

Oceania Healthcare

FY20 Result – Calmer Waters

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NEUTRAL

Oceania Healthcare (OCA) reported FY20 EBITDA of NZ\$63.4m flat on FY19, slightly ahead of our estimates of NZ\$61.7m despite NZ\$4m of net COVID-19 costs. Underlying profits (NZ\$42.9m, -16% pcp) came in NZ\$4m below our expectations driven by higher finance and depreciation. NTA per share declined by 4cps (to NZ\$0.99 from NZ\$1.03). We believe the decline in NTA dominated the share price reaction on the day, but we walk away encouraged by OCA's progress. Specifically we note three positive signs; (1) Care Occupational Rights Agreement (ORA) sales of 114 units compares to total delivered Care Suites of 137, suggesting >80% of Care Suites were being sold as ORA at delivery; (2) OCA's development operations are progressing towards cash positive. Total capex of NZ\$136m for FY20 compares to new sales of NZ\$103m, c. NZ\$10–15m of increased unsold stock and c. NZ\$50m of increased work in progress; and (3) allowing for significant de-commissions, a decline of c. -6% in beds, we estimate that care fees per bed, excluding DMF, was up +6% from FY19.

NZX Code	OCA	Financials: May/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.99	NPAT* (NZ\$m)	42.8	47.9	58.0	65.8	EV/EBITDA	14.0	13.2	11.5	10.4
Target price	NZ\$1.10	EPS* (NZc)	7.0	7.7	9.4	10.6	EV/EBIT	18.2	16.9	14.5	12.9
Risk rating	Medium	EPS growth* (%)	-15.1	11.1	21.2	13.5	PE	14.2	12.8	10.5	9.3
Issued shares	618.1m	DPS (NZc)	3.5	4.0	4.6	5.0	Price / NTA	1.1	1.1	1.0	1.0
Market cap	NZ\$612m	Imputation (%)	0	0	0	0	Cash div yld (%)	3.5	4.0	4.6	5.1
Avg daily turnover	2,434k (NZ\$2,484k)	*Based on normalised profits					Gross div yld (%)	3.5	4.0	4.6	5.1

Cash in Cash out? – The proof is in the net debt pudding

The aged care sector's attraction, to a large extent, relies on its unique funding structure, or ability to recycle capital; effectively building an annuity stream with no invested capital. Over the last few years this recycling has been more difficult than historically to observe; new sales have been far from covering extensive capex program and net debt has built up across the sector. One key reason for this is larger, and hence longer to monetise, developments. However, higher costs to build care and common facilities which are not sold under ORA may also have been a contributing factor. In this context, we believe care ORA's will be a more common feature going forward and see OCA as the pioneer for this approach in NZ; their success or not may have material implications for the sector.

Monetising care – the key to stem the net debt build up?

OCA has, like its bigger peers, also seen net debt build and gearing has increased from 22% in FY18 to 34% today. Looking at OCA's FY20 numbers in more detail suggests that we could be nearing an inflection point. OCA's new sales value of c. NZ\$100m, against which they spent NZ\$136m in capex, driving the majority of the increase in net debt. Looking at "uses" of capex, however, we estimate that inventory of un-sold units increased by NZ\$10m–NZ\$15m, in addition to which OCA reported an increase in properties under development of c. NZ\$50m. Adding these numbers up yields a net surplus of c. NZ\$30m, giving credibility to OCA's reported development margin of NZ\$34m. We view these results as encouraging for OCA's ability to deliver neutral or even positive free cash flow from expansionary development, however, the proof remains in the net debt pudding, for now.

Near term numbers up as COVID-19 fades into the background.

We increase our FY21/FY22 EBITDA by 32%/20% due to increased sales, re-sales and lower costs. Our underlying profit increases by 24%/10%, due to increased depreciation. We expect development margins to fall from 33%(FY20) to 22% (FY22). Our 12m forward DCF price target increases by 2cps, as increased near term earnings are somewhat offset by slightly lower FY23 onwards earnings.

