

# Capital Senior Living Corporation (CSU) CEO Kimberly Lody on Q3 2020 Results - Earnings Call Transcript

November 5, 2020 2:30 PM ET Capital Senior Living Corporation (CSU)

Capital Senior Living Corporation (NYSE:[CSU](#)) Q1 2021 Results Conference Call  
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## Company Participants

Kimberly Lody - President and Chief Executive Officer

Carey Hendrickson - Chief Financial Officer

Brandon Ribar - Chief Operating Officer

## Conference Call Participants

Steven Valiquette - Barclays

## Operator

Good day, and welcome to the Capital Senior Living Third 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 laws. 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 in 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 at [capitalsenior.com/investor-relations](http://capitalsenior.com/investor-relations) and was furnished in the 8-K filing this morning. Also, please note that during this call, the company will present non-GAAP financial measures. For reconciliation of each non-GAAP measure 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's President and CEO, Ms. Kimberly Lody.

## Kimberly Lody

Thank you, Hector, and good afternoon, everyone. First and foremost, I hope you and your families are safe and healthy. Before I get into the accomplishments for the quarter

as well as a strategy update, I want to personally thank Carey Hendrickson, our Chief Financial Officer, for his service to the company over the last 6 years. As we have announced a few weeks ago, Carey will be leaving the company at the close of business tomorrow. I appreciate his standing by my side for the last 7 quarters and for his instrumental role in the transformation of Capital Senior Living. He will be missed, and we wish him well in his future endeavors.

We have a strong accounting and finance team currently led by Tiffany Dutton, our Vice President of Accounting and Financial Reporting. Tiffany joined the company in January and has reshaped our finance and accounting functions to upgrade talent, streamline processes, shorten close cycles and improve the collaboration between operations and finance. The near-term operating environment and smaller footprint of the company will inform our short- and long-term financial needs as well as the ideal skill sets for the CFO role. In the interim, Tiffany and I will continue working closely together to lead our accounting and finance functions.

Turning to our strategy, today, we are about 60% through our 3-year plan to improve the company's operating performance and financial foundation. This strategy has 3 main goals: to stabilize operations, to completely restructure the company's portfolio of assets and to improve our balance sheet. The work we have done since the beginning of 2019 continues to serve us well during the COVID pandemic and corresponding challenging operating environment. As a reminder, our turnaround plan was taking hold and beginning to show results prior to the pandemic. In January and February, our 95 same-store communities, our move-ins were up 6.9% and move-outs were down 5% compared to the same period in the prior year. We also reported \$2.7 million of sequential margin expansion in the first quarter of this year.

When the pandemic set in during March, we continued to operate with discipline and diligence. And in Q2, we were pleased to report less occupancy deterioration, lower percentage revenue decline, better expense control and better margin protection than most of our industry peers. And while operating conditions remained challenging throughout the third quarter, the company has continued to perform well in the face of this pandemic. The NIC MAP Q3 2020 data shows occupancy for seniors' housing secondary markets dropped 250 basis points from the second to the third quarter. Our 95 same-community portfolio, which operates mostly in secondary markets, experienced a similar but less pronounced downturn with occupancy declining 190 basis points from the second to the third quarter and with declines decelerating each month of the quarter. Our volume metrics continue to improve. During the third quarter, leads improved 8%, tours increased 28% and move-ins increased 18% as compared to the second quarter of this year. Additionally, our same-store portfolio recaptured 87% of the move-in volume for the same period in the prior year.

Pages 7 and 8 of the disclosure presentation released today shows more information about these trends. This is very good progress in protecting our occupancy and revenue as much as possible in the challenging operating environment while helping prospective residents and their families receive the senior living services they are seeking, as our care and services are needed now more than ever. Move-outs were elevated in the third

quarter after several months of being well below pre-COVID levels. We track move-outs carefully. And in Q3, as the urban markets across the United States experienced escalating COVID-19 cases, the level of move-outs attributable to home or self-care increased in our portfolio. We believe this is a short-term situation due to family fatigue with COVID-related state restrictions on visitation and assisted living facilities. While our leading indicators continue to improve each quarter, we expect occupancy recovery to take some time due to the prolonged duration of the pandemic and the unique challenges that creates for families seeking senior living services.

With respect to liquidity, we continue to manage cash very carefully. We have applied for the federal CARES Act Phase 2 and Phase 3 funds. Our Phase 2 application was approved and we were recently notified that we will receive approximately \$8 million in the next day or so. When received, these funds are grants to offset the revenue losses and incremental expenses attributable to COVID-19 and do not need to be repaid. We have also received various amounts of relief from select states in which we operate and expect to receive additional state relief funds by the end of the year.

