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LTC Properties, Inc. (LTC)

Q3 2013 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the LTC Properties, Inc. Third Quarter 2013 Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions]

I'd like to remind everyone that today's comments, including the question-and-answer session, will include forward-looking statements. These statements are subject to risks and uncertainties that may cause actual results and events to differ materially. These risks and uncertainties are detailed in LTC Properties, Inc.'s filings with the Securities and Exchange Commission, including the company's 10-K dated December 31, 2012. Please also note that this event is being recorded.

I would now like to turn the conference over to Ms. Wendy Simpson. Please go ahead, ma'am.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

Thank you. Good morning, everyone, and thank you for joining us today. Since our last call, LTC has completed the initial funding of the Michigan deal. The Florida sale-leaseback transaction and locked rate at 3.99% for $70 million of senior unsecured promissory notes. Additionally, we've raised our monthly dividend by 9.7% to $0.17 per share per month or $2.04 per year. We are having a very successful year and see additional opportunity ahead.

Right now, I will turn the call over to Pam Kessler, our Executive Vice President and Chief Financial Officer, who will provide more details of the 3.99% debt transaction and to comment on our financial results and operator coverage statistics. Then Clint Malin, our Executive Vice President and Chief Investment Officer, will talk about our active quarter and comment on how we view our pipeline and development activities. I will then have closing comments before opening the call to questions. Pam?

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Pamela J. Shelley-Kessler

Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

Thank you, Wendy. I'm going to be discussing third quarter compared to second quarter results. I'll refer you to the 10-Q that was filed yesterday for year-over-year results. During the third quarter, revenues increased approximately $400,000, primarily due to completed development projects. Interest expense decreased approximately $200,000 due to the pay-off of our line of credit with the proceeds from the May equity offering. General and administrative expenses decreased roughly $200,000 due to the timing of certain seasonal expenditures related to marketing conferences, the proxy, and the annual meeting that are traditionally higher in the second quarter than in the third.

Last quarter, I gave an approximate $2.6 million to $2.7 million run rate estimates for our G&A expense. I would like to point out that included in G&A as a non-cash GAAP reserves for bad debt expense, which typically doesn't fluctuate much quarter-to-quarter. However, with the Michigan mortgage loan origination, fourth quarter bad debt expense will have a one-time increase of approximately $1.2 million, which represents a 1% reserve on the mortgage loan origination balance. I'll refer you to our 10-K for a full subscription of this and our other accounting policies.

During this third quarter, we recognized a $2.6 million gain on the sale of six skilled nursing properties in Ohio. Net income available to common shareholders increased $4.4 million in the third quarter, primarily due to revenues in the development projects and the gain on sale.

Normalized fully diluted FFO per share was $0.57 this quarter compared to $0.57 last quarter, due to a higher weighted average shares outstanding in the third quarter than in the second quarter resulting from the May equity offering. Normalized fully diluted FAD per share was $0.56 this quarter compared to $0.57 last quarter, due to the higher weighted average shares outstanding in the third quarter than in the second quarter.

Turning to the balance sheet. During the third quarter, we invested approximately $7.9 million in development, redevelopment, and capital improvements at a weighted average yield of approximately 9%. Capitalized interest for the quarter was approximately $200,000. We purchased two parcels of land in Colorado for a total of $2.1 million and entered into development commitments totaling $19.6 million, to purchase the land and build two memory care community, one with 60 units and the other with 48 units. We sold six skilled nursing properties, as previously discussed.

During the quarter, we funded $1.9 million under our construction loan and received approximately $500,000 in scheduled principal payments on mortgage loans receivable. During the quarter, we paid a $7 million earn-out liability that was previously reported and related to the purchase of four skilled nursing properties in 2011.

At September 30, our line of credit was undrawn. However, subsequent to September 30, we borrowed $86 million under our line of credit and used cash on hand to fund the Michigan and Florida transactions announced last quarter. Therefore, we currently have $154 million available under our line of credit. Also, subsequent to September 30, we locked rate at 3.99% on $70 million of senior unsecured notes under our shelf agreement with Prudential. The notes will mature in eight years and have interest-only payments for the first two years and annual principal payments thereafter.

We expect the sales of the notes to occur on or around November 20 and use proceeds to pay down the line of credit. After the sale of the notes to Prudential, we will have $30 million available under our shelf agreement with them.

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During the third quarter, we paid $17 million in preferred and common dividends. In discussing operator statistics, I'll give the general caveat that these numbers come from our operators. They are unaudited and have not been independently verified by us.

