Ventas, Inc. (NYSE:VTR) Research Summary

Ventas, Inc. (NYSE:VTR) is a real estate investment trust (REIT) based in Chicago, IL, and operating across the United States, Canada, and United Kingdom. It specializes in healthcare and seniors' housing.

We began our search with an interest in investing in REITs as part of the portion of our portfolio allocated to investments designed to produce stability. This was due to

a) the general stability of real estate as an asset class (deriving from a stable minimum demand and tangible operating assets), and
b) the legal requirements mandating dividend payout ratios of at least 90%, promising a consistent source of income assuming consistently positive net income.

Qualitative Screening and Comparable Companies Analysis

We then constructed a comparable companies table of fourteen US REITs, emphasizing the largest REITs by market capitalization, and began with each of these as potential investment candidates. We excluded technology-focused REITs, as we believe these benefit from the general trend of technology and technology-adjacent companies being overvalued and therefore offer relatively fewer sound, reliable growth opportunities. The inclusion of companies trading at inflated ratios would affect our mean and median ratios in the comparables table, so they were excluded not only as investment candidates but from the table altogether.

Further, we have concerns about the long-term health of domestic residential and commercial real estate. We believe the shift to working from home (WFH) and e-commerce induced by the COVID-19 crisis will not completely reverse, and this will result in the underutilization of many commercial and office real estate properties. Faced with declining rental revenues in commercial and office segments, we predict that many real estate holding companies (REIT and otherwise) will be compelled to convert these properties to residential properties, a shift that will eventually cause a glut (oversupply that drives down prices) in the residential real estate market as well. As such, we removed general commercial, residential, and office REITs from our list of investment candidates. REITs that hold properties used for specialized purposes benefit from higher barriers to entry and greater market share in their relatively niche sectors of real estate, helping to shield them future gluts.

We then narrowed our list of investment candidates to only those stocks that were trading at a significant discount year-to-date (YTD), as this implies opportunity for growth in share price as the companies recover from the COVID-19 crisis. This resulted in three candidates: Public Storage (NYSE:PSA); Ventas, Inc. (NYSE:VTR); and Welltower, Inc. (NYSE:WELL). The former specializes in self-storage and the latter two in healthcare and seniors' housing.

We then returned to the comparables table to examine these companies' ratios. In additional to the traditional metrics and ratios, we noted several others that were meant to assist specifically in the valuation of REITs, including total real estate assets (REA), REA/EBITDA, REA/EBIT, and price-to-tangible book value per share (P/TangBV). Real estate assets generally consist of property, plant, & equipment and assets held for development. REA/EBITDA and REA/EBIT are meant to gauge the efficacy of the company's business model in extracting earnings from its real estate assets. (Net income would, of course, be inappropriate to use for these ratios, as it is attributable only to equity investors whereas real estate assets could be funded by a variety of investor groups.)

We eliminated PSA, as its P/TangBV ratio was more than thrice the median of the comparable companies.

We then examined in depth the revenue and earnings sources of WELL and VTR, both of which recently released earnings for the second quarter of 2020. We noticed that while Welltower reported earnings for the three- and six-month periods ending 6/30 similar to the previous years' figures, a very large portion of these earnings were derived from gains on dispositions (sales) of real estate assets. If we examine income from continuing operations before income taxes and other items (which excludes these gains on dispositions) and compare the 2020 figures to the figures from the same periods the previous year, we see a much more grim picture: $4.3mm vs $167.4b for the trailing three months and $79.9b vs $289.7b for the trailing six months.

In total, Welltower sold $949mm of real estate in Q2, compared to sales of $53.8mm in the same period by Ventas. Such large sales are concerning not only because they artificially inflate the company's earnings, but (more significantly) because they significantly reduce the company's future sources of revenue.

As such, we resolved that Ventas would be a better investment than Welltower.

Conclusions

Due to the general reliability of real estate as an asset class, its legally mandated attractive dividend policy, its sector's insulation from many concerning trends, its opportunity for share price appreciation as it recovers from the current economic crisis, and the relative sustainability of its revenue streams, we have taken a long position on Ventas, Inc.

---*Wasim Rahaman*