Integrity + Quality + Clarity

AGED CARE FINANCIAL PERFORMANCE SURVEY

APPROVED PROVIDER ORGANISATION ANALYSIS - MARCH 2017

The StewartBrown *Aged Care Financial Performance Survey* incorporates detailed financial and supporting data for the period ended **31 December 2016** from over 830 residential aged care facilities and 445 home care programs across Australia. The quarterly survey is the largest benchmark within the aged care sector and provides an invaluable insight into the trends and drivers of financial performance at the sector level and at the facility or program level.

Significant aged care knowledge

If you work in aged care, disability or community services you have likely have heard our name; StewartBrown is trusted by industry experts, providers and government to provide analysis and insights.

We are recognised nationally as the leading provider of audit, accounting and consulting services to the aged care sector in Australia.

We also run Australia's largest aged and community care financial benchmarking survey. Our data is recognised in the industry, by government and the finance sector, as the leading information source and performance monitor for aged care.

We have over 180 providers participating, including 830 residential aged care facilities and 450 home care programs.

"Advice using your language, supporting your goals"

AGED CARE FINANCIAL PERFORMANCE SURVEY

830+ RESIDENTIAL CARE PROVIDERS

450+ HOME CARE PROVIDERS

23 MILLION CARE DAYS OF DATA

6 ANNUAL ROADSHOWS TO 600 ATTENDEES

30+ PRESENTATIONS TO INDUSTRY

6+ CONFERENCE KEYNOTES

PUBLIC REPORTING BACK TO 2007

QUARTERLY REPORTING

Contents

December 2016 Balance Sheet Summary

Assets

Cash and cash equivalents
$2.8 billion
[June 2016 $2.6b]

Other financial assets
$1.5 billion
[June 2016 $2.6b]

Property, plant & equipment
$9.4 billion
[June 2016 $8.6b]

Investment property
$1.7 billion
[June 2016 $1.6b]

Intangible assets
$0.5 billion
[June 2016 $0.5b]

Other current and non-current assets
$0.6 billion
[June 2016 $0.6b]

Total Assets
$16.4 billion
[June 2016 $15.3b]

Liabilities

Resident liabilities (Aged Care)
$4.7 billion
[June 2016 $4.3b]

Borrowings
$0.7 billion
[June 2016 $0.6b]

Resident liabilities (ILU and other)
$3.4 billion
[June 2016 $3.0b]

Employee liabilities
$0.5 billion
[June 2016 $0.5b]

Creditors and other current and non-current liabilities
$0.8 billion
[June 2016 $0.6b]

Total Liabilities
$10.1 billion
[June 2016 $9.1b]

NET ASSETS
$6.3 billion
[June 2016 $6.2b]

INTRODUCTION

The StewartBrown *Aged Care Financial Performance Survey* (ACFPS) surveys quarterly financial and non-financial data for residential (by facility) and home care (by program) at a granular level. In addition, the survey obtains specific segment information and key balance sheet information at organisation (approved provider) level every six months.

The Approved Provider Organisation Analysis report is prepared every six months and includes an analysis and comparison to the public equity listed providers.

This current report concentrates on the balance sheet (equity) and revenue and expense financial analytics comprising detailed and granular financial information provided from the 106 common provider organisations who submitted this information for both the year ended 30 June 2016 and 31 December 2016.

Accordingly, for the June 2016 comparison purposes, we have used the same provider organisations as noted above. We have also included the summarised financial information for the three (3) listed entities (Regis Aged Care, Estia Health and Japara Healthcare).

A number of other provider organisations submitted their respective residential and HCP data but were unable at the time to provide the balance sheet data in the format for these periods as required. However, we have included some core statistics for the entire survey to obtain some additional comparative analysis as appropriate.

Please note that unless otherwise stated the *Average* and *Top Quartile* data analysis quoted in this report are based on the **organisation performance as reported in the consolidated financial performance statement** and as such may vary from the quartiles included in the quarterly StewartBrown ACFPS survey which groups segment analysis based on individual facility and program levels.

This intent of the Organisation Report is to provide a detailed insight into the balance sheet and financial performance of aged care providers at organisation level rather than at segment level.

HEADLINE FINANCIAL RESULTS

The following provides a **snapshot analysis as at 31 December 2016** for the three listed companies and the StewartBrown ACFPS *ALL* and *Top Quartile* Approved Provider organisations.

Table 1: Snapshot analysis of the aged care listed providers and the StewartBrown ACFPS Organisation Survey Providers as at 31 December 2016

	ESTIA	JAPARA	REGIS	ACFPS *ALL*	ACFPS *TOP 25%*
Normalised revenue*	$263.1m	$178.5m	$284.7m	$2,661.4m	$224.9m
Normalised EBITDA	$45.2m	$29.1m	$61.8m	$281.0m	$51.3m
EBITDA as % of Normalised revenue	*17.2%*	*16.3%*	*21.7%*	*10.6%*	*22.8%*
Equity**	$673.3m	$534.4m	$188.5m	$6,330.8m	$1,151.4m
Retained earnings (Accumulated losses)	($62.3m)	$12.9m	$12.9m	n/a	n/a
Net tangible assets (liabilities)	($298.3m)	$68.9m	($212.9m)	$5,852.0m	$1,125.1m
Cash and financial assets (liquid)	$86.2m	$63.2m	$54.1m	$4,268.0m	$659.0m
Resident debt	$691.7m	$431.4m	$899.7m	$8,101.3m	$1,102.8m
External debt	$267.5m	$71.0m	$199.6m	$702.9m	$135.9m
Liquid cash assets as % of debt	*9.0%*	*12.6%*	*4.9%*	*48.5%*	*53.2%*

**Normalised for the acquisitions and other one off items*
***Equity includes goodwill and other intangibles*

FINANCIAL PERFORMANCE - EBITDA

The sector primarily uses EBITDA[1] as a measure of financial performance. EBITDA is defined as earnings before interest, tax, depreciation and amortisation. For the listed providers, we have used Normalised EBITDA which excludes acquisition-related costs and one-off costs. EBIT is calculated as EBITDA plus depreciation and amortisation. The following table set out the Organisation EBITDA financial ratios for the three listed providers and the ACFPS *Top 25%* and *Average* for the **half year to 31 December 2016** and the **year ended 30 June 2016**.

