LTC Properties, Inc.

First Quarter 2015 Earnings Call

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CORPORATE PARTICIPANTS

Wendy Simpson – *CEO and President*

Pam Kessler – *EVP and Chief Financial Officer*

Clint Malin – *EVP and Chief Investment Officer*

PRESENTATION

Operator
Good day, and welcome to the LTC Properties Inc. 1Q 2015 Analyst and Investor Call and Webcast. All participants will be in listen-only mode. Should you need assistance, please press signal a conference specialist by pressing the star key followed by zero. After today's presentation there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press star then two.

Before management begins it presentation, please note that today's comments, including the question and answer session, may include forward-looking statements subject to risks and uncertainties that may cause actual results and events to differ materially. These risks and uncertainties are detailed in LTC Properties' filings with the Securities and Exchange Commission from time to time including the company's most recent 10-K dated December 31, 2014. 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
Thank you. Good morning, everyone, and thank you for joining us today. Pam Kessler, our CFO, will start our presentation with comments on our financial results for the first quarter and will be followed by comments from Clint Malin, our Chief Investment Officer, who will talk about the transaction that is closed as well as our current outlook for additional 2015 investments.

At this time, I'll turn the call over to Pam.

Pam Kessler
Thank you, Wendy. Normalized FFO increased 4.5% for the first quarter of 2015 to $23.4 million or $0.65 on a fully diluted per share basis from $22.4 million or $0.63 per fully diluted share a year ago.

Revenues for the quarter increased nearly 7% or $2 million year-over-year. The improvement primarily reflected completed development and capital improvement projects in 2014 and the first quarter of 2015, as well as an increase in interest income from mortgage loans resulting from a loan origination and the amendment to the Michigan loan.

First quarter interest expense was $3.8 million, an increase of $579,000 over the comparable 2014 quarter due primarily to the sale of senior unsecured notes, lower capitalized interest and greater utilization of our line of credit to fund acquisitions and development.

General and administrative expenses were $3.5 million or $550,000 higher this quarter compared to a year ago, due to increase staffing, restrictive stock vesting expense related to awards granted in February and the timing of certain other expenditures.

Given that there is some seasonality in first quarter G&A, we are currently anticipating a G&A run rate of approximately $3.4 million per quarter for 2015. During the quarter we recognized $116,000 in income from unconsolidated joint ventures related to a preferred equity investment that Clint will discuss in greater detail.

Turning to the balance sheet, during the quarter we invested $54.5 million in a variety of transactions. As disclosed in our last quarter's earnings release as a subsequent event, we purchased two parcels of land and improvements for a total of $9.7 million and entered into development commitments to complete the construction of a 56 unit memory care community in Texas and an 89 unit combination assisted living and memory care community in South Carolina. We also exercised our purchase options under a $10.6 million mortgage loan and acquired and equipped a 106 bed skilled nursing center for $13.9 million, an incremental $3.3 million from the mortgage loan investment.

We originated an $11 million mortgage loan, $9.5 million of which was funded at closing, secured by a 157 bed skilled nursing center in Michigan, and we amended a mortgage loan securing 15 skilled nursing centers in Michigan to provide 20 million in loan proceeds for the redevelopment of two of the properties and the forfeiture of the borrower's prepayment option. During the quarter, we began recognizing non-cash effective interest on this loan.

On Page 20 of the supplemental, we break out our estimates of non-cash revenue components which now include effective interest along with straight line rent and the amortization of lease inducements.

Included in the effective interest estimate are our existing loans, the loan we originated this quarter and the revision to the estimate of the effective interest related to the Michigan loan amendment. Also during the quarter we invested $20.1 million in a joint venture that Clint will talk about, we invested $10 million in properties under development in capital improvement projects at a weighted average yield of 8.7%, funded $1.9 million under our construction loan and received $2.8 million in mortgage loan receivable payoffs and principal amortization.

