Q3 2018 Earnings Call

Company Participants

- Frederico Villa, Chief Financial Officer and Investor Relations Director
- Ruy Kameyama, Chief Executive Officer

Other Participants

- Andre Mazini, Analyst
- Enrico Trotta, Analyst
- Jorel Guilloty, Analyst
- Luis Stacchini, Analyst
- Marcelo Motta, Analyst
- Nicole Inui, Analyst
- Roberto Bruno, Analyst
- Unidentified Participant

Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the audio conference to discuss the Third Quarter Results for BR Malls. Today with us, to comment on the results we have Mr. Ruy Kameyama, Frederico Villa, and Derek Tang. We'd like to inform you, that all participants will be connected in listen-only mode, during the company's remark. After that, we will start a Q&A session and further instructions will be provided. (Operator Instructions)

Before moving on, we'd like to say that forward-looking statements made during this call relative to the company's business outlook, operating and financial goals and targets are based on beliefs and assumptions on the part of the company's management and also information currently available. Forward-looking statements are not guarantees of performance as they involve risks, uncertainties and assumptions as they refer to future events, which depends on circumstances that may or not materialized.

Now, I'd like the turn the floor over to Mr. Ruy Kameyama. Please Mr. Kameyama, you have the floor.

Ruy Kameyama {BIO 16672412 <GO>}

Good morning, everyone. Welcome to our earnings call for the BR MALLS relative to the third quarter of 2018. I'll start with the highlight of the quarter making reference to the slide deck and then we'll have a Q&A session.

The third quarter was marked by a recovery -- operational recovery after second quarter, which was quite challenging marked by non-recurring events. The first two weeks were impacted negatively by the World Cup (inaudible) September, those months showed good level of recovery, which contributed towards growth of sales. Total sales at 5.1 quarter on same mall basis. The third quarter of last year, the comparative basis was strong sales driven by the FGGS fund. In terms of same-store sales, we grew 2.5% a partly variation of 3.8 points when compared with second quarter.

Geographically, the Midwest region grew 6.5% in same-store sales, followed by the Southern region with 5%. After a negative quarter for same-store launch, we filed a growth of 3.3% in this indicator, a positive variation of 4.4% when compared to the second quarter. That increase is related to a better sales performance, increase in inflation and also the (inaudible) of some discount levels.

Now the second slide, slide number two show that financial impact of our store portfolio. Commercialized (inaudible) new stores in this quarter and this effort to improve the mix on top improvement in the collection process, let us to file net delinquency rate of 0.8%, the lowest level since 2014 with unique levels we had pre-crisis [ph].

Likewise, growth delinquency kept downtrend totaling 6.4% down 3.3% compare to previous period. Lower delinquency has contributed to a lower provision balance. In this quarter, our provision for bad debt was about BRL10 million, so a 3.3% of our net revenues, a drop of 82.2% or BRL45 million when compare with the same quarter of last year. The execution of our commercial strategy also allowed the company to increase the occupancy rate, which reached 96.3% at the end of the quarter up 1.1% from last year.

On slide number three, we have our NOI performance, which reached BRL272 million, a growth of 2.1% in comparable basis, which can be explained mainly by an increase in parking, (inaudible) and percentage rent, as can be seen on the chart. In the chart on the left, the NOI growth on a comparable basis have shown an important expansion for the past quarters driven mainly by a strengthening strategy for the mixed tenant improvement in the occupancy rate.

On slide number four, we have the adjusted EBITDA, which saw an increase of 7.7% of 14.2% in comparable basis reaching BRL233 million in the third quarter. EBITDA -- adjusted EBITDA margin, totaled 71.2% and up 7% from last year. The main contribution for that improvement was the reduction of provision for bad debt as mentioned. Year-to-date, the adjusted EBITDA growth, this should impact 6% or 13.5% in comparable basis.

On slide number five, we have a growth of approximately 12% in AFFO in the quarter, with 41.3% and a year-to-date AFFO reaching BRL128 million in the quarter and BRL413 million year-to-date. For the first nine months of the year, we have reached in 2018 their highest AFFO in company's history. The AFFO per share, the main metric for value creation in the long run include 15.4% in the third quarter and 29.7% in the first nine months of 2018, reaching the total value of BRL0.48 per share year-to-date.

