Capital Senior Living Corporation (CSU) CEO Kimberly Lody on Q2 2020 Results - Earnings Call Transcript

August 6, 2020 10:30 AM ET **Capital Senior Living Corporation (CSU)**

Capital Senior Living Corporation (NYSE:CSU) Q2 2020 Results Conference Call
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Company Participants

Kimberly Lody - President, CEO & Director

Brandon Ribar - EVP & COO

Carey Hendrickson - EVP & CFO

Conference Call Participants

Steven Valiquette - Barclays Bank

Morgan McCarthy - Barclays Bank

Operator

Good day, and welcome to the Capital Senior Living Second Quarter 2020 Earnings Release Conference Call. Today's conference is being recorded.

All statements today, which are not historical facts may be deemed to be forward-looking statements within the meaning of the federal securities law. These statements are made as of today's date and the company expressly disclaims any obligation to update these statements in the future. Actual results and performance may differ materially from forward-looking statements. Certain of these factors that could cause actual results to differ are detailed in the earnings release the company issued earlier today as well as in the reports the company files within 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 statements, which may be found at capitalsenior.com/investor-relations and was furnished in an 8-K filing this morning.

Also, please note that during the call, the company will present non-GAAP financial measures. For reconciliations of each non-GAAP measures from the most comparable GAAP measure, please also see today's press release.

At this time, I would like to turn the call over to Capital Senior Living, President and Chief Executive Officer, Ms. Kimberly Lody. Please go ahead.

Kimberly Lody

Good morning, everyone. Thank you for joining us for Capital Senior Living's Second Quarter 2020 Investor and Analyst call. Joining me this morning is Carey Hendrickson, our Chief Financial Officer; and Brandon Ribar, our Chief Operating Officer.

First and foremost, I want to highlight and recognize our 6,000-plus employees who have continued to diligently and heroically care for our residents' physical, cognitive and emotional well-being in the face of the COVID-19 pandemic. Their positive and profound impact each day on the lives of America's most vulnerable population is truly inspiring.

As I mentioned on our first quarter call, we acted early and swiftly in the procurement of PPE, infection control systems, test kits and other supplies to fortify our reserves and ensure our preparedness for fighting COVID-19. We also expanded our existing comprehensive disease prevention protocols across our portfolio and implemented robust communication platforms to provide comprehensive operational and clinical support to our communities day and night.

I want to thank our Capital Senior Living team, our residents, their families, our vendors and industry partners for their relentless commitment to the safety and well-being of everyone in our communities. These efforts have helped us mitigate the clinical, operational and financial impacts of the pandemic, and today, our resident infection rate across the portfolio is well below 1%. As of this morning, 48 of our 10,000 residents have an active COVID diagnosis. Brandon will provide additional insights to our COVID-19 response.

Turning to our operating results. According to data published by NIC, occupancy for seniors' housing fell 280 basis points in the second quarter with the largest drop occurring in April and then lesser deteriorations in May and June. Our 118 same-store portfolio experienced a similar but better occupancy pattern, declining 230 basis points in the second quarter with most of that decline occurring in the first several weeks of the quarter.

I'm pleased to report that in June, move-ins returned to pre-COVID levels and exceeded move-outs for the month. June occupancy increased 30 basis points from May 31 to June 30. However, in July, as the resurgence of COVID cases developed through many states, move-ins and move-outs developed more similarly to May, and our July sequential occupancy declined 30 basis points from June. July move-ins were 20% lower than June but 60% higher than the April-May average.

Leading sales indicators in the second quarter were also lower as consumers postponed decisions about senior housing. Compared to Q1, leads were 24% lower. Tours were 43% lower, and move-ins were 22% lower. Move-outs were 4.7% better, which helped to mitigate occupancy impacts. These statistics were at their lowest in April and improved incrementally throughout the quarter. Looking forward into Q3, July leading indicators continue to trend favorably, especially tour volume, and while we are encouraged by this, neither leads nor tours have yet achieved pre-COVID levels.

