

Metlifecare Limited

Bond Offer

Metlifecare (MET) is undertaking an offer of up to NZ\$75m (plus the ability to accept up to NZ\$25m of oversubscriptions) of secured, unsubordinated fixed rate bonds. The seven year bonds will be quoted on the NZDX. Neither MET nor the bonds are rated.

Key Points:

- 7 year senior bonds, quoted on the NZDX
- A prudent approach to development
- Proceeds will be used to repay existing bank debt

Auckland focussed

MET is an aged care provider with a portfolio that is dominated by assets located in Auckland and the upper North Island. MET operates 25 villages and is home to over 5,500 residents. MET's portfolio is tilted towards an independent living unit (ILU) offering, but its care operations are substantial and growing.

Resales gains provide earnings lift

MET's occupational right agreement (ORA) structure provides it with the ability to recycle capital into new development and capture capital gains when units are resold. This was a key feature of its recent FY19 result as it recorded NZ\$39.4m of resale gains at a margin of 35%. These resale gains have driven the majority of MET's earnings growth over the past few years, and have been supported by a strengthening Auckland housing market.

Repaying bank debt

MET has indicated that it intends to raise debt via the bond market to repay existing bank debt. This will allow MET to (i) diversify its funding sources and (ii) improve its maturity profile to 4.1 years (versus its current weighted average debt maturity of 2.9 years). MET is planning to reduce its bank facilities following the bond issue.

Property market sensitivity

MET has 4 development sites with a plan to add further sites in the coming years. The Auckland property market in particular has slowed in recent times and the cost of construction continues to be a concern for aged care providers. MET indicated at its FY19 result that it has reduced its planned annual build rate from 300 to 200 units and beds.

Issuer	Metlifecare
Security	Secured, unsubordinated
NZDX Code	MET010
Coupon	TBA
Margin	TBA
Amount on issue	NZ\$75m (plus NZ\$25m)
Interest frequency	Quarterly
Maturity date	30-Sep-2026
Credit rating	n/r
ISIN	NZMETDT001C2
Supervisor	Public Trust
Registrar	Computershare

Important Dates

Opening	16-Sep-19
Closing	20-Sep-19
Rate set	20-Sep-19
Issue date	30-Sep-19
Interest payments	Mar, Jun, Sep, Dec
Maturity	30-Sep-26

Source: Forsyth Barr analysis

Matt Sturmer

matt.sturmer@forsythbarr.co.nz
+64 4 495 8204

Forsyth Barr Limited has been appointed Joint Lead Manager to the offer of Bonds and will receive fees in connection with this role. The offer is only being offered to investors who are resident in New Zealand. Full details of the offer are contained in the Product Disclosure Statement. Potential investors should read the Product Disclosure Statement thoroughly.

Structure of the Issue

MET uses debt to develop its villages and this debt is repaid from the sale of new developed units. Metlifecare owns the companies within the Metlifecare Group and is the issuer of the bonds. Each retirement company is owned by Metlifecare or Metlifecare Holdings.

In the event of financial difficulties, Metlifecare believe it would have a number of options such as; slow development, rely on core earnings, sell undeveloped land or sell villages as going concerns.

In a liquidation event, the relevant statutory supervisor has the first rights to the proceeds of enforcement against the land (including permanent buildings) of each retirement village company — on behalf of residents.

The bonds are guaranteed, secured, unsubordinated fixed rate securities. Bondholders and bank lenders have a first ranking mortgage over undeveloped land and land under development owned by Non-Village Registered companies. Bondholders and bank lenders are second ranking security holders on land and permanent buildings held by Village Registered companies.

A Non-Village Registered company builds a retirement village and when completed it registers that village under the Retirement Villages Act and it becomes a Village Registered Company.

