CORPORATE PARTICIPANTS

Blair Welch
Chief Executive Officer

Joe Pleckaitis
Chief Financial Officer

Connor O'Brien
Managing Director

Allen Gordon
Senior Vice President

Paul Wolanski
Senior Vice President, National Sales and Investor Relations

Braden Lyons
Vice President

CONFERENCE CALL PARTICIPANTS

Sairam Srinivas
Cormark Securities

Brad Sturges
Raymond James

Gaurav Mathur
Laurentian Bank Securities

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Slate Grocery REIT Third Quarter 2023 Financial Results Conference Call.

At this time, all lines are in listen-only mode. Following the presentation, we'll conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star-zero for the operator. This call is being recorded on Tuesday, November 7th, 2023.

I would now like to turn the conference over to Paul Wolanski, Senior Vice President, National Sales and Investor Relations. Please go ahead.

Paul Wolanski, SVP, National Sales and Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q3 2023 conference call for Slate Grocery REIT. I'm joined this morning by Blair Welch, Chief Executive Officer; Joe Pleckaitis, Chief Financial Officer; Connor O'Brien, Managing Director; Allen Gordon, Senior Vice President; and Braden Lyons, Vice President.

Before getting started, I would like to remind participants that our discussion today may contain forward-looking statements, and therefore we ask you to review the disclaimers regarding forward-looking statements as well as non-IFRS measures, both of which can be found in management's discussion and analysis. You can visit Slate Grocery REIT's website to access all of the REIT's financial disclosure, including our Q3 2023 investor update, which is available now.

I will now hand over the call to Blair Welch for opening remarks.

Blair Welch, Chief Executive Officer

Thanks, Paul, and hello, everyone. I'm pleased to share our team's positive third quarter results, which highlight our portfolio's continued strong leasing fundamentals and rental spreads driving occupancy and income growth.

We have completed over 690,000 square feet of total leasing in the quarter. New deals were done at an 18.4% above comparable average in-place rent. Non-option renewal spreads were similarly strong at 14.8% above expiring rents.

Our leasing momentum continues to support occupancy gains. We are up 90 basis-points from the start of the year, bringing occupancy to over 94% at the close of the quarter. Our same property NOI continues to trend positively, increasing by 2% on a trailing 12-month basis after adjusting for completed redevelopments.

In today's elevated interest rate environment, the REIT remains well-positioned. The majority of the REIT's debt is fixed at a weighted average interest rate of 4.2%. Notably, there remains a positive leverage between our current cost of financing and the REIT's Q3 2023 IFRS value at a 7 percent cap rate.

Further, at $12.37 per square foot, the REIT's average in-place rent is well below market, providing significant runway for continued NOI growth and stability of cash flow.

Despite the REIT's strong fundamentals and operational performance, the REIT's units are trading at a discount to net asset value, which we believe provides an attractive entry point for investors. The REIT's unit price at the close of the quarter indicates an implied cap rate of 8.5%, which represents a 41% discount to NAV.

The REIT's NAV has been externally validated by a private fund's investment of $180 million into the REIT at NAV last year. We believe our below market in-place rents will continue to drive attractive renewal spreads and new leasing will support strong NOI growth.

Supply-demand dynamics in the grocery-anchored sector remain favorable, providing landlords with leverage to increase rents. And resilient consumer spending on essential goods and services is driving robust foot traffic for grocery-anchored centers. We believe in the value of our grocery-anchored real estate and are confident that our portfolio is positioned for continued, stable growth.

On behalf of the Slate Grocery REIT team and the Board, I'd like to thank the investor community for their continued confidence and support.

I will now hand it over for questions.

Operator

Thank you. We'll now begin the question-and-answer session. Should you wish ask a question, please press star followed by two. If you'd like to withdraw your question, please press star followed by two. If you're using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.

And your first question comes from Sairam Srinivas from Cormark Securities. Please go ahead.

Sairam Srinivas, Cormark Securities

Thank you, operator. Good morning, guys.

