Invesque Inc.

Fourth Quarter 2022 Conference Call

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CORPORATE PARTICIPANTS

Scott Higgs
Invesque Inc. — Chief Financial Officer

Scott White
Invesque Inc. — Chairman and Chief Executive Officer

Adlai Chester
Invesque Inc. — Chief Investment Officer

CONFERENCE CALL PARTICIPANTS

Tal Woolley
National Bank Financial — Analyst

Frank Liu
BMO Capital Markets — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Invesque's fourth quarter 2022 conference call. Today's call is being recorded.

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. Good morning, and thank you for joining our fourth quarter 2022 conference call.

I'm joined today by Scott White, our Chairman and Chief Executive Officer, and Adlai Chester, our Chief Investment Officer.

Following our prepared remarks, we will open the line for questions.

The fourth quarter 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 March 23rd.

Please remember that today's call may include forward-looking statements regarding 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, unless otherwise specified.

I will now turn the call over to Scott White.

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

Good morning, all, and thank you for joining the call. 2022 was a transformational year for Invesque, a transformation which is ongoing in 2023, which I'm excited to talk about further during this call.

Over the course of the year, we sold 24 nonstrategic assets for more than $220 million and are well on our way to having a predominantly private-pay seniors housing-focused portfolio.

An important step in the shift to private-pay seniors housing was the sale of our medical office building portfolio.

As you may recall, we sold the majority of our medical office portfolio last summer, with one remaining Canadian asset that was separately marketed for sale. In the fourth quarter of 2022, we sold this final medical office building in Canada for approximately $6 million.

This bifurcated approach to selling the Canadian medical offices led to higher net proceeds from sale than if we had sold the entire portfolio together.

Additionally, I'm pleased to announce that we have executed an agreement to sell the MetroWest medical office building in Orlando, Florida for $6.4 million. The buyer is in the final stages of their due diligence period, and we expect the sale to occur in the next month or two.

And while we've not finalized any agreements to sell our final two medical office buildings, productive discussions are ongoing.

As of year-end, 75 percent of our properties are seniors housing assets, offering independent living, assisted living, and memory care services. The remaining 25 percent are skilled nursing facilities or medical office buildings.

This represents a drastic shift in portfolio composition compared to where we sat 24 months ago. Invesque remains focused on executing on the simplification plan, and we expect continued progress over the next few months.

On that note, I'm excited to announce that we've executed a purchase and sale agreement to sell the eight skilled nursing facilities in Illinois currently leased to SymCare, for $125 million. This transaction represents a significant portion of our remaining skilled nursing portfolio and, although subject to ongoing standard due diligence conditions, we expect to close on this sale during the second quarter of 2023.

Following completion of the sale, the Company will have only nine skilled nursing facilities remaining in the portfolio, and we anticipate that 80 percent of our company NOI will be generated from seniors housing investments.

Switching gears to touch on financial performance in 2022. We continue to be pleased with our SHOP portfolio performance, especially the Commonwealth Senior Living portfolio that we acquired in 2019.

As you likely recall, Commonwealth is a regional operator in the mid-Atlantic, currently managing 36 communities, 28 of which are owned by Invesque. Commonwealth successfully rebounded to pre-pandemic occupancy levels in the second half 2022 and gained more than 600 basis points occupancy from the first quarter to the fourth quarter.

The Company continues to be successful in growing resident rental rates to offset continued expense pressure seen in labour, utilities, and food costs. We're also optimistic about progress made on the hiring and retention front at Commonwealth central offices and the 36 managed communities, and we're looking forward to continued improvements in 2023.

Many of our other seniors housing partners are seeing similar trends, and I continue to be optimistic about the growing demand for our industry in the coming years, and the opportunities that demand will create for investors in this space.

Before I turn the call over to Scott, I'd like to highlight that for the fourth year in a row, Invesque has been named one of the Best Places to Work in Indiana. When we created this company seven years ago, it was crucial to the management team that we created an environment with a strong culture, shared values, and where people truly wanted to work.

