

# Metlifecare Limited

Independent Adviser's Report in relation to the proposed scheme of arrangement with Asia Pacific Village Group Limited

June 2020

## STATEMENT OF INDEPENDENCE

KordaMentha confirms that it:

- a. has no conflict of interest that could affect its ability to provide an unbiased report; and
- b. has no direct or indirect pecuniary or other interest in the proposed transaction considered in this report, including any success or contingency fee or remuneration, other than to receive the cash fee for providing this report.

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# 1 Executive Summary

## 1.1 Introduction

Metlifecare Limited (**Metlifecare** or **the Company**) is a New Zealand incorporated company listed on the NZX Main Board. Metlifecare owns and operates a portfolio of 25 retirement villages and related care facilities, which are predominantly located in the upper North Island of New Zealand.

On 29 December 2019, Metlifecare entered into a Scheme Implementation Agreement (**SIA**) with Asia Pacific Village Group Limited (**APVG**), pursuant to which the parties agreed to implement a court-approved Scheme of Arrangement (**the Scheme**) to effect the sale of all of the outstanding shares in Metlifecare to APVG.

The proposed consideration is \$7.00 cash per Metlifecare share. The interim dividend that Metlifecare usually pays in March each year has been suspended.

## 1.2 APVG and Metlifecare dispute

As detailed further in the Explanatory Notes to the Notice of Special Meeting of Shareholders, Metlifecare and APVG are currently in dispute about a notice from APVG purporting to terminate the SIA. Metlifecare has rejected that notice and is treating APVG's actions as a 'repudiation' (invalid termination) of APVG's contractual obligations. Metlifecare has filed a statement of claim seeking court orders requiring APVG and EQT Infrastructure Fund to comply with their obligations. However, should it be determined that APVG has validly terminated the SIA, then the Scheme cannot proceed.

The Scheme cannot proceed if Metlifecare is not successful in its litigation with APVG concerning the dispute over whether a valid notice terminating the SIA has been given. It is possible that Metlifecare may establish there has been an invalid termination but that the Court decides not to exercise discretion to order specific performance requiring APVG and EQT Infrastructure IV Fund to perform their contracted obligations. There could be some delays in a final outcome, if APVG or Metlifecare appeal. If Metlifecare does not succeed in its litigation the Court may order Metlifecare to pay for some of the costs of APVG and/or EQT Infrastructure IV Fund.

An earlier draft version of this report was prepared as an independent adviser's report on the Scheme. At the present stage, shareholders are not being asked to vote on the Scheme. Instead, shareholders are being asked to vote on whether Metlifecare should pursue its litigation against APVG. To assist shareholders in this vote, Metlifecare has requested that KordaMentha finalise this report. In order to do so, we have made several changes to reflect the present context.

This report was finalised in June 2020, based on the information available at the present time. If Metlifecare is successful in its litigation against APVG, and APVG is obliged to proceed with the Scheme, then a new Independent Adviser's Report will be required. Any new report would need to consider the information available at that point in time, which may be materially different due to the passage of time. As a consequence, the merits of the transaction may be different once the litigation between Metlifecare and APVG is resolved.

## 1.3 COVID-19 and lockdown restrictions

New Zealand had its first confirmed case of COVID-19 on 28 February 2020.

In response to the COVID-19 pandemic, the New Zealand Government introduced a four-level alert level system on 21 March 2020 to manage the outbreak within New Zealand, with each level having added restrictions on activities and the movement of people. The alert level was initially set to Level 2.

The New Zealand Government implemented Level 4 lockdown restrictions at 11.59pm on Wednesday 25 March 2020. These restrictions were in place for approximately five weeks. After that, New Zealand had a period of two weeks with Level 3 lockdown restrictions.

At the time this report is being finalised, New Zealand is at Alert Level 2. While most of the lockdown restrictions have been lifted, many physical distancing requirements remain.

The global COVID-19 pandemic, the lockdown restrictions and an expected deterioration in general economic conditions have had a significant impact on listed companies share prices. In particular, many New Zealand listed companies' share prices experienced significant falls during March 2020. At the time this report is being finalised, the share prices for many companies have partially recovered, but share prices remain volatile.

As an operator of retirement villages and aged care homes, Metlifecare is an 'essential services' provider. Metlifecare was able to continue operating its villages and care homes while the lockdown restrictions were in place. However, Metlifecare was restricted from showing prospective residents around its villages, which affected the turnover of its units. The lockdown restrictions also affected Metlifecare's development activities, which were paused under Level 4.

KordaMentha's valuation of Metlifecare, as set out in this report, was last updated on 5 June 2020. This valuation was based on financial forecasts and projections provided by Metlifecare in May 2020. The key assumptions that underpin the forecasts are set out at Section 6.2.1 of this report. Metlifecare has considered the inputs to its forecasts, which span a period of 20 years and advised on 5 June 2020 that the forecasts and projections are its best view as to its future financial performance. Nevertheless, Metlifecare also considers that there is uncertainty as to the economic conditions over the next few years, which makes it difficult to forecast its near-term financial performance with any degree of certainty.

Given the uncertain economic conditions and volatility in share prices, shareholders should remember that this report was finalised on 5 June 2020 and does not take account of unforeseen events that occurred after that date.

## 1.4 Key issues to be considered

Key issues to be considered include:

- The proposed consideration of \$7.00 per share sits slightly above our assessed standalone valuation range of \$5.80 to \$6.90 per share. This value range was determined on 5 June 2020. The proposed consideration is above the \$6.35 per share midpoint of our range.
- Metlifecare forecasts that its underlying earnings (unlevered) will be \$96.2 million in FY20, which is broadly consistent with its earnings in the prior financial year. The earnings forecast includes negative impacts from the lockdown restrictions, partly offset by the Government's wage subsidy program and cost savings that Metlifecare has achieved while the lockdown was in place. Longer term, Metlifecare's financial performance is highly dependent on growth in house prices in Auckland and Tauranga, as well as the performance of its development activities. It is currently unclear whether COVID-19 will have a long term impact on the prices and demand for retirement village units.
- Unlike many of the listed retirement village operators, Metlifecare earns a relatively low proportion of its underlying profit from development activities. Metlifecare plans to increase its development activities, which could improve its profitability. However, when compared to some other listed operators, it has relatively less recent experience at undertaking developments, has less development land and is targeting a lower growth rate in units relative to the size of its existing portfolio. Metlifecare having less exposure to development activities may be an advantage during a recession, as its earnings are likely to be more resilient, due to a lower reliance on development profits.
- At the time of our report going to print, there has been no superior alternative proposal to the \$7.00 per share in the SIA. In any event, there is nothing to prevent another party from announcing its interest in acquiring Metlifecare at some time before Metlifecare shareholders vote on the proposed transaction. Such a potential acquirer could also acquire a blocking interest in Metlifecare on market, potentially at prices above the proposed Scheme consideration.
- The proposed consideration is at a 38% premium to the share price of \$5.08 per share, being the last close price on 19 November 2019, that existed just prior to Metlifecare's announcement of the receipt of a non-binding preliminary expression of interest on 20 November 2019. The proposed consideration is also at a premium to the Metlifecare share price at the time this report is going to print.
- Should Metlifecare be successful in its litigation against APVG, then the value subsequently determined by an independent adviser may be materially different from the assessment in this report, due to the passage of time and events since 5 June 2020, being the date when our valuation of Metlifecare was finalised.

## 2 Background

### 2.1 The proposed Scheme

On 29 December 2019, Metlifecare entered into the SIA to effect the sale of all the outstanding shares in Metlifecare to APVG.

The proposed consideration is \$7.00 cash per Metlifecare share. The interim dividend that Metlifecare usually pays annually in March has been suspended for 2020.

If Metlifecare is successful in its litigation, then the SIA is to be implemented through a scheme of arrangement under the Companies Act 1993 (**the Companies Act**) between Metlifecare, APVG, and Metlifecare's shareholders and is subject to several key conditions, including:

- The approval of Metlifecare's shareholders
- The approval of the High Court of New Zealand in accordance with the Companies Act
- The approval of the New Zealand Overseas Investment Office
- No material adverse change to Metlifecare (as defined in the SIA).

Pursuant to the SIA, Metlifecare cannot solicit any superior alternative proposal. However, should a superior proposal eventuate, in certain circumstances Metlifecare can respond and facilitate an alternative transaction. Should a superior alternative proposal eventuate then APVG has the right to match that proposal.

The Directors have recommended the Scheme, absent a superior alternative proposal. However, under certain circumstances, including if a Metlifecare director changes, qualifies or withdraws his or her recommendation of the Scheme, or recommends a competing transaction, or APVG validly terminates the SIA due to material default by Metlifecare, or there is a successful proposal to acquire Metlifecare, Metlifecare must pay APVG a break fee of \$14.91 million.

APVG is obligated to pay Metlifecare a reimbursement of \$14.91 million Metlifecare validly terminates the SIA due to material default by APVG.

### 2.2 Profile of APVG

APVG is a New Zealand incorporated subsidiary indirectly owned by the EQT Infrastructure IV fund (**EQT Infrastructure IV Fund**), represented by its manager (*gérant*) EQT Fund Management S.à r.l.<sup>1</sup>

EQT Infrastructure IV Fund is managed as part of the EQT AB Group, which is based in Sweden and includes entities advising EQT funds, as well as general partners and fund managers of EQT funds.

EQT AB Group is a global differentiated investment organisation with more than EUR 62 billion in raised capital and around EUR 41 billion in assets under management across 20 active funds. Some of EQT's notable investments in the healthcare sector include Charleston, which operates within the German nursing home care market and I-MED, a leading diagnostic imaging provider in Australia.

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<sup>1</sup> EQT Fund Management S.à r.l., is a Luxembourg limited liability company (*société à responsabilité limitée*) with registered office at 26A, Boulevard Royal, L-2449 Luxembourg and registered with the Luxembourg trade and companies register (*Registre de Commerce et des Sociétés, Luxembourg*), under number B167.972, and acts as manager (*gérant*) of the various investment vehicles comprising the fund known as EQT Infrastructure IV, including EQT Infrastructure IV EUR SCSp and EQT Infrastructure IV USD SCSp, each a Luxembourg special limited partnership (*société en commandite spéciale*) with its registered office at 26A, Boulevard Royal, L-2449 Luxembourg, registered with the Luxembourg trade and companies register (*Registre de Commerce et des Sociétés, Luxembourg*) under numbers B 225.967 and B 225.964 respectively.

## 2.3 Purpose of this Report

Metlifecare is subject to the Takeovers Code (**the Code**).

Should Metlifecare be successful in its litigation against APVG, the Scheme will need to be approved by the High Court of New Zealand in order to proceed. The High Court will not approve a scheme that affects the voting rights of a company subject to the Code unless:

- It is satisfied that the shareholders of the company will not be adversely affected by the use of a scheme rather than the Code to effect the change involving the Code company; or
- The Court is presented with a no-objection statement from the Takeovers Panel (**the Panel**). The Panel will take various factors into account when considering an application for a no objection statement, including:
  - All material information relating to the scheme proposal has been disclosed;
  - The standard of disclosure to all shareholders has been equivalent to the standard that would be required by the Code in a Code regulated transaction or is otherwise appropriate in all of the relevant circumstances;
  - The interest classes of shareholders have been adequately identified; and
  - Other key matters have been addressed, and there are no other reasons for the Panel to object to the Scheme.

The practice of the Panel (except in very limited circumstances) is to require the preparation of an independent adviser's report before it will consider issuing a 'no-objection statement' to the High Court.

Before the dispute between Metlifecare and APVG, the Directors of Metlifecare engaged KordaMentha to prepare an independent adviser's report on the Scheme. Our appointment was approved by the Panel.

KordaMentha prepared a draft independent adviser's report on the merits of the Scheme, which was provided to the High Court on 28 May 2020. The dispute between Metlifecare and APVG arose during the preparation of that draft report.

Due to the dispute between Metlifecare and APVG, shareholders are not being asked to vote on the Scheme at the present time. Instead, shareholders are being asked to vote on whether Metlifecare should pursue its litigation against APVG. To assist shareholders in this vote, Metlifecare has requested that KordaMentha finalise the draft independent adviser's report that was provided to the High Court.

This report has been prepared in order to meet Metlifecare's request for a final version of the independent adviser's report. However, as shareholders are being asked to approve the litigation resolution (rather than vote on the Scheme), we have made some changes from the version that was provided to the High Court on 28 May 2020, to reflect the present context. This report does not address all the merits of the Scheme.

Should Metlifecare be successful in its litigation against APVG, then shareholders will have the opportunity to vote to approve or reject the Scheme. Prior to that vote, shareholders will be provided with another independent adviser's report that will consider the merits of the Scheme at that point in time.

## 2.4 Other

The sources of information to which we have had access and upon which we have relied are set out in Appendix 1.

The Report should be read in conjunction with the statements and declarations set out in Appendix 2, regarding our independence, qualifications, general disclaimer and indemnity and the restrictions upon the use of the Report.

References to '\$', 'NZD' or dollars are to New Zealand Dollars, unless specified otherwise. When referring to Metlifecare, references to financial years or 'FY' mean Metlifecare's financial year ended 30 June. Please note, tables may not add due to rounding.



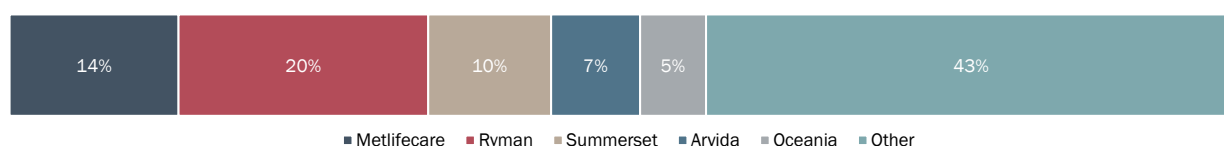
## 3 Retirement village industry

### 3.1 Overview

There are approximately 400 retirement villages and more than 40,000 village residents in New Zealand. The retirement village industry contributes approximately \$1.1 billion or 0.4% to national GDP.<sup>2</sup>

The largest retirement village operators are predominantly NZX-listed companies (Metlifecare, Ryman Healthcare, Summerset Group, Oceania Healthcare and Arvida Group). The only other significant operator is global healthcare and insurance company Bupa. Together, the five NZX listed operators make up 57% of the New Zealand retirement village market, as shown in below.

Figure 3.1: Share of retirement village industry by operator (by units)



Source: 2019 Annual Reports, Investor Presentations of NZX listed retirement village operators and KordaMentha estimates

### 3.2 Accommodation and care options

New Zealand retirement village operators offer a mix of accommodation and care services. While there is a full continuum of options available to meet the needs of residents, operators generally differentiate their products into four categories:

- Independent living units (ILU);
- Serviced apartments (SA);
- Age related residential care (ARRC) services in apartments; and
- Residential aged care homes (RCH).

#### Independent living units

ILUs are designed for residents who are still active, self-sufficient and want to live independently. These units vary in size, typically comprising one, two and three-bedroom villas, townhouses and apartments. The benefit of these units, when compared to a standalone house, is that residents are able to live independently in their own home while enjoying the security, social aspects, convenience and facilities offered by the village community.

#### Serviced apartments

SAs are designed for residents who require extra assistance in their day-to-day life while maintaining independence within their own home. These apartments are typically smaller and offer a broader array of additional services, such as meals, cleaning and laundry services.

#### Age related residential care services

Care apartments or suites provide certified residential aged care services; for example, rest home care delivered into a resident's apartment. This enables a resident to stay in their own apartment while also receiving high level care services.

#### Residential aged care homes

RCH offer residents 24 hour-a-day certified hospital, dementia or rest home care services. Staff, including qualified nurses, provide residents with complex nursing care, in addition to assisting residents with their daily activities.

Retirement village operators and other providers of aged care services work closely with one another to provide a continuum of care to meet the varying needs of older adults. Approximately half of the aged-care industry's bed count is located within retirement villages.

<sup>2</sup> Retirement village contribution to housing, employment, and GDP in New Zealand report by PWC, March 2018

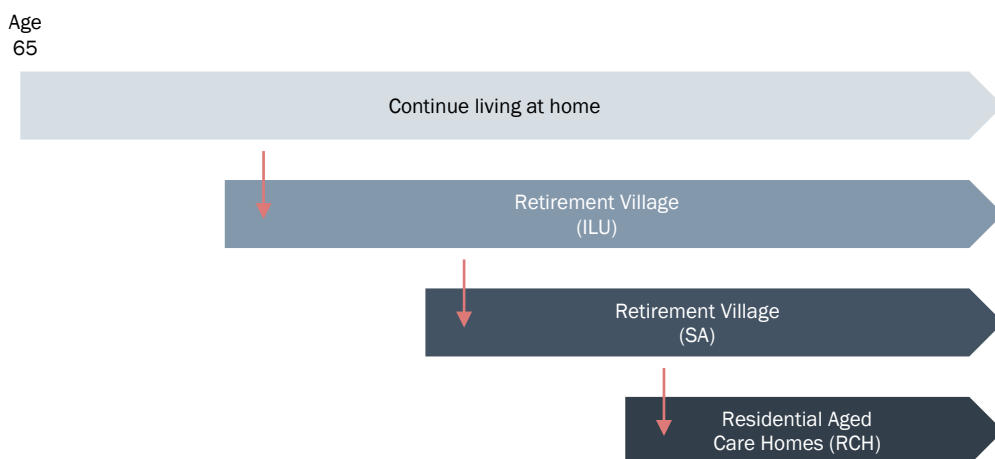
Entry into an RCH is usually prompted by deteriorating health or family support no longer being able to meet the required level of care. Residents can access an RCH from either the retirement village or directly from the community. To enter an RCH, a resident requires an independent assessment by a District Health Board (DHB) Needs Assessor.

Work and Income New Zealand (WINZ) provides means tested subsidies to support RCH residents with care fees.

### Continuum of accommodation and care

The industry average entry age of a resident moving into an ILU is currently around 79 years, and 85 years for a resident moving into a SA. Figure 3.2 illustrates the typical movement of a resident through the retirement village environment as they age and greater assistance is needed.

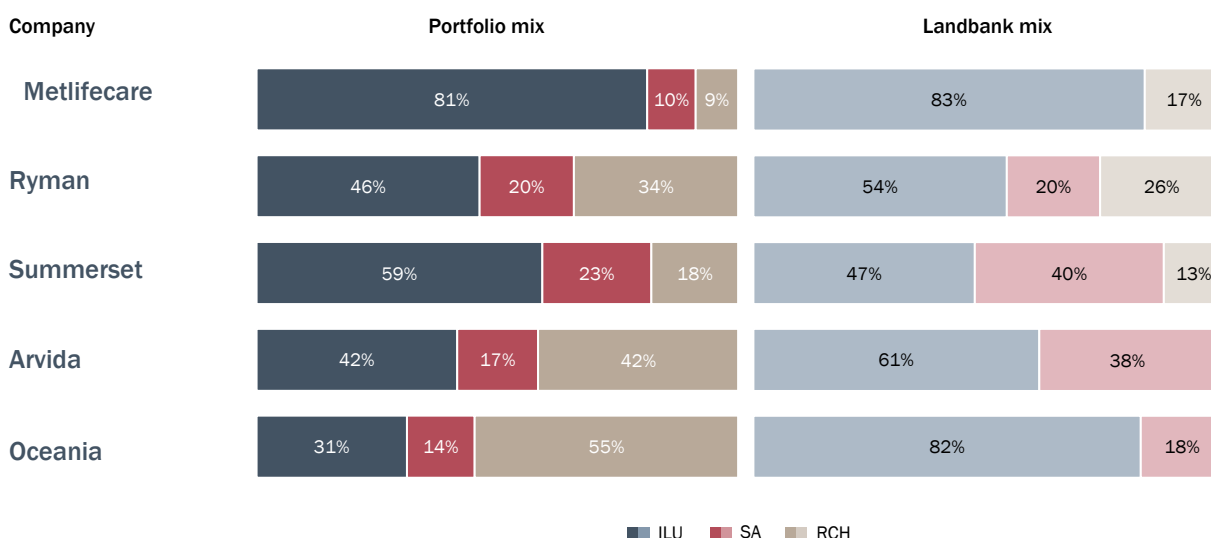
Figure 3.2: Continuum of accommodation and care provided by retirement village operators



### Portfolio mix

Figure 3.3 shows the accommodation mix in each NZX listed operator's portfolio and the transition toward ILUs in the development pipeline. Of all the operators, Metlifecare is the most focused on ILUs. Arvida and Oceania currently have the highest proportion of RCH.

