REFINITIV STREETEVENTS

EDITED TRANSCRIPT

PECO.OQ - Q1 2022 Phillips Edison & Co Inc Earnings Call

EVENT DATE/TIME: MAY 06, 2022 / 4:00PM GMT

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

CORPORATE PARTICIPANTS

Devin Ignatius Murphy *Phillips Edison & Company, Inc. - President*

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

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

Stephanie Hout *Phillips Edison & Company, Inc. - Director of IR*

CONFERENCE CALL PARTICIPANTS

Caitlin Burrows *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Craig Richard Schmidt *BofA Securities, Research Division - Director*

Floris Gerbrand Hendrik Van Dijkum *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

Michael William Mueller *JPMorgan Chase & Co, Research Division - Senior Analyst*

Richard Hill *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

Tamara Jane Fique *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Todd Michael Thomas *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

PRESENTATION

Operator

Good morning, and welcome to Phillips Edison & Company's First Quarter 2021 Results Presentation. My name is Latif, and I will be your conference call operator today. Before we begin, I would like to remind our listeners that today's presentation is being recorded and simultaneously webcast. The company's earnings release, quarterly financial supplement and 10-Q were issued yesterday, May 5, after market close. These documents and a replay of today's call can be accessed on the Investors section of the Phillips Edison & Company website at phillipsedison.com. I would now like to turn the call over to Stephanie Hout with Phillips Edison & Company.

Stephanie Hout - *Phillips Edison & Company, Inc. - Director of IR*

Thank you, operator. Good afternoon, everyone, and thank you for joining us. My name is Stephanie Hout, and I'm the Director of Investor Relations with Phillips Edison and Company. Joining me on today's call are our Chairman and Chief Executive Officer, Jeff Edison; our President, Devin Murphy; and our Chief Financial Officer, John Caulfield.

During today's presentation, Jeff will discuss our differentiated strategy and touch on the highlights for the quarter. Devin will discuss our first quarter operational results, and John will review our first quarter financial results, our recent capital markets activity and discuss our guidance. Lastly, Jeff will return to provide an update on our investment activity and provide closing comments. Following our prepared remarks, we will answer questions from the institutional analyst community.

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

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Thank you, Stephanie. Good afternoon, everyone. We're encouraged by the activity we have seen since the start of the year, which is reflected in our Q1 results. The leasing environment continues to be strong as evidenced by our robust leasing spreads, high retention rate and resulting high occupancy level. There is continued demand in the market to be located at centers anchored by the #1 or #2 grocer.

These grocers and our necessity-based retailers drive high levels of foot traffic to our small shops. Our team has been able to leverage this demand and the pricing power that we have as a result of the high occupancy to produce exceptional new and renewal leasing spreads. Our strong retention rates and high level of collections are a testament to our strategy. Our neighborhood shopping centers and their formats drive results.

On the acquisition front, the market for grocery-anchored centers remains competitive. However, we believe a key differentiator for us is the markets we operate in. Our team continues to find value and drive returns in centers anchored by the #1 or #2 grocer in our markets. We have successfully done this across multiple cycles for over 30 years, one asset at a time.

We remain disciplined in our acquisition efforts and continue to target acquisition IRRs over 8%. When we review the assets we have acquired in 2021, they are all performing better than our underwriting, and we're very optimistic about our 2022 acquisitions.

Yesterday, we announced we are reaffirming our 2022 guidance of net acquisitions of $300 million to $400 million this year. We are targeting unlevered IRRs of over 8%. Our strong results for the quarter and the continued successful execution of our growth strategy by the team have allowed us to raise the lower end of our core FFO and same-center NOI guidance for 2022. John will speak about this shortly. Now I'd like to turn the call over to Devin who will speak in more detail about our operating results for the quarter. Devin?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Thank you, Jeff. Good afternoon, everyone. Thank you for joining us today. First, I will review the operational and leasing highlights of the quarter. As of 3/31, our leased portfolio occupancy was 96.2% compared to 94.8% at 3/31/21, an increase of 140 basis points.

