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# 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 |
|---|---|
| Share price | NZ$1.30 |
| Target price | NZ$1.65 |
| Risk rating | Medium |
| Issued shares | 618.1m |
| Market cap | NZ$804m |
| Avg daily turnover | 2,542k (NZ$2,603k) |

| Financials: May/ | 20A | 21E | 22E | 23E |
|---|---|---|---|---|
| NPAT* (NZ$m) | 42.5 | 49.5 | 59.8 | 69.0 |
| EPS* (NZc) | 6.9 | 8.0 | 9.7 | 11.2 |
| EPS growth* (%) | -15.8 | 15.9 | 20.7 | 15.4 |
| DPS (NZc) | 3.5 | 4.0 | 4.5 | 5.0 |
| Imputation (%) | 0 | 0 | 0 | 0 |

*Based on normalised profits

| Valuation (x) | 20A | 21E | 22E | 23E |
|---|---|---|---|---|
| PE | 18.8 | 16.2 | 13.4 | 11.6 |
| EV/EBIT | 22.2 | 19.8 | 16.8 | 14.8 |
| EV/EBITDA | 17.1 | 15.5 | 13.5 | 12.0 |
| Price / NTA | 1.5 | 1.4 | 1.4 | 1.3 |
| Cash div yld (%) | 2.7 | 3.1 | 3.5 | 3.8 |
| 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 | Change |
| **Total revenue** | **241.7** | **253.9** | **256.7** | **1.1%** | **276.8** | **277.9** | **0.4%** | **297.6** | **297.0** | **-0.2%** |
| Total costs | 178.6 | 182.6 | 183.8 | 0.6% | 193.6 | 192.5 | -0.6% | 205.2 | 200.7 | -2.2% |
| **EBITDA** | **63.1** | **71.3** | **72.9** | **2.3%** | **83.2** | **85.4** | **2.6%** | **92.3** | **96.3** | **4.3%** |
| Depreciation & amortisation | 14.5 | 15.7 | 15.7 | -0.1% | 17.0 | 17.0 | -0.2% | 18.2 | 18.2 | 0.2% |
| **EBIT** | **48.6** | **55.6** | **57.2** | **3.0%** | **66.3** | **68.4** | **3.2%** | **74.1** | **78.0** | **5.3%** |
| Net interest | 6.2 | 7.7 | 7.7 | 0.1% | 8.3 | 8.6 | 4.0% | 8.3 | 9.0 | 8.6% |
| **Underlying profit** | **42.5** | **47.9** | **49.5** | **3.4%** | **58.0** | **59.8** | **3.1%** | **65.8** | **69.0** | **4.9%** |
| EPS (cps) | 6.9 | 7.7 | 8.0 | 3.4% | 9.4 | 9.7 | 3.1% | 11.2 | 11.2 | 0.1% |
| DPS (cps) | 3.5 | 4.0 | 4.0 | 0.0% | 4.6 | 4.5 | -2.2% | 5.0 | 5.0 | 0.0% |
| Sales - new units | 189.0 | 225 | 235 | 4.4% | 255 | 255 | 0.0% | 270 | 270 | 0.0% |
| New sales margin (%) | 33% | 26% | 26% | 0.0% | 22% | 22% | 0.0% | 20% | 20% | 0.0% |
| Sales - resold units | 166.0 | 212 | 234 | 10.5% | 261 | 286 | 9.6% | 315 | 348 | 10.3% |
| Resales margin (%) | 20% | 18% | 18% | 0.0% | 18% | 18% | 0.1% | 18% | 17% | -0.6% |

Source: Forsyth Barr analysis, Company reports

# Oceania Healthcare Limited (OCA)

| | |
|---|---|
| Priced as at 14 Oct 2020 (NZ$) | 1.30 |

| 12-month target price (NZ$)* | 1.65 |
|---|---|
| Expected share price return | 26.9% |
| Net dividend yield | 3.2% |
| Estimated 12-month return | 30.2% |

| Spot valuations (NZ$) | |
|---|---|
| 1. EV/Annuity EBITDA | 1.65 |
| 2. DDM | 1.65 |
| 3. n/a | n/a |

