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COMPANY INTERVIEW

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Sabra Health Care REIT, Inc.

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Sabra Health Care REIT, Inc. (NASDAQ:SBRA)

RICK MATROS has served as Sabra Health Care REIT, Inc.'s President and Chief Executive Officer and as a Director since May 2010, and he has served as Board Chair since November 2010. He was Chair of the Board of Directors and Chief Executive Officer of Sun Healthcare Group, Inc. from 2001 until Sabra's inception in November 2010. Mr. Matros founded and served as Chief Executive Officer and President of Bright Now! Dental from 1998 to 2000, and as a Director from 1998 until its sale in December 2010. From 1998 until the sale of its operations in 2006, Mr. Matros also was a member and Management Committee member of CareMeridian, LLC, a health care company that specialized in offering subacute and skilled nursing for patients suffering from traumatic brain injury, spinal cord injury, and other catastrophic injuries. Previously, from 1994 to 1997, he served Regency Health Services, Inc., a publicly held long-term care operator, holding positions as CEO, President, Director and Chief Operating Officer. Prior to that time, from 1988 to 1994, he served Care Enterprises, Inc., holding positions as CEO, President, COO, Director and Executive Vice President—Operations. Mr. Matros currently serves on the nonprofit boards of IsraAID and the American Israel Public Affairs Committee, and is the Executive Producer of Sabra Films, LLC.

SECTOR — REAL ESTATE

(BDO600) TWST: We spoke several years ago, but for our readers, would you start with a quick snapshot of Sabra's history and any important milestones in recent years?

Mr. Matros: Sure. The company went through a pretty large transformation in the latter part of 2017 with a merger and some subsequent acquisitions and some major dispositions, primarily driven by us having concerns over our largest tenant. There was a lot of work that we had to do to restructure and reposition the company throughout 2018, and we got all that done, and a number of good things came out of that that we had set goals for, such as becoming investment grade, just becoming larger, having more liquidity in the stock, and things like that.

And so we had a pretty nice year actually in 2019 once we got all that behind us, and we were looking forward to a nice run — and then the pandemic hit. That's been really difficult, being in senior care and skilled nursing; the businesses have gotten hit dramatically. And you saw the business starting to recover last year, and then the double whammy of Delta and Omicron set everything back quite a bit.

TWST: Yes, and I was going to ask you about how your tenant base, and thus your company, was impacted, and how you have held up during what were obviously very challenging times these last couple of years.

Mr. Matros: Our tenant base held up actually quite well. In part because, particularly on the skilled nursing side, less so on the senior housing side, there was a lot of government assistance, which really helped. And then, because of all the work that we had done in 2017 and 2018, almost all of our tenants were positioned pretty strongly, the rent coverage was very strong right before the pandemic hit. And so as a result, unlike a number of our peers, we only had one tenant that we had to restructure rent on. So it's been remarkably stable. And that's not to imply that our peers didn't have tenants that were as good, but we had just done all that work, so the timing was fortuitous for us.

That said, it's been just extremely difficult at the operational level, and the impact of Delta and Omicron has set the recovery back about a year. For example, in skilled nursing, as we're talking today, we thought we would have been fully recovered by now, if you look at last year's trends prior to Delta, and now we're probably looking at first quarter next year. In senior housing, we thought we probably would have been recovered by mid-year this year, and that's probably pushed out a year as well.

The combination of low occupancy from hospitals being overrun by COVID patients and disrupting elective surgeries and the like, the cost side of the equation, burnout from staffing, using temporary agencies, and all the price gouging that occurred with temporary staffing and PPE and things like that, it just really hurt.

TWST: Let's talk more about the company's overall property portfolio and what it looks like today. As you well know, within health care there's a variety of property types, so what types of properties are you invested in, and also what geographic markets, and what's changed?

Mr. Matros: I will start with geographic, because that's easy — we're in almost every state. We're in 43 states, and we're in Canada. Things that have changed for us? We've actually been able to get some nice things done, despite the pandemic, from an investment perspective. We still have more skilled nursing than anything else, about 61%, but that's dropping this year by design, so that we are more diversified, and by year end we expect that to be closer to 50% than 60%, which will be an all-time low for us with exposure in that space. We're continuing to grow our senior housing, so assisted living, independent living, memory care.

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But the other space that's newer to us — and we're the first REIT to get into it, we started several years ago — is the behavioral and addiction space. Addiction treatment is really a very young industry in our country, very fragmented. There aren't very many tried and true operators, but we've got three strong operators now. We made a $325 million investment in one of them, Recovery Centers of America, last year, with more to come. And so that's helping to diversify the portfolio as well. The growth there will be more incremental, because it is, as I said, a very young space and very fragmented, but the opportunity to have one more asset class to help diversify the portfolio, we think, will be helpful.

