EDITED TRANSCRIPT

Agree Realty Corporation's
Second Quarter 2017 Earnings Conference Call
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PRESENTATION

Operator
Good morning and welcome to the Agree Realty First Quarter 2017 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a Conference Specialist by pressing the * key followed by 0.

After today's presentation, there will be an opportunity to ask questions. To ask a question you may press * then 1 on your touch-tone phone. To withdraw your question, please press * then 2. Each questioner will be limited to 2 questions only. Please note: this event is being recorded.

Operator: Good morning, and welcome to the Agree Realty second quarter 2017 conference call. [Operator Instructions]

I would now like to turn the conference over to Joey Agree, President and CEO. Please go ahead, sir.

Joey Agree
Thank you, Denis, and good morning, everyone. Thank you for joining us for Agree Reality's second quarter 2017 earnings call.

Joining me this morning is Matt Partridge, our Chief Financial Officer; as well as Ken Howe, who will serve as interim Chief Financial Officer upon Matt's departure on August 4th.

I'm pleased to report that we continued our strong performance during the quarter, executing across all phases of our operating strategy while maintaining a sector-leading balance sheet. Our many capabilities to create value were on full display during the quarter.

Total investment capital deployed across our three external growth platforms in the second quarter was approximately $140 million. We either acquired or completed development of 37 high-quality retail net lease properties. Of those 37 investments, 36 properties were sourced through our acquisition platform, amounting to a total acquisition volume of $131 million in the quarter. The properties were acquired at a weighted average cap rate of 7.7%, with a weighted average remaining lease term of approximately 12.7 years.

The acquired properties are located in 19 states and are leased to 31 industry-leading tenants. These tenants operate in 18 ecommerce and recession-resistant retail sectors, including discount apparel, convenience stores, auto parts, auto service, health and fitness and home improvement.

Through the first 6 months of the year, we've invested a record $201 million into 50 retail net lease properties spread across 22 states. Of the over $200 million invested through June 30th, approximately $184 million was sourced through our acquisition platform. The 47 properties acquired through the first 2 quarters of the year are leased to 38 leading retail tenants operating in 20 distinct sectors. These properties were acquired at a weighted average cap rate of 7.7%, with a weighted average remaining lease term of 12.1 years.

While the company has achieved record investment volume in the first 6 months of the year, I want to reiterate that our investment standards remain as rigorous as ever. Elevated acquisition volume during the quarter was opportunistic, including the culmination of transactions we have been actively working on for a number of years, as well as a handful of smaller portfolio transactions. We fully intend to remain disciplined, focused and adherent to our historical standards.

The assets that we've recently added to our portfolio and those in our pipeline are of the highest quality of any assets that we've acquired since the launch of the acquisition platform in 2010. We continue to emphasize retail real estate fundamentals including retail synergy, visibility, demographics, traffic patterns and access, with a sharp focus on high-quality real estate industry-leading tenants.

During the quarter, we added a number of fantastic assets to our portfolio, including our first Publix, Panera Bread, Ruler Foods, Kroger's expanding deep-discount concept; as well as a portfolio of RaceTrac convenience stores. We've also strategically increased our exposure to leading retailers including AutoZone, National Tire & Battery, HomeGoods, LA Fitness, O'Reilly Auto Parts, Starbucks, Ross Dress for Less, Bridgestone Firestone, and a one-of-a-kind Dave & Buster's in downtown New Orleans. Our focus remains on leading retailers and sectors that have a compelling omni-channel platform or a value-oriented business model that necessitates a brick-and-mortar retail presence.

Turning to our development and partner capital solutions programs -- we are pleased to have completed and brought online our Camping World project in Georgetown, Kentucky during the quarter. The project was the company's first ground-up development for Camping World and is subject to a new 20-year net lease. Total project costs were approximately $8.2 million.

Also during the quarter, the company completed landlord's work in Boynton Beach, Florida. The property has been redeveloped and expanded for Orchard Supply Hardware. The project is leased to a new 15-year net lease that is guaranteed by Lowe's Companies, which carries an A minus credit rating from S&P. Rent is anticipated to commence in the third quarter of this year following completion of the tenant's work. Boynton Beach will join our Sunnyvale, California and be our second Orchard Supply Hardware in our growing portfolio.

During the quarter, we are very excited to have welcomed Jeff Konkle as our new Director of Construction. Jeff is a longtime industry veteran whose budgeting, project management and leadership skills will be a fantastic addition to our growing team. We have worked with Jeff for a number of years and are very pleased to bring him in-house at Agree.

We commenced three exciting new development and Partner Capital Solutions projects during the second quarter. In June, construction commenced on the company's first Art Van Furniture project located in Canton, Michigan. The site is located on Ford Road, directly across the street from and sharing a signalized intersection with Michigan's only IKEA store. The Ford Road corridor is one of the state's dominant retail trade areas. The project has anticipated total costs of approximately $18 million and is subject to a new 20-year lease upon completion.

Art Van will be paying incremental rent while the project is under development. We anticipate full rent to come online commensurate with a store opening during the first quarter of 2018. This development represents the unique opportunity for our company to partner with an industry-leading home furnishings retailer on a very familiar and compelling piece of real estate. It is our first investment in the retail furniture space.

We're also very excited to have launched a partnership with Mister Carwash, the nation's leading carwash operator, to develop newly created freestanding prototypes. While we previously executed on a sale leaseback transaction with Mister Carwash, this is the first time that we've embarked on organically developing new units. Construction commenced on our first two projects during the quarter.

The projects, which are subject to new 20-year net leases, are located in Urbandale, Iowa and Bernalillo, New Mexico. We anticipate rent to commence on both projects during the fourth quarter of this year. Our unique capability to acquire as well as develop for leading retailers is being leveraged to facilitate Mister Carwash's future growth.