Figure 1. Security structure

Source: Forsyth Barr analysis, Metlifecare

Financial Covenants

Loan to Valuation Ratio

One of the covenants requires MET to not exceed an LVR of 50%, and this will be tested semi annually. More formally:

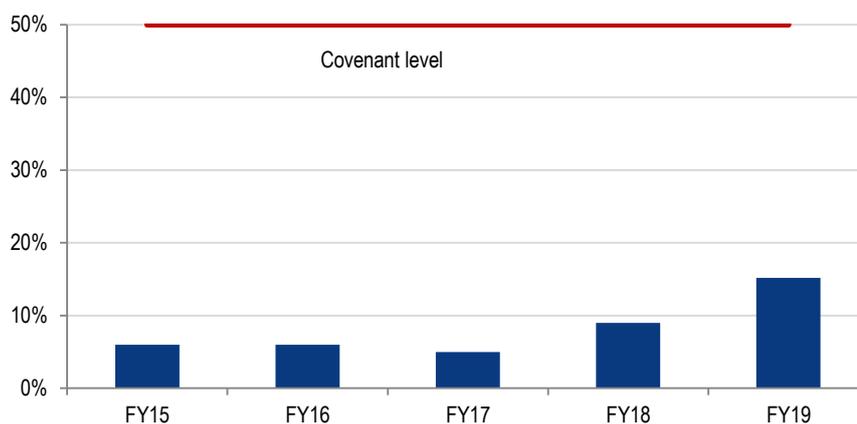
“Under the Loan to Valuation Ratio, Metlifecare has agreed to ensure that the total principal amount of all debt secured under the Security Trust Deed is not more than 50% of the total valuation of the Retirement Village and Care Home Portfolio, on 30 June and 31 December in each year.”

MET’s track record suggests that this will not be a problem, with its LVR being very low over the past few years. As at 30 June 2019, MET’s LVR covenant was 15.1%. Whilst a significant jump from FY18’s 9%, the LVR compares favourably to its peers. Summerset’s LVR covenant as at 31 December 2018, (full year result) was 32.3%.

Plenty of time to remedy

If there is a breach of the LVR covenant, MET must remedy or provide a plan to remedy the breach within six months. This effectively provides MET 12 months to remedy any breach. If the breach is not remedied within 12 months, however, an Event of Default will occur.

Figure 2. MET LVR covenant



Source: Forsyth Barr analysis

Other covenants

MET is also subject to further covenants via its bank facility. At present the covenants are an LVR covenant, the same as bondholders, although this is measured on a quarterly basis.

A minimum interest cover ratio of 1.75:1, (currently 5.9x) also measured quarterly alongside a forecast interest cover ratio of 1.50:1 (currently 3.8x).

Distribution Stopper

MET is not permitted to make any distribution if an Event of Default is continuing or if it would result in an Event of Default.

Credit Rating

The bonds are not rated by any credit rating agency.

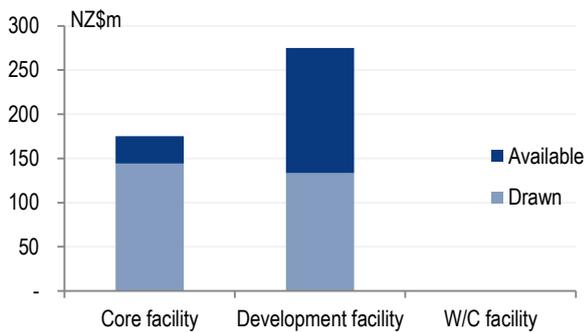
Debt

MET's debt increased by +78% in FY19 from NZ\$156m to NZ\$278m as at 30 June 2019. This was due to MET beginning to build up its development programme. MET now has development across 10 sites which is 1,327 units and beds.

As at 30 June 2019, MET had drawn debt of NZ\$278m with facilities of NZ\$450m. These debt facilities are provided by ANZ, BNZ, CBA and Westpac. The proceeds of the bond issue will be used to repay existing bank debt. The total banking facility will be reduced post the issuance of the bond.

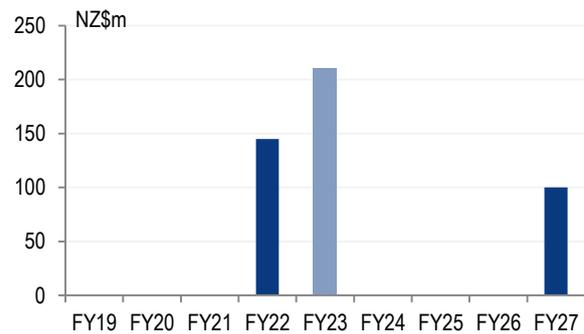
The bond issue will provide funding diversification as well as increasing MET's debt maturity profile to 4.1 years (from 2.9 years). The weighted average cost of debt for MET's existing debt portfolio is 3.3%.

