⌄ Company Participants

Jason Finkelstein - IGNITION Investor Relations, Founder
Brandon M. Ribar - Sonida Senior Living, Inc., President, Chief Executive Officer & Director
Kevin Detz - Sonida Senior Living, Inc., Chief Financial Officer

MANAGEMENT DISCUSSION SECTION

Operator

00:00:10 Greetings and welcome to the Sonida Senior Living Second Quarter 2024 Earnings Results Call. At this time, all participants are in a listen-only mode. As a reminder, this call is being recorded.

00:00:20 I would now like to turn the call over to Jason Finkelstein, Investor Relations. Thank you, Jason. You may begin.

Jason Finkelstein

00:00:30 Thank you, operator. All statements made today, August 12, 2024, which are not historical facts, may be deemed to be forward-looking statements within the meaning of federal security laws. The company expressly disclaims any obligation to update these statements in the future. Actual results or performance may differ materially from forward-looking statements.

00:00:52 Certain factors that can cause actual results to differ are detailed in the Earnings Release that the company issued earlier today, as well as in the reports that the company files with the SEC from time-to-time, including the risk factors contained in the Annual Report on Form 10-K and Quarterly Reports on Form 10-Q. Please see today's press release for the full Safe Harbor statement, which may be found in the 8-K filing from this morning at the company's Investor Relations page found at www.sonidaseniorliving.com.

00:01:24 Also, please note that during this call, the company will present non-GAAP financial measures. The reconciliations of these non-GAAP measures to the most comparable GAAP measure, please also see today's press release.

00:01:36 At this time, I'd like to turn the call over to Sonida Senior Living President and CEO, Brandon Ribar.

Brandon M. Ribar

00:01:44 Thank you, Jason. Hello and welcome to our 2024 second quarter earnings call. I'm joined today by Kevin Detz, our Chief Financial Officer. Earlier today, we released our Q2 earnings and investor presentation, which will be referenced throughout this call as we discuss our strategic priorities and operating results, in addition to updating you on our growth efforts in 2024. You can find our latest presentation at sonidaseniorliving.com in the Investor Relations section if you would like to follow along. In addition, we've included supplemental earnings information within our investor presentation, consistent with the prior-quarter release.

00:02:20 In the second quarter, the company delivered considerable progress across both our organic and inorganic or externally accretive growth initiatives. First and foremost, the same-store portfolio continued generating strong operating results on both a sequential and year-over-year basis, culminating with our highest occupancy in this portfolio's operating history and operating margins exceeding 28% for the quarter. The same-store owned portfolio averaged 86.2% occupancy for the quarter, with June averaging nearly 87% and spot occupancy for June 30 at 87.9%.

00:02:57 Average occupancy for the second quarter improved by 220 basis points year-over-year and 30 basis points sequentially, with June occupancy finishing 290 basis points higher than June of 2023. As a frame of reference, Q4 2019 average occupancy and spot occupancy were around 84%. The occupancy gains reflect a growing trend of strength across each of our operating regions and the ability to drive recovery in our underperforming communities.

00:03:27 The second half of the year has shown continuous positive momentum and portfolio-wide occupancy of 90% is our next significant goal. Based on our high-quality portfolio and industry wide supply demand dynamics, we believe that normalized occupancy can be meaningfully greater than 90% over the next several years.

00:03:47 We also experienced continued growth on the rate front, driven by our March 1 annual rate increases, coupled with a positive releasing spread on new move-ins, leading to year-over-year rate growth of 8.4% for the quarter and 3% sequential improvement from Q1. Kevin will provide further detail on our REIT strategy as we look to leverage higher occupancy levels to further grow market rates.

00:04:10 Finally, with the increased occupancy and rate profile across the portfolio, our operating margin continues to expand. Same-store net operating income increased 31% from Q2 of 2023 and 19% sequentially. We are also encouraged by the 400 basis point margin expansion year-over-year to 28% and see even further opportunity to improve. Again, Kevin will dive into further detail around the key operating metrics in his comments.

