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Medical Properties Trust, Inc. (MPW)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Q4 2022 Medical Properties Trust Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please also note today's event is being recorded.

At this time, I'd like to turn the floor over to Charles Lambert, Vice President. Sir, please go ahead.

Charles Reynolds Lambert
Vice President, Treasurer & Managing Director-Capital Markets, Medical Properties Trust, Inc.

Thank you. Good morning and welcome to the Medical Properties Trust conference call to discuss our fourth quarter and full year 2022 financial results. With me today are Edward K. Aldag, Jr., Chairman, President and Chief Executive Officer of the company; and Steven Hamner, Executive Vice President and Chief Financial Officer.

Our press release was distributed this morning and furnished on Form 8-K with the Securities and Exchange Commission. If you did not receive a copy, it is available on our website at medicalpropertiestrust.com in the Investor Relations section. Additionally, we're hosting a live webcast of today's call, which you can access in that same section.

During the course of this call, we will make projections and certain other statements that may be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause our financial results and future events to differ materially from those expressed in or underlying such forward-looking statements. We refer you to the company's reports filed with the Securities and Exchange Commission for a discussion of the factors that could cause the company's actual results or future events to differ materially from those expressed in this call. The information being provided today is as of this date only, and except as required by the federal securities laws, the company does not undertake a duty to update any such information.

In addition, during the course of the conference call, we will describe certain non-GAAP financial measures which should be considered in addition to and not in lieu of comparable GAAP financial measures. Please note that in our press release, Medical Properties Trust has reconciled all non-GAAP financial measures to the most directly comparable GAAP measures in accordance with Reg G requirements. You can also refer to our website at medicalpropertiestrust.com for the most directly comparable financial measures and related reconciliations.

I will now turn the call over to our Chief Executive Officer, Ed Aldag.

Edward K. Aldag, Jr.

Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

Thank you, Charles, and thank you all for listening in today on our fourth quarter earnings call. As one of the largest publicly traded owners of hospitals in the world across 10 different countries on 4 continents, we find the outlook for our tenants extremely encouraging on all fronts. Recent public comments from US operators confirm the optimism about the industry.

Staffing costs are dramatically improved going into 2023, as is access to qualified patient care staff; and our tenants are implementing innovative means to develop and retain employees. Contract labor calls peaked last March and have come down approximately 33%. Our operators continue to take advantage of advances in technology to increase efficiencies, deliver quality patient care and reduce cost on a per-patient basis. My point being that simply because an inflation index is higher doesn't mean that our operators do not have arrows in their quiver to reduce structural cost, transform procedures, et cetera. Hospitals have been for decades required to continually improve process procedures, treatments, and optimize charges to maintain equilibrium with a rapidly growing demand for patient treatment. As we move into 2023, the prognosis for generalized margin improvement across the entire industry on an increasing volume is encouraging.

Our operators are experiencing low- to mid-single-digit comparable revenue increases, depending on the diagnosis, acuity and payer, which along with improving volumes and expanding reimbursement programs all along the scale are expected to generate an attractive 2023 for MPT's tenants. We've been very busy during all of 2022 maintaining relationships, building new ones, and keeping our sights on our abundant opportunities throughout the world. We continue to see tremendous opportunities and are prepared to act on them as soon as the world settles down on the new normal for interest rates. We continue to have a strong pipeline in our current markets like the United States, Europe, and South America, but we also continue to explore new markets across the NAFTA and ASEAN business quarters.

Our portfolio continues to produce operating results in line with our original underwriting standards. Like the results posted by the publicly reporting hospital operators, our operators continue to see vast improvements to the labor issues that affected the market this time last year. In December of 2022, we acquired approximately £230 million of additional properties. This addition of six Priory hospitals purchased from a third party will be added to our master lease with Priory and improve the already strong Priory portfolio.

And as you all know, we recently completed the Springstone transaction with Apollo. Springstone will be added to the LifePoint portfolio. This is another good example of our acquiring a holdco, spinning out the operating piece out to a third party for profit and retaining the real estate.

I'll spend a few minutes reviewing Prospect due to its relevance this quarter. Prospect continues to make progress with their East Coast divestitures in Rhode Island and Connecticut. The transaction in Connecticut with Yale New Haven Health Systems (sic) [System] (00:06:28) is still tracking for a midyear close, while the non-MPT facilities in Rhode Island are expected to close in the latter part of 2023.

