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RMR.OQ - Q2 2025 RMR Group Inc Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to The RMR Group fiscal second-quarter 2025 earnings conference call. (Operator Instructions) Please note today's event is being recorded.

I would now like to turn the conference over to Matt Murphy, Manager of Investor Relations. Please go ahead.

Matthew Murphy - *RMR Group Inc - Manager of Investor Relations*

Good afternoon, and thank you for joining RMR's second-quarter fiscal 2025 conference call. With me on today's call are President and CEO, Adam Portnoy; and Chief Financial Officer, Matt Jordan. In just a moment, they will provide details about our business and quarterly results, followed by a question-and-answer session. I would also like to note that the recording and retransmission of today's conference call is prohibited without the prior written consent of the company. Today's conference call contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and other securities laws.

These forward-looking statements are based on RMR's beliefs and expectations as of today, May 7, 2025, and actual results may differ materially from those that we project. The company undertakes no obligation to revise or publicly release the results of any revision to the forward-looking statements made in today's conference call.

Additional information concerning factors that could cause those differences is contained in our filings with the Securities and Exchange Commission, which can be found on our website at rmrgroup.com. Investors are cautioned not to place undue reliance upon any forward-looking statements. In addition, we may discuss non-GAAP numbers during this call, including adjusted net income, adjusted earnings per share, distributable earnings, and adjusted EBITDA.

A reconciliation of net income determined in accordance with US generally accepted accounting principles to these non-GAAP figures can be found in our financial results. I will now turn the call over to Adam.

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

Thanks, Matt, and thank you all for joining us this afternoon. Yesterday, we reported second-quarter results that were slightly below our expectations, with adjusted net income coming in at \$0.28 per share and distributable earnings of \$0.40 per share.

The shortfall to our expectations primarily related to our managed equity REIT spending less on capital expenditures given the more uncertain economic environment and deleveraging activities adversely impacting RMR's revenues. While in recent months, we've been forced to navigate

economic volatility, we continue to engage with private capital investors regarding our various investment initiatives across the residential sector, credit strategies and select development opportunities.

While we found most partners ready to start investing in a significant way in the latter part of 2024 and into early 2025, recent market volatility has modestly tempered enthusiasm and caused some investors to temporarily pause new allocations.

With that said, across many of our investment strategies, we believe now is the time to take advantage of opportunities when others are pulling back. As an example, we were already seeing new supply decrease in the residential sector, which bodes well for rent growth and occupancy gains heading into 2026.

With the recent tariff actions, we believe this will further slow new construction starts and strengthen residential fundamentals in many of our Sunbelt markets where migration trends continue to drive housing shortages. During the quarter, we closed two joint venture acquisitions of residential communities in South Florida for an aggregate transaction value of approximately \$196 million. RMR raised an aggregate \$64.3 million in equity from institutional investors to capitalize these joint ventures with RMR acting as the general partner and contributing a total of \$11 million or retaining a weighted average 15% interest in the combined ventures.

Another example of a real estate sector where we have conviction and believe an opportunity exists in today's turbulent market in April, we closed on a \$21 million value-add community shopping center located outside of Chicago. This center is currently 77% occupied and our business plan includes leasing up current vacancy while also rolling up rents for existing tenants, which today are almost 20% below market. Our target returns over the projected five-year hold period are in the mid- to high teens.

Our value-add retail strategy is centered on leveraging the experienced retail team we already have in place at RMR to establish a track record within the value-add retail sector that we can then fundraise around in the future. This initial purchase in Chicago is expected to be part of a small portfolio of value-add retail properties we acquire using RMR's balance sheet over the next 6 to 12 months that will aggregate to approximately \$100 million.

On-balance sheet investments such as this value-add retail acquisition are all part of our continued strategy to diversify our client base and grow our private capital AUM. While the current fundraising environment may be challenging, we remain confident in our ability to grow private capital AUM in the future.

As a reminder, in less than five years time, our private capital assets under management have grown from essentially zero to over \$12 billion, and we believe it could comprise over half of RMR's total AUM in the next five years. Turning to a few notable updates at our public capital clients. DHC posted solid first quarter results with revenue, normalized FFO per share and adjusted EBITDA, all handedly beating consensus estimates.

These strong results were led by DHC SHOP segment, which saw consolidated NOI improved 49% year over year because of active asset management and the positive impact of capital deployed to upgrade many of the communities over the last few years. At SVC, first-quarter results also exceeded consensus expectations. RevPAR at SVC's hotel portfolio improved 2.6% year over year and outpaced the industry by 40 basis points despite meaningful revenue displacement from renovation activity.

