# Metlifecare

**NEUTRAL**

## Downgrade to NEUTRAL — Waiting for NBIO Info

**MET's share price has risen around +40% recently following the announcement of a share buyback, a lift in sentiment towards the Auckland housing market, and possible corporate action with MET advising the market that it has received a non-binding indicative offer (NBIO). We have pulled our rating back to NEUTRAL from OUTPERFORM and investors should wait for more info.**

### What's changed?

- **Earnings:** No change
- **Target Price:** Lifted from NZ$5.60 to NZ$6.30 from a lift in our DCF valuation due to time value of money impact since our last review and slightly stronger longer term pricing assumptions
- **Rating:** Downgraded from OUTPERFORM to NEUTRAL

### Company in play with a NBIO

MET noted on 20 November that it has received a highly conditional, non-binding preliminary expression of interest from a credible third party to acquire the company (NBIO). MET also noted that it has commenced discussions on the NBIO, although the price proposed is below the board's expectations on value. MET's share buyback programme was suspended. While the outlook remains very uncertain with regard to possible corporate activity, we recommend investors wait for more information.

### Lift in target price to NZ$6.30

Our target price has increased due to the time value of money impact on our DCF and we have taken a slightly more positive view on longer-term unit pricing. We have lifted long run new sales pricing growth from an average of +1.6% pa to +2% pa, and we have lifted long run resales price growth from +1.6% pa to +2.5% pa. This has lifted our DCF valuation from NZ$5.20 to NZ$5.80 and our target price from NZ$5.60 to NZ$6.30. We consider our valuation to be conservative, both in terms of unit pricing inflation and also because we assume only around half of MET's ~1,300 unit/bed pipeline is built.

### Downgraded to NEUTRAL

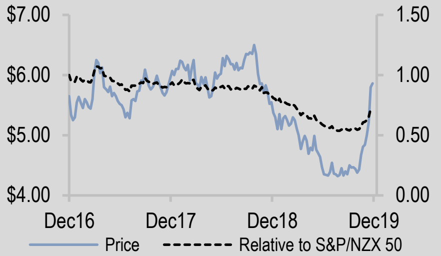
MET had been oversold on housing market and development execution concerns and a significant portion of this discount has closed up in recent weeks. Operationally we don't expect significant momentum to return to the business until 2H21. MET is still trading at a significant discount to its NZ$6.96 June 2019 NTA, and we expect the NTA to lift again in FY20.

**Investment View**

There is medium-term upside as the market gains confidence in MET's ability to execute on developments, and if it can demonstrate its ability to capitalise on the growth potential in the sector and hold up investment property value in a slower market. With MET trading at 0.8x P/NTA ratio the market continues to factor in a level of caution and gives no credit for its development pipeline. We expect the NTA to continue to hold steady or lift slightly in the current environment with new stock delivery helping. Our rating is NEUTRAL.

| NZX Code | MET |
|---|---|
| Share price | NZ$5.86 |
| Target price | NZ$6.30 |
| Risk rating | High |
| Issued shares | 213.3m |
| Market cap | NZ$1,250m |
| Average daily turnover | 208.8k (NZ$1,004k) |

**Share Price Performance**




| Financials: June | 19A | 20E | 21E | 22E |
|---|---|---|---|---|
| NPAT* (NZ$m) | 90.5 | 90.6 | 97.6 | 107.6 |
| EPS* (NZc) | 42.4 | 42.5 | 45.7 | 50.4 |
| EPS growth* (%) | 3.8 | 0.0 | 7.7 | 10.3 |
| DPS (NZc) | 11.0 | 11.3 | 11.5 | 11.8 |
| Imputation (%) | 0 | 0 | 0 | 0 |

| Valuation (x) | 19A | 20E | 21E | 22E |
|---|---|---|---|---|
| EV/EBITDA | 14.8 | 15.1 | 13.9 | 12.7 |
| EV/EBIT | 15.7 | 16.1 | 14.8 | 13.5 |
| PE | 13.8 | 13.8 | 12.8 | 11.6 |
| Price / NTA | 0.8 | 0.8 | 0.7 | n/a |
| Cash dividend yield (%) | 1.9 | 1.9 | 2.0 | 2.0 |
| Gross dividend yield (%) | 1.9 | 1.9 | 2.0 | 2.0 |

