

Summerset Group

OUTPERFORM

Run to Paradise

Summerset Group (SUM) has made its first foray into Australia with the acquisition of a large broad acre site in Victoria, 41 km South East of Melbourne. This fits its strategy to initially undertake a less capital intensive approach with a mid-size village with largely single level villas and village centre offering a full continuum of care. SUM's valuation multiples have de-rated significantly over the last 12 months providing an attractive entry point. OUTPERFORM.

What's changed?

- **Earnings:** FY19 up +4%, +1% and +1%
- **Target Price:** Up slightly from NZ\$7.10 to NZ\$7.20
- **Rating:** OUTPERFORM

Kicking off in Melbourne

This was not unexpected given the company has been looking for a while and indicated it was getting close to finalising an acquisition after a couple of years due diligence in the market. We suspect the first acquisition was delayed by the recent volatility in the housing market. SUM noted that there is little in the way of retirement village competition in the location and only a modest integrated care offer. We remain very positive about the competitive opportunity for NZ operators with a proven integrated full continuum of care offering. We expect SUM will run with its NZ ORA terms. No purchase price was disclosed but it is expected to be within SUM's target range of around A\$15m to A\$20m.

In line with strategy

It is a large 8ha broad acre site (net ~5ha for the actual development) and hence will be villas (ie not high rise apartments) plus a three level village centre with a care facility and serviced apartments (SAs). The location is mid market and is 41km south east of Melbourne CBD with a median house price of around A\$0.55m to A\$0.66m allowing a likely standard 2 BR villa price of ~A\$0.5m.

Less capital intensive broad acre approach to start

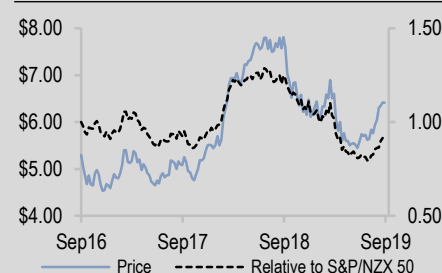
This is a lower risk approach and again this was what SUM had been signalling strategically. The village size is likely to be slightly smaller than a typical new NZ village with 145 villas, 50 SAs and 75 beds, which, pleasingly, will include around 25 dementia beds. The site looks to be well located to amenities for residents. The opportunity remains to improve capital recycling with refundable accommodation deposits (RADs) for aged care beds of typically around A\$500,000. We expect SUM to announce further sites over the next 18 months as it looks to establish a pipeline to leverage.

Investment View

SUM continues to strengthen its development and operational track record and has a land bank of over six years. There remains significant long-term growth potential from demographic trends and SUM has the expertise to capitalise on these themes. Execution risk is increasing near-term as it tackles large and intensive Auckland developments late in the cycle but the business remains very well placed over the longer term. At current pricing SUM is getting very little credit for its operational and development track record since listing. OUTPERFORM.

NZX Code	SUM
Share price	NZ\$6.41
Target price	NZ\$7.20
Risk rating	High
Issued shares	225.8m
Market cap	NZ\$1,447m
Average daily turnover	338.0k (NZ\$2,038k)

Share Price Performance



Financials: December	18A	19E	20E	21E
NPAT* (NZ\$m)	98.8	102.1	117.5	134.3
EPS* (NZc)	43.9	45.2	52.1	59.5
EPS growth* (%)	19.7	3.0	15.1	14.3
DPS (NZc)	13.2	13.6	15.6	17.9
Imputation (%)	0	0	0	0

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	7.8	15.6	13.6	12.0
EV/EBIT	8.1	16.5	14.4	12.6
PE	14.6	14.2	12.3	10.8
Price / NTA	1.5	1.4	1.3	1.2
Cash dividend yield (%)	2.1	2.1	2.4	2.8
Gross dividend yield (%)	2.1	2.1	2.4	2.8

