FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | AGED CARE | RETIREMENT & CARE OPERATOR

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Ryman Healthcare
Upgrade to OUTPERFORM

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OUTPERFORM

The recent significant pull back in the RYM share price is an opportunity to buy the market leader and a business that remains very well placed for medium to long term growth, given its needs based portfolio and development expertise. Upgrade to OUTPERFORM. Consistent with our sector view, we have reduced near-term earnings based on a scenario that assumes very soft conditions for sales of retirement units over the next six months, and no development activity, then a recovery over the following 18 to 24 months given the significant uncertainties that exist.

NZX Code	RYM
Share price	NZ$10.67
Target price	NZ$13.80
Risk rating	Medium
Issued shares	500.0m
Market cap	NZ$5,335m
Avg daily turnover	524.3k (NZ$6,760k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	227.0	241.5	155.6	236.3
EPS* (NZc)	45.4	48.3	31.1	47.3
EPS growth* (%)	11.5	6.4	-35.6	51.9
DPS (NZc)	22.7	24.1	15.6	23.6
Imputation (%)	0	0	0	0

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	24.3	23.1	32.8	23.2
EV/EBIT	26.6	25.5	37.9	25.8
PE	23.5	22.1	34.3	22.6
Price / NTA	2.5	2.4	2.3	2.2
Cash div yld (%)	2.1	2.3	1.5	2.2
Gross div yld (%)	2.1	2.3	1.5	2.2

Upgraded to OUTPERFORM

While the outlook for operators is likely to continue to contain a number of uncertainties, we remain positive about the long term business case for RYM. While it is still trading at a significant premium to the sector, this is an opportunity to buy the market leader. Our operating scenario of essentially no sales over the next six months and a recovery over the subsequent 18–24 months has resulted in significantly lower underlying earnings as detailed in Figure 2. Our DCF valuation under this scenario has dropped from NZ$14.50 to NZ$12.80 down -12%, and our target price has dropped from NZ$15.70 to NZ$13.80, down -12%, and still well above the share price.

A strong care brand a key driver

A risk factor for operators has been a near-term oversupply of retirement village units. We expect unlisted operators will take considerably longer to re-launch development activity on the other side of this crisis. We also expect an even greater shortage of good quality aged care beds, which were only getting built by the large integrated operators given the low returns on new direct aged care investment. Going into this crisis, good quality facilities were already essentially full and the demographics are not changing with a sharply increasing number of people aged in their mid-80s starting to occur. This plays into the hands of the integrated operators with a strong care brand, and RYM is the market leader in this regard.

RYM has the only genuine nationwide full continuum of care with dementia services, a high number of serviced apartments which are affordable, and heavily needs based product. RYM has significant headroom to lower prices and still generate solid resales gains. Compared to 2–3 years ago it has a more flexible development pipeline in terms of the type of development and geographic location, giving it development flexibility.

Ryman Healthcare Ltd (RYM)

Forsyth Barr valuation	
Valuation methodology	DCF 30% base case & 70% Aust expansion

12-month target price (NZ$)*	**13.80**	**Spot valuations (NZ$)**	
Expected share price return	29.3%	1. DCF	12.80
Net dividend yield	1.5%	2. n/a	n/a
Estimated 12-month return	30.9%	3. n/a	n/a

Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.75%	Total firm value	7,829
Equity beta	0.81	(Net debt)/cash	(1,324)
WACC	8.0%	Value of equity	6,505
Terminal growth	1.5%	Shares (m)	500

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	508.3	572.3	630.6	570.3	683.4
Normalised EBITDA	**240.3**	**268.6**	**290.8**	**205.6**	**291.1**
Depreciation and amortisation	(20.6)	(23.1)	(28.2)	(27.6)	(29.7)
Normalised EBIT	**219.7**	**245.4**	**262.6**	**178.0**	**261.4**
Net interest	(16.1)	(18.4)	(19.2)	(19.9)	(20.1)
Associate income	0	0	0	0	0
Tax	(0.6)	(3.4)	(1.9)	(2.6)	(5.1)
Minority interests	0	0	0	0	0
Normalised NPAT	**203.5**	**227.0**	**241.5**	**155.6**	**236.3**
Abnormals/other	184.7	99.0	0	0	0
Reported NPAT	**388.2**	**326.0**	**241.5**	**155.6**	**236.3**
Normalised EPS (cps)	40.7	45.4	48.3	31.1	47.3
DPS (cps)	20.4	22.7	24.1	15.6	23.6