Anchor leased occupancy increased by 80 basis points from a year ago to 98.1%. Our in-line leased occupancy increased by 280 basis points over last year to 92.6%. Sequentially, our in-line leased occupancy decreased by 10 basis points from 12/31/21 due to vacancy that we gained through acquisitions that we closed on in the quarter.

Our economic occupancy improved this quarter to 95.7% and the spread between leased and economic occupancy tightened by 50 basis points, which brings this spread close to our historical level of approximately 60 basis points. The smaller sized spaces in our centers allow us to move neighbors into the space quickly post lease execution.

During the quarter, we executed 92 new and 152 renewal leases and options totaling 776,000 square feet. This total lease volume is consistent with our historical levels of leasing volume. Our expectation is that renewals will continue to make up a larger percentage of our leasing volume given our high retention rates. We view our high retention rate as a strength since there is no downtime and less TI required for a renewal lease versus a new lease.

Comparable new lease rent spreads were 34% this quarter. Comparable renewal rent spreads were 14.7%. The total combined rent spread for the quarter, inclusive of new renewal and option leases was 14.6%. We continue to see strong demand for space in our centers and executed leases this quarter with retailers such as Panera Bread, Jersey Mikes, and CenterWell Primary Care, a Humana company.

As Jeff noted, we are encouraged by the continued success that our neighbors are enjoying at our centers. During the first quarter, we realized a retention rate of 89.7%. The leasing spreads that we are seeing, combined with our strong retention rate is clear evidence of the continued high demand for space in our centers and the pricing power that we currently enjoy.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Lastly, I will discuss the results we achieved through our development and redevelopment activities. We continue to execute on our pipeline of ground-up and repositioning projects. Currently, we have 20 ground-up and redevelopment projects under active construction, which represent total investment of approximately $48 million. The average yield on these projects is estimated to be 10% to 12% unlevered.

We stabilized 2 of these projects in the first quarter. Both are fully leased and rent has commenced. In addition to the 20 active projects, we also have a pipeline of 10-plus projects expected to begin construction throughout the balance of this year. This activity will keep us on pace to meet our target of $45 million to $50 million of total redevelopment spend for 2022 with yields of 10% unlevered.

This concludes the summary of our operating results for the quarter. I will now turn the call over to John for a discussion of our financial results, recent capital markets activity and guidance. John?

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

Thank you, Devin, and good afternoon, everyone. First quarter 2022 NAREIT FFO increased 49.1% to $67.1 million or $0.52 per diluted share. This result was driven by an increase in rental income and improvement in collections as well as a reduction in noncash expense as a result of the final settlement of the earn-out liability with the issuance of 1.6 million operating partnership units in January of this year.

Our first quarter FFO increased 14.2% to $72.6 million, driven by increased revenue at our properties from our higher occupancy levels and strong leasing spreads, our expanded portfolio, as well as lower interest expense from our lower leverage level versus a year ago.

On a per share basis, core FFO decreased to $0.56 per diluted share as a result of the number of incremental shares we issued during our July 2021 underwritten IPO. Sequentially, our core FFO per share increased from $0.47 in the fourth quarter on higher revenues and lower property operating and G&A expenses.

Our Q1 2022 same-center net operating income, or NOI, increased to $89.8 million, up 6.8% from a year ago. This improvement was primarily driven by higher occupancy, a 2.8% increase in average base rent per square foot and stronger collections compared to 2021.

Turning to the balance sheet. We continue to view our balance sheet as a strength with our net debt to adjusted EBITDAR of 5.7x as of March 31, 2022, compared to 5.6x at December 31, 2021. At March 31, our debt had a weighted average interest rate of 3.2% and a weighted average maturity of 5.1 years. Approximately 96% of our debt was fixed rate.

At the end of the period, we had approximately $462 million of total liquidity, comprised of $17 million of cash, cash equivalents and restricted cash, plus $445 million of borrowing capacity available on our $500 million credit facility. We intend to utilize our revolving credit facility to fund our acquisition plans. With no significant debt maturities due until 2024, we continue to carefully evaluate and monitor the capital markets as we consider our future financing options.