As we have reported in prior periods, we took several actions this year to restructure the portfolio, address the company's leverage and improve liquidity. By the end of the year, which is just 8 weeks away, we will have exited substantially all of our triple-net leases, most of which were underperforming. This will significantly improve the company's cash flow and reduce our long-term liabilities. While most of the currently leased communities will transition to other operators, we expect to retain 15% to 20% of these communities under management agreements. In August, we announced the turn-back of 18 communities with non-recourse mortgage debt to Fannie Mae. This decision immediately improved our cash flow. And when the transitions are complete, the debt associated with these communities will be eliminated. Since August, we have continued operating these communities on Fannie Mae's behalf in exchange for a management fee, and we'll continue to do so until such time as they can be transitioned to other operators.

When all transitions are complete, our portfolio will consist of 60 owned communities. This owned portfolio is comprised of assets with our strongest historical operating performance. In 2019, occupancy in this group of assets ranged between 84.4% and 85.7% and quarterly NOI margin ranged from 28.9% to 33%. I see no reason why these communities cannot begin to return to at least the same level of performance as the operating environment stabilizes. Pages 19 to 22 of the disclosure presentation released this morning, includes additional information about this future portfolio.

Lastly, as we adjust the size of our portfolio, we have also taken action to reduce our G&A expenses. First, we downsized our Dallas support center, which will save us approximately \$450,000 annually in office lease expense. Also, completely restructured our operations leadership teams to reduce overhead and more closely align all business units and field support functions directly to move-ins. And lastly, we have restructured our Dallas support center teams so that our G&A cost declined as our community portfolio become smaller through the rest of this year and into the first half of next year. We expect our 2021 G&A to be approximately \$7.5 million less than the annualized

G&A cost in 2020. We feel good about our restructured portfolio, our improving balance sheet and our path and stabilized operations. We also remain cognizant of the operating environment and the COVID pandemic as we continue to focus on our number one priority of providing the best care possible to people who live in our communities.

I will now turn the call over to Brandon to provide more detail on the actions we have taken and continue to take to adjust our operating model for the current environment.

### **Brandon Ribar**

Thank you, Kim and good afternoon. As we near the end of 2020 and enter what promises to be a challenging winter season across the nation, I want to again recognize the tireless efforts and dedication of our community teams. We entered the pandemic more than 8 months ago and the health and safety of our residents and staff remains the primary focus every day. The stable operating performance CSL has produced relative to peers and adjacent sectors during this pandemic reflects ongoing confidence in our operating model in spite of continued occupancy pressure industry-wide. Same community revenue at 97% of 2019 on a year-to-date basis and the achievement of nearly 90% of prior year net operating income compare favorably with publicly reported competitive data.

Most recently, revenue in September remained stable on a same community basis, with a minimal sequential decline of \$100,000 from August. Recent move-in and move-out activity indicate a similar expected change in October revenue. These results reflect the ongoing commitment to focused operating and clinical excellence across the local and regional leadership teams. Our leadership retention and employee turnover metrics continue to trend favorably on a year-over-year basis. Our total company turnover year-over-year improved nearly 10 percentage points, and the retention of our key leadership roles remained strong.

Our leadership stability in the face of the prolonged COVID-19 pandemic is paramount to operating results in Q4 and beyond. Local adherence to strong infection control and resident safety protocols depends on strong Executive Director and Wellness Director presence and engaged relationships with our frontline caregivers and service providers. Additionally, ongoing partnership with local regulators and an understanding of often fluid operating guidelines imposed at the state level, require focused and dedicated leadership in each community.

Let me now take a few minutes to review the current status of our operational response to COVID-19 and operating protocols across the portfolio. We continue diligent infection control practices, including use of PPE, comprehensive screening of all visitors and staff and extensive disinfecting protocols. Our communities consistently obtain or administer COVID-19 testing for new residents and those returning from high-risk environments such as hospitals or skilled nursing facilities.

In accordance with state and CSL guidelines, broad testing of staff through third-party lab partners and state-provided resources continues on a day-to-day basis. We currently have 86 residents with active COVID-19 cases in our population of

approximately 9,000 residents. All communities are currently open for new resident move-ins and tour volume continues to improve, both through virtual and on-site options. From a health and wellness perspective, CSL continues to work diligently with our therapy and wellness partners to address the ongoing needs and interests of our residents. The diligent monitoring of our residents' health and well-being and access to recovery services, should decline begin to occur, are key components of preventing move-outs. Our move-out volume in October decreased 11% from our Q3 average.

