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Madeline Sarracini
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Greg Stevenson
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CONFERENCE CALL PARTICIPANTS

Sumayya Hussain
CIBC World Markets

Himanshu Gupta
GMP Securities

Johann Rodrigues
Raymond James

Stephane Boire
Echelon Wealth Partners

PRESENTATION

Operator

Good morning. My name is Kim and I will be your conference operator for today. At this time, I would like to welcome everyone to the Slate Retail REIT Third Quarter 2018 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. Thank you.

Madeline Sarracini, you may begin your conference.

Madeline Sarracini, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the third quarter 2018 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 Retail REIT's website to access all of the REIT's financial disclosure, including our Q3 2018 investor update, which is available now.

I will now hand over the call to Greg Stevenson and Robert Armstrong for opening remarks.

Greg Stevenson, Chief Executive Officer

Thank you, Maddie, and thank you to the participants for joining the call this morning.

In the fourth quarter of last year we laid out in detail the business plan for the REIT for 2018. The team has done an excellent job of executing and delivering on our plan and the third quarter results highlight an inflection point for all of the hard work that has been put in over the last 12 to 18 months. Specifically, occupancy is up 170 basis points year over year, currently at 94.3%, on the back of solid leasing results and maintaining our industry-leading retention ratio above 90%.

Our properties continue to be a place tenants want to operate their businesses and, as importantly, our asset management team are people they want and enjoy doing business with. The level of service and dedication our team brings has, no question, played a big part in delivering on our plans. In addition, we have made progress on our development pipeline with $2.7 million of estimated incremental net operating income to be generated upon completion, representing an approximately 11% yield on costs. In addition to the incremental income these projects will generate, the capital spend and new tenancies will also serve to increase the value of the properties significantly.

Leasing was strong again this quarter helping to drive 2.4% same-store NOI growth. In addition to this, signed leases with tenants that are not yet open for business and paying rent has grown in excess of $2 million of annual base rent, which will also be incremental to our Q3 results.

Lastly, we will continue to sell non-core properties that will allow us to recycle capital that can be more opportunistically deployed to generate future growth as well as upgrade the quality of the portfolio along the way.

I want to thank the Slate Retail REIT team for all their hard work and will now turn it over to our CFO, Robert Armstrong.

Robert Armstrong, Chief Financial Officer

Thanks, Greg. Just a couple notes.

During the quarter the REIT entered into an additional $350 million of interest rate swaps. The REIT's net debt is now 99% fixed, eliminating our exposure to future interest rate hikes. Further, the weighted average rate of our swaps is about 2.03%. This is below the current one-month U.S. LIBOR of 2.3% and we think is a good spot given the market expectation of future rate hikes in 2019.

As a result of our continued income growth, strong occupancy, and portfolio performance, the REIT will increase its monthly distribution to $0.855 annually. This is an increase of 1.8% over the current distribution and marks the fifth consecutive annual distribution increase since the REIT listed on the TSX in 2014.

Also, as an update on our unit repurchase activity, the REIT has repurchased 1.4 million units on a year-to-date basis for a total capital outlay of about $14 million. A significant number of these purchases occurred subsequent to quarter end. These repurchases have resulted in an immediate increase to NAV to unitholders and we intend to continue to repurchase units where appropriate pricing exists.

Both Greg and I thank you for our continued support and I'll now hand it over for questions.

QUESTION AND ANSWER SESSION

Operator

At this time, if you would like to ask a question, please press star and the number one on your telephone keypad.

Your first question comes from Sumayya Hussain from CIBC. Your line is open.

Sumayya Hussain, CIBC World Markets

Thanks. Just firstly, your occupancy, like you mentioned, has ticked up a decent amount of over 94% and you've noted in the filings that there's still a significant leasing that's yet to show up in the numbers. Do you have a sense of what that gap is between in-place and committed occupancy and over what timeframe would we see that show up in the numbers?