SVC also continues to benefit from the stable cash flows generated from its triple net lease assets, led by its \$3.3 billion investment in travel centers, which are currently leased to investment-grade rated BP. In terms of its deleveraging efforts, we are pleased to report that SVC remains on track to sell 123 noncore hotels for approximately \$1.1 billion this year.

Despite the ongoing macroeconomic uncertainty, the sales process generated significant interest and pricing that met or exceeded our expectations. ILPT reported first quarter results that highlight the quality of its portfolio as tenants continue to renew in place while also delivering meaningful roll-ups in rent. ILPT completed 2.3 million square feet of leasing activity in the quarter and weighted average rental rates that were approximately 19% higher than prior rents.

Although ILPT has no final debt maturities until 2027, it continues to explore ways to delever its balance sheet while also looking to refinance its current debt with longer-term fixed rate debt. Lastly, OPI continues to face headwinds associated with its nationwide portfolio of office properties.

OPI, along with its advisers, continues to explore all options to address its upcoming debt obligations. To conclude, we are pleased with the progress we have made assisting our clients with their financial and strategic objectives. We also believe that RMR operates a durable business model supported by clients with a nationwide portfolio of real estate across multiple sectors. This durable business model with almost 70% of our AUM coming from perpetual capital enables us to drive new initiatives forward in a volatile economic environment. We look forward to updating you on our progress in the coming quarters.

With that, I'll now turn the call over to Matt Jordan, Executive Vice President and our Chief Financial Officer.

Matthew Jordan - RMR Group Inc - Chief Financial Officer, Executive Vice President, Treasurer

Thanks, Adam. Good afternoon, everyone. As Adam highlighted earlier, this quarter's results were slightly below our expectations as RMR generated adjusted net income of \$0.28 per share and distributable earnings of \$0.40 per share. Recurring service revenues were \$45.5 million this quarter, a sequential quarter decrease of approximately \$1.8 million, driven primarily by lower-than-expected capital spend as well as declines in the enterprise values of the managed equity REITs, both of which were partially offset by \$700,000 in acquisition fees earned from the two residential joint ventures Adam discussed earlier.

Next quarter, based on the current enterprise values of our managed equity REITs and continued muted levels of capital spend, we expect recurring service revenues to be between \$44 million and \$45 million. As it relates to the value-add shopping center in Chicago that Adam highlighted earlier, we expect this acquisition to generate EBITDA of approximately \$350,000 per quarter in fiscal 2025. Turning to expenses. Recurring cash compensation was \$42.1 million this quarter, a decline of approximately \$500,000 sequentially, which reflects the impact of headcount actions taken in recent quarters.

Looking ahead to next quarter, we expect recurring cash compensation to decrease to approximately \$39 million through continued cost containment measures driven by strategic asset sales. Given that a significant number of the headcount actions were associated with strategic asset sales and were thus reimbursable roles, next quarter's cash compensation reimbursement rate is expected to decline to 48%.

Recurring G&A this quarter was \$10.7 million after excluding \$600,000 in annual director share grants. Recurring G&A of \$10.7 million represents a modest sequential quarter decrease due to lower third-party construction costs and continued expense management. Next quarter, we expect recurring G&A to be closer to \$10.5 million. Aggregating these collective assumptions, next quarter, we expect adjusted earnings per share to be between \$0.28 and \$0.30 per share, adjusted EBITDA to be between \$19 million and \$20 million and distributable earnings to be between \$0.42 and \$0.44 per share.

Our dividend remains well covered with a payout ratio of approximately 79%, which is shown on page 12 of our financial results.

With \$137 million of cash on hand and no corporate debt, we remain poised to take advantage of strategic opportunities. Before we take questions, I would like to highlight the recent publication of our annual sustainability report. This report provides a comprehensive overview of our commitment to addressing sustainability across our portfolio of approximately 2,000 properties. A link to the report can be found on our website at rmrgroup.com. That concludes our prepared remarks.

Operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Tyler Batory, Oppenheimer.

Tyler Batory - Oppenheimer & Co., Inc. - Analyst

Hey, good afternoon, thank you. My first question, I thought the value-add retail acquisition was interesting. So could you give a little bit more details on the strategic rationale for doing this, and if you talked about using the balance sheets, to do about \$100 million in the next 6 to 12 months. So why keep these on balance sheets, and just talk a little bit more about, plans for this area of the business.

Adam Portnoy - RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director

Sure, thank you for that question. So you're right, the retail value add retail, acquisition this year, this quarter, is a little different for us. It's different for us because we typically, have not bought much value add retail or community shopping centers in the past. We're really building off of a deep bench of expertise in retail within RMR. We've been investing in retail for about 15 years. Today's entire port -- today, we have an entire portfolio. About \$5 billion of our AUM is in retail, and it's over 500 properties that we have today that are classified as retail properties that which we manage and oversee.

