



Transcript of Sovran Self Storage

First Quarter 2014 Earnings Release Conference Call - Edited May 1, 2014

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Participants

Diane Piegza – Vice President, Corporate Communications
Dave Rogers – CEO
Andy Gregoire – CFO
Paul Powell – EVP, Real Estate Investment

Analysts

Christy McElroy – Citigroup
Ross Nussbaum – UBS
Todd Thomas – KeyBanc Capital Markets
Gaurav Mehta – Cantor Fitzgerald
Paula Poskon – Robert W. Baird
Phil DeFelice – Wells Fargo Securities
RJ Milligan – Raymond James

Presentation

Operator

Greetings, and welcome to the Sovran Self Storage First Quarter 2014 Earnings Release Conference Call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Diane Piegza, Vice President, Corporate Communications.

Diane Piegza – Vice President, Corporate Communications

Thank you, Rob, and good morning, everyone. Welcome to our first quarter 2014 conference call. Leading today's call will be David Rogers, our Chief Executive Officer. Also participating are Andy Gregoire, Chief Financial Officer; and Paul Powell, our Executive Vice President of Real Estate Investment.

Each of you should have received a copy of our earnings release last evening. If you did not and wish to be added to our distribution list, please e-mail invest@sovranss.com. As a reminder, the following discussion and answers to your questions contain forward-looking statements. Sovran's actual results may differ materially from projected results. Additional information concerning the factors that may cause such differences is included in our Company's SEC filings. Copies of these filings may be obtained by contacting the Company or the SEC.

At this time, I will turn the call over to Dave Rogers, Chief Executive Officer.

Dave Rogers – CEO

Thank you, Diane. Good morning, everyone. Our first quarter was a good one. We were a little surprised by the top-line growth, pleasantly, and it was primarily due to the fact that our move outs abated pretty significantly. We thought that maybe the harsh winter deterred our customers from vacating, but the properties in the good weather states like Florida and Texas did no worse than our stores in the harsher climates. So we're going to credit the slowdown in move outs to the pricing strategy we implemented in 2012 where we put less emphasis on move-in incentives and more focus on the regular monthly rates. It paid off big this winter because in a traditionally weak leasing period we increased occupancy by over 300 basis points, not because of higher traffic and new tenants, but because of greater retention of existing tenants.

Andy will give the rest of the details, but Q1 gives us a great jump out of the paddock to start 2014. Most of the acquisitions we did in the quarter had already been completed as of our last call, so as happy as we are with the new stores I won't go bragging about them all over again. We did add one to our Chicago portfolio at the end of March for \$8.7 million, so that put us in almost \$100 million invested for the quarter. We have quite a bit in the hopper right now with some 120 million plus under contract and much more under consideration. It's a very competitive market though with a lot of folks willing to pay up for anything resembling a decent store in a decent market.

Before I step aside I'll reiterate what we've been saying over our past seven or eight earnings calls concerning the storage sector. Demand is picking up, customer awareness continues to grow. There is noise about new supply coming on in some markets, but we expect the impact to be de minimis for at least the next couple of years. The bigger operators with a scale to develop and staff and integrate a set of marketing, RMS and customer service platforms should continue to win an outside share of the market. Times are good and we expect that to continue.

Okay, Andy, go.

Andy Gregoire – CFO

Thank you, Dave. Regarding operations, same-store revenues increased 8.3% over those of the first quarter of 2013, the growth was the result of a 310 basis points increase in average occupancy and a 3.4% increase in rates. Same-store occupancy held up well during the slow season, and was 88.9% at March 31st. Tenant insurance income continued to show strong growth increasing 37.3% for the first quarter of 2014 as compared to the same period in 2013. Total property operating expenses on a same-store basis increased by 6.4%, primarily as a result of the increased utilities, snow removal cost and the expected increase in property taxes. Expenses benefit from the lower than expected payroll and benefits expense.

Same-store operating income increased 9.3% for the quarter. We've included in our release some additional data on previous things for our pools to give our investors more color as for the excellent performance of our more mature stores. In addition, the data highlight tell how the implementation of our technology platforms on the 2012 acquisitions was able to further drive our growth. G&A costs were 1.2 million higher this quarter over that of the previous year. Besides almost \$366,000 increase in Internet advertising the main reasons for the increase were the fact that we operated 22 more stores at the end of this quarter as compared to January 1, 2013, our continued investment in revenue management and incentive compensation.

