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Mainstreet Health Investments Inc.

2016 Second Quarter Results Conference Call

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CORPORATE PARTICIPANTS

Randy Henry
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CONFERENCE CALL PARTICIPANTS

Troy MacLean
BMO Capital Markets — Analyst

Matt Kornack
National Bank Financial — Analyst

Rob Sutherland
Echelon Wealth Partners — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Mainstreet Health Investments 2016 Second Quarter Results Conference Call.

I would now like to turn the call over to Randy Henry, Director of Investor Relations. Please go ahead, Mr. Henry.

Randy Henry — Director of Investor Relations, Mainstreet Health Investments Inc.

Thank you, Sharon. Good morning, everyone, and welcome to the Mainstreet Health Investments 2016 Second Quarter Results Conference Call, and I might add our first such call as the Mainstreet Health Investments management team.

With me today are Adlai Chester, Chief Executive Officer; Scott White, President and Chief Operating Officer; and Scott Higgs, Chief Financial Officer.

The second quarter earnings release, financial statements, and MD&A are available on our website. And a replay of this call will be available beginning at 1:00 p.m. today through midnight on August 18th.

Before we get started, please be reminded that today's call may include forward-looking statements regarding our future operations. Such statements involve known and unknown risks and uncertainties that may cause actual results to differ materially from those expressed or implied today. We have identified such risk factors in our news releases and other public filings.

And also a reminder as we discuss our performance, please bear in mind that all amounts are in US dollars.

And with that, I will turn the call over to Adlai Chester.

Adlai Chester — Chief Executive Officer, Mainstreet Health Investments Inc.

Thanks, Randy. Good morning, everyone. I am very excited to welcome you to the first quarterly call for Mainstreet Health Investments. We are happy to be back in the Canadian markets, and we have enjoyed reengaging with many of you were are part of the HealthLease Properties story.

I will touch base on a few of our accomplishments this quarter, as well as the overall strategy of the Company. Scott White will comment on our initial portfolio, and Scott Higgs will discuss our financial results for the quarter. We will then open the lines for your questions.

Last fall we started the process of identifying the best way for us to come back to the Canadian public real estate market after the success of HealthLease Properties. After months of work, we are very pleased to have closed the reverse takeover transaction with Kingsway Arms, issued nearly $110 million of common shares in our initial offering, and acquired 22 high-quality properties. Most of this occurred in the second quarter in a flurry of activity, which is exactly how we like it.

We are really pleased with the level of interest in our public offerings, and happy to see so many familiar faces when we went out on our road show in May.

Our strategy is very much the same as it was with HealthLease Properties. Just like previously, we have an important relationship with Mainstreet Property Group, who develops transitional-tier properties throughout the United States. This is a key differentiator for us, and one that will help create meaningful value for our shareholders.

Our plan is very straightforward. We intend to aggregate a portfolio of income-producing senior housing and care real estate through acquisition opportunities in both the US and in Canada. We are looking to create a diversified portfolio of assets comprised of transitional care; assisted living, including memory care; long-term care; and independent living properties. As we look at acquisition opportunities, we will be cognizant of the operator; the asset quality; the asset type; and the geography. In a lot of cases, we will also enter into a triple-net lease structure with the operator.

So what is different now from HealthLease Properties? First, we have a broader team and more resources. What was done by a handful of people last time is now a much broader team with greater experience.

A perfect example of this is that we now have an asset management team that works hand-in-hand with our operators of the Mainstreet Health Investment assets. Together with them, they develop a capital plan and assure the assets are being maintained to meet licence requirements, as well as planning ahead for longer-term capital needs.

Secondly, we have access to a robust development pipeline via Mainstreet Property Group. Mainstreet Property Group is the largest developer of transitional care assets in the US. Mainstreet Health Investments entered into a development agreement with them that allows us an opportunity to provide mezzanine financing and preferred equity during the development stage in exchange for purchase options to acquire those assets. Over the past year or so the Mainstreet Property Group development pipeline has expanded in terms of both geography and in the number of operators. We believe that this new expanded relationship is a key part of our growth strategy.

And finally, as Mainstreet Property Group has grown significantly over the last few years, so too have the depth and breadth of our relationships. We have developed and grown really strong connections over the last few years with operating partners, real estate owners, developers, and others within the industry.

