CORPORATE PARTICIPANTS

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Investor Relations

David Dunn
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CONFERENCE CALL PARTICIPANTS

Li Chen
iA Capital Markets

Himanshu Gupta
Scotiabank

Sumayya Syed
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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Slate Grocery REIT Second Quarter 2021 Financial Results Conference Call. At this time, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. To ask a question during this session, please press star one on your telephone keypad. Please be advised that today's conference is being recorded.

I would now like to hand the conference over to Jennifer Pyper, Investor Relations. Please go ahead.

Jennifer Pyper, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q2 2021 conference call for Slate Grocery REIT. I am 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 of the REIT's financial disclosure, including our Q2 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, Jennifer, and thank you to all the participants for joining the call this morning. While the last 17 months certainly presented us all with novel challenges, there is no doubt that there are positive takeaways for our business as the pandemic fades further into the rear-view mirror in the United States. Both the public and private markets' view of the grocery industry has changed, and for the better. It is now clear to all that grocery-anchored real estate, due to its critical nature and cash flow durability, should be viewed as an asset class that is differentiated from broader retail.

First, I will touch on some recent trends within the grocery industry. Mobility data from Apple shows us that Americans are walking and driving around this month at the highest levels since the pandemic began and their usage of various modes of public transportation has returned to 2019 levels.

Even in a post-pandemic environment, America's largest omnichannel grocers, who are also our largest tenants, continue to perform extremely well. Grocers have introduced a new metric that they are calling two-year stack sales to compare their current year comparable sales versus pre-pandemic levels. On that basis, the two-year stack sales metrics for the most recent quarter for Walmart, Kroger and Ahold Delhaize were up 16.0%, 14.9% and 15.5%, respectively. And all three grocers increased their full-year 2021 financial guidance. Put simply, grocers continue to experience elevated sales levels, and there are broader trends in the food industry that give us conviction this will continue.

The Food Industry Association recently completed a study identifying several interesting trends that point to grocers further increasing their share of wallet on food and essential spend. Number one, post-pandemic, people are more likely to cook at home for reasons associated with health, wellness and cost savings. Two, people are keeping higher inventories of food and essential items on hand at home. Three, American households are spending more on groceries now than they did before the pandemic with 2021 weekly grocery spend up 17% versus 2020 and up 26% versus 2019.

These positive tailwinds will support continued capital investments by grocers in both their in-store infrastructure and their last-mile fulfillment networks, which will, in turn, make our tenancies stickier and our real estate more valuable.

Next, I will touch on our strategic acquisitions. We are on track to close our transformational 25-property acquisition in Q3. We have been working with our new joint venture partners since the transaction was announced in March. Our partners have already completed more than 65,000 square feet of new leasing with an incremental new leasing pipeline of roughly 60,000 square feet. These deals can add up to $1.7 million of annual base rent and more than 250 basis points of occupancy, both of which represent improvements relative to our initial underwriting.

For our $90 million portfolio acquisition completed in June of 2020, Slate's hands on asset management approach has similarly enabled us to outperform the assumptions we made during due diligence, including: year one occupancy is up 360 basis points to 93.5%. Year one net operating income is up $900,000, which is equal to 11.6%. The projected IRR over the five-year hold period increased by 500 basis points to 21.5%.

We are proud to have opportunistically acquired more than $540 million of quality grocery-anchored real estate over the last 13 months. These acquisitions will support further net asset value and net operating income growth for the REIT, creating a compelling total return investment opportunity when combined with the upcoming organic growth within our existing portfolio.

Lastly, I will speak to our organic growth and ancillary revenue initiatives. Our portfolio's strong performance continued in the second quarter. Occupancy increased for the fourth consecutive quarter and now sits at 93.2%, representing a 100 basis point increase since the onset of the pandemic. Two anchor leases commenced rent payment in the quarter, and two more are scheduled to come online in the second half of the year. The rent from these tenants and other recently completed lease deals will contribute $2.3 million of base rent in the second half of the year. Our team is also in the process of finalizing more than 90,000 square feet of new lease deals, which we expect will be executed within the next 30 days.

