CT REIT 2015 Second Quarter Results Conference Call
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PRESENTATION

Operator

Good morning, my name is Melanie and I will be your conference Operator today. At this time, I would like to welcome everyone to CT REIT's Q2 Earnings Conference Call and Webcast. 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 2014 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, Operator, and good morning, everyone. We're very pleased to welcome you to CT REIT's Second Quarter 2015 Investor Conference Call. I'll lead off with an update of our investment activity and Louis will then briefly review certain financial matters.

Yesterday afternoon, we announced five new investments: the acquisition of an existing Canadian Tire store in Montreal from CTC, the acquisition of a parcel of land in Innisfil, Ontario for a new Canadian Tire store to be developed, an existing mall from a third party, and two intensifications of existing Canadian Tire stores in the REIT portfolio. All told, these new investments represent $45.2 million of capital, approximately 276,000 square feet of incremental gross leasable area and are expected to earn a 6.8 percent weighted average going-in cap rate upon completion. The purchase of the existing store from

CTC was completed in mid-June. The land acquisition was recently completed and construction of the new store will commence shortly, with openings scheduled for the second quarter of 2016.

I'd like to expand a little on one of our new investments, Arnprior Mall. It is by no means the largest investment we will make, but demonstrates a new type of activity and an example of the many opportunities before us. We completed this acquisition from a private owner last week. The existing mall comprises 114,000 square feet of gross leasable area and includes some solid tenants, such as Metro and TD Bank. However, the mall has suffered from high vacancies for a few years. Adjacent to the mall is an existing small Canadian Tire store, retained and owned by CTC, and which had been identified as a store requiring replacement. The plan is to redevelop and partially de-mall, relocating the nearby Canadian Tire and an existing Mark's store into larger premises in the mall, while retaining and relocating existing tenants and leasing vacant space. Upon completion, the mall should be a very solid retail destination in that part of the Ottawa Valley and a nice addition to the REIT's portfolio. Once Canadian Tire has vacated its existing store, that property could also become an acquisition and redevelopment opportunity for the REIT.

Funding of these investments includes any combination of the issuance of Class B LP units, Class C LP units, draws on our credit facility, and cash on hand.

Our press release also provides an update on a number of our previous announcements, which I'll touch on now.

During the second quarter, the REIT completed four previously-announced property acquisitions from Canadian Tire, plus one additional acquisition of a Canadian Tire store located in Montreal and announced yesterday. As well, we completed one development investment and five intensifications, at a total cost in the quarter of $91.1 million. These investments were funded by the issuance of approximately $3.2 million Class B LP units to CTC at a price of $11.95 per unit, the issuance of $15 million of Class C LP units bearing interest at 1.71 percent and redeemable on May 31, 2017, and by the use of approximately $37.9 million of cash.

The acquisitions, developments and intensifications completed or underway in the second quarter of 2015, were newly announced yesterday for future completion, represent $166 million and 871,000 square feet of incremental GLA, or 4.3 percent growth over the gross leasable area of our portfolio at the beginning of the year.

This quarter, we have introduced a new disclosure in our press release and MD&A about our development activity. The point is to illustrate the growth to date in this area, let the reader track our performance, and more importantly, pave the way for what will hopefully be a more significant component of CT REIT's business in the years ahead.

As previously disclosed, the REIT is funding new Canadian Tire stores in High River, Alberta, and in Martensville, Saskatchewan, and it is also building new premises for Mark's and Sport Chek in Waterdown, Ontario, Selkirk, Manitoba, and Swift Current, Saskatchewan. These projects are all proceeding on time and on budget.

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 second quarter results are positive and represent strong growth in AFFO per unit over the reported results for Q2 2014. In Q2 2015, we reported FFO per unit of $0.256, as compared to $0.238 per unit in Q2 of 2014. AFFO per unit was $0.199, as compared to $0.179 in the comparable period, representing a very healthy 11.2 percent growth rate.

Net operating income was $65.3 million, an 11.2 percent increase over the $58.7 million of NOI reported for Q2 2014. Our MD&A breaks this headline growth into its components: 1.6 growth on a same-store basis, 2.4 percent growth on a same-property basis, and the balance as a result of acquisition 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.

Both of these metrics were held back this quarter compared to Q1 for two reasons. The Q1 results included a catch-up amount for recoverable capital expenditures that had not been reported in Q4 of 2014, and in addition, we had a slight reduction in our estimated expense recovery rate. We expect Q3 NOI to return to a level much closer to the Q1 amount.

