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LTC - Q1 2014 LTC Properties Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Karin Ford *KeyBanc Capital Markets - Analyst*

Michael Carroll *RBC Capital Markets - Analyst*

Daniel Bernstein *Stifel Nicolaus - Analyst*

Doug Christopher *Stifel Nicolaus - Analyst*

PRESENTATION

Operator

Good day, and welcome to the LTC Properties Inc. first quarter 2014 analyst and investor call and webcast. All participants will be in a 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 Security and Exchanges Commission, including the Company's 10K dated Dec 31, 2013. Please also note, this event is being recorded. I would now like to turn the conference over to Ms. Wendy Simpson, CEO and President. Please go ahead.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thank you, are Denise. Good morning, everyone, and thank you for joining us today. This morning, Pam Kessler, our CFO, will start our presentation with comments about our financial results for the first quarter of 2014. After Pam's comments, Clint Malin, our Chief Investment Officer, will talk about our project for re-leasing the Extendicare Enlivant properties, and he will also comment on the performance of our portfolio and the progress with our development projects and our pipeline. Pam?

Pam Kessler - *LTC Properties Inc - CFO*

Thank you, Wendy. Normalized FFO increased 18% this quarter to $22.4 million from $19 million in the first quarter of last year. Normalized fully diluted FFO per share was $0.63 this quarter compared to $0.61 a year ago. Revenues increased 15%, or $3.8 million year-over-year, primarily due to the investments made during 2013 and completed development projects partially offset by property disposals in 2013.

General and administrative expenses decreased 14% this quarter compared to a year ago. However, the first quarter of last year included a one time $700,000 charge related to the retirement of our former senior vice president of marketing and strategic planning. On a normalized basis, G&A increased $200,000 this quarter as compared to a year ago due to increased staffing levels reflective of higher investment activity. Cash flow from operations increased 13% to $19.8 million from $17.6 million in the first quarter of last year.

During the quarter, we invested $16.1 million in properties under development and capital improvement projects. Capitalized interest for the quarter was $300,000. We currently have $41 million outstanding and $199 million available under our line of credit. Additionally, we have $30 million available under our shelf agreement with Prudential. At the end of the quarter, our investment grade metrics remained one of the best in the healthcare universe with debt to normalized EBITDA of 3 times, a normal fixed charge coverage ratio of 6.7 times, and debt market value of just under18%.

I hope everyone has their calendars marked for our analyst day and property tour next month. As a reminder, we are hosting our analyst day and property tour beginning at 9.00 AM on Thursday, June 5, at the Waldorf Astoria in New York City. If you have not already RCP'd, just shoot me an e-mail, and I'll take care of it. We look forward to seeing you there. I'll now turn the call over to Clint.

Clint Malin - *LTC Properties Inc - CIO*

Thank you, Pam, and good morning, everyone. First I will provide an update on our re-leasing initiative for our portfolio of 37 assisted living communities leased to Extendicare and Enlivant, formerly known as Assisted Living Concepts. As a reminder, the two leases for this portfolio expire on December 31, 2014. We have received a high level of interest in the properties and have narrowed the pool of qualified candidates to participate in the second round of the process. As part of this phase, operators will be conducting detailed due diligence, participating in property tours, and negotiating lease terms. Although it is possible to lease the entire portfolio to a single operator, there is a higher probability that we will release the properties to operators on a state or regional basis. Re-leasing the portfolio to multiple operators has the potential to further diversify our operator base and provide us with additional operator relationships for future growth of LTC.

Turning to our portfolio, trailing 12-month lease coverage at the end of 2014 for our portfolio remains consistent and strong. I will caveat that the following coverage metrics are derived from unaudited finance statements provided to us by our operators and are reported one quarter in arrears. For our skilled nursing portfolio, EBITDA in coverage is 2.28 times, and our assisted living portfolio, excluding the properties leased to Extendicare and Enlivant, is 1.65 times and 1.39 times including these properties.