During the quarter, we borrowed $36.5 million under our line of credit and made $4.2 million in scheduled principal payments under our senior unsecured notes. Currently, we have borrowings of $36.5 million outstanding and $363.5 million available under our revolver.

In the first quarter of 2015, we granted 65,750 shares of restricted stock and paid $18.9 million in common and preferred dividends. This week we amended and restated our private shelf agreement with Prudential, providing for an immediate availability of $102 million senior unsecured notes.

Notes issued under the shelf will bear interest that is spread over applicable treasury rates with maturities of up to 15 years from the date of issuance and a maximum average life of 12 years.

At the end of the quarter, LTC's investment grade credit metrics remain one of the best in the healthcare REIT universe with debt to trailing 12 months normalized EBITDA of 2.9 times, a normalized trailing 12 months fixed charge coverage ratio of 5.9 and debt to enterprise value of 15.8%.

I'll now turn the call over to Clint.

Clint Malin
Thank you, Pam. Good morning, everyone, and thank you for joining us today. In March, we executed on a preferred equity investment and a joint venture with two existing customers. We initially deployed $20.1 million of a $25.6 million commitment to facilitate the acquisition of a 29-acre, 436-unit, 3-building campus in Peoria, Arizona that provides independent assisted living—independent living, assisted living, and memory care services and a 149-unit property in Yuma, Arizona that provides assisted living and memory care services. The remaining $5.5 million of the commitment is available to fund capital improvements to the communities.

This investment yields a 15% net preferred return to LTC. To the extent cash flow of the joint venture is insufficient to pay the preferred return in its entirety, LTC will be paid a priority preferred cash distribution of 5% in each of years one and two with the minimum distribution percentage increasing annually thereafter by 100 basis points through year five.

LTC has a call protection period affording us a 15% annual rate of return through the third year of this investment. Additionally, LTC is being granted a fair market value purchase option exercisable during a 17-month period beginning in April of 2018.

Four properties are operated by Senior Lifestyle Corporation, who is also an equity investor. This investment furthers our growth oriented leadership with one of the leading senior living providers in the country.

To date in 2015 we have executed on approximately $100 million of investments and development commitments and, as announced in our previous earnings call, added a new operator relationship to our portfolio, Thrive Senior Living.

Closing on the preferred equity investment represents execution on 25% of $100 million active investment pipeline I discussed on last quarter's earnings call. Since then two additional investment opportunities have been added to our active pipeline, which maintains a balance of approximately $100 million.

The active pipeline is now comprised primarily of development projects and weighted mainly towards private pay seniors housing. Two of the development projects in the pipeline subject to a letter of intent are currently under construction and the deal is structured such that LTC will acquire the properties upon completion of construction and licensure providing a current return on our deployment of capital.

Our shuttle pipeline is strong and includes a couple of unique opportunities sourced by existing partners which we hope will be added to our active pipeline in the near term. The strength of our relationships with our existing customers continues to drive organic growth for LTC. We're off to a great start in 2015 on the investment front and with the strong pipeline, we are optimistic about our investment opportunities for the remainder of the year.

Turning to the portfolio, our leased coverage for the trailing 12-month period ended in the fourth quarter 2014 remains consistent and strong. I'll caveat that the following coverage metrics are derived from unaudited financial statements provided to us by operators and are reported one quarter in arrears.

EBITDARM coverage for skilled nursing is 2.25 times, assisted living is 1.63 times and range of care is 1.79 times. EBITDAR coverage after an allocated management fee of 5% of revenues is 1.66 times for skilled nursing, 1.4 times for assisted living and 1.3 times for range of care.

Compared with the previous quarter, occupancy has remained consistent across all property types, occupancy for the remaining 12 months—for the trailing 12-months period ended in the fourth quarter of 2014 is as follows; assisted living 85.1, skilled nursing 79.7 and range of care 85.6. Our quality of mix remains strong as well with 56% of our underlying revenue derived from private pay sources.

