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Medical Properties Trust, Inc. (MPW)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Q3 2024 Medical Properties Trust Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is a 60-minute presentation and is being recorded.

I would now like to turn the conference to Charles Lambert, Senior Vice President. Please go ahead.

Charles Reynolds Lambert

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

Good morning. Welcome to the Medical Properties Trust Conference Call to Discuss Our Third Quarter 2024 Financial Results. With me today are Edward K. Aldag Jr., Chairman, President and Chief Executive Officer of the company; Steven Hamner, Executive Vice President and Chief Financial Officer; Kevin Hanna, Senior Vice President, Controller and Chief Accounting Officer; Rosa Hooper, Senior Vice President of Operations and Secretary; and Jason Frey, Managing Director, Asset Management and Underwriting.

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 and/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 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

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

Thank you, Charles, and thanks to all of you for joining us this morning on our third quarter 2024 earnings call. I'm pleased to be joined again today by Steve Hamner, Kevin Hanna, Rosa Hooper, and Jason Frey. Before you hear from the rest of the team, I'll spend a few minutes covering a few important three strategic updates. The big news during the quarter was our global settlement with Steward and its creditors that enabled us to take back control of our real estate and sever our relationship with Steward. While there has been widespread media attention on Steward's bankruptcy process over the past few months, we believe these stories failed to note the significant steps that MPT has taken throughout the process to avoid hospital closures, protect jobs, and ensure continuity of patient care.

What Steward was unable to complete transactions with buyers for its operations around the country, our team worked around the clock for weeks to indentify a diverse set of qualified operators to take over facilities in five markets. We are confident these five operators are better positioned to serve their respective communities in Arizona, Florida, Louisiana, Ohio, and Texas.

The four operators that assumed management of 15 facilities in September, HSA, HonorHealth, Insight Health, and Quorum Health, have already done a tremendous job of stabilizing the hospitals in each market and laying the foundations to return them to profitability by providing high-quality patient care. They have dedicated significant time and energy to employee, physician and community outreach, all of which have reportedly been well-received. While it will take time for these facilities to return to pre-bankruptcy operational performance, we are very impressed with what we have seen so far.

In most cases, October discharges are trending higher than the low point in September prior to these transitions. Earlier this week, we reached an agreement with College Health to lease the Saint Luke's campus in Phoenix, Arizona. College Health has over 35 years of experience and specializes in inpatient behavioral health services. They expect to reopen the campus as a behavioral health hospital in the first quarter of 2025. With the successful re-tenanting of these 17 properties, which collectively carry a lease base of approximately $2.1 billion, we expect to gradually resume receipt of cash rent on this portfolio in the first quarter of 2025, ramping up to approximately $90 million in the aggregate annualized rent by the end of 2025 and fully stabilized aggregate annualized rent of approximately $160 million by the end of 2026.

Assuming no further changes to our portfolio, when these 17 properties begin paying full rent, we expect MPT's total annualized cash rent to be in excess of $1 billion. We are also actively engaged in discussions regarding the four other properties with an aggregate lease base of approximately $170 million, as well as our development projects in Texarkana, Texas, and Norwood, Massachusetts. With respect to Norwood, we remain in discussions with the state regarding critical licensing decisions.

Before moving on from Steward, it's worth zooming out for a moment to evaluate our real estate portfolio. Beginning in 2016, MPT spent roughly $5.3 billion on real estate that was leased or mortgaged to Steward. We recovered approximately 45% of that through cash proceeds from asset sales and other transactions involving this portfolio. As just discussed, we also continue to hold a real estate portfolio with a lease base of approximately $2.3 billion, excluding the development projects, more than 90% of which has already been re-tenanted. Over the years, we also collected approximately $1.9 billion in cash rent and mortgage interest.

During the third quarter, we continue to advance our strategy of generating additional liquidity to accelerate debt pay down and enhance financial flexibility. We sold 18 freestanding emergency departments as well as a general acute care hospital in Arizona and Colorado for approximately $246 million. In October, we sustain this momentum by closing the sale of two additional small freestanding EDs in Texas for approximately $5 million, as well as the sale of Watsonville Community Hospital in California for approximately $40 million.

Watsonville is a great story of community perseverance and our business model working as intended. Watsonville was forced into bankruptcy primarily because it was unable to access COVID funding similar to most of the other hospitals in 2020. At the time, MPT was virtually the only party willing to step in and provide the funds necessary to ensure the hospital could remain open. Our close engagement with community leaders helped facilitate the formation of a local nonprofit to take over operations in 2022. And now, for that same group, to acquire the property outright by exhibiting patience and focusing on doing the right thing for the community, we were ultimately able to fully recover our real estate investment.

