11.2	Net debt/ND+E (%)	28.9	35.7	37.9	36.7	34.4
DPS (cps)	4.7	3.5	4.0	4.5	5.0	Net debt/EBITDA (x)	3.9	4.9	4.8	4.1	3.5
<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Revenue (%)	5.2	3.5	6.2	8.2	6.9	Return on assets (%)	3.8	3.2	3.4	3.7	3.8
EBITDA (%)	-0.9	-0.1	15.6	17.1	12.8	Return on equity (%)	8.2	7.7	8.7	9.9	10.9
EBIT (%)	-2.4	-9.3	17.8	19.5	14.0	Return on funds employed (%)	5.7	4.8	5.2	6.1	6.8
Normalised NPAT (%)	-3.9	-15.2	16.7	20.7	15.4	EBITDA margin (%)	27.0	26.1	28.4	30.7	32.4
Normalised EPS (%)	-3.9	-15.8	15.9	20.7	15.4	EBIT margin (%)	23.0	20.1	22.3	24.6	26.3
Ordinary DPS (%)	0.0	-25.5	14.3	12.5	11.1	Capex to sales (%)	65.9	56.3	54.5	50.4	47.1
						Capex to depreciation (%)	1,611	941	893	825	768
						Imputation (%)	0	0	0	0	0
						Pay-out ratio (%)	57	51	50	47	45
<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>EBITDA</b>	<b>63.1</b>	<b>63.1</b>	<b>72.9</b>	<b>85.4</b>	<b>96.3</b>	<b>Revenue (NZ\$m)*</b>					
Working capital change	(1.8)	(2.4)	1.3	1.4	1.2	Care fees	156.6	156.4	162.2	169.0	173.4
Interest & tax paid	(3.5)	(6.2)	(7.7)	(8.6)	(9.0)	Management fees	22.3	29.2	37.3	45.9	56.2
Other	37.0	44.8	57.0	89.2	98.8	Other	10.4	10.6	11.0	11.6	12.2
<b>Operating cash flow</b>	<b>94.8</b>	<b>99.4</b>	<b>123.5</b>	<b>167.4</b>	<b>187.2</b>	Gain on resales	15.1	11.5	15.9	19.7	23.7
Capital expenditure	(153.8)	(136.0)	(140.0)	(140.0)	(140.0)	Gain on new sales	29.1	33.9	30.3	31.7	31.5
(Acquisitions)/divestments	0	0	0	0	0	<b>Total revenue</b>	<b>233.5</b>	<b>241.7</b>	<b>256.7</b>	<b>277.9</b>	<b>297.0</b>
Other	0.0	(3.2)	0	(0.0)	0						
<b>Funding available/(required)</b>	<b>(59.0)</b>	<b>(39.8)</b>	<b>(16.5)</b>	<b>27.4</b>	<b>47.2</b>	<b>Key Drivers</b>					
Dividends paid	(28.4)	(22.2)	(24.7)	(27.8)	(30.9)	Sales - new units	133	189	235	255	270
Equity raised/(returned)	1.3	0	0	0	0	Sales - resold units	177	166	234	286	348
<b>(Increase)/decrease in net debt</b>	<b>(86.1)</b>	<b>(62.0)</b>	<b>(41.2)</b>	<b>(0.4)</b>	<b>16.3</b>	Gross development margin	36%	33%	26%	22%	20%
						Gross resales margin	25%	20%	18%	18%	17%
						Average new sales price (NZ\$000)	609	542	497	564	583
						Average resales price (NZ\$000)	348	354	377	390	400
<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Portfolio Overview</b>					
Working capital	5.0	6.8	9.2	7.9	6.5	ILU's	1,202	1,285	1,370	1,505	1,645
Fixed assets	1,324.4	1,437.8	1,607.1	1,780.2	1,951.9	Care Suites (ORA)	326	440	580	700	830
Intangibles	8.7	10.8	10.8	10.8	10.8	Care Suites (PAC)	216	239	251	241	235
Right of use asset	0	0	0	0	0	Care Beds	2,112	1,882	1,832	1,732	1,632
Other assets	0	0	0	0	0	<b>Total</b>	<b>3,856</b>	<b>3,846</b>	<b>4,033</b>	<b>4,178</b>	<b>4,342</b>
<b>Total funds employed</b>	<b>1,338.0</b>	<b>1,455.4</b>	<b>1,627.1</b>	<b>1,798.9</b>	<b>1,969.2</b>						
Net debt/(cash)	247.4	307.8	349.0	349.4	333.1						
Lease liability	0	13.0	13.0	13.0	13.0						
Other liabilities	480.8	580.2	693.6	834.4	988.0						
Shareholder's funds	609.9	554.4	571.5	602.1	635.1						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>1,338.0</b>	<b>1,455.4</b>	<b>1,627.1</b>	<b>1,798.9</b>	<b>1,969.2</b>						

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

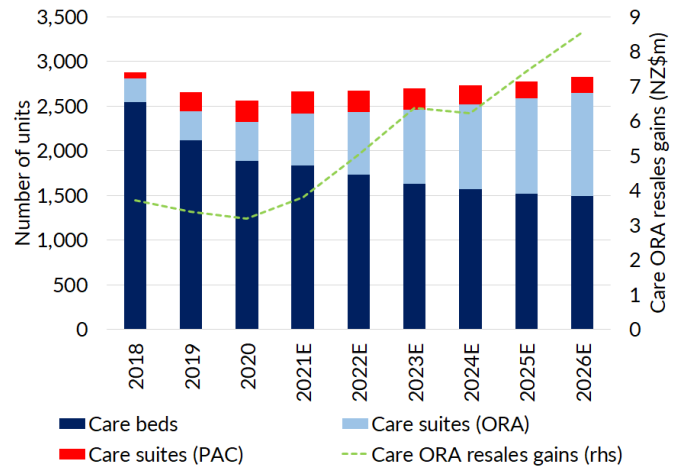
## Our thesis in pictures

Figure 2. Substantial growth in care suites...



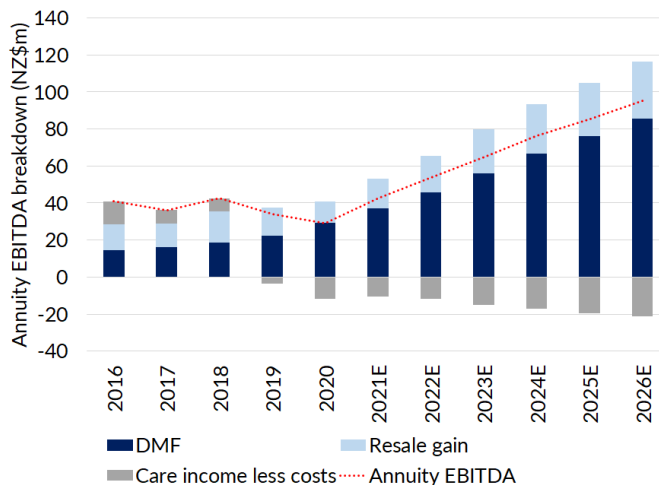
Source: Forsyth Barr analysis, Company reports

Figure 3. ...is transforming the care portfolio mix...



