

Summerset Group

1H20 Result — Gearing Up For Summer

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OUTPERFORM

Summerset Group's (SUM) 1H20 underlying net profit was largely pre-announced, however, we like the mix of these results. High quality annuity earnings in the form of deferred management fees and re-sale gains were ahead of our expectations while more volatile new sale gains were below, driven primarily by a less Auckland centric, and therefore lower priced, new sales mix. We were also encouraged by the relatively stable gearing ratios despite COVID-19 headwinds. We increase our FY20 estimates by c. 10% primarily driven by higher re-sales but leave our FY21/22 estimates largely unchanged. SUM is our preferred aged-care stock; we retain our OUTPERFORM rating and increase our target price to NZ\$9.15 from NZ\$9.00.

NZX Code	SUM	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$7.77	NPAT* (NZ\$m)	107.9	95.0	119.6	146.8	EV/EBITDA	16.5	18.3	15.4	12.8
Target price	NZ\$9.15	EPS* (NZc)	48.6	42.4	53.2	65.3	EV/EBIT	17.6	19.8	16.4	13.6
Risk rating	Medium	EPS growth* (%)	11.5	-12.8	25.4	22.7	PE	16.0	18.3	14.6	11.9
Issued shares	224.9m	DPS (NZc)	14.1	14.2	16.0	20.0	Price / NTA	1.7	1.6	1.6	1.4
Market cap	NZ\$1,748m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.8	1.8	2.1	2.6
Avg daily turnover	310.2k (NZ\$2,112k)	*Based on normalised profits					Gross div yld (%)	2.5	2.5	2.9	3.6

Net debt increasing slightly less than expectations despite headwinds; but stable gearing ratios at least a year away

We view net debt development as a key area of focus for the sector. SUM added a further NZ\$56m in 1H20, slightly below our estimate of NZ\$66m, despite higher unit delivery, driven primarily by lower land purchase cash flow. Looking ahead, we believe net debt will increase by a further c. NZ\$80m to c. NZ\$700m by year end FY20, depending on land purchases. Company commentary suggests that FY20 will (again) be a year of increased leverage as they complete several capex hungry multi-storey buildings, but we believe FY21 is likely to see a plateauing of leverage, although is dependent on Victoria's capex profile. We have increased our FY20 capex estimates due to our increased unit delivery expectations to 325 units (previously 300 units), the mid-point of guidance.

New sales and re-sales tracking well ahead of last year post lock-down

SUM's commentary suggested that new sales and re-sales were tracking c. 50% and 30% above last year's level post lock-down, implying that a portion of the reported inflated re-sales stock levels has already begun to reduce. Accordingly, we have increased our FY20 new and re-sale sales forecasts. We understand that the increased resale stock is not only driven by COVID-19 related restrictions, but also partly by increased general churn, a reversal of the last few years trend of falling churn. We acknowledge that there is a large degree of noise (randomness) in these numbers, but it does suggest that the trend of falling churn/longer tenancies may not be as strong as the last few years would suggest.

Dividends reduced by 0.4cps vs 1H19 — we expect a reversal in 2H

Dividends of 6cps (down 0.4cps on pc) was our one area of disappointment, below our 7cps. Reducing the dividend by 0.4cps from last year saved SUM less than NZ\$1m in cash, but it put a dent in 7 years of un-interrupted DPS growth. While the aged-care sector is not part of the extensive yield universe in NZ, we believe confidence to pay dividends is an important signalling mechanism to investors, particularly in light of the low cash conversion. We believe that RYM's valuation premium to SUM is, to a significant degree, driven by its long track record of delivering EPS/DPS growth and being partly priced by international investors with a lower cost of capital for NZ stocks. We are looking for an 8.2cps DPS in 2H, taking full year DPS to 14.2, a nominal growth of 0.1cps.

