

Summerset Group

SUM Doing Better than Others

AARON IBBOTSON CFA

aaron.ibbotson@forsythbarr.co.nz
+64 9 368 0024

MATT MONTGOMERIE

matt.montgomerie@forsythbarr.co.nz
+64 9 368 0124

OUTPERFORM

Summerset (SUM) has provided FY20 underlying profit guidance for NZ\$96m to NZ\$98m, this excludes the NZ\$8.6m wage subsidy following its decision to repay it in light of strong recent performance and the positive outlook across the sector. This is a positive update and ahead of our prior expectations of NZ\$89.5m (excluding the wage subsidy). It has become increasingly clear that SUM has not only outperformed over the difficult COVID-19 first half of 2020, but that it has also emerged stronger than its peers. We retain the OUTPERFORM rating and increase our target price to NZ\$12.80.

NZX Code	SUM	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$11.20	NPAT* (NZ\$m)	106.2	97.1	126.5	153.1	PE	23.4	25.8	19.9	16.5
Target price	NZ\$12.80	EPS* (NZc)	47.9	43.3	56.2	68.1	EV/EBIT	23.9	25.9	20.7	17.3
Risk rating	Medium	EPS growth* (%)	7.9	-9.5	29.8	21.0	EV/EBITDA	22.5	24.0	19.3	16.2
Issued shares	224.9m	DPS (NZc)	14.1	14.2	16.0	20.0	Price / NTA	2.5	2.2	2.3	2.0
Market cap	NZ\$2,519m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.3	1.3	1.4	1.8
Avg daily turnover	321.3k (NZ\$2,439k)	*Based on normalised profits					Gross div yld (%)	1.7	1.8	2.0	2.5

What's changed?

- **Earnings:** FY20 underlying profit excluding wage subsidy increased by +8%, minimal changes thereafter
- **Target price:** Increased to NZ\$12.80 (from NZ\$11.90)

The COVID-19 half was challenging for all aged care operators, but SUM outperformed...

The COVID-19 lockdowns in the first half of 2020 severely impacted all the aged care operators earnings, but the impact appears to have been significantly less severe for SUM versus the other three operators. Different balance dates make comparisons imperfect, but working with what we have, we estimate that – excluding the wage subsidy and other government support – SUM delivered almost flat (-2%) annuity earnings in 1H20 (six months to June) vs pc. This compares to a ~-20% decline for Arvida (ARV) and Ryman (RYM) in the six months to September and Oceania (OCA) in the six months to May. The strong performance comes despite SUM's 1H20 including all the worst impacted months while ARV's and RYM's results exclude March and OCA's excludes June.

...and appear to be emerging stronger

Post the disruptions, SUM has reported very strong Q3 (September) new sales and re-sales and updated its full year underlying profit guidance, showcasing its superior performance emerging from the COVID-19 half relative to peers. Looking at the six months to September, SUM's re-sales and new sales were up 14% yoy, this compares to ARV and RYM (to September) down ~15–20%. Overall and underpinning our preference for SUM, we now estimate that SUM will report annuity EBITDA up +6.5% yoy in FY20 despite two months of lockdown and ~NZ\$5m of additional costs.

Why are we so focussed on annuity EBITDA?

Annuity EBITDA excludes new sales gains and is our best estimate of ongoing earnings power for the aged care operators, earnings which we believe the market ascribes a high multiple to. New sales gains are non-repeatable by nature, cash flow negative and inherently volatile; we consider it be more reminiscent of capex efficiency than earnings. SUM had unusually high new sales gains in FY19 driven by the delivery of premium sites in Auckland, and prior to COVID-19 had guided already towards a substantial decline in new sales gains in FY20. We expect this to be the case, albeit, expect new sales volumes to be materially higher in FY20.