| Key WACC assumptions | |
|---|---|
| Risk free rate | 1.30% |
| Equity beta | 0.88 |
| WACC | 6.4% |
| 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 |
|---|---|---|---|---|---|
| Sales revenue | 233.5 | 241.7 | 256.7 | 277.9 | 297.0 |
| **Normalised EBITDA** | **63.1** | **63.1** | **72.9** | **85.4** | **96.3** |
| Depreciation and amortisation | (9.5) | (14.5) | (15.7) | (17.0) | (18.2) |
| **Normalised EBIT** | **53.6** | **48.6** | **57.2** | **68.4** | **78.0** |
| Net interest | (3.5) | (6.2) | (7.7) | (8.6) | (9.0) |
| Associate income | 0 | 0 | 0 | 0 | 0 |
| Tax | 0 | 0 | 0 | 0 | 0 |
| Minority interests | 0 | 0 | 0 | 0 | 0 |
| **Normalised NPAT** | **50.1** | **42.5** | **49.5** | **59.8** | **69.0** |
| Abnormals/other | (4.7) | (56.1) | (7.7) | (1.4) | (5.1) |
| **Reported NPAT** | **45.4** | **(13.6)** | **41.8** | **58.4** | **63.9** |
| Normalised EPS (cps) | 8.2 | 6.9 | 8.0 | 9.7 | 11.2 |
| DPS (cps) | 4.7 | 3.5 | 4.0 | 4.5 | 5.0 |

| Valuation Ratios | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| EV/EBITDA (x) | 15.9 | 17.1 | 15.5 | 13.5 | 12.0 |
| EV/EBIT (x) | 18.7 | 22.2 | 19.8 | 16.8 | 14.8 |
| PE (x) | 15.8 | 18.8 | 16.2 | 13.4 | 11.6 |
| Price/NTA (x) | 1.3 | 1.5 | 1.4 | 1.4 | 1.3 |
| Free cash flow yield (%) | 30.9 | 29.3 | 32.8 | 38.3 | 40.7 |
| Net dividend yield (%) | 3.6 | 2.7 | 3.1 | 3.5 | 3.8 |
| Gross dividend yield (%) | 3.6 | 2.7 | 3.1 | 3.5 | 3.8 |

| Capital Structure | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| Interest cover EBIT (x) | 15.3 | 7.9 | 7.4 | 7.9 | 8.7 |
| Interest cover EBITDA (x) | 18.1 | 10.2 | 9.5 | 9.9 | 10.7 |
| Net debt/ND+E (%) | 28.9 | 35.7 | 37.9 | 36.7 | 34.4 |
| Net debt/EBITDA (x) | 3.9 | 4.9 | 4.8 | 4.1 | 3.5 |

| Growth Rates | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| Revenue (%) | 5.2 | 3.5 | 6.2 | 8.2 | 6.9 |
| EBITDA (%) | -0.9 | -0.1 | 15.6 | 17.1 | 12.8 |
| EBIT (%) | -2.4 | -9.3 | 17.8 | 19.5 | 14.0 |
| Normalised NPAT (%) | -3.9 | -15.2 | 16.7 | 20.7 | 15.4 |
| Normalised EPS (%) | -3.9 | -15.8 | 15.9 | 20.7 | 15.4 |
| Ordinary DPS (%) | 0.0 | -25.5 | 14.3 | 12.5 | 11.1 |

| Key Ratios | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| Return on assets (%) | 3.8 | 3.2 | 3.4 | 3.7 | 3.8 |
| Return on equity (%) | 8.2 | 7.7 | 8.7 | 9.9 | 10.9 |
| Return on funds employed (%) | 5.7 | 4.8 | 5.2 | 6.1 | 6.8 |
| EBITDA margin (%) | 27.0 | 26.1 | 28.4 | 30.7 | 32.4 |
| EBIT margin (%) | 23.0 | 20.1 | 22.3 | 24.6 | 26.3 |
| 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 |

| Cash Flow (NZ$m) | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| **EBITDA** | **63.1** | **63.1** | **72.9** | **85.4** | **96.3** |
| Working capital change | (1.8) | (2.4) | 1.3 | 1.4 | 1.2 |
| Interest & tax paid | (3.5) | (6.2) | (7.7) | (8.6) | (9.0) |
| Other | 37.0 | 44.8 | 57.0 | 89.2 | 98.8 |
| **Operating cash flow** | **94.8** | **99.4** | **123.5** | **167.4** | **187.2** |
| Capital expenditure | (153.8) | (136.0) | (140.0) | (140.0) | (140.0) |
| (Acquisitions)/divestments | 0 | 0 | 0 | 0 | 0 |
| Other | 0.0 | (3.2) | 0 | (0.0) | 0 |
| **Funding available/(required)** | **(59.0)** | **(39.8)** | **(16.5)** | **27.4** | **47.2** |
| Dividends paid | (28.4) | (22.2) | (24.7) | (27.8) | (30.9) |
| Equity raised/(returned) | 1.3 | 0 | 0 | 0 | 0 |
| **(Increase)/decrease in net debt** | **(86.1)** | **(62.0)** | **(41.2)** | **(0.4)** | **16.3** |