Looking back, spreads on nearly 100,000 square feet of new leases completed thus far in 2021 have been a strong 10.5%. We are focused on completing deals with more essential tenants and have achieved net effective rents that are 10% to 15% above historical levels, meaning we are spending less capital to complete a lease transaction in today's marketplace.

Finally, we are making solid progress on our ancillary revenue initiatives that we introduced last quarter. Since the beginning of the program earlier this year, we have already executed contractual agreements that will generate $300,000 of net operating income on an annualized basis at no cost to the REIT. We are continuing to build out these initiatives and are targeting $750,000 and $1 million of recurring annualized net operating income by 2022 and 2023, respectively.

In closing, we are pleased with the state of our portfolio and the strengthening fundamentals within the grocery-anchored sector as we put the pandemic behind us and drive our business forward. I continue to be grateful for the significant efforts put forth by our team at Slate Asset Management, and I am excited to create additional value for 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

Thank you. As a reminder, to ask a question, please press star one on your telephone keypad. To withdraw your question, press the pound key. Please stand by while we compile the Q&A roster. And your first question comes from Li Chen of iA Capital Markets.

Li Chen, iA Capital Markets

Hi, good morning. My first question is regarding rising cases of COVID from the Delta variant. Vaccination rates have slowed down in the U.S., and more and more it seems that COVID could either become endemic or a seasonal thing, so just in regards to your nonessential tenants that are more sensitive to restrictions, in the U.S. this seems to be more of a contentious subject, but have you had conversations as to how they would balance public safety and the freedom of choice regarding wearing a mask or social distancing?

David Dunn, Chief Executive Officer

Hey, Li, good morning. Thanks for your question. Our team is reading the same things in the news. It is just simply not translating to an impact on our business. We were good partners with our tenants 18 months ago when the pandemic was first announced, and we worked together, and we found a way to manage our respective businesses effectively. And right now, the economy in America is booming. GDP growth, they are looking at 9% annualized growth in 2021. Different states are approaching masks and the pandemic differently, but as it relates to our business, we do not see any challenges or concerns today, and we think America will sort it out just as they did effectively 9 to 12 months ago.

Li Chen, iA Capital Markets

Oh, that is great. And just last one for me, regarding your ancillary revenue program, I know it is still early, but can you comment on what the long-term percentage target would be? Do you believe that could be a significant driver or contribute significantly more than 1% to your NOI?

David Dunn, Chief Executive Officer

We do. So right now, we are very pleased with the progress we have made. We had high hopes for this program as it has materialized over the last six months, but frankly, even management is impressed with the contractual revenue we have generated to date. We felt the two drivers of ancillary revenue were going to be 5G and solar panels on rooftops, 5G being installation of antennas with telco providers, including AT&T, Verizon, Google, Amazon, etc. and we have not done any of those deals yet, and we are already honing in on $600,000 of annualized revenue. We felt compelled to talk about some targets, and $1 million in 2023 is north of 1% on an NOI compound annual growth rate.

The nature of these deals will be recurring, and we feel that we can compound that and grow it over time. Right now, we are comfortable with the $1 million target in 2023, and we will be assessing as we continue to make progress.

Li Chen, iA Capital Markets

That is great to hear. That is it for me. I will turn it back. Thanks.

David Dunn, Chief Executive Officer

Thank you.

Operator

And once again, if you would like to ask a question, press star one. And your next question comes from Himanshu Gupta of Scotiabank.

Himanshu Gupta, Scotiabank

Thank you, and good morning. So just first one, rent collections. How is rent collections trending in June and July so far, and are there any categories of tenants which are still not paying?

Andrew Agatep, Chief Financial Officer

Yeah. Hey, Himanshu, it is Andrew. Thanks for the question. Our collections continue at the same pace that we have seen since the start of the pandemic, which is about 97%. It is kind of creeping up higher than what we have seen. Most of our tenants remain in operation and continue to pay, I would say some of the restaurants is where we see a bit of the slow payers, but for the most part, our collections continue to be strong.

