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Li Chen
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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Slate Grocery REIT third 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 "*" "1" on your telephone. If you require any further assistance, please "*" "0." I would now like to hand the conference over to your speaker today, Jennifer Pyper with Investor Relations. Thank you. Please go ahead.

Jennifer Pyper, Investor Relations

Thank you, Operator, and good morning, everyone. Welcome to the Q3 2021 conference calls 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 Q3 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. Since our inception, Slate Grocery REIT's objective has been to create the superior portfolio of U.S. grocery anchored assets that provide long term sustainable income in all market conditions. Our unwavering focus on this objective has propelled our growth and benefited our performance.

Today, I am pleased to share that Slate Grocery REIT has just concluded one of its best and most consequential quarters to date. Strong tailwinds within the grocery anchored sector, coupled with our team's continued exceptional operating performance, drove record acquisition activity and organic growth in Q3, which has further enhanced the durability of our portfolio and positioned us well for continued growth.

Grocery real estate has proven to be a resilient and defensive asset class through previous economic cycles, and it has re-emphasized its strength over the last 20 months. U.S. grocery sales have continued to outperform expectations, driven in part by the acceleration of e-commerce in the grocery sector. This growing penetration of online sales relies heavily on local stores, which are located in neighborhoods in close proximity to the end consumer.

The reliance on bricks and mortar stores to fulfill not only in store sales, but also online orders and home delivery, has solidified grocery real estate's critical role in the supply chain. Slate Grocery REIT’s investment strategy is to identify high quality assets in major markets across the United States that are anchored by leading national grocers. The REIT’s five largest tenants are Walmart, Kroger, Ahold Delhaize, Albertsons and Publix, all of whom continued to bolster their omni channel capabilities and produce elevated same store sales growth compared to pre-pandemic levels.

Kroger continues to expand its diverse omnichannel platform with new fulfillment initiatives. Most recently, the company announced *Kroger Delivery Now*, a national partnership with Instacart that facilitates grocery deliveries from Kroger stores to customers’ doors within 30 minutes. Albertsons, another innovator within the grocery space, recently disclosed that its DriveUp & Go and home delivery capabilities now reach 95% of its customers. This reach is four times greater when compared to 2019. Albertsons has found that these digital customers spend three times more than in store only shoppers.

To service this growing customer base, the company has expanded its curbside pickup capabilities, is testing various methods of automated delivery from its stores, and is leveraging artificial intelligence through its partnership with Google to understand their customers’ needs on a deeper level. This kind of innovation has driven outsized growth for the REIT’s grocery tenants and has made the real estate they occupy even more essential and valuable. Combined, SGR’s five largest grocery tenants have grown same store sales by an average of 17.5% on a two-year stacked basis. The grocers continued to reiterate their investments in omni channel are critical to their success.

Against this backdrop, our team's continued exceptional operating performance, drove record quarterly growth, and further enhanced the durability of our portfolio. On September 22, Slate Grocery REIT closed the transformational acquisition of 25 quality, grocery anchored properties across the U.S. This transaction, coupled with our other acquisition activity in Q3, increased the asset value of SGR’s portfolio by approximately 415 million, bringing total assets under management to nearly 1.9 billion across 13.2 million square feet.

At the same time, we deepened our presence in America's gateway markets, which have strong demographics and contribute meaningfully to the portfolio's income. The REIT’s exceptional operating performance continued in the third quarter, underscoring the strength of our team and the value that Slate delivers to unit holders. After completing record annual leasing volumes in 2020, the team set another record in the third quarter, completing 230,000 square feet of new leasing, which is nearly 20% above the previous high watermark.

This new leasing was completed at a spread of 20.5%, which is double the new leasing spread for the portfolio through Q2 of 2021. Our portfolio of occupancy grew for the fifth consecutive quarter, netting out at 93.5% as of September 30th. Excluding the assets acquired during the third quarter, the portfolio's occupancy is 94.4%, an increase of 120 basis points quarter over quarter and 220 basis points since Q2 of 2020. Not only do these metrics validate our team's asset management and operational performance, they also underscore the quality and desirability of the REIT’s portfolio amongst institutional tenants.

Our team's performance this quarter positions as well for continued organic growth and acquisition activity. Firstly, the REIT’s contractual base rent commitments not yet online now total more than 2.5 million for the next three quarters. And our team has a new leasing pipeline of approximately 150,000 square feet, which will add incremental NOI growth well into 2023.

