



27 January 2017

Investment Ideas: Value yet to be realised in Australian Aged Care

We believe there is upside potential in retirement village operators, although legislative/regulatory risk is likely to be an ongoing concern.

We believe EGH and GTY to be attractive options to gain exposure to the Australian aged care sector. At current prices, investments in EGH and GTY represents total potential upside of around 40% and 29%, respectively, based on IRESS consensus estimates.

The aged care sector had a tumultuous year in 2016, with proposed cuts to aged care funding by the Federal government severely impacting investor sentiment. This sparked high volatility and negative returns for the sectors' largest operators Regis Healthcare (ASX: REG), Estia Healthcare (ASX: EHE), and Japara Healthcare (ASX: JHC), as the revenue structure in these companies relies primarily on government subsidies.

Over the same period, the operators of retirement villages: Eureka Group Holdings (ASX: EGH), Gateway Lifestyle (ASX: GTY), Lifestyle Communities (ASX: LIC) and Igenia Communities Group (ASX: INA), have proven to be uncorrelated with the aged care companies REG, EHE and JHC. Retirement village operators remain attractive and have been able to differentiate from the full serviced aged care providers as the Aged Care Funding Instrument (ACFI) is not a primary source of income. Whilst the ACFI is set to be slashed come July 2017, demand for properties within retirement villages is rising.

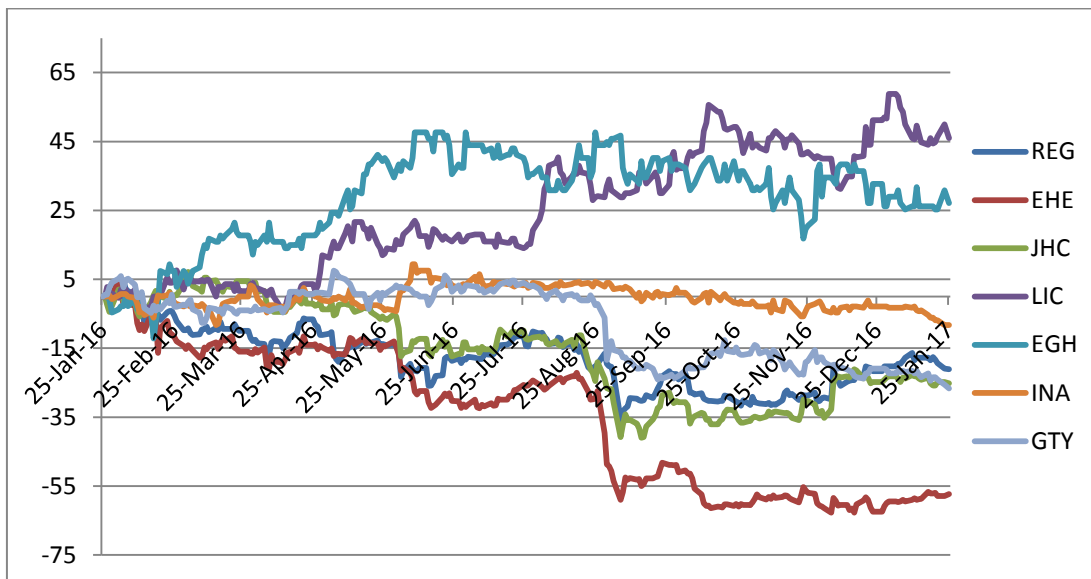
The sector remains an attractive and fundamentally strong industry, backed by favourable population demographics.

- The Australian population over 65 is set to rise to 4.2 million by 2020, and 8.8 million by 2050 from current levels at 3.6 million today.
- According to Eureka, revenue from retirement villages comprised approximately \$3 billion of the total \$17 billion revenue from aged care accommodation over the period 2014 – 2015. This is forecasted to increase significantly as the population ages over time.

