Russell Kennedy & EY Webinar –
The new normal for capital markets: Australian Aged Care

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Presenters: Victor Harcourt, Mark Miller, Rohan Harris and Solomon Miller

Russell Kennedy
Lawyers

EY

Melbourne > Sydney

Webinar Overview

- Housekeeping
- Overview
- Capital markets
- The latest phase in Australian Aged Care
- How to navigate the funding options universe
- Next steps & what you can do now
- Q&A

Webinar housekeeping

- All attendees will be on mute and their cameras turned off for the entire webinar
- We have BD tech support live to assist with any technical issues
- **Use the chat function** for any comments/technical issues
- **Use the Q&A function** for specific questions related to the webinar content - Questions will be addressed at the end of the webinar
- There will be a post webinar survey link sent at the end of the webinar, we value attendee feedback, presentation slides will also be sent to all attendees
- We will also have a QR code linking to our feedback survey towards the end of the presentation so you can provide instant feedback
- This webinar is being recorded

Disclaimer

The information contained in this presentation is intended as **general commentary only** and should not be regarded as legal advice.

Should you require specific advice on the topics or areas discussed, please contact the presenters directly.

Summary

1. Capital markets: stimulus vs crisis
2. The latest phase in Australian Aged Care
3. Navigating the funding options universe

Key takeaways

- Markets are highly liquid, with uncertainty resulting in a flight to quality and therefore pricing impact depending on credit profile
- Corporate strategies have focused on securing access to funds and financial covenant management
- Pandemic impact on Aged Care is emerging as a squeeze on liquidity due to net RAD outflows
- Banks are generally supportive of Aged Care operators in considering funding requests and financial covenant waivers, however this may change into early 2021 as JobKeeper and other support mechanisms are lifted
- The future is uncertain - Aged Care operators are encouraged to review their capital management strategies, consider all financing options (incl. non-bank) and implement funding solutions while lenders are supportive

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1

Capital Markets: Stimulus vs Crisis

"You can't fight the Fed"

International debt capital provider
August 2020

Business test – the pandemic has exposed the liquidity strength of businesses by reducing demand and revenue like never before

Highly liquid markets – regulatory bodies globally have flooded capital markets with liquidity, increasing demand for assets

Quick decision-making - Large corporates moved quickly to fortify their balance sheets through capital raisings

Flight to quality – Markets are open and functioning with investors rotating toward higher quality names

Pricing inequality – While borrowing base rates have fallen, changes in risk premiums (margins) have varied depending on credit profile

Residential aged care sector observations and trends

- Government “stimulus” has been more focussed on subsidising additional staffing, crisis management and infection control/PPE costs associated with the pandemic
- Many boards and executive teams in both corporate and NFP sectors are understandably spending more time on infection prevention, stakeholder engagement and crisis management
- Stocks in ASX listed operators which were already in decline before pandemic have taken a further hit – which must impact on availability of further capital (equity/debt) for future investment
- Bank debt remains unattainable or very expensive for smaller providers who present either high or unacceptable credit risk
- Equity capital raising is not an option for NFP providers, a very large proportion of whom already run financially unprofitable operations