On an extremely encouraging note, independent third parties have valued Prospect's managed care business at around $1 billion. With our security interest in this managed care business, our share of proceeds from the Yale sale and the excess value in the California properties, we believe we have more than sufficient collateral, even without regard to the value of the Pennsylvania properties, to more than realize a full return of our investment in Prospect, including any deferred rent.

In addition to multiple initiatives at their hospitals, Prospect management is focused on an aggressive cost-cutting measure that should enable them to return the Pennsylvania market to profitability in approximately 12 months to 18 months. The California facilities are currently generating a coverage of 1.2 times on a trailing 12-month basis as of the end of the third quarter 2022.

That being said, given the elongated timing of the Pennsylvania recovery, we felt it prudent to write off previously recorded straight-line rent and write down the Pennsylvania facilities. Last week, Steward and CommonSpirit announced a definitive agreement for Steward to sell the operations of their Utah facilities to Catholic Health Initiatives, a CommonSpirit subsidiary.

The purchase price will be used by Steward to pay down debt obligations, including the loan MPT made to Steward last summer and provides Steward with a good amount of liquidity. We announced our agreement to lease our entire Steward Utah hospital portfolio to Catholic Health Initiatives. This will be the second transaction we've done with CommonSpirit and we are excited to expand this relationship. As you know, CommonSpirit, with a credit rating of A is one of the country's largest and most respected not-for-profit healthcare providers. The announcement made last week regarding Steward's pending sale of its Utah facilities once again validates the MPT model of underwriting and further validates the value of our entire portfolio. Our track record of underwriting hospital real estate where the demand for the operations enhance the value of the underlying real estate can far outlast the operator itself has a 20-year outstanding history.

I want to close this part of our earnings call to make a few comments about one of mine and Steve's co-founders, Emmett McLean. Today, we will announce Emmett's retirement from MPT effective on September 1, 2023. Emmett and Steve and I met in 2003 and have worked closely with each other ever since. It has been a remarkable collaboration of different streams. I want to take this time to publicly thank Emmett for his work and dedication for the past 20 years. Emmett, we know that you and Catherine, your children and those precious grandchildren will cherish your much earned retirement. Congratulations.

We will issue a press release and an 8-K later today on Emmett's retirement. Steve?

R. Steven Hamner

Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

Thank you, Ed. This morning we reported normalized FFO of $0.43 and $1.82 per diluted share for the fourth quarter and full year 2022 respectively in line with our prior expectations. We also introduced our estimate of 2023 calendar net income and normalized FFO, which I will reconcile to the fourth quarter's results momentarily.

First, I'll just mention a change we made to our supplemental reporting around our concentration metrics. In prior quarters, we have based operator concentration on an adjusted gross asset basis, that is a non-GAAP basis. Starting this quarter, we are using GAAP numbers. That's because in December 2022, the SEC published updates to its non-GAAP financial measure guidance and basically stated that non-GAAP disclosures in charts, tables, and graphs, need to display the related GAAP measure in equal or greater prominence.

In order to avoid duplicative disclosures of these charts, tables and graphs, we chose to provide the GAAP-related charts, tables and graphs to reduce confusion. However, we did provide our historical non-GAAP concentration metric on our key operators in the footnote to page 11 of our supplemental for comparative purposes to the prior quarters.

As described in the press release and Ed's earlier comments included in the determination of fourth quarter normalized FFO are adjustments to reserve Prospect's straight-line rent and the carrying value of our Pennsylvania Prospect facilities. In conjunction with Prospect's continuing progress in improving its East Coast operations and strategies, we have decided to fully exit our non-California Prospect investments and reallocate that capital to new investment.

At the end of this period of transition, we expect that we will have recovered and have available for reinvestment most or all of our original investment plus any interim deferrals of rent through the following. As we have alluded to in recent months, Prospect owns a valuable managed care business that we believe, based on third-party offers and negotiations and independent valuations, is currently worth about $1 billion. More immediately, we continue to expect the pending sale to the Yale New Haven Health System of our Connecticut hospitals to close by late next quarter.

We do anticipate also that as hospital operations and financial results improve over the next several quarters, our Pennsylvania hospitals will become increasingly attractive acquisition targets. And proceeds from their future sale will provide additional resources for reinvestment. The accounting adjustment in the fourth quarter to recognize an impairment acknowledges the possibility that such proceeds may be less than our original investment. However, we expect the value of the managed care business will significantly exceed the aggregate amount of the fourth quarter impairment, any investment unrecovered from cash proceeds from the sale of Connecticut and the non-real estate loan that we originally extended to Prospect in 2019.

