Sound Income Strategies
Fixed Income Quarterly

Fixed Income Quarterly: Q1 2024

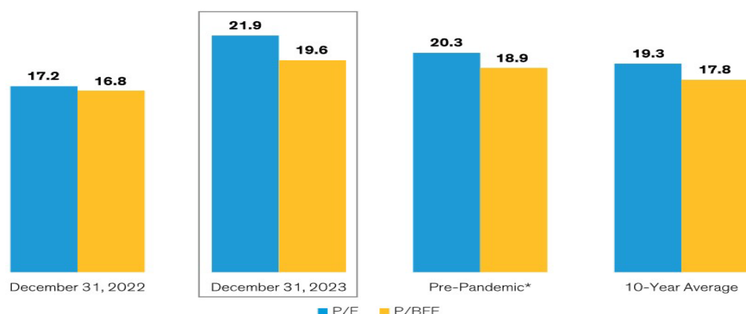
It has become increasingly clear to me that one's capacity for risk-bearing depends importantly upon one's age and ability to earn income from noninvestment sources.

-A Random Walk Down Wall Street

The Markets:

Given the markets' Q1 expectations for a top-line increase in revenue of 3.5% and earnings increases of 2.4% for the S&P 500, and Q4 '23 GDP coming in at 3.4%, (3rd release) versus expectations of 2%, the equity market bull continues to buck! However, the MAG-7 represents over 30% of the market capitalization of the S&P 500 so their earnings and momentum are having a real effect. Still, it was a good quarter for financial markets with the Dow up +6.1%, NASDAQ +9.1%, the S&P 500 +10.5%, and even the S&P Value Index returned 8.0% during the first quarter of the year.

There are still negative factors affecting markets, first, stubborn inflation keeps the Fed from lowering rates and as we expected, whipsawed fixed-income markets a bit during Q1, the Bloomberg Aggregate Index returned -0.78% and 10-year US Treasuries were down -1.6%. Fortunately, our Core Plus portfolio was up +2.4%, with each of its asset classes, except REITs, adding a positive contribution during the quarter. Another factor that could limit forward equity returns is frothy P/E ratios as the blended rate or forward stands at 19.6x vs a 10-year average of 17.8x.



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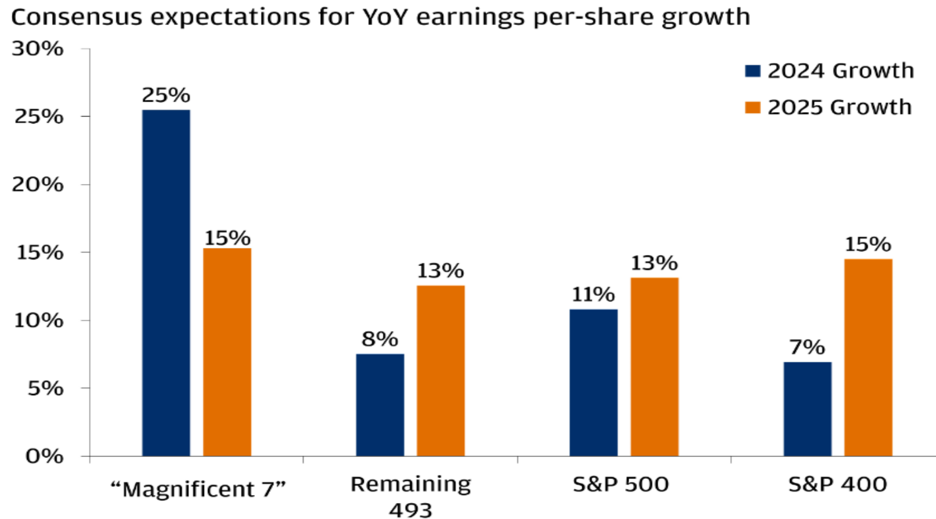
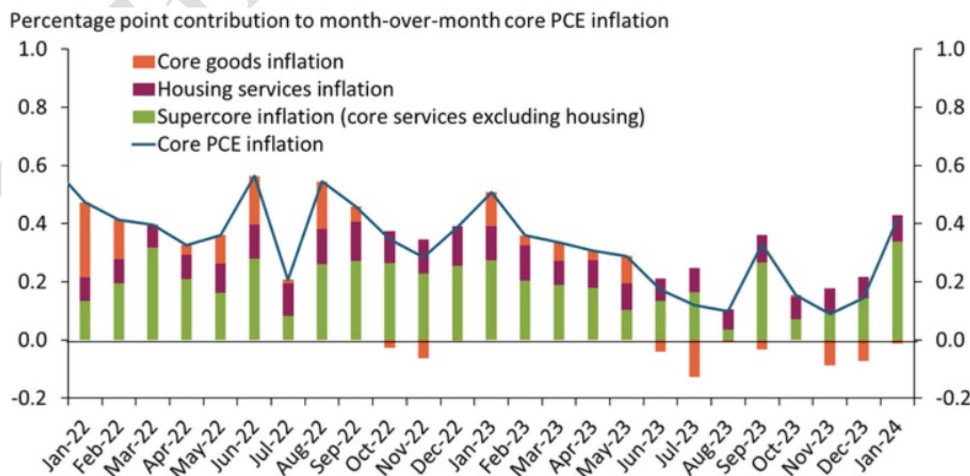
However, we'll see how the forward P/E changes as S&P firms reported Q4 earnings at about 4% higher than expectations with Technology, Industrials, and Consumer Discretionary leading higher. Consensus is calling for a 10.9% growth in S&P 500 earnings for 2024, which would increase the forward P/E from the year-end graph above of 19.6x to 20.4x.



