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Yovich & Co. Market Update

26th June 2022

As at 24th June	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	10589.19	6663.29	3316.79	7016.25	29888.78	10798.35	0.9104	0.6316	2.00%
Week Close	10813.92	6762.38	3349.75	7208.81	31500.68	11607.62	0.9096	0.6327	2.00%
Change	2.12%	1.49%	0.99%	2.74%	5.39%	7.49%	-0.09%	0.18%	0.00%

We saw some recovery in sharemarkets globally last week, following the previous negative week which saw the NZ and US markets go into bear market territory (down 20% from peak). The NZ market recovered 2.12% during the week, while the US market rebounded strongly, the Dow up 5.39% and the NASDAQ up 7.49%.

The price of oil and commodities dropped over the week, prompting hopeful forecasts that inflation may be peaking, which had the effect of lowering interest rates, and causing sharemarkets to rebound.

In the US, the 10-year Treasury rate was down 9bps to 3.13%, while the 2-year Treasury rate was down 11bps to 3.07%, steepening the yield curve after it got closer to flattening last week. In NZ, the effect was more pronounced, with the 10-year swap rate falling a heavy 27bps back down to 4.26%, while the 2-year swap rate fell 28bps to 4.24%.

The price of oil dropped: after having peaked at US$125 the previous week, the price dropped down to finish the week at US$113 per barrel. The price of iron ore dropped by 6.8%, having already fallen the previous week, and other metals such as copper fell during the week also.

On the lockdowns in China, Beijing on Saturday said it would allow primary and secondary schools to resume in-person classes while Shanghai reported zero new local cases for the first time in 2 months. However, Shanghai still plans to continue conducting mass PCR testing for its 25m residents every weekend until the end of July.

The biggest movers of the week ending 24th June 2022			
Up		**Down**	
Skellerup	11.21%	EROAD	-14.36%
Fletcher Building	6.72%	Pacific Edge	-4.23%
Chorus	5.84%	Manawa Energy	-3.76%

Market Highlight – Summerset Group Holdings

Summerset is an operator and developer of retirement villages and aged-care facilities throughout NZ. Retirement villages earn income via:

- Village services (e.g. rates, insurance, grounds maintenance, village services)
- Deferred management fees
- Realised resale gains
- Realised development margin
- Aged care fees

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Deferred Management Fees

When a resident moves into a retirement village, they do not purchase the unit outright. They instead purchase a licence to occupy, giving them the right to live in the unit. When the resident leaves the village, they (or their estate) pay a deferred management fee, being a percentage of the original cost of buying the licence to occupy. This management fee is usually calculated in annual increments up to a cap, for example 5% after 1 year, increasing each year to a cap of generally 20-25% after 3-5 years. The company uses the fee to refurbish the property ready for resale, and pays out the exiting resident the remainder of their original purchase price. For example, a resident who pays say $500k for their unit, and stays for the average term of 7 years, will be paid out $375k-$400k depending on the contract.

Realised Resale Gains

Once the company refurbishes the unit, the unit is then offered for re-sale via a licence to occupy. If, in the above case, the unit is re-sold for $650k, then the village has made a resale gain of $150k due to increasing house values over time.

Realised Development Margin

Retirement companies like Ryman and Summerset are large developers of new villages and units. Like any residential house developer, retirement companies generate revenue via buying land and building residential units to sell (via licences to occupy). The amount of money they make from this enterprise depends on what price they can get for the sale, compared to how much it cost to develop, being the development margin.
Summerset has set a medium-term target range development margin of 20%-25%.

Aged Care Fees

Summerset villages aim to provide a continuum of care, starting from independent living units (villas or apartments), moving through to assisted living via serviced apartments, and then specialised care, which includes rest-home care and hospital care. Residents will often move between service levels as circumstances require.
Aged care fees come from the specialised care, including rest-home care and hospital care facilities. Residents are looked after by caregivers and nurses, and their funding can be subsidised by government assistance via the DHB.
This division of the business is more defensive in nature, and attracts residents looking for the continuum of care, but provides a lower margin than the selling and re-selling retirement units. Summerset has a c. 80:20 split between retirement units and aged-care beds.

