CORPORATE PARTICIPANTS

Braden Lyons
Investor Relations

David Dunn
Chief Executive Officer

Andrew Agatep
Chief Financial Officer

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to this Slate Grocery REIT First Quarter 2021 Financial Results Conference Call. At this time, all participants are in a listen only mode. After the speaker's presentation there will be a question and answer session. To ask a question during the session, you will need to press star, one, on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star, zero.

I would like to now hand the conference to your speaker today, Braden Lyons, Investor Relations. Thank you. Please go ahead, sir.

Braden Lyons, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q1 2021 Conference Call for Slate Grocery REIT. I'm joined this morning by David Dunn, Chief Executive Officer and Andrew Agatep, Chief Financial Officer.

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 the recent financial disclosure, including our Q1 2021 Investor Update, which is available now.

I will now hand over the call to David Dunn for opening remarks.

David Dunn, Chief Executive Officer

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

I would like to focus on three key factors that are positioning Slate Grocery REIT well to continue providing our investors with a strong total return investment. Number one, the durability of our cash flows and our actual pipeline for continued net operating income growth. Number two, the critical role that the neighborhood grocery stores play in the cost effective and timely fulfillment of the last mile of food logistics. And number three, the strong macroeconomic tailwinds in the United States.

First, on the cash flow durability and growth. Following Slate Grocery REIT’s record performance in 2020, including the best annual new and total leasing volumes since inception, our business continued to advance operationally in the first quarter of 2021. The REIT’s occupancy finished Q1 at 93.1%, 90 basis points higher than pre-pandemic levels, representing the fourth consecutive quarter of occupancy gains. We have over $2 million of committed base rent coming online in the next several quarters, which will further increase the REIT’s near-term cash flow.

Additionally, our new leasing pipeline is deep. Our team is working on more than 200,000 square feet of actionable new leases, a testament to the continued desirability of our portfolio, and grocery anchored real estate more broadly. I would also like to highlight a few of the creative initiatives our team is working on to enhance our existing revenue streams. In January, we entered into an agreement with 5G LLC, who we will partner with to lease out our rooftops to telecom providers. Businesses like Verizon, AT&T and Amazon will then install antennas on our rooftops to enhance their 5G infrastructure across the United States.

Perhaps the most compelling part of this opportunity is these long-term leases require zero landlord capital. We can execute leases with multiple providers per property. Each deal will contribute ~$30,000 annually, and we expect the program will produce cash flow in 2022. We are also actively evaluating other opportunities to further drive revenue growth through rooftop solar panels, underutilized common areas, pop-up shops and seasonal installations. These attractive opportunities are available to us because our assets are both highly visible and well located within neighborhoods in close proximity to the end consumer.

Second, on grocery fulfillment. Customer expectations are changing, and they are demanding access to their groceries faster than ever before. For example, Walmart is doing 1.5 million deliveries each and every week from their stores, which is seven times more than they were doing a year ago. In response, grocers are investing billions into automated fulfillment solutions. These investments are being made at or adjacent to their stores because the last mile is the most expensive component of the supply chain due to the cost of delivery and labor.

So, to be clear, despite the increase in online grocery shopping in the United States, from 4% of total grocery sales pre-pandemic to 10% now, the majority of these online sales are still being fulfilled through the neighborhood store to minimize the time and cost associated with the last mile.

Additionally, grocers are also investing in technology to incentivize in-store shopping, as this is where margins are the highest. A few examples of this are automated carts like the KroGO cart, mobile applications that allow customers to scan and pay for their groceries with their smartphone, as well as automated kiosks to support in-store navigation. Collectively, the growing investments in both automated fulfillment and the in-store experience illustrate the integral role neighborhood stores are playing in the future of grocery. They make our tenant relationships stickier and ultimately increase the value of our real estate.

