CORPORATE PARTICIPANTS

Blair Welch
Chief Executive Officer

Andrew Agatep
Chief Financial Officer

Connor O'Brien
Managing Director

Paul Wolansky
Senior Vice President, National Sales and Investor Relations

Allen Gordon
Senior Vice President

Braden Lyons
Vice President

CONFERENCE CALL PARTICIPANTS

Brad Sturges
Raymond James

Gaurav Mathur
IA Capital Markets

Munish Garg
Laurentian Bank Securities

Sairam Srinivas
Cormark Securities

PRESENTATION

Operator

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

At this time, all lines are in listen-only mode, and following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star-zero for the operator. This call is being recorded on Thursday, May 4th, 2023.

I would now like to turn the conference call over to Mr. Paul Wolansky. Please go ahead.

Paul Wolansky, SVP, National Sales, Investor Relations

Thank you, operator, and good morning, everyone. Welcome to the Q1 2023 conference call for Slate Grocery REIT. I'm joined this morning by Blair Welch, Chief Executive Officer; Andrew Agatep, Chief Financial Officer; Connor O'Brien, Managing Director; Allen Gordon, Senior Vice President; and Braden Lyons, Vice President.

Before getting started, I would like to remind participants that our discussion today may contain forward-looking statements, and therefore we ask you to review the disclaimers regarding forward-looking statements as well as non-IFRS measures, both of which can be found in management's discussion and analysis. You can visit Slate Grocery REIT's website to access all of the REIT's financial disclosures, including our Q1 2023 investor update, which is now available.

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

Blair Welch, Chief Executive Officer

Thanks, Paul. Our grocery-anchored real estate portfolio continues to demonstrate strong performance in today's high interest rate, inflationary environment.

Market fundamentals in the grocery-anchored real estate sector are favorable. The availability of neighborhood retail space is at historic lows in the U.S., and the cost of construction remains high.

These conditions make our tenancies sticky. The cost for our tenants to relocate or build new is prohibitive. This dynamic also gives landlords leverage to increase asking rents.

For Slate Grocery REIT, the weighted average rent across our portfolio is well below market at $12.24 per square foot. We are well positioned to grow through steady increases to our below market rents, which will, in turn, drive sustained valuation increases for our business.

Our leasing performance in Q1 demonstrates the embedded growth in our portfolio. We completed 590,000 square feet of total leasing at attractive spreads that drove up occupancy and revenue growth. New deals were completed at 17.1% above comparable average in-place rent, and renewals at 8.4% above expiring rent.

Our new leasing drove a 50-basis point occupancy gain from the 2022 year-end. Occupancy at the close of the quarter was 93.7%. As a result of our strong leasing momentum, same property net operating income increased by 3% year-over-year.

We also enhanced the REIT's financial flexibility and balance sheet to create liquidity for continued accretive growth. In Q1, the REIT closed a $56 million mortgage loan with a 2033 maturity. We used net proceeds from the loan to pay down the REIT's nearest term debt maturity in 2023. Post refinancing, the REIT has no remaining debt maturities in 2023.

We have also repurchased over 240,000 units at a 30% discount to the REIT's net asset value, which provides the REIT with additional liquidity.

We believe the disruption and dislocation we are seeing in the broader market will create attractive buying opportunities for the REIT. We continue to underwrite well-located grocery real estate, anchored by strong grocers at below-market rents.

The REIT's partnership with Slate North American Essential Fund provides a source of private equity capital in addition to the REIT's public funding strategies. This allows us to be nimble in today's environment. We are well positioned for growth, and we will continue to allocate capital strategically in ways that are accretive for the REIT.

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

Operator

Thank you. Ladies and gentlemen, we'll now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will then hear a three tone prompt acknowledging your request, and your questions will be polled in the order that they are received. Should you wish to decline from the polling process, please press the star followed by the two. And if you are using a speakerphone, please lift the handset before pressing any keys. One moment, please, for your first question.

And your first question comes from Mr. Brad Sturges from Raymond James. Please go ahead.

Brad Sturges, Raymond James

Hi. Good morning.

Blair Welch, Chief Executive Officer

Morning, Brad.