FY21 Results

Resales – Summerset resold a record 438 units during FY21, up 15% on the previous year. The resale margin achieved was 25.9%, equating to revenue of $59.9m, an increase of 30% compared to FY20.
New Developments – Summerset began construction of three new villages in Canterbury, Kapiti, and Cambridge, and completed two villages in Tasman and Christchurch (Avonhead). In total, 619 new units were developed in FY21, with 540 new retirement units sold, up from 404 last year. With a development margin achieved of 23.1%, revenue from new sales was $78.5m, up 63% on FY20.

With $126.8m revenue from aged care services and village fees, and $75.2m from management fees, underlying net profit after tax was $141.1m, up 44% from FY20. This is despite higher operating costs due to wages and costs increasing at a higher rate than the increases to DHB funding.
Further, with the Covid-19 lockdown, Summerset incurred $4.7m of one-off operational costs due to Covid-19 in FY21. This was predominantly from additional staff wages, pandemic kits, and personal protective equipment (PPE).

Guidance for FY22

Management provided guidance for an FY22 build rate of 550-650 units including care beds, with development margins being within the target range of 20%-25%.

Like its competitor Ryman, Summerset has acquired land in Victoria Australia to provide for future growth. Earthworks have begun on their first village at Cranbourne North in Melbourne, and the first units are forecast for FY23.

Valuation

Consensus target price for Summerset is $14.26, based on an average of four analysts' price targets. Jarden's price target is $12.00.

At the current price of $9.55, this provides a trailing PE ratio of 15.7x. The forecast PE ratio based on forecast FY22 results is 13.6x. This is based on forecast earnings increasing by 15% compared to FY21.

With price appreciation in the housing market, net tangible assets (NTA) grew by 41% to $8.44 per share. At the current price of $9.55, the price to NTA multiple is now 1.13, well below its 5-year average of 1.8x.

Investment News

Contact Energy (CEN.NZ) – Te Rapa Power Station Closing in June 2023

Contact Energy will close its Te Rapa power station in June 2023, reducing its emissions by 20%. The plant is a gas-fuelled cogeneration plant, providing steam and electricity to Fonterra's Te Rapa dairy factory. The current agreement with Fonterra expires in June 2023, at which time Fonterra will acquire the boiler, but the gas turbine used to generate electricity will be retired. The gap in electricity generation will be replaced by renewable generation – currently 83% of Contact's electricity generation is renewable.

Current Share Price: $7.25, **Consensus Target Price**: $8.49

Fletcher Building (FBU.NZ) Reiterates FY2022 EBIT Guidance of $750m

Fletcher Building has reiterated their guidance for EBIT of c.$750m for FY2022, and a forecast EBIT margin of 9.5% for the second half of FY2022.

Current Share Price: $5.08, **Consensus Target Price**: $7.35

Pacific Edge (PEB.NZ) – FY2022 Loss of $19.8m

Cancer diagnostics company Pacific Edge has announced their FY2022 results, being a net loss of $19.8m, down from a loss of $14.2m in the previous year. Revenue was up from $10.4m in pcp to $13.9m, an increase of 33%, reflecting growth in the adoption of the company's diagnostics tests by physicians and healthcare organisations. Cxbladder total test volumes increased 46%.

Current Share Price: $0.68, **Consensus Target Price**: $0.98

Fonterra (FCG.NZ, FSF.NZ) Raises Farmgate Milk Price Forecast

Fonterra has raised its farmgate milk price forecast for the next NZ production year to $8.75-$10.25, an increase of $0.50 from the previous range. The increase is due to tight global supplies and a strong US dollar.

Current Share Price: $3.16, **Consensus Target Price**: $3.61