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	18.5	12.6	10.2	-9.6	19.8
EBITDA (%)	18.1	11.8	8.3	-29.3	41.6
EBIT (%)	16.5	11.7	7.0	-32.2	46.9
Normalised NPAT (%)	14.1	11.5	6.4	-35.6	51.9
Normalised EPS (%)	14.1	11.5	6.4	-35.6	51.9
DPS (%)	14.4	11.3	6.4	-35.6	51.9

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**240.3**	**268.6**	**290.8**	**205.6**	**291.1**
Working capital change	123.0	151.0	243.7	266.3	300.3
Interest & tax paid	(14.0)	(21.5)	(21.1)	(22.4)	(25.1)
Other	0	0	0	0	0
Operating cash flow	**349.3**	**398.0**	**513.3**	**449.4**	**566.3**
Capital expenditure	(477.9)	(552.4)	(478.5)	(367.1)	(466.9)
(Acquisitions)/divestments	0	0	0	0	0
Other	(1.0)	(2.3)	0	0	0
Funding available/(required)	**(129.6)**	**(156.7)**	**34.8**	**82.3**	**99.4**
Dividends paid	(95.0)	(108.5)	(128.4)	(84.8)	(124.1)
Equity raised/(returned)	0	0	0	0	0
Increase/(decrease) in net debt	**226.6**	**270.1**	**93.6**	**2.4**	**24.6**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	265.0	226.1	248.3	225.3	268.4
Fixed assets	5,412.8	6,270.5	6,929.1	7,376.5	7,990.8
Intangibles	20.7	28.0	28.0	28.0	28.0
Other assets	0	0	0	0	0
Total funds employed	**5,698.5**	**6,524.6**	**7,205.3**	**7,629.8**	**8,287.2**
Net debt/(cash)	1,060.5	1,324.0	1,417.6	1,420.1	1,444.7
Other non current liabilities	2,697.5	3,030.4	3,531.5	3,860.2	4,395.7
Shareholder's funds	1,940.5	2,170.1	2,256.2	2,349.5	2,446.8
Minority interests	0	0	0	0	0
Total funding sources	**5,698.5**	**6,524.6**	**7,205.3**	**7,629.8**	**8,287.2**

* 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)	26.2	24.3	23.1	32.8	23.2
EV/EBIT (x)	28.6	26.6	25.5	37.9	25.8
PE (x)	26.2	23.5	22.1	34.3	22.6
Price/NTA (x)	2.8	2.5	2.4	2.3	2.2
Free cash flow yield (%)	-2.4	-2.9	0.7	1.5	1.9
Net dividend yield (%)	1.9	2.1	2.3	1.5	2.2
Gross dividend yield (%)	1.9	2.1	2.3	1.5	2.2
Imputation (%)	0	0	0	0	0
Pay-out ratio (%)	50	50	50	50	50

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	14.1	13.8	14.5	9.7	13.6
Interest cover EBITDA (x)	15.4	15.0	16.0	11.1	15.1
Net debt/ND+E (%)	35.3	37.9	38.6	37.7	37.1
Net debt/EBITDA (x)	4.4	4.9	4.9	6.9	5.0

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	3.9	3.8	3.8	2.5	3.2
Return on equity (%)	10.5	10.5	10.7	6.6	9.7
Return on funds employed (%)	7.8	7.3	7.1	4.6	6.5
EBITDA margin (%)	47.3	46.9	46.1	36.1	42.6
EBIT margin (%)	43.2	42.9	41.6	31.2	38.3
Capex to sales (%)	94.0	96.5	75.9	64.4	68.3
Capex to depreciation (%)	2,322	2,389	1,697	1,329	1,574

