Invesque Inc.

Third Quarter Results Conference Call

Event Date/Time: November 11, 2021 — 10:00 a.m. E.T.

Length: 30 minutes

"While Cision has used commercially reasonable efforts to produce this transcript, it does not represent or warrant that this transcript is error-free. Cision will not be responsible for any direct, indirect, incidental, special, consequential, loss of profits or other damages or liabilities which may arise out of or result from any use made of this transcript or any error contained therein."

« Bien que Cision ait fait des efforts commercialement raisonnables afin de produire cette transcription, la société ne peut affirmer ou garantir qu'elle ne contient aucune erreur. Cision ne peut être tenue responsable pour toute perte de profits ou autres dommage ou responsabilité causé par ou découlant directement, indirectement, accessoirement ou spécialement de toute erreur liée à l'utilisation de ce texte ou à toute erreur qu'il contiendrait. »

CORPORATE PARTICIPANTS

Scott Higgs
Invesque Inc. — Chief Financial Officer

Scott White
Invesque Inc. — Chairman and Chief Executive Officer

Adlai Chester
Invesque Inc. — Director and Chief Investment Officer

Bryan Hickman
Invesque Inc. — Senior Vice President, Investments

CONFERENCE CALL PARTICIPANTS

Joanne Chen
BMO Capital Markets — Analyst

Tal Woolley
National Bank Financial — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Invesque's third quarter 2021 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 and good morning, everyone. Thanks for joining the call. With me here today are Scott White, our Chairman and Chief Executive Officer, and Adlai Chester, our Chief Investment Officer. I will first hand things over to Scott to provide a brief industry update and walk through some of our highlights from the quarter. I will then discuss our third quarter financial results and Adlai will close things out with some additional details on disposition activities and other portfolio management efforts to date in 2021 before opening the line for questions.

The third 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 p.m. Eastern Time today until 11:59 p.m. Eastern Time on November 18th.

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 pass it over to Scott.

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

Good morning. Thank you all for joining our third quarter 2021 earnings call. I'm happy to report that we hosted our Board of Directors yesterday in Indiana, and we're doing an in-person earnings call for the first time in 18 months.

I spent a few days in Houston last week with a couple of members of our team at our key industry conference, the NIC conference, and I can honestly say it was great to be back with many of our industry peers and operating partners for a couple of days. There was great energy, collaboration, and excitement regarding the future of our industry, and I know our team is feeling reenergized as we head into the final months of 2021 and look out to 2022.

Our teams have been very busy over the last 90 days with our active portfolio management initiatives. We kicked off the quarter by completing the previously announced sale of four seniors housing assets back to our former tenant, Inspirit Senior Living, on July 1st. As a reminder, this sale resulted in approximately $15 million of net cash proceeds, which were used to continue delevering our balance sheet. Adlai will touch on the specifics of the transaction a bit later in the call.

In early October, we sold five small noncore assisted living communities in Pennsylvania that were previously managed by Saber Healthcare, subject to a long-term, triple-net master lease. The assets struggled historically from a financial perspective and were a drag on the portfolio lease coverage ratios that also include two skilled nursing facilities. The sale of these five properties netted approximately $2.7 million in proceeds that were used to delever.

As part of the sale, Invesque reduced the rent by approximately $215,000 annually to account for the five sold assets. Saber continues to operate the two skilled nursing facilities, which are subject to a triple-net master lease with enhanced coverage, thus strengthening our portfolio and relationship with Saber for the long term. We look forward to continuing to partner with them on this portfolio.

In late October, we sold a property in Richmond, Virginia netting Invesque $3.4 million in cash proceeds. Upon careful assessment, we decided, in tandem with Commonwealth, to strategically close the property at the end of 2020 and move the property to our held-for-sale bucket earlier this year. While the property is in an excellent location in downtown Richmond, our market assessment, with Commonwealth's assistance, led us to conclude the property is best positioned for an alternative use. Proceeds from this sale were also used to further delever our balance sheet.

Before I turn the call over to Scott to discuss our financials, I'll provide a quick update on COVID-19 and its continued impact on our industry. We continue to see minimal COVID-19 positive cases within our portfolio as most residents and a good majority of associates have received the COVID-19 vaccine. We still see an occasional outbreak at communities within the portfolio, but the number of deaths and serious illnesses have been minimal. I'm extremely proud of our operating partners and their commitment to the care and safety of residents and staff. It has truly been a heroic effort over the last 18 months, and I'm extremely grateful for everything they continue to do.