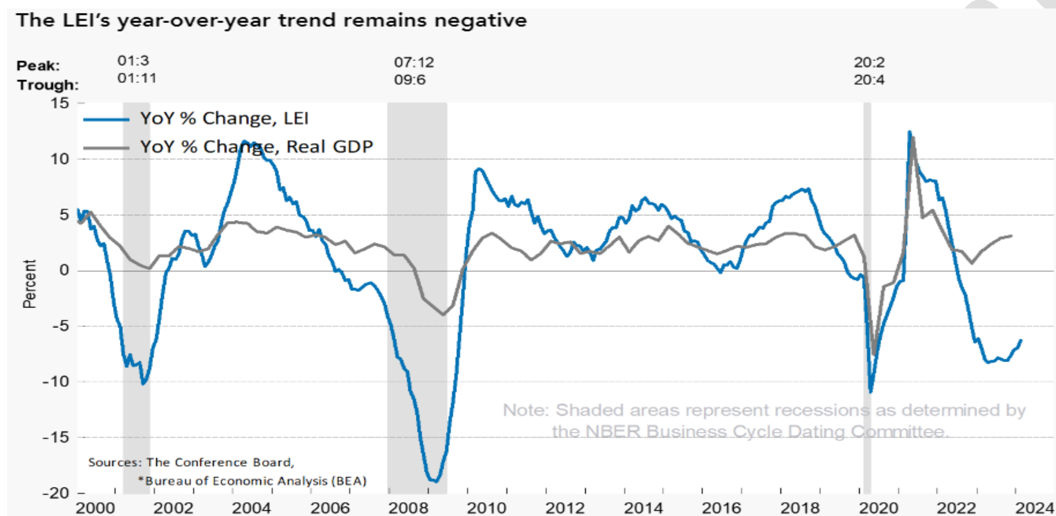
Though overall inflation is declining, Core PCE YoY's latest reading is 2.8%, and CPI YoY is 3.2%, this is still not fast enough for the Fed. Capital markets were discounting up to five or more quarter-point moves for 2024, but now it's looking more like three quarter-point moves by year-end. This has pushed up US Treasury and bond yields in general as the markets have come to realize that the Fed isn't in a hurry to drop rates.

As can be seen from the graph below core services, excluding shelter, referred to as SuperCore inflation, by the Fed, have been increasing since last fall and are causing hesitation by the Fed to move.

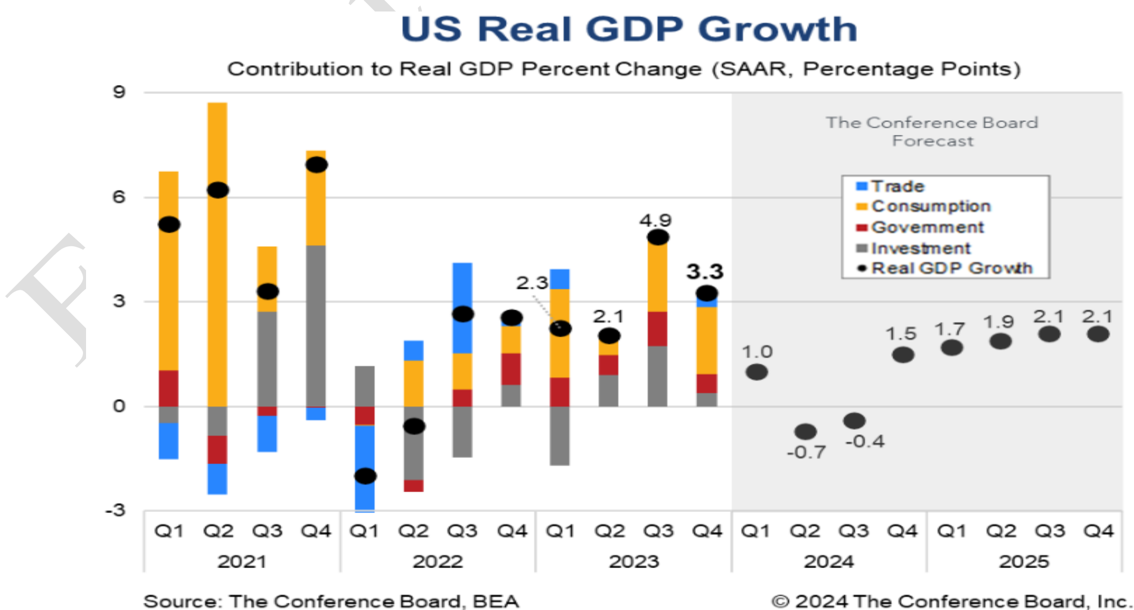


Sources: U.S. Bureau of Economic Analysis (Haver Analytics) and authors' calculations.

