

Summerset Group

Travel and Arrival – Downgrade to NEUTRAL

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NEUTRAL

Summerset Group (SUM) reported a solid FY20 result, in-line with guidance. The forward messaging was confident with strong reported pre-sales and contracted stock levels, a combination supportive of growth into FY21. Specifically, management guided towards 500–550 unit deliveries in FY21, with potential to reach 600 units should the current buoyant market conditions remain. One area of weakness relative to our expectations were costs which came in +20% against the prior year, suggesting limited operating leverage. Looking ahead into FY21 and FY22 we increase our reported EBITDA and underlying earnings but reduce our annuity EBITDA estimates. The upgrades of reported earnings are almost exclusively related to new sales (not included in annuity EBITDA), while costs more than offset modest upgrades in re-sale margins. We keep our target price unchanged at NZ\$12.80 but downgrade to NEUTRAL following strong share price performance.

NZX Code	SUM	Financials: Dec/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$12.79	NPAT* (NZ\$m)	98.3	134.8	161.4	180.3	PE	29.2	21.4	17.9	16.0
Target price	NZ\$12.80	EPS* (NZc)	43.8	59.8	71.6	79.9	EV/EBIT	30.4	23.0	19.5	17.4
Risk rating	Medium	EPS growth* (%)	-8.4	36.4	19.7	11.7	EV/EBITDA	28.3	21.6	18.4	16.4
Issued shares	225.5m	DPS (NZc)	13.0	18.0	21.0	25.0	Price / NTA	2.6	2.1	1.9	1.8
Market cap	NZ\$2,884m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.0	1.4	1.6	2.0
Avg daily turnover	302.4k (NZ\$2,388k)	*Based on normalised profits					Gross div yld (%)	1.4	2.0	2.3	2.7

What's changed?

- **Earnings:** Annuity EBITDA decreased -7%/-4%/-2% in FY21/22/23 reflecting increased operating costs partly offset by higher re-sales margins. Reported underlying EBITDA increased by +2%/+2%/0% due to higher new sales gains
- **Rating:** Downgrade to NEUTRAL following recent strong share price performance and limited valuation upside

Many moving parts within costs, but lack of operating leverage a small fly in the ointment

FY20 included many moving parts – received and re-paid wage subsidy, COVID-19 excess costs and impairments to mention a few. On a gross reported basis 2H20 operating expenses were up +27% against the prior, on revenues up +11%. However, 2H20 costs included an impairment charge and COVID-19 related costs. Adjusting for this we arrive at underlying "like for like" growth of ~+13%, largely in-line with revenues. We had expected slightly higher underlying operating leverage, particularly because a substantial proportion of the growth relates to re-sale gains which do not carry meaningful direct costs.

Valuation fair and strong recent performance; downgrade to NEUTRAL

We view SUM as a long term structurally attractive stock. It has the best long term growth prospects in the sector driven by sector leading cash recovery of capex, a large and diversified land bank, and a high proportion of immature villages. However, at ~35x 24 months forward EV/annuity EBITDA we consider it fairly valued. SUM is moving into a phase with new villages opening, driving costs up at a similar or greater pace than revenue, creating flat to declining EBITDA margins. We view a further re-rating as unlikely in the medium term.

Summerset Group Limited (SUM)

Priced as at 23 Feb 2021 (NZ\$)

12.79

12-month target price (NZ\$)*

12.80

Expected share price return

0.1%

Net dividend yield

1.4%

Estimated 12-month return

1.5%

Spot valuations (NZ\$)

1. EV/Annuity EBITDA

13.70

2. DDM

11.85

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.30%

Equity beta

0.84

WACC

6.1%

Terminal growth

2.0%

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	251.6	266.7	323.5	375.2	421.5
Normalised EBITDA	129.2	119.9	162.6	193.3	216.9
Depreciation and amortisation	(7.8)	(8.1)	(9.5)	(10.9)	(12.4)
Normalised EBIT	121.4	111.8	153.0	182.4	204.5
Net interest	(15.2)	(13.4)	(18.2)	(21.0)	(24.2)
Associate income	0	0	0	0	0
Tax	0	0	0	0	0
Minority interests	0	0	0	0	0
Normalised NPAT	106.2	98.3	134.8	161.4	180.3
Abnormals/other	69.1	132.5	42.7	29.1	20.2
Reported NPAT	175.3	230.8	177.6	190.5	200.4
Normalised EPS (cps)	47.9	43.8	59.8	71.6	79.9
DPS (cps)	14.1	13.0	18.0	21.0	25.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	9.8	6.0	21.3	16.0	12.3
EBITDA (%)	10.7	-7.2	35.6	18.9	12.2
EBIT (%)	10.3	-7.9	36.9	19.2	12.1
Normalised NPAT (%)	7.7	-7.4	37.1	19.7	11.7
Normalised EPS (%)	7.9	-8.4	36.4	19.7	11.7
Ordinary DPS (%)	6.8	-7.8	38.5	16.7	19.0

