

FINAL TRANSCRIPT

Mainstreet Health Investments Inc.

Second Quarter 2017 Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Mainstreet Health Investments Second Quarter 2017 Earnings Conference Call.

I would now like to turn the call over to Scott Higgs, Chief Financial Officer. Please go ahead, Mr. Higgs.

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

Thank you, Leandra (phon). Good morning, everyone. With me today is Scott White, our CEO.

For today's call, Scott will talk about our activity for the quarter, along with some of our continued initiatives. I will then cover our second quarter financial results. Then we'll open up the line for your questions.

The second quarter earnings release, financial statements, and MD&A are available on our website, and a replay of this call will be available from 1:00 p.m. today until midnight on August 17th.

Before we get started, please be reminded that today's call may contain forward-looking statements regarding our future operation. 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 factors in our news release and other public filings.

As we discuss our performance, please bear in mind that all amounts are in US dollars.

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With that, I'll turn it over to Scott.

Scott White — Chief Executive Officer, Mainstreet Health Investments Inc.

Thank you, and good morning, everybody. I am pleased to report we had another great quarter.

In the second quarter of 2017, we continued to focus on executing on our growth strategy and again delivered solid results. Our activities in the quarter centred on adding new properties, continuing to strengthen our operator partnerships, and solidifying our financial platform and resources for further growth.

In terms of acquisitions, we continued to see our pipeline grow. There's no shortage of opportunities for us to build out this portfolio.

We continue to diligently underwrite a great number of transactions; however, we remain steadfast in our commitment to completing accretive and portfolio-enhancing deals. We're confident our pipeline will produce accretive acquisitions in the second half of 2017.

In May, we closed the previously announced sale leaseback of two facilities in California and one in Arizona from The Ensign Group. Ensign has leased the properties under a 20-year triple-net master lease. They were acquired for \$38 million in cash and debt, and were immediately accretive to AFFO.

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We're very excited about the addition of these facilities to our portfolio and the continued expansion of the partnership with Ensign. The Ensign Group's a great industry-leading operator, and we are fortunate to have them as our partners.

These stabilized facilities are prime examples of our ability to continue to grow our portfolio with value-enhancing transactions. These are our first properties in each state, and establish a strong foothold that we can develop into a larger presence.

We continue to look at opportunities in high-quality markets across the senior living and care spectrum. We remain very diligent and disciplined in our strategy to establish a diverse portfolio of health care assets operated by best-in-class partners.

More importantly, we're staying committed to not growing our portfolio just for growth's sake. We'll execute when we find the right facilities that align with our vision and that will create long-term shareholder value. We'll also continue to evaluate our portfolio, and selectively look for opportunities to redeploy capital as a mechanism for creating enhanced value.

Subsequent to quarter end, we entered into a purchase agreement to sell our properties in Wichita, Kansas, and Fort Worth, Texas to Mainstreet Property Group. We agreed to sell these properties for a total of \$47 million, and this transaction is expected to close by year-end.

Until the transaction closes, we've entered into a lease agreement with an affiliate of Mainstreet Property Group to operate the properties. The lease agreements are triple-net with an initial term of 15 years.

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We're also pleased to report that we have strengthened our balance sheet during the quarter. During the second quarter, we successfully executed an amendment to our credit facility. The amended facility has an increased capacity of \$300 million comprised of a five-year term loan of \$200 million and a four-year \$100 million revolving line of credit with a one-year option to extend. The facility also has an accordion feature which will allow the line of credit to expand and bring the total facility to \$500 million.

Our weighted average debt maturity is now extended to 5.4 years. The amended facility will help to support our growth plans and improve our debt profile.

We're very pleased with the progress we've made since we launched a year ago, and we'll continue with this momentum created during the first year.

We've had a great first year as a public company, and I'm excited about the opportunity ahead of us.

Let me take a moment to comment on this opportunity. When we set out and launched this company a year ago, it was based on the premise that there is meaningful opportunity to invest in health care real estate. Not only that, but given the macro-demographic shift in the North American population, the opportunity to invest in health care real estate will be in greater demand as the population ages.