"Addiction treatment is really a very young industry in our country, very fragmented. There aren't very many tried and true operators, but we've got three strong operators now. We made a $325 million investment in one of them, Recovery Centers of America, last year, with more to come. And so that's helping to diversify the portfolio as well."

And as we look back on our history, the more diversified we are, the better we trade from a stock perspective. When we had done the merger in 2017, that dramatically increased our skilled nursing. It was a means to an end, and as I mentioned, we accomplished the things that we wanted to accomplish, but since then we've been focused on getting that exposure down so we are more diversified.

TWST: Would you tell us more about RCA, the operator, which is your tenant, and anything else you can say about your plans with them going forward?

Mr. Matros: RCA has nine inpatient treatment centers currently, and to make the point of how small and young the industry is, that makes them the largest provider of inpatient addiction treatment in the country. Think about other sectors having hundreds of facilities. They have large facilities, they have outpatient as part of their model, centralized call centers.

And what we see in addiction treatment today is that the model has moved beyond the old 12-step program, which always had very high recidivism, and the models today really combine a holistic approach of science, medical treatment, psychosocial support, therapy, and the like. It's a much more all-encompassing, holistic kind of approach, and that is impacting recidivism, although I know it is still higher than everybody would like, it's more effective. So that's really their approach.

Their reimbursement is commercial insurance, and the dialogue and the tone has changed at the policy level with insurers and in Washington, and finally mental health is being seen as a legitimate problem and issue that people are having to deal with, much like any other illness, and that's fueling a lot of this. So we expect to be the primary partner, and certainly would like to be the primary partner, for RCA as they continue to grow.

Similarly, we have another partner called Landmark. Their model is a little bit different. They're smaller facilities, and their facilities receive not only commercial insurance but Medicaid reimbursement, and that's very state specific; every state's got a different Medicaid system. There are some states that have really recognized the need to provide support for mental health and addiction treatment services, and so Landmark focuses on those states that have recognized that so they can have a model that's actually viable. We were their first partner. So they're a little bit smaller than RCA, but they're growing as well.

And the other point I would make in the context of all this is, this isn't just an expansion through acquisition — we're also repurposing some existing facilities. Historically, skilled nursing was viewed as a single-purpose asset. With addiction treatment, you can actually convert skilled nursing facilities that maybe are in markets where the population isn't there anymore, or they are obsolete from a functionality perspective, and rather than having to close them and just sell them for the price of land or whatever the case may be, they can be repurposed.

Similarly, senior housing facilities even more easily can be transformed to addiction treatment centers. There's been a lot of oversupply in the market for a number of years prior to the pandemic, and even some of the newer senior housing facilities have really struggled, so being able to repurpose these has been really effective. It's another way for us to look at our portfolio and say, "What can we do differently with some of the assets in our portfolio?"

And then, a final point is the most recent deal that we did with RCA was to convert an old hotel. So there are a number of different asset classes out there that can be repurposed for addiction treatment, and so our focus is really holistically looking at every possibility, and not just growing our exposure to that space through acquisition but through repurposing as well.

TWST: One of your other recent announcements was regarding the relationship with Sienna Senior Living. Can you tell us about that? And was this your entry into Canada or were you already in the Canadian market?

Mr. Matros: We really like Canada; we were already in the Canadian market. Sienna is an existing operating partner for us, and we got into the Canadian market around seven years ago with the portfolio that we eventually brought Sienna into. And then we had a single facility that's run by Amica, as well, in Calgary. We thought that would be the basis for us to have more growth there, and it really just didn't happen. Things don't trade very much in Canada like they do in the States. It's a very stable market. In the U.S. senior housing, there's a lot of investment in senior housing in the States from private equity. You don't see that in Canada; a lot of it's pension fund money that finances it. And so we just had this dry period when we weren't growing in Canada, despite looking at opportunities up there.

We're one of only three of the American REITs that are up there, the other two being Ventas and Welltower, and we're obviously much smaller than them, so we tend to look at smaller deals and don't really have to necessarily compete against them.

But the last year, year and a half, there's been a lot more activity in Canada, and a lot of that's been generational — owners that have been in place for a long time who are retiring, getting out of the business or whatever. So that's presented more opportunities, and that presented this new opportunity with Sienna. We also have generally seen more deal flow out of Canada, and we now do expect to get more done there.

I think the announcement about this JV with Sienna has helped increase our deal flow as well, because as you would expect, because there had been no trades for a while, I think we had fallen off the radar a little bit, but we're clearly back on now. That growth is going to be specifically in senior housing — we won't invest in long-term care in Canada — but that gives us, from a geographic perspective, another avenue for growth and diversification.