On slide number six, we have the company's capital structure, at the end of the quarter our net debt was BRL1.9 billion, down 17% when compared to previous year and reached a net debt-EBITDA ratio of 0.2 [ph] times. In September, we see an upgrade -- upgrading from Fitch to reach AAA and national scale, which is an important acknowledgement of the strength of our balance sheet, low leverage with low execution to foreign exchange fluctuations with a strong capacity to make more investments and also we've planned capital to our shareholders. The improvement in our debt profile has allowed us to advancing liability management. I mean, this quarter we negotiated approximately BRL1.5 billion of our net balance ranking above the average cost at about 0.9% of the debt paid to the TR on top of the expansion of our amortization and schedule.

On slide number seven, in terms of investments, our highlight in the quarter was the opening of the greenfield, Estacao Cuiaba (inaudible)

economy has proven to be prosperous in great potential given many buyout with business and this mall were started off as the largest and more complete -- almost completed to say. The product brought many innovations and gourmet store user experience on top of the best cinema complex in the region, a strong mix of stores, it also focused on culinary -- the culinary experience with great food court and a mix of restaurants, including Outback, Johnny Rockets, Coco bambu and we also opened a food hall, which we called Taste Lab, in a space of 2,000 square meters, which has been great in terms of sales experience. And the shopping mall is performing well, the cinema complex in two weeks has reached number one market share and initial sales are very promising.

As for other investments, in this quarter we acquired 30% of Alvear referred to the Catuai Londrina, Catuai Maringa, and Londrina Norte malls. As for the share buyback, we (inaudible) third quarter, approximately BRL300 million, which has shown, proven to be a good capital allocation for our shareholders. We also moved on in our retrofit work and we have accelerate construction in this quarter.

Moving down to the last slide, slide number eight. I'm going to talk about our outlook for the future. Our strategy for next year, is focused on following agenda. Number one, we continue to recover our operating results. We expect to maintain a consistent level of lower vacancy and to control the delinquency, which are important drivers for growth on top of complementary revenue coming from parking mall and media.

As for strengthening our portfolio, at the end of the political uncertainty, we will have more productively in a more favorable environment for those setting of non-core assets will follow on with our retrofit project, the main assets and also try to (inaudible) with our mix. As an example, the opening of the Zara store, at the Mooca Plaza mall, which took place last September and it became the largest Zara outlook in the country, an important (inaudible) store for that mall. In the omnichannel, we have dedicated (inaudible) time from the senior management and strategic planning.

We are now going through a rollout process. It's already in place in Rio, in Tijuca which are the -- our three largest malls in Rio. This rollout also take place in Sao Paulo next year.

Lastly November, we announced the hiring of Silvio Genesini in our Board, very experienced professional and technology innovation who will help us speed up our omnichannel solution.

We now close the presentation and now we will remain available for questions that you may have.

Questions And Answers

Operator

Thank you. We now start the Q&A session. (Operator Instructions) Our first question comes from Enrico Trotta from Itau BBA. Please (inaudible).

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning to everyone. Thank you for taking my call, thank you for the presentation. Two questions from my side. First, if you could please talk about turnover for the store in the full quarter has gone up, recently had dropped in the second quarter, what has happened actually understand those are special with specific reason for that in the third quarter, so that turnover should increase or if it is inline with your strategy in terms of improving the asset mix.

And if you could also mention, how much you have to go interchanging the mix going forward from the fourth quarter. What kind of expectation you have in terms of turnover going forward, if there is a down trend in the later.

And the second question, if you could perhaps let's say, sales for the fourth quarter, October, November, to-date and what are your expectations for the fourth quarter, if you will, including Black Friday and Christmas. If you have specific initiatives for those two events. Did you expect fourth quarter to be better than last year? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Enrico. Thank you for your questions. As for the turnover, I think it was an one-off situation, we didn't change our strategy. But in terms of the renewal of our portfolio as you could see, we've managed to solve much of our delinquency issue, we have moved significantly ahead on that front of max delinquency reaching pre-crisis levels September 14, so we manage to move ahead significantly on that front.

At the same time, we also had a positive trend in the form of a higher interest on the part of store owners, who want to expand operations. So very critical for us to predict where will be, even the turnover going forward. But what I can tell you is that, there was no change in our strategy. The renewal process is what we do as a necessary movement.

