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ARV.NZ - Half Year 2021 Arvida Group Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Arvida Group investor conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today to Mr. Bill McDonald, CEO. Thank you. Please go ahead.

William Adam McDonald - *Arvida Group Limited - CEO*

Thanks very much, and thanks to everybody joining us this morning. We're very pleased to announce our first half '21 results. Considering the environment in which we were trading, particularly in the early period, we're very happy with where we have landed. When we were looking at from March, considering what the economy might look like and where the housing market might be, we felt a very different view to what we have today as we see strong sales and really good activity in the residential housing market, plus good demand for our care product with us remaining at 95% as we sit here today.

Our net profit after tax of $41.8 million was down $3.2 million on the prior corresponding period, and of course, that was specifically impacted by COVID-19. Although a strong result, I think, given the focus on resident safety over the period. Assets now $2 billion on the improved valuations with a bit of an unwinding of those COVID-related assumptions and a firm property market and good new sales deliveries -- new unit deliveries.

If we look at the second page of the presentation, we've got a snapshot there of financial performance over the last 4.5 years, and Jeremy will touch on some of those numbers as we get into the financials. Key to me is to see that the asset growth is really strong, which will enable us to capitalize on the current buoyant conditions, which we hope will continue into next year.

Our response to COVID was a successful one, of course, with no infection across our resident or staff bodies, which was extremely pleasing as we sit here today. Our prevention strategy was pretty strong. Of course, when the pandemic hit, we had a pandemic plan in place. But like most people in our community, our response needed to be very different as we -- none of us had ever experienced a pandemic before. So very early on, we established a pandemic panel made up of some of our key senior leadership team. And we also employed our virologist, Professor Lance Jennings, who was very helpful. And we held very regular meetings to try and understand the environment around us and make the appropriate and fast decisioning that we needed to do. We also, through my involvement with the RVA and (inaudible), formed part of the task force response, which was, I think, very useful for us and for the sector who came together really well, and as we see now, have great response to the threats which were emerging at the time.

We really focused on actively engaging in the well-being of our residents, and I think this is a credit to our village management teams that our result was so strong. So we are really pleased with how our managers and our teams performed on site, and that was really the key to us getting through this period. Of course, from a corporate perspective, we were very early to secure an additional $100 million of bank debt capacity to enable us to be in a strengthened position if things didn't eventuate as well as they had. Certainly, at the time, we didn't think we'd be seeing such a very buoyant residential property market, and we could have been in a very different position, of course.

If we look at the effects that COVID had on us, obviously, the lockdown periods and work Level 3 periods ceased our sales activity. But that did bounce back very strongly to normalized levels in September, which was very pleasing to see. And of course, during lock down, all 4 of our construction and development activity is pretty much ceased. And during that period, we formulated strategies in which has enabled us to operate at more normalized levels coming into Level 3 and then Level 2, and of course, we still have some protocols in place at Level one. But I'm very pleased that we're able to keep on track with our delivery of plus [200] units, and in all likelihood, we'll be delivering 247 units for the full year.

Operations and finances. We had a lot of additional costs, which you would imagine, during the pandemic as we kept our residents and staff safe, particularly it was additional staff cost. That was the main driver of the cost increase, plus increased PPE costs. So most of that is now normalized, although due to the world demand for PPE, we're still at pretty high pricing there. So although generally, we're back to a normalized position, there's still some costs like PPE and continued cleaning, which continue.

If we flip the page, we have had great feedback from our residents and staff (inaudible) wide experience with sentiment towards the sector has really improved post COVID as people in the broad community looked over at the (inaudible) retirement villages and said, "Well, that's probably not a bad place to be." We're able to manage our residents very effectively. We're able to assist them with their well-being and ensure that loneliness and isolation issues, which were the key thing to all the people living in the broader community, were welled through good communication and the formulation of bubbles within the villages.