Figure 3.3: Industry operators' portfolios and development pipelines by accommodation type



Source: 2019 Annual Reports and Investor Presentations of NZX listed retirement village operators



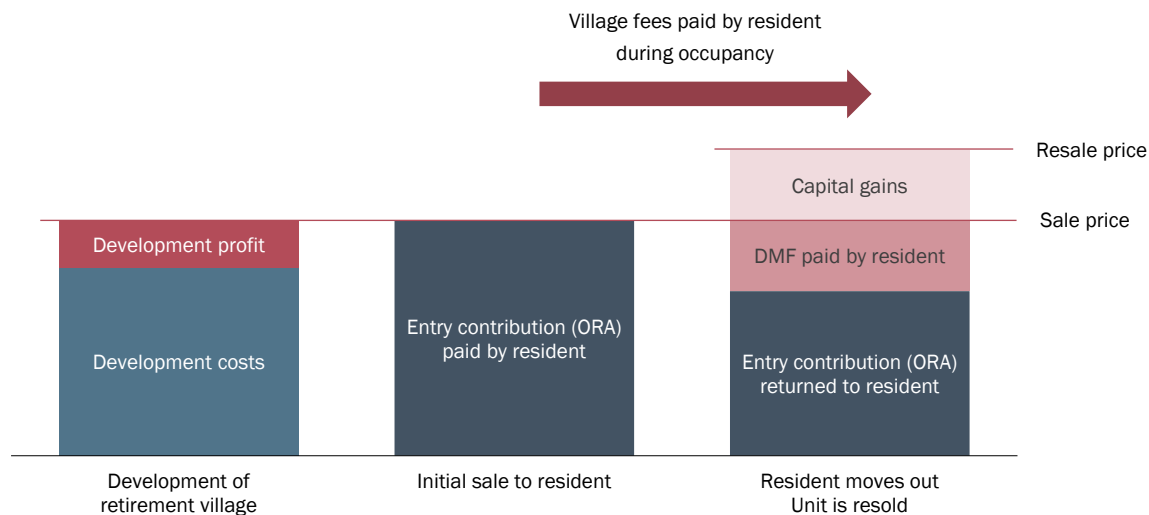
### 3.3 Ownership model

There are a variety of commercial models offered by retirement village operators; however, the key components of the typical model are:

- An Occupational Right Agreement (**ORA**), which usually includes a Deferred Management Fee (**DMF**); and
- Weekly village, services and care fees.

Figure 3.4 illustrates the typical revenue streams, shown in red, for operators.

Figure 3.4: Retirement village revenue



#### Occupational Right Agreement

Most retirement village operators in New Zealand have adopted ORA as the arrangement allowing individuals to take up residence.

Under the terms of an ORA, an incoming resident enters into an arrangement in which the village operator retains the freehold title of the unit. The resident pays an entry contribution to secure the ORA, which in turn secures their right to occupy their unit. The price paid for the ORA is generally equal to the market value of the unit, which varies based on the village and its facilities, the size and location of the unit and residential housing prices in the area. Given the upfront capital sum required to secure an ORA, incoming residents often rely on selling their family home as the main source of capital to fund their entry into a retirement village. The entry contribution is paid back to a resident (less a DMF) when they leave the village and the operator is able to settle an ORA with a new resident.

The market value of the ORA often changes during the term of a resident's occupancy. When a resident moves out of the village, the difference in price between their original entry contribution and the entry contribution paid by the unit's new resident is generally retained by the village operator. That is, the village operator generally keeps any capital gains. In limited instances, capital gains (and losses) are shared with the resident.

As operators are legally obliged to return the entry contribution to an outgoing resident, the entry contribution is treated as interest free loan to the operator.

Operators do not realise (in a cash sense) the appreciation in value of property until a resident moves out of a unit and a new resident signs and pays for a new ORA. However, operators generally revalue their property assets regularly and accrue any capital gain in their income statement.

For simplicity, we refer to the entry contribution paid to secure the ORA as the price paid for a unit. Likewise, we refer to the process of signing the ORA and the payment of the entry contribution by a new resident as the sale or resale of a unit.

### *Deferred Management Fee*

The DMF is typically capped at between 20% to 30% of the price paid for a unit and accrues contractually over the first three to five years of a resident's occupancy.<sup>3</sup> This fee is usually deducted from the ORA returned to the resident when the resident moves out and the operator resells the unit to a new resident.

The DMF is generally designed to cover the long-term maintenance costs in villages together with costs associated with refurbishing and reselling the unit at the end of a resident's occupancy, with any surplus retained by the operator.

DMF income increases when there is a higher turnover of residents. Increasing life expectancies could lengthen the average occupancy periods for retirement village residents, assuming the entry age of residents remains relatively constant. Accordingly, this could negatively impact the DMF revenue stream of operators over time unless operators maintain discipline around age-of-entry. Conversely, lowering age-of-entry levels broadens the market for operators' current product and future developments.

### *Village fee*

Village fees cover the day-to-day maintenance and operating costs of the village. These fees, paid periodically, cover expenses such as rates, building insurance, maintenance of community amenities, staff costs and the cost of maintaining and managing the village as a whole. Residents are generally responsible for their own expenses such as internal maintenance, power and phone bills. Some providers offer these fees at a fixed rate for the length of the tenancy.

These fees vary by village and by resident based on the facilities, activities, level of care and incremental support services offered by operators.

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<sup>3</sup> For financial reporting purposes, the DMF is typically accrued over the expected length of occupancy

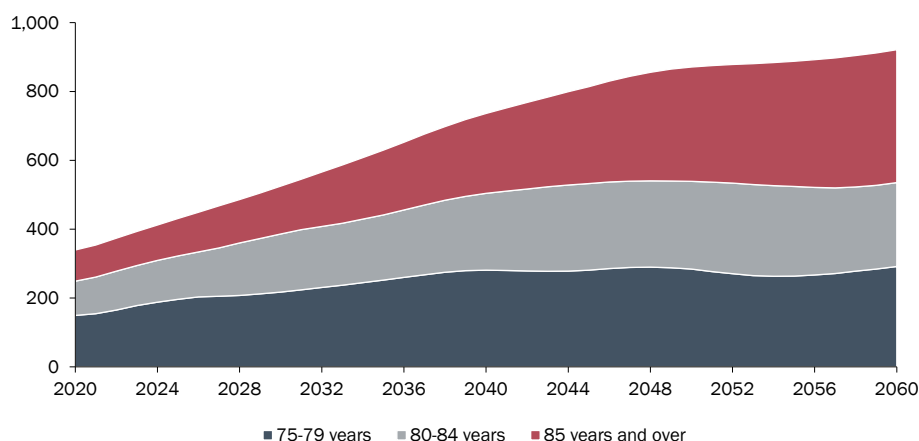


## 3.4 Key industry drivers

### 3.4.1 Aging population

As illustrated in Figure 3.5, it is estimated that the New Zealand population aged 75+ years will experience strong annualised growth of 3.9% over the next 20 years, increasing from 340,000 to 736,000 by 2040. The growth rate is expected to slow after 2040 and reaches a plateau around 2050.<sup>4</sup>

Figure 3.5: Population aged 75+ years



Source: Statistics New Zealand

People aged 75+ years currently represent 7% of New Zealand's population; however, this is expected to increase to 13% by 2040.

As people age, they become more susceptible to a range of age-related and degenerative conditions, which creates the need for ongoing assistance with their everyday activities and personal care.<sup>5</sup> Relative to previous generations, elderly people moving into full-care residential facilities are older and have more complex needs. As the average age of retirement village residents increase, the demand for aged-care and incremental services offered by operators is likely to increase.

### 3.4.2 Penetration rates

Industry research indicates that people's views towards retirement villages have become more favourable over the last decade.<sup>6</sup> Reasons outlined for this shift in opinion are:

- Increased familiarity and acceptance of the retirement village concept. This includes a better understanding of the difference between rest homes and retirement villages - which offer a 'lifestyle resort'. Industry players have invested heavily in marketing and education initiatives to expedite this market penetration.
- A shift in accommodation mix towards 'lifestyle resort' villages, which has widened the target market of the sector.
- Higher quality facilities and services offered by operators. The improved quality and consistency of product offerings has been aided by the consolidation of the sector over the last decade.
- Increased awareness of isolation and loneliness within the elderly community. Research has found that physical and mental well-being among retirement village residents is greater due to better social environments and more opportunities to keep active.<sup>7</sup>
- Operator's increased efforts to engage with the local community, which is partly aimed at changing perceptions that retirement villages are expensive and a luxury that only the wealthy can afford.

<sup>4</sup> Statistics New Zealand

<sup>5</sup> Aged Care Residential Services in New Zealand report by IBISWorld, May 2019

<sup>6</sup> Retirement Village Sector Insights by ANZ, October 2019

<sup>7</sup> 'What matters most to people in retirement villages and their transition to residential aged care' by P Yeung and others, 2015

Between 2008 and 2018, the proportion of people aged over 75 who reside in retirement villages has steadily increased. Over this period, the proportion in Auckland has increased from approximately 13.0% to 18.0%. Excluding Auckland, the proportion over the rest of New Zealand has increased from approximately 9.5% to 13.5%.<sup>8</sup>

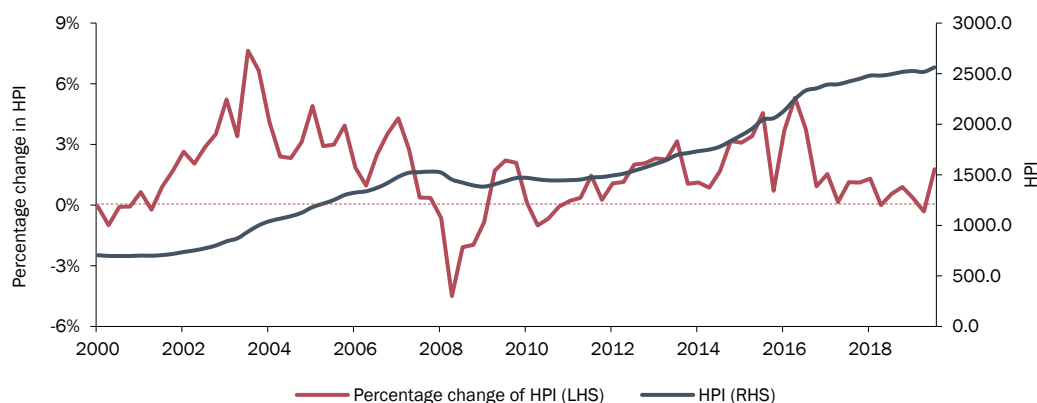
### 3.4.3 Property market

#### Residential housing prices

Retirement village operators' generally price their units with reference to prevailing house prices in the area surrounding a village. Under the ORA ownership model, if the price of houses in the area appreciate, operators will generally capture the capital gains for the units, this is set out in Section 3.3 and shown in Figure 3.4. Because of this, residential house prices heavily influence the industry's financial performance.

Over the last 10 years, New Zealand residential property prices have experienced strong growth. The Housing Price Index (HPI), which is a measure of property values in New Zealand, has increased by 78% over this period, as illustrated in Figure 3.6.<sup>9</sup> In absolute terms, the median house price increased from \$352,000 to \$629,000 between December 2009 and December 2019.

Figure 3.6: Growth in Housing Price Index over last 20 years



Source: Reserve Bank of New Zealand

The growth in house prices has been driven by:

- Robust population growth as a result of both natural population growth and strong net migration. In the twelve months to June 2019, New Zealand's net migration was 56,000, which equates to a population increase of approximately 1.1% over a single year.<sup>10</sup> For comparison, this rate is similar to Australia's but triple that of the United States and the United Kingdom. Since 2014, net migration has ranged between 48,000 and 64,000, however forecasts estimate that net migration will decline over the next few years.
- The construction of new homes has lagged the demand for housing. High construction costs and shortages of skilled labour have impacted development both in terms of timing and profitability. This has led to an undersupply in housing stock – it is estimated that there is a total shortfall of 130,000 homes in New Zealand.<sup>11</sup> In addition, this shortage is not distributed evenly throughout the country. It is estimated that Auckland needs nearly 30,000 new homes to meet current demand, whereas Christchurch has an oversupply of approximately 11,000 homes.
- The low interest rate environment in the wake of the economic downturn of 2008/09 has lowered the cost of capital. This has generally allowed homeowners to borrow more when purchasing property.

<sup>8</sup> CBRE, Statistics New Zealand, First NZ Capital and Credit Suisse broker reports

<sup>9</sup> Monthly House Price Index Report by REINZ, January 2020

<sup>10</sup> Statistics New Zealand

<sup>11</sup> 'Property Insights: New Zealand's housing shortage is getting worse, not better' by Kiwibank, July 2019

The growth profile of house prices over the last decade can be categorised geographically between Auckland and the rest of the country:

- In the wake of the economic downturn in 2008/09, the Auckland market was the first to experience strong growth, with the median house price doubling in the five years between 2012 and 2017. However, since 2017, Auckland property prices have remained largely flat.
- In contrast, housing prices in the rest of the country generally experienced low or no growth between 2009 and 2016. However, these areas have generally experienced high growth since 2016.

Table 3.1 shows economists' forecasts for year-on-year HPI growth. These forecasts are subjective by nature and often coloured by prevailing market sentiment when issued. These show a fall in house prices in 2020, followed by a recovery and growth in the following years.

**Table 3.1: Housing Price Index forecasts (calendar year-on-year growth rate, %)**

Organisation	Report date	2019	2020	2021	2022
ASB <sup>12</sup>	May 2020	4.3	(3.9)	1.0	2.9
Kiwibank	April 2020	5.5	(9.0)	4.5	6.3
RBNZ	May 2020	4.7	(6.8)	6.4	4.3
Westpac	May 2020	4.3	(4.7)	3.0	11.0
<b>Median</b>		<b>4.5</b>	<b>(5.8)</b>	<b>3.8</b>	<b>5.3</b>
<b>Mean</b>		<b>4.7</b>	<b>(6.1)</b>	<b>3.7</b>	<b>6.1</b>

Source: Published economic updates and RBNZ Monetary Policy Statement May 2020

Metlifecare considers that the demand for retirement village units is less price elastic than general housing stock. It expects that when compared to the changes shown in Table 3.1, there will be a smaller reduction in retirement village unit prices in 2020, followed by lower growth rates in each of 2021 and 2022.

### **Liquidity of property market**

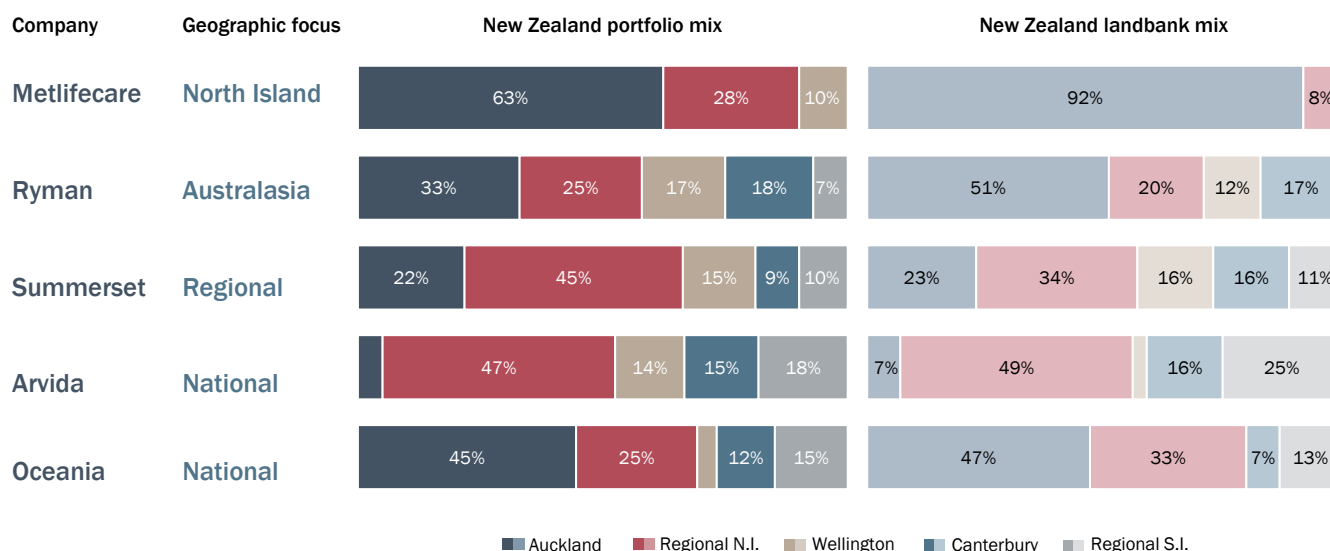
New residents often rely on selling their family home as the main source of capital to fund their entry into a retirement village. It will often take potential new residents longer to sell their homes at a value they expect when liquidity is low, and the property market is slowing. This can delay potential new residents' entry into a village, which impacts on retirement village operators' turnover of units and cashflows.

<sup>12</sup> The ASB data is for 2021 and 2022 are based on the 12 month periods ended 31 March 2022 and 31 March 2023.

### 3.4.4 Demographics and location

The main catchment area for a retirement village in urban environments is often considered to be within an 8-10km radius. As such, competition in the retirement village sector is generally localised. Figure 3.7 shows the breakdown of each NZX listed operator's portfolio by location.

Figure 3.7: Industry portfolios by location (by units)



Source: Annual Reports and Investor Presentations of NZX listed retirement village operators

Metlifecare's portfolio is heavily focused on the Auckland market, with 63% of its existing and 92% of its land banked capacity located in the area. In contrast, the four other operators have portfolios balanced throughout New Zealand, including between 19% and 33% of their portfolios in the South Island.

Operators complete a detailed analysis of demand for and the supply of retirement living and aged care facilities in a particular community before making the decision to acquire or develop a new village in the area. Key determinants that are considered by this measure are the local community's socio-economic status, ethnicity, home ownership levels and median house prices among other demographic factors. While most potential village residents will be locals, the desirability of the area is also carefully considered in order to attract potential village residents from further afield.

The urbanisation of New Zealand's population is not necessarily reflected in the retirement village population. This is likely driven by the preference of some residents to:

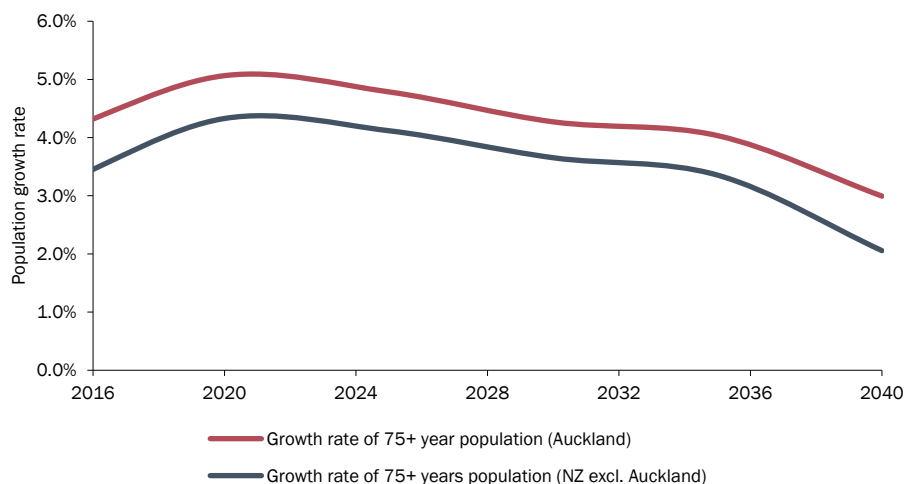
- Return to their hometown
- Seek a quiet location for retirement
- Release equity by moving from a high-priced housing area to a lower-priced area.<sup>13</sup>

<sup>13</sup> Retirement Village Sector Insights by ANZ, October 2019



The growth in the population aged 75+ years is expected to be approximately 0.75% higher in Auckland than the rest of New Zealand over the next 20 years, as shown in Figure 3.8 below. In absolute terms, this equates to 125,000 additional people in Auckland.<sup>14</sup> As a result, the proportion of the population aged 75+ who live in Auckland is forecast to increase from 27% to 31% of the total across New Zealand.

**Figure 3.8: Growth rate of 75+ year population**



Source: Statistics New Zealand

### 3.4.5 Staffing

The retirement village industry is a major employer across New Zealand. Retirement villages employ more than 19,000 people in their day-to-day operators and demand a variety of skillsets and roles including onsite carers, registered nurses, kitchen staff, activity coordinators, cleaners, village managers and administrators.<sup>15</sup>

Industry surveys have identified higher wage demands and the difficulty of finding the right staff as key concerns of operators.<sup>16</sup> These staffing concerns could be further exacerbated by the industry's planned development of approximately 14,700 accommodation units in the next eight years, which may require over 9,500 new staff.