Greg Stevenson, Chief Executive Officer

Hi, Sumayya. The gap is really, and we've talked about this in last quarter, is really the approximately $2 million, which is slightly higher than that now, of annual base rent where you have a signed lease but the tenant is not yet in and rent paying. Some of that started in Q3. When we talked a lot about it earlier in the year saying we expect most of the growth to be in the second half of 2018, a lot of that is what we're referring to - that we have good visibility on the leasing that we've done and we can see the income expect to come in.

In terms of timing, a little bit in Q3, more into Q4, and I would say the majority of that would be coming in by the end of the first quarter.

Sumayya Hussain, CIBC World Markets

So, fairly near term. Great, okay. Can you give some background on the joint venture with Kroger on Windmill and how it came about and if you see other similar opportunities down the road, especially given there's limited supply of quality assets out there?

Greg Stevenson, Chief Executive Officer

Sure. That deal goes back a few years and it was really the team doing a great job being proactive and getting in front of the grocers, which is a big part of our strategy. Kroger identified Slate as a counterparty that they wanted to do business with and they came to us as opposed to us going to them with the idea that we should look for sites where they could build their new store concepts, Windmill Plaza being one of them. At the time it was a Kmart-anchored centre. We purchased it, we being SLAM, on behalf of Kroger and the REIT gave a loan with the right to purchase the centre. Kroger has signed the lease. They're working on building the store and we're working on backfilling the former Kroger box.

When you do this, two things happen. One, you take a $2-ish Kmart rent and you replace it with a slightly higher Kroger rent, but you're also replacing a Kmart credit with a Kroger credit, which has significant cap rate compression that comes along with it and you're signing a 15-year to 20-year lease with Kroger on a brand-new store where we expect sales to be significant. Where a lot of the return comes from is then backfilling that Kroger box with tenants who want to be next to a brand-new Kroger, and that's a long list of tenants, and you're earning, in some cases, four to five times the rent that Kroger or Kmart was paying on that box.

We are really excited about Windmill. Tyler and the team have done a great job and our partnership with Kroger, as a result, just continues to grow. We are really excited about the opportunity.

Sumayya Hussain, CIBC World Markets

Okay. That's great colour and that's all for me. Thank you.

Operator

Your next question comes from Himanshu Gupta from GMP Securities. Your line is open.

Himanshu Gupta, GMP Securities

Thank you and good morning, guys.

Robert Armstrong, Chief Financial Officer

Good morning.

Himanshu Gupta, GMP Securities

Just to follow up on Sumayya's question on ABR signed but not commenced, so when you say $2 million of incremental ABR does this include the incremental NOI from development? I know in the MD&A you mentioned $2.7 million from the development repositioning efforts.

Greg Stevenson, Chief Executive Officer

No, it doesn't, and that's why we wanted to talk about both separately in the letter and on the call is that you if take trailing 12-month NOI at the end of Q3 it's about $100 million. You then add what we know are signed expected to pay rent leases, that's another, let's call it $2 million, and then you take incremental NOI from development projects, four of which are effectively pre-leased so, like we talked about in the letter, a very high probability of execution there. You add those together you're $4.7 million on $100 million of trailing 12-month NOI. You can get a sense of what we think the growth over the next 6 to 12 months on a total portfolio NOI basis. Now, same store will differ because same-store NOI excludes quite a few properties due to our acquisition activity and development activity. We look at it on a total portfolio basis. To answer your question, no, you have to add both those things together.

Himanshu Gupta, GMP Securities

Okay. Thank you. And by the way, thanks for the additional disclosure on the incremental development NOI. That was pretty useful.

Moving on, on the acquisition of this Plymouth Station, can you elaborate here? Are you going to be more active on the acquisition front or was it a case of a more opportunistic transaction?