During the Q2 letter last year, we showed the Leading Economic Indicators and how they turned negative and had been falling since their peak at the end of 2020. Though we're still negative, the LEI looks to have bottomed and shows an improving situation. Does this mean "we're out of the woods" and all is clear? When the Fed commenced its tighten phase, consumers were still coasting from the pandemic stimulus, student debt repayment was put on hold and many businesses were smart enough to take out debt or extend maturities before rate increases really took hold. Thereby delaying any negative effects that come from increasing the cost of capital or monetary tightening.

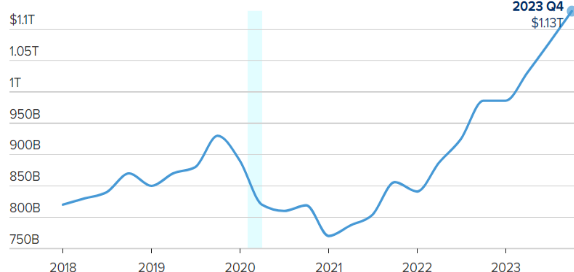


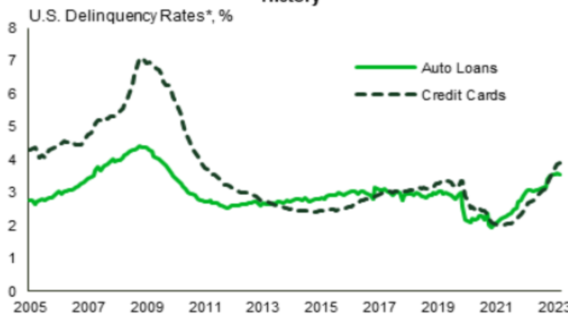
From the graph below, we can see that GDP finished 2023 on solid ground with consumption, about 70% of GDP historically, and consumers finished strong going into year-end. The Fed has been alluding to a peak in rates and their future outlook will be declining rates this year.



Lower rates might come just in time considering that credit card and auto loan debt, along with their delinquencies are the highest they've been going back to 2011. Perhaps some consumers aren't in such good shape after all, which could weigh on future consumption/GDP numbers.

On the other hand, this could be the first time we've had a negative yield curve, poor Leading Economic Indicators at this magnitude, and a material drop in the growth of M2 and not have a material economic slow-down, recession, or soft landing. Maybe the Fed's countercyclical monetary policy to counter the business cycle is working, maybe they can smooth the runway so much that we won't feel any bumps, or we may just keep flying with no need to land at all. Could be I'm a bit pessimistic, but I think we'll still see a slowdown even if printing tons of capital has delayed that outcome. Regardless, we'll keep looking for companies that can produce income and service their debt in all business cycles.





Bond World

It's hard to believe four years have passed since the beginning of the pandemic and the bond index still hasn't fully recovered, but with the fastest interest rate increase since 1980, it shouldn't be too big a surprise. As stated in the year-end letter, I believed the fixed income market got a little ahead of itself during Q4 last year and we'd see bonds stumbling a bit during Q1 this year.

Unfortunately, after stronger-than-expected payroll numbers the first week in February, the market started to believe J. Powell's message about not necessarily lowering rates by March and the U.S. Treasury sold off, pushing the belly of the curve and longer maturity Treasuries nearly 30 bps higher from the beginning of the year, with the 10-year ending at 4.20%.

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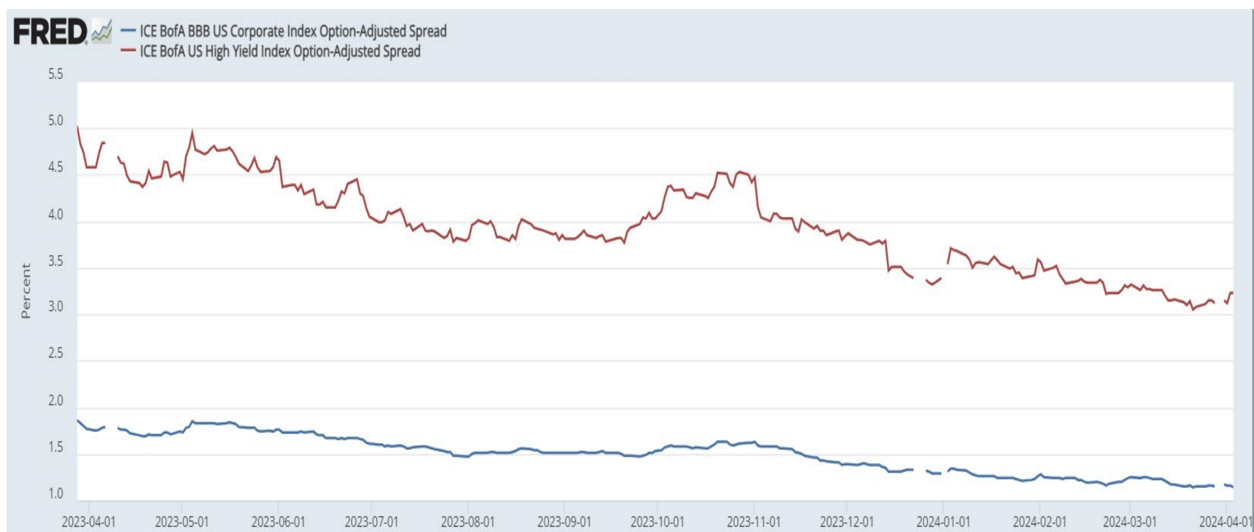
IG and HY Corporate bond spreads both tightened during Q1, though the US Treasury curve sold off or widened during the quarter. The graph below is a real-world example of credit spread compression we often discuss this concept during the year-end webinar.



