FINAL TRANSCRIPT

Invesque Inc.

Second Quarter 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Sriram Sheraz
BMO — Analyst

Chris Couprie
CIBC — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Invesque's second quarter 2020 earnings conference call.

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

Scott Higgs — Chief Financial Officer, Invesque Inc.

Thank you, Amy. Good morning, everyone, and thanks for joining the call. With me today are Scott White, our Chairman and Chief Executive Officer; and Adlai Chester, our Chief Investment Officer.

Scott will start things off discussing some colour around the industry and the ongoing COVID-19 impact to our portfolio. I will then cover our financial results and Adlai will review our portfolio performance and some strategic portfolio management efforts before opening the call up for Q&A.

The second quarter 2020 earnings release, financial statements, and MD&A are available on our website, and a replay of this call will be available from 12:45 p.m. Eastern Time today until 11:59 p.m. Eastern Time on August 20th.

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 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.

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

Scott White — Chairman and Chief Executive Officer, Invesque Inc.

Good morning, all. Thank you for joining our second quarter 2020 earnings call, and I hope everyone joining the call is safe and healthy.

When we last spoke in mid-May, we were two months into the COVID-19 pandemic and it continues to impact all of us, both personally and professionally.

Before diving in to discuss the quarter and our recent activities, I want to say thank you once again to our operating partners and frontline caregivers for their hard work and tireless commitment to keeping patients and residents safe over the last five months. All the positive videos and stories we have seen from our communities during these trying times have been truly inspiring, and we're grateful to be partnered with such dedicated operators.

We continue to focus on our 2020 asset management initiative to ensure we are maximizing profitability and enhancing the value of our assets. Our portfolio management plans are a continuation of our strategy of building a world-class portfolio with the right partner in each of our communities across our various business lines.

As you have seen in the last few quarters, we are proactively and thoughtfully replacing operators when we think there's a chance to enhance value. With that said, I am pleased to announce that we will be transitioning the property management and leasing services for our MOB portfolio to JLL.

When we entered the MOB business with the acquisition of Mohawk two years ago, we always had a vision of scaling and institutionalizing this platform. JLL is a world-renowned leader in property management services and will significantly expand our capabilities, and I will touch on more specifics around the transition to JLL later in the call.

Given the rapid changes in the market environment and elevated uncertainty around COVID-19, I'll focus my comments on what we're observing at the ground level within our portfolio and across the industry.

The COVID-19 pandemic continues to create a challenging operating environment for many of our partners. Like our publicly traded peers, we are not immune to the impacts of the virus on operations and financial performance. We remain in constant contact with our operators, and are pleased to report that we have seen significant decline in COVID-positive cases within our portfolio over the last 30 days. This trend has occurred despite many states beginning to reopen and continued increase of COVID-positive cases across the United States.

Many of our operators that were impacted in April and May have now implemented phased reopening plans where they're able to conduct small group activities, dining, and family visitations, all under strict protocols to continue protecting residents and staff.

As of August 7th, 70 of our 106 seniors housing and skilled nursing assets have been impacted with positive COVID-19 cases in residents and/or staff. More importantly, as of August 7th, there are only 29 total patients or residents with COVID-19 being treated and quarantined in Invesque communities today. Considering the size of our portfolio of almost 11,000 beds, we are pleased to have so few active cases at the moment.

The community-level impact varies across our portfolio with very few positive cases today, which is a great improvement from where we were 90 days ago. The current rate of incidence in our portfolio is significantly below peak activity observed across the portfolio mid-May. This trend of moderation in active cases began in the first week of July and has remained steady since that time.

One important thing to note is that the cases that are currently being observed in our skilled nursing facilities are generally direct admissions of COVID-19 patients from hospitals to improve capacity in local health systems and are being cared for in dedicated COVID-19 units

We continue to be extremely proud of our operators' effort navigating through this challenging time. We acknowledge we are not on the other side of this pandemic quite yet, but we are confident that our operators have implemented the necessary policies and procedures to continue taking the best possible care of their residents and staff during this time.

Our skilled nursing operators have received government funding relief under the CARES Act and we're happy to see that an additional $5 billion was committed to this relief effort in late July. In addition, we were pleased to see that CMS has finalized the previously proposed rule to increase Medicare funding to nursing homes by $750 million, or 2.2 percent for the 2021 fiscal year, which begins on October 1st of this year.

Although our senior housing operating partners have not received similar relief under the CARES Act to date, we are hopeful that industry trade associations and lobbying efforts will result in some federal relief in the coming months. We are encouraged that HHS has begun collecting data from seniors housing operators to evaluate the possibility of providing financial aid, and we've confirmed that our operators have participated in this data collection effort.