I mentioned that I spent last week at the NIC conference. Let me spend a few minutes sharing with you some of the industry themes prevalent there, as well as the recent trends we're seeing in our Commonwealth Senior Living portfolio. As a reminder, Commonwealth is our captive senior housing operating and management company subsidiary. Commonwealth currently operates and manages 34 communities in the Mid-Atlantic region of the United States led by CEO Earl Parker. Commonwealth continues to see strong long-term move-in numbers following trough census in the first quarter of this year.

Occupancy at Commonwealth continued to trend positively throughout the second and third quarters, and this momentum continued through October. Spot occupancy in the 20-community

Commonwealth portfolio that we acquired in August of 2019 was 170 basis points higher on September 30th versus June 30th and 250 basis points higher versus March 31st. This favourable trend continued in October with the 20-community portfolio adding an additional 35 basis points of occupancy over that month.

Looking beyond just the Commonwealth 20-community portfolio, our overall stabilized SHOP portfolio saw an approximately 140 basis-point jump in occupancy quarter over quarter.

Despite the occupancy gains we have seen in our Commonwealth portfolio and other SHOP assets over the last six months, the operating environment continues to be challenging with the labour and staffing headwinds coming to the forefront. The staffing crisis you hear about daily in the news and likely see at your grocery stores and restaurants has had a significant impact on the seniors housing and care industry as well. Operators are struggling to find and retain staff, and we are all, as an industry, laser focused on finding creative ways to attract new talent to the industry.

We're confident that the demand for our product type over the next few years is coming full steam ahead as the 80-plus demographic continues to move in our favour. But solving the staffing challenge for now and in the years to come is a critical piece of the industry puzzle.

On the other side of the coin, social security benefits are expected to grow for seniors by almost 6 percent in 2022, which is the largest increase in these benefits in nearly 40 years. When coupling these increases in social security benefits with inflation and acceleration in street rates that our public peers have indicated over the last few weeks, we believe our operators have the proverbial wind at their backs to start pushing rate over the coming quarters.

We will continue to collaborate with our operating partners and industry peers to tackle these challenges and capitalize on the opportunity to capture top-line growth to offset labour challenges and

wage pressure. I remain optimistic about our team, our stable, tight-knit operators, and our exceptionally young portfolio as we navigate the environment over the coming years.

With that, I'll hand it over to Scott to touch on some key financial metrics for the quarter.

Scott Higgs

Thank you, Scott. For the quarter ending September 30th, FFO was $0.10 per share, and AFFO was $0.08 per share. Compared to the second quarter, we saw a reduction in AFFO of approximately $0.06 per share of the Commonwealth portfolio, of which $0.04 was associated with stimulus funds received in Q2 that was not received in Q3, as well as increased COVID-related costs incurred in Q3, which accumulated to approximately $0.02 per share.

We do expect that our operators will receive additional funding from HHS through the recently announced Phase 4 funding. In September, the government announced a $25.5 billion in additional funding available for health care providers affected by COVID-19. Of this amount, $17 billion has been allocated to providers who lost revenue and incurred additional expenses because of the pandemic. Many of our operating partners have submitted the required documentation to HHS, and we expect funding under Phase 4 will be received prior to year-end or shortly thereafter. We will provide an update on the results of this potential funding as it becomes available to us.

During the third quarter, we continued to shore up our balance sheet and use excess cash to delev. We utilized proceeds from the asset sales Scott mentioned earlier to pay off property-level mortgages and pay down our corporate credit facility.

Compared to last quarter, we were able to reduce overall company leverage by approximately 100 basis points, which also represents a reduction of leverage of nearly 300 basis points since Q3 of 2020.

These strategic dispositions allowed us not only to delever, but also to enhance our flexibility through additional availability under the credit facility.

As we move forward with our delevering strategy, we will look to utilize proceeds in the most accretive manner from a capital structure perspective, with a particular focus to pay down our higher-priced debt, given the favourable interest rate environment. Consistent with this approach, we are constantly evaluating strategies to solidify our financial position and provide the Company with financial flexibility.

At the end of the quarter, we announced proposed enhancements to the terms of our 2016 convertible debentures that are due January 31, 2022. After dialogue with a number of debenture holders, we have further revised the enhancements that were originally offered at the end of September. These further revisions have been unanimously approved by the board and have been positively received by debenture holders.