During this transaction period, and Ed earlier mentioned that it is likely to extend beyond calendar 2023, we are considering providing rent and interest deferral options to Prospect and expect to account for rental income from our non-California Prospect investment along with any interest from our $115 million non-real estate loan on a cash basis. And our 2023 guidance estimates take into account the range of our expectations about rent and interest that may not be paid during that period.

So, today we are providing our estimate of calendar 2023, normalized FFO. The following may help investors bridge from our fourth quarter 2022 normalized FFO annualized run rate of about $1.71 to our guidance range of approximately $1.50 to $1.65 for normalized FFO on a calendar basis.

Starting with the $1.71; contractual rent escalations will add about $0.05 a share and the impact of rent and interest income from acquisitions and dispositions and the CommonSpirit Utah transaction, their related cash proceeds and interest expense with respect to transactions in the fourth quarter and through today is an aggregate pro forma of another $0.03 a shares. So those estimates on their own would yield a guidance estimate of approximately $1.79 of normalized FFO on a Prospect-neutral basis. That is as if Prospect paid all its 2023 rent and interest obligations.

Our estimates of potential outcomes regarding Prospect range from a worst case scenario, in which case we would recognize no rent or interest to our more reasonably expected likely outcome that we recognize most of our California and Connecticut rent, but nothing from the Pennsylvania investment. The per-share range of these scenarios would be 2023 normalized FFO of between $1.50 and $1.65, and as that is what we reported in this morning's press release.

Even at the $1.65 high end of our 2023 guidance, it does not consider incremental FFO that would be created by the recycling of our current investment in our Prospect East Coast investments, assuming success in the restructuring and monetization of Prospect's managed care business.

With that, we have time for a few questions, and I'll turn the call back to the operator.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. [Operator Instructions] Our first question today comes from Austin Wurschmidt from KeyBanc Capital Markets. Please go ahead with your question.

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey. Good morning, everybody, and thanks for the time here. I just want to, Steve, want to hit on that – the guidance and sort of the buildup that you provided. So, it sounds like when all is said and done, that $1.79 captures all of the announced activity that you've announced over the last 6-plus months and would be maybe a reasonable jumping-off point once we think about sort of you reinvesting proceeds into any future activity once you've buttoned up the Prospect deal. Is that a fair way to think about it? I'm just trying to understand what sort of the exit rate or run rate is on a go-forward basis once accounting for Prospect.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

I think that's generally correct. And again, assumes generally that we will replace the Prospect income with income from new investments, again, assuming the recycling of that capital.

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

And then I was hoping that you could maybe share with us how to think about sort of the monetization of the managed care – do you expect to receive proceeds, I guess, from the sale of their managed care business or could you end up in some scenario with just a partial investment in that business down the line that maybe takes longer to monetize and ultimately reinvest the proceeds? I mean, is there any timeline you can give us on when you would expect to receive that investment?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

I think it's the...

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

Or proceeds – receive the proceeds from that investment.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

Yeah. I think it's the 12 months to 18 months that Ed mentioned earlier. That business as probably many on this call are aware, is very, very vibrant, very, very attractive right now. And again, we just saw yesterday the Amazon closing of its transaction with a kind of a similar business plan. And it is an up and running and currently profitable business for Prospect now and to try to anticipate kind of beyond a 12- to 18-month sale process which could involve any number of alternatives, and I won't mention them here, but that's our expectation is that we hope not to end up with a long-term equity type investment, and we don't think that's the likely outcome. We think it's more likely that there will be a sale or a recapitalization that we'll recover at least and possibly more than our investment in the East Coast properties.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

And then Austin...

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

Thank you.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

...you're absolutely right. It is our intent – as we work through this, to push forward a sale sooner rather than later. But we – there are other issues that we have to work through.

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

No, understood. And can you just remind us what the total dollar investment is in those four Eastern PA hospitals and then what the contractual annual cash rent that those – from those buildings?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

So the Pennsylvania hospitals have an aggregate gross investment of about $420 million. Yeah, but before impairment.

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.
Q

Before impairment, and then we should just describe sort of a high-single, low-double-digit type yield on that to get to an annual cash rent from those facilities?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Well, that would be right. But just to point out that in – even in our high end of the range of the $1.65, we're not counting on rent from Pennsylvania.

Austin Wurschmidt
Analyst, KeyBanc Capital Markets, Inc.

Q

Got it. Understood. Just trying to understand what you'll need to reinvest to sort of recapture, I guess that, that earned rent. That's all for me. I'll hop back into the queue. Thank you.

