Deutsche Bank
Markets Research

Australasia
Australia
Health & Biotechnology

Industry
Aged Care

Date
23 January 2015

Initiation of Coverage

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Initiating coverage on the Aged Care sector: Two thumbs up

Two opportunities to gain exposure to an attractive sector – Buy Estia & Regis

The aged care sector offers investors exposure to a defensive earnings stream supported by positive demographic trends and is ripe for consolidation. Importantly the Govt funding reforms have opened up access to market linked accommodation payments significantly raising the potential returns. While these positives need to be weighed against the reliance on Government funding in an era of significant fiscal pressure, we are broadly confident the sector will escape material cuts before the planned 2017 review. Our preferred picks in the sector are Estia (Buy, $5.90) and Regis (Buy, $4.50)

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Estia's acquisition strategy underpins strong earnings growth

With the acquisition of over 1,300 places via bolt-on acquisitions in the last two years Estia has become a leading player in the ongoing consolidation of the fragmented residential aged care sector. While the rapid aggregation of the portfolio and the relatively new management team raises the risk, we take comfort from the quality of the portfolio (weighting to single rooms and extra service places) and the proforma track record of market leading operating margins. Given Estia offers an attractive growth profile and significant upside to our price target we have initiated with a Buy rating. Price target $5.90.

Estia offers the most upside following a disappointing debut

Estia has traded poorly since listing late last year. We attribute this to concerns raised by Japara's payroll issues, caution over the group's relatively rapid occupancy uplift forecasts and concern regarding the rising cost of aged care acquisitions. We believe these fears are over done and hence the share price weakness presents an attractive opportunity to gain exposure to the aged care sector's leading consolidator.

Regis' offers a strong development pipeline and experienced management

As one of the largest residential aged care operators in Australia with a high quality portfolio and strong systems Regis is well positioned to be a key beneficiary of the new funding regime. The long standing management team has a reputation for astute investment and conservative governance. We expect the group's extensive development pipeline to support strong growth in free cashflows underpinning our DCF based price target. We are initiating with a Buy rating and a $4.50 Price Target.

Japara offers valuation appeal but systems & earnings risk keeps us cautious

Japara has faced a number of challenges since listing including two funding changes and a payroll system issue. Despite these headwinds and the slightly soft first result management has maintained its FY15 earnings guidance. Given these challenges and limited upside to our price target (based on the low end of our DCF valuation) we have initiated with a Hold rating. Price target $2.12.

Valuation/Risk

We have relied on DCF valuations to set our price targets. The key risk for the sector is funding pressure as the Government seeks savings due to fiscal pressures. Please refer to company specific sections for information on valuation and risks.

Key Changes

Company	Target Price	Rating
EHE.AX	– to 5.90(AUD)	NR to Buy
JHC.AX	– to 2.12(AUD)	NR to Hold
REG.AX	– to 4.50(AUD)	NR to Buy

Source: Deutsche Bank

Top picks

Estia Health (EHE.AX),AUD4.70	Buy
Regis Healthcare (REG.AX),AUD3.97	Buy

Source: Deutsche Bank

Companies Featured

Estia Health (EHE.AX),AUD4.70			Buy
	2015A	2016E	2017E
P/E (x)	20.1	17.0	14.9
Div yield (%)	2.7	5.9	6.7
Price/book (x)	1.3	1.3	1.3

Japara Healthcare (JHC.AX),AUD2.00			Hold
	2015A	2016E	2017E
P/E (x)	22.4	16.3	14.8
Div yield (%)	4.6	6.2	6.7
Price/book (x)	1.0	1.0	1.0

Regis Healthcare (REG.AX),AUD3.97			Buy
	2015A	2016E	2017E
P/E (x)	24.9	21.1	19.6
Div yield (%)	2.8	4.8	5.1
Price/book (x)	5.7	5.8	5.8

Source: Deutsche Bank

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Executive Summary

Initiating coverage on the aged care sector

The aged care sector offers investors exposure to a defensive earnings stream supported by positive demographic trends and is ripe for consolidation. More importantly the funding reforms introduced last July have opened up access to market linked accommodation payments significantly raising the potential returns from the sector. Although these positives have to be weighed against the heavy reliance on Government funding in an era of significant fiscal pressure, we are broadly confident the sector will escape material cuts as the Government allows the recent reforms to have their desired effect.

Our preferred picks in the sector are Estia Health (EHE.AX, Buy, $5.90) and Regis Healthcare (REG.AX, Buy, $4.50).

Strong industry fundamentals

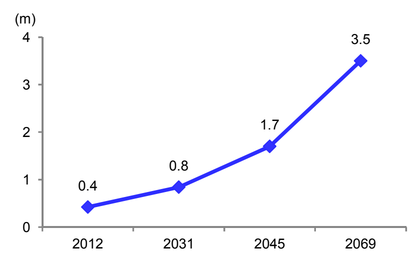
- **Solid demand growth from wealthy aging baby boomers**. The demand for aged care is growing underpinned by demographic trends including rising life expectancy and growth in the proportion of the elderly suffering from disabilities such as dementia. Industry modeling indicates the number of residential aged care places will need to increase by 70,000 by 2022 equating to 3.5% CAGR. The growth outlook is supported by rising wealth levels amongst the elderly which will provide opportunities as demand for higher end services expand. It also supports the funding outlook given individuals will inevitably be required to fund an increasing share of the cost.

- **Controlled supply and regulation create barriers to entry**. The aged care sector is highly regulated by the Australian Government including the allocation of new place licenses. The operational regulations have progressively increased over the years demanding a more sophisticated approach by providers as funding is increasingly tied to compliance. This has created barriers to entry and promotes industry consolidation as weaker providers struggle to keep up.

- **July 2014 funding reforms a material opportunity**. The Living Longer Living Better aged care reforms were designed to encourage investment (to lift the sector's capacity) and to relieve financial pressure on providers. This has opened up exciting opportunities, particularly the ability to charge market linked accommodation fees to most residents. The deregulation of the rules relating to the charging for "extra" services will also unlock opportunities.

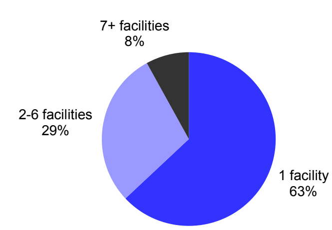
- **Fragmented industry offers consolidation opportunity**. The aged care industry is highly fragmented with over 60% of providers only operating a single facility. With rising care requirements for increasingly frail residents and growing regulation, we expect smaller operators will continue to look to exit the industry. While consolidation to date has been concentrated in the smaller for-profit segment of the industry (36% of the market), we also expect many charitable providers to consider their options including selling out to more capable providers.

Figure 1: Projected population over 85 years of age



Source: Australian Bureau of Statistics

Figure 2: Providers by # of facilities



Source: "Report on the Operation of the Age Care Act 1997", Department of Health 2013

Figure 3: Comparison of aged care portfolios

	Japara	Regis	Estia
Number of aged care facilities	39	47	45
Facilities owned %	91%	100%	89%
Facilities in metro areas %	63%	76%	84%
Total places	**3,391**	**5,048**	**3,693**
Average facility size (places)	87	107	82
Extra services - %	11%	30%	32%
Single rooms %	na	72%	92%
Average new bond value ($k) - 30 Jun 2014	268	308	238
Proportion residents paying RADs/Bonds - 30 Jun 14	35%	43%	44%

Source: Company data, Deutsche Bank

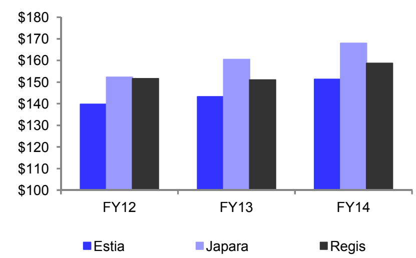
Portfolio metrics favour Estia and Regis

Estia: Building a superior portfolio via acquisition - Buy

With the acquisition of over 1,300 places via bolt-on acquisitions in the last two years Estia has become a leading player in the ongoing consolidation of the residential aged care sector. Given the group's attractive growth profile and the upside to our price target we have initiated with a Buy rating. The key drivers of Estia's success and competitive advantage include:

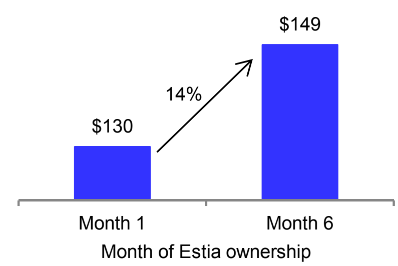
- **High quality portfolio of single rooms weighted to extra services**. Estia has a strong portfolio of facilities largely focused on high care services with 92% of places single rooms. The facilities are generally located in higher socio-economic metro locations where residents are better positioned to self-fund their aged care and have a greater capacity to pay for additional services (ie Extra Services). Its facilities are generally clustered together allowing it to derive local economies of scale.
- **Superior cost control explains industry leading margins**. Estia's staffing costs have consistently been below its peers on a per place day basis (See Figure 4). While this in part reflects the quality of the larger acquisitions has been maintained even as the group has integrated numerous acquisitions. Estia also has a track record for rapidly raising ACFI rates at facilities it acquires (See Figure 5).
- **Acquisition strategy underpins industry leading earnings growth**. Estia has an impressive track record of acquiring and integrating new aged care facilities. It has grown its place numbers by 20% per annum largely via acquisitions. This track record has established Estia as a first port of call for owners of aged care assets looking to sell out, which should ensure it can continue to expand its portfolio. Acquisitions are a key driver of the group's double digit EBITDA growth outlook.
- **Offers the most upside following a disappointing debut**. Estia has traded poorly since listing late last year. We attribute this to concerns raised by Japara's payroll issues, caution over the group's rapid occupancy uplift forecasts and concern regarding the rising cost of aged care acquisitions. We believe these fears are over done and hence the share price weakness presents an attractive opportunity to gain exposure to the aged care sector's leading consolidator.

Figure 4: Historic staff costs per occupied place day[1]



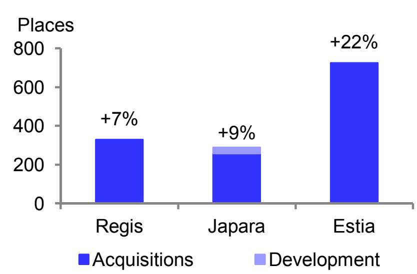
Source: Company data
Note 1. Proforma data

Figure 5: ACFI per occupied patient day post acquisition



Source: Estia

Figure 6: FY15 place expansion



Source: Deutsche Bank, Company data

Figure 7: Revenue and earnings growth forecasts[1]

Change in place numbers	FY13	FY14	**FY15e**	FY16e	FY17e
Estia		20.5%	**24.4%**	9.5%	8.7%
Japara		11.5%	**10.2%**	10.1%	9.2%
Regis		3.0%	**7.0%**	4.9%	10.0%
Revenue growth					
Estia	9.0%	22.8%	**35.5%**	19.2%	13.4%
Japara	3.7%	6.6%	**18.3%**	10.8%	12.8%
Regis	8.2%	14.8%	**7.3%**	10.9%	9.6%
EBITDA growth					
Estia	11.8%	15.0%	**49.7%**	16.2%	14.1%
Japara	-8.7%	-4.3%	**23.6%**	9.1%	10.9%
Regis	46.3%	30.6%	**6.6%**	14.9%	6.7%
NPAT/EPS growth					
Estia				17.0%	14.1%
Japara				10.7%	10.5%
Regis				17.6%	7.4%

Source: Deutsche Bank
Note: Based on proforma data for Estia in FY13-FY15, Japara, FY13-FY14 and Regis FY13-FY15

Estia offers the strongest growth profile

Japara: Systems issues and earnings risks keep us cautious – Hold

Japara has faced a number of challenges since listing including two funding cuts and a payroll system issue. Despite these headwinds and the slightly soft first result, management has maintained its FY15 earnings guidance. Given these challenges and limited upside to our price target (based on the low end of our DCF valuation) we have initiated with a Hold rating. Price target $2.12.

- **Strong EBITDA growth expected but guidance a stretch**. The acquisition of Whelan late last year along with the completion of three development projects in FY14 has boosted Japara's place numbers by nearly 9%. This capacity growth underpins the 24% EBITDA growth we have forecast in FY15. However our estimates sit ~2% below management's guidance reflecting our concerns regarding the unforeseen difficulties the business has faced during the period.
- **Systems issues suggests additional IT capex may be required**. Late last year Japara announced a review of its payroll had revealed it has underpaid employees by $5m ($0.4m pre tax impact in FY15). We have increased forecast capex to cover the potential cost of updating IT systems.
- **Ambitious development plans outlined**. Japara outlined plans to add nearly 1,200 places via brownfield and greenfield development projects over the next five years. This will increase its number of places by over one third and should underpin solid earnings growth and RAD cash inflows in the medium term.
- **Valuation upside highlights the potential**. Our mid case DCF valuation is $2.58 based on the expected addition of ~300 places per annum for the next five years. This is nearly 30% above the current share price highlighting the potential upside if the management team can deliver on its forecasts and reassure investors the payroll issue was a one off.

Figure 8: Free cash flow estimates

Cashflow from RADs	FY14	FY15e	FY16e	FY17e
Estia	50.6	32.7	31.8	27.8
Japara	25.8	85.0	53.2	56.5
Regis	79.3	48.0	104.6	119.5
Free cashflow				
Estia	93.0	95.9	108.0	118.7
Japara	59.2	120.7	90.4	88.8
Regis	154.8	121.0	202.2	228.1
%chg				
Estia		3%	13%	10%
Japara		104%	-25%	-2%
Regis		-22%	66%	13%

Source: Deutsche Bank

Regis expected to generate the strongest free cashflow

Regis: Strong development pipeline plus experienced management – Buy

As one of the largest residential aged care operators in Australia with a high quality portfolio and strong systems Regis is well positioned to be a key beneficiary of the new funding regime. The long standing management team has a reputation for astute investment and conservative governance. We expect the group's extensive development pipeline to support strong free cashflow growth underpinning our DCF based price target. We are initiating on Regis with a Buy rating and a $4.50 price target.

- **Long standing management team limits risk**. In our view the long tenure of the Regis management team reduces the risk of negative operational surprises increasing our confidence in the guidance. In addition the team's track record of acquiring and building aged care facilities materially reduces the risk inherent in the group's development pipeline.
- **Large IT investment also reassuring.** Regis has invested heavily in IT systems in the years prior to its listing. While this has resulted in a higher depreciation charge than its competitors we are confident it materially reduces the risk it will face the sort of system issues recently reported by Japara.
- **DB estimates above guidance**. Our FY15 revenue and EBITDA estimates are ~3% above management's guidance. This reflects our confidence in the group's ability to meet its arguably conservative forecasts. We also see upside risk to the expected RAD cash inflow from greater uptake by residents and higher average bond prices.
- **Large development pipeline underpins strong cashflow growth**. Regis' development plans (outlined in detail later in this report) are the key driver of the growth in our free cashflow estimates. Our modeling indicates the group will generate attractive returns on the funds it employs developing new sites (given the opportunity to charge incoming residents RADs), and redeveloping existing sites given the new 'significant refurbishment' supplement introduced with the recent funding reforms.

Valuation

In our view DCF is the most logical methodology to value the aged care operators because it captures the value of accommodation bond (RADs) cash flows which do not impact on the P&L. Our DCF valuations based on low, mid and high scenarios of operating place growth (a key driver of free cashflows) are set out below.

DCF methodology preferred

Scenarios allow for differing growth rates in operating places

Figure 9: DCF valuation – high, low and mid cases

DCF Scenarios	Low	Mid	High
Estia	$5.22	**$5.91**	$7.03
Japara	**$2.12**	$2.58	$2.85
Regis	$4.15	**$4.47**	$5.19
Places acquired or developed under each scenario			
Estia	125	350	575
Japara	150	300	450
Regis	175	350	650

Source: Deutsche Bank

Each of our mid case scenarios generates a DCF valuation well above the current share prices as shown in the table below. This reflects the strong free cashflow opportunity the sector offers.

DCF valuations well above current share prices

Figure 10: Share price upside to DCF valuations – prices as at 21 Jan 2015

	Share price	DCF mid case	Upside
Estia	$4.70	$5.91	25.7%
Japara	$2.00	$2.58	29.0%
Regis	$3.97	$4.47	12.6%

Source: Deutsche Bank

We have used our mid case DCF to set our price targets for Estia and Regis. However given our concerns with regards to IT systems and earnings risk for Japara we have used our low case as the basis of our price target.

Finally we have used PE and EV / EBITDA multiples based on our CY15 forecasts as a secondary valuation methodology. This data highlights the relative value of Estia and Japara compared with Regis, reflecting the stronger earnings growth they both offer over the next 12 months.

Multiple based valuations favour Estia and Japara

Figure 11: CY15 PE and EV/EBITDA multiples

x	Estia	Japara	Regis
P/E	18.0	17.8	22.1
EV / EBITDA	9.4	9.2	12.0

Source: Deutsche Bank

Listed providers compared

Estia and Regis preferred over Japara

The domestic aged care sector offers attractive investment fundamentals with solid demand growth assured from an aging population. More importantly we expect a material lift in cashflows from market linked accommodation payments following the introduction of the Living Longer, Living Better reforms last July. This contribution, largely from residents, should boost earnings growth and deliver strong free cash flows. Finally the sector is ripe for consolidation given the large number of small providers and the increasing regulatory complexity.

The three listed aged care operators are all exposed to these positive trends but are pursuing differing strategies which will likely result in differing growth rates in both earnings and free cash. The table below sets out the key financial and valuation metrics based on our estimates.

Figure 12: Aged care coverage universe – prices as at 21st Jan 2015

			Price		Market		EBITDA growth[1]		P/E		EV / EBITDA	
Name	Ticker	Rating	Target	Price	Cap ($m)	EV ($m)	FY15	FY16	FY15	FY16	FY15	FY16
ESTIA HEALTH	EHE.AX	Buy	$5.90	$4.70	850	734	49.7%	16.2%	19.9x	18.1x	10.5x	9.3x
JAPARA HEALTHCARE	JHC.AX	Hold	$2.15	$2.00	526	488	23.6%	14.4%	19.7x	16.7x	9.9x	8.7x
REGIS HEALTHCARE	REG.AX	Buy	$4.50	$3.97	1,192	1,165	6.6%	14.9%	24.1x	20.5x	13.1x	11.1x

Source: Deutsche Bank
Note 1. EBITDA growth based on proforma estimates

In this section we have compared and contrasted the three listed providers' operations, strategies and earnings outlook and set out the rational for our preferences for Estia and Regis over Japara.

Portfolio metrics favour Estia and Regis

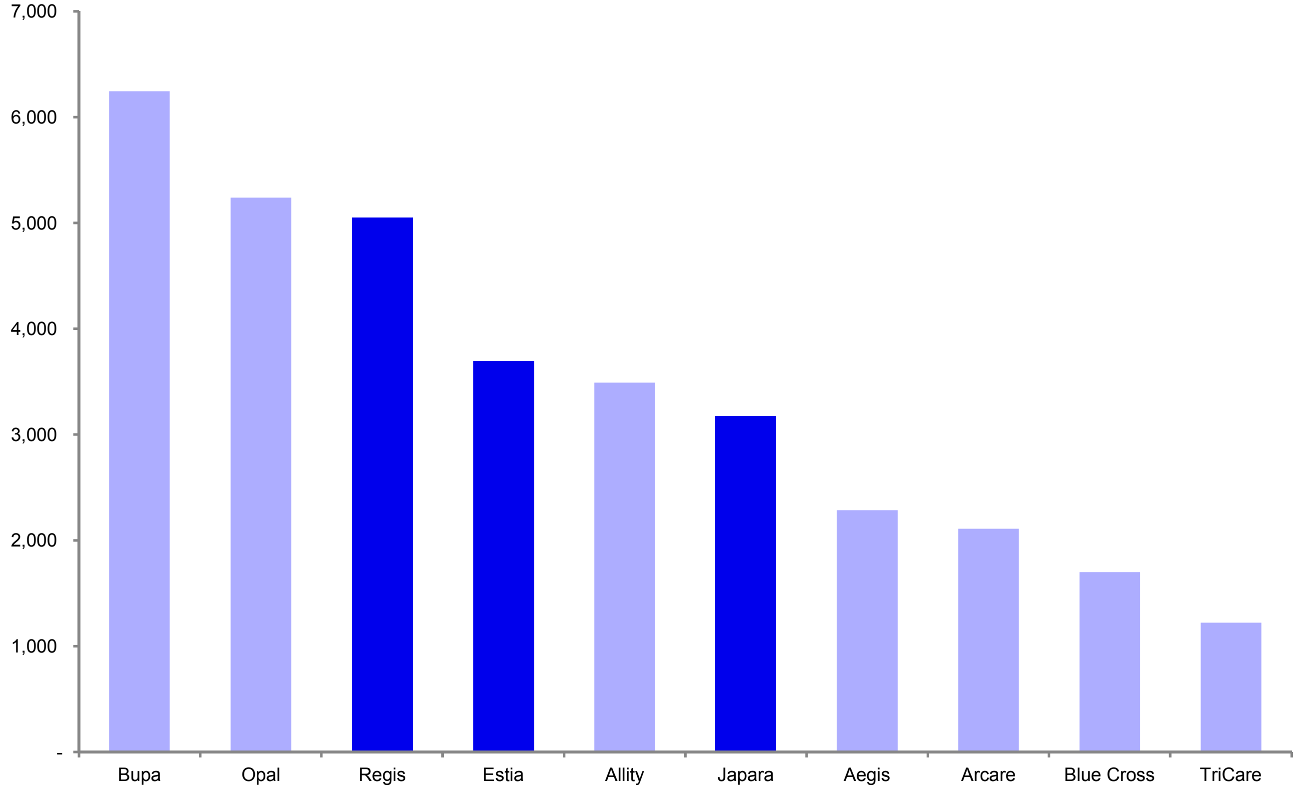
All three of the listed providers have sufficient scale to place them within the largest six for-profit providers as shown in Figure 14 over the page. Putting aside the difference in place numbers, Estia compares favorably on most metrics – single rooms, extra services, metro locations – but Regis' facilities are on average located in higher socioeconomic areas allowing them to secure higher average bonds.

Figure 13: Comparison of aged care portfolios

	Japara	Regis	Estia
Number of aged care facilities	39	47	45
Facilities owned %	91%	100%	89%
Facilities in metro areas %	63%	76%	84%
Total places	**3,391**	**5,048**	**3,693**
Average facility size (places)	87	107	82
Extra services - %	11%	30%	32%
Single rooms %	na	72%	92%
Average new bond value ($k) - 30 Jun 2014	268	308	238
Proportion residents paying RADs/Bonds - 30 Jun 14	35%	43%	44%

Source: Company data, Deutsche Bank

Figure 14: Top ten private residential aged care providers in Australia



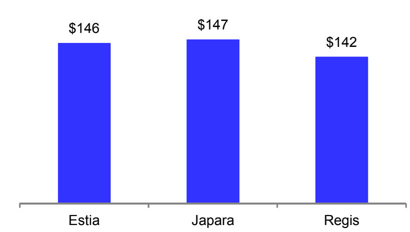
Source: Public data from each provider
Note: Includes all announced acquisitions

Operating metrics highlight Estia's tight cost control

Figure 16 shows the broadly similar revenue per occupied place day generated by the three listed providers in FY14. Notably Japara generates a slightly higher ACFI than its peers but its overall revenue per day is on par. This suggests it receives less revenue per day from other sources, most notably payments from residents for extra services and accommodation.

We expect Estia and Regis to report good growth in revenue per occupied place day in FY15 as the resident contributions from extra services and accommodation payments rises. We attribute the more modest growth at Japara to the lost dementia payments (which were removed from the comparable period for Estia and Regis) and a smaller contribution from resident payments.

Figure 15: FY14 ACFI rates



Source: Company data

Figure 16: Revenue per occupied place day

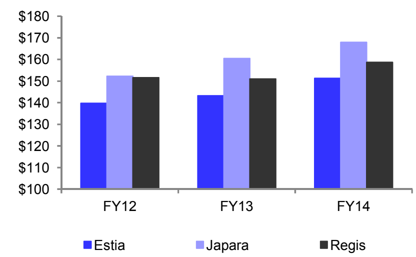
	FY14	FY15E	%chg
Estia	$247	$258	4.4%
Japara	$250	$253	1.2%
Regis	$250	$258	3.0%

Source: Deutsche Bank, Company data

There is greater variability in the providers' costs when measured on a per occupied place day as shown in Figure 18. Most notably Estia's spend on staff per place day is lower than its peers which largely explains its higher margins. While some commentators have questioned the sustainability of its lower spend on staff we note the trend has prevailed for a number of years (see Figure 17). Notably Estia's lower spend on staffing per place day along with its ability to rapidly lift ACFI at acquired facilities supports the group's acquisition led growth strategy.

We expect some variability in the growth in operating costs during FY15. The decline in costs at Estia largely reflects the strong expected lift in occupancy levels. Japara is expected to benefit from a slight lift in occupancy as well and we do not expect the opening of 60 newly developed places and the acquisition of Whelan (258 places) to be a drag. We have assumed Regis' costs rise broadly in line with the wage inflation plus the incremental costs of becoming a listed company.

Figure 17: Historic staff costs per occupied place day[1]



Source: Company data
Note 1. Proforma data

Figure 18: Costs per occupied place day

Staff	FY14	FY15	%chg / %diff
Estia	$151	$152	0.7%
Japara	$168	$170	1.5%
Regis	$159	$164	3.0%
Total cost			
Estia	$194	$197	1.3%
Japara	$209	$210	0.4%
Regis	$198	$205	3.2%
Staff as % of total cost			
Estia	77.9%	77.5%	-0.4%
Japara	80.4%	81.6%	1.2%
Regis	80.0%	80.0%	-0.0%

Source: Deutsche Bank, Company data

Estia has historically enjoyed lower staff costs per place supporting its superior margins

The final table in this series shows EBITDA per occupied place day and EBITDA margins. Again Estia stands out in terms of the expected margin uplift which we attribute to the benefit of higher occupancy. Over the medium term we expect margins for each of the groups to moderate. This allows for the likelihood the funding environment will become more difficult given the fiscal pressures faced by the Government.

Margins expected to moderate over time

Figure 19: EBITDA per occupied place day

$	FY13	FY14	FY15e	FY16e	FY17e
Estia	$55	$53	$61	$61	$64
Japara	$44	$41	$43	$44	$44
Regis	$42	$52	$53	$58	$58
Margin					
Estia	23.1%	21.3%	23.7%	23.1%	23.2%
Japara	18.2%	16.3%	17.1%	16.8%	16.5%
Regis	18.2%	20.7%	20.5%	21.3%	20.8%

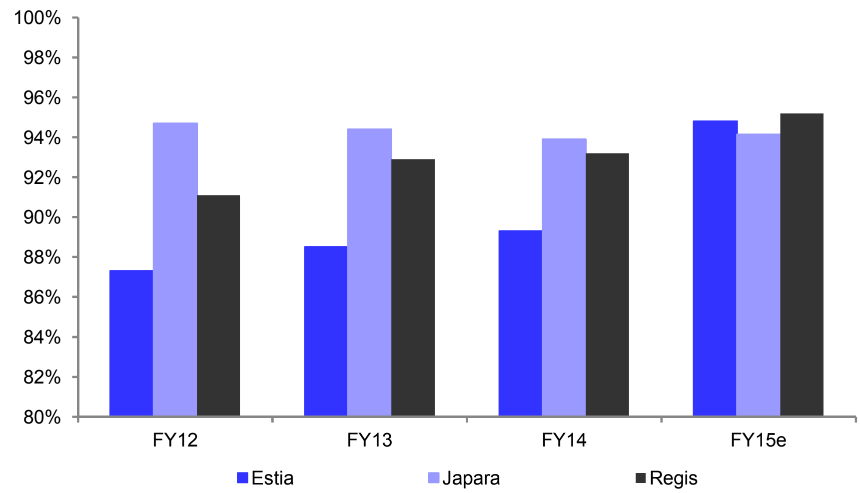
Source: Deutsche Bank

Occupancy levels likely to be similar by FY15

The three companies have all guided to occupancy levels of ~95% and hence there is little to separate them on this measure. Clearly Estia is expected to be the big improver in FY15 arising from a solid lift in occupancy at the group's ten 'ramp-up' facilities.

Occupancy levels all 94-95%

Figure 20: Occupancy levels: FY12- FY15e

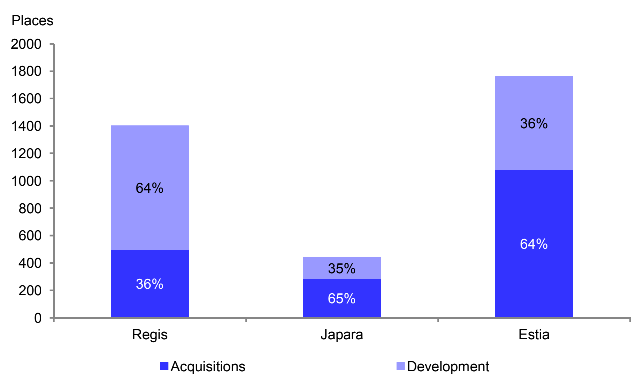


Source: Deutsche Bank, Company data

Growth strategies differ – development v acquisitions

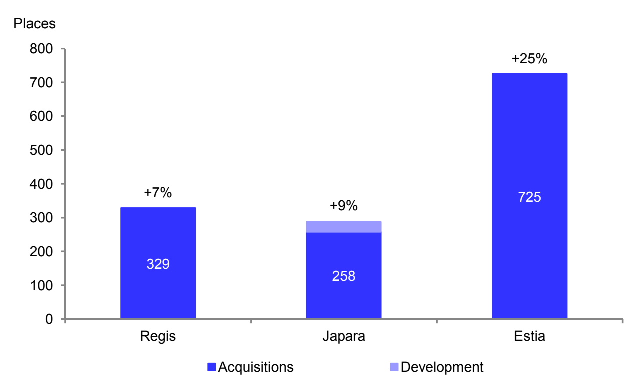
The differing growth strategies employed by the three listed providers are well illustrated by Figure 21 which shows the new places added by acquisitions and development projects historically. This data highlights Estia's aggressive focus on expansion by acquisition compared with its listed peers. Figure 22 shows this trend has broadly continued in FY15.

Figure 21: Listed providers expansion: FY08 – FY14



Source: Company data
Note: Ignores site closures

Figure 22: FY15 expansion by listed providers



Source: Deutsche Bank, Company data

Estia focused on acquisitions

The key focus of Estia's growth strategy is acquisitions. The group has built a reputation for rapidly moving on acquisition opportunities and has developed a network of advisors and contacts in the industry to facilitate this activity. This is broadly confirmed by the 725 places the group has acquired (or contracted to acquire) during FY15.

The group also has a development pipeline but this is relatively small compared with the other listed providers. Estia has indicated it has identified opportunities for brownfield development at eight of its facilities. These developments are expected to result in 203 new places and the redevelopment of 539 existing places.

Estia's development pipeline modest

DB forecasts assume Estia acquires 300 places pa

Our forecasts assume Estia will acquire 300 places per annum and develop 50 new places per year. This will result in the group reaching approximately 5,000 places by FY20 and can be achieved without requiring external funding. Notably management has indicated a medium term goal of growing the business to 10,000 places. While this would almost certainly require the company to seek additional funding it clearly represents significant upside to our forecasts.

Estia targeting 10k places

Japara expansion plans include acquisitions and a large development pipeline

Japara also intends to underpin its growth with "selective" acquisitions as illustrated by the recent Whelan deal which added 258 places. However the group has outlined more ambitious development plans. According to the presentation at its AGM, Japara has brownfield development projects underway or planned which will add 690 places and greenfield developments planned which will add 500 places over five years. These development projects will boost Japara's place numbers by ~35%. The group's plans are supported by the 465 places Japara was issued in the 2014 ACAR round.

Japara planning ~1,200 development places over 5 years

Acquisitions to be "selective"

Our forecasts are broadly in line with Japara's announced plans, allowing for 200 developed places to be opened each year from FY16, a meaningful step up relative to the company's historic development track record. We have also assumed 150 places will be acquired per annum.

Regis focused on its development pipeline

Regis's growth strategy includes greenfield developments covering multiple sites and "bolt on" acquisitions as attractive opportunities are identified. The group will also look to brownfield developments which "expand and reconfigure" existing sites. These development plans are supported by 848 non-operational places the group holds including the 159 places allocated in the 2014 ACAR round.

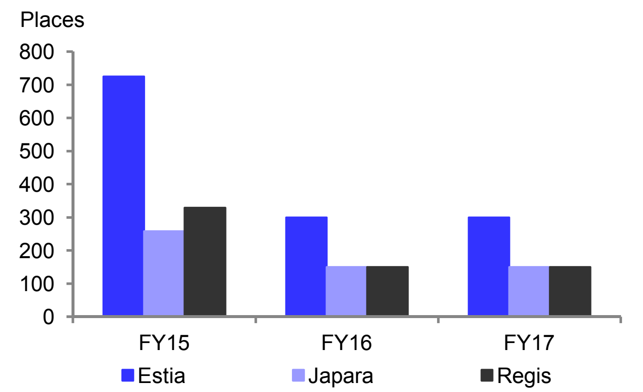
Regis to open 475 development places in FY16 and FY17

Regis' prospectus outlines development projects which will add 475 places in FY16 and FY17 (no new places are expected to open in FY15). We have assumed 200 places are opened per annum from FY18. We have also assumed 150 places are acquired per annum from FY16 which is broadly consistent with the group's historic experience.

Bolt-on acquisition sought

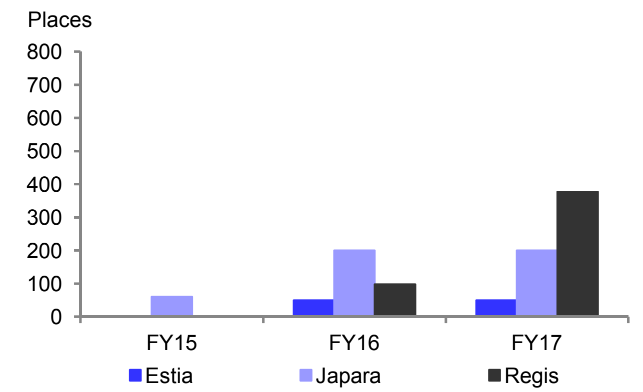
The charts below illustrate the places we expect each of the listed providers to add over the next three years from acquisitions and development projects. Our forecasts assume Estia maintains its faster growth in total place numbers compared with Japara and Regis.

Figure 23: Places added via acquisition



Source: Company data, Deutsche Bank

Figure 24: Places added via development



Source: Company data, Deutsche Bank

Estia's strategy should deliver stronger revenue and EBITDA growth while the more development weighted strategies pursued by Japara and Regis, should offer stronger cashflows from RADs and hence a better return on invested capital.

Estia offers superior growth outlook

Estia's growth by acquisition supports strong EBITDA growth

Figure 25 sets out a comparison of historic and forecast revenue and earnings growth. This highlights the superior growth profile offered by Estia in FY15 and beyond. The strong growth reflects the group's recent acquisitions (725 places added in FY15) and strong expected lift in occupancy levels. In order to maintain this growth profile the group will need to continue to make acquisitions as discussed above.

Figure 25: Revenue and earnings growth forecasts[1]

Change in place numbers	FY13	FY14	**FY15e**	FY16e	FY17e
Estia		20.5%	**24.4%**	9.5%	8.7%
Japara		11.5%	**10.2%**	10.1%	9.2%
Regis		3.0%	**7.0%**	4.9%	10.0%
Revenue growth					
Estia	9.0%	22.8%	**35.5%**	19.2%	13.4%
Japara	3.7%	6.6%	**18.3%**	10.8%	12.8%
Regis	8.2%	14.8%	**7.3%**	10.9%	9.6%
EBITDA growth					
Estia	11.8%	15.0%	**49.7%**	16.2%	14.1%
Japara	-8.7%	-4.3%	**23.6%**	9.1%	10.9%
Regis	46.3%	30.6%	**6.6%**	14.9%	6.7%
NPAT/EPS growth					
Estia				17.0%	14.1%
Japara				10.7%	10.5%
Regis				17.6%	7.4%

Source: Deutsche Bank
Note: Based on proforma data for Estia in FY13-FY15, Japara, FY13-FY14 and Regis FY13-FY15

Japara is also expected to deliver a strong lift in EBITDA growth in FY15 underpinned by the Whelan acquisition and recently opened places developed in FY14.

Finally Regis is expected to deliver more modest growth in FY15 as the number of places it operates is set to increase by 7% (from the Tiwi Garden's and Cairns acquisitions) with no new development places due to open.

RADs and cashflow analysis favours Regis and Japara

The table below sets out the expected cashflow contribution from RADs over the next few years. This data highlights the large cashflow benefit we expect for the aged care providers from RADs. Regis and Japara are expected to enjoy a greatest inflow from RADs reflecting their plans to develop new places and because they started FY15 with a lower level of bonding.

Please note the forecasting of RAD flows is particularly difficult at this stage given the lack of experience with the new funding regime. Our forecasts assume RAD values continue to increase but at a diminishing rate over the next five years with a terminal growth rate of 3.5%. We also assume the proportion of residents choosing to pay a bond increases modestly over time[1]. The volatility of these forecasts reflects the timing of various development place openings.