Brad Sturges, Raymond James

Starting on the IFRS value change, as you made a small adjustment, can you walk through what was driving the change on the IFRS value? Is that tied to internal assumptions, or are you tying that to transactions you see in the market?

Blair Welch, Chief Executive Officer

Yes, it's a little bit of both, Brad. We feel really confident in our valuation, and it was a little change.

We have below market rents, and when we compare our rents to our peers, we are below them. We also feel that we have a conservative cap rate. Put another way, we are in a positive leverage territory at our IFRS value rewards investors. We feel comfortable that our assets would trade at that value.

As a management team, that's what we try and always do. Do we think we could value our portfolio with this, and we think we're being fair? I know in the market it's challenging right now, but the team has done a really good job of showing that we can finance assets, like we did with the Life Co financing of $56 million where that was done in the mid 5%'s.

I think it all holds together. We don't anticipate significant changes going forward because of our below market rents and how we're seeing rental growth.

Brad Sturges, Raymond James

Okay, the adjustments were broad based across the portfolio. But it sounds like you're starting to see some pickup in transaction activity that allowed for some of those tweaks as well.

Blair Welch, Chief Executive Officer

Yes. Obviously, we do use third party appraisals, so there's a lot of data points. I would say investment activity has been subdued, but there are some.

What we try and do, is we see where financing is. We see what's happening. There haven't been many.

Perhaps in the tail of 2023, given refinancings, there might be more visibility.

But what we want to do is focus on the cash flow this company throws out, the below market rents, and the occupancy. That's how we look at it. We put it all together, work with appraisers, work with our auditors, and we're in the market all the time, so we're just trying to reflect that in our IFRS NAV.

Brad Sturges, Raymond James

Okay. Switching gears to on the leasing side, good start to the year in terms of the renewal and the new leasing spreads that you're achieving. How should we think about the type of spreads you can get for what's coming? What's rolling over for the rest of the year? And for grocery-anchored renewals, has there been much change in terms of the TI packages required for a longer term deal?

Allen Gordon, Senior Vice President

No, we're not seeing much change on what is required from the grocery boxes. We see things being pretty consistent moving forward on our small shop space as well.

Blair Welch, Chief Executive Officer

We would love to have more space to lease, let's just say that.

Brad Sturges, Raymond James

And in terms of spreads you're expecting, could we see similar blended spreads for the rest of the year, or was there something specific in Q1 that was driving some of the spreads you realized?

Allen Gordon, Senior Vice President

I think we see those remaining pretty consistent.

Andrew Agatep, Chief Financial Officer

Yes. Historically, we've had leasing spreads within this range, so it's nothing unusual, 6% to 10% since inception. Thinking about having limited availability in the market and demand for our spaces, we're going to continue to drive positive spreads in the future.

Brad Sturges, Raymond James

Yes, sounds good. I'll turn it back. Thanks.

Blair Welch, Chief Executive Officer

Thanks, Brad.

Allen Gordon, Senior Vice President

Thanks, Brad.

Operator

Thank you. And your next question comes from Gaurav Mathur from IA Capital Markets. Please go ahead.

Gaurav Mathur, IA Capital Markets

Thank you, and good morning, everyone.

Blair Welch, Chief Executive Officer

Good morning, Gaurav.

Gaurav Mathur, IA Capital Markets

On the tenant base, with the ongoing Albertsons/Kroger merger, do you foresee any store reductions across the portfolio?

Blair Welch, Chief Executive Officer

When we look at this merger across the entire space, we don't see it impacting real estate values for many reasons.

But moreover, we look at it as Kroger and Albertsons are going to be forced to sell assets in markets that they like, but that's a competition thing. I think what they're really trying to do is protect one of their competitors to getting access to these locations, either cheaper rent or cheaper price, where they can all be price competitive in the grocery business.

They're actually playing defense. With that merger, they are forced to sell some assets, and there are not that many, and they don't want to give them away to a competitor.

There hasn't been much chatter as of late. They have until 2024, next year, so there's still some time. And we are still renewing leases and it's business as usual with both tenants. I'll pass it on to the team for some more color there.

Connor O'Brien, Managing Director

In terms of the SGR total exposure, it's quite limited. We did an analysis as soon as the announcement was made, and there are roughly 15 stores where there's Albertsons and Kroger overlap within a five-mile radius, which is quite substantial distance in terms of catchment area for the competition.