2

The latest phase in Australian Aged Care

We are learning to expect the unexpected

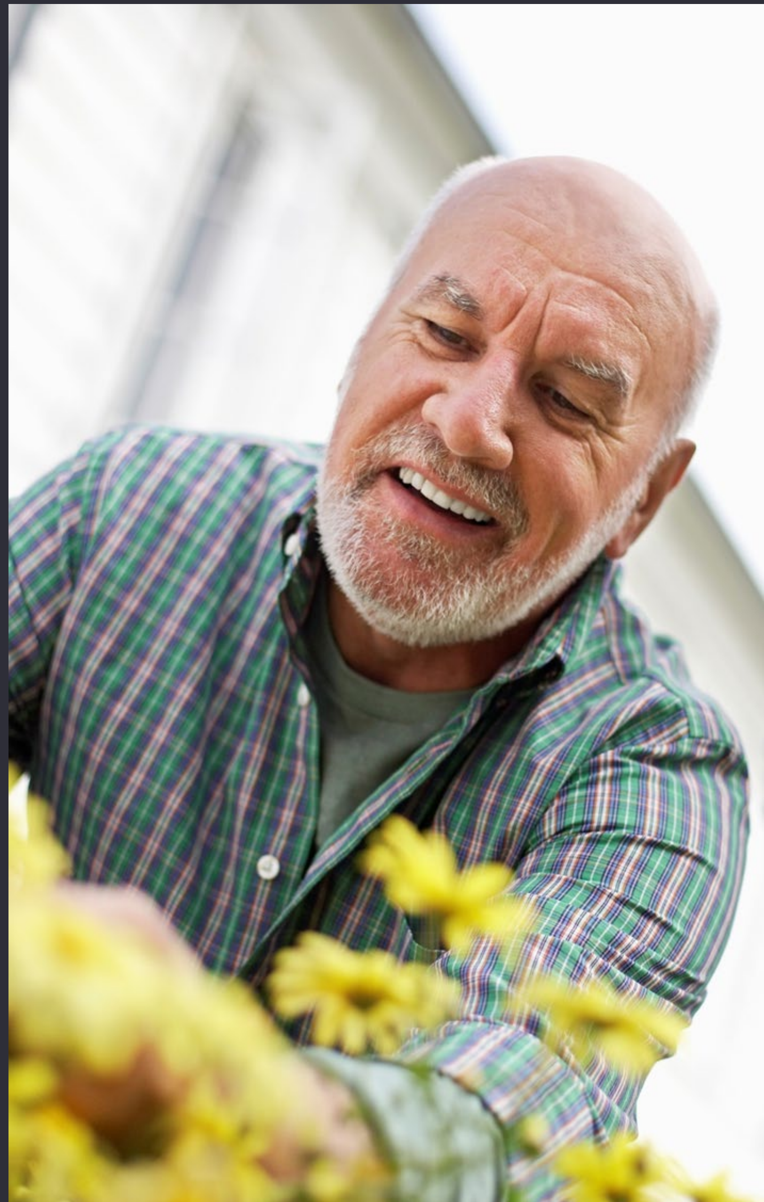
Pre-pandemic

Profitability, cashflow and occupancy all declining, exacerbated by the Aged Care Royal Commission and current regulatory framework

Slower ramp-up of residents into new sites, taking ~24 months to fill (an additional 6-12 months)

RAD / DAP ratio has seen minor reduction but mostly steady

RAD levels relatively stable (amongst steadily rising property market), but some instances of RAD discounting on trade-up



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Sans-pandemic

Australia (ex-Victoria)

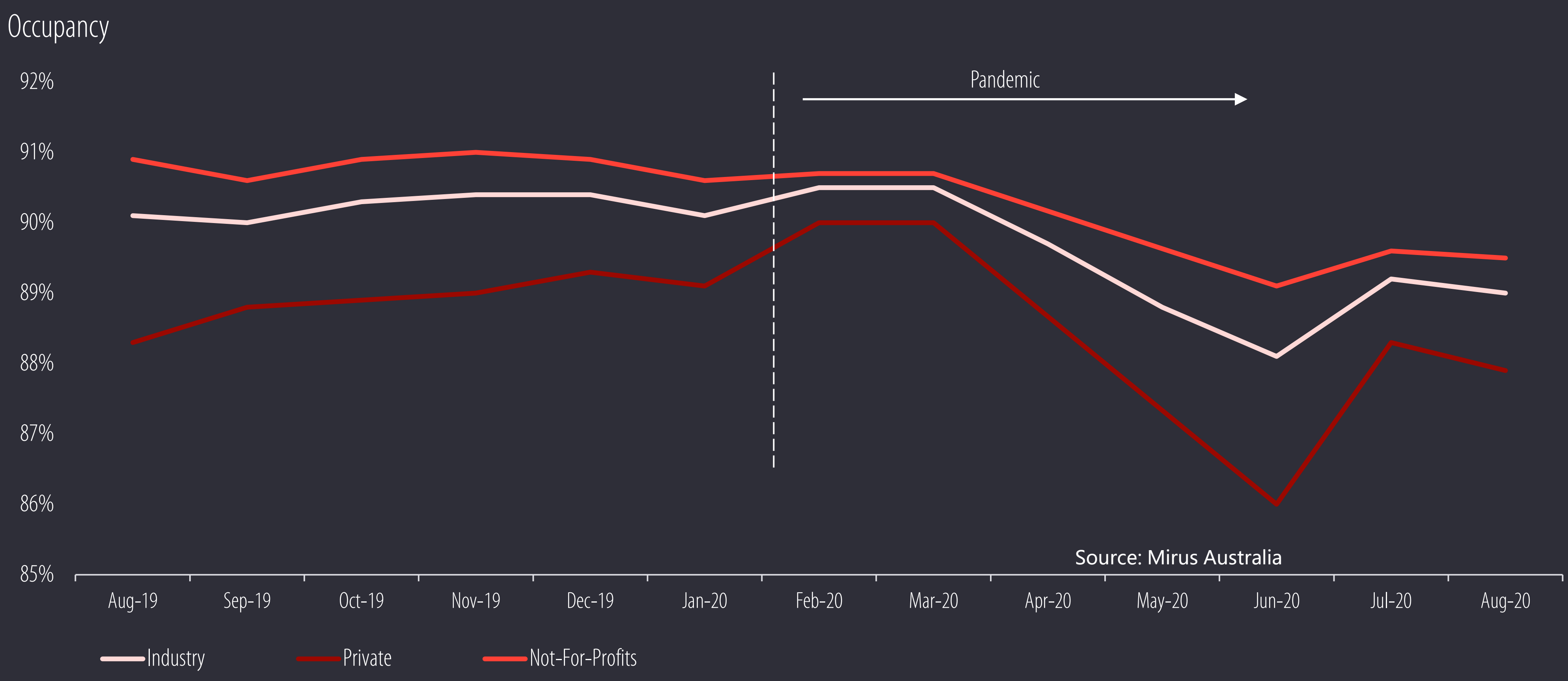
- Higher costs from greater infection controls and staff taking paid sick leave whilst being replaced by agency staff / contractors
- Reduced occupancy and revenue from an increase in residents taking social leave
- However some sites experiencing a temporary increase in residents due to transfers from hospitals and respite patients