Blair Welch, Chief Executive Officer

Hey, Sai.

Sairam Srinivas, Cormark Securities

Just looking back at the leasing numbers coming from this quarter, obviously leasing spreads look very strong. Blair, looking ahead in the next 12 months, how do you see these leasing spreads evolving, and how do you see that reflecting into your SB&R numbers?

Blair Welch, Chief Executive Officer

Thanks for joining, Sai. We're very confident in the fundamentals of the real estate, and we've always been very selective on what we buy because we try to buy cheap in-place rents. So, that provides durability of cash flow. And the team's done a good job of executing leases that provide that growth.

Going forward, given our average in-place rents in the mid-$12.00, which is half of market as quoted by Green Street, we still see that growth happening. We do not see a change in that.

In addition to that, we were strategic through the lockdowns in COVID and bought some of what we'll call underperforming portfolios, we thought. We were able to buy those cheap in-place rents at a lower occupancy. So, that NOI that the team is doing a good job leasing is coming on, so our forward-looking NOI looks good. And I don't see that changing in the short term just because of the supply-demand fundamentals in the market.

We're feeling confident. And operationally, this real estate is really stable right now.

Sairam Srinivas, Cormark Securities

That's good to hear, Blair. And just looking at the leasing environment, do you see any investments required in terms of leasing incentives? Are any of those things clearer in the market?

Blair Welch, Chief Executive Officer

On the investing environment and the lending environment, I would say generally in real estate, there's not a lot of capital and everyone's fighting for it. In the grocery-anchored space, I think lenders and investors like the stability and the durability of the cash flow. These are essential goods.

If you look historically through decades, the occupancy's been stable, the cash flow's been stable, and lenders and participants in real estate need to invest in the asset class. And big grocery-anchored real estate is an asset class that they like, perhaps more now than others from a stability standpoint, but the transaction market is subdued.

When we've seen M&A across spaces, it's paper for paper, not cash. But we feel confident there's cash out there for real estate deals. And we will be opportunistic in the future if we can buy a great grocery-anchored real estate asset that's mispriced because of the capital structure. We're just keeping our eyes and ears open right now.

Sairam Srinivas, Cormark Securities

Thanks for the color there, Blair. I was basically asking in terms of the leasing incentives that go on in terms of filling up all the leases that are coming up.

Blair Welch, Chief Executive Officer

I'll pass it over the team, but it has been pretty stable.

Sairam Srinivas, Cormark Securities

Okay.

Blair Welch, Chief Executive Officer

What are you guys seeing out there in the market? On incentives, are tenants asking for anything more? What's the color there? Has it been that they're fighting for our space?

Allen Gordon, Senior Vice President

Yes, I think they're fighting for our space. One of the reasons that they're fighting for our space is due to the lack of supply in the market and the cost to construct within the market as well. That's where we're favorable.

Blair Welch, Chief Executive Officer

One thing I'll add, Sai, just more color, which is positive for our durability of cash flow. We're seeing tenants want to go longer with options and try and lock in option bumps to their rents. That's good because they're trying to lock into our centers for a long period of time and control their rental cost. It's good bumps for us.

But I think that shows that the tenants still think inflation's going to be around for some period of time. It's positive for the REIT, but that's just some more color on leasing - people are trying to lock into space because there's not a lot of space around right now.

Sairam Srinivas, Cormark Securities

Brilliant. That sounds good, guys. Thank you so much for the color. I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks.

Operator

Ladies and gentlemen, as a reminder, should you wish to ask a question, please press star followed by one. Your next question comes from Brad Sturges from Raymond James. Brad, please go ahead.

Brad Sturges, Raymond James

Hey, good morning.

Blair Welch, Chief Executive Officer

Hey, Brad.

Brad Sturges, Raymond James

I wanted to get some updated thoughts or comments on the Kroger-Albertson's merger. And it would be based on what you know today, but just curious in terms of the planned divestitures as part of the merger. Do you know what your exposure could be to that at this point?

