Lend Lease

LEND LEASE STRATEGY DAY

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AT THE OBSERVATORY HOTEL, SYDNEY

ROD FEHRING
OVERVIEW OFRETIREMENT LIVING PRESENTATION

ROD FEHRING: My name's Rod Fehring, and I'll provide an overview for Lend Lease Primelife. My background, I joined Lend Lease in 2001 just by way of introduction, with the acquisition of the Delfin business, and I ran the development businesses here including Delfin for the best part of six, seven years, and now responsible for the Lend Lease Primelife portfolio. Which I'll provide a bit of an overview of the business and the strategy, if we just move onto the next slide. Then some focus on the retirement living business, particularly the business model and finish off with the aged care business, which is part of it.

The business was – we acquired the former Babcock and Brown communities business for the management rights for that entity for $17.5 million, and took over responsibility for the management of the entity on the 28th of November. And Lend Lease by vote of shareholders on the 30th of December, re-capitalised the business, injecting the best part of $200 million or a 43% shareholding in the company. And that's put the business, if you like, onto a foundation setting and what I'd like to overview now is just what we found and what the business is and we'll deal with questions at the end as Sally has introduced.

By way of positioning on the next slide, the business consists of two business streams, retirement villages, retirement living, at about 11,200 units ranging from Perth all the way across to Auckland, up to Townsville and pretty much everywhere in between. The business is mixed, 65 separate villages ranging in age from in development from the point of view of only two or three years old, through to 28 years old. The portfolio also consists of an aged care 2,300 beds, and it's important that we understand the difference between aged care and retirement living. They are fundamentally different businesses, and I'll talk about that a little bit later.

The other thing to point out on this slide is the reduction in our backlog down to around – I can't even read that – about 1,200 in backlog. That's units yet to develop. The reason for that is we've deliberately done that with an asset sales programme, which has been previously announced, and that has been reduced down by about 1,000 dwellings, largely because we can source our

development pipeline by virtue of our relationship with Lend Lease. And so we don't necessarily have to carry a significant amount of future development backlog on our balance sheet. We would rather recycle that capital and focus on the replenishment of and rejuvenation of and the asset management of the existing portfolio.

I think the other thing to say about this slide is that the consolidation process of which Babcock and Brown communities was one of the main consolidating entities. But now has morphed into Lend Lease Primelife, has really only entered its first phase, the first five years I suppose that's been going on. It'll go on for another ten, thereabouts, so is a fair way of consolidation ahead yet.

What's the value of having scale, because that suggests that there needs to be value if you're going to pursue a consolidation strategy? The initial findings that we have in terms of exploiting scale – and if you don't exploit scale there's no point having it. The diversification benefits across multiple portfolios, multiple geographies and multiple sectors has value. It provides a diverse range of product types and a diverse range of market exposures and a diverse range of consumers to which you expose the product.

Secondly, the opportunity for asset management in this portfolio is significant, given that the bulk of it is – we have a perpetual relationship with the asset. The importance of that enables you to start to reinvest in the amenity of place, and at the same time enable consumers to invest in the quality of home. Which is a parallel strategy, where one is funded by the company, the other is funded by the individual asset owner. The other opportunities in having scale and exploiting it, obviously the opportunity to emerge as a branded entity. The Primelife brand has the pre-eminent positioning in terms of consumer recognition in Victoria and New South Wales. It has no penetration in other markets at this stage. We aim to develop that.

The other benefit is procurement. Now we have on average about – well not on average – we have 33,000 suppliers in this business. On average we bill around about $512 per supplier, so there is opportunity to rationalise with the procurement spend that we have, which is about $165 million a year, to be able to do a little bit better by exploiting that scale.

In terms of strategy, our strategy really operates under three themes. The reason for the first theme, simplification, is this is a complex business. Essentially six acquisitions over the best part of three years, integration processes have either not happened or have only just begun to happen. Multiple cultures, multiple systems, which we're progressively rationalising, much of which have not been rolled out yet. That presents both an opportunity and a problem, a problem in the form of the complexity in the business, an opportunity in terms of being able to extract synergy.

The other comment to make in relation to the simplification theme is the opportunity to move to a single platform and tidy up our brand and brand

positioning. When you look at a brand hierarchy within the organisation there's literally a dog's breakfast. The opportunity to be able to rationalise that and bring it into some order, and then get behind it from a customer service and marketing point of view, is significant. To build brand equity and become if you like a partner of choice. We are not in my view – while we manage a number of partnerships in the business, we're not yet a good partner. The legacy of a long period of time of consolidation and uncertainty in this business, means that the approach to partnering has been a little bit hit and miss. I think there's a huge opportunity for us to be able to develop our partnering capabilities within the business to emerge as a partner of choice. Because there is a huge opportunity to grow this business in a "capital lite' manner through management arrangements with asset owners who have not got the management expertise, branding or systems capable of taking assets that are old or assets that are under-funded, and adding value to them over time.

