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CEO's address
Annual General Meeting 2016
Estia Health Limited (EHE)

Norah Barlow, CEO & Managing Director
Wednesday 23 November 2016

Thank you Pat.

Executive team

First, I would like to introduce our members of the Estia Health senior executive team and I invite them to stand as I introduce them to you.

- **Steven Boggiano** – Acting Chief Financial Officer
- **Ian Thorley** – Chief Operating Officer
- **Mark Brandon** – Chief Policy & Regulatory Officer
- **Kate Sellick** – People and Communications Director
- **Mary Burke** – Quality Director
- **Peter Hamilton** – Development Director
- **Mark Kennedy** – Development Director

Financial results

As Pat has already summarised our financial results for FY16, I will not focus on those. I would like to spend some time discussing our operational performance in the current financial year. I would also like to discuss the progress of the strategic and operational review that was announced to the market on 6 October 2016.

Operational update

Operating performance

We achieved an average occupancy rate of 94.4 per cent across the company in FY16 which is a strong result, however we are currently tracking slightly lower in FY17 year to date with an occupancy rate for the period of 93.1 per cent. This average reflects the fact that some of our homes, in the main the newly acquired homes, have experienced a drop in

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occupancy which we are working to correct. This reduction in occupancy over the portfolio was a factor in revising our FY17 guidance.

Other key operating metrics have been tracking broadly in line with our expectations with improvements in revenues per occupied bed day, strong RAD pricing and strong total RAD net cashflows.

Care, quality and compliance

Estia is focused on and committed to providing quality care for our 5,500 residents. Every Estia home is under the leadership of an Executive Director and Care Director who are supported by a team of carers and registered nurses.

We operate in a sector which is subject to strict regulatory oversight and rely on an integrated suite of quality systems and management structures across our portfolio of homes to ensure the highest standard of quality and compliance is achieved. All 69 of our homes are accredited and during the last 12 months, 18 of our homes have been re-accredited.

However, we are conscious of the fact that we have had some non-compliance.

I believe we are in a sector which is quite correctly subject to regulatory oversight. The public status of this company brings these regulatory issues to public attention. Although we do not want to be the subject of such issues in the first place, this level of scrutiny is a good thing. It holds us to a greater level of accountability and helps to ensure we always live up to our responsibilities to our residents. We acknowledge our issues, and very much regret that we were not up to our own standards in these unique cases.

We took immediate action to address the areas of concern and all issues identified have either already been rectified or will be rectified within the timetable for improvement provided by the Quality Agency.

Since July this year, it is to be noted that 57 of our homes have received a visit from the Agency. This represents more than 80% of our portfolio. We welcome these visits and believe strongly that our homes should always be acting in full accordance with all requirements and indeed should be providing first class service and support to all residents at all time. Any time we fail in this is unacceptable to our team.

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Staff initiatives

With a workforce of more than 7,000, it is our people who underpin the success and quality of our company. It is the people in our homes who provide care and services to our residents, every day. We have undertaken a range of initiatives to support our people in doing the very valuable work that they do.

Our Graduate Nurse Internship program is entering its second year. This program aims to attract and develop our next generation of leaders and recruitment for our 2017 program is well underway.

The Network Ambassador program sees our top talent providing support and expertise to other homes in their region – it enables us to share knowledge and best practice across our homes and we see this as one of the benefits of being an organisation of our size.

Our Happy Days engagement program is a truly unique program that speaks to the heart of delivering person-centred care. It is about taking the time to understand what is truly important to a resident - an individual - and making a commitment to do something special for that person. It can be small, yet significant - we have real examples of these on the walls here today to share with you and give you a small insight into how our people go beyond just providing care in our homes.

Our safe workplaces initiatives are vitally important, we have a wide range of initiatives and tools in place to ensure we maintain a safe workplace environment for our 7,000 staff.

Strategic and operational review

In response to changes in our operating environment and a number of external and company specific challenges, we announced a strategic and operational review on 6 October 2016.

The objective of this review is to assess the company's operations, including management structure, business systems, the reporting framework, the company's asset base and capital structure and to initiate actions aimed at optimising the Group's performance and ensuring it is best placed to capture the opportunities inherent within the business.

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This review is progressing well, but I would emphasise that it is not yet complete. It has produced a number of preliminary observations to date, which will be discussed shortly.

I would like to stress that so far, the review has shown that the overall Estia Health business is sound. There are a range of tangible operational initiatives and exciting development opportunities that exist within the current business. Our main emphasis going forward will be on executing these initiatives as well as possible.

This is what attracted me to putting myself forward for this role. I could see a company which has started well, which has become one company from a number of acquisitions made over a relatively short period of time, and which has a number of very high quality staff. I could also see the areas which have not been able to be maximised, and where I could see significant value to be added.

