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Life Storage, Inc. (LSI)

Q1 2019 Earnings Call

CORPORATE PARTICIPANTS

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Chief Executive Officer, Life Storage, Inc.

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.

OTHER PARTICIPANTS

Smedes Rose
Analyst, Citigroup Global Markets, Inc.

R. Jeremy Metz
Analyst, BMO Capital Markets (United States)

Jason Belcher
Analyst, Wells Fargo Securities LLC

Steve Sakwa
Analyst, Evercore Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Life Storage First Quarter 2019 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 being recorded.

I would now like to turn the conference over to David Dodman, Vice President of Investor Relations. Please go ahead.

David Dodman

VP, Investor Relations and Strategic Planning, Life Storage, Inc.

Good morning, and welcome to our first quarter 2019 earnings conference call. Leading today's discussion will be Joe Saffire, Chief Executive Officer of Life Storage; and Andy Gregoire, Chief Financial Officer.

As a reminder, the following discussion and answers to your questions contain forward-looking statements. Our actual results may differ from those projected due to risks and uncertainties with the company's business. Additional information regarding these factors can be found in the company's SEC filings. A copy of our press release and quarterly supplement may be found on the Investor Relations page at lifestorage.com.

As a reminder, during today's question-and-answer session, we ask that you please limit yourself to two questions to allow time for everyone who wishes to participate. Please re-queue with any follow-up questions thereafter.

At this time, I'll turn the call over to Joe.

Joseph V. Saffire

Chief Executive Officer, Life Storage, Inc.

Thanks, Dave. Good morning to everyone, and welcome to our first quarter earnings call. We reported solid first quarter results late yesterday of adjusted FFO of $1.31 per share and I'm pleased that we achieved a high end of our guidance provided in February. So, I'm just going to jump right into it. Operationally, of our largest markets, metro New York City, Buffalo, Las Vegas, and New England continued to perform very well. We are seeing stabilized and improving trends in markets that were impacted early in the supply cycle, particularly Chicago and Austin. With regard to markets that remain on our watch list, Houston, Dallas and Miami continue to be impacted by new supply. Houston performance has also been challenged by difficult year-over-year comps due to elevated Hurricane driven demand which did not begin to normalize until the second quarter of 2018.

With regards to our portfolio, we continue to execute on our asset rotation strategy to increase exposure to markets with more attractive demographics and newer properties with higher revenue and better growth prospects. During the quarter, we closed on two acquisitions announced in February in Long Island City and Tampa and we remain under contract on 16 properties totaling a $178 million in mid-Atlantic, Southeastern and mid-West markets which we disclosed on our February call. Three of these properties were acquired in April for $33 million. We expect to close on the remaining properties in the third quarter of 2019. However, these opportunities remain subject to further due diligence and closing conditions and therefore no assurance can be given that they will be purchased according to the currently contemplated terms.

To finance these acquisitions, our guidance continues to include the sale of $225 million of mature assets this year. While our asset rotation program comes with some minor short-term dilution, we believe the long term strategy will ultimately benefit our shareholders. Our expansion in Canada is gaining traction as we added six third-party managed stores in the surrounding Greater Toronto Area including two operating properties in which we made minority joint venture investments. Having been operating there for only a few months, I am very pleased with the progress our entire team has made.

Now on to our platform investments. I'm happy to report that we have completed the rollout of Rent Now, our fully digital rental platform for customers who prefer to self-serve and skip the counter. We remain excited by this industry leading technology which enables more flexibility for prospective customers to sign a lease with us. With on average of 8% of our new move-ins using this platform already, we believe that the operating expense efficiencies will be achieved.

With regards to our Warehouse Anywhere platform, we welcome Steve Syverson from FedEx Supply Chain. Steve has hit the ground running in his sales leadership role. Our pipeline continues to grow as we demonstrate to many businesses how our technology and unique network of 11,000 storage facilities can support and solve their last mile delivery demand.

In summary, though new development and supply challenges remain, we continue to drive revenue growth and remain keenly focused on expense control. We continue to see customer demand across the portfolio and we are encouraged as we head into the peak rental season.

I will now hand it over to Andy.

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.

Thanks, Joe. As Joe mentioned, we reported adjusted quarterly funds from operations of a $1.31 per share last night. Our same store performance was highlighted by NOI growth of 2.5% achieved by a combination of revenue growth and controlled expenses. Specifically, same store revenue rose 2.4% over the same period last year driven by realized rates per square foot that increased 3.5% over the first quarter of 2018.

