

Summerset Group

FY20 Result Preview — Time to Look Ahead

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OUTPERFORM

SUM will report largely pre-announced 1H underlying earnings on August 17th. We expect focus to be forward looking and on current activity rather than results, particularly in light of the re-emergence of COVID-19 community spread in NZ. Overall we are increasing our estimates and price target substantially as we are reversing what we now believe to have been an overly pessimistic view of the aged-care sector post COVID-19 lock-down. The recent experience also gives us some comfort in that the re-emergence of COVID-19, while potentially short term disruptive, is unlikely to cause long term demand destruction. SUM is our preferred name in the aged-care sector due to its combination of sector leading organic growth, only modest debt build up and undemanding valuation in light of the record high P/E ratios for the NZ market.

NZX Code	SUM	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$7.45	NPAT* (NZ\$m)	107.9	82.5	117.3	143.1	EV/EBITDA	15.8	19.2	14.6	12.1
Target price	NZ\$9.00	EPS* (NZc)	48.6	37.0	52.6	64.2	EV/EBIT	16.9	21.0	15.7	13.0
Risk rating	Medium	EPS growth* (%)	11.5	-23.9	42.2	22.0	PE	15.3	20.1	14.2	11.6
Issued shares	223.0m	DPS (NZc)	14.1	14.0	15.0	18.0	Price / NTA	1.7	1.4	1.4	1.2
Market cap	NZ\$1,661m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.9	1.9	2.0	2.4
Avg daily turnover	311.4k (NZ\$2,112k)	*Based on normalised profits					Gross div yld (%)	2.6	2.6	2.8	3.4

Recent activity likely to be strong — focus will be on implications from return to Level 3/2 in Auckland/NZ and current activity

All aged care operators have reported strong sales coming out of lockdown. Anecdotal evidence coupled with reported numbers for June leaves us with the impression that the "lockdown experience" has increased the interest in retirement village living. Specifically, RYM noted at its ASM yesterday that sales in NZ for the four months to July was up from 2019, a very strong result given two months of highly restricted sales. SUM has already pre-announced their sales for the half, ahead of our expectations at 128 and 136 new and re-sales respectively. We will be looking for comments around July sales and expectations for H2. Our substantially upgraded forecasts implies ~10% decline year over year.

Key focus areas: (1) Mix of results; (2) Net debt and (3) Delivery of units

- **Result mix:** SUM pre-announced its 1H20 underlying earnings expectations of NZ\$40–NZ\$45m. However, we have little insight into the mix of the results. Specifically, we estimate that there was a c. NZ\$6m net COVID-19 related benefit, suggesting a low headline cost number and new and re-sale margins of ~20–25%. We will be particularly focussed on the more stable re-sale margins; signs of these deviating meaningfully from our expectations in either direction will be a focus area.
- **Net debt:** Another key area will be the degree of debt build up and the closely related capex. In FY19 SUM added c. NZ\$130m of net debt, we expect a further NZ\$90m to be added in FY20. This is somewhat below guidance, driven by our expectations of 300 units delivered in FY20, at the very low end of the revised guidance.
- **Unit delivery:** Oceania (OCA) reported a 4cps decline in NAV per share on 23 July which we believe contributed to the weak initial share price reaction on the day. The reduced NAV was driven by revised valuer assumptions and while we are not focussed on these relatively temporary changes, we acknowledge that it is an important metric for the industry. We expect a small decline in NAV for SUM driven by a negative revaluation gain. We have low confidence in our expectation of a negative valuation gain, but caution that SUM may very well report a negative headline number as a consequence.