Management & operational structure

An early outcome of the review is a regeneration of the management team and I thank Pat for the kind welcome. I am grateful to have this opportunity to be part of, and lead the Estia Executive team and I look forward to working with our all our valued Estia stakeholders.

We have, as mentioned earlier, appointed Mr Ian Thorley as Chief Operating Officer. Mr Steven Boggiano will continue in the role of Acting Chief Financial Officer and I thank him for his exceptional work in this capacity as we initiate an active search for a permanent CFO.

As part of the regeneration and strengthening of the management team, and absolute importance we place on compliance, we have also restructured the Quality roles in the company. This includes adding a new Head of Quality role with Quality Managers and Clinical Educators in each state. These roles will be responsible for ensuring that not only are we always fully compliant with the accreditation standards, but that we continually strive for excellence in our homes.

We have also introduced a new Chief Policy and Regulatory Officer role. The future Government direction in aged care is undergoing some change, and we need to be sure that we are always fully aware of what these changes are, and indeed that we are in a position to bring matters which impact on us to the attention of the regulators.

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Operational management & quality review completed

In addition to rebuilding the senior management team, we have identified the need for an enhanced management structure from the home level up. We could see that many of the areas that we identified as underperforming were in fact due to a system which did not provide full accountability at home level for the performance of that home. By re-designing this structure, we are aiming to maximise efficiencies and improve facility level accountability and performance. A number of initiatives will be undertaken to achieve this including:

- A reallocation of responsibility from the corporate office to regional managers for aspects such as budget, quality, staff/culture and occupancy
- The introduction of specialist roles, across every state, covering quality, clinical education, human resources and client relations
- Introducing a greater emphasis on home level operational and financial reporting.

We look at this as the main issue facing the business. The previous structure was developed a year ago primarily as a cost saving measure. This structure removed middle management, and put more responsibility to groups of homes, in a peer type structure. This was intended to empower staff at home level, and put more decision making at grass roots. Counter intuitively it, in fact, had the opposite impact. It removed accountability for the individual home from the structure, and therefore has had the impact of reduced focus on financial performance and quality of care. We are putting this accountability and responsibility back where it belongs, and will be enhancing our operational structure.

We have also identified the importance of suitable incentive structures, which are currently being reviewed, to ensure optimal alignment with performance outcomes.

Operational efficiencies

As part of the ongoing strategic review, we have reviewed our business and operating systems and procurement practices.

We are pleased to report market best practice business systems have been fully deployed across the portfolio. We do, however, see that these systems have not to date been optimised, and we have a clear focus in the business on doing just that.

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We have also taken the time to evaluate our procurement processes. As a result we see an opportunity to streamline and improve these. This may include, but is not limited to:

- Renegotiation of all significant contracts such as food, physiotherapy, medical supplies
- Rationalising product lines and supplier base
- Improving inventory management and reporting at the home level
- Ensuring compliance to group preferred supplier arrangements.

There is a significant amount of upside here, with all being good systems, but not yet fully realised.

Earnings initiatives

Changes to Government funding will increasingly impact the business over coming years and in particular the review examines the changes to complex health care funding and the likely impact on Estia. It is clear that the number of older people in Australia is increasing, with numbers of people over 65 to double in the next 40 years. It is also clear that governments all over the world are challenged with how to pay for the cost of the increased health care needs. However, I would say that all of us, including the many vulnerable people who need aged care, would benefit from certainty in government funding policy for these valuable services. I would hope we would get this in the foreseeable future.

The changes in Government funding recently announced will have a significant adverse impact on earnings in FY 18 and 19, if we don't put strategies in place to mitigate this.

We have implemented a range of initiatives now which we see will assist in this mitigation. We need to ensure good processes throughout the business and in particular in areas to maximise occupancy through the homes.

I will talk specifically about the opportunities we can see with significant refurbishment later.

Acquisitions

As part of the strategic and operational review process we have analysed our acquisition and development strategy.

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We have acquired 1,920 places in FY16 across multiple geographies. This has added significant scale to the portfolio, a number of high quality assets, and significant organic growth opportunities. All acquisitions are fully integrated, with the exception of Kennedy where we are undertaking the final stages of its integration.

There are no remaining acquisition payments outstanding following final payment to Kennedy in October this year.

Development summary

As we move forward, our growth strategy will focus on our robust development pipeline, with no further acquisitions likely to be undertaken in the short to medium term. In addition, we are focused on enhancing our existing homes to ensure we provide an excellent level of accommodation and we also benefit from the significant refurbishment program. I will touch on this in more detail shortly.

Our development pipeline represents a material strategic opportunity in the coming years. What we have achieved in recent times, together with what we have in prospect, is probably more significant than our shareholders might have understood to date.

