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EXE-TSX

Rating:	Buy
Target:	$8.00
Price:	$6.75
Return:	25.6%
Valuation:	10x AFFO, 10x EV/ EBITDA (F2022 est)

Market Data

Basic Shares O/S (M)	89.5
Market capitalization ($M)	591.0
Enterprise Value ($M)	989.7
Cash & equiv ($M)	172.5
Total debt ($M)	571.2
52 Week Range	$4.90/$8.85
Avg. Weekly Volume (M)	1.35
Fiscal Year End	Dec-31
Annual dividend per share	$0.48
Dividend yield (%)	7.1%

Financial Metrics

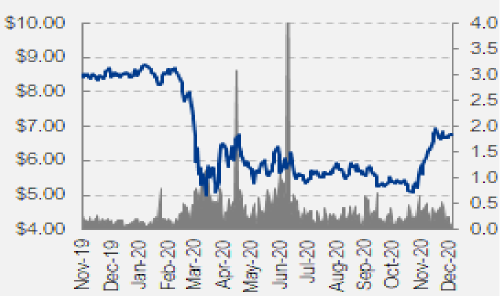
In C$	2020E	2021E	2022E
Rev. LTC ($M)	682.0	634.2	634.2
Rev. homecare ($M)	368.1	395.2	397.2
Rev. retire res ($M)	46.9	44.4	44.4
Rev. other ($M)	25.8	26.0	26.2
EBITDA ($M)	58.7	111.2	113.4
EBT ($M)	(10.6)	50.1	52.3
Adj net inc ($M)	(21.4)	37.6	39.2
EPS (basic)	($0.24)	$0.42	$0.44
AFFO (basic)	$0.16	$0.77	$0.79
P/AFFO	*41.8x*	*8.8x*	*8.5x*
EV/EBITDA	*16.9x*	*8.9x*	*8.7x*

Quarterly Data (Cdn LTC/homecare)

In C$M		Q1	Q2	Q3	Q4
REVENUE	2020A	268.8	281.9	296.8	275.1
	2021E	274.9	274.2	275.0	243.2
EBITDA	2020A	19.9	8.2	13.0	17.7
	2021E	25.4	29.0	29.2	23.2

Company Description

Extendicare is a Canadian long-term care, retirement residence & home-care service provider, with operations in four Canadian provinces and with long-term care/home-care focused mainly in ON/AB.



Source: Consensus data- Refinitiv, Forecasts/Estimates - Leede Jones Gable

Initiating Coverage on Leading Eldercare Services Provider with a BUY Rating

We are initiating coverage on ON-based eldercare services firm Extendicare with a BUY rating and a price target of $8.00. Extendicare operates multiple healthcare services silos in several Canadian provinces (though mostly in ON/AB), with particular emphasis on nursing home and home healthcare operations. In parallel, the firm operates more modest but highly profitable retirement residences facilities in ON/SK. Extendicare's legacy nursing home operations in the US have long ago been divested (in FQ414, to Formation Capital) and indeed, cash proceeds from that transaction were substantially deployed to acquire many of its foundational retirement residence assets. Accordingly, our EXE investment thesis and valuation have long been focused on Canadian eldercare services, with even greater emphasis on home healthcare generated through the acquisition of Revera's (private) home healthcare operations back in F2015. We provide supplemental commentary on all three of Extendicare's EBITDA-contributing business units below, while providing retrospective emphasis specifically on FQ320 financial data just reported.

Investment Summary

Margin augmentation is imminently achievable, particularly in home healthcare, once pandemic logistics subside: The firm has clearly endured multiple operational challenges imposed by COVID-19 pandemic considerations, and FQ220/FQ320 financial data reflect those challenges specifically though not uniquely in its home healthcare operations, but we are encouraged by how well the firm has adapted to new industry realities and we thus believe that risk to its operational stability and to its current dividend policy is low. Our valuation is based on the average of three distinct methodologies based on our F2022 financial forecasts for the firm (10x AFFO, 10x EV/EBITDA), with our target corresponding to a one-year target return of 18.5%, and total return (including dividend yield of 7.1%) of 25.6%.

Unsurprisingly, financial data in the most recent quarter was a mixed bag of pandemic-motivated costs, partially offset by supplemental funding: Shifting to FQ320 financial data as reported by the firm last month, we are sort of caught between hops on our perceptions of the period. On the positive side, FQ320 consolidated EBITDA and AFFO were massively above our original expectations at $63.8M and $42.8M ($0.48/shr) respectively. This was hugely above our expectations at the time of $18.0M/$9.2M ($0.10/shr), in which our expectations for pandemic-impacted margin compression were more substantial.

But of course, as-reported EBITDA/AFFO were simultaneously impacted by the $50.8M Canada Emergency Wage Subsidy payment in the period. If we were to exclude this payment in order to normalize comparisons to prior periods, EBITDA would have otherwise been $13.0M (as we indicate in Exhibit 7) and AFFO would have been negative through the mechanisms by which Extendicare calculates its AFFO. But taking both analytical extremes into consideration, we believe that Extendicare's core long-term care and home healthcare operations can return to historic margin norms in a post-pandemic universe, which could optimistically be on the horizon in F2021.

