CT REIT 2015 First Quarter Results Conference Call
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PRESENTATION

Operator

Good afternoon, my name is Mary, and I will be your conference Operator today. At this time, I would like to welcome everyone to CT REIT's Q1 earnings 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 that time, simply press star, then the number one, on your telephone keypad. To withdraw your question, press the pound key.

The speakers on the call today are Ken Silver, Chief Executive Officer of CT REIT and Louis Forbes, Chief Financial Officer of CT REIT.

Today's discussion may include forward-looking statements. Such statements are based on Management's assumptions and beliefs. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. Please see CT REIT's public filings for a discussion of these risk factors which are included in their 2015 MD&A and AIF, which can be found on the CT REIT website and on SEDAR.

I will now turn the call over to Ken Silver. Ken?

Ken Silver, Chief Executive Officer, CT REIT

Thank you, Mary, and good afternoon, everyone. We're very pleased to welcome you to CT REIT's first quarter 2015 investor conference call. This marks our first quarter where we can let go of our IPO forecast and begin comparing for you our year-over-year operating performance. I'll lead off with an update of our investment activity, and Louis will then briefly review certain financial matters.

This morning we announced 11 new store investments: the acquisition of four existing Canadian Tire stores from CTC, the acquisition of a newly-developed Canadian Tire store, and six intensifications of existing Canadian Tire stores in the REIT portfolio. All told, these new investments represent $73.5 million of capital, approximately 433,000 square feet of incremental gross leasable area, and are expected to earn a 6.88 percent weighted average going in cap rate upon completion. We expect these acquisitions will close in June.

I would like to expand a little on one of these new investments, the new Canadian Tire store nearing completion in South Edmonton Common. At closing, the REIT will take an assignment of the ground lease upon which the store is built, acquire the new store, and enter into a sublease with Canadian Tire. The store is scheduled to open for business in a few weeks and is located at the entrance to the biggest Power Centre in the country. This Canadian Tire store, which replaces an existing store lease from a third party, will be the largest store in the retail network and will showcase the best of what Canadian Tire has to offer.

The REIT expects to fund these investments by a combination of the issuance of Class B LP Units, Class C LP Units, and draws on its credit facility.

Our press release also provides an update on a number of our previous announcements which I'll touch on now. During the first quarter, the REIT completed five previously-announced property acquisitions from Canadian Tire at a total cost of $62 million. They were funded by the issuance of approximately 4.8 million Class B LP Units to CTC at a price of $12.92 per unit. In addition, we completed the purchase of a development site in Martensville, Saskatchewan, and the REIT funded three intensifications of Canadian Tire stores in the REIT portfolio.

The acquisitions, developments, and intensifications completed in 2015 or newly announced today for future completion represent $167.2 million and 897,000 square feet of incremental GLA, or 4.4 percent growth over the gross leasable area of our portfolio at the beginning of the year.

In other news, I'm sure you are aware of CTC's announcement last week that it is acquiring, subject to court approval, 12 lease properties from Target Canada in connection with its CCAA proceedings. Flowing out of this transaction, CTC will be making nine existing own stores redundant as it repositions and right-sizes its store network. At the time of the REIT's IPO, these nine stores were retained by CTC as they had been identified as requiring repositioning if ideally an opportunity arose to do so. Pursuant to the REIT's ROFO agreement with CTC, we will be looking at these redundant stores for potential acquisition and redevelopment and expect that some of them will be future growth opportunities for the REIT.

Before I turn it over to Louis, I can't help but point out the 11.1 percent growth in our AFFO per unit in Q1 2015 as compared to Q1 2014. Of course, this is in part the result of the dilutive effect in 2014 of the exercise at our IPO of the overallotment option, so admittedly, we had a soft comp. But if you look at the results in detail, you will see this performance more importantly confirms everything we said about our “falling out of bed growth” and about our accretive acquisition, intensification and development growth strategy.

In addition, I'm pleased to note that the REIT paid its first distribution increase in Q1 of this year.

With that, I will turn it over to Louis for a review of our financial results.

Louis Forbes, Chief Financial Officer, CT REIT

Thanks, Ken. Our first quarter results are positive and, as Ken said, represent very strong growth in AFFO per unit over the reported results for Q1 2014. In Q1 of 2015, we reported FFO per unit of $0.258 as compared to $0.238 per unit in Q1 of 2014. AFFO per unit was $0.20 as compared to $0.18 in the comparable period.

Net operating income was $64.5 million, an 11.1 percent increase over the $58 million of NOI reported for Q1 2014. Our MD&A breaks this headline growth into its components: 2.5 percent growth on a same-store basis, 3.2 percent growth on a same-property basis, and the balance as a result of acquisition and investment activity. The same-store growth is the result of the annual 1.5 percent average increase in minimum rent on January 1 of this year, as well as the contribution earned from the growth in expense recoveries from capital expenditures, together with interest earned thereon. The same-property growth layers in the effect of intensifications on our results.

