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Estia Health 11/12/2018 **FAT-AUS-902**

EHE AUD $2.21 Spec. **HIGH** S

Under the microscope

Former Federal Court Judge Richard Tracey has been appointed to the Royal Commission into Aged Care, replacing one of the former commissioners who withdrew for family reasons. Health Minister Greg Hunt said the appointment will have no impact on the time frame for the Royal Commission, which is scheduled to release an interim report on the aged care sector by October 31 next year and a final report by 30 April 2020. Investors are braced for an extended period of significant scrutiny into the sector and for some “difficult stories” that will impact stocks across the sector, including Estia Health (ASX.EHE).

Industry CEOs earlier put on a brave face in response to the surprise announcement of a full scale Royal Commission into the sector. Estia Health’s then CEO, Norah Barlow released a statement that the company welcomed "scrutiny of the sector and any measures that would help not only ensure the safety and quality care of its residents but also provide a sustainable sector for all those in aged care." She went on that Estia “looks forward to engaging in the consultation with government on the terms of reference for the commission."

Earlier Barlow had called for a national register of aged care workers, so employers in the sector can better screen for workers. As with other industries, most workers are doing the job to the best of their ability and those workers are appalled when there is so-called ‘rough handling’ by some staff of our aged community in care.

The Royal Commission into the Banking, Superannuation and Financial Services Industry has highlighted how destructive they can be on the valuations of the companies in the spotlight, with the fallout continuing.

The top down thematic for the aged care sector has some compelling aspects, with Australians living longer, and many baby boomers are set to retire over the next two decades, increasing the demand for high quality aged care services. This is particularly as studies show that most retirees will need to cash up equity in their own homes, and move into care to sustain themselves in their golden years.

A PWC report estimates that that an additional 226,000 residential aged care places will be required by 2040 at a cost of just under $30 billion given a growing and aging population.

Source: PWC

In addition to the top down tailwind, we also note sector valuations, including those of Estia Health have already compressed materially, <u>but we are increasingly cautious about the potential for further damage to valuations in the aged care sector from the Royal Commission.</u>

While revelations of bad behaviour by banks and other financial institutions have been negatively received. **The potential for stories that shock in the aged care sector is much higher, given many of us have relatives in care and will end up in care ourselves at some point.**

There have already been various shocking stories emerge over recent years of mistreatment and neglect in the sector and this really strikes home. The attention will be coming in spades, and an earlier ABC investigation highlighted some deplorable instances of mistreatment and neglect. This has ranged from physical abuse to the serving of food regarded as not fit for human consumption.

We don't know which companies will find themselves in the crosshairs in the Royal Commission. We would hope there would be none and there were no instances revealed of mistreatment or neglect, but sadly that is unrealistic. Most workers in the sector provide the best care they can in often tough working conditions, but we know from past exposes there are some very sad stories of mistreatment or neglect in the industry.

As we have seen with the banking and financial services sector, an outcome from the commission will no doubt be tighter regulation.

<u>A likely outcome is recommended minimum staffing levels and qualifications in the sector, and while that makes sense, there are already nursing shortages.</u> A welcome (for staff) increase in remuneration would pressure margins in an industry where some operators are already unprofitable, and likely to go out of business if costs rise significantly further (and hence Ms Barlow's reference to providing for a 'sustainable sector.) The government will have to shoulder some of the burden, but that won't be an easy 'fix' and it remains to be seen how much the Federal Government can, or will chip in. Consumers are the other party

that will need to shoulder some of the increased cost, but a slowdown in the housing market won't help on that front.