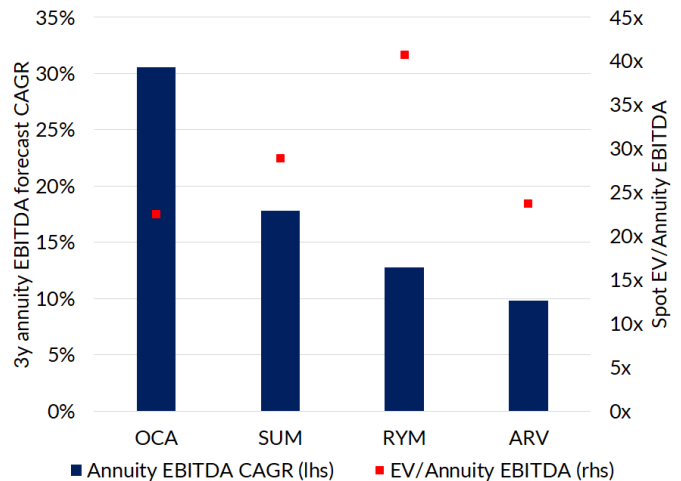
Source: Forsyth Barr analysis, Company reports

Figure 4. ...delivering strong growth in annuity EBITDA...



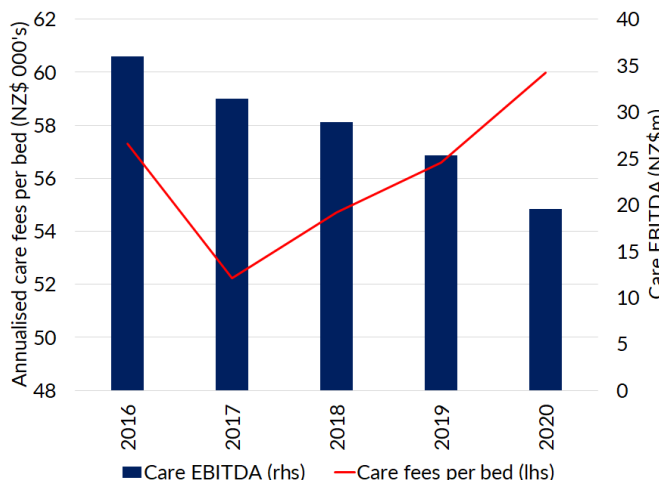
Source: Forsyth Barr analysis, Company reports

Figure 5. ...we estimate will be the fastest in the sector



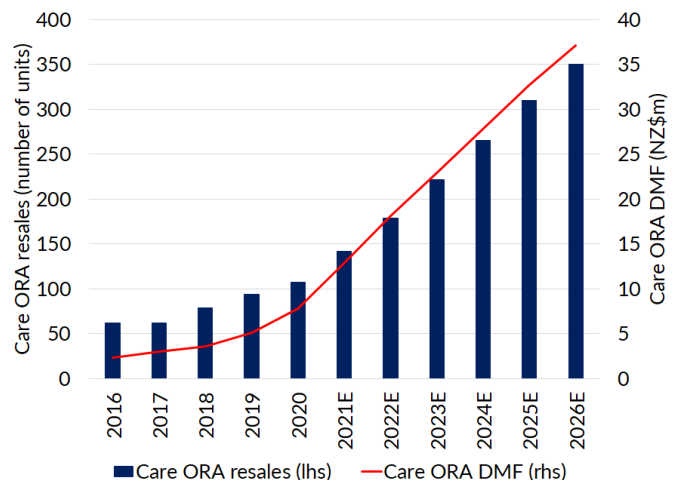
Source: Forsyth Barr analysis

Figure 6. Care earnings a drag but revenue resilient

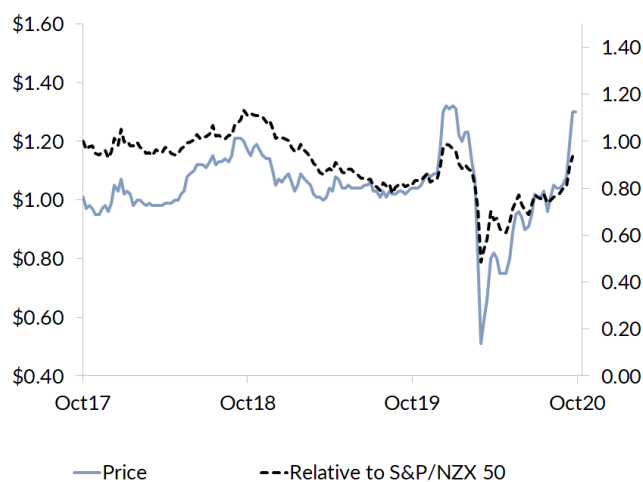


Source: Forsyth Barr analysis, Company reports

Figure 7. High turnover will drive DMF growth



Source: Forsyth Barr analysis, Company reports

**Figure 8. Price performance**


Source: Forsyth Barr analysis

**Figure 9. Substantial shareholders**

Shareholder	Latest Holding
ANZ NZ Investments	8.5%
Harbour Asset Management & Jarden Securities Limited	5.3%
ACC	5.1%

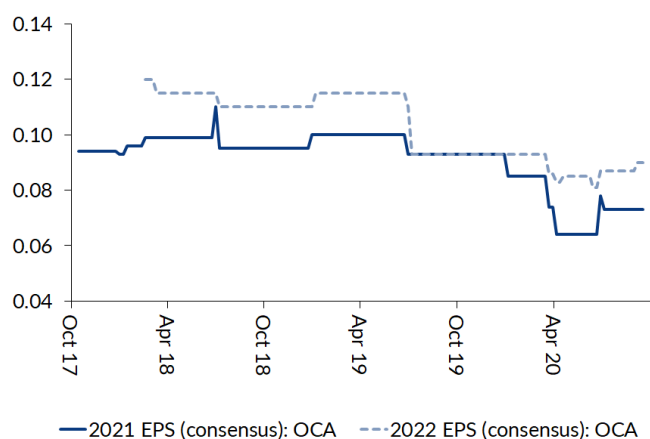
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 10. International valuation comparisons**