The enhanced terms feature a $20 million pay down on January 31, 2022; an increase to the interest rate from 5 percent to 7 percent; a decrease in conversion price from $11 to $5; and a 3-year extension of the maturity date to January 31, 2025. Our goal with this extension is to provide enhanced terms (unintelligible) debenture holders while providing the Company and all of its stakeholders with additional financial flexibility for other strategic initiatives.

As of September 30th, we have less than 7 percent of our debt maturing over the next 12 months. Our finance team continues to be busy exploring opportunities to take advantage of the current capital markets, with a renewed focus on consolidating debt at very attractive rates to further ladder our maturities. The debt markets continue to remain attractive, and we are actively looking up and down our capital structure to maximize cash flow and value for our stakeholders.

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

Adlai Chester — Director and Chief Investment Officer, Invesque Inc.

Thanks, Scott. Before I kick off, it is important to remind you all that we report the operating metrics of our triple-net lease portfolio at quarter in arrears due to the timing of receipt of operator financial statements.

We continue to see some challenges in our triple-net portfolio as operators continue to deal with lingering effects of COVID and work to solve the staffing challenges that Scott touched on earlier in the call.

On a trailing 12-month basis for the period ended June 30th, our stabilized portfolio EBITDAR and EBITDARM coverage ratios were 1.0 times and 1.3 times respectively.

As of June 30th, our trailing 12-month occupancy for the stabilized triple-net assets and stabilized SHOP portfolio was 74 percent and 78 percent respectively, while our medical office portfolio stabilized occupancy declined slightly to 82 percent.

As Scott noted at the top of the call, we closed on several dispositions during the third quarter. This activity is in line with our continued efforts to streamline the portfolio and focus on the assets and operators that are long-term strategic holds for Invesque. We are focused on continuing to work with the group of operators and partners that we believe are some of the best in the business, and we'll look to grow with them in 2022 and beyond.

We closed on the sale of four senior housing communities to our former tenant, Inspirit Senior Living, on July 1st. The transaction was a win-win for all sides as we achieved strong pricing for the properties, and Inspirit was able to accelerate their go-forward strategy to own more of their own real estate.

The transaction resulted in over $15 million of net cash proceeds to Invesque. We used the net proceeds to delever our balance sheet, and with the closing of the sale, we closed out our relationship with Inspirit. We hold Inspirit in high regard, and we wish them all the best in the future.

In addition to the sale of the communities to Inspirit and the other noncore dispositions over the last few months, in October, we transitioned operations of two senior housing communities in New York to an affiliate of Hearth Management. Hearth has been and continues to be one of our preferred operators in New York, and the transition is in line with our portfolio management initiative to ensure we have the right partner in each of our assets. We are excited to expand our relationship with Hearth and grow their strategic footprint in the region.

These two properties were previously operated by Premier Senior Living and were subject to a long-term, triple-net lease. With the transition, the two properties were moved to Invesque's SHOP portfolio, and Hearth entered into an interim consulting agreement that will convert to a management agreement once regulatory approvals are received.

Once the regulatory approvals are received, Invesque will no longer have any partnership with Premiere. We appreciate Premiere's cooperation throughout the process to minimize any disruptions to the residents and wish them continued success with their go-forward operations in the senior housing space.

We continue to focus on portfolio management and streamlining our partnerships to ensure we have the right operator in place for each of our own assets. Through our active portfolio management initiatives over the last two years, we have assembled one of the youngest portfolios in the public health care real estate space today, with an average age of slightly over 10 years. This is an important achievement to highlight given the older age of the assets of some of our peers.

As Scott noted earlier, the industry and the economy as a whole are struggling with labour inflation. Having owner assets that require maintenance will cause a larger cost burden to these older assets fresh and competitive ones will provide a much better solution. With new construction at a five-year low, pressure on labour, and supply chain issues driving up costs, it is much harder for new projects to get off the ground and hit budgets. Having a young portfolio with occupancy upside provides a unique competitive advantage over some of our public peers and should position our operators to see outsized NOI growth over the coming years.

Our strategic reposition has also 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 at the time of our IPO 5 years ago. Shifting to a majority private-pay portfolio has been a long-term goal for our team, and I am proud of where we stand today with skilled nursing today representing slightly over 35 percent of our pro forma NOI.

In addition, we have strengthened our credit profile and stability of our cash flows with 12 years of average lease duration in the triple-net lease portfolio today.

I'll now comment briefly on transaction activity in the senior housing and skilled nursing space. In spite of the challenges the COVID-19 pandemic has presented to both asset classes, transaction activity continues to heat up in the health care real estate space. Several companies have announced intentions to or have deployed in excess of $5 billion in investment capital, with a particular focus on the senior housing sector.