Shifting to our operating results on a same-community basis, sequential revenue decline of \$2.3 million or 2.9% was driven by the 190-point reduction in occupancy from Q2 to Q3 that Kim referenced earlier. Rate held steady with a slight sequential decrease of 0.4% when excluding COVID-19 relief dollars. Year-over-year rates have increased 0.6% for Q3 versus prior year quarter. And for Q3, discounting of rates for new residents remained strategic, disciplined and focused in markets where competition continues to materially discount rent and increase concessions to offset occupancy pressures.

On the expense front, Q3 expenses, excluding \$1.3 million of COVID-19 costs increased only \$0.1 million or 0.1% compared to Q3 of last year. Sequentially, and including COVID-19 costs, controllable operating expenses increased \$0.3 million or 0.5% from Q2. The increase was due to additional sales and marketing costs associated with our increased move-in volume and outreach efforts. In addition, investments in our communities' physical plant and seasonal utility increases also contributed to the change. Labor costs decreased \$400,000 from Q2, including COVID-19 hero pay for frontline caregivers. Our local operating teams continue to diligently adjust their operating model to address changes in occupancy while ensuring the safety and well-being of our residents and staff on a day-to-day basis. Our net operating margin percentage for Q3 was 29% in spite of the prolonged COVID-19 operating environment.

As Kim mentioned, our revenue key performance indicators improved throughout the third quarter with Q3 move-ins reaching 87% of normal. Over the next two quarters, we will continue investing in our sales process, resident programming and physical product to ensure we remain highly competitive and well positioned to grow revenue as the impacts of COVID-19 subside. The ongoing rollout of differentiated programming for residents with shorter-term stay expectations and those with memory care needs, in addition to the expansion of inside sales capabilities, will support the growth phase of our SING strategy.

While the impacts of COVID-19 on near-term revenue growth expectations remain uncertain, we continue to utilize strong operating practices and protocols to responsibly manage business performance and maintain stable financial results. We remain confident in our leadership teams across our individual communities and our regional team to navigate the always changing environment and continue providing a safe and enjoyable environment for current and future residents.

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

## Carey Hendrickson

Great. Thank you, Brandon and good afternoon to everyone on the call. Our third quarter 2020 results reflect the impacts of COVID-19 on our occupancy revenue and expenses. However, as they did in the second quarter, our operations team did an excellent job in managing the cost within their control to mitigate the impact of COVID-19 on our overall results and eliminating the declines in occupancy during the quarter. The third quarter also reflects positive impacts associated with the actions we've taken in recent months related to our lease portfolio and the transition of our 18 underperforming communities to Fannie Mae.

Looking at our third quarter results, our total consolidated revenues in the third quarter were \$96.3 million, which compares to \$111.1 million on a reported basis in the third quarter of 2019. This \$14.8 million decline is mostly related to communities that we've transitioned in one way or another since the third quarter of last year. The company had 33 less communities for all or part of the third quarter of 2020 than it had in the third quarter of 2019. The 18 communities that we have transitioned to Fannie Mae effective August 1, 2020, represented \$9.8 million of the revenue decline, 3 communities sold since the third quarter of last year represented \$4.1 million, 6 formerly leased communities transitioned to new operators contributed \$2.9 million to the revenue decline and then 6 formerly leased communities transitioned to management agreements represented a decline of \$3.2 million. The decline in revenues from these transition communities was partially offset by \$10.2 million of revenue related to our management of 24 communities for part or all of the third quarter, the 6 Healthpeak communities that we've been managing since February of this year and in the 18 Fannie Mae communities that we began managing in August and will continue to manage until they're fully transferred to new operators.

Most of the revenue associated with these managed communities, \$9.6 million of it, was related to the reimbursement of certain operating costs that we paid on their behalf, and you will see there is a corresponding expense on our income statement for this same amount. Our management fee revenue in third quarter was \$600,000. The financial occupancy for our consolidated communities was 76.1% in the third quarter, a decline of 150 basis points from the second quarter of 2020 and a decline of 520 basis points from the third quarter of 2019.

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 percents as a percent of total revenues collected. We have seen an increase in 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.

Operating expenses in the third quarter of 2020 were \$65.2 million, a decrease of \$15.2 million when compared to the third quarter of 2019. As I mentioned when discussing our decline in revenue, we had 33 less communities for all or part of the third quarter of

2020 than we had in the third quarter of 2019. These 33 communities accounted for \$14.3 million of the decrease in expenses on a combined basis.

