

Oceania Healthcare

1H21 Result — Inflection

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OUTPERFORM

We walk away from OCA's 1H21 result with increased confidence in our view that OCA has reached an earnings inflection point and are on track to double annuity EBITDA from FY20 to FY23. Specifically, we note three positive developments; (1) OCA reported positive free cash flow and reduced net debt from its FY20 result (May year end), the first aged care operator to do so for several years; (2) annuity EBITDA grew by ~+30% versus 2H20 and +20% versus 1H20 – we firmly believe that OCA's earnings have troughed and will continue to grow over the coming years; and (3) we were encouraged by the large proportion (we estimate 80-90%) of delivered care suites that were sold under an ORA versus care beds with an associated premium accommodation charge (PAC). We reiterate our OUTPERFORM rating with an increased target price of NZ\$1.70.

NZX Code	OCA	Financials: May/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.48	NPAT* (NZ\$m)	42.5	49.8	61.1	69.8	PE	21.4	18.4	15.0	13.1
Target price	NZ\$1.70	EPS* (NZc)	6.9	8.1	9.9	11.3	EV/EBIT	24.7	21.7	18.2	16.1
Risk rating	Medium	EPS growth* (%)	-15.8	16.5	22.8	14.2	EV/EBITDA	19.0	17.0	14.7	13.1
Issued shares	618.1m	DPS (NZc)	3.5	4.0	4.5	5.0	Price / NTA	1.7	1.6	1.5	1.5
Market cap	NZ\$915m	Imputation (%)	0	0	0	0	Cash div yld (%)	2.4	2.7	3.0	3.4
Avg daily turnover	2,636k (NZ\$2,761k)	*Based on normalised profits					Gross div yld (%)	2.4	2.7	3.0	3.4

What's changed?

- **Earnings:** Small increase in annuity EBITDA driven predominately by higher resales gains, underlying earnings are largely unchanged (higher resale gains are offset by slightly higher depreciation & amortisation and lower newsale gains)
- **Target price:** Increased to NZ\$1.70 from NZ\$1.65

Proving up the care suite model; an important milestone

The biggest risk to our positive view on OCA centres around the so far relatively unproven care suite model whereby care beds are sold under an ORA. The care ORA model improve the economics of aged care meaningfully for two reasons. Firstly, and most importantly, it reduces the cash drag on growth. The ability to sell care suites, not just independent living units, implies a cash neutral or even cash positive development (growth). Secondly, it improves the profitability of care even with low positive house price inflation. OCA's 1H21 result was encouraging on both fronts as OCA was free cash flow positive for the first time in several years and our estimate of care annuity earnings grew ~+30% versus 1H20, a change in tack following a period of decline across the sector but particularly in the case of OCA.

1H21 reaffirms our positive view

OCA's 1H21 result delivered on our expectations and reaffirmed our positive view given; (1) valuation metrics remain undemanding despite its recent strong share price performance. Trading on 15x P/E and ~22x EV/Annuity EBITDA on our FY22 forecasts, OCA continues to be valued at a significant discount to its larger peers despite, (2) us forecasting it has the fastest annuity EBITDA growth in the sector over the next three years, predominately driven by the frequent recycling of (deferred management fees) DMF and resales gains from the care suite product and, (3) it has the lowest cash drag in the sector, over the past few years the sector has been characterised by rising debt levels as capital recycling has become harder. OCA reported a net debt decline in 1H21 and was free cash flow positive for the first time in several years, a rare occurrence in the aged care sector.

Oceania Healthcare Limited (OCA)

Priced as at 22 Jan 2021 (NZ\$) **1.48**

12-month target price (NZ\$)*	1.70
Expected share price return	14.9%
Net dividend yield	2.9%
Estimated 12-month return	17.8%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.88
WACC	6.4%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. EV/Annuity EBITDA	1.75
2. DDM	1.65
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
Sales revenue	233.5	241.7	262.3	285.3	304.2
Normalised EBITDA	63.1	63.1	73.6	86.2	96.5
Depreciation and amortisation	(9.5)	(14.5)	(16.2)	(17.0)	(18.2)
Normalised EBIT	53.6	48.6	57.5	69.2	78.2
Net interest	(3.5)	(6.2)	(7.7)	(8.1)	(8.4)
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	49.8	61.1	69.8
Abnormals/other	(4.7)	(56.1)	(0.7)	(3.5)	(7.8)
Reported NPAT	45.4	(13.6)	49.0	57.7	62.0
Normalised EPS (cps)	8.2	6.9	8.1	9.9	11.3
DPS (cps)	4.7	3.5	4.0	4.5	5.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.2	3.5	8.6	8.8	6.6
EBITDA (%)	-0.9	-0.1	16.8	17.0	12.0
EBIT (%)	-2.4	-9.3	18.2	20.4	13.0
Normalised NPAT (%)	-3.9	-15.2	17.2	22.8	14.2
Normalised EPS (%)	-3.9	-15.8	16.5	22.8	14.2
Ordinary DPS (%)	0.0	-25.5	14.3	12.5	11.1

