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Madeline Sarracini
Investor Relations

Greg Stevenson
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CONFERENCE CALL PARTICIPANTS

Troy MacLean
BMO Capital Markets

Dawoon Chung
National Bank Financial

Dean Wilkinson
CIBC World Markets

Jimmy Shan
GMP Securities

PRESENTATION

Operator

Good morning. My name is Julie and I will be your conference operator today. At this time, I would like to welcome everyone to the Slate Retail REIT Second Quarter 2017 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. I would now like to turn the call over to Madeline Sarracini, Investor Relations. You may begin your conference.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the second quarter 2017 conference call for Slate Retail REIT. I am joined today by Robert Armstrong, Chief Financial Officer, and Greg Stevenson, Chief Executive Officer.

Before getting started I'd like to remind participants that our discussion today may contain forward-looking statements and therefore ask you to familiarize yourself with the disclaimers regarding forward-looking statements as well as non-IFRS financial measures, both of which can be found in management's discussion and analysis.

You can visit Slate's website to access all of the REIT's financial disclosure, including our Q2 2017 investor update, which is available now.

We will now allocate the remainder of this call to answering your questions. Thank you.

QUESTION AND ANSWER SESSION

Operator

Again, if you would like to ask a question, press star one on your telephone keypad.

Your first question comes from the line of Troy MacLean with BMO. Please go ahead, your line is open.

Troy MacLean, BMO Capital Markets

Good morning.

Greg Stevenson, Chief Executive Officer

Hey, Troy.

Robert Armstrong, Chief Financial Officer

Hey, Troy.

Troy MacLean, BMO Capital Markets

Just looking at the renewals in the quarter, the retention rate for the tenants below 10,000 square feet, it looks like retention ticked down in the quarter. What drove that?

Greg Stevenson, Chief Executive Officer

I think it was just a result of some of the tenants that we let expire at some of our existing redevelopment opportunity properties. The number will jump around probably a little bit, every 90 days, but we largely expect to be sort of back to where we were in the past, which is, you know, 85 percent to 90 percent. I think it's just a bit of an anomaly.

Troy MacLean, BMO Capital Markets

Are there any tenants in your portfolio that you're looking to, you know, any tenant types that you're looking to get rid of as they come up for renewal?

Greg Stevenson, Chief Executive Officer

Not necessarily. I think what we really do is just try and make sure that the mix and the offerings at the centre are complementary to each other. We run void analysis to make sure that, you know, if there's no retail uses in the nodes that we're in that we're bringing them to our centre and we're spending capital to do that, and we obviously focus on improving credit quality across the board as well. I think we want the best tenants and the best offering and we want those tenants to be successful with growing sales, because if all that happens it means that the rent that we charge can grow as well.

Troy MacLean, BMO Capital Markets

And then you early renewed two grocery tenants; was that driven by, you know, they wanted to invest some money in the space and you had to extend the term or did you approach them?

Greg Stevenson, Chief Executive Officer

Winn-Dixie at Errol Plaza was them approaching us. They did a multi-million dollar remodel at that store that saw their sales per square foot double, so that would be one of the top five stores in their entire chain, and they wanted to expand their liquor and extend the term. So that was them approaching us, which gave an additional nine years of term at that site, which is a good thing for us. And we're going to invest capital alongside of them on the parking lot and lights. And then the other centre was Charles Town or, sorry, the other centre was really them coming to us wanting to increase the lease in advance, and that was sort of a plain vanilla deal, no capital, just another five years. They're happy at the site and they extended in advance of their expiration.

Troy MacLean, BMO Capital Markets

And then just on the new tenant at County Line, is that a grocery tenant or are you putting a new type of tenant in there?

Greg Stevenson, Chief Executive Officer

It's a gym user. So, talked to a few grocery users and a few other users, I think the good news is we had a lot of demand at the centre. From an economics perspective, the gym use made the most sense. The yield on cost for that project based on what the gym is going to pay us is close to 15 percent. I think once you account for downtime between A&P and Edge Fitness it's probably closer to 11 percent, and that's the math that I use, but it's still a pretty good outcome and we think that that will drive leasing demand at the out parcel that we have at site and we're going to work through some other opportunities there. And effectively, as a result, because it's not a grocery-anchored centre, we may look to dispose of that in the future but, needless to say, it was a great outcome.

Troy MacLean, BMO Capital Markets

When will they start paying rent?

Greg Stevenson, Chief Executive Officer

We expect within the next 12 months or less.

Troy MacLean, BMO Capital Markets

And then just finally, just kind of curious, you know, given the changes you've seen in the grocery space, and you've been fairly active on the acquisition front, are you seeing more properties come for sale or have you seen any change in valuation? Any kind of colour there?

