

Summerset Group

FY19 Preview – No Dry Spell For This Summer

JEREMY SIMPSON CFA

 jeremy.simpson@forsythbarr.co.nz
 +64 9 368 0022

OUTPERFORM 

We expect Summerset (SUM) to report a robust FY19 result on 25 February 2020, reflecting solid ongoing demand for its retirement and aged care product but impacted by a slower build rate in 1H. We are forecasting underlying EPS growth of +7% and SUM has already confirmed strong 4Q sales and resales volumes. There is no guidance and our numbers are slightly above consensus.

NZX Code	SUM	Financials: Dec/	18A	19E	20E	21E	Valuation (x)	18A	19E	20E	21E
Share price	NZ\$9.10	NPAT* (NZ\$m)	98.8	106.0	123.7	142.9	EV/EBITDA	20.9	19.9	17.2	15.0
Target price	NZ\$8.90	EPS* (NZc)	43.9	46.9	54.8	63.3	EV/EBIT	22.2	21.0	18.2	15.8
Risk rating	High	EPS growth* (%)	19.7	6.9	16.7	15.5	PE	20.7	19.4	16.6	14.4
Issued shares	225.8m	DPS (NZc)	13.2	14.1	16.4	19.0	Price / NTA	2.1	2.0	1.9	1.7
Market cap	NZ\$2,054m	Imputation (%)	0	0	0	0	Cash div yld (%)	1.5	1.5	1.8	2.1
Avg daily turnover	342.5k (NZ\$2,187k)	*Based on normalised profits					Gross div yld (%)	1.5	1.5	1.8	2.1

Key issues to consider at SUM's FY20 result:

- **Healthy pricing and margins expected** – While SUM has confirmed robust new sales and resales volumes for FY19, we also expect FY19 to be boosted by strong pricing and margins.
- **Development activity** – SUM's guidance is for 350 new units to be delivered which implies a strong 2H19 for completions and we expect this to be achieved.
- **Australian update** – A progress report regarding SUM's first site in Victoria, plus there is scope for a further site to be confirmed.
- **Positive demand markers** – Demand has improved for recent stages at SUM's Auckland villages, meanwhile first stages at its new non-Auckland villages have sold down well. New stock levels have increased in recent periods and we expect this will have stabilised although a risk for new stock levels is the late timing of new stock in 2H. Aged care occupancy will remain well above industry averages.
- **Guidance and outlook** – SUM does not typically provide earnings guidance with its final result, however, forward looking comments on the build rate is of interest given the expected pick-up in FY20/21 towards SUM's medium term target of 600 units per annum.

Investor briefing

Conference call: 11am (NZ time) dial 09 280 5280, 0800 444 845, AU 1 800 175 864. Code: 5479555

Figure 1. FY19 result summary (NZ\$m)

12 months ending 31 December	FY18	FY19E	Chg
Underlying revenue	229.3	251.1	10%
Underlying EBITDA	116.8	125.8	8%
Underlying profit	96.9	106.0	9%
EPS - underlying profit (cps)	43.9	46.9	7%
1H dividend (cps)	7.2	7.7	7%

Source: Forsyth Barr analysis

Summerset Group Holdings (SUM)