Exhibit 1. Financial Summary for Extendicare

(C$M, except per share & ratio data)	2011A	2012A	2013A	2014A	2015A	2016A	2017A	2018A	2019E	2020E	2021E	2022E
Revenue, SNFs	$525.8	$550.3	$568.9	$583.7	$594.2	$608.6	$616.9	$632.5	$643.8	$682.0	$634.2	$634.2
Revenue, ParaMed	$165.0	$170.3	$174.1	$185.5	$195.4	$215.2	$220.7	$222.3	$214.0	$188.3	$206.2	$208.2
Revenue, Revera home	$0.0	$0.0	$0.0	$0.0	$131.6	$199.2	$215.0	$209.0	$209.0	$179.8	$189.0	$189.0
Revenue, Assist liv	$0.0	$0.0	$0.0	$0.0	$1.2	$15.5	$20.7	$33.4	$41.3	$46.9	$44.4	$44.4
Revenue, other Cdn ops	$7.5	$8.3	$10.0	$12.8	$15.6	$18.6	$18.8	$22.3	$23.9	$25.8	$26.0	$26.2
Revenue, US ops	$0.0	$0.0	$31.0	$34.2	$41.7	$11.8	$5.3	$0.4	$0.0	$0.0	$0.0	$0.0
Consolidated revenue [1,3]	$698.4	$729.0	$784.0	$816.2	$979.6	$1,068.9	$1,097.3	$1,120.0	$1,132.0	$1,122.7	$1,099.8	$1,102.1
Rev growth (%)	*NA*	*4.4%*	*7.5%*	*4.1%*	*20.0%*	*9.1%*	*2.7%*	*2.1%*	*1.1%*	*(0.8%)*	*(2.0%)*	*0.2%*
EBITDA [3]	$65.8	$72.2	$69.6	$74.7	$86.4	$92.9	$97.6	$94.2	$91.1	$58.7	$111.2	$113.4
EBITDA margin (%)	*9.4%*	*9.9%*	*8.9%*	*9.1%*	*8.8%*	*8.7%*	*8.9%*	*8.4%*	*8.0%*	*5.2%*	*10.1%*	*10.3%*
EBITDA growth (%)	*NA*	*9.8%*	*(3.7%)*	*7.4%*	*15.8%*	*7.5%*	*5.0%*	*(3.4%)*	*(3.3%)*	*(35.5%)*	*89.3%*	*2.0%*
Non-oper exp (inc D&A)	*NA*	*NA*	*$18.8*	*$32.9*	*$18.7*	*$28.0*	*$27.0*	*$34.1*	*$35.7*	*$37.6*	*$30.5*	*$30.6*
Interest expense	*NA*	*NA*	*$34.5*	*$32.9*	*$31.1*	*$27.0*	*$28.1*	*$27.6*	*$28.7*	*$28.5*	*$28.6*	*$28.6*
Tax expense	*NA*	*NA*	*$6.1*	*$4.5*	*$13.5*	*$7.4*	*$10.9*	*$4.2*	*$7.2*	*$10.8*	*$12.5*	*$13.1*
Adjusted EPS (basic) [1]	*NA*	*NA*	$0.12	$0.05	$0.26	$0.35	$0.36	$0.09	$0.19	($0.24)	$0.42	$0.44
Adjusted AFFO	*NA*	*NA*	$0.38	$0.39	$0.51	$0.75	$0.66	$0.65	$0.59	$0.16	$0.77	$0.79
Dividend per share	*NA*	*NA*	48%	48%	48%	48%	48%	48%	148%	248%	348%	448%
Implied payout ratio (%)	*NA*	*NA*	*126%*	*123%*	*94%*	*64%*	*73%*	*73%*	*251%*	*1,537%*	*453%*	*567%*
P/E ratio	*NA*	*NA*	*57.5x*	*137.0x*	*25.6x*	*19.6x*	*18.9x*	*73.8x*	*35.3x*	*(28.3x)*	*16.1x*	*15.4x*
Pro forma EV-to-EBITDA	*15.0x*	*13.7x*	*14.2x*	*13.3x*	*11.4x*	*10.6x*	*10.1x*	*10.5x*	*10.9x*	*16.9x*	*8.9x*	*8.7x*
Price/AFFO	*NA*	*NA*	*17.8x*	*17.2x*	*13.3x*	*9.0x*	*10.2x*	*10.3x*	*11.4x*	*41.8x*	*8.8x*	*8.5x*

[1] *All revenue/EBITDA are adjusted for Canadian operations only, including F2011/12*

[2,3] *EV includes FQ320 cash of $172.5M, FQ320 total debt of $571.2M; historic F2011/12 revenue, EBITDA, & EV/EBITDA multiples based on Canadian data only*

Source: Historical data – Company Information (Extendicare), Forecasts/Estimates – Leede Jones Gable

As in FH120 data, FQ320 nursing home operations were impacted by a mix of new costs and new funding, though with combined effect that supported AFFO and dividend support: Reflecting back on FQ320 long-term care (LTC) operations, Extendicare actually generated reasonably strong LTC revenue of $184.7M that was up sequentially from $178.5M in FQ220 (a quarter that itself was encumbered with pandemic considerations) and up more substantially from $161.0M reported in FQ319. FQ3 tends to be a seasonally strong margin quarter for Extendicare's LTC operations, mostly because utility costs tend to be lower in the summer months, but of course pandemic-related costs negatively impacted operating income/margin in the quarter as in FQ220, with $13.0M/7.0% comparing favorably to $11.1M/6.2% last quarter, but predictably comparing more negatively to FQ319 data of $20.6M/12.8% that is more typical of LTC operations in this period.