*Historic and forecast numbers based on underlying profits

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| Metlifecare Limited (MET) | | Priced as at 27 Nov 2019: NZ$5.86 | | | |
|---|---|---|---|---|---|
| **Forsyth Barr valuation** | | | | | |
| Valuation methodology | | | | | DCF |
| **12-month target price (NZ$)*** | **6.30** | **Spot valuations (NZ$)** | | | |
| Expected share price return | 7.5% | 1. DCF | | | 5.80 |
| Net dividend yield | 1.9% | 2. n/a | | | n/a |
| Estimated 12-month return | 9.4% | 3. n/a | | | n/a |
| **Key WACC assumptions** | | **DCF valuation summary (NZ$m)** | | | |
| Risk free rate | 2.00% | Total firm value | | | 1,505 |
| Equity beta | 0.91 | (Net debt)/cash | | | (276) |
| WACC | 8.1% | Value of equity | | | 1,229 |
| Terminal growth | 1.5% | Shares (m) | | | 213 |

| **Profit and Loss Account (NZ$m)** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| Sales revenue | 195 | 213 | 218 | 232 | 251 |
| **Normalised EBITDA** | **91** | **98** | **99** | **106** | **117** |
| Depreciation and amortisation | (4) | (6) | (6) | (6) | (7) |
| **Normalised EBIT** | **87** | **92** | **93** | **100** | **110** |
| Net interest | (0) | (2) | (3) | (2) | (3) |
| Associate income | - | - | - | - | - |
| Tax | - | - | - | - | - |
| Minority interests | - | - | - | - | - |
| **Normalised NPAT** | **87** | **91** | **91** | **98** | **108** |
| Abnormals/other | 35 | (51) | - | - | - |
| **Reported NPAT** | **123** | **39** | **91** | **98** | **108** |
| Normalised EPS (cps) | 40.9 | 42.4 | 42.5 | 45.7 | 50.4 |
| DPS (cps) | 10.0 | 11.0 | 11.3 | 11.5 | 11.8 |

| **Growth Rates** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| Revenue (%) | 5.3 | 8.9 | 2.5 | 6.3 | 8.1 |
| EBITDA (%) | 6.1 | 7.1 | 1.2 | 7.4 | 9.9 |
| EBIT (%) | 13.3 | 5.6 | 1.1 | 7.4 | 10.0 |
| Normalised NPAT (%) | 6.1 | 3.9 | 0.0 | 7.7 | 10.3 |
| Normalised EPS (%) | 6.1 | 3.8 | 0.0 | 7.7 | 10.3 |
| DPS (%) | 24.2 | 10.0 | 2.3 | 2.2 | 2.2 |

| **Cash Flow (NZ$m)** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| **EBITDA** | **91** | **98** | **99** | **106** | **117** |
| Working capital change | 19 | 23 | 53 | 125 | 110 |
| Interest & tax paid | 1 | (1) | (3) | (2) | (3) |
| Other | - | - | - | - | - |
| **Operating cash flow** | **111** | **120** | **149** | **228** | **224** |
| Capital expenditure | (174) | (233) | (92) | (218) | (190) |
| (Acquisitions)/divestments | - | - | - | - | - |
| Other | 1 | (0) | - | - | - |
| **Funding available/(required)** | **(62)** | **(113)** | **58** | **10** | **34** |
| Dividends paid | (19) | (22) | (24) | (25) | (25) |
| Equity raised/(returned) | - | - | - | - | - |
| **Increase/(decrease) in net debt** | **81** | **135** | **(34)** | **14** | **(9)** |

| **Balance Sheet (NZ$m)** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| Working capital | (51) | (18) | (17) | (18) | (20) |
| Fixed assets | 3,237 | 3,477 | 3,649 | 3,950 | 4,228 |
| Intangibles | 1 | 1 | 1 | 1 | 1 |
| Other assets | 11 | 11 | 11 | 11 | 11 |
| **Total funds employed** | **3,198** | **3,471** | **3,643** | **3,943** | **4,219** |
| Net debt/(cash) | 140 | 276 | 242 | 257 | 247 |
| Other non current liabilities | 1,590 | 1,710 | 1,762 | 1,936 | 2,113 |
| Shareholder's funds | 1,468 | 1,485 | 1,639 | 1,750 | 1,859 |
| Minority interests | - | - | - | - | - |
| **Total funding sources** | **3,198** | **3,471** | **3,643** | **3,943** | **4,219** |