Victoria

- Greater direct impact emerging
- Occupancy reducing due to lower intakes
  - Prospective residents can't tour sites
  - Staying in home care longer (children holding back placement of parents into Aged Care facilities)
  - Single room restrictions
  - However still event driven new residents
- Staffing challenges impacting quality of care
  - Restricted to working at one site
  - Reluctance to work at infected sites
- Reputation for care now carries greater importance with potential new residents

Sans-pandemic

More recent occupancy reduction from COVID, noting July bounce aided by respite patients filling empty beds



Potential future impact

The duration of the pandemic is uncertain and remains a risk to operators

Expenses

Continuation of additional staff costs and expenditure on personal protective equipment and higher consumable spending

Occupancy

Residents succumbing to virus

Facility contagion risk (potential new residents not moving into the facility)

Sector contagion risk (potential new residents continue to be cared for at home)

RAD / DAP ratio

Potential reduction due to new residents being unable to sell their home in the current economic climate to finance their RAD, instead paying a DAP

Avg. RAD levels

Reducing commensurate with forecast property price falls

Potential liquidity squeeze

3

Navigating the funding options universe

Getting prepared financially for future uncertainty

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Capital management considerations

Scenario analysis and stress testing

Perform scenario and stress testing analysis to examine financial position and liquidity requirements

Financing options

Review existing facilities and consider whether amendments, additional headroom or waivers are appropriate.

Capital management strategy

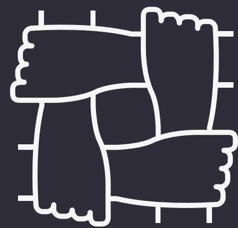
Help establish a capital management plan for now and post pandemic including an optimal capital structure for the circumstances

Financing options update

Bank debt

Sale & leaseback / Opco Propco

Development financing



Industry consolidation

Traditional

Alternative

Financing options

Bank debt

Generally supportive

Working capital and covenant waivers available (for now) but limited appetite to fund additional core requirements, particularly for 'new to bank' names

Sale & leaseback / Opco Propco

Becoming selective

Focus on stronger counterparties (top 20% profitability) and larger scale players (>100 beds or >3-4 sites)

Development financing

Scrutiny

Increased scrutiny around sustainability of operators during & post pandemic

Industry consolidation

Higher pricing

Internal focus on returns and use of capital has led to higher pricing

Financing options

Bank debt

Sale & leaseback / Opco Propco

Development financing

Industry consolidation

Strong appetite

Numerous seeking to acquire large multi-site freehold property portfolios from providers