<sup>14</sup> Statistics New Zealand

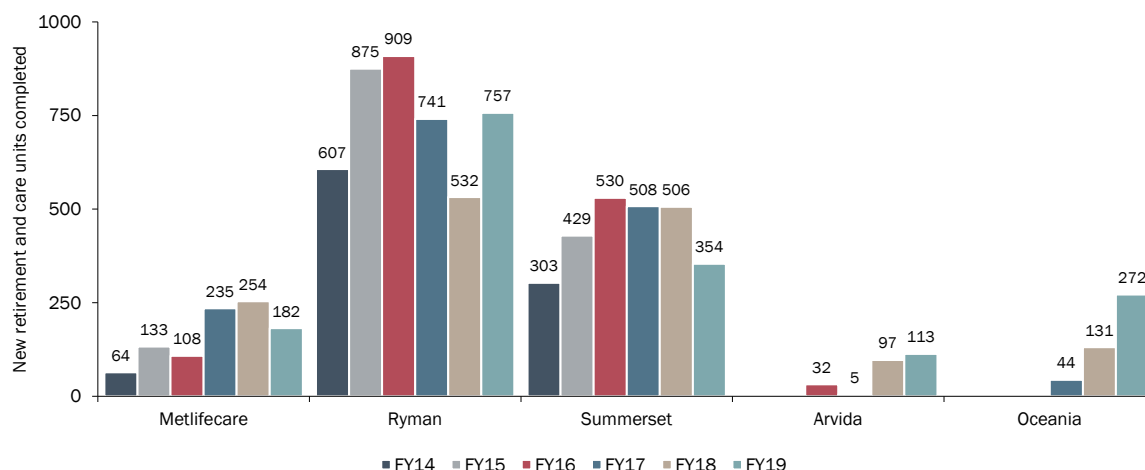
<sup>15</sup> Retirement village contribution to housing, employment, and GDP in New Zealand report by PWC, March 2018

<sup>16</sup> Retirement Village Sector Insights by ANZ, October 2019

### 3.5 Development

With the occupancy rates at many existing villages exceeding 95%, the development and sale of new retirement villages represent the main growth opportunity for operators. Operators have increased their development activities in recent years (as shown in Figure 3.9), in response to the anticipated growth of the population aged over 75 years.

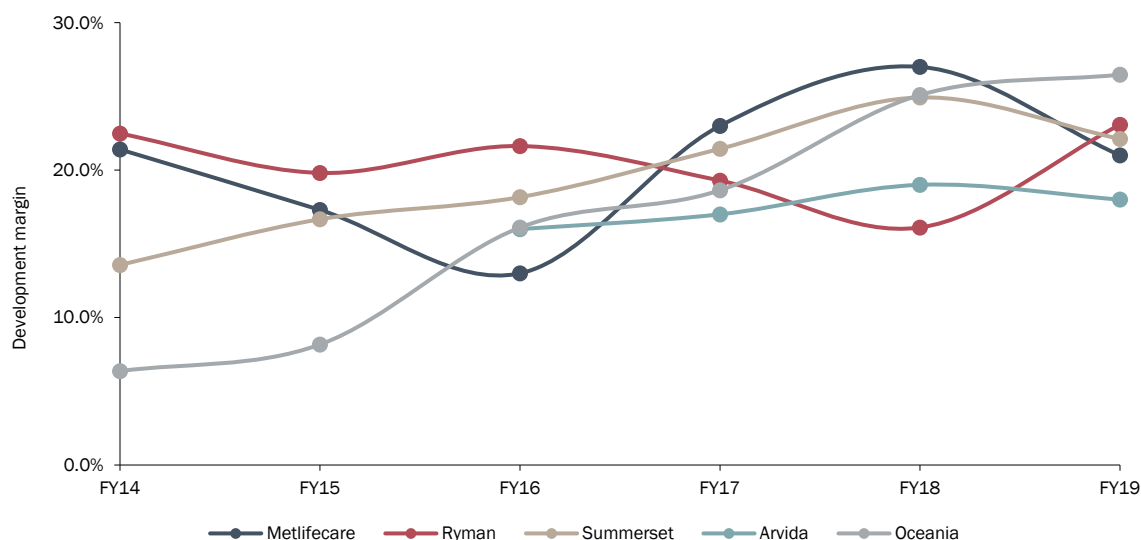
Figure 3.9: New retirement and care units completed by large operators



Source: Annual Reports and Investor Presentations of NZX listed retirement village operators

The new units added between FY14 and FY19 represent a 23% increase to the Metlifecare portfolio. This compares to a 71% and 105% for the Ryman and Summerset portfolios respectively. Figure 3.10 below shows the development margin achieved by the large operators. The development margin is the difference between the cost of building a new unit and the sale price of that unit as a percentage of the unit's sale price.<sup>17</sup>

Figure 3.10: New retirement and care units completed by large operators

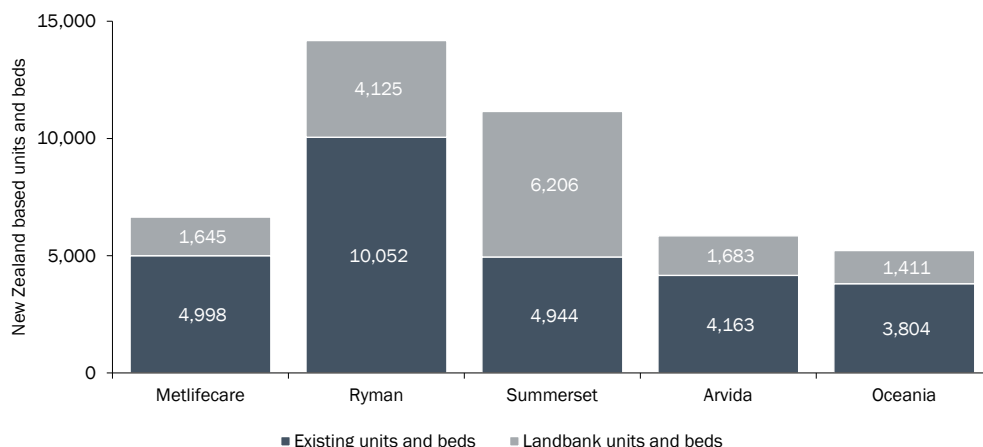


Source: Annual Reports, Investor Presentations of NZX listed retirement village operators and KordaMentha analysis

<sup>17</sup> Metlifecare understands that published development margins of some other publicly listed retirement village operators are calculated as a percentage of the cost of building; whereas, Metlifecare reports development margins as a percentage of sale price. To allow comparison, we have adjusted margins of other publicly listed companies to be comparable to Metlifecare.

The increased development activity is likely to continue, as operators have significant amounts of land banked property. Figure 3.11 shows the relative size of each NZX listed operator's portfolio and development pipeline by number of units and beds within New Zealand.

**Figure 3.11: Relative size of industry portfolios and development pipelines in New Zealand**



Source: Investor presentations for NZX listed retirement village operators

Summerset has the most significant New Zealand landbank relative to the size its existing portfolio, at a ratio of 1.26:1. In comparison, Metlifecare has the smallest landbank, at a ratio of 0.33:1 landbank to existing portfolio.

In addition to the units and beds shown in Figure 3.11, Ryman has a material presence in Australia, with a relatively small number of existing sites (679 units and beds) and a large landbank (2,949 units and beds). Including its Australian assets, Ryman has approximately 7,000 landbank units and beds, and a ratio between its landbank and existing portfolio of 0.66:1.

Retirement village operators were required to pause their development activities while the Level 4 lockdown restrictions were in place. The timing of future development activity may also be impacted by the general economic conditions, which could be affected by COVID-19 and the lockdown restrictions.

## 3.6 Regulation

### *Retirement Villages Act 2003*

The rapid development of the sector in the late 1990's led to the introduction of the Retirement Villages Act 2003. The aim of this legislation, which is administered by the Ministry of Housing, is to standardise and regulate the industry, thereby protecting the interests of retirement village residents. Among other obligations, the Act requires retirement village operators to:

- Register the village on the Retirement Villages Register, which is maintained by the Companies Office
- Make annual returns to the Registrar
- Appoint an approved statutory supervisor (statutory supervisors are appointed under a deed of supervision and provide the role of safeguarding the interests of residents)
- Provide a disclosure statement to every potential resident
- Have a clear and unambiguous ORA
- Ensure potential residents receive independent legal advice
- Provide potential residents with a minimum 15 working days "cooling off" period (i.e. a period which allows residents to change their mind about becoming a resident after signing an ORA and receive a refund of any deposit that may already have been paid).

This regulatory regime is considered by industry bodies as world leading. In a report commissioned by the UK industry body Associated Retirement Community Operators it was noted that "perhaps the strongest example of legislation specific to this (retirement villages) sector comes from New Zealand, where the Retirement Village Act was passed in 2003", and "the NZ model incorporates a range of innovative elements that outline the requirements for operators and offer extensive consumer protection".<sup>18</sup>

There has been a growing policy focus on the aged-care sector in New Zealand, which could affect retirement village operators. Industry body New Zealand Aged Care Association has been calling for a dedicated Minister of Health and Ageing to be established, to coordinate a united response to the changing nature of aged-care services.<sup>19</sup>

### *Tax*

Under New Zealand's income tax rules, the income earned through the revaluation of operator's property assets is not included in taxable income. This means that retirement village operators typically pay relatively low levels of income tax.

The basis of this approach is that the underlying land and buildings are rarely if ever legally sold. Under the widely adopted ORA ownership model, the change in valuation stems from the present value of the expected cashflow from future ORA entry contributions. Pursuant to the ORA financial arrangement, operators are legally obliged to return the entry contribution to an outgoing resident. Accordingly, any income arising on receipt of the entry contribution is immediately offset by an equal deduction for its future repayment. As such, the entry contribution is treated as an advance or interest free loan for tax purposes and is therefore not considered taxable income. Therefore, the economic gain of retirement village operators through capital gains does not give rise to net income for tax purposes.

The Tax Working Group investigated the tax treatment of the retirement village industry in its broader review of the New Zealand tax system in 2018. Submissions from an independent advisor and the Retirement Village Association of New Zealand both noted that while income tax paid by operators is low, dividends paid to shareholders are generally unimputed – meaning the tax is borne by shareholders.<sup>20</sup> As such, commercial operators are fully taxed on economic income, albeit in a different way than other industries. In its final report, the Tax Working Group made no recommendations to change the tax structure of the industry; however, this does not rule out the possibility of future change.

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<sup>18</sup> 'Stronger Foundations: International Lessons for the Housing-with-Care Sector in the UK' by B Beach, 2018

<sup>19</sup> Aged Care Residential Services in New Zealand report by IBISWorld.

<sup>20</sup> Tax Working Group submission: Retirement villages and capital income by Andrea Black, August 2018 and Tax Working Group submission: Future of Tax - Background Paper by Retirement Village Association of New Zealand, April 2018

## 4 Metlifecare overview

### 4.1 Background and history

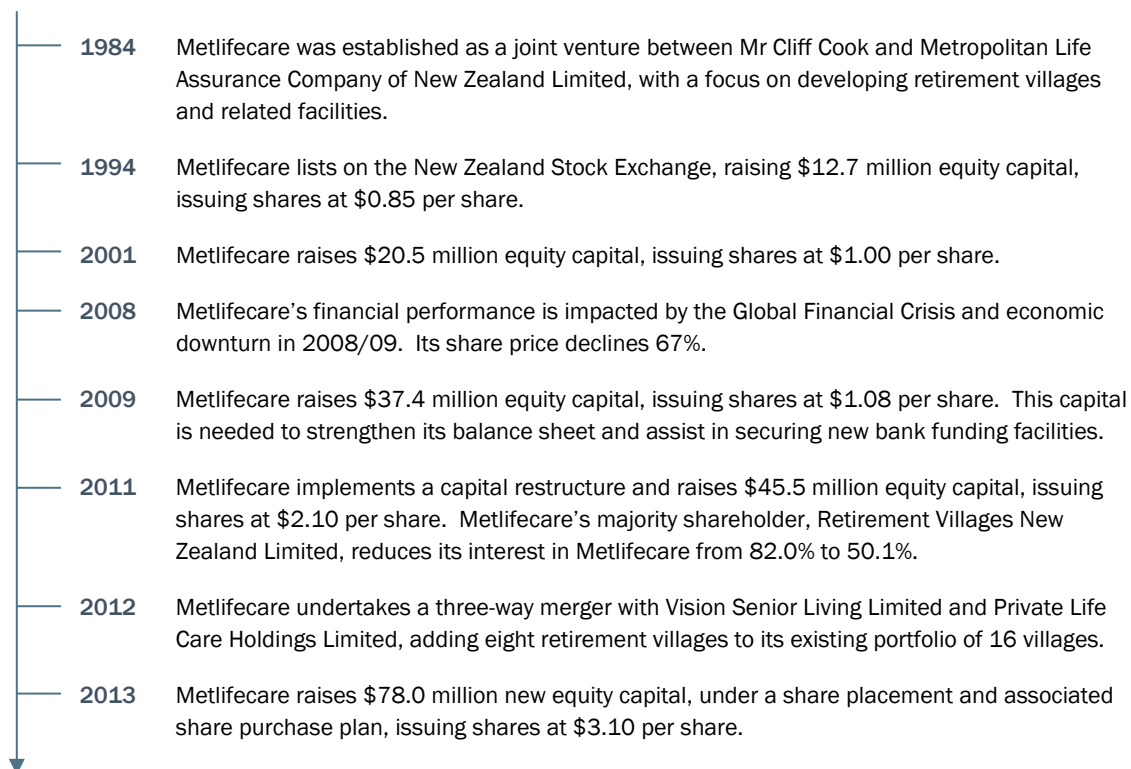
Established in 1984, Metlifecare is one of New Zealand's largest retirement village operators, with a portfolio of 25 retirement villages, over 5,600 residents and approximately 1,000 staff. Metlifecare is headquartered in Auckland.

Metlifecare has positioned itself at the premium end of the retirement living market, with a geographic focus on the upper North Island of New Zealand. It provides a continuum of care to residents, including 4,064 ILUs, 494 SAs and 440 care beds. Metlifecare also has eight land banked sites for future development, which have the potential, within its existing development land bank, to add 1,036 ILUs, 30 SAs and 225 care beds to its portfolio.

The majority of Metlifecare's earnings are generated from DMF and capital gains under the ORA ownership structure. Metlifecare also receives ongoing revenue from village operations and services, as well as fees for its care suites.

A timeline of key events since Metlifecare was established is shown in Figure 4.1 below.

Figure 4.1: Timeline of key events



Since 2015, Metlifecare has had a broad refresh of personnel throughout its development, operations, sales and marketing teams, as well as the appointment of Glen Sowry as CEO in 2016 and Richard Thomson as CFO in 2017.

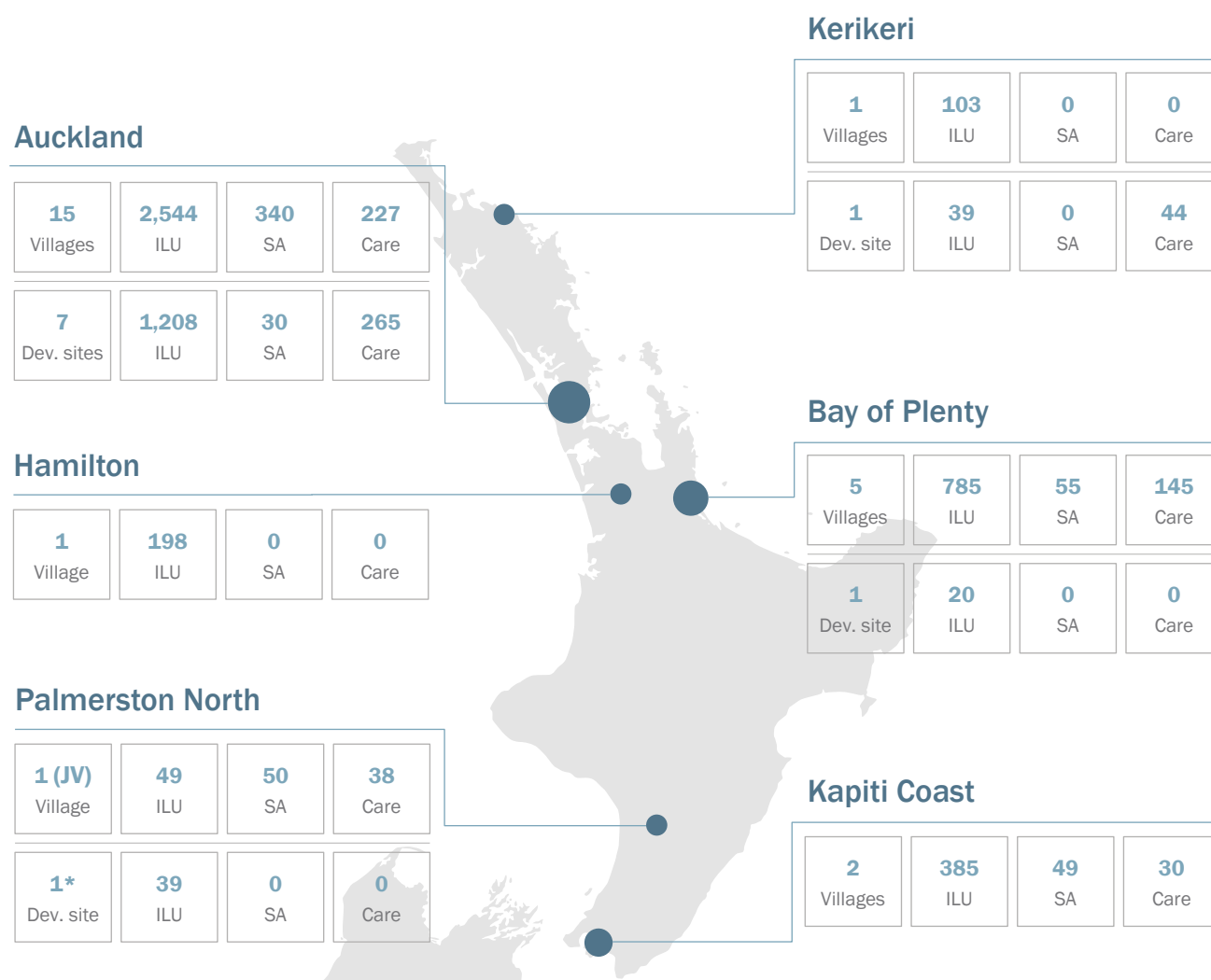
## 4.2 Geographic coverage

Metlifecare's operations are predominantly based in the economic 'Golden Triangle' of the North Island of New Zealand, which is comprised of the Auckland, Waikato and Bay of Plenty regions.

Metlifecare is particularly focused on the key urban centres of Auckland and Tauranga, which are among the fastest growing areas in New Zealand, with population growth of 15.6% and 18.9% respectively between 2009 and 2019 (compared to a national average of 14.4%).<sup>21</sup> Auckland and Tauranga also have high median house prices of \$890,000 and \$710,000 respectively, which compares to a national average of \$629,000<sup>22</sup>; and have populations with relatively high net worth, which makes passing on construction costs to incoming residents less challenging.

The geographic distribution of Metlifecare's villages and development sites are illustrated in Figure 4.2.

Figure 4.2: Metlifecare villages and development sites as at 31 December 2019



\* The Palmerston North development site is owned by the Palmerston North Maori Reserve Corporate Trustee Limited. Metlifecare and the iwi are in the process of jointly developing the land as an extension of the existing retirement village

<sup>21</sup> Statistics New Zealand

<sup>22</sup> Monthly Property Report by REINZ, January 2020



### 4.3 Retirement village operations

Table 4.1 summarises the key metrics for Metlifecare's villages. Metlifecare's ILUs and SAs constitute 90% of its total units. Metlifecare's 25 villages all have ILUs, while SAs and care beds are available at 16 and 14 villages respectively.

**Table 4.1: Metlifecare villages – key metrics as at 31 December 2019**

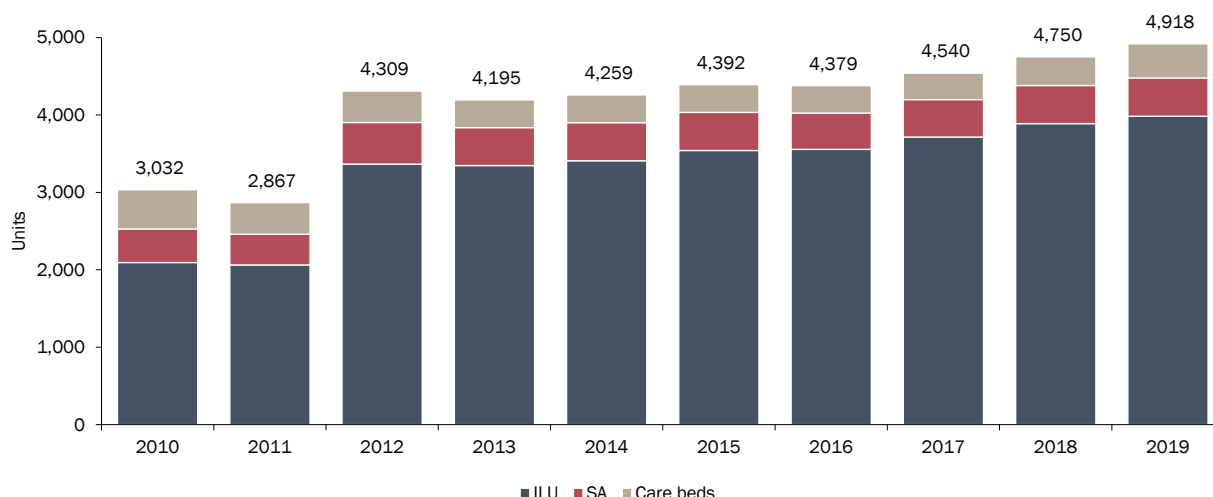
Village	Units			Occupancy	Village age	Average resident age	CBRE valuation <sup>23</sup> (\$ million)
	ILU	SA	Care Beds				
Crestwood	134	14	41	97%	33	81.7	56.9
Dannemora Gardens	201	–	–	98%	17	80.8	84.6
The Orchards	96	–	36	98%	4	80.2	38.6
Hibiscus Coast Village	221	48	–	99%	33	83.4	99.0
Hillsborough Heights	176	42	–	92%	34	82.2	71.6
Highlands	129	70	41	92%	32	84.0	72.8
Longford Park Village	144	49	–	96%	22	83.9	61.1
Edgewater Village	62	13	–	93%	33	83.0	25.3
Pinesong	360	27	9	94%	20	81.7	182.0
Powley	46	34	45	83%	34	84.2	25.7
The Poynton	242	15	5	95%	10	81.6	132.7
7 Saint Vincent	81	12	2	91%	20	86.2	76.3
Greenwich Gardens	273	16	48	96%	4	78.7	150.2
Waitakere Gardens	324	–	–	97%	20	81.4	108.6
Gulf Rise	55	–	–	Just opened	1	76.9	56.1
<b>Auckland villages</b>	<b>2,544</b>	<b>340</b>	<b>227</b>	<b>95%</b>			<b>1,241.3</b>
The Avenues	90	–	30	100%	19	81.9	37.6
Bayswater	215	17	6	97%	23	82.8	91.2
Greenwood Park	229	11	–	98%	36	83.0	89.1
Papamoa Beach Village	168	–	40	100%	14	78.8	51.4
Somervale	83	27	69	99%	34	86.3	42.0
<b>Bay of Plenty villages</b>	<b>785</b>	<b>55</b>	<b>145</b>	<b>99%</b>			<b>311.3</b>
Coastal Villas	160	49	30	99%	23	83.4	58.1
Kapiti Village	225	–	–	99%	24	81.4	55.1
Palmerston North Village	49	50	38	94%	25	85.0	25.3
Oakridge Villas	103	–	–	96%	15	79.2	28.2
Forest Lake Gardens	198	–	–	100%	16	82.3	70.0
<b>Other villages</b>	<b>735</b>	<b>99</b>	<b>68</b>	<b>98%</b>			<b>236.6</b>
<b>All villages</b>	<b>4,064</b>	<b>494</b>	<b>440</b>	<b>96%<sup>24</sup></b>	<b>21<sup>25</sup></b>	<b>82.0</b>	<b>1,789.2</b>

<sup>23</sup> Independent property valuer CBRE undertake a valuation of each retirement village in the Metlifecare portfolio every 6 months for financial reporting purposes

## Village acquisition and development

Figure 4.3 shows the growth of Metlifecare's portfolio over time.