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As I stand here today, one year after we've launched, I remain strongly committed to the initial investment thesis. We're very, very early in the wave of aging Baby Boomers. The opportunity will grow rapidly in the coming years.

While many talk about headwinds in the industry, we've seen real opportunity. The numbers speak for themselves. We have many years of significant growth ahead of us in this industry. Our thesis is a long-term one. While we continue to deliver on our quarterly results, our focus remains longer term.

We love the industry, we love our partners, and we love this opportunity. We don't worry about the short-term headwinds. Rather, we embrace the industry and the opportunity, and continue to execute on our strategy.

With that, I'd like to ask Scott Higgs to further review our results for the second quarter of 2017.

Scott Higgs

Thank you, Scott. We're pleased to report that our Q2 2017 AFFO is \$0.26 per share compared to our forecast of \$0.23 as adjusted for the over-allotment of the June 2016 offering.

On a normalized basis, we target our payout ratio to hover in the mid-70s on an AFFO basis for the year. For the quarter, our payout ratio on an AFFO basis was 72 percent.

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A testament to our team's investment discipline and our operator selection process, our EBITDAR and EBITDARM coverage is 1.2 times and 1.6 times, respectively. We continue to execute on our growth strategy while meeting and exceeding our forecasted financial metrics.

We have approximately 229 million drawn on our credit facility with sufficient capacity remaining. Of our existing debt, approximately 81 percent is fixed rate. This aids in ensuring that our results and financial execution are more predictable as we move forward.

At the end of the second quarter of 2017, our debt to gross book value was 55.2 percent, and exclusive of the convertible debentures was 49.5 percent.

I'd like to echo Scott's previous comments on the amendment of our credit facility. Extending our debt maturities, as well as the capacity, are significant enhancements to our credit profile.

The credit amendment in conjunction with our base shelf prospectus have positioned us well to grow our platform efficiently and effectively.

On behalf of the team, I'd like to reiterate how happy and proud we are of the success we've had in the quarter, and our progress in building a platform for sustained growth.

We'll now open up the line for questions. Leandra, please provide instructions.

Q&A

Operator

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At this time, if you would like to ask a question, you can press *, and the number 1 on your telephone keypad. And we'll pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Troy MacLean with BMO Capital Markets. Your line is open.

Troy MacLean — BMO Capital Markets

Thank you. Good morning.

Scott White

Good morning, Troy.

Scott Higgs

Good morning.

Troy MacLean

Your leverage target—sorry, leverage in the quarter reached 55 percent. That's basically, yeah, your target. Would you be willing to go higher than that for a short period of time in order to acquire more properties? How should we think about that?

Scott Higgs

Yeah. Troy, thanks for the question. I think the short answer is yeah, I think we would for a short period of time. The 50 to 55 percent leverage target is a long-term one. While I wouldn't expect that'd we exceed it for a long period of time, I think if the right opportunity presented itself you could anticipate that that could happen for a short period of time.

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**Troy MacLean**

And then, Scott, you said that the pipeline looks good. What type of properties are you mainly focused on right now? Is it a particular type or geographic market?

Scott White

It's not, Troy. We see it across the spectrum. Now as we said in the past, we continue to focus on building a diversified portfolio, so right now we have, as you look at our portfolio, we have a lot of concentration in single-stay; we have a lot of concentration on the single operators. We're looking to diversify away from that. We also have a greater concentration towards skilled nursing. It doesn't mean we won't do our next deal as a skilled nursing deal, but all else being equal I think we'd rather do a private pay deal to balance out the portfolio.

But again, it's an ever-evolving pipeline. We see opportunities across the entire spectrum, and where it makes sense from a pricing standpoint and a portfolio proposition, we'll execute.

Troy MacLean

And then have you seen much change in cap rates in the market for the types of properties you're looking for?