Conference call: 11am (NZ time), New Zealand 0800 444 845 or 09 280 5280, Australia 1 800 175 864. Passcode: 2578358

Summerset Group Limited (SUM)

Priced as at 13 Aug 2020 (NZ\$) **7.45**

12-month target price (NZ\$)*	9.00
Expected share price return	20.8%
Net dividend yield	2.0%
Estimated 12-month return	22.8%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.84
WACC	5.6%
Terminal growth	2.0%

Spot valuations (NZ\$)	
1. DDM	8.47
2. n/a	n/a
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	242.0	292.2	338.6
Normalised EBITDA	116.7	129.2	112.1	151.2	181.6
Depreciation and amortisation	(6.7)	(7.8)	(9.8)	(10.7)	(12.3)
Normalised EBIT	110.1	121.4	102.3	140.5	169.3
Net interest	(11.4)	(15.2)	(19.8)	(23.2)	(26.2)
Associate income	0	0	0	0	0
Tax	(1.7)	1.7	0	0	0
Minority interests	0	0	0	0	0
Normalised NPAT	97.0	107.9	82.5	117.3	143.1
Abnormals/other	117.5	67.4	(27.3)	51.8	40.6
Reported NPAT	214.5	175.3	55.2	169.2	183.8
Normalised EPS (cps)	43.6	48.6	37.0	52.6	64.2
DPS (cps)	13.2	14.1	14.0	15.0	18.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	23.1	9.8	-3.8	20.8	15.9
EBITDA (%)	19.6	10.7	-13.3	34.9	20.1
EBIT (%)	18.4	10.3	-15.7	37.3	20.5
Normalised NPAT (%)	19.2	11.3	-23.5	42.2	22.0
Normalised EPS (%)	19.3	11.5	-23.9	42.2	22.0
Ordinary DPS (%)	20.0	6.8	-0.7	7.1	20.0

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	116.7	129.2	112.1	151.2	181.6
Working capital change	29.8	54.3	62.7	1.3	1.7
Interest & tax paid	(13.1)	(13.5)	(19.8)	(23.2)	(26.2)
Other	84.3	67.9	73.9	246.6	253.7
Operating cash flow	217.8	237.9	228.9	376.0	410.9
Capital expenditure	(209.2)	(240.0)	(194.2)	(295.8)	(325.5)
(Acquisitions)/divestments	(54.7)	(57.3)	(50.0)	(50.0)	(40.0)
Other	75.4	106.1	99.5	71.4	70.3
Funding available/(required)	29.3	46.7	84.2	101.6	115.7
Dividends paid	(19.7)	(19.5)	(31.2)	(33.5)	(40.1)
Equity raised/(returned)	0	1.9	2.2	0	0
(Increase)/decrease in net debt	9.7	29.1	55.2	68.1	75.5

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(83.7)	(137.9)	(200.6)	(201.9)	(203.7)
Fixed assets	2,193.1	2,717.8	3,261.0	3,569.0	4,091.6
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	3,387.8	3,910.7
Net debt/(cash)	339.7	431.3	542.5	622.5	673.1
Lease liability	0	0	10.5	10.5	10.5
Other liabilities	990.8	1,167.0	1,361.2	1,554.0	1,886.2
Shareholder's funds	789.1	1,000.8	1,165.0	1,200.8	1,340.9
Minority interests	0	0	0	0	0
Total funding sources	2,119.6	2,599.1	3,079.2	3,387.8	3,910.7

* 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)	16.8	15.8	19.2	14.6	12.1
EV/EBIT (x)	17.8	16.9	21.0	15.7	13.0
PE (x)	17.1	15.3	20.1	14.2	11.6
Price/NTA (x)	2.1	1.7	1.4	1.4	1.2
Free cash flow yield (%)	0.5	-0.1	2.1	4.8	5.1
Net dividend yield (%)	1.8	1.9	1.9	2.0	2.4
Gross dividend yield (%)	2.5	2.6	2.6	2.8	3.4

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	9.6	8.0	5.2	6.1	6.5
Interest cover EBITDA (x)	10.2	8.5	5.7	6.5	6.9
Net debt/ND+E (%)	30.1	30.1	31.8	34.1	33.4
Net debt/EBITDA (x)	2.9	3.3	4.8	4.1	3.7