Low cap rates

Opportunity to take advantage of current low freehold capitalisation rates

Efficient

Can be a more efficient allocation of capital, allowing investment in operational aspects such as quality and capacity

Majority Opco Propco

Release capital whilst retaining majority ownership and control of the Propco

Financing options

Bank debt

Sale & leaseback / Opco Propco

Development financing

Industry consolidation

Additional capacity

Finance the construction of new developments (in some cases as high as 100% of development costs)

Expansion

Expand capacity via new sites without the need for any capital investment or sale of existing properties

Savings

Non bank solutions can provide potential savings on the capital costs of holding expensive undrawn lines

Ring-fence or lease

Can be ring-fenced from group debt facilities or as a sale & leaseback structure

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Financing options

Bank debt

Sale & leaseback / Opco Propco

Development financing

Industry consolidation

Increasing interest

Equity interest in the sector has increased recently, noting media has reported private equity firms circling the listed operators

Improve balance sheet

Consolidation can reduce overhead costs and improve balance sheet strength

Access capital

Assist in accessing capital for the purposes of refurbishing existing assets and greenfield development

Strategy alignment

Important to ensure the appropriate platform is in place to achieve the intended alignment of strategy

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Consolidation and what to expect as a seller

- Sophisticated buyers will want an open book and will know what to look for – be ready for the due diligence process
- Expect “material adverse change” get-out clauses for COVID infection risk events
- Some buyers may take on known non-compliance risk, but will price accordingly
- Management of communications and expectations of residents, families and staff is critical
- Good location and scope for capital improvement is helpful
- Watch for timing of COVID subsidies and adjustments pre and post settlement

Observations and trends

Need to strategise – more than ever this step is crucial to establishing the appropriate capital platform to ride out the pandemic

Generally supportive - Banks and non-bank lenders remain supportive of existing clients, although this may change should there be a material negative impact to the economy/sector

Longer process – Bank credit processes taking longer due to more onerous due diligence requirements and banks incurring bottlenecks in credit decisioning due to workload

Alternative funding – Considered should liquidity (or accessibility of funding lines) become an issue, whether actual or forecast

Window may be closing – Proposals to bank lenders should be made soon and carefully considered with regards to pandemic impact and recovery

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Takeaways

1. It's a challenging time to navigate capital markets, however high liquidity means funding sources remaining open

2. Operators should reassess their capital management strategy to accommodate an extended pandemic impact, and consider both bank and non-bank funding options

3. Window of opportunity could be closing with banks to negotiate additional funding flexibility/capacity

Next steps & what you can do now

- The gap between the "haves" and the "have nots" in the sector and their ability to see things through is likely to increase
- The demands and accountability placed on owners, boards and executive teams is even more amplified
- If it wasn't already the case before the pandemic, then operators should be considering the case for consolidation or growth vs. the case for exit
- This applies equally in the for profit and NFP sectors where we expect to see further consolidation and merger activity in the coming months

Q&A – Your Russell Kennedy Contacts

Victor Harcourt
Russell Kennedy - Melbourne
Principal
(03) 9609 1693
vharcourt@rk.com.au

Mark Miller
EY
Director | Capital & Debt Advisory
(03) 8650 7838
mark.miller@au.ey.com

Rohan Harris
Russell Kennedy - Sydney
Principal
(02) 8987 0024
rharris@rk.com.au

Solomon Miller
Russell Kennedy - Melbourne
Principal
(03) 9609 1650
smiller@rk.com.au

Matt Anning
EY
Director, Perth
+61 8 9429 2451
matt.anning@au.ey.com

Anita Courtney
Russell Kennedy - Melbourne
Principal
(03) 8602 7211
acourtney@rk.com.au

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Russell Kennedy Pty Ltd
info@rk.com.au
russellkennedy.com.au

Melbourne
Level 12, 469 La Trobe Street
Melbourne VIC 3000
PO Box 5146
Melbourne VIC 3001 DX 494 Melbourne
T +61 3 9609 1555 **F** +61 3 9609 1600

Sydney
Level 6, 75 Elizabeth Street
Sydney NSW 2000
Postal GPO Box 1520
Sydney NSW 2001
T +61 2 8987 0000 **F** +61 2 8987 0077