Figure 4.3: Metlifecare units (data as at 30 June each year)



The most significant change in units occurred in 2012, when Metlifecare undertook its merger with Vision Senior Living and Private Life Care. In that merger, the following villages were consolidated into Metlifecare's existing portfolio:

- **Vision Senior Living:** Dannemora Gardens, Forest Lake Gardens, Oakridge Villas, Papamoa Beach Village and Waitakere Gardens.
- **Private Life Care:** Hillsborough Heights, Hibiscus Coast and Longford Park Village.

Some of the villages acquired in Metlifecare's merger have suffered from water ingress issues, particularly Waitakere Gardens and Dannemora Gardens. Metlifecare has incurred \$27 million to date to remediate sites that have suffered from water ingress issues and expects to incur a further \$44 million over the next few years (including FY20) to complete the remediation.

Following the merger, Metlifecare increased its total number of units and care beds from 4,309 to 4,918 as at 30 June 2019. Included in this 'net' change is Metlifecare selling its 'Oakwoods' village in FY13. Excluding the merger, most of the increase has occurred since 2016, as Metlifecare has increased its development activities in recent years.

Key development activities undertaken by Metlifecare include:

- **The Avenues:** This village is in Tauranga, in the Bay of Plenty. Metlifecare completed an integrative homestead care home in 2019, offering 30 new care beds.
- **The Poynton:** This village is in Takapuna, Auckland. It was developed over seven years on a staged basis and completed in 2015. The Poynton has 242 ILUs and a small number of SAs and care beds.
- **The Orchards:** This village is in Glenfield, Auckland. Metlifecare acquired the land for this development in 2012 and completed construction of the village in late 2016. The Orchards has 96 ILUs and 36 care beds.
- **Oakridge Villas:** This village is in Kerikeri, Northland. This village was originally acquired as part of Metlifecare's merger with Vision Senior Living. Metlifecare has developed Oakridge Villas, increasing the ILU numbers from 40 to 103. Metlifecare acquired land adjacent to this site in 2016 and again in 2019, on which it plans to construct a care home and further ILUs.
- **Somervale:** This village is in Mount Maunganui, in the Bay of Plenty. Metlifecare completed 16 new SAs and 69 care beds in an innovative homestead style RCH on this site in 2018. Metlifecare advises that further regeneration opportunities exist on the site of the previous decommissioned care home.

<sup>24</sup> Averages weighted by number of units

<sup>25</sup> Averages weighted by village valuation

- **Greenwich Gardens:** This village is in Unsworth Heights, Auckland. The land for this village was acquired as part of Metlifecare's merger with Vision Senior Living. Metlifecare has subsequently undertaken a staged development on this site, delivering an award-winning homestead style care home in 2017 housing 48 care beds. The most recent Stages 9 and 10 were completed in calendar year 2019, adding a further 48 ILUs in each stage.
- **Papamoa Beach Village:** This village is in Papamoa, in the Bay of Plenty. The village was originally acquired as part of Metlifecare's merger with Vision Senior Living. At the time of the merger it had 33 units. Metlifecare completed development of the site in 2019, having added 135 ILUs (taking the total to 168), a 40-bed RCH and dementia unit and an expanded village centre.
- **Crestwood:** This village is in New Lynn, Auckland. Metlifecare completed 13 ILUs on this site in late 2019.

### *Village maintenance and betterment*

While Metlifecare has eight villages in its portfolio that are over 30 years old, the units and facilities are maintained and upgraded over time, in order to extract their maximum economic value. For example, in 2019 Metlifecare:

- Refurbished 420 homes (9% of units) as residents moved out. Depending on the state of the unit, this work ranged from a 'deep clean' to a 'full refit', including the installation of new kitchens and bathrooms.
- Upgraded and developed the communal spaces at 10 villages, this included new bars, cafés and leisure facilities.
- Undertook regeneration projects at five villages, which are aimed at refreshing and modernising the villages in order to maintain their competitiveness and appeal.

### *Resident age*

We understand from Metlifecare that it has historically had a younger resident profile than its competitors, particularly following its merger with Vision Senior Living and Private Life Care in 2012. However, its resident age profile has risen over time and is now broadly consistent with the industry average.

The weighted average age of Metlifecare's ILU residents is 81.7 years, with an average entry age of 78.7 years. The average length of occupancy for an ILU varies somewhat but is generally expected to average around 8 years. For the six-month period ending 31 December 2019, the figure was 9.1 years.

The weighted average age of Metlifecare's SA residents is 86.8 years, with an average entry age of 86.2 years. The average length of occupancy for a SA is typically around 4 years. For the six-month period ended 31 December 2019, the figure was 3.3 years.

### *Resident contracts*

Metlifecare's ILUs and SAs are all occupied under the ORA structure. Since 2014, Metlifecare's typical ORA terms have included:

- The DMF for incoming residents accrues at 10% of the ORA price per annum, up to a maximum of 30%
- All the capital gains and losses on the unit accrue to Metlifecare
- Metlifecare is responsible for the refurbishment costs of the unit when the resident moves out
- Village fees vary by village, unit and circumstance, but typically range between \$600 and \$800 per month.

Metlifecare has some legacy ORA contracts that feature terms that differ to those summarised above. For example, Metlifecare has roughly 100 contracts where the residents are entitled to share in all or part of any capital gains derived on the units. Similarly, there are roughly 500 contracts where, in some instances, the resident is responsible for the cost of refurbishing the unit at the end of their occupancy. These contracts generally commenced prior to 2006 at a small number of villages.

## 4.4 Aged-care operations

Metlifecare's aged-care operations make up a small portion of its whole business, with 440 aged-care beds across 14 villages. Metlifecare considers its RCH operations to be an important part of business, both for its standalone performance and the ability to support its core retirement village operations.

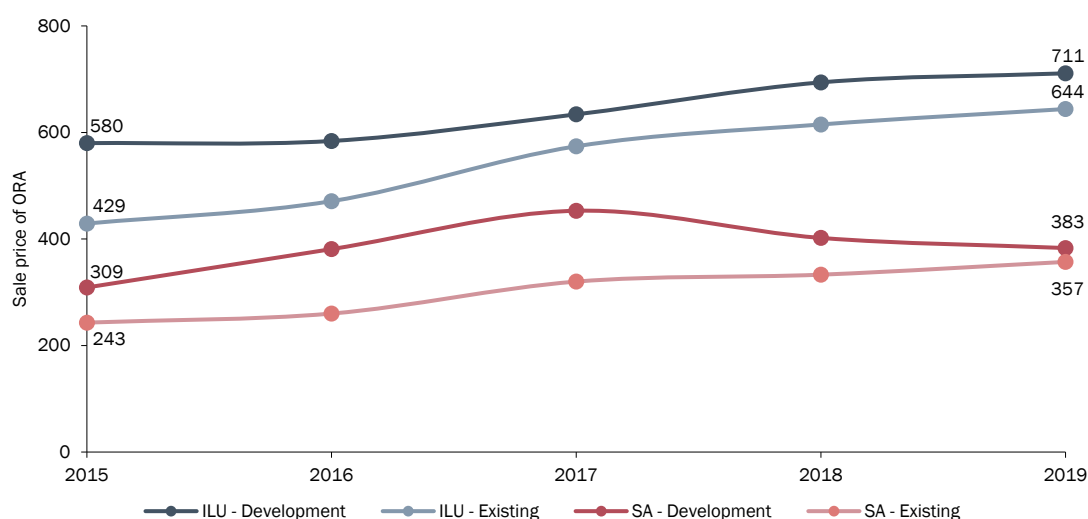
In 2019, Metlifecare increased its care capacity by 19% with 70 new care beds delivered at The Avenues and Papamoa Beach Village. Occupancy rates for Metlifecare's existing RCH operations remain high, at 96% and occupancy at the newly opened RCHs is growing.

Of Metlifecare's eleven villages that have RCH, all are certified by the Ministry of Health. Six of these are "gold-standard" four-year certifications, three have three-year certifications and the recently opened RCH at The Avenues and Papamoa have two-years as they become established. This certification requires an independent audit of the facility to ensure compliance with the Health and Disability Services (Safety) Act 2001.

## 4.5 Unit sales

The capital gains realised upon the sale and resale of new and existing units has historically been a key driver of Metlifecare's financial performance. The average sale price for new and existing development is illustrated in Figure 4.4.

Figure 4.4: Historical sale price of Metlifecare's development and existing units



Source: Metlifecare information

The sale price that Metlifecare has sold new development units for has tended to be higher than the price of existing units.

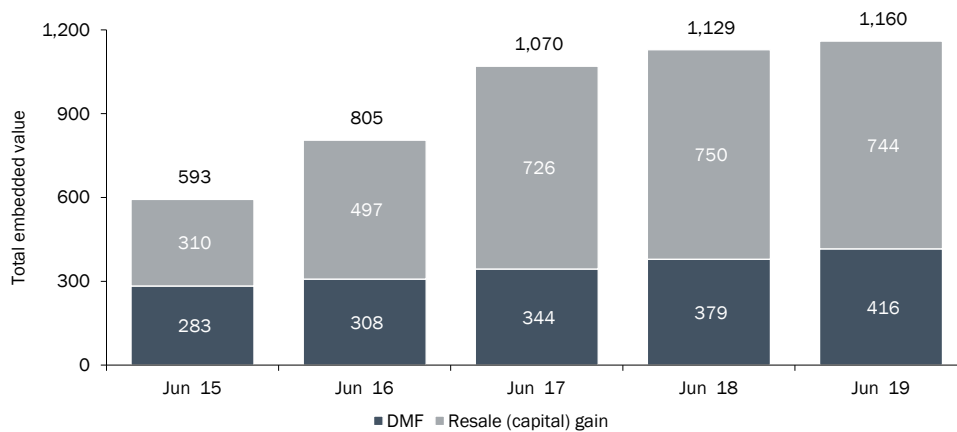
The price for new units has increased more slowly than for existing units, with the difference between the price of new and existing units narrowing over time. This partly depends on the type and features of the new units coming online at any point in time. Nevertheless, the price of new units has increased at a compound annual growth rate (CAGR) of 5.2% and 5.5% for ILUs and SAs respectively over the last five years; whereas the CAGR for existing units has increased at 10.7% and 10.1% for ILUs and SAs respectively.

The upward trend in the sales price of Metlifecare's units reflects the influence of rising residential house prices over the last five years. The slower growth in unit prices over the last two years is partly due to Metlifecare's exposure to the Auckland residential property market, which has been relatively soft.

The average price of one of Metlifecare's Auckland ILUs is 72.8% of the median house price in the region. In comparison, Metlifecare's units in Bay of Plenty and Lower North Island are at 81.8% and 93.8% of the median house price in each region, respectively.

Metlifecare revalues its property assets semi-annually and reflects movements in the value of its property portfolio in its statement of financial performance. However, it does not realise (in a cash sense) the appreciation in value of property until a resident moves out of a unit and a new resident signs and pays for a new ORA. Metlifecare uses a measure called embedded value that provides an indication of the potential future cash generation of each unit in the portfolio in terms of yet-to-be realised capital gains and DMF. The embedded value takes the sum of all unit prices at a particular point in time and subtracts the value of all resident liabilities at that time, then splits the residual value between DMF and capital gains. Figure 4.5 shows the growth in Metlifecare's portfolio's embedded value over the last five years.

**Figure 4.5: Embedded value of Metlifecare portfolio (\$ million)**

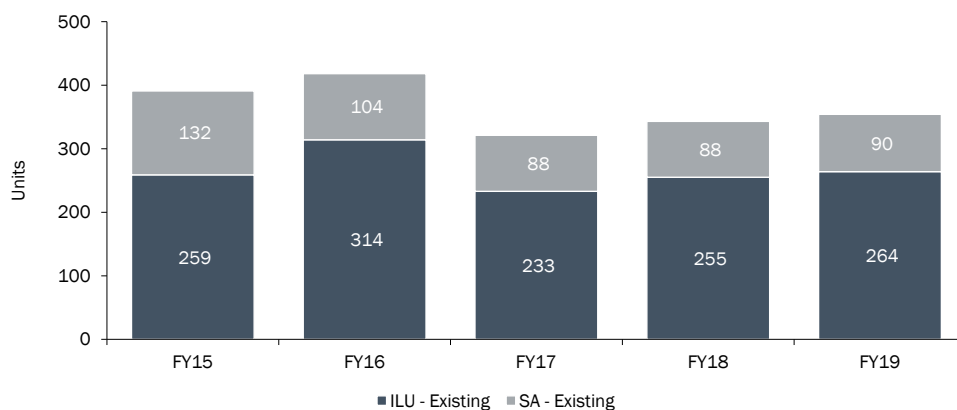


Source: Metlifecare information

The embedded value shown in Figure 4.5 implies that the value of future cash that will be extracted from units before costs, based on current valuations (at the time), has increased from \$0.6 billion to \$1.2 billion between 2015 and 2019.

The rate at which the embedded value can be realised (in a cash sense) is governed by the rate at which units are turned over. Figure 4.6 shows the steady rate, ranging between 321 and 418 units per year, at which Metlifecare has been reselling existing units over the last five years.

**Figure 4.6: Historical resale volume of Metlifecare's existing units**

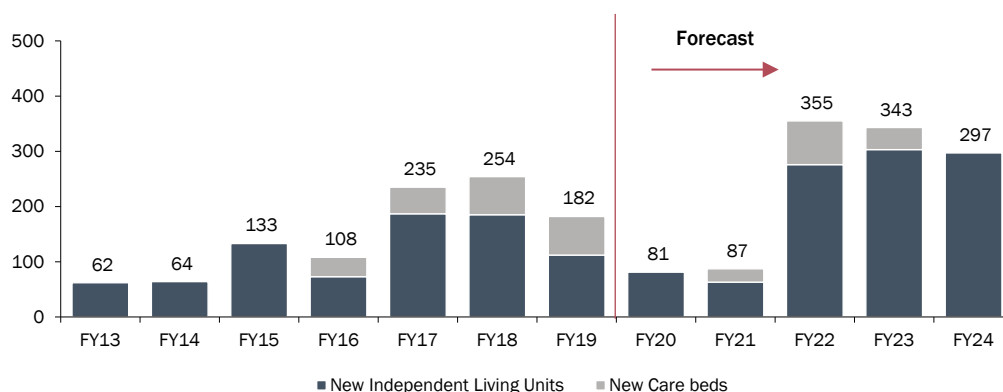


Source: Metlifecare information

## 4.6 Development performance and pipeline

Figure 4.7 shows Metlifecare's historical delivery and development pipeline for ILU and care beds through to FY24.

Figure 4.7: Metlifecare's new ILU and care beds completed by year



Source: Metlifecare

Metlifecare's recent development track record can be categorised into three periods:

- **2005 – 2012:** In the wake of the economic downturn of 2008/09, Metlifecare experienced tough trading conditions with high levels of debt and slowing unit sales. Metlifecare focused on its day-to-day operations.
- **2013 – 2016:** After the merger with Vision Senior Living and Private Life Care, Metlifecare focused on the integration of the new villages and extracting synergies from the merger.
- **Since 2016:** Metlifecare has become more focused on development led growth. Metlifecare has increased its land bank through the acquisition of six new sites and developed existing brownfield and greenfield sites. It has also expanded its in-house design capabilities, standardisation and modularisation to provide cost efficiencies for future developments.

Management's stated target is to deliver an average of 250 new units every year beyond 2024. Table 4.2 below lists the sites that are currently under development by Metlifecare, including those targeted. The timing of future developments remains subject to regular review based on prevailing conditions prior to committing to each new stage of development.

Table 4.2: Current development pipeline (as at 5 June 2020)

Village	Region	Type	Expected completion	ILU and SA	Care Beds
Edgewater Village	Auckland	Brownfield	FY21	47	24
Greenwich Gardens	Auckland	Staged	FY23	50	-
Gulf Rise	Auckland	Greenfield	FY22–FY24	181	43
Orion Point	Auckland	Greenfield	FY22–FY26	245	40
Fairway Gardens	Auckland	Greenfield	FY22–FY25	248	40
Pohutukawa Landing	Auckland	Greenfield	FY21–FY24	185	36
Albany	Auckland	Greenfield	FY24–FY27	320	84
Somervale	Bay of Plenty	Brownfield	To be determined	20+	-
Palmerston North Village	Palmerston North	Brownfield	FY22–FY23	39	-
Oakridge Villas	Kerikeri	Brownfield	To be determined	47	-
<b>Total</b>				<b>1,382</b>	<b>267</b>

Source: Metlifecare information

Metlifecare is undertaking staged developments and upgrades of existing 'brownfield' sites, as well as the development of new 'greenfield' sites. As part of its development strategy Metlifecare is actively seeking new sites, particularly in the Upper North Island.



Metlifecare targets a development margin between 20% and 30% (when calculated relative to the sale price), with a targeted minimum hurdle range of 15% for new developments. In August 2019, Metlifecare announced that it had made programme timing changes to its short-term development programme to ensure its vertical construction model met significant market changes, in order to retain development margins. In light of stabilising construction cost metrics and the Auckland residential housing market showing signs of recovery, Metlifecare announced its updated programme to the NZX and ASX on 6 December 2019.

## 4.7 Share ownership and price history

Metlifecare had 213,304,722 shares on issue and more than 5,000 registered shareholders as at 19 May 2020. Table 4.3 shows the top 20 named shareholders as at 19 May 2020, which together hold 81.6% of the shares on issue.

Table 4.3: Share register as at 19 May 2020

Shareholder	Shares	Proportion
1 HSBC Nominees (New Zealand) Limited	48,469,238	22.72%
2 HSBC Nominees A/C NZ Superannuation Fund Nominees Limited	42,363,688	19.86%
3 Citibank Nominees (New Zealand) Limited	20,069,996	9.41%
4 JPMorgan Chase Bank NA NZ Branch-Segregated Clients Acct	14,489,962	6.79%
5 Accident Compensation Corporation	12,261,899	5.75%
6 HSBC Nominees (New Zealand) Limited A/C State Street	6,314,182	2.96%
7 JBWere (NZ) Nominees Limited	4,299,313	2.02%
8 BNP Paribas Nominees (NZ) Limited	3,671,947	1.72%
9 FNZ Custodians Limited	3,223,788	1.51%
10 Forsyth Barr Custodians Limited	3,060,005	1.43%
11 New Zealand Depository Nominee Limited	2,595,080	1.22%
12 BNP Paribas Nominees (NZ) Limited	2,483,511	1.16%
13 ANZ Wholesale Australasian Share Fund	1,697,375	0.80%
14 Generate Kiwisaver Public Trust Nominees Limited	1,645,773	0.77%
15 TEA Custodians Limited Client Property Trust Account	1,626,737	0.76%
16 Custodial Services Limited	1,512,966	0.71%
17 Custodial Services Limited	1,152,104	0.54%
18 ANZ Wholesale Trans-Tasman Property Securities Fund	1,096,781	0.51%
19 M3 Capital Limited	1,009,171	0.47%
20 Custodial Services Limited	1,008,509	0.47%
<b>Top 20 shareholders</b>	<b>174,052,025</b>	<b>81.60%</b>
Remaining shareholders	39,252,697	18.40%
<b>Total</b>	<b>213,304,722</b>	<b>100.00%</b>

Source: Computershare data, which looks through shares held by New Zealand Central Securities Depository Limited as a bare trustee custodian

Table 4.4 shows the most recent substantial product holder (**SPH**) interests notified to NZX, as at 19 May 2020. The SPH holdings differ from those in Table 4.3 due to timing and differences between legal interests and interests that need to be disclosed to NZX as substantial product holder interests under New Zealand legal requirements.

