THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

STAR - Q2 2016 iStar Inc Earnings Call

EVENT DATE/TIME: AUGUST 04, 2016 / 2:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Jason Fooks *iStar, Inc. - VP, IR and Marketing*

Jay Sugarman *iStar, Inc. - Chairman & CEO*

Geoff Jervis *iStar, Inc. - COO & CFO*

CONFERENCE CALL PARTICIPANTS

Jade Rahmani *KBW - Analyst*

Sean Monaghan *PENN Capital Management Company - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Good day and welcome to iStar's second-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Jason Fooks, Vice President of Investor Relations and Marketing. Please go ahead, sir.

Jason Fooks - *iStar, Inc. - VP, IR and Marketing*

Thank you, John, and good morning, everyone. Thank you for joining us today to review iStar's second-quarter 2016 earnings report.

With me today are Jay Sugarman, Chairman and Chief Executive Officer, and Geoff Jervis, who recently joined the firm in June as our Chief Operating Officer, Chief Financial Officer.

This morning's call is being webcast on our website at iStar.com in the investors section. There will be a replay of the call beginning at 12:30 PM Eastern Time today. Dial-in for the replay is 1-800-475-6701, with the confirmation code of 391431.

Before I turn the call over to Jay, I would like to remind everyone that statements in this earnings call which are not historical facts will be forward-looking. iStar's actual results may differ materially from these forward-looking statements and the risk factors that could cause these differences are detailed our SEC reports and our investor presentation, which is posted on our website. iStar disclaims any intent or obligation to update these forward-looking statements except as expressly required by law.

Now I would like to turn the call over to iStar's Chairman and CEO, Jay Sugarman. Jay?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

Thanks, Jason. Thanks to all of you for joining us today.

Our second quarter was highlighted by strong earnings, successful sales of operating properties, and the closing of a flexible term loan to partially address remaining debt maturities this year. While the timing on a number of new investments and asset monetization flipped to later in the year, we successfully completed many important projects, including the completion of a large luxury multifamily project in Chicago; a hotel and multifamily project in Sarasota, Florida; residential and retail project in Waikiki; an oceanfront amphitheater in Coney Island; and well-received hotel in Asbury Park. Each of these represents significant milestones on the path to monetization of assets that have been contributing only partially or not at all to the P&L over the last several years.

We also continued to repurchase shares in the open market, reducing basic share count by another 5%. Our sizable cash balances give us the opportunity to invest in new assets, existing assets, or within our own capital structure, and we look to deploy these cash holdings where the best risk-adjusted returns are available. With the second quarter now behind us, we continue to anticipate adjusted earnings per share this year to be up over 50% from last year.

Lastly, we were pleased to welcome Geoff Jervis to iStar this quarter in the combined role of CFO and COO, a role that will help accelerate many of the initiatives we have laid out as part of the iStar 3.0 platform. Geoff has hit the ground running and I will turn it over to him now to take you through the financials for the quarter. Geoff?

Geoff Jervis - *iStar, Inc. - COO & CFO*

Thank you, Jay, and good morning, everyone. I am very pleased to be joining the iStar team at such an exciting time for the Company.

In the short time I've been here, I have learned a great deal about iStar and its people. I've also had the chance to meet a number of our investors and have appreciated hearing directly from you the opportunities and challenges as you see them. Jason and I are looking forward to meeting many more investors in the coming months as we get out on the road to tell the story.

With that, let me turn to our financial results for the quarter. The second quarter was strong on both a relative and absolute basis. We posted net income allocable to common shareholders of $38 million compared to a $21 million loss in Q1. On a fully-diluted basis we reported net income of $0.37 per share.

In addition to GAAP net income, we use non-GAAP measures to assess performance internally. On a corporate basis we primarily use adjusted income, a measure that, in general terms, starts with GAAP net income and eliminates the impact of non-cash charges, such as depreciation and loan-loss reserves. We believe that this adjusted measure gives us a good sense of our operating earnings and, therefore, is important information for the investment community.