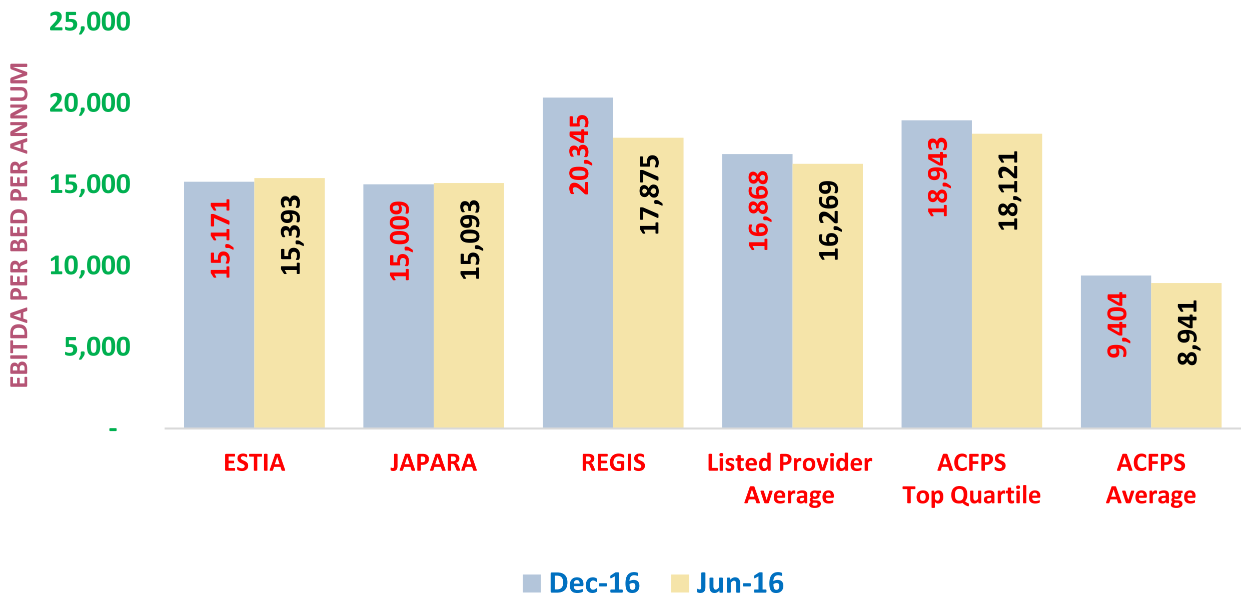
[1] Earnings before interest, tax, depreciation and amortization (EBITDA) is a measure of an organisation's operating performance. Essentially, it's a way to evaluate an organisation's performance without having to factor in financing decisions, accounting decisions or tax environments.

Table 2: Comparison of Key Financial Performance ratios between listed entities and StewartBrown ACFPS for the year ended 31 December 2016

	ESTIA	ESTIA	JAPARA	JAPARA	REGIS	REGIS	Listed Company Average	Listed Company Average	ACFPS Top 25%	ACFPS Top 25%	ACFPS Average	ACFPS Average
	Dec-16	Jun-16	Dec-16	Jun-16	Dec-16	Jun-16	Dec-16	Jun-16	Dec-16	Jun-16	Dec-16	Jun-16
Normalised EBIT *(% of total revenue)*	**14.0%**	17.1%	**12.5%**	13.5%	**16.7%**	17.2%	**14.4%**	16.2%	**14.4%**	13.1%	**4.4%**	4.6%
Normalised EBITDA *(% of operating revenue)*	**17.2%**	20.1%	**16.4%**	17.2%	**22.1%**	22.4%	**18.7%**	20.2%	**25.2%**	23.7%	**11.0%**	11.4%
Normalised EBIT *(return on equity annualised)*	**11.5%**	14.8%	**8.9%**	9.0%	**67.7%**	90.2%	**16.3%**	18.5%	**5.8%**	5.2%	**3.7%**	4.0%
Normalised EBITDA *(return on equity annualised)*	**14.2%**	17.3%	**11.6%**	11.5%	**87.8%**	114.8%	**20.9%**	22.8%	**9.2%**	8.8%	**9.0%**	9.4%
Normalised EBITDA *(return on total assets annual)*	**5.0%**	5.2%	**5.2%**	5.2%	**8.6%**	7.8%	**6.2%**	6.1%	**4.2%**	3.9%	**3.4%**	3.7%
Normalised EBITDA *(return on tangible assets annual)*	**11.2%**	11.6%	**8.8%**	9.3%	**12.0%**	11.0%	**10.8%**	10.8%	**4.2%**	4.0%	**3.6%**	3.8%
Cash Equivalents as % of debt	**9.0%**	3.3%	**12.6%**	5.3%	**4.9%**	2.4%	**7.9%**	3.3%	**34.0%**	31.8%	**31.7%**	33.4%
Cash/Financial assets % of debt	**9.0%**	3.3%	**12.6%**	5.3%	**4.9%**	2.4%	**7.9%**	3.3%	**53.2%**	51.1%	**48.5%**	50.7%
Staff costs *(% operating revenue)*	**64.2%**	61.9%	**68.5%**	67.5%	**64.4%**	65.1%	**65.3%**	64.6%	**60.1%**	59.0%	**67.6%**	67.3%
Staff costs *(% total revenue)*	**64.0%**	61.4%	**67.9%**	67.1%	**63.2%**	63.7%	**64.7%**	63.8%	**54.4%**	54.6%	**64.9%**	64.4%
Staff costs *(% total expenses)*	**71.9%**	68.5%	**76.9%**	77.0%	**74.9%**	74.5%	**74.2%**	73.0%	**63.0%**	62.4%	**67.5%**	67.1%

The chart below illustrates the organisation EBITDA per bed day per annum for listed providers compared to the StewartBrown ACFPS *Average* and *Top Quartile*. The calculation is based on number of available beds and differs to the listed providers' calculation in their presentations which is based on the number of occupied beds.

Figure 1: EBITDA per bed per annum comparison



Brief Commentary

- The listed providers' EBIT and EBITDA ratios are better than the Survey *Average*
- The Survey *Top Quartile* performs better than the listed provider average (lower than Regis) as measured by normalised EBITDA (% of operating revenue) however the listed providers' EBIT ratios are slightly higher than the *Top 25%.* This mostly reflects the different depreciation policies adopted by the listed and most other aged care providers. We have examined depreciation in detail later on in this report.
- Regis' EBIT and EBITDA return on equity reflects its low equity figure
- The listed providers have a significantly lower cash and financial assets as a percentage of debt ratio leading to the higher return on total and tangible assets
- The *Top Quartile* have a lower ratio of staff costs as a percentage of total revenue and total expenses compared to the listed providers and the Survey average

Further analysis

The average residential facility EBITDA per bed per annum in the StewartBrown ACFPS benchmark at **$9,404** (June 2016 $8,941) is much lower than the listed providers' average of **$16,868** (June 2016 $16,269). This is not surprising as the StewartBrown survey includes a variety of organisations - from single site to large not-for-profits. However, compared to the top quartile at **$18,943** (June 2016 $18,121), the ASX listed providers EBITDA per bed day is lower.

EBITDA is generically used as a proxy to describe the performance of an organisation, which for longitudinal analysis of an organisation's performance means ignoring every cost that is considered a "one off" or does not occur in the normal course of business. This allows comparative analysis to a certain extent, however, the simplification of EBITDA as an absolute measure within the aged care sector means that it can result in considering too many cost items as "one off", "unique" or "non-core", and thus inflating profitability. Of more importance, EBITDA ignores very specific expenses such as depreciation which will affect the overall assessment of financial performance and viability at provider and, in the case of residential, facility level.

DEPRECIATION

A section titled "Importance of Realistic Depreciation Expense" was included in the recently published *Aged Care Financial Performance Survey* Residential Care Report (pages 30 - 33). Given the importance of recognising depreciation expense together with the financial planning for future refurbishment, we have incorporated aspects again in this report together with a specific review of the approach to building depreciation.