With respect to the balance sheet, the financial position is strong and liquid. At June 30, the REIT's indebtedness ratio was 48.3 percent. The REIT's liquidity was at an all-time high at the end of the quarter. We have $200 million available on the credit facility, with an accordion feature for an additional $100 million. In July, we extended the term on this facility to July of 2020, and there was roughly $47 million of cash on hand.

During the second quarter, the REIT completed its inaugural public debt offering. The proceeds were used to redeem Series 1 of the Class C LP units, as mentioned on our May call, to repay the balance on the credit facility to fund the cash component of the June investment activity and to contribute cash to the balance sheet. We issued two series of debentures: $150 million for a seven-year term and bearing interest at 2.85 percent, and $200 million for a 10-year term and bearing interest at 3.53 percent. This transaction set new record-low coupons for the sector for borrowings of these tenors and established CT REIT as the tightest credit spread borrower in the Canadian REIT sector.

In terms of our debt market strategy, it was our objective to issue more than one tenor of debt in order to begin to establish a bit of a curve, and more importantly, to borrow for as long a term as we could. The new money bears a weighted average coupon lower than the rate on the Class C LP units redeemed. The savings would have been substantially greater had we chosen to borrow the new money all at the five-year term.

Interest coverage for the quarter was a strong 3.23 times. Our AFFO payout ratio was again a solid 83 percent, reflecting the benefits of our investing activity on operating results.

On an operating basis, our portfolio continues to be 99.9 percent occupied. Canadian Tire represents 94.4 percent of our annualized base minimum rent, and when combined with other CTC banners, represents 96.5 percent of our annualized base minimum rent. All metrics are largely unchanged from a year ago.

I would like to take a minute to speak to the trend in our book value per unit. This metric represents the fair value of our real estate. Our real estate valuation metrics have been virtually unchanged since reporting Q1 of 2014, so we now have six quarters of reported results with no change in cap rate, discount rates, or other value assumptions.

The book value per unit a year ago was $10.79 at June 30, 2014. At June 30, 2015, it was $11.36, representing 5.3 percent growth over the year. A number of factors contribute to this growth in book value: the higher value of income-producing properties due to ongoing growth and cash flow resulting from annual rent increases—and remember, the valuation metrics have not changed—and then retained cash flow, a growing receivable due to the recoverable capex spend, and accretive investing activity financed in part by equity issuance that is accretive to this book value per unit.

With that, I will turn it back to Ken.

Ken Silver, Chief Executive Officer, CT REIT

Thanks, Louis. To conclude, I'm very pleased by our reported results and the ongoing maturation of CT REIT. We are developing a track record of predictable operating results, complemented by a solid growth strategy and an attractive cost to capital.

Now, Operator, 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 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'll pause for just a moment to compile the Q&A roster.

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

Alex Avery, CIBC

Thank you. In your introductory remarks, you noted this Arnprior mall acquisition. Looking through the month disclosure there on the acquisitions, if you break out the remainder of the properties and put some rough estimates on them, it seems like this Arnprior mall is being bought at a pretty big discount to, perhaps, replacement cost. Can you talk a little bit about the economics there?

Ken Silver, Chief Executive Officer, CT REIT

Sure, Alex, it's Ken. Yes, you're right. We bought the property at a relatively low cost per square foot and in redeveloping the mall and putting Canadian Tire and repositioning some of the existing tenants, we'll certainly be investing additional funds into the property. In total, I would say the yield on that property would be in the range of about 8 percent.

Alex Avery, CIBC

Is there an occupancy that you would have on that, I guess, currently?

Ken Silver, Chief Executive Officer, CT REIT

Well, today we—actually, one of the conditions of our acquisition was that certain tenants need to be terminated. We bought it today with a current vacancy of about 40 percent and we expect it to be substantially completely leased by the time we're done.

Alex Avery, CIBC

Okay, and you mentioned that this is a new type of investment. Do you see a lot of these opportunities?

Ken Silver, Chief Executive Officer, CT REIT

They are out there, for sure. I would say that, you know, since we went public, I'd say the range of opportunities that we find in front of us is probably wider, more varied and deeper than we even originally imagined, and I think this transaction just kind of represents why we feel that way. Certainly, there are others out there and sometimes it's just a question of timing as to when circumstances come together that, you know, we can do something with a vendor that makes sense.

Alex Avery, CIBC

Okay, and then just the way that I'm thinking about it, I guess you could kind of break it down into two subsets, one where you have an existing property or an existing Canadian Tire property adjacent to something else; and then, I guess, perhaps more broadly, have you been seeing much in the way of vacated Target stores or other retail owners that have recently vacated space that you might be able to take advantage of and redevelop those properties?