Exhibit 2. Valuation Scenarios for Extendicare

AFFO multiple, F2022	6x	8x	9x	10x	11x	13x
Implied unit price [1]	$4.74	$6.32	$7.11	$7.90	$8.69	$10.27
EV-to-EBITDA multiple, F2022	**6x**	**8x**	**9x**	**10x**	**11x**	**12x**
Implied unit price [1,2]	$3.15	$5.68	$6.95	$8.21	$9.48	$10.75
One-year EXE target price [2]				***$8.06***		
Implied dividend yield (%)				***6.0%***		
Current dividend yield (%)				*7.1%*		

[1] *Based on F2022 EBITDA forecast of $113.4M & F2022 AFFO forecast of $0.79, using 10x EV/EBITDA multiple & 10x AFFO*

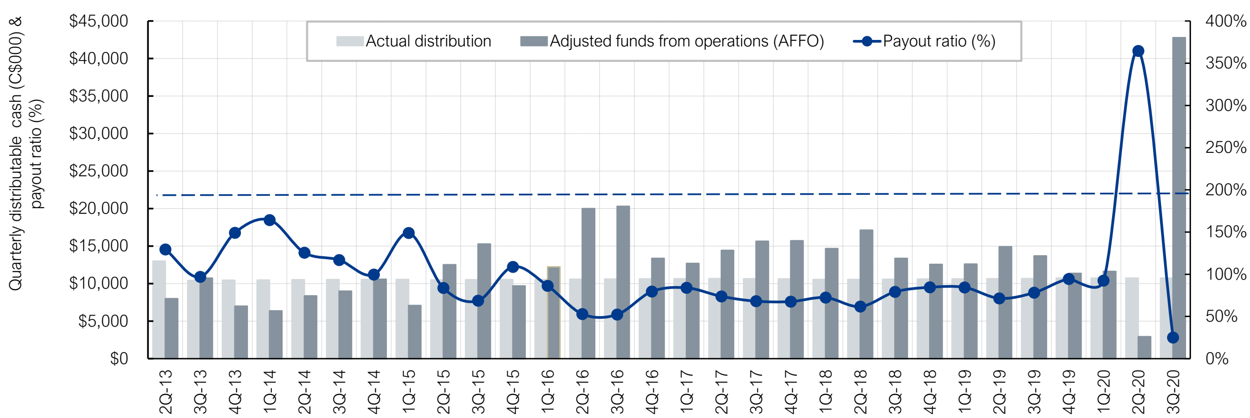
[2] *EV includes FQ320 cash of $172.5M; LT debt of $571.2M*

Source: Forecasts/Estimates – Leede Jones Gable

We do not consider pandemically-influenced margins to be predictive of future margins in this or any other Extendicare eldercare services operation and so near-term margins do not materially influence our investment thesis on the firm. That said, pandemic challenges were measurable and considerable. New pandemic costs exceeded supplemental pandemic funding by ($6.6M) in the period (obviously offset by the $50.8M CEWS funding to home healthcare in the period) and cumulatively by ($15.5M) YTD. Occupancy continues to drift downward as the firm continues to be unable to fill newly-unoccupied beds, at least until pandemic restrictions subside. Overall LTC occupancy was 90% in the period and thus well below the 97% threshold required to qualify for full funding in ON under its envelop cost-plus funding mechanism. The province has appropriately relaxed that qualification at least through F2020, and we assume into F2021.

Service dynamics in home healthcare that by definition require community reach-out would make this division more vulnerable to pandemic constraints that Extendicare's LTC care/retirement residence operations: Shifting to Extendicare's home healthcare division, this division consists of a combination of legacy operations long branded as ParaMed, plus supplemental operations acquired from Revera in F2015 as indicated above. FQ320 revenue of $93.2M was up sequentially from $85.5M in FQ220, itself soft by conventional expectations but with more dramatic pandemic impact based on reduction in service hours in the period for what is a community reach-out operation that was necessarily curtailed under distancing/lockdown measures employed in Extendicare's target geographies (mostly ON/AB). FQ319 home healthcare revenue was far higher at $105.4M, but this of course included revenue from service hours in BC, and excluding that revenue (which generated virtually no operating income), adjusted FQ319 home healthcare revenue would have been $92.3M, revealing modest but still positive revenue growth within Extendicare's continuing home healthcare operations on ON/BC.