Trailing 12 EBITDAR, including an allocated management fee of 5% of revenues, is 1.68 times for skilled nursing and 1.39 times for assisted living, excluding Extendicare and Enlivant, and 1.16 times including them. The proposed net 2% Medicare rate increase announced by CMS on May 1 is scheduled to become effective October 1 barring any legislative challenge and should be a further enhancement to our already strong SNF coverage metric.

Compared to the previous quarter, occupancy increased across all property types, including the portfolio leased Extendicare and Enlivant. Occupancy for the trailing 12 month period ended fourth quarter 2013 compared to the trailing 12 month period into third quarter 2013 increased as follows. Assisted living -- I'm sorry, assisted living, excluding the Extendicare and Enlivant portfolio increased 30 basis points to 87.7% and including the properties, increased 40 basis points to 79.3%. Skilled nursing increased 60 basis points to 79.7%, and range of care increased by 50 basis points to 86.7% . Our quality mix remains strong with almost 60% of our underlying rental revenue coming from private pay sources. Within the last 12 months, four development projects have opened, which I had mentioned on previous calls.

I'm very pleased to report that occupancy during the lease-up continues to be ahead of projection at each property, with one property already achieving 100% occupancy. We continue to have success with our development program and expect at least two more development projects and possibly four will open this year. Our pipeline remains strong, consisting of sale lease pack and development opportunities, as well as expansion and replacement projects within our portfolio. Pipeline consists of both skilled nursing and private pay seniors housing opportunities. Consistent with my comments on previous earnings calls, we anticipate 2014 investments to be back loaded in the second half of the year, most likely occurring in late third quarter and fourth quarter. Now, I'll turn the call to Wendy for her comments.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thank you, Clint and Pam. When I talked to you in February, I mentioned that we might look at our portfolio and determine if there were assets that we would consider selling to recycle some capital. While we will continue to look -- take a critical look at our portfolio, we're basically pretty satisfied with the vast majority of LTC investments. That being said, we will most likely sell three noncore assets that will generate approximately $7.7 million in proceeds and result in a net gain of approximately $1.2 million.

We've been quiet on the acquisition front for the first quarter, and we did advise you that our investment activity will likely be during the second half of 2014, as Clint has just mentioned. I'd like to remind you that we did $16 million in properties under development and improvements in the first quarter of 2014. And for the next three quarters of 2014, our projections are that will invest another $49 million in these ongoing projects, some of which will open this year, as Clint mentioned. So, we are investing about $65 million in new assets in 2014 that will be revenue producing to LTC later in 2014 and definitely in 2015. With low interest rates likely to hold for several future quarters and our low leverage, we do need to do more investing in sale leaseback transactions while continuing our investment platform of building assets with our current operators and possibly some new operators. We believe we have a solid base for the growth through development for the near future.

So far in 2014, we have not found a sale leaseback transaction that met our underwriting guidelines, but we are now primarily focused on mining our development pipeline. We are currently seeing increased potential transaction activity and will be spending less time in establishing new development platforms and more time working on acquiring already existing assets through sale leaseback transactions.

So, at this time, I'm not changing guidance. At this point, I believe our normalized 2014 FFO will be between $2.56 and $2.58. Denise will now open it up for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question and answer session.

(Operator Instructions)

Our first question will come from Karin Ford of KeyBanc Capital Markets. Please go ahead.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Hello, good morning. My first question is on your -- the three noncore asset sales that you guys are thinking about. What was it about those properties that decided -- you decided to shed them? And are any of those in the former ALC portfolio?

Wendy Simpson - *LTC Properties Inc - President & CEO*

They are not, Karin. One of them is a school which Pam has been trying to get us to get rid of for years. It's the school in Minnesota. It's currently leased by the Autistic Society of Minnesota or something like that. They would like to buy it. It's at a price that is -- it makes it worthwhile for us to sell it. So, we're just going to get that out of our portfolio.

The other three assets, or two assets are very old independent assisted living properties that the lease was running out, and we thought it would be much better to allow the operator to buy them than try to find somebody to lease them. We consider them basically noncore assets. One in Georgia and one in Florida, I think. Even -- there were just two properties and not in the same state, so it just made sense to approach the operators and give them the opportunity to buy them.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Great, thanks. Next question is just on pricing. I've been hearing that cap rates may be coming down for skilled nursing properties. Are you seeing that? And is your current pipeline more biased towards one asset class or the other?