Greg Stevenson, Chief Executive Officer

We haven't but, again, we're not in the markets where there's a Whole Foods or the Amazon acquisition have taken place. We're outside of those in sort of the secondary markets. For a reason, a targeted reason. We don't want to be in those markets. We think they're too competitive. Retail is obviously changing but as it relates to grocery anchored it's pretty steady. We've seen a pickup in opportunities but I think that's more a result of people knowing who we are and developing stronger relationships over time and effectively being one of the only groups in the US specifically focused only on grocer anchored and only on secondary markets. So we're pretty niche and we see a lot of deals as a result but, you know, largely quiet and unchanged relative to the last 12 to 24 months.

Troy MacLean, BMO Capital Markets

Thank you. I'll turn it back.

Greg Stevenson, Chief Executive Officer

Thanks, Troy.

Operator

Your next question comes from the line of Dawoon Chung with National Bank. Please go ahead, your line is open.

Dawoon Chung, National Bank Financial

Good morning.

Greg Stevenson, Chief Executive Officer

Good morning.

Dawoon Chung, National Bank Financial

Thank you for providing more disclosure in the MD&A this quarter. Greg, in your letter to your unitholders you shared your views on the Amazon deal and the changing landscape of the US retail markets. Given these changes, what are some of the things that kind of jumps out at you that existing players such as Wal-Mart and Kroger, what they're doing to maintain their market dominance?

Greg Stevenson, Chief Executive Officer

I think that's one of the, well, first of all, you have Bobby to thank for the MD&A. We're happy to have him on the team and I think, I agree with you, I think there's a lot of great information in there now. On the Amazon thing, that's what I think one of the things that are being overlooked is how much time, effort, and money are being spent by the Krogers and Wal-Marts of the world. And Wal-Mart with the Jet acquisition, Wal-Mart is a perfect example. In 2015, they had zero click-and-collect locations; by the end of 2017 they'll have 2,000. Kroger is not dissimilar. They'll have zero to 700 in a matter of two years. In addition, increasing their online offerings and effectively taking advantage of the fact that they're the two largest retailers in the United States with more distribution centres in stores than anyone else by a wide margin.

So, you know, both of those folks, including a lot of the other large grocers like Publix, Safeway, and they others, they're spending a lot of money, and I think the reality is that in our markets, you know, the grocers are spending efforts on figuring out the convenience part of it, which is where technology comes in. We speak with all of them on a regular basis. Sales are up across our portfolio and across our stores and, you know, foot traffic is increasing at the stores. People are still shopping for groceries in our markets and they're doing it more than they were 12 months ago. And fundamentals are still okay. I think the reality is is that this technology pushes a good thing and the customer will benefit and maybe the checkout times are faster and people don't have to get out of their cars, but the reality is, our belief is, and there's no reason to believe based on what we see in the data, that this is going to change any time soon.

Robert Armstrong, Chief Financial Officer

Dawoon, one other thing I'd add there is the click-and-collect and the massive investment that the Krogers, Publix, Wal-Marts have made, in our view this investment is a reinforcement in investment in the real estate, because the click-and-collect rather than getting delivery to your front door is driving the consumer to the centre and that natural distribution chain is important and continues to be important for grocers.

Dawoon Chung, National Bank Financial

Great. Just looking into your MD&A, it seems like your delta between the in-place rent and market rent, there's a good opportunity to generate organic growth there, but historically speaking the spread has widened. Is this just a function of market rents increasing much faster than what you guys can achieve?

Greg Stevenson, Chief Executive Officer

What's the delta that you're looking at?

Dawoon Chung, National Bank Financial

I'm looking at the in-place rent and then the market rent. I know you guys have provided that over the course of, from Q2 of 2017 all the way back to Q3 2015, page number ten.

Greg Stevenson, Chief Executive Officer

I think it's a useful metric just to highlight the spreads and obviously I think our leasing activity numbers show that we're able to grow our rents and that's flowing through to positive same property NOI growth. That information, I guess it gets a bit diluted by the fact that we've tripled in size over the last three years, going from 3 million square feet when we listed in 2014 to 10 million square feet today. So, you're sort of adding new properties every quarter with a $10 per square foot in-place rent.

As part of our strategy we're targeting centres with under market rents. So, you own 10 properties, you grow those rents, you buy another 10 properties with lower rents and, you know, that number is masked, I guess, by the growth. So, there's no real change. The growth in rents, we believe, will continue. If you look at our lease expiration chart, you know, we're $9 to $10 rents on average expiring for like the next five years, and if we continue to do renewals in the $12 range and new leases in the $16 to $17 range we have no reason to believe that our income won't continue to grow like it has in the past.