Exhibit 3. Historic AFFO and Payout Ratio for Extendicare

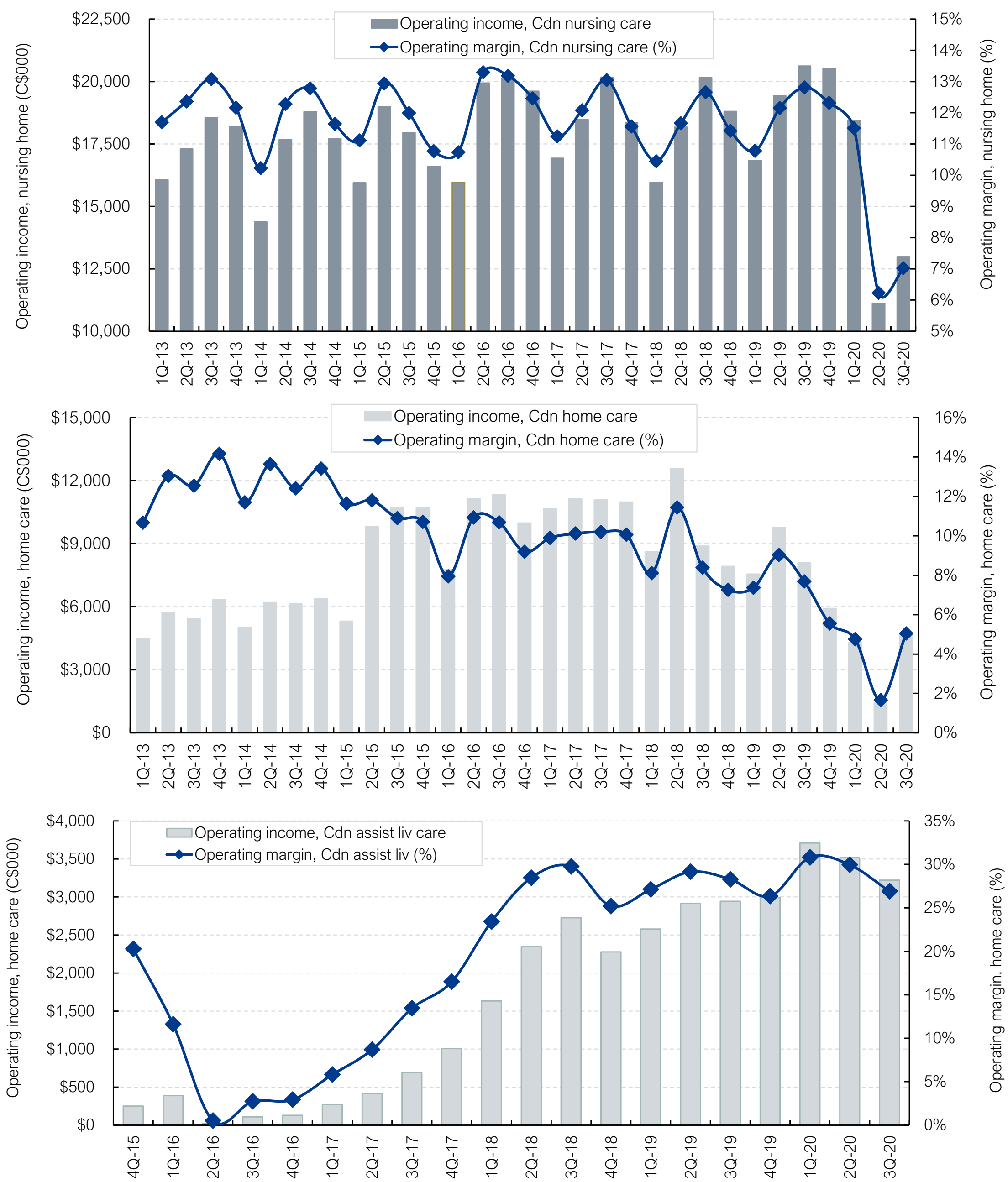


Source: Historical data – Extendicare, modified for presentation by Leede Jones Gable

Home healthcare generated operating income/margin of $4.7M/5.0% and thus solidly above $1.4M/1.7% generated in also-pandemically-impacted FQ220. This was still well below $8.1M/7.7% generated in FQ319, (excluding BC home healthcare revenue has negligible impact on operating income, but it does lift retrospectively adjusted margin to 8.7%, in line with what we believe is achievable as baseline for this division in F2021 and thereafter). Operating margin softness is a direct consequence of service hour softness, which were down nearly 10% y/y though with encouraging trendlines from trough levels reported in FQ220 (total hours were 2.1M, up from 1.85M in FQ220) that are continuing into FQ420 (and indeed were up sequentially by 5.2% by mid-Nov/20). We see no reason why quarterly service hours cannot return to pre-pandemic levels of about 2.3M-to-2.4M in the next few quarters, while simultaneously lifting quarterly operating margin specifically for home healthcare back to the 11-14% range that Extendicare routinely achieved back in F2013-to-F2015.

Retirement residence operations still generating strong operating income and margin in FQ320, even though newly-opened lease-up facilities have predictably been slow to grow occupancy above pre-pandemic levels: Financial metrics for the firm's retirement residence portfolio in ON/SK actually performed well in relative terms, if showing some predictable operating income/margin softness on slightly receding occupancy levels in the quarter. Stabilized occupancy of more mature facilities was 91.9% and was actually a bit above 91.5% reported in FQ220, but with both periods below the 94%-95% level achieved during FH219. Newly-opened facilities in Barrie ON, Bolton ON, and Moose Jaw SK remained surprisingly stable at 68.3% occupancy, as compared to 67.3% in FQ220. We would of course expect new facilities to exhibit more substantial occupancy growth than transpired in FQ320 and so there is clear potential for overall retirement residence occupancy to grow in future periods once pandemic considerations subside.

Exhibit 4. Quarterly Operating Income & Margin Data For Extendicare, By Division



Source: Historical data – Extendicare, modified for presentation by Leede Jones Gable

On retirement residence financial data themselves, FQ320 revenue/operating income/margin of $12.0M/ $3.2M/26.9% was fairly stable on top-line if a bit softer sequentially on margin at $11.7M/$3.5M/30% in FQ220 and from $12.0M/$3.7M/30.8% in FQ120. As is clear in the magnitude of the operating income drop from FQ120 to FQ320, Extendicare calculates that pandemic considerations negatively impacted retirement residence operating income in FQ320 by about ($0.5M), mostly on lack of occupancy growth in new facilities but also some occupancy compression in mature facilities, both of which should lift in our view during F2021.

