Y 2017 Earnings Call

Company Participants

- Ruy Kameyama, Chief Executive Officer

Other Participants

- Daniel Gasparete, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everybody to BR Malls Fourth Quarter 2017 Conference Call.

Today with us we have Mr. Ruy Kameyama, Frederico Villa, and Derek Tang. We would like to inform you that this event is being recorded, and all participants will be in listen-only mode during the company's presentation. After that, there will be a question-and-answer session for analysts and shareholders. At that time, further instructions will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of BR Malls' management and on information currently available to the company. They involve risks, uncertainties and assumptions, because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of BR Malls and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Ruy Kameyama, who will begin the presentation. Mr. Ruy Kameyama, you may begin your conference.

Ruy Kameyama {BIO 16672412 <GO>}

Good morning, everyone. Thank you for participating in our fourth quarter conference call. We will go over a brief summary of the quarter results making reference to the presentation available in our website, and then we will be available to answer any question you have.

Moving on to the first slide of the presentation, the year 2017 was a particularly important year for BR Malls. Along with the challenging times brought by the recession in Brazil, we went through very important internal changes last year. We believe to have set the foundations that will allow us to safely advance towards our long term goals. Nevertheless, the accounting changes materialized into non-recurring expenses that affected our short-term results.

In slide number two, 2017 was a remarkable year talking about our portfolio strength. In terms of strategy, we decided to focus patiently in our exposure in dominant assets. In 2017, we sold stakes in six malls for a total of R$824 million. With this, we reached the end of the year with 86% of our NOI exposed to assets certified in tier 1 or 2, and this is compared to 76% in 2013.

Moving on to slide number three, we show another important step of our portfolio strengthening strategy with the announcement of the progress that has been made in our retrofit projects. We went through a restructuring of our development department bringing in new people (inaudible) to our team, and further developing the new profile of our consumers and assets for the long term. We defined five projects to be started this year, of which construction has already started in Norte Shopping, and we are advancing along with our partners (inaudible) definition of the remaining four projects to be started this year.

We started 2018 with a more concentrated portfolio and we are seeking new opportunities to recycle our portfolio and acquire assets that are in line with our dominant strategy. We will take important steps with our redevelopment investments. Additionally, we will develop solutions and technologies to facilitate omni-channel and consumer interaction. We believe that we will transform our main assets and raise the bar in term of consumer experience and increase the long-term attractiveness.

On slide number four, we present important changes made to our company's corporate governance and management team. We had changes in our board of directors with new board members coming in, we concluded important changes to our committees, promoted changes to our compensation model, and reviewed policies and accounting practices. These changes allowed for a better alignment with shareholders' interest and consequently, a top score in ISS' Governance Quickscore.

On slide number five, I will comment on leasing performance and tenant mix. We started 2016 and 2017 with a high level of late payments that impacted provision for doubtful accounts and cash generation. In early 2017, we changed our leasing policies with a greater focus on cash generation. Throughout the year, we replaced stores that were underperforming, which led to a temporary higher vacancies. But after intense leasing activities, we were able to recover our occupancy rate to bring back to the level that (inaudible) December 2017. These movements proved itself as the right move to do with the decrease in net late payments and better cash generation. With this, we observed a negative cycle of high late payment and provisioning, and entered January 2018 with a healthier tenant mix. Our new criteria for bad debt provision with the adoption of IFRS 9 and gradual provisioning up to 180 days shall improve our cash generation and reduce volatility in our results.

Moving on to slide number six, net revenue for the fourth quarter totaled R$370 million, down by 4.6% compared to the fourth quarter of 2016, and excluding divestments, the negative variation was 2.2%. In 2017, net revenue changed to R$1.34 billion, 1.6% below the reported for 2016, or minus 0.3% when excluding divestments. We recorded an adjusted EBITDA of R$235 million in the quarter, with a margin of 63%. For the year, our adjusted EBITDA decreased by 13.8%, totaling R$876 million, with a margin of 65%.

In slide number seven, we can observe the main factors that negatively impacted our adjusted EBITDA. Sales expenses totaled R$68 million in the quarter and R$207 million in 2017. This rise is mainly explained by provisions for doubtful accounts, which resulted from rise in delinquency rates during the financial crisis period and also due to the change in the provisioning period from 360 days to 180 day as of the fourth quarter of last year.