00:04:39 On our previous earnings call, we outlined three areas of focus to drive growth in our existing portfolio. First, reinforcing the strength and importance of our local and regional leadership teams. Second, further investments in capital and programming to support our community performance. And finally, driving the recovery and stabilization of a concentrated set of underperforming communities.

00:05:01 On the people front, local and regional leadership trained and empowered by strong central leadership for on-the-ground decision making and building and reinforcing overall culture is crucial to our success. Throughout Q2, we experienced continued improvement in retention at the community level and proudly promoted a number of executive directors to regional leadership roles as we completed recent acquisitions.

00:05:24 On the capital investment front, in the first half of the year, we invested more than $12 million across both technology and community-based capital expenditures, including both targeted NOI generating capital and recurring maintenance. We expect these targeted NOI projects, which feature additional or converted resident units to positively impact performance in 2025.

00:05:46 On the programming front, investment in technology to improve the resident experience and simplify our care model continues rolling across our business. This includes both monitoring systems to support fall prevention and employee notification technology to ensure prompt response times to meet resident needs.

00:06:06 Additionally, a new level of care initiative across each of our Magnolia Trails Memory Care locations more effectively matches services provided to residents with the cost of care. The collective impact of these efforts and investments drove significant improvement across our lower performing communities in Q2 and strengthened key operating metrics across the board.

00:06:27 I'll briefly comment on the expense side of the business, and Kevin will provide further detail and commentary. Each of the significant cost components of our operating structure remain stable and in line with our 2024 projections. The total cost of labor declined sequentially by 2% from Q1 as premium labor costs improved. Labor costs for the quarter increased 3.3% on a year-over-year basis, combined with stability across other major cost categories and a reduction in cost and dependence on third-party referral agencies, our overall expense profile is trending well and declining as a percent of revenue.

00:07:03 Switching to the external growth front, we continue to focus on the identification of high quality, recently constructed communities with significant value-add opportunity at an attractive basis. Collectively, we purchased nine communities either outright or through strategic joint ventures and deployed approximately $50 million of equity at an average basis of less than $125,000 per unit. Each of the assets created further density in attractive existing markets or provided an entry into targeted markets across both Texas and the Southeast. Each acquisition offers material performance upside with the successful application of Sonida's operating model.

00:07:44 Development and training for the local leadership teams blended with knowledge of the market at the regional support level, and centralized support collectively drive improvement. Through a combination of occupancy growth, ongoing rate improvement and effective expense management, each investment can stabilize at a double-digit cap rate based on what we believe is an attractive basis.

00:08:05 We've included a summary of our recent investments in the investor deck, and each deal reflects a specific approach to growth opportunities in this market. From distressed purchases through banking relationships, to strategic joint ventures and recapitalizations, our network of relationships continues to deliver accretive investments.

00:08:23 Looking ahead, we have clear line of sight to additional external growth investments. Within our targeted community acquisition profile along a multifaceted sourcing strategy, our external growth focus remains both simple and concentrated, construct a high quality, low leverage and regionally focused real estate portfolio with a best-in-class operating team to deliver accretive cash flow growth to our shareholders. We then bring the Sonida operating model to these assets. And as a result, we believe our corporate structure as a pure play senior housing operator, owner and investor provides significant benefit to shareholders.

00:09:01 Additionally, the opportunity to fully control the operations through real estate ownership and reinvest cash flow as a C corp into accretive acquisitions is both distinctive and highly attractive for Sonida as the senior housing market recovery accelerates.

00:09:17 As alluded to earlier, we believe that the financial success of a community is first and foremost, dependent on having a strong local leadership team, and key to our success is the hiring and retention of great talent that together with Sonida's tools and programs, are able to stabilize challenged assets.

00:09:34 In Q2, we introduced an operational excellence team, led by our Chief Clinical Officer, focused on the integration of new acquisitions, including training and development on Sonida best practices and technology support systems. The team is comprised of operational, clinical and sales resources with the experience and track record of successfully driving recovery in underperforming communities. Our support teams have identified significant areas for operational improvement in each of our new communities in line with pre-transaction underwriting assumptions.