Operator: Our next question comes from Vikram Malhotra from Mizuho. Please go ahead with your question.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC

Q

Thanks for taking the questions. Maybe just first on, Steward, post the Utah transaction. Can you maybe just provide two things, one, just any update on your view on underlying cash flow projections as we look at 2023 or other ins and outs? And then just second, the remaining non-Utah, would you give us a sense of like the underlying health of those businesses/rent coverage?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

Sure, Vikram. But the expectations for 2023 continues to be in excess of $350 million including the Utah facilities. The Utah facilities represent approximately $80 million of that. So, somewhere in the $300 million annualized 2023 post the Utah transaction. I think there is a public misnomer thinking that the Utah properties are the most profitable properties in the Steward portfolio. Actually, that is not the case. When the Utah property transaction closes, their overall coverage will actually increase. So, it's an opportunity for them to take proceeds from a mature market from their concern into markets where they have the ability to grow even more. As we've stated before, the Florida properties in particular continue to way outperform our original underwriting, and Steward still believes there's tremendous growth there.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC

Q

Okay. That's helpful. And then just so on this disclosure based on the new GAAP guidance or SEC guidance, I guess maybe – and it seems like a sizeable change, and maybe I'm not fully understanding what change. Would you mind we – I typically won't do this on the call, but would you mind just giving us an example like take the Steward Florida or Circle Health, just explain to us, like, what changed in the disclosure? And it would be helpful if you can maybe in an update give us just a – I know it's a lot more pages, but give us the pro forma versus what changed. And I guess, again, I'm not understanding what change because I didn't see, like, other REITs having to make this change in their supplements.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

So, the biggest changes, I'll just address that generally, and we can absolutely supplement our supplement with our prior guidance. But the big changes were, again, just GAAP changes, for example, to deduct depreciation, accumulated depreciation that that affects obviously the relative and the overall denominator of the calculation. And then, in our prior pro forma examples, we would pro forma, for example, binding contracts for transactions that had not yet closed. So just by way, I'll give you a very brief example here. If you have the supplement in front of you, page 11, and you look at the Steward Health Care, the aggregate of all of the Steward Health Care market shown in the GAAP basis statement is 24.2%. Had we presented this on the old method, it would have been – as the footnote says, it would have been 19.8%. And again, instead of going through line-by-line, the details of that, we will get out, as I say, a supplement to the supplement.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC

Q

Okay. That would be helpful, as you can bridge the two with all the GAAP, like you said depreciation because I felt both were net, but maybe I'm just reading it incorrectly, and then any pro forma adjustments, just to make it like crystal clear, in terms of what you did. Just last question. Can you remind us just in effort to shore up more cash flow or/and hopefully reduce leverage going forward, can you remind us sort of any update on, say, the Australian assets or other assets that you may be monetizing, what the underlying appetite is for hospital real estate today?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Well, we don't have anything to report on Australia. But other than to address your question we continue to see strong appetite across the geographies and that's indicated by the unsolicited, occasional but fairly frequent inquires about our assets across Western Europe. And although we've never acknowledged the Australian sale process, we don't deny it, but we have nothing to report on that at this time.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you.

Operator: Our next question comes from Steven Valiquette from Barclays. Please go ahead with your question.

Steven Valiquette
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning. Thanks for taking the question. And also appreciate the extra color around Prospect Medical but maybe just to provide some additional updated color around their underlying operations within the Pennsylvania hospitals, can you just remind us what the key variables are to improve the profitability of the operations?

And I recall there was some conjecture to potentially repurpose some of those PA assets into alternative use, I believe, on the behavioral side, but that may have hit some roadblocks. I'm just curious if you can just give us an update on these collective dynamics or just the path to improvement for these Pennsylvania hospitals, just based on what you know right now. Thanks.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

Yeah. Sure, Steve. As we've all talked about previously that particular area was hit harder with COVID than a lot of other areas in the United States and that's not just from a patient standpoint, but probably worse from a staffing standpoint. The rules that we all used have to go by if you tested positive for COVID, if you even tested for COVID. Most hospitals don't even test for COVID anymore, so most of those issues have been resolved.

But you're right. When they originally bought these facilities, they had a plan which we knew about and in light of repurposing a number of the facilities. The problem is you've got facilities there that are very close to each other that are providing the same services and we think they had a very good plan for repositioning what services were provided in each individual facility.

