LTC Properties

Third Quarter 2018 Analyst and Investor Call

November 6, 2018 at 8:00 AM Pacific

CORPORATE PARTICIPANTS

Wendy Simpson – *Chief Executive Officer*

Pam Kessler – *Chief Financial Officer*

Clint Malin – *Chief Investment Officer*

PRESENTATION

Operator
Good day and welcome to LTC's 2018 Third Quarter Investor Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your telephone keypad. To withdraw your question, please press star (*) then two (2). Please note this event is being recorded.

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

Wendy Simpson
Thank you, Operator. Welcome everybody. Joining me today are Pam Kessler, our CFO; and Clint Malin, our Chief Investment Officer. As always, I'll begin the call with some introductory remarks, Pam will follow with the discussion of our financial results, and Clint will provide commentary on our portfolio, recent activity, and operator performance. I'll finish with a brief wrap-up before we begin the questions and answers.

We are executing on a steady path, working closely with existing and prospective operators to offer flexible, innovative financing solutions while continually evaluating and strengthening our portfolio. Most recently we made two investments and sold three properties, two of which were sold during the quarter and one just after. These transactions represent a recycling of capital to optimize our portfolio for long-term and sustainable growth. We are continuing to selectively and strategically identify a few assets within our portfolio for sale where we believe we can mitigate risk and recycle the capital into better opportunities in the future. To be clear, we are focused on making decisions that will positively impact LTC for years to come. As I've said before because it remains true and is core to who we are, LTC has both the fortitude and the ability to wait until we find the right deal, one that is strategic for our shareholders and for our partners. However, you should not mistake our patience for inactivity. We have been proactive in managing our existing assets, focusing on building relationships to help source future off-market deals and expanding the innovative financing structures we offer to attract new regional operating partners who are excited to have a capital provider who can and will bring multiple financing solutions to the table.

Now, I'll provide a brief update on two of our current operators, starting with Anthem. We are in regular contact with Anthem to ensure they are meeting their 2018 goals. They continue to pay rent in line with our expectations and are showing progress. We are currently reviewing budgets with them and are in the process of setting increased rent expectations for 2019. From an occupancy standpoint, Anthem's Murrieta community is holding steady at around 89%. Burr Ridge and Glenview are seeing solid gains, with occupancies at 77% and 64% respectively. Tinley Park's occupancy is down slightly, but Oak Lawn, which began admitting residents in late May, is 30% occupied as lease-up activities continue. We will continue to closely monitor Anthem's progress.

Moving now to Thrive, total occupancy at the Thrive properties has remained relatively flat since our last call, and Thrive has exhausted the $1.4 million of deferred rent we announced last quarter. Unfortunately, we had anticipated the deferred rent would provide a longer runway towards stabilization under modest lease-up assumptions through the second half of the year, and that has not yet materialized. We are currently working with Thrive to understand the extent to which they will be able to meet their contractual 2019 rent obligations with combined cash flow from the portfolio and corporate guarantors. As we have demonstrated in similar situations, our focus will be on generating the best possible outcome for our shareholders.

Before Pam's comments, I'd like to provide our 2018 guidance. This guidance includes all transactions that have closed to-date, but assumes no additional investment activity or asset sales, financing, or equity issuances. FFO for 2018 is now expected to be between $3.07 and $3.09 per share, which includes an $0.08 non-recurring income related to the write-off of an earn-out liability and the related lease incentive, which Pam will discuss shortly. Pam?

Pam Kessler
Thank you, Wendy. NAREIT FFO was $0.75 compared with $0.76 in last year's third quarter. The change related to higher rental and interest income resulting from acquisitions and mortgage loans. Net income available to common shareholders increased $14.2 million from the prior year due to a gain related to the sale of two skilled nursing centers in Alabama in the third quarter. Clint will provide more detail later in the call. Revenues increased $530,000 due primarily to acquisitions, increased rent from Anthem, and interest income from amounts funded under mortgage loans, partially offset by properties sold and non-recurring income in the prior year. Interest expense decreased $147,000 primarily due to lower debt balances resulting from scheduled principal payments on our senior unsecured notes. This was partially offset by a higher average outstanding balance on our line of credit last quarter.