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (NZ$m)					
Care fees	270.5	302.0	332.3	356.6	383.6
Management fees	70.1	78.9	89.3	104.8	121.7
Other	1.5	0.9	0.9	0.9	1.0
Fair value m'ment in Investment Property (NZ$m)					
Realised	166.2	190.5	208.2	108.0	177.1
Unrealised	0	0	0	0	0
Total revenue	**508.3**	**572.3**	**630.6**	**570.3**	**683.4**
Key Drivers					
Sales - new NZ units	416.0	284.1	450.0	247.5	333.0
Sales - new Australian units	42.0	156.8	90.0	135.0	270.0
Sales - total new units	458.0	440.8	540.0	382.5	603.0
Unit price - new sales (NZ$000s)	671.0	702.2	723.2	730.5	752.4
Ave new unit price inflation (%)	52.9	4.7	3.0	1.0	3.0
Sales - resold units	825.0	824.0	847.5	497.1	825.4
Unit price - resales (NZ$000s)	502.5	506.6	521.8	495.7	495.7
Ave resold unit price inflation (%)	15.9	0.8	3.0	-5.0	0.0
Gross development margin (%)	19.2	29.9	25.0	21.0	21.0
Gross resales margin (%)	25.9	24.9	25.0	20.0	20.0
New units					
NZ	404.0	299.0	500.0	275.0	370.0
Australia	42.0	165.0	100.0	150.0	300.0
Total	446.0	464.0	600.0	425.0	670.0
New beds					
NZ	86.0	154.0	200.0	120.0	120.0
Australia	0	139.0	0	120.0	120.0
Total	86.0	293.0	200.0	192.0	240.0
Total portfolio					
Apartments/units	6,414.0	6,878.0	7,478.0	7,903.0	8,573.0
Beds	3,367.0	3,660.0	3,860.0	4,052.0	4,292.0

Earnings and valuation review

Ryman's market comments since the COVID-19 lock-down

- RYM villages are closed with visits only allowed in exceptional circumstances for families of residents in end-of-life or palliative care.
- Essential staff such as carers and registered nurses have received a pay rise of NZ$2.00 per hour during the crisis, approximately a +10% increase for carers.
- RYM has withdrawn previously communicated profit and build rate guidance, ceased building in NZ, and is monitoring the situation in Victoria.
- RYM expects sales of occupation rights to be severely restricted in coming weeks due to the emergency announcements.
- RYM will continue to admit new residents to its care centres and retirement villages during this period, so older people who need or wish to access services can. RYM will admit new residents in accordance with Public Health guidelines and they will be isolated as required.
- RYM has extensive infection control and pandemic plans in place, and has been planning and preparing all parts of its business to cope with the threat of COVID-19 since January.

Changes to key drivers — we have assumed a very slow next six months and no new build

We have reviewed our earnings and valuation for RYM under a similar scenario to what we did previously with SUM (see our note dated 2 April 2020) and ARV (see our note dated 6 April 2020). Different year ends mean that annual changes may not be directly comparable.

Figure 1 has a summary of our changes to key drivers.

Figure 1. Changes to key drivers

Year ending 31 March	Old	New	Chg %
Gross devel margin % FY20	25.0	25.0	0.0%
Gross devel margin % FY21	24.0	21.0	-12.5%
Gross devel margin % FY22	23.0	21.0	-8.7%
New units built FY20	700	600.0	-14.3%
New units built FY21	850	425.0	-50.0%
New units built FY22	950	670.0	-29.5%
Sales - new units FY20	595	540	-9.2%
Sales - new units FY21	765	383	-50.0%
Sales - new units FY22	855	603	-29.5%
Ave price - new sales FY20 (NZ$000's)	723	723	0.0%
Ave price - new sales FY20 (NZ$000's)	730	730	0.0%
Ave price - new sales FY20 (NZ$000's)	752	752	0.0%
Sales - resold units FY20	919	847	-7.8%
Sales - resold units FY21	994	497	-50.0%
Sales - resold units FY22	1100	825	-25.0%
Ave price - resold sales FY19 (NZ$000's)	522	522	0.0%
Ave price - resold sales FY20 (NZ$000's)	532	496	-6.9%
Ave price - resold sales FY21 (NZ$000's)	548	496	-9.6%
Gross resales margin % FY20	25.0	25.0	0.0%
Gross resales margin % FY21	23.0	20.0	-13.0%
Gross resales margin % FY22	23.0	20.0	-13.0%

Source: Forsyth Barr analysis

We have adopted a scenario where new sales and resales are very modest, if not non-existent over the next six months and we have assumed development activity remains stalled over this period as well. We assume not all the expected 700 units are completed in FY21, and that the build rate is halved in FY21 and starts recovering from FY22, then back to the pre-COVID medium term build rate target of 1,000 units in FY24. RYM may in fact deliver more than 50% of its previous FY21 target given how advanced it is with a number of key villages and with a heavier weighting to 2H20 for new delivery. With the slower build rate and uncertain near-term market conditions, and the ability for future residents to transact, we have assumed a significant drop in forecast new sales volumes over the next three years, in line with the lower build rate.