At the state level, we're encouraged by recent announcements of relief efforts where we have significant senior housing exposure. Virginia and Pennsylvania, two of our largest markets as a percentage of our NOI, both recently announced state funding relief for assisted living providers. While we do not have specific numbers yet from our operators in these states, we expect the relief payments will offset a substantial amount of the short-term COVID-related expenses they have incurred.

Moving on to the Commonwealth vertical of our business, we are thrilled to see the Commonwealth acquisition and portfolio management efforts over the last year continue to strengthen our results. As a reminder, Commonwealth is our subsidiary seniors housing management and operating company and represents almost 25 percent of our forward-looking NOI. Our ownership of Commonwealth provides us unique insight into day-to-day financial and operating performance of one of the most sophisticated operators in the industry.

In the 20-asset Commonwealth portfolio we acquired last year saw a 660 basis points improvement in NOI on a quarter-over-quarter basis, despite a 220 basis points dip in occupancy in the portfolio during that quarter. This is a function of pricing power and rate growth, with average daily rates increasing almost 200 basis points quarter over quarter and over 500 basis points on a year-over-year basis. The results are particularly impressive considering the ongoing pandemic.

In terms of census trends within the Commonwealth portfolio, we're very encouraged by the positive sales trends over the last six weeks, with occupancy up by roughly 100 basis points since the end of the second quarter.

In summary, we're encouraged by the results of our portfolio. Rent collections continue to be strong, our team continues to work productively from home, and our liquidity is in good shape as we look at our short-term obligations.

While sentiment towards seniors housing and skilled nursing will remain challenged in the short term, our regional secondary market focus with local sharpshooters has proven to be a sound strategy over the last few months. We will continue to focus on maximizing profitability and asset value within our portfolio for the balance of the year to strengthen our high-quality portfolio of real estate with our preferred partners.

Before turning the call back to Scott Higgs to discuss our financial performance for the quarter, I do want to highlight a couple of awards Commonwealth has received over the last couple of months.

Commonwealth was certified as a Great Place to Work by the Great Place to Work Institute for the second year in a row and was also recently recognized as one of Argentum's Best of the Best for one of its innovative programs. We continue to be very excited about our relationship with the Commonwealth team and look forward to continued success.

And with that, I'll pass it to Scott.

Scott Higgs

Thank you, Scott. For the quarter ending June 30th, FFO was $0.19 per share and AFFO was $0.17 per share. Excluding the impact of COVID-19 and severance costs for the three-month period, FFO was $0.21 and AFFO was $0.19 per common share.

As we discussed in May, in the second quarter we announced a series of initiatives to strengthen our liquidity position and preserve cash. To stay ahead of the curve and maintain flexibility, we announced the suspension of the dividend to common shareholders as of April 1, 2020. The dividend suspension will result in approximately $41 million of gross cash preserved on an annual basis.

To further enhance our liquidity position, we took immediate cost-reduction measures, including the suspension of executive team cash bonuses, personnel cutbacks, and other G&A reductions. All these cost-cutting measures are anticipated to result in approximately $2.5 million to $3 million of cost savings in 2020 and we have started to see the impact in the second quarter results. And we have also curtailed and deferred nonessential capital expenditures, which will result in an additional $2.5 million to $3 million in cash savings.

We continue to analyze additional liquidity measures, including the possible sale of assets. With the refinancings completed in the first half of the year, we have dealt with the majority of our near-term current obligation. The remaining current obligations contain company-controlled extension options at no cost. Assuming we exercise our extension options, we have only 3 percent of our total debt maturing over the next 12 months.

In addition to laddering our maturities, we have been very active throughout the first half of the year in the refinancing markets. Our refinancing activity year to date has allowed us to create almost $1 million in year one cash savings through lower rates and interest-only periods.

We continue to work closely on other refinancing options throughout our debt stack that are projected to yield at least another $1 million in cash savings. We have on a consolidated basis reduced our average cost of borrowing by approximately 35 basis points since the end of 2019.

Given the uncertainty in the marketplace, I want to spend a few moments on rental revenue collections. As a percentage of gross rents due, our collections remain consistent at approximately 94 percent for the months of May, June, and July, up from our trough month in the second quarter of April at 88 percent.

Breaking this down a bit further, collections in our consolidated shop portfolio were approximately 99 percent, collections in our MOB portfolio were approximately 93 percent, and collections in our triple-net portfolio were approximately 85 percent. As of today, our August rental revenue collections remain in line with July.

Further, in the second quarter, given the pandemic and the impact in our business lines, we have increased the risk factors in our valuation models, which in turn caused a lowering in value of our investment properties and increased reserves on loans receivable.

With that, I'll pass it over to Adlai to discuss our portfolio performance for the quarter and additional details on the upcoming MOB portfolio transition to JLL.

Adlai Chester — Chief Investment Officer, Invesque Inc.

