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LTC - Q2 2014 LTC Properties Inc Earnings Call

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CORPORATE PARTICIPANTS

Wendy Simpson *LTC Properties, Inc. - Chairman, CEO & President*

Pam Kessler *LTC Properties, Inc. - EVP, CFO & Secretary*

Clint Malin *LTC Properties, Inc. - EVP & CIO*

CONFERENCE CALL PARTICIPANTS

Paul Morgan *MLV & Co. - Analyst*

Michael Carroll *RBS Capital Markets - Analyst*

Karin Ford *KeyBanc Capital Markets - Analyst*

Daniel Bernstein *Stifel Nicolaus & Company - Analyst*

PRESENTATION

Operator

Hello and welcome to LTC Properties, Inc. 2Q14 analyst and investor call and webcast. All participants will be in listen-only mode. (Operator Instructions). After the 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 risks and uncertainties that may cause actual results to differ materially. These risks and uncertainties are detailed in the LTC Properties, Inc.'s filings with Security and Exchange Commission, including the Company's 10-K dated December 31, 2011. Please also note this event is being recorded.

I would now like to turn the conference over to Ms. Wendy Simpson, Chairman, CEO, and President. Please go ahead.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thank you. Good morning, everyone, and thank you for joining us today. This morning, Pam Kessler, our CFO, will start our presentation with comments on our financial results for the second quarter of 2014. After Pam's comments, Clint Malin, our Chief Investment Officer, will talk about the performance of our portfolio, our pipeline, and the project of repositioning the assets currently leased to Enlivant and Extendicare. Pam?

Pam Kessler - *LTC Properties, Inc. - EVP, CFO & Secretary*

Thank you, Wendy. Normalized FFO increased 17% this quarter to $22.5 million from $19.2 million in the second quarter of last year. Normalized fully-diluted FFO per share was $0.64 this quarter compared to $0.57 a year ago. Revenues for the quarter increased 14% or $3.5 million year over year, primarily due to investments made in the second half of 2013 and completed development projects partially offset by property disposals in 2013 and 2014.

Interest expense increased $290,000 from the second quarter of last year due to increased borrowing under our line of credit and the sale of senior unsecured notes in 2013 to fund acquisitions. General and administrative expenses were $165,000 lower this quarter compared to a year ago due to the timing of certain marketing expenditures.

During the quarter we sold two assisted living communities with a total of 133 units and a school for combined sales price $7.9 million. We received total proceeds of $7.7 million and recognized a $1.1 million gain in conjunction with these transactions. During the quarter we invested $14 million in properties under development and capital improvement projects at a weighted average yield of 8.7%. Capitalized interest for the quarter was $435,000.

We currently have $47 million outstanding and $193 million available under our line of credit. In July, we locked rate on the remaining $30 million available under our shelf agreement with Prudential. The senior unsecured notes will bear interest at 4.5% and have a 12-year maturity. This transaction is expected to close later this month. At the end of the quarter, our investment-grade credit metrics remained one of the best in the healthcare REIT universe with debt to trailing 12-month normalized EBITDA of 2.9 times, a normalized trailing 12-months fixed charge coverage ratio of 6.3, and a debt to enterprise value of just under 18%. I'll now turn the call over to Clint.

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Thank you, Pam. Good morning, everyone, and thank you for joining us today. First I will provide an update on our re-leasing initiative for our portfolio of 37 assisted living communities co-leased to an affiliate of Extendicare and Enlivant.

The two master leases on this portfolio of properties expire on December 31st of this year. With the exception of 15 properties in the Pacific Northwest, which have been the most occupancy-challenged in this portfolio, we have made operator selections to lease the remaining 22 properties. These 22 properties will be leased on a regional basis to four operating companies, two of which are existing LTC relationships, and the other two will be new to our operator base. Site visits to these 22 properties have been completed by the operators and leases are being negotiated.

Given the occupancy challenges in the Pacific Northwest, we have decided to pursue a two-pronged approach of re-leasing the properties as well as considering a sale of the properties. With the lower occupancies in the Northwest, maximizing rental income for LTC in a lease will come from the participation and revenue increases at the communities over time.