General and administrative expense increased $735,000 to $4.9 million primarily related to performance-based incentive compensation. Last year in the same period, amounts were reduced due to the Anthem lease default. We expect G&A to be in the $4.7 million to $4.8 million range for the fourth quarter. In addition to the sale of two properties in Alabama, we closed the acquisition of an independent living community in Oregon for $14.4 million through a real estate joint venture that Clint discussed in detail on our second quarter call. LTC contributed $11.5 million of cash, and our JV partner contributed $2.9 million of equity. During the quarter, we also added a skilled nursing center in Michigan as security to an existing mortgage loan funding $7.1 million upon origination and committed to fund another $3 million for capital improvements at an incremental yield of 9.4%. In the quarter, we received $1.5 million from the pay-off of one mezzanine loan and the pay down on another mezzanine loan. Subsequent to the end of the quarter, we sold a skilled nursing center in Florida for $5 million. Again, Clint will talk more about this transaction later.

We amended a master lease to remove an earn-out provision and agreed to sell under certain conditions a memory care community in Colorado. Accordingly, in the fourth quarter, we will write off the contingent earn-out liability and related lease incentive asset, which will result in a one-time net income recognition of $3 million or $0.08 per share, which is included in the guidance Wendy gave earlier.

In the third quarter we borrowed $34.5 million under our line of credit. Subsequent to September 30th, we repaid $20 million on the line, bringing the total outstanding to $100 million. Additionally, during the third quarter, we funded LTC's $0.19 per share monthly dividend and paid $16 million in scheduled principal pay downs on our senior unsecured notes. We also funded $7.4 million under existing commitments for development and capital improvement projects and $1.8 million under mortgage loans. At September 30th, we owned three properties under development and two under renovation, with remaining commitments totaling $40.2 million. We also have $16.4 million in remaining commitments under mortgage loans for expansions and renovations on eight properties located in Michigan and $2.1 million remaining under a preferred equity commitment.

Our balance sheet remains strong and provides us with the ability to fund current and future growth initiatives. We have $500 million available under our line of credit, $80 million under our shelf agreement with Prudential, and $184 million under our ATM program. In total, that provides $764 million of liquidity. Our strategic and conservative capital allocation philosophy has served us well, and we plan to maintain this philosophy going forward. Our long-term debt-to-maturity profile remains well-matched to our projected free cash flow, helping moderate future refinancing risk, and we have no significant long-term debt maturities over the next five years. At the end of the third quarter, our credit metrics remained well-matched to the healthcare REIT industry average with debt-to-annualized adjusted EBITDA of 4.5 times and annualized adjusted fixed charge coverage ratio of 4.8 times, and a debt-to-enterprise value of about 28%.

Now, I would like to hand things over to Clint.

Clint Malin

Thanks, Pam. Although the deals we completed this quarter and just subsequent were not large, they demonstrate our willingness and ability to make positive changes for the long-term health and stability of our portfolio. Year-to-date, including the deals we completed in the third quarter, we have closed $73 million in new investments. I'll start by discussing the three asset sales, which were completed under two separate transactions. Our relationships with these two operators involved in these transactions commenced in the early 2000s and have not grown since that time. Consistent with our strategy, we are choosing to recycle capital in circumstances where we do not see growth potential or opportunity. The first transaction included the sale of two older skilled nursing centers in Alabama comprising a total of 285 beds which we sold back to the operator whose lease expiration was scheduled for later this year.

The second transaction is an older 60-bed skilled nursing center located in Jacksonville, Florida that was sold to the lessee subsequent to the end of the quarter. The combined proceeds for the transactions were $22.5 million against combined gross and net book values of $11.4 million and $4.9 million respectively. Total annualized GAAP rent from these properties was approximately $2.2 million. These sales are included in Wendy's FFO guidance. Our total gain on sale from these transactions is approximately $17.7 million, $14.3 million of which we recognized in the third quarter and $3.4 million of which we will recognize in the fourth quarter related to the Jacksonville sale. Year-to-date, we have sold properties with a gross book value of nearly $47 million resulting in net proceeds of $82.5 million and a combined gain on sale of $62.7 million. We anticipate selling three additional properties in our portfolio, two are under contract and the third is the memory care community Pam mentioned, which is being marketed by a broker. We will provide additional details as they emerge.

Last quarter we discussed two assisted living communities in California with upcoming lease expirations. We are nearing an agreement to lease these two communities to another operator within our portfolio and expect to have a signed agreement by the end of this year. Next, I'll discuss the portfolio numbers. Q2 trailing 12-month EBITDARM and EBITDAR coverage using a 5% management fee was 1.43 times and 1.21 times respectively for our assisted living portfolio and 1.78 times and 1.28 times respectively for our skilled nursing portfolio. Coverage on our assisted living and skilled nursing portfolios was relatively flat compared with last quarter. We are continuing to engage our operating partners to monitor SNF coverage and gain insight into their preparation for the scheduled implementation of the PDPM reimbursement model in October of 2019.