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	63.1	63.1	73.6	86.2	96.5
Working capital change	(1.8)	2.0	0.6	1.6	1.2
Interest & tax paid	(3.5)	(6.2)	(7.7)	(8.1)	(8.4)
Other	37.0	40.4	61.5	81.5	96.2
Operating cash flow	94.8	99.4	128.1	161.2	185.5
Capital expenditure	(153.8)	(136.0)	(130.0)	(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)	(1.9)	21.2	45.5
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)	(26.6)	(6.6)	14.5

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	5.0	6.8	4.8	4.2	2.5
Fixed assets	1,324.4	1,437.8	1,596.6	1,769.7	1,941.4
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	1,612.2	1,784.6	1,954.8
Net debt/(cash)	247.4	307.8	334.5	341.1	326.5
Lease liability	0	13.0	13.0	13.0	13.0
Other liabilities	480.8	580.2	686.1	822.0	975.6
Shareholder's funds	609.9	554.4	578.7	608.5	639.7
Minority interests	0	0	0	0	0
Total funding sources	1,338.0	1,455.4	1,612.2	1,784.6	1,954.8

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	17.6	19.0	17.0	14.7	13.1
EV/EBIT (x)	20.8	24.7	21.7	18.2	16.1
PE (x)	18.0	21.4	18.4	15.0	13.1
Price/NTA (x)	1.5	1.7	1.6	1.5	1.5
Free cash flow yield (%)	27.2	25.7	28.2	32.9	35.6
Net dividend yield (%)	3.2	2.4	2.7	3.0	3.4
Gross dividend yield (%)	3.2	2.4	2.7	3.0	3.4

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	15.3	7.9	7.5	8.6	9.3
Interest cover EBITDA (x)	18.1	10.2	9.6	10.7	11.5
Net debt/ND+E (%)	28.9	35.7	36.6	35.9	33.8
Net debt/EBITDA (x)	3.9	4.9	4.5	4.0	3.4

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	3.8	3.2	3.4	3.8	3.8
Return on equity (%)	8.2	7.7	8.6	10.0	10.9
Return on funds employed (%)	5.7	4.8	5.4	6.4	7.1
EBITDA margin (%)	27.0	26.1	28.1	30.2	31.7
EBIT margin (%)	23.0	20.1	21.9	24.3	25.7
Capex to sales (%)	65.9	56.3	49.6	49.1	46.0
Capex to depreciation (%)	1,611	941	804	825	768
Imputation (%)	0	0	0	0	0
Pay-out ratio (%)	57	51	50	45	44

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)*					
Care fees	156.6	156.4	164.2	173.2	177.8
Management fees	22.3	29.2	38.1	47.2	56.5
Other	10.4	10.6	10.8	11.4	12.0
Gain on resales	15.1	11.5	19.2	23.4	26.9
Gain on new sales	29.1	33.9	30.1	30.1	30.8
Total revenue	233.5	241.7	262.3	285.3	304.2

Key Drivers	2019A	2020A	2021E	2022E	2023E
Sales - new units	133	189	255	250	270
Sales - resold units	177	166	241	286	348
Gross development margin	36%	33%	26%	22%	20%
Gross resales margin	25%	20%	20%	20%	19%
Average new sales price (NZ\$000)	609	542	454	548	571
Average resales price (NZ\$000)	348	354	397	401	412

Portfolio Overview	2019A	2020A	2021E	2022E	2023E
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	266	256	250
Care Beds	2,112	1,882	1,832	1,732	1,632
Total	3,856	3,846	4,048	4,193	4,357