I remain extremely proud of the culture we have created and am happy that Invesque continues to be recognized for these efforts.

With that, I'll turn the call back to Scott to touch on our financial results.

Scott Higgs

Thank you, Scott. For the three months ending December 31st, FFO was $0.12 per share and AFFO was $0.10 per share. And for fiscal year 2022, FFO was $0.42 per share and AFFO was $0.39 per share.

From a finance perspective, 2022 was about delevering and de-risking our balance sheet. Through asset sales and organic cash flow, our team has strategically allocated cash to repay debt and streamline our capital stack.

For the year ended 2022, we repaid $133 million in consolidated indebtedness and $53 million in JV indebtedness.

Over the past eight quarters, the Company's leverage has been reduced by approximately 450 basis points. Additionally, in 2022, we utilized available funds to retire approximately $10 million of the preferred equity that encumbers the Commonwealth Senior Living portfolio.

Consistent with the strategy that we have previously disclosed, we continue to retire both common equity and convertible debentures through our normal course issuer bid. This initiative continues to be among our best uses of capital.

Since the inception of our normal course issuer bid through December 31, 2022, we've retired nearly 588,000 common equity shares at an average price of $1.69 per share and 1,660,000 convertible debenture units averaging 81 percent of face value.

Looking ahead to 2023, our finance team will continue to implement the delevering and de-risking strategy as we continue to pay down debt, address near-term maturities, and manage the escalating interest rate environment.

Our team prides itself on maintaining a number of close and mutually beneficial relationships with our industry financing sources. As we emerge from the pandemic, a number of lenders have reached out looking for new owners and operators for assets within their portfolio.

We view this as an opportunity to utilize our banking and operational relationships to create shareholder value. Assuming the opportunity is in the right market and fits our go-forward senior housing strategy, we may look to acquire ownership with limited equity out of pocket, bringing in a preferred equity partner to turn around and stabilize operations.

On December 5, 2022, we acquired a loan encumbering a 43-bed memory care facility located in Carrollton, Texas. Subsequent to year-end, we have entered into an agreement to acquire the property and lease the community to Constant Care Management Company, one of our preferred operating partners focused on memory care.

We're very excited about this opportunity and look forward to working with Constant Care on this project.

I will now turn things over to Adlai Chester, our Chief Investment Officer.

Adlai Chester — Chief Investment Officer, Invesque Inc.

Thank you, Scott. Our stabilized portfolio EBITDARM coverage remained just under 1.0 times for the period ended September 30, 2022.

As of September 30th, the trailing 12-month occupancy for the stabilized triple-net assets and stabilized SHOP portfolio was 77 percent and 78 percent, respectively.

As noted for the last two quarters, we will not be providing financial metrics on the three remaining medical office assets, as they are designated as held for sale and make up a very small portion of our portfolio going forward.

As Scott touched on, we saw positive trends from our Commonwealth and other SHOP operators throughout 2022. Many of our assets have bounced back to pre-pandemic occupancy levels, and a number of assets in our portfolio have even hit 100 percent occupancy, an impressive feat in our industry.

According to the National Investment Center, or NIC, industry-wide senior housing occupancy reached 82 percent in the fourth quarter, about 5 percentage points below the occupancy level prior to the pandemic. As of December, our SHOP portfolio achieved 81 percent occupancy.

While that marginally trails the industry, it is actually 1 percentage point higher than the portfolio's occupancy back in February 2020.

The pace of occupancy recovery in 2022 was encouraging, but we have observed data that would suggest industry-wide occupancy declined slightly in the first quarter.

Despite the broader trend, we expect our SHOP portfolio will post another modest occupancy gain.

Most of our senior housing operators increased residence rates by an additional 5 percent to 10 percent this year, continuing a trend of larger-than-normal increases over the last 24 months. These increases have been met with minimal resistance from resident families, which highlights the critical value of services that our operating partners provide.

The combination of improved occupancy and rate growth have helped drive net operating income closer to pre-pandemic levels. We don’t see that as the endgame, though.