June year end

| **Valuation Ratios** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| EV/EBITDA (x) | 14.7 | 14.8 | 15.1 | 13.9 | 12.7 |
| EV/EBIT (x) | 15.4 | 15.7 | 16.1 | 14.8 | 13.5 |
| PE (x) | 14.3 | 13.8 | 13.8 | 12.8 | 11.6 |
| Price/NTA (x) | 0.9 | 0.8 | 0.8 | 0.7 | 0.7 |
| Free cash flow yield (%) | -5.0 | -9.0 | 4.6 | 0.8 | 2.8 |
| Net dividend yield (%) | 1.7 | 1.9 | 1.9 | 2.0 | 2.0 |
| Gross dividend yield (%) | 1.7 | 1.9 | 1.9 | 2.0 | 2.0 |
| Imputation (%) | 0 | 0 | 0 | 0 | 0 |
| Pay-out ratio (%) | 24 | 26 | 26 | 25 | 23 |

| **Capital Structure** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| Interest cover EBIT (x) | >100x | 56.7 | 36.0 | 40.1 | 43.7 |
| Interest cover EBITDA (x) | 82.2 | 31.5 | 38.3 | 42.7 | 46.4 |
| Net debt/ND+E (%) | 8.7 | 15.7 | 12.9 | 12.8 | 11.7 |
| Net debt/EBITDA (x) | 1.5 | 2.8 | 2.4 | 2.4 | 2.1 |

| **Key Ratios** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| Return on assets (%) | 2.7 | 2.6 | 2.5 | 2.5 | 2.6 |
| Return on equity (%) | 5.9 | 6.1 | 5.5 | 5.6 | 5.8 |
| Return on funds employed (%) | 5.7 | 5.4 | 5.1 | 5.1 | 5.3 |
| EBITDA margin (%) | 46.8 | 46.0 | 45.4 | 45.9 | 46.6 |
| EBIT margin (%) | 44.6 | 43.3 | 42.7 | 43.1 | 43.9 |
| Capex to sales (%) | 89.0 | 109.4 | 42.1 | 94.1 | 75.7 |
| Capex to depreciation (%) | 4,139 | 4,016 | 1,541 | 3,437 | 2,776 |

| **Operating Performance** | **2018A** | **2019A** | **2020E** | **2021E** | **2022E** |
|---|---|---|---|---|---|
| **Revenue (NZ$m)** | | | | | |
| Village/care fees | 60 | 65 | 67 | 69 | 73 |
| Management fees | 55 | 59 | 65 | 73 | 82 |
| **Fair value m'ment in Investment Property (NZ$m)** | | | | | |
| Realised | 79 | 88 | 86 | 89 | 95 |
| Unrealised | - | - | - | - | - |
| **Total revenue** | **195** | **213** | **218** | **232** | **251** |
| **Key Drivers** | | | | | |
| Sales - new units | 98 | 116 | 126 | 142 | 138 |
| Ave unit price - new sales (NZ$000) | 655 | 690 | 717 | 739 | 754 |
| Sales - resold units | 343 | 354 | 356 | 373 | 397 |
| Ave unit price - resales (NZ$000) | 542 | 572 | 589 | 601 | 613 |
| Gross development margin (%) | 25.5 | 21.1 | 16.0 | 19.0 | 21.0 |
| Gross resales margin (%) | 33.5 | 35.3 | 34.0 | 31.0 | 30.0 |
| New apartments/units | 185 | 112 | 80 | 220 | 180 |
| New beds | 69 | 70 | - | 60 | 40 |
| **Divestments** | | | | | |
| Units sold | | | | | |
| Beds sold | | | | | |
| **Portfolio** | | | | | |
| Apartments/units | 4,391 | 4,478 | 4,558 | 4,778 | 4,958 |
| Beds | 388 | 440 | 440 | 500 | 540 |