So if you move on to the development activity. We delivered 48 new units to the half, and they were all independent living units. And if you look at the next slide, we are on target to deliver the 247 units in FY '21, and they're predominantly coming from 143 care suites and apartments for Aria Bay Copper Crest. It's a very exciting move for us as we transition into our care suite strategy in a more fulsome way with the delivery of those 2 sites. We're very pleased with the demand that we have had to date from villages. And very soon, we'll be going out to the broader community after we address the internal demand. It's proved to us that this product really is demand driven, and we're confident that going forward, it will underpin some of those cost-related issues that relate to care.

We've also received resource consent at our Kerikeri site, and we're underway with the construction of our first 16 villas there. So that's also really exciting. And it's also worth mentioning that Waimea Plains, we're now into our third phase of construction of villas and townhouses there, and we're also building the clubhouse. That's been a phenomenally successful first venture into greenfield, and we're really pleased with (inaudible). Here's a couple of pictures on the next page, some grade shops, (inaudible) to set the location (inaudible) in various locations around the country. So some nice pictures there.

With the adoption of our sustainability policy last year, we've undertaken a few significant projects there, particularly in wetland generation. The picture there of wetland area in stage 5 at Bethlehem Shores. There was a serious amount of (inaudible) to facilitate this regeneration. And it's great to see. We've got a few new folks coming up into regenerate as well Waimea Plains and Te Puna Waiora, which is a new Kerikeri site.

So an update on the key development areas. At Aria Bay, as I mentioned, we've got our 59 care suites coming to fruition very soon. We're (inaudible) with our existing residents to transfer them over soon, and there is going to be (inaudible) very strong demand from the community for this product. And it's great to see how well it's been handled, particularly in line with the COVID-19 restrictions and the further Level 4 restrictions that we've been impacted within Auckland. In Copper Crest, it's absolutely wonderful to see this facility come out of the ground. It's with our first development that we handled to our own team. As you may recall, we picked up that Fletchers team a couple of years ago in this delivery. It's been very high quality and on time, on budget and looking great. And I think the key thing for us at the moment is just how strong the demand has been for this product in the last short while in which we have presented it to the residents. So very pleased our strategy is coming together there. And look forward to being able to rate more care suite across 3 or 4 other villages in FY '22.

Waimea Plains, I mentioned, is going particularly well into a great shop there. And if you look closely, you'll see the (inaudible) a big villa. It pretty much is. It's a big homestead type complex. And I was down there the other week and (inaudible) pretty well and looking forward to that being open (inaudible) this year.

If you look at the development pipeline on the next page, we've got 1,574 units remaining in the pipeline as we start working through that. We've got 15 brownfield projects there and 2 greenfield projects. (inaudible) projects actively under construction. So there's been a lot of work going on, as you'd imagine, and we're very pleased with the way in which that has been delivered over the period.

So I now hand over to Jeremy to touch on the financials.

Jeremy Nicoll - *Arvida Group Limited - CFO*

Good morning, everybody. Very pleased with the result, given the circumstances. So that would be profit after tax for the 6 months was $41.8 million. We saw revenue up 8% on the prior corresponding period, mainly as a result of the inclusion of the (inaudible) 6 for all 6 months. We've seen our deferred management fee line grow to $15.5 million. We expect that to continue to grow in the second half of the year. The first half was slightly lower than our normal run rate as we had some extension to the valuers' assumptions on average tiers, which impacted the Q1 DMF calculation.

In terms of operating costs, there was about $5 million additional costs in relation to COVID measures, mainly in relation to paying our frontline staff $2 more per hour for every hour worked during Levels 4 and 3. We have now normalized costs. So additional costs in relation to staffing and PPE are generally back to normal levels. We will carry on using probably more PPE than we were previously and cleaning protocols have also been increased.

In terms of the valuation result, we had CBRE and JLL complete a desktop review of our investment properties. That delivered a $38 million increase. As you will recall, at 31 March, the valuers introduced some conservatism to their assumptions, and these have been partially reversed. In the back of the presentation, there's a slide that shows what those assumptions were at 31 March versus 30 September. So a slight decrease in discount rates and an improvement in growth rates, particularly year 1 biller growth rates.