As our business has evolved, our definition of adjusted income has also evolved and beginning this quarter, for the purposes of adjusted income, we will calculate gains and losses on the sale of investments based upon our book balance, gross of reserves impairments, a more conservative cancellation of the impact of asset sales. As always, we provide the complete definition and a reconciliation of adjusted income to GAAP net income at the end of our earnings release.

For the quarter adjusted income was $61 million, up from approximately breakeven in Q1. On a fully-diluted basis, adjusted income per share was $0.56. Earnings this quarter included $75 million of gains associated with $277 million of asset sales comprised primarily of sales of commercial operating properties, condos, and land and development properties. These sales and the associated gains demonstrate the opportunity embedded in our operating and land portfolios and will continue to monetize assets in these portfolios in the coming quarters.

In February, we gave adjusted income per share guidance to the Street of 50% year-over-year growth. Through the six months we posted $0.59 of adjusted income per diluted share and expect to meet or exceed our stated full-year guidance. As always, our achievement of these targets is based upon multiple factors, including operating property and land sales and the reinvestment of sales proceeds, so there's real potential for short-term volatility to both the upside and downside in our period-by-period projections.

Switching gears to investment activity and the performance of our business segments, during the quarter we funded a total of $118 million associated with new investments, prior financing commitments, and ongoing developments. Fundings on the two new investments closed this quarter were only $16 million. However, subsequent quarter end, we also closed on $169 million net lease asset to be funded by our net lease joint venture and committed to a $160 million investment just yesterday.

Turning to the balance sheet, assets decreased by $283 million as a result of the aforementioned sales, while liabilities were reduced by $298 million as we used cash and proceeds from our new $450 million term loan to repay $785 million of outstanding debt. Common equity rose by $5 million as we posted income of $38 million to retained earnings, offset by $34 million of share repurchases.

On the loan front, we received $183 million of sales and repayments and funded $64 million of new loans and existing loan fundings during the quarter. For the quarter, our $1.6 billion loan portfolio yielded 8.4% and generated $15 million of segment profit.

During the quarter we classified one loan secured by a portfolio of hotels in Europe as nonperforming, but based upon our risk assessment, it did not require a specific reserve. In total, at the end of the second quarter we had $110 million of loan-loss reserves and $79 million of nonperforming loans.

Our $1.5 billion net lease portfolio generated an 8.2% yield for the quarter and overall segment profit of $17 million. At quarter end, the portfolio was 98% leased with a weighted average remaining lease term of approximately 15 years. During the quarter, we sold net lease assets for $20 million recording a $4 million gain and purchased one new net lease property.

Turning to our operating property portfolio, our $537 million portfolio of operating properties is comprised of $427 million of commercial and $110 million of residential real estate. On the residential side, we continued to see demand for our condominiums. This quarter we sold 55 units for $39 million and booked a $14 million gain, a 35% profit margin. 194 condominium units remain in this portfolio and during the period we took a $3 million impairment on one project's unsold inventory as we witnessed a slowdown in the high-end condo markets.

On the commercial side, we made considerable progress on our strategy of maximizing value and monetizing assets this quarter. We sold three properties this quarter: Valley Square, a shopping center in Warrington, Pennsylvania; RiverEdge, an office building in Atlanta, Georgia; and our joint venture interest in the Tanger Outlet at Westgate Mall in Glendale, Arizona. We generated $193 million of proceeds and $47 million of gains after allocating $10 million of gains for our minority interest partner in the Tanger asset.

As a result of the sales in this portfolio, the balance of commercial operating properties has declined by 30% year over year. Furthermore, the percentage of stabilized properties in the portfolio grew from 18% to 35% over the same period, a testament to our continued progress with our transitional properties.

That brings me to our land and development portfolio, where we have, as Jay mentioned in his remarks, also meaningfully advanced on a number of projects. At the end of the quarter this portfolio totaled $1.1 billion, comprised of 11 master-planned communities, 13 infill land parcels, and six waterfront land parcels. During the quarter we sold $28 million of land and generated gross margins of $13 million versus $6 million for the same quarter last year.