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

# Investment summary

**Metlifecare (MET) is lifting its development activity and is delivering strong resales gains. There is medium-term upside as the market gains confidence in MET's ability to execute on developments more effectively, capitalising on the growth potential in the sector. A risk factor for MET is that its villages without care operations are exposed to a softening in the housing market, but with MET trading at the lowest P/NTA in the sector at around 0.8x significant negativity is already priced in. NEUTRAL.**

## Earnings and cash flow outlook

- **Lifting the build rate:** MET is focussed on developing new integrated villages and has a goal of 200+ units and beds. This has dialled back from a goal of 300+ units and beds per annum from FY20 and has a significantly lower build rate in FY20 as it resets its programme.
- **Leveraged to Auckland market:** With 15 villages in Auckland, MET can capitalise on high house prices and significant levels of embedded value.
- **Recycling capital:** The occupational right agreement (ORA) structure provides MET with the ability to recycle capital into new development and capture capital gains when units are resold.
- **Positive demographic trends:** There are currently 280,000 people in NZ aged 75 and over, a figure expected to more than double by 2035.

## Business quality

- **Development expertise growing:** Development activity underway, including large greenfield projects, provides MET with an opportunity to demonstrate its capability, allowing further upside to our expectations.
- **Care expertise:** The expertise required to successfully operate in the aged care sector is a barrier to entry and a key focus for MET going forward.

## Balance sheet

- **Balance sheet robust:** Contrasted with last cycle, MET has a low level of gearing at around 15%, providing ample capacity to work through its development pipeline or to provide cover should market conditions slow.

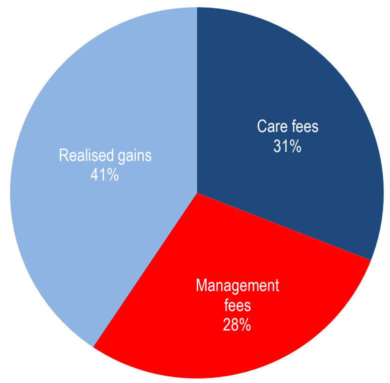
## Key risks

- **Housing market downturn:** Any significant downturn in the slowing Auckland housing market poses a threat to resales and new sales pricing. MET's existing portfolio remains weighted to independent living (lifestyle villages) with a small number of care beds and serviced apartments.
- **Oversupply:** The significant development pipeline in Auckland poses the threat of a short-term oversupply for retirement units.

**Company description**

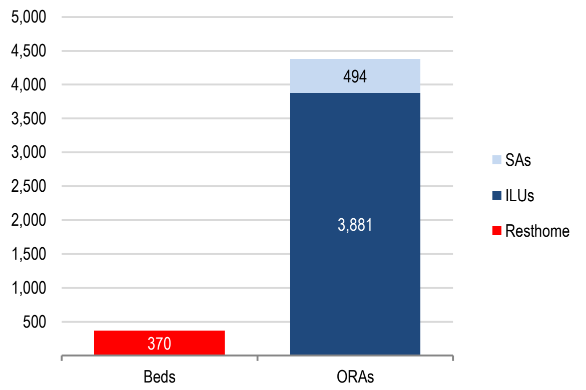
MET is the second largest retirement village operator in New Zealand with a portfolio of 4,478 retirement units across 25villages. MET's aged care operations are smaller, with 11 villages being integrated and a total of 440 beds; albeit this is continuously growing as the majority of MET's new villages are incorporating care facilities. MET's portfolio is leveraged to the Auckland region with 15 villages and a further three greenfield sites and four brownfield sites. MET was established in 1984 and listed in 1994 with eight villages. In 2012 MET expanded with the merger with Private Life Care and Vision Senior Living.