Clint Malin - *LTC Properties Inc - CIO*

Karin, this is Clint, good morning. As far as cap rates on skilled nursing, I think it is going to become more competitive. There's still a lot of capital, looking at assets, probably more on the private pay seniors housing side than the skilled. But we're still seeing -- we've been investing on skilled assets between 8.5%, 9%, and probably more so 8.75% to 9%. And I would still see that to be, the 8.5% to 9% is probably where we'd be at on skilled.

I think there'll be opportunities, those numbers. There are still some opportunities north of 9%, but we found the asset quality that we're looking to bring into the portfolio typically commands a price around 9% or a little under. And 8.5% would be a unique investment for us. Carespring, which we did that transaction in Ohio a couple years ago, basically brand-new skilled nursing facilities. They commanded that cap rate, given the organization as well as the location and the quality of the assets.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Thanks. And then my last question is just on the re-leasing process. I know you're still in process on that, but any additional thoughts you've had now that you've seen -- now that the first round has come through on how you're thinking about structuring the new leases? Whether you'd want to try to capture any of the potential operating upside there, or how you think the pricing is going to shake out on those?

Clint Malin - *LTC Properties Inc - CIO*

Sure. Well, we are still in the process. We have gone through and qualified the candidates that we think are most viable for this. It really depends on the geography.

And as Wendy mentioned on the last call, you look at the portfolio, where the part of the portfolio is a little more challenged, which is in the Northwest, I think we would still look at a triple net lease, but we would find a way to escalate the rent probably over time on that portfolio. Other components of the portfolio are doing stronger, and we would have solid rents on those. I think it just depends on which geography we're talking about within the portfolio.

Karin Ford - *KeyBanc Capital Markets - Analyst*

And how many operators were in the first round, and how many made it to the second round?

Clint Malin - *LTC Properties Inc - CIO*

I don't want to negotiate in public on that. I think that I would say that it was -- multiple. And we've got a solid base to choose from going into the second round.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Great. Thank you.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thanks, Karin.

Operator

The next question will come from Michael Carroll of RBC Capital Markets.

Michael Carroll - *RBC Capital Markets - Analyst*

Thanks. What's the potential timing of the completion of the transition of these assets? Could it occur sooner than the December 31 lease expiration?

Clint Malin - *LTC Properties Inc - CIO*

Definitely it's possible. We would have to have an agreement with Extendicare and Enlivant to do that. But I think that's possible.

In our discussions with Enlivant and TPG, their owner, they're willing to look at that. So, I think it's possible. We'll have to see how it goes, but I wouldn't rule it out. But still, if anything would happen earlier, it would probably be - it would be in the early fourth quarter, possibly. I don't see that occurring too much earlier than the end of the year.

Wendy Simpson - *LTC Properties Inc - President & CEO*

But I want to say, Mike, I'm not actively involved other than being informed in this process. It appears that the Enlivant people are being extremely cooperative. Whatever we've asked them for, they've come through.

We get comments about certain things and talk to Enlivant, and they're right on it. So I've got to say they have been absolutely wonderful throughout this process. I've got to say they've been absolutely wonderful throughout this process, so we're very hopeful that everything will continue to go smoothly.

Clint Malin - *LTC Properties Inc - CIO*

Yes, they're a very cooperative process, so it's making the transition process here much, much smoother.

Michael Carroll - *RBC Capital Markets - Analyst*

Okay. And then Clint, can you give us an idea ever what's going on with the triple net acquisitions? I know last quarter, it sounded like a majority of those deals were going to close in the second half of the year. What could we really expect in the second quarter? Are you close, or is pretty much all of them going to close in second half?

Clint Malin - *LTC Properties Inc - CIO*

I think everything would be second half that we're working on. That would be more second half.

Michael Carroll - *RBC Capital Markets - Analyst*

Okay. Did you mention the size of the pipeline or what you're actually working on right now?