Peer comparative					
	Share Price (\$)	Target Price (\$)	Upside/ (downside) (%)	Dividend Yield (%)	Market Cap. (m)
EGH	0.68	0.95	40	-	162
GTY	2.02	2.51	24	5.3	613
INA	2.56	3.08	20	4.3	453
LIC	3.66	3.78	3	1.2	382
EHE	2.71	2.83	4	7.9	705
JHC	2.21	2.37	7	5.5	587
REG	4.47	4.69	5	4.5	1,342

Source: IRESS, State One Stockbroking

Relative Share Price Performance of REG, EHE, JHC, LIC, EGH, INA (25 Jan 16 - Present)

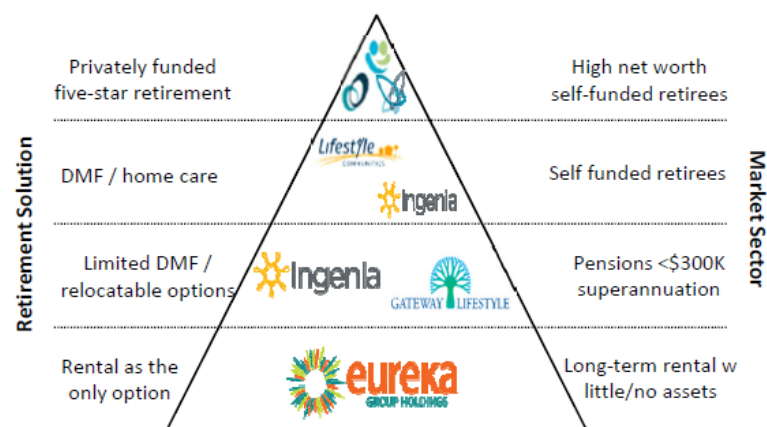


Source: IRESS, State One Stockbroking

Uncorrelated with the Turmoil of the Aged Care Sector:

- Whilst there are similarities between some of the companies, such as their reliance on government funding, there are major differences, as illustrated in Figure 1 below.
- REG, EHE and JHC service the top end of the market offering full service facilities, including nursing and healthcare support. These companies are most affected by changes to the levels of government funding as the ACFI is set to be slashed and false claims on patient health needs are to be cracked down. Residents currently receive a Home Care Subsidy rate based on their dependency, and also receive additional benefits according to their needs.
- Lifestyle Communities, Eureka, Gateway, and Igenia each offer seniors opportunities to purchase or rent a property within communities developed specifically for people over a certain age. Whilst not specifically classified as an aged care operator, these companies directly target this sector without direct or full exposure to government funding changes (LIC and INA both offer home care options). Eureka is indirectly funded by the government by targeting those on the full aged pension.

Figure 1.



Source: Eureka Group

Value in Retirement Village Developers:

Eureka Group Holdings:

- Eureka is the smallest of the three companies with only 35 villages in its portfolio. Villages in its portfolio are spread across four Australian states – SA, NSW, VIC, QLD
- Eureka only provides residents with the ability to rent properties within villages. Through an external partnership with Blue Care Alliance, residents are provided with home care based on their needs. This provides the company with a competitive advantage over other affordable aged care communities. In other low cost villages residents must organise their home care needs independently
- EGH also has the highest growth rate with properties owned increasing 91% in FY16. This is expected to continue with 8-12 acquisitions targeted and further development of existing communities to add 295 additional units in FY17
- **Eureka remains the most attractive aged care community company with significant increases in the company's Revenue (98%), EBITDA (202%), and EPS (132%) in FY16. EGH expects to build on this growth in FY17**
- The company also maintains a strong balance sheet with net assets of around \$111m

Gateway Lifestyle:

- GTY holds a portfolio of 54 communities across QLD, NSW and VIC for retirees over 50
- FY16 results were either in line or ahead of prospectus forecasts in key financial metrics: Revenue (+2%), EBITDA (0%), EPS (0%)
- FY17 target growth rate in NPAT of 5%, compared with 8% in FY16 was not well received by the market but looks to now be priced into the share price
- Company is positioned for future growth through acquisitions with debt capacity of \$115m and undergoing development of 10 new communities