At the same time, we positioned our portfolio well to weather inflationary environments. Excluding grocers, more than 70% of the portfolio's almost 1700 tenants pay base rent increases during their lease term, and approximately 90% have escalations embedded within the renewal options. We also have downside cost protection, given our triple net lease structure.

Lastly, we remain focused on uncovering accretive external growth opportunities to further enhance the quality and scale of our portfolio. The investment market for grocery anchored real estate remains liquid and strong, and our team is actively underwriting a deep pipeline of compelling new opportunities that would create additional value for our unit holders. This, combined with our accelerated organic growth, will continue to expand our portfolio size and scale.

It has been a pleasure to be part of the exceptional team at Slate as we navigated a truly unique environment to meet both our operational and strategic objectives. I would like to sincerely thank our entire team for their unwavering dedication and drive, which underpins our portfolio's strong performance quarter over quarter. We have emerged from the pandemic larger, stronger and poised for further growth and success. On behalf of the entire Slate Grocery team, we thank you for your continued support. I will now hand it over for Q&A.

QUESTION AND ANSWER SESSION

Operator

Thank you, sir. And at this time, ladies and gentlemen, if you would like to ask a question, you may do so by pressing "*" then the number "1" on your telephone keypad. Again, that is "*" "1" on your telephone keypad. We will pause for just a moment to compile the Q&A roster. Your first question comes from the line of Jenny Ma with BMO Capital Markets.

Jenny Ma, BMO Capital Markets

Hi, good morning.

David Dunn, Chief Executive Officer

Good morning, Jenny.

Jenny Ma, BMO Capital Markets

Congratulations on a strong quarter and closing the high volume of acquisitions. You had mentioned throughout the duration of the transaction that there was some leasing activity that you guys have done prior to close, and it sounded pretty positive. I am wondering if you could provide an update on how it has been going since then and if the occupancy rate of the portfolio that you acquired has crept up a bit since we last talked about it.

David Dunn, Chief Executive Officer

Hey. Good morning, Jenny. Thanks for the question. Yes, we have been pleased, as I stated last quarter, with the partnership that we entered into with our three JVs. It started back in March, when we firmed up the deal. We have worked closely alongside our partners since then. It is true, our original underwriting has been exceeded. We are about 75 basis points ahead on occupancy, which is producing about 5 or $600,000 of incremental NOI.

However, there is still momentum going. The pipeline I referenced of 150,000 square feet of new leasing does not even include the 25 properties that we acquired. They have momentum in their own right. And we are tracking to be about 150 basis points better on an occupancy basis, which obviously flows through NOI through our hold period, by the middle of our first year of ownership. So it was originally accretive to AFFO to about $0.04, and over the hold period, we were going to add approximately $1.50 to NAV. We expect to outpace those numbers as we take hold of ownership and drive this forward.

Jenny Ma, BMO Capital Markets

Okay. Great, thank you. Can you give us an update on how the acquisition pipeline might look? What is the market looking like? Is there a lot of volume out there? And how competitive is it? And if you can give us any sort of insight into what you might expect for 2022?

David Dunn, Chief Executive Officer

Certainly can. So, first of all, we are extremely excited to have closed $414 million worth of assets at $127 a square foot – quality properties in gateway markets. Our focus now is to continue that trend. A quick comment on outlook and sentiment for the market. I would suggest to you the desirability of stabilized grocery real estate is at an all-time high. It is as strong as ever.

The investment market continues to produce transactions that are supportive of increasing values. We are seeing bid lists for marketed deals that are deep and values are regularly surpassing broker guidance. A couple of examples of what we are seeing, I mean, these are larger transactions, but just last week, there was an announcement of Blackstone and Kimco JVing a portfolio of six Publix anchored centers – 425 million, 5 in Miami and 1 in Atlanta, modeled in at a sub five cap.

That is an illustration of the desirability of the property. It also says to me that we need to continue to be creative in finding these deals. That deal happened to be off market. So not all off market deals produce the immediate value creation that we have been successful in doing. And we are digging deep. We are using our relationships and our partners in the market. And we are focused on finding incremental quality growth opportunities in 2022.

Jenny Ma, BMO Capital Markets

Do you care to venture a quantum of what you might expect?