CEWS payment was necessary to push FQ320 AFFO into positive territory, but excluding pandemic considerations, AFFO would conventionally have been seasonally strong in FQ320: We do not have division-specific AFFO data, though it would clearly not be relevant to Extendicare's dividend policy and yield if we did. On a consolidated basis, as-reported FQ320 AFFO of $42.8M

($0.48/shr) was substantially above actual distribution in the period of $10.7M ($0.12/shr). This corresponds to a highly-unique quarterly payout ratio of 25.1% in the period, a substantial if unsustainable improvement over 92.5%-to-94.5% in FQ419-FQ120. This is also substantially superior to 365% generated in FQ220 in the absence of supplemental CEWS funding that if absent from FQ320 AFFO calculation would have led to negative AFFO in the period, as indicated above. Accordingly, it is difficult to project any AFFO growth trajectory from FQ320 data, other than to indicate that we believe that Extendicare's current dividend policy is safe as long as provincial supplemental funding is available to offset any future pandemic-related operating costs it incurs.

Exhibit 5. Comparable Companies for Extendicare

Company	Curr.	Sym.	Shares Out. (M)	Share Price 13-Dec-20	Mkt Cap ($M)	Ent. Value ($M)	EV/EBITDA (T12)	EV/EBITDA (FY1)	EV/EBITDA (FY2)	Price/Earnings (T12)	Price/Earnings (FY1)	Price/Earnings (FY2)	Price/FFO (FY1)	Price/FFO (FY2)	Dividend	Yield (%)
Canadian healthcare trusts or dividend-paying healthcare firms																
Chartwell REIT	CAD	CSH.UN	215.6	$11.57	2,494	4,981	18.5x	19.2x	17.6x	NA	NA	NA	15.5x	14.2x	$0.54	4.7%
Invesque [1]	USD	IVQ	55.8	$1.80	101	1,177	NA	NA	NA	NA	2.5x	2.9x	2.7x	2.8x	$0.90	NA
K-Bro Linen	CAD	KBL	10.7	$37.56	401	503	17.1x	12.5x	11.6x	NA	NA	38.6x	NA	NA	$1.15	3.1%
Medical Facilities [2]	CAD	DR	31.1	$7.35	229	368	4.5x	3.9x	4.4x	3.4x	17.9x	21.3x	NA	4.7x	$0.28	3.8%
Northwest Healthcare Properties	CAD	NWH.UN	175.7	$12.46	2,190	5,011	19.3x	18.1x	16.4x	14.1x	14.3x	19.5x	15.0x	13.6x	$0.80	6.4%
Sienna Senior Living	CAD	SIA	67.0	$13.63	914	1,895	18.4x	18.8x	16.0x	NA	NA	NA	12.9x	11.7x	$0.90	6.6%
Average							13.4x	11.8x	11.2x	8.7x	11.6x	20.6x	11.5x	9.4x		3.8%
Extendicare	CAD	EXE	89.5	$6.75	604	1,003	8.7x	8.1x	10.8x	19.6x	18.9x	NA	11.4x	11.6x	$0.48	7.1%
Healthcare REITs																
HCP Inc.	USD	HCP	538.4	$29.33	15,790	21,973	22.9x	20.3x	20.1x	50.0x	52.7x	NA	17.9x	18.1x	$1.48	5.0%
Healthcare Realty	USD	HR	136.1	$29.57	4,023	5,474	12.3x	20.0x	18.8x	34.8x	49.4x	NA	18.1x	17.3x	$1.20	4.1%
Healthcare Trust of America	USD	HTA	218.6	$26.18	5,722	8,522	18.4x	18.3x	17.2x	NA	NA	NA	15.6x	15.2x	$1.28	4.9%
LTC Properties	USD	LTC	39.2	$38.65	1,517	2,158	17.3x	16.8x	14.8x	16.9x	15.6x	21.2x	15.5x	13.5x	$2.28	5.9%
Medical Properties Trust	USD	MPW	536.0	$20.68	11,084	19,091	18.7x	17.1x	15.4x	23.8x	23.5x	18.7x	13.3x	12.3x	$1.08	5.2%
National Health Investors	USD	NHI	44.7	$67.03	2,998	4,485	14.6x	14.5x	14.7x	15.7x	15.9x	18.5x	11.9x	12.0x	$4.41	6.6%
Omega Healthcare Investors	USD	OHI	227.0	$37.59	8,533	13,670	17.7x	15.7x	13.8x	53.5x	41.0x	22.8x	12.0x	11.6x	$2.68	7.1%
Sabra Healthcare	USD	SBRA	206.9	$25.40	5,256	7,644	NA	17.4x	17.0x	36.6x	38.3x	35.5x	14.2x	14.5x	$1.78	7.0%
Senior Housing Properties Trust	#N/A	SNH	238.3	$0.00	0	3,416	8.3x	8.9x	10.4x	NA	NA	NA	NA	NA	$0.00	0.0%
Universal Health Services	USD	UHT	13.8	$69.76	961	1,241	24.4x	NA	NA	47.2x	NA	NA	NA	NA	$2.78	4.0%
Ventas	USD	VTR	374.6	$49.05	18,373	29,832	14.9x	18.0x	18.1x	53.8x	56.2x	NA	15.2x	15.9x	$1.80	3.7%
Welltower	CAD	WELL	159.5	$6.90	1,101	1,073	NA	NA	NA	NA	NA	NA	NA	NA	$0.00	0.0%
Average									16.0x			23.3x	14.9x	14.5x		4.9%
Assisted living & US nursing care																
Brookdale Senior	USD	BKD	183.4	$4.01	735	4,742	9.8x	14.7x	15.5x	21.7x	4.1x	NA				
Capital Senior Living	USD	CSU	31.9	$1.01	32	934	22.5x	NA	NA	NA	NA	NA				
Ensign Group	USD	ENSG	54.2	$72.22	3,917	3,841	16.7x	13.1x	11.7x	29.0x	23.2x	20.6x				
Genesis Healthcare	USD	GEN	166.8	$0.57	95	1,447	13.3x	NA	NA	NA	1.9x	1.3x				
Average									13.6x			11.0x				

