Q3 2017 Earnings Call

Company Participants

- Ruy Kameyama, Chief Executive Officer

Other Participants

- Marcelo Motta, Analyst

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to BRMALLS' Third Quarter 2017 Results Conference Call. With us here today, we have Ruy Kameyama, Frederico Villa, and Derek Tang. This event is being recorded and all participants will be in listen-only mode during the company's presentation. After BRMALLS' remarks there will be a question and answer session. At that time further instructions will be given. (Operator Instructions)

Investors and analysts should understand that macroeconomic condition, industry conditions and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

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

Ruy Kameyama {BIO 16672412 <GO>}

Good morning, everyone. Thank you for participating in our third quarter 2017 conference call. As we have done in previous calls, we'll go over a brief summary of the results, making reference to the presentation available in our website. And then we will be available to answer any questions.

This quarter we kept implementing the adjustments that started earlier this year. Relevant changes are being made in a way to focus our attention and efforts in a portfolio of dominant malls. We believe that by focusing on main assets and by developing closer relationship with our clients, we will be prepared for the opportunities that will arise with the recovery of the economy and retail sector.

Moving on to the first slide of our presentation, we observed signs of gradual improvement in retail and consumption levels. Total sales grew by 5.5%, when we exclude the effects of the asset sales over the last 12 months. Our sales per square meter grew by 6.8% and our same store sales grew by 4.6%, the best third quarter growth over the last four years.

On slide number 2, we reported an additional reduction in late payments, reaching 9.5%. The levels of net delinquency remained low at 1.7% and our occupancy rate increased 0.5% compared to last quarter, reaching 95.2%.

Switching to slide number 3, our net revenues reduced by 1.8%. Our adjustment process has been focused on reducing delinquency and increasing cash flow generation. This process involved temporary discount concessions and the eviction of delinquent tenants, which in turn effect our short-term revenues. We are confident that our commercial strategy will allow us in the next quarters to improve our occupancy rate, decrease discounts and increase our revenues. Our adjusted EBITDA reduced by 15% mainly due to a more challenging scenario for credit recovery of past settlements of confession indebtedness, which amounted to BRL34 million, causing a write-off in our accounts receivable of confession of indebtness. In face of the financial vulnerability of some of our tenants over the next quarter, we will proceed with our strategy of improving our criteria for provision for doubtful accounts to more conservative metrics and in line with the IFRS 9 recommendations.

On slide number 4, our adjusted FFO reached BRL114 [ph] million with a 35% margin, the best reported AFFO margin since 2014, mainly due to reduction in interest rates and the company's lower leverage level.

Slide number 5 illustrates the improvement in the company's capital structure. On July this year we concluded the buyback of our $378 million perpetual notes and thus we are no longer materially exposed to foreign currencies. We ended the quarter with a net debt to adjusted EBITDA of 2.4 times, the lowest level in our history and with a healthier credit profile, we continue to work on managing our liabilities. During this quarter, we renegotiated the cost of part of our TR denominated debt, our largest exposure, and therefore reduced the average cost of our outstanding TR linked debt by 30 basis points. After the end of the quarter, we announced the issuance of a CRI securitized debt in the amount of BRL400 million at a rate of 97.5% of CDI due in 2023. In November Moody's rating agency upgraded BRMALLS' corporate rating on a national scale to Aa1 from Aa2.

On the improvement of our leasing structure on slide number 6, we continue to focus in strengthening the productivity of our sales team. This quarter, we leased 423 contracts in existing malls, the highest third quarter figure since 2012 and additionally, we launched BRMALLS Partners, a project to develop and accelerate retail chains in partnership with Endeavor, the most renowned entrepreneurship organization. They will provide mentoring, know-how and priority access to high potential retailers. This will also help us improve the relationship and preference of our clients.

Talking about investments on slide number 7, we show that our next greenfield project, Estacao Cuiaba is currently in advanced stage of its construction and is expected to open on fourth quarter 2018. Leasing is advancing at a good pace and currently more than 80% of the GLA has been leased already.