As we can also see from the IG and HY spread graph above, IG, (investment grade) spreads coming down to the +135 area or 1.35% above the equivalent US Treasury maturity is one of the narrowest levels in decades, showing just how hungry investors are for bonds and some of the highest nominal yields not seen since the 2008-2009 recession.

Overall, it wasn't the most interesting quarter we've seen for our fixed-income portfolios, but we did make some changes during the quarter, and we'll continue to adjust securities in a few of our asset classes going forward.

<u>Trades:</u>

<u>Dana Incorporated (DAN) 4.25% 9/01/30 (B1/BB-/BB+) @ $87.00/ 6.70%</u>

Dana is a global provider of high-technology products to virtually every major vehicle manufacturer in the world. They serve global light vehicle, medium/heavy vehicle, and off-highway markets through four business units – Light Vehicle Drive Systems (Light Vehicle), Commercial Vehicle Drive and Motion Systems (Commercial Vehicle), Off-Highway Drive and Motion Systems (Off-Highway), and Power Technologies, which consists of sealing and thermal-management technologies that span all customers in our on-highway and off-highway markets. Dana has a diverse customer base and geographic footprint which minimizes their exposure to

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individual market and segment declines. In 2022, 48% of their sales came from North American operations and 52% from operations throughout the rest of the world. Sales by operating segment: Light Vehicle: 40%, Commercial Vehicle: 20%, Off-Highway: 29% and Power Technologies: 11%. Rear/front axles, driveshafts, transmissions, sealants, and service of OEM parts come from 88 facilities across the globe.

Catalyst:

COVID-19 had caused a rough ride for the Big Three domestic auto manufacturers, therefore materially affecting Dana Inc's margins and EBITDA. Given that the Big Three, which account for almost a third of Dana's revenue, have finally settled with the UAW, that should clear the runway for improved margins and free cash for in 2024. Q3 '23 had a 5% increase in top-line revenue and 70% of net sales growth was from ICE, (traditional combustion vehicles) programs, and 70% of adjusted EBITDA growth was driven by EV programs. Dana has been investing, via capex, and prepping for EVs, (electric vehicles) for several years now. This will more than likely continue as governments force auto manufacturers into the EV space. The improved margins for the EV space represent an important shift for Dana.

The company's cash position improved by 10% YoY, with liquidity mostly unchanged. Current leverage stands at 2.6x and 3.0x on a net and gross basis. Management has stated that they want to move back towards net leverage of 2.0x by 2025. The UAW strike pushed Dana bonds wider, as expected, but given the clarity of the contract and Dana management's goal of de-leveraging, we should see some spread compression from current levels of +270 over the 5-year UST bond.

Risk & Outlook:

The UAW strike hurt margins and cash flows, pushing management to lower 2023 guidance, with cash flows turning negative from estimated positive amounts during the year. Increased working capital needs and higher capex to support new business and product launches have taken a near-term toll on profitability. Another COVID-like black swan event would severally hurt Dana and the auto industry's recovery, but that's an inherent risk for all sectors.

Outside of general economic, market, and geopolitical risks, the idiosyncratic risk to Dana doesn't seem material at this point in their business cycle. Increasing YoY sales and favorable currency outlook for a less strong USD combined with an end to the UAW strikes and clarity on worker contracts management should be able to de-leverage further in the years ahead.

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Recommendation:

Adjusted EBITDA has improved by 35% over the past year, management plans on reducing outstanding debt with a net leverage goal of 2.0x by 2025, with long-term leverage falling to 1.0-1.5x. Leverage mostly increased with acquisition pre-COVID amounts to over $1 billion as management moved towards an increasing global EV market. Given that supply chains are mostly back to pre-covid "normality", the UAW strike is over, and EV is starting to improve EBITDA mix bonds should look narrow at some point over the next 12 months. We have very little exposure to the auto and sub-industry and given management's focus to de-lever spreads should improve so we are adding the credit to our portfolios.

DAN US Equity

Financial Metrics	Q4 2023	2023 LTM	2022	2021	2020
Adj Revenues		$ 10,616	$ 10,156	$ 8,945	$ 7,106
% chg	-100.0%	4.5%	13.5%	25.9%	-17.6%
Adj EBITDA		$ 827	$ 661	$ 814	$ 614
% chg	-100.0%	60.6%	-19%	32.6%	-40.2%
Capex		$ 499	$ 440	$ 369	$ 326
% chg	-100%	13%	19%	13%	-23%
Interest Exp		$ 128	$ 117	$ 122	$ 129
Net Leverage (ND/EBITDA)		2.6x	2.8x	2.7x	3.2x
CFO		$540	$649	$158	$386
FCF		$41	$209	-$211	$60
Cash & Equ		$421	$425	$285	$580
Equity Price	$ 12.84	RQ005			
Market Cap $B	$ 1,871	RR902			
BV Equity	$ 1,798	RR007			
Gross Debt $B	$ 2,721	RR251			
LTM FCF $mm	$ 41	RR843			
FCF Yield (LTM)	2.2%	RX072			
P/CF	3.45	RR908			
P/E (LTM)	21.24	RR900			
Dividend Yield	3.1%	DV012			
Payout Ratio	#VALUE!	RR049			