"It's almost impossible to find quality senior housing assets to invest in under a triple net lease structure. I think part of that was because coverages were underwritten pretty tightly, with pretty large escalators, and when the space hits a downturn, that just doesn't give operators much breathing room. Having a managed structure, where we all participate in the NOI, provides a lot more flexibility."

TWST: What is your typical finance structure and strategy for enabling this portfolio growth?

Mr. Matros: It depends on the asset class. For skilled nursing, and so far for addiction treatment and behavioral, it's traditional triple net. In the case of senior housing, these are managed portfolios using the RIDEA structure that was approved by Congress years ago. In the managed structure we engage in a partnership, and that partnership can look very different. In the case of Sienna, it's a 50/50 partnership; in others it can be 80/20 real estate, and maybe the operator owns all of opco — so it's just different depending on the circumstances. There isn't a blueprint there, but a third party is engaged to operate on behalf of the JV. So in the case of our JV with Sienna, the JV contracts with Sienna as a third-party operator.

Much of our senior housing portfolio, like others like Welltower and Ventas, has that kind of structure in place. It used to be that triple net was popular in senior housing, but it hasn't been for quite some time, and so if you're going to grow in senior housing, you're almost always going to go the managed route. It's almost impossible to find quality senior housing assets to invest in under a triple net lease structure. I think part of that was because coverages were underwritten pretty tightly, with pretty large escalators, and when the space hits a downturn, that just doesn't give operators much breathing room. Having a managed structure, where we all participate in the NOI, provides a lot more flexibility.

The pandemic actually created a new opportunity. Prior to the pandemic, there had been so much new development that, despite the fact that there was a demographic increase, it actually wasn't keeping up with all the new development, and so occupancy and senior housing really plateaued. The pandemic obviously had a very negative effect on occupancy, and it also put a halt to all the new development, with construction costs being higher – lumber and other components as well — and so now you've got this demographic upswing and a much lower occupancy base to grow from as the industry recovers from COVID, and without much new supply getting in the way.

Even if you were to assume that new supply would get back to its pre-pandemic levels, say in 2023, by the time you break ground, by the time you open the facility and lease up, you're probably looking at 2026 or 2027 before there's any meaningful new supply. So there's a really great opportunity, a really nice window here, for senior housing to grow, and that managed structure really provides the impetus for that opportunity.

I would also note, on skilled nursing the opportunity is also quite good, because unlike senior housing, there's been a continual decline in skilled nursing assets. It's a very regulated business, it's very expensive, and so you just don't see investment in new skilled nursing. And the pandemic has actually accelerated the decline in supply. So, in the case of skilled nursing, you've got an increasing demographic with a declining supply, and you're going to have pretty close to a fully occupied industry in the latter part of this decade, so not that many years out.

So, I think for both sectors it's a function of hanging in there through these tough times in the past couple of years, and I think some nice tailwinds for both those sectors are ahead of us over the next number of years.

TWST: I know we're talking ahead of your first quarter results announcement, but what were the highlights from your mid-February business update?

Mr. Matros: I think the highlight primarily was that we had no new tenant issues, while others were still having tenant issues. That was the primary highlight, because that indicated a degree of stability in the portfolio. I think that we have not gotten the credit for it that we think we should, but I also understand from an investment community perspective, when you've got other REITs that are very good and have very good management teams having tenant issues quarter after quarter, there's just this sort of cloud over the space. I think it'll take another couple of quarters of the stability that we've shown recently on our end to actually start getting credit for it.

So, on the one hand, it's a little bit frustrating, but on the other hand, we understand the investment community's concern about additional potential tenant issues, regardless of the stability that we've shown so far. I would also note that we got the year off to a pretty good start with almost $150 million in new investments, so that was good as well.

TWST: I don't believe you've issued formal guidance yet, but more broadly could you speak to your outlook for the company the rest of this year?

Mr. Matros: In terms of guidance, we were one of a handful that actually gave some guidance last year, but with Delta and Omicron it's just too hard right now to project the rate of recovery, particularly on senior housing. Triple net is not really that much of an issue, but it's a much bigger issue on the managed portfolio. But that said, our strategy and our message to the Street is really where we were in 2019, which was, we repositioned the company; we did a lot of work. There was a lot of noise around the company and uncertainty, and there's nothing the Street hates more than uncertainty. They can model bad news, but they can't model uncertainty.