With respect to the balance sheet, our financial position is strong and liquid. At March 31, the REIT's indebtedness ratio was 48.2 percent and there was over $125 million of undrawn credit on our facility. In addition, interest coverage for the quarter was a strong 3.19 times.

Our AFFO payout ratio continued to improve in the first quarter and was a solid 83 percent, reflecting the benefits of our investing activity on operating results. This improvement in payout ratio was achieved despite a 2 percent increase in distributions in the first quarter of this year.

On an operating basis, our portfolio continues to be 99.9 percent occupied. Canadian Tire represents 94.2 percent of our annualized base minimum rent, and when combined with other CTC banners represents 96.4 percent of our annualized base minimum rent. All metrics are largely unchanged from a year ago.

Moving on from results, as discussed on our previous call, in Q1, the REIT gave a notice of redemption to Canadian Tire for the Series 1 Class C LP Units which are scheduled for a rate reset or redemption on May 31 of this year. We are announcing today that the REIT intends to redeem this series of units. There is $200 million outstanding on this series and the current rate is 3.5 percent, and we are currently exploring our available sources of funding to fund the redemption. These sources may include the issuance of public debt or equity, the issuance of LP Units, mortgage debt, draws on our existing credit facility, an alternative arrangement with CTC, or any combination thereof.

With that, I will turn it back to Ken.

Ken Silver, Chief Executive Officer, CT REIT

Thanks, Louis. It's still early days, but we're establishing a positive track record. And, as much as I am very pleased by our reported results, I'm more enthusiastic about CT REIT's future. Everything is going in the right direction. We fully expect our baseline growth to continue, investment opportunities remain available, our recent land acquisitions should provide near-term growth opportunities, and capital markets remain accommodating.

Now, Mary, I will turn the call back to you for any questions from our listeners.

QUESTION AND ANSWER SESSION

Operator

Thank you. At this time I would like to remind everyone in order to ask a question, please press the star, then the number one, on your telephone keypad. We ask that you please pick up the handset or step close to your speakerphone system when asking your question to provide maximum audio clarity. We will pause for just a moment to compile the Q&A roster.

The first question is from Alex Avery from CIBC. Please go ahead.

Alex Avery, CIBC

Thank you and congrats on the strong quarter.

Ken Silver, Chief Executive Officer, CT REIT

Thank you.

Alex Avery, CIBC

Just sort of a technical question for Louis. On the recovery of capital expenditures, you treat some of them as, you know, recoverable in the quarter that they're incurred and some of them, you know, get amortized over a longer period of time. Can you give us just a little bit more detail in terms of how you make that decision and perhaps what the breakdown might've been in Q1 '15?

Louis Forbes, Chief Financial Officer, CT REIT

I think it depends on the useful life of the work done, but any work done that would have a very short life would be charged fully to the tenant in the year it was incurred. It would be a recoverable expense just like heat and water and property taxes. If an expenditure relates to something that has a longer life, like a parking lot replacement or a roof replacement, the estimated useful life is typically on the order of 15 years and we would amortize it into the tenants charges over a 15-year period.

I don't think there's anything unusual in terms of operating or capital expenses this year that were charged for just the one year, so what you're seeing going through NOI would be the longer life stuff like roofs, HVAC units, and parking lots.

Alex Avery, CIBC

So that amount would be a recurring item in future quarters and probably grow in future quarters as well.

Louis Forbes, Chief Financial Officer, CT REIT

That's correct. I should point out that the rate of charge in Q1 of this year could be equaled or surpassed in Q2, but it did include a small amount that was not charged in Q4 of last year. So there was a little bit of a catch-up in this Q1, so don't use Q1 as an indicator. But that's not to say Q2 may still be higher. It's just we were getting some capital expenditures completed during Q1 that could result in fresh start amortizations in Q2.

Alex Avery, CIBC

Smoothing for any of that sort of timing, it would be a growing item?

Louis Forbes, Chief Financial Officer, CT REIT

It absolutely should be a growing item, Alex, yes. Correct.

Alex Avery, CIBC

Okay. Then, you know, in Q1 you did announce the Series 1 redemption that you, I guess, communicated to Canadian Tire. Was that—can you just talk a little bit about, I guess, your thinking behind that, I guess, desire to become a public issuer of unsecured debentures? Is that part of the thinking there?