This network will provide us with opportunities to see various types of senior health care real estate deals. Sometimes these are non-marketed deals and sometimes these are opportunities we have in part created. A key part of our strategy to grow our portfolio is the access to these potential opportunities.

These last two points that I've mentioned were the primary driver for us to return to the Canadian capital markets. We were and are continuing to see opportunities to acquire assets that we really want to own, and now the vehicle to execute on these opportunities is in place.

We are back and ready to build on our past success with a deeper team and what we believe will be even more acquisition opportunities to amass a high-quality portfolio over the long term.

I will now turn the call over to Scott White to comment on the initial portfolio.

Scott

Scott White — President and Chief Operating Officer, Mainstreet Health Investments Inc.

Thank you, Adlai, and welcome, everyone. It is very exciting to be here on our first quarterly call.

It has been a rewarding process to see this new company come to fruition. Thanks again to everyone for the tremendous support during the road show. We had a lot of fun launching this.

I want to touch base on our initial portfolio and how we targeted these assets. It really demonstrates the concept of our ability to find or create transactions through our industry relationships that Adlai alluded to.

The 11-asset portfolio we acquired from Symphony is a perfect example. Mainstreet Property Group has had a long development relationship with Symphony and has developed numerous transitional care assets for Symphony, so we know that team very well. The relationship led to both parties discussing this transaction, ultimately coming to a deal. They knew our strategy with Mainstreet Health Investments, and we knew their reputation as one of the premier transitional care operators in the country. A perfect match.

The assets in Scranton are another example of our relationships leading to opportunities. Saber brought this opportunity to Mainstreet Property Group as a result of a successful partnership history. Saber and Mainstreet Property Group formed a joint venture in 2014, and we have worked together since.

Finally, the acquisition of three transitional care-focused assets is a good example of the opportunity we have to acquire projects directly from Mainstreet Property Group. We liked the location of these assets and the operators. Symphony is the operator of our asset in Chesterton, Indiana, which is just south of Chicago. Trilogy is the operator of the asset in Mooresville, Indiana, which is a suburb of Indianapolis. Trilogy is the operator of several Mainstreet Property Group projects developed over the past few years, so we also know them very well.

Finally, The Ensign Group will operate the Topeka, Kansas asset. The Ensign Group is a U.S. publically traded operator with whom Mainstreet Property Group is working with on multiple transitional care development projects. We have a great deal of respect for Ensign, and are pleased to have them as an operator in our portfolio.

Before I turn it over to Scott Higgs, I wanted to add a little colour on two subsequent events that we mentioned in the press release.

First, last week we closed on the Hearth at Greenpoint, the first of three assets we agreed to acquire from Hearth as part of the equity raise. You'll recall, we have to close on these assets individually since they're secured by government-backed loans and the assumption takes time to work through. The purchase price was approximately $33.0 million. This includes the assumption of a mortgage debt on the property of $13.3 million. We're proceeding as expected on closing on the remaining two assets.

Yesterday, we received Board approval to provide funding for three additional transitional care projects that will be developed by Mainstreet Property Group. Two of these projects are located in Arizona and one in Colorado. Mainstreet Health Investments will receive a purchase option on all three projects. The total investment in these three projects is approximately $4.3 million, which we will fund from available cash. The timing for the funding is in late Q3, early Q4 this year. These projects are expected to be completed between late 2017 and early 2018.

The purchase option price for each project will be based upon fair market value at the time construction is completed, as approved by our independent Board of Directors. These are brand-new high-quality, state-of-the-art projects that will fit well into our portfolio.

This is an immediate example of the power of the relationship of Mainstreet Property Group. As previously noted, we expect this to be an important part of our ongoing growth strategy. This transaction is subject to TSX acceptance and approval.

With that, I'll now turn it over to our CFO, Scott Higgs.

Scott Higgs — Chief Financial Officer, Mainstreet Health Investments Inc.

Thanks, Scott. I echo previous comments on our excitement to finally have the Company running and executing on transactions.

