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SAY HELLO TO EPR

New name and brand reflect evolution at the former Entertainment Properties Trust

By: Anna Robaton

David M. Brain has long presided over a company that in the REIT world has been closely associated with the cinema business. Kansas City, Mo.-based Entertainment Properties Trust was launched by AMC Entertainment Inc. in 1997 as a vehicle to free up capital to fund the expansion of its then-fledgling megaplex cinema business, initially through sale-leaseback transactions.

Within a few a years of its founding, Entertainment Properties began to do business, including build-to-suit deals, with other theater companies and over time amassed a major megaplex portfolio. But as growth opportunities in that sector have diminished, the company has diversified into new asset classes, from charter schools to ski parks, and struggled to publicly reconcile those moves with its name.

After pondering a rebranding for some time, the company announced in October that it planned to change its name to **EPR Properties** (NYSE: EPR) the following month, when it also celebrates the 15th anniversary of its IPO. Brain, the company's president and chief executive officer, says the company had outgrown its name. Its new moniker gives it greater latitude in pursuing investments and more credibility with tenants outside the entertainment world.

"Our identity," he explains, "is as a specialty investor in unique categories that require unique industry knowledge. The thesis of the company is no longer confined to entertainment."

THE BRAINS BEHIND EPR

Brain is a former investment banker who served as consultant to AMC during the launch of Entertainment Properties. He became the newly formed company's chief financial officer and later its chief operating officer as well. In 1999 he was named president and chief executive officer.

"It makes sense to adopt a name that synchronizes a bit better with our business and helps us to forge an identity beyond our heritage," Brain says.

This year, the company expects to invest some $300 million in three property categories, entertainment, education and recreation. In March, it announced that it already had signed commitments for investment spending totaling $150 million for projects ranging from a build-to-suit 16-screen Regal Stadium Theater in Albuquerque, N.M., to the acquisition of a 40,000-square-foot charter school in Washington, D.C.

As of June 30, the company's $3.1 billion investment portfolio included 113 freestanding megaplex theaters in 37 states. Its real estate holdings also included a number of entertainment-focused retail centers, which are typically anchored by theaters and co-tenanted by restaurants, bowling alleys, comedy clubs, sporting goods stores and such chains as Dave & Buster's.

The company also owned 39 public charter schools, including five under construction, in 10 states and the District of Columbia, five

EPR Properties At A Glance:
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VP, COO & General Counsel

Mark Peterson
VP & CFO

Mike Hirons
VP, Finance

Jerry Earnest
CIO

vineyards and eight wineries. The company's real estate portfolio was 98 percent occupied in the second quarter. EPR's mortgage loan portfolio, valued at about $404 million, provides financing for properties including 10 ski parks that comprise about 6,100 acres in six states.

SUBJECT TO SKEPTICISM

AMC is still the company's largest tenant as measured by its contribution to revenue, which was just over 30 percent in the second quarter of this year. (Acquired this year by privately held Chinese conglomerate Dalian Wanda Group Co., AMC opened America's first megaplex in 1995, a 24-screen theater in Dallas designed to dominate its market by offering high seating capacity, staggered movie times and multiple leading films.) The company's other top-five tenants include Rave Cinemas LLC, Imagine Schools Inc., Regal Cinemas Inc. and Peak Resorts Inc., which runs about a dozen ski facilities. Arlington, Va.-based Imagine is one of the country's largest operators of public charter schools.

EPR's moves into non-traditional asset classes, including its foray into the vineyard and winery business, have caused concern among some investors, and analysts say the stock has lagged its triple-net-lease peers as a result. But EPR is no stranger to such skepticism.

Since its early years, the company has been dogged by outside concerns over the long-term health of the cinema industry. Yet, U.S. box-office revenue has climbed at a compound annual growth rate of about 4 percent since 1987, according to EPR, which cites data from Web-based Box Office Mojo. This year, box-office revenue is expected to climb by about 5 percent over 2011.

The company has managed risk and costs, both in its theater portfolio and its other investments, by generally entering into long-term, triple-net leases. It has also focused on well-located, state-of-the-art facilities, properties that have good re-leasing prospects should an operator go dark, analysts say. "Their core strength is identifying real estate with good income characteristics no matter who the operator may be," says Paul Adornato, an analyst at BMO Capital Markets.

About two-thirds of EPR's theaters rank among the top-four performers in their markets, according to the company. Since EPR's inception, its theater operators have never missed a month of rent, according to Brain.

Ironically, the company recently re-leased the former The Grand 24 in Dallas, AMC's first megaplex, after AMC opted not to renew its lease for the historic theater. It was EPR's first-ever non-renewal, according to the company, which repositioned the property as a theater, restaurant and concert venue. It re-leased the property to a 14-screen AmStar Cinemas and Toby Keith's I Love This Bar & Grill.

In the early 2000s, "the theater industry had some problems, yet EPR's tenants didn't end up missing any rent payments, and its theaters performed well," says Anthony Paolone, an analyst with J.P. Morgan. "Over time, EPR has been proven right about the risk profile of well-located movie theaters," he adds.

Brain says skeptics have been incorrectly predicting the demise of the movie theater since Americans began buying VCRs. "As they say in Hollywood, 'every home has a kitchen and people still go out to eat.' Just because you can do it at home, doesn't mean you are always going to do it at home," he says.

About half of all moviegoers are ages 14 to 24, which bodes well for continued demand, he says. "As long as there are kids at home wanting to get away from their parents and parents wanting to get away from their kids, for that matter, you will have demand for cinemas," Brain quips.

Ben Franklin Academy in Highlands Ranch, Colo.