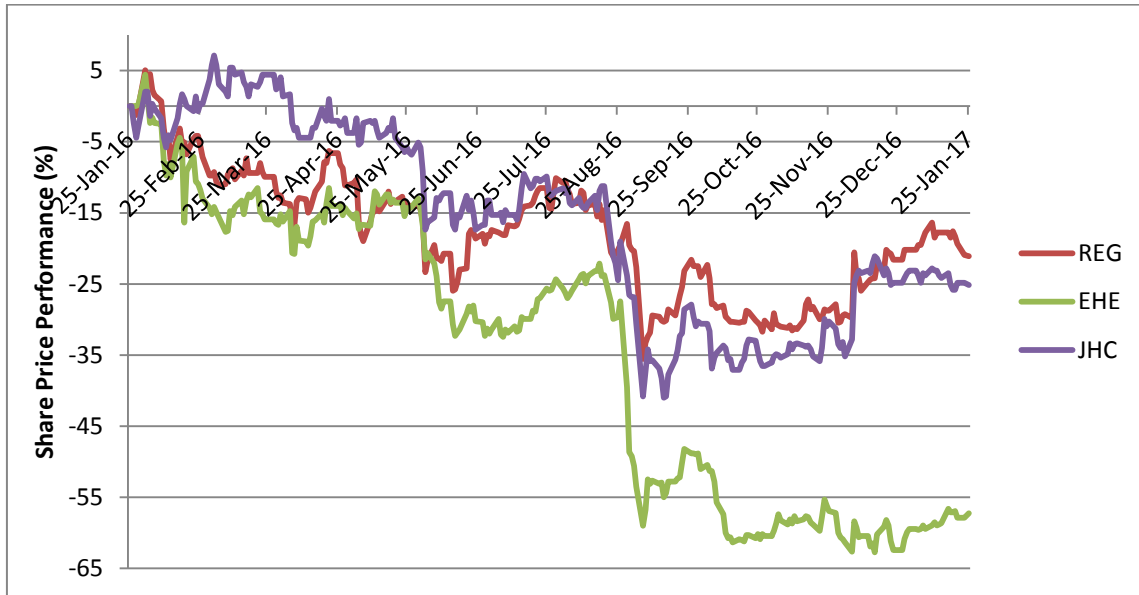
Lifestyle Communities:

- LIC currently holds a portfolio of 13 communities within Victoria for retirees over 50
- The company focuses on delivering affordable living to residents with homes generally priced at 75 to 80% of the median house price
- The financial performance of the company declined in FY16 with declines in Revenue (-11%), EBIT (-11%), however an increase in EPS (13%)
- The company targets 250 – 270 home settlements in FY17

Igenia Communities:

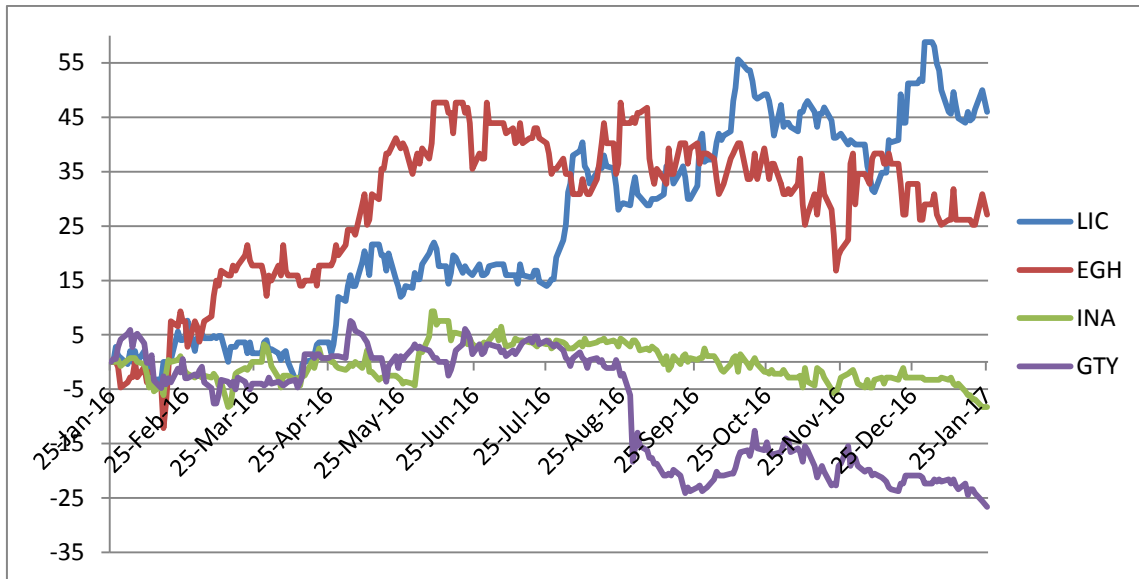
- INA holds a more diversified portfolio with 68 communities across five Australian states.
- The company achieved an increase in revenue (40.9%), EBIT (34.1%), however a decline EPS (-14.36%)
- Targets to achieve at least 150 home settlements in FY17

Relative Share Price Performance of Aged Care Operators (25 Jan 16 - Present)



Source: IRESS, State One Stockbroking

Relative Share Price Performance of Retirement Village Operators (25 Jan 16 - Present)



Source: IRESS, State One Stockbroking



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