Through the first 6 months of this year, we have projects completed or under construction that represent approximately $46 million of total committed capital. We are pleased with our performance and remain excited about our development pipeline. The value proposition of being a full-service net lease real estate company continues to differentiate our capabilities for growing retailers.

While we've been quite busy executing on our three external growth platforms, we've also sought to reduce exposures through our disposition efforts. This continued in the second quarter as we sold two properties net leased to Walgreens for gross proceeds of approximately $12 million. The properties were located in Lowell, Michigan as well as Shelby Township, Michigan. These dispositions were completed at a weighted average cap rate of approximately 6%. Year-to-date, we have sold three Walgreens properties, all located in Michigan, for total gross proceeds of approximately $22.6 million. As a result of these dispositions, our Walgreens concentration was down to 8.8% at quarter end, below our goal of sub-10% by year-end.

Over the past 12 months, our Walgreens exposure has decreased roughly 530 basis points, down from 14.1% at the end of the second quarter of 2016. We are committed and on track to bring our concentration below 5% by year-end 2018.

Recent disposition activities and our continued growth have also served to reduce our exposure to both the pharmacy sector and the state of Michigan. Our pharmacy exposure decreased approximately 540 basis points year-over-year to 13.7%, while our Michigan exposure decreased roughly 420 basis points to 12.5%.

Moving forward, we will continue to call the portfolio of lower-tier assets that aren't representative of our portfolio, and also look to opportunistically divest of assets where we have a divergent perspective of our value relative to market. Aside from dispositions, our asset management team has been very proactive in addressing future lease maturities. Today, we only have one remaining lease maturity in 2017, representing just 0.3% of annualized base rents. The lease expires at year-end, and we are working with the tenant to renew prior to the expiration date.

During the quarter, we executed new leases, extensions or options on approximately 86,000 square feet of gross leasable area; the new leases, extensions or options including a 33,600 square-foot Big Lots in Cedar Park, Texas. Through the first six months of the year, we've executed new leases, extensions or options on almost 432,000 square feet of gross leasable space, eliminating 22 pending lease maturities, including four leases that were set to expire in 2018. Our asset management team is now focused on addressing our remaining 2018 lease maturities, which represent only 1.5% of today's annualized base rents.

As of June 30th, our growing retail portfolio consisted of 413 properties in 43 states. Our tenants are comprised primarily of industry-leading retailers operating in more than 25 distinct retail sectors, with 44% of annualized base rent coming from tenants with an investment-grade credit rating. The portfolio remains effectively fully occupied at 99.6% and has a weighted average lease term of 10.6 years.

In addition to these metrics, the quality of our portfolio is further demonstrated by our ground lease portfolio, where over 86% of the ground leases are with leading retailers that carry an investment-grade credit rating. Our ground lease portfolio continues to represent 7% of total annualized base rent. This quarter, we've added four more assets to this unique portfolio that are ground leased to leading retailers, including Starbucks and National Tire & Battery. This portfolio continues to present an extremely attractive risk-adjusted investment for our shareholders.

Before I turn it over to Matt to discuss our second quarter's financial results, I'd like to take a minute to address the numerous retail headlines and reiterate our unique perspective on brick-and-mortar retail. For many years, we have believed that omni-channel retail was the future. My own personal perspective was informed by my experience with Borders as a young executive. Our acquisition platform, which was launched in 2010, sought to identify the sectors and leading retailers that we believed would be successful in the disruptive period that would ensue.

Fast-forward to today, and I believe that we have now entered the third phase of post-internet retail. Phase 1 was the launch of ecommerce. The landscape was dotted by ecommerce startups, the vast majority of which were unprofitable and, frankly, unsuccessful. Profitability online only proved very difficult to achieve, and only few handful survived.

We then moved into Phase 2 -- traditional brick-and-mortar retailers rushed to launch ecommerce sites to compete with their new ecommerce-only competitors. Many retailers here, too, were highly unsuccessful. Their technology's been ramped, their store visits dropped, and their bottom line shrunk. Rushing to compete online with a bunch of startups was a challenge, to say the least.

Fast-forward to the third phase -- today, we are witnessing the creation of true omni-channel retailers who effectively have access and profitable sales windows to their customers both physically as well as digitally. An effective omni-channel retailer can drive customers to their stores with a compelling experience, has a website that is easily navigable, can offer in-store pickup as well as home delivery, and then the ability to return in-store, driving a repurchase rate on new goods. Whether it's [Wulry Parker] opening stores or Amazon's purchase of Whole Foods, the in-store experience of brick-and-mortar retail has been validated.

At the same time, we see brick-and-mortar retailers such as Walmart acquiring Jet.com, Bonobos and MooseShop; PetSmart buying Chewy, and Saks acquiring Guild. The bottom line is this -- fast-forward a decade, and effective omni-channel retailers will be comprised of both those that have brick-and-mortar roots as well as ecommerce roots. We really end up in the same place. We believe the key is being able to look ahead and pick those retailers that are best positioned to be winners, not being reactive to the latest rumors of Amazon entering any given retail space.

With that, I appreciate your patience and look forward to hearing your thoughts. I'll turn it over to Matt to discuss our financial results.

Matt Partridge
Thanks, Joey. Good morning, everyone.

As a reminder, please note that during this call we will make certain statements that may be considered forward-looking under federal securities law. Our actual results may differ significantly from the matters discussed in any forward-looking statements.

In addition, we discuss non-GAAP financial measures, including funds from operations or FFO, and adjusted funds from operations or AFFO. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures can be found in our earnings release.

