

# Research

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## Research Update:

# Ventas Inc. Rating Raised To 'BBB+' From 'BBB' On Revised Criteria; Outlook Stable

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## Research Update:

# Ventas Inc. Rating Raised To 'BBB+' From 'BBB' On Revised Criteria; Outlook Stable

## Overview

- Standard & Poor's Ratings Services published its revised corporate ratings criteria on Nov. 19, 2013.
- We have revised our assessment of Ventas Inc.'s financial risk profile to "modest" from "intermediate" based on strong coverage measures supported by stable cash flow and management's commitment to conservative balance sheet management.
- We are raising our corporate credit rating on Ventas to 'BBB+' from 'BBB', and removing it from CreditWatch, where we placed it with positive implications Nov. 26, 2013, in conjunction with our criteria review.
- The stable outlook reflects our expectation for stable cash flow and profitable and prudently financed growth that maintains currently strong coverage measures and moderate leverage.

## Rating Action

On Dec. 16, 2013, Standard & Poor's Ratings Services raised its corporate credit rating on Ventas Inc. to 'BBB+' from 'BBB'. We also raised the ratings on Ventas' senior notes to 'BBB+' from 'BBB'. We removed the corporate credit rating and all other ratings from CreditWatch, where we placed them with positive implications on Nov. 26, 2013. The outlook is stable.

## Rationale

We base our upgrade primarily on our reassessment of Ventas' financial risk profile, which we now view as "modest," given current and projected strong coverage measures that are supported by stable cash flow. We also factored in management's commitment to a conservative leverage policy, predominant use of fixed-rate debt, maintenance of a long-debt tenor (nearly seven years), as well as adequate liquidity. We expect Ventas will end 2013 with fixed-charge coverage of around 4x, debt to EBITDA just over 6x, and debt to capital (undepreciated) in the mid-40% area. Debt includes an operating lease adjustment that adds about \$260 million of debt.

Our business risk profile incorporates our view of the REIT industry's "low" risk and "very low" country risk. We view Ventas' business risk profile as "satisfactory," which is supported by the REIT's large and diverse portfolio of health care facilities. Ventas has grown its asset base to more than \$20 billion following several large acquisitions that have diversified the portfolio and improved the quality of its assets through increased exposure to

higher-barrier/cost markets. We note the diversity of the portfolio also comes with different sets of risks, such as Ventas' direct investments (via RIDEA structure) in senior housing operating assets (27% of net operating income [NOI]) that are more management intensive and potentially vulnerable to macroeconomic trends and cash flow volatility than its triple-net lease investments. Nonetheless, we expect property level cash flow should be fairly predictable over the next one to two years benefiting from supportive fundamentals; weaker, but adequate rent coverage (for triple-net leases); and long-term leases with contractual rent increases. We believe the company also benefits from relatively limited exposure to government reimbursement risk, since 73% of NOI is derived or supported by facilities that obtain their revenues from private-pay sources.

Our 2014 base case assumes:

- Low-single-digit same-store revenue growth.
- \$1.5 billion of acquisitions yielding 6.5% to 7% and funded in a leverage-neutral manner.
- \$100 million to \$150 million of development/redevelopment completions yielding 8%.
- \$200 million to \$300 million of asset dispositions at an 8% to 9% capitalization rate
- SG&A to revenues of 4%.

Based on these assumptions, we arrive at the following credit metrics:

- Fixed-charge coverage in the high-3x to 4x range.
- 6.0x debt to EBITDA.
- Debt to undepreciated capital in the low-40% area.

## **Liquidity**

Standard & Poor's views Ventas' liquidity as "adequate" over the next 12 months. We expect sources of liquidity, including cash, forecast funds from operations (FFO) and availability under the company's credit facility) will exceed uses by over 2x. While liquidity appears to meet the threshold for a "strong," assessment we characterize Ventas' liquidity as adequate given its acquisition appetite and note that sources of liquidity in our assessment are heavily supported by its sizable revolver capacity.

Principal liquidity sources:

- \$55 million of cash as of Sept. 30, 2013.
- About \$1.7 billion available under its \$2 billion revolving credit facility due in January 2018.
- About \$1.3 billion in annual FFO.

Principal liquidity uses:

- About \$850 million of projected common distributions.
- No senior unsecured debt maturities (we do not factor nonrecourse mortgage debt into our liquidity analysis).
- \$200 million of capital expenditures (including active development/redevelopment expenditures).

Additional potential sources of capital include access to secured debt, though we have not factored this into our liquidity assessment. Ventas' encumbrance level was fairly modest at less than 15% secured debt to undepreciated real estate and nearly 80% of NOI is unencumbered, and we believe the company has some flexibility to pursue additional secured debt without jeopardizing its current credit rating. As of Sept. 30, 2013, the company was also in comfortable compliance with its bank and bond covenants.

## Outlook

We expect Ventas' large and diverse portfolio of good quality healthcare facilities to result in steady revenue and EBITDA growth over the next one to two years. Ventas' revenues and cash flow benefit from long-term leases, good rent coverage, and favorable fundamentals. The stable outlook also factors in Ventas' manageable debt maturities, strong access to capital, and at least a leverage-neutral growth funding strategy that supports currently strong debt coverage measures and moderate leverage.

### Upside scenario

Although we consider it unlikely over the next one to two years, we could raise our rating on Ventas if the company pursues growth prudently and profitably and without any integration issues, while increasing tenant diversity. We would also look for a longer track record of successful management of its senior housing operating portfolio through a cycle that when combined with careful growth could ultimately support a "strong" business risk profile. We would also expect Ventas to maintain a modest financial risk profile.

### Downside scenario

We would lower our rating by one notch if fixed-charge coverage approaches 3x and leverage increased materially. In addition, we could lower the rating if debt to EBITDA rose to 7x or higher or debt to capital exceeded 50% on a sustained basis. Weaker credit metrics could be the result of either a large debt-financed acquisitions or a prolonged economic downturn that caused material deterioration in cash flow from Ventas' healthcare portfolio.

## Ratings Score Snapshot

Corporate credit rating: BBB+/Stable/--

Business risk:

- Country risk: Very low risk
- Industry risk: Low risk
- Competitive position: Satisfactory

Financial risk:

- Cash flow/Leverage: Modest

Anchor: 'bbb+'

#### Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria And Research

### Related Criteria

- Corporate Methodology, Nov. 19, 2013
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

## Ratings List

Upgraded; CreditWatch/Outlook Action

|   | To             | From             |
|---|----------------|------------------|
| Ventas Inc.<br>Ventas Realty L.P.<br>Ventas Capital Corp.<br>Nationwide Health Properties Inc.<br>Corporate Credit Rating | BBB+/Stable/-- | BBB/Watch Pos/-- |
| Nationwide Health Properties Inc.<br>Senior Unsecured   | BBB+           | BBB/Watch Pos    |
| Ventas Capital Corp.<br>Senior Unsecured  | BBB+           | BBB/Watch Pos    |
| Ventas Realty L.P.<br>Senior Unsecured  | BBB+           | BBB/Watch Pos    |

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