*Historic and forecast numbers based on underlying profits

Jeremy Simpson, CFA

jeremy.simpson@forsythbarr.co.nz

+64 9 368 0022

Summerset Group Holdings (SUM)		Priced as at 26 Sep 2019: NZ\$6.41					December year end									
Forsyth Barr valuation						Valuation Ratios										
Valuation methodology						DCF	2017A	2018A	2019E	2020E	2021E					
12-month target price (NZ\$)*						7.20	Spot valuations (NZ\$)	EV/EBITDA (x)	17.9	7.8	15.6	13.6	12.0			
Expected share price return						12.3%	1. DCF	6.70	EV/EBIT (x)	18.8	8.1	16.5	14.4	12.6		
Net dividend yield						2.4%	n/a	n/a	PE (x)	17.5	14.6	14.2	12.3	10.8		
Estimated 12-month return						14.7%	3. n/a	n/a	Price/NTA (x)	1.8	1.5	1.4	1.3	1.2		
Key WACC assumptions						DCF valuation summary (NZ\$m)										
Risk free rate						2.00%	Total firm value	1,992	Imputation (%)	0	0	0	0	0		
Equity beta						0.88	(Net debt)/cash	(444)	Pay-out ratio (%)	30	30	30	30	30		
WACC						7.7%	Value of equity	1,548	Capital Structure							
Terminal growth						1.5%	Shares (m)	226	2017A	2018A	2019E	2020E	2021E			
Profit and Loss Account (NZ\$m)						2017A	2018A	2019E	2020E	2021E	Interest cover EBIT (x)					
Sales revenue						186	347	247	283	321	8.4	9.3	8.3	8.6	8.9	
Normalised EBITDA						98	234	122	140	159	Interest cover EBITDA (x)					
Depreciation and amortisation						(5)	(7)	(7)	(8)	(9)	8.5	20.2	9.3	9.6	9.8	
Normalised EBIT						93	228	115	132	151	Net debt/ND+E (%)					
Net interest						(12)	(12)	(13)	(15)	(16)	30.2	31.3	30.8	29.9	28.2	
Associate income						-	-	-	-	-	Net debt/EBITDA (x)					
Tax						(0)	(2)	-	-	-	3.5	1.9	3.8	3.4	2.9	
Minority interests						-	-	-	-	-	Key Ratios					
Normalised NPAT						82	99	102	118	134	2017A	2018A	2019E	2020E	2021E	
Abnormals/other						158	116	-	-	-	Return on assets (%)	4.4	3.9	3.6	3.6	3.7
Reported NPAT						240	215	102	118	134	Return on equity (%)	10.4	10.1	9.9	10.7	11.3
Normalised EPS (cps)						36.7	43.9	45.2	52.1	59.5	Return on funds employed (%)	9.3	8.4	7.7	8.4	9.1
DPS (cps)						11.0	13.2	13.6	15.6	17.9	EBITDA margin (%)	52.5	67.6	49.3	49.4	49.6
Growth Rates						2017A	2018A	2019E	2020E	2021E	EBIT margin (%)	50.0	65.7	46.6	46.8	47.0
Revenue (%)						32.6	86.2	-28.7	14.2	13.5	Capex to sales (%)	138.2	82.7	84.6	100.0	106.1
EBITDA (%)						40.9	>100	-47.9	14.4	14.0	Capex to depreciation (%)	5,564	4,293	3,092	3,742	3,991
EBIT (%)						41.7	>100	-49.4	14.6	14.0	Operating Performance					
Normalised NPAT (%)						44.2	21.0	3.4	15.1	14.3	2017A	2018A	2019E	2020E	2021E	
Normalised EPS (%)						42.8	19.7	3.0	15.1	14.3	Revenue (NZ\$m)					
DPS (%)						42.9	20.0	2.8	15.1	14.3	Care fees	75	91	105	118	131
Cash Flow (NZ\$m)						2017A	2018A	2019E	2020E	2021E	Management fees	36	46	52	62	74
EBITDA						98	234	122	140	159	Other	0	0	-	-	-
Working capital change						110	(17)	118	183	241	Fair value m'tment in Investment Property (NZ\$m)					
Interest & tax paid						(13)	(13)	(13)	(15)	(16)	Realised	76	92	90	102	116
Other						0	-	-	-	-	Unrealised	-	117	-	-	-
Operating cash flow						195	204	227	308	384	Total revenue					
Capital expenditure						(257)	(287)	(209)	(283)	(340)	186	347	247	283	321	
(Acquisitions)/divestments						-	-	-	-	-	Key Drivers					
Other						-	-	-	-	-	Sales - new units	382	339	333	400	480
Funding available/(required)						(62)	(83)	18	26	44	Ave unit price - new sales (NZ\$00C)	488	566	623	635	648
Dividends paid						(12)	(18)	(31)	(35)	(40)	Sales - resold units	300	301	308	361	418
Equity raised/(returned)						-	-	-	-	-	Ave unit price - resales (NZ\$000s)	383	406	438	460	483
Increase/(decrease) in net debt						75	100	13	10	(3)	Gross development margin (%)	27.3	33.2	28.0	25.0	23.0
Balance Sheet (NZ\$m)						2017A	2018A	2019E	2020E	2021E	Gross resales margin (%)	21.7	23.5	24.0	23.0	22.0
Working capital						(26)	(57)	(48)	(55)	(62)	New apartments/units	450	454	350	500	600
Fixed assets						2,193	2,718	3,011	3,387	3,835	New beds	56	52	80	80	80
Intangibles						6	7	7	7	7	Portfolio					
Other assets						1	5	5	5	5	Apartments/units	3,278	3,732	4,082	4,582	5,182
Total funds employed						2,173	2,672	2,974	3,344	3,784	Beds	793	845	925	1,005	1,085
Net debt/(cash)						340	445	458	468	465						
Other non current liabilities						1,048	1,248	1,487	1,780	2,135						
Shareholder's funds						786	979	1,028	1,096	1,184						
Minority interests						-	-	-	-	-						
Total funding sources						2,173	2,672	2,974	3,344	3,784						