On February 10, we filed an automatically effective shelf registration statement and commenced the $250 million ATM equity offering program. This provides us with a useful tool to efficiently access the capital markets as opportunities arise. We have not utilized the ATM to date, and we'll evaluate future use based on a combination of favorable market conditions, acquisition opportunities and identifying uses of proceeds that are earnings accretive.

AAs we have previously communicated, we have an external growth target to buy $1 billion of assets over the 3 years post our July 2021 underwritten IPO. While we do not need to issue equity to execute this plan, we will consider equity opportunities in the future as appropriate to allow us to maintain our strong balance sheet position. I want to reiterate that any proceeds raised in the equity or debt capital markets will be invested in a manner that we believe will be accretive to our per share financial metrics.

As Jeff mentioned, we're pleased to raise the midpoint of our NAREIT FFO and core FFO per share guidance based on our success in identifying assets early in the year and our favorable operating results year-to-date. Our new range for core FFO per share is $2.18 to $2.24. We are also tightening

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

the range and increasing the midpoint for our same-center NOI guidance to 3.25% to 4%. We are reaffirming our net acquisition guidance of $300 million to $400 million for 2022.

Jeff will be discussing our acquisitions during the period as well as our pipeline. The opportunity to reach our acquisition target ahead of schedule, gives us confidence in our financial guidance for the year. We continue to evaluate all centers that fit our investment criteria as they come to market. And as we look ahead, we will use our [BODsquad] portfolio analysis to consider trades of additional acquisitions for lower growth assets in our existing portfolio.

We believe this strategic exercise of match funding is prudent as we evaluate the impact of the debt capital markets and rising interest rates on the transaction market. With that, I would like to turn the call back over to Jeff to expand on our investment activity for the quarter and recap our long-term growth strategy. Jeff?

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

Thank you, John. In the first quarter of 2022, we acquired 3 grocery anchored shopping centers for approximately $100 million. Our acquisitions included the Cascades Overlook in Sterling, Virginia in the GC MSA. This center is in a trade area with very favorable income and population demographics. In addition to the vacancy, we plan to lease at the center, we believe there is leasing upside at this asset through increasing occupancy and marking rents to market.

We also purchased Oak Meadows in the Austin MSA. It is in a location where we expect to see continued growth as a result of planned in-process developments in the surrounding trade area. We believe we can achieve growth by completing the leasing efforts as well as through existing contractual rent bumps.

Our final purchase during the period was the shops at Avalon located in Spring Hill, Florida, near Tampa. This center provides a unique opportunity for us. The purchase included multiple undeveloped land parcels where we believe we can deliver growth through various forms, including ground leases, ground-up development and land sales. This is in addition to the growth we can achieve through the upside in leasing the existing vacant space.

We are currently in the closing process of an additional grocery-anchored shopping center up for approximately $70 million, which should close this month. Additionally, we are in active negotiations on other centers that would bring us meaningfully closer to our acquisition target. We are confident we will meet our acquisition guidance. All these centers acquired or under contract would exceed our 8% unlevered IRR. We are excited at the opportunities that our team has been able to identify and convert in this market.

Now before we get to the Q&A section, I would like to quickly recap our quarter. The leasing environment continues to be strong as evidenced by our leasing spreads and retention rates. We are capitalizing on our ability to drive rents. Our team continues to find opportunities in the acquisition market that meet our required returns. As a result of this internal and external growth, we're able to tighten and improve our financial guidance ranges. Now with that, we will begin the Q&A portion of our call. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Craig Schmidt of Bank of America.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Craig Richard Schmidt - *BofA Securities, Research Division - Director*

I'm wondering, given the reduction in activity, first quarter '22 versus '21, do you see that happening for the second, third and fourth quarter? Or was this just a pause and you might return to higher leasing volumes?

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

Craig, this is Jeff. Thank you for the question. And if you look at the total volume of all of our leasing activity, it was quite in line during the first quarter. We just had a lot more retention than is normal and our new leases was down slightly. But overall, I mean, I think our backlog going into the quarter is at a very strong level, very consistent with what we've been able to do historically, if not a little ahead of that.