Offsetting a portion of the overhead cost was an increase of approximately \$125,000 in third-party management fees during this quarter. Regarding properties, Dave

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mentioned the seven stores we purchased during the quarter for 95.4 million and the 17 stores we have under contract for over 120 million. Our acquisition for 2014 has started strong, we have a lot in the pipeline and we're expecting to acquire a good number of quality properties.

From a balance sheet perspective, we finished the quarter in a very solid position. During the quarter, we issued 359,000 common shares through our ATM program resulting in net proceeds of 26.3 million and about 66 million on our line of credit to fund the acquisition of the seven stores. Subsequent to the end of the quarter, we issued 175 million 10 year term notes bearing interest at 4.533%. The proceeds were used to repay the entire \$115 million outstanding on our line of credit. Subsequent to the issuance of the term notes, we have approximately \$60 million of cash on-hand and \$250 million available on our line of credit, including this accordion feature.

With regards to guidance, we've include in our release the expected ranges of revenues and expenses for the second quarter and the entire year. Same-store revenue for Q2 should be in the 6.5% to 7.5% range and NOI growth also around 6.5% to 7.5% for the quarter. Expenses outside the property taxes should be in the 4.5% to 5.5% range and property taxes for the quarter are expected to increase very similar to Q1 at between 10% and 11%. Core G&A expenses are projected as 39 million for 2014 including over \$5.1 million of Internet advertising.

Our guidance assumes an additional \$100 million of acquisitions weighted equally over the next nine months. We have also included the diluted impact of the \$60 million in cash resulting from our April term note until such time that those proceeds are deployed for acquisitions. We have not included in guidance the related acquisition cost incurred to-date or that could occur in the future. Our guidance assumes a weighted average diluted share count of 32.9 million common shares for 2014. As a result of the above assumptions, we are increasing guidance and are forecasting funds from operations for the full year 2014 at between \$4.25 and \$4.29 per share and between \$1.03 and \$1.05 per share for the second quarter of 2014.

With that Rob, we will open the call for questions.

Operator

(Operator instructions.) Our first question comes from the line of Christy McElroy of Citigroup.

<Q>: First, I just wanted to say thank you so much for the new same-store disclosure, it's great and much appreciated. Dave, you talked in your opening remarks about less and less focus on move-in incentives, can you sort of talk about, what was the year-over-year decline in discounts? What do you think the impact of that decline was on your 3.4% growth in realized rents in the quarter?

Andy Gregoire – CFO

The concessions on the same-store basis went from 1.9 million to 1.57 million for the quarter, so there was about \$320,000 decrease in incentives during the quarter, so it's about 50 basis points of revenue growth.

<Q>: Then in terms of occupancy you were at a 340 basis point delta as of quarter end. Where are you today year-over-year, so at the end of April, and how do you see that spread trending through the year?

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Andy Gregoire – CFO

At the end of April we were at 330 basis points above last April, so we are at 90%, we were at 86.7 at the end of last April. We would expect that to shrink as we go through the year, but we're going to, for the whole year we expect probably a 300 basis points on average for the whole year.

<Q>: So if you're talking about sort of 93% may be 94% occupancy during the peak quarters, what changes in terms of your pricing strategies? And if you're at sort of a 3.5% realized rent growth today, where do you see that going this year and next?

Andy Gregoire – CFO

The revenue management system is going to dictate that how we maximize revenues, but right now, as we said, we would expect some 3% increase in revenue from occupancy growth and probably 3.5% from rate growth.

<Q>: Then just lastly on acquisitions, I wonder if you could talk about the extent to which you're looking at certificate of occupancy deals, what makes them attractive? How do you think about valuation and how much of the 200 or so million of acquisitions do you expect this year, could these deals comprise?

Paul Powell – EVP, Real Estate Investment

Yes, we are talking with quite a few developers in some of our markets, some of our larger markets and doing some C of O deals. We've got a few in the pipeline, we feel this is a good way to continue to grow in some of the bigger MSAs that we want to be in, we know the markets, we can do a decent job projecting a five year, lease up period. We're working with developers in different models on how to value based on today's, based on the cap rate at stabilization and then doing a discounted cash flow for today. So we hope to do a few, I don't think we're going to do too many this year. We will have a couple that will probably close this year, maybe \$5 million or \$10 million worth, but going into 2015 we hope to do maybe another 10 or 15 million more.

Dave Rogers – CEO

It's a big platform, Christy, for our 3PM, our third-party management group. We have a lot of people who are interested in developing that would like us to manage their stores and we found that if we're going to put that kind of effort in we'd like to have the opportunity or maybe even the right to buy them first. So it takes the right developer, certainly. There is a lot of people who think they can do it and we've discarded a lot of that already, but if it's a market that we know, it's a market that we like and a developer that we trust and think understands the market, I think it'll be something we'll do and if it hasn't been anything we have done, so this was a new way for us to go.