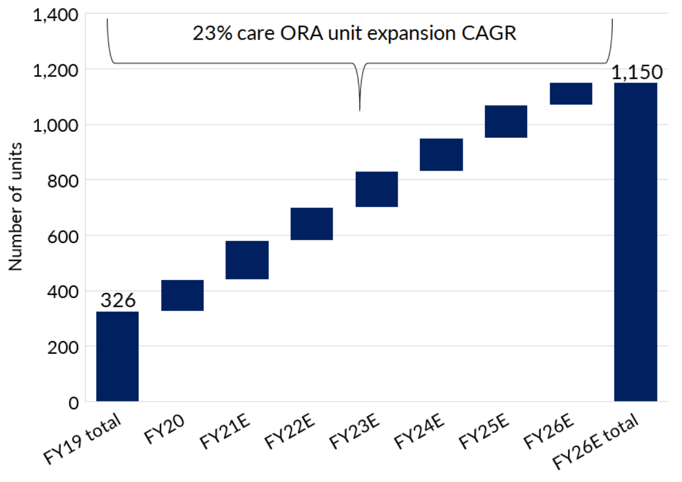
| Operating Performance | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| **Revenue (NZ$m)*** | | | | | |
| Care fees | 156.6 | 156.4 | 162.2 | 169.0 | 173.4 |
| Management fees | 22.3 | 29.2 | 37.3 | 45.9 | 56.2 |
| Other | 10.4 | 10.6 | 11.0 | 11.6 | 12.2 |
| Gain on resales | 15.1 | 11.5 | 15.9 | 19.7 | 23.7 |
| Gain on new sales | 29.1 | 33.9 | 30.3 | 31.7 | 31.5 |
| **Total revenue** | **233.5** | **241.7** | **256.7** | **277.9** | **297.0** |
| | | | | | |
| **Key Drivers** | | | | | |
| Sales - new units | 133 | 189 | 235 | 255 | 270 |
| Sales - resold units | 177 | 166 | 234 | 286 | 348 |
| 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 |
| | | | | | |
| **Portfolio Overview** | | | | | |
| ILU's | 1,202 | 1,285 | 1,370 | 1,505 | 1,645 |
| Care Suites (ORA) | 326 | 440 | 580 | 700 | 830 |
| Care Suites (PAC) | 216 | 239 | 251 | 241 | 235 |
| Care Beds | 2,112 | 1,882 | 1,832 | 1,732 | 1,632 |
| **Total** | **3,856** | **3,846** | **4,033** | **4,178** | **4,342** |

| Balance Sheet (NZ$m) | 2019A | 2020A | 2021E | 2022E | 2023E |
|---|---|---|---|---|---|
| Working capital | 5.0 | 6.8 | 9.2 | 7.9 | 6.5 |
| Fixed assets | 1,324.4 | 1,437.8 | 1,607.1 | 1,780.2 | 1,951.9 |
| Intangibles | 8.7 | 10.8 | 10.8 | 10.8 | 10.8 |
| Right of use asset | 0 | 0 | 0 | 0 | 0 |
| Other assets | 0 | 0 | 0 | 0 | 0 |
| **Total funds employed** | **1,338.0** | **1,455.4** | **1,627.1** | **1,798.9** | **1,969.2** |
| 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 |
| **Total funding sources** | **1,338.0** | **1,455.4** | **1,627.1** | **1,798.9** | **1,969.2** |