Craig Richard Schmidt - *BofA Securities, Research Division - Director*

I guess that kind of ties into the follow-up. You had strong leasing, but particularly impressive was your strong leasing on renewals. Is there anything that's driving your renewals better than some of your peers?

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

Devin, do you want to take that?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Sure. I mean, Craig, we've always enjoyed very high retention rates in our portfolio. Again, we believe this is one of the benefits of our business model. And our retention rate in the quarter was highly consistent with what our retention rate has been over time. We've over time, enjoyed a retention rate in the high 80s. And the reason that we view that as a strength is the fact that, as you know, with a retention rate at that level, we're not incurring any downtime and the amount of TI that we're having to put back into the space relative to what we have to put in on new leases is dramatically lower.

So we just think it's a function of our format and a function that our neighbors are performing well in our centers and want to stay in our centers. And therefore, we're able to get the kind of release in spreads we saw in the quarter, which on our renewals were in the mid-teens, which is, again, a very high level and compares very favorably to what that level has been historically, which has been circa 8% to 10%.

So we enjoyed that. And we expect to see that continue because we continue to be the beneficiary of a number of the macro trends that our portfolio is benefiting from, which is the growth in the Sunbelt. Over 50% of this portfolio sits in the Sunbelt, and it's 100% in the suburbs, and we benefit from the trend of suburbanization and the trend of working from home, which is creating incremental demand for our centers.

Operator

Our next question comes from Caitlin Burrows of Goldman Sachs.

Caitlin Burrows - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Maybe just a follow-up on the leasing side following those other questions. So it looks like you guys do have some good pricing power, there's good demand. But specifically looking at that lease versus occupied spread it has narrowed. So I'm wondering if you could give some commentary on how leasing activity has been progressing over the past 6 months, maybe how deep it is, types of tenants and what's the outlook for continued occupancy increases? And I know that's a lot. But also, have you noticed any potential tenants get more cautious due to the current macro situation?

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Devin, do you want to take that?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Sure. Thanks, Caitlin. The spread in the quarter actually is more consistent with our historical spread of circa 50 basis points. The spread that you saw in Q4 and Q3 last year of circa 100 basis points was wider than what we've typically seen. Again, one of the benefits of our format is that our average tenant ex the grocer is 2,500 square feet, and we're able to get these tenants into the space very quickly once they sign a lease.

Our average time from lease signature to rent commencement date is between 4 and 5 months. So we don't have a lot of downtime between signing the lease and the tenant actually taking possession and beginning to pay rent, which is a real benefit to our format.

In terms of what we're seeing on leasing activity, the pipeline continues to be very strong. We believe we can continue to grow our occupancy. We believe we'll be able to hit in-line occupancy of 95% by the end of 2023, which is another circa 250 basis points of occupancy upside, and we're confident we'll be able to hit that.

And then we are not seeing tenants pull back yet. Obviously, it's something that we're very focused on and watch very carefully, but we have not yet seen the tenants pull back. In fact, when you look at the kind of occupancy gains we had, the kind of leasing spreads we're getting. In addition to the very attractive leasing spreads, we're getting the tenants to sign up for rent CAGRs that are in the mid-2s. So not only are they agreeing to rent bumps on renewals in the mid-teens, but they're also signing up for CAGRs in the mid-2s. So we just think that points to the continued strength of the leasing environment.

Caitlin Burrows - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I know that average time of 4 to 5 months is, I don't know, impressive or great. So good to hear that. And then maybe a follow-up on the balance sheet side. John, I know you mentioned that you don't need to issue equity to meet your acquisition targets. But with debt-to-EBITDA now at 5.7x, could you comment just what range do you want to stay within. Is lower necessarily better? Or are you equally as comfortable at some higher number? And if so, just wondering what that number range is?

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

So we are at 5.7x, and we're very comfortable with that. But we do have our growth plans in front of us. We would envision that we can take this to 6x. And given the macro uncertainty, we've communicated previously and are still comfortable with the low 6x range. But I think that around 6% is what we're looking at. But as I also mentioned on the call in this time, we want to have all options available to us so that we can seize opportunities as we see them. So with our leverage at 5.7x, I think we're in a good position to continue to do that.