Operator

Next question comes from the line of Ross Nussbaum of UBS.

<Q>: Can you talk about the greater retention of existing tenants that you referenced was helpful in the quarter, specifically can you talk about the average or maybe it's more impactful to talk about the median length of stay and how that's been trending?

Andy Gregoire – CFO

What we look at is the number of customers that have been with us more than one year and more than two years, and that the customers with us more than one year at the end of March were 57.4%, which compares to last March of 55.3% on the same-store group. So that's the number we're growing, that's what we want to see, those

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are the numbers, the longer stay customers that we can push rates on, put rate increases on, so that's the number we look at and it's been growing.

<Q>: And that was for the customers staying more than one year, did you have those numbers for the more than two year group?

Andy Gregoire – CFO

Yes. More than two years, last in 2013 March it was 37.6 and now it's 39.45.

<Q>: Second question, on the acquisitions for the 120 million that are under contract what will be the going in initial cash-on-cash return and what are you modeling for a stabilized yield and when do you expect to see those stabilized yields?

Paul Powell – EVP, Real Estate Investment

The 120 million we have under contract now, overall we expect the first year going in cap rate to be a little bit north of, about six and three quarters, or, excuse me, six and a half to six and three quarters as a cap rate. And then subsequent to the end of the first quarter we do have under contract another 21 million, those cap rates, one of those is a C of O deal, and none of these are—we're still in our due diligence so some of could fall out, but one of them is a C of O deal, so that will have a zero cap rate year one but those should be about six and a half. So what we have in our contract now, year one cap rates should be around six and a half for those 10 properties, or, excuse me, 20 properties.

<Q>: In terms of geography I assume are these existing markets?

Paul Powell – EVP, Real Estate Investment

All of them are existing markets; some in New Jersey, San Antonio, Atlanta, North of New York City and then another one in Chicago.

<Q>: Then the last question I would have is clearly the occupancy numbers have been stronger than I think anybody would have expected. But the rate growth has been stable, I don't think anybody is complaining about that, but when we roll forward 12 months from now and I assume you're not going to be able to push occupancy to 97%, that might be theoretically impossible for the sector, what does your experience tell you the pricing elasticity is for your customer base to accelerate that 3.5% rate growth?

Dave Rogers – CEO

I wish you were asking us in June, I think we would have the benefit of a lot of call volume and a lot of tests over the next couple of months. We've had some decent success this past quarter, but on a limited call volume. We say it's the slow season and you don't see it anymore because our rents have sort of flattened out pretty much, but certainly in terms of our call center and our Internet queries the volume is down, December, January, February, March. Starting now it's picked up, we think it's a couple of weeks later than last year, but it has started to pick up. Now is when we really get to play them and test and probe.

We feel pretty good. We're probably, I would hope we're going to be light on our revenue growth because all the models show that we should be able to push higher, but as we have talked about before when you're at 92%-93% that means you got a lot of your popular units pretty close to full, if not absolutely full, and if it was a streamline matching unit size perfectly to what the market wanted we could have a better exercise in terms of how this modeling works out. But you're right, we're not going to get to 95% or certainly 97%, it can't be done on a practical basis on our sector.

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We'll be pushing harder than we have in the past few months because we've got the opportunity to catch a call, lose that potential customer, but have another one ring right behind them. I think it's going to be better, Ross, I just, we've got to see. We think a lot of the supply has been sopped up in the mom and pop parts of most of our markets, so I think the pricing, this will be a good test. May and June will be a good test as to what pricing power really is all about, I think it's going to go the right way, but we don't have the confidence quite yet to forecast it.

Operator

The next question is from the line of Todd Thomas of KeyBanc.

<Q>: I echo Christy's comments, I appreciate the new disclosure on the same-store. So by my back of the envelope math it looks like for the 28 properties that were acquired in 2012 that entered the same-store pool that the occupancy lift on average was around 15%, maybe 16%. So you took occupancy from around 70% to 85%, which is a real strong pop. So I was just wondering if you can talk about the opportunity you see to continue buying property and realize this kind of operating upside.