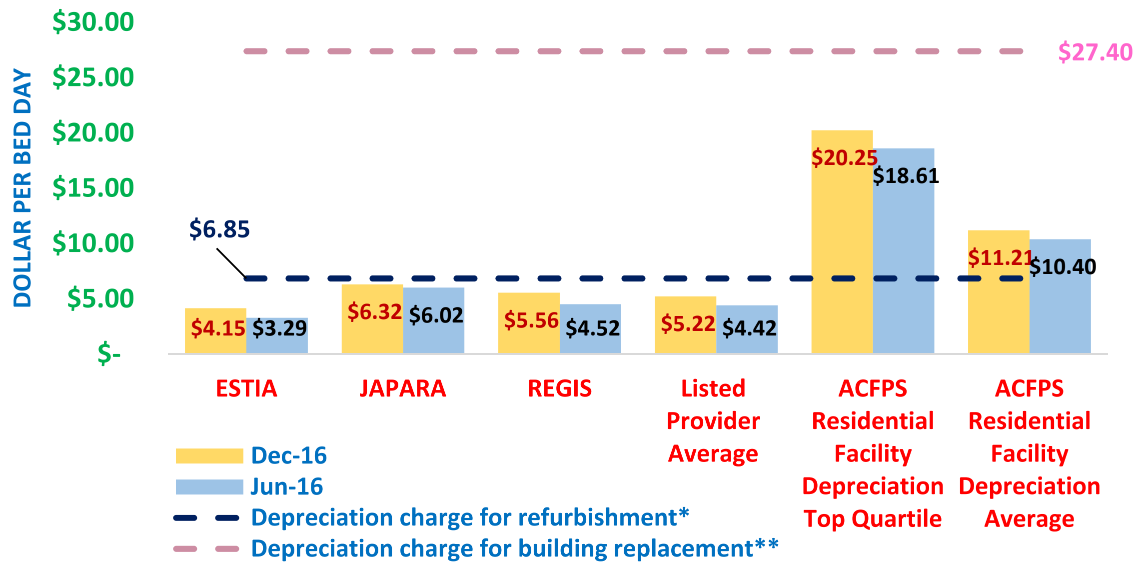
The listed entities Interim Financial Reports for the six months ended 31 December 2016 provided no specific guidance in relation to their respective depreciation policies. It is possible, however to determine the depreciation charged and relationship to the total building cost by reference to the specific "property, plant and equipment" note to the interim financial statements.

Reference to the 30 June 2016 financial statements and ASX Release provides a more definitive guidance as to the respective building depreciation policies for the listed entities as below:-

	ESTIA	JAPARA	REGIS
Buildings	60 years	50 years	55 years
Plant and equipment, furniture and fixtures	4 to 15 years	4 to 25 years	3 to 30 years
Property improvements	60 years	4 to 50 years	n/a

A summary of the residential aged care building depreciation expense (expressed in $ per bed day) for the December 2016 and June 2016 periods, with comparison to the building depreciation charged by the listed entities, is below: -

Figure 2: Residential Building Depreciation Expense per bed day - StewartBrown ACFPS results at facility level compared to Listed Entities for December 2016 and June 2016



Relationship between Depreciation, Refurbishment and Replacement Policy

Depreciation is an accounting method of allocating the cost of a tangible asset, such as a building, over its useful life. Organisations depreciate long-term assets for both tax and accounting purposes and to ensure that they have allocated sufficient funds to prepare for refurbishment or re-build. As a non-cash expense its importance is often underappreciated or in some cases underreported as a means of improving profitability.

The depreciation policy of many providers continues to not appear to match their policy on refurbishment. Given that close to half of the providers indicated that their renewal policy is to undertake a major refurbishment of a facility in under 12 years, then it could be expected that the average depreciation rate would be closer to **20 or 30 years** rather than 40 years and over.

Figure 2 above shows the actual building depreciation expensed ($ per bed day) and also includes a comparison with the estimated depreciation required for refurbishments and building replacement.

We have overlayed on the graph the depreciation (or return) required to provide for the following: -

- Building replacement (we have assumed a replacement cost of $250,000 per bed and an effective life of 25 years) which equates to **$27.40 per bed day**
- Building refurbishment (we have assumed a refurbishment cost of $25,000 per bed and a refurbishment cycle of 10 years) which equates to **$6.85 per bed day**

The below table (*Table 3*) shows the respective calculation methodologies.

Table 3: Depreciation requirement for building replacement or refurbishment

Building Replacement Cost ($ per bed)	**$ 250,000**	**$ 275,000**	**$ 300,000**	**$ 325,000**
Depreciation rate (%) *(40 years)*	2.5%	2.5%	2.5%	2.5%
Depreciation charge ($pa)	$ 6,250	$ 6,875	$ 7,500	$ 8,125
Depreciation charge ($pbd)	$ 17.12	$ 18.84	$ 20.55	$ 22.26
Depreciation rate (%) *(25 years)*	4%	4%	4%	4%
Depreciation charge ($pa)	$ 10,000	$ 11,000	$ 12,000	$ 13,000
Depreciation charge ($pbd)	**$ 27.40**	$ 30.14	$ 32.88	$ 35.62

Refurbishment Cost ($ per bed)	**$ 25,000**	**$ 35,000**	**$ 50,000**	**$ 60,000**
Depreciation rate (%) *(15 years)*	6.67%	6.67%	6.67%	6.67%
Depreciation charge ($pa)	$ 1,668	$ 2,335	$ 3,335	$ 4,002
Depreciation charge ($pbd)	$ 4.57	$ 6.40	$ 9.14	$ 10.96
Depreciation rate (%) *(10 years)*	10%	10%	10%	10%
Depreciation charge ($pa)	$ 2,500	$ 3,500	$ 5,000	$ 6,000
Depreciation charge ($pbd)	**$ 6.85**	$ 9.59	$ 13.70	$ 16.44

Building Historical Cost ($ per bed)	**$ 100,000**	**$ 125,000**	**$ 150,000**	**$ 175,000**
Depreciation rate (%) *(25 years)*	4.0%	4.0%	4.0%	4.0%
Depreciation charge ($pa)	$ 4,000	$ 5,000	$ 6,000	$ 7,000
Depreciation charge ($pbd)	$ 10.96	$ 13.70	$ 16.44	$ 19.18
Depreciation rate (%) *(15 years)*	6.67%	6.67%	6.67%	6.67%
Depreciation charge ($pa)	$ 6,670	$ 8,338	$ 10,005	$ 11,673
Depreciation charge ($pbd)	**$ 18.27**	$ 22.84	$ 27.41	$ 31.98