Clint Malin - *LTC Properties Inc - CIO*

I didn't mention the size of the pipeline, but it's -- I will give you a little color on the pipeline. We are seeing more activity and more opportunity, both on the seniors housing side, as well as skilled nursing. There are a combination of smaller and some larger transactions marked up market and a few marketed transactions. If you look at everything we're looking at right now, which would inclusive of sales leasebacks as well as development.

And again, we're been very actively involved in trying to negotiate pipeline agreements with operating companies. We're looking at sourcing five or six different companies on the development side. We have three in our portfolio right now, and we're working with a few others to try to build that out. This pipeline would include a series of development projects with these companies. But in total between sale leasebacks, development, and projects within our portfolio, we can say that we probably have $900 million to $1 billion of deals that we're looking at.

Now, I'm quoting this a little different than we've talked in the past, because this is looking at the totality of deal flow that's coming into the Company. Now, we will vet out that $1 billion and it'll get narrowed down further. But we are seeing increased levels of activity. We're encouraged by what we're seeing, and we think there's opportunity for us to go ahead and execute as we go into the latter part of the year.

Michael Carroll - *RBC Capital Markets - Analyst*

Previously you indicated on the size of the size of the pipeline and amount of deals that you're working on that you expect will close. Can you give us some color on that stat?

Clint Malin - *LTC Properties Inc - CIO*

Sure. Right now between -- as far as -- if you narrow this sort $1 billion number that we're working on down into what we think we could potentially close on, it probably would be more consistent with what I talked about in the first quarter. In the, probably -- our pipeline, we've about $250 million, so could we close on $150 million to $200 million? It's possible on that.

Wendy Simpson - *LTC Properties Inc - President & CEO*

In this potential deal list that we have that we keep, Mike, there are a couple of projects -- couple of possibilities that are marketed. While we haven't in the past spent much time on marketed deals because they're generally really big deals, a couple of these marketed deals are really within our sweet spot of transactions.

We have some, I think, ability to be competitive in looking at some of these smaller marketed deals. If a couple of these marketed deals or even one of the marketed deals happened, that would be a fairly large transaction for us. Less than $200 million, but more than $100 million in one transaction.

We are paying attention to some of these marketed deals now because they are not the $500 million marketed deal or a $750 million marketed deal. We -- what we have seen transition in this first quarter, and certainly, I think more so in April, May, is that there are more larger small deals that have come across our desk that if we determined, well, this is now in our strike zone.

Clint Malin - *LTC Properties Inc - CIO*

And those larger small deals, it's $100 million, $150 million transactions. And also the reason for providing color on this is that although we haven't closed any acquisitions or announced anything to date, we are actively engaged in looking at transactions. And we also have spent a fair amount of time trying to build out our development program, and I think we're close on a few of these relationships.

So, that does take time. But this, again, is to provide color that we are actively engaged and we're seeing a lot of transactions, and we're encouraged by what we're seeing.

Michael Carroll - *RBC Capital Markets - Analyst*

Okay, great, thank you.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thanks, Mike.

Clint Malin - *LTC Properties Inc - CIO*

Thank you.

Operator

The next question will come from Daniel Bernstein of Stifel. Please go ahead.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

Hello, good morning.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Hello, Dan.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

Hello. I'm trying to think about, historically, when cap rates have been decreasing, competition increasing, you've tended to retrench from acquisitions as a Company and maybe deleverage a little bit. But it sounds like your strategy here is going to be a little bit different.

And I guess I'm trying to understand, is the quality -- what's different in the strategy than -- what's making you want to go ahead and look now again at asset buying versus being a little bit more careful as cap rates pull in? I'm just trying to understand the process a little bit.

Pam Kessler - *LTC Properties Inc - CFO*

Okay. My glass is currently half full instead of being half empty. I really do believe that interest rates are going to stay low for most of this year. So, as cap rates compress, and as our cost of capital stays down, are I think we have an opportunity, at least within this year, to put some additional accretive assets on our balance sheet and finance them on a permanent basis at relatively low interest rates.