Near-Term Debt

There is $200mm debt due in 2025, $400mm due 2027, $400mm in revolver capital for 2028, $335mm in 2029 and $400mm in 2030

Key Transactios, Material Changes

While there are no large M&A transactions, Dana continues to look for smaller stretegic acquisitions or partnerships for sales outside of their larger auto clients. EV will continue to drive better margins and growth as world governements push for, what is considered more "green" companies.

Ratio Analysis	DAN	vs Comps
Current Ratio	1.58x	1.83x
Quick Ratio	0.73x	1.17x
Debt/Mkt Cap	159.0%	77.9%
T.Assets/T.Equity	23.4%	86.90%
Debt/ Assets	37.24%	24.70%
Debt/ Capital	61.42%	37.09%
Debt/ Equity	159.18%	77.89%
N.Debt/ EBITDA-Capex	7.73x	3.17x
EBIT/ Int Exp	3.07x	81.83x
Net Debt/ Adj. EBITDA	2.6x	1.5x
FCF/ Debt	2%	18%
Asset Coverage	1.69x	6.56x
Gross Margin (LTM)	8.8%	16.9%
Operating Margin (LTM)	3.4%	5.8%
Profit Margin (LTM)	0.7%	3.6%

National Retail Properties (NNN) @ 5.4% yield

NNN REIT Inc. is a real estate investment trust that acquires, develops, leases, and manages retail spaces to tenants under long-term net leases and is primarily to retail under longer-term agreements. The REIT has a well-diversified tenant roster with 3,532 properties with 390 different tenants in 49 states. There is some concentration in the Sunbelt states such as Florida, Texas, George, North Carolina, and Tennessee, which are still growth areas. The REIT is also well diversified across the retail sector such as convenience and automotive stores, restaurants,

entertainment, health & fitness, equipment, pharmacy, electronics, and several other sub-sectors.

Key Points:

During the Q4 earnings call, management indicated that the pipeline for M&A was going to be soft due to low cap rates and sticky inflation, hence a higher for longer interest rate outlook for at least the first half of 2024. FFO was $589mm/ $3.27 FFO per share for 2023 with expectations of $602mm/ $3.29 per share for 2024. Q4 FFO was at/above consensus due in part to one tenant moving from a cash basis to accrual basis reporting, hence a non-cash item. Consensus is expecting '24/'25 FFO of $3.29 and $3.39 and AFFO of $3.33 and $3.43 per share.

Though growth will be anemic for at least the first half of this year, dividends are expected to be $0.565 quarterly for $2.26 during 2024, which equates to a conservative 68.7% FFO payout ratio.

Properties, Expatriations Acquisitions & Dispositions:

	2023	2022	2021
Properties Owned:			
Number	3,532	3,411	3,223
Total gross leasable area (square feet)	35,966,000	35,010,000	32,753,000
Properties:			
Leased and unimproved land	3,514	3,390	3,191
Percent of Properties – leased and unimproved land	99 %	99 %	99 %
Weighted average remaining lease term (years)	10.1	10.4	10.6
Total gross leasable area (square feet) – leased	35,683,000	34,829,000	32,395,000
Total annualized base rent	$ 818,749,000	$ 771,984,000	$ 713,169,000

The following table summarizes the lease expirations, assuming none of the tenants exercise renewal options, of the Property Portfolio for each of the next 10 years and then thereafter in the aggregate as of December 31, 2023:

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	% of Annual Base Rent[1]	# of Properties	Gross Leasable Area[2]		% of Annual Base Rent[1]	# of Properties	Gross Leasable Area[2]
2024	1.7%	54	803,000	2030	3.3%	109	1,221,000
2025	5.1%	185	1,941,000	2031	7.3%	185	2,697,000
2026	4.8%	212	2,127,000	2032	5.9%	215	2,328,000
2027	8.2%	235	3,591,000	2033	4.9%	138	1,467,000
2028	5.7%	229	2,172,000	Thereafter	49.1%	1,831	15,592,000
2029	4.0%	119	1,744,000				

(1) Based on the annualized base rent for all leases in place as of December 31, 2023.
(2) Square feet.

	2023	2022	2021
Acquisitions:			
Number of Properties	165	223	156
Gross leasable area (square feet)[1]	1,281,000	2,629,000	1,341,000
Cap rate[2]	7.3 %	6.4 %	6.5 %
Total dollars invested[3]	$ 819,710	$ 847,747	$ 555,415

(1) Includes additional square footage from completed construction on existing Properties.
(2) The cap rate is a weighted average, calculated as the initial cash annual base rent divided by the total purchase price of the Properties.
(3) Includes dollars invested in projects under construction or tenant improvements for each respective year.