Strong service execution by our community and support center teams allowed us to mitigate some of the COVID impact to our business. Most notably for our 118 same-store portfolio, our Q2 operating expenses declined sequentially by $1.7 million from $70.3 million in Q1 to $68.6 million in Q2, as our teams exerted tremendous discipline to reduce spending in nonessential categories in order to offset increased spending on COVID-related items and services. As a result, net operating margin remained stable at approximately 31% in both Q2 and Q1. Our community and central support systems have delivered respectable, responsible and commendable performance in the face of their relentless focus on protecting our residents and employees from COVID-19.

Turning to the balance sheet for a moment. Earlier this year, as part of our strategic plan, we announced agreements with our 3 REIT partners that would, subject to certain conditions, effectively eliminate our multiyear lease liabilities at the end of 2020. In the second quarter, we began to see the positive impact of these agreements as 25% rent reductions increased CFFO by $800,000 in the second quarter compared to Q1. Note that, for the quarter, our 79 owned communities delivered $0.20 of CFFO per share compared to negative $0.02 of CFFO per share from the lease portfolio. We remain committed to the agreements with Welltower, Ventas and Healthpeak and appreciate our continued collaborative relationships with all three.

As the next step in restructuring our balance sheet, we announced today that we've made the decision to turn back 18 communities with unsustainable nonrecourse mortgage debt to Fannie Mae. These communities have been heavily impacted by the current COVID environment. With their high debt load and generally difficult operating conditions, it did not make sense for us to continue to incur significant losses on these communities after debt service. While a difficult decision, after months of discussions with Fannie Mae, we were unable to reach an agreement to materially modify the debt. Turning back these communities to meaningfully improve our operating performance and liquidity is in the best interest of the company and its shareholders. The transfer will reduce the company's debt by $216.3 million and increase annual cash flow by approximately $10 million. We're working with Fannie Mae to finalize the details and timings of these transitions, and we'll provide more information to investors as it becomes available. This step, when completed, along with the progress made earlier this year to address the company's triple net leases, will significantly improve the company's balance sheet by reducing total lease and debt liabilities by approximately $469 million while improving our annual cash flow by approximately $32 million.

In summary, we're pleased with our strong service execution and stable NOI for the quarter. Today, our value proposition is more compelling than ever before as elderly citizens and their families seek senior care solutions. By strengthening our operating platforms during the past 18 months and investing in our leadership teams, technology, community aesthetics and programmatic enhancements to our resident experience, we have established a solid foundation from which to responsibly evolve our operating model while innovating and managing our business. We are excited about the future of our go-forward portfolio. Above all, we remain steadfastly committed to making decisions that best position us to deliver value to our shareholders, residents, employees, vendors and all constituents over the long term.

I'll now turn the call over to Brandon to provide a brief update on our operations.

Brandon Ribar

Thank you, Kim, and good morning. More than 5 months into the COVID-19 pandemic, Capital Senior Living's preparation, response and ongoing efforts to ensure the safety of our residents and employees continues as the top priority of our operating team. In Q1, CSL prepared for a prolonged change in our operating environment by solidifying our staffing support, developing nationwide supply hubs, improving technology capabilities, and redesigning the dining and activities experience. While some weeks feel like running a marathon in the current environment, our clinical and operating results reflect the dedication and commitment to excellence in each one of our communities. Tireless and intense adherence to revised and improved clinical and infection control protocols, and consistent communication efforts with employees, residents and their loved ones continue to make the difference. Learning, adjusting and incorporating best practices as the national response to COVID-19 has evolved continues to drive our daily operating activity.

Leadership stability has been constantly tested in the first half of 2020. The intensity of the senior living operating environment and the regulatory and customer communication needs have never been more demanding for our entire leadership team but especially our executive directors and wellness directors. Our leaders work daily to calm concerned and frustrated family members unable for many months to visit inside our communities. They share their stories and experiences with national and state legislators and regulators to ensure the true impact of this virus is heard.

Their dedication, leadership and daily inspiration of frontline caregivers is reflected in our employee turnover numbers for the first half of 2020. Our total company turnover continues to show year-over-year improvement of more than 10 percentage points, and the retention of our key leadership roles remain strong. The strength, compassion and confidence of our local leadership teams and the frontline caregivers and employees across each of our communities continues to shine throughout this challenging operating environment.