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

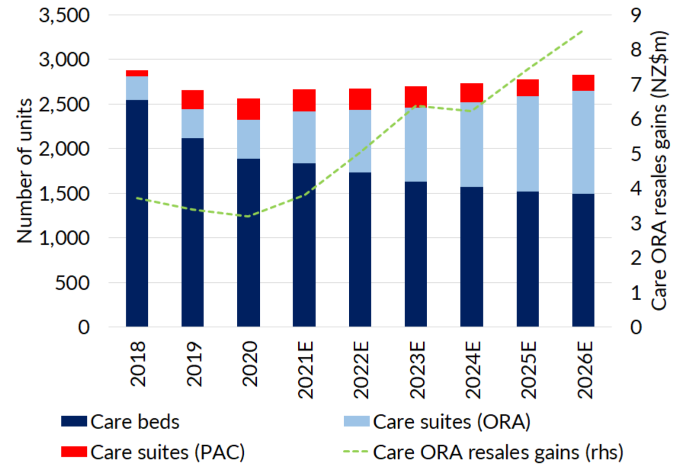
# Our thesis in pictures

**Figure 2. Substantial growth in care suites...**



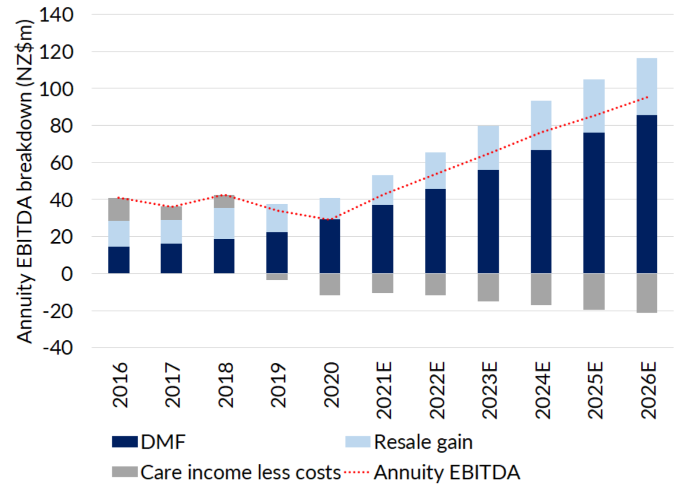

Source: Forsyth Barr analysis, Company reports

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



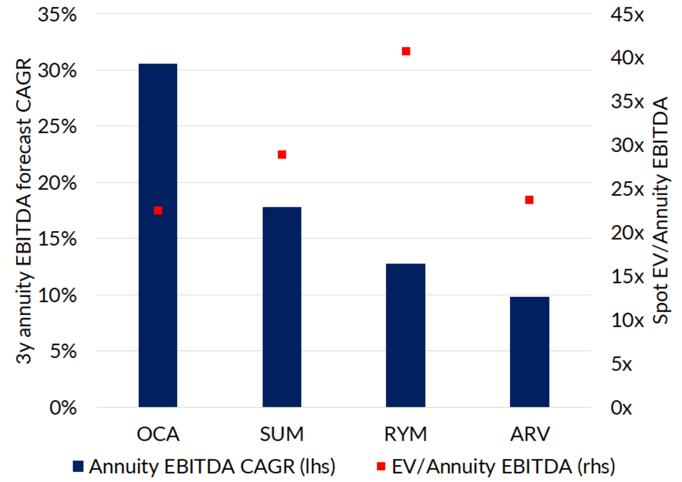

Source: Forsyth Barr analysis, Company reports

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



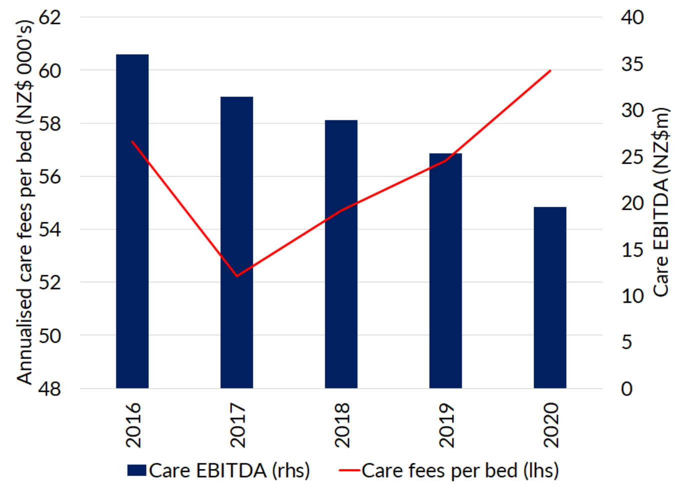

Source: Forsyth Barr analysis, Company reports

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



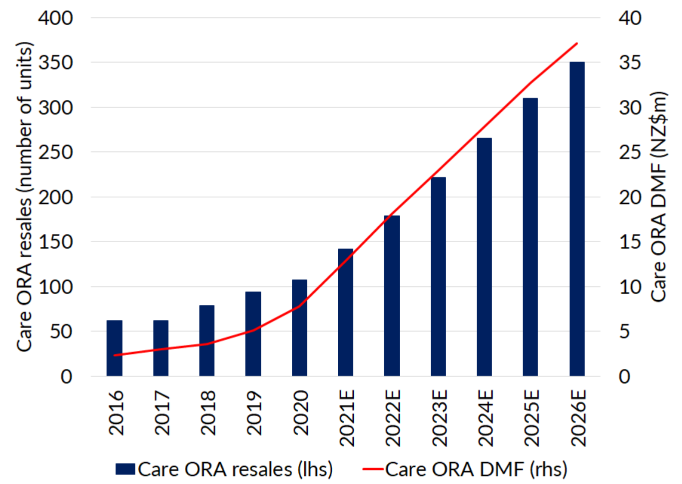

Source: Forsyth Barr analysis

**Figure 6. Care earnings a drag but revenue resilient**



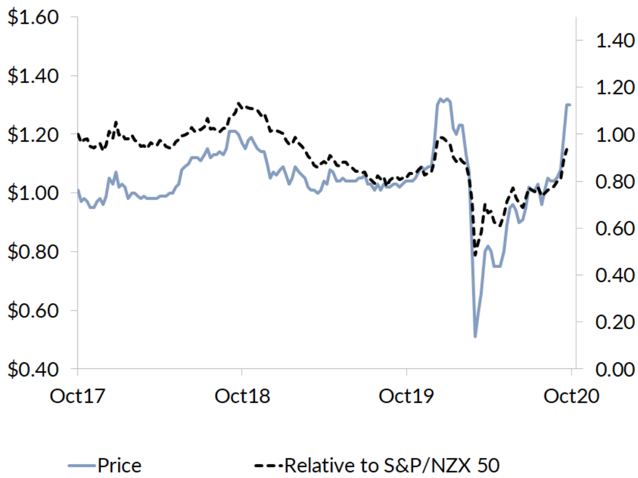

Source: Forsyth Barr analysis, Company reports

**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% |

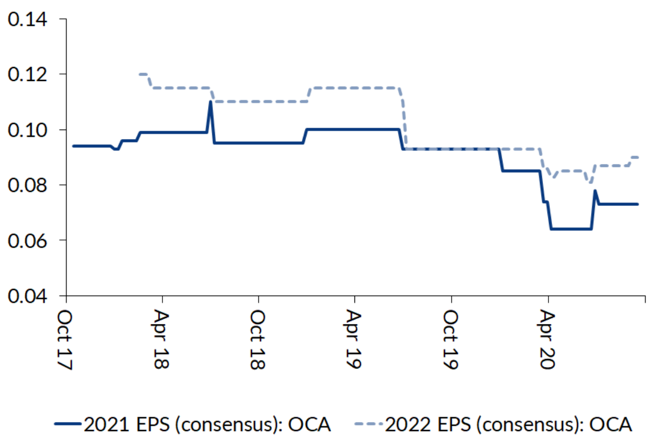