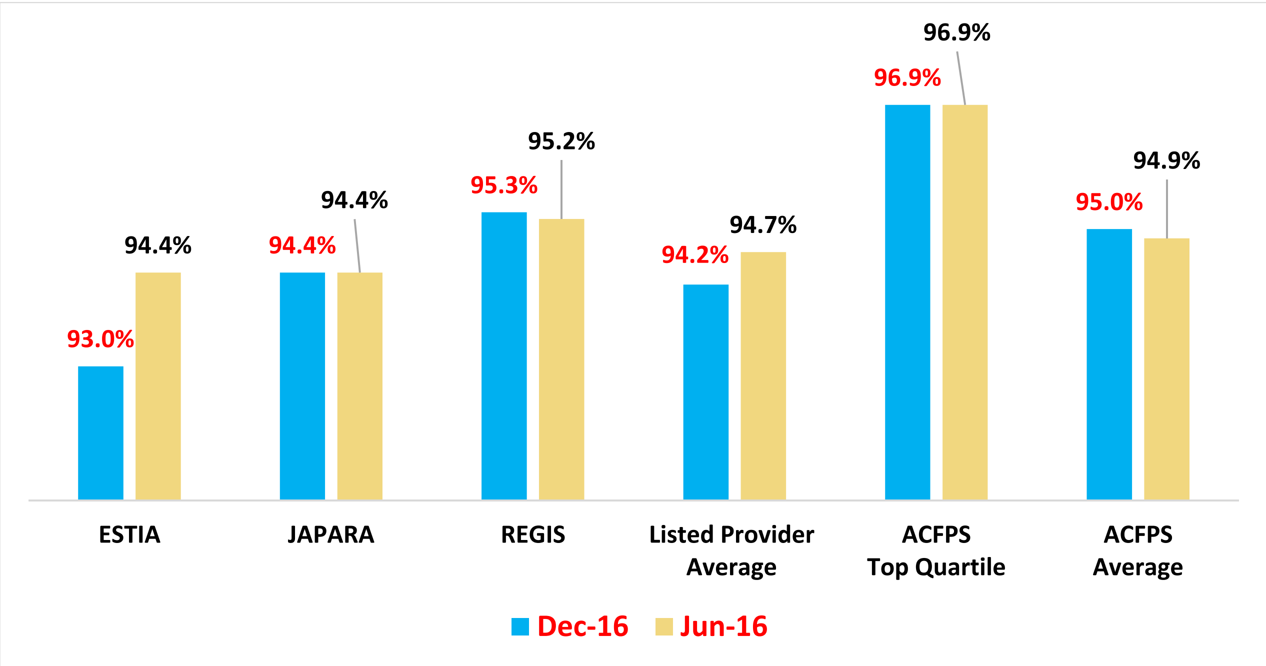
Brief Commentary

- The sector, in our opinion, continues to not adequately match the building depreciation policy with a representative effective life for building replacement and/or building refurbishment
- The ACFPS *top quartile* providers are depreciating (or accelerating their depreciation) charge for buildings over a period of between 20 to 25 years on average *(based on $20.25 pbd which equates to an annual depreciation charge of $7,391 per bed)*
- The ACFPS *average* for providers are depreciating buildings over a period of between 30 to 35 years on average *(based on $11.21 pbd which equates to an annual depreciation charge of $4,092 per bed)*.
- The listed providers' residential aged care buildings depreciation per bed day is significantly lower than the average and top quartile providers in the StewartBrown Survey.
- *We would caution providers against adopting the depreciation policies of the listed entities (effective life of between 50 and 60 years) with resultant depreciation charge averaging $5.22 per bed day ($1,905 per bed per annum). Whilst lower depreciation expense improves the EBIT (and related dividend policy) there may be a significant equity and funding issue when residential aged care buildings need to be replaced/refurbished coupled with the RAD growth to likely stabilise and with a proportional shift to DAP's and combination RAD/DAP.*

RESIDENTIAL OCCUPANCY

The listed providers generally have lower than average occupancy rates compared to the StewartBrown ACFPS *Average*. This may be partially explained by timing differences between the operational places being put into use upon completion or through acquisition and the operational places being taken up by residents.

Figure 3: Average Occupancy rates for the listed entities and the StewartBrown ACFPS for 31 December 2016 and 30 June 2016



FINANCIAL POSITION

A summary of the balance sheets comprising the 106 respondent provider organisations from the *StewartBrown Aged Care Financial Performance Survey* (ACFPS) together with the listed provider balance sheets as per their release of results to the market is included in the table below.

The balance sheets of the majority of facilities included in the ACFPS are largely typical of a not-for-profit organisation who have received capital funding in the early stages of their development phase and have significant levels of cash reserves. Many of these balance sheets display a level of conservatism and a low appetite for risk that is the signature of a large number of not-for-profit organisations.

The balance sheets also reveal that there is far less reliance on external borrowings than in the private sector. Most of the debt in the balance sheet of ACFPS participants relates to resident liabilities.

Table 3: Summary Balance Sheets for StewartBrown survey organisations and listed entities

	31/12/16 Estia $'000	31/12/16 Japara $'000	31/12/16 Regis $'000	31/12/16 ACFPS $'000
Cash and cash equivalents	86,239	63,227	53,610	2,788,760
Financial assets	0	0	444	1,479,257
Other current assets	16,438	23,833	12,790	368,425
Property, plant & equipment	706,548	533,229	879,283	9,449,991
Investment property	1,500	32,967	82,158	1,651,883
Intangibles	971,683	465,552	401,406	478,815
Other non-current assets	0	12,092	0	195,264
Total assets	**1,782,408**	**1,130,900**	**1,429,691**	**16,412,396**
Creditors and other current liabilities	67,001	59,258	86,112	682,170
Resident liabilities (residential)	691,713	409,512	850,774	4,730,492
Resident liabilities (other)	0	21,858	48,975	3,370,818
Borrowings	267,480	71,000	199,556	702,925
Employee entitlements	40,481	34,844	53,482	521,509
Other non-current liabilities	42,397	0	2,304	73,648
Total liabilities	**1,109,072**	**596,472**	**1,241,203**	**10,081,563**
Net assets	**673,336**	**534,428**	**188,488**	**6,330,833**
Net tangible assets	***(298,347)***	***68,876***	***(212,918)***	***5,852,018***

Number of facilities	68	43	54	499
Number of places	5,910	3,840	6,027	39,589

Brief Commentary

- Estia ($298m) and Regis ($213m) have **net tangible liabilities** as at 31 December 2016
- Liquid investments (cash + financial assets) increased by **6.3%** for the ACFPS *Average* compared to over 100% for the listed entities (Estia 189.3%, Japara 157.2% and Regis 114.1%)
- Property, plant & equipment (net) increased by **9.4%** for the ACFPS participants compared to an average of **2.9%** increase in the listed entities
- Resident liabilities (residential) increased by **9.1%** for the ACFPS participants compared to an average of **5.8%** for the listed entities

- External borrowing increased by **20.4%** for the ACFPS participants compared to **2.8%** increase in borrowings by the listed entities. Borrowings as a percentage of total assets was only **4.3%** for ACFPS participants compared to an average of **12.4%** for the listed entities.

In order to allow for comparison of results, the following table presents the assets as a proportion of total assets and the liabilities as a proportion of total liabilities.

Table 4: Summary Balance Sheets for StewartBrown ACFPS organisations and listed entities with assets as a proportion of total assets and liabilities as a proportion of total liabilities

	ACFPS ALL		ACFPS Top Quartile		Listed Providers (ave)	
	31/12/2016	30/06/2016	31/12/2016	30/06/2016	31/12/2016	30/06/2016
	Proportion of Total Assets					
Cash	17%	17%	17%	16%	5%	2%
Financial assets	9%	9%	10%	10%	0%	0%
Investment property	10%	11%	17%	17%	3%	3%
PPE	58%	56%	53%	54%	49%	50%
Intangibles	3%	3%	1%	1%	42%	44%
Other	3%	4%	2%	2%	2%	2%
Total assets	100%	100%	100%	100%	100%	100%
	Proportion of Total Liabilities					
Trade and other liabilities	7%	7%	4%	3%	9%	9%
Employee liabilities	5%	6%	3%	3%	4%	4%
Resident liabilities	80%	81%	83%	85%	69%	68%
Borrowings	7%	6%	10%	9%	18%	19%
Total liabilities	100%	100%	100%	100%	100%	100%
	Other Metrics					
Cash and financial assets to total resident liabilities and borrowings	48%	51%	53%	51%	8%	3%
Cash and financial assets to resident liabilities	53%	55%	60%	56%	10%	4%
Resident liabilities as a proportion of net assets	128%	118%	96%	94%	145%	148%

Brief Commentary

- Assets
  - Little change in composition of balance sheet assets since June 2016 for StewartBrown ACFPS *Average* or *Top Quartile*
  - The average of the listed entities has seen an improvement in the cash held *(note that Estia had a share capital issue of net $86m)*
- Liabilities
  - Similar to Assets, little change in composition of balance sheet liabilities since June 2016 for StewartBrown ACFPS *Average*
  - Resident liabilities as a proportion of the total liabilities have **decreased by 2%** since June 2016 for the StewartBrown ACFPS *Top Quartile* with an **increase in borrowings of 2%** as a proportion of the total liabilities.
  - No significant change in the composition of the liabilities for the average of the listed entities

KEY BALANCE SHEET RATIOS

Many of the ratios in table below are relative to liquidity as well as how organisations look to maximise potential earnings.