When we look at the delinquency rate, as I said, in maths terms, we are very comfortable. So again it was a one-off increase, 8.8% in this quarter but a one-off situation. As for the perspectives for the fourth quarter in terms of sale, what I can tell you, what we've noticed in October was a good result both in total sales, quite interesting results of that recovery we saw in the third quarter. We expect to remain consistent in the fourth quarter as well, it's difficult to anticipate or to quantify the impact of Black Friday and Christmas coming up. But we can already say that the trust, the mood of retailers is much better now after the election period. We expect to have a more favorable business environment with the new administration. But again, it's difficult to predict when that level of trust will return for consumers. Many events, I think, we are now moving along the right path for the fourth quarter.

Q - Enrico Trotta {BIO 16742911 <GO>}

Thank you, Ruy. Have a nice day.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you.

Operator

Next question comes from Andre Mazini from Citibank. Will you (inaudible).

Q - Andre Mazini {BIO 20377100 <GO>}

Hello, everyone. Good morning. We're seeing the percentage growing over 0.6%, my question is, is it coming from the demand from the retailers? Would they be willing to pay higher percentage? Also in this context, what kind of discount have you removed and how much you still have to go on that front? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Good morning. Thank you for your question. The percentage of revenue in the quarter grew by 10%. It's accelerated when compared to the minimum rents. I think, we need to take in to account what we have seen from the past two to three years into negative spread. Once again, we had the homework to substitute the retailer base for the past two years. It came from an occupancy rate, which is below 95% last year. So we've set up the mix strategy, which proved to be correct, when we look at the minimum rent along with the provision for that debt.

Today, we waived the minimum rent on the one hand and we have negative spread from the other hand. We improved our provision our bad debt and the impact on third quarter EBITDA was quite positive. We grew almost 40% on a comparable EBITDA. That's the effect of NOI plus a little bit of bad debt. So we are comfortable with that. And the good news is that we were able to come back to that and adjustment very expeditely to -- in terms of bringing bad debt to a little bit better level. Delinquency rates to better level. So as we move forward, we might change back to percentage rents. So that was the moment of the record level that we had from the third quarter. As for discounts, we continue to bring the basis down at a time that accounted for 5.5%, almost 6%. Now we are closer to 3%, so we think there's still some room when we compared that to precrisis spread levels and we are moving towards that (inaudible).

Q - Andre Mazini {BIO 20377100 <GO>}

Okay, Ruy. Thank you. And the 6% is same and then the revenue from rents, that's a total margin comparison [ph]?

A - Ruy Kameyama {BIO 16672412 <GO>}

Can you repeat the question please?

Q - Andre Mazini {BIO 20377100 <GO>}

You'd mentioned 6%, it is referring to net revenue or from rent revenue?

A - Ruy Kameyama {BIO 16672412 <GO>}

No, from rent revenue.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay, thank you.

Operator

Next question comes from Jorel Guilloty from Morgan Stanley. Please carry on sir.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning, everyone. I have a few questions. I was wondering if you could perhaps, first, how do you see the spreads for new contract today? It will be interesting to know what will be the trend that affected?

The other question, if you could perhaps talk about the delivery center experience at malls where the platforms are already active. I understand, sales in Tijuca were helped by that. So how do you see the rollout of the platform to other malls, what kind of the fact you expect on sales moving forward for other store?

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Jorel. Thank you for your questions. As for the spread, we have been improving throughout the first quarter. If you see a negative but much better that was in past quarter as you know, we haven't been given specific numbers because that's part of our commercial strategy. So that's some of the color that I can give you. Numbers have been improving from negative. And I think for next year, we will have even more progress on that front. When we look forward, but it is very comfortable. We believe this will be very important fact is when we try to understand the supply demand dynamics for retail real estate coming -- going forward.

When you look at the opening of new stores, we had a very good season of opening between 2010 and 2013, where which they peak in 2013 with over 10% of new stores being offered in the market. For the new openings of the greenfields and other expansions, that big number from (inaudible) had been dropping and to-date we are around 2% of additional API. And for next year that level, it's even lower close to 1% and what we saw, when you think about the big developers, there is no other big construction we play.