Figure 3. Debt profile



Source: Forsyth Barr analysis, as at 30 June 2019

Figure 4. Maturity profile

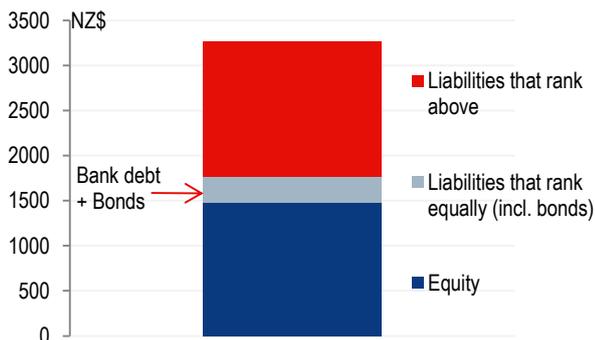


Source: Forsyth Barr analysis, assumes NZ\$100m MET010 is issued

Subordinated to resident loans

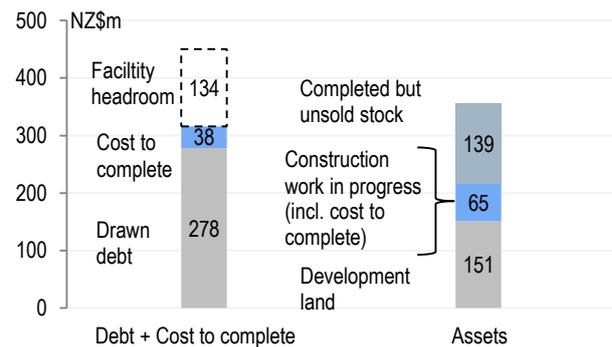
MET's debt is associated with its development of new villages. As Figure 6 highlights as at 30 June 2019, MET had NZ\$355m of development assets supporting NZ\$278m of debt. In a severe economic downturn the value of the development land remains uncertain.

Figure 5. Ranking



Source: Forsyth Barr analysis

Figure 6. Borrowing supported by development land & stock value



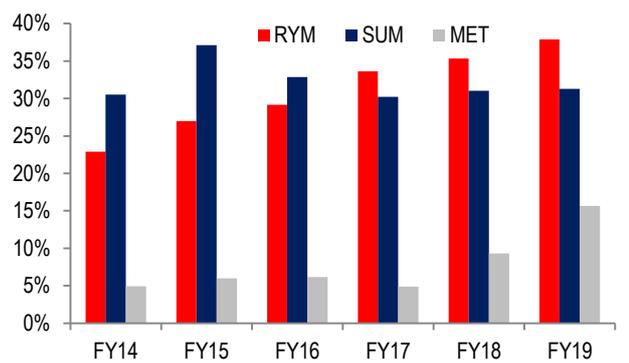
Source: Forsyth Barr analysis

Credit Metrics

MET becomes the second aged care provider after Summerset (SUM) to issue bonds as opposed to rely solely on bank debt funding. MET's current credit metrics give it plenty of headroom to increase its development programme.

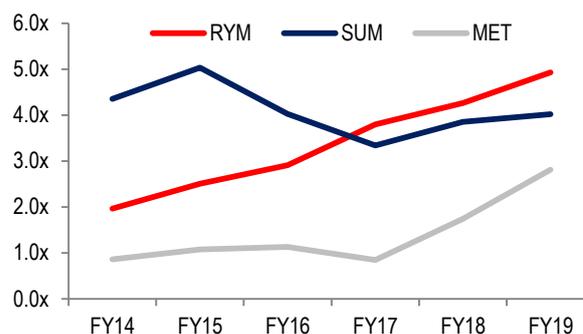
Both net debt to net debt plus equity and net debt to EBITDA ratios are well inside those of its peers, Ryman Healthcare (RYM) and SUM, although it is likely that changes as MET undertakes developments.

Figure 7. Net debt / net + equity



Source: Forsyth Barr analysis, SUM FY19 forecast

Figure 8. Net debt / EBITDA



Source: Forsyth Barr analysis, SUM FY19 forecast

Performance

MET has 90% of its future development planned for Auckland and its FY19 result signalled a cautious approach to this strategy. Underlying profit increased by +4% to NZ\$90.5m with solid gains in care and village fees (+9% on the pcp). MET also recorded a +15% lift in resales on the back of increased margins (35.3%) and pricing (+6% at NZ\$572k per unit). MET's development margins also remained healthy at 21% in FY19.