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

Wendy Simpson
Thank you, Clint and Pam. As Pam mentioned, we have secured another $102 million shelf financing agreement with Prudential and still have a minimum of $363.5 million available under our bank line not including using the $200 million accordion feature.

To reach a leverage ratio of 30:70, LTC could still add $400 million in long-term debt before needing to consider any additional equity. Based on the potential transactions being considered at this time, our securing of the additional Prudential availability provides us with security to consider larger transactions and eliminate the concern of possible financing contingencies.

We've been very pleased with our development partners and, as Clint mentioned, we have added Thrive this quarter. Our goal when we began our development initiatives and what we have actually achieved was and is to provide LTC with future new state-of-the-art industry assets in both skilled and senior care investments.

We've realized cash returns on these investments takes longer, but the quality and longevity of the assets is a solid investment in the long-term view that we have at LTC. I remain bullish on LTC's opportunities in 2015 and look forward to reporting on additional investments as the year progresses.

At this time I'm increasing FFO guidance by $0.09 to a range of $2.66 to $2.68 and again look forward to being able to increase that when we next talk.

Thank you for dialing in and I'll now open it for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. Again, it is star then one to ask a question.

And our first question comes from Jordan Sadler of KeyBanc. Please go ahead.

Jordan Sadler
Thank you, good morning. Wanted to follow-up on the guidance that you just touched, the $0.09 increase, is that purely a function of the preferred investment made in the quarter?

Wendy Simpson
$0.05 of it is from the preferred investment and $0.04 is from the Michigan loan amendment.

Jordan Sadler
Okay, helpful. On the preferred investment, can we talk a little bit or can you share a little bit of light on that return opportunity, obviously a pretty good premium there for a preferred return. Maybe talk about why it's so significant and if there are any additional opportunities either in the pipeline or shadow pipeline that have similar sort of characteristics?

Clint Malin
Good question. We've looked at some preferred equity investment opportunities over the past year, year and half and I would say that the 15% rate is I think sort of marketable, but we're seeing further opportunities, so I don't think it's out of line for other opportunities that we've seen.

And again the opportunity was a turnaround that Senior Lifestyle had involved with for a little bit that did not have an equity position previous to the closing on this deal. So the priority cash distribution provides some flexibility for them to go ahead and reposition the asset, but we think there is a lot of opportunity with this investment for us and our partner.

Jordan Sadler
In terms of the pipeline, though, are there additional preferred opportunities in there and is this a strategy you think you can kind of continue to pursue?

Clint Malin
Sure, I think we would definitely look at additional preferred equity investments, I think they would be more unique where we have partnership related relationship based transactions to afford us the time to evaluate and structure transactions. So I think for the right opportunity and there are some other partners we're talking to about preferred equity investments. So I still see it being a smaller portion of our investment strategy, but to the extent there is opportunities we definitely would look at it.

Jordan Sadler
And then I guess as one other follow-up may be again for you, Clint, as on the shadow pipeline it sounds like you said there is a couple of unique opportunities. I'm just curious in terms of the composition, I know those are further out, not committed but composition of the shadow pipeline, is it looking a lot like the active pipeline or there is some differences and any changes in thinking as we sort of make our way through the reimbursement outlook?

Clint Malin
I would say the shadow pipeline is probably more acquisitions, not as much--our active pipeline has a lot of development in it. The shadow pipeline has more acquisitions and that would include both private patient housing as well as skilled nursing, so it's a combination. Again the shadow pipeline is deals that we're currently vetting and trying to put a structure together to them. So to the extent we're able to execute, we're not positive on that. That's why we try to break out the total pipeline and just the active pipeline to give you guys more color on what we're seeing and where we're focusing efforts. But it's both skilled nursing and assisted living in that shadow pipeline.

Jordan Sadler
Okay. Thank you.

Operator
Our next question comes from Mike Carroll of RBC Capital. Please go ahead.