So we feel like we have a very good understanding of the market and we've been watching the retail market now for some years, and we really think there's a turning point going on in parts of retail that make a lot of sense to generate very high returns specifically around community shopping centers or grocery anchored or drugstore anchored shopping centers. What we've observed in the retail space, both as a market and within our own portfolio is in the last couple of years vacancies have become very low.

And there's really been a lot of positive absorption. We've seen that in the marketplace and we're also seeing that within our own portfolio. Anecdotally, space comes up in one of our existing retail locations. We often, 9 times out of 10, have a list of folks that we can go to that will backfill and often they backfill and pay higher rents. And you can ask, what's driving this within our own portfolio and also more generally in the market. It's really a lack of supply that's happened.

There hasn't been much retail building going on for over a decade and demand is sort of finally caught up and it's really caught up in the last couple of years and we think this is a great time because we don't think there's going to be any more real building or significant building in retail.

And we expect vacancies to remain low, and so we think, tapping into the expertise we have within RMR to really generate outsized returns for these types of investments, we think now is the time to do that. In terms of your question around using of the balance sheet, look, we haven't made value add retail investments before and so I think the first step is to do some of them on our balance sheet.

I'm not saying we wouldn't move these off balance sheet. I just think it's more likely that they will stay on balance sheet till we build up a little bit of a track record in this -- with maybe a small portfolio. Then I think we'll use that track record to go raise more money, third party capital around it.

This gets back to using our balance sheet to really seed investment ideas or initiatives that we think can generate outsized returns. The other thing that's sort of thematic about this is you'll notice the return profile, its value add. If you look at the \$40 billion of AUM we manage, the vast majority of it is what people would call core plus, meaning stable, meaning high occupancy, not a lot of active management, and let's say turning it around to then sell at a high return.

You'll notice we do that type of investing in our residential sector today. We're starting to do it now more in retail. I expect over time you'll see us do even more of that type of investing in other asset classes as well. So that's a long winded answer to what your question was, but hopefully that answers it.

Tyler Batory - *Oppenheimer & Co., Inc. - Analyst*

You know that's very good detail. I appreciate it. A specific question on the quarter and the outlook, a little bit of a surprise perhaps to see the lower construction fees, REIT spending a little bit less on CapEx. So just talk a little bit more about that. Is this a good run rate here and how do you also think about seasonality quarter to quarter in terms of some of that spending and how it flows through?

Matthew Jordan - *RMR Group Inc - Chief Financial Officer, Executive Vice President, Treasurer*

Yeah, good question. The first calendar quarter of every year tends to be a seasonally low quarter, as people kind of -- as you may remember, the last quarter of last calendar year is always a high number for us as people use up their budgets. Unfortunately, I think the seasonality, this run rate is going to stick for a couple quarters given some of the judicial spending and capital constraints at our clients right now.

Tyler Batory - *Oppenheimer & Co., Inc. - Analyst*

Okay, makes sense. The last one for me, I'm getting a few questions from folks on the dividends and I think you added a new slide in the presentation that helps address that, but I'm curious if you can just talk a little bit more about how you feel about coverage for the dividends, and we look at capital allocation broadly, I mean with stock yielding where it is right now, you kind of thinking about other uses for capital instead of the dividends. Just kind of walk through some of the thinking there if you could please.

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

Sure. So I'll let Matt say a couple words about some of the information we put in the slide and how we calculate our payout ratio, but we feel very comfortable, generally speaking, with our payout ratio, as it sits today, and I'll let Matt get into that in a second. But more broadly, in terms of your question around capital allocation, we still feel we have very -- we have no corporate level debt, and we have -- we are still sitting on a sizable amount of cash.

We have an untapped corporate credit facility. We still feel that we have a tremendous amount of capacity to add investments on our balance sheet. And when you think about capital allocation, we do believe it's important to provide some return given we have a high margin, high cash flowing business to our shareholders and so we've always felt the best balance was to provide some return to shareholders in the form of a dividend.

But on top of that, the type of investments that we are then using our cash and liquidity for we believe are very high returning investments, meaning, we think, very high, in terms of return on investments and we expect them to return those -- have a very high return in the short term, two to three, maybe two to three at most five years. And as we think about capital allocation, until we sort of get closer to even possibly exhausting our liquidity, which we are very far from doing, I think, that's going to be -- continue to be where we focus on allocating capital and keep the dividend relatively stable.

Matthew Jordan - *RMR Group Inc - Chief Financial Officer, Executive Vice President, Treasurer*

And from a coverage perspective and the questions you may be getting, as we illustrate in our earnings, the dividends cover about 79% and I guess what I would remind folks is this is always the low point for us for a number of seasonal reasons, both on the top line and in the expense line for compensation. And when you look at our guidance at \$0.42 to \$0.44, and as I think further out as we get some of this AUM growth happening on the residential side, the REIT share price is improving, I really think this is a low point and we're still covered at 79%. So the any risk around the dividend is not something we're focused on right now.