Village occupancy of 97% and care occupancy of 96% illustrate solid demand for MET's product. MET is maintaining its quest for a greater care offering with +19% increase in care capacity during FY19.

Figure 9. Resales activity (NZ\$m)

12 months ending	FY18	FY19	% chg pcp	1H19	2H19	pcp chg	seq chg
30 June							
Realised gains	\$62.3m	\$71.5m	14.80%	\$32.1m	\$39.4m	9.90%	22.70%
Resale margin	33.50%	35.30%	5.40%	33.00%	37.40%	10.10%	13.30%
Gross proceeds	\$185.9m	\$202.5m	8.90%	\$97.2m	\$105.3m	-0.20%	8.30%
Value per unit	\$541,983	\$572,034	5.50%	\$571,765	\$572,283	4.70%	0.10%
Total units	343	354	3.20%	170	184	-4.70%	8.20%

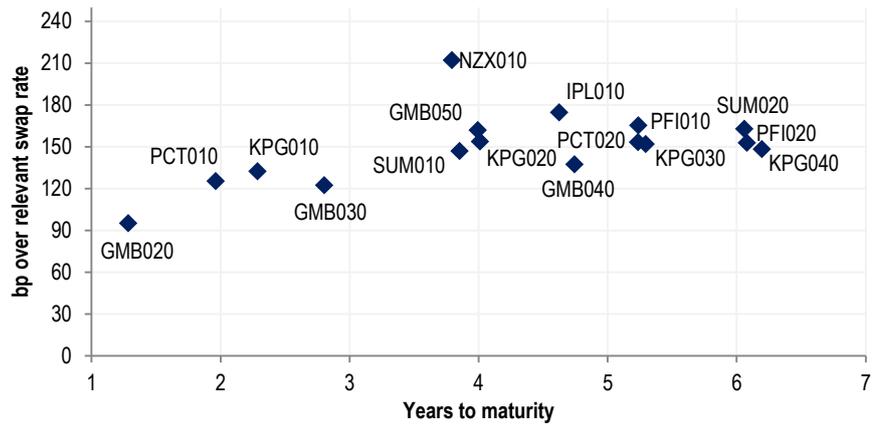
Source: Forsyth Barr analysis, Company reports

Pricing

SUM has issued two bonds with its latest issued in September 2018. The NZ\$125m seven year issue was priced at 165bp over swap. SUM is also unrated. With six years remaining until maturity SUM020 is currently trading at 163bp based on its last yield of 2.60%.

The most recent unrated senior seven year issue completed was issued by Trustpower (TPW). This bond was issued at a margin of 175bp. In terms of bonds issued in the property sector, Argosy (ARG) issued a seven year bond back in March, also at a margin of 175bp.

Figure 10. Secondary market credit spreads



Source: Forsyth Barr analysis, Thomson Reuters

Base rate

The coupon rate will be set at a credit spread (indicative range to be announced 16 September) over the prevailing seven year swap rate on 20 September (subject to the minimum rate).

Figure 11. Seven year swap rate



Source: Forsyth Barr analysis, Thomson Reuters

Cash flow

Through monthly fees, care fees, capital gains (resale margins) via beneficial Occupation Right Agreements, deferred management fees and development margins, MET receives its income from a variety of different sources.

Occupation Right Agreements

Every resident moving into a MET retirement village enters into an Occupation Right Agreement (ORA) and this is a key driver of MET's cash flow. An ORA grants the resident the right to occupy a retirement unit for as long as they choose to in exchange for a lump sum (NZ\$500k in the below chart). Legal ownership of the unit remains with MET and the lump sum is recorded as residents' loans on MET's balance sheet. The residents' loans have no set term and are non-interest bearing. Another key feature and protection for MET in a potential property downturn is that MET is not required to repay an outgoing resident the repayment amount (NZ\$350k in the below chart) until the ORA for the unit is resold to an incoming resident. A resident is not entitled to any possible capital gain over the period (NZ\$109k in the chart below).