Scott White

Not as much as I would have expected, to be honest. Yeah. A little bit around the fringes, but I think we're going to see more. I really do. It is sort of a little bit surprising to me that—and I mentioned this a little bit in my comments. Everyone's talking about headwinds in the industry.

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There's no doubt as you read all the industry rags and the headlines are about the various sort of reimbursement risk, about skilled nursing in general being sort of out of favour, about shortage of labour. The reality, Troy, the industry isn't going away, and it doesn't spook us.

Cap rates haven't quite adjusted as much as I expected given that headline, but I suspect in the coming quarters we're going to see more of an adjustment. And also, it's a little bit part of the reason why we're being very disciplined. We went out and we did a lot of transactions in the first six months of our existence, and in the last six months you've seen us execute on less. It is not for a lack of opportunity. It's really just about being smart.

We don't want to look back a year or two from now and say, well, we do that deal just for the sake of the deal. Rather, we're going to do the deals that make sense.

Troy MacLean

When you say you want to add to the private pay side, what's kind of the range of cap rates you're seeing in that part of the market?

Scott White

Hey, Matt, you want to take that? Matt Monson is the one who leads our acquisition team, and I think I'd look for him to give you some real-time feedback on that.

Matt Monson — Vice President of Acquisitions and Business Development, Mainstreet Health Investments Inc.

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Yeah. I'd be happy to. Troy, we see cap rates anywhere in the mid 6s to the low 7s for high-quality Class A private pay senior living assets. So that's what we've anticipated going forward. It's been pretty consistent both in Canada and the US. We're really not seeing much of a discrepancy between the two countries or in various geographies throughout either country.

Troy MacLean

Okay. Yeah. Thank you. That's great colour. I'll turn it back.

Scott White

Thanks, Troy.

Operator

Your next question comes from the line of Jenny Ma with Canaccord Genuity. Your line is open.

Jenny Ma — Canaccord Genuity

Hi. Good morning, everyone.

Scott Higgs

Hey, Jenny.

Scott White

Good morning.

Jenny Ma

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Wanted an update on the mez pipeline if you could just give us a sense of when the estimated completions would be on those ones? And then my second question is with Aurora and Phoenix sold subsequent to quarter-end, just wondering if you guys had considered buying them? Or have you really considered it? Or was it something that you let go of pretty early on in the process?

Scott White

So let me start with Aurora and Phoenix. We did not let those go early in the process. There's really no need to. We consider it when they become available to us. When we enter into a mez loan, it is always, always, always with the intention of acquiring that property. We are not in the business of providing mez loans and financing solely for the sake of providing financing. We do it because it provides us a pipeline and an outlook into the future.

With that said, as each property becomes available we then make an assessment based on where we are and where our portfolio is. So we sat down as a team and we looked the portfolio. We looked at how many assets we had that were in lease-up versus those that were stabilized; we looked at the number of newer assets we had versus older assets; we looked at the distribution of our operators and made a determination that these didn't fit in right now. And we also thought that given the other deals we were seeing in the pipeline on a relative opportunity cost of capital basis, we could deploy that capital more efficiently.

So we did not decline those properties early. We declined them at the very end, so to speak, because we thought that made the most sense.

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In terms of the mez pipeline, right now, what do we have, 10 mez loans outstanding, Scott, if I remember correctly?

Scott Higgs

Yup.

Scott White

Sound right? So the mez pipeline is 10 loans outstanding. Just put my finger in the air, very rough math, these properties are approximately \$20 million each, plus or minus a few million dollars, but it gives you a rough sense of \$200 million in the pipeline, there's three or four operators, there's probably four or five states in that, so it does give us some diversity and some ... the ability to select those that make sense.

Which ones we'll execute on? Hard to say. I could tell you that as we look out over the next 18 or so months, I think it would be very difficult for us to acquire all 10 of those.

Jenny Ma

Mm-hmm.

Scott White

But I also can tell you, Jenny, that you should expect we will acquire some of them.