Although we believe the reasons for the occupancy challenges at these properties are not building- or market-specific, relying upon revenue growth at the communities to achieve higher rent for LTC is not without risk. Therefore, we believe the exploration of asset sales to recycle capital on these assets is a prudent consideration for LTC to evaluate. We have received multiple indications of interest to purchase the properties and are evaluating these proposals in comparison to the lease proposals and will make a decision shortly as to which direction to proceed. Although it is possible to transition the communities to new operators before year end, most likely the new leases, or asset sales if applicable, will be effective January 1, 2015.

Turing to the portfolio, lease coverage for the trailing 12-month period ended first quarter 2014 remains strong and consistent. A caveat, that the following coverage metrics are derived from unaudited financial statements provided to us by our operators and reported one quarter in arrears. For our skilled nursing portfolio, EBITDARM coverage is 2.29 times and our assisted living portfolio, excluding the properties leased to Extendicare and Enlivant, is 1.64 times and 1.4 times including these properties. EBITDR coverage, including an allocated management fee of 5% revenues, is 1.69 times for skilled nursing and 1.4 times for assisted living, excluding Extendicare and Enlivant, and 1.18 times including them.

Compared to the previous quarter, occupancy has remained consistent across all property types. Occupancy for the trailing 12-month period ended first quarter of 2014 is as follows. Assisted living, excluding the Extendicare and Enlivant portfolio, is 89.2% and including these properties it's 80.4%. Skilled nursing is 79.9% and range of care is 83.6%. Our quality mix remains strong with almost 60% of our underlying rental revenue coming from private-pay sources.

Also, we continue to have success with our development program and anticipate three new development projects will open before year-end. Our pipeline remains strong at approximately $600 million, which includes sale-leaseback and development opportunities as well as expansion replacement projects within our portfolio. Currently, we see more opportunity relating to seniors' housing as opposed to skilled nursing. Although we have a strong pipeline which includes off-market transactions, we continue to see significant competition for assets in today's market, especially on fully-marketed seniors' housing deals, which continues to drive asset pricing.

As Wendy mentioned on our previous earnings call, we plan to use our strong balance sheet to make accretive investments while interest rates remain low. However, we continue to exercise discipline, remain prudent in our underwriting, and focus on off-market relationship-driven transactions.

To provide some color on our pipeline, we have two fully-executed letters of intent for two memory care development projects. One of the projects was sourced from our exclusive development pipeline agreement with Anthem Memory Care, which, if we are able to successfully acquire the land side, will be our fifth development project together. The other development project will be the start of a new operator relationship and, in addition to standard due diligence, remains subject to execution of a development pipeline agreement, which is close to finalization.

Also, we have two fully-executed letters of intent to acquire a total of five seniors' housing communities, which, if we're able to successfully acquire the properties, will be leased to two operators within our portfolio. These five assets are all subject to low-rate HUD debt that will be assumed by LTC. Therefore, closing might extend into early 2015, but our goal is to close by the end of this year if possible.

The deals subject to these four LOIs represent approximately $85 million of investment opportunity for LTC with yields ranging from 6.75% to 7% on the sale-leaseback transactions at 8.75% to 9% on the development projects. Although we have executed letters of intent on these four transactions, I must caution that these deals remain subject to due diligence and therefore may not be converted to closed investments. Now, I'll turn the call to Wendy for her comments.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thanks, Clint and Pam. The last time we talked, I mentioned that I felt that interest rates would be low for a while and we would definitely do investments using our leveraging ability and Clint commented on that. I still believe that.

While we have not yet done sale leasebacks this year, we have invested approximately $27.5 million in projects under development and capital improvements. When you have a chance to look at our supplemental information, you'll see that on page 7 we show that we have an additional $19.3 million remaining to spend projected in 2014 on development and capital improvement. The rates at which LTC will collect rental revenue on these investments range from 9.25% for new development to 7% for small projects related to improving and updating certain existing assets.

We locked in a very attractive spread on the first $30 million of these investments by drawing the remainder of Prudential shelf at a 4.5% rate. This makes more of our unsecured line available to make additional accretive investments.