As announced in yesterday's press release, total rental revenue including percentage rents for the second quarter of 2017 was $25.2 million, an increase of 26.3% over the second quarter of 2016. Year-to-date, total rental revenue has increased 28% over the comparable period in 2016, to $49.4 million. General and administrative expenses were approximately 9.2% total revenue, representing a decrease of roughly 10 basis points year-over-year as compared to 9.3% of total revenue in the second quarter of 2016.

We anticipate that G&A as a percentage of total revenue will be below 8.5% for the full year, representing a more than 700-basis-point decrease in G&A as a percentage of total revenue over the last 5 years. Funds from operations for the second quarter was $18 million, representing an increase of 30.6% over the comparable period of 2016.

On a per-share basis, FFO increased to $0.67 per share, a 10.2% increase as compared to the second quarter of 2016. Funds from operations for the first 6 months of 2017 was $35 million, representing an increase of 32.5% over the comparable period of 2016. On a per-share basis, FFO increased to $1.32 per share, an 8.3% increase as compared to the first six months of 2016.

Adjusted funds from operations for the second quarter was $17.9 million, representing an increase of 30.1% over the comparable period of 2016. And on a per-share basis, AFFO increased to $0.67 per share, a 9.7% increase as compared to the second quarter of 2016. Adjusted funds from operations for the first 6 months of 2017 was $34.9 million, representing an increase of 32% over the comparable period of 2016. And on a per-share basis, AFFO increased to $1.31 per share, a 7.9% increase as compared to the first six months of 2016.

Turning to our capital markets activities -- in June, we completed a follow-on offering of 2,415,000 shares of common stock, which included the underwriter's full exercise of their option to purchase additional shares. Total net proceeds from the common equity offering were approximately $108 million after deducting the discount and operating expenses.

This offering refortified our balance sheet, which continues to be one of the strongest in the industry. As of June 30th, 2017, total debt-to-enterprise value was approximately 24.7%. And our fixed-charge coverage ratio, which includes principal amortization, was a healthy 4x. Furthermore, net debt to recurring EBITDA was approximately 4.6x, below the low end of our stated leverage range of 5x to 6x.

The company paid a dividend of $0.505 per share on July 14th to stockholders of record on June 30th, 2017. The quarterly dividend represents a 5.2% increase over the $0.48 per-share quarterly dividend declared in the second quarter of 2016. The company has paid 93 consecutive dividends since its IPO in 1994.

Our quarterly payout ratios for the second quarter of 2017 were 75% of FFO and 76% of AFFO. Both payout ratios are at the low end of the company's targeted ranges and reflect a very well-covered dividend.

With that, I'd like to turn the call back over to Joey.

Joey Agree
Thank you, Matt.

I'd like to take this opportunity to thank Matt for his contributions over the past 1.5 years. He's been an important part of our growing team, and we wish him and his family our very best in all their future endeavors.

I'd also like to reintroduce all of our stakeholders to Ken Howe, who'll be serving as interim chief financial officer while we conduct a thorough and comprehensive search for Matt's successor. Ken has been with our company and its private predecessor for nearly 40 years and served as chief financial officer for almost 2 decades. We are lucky to have him and are grateful for his willingness to step in on an interim basis.

Ken?

Ken Howe
Thanks, Joey.

I would also like to wish Matt the best of luck in his new endeavor and thank him for the assistance in helping me assume the interim CFO position. I look forward to becoming reacquainted with all of you in the near future, and I am very excited to rejoin the very energetic and professional Agree team.

Joey Agree
Thank you, Ken.

That wraps up the prepared portion of the call. It was a fantastic quarter for our growing company.

At this time, we'll open it up for questions. Denise?

QUESTIONS AND ANSWERS

Operator
To ask a question, you may press * then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If your question has been addressed you may withdraw from the que by pressing * then Q. Please limit yourself to 1 question and 1 follow up. If you have further questions you may reenter the question que. And your first question will come from Dan Dolan, Ladenburg Thalmann. Please go ahead.

Dan Donlan*; Ladenburg Thalmann; Analyst* First off, Matt, just wanted to congratulate you on your next experience. It's been fun working with you.

Matt Partridge, *Agree Realty Corporation - CFO*
Thanks, Dan.

Dan Donlan*; Ladenburg Thalmann; Analyst*
You're welcome. And then, Joey, just wanted to talk about your comments on the omni-channel world. As you're talking about picking future winners in this space, three as you describe, I'm curious how you identified these winners. And how critical is that to acquiring an asset if you think you have very good real estate, in which case you might be able to put somebody in should a retailer go dark?

Joey Agree, *Agree Realty Corporation – President & CEO*
Good morning, Dan, and I appreciate the question. I think we really look for -- starting with a lens of ecommerce and recession resistance, then really drive to three fundamental things in terms of retail sectors and then tenants -- one, a unique and compelling customer experience in the brick-and-mortar arena; a value proposition that is delivered via that brick-and-mortar experience. That value can come in price, but that value can also come in different areas. And then, lastly, a brick-and-mortar experience that isn't easily replicable online, gas and C-stores. The RaceTrac portfolio we acquired this quarter is a good example of that. Our investment strategy starts with a bottoms-up approach on the individual asset level.

We're an aggregator by nature. We're not a sale leaseback financier, we're not a portfolio purchaser. So real estate attributes are critical to all of our underwriting. That said, when and if we see a credit that doesn't necessarily -- or a tenant that doesn't necessarily fit within that context of retail in our perspective, but it's a fantastic underlying piece of real estate or is a compelling transaction for its real estate merits, below-market rents; or, frankly, if we have a relationship with a tenant who's ready to take that space unbeknownst to a seller, those are transactions that we like to get our arms around as well. So I would tell you that all transactions are different. We look at it through that 30,000-foot lens, and then we start really from a bottoms-up approach.