Most importantly, what we really see limiting our downside is the low in-place rents that these tenants have. If they're determining which center they're going to stay in regarding closure, they're going to look at what rent they're paying. And the average rent for both the Kroger and Albertsons within this overlap is around $8.00 per square foot.

We find ourselves really comfortable with that rent basis, and it gives us a lot of optionality and negotiating power with these tenants going forward.

Gaurav Mathur, IA Capital Markets

Okay, great. Switching gears on capital allocation, we saw the NCIB usage added to the cash flows. How are you thinking about capital allocation going forward between the NCIB acquisitions and the development pipeline?

Blair Welch, Chief Executive Officer

Yes. It's something that we are continuously reviewing, whether we buy an asset, redevelop an existing asset, or use liquidity to buy back our own stock if we think it's at a discount. We're always talking to our Board about all three of those, because the market is always changing, and we're in the market looking to buy and we're in the market developing our assets, and we're trying to create the best return for all unitholders.

It's going to be a bit of both, or all three, but it's more fluid than that. There was a question from Brad, which is a good one, on our IFRS NAV. I feel 100% confident in that value at our rents. If we're trading at a discount to that, that's pretty compelling, because we have a good team, we know all the assets. If you can get a good return, that might be a good investment.

It's something we're always talking to our Board about, Gaurav, and it'll change quarter to quarter.

Gaurav Mathur, IA Capital Markets

Okay, great. Staying on the cash flow theme, we also noticed the uptick in the AFFO payout ratio. Is there a certain range which you're targeting for 2023?

Andrew Agatep, Chief Financial Officer

Yes. Slight uptick in our payout ratio is simply because we had dispositions last quarter, which is fully baked into this quarter. We have liquidity there which we look to deploy later in the year.

In terms of where we see payout ratio heading towards, it's positive. There is a lot of leasing activity that we see, which is good, so occupancy is expected to tick up, but in turn, we think the payout ratio is going to go down.

Gaurav Mathur, IA Capital Markets

Okay, but you wouldn't be comfortable in giving some guidance on that at this time?

Andrew Agatep, Chief Financial Officer

Yes, we're targeting around mid 90s.

Gaurav Mathur, IA Capital Markets

Okay, perfect. On your comment on occupancy, any guidance towards where you think occupancy will be by the end of the year?

Blair Welch, Chief Executive Officer

Higher. The team did a good job of buying assets that had low occupancy compared to the market, and that was a strategy. In some of the specific portfolios, the team's done an excellent job increasing that occupancy, which gives the portfolio wide occupancy gains.

I think we'll continue to gravitate towards the mid 90s over time just because of the demand. However, we've never seen a leasing market this strong, and we want it to last forever, but it usually never does. I would say we're pretty confident that it will continue to uptick, and we're trying to get to that mid 90 range as quickly as possible.

Gaurav Mathur, IA Capital Markets

Okay, great. Thank you for the color, gentlemen. I'll turn it back to the operator.

Blair Welch, Chief Executive Officer

Thanks.

Operator

Thank you. And your last question comes from Munish Garg from Laurentian Bank Securities. Please go ahead.

Munish Garg, Laurentian Bank Securities

Thank you, and good morning, everyone.

Blair Welch, Chief Executive Officer

Morning, Munish.

Munish Garg, Laurentian Bank Securities

On the mark-to-market in the portfolio, I was wondering if you could provide some color on how you see, in terms of timelines, to realize that mark-to-market.

Blair Welch, Chief Executive Officer

Do you mean the discount between our stock price and our NAV? What do you mean specifically?

Munish Garg, Laurentian Bank Securities

No, I mean the rents, because you mentioned the rents are significantly below the market rents.

Blair Welch, Chief Executive Officer

Sure. We feel we're plus or minus half of market rents, and for new builds and everything else, so over time, you get there.

What we like to do, and as Andrew stated, historically we've achieved 6% to 10% rental spreads, and we're confident that will continue. What we'd like to do is we like to get lifts from our anchors, and then all the shop space wants to be around that activity that the grocery anchor provides. You can get increased spreads from them, so I think that blends out to that 6% to 10%.