Operator

Our next question comes from Richard Hill of Morgan Stanley.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

Maybe just unpacking Caitlin's questions just a little bit deeper. So 250 basis points of upside of in-line space. It sounds like anchor space is pretty good at 98.1%. There's obviously some structural reasons that you might not be a bit higher than that. So as we're thinking about total portfolio, does that mean total portfolio can maybe go up to around 97% or so?

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Yes. That's correct, Rich. That's the right number.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

Great. And as we think about renewals, obviously, Craig highlighted how well your renewal spreads were in 1Q '22. Is that the new normal given the amount of tenants you're able to capture? Or do you think we're going to go back down to more of an 8% to 9% level. And by the way, those 8% to 9% levels are still really strong as well. What I'm trying to unpack in my own mind is sort of like without asking you a guide, I'm trying to do it myself, what is same-store NOI look like in '23. So if you have 100 basis points of uplift on occupancy, I get that. But should we be thinking about renewals in the 8% to 9% range? Or should we be thinking about renewals in more of the, call it, the low double digits to maybe even in the 14% range.

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Rich, we haven't seen anything in the environment that leads us to believe that these spreads are going to be declining from where they are right now. I mean, as you know, we're in a very dynamic environment with so many things going on between interest rates and war in Europe, et cetera, et cetera.

So we are very hesitant to predict that we're going to see long-term re-leasing spreads in the mid-teens, which is almost double what they've been historically. That being said, we haven't seen anything that leads us to believe that we're not going to be able to continue to see these kind of spreads in the near term.

But in terms of predicting a longer-term trend, as you know, re-leasing spreads in the high single to low double digits is a very strong number, and we're confident with the number in that range. Speculating on a number that's almost 2x that number is something that we are not willing to be that aggressive at this point in time, given all the uncertainty out there in the environment.

Richard Hill - *Morgan Stanley, Research Division - Head of U.S. REIT Equity & Commercial Real Estate Debt Research and Head of U.S. CMBS*

And so maybe that just leads me to my final question here. And at the risk of asking an obnoxious question. Your first quarter was really, really strong and the outlook feels really good. Why not be more aggressive on the guide? I recognize that you're still a newly IPO-ed company in the scheme of things. Is it just really taking a conservative approach, wanting to make sure you're meeting and exceeding expectations, especially against an uncertain backdrop?

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

Rich, it's Jeff. John, why don't you take the first, and then I'll also want to have a couple of things to say.

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

Yes. Thanks, Jeff, and thanks, Rich. So we did have a solid first quarter and we see strength for the remainder of the year.

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

John, you're on mute.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Sorry about that. We had a solid first quarter, and we see strength for the remainder of the year, but there is uncertainty with both inflation and interest rates. In the first quarter, we did have a few higher items like I think lease termination income was up a little, which is seasonally higher in the first quarter. And also our bad debt of approximately 60 basis points was a little lower than our historical levels. So as we look to the full year, we are kind of in that 60 to 90 basis points range on bad debt.

But interest rates have risen since our initial guidance. And so that's also included in there. So our operating strength is allowing us to improve our guidance and estimates overall, but we still want to be conservative as we look to the full year.

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

This is Jeff. The only other thing I would add there is we are in a battle of the -- a really strong operating environment and an increasing interest rate environment. And so early in the year, we are going to take a generally conservative approach to how that battle will work its way out in the market. We -- but as Devin pointed out, we -- the operating environment, there's nothing on the operating environment from our perspective right now that where there are big clouds, but we're watching it.

And in this kind of environment, we're going to keep -- we'll be watching it closely and seeing where we can go. So I mean, honestly, we're very excited about the operating environment, as you can tell. And we continue to push hard for the kind of results that we were able to get on the operating side in the first quarter. And hopefully, we can continue that through the year and that the interest rate impact is not too big. So that's really why we took the approach that we did.

Operator

Our next question comes from Floris Van Dijkum of Compass Point.