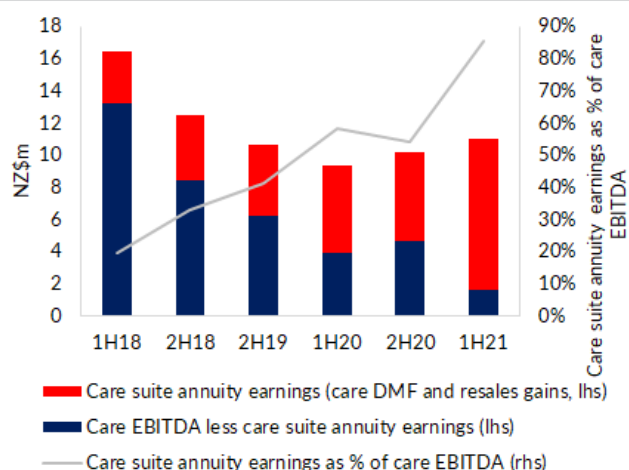
Figures of interest

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

	FY21E			FY22E			FY23E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care fees	162.2	164.2	1.3%	169.0	173.2	2.5%	173.4	177.8	2.5%
DMF	37.3	38.1	2.0%	45.9	47.2	2.9%	56.2	56.5	0.7%
Village fees	10.0	9.8	-1.9%	10.6	10.4	-1.9%	11.2	11.0	-1.9%
Resale gains	15.9	19.2	20.8%	19.7	23.4	18.3%	23.7	26.9	13.8%
Newsale gains	30.3	30.1	-0.9%	31.7	30.1	-4.9%	31.5	30.8	-2.0%
Other	1.0	1.0	0.0%	1.0	1.0	0.0%	1.0	1.0	0.0%
Total revenue	256.7	262.3	2.2%	277.9	285.3	2.7%	297.0	304.2	2.4%
Total costs	183.8	188.7	2.7%	192.5	199.2	3.5%	200.7	207.7	3.5%
EBITDA	72.9	73.6	1.0%	85.4	86.2	0.9%	96.3	96.5	0.2%
Depreciation & amortisation	15.7	16.2	3.1%	17.0	17.0	0.0%	18.2	18.2	0.0%
EBIT	57.2	57.5	0.4%	68.4	69.2	1.1%	78.0	78.2	0.2%
Net interest	7.7	7.7	0.0%	8.6	8.1	-6.7%	9.0	8.4	-6.7%
Underlying profit	49.5	49.8	0.5%	59.8	61.1	2.2%	69.0	69.8	1.1%
Annuity EBITDA	42.6	43.6	2.3%	53.7	56.0	4.3%	64.8	65.6	1.3%
DPS (cps)	4.0	4.0	0.0%	4.5	4.5	0.0%	5.0	5.0	0.0%

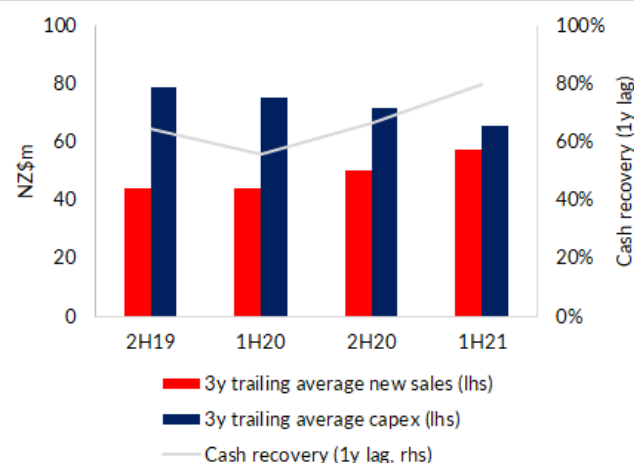
Source: Forsyth Barr analysis. NB: OCA is changing its balance date for FY21 onwards to 31 March (from 31 May), at this point our forecasts still assume a 31 May balance date

Figure 2. Care suite annuity earnings are increasing



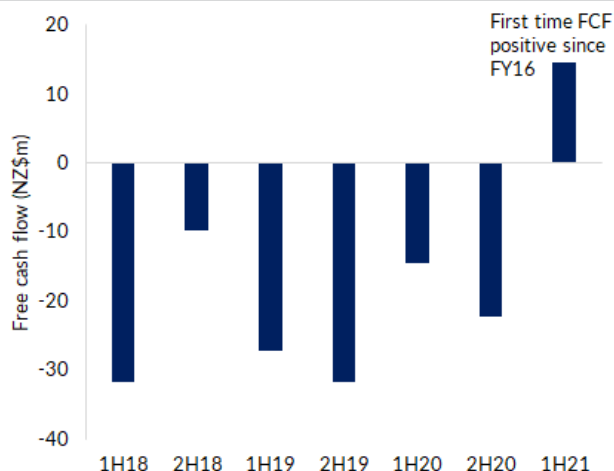
Source: Forsyth Barr analysis, Company reports