Additionally, the occupancy and lease coverage information is for the trailing 12 months, second quarter 2013 compared to the trailing 12 months for the first quarter of 2013. Occupancy in our same property ALF portfolio was flat at 78%. Excluding properties leased to Assisted Living Concepts and Extendicare, occupancy in our ALF portfolio was 87%. EBITDAR lease coverage after a 5% management fee was 1.4 times. Before management fee or EBITDARM, coverage was 1.7 times.

Occupancy in our same property SNF portfolio was flat at 79%. EBITDAR lease coverage after 5% management fee was 1.8 times. Before management fee or EBITDARM, coverage for our SNF portfolio was 2.5 times.

Occupancy in our same-property Range of Care portfolio, which consists of properties that provide any combination of skilled nursing, assisted living, independent living, and/or memory care services, was 87%. EBITDAR lease coverage after a 5% management fee was 1.4 times. Before management fee or EBITDARM, coverage was 1.9 times.

The underlying payor mix for the six months ended June 30, 2013, for our same property portfolio, which includes skilled nursing, assisted living, memory care, independent living, and properties with a combination thereof, was 59% private pay, 16% Medicare, and 25% Medicaid. Within our same property SNF portfolio, the underlying payor mix was 25% private pay, 28% Medicare, and 47% Medicaid.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

Thank you, Pam. Clint?

Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

Thank you, Wendy. Good morning, everyone. The last 30 days have been quite productive for LTC from an investment perspective. On October 8, we announced our exclusive development pipeline agreement with Anthem Memory Care and acquired two parcels of land in Colorado, as Pam mentioned, to fund construction of two free-standing private-pay memory care properties.

On October 31, we closed our previously announced investment for the skilled nursing portfolio funding $126 million. On November 1, we closed on our previously announced deal for the acquisition of a newly-built skilled nursing facility in Florida funding $14.4 million. Additionally, on November 1, our 77-unit combination of assisted living and memory care development project in Wichita, Kansas leased to an affiliate of Oxford Senior Living opened with 18 resident deposits. Of these 18 deposits, six residents moved into the community on the 1st.

Our 2013 year-to-date investment activity for closed transactions and underwritten capital commitments totals approximately $170 million, including the $12 million commitment for renovations to properties in the Michigan portfolio. In addition, we anticipate entering into one more development commitment for a private-pay memory care project prior to year-end for approximately $10 million including land cost.

Our 2013 investment activity is slightly ahead of guidance provided earlier in the year. Now turning to developed projects, which opened during the summer. Our 60-unit memory care property in Littleton, Colorado leased to Anthem continues its successful lease up. As of yesterday, the community's occupancy was at 93%, which is very

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impressive considering it has been open for less than four months. Our 120-bed skilled nursing replacement property in Amarillo, Texas leased to an affiliate of Fundamental is at 73% occupancy with a 51% quality mix based on census translating into an even higher revenue quality mix.

Our next development project scheduled for completion is the 106-bed skilled nursing replacement property in Wisconsin, which will be operated by an affiliate of Fundamental. This project is anticipated to open early January and is currently on time and on budget.

Now, with our first exclusive development pipeline agreement in place, we have structured a mutually beneficial framework with Anthem Memory Care, to help them strategically grow their company and continue adding purpose built free-standing memory care properties to our portfolio. This is an important step for LTC, because it demonstrates success in execution of our strategy to grow our portfolio in the memory care space.

Furthermore, it is an investment vehicle to assist in maintaining a diversified balance on our portfolio between private-pay and government-reimbursed assets and the revenues derived there from. We are pursuing similar type arrangements with other operators on our portfolio, with a goal of aligning interest for mutual growth and feeding our development pipeline via master-leased investments targeting private-pay senior housing projects.

Our pipeline remains consistent and strong at the $200 million level, consisting of sale-leaseback opportunities, new development projects as well as expansion and replacement projects within our portfolio. Following the closing on our $141 million of Michigan SNF investment, we continue to focus on acquisition opportunities for private-pay senior housing properties to maintain diversification in our portfolio between private-pay and government-reimbursed assets.

However, outside of Littleton and unique opportunities we are currently seeing, the pricing for acquisition of private-pay assets continues to be at a premium given the significant amount of capital chasing such investments. And at current market rate, cap rates, such investments acquired in a triple net lease structure, yield little to no rent coverage at prices arguably in some cases in excess of replacement cost, significantly increasing the risk profile of the investment.