So, new supply from the market for the 10 years, we will be much more than it is. And we also realize a growing demand on the top of retailer. We feel that in our conversation about expansion plan, and as you -- as we probably can absorb that, when you deal with retail covenants everybody's talking about expanding their footprint in the next two to three years. So if you think that spread dynamic, which basically has significant supply and demand, has reached very difficult moment to speak about fashions but since then, it has been stabilizing and looking ahead, -- looking forward, I think, we will see some recovery.

In our case, with an occupancy rate above 96.5%, whereas remain (inaudible) main assets is close to 97%, we're at a very comfortable position, we're very comfortable that will recover threats from new rents going forward. About the delivery center, the platform, the project is moving ahead in line with our expectation. It was implemented at our -- in three main malls in Rio, the food court, the food outlets, which were the first one to be connected and saw a sales increase close to 15 this time for a very short period of time. It has currently being very promising project.

As for the rollout, we will implement that at Metro Santa Cruz, the first mall in Sao Paulo where we rollout the platform, the first mall in the city of Sao Paulo in the end of the year in December, we will launch an app called and that amazing (inaudible) which will allow users to buy not only food but also other items from traditional vendors and traditional stores. And today moving from one segment to another. We will be following that up close, it's very promising. It has been well accepted by retailers, they have advanced their omnichannel strategies quick and collect, if in reality, and of course -- this of course, makes our ship-and-source model more acceptable and that's for third party mall, they already using the platform. We see already other third-party malls in Rio, especially in the platform and the trend is that, Rio (inaudible) at the end of the year, you operating 10 minutes of the delivery centers.

Furthermore, which we will be third-party malls, that is an important project we have been paying close attention to that and it is in line, as I mentioned, with our strategy of speeding up our omnichannel immediately.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Okay, thank you.

Operator

Next question comes from Roberto Bruno [ph] from Bradesco. Carry on, sir.

Q - Roberto Bruno {BIO 17686071 <GO>}

Good morning. Thank you for taking the question. I have two questions. Number one, you can see that in this quarter we had some labor liabilities, which negatively impacted expenses. Can you comment on that please. And what can we expect going forward. And number two, where do you expect, in terms of EBITDA margin taken into account an increase in the bonus. Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Roberto. Thank you for your question. As for labor contingencies, that was a one-off situation, no major source of concern. In comparable basis, for example, last year we had a reverse of contingencies, which favored the numbers last year. This year we had a continuity, which negatively affected. But as I said, it is a one-off non-recurring situations, no major source of concerns out there.

As for the EBITDA margin, I think, fundamentally, we work on taxes by increasing division for the tax. And for the first three quarters what we see is closer to what we consider normal for bad debt. That will help us recover the EBITDA margin. We cannot say anything more specific about future margins but as the bad debt provision had a very significant impact, last year, we can say that, what we can see is a new normal, if you are going forward in terms of bad debt efficient levels.

Q - Roberto Bruno {BIO 17686071 <GO>}

Okay, thank you.

Operator

Next question from Luis Stacchini from Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning, Ruy. Thank you for the presentation. I have two questions. If you could perhaps talk about this drop in occupancy rates. So there is the gap between same-store rents and same-store sales. What are the drivers behind that drop? Do you see that as (inaudible) having in for growth in rent going forward? And number two, as for services, you saw an important growth as you have showed short in the release, more malls being serviced. So in this initiative of centralizing back office services, do you see the potential to improve, are there more to be included in that central hub? And what kind of benefit can you leave from that initiative in the mid and short run?

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you, Luis for your questions. As for the drop in occupation cost, we see that as a healthy movement. We expect with the long run in same store sales will help as we have indicators, we understand this level of 10.8, which we have led now it's comfortable -- its comfortable for retailers as you saw delinquency has been our balance point. So we are constantly working trying to bring cost down.

Most of that work has been done, there is not many inefficiencies to be captured going forward. So going forward, we expect to see growth in sales and growth in rent. In this quarter, they lend sort of handing them, so no major concerns there. So with levels in several different metrics are quite comfortable in terms of occupation cost.

As for CSC, we haven't expanded the scope this year in centralizing some activities bringing several activities and to the back office hubs. But once again, there's not much more room to increase. We have reached a good level of services, we will see much expansion on that front.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you. Another question, you said, that you feel comfortable with the current occupation costs if we have a higher inflation going forward or start in the fourth quarter especially and even stronger next year? Do you see that there is a possibility of passing along higher rents in cost due to inflation and high inflation next year plus along that increase.