With the exception of the LOIs Clint mentioned, we have not found additional sale-leaseback transactions in 2014 that meet our underwriting guidelines and are priced at a level that will benefit the shareholders of LTC except for adding assets and debt to the balance sheet. They're not accretive. We continue to be able to work with our customers for development deals and look forward to announcing additional deals but we are leery of the inflated prices we see in the market for certain assets. As Clint mentioned, our pipeline is strong and we still anticipate being able to complete some sale-leaseback transactions in 2014 as well as begin at least two additional development projects and look forward to announcing them as soon as possible.

The new Prudential debt, assuming no other changes, would be about $0.01 dilutive this year, but at this time I'm not changing our guidance, which for 2014 is FFO between $2.56 and $2.58.

I'll open the call now for questions and I'm sure some of you on the phone have heard yada yada yada number, yada yada yada number; when am I going to get a number specifically for Enlivant? So, we are not going to be able to say anything more specific about our negotiations for the Enlivant properties. We can answer general questions about how the process is going and that sort of thing, but we are down to the very detail of negotiating these things and we are not going to be giving specifics on this call. I can assure you that, as soon as we know what the numbers are, we will have a press release and let everybody know what the numbers are, but we don't know that at this moment. So, please, any questions. Operator?

QUESTIONS AND ANSWERS

Operator

Yes, thank you. We will now begin the question and answer session. (Operator Instructions). Paul Morgan, MLV.

Paul Morgan - *MLV & Co. - Analyst*

Hi, good morning. I don't know if this falls under the category of stuff you can't comment on, but with respect to Enlivant, maybe just a couple of things. One, specifically, do you have a breakout of the book value and the share of rent that's in the Pacific Northwest component from the 15 properties?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

This is Clint. We don't allocate it because of the master lease, but I mean you could derive that calculation by looking at the number of units or properties to get the un-existing rents.

Paul Morgan - *MLV & Co. - Analyst*

Okay. And are there any, just more anecdotally then, were there any takeaways from the operator tours specific to the portfolio that you could share? Or places where, specific, there might be upside? I mean you obviously said that we know where the challenges are. But, any other color from all the operator tours that took place recently?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Basically, all of the operator tours -- Clint has been on some. I've been on some. They're very pleased with the state of the buildings physically. They see additional upside, of course. One of the issues in the Pacific Northwest probably is still relative that Enlivant still does not allow Medicaid admissions. So, that possibility of additional occupancy is shortstopped by the fact that they still don't allow their administrators to take admissions for Medicaid or potentially converting into Medicaid.

So, of the operators that had made the ability to go out and see the properties, everybody was very encouraged. Of course there's; we'd like a little money for new furniture or things like that. And we are accumulating those numbers because Enlivant is supposed to be returning these buildings in the state in which they got them. So we'll be talking to them about CapEx requirements. But, generally, it all went well.

Paul Morgan - *MLV & Co. - Analyst*

Great. And then, as you weigh selling versus re-leasing the Pacific Northwest, I mean how important is it in your mind having a use of proceeds and the timing of being able to put the money back to work? Or are you really evaluating it independent of uses of proceeds?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Oh, no, we'd have to consider use of proceeds. Considering that we have very little debt. So it would definitely make a difference to us, use of proceeds. But, we want to get this done. We want to get some surety to our shareholders and we're working towards that.

Paul Morgan - *MLV & Co. - Analyst*

Okay, great. And then, just last question for me. At your investor day you talked about some portfolios in senior housing that were kind of in your sweet spot, in $100 million to $200 million range, and that some of those were in your pipeline. You didn't mention that specifically now except for maybe referring to pricing. I mean are they still there of that size? Or are you much more focused on off-market deals because of where pricing of kind of for portfolios are?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Paul, this is Clint. We've had the opportunity to look at some of those size transactions and pricing and competition make those a little bit of a challenge so we have tried to focus more on the off-market transactions or deals of a little bit smaller size.

Paul Morgan - *MLV & Co. - Analyst*

Okay, great. Thanks.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thank you.

Operator

Thank you. Michael Carroll, RBC Capital Markets.