Summerset Group Limited (SUM)

Priced as at 17 Aug 2020 (NZ\$)

7.77

12-month target price (NZ\$)*	9.15
Expected share price return	17.8%
Net dividend yield	2.0%
Estimated 12-month return	19.7%

Spot valuations (NZ\$)	
1. DDM	8.61
2. n/a	n/a
3. n/a	n/a

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.84
WACC	5.6%
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)	2018A	2019A	2020E	2021E	2022E
Sales revenue	229.2	251.6	252.0	293.9	340.7
Normalised EBITDA	116.7	129.2	122.9	151.4	182.2
Depreciation and amortisation	(6.7)	(7.8)	(8.8)	(9.6)	(11.0)
Normalised EBIT	110.1	121.4	114.1	141.7	171.2
Net interest	(11.4)	(15.2)	(19.1)	(22.1)	(24.4)
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	95.0	119.6	146.8
Abnormals/other	117.5	67.4	(81.8)	50.0	39.3
Reported NPAT	214.5	175.3	13.1	169.6	186.1
Normalised EPS (cps)	43.6	48.6	42.4	53.2	65.3
DPS (cps)	13.2	14.1	14.2	16.0	20.0

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	17.6	16.5	18.3	15.4	12.8
EV/EBIT (x)	18.6	17.6	19.8	16.4	13.6
PE (x)	17.8	16.0	18.3	14.6	11.9
Price/NTA (x)	2.2	1.7	1.6	1.6	1.4
Free cash flow yield (%)	0.5	-0.1	0.5	4.2	5.0
Net dividend yield (%)	1.7	1.8	1.8	2.1	2.6
Gross dividend yield (%)	2.4	2.5	2.5	2.9	3.6

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	23.1	9.8	0.2	16.6	15.9
EBITDA (%)	19.6	10.7	-4.9	23.2	20.3
EBIT (%)	18.4	10.3	-6.0	24.2	20.8
Normalised NPAT (%)	19.2	11.3	-12.0	26.0	22.7
Normalised EPS (%)	19.3	11.5	-12.8	25.4	22.7
Ordinary DPS (%)	20.0	6.8	0.7	12.7	25.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	9.6	8.0	6.0	6.4	7.0
Interest cover EBITDA (x)	10.2	8.5	6.4	6.8	7.5
Net debt/ND+E (%)	30.1	30.1	34.1	38.8	38.8
Net debt/EBITDA (x)	2.9	3.3	4.7	4.7	4.3

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	116.7	129.2	122.9	151.4	182.2
Working capital change	29.8	54.3	62.7	6.8	2.2
Interest & tax paid	(13.1)	(13.5)	(19.1)	(22.1)	(24.4)
Other	84.3	67.9	70.7	192.5	225.3
Operating cash flow	217.8	237.9	237.2	328.6	385.2
Capital expenditure	(209.2)	(240.0)	(228.8)	(255.4)	(297.7)
(Acquisitions)/divestments	(54.7)	(57.3)	(60.0)	(65.0)	(70.0)
Other	75.4	106.1	95.6	51.4	50.3
Funding available/(required)	29.3	46.7	44.0	59.6	67.8
Dividends paid	(19.7)	(19.5)	(31.9)	(36.0)	(45.0)
Equity raised/(returned)	0	1.9	2.2	0	0
(Increase)/decrease in net debt	9.7	29.1	14.3	23.6	22.8

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.9	4.4	3.4	3.9	4.1
Return on equity (%)	12.3	10.8	8.4	10.7	11.8
Return on funds employed (%)	8.5	7.4	5.5	6.5	7.2
EBITDA margin (%)	50.9	51.4	48.8	51.5	53.5
EBIT margin (%)	48.0	48.2	45.3	48.2	50.3
Capex to sales (%)	91.3	95.4	90.8	86.9	87.4
Capex to depreciation (%)	3,129	3,064	2,598	2,651	2,717
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	30	29	33	30	31

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(83.7)	(137.9)	(200.6)	(207.4)	(209.6)
Fixed assets	2,193.1	2,717.8	3,261.0	3,568.4	4,057.9
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	3,381.7	3,871.0
Net debt/(cash)	339.7	431.3	582.7	706.2	787.8
Lease liability	0	0	10.5	10.5	10.5
Other liabilities	990.8	1,167.0	1,361.2	1,550.5	1,827.7
Shareholder's funds	789.1	1,000.8	1,124.8	1,114.6	1,245.1
Minority interests	0	0	0	0	0
Total funding sources	2,119.6	2,599.1	3,079.2	3,381.7	3,871.0

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ\$m)					
Care fees	91.2	101.3	110.6	123.2	137.2
Management fees	45.6	52.5	59.6	68.6	79.6
Gain on resales	28.7	36.9	38.3	40.6	44.5
Gain on new sales	63.7	61.0	43.5	61.5	79.5
Total revenue	229.2	251.6	252.0	293.9	340.7

