

Disconnect?

Given how the market is currently pricing its shares, one might assume New Senior Investment Group is a poorly managed, secularly challenged business. Ignoring the market's view can yield a much different assessment.

One description of the value investor's task is to identify inexpensive stocks, determine why they're cheap, and then assess whether the negativity reflected in the share price is warranted. Opportunity knocks if the answer is no.

A current case in point: New Senior Investment Group. The publicly traded real estate investment trust owns independent-living and assisted-living U.S. housing properties targeted at seniors. Average monthly rents are a middle-of-the-road \$3,200 and are paid in over 90% of the cases by private-pay sources.

At just under \$10, the stock trades on the company's estimated 2016 adjusted funds from operations [AFFO] at roughly half the multiple of peers. On the estimated \$240 million run rate of its net operating income [NOI] within a year, the shares trade at a 9% cap rate, vs. 6% for peers.

Among the most important reasons the shares are poorly regarded: SNR management is handled externally, a construct of which REIT investors are leery due to potential conflicts of interest. The external manager is an affiliate of Fortress Investment Group, a well-known firm with more than \$70 billion in assets, but which took a reputation hit recently from shuttering its flagship macro hedge fund. SNR itself is highly leveraged, with net debt of \$1.9 billion that is 8x the firm's estimated normalized NOI. Also concerning to some, dividend payments have been irregular.

While acknowledging the concerns, Jeff Erber and Eric Brugel of Grey Owl Capital Management believe they're overdone. The underlying business is sound – the portfolio weathered the financial crisis with little difficulty – and management has proven adept in both increasing occu-

pancy rates and lowering costs at acquired properties. Fortress has also proven adequately incented to act in shareholders' interest, one key example being a new \$100 million stock buyback plan instituted to increase shareholder value, even though

shrinking the capital base is not entirely in Fortress' interest as an external manager.

The debt – the vast majority of which consists of property-level mortgages with fixed interest rates and maturities in 2020 and beyond – is manageable, with nor-

INVESTMENT SNAPSHOT

New Senior Investment Group (NYSE: SNR)

Business: REIT that owns more than 150 primarily independent-living and assisted-living senior housing properties in the U.S.

Share Information (@12/30/15):

Price	9.89
52-Week Range	8.56 – 17.74
Dividend Yield	10.5%
Market Cap	\$845.1 million

Financials (TTM):

Revenue	\$340.4 million
AFFO Margin	20.9%

Valuation Metrics

(@12/30/15):

	SNR
P/AFFO (TTM)	11.4
Forward P/AFFO (Est.)	7.2

Largest Institutional Owners

(@9/30/15):

Company	% Owned
Vanguard Group	13.6%
Omega Advisors	6.5%
Levin Capital Strategies	6.3%

Short Interest (as of 12/15/15):

Shares Short/Float	4.3%
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SNR PRICE HISTORY



THE BOTTOM LINE

The beaten-down valuation of the company's shares appears overdone relative to its fundamentally sound and stable business, says Eric Brugel. At a peer-group cap rate on his estimate of normalized net operating income, the shares would trade at \$20. In the meantime, he considers the 10%-plus dividend yield safe and "paying us nicely to wait."

Sources: Company reports, other publicly available information

malized annual NOI at 3x annual interest expense, says Erber. As for dividends, he says, any timing irregularities have been for technical reasons and the key point is that AFFO, assuming rent increases and modest occupancy and cost improvements

in newly acquired properties, should support a quarterly 30-cent dividend by next year – a 12% yield on today's share price.

At even an 8% cap rate on normalized NOI, Brugel says, SNR shares would go for just over \$12. With a peer-level cap

rate of 6%, they'd trade at \$20. "The stock to us just isn't trading in a way that's connected to the fundamentals," he says. "We don't know exactly when that changes, but in the meantime the dividend is paying us nicely to wait." **vii**



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