Figure 26: Cashflow from RADs (bonds)

	FY14	FY15e	FY16e	FY17e	3yrs
Estia	50.6	32.7	31.8	27.8	**92.2**
Japara	25.8	85.0	53.2	56.5	**194.7**
Regis	79.3	48.0	104.6	119.5	**272.1**
%chg					
Estia		-35%	-3%	-13%	
Japara		229%	-37%	6%	
Regis		-39%	118%	14%	

Source: Deutsche Bank

Free cash flow estimates include the contribution from RADs and the cost of maintenance capex. Again the volatility of the cashflows reflects the timing of the inflow of RAD payments. Estia's more stable cashflow growth reflects its more limited development program.

Figure 27: Free cash flow estimates

Free cashflow	FY14	FY15e	FY16e	FY17e
Estia	93.0	95.9	108.0	118.7
Japara	59.2	120.7	90.4	88.8
Regis	154.8	121.0	202.2	228.1
%chg				
Estia		3%	13%	10%
Japara		104%	-25%	-2%
Regis		-22%	66%	13%

Source: Deutsche Bank

[1] Our modelling assumes the proportion of non-concessional residents choosing a RAD is consistent with the FY14 level for low care / extra service places. This results in a modest growth in the overall proportion choosing a RAD over time

Valuation metrics

DCF valuations well above current share prices

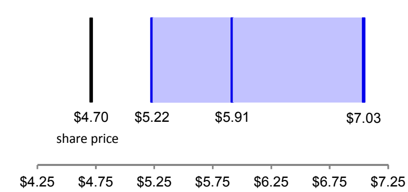
In our view DCF is the most logical methodology to value the aged care operators because it captures the value of accommodation bond (RADs) cash flows which do not impact on the P&L. However DCF is complicated by the need to capture medium term growth expectations which will clearly be impacted by acquisitions and development projects. In order to allow for this we have considered a range of possible outcomes across three scenarios. These valuation ranges relative to current share prices are charted in the right hand column.

Figure 29: DCF valuation – high, low and mid cases

DCF Scenarios	Low	Mid	High
Estia	$5.22	**$5.91**	$7.03
Japara	**$2.12**	$2.58	$2.85
Regis	$4.15	**$4.47**	$5.19

Source: Deutsche Bank

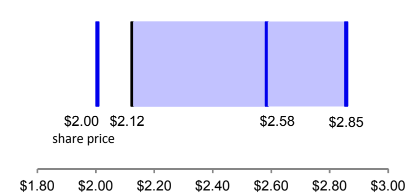
Figure 28: Estia DCF range



Source: Deutsche Bank

The acquisitions and development assumptions underlying our DCF valuations are set out in the tables below. We have also shown the actual data from FY14 and our FY15 expectations based on actual data and prospectus forecasts. Our acquisition forecasts are arguably conservative given the three bolt-on acquisitions announced in recent months suggest the role of consolidating may be accelerating. The more aggressive development projections relative to recent history reflect the near term plans outlined by the three companies.

Figure 30: Japara DCF range



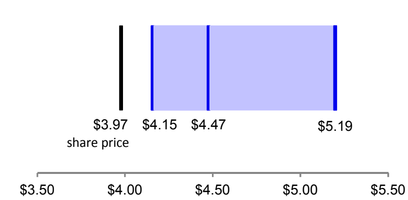
Source: Deutsche Bank

Figure 31: Assumptions underlying DCF valuations

Places acquired per annum	Low	Mid	High	FY14	FY15e
Estia	100	**300**	500	480	725
Japara	75	**150**	200	196	258
Regis	75	**150**	250	125	329
Development places opened					
Estia	25	**50**	75	24	-
Japara	100	**200**	300	128	60
Regis	100	**200**	400	92	-

Source: Deutsche Bank

Figure 32: Regis DCF range



Source: Deutsche Bank

Our mid case DCF valuations have been used to set our price targets for Estia and Regis. However we have used the low case for Japara to reflect our concerns over the company's recent payroll system issues and the risk earnings will fail to match management's guidance.

Multiple based valuations

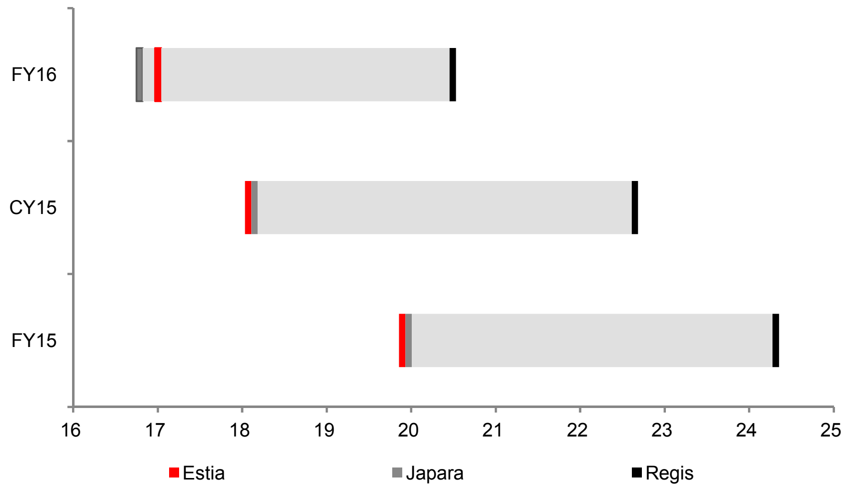
Earnings multiple valuation methods have some limitation as the P&L earnings measures don't capture the value of RAD inflows. We use have presented PE and EV/EBITDA multiples as a secondary methodology.

Set out below is the P/E multiples for FY15, CY15 and FY16. These highlight the relative attractiveness of Estia and Japara.

Earnings multiples favour Estia and Japara

Figure 33: P/E multiples

x	FY15	CY15	FY16	Tgt Price CY 15
Estia	19.9x	**18.0x**	17.0x	22.6x
Japara	197x	**17.6x**	16.7x	18.7x
Regis	24.1x	**22.1x**	20.5x	25.1x

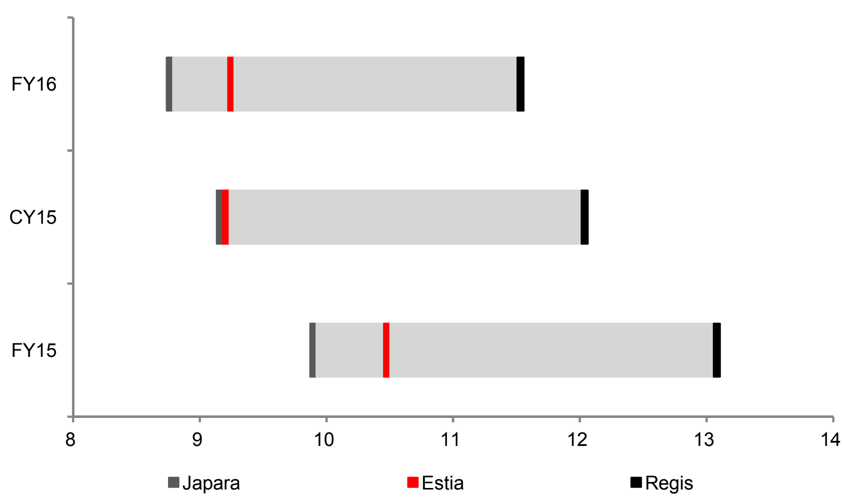


Source: Deutsche Bank

The EBITDA multiple analysis tells a similar story.

Figure 34: EV / EBITDA multiples

x	FY15	CY15	FY16
Estia	10.5x	**9.6x**	9.2x
Japara	9.9x	**9.1x**	8.7x
Regis	13.1x	**12.0x**	11.1x



Source: Deutsche Bank

Free cashflow multiples

Finally we have presented free cash flow multiples which capture the inflow from RADs. However we caution multiples based on a single years results can be impacted by the timing of development projects and the inflow from associated RADs. As a result we have considered average cashflow multiples over two years. We are also cautious the LLLB reforms will boost the cashflow results over the next few years as incoming 'high care' residents are required to pay for their accommodation for the first time.

This analysis highlights the relative value offered by Japara. However this largely reflects the large uplift in RAD flows expected in FY15. As shown in Figure 27 we expect Japara's free cashflow to decline in FY16 as the rate of inflow from RADs moderates.

Figure 35: Free cashflow multiples

x	FY15	FY16	**2yr ave**
Estia	8.8	7.8	**8.3**
Japara	4.1	5.0	**4.5**
Regis	9.8	5.9	**7.9**

Source: Deutsche Bank

Yield

The table below sets out the expected dividend yields from the three aged care providers. Notably there is little to separate the three companies on this measure over the next twelve months (CY15).

Expected dividend yield similar in CY15

Figure 36: Estia's forecast dividend yield

Yield	FY15	CY15	FY16
Estia	2.7%	5.3%	5.9%
Japara	5.3%	5.4%	6.0%
Regis	2.9%	5.4%	4.9%

Source: Deutsche Bank

Aged care industry Overview

The Australian residential aged care industry caters for people who can no longer live independently due to health reasons and require care. The industry fits between “home and community care” and acute hospital care in the broader care spectrum. Residential aged care is regulated and funded by the Federal Government which controls the number of bed licenses. There were ~190k places licensed as at 30 June 2013, the last date the Government provided updated data.

The Federal Government regulates, controls and funds aged care

People typically move into residential aged care at the point when they require a level of clinical care which can no longer be supported in their own home.

At 30-Jun-13 there were ~190k licensed places

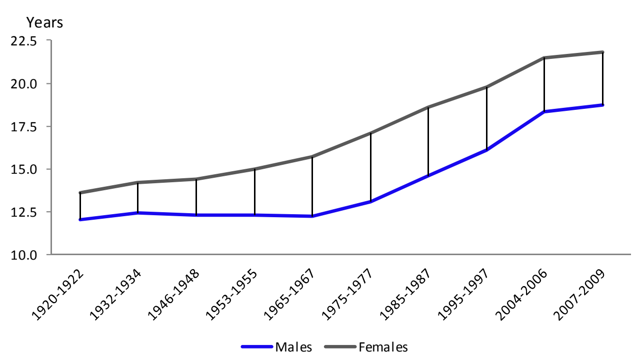
Demographic trends underpin growing demand

The demographic trends affecting the Australian population including, an increase in the average age expectancy and an increase in patients suffering from disabilities, are clearly favorable for aged care providers. The Figures below show evidence and outlook for the Australian ageing population which is expected to continue to underpin volume growth for aged care providers in the medium to long term.

An aging population and increase in age related disabilities underpins demand

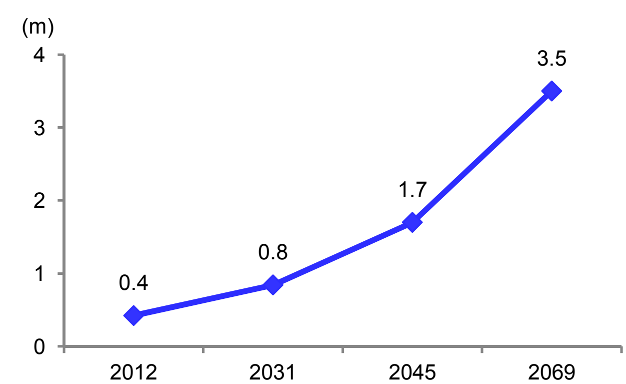
Specifically the two Figures below highlight the rising life expectancy which is leading to a greater number of elderly people. In particular the ABS has forecast the number of Australians aged over 85 will double by 2031 and double again by 2045. It is this older cohort of individuals which increasingly makes up the bulk of aged care residents as shown in the next set of charts.

Figure 37: Life expectancy at 65 years old



Source: IMF, Australian Bureau of Statistics

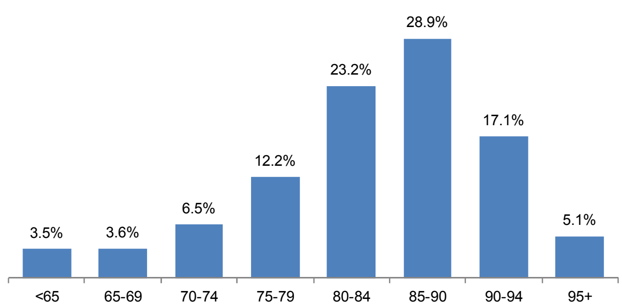
Figure 38: Projected population over 85 years of age



Source: Australian Bureau of Statistics

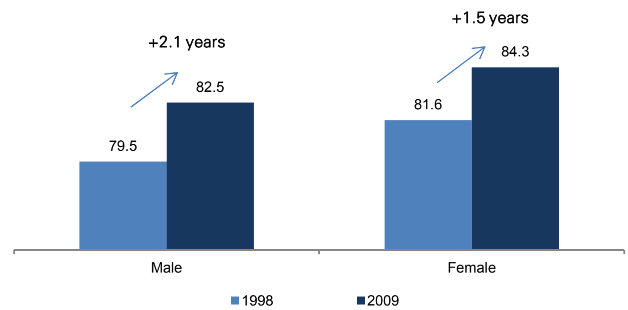
The Figures below show the distribution of residents in terms of age groups and the increase in recent years in the average age of resident admissions.

Figure 39: Distribution entering aged care - FY12



Source: Australian Institute of Health and Welfare

Figure 40: Average age of residents' admission



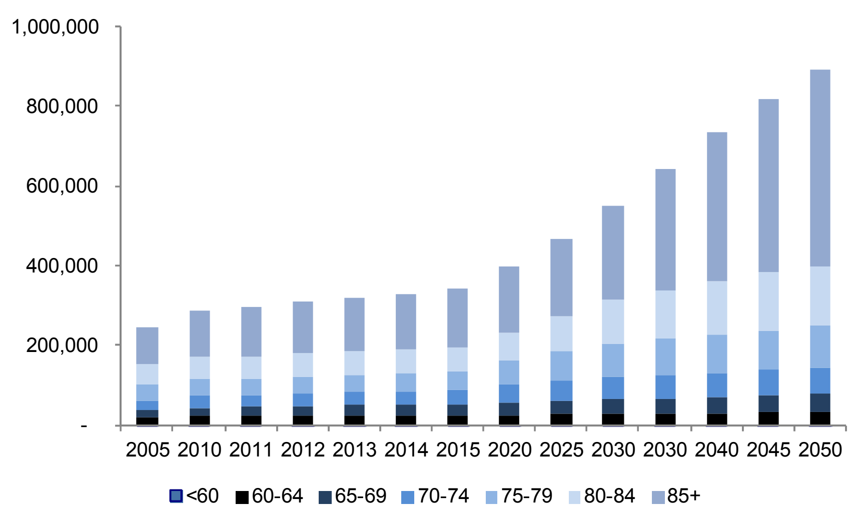
Source: "Productivity Commission Inquiry Caring for Older Australians", Department of Health

In association with rising life expectancy there has been an increase in the rates of patients suffering from disabilities, most notably dementia. Figure 41 shows how the population of individuals with dementia is expected to increase by ~92k by 2020 and by ~700k by 2050 (equivalent to approximately 2.8% of the Australian population).

Increasing rates of dementia driving demand for high care

It is the combination of aging and the associated rise in the proportion of people with disabilities which is expected to underpin demand for aged care facilities. In particular it will raise the need for facilities able to cater for patients with high care needs.

Figure 41: Estimate people with dementia by age (2005-2050)



Source: Australian Institute of Health and Welfare

By 2050 ~3% of Australians are forecasted to have dementia

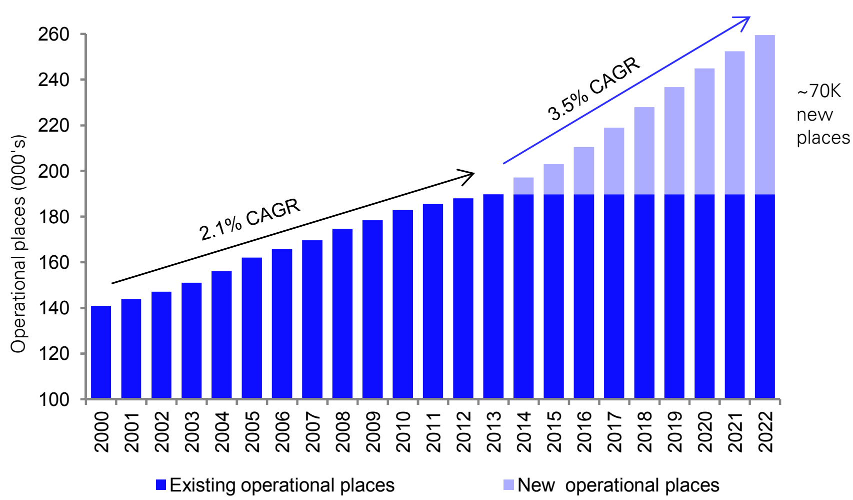
Increased supply required to meet expected demand

Figure 42 shows the projected growth in total number of places estimated by the Aged Care Financing Authority in its 2013 report. This estimate indicates an additional 70,000 places will be required to meet the expected demand. This equates to growth of 37% or a CAGR of 3.5%. Notably this is well ahead of the approximately 2% growth in the number of places which have become operational over the last decade.

Historic CAGR of 2.1% in No. of places not enough…

CAGR of 3.5% needed to meet forecasted demand

Figure 42: Supply required to meet projected demand



Source: Deutsche Bank, Aged Care Financing Authority, "Report on Government Services Volume F Chapter 13" – Productivity Commission

Regulation a barrier to entry

The Australian residential aged care industry is highly regulated by the Australian government via the Department of Social Services (DSS). The criteria to meet and maintain regulatory requirements are significant and create barriers to entry for new entrants. The key regulations include and relate to the following:

The DSS regulates the residential aged care industry

Approved provider

In order for a private aged care operator to receive Australian Government subsidies relating to the provision of aged care services it must become an approved provider under the Aged Care Act 1997 (Approved Provider). The following considerations are taken into account to assess a provider's ability to become an Approved Provider: 1) ability and suitability to provide care, 2) experience of staff and management, 3) record of financial management, 4) ability to meet relevant standards for aged care, and 5) commitment to the rights of residents.

Aged care places regulated

An Approved Provider must also be allocated aged care places in order to receive funding. Aged care places are issued each year by the Australian Government. The number of new allocations is determined yearly by the Department of Social Services (DSS) taking into account the population aged greater than 70 years in specified regions in each State and Territory.

To receive Govt. funding must have been allocated places

In order to obtain either new allocations or transfer existing ones, an Approved Provider must apply to the DSS via the Aged Care Approvals Round (ACAR) which is a competitive bidding process. Allocations may be effective immediately (in which case funding applies immediately) or on a provisional basis on a new facility being built or upgraded. Notably providers retain a degree of discretion as to the timing of development projects needed to construct the required facilities. Transfers of provisionally allocated places require consent of the Secretary of the DSS and places can be relinquished.

New allocations or transfers of places are done thru the ACAR process

Facility accreditation

Under the Aged Care Act 1997 all aged care facilities must be accredited. The independent Australian Aged Care Quality Agency (AACQA) is responsible for the accreditation of any aged care facilities and assesses facilities' performance against legislated standards. Accreditation lasts for 1-3yrs and during this time the AACQA monitors and conducts announced and unannounced audits twice a year. These audits are across 44 indicators and expected outcomes including: 1) management systems, staffing and organisation support, 2) health and personal care, 3) resident lifestyle, and 4) physical environment and safety systems.

All aged care facilities must be accredited by the AACQA

Facility certification

Facilities must receive certification from the DSS in order to be able to charge accommodation payments (including RADs and DAPs). Certification is based on the relevant facility/building meeting fire safety, privacy and space (i.e. max no. of residents per room) requirements which are set by State and Territory building regulations. Facilities must receive a positive assessment on at least 30 of the measures to pass. The facility will be required to address short comings on any of these criteria before the next audit.

Resident classification, subsidies and supplements

In order to receive Australian Government funding an incoming resident must be assessed by an Aged Care Assessment Team (ACAT). ACAT's are Government approved and are engaged by State and Territory Governments. Once admitted, the provider and typically a GP undertake an Aged Care Assessment (ACA) to assess the level of care required by an incoming resident (via standard assessment tools and ACFI checklists). This then determines the daily subsidy the aged care provider receives from the Australian Government. ACFI assessments are regularly audited by the Government.

To receive funding ACATs assess all incoming residents

Complaints handling

Complaints handling is managed by the Aged Care Complaints Investigation Scheme (Scheme). Any complaints are either resolved via the Scheme or a process which may include an investigation, conciliation or mediation process. The Scheme examines complaints from residents and relates to among other things complaints relating to the quality of care and choice of activities.

2014 ACAR round bed licence numbers lift sharply

Under the 2014 Aged Care Approvals Round (ACAR) 11,196 new residential aged care places were allocated across Australia, with an estimated annual recurrent funding value of approximately $660m. Japara was allocated 465 places and Regis was allocated 159 places. Estia was not allocated any new places.

Japara a winner from 2014 ACAR

Regis has sufficient licenses to support its development plans

Japara was the clear winner from this allocation process and is now well positioned to deliver on its stated intention to add over 1,000 new places from brown and green field developments over the next five years. Discussion with Regis and Estia indicate the outcome will not affect their forecasts and should not materially impact on their development plans. In Regis' case this reflects the number of non-operation places it already has on its books. Estia's growth strategy is largely focused on acquisition and it reports it has sufficient places to support its more modest development plans.

Estia focused on acquisitions

The number of places allocated lifted sharply from the 7,775 issued in 2013 and is the largest allocation since 2007 according to a press report. The Government releases noted a significant lift in demand with applications received for 19,169 places. The Government allocates places "having regard to the national planning benchmark, population projections provided by the Australian Bureau of Statistics, and the level of current service provision." Hence the lift in the number of places allocated in theory reflects expected demand.

It is also worth noting the number of places allocated has not historically matched the net increase in the number of operational places due to the time required to build new facilities, facility closure and the forfeiture of unused licenses etc (see Figure 43). According to Government modeling an additional ~8k places will be needed each year to meet the expected demand.

Figure 43: ACAR rounds operational and allocated places 2008-14

Year	Places allocated	Operational places	Net chg in operational places
2008-09	5,748	178,379	3,710
2009-10	5,643	182,936	4,557
2011	7,933	185,559	2,623
2012	-	187,941	2,382
2012-13	7,775	189,761	1,820
2014	11,196		

Source: Deutsche Bank
Note: Note the ACAR timing changes from year to year complicating the comparison

Our forecasts for the three listed providers assume each receives sufficient place allocations to support their development growth plans. Hence the relatively large allocation of new places in 2014 had no material impact on our estimates. However in some quarters it has added to the conjecture about the potential for the Government to deregulate supply as discussed below.

Aged care reform and deregulation of supply

Deregulation of supply is a possibility

The Living Longer Living Better Reforms were designed to place the consumer at the centre of the aged care system. The Government has indicated it would like to move to a consumer demand driven model and away from the current planned system. Further indication of the Government's plans was provided in a speech by the Aged Care Minister, Senator Mitch Fifield, last November.

The speech covered the need for further Aged Care Reform and called for a legislated review of the current aged care changes, examining whether "further steps could be taken to change key aged care services from a supply driven model to a consumer demand driven model". This suggests the Government would like to deregulate the supply of aged care places.

Operators have mixed views of deregulation of supply

A consumer-led model would likely remove the current licensing arrangements (and the associated ACAR allocation process), allowing providers to offer residential aged care facilities and services based on market intelligence about expected demand and allow operators to attract customers through price and service. Notably Senator Fifield didn't propose blanket deregulation and stressed that not all areas of Australia may be in a position to deliver this form of market-based aged care, with potentially different approaches being needed in different parts of the country.

Discussions with operators indicate mixed views amongst providers with regard to the potential for the deregulation of supply. While there is almost universal criticism of the current ACAR process (which has been described as akin to an essay writing contest) there are differing views on the potential impact on existing provides. Many industry participants also believe the Government will need to carefully consider the potential for such changes to lead to supply disruption (if some operators became unviable due to falling occupancy) and reduced ability for the Government to forecasts aged funding needs.

Listed operators likely to benefit from deregulation of supply

In our view deregulation of supply is likely in coming years but given the associated risks the Government will probably choose to phase changes in rather than moving quickly to a completely deregulated approach. We expect the larger commercial operators including Estia, Japara and Regis will broadly benefit from a deregulation as it will allow them to plan capacity expansion with greater certainty. However the risk of increased competition is a potential concern.

How residents are directed to aged care

Each aged care facility operates in its own 'catchment area', which in an urban setting typically covers an area stretching in a 5km radius around the facility. The majority of a facility's residents come from within this catchment area. Often the decision to enter an aged care facility is triggered by a medical issue and/or hospital stay. As discussed earlier new residents are assessed by an Aged Care Assessment Team (ACAT) which determines if the person is eligible to enter an aged care facility.

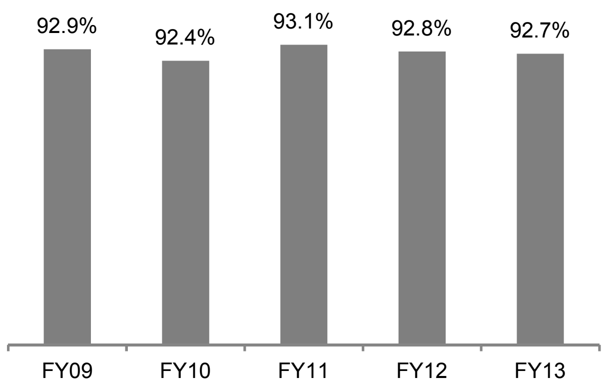
Reputation for care, relationships with intermediaries (including ACATs, placement agents, medical professionals, etc.) and the quality of the facility all impact on a facility operator's ability to compete effectively with other facility operators in their catchment area.

Strong demand and tight supply underpin high occupancy

Currently the occupancy levels across the industry are in the low nineties as shown in Figure 44. This high rate of occupancy is being driven by the continued growth in demand and the relatively tight control of supply. Notably occupancies have fallen over the past decade from the high to the low nineties.

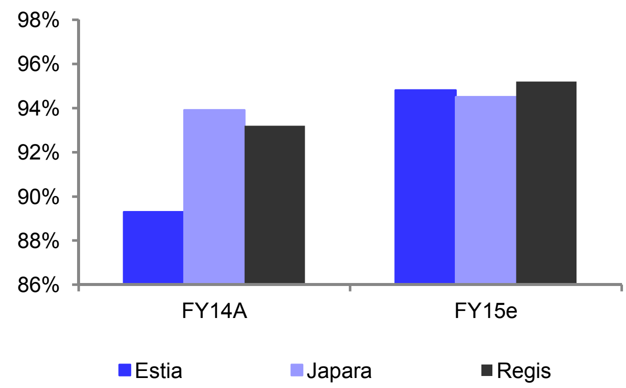
High rates of occupancy are a key driver of an aged care operator's financial performance. We are comfortable there is little risk of further decline under the current supply structure given the expected demand from the baby boomer generation entering their seventies and eighties. However as discussed earlier deregulation of the supply may impact on occupancies levels in the future although we believe this is likely to be highly localised. The charts below show the trend in industry occupancy levels and compare occupancy levels are the three listed providers.

Figure 44: Industry average occupancy levels



Source: Report on the Operation of the Age Care Act 1997, Department of Health 2013

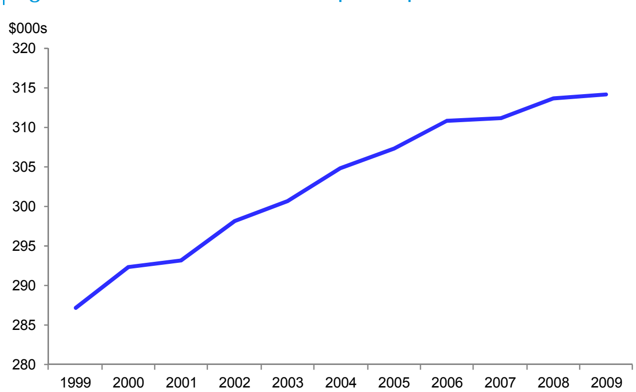
Figure 45: Occupancy levels compared



Rising wealth to offset funding pressure

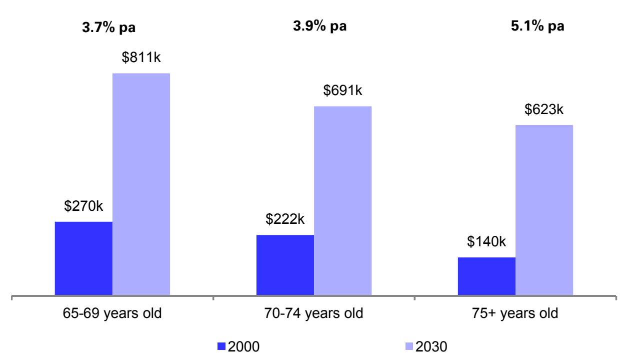
Increased wealth will help support demand growth even as the proportion of the cost borne by individuals continues to rise. The Figures below show the growth in wealth per capita (and by age group) in recent years and expectations for older Australians. The rising wealth levels are also attractive to aged care providers as it adds potential to boost operating margins by providing additional services (including extra care services) for which residents can be charged.

Figure 46: Increase in wealth per capita 1999-2009



Source: Australian Bureau of Statistics

Figure 47: Projected average family wealth by age group



Source: Source: "Caring for Older Australians: Productivity Commission Inquiry Report Overview (No. 53)", Australian Government - Productivity Commission, 28 June 2011

We expect the three listed providers to take advantage of this rising wealth trend by offering such services. We suspect facilities located in higher socioeconomic areas will enjoy the greatest benefit from this opportunity. On this basis Regis arguably enjoys an advantage. However Estia's high proportion of 'extra service' deemed places suggests it has attracted many residents able to pay for such services despite the slightly lower average socioeconomic level, relative to Regis, of the suburbs where its facilities are located.

Fragmented industry – a multifaceted opportunity

The Australian residential aged care industry is highly fragmented. At 30 June 2013 there were approximately 1,000 providers operating more than 2,700 residential aged care facilities. 63% of these providers operated only a single facility.

Figure 48: For-profit share of places has increased

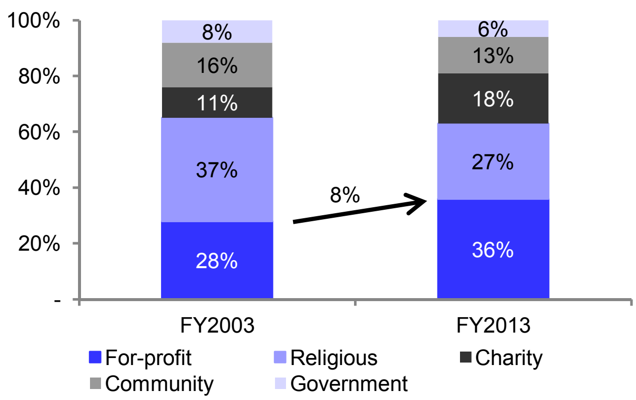
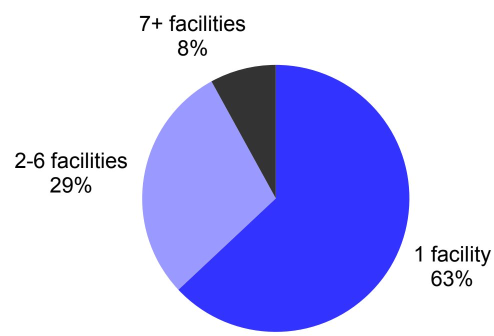


Figure 49: Providers by number of facilities



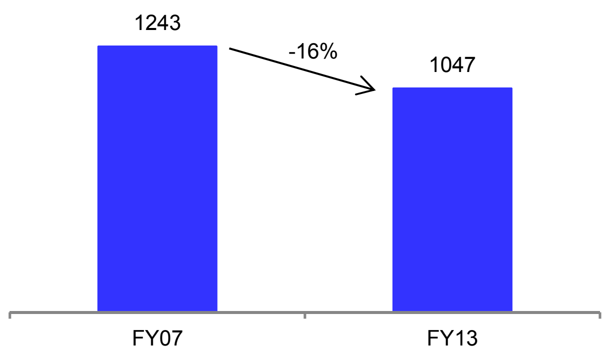
Source: Report on the Operation of the Age Care Act 1997, Department of Health 2003 and 2013, Deutsche Bank

Shift to private providers

While Government and not-for-profit operators still dominate the aged care sector as Figure 48 shows, there has been a trend to for-profit operators with "charitable groups" the only other segment which has grown. Governments (both State and Commonwealth) have progressively reduced their involvement in operating facilities.

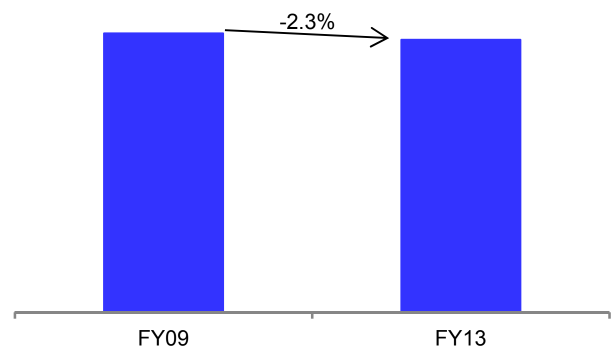
We believe this trend has been driven by regulatory reforms which have steadily increased standards of care requiring a more professional approach. In our view this has placed pressure on many smaller providers. The latest changes introduced by The Living Longer Living Better Aged Care Reforms (announced in April 2012 and implemented from July 2014) have only increased the complexity and hence boosted the need for strong operational procedures and systems. The next two charts highlight the consolidation of the industry as smaller providers exit the industry and to a much lesser extent, some facilities are closed. Industry feedback indicates that most of this activity has happened amongst the for-profit providers. However it is not uncommon for larger charitable groups to take over underperforming providers where they share a similar philosophical approach.

Figure 50: Decline in aged care providers



Source: 2014 Report on the Funding and Financing of the Aged Care Industry, Aged Care Financing Authority

Figure 51: Decline in aged care facilities

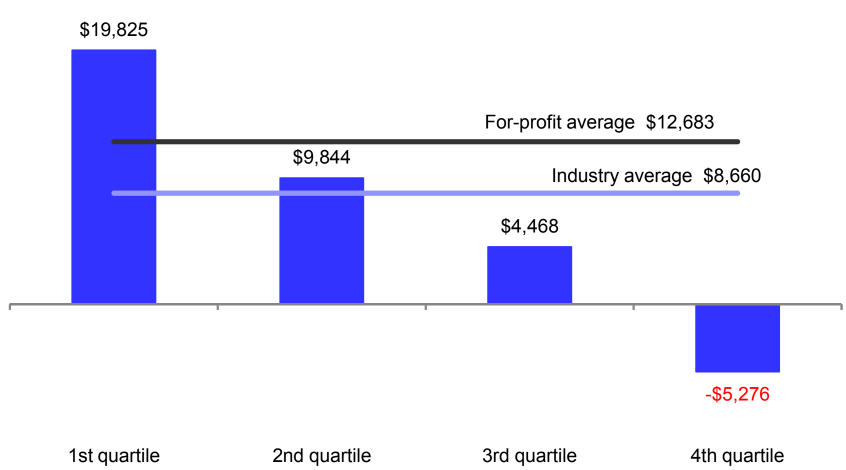


Source: Aged Care Service List, Department of Health, June 2009 & 2013

Financial pressure also promotes industry consolidation

There is a wide variance in financial performance of aged care providers. As shown in Figure 52 the material losses being generated by the fourth quartile providers limits the likelihood of a contraction in Government funding as it could force some providers to close. This data also supports the view further industry consolidation is likely given the apparent un-sustainability of the bottom quartile providers.

Figure 52: Average EBITDA per line across provider quartiles - FY13



Source: Report on the Funding and Financing of the Aged Care Industry, Aged Care Financing Authority, July 2014

Acquisition opportunity remains large

Fragmented market offers significant opportunity

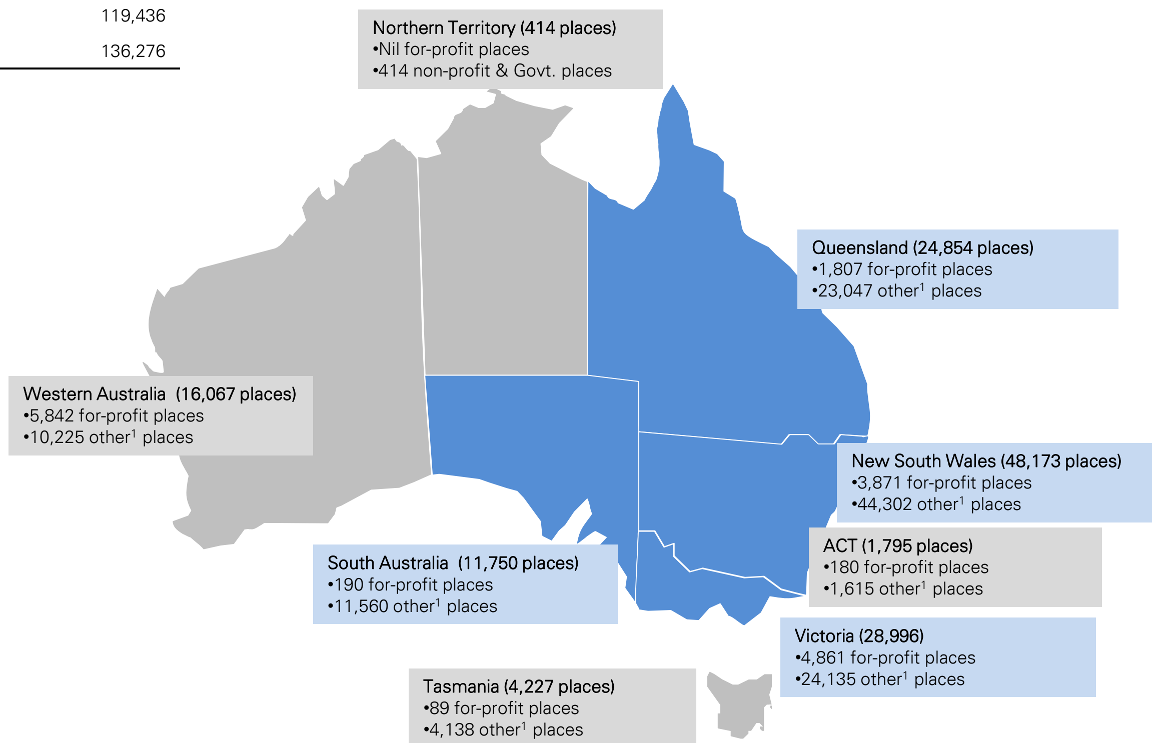
The acquisition opportunity set for the listed operators is sizeable as shown in Figure 53. The map sets out the number of places operated by all but the top five residential aged care providers in each state. This data indicates there are potentially 16,840 places operated by for profit providers and over 100,000 places operated by non-for-profit providers which could potentially be acquired.