The transactions that have closed have featured cap rates that are well below historic norms for the industry, and many have featured attractive per-unit prices, which we estimate to average around

$200,000 per unit. These valuations compel us to continue to diligently manage our portfolio and capitalize on strategic dispositions at very favourable pricing for assets we view as noncore.

In the coming months, you can expect to see additional transactions to further push us towards senior housing. We will continue to transition properties to strengthen alignment and grow with our preferred partners, while continuing to dispose of our noncore assets.

As we have always done, we remain laser focused on maximizing value for all of our stakeholders, whether through transitions, dispositions, or acquisitions, with an eye on growing our private-pay exposure with our preferred operating partners.

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

Q&A

Operator

Thank you. If you wish to ask a question, please signal by pressing *, 1 on the telephone keypad. And if you are using a speakerphone, please ensure that your mute function is turned off. Again, press *, 1 for a question. We'll now pause for just one moment.

First question comes from Joanne Chen from BMO Capital Markets. Please go ahead.

Joanne Chen — BMO Capital Markets

Hi. Good morning, guys.

Scott Higgs

Morning.

Scott White

Morning.

Joanne Chen

I guess just on maybe sticking on the disposition front, how should we think about I guess kind of the magnitude over the near term, then? You're thinking around the redeployment of the proceeds, whether kind of still focused on the debt reduction. Or are you seeing attractive opportunities on the acquisition front right now?

Scott White

Morning, Joanne. So in terms of dispositions, I think you've seen, over the course of the last year-end quarter, we have selectively disposed of small noncore assets. I don't think you should expect to see—

Joanne Chen

Yeah.

Scott White

—a massive portfolio disposition. And you'll continue to see a number of the facilities that either aren't core to our operations or operators that we don't see an opportunity to grow with as the types of assets we'll dispose.

In terms of redeployment of capital, we've generally been focused on delevering and providing incremental liquidity. There are opportunities in the market. We're being very disciplined and selective in terms of redeployment of that capital. For the right opportunities, we will deploy that capital. But right now, it's really focusing on delevering, as we mentioned a few times, and on preserving liquidity.

Joanne Chen

Got it. Okay. That was good to hear. And I guess just with current things kind of the environment improving with COVID, have you noticed the continuous improvement subsequent to quarter-end with respect to overall—

Scott White

So we absolutely—

Joanne Chen

—and all that? Yep. Okay.

Scott White

Yeah. So we absolutely have. We've noticed substantial improvement in a couple of respects. First, for the most part, the industry has been able to handle and contain the COVID virus. We're seeing fewer outbreaks across the industry. We're certainly seeing fewer deaths and fewer severely negative outcomes. So I say that's a positive. We're seeing enhancements in occupancy across the industry. I'd say that's a positive outcome.

The issue and the concern that I highlighted in my comments, and I think it's worth reemphasizing, is the industry is really struggling with labour.

Joanne Chen

Yeah.

Scott White

And that has an impact on the bottom line. So while we are getting more people in the door, we're also requiring more caregivers, and the industry is struggling, as are many industries, and we are not immune.

Joanne Chen

Right. So how are you guys addressing I guess the staffing challenges right now? Is it just kind of in terms of on the salary front kind of incentivizing? Or is that not even helping these days?

Adlai Chester

Yeah. This is Adlai. What we're seeing from our operators, yeah. They're having to provide incentives for retention and sign-on bonuses, but you're also seeing them use a lot more agencies. And what that's doing is occupancy is, in fact, increasing. NOI is not necessarily growing at the same pace as the occupancy. So it is a struggle. I think we're pretty confident with our operators. In fact, we were just having conversations with several of them over the last couple of days, and they're optimistic. Once again, they're worried about it, but they're optimistic with their plan, and they think they're going to be able to overcome it over the next 12 to 24 months.

Joanne Chen

Okay. Got it. That's helpful. Okay. That's it for me. I will turn it back. Thanks, guys.

Scott White

Thanks so much, Joanne.

Operator

Our next question comes from Tal Woolley from National Bank Financial. Please go ahead.

Tal Woolley — National Bank Financial

Hi. Good morning, everyone.

Scott White

Morning, Tal.

Tal Woolley

You'd mentioned earlier in your comments about holding a young portfolio with occupancy upside. I guess like one of the questions I'm interested in hearing your thoughts on is, how long do you see it taking to sort of get to what you would consider a stabilized number given some of the labour constraints and everything else going on in the market. Do you have a sense of or how are you planning for that?