Michael Carroll - *RBS Capital Markets - Analyst*

Thanks. Clint, can you give us some color how occupancy has trended at the Pacific Northwest Enlivant properties?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Sure. The occupancy has trended down on a quarter-by-quarter basis and I think that's not to be unexpected in this type of situation. Nothing specific against Enlivant, but as they have a new investor in their organization and they have assets that they're focusing on turning around, that probably has caused a little bit of decline in the occupancy. One thing, when Wendy and I were out touring properties just in general, is there are some newer executive directors at the communities so the consistency of the leadership could be a function of some of the decline in the occupancies. Also, we've identified that Enlivant has been charging a community-based fee that may be not have been assessed in the past and that could be impacting some of the occupancy and move-ins as well.

But, one of the positive things that we're seeing is that the rates are trending up. When you look at the current, or I guess second quarter, compared to the end of 2013, we've seen and uptick in rates across, not just the Northwest, but across the board of about 3.5% on rates. So, we're seeing a positive trending on rates.

Michael Carroll - *RBS Capital Markets - Analyst*

Is the Pacific Northwest, I guess, different from the other properties within that lease? Is that weaker than the other ones, the occupancy trend?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

It is, yes.

Michael Carroll - *RBS Capital Markets - Analyst*

Is there a reason why the Pacific Northwest is weaker? Is it something with the properties, the market, or is it just the turnover at the property level?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

I think it refers back to a comment that Wendy made about Medicaid admissions. If you back and look historically, and we have information, back probably in 2006, 2007 timeframe, these properties in the Northwest were probably accepting around 50% Medicaid, which today, it's zero. So I think that represents. Again, when assisted living concept was born, it was based on that affordability model and having some Medicaid occupancy in some of the markets these are in cater more to that. So, I think as we bring on additional operators, that willingness to accept some percentage of Medicaid waiver will definitely have an impact on occupancies at Northwest communities.

Michael Carroll - *RBS Capital Markets - Analyst*

So they accept Medicaid at the other properties or is it just they haven't the changes?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

The only property in our portfolio that accepts Medicaid is New Jersey and I think that's a state requirement in New Jersey, but it's only one property. So, across the board, outside of state requirements, there are no other Medicaid residents in any of the 37 except the one in New Jersey.

Michael Carroll - *RBS Capital Markets - Analyst*

Okay. Then how confident are the prospective tenants or buyers that they will be able to stabilize these assets?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Well, I think just by the interest that people are looking at it; I mean they see it as an opportunity. So, by the fact that people are motivated and looking at this, I think it represents that they see opportunity to be able to utilize their reputation, the companies we're talking to that have experience operating in the Northwest, to rely upon their reputations and knowledge in the industry to drive occupancies. Plus, just the admission of Medicaid residents will help drive that occupancy.

Michael Carroll - *RBS Capital Markets - Analyst*

Okay, great. Thanks.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thanks.

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Thank you.

Operator

Thank you. Karin Ford, KeyBanc Capital Markets.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Wendy, just curious, why do you think it is that you haven't seen a lot of skilled nursing product that's meeting your investment criteria recently? And has there been a big change in pricing there?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

There seems to be a big change in pricing in some of the big packages, down in the maybe 7% cap rates. We hear rumor of a package that might be sub-7% cap rates. But that's rumor. And so, we're just, unless it's a brand-new facility with a lot of upside or a lot of private pay or something like that, but a traditional SNF, even though it might be in the 1990s built or even the 2000s, I still, even though I'm willing to lever up much more than I was in the past, I'm still a little leery about SNF assets in the 7% cap range.

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Absolutely. And I think also, Karin, our pipeline, obviously we vet transactions going into the pipeline and we have seen skilled nursing opportunities to look at. But again, they've just not met our investment criteria so we've passed on those transactions. So, we're seeing some of that but just the quality of the assets is not what we're looking at bringing into the portfolio. So, it just happens to be at the current time there's been more opportunities on the seniors' housing side.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Got it. Thanks. It looked like a few of the developments in your pipeline, I think three of them, saw a delay in when they're going to be paying you rent this year. Can you just talk about what's the cause for the delay and if it's going to have any impact on FFO this year?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Sure. These are primarily -- they're all expansion renovation projects, not new development. And they're smaller projects. The one in Colorado was weather-related and the other ones were just minor changes in scope that pushed them out. So, really nothing substantive or significant on those.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Okay. And then, last question is just on the guidance. I know you said the debt refinancing is going to be about $0.01 but you're not changing the range. Was there something on the positive side that's offsetting the $0.01 or do you just feel like your trending sort of to the lower end of the range today?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Yes, we're trending probably to the lower end of the range.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Okay. Thank you.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thank you, Karin.