**Figure 1. FY18 revenue mix**




Source: Forsyth Barr analysis, Company Reports

**Figure 2. Portfolio as at 31 December 2018**




Source: Forsyth Barr analysis, Company Reports

**Figure 3. Substantial Shareholders**

| Shareholder | Latest Holding |
|---|---|
| New Zealand Superannuation Fund | 19.9% |
| ANZ NZ Investments | 11.8% |
| Investment Services Group | 7.7% |
| ACC | 5.0% |

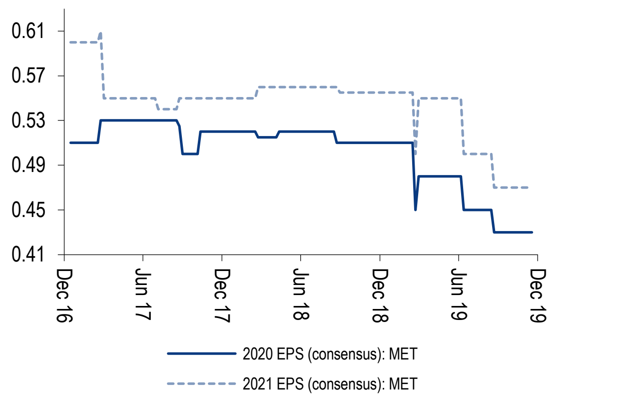
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 4. International Compcos**

| Company | Code | Price | Mkt Cap | PE | | EV/EBITDA | | EV/EBIT | | Cash D/Yld |
|---|---|---|---|---|---|---|---|---|---|---|
| *(metrics re-weighted to reflect MET's balance date - June)* | | | (m) | 2020E | 2021E | 2020E | 2021E | 2020E | 2021E | 2021E |
| **Metlifecare** | **MET NZ** | **NZ$5.86** | **NZ$1,250** | **13.8x** | **12.8x** | **15.4x** | **14.3x** | **16.4x** | **15.2x** | **2.0%** |
| Ryman Healthcare * | RYM NZ | NZ$14.22 | NZ$7,110 | 26.2x | 22.6x | 26.2x | 22.7x | 28.8x | 24.7x | 2.2% |
| Summerset Group * | SUM NZ | NZ$7.55 | NZ$1,713 | 15.6x | 13.6x | 16.6x | 14.5x | 17.5x | 15.3x | 2.2% |
| Oceania Healthcare * | OCA NZ | NZ$1.08 | NZ$658 | 11.4x | 10.7x | 12.4x | 11.7x | 14.6x | 13.7x | 5.2% |
| Arvida Group Limited * | ARV NZ | NZ$1.64 | NZ$889 | 14.7x | 13.1x | 14.9x | 12.4x | 16.4x | 13.7x | 4.2% |
| | | | **Compco Average:** | **17.0x** | **15.0x** | **17.5x** | **15.3x** | **19.3x** | **16.8x** | **3.4%** |
| *EV = Current Market Cap + Actual Net Debt* | | | **MET Relative:** | **-19%** | **-14%** | **-12%** | **-7%** | **-15%** | **-9%** | **-43%** |

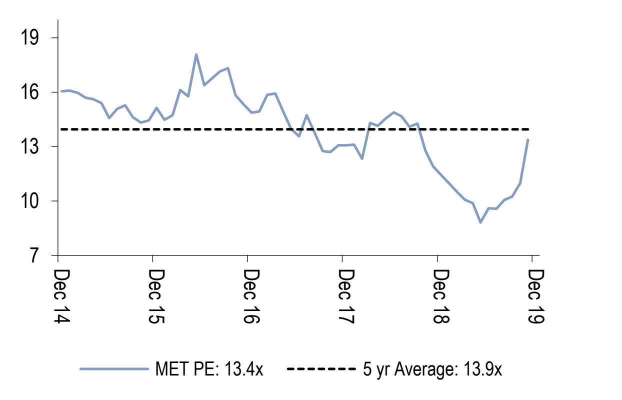
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MET) companies fiscal year end

**Figure 5. Consensus EPS Momentum**




Source: Forsyth Barr analysis, Bloomberg

**Figure 6. 12 Month Forward PE**




Source: Forsyth Barr analysis