NNN typically funds Property acquisitions either through borrowings under NNN's unsecured revolving credit facility (the "Credit Facility"), by issuing its debt or equity securities in the capital markets, with undistributed funds from operations or with proceeds from the sale of Properties.

Property Dispositions. The following table summarizes the properties sold by NNN for each of the years ended December 31 (dollars in thousands):

	2023	2022	2021
Number of properties	45	33	74
Gross leasable area (square feet)	293,000	311,000	1,015,000
Net sales proceeds	$ 115,716	$ 65,216	$ 122,018
Net gain on disposition of real estate	$ 47,485	$ 17,443	$ 23,094
Cap rate[1]	5.9 %	5.9 %	7.4 %

[1] The cap rate is a weighted average of properties occupied at disposition, calculated as the cash annual base rent dividend by the total sales price of the properties.

NNN typically uses the disposition proceeds to either pay down the Credit Facility or reinvest in real estate.

Revenues & Expenses:

	2023	2022	2021	2023 Versus 2022	2022 Versus 2021
Rental Revenues[1]	$ 807,327	$ 753,816	$ 705,194	7.1 %	6.9 %
Real estate expense reimbursement from tenants	18,763	17,802	18,665	5.4 %	(4.6)%
Rental income	826,090	771,618	723,859	7.1 %	6.6 %
Interest and other income from real estate transactions	2,021	1,435	2,548	40.8 %	(43.7)%
Total revenues	$ 828,111	$ 773,053	$ 726,407	7.1 %	6.4 %

[1] Includes rental income from operating leases, earned income from direct financing leases and percentage rent ("Rental Revenues").

Rental Income. Rental income increased for the year ended December 31, 2023, as compared to the same period in 2022. The increase is primarily due to the Rental Revenues from NNN's recent Property acquisitions (see "Results of Operations – Property Analysis – Property Acquisitions").

	2023	2022	2021	2023 Versus 2022	2022 Versus 2021
General and administrative	$ 43,746	$ 41,695	$ 44,640	4.9 %	(6.6)%
Real estate	28,378	26,281	28,385	8.0 %	(7.4)%
Depreciation and amortization	238,625	223,834	205,220	6.6 %	9.1 %
Leasing transaction costs	299	320	203	(6.6)%	57.6 %
Impairment losses – real estate, net of recoveries	5,990	8,309	21,957	(27.9)%	(62.2)%
Executive retirement costs	3,454	7,520	—	(54.1)%	N/C
Total operating expenses	$ 320,492	$ 307,959	$ 300,405	4.1 %	2.5 %
Interest and other income	$ (1,134)	$ (149)	$ (216)	661.1 %	(31.0)%
Interest expense	163,898	148,065	137,874	10.7 %	7.4 %
Loss on early extinguishment of debt	—	—	21,328	— %	(100.0)%
Total other expenses	$ 162,764	$ 147,916	$ 158,986	10.0 %	(7.0)%
As a percentage of total revenues:					
General and administrative	5.3 %	5.4 %	6.1 %		
Real estate	3.4 %	3.4 %	3.9 %		

Outlook:

Management has been able to increase their dividend each year going back to 1990 and their occupancy rate has always been strong at 98%, even during the 2008-2009 recession and the COVID-19 pandemic.

Currently, NNN has a 99.5% occupancy, a 10+ year weighted average lease term, only 6.7% of outstanding leases coming due for 2024/2025, a decent cap rate spread between acquisitions and dispositions, (1.4% 2023), and a low FFO/AFFO payout ratio of 69% along with a current multiple near the lower end of the historic range 12x. A 5.8x net debt/EBITDA, interest and fixed charge coverage ratios at 4.3x, and NOI flat to slightly lower YoY combined with increasing FFO/AFFO and a flat debt maturity structure with roughly 8% maturating in ‘24/25, should position NNN as a defensive to stable REIT going forward during uncertain times with interest rates.

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P/FFO multiples have ranged from 9.3x up to 22.7x over the past decade for NNN and the multiple currently stands at 12x. The tenants are roughly 18% IG with a 6.45% cap and a 57% weight to non-IG tenants with a 6.7% cap and the residual exposure at a 6.9% Cap to public/non-rated tenants. Though net investment activity is expected to be around 70% of 2023 activity NNN is a conservative play in the triple-net-lease space and offering us a 5.4% yield.

We are looking to replace some of our names in the Medical REIT sector that will have a difficult time keeping their dividend rate up going forward and NNN should be a stable replacement for these positions.