As per the historical experience we expect acquisitions to be concentrated on the for-profit providers. However we also anticipate some charitable providers will seek to exit the sector due to the increased regulatory requirements and the rising care needs of older resident populations which many find increasingly challenging to provide. We note both Estia and Regis have acquired facilities from a charitable group in the past.

Figure 53: Potential acquisition opportunity set – Places operated by all but the top five providers in each state

Summary

No. Places	
For-profit	16,840
Other	119,436
Total	136,276



Source: Estia

Drivers of financial performance

The drivers of providers' financial performance can be divided into structural factors and provider capabilities. Structural factors reflect operational and strategic decisions which provide competitive advantage and are hard to replicate. Provider/organisational capabilities are required to operate a large number of places and typically are developed by larger providers.

Structural factors include:

- **Quality of facilities**: Modern facilities with a higher ratio of single rooms and the offering of extra service amenities attract residents leading to higher occupancy and higher income per resident.
- **Scale**: Larger scale enables fixed cost leverage with investment in centralized systems (ie compliance, IT, human resources and procurement) spread across facilities. This in-turn maximizes income by lifting operational efficiency.

- **Location of facilities**: Facilities located in wealthier areas are better positioned to generate higher incomes as they are able to attract residents who can afford to pay for higher value services and pay RADs.

Provider/organisational capabilities include:

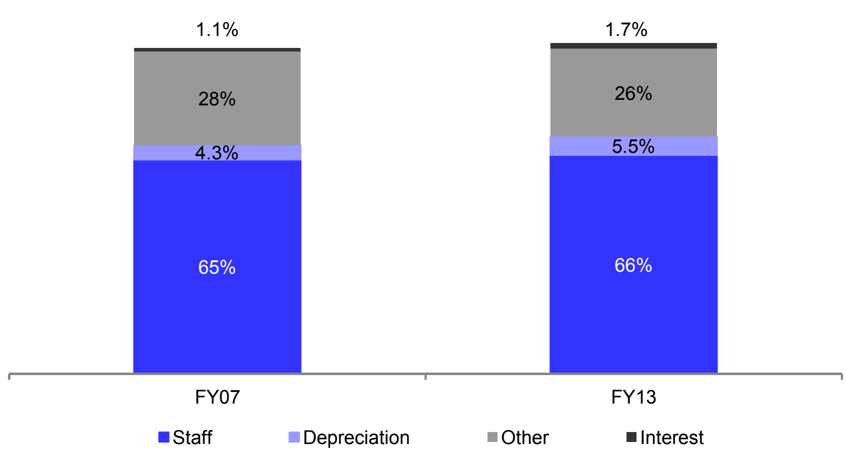
- **Reputation for care**: The provision of high standard clinical care for all residents, builds and maintains strong relationships with referrers, the community and regulators.
- **Systems and processes**: Accurate identification and documentation of clinical care ensures the provider receives appropriate ACFI payments. Strong systems also assist with regulatory compliance and optimal staffing.
- **Management of growth**: This includes the effective integration of acquisitions and strong operating metrics, most notably occupancy levels.

Key costs

The main operating cost for aged care operators is labour which includes nurses and patient care assistants. Wages costs are primarily set by Enterprise Bargaining Agreements (EBA). This cost typically accounts for ~66% of total revenue as shown in Figure 54. The aged care nursing EBAs vary between providers and regions. Wages have increased by 3.0 - 3.5% per annum in recent years.

Labour costs are the main costs for aged care operators

Figure 54: Aged care provider cost mix: FY07 – FY13



Source: Report on the Funding and Financing of the Aged Care Industry, Aged Care Financing Authority, July 2014 & 2013

Other operating costs include catering, cleaning, laundering, consumables, repairs/maintenance, energy, utilities, and admin/corporate costs.

Aged care funding

Outlook remains attractive after LLLB reforms

The Living Longer Living Better (LLLB) aged care reforms introduced in July 2014 have undoubtedly made investment in the residential aged care sector much more attractive. We expect strong growth in payments from residents over the next five years as providers are able to charge a greater proportion of residents market linked accommodation rates, largely via RADs (bonds). The deregulation of the charging for additional services should also provide an additional boost to the growth rate of revenues from residents.

Government funding accounts for ~70%...

Government funding on the other hand is likely to grow at a steady but more subdued pace. However we believe the Government will endeavor to provide a relatively stable funding environment in 2015 and 2016. This will allow the impact of the LLLB reforms to be assessed before further revisions and possibly deregulation are introduced.

... of the total spending on residential aged care

While the risk of fiscal pressures leading to cuts in the next Federal Budget cannot be ruled out, we do not expect a repeat on the 2014 experience when import supplements (for payroll and dementia) were removed. Potential revisions in the upcoming Budget include:

- **Higher accommodation supplement:** We suspect the higher accommodation supplement for new or significantly refurbished residential aged care facilities may be refined. This could limit or remove the uplift for refurbished facilities. However we note industry feedback indicating the outlays for this supplement are currently within budget levels.
- **Dementia supplement:** A revised dementia supplement is likely in our view but more targeted. We expect the financial implications for the listed providers will be immaterial.

In our view these changes will not have a material impact on the financial results of the listed providers.

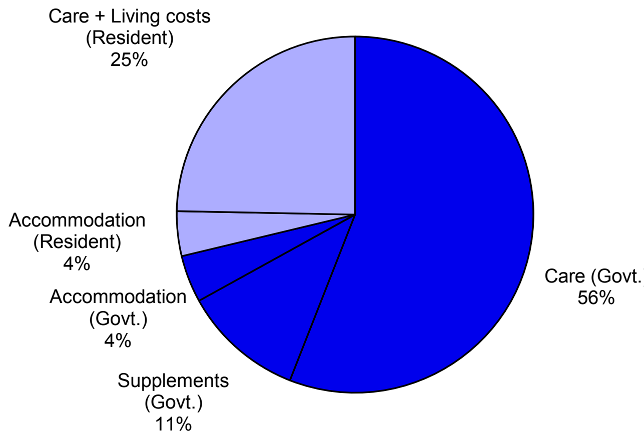
Government the predominant source of funding

Australian Government expenditure on aged care during FY13 totaled $13.3b, with $9.2b directed to residential care[2]. Government funding accounts for approximately 70% of total spending on residential aged care with the rest coming from residents.

The source of funding for the aged care services varies depending on the nature of the services and the financial situation of the residents. Figure 55 below shows the major sources of funding for each type of service provided.

[2] "2012-2013 Report on the Operation of the Aged Care Act 1997", Australian Government – Department of Health 2013

Figure 55: Sources of residential aged care funding - FY12



Source: Inaugural Report on the funding and financing of the Aged Care Sector, 2013, Aged Care Financing Authority, Deutsche Bank

Government funding

Residential care funding from the government includes: a) basic residential care subsidy, b) primary and other supplements, and c) accommodation funding. The basic residential care subsidy is based on the residents' assessed care needs and is set on a per day basis in accordance with the Aged Care Funding Instrument (ACFI - discussed in the next section).

Government accommodation funding is provided to lower means residents

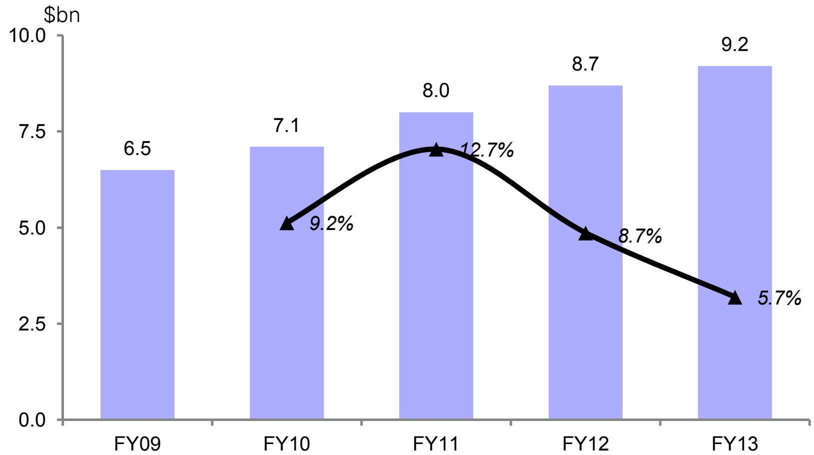
The Government also covers the accommodation costs of residents who are classified as of lower means. Primary supplements from the Government are payable to operators who provide care to residents that require supply of oxygen or administration of tube feeding etc. Finally other supplements from the government largely arise from payments to operators who provide more than 40% of their services to supported (lower means) residents.

Figure 56 illustrates the growth in Government funding over the past six years. This level of growth has been driven by an increase in average care costs and growth in the number people requiring residential aged care services.

Funding growth now targeted at 2-3% above inflation

Funding requirements have typically risen at high single digit rates. The drop in growth in FY13 largely reflects the previous Labor Government's decision to freeze care payments. However as discussed in more detail below the current Federal Government implemented more regular indexation from FY14. The Government is now targeting growth in funding of 2-3% above inflation, which we estimate implies a 5% to 6% annual growth.

Figure 56: Historical Australian Government funding, versus PCP growth



Source: "2012-13 Report on the Operation of the Aged Care Act 1997", Australian Government - Department of Health 2013, Deutsche Bank

Residents' contributions

From July 2014 Resident Agreement (Agreement) contributions come from:

- **Standard resident contributions (resident fee)**: these fees relate to costs associated with living expenses (meals, laundry, etc.). This fee is calculated daily and payable on a monthly basis. This fee comprises a standard resident contribution which is set by the Government and reviewed every 6 months. For new residents, the maximum basic daily fee is 85% of the single person rate of the basic Age Pension.
- **Accommodation charges**: residents are responsible for the cost of their accommodation. This can be paid as a daily amount (daily accommodation charge – DAC) or as lump sum (refundable accommodation deposit – RAD) or a combination. The amount payable is agreed between the Resident and the aged care operator subject to limits set by the Government. As mentioned above where the resident is classified as lower means the DAC is paid in whole or part by the Government.

Accommodation charges can be paid daily (DAC) or in lump sum (RAD)

- **Means tested care fee**: permanent residents are required to make payments to cover the cost of their care if they exceed the means tested income and asset thresholds (discussed in greater detail later in this section).
- **Extra Services fees**: for higher standards of accommodation, food and services (ie entertainment) which are not dependant on level of care.
- **Additional personal services fees (additional fees)**: for payment of services which are distinct from the services provided to places with Extra Service status (including outings, hairdressing, companion carers etc.). These services must be paid for as set out in the Agreement.

The various sources of funding for each services type are summarised in Figure 57 below. A more detailed discussion of each service and its funding is set out below.

Figure 57: Sources of funding by service type

	Clinical care services	Daily living services	Accommodation services	Extra/Additional services
Source of funding	Primarily Government funding	Residents	Primarily residents if they have the means, if not the Government	Residents
	Residents contribute if they have the means			

Source: Estia

Clinical care services funding - ACFI

The Aged Care Funding Instrument (ACFI) was introduced in March 2008 and is designed to match funding to the care needs of residents. The ACFI appraisal process involves a detailed assessment of the resident's care needs based on data collected through twelve questions. Daily funding is then determined based on the score from this assessment with higher rates paid for residents who require greater care. A detailed discussion of the ACFI assessment process is set out in Appendix C.

Figure 58 below shows the daily ACFI subsidy rates applicable in FY15 for each level of funding allocation. Effectively ACFI for each category ranges from 'nil' to 'high' and hence the ACFI rate ranges from $0 to $209 per day.

Figure 58: FY15 ACFI subsidies

Level	Activities of Daily Living	Behaviour	Complex Health Care	**Total**
Low	$35.65	$8.14	$16.04	**$59.83**
Medium	$77.61	$16.88	$45.68	**$140.17**
High	$107.52	$35.20	$65.96	**$208.68**

Source: Australian Department of Social Services, Deutsche Bank

The average ACFI subsidy received by the three listed players in FY14 was $140-150 by our estimates, well above the industry average.

The daily ACFI subsidy rates are reviewed regularly and indexed annually (financial years) based on an inflationary adjuster known as the COPO (Commonwealth Own Purpose Outlays). The indexation of ACFI rates has generally matched inflation but the average AFCI rate has risen more quickly due to the increasing care requirements of the average resident.

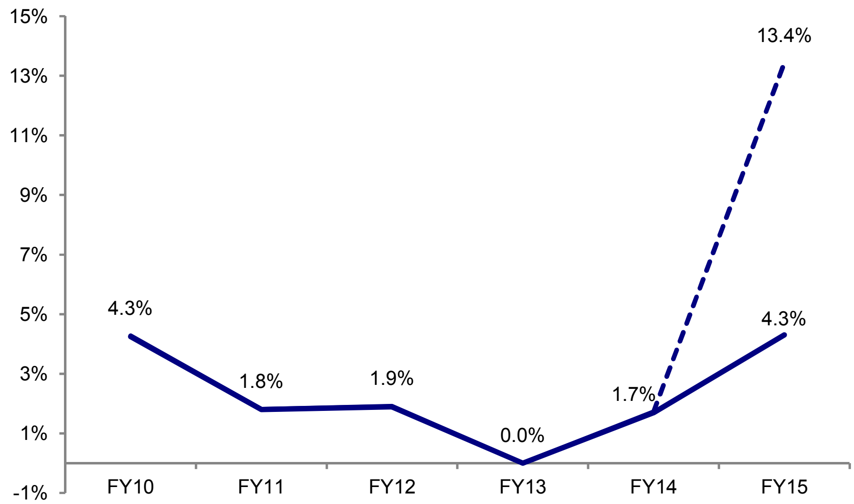
The published ACFI rates have also reflected adjustments beyond indexation and political intervention. In FY13 the Government froze the ACFI in response to relatively rapid growth in aged care outlays inflation in FY12. This caused significant earnings pressure across the industry in FY13. With the change of Government there was a return to more regular indexation in FY14.

In FY15 the industry received a one-off 2.4% due to the redirecting of the "Workforce Supplement" (a Labor Party initiative which was scrapped by the Abbott Government) in addition to the usual indexation of 1.9%. According to the Department of Health website the Government is targeting an annual growth for the clinical funding of 2-3% above inflation.

The Conditional Adjustment Payment (CAP – 8.75% of the basic subsidy rate) was also included in the ACFI from FY15 causing it to jump sharply (see Figure 59). The CAP was previously paid to providers which encouraged staff to undertake training, published audited financial statements and participated in periodic workforce surveys.

From FY15 CAP also included in ACFI, causing it to jump sharply

Figure 59: Annual growth rates for daily ACFI subsidies from FY10 to FY15



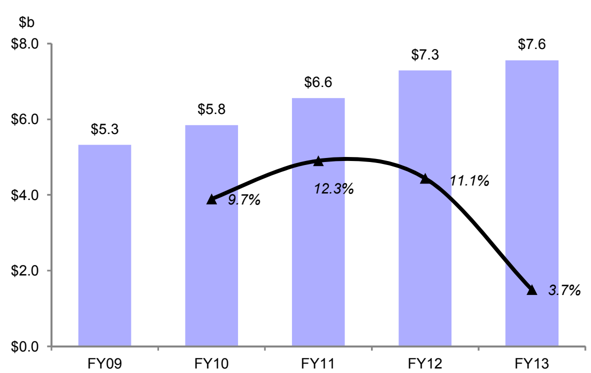
Source: Deutsche Bank, Department of Health and Aging
Note: The FY15 growth in the reported ACFI rate is 13.4% includes the reclassification of the CAP payment.

Freezing of ACFI indexation in FY13 led to slowing in growth

Return to mid single digit growth expected from FY14

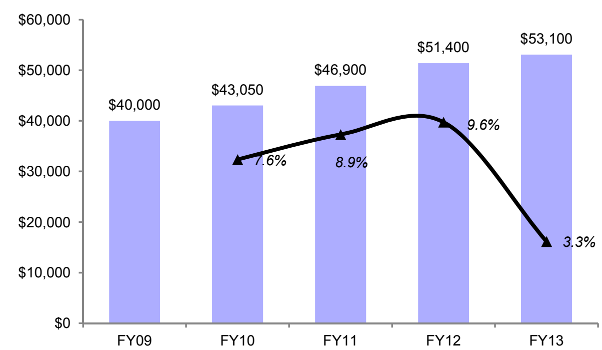
The left hand chart below shows total funding of care and the chart on the right shows total Government spending per permanent aged care resident. In both cases the freezing of the ACFI indexation in FY13 led to a sharp slowing in growth. With indexation normalising and the continued growth in resident numbers we expect a return to at least mid single digit growth from FY14.

Figure 60: Total care funding – Govt and residents



Source: "2012-13 Report on the Operation of the Aged Care Act 1997", Australian Government - Department of Health 2013, Deutsche Bank

Figure 61: Govt funding per resident



Source: "2012-13 Report on the Operation of the Aged Care Act 1997", Australian Government - Department of Health 2013, Deutsche Bank

Dementia funding reforms and concerns

Even though the ACFI assessment contains a dementia code within its 'mental and behavioral' diagnosis coding, the full range of dementia diagnostic terms is not available. As a result the ACFI assessment arguably does not capture the more complex symptoms (behavioral and psychological) associated with dementia.

ACFI coding is deficient in capturing dementia patients with complex symptoms

Given this perceived deficiency of the ACFI and resultant concerns people with severe dementia may be less likely to be accepted into residential care facilities due to the lack of compensation/reimbursement, a new Dementia and Severe Behaviors Supplement (Supplement) was introduced by the Labor Government as part of its Living Longer Living Better (LLLB) Aged Care reforms. The Supplement came into effect from August 2013 and was designed to provide sufficient funding to enable access to appropriate care for patients suffering from these severe conditions.

But most providers report the level of ACFI funding for dementia is sufficient

Dementia funding supplement dropped

The Supplement was designed to cover the costs arising from caring for people with severe behavioural and psychological symptoms of dementia and other conditions. The supplement was on top of the basic subsidies for care recipients received which include allowance for the cost of caring for dementia sufferers.

Dementia Supplement introduced in Aug-13…

The Supplement was designed to cater for approximately 2,000 residents or approximately 1% of people with dementia in residential care. However a significantly higher number of applications were received from aged care operators causing the costs to exceed its budget by almost ten times in its first year (FY13), costing $110m rather than budgeted $12m. This funding was subsequently dropped at the end of July 2014.

…poorly designed, exceeded budget by 10x's…

…funding dropped end of Jul-14

The industry is currently working with the Government to develop a replacement funding package to support care for the growing number of aged care residents suffering from dementia. However, given the previously budgeted amount and the pressure on the Federal Budget, we expect any replacement funding will likely be relatively immaterial.

More importantly discussions with various providers have led us to conclude the current funding provided via ACFI is sufficient. In other words most providers report caring for residents with dementia generates reasonable margins and returns.

Respite care funding

Respite care is residential care provided as an alternative care arrangement with the primary purpose of giving a carer or a care recipient a short-term break from their usual care arrangement. The Government spent $168m on respite care in FY13.

The Govt. spent $168m on respite care in FY13

An approved provider is eligible for the respite supplement for each day they provide residential respite care to an approved respite care recipient who has not used up his or her annual allocation of respite days. A person can have up to 63 days of respite care in a financial year with the possibility of 21 day extensions if approved by an ACAT[3].

While respite care allows on operator to fill an unoccupied bed, the level of funding is well below that available to a typical permanent resident.

Respite care funding is well below permanent resident funding

Accommodation funding - the RAD new regime

Aged care residents are required to cover the cost of their accommodation at an aged care facility unless they are deemed to be of low means. In such case the Government pays for some or all of the cost.

Accommodation is paid for by either RAD, DAP or both

Accommodation is paid by way of either:

- Refundable Accommodation Deposit (RAD),
- Daily Accommodation Payments (DAPs), or
- a combination of both.

The resident has up to 28 days after entering the facility to elect how they will pay. A new resident will likely consider a number of factors when electing the method of payment including:

- annual after-tax income and ability to pay a DAP,
- level of assets (including primary residence) and ability to pay a RAD[4], and
- level of discount offered relative to the advertised RAD amount by the provider versus the amount of a DAP (which is calculated using the advertised RAD amount).

Post Jul-14 bond rules for 'low care' vs. 'high care' changed...

...aged care operators can now charge bonds to either

Prior to July 2014 aged care operators were only able to charge bonds (now known as RADs) to residents entering 'low care' or places with Extra Services status. The deregulation of bonding has undoubtedly opened up a significant new source of funding for aged care providers.

Refundable Accommodation Deposits – previously Accommodation Bonds

RADs are an upfront payment made by a resident to the aged care provider for the resident's accommodation in the facility. The amount of RADs chargeable by an aged care operator (at any facility) is subject to the resident's capacity to pay and also the Government's mandated cap of $550,000. If a provider wishes to charge a RAD above $550,000 they require the approval of the Aged Care Pricing Commissioner. RADs are a key source of cash for providers as:

- any income (eg interest) generated from a RAD is retained by the provider, and
- where an incoming resident pays a RAD higher than the RAD refunded to the outgoing resident, it generates additional cash flow to the provider, which may be used for regulated permitted purposes and is not taxable.

[3] "Residential Care Manuel 2014", Australian Government – Department of Social Sciences

[4] Noting the value of a RAD is excluded from assets for purposes of determining an individual's eligibility to any Centrelink payments

Value of a RAD is partially linked to real estate value

The value of RADs is partially linked to the value of residential real estate in the surrounding catchment area and also supply and demand dynamics. Some of the factors that determine the value of a RAD charged to a resident include:

- quality and location of the facility,
- nature of the place offered (eg single room with en-suite bathroom will likely attract a higher RAD than a multi-bed shared room), and
- quality and level of the services offered at the facility and resident demand for such facilities.

RADs are a key source of interest free capital funding

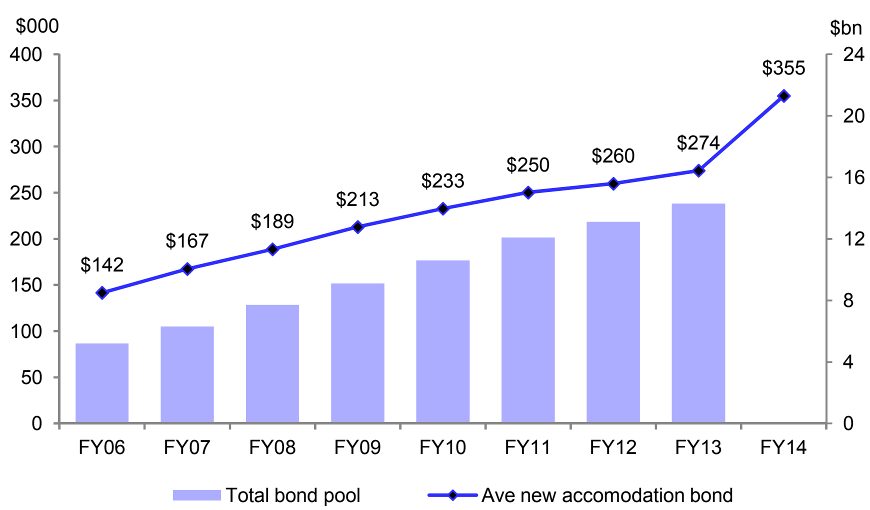
RADs are a key source of interest free capital funding (for approved purposes) for aged care operators and historically outgoing RADs have generally been replaced by incoming RADs at an equivalent or higher amount. RADs need to be paid back generally within 14 days after either receipt of a notice the resident is leaving or receipt of probate of a resident's will. RADs are guaranteed by the Government in the event of operator default.

The average price of accommodation bonds is rising

Rising wealth among residents, supply and demand dynamics for aged care service and the higher cost of providing accommodation is driving up the average price of accommodation bonds and the bond pool. Figure 62 shows the historical increase in the average price of new accommodation bonds (broadly equivalent to RADs prior to July 2014) over the last eight years. Bonds have grown at a CAGR of nearly 10% over this period. The total accommodation bond pool increased from $5.2b to $13.1b between FY06 to FY12, representing a CAGR of 16.6%.

Bonds have grown at ~8% CAGR from FY06-FY14

Figure 62: Historical average new RAD/bond and total industry pool



Source: Report on the Funding and Financing of the Aged Care Sector, Aged Care Financing Authority 2014

Daily Accommodation Payments

DAPs are daily ongoing accommodation payments made by a resident in lieu of a lump sum and are payable monthly, one month in advance. Historically approximately 90% of non-supported residents eligible to pay either a bond (ie low care or extra care residents) have paid bonds over the last five years. This is encouraging as higher bonding provides access to additional cashflow. While it is uncertain whether this trend will continue under the new funding rules which came into effect last July early evidence suggests the majority of residents are still choosing to pay some or all of their accommodation costs via RADs rather than DAPs.

DAPs are in lieu of RADs, are payable monthly, one month in advance

The amount of a DAP is calculated as the Maximum Permissible Interest Rate (MPIR)[5], multiplied by the advertised RAD amount, divided by 365 days in a year. The payment of a DAP is recognised by a provider on its income statement whereas a RAD is recognized by the provider on its balance sheet.

Supported resident requirements

The Government's aged care funding regulations include provisions designed to ensure adequate access to aged care services for residents with limited means. The key elements of the policy are:

Minimum target ratios for supported residents must be met by all providers

- Minimum target ratios for supported residents to total residents must be met by all providers. Sanctions may be applied to those services that do not meet the required ratio.
- The Government funds part or all of the accommodation and daily living costs of supported residents.
- Additional supplement payments are available for:
  - Providers which have 40% or more supported residents in a facility.
  - Higher daily accommodation rates are available if a facility is upgraded[6].

As at June 2013 there were 68,000 supported (previously known as concessional residents) in residential care (~44% of the non-extra services resident population). For each aged care planning region there is a minimum target ratio for supported to total residents. The lowest regional target ratio is 16% and the highest is 40%, these are based on regional socio-economic indices. If a facility does not meet the required ratio the Government may impose sanctions on the operator.

[5] The MPIR is set quarterly by the Australian Government and is 6.69% (effective 1-July-2014).

[6] The LLLB reforms included a significant refurbishment supplement. Where a facilities have been built or significantly refurbished on or after 20 April 2012 and meet the building requirements the accommodation rate for supported residents is increased for $34 to $52 per day.

Means testing

At 30-Jun-13 there were 68k supported residents

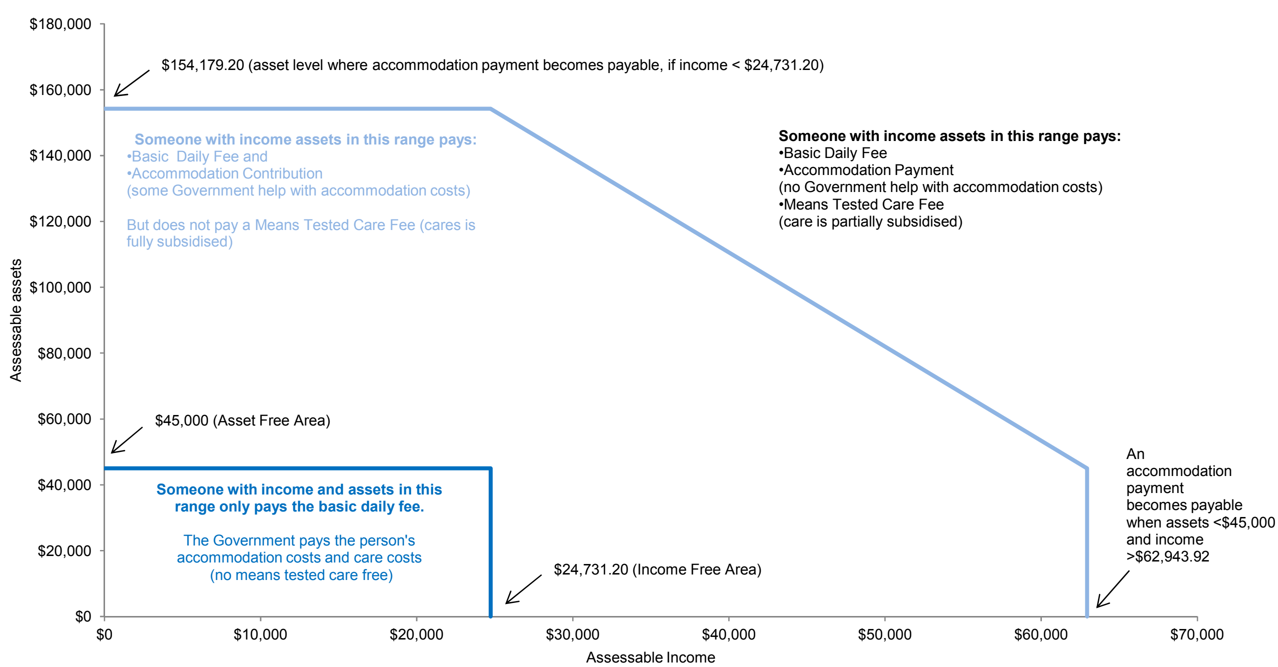
In an effort to ensure the sustainability of the aged care system the Government revised the means testing arrangements for people entering residential care from July 2014. Residents of sufficient means are required to make a contribution to the cost of their care and cover the cost of their accommodation. A resident's combined income and assets are used to determine their eligibility for Government assistance. The assessment is carried out by the Department of Human Services or the Department of Veterans' Affairs.

Residents with sufficient means…

These regulations are complex and may have a bearing on a resident's decision to pay for their accommodation via a lump sum (RAD) or by daily payments (DAP). Figure 63 below demonstrates how the means testing arrangements create three tiers of resident's contributions towards aged care.

…must make contributions towards their cost of care and accommodation

Figure 63: Residential Care income and asset thresholds: Single person, March 2014 prices



Source: Department of Social Services

The three tiers are as follows:

- **Low means residents** are required to pay only the basic daily fee (85% of the single aged pension) as a contribution towards their daily living expenses, their accommodation and care costs are funded by the Government.
- **Moderate means residents** in addition to contributions towards their daily living expenses (ie paying the basic daily fee) also make a capped contribution towards their accommodation costs.

- **Greater means residents** in addition to a contribution towards their daily living expenses also pay a basic daily fee for their accommodation costs (paid in full) and make a capped contribution towards their care costs.

Clinical care costs

A resident is required to make a contribution towards the cost of their clinical care if:

- the resident has assets worth less than $45,000 but an annual income above $63,000, or
- the resident has annual income of $25,000 or less but has assets worth more than $154,000.

An annual cap of $25,000 and lifetime cap of $61,000 are applied to the cost of care.

Accommodation costs

A resident is required to pay for some or all of the cost of their accommodation if:

- The resident has an annual income above $25,000 or assets worth more than $45,000 they will be required to make an 'accommodation contribution' with the Government paying the remainder.
- If the resident has an annual income and assets above $63,000 and assets worth more than $154,000, they will be required to cover the full cost of their accommodation.

The accommodation contribution will otherwise be treated similarly to an accommodation payment with the Government coving the cost.

The Schedule of fees and charges for residential and home care which apply post 1 July 2014 is set out in Appendix D.

Industry changes from July 2014

The Living Longer Living Better (LLLB) aged care reforms came into effect on 1 July 2014 (announced in April 2012). The key changes which impact residents and providers included:

- **Removing the distinction between 'high care' and 'low care'**: Providers can now charge bonds (RADs) to all residents (regardless of whether classified 'high care' or 'low care') who entered/enter after July 2014 (subject to means tests and maintenance of Supported Residents ratios). Previously providers could only charge accommodation bonds on 'low care' places and 'high care' places with Extra Services status.

Under the LLLB, additional funding is being provided

- **Changes to the level of care and extra-services**: Providers can now charge a lump sum as a RAD or DAP equivalent in place of a daily accommodation charge for residents who entered/enter after July 2014. Government approval is required if a provider wants to charge a RAD or DAP equivalent which is greater than $550,000. Previously providers could only charge a 'high care' resident a daily accommodation charge for places without Extra Services.

- **Greater choice for residents in how to pay**: Residents who entered/enter a facility after July 2014 can now choose whether they pay for accommodation and care using a RAD or DAP or combination of both. Residents have 28 days to make this election.
- **Retention amounts out of residents accommodation bonds no longer permitted**: Providers can no longer withhold a monthly amount of money out of accommodation bonds for residents who entered/enter a facility post July 2014.
- **Additional accommodation funding available for low means residents**: Additional funding (an accommodation supplement) is available for low means residents who entered/entering after July 2014 whom meet certain criteria, primarily related to minimum capital expenditure thresholds.
- **Removal of the Extra Service "clawback"**: The Government Extra Service "clawback" imposed on providers (equal to 25% of fees for Extra Services) which was charged to residents occupying places with Extra Services no longer applies.

Significantly refurbished facilities

The Government has increased its contribution towards the accommodation costs of supported residents in new or significantly refurbished residential aged care facilities. The new daily rate rises by just over 60% to $52.49 from July 2014.

Newly built and significantly refurbished facilities…

If a facility is to qualify as a significantly refurnished facility an approval by a building authority as a major refurbishment is required. The criteria used for such determination should be in accordance with the following points:

…are eligible for higher accommodation supplements

- The refurbishment cost must at least equal a minimum monetary spend amount calculated on the number of care recipient's rooms in the facility.
- The refurbishment must have made significant improvements and upgrades with a direct benefit for residents, especially for those who qualify for accommodation costs assistance.
- The refurbishment must provide benefits for at least 40% of residents (eg having a refurbished bedroom) or an extension to the facility must have increased the total number of rooms by 25%.
- The proportion of the care recipient's rooms available for residents who qualify for accommodation costs assistance must not have been reduced after the refurbishment.
- The relevant costs must be capitalised in accordance with Australian accounting standards.

The work must have been completed by or after 20 April 2012.

Changes announced in the 2014 Federal Budget

The May 2014 Federal Budget included a number of measures affecting aged care providers. The changes at a high level were as follows:

The Payroll Tax changes will hit aged care providers the hardest

- **Payroll Tax change (effective Jan 15)**: The Federal Budget discontinued the Payroll Tax Supplement for eligible aged care providers. This was the most significant change and effectively will reduce the profitability of residential aged care providers (legislated and comes into effect on January 2015). However this change was partially offset by other changes which are listed below.
- **Workforce Supplement change (effective Jul 2014)**: The redirecting of the Workforce Supplement ($1.5b in funding) has resulted in a 2.4% increase in the ACFI from July 2014.
- **Reduction in the indexing of pensions (effective from 2017)**: From 2017 pensions will be indexed to the Consumer Price Index (CPI). Currently these payments are indexed to the higher of the increases in: 1) the CPI, 2) Male Total Average Weekly Earnings, or 3) the Pensioner and Beneficiary Living Cost Index. The reduced increase will impact on residential aged care providers as resident fees each year are set at 85% of the single aged pension.
- **Regional, rural and remote boost**: $54m of additional funding will be directed to regional, rural, and remote aged care providers over four years from a 20% increase in the Viability Supplement.

Risks

Key risks which could adversely impact the financial performance of the aged care operators business viability and future include the following:

- **Regulatory and funding risk**: Given the highly regulated nature of the aged care industry, any changes in regulation, or to the level of government funding or the funding model, may adversely impact operations and financial performance. Examples of adverse changes include changes to:

  Changes to the regulation may adversely impact operations if…

  - **Government policy initiatives which stem/limit funding growth or re-directs funding to other targets**: Changes which have potential to impact subsidy levels (through modification of the ACFI fee schedules), change the funding model (ie to a more 'user pays' model), and/or re-direct or increase funding (including for home and community packages, aimed at getting people to stay longer in their residential homes).

    …impacts funding…

  - **Restrictions on RADs use and replacement, including on issuing RADs for "Extra Services"**: Prudential or regulatory restrictions on use, price of, issuance and replacing RADs, including limitations on amounts that be charged for RADs.

    … restricts RADs use, issuance or replacement

  - **Regulation of approved places**: Deregulation of approved places which could lead to a rapid increase in supply.
  - **Accreditation standards and physical structure requirements**: Changes which increase compliance costs relating to accreditation and also to physical building and structure requirements for aged care facilities which result in an increase in capital expenditure requirements.
- **Repayment and value of accommodation bonds / RADs risk**: Fluctuations in general and investment market conditions (including the housing market) may impact the value of bonds and RADs. This could reduce the value of RADs which would lead to negative cash flow, as existing RADs are repaid and replaced with lower price RADs. A decline in occupancy at a single facility or across the group's portfolio would require operators to repay RADs without receiving sufficient new RADs from incoming residents, potentially leaving the operator unable to repay RADs within the required period. Operators are also exposed to a decline in the proportion of residents choosing to pay a RAD rather than a DAP which would also lead to an outflow of funds.
- **Clinical care and reputational risk**: Failure by an operator to meet clinical care requirements due to for example: 1) clinical incidents not being identified/addressed, and 2) employees/contractors not following process which could lead to injury of patients, visitors, etc. These could potentially lead to the operator being liable for damages, penalties and subject to sanctions and litigation (including medical indemnity claims). The operator's reputation could be damaged by adverse publicity from these types of events, which could impact its ability to attract new residents or lead to residents leaving.