Just with reference to our deferral program, as we are on this topic, we are now done. It is about $1.2 million that we have entered into since the start of the second half of last year, and since this quarter we have now completed it. So, to speak to David's point, there is positive sentiment around the U.S.. Operations are running smoothly and we continue to collect on rent.

Himanshu Gupta, Scotiabank

Okay, thank you. So, I am assuming that the restaurants and fitness tenants are back to pre-pandemic or closer to normalized collections now.

David Dunn, Chief Executive Officer

Yeah, gym operators are back open. They have been open since late last year. And we are seeing macro trends with retail spending, foot traffic, seated dining at restaurants in excess of 2019 levels. There is no COVID accounts receivable that we are dealing with. As Andrew described, we are 100% collected on the deferrals that we entered into.

If there were an area where we are working with tenants, it would be in the larger restaurant, the 5,000-square-foot-plus restaurant space. We have a limited exposure to them. There are a handful of them. They are catching up on rent that may have been lagging even pre-pandemic, and we are confident that we have addressed our bad debt provisioning appropriately. I will note that the last two quarters it has been at or below our historical run rate, we feel like provisions have been adequately provided for, and we do not foresee any major swings from what we have been seeing recently

Himanshu Gupta, Scotiabank

All right, that is helpful. And then turning to the leasing environment for small shop tenants, obviously we are hearing about an economic rebound. You mentioned about almost 9% GDP growth, as well. Is all the economic rebound translating into better leasing environment, as well, from the landlord perspective?

David Dunn, Chief Executive Officer

Since January, we have seen a robust leasing environment. I spoke a little bit last quarter about the types of deals. We are seeing essential tenants taking advantage of recently-vacated premises to maybe upgrade a position in a trade area or to add scale, maybe open a new store.

We have been the beneficiary of that. There is no doubt, Himanshu. So that is the larger tenant set. As it relates to smaller tenants, they are also doing deals. I cannot point to one specific trend, but restauranteurs, entrepreneurs are seizing the moment and opening restaurants. There is $5 trillion of stimulus in the marketplace right now from the Fed. That is helping, for sure, and unemployment is improving.

One point I want to make is a trend that Morgan Stanley came out with in a report a couple months ago forecasting up to 30% of enclosed malls may close in the coming years. There are viable tenants in these malls, and strip centers with strong positions in the trade area with good anchors stand to benefit. And if you are a mall tenant leaving to go find another location with a more vibrant tenant mix, in all likelihood you are paying more rent at an enclosed mall.

You can come to a strip center and get higher visibility. You get signage on the street and above your front door, and you can have your customers park directly in front of the store. All of these are compelling in our mind, and we believe that this type of trend will drive future new leasing velocity for Slate Grocery REIT.

Himanshu Gupta, Scotiabank

Got it. Okay, that is helpful there. And then just turning onto the acquisition side, how is the acquisition pipeline looking, and what are you seeing in terms of valuation or capital trends in the near term?

David Dunn, Chief Executive Officer

We are always looking out for deals that are mispriced in the market. Whether we are buying deals on a portfolio basis from another REIT who is wanting to own a joint venture, or we are buying a business from a market participant like Annaly, we have been very creative in sourcing deals, and they are mispriced based on the purchase price.

Sentiment in the market right now has probably never been stronger for stabilized grocery-anchored real estate. And across America, but specifically in the Southeast. I will point you to several transactions that speak to strong demand and increasing values. And we have talked about this in the past, but obviously Kimco Weingarten, which is a mid-five cap transaction, PECO, which is Phillips Edison Company just IPO-ed and they’re about $1 billion market cap, at $175 a foot, which is higher than our $144 price per square foot.

And the most compelling trade, the most like our portfolio, is a BentallGreenOak portfolio that is in the market right now. Ten assets; many of the trade areas and markets overlay with the Slate Grocery portfolio, $500 million. Guidance was a mid-five cap. And what we are hearing from brokers and on the street is that activity has been very strong, and interest has been strong, and the expectation is that it will trade inside of a five cap.

So, all those are examples of strong velocity and interest in grocery-anchored strip centers, and we like where our position is today, certainly.