On slide 8, we highlight our main renovations projects that will begin their construction phase between this year and the following year. The renovations will increase their attractiveness over the long term for the consumers and tenants and will make it possible to benefit from the assets' potential in a broader manner. The company plans to invest in renovations at least 5% of our NOI, in addition to approximately BRL50 million per year. In September, the company received a notice of interest to exercise the put option of a 30% stake held by our partners in Alvear Participacoes which holds interest in malls, Catuai Londrina, Maringa, Londrina Norte and in the Cascavel greenfield project. In order to conclude acquisition our stock price must be higher than BRL18.28. We believe that the acquisition of the remaining stake if concluded will strengthen our portfolio, and the aforementioned put option and its accounting effects have been demonstrated in our financial statements.

In accordance to the accounting standards regarding this type of transaction, the proper accounting is to treat the event as a capital transaction with non-controlling shareholder, according to CPC 36, standards, and should generate an offset effect on our shareholders' equity and therefore not have an effect in our income statement. We recorded the obligation in our long-term liabilities BRL499 million and the 30% investment in Alvear has been recorded on shareholders' equity, BRL322 million on the NCI account. The difference approximately 177 million has been recorded under capital reserves account. We include a detailed explanation on section 1 to 2 of our quarterly financial statements and on Appendix V of our earnings release.

On slide 9, we show the new composition of our Board. In October we announced with sadness the passing of our Chairman, Pedro Damasceno. The company will always be grateful to his important contributions. Our Board of Directors was recomposed with the entrance of the substitute member, Jose Castanheira and the entrance of Bruno Rudge after the resignation of Director, Marcos Pinto. Furthermore Claudio Bruni was elected Chairman of the Board. We reiterate that the Board's agenda remains unchanged and its composition continues with multi-disciplinary, complementary and independent members, who are aligned with the shareholders of the company. With the objective of strengthening our management team, Mr. David Contis, former Vice President of Simon Property Group and Equity Investment Group joined BRMALLS as a Strategic Exclusive Consultant in Brazil.

Regarding our portfolio recycling strategy we started negotiations with investors they are interested in acquiring some of our malls. These asset sales are part of the selected group of malls within our portfolio recycling effort, in line with the company's strategy of focusing attention towards the dominant portfolio.

This concludes our presentation and we are available for any questions you might have.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Marcelo Motta, JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Hi, good morning everyone. Two questions from me, if you guys could comment a little bit on, what should we expect in terms of margins for the company. I mean during the presentation, Ruy mentioned that the commercial strategy should have also an improvement on occupancy rate and a reduction on discounts. But on the other hand, you've also mentioned, there will be pressure from provisions and the company will try to be as conservative as possible on that line. So just wondering how those two effects will impact your FFO margin. And the second question is regarding the assets sale strategy. I mean we saw the company fire Foran [ph] Real Estate Fund. I mean, which are the initiatives could we see until year end, and I mean -- and how much could it generate for the company?

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Marcelo, good morning. Thank you for the question. As regards with the margins, your first question, the biggest driver for the margin recovery will be the gradual reduction of the provision for doubtful accounts. Currently the PDD [ph], the provision accounts for approximately 16% of our margin and that 11% higher than our historical average. So as you can see this has a very big weight on our EBITDA margin. Over the next quarters we think that the revenues will gradually recover, but this high level of provision should represent the highest upside when we think about 2018. We think this will be a gradual recovery and we expect to see it throughout the -- evolving throughout next year.

When you look at our net delinquency rate, you can see that starting from second quarter of this year there was a big improvement and given the lag effect, we think that this should -- we can see it more clearly through our provisions, throughout next year, especially in the second half of 2018.

And as regards with the portfolio recycling strategy, yes, we keep on going the Fondo Inmobiliarios [ph] or the REIT is one potential buyer. But there are other groups interested. So we are advancing with all these conversations, both with the Fondo Inmobiliarios and some private players. We expect -- we have the incentive to close this deal until the end of this year, so we can use the tax benefit from the repurchase of the perpetual bond. But we are trying to close these deals by the end of this year. And we believe that we do not -- we are not going to anticipate the exact amount of the proceeds, because this is too part of the negotiations that are undergoing. But whenever this becomes available we will go and disclose all the information for you.

Q - Marcelo Motta {BIO 16438725 <GO>}

Perfect. Thank you very much, Ruy.

Operator

(Operator Instructions) We conclude today's question-and-answer session. I would like to invite Mr. Ruy to proceed with his closing statement. Please go ahead sir.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you for your time in our third quarter '17 conference call. And if you have further questions please contact us here at BRMALLS. Have a nice day.

Operator

That does conclude the BRMALLS audio conference for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.