00:10:07 On the financing front, we look forward to expanding our deep banking relationships with four new lenders providing debt capital for the acquisitions referenced in our presentation. We view these relationships as key for evaluating the optimized cost and structure, including overall leverage as we pursue further acquisitions. Each recent transaction was financed with a goal of reducing overall portfolio leverage and improving portfolio loan to value and coverage ratios. We are committed to further deleveraging the portfolio over the medium and long-term.

00:10:39 For the second half of the year, we continue to target similar opportunities to purchase assets outright or through joint venture relationships. The increasing default rate and level of non-performing loans across the market, in addition to the absence of interest rate relief to date in 2024, continues to generate a robust pipeline of growth opportunities that we are positioned to access.

00:11:02 In summary, the Sonida platform, with its differentiated approach to operating, owning and investing in senior living communities, positions the company to meaningfully capitalize on near term market dislocation by layering on value-creating external investments designed to further enhance shareholder return, reinforced by the powerful trends of a growing senior population against the backdrop of an extended slowdown in construction activity of new properties.

00:11:28 Sonida's disciplined deployment of balance sheet capital, coupled with flexible and creative deal structuring, allows us to strategically acquire assets that can favorably impact our portfolio through an expansion of operations and highly attractive returns upon stabilization. Sonida's culture characterized by our commitment to building high-performing teams and delivering a valuable living experience to our residents will remain the key to ongoing improvement in both our existing and newly acquired communities.

00:11:59 I'll now turn it over to Kevin for discussion of the financial results.

Kevin Detz

00:12:04 Thanks, Brandon. I will be walking through select pages of today's investor presentation starting with slide 12. I wanted to note that most of the financial slides discussed on today's call will be presented on a same-store basis, which for comparative purposes excludes the May acquisition for Macedonia community and the four communities under a joint venture structure. The appendix slides and the broader investor presentation include references to the company's consolidated portfolio, as well as the 12 communities under third-party management agreements.

00:12:36 As Brandon mentioned during the outset of the call, the company continued to steadily push up occupancy, which (00:25:37) increase from the previous quarter. This 86.2% weighted average occupancy is 230 basis points higher than the prior year due to occupancy of 83.9%. These occupancy gains were driven from a significant reduction in move-outs, which has been a continued focus of our community leadership teams in concert with our chief clinical officer, who joined the team late last year. Specifically for the second quarter, move-outs decreased 19% and

16% from the preceding quarter and comparable quarter in 2023. As of quarter end, only four Sonida communities remained less than 75% occupied, with just one of those under 70%.

00:13:27 The company continues to focus on elevating rate with a quarter-over-quarter RevPOR increase of 3% driven from its March 1 portfolio-wide increases and continued success on market rate optimization, particularly in higher occupancy communities. On a year-over-year basis, RevPOR and RevPAR increased 8.3% and 11.3%, respectively, with the latter reflective of the company's revised level of care program in our assisted and memory care communities.

00:13:57 The stabilization of labor and occupancy-based expense accounts continues to support incremental NOI growth, with increases of 19% and 31% from prior quarter and the same quarter last year, respectively. Note that the first quarter is historically the lowest performing due to the seasonality associated with lead volume and higher benefit loads to start the calendar year, as referenced in our May earnings call.

00:14:24 Moving ahead to slide 15, resident rates for the quarter increased 9.4% from the same quarter in 2023. Diving deeper into care levels, both assisted living and memory care had double digit rate increases over the past year. Beyond the rework (00:27:35) level of care platform reference, the company has developed new pricing structures on higher acuity care through its Magnolia Trails Program, including the recent extension to our memory care level. This has led to both assisted living and memory care levels outpacing rate increases in independent living, as well as the same care levels across the industry. Also responsible for driving up the rate profile in these care levels has been the increase in Medicaid rates in Indiana, as a result of legislation passed in the summer of 2023.

00:15:15 Moving to operating expense trends on slide 16, the cost of incremental labor to incremental revenue continues to show stabilization. For the first time since the industry started experiencing inflationary increases after COVID, the company's direct labor decreased slightly from the first quarter of 2024. This quarter's total hours decreased 110 basis points from Q1 2024, more than offsetting the 100-basis point increase in average wage costs for that same period.