The other opportunities, which I'll only briefly mention, obviously value creation. There is a significant opportunity to really diversify product range in this portfolio. It has more than 180 different forms of DMF contract that has on average about 290 different building plans that we have in the business. The opportunity to be able to actually do more of what sells well and less of what doesn't, is pretty obvious but in any event when you're acquiring portfolios at the rate that B&B did, none of those opportunities were really realised.

The other opportunity I think in terms of the fact that this is a business, which has a perpetual relationship with the asset and the people who use that asset. Therefore demands a service culture, which is market leading. It demands it for the simple reason that you have a perpetual relationship. So the ability to be able to meet exceed consumer expectations but also resident expectations and manage those expectations on an ongoing basis, is a critical opportunity for the business going forward.

I'll spend a little bit of time now distinguishing between the retirement living and the aged care businesses. They are fundamentally different. The two things that I would point to here is there is a significant change undergoing or ongoing in the market at the moment. We're largely driven by the way aged care is being funded by the government. A rough – so the care level which is currently in RV's no care largely provided, by care, I mean clinical care health based care. In aged care that's what it is. It is health based clinical care, and that's the dividing line between the two. On average in the – sorry – in the business, the aged care business of the 2,300 people we employ in the community, 82% of them are in the aged care business, about 540 are in the retirement living business.

The change in way funding of aged care is moving is on average the spend per person in low level care in aged care, is around about $37,000. Moving to high care – that's per annum – moving to high care at about $75,000 per

annum. The introduction of the caps programmes provides in-home care services equivalent to but slightly below low level care levels at about $12,000 per person per annum. It's pretty clear that from a government point of view in terms of spending, if you can provide an in-home A caps package to individuals at a third of the cost of providing low care and at whatever $12,000 into $75 is of the cost of hire care. Then it's significant opportunity for the government to do one thing, is save money, and it's necessary they do it for the simple reason the demography doesn't lie. There is an inexorable increasing demand for these services, and as a result of that the government needs to find ways to fund it.

The other shift – and what that suggests is two things. One, a potential elongation of the time that people stay in retirement villages by virtue of the fact that they can age in place, which is a stated government policy. And second, the opportunity, I guess, on the other side is to be able to provide those services as part of your aged care platform. So there is essentially an emergent continuum of care, which maintains that perpetual relationship between the place, the person and the services provided.

Just moving on. With that distinction in mind, this is an attempt to try and explain the business model for the retirement village. Every time I've actually put this slide up I thought I was really simple but no one's got it, but I'll try again and see how we go. The first column moving from your left to right, the development of a unit in a retirement village, just a straight development process. Average margins, no more, no less, except that there is the opportunity to be able to capture or add to the return a deferred management fee. So we get the margin up front, a development margin on sale.

The second structure or return that we get is in the form of the deferred management fee, which has as I mentioned before about 180 different versions of it in the company. This is a sort of a garden variety version, where you get two sources of benefit. One is in the deferred management fee, which as it suggests is a fee, which is calculated on average at around about 3% per annum capped for 10 years. It is either based on either the ingoing price or the outgoing price. The other fee that you get is – or benefit that you get, is a share of capital gain, the upside, because on average people occupy these dwellings about 11 years. So if a unit appreciated at a rate of around about 4% per annum running for 11 years, the accrued value of the property would be around about $518,000, the entry price at $350,000. The difference is then set out in the contract as to how much of that benefit you get. It ranges from nothing to 100%, and the quid pro quo is how much your share you get of the deferred management fee. It's either all deferred management fee, no capital gain, all capital gain, no management fee, a bit of both.

The other fee or benefit that you get at the end of the turnover rate or ongoing is that red line through there, which are your fee streams, which are cost recovery. On average that enables us to be able to pay for village management services, which are paid for residents. On average that's about

$200-300 per month per dwelling ongoing for the term of occupation.

The other thing that I'd say about this slide is that the – and there's much – what's the word – misinterpretation I suppose, DMFs. What DMFs are, are a financial instrument to enable affordable secure housing for older people who couldn't otherwise afford it. Will the demand for that rise in the future or not? My view is yes it will for the simple reason that under-funded and unfunded superannuants aren't getting any younger. And as a result of that the need for products like the DMF will continue, on the basis that it is a better alternative than cashing out of homes of necessity, reverse mortgages and in other variations on these themes, and relocating to areas, which are affordable, usually dislocated from the neighbourhoods in which people grew up. Because essentially what people are buying in RV's is they are buying not only property, but they're also buying connection, a community with people – with other people like them in it.