Rate growth was partially offset by 110 basis point decline in average occupancy which was impacted by the difficult year-over-year comp in Houston that Joe noted. First quarter same store expenses outside of property taxes were extremely well controlled again, increasing only 50 basis points over the first quarter of 2018. Our store teams are doing a great job improving efficiencies at the stores. And this is showing up on the expense side. As we anticipated, property taxes increased 5.8% for the quarter. Additionally, as it relates to our same store supplemental financial reporting, we transitioned our customer insurance program from a third-party product to a captive solution as of April 1. We believe this program will provide great revenue and margin. As a result of this transition, insurance related revenue has been removed from our same store reporting. This project was no small feat. And we are very proud of our team for executing a seamless transition that results in virtually no customer insurance coverage attrition.

In addition to the strong performance of our same store portfolio, we continue to see consistent growth trends at the properties that we purchased at certificate of occupancy or very early in the lease-up stage. But with quarterly occupancy of 65.1% these lease-up stores still have significant room to grow. Our overall first quarter revenue increase also reflected a 28.9% increase in other operating income driven by the increase in third-party management fees.

Our balance sheet remains very solid and we continue to have significant flexibility to capitalize on attractive investment opportunities when they meet our return requirements. At quarter end, we had cash on hand of $8.9 million and $323 million available on our line of credit. We have no debt maturities until June of 2020. Our average debt maturity is 6.7 years and 85% of our total debt is fixed rate. Our debt service coverage ratio was a healthy 4.5 times and our net debt to recurring EBITDA ratio is 5.8 times.

Regarding guidance, although we continue to achieve positive trends in our same store pool, we remain cautious due to the impact of new supply. Given our better than expected performance in the first quarter, we have increased the low end of our annual adjusted FFO range $0.02 and therefore expect FFO per share to be between $5.55 and $5.63 for the year.

With that, operator, we will now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] At this time we will pause momentarily to assemble our roster. And our first question comes from Smedes Rose of Citi. Please go ahead.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.
Q

Hi thanks. I just wanted to ask you a little more about bringing the tenant reinsurance program in-house? Kind of what sort of incremental I guess profits around that do you think you can realize and maybe just some more thoughts around just the strategy of doing that?

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.
A

Good morning, Smedes, it's Andy. There's a couple of reasons for the strategy. As we looked at the customer insurance program, as we've grown over the years and the platforms have gotten bigger we've seen the revenue, if you look at that revenue, it's pretty much flat-lined. We've done what we could with the third party product. We like the greater revenue and margin potential that we can see through the captive solutions. We're looking at first year conservatively $1 million of additional NOI from the program. We did pass off some of the risk and we re-insured some of that risk on the catastrophe, first year, just to walk before we run with this program. So, I think when we look at it, just couple of things that's better for our shareholders meaning the bottom-line should look better and it's better for our customers, the better products that we offer to the customers and they're willing to pay a little bit more for their better product.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.
Q

Okay. And then I just also wanted to ask you, the timing around the portfolio of 16 assets where you closed three, I guess, and the other three – other balance in the third quarter of 2019. That just seems like a longer timeframe than what we have seen before in terms of getting a portfolio closed. Just wondering what sort of maybe more complicated about this deal or maybe just some color around that – why the timing is so long?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.
A

Yeah. Thanks Smedes. It's Joe. Of the 16, there is one that's a 12 pack and that's been going very smoothly. The contracts have been signed. We've actually finished due diligence and it's a delayed closing until I believe July, early July and that's more of the seller having to deal with some situation on their side, I believe it's tax related. So, other than that, everything has gone very smoothly and we look forward to those stores. They're all Class A in markets we like. And as Andy said earlier, we're looking forward to some of the upsides that these will bring in future years ahead.

Smedes Rose
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thank you.

Operator: Our next question comes from Shirley Wu of Bank of America Merrill Lynch. Please go ahead.

<[Q – 0HC2P0-E Shirley Wu]>: Good morning, guys. Thanks for taking the questions. So, for your Canada market, you mentioned that you joined two new JVs. So, could you talk about the strategy in terms of ramping up in Ontario and whether that you're going to see so mostly third-party management or more JV deals or maybe even potentially doing straight-up acquisitions?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

A

Yeah, hi, Shirley. It's Joe, thanks. As we said earlier in the year, we have always looked at Toronto. It's very close to our head office and we found a great partner in Bluebird and they've been up there for several years. We've worked with them for a number of years in the U.S. and the timing was right for us to work together. We said we would get up there and kind of walk before we run. Get familiar with the landscape, get familiar with all the rules, regulations and there's a lot going on in different countries. So, so far we're very pleased with what we've been accomplishing in just a matter of a few months. We already have six stores up there that we're operating. And we should have probably within, by the end of the year, early next year upwards of 9 or 10 with this partner. We'll continue to work with them exclusively. There has been other opportunities. We believe that we could do a little bit more third party, but, again, we're going to work with these guys and we'll see how we do over the next few months and then ultimately we see it as a pretty good opportunity for us and if all goes well, we will definitely be doing some more on our own up there.