(NOT-SO-)SLIPPERY SLOPE

Nonetheless, the company has been diversifying into other asset classes since 2005, when it purchased its first ski facility and leased the property back to Peak Resorts. Two years later, it made its first charter school and waterpark investments. Between 2006 and 2007, the company's non-theater investments surged from $35 million (out of total investments of $1.7 billion) to $350 million (out of total investments of $2.3 billion), according to EPR.

"The company determined that there were not enough high-quality megaplex theaters to invest in to maintain the level of growth it desired and, therefore, it looked to other property types in order to have access to ample investment opportunities," says Adornato of BMO Capital Markets.

As EPR moved beyond its initial narrow focus, it unveiled what it calls its "five-star investment strategy," which it devised by taking inventory of the factors that were responsible for its success in the megaplex sector, Brain says.

Its strategy includes a focus on market-dominant, new-generation facilities that replace older structures and emerge as a result of new technology or consumer lifestyle changes. Its investments, according to the company, should provide "accretive returns initially and increasing returns over time with rent escalators and percentage-rent features that allow participation in the financial performance of the property." The company also seeks to gain a "competitive advantage" in a particular sector through knowledge, access to industry information and preferred-tenant relationships that serve as pipelines to deals.

Some of its non-theater ventures have worked out well, while others have fallen short of expectations. "We have made some very good investments, and we have also had some challenges. That is true of anybody," Brain says.

The company's portfolio of 11 ski properties had record attendance levels and revenues during the 2010-11 season, according to EPR. The company has focused on ski properties that draw from their surrounding markets, rather than the resort-type ski destinations that tend to suffer more during recessions and have burned some investors in the past.

"The admissions and concessions business of the ski hill looked a lot to us like a theater," says Brain, explaining the company's initial investments in ski parks, many of which have benefitted from the growing popularity of snowboarding.

SCHOOL DAYS

EPR's foray into the vineyard and winery business didn't prove nearly as fortuitous, and the company has been exiting that industry. It entered the business just prior to the Great Recession, purchasing vineyards and wineries from producers of mid-priced wines who wanted to free up capital for operations and expansion. EPR hoped to benefit from anticipated consolidation in the industry, but the recession dealt a severe blow to sales of mid-priced wines, and EPR's tenants in the sector were hard pressed to pay rent, explains Brain, adding that some had their credit lines frozen.

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"They weren't bankrupt, but they had a cash crisis and insolvency that nobody had ever seen before. The instability was more than we were willing to tolerate," he says.

Brain remains bullish on the charter school sector, despite the recent troubles of Imagine, which operates about 70 charter schools across the country. Earlier this year, Imagine lost its contracts to manage seven schools in St. Louis and two in Georgia amid criticism over the academic performance of students and its financial management of the schools.

The nine schools are expected to close at the end of this academic year, but EPR doesn't expect to suffer any loss of income as a result, Brain says. The properties are part of a 27-school master lease. In July, EPR announced that it had come up with a solution involving three of the shuttered schools, which represent about half of the total $72 million asset value of all nine schools. According to EPR, Imagine planned to substitute three other schools by the beginning of this academic year. EPR was exploring options for the remaining schools.

Brain says Imagine's St. Louis schools had strong enrollment during the 2011-12 academic year, but Imagine wasn't able to turn around the academically-troubled institutions quickly enough to satisfy local officials. "It is a particular set of circumstances that is not systemic to Imagine," Brain says. "In St. Louis, they tried to come in and do too much too fast."

According to EPR, there are some 6,000 public charter schools in the United States and about 450 open each year, growth that has been fueled by the desire of many parents for greater choice, frustration in some areas over the performance of public schools and some well-documented good results among charter schools.

Most start-up charter schools operate out of older school buildings or other types of facilities that aren't ideally suited for educational purposes, Brain says. Those that perform well typically outgrow their spaces within a few years, but often don't have the capital to renovate their existing facilities or build larger structures, he explains. Public charter schools are generally financed by state-funded school districts.

"We get into the deal when the school has had two to three years of operation and has visible enrollment and a waiting list," says Brain, adding that the company has steered clear of making charter school investments in financially troubled states including California.

"We think this is a very logical business for a REIT to be in. It is not that different from a traditional part of the REIT world, which is Medicare- and Medicaid-reimbursed elder-care properties," he adds.

A MOVIE SCRIPT ENDING

EPR is already one of the largest landlords in the highly fragmented charter school sector, says Richard Moore, an analyst at RBC Capital Markets. Yet, Brain says the company is by no means giving up on expanding its theater portfolio. It has recently capitalized on the proliferation of smaller, high-end theaters that boast auditoriums with living-room style furnishings, offer restaurant-style food and liquor and generally appeal to an older crowd.

"We are still very bullish on the theater industry and interested in adding to our portfolio as we find good deals. We are not moving away from theaters in any sense," Brain comments.

EPR's theater portfolio still generates about 70 percent of its earnings, says Moore, adding that the stock has traded at a discount relative to its peers because some investors scratch their heads over the company's investments in non-traditional asset classes. Last year, EPR increased its common dividend by 8 percent to $2.80 per share, a move that was made possible by an approximately 17 percent increase in funds from operations over the prior year to about $150 million.

"People make a little too much of their non-theater investments, which still represent a small percentage of their EBITDA," Moore says.

Brain says there are good reasons to continue investing in esoteric asset classes that REITs focused on traditional property sectors generally avoid. "If you do your homework, there are categories that are very attractive, and you can enjoy a premium to those commodity-type investments that many people want to be in," he says.

"We don't worry about what we can sell a property for," he adds. "As an owner, we are focused on what a property will earn us on a reliable, sustainable basis over the long term." ◆

Anna Robaton is a regular contributor to REIT magazine.