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PECO.OQ - Phillips Edison & Co Inc To Host GROW Update For Financial Advisors And Retail Investors Call

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PRESENTATION

Operator

Good afternoon, and welcome to Phillips Edison & Company's webcast presentation for its financial advisers and retail investors. My name is Eric, and I will be your operator today. Before we begin, I would like to remind our listeners that today's webcast is being recorded and simultaneously webcast. I will now turn the call over to Kimberly Green, Head of Investor Relations. Kimberly, you may begin.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, operator. Good afternoon, everyone. Thank you for joining us for the PECO GROW update for financial advisers and retail investors. I'm joined on today's webcast by our Chairman and Chief Executive Officer, Jeff Edison; our Chief Operating Officer, Bob Myers; and our Chief Financial Officer, John Caulfield.

Once we conclude our prepared remarks, we will answer questions submitted through the webcast chat function. An archived version of the webcast and presentation slides will be published on our Investor Relations website.

Before we begin, I would like to remind our audience that statements made during today's webcast may be considered forward-looking, which are subject to various risks and uncertainties as described in our SEC filings. In addition, we may also refer to certain non-GAAP financial measures. Information regarding our use of these and reconciliations of these measures to our GAAP results are available for download on our website. With that, it is my pleasure to turn the call over to Jeff Edison, our Chief Executive Officer. Jeff?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Kim. Good morning, everyone, and thank you for joining us. Last week, the PECO team delivered another solid quarter of growth with continued strength in portfolio occupancy and rent spreads. We continue to see a resilient consumer and strong retailer demand. We believe we will end the year with positive earnings growth despite the higher interest rates and other macro headwinds.

The continued strength of our operating performance is attributable to our differentiated and focused strategy of exclusively owning grocery-anchored neighborhood shopping centers. It's also attributable to our ability to drive results at the property level through our integrated and cycle-tested operating platform.

I would like to highlight the Board's announcement in September to increase PECO's dividend distribution rate by 4.5%. We offer a predictable income stream from monthly distributions, combined with our unique ability to drive internal and external growth. We believe an investment in PECO provides shareholders with the right balance of stability and growth. PECO continues to benefit from a number of positive macroeconomic trends that create strong tailwinds and drive strong neighbor demand. These trends include the following: a resilient consumer, hybrid work, migration to the Sunbelt, population shifts that favor suburban communities, and the importance of physical locations in last-mile delivery. The impact of these demand factors are further amplified due to limited new supply over the last 10 years and going forward. Current economic returns do not justify the cost of new construction.

The price of PECO's common stock was $35.09 per share as of market close on November 3, 2023. PECO's stock price is 10% higher year-to-date. This compares favorably to the year-to-date performance of the MSCI real estate index, which was down 75 basis points, and our retail shopping center peers were down 2%. Your investment in neighborhood grocery-anchored necessity-based retail provides you the economic resilience plus the opportunity to realize potential upside from here.

Our largest stockholders include many high-quality institutional investors. Together, these funds manage trillions of dollars and continue to believe in the PECO story. They are invested right alongside you. We continue to believe there is untapped demand for PECO's stock in both the retail and institutional markets. The demand for space in our grocery-anchored neighborhood shopping centers is better than we've seen in the 30 years' history of PECO. Our neighbors are thriving in our grocery-anchored centers as evidenced by our continued high occupancy, renewal rent spreads and retention. PECO's leasing team continues to convert this demand into new leases, which is reflected in our financial results.

In addition to our strong rental growth trends, we continue to invest in value-creating ground-up outparcel development and repositioning projects. These projects have a meaningful impact on our long-term NOI growth. This activity remains a great use of our free cash flow and produces attractive returns with limited risk. We are making great progress on these projects and we are working hard to continue to build our future pipeline.

Additionally, PECO is positioned for growth and to gain share. We buy grocery-anchored shopping centers from a target market of 5,800 identified shopping centers across the United States. We have seen an increase in deal activity beginning in the third quarter as cap rates continue to adjust in response to higher interest rates. Based on our current pipeline, we increased the low end of our guidance range for acquisitions. While it's still a market in transition, we are confident in our ability to close on $250 million to $300 million in net acquisitions this year.