Dan Donlan*; Ladenburg Thalmann; Analyst*
Okay, Appreciate the comment. And then, just curious on your thoughts on the furniture space. Art Van is your first development with them, your first, I think, property in the furniture space. Is this, you know, a sector you think there is more growth coming from than an acquisition? Or it's just kind of a one-off opportunity that you saw an advantage to get a nice, large development tack in your pipeline?

Joey Agree, *Agree Realty Corporation – President & CEO*
Yes. As you mentioned, this is our first investment in a furniture retailer. It is obviously our first exposure to Art Van. I'll tell you that we're very familiar with Art Van. As many people know, they were recently acquired by TH Lee into the sale leaseback with some of our peers, both private as well as public, on -- I think it's 37 stores. That didn't interest us. That isn't our M.O., that's not our operating strategy. Art Van's been an operation based here in Michigan for almost 60 years. They have over 100 stores, they're the 9th-largest conventional furniture retailer in the country, the 18th-largest -- and when you rip out effectively mattress sales, they are the number-one retailer for furniture in the state of Michigan, with 98% brand awareness, which is frankly off the charts. I grew up listening to Art Van commercials. This site specifically is on one of the major retail corridors and destinations in the state of Michigan, which we're intimately familiar with. It's on Ford Road, right off of a major freeway, I-275. Ford Road has 48,000 vehicles per day in terms of traffic count. The 5-mile population density is almost 210,000 people. This store will draw for much larger. It shares an intersection, newly signalized four-way intersection, with Michigan's only IKEA, which draws 2 million people per year with median household income of approximately $75,000. So the combination of the underlying real estate, the familiarity of that real estate that's frankly down the street from us here -- our experience on the Ford Road Corridor, both historic development -- mean, it's a really compelling piece of real estate -- in terms of additional investments in the furniture space, it's something that we will consider. I'll tell you it's not currently on the radar. It's something that we'll be aware of. And we thought that this transaction specifically was very unique.

Dan Donlan*; Ladenburg Thalmann; Analyst*
Okay. Thank you.

Operator
The next question will be from Ki Bin Kim of SunTrust. Please go ahead.

Ian Guale*; SunTrust; Analyst*
Unknown Analyst: This is Ian on for Ki Bin. Just wondering what you guys are seeing in the market for the back half of the year. You did a good chunk of your acquisition guidance. I'm just curious what you're seeing in the back half right now.

Joey Agree, *Agree Realty Corporation – President & CEO*
Good Morning. We haven't seen any significant movement in terms of the macros, in terms of cap rates. Obviously, interest rates remain low. We've seen some sectorial changes, some of the, I would call it,

risk-averse from a headline perspective tenants and sectors. We've seen cap rate compression in terms of ask. Tire service, auto service, a number of those sectors where people don't see the Amazon headlines on The Wall Street Journal flashing across their screen. But at the same time, we've seen a slight expansion in sectors where there hasn't been a compelling bid, and you have a significant amount of product coming online, specifically Dollar Stores, with over 1,000 Dollar Stores opening up within this country in 2017 alone between Dollar General and Family Dollar/Dollar Tree. So cap rates have frankly been quite stable. Our focus and our goal remains finding those transactions across the net lease spectrum through all three external growth strategies where we can deliver value to our shareholders.

Ki Bin Kim*; SunTrust; Analyst*
Hey, Joey, it's Ki Bin. Just going back here to your earlier comments, about Amazon and ecommerce, you guys have a lot of different business segments that you're a lanlord to -- are there certain segments that you're further kind of carving out and saying maybe we don't want to own those assets or be in that business longer term? Besides the ones that we already know about?

Joey Agree, *Agree Realty Corporation – President & CEO*
It's a good question. Soft and hard goods that are easily commoditized, a retailer that doesn't have a compelling experience or a unique value proposition or is easily reparable gives us pause. I mean, there are a number of sectors that you can think about that we want to see that shakeout. Obviously, the quintessential sectors which everyone gets concerned about are office supplies and electronics and things of that nature. That said, as we move forward -- and I said in my prepared remarks, over the next decade, that's obviously a round number -- as we move forward, we believe there's going to be winners and losers in those sectors. Now, are we actively pursuing opportunities within them? No. But like everybody, we continue to refine our approach, we continue to learn. And we continue, frankly, to target the retailers in those sectors which we are confident in that are at the top end of the spectrum in terms of performance on a go-forward basis and historically.

Ki Bin Kim*; SunTrust; Analyst*
And given what you're seeing, does it incrementally make you want to maybe reprioritize what makes it to the top in terms of importance, whether it be tenant quality, business viability, or maybe even demographics? And does that have any implications for maybe the go-forward yields coming down? Like you said earlier, it seems already that some of the non-Amazonable businesses are seen slightly compressed cap rates. But just curious to see what we can see going forward from you guys.

Joey Agree, *Agree Realty Corporation – President & CEO*
I would tell you we retain the optionality, if we really -- given our cost of capital today -- we did it with the portfolio transaction last year, we've done it on single assets, where we really honed in and really the underlying real estate, the underlying store performance or something -- that we've retained the optionality to go get something and to buy it. That’s the fragmentation of the net lease space, the size of our funnel, the performance of our team, the commitment of our team. We see a host of different opportunities to then leverage our relationships with retailers to find value. As I said in the prepared remarks, our second quarter acquisitions were the highest quality since 2010. RaceTrac is a leading gas and convenience store. We were very pleased to execute on that transaction. We added Ross Dress for Less, which is a fantastic off-price retailer, to the portfolio. A number of O'Reillys, the LA Fitness in Columbus, part of the new nationwide corporate campus in Grandview Heights is a fantastic piece of real estate in an exciting, burgeoning submarket adjacent to downtown Columbus with great store performance. So we are picking the cream of the crop today. And we're able to see it because of the size of our funnel and, frankly, the performance of all of our team members and partners here.