NNN REIT INC	DS002				
Retail REITs	DX208				
	2023	**2022**	**2021**	**2020**	**2019**
FFO per share	$3.27	$3.14	$ 2.86	$ 2.59	$ 2.71
AFFO per share	$ 3.26	$ 3.21	$ 3.06	$ 2.51	$ 2.80
FFO payout	68.6%	69.4%	78.4%	83.1%	74.8%
Dividend	$ 2.23	$ 2.16	$ 2.10	$ 2.07	$ 2.03
# Properties	3,532				

	APLE		**Comps**
Price	$ 42.32	RQ005	
Div Yield	5.31%	DV012	
Mkt Cap in Billions	$ 7,760	RR902	
Shares out mm	$ 182.47	DS124	
Net Debt mm	$4,359.36	RR208	
NOI mm		IS687	
NOI growth 1 yr	7.0%	RR551	
SSNOI growth	7.04%	M0047	
FFO mm	$ 589	CF233	
AFFO mm	$ 593	FO579	
FFO per share	$ 3.270	CF064	
AFFO per share	$ 3.26	CF203	
Implied CAP rate	6.6%	RR870	
FFO yield	7.7%	RR890	
FFO payout	69%	RR106	
FAD payout	68.5%	FO893	
P/FFO	12.9		
P/AFFO	13.0		
Debt/ Capital	51.2%	RR045	
N Debt/ Adj EBITDA	6.2	F1178	
FFO/ Total Debt	13.5	RR129	

<u>National Health Investors -NHI @ 5.8% yield</u>

NHI is a self-managed REIT specializing in sale-leaseback, joint venture, and mortgage/mezzanine financing for senior housing and medical facility investments. The REIT held real estate, mortgage, and notes receivable for 179 facilities in 31 states, (106-SHP, 72-

SNFs, and 1-HOSP). These properties have an aggregate original cost of approximately $2.4 billion, rented mostly with triple-net leases to 25 tenants. The earnings breakdown into two reportable segments, real estate rental properties, and a SHOP segment (Senior Housing Operating Portfolio) that holds two ventures owning 15 ILFs throughout the U.S. operated by independent managers. These 15 ILFs were previously leased as triple-net-lease agreements until April of 2022, at which point they were moved to the two joint ventures under a TRS for compliance under the REIT structure.

Key Points:

NHI falls under the Healthcare subsector, they are mostly set up as a triple-net-lease manager. At year-end about 40% of their revenue came from just three tenants, Senior Living (16%), NHC (12%), and Bickford (12%). Most of the Healthcare sector, REITs included, suffered greatly under the COVID-19 pandemic and many healthcare REITs/operators are still struggling from increasing costs, oversupply, questionable local, state, and federal reimbursements, and to some degree, even private pay insurance is attempting to cap payments to healthcare operators.

While NHI management has done a good job of maintaining the capital structure and overall leverage, like others, they have had to write off and incur accounting changes due to uncollectible rental payments from some healthcare operators and restructure some of those obligations. During 2022 there were at least $10.7mm in pandemic-related rent concessions, but fortunately nothing during the second half of 2023. Total deferral payments since the beginning of the pandemic were $37.5mm. Part of NHI's plan for struggling operators was taking 15 ILCs, (independent living communities) from a triple-net-lease structure and placing them in a joint venture with Merrill Gardens and Discovery Senior Living as managing operators. *If industry fundamentals continue to improve, and they did a bit in '23, this could help NOI going forward, as NHI believes NOI margins will increase back to the mid-30% area. At the end of last year, there were $31.8mm left in deferrals which management expects to realize with repayments and other value-creating transactions.

The other concerns for the subsector are government and insurance payments. Payments from government programs and private payors are subject to many statutory and regulatory changes, unfair retroactive rate adjustments, recovery of program overpayments, or ongoing governmental investigations/audits. One issue that's still overcast on the industry is the Budget Control Act of 2011, (BCA) which requires automatic spending reductions to reduce the Federal deficit, resulting in uniform payment reduction across all Medicare programs of 2% per year and goes until July of 2032. Fortunately, Congress has delayed the, up to 4%, Medicare payment reduction which was supposed to take effect in January of '22. So, this could become an issue during '25, after the election. Obviously, any material governmental reductions in payments could adversely affect the tenants of NHI.

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Portfolio Overview	Q4 2023	Q3 2023	Q2 2023	Q1 2023	Q4 2022
Properties	15	15	15	15	15
Units	1,733	1,734	1,734	1,734	1,732
Occupancy	83.2%	79.0%	75.5%	75.2%	75.8%
REVPOR	$2,995	$3,010	$3,004	$2,989	$2,994
Resident fees	$12,950	$12,367	$11,793	$11,700	$11,791
Operating expenses	(9,416)	(9,428)	(9,094)	(9,215)	(9,253)
Management fees	(645)	(616)	(588)	(584)	(589)
NOI	$2,888	$2,323	$2,111	$1,901	$1,949
NOI Margin	22.3 %	18.8%	17.9 %	16.2%	16.5%
Recurring capex	$439	$722	$277	$407	$130

The following table reconciles NOI to net income, the most directly comparable GAAP metric (*$ in thousands*):

	Years Ended December 31,		
NOI Reconciliations:	2023	2022	2021
Net income	$ 134,381	$ 65,501	$ 111,967
(Gains) losses from equity method investment	(555)	(569)	1,545
Other income	(202)	—	(350)
Loss on early retirement of debt	73	151	1,912
Gain on note receivable payoff	—	(1,113)	—
(Gain) loss on operations transfer, net	(20)	710	—
Gains on sales of real estate, net	(14,721)	(28,342)	(32,498)
Loan and realty losses, net	1,376	61,911	52,766
General and administrative	19,314	22,768	18,431
Franchise, excise and other taxes	449	844	788
Legal	507	2,555	908
Interest	58,160	44,917	50,810
Depreciation	69,973	70,880	80,798
Consolidated NOI	$ 268,735	$ 240,213	$ 287,077
NOI by segment:			
Real Estate Investments	$ 259,162	$ 232,295	$ 283,945
SHOP	9,222	7,603	—
Non-Segment/Corporate	351	315	3,132
Total NOI	$ 268,735	$ 240,213	$ 287,077