Dawoon Chung, National Bank Financial

Great. My last question is just from a modelling standpoint it looks like straight line rent was a little bit higher this quarter. What's a good run rate to use around the historical number or this latest quarter?

Robert Armstrong, Chief Financial Officer
I'd probably say an average of the last couple quarters, Dawoon. It's really just the timing of when free rent hits and the timing of deals and when the step-ups occur, but that's a good run rate.

Dawoon Chung, National Bank Financial

All right. Perfect. Thank you. That's it for me.

Operator

Your next question comes from the line of Dean Wilkinson with CIBC. Please go ahead, your line is open.

Dean Wilkinson, CIBC World Markets

Thanks. Good morning, guys.

Greg Stevenson, Chief Executive Officer

Hey, Dean.

Dean Wilkinson, CIBC World Markets

Hey, Greg. On the occupancy, just seems that the slippage seemed to be mostly the Kmart in Springboro. Does the call it 80,000 feet you've released in the quarter, does that effectively fill that gap? Or will it be higher?

Greg Stevenson, Chief Executive Officer

I want to make sure I understand the question. So, the 100,000 square feet from Kmart and then we renewed 80,000 elsewhere?

Dean Wilkinson, CIBC World Markets

Yep. The new leasing.

Greg Stevenson, Chief Executive Officer

Oh, the new leasing.

Dean Wilkinson, CIBC World Markets

Yeah. Like can I think of those as an offset or is there actually maybe a bit of a pick up on the new leasing versus the Kmart?

Greg Stevenson, Chief Executive Officer

Yeah, there would be a pickup from an income perspective, because the Kmart rent was in the low single digit range. So, we're out, we let Kmart roll because we're out similar to the success we had at North Augusta where we sort of more than doubled the rents on the Kmart space. We're excited about this one because we think we can do the same thing and we're working with Kroger on a development there.

Dean Wilkinson, CIBC World Markets

Okay. So that was my next question in terms of is it similar to the scope at North Augusta and sort of $11 million, $12 million CapEx is what we should be thinking?

Greg Stevenson, Chief Executive Officer

Yeah. Yeah, I think so. That number, it could bump around, and it's really going to depend on what Kroger comes back to us with exactly, what they want to do, and we don't have those final plans yet. But, needless to say, it should be somewhere within that range. It's not going to be a huge delta.

Dean Wilkinson, CIBC World Markets

Would that represent a new market for Kroger or are they just moving a location?

Greg Stevenson, Chief Executive Officer

They're on site right now.

Dean Wilkinson, CIBC World Markets

Oh, okay. So, it's bumping out their space.

Greg Stevenson, Chief Executive Officer

Correct. There's a few options, and one could be their 100,000-plus square foot marketplace store there.

Dean Wilkinson, CIBC World Markets

Gotcha. Gotcha. Okay. And the timing on that would be more towards the end of the year?

Greg Stevenson, Chief Executive Officer

We'll hopefully know what they want to do in the next few months and then the timing after that would be, you know, probably 12 to 18 months after that. It's not super near term but we're moving in that direction.

Dean Wilkinson, CIBC World Markets

Perfect. And then I guess just generally on the Kroger, the 18 stores that you've got, your discussions with them, how do they feel about those locations versus sort of, you know, their overall portfolio and how those stores are operating?

Greg Stevenson, Chief Executive Officer

We talk to them a lot and I think they're, they're very happy and it's, I think, a large reason why we continue to focus on the stores and the sites that we do, which is really high sales per square foot with a really low rent per foot number. Our average GROC or health ratio, call it what you want, effectively gross rent as a percentage of sales for Kroger, across those stores, is sub 2 percent. I mean you're talking about a GROC that starts with 1. And then what I learned from the whole Lidl thing, we toured a bunch of Lidl stores last week, so real estate costs and labour, humans, make up more than 50 percent of the fixed cost at grocery stores, so it really highlights the importance of that ratio when you're looking to extend leases and keep those grocers around for a long period of time.

I think sales are growing at all the Krogers that we have and the rent is really low. Whether or not that translates into income gains I think the reality is it translates into longer-term leases and having a grocer there for the long run. I think they're very happy.

Dean Wilkinson, CIBC World Markets

Absolutely. I mean sub 2 percent is a great number. That's it for me. I'll hand it back over. Thanks, guys.

Greg Stevenson, Chief Executive Officer

Thanks.

Operator

Again, if you would like to ask a question, press star one on your telephone keypad.