Ki Bin Kim*; SunTrust; Analyst*
Okay, thanks. And congrats, Matt.

Matt Partridge, *Agree Realty Corporation - CFO*
Thank you.

Operator
The next question will be from David Corak of FBR. Please go ahead.

David Corak*; FBR; Analyst*
Good Morning, Guys. Looking at the development and PSC business, two first-time development customers there, which sort of proves out the idea of leveraging existing relationships on the owner's side, at least for one of them, to get development business [inaudible]. But maybe specifically with Mister Carwash, Joey, can you just give us some background on how that came to fruition, and if there are other potential scenarios like this in the existing portfolio going forward?

Joey Agree, *Agree Realty Corporation – President & CEO*
Yes. Look, we're very pleased, and we're excited about our partnership with Mister Carwash. Obviously, we transacted in the sale leaseback with Mister Carwash last year. And similar to how we executed on a sale leaseback with Camping World, with Meridian, our Burger King franchisee; with the acquisitions of a Wawa before we went in the ground actively with them in Florida, we're able to use our balance sheet's selected use of sale leasebacks. What we're not able to telegraph to the market -- obviously, we report acquisitions on a quarterly basis -- is what we're doing behind the scenes in terms of the shadow pipeline in regards to development. At the time of the sale leaseback with Mister Carwash, we were actively working on the design of prototypes. Mister Carwash is obviously the number-one carwash operator in the country, over 200 carwashes, a fantastic management team, over 48 years in operation, operating in 21 states. But they had never developed net new units for an organic perspective. Their growth has come, and it's been tremendous growth through the acquisition of operators, disparate operators, across the continental U.S. And so we work with Mister Carwash hand-in-hand, and they're a fantastic partner in designing with the optimal prototypes for over a year. It's been a process, a learning process, for both of us. And we're very pleased to get the first two in the ground in New Mexico and Iowa respectively, two different prototypes, and two exciting projects. And we look forward to helping Mister Carwash, as an important constituent and as a partner, develop organically and/or relocations, hopefully, for years to come. And so those are -- again, it is an example of us being able to leverage our multiple capabilities here. And I think in the quarter, you see our acquisition platform firing, our partner capital solutions producing awesome opportunities, and frankly our development platform with shovels in the ground.

David Corak*; FBR; Analyst*
Okay. So then, I guess, just sticking with that, you've mentioned doing the $50 to $100 million deals in-process or closed, I think, was the term annually, by '18. Is that still a pace that you're comfortable with? Or is there anything changed in the retail landscape that would kind of make you alter your thoughts there?

Joey Agree, *Agree Realty Corporation – President & CEO*
We have $46 million delivered and/or under construction currently, through development and Partner Capital Solutions. So obviously, we're on-pace for that $50 million to $100 million, frankly ahead of pace. In terms of go-forward into 2018 and beyond -- the retail landscape or the macro doesn't really have, frankly, any bearing on what our pipeline and shadow pipeline look like. Our performance will be based upon the opportunity that we uncover, our partners' appetites for new stores, as well as any new business development that we're working on currently for 2018.

David Corak*; FBR; Analyst*
Okay. And then, one last one, can you just walk us through how you guys are balancing, how you think about doing a larger portfolio deal today on the acquisition side versus kind of spreading that out over a few years with one-off acquisitions, kind of the strategy that you've acquired year-to-date?

Joey Agree, *Agree Realty Corporation – President & CEO*
Yes. We continued to be an aggregator through all three external growth platforms on a one-off basis. That's our DNA, that's our M.O, that's how we view real estate on a single transactional level. We look at portfolios up to the multibillion-dollar size. We have not obviously struck on anything similar. If we find something larger that makes sense, it would have to fit within context of the quality of our portfolio and obviously would have to work from a financial perspective as well. When I speak of financial, have to work from not only a P&L perspective but a balance sheet perspective. And so we aren't going to take any outsized risks to the quality of the portfolio, the balance sheet, frankly the consistency and sustainability of our earnings and dividends. We are happy to continue and excited, frankly, to continue to scale and build out our three external growth platforms regardless of larger portfolio opportunities.

David Corak*; FBR; Analyst*
Fair enough, thanks, guys.

Operator
The next question will come from Nick Joseph of Citigroup. Please go ahead.

Michael Bilerman*; Citigroup; Analyst*
Hey, Joey, it's Michael Bilerman here with Nick. I'm just curious, between Brian and Matt, both CFOs you hired after Ken had taken his retirement, sort of lasted, call it, 1.5 years each. So I guess, as you're going through the process now of re-backfilling the role a third time, what have you learned about the role at Agree that is limiting the tenure of these CFOs? Is it the responsibilities? It is the pay? Is it the management or culture that they don't like? What is it about the job that's not keeping the butts in the seat?

Joey Agree, *Agree Realty Corporation – President & CEO*
Good Morning Michael. It's an interesting question. I would tell you that I think that the opportunity afforded by this organization, whether it be internally or external, at different companies, or different roles for people, is the most important takeaway here. I think also it's a testament to the organization that the management team here, is frankly, is talented. The company has experienced fantastic growth. The company has been very successful. And so it's a testament to the management team that, frankly, there are outside suitors for them. Now as CEO, and as ultimately accountable and a leader of this company, I view my job as -- one is creating opportunities for people. And my important job, my most important job as a manger, is putting people in a position to be successful. I would tell you that overall our turnover has been very low, it's unique to the seat. I'll let you talk to Matt offline. I don't think he needs to go through in details on the call, unless he wants to. But Matt specifically -- and I'll speak for him, Matt, feel free to jump in -- saw a unique opportunity for himself and his family. And we won't hold anybody back from pursuing them. I mean, Brian Dickman did a fantastic job as CFO. He saw a unique opportunity at Seritage. And Matt saw a unique opportunity that they wanted to take advantage of. So we have a fantastic team in place. We will go through a contemplative search to find the right successor for the company on a go-forward basis. I would tell you that the position, the role and the responsibility has dynamically changed. You're talking about a company, in Matt's tenure alone, that's gone from 18 to 30 people in just 18 months. And we're confident that we're going to find a fantastic successor to Matt. And

we're also confident that Matt's going to have a fantastic career ahead of him. And we're going to remain friends and keep in touch.

