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

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PRESENTATION

Operator

Good afternoon, and welcome to the Phillips Edison & Company's webcast presentation for its financial advisors and retail investors. My name is Mandeep, and I'll 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.

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

Thank you, operator, and good afternoon, everyone. Thank you for joining us for the PECO GROW update for financial advisors and retail investors. I'm joined on today's webcast by our Chairman and Chief Executive Officer, Jeff Edison; our President, 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 An archived version of the webcast and presentation slides will be published on our Investor Relations website.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?

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Kim. Good afternoon, everyone, and thank you for joining us. The PECO team accomplished a great deal in 2023. We continued our track record of delivering strong growth with same-center NOI increasing by 4.2%. The strong performance of our portfolio is driven by our high occupancy, strong leasing spreads, high retention, and the many advantages of the suburban markets where we operate our neighborhood shopping centers. At the macroeconomic level, 2023 presented many challenges, with high inflation, volatile and rising interest rates, and global conflict. However, the consistency of our growth is a testament to our differentiated and focused strategy of exclusively owning right-sized, grocery-anchored neighborhood shopping centers anchored by the number one or two grocer by sales in the market.

Our results at the property level are driven by our integrated operating platform and our experienced and cycle-tested team. The operating environment remains strong with the resilient consumer. Retailers want to be located in our centers where our grocery drives consistent and recurring foot traffic. PECO's leasing team continues to convert this demand into higher rents for our centers.

PECO continues to benefit from a number of positive macroeconomic trends that create strong tailwinds and drive strong neighbor demand. These trends include a resilient consumer, hybrid work, migration to the Sunbelt, population shifts that favor suburban neighborhoods, 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, given that current economic returns do not justify new construction.

Looking at total returns, PECO has the highest total shareholder return of the shopping center REITs at 42% since our IPO through February 12, 2024. For the full year 2023, PECO's stock price increased 15%, this compared to the year-end performance of the MSCI Real Estate Index, which was up 14%, and our retail shopping center peer group, up 6% on average. In addition, PECO's dividend yield of 3.2% in 2023 compared favorably to the S&P 500 dividend yield of 1.7%. Your investment in neighborhood, grocery-anchored, necessity-based retail provides you with 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. One fact that continues to frustrate the PECO team is that open-air retail does not get the valuation metrics that we believe it deserves. When we compare the fundamentals of our business to those of multifamily and industrial sectors, we offer comparable occupancy metrics and less supply in the pipeline, yet we trade at multiples that are 10% and 35% below multifamily and industrial, respectively. Our hope is that the strength of the operating fundamentals in our business, as well as the resiliency demonstrated by the sector's performance during the down cycles, will be better recognized by the market and that the multiples for the shopping center sector will expand accordingly.

In addition to our strong rental growth trends, we continue to invest in value creating ground-up, outparcel development, and repositioning projects. In 2023, we stabilized 13 projects and delivered over 230,000 square feet of space to our neighbors. These projects add incremental NOI of approximately $3.4 million, annually. These projects have a meaningful impact on our long-term NOI growth. We continue to expect to invest $40 million to $50 million annually in ground-up development and repositioning opportunities with a weighted average cash-on-cash yield between 9% and 12%. This activity remains a great use of free cash flow and produces attractive returns with less risk. We continue to make progress on these properties, and our team is working hard on growing this pipeline.

PECO has always been a growth company. Since our IPO, our net acquisitions have totaled over $700 million. With our low leverage, we are well positioned to continue to grow. 2023 was no exception; we acquired 11 shopping centers, two outparcels, and one land parcel for net acquisitions totaling $272 million at a weighted average cap rate of 6.6%. We're excited to add two more Trader Joe's anchored centers and another H-E-B anchored center to our portfolio.

The transaction market was tough in 2023 as the bid-ask spreads were very wide. Our team has proven its ability to navigate and successfully execute through these tough markets. This result is due to our scale, our ability to buy in many markets across the country, our reputation as a sophisticated all-cash buyer, and our strong relationships. We are confident in our ability to continue to acquire high-quality centers as the transaction market opens up further. While it's early, we continue to successfully find attractive acquisition opportunities.