Ken Silver, Chief Executive Officer, CT REIT

Well, certainly, there are a large number of properties where Canadian Tire shadow anchors an adjacent property and we certainly think of those as potential opportunities for us. Clearly, there's lots of change happening in the retail sector right now and we continue to work closely with the Canadian Tire real estate team on their plans for the various retail banners and are always looking for opportunities that might shake out of that for the REIT.

Alex Avery, CIBC

Okay. Then, I guess, just trying to get a little bit more sense for, I guess, how the third party acquisition opportunity set is evolving, would you say that it's picking up?

Ken Silver, Chief Executive Officer, CT REIT

I think it will be picking up. Right now, I'd say that there are large segments of our industry that are distracted and busy repositioning properties as a result of Target's exit. I suspect there will be increasing opportunities that will fall out of—you know, once that stuff gets resolved.

Alex Avery, CIBC

Okay, that's great. Thank you.

Ken Silver, Chief Executive Officer, CT REIT

Thank you.

Operator

Thank you. Once again, please press star, one at this time if you have a question.

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

Troy MacLean, BMO Capital Markets

Good morning.

Ken Silver, Chief Executive Officer, CT REIT

Morning.

Troy MacLean, BMO Capital Markets

What type of tenants are you looking for to fill the 29,000 square feet of space that you have under development right now, you know, that is not committed to lease but you want to develop?

Ken Silver, Chief Executive Officer, CT REIT

Primarily, those are our pad deals, so it would be the usual suspects, restaurants, banks, potentially dollar stores, you know, typically users of up to about 5,000 to 10,000 square feet.

Troy MacLean, BMO Capital Markets

Do you expect to have that leased this year or is that—how is leasing progressing on that?

Ken Silver, Chief Executive Officer, CT REIT

Leasing is progressing well. Our focus was primarily to get the Canadian Tire banners under construction as quickly as possible, and the lease-up of the pads is following, we have a fair bit of interest. I wouldn't expect that they will be built and income-producing this year, so I would say most likely next year.

Troy MacLean, BMO Capital Markets

Then just on the Ottawa redevelopment, you mentioned that you could buy the CT store, that they would leave to go to that mall for redevelopment. What would you want to redevelop that property into?

Ken Silver, Chief Executive Officer, CT REIT

Well, it could be a complementary use to the uses in the mall. Any of the retailers that we couldn't accommodate inside the redevelopment of the mall could be candidates for something, say, in a small strip, on the old Canadian Tire parcel. There's an existing Canadian Tire gas bar on the property that we would expect to be redeveloped, as well.

Troy MacLean, BMO Capital Markets

Thank you. I'll turn it back.

Operator

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

Michael Smith, RBC Capital Markets

Thank you. Louis, you talked about the valuation metrics and how they've stayed constant since the IPO. You know, bond yields have been up and down since then, they're now down. Could you talk about where—you know, if they were to change, where's the pressure?

Louis Forbes, Chief Financial Officer, CT REIT

Are you asking is there a directional bias to where we see them going?

Michael Smith, RBC Capital Markets

Yes.

Louis Forbes, Chief Financial Officer, CT REIT

Yes, okay.

Michael Smith, RBC Capital Markets

Yes, yes, exactly.

Louis Forbes, Chief Financial Officer, CT REIT

Okay, well, we've got some indication on that. We have a very well thought-out and documented process for valuing our income-producing properties, and that process also includes the materiality threshold. In other words, cap rates can move and we can observe that movement in cap rate, but we do nothing, unless the line is getting pushed more than a certain amount, and that's just because—I mean, we all acknowledge there's as much art as there is science in property valuations and there's no point in moving for $5 million amounts, because our estimate isn't that accurate.

So, a long-winded response, but we have seen some downward movement in cap rates in some of the markets that we operate in, and so I would say cap rates are lower, a bit, than what we have used, but not lower enough to cross our materiality threshold, so we haven't adjusted our numbers. A small…

Michael Smith, RBC Capital Markets

Sorry, go ahead?

Louis Forbes, Chief Financial Officer, CT REIT

A small downward bias is the short answer.

Michael Smith, RBC Capital Markets

Would that be—when you say "some markets" is that just the bigger markets, or is there any—or is it across the board?

Louis Forbes, Chief Financial Officer, CT REIT

No, I would say it's certain urban markets.

Michael Smith, RBC Capital Markets

The smaller markets, it's pretty consistent, pretty flattish?

Louis Forbes, Chief Financial Officer, CT REIT

It's very consistent.

Michael Smith, RBC Capital Markets

Okay. Thank you.

Operator

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

Ken Silver, Chief Executive Officer, CT REIT

Thank you, Operator, and thank you all for joining us today. We expect our third quarter will be released the week of November 9, and we look forward to speaking with you then. Thanks.

Operator

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