- **Occupancy level risks**: Factors such as industry deregulation, decline in residency referrals (from hospitals, etc), and increased competition, could reduce occupancy levels. This would negatively impact both the level of government funding (the main source of funding) and also cash flows from resident contributions (RADs, DAPs, etc).
- **Acquisition related risk**: Notwithstanding extensive due diligence relating to acquisitions there is the possibility material issues may not have been identified, or are greater than expected and standard protections (in the form of reps and warranties) negotiated in the deal may have expired, or are inadequate in the circumstances.
- **Increased competition**: While the current barriers to entry are relatively high, a substantial increase in competition may lead to operators experiencing among other things, lower occupancy levels, reduced operating margins, lower RADs and/or a loss of market share.
- **Employee related risk**: Residential aged care operators are highly reliant on access to quality and skilled staff. There is a risk providers may not be able to retain or expand its workplaces with appropriately skilled and trained staff to meet existing and future demands. Given a high level of the aged care workforce are employed under EBAs, there is also a risk of industrial action which results in workplace disruptions and/or increases in wages. With such increases not being able to be passed onto residents or recognized under ACFI rate adjustments.
- **Illiquidity and fixed costs risks**: Residential aged care assets/facilities are illiquid by nature and operators may not be able to realise the value of facilities within a required timeframe or valuation. In addition aged care operators face relatively high fixed costs including maintenance costs, property taxes, etc along with on-going maintenance capex requirements. As a result earnings are leveraged to any decline in revenue.
- **Construction and property development risk**: The operators brownfield and greenfield expansion strategies exposures the businesses to construction risk (relating to among other things delays, unforeseen cost), and default risk (both contractor and other participants in the construction process).
- **IT failure risk**: Operators are reliant on its IT systems to support daily business operations (including record management, staff rostering and financial reporting) and scalability. Any fraud, faults or failure of IT systems, could adversely impact providers ability to operate and impact their financial performance both current and future.
- **Environmental risk**: Risk of contamination of any of operators facilities, not covered under any indemnities contained under acquisition agreements could expose the operators to fines under environmental laws.

Rating
Buy

Australasia
Australia

Health & Biotechnology

Company
Estia Health

Reuters	Bloomberg
EHE.AX	EHE AU

Price at 21 Jan 2015	4.70
Price target - 12mth	5.90
52 week range (AUD)	4.92 - 4.45
ALL ORDINARIES	5,398

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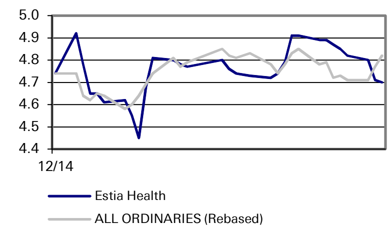
Price/price relative



Performance (%)	1m	3m	12m
Absolute	-6.3	–	–
ALL ORDINARIES	0.0	0.4	1.5

Source: Deutsche Bank

Initiating Coverage with a Buy Rating

Acquisition lead strategy set to deliver strong earnings growth

With the acquisition of over 1,300 places via bolt-on acquisitions in the last two years Estia has become a leading player in the ongoing consolidation of the fragmented residential aged care sector. While the rapid aggregation of the portfolio and the relatively new management team raises the risk, we take comfort from the quality of the portfolio (weighting to single rooms and extra service places) and the proforma track record of market leading operating margins. Given Estia offers an attractive growth profile and significant upside to our price target we have initiated with a Buy rating. Price target $5.90.

Estimates in line with prospectus forecasts

The near 50% lift in operating places in the last 24 months plus a step up in occupancy levels driven by the group's ramp-up facilities, underpin 35% revenue growth in FY15. EBITDA is expected to grow by almost 50% as the group benefits from the leverage to higher occupancy levels. We see upside to our forecasts if the group is able to secure further bolt on acquisitions in FY15.

$5.90 price target offers solid upside to current share price

Our price target is based on a DCF (WACC 10.1%, 5.00% bond yield, Beta 0.85, and TY growth of 7%). Our forecasts assume Estia adds ~350 places per annum via acquisitions and development projects. The key downside risks are: 1) change to Govt regulation and/or funding, 2) risk to RAD values, 3) increased competition, and 4) the limited track record of the group and new management.

Forecasts And Ratios

Year End Jun 30	2015A	2016E	2017E	2018E
Sales (AUDm)	296	353	400	450
EBITDA (AUDm)	70	82	93	106
Net Profit (AUDm)	43	50	57	65
EPS (AUD)	0.24	0.28	0.32	0.36
% Change	–	–	–	–
EPS Growth (%)	–	17.0	14.1	14.0
PER (x)	20.1	17.0	14.9	13.0
EV/EBITDA (x)	11.4	9.1	8.2	7.4
DPS (net) (AUD)	0.13	0.28	0.32	0.36
Yield (net) (%)	2.7	5.9	6.7	7.7
Franking (%)	100	100	100	100

Source: Deutsche Bank estimates, company data

[1] Pre-exceptionals/extraordinaries
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated:22 January 2015

Running the numbers

Australasia

Australia

Health & Biotechnology

Estia Health

Reuters: EHE.AX Bloomberg: EHE AU

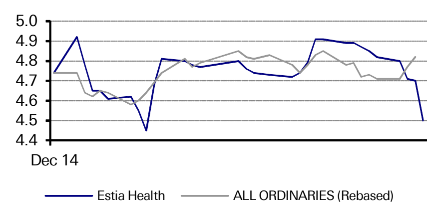
Buy

Price (21 Jan 15)	AUD 4.70
Target Price	AUD 5.90
52 Week range	AUD 4.45 - 4.92
Market Cap (m)	AUDm 846
	USDm 690

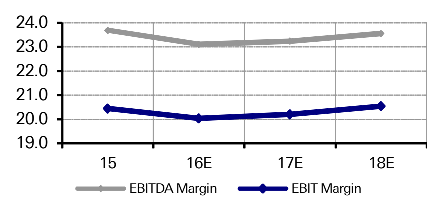
Company Profile

Estia operates a portfolio of aged care facilities across Australia, located in Victoria, South Australia, New South Wales and Queensland.

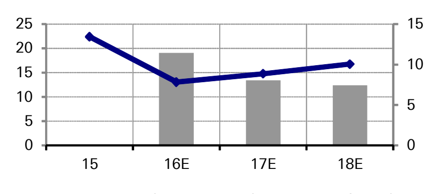
Price Performance



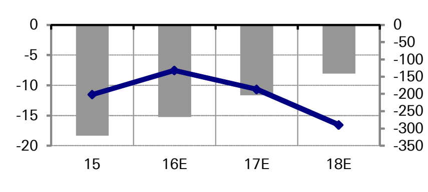
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 30-Jun	2015	2016E	2017E	2018E
Financial Summary				
DB EPS (AUD)	0.24	0.28	0.32	0.36
Reported EPS (AUD)	0.24	0.28	0.32	0.36
DPS (AUD)	0.13	0.28	0.32	0.36
BVPS (AUD)	3.53	3.56	3.58	3.60
Valuation Metrics				
Price/Sales (x)	2.9	2.4	2.1	1.9
P/E (DB) (x)	20.1	17.0	14.9	13.0
P/E (Reported) (x)	20.1	17.0	14.9	13.0
P/BV (x)	1.3	1.3	1.3	1.3
FCF yield (%)	5.3	8.2	9.1	10.2
Dividend yield (%)	2.7	5.9	6.7	7.7
EV/Sales	2.7	2.1	1.9	1.7
EV/EBITDA	11.4	9.1	8.2	7.4
EV/EBIT	13.2	10.5	9.4	8.5
Income Statement (AUDm)				
Sales	296	353	400	450
EBITDA	70	82	93	106
EBIT	61	71	81	92
Pre-tax profit	61	71	81	93
Net income	43	50	57	65
Cash Flow (AUDm)				
Cash flow from operations	25	60	72	82
Net Capex	20	9	4	4
Free cash flow	45	70	77	86
Equity raised/(bought back)	506	0	0	0
Dividends paid	0	-45	-53	-60
Net inc/(dec) in borrowings	-102	0	0	0
Other investing/financing cash flows	-418	-44	-46	-49
Net cash flow	31	-19	-23	-23
Change in working capital	*12*	*3*	*2*	*2*
Balance Sheet (AUDm)				
Cash and cash equivalents	116	98	75	52
Property, plant & equipment	287	321	355	390
Goodwill	15	15	15	15
Other assets	582	605	629	654
Total assets	1,001	1,038	1,074	1,111
Debt	0	0	0	0
Other liabilities	366	398	430	463
Total liabilities	366	398	430	463
Total shareholders' equity	635	640	644	649
Net debt	*-116*	*-98*	*-75*	*-52*
Key Company Metrics				
Sales growth (%)	nm	19.1	13.4	12.4
DB EPS growth (%)	na	17.0	14.1	14.0
Payout ratio (%)	53.9	99.3	99.7	99.9
EBITDA Margin (%)	23.7	23.1	23.2	23.6
EBIT Margin (%)	20.4	20.0	20.2	20.5
ROE (%)	13.4	7.8	8.9	10.0
Net debt/equity (%)	-18.3	-15.3	-11.7	-8.1
Net interest cover (x)	-202.0	-132.1	-187.0	-290.1
DuPont Analysis				
EBIT margin (%)	20.4	20.0	20.2	20.5
x Asset turnover (x)	0.6	0.3	0.4	0.4
x Financial cost ratio (x)	1.0	1.0	1.0	1.0
x Tax and other effects (x)	0.7	0.7	0.7	0.7
= ROA (post tax) (%)	8.5	4.9	5.4	5.9
x Financial leverage (x)	1.6	1.6	1.6	1.7
= ROE (%)	13.4	7.8	8.9	10.0
annual growth (%)	*na*	*-41.7*	*13.3*	*13.3*
x NTA/share (avg) (x)	1.8	3.5	3.6	3.6
= Reported EPS	0.24	0.28	0.32	0.36
annual growth (%)	*na*	*17.0*	*14.1*	*14.0*

Source: Company data, Deutsche Bank estimates

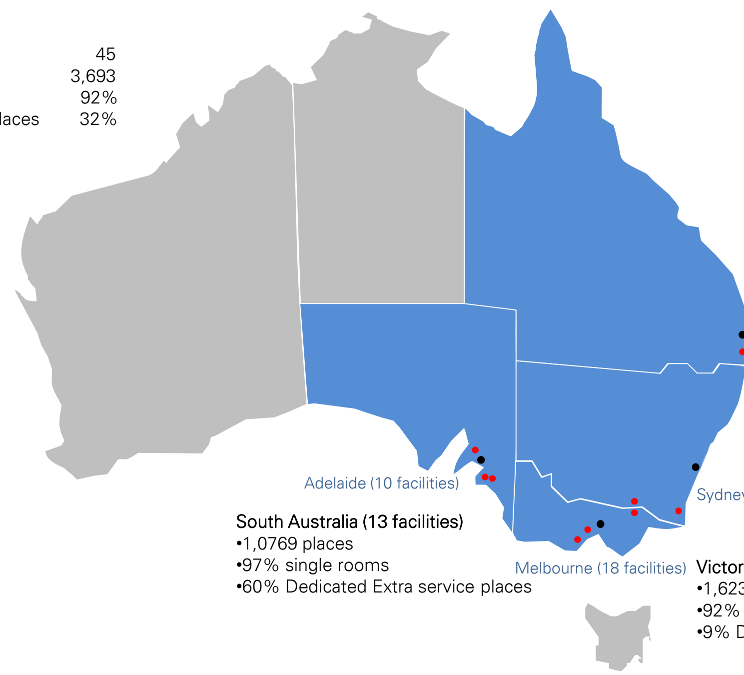
Estia Health

Company description

Estia is one of the largest residential aged care operators in Australia in terms of number of places. The company currently operates 3,433 places across 42 aged care facilities located in Victoria, South Australia, New South Wales and Queensland. Estia expects to add an additional 260 places when it settles the acquisitions of three facilities in the first half of 2015, taking it to 3,693 places.

Figure 64: Estia Health map of facility locations

Summary	
Number of facilities	45
Number of places	3,693
% of single rooms	92%
% of Dedicated Extra Service places	32%



Source: Estia

Estia has a high quality portfolio heavily weighted to single rooms in facilities in metropolitan areas.

Figure 65: Key Portfolio Statistics

Portfolio attributes	Facilities /Places	Proportion
Number of facilities (owned and contacted to be acquired)	45	
Number of in metro areas	37	84%
Number of freehold facilities	40	89%
Operational places (owned and contacted to be acquired)	3,693	
Single rooms	3,324	92%
Extra service status[1]	1,224	32%
Occupancy - FY15 estimate		95%
Proportion residents paying RADs/Bonds - 30 Jun 2014		44%

Source: Estia, Deutsche Bank
Note 1. Based on facilities owned and contracted to be acquired.

After the float the previous owners hold 30% of the stock. 21% is held by the private equity vendors and the rest is in the hands of the founder and management. This stock is under escrow until after the FY15 full year results unless the share price exceeds $6.90 for 10 consecutive days.

History

Estia Health (Victoria) was founded in 2005 as Lasting Changes. In July 2014 Lasting Changes/Estia Health (Victoria) merged with Padman Health Care (in South Australia) and Cook Care (in both New South Wales and Queensland). This formed one of Australia's largest (by number of places) and most geographically diverse for-profit aged care providers. Figure 66 outlines a brief history of each of the main businesses.

Figure 66: Estia's business history

	Estia Health	Cook Care Group	Padman Health Care
1980 -1990		▪ Founded in 1987	▪ Founded in 1984 ▪ Encounter Bay and Aberfoyle Park constructed
1990 - 2000		▪ Albany Creek and Mona Vale constructed ▪ Ryde re-developed	▪ Flagstaff Hill constructed ▪ Kadina acquired ▪ Aberfoyle Park extended
2000 - 2010	▪ Founded in 2005 following acquisition of Knox ▪ Glen Waverly, Ringwood, Dandenong and Bentleigh acquired	▪ Willoughby, Manly, and Southport constructed ▪ Mona Vale, Albany Creek, Dalmeny, Mudgeeraba, and Willoughby upgraded / or extended	▪ Salibury, Nambour, Strathalbyn and Golden Grove constructed ▪ Craigmore and Aberfoyle Park acquired ▪ Encounter Bay, Parkside, Kadina and Flagstaff Hill extended
2011	▪ Melton acquired		▪ Daw Park constructed
2012	▪ South Morang and Werribee acquired		
2013	▪ Coolaroo acquired ▪ Quadrant Private Equity invests and acquires majority interest	▪ Epping constructed	▪ Lockleys constructed
2014	▪ Altona Meadows, Ardeer, Oakleigh, Yarra Junction, Plenty Valley, Wodonga, Albury and Leopold acquired ▪ **All three businesses brought together in July 2014**; Mercury Capital invests and acquires a minority interest ▪ Six facilities contracted to be acquired, subject to customary closing conditions		

Source: Estia

The three main businesses, Estia, Padman and Cook each had strong track records in their own right. Key features of these businesses included:

- **Experienced management and strong reputations**: Each business has a history of providing a high level of compliant, consistent and clinical care to residents.
- **Limited geographic overlap**: All businesses hold strong positions in their respective markets with limited geographic overlap.
- **Modern facilities**: Each group had a portfolios of facilities focused on single occupant rooms and extra services in largely metro areas.

- **Acquisition/development experience**: All three had strong track records including for the execution and integration of acquisitions and/or developments (brownfield and/or greenfields).

Business model

Estia owns and operates high quality aged care facilities in attractive catchment areas where demand from individuals able to self fund their aged care needs is strong. The quality of Estia's portfolio and its efficient business model are reflected in its strong operational metrics, including earnings well above the industry average and high occupancy rates. For example Estia currently generates over $24,000 in EBITDA per resident pre corporate costs. Comparing this to the latest industry data for FY12, industry average EBITDA was $8,660 and $12,683 by for-profit providers[7].

Superior portfolio

Strong management

In our view the two key elements of Estia's successful business model are its superior portfolio of facilities and its management capabilities. These elements are discussed in more detail below.

A superior portfolio

The quality of Estia's facilities allows it to attract wealthier residents which supports the generation of strong revenues from complementary services (Extra Services, etc.) in addition to the standard clinical care payments. Key features of Estia's portfolio include:

- **High standard of accommodation**: Estia's quality facilities offer a high standard of accommodation and predominantly feature single rooms (92%) which support both high occupancy levels and potentially higher bond rates. The high standard of facilities and low average age of its facilities (currently less than 10 years) also help ensure Estia meets the Government's accreditation and compliance requirements while keeping maintenance costs relatively low.

92% single rooms

Less than 10 yrs old on average

- **High socio-economic locations**: Estia's facilities are mainly located in metropolitan areas featuring a high concentration of residents with above-average socio-economic status. This is advantageous as wealthier residents generally have a higher capacity to pay for extra/complementary services (ie Extra Services). Approximately 85% of Estia's facilities are located in metropolitan areas (including those yet to be settled). A detailed list of Estia's facilities is set out in Appendix B.

Located in wealthier areas

- **Focus on high care services**: Estia's facilities are set-up to serve higher and more complex care services which is a positive given these services receive a higher rate of funding from the Government. Demand for these types of higher care services is likely to increase as the average age and frailty of incoming residents increases. The proportion of 'High Care' beds was 77% compared with an industry average of approximately 50%.

Focused on high care

Weighted to higher paying Extra Services

- **Ability to provide Extra Services**: Estia operates 1,224 dedicated Extra Services places (or 32% of total places) across its portfolio. This

[7] 2014 Report on the Funding and Financing of the Aged Care Industry, Aged Care Financing Authority

represents an opportunity for Estia to generate revenue from the provision of additional services. Estia is also well positioned to provide more Extra Services on a user pays basis as is allowed under the funding rules which came into effect from July 2014.

- **Geographically diversified, clustered locations**: Estia's facilities are located across four states. This geographic diversification gives it a greater opportunity to acquire and/or develop facilities in the more attractive (ie wealthy) socio economic regions across these states. However within the states Estia's facilities are often clustered together which allows the facilities to benefit from economies of scale at a regional level.

Clustering of sites ensures local economies of scale

- **Modern efficient layouts**: Estia has modern facilities featuring efficient layouts. This provides Estia with both flexibility when changing a facilities rooms' design (eg from 2/3-bed rooms to single rooms) and also the ability to optimise its staffing levels (ie ratios of staff per place/resident).

Modern faculties support operation efficiencies

The location and quality of Estia's portfolio should help it attract RAD (refundable accommodations bond) paying residents. This is a particularly important element of the business given the changes to Government regulations which allow providers to seek RADs from all residents from July 2014 (discussed in more detail below).

A strong reputation for care

Estia has established a comprehensive compliance program which has helped it to build a solid track record for adherence with the Government's accreditation standards. This process driven approach was common across the three major operations which make up Estia's group of facilities (ie Lasting Changes/Estia Health, Padman Health Care and Cook Care). As a result Estia's facilities generally enjoy a strong reputation for care.

Standardised systems applies across all facilities

The key tool Estia has developed is a clinical governance framework which is implemented across all of its facilities. This framework is designed to ensure Estia's facilities meet all 44 indicators set by the Australian Aged Care Quality Agency's (AACQA) legislated accreditation standards. Accreditation is given for periods of one to three years. Estia's clinical governance framework aims to ensure all 44 indicators and outcomes are achieved and Estia regularly audits itself to ensure its facilities are meeting these standards.

Ensures accreditation standards are consistently met

The reputation for quality care, along with active engagement with Aged Care Assessment Teams (ACAT), who assist residents requiring residential accommodation, explains the high levels of occupancy across Estia's mature facilities. Estia employs admissions managers and resident liaison officers to facilitate the placing of new residents.

Reputation supports occupancy…

Strong systems are also important given the relatively high level of staff turnover across the aged sector. Estia's staff turnover is typically well below industry levels across the bulk of its facilities. We attribute this lower turnover to the higher than market rates paid by Estia and the strong focus on patient care, both of which engender greater employee stability. This is also reflected in the relatively lower agency rates at Estia.

Low staff turnover

Centralised functions deliver economies of scale

At Estia, services including Finance, HR, IT, business development, procurement and facilities maintenance are centralised at either a state or national level. This ensures the group benefits from its relatively large scale and also ensures consistency across these services. The centralised functions also support the rapid integration of acquired facilities into the group without materially lifting overhead costs.

Rapid integration of acquisitions is reliant on centralised services and standardised procedures

Following the integration of the Cook and Padman acquisition the management team has bought all the operations onto single financial and payroll systems in late 2014. Management is confident it does not face the payroll issues disclosed by Japara in December 2014. The group expects to fully roll out its Clinical care IT system in the first half of calendar 2015. Currently this system is used across its Victorian operations.

Organic growth strategy

By our estimates the group should deliver mid to high single digit EBITDA growth even without acquisitions or development projects. The chief sources of organic growth include lifting occupancy at the group's facilities and increasing revenues per operating place day (POPD).

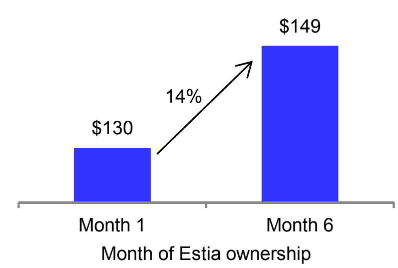
Mid to high single digit organic growth expected

Organic growth from lifting funding per day

The key opportunity to lift POPD is via the implementation of the Aged Care Funding Instrument (ACFI) rules. Estia has a strong track record for lifting its average ACFI rates to ensure the appropriate level of care is being provided.

Estia has been particularly good at lifting ACFI rates at newly acquired facilities. As depicted in Figure 67 Estia has been able to lift the average ACFI at a newly acquired facility by 14% within six months of taking over. We attribute this material uplift to the effective operating procedures Estia has in place.

Figure 67: ACFI per occupied patient day post acquisition



Source: Estia

In addition to ACFI payments we expect Estia to raise the proportion of fees it generates from Extra Service offerings over coming years. The July 2014 regulatory reforms provide a potential to boost revenues from the provision of additional services (including Extra Services). This opens up the opportunity to introduce pay per use services for the remaining two thirds of Estia's places which are not deemed 'Extra services'. Notably Estia has reported it currently provides some services for free, which under the new regulations it can now charge residents for. Estia expects to introduce fees for such services over time.

Below industry occupancy a key opportunity

Estia's occupancy below industry average

Occupancy at Estia's facilities is currently approximately 90% but this is weighed down by facilities in ramp-up stage and a small number of underperforming sites (see Figure 68). Excluding these sites Estia's occupancy is nearly 95%. However this represents an important opportunity for Estia given its occupancy is below the most recent industry data which shows average occupancy of 92.7% in FY13[8].

Reflects ramp-up sites

Figure 68: Estia occupancy – August 2014

Facilities	Sites	Occupancy
Mature facilities	34	94.7%
Ramp up sites	10	80.2%
Total	**44**	**90.0%**

Source: Estia

Lifting occupancy at ramp-up sites and more importantly the underperforming facilities is a key focus of the group in FY15. Estia plan to employ different strategies at each of its lower occupancy sites in order to deliver improvement. This includes revising down the advertised RAD prices to attract new residents.

Figure 69 shows the forecast lift in occupancy levels at Estia's sites, both the mature facilities and more importantly the 'ramp up' sites. The big lift forecasted for FY15 reflects the focused efforts by the management team to lift the performance of the lower occupancy sites. This uplift is an important driver of the strong lift in EBITDA Estia is forecasting in FY15.

Rising occupancy forecast in FY15

Figure 69: Historic and forecast improvement in occupancy

	FY12	FY13	FY14	FY15	CY15
Mature facilities	92.1%	93.2%	94.3%	96.1%	96.5%
Ramp-up sites	77.0%	73.0%	76.2%	91.4%	95.8%
Total	**87.3%**	**88.5%**	**89.3%**	**94.8%**	**96.3%**
Chg		**1.2%**	**0.8%**	**4.8%**	**1.5%**

Source: Estia

Expansion strategy – acquisitions and development

Estia plans to undertake brownfield expansion projects, seek acquisitions and corporate partnerships and to a lesser degree, consider greenfield development opportunities. Estia has acquired, or entered into, binding agreements to acquire fourteen facilities in approximately the last 18 months. It has also undertaken a number of successful brown and greenfield expansion projects.

We expect these growth plans to be principally funded from operating cashflows and the inflow of funds from residents paying RADs (bonds). Estia also has an established $130m debt facility which will allow it to take advantage of more sizeable opportunities should they arise. Based on expected cashflows Estia will be debt free.

Figure 70: Places added by Estia

	Acquisitions & Developments	Annual growth
FY12	290	14%
FY13	60	3%
FY14	631	26%
FY15F	725	26%
Total	**1,493**	**21%**

Source: Estia
Note: Annual figures ignore 112 places closed over the period. Total growth is CAGR including closures.

[8] Report on the Operation of the Aged Care Act 1997, 2013

Acquisition track record a key differentiator

Since 2008, Estia has completed acquisitions which have added 1,313 places to the group's portfolio, effectively doubling its size. Estia's appetite for acquisitions and ability to move quickly on transactions has positioned the group as a first port of call for many sellers of aged care assets. This is evidenced by the nine facilities the group has contracted to acquire in FY15 which will add 725 places once these deals are settled.

The company reports past acquisitions have generated strong returns reflecting the attractive acquisition prices and the implementation of operational improvements to quickly improve the facility earnings. As discussed earlier, Estia has been able to rapidly lift the ACFI rates at newly acquired facilities. It has also lifted occupancy levels and introduced operational efficiencies. Based on historic data, the group is typically able to double the EBIT contribution from each acquisition, often within six months.

Figure 72 shows some metrics from the acquisitions undertaken in the last couple of years. The relatively low EBITDA multiples reflect the rapid and effective integration of acquisitions by the group.

Figure 71: Estia's FY15 acquisitions

	Date operational	Places
Leopold	Oct-14	75
Albury	Oct-14	80
Wodonga	Oct-14	80
Salisbury	Dec-14	71
Wattle Glen	Dec-14	101
Prahran	Dec-14	58
Unnamed	Feb-15	120
Unnamed	Feb-15	60
Unnamed	Mar-15	80
Total		**725**

Source: Estia

Figure 72: Recent acquisitions

Acquisitions	Cost	EBITDA in 1st full yr	Post integration multiple	Places	Cost per Places
FY14	47.4	9.8	4.8	436	108.7
FY15	87.2	14.0	6.2	645	135.2

Source: Estia, Deutsche Bank

Estia acquisition processes well developed

Estia has developed a stream-lined approach to identifying then acting on acquisition opportunities. While the opportunity identification is undertaken at a national level the group has state and national teams involved at every remaining step.

Strong track record for rapid integration and EBIT uplift from acquisitions

Estia uses the criteria outlined in Figure 73 when considering an acquisition. From a financial perspective the analysis of data from previous acquisitions suggests the group has historically on average approximately doubled the EBIT from acquisitions, often within less than six months of the integration.

Figure 73: Estia's acquisition criteria

Property considerations	Financial considerations
▪ Modern facility	▪ Earnings uplift potential (occupancy, efficiency, daily rates)
▪ High proportion of single rooms	▪ Opportunity to lift RADs
▪ Good location / catchment areas	▪ Valuation
▪ Close proximity to existing facilities	
▪ Capable of supporting high care residents	
▪ Freehold property preferred	
▪ 45+ places	

Source: Estia

Brownfields investment opportunities

The expansion of existing facilities to add more places represents an attractive low risk growth opportunity for Estia, given the expected growth in demand. Estia has successfully added 90 places via brownfield developments in recent years. Apart from boosting revenue, additional places open up the opportunity to charge RADs which can be used to help fund the cost of the expansion.

Estia has provided examples of one completed brownfield project, Kensington Gardens in South Australia and two projects under construction, Kadina and Craigmore, which are due to be completed by December 2015. The capex associated with Kensington Gardens was $3.4m and Estia expects to charge RADs at 15 of the 24 new places raising over $5m based on average RAD prices of approximately $350,000 per place.

Including the projects already under construction, Kadina and Craigmore, Estia has identified brownfield development opportunities at eight facilities which combined would add approximately 203 new places and involve the redevelopment of 539 existing places.

Brownfield opportunities identified at 8 facilities

Greenfields investments will also be considered

While brownfield investments are preferable, Estia may consider greenfield investments where it sees sufficient demand but is unable to secure a suitable site. While Estia has added 588 places via greenfield projects in recent years, the management team has highlighted such projects are riskier and generally have longer pay back periods.

Greenfield are less preferable to brownfield due to higher risk profile…

The group has undertaken two greenfield projects in recent years, one at Epping (NSW, in Sydney's North Western suburbs) and Lockleys (SA, in Adelaide's inner west), both of which opened in December 2012. Estia has noted to date both of these projects are ahead of budget.

… only two greenfields undertaken in recent yrs

Corporate partnerships may open up new growth avenue

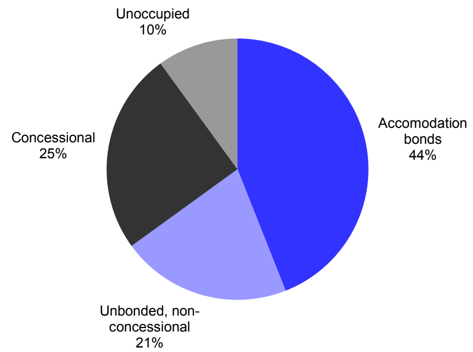
In addition to brownfield and greenfield expansion, Estia proposes to seek to grow the number of places it operates by pursuing opportunities for strategic alliances or other corporate partnerships. This would be for the purpose of acquiring interests in, or jointly operating residential aged care facilities.

For example Estia may seek to work with retirement village groups. Under such an arrangement Estia would likely operate residential aged care facilities within retirement villages.

RADs funding to support expansion strategy

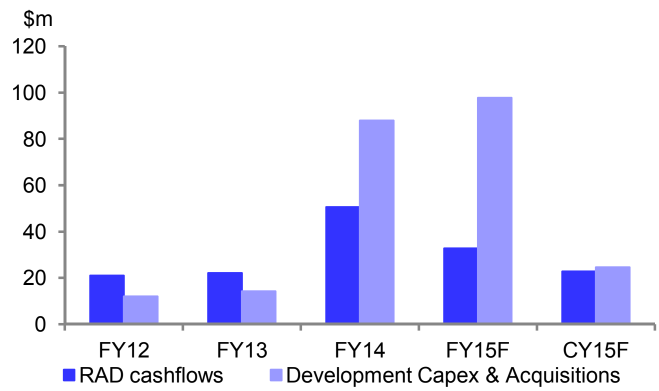
Estia expects to fund a large part of its expansion strategy from RADs paid by residents. This is the key opportunity which emerged from the July 2014 regulatory changes which allowed 'high care' residents to be charged a bond for the first time. Figure 74 shows only 44% of Estia's residents had paid a bond as at 30 June 2014. Figure 75 highlights the significant cashflows RADs can deliver for the group, which in many periods has fully covered Estia's investment in new places via acquisition and development projects.

Figure 74: Mix of residents – June 2014



Source: Estia

Figure 75: RAD cash flows v capex and acquisitions



Source: Estia

In addition to increasing the proportion of residents paying RADs Estia also expects to lift the value of the deposits its residents pay. Estia's current average RAD of $310,000 (FY15 YTD) is well below the industry average of $355,000. Notably the value of accommodation bonds rose by an average of 12% per annum from 2006 to 2014 according to the Aged Care Financing Authority.

Estia expects to lift the value of deposits its residents pay

Estia expects to lift the proportion of residents paying a RAD from 44% at the end of FY14 to nearly 50% by the end of FY15. This implies approximately 70% of non-concessional residents will be bond paying by the end of FY15. Estia expects this transition to contribute nearly $33m in cashflows during FY15 based on an expected average RAD of $238,000. Notably Estia has reported the average RAD received to date in FY15 has been $310,000 suggesting the positive cashflow from RADs received may exceed this forecast.

% of RADS will rise from 44% to 50% by the end of FY15…

…will contribute ~$33m in cashflows during FY15

Staffing and other costs

Estia employs approximately 3,700 workers, of which 67.5% are nurses and personal care attendants. Most of them are represented by the Health Services Union and the Australian Nursing Federation, and are subject to collective and bargaining agreements and awards. Estia's state human resources managers provide the staff with the mandatory and voluntary education programs for professional development and accreditation.

Estia employs 4,000 workers

Estia has a scalable organisational structure from national managers to state, regional and facility managers. Figure 77 shows Estia's organisational structure.

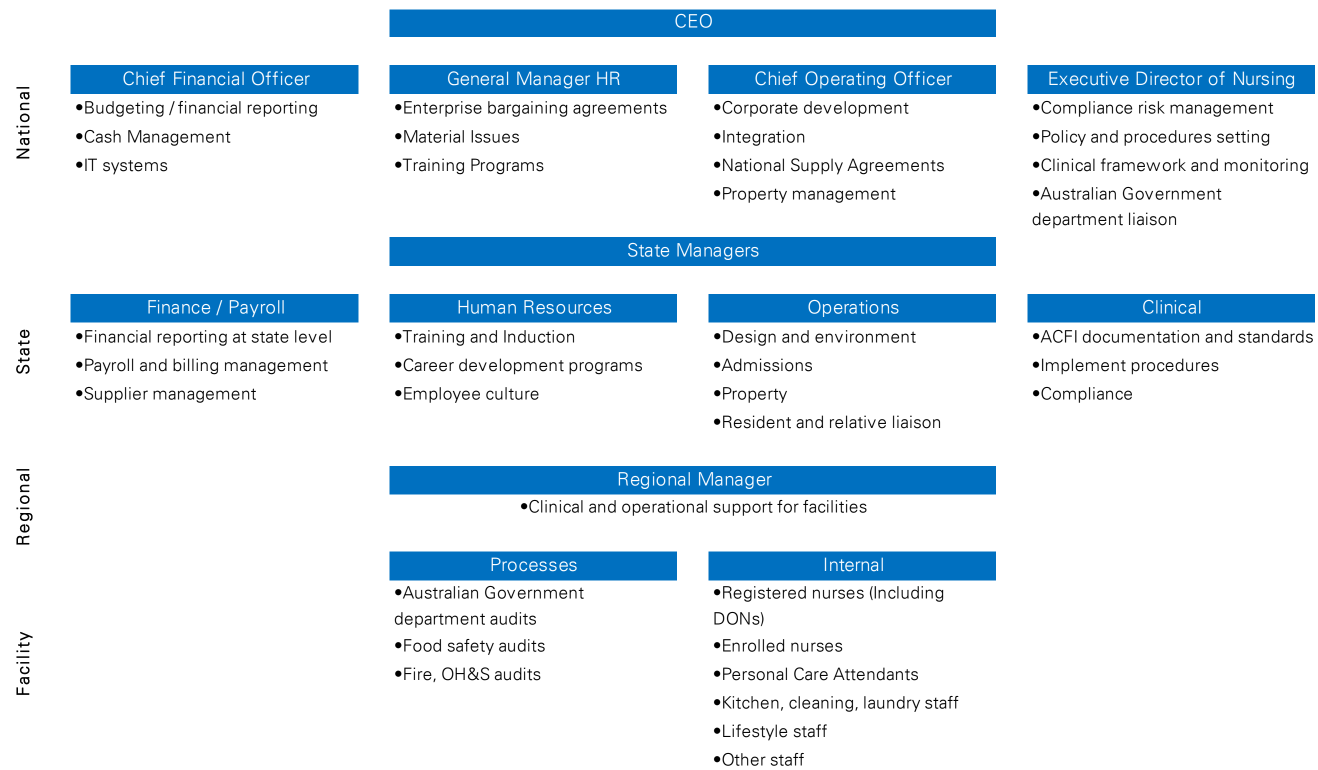
Figure 76: Costs as % revenue

	FY12	FY13	FY14	FY15F
Staff costs	61.5%	60.6%	61.2%	59.1%
Resident costs	5.2%	4.9%	5.4%	5.3%
Other costs	11.0%	12.2%	12.0%	11.9%

Source: Deutsche Bank

The economies of scale are expected to become apparent in FY15 when staff costs in particular are expected to rise more slowly than revenues. In part we attribute this improvement to the impact of the many bolt-on acquisitions in recent years which have been accommodated by the group's centralised service structure without raising costs.

Figure 77: Estia organisational structure



Source: Estia

Financial performance

The figures presented in this section comprise Estia management's pro-forma historical and our forecast estimates for the profit and loss statement, cash flow statement and balance sheet.

The pro-forma statements adjust statutory results to present historical and forecast performance on the same basis as the current business. In particular the accounts assume the three entities which were combined to form Estia – Lasting Changes Group, Padman and Cook Care – had operated as Estia since 1 July 2011. Single facility acquisitions or incremental operating places from developments are included from the date of completion of the acquisition or the date at which the relevant places became operational.

The proforma statements also remove the income from the dementia supplement (as it was cut in July 2014) and adjust for the additional costs expected to be incurred as a public company.

Profit and loss statement

Estia's pro-forma financial statements reveal a healthy business with strong revenue and EBITDA growth and no debt.