**Table 4.4: Substantial product holder interests as at 19 May 2020**

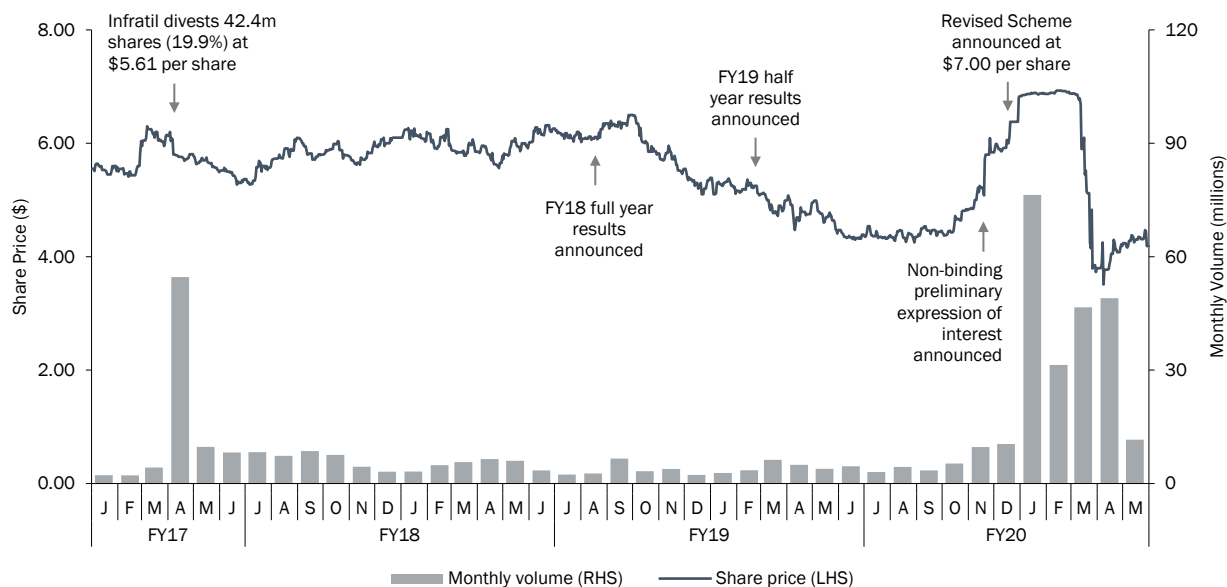
	<b>Date of notice</b>	<b>Shares</b>	<b>Percentage</b>
New Zealand Superannuation Fund Nominees Limited	29 Dec 2019	42,363,688	19.86%
UBS Group AG and its related bodies corporate	12 May 2020	22,522,798	10.56%
Millennium Capital Management (Singapore) Pte Ltd	18 March 2020	14,753,912	6.92%
Maso Capital Partners Limited	28 February 2020	11,597,797	5.44%
Accident Compensation Corporation	14 April 2020	11,177,414	5.24%
Credit Suisse Group AG and its related bodies corporate	20 May 2020	10,679,020	5.01%

The largest shareholder is New Zealand Superannuation Fund Nominees Limited (**NZSF**). Other than NZSF, Metlifecare's shares are widely held by retail and institutional investors, as well as certain hedge funds.

## 4.8 Share price performance

Figure 4.8 illustrates the price and volume for shares traded in Metlifecare since January 2017.

Figure 4.8: Share price and volume



Source: Capital IQ and KordaMentha Analysis

Metlifecare's share price steadily climbed between January 2016 and September 2018, increasing from around \$5.60 to a high of \$6.50 per share. Since then, Metlifecare's share price had dropped, during a period when Auckland property prices stagnated. The share price reached a low of \$4.20 per share in June 2019. Metlifecare's share price increased modestly before the expression of interest was announced, possibly due to emerging signs of an improving outlook for the Auckland property market and the announcement of a proposed share buy-back at the Annual Shareholders Meeting on 24 October 2019. For completeness, the share buy-back did not occur as a result of the expression of interest received in November 2019.

Metlifecare's share price increased sharply following the announcement of the expression of interest. In addition, since the announcement there has been a significant number of Metlifecare shares traded. In January 2020, 76.3 million shares traded, which is equivalent to 35.8% of the total shares on issue.

Table 4.5: Share prices and volumes as at 19 November 2019

	Share Price			Volume (million)	Proportion of Issued Capital
	Low	High	VWAP		
One month	4.61	5.26	4.98	9.0	4.2%
Three months	4.25	5.26	4.72	17.1	8.0%
Twelve months	4.20	5.75	4.79	52.6	24.7%

Source: Capital IQ and KordaMentha analysis

Approximately 52.6 million shares traded in the 12 months to 19 November 2019, just prior to Metlifecare's announcement of the receipt of a non-binding preliminary expression of interest. Shares traded between \$4.20 and \$5.75 per share over this period. The proposed consideration of \$7.00 per share represents a:

- Premium of 38% to the share price of \$5.08 on 19 November 2019
- Premium of 41% to the VWAP of \$4.98 in the month ended 19 November 2019
- Premium of 48% to the VWAP of \$4.72 in the three months ended 19 November 2019
- Premium of 46% to the VWAP of \$4.79 in the twelve months ended 19 November 2019.

## 5 Financial overview

### 5.1 Financial performance

Table 5.1 summarises Metlifecare's earnings for FY16 to FY19 (actuals) and FY20 (forecast). The historical accounts are based on audited annual financial statements and management accounts. The amounts shown exclude abnormal/non-recurring amounts. The financials are also based on realised, rather than accrued gains on sale.

**Table 5.1: Historical financial performance summary (\$ million)<sup>26</sup>**

	<b>FY16 Actual</b>	<b>FY17 Actual</b>	<b>FY18 Actual</b>	<b>FY19 Actual</b>	<b>FY20 Forecast</b>
Management fees	44.6	48.8	52.0	55.5	58.9
Rest home, hospital service fees	29.7	27.2	31.1	35.8	40.8
Village fees	27.8	28.8	28.8	29.6	30.6
Other revenue <sup>27</sup>	4.3	5.5	4.7	3.6	2.8
<b>Total operating revenue</b>	<b>106.4</b>	<b>110.3</b>	<b>116.7</b>	<b>124.4</b>	<b>133.1</b>
Employee costs	(44.6)	(43.3)	(49.7)	(53.1)	(57.0)
Property costs	(24.1)	(23.1)	(24.7)	(28.9)	(28.1)
Other expenses	(20.9)	(23.8)	(25.0)	(29.2)	(26.7)
<b>EBITDA</b>	<b>16.8</b>	<b>20.1</b>	<b>17.3</b>	<b>13.2</b>	<b>21.3</b>
Depreciation and amortisation	(2.5)	(3.0)	(4.2)	(5.8)	(5.6)
<b>Net operating profit before fair value movements</b>	<b>14.3</b>	<b>17.1</b>	<b>13.2</b>	<b>7.4</b>	<b>15.7</b>
Realised resales gains	46.5	55.3	62.3	71.5	62.6
Realised development margin	10.1	19.0	16.4	16.9	10.7
Wage subsidy (offset to employee costs)	-	-	-	-	7.1
<b>Underlying profit (ungeared)</b>	<b>70.8</b>	<b>91.4</b>	<b>91.9</b>	<b>95.8</b>	<b>96.2</b>
Shares on issue (millions)	212.9	213.0	213.1	213.3	213.3
Adjusted EPS (cents)	31.0	38.5	40.8	43.2	
DPS (cents)	5.8	8.1	10.0	11.0	

Source: Metlifecare statutory accounts, management accounts and forecasts

Metlifecare's FY20 financial performance has been influenced by the Government mandated restrictions for the containment and elimination of COVID-19. These measures have restricted access to Metlifecare's village's which has, in turn, impacted the Metlifecare's ability (in the short term) to market and sell existing and newly developed retirement village units, undertake anything other than essential property maintenance and delayed the construction activity relating to its development projects. In addition, Metlifecare has incurred additional costs associated with ensuring the safe and effective operation of its villages and care facilities throughout the restriction period.

Before resale gains and development margin Metlifecare's net operating profit before fair value movements has trended down from \$14.3 million to \$7.4 million between FY16 and FY19. Metlifecare had forecast this to improve to \$15.7 million in FY20, before allowing for the wage subsidy.

<sup>26</sup> The 'underlying profit (ungeared)' shown in Table 5.1 differs from the 'underlying profit' commonly reported by Metlifecare. We have measured underlying profit on an unlevered basis, before Metlifecare's net interest expense is deducted. In addition, we have not deducted the movement in the provision for residents' share of capital gains because the capital gains that are realised and paid to qualifying residents are already captured within the net amount 'realised resale gains'.

<sup>27</sup> \$6.5 million of one-off income received in FY19 has been excluded.

Metlifecare's underlying profit (ungeared) increased from \$70.8 million to \$95.8 million over the four-year period from FY16 to FY19. Metlifecare has forecast its FY20 underlying profit (ungeared) to be broadly in line with FY19.

Before the Level 4 lockdown restrictions were implemented, Metlifecare had forecast \$97.0 million Underlying Profit (ungeared). Its current forecast Underlying Profit (ungeared) is broadly similar, as cost savings achieved during the lockdown period and the wage subsidy have largely offset reduced revenue and lower realised resales gains.

We set out below an analysis of key parts of Metlifecare's financial performance.

### Revenue – management fees

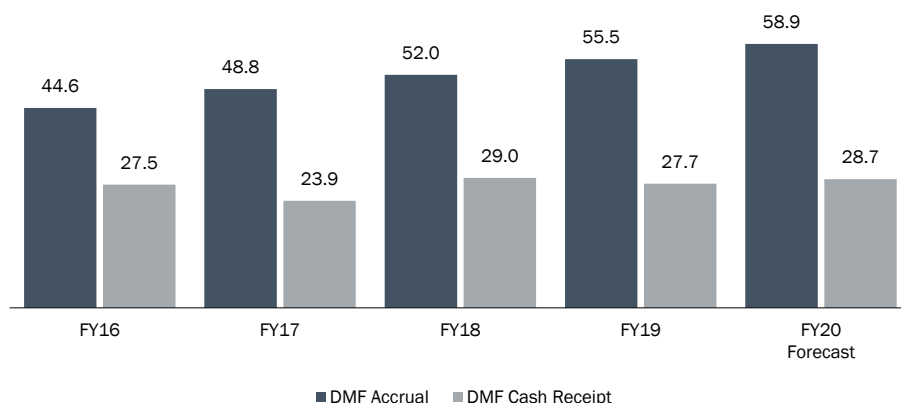
Management fees increased from \$44.6 million to \$55.5 million between FY16 and FY19, largely as a result of:

- The sale of new development units (Metlifecare increased its ILU and SA portfolio by 11% over this period); and
- The resale of existing units at a higher price and, therefore, a higher DMF.

Metlifecare's management fees are predominantly DMF, which are only received when residents' exit their units. The accounting for DMF is sensitive to the expected turnover of residents. This is because DMF is recognised on a straight-line (accrual) basis over the expected occupancy period for residents.

Figure 5.1 illustrates the difference between accrual and cash receipt of DMF. The accrual amounts are used in the financial accounts, including underlying profit. The cash amounts are important to valuation methodologies that rely on cashflows.

Figure 5.1: DMF accrual and cash receipt (\$ million)



Source: Metlifecare management accounts

### Revenue – other operating revenue

Rest home, hospital and service fees are governed by the individual care admission agreements with each care home resident. These fees are mainly earned in Metlifecare's RCH, with some also being earned from ancillary services offered to its other residents.

Metlifecare offers ILU and SA residents a flat-rate village fee for the length of their occupancy. This is the same policy that has been adopted by all the major retirement village operators. The flat rate means that this revenue typically only increases when new residents enter a village.

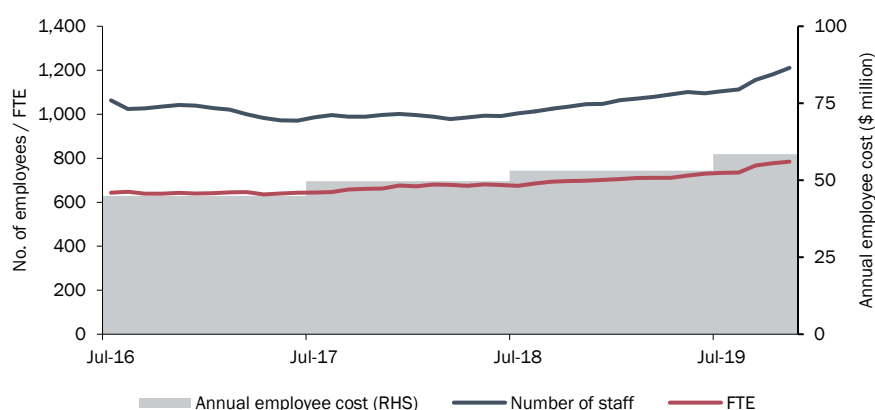
Other revenue predominantly relates to the refurbishment recoveries and administration fees collected from outgoing residents. This revenue is largely associated with legacy ORA contracts. These contracts were typically issued prior to 2006 and are reducing every year.



## Employee costs

Between FY16 and FY19, employee costs increased from \$44.6 million to \$53.1 million. The primary causes for the increase in employee costs are wage inflation, some of which related to the Government's pay-equity settlement, increases to the number of people in the development team and an increase in Metlifecare's village operations (e.g. new villages and care homes). Figure 5.2 shows annual employee costs increasing with a rising number of full time equivalent (FTE) employees.

**Table 5.2: Annual employee cost and number of staff**



Source: Metlifecare

## Property costs

Property costs are a major expense for retirement village operators. The major costs are repairs and maintenance, and utilities. Table 5.2 shows the split of these costs for Metlifecare between FY16 and FY20.

**Table 5.2: Property costs (\$ million)**

	FY16 Actual	FY17 Actual	FY18 Actual	FY19 Actual	FY20 Forecast
Repairs and maintenance	13.1	12.1	12.6	16.5	15.1
Utilities and other property costs	11.0	11.0	12.1	12.4	13.0
<b>Property costs</b>	<b>24.1</b>	<b>23.1</b>	<b>24.7</b>	<b>28.9</b>	<b>28.1</b>

Source: Metlifecare statutory and management accounts

Repairs and maintenance include:

- Every-day 'break and fix' repairs and maintenance
- The expensed portion of costs associated with the refurbishment of unit interiors when residents move out
- Planned preventative property maintenance, including painting, replacing roofs and the expensed portion of long-term maintenance.

Utilities and other property costs are a significant cost for retirement village operators. These costs are mainly property rates and utility costs for communal areas.

## Other expenses

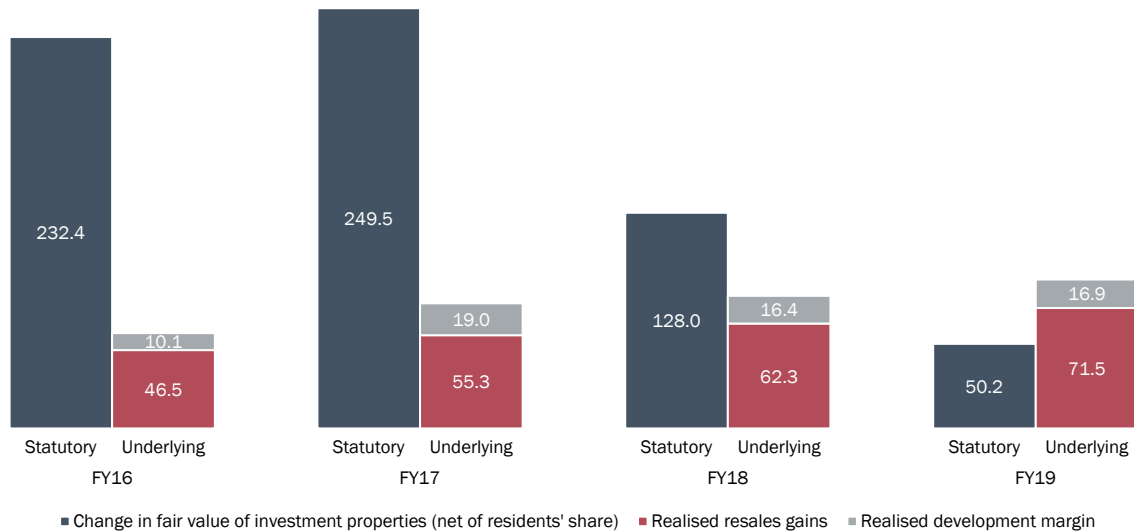
Other expenses include marketing and promotion, resident costs, communications, and other employee costs. These costs have increased significantly, from \$20.9 million to \$29.2 million, between FY16 and FY19. This increase reflects a combination of factors including an increase in marketing and promotional costs for both existing villages and new developments.

### Change in fair value of investment properties

The majority of Metlifecare's underlying profit comes from the fair value movements on its properties.

We have presented the financials in Table 5.1 (above) based on **realised** gains from the sale of units. In comparison, Metlifecare's statutory accounts show profits based on the accrued change in the value of units each year. Figure 5.3 illustrates the difference between statutory (accounting) gains and realised (underlying) gains.

Figure 5.3: Accrued change in fair value vs realised resale gains and development margin (\$ million)



Source: Metlifecare annual reports

Metlifecare's realised resale gains are more stable than its accrued changes in fair value in any particular year. In effect the accrued changes in fair value become embedded value in the units, which is then released as 'realised gains on sale' when units are sold.

We have shown realised gains net of the portion that has accrued to residents. Table 5.3 shows the gross amount of realised gains. Resident's share of capital gains is largely associated with legacy ORA contracts issued prior to 2006 where residents were entitled to all or a portion of the capital gains over their occupancy period.

Table 5.3: Realised resale gains

	FY16 Actual	FY17 Actual	FY18 Actual	FY19 Actual	FY20 Forecast
Realised resale gains (gross amount)	47.8	59.4	66.6	75.7	66.4
Residents' share of capital gains	(1.3)	(4.1)	(4.3)	(4.2)	(3.8)
<b>Realised resale gains (net of residents' share)</b>	<b>46.5</b>	<b>55.3</b>	<b>62.3</b>	<b>71.5</b>	<b>62.6</b>

Source: Metlifecare information

The realised resale gains in FY20 was materially affected by the Level 4 lockdown restrictions. Before restrictions were implemented, Metlifecare had been forecasting \$72.8 million of net realised resale gains in FY20.

## 5.2 Financial position

Table 5.4 shows Metlifecare's financial position as at 30 June between 2016 and 2019, based on audited annual reports and as at 31 December 2019 and 30 April 2020 based on management accounts.

**Table 5.4: Historical financial position (\$ million)**

	Jun 16	Jun 17	Jun 18	Jun 19	Dec 19	Apr 20
Cash and cash equivalents	6.6	2.9	16.3	3.4	4.2	3.5
Trade receivables and other assets	9.6	8.8	20.9	23.5	23.6	28.2
Property, plant and equipment	36.4	50.7	54.8	53.4	56.7	55.8
Intangible assets	1.5	1.5	1.2	1.0	0.8	0.6
Investment properties	2,524.8	2,885.3	3,182.6	3,423.6	3,523.1	3,546.2
Investment in joint venture	7.7	9.7	10.8	10.8	11.0	11.2
Asset held for sale	-	-	-	-	1.2	-
<b>Total assets</b>	<b>2,586.4</b>	<b>2,958.9</b>	<b>3,286.6</b>	<b>3,515.7</b>	<b>3,615.7</b>	<b>3,645.5</b>
Trade and other payables	(31.3)	(49.9)	(72.0)	(41.3)	(32.0)	(31.2)
Derivative financial instruments	-	-	(0.4)	(1.5)	(2.6)	(1.9)
Lease liabilities	(0.2)	(0.1)	(2.4)	(2.0)	(1.8)	(1.6)
Bank loans	(80.6)	(75.3)	(154.4)	(277.2)	(309.4)	(317.4)
Deferred management fees	(93.5)	(106.2)	(117.0)	(126.3)	(130.7)	(133.9)
Refundable ORA	(1,154.1)	(1,260.2)	(1,355.1)	(1,458.4)	(1,517.6)	(1,533.0)
Deferred tax liability	(93.7)	(102.6)	(117.2)	(124.0)	(128.2)	(128.2)
<b>Total liabilities</b>	<b>(1,453.5)</b>	<b>(1,594.3)</b>	<b>(1,818.5)</b>	<b>(2,030.7)</b>	<b>(2,122.4)</b>	<b>(2,149.8)</b>
<b>Net assets</b>	<b>1,133.0</b>	<b>1,364.5</b>	<b>1,468.1</b>	<b>1,485.0</b>	<b>1,493.3</b>	<b>1,498.3</b>
Shares on issue (million)	212.9	213.0	213.1	213.3	213.3	213.3
Net assets per share	\$5.32	\$6.41	\$6.89	\$6.96	\$7.00	\$7.02

Source: Metlifecare statutory accounts and management accounts

Investment property is valued by an independent property valuer (CBRE). When it undertakes its valuations, CBRE does not include head office costs.