I won't spend a lot of time on the demography. I mean, it's pretty self-evident. Other than to say that the key drivers in terms of the push factors that actually grow this market are not only just numbers in terms of number of people getting older. But it's the funding source as I mentioned and the circumstances the individual find themselves, when they are now 67, not 65. The other point to make is that target market is not anyone over 55. The people we sell to are on average couples at 75 years of age or older, or women the age of 70 – sorry couples at 74, women at 75. The key determinant of the person who buys, the woman who buys at 75, is her eldest daughter. So the person we're selling to is not granny, it's her daughter, and understanding that from a marketing point of view is pretty important. Apparently men and older sons don't play as big a role in that decision making process themselves.

The other needs that are driving the choice – and it is a choice of retirement living over other forms of accommodation are what we call negative needs. Uncertainty of health of an individual partner, uncertainty of health of the individual themselves. Financial circumstances or more often than not, the desire to find a place to live in a secure environment with people like them of a similar age. As neighbourhoods change over, invariably the people that these people grew up with, aged with, are no longer there. Neighbourhoods change and the opportunity to reconnect in environments where they feel comfortable, is a key driver.

The other numbers that are relevant here in terms of penetration rates within the Australian market, generally speaking by comparison to New Zealand and the US, much lower. If we're able to emulate from what was traditionally seen as about a 3% penetration rate in terms of new households occupying this form of delivery at about 3%, that's moved up to 5% over the last 10 years. Our view is that it will increase to somewhere in the order of 8%, rising potentially as high as 12 but not necessarily. That requires if you like on average about 10,000 new units per annum over the next 15 years in rough

terms.

So the demand opportunities for this business are significant. I have no reason to believe that we will not be able to find or source growth opportunities. The issue and the fundamental issue in the business is the management of the cashflows in the business, and that's where all of our focus inevitably will continue to be. The aged care business just briefly. It's number five. Interesting to note the other players in that market, none of which are listed. The other comment is that the B&B effectively developed the systems, which are proprietary systems for this business. With a scaleable ability to run to about 10,000 beds, so at the moment on the basis of 2,300 beds, it's sub-scale at the moment.

The industry is – but having said that – those systems have not been rolled out and the integrations haven't been completed to the extent necessary. We believe that's going to take us another 12 months to complete that process. The industry is dominated by the not for profit sector, and it's only recent that the not for profit sector has started to increase its share. The same issues of access to capital are driving difficulties, increasing difficulties in the provision of new products in the market. To the extent that the government is increasingly finding it more difficult to be able to allocate or place beds with accredited providers, in locations that are high priority. If you want to do something in the Gold Coast that's fine, but they are low priority from the point of view of bed allocations. You want to do something in Orange or Griffith, high priority in terms of where beds are being allocated, but not many takers in those circumstances.

The opportunity though, the cost base in terms of being able to deliver aged care facilities at a level of amenity that families are prepared to commit to, is much higher than the actual cashflows being generated by those entities. The significant performers in this particular portfolio are the older facilities, which conversely are those facilities which have higher capex needs, and also have a tendency for families who are ultimately making the decision about who lives – which facility is chosen – are more reluctant to place their loved ones in. There is a conundrum that is emerging from the government driven by demography, driven by the funding obligations that they have and the consumer's choice to come up with a different model. And that's been recommended under the aged care reviews that are being conducted now, and over the next 12-18 months.

The other thing to say is that this is not an industry that is driven by financial considerations. It is driven by necessity. It is a cashflow business. On the 18th of every month we get paid, which in this environment is a very good thing. The opportunity – and the Minister for Aged Care is on notice as having said that every – not some – but every aged care operator at the moment is basically foregoing about $2,500 of EBIT per bed on the basis that their systems do not allow them to charge for all of the things that the AcFee charging, fee structure, enables to charge for. Which suggests that

professional systems development and quality operational management do represent a significant upside within this business. The average EBITDA for businesses operating in the aged care area, ranges from best practice of around about $12-13,000 EBITDA per bed. The LLP business is not achieving those levels at this stage.

Finally to finish off, the opportunity for – and the focus for Lend Lease Primelife is that we have scale. It was built by someone else but we've got the opportunity to be able to turn it into value. The focus for us is very much in terms of cash and cashflow management. There are significant opportunities to be able to improve cashflow management within the business, and there is significant commercial complexity associated with a number of transactions that are embedded within the business, which we're actively working on un-picking.

The process of doing that improves the flexibility and choice we have about how we work with the business, and also how we structure it from a capital structure point of view, and from an ownership point of view. The DMF is not something that will go away, for the simple reason that the government has to choose another way of funding the under-funded and unfunded superannuants who significantly start to dominate our demography over the next 20 years. The tax system would seem to be not a favoured place through which the government would choose to do that. Private sector initiated choices based on – initiated solutions based on consumers exercising choice, would inevitably in our view be the way forward in that regard.

The aged care business, there is significant opportunity for us to be able to grow value in the business, and also we value its cash contribution to the portfolio in its current state. And I'll leave it at that point, and I understand that we now move to Q&A in a panel. Thank you.

END OF TRANSCRIPT