Oceania Healthcare Limited (OCA)

Priced as at 23 Jul 2020 (NZ\$)

0.99
12-month target price (NZ\$)*
1.10

Expected share price return	11.4%
Net dividend yield	4.1%
Estimated 12-month return	15.6%

Spot valuations (NZ\$)

1. DCF	1.10
2. n/a	n/a
3. n/a	n/a

Key WACC assumptions

Risk free rate	2.00%
Equity beta	0.88
WACC	7.4%
Terminal growth	1.5%

DCF valuation summary (NZ\$m)

Total firm value	936
(Net debt)/cash	(308)
Less: Capitalised operating leases	n/a
Value of equity	628

Profit and Loss Account (NZ\$m)

	2019A	2020A	2021E	2022E	2023E
Sales revenue	233.5	242.0	253.9	276.8	297.5
Normalised EBITDA	63.2	63.4	71.3	83.2	92.3
Depreciation and amortisation	(9.5)	(14.5)	(15.7)	(17.0)	(18.2)
Normalised EBIT	53.6	49.0	55.6	66.3	74.1
Net interest	(3.5)	(6.2)	(7.7)	(8.3)	(8.3)
Associate income	0	0	0	0	0
Tax	0	0	0	0	0
Minority interests	0	0	0	0	0
Normalised NPAT	50.1	42.8	47.9	58.0	65.8
Abnormals/other	(4.8)	(56.5)	(1.3)	(2.6)	(5.5)
Reported NPAT	45.4	(13.6)	46.6	55.4	60.3
Normalised EPS (cps)	8.2	7.0	7.7	9.4	10.6
DPS (cps)	4.7	3.5	4.0	4.6	5.0

Growth Rates

	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.2	3.7	4.9	9.0	7.5
EBITDA (%)	-0.9	0.5	12.3	16.8	10.9
EBIT (%)	-2.3	-8.6	13.5	19.2	11.8
Normalised NPAT (%)	-3.8	-14.5	11.8	21.2	13.5
Normalised EPS (%)	-3.8	-15.1	11.1	21.2	13.5
Ordinary DPS (%)	0.0	-25.5	14.3	15.0	8.7

Cash Flow (NZ\$m)

	2019A	2020A	2021E	2022E	2023E
EBITDA	63.2	63.4	71.3	83.2	92.3
Working capital change	(1.8)	(1.7)	1.1	0.9	1.0
Interest & tax paid	(3.5)	(6.2)	(7.7)	(8.3)	(8.3)
Other	37.0	43.8	61.9	93.3	96.6
Operating cash flow	94.8	99.4	126.6	169.1	181.7
Capital expenditure	(153.8)	(136.0)	(140.0)	(140.0)	(150.0)
(Acquisitions)/divestments	0	0	0	0	0
Other	0.0	(3.2)	0	(0.0)	0
Funding available/(required)	(59.0)	(39.8)	(13.4)	29.1	31.7
Dividends paid	(28.4)	(22.2)	(24.7)	(28.4)	(30.9)
Equity raised/(returned)	1.3	0	0	0	0
(Increase)/decrease in net debt	(86.1)	(62.0)	(38.2)	0.7	0.8

Balance Sheet (NZ\$m)

	2019A	2020A	2021E	2022E	2023E
Working capital	5.0	6.8	8.5	7.4	6.5
Fixed assets	1,324.4	1,437.8	1,607.1	1,780.2	1,961.9
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	1,626.5	1,798.4	1,979.3
Net debt/(cash)	247.4	307.8	346.0	345.3	344.5
Lease liability	0	13.0	13.0	13.0	13.0
Other liabilities	480.8	580.2	691.2	836.8	989.1
Shareholder's funds	609.9	554.4	576.2	603.2	632.7
Minority interests	0	0	0	0	0
Total funding sources	1,338.0	1,455.4	1,626.5	1,798.4	1,979.3

* 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)	12.8	14.0	13.2	11.5	10.4
EV/EBIT (x)	15.1	18.2	16.9	14.5	12.9
PE (x)	12.1	14.2	12.8	10.5	9.3
Price/NTA (x)	1.0	1.1	1.1	1.0	1.0
Free cash flow yield (%)	40.6	38.5	43.6	50.5	54.2
Net dividend yield (%)	4.7	3.5	4.0	4.6	5.1
Gross dividend yield (%)	4.7	3.5	4.0	4.6	5.1

Capital Structure

	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	15.3	8.0	7.2	8.0	9.0
Interest cover EBITDA (x)	18.1	10.3	9.2	10.1	11.2
Net debt/ND+E (%)	28.9	35.7	37.5	36.4	35.3
Net debt/EBITDA (x)	3.9	4.9	4.9	4.1	3.7