In closing, before I turn it over to Rosa, there is no doubt the health care sector is uniquely exposed to the impacts of global macroeconomic trends. At various intervals over the past few years, hospitals have been forced to navigate lagging reimbursement rates, declining patient volumes, heightened operating expenses, rising interest rates, revenue cycle management challenges, and cybersecurity incidents. While we are pleased that many of these trends appear to be reversing, it is important to remember that access to a broad array of potential capital solutions is critical to help ensure a flourishing health care sector over the long term. Simply put, sale leaseback transactions are a superior financing source for many operators compared to any other sources available.

Land and buildings are often an operator single largest asset and that must be funded with some form of capital sale. Sale leasebacks provide a relatively inexpensive way for operators to access up to 100% of the value of their real estate to fund improvements that were more directly affect patient care. They enable operators to negotiate rents that typically represent only a small, single-digit percentage of total sustainable reimbursement revenue, and they plan for fixed annual amount over the long term without being subject to refinancing risk. For these reasons, we strongly believe MPT's business model is more important than ever. We continue to take meaningful actions that better positions our business to create compelling shareholder value over the long term.

And following our successful re-tenanting strategy, we look forward to demonstrating the strength and resilience of our business model. Rosa?

Rosa Hooper

Assistant Secretary & Senior Vice President-Operations, Medical Properties Trust, Inc.

Thank you, Ed. As usual, I will take you through some of the highlights across our portfolio of critical hospital real estate. We are encouraged by the positive utilization and revenue trends we continue to see across our portfolio. In line with what's recently been reported by several large public operators, hospital fundamentals continue to strengthen. Admissions are growing, surgical volumes are increasing, and operators are starting to realize the benefits from cost efficiency programs they've been implementing over the past few years.

Within our portfolio of hospitals, general acute care properties reported the largest increase in year-over-year revenues, followed by our behavioral health properties, which have delivered steady performance over the past several quarters. In the UK, utilization of private medical insurance and self-pay has hit a new all-time high as patient demand for quality and timely access to care continues. Circle Health is a clear beneficiary of this trend, recording consistent growth in both private medical insurance and self-pay volumes. Circle's performance has also benefited from improved patient acuity mix, as more complex cases are now being addressed in the private sector. In addition, the UK Health Secretary has called for the NHS to grow its partnership with the private sector to reduce their backlog.

Priory, the largest independent mental health care provider in the UK, continued to produce positive cash flow from operations in 2023 and its cash flow generation has accelerated year-to-date in 2024. In fact, revenue and EBITDAre are meaningfully outperforming prior year. Last quarter, we mentioned our focus on a comprehensive strategy for improving quality and optimizing our occupancy mix. Continued focus on this strategy has increased acuity, driving reimbursement rates higher while promoting a more efficient utilization of external labor, resulting in bolstered financial performance, including improved coverages for the portfolio. Notably, the change in government in the UK has created some uncertainties around referrals into the behavioral health market, and Priory is anticipating lower occupancy levels. Their increased focus on higher acuity patients and collaborative work with commissioners should help to offset any potential disruption.

Turning to Priory parent company, MEDIAN, these assets have delivered strong year-to-date performance in 2024, driven by an improving reimbursement rate environment in Germany, as well as improving occupancy trends. With Medical Networks' solid top line growth and ongoing cost optimization efforts have resulted in 10% year-over-year earnings growth for the first half of 2024. In September, Swiss Medical Network officially opened its Genolier Innovation Hub, which will also help to drive additional cash flows to MPT over time. They anticipate significant activity in the center working toward the continuous improvement of health care for patients now as well as for future generations. During the quarter, MPT and our JV partner increased the equity investment in Infracore by retiring approximately CHF 50 million in maturing third-party debt.

Turning to our US portfolio, where my comments do not include the recently re-tenanted Steward properties, overall general acute care revenue trends continue to benefit from increasing admissions, surgeries and higher reimbursement rates. And in our behavioral portfolio, we continue to see steadily increasing volumes as well as reduced reliance on contract labor. Ernest Health's consolidated EBITDARM coverage remained stable at approximately 2 times, while Ernest's legacy IRF continued to perform exceptionally well with coverages above 2.5 times, their newer IRFs are continuing to ramp up with improved volumes quarter-over-quarter. In order to counteract the declines in LTACH reimbursement nationally, Ernest recently converted a portion of their Provo LTACH beds to an inpatient rehabilitation unit. Given the success of this unit, Ernest is actively exploring options to implement this model in other markets.