Your next question comes from the line of Jimmy Shan with GMP Securities. Please go ahead, your line is open.

Jimmy Shan, GMP Securities

Thanks. Hey, guys. Just to follow up on that in-place versus market rate gap sort of widening out because of portfolio mix, if you were to look at it on a same portfolio basis what would be your best guess? Is that gap actually closing? Because I would imagine that you'd be capturing that market rent over time and over two years we should see that gap sort of close on a same portfolio. Would that be fair?

Greg Stevenson, Chief Executive Officer

Yeah. Absolutely.

Jimmy Shan, GMP Securities

Okay. And just to press you on the cap rate question, I've heard from some of your peers talking about cap rates expanding 50 to 100 basis points in some cases in some of the secondary markets. Now I'm not sure which asset class they're talking about. And then I've heard some guys saying grocer cap rates have stayed about the same. Just maybe if you could talk to what you're seeing in your particular markets in terms of when you're out and bidding and what would be the trend that you would expect in the near term.

Greg Stevenson, Chief Executive Officer

Yeah, I would agree with the grocery cap rates are holding steady. I think that, you know, a well-located grocery-anchored strip centre with strong sales is still highly sought after and/or is now wanting to be held as opposed to sold, just because that percentage of grocery exposure slide in everyone's investor deck is now a little more coveted than it was 12 to 18 months ago. So far, no real change I think other than the fact that, as I stated earlier, I think that Darrell and his team, and of course our guys on the asset management side are out there as well, we're just, ah, we've got our ears to the ground and we're finding good opportunities just I think from being entrepreneurial and getting out there and talking to people.

Jimmy Shan, GMP Securities

Okay. And then just to follow up on the Kroger comment, so at Mulberry Square I think you're going to go through some redevelopment as well, you know, with them adding the grocery pickup and all that stuff. So, again, when you look at your Kroger stores is your expectation that they'll start to, you'll see a bit of a pickup in them investing and reformatting their stores and investing more capital just on the back of this whole Amazon entry?

Greg Stevenson, Chief Executive Officer

Yeah, I think that—the answer is yes. Certainly at our stores. I can't speak to the rest of their portfolio but I know at the stores that we've purchased with them, and before we do so we have some high-level conversations about what they want to do at the centres so we have a bit of an idea ahead of time, and all of those things are sort of on track and they're spending more money and they're investing in their stores and obviously the stores need to be good ones. But I think just generally they're sort of slowing down on the new store builds, which is sort of prevalent across the entire asset class. Supply is at a multi-decade low and money for all of the grocers, not just Kroger, is being reinvested into existing sites where they think they're going to see returns. And the Winn-Dixie Centre at Errol Plaza that we renewed for an additional nine years is a perfect example of that. I mean they reinvested a few million dollars of their own money into our store and they saw their sales per square foot more than double and I think, I don't know that they all hope that that happens but the feedback we get from a lot of our grocers, Kroger included, is that the returns that they're earning on store remodels for strong existing stores are better than what they've seen in their new stores. We hope that trend continues.

Jimmy Shan, GMP Securities

Right. And then your share as the landlord, your share of the additional CapEx, maybe at a high level can you walk me through how does that work?

Greg Stevenson, Chief Executive Officer

I mean it depends. It's very deal-by-deal specific. In some cases, there could be a JV where it's 50/50. In some cases, it could be 100 percent Kroger and 0 percent Slate where we might then be responsible for the parking lot or some lighting or some landscaping. My guess is it'll be more the latter than the former, so more mostly Kroger and less Slate. They've got a cheaper cost of capital. And like most other grocers, they like to do it all themselves, and we're very okay with that because it usually results in better math for us anyway. So, you know, I don't know exactly what every deal will look like but my guess is it'll be largely the grocer putting in most of the capital and less Slate. But certainly us, unlike other landlords in the market, and I think this is a big competitive advantage for us, is that we've got the capital and the team and the expertise to then go in and do new facades and, you know, on the shop space and landscaping and parking lot, which again, you know, you buy a centre for $120 a foot, you do all this, you've got a brand-new grocery store with multimillion dollars invested and our basis goes up in some cases $10 to $15 per square foot. And in some cases, can come with a 10 to 20-year lease. So, there's huge value creation opportunity there with not a lot of capital that needs to be reinvested.

Jimmy Shan, GMP Securities

Okay. Okay, thank you.

Greg Stevenson, Chief Executive Officer

Thanks.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

Madeline Sarracini, Investor Relations

Thank you, everyone, for joining the second quarter 2017 conference call for Slate Retail REIT. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.