Figure 3. Cash recovery of capex is beginning to improve



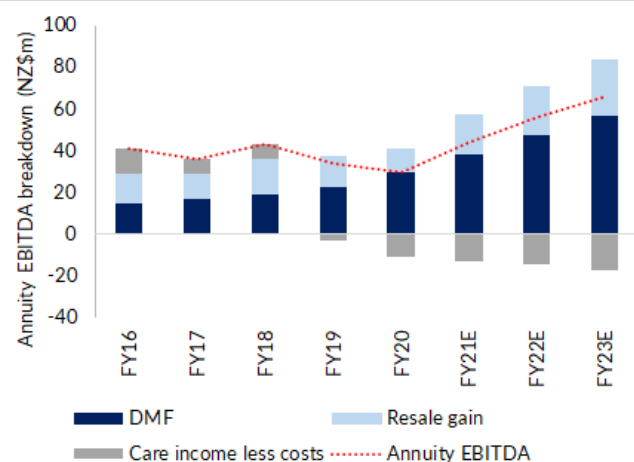
Source: Forsyth Barr analysis, Company reports

Figure 4. Positive free cash flow generation in 1H21

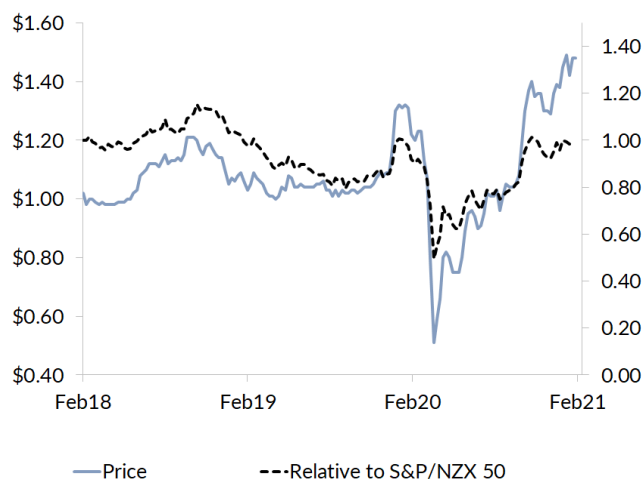


Source: Forsyth Barr analysis, Company reports

Figure 5. Strong annuity EBITDA growth forecasted



Source: Forsyth Barr analysis, Company reports

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	7.4%
Harbour Asset Management & Jarden Securities Limited	5.3%
ACC	5.1%

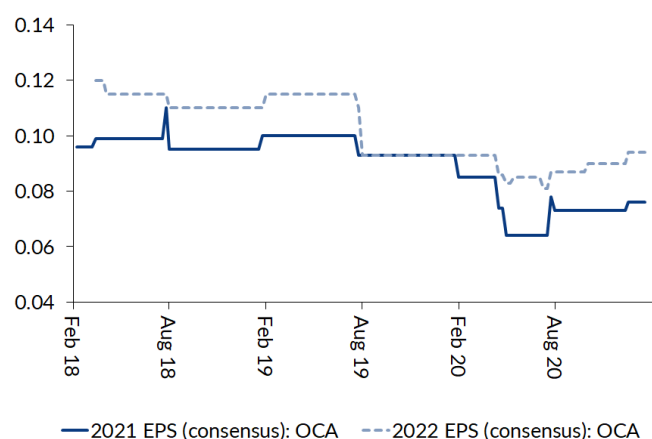
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

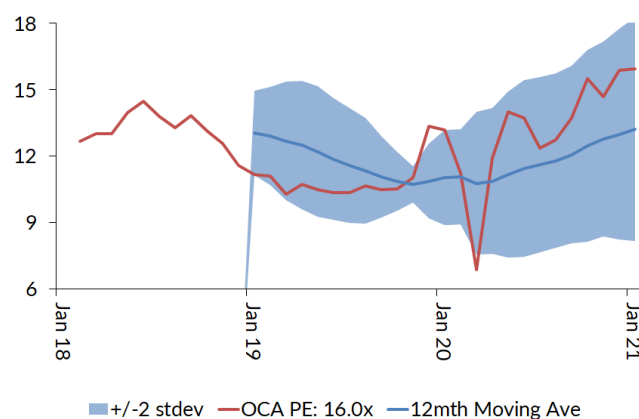
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect OCA's balance date - May)										
Oceania Healthcare	OCA NZ	NZ\$1.48	NZ\$915	18.4x	15.0x	16.6x	14.2x	21.3x	17.7x	3.0%
RYMAN HEALTHCARE *	RYM NZ	NZ\$14.75	NZ\$7,375	29.6x	23.8x	29.9x	24.3x	33.6x	27.1x	2.1%
SUMMERSET GROUP LIMITED *	SUM NZ	NZ\$12.04	NZ\$2,755	25.1x	19.9x	23.1x	18.7x	24.9x	20.0x	1.5%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.70	NZ\$922	17.3x	13.6x	18.3x	14.9x	20.5x	16.6x	4.2%
Compco Average:				24.0x	19.1x	23.8x	19.3x	26.3x	21.2x	2.6%
OCA Relative:				-23%	-22%	-30%	-27%	-19%	-17%	18%

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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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