When we acquired the Commonwealth portfolio and brought the communities formerly operated by Greenfield under the Commonwealth umbrella, we believed there would be considerable growth in net operating income. Our expectation is that net operating income will continue to grow in 2023.

Next, I’d like to provide some additional commentary about the sales transactions that we expect to accomplish over the next several months.

The sale of the SymCare portfolio represents a substantial accomplishment for becoming a predominantly private-pay senior housing owner. Recall that we consummated a restructuring transaction with SymCare in 2021, in which we sold four properties and re-tenanted another four before amending and restating our master lease with SymCare.

After this transaction was complete, we expected the fundamentals of skilled nursing operations to rebound similar to our senior housing investments. Data from NIC and the Centers for Medicare & Medicaid Services show that the recovery in occupancy is about half that of seniors housing.

Additionally, the growth in Medicare and Medicaid rates have been substantially below the pace of inflation. Skilled nursing operators face real challenges from not being able to directly pass along their increased costs to residents and patient families the way that senior housing operators can.

These factors, in addition to the substantial expense pressures, like those we've observed on senior housing, led to the closure of 135 skilled nursing facilities in 2022.

Additionally, other large owners and operators of skilled nursing facilities are seeing ongoing lease restructurings to account for the delay in recovery. This all set a tough backdrop that ultimately continued to push us towards exiting our skilled nursing assets.

In spite of the challenges to operating fundamentals that I just described, we've been surprised to see asset prices on a per bed or per unit basis have not dropped. According to NIC data, average prices have remained fairly consistent for the past 10 years.

Our sale of the SymCare portfolio represents a price per bed of $72,000, which we think compares favourably to similar transactions in Illinois at $65,000 per bed and in line with the national average of around $80,000 per bed.

Similar to several of the transactions that we accomplished in 2022, we spoke to our network of friends in the industry to identify an efficient and appropriately priced transaction. As Scott highlighted, this will be a transformational deal for Invesque.

Finally, I'd like to comment on our remaining medical office portfolio sales. Last year, we were successful in transacting the sale of the first 10 properties with logical groups with whom we were familiar with. But that's not our only strategy to maximize value in a sales transaction.

The sale of MetroWest was part of a competitive process that involved a long list of buyers that specialize in off-campus medical office buildings.

We are conducting a similar competitive process with an advisor to identify the best value for the remaining Upstate New York properties. The trade-off with this approach is that a broad competitive process can take longer, but we think it is the right approach in these two situations to maximize the value of the remaining properties.

That concludes our prepared remarks for today's call. Operator, please open the lines for questions.

Q&A

Operator

Thank you. If you would like to ask a question, please signal by pressing *, 1 on your telephone keypad.

If you're joining us today using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. And that is the * key, followed by the digit 1. We'll pause for a moment.

We do have your first caller in the queue. We'll hear from Tal Woolley from National Bank Financial. Please go ahead.

Tal Woolley — National Bank Financial

Hey. Good morning, guys. How are you doing?

Scott White

Good morning, Tal. How are you?

Scott Higgs

Good morning.

Tal Woolley

Good. Just with the proposed SymCare sale, can we just get a little bit of colour about how much secured debt there is outstanding against those assets?

Scott White

So those assets are on our line of credit. So as a result—

Tal Woolley

Okay.

Scott White

—substantially all of the proceeds from the sale will go to pay down the line.

Tal Woolley

Perfect. All right. And then in the context of because I think you still have some money out lent to SymCare, do you expect to receive the full proceeds back from that now with the sale process ongoing?

Scott White

So as part of the sales process, we're still in discussions and negotiations with the various parties at the table and we're not in a position to announce any of that yet.

Tal Woolley

Okay. And I guess just with a lot of refinancing work to do over the next stretch here, I guess, let's talk about two things. Just where you see cost of debt ultimately landing when you get past refinancing the credit facility and the debentures? And then like what's sort of the ideal mix on the liability side between credit facilities, secured debt, and other unsecured options?