Floris Gerbrand Hendrik Van Dijkum - *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

I know we've talked a little bit about occupancy, but what was your peak occupancy for both small shop and anchor? And what gives you the confidence that the 97% or maybe even going beyond that?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Yes, Floris. So we are at historically high occupancy levels, both overall and in line. But the reason for that is that we have improved the quality of the portfolio over time. And the portfolio today is of a higher quality than it has been historically. And therefore, we are confident that we can take the occupancy levels up to the numbers we're speaking about.

We also believe that when we look at the environment that these are levels that others have achieved. And therefore, we're confident we'll be able to achieve them as well. And then lastly, given the environment that we're in and what the leasing team is telling us, that adds to our level of confidence. So it's a combination of all those factors for us.

Floris Gerbrand Hendrik Van Dijkum - *Compass Point Research & Trading, LLC, Research Division - MD & Senior Research Analyst*

And Devin, maybe ask one more question for me, which is your average size of your assets is about $20 million in terms of value. On the low side relative to your public peers. The stuff that you've been buying is more in the $40 million center, although you bought a couple of smaller ones this quarter as well. But how do you see that -- how your portfolio transforming? And are you going to be looking to buy larger assets than your

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

typical asset that you currently own? And what are the benefits in your view of that? And what does that mean in terms of how does this -- the composition of your portfolio look like 3 years from now?

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

Floris, this is Jeff. Great question. As you know, our average center is 115,000 square feet. It's got a 40,000 square foot to 50,000 square foot grocer in it; 34% of our income is coming from that grocer. And that dynamic as a whole will not change. There are selective opportunities that we're seeing in the market where we think we can get outsized returns with slightly bigger or slightly more big-box concentration than what we have had historically.

But that is not where -- I mean, if you look at where -- what the core of our buying is that is a, by exception, not at the core. But as all buyers are, we've got to be opportunistic in this kind of environment to make sure we're taking advantage of certain circumstances where things are, in our mind, slightly mispriced. And that is the -- we will continue to do that, and you'll see that throughout the history of the company.

We've always done that where we've got things that -- where we are highly confident in what we can do with the centers and return that 8-plus unlevered IRR with even a better risk profile just because of the unique situation. And that's what I think you will see as we go forward. And we're actually very excited about the projects that we've got under contract as well as working to get under contract that have sort of some unique -- you will notice there is a consistency of still having the #1 or #2 grocer in them, which obviously is an important thing from our perspective.

Operator

Our next question comes from Juan Sanabria of BMO Capital Markets.

Unidentified Analyst

It's [Eric] on for Juan. Kind of switching gears on the development pipeline. So are you seeing any cost increase across your builds? And then how should we think about the numerator side of things as we think about your target yield of 10% to 12%. Is there any risk embedded there?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

So one of the benefits, again, of our format is that our redevelopment projects are small and they have a shorter duration. So we're able to build in to our financial projections, increases in costs that we're seeing real time. So the numbers that we're quoting of 10 to 12 are inclusive of the current environment from a cost perspective. So our view is, is that given the fact that these projects are typically delivered in circa 12 months that we're able to build into our financial models, current costs. And to date, we've been able to get the rents we need to continue to hold that 10% to 12% return on cost.

Operator

Our next question comes from Mike Mueller of JPMorgan.

Michael William Mueller - *JPMorgan Chase & Co, Research Division - Senior Analyst*

I know you've been trying to increase your portfolio escalators over time. But has the magnitude of what you're asking for today stepped up over the past, I don't know, several months just given the backdrop -- the metro backdrop?

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

So Mike, it's a great question and one that we're working on in real time. The answer is that we are -- what we're able to get today is bigger rent increases upfront and our CAGR is staying in that mid-2s kind of range. Our target is to continue to keep that process going and to bump those -- the regular bumps, the CAGRs that we get and the leases that we're signing.

But we've seen probably -- I mean, and this is one of the reasons we've had the results we've had. We've seen less pushback on bigger rent spreads upfront than we have on getting the CAGRs up to 3%, 4%, 5% to match kind of where people are seeing inflation. So I believe it will get there if inflation stays as it is right now. But right now, we're seeing it in the rent spreads more than we are in the CAGRs. And we'll continue to push that.