Key Drivers					
Sales - new units	339	329	320	435	500
Ave unit price - new sales (NZ\$000s)	566	665	618	643	662
Sales - resold units	301	323	348	370	408
Ave unit price - resales (NZ\$000s)	406	445	458	477	496
Gross development margin (%)	33.2%	27.9%	22.0%	22.0%	24.0%
Gross resales margin (%)	23.5%	25.7%	24.0%	23.0%	22.0%
New apartments/units	454	354	325	425	480
New beds	52	0	86	80	80
Total	506	354	411	505	560

Portfolio					
Apartments/units	3,732	4,086	4,411	4,846	5,346
Beds	858	858	944	1,024	1,104
Total Portfolio	4,590	4,944	5,355	5,870	6,450

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

1H20 result summary and forecast changes

We increase our FY20 estimates but leave our FY21/22 estimates largely unchanged. The key areas of change for FY20 are; (1) increased re-sale gains driven by an increased number of re-sale units; (2) higher new sales offset by lower new-sale prices and, (3) higher DMF and care fees. Our small FY21/22 changes reflect a change in revenue mix with a greater contribution from care fees and re-sale gains offset by a lower contribution from new-sales. Accordingly, we have reduced our new-unit sales forecast in FY21 from 475 to 435, reflecting a prolonged period until a return to "trend" growth. Our target price increases to NZ\$9.15 (from NZ\$9.00).

Figure 1. 1H20 result summary (NZ\$m)

	1H19	1H20	Change	Forsyth Barr	Actual vs FB
Care Fees	48.8	53.3	9%	51.2	4%
DMF	25.1	28.7	15%	27.9	3%
Resale Gains	14.3	15.7	10%	14.9	5%
Newsale Gains	27.1	17.4	-36%	19.9	-12%
Total Revenue	115.3	115.1	0%	113.8	1%
Total Costs	56.9	57.8	2%	57.1	1%
EBITDA	58.4	57.3	-2%	56.7	1%
Depreciation & Amortisation	3.9	3.9	0%	4.9	-20%
EBIT	54.4	53.3	-2%	51.8	3%
Net interest	6.7	8.3	24%	9.9	-16%
Underlying profit	47.8	45.1	-6%	41.9	7%
EPS (cents)	21.3	18.4	-14%	18.8	-2%
DPS (cents)	6.4	6.0	-6%	7.0	-14%
Sales - new units	136	128	-6%	128	0%
Average unit price - new sales (NZ\$000's)	701	609	-13%	722	-16%
New sales margin (%)	28%	22%	-6%	22%	1%
Sales - resold units	142	136	-4%	136	0%
Average unit price - resales (NZ\$000's)	430	457	6%	456	0%
Resales margin (%)	23%	25%	2%	24%	1%

Source: Forsyth Barr analysis, Company reports

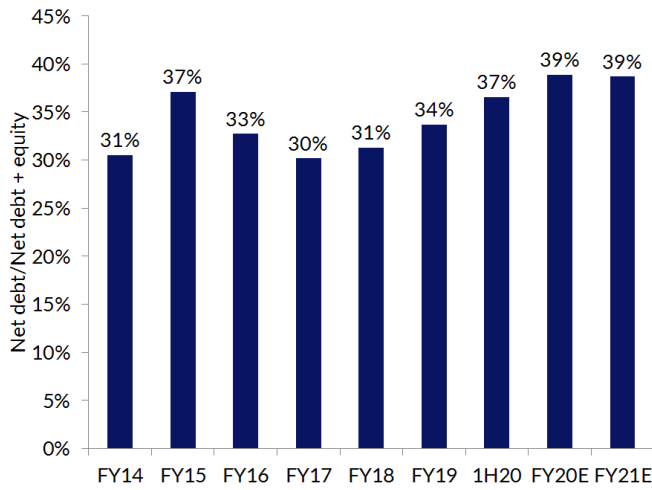
Figure 2. Detailed forecast changes (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Change	Old	New	Change	Old	New	Change
Care Fees	106.3	110.6	4%	115.7	123.2	6%	129.8	137.2	6%
DMF	58.3	59.6	2%	67.4	68.6	2%	77.1	79.6	3%
Resale Gains	33.6	38.3	14%	38.8	40.6	5%	44.6	44.5	0%
Newsale Gains	43.7	43.5	0%	70.3	61.5	-13%	87.2	79.5	-9%
Total Revenue	242.0	252.0	4%	292.2	293.9	1%	338.6	340.7	1%
Total Costs	129.9	129.2	-1%	141.0	142.5	1%	157.0	158.5	1%
EBITDA	112.1	122.9	10%	151.2	151.4	0%	181.6	182.2	0%
Depreciation & Amortisation	9.8	8.8	-10%	10.7	9.6	-10%	12.3	11.0	-11%
EBIT	102.3	114.1	12%	140.5	141.7	1%	169.3	171.2	1%
Net interest	19.8	19.1	-3%	23.2	22.1	-5%	26.2	24.4	-7%
Underlying profit	82.5	95.0	15%	117.3	119.6	2%	143.1	146.8	3%
EPS (cents)	37.0	42.2	14%	52.6	53.2	1%	64.2	65.3	2%
DPS (cents)	14.0	14.2	1%	15.0	16.0	7%	18.0	20.0	11%
Sales - new units	290	320	10%	475	435	-8%	500	500	0%
Average unit price - new sales (NZ\$000's)	685	618	-10%	705	643	-9%	726	662	-9%
New sales margin (%)	22.0%	22.0%	0.0%	21.0%	22.0%	1.0%	24.0%	24.0%	0.0%
Sales - resold units	297	348	17%	370	370	0%	409	408	0%
Average unit price - resales (NZ\$000's)	454	458	1%	476	477	0%	496	496	0%
Resales margin (%)	25.0%	24.0%	-1.0%	22.0%	23.0%	1.0%	22.0%	22.0%	0.0%