What I guess none of us took into account was the political fallout that that would cause of various politicians saying, well, don't take my hospital away, those types of things. That's been much harder than any of us realized. I think that as soon as Prospect has gone through this, the politicians have been much easier to work with as of late. So, we do have hope that they can do what their original plan was and repurposing some of those facilities.

You know, I don't want to make a plan based on the last month and two-months-and-a-half, but their operating statistics all look dramatically better than they did this time last year. And so, they're clearly making some progress. But 2.5 months don't make a [ph] real plan (00:28:33) at this point.

Steven Valiquette
Analyst, Barclays Capital, Inc.
Q

Okay. All right. Appreciate that color. Thanks.

Operator: Our next question comes from Michael Carroll from RBC Capital Markets. Please go ahead with your question.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Yeah. Thanks. I wanted to stay on Prospect. And, I guess, Steve, you made some comments that you provided Prospect with some percent potential deferred rent options. I mean, what do those options include? And have they made a decision on what they wanted to do with those options?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

No. I think just to be clear, we're considering that, and we expect that we will provide some fairly significant rent options, rent deferral options. Again, going back to Ed's opening comments about Prospect, it's going to be a, at least a 12- to 18-month process. And that's the reason, for example, we gave the worst case scenario as if during 2023, we collect nothing from Prospect. That's what gets you to the $1.50. So that truly is a worst case scenario. We do expect to provide Prospect some alternatives to manage its cash flow across the quarters, but we have not finalized that yet. And just because we are presenting a worst case scenario of collecting no rent, that's not necessarily to imply that that's what we intend to offer Prospect.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

So what – under what scenario would you defer all your rent? I mean, if they ask for it, would you necessarily provide that to them?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

Well, we're a long way from that. There are lots of parties involved in the Prospect strategies and negotiations. And we have simply said that along with other parties, we are willing to consider contributing to Prospect's 2023 cash needs and primarily by virtue of a potential rent concessions, rent deferrals.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Did Prospect pay their full rent in January and February?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

No.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Okay. Did they pay any rent in January and February?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

That we haven't disclosed. But no, they did not pay their full rent.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Okay. And then under what scenario, I guess, do you expect that this will be completed? I know in the press release you highlighted that this will take 12 months to 18 months, but then you also indicated that you would expect to get some recoveries in the second half of the year. I mean, what's the give and takes with that potential outcome?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

Yeah. Well, if the Yale failed or Connecticut failed, the improvement of the overall operations and the facilities and an ultimate conclusion of a restructuring for them.

Michael Carroll
Analyst, RBC Capital Markets LLC
Q

Okay. And then last question for me is like what why has this transaction taken so long? I know in the middle of 2022, you kind of expected something would get done in the fourth quarter. So why is it being pushed out further into 2023? It sounds like probably 2024.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

Well, we did expect, we had good reason to expect in the fourth quarter actually going into the first quarter into the early weeks of January. We – now I say we, Prospect, was negotiating with a potential financial partner that

that would have begun the monetization process of the managed care business, that would have provided immediate liquidity for operations. And those negotiations went very deep.

And it was only in the middle of January that it became apparent that that particular party was not going to continue to move forward. And that's what – that's the big change that caused us to make these accounting decisions.

Michael Carroll Q
Analyst, RBC Capital Markets LLC

Okay. Great. Thank you.

Operator: Our next question comes from Michael Mueller from JPMorgan. Please go ahead with your question.

Michael W. Mueller Q
Analyst, JPMorgan Securities LLC

Oh, take it off mute there. So, first of all, I guess, after the Connecticut assets are sold, are you anticipating a rent cut on Pennsylvania and the California assets on a go-forward basis? And is any of that baked into that $0.15 cash recovery?

R. Steven Hamner A
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

No. The difference, the primary difference between the $1.50 worst case scenario, which again not to belabor it, but assumes no rent at all from any Prospect properties; the difference between $1.50 and the $1.65 is primarily a collection of the Connecticut rent and collection of the California rent and the interest.

Michael W. Mueller Q
Analyst, JPMorgan Securities LLC

Got it. But on a go-forward basis, so you're assuming – what are you assuming on a go-forward basis, not necessarily calendar 2023 but for the Pennsylvania assets, are you anticipating some sort of rent diminution there or just that operation's going to pick up or...