Table 5: Comparison of Key Financial Balance Sheet ratios between listed entities and StewartBrown ACFPS for the year ended 31 December 2016

	ESTIA Dec-16	JAPARA Dec-16	REGIS Dec-16	Listed Company Average Dec-16	ACFPS Top 25% Dec-16	ACFPS ALL Dec-16
Cash and cash equivalents *(% resident liabilities)*	12%	15%	6%	4%	38%	34%
Cash and financial assets *(% resident liabilities)*	12%	15%	6%	4%	60%	53%
Cash and financial assets *(% RADs and bonds)*	12%	15%	6%	4%	120%	90%
Cash and financial assets *(% total liabilities)*	12%	15%	6%	3%	50%	42%
Cash and financial assets *(% total borrowings)*	8%	11%	4%	3%	34%	32%
Resident debt *(% of total liabilities)*	62%	72%	72%	68%	83%	80%
Equity to total assets	38%	47%	13%	32%	46%	39%
Non-resident borrowings *(% total assets)*	15%	6%	14%	13%	5%	4%

Cash and Liquid Financial Assets to debt

The listed providers' level of cash and liquid financial assets to debt is much lower than the StewartBrown ACFPS *Average*.

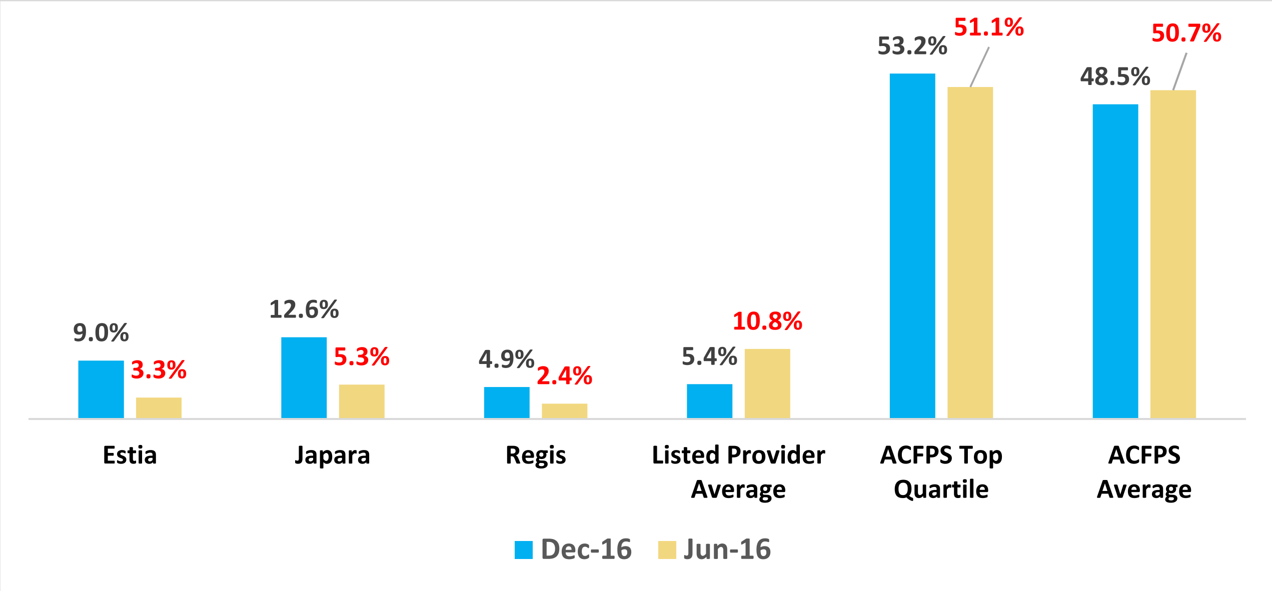
The level of cash and liquid financial assets to total debt (resident plus external) has increased slightly across all three ASX listed companies and the average is now **7.9%** (June 2016 3.3%). This is significantly lower than the StewartBrown ACFPS *Average* for December 2016 of **48.5%** (June 2016 50.7%).

The listed entities would be expected to be more likely to utilise their cash reserves to maximise potential earnings by reinvesting back into the operation via capital expenditure or expansion to stimulate further growth in the long term. Whether this is actually occurring in comparison to the NFP entities is a moot point.

The not-for-profit organisations (as reflected in the StewartBrown ACFPS *Average*) have traditionally tended to take a more reserved approach with cash generated by depositing a large portion of it with financial institutions and earning the interest income or making alternate low risk investments. In the last 18 months, in particular, the NFP sector has been undergoing quite an extensive refurbishment and rebuilding program with the capital costs being absorbed by increased accommodation pricing and receipts.

The listed entities had an average EBITDA return on total assets of **3.1%** for the half year to December 2016 compared to **1.7%** for the StewartBrown ACFPS *Average* and **2.1%** for the ACFPS *Top Quartile*. This is despite the fact that a large proportion of the assets of the listed entities are made up of intangible assets. The average return on tangible assets for the listed entities was **5.4%** for the 2016 financial year compared to the ACFPS *Average* of **1.8%** and the ACFPS *Top Quartile* of **2.1%**. This indicates that the cash from resident liabilities are earning a better return than from being invested in the bank or on low risk investments.

Figure 4: Cash and Financial Assets to Debt - StewartBrown ACFPS by Top Quartile and Average compared to listed provider ratios



It is interesting to note that while the ratio of cash and financial assets as a proportion of debt increased for the three listed providers and the ACFPS Top 25%, it decreased somewhat for the ACFPS Average. This may be due to an increased capital spend on refurbishing facilities by the NFP sector in particular.