DB FY15 estimates in line with prospectus forecasts

Figure 78: Pro-forma historical and forecast profit and loss statement

P&L	FY2012	FY2013	FY2014	FY2015F	FY2016F	FY2017F
Total Revenue	**163.7**	**178.4**	**219.0**	**296.4**	**353.0**	**400.4**
growth		9.0%	22.8%	**35.3%**	19.1%	13.4%
Total costs	127.2	137.6	172.1	**226.2**	271.5	307.3
growth		8.2%	25.1%	**31.4%**	20.0%	13.2%
EBITDA	**36.5**	**40.8**	**46.9**	**70.2**	**81.6**	**93.0**
growth		11.8%	15.0%	**49.7%**	16.2%	14.1%
margin	**22.3%**	**22.9%**	**21.4%**	**23.7%**	**23.1%**	**23.2%**
D&A	7.6	7.0	8.5	**9.6**	10.8	12.2
EBIT	28.9	33.8	38.4	**60.6**	70.7	80.9
Net interest				**0.3**	0.5	0.4
Profit before tax				**60.9**	71.3	81.3
Tax expense				**-18.3**	-21.4	-24.4
NPAT				**42.6**	49.9	56.9

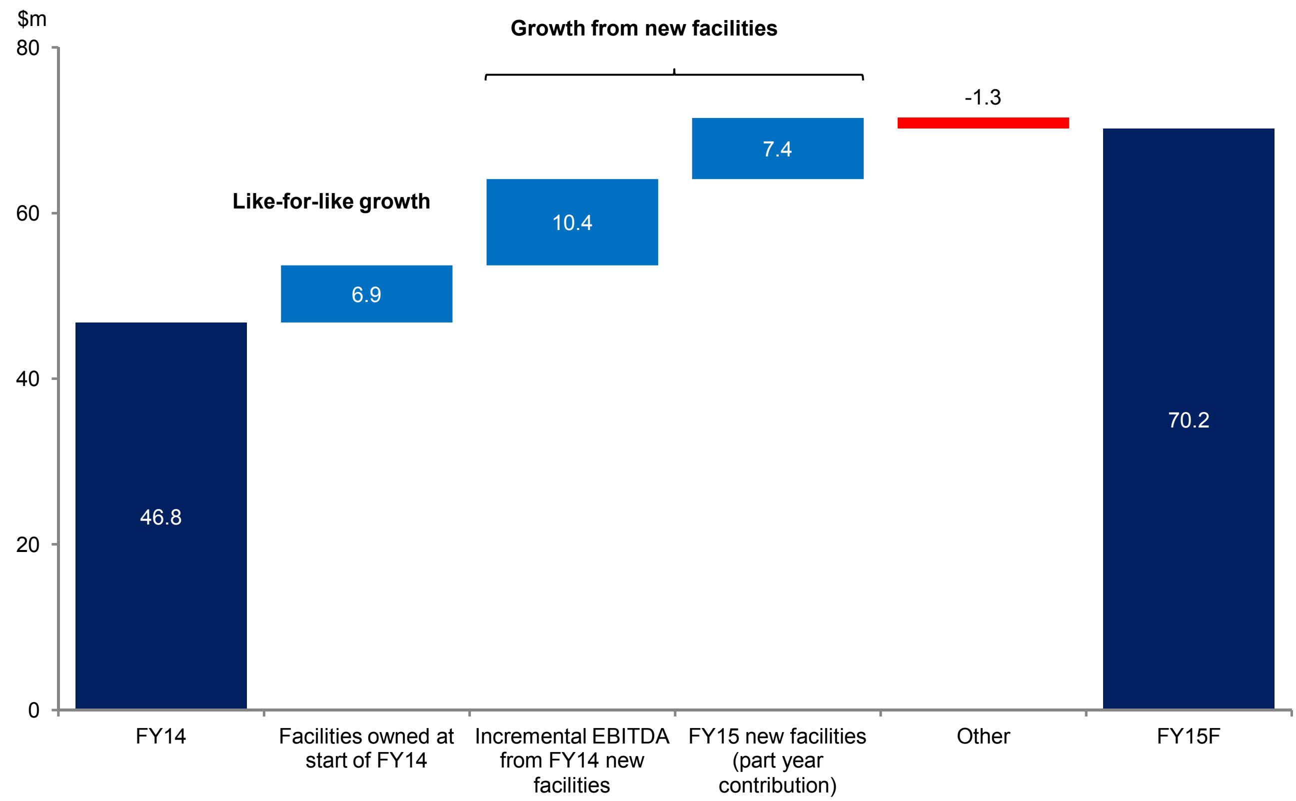
Source: Deutsche Bank, Estia

Key points we highlight from the profit and loss statement include:

- **Strong growth underpinned by acquisitions**: The strong uplift in revenues in large part reflects the contribution from the 21 facilities acquired or developed since FY12. Estia has a strong track record for quickly integrating acquisitions and boosting the contribution they make.
- **Occupancy and raising ACFI also support earnings growth**: The revenue growth is also supported by rising occupancy levels, especially in FY15. Revenues per occupied patient day have historically risen faster than inflation, reflecting the aging of the resident population and Estia's focus on ensuring it is paid appropriately for the care it provides. The softer growth in FY13 in part reflected the lack of ACFI indexation that year.
- **FY15 EBITDA guidance achievable**: Our forecasts are in-line with the prospectus forecasts.
- **Rapid growth limited margin expansion in historic period:** The slight deterioration in margins in FY14 reflects the ramp up of new developments and the integration of new acquisitions, some of which had low occupancy levels and many of which were margin dilutive. This obscured underlying margin expansion.
- **Focus on occupancy underlies FY15 margin expansion**: Margins in FY15 and CY15 are forecast to rise sharply underpinning very strong EBITDA growth. This reflects a sharp (500bps) rise in occupancy expected in FY15 as management has focused on lifting the resident numbers at facilities in ramp-up. This is also supported by ongoing scale and efficiency improvements.

The contributors to the earnings growth forecast in FY15 are illustrated below.

Figure 79: Lift in EBITDA between FY14 and FY15F



Source: Estia
Note: Other reflects the impact of the closure of a facility, change in corporate costs and various pro forma adjustments including redundancy expenses, straight-line rental expense adjustment and inter-period adjustments.

Per operating day metrics

With revenue per place day broadly in-line with historic periods the strong uplift in EBITDA margins forecast in FY15 is largely due to the subdued cost inflation. Notably Estia has lower staff cost per operating place day relative to its listed peers, both historically and in the forecast period.

FY15 margin uplift reflects cost leverage

Figure 80: Key per day operating metrics

FYE 30 Jun	FY2012	FY2013	FY2014	**FY2015F**	FY2016F	FY2017F
Per operating place day rates						
Revenue	$227	$237	$247	**$258**	$264	$274
Costs	$177	$182	$194	**$197**	$203	$211
EBITDA	$50	$55	$53	**$61**	$61	$64
Growth						
Revenue		4.4%	4.2%	**4.4%**	2.5%	3.8%
Costs		3.3%	6.6%	**1.3%**	3.3%	3.7%
EBITDA		8.3%	-3.7%	**16.0%**	0.3%	4.5%
Occupancy	**87.3%**	**88.5%**	**89.3%**	**94.8%**	**94.5%**	**94.7%**
Staff costs per day	$140	$143	$151	**$152**	$158	$164
growth		2.5%	5.6%	**0.7%**	3.5%	4.5%
Staff costs as % of revenue	**61.5%**	**60.6%**	**61.2%**	**59.1%**	**59.7%**	**59.8%**

Source: Deutsche Bank, Estia

Cash flow statement

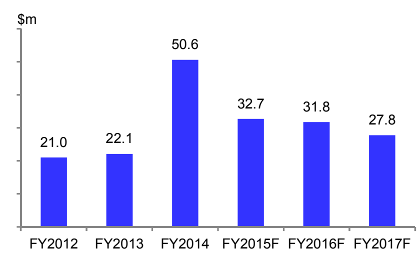
Estia's cashflow is set out below. Note the FY15 forecasts are the statutory rather than proforma numbers.

Figure 82: Pro forma historical and forecast cash flow

FYE 30 Jun ($m)	FY2012	FY2013	FY2014	**FY2015F**	FY2016F	FY2017F
EBITDA	36.5	40.8	46.9	**70.2**	81.6	93.0
Non-cash items / other	-3.2	-4.0	-5.0	**-39.7**	-4.0	-
Change in net working capital	2.0	-1.2	6.8	**11.6**	2.5	2.1
Operating cash flows	**35.3**	**35.6**	**48.7**	**42.1**	**80.1**	**95.2**
Net RAD receipts	**21.0**	**22.1**	**50.6**	**32.7**	**31.8**	**27.8**
Maintenance capex	-3.6	-2.7	-6.3	**-3.4**	-3.9	-4.2
Cash Ops pre Fin, int & tax	**52.7**	**55.0**	**93.0**	**71.4**	**108.0**	**118.7**
Upgrade & development capex	-0.8	-12.7	-32.3	**-9.0**	-18.6	-19.1
Acquisitions	-16.2	-6.7	-47.4	**-417.6**	-43.6	-46.4
Net Cash pre interest & tax	**35.7**	**35.6**	**13.3**	**-355.2**	**45.8**	**53.2**
Net interest paid				**-17.3**	0.5	0.4
Income tax paid				**-**	-20.3	-23.2
Equity Issue				**505.6**		
Debt raised/(repaid)				**-101.7**		
Net cash flows before divs				**31.4**	26.0	30.4
Dividends				**-**	-44.6	-53.1
Net cashflows				**31.4**	-18.6	-22.7

Source: Deutsche Bank, Estia

Figure 81: Net cash flows from RADs / Bonds



Source: Deutsche Bank, Estia

A key source of funding is the net cashflows from residents paying RADs (or accommodation bonds prior to July 2014). The strong uplift in FY14 bond inflows resulted from the opening of 213 places with the completion of three development projects. The inflows are expected to moderate in FY15 and CY15 with growth dependent upon the proportion of residents choosing this form of accommodation payment, the growth in average bond values and changes in occupancy.

Balance sheet

Estia will have a debt free balance sheet. The group has access to a $130m debt facility which we expect it will utilise if suitable acquisitions are found.

Figure 83: Balance sheet as at 30 June 2015

Cash and cash equivalents	116.4
Trade and other receivables	4.6
Other current assets	3.3
Total current assets	**124.3**
Property, plant and equipment	287.3
Goodwill	497.8
Other intangible assets	76.2
Other non-current assets	15.1
Total non-current assets	**876.4**
Total assets	**1,000.7**
Trade and other payables	17.8
Accommodation bonds (RADs)	300.7
Current borrowings	-
Provisions	30.1
Other current liabilities	1.5
Total current liabilities	**350.1**
Non-current borrowings	-
Provisions	3.8
Other non-current liabilities	11.7
Total non-current liabilities	**15.5**
Total liabilities	**365.6**
Net assets	**635.1**

Source: Deutsche Bank, Estia

Net current deficiency reflects RAD accounting: The Estia balance sheet shows a net current asset deficiency of $226m due to the RADs being recorded as a current liability. We do not view this a material risk given historic experience shows only a limited amount of RADs are likely to be required to be paid in the next 12 months and outgoing RADs are typically replaced by new RADs inflows of a higher amount. Furthermore the business generates sufficient operating cashflows to cover any RAD outflows.

Dividend policy

Pay-out of "up to 100% of NPAT" targeted

Estia intends to pay a final dividend in respect of the period from completion to 30 June 2015 of $23m. It is the Board's current intention to target a payout ratio of up to 100% of NPAT.

Beyond FY15 it is the intention of the Board to pay interim dividends and final dividends. It is expected that all future dividends will be franked to the maximum extent possible.

Valuation

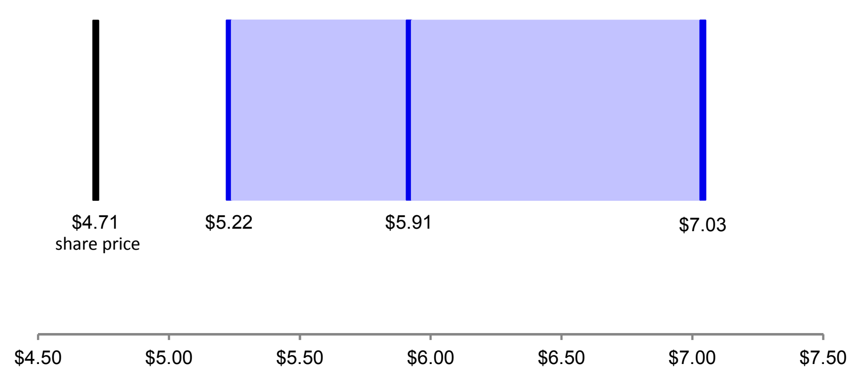
DB valuation range of $5.22 - $7.03

In our view DCF is the most logical methodology to value the aged care companies because it captures the value of accommodation bond (RADs) cash flows which do not impact on the P&L. However DCF is complicated by the need to capture medium term growth expectations generated by acquisitions and development projects.

In order to allow for this we have considered a range of possible outcomes with regard to the number of places acquired and developed per annum. This analysis implies a valuation range of $5.22 - 7.03 per share with a mid case of $5.91. The mid case equates to CY15 PE multiple of 22.7x. The mid case valuation is used as the basis of our price target for Estia of $5.90.

Figure 84: DCF valuation – high, low and mid cases

Assumptions	Low	Mid	High
Places acquired pa	100	**300**	500
Development places pa	25	**50**	75
Value	$5.22	**$5.91**	$7.03
Implied P/E CY15	20.0x	**22.7x**	27.0x



Source: Deutsche Bank

Discounted cash flow assumptions

- **Acquisitions** – In the low case we have assumed Estia will acquire 100 new places per annum. In the high case we assumed Estia acquires 500 places per annum. Our mid case assumptions of 300 places compares to Estia acquisition of 480 places in FY14 and 725 in FY15 (excluding the larger Padman and Cook deals).
- **Development** – In the low case we assumed Estia opens 25 places from brownfield and greenfield development projects per annum. In

the high case we assumed Estia develops 75 places. The mid case assumption of 50 places per annum is broadly consistent with the plans outlined in the prospectus to develop 203 places over the next few years.

- **RADs, acquisition and development costs:** We have assumed average RAD values and the acquisition prices per place appreciate at an equivalent rate. Staring at 6.5% in FY15 and moderating to 3.5% in FY19 the final forecast year. Development costs rise by 3.5% pa.
- **RAD uptake by residents** - We assumed 70% of Estia's unsupported residents continue to choose RADs under all scenarios and residents turnover stay for an average of three years.
- **Debt** - In the low and mid cases our analysis suggests Estia will not need to take on any debt. In the high case we assume Estia borrows a modest amount (circa $25m by FY19).

Figure 85: DCF valuation components

(%)			
DCF input assumptions			
WACC	10.1%	10-year government bond rate	5.00%
Cost of equity	10.1%	Market risk premium	6.0%
Cost of debt	3.5%	Company beta	0.85
Current debt/value ratio	-	Imputation adjustment factor	40.4%
Current equity/value ratio	100.0%	Number of forecast/horizon years	5 / 5
Corporate tax rate	30.0%	Horizon/perpetuity growth rate	7.0%
Valuation			
Present value of cash flows	1,064	Ordinary shares on issue (M)	180.1
Plus under-utilised assets, excess cash	0	Current share price	4.70
Entity value	1,064	**Value/share**	**5.91**
Less weighted average net debt	0	Price/NPV (x)	0.80
Total calculated value of extraordinary equity	**1,064**		

Source: Deutsche Bank Estimates

Our DCF valuation and WACC assume Estia remains largely ungeared (some debt is taken on in the high case scenario). However, we see potential for gearing to be added to support more aggressive acquisition scenarios which would increase our valuation. The company currently has a $130m debt facility in place to facilitate larger acquisitions.

Under the scenario where Estia makes no further acquisitions nor pursues any development projects, our valuation drops to $5.18.

Yield

The table below sets out the expected yield from Estia. This assumes a 100% payout which is the Estia board's intended target. The CY15 yield is on par with its two peers.

Figure 86: Estia's forecast dividend yield

Yield	FY15	CY15	FY16
Estia	2.7%	5.3%	5.9%

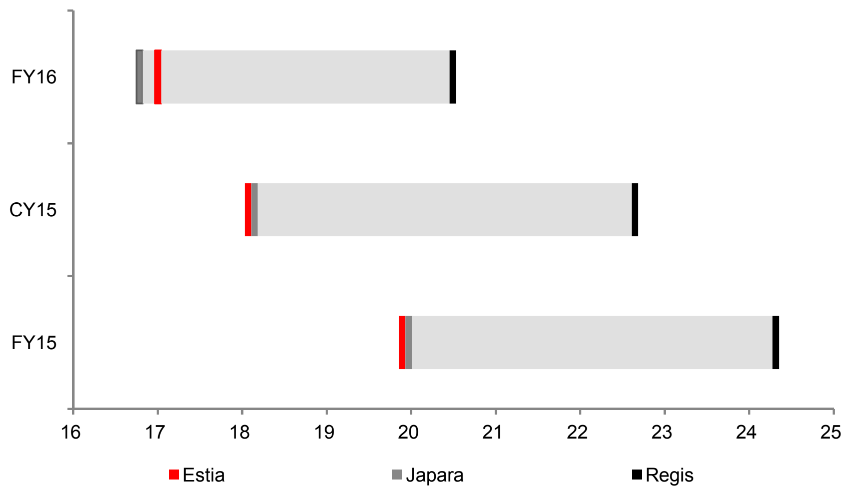
Source: Deutsche Bank

Earnings multiples

Earnings multiple valuation methods have some limitation as the P&L earnings measures don't capture the value of RAD inflows. On a multiple basis Estia appears relatively cheap compared to its listed peers, especially Regis.

Figure 87: P/E multiples

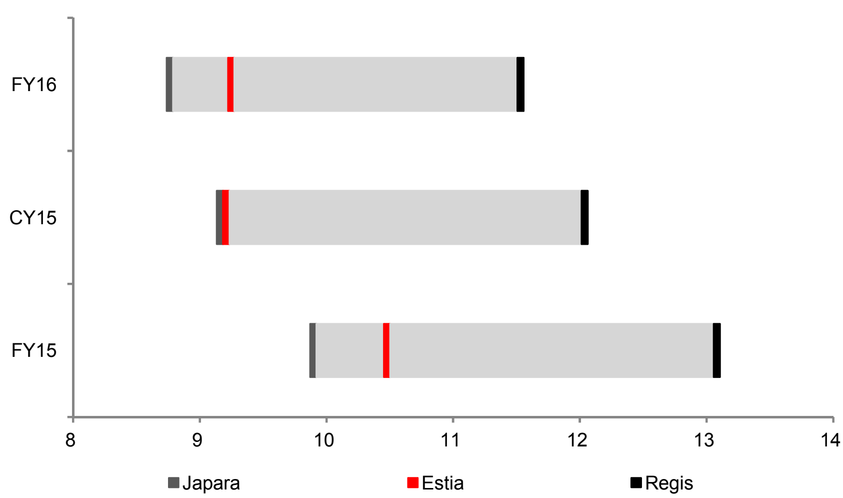
	FY15	CY15	FY16	Tgt Price CY 15
Estia	19.9x	18.0x	17.0x	22.6x



Source: Deutsche Bank

Figure 88: EV / EBITDA multiples

	FY15	CY15	FY16
Estia	10.5x	9.6x	9.2x



Source: Deutsche Bank

Free cashflow multiples

Finally we have presented free cash flow multiples (which capture the inflow from RADs) compared with the two listed peers. While this analysis highlights the relative value offered by Japara this is largely is skewed by the large uplift in RAD inflows forecast in FY15. As shown in Figure 27 we expect Japara's cashflows to decline in FY16 and FY17 as the rate of inflow from RADs moderates.

Figure 89: Free cashflow multiples

	FY15	FY16	**2yr ave**
Estia	8.8	7.8	**8.3**
Japara	4.1	5.0	**4.5**
Regis	9.8	5.9	**7.9**

Source: Deutsche Bank

Senior management

Directors

Patrick Grier, Chairman, Non-executive Director: Patrick was appointed Chairman and independent, non-executive director of Estia in November 2014. Patrick has over 20yrs of experience in the private healthcare industry. Prior to joining Estia Patrick was Managing Director and Chief Executive Officer of Ramsay Health Care Ltd for 14yrs (Patrick remains on the board of Ramsay as a non-executive director). Prior to this Patrick was with Hospital Corporation Australia. Patrick also served as both President and Chairman of the Australian Private Hospitals Association for over 10yrs. Patrick is also currently a director of Prime Media Group Ltd.

Paul Gregersen, Chief Executive Officer, Executive Director: Paul was appointed Chief Executive Officer in August 2014. Prior to joining Estia Paul was Managing Director of BUPA Aged Care Services for nearly 5yrs. Paul also spent ~12yrs with BUPA across the UK, Singapore, Australia and China. Paul has extensive experience advising the Government including acting as the inaugural chair of The Aged Care Guild and as an impendent expert for the Aged Care Financing Authority.

Peter Arvanitis, Non-executive Director: Peter is the founder and former Chief Executive Officer of Estia. Peter founded Lasting Changes in 2005. Prior to founding Estia, Peter founded and sold a number of businesses in the transport and property sector. Peter will remain as a non-executive Director to assist the Board with its long term objectives.

Norah Barlow, Non-executive Director: Norah was appointed as independent non-executive Director of Estia in November 2014. Prior to joining Estia Norah was Chief Executive Officer of Summerset in NZ for 13yrs. Norah was also president of the Retirement Villages Association of NZ for 7yrs until retiring from that position. Norah is also a director of Cigna Life Insurance Ltd, Cooks Global Food Group Ltd, Ingenia Communities Ltd (Australia) and Vigil Monitoring Ltd.

Andrew Harrison, Non-executive Director: Andrew was appointed as independent non-executive Director of Estia in November 2014. Andrew currently is a non-executive director of Burson Group Ltd. Andrew previously held roles as Chief Financial Officer of Seven Group Holdings, Group Finance Director of Landis + Gyr., and Chief Financial Officer and director of Alesco.

Management

Paul Gregersen: Refer to profile above.

Joe Genova, Chief Financial Officer: Joe joined Estia in 2014 as Chief Financial Officer. Prior to joining Estia Joe spent nine years primarily with BUPA Aged Care Services where he was a board member and Director of Finance. Joe was also a Director of Health, Ageing & Human Services at KPMG, and also held positions at Hollinger Inc in Canada as Managing Reporting Consultant, and as financial controller at Envoy Communications Incentives Inc/Communique Incentives Inc.

Nick Yannopoulos, Director, Strategy and Development: Nick joined Estia in 2011 and holds the position of Director, Risk and Quality. Prior to joining Estia, Nick ran a real estate practice for over 10yrs.

Ruvani De Silva, Director, Risk and Quality, Executive Director of Nursing: Ruvani joined Estia in 2010 and holds the position of Director, Risk and Quality. Ruvani is a registered nurse and has over 30yrs of experience in aged care, including several years as a Nurse Advisor to the Department of Health and Ageing.

Kate Sellick, Director, People and Communications: Kate joined Estia as Director of People and Communications in 2014. Prior to joining Estia, Kate was HR and Corporate Affairs Director at Bupa Aged Care Services Australia from 2007-2012. Kate also acted as strategic consultant during 2013 and 2014 at Opal, Uniting Care Ageing and Pulse Health.

Performance incentives

Estia's offers the following performance incentives to its senior management:

STI plan

The STI plan (STIP) provides Estia's CEO and other members of Estia's senior management with potential for a cash incentive payment calculated as a percentage of their annual fixed remuneration. This payment is conditional on achievement of certain financial and non-financial performance measures. While performance measures against each participant STI's are assessed with relative weighting tailored to a participant's role, as set by the Board, the key financial measures are as follows:

- **Financial measure for FY15**. Will be a comparison of Estia's actual FY15 EBITDA vs. FY15e EBITDA. Estia's forecast FY15 EBITDA is detailed in the Financial Statement section of this report.
- **Maximum incentive/STI**. Awarded to Estia's CEO, CFO and Director of Strategy and Development as follows:
  - CEO, maximum STI is 50%.
  - CFO and Director of Strategy and Development, maximum STI is 30%.

Performance is tested annually after the end of the relevant financial year, with all payments determined by the Nomination and Remuneration Committee and the Board, acting in their absolute discretion. Payments under the STIP will be made immediately in cash after the release of FY financial results to the ASX.

Payment to certain members of Estia's senior management and Estia's CEO, 25% of any payment will be deferred for a period of 12 months. Vesting of the deferred component is conditional on the participant remaining employed by Estia.

LTI plan

The long term incentive plant (LTIP) is for the grant of performance rights over shares and is available to any employee of Estia (at the Board's discretion). While Estia's CEO, and members of the senior management may be entitled to the LTIP, non-executive Directors are not entitled to participate.

It is intended that offers of the performance rights under LTIP will be made to senior management on or shortly after completion and going forward, on an annual basis.

Estia's CEO will not be offered any performance rights under the LTIP on completion, it is anticipated that the first offer will be made at Estia's FY15 AGM. At the time of completion, Joe Genova (CFO), Nick Yannopoulos (Director, Strategy and Development) will be offered performance rights under the LTIP with an aggregate value of face value of $204,000. The maximum aggregate number of performance rights offered to both of them will be determined by dividing $204,000 by the final price of the completion shares.

The Board has the discretion to set the terms and conditions of the performance rights under the LTIP, including vesting and different terms and conditions.

Performance rights under the LTIP vest in two tranches, each comprising 50% of the total number of performance rights, both subject to a relative TSR vesting condition, measured over the performance period, from approximately 8-December-2014 to 30-June-2017, a period of 31 months (Performance Period). Performance rights for each tranches are as follows:

- **First tranche**. Estia's relative TSR compared to a comparator group comprising companies in the S&P/ASX 200 Index.
- **Second tranche**. Estia's relative TSR compared to a comparator group comprising companies in the S&P/ASX Healthcare Index.

The percentage of the performance rights in each tranche that vest (if any) is based on Estia's TSR ranking against comparator group over the Performance Period, is set out in Figure 90 below.

Figure 90: Vesting of LTIP performance rights by tranche

Estia's TSR relative to the TSR of the relevant comparator group over the Performance Period	% of performance rights in the tranche that vest
Up to 50th percentile	Nil
Equal to the 50th percentile	50%
Greater than the 50th percentile but less than the 75th percentile	Pro-rata straight-line between 50% and 100%
Greater than or equal to the 75th percentile	100%

Any performance rights that have not vested at the end of the Performance Period will lapse immediately. There will be no re-testing.

Source: Estia

Performance rights under the LTIP lapse if: 1) the employment is ceased other than as a "good leaver", and 2) or terminated for cause "bad leaver", in each case unless the Board determines otherwise. In the case the person is a "good leaver", upon cessation of employment, performance rights will lapse according to a formula which takes into account the length of time the participant has held the rights and the performance period for the rights.

Risks

Company specific risk include

- **Merger group has limited track record.** The merger of the three founding aged care businesses – Lasting Changes/Estia Health, Padman Healthcare and Cook Care – occurred in July 2014. The historic financial results and investments in capacity expansion are based on pro forma accounts combining the results of the three separate businesses. The relatively short history as a combined business raises the risk of unforeseen operational issues arising from the integration of the operations. This is in addition to the acquisition risk arising from the large Padman Health Care and Cook Care deals.
- **Senior management's limited tenure.** The Estia CEO and CFO were appointed in August and September 2014 respectively. This followed the merger of the three founding aged care businesses in July 2014. While both individuals have extensive experience working in the aged care sector and working together, they are relatively new to the Estia business which raises the risk that the combined group's historic record is not a good guide to its future.
- **Environmental risk**. Estia recently acquired Southport Nursing Centre (as part of Cook Care portfolio) which is currently undergoing asbestos removal however this is covered under an indemnity from vendors of Cook Care. To the extent Estia hasn't identified environmental liabilities from vendors Estia would have to undertake remedial work at its own cost.

Other industry wide risks include

- **Regulatory and funding risk.** Given the highly regulated nature of the aged care industry and its heavy reliance on Government funds Estia faces regulatory and funding risk including: 1) policy changes which reduce or redirect funding, 2) restrictions on the use of RADs, 3) changes to the rules governing the allocation of approved places, and d) changes to accreditation standards and physical structure requirements.
- **Repayment of and value of RADs**: Fluctuations in general macro-economic and investment market conditions (including the housing market) may impact the value of bonds and RADs, which would impact on Estia's cashflows.
- **Clinical care and reputational risk**: Failure by Estia to meet clinical care requirements could damage Estia's reputation.
- **Occupancy level risks**: Factors such as industry deregulation, decline in referrals and increased competition could reduce occupancy levels impacting on earnings.
- **Acquisition related risk**. Notwithstanding extensive due diligence relating to acquisitions there is the possibility material issues may not have been identified.

Rating
Hold

Australasia
Australia

Health & Biotechnology

Company
Japara Healthcare

Reuters	Bloomberg
JHC.AX	JHC AU

Price at 21 Jan 2015	2.00
Price target - 12mth	2.12
52 week range (AUD)	2.72 - 1.87
ALL ORDINARIES	5,398

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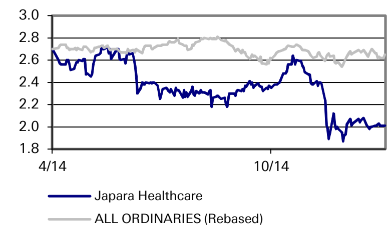
Initiating with a Hold Rating

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-1.0	-16.0	–
ALL ORDINARIES	0.6	0.7	1.3

Source: Deutsche Bank

Valuation appeal but systems issues and earning risk keep us cautious

Japara has faced a number of challenges since listing including two funding changes and a payroll system issue. Despite these headwinds and the slightly soft first result, management has maintained its FY15 earnings guidance. Given these challenges and limited upside to our price target (based on the low end of our DCF valuation) we have initiated with a Hold rating. Price target $2.12.

FY15 estimates just below prospectus forecast

We expect Japara to report a 20%+ uplift in proforma EBITDA in FY15 as revenues are boosted by the recent Whelan acquisition and the opening of three new facilities late in FY14. However our EBITDA forecasts fall ~2% short of the group's guidance reflecting some caution over occupancy levels and the impact of the recent payroll issues. While we expect EBITDA growth to moderate in FY16 we see upside to our low double digit growth forecasts and free cashflow estimates if Japara is able to deliver on its ambitious development pipeline or make multiple bolt-on acquisitions.

$2.12 price target offers modest upside to current share price

We have used the bottom end of our DCF range of $2.12 (WACC 10.1%, 5.0% bond yield, Beta 0.85, and TY growth of 7%) to set our price target to reflect the risks raised by the payroll issue (see page 80 for more detail). The key downside risks are: 1) change to Govt regulation and/or funding, 2) risk to RAD values, and 3) increased competition. Key upside risks are: 1) earnings upside from development of brownfield and greenfield investments, 2) further acquisition and development opportunities, and 3) larger RAD inflows.

Forecasts And Ratios

Year End Jun 30	2015A	2016E	2017E	2018E
Sales (AUDm)	290	321	362	407
EBITDA (AUDm)	49	57	63	70
Net Profit (AUDm)	27	31	35	39
EPS (AUD)	0.10	0.12	0.13	0.15
% Change	–	–	–	–
EPS Growth (%)	–	17.7	10.7	12.3
PER (x)	22.4	16.7	15.1	13.5
EV/EBITDA (x)	11.7	8.7	7.9	7.1
DPS (net) (AUD)	0.10	0.12	0.13	0.15
Yield (net) (%)	4.6	6.0	6.5	7.5
Franking (%)	100	100	100	100

Source: Deutsche Bank estimates, company data

[1] Pre-exceptionals/extraordinaries
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated:22 January 2015

Running the numbers

Australasia

Australia

Health & Biotechnology

Japara Healthcare

Reuters: JHC.AX Bloomberg: JHC AU

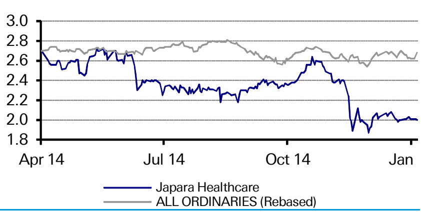
Hold

Price (21 Jan 15)	AUD 2.00
Target Price	AUD 2.12
52 Week range	AUD 1.87 - 2.72
Market Cap (m)	AUDm 526
	USDm 428

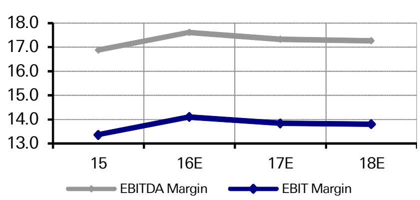
Company Profile

Japara Healthcare owns a network of aged care facilities providing a range of services to its residents across Victoria, New South Wales, South Australia and Tasmania. Its services include: 1) clinical care services (incl. 24 hr nursing care, wound management, physio and occupational therapy, etc.), 2) daily living services (incl. laundry, meals, etc.), 3) accommodation services (single to shared rooms), and 4) extra services.

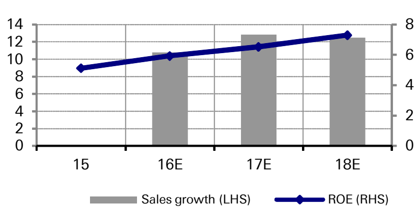
Price Performance



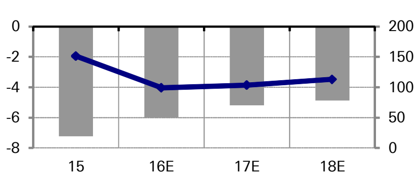
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 30-Jun	2015	2016E	2017E	2018E
Financial Summary				
DB EPS (AUD)	0.10	0.12	0.13	0.15
Reported EPS (AUD)	0.10	0.12	0.13	0.15
DPS (AUD)	0.11	0.12	0.13	0.15
BVPS (AUD)	2.01	2.02	2.03	2.04
Valuation Metrics				
Price/Sales (x)	2.1	1.6	1.5	1.3
P/E (DB) (x)	22.4	16.7	15.1	13.5
P/E (Reported) (x)	22.0	16.7	15.1	13.5
P/BV (x)	1.0	1.0	1.0	1.0
FCF yield (%)	13.9	8.3	9.9	11.1
Dividend yield (%)	4.6	6.0	6.5	7.5
EV/Sales	2.0	1.5	1.4	1.2
EV/EBITDA	11.7	8.7	7.9	7.1
EV/EBIT	14.8	10.8	9.9	8.9
Income Statement (AUDm)				
Sales	290	321	362	407
EBITDA	49	57	63	70
EBIT	39	45	50	56
Pre-tax profit	39	45	50	56
Net income	27	31	35	39
Cash Flow (AUDm)				
Cash flow from operations	36	43	49	55
Net Capex	47	0	3	3
Free cash flow	83	44	52	58
Equity raised/(bought back)	0	0	0	0
Dividends paid	-12	-28	-33	-36
Net inc/(dec) in borrowings	0	0	0	0
Other investing/financing cash flows	-45	-22	-23	-24
Net cash flow	26	-6	-4	-2
Change in working capital	*0*	*1*	*1*	*1*
Balance Sheet (AUDm)				
Cash and cash equivalents	54	48	44	42
Property, plant & equipment	391	443	496	541
Goodwill	32	32	32	32
Other assets	425	438	451	465
Total assets	902	961	1,023	1,079
Debt	16	16	16	16
Other liabilities	358	414	473	526
Total liabilities	374	429	489	542
Total shareholders' equity	529	532	534	537
Net debt	*-38*	*-32*	*-28*	*-26*
Key Company Metrics				
Sales growth (%)	nm	10.8	12.8	12.5
DB EPS growth (%)	na	17.7	10.7	12.3
Payout ratio (%)	101.5	100.5	98.4	101.1
EBITDA Margin (%)	16.9	17.6	17.3	17.3
EBIT Margin (%)	13.4	14.1	13.8	13.8
ROE (%)	5.1	5.9	6.5	7.3
Net debt/equity (%)	-7.2	-6.0	-5.2	-4.9
Net interest cover (x)	151.3	99.0	103.6	113.0
DuPont Analysis				
EBIT margin (%)	13.4	14.1	13.8	13.8
x Asset turnover (x)	0.3	0.3	0.4	0.4
x Financial cost ratio (x)	1.0	1.0	1.0	1.0
x Tax and other effects (x)	0.7	0.7	0.7	0.7
= ROA (post tax) (%)	3.2	3.4	3.5	3.7
x Financial leverage (x)	1.6	1.8	1.9	2.0
= ROE (%)	5.2	5.9	6.5	7.3
annual growth (%)	*na*	*13.6*	*10.2*	*11.7*
x NTA/share (avg) (x)	2.0	2.0	2.0	2.0
= Reported EPS	0.10	0.12	0.13	0.15
annual growth (%)	*na*	*15.5*	*10.7*	*12.3*

Source: Company data, Deutsche Bank estimates

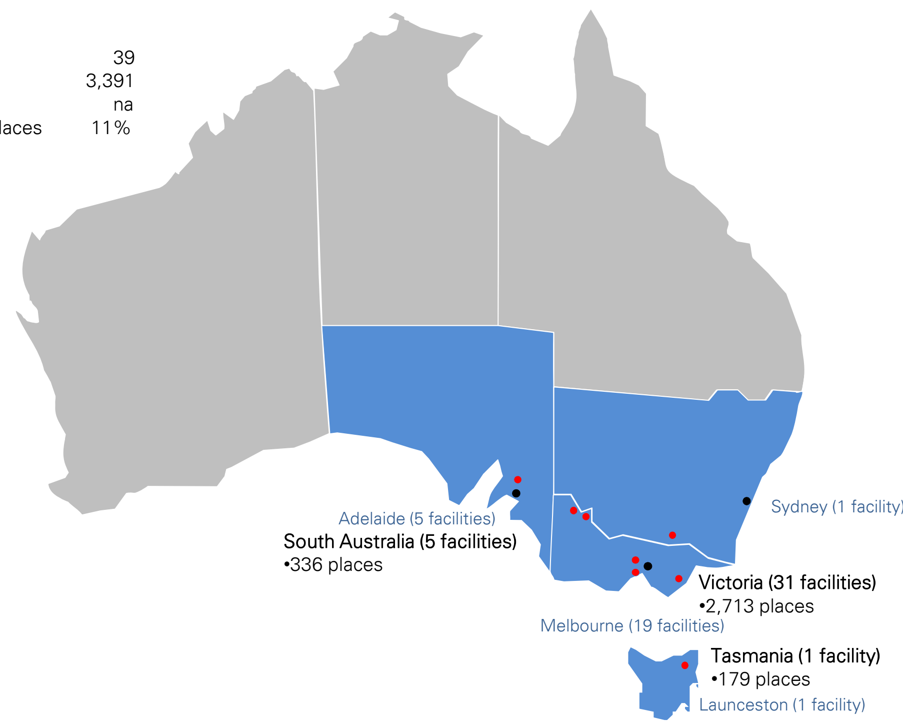
Japara Healthcare

Company description

Japara was founded in 2005 and listed in 2014. It is one of the largest residential aged care operators in Australia in terms of number of places. The company currently operates 3,391 places (total operational places 3,172) and 39 ILUs across 39 aged care facilities located in Victoria, New South Wales, South Australia and Tasmania.