Activity in the first quarter remained solid, and we recently reaffirmed our guidance for $200 million to $300 million of net acquisitions for the full year. We have the capabilities and leverage capacity to acquire much more if attractive opportunities materialize. We continue to target an unlevered IRR of 9% or greater for our acquisitions. The acquisitions that we completed in the second half of 2023 underwrote to over 9.5% on levered IRR. We will maintain our disciplined approach and focus on accretively growing our portfolio.

We're hopeful that buyers will increase throughout the year. It's in times like this in an evolving market that we have historically found some of our best opportunities. With the target market of 5,800 identified centers across the United States, we have a long runway for external growth. In addition, we will have one of the lowest-levered balance sheets in the shopping center space. With a fortress balance sheet and ample liquidity, PECO continues to be well positioned to drive strong earnings growth and achieve our capital deployment goals in the years ahead.

Looking beyond 2024 and assuming a more stable interest rate environment and acquisitions market, we believe our portfolio can deliver mid to high single digit core FFO per share growth on a long-term basis. This will be driven by both internal and external growth. Combined with our dividend yield, we believe PECO will provide high single digit to low double digit shareholder returns on a going-forward basis.

As previously announced by Kroger and Albertsons, the estimated closing date for the proposed merger was recently pushed back, and earlier this week, the FTC formally filed suit against the merger. We believe Kroger and Albertsons will fight this lawsuit. We remain cautiously optimistic about the impact of this merger on PECO. We continue to believe it is ultimately a 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, we believe the impact on PECO is a net positive. Our Albertsons stores will be operated by Kroger, which reinvests regularly in the stores and produce higher sales volumes. If the merger does not occur, our Albertsons anchored centers will continue the strong performance that they have produced to date.

With that, I'll now turn the call over to Bob Myers to provide more color on the operating environment. Bob?

Bob Myers - *Phillips Edison & Company, Inc. - President*

Thank you, Jeff. 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 number one or number two grocer by sales in the 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 thrive in this emerging omnichannel environment. We are well aligned and experienced. Management is one of PECO's largest stockholders, owning approximately 8% of the company and interest valued at over $300 million. It is hard to find better alignment than having meaningful skin in the game. Since our founding, our exclusive focus has been owning and operating neighborhood grocery-anchored shopping centers anchored by the number one or number two grocer in the market.

Our top neighbors are strong grocers, Kroger and Publix are PECO's number one and number two neighbors, respectively. We are excited to add four more Publix-anchored centers and another Kroger-anchored center to our portfolio in 2023. PECO's three-mile trade area demographics include an average population of 66,000 people and an average median household income of $80,000, which is higher than the US median. These demographics are in line with the store demographics of Kroger and Publix, which are PECO's top two names.

Our centers are situated in trade areas where our top grocers are profitable and our neighbors are successful. 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 three-mile trade area. These categories include grocery stores, quick-service restaurants, beauty and 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 focused 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 are in. 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 on the corner of Main and May. In addition, our exposure to at-risk retailers continues to remain limited. This is deliberate and the result of our grocery-anchored strategy and focus on necessity-based goods and services.

All 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.

In 2023, PECO's Board of Directors approved an increase of 4.5% to the monthly distribution rate, which followed an increase of 3.7% in 2022. We have said we will increase our distributions as our cash flow increases. 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 are proud of our track record of positive results. We believe our future is bright, and 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 the last-mile delivery and buy online and pickup in store. BOPUS, commerce for retailers. Through BOPUS, customers order their products online and then pick them up at our centers. Grocers have embraced BOPUS 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 BOPUS customers. Our centers help solve the last-mile delivery delimit 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 and 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 experience and aligned management team owns 8% of the company. We had meaningful skin in the game and are committed to driving stockholder value. We are proud of our team and how much we have accomplished. PECO is the ninth largest company in Cincinnati based on market cap, being named the 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'd like to turn the call back over to Jeff. Jeff?

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Thank you, Bob. In summary, we're encouraged by the meaningful growth opportunities that lie ahead. We encourage you to continue to grow with us. We firmly 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 of my 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'll now answer your questions.