The valuation of investment property occurs semi-annually for the December and June balance sheets. The 30 April 2020 balance sheet is therefore based on the investment property valuations from 31 December 2019 and do not capture any impact of COVID-19, the lockdown restrictions and the resulting economic conditions.

Metlifecare's most significant asset is its investment property portfolio. As at 30 April 2020, investment properties included:

- \$292.2 million of development land, work in progress (WIP) and newly developed units that have not been sold for the first time
- \$3,254.0 million of retirement village assets.

As at 30 April 2020, Metlifecare had \$313.9 million of net debt and financial derivatives. Metlifecare uses debt to fund its development projects and generally receives the majority of the development cost back when it sells the units in a new retirement village. Metlifecare advises that it does not generally have debt for its core (non-development) activities.

Metlifecare's investment in a joint venture relates to its 50% interest in the Metlifecare Palmerston North Village. This village is a joint venture with Palmerston North Maori Reserve Corporate Trustee Limited.

Metlifecare's net assets per share have increased from \$5.32 to \$7.02 between 30 June 2016 and 30 April 2020. Over this period, the number of Metlifecare shares on issue has been relatively stable.

### 5.3 Capital expenditure

Metlifecare's capital expenditure is summarised in Table 5.5. Capital expenditure includes new developments, asset replacement and regeneration, and remediation projects.

**Table 5.5: Fixed asset additions (\$ million)**

	<b>FY16 Actual</b>	<b>FY17 Actual</b>	<b>FY18 Actual</b>	<b>FY19 Actual</b>	<b>FY20 Forecast</b>
Investment properties	132.3	115.6	166.8	187.3	101.0
Other property assets <sup>28</sup>	4.9	18.7	7.5	16.7	1.5
Plant, furniture, equipment and motor vehicles	2.0	3.9	3.5	2.6	2.5
<b>Total additions</b>	<b>139.3</b>	<b>138.2</b>	<b>177.8</b>	<b>206.6</b>	<b>105.0</b>

*Source: Metlifecare information*

Capital expenditure increased between FY17 and FY19, primarily due to increased investment property additions.

Capital expenditure was impacted by remediation work undertaken to address the water ingress issues at some villages. The majority of the remediation work started in FY17 and is scheduled to be largely completed in FY23. Metlifecare will have incurred \$34 million of remediation costs to 30 June 2020 and expects to incur a further \$42 million to complete remediation.

<sup>28</sup> Includes 'construction work in progress' additions that are not otherwise captured within investment properties.

## 6 Valuation

### 6.1 Valuation approach

#### *Impact of New Zealand lockdown and COVID-19*

The valuation contained in this report was finalised on 5 June 2020. The valuation takes account of Metlifecare's best estimate of the impact of COVID-19, the lockdown restrictions and general economic conditions will have on its operations. However, share prices remain volatile and the full impact of COVID-19 is unlikely to be known for several years. Shareholders should therefore consider our valuation range in combination with the share price movements for listed companies that occur after 5 June 2020, as well as any further earnings guidance from Metlifecare.

#### *Standard of value*

We have estimated the 'fair market value' of Metlifecare. Fair market value is the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller, both acting at arm's length.

#### *Business interest being valued*

Our valuation is based on the acquisition of the whole of Metlifecare and accordingly incorporates a premium for control.

All else being equal, a controlling interest in shares is typically more valuable than an interest without control. This is because a non-controlling interest has limited influence over important business decisions, such as declaring dividends and determining the investment strategy. Accordingly, the value we have assessed exceeds the level at which, under normal market conditions, we would generally expect shares in Metlifecare would trade on the share market.

#### *Valuation techniques to be employed*

There are four valuation methodologies that are commonly used for valuing businesses:

- Discounted Cash Flow (DCF) analysis;
- Capitalisation of earnings;
- Estimate of proceeds from an orderly realisation of assets; and
- Industry rule of thumb.

Each of these methodologies is appropriate in different circumstances. A key factor in determining which methodology is appropriate is the actual practice commonly adopted by purchasers of the type of businesses involved. These valuation methodologies are detailed in Appendix 3.

We have adopted the DCF methodology to estimate the fair market value of Metlifecare. We consider this approach is appropriate because:

- Metlifecare has prepared long-term projections for the 20-year period FY20–FY39 (**the Forecast**). The Forecast was finalised in May 2020 and includes Metlifecare's best estimate of its future financial performance. Metlifecare considers that there will be a short term impact on its operations from the lockdown restrictions and also expects there to be reduced residential housing market liquidity caused by economic conditions over the next two years, resulting in some softness in the prices for retirement village units and slightly longer periods between unit vacation and resettlement. However, Metlifecare expects that the longer term impact from COVID-19 on its financial performance will be minimal.
- The DCF methodology is commonly used by parties within the retirement village industry.
- The DCF methodology is suited to valuing businesses where current earnings are not representative of reasonably expected of future earnings. Metlifecare's statutory earnings are heavily influenced by the capital gains accrued in the period being measured. Its underlying profits are heavily influenced by the embedded value of its portfolio. However, neither statutory earnings nor underlying profits are representative of reasonably expected future earnings, which are heavily influenced by future capital gains. Using the DCF methodology allows factors such as possible future house price inflation, the turnover of units, and development profits to be specifically addressed in the valuation.

- The DCF methodology is suited to businesses that have accounting earnings that are timed differently to cashflows. Most capitalisation of earnings valuations use earnings as a proxy for cashflows, so are ill-suited to situations where the timing of cashflows and accounting earnings are significantly different from the recognition of profits (such as with retirement village operators).

We have also considered the capitalisation of earnings methodology as a secondary valuation methodology. We have focused on underlying profits (ungeared) when using the capitalisation of earnings methodology, as this is more stable over time and therefore more likely to be comparable between operators. In comparison, statutory profits are dependent on the capital gains made in the particular year that earnings are measured, which can be heavily influenced on where operators' retirement villages are located.

We have also considered the book value of Metlifecare's net assets. However, the book values of retirement village operators' assets are based on DCF valuations that exclude key cashflows that are part of the operators' business (e.g. head office costs and development profits). We have therefore assessed an adjusted book value to take account of these differences.

## 6.2 Discounted cash flow

### 6.2.1 Principal assumptions and valuation parameters

**Valuation date:** We have used a valuation date of 30 April 2020.

**Discount rate:** We have separately considered Metlifecare's existing and development operations. We consider the risk associated with each of these activities is different and have therefore applied different discount rate to each. The discount rates have been determined as follows:

- We have estimated Metlifecare's post-tax, nominal Weighted Average Cost of Capital (**WACC**) for its existing operations. Our assessment is detailed at Appendix 5.
- We have added an 8% premium to the discount rate that we use for Metlifecare's development operations, to account for the added risk to undertaking new developments. This premium is higher than we would have applied prior to the COVID-19 lockdown restrictions. We consider a higher premium is appropriate to take account of the increased uncertainty at the present time.
- We have applied different discount rates to each year's cashflows, based on the cashflows' durations. The rates we have applied are broadly equivalent to a single discount rate of 8.0% for Metlifecare's existing operations and 15.3% for its development operations. The discount rates are also equivalent to a single blended discount rate of 9.0% applied to Metlifecare's whole business (existing and development operations).

**Forecast cashflows:** The DCF valuation is based on Metlifecare's financial forecast to 30 June 2039. The principal assumptions that underpin the Forecast include:

- The realised DMF and gains on sale are forecast based on the turnover of units and price increases for those units.
- Metlifecare's units, which are predominantly located in Auckland and Tauranga, increase/(decrease) in value at the following rates:
  - (2.0%) in FY21
  - 0.5% in FY22
  - 2.0% in FY23
  - 3.0% in FY24
  - 3.4% from FY25.

These rates were adopted by Metlifecare after considering the latest HPI forecasts, as set out at Section 3.4.3 of this report, as well as after considering the significant events related to COVID-19, including the lockdown period and its impact on the economic conditions.

On 26 May 2020, Arvida announced its financial results for the 12 months ended 31 March 2020. The announcement included forecast growth rates for the price of its units, as adopted by the valuers of Arvida's villages. The growth rates adopted by CBRE for Arvida's Auckland and Tauranga sites were broadly similar to the growth rates Metlifecare has adopted in its Forecast.

- The turnover of units is based on a Monte Carlo simulation undertaken by Metlifecare management. This simulation is based on existing and new residents actual and expected gender (66% female and 34% male) and age (with a normal distribution). Management expects the number of units turned over to increase from around 400 in FY20 (300 ILUs and 100 SAs) to around 500 in FY39 (400 ILUs and 100 SAs). This increase is solely for existing units and is largely due to new units that have been tenanted in recent years reaching a 'steady-state' level of turnover.
- Metlifecare never needs to pay cash income tax (refer Section 3.6).
- Excluding DMF and gains on sale, revenue and costs generally increase at 2.5% per annum (above inflation). Some amounts change at slightly different rates, but with changes in revenue offsetting changes in expenses. Metlifecare's costs are largely associated with employees and maintenance costs. Excluding DMF and gains on sale, Metlifecare's revenue is largely from village operations, village services and its care facilities.
- The cost to refurbish units that are turned over is forecast to reduce from around 8.6% of the unit's sale price in FY20 to around 6.4% in FY29.
- Metlifecare expects to incur \$42 million on remediation costs for properties that currently suffer from water ingress issues. Following remediation, Metlifecare expects to receive income when the units re-enter circulation.
- For its development operations, Metlifecare forecasts having 80 new units in FY21 and is targeting an average of 250 new units per annum between FY22 and FY39, earning a development margin of 20% (relative to the units' sale price). The number of units in FY21 is affected by delays caused by the lockdown period, as well as an expected delay in some developments units caused by the general economic conditions.

**Terminal value assumptions:** Terminal value is calculated by assuming terminal year's unlevered free cash flows increases into perpetuity at a terminal growth rate (TGR). We have adopted different TGR for Metlifecare's existing and development operations.

- We have adopted a TGR of 2.5% per annum (beyond FY39) for Metlifecare's existing operations. This rate is between:
  - The expected inflation rate, which is forecast by The Treasury to be 1.79% in 2040 and reach 2.00% by 2065.<sup>29</sup>
  - The long run HPI growth rate, which is forecast by CBRE to be 3.4% per annum in nominal terms.

While property prices are forecast to increase at 3.4% per annum over the long term, Metlifecare is likely to be more exposed to price pressure from 2040, as the number of persons entering retirement villages is forecast to plateau by around this point in time.

- We have adopted a TGR of negative 10% per annum (beyond FY39) for Metlifecare's development operations. This rate has been determined based on the in persons entering retirement villages reaching a plateau around 2040. Without any need for new villages, we consider that the rate of new development will reduce significantly. In addition, with a reduction in demand for new villages, we consider that the development margin earned by operators who do undertake new developments is likely to reduce.

## 6.2.2 Risks to financial performance

While an aging population and generally increasing property prices are supportive to Metlifecare's financial prospects, there are key risks which could impact its financial performance, including:

- Metlifecare has forecast adding 250 units per annum from FY22 and achieving a development margin on these units of 20% of the sale price. Over the last several years, Metlifecare has developed fewer new retirement villages than its competitors and has added less than 250 units per annum. Furthermore, there is a risk that increased competition between retirement village operators will result in lower development margins.
- While the long-term macro-economic environment is supportive, there will come a point when the market becomes saturated. Once this happens, Metlifecare and other retirement village operators may come under increased price pressure.
- Much of the revenue earned by retirement village operators is associated with DMF, which is fixed from the point in time that residents move into the village. If people stay in their units for longer than expected, then this could have a material impact on profits. Due to the fixed and long-term nature of these contracts, it takes a long time for operators to adjust their fee structure and have that flow through to cashflows.

<sup>29</sup> <https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes>

- The forecast is heavily dependent on property prices increasing at the projected rate (3.4% over the long term). If property prices increase faster or slower than forecast, then this would have a significant impact on the value of Metlifecare.
- While Metlifecare has provided KordaMentha with its best estimate of its future financial performance, given events to date, it is impossible to know the exact impact that COVID-19, the lockdown restrictions and the resulting economic conditions will have on Metlifecare's financial performance. For example, it is possible that there will be additional lockdown periods. It is also unclear what impact COVID-19 might have on the demand for units in the longer term. There might be reduced demand if there are significant outbreaks of COVID-19 at multiple villages. In contrast, retirement villages that are shown to have effective systems in place that keep the elderly safe might have increased demand on their units.

### 6.2.3 DCF valuation

Our DCF valuation of Metlifecare is summarised at Table 6.1. We estimate the equity value of Metlifecare at between \$1.3 billion and \$1.5 billion, which is equivalent to \$5.89 to \$7.23 per share, with a midpoint of \$6.56 per share.

**Table 6.1: Summary of DCF valuation (\$ million)**

	Low	High
Existing operations	998	1,215
Development operations	258	327
Land Bank, Completed Stock, WIP	316	316
<b>Enterprise Value</b>	<b>1,572</b>	<b>1,859</b>
Net debt	(316)	(316)
<b>Equity value</b>	<b>1,256</b>	<b>1,543</b>
Shares on issue (millions)	213.3	213.3
<b>Value per share</b>	<b>\$5.89</b>	<b>\$7.23</b>

Source: KordaMentha analysis

The low and high ends in the above valuation range have been determined as follows:

- **Existing operations:** We have used the Forecast for Metlifecare's existing operations. However, due to the uncertainty around HPI forecasts, and the significant impact these forecasts have on value, we have based the low and high end of our value range on HPI growth rates being 25 basis points below and above the base rates set out at Section 6.2.1.
- **Development operations:** We have used Metlifecare's target rate of 250 new units per annum from FY22 for the high end of the value range for the development operations. At the low end we have set the new units to 200 per annum from FY22, to account for the risk that Metlifecare does not reach its targeted level.
- **Land Bank, Completed Stock, WIP:** We have added the value of property held by Metlifecare that is not part of its existing operations. Most of this property is being or is expected to be used for developments. We have added the same value to the low and high end of our value range based on the most recent land and buildings valuations for the property.
- **Net debt:** We have deducted net debt held by Metlifecare as at the valuation date.



## 6.2.4 DCF sensitivity

We have undertaken a range of sensitivities from our base case. Figure 6.1 shows the impact on our valuation of varying key assumptions.

Figure 6.1: DCF sensitivity

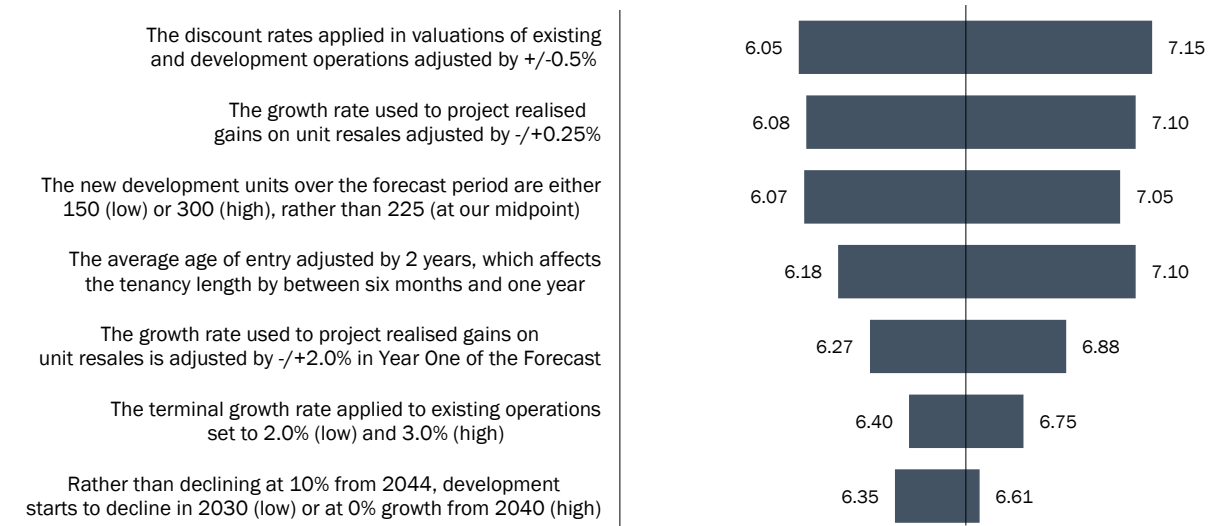


Figure 6.1 shows that a significant portion of the value we ascribe to the Metlifecare shares is associated with the development of new units. In particular, of the total \$6.56 per share that we ascribe to Metlifecare (at the midpoint), approximately \$1.37 (21%) is associated with future development profits earned by Metlifecare. This also shows that our assumption that development declines at 10% from 2040 does not have a material impact on value, but if the decline started earlier (in 2030), then we would reduce our assessed value to approximately \$6.35 per share.

This also shows that the growth rate used to project the price of Metlifecare units has a material impact on the value we assess. The base case forecast has the change in prices going from a 2% decline in FY21 to positive growth of 3.4% per annum from FY25. Even relatively small changes of 25 basis points (every year) have a significant impact of approximately 50 cents on the value that we assess for the Metlifecare shares. This range is equivalent to long-term price increases averaging between 3.15% and 3.65% per annum.

We have also considered the impact of a short term, but non-recurring impact on Metlifecare unit prices. A 200 basis point change in unit prices has an impact of approximately 30 cents on the value we assess for the Metlifecare shares. This is relevant in the present circumstances, given the recent speculation in the media as to the impact that COVID-19, including the lockdown period, and a possible recession will have on property prices.

Figure 6.1 shows the impact of changes to average age of entry and, in turn, the length of occupancy on the value of Metlifecare. If average occupancy is longer than projected, then this causes a reduction in the value we assess for Metlifecare, and vice versa. The change shown is a movement in entry age of two years, which is broadly equivalent to a change in occupancy period of between six months and one year. The average occupancy period implied by Metlifecare's forecast model is 10.0 years for ILU and 4.1 years for SA.

## 6.3 Capitalisation of earnings

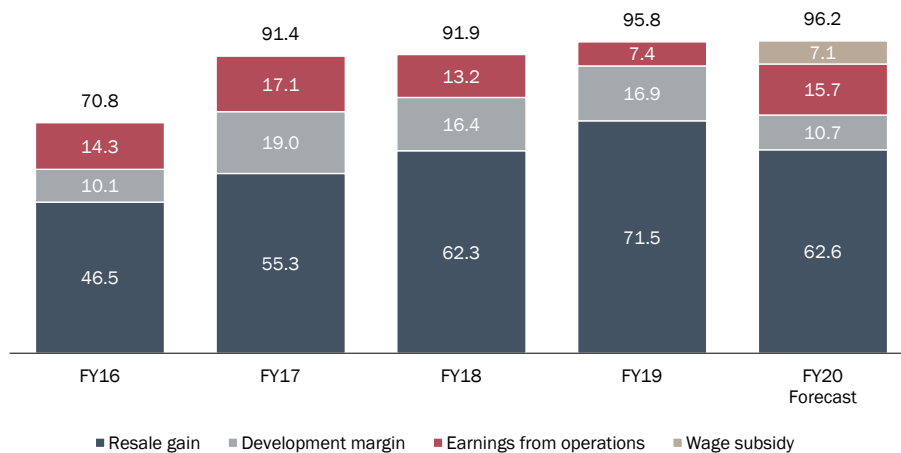
There are several commonly adopted types of earnings and earnings multiples used to undertake a capitalisation of earnings valuation, including EBITDA, EBIT and price-earnings. The choice of the type of earnings and earnings multiple is typically based on the nature of the business and the industry in which it operates.

To value Metlifecare we have focused on its underlying profits (ungeared), which are more stable over time and we consider allow for better comparisons between operators. In contrast, the statutory profits in any one year are influenced by unrealised gains on units in that year, which will often be volatile and depend on the period in which earnings are measured (i.e. the month in a financial year ends) and the location of operators' retirement villages.

### 6.3.1 Underlying profit

In order to assess a level of earnings to use in our capitalisation of earnings valuation, we have considered Metlifecare's underlying profits (ungeared) over the last four financial years, plus the FY20 forecast, which are illustrated in Figure 6.2. We have also considered Metlifecare's FY20 forecast, prepared before the lockdown restrictions were implemented, which was for \$97 million underlying profit (ungeared).