Third, on macro-economic growth. In stark contrast to what is currently happening in Canada, life is approaching pre pandemic norms in the United States. The $5 trillion in government aid for both households and businesses, coupled with an impressively managed vaccine rollout have combined to increase consumer confidence and spending in the United States, ultimately resulting in three straight quarters of robust economic growth. The consensus view among economists is GDP growth will pick up further in the second quarter and remain steady in the second half of the year. These supportive macroeconomic tailwinds bode well for our business and provide us with further confidence that demand for our grocery-anchored real estate will continue to be strong in the coming quarters.

Finally, our strong operational performance throughout the pandemic enabled us to execute over $530 million of opportunistic and off market acquisitions since June 2020. Our most recent acquisition of 25 properties, which we expect will close in early Q3, represented a unique opportunity to purchase $390 million of grocery anchored real estate in a single transaction and highlights the value of the Slate Asset Management platform. 83% of the acquired portfolio's income is derived from the top 50 metropolitan statistical areas, including 46% from New York City and Dallas, two of the largest markets in America.

We continue to be pleased with the performance of our business in what has been a unique and challenging operating environment. We are fortunate to have a fantastic team at Slate Grocery REIT that brings unwavering passion and commitment every day to add value for both our business and our unitholders. On behalf of the entire Slate Grocery REIT team, we wish you and yours good health and we thank you for your continued support. I will now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

At this time, as a reminder, in order to ask a question, please press star then the number one on your telephone keypad. We will pause for a moment to compile the Q&A roster.

Your first question comes from Li Chen with IA Capital Markets. Your line is open.

Li Chen, iA Capital Markets

Hi, good morning, guys. A couple of quick ones from me. So, with the latest acquisition that is set to close in Q3, like you mentioned and with pro forma debt to gross book value at around 61%, I was just wondering if you can comment as to what we can expect on your pipeline for the rest of the year? Or are you going to focus more on reducing your leverage?

David Dunn, Chief Executive Officer

Hey. Good morning, Li. Look, we have proven to be prudent capital allocators over what has been a challenging period. We have been able to buy $530 million of quality, grocery anchored real estate at a basis well below what we think market is today. That most recent portfolio acquisition was at $127 per square foot. We think there is value in buying on a portfolio basis off market. And when you contrast that with what we are seeing from a sentiment standpoint, with marketed transactions in the marketplace, this real estate is undervalued. So, we believe our debt to gross book value comes down once we acquire this and put it on our books and go through our fair value process like we do every quarter.

Andrew Agatep, Chief Financial Officer

One thing I wanted to add, just to give context with this deal is, this was something that we were negotiating in the second half of 2020. Think of the sentiment then around COVID-19, the elections and the vaccine rollout. There were not many transactions around that time. And when we think about it now, the pricing for that deal would be very different today. Said another way, we acquired at a 7.8% cap, we think that there is value taking it inside to where we see our cap rate today, which is around 7% for our portfolio.

Li Chen, iA Capital Markets

That is great. Thanks. And just last one for me. Just regarding leasing spreads on new leases versus lease renewals. Going forward, do you believe this is the beginning of a return to a more usual trend that you are used to, where the spread on new leases is considerably higher than on renewals?

David Dunn, Chief Executive Officer

I certainly do. I will make a comment on spreads. We are coming off four quarters of record leasing, we did 1.7 million feet, which is 20% of our portfolio. There was just less leasing to do this quarter. We believe we are entering an environment now, where spreads and rents are going to go up. It is something we are talking about with our team these days. We worked with tenants throughout the pandemic, we limited rent increases to help the tenants we think are viable and will be around for the long haul.

So, we feel the environment is changing now, to where we can push spreads, there are good tenants out there. The $5 trillion of stimulus that has been injected from the feds, the vaccine rollout in America is strong and America is open for business. And tenants are doing well. So, we feel like we are entering an environment where we can push spreads and bring them at or above our historical run rate.

Li Chen, iA Capital Markets

That is great. That is it for me. Thanks, guys. I will turn it back.

Operator

Your next question comes from Pammi Bir, with RBC Capital Markets, your line is open.