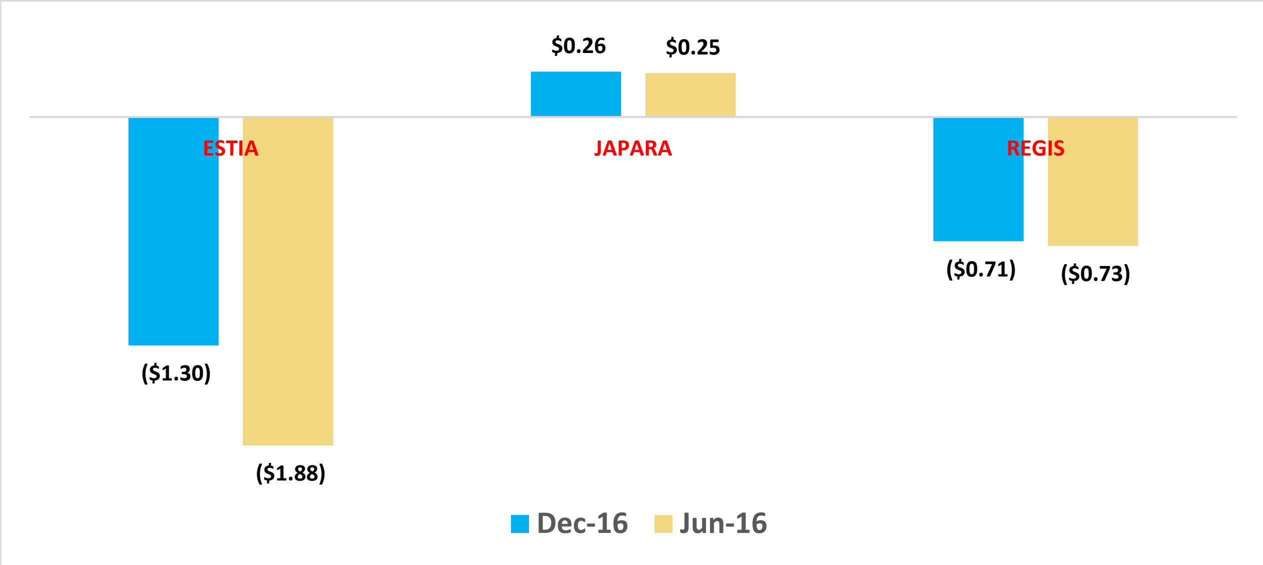
Net Tangible Assets

Net tangible assets excludes all intangibles assets which predominantly comprise bed licences, acquired goodwill and software.

The quantum of intangible assets balances increased in the half year to December 2016 reflecting the purchasing of bed licenses and goodwill recorded upon acquisition. Net assets have increased over this period as well, therefore the net tangible assets and net tangible assets per share have decreased in the period compared to June 2016 for all three listed aged care providers.

As noted previously, both Estia and Regis still reported at 31 December 2016 a negative asset backing per equity security (share).

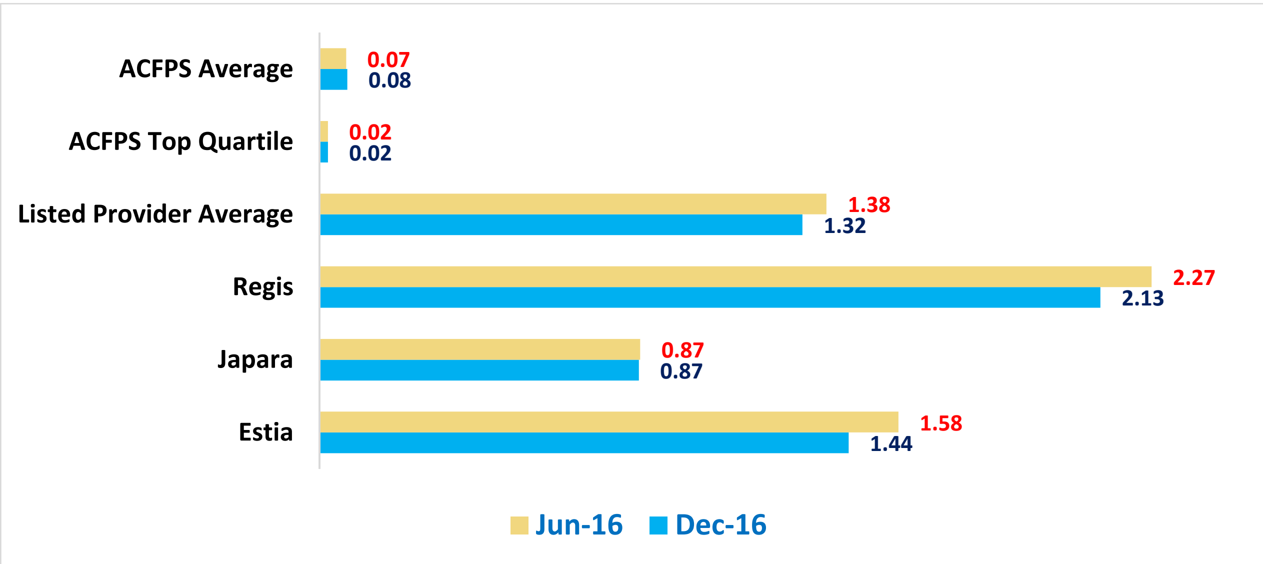
Figure 5: Net tangible assets per share for listed providers



Intangible assets

Intangible assets[2] as a percentage of net assets for the providers in the ACFPS has remained at **7%** on *average*. However, the intangible assets balances for the listed providers increased in FY16 reflecting the purchase of bed licenses and goodwill recorded upon acquisition thus increasing their intangible assets as a percentage of net assets.

Figure 6: Intangible Assets to Net Asset ratio - StewartBrown ACFPS by Top Quartile and Average compared to listed provider ratios



A ratio of greater than 100% reflects the fact that the intangible assets are <u>greater</u> than the net tangible assets, in other words the entity has <u>negative tangible assets</u>. In the case of the largely not-for-profit entities in the StewartBrown ACFPS, the level of intangible assets is very low.

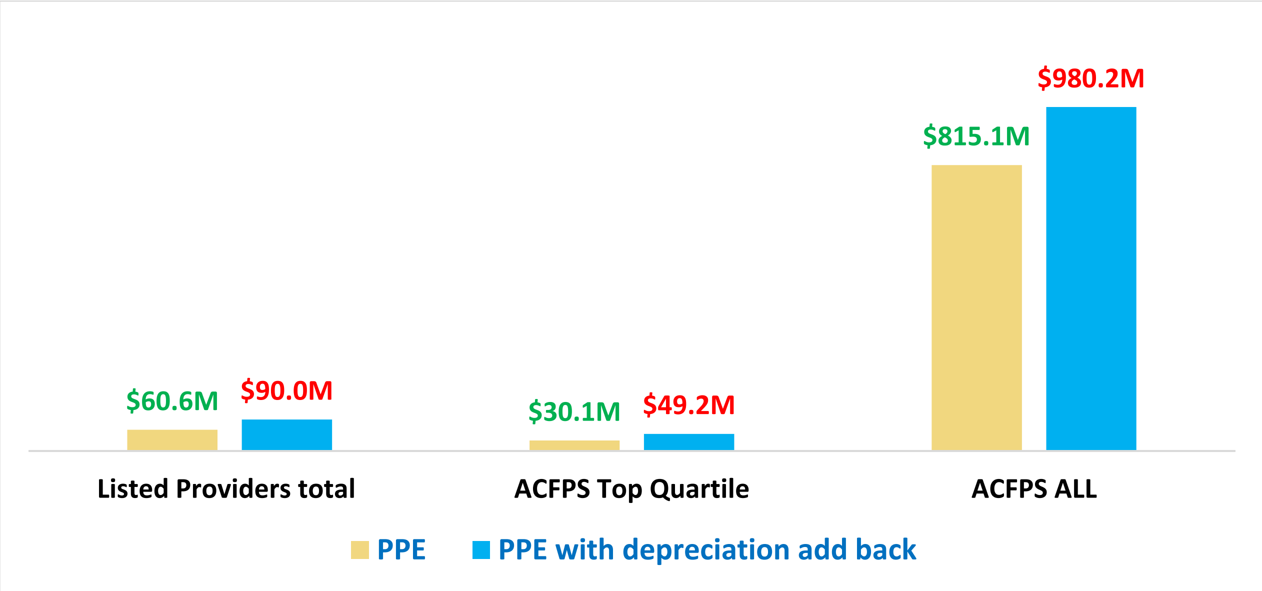
[2] An intangible asset is an asset that is not physical in nature. An organisation's intellectual property, including items such as trademarks, business methodologies, goodwill (bed licences) and brand recognition are intangible assets.

