

Summerset Group

Tracking Well Pre Lockdown

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OUTPERFORM

Summerset Group (SUM) has announced total sales of 141 retirement village units for the quarter to 31 March 2020, in line with 1Q19 levels, and SUM noted sales were maintained at normal levels. We have not changed our forecasts or target price and refer to our SUM research note dated 2 April 2020, and our revised earnings expectations under a scenario of very weak sales activity over the next six months. Although near-term uncertainties remain, including investor sentiment towards the sector given the COVID-19 outbreak and how long it will be until residential sales transact, sector share prices are back substantially and already factor in a highly negative outlook. We remain confident of the long term business model for SUM. OUTPERFORM.

NZX Code	SUM	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$5.97	NPAT* (NZ\$m)	106.2	40.2	61.2	133.6	EV/EBITDA	14.3	30.0	22.6	12.4
Target price	NZ\$7.20	EPS* (NZc)	47.1	17.8	27.1	59.2	EV/EBIT	15.3	34.1	25.0	13.2
Risk rating	High	EPS growth* (%)	7.1	-62.1	52.1	n/a	PE	12.7	33.5	22.0	10.1
Issued shares	225.8m	DPS (NZc)	14.1	5.3	8.1	17.8	Price / NTA	1.2	1.2	1.2	1.1
Market cap	NZ\$1,348m	Imputation (%)	0	0	0	0	Cash div yld (%)	2.4	0.9	1.4	3.0
Avg daily turnover	363.3k (NZ\$2,307k)	*Based on normalised profits					Gross div yld (%)	2.4	0.9	1.4	3.0

1Q20 sales volumes close to 1Q19

New sales were 70 units and resales were 71 units versus 71 and 66 units in the pcq respectively. Volumes were well down on the typically large volume fourth quarter as detailed in Figure 1 but broadly in line with other quarters. January is a seasonally slower month and typically the December quarter is very busy with year-end and selling down new stock delivery that was more heavily weighted to 2H19.

Too early to gauge COVID-19 impact

SUM noted that it was only impacted by one week of the lockdown and it does not appear to have impacted materially. The impact will be more pronounced in 2Q and SUM has stated that it is too early to tell what the impact of COVID-19 will be on this quarter. SUM also does not typically provide any forward guidance with its quarterly sales release.

Strong pre-sales at new villages

SUM noted that the first quarter was boosted by good pre-sales at its new Kenepuru village in Wellington and its new Te Awa village in Napier. At 31 March SUM advised that it had a high level of sales contracts in place with 98 new sales and 73 resales contracts in place that had yet to settle.

Figure 1. Quarterly sales track

	1Q19	2Q19	3Q19	4Q19	FY19	1Q20	% chg pcq
New Sales	71	65	77	116	329	70	-1.4%
Resales	66	76	88	93	323	71	7.6%
Total	137	141	165	209	652	141	2.9%

Source: Forsyth Barr analysis, Company reports

Summerset Group Holdings (SUM)

Priced as at 09 Apr 2020 (NZ\$)

5.97

12-month target price (NZ\$)*

7.20

Expected share price return

20.6%

Net dividend yield

1.1%

Estimated 12-month return

21.7%

Spot valuations (NZ\$)

1. DCF

6.70

2. n/a

n/a

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.00%

Equity beta

0.88

WACC

7.7%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

2,113

(Net debt)/cash

(576)