QUESTIONS AND ANSWERS

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

Thank you, Jeff. Good afternoon, everyone. We will now begin the question-and-answer session. Listeners can submit a question through the webcast portal, simply type your question into the chat box and click submit question. To start, we received a handful of questions about the health of the consumer and the operating environment we're seeing today. Bob, can you speak to PECO's current view on the health of the consumer? And as a follow-up, what is PECO's outlooks for the retail environment in 2024?

Bob Myers - *Phillips Edison & Company, Inc. - President*

Thanks, Kim. We're encouraged by the continued positive trends we're seeing and we continue to see a resilient consumer and steady foot traffic to our centers. I have really good visibility out for the next six months and what I'm saying is that the demand is -- it's the highest I've ever seen. So we have a very nice outlook on leases out for signature, renewals, leasing spreads continue to be very solid, consistent with what we've generated in the past, even better, towards the future. We're not seeing any cracks, anything slowing so leasing spreads, renewal spreads, retention, everything is positive from what I'm seeing for the next six to nine months.

And as Jeff mentioned, we continue to see a benefit from a positive macroeconomic trends. So labor demand, resilient consumer hybrid work, migration to the Sunbelt, population shifts that favor suburban communities, and certainly the importance of physical locations in the last mile. High occupancy, limited supply, and honestly, we just haven't seen any new development over the last 10 years so for the foreseeable future, we feel very positive about the outlook of our portfolio.

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

Thank you, Bob. Our next question comes from an advisor who -- Jeff, this might be a great question for you. How does PECO's outlook change if we were to move into a recession?

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

That's a great question. Thanks for the question. First of all, our view has evolved over the last 12 months and we are probably have moved from what we thought was going to be a fairly significant recession to now where our view is that it is probably 50-50, whether we hit a mild recession or we have a soft landing. We're generally optimistic that the change in the market that has happened is going to be much less -- much smaller recession, if it does happen, than what could have happened, what we've been talking about a year ago.

And so, I think every recession is a little bit different and this one, if it does happen, we do think will be light. In our in our space, the niche that we operate in, because 70% of our goods are necessity based, we're sort of the last ones to see a recession when it hits. And it's simple to think about which is the consumer stop shopping for groceries or trades down in the grocery side as one of the last things they do. The consumer tends to in a recession, stop on the buying of just things that are not fully discretionary. So if they don't need a pair of nice shoes, they might put that off, but they still go to the grocery store.

And that's where our niche is, is on that grocery side and then necessity-based goods. We always keep our eye on the economy because it's never good for retail when you hit a recession. But fortunately, we're well positioned. And I think as we've said before, in our conversation with you guys, we think this necessity-based gives us less beta that's up and down during these changes. And with the alpha we have from other growth vehicles, we feel really good about having that position. And one of the reasons that we're very bullish on the stock is that we can -- we've got downside protection, but we've also got some upside opportunity.

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

Thank you, Jeff. Next question comes from David. I think this is a good one for Bob, really speaks to leasing demand and PECO's high occupancy. So Bob, if you could speak to where we're currently seeing leasing demand and what retailers are growing with PECO. If you could answer that, that would be great.

Bob Myers - *Phillips Edison & Company, Inc. - President*

Thanks, Kim. Appreciate the question. We see a lot of demand. The focus right now has been specifically restaurants, fast casual restaurants. When I look at that pipeline, it represents about 40% of our activity. When you think about fast casual restaurants, that's been a huge demand. Neighbors such as Zaxby's, Dunkin Donuts, Starbucks, Firehouse Subs, Wingstop, Chipotle, Cava, Jersey Mike's, to name a few, so the restaurant category is our largest component of our pipeline. We also see a lot of activity on our health and wellness services, that makes up about 11% of our current leasing demand and examples would be med spas, massage fitness, as an example. And then, really the medical, medtail as we call it, is one of the fastest growing uses in our portfolio. So we're really encouraged by that component of our merchandising and those users would typically be dental, vision, chiropractic, physical therapy, to name a few.

And the last category where we continue to see demand that ties directly to what Jeff mentioned, are necessity-based goods and services. It's our services. You think about UPS stores, Great Clips, AT&T, banks, as an example. Again, with great visibility out the next six months, we continue to see a tremendous amount of demand for our focus on owning the number one, number two grocers in our market. So great leasing demand. I look forward to this year.

