THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit http://www.djreprints.com.

http://online.wsj.com/articles/american-realty-says-it-overstated-funds-from-operations-in-2013-1414588112

ARTICLE FREE PASS
Enjoy your free sample of exclusive subscriber content. $12 for 12 Weeks SUBSCRIBE NOW

MARKETS

SEC to Open Inquiry Into American Realty Capital Properties' Accounting

Real-Estate Investment Trust Says Two Top Executives Resigned, Financial Statements Can't Be Relied On

By **ROBBIE WHELAN**, **CRAIG KARMIN** and **JEAN EAGLESHAM**
Updated Oct. 29, 2014 6:35 p.m. ET

One of the largest U.S. real-estate empires was battered Wednesday by its disclosure of an accounting mistake and subsequent coverup that forced the resignations of two top executives, slashed its flagship company's stock-market value by 19% and sparked a regulatory probe.

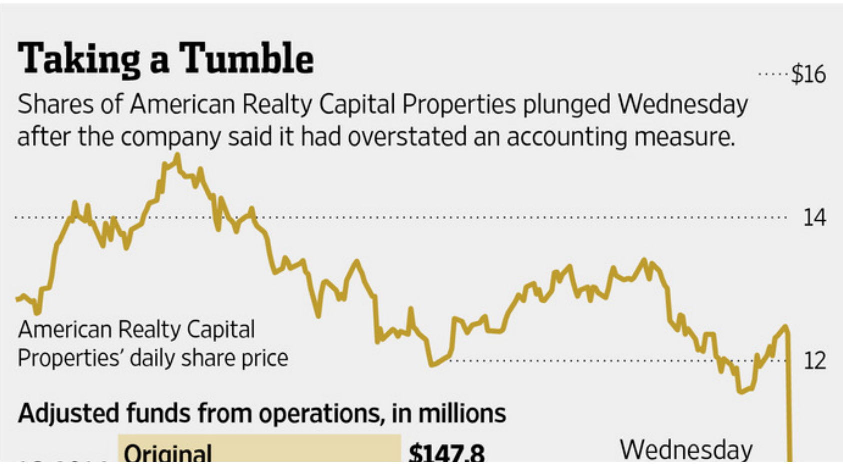
THE LATEST

- Thursday's Markets: American Realty Capital Shares Tumble (http://online.wsj.com/articles/american-realty-capital-shares-tumble-8-1414678916)

American Realty Capital Properties Inc., the primary holding of property mogul Nicholas Schorsch, said in a securities filing that it asked its chief financial officer and chief accounting officer to resign after determining the company had overstated a measure of income in the first quarter, and that the executives chose not to correct the error in the second quarter. Shares of three other companies overseen by Mr. Schorsch also fell.

The Securities and Exchange Commission intends to launch an inquiry into the accounting irregularities, according to a person familiar with the matter.

The revelation is a black eye for Mr. Schorsch, chairman of American Realty Capital and one of the biggest real-estate investors in the U.S. The college dropout and son of a scrapyard owner in recent years embarked on an acquisition spree that fueled one of the swiftest rises in the real-estate world.



Mr. Schorsch, 53 years old, helps oversee more than a dozen publicly traded and unlisted companies that together hold billions of dollars' worth of property assets ranging from office towers and senior-care centers to 500 locations of the restaurant chain Red Lobster. The incident might make it harder for American Realty Capital, which manages nearly $30 billion in real estate, and his other companies to raise capital for purchasing properties, analysts said.

Mr. Schorsch declined to comment.

The company determined there was no intent to overstate the accounting measure for the first quarter, but that the second-quarter number was based on a calculation made "in order to conceal the error from the first quarter," Chief Executive David S. Kay said in a conference call Wednesday. "We don't have bad people, we had some bad judgment there."

Overall, Mr. Schorsch's publicly traded companies lost about $2.4 billion in market value on Wednesday. Shares of real-estate broker RCS Capital Corp. fell 14%, while New York REIT Inc. shed 2.1% and American Realty Capital Healthcare Trust Inc. was down 2%. Mr. Schorsch is chairman or executive chairman of all three.

Standard & Poor's on Wednesday placed American Realty Capital's triple-B-minus credit rating, which is one notch above so-called junk status, on watch for possible downgrade.

The accounting incident sent shock waves through the real-estate industry, where Mr. Schorsch has raised tens of billions of dollars in recent years, much of it from individual investors.