I will briefly touch on the topic of testing, which continues as a focus of national conversation. We continue to follow all CDC protocols and local and state health department guidance related to testing and have facilitated or administered more than 10,000 tests across our communities. However, until testing results are accurate and available on a real-time basis, wide-scale, point-in-time testing does not prevent exposure. However, our experience has shown that diligent infection control practices, including use of PPE, comprehensive screening of all visitors and staff and extensive disinfecting protocols, greatly limits both exposure and transmission for our residents and staff. As Kim mentioned, we currently have 48 residents with active COVID-19 cases in our population of nearly 10,000.

Shifting to our operating results, we continue to measure the number of communities showing sequential quarterly improvement throughout this prolonged period of economic uncertainty. In Q1, we communicated significant progress sequentially in spite

of increased costs associated with COVID-19 preparations and significant slowdown in move-in volume for the second half of March. Remarkably, community level operating results in Q2 remained stable with same community net operating income declining just $800,000 or 2.5% sequentially. As impressive, 50% of our 118 communities were able to achieve sequential NOI growth with no material government funding and including all COVID-19-related expenses. More than $1.6 million in additional pay to support our CSL frontline employees was offset by a $2.6 million reduction in discretionary spending associated with marketing and third-party services.

We are also pleased to highlight the ongoing reduction in third-party contract labor by another $100,000 sequentially and down $1.4 million year-over-year for Q2. Our sequential revenue decline was driven by the 230 basis point reduction in occupancy that Kim referenced. Our rates held steady in Q2 with a sequential change of positive 0.2% when excluding COVID relief dollars. For Q3, discounting of rates for new residents moving into a CSL community remains strategic, disciplined and focused in markets where significant impacts to the senior living industry as a whole have created intense pricing competition, as communities rebuild occupancy.

As Kim mentioned, our revenue key performance indicators improved throughout the second quarter with June move-ins reaching pre-COVID levels and exceeding the prior year by more than 15%. The strength of these results gives us confidence that as COVID-19 restrictions ease, the investment in our safety protocols and procedures and improving sales capabilities can drive occupancy growth.

Early Q3 indicators show ongoing increases in leads and tour volume. However, acceleration of COVID-19 cases statewide have required delayed move-in activity in our southern portfolio, including Texas, Florida and Arizona. While the impacts of COVID-19 on Q3 performance and beyond still remain uncertain, we continue to implement strong operating practices and protocols to responsibly manage business performance through these unprecedented times.

We remain confident in our leadership teams across our individual communities and our regional team to navigate the always changing landscape and continue providing a safe and enjoyable environment for current and future residents.

Now I'll turn the call over to Carey to provide a detailed review of our financials.

Carey Hendrickson

Thank you, Brandon, and good morning, everyone. Our second quarter 2020 results reflect the impacts of COVID-19 under occupancy revenue and expenses. However, our sales and operations team did an excellent job in marketing our communities to new residents in what was a very challenging environment and in managing the costs within their control to mitigate the impact of COVID-19 on our overall results. The second quarter also reflects positive impacts associated with the actions that we took in the first and second quarters related to our lease portfolio. As a result, even with the declines in our adjusted EBITDAR in the second quarter of 2020 as compared to the first quarter of 2020, our adjusted CFFO increased quarter-over-quarter.

Looking at some of the details on our second quarter results. Our total consolidated revenues in the second quarter were $101.5 million, as you saw in the release, and that compares to $113 million in the second quarter of 2019. A good chunk of that difference, $5.8 million, was related to dispositions and conversions of assets since the first quarter of 2019, with the rest due to lower occupancy levels primarily related to the impacts of COVID-19 was slightly offset by a 3.3% increase that we had in our rate.

The second quarter also includes $2 million of revenue related to our management of 6 Healthpeak communities, which were converted to management agreements in March of this year. Most of that revenue is related to the reimbursement of certain operating costs that we paid on behalf of those managed communities, and you'll see on the income statement that there's a corresponding expense there for the same amount. Our financial occupancy for all communities was 77.6% in the second quarter, which was a decline of 240 basis points from the first quarter and a decline of 480 basis points from the second quarter of 2019.