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.9	4.4	3.0	3.8	3.9
Return on equity (%)	12.3	10.8	7.1	9.8	10.7
Return on funds employed (%)	8.5	7.4	4.7	6.1	6.6
EBITDA margin (%)	50.9	51.4	46.3	51.7	53.6
EBIT margin (%)	48.0	48.2	42.3	48.1	50.0
Capex to sales (%)	91.3	95.4	80.3	101.2	96.1
Capex to depreciation (%)	3,129	3,064	1,985	2,763	2,652
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	30	29	38	29	28

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ\$m)					
Care fees	91.2	101.3	106.3	115.7	129.8
Management fees	45.6	52.5	58.3	67.4	77.1
Gain on resales	28.7	36.9	33.6	38.8	44.6
Gain on new sales	63.7	61.0	43.7	70.3	87.2
Total revenue	229.2	251.6	242.0	292.2	338.6

Key Drivers	2018A	2019A	2020E	2021E	2022E
Sales - new units	339	329	290	475	500
Ave unit price - new sales (NZ\$000s)	566	665	685	705	726
Sales - resold units	301	323	297	370	409
Ave unit price - resales (NZ\$000s)	406	445	454	476	496
Gross development margin (%)	33.2%	27.9%	22.0%	21.0%	24.0%
Gross resales margin (%)	23.5%	25.7%	25.0%	22.0%	22.0%
New apartments/units	454	354	300	450	480
New beds	52	0	0	80	80
Total	506	354	300	530	560

Portfolio	2018A	2019A	2020E	2021E	2022E
Apartments/units	3,732	4,086	4,386	4,861	5,361
Beds	858	858	858	938	1,018
Total Portfolio	4,590	4,944	5,244	5,799	6,379

Forecast earnings changes and result preview

We make material changes to our FY20 and FY21 underlying earnings as part of the aged-care sector unwind from our materially reduced numbers made in the midst of initial COVID-19 lockdowns in March. The predominant drivers of change are resale gains and new sale gains reflecting a significant increase in unit sales in FY20 and FY21. Minimal changes are made in FY22 and beyond, we also highlight in Figure 3 our current forecasts vs Forsyth Barr's pre COVID-19 forecasts in February. Our target price increases to NZ\$9.00 (from NZ\$7.20)

Figure 1. Detailed forecast changes (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care Fees	109.8	106.3	-3%	123.3	115.7	-6%	136.2	129.8	-5%
DMF	57.2	58.3	2%	62.3	67.4	8%	71.5	77.1	8%
Resale Gains	18.3	33.6	84%	31.8	38.8	22%	56.4	44.6	-21%
Newsale Gains	25.4	43.7	72%	34.9	70.3	102%	80.3	87.2	9%
Total Revenue	210.7	242.0	15%	252.3	292.2	16%	344.4	338.6	-2%
Total Costs	145.4	129.9	-11%	164.3	141.0	-14%	184.0	157.0	-15%
EBITDA	65.3	112.1	72%	88.0	151.2	72%	160.4	181.6	13%
Depreciation & Amortisation	7.9	9.8	24%	8.3	10.7	29%	9.1	12.3	35%
EBIT	57.4	102.3	78%	79.7	140.5	76%	151.3	169.3	12%
Net interest	17.2	19.8	15%	18.5	23.2	25%	17.8	26.2	47%
Underlying profit	40.2	82.5	105%	61.2	117.3	92%	133.6	143.1	7%
EPS (cents)	17.8	37.0	108%	27.1	52.6	94%	59.2	64.2	8%
DPS (cents)	5.3	14.0	164%	8.1	15.0	85%	17.8	18.0	1%
Sales - new units	169	290	72%	225	475	111%	425	500	18%
Average unit price - new sales (NZ\$000's)	685	685	0%	705	705	0%	726	726	0%
New sales margin (%)	22%	22%	0%	22%	21%	-5%	26%	24%	-8%
Sales - resold units	180	297	65%	299	370	24%	470	409	-13%
Average unit price - resales (NZ\$000's)	423	454	7%	444	476	7%	462	496	7%
Resales margin (%)	24%	25%	4%	24%	22%	-8%	26%	22%	-15%