American Realty Capital, based in New York, focuses almost exclusively on single-tenant retail properties such as gas stations, fast-food restaurants and drugstore chains, helping to make Mr. Schorsch the largest owner of this type of real estate in the U.S.

American Realty Capital Properties was founded by Nicholas Schorsch, who is currently chairman. The real-estate investment trust said financial statements going back to 2013 can't be relied upon. *BLOOMBERG NEWS*

In July, the company closed on the $1.5 billion purchase of seafood chain Red Lobster's real-estate portfolio. Just a few months earlier, the company closed on the acquisition of Cole Real Estate Investments, Inc., in a deal valued at $11.2 billion, including the assumption of $3.9 billion in debt.

Mr. Kay said on Wednesday's call that an employee alerted the company's audit committee about the irregularities in early September, after which the committee launched an investigation. Management wasn't informed of the problems until Friday of last week, he said.

American Realty Capital said it overstated its adjusted funds from operations, a common measure of REIT performance that shows a trust's net income, by $12 million, or 8.8%, for the first three months of 2014, and by about $10.9 million, or 5.6%, for the three months ending June 30, 2014.

American Realty Capital said in the filing its audit committee believed certain financial errors "were intentionally made," and that they were "intentionally not corrected."

Chief Financial Officer Brian Block was replaced by Michael Sodo, an executive vice president, effective immediately, the company said. Chief Accounting Officer Lisa McAlister was replaced by Gavin Brandon, another executive vice president, effective immediately.

Mr. Block didn't respond to requests for comment. A spokeswoman for Grant Thornton LLP, American Realty's auditor, declined to comment. Ms. McAlister couldn't be reached for comment.

American Realty Capital has run into accounting issues before. In June, shortly after the company announced it had agreed to pay $1.5 billion for 500 Red Lobster locations, hedge-fund firm Marcato Capital Management LP sent a letter to American Realty Capital's board in which it criticized two errors related to the deal.

In one instance, American Realty Capital reported an inaccurate share count to investors in its first quarter 2014 financial statements, according to Marcato, one of the REIT's largest shareholders. The company later corrected the share count in a filing.

American Realty Capital also stated that fees associated with the Red Lobster deal were $108 million, but in a later filing said that the fees were actually $10.8 million.

"We believe the existence of these errors is symptomatic of the larger problem: The Company is engaging in too many transformative transactions too quickly," Marcato wrote at the time.

Analysts suggested it was too soon to assess the damage to the company or Mr. Schorsch's broader empire. Some investors "may throw in the towel on today's news, as accounting missteps take a while to sort out," Paul Adornato, a REIT analyst with BMO Capital Markets, said in a client note. "Confidence takes longer to return, if ever."

Others said the errors could directly undermine American Realty Capital's growth strategy, which has relied on tapping the debt and equity markets for capital to pay for acquisitions.

The company's "credibility is likely impugned for some period of time," wrote J.P. Morgan analyst Anthony Paolone, adding that "capital costs will be higher in the near term...thus making growth more difficult."

Investors also are worried the timing of the accounting revelations could imperil a deal that American Realty Capital announced earlier this month, according to a person familiar with the matter.

On Oct. 1, the company said that it would sell its private capital-management business, Cole Capital, which raises money for nontraded REITs, for $700 million to RCS Capital Corp., another company chaired by Mr. Schorsch.

Born in Philadelphia, Mr. Schorsch worked at his family's scrap-metal business while attending Drexel University before dropping out. He later took over the company and sold it for a big profit while still in his 20s.

In the 1990s, Mr. Schorsch turned his attention to real estate. He started buying up branch offices from Wachovia Corp. and other banks, then leasing the spaces back to them. This activity led media in Philadelphia to dub him the "bankers' landlord."

He moved to New York around 2007 and with William Kahane, a former Morgan Stanley real-estate executive, started American Realty Capital.

In an April regulatory filing, American Realty Capital disclosed an outperformance plan that could net Mr. Schorsch as much as $94.4 million over the next five years, according to an analysis by FPL Associates LP, a compensation-consulting firm.

Thursday's Markets: American Realty Capital Shares Tumble

Write to Robbie Whelan at robbie.whelan@wsj.com, Craig Karmin at craig.karmin@wsj.com and Jean Eaglesham at jean.eaglesham@wsj.com

Copyright 2014 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.