Key Ratios

	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	3.8	3.2	3.3	3.5	3.6
Return on equity (%)	8.2	7.7	8.3	9.6	10.4
Return on funds employed (%)	5.7	4.9	5.0	5.9	6.5
EBITDA margin (%)	27.0	26.2	28.1	30.1	31.0
EBIT margin (%)	23.0	20.2	21.9	23.9	24.9
Capex to sales (%)	65.9	56.2	55.1	50.6	50.4
Capex to depreciation (%)	1,611	941	893	825	822
Imputation (%)	0	0	0	0	0
Pay-out ratio (%)	57	50	52	49	47

Operating Performance

	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)*					
Care fees	156.6	156.4	159.8	168.1	174.3
Management fees	22.3	29.2	37.0	44.9	56.1
Other	10.4	10.6	10.8	11.2	11.6
Gain on resales	15.1	11.5	14.7	18.3	22.7
Gain on new sales	29.2	34.3	31.6	34.3	32.8
Total revenue	233.5	242.0	253.9	276.8	297.5

Key Drivers

Sales - new units	133	189	225	255	270
Sales - resold units	610	548	540	611	608
Gross development margin	36%	33%	26%	22%	20%
Gross resales margin	25%	20%	18%	18%	18%
Average new sales price (NZ\$000)	610	548	540	611	608
Average resles price (NZ\$000)	348	354	386	399	410

Portfolio Overview

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	251	241	235
Care Beds	2,112	1,882	1,832	1,732	1,632
Total	3,856	3,846	4,033	4,178	4,342

FY20 result summary

Figure 1. FY20 result summary (NZ\$m)

Year ending 31 May	FY19	FY20	Change	Forbar	Actual vs Forbar
Revenue					
Care Fees	156.6	156.4	0%	168.9	-7%
Care DMF	5.1	7.8	53%	7.4	5%
Village DMF	17.2	21.4	24%	21.0	2%
Village Fees	9.2	9.4	3%	9.7	-3%
Resale Gains	15.1	11.5	-24%	14	-18%
New sale Gains	29.2	34.3	17%	27.5	25%
Other	1.2	1.2	2%	1.5	-20%
Total revenue	233.5	242.0	4%	250.8	-3%
Total costs	170.3	178.6	5%	189.1	-6%
EBITDA	63.2	63.4	0%	61.7	3%
Depreciation & Amortisation	9.5	14.5	51%	11.1	31%
EBIT	53.6	49.0	-9%	50.6	-3%
Net interest	3.5	6.2	76%	3.9	58%
Underlying profit	50.1	42.8	-15%	46.7	-8%
EPS (cents)	8.2	6.9	-16%	7.7	-10%
DPS (cents)	4.7	3.3	-30%	4.2	-21%

Source: Forsyth Barr analysis, Company reports

Figure 2. Forecast changes (NZ\$m)

	2021E			2022E			2023E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	253.3	253.9	0.2%	276.7	276.8	0.0%	316.8	297.5	-6.1%
EBITDA	54.2	71.3	31.5%	69.3	83.2	20.1%	100.6	92.3	-8.2%
Underlying profit	38.8	47.9	23.5%	52.8	58.0	9.9%	82.1	65.8	-19.8%
EPS (cps)	6.4	7.7	21.9%	8.6	9.4	8.5%	13.4	10.6	-20.5%
DPS (cps)	3.5	4.0	14.4%	4.8	4.6	-3.3%	7.4	5.0	-32.4%

Source: Forsyth Barr analysis, Company reports

Figure 3. Development pipeline – FY21 guidance of 217 units

Site	Stages	ILU's	Care Suites	Gross Units	Decomission	Net Units	Due for completion
Meadowbank, Auckland	Stage 6	0	36	36	0	36	
Awatere, Hamilton	Stage 2	63	0	63	0	63	
	Stage 3	71	0	71	106	(35)	
Green Gables, Nelson		28	61	89	0	89	1H21
The BayView, Tauranga	Stage 2a	35	0	35	0	35	2H21
	Stages 2b	39	0	39	0	39	FY22
	Stages 3-5	137	0	137	5	132	
The Bellevue, Christchurch	Stage 1	22	71	93	0	93	2H21
	Stage 2	46	0	46	17	29	
Eden, Auckland		49	0	49	0	49	FY22
Lady Allum, Auckland	Stage 1	0	113	113	130	(17)	
	Stage 2-3	137	0	137	0	137	
Gracelands	Stage 3	18	0	18	0	18	
Eversley, Hastings		0	61	61	6	55	
Whitianga	Stage 2	8	0	8	0	8	
Elmwood, Auckland	Stage 1	0	100	100	30	70	
	Stage 2-3	229	0	229	96	133	
Waimarie Street, Auckland		76	32	108	0	108	
Other sites - consented		42	124	166	72	94	
Total consented/under construction		1,000	598	1,598	462	1,136	
Elmwood, Auckland	Stage 4	81	0	81	11	70	
Other sites - planned		77	95	172	46	126	
Total development pipeline		1,158	693	1,851	519	1,332	