Source: Forsyth Barr analysis

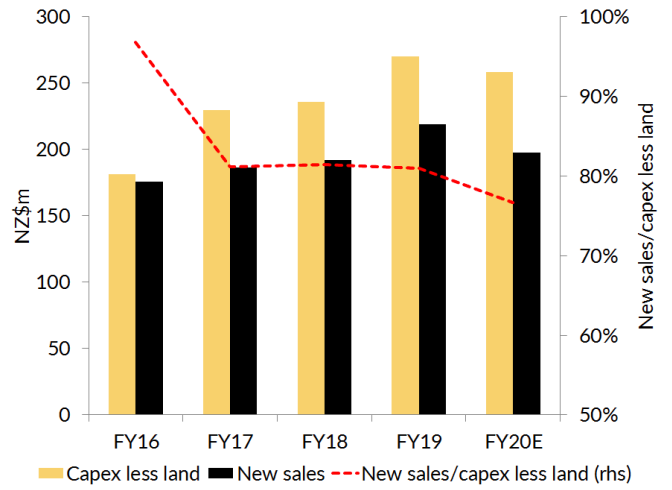
Charts of interest

Figure 3. Net debt/Net debt + equity over time



Source: Forsyth Barr analysis, Company reports

Figure 4. New sales vs capex less land



Source: Forsyth Barr analysis, Company reports

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.

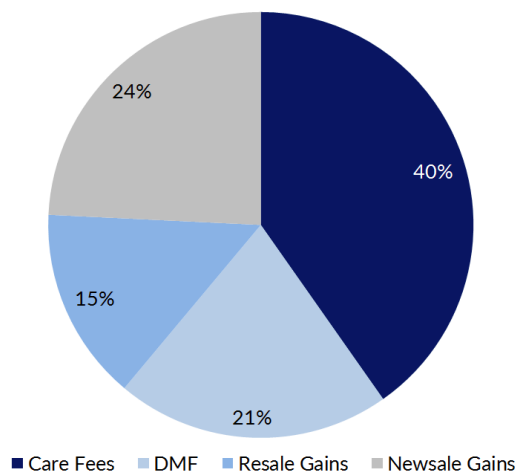
Financial structure

- **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

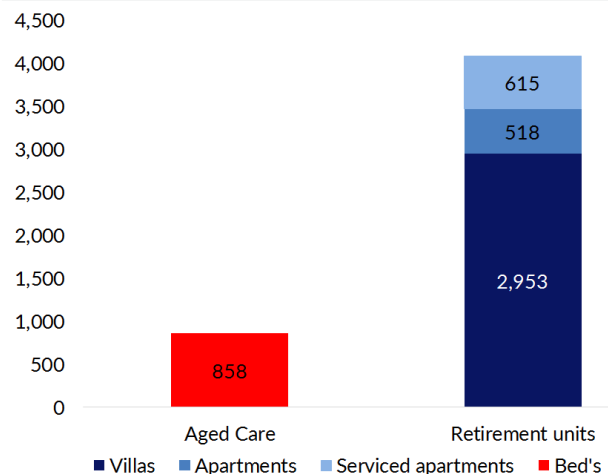
- **Oversupply:** The significant industry pipeline poses the threat of short-term oversupply, offset by a likely shortage of quality beds longer term. With a stalling in the economy with COVID-19, we expect private operators will find it tougher to resurrect development programmes than the well funded 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 5. SUM FY19 revenue mix