Summerset Group Limited (SUM)

Priced as at 16 Dec 2020 (NZ\$) **11.20**

12-month target price (NZ\$)*	12.80
Expected share price return	14.3%
Net dividend yield	1.4%
Estimated 12-month return	15.7%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.84
WACC	5.7%
Terminal growth	2.0%

Spot valuations (NZ\$)	
1. EV/Annuity EBITDA	14.80
2. DDM	10.85
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)	2018A	2019A	2020E	2021E	2022E
Sales revenue	229.2	251.6	267.2	305.4	354.6
Normalised EBITDA	116.7	129.2	125.6	158.9	189.3
Depreciation and amortisation	(6.7)	(7.8)	(9.5)	(10.3)	(11.8)
Normalised EBIT	110.1	121.4	116.2	148.6	177.5
Net interest	(11.4)	(15.2)	(19.1)	(22.1)	(24.4)
Associate income	0	0	0	0	0
Tax	0	0	0	0	0
Minority interests	0	0	0	0	0
Normalised NPAT	98.6	106.2	97.1	126.5	153.1
Abnormals/other	115.9	69.1	(96.0)	50.9	38.5
Reported NPAT	214.5	175.3	1.1	177.4	191.6
Normalised EPS (cps)	44.4	47.9	43.3	56.2	68.1
DPS (cps)	13.2	14.1	14.2	16.0	20.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	23.1	9.8	6.2	14.3	16.1
EBITDA (%)	19.6	10.7	-2.8	26.5	19.1
EBIT (%)	18.4	10.3	-4.3	27.9	19.5
Normalised NPAT (%)	20.8	7.7	-8.6	30.3	21.0
Normalised EPS (%)	20.9	7.9	-9.5	29.8	21.0
Ordinary DPS (%)	20.0	6.8	0.7	12.7	25.0

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	116.7	129.2	125.6	158.9	189.3
Working capital change	29.8	54.3	62.7	7.9	1.4
Interest & tax paid	(11.4)	(15.2)	(19.1)	(22.1)	(24.4)
Other	82.6	69.6	106.6	190.9	225.6
Operating cash flow	217.8	237.9	275.8	335.7	391.8
Capital expenditure	(209.2)	(240.0)	(228.8)	(255.4)	(297.7)
(Acquisitions)/divestments	(54.7)	(57.3)	(60.0)	(65.0)	(70.0)
Other	75.4	106.1	95.6	51.4	50.3
Funding available/(required)	29.3	46.7	82.6	66.7	74.4
Dividends paid	(19.7)	(19.5)	(31.9)	(36.0)	(45.0)
Equity raised/(returned)	0	1.9	2.2	0	0
(Increase)/decrease in net debt	9.7	29.1	52.9	30.7	29.4

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(83.7)	(137.9)	(200.6)	(208.5)	(209.9)
Fixed assets	2,193.1	2,717.8	3,261.0	3,567.8	4,066.8
Intangibles	5.6	6.6	6.1	8.1	10.1
Right of use asset	0	0	0	0	0
Other assets	4.6	12.6	12.6	12.6	12.6
Total funds employed	2,119.6	2,599.1	3,079.2	3,380.0	3,879.6
Net debt/(cash)	339.7	431.3	544.1	660.5	735.6
Lease liability	0	0	10.5	10.5	10.5
Other liabilities	990.8	1,167.0	1,361.2	1,599.4	1,886.2
Shareholder's funds	789.1	1,000.8	1,163.4	1,109.6	1,247.4
Minority interests	0	0	0	0	0
Total funding sources	2,119.6	2,599.1	3,079.2	3,380.0	3,879.6

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

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	24.2	22.5	24.0	19.3	16.2
EV/EBIT (x)	25.6	23.9	25.9	20.7	17.3
PE (x)	25.3	23.4	25.8	19.9	16.5
Price/NTA (x)	3.2	2.5	2.2	2.3	2.0
Free cash flow yield (%)	0.3	-0.1	1.9	3.2	3.7
Net dividend yield (%)	1.2	1.3	1.3	1.4	1.8
Gross dividend yield (%)	1.6	1.7	1.8	2.0	2.5