In terms of resales, we essentially again assume very little over the next six months, so essentially volumes have been halved for FY21, with a partial recovery in FY22, and then back to expected normal levels in FY23. We have also reduced average resale pricing and margins materially in the near-term as detailed in Figure 1. RYM has ~30% of its retirement stock as serviced apartments which are very affordable and a heavy needs based product which will support demand in a slower environment. RYM also has considerable head room to drop resales prices and still achieve a reasonable resales margin while keeping cash flowing in the business. Historically RYM's approach has been to not get greedy in terms of sales prices at the expense of turnover.

Gearing levels maintained

In addition to halting development activity, the other near-term lever for the retirement and aged care operators will be to cut the dividend. Although sector dividend pay-out rates are low (20–55%). At this stage we remain with a forecast dividend pay-out of 50% for RYM. RYM could also introduce a dividend reinvestment plan. Under the above scenario gearing remains steady around the current ~38%. RYM believes it has substantial headroom and the ability to manage its gearing through a prolonged slow period, in particular as it can stop its building activity. As with the other major operators, we remain confident from a banking perspective given the support and understanding of the sector by the major banks.

RYM's land bank and near-term pipeline is a lot more diversified than 2–3 years ago in terms of having a better mix of high density, mid density and broad acre projects. It has much more flexibility now to manage development levels as needed. It also has a wide geographic mix of development options within NZ and Victoria.

Figure 2. Summary of forecast changes (NZ$m)

Year ending 31 March $m	Old	New	Chg %
Underlying Revenue FY20	650.6	630.6	-3.1%
Underlying Revenue FY21	724.9	570.3	-21.3%
Underlying Revenue FY22	809.2	683.4	-15.6%
Realised new sales gains FY20	107.6	97.6	-9.2%
Realised new sales gains FY21	134.1	58.7	-56.3%
Realised new sales gains FY22	148.0	95.3	-35.6%
Realised resales gains FY20	119.9	110.5	-7.8%
Realised resales gains FY21	121.7	49.3	-59.5%
Realised resales gains FY22	138.7	81.8	-41.0%
Underlying EBITDA FY20	310.8	290.8	-6.4%
Underlying EBITDA FY21	360.2	205.6	-42.9%
Underlying EBITDA FY22	417.0	291.1	-30.2%
Normalised Profit FY20	261.0	241.5	-7.5%
Normalised Profit FY21	306.1	155.6	-49.2%
Normalised Profit FY22	356.6	236.3	-33.7%
DPS cents FY20	26.1	24.1	-7.5%
DPS cents FY21	30.6	15.6	-49.2%

Source: Forsyth Barr analysis

Downgraded earnings and price target

Figure 2 summarises our forecast changes.

As expected the changes above have pulled back near-term underlying profit forecasts considerably. Our forecast for care revenue is largely unchanged at this point. Deferred management fee revenue drops from the lower level of resales and the lower pricing. The key driver of the change is the lower realised gains from new sales and resales which is around half of the previous forecast for FY21 and also well down in FY22. This has resulted in a similar fall in underlying profit and dividends.

Our DCF valuation under this scenario has dropped from NZ$14.50 to NZ$12.80 down -12%, and our target price has dropped from NZ$15.70 to NZ$13.80, down -12%.

Should sales transactions remain problematic for over six months the operators will need to consider how it handles resales that have not been sold for over a six month period. Under the retirement village Act, operators do not need to reap the occupation right agreement (less the deferred management fee) unless the unit has been resold, however, in NZ a number of operators try not to keep families waiting any longer than six months. In a protracted downturn, deals could be done with banks and residents regarding deferred settlements. It is still very early days in terms of how this will unfold.

Upgrade to OUTPERFORM rating

The near-term is very uncertain in terms of sales activity, hence crystallising cash deferred management fees and from an earnings perspective from the actual realised gains on new sales and resales. The market is likely to remain volatile, however, we are confident with regard to financial strength and the business model going forward, once operating conditions normalise.

RYM has a high needs based ratio with a large and well organised care operation with scale (including dementia services in most villages) and has built a high number of serviced apartments (SAs) in each village for a number of years. Scale is very helpful and RYM's care receipts can cover a large portion of head office costs, something many other operators do not enjoy. However, like all operators, costs would have increased again in recent weeks. The SAs are very affordable which will assist with transactions over the near-term if house sales are not able to transact easily.