In terms of new unit sales, we sold and settled 42 units, delivering $36.7 million, which is an average value of 8.75 -- $874,000, which is up 12% on the same period of last year. In terms of ORA resales, we delivered 103 settlements over the 6 months (technical difficulty) on last year, really on service department sales. The access to those service departments was limited as we locked down care facilities. So we'll look to see we can clear some of that service departments resale stock over the next 6 months.

The prices we achieved in the first half were, on average, 3% above what the valuers had assumed at 31 March 2020, and we realized TMS of $6 million. In terms of the underlying profit, $20.5 million for the 6 months compared to $23.4 million for the prior 6 months. Obviously, the COVID costs and reduced sales, particularly in Q1, were the key reasons for that. We've shown a sort of a waterfall chart of the movement in underlying profit. So you can see there, the acquisitions from last year delivered $3.6 million more of underlying profit in the first half of the last period, obviously, 6 months this year and a 2-month contribution in the prior period. The existing portfolio's underlying profit contribution was down $2 million. Again, that's really on the back of lower levels of resales in the first half.

Balance sheet-wise, we have just ticked over $2 billion worth of assets. We've already talked about the investment profit increase. And we have spent $68 million on our development projects over the first 6 months or really just 5 months when obviously, we spent no money as all the sites were shut down. In terms of embedded value, that's continued to increase up to $410 million, up $21 million since the start of the year.

In terms of capital structure, gearing is at 32%. We have, as Bill mentioned, added a $100 million tranche to our debt -- bank debt facility. We will explore a potential retail bond issuance early in the new year just to provide some diversity of tenor and funding sources. In terms of interest cover, we did receive a waiver from our banking syndicates in relation to interest cover due to the additional COVID costs against the lower level of resales that occurred in the first quarter.

Cash flow-wise, very strong results from operating activities of $53 million, up from $30 million in the prior period. So very pleased to see that increased cash flow, particularly coming from the sale of new units in the first half. In terms of our dividends, we retained the dividend at $0.012 per share for the second quarter. That brings us to $0.024 per share for the first half, which is around 63% of our underlying profit for the period. The Board will review dividend guidance for the second half in February, and we'll provide an update at that point in time.

In terms of challenges, COVID continues to be a challenge or a potential risk for us moving forward. If there are more outbreaks or changes in (inaudible) throughout New Zealand, we still see cost pressures in relation to (inaudible) pay rates. So we're working with the (inaudible) hopefully on resolving this (technical difficulty) pay raise in the public system versus aged care. We aren't seeing any impacts on labor supply at the moment. The immigration policies have been helpful, and we'll just continue to monitor that as order restrictions carry into the new year.

So we're still looking strong for the second half of the year. We've got a lot of development delivery that will occur. We have seen our cost base normalize post the initial lockdowns. And so we expect to see a strong result coming through in the second half of the financial year. So that brings us to the close of the presentation.

I'll just hand back to Kevin, and he'll facilitate question-and-answer time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question in queue is from Aaron Ibbotson from Forsyth Barr.

Aaron Ibbotson - *Forsyth Barr Group Ltd., Research Division - Research Analyst*

I have just a couple of questions around care ORA, you mentioned strong demand for the product internally. So firstly, I just wondered if you could remind us how you -- what you expect the split to be between care ORA and I guess pack beds on Aria Bay and Copper Crest? And secondly, if I may, I wanted to just probe or hear your thoughts, if it's okay, on Ryman's announcement last week that they are introducing RAD. And if you think that will have any impact on your care ORA strategy? And maybe more specifically, also, if this is something you've considered for your existing care operation outside of the ones where you plan at care ORA?