Operator

Our next question comes from Todd Thomas of KeyBanc Capital Markets.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

I wanted to circle back to investments real quick. You're well on track towards achieving the $300 million to $400 million annual guidance. You talked about what's under contract. It sounds like the pipeline is pretty healthy, but leverage did tick up a little bit, and it sounds like from John's comments that the line will be used to fund investments going forward.

And you have room and capacity to continue acquiring before hitting that 6x range or low 6x leverage level. But just given the macro headwinds and the increase in borrowing costs, does the thought process toward investments and increasing leverage a bit at the margin change just given the greater uncertainty today?

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

Todd, it's a great question. Thanks for it. And we are -- it's something we're in kind of constant discussion about. The thing that we're laying over this -- all of the outside noise is the strong performance we're having at the property level. And if you match the strong performance at the property level on a go-forward basis, a lot of the pricing that we're seeing in the market is not expensive if you can continue this kind of growth.

So you're -- I mean, as a risk reward, we're weighing off those 2 things of increasing interest rates and those costs against really strong operating results. And we keep coming back to the tailwinds that are in our business today that are driving more people to our centers more often. And as long as that pace continues and that those tailwinds continue where more people are working from home and more people are seeing the convenience of a shopping center, 3 miles from their house, we're going to continue to make that bet and think that we're going to be able to get better returns than even we underwrite because of the strong operating environment we're in.

But as you point out, there are headwinds as well as tailwinds and we're always going to have to be kind of weighing those 2 things off. But as we said at the IPO and continue to do, we've got a plan for over 3 years buying $1 billion net of dispositions. And at this point, we're not coming off of that guidance. We think that that's a prudent use of capital in the current environment.

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Jeff, the only thing to add to that, Todd, to give you a little bit more perspective on what Jeff just said. When we look at the assets that we acquired in 2021, and as you know, we're targeting an 8% unlevered. And when we re-underwrite those assets given the strength of the operating environment, we believe that the unlevered IRR on those assets will be circa 100 basis points higher than what we underwrote.

So that reflects what Jeff just said in terms of where we believe that there's a depth to the acquisition environment where we can continue to hit the returns we're targeting given the strength of the operating environment.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

Are you seeing any change in pricing at all maybe relative to the 5.8% cap rate on the 3 assets completed in the quarter? Are you expecting any change in pricing as you move forward to maybe compensate for some of the greater uncertainty? I mean what's kind of the forward pipeline look like in terms of pricing here?

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

I would say that for us, on our example, the forward pricing has -- is on an IRR basis better than what we have been able to buy in the past. It may appear on a cap rate basis to be more aggressive. But when you look at the long-term returns, we think we bounced up where there is significant upside.

And in the environment we're in, we think that's the right bet to be making. And so cap rate tells a little bit of the story but certainly not the story that we believe, which is really going to be driven by very strong IRRs in a strong operating environment with good amount of vacancy and ability to move properties.

So that's sort of what we're seeing. We do, as always, we're paranoid about the market and because there are certainly headwinds to pricing. We are seeing no real let up in demand in real time. But we do anticipate that there will be some as the year progresses. I mean you certainly -- the leverage buyer, we think, will be a much less effective competitor going forward than they have been historically over the last 18 months.

So that part should be positive, but there's still a ton of less leveraged capital that's out there, and we don't see that getting used up quickly. So we'll continue to monitor it. As I think we've talked about, one of our questions is, has the risk profile of grocery-anchored shopping centers relative to other real estate types, is that moving away from really, the really tough markets that we've been in over the last 3 years where everything -- the retail is coming to an end? Are we seeing some repricing in terms of that risk profile as well.

So you are -- there's just an awful lot going on, and I don't think it's just one theme. I think it's all of these things sort of working their way out, which will drive -- which will determine where sort of values go over the next 12 to 18 months.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

Okay. That's helpful. And just a last question for John, real quick. The interest rate swap with a notional value of $175 million, that had an expiration of April '22. What happened there? And what's the impact?

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

Yes, Todd. So that -- we did let that expire. And so the impact is that post effective for that, we would be 87% fixed at that, at the end of April or where I sit today.

Todd Michael Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Equity Research Analyst*

What's the change in interest on the interest expense related to that $175 million?