What we're seeing, which we talked about this last time, is anchored inline space had its traditional tenants, but now we're seeing tenants come from B and C enclosed malls that want to be around this activity.

We're also seeing tenants that typically wanted to be in their own pad in the parking field realizing that that costs too much, so they're coming inline, or into the strip. That demand is exceptional for us. We're confident that we'll be able to achieve the leasing spreads. It's going to take some time, but if you run it at 6% to 10% on a year-over-year basis, that's how we'll get there.

What it does is it shows revenue growth. Are we going to get to market anytime soon? No. But it's great durability of cash flow with growth. That defensive nature is something that Slate Grocery REIT has, that some of our peers don't.

Munish Garg, Laurentian Bank Securities

Okay, great. In terms of supply for grocery-anchored, what scenarios are you seeing for 2023 in your markets?

Blair Welch, Chief Executive Officer

New supply of competitive space coming in?

Munish Garg, Laurentian Bank Securities

Yes.

Blair Welch, Chief Executive Officer

Yes. It's at historic lows. There's not a lot of new supply. Where you are seeing grocery done would be perhaps in new subdivisions in growing towns in the Southeast and other towns.

However, those would be done at higher market rents. What we like to do is buy the existing infill at low market rents, because the sales don't change and it's a tight margin business, so the grocer is very focused on cost, of which rent is one. That stickiness is how we focus.

There's not a lot of new space. Then a question you would then answer is what about bankruptcies and is there existing space that's vacant? And as we've said in this call, that's all being taken up.

The health of the retail sector -- there's no new build. Big competitors of existing boxes have been backfilled. That's what's creating this occupancy uptick and rental increases in our portfolio.

Munish Garg, Laurentian Bank Securities

Okay, great. Thanks a lot, and I'll turn it back.

Blair Welch, Chief Executive Officer

Thanks.

Operator

Thank you. And your last question comes from Sairam Srinivas from Cormark Securities. Please go ahead.

Sairam Srinivas, Cormark Securities

Blair, thanks for the comments on the supply, and I just want to double down on that one. When you look at the reasons for the lack of supply in those markets, obviously ones where there's not much space available, but would you say it's only construction cost versus interest rates? What's driving the lack of supply in those markets?

Blair Welch, Chief Executive Officer

It's all of the above. I want to focus on the fact that we own 100% grocery-anchored real estate. When someone says the word retail, that's a big word and has a bunch of different assets in that. We focus on grocery.

It's an essential good, and in good times and bad, people go to the grocery store. The grocery stores fulfill omnichannel distribution, so you either go to the store, you click-and-collect, or you deliver to your home from that store. That activity is different than a lot of other retail.

I would say is the cost to construct new can be prohibitive for new tenants. They like to get into cheaper space. Simply put, if there was an empty field across from our grocery store or an empty box and you wanted to build a new store, pay market, the grocer would have to pay double the rent from one of the Slate Grocery REIT sites.

In simple math, would they get double the sales moving across the street? The answer typically is no. In a tight margin business, that's why they like focusing on cheap rent. Costs are prohibitive to construct. We feel that we're at - when you include fit-out and land - less than half of replacement cost for a comparable center, which is good.

From a financing side, we can finance our assets through traditional means, either banks or Life Cos. But some of the tenants have to deal with regional banks and other things to fund their businesses, and we are watching that.

Construction financing is a bit tighter, but we're happy we're in the grocery space, and not in some of the other sectors, because we are seeing liquidity. We are seeing financing and our tenants are healthy.

But, yes, it's cost, it's availability of capital for construction, it's what's going to happen to other types of real estate. All of that's being factored in, but we're feeling good and stable about our assets.

Sairam Srinivas, Cormark Securities

That was exactly what I was looking for, Blair. Thank you. My other questions have been answered, so I'll turn it back.

Andrew Agatep, Chief Financial Officer

Thank you.

Operator

Thank you. There are no further questions at this time. Mr. Paul Wolansky, you may proceed.

Paul Wolansky, SVP, National Sales, Investor Relations

Thank you, everyone, for joining the Q1 2023 conference call for Slate Grocery REIT. Have a great day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you very much for participating and ask that you please disconnect your lines. Have a great day.