William Adam McDonald - *Arvida Group Limited - CEO*

Thanks, Aaron. So in terms of the splits at Aria Bay and Copper Crest between (inaudible) and pack beds, it will be a slightly different strategy for each development. So we'll start with Copper Crest. So that's a brand-new care facility for that village. So we are aiming to sell around about 80% of those care suites, and we expect that we'll have around 20% that is pack. It's slightly different at Aria Bay. At Aria Bay, we've got an existing old care facility there with 35 residents in it. We will transition those residents across to the new care facility, and they will be continuing to pay the current daily rate plus the premium accommodation charge. Once they leave those rooms, we'll then look to sell them as ORAs, and we'd expect, within a few years, we'll be back to the 80-20 split again. In terms of the Ryman RAD approach, I think what Ryman is doing and what we are doing are different. Ryman are introducing RADs across traditional tier beds. We're making purpose-built care suite facilities designed around our Attitude of Living Well care model which are split into households. So I think the products are slightly different. And what Ryman is doing is really just taking a traditional care bed and asking for a deposit in lieu of a premium accommodation charge.

Aaron Ibbotson - *Forsyth Barr Group Ltd., Research Division - Research Analyst*

But sorry, if I could just probe on your second half -- second question there. So -- but if I look at your traditional care beds, if Ryman is being successful with this RAD offering, is that something you think you would consider or have considered? So run a dual-track effectively with care or as on these more targeted care suites and then a RAD on the more traditional care offering from your existing portfolio?

William Adam McDonald - *Arvida Group Limited - CEO*

Yes. So we'll monitor how Ryman go with it. It would be very interesting to see. I mean you can tell by looking at the numbers that they have put out, there's a trade-off between income, which they're losing, versus a reduction in the interest expense. So it will be dilutive to earnings, but be beneficial for their gearing position.

Aaron Ibbotson - *Forsyth Barr Group Ltd., Research Division - Research Analyst*

Okay. And then just a very quick follow-up detail, if it's okay. Is there any chance you could share with us your second quarter DMF? Because I believe you mentioned this sort of one-off type adjustment that you had in the first quarter, just so we get an idea of the run rate going forward.

William Adam McDonald - *Arvida Group Limited - CEO*

Yes. So it was $7.25 million in the first quarter and $8.25 million in the second quarter.

Operator

(Operator Instructions) Our next telephone question in queue is from Shane (inaudible) from (inaudible).

Shane Solly - *Harbour Asset Management Limited - Director & Portfolio Manager*

Just -- Jeremy, can you just expand a little bit on the DMF? So the adjustment in the first quarter reflected change in assumptions. How normal -- how regularly do you see those changes in assumptions?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Yes. So the one we calculate the DMF is by using the [10-year] that's determined by the valuer for each type of unit at each village. So once a year, which is in the first quarter of each financial year, we will update those average tenures. If the 10-year expands, then that has an impact of -- we have to reverse some of the income that we've previously recognized. So it has a negative effect on that first quarter if the 10-year expands. Obviously, the opposite happens if the 10-year contracts. I believe that the others generally have -- they might just use 5 years for service departments and 9 years for villas billers, and they don't move them. So I think we do treat it slightly differently to some of the others.

Shane Solly - *Harbour Asset Management Limited - Director & Portfolio Manager*

All right. That's helpful. In terms of so in terms of variance between a quarter, is this -- would you call anything else as being unusual in this particular quarter, this first quarter? Or is just the way the cards fell, so to speak?

Jeremy Nicoll - *Arvida Group Limited - CFO*

No, nothing unusual, just the way the cards fell.

Shane Solly - *Harbour Asset Management Limited - Director & Portfolio Manager*

And does that change over time with -- as you change the mix of your asset base?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Not really, no. No. The calculation is done by unit type by village. So won't have an impact.

Shane Solly - *Harbour Asset Management Limited - Director & Portfolio Manager*

Okay. Just in terms of development in -- obviously, well done, continue with the rate you have. And well done in general, by the way, test looking after regiments so well. In terms of your confidence to go forward with growth if you've called out medium-term 200 build rate, is it anything that is sort of conditional upon anything? Is there things that you'd be watching to (inaudible).