Figure 91: Japara map of facility locations

Summary	
Number of facilities	39
Number of places	3,391
% of single rooms	na
% of Dedicated Extra Service places	11%



Source: Japara, Deutsche Bank

Japara's key portfolio statistics are listed in Figure 92.

Figure 92: Key Portfolio Statistics

Portfolio attributes	Facilities /Places	Proportion
Number of facilities (owned and contacted to be acquired)	39	
Number of in metro areas	25	64%
Number of freehold facilities	36	92%
Total places	3,391	
Operational places	3,172	94%
Extra service status	329	11%
Total portfolio occupancy – FY15 estimate		94%
Proportion residents paying RADs/Bonds - 30 Jun 2014		35%

Source: Japara, Deutsche Bank

After the float the CEO held 6% and the founders retained 8%. This stock is subject to escrow conditions.

Business model

Japara owns and operates high quality aged care facilities in catchment areas where demand from individuals whom are able to self fund their aged care is strong. Japara's portfolio and the management team's operational expertise have allowed it to historically generate operational metrics and earnings well above industry average.

Japara's business/operating strategy focuses on five core operational areas:

- **Facilities**: High quality facilities equipped with a full spectrum of care to meet Resident requirements.
- **Internal processes**: Funding application and general management systems to ensure appropriate resident classification and internal processes to ensure receipt of all entitled Government funding.
- **Human resources**: Appropriate staffing and education through:
  - Minimizing reliance on external agency staff.
  - Retention of superior talent at all employee levels.
  - Matching appropriate mix of staff with care needs of residents.
- **Cost management**: Rigorous cost controls and leveraging economies of scale via bulk purchasing arrangements and internalisation of functions such as catering and laundry costs.
- **Corporate governance**: In order to minimize operational and compliance risk, implementation of rigorous cost controls and leveraging economies of scale, via bulk purchasing arrangements.

A high quality diversified portfolio

Japara operates a diversified well-established portfolio of residential aged care facilities, equipped to provide a full continuum of high quality care to residents. The quality of these facilities allows it to attract the upper echelon of residents which supports the generation of strong revenues from complementary services in addition to the standard clinical care payments. Japara owns the freehold title to the majority of its facilities and has implemented programs to ensure the long-term lifecycle of assets is maintained.

Internal systems

Japara has a robust infrastructure and compliance platform which is central to Japara's ambition to increase its portfolio to ~5,000 places over the medium term. Over the last five years Japara has maintained 100% accreditation across all of its facilities.

Most recently at its AGM Japara noted 8 facilities were reassessed during FY14 and all of their facilities were accredited on a rolling 3 year basis and had received a perfect score. This demonstrates the effectiveness of Japara's systems for ensuring regulatory compliance and managing accreditation assessments.

However despite Japara's investment in systems the group announced late last year a review of its payroll systems revealed it had under paid staff $5m although only $0.4m relates to the current financial year. In addition the company reported high agency staffing levels in the FY14 year which was blamed on an influenza outbreak.

These issues suggest further investment in systems will likely be needed in coming years. It also leads us to be cautious with regard to Japara's ability to rapidly integrate acquisitions.

Organic growth strategy

Japara plans to grow both organically via lifting its revenue generated per day and also occupancy rates. It also plans to continue to expand via acquisitions and development projects.

Organic growth via lifting revenue per occupied place day

Japara achieved ACFI funding of $146 per day per place which was above the industry average of ~$125 in FY13. However at its 2014 AGM Japara noted its underlying ACFI rate for new residents was marginally below expectations. We expect Japara to maintain its ACFI rates at well above industry averages via ongoing resident reassessments to better align ACFI funding with resident acuity levels. We also expect the group to boost revenue through offering additional services to residents (eg wellbeing and lifestyle services).

Occupancy levels

Japara has consistently maintained above industry average occupancy levels which it attributes to the high standard of resident care across the broad spectrum of aged care services it offers. However Japara reported its occupancy uplift was slower than expectations in 2H14 due to the influenza outbreak. We are expecting occupancy levels to remain relatively stable over the next few years despite the addition of places from acquisitions and development projects.

Figure 93: Historic and forecast improvement in occupancy

	FY12	FY13	FY14	FY15
Total	94.7%	94.4%	93.9%	93.2%
Chg		-0.3%	-0.5%	-0.8%

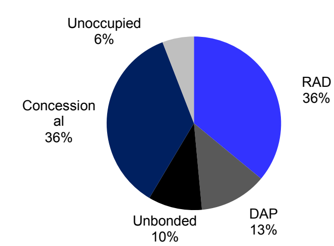
Source: Japara, Deutsche Bank

Rising accommodation payments

Japara expects to boost the level of accommodation payments post the introduction of the LLLB reforms. Key sources of uplift include:

- **RAD/DAP payments**: Introduction of RAD/DAP payments at places which were previous unbounded as residents turn over. In particular Japara expects the proportion of concessional residents to decline as a greater proportion pay RADs/DAPs.
- **Govt Accommodation Supplement**: The higher accommodation supplement for new or significantly refurbished residential aged care facilities allows providers to access payments for concessional residents at level which equates to a RAD of almost $300k.

Figure 94: Mix of residents – FY15



Source: Japara, Deutsche Bank

Expansion strategy – acquisitions and development

Japara's expansion strategy also involves both the acquisition of existing aged care facilities as well as brownfield developments. Japara has successfully implemented this strategy over the last five years and has undertaken six acquisitions and completed three brownfield developments increasing its portfolio by over 400 places.

Acquisition processes

When looking for potential acquisitions Japara has a strict investment criteria and evaluates the following:

- **Lifecycle/age of the facility**: Facilities with a minimum 15 year economic life.
- **Demand for aged care**: Facilities located in areas with unmet demand. This is determined through the Japara research index (an index which measures supply versus demand of existing aged care facilities in the LGA).
- **Growth potential of facilities**: Facilities which provide potential for long term growth from income and bonds.
- **Cash flow**: Facilities that have a high operational income flow.
- **Potential for value creation**: Facilities that provide an opportunity for Japara to execute value enhancement and asset management strategies.

Recent acquisitions

- **Whelan Care, Adelaide**: Japara's latest acquisition was of the Whelan Care portfolio, completed last October. This acquisition added 258 places and 41 Independent Living Apartments (ILAs). While this acquisition had a bond/RAD liability of $22.5m and resident loans (applicable to ILAs) of $7m, the company sees potential to lift the level of RAD's by ~$15m over the next three years.

Extensive brownfield development pipeline

One of Japara's key growth strategies is brownfield development. Japara has two types of brownfield developments:

- **Replacement of existing facilities**: This includes the knockdown and building of new facilities which are intended to replace the existing ones.
- **Expansion of existing facilities**: This includes construction of additional rooms, or conversion of rooms from one service type to another (ie low to high care).

There are currently 690 additional places currently underway or planned from brownfield developments. A number of Japara's recently completed and also planned phase I and II brownfield projects are listed in Figure 95 over the page. The three brownfield projects completed in FY14 added 128 places and according to comments at its AGM, new resident intake has been above initial expectations as were the accommodation contributions from DAPs and RADs.

Figure 95: Japara's recently completed and planned phase I and phase II projects

Site	Proposed development	Project status	Expected completion date
Phase I brownfield projects			
Millward	Extension 70 place extension	Commenced Sep-12	Complete (added 63 new places)
Mirridong	Extension 30 place extension and 14 place conversion	Commenced Feb-13	Complete
Albury	Replacement 90 place new build	Commenced Feb-13	Complete
Kelaston	Extension 32 place extension	Commenced Mar-14	Apr-15
Bayview	Extension 30 place extension, 10 place refurbishment, 20 place conversion	Planned to commence May-14	Jul-15
Central Park	Extension 25 place extension and conversion	Planned to commence Jul-14	Aug-15
Tamar Park	Replacement 75 place new build	Planned to commence Jul-15	Jun-16
Yarra West	Replacement 90 place new build	Planned to commence Jul-15	Sep-16
Phase II brownfield projects			
George Vowell	Extension 30 place extension, 10 place refurbishment, 20 place conversion	Planned to commence Jun-15	Sep-16
Hallam	Extension 30 place extension, 10 place refurbishment, 20 place conversion	Planned to commence Jun-15	Sep-16
St Judes	Extension 10 place refurbishment, 20 place conversion	Planned to commence Jun-15	Nov-16
Bayview Gardens	Replacement 90 place new build	Planned to commence Feb-16	Apr-17
Kiverton Park	Replacement 90 place new build	Planned to commence Feb-16	Apr-17
Capel Sands	Replacement 30 place extension	Planned to commence Mar-16	Apr-17
Lower Plenty Garden Views	Replacement 30 place extension	Planned to commence Jun-16	Aug-17

Source: Japara

Greenfields developments

Greenfield developments also play a major role in Japara's growth strategy. At its AGM, Japara noted it is planning 500 additional places over the next five years from greenfield developments. Future greenfield developments include:

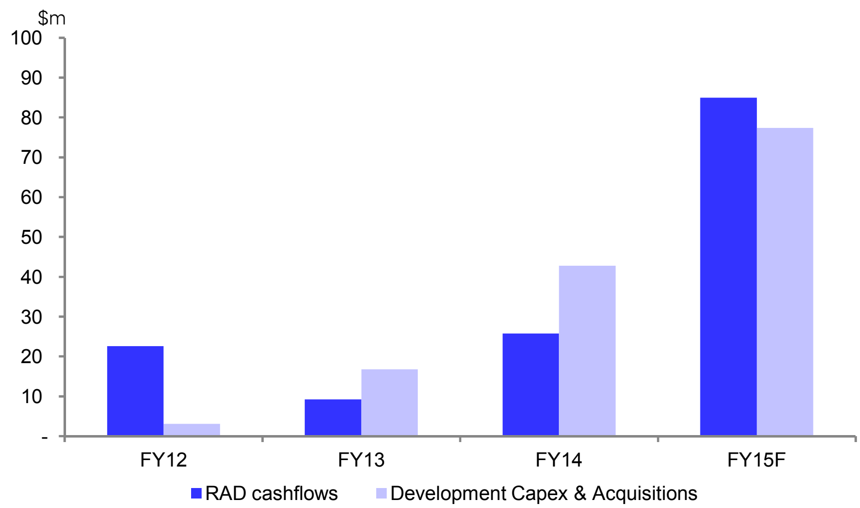
- **Tasmania, Victoria**. Proposed development of 75 places.
- **Victoria, Glen Waverley**. Proposed development of a minimum of 65 places

RADs funding and expansion strategy

Historically Japara has employed a conservative bond accommodation regime with the average value of accommodation bonds only ~50% of the median house price in the area. In FY13 its average bond value of $236k was below the industry average of $276k.

However the group has forecast a large uplift in cash inflows from bonds during FY15 as a growing proportion of residents are charged for their accommodation. As shown in Figure 120 Japara's expansionary spending is likely to be fully funded by inflows from RADs. While we expect the level of inflows to moderate in FY16 Japara's expansions plans should still largely by financed by RAD inflows.

Figure 96: RAD cash flows v capex and acquisitions



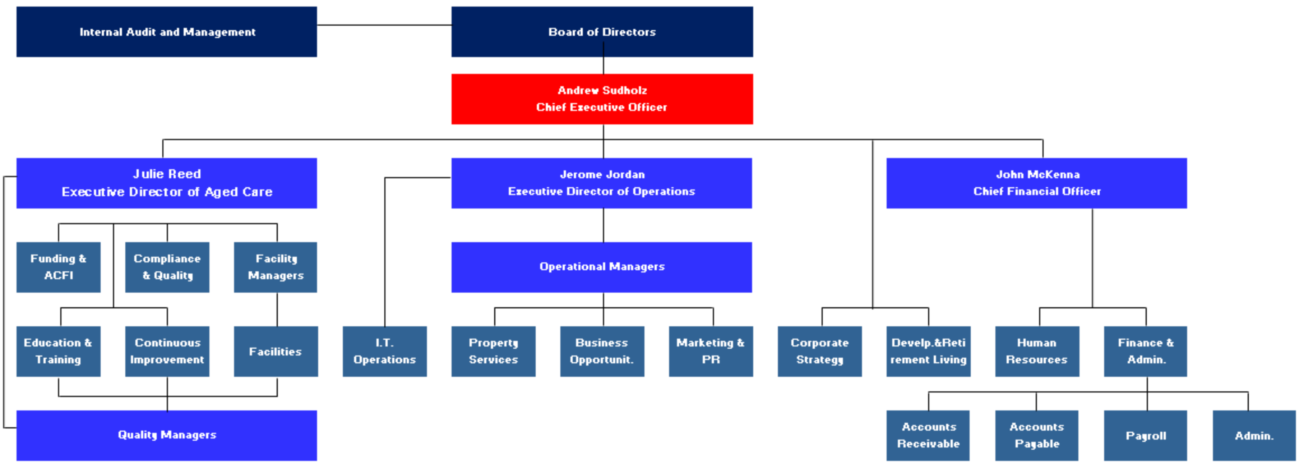
Source: Japara

Staffing and other costs

Japara has more than 3,500 full time, part time and casual employees across its facilities whom are led by an experienced management team (Japara's organisational structure is listed in Figure 97).

Given its large number of employees, one of its key costs relates to labor (~65% of total revenue for FY13). Its remaining costs relate to medical supplies, catering, cleaning, consumables, repairs/maintenance, energy, utilities and administration corporate costs.

Figure 97: Japara's organisational structure



Source: Japara, Deutsche Bank

Financial statements

Profit and loss statement

Japara's pro-forma financial statements reveal a business with lower EBITDA margins than its listed peers. However it offers an attractive growth profile supported by its recent acquisition of Whelan Care and its solid development pipeline.

DB EBITDA estimate ~$49m slightly below management guidance of $50m

Figure 98: Pro-forma historical and forecast profit and loss statement

P&L	FY2012	FY2013	FY2014	FY2015F	FY2016F	FY2017F
Total Revenue	**221.8**	**229.9**	**245.0**	**289.8**	**321.1**	**362.3**
growth		3.7%	6.6%	**18.3%**	10.8%	12.8%
Total costs	176.0	188.1	205.0	**240.4**	264.5	299.5
growth		6.9%	9.0%	**17.3%**	10.0%	13.2%
EBITDA	**45.8**	**41.8**	**40.0**	**49.4**	**56.6**	**62.8**
growth		-8.7%	-4.3%	**23.6%**	14.4%	11.0%
margin	**20.6%**	**18.2%**	**16.3%**	**17.1%**	**17.6%**	**17.3%**
D&A	7.7	8.4	9.0	**10.2**	11.3	12.7
EBIT	38.1	33.4	31.0	**39.2**	45.3	50.1
Net interest				**-0.3**	-0.4	-0.4
Profit before tax				**39.0**	44.9	49.7
Tax expense				**-11.8**	-13.5	-14.9
NPAT				**27.2**	**31.4**	**34.8**

Source: Deutsche Bank, Japara

Key points we highlight from the profit and loss statement include:

- **Growth supported by acquisitions and development projects**: The strong lift in forecast revenues in FY15 reflects the contribution from the brownfield development projects which were completed in FY14 (128 places added) and the acquisition of Whelan Health (258 places). While the adverse funding changes during FY14 (lost payroll tax and dementia supplements) are a head wind our revenue forecasts are ahead of the prospectus forecasts largely due to the Whelan acquisition.
- **Funding cuts and payroll issue headwinds for FY15**: Japara's FY14 result fell just short of its proforma prospectus forecasts due to slower than expected occupancy uplift. However at its AGM the company reported occupancy has been stable in FY15 and guided to EBITDA of $50.3m, in-line with its proforma prospectus forecast adjusted for the Whelan acquisition. Our forecast of $49.5m is ~2% below this guidance due to concerns over the funding headwinds and the payroll issue the company announced last December.
- **Margin expected to lift in FY15:** We expect EBITDA margins to rise by ~75bps in FY15 despite the tougher funding environment and the negative trend since FY13. This compares with the prospectus forecasts which assumed over 200bps of margin expansion.

Per operating day metrics

Japara's EBITDA margin gains in FY15 reflect slightly stronger revenue growth than costs during FY15. The group should also benefit from a slight rise in occupancy. Notably Japara's wage costs per operating place day are materially higher than those reported by Estia and Regis.

Figure 99: Key operating metrics

FYE 30 Jun	FY2012	FY2013	FY2014	**FY2015F**	FY2016F	FY2017F
Per operating place day rates						
Revenue	$234	$242	$250	**$253**	$260	$268
Costs	$186	$198	$209	**$208**	$214	$222
EBITDA	$48	$44	$41	**$45**	$46	$46
Growth						
Revenue		3.4%	3.3%	**1.2%**	3.0%	3.0%
Costs		6.5%	5.6%	**-0.6%**	3.3%	3.3%
EBITDA		-8.9%	-7.3%	**10.8%**	1.5%	1.3%
Occupancy	**94.7%**	**94.4%**	**93.9%**	**94.1%**	**93.1%**	**93.1%**
Staff costs per day	$152	$160	$168	**$170**	$176	$183
growth		5.4%	4.6%	**1.5%**	3.5%	3.5%
Staff costs as % of revenue	**65.1%**	**66.4%**	**67.3%**	**67.8%**	**67.8%**	**68.1%**

Source: Deutsche Bank, Japara

Cash flow statement

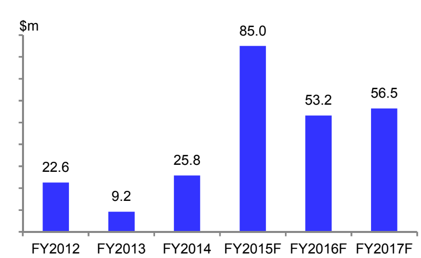
Japara's cashflow is set out below. Note the FY15 forecasts are the statutory rather than proforma numbers. The large lift in RADs cashflows in FY15 is attributable to the opening up of high care resident places to bonding as well as the opening of places from brownfields projects completed in FY14.

Figure 101: Pro forma historical and forecast cash flow

FYE 30 Jun ($m)	FY2012	FY2013	FY2014	**FY2015F**	FY2016F	FY2017F
EBITDA	45.8	41.8	40.0	**49.4**	56.6	62.8
Non-cash items / other	-2.7	-2.9	-3.2	**-2.2**	-1.0	-
Change in net working capital	4.4	5.0	-0.6	-	0.9	1.2
Operating cash flows	**47.5**	**43.9**	**36.2**	**47.2**	**56.5**	**64.0**
Net RAD receipts	**22.6**	**9.2**	**25.8**	**85.0**	**53.2**	**56.5**
Maintenance capex	-2.4	-3.1	-2.8	**-3.2**	-3.6	-4.0
Cash Ops pre Fin, int & tax	**67.7**	**50.0**	**59.2**	**129.0**	**106.1**	**116.5**
Upgrade & development capex	-3.1	-10.9	-28.4	**-25.8**	-44.2	-46.5
Acquisitions	-	-5.9	-14.4	**-44.7**	-21.8	-23.2
Net Cash pre interest & tax	**64.6**	**33.2**	**16.4**	**58.6**	**40.1**	**46.8**
Net interest paid				**0.1**	-0.4	-0.4
Income tax paid				**-11.8**	-12.8	-14.2
Equity Issue				**-**	-	-
Debt raised/(repaid)				**-**	-	-
Net cash flows before divs				**46.9**	26.9	32.3
Dividends				**-12.4**	-28.3	-32.9
Net cashflows				**34.5**	-1.4	-0.6

Source: Deutsche Bank, Japara

Figure 100: Net cash flows from RADs / Bonds



Source: Deutsche Bank, Japara

Balance sheet

At its previous balance date Japara had a bond balance of $221m. We expect this to rise to over $300m during FY15 as the number of RAD paying residents lifts and includes Japara's assumption of $22.5m of RADs from the Whelan acquisition. Apart from the RADs balance Japara has a debt free balance sheet.

Figure 102: Balance sheet as at 30 June 2015

Cash and cash equivalents	63.2
Trade and other receivables	8.7
Other current assets	8.5
Total current assets	**80.4**
Property, plant and equipment	381.9
Goodwill	282.8
Other intangible assets	124.0
Other non-current assets	33.2
Total non-current assets	**821.9**
Total assets	**902.3**
Trade and other payables	17.4
Accommodation bonds (RADs)	305.9
Current borrowings	15.8
Provisions	23.1
Other current liabilities	9.3
Total current liabilities	**371.6**
Non-current borrowings	-
Provisions	2.0
Other non-current liabilities	-
Total non-current liabilities	**2.0**
Total liabilities	**373.6**
Net assets	**528.7**

Source: Deutsche Bank, Japara

Net current deficiency reflects RAD accounting: Japara' balance sheet shows a net current asset deficiency of $289m due to the RADs being recorded as a current liability. We do not view this as a material risk given historic experience shows only a limited amount of RADs are likely to be required to be paid in the next 12 months and outgoing RADs are typically replaced by new RADs inflows of a higher amount. Furthermore the business generates sufficient operating cashflows to cover any RAD outflows.

Dividend policy

Pay-out of "up to 100% of NPAT" targeted

Japara directors intend to target a dividend payout ratio of up to 100% of NPAT, however the level of dividend payout ratio is expected to vary between periods depending on various factors including business conditions, capex requirements and RAD cashflows. It is expected that all future dividends will be franked to the maximum extent possible.

10.5¢ dividend forecast

The first dividend paid by Japara will be an interim dividend in respect of the half year ending 31 December 2014. While we are forecasting a slightly lower operating result in FY15 our dividend forecast of 10.5¢ is in-line with the level forecast in the prospectus.

Valuation

DB valuation range of $2.12 - $2.85

In our view DCF is the most logical methodology to value the aged care companies because it captures the value of accommodation bond (RADs) cash flows which do not impact on the P&L. However DCF is complicated by the need to capture medium term growth expectations generated by acquisitions and development projects.

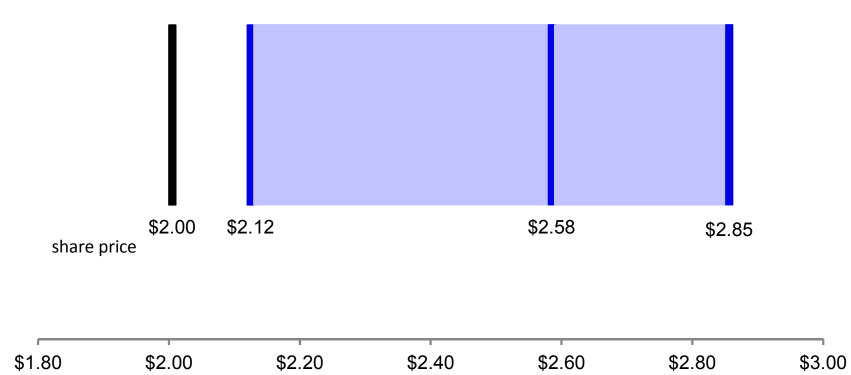
In order to allow for this we have considered a range of possible outcomes with regard to the number of places acquired and developed per annum. This analysis implies a valuation range of $2.12 - $2.85 per share with a mid case of $2.58. The mid case equates to CY15 PE multiple of 22.8x.

Bottom end of DCF used to set price target due to concerns over system issues

We have used the bottom end of our DCF range, $2.12 to set our price target for Japara. This reflects our view that the stock price is unlikely to approach fair value until investors gain confidence in the company's systems following the payroll issue reported last December and the risk earnings will fail to match management's guidance.

Figure 103: DCF valuation – high, low and mid cases

Assumptions	Low	**Mid**	High
Places acquired pa	75	**150**	200
Development places pa	100	**200**	300
Value	$2.12	**$2.58**	$2.85
Implied P/E CY15	18.7x	**22.8x**	25.2x



Source: Deutsche Bank

Discounted cash flow assumptions

- **Acquisitions:** In the low case we have assumed Japara will acquire 75 new places per annum. In the high case we assumed Japara acquires 200 places per annum. Our mid case assumption of 150 places per annum compares to Japara's acquisition of 196 places in FY14 and 258 in FY15.

- **Development:** In the low case we assumed Japara opens 100 places from brownfield and greenfield development projects per annum. In the high case we assumed Japara develops 300 places. The mid case assumption of 200 places per annum is broadly consistent with the plans outlined at the recent AGM to open 1,190 places over the next five years.
- **RADs, acquisition and development costs:** We have assumed average RAD values and the acquisition prices per place appreciate at an equivalent rate. Staring at 6.5% in FY15 and moderating to 3.5% in FY19 the final forecast year. Development costs rise by 3.5% pa.
- **RAD uptake by residents**: We assumed 68% of Japara's unsupported residents continue to choose RADs under all scenarios and residents turnover stay for an average of three years.
- **Debt:** In the low and mid cases our analysis suggests Japara will not need to take on any debt. In the high case we assume Japara borrows a modest amount (circa $35m by FY19).

Figure 104: DCF valuation components

(%)			
DCF input assumptions			
WACC	10.1%	10-year government bond rate	5.00%
Cost of equity	10.1%	Market risk premium	6.0%
Cost of debt	3.5%	Company beta	0.85
Current debt/value ratio	-	Imputation adjustment factor	40.4%
Current equity/value ratio	100.0%	Number of forecast/horizon years	5 / 5
Corporate tax rate	30.0%	Horizon/perpetuity growth rate	7.0%
Valuation			
Present value of cash flows	679	Ordinary shares on issue (M)	262.8
Plus under-utilised assets, excess cash	0	Current share price	2.00
Entity value	679	**Value/share**	**2.58**
Less weighted average net debt	0	Price/NPV (x)	0.77
Total calculated value of extraordinary equity	679		

Source: Deutsche Bank Estimates

Our DCF valuation and WACC assume Japara remains largely ungeared (some debt is taken on in the high case scenario). However we see potential for gearing to be added to support more aggressive acquisition scenarios which would increase our valuation.

Yield

The table below sets out the expected yield from Japara. This assumes a 100% payout which is the Japara board's intended target. The CY15 yield is on par with its two peers.

Figure 105: Japara's forecast dividend yield

Yield	FY15	CY15	FY16
Japara	5.3%	5.4%	6.0%

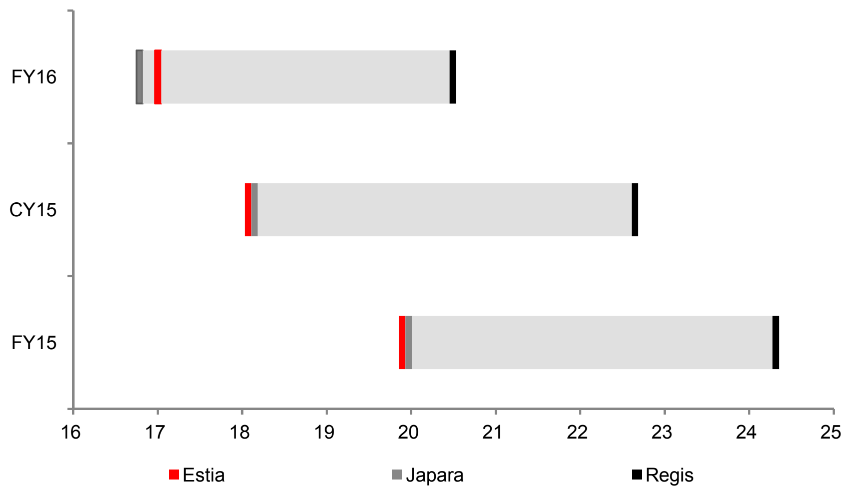
Source: Deutsche Bank

Earnings multiples

Earnings multiple valuation methods have some limitation as the P&L earnings measures don't capture the value of RAD inflows. Nonetheless we have presented PE and EV/EBITDA multiples as a secondary methodology. On a multiple basis Japara appears relatively cheap compared to its listed peers, especially Regis.

Figure 106: P/E multiples

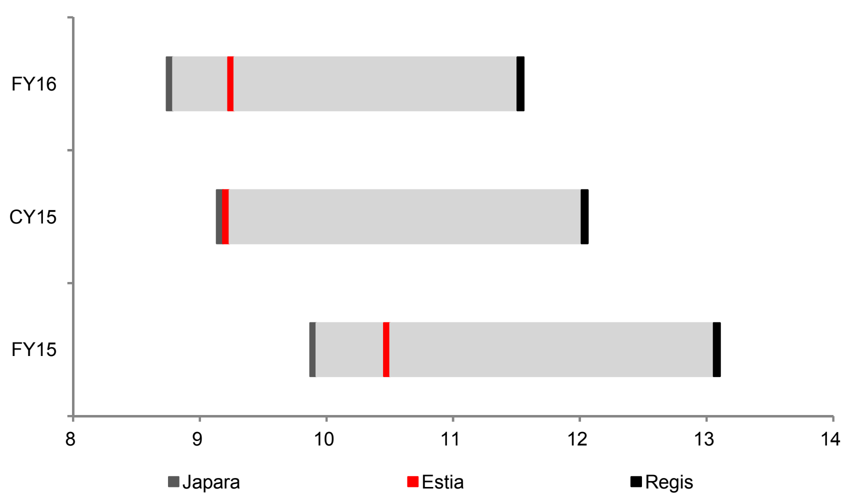
	FY15	CY15	FY16	Tgt Price CY 15
Japara	19.7x	17.6x	16.7x	18.7x



Source: Deutsche Bank

Figure 107: EV / EBITDA multiples

	FY15	CY15	FY16
Japara	9.9x	9.1x	8.7x



Source: Deutsche Bank

Free cashflow multiples

Finally we have presented free cash flow multiples (which capture the inflow from RADs) compared with the two listed peers. While this analysis highlights the relative value offered by Japara this is largely skewed by the large uplift in RAD inflows forecast in FY15. As shown in Figure 27 we expect Japara's cashflows to decline in FY16 and FY17 as the rate of inflow from RADs moderates.

Figure 108: Free cashflow multiples

	FY15	FY16	**2yr ave**
Estia	8.8	7.8	**8.3**
Japara	4.1	5.0	**4.5**
Regis	9.8	5.9	**7.9**

Source: Deutsche Bank

Senior management

Directors

Linda Bardo Nicholl's AO, Non-Executive Chairman: Linda has over 30yrs of experience. Prior to joining Japara Linda held the position of chairman at companies including Healthscope and Australia Post, and was a director of St. George. Linda is also the chairman of Yarra Trams and has directorships with Fairfax Media, Medibank Private, Pacific Brands Group and Sigma Pharmaceutical Group.

Andrew Sudholz, Chief Executive Officer and Executive Director: Andrew founded Japara and has over 30yrs'experience in the real estate, healthcare and professional services industries. Prior to establishing Japara, Andrew was a partner of Arthur Anderson Group, a national partner of Ernst & Young's Real Estate Advisory Services Group and the state general manager of the Triden Corporation. Andrew was former president of the Australian Financial Services Licensing regime, a former president of the Victorian division and a national board member of the Property Council of Australia. Andrew is currently a member of the Australian Institute of Company Directors.

Richard England, Non-Executive Director: Richard has more than 18yrs'experience as a non-executive director and Chairman across the financial services banking, healthcare and insurance industries. Prior to joining Japara Richard was a partner at Ernst & Young. Richard is currently the chairman of Chandler Macleod Group and of Ruralco Holdings and is a non-executive director of Nanosonics and Macquarie Atlas Roads.

Tim Poole, Non-Executive Director: Tim has more than 15yrs'experience as a director and chairman across financial, infrastructure and natural resources industries. Prior to joining Japara Tim was managing director of Hastings Funds Management and chairman of Asciano. Tim is currently a non-executive director of Newcrest Mining, McMillan Shakespeare and AustralianSuper, chairman of Lifestyle Communications. Prior to joining Estia, Norah was CEO of Summerset in NZ for 13yrs. Norah was also president of the Retirement Villages Association of NZ for 7yrs until retiring from that position.

David Blight, Non-Executive Director: David has more than 30yrs experience in the real estate industry, across all major global markets and property sectors. Prior to joining Japara, David was managing director of APN Property Group and also held various positions at ING, including chairman and chief executive officer of ING Real Estate Investment Management and vice chairman. David also held several senior executive positions with Armstrong Jones and Mirvac across Australia and New Zealand.

Management

Andrew Sudholz, Chief Executive Officer and Executive Director: Refer to profile above.

John McKenna, Chief Financial Officer and Company Secretary: David has more than 30yrs' experience in the financial services and related sectors. Prior to joining Japara John was an executive director and chief operating officer of Burdett Buckeridge Young and also head of finance at National Australia Bank Group and financial controller of the UK branch.

Jerome Jordan, Executive Director of Operations: Jerome has more than 20yrs'experience working in the aged care industry. Prior to joining Japara, Jerome was executive director of Glenvoir Holdings and also worked as director of nursing at several aged care facilities and nursing homes.

Julie Reed, Executive Director of Aged Care Services: Julie has over 30yrs'experience in the aged care industry. Prior to joining Japara Julie was a registered nurse and also a director of nursing of several aged care facilities and nursing homes. Julie also was a founding member of NURSAC.

Performance incentives

Japara offers the following performance incentives to its senior management:

STI plan

The STI plan (STIP) provides Japara's CEO and the Executive Director of Operations (Jerome Jordan), and Eexcutive Director of Aged Care Services (Julie Reed) with potential for a cash incentive up to 40% of TFR. This payment is conditional on achievement of certain financial and non-financial performance measures.

LTI plan – Loan Plan & Rights Plan

The long term incentive plant (LTIP) is for the grant of performance rights over shares and is available to any employee of Japara (at the Board's discretion) and comprises a: 1) Loan Plan, and 2) Rights Plan.

Japara's Loan Plan entitles an employee to acquire Loan Shares in Japara. The eligibility to participate and the number of shares Loan Shares is at the Board's discretion. Loan shares vest subject to satisfaction of performance conditions set by the Board, tested over a performance period of three years, commencing on the Listing Date and ending on 30 June 2017. In the event the performance conditions attaching to the Loan Shares are not met, the outstanding balance must be repaid seven years from the grant date.

Notably the CEO was entitled to participate in the Loan Plan and upon listing the CEO acquired Loans Shares with fair value of $481,000.

The percentage of the Loan Shares that vest, will be determined as set out in Figure 109. In addition there is a gateway hurdle that applies to the grant related to a number of thresholds and compliance and regulatory guidelines being met.

Figure 109: Vesting of CEO's Loan Shares / Right's Plan

Japara's CAGR of EPS over the performance period	% of Loan Shares that vest
Less than threshold CAGR	Nil
Threshold CAGR	20%
Between threshold and stretch CAGR	Pro-rata straight-line between 20% and 100%
Stretch CAGR	100%

Source: Japara

The Rights Plan is for the grant of performance rights over shares and is available to any employee of Japara (at the Board's discretion). Performance conditions will vest subject to the satisfaction of the performance conditions over a period of at least three years ending 30 June 2017. In addition there is a gateway hurdle that applies related to a number of thresholds and compliance and regulatory guidelines being met.

It is intended that offers of the performance rights under LTIP will be made to senior management on or shortly after completion and going forward, on an annual basis. Performance rights under the LTIP both the Loan Plan and the Rights Plan lapse if employment is ceased for cause or due to resignation, in each case unless the Board determines otherwise.

Risks

Company specific risk include

- **Third party leasing risk.** Japara currently leases a number of facilities (being Kiverton Park, Viewhills Manor and Bayview Gardens) from third party lessors. Failure of a lessor to discharge its obligations as agreed by Japara or failure to renew a lease (ie the leases at Bayview Gardens and Kiverton Park which have expired and are operating on a month by month lease basis, while negotiations are ongoing for longer leases) in the latter meaning affected esidents would need to move may adversely affect operations and affect Japara's future financial performance and position.

- **State Revenue Office of Victoria stamp duty risk**. There is a risk the State Revenue Office of Victoria might withdraw or replace a ruling which grants Japara stamp duty relief in connection with the restructure meaning Japara may have to pay additional stamp duty.

Other industry wide risks include

- **Regulatory and funding risk.** Given the highly regulated nature of the aged care industry and its heavy reliance on Government funds Japara faces regulatory and funding risk including: 1) policy changes which reduce or redirect funding, 2) restrictions on the use of RADs, 3) changes to the rules governing the allocation of approved places, and d) changes to accreditation standards and physical structure requirements.