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Devin Ignatius Murphy - *Phillips Edison & Company, Inc. - President*

So when we look at that, I actually think that it would have been close to where it is currently because those swaps were put in place several years ago. So I think it's neutral. But as we look at that and as we look at the forward curve, I mean, we do see the interest rates higher, which we're taking effect into our guidance. I mean, I think that we -- for the quarter, we were at 3.2%. And I want to say it gets to 3.4%, 3.5% later this year.

Operator

Our next question comes from Tammi Fique of Wells Fargo Securities.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Maybe just following up on the acquisitions. I guess, 1, are you seeing more sellers come to the market in anticipation of higher rates and sort of the risk of lower demand from leveraged buyers?

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

This is Jeff. Yes. We have seen that actually coming into the beginning of the year, and it has continued through this first quarter. There is a fairly substantial increase in the volume of product. Now part of that is just there was just no volume during the pandemic, and we started to see increases in the fall of last year. We continue to see that and I think the aggressive demand for grocery anchored shopping centers has continued and continues to expand the number of centers that are on the market.

And I would say on a regular investment committee meeting, we're seeing probably close to 25% more deals than we did in the fourth quarter last year. But that's just a sort of a guesstimate. Okay.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Did you quantify the range of going in cap rate on this next group of acquisitions that you're looking at today? I just wanted to understand more about how you're still underwriting to the 8% IRRs and what might have changed in that calculation?

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

I don't think we have disclosed the cap rates on the new -- the ones that are not closed yet, and we just have not done that. I can tell you that the underwriting is very similar. I mean, we have not gotten more aggressive on our underwriting, even though the environment is really strong, we stay fairly conservative on the underwriting of these -- the new assets that we're buying. We have found a couple of unique -- I mean we believe we found a couple of unique circumstances where we have more occupancy or more vacancy to create some upside than we have historically, and they just happen to be centers fit that mode.

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

And then my last question is really just on dispositions. You did a couple in the quarter. Just wondering if you have anything under contract right now are looking to sell additional assets this year?

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

We closed the things that we have in the market, and we're continuing to monitor our acquisition market so that we can start to match fund some of the disposed in the second half of the year. But right now, we're in the very early stages of looking at that. And so I would anticipate we will do

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

additional dispositions as well as additional acquisitions through really the second, third, and fourth quarter. But again, with that number of $300 million to $400 million being a net number and match funding the others. Does that answer your question?

Tamara Jane Fique - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Yes, that does.

Operator

This concludes our question-and-answer session. I would like to turn it back to Mr. Edison for some closing comments.

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

Great. Well, thanks, everybody, for being on the call. As we sort of think about the quarter, some of our highlights are that we do think we're going to generate almost $90 million of free cash flow this year from the company, which is, again, a great growth engine for us. The operating environment is strong, which is augmented by our high level of occupancy. Both leasing spreads and retention are at really, really strong levels.

As we talked about on the acquisition side, the demand for grocery-anchored remains strong. There's a lot of capital there. So we don't -- and we don't see that going away. We feel good about the fact that to date, our neighbors have been able to pass on most of their increasing cost to the customer. And they appear to be doing quite well. And obviously, the renewals and the leasing spreads are a testament to that.

And we think that the macro trends that have been a helpful tailwind for us over the last 12 months continue to be positive. Obviously, there's some headwinds that are out there now that will -- we've got to keep a close eye on. But we're -- we think as a net, the tailwinds are helping us more than the headwinds are hitting us.

And we will continue to tell you that we think there's a value proposition in our format centers with a #1 or #2 grocer. We're not priced like others who are in that business, and we think we will be. And we're going to keep pushing you guys to get us there, but we think there's a value opportunity there.

And with that, we're really happy we're able to beat and raise our guidance for this quarter. And we're looking forward to continuing to push through the year and see really strong results. So thank you guys for your time. We appreciate it, and we'll talk to you probably before next quarter. Hopefully, at the ICSC or at NAREIT. So thank you guys.

Operator

Thank you. You may now disconnect.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2022, Refinitiv. All Rights Reserved.

©2022 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV