Invesque Inc.

Fourth Quarter 2021 and Year-End 2021 Conference Call

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Invesque's Fourth Quarter 2021 and Year-End 2021 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 and good morning, everyone. Thanks for joining the call.

With me on the call today are Scott White, our Chairman and Chief Executive Officer, and Adlai Chester, our Chief Investment Officer.

Scott will kick things off with a summary of investment disposition activity in 2021, as well as a brief COVID and operations update. I will then dig into our financial results for the fourth quarter and full year, and Adlai will wrap things up with some colour on portfolio trends and acquisition and disposition activity. We will then open the line for questions.

The fourth quarter 2021 earnings release, financial statements, and MD&A are available on our website, and a replay of this call will be available from 12:45 Eastern Time today until 11:59 p.m. Eastern Time on March 17th.

As always, 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 will turn the call over to Scott.

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

Good morning and thank you all for joining our fourth quarter 2021 earnings call. It's hard to believe that it's already March and over four months since our last call. Our team had a very busy end to 2021 and has been working tirelessly over the last couple of months to position our portfolio for future success.

I plan to briefly remind you all of our 2021 disposition activity, as well as highlight an add-on acquisition that we completed with one of our preferred operating partners earlier this year, and then to provide a real-time update on COVID-19 within the portfolio and highlight some recent operating trends from our SHOP portfolio.

2021 was a record disposition year for Invesque. We sold more than $210 million worth of assets over the course of the year, with an almost half of that occurring in the fourth quarter. As previously announced, in October, we sold five small, noncore assisted living communities in Pennsylvania, previously managed by Saber Healthcare, netting approximately $2.7 million in proceeds. Additionally, in late October, we sold the vacant property in Richmond, Virginia, netting Invesque $3.4 million in cash proceeds.

Subsequent to our earnings release in November, we sold a five-property portfolio to The Ensign Group for $93 million. The sale included a four-property skilled nursing portfolio with 436 beds, that was previously operated under triple-net leases by Ensign, and a 144-bed assisted living community previously operated under a triple-net lease by The Pennant Group. The assets were located in California, Kansas, and Arizona, and were owned in a joint venture. The sale provided the joint venture with approximately $22 million of net proceeds, following the repayment of outstanding debt and transaction costs.

Although we’re sad to lose Ensign and Pennant as operating partners, given their strong track records, we’re pleased that we were able to quickly execute this sale at very attractive pricing.

Earlier this month, when we sold an assisted living and memory care community in Harrisburg, Pennsylvania to a regional operator in the Northeast, it was looking to grow their assisted living platform. This community was previously managed by our wholly-owned operator, Commonwealth Senior Living, and after much consideration, it was determined that the asset could be better suited for a group that is more local to the Harrisburg market.

Although the majority of the sale proceeds were used to pay down debt, this sale represents another example of our team’s ability to dispose of assets that do not fit our operating partners’ long-term strategies. I’m pleased by the level of disposition activity in 2021, and I expect us to continue to dispose of noncore assets.

As I have mentioned in the past, our strategic focus right now is to simplify our portfolio and our capital structure. We continue to identify noncore assets and look to sell at appropriate pricing. To be clear, we’re not looking to exit assets at pricing we don’t believe properly reflects the value of those assets.

Turning from dispositions to acquisitions, on February 1st, we closed on the purchase of a stand-alone memory care community in Wyoming, Michigan that was added to our existing master lease with Constant Care. Adlai will provide further details on this transaction later in the call, but it’s important for me to highlight that we’ll continue to grow our portfolio with our core operating partners in markets that have viable long-term potential.

While I highlighted a strategic focus on dispositions, it’s important to note that we will continue to grow as well. Our overall strategic direction is to continue to simplify our portfolio and our capital structure.

I'll now turn to COVID-19, which has been a topic on our earnings call for over two years. Following an increase in positive COVID-19 cases in December and January, as the Omicron variant spread rapidly through the US, we are currently seeing very low levels of positive cases within the portfolio. For the most part, associates and residents that are vaccinated but test positive see minimal or no symptoms.

The largest impact we continued to see from the virus in the fourth quarter relates to staffing and the requirements for positive staff members to be out of work for a handful of days, further impacting staffing challenges that are more prevalent than ever.

We've begun to see this trend slow in the early part of 2022, and we're cautiously optimistic that it will continue throughout the remainder of the year. I'm proud of, and grateful for, our operating partners' dedication to keeping residents and staff safe and healthy, and I'm hopeful we continue to see the impact of the virus minimized as we move forward through 2022.

The team at Commonwealth continues to rebuild census following 2020 and 2021, where occupancy and overall financial profitability were significantly impacted by COVID-19. Following trough census in the first quarter of 2021, Commonwealth saw a strong move-in numbers during the second half of the year.

The core 20-asset portfolio that Invesque owns, operated by Commonwealth, saw a 110-basis-point increase in occupancy in Q4 as compared to Q3, and current occupancy as of March 4th is an additional 50 basis points higher than Q4 2021. We're proud of the Commonwealth team's resilience and look forward to further positive momentum in the coming months.

As I touched on briefly last quarter, and you have likely heard from our peers over the last few weeks, staffing continues to be the number-one challenge our industry is facing. Despite the continued occupancy gains in most of our SHOP portfolio assets, agency staffing costs in the fourth quarter of 2021 were higher than we have ever seen. Our operating partners are getting creative and trying many initiatives to combat the staffing crisis. We know this issue is likely a challenge that will be in place for the foreseeable future.

I think it’s important to note that most of our seniors housing operators did increase residential rental rates in 2022 at a higher percentage than what has been done historically, in order to offset some or all of the increases in staffing costs that are being seen. And we continue to evaluate whether or not those increases were sufficient, or additional increases will be needed later this year.

Overall, I’m extremely proud of our team and what we accomplished last year. It wasn’t an easy year for the industry or our company. We’re a relatively small team, and it was a true team effort to accomplish what we did in 2021.

I also have to highlight that we were recently named as one of the Best Places to Work in Indiana for the third year in a row. I look forward to celebrating this success with the team soon.

With that, I’ll hand it over to Scott to touch on some of our financial metrics.

Scott Higgs

For the quarter ending December 31, FFO was $0.11 per share, and AFFO was $0.09 per share. And for 2021, FFO was $0.47 per share, and AFFO was $0.44 per share.

On November 15, 2021, the Company announced an amendment and partial redemption of $20 million of the 2022 convertible debentures. In January of 2022, we completed the redemption by repaying $20 million of the outstanding principal, plus all accrued and unpaid interest.

The remaining outstanding 2022 debentures were amended to change the interest rate to 7 percent, effective January 31, 2022, and extend the maturity date of the remaining outstanding 2022 convertible debentures to January 31, 2025. This amendment and extension provide the Company more financial flexibility as we work with our operating partners to come out of the pandemic stronger than ever. It also provides our debenture holders with what we feel is an attractive investment opportunity.

On December 20, 2021, the Company announced that the Toronto Stock Exchange approved its notice of intention to make a normal course issuer bid for a portion of its common shares and a portion of its 6 percent convertible unsecured subordinated debentures, due September 30, 2023, as appropriate opportunities arise from time to time. Any normal course issuer bid will be made in accordance with the rules of the Toronto Stock Exchange. Purchases under both programs began in January 2022, and we continue to believe that this nominal use of capital is of great inherent value to the Company and its stakeholders.

At the end of the year, the finance team successfully extended the maturity of the Company's $200 million revolving credit facility, led by KeyBank, by one year. The credit facility is now due in December 2023, which is coterminous with the corresponding KeyBank term loan.

Additionally, this amendment also permanently reduced the Company's fixed charge coverage ratio covenant from 1.6 times to 1.5 times. This change provides additional cushion and resizes the covenant to more appropriately correlate to the composition of our portfolio.

Our team was intensely focused on delevering throughout 2021, and I'm happy to report that we reduced overall company leverage by more than 300 basis points, ending the year at approximately 57 percent. We were able to accomplish this goal by strategically disposing of noncore assets, as well as utilizing organic cash flow generated by the portfolio. Again, this is consistent with our strategy, as Scott just highlighted.

This initiative has further solidified our balance sheet, puts us more in line with target leverage levels, and lowers our monthly carrying costs.

As of December 31st, there are approximately 6 percent of our total debt maturing over the next 12 months. However, as we sit today, that number is 1.5 percent because of the work we've done earlier this year to refinance and extend pending maturities.

Our finance team will continue to look for opportunities to maximize value and streamline our capital stack. In fact, in February, we were able to utilize capacity on our corporate credit facility to refinance the three-property Commonwealth portfolio, which will save us over $700,000 in annual debt service payment.

Further, in January, we redeemed $10 million of the preferred equity that encumbers our Commonwealth portfolio. This move further reduces our portfolio carried and fixed charges by $650,000 per year. Throughout 2022, we will leave no stone unturned when it comes to ways to strengthen and streamline our capital structure.

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

Adlai Chester — Chief Investment Officer, Invesque Inc.

Thanks, Scott. As a reminder, we report the operating metrics of our triple-net lease portfolio a quarter in arrears due to the timing of receipt of operator financial statements.

Our triple-net portfolio continues to struggle as operators work to rebuild census, as well as deal with increased operating costs, specifically on the labour side of things. As a result, our stabilized portfolio's EBITDARM coverage performed slightly below 1.0 times for the period ended September 30, 2021. As of September 30th, our trailing 12-month occupancy for the stabilized triple-net assets and stabilized SHOP portfolio was 75 percent and 76 percent respectively, while our medical office portfolio's stabilized occupancy stood at 81 percent.

In addition to occupancy, it is important to highlight that our SHOP operators have been successful in increasing resident rental rates over the last 18 months. For the 12-month period ended September 30, 2021, the average monthly rate paid by residents in our stabilized SHOP portfolio was up 4.2 percent versus the period ended September 30, 2020.

We expect to see this rate increase trend continue as our operators, along with the majority of senior housing providers in the industry, raise rates in 2022 at a higher percentage than historical norms. Most of our partners have implemented rate increases in the 5 percent-to-10 percent range for 2022 to help offset significant increases in operating expenses.

As Scott noted earlier in the call, we disposed of over $200 million in assets in 2021, with roughly $100 million of that activity occurring in the fourth quarter. This portfolio pruning process will likely continue in 2022 as we look to further optimize our portfolio with a go-forward focus on assets and operators that are a strategic fit for Invesque.

The sale to Ensign that was announced in November was a competitive process that resulted in favourable pricing for a portfolio with a majority skilled-nursing assets. The team at Ensign was familiar with all assets acquired, given their ongoing operation of four of the five properties, and closed quickly and efficiently. With the closing of the sale, we closed out our relationship with Ensign and Pennant, and we wish both of them continued success in the future.

As Scott touched on, earlier this month, we closed on the sale of a Harrisburg, Pennsylvania assisted living and memory care community to a Northeast operator that is expanding their operating platform into Pennsylvania. The community was managed by Commonwealth Senior Living prior to the sale and was one of only two assets in Pennsylvania managed by Commonwealth. Despite a conversion of the lower level of the community to memory care last year, the property continued to struggle financially and was ultimately determined to be nonstrategic for Invesque and Commonwealth.

I'm really pleased to announce that we acquired another stand-alone memory care community with Constant Care in February. The community in Wyoming, Michigan, part of the Grand Rapids MSA, was bought for approximately $12.5 million. Chad Anderson and his team at Constant Care have done a great job building their platform and are one of the best memory care operators in the country.

We now have a portfolio of nine assets with Constant Care and, as part of the Michigan acquisition, we consolidated all properties into a single master lease with a 15-year term and two 5-year renewal options. We look forward to working with the Constant Care team for the long haul and will likely look to grow this relationship further, if good opportunities present themselves.

As we have stated in the past, we focus on structuring our triple-net portfolio in master lease structures to provide greater cash flow protection. And today, over 93 percent of our triple-net portfolio rent is in cross-collateralized, master lease structures with the respective tenants.

As we highlighted last quarter, our strategic reposition has shifted the balance of our portfolio to be predominantly private pay, with nearly 60 percent of our pro forma NOI coming from senior housing, versus over 75 percent of our NOI coming from skilled nursing just over five years ago. Further increasing exposure to private pay assets will likely occur in the next 12 to 24 months as we continue our focus on asset management and portfolio optimization.

During our call last quarter, I provided an update with respect to the tremendous amount of capital deployed by companies in our space. The transaction market for senior housing and skilled nursing remains robust, which helped us to accomplish our dispositions over the course of 2021. Year to date in

2022, a greater emphasis has been placed on investors restructuring relationships with triple-net tenants in senior housing and skilled nursing.

There are several contributing factors driving these restructurings which generally relate to COVID-19. New variants have been disruptive to staffing, resulting in increased costs, and have slowed move-ins. State-mandated operating restrictions have also constrained available beds. We also believe that additional US government relief is unlikely. These are all factors that impact our portfolio, just like our other triple-net portfolios in our industry.

However, year to date, we have continued to receive timely payments from our operating partners with no disruptions. We remain in constant dialogue with our SHOP and triple-net operating partners to understand the industry's recovery and how we can contribute to reaching and exceeding pre-pandemic performance.

With that, I would like to thank everyone for joining the call. And, Operator, please open the line for questions.

Q&A

Operator

Yes, sir. Thank you. And if you would like to ask a question, please signal by pressing *, 1 on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that is *, 1 if you would like to ask a question. And we'll pause for just a moment. And once again, that is *, 1 if you would like to ask a question.

And we'll take our first question from Joanne Chen with BMO Capital Markets.

Joanne Chen — BMO Capital Markets

Hey. Good morning.

Scott White

Good morning, Joanne. How are you?

Joanne Chen

Congrats on a very, very busy year. I'm sure you guys have been working very hard on—

Scott White

Thank you.

Joanne Chen

—with all the capital recycling. But just wondering, how much more opportunities, I guess, within your portfolio do you see? I guess, should we think about, for 2022, in terms of more dispositions? And how would you recycle that capital? I know you guys have done a great job with improving the balance sheet but, kind of just, I guess, the deployment, perhaps acquisition opportunities that you're seeing now that look interesting?

Scott White

Yeah. So let me—I'll take that as two parts; one, in terms of what you'd expect going forward. I don't want to draw a line in the sand or give a number of what to expect in terms of dispositions. But we had a robust year in 2021; I had said over $200 million in dispositions, more than half coming in Q4. And if you see the trajectory of beginning of 2021 versus end of 2021, you see a ramp-up in dispositions toward the end of the year, and I think it is reasonable to expect that we will continue to announce additional dispositions of noncore assets.

Again, I want to emphasize we're focusing on—we're not selling off the entire portfolio, nor are we selling off at valuations below what we think is reasonable and fair and our expectations. So we're not in a hurry to dispose. What we're doing is we're trying to be really smart and say, where do we want to grow, who are those operators, what are the right opportunities, and streamline instead of having such a broad and diverse portfolio.

In terms of recycling of the capital—

Joanne Chen

Right.

Scott White

—and what we're going to do with it, we think about every dollar as a fiduciary for our investors and every dollar, for that matter, every penny is vitally important. We just look at what is the highest and best use of that dollar. Do we see acquisition opportunities? We do, but we're being very selective. As we announced, we did an acquisition with Constant Care because they're one of our core operators that we'd like to continue to grow with. And I think you should expect to see more of that.

We also talked about it—

Joanne Chen

Got it.

Scott White

—and Higgs spoke about this, how much we delevered during 2021, and I think you should continue to see that activity. As I said, two primary areas of focus is simplifying our story, i.e. our portfolio, and simplifying our balance sheet.

Joanne Chen

Got it. No. That's helpful. And I guess you did mention, I guess, is that the whole industry is, on the staffing front, some challenges. So how should we be thinking about, I guess, margins in 2022, given that impact? I mean I know you guys are getting—with the reopening, you're getting the top-line growth, but just how should we think about that?

Scott White

Yes. I'd say there's a couple of things there, and I'll strictly address margin. First, we are seeing occupancy increases. So you're right. Top-line growth, in terms of—

Joanne Chen

Mm-hmm.

Scott White

—the occupancy driver, is positive. It's slow. It's not month-over-month massive increases. But it's certainly trending in the right direction. Each month is getting better, and I expect that to continue throughout the year.

I think the most important response to your question, and it's an important one, is we'll continue to drive top-line growth. And when I say we, I talk one, Commonwealth, our wholly owned operating subsidiary and, two, our operating partners, by increasing rental rates for the underlying tenants. And that's really important—the residents, I should say.

There's been a fairly sizable increase in year-over-year rental rates because the market understands that labour is such an issue, and the only way to make this a long-term, sustainable, viable business model and to preserve the margins—which is what you specifically asked about, Joanne—is to—

Joanne Chen

Mm-hmm.

Scott White

—make sure that your rent increases are commensurate with, or greater than, the increases in labour costs.

Joanne Chen

For sure. Okay. No. That's super helpful. And maybe just one last quick one for me. I guess, by market, where are you seeing the quickest—I guess in terms of the recovery—the markets of strength for you guys right now within your portfolios?

Scott White

Yeah. It really isn't specific to a market. It would be hard to say geographically—

Joanne Chen

Okay.

Scott White

—one part of the country is coming back faster, or one particular type of asset is coming back faster, really is asset-specific. It really is—even within geographic locales, you see some facilities increasing occupancy faster than others.

I think, as a general proposition, we're probably seeing the seniors housing side of the equation come back faster than the skilled nursing side of the equation. But if—

Joanne Chen

Got it.

Scott White

—if your question was more specific to geography, I think that's very hard.

Joanne Chen

No. Okay. That's fair. That's fair. Okay. No. That's it for me. Thank you very much. It's been very helpful. I will turn it back.

Scott White

Wonderful. Thank you so much, Joanne.

Operator

We'll now take our next question from Tal Woolley with National Bank Financial.

Tal Woolley — National Bank Financial

Hi. Good morning.

Scott White

Good morning.

Tal Woolley

Just wondering, how big is the—or sorry—what's the dollar volume of assets in the triple-net skilled nursing portfolio that you still own?

Scott White

That's a good question. Adlai or Higgs, do you happen to know that off the top of your head in terms of dollars? You're asking asset value? Or are you asking—

Tal Woolley

Yeah. Asset value.

Scott White

—percent NOI?

Tal Woolley

Yeah.

Scott White

Asset value of our skilled triple-net lease portfolio, it shrunk considerably. I don't know that off the top of my head. I don't know if, Adlai or Higgs, you do? If not we'll have to follow up with you, Tal.

Tal Woolley

Okay. And then, I guess, as we liberate proceeds—and just going back to the question that Joanne was asking—obviously, you want to simplify the balance sheet. I'm just wondering, like obviously, the easiest thing to do is like you've got credit facilities. You can put money against there. You're going to pay off mortgages as you—or secured financing against the assets as you sell them. How are you thinking about the prefs? Because that's some of the costliest stuff in your portfolio, and I'm just wondering—refinancing or buying back some of that stuff would certainly be very impactful, I would say, for the—

Scott White

Yes. No doubt, Tal. I think that's a great question because it actually gives me a chance to highlight. I said simplify the balance sheet. Well, you're peeling back another layer of the onion: what do you mean by simplifying the balance sheet?

When you look at our balance sheet, we have various tranches of debt. You mentioned the mortgages. We have corporate-level debt, we have the publicly traded debt, and then we do have two tranches of prefs. So when you look at two tranches of pref, two publicly traded converts, mortgages, corporate level, there's a fair number. We're very proud, quite frankly, of our ability to grow so quickly, in part because of the creativity that we had with structuring transactions, and because of the creativity we had with financing transactions. Now we're really focused on trying to simplify and, specifically now, to answer the question directly, we are focused on reducing those pref balances. And we've already paid down one of them by about $10 million. And you should expect to see recycling of—I shouldn't say recycling—redeployment of capital as we sell off assets, going in part to pay down those pref balances.