Less: Capitalised operating leases

0

Value of equity

1,538

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	229.5	251.9	210.7	252.3	344.4	EV/EBITDA (x)	14.9	14.3	30.0	22.6	12.4
Normalised EBITDA	117.0	129.5	65.3	88.0	160.4	EV/EBIT (x)	15.8	15.3	34.1	25.0	13.2
Depreciation and amortisation	(6.7)	(7.8)	(7.9)	(8.3)	(9.1)	PE (x)	13.6	12.7	33.5	22.0	10.1
Normalised EBIT	110.4	121.7	57.4	79.7	151.4	Price/NTA (x)	1.4	1.2	1.2	1.2	1.1
Net interest	(11.6)	(15.4)	(17.2)	(18.5)	(17.8)	Free cash flow yield (%)	-6.4	-7.6	-4.3	3.0	7.4
Associate income	0	0	0	0	0	Net dividend yield (%)	2.2	2.4	0.9	1.4	3.0
Tax	(1.7)	1.6	0	0	0	Gross dividend yield (%)	2.2	2.4	0.9	1.4	3.0
Minority interests	0	0	0	0	0						
Normalised NPAT	98.8	106.2	40.2	61.2	133.6	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	116.0	69.0	0	0	0	Interest cover EBIT (x)	9.3	7.3	2.9	4.1	8.3
Reported NPAT	214.8	175.2	40.2	61.2	133.6	Interest cover EBITDA (x)	10.1	8.4	3.8	4.8	9.0
Normalised EPS (cps)	43.9	47.1	17.8	27.1	59.2	Net debt/ND+E (%)	31.3	33.7	36.2	34.7	30.6
DPS (cps)	13.2	14.1	5.3	8.1	17.8	Net debt/EBITDA (x)	3.8	4.4	9.9	7.1	3.5
Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	23.2	9.8	-16.4	19.7	36.5	Return on assets (%)	3.9	3.3	1.5	2.0	3.6
EBITDA (%)	19.7	10.7	-49.6	34.8	82.2	Return on equity (%)	10.1	9.4	3.5	5.2	10.5
EBIT (%)	18.5	10.3	-52.8	38.8	89.9	Return on funds employed (%)	8.4	7.5	3.0	4.2	8.1
Normalised NPAT (%)	21.0	7.6	-62.1	52.1	>100	EBITDA margin (%)	51.0	51.4	31.0	34.9	46.6
Normalised EPS (%)	19.7	7.1	-62.1	52.1	>100	EBIT margin (%)	48.1	48.3	27.3	31.6	43.9
Ordinary DPS (%)	20.0	6.8	-62.1	52.1	>100	Capex to sales (%)	126.5	130.0	54.7	61.1	86.8
						Capex to depreciation (%)	4,344	4,198	1,461	1,853	3,293
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Imputation (%)	0	0	0	0	0
EBITDA	117.0	129.5	65.3	88.0	160.4	Pay-out ratio (%)	30	30	30	30	30
Working capital change	100.5	108.2	9.8	125.6	256.5						
Interest & tax paid	(13.1)	(13.3)	(17.2)	(18.5)	(17.8)	Operating Performance	2018A	2019A	2020A	2021A	2022E
Other	0	0	0	0	0	Revenue (NZ\$m)					
Operating cash flow	204.4	224.4	57.9	195.1	399.2	Care fees	91.2	101.3	109.8	123.3	136.2
Capital expenditure	(290.4)	(327.4)	(115.3)	(154.2)	(298.8)	Management fees	45.6	52.5	57.2	62.3	71.5
(Acquisitions)/divestments	0	0	0	0	0	Other	0.2	0.2	0	0	0
Other	(1.3)	0	0	0	0	Fair value m'tment in Investment Property (NZ\$m)					
Funding available/(required)	(87.2)	(103.0)	(57.4)	40.9	100.4	Realised	92.5	97.9	43.7	66.7	136.7
Dividends paid	(19.7)	(19.5)	(12.1)	(18.4)	(40.1)	Unrealised	0	0	0	0	0
Equity raised/(returned)	1.9	2.2	0	0	0	Total revenue	229.5	251.9	210.7	252.3	344.4
(Increase)/decrease in net debt	(105.0)	(120.4)	(69.5)	22.5	60.3						
						Key Drivers					
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Sales - new units	339	329	169	225	425
Working capital	(57.4)	(98.0)	(41.0)	(49.1)	(67.0)	Ave unit price - new sales (NZ\$000s)	566	665	685	705	726
Fixed assets	2,717.8	3,261.0	3,412.1	3,624.7	4,051.1	Sales - resold units	301	323	180	299	470
Intangibles	6.6	6.1	6.1	6.1	6.1	Ave unit price - resales (NZ\$000s)	406	445	423	444	462
Right of use asset	0	0	0	0	0	Gross development margin (%)	33.2	27.9	22.0	22.0	26.0
Other assets	4.6	12.6	12.6	12.6	12.6	Gross resales margin (%)	23.5	25.7	24.0	24.0	26.0
Total funds employed	2,671.6	3,181.7	3,389.9	3,594.4	4,002.9	New apartments/units	454	354	225	300	500
Net debt/(cash)	445.3	575.6	645.1	622.6	562.3	New beds	52	0	80	80	80
Lease liability	0	0	0	0	0						
Other liabilities	1,247.6	1,474.2	1,608.0	1,798.5	2,163.6	Portfolio					
Shareholder's funds	978.8	1,131.9	1,136.7	1,173.3	1,277.0	Apartments/units	3,732	4,086	4,311	4,611	5,111
Minority interests	0	0	0	0	0	Beds	845	845	925	1,005	1,085
Total funding sources	2,671.6	3,181.7	3,389.9	3,594.4	4,002.9						