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

Australian Beachhead

Over 5,000 units in a geographically diverse pipeline

Below is SUM's development pipeline as at 30 June 2019, plus the inclusion of the new Cranbourne North site in Melbourne.

SUM's guidance for FY20 new stock delivery is 350 units which implies a busy 2H19 with delivery of 211 units. The near-term development focus is the delivery of remaining independent living units and villas at Rototuna in Hamilton, Casebrook in Christchurch and Ellerslie in Auckland and opening new villages at Kenepuru in Wellington, Richmond in Nelson and Avonhead in Christchurch.

In terms of near term consenting, SUM is waiting for Environment Court decisions for its Lower Hutt site (likely in the next month) and St Johns (next 3–5 months).

Figure 1. Development Pipeline/ Landbank

	Region	Villas	Apartments	SAs	Total units	Care beds	Consented
Existing sites							
Ellerslie	Auckland	8	140		148		yes
Hobsonville	Auckland	32			32		yes
Rototuna	Waikato	98		76	174	43	yes
Casebrook	Christchurch	170		76	246	43	yes
Total existing sites		308	140	152	600	86	
New sites							
Milldale	Auckland	99	117	76	292	43	no
Parnell	Auckland	0	264	76	340	48	no
St Johns	Auckland	0	236	76	312	32	yes
Papamoa	Bay of Plenty	211		76	287	43	no
Pohutukawa Place	Taranaki	222		76	298	43	no
Te Awa	Hawke's Bay	241		76	317	43	yes
Kenepuru	Wellington	114	48	106	268	43	yes
Lower Hutt	Wellington	42	109	66	217	30	yes
Waikanae	Wellington	214		76	290	43	no
Richmond	Nelson	234		76	310	43	yes
Blenheim	Nelson	140		76	216	43	no
Rangiora	Christchurch	245		76	321	43	no
Avonhead	Christchurch	136		99	235	43	yes
Cambridge	Cambridge	214		76	290	43	no
Whangarei	Whangarei	214		76	290	43	no
Cranbourne North	Melbourne	145		50	195	75	no
Total new sites		2,471	774	1,233	4,478	701	
Total landbank		2,779	914	1,385	5,078	787	
Auckland landbank		139	757	228	1,124	123	
Proportion Auckland(%)		5%	83%	16%	22%	16%	

Source: Forsyth Barr analysis, Company Reports

Minor changes to near-term earnings and price target

We remain with a forecast build rate of 350 units in FY19, 500 in FY20 and 600 in FY21. For FY19 we have slightly lifted forecast development and resales margins, and new sales and resales volumes to reflect the ongoing relatively robust operating environment across NZ.