Himanshu Gupta, Scotiabank

Awesome. Thanks for finding all those transactions, and especially BentallGreenOak, which is in the market. And then maybe just the last question from a timing perspective. When do you close the Annaly transaction? I know you mentioned Q3, but do you have any sense of more precise timing there from a modeling perspective?

David Dunn, Chief Executive Officer

Right, you probably saw the press release on Monday. The other component of the transaction closed. They were always separate and distinct, and we are going to close at a different time. So, from our standpoint, Slate Grocery REIT is ready to go. The nuance with our bucket of assets is it requires consents from CMBS lenders, and that historically takes a little longer. So, we are confident it will close in Q3, very confident, and we are hopeful it is August. But again, we are working diligently with the lenders. But to a certain extent, they will dictate the speed at which we close.

Himanshu Gupta, Scotiabank

Thank you. All the best for the closing of that transaction, and thank you so much, and I will turn it back.

Operator

Thank you. Your next question is from Sumayya Syed from CIBC.

Sumayya Syed, CIBC

Thanks. Good morning. Just on the pending portfolio acquisition, obviously you achieved some occupancy gains there. Is there still some upside there remaining in terms of occupancy, and if so, when do you think you can get there?

David Dunn, Chief Executive Officer

Good morning, Sumayya. Thanks for your question. Our year-one occupancy for the Annaly 25-asset transaction was just a shade under 90%, so lots of legs to add value at occupancy. We did not assume any occupancy gains until year three, so to have already secured a few hundred basis points lift in occupancy, which is obviously adding NOI before we even close is a very good place to be. We have been working with, since virtually the day after we firmed up the transaction, our new JV partners.

As I have alluded to in some of my messaging, we really enjoy working with them. They are like-minded. They are strong operators. And they have been very open in sharing information with us. And we do transactions in a similar manner. So yes, we think there is incremental legs to grow it. And we are going to be tracking our performance specifically relating to underwriting on the $540 million of acquisitions we have made in the last 13 months, and we will be pleased to update the market every so often. But the answer to your question is absolutely yes. We are striving for 95% occupancy, which would be a stabilized basis.

Sumayya Syed, CIBC

Okay, looking forward to the updates. And then on the Glenlake acquisition that is at a discount to replacement cost, so on a stabilized basis, what would that valuation now look like?

David Dunn, Chief Executive Officer

I will make a few comments on that. It pales in comparison to the portfolios we have purchased. A single asset at $8.5 million, but we love this deal. It furthers our relationship with Kroger, who is a valued partner for Slate Grocery REIT. Sale leaseback transaction in Indianapolis MSA, which is the 31st largest MSA in America. The basis is $81 a square foot and the occupancy is 85%. So, I think of this deal as, call it an older school Slate Grocery REIT transaction where we can add real value in lease up and stabilizing occupancy, and we know we can do that because Kroger had a change of their strategy, and they were letting leases expire in order to reposition the asset. So, there is going to be interest from co-tenants with the new 15-year Kroger lease, and when they reposition their store, we believe we can partner with them to drive value for the asset and lease it up expeditiously.

Sumayya Syed, CIBC

Okay, and then you touched on the Kroger relationship. I do not know how much you can comment on their strategy, but what does that pipeline look like in terms of opportunities for Slate?

David Dunn, Chief Executive Officer

We talk to our key tenants on a regular basis, but we make a point of going to see in person our biggest grocer tenants. That builds relationships. It builds trust. And we are looking forward to continuing to grow with Kroger. I am not going to speak to their strategy. That would not be appropriate. But I can say that if there are opportunities to grow together, we believe we are going to get an opportunity to do so. We have been able to secure these types of deals with other tenants, not only Kroger in the past, and we have been focused on transformational growth, off-market portfolios. But there is always going to be an opportunity to talk to our key grocers and expand our relationships with them.

Sumayya Syed, CIBC

Great, thank you.

Operator

Thank you. We have no further questions at this time. I will now turn the call over to Jennifer Pyper for any additional or closing remarks.

Jennifer Pyper, Investor Relations

Thank you, everyone, for joining the Q2 2021 conference call for Slate Grocery REIT. Have a great day.

Operator

Thank you. This does conclude today's conference call. You may now disconnect.