Greg Stevenson, Chief Executive Officer

It was really recycling capital. So, you will probably note in the MD&A that we talked about selling non-core outparcels. Really what we sold is about the same dollar amount that Plymouth Station was acquired for. We sold an outparcel at one of our centres, which was effectively a power centre, sort of big box retailers, which we don't have a lot of and we don't want. We sold those and we replaced that with Plymouth Station, which is a brand-new, Hy-Vee anchored, just signed a 15-year lease and the grand opening was actually two days ago in a very affluent area and growing area of Minneapolis for effectively the same cap rate.

I think it's two things: one, we're managing earnings and, two, as we talked about on the call and in the letter, we're going to recycle this capital and we think we can do it accretively over time, if not to keep earnings neutral, and I think where it becomes significant is the quality that we're getting in terms of upgrading. I mean if you compare an unanchored strip parcel with power center tenants and you hit the same cap rate where we think is much more upside with an asset like Plymouth Station and, more importantly, a grocer like Hy-Vee who came to us with the idea, similar to Windmill, we're having grocers approach us, so the risk-adjusted nature of that return we think is excellent.

It's something we're going to continue to look for but effectively any acquisitions we do, to answer your question, are going to be to replace income from sold assets if we don't have a better use for those proceeds.

Himanshu Gupta, GMP Securities

Right. So, this looks like a brand-new asset there, right?

Greg Stevenson, Chief Executive Officer

That's correct. Bobby, I don't know if you want to add anything.

Robert Armstrong, Chief Financial Officer

Himanshu, what I would add is, just looking back at what we've done in 2018 and coming out of 2017 we were very purposeful that we wanted 2018 to be a year of integration given 2017 we had close to $400 million of acquisitions, and I think we are mostly through that. We've increased occupancy 170 basis points year over year. Over the last two years, six of the eight quarters have been positive NOI growth and when I look forward to 2019 with that integration on track and we are doing about 250,000 square feet of leasing in the quarter, I think we will be more acquisition focused in 2019. But to Greg's point, a large part of that would be funded from capital recycling where we're being opportunistic in either solidifying value where we think we've created value or de-risking but looking to really bring up the quality of the portfolio. But we do think there's a lot of opportunities out there and I think we'll be net acquirers going into 2019.

Himanshu Gupta, GMP Securities

Got it. Some of your large peers have been net sellers or have been selling assets in the secondary market like yours. Did you look into any of those assets as well? What kind of pricing do you think they were able to achieve in some of your markets?

Greg Stevenson, Chief Executive Officer

Yes, we see them all. We are still the only North American REIT that is 100% pure-play grocery-anchored, so anything that happens in the space comes to us. We are constantly out understanding the opportunities in the market and the pricing and how it is safer for high-quality properties with a productive grocer. That just means high sales and growing sales, which is what we look for. Pricing has held strong. I think market participants still view grocery as a ballast in their portfolio because if you look back at the grocery-anchored asset class you can go back decades, you can go back to the financial crisis, which was the worst financial crisis in the last 100 years, grocery-anchored real estate held up extremely well and continues to hold up extremely well today. So, the demand has been strong. I think in maybe some tertiary markets demand has softened as capital flow has softened. It hasn't had anything to do with fundamentals or performance, I think it is just more capital, temporary capital flows.

However, demand for the asset class has held up and I think I've gone through a lot of the Q3 earnings calls just to check in on some of those numbers, Kimco, Brixmor, Regency, Equity One, and the numbers have been solid. I mean they are selling hundreds of millions of dollars of assets between 7% and 8%, let's call it 7.5% on average, for product that we believe is, on average, not nearly as high quality as the portfolio that we own. So, when we think about our cap rate, our implied cap rate today, part of that value is why we think purchasing our units is quite attractive.

Himanshu Gupta, GMP Securities

Got it. Looking at your 2019 lease expiries, are you starting to have conversations with the anchor tenants? Is there any pushback or do you need to spend some capital there?

Greg Stevenson, Chief Executive Officer

I would say we never stop talking with our grocery tenants, expiries or otherwise, so the answer is yes. No real capital pushback. I think the very simple math is, you have a grocer, and in a lot of cases $6, $7 rents, in some cases lower, we've got some grocers paying $2, the rent at these stores on 40,000 feet at $6 is really a small part of their fixed-cost base and it's not something they're usually focused on.