We continue to have a very disciplined acquisition process. We remain focused on accretively growing our shopping center portfolio at the right price while achieving our acquisition hurdle of a 9% unlevered IRR. The acquisitions that we will complete in the second half of the year underwrite to over 9.5% unlevered IRR. There's no question that inflation, higher interest rates and global conflict continue to create challenges. Importantly, despite the impacts of higher interest rates and other macro headwinds, we are delivering earnings growth due to the continued strong performance of our portfolio, driven by leasing spreads, occupancy and high retention. The PECO team remains focused on investing in our portfolio and driving cash flow growth.

In addition, we still have one of the lowest levered balance sheets in the shopping center space. With a fortress balance sheet and ample liquidity, we remain prepared for challenges and opportunities that may arise for the rest of this year and into next year.

I would like to provide a quick update on the proposed Kroger and Albertsons merger. In September, Kroger announced the divestiture plan with C&S Wholesale Grocers in connection with the proposed Kroger and Albertsons merger. We remain cautiously optimistic about the impact on PECO. We continue to believe it is ultimately positive for PECO, for our centers and for the communities that our centers serve. While the market still gives the merger a low probability of occurring, should it close and 413 stores are sold to C&S, the impact on PECO is a net positive. C&S has been operating for over 100 years, and they're one of the largest wholesale operators with demonstrated experience in retail operations.

We believe the recent announcement is potentially a better outcome for PECO than a new SpinCo that Kroger and Albertsons had considered. Importantly, should the merger occur, the majority of our Albertsons stores will be operated by an excellent operator in Kroger. If the merger does not occur, our Albertsons-anchored centers will continue the strong performance that they have enjoyed to date.

I would also like to acknowledge the press release we issued last week announcing changes to PECO's leadership team. Devin Murphy will step down as President on December 31. At that time, Bob will become President; and Joe Schlosser, currently the Head of Portfolio Management, will become our Chief Operating Officer and an Executive Vice President. This is the culmination of our long-standing succession plan. Bob and Joe are extremely talented, proven leaders and team players who have been critical to the consistent strength of our operating performance. They have played an important role throughout the majority of PECO's 30-year history, growing the portfolio into what exists today.

They have successfully managed operations, development, acquisitions and dispositions through multiple cycles. I'm confident they will continue to scale the company and the portfolio from here. I look forward to continuing to partner with them in delivering long-term growth and value creation. Devin will serve as the Managing Director of Investment Management through his planned retirement at the end of June. During this time, he will work closely with me and the team to ensure a seamless handoff of his current responsibilities. Devin is also in discussions with the Nominating Governance Committee about joining PECO's Board of Directors following his retirement. With that, I would like to now turn it over to Bob. Bob?

Robert F. Myers - *Phillips Edison & Company, Inc. - Executive VP & COO*

Thank you, Jeff. Well, good afternoon, everyone, and thank you for joining us. We are excited about the future growth opportunities at PECO, and we hope you will continue to remain invested alongside us for many years to come. Here is why we are excited about the future of PECO. We exclusively own and operate grocery-anchored neighborhood shopping centers anchored by the #1 or #2 grocery by sales in a market. Our differentiated strategy and strong operating results allow us to provide regular income and strong total returns to our investors.

We are an omnichannel landlord. Our neighborhood centers are complementary to e-commerce and have thrived in this emerging omnichannel environment. We are well aligned and experienced. Our management team is PECO's largest stockholder, owning approximately 8% of the company. It is hard to find a better alignment than having meaningful skin in the game.

Since our founding, our exclusive focus has been on owning and operating grocery-anchored shopping centers anchored by the #1 or #2 grocer in our market. Our top neighbors are strong grocers. Kroger and Publix are PECO's #1 and #2 neighbors, respectively. As we have said, PECO's 3-mile trade area demographics, including an average population of 65,000 people and an average median household income of $79,000. These are in line with Kroger and Publix store demographics. Our centers are close to the end consumer where America's leading grocers are profitable and, in turn, our neighbors are profitable, which allows PECO to be profitable.

Over 70% of PECO's total rent comes from necessity-based goods and services, which drive regular and reoccurring foot traffic from customers in the 3-mile trade area. These categories include grocery stores, quick-service restaurants, beauty, health care and medical retail or medtail, as we call this growing category. We believe consumers will continue to visit and spend in these categories even if they do reduce spending on vacations, luxury items and other discretionary purchases. We focus on building community at each center we own, which is why we refer to our tenants as neighbors.