- **Repayment of and value of RADs**: Fluctuations in general macro-economic and investment market conditions (including the housing market) may impact the value of bonds and RADs, which would impact on Japara's cashflows.

- **Clinical care and reputational risk**: Failure by Japara to meet clinical care requirements could damage Japara's reputation.

- **Occupancy level risks**: Factors such as industry deregulation, decline in referrals and increased competition could reduce occupancy levels impacting on earnings.
- **Acquisition related risk**. Notwithstanding extensive due diligence relating to acquisitions there is the possibility material issues may not have been identified.

Rating
Buy

Australasia
Australia

Health & Biotechnology

Company
Regis Healthcare

Reuters	Bloomberg
REG.AX	REG AT

Price at 21 Jan 2015	3.97
Price target - 12mth	4.50
52 week range (AUD)	4.27 - 3.80
ALL ORDINARIES	5,342

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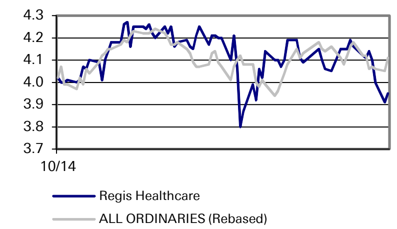
Price/price relative



Performance (%)	1m	3m	12m
Absolute	-5.3	-1.0	32.8
ALL ORDINARIES	-0.5	-0.3	0.3

Source: Deutsche Bank

Initiating with a Buy Rating

Strong development pipeline plus experienced management team

As one of the largest residential aged care operators in Australia with a high quality portfolio and strong systems Regis is well positioned to be a key beneficiary of the new funding regime. The long standing management team has a reputation for astute investment and conservative governance. We expect the group's extensive development pipeline to support strong growth in free cashflows underpinning our DCF based price target. We are initiating with a Buy rating and a $4.50 Price Target.

FY15 estimates ahead of prospectus forecast

Regis is a healthy business with a solid revenue and EBITDA growth outlook and no debt. We expect rising occupancy and stable costs to ensure the current above industry margins are maintained despite the recent dilutive acquisition. Our FY15 EBITDA and NPAT estimates are 2-3% ahead of prospectus forecasts reflecting slightly higher revenue and margin assumptions. We expect Regis' EBITDA margins to remain relatively stable in the medium term even as newly developed places are opened and acquisitions made. Upside risk to our estimates comes from the potential to lift accommodation payments from the residents and the Government.

$4.50 price target offers solid upside to current share price

Our price target is based on a DCF (WACC 10.1%, 5.00% bond yield, Beta 0.85, and TY growth of 7%). Our forecasts assume Regis adds ~350 places per annum via acquisitions and development projects. The key downside risks are: 1) change to Govt regulation and/or funding, 2) risk to RAD values, and 3) increased competition.

Forecasts And Ratios

Year End Jun 30	2015A	2016E	2017E	2018E
Sales (AUDm)	434	481	527	585
EBITDA (AUDm)	89	103	109	118
Net Profit (AUDm)	50	58	63	68
EPS (AUD)	0.17	0.19	0.21	0.22
% Change	–	–	–	–
EPS Growth (%)	–	17.6	7.4	8.0
PER (x)	24.9	20.5	19.1	17.6
EV/EBITDA (x)	13.7	11.2	10.2	9.2
DPS (net) (AUD)	0.12	0.20	0.21	0.22
Yield (net) (%)	2.8	4.9	5.3	5.7
Franking (%)	100	100	100	100

Source: Deutsche Bank estimates, company data

[1] Pre-exceptionals/extraordinaries
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated:21 January 2015

Running the numbers

Australasia

Australia

Health & Biotechnology

Regis Healthcare

Reuters: REG.AX Bloomberg: REG AT

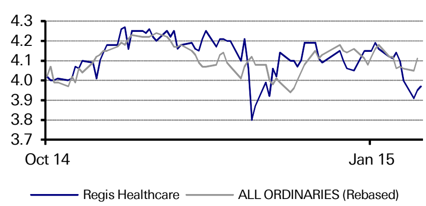
Buy

Price (21 Jan 15)	AUD 3.97
Target Price	AUD 4.50
52 Week range	AUD 3.80 - 4.27
Market Cap (m)	AUDm 1,192
	USDm 975

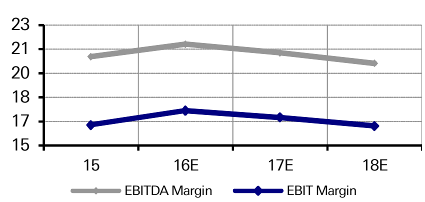
Company Profile

Regis Healthcare operates a network of aged care facilities providing a range of services to its residents across Queensland, Western Australia, New South Wales and South Australia. Its services include: 1) clinical care services (incl. 24 hr nursing care, wound management, physio and occupational therapy, etc.), 2) daily living services (incl. laundry, meals, etc.), 3) accommodation services (single to shared rooms), and 4) extra services.

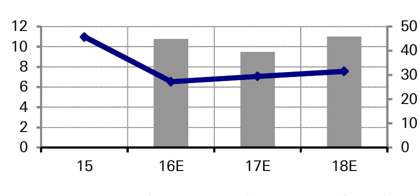
Price Performance



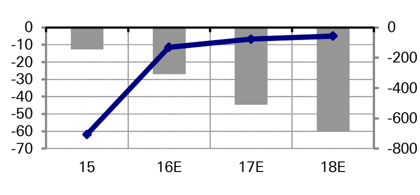
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 30-Jun	2015	2016E	2017E	2018E
Financial Summary				
DB EPS (AUD)	0.17	0.19	0.21	0.22
Reported EPS (AUD)	0.17	0.19	0.21	0.22
DPS (AUD)	0.12	0.20	0.21	0.23
BVPS (AUD)	0.72	0.70	0.71	0.72
Valuation Metrics				
Price/Sales (x)	2.8	2.5	2.3	2.0
P/E (DB) (x)	24.9	20.5	19.1	17.6
P/E (Reported) (x)	24.9	20.5	19.1	17.6
P/BV (x)	5.5	5.6	5.6	5.5
FCF yield (%)	1.4	9.6	10.3	10.3
Dividend yield (%)	2.8	4.9	5.3	5.7
EV/Sales	2.8	2.4	2.1	1.8
EV/EBITDA	13.7	11.2	10.2	9.2
EV/EBIT	17.3	13.9	12.6	11.4
Income Statement (AUDm)				
Sales	434	481	527	585
EBITDA	89	103	109	118
EBIT	71	83	88	95
Pre-tax profit	71	83	89	97
Net income	50	58	63	68
Cash Flow (AUDm)				
Cash flow from operations	53	78	88	96
Net Capex	-35	37	34	28
Free cash flow	18	115	122	123
Equity raised/(bought back)	389	0	0	0
Dividends paid	0	-64	-61	-65
Net inc/(dec) in borrowings	-394	0	0	0
Other investing/financing cash flows	-26	-22	-23	-24
Net cash flow	-13	29	38	34
Change in working capital	*-1*	*3*	*3*	*4*
Balance Sheet (AUDm)				
Cash and cash equivalents	28	57	95	129
Property, plant & equipment	658	717	793	853
Goodwill	42	46	46	46
Other assets	258	270	282	294
Total assets	986	1,090	1,216	1,323
Debt	0	0	0	0
Other liabilities	769	879	1,003	1,107
Total liabilities	769	879	1,003	1,107
Total shareholders' equity	217	212	213	216
Net debt	*-28*	*-57*	*-95*	*-129*
Key Company Metrics				
Sales growth (%)	nm	10.8	9.5	11.0
DB EPS growth (%)	na	17.6	7.4	8.0
Payout ratio (%)	69.7	100.5	100.8	100.0
EBITDA Margin (%)	20.5	21.3	20.8	20.1
EBIT Margin (%)	16.3	17.2	16.8	16.2
ROE (%)	45.6	27.2	29.4	31.5
Net debt/equity (%)	-12.7	-26.9	-44.7	-59.8
Net interest cover (x)	-707.1	-130.4	-77.3	-56.4
DuPont Analysis				
EBIT margin (%)	16.3	17.2	16.8	16.2
x Asset turnover (x)	0.9	0.5	0.5	0.5
x Financial cost ratio (x)	1.0	1.0	1.0	1.0
x Tax and other effects (x)	0.7	0.7	0.7	0.7
= ROA (post tax) (%)	10.1	5.6	5.4	5.3
x Financial leverage (x)	4.5	4.8	5.4	5.9
= ROE (%)	45.6	27.2	29.4	31.5
annual growth (%)	*na*	*-40.5*	*8.3*	*7.0*
x NTA/share (avg) (x)	0.4	0.7	0.7	0.7
= Reported EPS	0.17	0.19	0.21	0.22
annual growth (%)	*na*	*17.6*	*7.4*	*8.0*

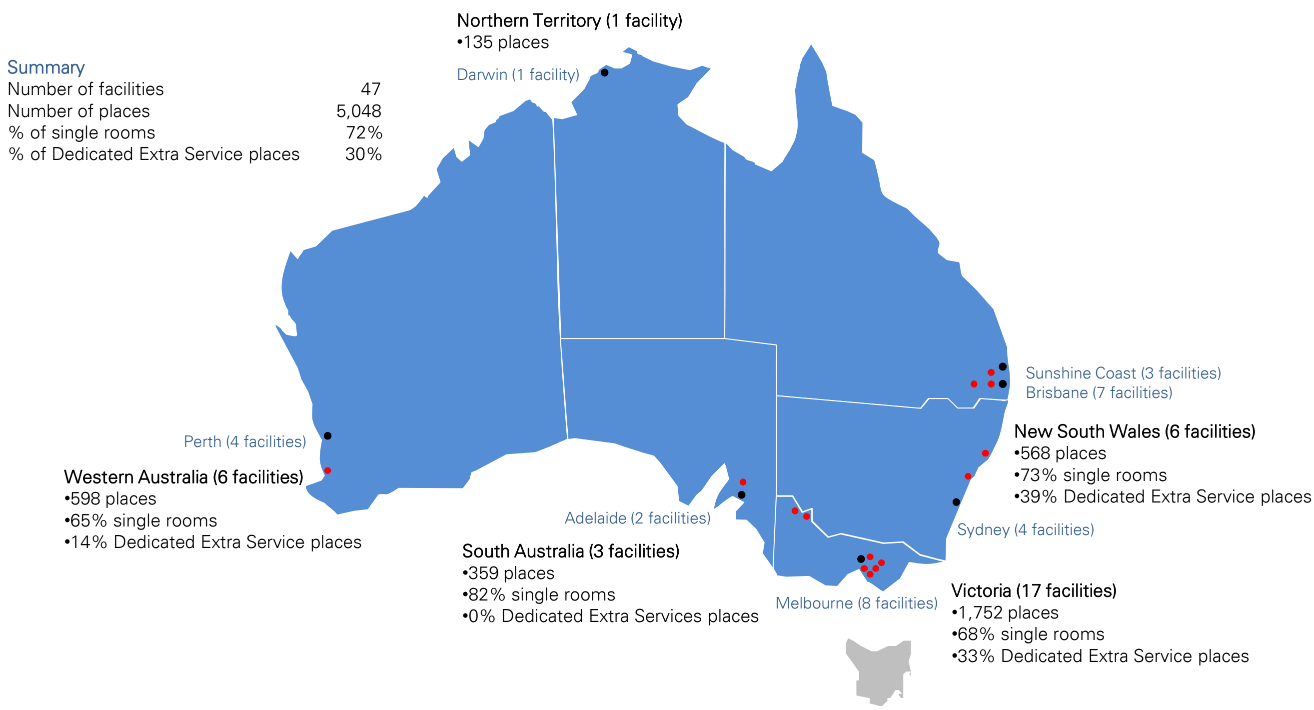
Source: Company data, Deutsche Bank estimates

Regis Healthcare

Company description

Regis is one of the largest Australian residential aged care operators in terms of number of places. The company operates around 5,048 places across 47 aged care facilities located in Victoria, Queensland, Western Australia, New South Wales and South Australia. This includes the recent 194 place acquisition in Cairns which is yet to settle and hence is not shown on the map below.

Figure 110: Regis Healthcare map of facility locations



Source: Regis, Deutsche Bank

Regis key portfolio statistics are listed in Figure 111.

Figure 111: Key Portfolio Statistics

Portfolio attributes	Facilities /Places	Proportion
Number of facilities (owned and contacted to be acquired)	47	
Number of in metro areas	36	77%
Number of freehold facilities	47	100%
Operational places	5,048	
Single rooms	3,653	72%
Extra service status	1,490	30%
Occupancy - FY15 estimate		95%
Proportion residents paying RADs/Bonds - 30 Jun 2014		43%

Source: Regis, Deutsche Bank

After the float the founders owned 55% of the stock and the CEO held 1% holding. This stock is subject to escrow conditions.

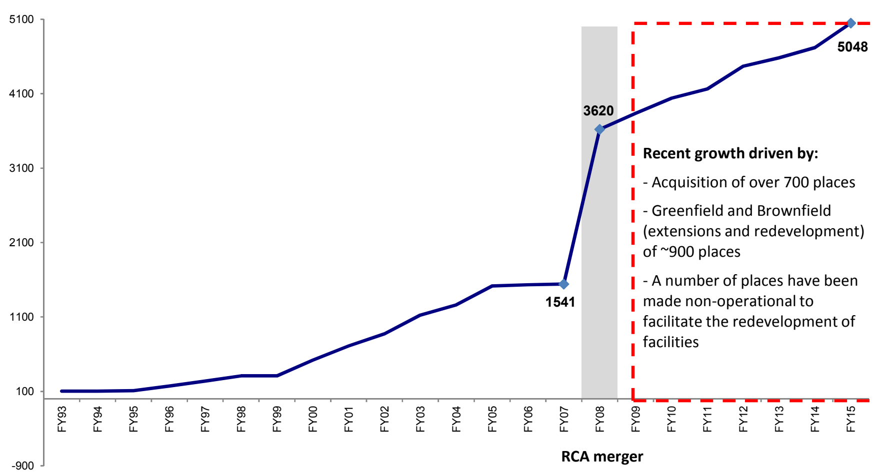
History

Regis was founded in the early 1990's by Bryan Dorman and Ian Roberts. In July 2007 Regis, comprising 18 facilities and 1,541 places in Victoria and Queensland, merged with Retirement Care Australia Holdings, a private company owned by Macquarie Capital Alliance Group, 'MCAG'.

MCAG had entered the aged care sector in 2005 when it acquired portfolios of aged care facilities from the Salvation Army and the Moran Group and operated under the name Retirement Care Australia (RCA). After the 2007 merger MCAG became a 46% owner of the combined group, Regis Aged Care, which managed over 3,650 places across 41 facilities.

In January 2014 MCAG exited its investment in Regis via a share buyback. Regis has acquired a further six facilities post the merger with RCA and has constructed/expanded or and/or refurbished another 18 facilities.

Figure 112: Timeline of growth in number of places



Source: Regis, Deutsche Bank

Business model

Regis owns and operates a portfolio of high quality aged care facilities in demographically attractive areas where demand for aged care services is high from individuals able to self fund their aged care needs. Regis' strong operational metrics including earnings well above the industry average and high occupancy rates reflect the quality of its systems and its ability to provide high quality healthcare. The five key drivers of Regis' business model include the following:

- **High quality portfolio**: Regis operates a high quality portfolio of facilities, primarily located in metropolitan areas with high median house prices. Typically the facilities are modern with a high proportion of single rooms and an emphasis on supported living and lifestyle. The key characteristics and benefits of each of these facilities are set out in Figure 113.

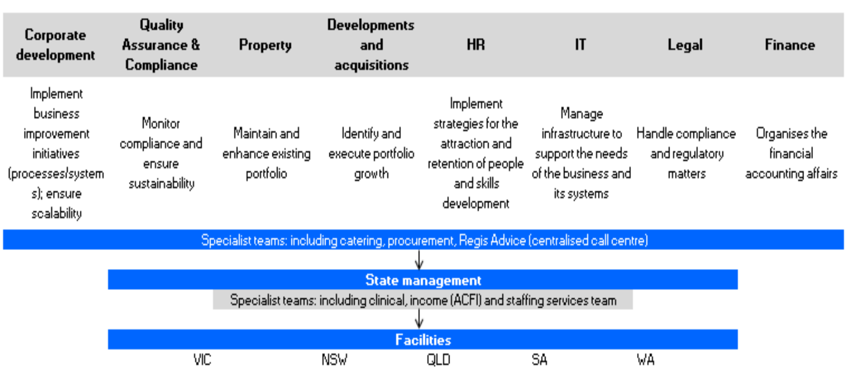
Figure 113: Characteristics of Regis' 'high quality' portfolio

Facility portfolio feature	Benefit
5,048 operational places across 47 sites in five states	Diversification provides maximum exposure to development and acquisition opportunities
76% of places single bed configuration	Modern accommodation that meets current demand expectation that underpins occupancy and accommodation payments
35 sites located in high density, urban areas and 12 sites located in regional areas	Prime location of facilities perpetuates higher demand for aged care services
91% high acuity care	Maximises revenue, minimal competition from non residential aged care
76% of places located in areas with median house prices above ~$400k	Higher median house price facilities a higher RAD per RAD-paying resident
30% of total places providing Extra Services	Improve Resident experience as well as supporting a higher level of resident payments

Source: Regis

- **Scalable platform**: Regis has invested in scalable business processes supported by IT systems. Management believes this provides a competitive advantage as it has the in house resources to facilitate the rapid integration of acquisitions and developments. The group employs specialist teams to work with state and facility-based management to deliver a high level of services to residents, grow the portfolio and achieve economies of scale. The group's systems have required a significant investment resulting in relatively high on going depreciation.

Figure 114: Scalable business platform



Source: Regis

- **Focused and well-resourced risk management**: Regis has a strong track record of risk management and compliance. It has a well resourced risk management team and has robust and responsive systems. Accordingly we understand no Regis operated facility has ever been sanctioned by the Department.

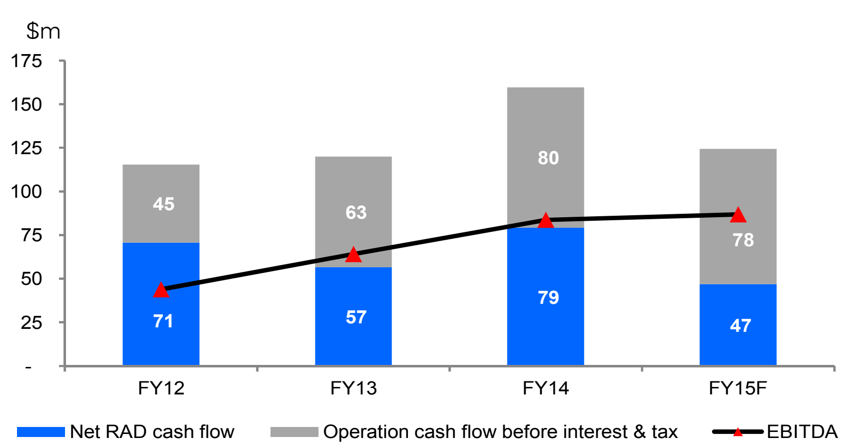
- **Vertical integrated approach to development**: Regis fully manages the development of new places. The spectrum of vertically integrated activities include: 1) site identifications, 2) site and facility acquisition, 3) greenfield and brownfield development, 4) mobilisation / integration, 5) operation, and 6) asset renewal. A description of each of these activities is listed in Figure 115.

Figure 115: Vertical integration one of the key drivers of Regis' business model

Source: Regis

- **Strong cash flow generation**: Regis has a track record of delivering strong cash flow from operations with the net bond (RAD) in flows plus operating cash flow before interest consistently exceeding EBITDA. The solid cash flows reflects the group's above industry margins and strong inflow from bonded places. Figure 116 shows the strong pro forma cash flows

Figure 116: Regis has a history of strong cashflow generation



Source: Deutsche Bank

Organic growth strategy

By our estimates Regis should deliver mid to high single digit EBITDA growth even without acquisitions or development projects. The chief sources of organic growth include lifting occupancy at the group's facilities, increasing revenues per operating place day (POPD) and increasing accommodation payments.

ACFI rates

Regis has achieved ACFI per Resident growth in excess of indexed growth with its FY14 rate growing by almost 10% to $147, well above industry average. We attribute this to the group's strong systems which ensure it receives the appropriate payment for the residents it cares for and to a lesser degree to rising acuity of its residents.

While we expect this above industry trend to continue in FY15 we have assumed a rate of growth which tracks back to industry norms over time..

Occupancy levels

Regis has a high level of occupancy which has historically been inline or above the industry average. Notably occupancy picked rose over FY14 to end the year at 95%, as the acquired places and recently opened developed places occupancy rose, as well as improved occupancy at the recently upgraded facilities, improved facility management and benefits from room reconfigurations. Figure 117 shows the forecast lift in occupancy levels.

Figure 117: Historic and forecast improvement in occupancy

	FY12	FY13	FY14	FY15
Total	91.1%	92.9%	93.2%	95.0%
Chg		1.8%	0.3%	1.8%

Source: Regis, Deutsche Bank

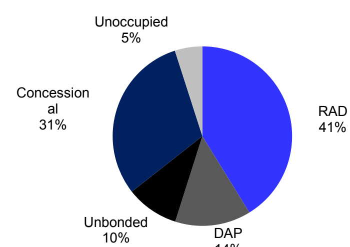
We expect this higher occupancy level to hold in FY15 despite some drag from the recent acquisitions. While further modest improvements are expected at the 'mature' sites the impact of acquisitions and newly developed places is expected to lead to group occupancy levels of ~94%.

Rising accommodation payments

A key opportunity for Regis is to boost the level of accommodation payments post the introduction of the LLLB reforms. Key source of uplift include:

- **RAD/DAP payments**: Regis will introduction of RAD/DAP payments at places which were previously unbounded as residents turn over.
- **Govt Accommodation Supplement**: The higher accommodation supplement for new or significantly refurbished residential aged care facilities allows providers to access payments for concessional residents at levels which equates to a RAD of almost $300k. This opportunity is particularly attractive in regional areas where bonds are less likely to reach this level.

Figure 118: Mix of residents – FY15



Source: Regis, Deutsche Bank

Expansion strategy – acquisitions and development

Regis's growth strategy involves the following:

- **Greenfield projects**. Capacity to develop multiple sites per annum.
- **Brownfield projects**. Expand and reconfigure existing sites.
- **Bolt on acquisitions**. Identify and continue to make single facility "bolt-on" acquisitions.
- **Portfolio acquisitions**. Assess portfolio acquisition opportunities as they arise.

Expansion strategy

As mentioned above part of Regis' growth strategy is via acquisition and both greenfield and brownfield developments. To support this growth strategy Regis has 848 places which are yet to be operational. These comprise:

- 337 offline places (places which have been taken offline pending redevelopment).
- 511 provisional allocations (including 195 places allocated in the 2014 ACAR round).

440 of these places will be used to operate the known expansion pipeline (listed in Figure 119). Another 201 relate to identified future greenfields and expansion/development of existing sites. The remaining 207 places are available for other future greenfields.

Regis also has a further 1,134 places with Extra Services status that can be used across several of the developments and/or also existing operational places.

ACAR track record to support growth strategy

Regis has a proven track record of ensuring places granted are made operational (which is one of the key ACRA applicant criteria). This has supported Regis' success with its ACAR applications. Over the last three allocation rounds Regis has been granted 452 places and been successful in its Extra Services applications relating to 1,079 places. Notably under the 2014 Aged Care Approvals Round (ACAR) Regis was allocated 159 places.

Acquisitions

- **Tiwi Gardens, Darwin**: August 2014 Regis signed a contract to acquire a 135 place aged care facility in Darwin, Northern Territory (Tiwi Residential Care Facility). Regis expects to take control in November 2014.
- **Redlynch Glenmead Village, Cairns**: On 21 January 2015 Regis announced it had contracted to purchase a 194 place aged care facility from Blue Care, part of UnitingCare Queensland, a not-for-profit provider. The acquisition is expected to complete on the 31 March 2015). This was Regis' seventh single site acquisition it has completed in the last four years.

Figure 119: Development pipeline

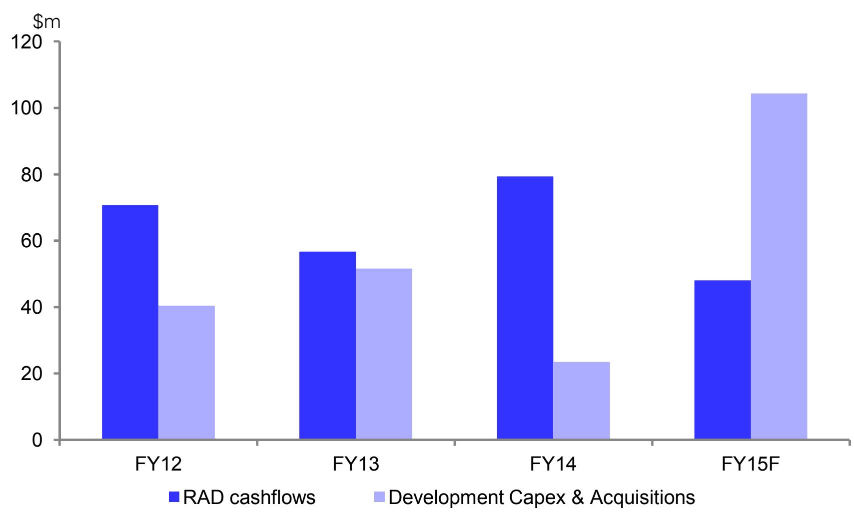
\Expansions of existing facilities	
Regis Ontario (38 additional places)	Construction expected to commence in Oct-14, ramp up early FY16
Regis Canning Lodge (60 additional places)	Construction expected to commence in Jan-15, ramp up early FY16
Redevelopments of existing facilities	
Regis North Freemantle (109 places, 95 places with Extra Services status)	Construction commenced in Aug-14
Regis Malvern East (148 places, 136 places with Extra Services status	Construction expected to commence in Dec-14
Greenfields	
Brisbane (100-120 places)	Settlement expected to occur in Nov-14. Construction expected to commence in 2HFY14
Significant refurbishments	
Approx. 700 eligible places, across 13 facilities	Total capex (FY15) $10m. Projects completed and approved FY16

Source: Regis, Deutsche Bank

RADs funding and expansion strategy

RADs account for a significant component of Regis' capital funding. Figure 120 shows the funding from RADs which is used to support the expansionary capex spend and acquisitions. Notably beyond FY15 we expect the inflow of funds from RADs to exceed the spend on expansionary projects.

Figure 120: RAD cash flows v capex and acquisitions



Source: Regis

Staffing and other costs

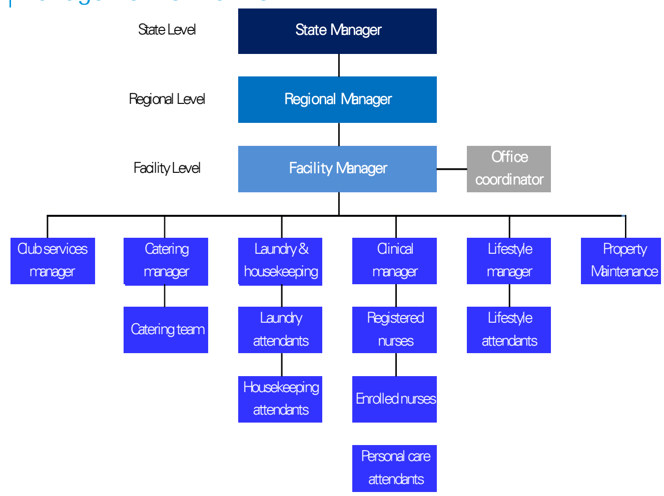
Regis currently employs more than 5,300 FTE's across its 47 facilities whom are led by a very strong management team. Figure 121 and Figure 122 shows the organisational structure at both the corporate and facility level. Notably a majority of Regis' employees are represented by the Australian Nursing Foundation and Health Services Union and are subject to awards, collective agreements and enterprise bargaining agreements.

Given the large number of employees, costs related to labour and staff makes up ~63% of Regis' FY14 revenue. Its remaining costs relate to medical supplies, catering, cleaning, consumables, repairs/maintenance, energy, utilities and administration corporate costs.

Figure 121: Regis organisational structure – Corporate management structure

Source: Deutsche Bank

Figure 122: Regis organisational structure – Facility management structure



Source: Deutsche Bank

Financial statements

Profit and loss statement

Regis' pro-forma financial statements reveal a healthy business with reasonable revenue and EBITDA growth and no debt. Strong growth in free cashflows is attractive, reflecting the benefit from the group's large development pipeline.

FY15 EBITDA ~$1.6m ahead of prospectus forecast

New development projects to support growth in out years

Figure 123: Pro-forma historical and forecast profit and loss statement

P&L	FY2012	FY2013	FY2014	FY2015F	FY2016F	FY2017F
Total Revenue	**326.0**	**352.7**	**404.9**	**434.4**	**481.1**	**526.7**
growth		8.2%	14.8%	7.3%	10.8%	9.5%
Total costs	282.2	288.6	321.2	345.2	378.6	417.3
growth		2.3%	11.3%	7.5%	9.7%	10.2%
EBITDA	**43.8**	**64.1**	**83.7**	**89.2**	**102.5**	**109.4**
growth		46.3%	30.6%	6.6%	14.9%	6.7%
margin	**13.4%**	**18.2%**	**20.7%**	**20.5%**	**21.3%**	**20.8%**
D&A	19.2	21.3	17.3	18.5	19.9	21.1
EBIT	24.6	42.8	66.4	70.7	82.6	88.3
Net interest				0.1	0.6	1.1
Profit before tax				70.8	83.3	89.4
Tax expense				-21.2	-25.0	-26.8
NPAT				**49.6**	**58.3**	**62.6**

Source: Deutsche Bank, Regis

Key points we highlight from the profit and loss statement include:

- **Growth underpinned by development projects**: The positive trend in revenues reflects the benefit from the Regis development project plans and the recent acquisitions.
- **EBITDA guidance appears conservative**: Regis' revenue growth is also supported by a lift in occupancy in FY15 reflecting the uplift across FY14. We expect Regis to deliver stable EBITDA margins in FY15, ahead of the 30bps contraction implied by the group's guidance. Our EBITDA and NPAT estimates are ~3% ahead of the prospectus forecasts.
- **Occupancy may soften as new developments open**: We expect ACFI indexation to ensure revenue growth per place exceeds cost growth. Beyond FY15 we assume a modest contraction in occupancy due to the timing of new facility openings, especially in FY17.
- **Margin expansion to moderate after FY14 uplift:** The strong uplift in FY14 reflects the expansion on ACFI and occupancy. We expect the margin expansion to moderate in FY15 before expanding again in FY16 as the group benefits from a lift in operating places and higher accommodation payments from residents.

Per operating day metrics

Regis is expected to report a broadly consistent rise in revenues and costs during FY15 before stronger growth in FY16. Notably Regis enjoys higher revenues per operating day than its two peers. We suspect this in part reflects its positioning in high socioeconomic suburbs relative to Japara and Estia.

Figure 124: Key operating metrics

FYE 30 Jun	FY2012	FY2013	FY2014	**FY2015F**	FY2016F	FY2017F
Per operating place day rates						
Revenue	$222	$231	$250	**$258**	$269	$277
Costs	$192	$189	$198	**$205**	$212	$219
EBITDA	$30	$42	$52	**$53**	$57	$57
Growth						
Revenue		4.1%	8.2%	**3.0%**	4.6%	2.7%
Costs		-1.6%	4.9%	**3.2%**	3.6%	3.4%
EBITDA		40.8%	23.1%	**2.4%**	8.6%	0.1%
Occupancy	**91.1%**	**92.9%**	**93.2%**	**95.0%**	**94.5%**	**93.7%**
Staff costs per day	$152	$151	$159	**$164**	$170	$176
growth		-0.4%	5.1%	3.3%	3.8%	3.5%
Staff costs as % of revenue	**61.5%**	**68.3%**	**65.4%**	**63.6%**	**63.1%**	**63.6%**

Source: Deutsche Bank, Regis

Cash flow statement

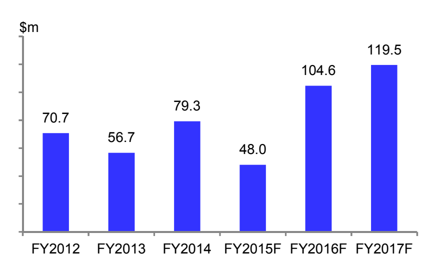
Regis' cashflow is set out below. Note the FY15 forecasts are the statutory rather than proforma numbers.

Figure 126: Pro forma historical and forecast cash flow

FYE 30 Jun ($m)	FY2012	FY2013	FY2014	FY2015F	FY2016F	FY2017F
EBITDA	43.8	64.1	83.7	89.2	102.5	109.4
Non-cash items / other	-6.1	-8.7	-10.9	-10.2	-4.5	-
Change in net working capital	6.9	8.1	7.5	-1.1	3.3	3.2
Operating cash flows	**44.6**	**63.5**	**80.3**	**77.9**	**101.3**	**112.6**
Net RAD receipts	**70.7**	**56.7**	**79.3**	**48.0**	**104.6**	**119.5**
Maintenance capex	-4.4	-4.5	-4.8	-4.9	-5.2	-5.6
Cash Ops pre Fin, int & tax	**110.9**	**115.7**	**154.8**	**121.1**	**200.7**	**226.5**
Upgrade & development capex	-33.2	-33.5	-12.7	-75.0	-62.6	-79.8
Acquisitions	-7.2	-18.1	-	-29.3	-21.8	-23.2
Net Cash pre interest & tax	**70.5**	**64.1**	**142.1**	**16.7**	**116.3**	**123.5**
Net interest paid				-5.0	0.6	1.1
Income tax paid				-20.2	-23.7	-25.5
Equity Issue				389.4		
Debt raised/(repaid)				-393.5		
Net cash flows before divs				-12.6	93.2	99.2
Dividends				-	-63.8	-60.8
Net cashflows				-12.6	29.4	38.4

Source: Deutsche Bank, Regis

Figure 125: Net cash flows from RADs / Bonds



Source: Deutsche Bank, Regis

Regis is well positioned to report strong cash flows from RADs given its extensive development pipeline.

Balance sheet

At its previous balance date Regis had a bond balance of $631m. We expect this to rise to nearly $680m during FY15 as it fills the recently developed places. Apart from the RADs balance Regis has a debt free balance sheet.

Figure 127: Balance sheet as at 30 June 2015

Cash and cash equivalents	27.5
Trade and other receivables	4.3
Other current assets	2.0
Total current assets	**33.9**
Property, plant and equipment	658.5
Goodwill	94.0
Other intangible assets	157.9
Other non-current assets	41.9
Total non-current assets	**952.2**
Total assets	**986.1**
Trade and other payables	34.8
Accommodation bonds (RADs)	678.7
Current borrowings	-
Provisions	31.6
Other current liabilities	8.6
Total current liabilities	**753.6**
Non-current borrowings	-
Provisions	4.1
Other non-current liabilities	11.2
Total non-current liabilities	**15.3**
Total liabilities	**768.9**
Net assets	**217.2**

Source: Deutsche Bank, Regis

Net current deficiency reflects RAD accounting: Regis' balance sheet shows a net current asset deficiency of $700m due to the RADs being recorded as a current liability. We do not view this as a material risk given historic experience shows only a limited amount of RADs are likely to be required to be paid in the next 12 months and outgoing RADs are typically replaced by new RADs inflows of a higher amount. Furthermore the business generates sufficient operating cashflows to cover any RAD outflows.

Dividend policy

Pay-out of "up to 100% of NPAT" targeted

Regis' directors intend to target a dividend payout ratio of up to 100% of NPAT, however the level of dividend payout ratio is expected to vary between periods, depending on various factors including business conditions, capex requirements and RAD cashflows. It is expected that all future dividends will be franked to the maximum extent possible.

The first dividend paid by Regis will be a final dividend in FY15. We have forecast a dividend of 11.5¢ in FY15.

Valuation

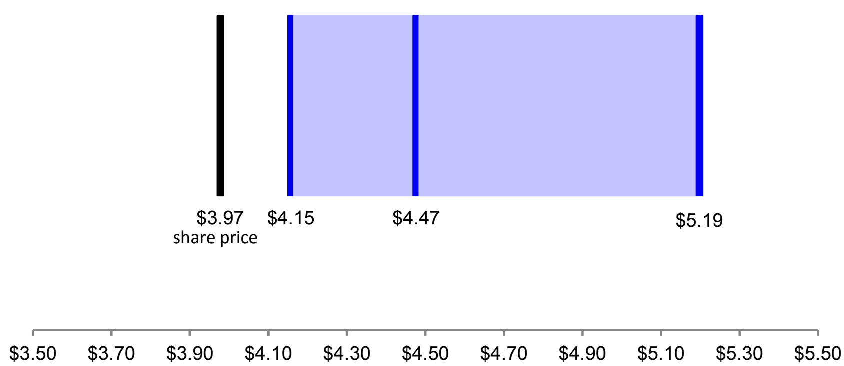
DB valuation range of $4.15 - $5.19

In our view DCF is the most logical methodology to value the aged care companies because it captures the value of accommodation bond (RADs) cash flows which do not impact on the P&L. However DCF is complicated by the need to capture medium term growth expectations generated by acquisitions and development projects.