Scott Higgs

Yeah. Thanks, Tal. With respect to the first question, it's hard to give you a specific number on cost of debt as we're still in the midst of negotiations. What I would say on each of the upcoming maturities and where they're going to land, I would expect that they're going to tick up some.

Certainly, there's some volatility even as recently as the last week on what's happening there. But there are decisions to be made in terms of tenor of term and that impacts rate and so on and so forth. Right?

So I do expect it to tick up. What I would say there is we've certainly been forecasting for that in our modelling and projections going forward, so it's not going to be unexpected. But from a run rate perspective, not in a position to give you a specific number, but do expect it to tick up.

In terms of the mix, somewhat agnostic, really, in terms of that. I think we're looking for the best fit for certain portfolios and how it works together with the assets that underlie them in terms of secured versus unsecured, and it all just sort of works together in that way.

Tal Woolley

Right. And then just lastly on the operating side. One of the things that we've been trying to get a better picture of going forward is just the labour expense rates and how to better manage them as occupancy rises across the seniors housing portfolio.

How are you sort of feeling about the outlook for that? Are you able to get the number of bodies you need? And how are you feeling about just wage rate outlook overall?

Scott White

Yes. Tal, I would say that that has been an issue and topic in our industry for at least the last decade that I've been around the industry. So it's not a new topic.

What’s fascinating now is that it’s kind of front and centre because it’s a broad global or a broad macro topic.

Tal Woolley

Yeah.

Scott White

Our industry has long struggled with labour retention and attraction, cost of labour. And there’s no doubt what’s going on particularly in the US economy as it relates to unemployment has made it very challenging.

I would say that our best look into that is through the lens of Commonwealth, and Commonwealth has filled a number, first, of senior positions, which is helpful to us. Two, it’s their belief that while it’s going to continue to be challenging, it does appear to be stabilizing. The last two quarters of last year were incredibly difficult, both in terms of attraction and retention, and pay raises, and so on and so forth.

I would say that we’re still challenged, but not growing in terms of the rate of wage growth, or the ongoing challenges to the extreme of retaining people.

Tal Woolley

Okay. That’s helpful. Thanks a lot.

Scott White

Thanks so much, Tal.

Scott Higgs

Thanks, Tal.

Scott White

Have a great day.

Operator

As a reminder, ladies and gentlemen, it is the * key, followed by the digit 1 if you have a question or comment.

We'll hear next from Frank Liu from BMO Capital.

Frank Liu — BMO Capital Markets

Good morning, and thanks for taking my questions. Just want to touch base on the—

Scott White

Good morning, Frank.

Frank Liu

—hey, good morning—just want to touch base on the skilled nursing facilities under contract. Could you comment on the purchase profile? And are they interested in the remaining facilities under your portfolio?

Scott White

So this is specific to this transaction. So I think your question is what about the other nine skilled nursing assets that you talked about? Or would this potential buyer be interested? Maybe, maybe not. It's not something we're discussing right now.

We are laser focused on this transaction and this transaction only. And once this one closes, we'll then move on to the next one.

Frank Liu

Got it. Okay. And also want to follow up on the SHOP portfolio side of things. What's your estimate expectation in terms of the SPNOI growth in 2023? I guess you will see some occupancy gain throughout the year, but the margin pressures to persist. Right?

Scott White

In terms of the margin growth or in terms of NOI growth, is that the question?

Frank Liu

I mean, in terms of the SHOP portfolio looking towards 2023, I mean, you will see some occupancy growth and then—but margin pressures still persist? So I guess like you will see some moderate SPNOI growth overall?

Scott White

Got it. Yeah. So look, I think it is safe to assume that we expect small, but we do expect occupancy growth. And as mentioned, I think, by Adlai in his comments, we have seen a push through of fairly sizable rent growth.

There's no doubt the expense side is growing as well. But I think that we're going to be able to maintain macro margins. So I do think that there's a—we do anticipate NOI growth.

Frank Liu

Got it. Thanks for the colour. I'll turn it back.

Scott White

Thank you so much.

Operator

With no additional callers in the queue, that will conclude today's teleconference. We do thank you all for your participation. You may now disconnect.