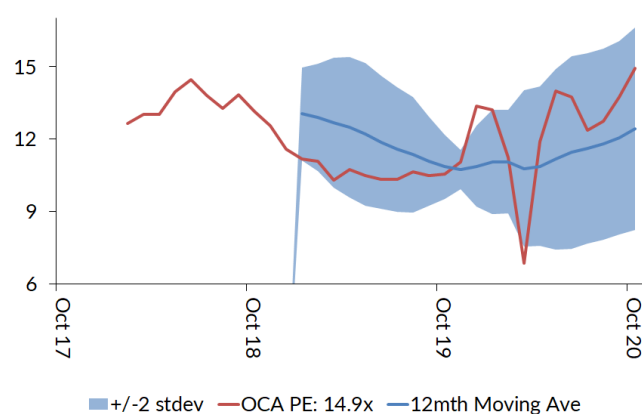
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect OCA's balance date - May)										
Oceania Healthcare	OCA NZ	NZ\$1.30	NZ\$804	16.2x	13.4x	15.2x	13.0x	19.4x	16.2x	3.5%
RYMAN HEALTHCARE *	RYM NZ	NZ\$14.84	NZ\$7,420	25.8x	21.9x	26.6x	22.8x	29.1x	24.7x	1.9%
METLIFECARE *	MET NZ	NZ\$5.95	NZ\$1,269	18.1x	15.1x	19.7x	16.6x	21.3x	17.9x	1.3%
SUMMERSET GROUP LIMITED *	SUM NZ	NZ\$9.98	NZ\$2,283	20.7x	16.4x	19.6x	15.9x	21.1x	17.0x	1.8%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.78	NZ\$966	16.7x	13.2x	18.3x	15.0x	20.7x	16.7x	3.6%
Compco Average:				20.3x	16.7x	21.1x	17.6x	23.1x	19.1x	2.1%
OCA Relative:				-20%	-19%	-28%	-26%	-16%	-15%	62%

EV = Current Market Cap + Actual Net Debt

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

**Figure 11. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 12. One year forward PE (x)**


Source: Forsyth Barr analysis

# Ryman Healthcare

## Fully Valued; Downgrade to NEUTRAL

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### NEUTRAL

Ryman Healthcare's (RYM) focus on continuum of care, low and stable fees and a well oiled development strategy has delivered 20% p.a. Total Shareholder Returns (TSR) for 20 years. We believe the combination of low fees, strong brand and high quality care offering makes RYM the most resilient of the four listed aged care operators to oversupply or adverse economic conditions in NZ. Over the last few years RYM has focussed on building out its capabilities in Australia as well as building more complex high rise villages in NZ, particularly in Auckland. This has resulted in a slowdown in annuity earnings growth and a reduction in recovery of capex. While we believe this is likely a necessary strategy to keep up with historical growth rates, we believe investors will find a better relative entry point into RYM when we are closer to seeing the long term investment in Australia pay off. We downgrade our rating to NEUTRAL with a price target of NZ\$14.00.

NZX Code	RYM	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$15.11	NPAT* (NZ\$m)	335.4	279.8	334.0	368.3	PE	22.5	27.0	22.6	20.5
Target price	NZ\$14.00	EPS* (NZc)	67.1	56.0	66.8	73.7	EV/EBIT	34.8	30.6	26.0	23.6
Risk rating	Medium	EPS growth* (%)	50.0	-16.6	19.4	10.3	EV/EBITDA	31.4	28.0	23.9	21.6
Issued shares	500.0m	DPS (NZc)	24.2	24.3	27.0	33.0	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$7,555m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.6	1.6	1.8	2.2
Avg daily turnover	548.9k (NZ\$7,191k)	*Based on normalised profits					Gross div yld (%)	2.2	2.2	2.5	3.0

### Building out Australia comes with long term gain but medium term pain

We believe that RYM's expansion into Australia makes strategic sense long term and believe there to be a high probability that it will be successful. However, over the last six years we estimate that RYM has only recovered ~50% of its total capex from sale of new units and over the last three years growth in Independent Living Units (ILUs) has slowed to 7-8% p.a. This slowdown has been accentuated by increased care costs and over the last two years annuity earnings have been flat while net debt has increased. Going forward we expect growth to re-accelerate as unit delivery in Australia picks up. However, we believe that RYM's defensive characteristics with the lowest charges and high proportion of care suggest that we will not see a full catch up of two "lost years".

**Figure 1. Forecast earnings changes (NZ\$m)**

	FY20A		FY21E		FY22E			FY23E		
	Actual	Old	New	Change	Old	New	Change	Old	New	Change
<b>Total Revenue</b>	638.5	675.7	716.0	6%	793.5	829.3	5%	922.6	929.0	1%
Total Costs	349.2	373.4	382.0	2%	413.6	434.6	5%	450.3	492.3	9%
<b>EBITDA</b>	289.2	302.3	334.0	10%	379.9	394.7	4%	472.4	436.7	-8%
Depreciation & Amortisation	28.6	29.0	28.0	-3%	31.7	31.6	0%	34.9	36.6	5%
<b>EBIT</b>	260.6	273.4	305.9	12%	348.2	363.1	4%	437.5	400.1	-9%
Net interest	18.8	24.2	26.1	8%	24.7	29.1	18%	25.0	31.7	27%
<b>Underlying profit</b>	241.8	231.4	279.8	21%	304.7	334.0	10%	390.4	368.3	-6%
EPS (cents)	67.1	46.3	56.0	21%	60.9	66.8	10%	78.1	73.7	-6%
DPS (cents)	24.2	23.1	24.3	5%	30.5	27.0	-11%	39.0	33.0	-15%
Sales - new units	513	600	700	17%	800	850	6%	900	900	0%
New sales margin (%)	27%	20.5%	24%	3.5%	21%	24%	3%	21%	24%	4%
Sales - resold units	923	834	969	16%	1032	1059	3%	1232	1162	-6%
Resales margin (%)	23%	22%	22%	0%	22%	23%	1%	23%	23%	0%

Source: Forsyth Barr analysis, Company reports

## Ryman Healthcare Limited (RYM)

Priced as at 14 Oct 2020 (NZ\$) **15.11**

<b>12-month target price (NZ\$)*</b>	<b>14.00</b>
Expected share price return	-7.3%
Net dividend yield	1.7%
Estimated 12-month return	-5.6%