Louis Forbes, Chief Financial Officer, CT REIT

Well, that's part of the agenda, Alex, but it's not the entire agenda. What we mentioned back on our Q1—or our year-end call back in February was that we had given notice to CTC that we wanted to redeem, but really all that does is protect the REIT and keep our options open under the terms of the Limited Partnership Agreement. It forces Canadian Tire to treat us on a market basis should they decide to not allow us to redeem. So that was the point of the notice back—delivered back in January.

What we've learned since, what's fresh news is that Canadian Tire has said that they agree we can redeem. So now we are moving on to redemption and determining how we wish to fund that redemption, and there's a laundry list of choices, as I enunciated on the call.

Alex Avery, CIBC

If you were to do an unsecured public, presumably you would try to fit something in maybe one of the gaps in your maturity profile?

Louis Forbes, Chief Financial Officer, CT REIT

I think anytime we're looking at any kind of debt we would try and manage to the maturity profile. Absolutely correct.

Alex Avery, CIBC

Okay. Then, Ken, you mentioned that Canadian Tire has nine redundant stores that were not included in the IPO. How might those be treated from a valuation? Or how would you look at, you know, perhaps buying those from

Canadian Tire, as vacant sites? Or presumably they would want to maximize the proceeds to Canadian Tire and maybe do some of that re-leasing work, or, you know, how should we think about that?

Ken Silver, Chief Executive Officer, CT REIT

I think it would depend to some extent on the location. We've acquired some sites from Canadian Tire where we paid for a fully redeveloped and re-tenanted property, so we have some precedence there. It might depend on whether there are Canadian Tire banner properties that might fill the space or whether it's something more speculative. I'd say at this time, Alex, we—you know, it's probably a little bit down the road as to determine which of the properties we'd be interested in and how they might be redeveloped because, of course, they'll trail whatever Canadian Tire's doing on the takeover of the Target stores.

Alex Avery, CIBC

Okay, and then just one last quick one. I'm sure it's in the Management Information Circular, but can you remind us how many employees there are of the REIT today?

Ken Silver, Chief Executive Officer, CT REIT

Well, we—in our first year we experienced a 50 percent increase in our headcount, so there's now three of us.

Alex Avery, CIBC

Perfect. Okay, thanks.

Operator

Thank you. The following question is from Troy MacLean from BMO Capital Markets. Please go ahead.

Troy MacLean, BMO Capital Markets

Good afternoon.

Ken Silver, Chief Executive Officer, CT REIT

Hi, Troy, how are you?

Troy MacLean, BMO Capital Markets

Very good. Just following up on the redundant assets; would you buy them, like, all at once, or would it be over time as you develop plans for them?

Ken Silver, Chief Executive Officer, CT REIT

At the moment we don't have a concrete plan for which of them we do or when we would do them. I would suspect that they will get, you know, acquired and redeveloped or redeveloped and acquired over some period of time and probably not all in one transaction.

Troy MacLean, BMO Capital Markets

Now that we've kind of worked through the Target leases, are you seeing more third-party acquisitions, you know, potentially someone missing a Target anchor for sale?

Ken Silver, Chief Executive Officer, CT REIT

So far not. I think, you know, notwithstanding the flurry of recent announcements on the Target portfolios, they still have to go through the finalization of the process. I personally have not yet seen, you know, an uptick in potential transaction activity. It has been quiet while landlords have been working through this process, but I haven't yet seen evidence that people are starting to market sites.

Troy MacLean, BMO Capital Markets

Then just on the South Edmonton Common development, you know, it's a very large Canadian Tire. Is that a sign that, you know, the box is getting bigger, or is it just a one-off for that property?

Ken Silver, Chief Executive Officer, CT REIT

I'd probably let Canadian Tire talk about, you know, what their plans are, particularly with respect to South Edmonton Common, but I wouldn't—my gut would be don't draw a pattern out of one store.

Troy MacLean, BMO Capital Markets

Thank you. I'll turn it back.

Operator

Thank you. The following question is from Michael Smith from RBC Capital Markets. Please go ahead.

Michael Smith, RBC Capital Markets

Thank you and good afternoon. Actually, most of my questions have been asked and answered. The only thing I would just ask is, on the Series 1, do you expect to have more or less the same kind of interest rate?

Louis Forbes, Chief Financial Officer, CT REIT

Well, Michael, your question presumes we're doing a debt refinancing, and that's a dangerous presumption. So, I mean, we could do equity. So—but if we were to do that, it—I think the coupon would obviously depend a lot on the terms selected. You know, five-year mortgages are priced differently than 10-year mortgages, and the same would be said about secured debentures. So, you know, the longest-term debt we could possibly do might have a coupon close to or slightly higher than the 3.5 percent distribution rate on the Series 1. Five-year debt would have a coupon well inside the 3.5 percent. So it depends on the term decision, if we're doing debt.