We are creating locally smart centers that will have the right mix of neighbors for the communities they serve. Our nationwide portfolio is geographically diverse. Rather than focusing exclusively on coastal markets, we focus on well-located suburban markets with growing populations and strong demographics. We compete at the corner of Main and Main. In addition, our exposure to at-risk retailers continues to remain limited. This is deliberate and a result of our grocery-anchored strategy and focus on necessity-based goods and services. All of these factors combined create regular monthly income and strong returns for our investors.

PECO's properties and our experienced team have delivered strong performance in many market cycles. We have a consistent track record of growing stockholder value. Our goal remains constant. We are focused on increasing the principal amount of your investment and providing income in the form of regular monthly distributions that can grow over time.

As Jeff mentioned earlier, PECO announced in September that the Board of Directors approved an increase of 4.5% to the monthly distribution rate. PECO has a stable payout ratio, which gives us confidence in the stability of our distribution rate while allowing us to invest meaningfully in our portfolio and drive additional cash flow. We're proud of our track record, our positive results. We believe our future is bright. We are well positioned to drive strong investor returns going forward.

We are an omnichannel landlord, which allows us to capitalize on the future of retail real estate. Our brick-and-mortar centers are a critical component to both last-mile delivery and buy online and pick up in store, or BOPIS. Through BOPIS, customers order their products online and then pick them up at our centers. Grocers have embraced BOPIS as delivering groceries continues to be logistically and economically challenging. Our brick-and-mortar assets are conveniently located in the communities they serve. This makes them ideal for BOPIS customers. Our centers help solve the last-mile delivery dilemma faced by retailers.

Because they are located close to the end consumer, our centers can also act as a local distribution point serving the surrounding neighborhoods. Our centers continue to be essential to their communities. As the needs of consumers and neighbors change, we are successfully evolving with them. As an omnichannel landlord, we are helping our neighbors grow their own businesses.

Lastly, we are well aligned with our investors. As we said, PECO's experienced and aligned management team owns 8% of the company. We have meaningful skin in the game and are committed to driving stockholder value. We are proud of our team and how much we have accomplished. Being named a Top Place to Work in Cincinnati for the seventh year in a row confirms that our strength is truly with our associates. Their engagement, expertise, dedication and innovation will continue to drive our success. Now I would like to turn the call back over to Jeff. Jeff?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Bob. In summary, we are encouraged by the meaningful growth opportunities that lie ahead. We encourage you to continue to grow with us. I believe PECO is a great long-term investment opportunity. As PECO's largest stockholder, it's important for you to know that I've never sold a share of PECO, and I do not plan to sell any shares in the near future. We appreciate your confidence in our team and your many years of support. We could not be more excited about the future of PECO, and we sincerely thank you for your investment. We will now answer your questions.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Jeff. Before we take questions, I would like to quickly mention that PECO has recently published our third quarter 2023 infographic, which is available on our Investor Relations website. This helpful resource for financial advisers and our retail investors highlights our operating and financial performance, so be sure to check it out if you haven't already.

In addition, please do not hesitate to reach out to ask a question or information requests during the quarter. We have provided the e-mail address for our Investor Relations team in today's PECO GROW presentation, which is posted to the webcast and our website. Now we will begin the question-and-answer session. (Operator Instructions)

QUESTIONS AND ANSWERS

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Our first question, I think this one is for you, Bob. What is your current view on the health of the consumer? And as a follow-up, what is your outlook for the retail and leasing environment as we head into 2024? Bob?

Robert F. Myers - *Phillips Edison & Company, Inc. - Executive VP & COO*

Thanks, Kim. Well, we're encouraged by the continued positive trends we are seeing, and we continue to see a resilient consumer and steady foot traffic to all our properties. We are seeing continued strong retailer demand, no current signs of slowing down, currently not seeing any cracks. We expect leasing spreads to end of the year strong and remain strong into 2024. We are currently in one of the best operating environments I've seen in over 30 years.

And we continue to benefit from a number of positive macroeconomic trends that are further supporting neighbor demand, including hybrid work, migration to the Sunbelt and population shifts that favor suburban markets. These demand factors are further accelerated with limited new supply delivered to the market since 2008. So I'm encouraged and bullish about what lies ahead.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Bob. Our next question, I think this one would be for Jeff. Jeff, if you want to take this one. How does your outlook change if the U.S. would move into a recession?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Well, it's a great question and one that we do think about a lot. The -- obviously, the severity of the recession has a big impact. Our focus on necessity-based retail gives us a great protection in a recession environment. It's the last thing that the consumer changes their spending habits on. And we look back to 2 of the biggest events we've had, both the pandemic and the great financial crisis.