Property, plant and equipment (PPE)

There has been significant and continuing level of investment in the sector over the past two to three years as provider organisations look to both refurbish and renew existing building stock as well as make an investment in new aged care places and independent living units.

For the organisations in the StewartBrown ACFPS, the total increase in property, plant and equiment for the half year to December 2016 was **$980.2 million** (after writing back depreciation) which indicates the significant investment in infrastructure (both residential aged care and independent living) in a relatively short period of time.

Figure 7: Increase in PPE - StewartBrown ACFPS ALL and Top Quartile compared to listed provider total



Commentary

The overarching comment in relation to the approved provider operating results and financial viability is that the sector is still very much in a state of flux, with continued uncertainty regarding future funding models, deregulation, compliance restraints and managing the increasing consumerism. It is clear that the functional aged care models are changing with new, innovative and market driven initiatives emerging.

The changes to the ACFI funding arrangements effective from 1 July 2016 have not impacted on the residential results to December 2016, with the ACFPS providers showing a slight improvement in results, whereas the listed entities remained at their parity in relation to EBITA per bed per day, however their financial ratios declined somewhat.

We expect to see a decline in residential performance in the ensuing periods, as the ACFI changes will start to really bite, and providers will be required to re-position from a “cost model” (reducing costs as the primary approach) to a “revenue model” (introducing more additional service offerings).

The specific areas the providers will need to address is in relation to targeted investment and funding technology and initiatives. We have focused on refurbishment and replacement of building stock, and the requirement to adopt a more appropriate (and funded) depreciation allowance to provide for the future redevelopment of residential facilities. This will increasingly become an issue for all providers to fund such capital expansion and our opinion is that the current policies of providers, and the listed entities in particular, need revision.

LISTED PROVIDER ADDENDUM

This addendum to the newsletter on the analysis of the listed providers' results includes a glossary of terms, a summary of the financial results on which the key ratios are calculated and the adjustments for normalised revenue and EBITDA.

Summary of Financial Results

The following figures have been summarised from the half year 31 December 2016 financial reports of each entity.

	ESTIA	JAPARA	REGIS
Balance Sheet	**$'000**	**$'000**	**$'000**
Cash and cash equivalents	86,239	63,227	53,610
PPE	706,548	533,229	879,283
Investment property	1,500	32,967	82,158
Intangibles	971,683	465,552	401,406
Other assets	16,438	35,925	12,790
Total assets	**1,782,408**	**1,130,900**	**1,429,691**
Resident liabilities	691,713	431,370	899,749
Borrowings	267,480	71,000	199,556
Employee entitlements	40,481	34,844	53,482
Creditors & other liabilities	109,398	59,258	88,416
Total liabilities	**1,109,072**	**596,472**	**1,241,203**
Net Assets	**673,336**	**534,428**	**188,488**
Income Statement			
Operating	262,485	177,093	279,364
Investment	0	0	325
Other	628	1,408	5,037
Total revenue	**263,113**	**178,501**	**284,726**
Staff costs	168,476	121,262	180,034
Depreciation	8,471	6,720	14,170
Net Finance Costs	5,854	1,589	3,748
Other	51,675	28,184	42,552
Total expenses	**234,476**	**157,755**	**240,504**
Tax	8,879	6,113	13,290
Result after tax	**19,758**	**14,633**	**30,932**
Other items - one off	0	0	521
Total comprehensive income for the year	**19,758**	**14,633**	**31,453**

Adjustments for Normalised Revenue and EBITDA

EBITDA is calculated as total revenue less total expenses before interest, finance costs and depreciation. Normalised EBITDA is from the results disclosed on the ASX.

Estia

Estia	$'000	$'000
	Dec-16	Jun-16
Total revenue from statutory accounts	263,113	446,510
EBITDA calculated from statutory accounts	42,962	66,618
Add back: Acquisition & Transaction related costs, one-offs & costs associated with restructuring	2,200	
Add back: Acquisition stamp duty, transaction and integration related cost		26,100
Add back: One off costs including redundancy costs related to acquisition		0
Less: Gains on bargain purchases and asset sales		3,700
EBITDA normalised	**45,200**	**89,000**
Normalised revenue	**263,113**	**442,800**

Japara

For Japara the normalised revenue and normalised EBITDA are the same as the total revenue and the EBITDA calculated from the statutory accounts. There are no adjustments.

Japara	$'000	$'000
	Dec-16	Jun-16
Total revenue from statutory accounts	178,501	327,266
EBITDA calculated from statutory accounts	29,055	56,102
EBITDA normalised	**29,055**	**56,102**
Normalised revenue	**178,501**	**327,266**

Regis

EBITDA and revenue has been adjusted for acquisitions and one-offs for the Jun-16 comparison.

Regis	$'000	$'000
	Dec-16	Jun-16
Total revenue from statutory accounts	284,726	479,930
EBITDA calculated from statutory accounts	61,815	92,977
Add back loss on disposal of property plant and equipment		1,638
Deduct gain from bargain purchase		-3,617
Add back acquisition-related expenses		14,105
EBITDA normalised	**61,815**	**105,103**
Normalised revenue	**284,726**	**479,930**

GLOSSARY

ACAR	Aged Care Approvals Round
ACFI	Aged Care Funding Instrument
Cash	Cash and cash equivalents
DAP	Daily Accommodation Payment
Debt	Resident loans (RADS, accommodation bonds), ILU resident loans, other loans and borrowings
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBIT	Earnings before interest and tax
Normalised EBITDA	Earnings before interest, tax, depreciation and amortisation excluding acquisition-related costs and one-off costs
RAD	Refundable Accommodation Deposit
Liquid financial assets	Current assets that can be converted into cash such as shares

StewartBrown Aged Care Executive Team

Stuart Hutcheon

Managing Partner

Stuart Hutcheon is the firm's Managing Partner and the head of our Audit & Assurance Division, and also provides consulting services to a diverse client base. He has had considerable experience with both commercial and not-for-surplus organisations. This experience covers all areas of professional services including auditing, management accounting, budgeting, salary packaging and FBT advice. Stuart has been involved in providing professional services to the aged care and community care sector sectors for over 20 years.

Grant Corderoy

Senior Partner

Grant Corderoy is the head of the Aged and Community Care and Business Consulting Division. Grant first established the *Aged Care Financial Performance Survey* in 1995. He specialises in a range of services for his clients including undertaking complex accounting assignments, business performance reviews, organisation and governance reviews, system reviews, management consulting, strategic planning and general business advice. He also has considerable experience in advising clients on the sale and purchases of businesses, business valuations and due diligence.

Patrick Reid

Director

Patrick has recently joined StewartBrown in the position of Director - Aged Care, Community and Disability after serving as CEO of LASA. As an experienced CEO, board director, business owner and executive with more than 20 years' success in business, association management and lobbying, Patrick possesses a proven track record in business, leadership, change management and advocacy. Patrick has highly developed financial, commercial, negotiation and management skills.