Figure 6.2: Underlying profit (ungeared) (\$ million)



Source: Metlifecare statutory accounts, management accounts and forecast

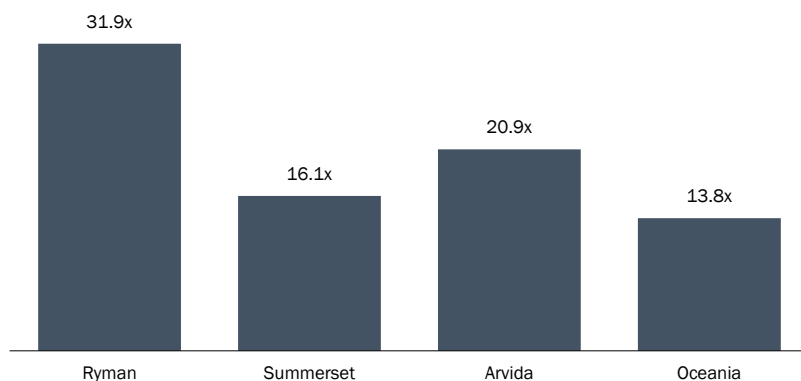
We have assessed underlying profit (ungeared) for Metlifecare at \$96 million. The bases for this estimate are:

- Metlifecare had \$95.8 million underlying profit (ungeared) in FY19. We consider FY19 earnings to be relevant to our capitalisation of earnings valuation because when we benchmark Metlifecare against the other listed operators, we have used their historical (rather than forecast) earnings.
- Metlifecare is forecasting \$96.2 million underlying profit (ungeared) in FY20. This includes the wage subsidy. The FY20 financial performance is affected by the Level 4 lockdown restrictions, which reduced the realised resale gains. Many of the issues that have affected Metlifecare in FY20 that relate to COVID-19 are likely to be non-recurring.
- Before the lockdown restrictions were implemented, Metlifecare had forecast \$97.0 million underlying profit (ungeared) in FY20. We consider this previous FY20 forecast as a useful guide to Metlifecare's underlying profits in a normal year, as it excludes the impact of COVID-19.

### 6.3.2 Earnings multiple

We have benchmarked Metlifecare against the four other listed retirement village operators. Figure 6.3 shows the earnings multiples for the other operators based on the underlying profit they earned in their last full financial years.<sup>30</sup>

Figure 6.3: Underlying profit multiples as at 19 May 2020



Source: Capital IQ, Annual Reports and Investor Presentations

A summarised description of each of the comparable operators is set out in Appendix 4.

The comparable listed operators have trading multiples between 13.8x and 31.9x underlying profit. There are fundamental differences between Metlifecare and the other listed operators, which are summarised in Table 6.2.

We observe that the median earnings multiple for the four comparable listed companies reduced by 21% between 5 March 2020 and 19 May 2020. The reduction was largely due to a net fall in the companies' share prices. During this period, the Level 4 lockdown was announced and implemented, as well as there being a deterioration in commentators' forecast economic growth rates in New Zealand and globally.

<sup>30</sup> Some of the listed operators report underlying profits on a slightly different basis to Metlifecare. Where possible, KordaMentha has adjusted the reported underlying profit of the other operators so that it is more comparable to Metlifecare.

**Table 6.2: Key metrics for retirement village operators**

Company	Enterprise value <sup>31</sup>	Underlying profit split <sup>32</sup>			Earnings growth <sup>33</sup>	Landbank as % of existing portfolio <sup>34</sup>	Unit growth	
		Operations	Resale gain	Development			Historical <sup>35</sup>	Target <sup>36</sup>
Ryman	7,831	24%	44%	32%	14%	66%	7%	9%
Summerset	1,953	18%	28%	54%	14%	126%	11%	12%
Arvida	1,005	52%	34%	14%	30%	40%	20%	7%
Oceania	740	26%	33%	41%	20%	37%	-3%	8%
<b>Median</b>	<b>1,479</b>	<b>25%</b>	<b>34%</b>	<b>36%</b>	<b>17%</b>	<b>53%</b>	<b>9%</b>	<b>8%</b>
Metlifecare	1,800	14%	68%	19%	2%	33%	4%	5%

Source: Annual Reports and Investor Presentations of NZX listed retirement village operators

Key observations concerning the metrics in Table 6.2 are:

- Over the last three years, Metlifecare has derived 14% of its underlying profit from operations. In contrast, the median for the other listed operators is to derive 25% of their underlying profit from operations. Of all the operators, Arvida derives the most of its underlying profit from operations, at 52%, which is largely due to its high proportion of care beds. Earnings from operations tend to be less reliant on HPI growth.
- Over the last three years, the portion of Metlifecare's underlying profit derived from resale gains have been roughly double the median of the other operators. Metlifecare's resale gain has been achieved because of the high growth in residential housing prices in Auckland and Tauranga over the last decade. Compared to other operators, Metlifecare's earnings appear to be more exposed to the HPI changes. However, Metlifecare also has a relatively high embedded value, which means that much of its current value is already embedded and based on past (rather than forecast) HPI changes.
- While influenced by external factors such as the property market and construction costs, earnings generated through development are also affected by operators' development efficiency and experience. Over the last three years, the portion of Metlifecare's earnings from development operations has been approximately half the median of the other operators. It is difficult to estimate the short to medium term impact of a deterioration in economic conditions on development profits; while a reduction in HPI is likely to lead to lower unit prices, the construction cost for developments may also fall.
- Metlifecare's underlying profit has grown at approximately 2% per annum over its last three financial years, which is significantly less than other operators.
- Metlifecare's current landbank, as a portion of its current portfolio, is 27%. This is materially less than the other operators. In particular, Summerset has a large landbank at 109% of its current portfolio. The value ascribed to an operator's landbank is included in its enterprise value, but has not contributed to past earnings; therefore, all else being equal, an entity with a larger landbank should have a higher earnings multiple.
- Over the last three years, Metlifecare's unit growth, in relative terms, has been below that of Ryman, Summerset and Arvida. Based on the operators' stated target build rates from FY21, this is likely to continue. Oceania's units have declined as it has exited some villages, but it has also achieved earnings growth over the same period.

<sup>31</sup> The enterprise values were assessed based on the comparable companies share prices as at 19 May 2020 and most recent disclosed cash and interest bearing debt balances. Metlifecare's enterprise value is based on the proposed consideration value of \$7.00 per share.

<sup>32</sup> We have split the underlying earnings based on a weighted average of the FY17 to FY19 financial results.

<sup>33</sup> The earnings growth is based on the annual change in underlying profit between FY17 and FY19.

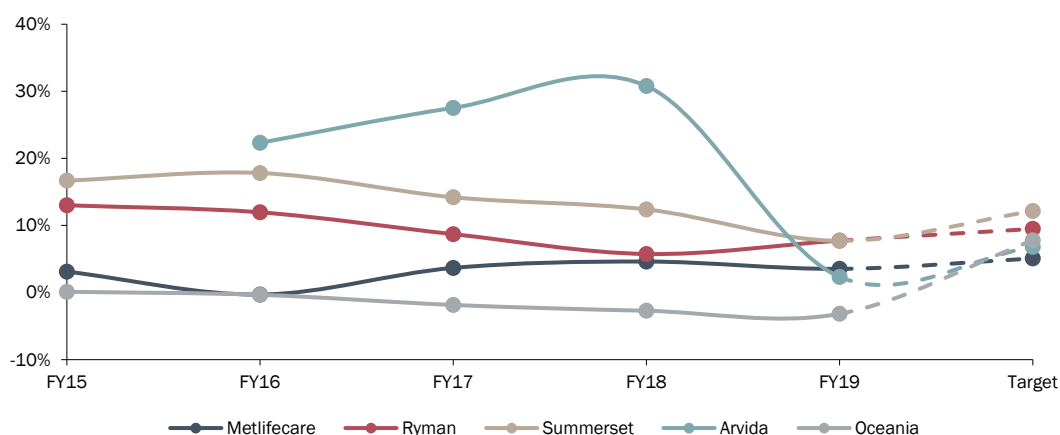
<sup>34</sup> This percentage compares the number of landbank units and beds to the number of existing units and beds. This includes Australian sites for Ryman and Summerset.

<sup>35</sup> The historical unit growth rate is based on the net annual change in units between FY16 and FY19.

<sup>36</sup> The target unit growth rate is based on the target number of units that the operators have stated will be added in or around FY21 before the Level 4 lockdown. Pre-lockdown build rates have been used as not all operators have announced updated target build rates, so these amounts would otherwise not be comparable with one another.

Figure 6.4 illustrates the historical and target growth rates of the operators' portfolios between FY15 and FY19, plus their target from FY21. Metlifecare's growth rate, relative to its existing size, has typically been lower than all the operators except for Oceania. Its target growth rate is the lowest of all the operators.

Figure 6.4: Portfolio growth rates (by units)



Source: Annual Reports and Investor Presentations of NZX listed retirement village operators

### Selection of earnings multiple

We have adopted an earnings multiple of 16x to 18x for Metlifecare, after considering:

- The comparable listed operators have multiples of between 13.8x and 31.9x underlying profit, and a median of 18.5x underlying profit.
- The comparable trading multiples are based on prices assessed for small minority parcels of shares. Therefore, the multiples set out above do not include a control premium that would typically apply to a 100% shareholding.
- Compared to the other operators, Metlifecare earns a higher proportion of its underlying profit from resale gains, which leaves it relatively more exposed to HPI.
- Metlifecare's earnings growth has been materially lower than the other listed operators over the last three years.
- Metlifecare's development activity has been less substantial than other listed operators. While it expects to increase its development of new villages, its target development level appears to be lower than the other operators, relative to the size of its existing portfolio.
- Metlifecare has a smaller land bank than the other operators.
- When compared to the comparable companies, Metlifecare has a relatively high portion of its value in its embedded value, which we consider is less affected by economic conditions than development operations, which the other operators are more reliant on for their earnings.

### 6.3.3 Capitalisation of earnings valuation

Table 6.3 summarises our capitalisation of earnings valuation for Metlifecare. The valuation range is \$5.72 to \$6.62 per share, with a midpoint of \$6.17 per share. This compares to the proposed consideration of \$7.00 per share.

Table 6.3: Capitalisation of earnings valuation

	Low	High
Underlying profit (ungeared)	96	96
Underlying profit multiple	16x	18x
<b>Enterprise value</b>	<b>1,536</b>	<b>1,728</b>
Cash/(net debt)	(316)	(316)
<b>Equity value</b>	<b>1,220</b>	<b>1,412</b>
Shares on issue (million)	213.3	213.3
<b>Value per share</b>	<b>5.72</b>	<b>6.62</b>

As a summary of the inputs to our capitalisation of earnings valuation:

- **Approach:** We have used underlying profit (ungeared) as the basis for the valuation
- **Underlying profit:** We have adopted underlying profit (ungeared) of \$96 million. This is primarily based on FY19 and FY20 (forecast).
- **Underlying profit multiple:** We have adopted an earnings multiple of 16x–18x. This was assessed by benchmarking Metlifecare against the other listed operators. This multiple includes a premium for control.
- **Net debt:** We have deducted net debt held by Metlifecare as at the valuation date.

## 6.4 Adjusted net assets crosscheck

We have used the book value of Metlifecare as a broad valuation crosscheck.

The majority of the book value of Metlifecare is based on a DCF valuation. However, that valuation excludes value associated with its development operations, and also excludes head office costs.

To crosscheck our valuation range, we have first adjusted the book value for the value associated with Metlifecare's development operations, as well as its head office costs (both of which are excluded from the valuations that underpin the book values of Metlifecare's assets). Our analysis is summarised in Table 6.4.

**Table 6.4: Adjusted book value (\$ per share)**

Value per share	Low	High
Net assets	\$7.02	\$7.02
Development operations	\$1.21	\$1.53
Head office	(\$1.75)	(\$1.75)
<b>Adjusted book value</b>	<b>\$6.48</b>	<b>\$6.80</b>

We have assessed an adjusted book value for Metlifecare at between \$6.48 and \$6.80 per share, which is based on:

- **Net assets:** The value of Metlifecare's net assets is equivalent to \$7.02 per share as at 30 April 2020. The net asset balance is based on CBRE valuation analysis as at 31 December 2019; therefore, it does not capture the impact of COVID-19, the lockdown restrictions and the resulting economic conditions.
- **Development operations:** We assess the present value of Metlifecare's future development profits at between \$258 million and \$327 million, which is equivalent to \$1.21 and \$1.53 per share (refer Section 6.2.3).
- **Head office costs:** We assess the present value of Metlifecare's shared support and corporate overhead function (excluding the portion associated with development) at \$372 million, which is equivalent to \$1.75 per share. This is based on costs of approximately \$21 million in FY21, increasing at 1.0% per annum.

We observe that some of the other retirement village operators have price to net asset multiples that are higher than Metlifecare. However, these entities have generally achieved development well above that of Metlifecare, which has resulted in higher earnings growth. In addition, Ryman is significantly larger than Metlifecare, which means its head office function is spread over a larger business. These factors will generally result in higher price to net asset multiples.

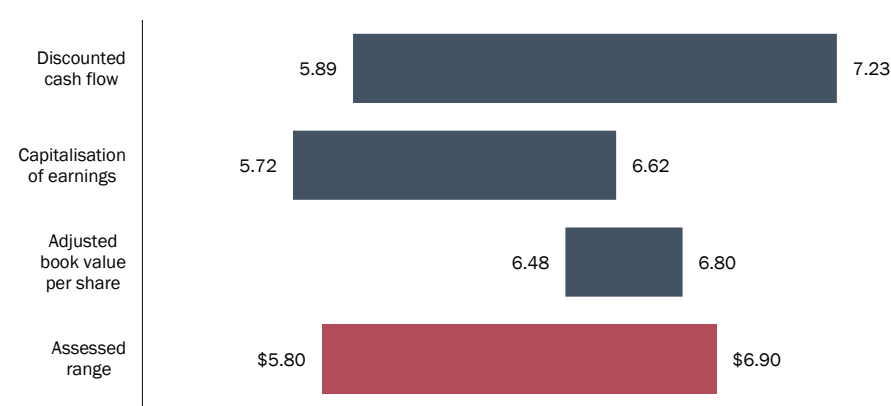
6.5 Valuation summary

We estimate the value of Metlifecare equity at between \$5.80 and \$6.90 per share, with a midpoint of \$6.35 per share. The valuation is for the full underlying value of Metlifecare assuming 100% of the company was available to be acquired and therefore includes a premium for control. The value exceeds the price at which, based on current market conditions, KordaMentha would expect Metlifecare shares to trade on the NZX in the absence of a takeover offer or acquisition scheme similar in nature to the Scheme.

We have adopted our valuation range after considering the DCF and capitalisation of earnings methodologies, as well as an adjusted book value per share for Metlifecare. Of the three approaches, we consider the DCF methodology to be the best guide to Metlifecare’s value, but also consider the other approaches to be useful crosschecks.

The value under each methodology, as well as our assessed valuation range are illustrated in Figure 6.5.

Figure 6.5: Valuation summary (\$ per share)



The proposed consideration of \$7.00 per share is slightly above our assessed range.





## Appendix 1: Sources of Information

### Documents relied upon

Key information we have used and relied upon, without independent verification, in preparing this report includes the following:

- Metlifecare annual reports
- Metlifecare investor presentations
- Metlifecare management accounts
- Metlifecare FY20 forecast
- Metlifecare 20-year forecast model
- Metlifecare share register and trading information
- Annual reports and investor presentations of other listed operators
- Capital IQ
- Statistics New Zealand website ([www.stats.govt.nz](http://www.stats.govt.nz))
- The Treasury website ([www.treasury.govt.nz](http://www.treasury.govt.nz))
- The Reserve Bank of New Zealand website ([www.rbnz.govt.nz](http://www.rbnz.govt.nz))
- Broker reports
- Economic outlook reports from banks, including HPI forecasts
- Other publicly available information.

We have also had discussions with Metlifecare's management in relation to the nature of Metlifecare's business operations, and the known risks and opportunities for the foreseeable future.

### Reliance upon information

In forming our opinion, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by Metlifecare and its advisers. We have no reason to believe any material facts have been withheld.

We have evaluated that information through analysis, enquiry and examination for the purposes of forming our opinion but we have not verified the accuracy or completeness of any such information. We have not carried out any form of due diligence or audited the accounting or other records of Metlifecare. We do not warrant that our enquiries would reveal any matter that an audit, due diligence review or extensive examination might disclose.

## Appendix 2: Qualifications and Declarations

### Qualifications

KordaMentha is an independent New Zealand Chartered Accounting practice, internationally affiliated with the KordaMentha group. The firm has established its name nationally through its provision of professional financial consultancy services with a corporate advisory and insolvency emphasis, and because it has no business advisory, audit or tax divisions, avoids any potential conflicts of interest which may otherwise arise. This places the firm in a position to act as an independent adviser and prepare independent reports.

The persons responsible for preparing and issuing this report are Grant Graham (BCom, CA) and Shaun Hayward (BCom, BProp, CFA). Both have significant experience in providing corporate finance advice on mergers, acquisitions and divestments, advising on the value of shares and undertaking financial investigations.

### Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of KordaMentha's opinion as to merits of the proposed transaction. KordaMentha expressly disclaims any liability to any Metlifecare security holder that relies or purports to rely on the Report for any other purpose and to any other party who relies or purports to rely on the Report for any purpose.

This report has been prepared by KordaMentha with care and diligence and the statements and opinions given by KordaMentha in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by KordaMentha or any of its officers or employees for errors or omissions however arising (including as a result of negligence) in the preparation of this report, provided that this shall not absolve KordaMentha from liability arising from an opinion expressed recklessly or in bad faith.

### Indemnity

Metlifecare has agreed that, to the extent permitted by law, it will indemnify KordaMentha and its partners, employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of this report. This indemnity does not apply in respect of any negligence, misconduct or breach of law. Metlifecare has also agreed to indemnify KordaMentha and its partners, employees and officers for time incurred and any costs in relation to any inquiry or proceeding initiated by any person except where KordaMentha or its partners, employees and officers are guilty of negligence, misconduct or breach of law in which case KordaMentha shall reimburse such costs.

### Independence

KordaMentha and the persons responsible for preparation of this report do not have at the date of this report, and have not had, any shareholding in, or other relationship, or conflict of interest with Metlifecare that could affect their ability to provide an unbiased opinion in relation to this transaction. KordaMentha will receive a fee for the preparation of this report. This fee is not contingent on the success or implementation of the proposed transaction or any transaction complementary to it. KordaMentha and the persons responsible for preparation of this report have no direct or indirect pecuniary interest or other interest in this transaction. We note for completeness that a draft of this report was provided to Metlifecare and its advisers, solely for the purpose of verifying the factual matters contained in the Report. While minor changes were made to the drafting, no material alteration to any part of the substance of this report, including the methodology or conclusions, were made as a result of issuing the draft.

### Consent

KordaMentha consents to the issuing of this report, in the form and context in which it is included, in the information to be sent to Metlifecare shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without the prior written consent of KordaMentha as to the form and context in which it appears.

## Appendix 3: Valuation Methodologies

There are four methodologies commonly used for valuing businesses:

- Discounted Cash Flow (**DCF**) analysis;
- Capitalisation of earnings;
- Estimate of proceeds from an orderly realisation of assets; and
- Industry rules of thumb.

Each of these valuation methodologies is appropriate in different circumstances. A key factor in determining which methodology is appropriate is the actual practice commonly adopted by purchasers of the type of businesses involved.

### Discounted cash flow

It is a fundamental principle that the value of an asset or business is represented by its expected future cash flows, discounted to present value at a rate which reflects the risk inherent in those cash flows. This approach, referred to as the DCF methodology, is particularly suited to situations where a business is in a growth phase or requires significant additional investment to achieve its projected earnings.

The DCF methodology requires considerable judgement in estimating future cash flows and the valuer generally places significant reliance on medium to long term projections prepared by management. The DCF valuation methodology can also be very sensitive to changes in underlying assumptions. Notwithstanding these limitations, DCF valuations are appropriate where current earnings are not representative of reasonable expectations of future earnings.

### Capitalisation of earnings

The capitalisation of earnings methodology requires an assessment of the maintainable earnings of the business and the selection of an appropriate capitalisation rate, or earnings multiple. This methodology is most appropriate where there is a long history of relatively stable returns and capital expenditure requirements are neither large nor irregular. In practice, it is often difficult to obtain accurate forecasts of future cash flows and therefore the capitalisation of earnings methodology is often used as a surrogate for the DCF methodology.

### Realisation of assets

The realisation of assets approach is based on an estimate of the proceeds from an orderly sale of assets. This methodology is more commonly applied to businesses that are not going concerns. The valuation result reflects liquidation values and typically attributes no value to any goodwill associated with on-going trading.

### Industry rules of thumb

In some industries, businesses are valued using well established 'rules of thumb'. Generally, these rules of thumb are used as a cross-check for other valuation methodologies.



## Appendix 4: Comparable listed companies

### Ryman Healthcare

Ryman Healthcare operates and develops integrated retirement villages, rest homes, and hospitals in New Zealand and Australia. Ryman's portfolio, the largest of any NZX-listed operator, consists of 34 villages in New Zealand and two villages in Australia, and houses over 11,000 residents. The company's development portfolio includes nine greenfield villages in both New Zealand and Australia in addition to brownfield developments. The company was founded in 1984 and is based in Christchurch, New Zealand.