Now, I'll hand the call back to Wendy for a wrap-up.

Wendy Simpson
Thank you, Pam and Clint. While we are seeing a variety of potential deals, they have not been up to our stringent underwriting standards, both from a pricing and property perspective. However, we believe in real estate cycles and are poised for when significant demographic demand starts to meet current supply. LTC is not only ready for this turning point but is well capitalized, offering a variety of financing structures to best take advantage of the upturn when it occurs. As we've discussed today, LTC is staying true to its philosophy and executing on a business strategy that we believe best positions the Company for sustainable long-term growth. We remain a supportive partner to our operators and a sensible steward to our shareholders. The relationships we are cultivating and nurturing and the strong balance sheet we have built will allow us to remain a supportive capital provider in seniors' housing for years to come as we continue to drive long-term value to our culture of trust, transparency, and shared success.

Thank you again for joining us today. We're ready for your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). At this time we will pause momentarily to assemble our roster. The first question comes from Rich Anderson of Mizuho Securities. Please go ahead.

Rich Anderson
Thanks. Good morning. Three REIT skilled nursing senior housing calls back to back for three hours of fun today, so what can a REIT analyst ask for more? The question that's weighing heavily on I think people's mind with you guys is senior care in light of what happened over at Sabra. Can you talk about your exposure to that operator in terms of coverage and how you feel about the situation as you see it?

Clint Malin
Good morning, Rich. This is Clint. We obviously are aware of the situation. We haven't provided coverage by operators specifically. They fall sort of in the mid-pack for us. So we have been fortunate, we do have coverage, but obviously they have a lot of corporate-level distraction with new leadership, the challenges that were announced yesterday, so it's something we're definitely actively engaged in monitoring. Wendy and I met with the ownership group last week in Orange County to try to get a better understanding of where they're at, and obviously they're probably limited in what information they can provide to us. But, we're actively engaged with them. We have a lease with the parent company. We do have credit enhancement as far as security deposits. We hold deposits for taxes and repair and maintenance reserves as well.

Wendy Simpson
We've also reached out to some of our other Texas operators to in -- since this has become public information. We've talked to them about their interest in these properties, should they have any. As we speak today, they are not in default in anything relative to our lease. So it is a situation that we are totally on top of, and we'll take action probably a little quicker than we would should

they default on anything because at this point, I don't think cooperating with them for a long-term solution may be the right answer if they have these significant problems with the Sabra assets.

Rich Anderson
Right. So, Clint, you said you don't give specific operator coverage metrics, but what did you - I missed, you kind of gave a little qualifier there. Is it in the range of what your averages are, is that what you said, I -- or maybe I missed that, if you could repeat?

Clint Malin
No. That's fair. That's fair.

Wendy Simpson
Yes. It's not that they're…

Wendy Simpson
Yeah, they're not --

Rich Anderson
Okay. I got you. And then could you maybe give any update on Preferred Care and how that situation has evolved?

Clint Malin
Sure. I think Preferred Care is making a lot of progress. I saw in Omega's call yesterday that they completed the sale or re-leasing of nine buildings on November 1st. They've a few more buildings to transfer. So, at this point, I would expect based on the communication we've had with Preferred Care, they're probably looking to emerge, I mean, sometime first quarter would be my guess at this point.

Rich Anderson
Okay. Last question, perhaps for Wendy, the whole movement now seems, at least in senior housing, is to a managed structure or RIDEA structure, most of the REITs have at least had the disproportionate amount of their activity going in that direction lately. You guys have held the line on RIDEA. I know that you're structuring around it with JVs, and you're trying to be creative. But, is there anything about a full-on operating structure that is starting to whet your whistle a little bit?

Wendy Simpson
No. We've talked to several significant operators who don't like the RIDEA structure. So, the market is fragmented even though the large REITs, healthcare REITs have done a lot of this business, there's still a lot of operators out there that are in our target groups that don't want to do RIDEA.

Rich Anderson
Okay. Fair enough. That's all for me. Thank you. Good call.

Wendy Simpson
Thanks, Chris.

Operator
The next question comes from Chad Vanacore of Stifel. Please go ahead.