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

Investment Summary

With a strengthening development and sales track record, and a land bank of circa seven years, Summerset Group (SUM) has been confident of achieving its medium term build target of 600 units per annum. However, development time frames are less certain near-term due to the economic uncertainties at present. There remains significant growth potential from demographic trends, and expansion into Australia with the acquisition of further sites 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 354 in FY19, and has achieved attractive development margins. 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

- **Underlying EPS growth track record:** Since listing on the NZX in 2011, SUM has generated strong EPS growth on a consistent basis. After a flatter year in FY20, SUM was expected to achieve strong EPS growth in FY21, however, this has been dialled back with the COVID-19 outbreak. This is expected to dampen earnings in FY20 and FY21 before recovering strongly in FY22.
- **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.

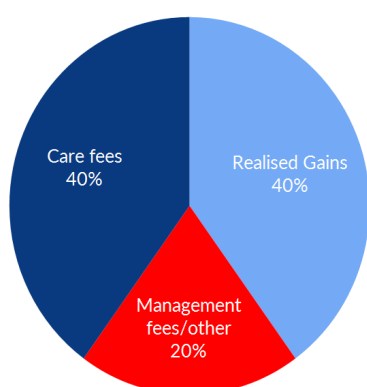
Financial structure

- **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 a 30%–50% target pay-out rate and has a dividend reinvestment plan in place.

Risk factors

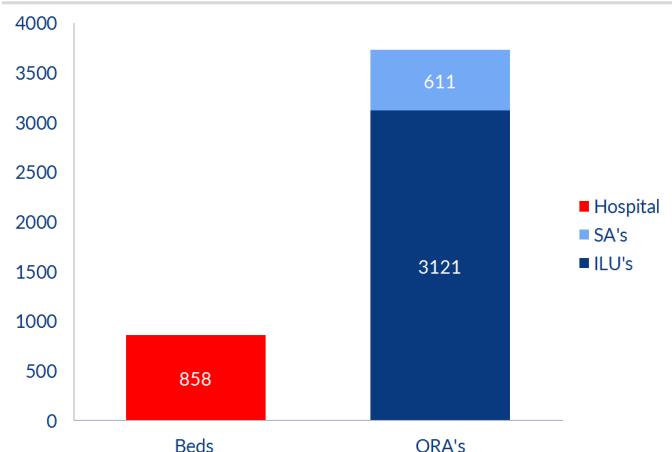
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term. With a stalling in the economy with COVID-19, we expect private operators will find it tougher to resurrect development programmes than the well funded listed operators.
- **Economic and housing market concerns:** A protracted downturn in the housing conditions and difficulty in new residents transacting is a threat to SUM's resales volumes, cash flows, and gearing.