Therefore, we believe taking on construction lease up risk on a selective and prudent underwriting – on selective and prudent underwriting – underwritten development projects and entering into such commitments at a major pace, provides our shareholders a better risk adjusted return, while adding new and modernized private-pay assets to our portfolio.

In view of our investment pipeline and ever expanding marketing program, we're excited about the investment prospects for 2014.

Now, I'll turn the call back to Wendy for her comments.

Wendy L. Simpson

Chairman, President & Chief Executive Officer, LTC Properties, Inc.

Thank you, Clint. Clint and I spent a lovely Saturday in Wichita, Kansas for the soft opening of the assisted living memory care property, financed by us and built and operated by Oxford Senior Living. I encourage you to look at the pictures we posted on our website. It's a very impressive addition to that growing area of Wichita.

Last month, we held a board meeting in Cincinnati and we're hosted by the fantastic group of operators and administrators from Carespring, the operating company, Carespring. We had the opportunity for our board to

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tour the Indianspring facility and also to look at the 143-bed skilled nursing property that we're building with Carespring in Kentucky. This $23.5 million building is projected to be completed near the end of the year. Currently, I'm – at the end of next year, sorry.

Currently, I'm encouraged by our pipeline opportunities. The sale-leaseback opportunities continue to be more skewed towards skilled nursing properties, but we're looking at some deals that have assisted living and independent living components within the assets for sale. And as Clint mentioned, we continue to invest in building new memory care and combined assisted living memory care in targeted markets with bedded operators.

We are ever closer to the lease renewal date of December 31, 2013, for the properties leased by Assisted Living Concepts and Extendicare. We continue to talk to interested operators about possibly leasing these properties, but we have not traded information with any outside party who would be a potential operator.

We do have plans in place to begin the process of offering these properties to new operators, but are mindful of the December 31 date and do not want to cause the new management team at assisted living any additional hassle while they work to turn around their company.

I sincerely believe the 12 months we have in 2014 to address the future of these assets will be adequate for Assisted Living Concepts and LTC to properly position these properties for both companies, and more importantly, for the employees and residents of the properties.

As for guidance for the year, assuming no additional accretive deals before year-end, I expect our normalized FFO will be between $2.35 and $2.37, which is the same range I provided last quarter.

I'm not prepared to give 2014 guidance at this time. We look forward to adding to our FFO by converting some deals in our pipeline and continuing to build our relationships with our operators and new operators we are meeting.

Thank you for taking time today to listen, and I will now open it up for questions. Rocco?

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QUESTION AND ANSWER SECTION

Operator: Thank you, ma'am. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Michael Carroll of RBC Capital Markets. Please go ahead.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Thank you. Hey, Wendy. With the ALC, does the underlining coverage ratios now include all the increased costs and how quickly could we expect these ratios to rebound as the census of these assets begin to improve?

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.
A

Yeah. Hi, Mike, it's Pam. It does include the full four quarters now. Last quarter, it only included three quarters of the full costs. So in terms of the turning around, I think that's a little bit more difficult to predict, because it's really going to depend how fast they can increase occupancy and their core revenues, but I think the costs are fully loaded now. I wouldn't expect much more additional costs.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Okay. What's the occupancy rate, I guess, currently versus 12 months ago? Do you have that number?

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.
A

The current occupancy – and I believe it is pretty flat. The current occupancy is 60% – probably 60%, and a year ago was roughly that as well. I mean it's bounced between 60% and 65%.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Okay. And then, Pam, have you had any discussions with the credit rating agencies recently and could we expect rating to occur in 2014 or is that still some time away?

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.
A

I think that's still some time away. As we get closer to the $2 billion market cap point, that's when we would begin the discussion. To do it before then would be not that productive. I mean we talked to them, but there is that hurdle that we got across and for right now, considering our investment pace, the Prudential shelf agreement and also the private placement market is really a sweet spot for us, because we can borrow, because to do investment grade bond deals, the minimum size is about $250 million. We just don't have the need for that much all at once. So to do a private placement at $75 million to $100 million, that's a really nice size for us. And the pricing is very competitive as you can see.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

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Okay. And then why did you decide to go through I guess Prudential on the shelf versus doing a private placement like you have done previously?

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

A

It was really opportunistic. We had that little window where rates pop down and with them, since it's already underwritten, they just have to do some bring down due diligence, the execution is much faster. It basically can be done in a couple of days. So we had the need for it. The market timing was right. So we did that.