Priced as at 18 Feb 2020 (NZ\$)						9.10						
12-month target price (NZ\$)*						8.90	Spot valuations (NZ\$)					
Expected share price return						-2.2%	1. DCF					8.27
Net dividend yield						1.9%	2. n/a					n/a
Estimated 12-month return						-0.3%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					2,328
Equity beta						0.88	(Net debt)/cash					(444)
WACC						7.7%	Less: Capitalised operating leases					0
Terminal growth						1.5%	Value of equity					1,884
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2017A	2018A	2019E	2020E	2021E		2017A	2018A	2019E	2020E	2021E	
Normalised EBITDA	186.3	229.5	251.1	288.2	328.0	EV/EBITDA (x)	24.1	20.9	19.9	17.2	15.0	
Depreciation and amortisation	97.7	117.0	125.8	145.3	166.6	EV/EBIT (x)	25.3	22.2	21.0	18.2	15.8	
Normalised EBIT	(4.6)	(6.7)	(6.8)	(7.6)	(8.6)	PE (x)	24.8	20.7	19.4	16.6	14.4	
Net interest	93.1	110.4	119.0	137.7	158.0	Price/NTA (x)	2.6	2.1	2.0	1.9	1.7	
Associate income	(11.5)	(11.6)	(13.0)	(14.0)	(15.1)	Free cash flow yield (%)	-3.0	-4.0	1.4	2.1	3.3	
Tax	0	0	0	0	0	Net dividend yield (%)	1.2	1.5	1.5	1.8	2.1	
Minority interests	(0.3)	(1.7)	0	0	0	Gross dividend yield (%)	1.2	1.5	1.5	1.8	2.1	
Normalised NPAT	0	0	0	0	0	Capital Structure						
Abnormals/other	81.6	98.8	106.0	123.7	142.9	Interest cover EBIT (x)	8.4	9.3	8.7	9.3	10.1	
Reported NPAT	158.6	117.4	0	0	0	Interest cover EBITDA (x)	8.5	10.1	9.7	10.4	11.0	
Normalised EPS (cps)	240.2	216.2	106.0	123.7	142.9	Net debt/ND+E (%)	30.2	31.3	30.3	28.7	25.9	
DPS (cps)	36.7	43.9	46.9	54.8	63.3	Net debt/EBITDA (x)	3.5	3.8	3.6	3.1	2.5	
	11.0	13.2	14.1	16.4	19.0	Key Ratios						
Growth Rates						2017A	2018A	2019E	2020E	2021E		
Revenue (%)	2017A	2018A	2019A	2020A	2021A	Return on assets (%)	4.4	3.9	3.7	3.8	3.9	
EBITDA (%)	32.6	23.2	9.4	14.8	13.8	Return on equity (%)	10.4	10.1	10.3	11.2	11.9	
EBIT (%)	40.9	19.7	7.5	15.5	14.6	Return on funds employed (%)	9.3	8.4	7.9	8.8	9.7	
Normalised NPAT (%)	41.7	18.5	7.8	15.7	14.7	EBITDA margin (%)	52.5	51.0	50.1	50.4	50.8	
Normalised EPS (%)	44.2	21.0	7.3	16.7	15.5	EBIT margin (%)	50.0	48.1	47.4	47.8	48.2	
Ordinary DPS (%)	42.8	19.7	6.9	16.7	15.5	Capex to sales (%)	138.2	125.1	83.3	98.1	103.7	
	42.9	20.0	6.7	16.7	15.5	Capex to depreciation (%)	5,564	4,293	3,090	3,735	3,978	
Cash Flow (NZ\$m)						Imputation (%)	0	0	0	0	0	
EBITDA	2017A	2018A	2019E	2020E	2021E	Pay-out ratio (%)	30	30	30	30	30	
Working capital change	97.7	117.0	125.8	145.3	166.6	Operating Performance						
Interest & tax paid	109.8	100.5	124.2	194.0	256.4	Revenue (NZ\$m)	2017A	2018A	2019A	2020A	2021E	
Other	(12.7)	(13.1)	(13.0)	(14.0)	(15.1)	Care fees	74.5	91.2	105.4	118.4	130.7	
Operating cash flow	0.2	0	0	0	0	Management fees	35.8	45.6	51.7	63.1	75.3	
Capital expenditure	195.0	204.4	237.0	325.3	407.9	Other	0.2	0.2	0	0	0	
(Acquisitions)/divestments	(257.5)	(287.0)	(209.2)	(282.6)	(340.1)	Fair value m'tment in Investment Property (NZ\$m)						
Other	0	0	0	0	0	Realised	75.8	92.5	94.0	106.7	122.0	
Funding available/(required)	(62.5)	(82.6)	27.8	42.6	67.7	Unrealised	0	0	0	0	0	
Dividends paid	(12.3)	(17.8)	(31.8)	(37.1)	(42.9)	Total revenue	186.3	229.5	251.1	288.2	328.0	
Equity raised/(returned)	0	0	0	0	0	Key Drivers						
(Increase)/decrease in net debt	(74.8)	(100.4)	(4.0)	5.5	24.8	Sales - new units	382	339	329	400	480	
Balance Sheet (NZ\$m)						Ave unit price - new sales (NZ\$000s)	488	566	651	671	691	
Working capital	2017A	2018A	2019E	2020E	2021E	Sales - resold units	300	301	323	370	422	
Fixed assets	(26.4)	(57.4)	(48.8)	(56.1)	(63.8)	Ave unit price - resales (NZ\$000s)	383	406	438	465	493	
Intangibles	2,193.1	2,717.8	3,014.2	3,395.9	3,849.5	Gross development margin (%)	27.3	33.2	28.0	25.0	23.0	
Right of use asset	5.6	6.6	6.6	6.6	6.6	Gross resales margin (%)	21.7	23.5	24.0	23.0	22.0	
Other assets	0	0	0	0	0	New apartments/units	450	454	350	500	600	
Total funds employed	1.2	4.6	4.6	4.6	4.6	New beds	56	52	80	80	80	
Net debt/(cash)	2,173.4	2,671.6	2,976.6	3,351.1	3,797.0	Portfolio						
Lease liability	339.6	445.3	449.3	443.8	418.9	Apartments/units	3,278	3,732	4,082	4,582	5,182	
Other liabilities	0	0	0	0	0	Beds	793	845	925	1,005	1,085	
Shareholder's funds	1,048.0	1,247.6	1,495.8	1,803.8	2,181.2							
Minority interests	785.8	978.8	1,031.5	1,103.6	1,196.9							
Total funding sources	0	0	0	0	0							