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

Thank you, Bob. Next question is with more balance sheet specifics so this = would be a good one for you, John. Your question comes from James on the webcast. Maybe if you could speak to debt maturity schedule and provide some color on the mature-- I think the question is specific to when would PECO have the next largest maturity coming due.

John Caulfield - *Phillips Edison & Company, Inc. - CFO*

Sure. I'll take that. Thank you for the question. We worked in 2023 to manage and extend our maturities and it's something that we actively focus on. Our next maturity isn't until late 2025, actually, November. We have over $600 million of liquidity and we're very lowly levered today, we're about 5.1 times on a debt to EBITDA basis. If we think about it on a loan to value basis, that's about 30% leverage, which is important to being investment grade rated. We have access to a lot of capital to help fund our acquisition and we plan to be an unsecured bond issuer because that market is very liquid and has the capacity to allow us to continue to grow. We don't have any meaningful maturities in '24, and really, most of '25, and the ability to continue to fund our growth as we go forward.

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

Thank you, John. A question on acquisition. Jeff, this is probably a good question for you. You mentioned PECO's guidance range for acquisitions in 2024. Could PECO do more?

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Yeah. Absolutely, and we hope we will. We were in a really tough market last year on the acquisition side. We bought basically $275 million of new acquisitions. This year I think will be a little bit better. It's not going to be a super liquid market yet, but it is improving. I think we've reviewed twice as many OMs this year, compared to last year, so there is a volume of ask. The question is the bid ask and how wide that is. So we're maintaining our guidance of $200 million to $300 million. If the opportunities come up, one of the things that we've done is prepare ourselves with the balance sheet that gives us ample capacity to do well beyond that amount. If we could find projects that give us a return and an unlevered IRR of north of a nine, then we can accretively invest and be able to continue to grow our operating results on the FFO and an AFFO basis.

So that's what we're hoping. But it's early days for the year. We'll see how the market evolves throughout the rest of the year. But we are working hard towards getting to make sure we get to our guidance and then we'll look beyond that if there's better opportunities.

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

Great. Thank you, Jeff. We have a handful of questions related to PECO's dividends. A lot of REITs have moved towards a quarterly dividend. Has PECO made any plans to change its monthly dividend to a quarterly distribution? As a follow up question, do you have plans to increase PECO's dividend?

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Well, thank you for that question. We do get it a lot from institutional investors. Why do you do it monthly? And the answer is simple. It's an important thing to our retail investors to have that monthly track and we have continued to do that over -- basically over almost 30 years that we've been doing this, since it's really an important part of the overall return on our investments to give that liquidity. And so, we are -- again, it's a Board decision, but we are very committed to continuing to give monthly distributions.

We have increased the dividend two years in a row. And with the operating results we have, we feel comfortable that we should have -- should be able to continue in that trend. And again, that is an important part of the return for our investors and one that we will continue to push forward and -- it's enough, we are the only shopping center REIT paying a monthly dividend. And I think that says a lot about the fact that our retail investors have been a solid part of our machine for a long time, and we greatly appreciate that, but we also are not going to be changing that strategy anytime that I see. So again, thanks for the question. We will continue to really push to grow our dividend, but also to pay it out on a monthly basis.

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

Great. Thank you, Jeff. This now concludes our question-and-answer session. Please do not hesitate to reach out to us with additional questions or information requests. We have provided the e-mail address for our Investor Relations team in today's PECO GROW presentation, which has been posted to our website. Jeff, I'll turn it back over to you for some closing comments.

Jeff Edison - *Phillips Edison & Company, Inc. - Chairman & CEO*

Great. Thanks, Kim, and thanks, everyone, for being on the call with us today. We're extremely proud of what the PECO team accomplished in 2023. Our differentiated focus strategy and our talented team combined to create a market leader in the shopping center business. We're confident that the PECO team will continue to deliver market-leading results in 2024. We remain optimistic about the future growth opportunities of PECO. We hope you share this excitement and will continue to remain invested 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, and please do not hesitate to reach out to myself or to anyone on the phone if you have additional questions. Thanks, everybody, and have a great day. Thanks again for being on the call.

Operator

Thank you. You may now disconnect.