Source: Forsyth Barr analysis, Company reports

Investment Summary

Oceania Healthcare (OCA) provides exposure to the strong industry dynamics in the retirement and aged care sectors. OCA has future growth prospects centred on brownfield expansion, land bank acquisitions and improving occupancy in its aged care business. Compared to its peers, it has an older and diverse portfolio mix which provides some challenges and opportunities. Our rating is NEUTRAL.

Business quality

- **Positive demographic trends:** OCA is benefiting from both the ageing population and growing popularity of retirement village living.
- **An integrated model:** Villages with care provide a resilient earnings base backed by government funding, as well as attracting older residents.

Earnings and cashflow outlook

- **New developments are critical to growth:** The timely development and sell down of significant new developments The Sands and Meadowbank and filling its new care facility at The Bay View, Tauranga and Awatere, Hamilton.
- **Acquisition strategy:** OCA is looking to acquire additional land, dependent on opportunity and fit within the current portfolio, in order to enhance its earnings and its significant brownfield development pipeline.
- **Brownfield development:** OCA has ~1,600 units and beds consented/under construction in its pipeline; this includes approximately 550 currently underway.
- **Defensive income streams:** OCA has a strong focus on continuum of care with ~70% of its portfolio needs based. Care fees are supported by government subsidies.

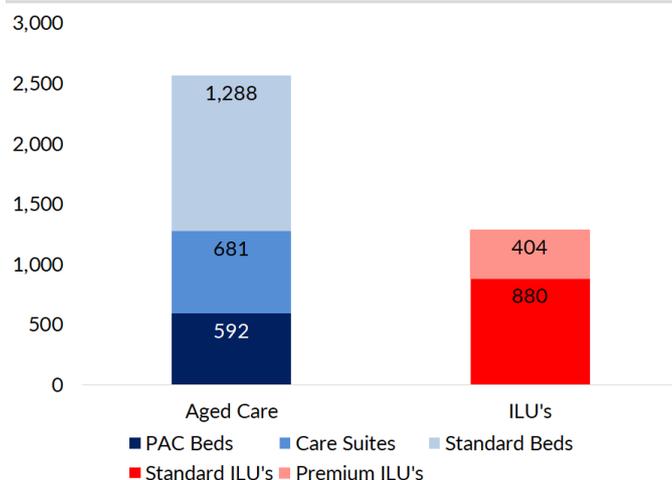
Financial structure

- **Balance sheet and dividends:** OCA's gearing is ~34% and is essentially all development related debt. It has a dividend pay-out rate of ~50%.

Risk factors

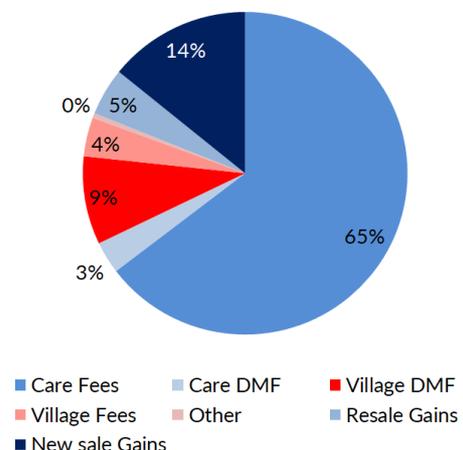
- **Care occupancy:** Competition with quality beds and a focus on home-based support are providing headwinds for near-term occupancy. OCA's 94% occupancy is below listed peers, which reflects its older portfolio.
- **Oversupply of retirement units:** The significant industry retirement unit development pipeline poses the threat of a potential short term oversupply in some areas, although with a very weak near-term economy this risk has reduced. This is offset by a likely shortage of quality beds.
- **Prolonged housing slowdown:** An expected economic recession will put pressure on the housing market which can be negative for investor sentiment towards the retirement sector. OCA's needs based product is a mitigating factor.