### Key WACC assumptions

Risk free rate	1.30%
Equity beta	0.78
WACC	5.8%
Terminal growth	1.5%

### Spot valuations (NZ\$)

1. EV/Annuity EBITDA	12.75
2. DDM	15.20
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

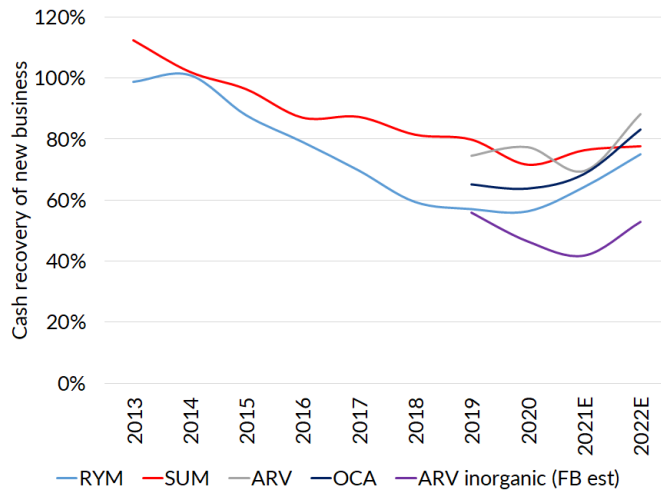
Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	572.3	638.5	716.0	829.3	929.0	EV/EBITDA (x)	32.6	31.4	28.0	23.9	21.6
<b>Normalised EBITDA</b>	<b>268.5</b>	<b>289.2</b>	<b>334.0</b>	<b>394.7</b>	<b>436.7</b>	EV/EBIT (x)	35.6	34.8	30.6	26.0	23.6
Depreciation and amortisation	(23.1)	(28.6)	(28.0)	(31.6)	(36.6)	PE (x)	33.8	22.5	27.0	22.6	20.5
<b>Normalised EBIT</b>	<b>245.4</b>	<b>260.6</b>	<b>305.9</b>	<b>363.1</b>	<b>400.1</b>	Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Net interest	(18.4)	(18.8)	(26.1)	(29.1)	(31.7)	Free cash flow yield (%)	-3.9	-4.4	-4.6	-5.4	-6.0
Associate income	0	0	0	0	0	Net dividend yield (%)	1.5	1.6	1.6	1.8	2.2
Tax	(3.4)	93.6	0	0	0	Gross dividend yield (%)	2.1	2.2	2.2	2.5	3.0
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>223.5</b>	<b>335.4</b>	<b>279.8</b>	<b>334.0</b>	<b>368.3</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	102.4	(70.7)	(92.0)	74.3	76.1	Interest cover EBIT (x)	13.3	13.9	11.7	12.5	12.6
<b>Reported NPAT</b>	<b>326.0</b>	<b>264.7</b>	<b>187.8</b>	<b>408.3</b>	<b>444.4</b>	Interest cover EBITDA (x)	14.6	15.4	12.8	13.6	13.8
Normalised EPS (cps)	44.7	67.1	56.0	66.8	73.7	Net debt/ND+E (%)	-35.1	-37.0	-35.5	-32.2	-30.1
DPS (cps)	22.7	24.2	24.3	27.0	33.0	Net debt/EBITDA (x)	4.9	5.9	5.7	5.1	5.0
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	12.6	11.6	12.1	15.8	12.0	Return on assets (%)	62.0	47.6	48.5	47.3	46.9
EBITDA (%)	11.8	7.7	15.5	18.2	10.6	Return on equity (%)	-4.4	-5.3	-3.9	-4.1	-3.9
EBIT (%)	11.7	6.2	17.4	18.7	10.2	Return on funds employed (%)	-5.9	-7.3	-5.3	-5.5	-5.2
Normalised NPAT (%)	10.2	50.0	-16.6	19.4	10.3	EBITDA margin (%)	46.9	45.3	46.6	47.6	47.0
Normalised EPS (%)	10.2	50.0	-16.6	19.4	10.3	EBIT margin (%)	42.9	40.8	42.7	43.8	43.1
Ordinary DPS (%)	11.3	6.6	0.4	11.1	22.2	Capex to sales (%)	80.5	88.6	78.1	78.2	77.0
						Capex to depreciation (%)	1,991	1,977	1,993	2,053	1,954
						Imputation (%)	100	100	100	100	100
						Pay-out ratio (%)	51	36	43	40	45
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Operating Performance	2019A	2020A	2021E	2022E	2023E
<b>EBITDA</b>	<b>268.5</b>	<b>289.2</b>	<b>334.0</b>	<b>394.7</b>	<b>436.7</b>	<b>Revenue (NZ\$m)*</b>					
Working capital change	(20.9)	(48.3)	(41.7)	(30.0)	(19.1)	Care fees	302.0	333.4	370.6	414.4	461.3
Interest & tax paid	(21.9)	74.8	(26.1)	(29.1)	(31.7)	Management fees	78.9	88.7	102.4	120.9	142.0
Other	(118.1)	(199.5)	(147.9)	(212.2)	(257.2)	Other	0.9	1.2	1.0	1.0	1.0
<b>Operating cash flow</b>	<b>107.7</b>	<b>116.2</b>	<b>118.3</b>	<b>123.4</b>	<b>128.6</b>	Gain on resales	102.6	109.6	113.8	132.7	151.4
Capital expenditure	(460.4)	(565.8)	(559.0)	(648.7)	(714.9)	Gain on new sales	87.9	105.6	128.2	160.3	173.2
(Acquisitions)/divestments	239.7	232.6	411.1	554.5	597.5	<b>Total revenue</b>	<b>572.3</b>	<b>638.5</b>	<b>716.0</b>	<b>829.3</b>	<b>929.0</b>
Other	(40.2)	(48.6)	(40.0)	(41.0)	(42.0)						
<b>Funding available/(required)</b>	<b>(153.3)</b>	<b>(265.6)</b>	<b>(69.6)</b>	<b>(11.7)</b>	<b>(30.8)</b>	<b>Key Drivers</b>					
Dividends paid	(108.5)	(117.0)	(121.5)	(135.0)	(165.0)	Sales - new units	414	513	700	850	900
Equity raised/(returned)	0	0	0	0	0	Sales - resold units	824	923	969	1,059	1,162
<b>(Increase)/decrease in net debt</b>	<b>(261.8)</b>	<b>(382.6)</b>	<b>(191.1)</b>	<b>(146.7)</b>	<b>(195.8)</b>	Gross development margin	30.2%	27.2%	24.0%	24.0%	24.0%
						Gross resales margin	24.6%	22.7%	22.0%	23.0%	23.0%
						Average new sales price (NZ\$000)	702	756	763	786	802
						Average resles price (NZ\$000)	507	524	534	545	566
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Total portfolio					
Working capital	207.9	256.2	297.9	327.9	347.0	Apartments/units	6,878	7,423	8,073	8,873	9,723
Fixed assets	14.6	16.8	15.6	22.4	35.6	Beds	3,660	3,911	4,181	4,561	4,981
Intangibles	28.0	38.1	48.1	59.1	71.1	<b>Total</b>	<b>10,538</b>	<b>11,334</b>	<b>12,254</b>	<b>13,434</b>	<b>14,704</b>
Right of use asset	0	0	0	0	0						
Other assets	8.2	32.7	31.5	32.8	34.1						
<b>Total funds employed</b>	<b>258.6</b>	<b>343.75</b>	<b>393.1</b>	<b>442.2</b>	<b>487.8</b>						
Net debt/(cash)	1,324.0	1,707.2	1,893.8	2,006.6	2,168.4						
Lease liability	0	15.1	15.1	15.1	15.1						
Other liabilities	4,032.9	4,943.5	5,719.0	6,651.9	7,670.1						
Shareholder's funds	(5,098.3)	(6,322.2)	(7,234.8)	(8,231.4)	(9,365.9)						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>258.6</b>	<b>344</b>	<b>393.1</b>	<b>442.2</b>	<b>487.8</b>						

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



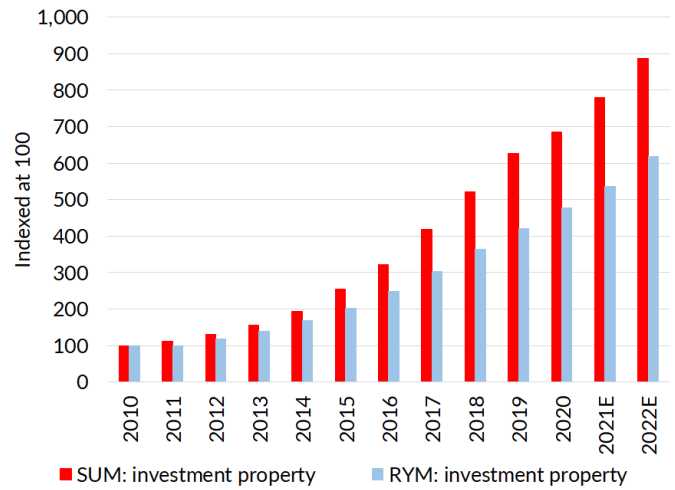
## Our thesis in pictures

Figure 2. Recovery of capex has waned in recent years...