Mike Carroll
Thanks. Clint, can you break out between the SNFs in senior housing acquisitions in the shadow pipeline and why are you seeing more senior housing acquisitions? I thought previously that valuations were bidding a little steep for you. Are you dropping your targets a little bit or are you seeing better deals or opportunities?

Clint Malin
I think it's just lumpy, I think you see certain opportunities over time and as I mentioned we're seeing some of these opportunities sourced from existing relationship that have unique avenues into transactions. So, I think it's just lumpiness in the market and it ebbs and flows as we react to opportunities that are in front of us.

Mike Carroll
Can you give us a breakout between the SNFs and senior housing?

Clint Malin
As far as the percentage goes in the shadow portion?

Mike Carroll
Exactly.

Clint Malin
I would say that it's probably 60% seniors housing.

Mike Carroll
And then you said most of that's acquisitions, what percentage of that is acquisitions?

Clint Malin
The percentage of acquisitions it's probably more around the 70% mark.

Mike Carroll
Great. And then can you give us some additional color on the preferred equity investment? I know you mentioned a little bit earlier when were these communities built and what exactly do they need to do to reposition the assets?

Clint Malin
The buildings were built in the late 80s, 90s early 90s, and I think it struggled from the large properties, the one in the Phoenix Metro is a large property and there had been a number of changes in management over the course of the past four to five years with Senior Lifestyle coming in within the last year or so. I think it just struggled from an identity crisis and it needed a manager that who has experience with these large properties. And it sits on 29-acres, 3 different buildings, it's a large property to manage and I think Senior Lifestyle has got, demonstrate expertise of being able to manage large communities like this.

So it's really trying to move around the— I think the previous operator had different resident population sort of commingled in certain buildings and it's really working on deploying capital into couple of buildings to be able to specialize in care for certain types, whether it be memory care, assisted living or IL.

Mike Carroll
Okay, great. Thank you.

Operator
Our next question comes from John Kim of BMO Capital Markets. Please go ahead.

John Kim
Thank you. Good morning. I was wondering if I can have your comments on the I guess quickly changing public landscape. You have Omega is a larger company, Care Capital Properties might be spun out, how does this change the way you view or you run your business?

Wendy Simpson
It doesn't change it at all. We continue to see opportunities for LTC to make accretive investments. We're patient investors, we're long-term investors. As Clint has mentioned several times a lot of our opportunity comes from existing relationships and existing partners, so I don't see any significant change into our opportunities in the market.

John Kim
So you don't see them becoming I suppose more competitive, they have potentially better cost of capital than you. I think they're probably looking to grow pretty quickly. This doesn't change the way you look at acquisitions or the balance sheet leverage?

Wendy Simpson
It does not.

John Kim
Okay. Wendy you mentioned the $400 million to get to 30% leverage. Is that something that you would be willing to go to?

Wendy Simpson
Pam says I would.

John Kim
But what do you say?

Wendy Simpson
I begin to get it little concerned in the mid-20s, so what it depends on of course, I mean it's just basic economics is when you're in the 20s, 24, 25 and 30 is kind of your cap and if you put shadow pipeline gets more out of the shadows into actuality. You've got to assess the market and determine whether this is an equity market or a debt market. And so, I'd say if we were approaching the 20 some percent leverage and equity was available and well-priced, we probably would do equity.

John Kim
Okay. And then a question on the straight-line adjustment this period that came in, I think about 14% higher than your projections early this year. Was this all acquisition related or is some of this due to release in during the period?

Pam Kessler
It was releasing the former ALC lease that expired at the end of the year was broken into two master leases with one existing operator and one new operator and that resulted in a large increase, most of the increase in the straight-line rent and the rest came from developments that were completed in the fourth quarter of last year and the first quarter of this year.

Wendy Simpson
They were both the existing operators.

Pam Kessler
That's right, yeah.

John Roberts
Was there anything unusual in the –

Wendy Simpson
Sorry, John -

John Roberts
Was anything unusual in the escalations or the term of the lease? I'm just wondering why the big increase.