[1] *Invesque transiently suspended monthly dividend payout at end of FQ120; was US$0.06134/shr per month*

[2] *Medical Facilities EBITDA/EPS estimates are adjusted for proportionate equity ownership by common shareholders (about 55% in FQ320)*

Source: Refinitiv

Cash flow was solidly positive in FQ320, even if we exclude CEWS payment: Turning to cash flow considerations, Extendicare generated pure operating cash flow in FQ320 of $57.0M, of which $50.8M was CEWS funding of course and if we back out that bolus of capital, adjusted operating cash flow in the quarter was $6.2M, modest by its own standards but still positive in a pandemically compressed period. Working capital deficit of ($2.5M) was mostly driven into negative territory by prepaid expense deficit, which can clearly reverse in future periods, and bringing cumulative adjusted operating cash flow in the period to $3.7M. That said, we suspect that we are being excessively punitive in our cash flow commentary by excluding CEWS payments that, whatever their justification, do represent non-dilutive capital that is now incorporated into Extendicare's balance sheet.

Exhibit 6. FQ320 Financial Summary For Extendicare – Segment Operating Income

(C$000, except per share and % data)	3Q-19	2Q-20	3Q-20	% chg (QoQ)	% chg (YoY)
Canadian operations, nursing care					
Revenue	160,972	178,471	184,727	3.5%	14.8%
Operating expenses	140,351	167,360	171,763	2.6%	22.4%
Operating income	20,621	11,111	12,964	16.7%	(37.1%)
Operating margin (%)	12.8%	6.2%	7.0%	12.7%	(45.2%)
Canadian operations, homecare (Paramed)					
Revenue	54,109	40,467	51,650	27.6%	(4.5%)
Operating expenses	50,008	43,048	48,452	12.6%	(3.1%)
Operating income	4,101	-2,581	3,198	(223.9%)	(22.0%)
Operating margin (%)	7.6%	(6.4%)	6.2%	(197.1%)	(18.3%)
Canadian operations, homecare (Revera) [1]					
Revenue	51,305	45,000	41,585	(7.6%)	(18.9%)
Operating expenses	47,305	41,000	40,085	(2.2%)	(15.3%)
Operating income [1]	4,000	4,000	1,500	(62.5%)	(62.5%)
Operating margin (%)	7.8%	8.9%	3.6%	(59.4%)	NA
Canadian operations, assisted living					
Revenue	10,406	11,737	11,978	2.1%	15.1%
Operating expenses	7,463	8,221	8,756	6.5%	17.3%
Operating income	2,943	3,516	3,222	(8.4%)	9.5%
Operating margin (%)	28.3%	30.0%	26.9%	(10.2%)	NA
Canadian operations, rehab services/Silver Group Purchasing/corporate					
Revenue	5,941	6,272	6,846	9.2%	15.2%
Operating expenses	2,739	2,384	2,554	7.1%	(6.8%)
Operating income	3,202	3,888	4,292	10.4%	34.0%
Operating margin (%)	53.9%	62.0%	62.7%	1.1%	16.3%
Revenue, Canadian operations	$282,733	$281,947	$296,786	5.3%	5.0%
Operating income, Canadian ops	$34,867	$19,934	$25,176	26.3%	(27.8%)
Operating margin, Canadian ops (%)	12.3%	7.1%	8.5%	20.0%	(31.2%)
Consolidated revenue	$282,733	$281,947	$296,786	5.3%	5.0%
Consolidated operating income	$34,867	$19,934	$25,176	26.3%	(27.8%)
Consolidated operating margin (%)	12.3%	7.1%	8.5%	20.0%	(31.2%)

[1] *Revera revenue data estimated from historic T12M data provided at acquisition; Revera data in other quarters as estimated by Leede Jones Gable*

Source: Historical data – Company Information (K-Bro), Forecasts/Estimates – Leede Jones Gable

Growth capex investment in home healthcare IT infrastructure nears full implementation, expect operating margin lift once pandemic subsides: We have long been focused on Extendicare's growth capex initiatives to establish a cloud-based IT infrastructure for scheduling home healthcare service hours. The firm stated in its MD&A that $11.6M has already been invested in that initiative and that 95% of the firm's operations (mostly in Ontario) have been converted to the new platform (Alberta-based operations should roll out later this quarter, if not already). In the near-term, it will be difficult for us to ascertain how impactful new IT infrastructure can be to operating income while pandemic considerations are pulling on the other end of the profitability rope, but our model assumes that home healthcare margins can return to pre-Revera levels by FH221.

No material update on timelines to refurbishing C-level LTC facilities in Ontario, but that should be a priority initiative in coming quarters post-pandemic: Progress on funding refurbishment of Extendicare's 3,287 C-level LTC beds in ON has been admittedly glacial since the firm announced its growth capex intentions on this theme a few years ago. And so we are encouraged that a $62.3M project in Sudbury to replace the firm's Falconbridge facility is on pace to commence this quarter. We assume that negotiations with the Ontario government on how to match Extendicare's growth capex requirements on home refurbishment with downstream funding are still ongoing.