These changes have led to a +4% lift in FY19 earnings and +1% in FY20 and FY21, and a slight lift in target price from NZ\$7.10 to NZ\$7.20.

Figure 2. Forecast key Drivers (NZ\$m)

Year ending 31 December	Old	New	% Chg
Gross devel margin % FY19	27.5	28.0	1.8%
Gross devel margin % FY20	25.0	25.0	0.0%
Gross devel margin % FY21	23.0	23.0	0.0%
Sales - new units FY19	326	333	2.2%
Sales - new units FY20	400	400	0.0%
Sales - new units FY21	480	480	0.0%
Ave price - new sales FY19 (NZ\$m)	623.0	623.0	0.0%
Ave price - new sales FY20 (NZ\$m)	635.5	635.5	0.0%
Ave price - new sales FY21 (NZ\$m)	648.2	648.2	0.0%
Sales - resold units FY19	304	308	1.4%
Sales - resold units FY20	361	361	0.0%
Sales - resold units FY21	418	418	0.0%
Ave price - resold sales FY19 (NZ\$m)	434.4	438.5	0.9%
Ave price - resold sales FY20 (NZ\$m)	456.1	460.4	0.9%
Ave price - resold sales FY21(NZ\$m)	478.9	483.4	0.9%
Gross resales margin % FY19	23.4	24.0	2.6%
Gross resales margin % FY20	23.0	23.0	0.0%
Gross resales margin % FY21	22.0	22.0	0.0%

Source: Forsyth Barr analysis

Figure 3. Changes to forecasts (NZ\$m)

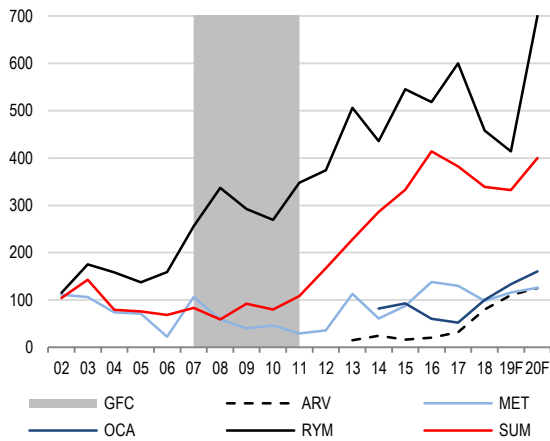
Year ending 31 December	Old	New	% Chg
Revenue FY19	243.5	247.4	1.6%
Revenue FY20	281.9	282.5	0.2%
Revenue FY21	319.9	320.6	0.2%
EBITDA FY19	118.1	122.0	3.3%
EBITDA FY20	139.1	139.7	0.4%
EBITDA FY21	158.5	159.2	0.4%
Normalised profit FY19	98.1	102.1	4.0%
Normalised profit FY20	116.8	117.5	0.7%
Normalised profit FY21	133.5	134.3	0.7%
Dividend FY19 (cps)	13.0	13.6	4.0%
Dividend FY20 (cps)	15.5	15.6	0.7%
Dividend FY21 (cps)	17.7	17.9	0.7%
Price Target	\$7.10	\$7.20	1.4%

Source: Forsyth Barr analysis

Figures 4 and 5 compare historic new sales and resales volumes across the sector. SUM has delivered a strong lift in new sales over the last eight years and is consolidating now before it sharply lifts its build rate again. Resales volumes will start to lift more strongly over the medium term as the new stock sold over the last decade starts to resell.