Matt Partridge, *Agree Realty Corporation - CFO*

Hey, Michael, this is Matt. I would just elaborate on that and say there's nothing at Agree that I would replace or change. It's a terrific place to work, it has a terrific culture. There's a bunch of wonderful people here that I've really enjoyed working with over the last 1.5 years. And I think it's a tremendous opportunity for anybody who's lucky enough to have it. Like Joey said, I had a unique opportunity. And I won't speak for Brian, but I know he had a unique opportunity as well. And sometimes those situations come up. But the company as a whole is obviously in a terrific place today, and it's a tremendous opportunity for anybody who's lucky enough to have it.

Michael Bilerman*; Citigroup; Analyst*

[Indiscernible] question.

Nick Joseph*, Citi; Analyst*

Thanks, Michael. Yes, this is Nick. You've talked in the past about targeted net debt to EBITDA ratio 5x to 6x. But over the last few quarters, it's been more in the mid- to high 4s. So I'm wondering if it's a shift in strategy to run at lower leverage, or if it's more of a reflection of just being opportunistic with capital. And should we expect to see leverage actually drift up going forward?

Joey Agree, *Agree Realty Corporation – President & CEO*

It's a good question, Nick, and I appreciate it. Because again, we ended the quarter at 4.6x net debt to EBITDA. Without the equity offering, pro forma remove the equity offering, we would've been in that 5.5x, 5.6x range. I think most important, it's not necessarily a shift in strategy. I think there is a relative opportunistic approach to it. But I would tell you at the same time, we know our operating strategy calls for us to continue to invest capital across three platforms. And we want to continue to maintain the balance sheet and the liquidity to be able to invest that capital on an accretive basis. At the same time, we don't need to use short-term variable-rate financing. We don't need to use -- we don't need to lever the balance sheet to provide double-digit shareholder returns, while maintaining the overall portfolio quality. We're in a unique perspective. Our spreads, I would tell you, are probably the largest in the net lease space, are investment spreads. And so we are confident that we can deliver significant AFFO and FFO growth on an annual basis without running, frankly, at the upper end of that leverage spectrum today. And so we're going to keep the balance sheet in a conservative, a flexible, a cable position, executing on the operating strategy while delivering the shareholder return that our shareholders are looking for us to execute on.

Nick Joseph*, Citi; Analyst*

Thanks. Then, just finally on Rite Aid -- how many of your stores will be sold to Walgreens, and how does that impact your exposure to both tenants?

Matt Partridge, *Agree Realty Corporation - CFO*

Yes, we have separated total in the portfolio. Three are in the geographic -- if you look at the maps that were in the investor deck posted by, I believe, both Rite Aid and Walgreens -- three are in the geographic territory where Walgreens will be acquiring Rite Aid specifically in the Northeast. And so it looks like potentially three of those stores will be acquired by Walgreens. One of those stores is currently subleased for the remainder of the term and has been by Rite Aid to Fresenius for a number of years.

Nick Joseph*, Citi; Analyst*

Thanks.

Matt Partridge, *Agree Realty Corporation - CFO*
Thanks, Michael.

Operator
The next question will come from Collin Mings of Raymond James. Please go ahead.

Collin Mings*; Raymond James; Analyst*
Just one follow-up for me. Just sticking with the questions this morning regarding just the strategy and the current environment -- Joey, maybe can you just update us on how you're thinking about your investment-grade exposure? Again, that's down to 44% versus north of 50% 2 years ago. I know it's not a metric you like to get too focused on, but just maybe talk about the shift in that that we've seen over the last 2 years, and how you think about that metric as you kind of go through the strategy going forward.

Joey Agree, *Agree Realty Corporation – President & CEO*
Yes, look, we're cognizant that the investment community looks at that number and monitors it. First, I would tell you that our retail investment-grade exposure is the highest in the space by far, number one. Number two, we have a number of high-quality retailers in our portfolio that don't have a credit rating at all. And I think I touched on it on the last call. Again, Publix this quarter, Panera Bread -- these aren't rated credits. I think if you look at the balance sheet of Tractor Supply, and Hobby Lobby specifically, Tractor Supply publicly available, Hobby Lobby is a company that has no debt. And so I don't think they would have a problem getting investment-grade credit rating. So I think if you take the credits in our portfolio -- another example is Meijer, where we have a Meijer ground lease in Plainfield, Indiana. If you take those credits in our portfolio, if we were to impute investment-grade credit ratings, you're talking about being north of 50% with just those well-known national or super-regional retailers that are extremely capable. So I'll tell you, we're cognizant of it, we're not going to start imputing credit ratings. We're not going to deviate from how we monitor credit or, frankly, mark credit. It's something that we'll continue to monitor. At the same time, our focus again is not necessarily on credit per se from a major rating agency; it's about how that retailer and that piece of real estate fits in an omni-channel retail world. And so there's a lot of retailers that aren't rated, some that are rated sub-investment-grade that are fantastic operators that we're very fond of. So we're going to continue to execute that number, we'll continue to monitor it. But it won't be a driver from an optical perspective. We're not going to let optics drive our investment strategy.