Debt-based financial ratios creep upward on adjusted EBITDA softness, but CEWS payment brings EBITDA-based ratios well into safe territory: On balance sheet considerations, the firm exited the quarter with $172.5M in cash (up from $138.8M at end of FQ220) and total debt of $571.2M. Total debt corresponds to a debt/adjusted EBITDA run-rate ratio of 11.0x and thus higher than we would like to see on a sustainable basis. In our view, there is a high probability that FQ220-FQ320 adjusted EBITDA represent the trough and not the apex of achievable EBITDA from Extendicare's flagship LTC-home healthcare-retirement residence operations. Extendicare's historic debt/EBITDA run-rate ratio has been in the 5-6x range, with which we are comfortable since much of its debt is based on real estate-based mortgages.

Exhibit 7. FQ320 Financial Summary for Extendicare – Consolidated EBITDA and Net Margin

(C$000, except per share and % data)	3Q-19	2Q-20	3Q-20	*% chg (QoQ)*	*% chg (YoY)*
Consolidated EBITDA & non-operating items					
Operating income, Canadian operations	$34,867	$19,934	$25,176	*26.3%*	*(27.8%)*
Less: corporate expense, Canadian	11,021	11,767	12,182	*3.5%*	*NA*
EBITDA, Canadian operations	$23,846	$8,167	$12,994	*59.1%*	*(45.5%)*
EBITDA margin, Canada (%)	*8.4%*	*2.9%*	*4.4%*	*51.1%*	*(48.1%)*
Operating income, US operations	$0	$0	$0	*NA*	*NA*
Less: corporate expense, US	0	0	0	*NA*	*NA*
EBITDA, US operations	($258)	$0	$0	*NA*	*(100.0%)*
EBITDA margin, US (%)	*NA*	*NA*	*NA*	*NA*	*NA*
EBITDA, consolidated operations	$23,588	$8,167	$12,994	*59.1%*	*(44.9%)*
EBITDA margin, consolidated (%)	*8.3%*	*2.9%*	*4.4%*	*51.1%*	*(47.5%)*
Depreciation & amortization	9,861	9,685	9,373	*(3.2%)*	*(4.9%)*
Interest	7,198	7,187	7,141	*(0.6%)*	*(0.8%)*
Interest income	(919)	(620)	(534)	*(13.9%)*	*NA*
Paramed CEWS payment, other	(40)	3,822	(50,443)	*NA*	*NA*
Adj EBT, consolidated operations	$7,488	($11,907)	$47,457	*(498.6%)*	*533.8%*
Adj EBT margin, consolidated (%)	*2.6%*	*(4.2%)*	*16.0%*	*(478.6%)*	*503.8%*
Income tax expense	2,241	(3,018)	12,813	*NA*	*471.8%*
Adj tax rate (%)	*29.9%*	*25.3%*	*27.0%*	*NA*	*NA*
Adj net income	$5,247	($8,889)	$34,644	*(489.7%)*	*560.3%*
Adj net margin (%)	*1.9%*	*(3.2%)*	*11.7%*	*(470.3%)*	*529.0%*

Source: Historical data – Company Information (K-Bro), Forecasts/Estimates – Leede Jones Gable

Legacy legal risk from divested US operations was quietly reduced to nil in the period: Interestingly, Extendicare did not really emphasize in its FQ320 commentary that its accruals for self-insured liabilities ascribed to its legacy US nursing home operations have now been eliminated from its balance sheet and were taken down to nil in the period from $12.2M at the start of F2020. During the T9M period, $3.2M of accrued liabilities were deployed to settle outstanding legal claims to US operations, and residual cash of $9.5M was thus released from Extendicare's captive insurance firm and into the firm's cash balance where it can be deployed for future capex activities.

Summary and valuation: In conclusion, we believe that Extendicare has done well during the T6M period to confer quality service in eldercare and retirement residence management in the wake of considerable challenges to its operations that pandemic considerations have brought to its doorstep. Trendlines on home healthcare service hours are notably encouraging, notwithstanding the more dramatic operating income downdraft that LTC operations have specifically encountered. The downdraft is on implementation of protective measures for staff and patients that risk of virus transmission made necessary, probably for many quarters to come.

For our consolidated forecasts, we project F2020 revenue/EBITDA/margin of $1.12B/$58.7M/5.2% (from which we exclude CEWS payment in FQ320, just for consistency across all financial periods). With only FQ420 remaining in that fiscal period, we are simultaneously projecting FQ420 data of $275.1M/$17.7M/6.4% that we are thus assuming can sustain EBITDA/margin growth into FQ420 from trough levels in FQ220. Moving forward, we are projecting F2021/F2022 data of $1.10M/$111.2M/10.1% and $1.10M/$113.4M/10.3%, clearly assuming that pandemic challenges in F2020 can be materially resolved by FH121. In parallel, we are projecting F2021/22 AFFO of $0.77/shr and $0.79/shr, both well above actual dividend payout of $0.48/shr and thus at an implied payout ratio of 62.5% and 60.7%, respectively.