With high existing resales margins of close to 30%, but many are much above this if residents have been there are a while, there is significant headroom to pull prices back and still make a resales margin. While dropping prices reduces the profitability, it does still keep the cash flowing and crystallises deferred management fees

We still expect RYM will deliver a solid result in FY20 with EPS growth of around +7% indicative of a business operating well.

Investment Summary

Ryman Healthcare (RYM) is leveraged to the rapidly ageing population in NZ and Victoria with growing demand for retirement accommodation and aged care. RYM's strong brand, fully integrated villages and care expertise provide a needs-based defensive customer base. It maximises development returns through its in-house expertise and has a long-run market leading EPS growth track record since 1999.

Business quality

- **A market leader:** Barriers to entry for retirement village operators include care expertise, brand, scale, and access to capital. RYM has all of these.
- **An integrated model:** RYM is the only nationwide operator of integrated retirement villages with a full continuum of care that includes dementia services.
- **Opportunity in Australia:** Entry into the AU market provides significant long-term earnings upside.
- **Defensive qualities:** RYM maintained a strong balance sheet, continued to build new units, and grew earnings through the global financial crisis.

Earnings and cashflow outlook

- **Underlying EPS growth target of around +15%:** We expect RYM to continue to generate strong EPS growth (post COVID-19) through the expansion of the business and growing recurring earnings streams via strong management execution.
- **Recycling capital:** The occupational right agreement (ORA) structure allows RYM to self-fund development and recycle capital.

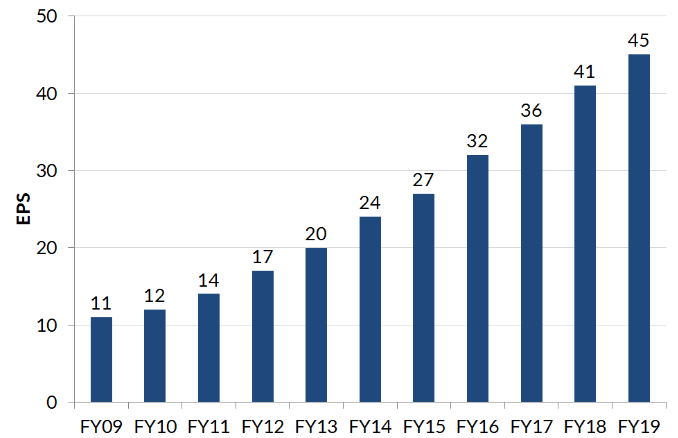
Financial structure

- **Balance sheet:** Gearing has increased in recent years as RYM has lifted its build rate, expanded into Australia and invested in higher priced metropolitan land, however, gearing is essentially project related and manageable. RYM is looking at a potential corporate bond.
- **Dividends:** RYM has had a long-running 50% dividend pay-out rate and as a result dividend growth has tracked the earnings growth. RYM is a market leader in terms of consistently growing its dividends for 20 years.

Risk factors

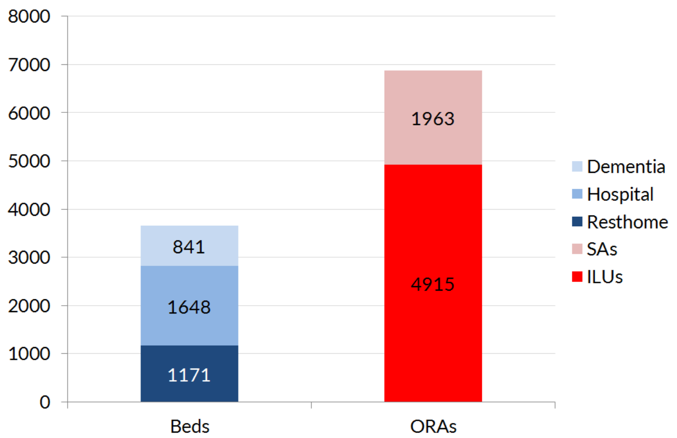
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term.
- **Housing market downturn:** Any sizable downturn in the current buoyant housing market conditions poses a threat to sales volumes and pricing.Insert your text here