Blair Welch, Chief Executive Officer

Yes, we'll be consistent with what we've talked about before in that any crossovers that we have, we feel good about. We don't know what they're doing yet, and we don't think we have exposure. But even if we did, the low in-place rents of our grocer are healthy.

We feel, as we've consistently said, this is a forced sale and they don't want to give a competitor a great opportunity at a low rent to kick their butts in sales. It's not like the locations aren't performing, they're being forced to sell these.

From a landlord perspective, we don't think we're going to lose a food store. It's just them managing the competition. When you think of the entire amount of stores that we're talking about for their portfolio, to the market, I think there's 400 stores they're talking about. That's probably 1% of the inventory or less. And when you think about the Slate portfolio, we don't see a significant risk. But I'll let the team add more color.

Connor O'Brien, Managing Director

I think there are certain headwinds with the FTC to get this deal approved, but what they are going to be focusing on is making sure that any divestitures are going into entity that is well-capitalized and can perform strong grocer sales going forward. They don't want these grocers to go in the hands of an over levered entity that's going to disappear in a few years.

Again, going back to Blair's point, our below market rents give us a lot of conviction in the stability of these assets. Whatever happens across the portfolio, we're confident in our ability to maintain or grow value going forward.

Blair Welch, Chief Executive Officer

And it's a good question, Brad, but food is different than other types of retail. If you're in a neighborhood and that grocery store sells $100 of food out of that store, for example, and then Kroger and Albertsons need to sell that store, there's still $100 of food demand at that location. That isn't changing. It's who's selling that food.

That's how we look at it and that's how it is. Someone's going to buy or want to buy that food sale because they're being forced to sell it. We believe that our locations at their cheap rent create a good margin opportunity for any operator.

Brad Sturges, Raymond James

That's great color. Really appreciate that. Just switching gears, you completed a couple redevelopment projects in the quarter. Just curious if there's anything else in the pipeline that you're looking at for 2024. And if so, what should we be thinking about in terms of modeling for capital spend next year?

Allen Gordon, Senior Vice President

We've got a few projects that we're currently looking at. As far as capital spend, we're working our way through that now. We don't have exact numbers on that as of yet as we're working through potential cost to construct and redevelop, but we're working through that now.

Blair Welch, Chief Executive Officer

Brad, you've seen what we try and do is all of our below the line costs are cash. We don't use an assumption. We only do deals when we think it's accretive in how we deal with it.

I would say it will be consistent to what we've done in years past, no big outrageous plans. We'll just do it as the assets require, and it will be what we've done in the last couple years. There's nothing big we're planning on the redevelopment side. It'll just be normal business.

Brad Sturges, Raymond James

Okay. Last question for me, there's a lot of volatility in the debt markets right now. If you had to peg where your debt costs are today, where would be the rough range?

Blair Welch, Chief Executive Officer

I think we'll be able to do a couple of things. We have good protection for the next couple years with some derivatives, and I think that's healthy. But we did some financing earlier this year with life cos., and we were in the mid 5s. It bounces around a lot, and we don't know the future, but I would say that we are in a positive leverage territory no matter what it is, which makes us unique in the Canadian REIT universe from an IFRS/NAV cap rate.

We're also fortunate that - whether it's life cos., banks, or other structured finance - buyers of paper want the stability of grocery. We have not heard of any of our lenders backing out of this space. We know in other spaces they are. We're still in positive leverage, but we still have some time and some years. Not all our debt will shift tomorrow into the new market norm, even though it'll still be positive leverage, and I think our NOI growth will offset that, so we're feeling good right now.

Brad Sturges, Raymond James

Okay. Thanks. I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks.

Operator

Your next question comes from Gaurav Mathur from Laurentian Bank Securities. Please go ahead.

Gaurav Mathur, Laurentian Bank Securities

Thank you, and good morning, everyone. There's been plenty of activity at the tenant level with bankruptcies in the sector, the stalled Albertson's-Kroger merger, and protests among pharmacy workers at CVS and Walgreens. My question is do you see any upcoming material tenant distress in the portfolio as we're looking at the next 12 to 18 months?