David Dunn, Chief Executive Officer

I would suggest it will be tough to grow to the same extent as we did in 2020, though, if we can find an opportunity to do so, we will. We have a board mandate to grow this business. Values are only increasing, so the sooner we can do this, the better.

We are going into some strategy planning with the board and in the coming quarter, so I think we will have our plan set on a target, probably in the range of 200 million, but we will be finalizing that in the coming weeks.

Jenny Ma, BMO Capital Markets

Okay, that is helpful. And then, my final question relates to some of the redevelopment properties. You have got a handful. They are fairly small in size, but the yields are quite attractive. Can you talk about whether or not you see more of those opportunities within the portfolio, and if any of them would be coming out of the acquired portfolio as well, like, is this kind of the volume you want to be looking at? Or do you expect there to be a bit of a ramp up in redevelopment activity?

David Dunn, Chief Executive Officer

You are certainly correct. Our success, we have had great success within the redevelopment pipeline. We had four assets come online within the last couple of quarters totaling approximately 15 million of spend, and our yield was a 14. We are on the back half of this program – we have a little less than 20 million outstanding and the yields are still going to reach double digits. When I look at the nature of these redevelopments they all have an anchor repositioning.

We are doing deals with Kroger and Publix to do new 15 and 20 year leases with them. These are the types of re-devs that we want to continue to find. And yes, we are looking to ramp up the pipeline – within reason. We do not want to extend ourselves too much.

We like the 25 to $35 million pipeline and we are looking to unearth new opportunities as the rest of our 15 or $20 million comes out of re-dev and back online.

Jenny Ma, BMO Capital Markets

Great. Thank you very much. I will turn it back.

Operator

Perfect. Thanks. I will pass the line.

Operator

Again, if you would like to ask a question, that is “*” “1” on your telephone keypad. And you do have a question from the line of Himanshu Gupta with Scotiabank.

Himanshu Gupta, Scotiabank

Thank you, and good morning.

David Dunn, Chief Executive Officer

Good morning.

Himanshu Gupta, Scotiabank

So just on the retail environment, I mean, it looks like the recent volumes have been good. So is it across the broad within sector, or is it just restricted to certain categories or certain regions?

David Dunn, Chief Executive Officer

Good morning, Himanshu. I mean, 2020 was a record new leasing year for us. Q3 of 2021 was a record. We are doing quality deals. We are in 23 states. Yes, the southeast is producing a slightly higher percentage of these deals, but we are seeing interesting leasing opportunities across the board.

This quarter, we did seven deals over 15,000 feet. It was a quarter of bigger leasing transactions, both anchors and junior anchors. But the spreads are strong. 20% spreads on our best performance by volume ever. Q1 and Q2 produced 10% spreads, which is extremely healthy.

And if you notice, we took our percentage of revenue from essential tenants from 65 to 69% this quarter. So that is an indication of the type of quality deals we are doing. NERs are strong. So it is a broad brush view, in our mind. And as I stated to Jenny's question, our JV partners have similar pipelines. And the last point I will make, that we are spending less to get these deals done. So net effective rents are higher by 5 to 10% than what we have seen in the past.

Himanshu Gupta, Scotiabank

Thank you. And by the way, that was my next question that, you know, if I look at the new leases, like 200,000 square feet, it will give us an ideal spread. What kind of incentives or capex are you giving there?

David Dunn, Chief Executive Officer

Broadly speaking, we are spending less. We are spending very little if anything, to retain a tenant, to renew them. And as it relates to TIs and/or landlords work that you would need to spend as a partnership when you are dealing with an anchor, it is down on a relative basis. Shop tenants, payback periods, we like to see less than two years for new deals, many of what we are doing have a one year payback.

And then, yes, larger anchors, we are looking at credit quality first – or junior anchors – credit quality first and foremost, and then we are allocating strategic amounts of capital that makes sense for us. But payback periods for our deals are down on a relative basis.

Himanshu Gupta, Scotiabank

Got it. And then, on the similar lines, I mean, if I look at the recent anchor renewals, rental spread has been flat on renewal, I would say, for the last two or three quarters. However, new leases you pick up quite a bit, you know, 20% or 10% plus. So why is that on the anchored renewals?