As we've discussed before, coming into next year, there would be a need probably to do some more and that might be done under a fully marketed deal. There's not a timing pressure on that, but we do have commitments out there for development in 2014 that we would like to fund a long-term, while rates are still low.

And we were being told, Mike, by our advisors that this year, the people who are buying private bo nds are pretty pull up. Yeah, it was...

Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

Well.

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

A

... yeah, kind of wait until January when they start their – that magic date of December 31...

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

Yeah, maybe.

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

A

... got to get past and then people have – the next day somehow money appears.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

Yeah.

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

A

So we were advised that it would probably be best to wait until 2014 to go into the public market and Prudential sharpened their pencil for us and got us a really good deal.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

Okay, great. And then my last question. Clint, what's included in that $200 million investment pipeline? Are there any of the pending deals still included in that number?

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Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

No.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

So these were all new deals that you're still working on that will probably close within – well sometime in 2014?

Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

Yeah, these are things that we've been working on towards 2014. Yeah.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

Okay. Great. Thank you.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

Thank you, Mike.

Pamela J. Shelley-Kessler
Executive Vice President, Chief Financial Officer and Secretary, LTC Properties, Inc.

A

Thank you, Mike.

Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

Thank you.

Operator: Our next question comes from Karin Ford of KeyBanc. Please go ahead.

Karin A. Ford
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, good morning. Just wanted to ask about portfolio allocation, skilled nursing is now, I guess, 58% of your revenue today. And you're talking about the challenges on the competition side and finding and sourcing ALF acquisitions, and of course, see ALF and memory care development side, as it takes a little bit more time, does that sort of put you in a little bit of a box given I guess your goal not to be too overexposed on the skilled nursing front? Will that potentially limit your ability to acquire next year, just because you're not looking to push that 58% number up significantly higher?

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

We haven't set a particular percentage of what we would want our assisted living. We just like to have it more balanced, but if we get a fantastic deal, that's a skilled nursing portfolio, we're not going to turn that down. So we could have – we could go above the 58%.

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Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

A good way – Karin, this is Clint. Good way to equate that is looking back a few years back when we were doing – pursuing acquisition opportunities in Texas. At that point in time, it's skewed us a little bit higher on concentration in Texas, but since then, through development or acquisition, we've been able to bring down our concentration in Texas. So I think we look at the right opportunity in the skilled space to capitalize on that when the opportunity presents itself, and then over time, be able to go ahead and realign that allocation between the two asset types.

Karin A. Ford
Analyst, KeyBanc Capital Markets, Inc.

Q

Is there an upper boundary that you're comfortable with – wouldn't be comfortable going about?

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

We haven't established that yet. That's something I suppose, we should sit down and determine, but we really haven't discussed it yet.

Karin A. Ford
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, thanks. And just my next question is just on new supply in both assisted living and memory care. Are you guys taking a hard look at that as you're underwriting new deals and where are you seeing potential pressure from new supply in your pipeline?

Clint B. Malin
Executive Vice President and Chief Investment Officer, LTC Properties, Inc.

A

No, we're absolutely cognizant of that, because it is – we go to conferences and field phone calls and in conversations with customers as we're trying to market and look for opportunities, it's something that's talked about. So we're always cognizant of what's happening and there's a lot more activity on the development side. So we're very strategic and we spend a lot of time in the marketplace and partner with companies that understand the marketplaces.

Texas has definitely been a state that has been on the radar screen as far as increased development. I've heard through the rumor mill that in Florida as well, although we've not spent a lot of time looking at opportunities in Florida. Arizona is another state, which has a lot of developments undergoing and also just being talked about in general. Colorado has had a fair amount, but we're actively participating in that and we've partnered with a company who has been involved in that marketplace for four years, five years and really understands the market. So we're very careful in going into markets on the development side.

Karin A. Ford
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, thank you.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

A

Thank you, Karin.

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Operator: [Operator Instructions] I'm showing no further questions at this time. So I'd like to turn the conference back over to Ms. Wendy Simpson for any final remarks.

Wendy L. Simpson
Chairman, President & Chief Executive Officer, LTC Properties, Inc.

Thank you, Rocco, and thank you everyone for listening to our call this morning. And we look forward to talking about a great year-end. Thank you. Have a great day.

Operator: And thank you for your time, ma'am. The conference is now concluded. And we thank you all for attending today's presentation. You may now disconnect your lines. And have a wonderful day.

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