Lifepoint Health has produced strong top line revenue growth and accelerating profitability, driven by the highest quarterly admissions seen in over three years. Lifepoint self-funded expansion of Conemaugh Memorial Medical Center in Johnstown, Pennsylvania, has driven significantly higher volumes, while labor costs have continued to moderate. We believe this will continue to drive EBITDARM improvements looking ahead. At Lifepoint behavioral, consistent year-over-year admissions growth coupled with disciplined labor cost management led to another quarter of improved operating performance. In ScionHealth, trailing 12-month EBITDARM coverage is up slightly year-over-year, as improved performance at its acute facilities is offsetting LTACH declines.

Finally, Prospect's California facilities continue to report growth driven by admissions and surgeries, which have each increased 3% year-over-year. Despite improved coverage trends across the six California properties, Prospect's overall liquidity continues to be impacted by ongoing sales processes in various East Coast markets. While it's our understanding that Prospect continues to work with regulators and potential buyers in each of these markets, they have been unable to pay rent in a timely fashion over the past few months. Prospect expects liquidity to improve in the coming months, as they are scheduled to receive approximately $100 million of quality assurance fee program or QAF payments during the first quarter of 2025. In closing, we are very encouraged by the volume, revenue and cost trends being reported across care types and geographies. Today, we are more diversified than ever before with tenants like Lifepoint, Ernest, HSA, and surgery partners in the US; and Circle, Priory, MEDIAN, and Swiss Medical Network internationally. The growth of these operators over the past five years has helped to largely offset the dilutive revenue impact of Steward's financial distress and asset sales.

Moving forward, we are confident that our portfolio is well-positioned to generate robust cash flows for MPT and our shareholders over both the near and long term. Kevin?

Kevin James Hanna

Chief Accounting Officer, Senior Vice President & Controller, Medical Properties Trust, Inc.

Thank you, Rosa. This morning we reported GAAP net loss of $1.34 per share and normalized FFO of $0.16 per share for the third quarter of 2024. As disclosed in our Form 8-K filed on September 17, our global settlement with Steward and its creditors resulted in multiple onetime accounting items that impacted our GAAP results and resulted in adjustments to normalized FFO. First, we impaired approximately $425 million of working capital loans previously made to Steward. Second, we recorded impairments of approximately $183 million, of which $180 million related to the real estate of the Space Coast facilities and certain excess properties, charges for property taxes and other obligations, net of recovery, and the donation of our former Steward-operated hospital in Hope, Arkansas, to a local community, rounded out the balance.

Lastly, the termination of our master lease agreement with Steward resulted in an accelerated amortization of about $115 million of lease intangible assets during the quarter. Before wrapping up on Steward, as noted in our press release this morning, we have received substantially all of the $45 million of proceeds expected from the sale of Space Coast hospitals in Orlando -- to Orlando Health. Normalized FFO was also adjusted during the quarter for the reduction in fair value of our investment in PHP Holdings by approximately $130 million to roughly $200 million based on the most recent independent third-party appraisal.

With that, I will hand the call over to Steve to discuss liquidity and capital allocation. Steve?

Richard Steven Hamner

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

Thank you, Kevin. At the end of the third quarter, we had cash balances of approximately $275 million and revolver capacity of about $880 million. Year-to-date, we have executed more than $2.9 billion in profitable asset sales and other monetization transactions, including the approximately $350 million during the third quarter that we had previously described. These are primarily the sales for $246 million of 18 freestanding emergency rooms, plus a general acute hospital that Ed mentioned, along with repayment by Prime of a $100 million mortgage loan. These transactions have effectively demonstrated, especially over the recent years since COVID, the strength of our business model in general and our real estate underwriting in particular. Not only have our real estate investments held their values in a volatile macroeconomic environment, but they have actually increased in value. This has provided us significant flexibility and optionality as we execute our delevering strategy.

Since the beginning of 2023, we have repaid $2.2 billion in debt. We have aggregate 2025 maturities of approximately $1.2 billion, which we believe we are well-positioned to address with our current liquidity and other options, including additional possible monetization transactions. For example, since the end of the quarter, we have settled certain insurance litigation that will result in incremental cash to us during the fourth quarter. We closed the Space Coast sale resulting in about $45 million to us. The Watsonville and small FSED sales mentioned earlier resulted in another $45 million. And we have signed non-binding LOIs and offer sheets for profitable sales that would generate additional cash proceeds. The aggregate of these transactions approximates another $400 million.

With respect to these non-binding LOIs and offer sheets, I will point out that there are buyer diligence rights and other conditions, and there is no certainty that these proposed transactions will actually be completed. We now believe that our cost of debt has likely peaked and is in fact coming down, albeit at different paces depending on the geography. At the same time, MPT continues to resolve difficult tenant situations and simplifies business strategies for the future, which we expect will make us more attractive to capital markets in the future. As a reminder, the normalized FFO of $0.16 we reported for the quarter does not recognize income from tenants we have moved to cash-based accounting. That includes investments related to about $1.6 billion of real estate formerly leased to Steward, now leased to new operators and accounted for under the cash basis. And an additional $400 million of real estate previously leased to Steward is accounted for under the GAAP basis straight-line method. We have plans to resolve these in the coming few quarters even further simplifying our business or returning them to collection status.