Pammi Bir, RBC Capital Markets

Thanks and good morning. Just looking at same property net operating income, was down a bit, same property occupancy, was up rather meaningfully on a year over year basis. Can you help us understand that disconnect? And then secondly, given the committed leasing that is coming online, should we anticipate some better growth through the year?

David Dunn, Chief Executive Officer

Hey, Pammi, thanks for the question. On a trailing 12-month basis, our same property net operating income was positive, both with and without termination fees, 0.9% and 0.2%, respectively. So, we have been been successful with gaining traction in re-tenanting some of the premises that were vacated in 2020. That might be a bit of the disconnect that you are referring to, but our momentum surrounding our portfolio at the moment is extremely strong. Coming off that record leasing, we have $2 million of committed base rent. These are contractual leases that will pay revenue, that will be captured in our reporting in the next couple of quarters.

And then when I look beyond that, we have a deep pipeline of new leasing opportunities. Our team has in excess of 200,000 square feet, with quality credit tenants. On balance, the deals, they look like they are requiring less landlord capital. So, net effective rents will be strong. And we think we can execute on this new leasing pipeline, the majority of leases should be signed in the next four to six months. So, I am thinking about filling a further pipeline of net operating income growth beyond the $2 million of committed base rent that I just referenced.

Pammi Bir, RBC Capital Markets

Got it. Yeah, I was referring more so to the Q1, not the trailing 12 months in terms of same property. But I take it that given the leasing and committed space, it sounds like it should be trending positively over the course of the year. Just switching gears, looking at the portfolio write up this quarter, you mentioned stronger demand for grocery anchored retail that is pushing cap rates lower. You guys have been able to source deals at comparatively better pricing. So, I am just curious, was the gain based on transactions that you are seeing in the market, or at least the changes in your cap rate assumptions?

David Dunn, Chief Executive Officer

I certainly can. The desirability and sentiment for grocery real estate continues to increase. And as a result, so are values. There are two reasons for that, that we see. And as I referenced, the visibility and resiliency of the cash flow we have seen through the pandemic. Assets with a high percentage of grocery revenue and essential tenant revenue such as our portfolio, where more than 67% of revenue comes from essential tenants, are commanding a ton of interest.

When you layer on the capital markets understanding how grocers are going to deal with the surge in online shopping through their stores, automating micro fulfillment, it is creating a strong tailwind. During the pandemic, there were limited trades to support value increases, but that has changed now, the floodgates are open. Whether you are looking at one off deals in a given market that we operate in or nationally in terms of M&A activity that we have seen, they are all supportive of strong values.

I will make one final point as well, this is not only a North American dynamic, we are seeing it globally. Our team at Slate Asset Management is in the process of refinancing its grocery business in Germany. They are seeing extremely strong demand, a large number of debt partners are coming to the table, and it is producing very strong values as well. So, we see this more broadly, from a global standpoint. Capital is flowing to the last mile of essential food logistics all over the world.

Pammi Bir, RBC Capital Markets

Got it. And just thinking about the $390 million acquisition that you still have to close, it was negotiated in the back half of last year. Is there a possibility you may actually book a gain, based on what it might actually be worth once the transaction closes?

David Dunn, Chief Executive Officer

I think that is a fair assumption. Once we close, we will go through the typical process, our fair value rigorous discussion, going through net operating income and leasing assumptions, cap rates that are supportive of the values. And I will come back to that comment. We bought this portfolio for $127 a foot, half of the portfolio is located in Dallas and New York metropolitan statistic areas. That is not an entry point that you see very often into the number one and number four markets in America. So, it is fair to assume that there will be some gains booked once we close this deal. But time will tell, and we will go through the process in Q3.

Pammi Bir, RBC Capital Markets

Okay, just last one for me. On the rooftop antennas, as you rollout that program, possibly next year, what is your sense of the potential scope of that opportunity over the next one to two years?

David Dunn, Chief Executive Officer

I am optimistic that it will produce some meaningful net operating income growth and net asset value growth. Telecommunication company budgets were just approved in March of this year. The team internally that is running this process thinks there will be a strong take up. It will take a bit of time, that is why I am a little cautious on guiding towards when net operating income will flow.