Where they may or may not come to us is if we're asking for extra term, i.e. generally these leases have five-year options and they'll extend those options and sometimes there will effectively be no conversation, simply "we're happy, here's our five-year renewal." In other cases where we think there may be an opportunity to go ten years, because we can upgrade the property by landscaping, pylon signs, facades, or parking lots, which again are all very inexpensive things for us to do, we just try and figure out if that investment is worth it for both the grocer and ourselves and we try and partner on these things. But, no, renewals have gone very well and they don't want to close productive, profitable stores. This is a business that relies on scale and distribution, so their end game is to keep their profitable stores open and they're not going to try and push landlords around in good stores, which are the stores that we own.

Himanshu Gupta, GMP Securities

Ok. Last question and continuing the theme of your conversations with grocers, what are your thoughts on the grocery delivery model or the curbside pickup? What are the notable trends in terms of omnichannel going forward? What are you hearing?

Greg Stevenson, Chief Executive Officer

I think there's a major push towards that. I think when people hear that online grocery purchases are expected to go from virtually 0% or 2% today in the U.S. to 10% by 2023 or the next five years, I don't think people fully understand what that means. What that actually means is that, that sale is still coming from the store. I think what's happened is there have been a few participants who have tried to figure out bypassing the store - that doesn't work. That is really what has happened.

Instacart for example, pick one of these ecommerce businesses that we all love to talk about in today's world, all those are are people inside our grocery stores doing the picking for you and bringing it to your house. As we talked about in the letter, I don't think people appreciate that the leaders in the innovation of this side are actually the grocers like Wal-Mart, Kroger leading that charge, partnering with Ocado, etc.

We feel more confident today than we did 12, 18 months ago that the grocery store is a last-mile distribution centre in that customers do want an omnichannel, some people want delivery, I would say the majority of people still go to the store, but the physical grocery store will be used for last-mile delivery. Our conviction is so high on that and the grocers are saying the same thing, the Silicon Valley start-ups are saying the same thing.

Effectively, all of the money and innovation is centred around figuring out how to best utilize the grocery store and what you may see is the store footprint shrink and some of that square footage be used for logistics and sorting and packing. For us, we don't really care what they use it for. If they do that, that's great, because it means they're spending money and investing in the store, but all it really means is that they're continuing to rent space and pay us on that.

Robert Armstrong, Chief Financial Officer

I think, Himanshu, the underlying trend, as Greg said, and just to put it simply, is that there's been overwhelming recognition by both owners of grocery stores, the grocers and the innovators, that the physical distribution centre, being the grocery store close to rooftops, has a massive competitive advantage over any distribution centre that isn't close to rooftops. That is effectively what we've kind of heard over the last four to five to six months and we think that's going to be the trend and what people are talking about going into 2019, because that's what we're hearing on the ground right now.

Himanshu Gupta, GMP Securities

Awesome. Thank you, guys. I'll turn it back.

Operator

Your next question comes from Johann Rodrigues from Raymond James. Your line is open.

Johann Rodrigues, Raymond James

Hey, guys. I had one quick clarification question first. Greg, in the letter on page one you have the chart there and it shows organic growth of 3.5%. I guess I was just wondering where that number came from.

Greg Stevenson, Chief Executive Officer

Yeah, if you look at that chart, you have Q4 2017 total portfolio NOI of $24,592 million, and then Q3 NOI is about 4% Q3 2018 NOI, so three quarters later our NOI is $255,551 million, so 3.9% higher.

Johann Rodrigues, Raymond James

So, is that your nine-month same-property NOI growth?

Greg Stevenson, Chief Executive Officer

It's the total portfolio.

Johann Rodrigues, Raymond James

Okay.