<[Q – 0HC2P0-E Shirley Wu]>: Got it. And so for my second question, could you talk about street rates in 1Q and also year-to-date in April? And also maybe on the net effective rent side and maybe a little bit of color for maybe notable markets?

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.

A

Sure. Hi Shirley. It's Andy. It's -- street rates in Q1 on average were down just slightly, it's a pretty flat 70 basis points they were down Q1-over-Q1, very similar in April, very similar trend. Net effective were down 3% in Q1, but it is market-by-market. When you see markets like New York up 6% and Vegas up 6%, but then you see Vegas or Houston obviously with the hurricane-driven demand last year, we could push rates pretty well. Q1, Houston were down 16%. So, overall down slightly, Houston being the biggest drag on that right now.

<[Q – 0HC2P0-E Shirley Wu]>: Got it. And so for 2Q that will normalize as well for Houston?

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.

A

Yeah. Rates in Q2 won't normalize in Houston. They were still pretty high last year. Occupancy will begin to normalize. Rates will take a couple more quarters.

<[Q – 0HC2P0-E Shirley Wu]>: Okay. Thanks for the color.

Operator: Our next question comes from Jeremy Metz of BMO Capital Markets. Please go ahead.

R. Jeremy Metz
Analyst, BMO Capital Markets (United States)

Q

Hey guys, just sticking with Houston, obviously you mentioned the supply pressures. Can you just give your outlook more broadly here as you look into the year? Obviously, you mentioned the hurricane comp starting to abate a little bit in 2Q. You had a negative 2.4%, I think it was revenue growth in the quarter. Should we start to see that? What sort of improvement should we start to see if at all in the revenue there as we go through the year?

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.
A

Jeremy, Q2 I don't think you'll see the improvement. Last year Q2 in Houston, we were positive 3.4% same store revenue growth. So it was a pretty strong quarter. Q3, you should start to see some normalization. It's going to stay negative for a few more quarters and it's hard to tell how fast it's going to switch, but we like what we're see in occupancy wise, occupancy is moving in Houston. Rates are not moving yet. So we'll have to play that out as we go through the busy season. But, as we sit right now, it's tough to say it's going to turn positive for the year. I think we're going to be negative at least for another couple of quarters.

R. Jeremy Metz
Analyst, BMO Capital Markets (United States)
Q

All right. And then, I know this all goes into a blender year to produce when resolved and that being revenue growth, but if you look at the split between rate and occupancy here, it seems like you're obviously willing to give up one for the other. As we look out into the busy season, just wondering how you are feeling and should we expect to see this continue with a focus more on the rate side?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.
A

Yeah. I think, if you – as we go to the busy season and we're not there yet, May is a big month for us. It's going to be maximizing revenue. It's not always about occupancy. We've got our in-place strategy that's working very well. Street rates down slightly, net effective will get a little easier compared to last year, free rent got a little easier comp in the second half of the year. But it's all about maximizing revenue. So, we're going to pull those levers that maximize the revenue as we go through the year.

R. Jeremy Metz
Analyst, BMO Capital Markets (United States)
Q

All right. Thanks.

Operator: Our next question comes from Jason Belcher of Wells Fargo. Please go ahead.

Jason Belcher
Analyst, Wells Fargo Securities LLC
Q

Good morning. Just wondering, you guys had several markets in the quarter that posted really strong double-digit same store NOI growth. Could you give us a little more color on those, maybe what was driving that outsized performance?

Andrew J. Gregoire
Chief Financial Officer, Life Storage, Inc.
A

Yeah. I think if you look at the New York where we got strong rates and occupancies are holding well. It really is – revenue is the driver. Expenses, if you see any outsized growth there, it's normally on the property tax line and there is still markets that are under expense property -- property tax expense pressures. But, it really is, it's – we've got some great traction in Vegas and in New York, in Buffalo, in Rochester and Syracuse. So, there is markets where new supply is not an issue and we can push rates and the occupancy is staying in a good spot and our current customers are acting well with our increases. So, it's a combination, but there is no magic sauce in certain markets versus others. Many times, it's new supply that's affecting that market.