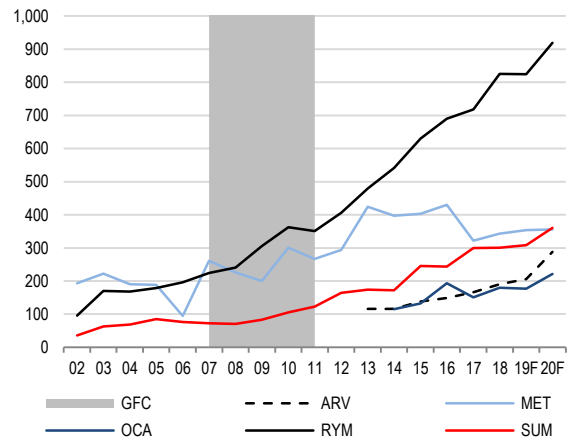
Figures 7 to 9 highlight the derating the sector has experienced, and in particular SUM, over the five years in terms of P/NTA ratios and PE ratios. With the exception of RYM, the sector is now trading around NTA and we believe SUM is getting little credit for the track record it has established since listing and its large well diversified pipeline. While the sector has historically traded to a premium of the broader equity market in terms of PE multiple due to its superior growth outlook, this is no longer the case with RYM the only one trading at a PE premium. We consider SUM attractive buying at these levels and remain with an OUTPERFORM rating.

Figure 4. New Sales



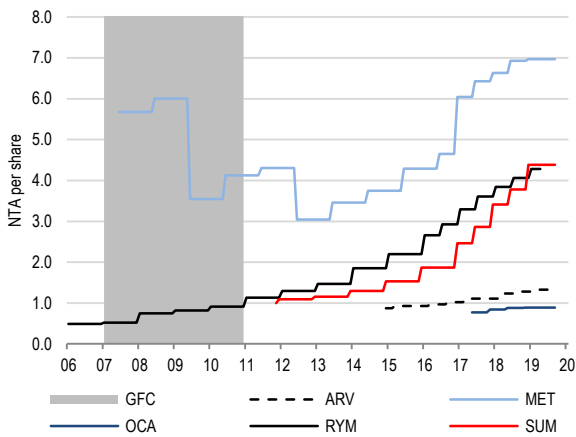
Source: Forsyth Barr analysis, Company Reports

Figure 5. Resales



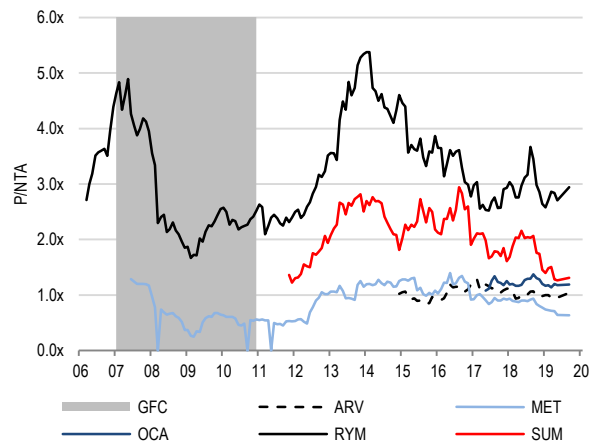
Source: Forsyth Barr analysis, Company Reports

Figure 6. NTA per share



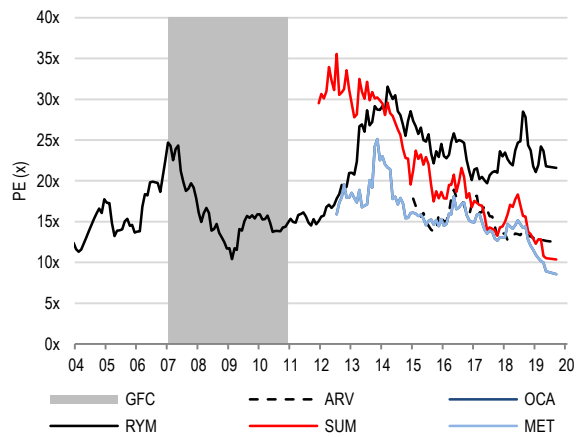
Source: Forsyth Barr analysis, Company Reports