David Sinclair

Director

David Sinclair has been with the firm for over 20 years and has been involved in the *Aged Care Financial Performance Survey* for the duration of that service and now heads the team undertaking the survey. David is also heavily involved in consulting assignments for aged care and community service clients including strategic planning, financial modelling, budgeting and governance reviews.

Tracy Thomas

Manager - Analyst and Consulting Division

Tracy is a Chartered Accountant with six years post qualification experience. She has a diverse background having worked in audit and assurance, for the regulator of private health insurance and for a private health insurance company. Since joining StewartBrown she has worked with several providers of residential aged care and home care and produced the *Aged Care Financial Performance Survey* Corporate Administration Report and Listed Providers Analysis for year ended June 2016. She specialises in data analysis and financial modelling.

StewartBrown - Our Knowledge is your success

StewartBrown, Chartered Accountants, was established in 1939 and is one of the leading boutique accountancy firms in Australia combining a full range of professional services with varied corporate assignments. Our professional mission statement is "*we deliver service beyond numbers*", which reflects the commitment to helping our extensive range of clients to achieve their financial goals.

We offer a depth of technical knowledge and varied professional experience, with many of our senior staff now having well over 10 years' of service with the firm, resulting in our clients benefitting from continuity and accountants who really understand their business.

What a boutique firm offers

Whilst StewartBrown provides a range of professional services, our "point of difference" is our ability to engage in assignments of a complex nature by providing a varied mix of experience and corporate skills. Examples of recent consulting assignments include:-

- Contract accounting
- Payroll processing and billing processing
- Financial modelling and unit costing analysis
- Strategic planning facilitation
- ITSC Project management
- Governance reviews
- Organisation restructures
- Risk management reviews
- Due diligence
- Work-flow building design
- FBT and GST reviews
- Detailed forecasting modelling

Audit and assurance services

Complementing our consulting services is our dynamic Audit division. StewartBrown adopts a risk based audit approach which is performed strictly in accordance with Australian Auditing Standards. Our engagements involve a detailed analysis of the client's business and systems of internal control to ensure we fully understand how the client operates and identify areas that pose the greatest risk of being materially misstated in the financial statements. Our detailed testing procedures are then tailored to meet the risks identified and also ensure an efficient and effective audit is performed. What we offer our audit clients are a mix of experience and knowledge well beyond that of most other firms. Our audit staff all have regular exposure to consulting and secondment assignments which significantly enhances the "value add" we bring to our audit clients.

Specialty in the aged care, community and disability sectors

StewartBrown is widely regarded as being a leading specialist within the aged care, community and disability sectors. Our client base includes many large national providers in addition to independent stand-alone providers, faith-based and community providers, culturally specific providers, as well as government and statutory bodies.

Our commitment to these important social sectors each year involve 30+ plus speaking engagements at Conferences, sector briefings, workshops, department briefings, organisation presentations and community consultations.

Integrity + Quality + Clarity

These terms which appear on our logo are more than aspirations, they appear for a very important reason - they encapsulate the professional standards that we strive to continually maintain and ensure best practice

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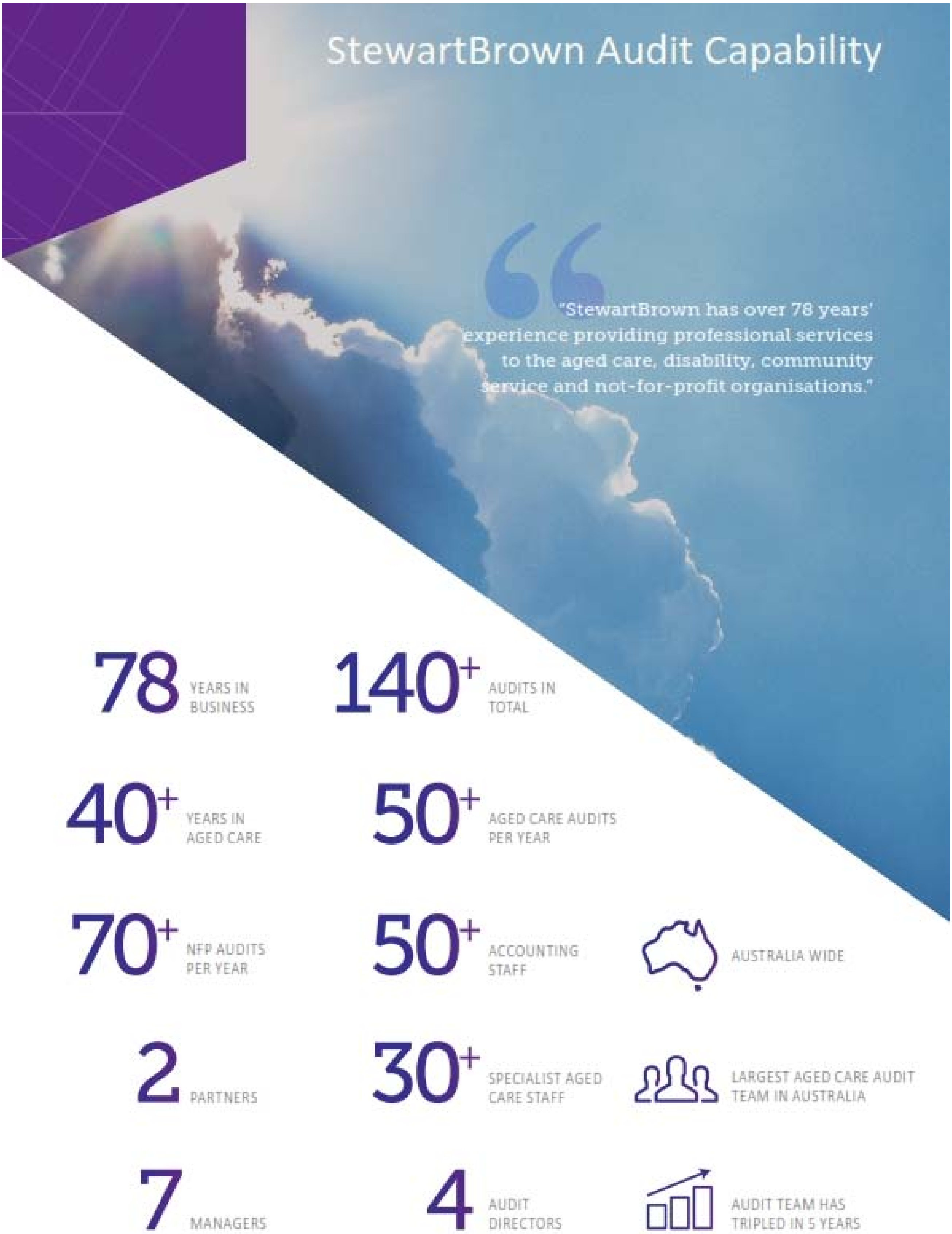
StewartBrown Audit Capability
"StewartBrown has over 78 years' experience providing professional services to the aged care, disability, community service and not-for-profit organisations."
78 YEARS IN BUSINESS
140+ AUDITS IN TOTAL
40+ YEARS IN AGED CARE
50+ AGED CARE AUDITS PER YEAR
70+ NFP AUDITS PER YEAR
50+ ACCOUNTING STAFF
AUSTRALIA WIDE
2 PARTNERS
30+ SPECIALIST AGED CARE STAFF
LARGEST AGED CARE AUDIT TEAM IN AUSTRALIA
7 MANAGERS
4 AUDIT DIRECTORS
AUDIT TEAM HAS TRIPLED IN 5 YEARS