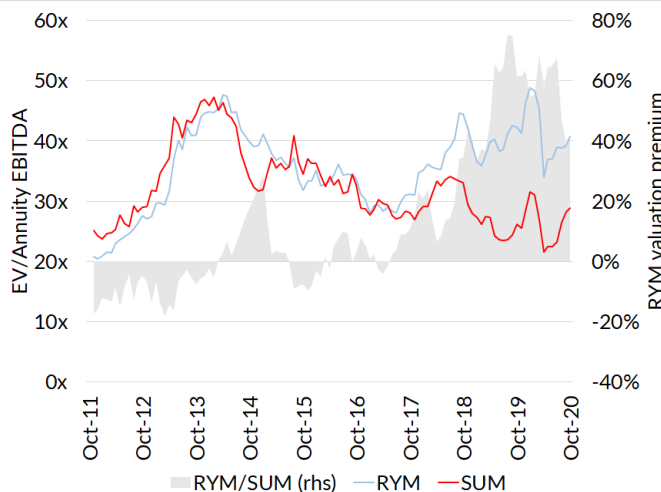
Source: Forsyth Barr analysis

Figure 3. ...as investment property growth has slowed



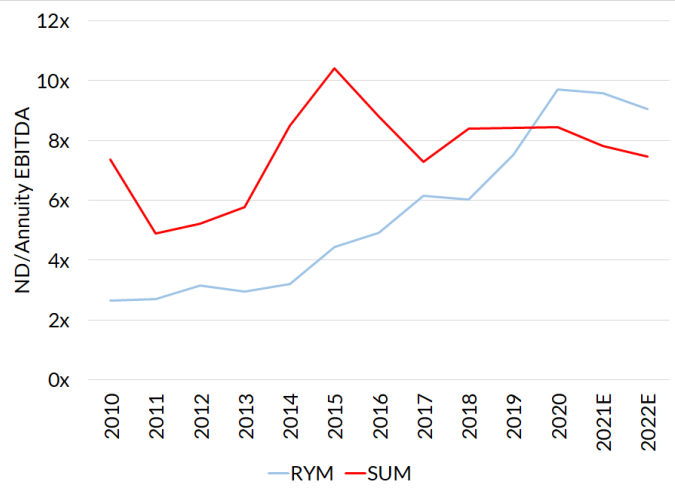
Source: Forsyth Barr analysis

Figure 4. Hard to justify the RYM valuation premium

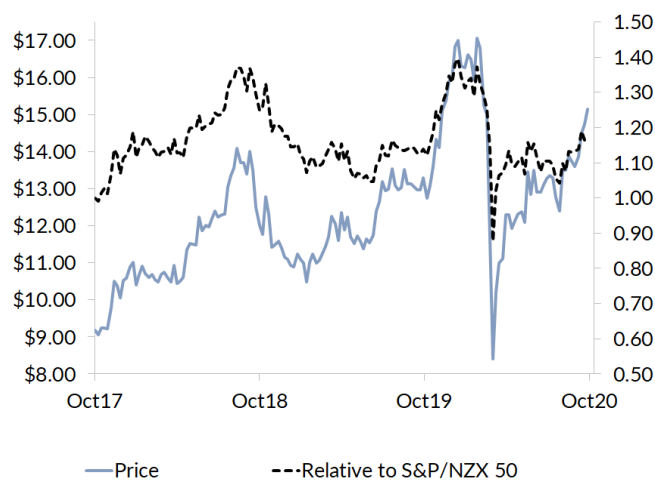


Source: Forsyth Barr analysis

Figure 5. A marked increase in gearing



Source: Forsyth Barr analysis

**Figure 6. Price performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

Shareholder	Latest Holding
Geoffrey A Cumming	10.2%
Hickman Family	6.6%

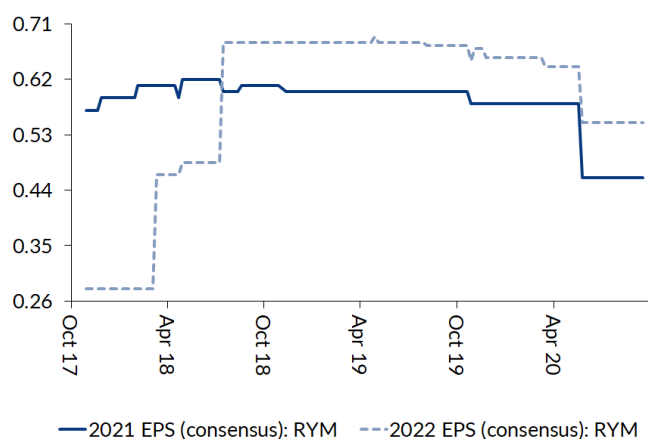
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 8. International valuation comparisons**

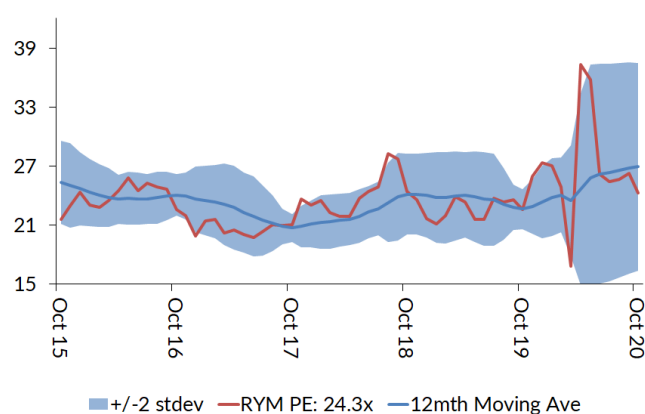
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect RYM's balance date - March)										
Ryman Healthcare	RYM NZ	NZ\$15.11	NZ\$7,555	27.0x	22.6x	27.7x	23.5x	30.3x	25.5x	1.8%
METLIFECARE *	MET NZ	NZ\$5.95	NZ\$1,269	18.0x	15.7x	19.5x	17.2x	21.2x	18.5x	1.3%
SUMMERSET GROUP LIMITED *	SUM NZ	NZ\$9.98	NZ\$2,283	21.5x	17.0x	20.4x	16.4x	21.9x	17.5x	1.7%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.30	NZ\$810	16.7x	13.9x	15.7x	13.5x	20.1x	16.9x	3.4%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.78	NZ\$966	17.3x	13.6x	18.9x	15.3x	21.5x	17.1x	3.5%
Compco Average:				18.4x	15.0x	18.6x	15.6x	21.2x	17.5x	2.5%
RYM Relative:				47%	51%	49%	50%	43%	46%	-28%