Figure 4. OCA portfolio as at 31 May 2020

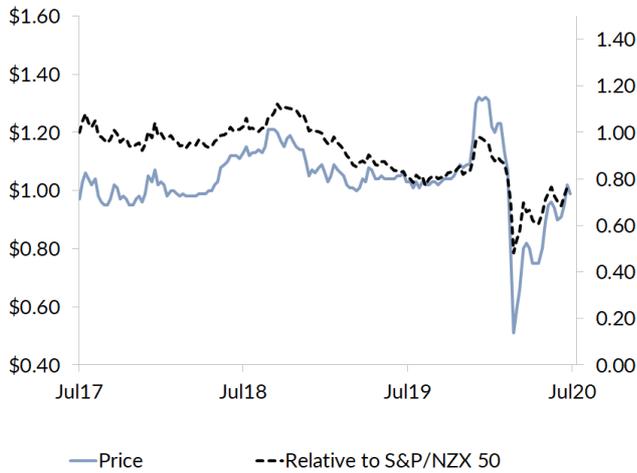


Source: Forsyth Barr analysis, Company reports

Figure 5. FY20 revenue mix



Source: Forsyth Barr analysis, Company reports

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	8.5%
Harbour Asset Management & Jarden Securities Limited	5.3%
ACC	5.1%

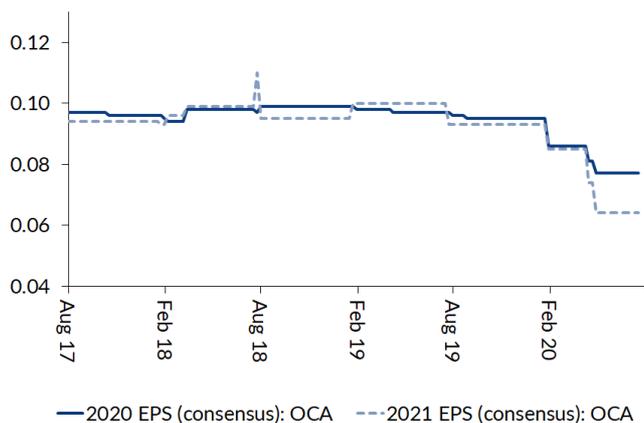
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

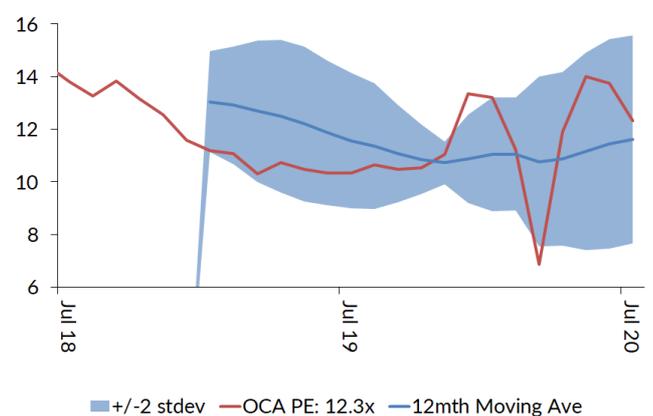
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				2021E	2022E	2021E	2022E	2021E	2022E	
Oceania Healthcare Limited	OCA NZ	NZ\$0.99	NZ\$612	12.8x	10.5x	12.9x	11.0x	16.5x	13.9x	4.6%
RYMAN HEALTHCARE *	RYM NZ	NZ\$13.50	NZ\$6,750	27.2x	21.5x	27.8x	22.6x	30.8x	24.7x	2.1%
METLIFECARE *	MET NZ	NZ\$5.91	NZ\$1,261	18.0x	15.0x	19.6x	16.5x	21.2x	17.8x	1.3%
SUMMERSET GROUP *	SUM NZ	NZ\$7.97	NZ\$1,817	38.3x	22.8x	32.7x	22.1x	36.8x	24.1x	1.5%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.67	NZ\$906	20.5x	15.5x	20.1x	15.7x	23.6x	18.0x	3.6%
Compcpo Average:				26.0x	18.7x	25.0x	19.2x	28.1x	21.1x	2.1%
OCA Relative:				-51%	-44%	-48%	-43%	-41%	-34%	118%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcpo 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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