Jenny Ma

So where are they in terms of the completion process? Are they mostly done? Are half of them done?

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**Scott White**

Well, none of them are done. Once they're done, then we have the opportunity to execute on the option. I would say—and, Scott, you may have greater clarity—probably two or so will be done this quarter. Does that sound all right? And then another two to three before year-end and the other five-ish early next year. Is that about right? I may be off a little bit.

Jenny Ma

Okay.

Scott White

But it's done over the next three quarters.

Jenny Ma

Okay. And then on ... I guess on a similar line, in the MD&A you mention that your covenant on the credit facility was breached as of June 30th. So just wondering exactly what that covenant was? And given that you've gotten the repayment of the two mez loans to get you back inside that, how close are you to that level? Or is it—or has that line moved because of this event?

Scott Higgs

Yeah. So the specific covenant, Jenny, is a \$5 million liquidity covenant.

Jenny Ma

Okay.

Scott Higgs

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And in terms of where we are today, it's not close. There's no change in the covenant. Just a quick clarification just to be clear for everybody: There was no default.

Jenny Ma

Mm-hmm.

Scott Higgs

And so we're—in terms of that, we have no issues from a covenant perspective. It's sort of a technical accounting reason that it got moved to current for the quarter. But just, look, that's a point-in-time estimate on cash and liquidity and so forth, and a couple weeks later the cash and liquidity position was much different.

So it's a balancing of ins and outs for cash flows as we're trying to grow the thing, so. But in terms of where we are today, we're well inside the guardrails, if you will, and we don't foresee any operational issues or this being an issue going forward.

Jenny Ma

Okay. Did that factor into the reason why you guys didn't buy these assets?

Scott White

No.

Jenny Ma

Pardon?

Scott White

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Not at all.

Jenny Ma

No? Okay.

Scott White

No, not at all. No, that was really, I'd say, a 10-day timing issue. If I remember correctly, it was a 10-day timing issue of when the mez loans were repaid versus—so as Scott sort of hinted at, but to be even more clear, we have cash inflows and outflows. And some of those outflows, as you're well aware, is we have committed to CapEx with our partners.

Jenny Ma

Mm-hmm.

Scott White

And we need to fund that CapEx on an ongoing basis. So we could have made the decision while some of our mez loans hadn't been repaid and we're going to hold on for the CapEx, but we don't want to slow down projects. So we funded a couple of CapEx invoices that came in, so to speak, in terms of capital expenditures a couple of days ahead of some of the cash flows coming in. And it made a very small—it wasn't even like we were out of cash—it was \$1 million or something like that where there was a small difference between the inflow and the outflow brought us under \$5 million; it was corrected within a couple of days.

As Scott pointed out, there was no technical breach or anything like that.

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Jenny Ma

Mm-hmm.

Scott White

So it really wasn't an issue. It doesn't change our business. It was a blip.

Jenny Ma

And there's no associated penalty with that, right? There's no change in the rates?

Scott White

No.

Jenny Ma

In the terms? Or anything?

Scott White

No, no, no.

Jenny Ma

It was just a technicality?

Scott White

Yup.

Scott Higgs

Nothing at all. Yeah. Just a technicality.

Jenny Ma

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Okay. And then with regard to your debt financing—I'm looking at Page 15 of the MD&A—and for the \$90 million of mortgages payable it says here the weighted average rate is 2.2 percent, which seems a little low. Can you give me some colour on what's behind that?

Scott Higgs

Yeah. So it's ... some of it is debt that's been in place for a long time. That would include some of the debt on automotive, it includes the agency debt, and so forth. So that's what's comprising that number of the fixed-rate mortgages, Jenny.

Jenny Ma

Okay. So if you're going out to secure fixed-rate mortgages conventionally, what kind of rates are you seeing these days for 5-year and 10-year?

Scott Higgs

Yeah. Conventional like we've priced some here in the last ... we've closed some in the last 90 days in the 5 to 10 years in the low 4s.

Jenny Ma

Okay.