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	129.2	119.9	162.6	193.3	216.9
Working capital change	54.3	62.7	54.8	(2.6)	1.2
Interest & tax paid	(15.2)	(13.4)	(18.2)	(21.0)	(24.2)
Other	69.6	97.8	172.0	252.4	259.8
Operating cash flow	237.9	266.8	371.1	422.2	453.6
Capital expenditure	(240.0)	(237.4)	(282.8)	(337.9)	(349.5)
(Acquisitions)/divestments	(57.3)	(44.4)	(65.0)	(70.0)	(70.0)
Other	106.1	38.0	52.6	50.2	69.0
Funding available/(required)	46.7	23.0	76.0	64.4	103.2
Dividends paid	(19.5)	(19.4)	(40.6)	(47.4)	(56.4)
Equity raised/(returned)	1.9	2.2	4.2	0	0
(Increase)/decrease in net debt	29.1	5.9	39.6	17.1	46.8

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(137.9)	(200.6)	(255.4)	(252.8)	(254.0)
Fixed assets	2,717.8	3,261.0	3,819.9	4,353.9	4,959.4
Intangibles	6.6	6.1	5.7	7.7	9.7
Right of use asset	0	0	0	0	0
Other assets	12.6	18.4	18.4	18.4	18.4
Total funds employed	2,599.1	3,085.0	3,588.6	4,127.2	4,733.5
Net debt/(cash)	431.3	581.3	654.1	738.0	795.4
Lease liability	0	10.5	11.2	11.2	11.2
Other liabilities	1,167.0	1,361.2	1,551.3	1,890.2	2,269.3
Shareholder's funds	1,000.8	1,132.0	1,372.1	1,487.9	1,657.6
Minority interests	0	0	0	0	0
Total funding sources	2,599.1	3,085.0	3,588.6	4,127.2	4,733.5

* 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)	25.3	28.3	21.6	18.4	16.4
EV/EBIT (x)	26.9	30.4	23.0	19.5	17.4
PE (x)	26.7	29.2	21.4	17.9	16.0
Price/NTA (x)	2.9	2.6	2.1	1.9	1.8
Free cash flow yield (%)	-0.1	1.0	3.1	2.9	3.6
Net dividend yield (%)	1.1	1.0	1.4	1.6	2.0
Gross dividend yield (%)	1.5	1.4	2.0	2.3	2.7

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	8.0	8.3	8.4	8.7	8.4
Interest cover EBITDA (x)	8.5	8.9	8.9	9.2	9.0
Net debt/ND+E (%)	30.1	33.9	32.3	33.2	32.4
Net debt/EBITDA (x)	3.3	4.8	4.0	3.8	3.7

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	4.4	3.3	3.9	4.1	4.0
Return on equity (%)	10.6	8.7	9.8	10.9	10.9
Return on funds employed (%)	7.3	5.7	6.5	7.2	7.2
EBITDA margin (%)	51.4	44.9	50.2	51.5	51.5
EBIT margin (%)	48.2	41.9	47.3	48.6	48.5
Capex to sales (%)	95.4	89.0	87.4	90.1	82.9
Capex to depreciation (%)	3,064	2,933	2,961	3,105	2,819
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	29	30	30	29	31

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)					
Care fees	101.3	111.6	124.8	138.6	152.4
Deferred management fees	52.5	60.8	71.0	85.0	100.0
Gain on resales	36.9	46.1	56.1	63.4	70.5
Gain on new sales	61.0	48.2	71.6	88.1	98.6
Total revenue	251.6	266.7	323.5	375.2	421.5

Key Drivers	2019A	2020A	2021E	2022E	2023E
Sales - new units	329	404	525	575	600
Ave unit price - new sales (NZ\$000s)	665	607	620	638	657
Sales - resold units	323	381	423	472	525
Ave unit price - resales (NZ\$000s)	445	464	492	516	537
Gross development margin (%)	28%	20%	22%	24%	25%
Gross resales margin (%)	26%	26%	27%	26%	25%

Portfolio	2019A	2020A	2021E	2022E	2023E
Apartments/units	4,086	4,435	4,960	5,535	6,135
Beds	858	922	992	1,072	1,152
Total Portfolio	4,944	5,357	5,952	6,607	7,287