The right of the resident under an ORA is protected by the Statutory Supervisor who has a first ranking mortgage over the land and permanent buildings owned by the MET company that operates the registered retirement village.

The bonds and bank debt rank below the residents' loans in respect of these assets.

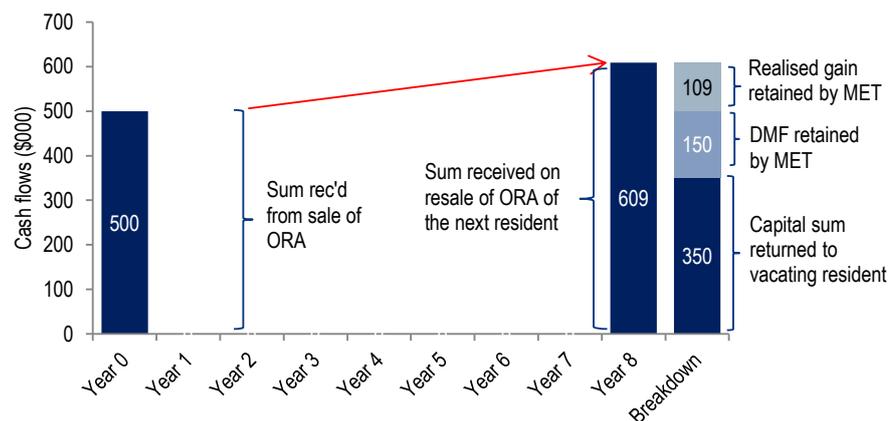
Deferred management fee

Income is also derived from a deferred management fee (DMF, represented as NZ\$150k on the chart below). This is a primary source of income for established villages. The DMF is accrued over a resident's occupancy of the unit and released on the resale of their ORA. For MET this is typically up to 30% of the ORA price. The DMF is deducted from the resale proceeds when an ORA is resold.

Other fees

A weekly fee is also payable. This contributes to costs such as rates, communal building insurance, lawns and garden care, rubbish collection etc. This fee can also increase with any increases in national superannuation.

Figure 12. ORA cash flows



Source: Forsyth Barr analysis

Financials

Figure 13. Financial summary

Year to 30 June	2018A	2019A	2020E	2021E	2022E
Total Revenue	195.4	212.9	218.2	232.0	250.8
Total Costs	104.0	114.9	119.1	125.6	133.9
EBITDA	91.4	98.0	99.1	106.4	116.9
Depreciation	4.2	5.8	6.0	6.4	6.8
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	87.2	92.2	93.2	100.1	110.1
Interest Income	0.2	0.2	0.0	0.0	0.0
Interest Expense	(0.3)	(1.9)	(2.6)	(2.5)	(2.5)
Net Interest	(0.1)	(1.6)	(2.6)	(2.5)	(2.5)
EBT	87.2	90.5	90.6	97.6	107.6
Tax	0.0	0.0	0.0	0.0	0.0
NPAT	87.2	90.5	90.6	97.6	107.6
Abnormal Items	0.0	0.0	0.0	0.0	0.0
Reported Profit	87.2	90.5	90.6	97.6	107.6
Normalised Profit	87.2	90.5	90.6	97.6	107.6
Cashflow					
Operating Cashflow	111.0	119.9	149.4	228.5	224.2
Capital Expenditure	173.8	232.9	91.8	218.3	189.7
Interest Paid	(0.1)	(1.6)	(2.6)	(2.5)	(2.5)
Balance Sheet					
Cash	16.3	3.4	3.4	3.4	3.4
Other Current Assets	20.9	23.5	17.9	19.1	20.6
Fixed Assets	3237.4	3477.0	3648.5	3949.8	4227.5
Other Non-Current Assets	12.1	11.8	11.8	11.8	11.8
Total Assets	3286.6	3515.7	3681.7	3984.1	4263.4
Net Debt	140.5	275.8	242.2	256.6	247.1
Other Liabilities	1678.0	1755.0	1800.1	1977.1	2157.6
Total Liabilities	1818.5	2030.7	2042.3	2233.7	2404.7
Shareholders' Funds	1468.1	1485.0	1639.4	1750.4	1858.7
Total Shareholder Equity	1468.1	1485.0	1639.4	1750.4	1858.7

Source: Forsyth Barr analysis

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