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

FY19 forecasts

Below is a summary of our underlying forecasts for FY19.

Figure 2. FY19 forecasts (NZ\$m)

12 months ending 31 December	FY18	FY19E	Chg	Forbar
Revenue				
Care fees	91.2	105.4	15.6%	105.4
Management fees/other	45.6	51.7	13.3%	51.7
Fair value movement of investment property				
Realised value movement				
Development margin	63.7	60.0	-5.9%	60.0
Resales margin	28.7	34.0	18.4%	34.0
Total realised value movement	92.5	94.0	1.7%	94.0
Underlying revenue	229.3	251.1	9.5%	251.1
Total Costs	112.4	125.3	11.5%	125.3
Underlying EBITDA	116.8	125.8	7.7%	125.8
Depreciation	6.7	6.8	1.3%	6.8
EBIT	110.1	119.0	8.1%	119.0
Net interest	11.6	13.0	12.2%	13.0
EBT	98.5	106.0	7.6%	106.0
Tax	1.7	0.0		0.0
Underlying profit	96.9	106.0	9.4%	106.0
EPS - underlying profit (cps)	43.9	46.9	6.9%	46.9
2H dividend (cps)	7.2	7.7	6.7%	14.1
FY19 dividend (cps)	13.2	14.1	6.7%	15.1

Source: Forsyth Barr analysis

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 cashflow 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.

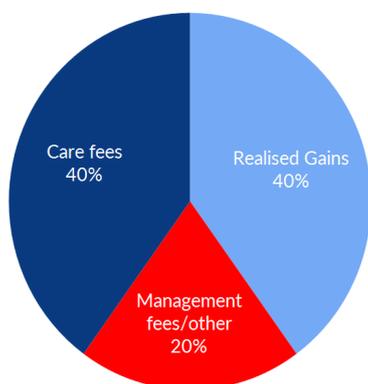
Financial structure

- **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.

Risk factors

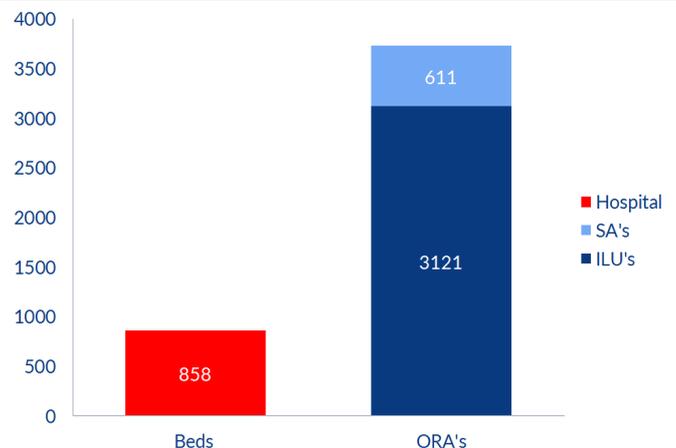
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term.
- **Housing market downturn:** A downturn in the buoyant housing conditions is a threat to SUM's resales volumes, cash flows, and gearing.