Collin Mings*; Raymond James; Analyst*
Okay. Thanks, Joey. And congratulations, Matt, on the new opportunity.

Matt Partridge, *Agree Realty Corporation - CFO*
Thanks, Collin.

Joey Agree, *Agree Realty Corporation – President & CEO*
Thank you, Collin.

Operator
The next question will be from R. J. Milligan of Robert W. Baird. Please go ahead.

R.J. Milligan*; Baird; Analyst*
Joey, just quick follow-up. I know you guys have maintained your occupancy. I'm curious, has your credit watch list changed at all or grown over the past six months?

Joey Agree, *Agree Realty Corporation – President & CEO*
I would tell you, the only material credit on our watch list, which we just touched on a couple questions ago, is Rite Aid. Obviously with the acquisition, they're going to have some proceeds here. They'll be more of a regional operator. And so the watch list -- there's always movement. I would tell you that our watch list as defined, we keep it fairly broad. We want to be watching every asset, all 415 in the portfolio. And so we're always looking at store performance underlying real estate trends, demographic trends, retail absorption trends and market occupancy rates, as well as balance sheet and profitability of those retailers. And so like I said, we'll continue to watch Rite Aid. They're down at number 16 at one point, call it 1.6%, 1.7% today. And we'll see how that transaction transpires and which stores Walgreens actually purchases.

R.J. Milligan*; Baird; Analyst*
Okay, thanks. And I know you guys just started the search for Matt's replacement, but can you give us an idea of what your targeted timeline is for bringing somebody else onboard?

Joey Agree, *Agree Realty Corporation – President & CEO*
Yes, I would tell you our thought process today -- and we've had, frankly, 25 inbounds as part of being publicly traded when the news goes out there. And we have a number of interested candidates on it. Our thought process today is to take our time, find the right candidate, find the right partner for this business to help execute on its operating strategy. And so in terms of a strict timeline, we don't have -- the luxury of having Dan Ravid having accounting tax and audit report to him, we have a fantastic luxury sitting next to me, Ken Howe, who knows more about this company than anybody and has been here for 4 years pre-IPO. And so the balance sheet's in fantastic shape. Obviously we raised equity. All the pieces and parts are there for us to take our time and find the right successor to Matt, who's done a fantastic job, and find the right partner for this growing and scaling business.

R.J. Milligan*; Baird; Analyst*
All right. Thanks, guys.

Joey Agree, *Agree Realty Corporation – President & CEO*
Thank you, R. J.

Operator
Your next question will be from Ryan Meliker of Canaccord Genuity. Please go ahead.

Ryan Meliker: *Canaccord Genuity; Analyst*
I just wanted to kind of take a big-picture for you, Joey. You gave some good color on your views on the retailer environment and ecommerce shaping it. I'm just wondering, over the past 5 or 10 years, how has your view changed? Has it changed? And are there any industries that have surprised you either towards their resilience against the ecommerce environment or, to the flipside, more challenges surrounding the ecommerce environment that have caused you guys to maybe rethink some positions there? Thanks.

Joey Agree, *Agree Realty Corporation – President & CEO*
It's an interesting question, Ryan, and I appreciate it. Good Morning. I think we are always learning, and we are always refining. I think what necessitated the prepared comments is that we often from investors, and as well as analysts, get questions, are you concerned about Amazon entering pharmacy? Well, if you look at The Wall Street Journal, and you look at the headlines over the course of the last couple months, we've had Amazon entering grocery, obviously; Amazon entering pharmacy, Amazon entering auto parts,

Amazon entering furniture, Amazon entering the appliance space now with their deal with Sears. And the reactivity of the equity markets, frankly, we believe is overblown. That's by definition the equity markets at times. And at the same time, we think people are, frankly, conflating a number of different things that are going on in the brick-and-mortar retail world. The failure and the evolution of the mall space is very divergent from the evolution of the net lease space. Macy's, JCPenney and Sears and those struggles aren't correlated necessarily to what we see in terms of sectors and the tenants in the net lease space. I'd tell you, one place that I've personally been surprised about in terms of ecommerce penetration and the inability of brick-and-mortar retails necessarily to win -- to maintain market share, I should say, is women's fashion. I had always believed that women would prefer to touch and feel and shop in a brick-and-mortar store as part of an experience. I would tell you that the penetration in terms of women's fashion in traditional brick-and-mortar retailers, inclusive of department stores, is as much of a factor as those historic brick-and-mortar retailers, a few of which I named, and then a few smaller operators in terms of GLA and national coverage, is that they have not changed their business model and have not evolved to maintain that market share. The experience of shopping in those stores, the value proposition of shopping in those stores, frankly, hasn't been successful. They haven't changed their business model. I think the internet's impacted everything, including brick-and-mortar retail. At the same time, in terms of women's apparel, you look at T. J. Maxx, Marshall's, obviously also TJX. You look at Ross, you look at Burlington -- the off-price retailers have thrived. And so what I see happening in women's fashion specifically is the traditional department store operators have not changed their business model. And you see the ecommerce penetration in taking market share, but you also see the off-price taking market share. And so that's one place that has surprised me. I'm not sure if it's as much as the advent of shopping in a box and having it delivered or online ordering and home delivery, as much as it is, frankly, the inability for some of those brick-and-mortar retailers to evolve their business model.

Ryan Meliker: *Canaccord Genuity; Analyst*
Thanks, Joey, that's good color. And I guess, just a second question -- you touched on this a little bit, maybe a little bit more detail? Obviously 2Q was pretty skewed towards acquisition volumes. You did announce a few development and PCS deals. How should we think about the breakdown between acquisitions and development and PCS going forward? Is it going to be more balanced? Are you just finding so many attractive acquisition opportunities at the right pricing that it just makes sense to put your capital in that boat right now? Help us understand how we should think about that.