Our third quarter 2020 operating expenses included \$1.4 million of costs directly related to COVID-19, primarily for employee hazard pay, specialized sterilization services, personal protective equipment and disposable foodservice supplies. The same-community results noted in our earnings release in which I'm about to discuss exclude these COVID costs. Our same-community revenues decreased \$3.9 million or 4.8% in the third quarter of 2020 compared to the third quarter of 2019. Compared to the second quarter of this year, revenue decreased \$2.3 million or 2.9%. Our same-community occupancy was 78.0%, which is 460 basis points lower than the third quarter of '19 and is 190 basis points lower than the second quarter of 2020. Based on the reported results of our peer companies and compared to NIC MAP results, as Kim noted, it appears that our sequential decline in occupancy from the second quarter to the third quarter is again considerably less than our peers as it was in the second quarter, when our same-community occupancy declined 230 basis points versus an average decline of 450 basis points for our peers.

Our combined second quarter and third quarter declines totaled 420 basis points, which is less than our peers' average decline for the second quarter alone. While we're certainly not pleased with any occupancy decline, our operations and sales teams have done an admirable job in an unprecedented challenging marketplace. On a month-by-month basis, same community occupancy was 79.2% in June, 78.8% in July, 77.8% in August and 77.3% in September. Our average monthly rent increased 0.6% to \$3,731 in the third quarter of 2020 over the third quarter of 2019, and it decreased slightly 0.4% as compared to the second quarter of 2020. Same-community expenses, which exclude COVID cost of \$1.3 million, increased only \$100,000 or 0.1% in the third quarter of 2020 as compared to the third quarter of last year due to our operations team's focus on and success in managing costs to offset the impact of incremental COVID-19 cost. Our employee labor cost increased \$500,000 or 1.4% and while all of our other expense categories combined decreased \$0.4 million or 1.9%, with our 2 other major cost categories, food and utilities, down 6.5% and 1.5%, respectively. Our same-community net operating income was \$22.3 million, and our NOI margin was 29%.

Our general and administrative expenses for the third quarter of 2020 were \$8.1 million compared to \$7.6 million in the third quarter of 2019. Excluding transaction costs for both years, our G&A expense decreased approximately \$300,000 in the third quarter of 2020 as compared to the third quarter of 2019 due to lower health care claims expense associated with our self-insured health plans. Our adjusted EBITDA in the third quarter of 2020 was \$15.7 million. And after excluding COVID-19 impacts, it was \$17.2 million. Our adjusted CFFO was negative \$5.2 million in the third quarter of 2020, and again, when COVID-19 impacts are excluded, adjusted CFFO was negative \$3.8 million.

We noted in the release that we had \$18.3 million of cash at September 30, including restricted cash. As Kim noted in her remarks, we've been approved for approximately \$8 million of relief funding under the CARES Act from HHS, which we expect to receive in the next few days, and we've applied for additional relief funds based on estimated

lost revenues and incremental expenses under the same program. We received approximately \$100,000 of relief funds to offset COVID-19 expenses from state programs in Wisconsin and Ohio in the third quarter with approximately \$800,000 of additional funds expected to be received under these programs in the fourth quarter. We've also received approximately \$1.1 million in distributions in the second and third quarters from the Ohio Bureau of Workers' Compensation to help companies doing business in Ohio during COVID. And we expect to receive another even more significant distribution from them in the fourth quarter.

In October, we extended and enhanced our forbearance agreement with one of our lenders that resulted in 3 additional months of full principal and interest relief on 10 communities and 3 additional months of interest-only on these 10 communities, which amounts to approximately \$2.8 million of additional relief. We also deferred payroll taxes of \$2.3 million under the CARES Act in the third quarter. And so far this year, we have deferred a total of \$5 million. The operating environment will remain challenging in the months ahead, but significant improvements have been made to the company's operating platform over the past 18 months that we believe will provide a path to growth and long-term value creation. The company's management team is working diligently to build a company that will have a consistent, high-quality product across its portfolio, and I'm confident that the hard work that has already been done and the strong efforts that continue to be made will serve the company well through this current challenge and as an emergence from the COVID-19 crisis.

I am moving on to another opportunity, but I strongly believe in this company and its dedicated employees in our Dallas support center and across our portfolio. As Kim noted, we have a strong finance and accounting team that will provide excellent support to the team. From my perspective, the company is stronger in many aspects than it's been in the 6.5 years that I've been with the company, particularly in sales and operations. I thank Kim for her support during our time together at Capital Senior, and I know she will very capably lead the team forward.