We experienced the most significant loss of occupancy from a physical net move-out standpoint in April with net move-outs for our 118 consolidated communities of 186 residents in April. May, as Kim noted, improved considerably, and we had net move-outs of 69 residents in May. And then June improved even more with our sales and operations team actually delivering growth in physical net move-ins of 33 residents for the month of June, which was an incredible feat, I think, in this very challenging COVID environment.

With the resurgence in COVID cases across the nation in July and several of our most significant states considered to be in hotspots, the July move-ins and move-outs played out much more like May with the decrease in physical net move-outs of approximately 75 residents. Here's how our financial occupancy played out through the second quarter. The starting point was financial occupancy of 79.8% for the month of March. Then occupancy dropped 110 basis points to 78.7% for the month of April. Then it dropped another 130 basis points to 77.4% in May and then 70 basis points to 76.7% in June. Our July financial occupancy showed a lesser decline, moving down 30 basis points to 76.4%.

As for collections, our overall collections as a percent of revenue through the pandemic period have remained consistent with the pre-pandemic period. Most of our collections are via ACH, and ACH collections have continued to be in the high 80% as a percent of our total revenue collected. We've seen a slight increase in our credit card usage for rent payments, but that still remains a very small percentage of our overall collections. And our return amounts have been very consistent with the pre-pandemic period. Returns bumped up slightly in March and then came right back down to normal levels in April and all the way through July.

Our operating expenses in the second quarter of 2020 were $71.3 million, which was a decrease of $3.1 million when compared to the second quarter of last year. The second quarter of last year included $3.9 million of operating expenses related to 5 communities

we've disposed of since then and also the 6 formerly leased communities that we're now managing as of March 1 of this year.

We also had some business interruption credits in the second quarter of last year that we don't have this year. That was $1.2 million. That was related to Hurricane Harvey and the insurance returns we continue to get related to those.

The same community results noted in our earnings release and which I'm about to reference exclude $500,000 of COVID-19 revenue relief that we received in the second quarter from a North Carolina State Medicaid program, and they also exclude $2.9 million of COVID-19 expense, primarily for hazard pay for employees at COVID-positive communities. That was about $1.5 million, and then the remaining $1.4 million was for increased cost for PPE, special sterilization services and then cleaning and disposable food service supplies primarily.

Our same community revenues on this basis decreased $5.1 million or 4.4% in the second quarter as compared to the second quarter of last year. Compared to the first quarter of this year, our revenue decreased $2.7 million or 2.7%. Our same community occupancy was 77.6%, which is 480 basis points lower than the second quarter of 2019 and it's 230 basis points lower than the first quarter, so a sequential decline in occupancy of 230 basis points on a same community basis.

Not all of our peers have reported yet, but based on what we've seen so far, we believe our sequential decline in occupancy will definitely be in the top tier performance. Our average monthly rent increased 0.6% to $3,729 in the second quarter of 2020 over the second quarter of 2019, and then it increased slightly 0.2% as compared to the first quarter of 2020.

Our same community expenses decreased 0.3% in the second quarter of 2020 as compared to the second quarter of last year due to our operations team's focus on and success in managing cost to offset the impact of the incremental COVID-19 cost. Our employee labor cost increased $2.1 million, but all of our other expense categories combined to decrease $2.4 million. Contract labor, which has been a focus for us over the last year, declined $1.4 million and most other categories, including food, advertising and promotion, repairs and maintenance and supplies all decreased as compared to the second quarter of 2019.

Our same community net operating income, which again excludes COVID-19 revenue relief and COVID-19 cost, was $30.4 million, which is $800,000 less than the first quarter of 2020. And our NOI margin was unchanged from the first quarter of 2020 at 31% despite the revenue decline.

Our G&A expenses for the second quarter of 2020 were $6.5 million, which compares to $6.6 million in the second quarter of 2019. If you exclude the transaction costs from both years, our G&A expense decreased about $800,000 in the second quarter as compared to the second quarter of last year, primarily due to lower health care claims expense that were associated with our self-insured health plans.