Joey Agree, *Agree Realty Corporation – President & CEO*
So, one, if we didn't have the outsized acquisition volume, which was a function of transactions -- one which literally was 4 years in the making, another which was 18 months in the making; and then some single-credit and mixed-credit portfolios -- if we didn't have the outsized acquisition volumes, frankly, the headline would probably be, and the takeaways would be, the ramp of our PCS and development activity. We have $24 million, $25 million effectively in the ground or committed between the two Mister Carwashes and the Art Van. If you took our Q1 acquisition volume of, call it, $55 million, $58 million -- if you took that volume, I think the headline would be that the PCS and the development activity ramped. Again, I would tell you, the elevated acquisition volume for Q2 is by no means the run rate. It was highly opportunistic. And I think the key takeaway for investors here, as well as analysts, is now we have three external growth platforms plus our active asset management platform, which divested of two assets for over $11 million, that were all firing. And I think that's the piece that gets the management team and the overall team here, the entire team, excited, is that we see opportunities across the full net lease spectrum from inception to older assets on a third-party basis, acquired on a third-party basis, where we can find, create and extract value.

Ryan Meliker: *Canaccord Genuity; Analyst*
Okay. Thanks, Joey, that's it for me.

Joey Agree, *Agree Realty Corporation – President & CEO*
Thank you, Ryan.

Operator
The next question will be from Rob Stevenson of Janney Capital Markets. Please go ahead.

Rob Stevenson*; Janney; Analyst*
Joey, can you talk about your experience with and thoughts on the auto parts retailers, and the sustainability of that business going forward? The stocks of AutoZone and O'Reillys and the like are off roughly a third in the last 3 months. You viewing that basically as a stock market issue? Is it signaling something about the business long-term prospects there?

Joey Agree, *Agree Realty Corporation – President & CEO*
I think the auto parts space specifically has a number of things going on. I won't try to predict or armchair quarterback the equity markets. Everything from the cycle of used cars to the age of the cars on the road have implications for the auto parts space. Our two primary, outside of tire service, which is, of course, Bridgestone Firestone and the NTB TBC concepts, as well as Goodyear -- our focus has been on O'Reilly and AutoZone. They're very good relationships of ours, retailers that have fantastic balance sheets; we believe have strong underlying business models. And I actually spent time in an AutoZone store a few months ago to even better understand the business. Because, frankly, I'm not very adept at auto parts personally. So they're very different businesses, frankly. AutoZone has more of a do-it-yourself customer that comes into the store. And part of that experience, when we talk about experience, part of that value proposition, is the ability to talk to a customer sales rep to find the right part and to tinker, and to be able to work through issues with that sales rep, and then take that part back immediately and go work on your car, sometimes even in the parking lot of the AutoZone. O'Reilly has a much bigger component than AutoZone of out-the-backdoor sales. Backdoor is the proverbial bump shop collision dealerships, who need the part in an hour. Now I think most interesting in all of this is the Amazon fears of Amazon entering the auto parts space because they can win on price. If you talk to somebody in the auto parts space, what they'll tell you is Amazon has taken market share in windshield wiper blades and floor mats. We don't see that as a threat to the top two operators in the space, O'Reilly and AutoZone, on a long-term basis. Will they have to tweak and change their business, effectuate an omni-channel strategy? Sure, 100%, like every retailer in this country. But we don't see Amazon shifting mufflers and heavy-duty auto parts on an effective profitable basis, taking significant market share long term from those two operators.

Rob Stevenson*; Janney; Analyst*
Okay. Thanks, guys, appreciate it.

Joey Agree, *Agree Realty Corporation – President & CEO*
Thank you.

Operator
The next question will be from George Hoglund of Jefferies. Please go ahead.

George Hoglund: *Jefferies; Analyst*
First of all, Matt, congratulations on the new job. And it's been a pleasure working with you over the past year or so.

Matt Partridge, *Agree Realty Corporation - CFO*

Great working with you as well.

George Hoglund: *Jefferies; Analyst*
Thanks. My question is on the new developments and PCS. On the three projects, what are sort of expected returns, and is that relatively consistent with what we've seen in the past?

Joey Agree, *Agree Realty Corporation – President & CEO*
Consistent with what you've seen in the past in terms of both development and PCS. So nothing new to report on those fronts there.

George Hoglund: *Jefferies; Analyst*
Okay. And then, just generally with construction costs, have you seen any changes in costs or availability of labor?

Joey Agree, *Agree Realty Corporation – President & CEO*
I wouldn't tell you in short term. And I talk to Jeff Konkle about it all the time, who I referenced in the prepared remarks. The general theme coming out of recession is the availability of labor has been very challenging in the construction industry. Because, frankly, 50% of the trade went out of business and did come back. And so the availability of labor makes it even more important to get for our team new bid to qualified general contractors that have access to those trades and can perform on time and on-budget. Obviously, we don't sell or perform any construction activities here. We go through a competitive bidding process, simply a GMP contract, where we'll bring in qualified regional contractors with experience in that product type. And then, their ability to access trades on an effective basis is critical.

George Hoglund: *Jefferies; Analyst*
Okay. Thanks for the color.

Joey Agree, *Agree Realty Corporation – President & CEO*
Thank you, George.

Operator
And ladies and gentlemen, this will conclude our question-and-answer session. I would like to hand the conference back to Joey Agree for his closing remarks.

Joey Agree, *Agree Realty Corporation – President & CEO*
Well, thank you, everybody, for your patience. And with that, I'd like to thank you for joining us today. And we look forward to speaking to you in Q3. Appreciate it, thank you.

Operator
Thank you, sir.

Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.