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Challenging Start to FY18 - recovery well underway

Australia's leading owner, operator and manager of retirement communities, Aveo Group (ASX: AOG), today released its financial results for the six months to 31 December 2017 (HY18).

Financial results

Aveo Group recorded a statutory profit after tax for HY18 of $149.3 million, up 23% on HY17. This result was driven by a continued focus on strengthening the Group's retirement business and development activities and underpinned by the continuing revaluation uplifts in the retirement portfolio and the sale of the Gasworks complex at Newstead, Brisbane at a substantial premium to its book value. Aveo's net tangible assets per security was up 8% to $3.63.

Key financial highlights for HY18 include:

- statutory profit after tax of $149.3 million, up 23%;
- underlying profit after tax and non-controlling interest down 33% to $36.3 million;
- earnings per stapled security (EPS) on underlying profit after tax and non-controlling interest down 33% to 6.4 cents;
- funds from operations (FFO) of $45.7 million ($82.8 million in HY17); and
- net tangible assets per stapled security of $3.63, up 8% from 30 June 2017.

Aveo Group Chief Executive Officer Geoff Grady said: "While we, and the industry as a whole, encountered a challenging period mid last year with significant negative media sentiment, an increasingly positive response from existing and new residents to the new contract initiatives we introduced has seen a strong recovery with sales momentum returning to more normalised levels by the end of last year.

"The package of new initiatives that we introduced last August – especially the money back guarantee and shortened buyback period – have been implemented and very well received by residents and other stakeholders.

"We remain totally focused on ensuring that we are Australia's leading and most innovative senior living provider and we know that we will sustain this through continuing to offer enhanced freedom of choice and quality of service delivery, in whatever form our consumers desire it.

"We invested significantly in a corporate marketing campaign during the half-year, which, together with these initiatives, has supported a recovery of sales rates across the portfolio."

Aveo's total retirement assets continued to grow in HY18 through both revaluation increases and the increased amount of capital invested into retirement development projects. Retirement assets will comprise 95% of Aveo's divisional assets following the completion of the sales of the two components of Gasworks[1].

Retirement revenue

Total Retirement revenue increased by 13% in HY18 to $153.2 million, driven by higher contributions from both the Development and Care and Support Services segments. Aveo recorded total retirement sales volumes of 463 units, down 25% from HY17. Development sales increased over the prior comparative period as Freedom minor development units, major development stock delivered in FY17, and new units delivered at Newcastle during the period, all continued to sell down.

[1] Pro-forma, as if the sale of Gasworks 1 and 2 had occurred on 31 December 2017.

Retirement Established Business

Revenues from Aveo's Retirement Established Business decreased 20% in HY18 to $72.3 million and profit contribution decreased 25% to $26.4 million.

While the total sales volumes decreased 42% to 299 units, sales prices increased: the average resales transaction price point increased 8% to $409,000.

Lower resale volumes provided opportunities to increase the number of units bought back for refurbishment and resale as part of Aveo's ongoing buyback and unit improvement program. This increase did not include Freedom transition buybacks, which were lower given sufficient stock on hand already existed.

Buyback sales revenues of stock from the improvement program (up 7% to $5.9 million) facilitated the ongoing release of invested capital.

Retirement Development

Aveo's Retirement Development business significantly lifted revenue (up 64% to $62.5 million) in HY18 driven by the delivery of 50 new major development units at Newcastle and an increased sale rate of minor development Freedom legacy and conversion units, with 75 sales during the period. The minor development sales rate continues to provide evidence of the market appeal of the Freedom product and the future potential of expanding this offering.

Development profit contribution of $2.1 million was impacted by a heavy upfront investment in marketing and overhead costs relating to future sales, both in the second half and the early part of FY19. The Retirement development team is now fully resourced to deliver 500 units per annum with a reduction in costs allocated to Non-retirement.

Construction is on schedule for the remaining development units to be delivered in FY18, with work at the biggest projects at Bella Vista and Newstead topped out and internal work well progressed for delivery in Q4.

Retirement Care and Support Services

Upfront costs associated with the ramp up of the new Durack residential aged care facility (RACF) impacted the profit contribution from this segment.

Construction remains on schedule for the delivery of the Newstead RACF as part of the new integrated retirement community at that site. The first residents are expected to move in by the end of FY18.

Aveo's Care offering is being complemented by the start-up of the Aveo Care at Home business, which will expand the availability of home care services to all Aveo communities.

Non-Retirement

The profit contribution from Aveo's Non-Retirement activities decreased by 7% to $28.7 million. This was primarily related to lower numbers of land lot sales, which was related to timing of stage deliveries.

The sale of Gasworks now leaves the residential land estates as Aveo's last material non-retirement assets.

Capital management

The first tranche of the settlement of the Gasworks sale (Gasworks 1 & 2) occurred on 8 February for $220.5m less sale adjustments. The Gasworks 3 component ($28m less sale adjustments) is expected to settle in September 2018.

Pro-forma reported gearing reduces to 16.3% post the settlement of Gasworks 1 and 2[2].

[2] Pro-forma, as if the sale of Gasworks 1 and 2 had occurred on 31 December 2017.

Outlook

Aveo's Retirement sales volumes continue to recover from the challenging start to FY18. Deposits taken in Q1 of FY18 were well down on the prior comparative period, however they recovered significantly in Q2 of FY18 on the back of the new initiatives launched by Aveo and a strong and targeted marketing campaign. By the end of December 2017, retirement sales deposits had returned to normalised levels.

Deposits taken to date in Q3 of FY18 are tracking in line with the prior comparative period.

As such, Aveo reaffirms its financial guidance for FY18, which was provided with the FY17 results, of:

- EPS of 20.4 cents per security , 7.9% higher than the 18.9 cents per security delivered in FY17; and
- Retirement return on asset target in the range of 7.5% – 8.0%.

Aveo's performance in FY18 was always going to have a second half skew due primarily to the timing of the delivery of new developments. That skew has been exacerbated by the lower Q1 sales rates and volumes.

Aveo's Development results are expected to be toward the higher end of the guidance range, due primarily to the sales of additional Freedom conversion minor development units. This is expected to offset the forecast result of the Established Business, which is expected to be at the lower end of the guidance range.

Aveo is targeting a full year distribution in the range of 40% - 60% of underlying profit.

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