Michael Smith, RBC Capital Markets

Is it too early to—you don't know which way you're leaning or...

Louis Forbes, Chief Financial Officer, CT REIT

It—yes.

Michael Smith, RBC Capital Markets

Okay. Okay, well thank you.

Ken Silver, Chief Executive Officer, CT REIT

Thank you.

Operator

Thank you. Once again, please press star, one, on your telephone keypad if you have a question.

The next question is from Jenny Ma from Canaccord Genuity. Please go ahead.

Jenny Ma, Canaccord Genuity

Thanks. Good afternoon, everyone.

Ken Silver, Chief Executive Officer, CT REIT

Good afternoon, Jenny.

Jenny Ma, Canaccord Genuity

So on the same vein of what Michael was asking, can you remind us how you go about pricing equity that's offered to CTC, whether it be through, you know, potential redemption, and is it the same as the way you would price equity offered to them as part of a vend-in from CTC?

Louis Forbes, Chief Financial Officer, CT REIT

So the pricing mechanism for vend-ins, which we used in February for that group of vend-ins, we make reference to the market price, and if the volume weighted average price in the market for the five trading day period ending—I don't know whether it's 24 hours or 48 hours before the scheduled closing of the real estate transaction, but it's very close to that date, and we just give ourselves a little bit of lead time so we can calculate the number of units we have to issue into closing. So it's a five-day VWAP. So that's how it works for vend-ins.

Jenny, it's been a while since I've read the mechanism in the limited partnership agreement for pricing units in the event we ever were to issue units to fund a redemption of a Series of Class Cs that were being redeemed, so I'm not—I can't speak to that off the top of my head. But I know our documents are all market driven in terms of their basis.

Jenny Ma, Canaccord Genuity

Okay, that's fine. Then also, on a different topic, with regards to G&A, it looks like you've got some smaller items in there. But as far as a run rate goes, is somewhere in the range of 2.5 percent of revenue a good proxy?

Louis Forbes, Chief Financial Officer, CT REIT

No, that might be a touch light.

Jenny Ma, Canaccord Genuity

Okay. It came in at 2.7 this quarter. Or is there another way you look at it?

Louis Forbes, Chief Financial Officer, CT REIT

Well, that is one of the good ways of looking at it. I mean, we look at it in absolute dollars, but we also—I mean, just because revenues are growing doesn't mean it should grow exactly in line with revenue growth. But revenue growth is one good way to look at it. It's probably the other good way to look at it. I would just say that 2.7 might be a touch below the run rate.

Jenny Ma, Canaccord Genuity

Okay, that's fine. Thank you very much.

Operator

Thank you. The next question is from Mike Markidis from Desjardins. Please go ahead.

Mike Markidis, Desjardins

Hi, thanks. Just one quick one for me. Ken, you mentioned the $167 million figure being comprised of what's closed so far and the new investments that you've announced. I'm just wondering, I think there still are remaining developments and intensifications that are ongoing to close in the latter half of the year, and what would be the volume of capital associated with those when they come online?

Ken Silver, Chief Executive Officer, CT REIT

We have under development—we've announced in February the development of Canadian Tire anchored properties in High River, Alberta, in Martensville, Saskatchewan, and a Sport Chek and Mark's property in Swift Current, and I think the capital associated with those three was approximately $37 million.

Mike Markidis, Desjardins

Okay.

Ken Silver, Chief Executive Officer, CT REIT

Those are left to be completed, of which we had invested almost $4 million in land. So part of that is already invested.

Mike Markidis, Desjardins

Okay, so that would—the $37 million would—you mentioned several properties. That would tie to the table in the press release where you've got, I think, it's High River, Martensville, and all the way down to Selkirk as well? With a couple intensifications there?

Ken Silver, Chief Executive Officer, CT REIT

Yes, intensifications were—are for another seven that are to be completed. Sorry, Dawson Creek we completed in Q1.

Mike Markidis, Desjardins

Okay, and then the $74 million of new, it sounds like that's all going to start hitting the P&L sometime in Q2, so we should be working that in for 3Q as well?

Ken Silver, Chief Executive Officer, CT REIT

The vend-ins would be in June and the—and most—actually, yes. Most of the intensification would also be in Q2.

Mike Markidis, Desjardins

Okay, that's great. Thanks very much for clarifying. Take care.

Operator

Thank you. As there are no further questions at this time, I will now turn the call over to Ken Silver, CEO, for any closing remarks.

Ken Silver, Chief Executive Officer, CT REIT

Thank you, Mary, and thank you all for joining us today. We expect our second quarter will be released the week of August 10, and we look forward to speaking with you then.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time. Thank you for your participation.