Tal Woolley

Okay. And you're like free to—like obviously, I recognize those are sort of, kind of bespoken instruments, and so you're free to pay off those at any time? It's just a negotiated process with the holders?

Scott White

Each tranche is slightly different. So I don't want—

Tal Woolley

Yeah.

Scott White

—to just make a blanket tranche that we can pay them all off. We've had regular dialogues with our holders, and I can tell you I am comfortable saying that we certainly want to pay them off. It will not be difficult, at least as of today. Anything could change tomorrow but, as of today, I'm confident that they are—we're able to pay those off.

Tal Woolley

Okay. And then, I guess I just—I'd like to maybe just walk back. In June—you guys have provided some AFFO guidance for this year and next. And I'm assuming that, given the volume of dispositions and stuff like that, that those benchmarks are not really in play anymore. And then I'm also just wondering, though, too, like given where you sort of were sitting in June, you were looking for $0.53 to $0.55. You end up reporting $0.44. You're sort of annualizing in the high $0.30s right now. Can you just sort of bridge to me, like what were the big blocks of things that happened there, that kind of brought the numbers where they were from what you were expecting in June?

Scott White

So I'm glad you brought that up. I think it's important that we do highlight that. I think the biggest change, and the biggest reason why those numbers are really not relevant today, and I'd say we're not focused on them, is because of the dispositions. When we sold $210 million in assets, that was a run rate based on the assets in place at that time. And the significant—when you think about it as a percent of our portfolio—sale of assets, both in terms of what's been sold and, as I've been clear about in terms of our 2022 strategy, continued asset sales, I think it's going to—those numbers were based on, at that time, fixed portfolio.

Tal Woolley

Yeah. Okay. And then you'd made reference to, you're continuing to consolidate individual asset leases under master leases with a single operator. As you're doing that right now, how are you thinking about price—like the growth terms in those leases, given the stress that's kind of in the system right now, and everything that's going on? This has often been—the growth terms in those leases have often kind of been the same, just kind of—or at least in my opinion, have kind of made or broken those leases over time. And so when you look at this Constant Care, or the Michigan memory care asset that you're purchasing or consolidating, what sort of growth terms are you pricing into master leases right now?

Scott White

So it's certainly going to vary by operator. I'd say, and we've historically said this, plus or minus 2 percent is a reasonable expectation. I hate to give that as a blanket statement because not everyone is like that.

I think the other thing that's important to note is that the—first of all, as it relates specifically to skilled nursing, so not just triple-net leases—you have seen that part of our portfolio has shrunken. You already asked the question at the beginning, how much of that is left. So the portion of our growth driven by triple-net leases, specifically on the skilled side, continues to shrink, and I think we should expect to see that over time and, thus, less of an ultimate contributor to our annualized performance.

Tal Woolley

Okay. So if we're still thinking, going forward, that those leases kind of will continue to hold, sort of—

Scott White

Yep.

Tal Woolley

—in the neighbourhood of 2 percent, that's a reasonable assumption, then?

Scott White

I think it is. But I think what's—I want to emphasize, just to bifurcate and be clear—we're seeing substantially higher increases as it relates to the individual residents underlying the seniors housing portfolio. So 2 percent—

Tal Woolley

Right.

Scott White

—would not be the right benchmark to think about for that. In fact, it's—I think Adlai had mentioned, across the industry, we're seeing numbers, 8 percent, 9 percent, 10 percent, and I expect that to be a reasonable increase over the next 12 months.

Tal Woolley

Okay. That’s great. Thanks very much, everyone.

Scott White

Thank you so much, Tal.

Operator

And that does conclude our question-and-answer session, as well as the presentation for today.

We’d like to thank you all for your participation. You may now disconnect.