Our adjusted EBITDAR in the second quarter of 2020 was $23.9 million, which was $2.4 million lower than the first quarter of 2020. Adjusted EBITDAR, if you exclude the impacts of COVID-19, the revenue relief and the COVID-19 cost, that was $26.3 million, which was a decrease of only $300,000 from our EBITDAR for the first quarter of this year.

Our adjusted CFFO was $546,000 in the second quarter of 2020, which was an increase of $800,000 as compared to the first quarter of 2020. That increase is due to the reductions in our lease expense in the second quarter related to the agreements that we reached with our landlords in the first and second quarters of 2020. And when you exclude the impacts of COVID-19, our adjusted CFFO was $2.9 million in the second quarter of 2020.

We noted in the release that we had $25.5 million of available cash at June 30 and including restricted cash, our cash balance was $28.8 million. We spent $2.7 million on capital expenditures in the second quarter, and so far this year, we've spent $8.1 million on capital expenditures.

I mentioned that we received COVID relief in the second quarter under a North Carolina State Medicaid program in the second quarter. Again, we received $500,000 in additional revenue from that program. It allowed for the billing of additional hours and at higher rates due to COVID for our residents in the state of North Carolina. And then that also provided us another $100,000 to offset certain COVID-19 expenses. That's the only relief that we've received to date. We do expect to receive relief funds from state Medicaid programs from the states of Nebraska and Wisconsin, but we don't know the timing or the amount of that relief yet. And we've also applied for relief from a CARES Act provider relief fund for eligible Medicaid providers. And we expect to receive some funds from that program, but we don't yet again know the amount or the timing of that relief.

We were able to defer $5.7 million of debt service payments under forbearance agreements from certain of our lenders in the second quarter with 1 of those forbearance agreements then extended through the month of July. We also deferred taxes of $2.7 million under the CARES Act in the second quarter.

Kim discussed our decision to turn back 18 communities to Fannie Mae. And as she said, that decision was difficult, but it was an important next step in our plan to restructure our balance sheet following the agreements that we reached with our REIT partners in the first quarter. We are fully committed to reducing our debt and getting our balance sheet in a state that will support our continued operational turnaround.

As we look forward, the operating environment will remain challenging in the months ahead, but we're confident that the steps we've taken and will continue to take to improve our balance sheet and the improvements that we've made to our operating platform over the past 18 months provide us with a path to growth and long-term value creation. We're working diligently to build a company that will have a consistent, high-quality product across its portfolio, and we know the hard work that we've done and are

continuing to do will serve us well through this current challenge and as we emerge from the COVID-19 crisis.

With that, France, I will turn the call back to you for Q&A. So if there are any questions, please let us know.

Question-and-Answer Session

Operator

[Operator Instructions] And our first question is from the line of Steven Valiquette with Barclays.

Steven Valiquette

I just want to follow up quickly on the facilities that were turned back to Fannie Mae. Yes, I looked in the 10-K and it discloses - I think you have 78 total facilities owned by the company, are encumbered by mortgage debt. I know you have 35 different mortgage loans with Fannie Mae. I don't know if that means 35 different properties. But I guess the questions are how'd you arrive at 18 as the proper number of properties to pull the trigger on this. And I guess the question is could there be additional properties in the near term that also can have sort of the same outcome. Just curious to get more color around that whole process.

Carey Hendrickson

Yes. Steve, this is Carey, and I'll start with that, and Kim can add in. We had 23 Fannie Mae communities that were under forbearance, and that was the beginning point of looking at those. Those were the ones - all of our other loans with Fannie Mae are performing well and are - have good debt service coverage ratios, and so there's - we just had those 23 that were eligible really for forbearance. And looking at that, there were 5 of those that have done pretty well through the COVID environment, and we made the decision that we could keep those. We brought those current at the end of July and made the August payment just like we would normally make as it relates to those 5.

The other 18 were underperforming or they were in underperforming loan pools, and we had to look at the pool as a whole with Fannie Mae. So, it was really based on looking at their leverage position, their contribution to cash flow from a levered cash flow standpoint and really determining that those were the 18 that we need to turn back. The rest of that Fannie portfolio is performing.