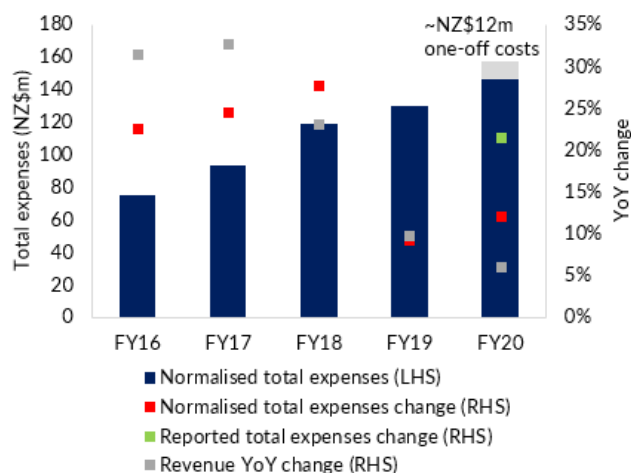
Earnings changes and charts of interest

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

	FY21E			FY22E			FY23E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care fees	123.2	124.8	1%	137.2	138.6	1%	150.5	152.4	1%
DMF	71.1	71.0	0%	82.4	85.0	3%	95.9	100.0	4%
Resale gains	49.9	56.1	13%	55.8	63.4	14%	59.8	70.5	18%
New sales gains	61.5	71.6	16%	79.5	88.1	11%	97.2	98.6	1%
Total revenue	305.7	323.5	6%	354.9	375.2	6%	403.3	421.5	5%
Total costs	146.4	161.0	10%	165.3	181.9	10%	185.9	204.6	10%
EBITDA	159.3	162.6	2%	189.6	193.3	2%	217.5	216.9	0%
Depreciation & amortisation	10.3	9.5	-8%	11.8	10.9	-8%	13.4	12.4	-8%
EBIT	148.9	153.0	3%	177.8	182.4	3%	204.1	204.5	0%
Net interest	22.1	18.2	-18%	24.4	21.0	-14%	27.0	24.2	-10%
Underlying profit	126.8	134.8	6%	153.4	161.4	5%	177.0	180.3	2%
Annuity EBITDA	97.7	91.0	-7%	110.1	105.2	-4%	120.3	118.3	-2%
DPS (cents)	16.0	18.0	13%	20.0	21.0	5%	25.0	25.0	0%

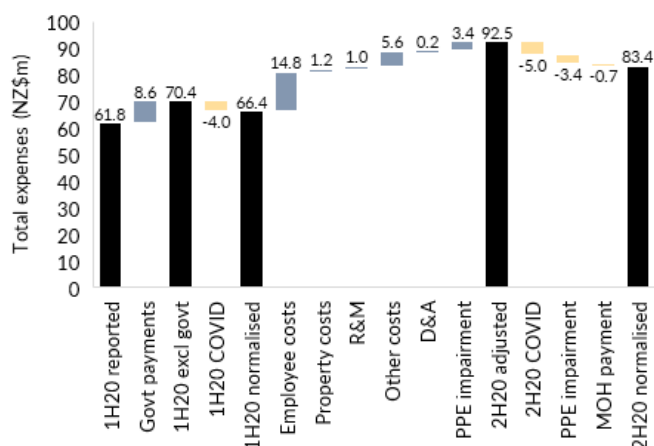
Source: Forsyth Barr analysis

Figure 2. Short term COVID-19 impact on costs...



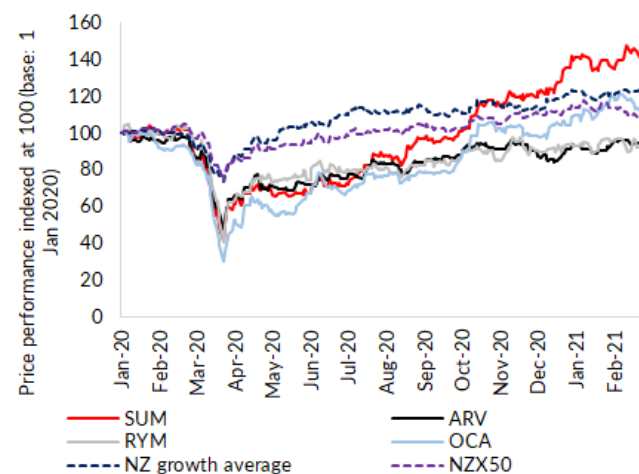
Source: Forsyth Barr analysis, Company reports