But I want to make it clear. There are half dozen telecom providers, some traditional some non-traditional, such as Google and Facebook. We can do multiple antennas on each roof. You can produce $30,000 a year times two, times three, times four, depending on the number of service providers. So, you can do the math. If we can get a take up of 10% or 15% in the first year, I think it can produce hundreds of thousands of dollars of income for zero capital. But it is just a matter of exactly when that happens.

What we are doing now with ancillary revenue is, we are being smarter. We are partnering with people who can take this portfolio wide. We have tried ancillary revenue in the past with our team. It is hard to talk multi-market with these folks. So, we think we found the right partner. They are excited and they think it will produce some returns, we are just going to have to be a little bit patient.

Pammi Bir, RBC Capital Markets

Thanks very much. I will turn it back.

Operator

Your next question comes from Himanshu Gupta with Scotiabank. Your line is open.

Himanshu Gupta, Scotiabank

Thank you and good morning. So, just on rent collection, how is it trending in the month of April and May so far. And with the vaccination rollout much ahead in the U.S., are you starting to see an uptick in the collection, as you get to reopening, and as we see more vaccinations rollout?

Andrew Agatep, Chief Financial Officer

Hey, Himanshu, it is Andrew. Collections continue to trend positively around 96%. We are seeing, even a slight uptick in collections since the start of the pandemic. We are now averaging around 97%, so it is very close to pre-pandemic levels. Just to give context, our operations in the U.S. are very different from what we are seeing in Canada. Most of our tenants, close to 100%, have been open since August.

Another way to think about that is with our deferral program. Strategically, we entered into $1.3 million of deferrals in early Q2 of last year. We are now 96% through that program, and we have $42,000, which is a drop in the bucket, of what we need to collect on in the remaining two quarters. So, I would say the sentiment in U.S. and our operations are different, they are performing well, and we expect cash collections to continue, 96% and plus.

Himanshu Gupta, Scotiabank

Got it. And then, maybe, can you comment on the leasing environment, specifically, with respect to the small shop tenants? What are you seeing there over the next six to 12 months, as the stimulus program winds down, do you see any impact on your tenants? And anything coming to you in the near term?

David Dunn, Chief Executive Officer

Hey, Himanshu, nice to hear from you today. Generally speaking, in the market, tenant activity is strong. We are seeing it in all different tenant uses and classes. But two key themes are coming through right now. Number one, essential tenants who have performed well during the pandemic, they are taking advantage of opportunities to add scale and presence in growth markets. And in the right asset, there are availabilities coming up for lease, just by virtue of the turnover through the pandemic.

So, we are seeing tenants, such as do it yourself companies, tool companies, pet shops, medical tenants, etcetera, taking advantage. We did two deals with essential tenants this quarter to backfill recently vacated, junior boxes.

The next trend is unique. And it speaks to the rebound in the U.S. economy. We are seeing restaurants who are both big and small take advantage of second-generation restaurant infrastructure that has been recently vacated. You can save $100 per square foot if you find a second-generation restaurant.

And they are making a move now because of the government stimulus. People are going out for dinner more, people are spending this money at their discretion. OpenTable came out last week and said seated dining has returned, based on their data, to near pre pandemic levels. And retail spending was up 9.8% in March. So, people are getting out and spending and I think entrepreneurs and quick-serve restaurants of the national variety are taking advantage. So, we are seeing strong leasing velocity across the spectrum.

Himanshu Gupta, Scotiabank

Good. That is helpful. And maybe last question on valuation. Obviously, you adjusted your IFRS cap rate down to 7%. So, my question is, how do you see appetite for portfolio transactions in the market today? Over the past few years, we have seen private, local capital being available for one off assets. So, is the appetite returning for portfolio transactions as well?

David Dunn, Chief Executive Officer

I think it is fair to say, yes, there is an appetite for portfolio transactions. We were able to do three of them in the last nine or 10 months. All of them were off market and of the opportunistic variety. We are probably not going to see screaming deals like we have seen, especially the $90 million acquisition we made last year. I think the cat is out of the bag in that respect. But what I will say is, when you do creative deals, it attracts other market participants who want to do creative deals.