Wendy Simpson
When you start a new lease, the increase is huge because that's the nature of straight-line rent. So when you take—I think the two leases were 15 years, yes, 15 years which is the standard lease we typically do between 10 and 15 years with 2.5% escalation.

Pam Kessler
Yes, roughly 2.5% escalation. That results in the beginning the initial year of the lease, a large difference between your cash rent and straight-line rental revenue.

John Roberts
Okay, got it. Okay, thank you.

Wendy Simpson
Thank you.

Operator
Again, if you have a question, please press star then zero. Our next question comes from Daniel Bernstein of Stifel. Please go ahead.

Daniel Bernstein
Good morning. I'm on a cell, so everybody can hear me okay?

Wendy Simpson
So you left Baltimore, why?

Daniel Bernstein
It's charming city. So I want to ask about your thoughts on assisted-living fundamentals, some of the NIC data has been a little bit soft in the last couple of quarters. That might be the book to integration a little bit, and maybe seasonality 1Q. Have you seen any material change in the performance at your Brookdale assets and then roughly how you are feeling about assisted living, memory care given some of that NIC MAP Data in the last couple quarters?

Clint Malin
Dan, on the Brookdale property operator, they've been strong performers for a number of years and we haven't seen that occupancy or coverage change in that portfolio. So that's been very strong and consistent for a number of years now. We are getting feedback from our operators that took over the ALC buildings in January and we've had in Texas had a very positive report on increased occupancy at those communities already.

So, I think that NIC MAP Data it really goes down to specific markets and what you're seeing. I mean that tends to attract larger metro markets and there is a lot of the US that you have lot of other markets that are not captured in the data. So I think it really goes back into local markets to be able to provide any specificity regarding what you're seeing on trends on occupancies and performance.

Daniel Bernstein
And you haven't say become favorable to independent living and the development or acquisitions side versus assisted, you're still more focused on that AL mem care?

Clint Malin
That's correct. We are doing one project, in Wichita we did a project on assisted-living memory care developments with Oxford Senior Living and they brought an opportunity to us to add independent living or senior apartments to that campus. So we're pursuing that with them to round out that campus. And do the extent we, on our existing developments, could add IL into it we would be very supportive of that. I think it's more of just a standalone IL that we haven't been pursuing.

Daniel Bernstein
Okay. And then just broadly on cap rates, there's been a lot of chat about cap rates compressing again in first quarter, first half of 2015. Obviously the ten year has moved up the last couple days, but do you see cap rates compressing when you bid for assets and maybe what do you see or think the difference is between the one off small portfolios versus large portfolio cap rates should be?

Clint Malin
Sure. I wouldn't say we're seeing a lot of compression beyond what we seen in the past but it's very competitive and cap rates are low. I would say it's depending whether you're a one off asset or portfolio, whether it's, IL, AL or skilled, you probably have a 100 basis point swing from or more between low end, between a one-off asset and a portfolio.

So that range probably if you're looking at assisted-living for example for us, we're looking at seeing 6.5 to 7.5 on what we would be able to invest in on assisted-living, and skilled probably goes from somewhere in the low 8s for large portfolio deal to somewhere in the 9s?

Daniel Bernstein
Okay.

Clint Malin
It's probably 100 basis point.

Daniel Bernstein
Okay. One quick question here on the occupancy on the development in lease up? Is that one quarter in arrears or first quarter and is that included in the lease coverage that you quote for the entire portfolio because it seems like that's moving in the right direction, there could be upside in your leased coverage.

Clint Malin
Not in lease coverage and those are actually, currency go to the supplemental on page –

Wendy Simpson
It's Page 7 and they are as of March 31st, so they are not in arrears.

Daniel Bernstein
Okay. And that's not in your stabilized portfolio lease coverage yet?

Wendy Simpson
No.

Clint Malin
No.