Including allocated expenses and other carrying costs, segment loss was $7 million for the quarter versus $11 million for the same quarter last year. We had eight land projects in production, 10 in development, and 12 in the pre-development phase. And we invested $31 million into our land and development portfolio during the quarter.

Turning to the capital markets activity for the quarter. On the debt side, we entered into a new four-year $450 million secured term loan at LIBOR plus 450 with a 1% floor. The new term loan was primarily used to refinance the $323 million balance on our 7% 2012 unsecured term loan, nine months ahead of its maturity. We were pleased to see the book nearly 2 times oversubscribed, which I think is in large part due to the strong performance of our prior bank facilities as well as the confidence of our credit investors and the strength of our balance sheet.

We also repaid approximately $460 million of debt during the quarter, including fully retiring $265 million of unsecured bonds maturing in July and paying down our secured revolving credit facility by $195 million. This left us with $720 million of unrestricted cash and capacity on our revolver at the end of the quarter.

For the remainder of the year we have $400 million of debt due in November comprised of two series of convertible notes. The notes are in two $200 million tranches and have a strike price of $11.77 and $17.29 per share, respectively. If the holders of these notes don't convert at maturity, it would result in a reduction of nearly 29 million diluted shares, which represents approximately 25% of our fully-diluted share count.

After November, we will still have one series of convertible securities, our Series J convertible preferred stock, which has a strike price of $12.79 and is callable beginning in March 2018.

Our weighted average cost of debt for the second quarter was 5.6% and at the end of the quarter our leverage was 2.1 times, inside our targeted range of 2 to 2.5 times. This quarter we continued to be active in our share repurchase programs, repurchasing 3.6 million shares of our common stock for a total of $34 million, equating to an average price of $9.30 per share. This brings our total stock repurchases since August of last year, including the tender of our HPUs last August, to 16.7 million shares of common stock and common stock equivalents, which represents 19% of our common equity.

We have been able to take advantage of current market conditions to purchase a significant amount of the Company at what we believe to be a material discount to intrinsic value, based upon our view of NAV. Substantially most of our prior plan exhausted, our Board has approved increasing our stock repurchase authorization back to the full $50 million.

And with that I will turn it back to Jay.

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

Thanks, Geoff. Earlier I mentioned some of the projects that are finally coming to fruition after years of work by our asset managers, our land teams, our construction personnel, and our JV partners. These are important steps in realizing the value of our land book and have created a very strong team at iStar that enhances almost everything we do from finance to net lease to development.

While we have seen good success on many projects, the development portfolio has not been without its bumps. The path to success and the timing of the projects are sometimes hard to pin down based on politics and the permitting process, but we remain focused on generating more earnings impact from this segment over the next 18 months to find ways to make these assets more productive and to create the best environment to maximize their value and monetize them.

While often a painful process, overall we continue to believe our efforts will be rewarded with improved returns. We will have more on these assets and the returns that they have been generating in the coming quarters.

So with that, let's open it up, operator, and listen if there any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jade Rahmani, KBW.

Jade Rahmani - *KBW - Analyst*

Thank you very much. Based on your current visibility, do you expect the pace of gains from asset sales to accelerate in the back half of the year? And would you expect a similar or greater level of gains next year?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

I think again we caution these are not things that are easily put into quarters particularly, but we do see gains continuing. We do see monetization events out from now to the next really 18 months in a reasonably steady stream, but again doing it quarter by quarter is always tricky for us. So what I would say is a continuation of what we have been laying out over the last couple of years should be taking place over the next 18 months.

Jade Rahmani - *KBW - Analyst*

In terms of the capital allocation, where are you seeing the most attractive incremental investment opportunities? And can you maybe give some color on the types of deals you are looking at, incremental yields on debt originations, for example?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

I guess I'd characterize the last quarter as really a heavy push on the existing asset base. We've pulled a lot of people to make these asset monetizations take place, because we know it's so critical to our future.