Scott White

Yeah. So thanks, Tal. It's Scott here. And I don't know if I can answer the question specifically as it relates to a stabilized number. I think what some people are grappling with and the industry is reflecting on is, when do you return to sort of pre-COVID world, whether it's occupancy, whether it's margin, whether it's overall cost of operating and maintaining the buildings. And I think it's hard to answer. I'm going to not be cagey, but I'm going to give you a non-answer because it's just really difficult to project.

It's not going to happen very quickly. I mean I do think that's important for all of our constituents and stakeholders to understand is that, yes, COVID cases are down substantially, substantially in the buildings. I can't emphasize that enough. And yes, occupancy is growing considerably, as I gave you some of those numbers. So those are all positive trends. But with that, I think we're going to be grappling with this labour issue for quite some time now.

Some people have gone on record as saying they expect 2023 to be the year that we will return to pre-COVID levels. I don't want to go on the record as reflecting on a certain time. I think what I will say is that it's not going to be quick. It's not going to be this year. It's not going to be early in the new year.

I do see a lot of positive momentum on occupancy. I do see a lot of—Adlai just commented on the labour issue, and it's a big issue. And by the way, it's not unique to our industry. It's a big issue across many industries. I'm not an economist. I don't pretend to be an economist. I do have a belief that the

labour issues are going to work their way through the system in the not-too-distant future; I think in the next 12, 18 months. You're going to have a natural pendulum swing in the economy, which is going to take the labour issues the other way. Will it be solved? No.

Remember, our industry has grappled with labour issues as long as I've been in the industry. I don't remember any time over the last decade where people were like, yeah, we have more employees than we know what to do with. That's never been an issue in our industry.

So you take an industry that has already struggled with labour, and then you smack it with what I think is a once-in-a-generation sort of coming out of COVID, no one has the appropriate labour they need across industries, and it's been challenging. So I think it's going to take some time to work our way through that.

But we are seeing positive signs. I think it's important to note that things are heading in the right direction. We reported much better occupancy numbers. We're seeing that month over month across the portfolio. But it's going to take time.

Tal Woolley

Okay. And can you just remind me like, in most of the companies we follow here in Canada, a lot of the staff or very high proportion of the staff is unionized. And so your only real labour exposure is on—particularly when you're running under capacity, the labour inflation is not maybe as big a deal because you've got the visibility of the contracts. Can you remind me like what sort of your unionized exposure is? And what sort of visibility you have on labour costs right now?

Bryan Hickman — Senior Vice President, Investments, Invesque Inc.

Hey, Tal. This is Bryan Hickman. Especially within our private-pay seniors housing portfolio, the portion of unionized staffing is basically zero.

Tal Woolley

Okay.

Bryan Hickman

In fact, that tends to be the case for I'd say almost all seniors housing. The limited exceptions are in skilled nursing and especially those located in sort of urban centres. So more specifically, we do see some union exposure within our Symphony portfolio. But the proportion of unionized staff is plus or minus 50 percent at most. And yes, we do have better line of sight to sort of what the year-over-year expenses are going to be as in connection with those union negotiations. But again, that does not impact our SHOP portfolio, which is where we have the direct NOI exposure.

Tal Woolley

Okay. And then just lastly on the balance sheet. You've got a credit facility up for renewal, I believe in 2022, and then you'll have the 2023 converts too. And given what's happened with the recent modification offer being successful, could you just talk to me about what your conversations are like with the lending syndicate right now? And how you're thinking about those 2023 converts too?

Scott Higgs

Yeah. Absolutely. It's Scott Higgs. So first, on the 2022, that's our primary corporate credit facility. The piece that's due in 2022 is the revolver. And we do have an option to extend that within our control. So that is there. But I'll tell you, as we've commented before, we're very grateful and thankful that we have a very collaborative and partner-oriented bank syndicate that we're working with. And we're working with them looking at different ways, whether it's via extension or other opportunities there, up and down the stack, but with that one in particular.

And then with the ’23s, I think as we finalize through the process with these ’22s, we’re certainly going to explore different alternatives there as well.

Tal Woolley

Okay. That’s perfect. Thanks, gentlemen.

Scott Higgs

Thanks, Tal.

Scott White

Thank you.

Operator

Okay. So it appears that there are no further questions at this time. Therefore, this concludes today’s call. Thank you for your participation. You may now disconnect.