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	9.6	8.0	6.1	6.7	7.3
Interest cover EBITDA (x)	10.2	8.5	6.6	7.2	7.8
Net debt/ND+E (%)	30.1	30.1	31.9	37.3	37.1
Net debt/EBITDA (x)	2.9	3.3	4.3	4.2	3.9

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.9	4.4	3.4	4.0	4.2
Return on equity (%)	12.5	10.6	8.3	11.4	12.3
Return on funds employed (%)	8.7	7.3	5.5	6.9	7.5
EBITDA margin (%)	50.9	51.4	47.0	52.0	53.4
EBIT margin (%)	48.0	48.2	43.5	48.7	50.1
Capex to sales (%)	91.3	95.4	85.6	83.6	83.9
Capex to depreciation (%)	3,129	3,064	2,419	2,469	2,524
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	30	29	33	28	29

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ\$m)					
Care fees	91.2	101.3	110.6	123.2	137.2
Management fees	45.6	52.5	60.7	70.8	82.1
Gain on resales	28.7	36.9	42.9	49.9	55.8
Gain on new sales	63.7	61.0	53.0	61.5	79.5
Total revenue	229.2	251.6	267.2	305.4	354.6

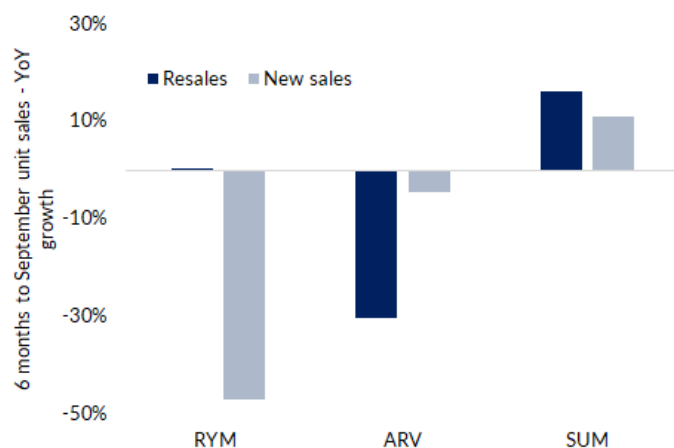
Key Drivers					
Sales - new units	339	329	390	435	500
Ave unit price - new sales (NZ\$000s)	566	665	618	643	662
Sales - resold units	301	323	382	417	448
Ave unit price - resales (NZ\$000s)	406	445	458	479	498
Gross development margin (%)	33.2%	27.9%	22.0%	22.0%	24.0%
Gross resales margin (%)	23.5%	25.7%	24.5%	25.0%	25.0%

New apartments/units	454	354	325	425	480
New beds	52	0	86	80	80
Total	506	354	411	505	560

Portfolio					
Apartments/units	3,732	4,086	4,411	4,846	5,346
Beds	858	858	944	1,024	1,104
Total Portfolio	4,590	4,944	5,355	5,870	6,450

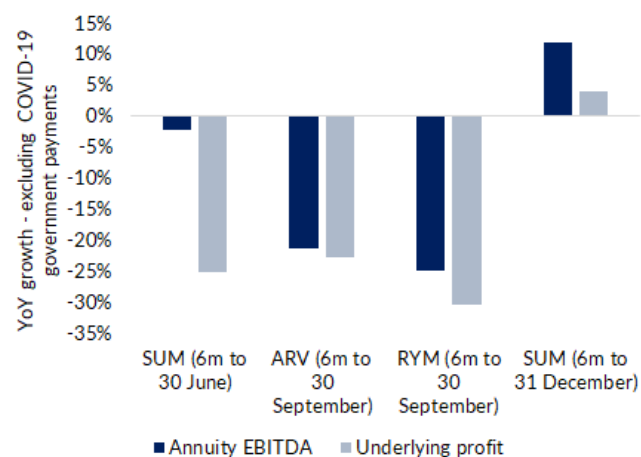
Figures of interest

Figure 1. SUM's sales have been strong in the past 6 months...