Scott Higgs

Well, I'd say 4 to 4.5, depending on all the metrics and leverage points and so on. Agency debt is a little bit lower than that.

Jenny Ma

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Okay. And then my last question is with regards to the development lease payments. It was just under \$1 million for Q2. I know there's a lot of ins and outs with the properties moving it around, but what is that looking like for the balance of the year?

Scott Higgs

So for the balance of the year as we switched—well, as we'd announced, Houston, one is going to be operated by Providence; started in the third quarter.

Jenny Ma

Mm-hmm.

Scott Higgs

And then with Fort Worth and Wichita transitioning to a lease—

Jenny Ma

Yeah.

Scott Higgs

—there will no—there will be a little bit in Q3, but primarily it'll all be rental revenue going forward.

Jenny Ma

Wait, is that income support? Or is that the development lease?

Scott Higgs

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So it's all kind of the same. It's just a matter of how it's classified from an accounting perspective. They're the same.

Jenny Ma

Yeah.

Scott Higgs

They come from the same properties, so there should be relatively little going forward.

Jenny Ma

Okay. And—

Scott Higgs

I can kind of help you off-line from—

Jenny Ma

Yeah. Yeah.

Scott Higgs

—but—

Jenny Ma

Okay.

Scott Higgs

—the predominance of it will be rental revenue in Q3 and 4.

Jenny Ma

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And it's only those three properties that are factoring into that line item right now?

Scott Higgs

That's correct. Yes.

Jenny Ma

Okay. Great. Thank you, and I'll turn it back.

Scott White

Thanks, Jenny.

Scott Higgs

Thanks, Jenny.

Operator

As a reminder, if you would like to ask a question, you can press *, and the number 1 on your telephone keypad.

And your next question comes from the line of Matt Kornack with National Bank. Your line is open.

Matt Kornack — National Bank

Hi, guys. Just wanted to quickly touch on the G&A in the quarter; it was a bit—well, it was lower than last quarter, but still fairly elevated. Is there anything in that that would be considered onetime? Or where do you see sort of a normalized G&A number being on a quarterly basis going forward?

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**Scott Higgs**

Yeah. Sort of the what I would call the onetime over the first two quarters that cause it to be a bit lumpy was the DSU expenses associated with the former CEO.

Matt Kornack

Mm-hmm.

Scott Higgs

So as part of that agreement that will end. There'll be a little more in Q3, but predominantly that's gone. And from a run rate basis on it from an AFFO adjusted basis, I still think 100 to 110 basis points of assets is a pretty good benchmark.

Matt Kornack

Okay. Then sorry, for those can you—what was the DSU amount for this quarter? Or—

Scott Higgs

So the DS—I can get to the specific amount, but it's approximately 300, I think, Matt.

Matt Kornack

Okay. With regards to the disposition of the former Ensign assets, is the timing of that later in the year because you anticipate sort of bringing on new assets at the same time so there won't be a drag from an FFO per unit standpoint?

Scott White

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So I think there's two questions there. One, we do have a robust pipeline and we do expect to redeploy that capital fairly quickly, but the timing isn't delaying until we have assets lined up. The timing is on the buyer's side, making sure they get everything—

Matt Kornack

Okay.

Scott White

—in order to acquire those assets. So we're prepared to sell this afternoon if they're ready.

Matt Kornack

Okay. But you have a pipeline, so presumably you could execute—

Scott White

We could.

Matt Kornack

—on a similar-sized acquisition?

Scott White

Yeah.

Matt Kornack

Okay.

Scott White

Yeah.

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Matt Kornack

Just what else was there? I think that's actually it for me. Thanks, guys.

Scott White

Great. Thanks, Scott.

Scott Higgs

Thanks, Scott.

Operator

I will now turn the call back over to the presenters for closing remark.

Scott Higgs

Thank you, all, for attending the call today, and we look forward to reporting our next quarterly results to you in mid-November.

Thanks a lot.

Operator

This concludes today's conference call. You may now disconnect.

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