On the new deal side, we have seen some interesting things on the net lease side where we can use both our debts capabilities and our net lease and our development capabilities all bundled together. So we are seeing some success there.

The things we are poking around at that are taking a little bit longer to gel have to do with the demographics and some of these ultralow interest rate environment opportunities we see. I think it's a little less -- the bread-and-butter stuff is still there. We have put back a little bit from the track loans that we completed last year and the year before.

Just wanted to get a reset in some of these major markets about where some of the dynamics were going on supply and demand. You've seen a little bit of oversupply in sort of the New York, San Francisco, Chicago markets, so we haven't been as active there as we were earlier on. But now we are starting to see an opportunity to use the skill set we think we have developed over the years to kind of bring all the parts of our puzzle to bear on these deals.

Some of them are turning into finance opportunities, some are going to turn into net lease opportunities, and some may turn into brand-new opportunities that we really haven't focused on before. So I'd say the market is good, but I wouldn't say -- at least in the major metros where we had a lot of opportunities in 2014 and 2015 -- in 2016 we haven't quite seen as many.

Jade Rahmani - *KBW - Analyst*

In terms of loan prepayments, do you expect a similar level as what you experienced this quarter?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

We had a couple large loan repayments so that was a little idiosyncratic. A lot of the stuff we put on in 2014 and 2015 has begun to partially pay down, but the loan book feels pretty good. We are still looking at parts of the market where we think there's less competition and those are still where we're spending most of our time.

Jade Rahmani - *KBW - Analyst*

On the Long Beach project, can you just give an update on how you see that proceeding in the recent vote?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

Yes, they said the development business is a tough business. There are good days and there are bad days. Oftentimes, we are not even sure politically where the winds are blowing.

We think we've put on the table a great project on an exceptional piece of land on the oceanfront in a community we think would tremendously benefit from it. There is a very sizable increase in the tax rolls if this project gets built, but at full taxes it's not a project we're willing to proceed with. And so the dynamic has been a little bit of an odd one in that there are tremendous benefits to the community above what they exist today.

We thought that would carry the day; it apparently hasn't. But we continue to be in dialogue in that jurisdiction and others to try to find solutions that -- candidly, in my own view, not doing something is a disservice to the community, so we try to work as a good partner and find ways that can work. And that dialogue continues.

Jade Rahmani - *KBW - Analyst*

Just more broadly across the land portfolio, what percentage of the lots that you loan are fully entitled to the planned use that you intend?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

I think what you said at the end is really the key. We started with mostly fully-entitled lots, but they weren't really what we wanted them to be or what the market we thought would value them most highly as.

So I would say at this point we have pretty much done all the work we need to get through the vast majority of those. There's one or two big projects in predevelopment that we are not quite at that point, so we are looking at interim steps to help make them more productive until we can get to a point where we know what they should be.

But almost everything that's either in production or in predevelopment has already been planned. We know what it should be. We know what the market demand for it is and we are on our way. So really the only things that are left that might not be in the exact form we would like are things we really haven't started developing.

Jade Rahmani - *KBW - Analyst*

So given the entitlement groundwork you've laid, does that present the opportunity to accelerate land sales to get that capital back and reinvest it?

Jay Sugarman - *iStar, Inc. - Chairman & CEO*

As I said, I think we will share with you some of the storylines that I know we've been wanting to share, but have not been able to because we've been going through political and permitting processes that would've been harmed by giving a blow-by-blow. But as we get to the end of those processes and come out the other side, we can show you why we think the value creation of doing that process has been quite good.

We can sell those. I think we are sensitive to maximizing the opportunity. Our cost of capital often allows us to go a little deeper into the process before we make that sale decision.

We certainly have said in the past we are not willing to sell things that we think are 15% to 20% IRRs. We would like to make that money here for our shareholders. But as they get to the point where they become more commodity-like, yes, we are going to be in the process of selling them.

Jade Rahmani - *KBW - Analyst*

Just I guess finally for Geoff. Would you be willing to share some observations or perhaps layout where you initially plan to focus most of your time?