R. Steven Hamner A
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

No. I think at any point along the range of $1.50 to $1.65, there is no Pennsylvania rent assumed there. Ideally, we'd like to see Pennsylvania improved, and as I mentioned earlier, become an attractive – it is an acquisition target, and you all may recall this time last year there was an offer, a non-binding offer from an investment grade rated not for profit, and it is still an attractive facility for operators. So, our preference would be for that to happen and Prospect to find a buyer and we actually sell the real estate and recover at least the impaired value of the real estate.

Edward K. Aldag, Jr. A
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

Mike, those hospitals aren't going away. As can be seen in the political fight about any potential closures of any particular parts of hospitals, people want those hospitals. The politicians want those hospitals all to stay open. We just believe this has already proven to us it'd be taking longer than we had anticipated, and we just don't know any more at this point to how quickly the Pennsylvania will be resolved. But it's not a zero.

Michael W. Mueller
Analyst, JPMorgan Securities LLC Q

Got it. Okay. And then I guess on the managed care side, the $1 billion appraised value there, I guess. How should we think about how much of that you're entitled to from, I guess, your – what you have structured into the leases? It sounds like you think that if it's $1 billion, as a base case, should we be thinking that you're entitled to at least based on what you're telling us, the $170 million that you've kind of written down on the PA assets, so that's kind of the minimum threshold of what you think you can kind of – you're entitled to out of the $1 billion valuation?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc. A

Yeah. I think a different way to look at it, Mike, would be that we think we're entitled to enough of it to get all of our money back, including obviously what we're going to get out of Connecticut and what we think the value of California is.

Michael W. Mueller
Analyst, JPMorgan Securities LLC Q

Okay. Okay. Thank you.

Operator: Our next question comes from Tayo Okusanya from Credit Suisse. Please go ahead with your question.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC Q

Hi. Yes. Good morning, everyone. So, a couple from me, again, still on Prospect, so again, you guys have moved to cash basis. I'm curious if from an auditor's perspective Prospect has any issues around being a going concern. If it does how do you guys kind of think about a potential bankruptcy there and a plan B for getting a new operator for those assets?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc. A

Well, we certainly haven't had anybody to raise the concern of a going concern at this particular point. But we believe we are in the same place, whether this is a bankruptcy or a work-together restructuring standpoint. Obviously, if it's a bankruptcy, it may take a little bit longer, but we still believe we're in a good position to recover all of our investments, including the deferred rent.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC Q

Okay. That's helpful. And then number two, moving on to priority. Could you talk a little bit about just the economics of that transaction, the cap rates you did the deal at and also the seller financing, what interest rates that was done at?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc. A

Yeah. This is one we just announced this morning, the additional six properties. These are six properties that were not owned by Priory when we bought the original transaction. These were owned by a third party who put them up for sale middle of late last year, last summer. And we've been working with them. They – we believe they are some of the very best assets for Priory. And they will be added to the master lease with Priory, go under the same terms that are there. We believe it will help it – even improve with already a strong coverage there and a strong collateral base.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC
Q

Yeah. But in regards to actual cap rates on it and as well as the funding costs on the seller financing and assumed debt, is that something you can provide?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

No. As you know, Tayo, we normally don't give specific cap rates other than this is attractive and accretive. And even on a cash basis, with the seller financing is cash flow accretive and again, is included in the guidance that we gave. I mentioned earlier the, I think, roughly $0.03 net accretion to the transactions that we announced this morning that.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Great. Then can we move over to kind of current leverage and just take a look at the balance sheet and some of the moving items there that kind of contributed towards higher leverage with the line of credit kind of going up a decent amount. It seems like, again, your accounts receivables increased. There's this kind of additional mortgage loans increase of about $60 million. Just kind of talk about kind of some of the items that may have contributed to the higher use of the line and higher net debt.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

Sure. The calculation we showed this morning at 6.4 times – and just to be clear, we footnoted that based on the range of a potential outcome with Prospect. But it's starting with the baseline, 6.4 times is up from last quarter's 5.8 times. That's due primarily, as I mentioned, to the effect of the range of Prospect assumptions.

Secondly, as you mentioned, our acquisition of the Priory assets in the fourth quarter funded with seller financing, and the impact of currency movements. The $60 million you mentioned was a European investment we made in the fourth quarter. And I think that's about...

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.
A

Yes. Right.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

Yeah.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC
Q

And then the AR receivables being up $50 million and anything going on there was kind of slower AR...