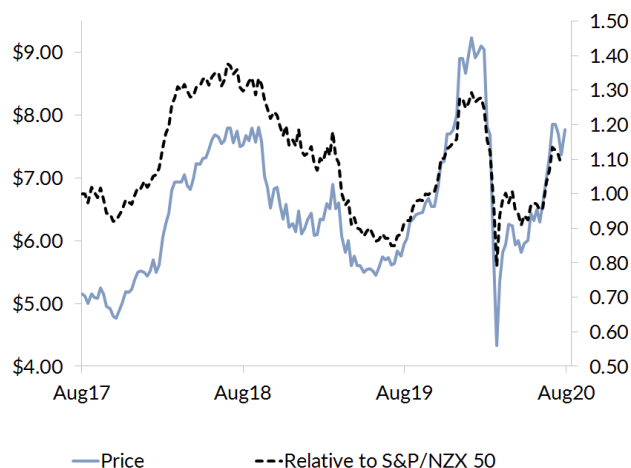


Source: Forsyth Barr analysis, Company reports

Figure 6. SUM portfolio as at 31 December 2019



Source: Forsyth Barr analysis, Company reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. 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%

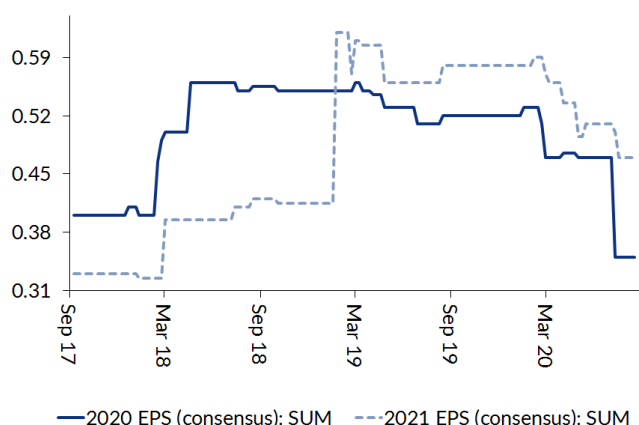
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 9. International valuation comparisons

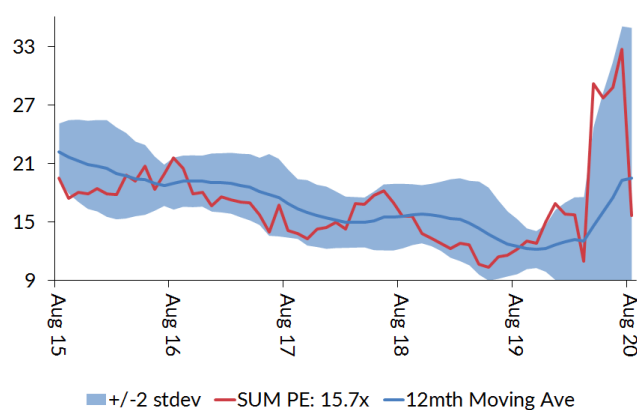
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SUM's balance date - December)										
Summerset Group Limited	SUM NZ	NZ\$7.77	NZ\$1,748	18.3x	14.6x	17.7x	14.4x	19.1x	15.4x	2.1%
METLIFECARE *	MET NZ	NZ\$5.92	NZ\$1,263	17.7x	16.4x	19.3x	17.9x	20.9x	19.4x	1.3%
RYMAN HEALTHCARE *	RYM NZ	NZ\$12.39	NZ\$6,195	25.8x	21.7x	26.9x	22.9x	29.9x	25.2x	2.1%
OCEANIA HEALTHCARE *	OCA NZ	NZ\$0.96	NZ\$595	13.0x	11.1x	13.3x	11.6x	17.1x	14.7x	4.5%
ARVIDA GROUP LIMITED *	ARV NZ	NZ\$1.49	NZ\$808	17.9x	15.6x	18.8x	16.1x	21.8x	18.6x	3.6%
Compco Average:				18.6x	16.2x	19.6x	17.1x	22.4x	19.5x	2.9%
SUM Relative:				-2%	-10%	-10%	-16%	-15%	-21%	-28%

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 10. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 11. 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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