So it's really picking up where we left off in 2019, which is, we are going to do digestible deals that are relatively predictable for our space, we're not going to have any noise. We actually were able to take advantage of some opportunities during the pandemic to strengthen the balance sheet, which was already quite strong but it's really pristine right now. And we're

going to be relatively quiet, we're going to get investments done and nothing's going to be that unusual about it.

We just want to focus on getting back to growth after what we've all gone through with the pandemic, and continue our diversification strategy. So it's pretty simple really, but I think what we want to see and what is expected of us, after all that we went through in 2017 and 2018, is just some consistency and some predictability and maybe being a little bit uneventful.

TWST: You had a stock offering last fall. Do you anticipate needing to access the capital markets this year?

Mr. Matros: That's a really good question. We were criticized for doing that and for how much we utilized the ATM last year, but you had the pandemic going on, and we saw an opportunity to strengthen the balance sheet more by de-levering. And in fact, we exited the year with the lowest leverage that we've ever had.

The offering that we did was in the context of the deals that we were doing with RCA and others, that we felt had really good embedded growth. The yield on that $325 million investment was 7.5%. And while no one wanted to see us do anything at $14.40, that was still actually at or slightly better than NAV. Not that we would normally want to do it, but we did the minimum amount possible, it was oversubscribed, we didn't take one dollar more than we needed to, and we put the company in the position that we wanted to put it in.

We had also just done a super successful investment-grade debt offering — $800 million, which is huge for a company our size, at 3.2% for 10 years. I think today that would probably be 4.4% or 4.5%. So the timing was great for us on that.

Specifically to answer your question, we don't need to access the markets this year, even with the investments that we anticipate doing, for a couple of reasons. One, we've built up a lot of cash over the last couple of years. Even though a lot of companies ended up cutting their dividends during the pandemic, we were the first ones in our space to do it — most of our peers did do it after we did — and that was worth about $90 million a year of additional cash for us. And then, we've got a number of asset sales that are happening, and those sales are going to add to the capital that we have on the balance sheet to fund the investments that we would expect to do this year. So I think we're good to go without accessing the equity markets.

The other point I would make that's an important one for investors is: Our max leverage is 5.5 times debt to EBITDA. We're around 5 times, so we have plenty of breathing room. Last year, we were really focused on getting it below 5 times. And so part of the message now is, we're growing the company, and if that means we go up to 5.1 or 5.2, it doesn't mean we're going to go out and use the ATM to access equity. We just don't need to do that, because some of it's just a function of timing — we know we have sales that are closing that will bring more proceeds in, and that will naturally get that leverage back down.

The other critical point is, as the managed portfolio recovers from the pandemic, our EBITDA is going to naturally grow as well, and that's going to reduce our leverage as well. So we're really like any other REIT at this point, and leverage will go up and down a little bit, but we have some organic mechanisms in there that will help us keep it where we want without accessing the equity markets.

TWST: What do you feel most distinguishes Sabra from other health care property REITs, both from an investor standpoint and a tenant/operator point of view?

Mr. Matros: A few things. One, I think we've been creative. In terms of asset classes, one we've already talked about, being the first to enter the addiction space and the behavioral space, I think separates us. Some of the creativity that we've used as we developed our development pipeline over the years, actually going back 10 years now, using a preferred equity structure has been very successful for us, whereas most of our peers would finance the entire construction project. So that's been very successful. It's brought in about $600 million in new assets to the company. And then thirdly, as I mentioned earlier, I think getting through the pandemic with the level of stability that we've had relative to our peers has been really quite good.

And I think part of that is because we're a little bit different in terms of management makeup, in that we've got a lot of deep operational experience. All my career prior to the REIT was in operations. Our entire asset management team consists of operators. So we all speak the same language, we understand what folks go through. I think it allows us to be good facilitators and be helpful where we can be helpful, and it also helps us to assess who we think the really good operators are.

So I think those are the things that distinguish us, and if we show the discipline that we intend to show in terms of the strategy that I articulated a few minutes ago, I think the returns will be there and our investors will be rewarded.

TWST: Is there anything else you want to add to wrap up?

Mr. Matros: The only other point that I would make is really in support of all the staff in our sectors. During the pandemic, the hospitals got a lot of the attention. They were heroes — which they were — and when they were short staffed or got hit with price gouging, everybody understood. That actually hasn't been the same for the folks that work in senior housing and skilled nursing, and they are as much heroes as anybody else.

They deserve that kind of acclaim, and not getting it and getting beat up the way some of them have, I think, really hurts. It hurts burnout, it hurts morale. Everybody's working really hard out there, and exposing themselves because they're trying to take care of people, and I think that sort of status and acclaim and recognition should be given to everybody in the health care space, not just to the hospitals. So I just want to put my plug in for that.

TWST: Thank you. (MN)

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