Tyler Batory - *Oppenheimer & Co., Inc. - Analyst*

Okay, I appreciate all the details. That's all for me. Thank you.

Operator

(Operator Instructions)

John Massocca, B. Riley Securities.

John Massocca - *B. Riley Securities - Analyst*

Good afternoon. If you kind of talk to your you know potential partners on either the JV side or you know some of these potential future funds you might see, what are they looking for in either the macro environment or the real estate environment before they get comfortable again and maybe kind of what are you thinking in terms of a timeline for when that kind of equity capital might be available again?

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

Sure. So the short answer is that our partners, generally speaking, the private capital LPs of the world are seeking a higher return on their dollars, generally speaking, than they were, let's say five years ago, which is partly too explain why we as a firm have decided to invest and devote more resources into what we call value add investments and that type of strategy because that's a strategy that's typically going to generate a mid-teen to high teen return for investors. And so that's what we're seeing from LPs generally speaking that would come into, let's say, funds.

The good thing -- the thing I think it is important to point out is LPs and investors are still investing. Just our last quarter that we brought in tens of millions of dollars in JB Capital for two properties we bought down in Florida. The investors are willing to open their checkbook and they are willing to make investments. In terms of when do we think that we could see a substantial increase in the amount of AUM and fees we generate? Look, today we are in a one of the most difficult fundraising environments for private equity and especially around real estate private equity, that's existed for -- since the great financial crisis, almost, 15 years, more than 15 years ago.

And so I think it's going to take probably another short period of time, I think as the world becomes more stable and there's more stable outlook around interest rates, I think LPs will be more interested in opening up their checkbook and allocating more resources to that.

With regards to RMR itself, look, we expect, and we said this during our last earnings call, upwards of \$1 billion in calendar year 2025 will be spent in and around private capital initiatives. And what do we mean by that? Us, that's total assets, that's us putting JVs together, and that's also buying some properties on our balance sheet. That's what I think we'll do this year and I think it ramps from there.

John Massocca - *B. Riley Securities - Analyst*

Is there potential for you to put more on your balance sheet, as you look at it this quarter versus last quarter, just given the appetite you're seeing for LPs today?

Matthew Jordan - *RMR Group Inc - Chief Financial Officer, Executive Vice President, Treasurer*

I think it's entirely -- I think it's entirely possible in the residential space, and as Adam highlighted, obviously, we're going to look for a couple more value add retail centers, but the key to our growth and accelerating AUM growth is going to be raising third-party capital with RMR co-investing as most third-party capital partners request.

John Massocca - *B. Riley Securities - Analyst*

Okay, and then I mean I may have missed it, but the value-add shopping centers beyond the one you closed in April, what's the size of that portfolio? Apologies, I think you might have been prepared remarks.

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

Sure, it's a \$21 million investment. It's about 204,000 square feet.

And I think we could grow it to about \$100 million in aggregate assets.

John Massocca - *B. Riley Securities - Analyst*

But are those \$100 million things that are like kind of in the pipeline under contract or is that just kind of -- I mean is that more of a pipeline number or is that kind of under a contract under LOI type of number?

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

That's a pipeline number. We have nothing under LOI or contract at this moment in addition to what we've closed on, but we're actively underwriting and bidding and evaluating those types of investments.

John Massocca - *B. Riley Securities - Analyst*

And then lastly on kind of the construction supervision revenue, if we kind of think about March 31, number as a as a run rate, is that taking into account some of the disposition activity, particularly from, DHC and SBC? Essentially, is that already accounted for given maybe capitalism being put into assets they're going to sell, or could that further decline as they look to disposes some assets for capital recycling and deleveraging purposes?

Matthew Jordan - *RMR Group Inc - Chief Financial Officer, Executive Vice President, Treasurer*

No, fair question. It is all inclusive and would consider all planned spend in all active disposition activity.

John Massocca - *B. Riley Securities - Analyst*

Okay, I appreciate the color. That's it for me.

Operator

Thank you. This concludes our question-and-answer session. I'd like to turn the conference back over to Adam Portnoy for closing remarks.

Adam Portnoy - *RMR Group Inc - Chairman of the Board, President, Chief Executive Officer, Managing Director*

Thank you all for joining our call today. We look forward to seeing many of you at the upcoming Nareit Conference in June. Institutional investors should contact RMR Investor Relations if you would like to schedule a meeting with management. Operator, that concludes our call.

Operator

Thank you, sir. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.

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