Source: Forsyth Barr analysis

Figure 2. 1H20 forecasts (NZ\$m)

	1H18	1H19	1H20E	Change
Care Fees	43.3	48.8	51.2	5%
DMF	22.3	25.1	27.9	11%
Resale Gains	14.9	14.3	14.9	4%
Newsale Gains	25.8	27.1	19.9	-27%
Total Revenue	106.3	115.3	113.8	-1%
Total Costs	52.9	56.9	57.1	0%
EBITDA	53.4	58.4	56.7	-3%
Depreciation & Amortisation	2.9	3.9	4.9	25%
EBIT	50.5	54.4	51.8	-5%
Net interest	5.3	6.7	9.9	48%
Underlying profit	45.2	47.8	41.9	-12%
EPS (cents)	20.9	21.3	18.8	-12%
DPS (cents)	7.1	7.2	7.0	-3%
Sales - new units	145	136	128	-6%
Average unit price - new sales (NZ\$000's)	540	701	722	3%
New sales margin (%)	33%	28%	22%	-24%
Sales - resold units	154	142	136	-4%
Average unit price - resales (NZ\$000's)	416	430	456	6%
Resales margin (%)	23%	23%	24%	3%

Source: Forsyth Barr analysis

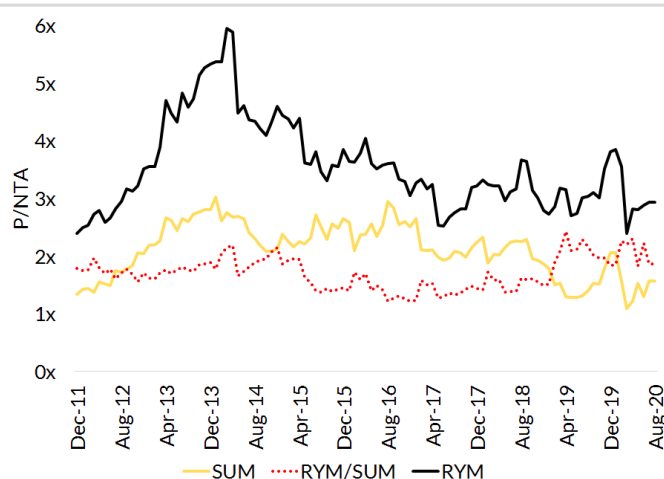
Figure 3. Detailed forecast changes vs Forsyth Barr February (pre-COVID) forecasts (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care Fees	109.8	106.3	-3%	123.3	115.7	-6%	136.2	129.8	-5%
DMF	60.5	58.3	-4%	72.1	67.4	-7%	85.8	77.1	-10%
Resale Gains	47.6	33.6	-29%	53.7	38.8	-28%	59.2	44.6	-25%
Newsale Gains	59.2	43.7	-26%	71.4	70.3	-1%	81.5	87.2	7%
Total Revenue	277.0	242.0	-13%	320.5	292.2	-9%	362.7	338.6	-7%
Total Costs	145.4	129.9	-11%	164.3	141.0	-14%	184.0	157.0	-15%
EBITDA	131.6	112.1	-15%	156.2	151.2	-3%	178.7	181.6	2%
Depreciation & Amortisation	8.1	9.8	20%	9.1	10.7	18%	10.2	12.3	21%
EBIT	123.5	102.3	-17%	147.2	140.5	-5%	168.6	169.3	0%
Net interest	16.9	19.8	17%	18.0	23.2	29%	17.3	26.2	51%
Underlying profit	106.6	82.5	-23%	129.2	117.3	-9%	151.3	143.1	-5%
EPS (cents)	47.2	37.0	-22%	57.2	52.6	-8%	67	64.2	-4%
DPS (cents)	14.2	14.0	-1%	17.2	15.0	-13%	20.1	18.0	-10%
Sales - new units	360	290	-19%	440	475	8%	510	500	-2%
Average unit price - new sales (NZ\$000's)	685	685	0%	705	705	0%	726	726	0%
New sales margin (%)	24%	22%	-8%	23%	21%	-9%	22%	24%	9%
Sales - resold units	370	297	-20%	422	370	-12%	470	409	-13%
Average unit price - resales (NZ\$000's)	476	454	-5%	509	476	-6%	525	496	-6%
Resales margin (%)	27%	25%	-7%	25%	22%	-12%	24%	22%	-8%