Dividend yield and expectations for LTC/home healthcare margin improvement drive value in our model into F2021/22: Our forecasts assume that nursing home-specific operating margin can equilibrate at 12.0% in both F2021/22, up from our projected 8.1% this year and thus comparable to margin achieved in F2019. We separately project home healthcare operating margin of 10.4%/10.9% in F2021/22, a more aggressive sequential growth trajectory from our 4.7% forecast this year. This is driven by our expectation for service hours to continue to scale upward back to F2019 levels and with supplemental margin lift from IT infrastructure now nearing full implementation. We expect retirement residence occupancy to separately scale upward during F2021/22, achieving stable operating margin of 32%-33% in both years.

Our valuation is specifically based on the average of 10x EV/F2022 EBITDA and 10x F2022 AFFO ($113.4M & $0.79/shr, respectively), using FQ320 balance sheet data (cash of $172.5M, total debt of $571.2M) and basic S/O of 89.5M in our EV calculation, as shown in Exhibits 1 and 2. In so doing, we derive a one-year PT for EXE of $8.06, which we round to $8.00. **Cumulative total return implied by our PT, including 7.1% dividend yield, is thus 25.6%, which we believe is sufficiently high to justify our BUY rating on the stock.** On the milestone watch, we are mostly focused on sustainable improvements in adjusted EBITDA/AFFO into FQ420, especially with the forthcoming quarter not expected to be as materially impacted by CEWS payments as in FQ320.

Exhibit 8. FQ320 Financial Summary For Extendicare – Consolidated AFFO

(C$000, except per share and % data)	3Q-19	2Q-20	3Q-20	*% chg (QoQ)*	*% chg (YoY)*
AFFO determination					
EBITDA	$23,588	$8,167	$12,994	*59.1%*	*(44.9%)*
Less:					
Net interest expense	6,279	6,567	6,607	*0.6%*	*5.2%*
Deprec expense for FFEC tangible assets	1,710	1,963	1,849	*(5.8%)*	*8.1%*
Depreciation for office leases	0	642	613	*NA*	*NA*
Current income tax expense	2,666	-1,848	14,118	*NA*	*429.6%*
CEWS payment to Paramed	0	0	-50,800	*NA*	*NA*
Accretion costs	386	307	311	*1.3%*	*(19.4%)*
Funds from operations (FFO)	12,547	536	40,296	*NA*	*221.2%*
FFO per unit	$0.141	$0.006	$0.450	*NA*	*220.1%*
Add:					
Amortization of financial costs	415	525	555	*5.7%*	*33.7%*
Accretion costs	386	307	311	*1.3%*	*(19.4%)*
Adj to value of investments for SILs	258	0	0	*NA*	*NA*
Inc support for acquired retire res	698	322	709	*NA*	*NA*
Principle portion of govt-funded paymts	1,373	1,450	1,448	*(0.1%)*	*5.5%*
Less: AFFO from discont operations	0	0	0	*NA*	*NA*
Distributable income (DI)	15,677	3,140	43,319	*NA*	*176.3%*
DI per unit	$0.176	$0.035	$0.484	*NA*	*175.4%*
Less:					
Adjustment for maintenance capex	1,346	194	532	*NA*	*(60.5%)*
Adjusted funds from operations (AFFO)	$14,331	$2,946	$42,787	*NA*	*198.6%*
AFFO per share	$0.161	$0.033	$0.478	*NA*	*197.6%*
Actual distribution	10,681	10,745	10,745	*NA*	*NA*
Actual distribution per share	0.12	0.12	0.12	*NA*	*NA*
Payout ratio (%)	*74.5%*	*364.7%*	*25.1%*	*NA*	*NA*
Shares outstanding (basic)	*89,253*	*89,539*	*89,539*	*NA*	*NA*
Capital expenditures					
Growth capex	*$5,276*	*$2,347*	*$7,578*	*222.9%*	*43.6%*
Maintenance capex	*$3,056*	*$2,157*	*$6,293*	*191.7%*	*105.9%*
Total capex	*$8,332*	*$4,504*	*$13,871*	*208.0%*	*66.5%*
% revenue, growth capex	*1.9%*	*0.8%*	*2.6%*	*NA*	*NA*
% revenue, maintenance capex	*1.1%*	*0.8%*	*2.1%*	*NA*	*NA*

Source: Historical data – Company Information (K-Bro), Forecasts/Estimates – Leede Jones Gable

Disclosures none

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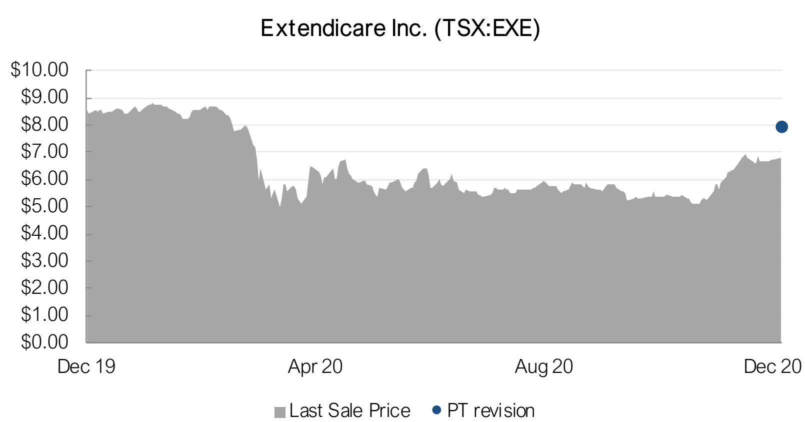

Date	Target ($)	Rating
15 Dec 2020	C$8.00	Buy

Coverage Initiated: Dec 15, 2020

Data sourced from: Refinitiv