So, I think now is the time to strike in those types of transactions. While my background is accounting and finance, and I've been trained for many, many years to mostly look at the downsides and the upsides, I think I'm finally convinced that interest rates are going to stay down for a significant amount of time in the future. Therefore, we can look at some of these compressed cap rates and be successful in buying something, and because of our low leverage, get some really attractive depth.

Wendy Simpson - *LTC Properties Inc - President & CEO*

And we have pulled back from the assisted living side, Dan. A couple years ago when the cap rates really compressed in the senior housing side, we announced the market is really frothy, and we see better opportunities in development. And so three years ago, we started our development program.

From the skilled nursing side, the talk of cap rate compression, I think it's the difference in asset quality versus a cap rate compression. It's not more dollars chasing 30-year-old skilled nursing. The new skilled nursing that's coming online, it's a very different product and it warrants a lower cap rate, and we've been investing in that for the past three years. I think you're hearing others say now what we've been saying for several years. And I don't think it's a change in our strategy at all.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

Okay. So, you're seeing some better quality assets.

Clint Malin - *LTC Properties Inc - CIO*

Absolutely. We are seeing better quality assets. And on the skill side, I think there's been a rush on the investment side on the private pay seniors housing assets, and I think you have seen cap rate compression on that side of the business. I think it's been a little bit more open on skilled nursing, as far as maybe some of our peers have been pursuing more of the private pay side, and some of the large REITs haven't been focused as much on skilled nursing or skilled nursing in the pricing -- or deal range of $100 million to $150 million deal value.

I think we're seeing opportunities that we want to invest in that space, and we're being selective, we're being prudent, and we're partnering with the right companies that are looking at what the next generation is for skilled nursing. That's where our opportunities are coming about, on the skilled nursing side.

On the private pay side, I think that it's probably more sale leasebacks, where we were monetizing real estate value with the operating companies as opposed to buying enterprise value at a marketed transaction. So, that really differs as far as whether you're looking at skilled or the private pay senior housing segment.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

Okay. And Wendy, if I interpret your comments on -- would it be correct to say that you're thinking about using some additional leverage on the -- increase the leverage on the balance sheet to go ahead and finance transactions in 2014 rather than equity --

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Wendy Simpson - *LTC Properties Inc - President & CEO*

Yes.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

-- given the cost of capital has pulled back, as well? Is that the right way to think about it?

Wendy Simpson - *LTC Properties Inc - President & CEO*

Yes, that's the right way to think of it.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

Okay.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thank you, Dan.

Daniel Bernstein - *Stifel Nicolaus - Analyst*

That's all for me. Thank you.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thank you.

Operator

(Operator Instructions)

And I'm showing now additional questions at this time. Oh, we do have a question that just came in from Doug Christopher of D.A. Davidson. Please go ahead.

Doug Christopher - *Stifel Nicolaus - Analyst*

Hello, thank you very much. Just a basic question here on the -- when I'm looking at estimating revenues. On the mortgage loans, figuring that out, is the current rate that you have in the quarter the good run rate to annualize and use as a quarterly -- as we develop our models going forward?

Pam Kessler - *LTC Properties Inc - CFO*

Yes, yes it is. We have a full quarter now of the Michigan loan.

Wendy Simpson - *LTC Properties Inc - President & CEO*

And we don't have any material payoff.

Pam Kessler - *LTC Properties Inc - CFO*

We don't have any material payoff until fourth quarter. So, if you look in our supplemental, we show the maturity schedule and the revenue associated with that. You'll just have some normal amortization of mortgage loans that is pretty immaterial. So, I think this first quarter is a good run rate.

Doug Christopher - *Stifel Nicolaus - Analyst*

Thank you very much.

Pam Kessler - *LTC Properties Inc - CFO*

Thank you, Doug.

Operator

(Operator Instructions)

And showing no additional questions in the queue. This will conclude our question and answer session. I would like to turn the conference back over to Wendy Simpson for her closing remarks.

Wendy Simpson - *LTC Properties Inc - President & CEO*

Thank you all for joining us today. And as Pam said, we're looking forward to our investor day and being able to show you this wonderful property out in Chatham run by Juniper, and talk about the Company in person. So, look forward to seeing you this summer. Thank you. Bye-bye.

Operator

Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.