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

So, yeah. So we just – yeah. Prospect is a big piece of unpaid billed rent.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC

Q

Got you. Okay. And then from an accounting perspective, just bear with me. Appreciate the explanation about the change to net investments that you discussed earlier on, Steve. I mean, the only challenge is when you – when we have that change, when we don't see gross investments we can't really see any additional investments that were made. Could you just talk about again, since you guys did the $250 million of investments to Steward and Prospect, if there were any additional investments to those two operators since that time?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

No. Other than a routine order of business, for example, the development funding that goes on with – of course, there are no development funding at Prospect. There's the Texarkana and Norwood construction projects in – with Steward but that, that's the increased investment.

Omotayo Okusanya
Analyst, Credit Suisse Securities (USA) LLC

Q

Got you. Okay. That's helpful. And just one final comment from me. I think, again, just having the EBITDA rent coverages that you used to provide in the past, I think investors do find that useful. It would be great if we could see a return of those metrics in the next supplemental in 1Q 2023. Thank you very much.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

Thanks, Tayo.

Operator: Our next question comes from John Pawlowski from Green Street Advisors. Please go ahead with your question.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Thanks for the time. Maybe a follow-up to the Tayo's question. Did you provide any operators at all financial support in the fourth quarter through the rent deferrals, loans, equity stakes or do you expect to have to in the coming quarters out of Prospect?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

What's that final part? Do we expect to?

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Yeah. Do you expect to as outside of Prospect?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Oh, aside from Prospect. No, we don't.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. And maybe going back to the Prospect restructuring. Steve, I think you alluded to you expect to collect most of the California rent. So, can you just take a step back and I know you put some scenarios in there. I'm less concerned about worst case scenarios that are better than guidance. I'm just trying to understand the actual reality in terms of how much cash is going to come in the door this year. So the total Prospect relationship, what percentage of your annual cash payments that are owed by Prospect do you actually expect to collect this year? And you can use a range if you'd like. I just – we just need some quantification.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Well, I think we've given the range. We don't expect the worst case. It's possible that the $1.65 which, as you point out, is basically collection of the California rent and six months of Connecticut, assuming we sell Connecticut at the end of the six months.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

And those are cash numbers.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Right.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. But do you – so am I right to interpret that there is going to be a shortfall in the California rent collection as well?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

That's quite possible, yes.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. Are they – are they paying rent currently on the – for California hospitals?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

No. For – as I mentioned a little earlier, very little of January, February rent has been paid.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. Last one for me. I assume that repayment of the upsize mortgage loan didn't occur in the fourth quarter. Can you give us a sense for when you expect that mortgage loan to be repaid in the California properties?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Along with the recovery from primarily the sale of managed care business, although there are other restructuring options with respect to that particular facility, that facility, obviously, as you point out, is mortgaged now. We are considering a number of options that could include acquisition of that facility for the mortgage balance. But there's nothing definitive or binding with respect to that possible strategy.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. Thank you.

Operator: Our next question comes from Andrew Rosivach from Wolfe Research. Please go ahead with your question.

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

Hey. Good morning, guys. How are you?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Hey, Andrew.

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

Fine. Thank you.

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

I was thinking maybe something that might help if you – would you be able to translate kind of your FFO into an AFFO guidance? Because I'm guessing some of the puts and takes related to Prospect are probably related to cash basis versus straight line.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

I got lost in that question, I'm sorry.

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

Oh, yeah. Sorry, Steve. So you have an FFO of $.150 to $1.65, and I think a lot of us are trying to back into dividend coverage. And I'm guessing that if we took it a step from 2022 to 2023, the difference in AFFO is less than the difference in FFO.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Yeah. So if you take that worst case scenario again at $1.50 and you make necessary adjustments for AFFO, we're at about $1.29.

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

Got it. Okay. No, thank you very much. And then my second one's really nerdy and I know some of these numbers are estimated, but your schedule for tenant disclosures used to have EBITDAR and EBITDARM. You now have EBITDARM; just curious why you went to one column.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Yeah. And Andrew, you may remember that we stopped doing EBITDAR a long time ago because it was confusing because...

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

Yeah.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

...a lot of that are assumptions that everyone has to make, including us, about what the M part of the EBITDARM is. For example, if you look at that page, which is page 14 in the supplement, a number of those operators, the EBITDARM and the EBITDAR is the same thing. So, what we did a long time ago when we were trying to show EBITDAR we used an arbitrary number for us that we got from what the management fee may be. Many times those were much higher than actual numbers. Another example, we have a couple of operators who prefer not to be named in this report, although it doesn't take a genius to figure out which ones those are. But the – we own a very small part of their overall portfolio. So, it's not easy to try to go from EBITDARM to EBITDAR based on when you own a very small part of the overall portfolio. So, what you see here on EBITDARM is what we've been reporting for a long time. And obviously you can go back and look at what the various trends are. And you'll see that the overall trend for most of our operators is up in the right direction. So, it's just that EBITDAR wasn't a scientific number, as we talked about in great detail, I believe this time last year, it was – it had a lot of subjectivity to it.