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

## Figure 10. International valuation comparisons

| Company | Code | Price | Mkt Cap | PE | | EV/EBITDA | | EV/EBIT | | Cash Yld |
|---|---|---|---|---|---|---|---|---|---|---|
| (metrics re-weighted to reflect OCA's balance date - May) | | | (m) | 2021E | 2022E | 2021E | 2022E | 2021E | 2022E | 2022E |
| **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%** |
| EV = Current Market Cap + Actual Net Debt | | | **OCA Relative:** | **-20%** | **-19%** | **-28%** | **-26%** | **-16%** | **-15%** | **62%** |

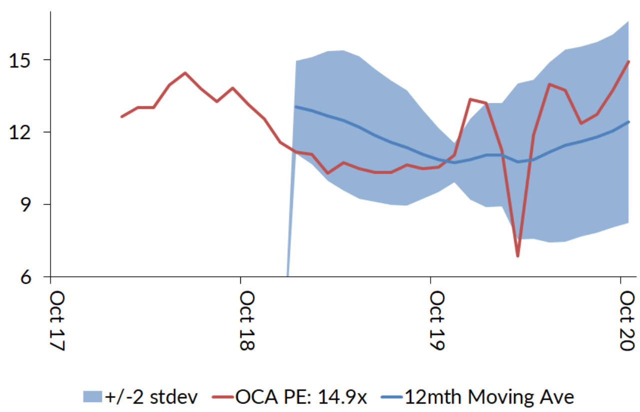
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (OCA) companies fiscal year end

## Figure 11. Consensus EPS momentum (NZ$)




Source: Forsyth Barr analysis

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




Source: Forsyth Barr analysis

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|---|---|---|
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