Blair Welch, Chief Executive Officer

Good morning, Gaurav. Good to hear from you. I'll go into detail to your question, but at the high level, our biggest mitigant to that is our low in-place rents. At $12.37, we are below all of our peers and we're below market. That's a huge opportunity to make sure the tenants stay sticky at our locations.

As it relates to what's happening in retail, we've done some analysis. Of all the bankruptcies in retail, and in all the peer universe, we're significantly lower on tenant exposure to the bankruptcies of late, whether that's Bed Bath & Beyond, Olympia Sports, Party City, Christmas Tree Shops, even Rite Aid. We have very limited exposure to that.

And I'll go back to it, even when that is the case, the in-place rents, we have demand to lease that back up. So, our biggest defense is our in-place rent, and we're mostly focused on essential tenants.

As it relates to the future, everyone's talking about real estate debt and it's over levered. But in the market, there's also a lot of levered loans. That market is $4.5 trillion last time I checked, and that's grown from $2 trillion since 2020.

I do believe there are many tenants in the greater real estate world that might face margin squeeze. But when we do analysis of our portfolio, the credits of our tenants are strong. We do not feel that our tenants are going to be impacted as much because they've cleaned up their balance sheets when I'm thinking of the grocers or the other nationals. Yes, the pharmacies are dealing with some labor issue, but they're still healthy and people need it. It's an essential good, and we have a cheap rent.

So, we do look at it. I am concerned outside of grocery looking forward to the stress on credits for tenants. I don't think people are paying enough attention to that. But as we look at Slate Grocery REIT, we feel we're insulated because we do that analysis, and our rents are the mitigant of the risk.

Gaurav Mathur, Laurentian Bank Securities

Okay, great. Well, thank you for the color on that. Just switching gears here, when you are thinking about capital allocation now in this environment and looking at 2024, just given where the units are currently trading, how are you thinking about the NCIB versus distributions and then acquisition activity as we're closer to interest rate normalization?

Blair Welch, Chief Executive Officer

We're obviously biased, but we think our units are unreasonably cheap. We have been using our NCIB. But we aren't going to change our consistent strategy of working with the Board and the team to allocate capital, whether that's NCIB, whether that's redevelopment, or whether that's buying outside acquisitions. We judge what's the right return and what's the best return for the unitholders, and we've always done that.

We'll look into next year and we'll just continue that. But we feel strongly that, given our strong operating fundamentals, where we currently trade in Toronto in Canada is totally disconnected to what is happening in the United States. And the team has done a good job - last year, we sold 18% of the company at NAV, and I believe in our NAV. Our NAV compared to most of our Canadian peers, we can show what that is, and it's positive leverage — if you go to mark-to-market financing, we have below market rent and strong rental growth.

It's a compelling investment right now. But we'll continue to work to come and talk to you and come talk to our investors and others to show that. But we're confident in our real estate and what we have.

Gaurav Mathur, Laurentian Bank Securities

Okay, great. And then just last question. From a distribution perspective, how should we think of the payout ratio going forward, given that it's been increasing through the year?

Blair Welch, Chief Executive Officer

It’s been increasing for a couple reasons, one, redevelopment and some costs. But we feel that based on the durability of our cash flow and the NOI growth, our cash flow is durable and it covers. We think that the fundamental part of our business is that we have low in-place rents and our NOI is going to grow. So, we feel that over time our payout ratio will go down, and we're comfortable with that.

Gaurav Mathur, Laurentian Bank Securities

Fantastic. Thank you for the color, Blair. I'll turn it back to the operator.

Blair Welch, Chief Executive Officer

Thanks, Gaurav.

Operator

There are no further questions at this time. I'll turn it back to Paul for closing remarks.

Paul Wolanski, SVP, National Sales and Investor Relations

Thank you, everyone, for joining the Q3 2023 conference call for Slate Grocery REIT. Have a great day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.