Operator

Thank you. Daniel Bernstein, Stifel.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Hi, good morning.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Hi, Dan.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

I promise I'll ask one question on Enlivant, just one.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Dan, you can ask as many as you want.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Just one and it won't be about what rates you're going to get on the leases.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Okay.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

When you talk about getting upside from those 15 properties in the future, are you thinking RIDEA structure or are you thinking some mechanisms to reset the leases down the road?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Go ahead.

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Dan, it's Clint. It would be probably a rent participation, based on as revenues grow over time with the property. So, we're not looking at RIDEA at this time, no.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

No. We're looking at almost any structure except RIDEA.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Okay.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

RIDEA is not something that we're running right at the moment.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Okay. Okay, alright. So I'll move away from Enlivant and ask you something that's more relevant to the rest of the business.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Okay.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

In the SNF pipeline and pipeline for acquisitions, are you seeing, new entrants, new competition for the assets? I mean what do you think is driving the cap rates lower? Is it just interest rates or are there actually new entrants interested in skilled nursing? And then secondly is, when you do off-market transactions are some of those sellers trying to use the transaction pricing to try to drive down cap rates on the non-marketed, off-market transactions?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Sure. Well, I think interest rates obviously have definitely a component do with that. Private equity, we definitely see more private equity investors and I think that's just the stability of industry. And that's probably more so on the private-pay seniors' housing side, which I think speaks to the overall industry as a whole and its stability. So you're seeing people looking at getting in the industry. You still have the non-traded REITs that we've seen be active as well. So, I think private equity would be the biggest competition that we're seeing for assets.

On the skilled side, I think that you're just seeing, as far as probably there's not as many transactions we're seeing on that, but it's still very competitive whether it's non-traded or publicly-traded. Quality assets will command a price and I think there's a lot of capital interest in those type of assets.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Okay. And then, in the past you've looked at maybe some LTACs and the cap rates on those assets have come down a little bit, but we're still probably at yields that are better than skilled nursing and seniors' housing. Are you looking at any LTACs or ERF assets or hospital assets in the pipeline?

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Not at this time, no.

Daniel Bernstein - *Stifel Nicolaus & Company - Analyst*

Okay, alright. That's all I have. Thanks.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Thanks, Dan.

Clint Malin - *LTC Properties, Inc. - EVP & CIO*

Thank you.

Operator

Thank you. Karin Ford, KeyBanc Capital Markets.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Hi. Wendy, how high are you willing to take leverage up to today?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

We're still about the 30-70. If we get to 30, we'll probably look at doing some equity. So, if we're at 38, it will definitely be equity time. But we still have $200 million to go before we'd be at 30. So, we have plenty of debt capacity right at the moment. And we'll be working with Prudential to put in a new shelf because we've found that product is very, very beneficial to us in being able to take down 30, 50, whatever we need, at a time and pretty quickly because they've done their underwriting. So, Pam has a very full fall reloading our bank line and our shelf with Prudential.

Karin Ford - *KeyBanc Capital Markets - Analyst*

That's helpful. And do you still think that, once you get the Enlivant re-leasing done, that you'll be back to looking at possibly getting rated and doing unsecured debt?

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

Yes, we do believe that that is our goal.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Great, thank you.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

And I think we're very close. But, thank you, Karin.

Karin Ford - *KeyBanc Capital Markets - Analyst*

Thanks.

Operator

Thank you. (Operator Instructions). Alright, as there is nothing more at the present time, I would like to turn the call back over to management for any closing comments.

Wendy Simpson - *LTC Properties, Inc. - Chairman, CEO & President*

No, but thank you all for joining us this morning. Thank you, Keith. And again, we will give you the details on the Enlivant transaction as soon as we have details. Thank you very much for your patience and your attention. Have a great day.

Operator

Thank you. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.