Figure 3. ...with a number of moving parts



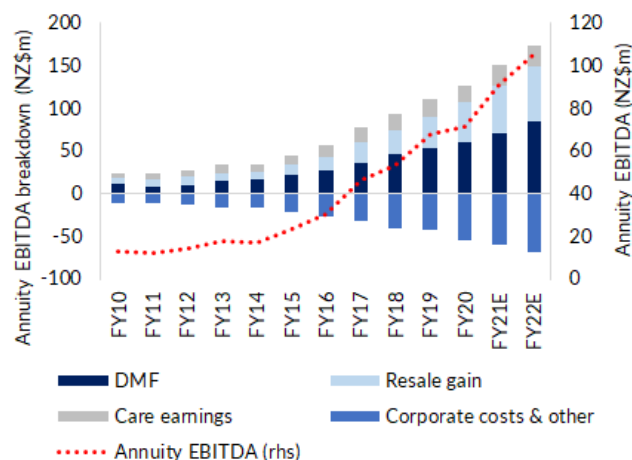
Source: Forsyth Barr analysis, Company reports

Figure 4. SUM has outperformed over the past 12 months

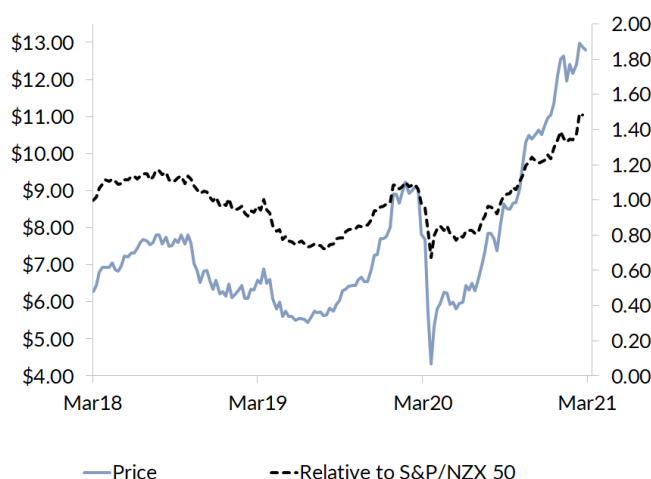


Source: Forsyth Barr analysis, Thomson Reuters

Figure 5. Annuity EBITDA run rate remaining strong



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%

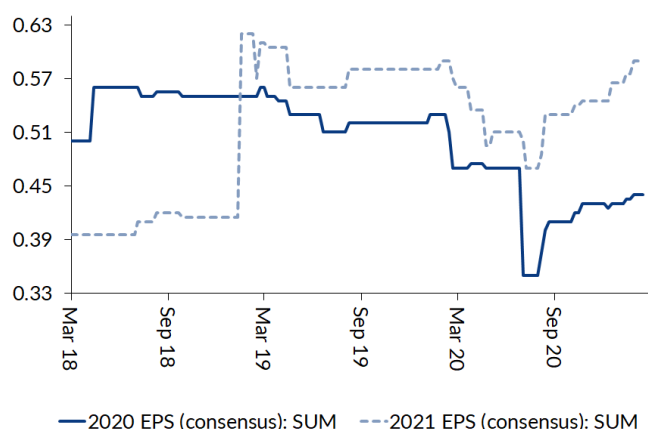
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

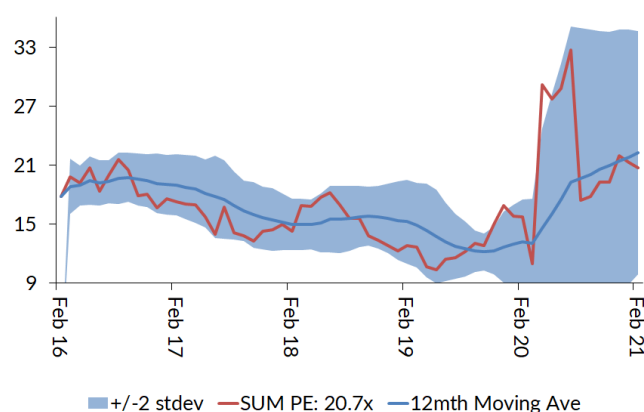
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect SUM's balance date - December)										
Summerset Group Limited	SUM NZ	NZ\$12.79	NZ\$2,884	21.4x	17.9x	21.3x	17.9x	22.6x	19.0x	1.6%
RYMAN HEALTHCARE *	RYM NZ	NZ\$15.05	NZ\$7,525	26.4x	22.9x	26.7x	23.3x	29.8x	26.0x	2.2%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$1.48	NZ\$922	16.4x	13.9x	15.3x	13.4x	19.3x	16.6x	3.2%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.81	NZ\$982	15.9x	13.3x	16.9x	14.5x	18.9x	16.1x	4.1%
Compco Average:				19.5x	16.7x	19.6x	17.0x	22.7x	19.6x	3.2%
SUM Relative:				9%	7%	9%	5%	-0%	-3%	-48%

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

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