Paul Powell – EVP, Real Estate Investment

Yes, some of those deals we did in 2012 were some leased up opportunities and did well over the last two years leasing those up; that's why we got that pop. We're still looking at some lease up opportunities, but mainly it's more civilized assets. So we're looking at more top-line growth on some of our acquisitions. Of course we do like to see some fiscal occupancy growth potential as well. But we're not seeing some of those were couple of larger portfolios that we had purchased that did have a lot of run room left as far as occupancy growth.

Dave Rogers – CEO

Todd, also this is in large part the reason we're feeling comfortable about going after CO deals. We think the average length of a lease up for most operators might be in excess of four years, but with our platforms and what we see we can do with stores that have sort of languished for three or four years at 60% or 70% occupancy, we come in and in a year's time with our platforms bump them by 1,500 basis points. We feel that taking over a CO deal with the right platforms in the right market can get us there a lot quicker than four years and make it work for us. In answer to the first part of your question, we do have a lot more confidence in our abilities to grow occupancy over the norm.

<Q>: And then just in terms of the potential for Sovran to assign its interest in the four properties CHHF joint venture. I was just wondering why not look to buy these for Sovran 100% wholly-owned basis? Maybe you can just kind of elaborate on the thinking. And then is this in terms of joint venture it sounds like this is something that Sovran may look to use going forward a little bit. How much appetite does your partner have here?

Dave Rogers – CEO

Okay, yes, we've had a real good relationship with Heitman; they are our joint venture partner on two big deals and we got in on the first program with them right before the downturn in '08 and despite the ensuing adversarial results in the storage sector they prove to be great partners. The second deal we did in 2011 was formed to purchase a block of stores in New Jersey from one entity and that too went well right from the start. So we like to work with them and although now we've got the capital and the resources to take down most deals, and we've said pretty much that we would like to

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JV deals that had a lot of mortgage debt that had to be assumed, or were in our mind very mature and didn't have a lot of room for upside. That's not really the case in this package. This package is essentially a second group of New Jersey properties that is owned by the same group that had sold to us and the JV the first package three years ago.

So it seemed like a good fit and we've got, as I said, a good relationship with Heitman. We like to keep them side-by-side with us for opportunities that might come along. This wasn't maybe the traditional deal for Sovran to do in a JV, but the history was there, the property was there, the legacy is there. The question is do they have the right of first refusal on our opportunities? No, we don't have an obligation to feed them deals. But it just seemed like a natural continuation of a good relationship and they were interested, we were interested, they have the need to place some money, we—it's just an ongoing relationship type of thing.

<Q>: Can you just remind us what the fee structure is for that joint venture in terms of property and asset management and if there are any other call center insurance commissions that Sovran collects?

Dave Rogers – CEO

Yes, it's standard 6% management fee, 1% call center fee, they pay a proportionate share of Internet advertising as whatever our store average is pretty much. The sharing of the profits is pari passu, there is no hurdle on this batch and I think there is a 50 basis points upfront due diligence and acquisition reimbursement. So it's very much of a side-by-side pari passu relationship except for the 6% plus 1% standard management call center fees.

Operator

The next question is from the line of David Toti of Cantor Fitzgerald.

<Q>: This is actually Gaurav Mehta with David Toti, a couple of questions. First question I have is on third-party management. In your press release you talk about your plans to expand 3P management platform in 2014. Can you elaborate a little bit more on that, what are you targeting and how many properties do you currently have?

Dave Rogers – CEO

We have right now about 24 plus the 55 that we manage, so it's about 70 almost 80 properties on our 3PM platform. We've turned away quite a few Gaurav, there is still a lot of people who are hurting that would like us to take over their headaches and we're just not that kind of company. Where we had made quite a bit of progress, and I'd say we're probably going to focus pretty intently on is newly built stores or to be built stores, advise on both a construction almost basis as well as a management basis. We turned one into a C of O acquisition, the one that Paul talked about just a bit ago.

So I don't think you're going to see a lot of numbers, it's not something that we find particularly attractive. In a lot of markets we stuck to our mantra if we're going to manage them we want to own them. So they're going to be in a market that we are either strong in or want to be in and the properties have to be as good or better than anything we have in those markets. So it's we're quite selective, you're not going to see a lot of growth there, but it has given us a great insight to the industry, great insight to a lot of opportunities and that's really all along been the focus of what we wanted to do with this platform.

<Q>: Second question I have is on acquisitions. If I look at what you already acquired and what's under contract it seems like you will reach 2014 guidance in

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second quarter. So does that mean that you're expecting a slowdown in transactions in the second half?