So, we are getting inbounds from a variety of our peers in America that want to do business with Slate Grocery REIT and Slate Asset Management, so we continue to be active, looking at opportunities. And we are going to, as I said earlier, allocate capital as prudently as possible. So, if I can get a double digit return on spending money organically to grow my redevelopment pipeline or to lease up space in our portfolio, we will look at that, as well as we will look at future growth opportunities by acquisition, if they are compelling.

Himanshu Gupta, Scotiabank

Got it. Thank you, guys, very helpful. I will turn it back.

Operator

Again, to ask a question, please press star then the number one on your telephone keypad.

Your next question comes from Sumayya Syed with CIBC, your line is open.

Sumayya Syed, CIBC

Thanks. Good morning. Just some more follow up on the fair value discussion and potential moves post the quarter. David, do see your cap rates moving even lower, and specifically reflecting the recent large M&A transaction?

David Dunn, Chief Executive Officer

So, at this point in time, we are happy with where cap rates are. They have come in commensurate with market demand and values over the last six months. With that said, we feel there is a lot of leasing we are doing, there is a lot of improvement of our merchandising within our shopping centers with credit tenants. And when we continue to execute on our leasing strategy, we re-tenant some of the vacancies that we are tracking. I referenced 200,000 square feet of quality, new leasing opportunities. I would expect that cap rates could potentially continue to come in.

Again, we are only four plus months into 2021. Investment activity is strong. There is definitely a catch up coming from the muted activity in 2020. And all that we have seen so far, they are supportive of the fact that our portfolio was undervalued in the past, and it is coming back in line. So, overall, the market is strong and we plan on continuing to take advantage of the opportunities while we can.

Sumayya Syed, CIBC

Right. And then in the pending portfolio acquisition, is there any low hanging fruit you could address in the near term, as you work the assets towards stabilization? And then what do you expect for overall timelines to get that portfolio fully stabilized?

David Dunn, Chief Executive Officer

I think there is a lot of opportunity. We have been meeting with our joint venture partners over the last couple of weeks getting to know them, integrating our approach and our data with theirs. They are saying the same things that I am saying on this call about the velocity of leasing and the quality of tenants. The portfolio we bought was only 90% occupied. We did not underwrite any material occupancy gains until year three. And I can tell you that, in aggregate, our three JV partners have about 150,000 square feet of leases they are working on right now, to likely be signed in and around when we close.

And all of that would be considered “gravy” to our underwriting. So, when we looked at approximately 4% accretion at underwriting, we still have to get these deals done, but we have reason to be optimistic that we can exceed that as we get in and work shoulder to shoulder with our new partners to take it to the next level.

Sumayya Syed, CIBC

Okay, so three years could be on the conservative side?

David Dunn, Chief Executive Officer

I would suggest so.

Sumayya Syed, CIBC

Okay. And you also spoke about the evolution of micro fulfillment centers. Are any of your tenants exploring incorporating this model in any of your assets?

David Dunn, Chief Executive Officer

That is a great question. So, the answer is yes. The ones that are leading the charge are Walmart, Kroger and Ahold Delhaize. The CEO of Walmart came out in February as part of their investor day and said they are going to spend about $15 billion to start scaling local fulfillment, which could be otherwise known as micro fulfillment. They are going to start in Benton, close to their head office, and in their major markets, gateways and then move towards us.

But what I will note, Sumayya, is already today, 98% of our grocery anchors are providing omni-channel solutions, regardless of this automation. So, they are providing delivery service from their stores, and click and collect from their stores. So, it is already there, they will just add a bit more of a technological enhancement in time.

Sumayya Syed, CIBC

Great. Thank you.

Operator

There are no further questions queued up at this time. I will turn the call back over to Braden Lyons.

Braden Lyons, Investor Relations

Thank you everyone for joining the Q1 2021 conference call for Slate Grocery REIT. Have a great day.

Operator

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