That concludes our prepared remarks, and I will ask our operator, Hector, to open the line for questions.

## **Question-and-Answer Session**

### **Operator**

Your first question comes from the line of Steven Valiquette with Barclays. Please proceed with your question.

### **Steven Valiquette**

Thanks. Good afternoon everyone. Thanks for taking the questions. So, I guess I'm just curious, some investors are trying to figure out that if we do get a COVID vaccine, how much that could really impact the occupancy within various business models including senior housing. So, I'm curious if you have any thoughts on whether this is something that you think can move the needle materially, perhaps right away, maybe in the first

month or first quarter as far as your occupancy, etcetera, once that comes out. And how does senior housing stack up on the availability to get vaccines versus other sectors or is it something that might take a little bit longer to play out as far as how much it really helped the business? Just want to get more color around how you are thinking about that? Thanks.

**Kimberly Lody**

Brandon?

**Brandon Ribar**

Hey, Steve. Good afternoon. Happy to kind of go into some thoughts around that. So first, to address the end of that question which was around the availability and based on what we've learned from HHS, we will be at the front of the line in terms of the availability of those vaccines for our residents and for our employees as well. So, a lot of – I guess, a lot of the outcome will depend on how quickly that is available, which markets it rolls into first and what the overall kind of, again, time to get all interested parties vaccinated. So, we do know that, that has been a consistent apprehension from people seeking senior services over – throughout the pandemic. So, in terms of the immediate impact on our occupancy, I think it's likely to take a few months for that to really play out. But it will be a very positive, I think, event for our industry to have access to that, again, towards the front of the line when it does become available.

**Steven Valiquette**

Okay. Maybe just a quick follow-up, I guess aside from the vaccine, what else do you think is the most critical piece of the puzzle or the biggest delta that will drive occupancy to the higher end or lower end of a range for internal budgeting purposes as you think about calendar 2021?

**Kimberly Lody**

Hey, Steve, it's Kim.

**Steven Valiquette**

And I know you are not supposed to give any guidance, obviously, but just for your internal thoughts as you are trying to map out the next year or so, how are you thinking about what else is the most critical?

**Kimberly Lody**

Yes. I think one of the most critical things is really consumer confidence in not only in our product, but in the overall assisted living segment. The vaccine, I think, will help quite a bit with that. I also think that as data becomes available from the various operating partners in the sector about how they have handled COVID-19, what impact it has had on their occupancy and on revenues, that will help build that confidence. That's one of the things that we are really focused on is educating the broader market through

our sales outreach as well as folks who reach out to us and contact our communities about all of the work that we have done to implement the infection control protocols and the changes to the operating model that we've instituted to help mitigate the effects of COVID and keep our residents safe. I mentioned earlier that we have seen in the third quarter, an uptick in the number of folks like as a percentage of move-outs that have selected the reason as home care or self-care, meaning they're likely moving back in with a family member. We view that as very temporary and short-term. We believe that it will – those same folks and others like them will continue to have the need for senior living, especially assisted living and memory care, which are very need-based. And once they have that confidence that people know how to operate in a COVID environment and that there is a vaccine that they will begin to return to senior housing again.

### **Steven Valiquette**

Okay, great. Another question for me, I might have missed some of the prepared comments around this. But just want to get a little more color on just overall PPE and operating cost. It feels like maybe the worst is behind us and maybe we're coming down the other end of that bell-shaped curve, just wanted to kind of confirm that? And just if there is any extra color you could add or any comment from that would be helpful as well? Thanks.

### **Brandon Ribar**

Yes. I would just say from an operating perspective, the driver of the additional expense really is around the cost of labor. And so, as we see the case numbers ultimately begin to decline and subside when a vaccine is introduced, I think there'll be a corresponding reduction. And we've actually seen a reduction in our cost of labor in Q3 versus Q2 when the pandemic was first impacting the industry. So, on the staffing front, we look forward to the continued reduction of that cost. And then on the PPE side of the world, we will continue to be purchasing all those supplies that have been required throughout the pandemic. So, I expect that will – that supply cost will stay pretty consistent as we ensure that all of our staff have everything needed, which is a bit of a less – a bit of a lower expense but still definitely considered.

### **Steven Valiquette**

Okay, got it. Okay, pursued all comments. Thanks.

### **Kimberly Lody**

Thanks, Steve.

### **Operator**

Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Ms. Kimberly Lody for closing remarks.

**Kimberly Lody**

Okay, great. Well, this concludes today's conference. Thank you, everyone and have a great day.