As many of you know, we completed our equity offering in the acquisition of 10 additional assets on June 2nd, then issued additional shares on June 21st from the exercise of the over-allotment option by our underwriters. This timing, combined with the closing of the reverse takeover transactions and related share consolidations, created circumstances that make AFFO and FFO per share metrics incomplete for the quarter. So we won't spend time on these metrics this quarter;

however, we will report on them in future periods. This quarter we collected rents on the properties we own and navigated through the stock offering.

I do want to point out a couple of key financial items from the quarter. We had cash on hand of $18.1 million as of June 30th. We paid down our secured term loan with approximately $36.1 million of cash that we had on hand after the public offering closed. A portion of the cash is earmarked for the remaining Hearth assets and other investments, but paying down our line in the short term reduces our finance costs.

As a reminder, when we closed the Hearth at Greenpoint transaction last week we assumed $13.3 million of debt, drew down $10 million on our revolver, and funded the remaining balance in available cash.

Also as of June 30th, debt to gross book value was 43.3 percent. It was approximately 46.1 percent after we closed on the first Hearth asset. Our overall debt strategy is to be in the range of 50 to 55 percent of gross book value.

As of June 30th, our weighted average interest rate on debt outstanding was 4.1 percent. Also, operating performance remained in line with our expectations, and in future periods we will report on coverages.

In July, we announced our dividend in the amount of approximately $0.06 per share. We anticipate the ongoing monthly dividend to be at this amount, which is approximately $0.74 per share on an annualized basis.

Also in July we announced our dividend reinvestment plan. Information and enrolment forms are available on the website, and will also be mailed.

I'll now turn the call back over to Randy.

Randy Henry

Thanks, Scott. Right now we will open up the line for any of your questions. Sharon, could you please walk us through the process?

Q&A

Operator

If you'd like to ask a question, please press *, then the number 1 on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from Troy MacLean from BMO Capital Markets. Your line is open.

Troy MacLean — BMO Capital Markets

Good morning.

Adlai Chester

Hey, Troy.

Scott White

Troy.

Troy MacLean

Just on the three new mezzanine loans, what's the expected rate that the Company will get on the loans to the development partner?

Adlai Chester

Yeah. So it'll be 14.5 percent: 10.5 percent would be current pay; 4.0 percent would be picked and paid at the end, approximately.

Troy MacLean

And then just on the acquisition market, maybe can you give us a little bit more colour on what you're seeing like in terms of cap rates? I'm assuming it's mostly non-portfolio transactions, but are you seeing—what type of volume and where that volume's at?

Adlai Chester

Yeah. So we're seeing very strong volume, both actually in Canada and in the US. In Canada, it tends to be in the assisted living space, maybe a little bit of independent living. In the US, we're seeing it across the spectrum with long-term care, transitional care, obviously, with the Mainstreet side of the business, and then assisted living; not a lot of independent living that we're looking at in the US at this moment in time.

From a cap rate standpoint, pretty much in line with what we've seen. We haven't seen any compression since the road show, nor have we seen a lot of increases. Once again, I do think we're seeing a little bit of maybe with some of the bigger players pulling out of the long-term care business we’re seeing some cap rates maybe going up slightly, but nothing dramatic.

Scott White

Troy, just as a reminder, a big part of what we have focused on and will focus on are smaller, off-market individual-type transactions. So while there's a lot of volume out there, even if there weren't, it really doesn't impact our strategy.

Troy MacLean

Since you completed that large equity offering and you increased the size of the portfolio, are you seeing more like off-market deals come to you now than before, let's say, before June?

Adlai Chester

Absolutely. Yeah. Yeah. So this is Adlai. I absolutely believe we're going to—we have a robust pipeline at this moment in time, and we believe that we're going to continue to see that. And the initial offering helped with that.

Troy MacLean

Yeah. Well, I thank you. That's it for me. I'll turn it back.

Randy Henry

Thank you.

Operator

Once again, if you'd like to ask a question, please press *, then the number 1 on your telephone keypad.

Your next question comes from Matt Kornack from National Bank Financial.

Your line is open.

Matt Kornack — National Bank Financial

Good morning, guys. Just wanted to quickly touch on the two developments; I think you mentioned that they're in Arizona and Colorado, is that correct? Can you just speak to those two markets from a seniors housing and care perspective?