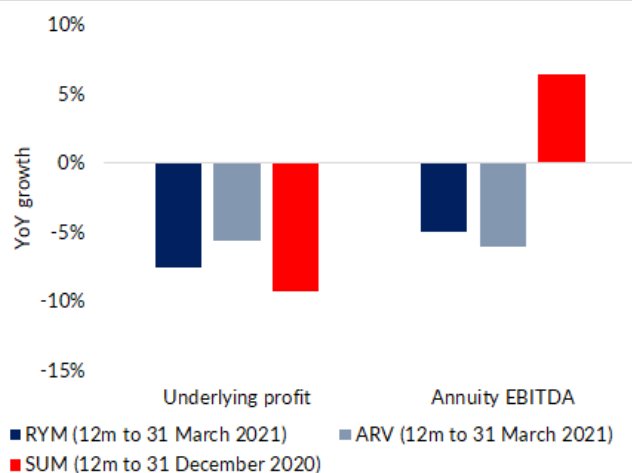
Source: Forsyth Barr analysis, Company reports

Figure 2. ...translating into strong financial performance



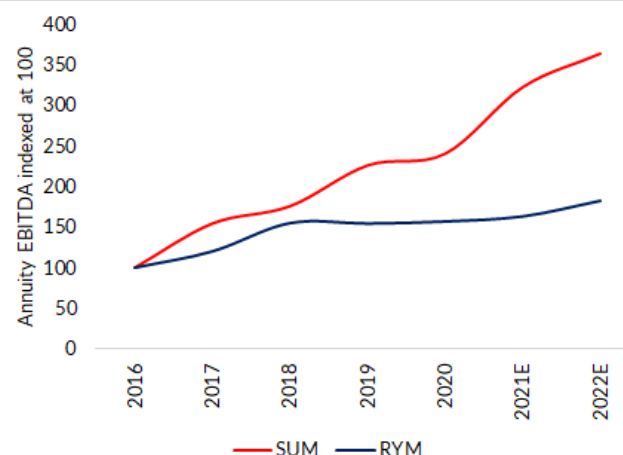
Source: Forsyth Barr analysis, Company reports