Greg Stevenson, Chief Executive Officer

Which is more how we think about it. Yes, because we were so acquisitive and obviously there's development. As a unitholder of the REIT you don't own a fractional interest in just the same property portfolio, you own all of them, we really view this as what is total NOI growing by. That number will, that same property store count will grow over time, but right now it's still 70% of the total portfolio, so we look at it holistically.

Robert Armstrong, Chief Financial Officer

The other way to kind of cut it is if you look over the last two years, six of the eight quarters have been positive NOI growth, and that's around 2%, but where you are really getting a lot of fast-paced growth is on the acquisition activity where there's some large gains being made right away, and that's not showing up in same store. You put those two together and it triangulates to what Greg's letter is talking about.

Greg Stevenson, Chief Executive Officer

That's exactly right.

Johann Rodrigues, Raymond James

Okay. That's helpful. 2018 has been quite a different year than 2017, you guys stopped the acquisitions ship, capital recycling was big for you guys, you bought back stock, so I'm wondering what the strategy is going into 2019 given that you guys are fairly levered up, the payout is still a little bit high, you're buying back stock, you can't really issue equity given the price, and then you just mentioned you think you'd be net acquirers, what's the capital allocation strategy for 2019? Like how do you fund that?

Greg Stevenson, Chief Executive Officer

I think part of it is our operating cash flow continues to grow, so that'll bring the payout ratio down. I think the payout ratio is artificially high right now driven by all the leasing that we have done. We do not anticipate capital to be 17%, 18% of NOI into perpetuity. That number we have used in our materials is probably closer to 10% and that probably starts to happen, meaning new capital probably starts to decrease back to normalized levels, Q2-ish of next year.

I think two things. One, we'll be patient, and two, as we talked about a bit earlier, there are assets in our portfolio that we have owned for eight years, we have done an exceptional job increasing value and I think there'll be capital recycling opportunities where we can take those, I'll call them very low-growth assets where the yield is fantastic but not a ton of growth left or upside probably in the cap rate, I think we can sell some of those assets and upgrade the portfolio. We are investing money into an environment where we think it's pretty attractive because you can effectively replace that yield with similar yield but a much higher-quality asset with more upside.

I think we will continue to think about ways to grow. I think we are creative people and it is something that we are not going to stop thinking about from an acquisitions perspective, but I think if we continue to be patient, it has been nine months so far, 2018, we may be looking at a different cost of capital even by the first quarter of next year.

Robert Armstrong, Chief Financial Officer

The growth on the leverage side, some of the leverage has popped up because of the buybacks, but this is a business that is spitting out about $60 million a year in FFO and we've got distributions of about $40 million on that. So that remaining $20 million, whether it goes to acquisitions or capital, that's accretive to NAV, in our view, and any capital we are spending on leasing and whatnot, as you'd obviously know, is growing value and creating additional NOI for us. We see a natural compression on the LTV that's going to probably have about 250, 300 basis points throughout the year because of that if cap rates stay stable, so we think plus that and the capital recycling, we should have the ability to be meaningfully acquisition focused in 2019.

Johann Rodrigues, Raymond James

Okay. My last question is just looking at U.S. peers, definitely this year they've started to bounce back a little bit in terms of operations, like rent growth or same property, and so I guess I was wondering where you guys think you'd slot in the group. Like obviously you'd be below like a Federal or a Regency. Will you be above Brixmor? Is that kind of how you view yourselves? Or in that group? Like from normalized same property for two or three years. You guys have had a bunch of kind of one-time items here and there over the last few quarters, I'd say probably half of the quarters since 2016, so that's kind of impacted same property, but on a normalized basis I think you guys mentioned 2%. Is that how we should be thinking about it for 2019?

Greg Stevenson, Chief Executive Officer

Yes, I certainly think for the next Q4, Q1, and Q2, as we talked about, you can understand the 2% from signed but not yet paying, the 2.7% from development, the growth there is pretty visible. After that, 2% is probably a fair number, particularly if we can continue to recycle into assets where we see leasing opportunities, et cetera.