EV = Current Market Cap + Actual Net Debt

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

**Figure 9. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**


Source: Forsyth Barr analysis

# Arvida Group

## Fully Valued; Downgrade to NEUTRAL

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### NEUTRAL

We downgrade Arvida (ARV) to NEUTRAL following its strong recent share price performance; we remain positive on ARV's long term growth outlook and portfolio mix transformation towards care suites but see better value elsewhere in the sector. We upgrade our price target to NZ\$1.90 (from NZ\$1.82) and increase our earnings materially following strong sector wide recovery post COVID-19 lockdowns. ARV has delivered impressive growth over the last four years driven primarily by acquisitions of villages with development potential. We estimate that ARV has grown annuity EBITDA organically at mid single digits since listing, but see potential for this to accelerate over the coming years. However, we do not foresee further re-rating until ARV can decisively demonstrate the benefit of its acquisition strategy.

NZX Code	ARV	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.80	NPAT* (NZ\$m)	54.5	55.8	71.0	84.2	PE	15.8	17.5	13.7	11.6
Target price	NZ\$1.90	EPS* (NZc)	11.4	10.3	13.1	15.5	EV/EBIT	20.8	21.5	17.4	14.8
Risk rating	Medium	EPS growth* (%)	12.4	-9.8	27.3	18.6	EV/EBITDA	18.9	19.0	15.6	13.4
Issued shares	541.9m	DPS (NZc)	5.8	5.8	6.2	7.0	Price / NTA	1.4	1.3	1.2	1.2
Market cap	NZ\$975m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.2	3.2	3.4	3.9
Avg daily turnover	601.6k (NZ\$931k)	*Based on normalised profits					Gross div yld (%)	4.5	4.5	4.8	5.4

### COVID unwind impacting earnings changes

Through acquisitions and some development ARV has transformed its business from one heavily reliant on stand alone care to a more integrated earnings mix where the lion's share of earnings are derived from DMF and re-sale gains. Going forward we expect this mix shift to further accelerate as ARV focuses development activity on care suites sold under an Occupational Rights Agreement and Independent Living Units. This should accelerate organic growth which has been low since listing due to declining profitability within care. We make material upgrades to near term forecasts as part of the final unwind from our COVID-19 dampened numbers.

**Figure 1. Forecast earnings changes (NZ\$m)**

	FY20A		FY21E		FY22E		FY23E			
	Actual	Old	New	Change	Old	New	Change	Old	New	Change
<b>Total Revenue</b>	203.0	209.2	221.3	6%	231.3	248.3	7%	265.1	275.2	4%
Total Costs	139.6	151.1	153.9	2%	157.1	165.2	5%	167.8	178.6	6%
<b>EBITDA</b>	63.3	58.1	67.4	16%	74.2	83.0	12%	97.3	96.6	-1%
Depreciation & Amortisation	5.8	8.7	8.1	-8%	9.5	8.5	-10%	10.4	8.8	-15%
<b>EBIT</b>	57.5	49.4	59.4	20%	64.7	74.5	15%	86.9	87.7	1%
Net interest and other adjustments	5.8	6.9	6.4	n/a	8.8	6.5	n/a	12.9	6.7	n/a
<b>Underlying profit</b>	51.7	42.5	53.0	25%	55.9	68.0	22%	74.0	81.0	9%
EPS (cents)	11.4	7.8	10.3	31%	10.3	13.1	27%	13.7	15.5	14%
DPS (cents)	5.8	4.3	5.8	35%	5.7	6.2	9%	7.5	7.0	-7%
Sales - new units	126	90	140	56%	140	230	64%	190	275	45%
New sales margin (%)	16%	18.5%	16%	-2.5%	20%	16%	-4%	19%	16%	-3%
Sales - resold units	278	204	258	26%	251	335	33%	360	382	6%
Resales margin (%)	23%	20%	25%	5%	20%	22%	2%	20%	22%	2%

Source: Forsyth Barr analysis, Company reports

## Arvida Group Limited (ARV)

Priced as at 14 Oct 2020 (NZ\$)