In order to allow for this we have considered a range of possible outcomes with regard to the number of places acquired and developed per annum. This analysis implies a valuation range of $4.15 - $5.19 per share with a mid case of $5.91. The mid case equates to CY15 PE multiple of 24.9x. The mid case valuation is used as the basis of our price target for Regis of $4.50.

Figure 128: DCF valuation – high, low and mid cases

Assumptions	Low	Mid	High
Places acquired pa	75	**150**	250
Development places pa	100	**200**	400
Value	$4.15	**$4.47**	$5.19
Implied P/E CY15	23.2x	**24.9x**	29.0x



Source: Deutsche Bank

Discounted cash flow assumptions

- **Acquisitions:** In the low case we have assumed Regis will acquire 75 new places per annum. In the high case we assumed Regis acquires 250 places per annum. Our mid case assumption of 150 places compares to Regis' acquisition of 125 places in FY14 and 329 in FY15.

- **Development:** In the low case we assumed Regis opens 75 places from brownfield and greenfield development projects per annum. In the high case we assumed Regis develops 250 places. The mid case assumption of 200 places per annum is broadly consistent with the plans outlined in the prospectus to open 475 places over the next few years.
- **RADs, acquisition and development costs:** We have assumed average RAD values and the acquisition prices per place appreciate at an equivalent rate. Starting at 6.5% in FY15 and moderating to 3.5% in FY19 the final forecast year. Development costs rise by 3.5% pa.
- **RAD uptake by residents**: We assumed 75% of Regis' unsupported residents continue to choose RADs under all scenarios and residents turnover staying for an average of three years.
- **Debt:** All the scenarios we considered do not require Regis to take on debt given the strong cashflows from RADs.

Figure 129: DCF valuation components

(%)			
DCF input assumptions			
WACC	10.1%	10-year government bond rate	5.00%
Cost of equity	10.1%	Market risk premium	6.0%
Cost of debt	3.5%	Company beta	0.85
Current debt/value ratio	-	Imputation adjustment factor	40.4%
Current equity/value ratio	100.0%	Number of forecast/horizon years	5 / 5
Corporate tax rate	30.0%	Horizon/perpetuity growth rate	7.0%
Valuation			
Present value of cash flows	1,343	Ordinary shares on issue (M)	300.3
Plus under-utilised assets, excess cash	0	Current share price	4.09
Entity value	1,343	**Value/share**	**4.47**
Less weighted average net debt	0	Price/NPV (x)	0.91
Total calculated value of extraordinary equity	**1,343**		

Source: Deutsche Bank Estimates

Our DCF valuation and WACC assume Regis remains ungeared. However, we see potential for gearing to be added to support more aggressive acquisition scenarios which would increase our valuation.

Yield

The table below sets out the expected yield from Regis. This assumes a 100% payout which is the Regis board's intended target. The CY15 yield is on par with its two peers.

Figure 130: Regis' forecast dividend yield

Yield	FY15	CY15	FY16
Estia	2.9%	5.4%	4.9%

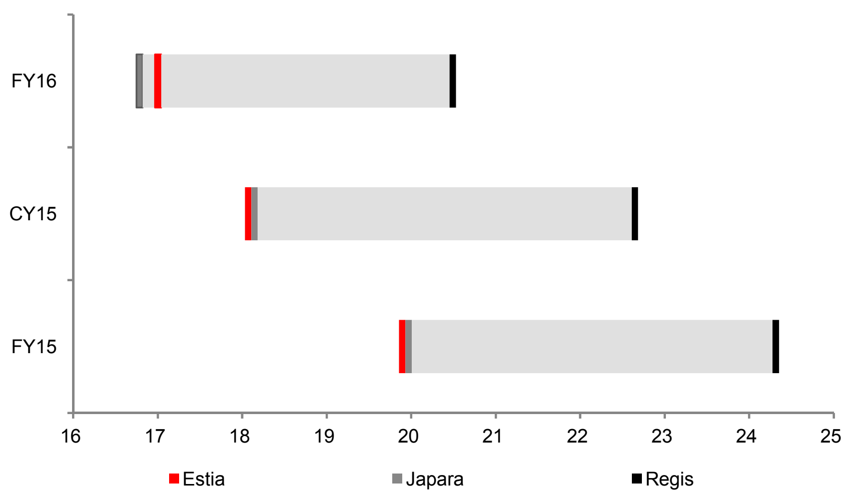
Source: Deutsche Bank

Earnings multiples

Earnings multiple valuation methods have some limitation as the P&L earnings measures don't capture the value of RAD inflows. Nonetheless we have presented PE and EV/EBITDA multiples as a secondary methodology. On a multiple basis Regis appears expensive relative to its listed peers.

Figure 131: P/E multiples

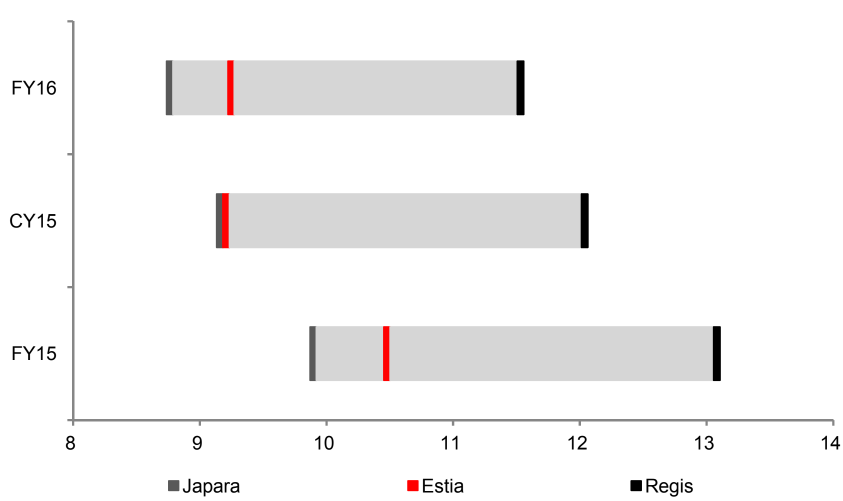
	FY15	CY15	FY16	Tgt Price CY 15
Regis	24.1x	22.1x	20.5x	25.1x



Source: Deutsche Bank

Figure 132: EV / EBITDA multiples

	FY15	CY15	FY16
Regis	13.1x	12.0x	11.1x



Source: Deutsche Bank

Free cashflow multiples

Finally we have presented free cash flow multiples (which capture the inflow from RADs) compared with the two listed peers. While this analysis highlights the relative value offered by Japara this is largely skewed by the large uplift in RAD inflows forecast in FY15. As shown in Figure 27 we expect Japara's cashflows to decline in FY16 and FY17 as the rate of inflow from RADs moderates.

Figure 133: Free cashflow multiples

	FY15	FY16	**2yr ave**
Estia	8.8	7.8	**8.3**
Japara	4.1	5.0	**4.5**
Regis	9.8	5.9	**7.9**

Source: Deutsche Bank

Senior management

Directors

Mark Birrell, Independent Non-Executive Chairman: Prior to joining Regis Mark was founding Chairman of Infrastructure Partnerships Australia, Deputy Chairman of the Australian Postal Corporation and Chairman of Evans & Peck Limited. Mark was also a Cabinet Minister and leader of the Government in the Victorian Upper House from 1992-1999. Mark is currently the Chairman of Infrastructure Australia, the Port of Melbourne Corporation, PostSuper Pty Ltd and Citywide Service Solutions Pty Ltd.

Ross Johnston, Managing Director and Chief Executive Officer: Ross was appointed chief executive officer of Regis in 2008. Ross has over 30yrs'experince in the construction and services industries. Prior to joining Regis, Ross was Chief Executive Officer of Spotless Australian Services and also held several senior executive positions at Lend Lease and Jennings. Ross is also the Chairman of the Aged Care Guild and Federal Director of Leading Aged Services Australia.

Bryan Dorman, Non-Executive Director: Bryan was Chairman of Regis from its commencement in the early 19902 until 2014 and Executive Chairman until 2008. Prior to joining Regis, Bryan was Partner of Rees Partners from 1977 until 2000 and was National President of the Aged Care Association of Australia from 2004-2012.

Sylvia Falzon, Independent Non-Executive Director: Sylvia has over 27yrs'experience in the financial services industry. Prior to joining Regis Sylvia was Head of Business Development at Aviva Investors Australia, an equity Partner at Alpha Investment Management and Chief Manager International Sales & Service at AXA Investment Management. Currently Sylvia is a non-executive director of Perpetual Limited, SAI Global Limited, Museums Board of Victoria and Cabrini Health Limited.

Trevor Gerber, Independent Non-Executive Director: Prior to becoming a professional director Trevor was an executive at Westfield Holdings Limited for 14yrs, including acting as Group Treasurer and Director of Funds Management. Trevor currently holds directorships at Leighton Holdings, Sydney Airports Group, Tassal Group and CFS Retail Property Trust Group.

Ian Roberts, Non-Executive Director: Ian has over 30yrs'experience in the real estate sector, including 20yrs in residential aged care. Ian currently holds non-executive director positions in several property and property services enterprises. Ian was a founding shareholder and Director (Executive Director prior to 2008) of Regis, Ian headed up the property division and oversaw among other things the development and implementation of strategy.

Management

Ian Smith, Chief Financial Officer: Ian was appointed chief financial officer of Regis in 2011. Ian has over 35yrs'experience in property development, construction and services industries. Prior to joining Regis, Ian was the Chief Financial Officer at MAB Corporation.

Darren Lynch, General Manager: Corporate Development and Acquisitions: Darren was appointed as General Manager: Corporate Development and Acquisitions at Regis in 2010. Darren has over 24 yrs'. Prior to joining Regis, Darren worked with Macquarie Group and was asset manager for its Australian and New Zealand aged care assets.

Michael Horwood, General Manager: Property: Michael was appointed General Manager: Corporate Development and Acquisitions at Regis in 2010. Michael has over 30yrs' experience in both the property development and construction industry specializing in the aged care sector. Prior to joining Regis, Michael held positions with Lend Lease, Primelife, Stockland, FKP and Tricare Limited.

Trish Fairman, General Manager: Quality Assurance / Compliance: Trish joined Regis in 2001 and was appointed General Manager: Quality Assurance / Compliance in 2009. Trish has over 20yrs'experience in senior management positions across residential and community based operations.

Phil Mackney, General Manager: Operations: Phil was appointed General Manager: Operations at Regis in 2009. Prior to joining Regis Phil held various general management and operations positions including in the Australian Defence Force Queensland and hospitality and security sectors.

Michelle Baker, General Manager: Operations: Michelle joined Regis in August 2009 in a project management role. Michelle has over 20yrs'experience in operations, business development and management experience across the hospitality and facilities management sectors.

Performance incentives

Regis offers the following performance incentives to its senior management:

Ongoing STI plan

The ongoing STI plan (STIP) provides Regis' CEO and other members of Regis' senior management with potential for a cash incentive payment calculated as a percentage of their annual fixed remuneration. This payment is conditional on achievement of certain financial and non-financial performance measures both specific to the person and also Regis. Notably if Regis does not meet both the threshold EBITDA target and an ongoing compliance and accreditation target no STI will be payable. In the event the STI award is payable:

1) For key executives it will be payable as follows:

- 66% in cash shortly after the release of Regis' FY15 audited results.
- 17% delivered by a grant of rights to acquire Shares (Performance Rights), which vest 12 months from the grant date

- 17% also delivered by a grant of Performance Rights which will vest after a period of two yrs from the grant date.

2) Other executives, 100% will be paid in cash after the release of Regis'FY15 results.

Legacy cash STI

The legacy cash STI relates to amounts awarded by the previous Board (prior to listing) and were based on set performance targets and other metrics specific to each executive. The total amounts of the grants to be awarded to the senior management team (other than Ross Johnston) are:

- FY13: $438,380, payable on 1 July in each of 2015, 2016, 2017
- FY14: $432,326, payable on 1 July in each of 2015, 2016, 2017
- FY15: $190,000, payable on 1 July in each of 2016, 2017, 2018

Equity LTI

The long term incentive plan (LTIP) is for the grant of performance rights over shares and is available to senior management. Notably on Listing senior management were granted Performance Rights with a face value of $643,860. The Board has the discretion to set the terms and conditions of the performance rights under the LTIP.

The performance period of the LTI will be generally 3yrs, commencing on the Listing ending 30 June 2017 with vesting subject to satisfaction of the performance conditions, with initial performance rights based on Regis' EPS over the Performance Period with the percentage of Performance Rights vesting as follows (and as determined by the Board):

- Less than threshold EPS: Nil
- Threshold EPS: 50%
- Between threshold and stretch EPS: 50-100% on a straight line sliding scale.
- Stretch: 100%

Risks

Company specific risk include

- **Dispute with State Revenue Office Victoria**: Regis is involved in legal action with the State Revenue Office (SRO) in relation to the acquisition by Regis of the shares in Paragon in July 2007. There is a risk the SRO may revise further its valuation of Paragon's Victorian land leading to a further amended assessment for additional duty (decision expected 1H15).

Other industry wide risks include

- **Regulatory and funding risk.** Given the highly regulated nature of the aged care industry and its heavy reliance on Government funds Regis faces regulatory and funding risk including: 1) policy changes which reduce or redirect funding, 2) restrictions on the use of RADs, 3) changes to the rules governing the allocation of approved places, and

d) changes to accreditation standards and physical structure requirements.

- **Repayment of and value of RADs**: Fluctuations in general macro-economic and investment market conditions (including the housing market) may impact the value of bonds and RADs, which would impact on Regis' cashflows.
- **Clinical care and reputational risk**: Failure by Regis to meet clinical care requirements could damage Regis's reputation.
- **Occupancy level risks**: Factors such as industry deregulation, decline in referrals and increased competition could reduce occupancy levels impacting on earnings.
- **Acquisition related risk**. Notwithstanding extensive due diligence relating to acquisitions there is the possibility material issues may not have been identified.

Appendix A – Facilities list

Estia

Figure 134: Location of Estia's facilities and key metrics

Name	Metro/Regional	Occupancy	Licensed places	Ave RAD price ($)	Extra Services places
New South Wales					
Albury	Regional	96%	80	216,515	80
Dalmeny	Regional	94%	115	246,818	36
Epping	Metro	76%	103	571,404	51
Manly	Metro	99%	82	425,662	82
Mona Vale	Metro	90%	54	-	0
Ryde	Metro	98%	40	180,000	0
Willoughby	Metro	96%	74	434,614	74
Queensland					
Albany Creek	Metro	99%	71	277,352	-
Mudgeeraba	Metro	74%	167	169,377	70
Nambour	Regional	78%	75	152,177	61
Southport	Metro	93%	60	200,000	-
South Australia					
Aberfoyle Park	Metro	95%	97	130,993	-
Craigmore	Metro	77%	125	123,100	-
Daw Park	Metro	99%	80	166,071	80
Encounter Bay	Regional	93%	121	128,135	55
Flagstaff Hill	Regional	94%	86	163,699	82
Golden Grove	Metro	89%	100	175,263	100
Kadina	Regional	89%	60	138,900	-
Kensington Gardens	Metro	80%	76	352,632	76
Lockleys	Metro	61%	86	230,347	86
Parkside	Metro	97%	40	172,196	40
Salisbury	Metro	84%	80	148,485	80
Strathalbyn	Regional	92%	47	156,846	47
Salisbury	Metro	97%	71	-	-
Victoria					
Altona Meadows	Metro	93%	90	231,633	-
Ardeer	Metro	94%	55	143,221	-
Bentleigh	Metro	92%	45	181,039	-
Coolaroo	Metro	95%	60	151,401	-
Dandenong	Metro	95%	60	131,694	-
Heidelberg West (Glen Waverly)	Metro	97%	45	136,575	-
Knoxville	Metro	99%	54	155,596	-
Leopold	Regional	95%	75	113,241	-
Melton South	Metro	98%	100	147,493	40

Figure 134: Location of Estia's facilities and key metrics (Cont'd)

Name	Metro/Regional	Occupancy	Licensed places	Ave RAD price ($)	Extra Services places
Oakleigh	Metro	88%	110	181,746	-
Plenty Valley	Metro	98%	68	192,560	-
Ringwood	Metro	96%	161	215,212	-
South Morang	Metro	95%	120	276,949	-
Werribee	Metro	97%	70	184,274	-
Wodonga	Regional	83%	80	178,539	80
Yarra Valley	Regional	92%	91	212,342	-
Wattle Glen	Metro	82%	101	-	-
Prahran	Metro	95%	58	-	-
Total Portfolio (ex acquisitions)			**3,433**		**1,220**
Contracted acquisition	Metro		120	-	-
Contracted acquisition	Metro	-	60	-	-
Subject to due diligence	Metro	-	80	-	-
Total Portfolio + acquisitions)			**3,693**		**1,220**

Source: Deutsche Bank

Japara

Figure 135: Location of Japara's facilities and key metrics

Name	Metro/Regional	Occupancy	Total places	Ave RAD price ($)	Extra Services places
Victoria					
Anglesea	Regional	90%	60	267,675	0
Balmoral Grove	Regional	90%	110	70,134	23
Barongarook Gdns	Regional	95%	60	51,079	0
Bayview	Regional	100%	60	64,482	0
Bonbeach	Metro	94%	70	75,586	0
Capel Sands	Regional	98%	60	65,871	0
Central Park	Metro	98%	165	58,749	165
Elanora	Metro	96%	142	60,647	51
Elouera	Regional	93%	75	59,371	0
George Vowell	Metro	97%	90	60,839	30
Goonawarra	Metro	97%	120	71,642	0
Hallam	Metro	93%	60	71,516	0
Kelaston	Regional	100%	60	65,298	0
Kingston Gardens	Metro	97%	72	62,036	0
Kirralee	Regional	98%	100	66,488	0
Lower Plenty Garden Views	Metro	100%	90	56,585	0
Millward	Metro	99%	163	64,334	0
Mirridong	Regional	95%	90	78,938	0
Narracan Gardens	Regional	92%	167	65,090	0
Roccoco	Metro	92%	77	69,955	0
Rosanna Views	Metro	96%	96	62,962	0
Sandhurst	Metro	97%	30	67,815	0
Scottvale	Metro	88%	110	-	0
Springvale	Metro	90%	73	72,140	0
St Judes	Metro	92%	60	66,249	0
Strzelecki House	Regional	95%	60	62,152	0
Vonlea Manor	Regional	100%	38	64,659	0
Lakes Entrance	Regional	93%	68	60,282	0
Yarra West	Metro	92%	60	72,300	0
Kiverton Park (leasehold)	Metro	93%	30	75,224	-
Viewhills Manor (leasehold)	Metro	97%	120	58,798	-
Tasmania					
Sandhill	Metro	91%	132	61,096	0
South Australia					
Brighton	Regional	97%	76	65,257	0
Lakes Entrance		93%	68		0
Yarra West		92%	60		0
Whelan	Metro	-	258	-	-

Figure 135: Location of Japara's facilities and key metrics (Cont'd)

Name	Metro/Regional	Occupancy	Total places	Ave RAD price ($)	Extra Services places
New South Wales					
Albury & District	Regional	95%	90	72,697	0
Bayview Gardens (leasehold)	Metro	90%	60	64,390	60
Japara's leasehold facilities					
Kiverton Park (Vic)	Metro	93%	30	75,224	
Viewhills Manor (Vic)	Metro	97%	120	58,798	
Bayview Gardens (NSW)	Metro	90%	60	64,390	60
Total Portfolio (ex acquisitions)			**3,172**		**718**
Acquisitions			219		
Total Portfolio + acquisitions			**3,391**		**389**

Source: Deutsche Bank

Regis

Figure 136: Location of Regis' facilities and key metrics

Name	Metro/Regional	Occupancy	Total places	Ave RAD price ($)	Extra Services places
Queensland					
Allora Lodge	Regional	100%	68	218,347	-
Anchorage House	Metro	100%	136	266,880	19
Boronia Heights	Regional	87%	160	230,810	30
Bulimba	Metro	96%	152	179,885	-
Canning Lodge	Regional	100%	120	-	-
Grange Wellington Point	Regional	98%	70	331,158	70
Kuluin	Regional	98%	120	298,511	120
Lakeside	Regional	96%	100	214,616	30
Parkland Manor	Metro	91%	122	326,376	122
Treetops Manor	Metro	97%	134	390,409	48
Valley Views	Regional	94%	60	243,608	-
Wynnum	Metro	60%	100	336,350	58
Yeronga	Metro	88%	100	431,163	100
Redlynch	Regional		194		
Total					
New South Wales					
Delphi House	Metro	82%	72	140,935	-
Gannon Gardens	Metro	96%	110	291,801	24
Hastings Manor	Regional	98%	100	281,624	15
Ku-ring-gai Gardens	Metro	100%	70	397,901	70
The Gardens	Regional	97%	150	307,981	45
Wentworth Manor	Metro	98%	66	452,598	66
South Australia					
Burnside	Metro	99%	167	180,543	-
Playford	Metro	100%	125	131,539	-
Sunset	Metro	96%	67	101,673	-
Victoria					
Amaroo	Metro	89%	90	186,453	42
Bayside Gardens	Metro	98%	65	448,856	65
Heathcliff Manor	Metro	91%	84	226,294	30
Inala	Metro	94%	315	245,671	30
Karingal Manor	Metro	99%	89	182,789	30
Lake Park	Metro	94%	202	413,396	172
McKinley House	Regional	94%	83	479,265	83
Ontairo	Regional	95%	70	127,642	-
Seaside Manor	Metro	96%	58	397,253	-
Shelton Manor	Metro	100%	106	187,274	-
Shenley Manor	Metro	99%	60	412,135	60
Sherwood Park	Metro	95%	149	153,065	-
Sunraysia	Regional	90%	81	86,506	-
The Grange	Regional	99%	129	234,272	-
Waverley Gardens	Regional	94%	171	219,943	60

Figure 136: Location of Regis' facilities and key metrics (Cont'd)

Name	Metro/Regional	Occupancy	Total places	Ave RAD price ($)	Extra Services places
Northern Territory					
Tiwi Gardens	Regional		194		
Western Australia					
Como House	Metro	99%	68	251,595	-
Cypress Gardens	Metro	96%	127	340,901	53
Embleton	Metro	100%	82	259,553	-
Forrest Gardens	Regional	98%	95	199,723	32
Hollywood (2 facilities)	Metro	97%	226	220,707	-
Total Portfolio (ex acquisitions)			**4,719**		**1,474**
Darwin acquisition			135		
Cairns acquisition			194		
Total Portfolio + acquisitions			**5,048**		**1,474**

Source: Deutsche Bank, Company data

Appendix B – ACFI explained

The Aged Care Funding Instrument (ACFI) was introduced in March 2008 and is designed to match funding to the care needs of residents. The ACFI appraisal process involves a detailed assessment of the resident's care needs based on data collected through twelve questions. Daily funding is then determined based on the score from this assessment with higher rates paid for residents who require greater care.

The questions are classified into three categories: 1) Activities of Daily Living (ADLs), 2) Behaviour Supplement, and 3) Complex Health Care Supplement. Residents' needs are classified as Low, Medium or High depending on an A, B, C or D assessment for each question (see Figure 137). In some cases a clinical diagnosis is also required to assess the allocation of funding.

Each aged care provider is responsible for completing the ACFI appraisal and submitting an application for classification to Medicare Australia. Reappraisals are required annually or when the resident's care needs change. Estia has become adept at accurately assessing the care needs of it residents to ensure it receives the appropriate level of funding.

Figure 137: Diagram of ACFI's funding allocation

	Questions	Score	Funding allocation
ADLs	1 - Nutrition 2 - Mobility 3 - Personal Hygiene 4 - toileting 5 - Continence	A, B, C, or D has a score. Total score determines the level of funding	High - Medium - Low
Behavior	6 - Cognitive Skills 7 - Wandering 8 - Verbal Behavior 9 - Physical Behavior 10 - Depression	A, B, C, or D has a score. Total score determines the level of funding	High - Medium - Low
Complex Health Care	11 - Medication 12 - Complex Health Care	A, B, C, or D is applied and a matrix is used to determine the level of funding	High - Medium - Low
Diagnosis	- Mental and behavioral - Medical	Used for minimum data set, support of other ratings, and Behavior Supplement	

Source: Australian Department of Health

Figure 138 below shows the cumulative daily ACFI subsidy rates during the Jul-2013 to Jan-2014 period. The growth rate (including indexation) was approximately 4.5%. The differences across States in terms of subsidies reflect the differences in demographic mix rather than differences in funding rates among States.

Figure 138: Cumulative daily ACFI subsidy rates from Jul-2013-to Jan-2014

State/Territory	July 2012 - January 2013	July 2013 - January 2014	Nominal Growth Over Same Period Previous Year	Real Growth Over Same Period Previous Year
Projected National	**$135.04**	**$141.54**	**4.82%**	**3.06%**
Actual National	**$135.04**	**$141.10**	**4.49%**	**2.74%**
NSW	$132.74	$136.96	3.18%	1.46%
ACT	$129.86	$136.78	5.33%	3.57%
NT	$134.37	$146.12	8.75%	6.93%
QLD	$133.07	$140.11	5.29%	3.53%
SA	$142.36	$147.25	3.44%	1.71%
TAS	$134.76	$140.97	4.61%	2.86%
VIC	$136.61	$143.36	4.94%	3.18%
WA	$135.83	$146.33	7.73%	5.93%

Source: ACFI Monitoring Group, Australian Department of Social Services, Deutsche Bank

The ACFI Monitoring Group evaluates the impact of ACFI's subsidies changes on both government expenditure growth and the aged care sector. It was established in 2012 and its six members serve as advisors to the Australian Government on the overall impact of the ACFI. The ACFI Monitoring Group has held seven meetings and they publish a report with the outcome meetings and relevant data associated with the ACFI subsidy rates.

Appendix C – Industry fee changes from July 14

Grandfathering provisions apply for individuals who enter care prior to 1-Jul-14. This is based on the provisos of continuation of care occurs, including: 1) no break in care for greater than 28 continuous days, 2) they don't move facility, and/or 3) they move or elect to be covered by the new arrangements.

Figure 139 sets out the schedule of fees and charges for residential care under the new reforms.

Figure 139: Schedule of fees and charges for residential and home care (post 1-Jul-14)

	Single person	Couple*	Couple**
Income Free Area (annual amount) Home Care and Residential Care			
Income Free Area	$25,118.60	$24,650.60	$19,492.20
Income Thresholds (annual amount) Home Care Income Test			
Income Threshold	$48,583.60	$48,115.60	$37,180.00
Asset Thresholds Residential Care Means Test			
Asset Free Threshold	$45,500	$45,500	$45,500
First Asset Threshold	$155,823.20	$155,823.20	$155,823.20
Second Asset Threshold	$376,469.60	$376,469.60	$376,469.60
Home Exemption Cap	$155,823.20	$155,823.20	$155,823.20
Caps on Income Tested Care Fees in Home Care			
First Cap	$13.92	$13.92	$13.92
Annual Cap – income not exceeding Income Threshold	$5,069.84	$5,069.84	$5,069.84
Second Cap	$27.85	$27.85	$27.85
Annual Cap – income exceeding the Income Threshold	$10,139.68	$10,139.68	$10,139.68
Cap on Means Tested Care Fees in Residential Care			
Annual cap	$25,349.21	$25,349.21	$25,349.21
Lifetime cap on Means Tested Care and Income Tested Care Fees in Home Care	$60,838.12	$60,838.12	$60,838.12
Maximum accommodation supplement (per day)	$53.04	$53.04	$53.04
Deeming thresholds and rates			
Thresholds	$48,000	$79,600	$79,600
Lower rate	2.0%	2.0%	2.0%
Higher rate	3.5%	3.5%	3.5%
Refundable deposits and daily payments			
Max Permissible Interest Rate (new residents, 1-Jul-14 to 30-Sep-14)	6.69%	6.69%	6.69%
Max Permissible Interest Rate (new residents 1-Oct-14 to 31-Dec-14)	6.63%	6.63%	6.63%
Maximum rate of interest chargeable on outstanding amount of daily payment	6.63%	6.63%	6.63%
Base Interest Rate	4.0%	4.0%	4.0%
Min permissible asset level	$45,500	$45,500	$45,500
Max refundable accommodation deposit (w/out approval)	$550,000	$550,000	$550,000

Source: Australian Department of Social Services
**Couple, illness separated, single rate*
***Living together, single rate*

Appendix D – Glossary of terms

Figure 140: Glossary of terms

Term	Definition
ACA	Aged Care Assessment
Agreement	Residents Agreement 2014
ACAR	Aged Care Approvals Round
ACAT	Aged Care Assessment Team
Accommodation bond	The term used prior to 1 July 2014 to refer to a lump sum refundable accommodation deposit
ACFI	Aged Care Funding Instrument
Aged Care Act	Aged Care Act 1997 (Cth)
AIHW	Australian Institute of Health and Welfare
Approved Provider	An aged care provider as accredited by the Department of Social Services under the Aged Care Act
AACQA	Australian Aged Care Quality Agency
Brownfield	An aged care development on a site where the aged care provider currently or has previously operated an aged care business
CAGR	Compound annual growth rate
CAP	Conditional Adjusted Payment
CEO	Chief Executive Officer
COO	Chief Operating Officer
COPO	Commonwealth Own Purpose Outlays
CFO	Chief Financial Officer
Cook Care	The residential aged care assets of the business that were operated under the Cook Care brand prior the acquisition by Estia Investments
CPI	Consumer Price Index
DAC	Daily Accommodation Contribution
DAP	Daily Accommodation Payment
Dedicated Extra Service	Status which allows aged care facilities to offer a higher than average standard of accommodation, services and food to residents
DSS	Department of Social Sciences
EBA	Enterprising Bargaining Agreement
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortization
Estia	Estia Health Limited
Extra Services	Services that are not dependent on the level of care and include, a higher standard of accommodation, food and services (ie entertainment)
Extra Services Agreement	Estia's resident agreement for all residents entering a Dedicated Extra Service place post 1 July 2014
Federal Budget	The Government's yearly budget
Greenfield	An aged care development on a site where the aged care provider has not previously operated an aged care business
Government	Australian Government
HR	Human resources
High Care	Nursing care services, in addition to personal care services, that are generally provided to residents who need almost complete assistance with almost all daily living activities
IT	Information technology
KPI	Key performance indicators
Listing	Listing means the listing of a stock on the ASX
LLLB	Living Longer Living Better
Low Care	Personal care services, such as assistance with daily living which may include clinical support, that are generally provided to more independent residents
LTIP	Estia's long term incentive plan

Figure 140: Glossary of terms (Cont'd)

Term	Definition
MPIR	Maximum Permissible Interest Rate, as determined by the Australian Government in accordance the with the Fees and Payments Principles 2014 (No.2)
NPAT	Net Profit after tax
Occupied place day	The number of days an operational place is occupied by a Resident
Operational place	A place available for occupancy by a Resident
Padman Health Care	The residential aged care assets of the business that were operated under the Padman Health Care brand prior the acquisition by Estia Investments
Performance Period	8-December-2014 to 30-June-2017 (a period of 31 months)
place	An allocated place under the Aged Care Act. being a place that is capable of attracting the residential care subsidy on a per resident per day basis
POPD	Per operating place day
Pro Forma Forecast Financial Information	The pro forma consolidated forecast income and cash flows from FY2015 and CY 2015
Pro Forma Forecast Results	Pro Forma consolidated forecast income statement for FY2015 and CY2015
Pro Forma Historical Results	Pro Forma historical income statements fro FY2012, FY 2013 and FY2014
RAC	Refundable Accommodation Contribution
RAD	Refundable Accommodation Deposit
Resident	A person who occupies a place within an aged care facility
Secretary	Secretary of the DSS
STIP	Estia's short term incentive plan
Supplement	Dementia and Severe Behaviors Supplement

Source: Deutsche Bank

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Japara Healthcare	JHC.AX	1.95 (AUD) 22 Jan 15	NA
Regis Healthcare	REG.AX	4.09 (AUD) 22 Jan 15	NA
Estia Health	EHE.AX	4.50 (AUD) 22 Jan 15	1,6,7

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors . Data is sourced from Deutsche Bank and subject companies.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States. See Important Disclosures Required by Non-US Regulators and Explanatory Notes.

1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.

6. Deutsche Bank and/or its affiliate(s) owns one percent or more of any class of common equity securities of this company calculated under computational methods required by US law.

7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.

Important Disclosures Required by Non-U.S. Regulators

Please also refer to disclosures in the Important Disclosures Required by US Regulators and the Explanatory Notes.

1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.

6. Deutsche Bank and/or its affiliate(s) owns one percent or more of any class of common equity securities of this company calculated under computational methods required by US law.

7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.

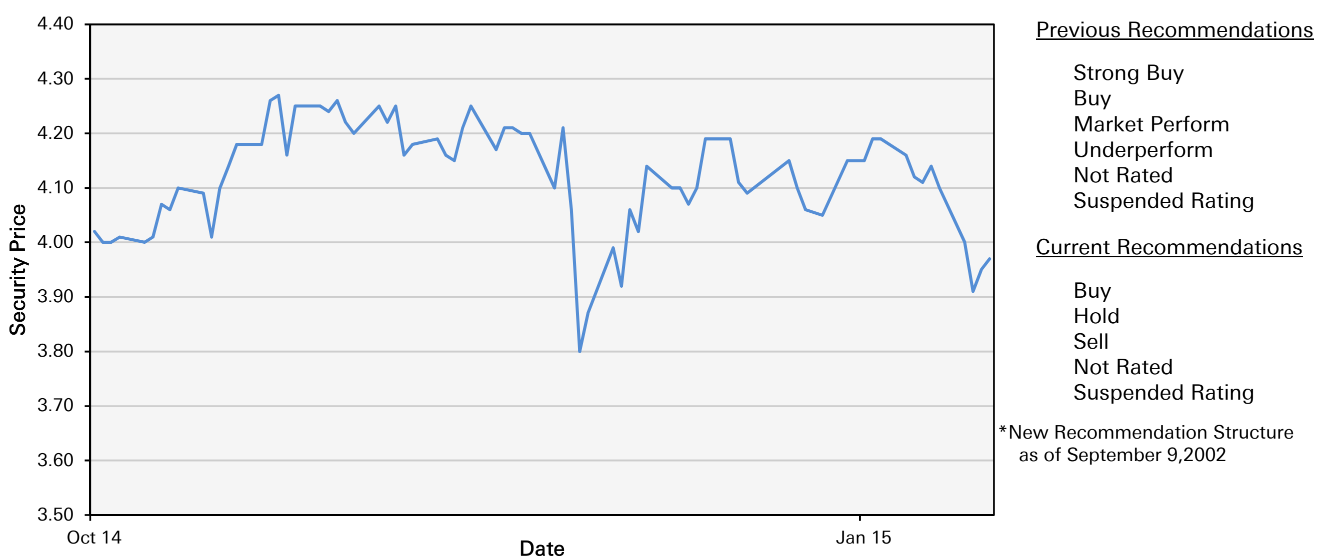
For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr

Analyst Certification

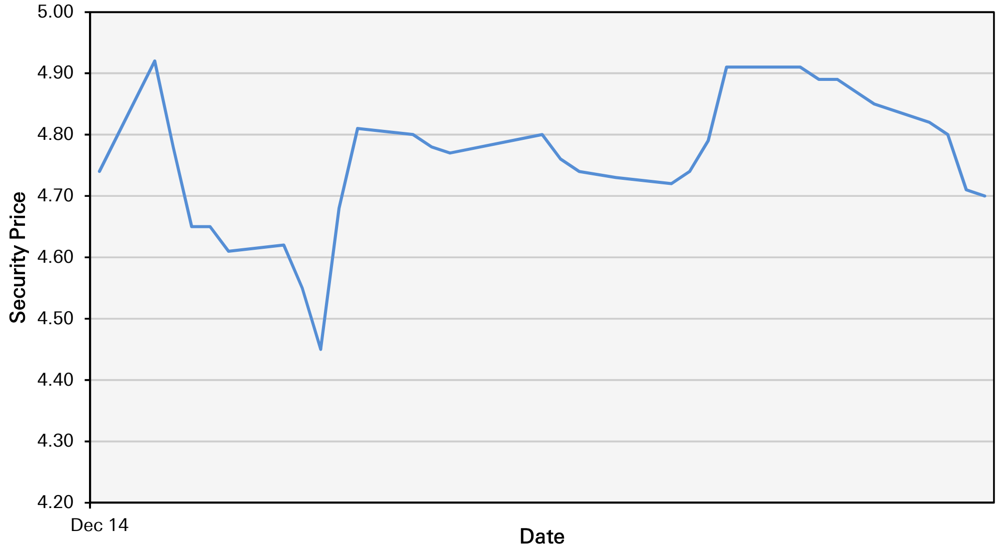
The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. David Low

Historical recommendations and target price: Japara Healthcare (JHC.AX)
(as of 1/22/2015)

Historical recommendations and target price: Regis Healthcare (REG.AX)
(as of 1/22/2015)



Historical recommendations and target price: Estia Health (EHE.AX)
(as of 1/22/2015)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

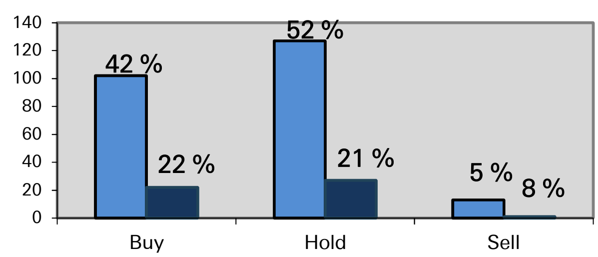
Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.
Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock
Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.
Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:

Buy: Expected total return (including dividends) of 10% or more over a 12-month period
Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Companies Covered Cos. w/ Banking Relationship

Australia Universe

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