Figure 7. P/NTA



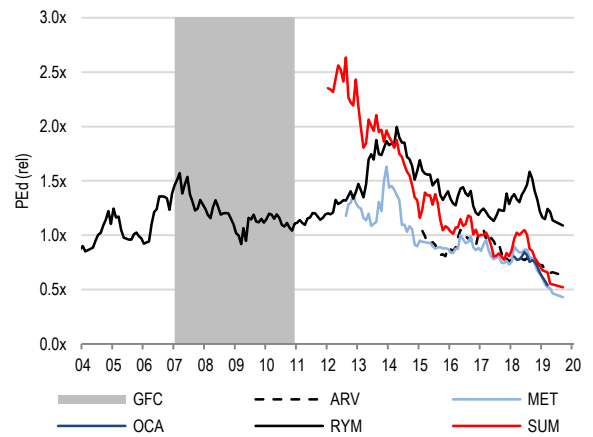
Source: Forsyth Barr analysis, Company Reports

Figure 8. P/E Multiple



Source: Forsyth Barr analysis, Company Reports

Figure 9. Relative P/E



Source: Forsyth Barr analysis, Company Reports

Figure 10. Major retirement and aged care sector portfolios

	ARV	BUPA	MET	OCA	RYM	SUM
Independent living units (ILUs)	1,592	1,497	3,881	1,202	4,915	3,256
Care/Serviced Apartments (SAs)	664	25	494	-	1,963	615
Total retirement village units	2,256	1,522	4,375	1,202	6,878	3,871
Rest home/Hospital/Dementia	1,722	3,497	382	2,580	3,660	858
Total units and beds	3,978	5,019	4,757	3,782	10,538	4,729
Aged care beds / SAs as % of portfolio	60%	70%	18%	68%	53%	31%
Retirement villages	30	31	25	24	36	23
ORAs per retirement village	75	49	175	50	191	168
Care villages	27	52	9	44	36	18
Beds per care village	64	67	42	59	102	48

Source: Forsyth Barr analysis, Company Reports

Investment summary

With a strengthening development and sales track record, and a land bank of circa seven years, Summerset Group (SUM) has delivered to its 450 unit FY18 new build target. There remains significant growth potential from demographic trends, a further lift in its build rate and expansion into Australia with the acquisition of its first site in Victoria.

Business quality

- **Positive demographic trends:** SUM has the expertise to leverage the ageing population and growing popularity of retirement village living.
- **Growing development track record:** SUM built 450 units in FY18, and has achieved attractive development margins recently. Execution is becoming critical as SUM starts building larger high rise developments and increasing project debt.
- **Investing in quality of care:** SUM is investing heavily in its care operation which is increasing the 'needs based' nature of its portfolio and it has started adding dementia services to new developments.

Earnings and cash flow outlook

- **Strong underlying EPS growth track record:** Since listing on the NZX in 2011, SUM has generated strong EPS growth on a consistent basis. A key EPS driver will be SUM lifting its build rate over the medium term from 450 to 600 units per annum and expansion into Australia.
- **Recycling capital:** The occupational right agreement (ORA) structure provides the ability to self-fund development, subsidise the cost of a care facility, recycle capital into new development, and capture capital gains when units are resold.

Company description

SUM is the second largest developer of integrated retirement villages in NZ. It offers a range of lifestyle options and aged care services for the long-stay care of the elderly. At 31 December 2018, it had a portfolio of 3,116 independent units, 601 serviced apartments and 858 care beds across 23 operating villages. Although its care operations are the smaller part of its business, SUM has increased its focus on aged care services in recent years and continues to invest in this area. SUM was established in 1994 and listed on the NZX in November 2011.

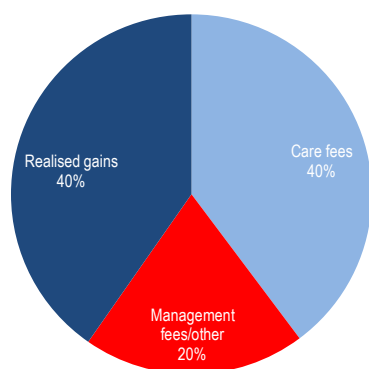
Financial structure

- **Balance sheet:** Gearing has increased as SUM has rapidly lifted its build rate, and invested in higher priced metropolitan land, but debt remains largely project related.
- **Dividends:** SUM has been paying out a dividend at the low end of its 30%–50% target pay-out rate and has a dividend reinvestment plan in place.