And in the great financial crisis, we lost 1.6% occupancy is all, and we lost only 0.8% during the pandemic. Our shopping centers are very resilient in a difficult environment and we've proven that over time. So I would say that we're -- obviously, recession is not good for any retail. But as a whole, we're very well protected from that. And when you think about 40% of our income coming from the grocer, you know that we have that draw, but we also have that stability in our cash flow, which has been one of the core anchors for our business over a long period of time.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Jeff. Our next question, this is a good one for Bob. So with the recent announcement, and Jeff, you mentioned the leadership team changes, Bob, in your new role as President, what will be your focus in the role? And maybe speak to what you're looking forward to in the role as President?

Robert F. Myers - *Phillips Edison & Company, Inc. - Executive VP & COO*

Yes, great question. I think I'll start by just sharing a little bit of my background. I've been with the company for 20 years. And I can remember when I started, we had 20 associates in about 30 properties. I was hired in as a senior leasing agent at the time and kind of moved through some cross-functional training opportunities and growth of the organization from a senior leasing agent to a leasing manager, where I managed 5 leasing agents to running the department as VP of Leasing. That all occurred over about a 7-year period. I was also then a VP of Leasing and Operations, so I had the opportunity to learn operations in conjunction with my past responsibilities as property management in other organizations.

And then for the last 13 years, I've been Chief Operating Officer at Phillips Edison. It's been an incredible ride, but it's consistent with our culture and what we do and our focus on cross-functional training and promoting from within. And I want to continue that move as I transition into this new role. I helped grow the portfolio as it exists today. Successfully hired and managed operations, development, acquisitions, construction, portfolio management and dispositions all through different economic cycles, and I'm confident in our ability to continue to do so.

We will continue to focus on executing our simple strategy and winning at the property level. I view every asset as though it's our own individual business, and our jobs here at Phillips Edison is to pick up all the pennies. And I certainly look forward to continuing to partner with Jeff and the PECO team in delivering long-term growth and value creation. Thanks, Kim.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Bob. And I actually just got another question, I think, is good for you. So where are you seeing leasing demand today and maybe speak to what retailers are growing at PECO?

Robert F. Myers - *Phillips Edison & Company, Inc. - Executive VP & COO*

Sure, sure. Well, I would say our ongoing success in leasing continues to be driven by the fundamental strong demand for our space across our grocery-anchored portfolio and targeted markets. And it continues to come from necessity and service-based neighbors. Currently, we're seeing leasing demand from restaurants, health and beauty, medical. I think restaurants represent 40% of our leasing pipeline today. I'm seeing a lot of activity from Starbucks, Chipotle, Jersey Mike's, Dave's Hot Chicken, to name a few examples. Health and beauty services are around 11% of our current demand. And I think about health and wellness as an example. And I see expansions in med spa, massage, fitness, retailers such as EOS Fitness, Orangetheory, Hand & Stone Massage, to name a few.

Medtail continues to be very active. It represents about 6% of our current ABR but 20% of our leasing pipeline. I see a lot of expansion in urgent care. Retailers such as AFC, American Family Care urgent care, Humana, BenchMark Physical Therapy. Pet health continues to be strong at Banfield Pet Hospital, to name a few. We'll continue to see a lot of growth in demand on the medical side, dental, vision, chiropractic, physical therapy.

And our local medical neighbors, they tend to sign on for longer lease terms. They've been in the space for an average of over 10 years, which is higher than the local average of 9 years. Beauty and personal services are e-commerce-resistant and tend to be recession-resistant. Our local beauty neighbors sign longer-term leases and have been in the space for over 11 years, higher than the local average of 9 years. I don't see anything slowing down in our horizon, and there are a lot of retailers that our national account team is focused on continuing to grow and expand into 2024.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Bob. And we have a couple acquisitions questions. I'll ask the first one, and this is probably a good one for John, for you to answer. So Jeff, in his remarks, mentioned our acquisition -- gave an update on our acquisitions. So the question that came in is, as it relates to our acquisitions, how do we fund that activity. John, do you want to answer that one?