1.80

### 12-month target price (NZ\$)\*

1.90

Expected share price return

5.6%

Net dividend yield

3.4%

Estimated 12-month return

8.9%

### Spot valuations (NZ\$)

1. EV/Annuity EBITDA

1.90

2. DDM

1.85

3. n/a

n/a

### Key WACC assumptions

Risk free rate

1.30%

Equity beta

0.88

WACC

5.5%

Terminal growth

1.5%

### DCF valuation summary (NZ\$m)

Total firm value

n/a

(Net debt)/cash

n/a

Less: Capitalised operating leases

n/a

Value of equity

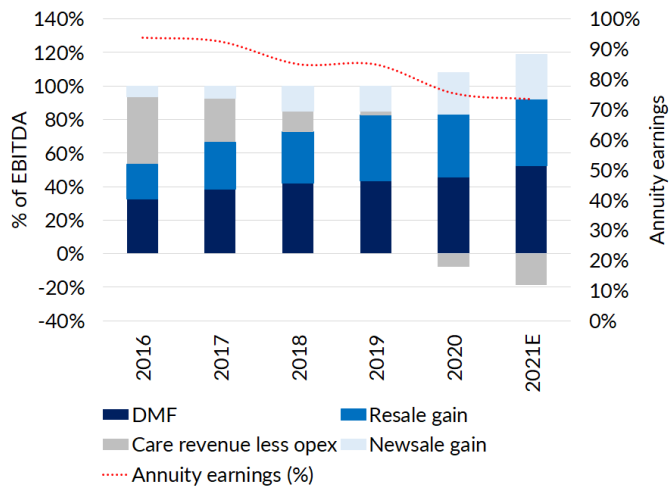
n/a

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	179.4	203.0	221.3	248.3	275.2	EV/EBITDA (x)	22.3	18.9	19.0	15.6	13.4
<b>Normalised EBITDA</b>	<b>49.6</b>	<b>63.3</b>	<b>67.4</b>	<b>83.0</b>	<b>96.6</b>	EV/EBIT (x)	24.8	20.8	21.5	17.4	14.8
Depreciation and amortisation	(5.0)	(5.8)	(8.1)	(8.5)	(8.8)	PE (x)	17.7	15.8	17.5	13.7	11.6
<b>Normalised EBIT</b>	<b>44.6</b>	<b>57.5</b>	<b>59.4</b>	<b>74.5</b>	<b>87.7</b>	Price/NTA (x)	1.5	1.4	1.3	1.2	1.2
Net interest	(3.6)	(4.1)	(5.4)	(6.5)	(6.7)	Free cash flow yield (%)	-5.4	-12.7	-12.0	-12.5	-16.0
Associate income	3.4	2.8	2.8	3.0	3.2	Net dividend yield (%)	3.0	3.2	3.2	3.4	3.9
Tax	(2.3)	(1.7)	(1.0)	0	0	Gross dividend yield (%)	4.1	4.5	4.5	4.8	5.4
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>42.0</b>	<b>54.5</b>	<b>55.8</b>	<b>71.0</b>	<b>84.2</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	17.1	(11.9)	20.4	14.5	9.5	Interest cover EBIT (x)	12.3	14.1	11.0	11.5	13.0
<b>Reported NPAT</b>	<b>59.1</b>	<b>42.6</b>	<b>76.1</b>	<b>85.5</b>	<b>93.7</b>	Interest cover EBITDA (x)	13.7	15.6	12.4	12.8	14.3
Normalised EPS (cps)	10.2	11.4	10.3	13.1	15.5	Net debt/ND+E (%)	24.9	29.7	31.1	29.4	27.3
DPS (cps)	5.4	5.8	5.8	6.2	7.0	Net debt/EBITDA (x)	3.7	4.9	5.2	4.1	3.4
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	18.0	13.1	9.0	12.2	10.8	Return on assets (%)	3.4	3.0	2.8	3.1	3.3
EBITDA (%)	14.7	27.7	6.5	23.1	16.3	Return on equity (%)	7.5	7.5	7.2	8.6	9.5
EBIT (%)	14.2	29.1	3.3	25.5	17.8	Return on funds employed (%)	5.2	5.0	4.7	5.8	6.6
Normalised NPAT (%)	10.2	29.7	2.3	27.3	18.6	EBITDA margin (%)	27.6	31.2	30.5	33.4	35.1
Normalised EPS (%)	-0.4	12.4	-9.8	27.3	18.6	EBIT margin (%)	24.8	28.3	26.8	30.0	31.9
Ordinary DPS (%)	6.8	8.4	0.0	6.9	12.9	Capex to sales (%)	45.7	74.2	66.7	70.1	74.5
						Capex to depreciation (%)	1,624	2,585	1,833	2,040	2,319
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	100	100	100
<b>EBITDA</b>	<b>49.6</b>	<b>63.3</b>	<b>67.4</b>	<b>83.0</b>	<b>96.6</b>	Pay-out ratio (%)	53	51	56	47	45
Working capital change	8.6	24.0	4.4	27.4	17.2						
Interest & tax paid	(5.9)	(5.8)	(6.4)	(6.5)	(6.7)	<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Other	(22.8)	(54.4)	(34.4)	(51.7)	(57.6)	Care fees	125.6	129.5	136.2	143.6	149.6
<b>Operating cash flow</b>	<b>29.5</b>	<b>27.1</b>	<b>31.0</b>	<b>52.2</b>	<b>49.4</b>	Management fees	21.4	29.0	35.4	41.5	49.8
Capital expenditure	(82.0)	(150.6)	(147.7)	(174.2)	(205.0)	Other	5.4	5.1	5.0	5.3	5.5
(Acquisitions)/divestments	12.2	(104.1)	105.0	160.6	205.0	Invest. property (total gains)	27.0	39.3	44.7	58.0	70.2
Other	(3.6)	(7.4)	1.0	1.0	1.0	<b>Total revenue</b>	<b>179.4</b>	<b>203.0</b>	<b>221.3</b>	<b>248.3</b>	<b>275.2</b>
<b>Funding available/(required)</b>	<b>(43.9)</b>	<b>(235.0)</b>	<b>(10.6)</b>	<b>39.6</b>	<b>50.4</b>						
Dividends paid	(22.7)	(29.6)	(31.4)	(33.6)	(37.9)	<b>Key Drivers</b>					
Equity raised/(returned)	0	141.7	0	0	0	Sales - new units	70	126	140	230	275
(Increase)/decrease in net debt	(66.6)	(122.8)	(42.1)	6.0	12.5	Ave price - new sales (NZ 000's)	633	763	700	675	665
						Sales - resold units	258	278	258	335	382
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Ave price - new sales (NZ 000's)	338	377	415	423	431
Working capital	(45.9)	(69.9)	(74.3)	(101.7)	(118.9)	Ave resold unit price inflation	8.8%	11.7%	10.0%	2.0%	2.0%
Fixed assets	1,190.3	1,804.2	2,009.1	2,248.5	2,525.8	Gross development margin	16.9%	16.2%	16.0%	16.0%	16.0%
Intangibles	54.0	36.0	36.0	36.0	36.0	Gross resales margin	22.4%	22.6%	24.0%	22.0%	22.0%
Right of use asset	0	0	0	0	0						
Other assets	42.8	51.4	51.3	60.7	65.2	<b>Total portfolio</b>					
<b>Total funds employed</b>	<b>1,241.2</b>	<b>1,821.8</b>	<b>2,022.1</b>	<b>2,243.5</b>	<b>2,508.1</b>	Apartments/units	1,955	2,475	2,668	2,878	3,148
Net debt/(cash)	185.5	308.3	350.3	344.3	331.9	<b>Beds</b>	1,722	1,688	1,715	1,715	1,735
Lease liability	0	4.9	4.9	4.9	4.9						
Other liabilities	496.8	778.8	892.4	1,067.9	1,289.2						
Shareholder's funds	558.8	729.8	774.5	826.4	882.2						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>1,241.2</b>	<b>1,821.8</b>	<b>2,022.1</b>	<b>2,243.5</b>	<b>2,508.1</b>						

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

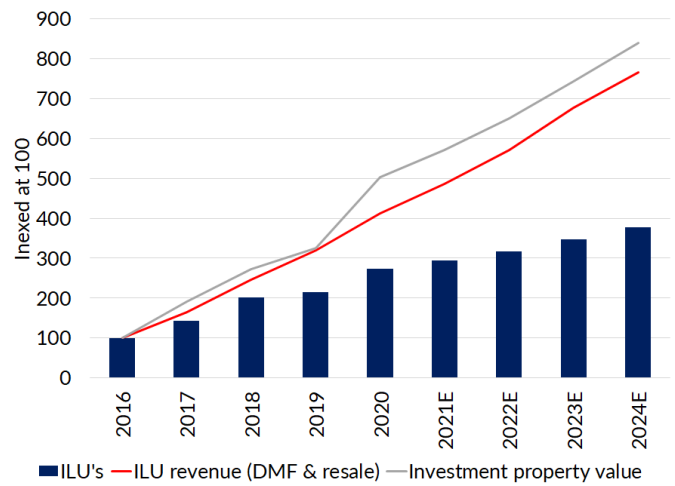
## Our thesis in pictures

Figure 2. Care earnings have dragged on the business...