Paul Powell – EVP, Real Estate Investment

Not necessarily, Gaurav, some of these deals we have under contract currently; there is no guarantee that we'll close on those. We are seeing some one-off deals or some deals with one or two properties here and there; we're not seeing a great activity there. We are hearing there could be some market portfolios coming to market, we'll certainly look at those. Right now we feel pretty comfortable with the guidance we've given on acquisitions. We hope we do a lot better than the 200 million that we're saying. And so we'll have to see. It's an unknown at this time. We're continuing to work with our owners and operators that we have networked with and we hope to get some more opportunities. But right we're comfortable with our guidance.

Operator

Our next question is from the line of Paula Poskon of Robert W. Baird.

<Q>: Just to follow-up on the acquisition discussion, so what are the determining factors in whether or not you assigned the purchase of the four facilities under contract to the joint venture?

Dave Rogers – CEO

They are side-by-side with us, Paula, right now on due diligence and it's theirs for the taking. We've offered it to them and I'm pretty sure that it'll work, but they're really, on this one, just because of it, I mentioned the history of the same branded Jersey properties, but the last one New Jersey properties that we bought through this is the same—some of the ones we didn't buy. So they're in the same general market, same basic construction, same basic deal. So nothing; they haven't signed off completely, we haven't signed up completely, but I would assume that once due diligence is passed we'll go ahead with it.

Operator

Our next question comes from the line of Phil DeFelice of Wells Fargo.

<Q>: Most of my questions have been asked and answered, but following up on Ross's question given the stickiness of the tenants recently could you offer your plans for the rate increases you'll be passing along to existing tenants; how that compares to the last couple of years?

Andy Gregoire - CFO

Yes, so if you look at Q1 we are a little more aggressive than we were last Q1. We put on rate increases to about 2.7% of our customers and that average increase was 11%. So we're pushing pretty hard on those customers. We do have that pool of over 50% that could be eligible. The revenue management system and our team of analysts assure me that we will not push on all 50% of them and we will be selective, we will try to keep that move out rate because it does cause move outs when you push on that rate, we'll try to keep that to a reasonable level, and we want to make sure we can back fill if that person moves out. So we'll be more aggressive than we were last year, but you won't see us push on everybody who is eligible.

<Q>: How often in the past have you gone back to that 50% that you kind of haven't touched in the past exactly?

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Andy Gregoire - CFO

We review them every month once they get passed the 10th month with us, so if at the 10th month we decide they meet the criteria that our algorithms say, they should get a rent increase letter, we send it out. If they don't get it that month they'll be put back in the pool and reassessed the next month.

Operator

The next question comes from the line of RJ Milligan of Raymond James.

<Q>: I just wanted to follow-up on guidance, a couple of questions. With the second quarter guidance it would imply you guys are going to do 225 in the back half of the year, the midpoint of guidance, and I was just wondering what was contributing to that big jump sequentially?

Andy Gregoire - CFO

I don't know if I am following you on the 225, RJ.

<Q>: So I think 98 in the first quarter or 104 in the second quarter, which would imply you guys are going to have a pretty good ramp [indiscernible].

Dave Rogers – CEO

You've got to talk in quarters; we can't add that well.

Andy Gregoire – CFO

It's really driven by the revenue obviously gets stronger in the back half. The expenses, if you look at earlier in the year that 4.5 to 5.5 expense growth, it's pretty high. I mean obviously utilities and snow removal were poor in the first quarter. We expect them to be high in the second quarter. Things will get back to normal we expect the third and fourth quarter, so expenses will be more in line that'll be below, the second half will be below the first half. Revenue will remain strong, so I think a lot of that flows right to the bottom-line.

<Q>: Okay and just a sort of specific question. You guys add back operating leases, straight line rent adjustment to get to your recurring \$0.98, is that included in the guidance of the 4.25 to 4.29?

Andy Gregoire – CFO

The add back is included in the guidance. That was really a non-cash add back for GAAP purposes you have to straight line the rent payments on those four Westy properties. So the actual cash that goes out per quarter is 1.5 million.

<Q>: I may have missed this, did you or can you comment on what the same-store NOI growth would have been if not for the increased snow removal cost?

Andy Gregoire – CFO

If we had normalized utilities and snow removal, let's say 5% or so, expenses would have been up 4.6 or so and NOI over 10.

Operator

At this time, I'll now turn the floor back over to Mr. Dave Rogers for closing comments.

Dave Rogers – CEO

Alright, we appreciate your interest in our call, everyone. Thank you for joining us and we look forward to seeing you at NAREIT or on our next call. Take care.

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Operator

This concludes today's teleconference. You may disconnect your lines at this time.
Thank you for your participation.

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