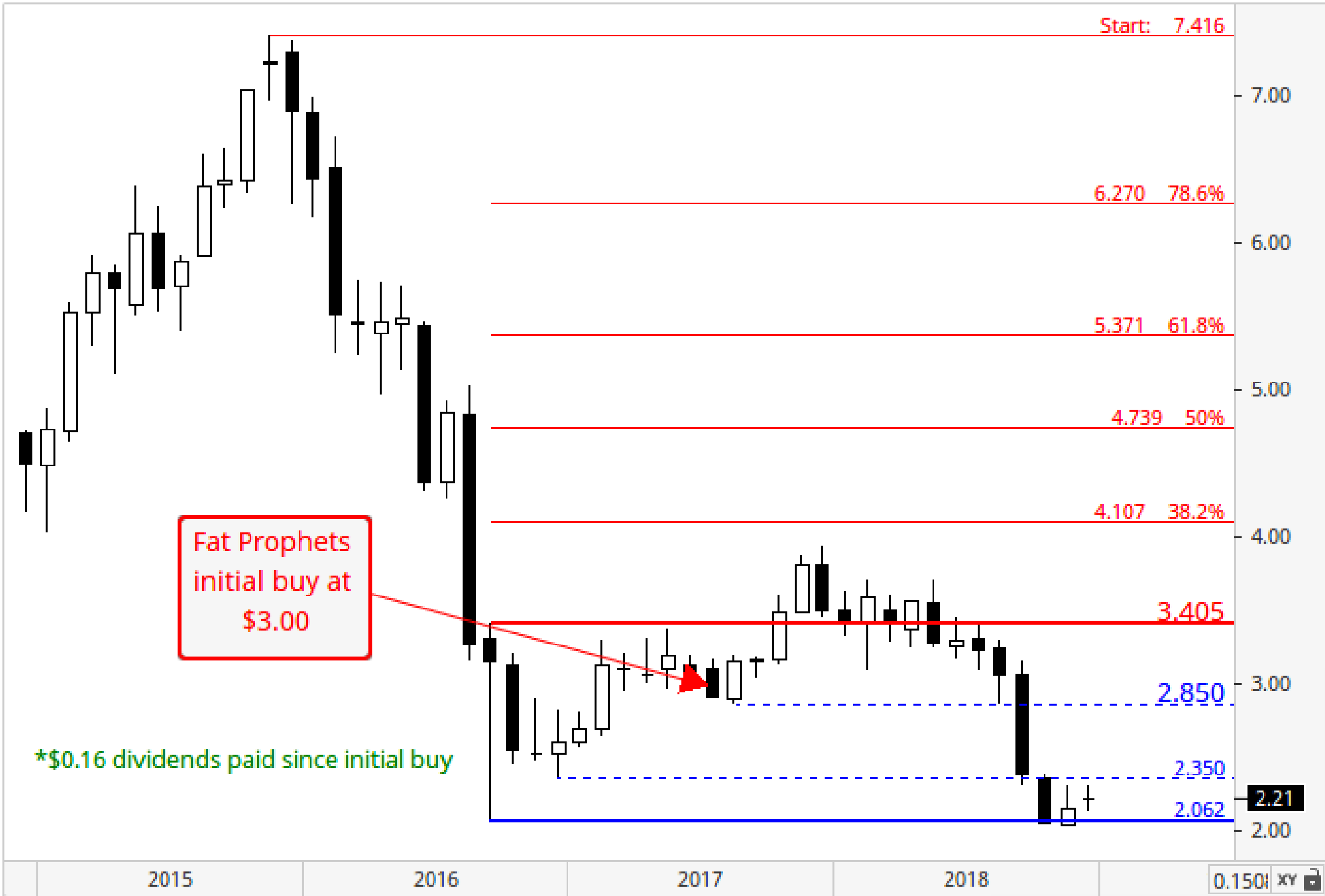
Besides tighter regulation, leading to higher costs in the sector, occupancy levels in the sector could be pressured by any “difficult stories” that emerge during the Royal Commission hearings. These will likely have some reconsidering or delaying decisions to move into an aged care home, for themselves or family members.

Turning to the charts, and the technical picture has deteriorated significantly following the announcement of the Royal Commission. Prices have dipped further below both the 50 day (red line) and 200 day (green line) moving averages. Support at $2.85 has also given way decisively, as has a buttress at $2.30. Support at the October lows of $2.03 could be under threat in the near term.

Estia Health Limited - EHE (ASX) - 1 Day CandleStick Chart - AUD

On the monthly, the share price touched an all-time low of $2.06 in September 2016 to form a 'bullish doji' candlestick formation. Positively, the highest price of this candle of $3.41 was surpassed in October 2017. This was a bullish development and signalled a medium-term upward shift in momentum. However, support at $2.85 then failed to hold, as did that at $2.35. The all-time low now looks to be under threat again, and at best an extended period of consolidation is likely.

Estia Health Limited - EHE (ASX) - 1 Month CandleStick Chart - AUD



Summary

Investors are braced for an extended period of significant scrutiny into the aged care sector, and for some “difficult stories” that will impact stocks across the sector, including Estia Health, with the Royal Commission scheduled to release an interim report on the aged care sector by October 31 next year and a final report by 30 April 2020.

We don’t know which companies will find themselves in the crosshairs in the Royal Commission. We would hope there would be none and there were no instances revealed of mistreatment or neglect, but sadly that is unrealistic. Most workers in the sector provide the best care they can in often tough working conditions, but we know from past exposes there are some very sad stories from mistreatment or neglect in the industry.

While the top down thematic for the industry has some compelling aspects, we believe the impact on the industry from the Royal Commission is likely to be material and lead to an extended period of weak sentiment towards stocks in the sector, including Estia Health.

Accordingly, we recommend Members sell Estia Health. It will be removed from the Fat Prophets portfolio.

Snapshot EHE

Estia Health

Latest Closing Price: $2.21

Estia Health is engaged in operating and developing owned and leased residential aged care facilities throughout Australia. The Company's homes offer a range of care services, from providing semi-independent living, to specific and comprehensive care for those with memory or cognitive support needs. The Company offers services, including personal assistance, meals, therapies and lifestyle activities. It offers residents with general activities, such as gardening, reading, movies, music, parties, cultural celebrations, art sessions or daytrips and lifestyle coordinators, and can also cater for many specialist interests. It offers clinical care that includes regular reviews and includes daily medication; pain management program; medical services, such as physiotherapy, pharmacy, podiatry, optometry and dental; specialist dementia care, and personal care. It operates homes in Victoria, South Australia, New South Wales and Queensland.

Market Capitalisation:$575.93m

	FY1	FY2
Price to Earnings	20.9	13.0
Dividend Yield (%)	4.8	7.4
Price to Book	1.1	0.7
Return on Equity (%)	5.4	5.9
EV/EBITDA	7.1	6.8