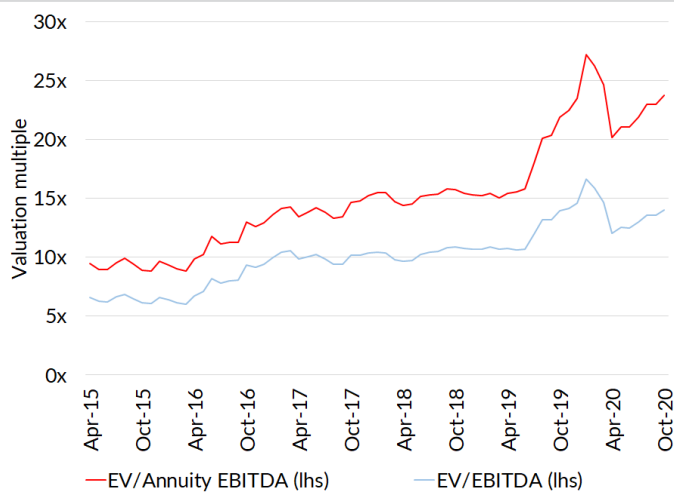
Source: Forsyth Barr analysis, Company reports

Figure 3. ...but have been offset by impressive ILU growth



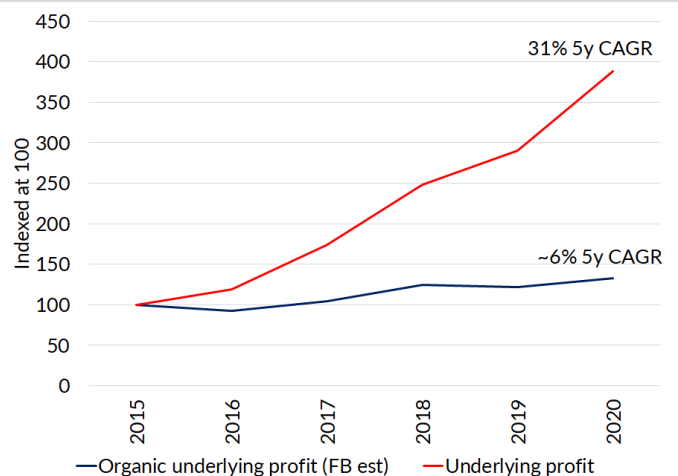
Source: Forsyth Barr analysis, Company reports

Figure 4. Valuation looks expensive versus history

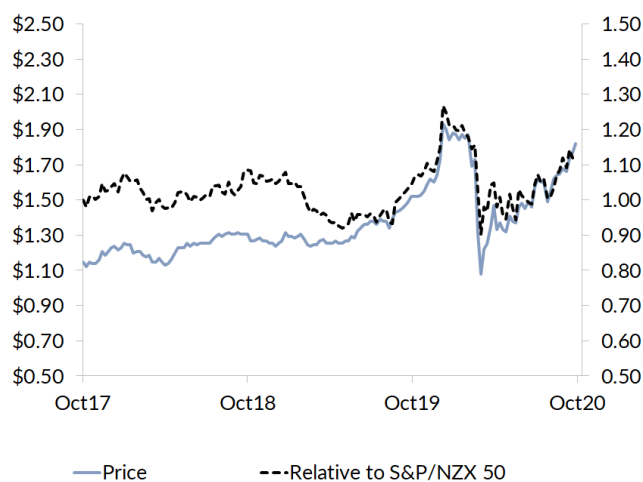


Source: Forsyth Barr analysis, Company reports

Figure 5. Impressive growth has been driven by acquisitions



Source: Forsyth Barr analysis, Company reports

**Figure 6. Price performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

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

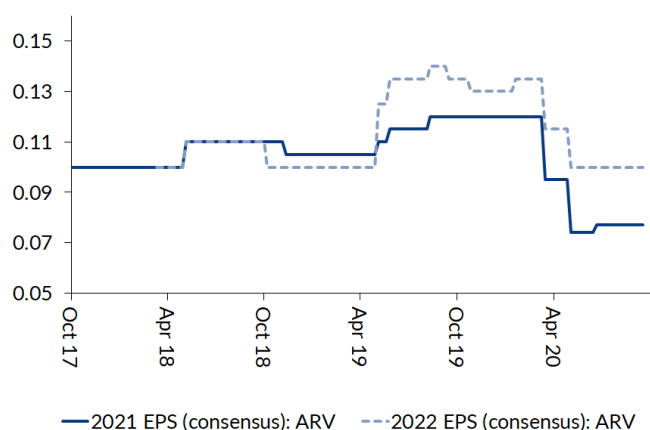
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 8. International valuation comparisons**

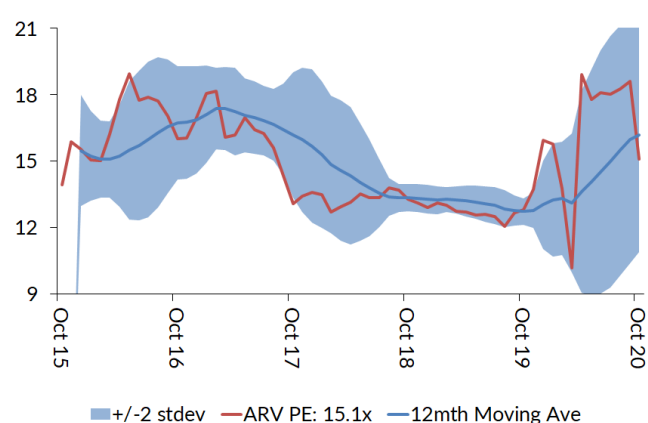
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect ARV's balance date - March)				2021E	2022E	2021E	2022E	2021E	2022E	2022E	
Arvida Group Limited	ARV NZ	NZ\$1.80	NZ\$975	17.5x	13.7x	19.0x	15.5x	21.6x	17.2x	3.4%	
RYMAN HEALTHCARE *	RYM NZ	NZ\$14.84	NZ\$7,420	26.5x	22.2x	27.3x	23.1x	29.8x	25.1x	1.8%	
SUMMERSET GROUP LIMITED *	SUM NZ	NZ\$9.98	NZ\$2,283	21.5x	17.0x	20.4x	16.4x	21.9x	17.5x	1.7%	
METLIFECARE *	MET NZ	NZ\$5.95	NZ\$1,269	18.0x	15.7x	19.5x	17.2x	21.2x	18.5x	1.3%	
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.30	NZ\$810	16.7x	13.9x	15.7x	13.5x	20.1x	16.9x	3.4%	
REGIS HEALTHCARE	REG AT	A\$1.01	A\$302	35.2x	16.1x	5.0x	5.2x	8.9x	8.9x	2.3%	
JAPARA HEALTHCARE	JHC AT	A\$0.40	A\$106	<0x	15.7x	8.3x	9.2x	>75x	>75x	4.4%	
ESTIA HEALTH	EHE AT	A\$1.45	A\$379	15.2x	16.3x	<0x	5.3x	6.1x	9.5x	6.0%	
Compco Average:				22.2x	16.7x	16.0x	12.8x	18.0x	16.1x	3.0%	
EV = Current Market Cap + Actual Net Debt				ARV Relative:	-21%	-18%	19%	20%	20%	7%	15%

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 9. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**


Source: Forsyth Barr analysis

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