Table A4.1: Ryman portfolio mix (units)

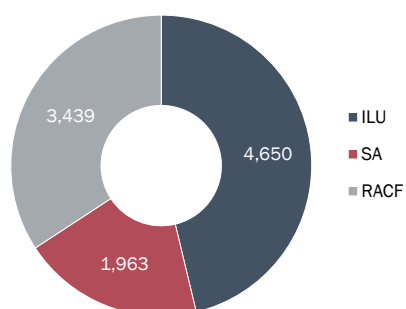


Table A4.2: Ryman geographic locations (by units)

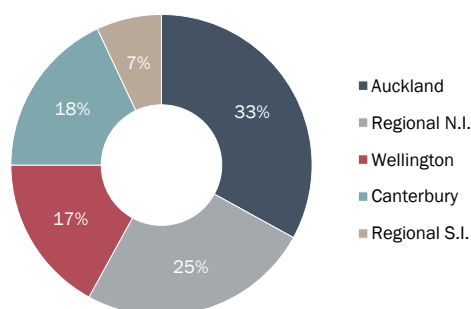
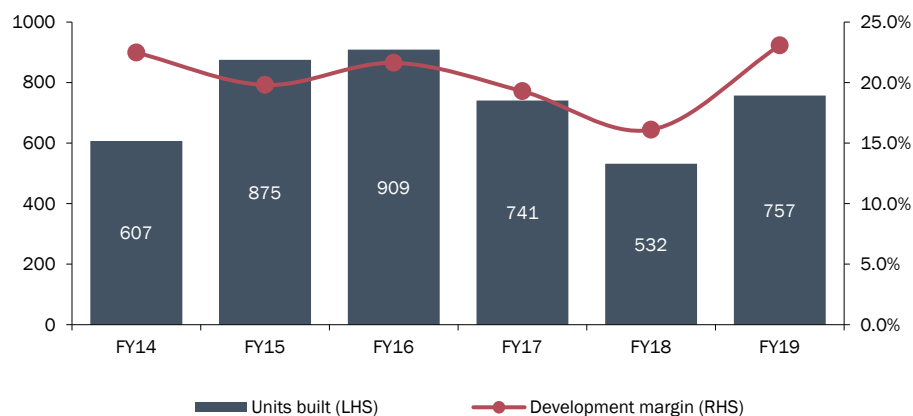


Table A4.3: Ryman financial information (\$ million, March year-end)

	FY17	FY18	FY19
Earnings through operations	48.2	53.5	54.9
Resale gains	77.3	107.2	102.6
Development margin	63.0	59.0	87.9
<b>Underlying profit</b>	<b>188.5</b>	<b>219.7</b>	<b>245.4</b>
<b>Enterprise value</b>			<b>7,830.9</b>
<i>Current enterprise value to underlying profit</i>	41.5x	35.6x	31.9x
<i>Underlying profit growth rate</i>		17%	12%

Table A4.4: Ryman historical development performance



## Summerset Group

Summerset Group has a portfolio of 28 villages across New Zealand. Its portfolio includes 3,871 units and accommodates over 5,300 residents. Summerset's has experienced strong growth over the last few years, led by the development of new villages. The company is now seeking to expand into Australia. Summerset Group was established in 1994.

Table A4.5: Summerset portfolio mix (units)

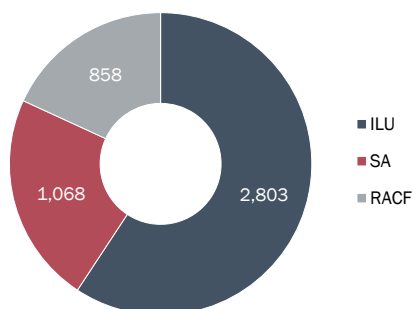


Table A4.6: Summerset geographic locations (by units)

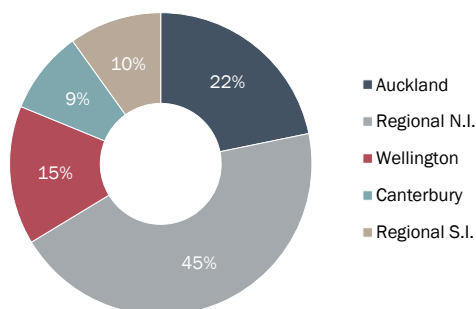
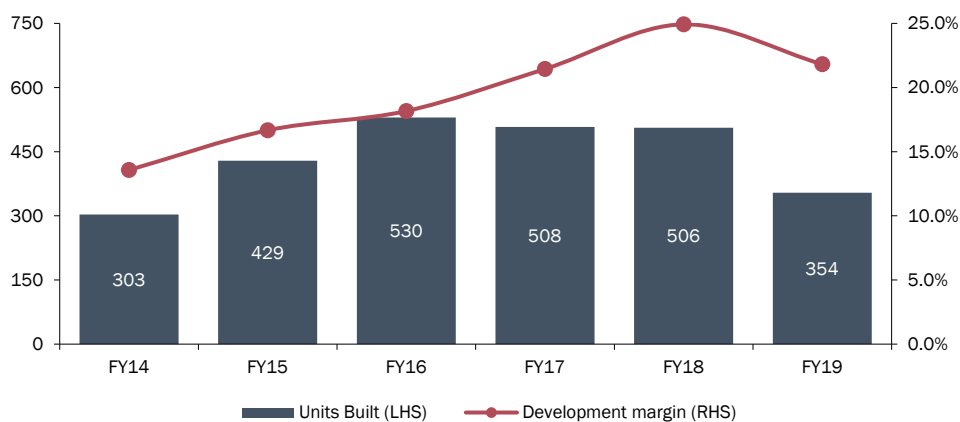


Table A4.7: Summerset financial information (\$ million, December year-end)

	FY17	FY18	FY19
Earnings through operations	17.1	17.7	23.5
Resale gains	24.9	28.7	36.9
Development margin	51.0	63.7	61.0
<b>Underlying profit</b>	<b>93.0</b>	<b>110.0</b>	<b>121.4</b>
<b>Enterprise value</b>			<b>1,953.2</b>
<i>Current enterprise value to underlying profit</i>	<i>21.0x</i>	<i>17.8x</i>	<i>16.1x</i>
<i>Underlying profit growth rate</i>		<i>18%</i>	<i>10%</i>

Table A4.8: Summerset historical development performance



## Arvida Group

Arvida Group owns and operates 32 retirement villages in New Zealand. Formerly known as Hercules Limited, Arvida was founded and listed on the NZX in 2014 and is based in Auckland, New Zealand.

Table A4.9: Arvida portfolio mix (units)

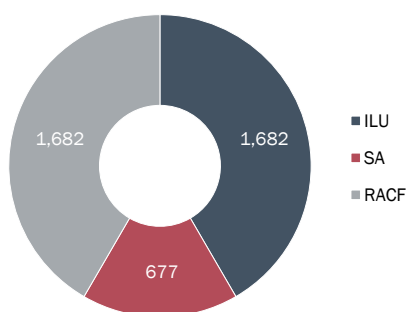


Table A4.10: Arvida geographic locations (by units)

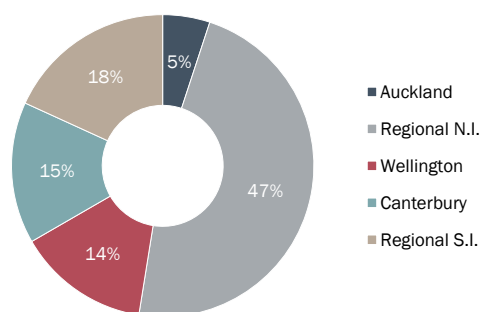
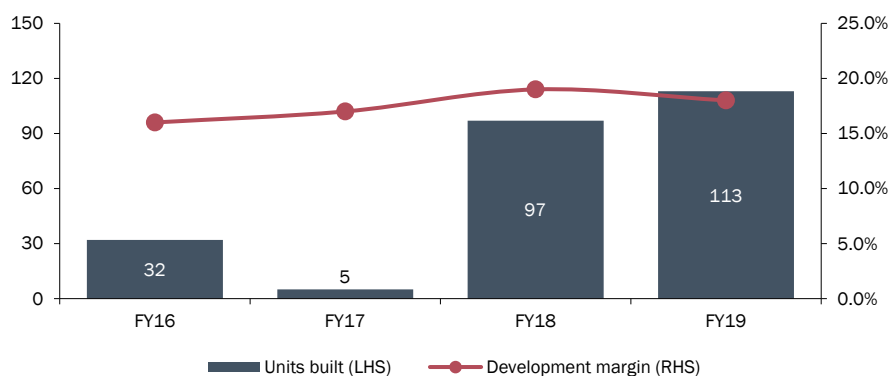


Table A4.11: Arvida financial information (\$ million, September year-end)

	FY17	FY18	FY19
Earnings through operations	17.3	24.4	20.9
Resale gains	8.9	13.3	19.5
Development margin	2.4	6.5	7.5
<b>Underlying profit</b>	<b>28.6</b>	<b>44.2</b>	<b>48.0</b>
<b>Enterprise value</b>			<b>1,004.6</b>
<i>Current enterprise value to underlying profit</i>	35.1x	22.7x	20.9x
<i>Underlying profit growth rate</i>		55%	8%

Table A4.12: Arvida historical development performance



## Oceania Healthcare

Oceania Healthcare Limited owns and operates 44 rest homes and retirement villages in New Zealand. Established in 2005, the Auckland based company was formerly known as Retirement Care (NZ) Limited and listed on the NZX in 2017.

Table A4.13: Oceania portfolio mix (units)

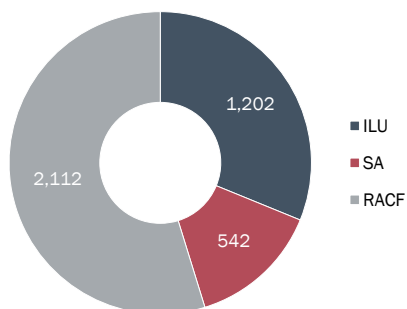


Table A4.14: Oceania geographic locations (by units)

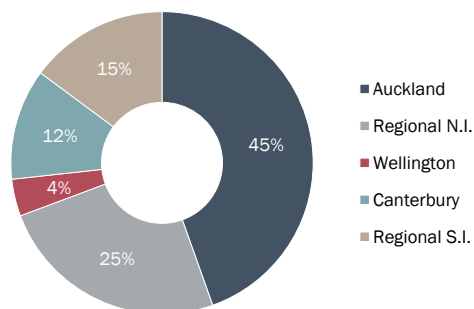
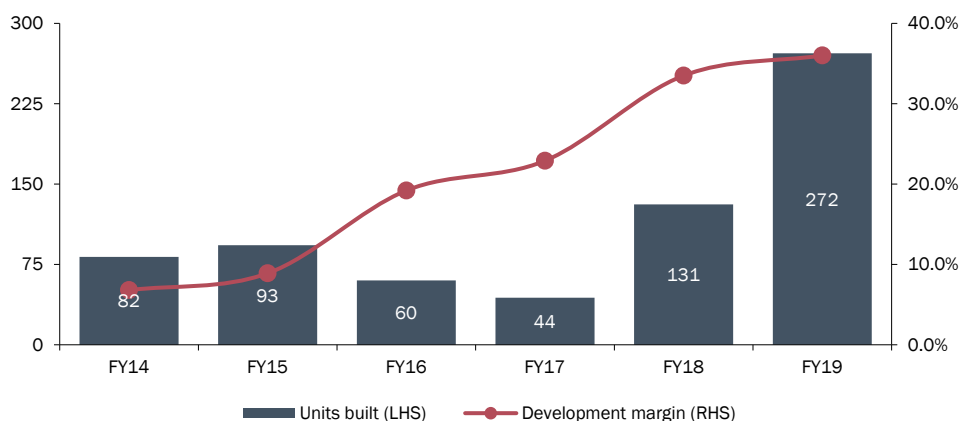


Table A4.15: Oceania financial information (\$ million, May year-end)

	FY17	FY18	FY19
Earnings through operations	15.6	11.0	9.3
Resale gains	12.7	16.9	15.1
Development margin	5.2	21.1	29.2
<b>Underlying profit</b>	<b>33.4</b>	<b>49.0</b>	<b>53.7</b>
<b>Enterprise value</b>			<b>739.6</b>
<i>Current enterprise value to underlying profit</i>	<i>22.1x</i>	<i>15.1x</i>	<i>13.8x</i>
<i>Underlying profit growth rate</i>		<i>41%</i>	<i>2%</i>

Table A4.16: Oceania historical development performance



## Appendix 5: Discount rates

We have determined the discount rates that we apply to Metlifecare based on an assessment of its post-tax, nominal Weighted Average Cost of Capital (**WACC**).

It is commonly accepted practice to determine WACC using the following formula:

$$WACC = R_d(1 - T_c) \frac{D}{D + E} + R_e \frac{E}{D + E}$$

Where:

- E** = the market value of equity capital
- D** = the market value of debt capital
- R<sub>d</sub>** = the required rate of return on debt capital (cost of debt)
- R<sub>e</sub>** = the required rate of return on equity capital (cost of equity)
- T<sub>c</sub>** = the statutory corporate tax rate.

### Leverage

When estimating Metlifecare's cost of capital, we have assumed an optimal capital structure with nil debt. We have adopted this approach partly due to the significant operational leverage that Metlifecare has built into its business model, due to upfront payments made by residents to acquire ORA, which provides a disincentive to additional leverage.

Metlifecare also pays no corporate tax, so it has no tax shield from its borrowings. This makes it relatively inefficient for Metlifecare to have debt over the long term, unless there are other benefits from having that debt.

In its current form, Metlifecare has slightly more than \$300 million net debt. This debt arose over the last few years as Metlifecare acquired land and undertook new developments. When the developments are completed, the amounts paid by the incoming residents for ORA should largely cover the acquisition and development costs. We understand from Metlifecare that debt capital was preferred for these developments as it avoids raising new equity capital, which would only need to be returned to shareholders when the developments are complete.

By assuming nil debt in Metlifecare's optimal capital structure, the WACC formula we use simplifies to solely an assessment of the required rate of return on equity capital. For completeness, an assessment of WACC in the New Zealand tax jurisdiction is generally not heavily affected by leverage.

### Capital Asset Pricing Model

The Capital Asset Pricing Model (**CAPM**) is typically used to determine a cost of equity.

The standard version of CAPM assumes that all sources of investment income are equally taxed at the personal level. This is not a good description of the New Zealand tax regime, because both capital gains and dividends are less onerously taxed than interest. Consequently, it is common practice in New Zealand to use a version of CAPM that recognises the favourable tax treatment of equity returns. The specification most commonly adopted in New Zealand is the simplified Brennan-Lally CAPM. This model is applicable to post-corporate tax, but pre-investor tax cash flows. It uses the following formula:

$$R_e = R_f(1 - T_i) + \beta_e[R_m - R_f(1 - T_i)]$$

Where:

- T<sub>i</sub>** = investors' effective tax rate on interest, dividends and capital gains
- R<sub>f</sub>** = the risk-free rate of return
- β<sub>e</sub>** = the equity beta for the entity being valued
- R<sub>m</sub>** = the expected return on the market portfolio

The terms  $[R_m - R_f(1 - T_i)]$  are generally grouped into a single tax adjusted market risk premium (**TAMRP**).



## Investors' effective tax rate ( $T_i$ )

We have adopted an effective investors' tax rate on interest, dividends and capital gains of 28%. This is the rate commonly used by valuers in New Zealand.

Unlike many other New Zealand companies, Metlifecare pays dividends without any imputation credits. However, like other New Zealand companies, its shareholders typically pay minimal capital gains tax. Important to our use of the simplified Brennan-Lally CAPM and adoption of a 28% investors' tax rate is that a new owner of Metlifecare can set a dividend policy as it sees fit. This could include reinvesting profits into other profitable activities, avoiding the need to pay unimputed dividends.

## Risk free rate ( $R_f$ )

Metlifecare has provided us with a 20-year cashflow forecast. We have assessed and applied different discount rates to the cashflows that occur in each year of the forecast, based on the timing of those cashflows. To do this, we have necessarily determined a different discount rate for each of the next 20 years. We have also considered value beyond the 20 year forecast period assuming discount rates revert to a long-term estimate.

The key difference between the discount rates we have determined for each period is the risk-free rate adopted. We have adopted the risk-free interest rates specified by The Treasury for use by Government entities for certain accounting valuation purposes.<sup>37</sup> These risk free interest rates are as at 31 January 2020 and were determined with reference to the overnight cash rate, Treasury bills, Government bond yields, and long-term expectations.

We have adjusted the rates stated by the Treasury for the change in Government bond yields between 31 January 2020 and 19 May 2020 (bond yields reduced during this time). We assume that, over time, bond yields will still revert to The Treasury's long-term interest rate estimate of 4.3%.

The one-year forward risk-free rates specified by the Treasury are summarised in Table A5.2.

## Equity beta ( $\beta_e$ )

An equity beta is a measure of an investment's volatility that arises from its exposure to the market. The beta of the market portfolio is 1.0. A beta above 1.0 indicates that an investment is more volatile than the market and has higher systematic (market-related) risk. A beta below 1.0 indicates that an investment has a lower level of systematic risk. An equity beta factors in the leveraging effect of debt in an investment's capital structure.

For a company with nil debt, the equity beta will equal the asset beta. As we have assumed an optimal capital structure for Metlifecare with nil debt, the equity beta we use when determine its cost of equity capital will be the same as its asset beta.

Table A5.1 shows the asset betas of the NZX listed retirement village operators in New Zealand, on both a two-year-weekly and five-year-monthly basis. Oceania was listed in May 2017 so only a two-year beta is available. We have assessed the Metlifecare beta as at 31 October 2019, rather than 30 April 2020, so that it excludes movements associated with the SIA.

**Table A5.1: Betas for New Zealand listed retirement village operators as at 30 April 2020**

Company	Median 2-year debt/equity	Two-year-weekly		Five-year-monthly	
		Asset beta	R <sup>2</sup>	Asset beta	R <sup>2</sup>
Metlifecare	23%	0.66	0.22	0.98	0.28
Ryman	24%	1.41	0.59	1.55	0.68
Summerset	40%	1.22	0.55	1.34	0.48
Arvida	35%	0.97	0.57	0.92	0.37
Oceania	39%	1.07	0.38		
<b>Median</b>	<b>35%</b>	<b>1.07</b>	<b>0.55</b>	<b>1.16</b>	<b>0.42</b>

Source: Capital IQ

<sup>37</sup> <https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/discount-rates/discount-rates-and-cpi-assumptions-accounting-valuation-purposes>

We estimate an asset beta for Metlifecare at between 0.8 and 1.0 after considering:

- The asset betas for listed retirement village operators in New Zealand. These asset betas, on a two-year basis, range between 0.66 and 1.41, with a median of 1.07. On a five-year basis, these betas range between 0.92 and 1.55, with a median of 1.16.
- We have assessed an asset beta of 0.36 for the New Zealand HPI in relation to the S&P NZX50 Index. This has been assessed over a 16-year period on an annual basis (since the inception of the NZX50 in 2003). We have then levered this beta to take account of the effective operation leverage that Metlifecare gains from its ORA liabilities. After this adjustment, the implied comparable asset beta for Metlifecare is 0.68.

For the purpose of valuing Metlifecare, we have adopted the midpoint of our beta range.

### **Tax adjusted market risk premium (TAMRP)**

A tax adjusted market risk premium is the excess expected return on the market portfolio of risky assets (equity market) over the return on risk-free assets (government bonds), with an adjustment for tax considerations. We have determined an appropriate TAMRP of 7.5% after considering:

- Valuation professionals typically use a tax adjusted market risk premium between 7.0% and 8.0% when valuing New Zealand companies. We consider a rate that is above the low end of this typical range is appropriate in the current economic environment. The mid-point of 7.5% is the most widely adopted TAMRP when valuing New Zealand companies.
- The New Zealand Treasury's guidance on discount rates suggests that a market risk premium of 7.0% is appropriate.



## Discount rates adopted

The discount rates we have adopted are shown in Table A5.1. The risk-free rates are one-year forward rates; therefore, the discount rates are also one-year forward rates. This means that a cashflow that occurred in (say) year five would need to be discounted once by each of the rates in years one to five.

**Table A5.2: Risk free rates**

Cashflow year	Forward risk-free rate	Equity beta	TAMRP	Forward WACC
Year 1	0.12%	0.90	7.50%	6.84%
Year 2	0.09%	0.90	7.50%	6.81%
Year 3	0.12%	0.90	7.50%	6.84%
Year 4	0.21%	0.90	7.50%	6.90%
Year 5	0.36%	0.90	7.50%	7.01%
Year 6	0.57%	0.90	7.50%	7.16%
Year 7	0.78%	0.90	7.50%	7.31%
Year 8	0.97%	0.90	7.50%	7.45%
Year 9	1.15%	0.90	7.50%	7.58%
Year 10	1.22%	0.90	7.50%	7.63%
Year 15	1.79%	0.90	7.50%	8.04%
Year 20	2.06%	0.90	7.50%	8.23%
Year 25	2.43%	0.90	7.50%	8.50%
Year 30	2.81%	0.90	7.50%	8.77%
Year 35	3.18%	0.90	7.50%	9.04%
Year 40	3.43%	0.90	7.50%	9.22%
Year 45	3.68%	0.90	7.50%	9.40%
Year 50	3.93%	0.90	7.50%	9.58%

Source: The Treasury data, KordaMentha estimates

To determine the terminal value, we have projected cashflows at their terminal growth rate and then discounted them at rates implied by risk free rates forecast by The Treasury to 2070.