Looking towards 2018, we will follow the IFRS 9 criteria and we will start provisioning based on time ranges of outstanding balances and their respective historical recovery rate. More information is available on Appendix V of our releases.

Regarding general and administrative expenses, we observed a decrease of 52% during the quarter, and 7% during the year, due to a more challenging economic scenario with a reduction in profit sharing amounts. Along with these, there was a reduction in stock based compensation as a result of a smaller impact of the long-term incentive plan.

On slide number eight, after a series of initiatives in the capital markets, we reached the end of the year with one of the most solid balance sheets in the sector, with a low leverage and without exposure to foreign exchange variation. This strong capital structure was responsible for a significant reduction in our financial expenses, and reestablished our capability to make new investments. Therefore, even during a challenging year, we were able to deliver 64% growth in our adjusted FFO which totaled R$491 million during the year, or R$0.60 per share, an increase of R$0.17 per share when compared with 2016.

Last, but not least, given our current comfortable cash position and leverage rate, we shall assess all the capital allocation alternatives, seeking to maximize shareholder value. As a subsequent event, in March, this year, a share repurchase program was approved of up to 41 million shares, approximately corresponding to 4.7% of the shares outstanding for a maximum period of 12 months.

The 2017 strategic changes, along with the response from our employees and improvement in our business in the past few months contribute to our belief that we will have a 2018 that is more compatible with the return levels that are sought by our shareholders.

This concludes our presentation, and we will be available for any questions you might have.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the questions and answers section. (Operator Instructions) Our first question is coming from Mr. Daniel Gasparete of Merrill Lynch. Mr. Gasparete, you may proceed.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Yeah. Thank you very much. Thank you, Ruy, for the call. Just a quick clear question here regarding the improvements on the tenant mix. We haven't seen that company has made some huge efforts on changing the tenant mix, turnover has reached highest level 9%, and we already start to see some improvements on the (inaudible) sales ratios. I wanted to get your view on how much days (inaudible) still for improving the tenant mix, and which kind of retail or which kind of segment do you think was changing are now close to a point where most of the changes have already made, and we mostly now should see turnover [ph] falling for the rest of the year? Thank you very much.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you. So, yeah, last year was an very important year in terms of improving the quality of our tenant sales. So, as I mentioned, we started last year with a tenant sales that -- relevant part of which was underperforming, and were struggling because of the recession in Brazil. And with the target circulating with more modern concepts that would perform better in the long-term. Always we've been patient to raise the cash generation for the company, given that those tenants -- some of those tenants are underperforming, we are not being able to (inaudible) therefore naturally hurting our delinquency rate, and therefore, hurting our provisioning for doubtful accounts as well. So we took a different stance on that, and we started to replace them with more modern concept (inaudible) why we had one of the highest levels of tenants turnover last year. We believe that most of the -- of that effort has been completed there is still something to be done this year, but that shall be a smaller turnover rate than we saw in 2017.

And then from a quality or tenant mix perspective, we've been adding more and more important folks [ph]. The good thing is that during the recession, we saw -- we also saw lots of rising new concepts that have great consumer preference like new restaurants, casual dining, or new retailers, (inaudible). We've been also adding besides restaurants, more services and entertainment features.

So, this is a long-term trend as we expect to remain within the business. The malls in Brazil as you all know is already very much different in terms of tenant mix with higher exposure to entertainment, restaurants and services. I would believe that the malls and the adjustments that we made last year were also in that direction. So, we think that part of the -- we will see some turnover still this year and that is natural because of these upgrades in the tenant mix, but most of the adjustments because of the underperforming tenants we did last year.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Great. Thank you very much, Ruy. Have a nice day.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you.

Operator

(Operator Instructions) This concludes the question-and-answer session. At this time, I would like to turn the floor back to Mr. Ruy Kameyama for any closing remarks.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you for participating in our conference call. If you have further questions, please contact us here at BR Malls. Have a nice day.

Operator

Thank you. This does concludes today's presentation. You may disconnect your line at this time, and have a nice day.