Source: Forsyth Barr analysis

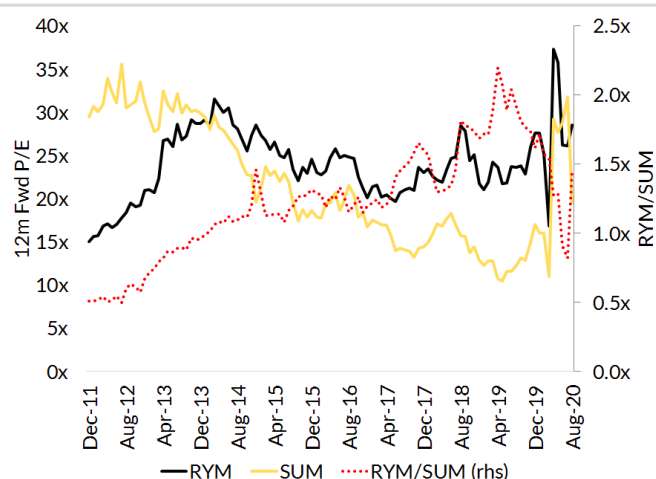
Charts of interest

Figure 4. SUM/RYM Price to NTA



Source: Forsyth Barr analysis

Figure 5. SUM/RYM 12m Fwd P/E



Source: Forsyth Barr analysis

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. **OUTPERFORM.**

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 guiding for a flat 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.

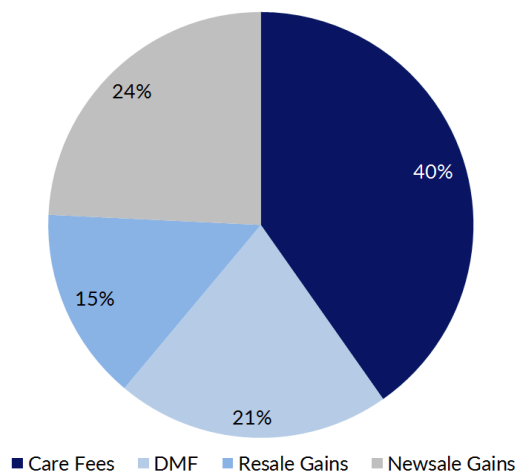
Financial structure

- **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

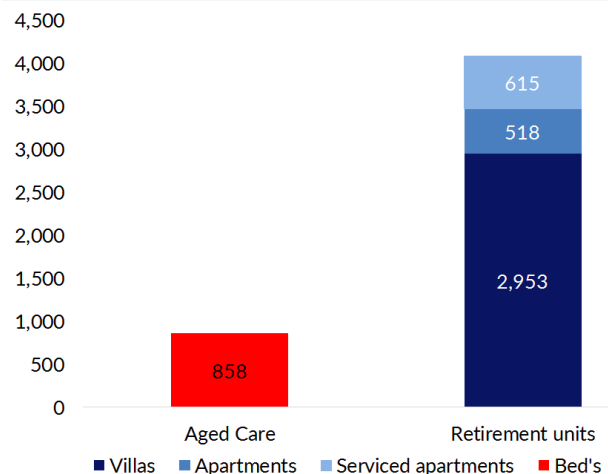
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term. With a stalling in the economy with COVID-19, we expect private operators will find it tougher to resurrect development programmes than the well funded 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 6. SUM FY19 revenue mix