Chad Vanacore
Thanks. So, just looking at your guidance, if you back out that one-time gain, that implies a relatively flat 4Q; is that about right?

Wendy Simpson
That's correct.

Chad Vanacore
Okay. And then just outside of the Thrive comments, have you had any further discussions with tenants about potentially restructuring leases? You got Genesis and Brookdale, they've gone through major restructuring with other landlords and then Preferred Care is going through the bankruptcy process. Anything we should think about there?

Clint Malin
Chad, this is Clint. We've not had significant conversations, I mean - I think a lot of those other discussions outside of our portfolio with those operators have really been facilitated based on their specific coverage and the necessity for that. So, to the extent we have circumstances discussed such as Thrive or Anthem, we've done so on our calls. So, right now that's - those are the two focal points for us right now.

Wendy Simpson
But we did restructure the lease that we're taking out. We - they gave up the earn-out and we offered to look at selling the Colorado property. So, we have restructured leases, but…

Clint Malin
But not much, Chad; but not from a modeling standpoint, not restructuring based on modification of rents.

Wendy Simpson
Right.

Clint Malin
Other than in the case of selling assets.

Chad Vanacore
All right. Is there anything that we should think about in terms of either your AL/memory care coverage or your SNF coverage that would, I want to say would skew that coverage one way or another?

Clint Malin
It continues to evolve quarter-by-quarter. There's pressure from occupancy and labor standpoints. So, that's a normal course that we're dealing with and our operators are working through. We have seen some uptick in occupancy on the AL side. Skilled side, we've talked last quarter about having a Medicaid rate increase in New Mexico. Obviously, the increase in October this year for Medicare, so, we could see some lumpiness. I don't see any large changes, but there could be some lumpiness in coverage or occupancy.

Chad Vanacore
All right. I appreciate the time. Thanks.

Clint Malin
Thank you.

Wendy Simpson
Thanks.

Operator
Again, if you have a question, please press star (*) then one (1) on a touchtone phone. The next question comes from Daniel Bernstein of Capital One. Please go ahead.

Daniel Bernstein
Hi. Good morning.

Wendy Simpson
Good morning.

Daniel Bernstein
I really only have two questions. One, I just want to go back to Thrive. Is there something, a problem with the properties themselves or is it market environment? I'm just trying to understand, or maybe something that Thrive is doing, I'm just trying to understand if it's a fixable issues there at those assets or if it's needs some, maybe some more intensive care?

Clint Malin
That's a great question, Dan. Thank you for that. Let's say we're actively working on assessing is it the operator or the markets? Right now we look at occupancy. They've been relatively flat since January of this year. They were at 67%, and as of October they were 72%. There has not been a lot of upward traction on occupancy. So, it's something we've been very engaged with them and trying to make that assessment; is it the market or is it the operator? But these are all relatively new buildings, some areas have more competition than others. So that's what we're trying to assess right now, market or operator.

Daniel Bernstein
Okay. Fair enough. And then, Wendy, I just wanted to go back to the very last comment that you made as you closed off your comments - your opening comments that you haven't seen I guess better opportunities that fit your criteria. Have you - has there been any incremental change towards those investment opportunities getting closer to what you would want to put money into, whether that's rate or coverage or asset quality, or is it really not much has changed from - from your point of view?

Wendy Simpson
Not much has changed right at the moment. We see some - some small deals that we're looking at that provide a decent return to us, but relative to spending even $50 million, I don't see that the spreads are getting to our level or the prices coming down.

Daniel Bernstein
Okay. Coming out of NIC, we heard from some people that lease coverage was getting a little bit better for skilled nursing deals, have you seen that, or is that - or am I just hearing random items?

Clint Malin
Dan, this is Clint. I think that it seems kind of forward looking from my perspective in that coverage, on that comment, because in general I think people are, have a positive viewpoint of

PDPM and kind of looking in, to the future. So I, from my vantage point, from NIC, that was sort of more predicated on going forward under the new reimbursement model.

Daniel Bernstein
Ah, okay. All right. I appreciate the color. Talk to you soon.

Wendy Simpson
Thank you, Dan.

Operator
This concludes our question and answer session. I would like to turn the conference back over to management for any closing remarks.

CONCLUSION

Wendy Simpson
Thank you. I appreciate everybody taking the time today. I know this is a very busy day for you, and maybe we'll see some of you in San Francisco at NAREIT. Have a great day.

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