Andrew Rosivach
Analyst, Wolfe Research LLC

Q

Yeah. You are typically taking – you're making I'm guessing an assumption of an expense as a percentage of revenues or...

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

That's correct.

Andrew Rosivach
Analyst, Wolfe Research LLC
Q

...and – yeah. Yeah. Whereas EBITDARM is an actual number that you're getting.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

That's correct.

Andrew Rosivach
Analyst, Wolfe Research LLC
Q

Terrific. Thanks a lot, guys.

Operator: And our next question is a follow-up from Vikram Malhotra from Mizuho. Please go ahead with your follow-up.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC
Q

Oh, thanks. Just two quick follow-ups. First, can you just clarify the Utah sale to CommonSpirit, my quick calculation, I think the new rent, is it about 10% lower on a cash basis. Can you clarify was there a rent change with CommonSpirit?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

Yes. Yes, there was. There was a rent change. On a cash basis, they're paying, you can do the arithmetic, they're paying 7.8% on the roughly $1.22 billion of investment. That's a reduction from what Steward paid in 2022 by a little more than $6 million. Some of that $6 million will be recovered through reallocation of that rent back to other Steward facilities. And again, all that's built in to the guidance numbers we gave.

Vikram Malhotra
Analyst, Mizuho Securities USA LLC
Q

Okay, that's helpful. And then can you just maybe give us a little bit more color on the – on the guidance components on two things, just what's the straight-line rent baked into the guide on either end of the range, if you can, and also what the G&A range is, if it's possible?

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.
A

I think we'll probably have to get back to you on that. I don't think anybody around this table has an immediate answer to that, especially the straight line, the G&A is a recent run rate, so...

Vikram Malhotra
Analyst, Mizuho Securities USA LLC
Q

Okay. Thank you.

Operator: And our next question is also a follow-up from John Pawlowski from Green Street Advisors. Please go ahead with your follow-up.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Thanks for taking the second question. Steve or Ed, what level of leverage on a debt to EBITDA basis on your metrics do you expect to be running at this time next year? Because I think Ed's opening remarks were pretty bullish on acquisition pipelines, but there's a lot of moving pieces in terms of potential dispositions. So this time next year, what level of leverage can shareholders expect you to be running at?

Edward K. Aldag, Jr.
Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

A

Well, let me make the point about the acquisitions that I was trying to make in the prepared remarks there. We have a great pipeline, but until we get a new norm for where interest rates are around the world, not going to be a whole lot of acquisitions from us. As we have said throughout the year we will continue to support our existing customers and other very strategic moves like we did with the Priory transaction we announced today. But other than that, I'm just making the point that the pipeline is strong. We're continuing to work out those relationships.

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Yeah. And what goes unsaid, probably that'd need to be said, with that is we certainly don't expect to be leveraging up to take advantage of marginally accretive transactions.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. Do you expect the leverage to remain essentially unchanged or do you expect...

[indiscernible] (00:52:40)

R. Steven Hamner
Co-founder, Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

Well, no, we expect it to remain at that 5 times to 6 times that we were working on and making great progress on until the latter part of last year. So that remains our strategy is to maintain that level of long-term leverage. And to do that, along with making accretive acquisitions we need to see first as Ed has mentioned now some certainty in the cost of debt. And we need to see some rationality on the part of sellers for recognizing that the cost of capital is driving down the otherwise value of their assets. And until that all happens and we can access affordable equity type capital, then we won't be making significant acquisitions. Certainly not if that means driving up leverage.

John Joseph Pawlowski
Analyst, Green Street Advisors LLC

Q

Okay. Thank you.

Operator: And ladies and gentlemen, with that, we will end today's question-and-answer session. I'd like to turn the floor back over to Ed Aldag for any closing remarks.

Edward K. Aldag, Jr.

Founder, Chairman, President & Chief Executive Officer, Medical Properties Trust, Inc.

Jamie, thank you very much. And as always, we appreciate your listening in and your interest. If you have any follow-up questions, please don't hesitate to give us a call. Thank you very much.

Operator: Ladies and gentlemen, with that we'll closing today's conference call and presentation. We do thank you for joining. You may now disconnect your lines.