Scott White

Yeah. Sure; happy to. So it's actually three projects: two in Arizona, one in Colorado. They are states that we worked with Mainstreet Property Group as the developer to identify both states, as well as more importantly than states—because states are important—but more importantly specific locations.

So one of the things that Mainstreet Property Group, or the developer, has become very proficient at is building an algorithm and having a fairly sophisticated site-selection model that demonstrates very clear demand for these specific assets.

So while your question, Matt, is around senior care and housing, which is a great question, I'd drill down one layer further and say, these are great markets for senior housing and care; these are exceptional markets for transitional care specifically because that is what these buildings are, and the site-selection algorithm and model focus is specifically on demand associated with transitional care.

Matt Kornack

And so I guess that that's ultimately trying to drive the sort of Medicare payer base, or a higher reimbursement payer base to those properties and its demographics related…

Scott White

That is exactly correct. So there's a big function associated with discharges from local hospitals that are Medicare-oriented. So you're absolutely correct. And that drives a lot of the model, which is why I sort of backed off kind of to senior housing and care industry, which looks at different variables that we would assess for different types of transactions.

But for this development in particular where it is focused on quality mix, Medicare-oriented, and volume of discharges. So in all three cases all these facilities will be near major discharging facilities that have demonstrated a high number of Medicare discharges.

Matt Kornack

Okay.

Scott White

It's also really important for everyone on the call to remember that these are our mezzanine loans in exchange for options. While we absolutely love these projects and have an expectation they'll be part of the portfolio, we will reassess what is going on in those markets at the time the options become available.

Matt Kornack

Fair enough. And on that point, did you say it's $4 million of mezz? And I don't know if you can provide this, but ballpark what do you think the assets will be worth on completion?

Adlai Chester

Matt, this is Adlai. I think from a purpose of just ballparking, I would say in the $20 million to $22 million range would probably be a pretty good—we can also follow up with more specifics around those.

Matt Kornack

No, that's fair enough. And then just finally with regards to growth going forward, you still have—even after this you'd have some cash available on the balance sheet. Can you sort of walk through how you think of acquisitions going forward and the buckets, whether you're looking at third-party acquisitions versus buying from—or deploying funds more into this mezz-type product?

Adlai Chester

Yeah. So as we said on the road show, one of the things, we believe this partnership with Mainstreet is a big part of our growth story, but not the only growth story. So I'm still staying with the fact that I believe it'll make up about a third of what we do.

So as we're looking at the other two-thirds, we are seeing a lot of opportunities, and we believe our ability to deploy that additional cash will not be in question.

Matt Kornack

Okay. Perfect. Thanks, guys, and congrats on your inaugural call.

Adlai Chester

Thanks, Matt.

Randy Henry

Thank you.

Operator

Your next question comes from Rob Sutherland from Echelon Wealth Partners. Your line is open.

Rob Sutherland — Echelon Wealth Partners

Hey, guys. Good morning.

Scott White

Hey, Rob.

Rob Sutherland

Not too much I can ask, but one thing I did want to just kind of get some more colour on, and it's probably the other Mainstreet side, but Scott was talking about demand for transitional care, and it's a new kind of bucket within the seniors-care spectrum. How much demand is there? How many—there's not a lot of these properties out there. How many properties in aggregate across the US or in different states do you really think that can be built?

Adlai Chester

Yeah. So if you look at skilled nursing licensure, which there's about 15,500 what we would say either a nursing home or long-term care, or even transitional care across the United States. There's obviously not that much demand for transitional care, so it has to have both volume in terms of the discharge at the hospital, but also volume in terms of the actual population of the market.

So as we've looked at it and assessed across the entire United States, we believe there's probably somewhere around 1,500 opportunities across—now some of those you can't get to because they're CON, certificate of need requirements, but we still believe there's a robust amount.

To your point, there's probably now about 100 that have been built across the United States, so there's still quite a bit of opportunity.

Rob Sutherland

Perfect. That's it for me. Like everyone else said, congratulations on the first quarter.

Scott Higgs

Thank you.

Randy Henry

Thanks, Rob.

Operator

Thank you. This concludes the Mainstreet Health Investments Second Quarter Conference Call.

You may now disconnect.

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