EBITDRAM Coverage & Occupancy:

NHI TOTAL PORTFOLIO[1]

PROPERTY TYPE	SH	SNF	MEDICAL NON-SNF	TOTAL
Properties	89	68	1	158
3Q22 Coverage	1.20x	2.41x	2.51x	1.66x
3Q22 Occupancy	84.6%	77.1%	75.3%	80.7%
3Q23 Coverage	1.36x	2.72x	3.05x	1.91x
3Q23 Occupancy	84.3%	80.7%	77.9%	82.4%

PROPERTY CLASS	NEED DRIVEN	NEED DRIVEN EXCL. BICKFORD	DISCRETIONARY	DISCRETIONARY EXCL. SLC	MEDICAL	MEDICAL EXCL. NHC
Properties	75	37	14	5	69	34
3Q22 Coverage	1.06x	1.03x	1.36x	1.69x	2.42x	2.03x
3Q22 Occupancy	85.4%	86.2%	83.5%	85.6%	77.1%	69.6%
3Q23 Coverage	1.31x	1.13x	1.41x	1.38x	2.74x	2.11x
3Q23 Occupancy	85.0%	86.8%	83.3%	84.1%	80.6%	72.9 %

CUSTOMERS	NHC[1]	SLC[2]	BICKFORD[2]
Properties	35	10	38
3Q22 Coverage	2.98x	1.22x	1.10x
3Q22 Occupancy	83.2%	82.2%	84.2%
3Q23 Coverage	3.54x	1.39x	1.52x
3Q23 Occupancy	87.1%	82.1%	82.6%

Outlook:

National Health Investors, for the Healthcare REIT space, has a decent balance sheet with interest coverage at 4.2x, fixed charge coverage at 4.4x, and total debt/ assets of 35.9%. The FFO and FAD payout ratios are 82.5%, again not bad. As can be seen from above the coverage and occupancy have improved with their REIT operators, but it's still a slow recovery in the space in general. If interest rates do decline this year and next, it should help lower NHI's WACC at 4.7% with 38% in variable debt. Given management was probably forced out of triple-net-leases properties and into 15 SHOP joint ventures, this could actually help NOI increase FFO per share going forward, provided management assumptions are accurate.

While we are lowering our exposure to Healthcare REITs overall, we are looking for some REITs in the sector that could improve with falling interest rates, better occupancy, and improving NOI going forward.

NHI US Equity					
NATL HEALTH INVESTORS INC	DS002				
Health Care REITs	DX208				
	2023	2022	2021	2020	2019
FFO per share	$ 4.39	$ 3.55	$ 4.62	$ 5.51	$ 5.49
AFFO per share	$ 4.33	$ 4.30	$ 4.60	$ 5.60	$ 5.50
FFO payout	82%	101%	82%	80%	77%
Dividend	$ 3.60	$ 3.60	$ 3.80	$ 4.41	$ 4.20
# Properties	179				

	APLE		Comps
Price	$ 62.32	RQ005	
Div Yield	5.80%	DV012	
Mkt Cap in Billions	$ 2,697	RR902	
Shares out mm	$ 43.41	DS124	
Net Debt mm	$ 1,113	RR208	
NOI mm	$ 268.7	IS687	
NOI growth 1 yr	17.8%	RR551	
SSNOI growth		M0047	
FFO mm	$ 135.6	CF233	
AFFO mm	$ 187.9	CF201	
FFO per share	$ 4.39	CF064	
AFFO per share	$ 4.33	CF203	
Implied CAP rate	7.5%	RR870	
FFO yield	7.1%	RR890	
FFO payout	82.1%	RR106	
FAD payout	82.5%	SI390	
P/FFO	14.2		
P/AFFO	14.4		
Debt/ Capital	47.1%	RR045	
N Debt/ Adj EBITDA	4.7	F1178	
FFO/ Total Debt	16.8	RR129	

Outlook

The world is watching our central bank and hoping for lower rates soon. Given the amount of government stimulus provided as a result of the pandemic, we have been coasting from savings and extensions of debt which has allowed continued consumption and pushed GDP higher. However, there always comes a point when the party is over and the bill comes. I've shown this

Use Only

simple graph before, but I want to reiterate that a recession doesn't start until after the Fed starts to lower rates again. The red bars show the beginning and end of the past four recessions and each time the Fed hit peak rates, kept rates there for a while, and then started to cut rates before the official recession began. I truly hope this time is different, and I love the positive bias novices and many professionals have with pushing an all-clear signal. Wall Street has gotten very rich from getting the rest of us to continue buying at tops and I don't expect the next top to be any different. Until then, we'll look for solid companies producing quality income no matter the gyrations of the financial markets.

Sincerely,
Eric Lutton, CFA
Chief Investment Officer

Investment Advisory Services offered through Sound Income Strategies, LLC, an SEC Registered Investment Advisory Firm.