00:15:47 The company also saw a more positive trending on its premium labor, which decreased in sequential quarters this year on the strength of our community leadership teams controlling overtime through our recently developed Labor BI tools. We believe both of these trends are sustainable and will be critical to the continued margin expansion as the portfolio's occupancy base grows.

00:16:09 On slide 17, non-labor operating expenses are also improving as a percentage of revenue, picking up 140 basis points comparing this quarter to the same quarter in 2023. On an absolute basis, these costs decreased nearly $800,000 in sequential quarters this year. Whereas areas such as food costs and real estate taxes have been primary drivers of this favorable improvement over the last 12 to 18 months, we are now seeing reduced commissions on third-party referrals due in part to the evolution of our internal sales strategy, which marries our strong local market presence with enhanced digital marketing capabilities, as well as a higher overall occupancy base.

00:16:52 Hitting on a few observations from our earnings release this morning, G&A remains below 10% as a percentage of total revenues under management, excluding the non-cash amortization of stock compensation and one-time transaction costs in connection with our recent debt, equity and acquisition activities. Just as important, the company should be able to further reduce this G&A to revenue ratio with its recent and expected portfolio growth.

00:17:20

These costs already contemplate the company's one-time strategic investments and the growth infrastructure Brandon referenced, namely the bolstering of our business development function, which continues to actively grow and convert our acquisition pipeline, and the newly created Operational Excellence Department that has been vital in supporting community onboarding to keep our regional leaders focused on our same-store communities.

00:17:45 Concluding the remarks on Q2 financial highlights, we will turn our attention to the balance sheet as seen on slide 13 and appendix 5. Last week, the company entered into loan modification agreements with one of its lenders on two cross communities in Texas. The modification included revised maturities and, more importantly, the ability to make a discounted payoff of $18.5 million on the $28.7-million balance, which represents a $10-million or 36% discount on the current loan principal. These two communities represent the last two communities that required material restructuring, with the company having addressed 58 of 60 loans in the past 12 months. The remaining two loans account for approximately 2.5% of the current principal balance.

00:18:36 Our total debt is comprised of 71% fixed rate notes, with the remaining variable rate notes fully hedged, yielding a weighted average interest rate just below 5% for the portfolio. Beyond this, the company continues to focus on delevering its balance sheet with the second of two scheduled $5-million principal payments due under the 2023 Fannie Mae restructuring made during the quarter. The company's outstanding indebtedness decreased nearly $60 million or roughly 10% on a year-over-year basis from Q2 2023. This excludes a further reduction of $10 million on the company's principal balance in connection with the DPO option.

00:19:20 As EBITDA continues to grow and we acquire assets at reset debt ratios, we expect to delever the portfolio even further. As of today, the company is in compliance with all financial covenants required under its mortgages. We continue to be encouraged by the operating trajectory of this portfolio, including our ability to realize performance improvement on the recently acquired communities.

00:19:45 Back to you, Brandon.

Brandon M. Ribar

00:19:48 Thanks, Kevin. 2024 continues to present opportunities for Sonida

00:19:52 to deliver on our differentiated approach to both internal and external growth. Our focus and commitment for the second half of 2024 revolves around three key deliverables. The continued improvement of our organic portfolio performance, with an expectation to achieve positive all-in cash flow by year-end remains a top priority.

00:20:13 Second, delivering on the expected performance improvements within recently acquired communities will further build a proven track record for stabilizing distressed assets. Finally, leveraging our broad network to identify attractive acquisitions will provide investors with a differentiated platform to access the highly attractive market dynamics surrounding the senior living sector in the near term.

00:20:37 We firmly believe Sonida is positioned to fulfill our commitments to residents, employees, and shareholders to continue building a best-in-class operator, owner and investor in senior living.

00:20:50 Thank you all for participating and this concludes today's conference call.

Operator

00:20:58 Thank you. You may now disconnect your lines. Thank you for your participation.

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