David Dunn, Chief Executive Officer

Himanshu, I look at it a little differently. We did a lot of volume in renewals this quarter below 10,000 square feet. That spread was 5.5%, and it has been more or less at the mid fives throughout our last four or five quarters, if you look at our stats. Our volumes for renewals above 10,000 feet have been low, and frankly, one of them was a grocer where they just popped their option.

It just happened to be a smaller data set, we did not secure a ton of lift on those deals. But that is an anomaly in my mind. The way we are looking at the future of renewals is to continue to see spreads between 5 and 7%.

Our team is pushing rents. We took a view of partnership in 2020 with our tenants. We were proactive with doing some renewal leasing to stabilize our portfolio. And now we are taking a different tact. We are being strategic, the passage of time has created a better leasing environment, and I think we are going to continue to see spreads in the 5 to 7% range for renewals going forward.

Himanshu Gupta, Scotiabank

Got it. I think these small shop tenant leasing velocity has improved quite a bit, so that is helpful there. And maybe the next question is on the anchor lease expiries in 2022. Any thoughts there? Any discussion so far?

David Dunn, Chief Executive Officer

Yes, we have a couple rolling. We are strategic about when we engage these tenants. We know their sales are meaningfully higher than they have been, as we have discussed, in the past. The majority of our anchors report sales, we see the trends, we see the investments they are making within their bricks and mortar real estate to take advantage of increasing online sales. Many of them are running trucks at the back of our shopping centers, delivering to customers, so we expect a successful outcome of the handful of grocery renewals that we have rolling in the next 12 months.

Himanshu Gupta, Scotiabank

All right. Okay, thank you. Thank you so much, and I will turn it back.

Operator

Your next question is from the line of Li Chen with IA Capital Markets.

Li Chen, IA Capital Markets

Hi, good morning. First of all, congrats on a strong quarter. Maybe just following up on Jenny's question. In terms of your acquisition pipeline, you mentioned that you are going to focus on gateway markets. Is the focus going to remain mostly within, you know, the Sun Belt region and the East Coast? Have you explored further opportunities outside of your core markets out on the West Coast?

David Dunn, Chief Executive Officer

Thanks for the question, Li. We are looking in major markets and we want to partner with investment grade national grocers. That could take us outside of where we have the highest concentration, but we also know that there is a lot of opportunity in the southeast, the Sunbelt, and the East Coast. So, I would not say we would never venture outside of our comfort zone or where our portfolio currently is located, if there is value. Our job is to continue to create value, find accretive acquisitions and continue to add scale with those top five grocers I mentioned in my opening remarks.

Li Chen, IA Capital Markets

Right. Thanks. And lastly, so recently Amazon announced that they are opening larger box stores across the U.S. beyond their pop up shops. Could that be an opportunity for the REIT to develop a new potential partnership?

David Dunn, Chief Executive Officer

Do you mean their grocery banner, or do you mean their foray into department stores?

Li Chen, IA Capital Markets

Yeah, department stores, but not sure if it is going to be like those super big ones. So I was just wondering if that could be an opportunity for the REITs. And unclear if they are going to open also those Amazon Go stores and Whole Foods besides them or within those shops?

David Dunn, Chief Executive Officer

I do not see us ever making a play into enclosed malls and/or power centers where these department stores are rumored to be replacing the JC Penney's and the Sears of the world. We will stick to what we are good at and stay focused on strip centers, with grocery stores as an anchor, centers that are 100 to 125,000 feet.

I would love to find a deal with Amazon Fresh. Their concept is 40,000-ish square feet. It fits nicely within our merchandising and composition of our stores. A little less likely that we do an Amazon Go – they’re a couple of thousand feet. They are usually in dense urban markets. And that is not really where we see the real value in America.

We like to be in major centers just outside of the downtown core, call it 5 to 10 miles in the suburbs, but markets that have more than a million people and where economies are growing and people are moving to.

Li Chen, IA Capital Markets

Great. Thanks for the commentary. And congrats on a strong quarter. I will turn it back.

Operator

At this time, there are no further questions. I would now like to hand the call back over to Ms. Jennifer Pyper.

Jennifer Pyper, Investor Relations

Thank you, everyone, for joining the Q3 2021 conference call for Slate Grocery REIT. Have a great day.

Operator

Ladies and gentlemen, this does conclude today's conference call. You may now disconnect at this time.