Jason Belcher
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you. And then, sorry if I missed this, but, what were the cap rates on the acquisitions you completed in the quarter?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

A

Yeah, thank you. Well, there -- the going in cap rates, let's see the ones we closed on, the Long Island City, that's a relatively early in the lease-up stage. But we feel it should hit a 6 cap around stabilization and that's probably two-and-a-half, three years out. Tampa as well was a new store, doing very well. It's already hit our first year projections and that was sub 5 cap. But again it was a relatively new store opened I believe in 2017. That one we believe should be well north of a 7 cap at stabilization Jason.

Jason Belcher
Analyst, Wells Fargo Securities LLC

Q

Great, thanks a lot guys.

Operator: [Operator Instructions] And our next question will come from Steve Sakwa of Evercore. Please go ahead.

Steve Sakwa
Analyst, Evercore Group LLC

Q

Thanks. Good morning. Joe, I just was wondering if you could talk generally speaking about new developments across the country. We've got sort of different views on kind of when supply has peaked or will peak, the impact it's having on results and just sort of how developers are thinking about new projects. It doesn't seem like we've had a lot of certainly distress in the system, although lease-ups are taking longer and I'm just curious as you survey and talk to some of the private developers and some of the new entrants. How are they sort of looking at the market and do you sense that there's a big pullback in new starts given the slowing lease-up periods?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

A

Yeah. Hi Steve. Thanks. It's definitely -- I don't see any real concern out there, we're not seeing any distressed properties. We have our own internal ways to monitor the supply in our markets. We've said before, we believe, it's not accelerating from 2018. 2018 was really a strong year for new development and deliveries. We believe the same should be in 2019. We don't really see it getting any slower, Steve. I think we try to monitor what's being planned out there and planning -- that could be a couple of years out. But we're really – we're watching it. You can also kind of look at how much is coming out of the REIT platforms in terms of third-party management and every quarter they'll see those construction deals open and kind of get to one of us to manage and that doesn't seem to be slowing down very much. Our economy is very strong. So, yeah, it's not slowing down, but we feel 2019 should be similar to 2018 with what we're monitoring and again we really monitor what's on – what's in our markets, some of the hotspots where the Portland's and Nashville's and Denver, we're not really exposed to those. So, I'm not sure if that's slowing down, but those have been really the hot ones. I think Texas is always going to be some new supply. I think Houston is really in absorption phase. There's going to be a few more we're monitoring that are going up. But our biggest concern is Dallas. There's still a lot of construction going on. But that said, we've fared very well.

Steve Sakwa
Analyst, Evercore Group LLC

Q

Okay. And then I just wanted to go back to your comment about the Rent Now program, I think you said 8% of the new move-ins were using that program and I'm just curious if you could and maybe it's too early, but, could you or can you talk about kind of customer behavior or ability to accept different rent levels or negotiations or lack thereof, I mean, how does somebody using that app compared to kind of the call in or walking in and how do you think that might trend over time?

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

A

Yeah. I mean, it is pretty early, Steve. But, with that said, we are – we are monitoring it. I think customer behaviors is kind of change. If you look around the country, a little bit regional differences, I think Texas we've seen on the high end of 10% to 12% of move-ins and that's where it's probably more useful, whereas Florida, we'll see some 5% so far, little more aging – aged population. So, that's one of the things we've noticed. The take up of insurance is no different than what we get from walk-ins or those who call it in the call center. We're not seeing people, they may be signing the lease in the middle of the night, but they're not coming in the middle of the night, they're coming in at normal hours, so they're still able to go in and buy some merchandise and talk to the store managers. And if there is any concern with what they purchase such as the wrong size, we can work with them and we do work with them. So again, it's still little early, but we are very encouraged by it. What we're doing at the moment is actually testing the closing of some stores on Sundays because of this. We can advertise if people do show up on a Sunday and they want to rent and there's no manager there, we do have signs and those sort of things to pinpoint our rent now or call centers, so people can actually still lease. That's still at testing. But, those are the types of savings we think we can get from this. But, overall, we're very encouraged by it. Again it's – the millennials is $80 million strong. Some of the concern was that millennials wouldn't be storage users, but we are seeing that they are big users of it. They're entering into their higher paying years. They're also a lot more mobile in terms of the type of work that they'll do. So, they are big consumers and this is something that they expect, they expect to be able to do things on their own. They expect to be self-served. And again, this is something that's going to play really well into that millennial sector.

Steve Sakwa
Analyst, Evercore Group LLC

Q

Okay, great. That's it for me. Thanks.

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

A

Thanks, Steve.

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

Joseph V. Saffire
Chief Executive Officer, Life Storage, Inc.

So, thank you everybody for dialing in. We look forward to seeing many of you at NAREIT in June. Have a great week.

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