Chartwell Retirement Residences or Extendicare Inc.: Which Is the Better Buy?

Description

When Amica Mature Lifestyles was acquired by the Ontario Teachers' Pension Plan for $578 million in late 2015, the acquisition signaled further industry consolidation could be in the cards given the fragmented nature of seniors' housing.

Chartwell Retirement Residences (TSX:CSH.UN) and **Extendicare Inc.** (TSX:EXE) are two of the public companies still trading after Amica's delisting last December. With lots of buyers out there but few sellers, industry consolidation remains a difficult task.

OTPP paid $18.75 per share for Amica, 113% higher than its $8.79 share price the day before it announced its deal in the press. Prices for operators of seniors' homes in Canada are rising, and that puts both of these companies in a pretty good bargaining position with would-be buyers. However, only one of them is worth owning. Read on and I'll tell you which one I feel is the better buy.

According to Steve Hiscox, senior director of Seniors' Housing and Health Care at CBRE Ltd., the top 15 operators in Canada own or manage just 38.2% of the total seniors' housing units available in this country; Chartwell is at the top of the list and operates more than 21,000 units. With approximately 85,608 units in the hands of the 15 largest operators (latest figures as of Q2 2015), another 138,499 are owned by countless smaller operators from coast to coast.

So, while Chartwell and Extendicare might be able to get a pretty penny for their units given the pent-up demand from institutions, etc., it's equally attractive to be a buyer and consolidator, not a seller, given low-interest rates. This conflicted state gives rise to even higher prices paid for seniors' housing because, in effect, they're competing with themselves for those units.

Assuming both are buyers, investors must ask themselves which of the two is better positioned to execute this plan. Without question, I believe Chartwell is.

As of March 31, 2016, it owned or managed 26,056 retirement units, which is almost a 25% increase from the second quarter in 2015. Its 12-month trailing revenue as of March 31 was $784.3 million with an adjusted EBITDA of $222.4 million. Chartwell's figures suggest there are 425,000 units available in Canada in 2016 and approximately 600,000 new ones will be required by 2036. So, not only is there going to consolidation, but there’s going to be development as well.

Extendicare, on the other hand, is considered the largest long-term-care operator in the country with 101 properties and 13,562 suites. The largest 15 operators in this part of seniors care account for 26% of the total number of units operated in the country. Chartwell makes this list as well with approximately 28 properties and 3,741 units reserved for long-term care. This too is ripe for consolidation.

My own mother lives in a retirement home; they are not cheap. While there is a long-term-care floor, most of the residents can take care of themselves on a daily basis. Long-term-care facilities, on the other hand, are for people who require 24-hour supervision and, to the best of my knowledge, they’re not nearly as profitable due to the extra costs involved with patient care.

Which brings me to Extendicare’s finances. They’re actually pretty good.

In fiscal 2015, it generated adjusted EBITDA of $86.4 million on $979.6 million in revenue. Both revenues and adjusted EBITDA increased by double digits year over year. Extendicare is in the process of growing its retirement division through both acquisitions and new development. It’s spending $81 million to build retirement homes in Simcoe, Bolton, and Uxbridge, Ontario. The first is expected to open in the fall with the other two next spring.

To complement its growth in the retirement segment, Extendicare acquired Revera’s home healthcare business in 2015 for $83 million. As a result, its home healthcare segment now generates about 31% of Extendicare’s total revenue to go with the 12% it now generates from its retirement segment. It continues to diversify its revenue streams from seniors care.

It’s a wise decision but it’s not enough to sway my opinion.

Extendicare’s adjusted EBITDA margin is around 8.8%. Its move into retirement homes should push that higher in the years ahead, but the simple fact is that Chartwell’s adjusted EBITDA margin is more than three times Extendicare’s. If anyone is going to be consolidating at a significant pace, I believe it will be Chartwell doing much of the large-scale buying.

While I believe both are going to pay off for investors long term, I see Chartwell as the better buy.

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1. Editor's Choice

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