Figure 3. RYM underlying EPS trajectory



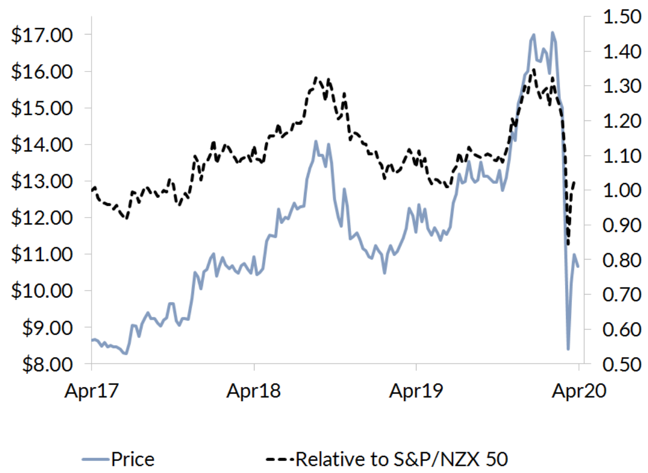
Source: Forsyth Barr analysis, Company reports

Figure 4. RYM portfolio as at 31 March 2019



Source: Forsyth Barr analysis, Company reports

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Geoffrey A Cumming	10.2%
Hickman Family	7.0%

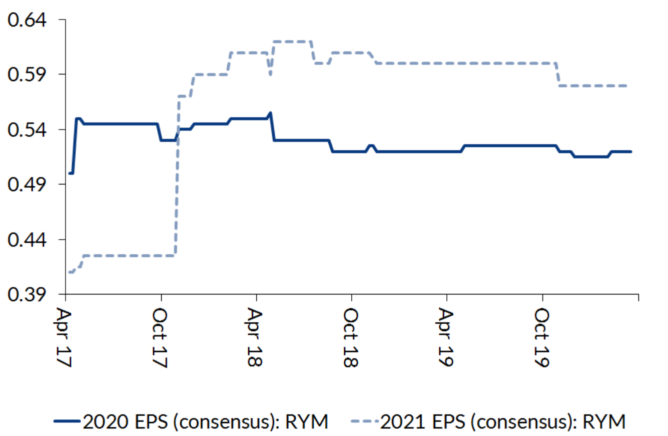
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect RYM's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Ryman Healthcare	**RYM NZ**	**NZ$10.67**	**NZ$5,335**	**22.1x**	**34.3x**	**22.9x**	**32.4x**	**25.4x**	**37.4x**	**1.5%**
Metlifecare *	MET NZ	NZ$4.15	NZ$885	9.8x	9.2x	11.7x	11.1x	12.5x	11.8x	2.1%
Summerset Group *	SUM NZ	NZ$4.51	NZ$1,028	13.5x	23.1x	15.4x	23.0x	16.9x	26.0x	1.3%
Oceania Healthcare *	OCA NZ	NZ$0.47	NZ$289	5.1x	4.7x	7.6x	7.0x	8.9x	8.2x	11.8%
Arvida Group Limited *	ARV NZ	NZ$1.00	NZ$542	9.5x	14.3x	10.9x	13.5x	12.0x	15.7x	3.8%
			Compco Average:	**9.5x**	**12.8x**	**11.4x**	**13.7x**	**12.6x**	**15.4x**	**4.8%**
EV = Current Market Cap + Actual Net Debt			**RYM Relative:**	**133%**	**167%**	**101%**	**137%**	**102%**	**142%**	**-69%**

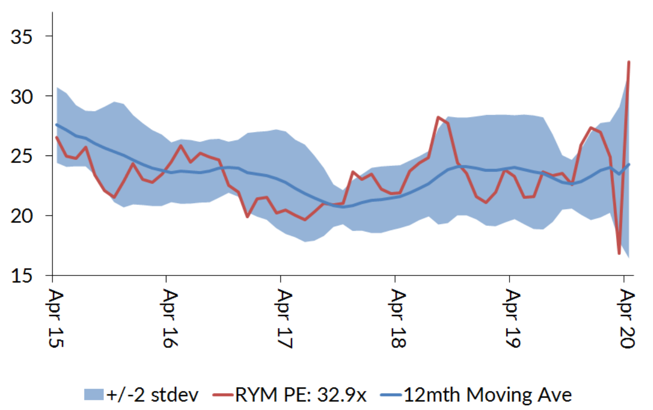
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (RYM) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

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