When considering these portfolio simplification efforts, our success in re-tenanting more than $2 billion of real estate formerly leased to Steward, as well as anticipated interest rate and capital market improvements, we expect an expanded set of levers to be able to address debt maturing in 2026 and beyond. As such, we are not limited only to continue reducing the size of our portfolio in order to meet our capital allocation objectives, especially given that we believe that even with the level of normalized FFO that we reported this morning, we are confident there is significant unrecognized value in MPT's current share price.

With that, I'll conclude and we'll be happy to take questions, and I'll turn the call back to the operator.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from Michael Carroll with RBC Capital Markets. You may now go ahead.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

Yeah. Thanks. Can you talk about why the working capital loans to, I guess, the former on the operators taking over the former Steward assets increased to $90 million? And kind of highlight the timing of the expected payments. I mean, how long does it take for these operators to get the necessary ABL that could pay back those working capital loans?

Richard Steven Hamner
Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

So, Mike, it is a simple answer on the $90 million, and that was additional primary professional fee cost not related to MPT or the new operators for the transitions. On the ABL, some of them already have replacement ABLs that they're in worked with. Others believe that they'll have them completed either by the end of this quarter or the early part of 2025. These are short-term loans and we expect them to be repaid within in 2025.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

Okay. Great. And then can you provide an update on the PHP sale? And I believe last call, you kind of highlighted that the final bids for this asset was due in August. I guess, did that sale process, is that starting to get completed? And then maybe kind of when you're answering that, can you highlight why the write-down in the PHP, why did that specifically occur again this quarter?

Richard Steven Hamner
Executive Vice President, Chief Financial Officer & Director, Medical Properties Trust, Inc.

A

So, Mike, the write-down is is based on the most recent what we believe reliable information that's available to us. And we can't comment further on the status of what are continued confidential negotiations amongst the buyers and seller, which is PHP.

Michael Carroll
Analyst, RBC Capital Markets LLC

Q

Okay. Great. Thank you.

Operator: Our next question will come from Omotayo Okusanya with Deutsche Bank. You may now go ahead.

Omotayo Okusanya
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Yes. Good morning, everyone. Could you please, for the Steward assets that have not yet been transitioned that you guys are now operating, could you just give us a sense of the earnings impact of those assets in third quarter and how we should kind of think about that going forward until you can also transition those assets?

Edward K. Aldag

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

A

Well, Tayo, these aren't operational facilities. These include the Youngstown, Ohio facility, which had been closed for years; the San Antonio facility, which was closed, I believe, last year. It also includes share in Pennsylvania, which is operational but is not operational by us. It's still being operated by Steward. And then it also includes a facility in Miami, which is when Steward still owned it, it had been rehabbed, it was getting ready to open, and it's still closed at this particular time. So, it shouldn't have any additional impact negative on it.

Omotayo Okusanya

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's helpful. All right. That's about it for me. Thank you.

Operator: Our next question will come from Nikita Bely with JPMorgan. You may now go ahead.

Nikita Bely

Analyst, JPMorgan Securities LLC

Q

Hey. Good morning, guys. Well, a couple of modeling questions. Where do you think you could issue new secured and unsecured debt, at what cost?

Richard Steven Hamner

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

A

Yes. So, we're not contemplating that right now. As I mentioned a few minutes ago, we think we're hopeful, I think with good reason that the yields on the outstanding notes are coming in. I think that's a result of two things. One, improving macroeconomic conditions in capital markets. And then obviously, as we resolve Steward and our hope and anticipation is that prospect follows shortly on that with resolution that the market spreads will also come in. But again, right now, we're not even out testing that market.

Nikita Bely

Analyst, JPMorgan Securities LLC

Q

How about the early thoughts on 2025 on term loan maturity, do you think you'll extend it or pay it off with sale...

Richard Steven Hamner

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

A

We think we have options on that. That's a good question. As we've laid out our liquidity, allows us a lot of optionality, whether that gets extended, partially extended, paid. We have liquidity now and with anticipated transactions that I walked through a few minutes ago, we think that gives us the optionality that I mentioned.

Nikita Bely

Analyst, JPMorgan Securities LLC

Q

Okay.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Ed Aldag for any closing remarks.

Edward K. Aldag

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

Thank you, Anthony, and thank you, all, for listening in today. And as always, if you have any questions later on, please give Drew or Tim a call.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.