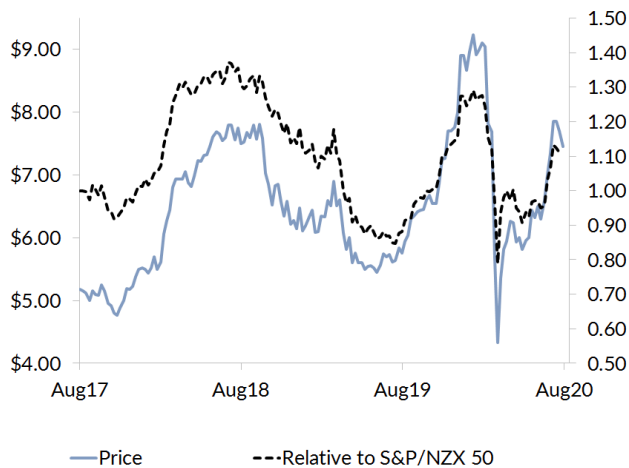


Source: Forsyth Barr analysis, Company reports

Figure 7. SUM portfolio as at 31 December 2019



Source: Forsyth Barr analysis, Company reports

Figure 8. Price performance


Source: Forsyth Barr analysis

Figure 9. Substantial shareholders

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	10.3%
Fisher Funds Management	6.2%
Milford Asset Management	5.3%
ACC	5.0%

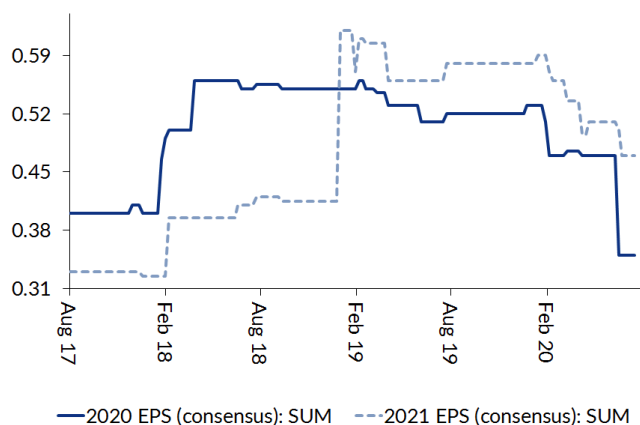
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

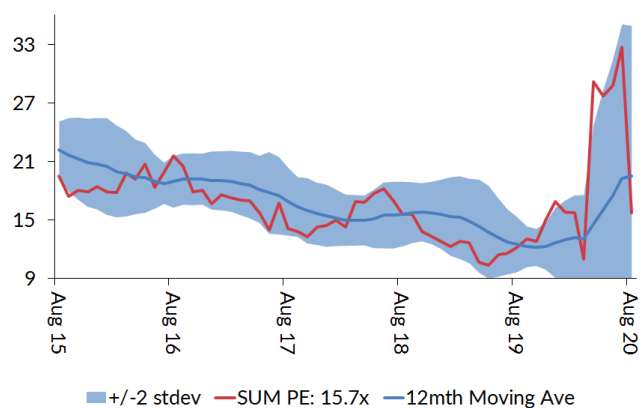
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SUM's balance date - December)										
Summerset Group Limited	SUM NZ	NZ\$7.45	NZ\$1,661	20.1x	14.2x	18.7x	13.8x	20.5x	14.9x	2.0%
METLIFECARE *	MET NZ	NZ\$5.90	NZ\$1,258	17.7x	16.4x	19.2x	17.9x	20.8x	19.4x	1.3%
RYMAN HEALTHCARE *	RYM NZ	NZ\$12.50	NZ\$6,250	26.1x	21.9x	27.1x	23.1x	30.1x	25.4x	2.1%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$0.96	NZ\$590	13.0x	11.1x	13.2x	11.5x	17.1x	14.6x	4.5%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.50	NZ\$814	18.0x	15.7x	18.9x	16.2x	21.9x	18.7x	3.6%
Compco Average:				18.7x	16.3x	19.6x	17.2x	22.5x	19.5x	2.9%
SUM Relative:				8%	-13%	-5%	-19%	-9%	-24%	-30%

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 11. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 12. One year forward PE (x)


Source: Forsyth Barr analysis

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	OUTPERFORM	NEUTRAL	UNDERPERFORM
	43.4%	43.4%	13.2%

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