I'll answer your question in terms of what, sophisticated REIT investors in the U.S. that I meet with tell me and where we sit and I would probably agree. I think that Brixmor is probably a very good comparable. I think where we are more attractive to those REIT investors from a purely capital markets perspective, ignoring the fact that I think we are better real estate operators and we have a site asset management machine that we are apart of and we have behind us that I think doesn't get talked about enough, I think that we are 86 assets, not 400 and something. We have a very good handle on every little thing that happens inside of our portfolio. It's easy to understand we're 75% neighbourhood strip centres. We have virtually no power centre exposure. You heard a million things about retailer restructurings. It's had virtually no impact on our results, which highlights really the asset class that we do own and the durability of our income. I don't think that's true for some of the large U.S. strip centre REITs. I think they have a lot more power centre exposure. I'm not sure they have a complete handle on their business plan because they do have a lot. These are very smart, talented people, so that's not a criticism; I just think that they're at a different stage of their business where they're still trying to figure out what they want to be when they grow up.

I think the other thing is we're 100% grocery anchored. There isn't a single REIT in North America that can say that and I think that's a huge differentiating factor when you think about risk-adjusted returns and where we're getting our income. I think that there is probably a countercyclical nature to that as well which proves to be defensive in a recessionary environment. I think those are the things that we get a lot of credit for but I would say that from a real estate, household incomes, demographics, locations, Brixmor is probably as close as you're going to get. But I would say from an asset class type we're probably more like ROIC in terms that we are a pure-play strip centre, neighbourhood strip centres as opposed to more community or power.

Johann Rodrigues, Raymond James

Okay. Thanks. I'll turn it back.

Operator

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

Your next question comes from Stephane Boire from Echelon Wealth Partners. Your line is open.

Stephane Boire, Echelon Wealth Partners

Good morning. Thank you. I just wanted to quickly push a little further on Johann's questions regarding capital allocation, if you don't mind. I was just wondering if you quantify the amount of capital recycling for next year.

Greg Stevenson, Chief Executive Officer

In the pipeline right now, which is what we have visibility on, it's probably $50 million. That number will change I'm sure as time passes, but right now we've identified $50 million. There are effectively two buckets. One is single tenant, generally quick service or bank outparcel where you get single tenant net lease REITs buying these things for below six caps, five caps, which is just an accretive recycling of capital for us and there's really nothing we can do with these outpads from a value perspective so we think that's a good trade. That would make up, let's call it half that bucket. And the other half is our properties, like I've said, that we've owned for a long period of time, we've executed on our strategy, we created the value, and we think we can take that money and put it into something with higher growth opportunities for the REIT.

Stephane Boire, Echelon Wealth Partners

Okay. And in terms of net acquisition, so on top of that, how much do you expect you will be able to acquire?

Greg Stevenson, Chief Executive Officer

It will probably be in and around that number. Maybe there is some capital that goes to paying down debt, maybe there's some capital that goes to buying back units, so it may be not the full amount of the sold assets, but somewhere close. It certainly probably won't be over and above that number. Bobby, I don't know if you have anything to add.

Robert Armstrong, Chief Financial Officer

No, I think that's fine.

Stephane Boire, Echelon Wealth Partners

Okay. Okay, that's good. Thanks. And just want to make sure I understand, so basically the buyback unit strategy is still on the table for next year.

Greg Stevenson, Chief Executive Officer

Yes – we are going to look at all different capital allocation opportunities and if there's a point in time where the REIT units look like the best investment we have, that's what we're going to do. If it turns out that we find an asset that we think is better at the time, we're going to do that. If we think paying down leverage is the right thing or increasing distributions or whatever it may be, we're going to allocate capital accordingly.

Stephane Boire, Echelon Wealth Partners

Okay. Okay, that's good. Thank you.

Operator

There are no further questions at this time. I turn the call back to Madeline Sarracini, Investor Relations.

Madeline Sarracini, Investor Relations

Thanks, everyone, for joining the third quarter 2018 conference call for Slate Retail REIT. Have a great day.

Operator

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