Daniel Bernstein
Okay.

Clint Malin
But again as far as all of the development, Dan, as far as lease up goes, everything has been on track or ahead of budget on our projects for occupancy.

Daniel Bernstein
Yes, I noted that it was moving up nicely in the last quarter. That's all questions I have, I'll hop off. Thanks.

Wendy Simpson
Thanks, Dan.

Operator
I'm showing no further questions. This concludes our question and answer session. I would like to turn the conference back over to management for any closing remarks.

Pardon me. We had one jump in the question queue just now. It's Doug Christopher of Crowell Weedon. Please go ahead.

Doug Christopher
Thanks for taking my question, thank you. I just have a follow-up on the preferred investment and has the feel of special situation opportunistic in investing as part of the portfolio. Are there other opportunities like that for LTC?

Clint Malin
As far as additional preferred investments or just different opportunities in general?

Doug Christopher
That type of rate and opportunities?

Clint Malin
I think this was a unique opportunity with an existing customer to support them. I think they'll come up from time to time but it's not, had it not been an existing customer, I don't know if we would have pursued this specific investment in this structure. But again, try to support our partners and be opportunistic where we can.

Doug Christopher
Thank you very much.

Clint Malin
Thank you.

Operator
And we have a follow-up from Jordan Sadler of KeyBanc. Please go ahead.

Jordan Sadler
Hi guys, sorry, just on the guidance, it sounded like Wendy—you mentioned that—Pam, that guidance could move up further later in the year and I think that that—does that refer to potential acquisitions closing, incremental investment closing? And then along those lines, I'm kind of curious, it sounds like the active pipeline is more development oriented, which—and it sounds like you guys would look to deploy upon completion of construction.

So I'm trying to think how incremental investment opportunity, that sort of in your sites right now, might be impactful to earnings in the back half of the year?

Wendy Simpson
Clinton, in your actual pipeline, the majority of those are construction projects or development projects. Quite a few of them are ones that we invest in at CMO.

Clint Malin
There is a couple of the development projects. They are structures I mentioned in my prepared remarks that they're already in construction. We're coming in as a takeout capital at CMO. So those would—even though they're in development today and they would be brand new, we're not taking on construction risk, we would only be taking on lease risk, so those would be acquisitions this year.

Wendy Simpson
And our timing on those are more half, the latter half of the year. So it wouldn't be impacting during the second quarter. These types of acquisitions would not be impacting during the second quarter. In the shadow pipeline, which are some sale leaseback transactions, if we can get to the end game with those partners, we would have accretive things in the second quarter. What we include in our projections are only signed deals and deals that we absolutely have signed up.

So in terms of looking at opportunities in our shadow pipeline and how far we are into the due diligence on these things, it gives me some confidence that we might be able to convert some of these things during this current quarter and increase our guidance during the second quarter based on those closings. We won't be doing any increasing our guidance until those other pipeline things are fully signed. So it's both the pipeline and the shadow pipeline that gives me some sort of confidence that we'll be able to increase our guidance.

Jordan Sadler
And then just to clarify on the developments, it sounded like you wouldn't take construction risk but you might take lease up risk, but that's obviously not on a [indiscernible] basis, right, that's just as it relates to the operator taking lease up risk?

Clint Malin
Those would just be sale leaseback, effectively, triple that lease.

Jordan Sadler
Okay. And you would be able to effectively earn current income on a non-lease property [indiscernible]?

Clint Malin
On a lease up property, correct.

Jordan Sadler
Okay. And it would have a step up or you'd start at current basis?

Clint Malin
Current basis.

Jordan Sadler
Okay. Thank you, guys.

Wendy Simpson
Thank you.

Operator
Now I'm showing no further questions. I'd like to turn the conference back over to management for closing remarks.

CONCLUSION

Wendy Simpson
Thank you. And again thank you all for joining our call. And again we look forward to talking to you after the end of the second quarter. Have a great day.

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