Figure 2. SUM FY19 revenue mix (NZ\$m)

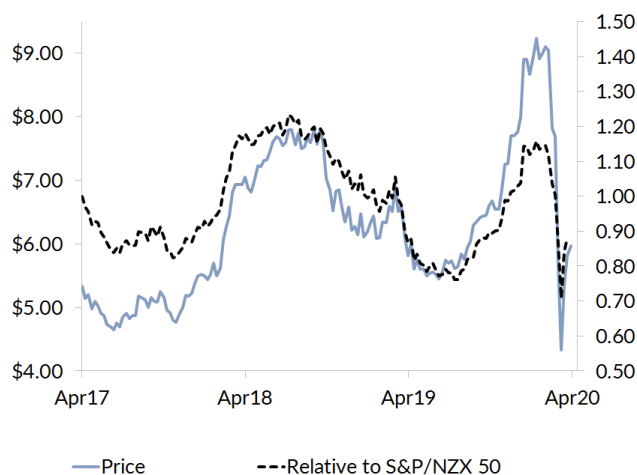


Source: Forsyth Barr analysis, Company Reports

Figure 3. SUM portfolio as at 31 December 2019



Source: Forsyth Barr analysis, Company Reports

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	10.3%
Fisher Funds Management	5.1%

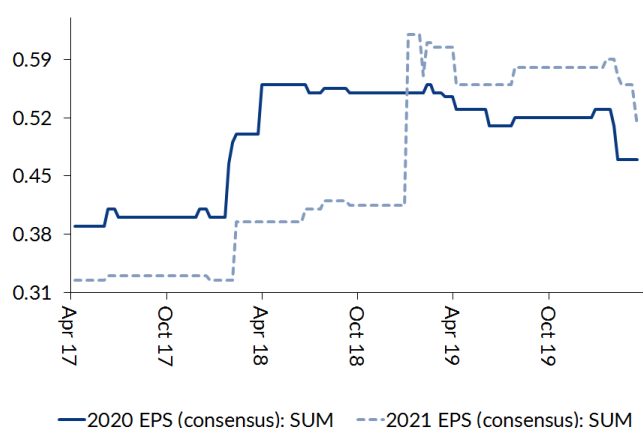
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

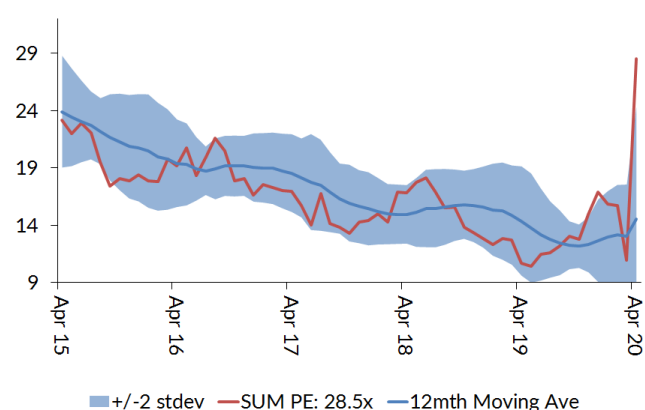
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SUM's balance date - December)										
Summerset Group	SUM NZ	NZ\$5.97	NZ\$1,348	33.5x	22.0x	29.4x	21.8x	33.5x	24.1x	1.4%
Metlifecare *	MET NZ	NZ\$4.15	NZ\$885	9.4x	8.6x	11.3x	10.4x	12.0x	11.1x	2.8%
Ryman Healthcare *	RYM NZ	NZ\$8.22	NZ\$4,110	24.1x	19.6x	24.5x	20.6x	28.1x	23.2x	2.6%
Oceania Healthcare *	OCA NZ	NZ\$0.47	NZ\$289	4.8x	4.4x	7.1x	6.7x	8.3x	7.7x	12.5%
Arvida Group Limited *	ARV NZ	NZ\$1.00	NZ\$542	13.1x	11.1x	12.9x	10.8x	14.8x	12.3x	5.1%
Compco Average:				12.8x	10.9x	13.9x	12.1x	15.8x	13.6x	5.7%
SUM Relative:				161%	101%	111%	80%	112%	78%	-76%

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 7. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)


Source: Forsyth Barr analysis

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