Development pipeline – completed or underway

- Since June 2016 we have opened five brownfield projects year to date, delivering 108 net new places.
- Two greenfield projects, Kogarah and Twin Waters are currently being constructed, set to deliver 123 net new places in total with both homes scheduled to open in FY18.
- Total FY17 development capex is estimated to be in the range of $38 million - $44 million.

Development pipeline – to be commenced

- We have seven further projects which either have a DA approved or submitted or have been identified as potential development opportunities but have no DA submitted. These projects are estimated to deliver a total of 546 net new places across FY19 – FY21.

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Significant refurbishment opportunities

Another key outcome of the review to date is an increased focus on significant refurbishment opportunities. This program provides additional earnings opportunities as well as further enhancing the quality of our homes and in turn the living environment and lifestyle experience for our residents. We see that there is a great deal of upside here.

The significant refurbishment program is progressing well, and is structured into two phases.

- Phase one includes 12 homes, with four already receiving significant refurbishment subsides, two completed with applications submitted, one underway and five identified but yet to commence
- Phase two involves 16 homes, representing approximately 700 places which may be eligible for future significant refurbishment subsides

It is currently estimated that phase one of this significant refurbishment program will deliver approximately $4 million in EBITDA on a stabilised basis, with an estimated further capex outlay of $9 million.

Asset portfolio review

When we announced the strategic review we highlighted that we would evaluate our overall asset portfolio to identify any assets that are surplus to our ongoing strategic needs. The process of identifying non-core assets remains ongoing and any divestment decisions will be made having regard to a wide range of factors including the strategic nature of each assets as well as current or future potential value.

While the review of the asset portfolio continues, it is clear that Estia Health has an extensive and profitable portfolio of homes and also holds a portfolio of property investments that are mostly key to the ongoing development and regeneration of our physical assets in the medium to longer term.

Leverage and liquidity

Let us now move on to leverage and liquidity.

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Estia remains comfortably within its debt covenants, with significant headroom.

As at 31 October 2016, we have a net debt position of $254.7 million, comprising $286.5 million of drawn debt, with approximately $70.0 million is attributable to development, and the remainder comprising core debt of approximately $216.6 million. The cash position as at 31 October is $31.8 million.

As mentioned earlier, Estia has no further provisions for acquisition consideration payable, with the final Kennedy payment made in October.

Based on the mid-point of our revised guidance of $86 million - $90 million, we have a net leverage ratio of 2.1 times as at 31 October 2016. This reflects our core net debt balance and excludes development debt.

This is comfortably within limits of 3.50 times and results in headroom of 1.40 times. Notwithstanding this, we acknowledge that our debt levels are higher than our peers and the average of the sector in which we operate in. As such, we see it as an objective to reduce our core debt position over the medium term.

We continue to assess alternatives to allow us to meet this objective, having regard to a number of important factors including:

- the earnings and operating cash flows delivered by the company;
- capital expenditure requirements of, and incremental earnings contribution from, our significant pipeline of greenfield and brownfield development and significant refurbishment;
- the level of RAD receipts which continue to be a positive inflow to the business; and
- other elements that impact on future cashflows.

The outcome of this ongoing assessment will be announced in due course, however, I would again emphasise that Estia remains comfortably within its banking covenant limits as at 31 October 2016.

Outlook

I would like to take this opportunity to confirm that we are currently tracking in line with our expectations for FY17 and re-affirm the company's guidance as provided to the market on the 6th of October.

FY17 underlying EBITDA is anticipated to be between $86 million to $90 million.

The business continues to generate strong cashflows and strong RAD receipts and we continue to see further considerable opportunities to improve performance through the range of initiatives that I have outlined including:

- Improving the management structure, systems and operations towards industry best practice standards;
- Better prosecuting opportunities such as significant refurbishment and additional services that have not been fully accessed to date; and
- Undertaking our significant pipeline of developments which will be largely self-funding over time

I've been fortunate as an independent director to have learned a lot about this business. When I accepted the role as interim CEO I did so in the knowledge that there was a tough road ahead but I had faith in the underlying business and in the people who operate it.

I can see Estia's strengths and growth opportunities and I'm excited by what lies ahead for this business. I look forward to providing you with further updates, including progress made on the strategic and operational review, as we move through FY17.

I would like to specifically thank all of the Estia staff who have welcomed me into the company. I would like to thank the management team, new and old, who are all pulling together to make this company great. I would like to thank the Board for their support and for the ongoing commitment they show to this company.

And finally I would like to thank you all as shareholders. We have a great opportunity, I believe the biggest opportunity in this sector, to maximise our performance and to grow shareholder returns. We do this best by providing the best care we can to our residents, by regaining our reputation in the market, by growing occupancy, and optimising our systems. We hope you share that journey with us.