Thanks, Scott. As of March 31st, our stabilized triple-net portfolio remained consistent in terms of coverage and occupancy with previous quarters.

On a trailing 12-month basis, our EBITDAR and EBITDARM coverage ratios were 1.2 times and 1.5 times, respectively. Our trailing 12-month occupancy as of March 31st stood at 85 percent for our triple-net assets and 87 percent for our stabilized shop assets.

For the medical office portfolio, stabilized occupancy stood at 87 percent. As of June 30th, our trailing 12-month and trailing 3-month occupancy for our stabilized shop assets stood at 86 percent and 83 percent, respectively, while our medical office portfolio stabilized occupancy stood at 86 percent. While we do not have complete Q2 coverage and occupancy numbers to report for our triple-net portfolio, it is our expectation that these numbers will trend down in light of the effects of COVID on the industry and our portfolio.

As we noted last quarter, portfolio management is and continues to be a key focus for Invesque. We are excited to announce that we are in the final stages of transitioning the management of our MOB portfolio in the United States and Canada to JLL. Mohawk, JLL, and Invesque have all been working together over the last few months to ensure a smooth transition in the third quarter.

As a reminder, we entered the MOB space with Mohawk acquisition over two years ago. We have continued to grow the portfolio since the Mohawk acquisition by extending further into the US. Today, our MOB portfolio is comprised of 15 assets, representing approximately 578,000 square feet of space across Canada and the US.

As we execute on our portfolio management initiative for 2020, our main goal is to ensure that we have the right partner in place for every single property in our portfolio. As we look at the MOB portfolio, we concluded that now is the right time to bring in a larger, more institutional property manager with global reach and scale.

JLL is one of the leading property management companies in the world with over 4.6 billion square feet under management. We believe that their robust platform, global reach, and top-notch leasing services will allow us to maximize profitability going forward. The breadth of their relationships and capital markets capabilities will also provide us proprietary market cover around the transaction and financing markets in North America.

We have announced several partner transitions over the last few quarters and continue to prioritize our asset management initiative. This initiative could lead to additional partner transitions during the remainder of 2020. Two areas of focus in active discussions are with Symphony and Bridgemoor. In both cases, we are working through interim COVID-19 relief, as well as possible long-term restructurings of their current leases.

These two portfolios have been hit hard by the pandemic, which has resulted in significant decreases in occupancy and increases in operating expenses. It is still too early to tell exactly how these restructures will play out. We continue to explore all options, including a potential rent reduction, a re-tenanting of the portfolios, a sale of certain properties, or a combination of the three options. We will report back to you once we have more to share on these topics in the coming quarters.

Year to date, we have two operators with rent deferrals in place for our entire triple-net portfolio. In the case of Symphony, we granted a rent deferral of 50 percent for the month of April and 25 percent for the months of May, June, July, and August. In addition, we granted one other operator in our portfolio a rent deferral of 25 percent for the month of May. This deferral is currently being paid to us in equal monthly installments from June 2020 through May 2021.

Our pipeline on the acquisition and development front remains light as the COVID-19 pandemic continues to significantly impact the United States and our industry specifically. As mentioned last quarter, transactions that we are likely to pursue over the next few months will be limited to those that we are already under contract with, or with existing relationships and with other preferred partners.

With that, we will now open the line for questions.

Q&A

Operator

At this time, ladies and gentlemen, if you would like to ask a question, please go ahead and press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, you may press the # key. Again, that is *, then 1 to ask a question.

Your first question today comes from the line of Sriram Sheraz (phon) of BMO. Please proceed with your question.

Sriram Sheraz — BMO

Hey, guys. Good morning, and thanks for time this morning. My question's primarily around the G&A expense related to the pandemic. So I know you incurred about $930,000 in Q2. What's the broad guidance going forward? What do you expect to incur?

Scott Higgs

Thanks for that.

Scott White

Go ahead, Scott.

Scott Higgs

Yeah. So I think in terms of a run rate and in terms of quarterly savings, I think it's a pretty fair run rate what you saw in Q2 in terms of cash G&A, yep.

Sriram Sheraz

Perfect. And probably when I'm thinking about, so you know the bad debt expense that came out this quarter in terms of $1.4 million, do you expect that to kind of go up in the future? And how do you think about that?

Scott White

Yeah—

Scott Higgs

So yeah, this is Scott Higgs. So the—look, I think it's going to depend on what happens in the marketplace. And every quarter we evaluate our risk evaluation models and our collectability model. And it's facts and circumstances based on those specific situations and those points in time, so it's hard to predict exactly what's going to happen with that over the course of time, but certainly something we're very focused on.

Sriram Sheraz

Thanks, Scott. That's good colour. Thanks so much for that. That's all for me. I'll turn it back.