Risks factors

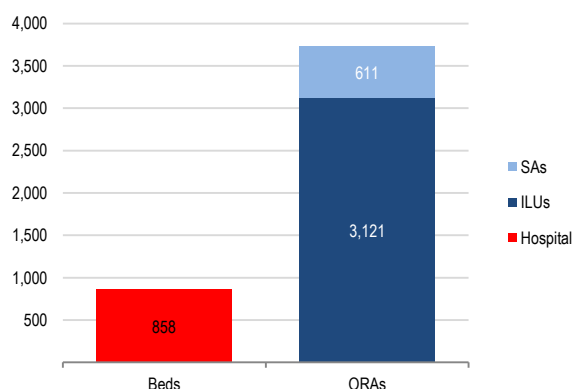
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term.
- **Housing market downturn:** A downturn in the buoyant housing conditions is a threat to SUM's resales volumes, cash flows, and gearing.

Figure 11. SUM FY18 revenue mix (NZ\$m)



Source: Forsyth Barr analysis, Company Reports

Figure 12. SUM portfolio as at 31 December 2018



Source: Forsyth Barr analysis, Company Reports

Figure 13. Substantial Shareholders

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

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

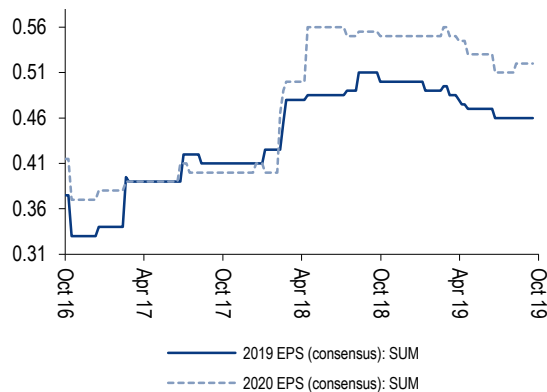
Figure 14. International Compco

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect SUM's balance date - December)</i>										
			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
Summerset Group	SUM NZ	NZ\$6.41	NZ\$1,447	14.2x	12.3x	15.5x	13.5x	16.4x	14.3x	2.4%
Metlifecare *	MET NZ	NZ\$4.38	NZ\$934	10.3x	9.9x	12.3x	11.8x	13.1x	12.5x	2.6%
Ryman Healthcare *	RYM NZ	NZ\$13.00	NZ\$6,500	26.0x	22.6x	26.1x	22.7x	28.5x	24.6x	2.2%
Oceania Healthcare *	OCA NZ	NZ\$1.02	NZ\$622	11.4x	10.4x	12.7x	11.6x	15.0x	13.6x	5.3%
Arvida Group Limited *	ARV NZ	NZ\$1.45	NZ\$786	13.9x	12.2x	15.5x	12.1x	17.1x	13.3x	4.6%
Compco Average:				15.4x	13.8x	16.7x	14.5x	18.4x	16.0x	3.7%
SUM Relative:				-8%	-11%	-7%	-7%	-11%	-11%	-34%

EV = Current Market Cap + Actual Net Debt

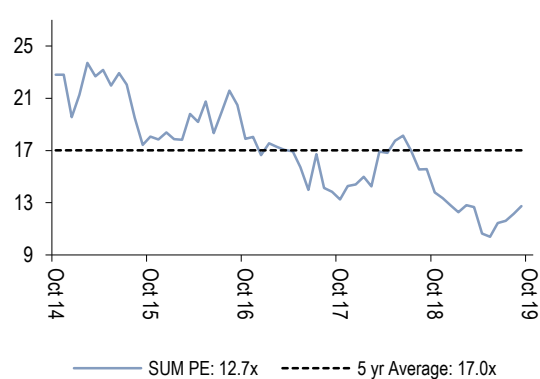
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SUM) companies fiscal year end

Figure 15. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 16. 12 Month Forward PE



Source: Forsyth Barr analysis

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge. **Disclosure:** Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Forsyth Barr confirms no inducement has been accepted from the researched entity, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. **Analyst Disclosure Statement:** In preparing this publication the analyst(s) may or may not have a threshold interest in the financial products referred to in this publication. For these purposes a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the entity being researched. **Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction. **Terms of use:** Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.