Steven Valiquette

Okay. And then just shifting gears a little bit. I got on the call a little bit late, but I think I heard your comments that you had positive move-ins, net move-ins in June, but then it sounds like it reversed a little bit in July. I was just curious to hear more about that reversal, if that was just tied to maybe certain states where COVID cases are starting to

spike up again. And was that - also as far as some of this shift that's going on, how much of this might be related to voluntary actions at the facilities on either not accepting new move-ins versus maybe the state government mandates that's forcing some of this? I just want to get more color around that as well.

Kimberly Lody

Sure. We can certainly provide that. So, we were really pleased with the performance in June and being able to achieve the positive net move-ins. And much of that has to do with our incredible safety protocols and the teams that we have there in the communities really managing that and our sales team in managing those prospects and helping them to be comfortable coming into our communities due to the safety protocols that we have in place and the actions that we've taken.

In July, from an operating perspective, those things didn't change, right? We still have those same protocols in place, but unfortunately, as we saw the number of COVID cases surge in various parts of the country, in particular, in the south and southeast, we saw that the move-ins began to pull back as people postponed their decisions to really head into senior housing giving that resurgence.

Operator

[Operator Instructions]. Our next question, from the line of Morgan McCarthy with Barclays.

Morgan McCarthy

I guess my first question is, I guess, I'm wondering how you've been thinking about the trade-off between occupancy and rate for the remainder of the year. I know you previously discussed the preference towards maintaining rate, and I guess I'm just wondering if any of the current pressures related to COVID have changed your views heading into the second half of the year.

Kimberly Lody

We're really looking at that balance between rate and occupancy pretty strategically and very focused in terms of the specific communities and the specific market conditions in which that community operates. So, if there are situations where we can help people feel more comfortable moving in by providing some reduction or concession with respect to rate, then we may do that in particular places.

I will say our business is very much a needs-based business. There is a fair amount of pent-up demand out there as seniors have been staying at home and feeling the impact of the isolation of COVID. So, where we need to, we're - we will adjust rate in order to help those move-ins happen. But for the most part, our focus is on maintaining that balance. And we feel like if we can keep rates stable while maintaining a either reduction - a small reduction decline in occupancy, perhaps even stabilize here by the end of the year, that's really our focus, the balance of those two things together.

Morgan McCarthy

Okay. And then just one more question. Can you provide any more color on the difference in - between some of your more needs-based facilities such as the assisted living versus independent living in the quarter and then even in July, around either move-ins or leads or rep work?

Kimberly Lody

We can - let me just get to that spot. So, for independent living, the changes in occupancy were, I'd say, relatively moderate. Most of the changes that have occurred in occupancy have been more in the assisted living and memory care settings.

Carey Hendrickson

Yes. And Morgan, to provide a little color on that, the - this is Carey. The occupancy for our independent living quarter-over-quarter declined 170 basis points, but the occupancy for AL and Alzheimer's declined - and this is sequential, declined around 260 to 270 basis points. So, there was obviously a less decline in IL than there was in AL.

Morgan McCarthy

Okay. Great. And then I just have one more final question. I guess I just want to see if you've heard any updates for senior housing industry to get any federal relief on a broader basis and how that's progressing with the trade associations.

Kimberly Lody

Well, we're very grateful to the trade associations and all of our peers in the industry because, of course, this is a huge focus for the entire industry and something that is critical. We've been, as an industry on the front lines, fighting this pandemic, and there really has been very limited relief available to providers outside of the things that are starting to trickle in from the various states.

We remain optimistic that there will be something in the upcoming bill that will provide relief to our industry. I think the industry is doing everything it can to encourage that and communicate and share data and make sure that the situation is well known. So we look forward to seeing how all of that develops here over the next several weeks.

Operator

I would now like to turn the call back to Kim Lody for her closing remarks. Please go ahead.

Kimberly Lody

Thanks, France. Thank you to our shareholders, vendors, residents and employees for your trust in Capital Senior Living. This concludes today's conference. Thanks, everyone. Have a great day.

Operator

Thank you. this does conclude the conference call for today. We thank you all for your participation and kindly ask that you please disconnect your lines. Have a great day, everyone.

Kimberly Lody

Thank you.