Operator

Your next question today comes from the line of Chris Couprie of CIBC. Please proceed with your question.

Chris Couprie — CIBC

Good morning.

Scott White

Good morning, Chris.

Chris Couprie

Hey. Just a quick question following up to the prior one. Was that bad debt expense all kind of tied to the deferrals that were granted in the quarter?

Scott Higgs

Yes.

Scott White

Higgs, you want to take it?

Chris Couprie

It was? Okay. And then just you're discussing talks that you're having with Symphony and Bridgemoor. I'm just wondering if you can give us some colour as to what's some of the thinking happening right now on that front?

Scott White

Hey. Hi, Chris. It's Scott White. With regards to both of those operators, it's consistent with the plan that we put in place at the end of last year as part of our strategic plan heading into 2020. Our goal was to look at our portfolio holistically, step back and say, hey, you've grown this portfolio now incredibly fast. Do you have all the right operators and the right facilities? Does the portfolio as a whole make sense in terms of maximizing value?

And as part of that you saw earlier in the year we made a couple of transitions of operators because we made the assessment that these might not have been the best operators for those facilities.

And that continues with our announcement today about the change in the medical office building portfolio.

Similarly, as we look at the Symphony and Bridgemoor portfolios, we're assessing if those are the right operators, if we've set them up correctly for long-term success. Our goal is to maximize the value of those assets, and we're going to look at a whole bunch of different things. It's real time. There's nothing that we've agreed to because, obviously, we would have announced that. It's a real-time discussion right now, and I think what has transpired as a result of the pandemic has really put a magnifying glass on it.

There's no doubt that the skilled nursing industry across the United States has been challenged by the pandemic and the implications of it. And that has really caused us to step back and talk to our operators and try to be good partners and figure out, A, how can we be helpful in the short term because it's in everyone's best interest that we make sure that these facilities continue to operate, they operate efficiently, and they provide the appropriate care for each of our residents and staff.

And then as you get sort of to the other side, as I like to call it, you think about how do you set these assets up for long-term success. And that's what we're doing with both the Symphony portfolio and the Bridgemoor portfolio.

Chris Couprie

I don't have the numbers in front of me, but was there any adjustment to fair value of investment properties this quarter tied to either of those two operators?

Scott White

Higgs?

Scott Higgs

So we don't really comment specifically on individual portfolios. But what I'd say to that, Chris, is again, as we look at the risk models associated with particularly what's going on with the pandemic and we look at just risks associated with cash flows and cap rates and so forth, we did adjust those this quarter, I would say, more broadly than specifically.

But as Scott mentioned, skilled nursing in particular has been challenged here and we recognize that in terms of the risk profile and our valuation model.

Chris Couprie

Got it. Understood. Then just last question for me just with respect to the Commonwealth portfolio. Can you maybe give some colour as to where the shop portfolio ended the quarter on an occupancy basis? And maybe how it's trended subsequent to quarter-end?

Scott White

Yeah. So with regards to when we talk about the Commonwealth portfolio, the shop portfolio, as we know, the Commonwealth portfolio has actually been one of the stronger performers in our portfolio. There's no doubt that they have been impacted by COVID. But what's fascinating as you watch some of your stronger operators is they've found ways to navigate it, first, in terms of expense control, second, in terms of ability to push pricing, which is somewhat fascinating as you think about the world we're in and you query the ability to be able to push the pricing.

There's no doubt that occupancy was impacted over the course of the quarter. However, we made up for it—or the Commonwealth team made up for it through pricing: some of it pricing related to COVID expenses, some of it just looking at their overall pricing strategy.

And what's interesting about that is that pre-dated COVID. As we met with the team earlier in the year and we laid out our strategic plan for the year, the Commonwealth team had a very clear plan, so a look at their pricing strategy and make sure that they were maximizing value. So specifically as it relates to the quarter—and we mentioned some of these numbers in the call—the occupancy was down a little bit; pricing was up to make up for it.

If you step back outside of the Commonwealth portfolio and look at the shop portfolio across the board, there's no doubt occupancy was impacted fairly meaningfully earlier in the quarter. Yet over the last few weeks—and I know you asked specifically about post the quarter—we have seen a considerable slowing in occupancy declines. We've seen a considerable increase in new visits to facilities. So we think it's just a matter of time, and I don't think it's a long time before we do see a return to the appropriate occupancy levels.

Chris Couprie

Thanks. I'll turn it back.

Scott White

Great. Thanks.

Operator

And I will now turn the call back to the presenters for any further remarks.

Scott White

Well, great. Thanks so much. We appreciate everyone joining us this quarter. And we wish you all a safe and healthy quarter ahead, and we look forward to talking to you next quarter. Thank you so much.

Take care. Bye-bye.

Operator

And this concludes today’s conference call. Thank you for your participation. You may now disconnect.