Figure 3. COVID-19 impacted comparative forecasts



Source: Forsyth Barr analysis, Company reports

Figure 4. SUM vs RYM annuity EBITDA

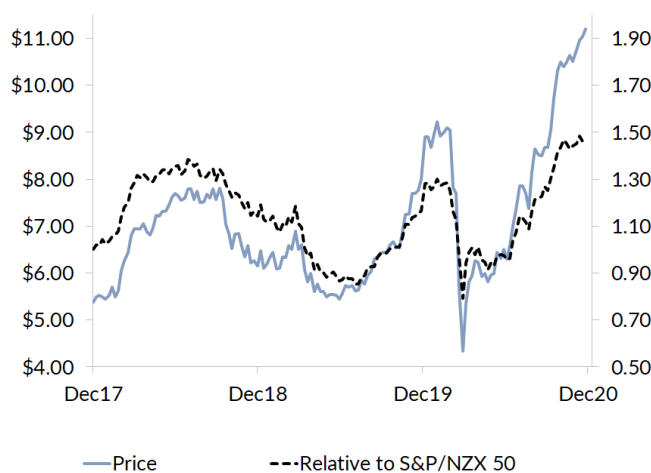


Source: Forsyth Barr analysis, Company reports

Figure 5. Forecast earnings changes (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Change	Old	New	Change	Old	New	Change
Total revenue	255.8	267.2	4%	301.1	305.4	1%	351.8	354.6	1%
Total costs	129.2	141.6	10%	142.5	146.4	3%	160.9	165.3	3%
EBITDA	126.6	125.6	-1%	158.6	158.9	0%	190.9	189.3	-1%
Depreciation & amortisation	9.5	9.5	0%	10.3	10.3	0%	11.8	11.8	0%
EBIT	117.2	116.2	-1%	148.3	148.6	0%	179.1	177.5	-1%
Net interest	19.1	19.1	0%	22.1	22.1	0%	24.4	24.4	0%
Underlying profit	98.1	97.1	-1%	126.2	126.5	0%	154.7	153.1	-1%
Annuity EBITDA	81.2	72.6	-11%	97.1	97.4	0%	111.5	109.8	-1%
Underlying profit excluding wage subsidy	89.5	97.1	8%						
Annuity EBITDA excluding wage subsidy	72.6	72.6	0%						
Sales — new units	350	390	11%	435	435	0%	500	500	0%
New sales margin (%)	21%	22%	1%	22%	22%	0%	24%	24%	0%
Sales — resold units	361	382	6%	393	417	6%	438	448	2%
Resales margin (%)	24.0%	24.5%	0.5%	25.0%	25.0%	0.0%	25.0%	25.0%	0.0%

Source: Forsyth Barr analysis, Company reports

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	8.3%
Fisher Funds Management	6.2%
Milford Asset Management	5.3%

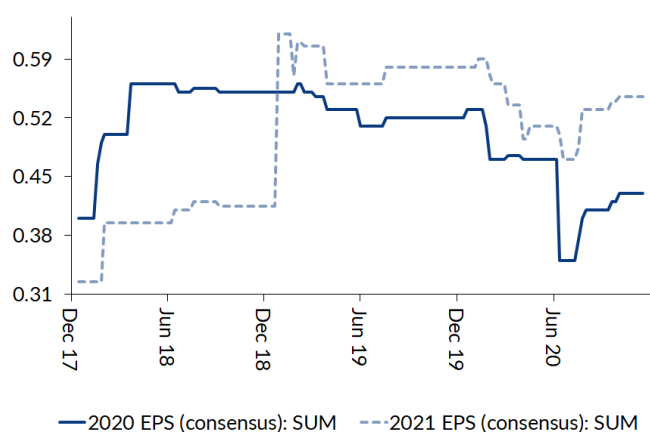
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

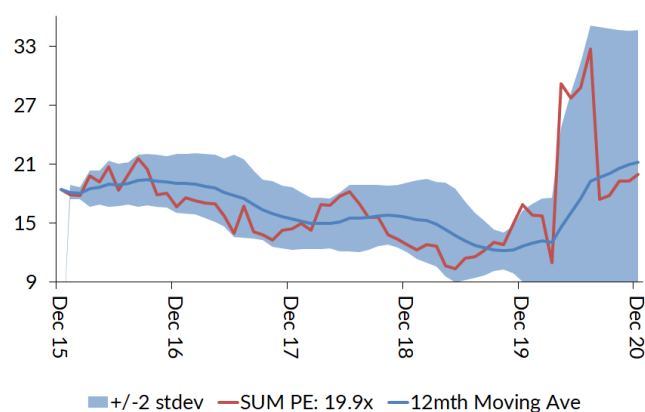
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SUM's balance date - December)										
Summerset Group Limited	SUM NZ	NZ\$11.20	NZ\$2,519	25.8x	19.9x	23.5x	18.6x	25.4x	19.9x	1.4%
METLIFECARE *	MET NZ	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
RYMAN HEALTHCARE *	RYM NZ	NZ\$15.00	NZ\$7,500	31.2x	26.3x	31.5x	26.6x	35.3x	29.8x	1.9%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.37	NZ\$854	18.2x	15.4x	17.0x	14.6x	21.8x	18.4x	3.1%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.62	NZ\$879	17.1x	14.2x	18.3x	15.6x	20.5x	17.4x	4.1%
Compco Average:				22.2x	18.6x	22.3x	18.9x	25.9x	21.8x	3.1%
SUM Relative:				17%	7%	5%	-2%	-2%	-9%	-53%

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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. 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: N/A. 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 15 Dec 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
42.6%	40.7%	16.7%

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 issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

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.