Geoff Jervis - *iStar, Inc. - COO & CFO*

Sure. I think, as I said in my remarks, first off as a background, it's been less than two months so still very much on a very steep part of the learning curve. I would say that I have been impressed with the people. I think that this is an extraordinarily smart group of people dedicated to realizing on the land and commercial and residential operating products and returning value to shareholders.

I think very interesting time at iStar. I think that some of the progress made on the capital markets front, particularly Michelle MacKay and what she did with the term loan -- the fact that we are 2 times oversubscribed, that we are paying off debt quarters in advance of its maturity -- I think is just a -- I think we have turned the corner there, too. So very optimistic about capital markets and about the plan that Jay and the team have laid out here.

Jade Rahmani - *KBW - Analyst*

Thanks very much for taking my questions.

Operator

(Operator Instructions) Sean Monaghan, PENN Capital Management.

Sean Monaghan - *PENN Capital Management Company - Analyst*

Great quarter. Just for you guys, can you guys walk us through what your -- are you guys keeping the same fiscal year guidance for sources and uses of cash after -- with Geoff just joining? And can you guys give some high level to next year or is it still too early for you guys?

Geoff Jervis - *iStar, Inc. - COO & CFO*

I think talking about 2017 is probably a little bit too early, but as you know, we've got a lot of cash on the balance sheet, a lot of availability under the revolver. And that's drawable availability so we already kind of have that as liquidity available to us.

I think we are going to continue to monetize assets. There's going to continue to be money coming in here. What we can't tell you quite right now is how we plan to spend it. As I said, we can put it into existing assets. We have lots of 100% guaranteed proprietary opportunities in assets we control, so those are always good places to put money at strong risk-adjusted returns.

We can deploy it into the market in any of our sectors. We are seeing some opportunities on the net lease side, which has been harder to put money out in. We certainly can do that on the finance side as well. And then, lastly, we look at our own capital structure and whether that's retiring the converts with cash or buying in additional shares, we've got plenty of places to put the money that's coming back. We are just trying to pick and choose to make it the most impactful on the Company.

So I think we feel pretty good second half of the year; we've set up all the liquidity we will need. As we go into 2017 I think that's a little bit further out but we feel good there as well.

Sean Monaghan - *PENN Capital Management Company - Analyst*

Thanks. Geoff, you've been on the road with existing investors. What's the message you've been sending to them in terms of the disconnect between the stock price and your thoughts on NAV? Are you getting pushback on the net lease, the land, or commercial -- embedding gains in the commercial? Just from your opinion.

Geoff Jervis - *iStar, Inc. - COO & CFO*

I think the focus has very much been on the land portfolio. I think that that's where I think there is the most focus on the investment community and I think that's appropriate.

So from a messaging standpoint, we continue to beat the drum on the message that the team has had, which is that our long-term goal here is to continue to work through the land portfolio, maximize value there, and in the operating and residential properties. And reinvest those in new opportunities, which we think will likely be loans and net leases as well as unidentified additional opportunities going forward.

Sean Monaghan - *PENN Capital Management Company - Analyst*

How many --? Just a random, how many condos do you guys have left?

Geoff Jervis - *iStar, Inc. - COO & CFO*

94 units left in inventory, in residential operating.

Sean Monaghan - *PENN Capital Management Company - Analyst*

All right, guys. That's it for me, thank you.

Operator

Mr. Fooks, we have no further questions in queue.

Jason Fooks - *iStar, Inc. - VP, IR and Marketing*

Thanks, John. Thanks to everyone for joining us this morning. If you should have any additional questions on today's earnings release, please feel free to contact me directly.

John, would you give the conference call replay instructions once again? Thanks.

Operator

Certainly. Ladies and gentlemen, this replay starts today at 12:30 PM Eastern Time, will go until August 18th at midnight. You may access the replay at any time by dialing 1-800-475-6701, entering the access code 398213. (Operator Instructions)

That does conclude your conference for today. Thank you for your participation, you may now disconnect.