John P. Caulfield - *Phillips Edison & Company, Inc. - CFO, Executive VP & Treasurer*

Certainly. Sure. Thanks, Kim. So we fund it with our balance sheet. So we have over $700 million of liquidity available to us on our revolver. And the growth from our assets give us cash flow that we're able to invest back into the properties. So we are 30% levered today so 4.9x on a debt-to-EBITDA basis. That 30% leverage compares to 50% right before PECO's IPO. So this gives us a lot of capacity to buy.

When the time is right, and I think we're seeing changes that give us confidence in our ability to execute and to continue to drive growth in this portfolio, but the key piece we've got is low leverage at times like this will allow us to be opportunistic. In the quarter, we did take the opportunity to -- we raised about $70 million in equity, which is allowing us to buy these assets while maintaining that low leverage. So as the market continues to change, we are prepared to take advantage of it with our balance sheet.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, John. And then we got a question from Daniel, and this one might be a good one for you, Jeff. Maybe if you could speak to if there are specific markets that we're looking at from an acquisition standpoint as we're looking to grow the portfolio.

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

So our acquisition strategy is based upon a core group of properties that fit our demographic and are anchored by the #1 or #2 grocer. There are 5,800 of those centers across the country, and we are very focused on -- and Bob sort of mentioned this in his question, which is we don't compete in regions, we don't compete in cities. We compete on the corner of Main and Main in a 3-mile radius around our centers.

And we have to actually win at each center that we own. And so if we have 20 properties in Atlanta, they don't compete against each other. They compete against other competitors that are in that 3-mile radius. So as we think about sort of the -- where we're going to buy, we're going to buy in that targeted market of 5,800 centers. And we're going to be very focused on making sure that the market that we're concerned about, that 3-mile radius around our centers, that we have the best center in that 3-mile radius and that we can drive results from that. And then those results on 300 shopping centers will build up to really strong growth for the company as a whole.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Jeff. And then another question for you, Jeff. This is related to our dividend distribution. A lot of -- the question is, a lot of REITs have moved towards a quarterly dividend. Are you planning to change your monthly dividend to a quarterly distribution? And as a follow-up question, we also got this one, do you have plans to increase PECO's dividend?

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

So the answer is no. We are not changing from a month -- or from our monthly dividend. We believe in it strongly and we think it's an important thing for our investors. Obviously, it's a Board decision, but I can tell you that there is -- we don't have any conversation about doing anything but continuing to pay that.

And we also, as you guys know, we did increase the dividend by 4.5% in October. That's one of the important things in the overall return for us that we are very focused on. So I think the -- for us, obviously, as you've heard in our presentation, we're very focused on growing the stock price of PECO, and we're very focused on growing our dividend. We think that those are 2 of the key pieces why investors really like PECO, and they see it as a long-term part of their portfolio. And we are not doing anything to change that. We're going to stay focused on our strategy. We're going to stay focused on growing our monthly dividend and growing the stock value of PECO.

Kim Green - *Phillips Edison & Company, Inc. - VP of IR*

Thank you, Jeff. All right. Well, this concludes our question-and-answer session. Thank you again for everyone who submitted questions. And again, if you have a question, you want to reach out to PECO, please don't hesitate to reach out to the -- we have the e-mail address on the PECO GROW webcast, and we'd love to hear from you. With that, I'll turn it back over to you, Jeff, for some closing comments.

Jeffrey S. Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Great. Thanks, Kim, and thanks, everybody, for being on the call. Everything we've done over the last 30 years and particularly since the IPO positions PECO to continue to outperform. Our well-aligned and cycle-tested team, fully integrated operating platform and grocery-anchored strategy place PECO in an excellent position.

We continue to see a resilient consumer and strong retailer demand. We believe we will end the year with positive earnings growth despite the interest rate headwinds that are in front of us. We believe our fortress balance sheet and liquidity will allow us to take advantage of acquisition opportunities as they arise. We remain optimistic about the future growth opportunities of PECO. We hope you share this excitement and will continue to remain invested right alongside us for many years to come.

On behalf of the entire management team, I'd like to express our appreciation for your continued support. Thank you again for joining us today. Please do not hesitate to reach out if you have any additional questions. Have a great day. Thank you.

Operator

Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.

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