Figure 3. SUM FY18 revenue mix (NZ\$m)

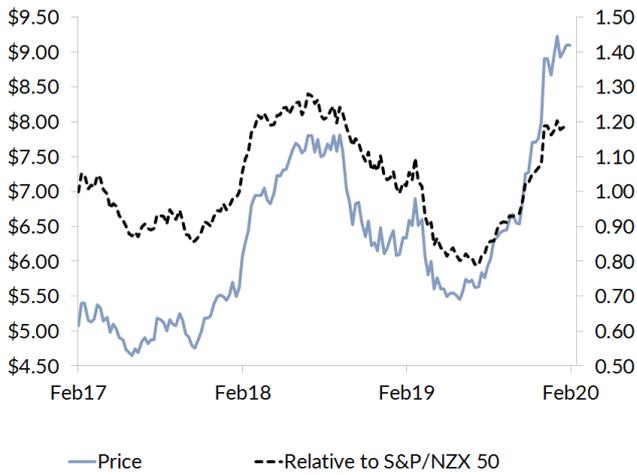


Source: Forsyth Barr analysis, Company Reports

Figure 4. SUM portfolio as at 31 December 2018



Source: Forsyth Barr analysis, Company Reports

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

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

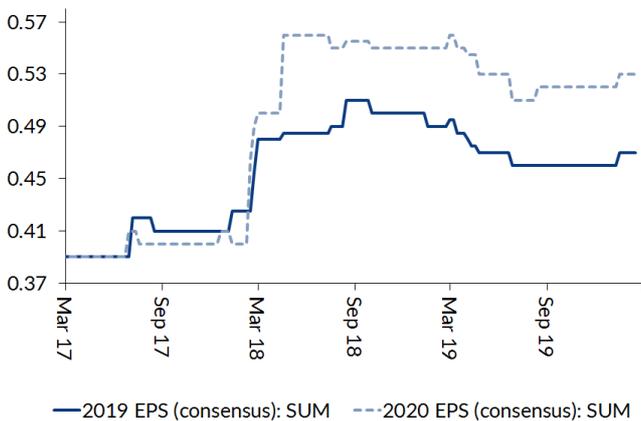
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

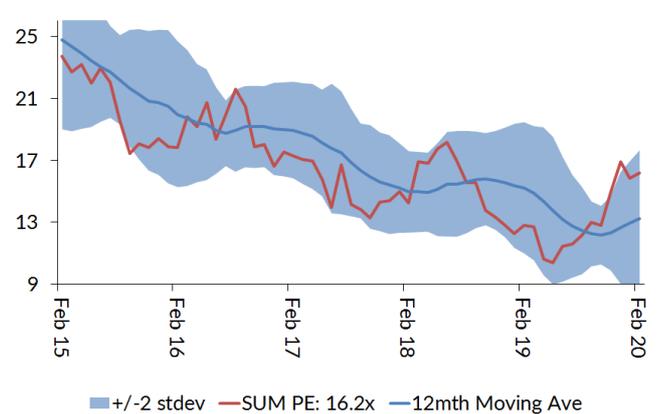
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2020E
				2019E	2020E	2019E	2020E	2019E	2020E	
Summerset Group	SUM NZ	NZ\$9.10	NZ\$2,054	19.4x	16.6x	19.9x	17.2x	21.0x	18.2x	1.8%
Metlifecare *	MET NZ	NZ\$6.93	NZ\$1,478	16.3x	15.7x	17.8x	17.1x	18.9x	18.2x	1.6%
Ryman Healthcare *	RYM NZ	NZ\$16.85	NZ\$8,425	33.5x	28.7x	32.6x	28.1x	35.8x	30.7x	1.7%
Oceania Healthcare *	OCA NZ	NZ\$1.23	NZ\$750	13.8x	12.5x	14.6x	13.2x	17.2x	15.5x	4.4%
Arvida Group Limited *	ARV NZ	NZ\$1.88	NZ\$1,019	18.1x	15.8x	19.2x	15.0x	21.2x	16.5x	3.5%
Compco Average:				20.4x	18.2x	21.0x	18.4x	23.3x	20.2x	2.8%
SUM Relative:				-5%	-9%	-6%	-6%	-10%	-10%	-36%

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 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: Jeremy Simpson. 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.

Ratings distributions: As at 17 Feb 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
31.4%	51.0%	17.6%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

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. 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. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the following issuers that are the subject of this publication: ARV MET PEB

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.

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 to you. 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. 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.