Jeremy Nicoll - *Arvida Group Limited - CFO*

Yes. So [3] things we're just looking at are demand. And at the moment, demand is very, very strong. The confidence that prospective residents have got with the ability to sell their home at good price within a reasonable time frame are were very strong. So at the moment, we're very confident with the outlook going forward. Next year, we've got a lot of pillar stock being delivered. So again, stock at the moment is selling particularly well. So yes, looking pretty confident for next year's delivery.

Operator

Our next telephone question is from Andrew Steele from Jarden.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

The first one for me is on development margin. I'm sorry if I missed it any comments on this earlier. Just at 14%, could you highlight any particular drivers for, I guess, the sort of low relative level versus prior periods? Is it sort of just a mix product? Or are you seeing greater-than-expected underlying cost pressure? And going forward, where do you expect it to settle for the full year?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Okay. So we target between 15% and 20% for our development margins. The slight drop is really a reflection on some of the Christchurch-based apartment stock, which has a lower margin than within our target band. So there's just a little bit of a dilution repeat from some of the new sales at Christchurch-based apartment buildings. All the villa developments are all within that 15% to 20% range.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

And so on a full year basis, you would expect to get back into that target range?

Jeremy Nicoll - *Arvida Group Limited - CFO*

I hope so, yes.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

Okay. That's great. Just on the movement in underlying profit bridge that you provide on Slide 21. Just looking at the decline in earnings from the existing portfolio, is it fair to assume that, that entirely relates to the sort of the $3.8 million of less sales gains that you highlight in the commentary?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Yes.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

Just -- sorry, continue, Jeremy.

Jeremy Nicoll - *Arvida Group Limited - CFO*

Just to reiterate, yes, directly, the COVID costs that ran through the net cut costs that ran through the P&L. So that that drop off is really in relation to resale activity.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

Okay. And so it is to add back that sort of drop off in the resale activity, I mean would there have actually been an underlying improvement in the existing portfolio? And what were the key drivers behind that?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Key drivers were net sales of service department stock over that first 6 months.

Andrew Steele - *Jarden Limited, Research Division - Director of Equity Research*

Okay. Then just in terms of your cash flow for the remainder of the year. Given some of your CapEx phasing and what's likely to be a stronger second half sales inflow, my sort of expectation would be that you might end up with net debt broadly flat or slightly up. I mean, is that sort of how you're thinking about those moving parts and your expectation for by the end of the year?

Jeremy Nicoll - *Arvida Group Limited - CFO*

Yes, that's pretty consistent with what we are expecting. We will see net debt increase. It won't increase by a hell of a lot. In the first 2 months since the end of this reporting period, we drew down $1.5 million in October and $1.5 million in November. So we are sort of largely covering the costs of our development spend through sales of new units or just general operating activities.

Operator

(Operator Instructions) And we have a question from Bianca (inaudible) from UBS.

Unidentified Analyst

Just 2 questions from me. First of all, can you give an indication on resales to date for the second half? And then secondly, what's the reason the average resale prices for care suites have been falling since 2019?

William Adam McDonald - *Arvida Group Limited - CEO*

Okay. So I'll deal with the second one first. So we've only got a very small portion of care suites within the portfolio. They were within Mary Doyle and Village at the Park, which were acquisitions that we made in 2017. I think in total, it's probably only about 25. So it's not a really big sample size to sort of the check pricing against. So what do we have? We have 4 sales in the first half and 2 in the prior corresponding period. So yes, it's very hard to read anything into those numbers. What we'll see going forward is once you've opened the 2 new facilities and get to a more normalized sort of number going forward.

In terms of resales in the area. Since reporting, we are just tracking along at historical averages is probably all I can say, given we haven't really released that data.

Operator

(Operator Instructions) There are no more further questions at this time. I would like to hand the call back to the speakers for closing remarks. Please go ahead.

William Adam McDonald - *Arvida Group Limited - CEO*

Yes. Thanks very much, everyone, for attending. And once again, it's been a really good year at half year from our perspective, given the circumstances, and we look forward to chatting with you again at the end of the year. Thank you.

Operator

Ladies and gentlemen, that does conclude the call. You may all disconnect. Have a great day. Goodbye.