A - Ruy Kameyama {BIO 16672412 <GO>}

In terms of inflation, we need to wait and see how sales will behave, if we will, in the coming quarters. We have an IGP-M indicator, which is close to 10% on the same time, you see that IPCA inflation is at a very lower level. So when look at retailers finances and other indicators, we have to take into account strong correlating IPCA. So it's difficult to predict how that will play out with a negotiation that we have in each and every retailers. So if we need to have to make adjustments, they don't be the temporary adjustment, our contract models is based on IGP-M. So there is one specific provision for debt, we need to look at occupation cost, sales and then, if we have to make adjustment, we will provide for every discounts.

Q - Luis Stacchini {BIO 18717891 <GO>}

Okay, thank you. Have a nice day.

Operator

Next question from Marcelo Motta from JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. If you could please comment on, you mentioned early in this quarter, Increase in cost of BRL300 million out of the problem, you mentioned. How much since you have to go by once this can hold initiative? Are you talking about variable remuneration? And also how you see multi-use project? Do you see areas like develop, we've a lots of land?

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you for your question. About the buyback, we have bought approximately BRL300 million that is shared in our buyback program. The average price was approximately 10.20, 10.24, as shown in our ITR on our quarterly report and there was an opportunity for us to create good value for shareholders. And in terms of capital allocation, we manage to maintain a very strong balance sheet. And at the same time, we created an opportunity to good return. We will maintain that for a time and we are considering all possibilities, including canceling, we can start and afford some other programs, not many news, these pieces of news on that front going forward, different from what has happened.

As for multi-use, we see that with good eye, ongoing, we have three projects, we have a wholesale in (inaudible) which will be open by the end of next year. It will be main wholesale in the city, same size the mall will have a residential cover also under construction in the city of (inaudible). And we are also looking at new possibilities. We had a few projects mapped out and we want to have everything ready. So that when demand recovers, we will be able to reap the benefit of those opportunities. It became clear for developers that multi-use product with an residential or commercial or hotels, they have shown to be more resilient during recession than the same products behave outside of shopping mall. So that should help our projects. So the answer is yes, we are looking at it. We have three projects, which are ongoing and we have a few others, which will be developed in the future.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay, thank you.

Operator

Next question comes from Nicole Inui from Bank of America.

Q - Nicole Inui {BIO 17757166 <GO>}

Thank you. Good morning. I have two questions. Number one, if you could please give a little more detail about the Cuiba mall, the commercialization process, the rent mix between variable mix, rent and minimum rent when compared to other mall. And how you can compared the mix of that mall when compared to more mature malls. So the main highlight for this quarter was the growth of same-store sales in the mid-last term region. So do you see that related to one specific mall or do you see that as a trend for the whole regions. So that I can have a better idea of how Cuiba mall will benefit from that going forward in the upcoming quarter?

And the second question is about the breakdown for same-store rent by segment. So for megastores, we have a very strong same-store rent but with a weaker same store sales. So, I just understand that a little bit, the comparison between same store rent and same store sales for the quarter. That's all, thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Nicole. Thank you for the question. Cuiba has shown to be quite a positive surprise, we had high expectation but the first not already shows that results would come even stronger than we expected. So on the one hand, we have a region, which is growing with the income levels, which are high and consistent driven mainly by agri business. And at the same time, when we talk about a capital city in which we had -- you will have competition so we created a very strong product in terms of mix.

And top of the food court restaurant, we have casual dining, fast food and we also have this food hall innovation, and we have very strong local chef who helped this develop that project, within the new concept of food hall that provides a new user experience that attracted the public that are mainly of millennials and sales for the first month were really good. And of course, this help with the highlight. Of course, entertainments played an important role. We are now offering the best cinema complex in the region, which in the first day has already reached number one in the state in terms of anchor store. We also did a good job, we have the first Outback to first stock on stock [ph] outlet in the state. So we used commercial leverage that we have to provide the best possible mix. So -- and they stated good income and will offer the acceptance level was high and gain quick. So it is a promising project.

As for percentage rent, minimal rent, it's not very different in terms of same area from our traditional differences. It took a little longer because of the Brazilian economy momentum at the time. But I think, we made the right decisions, including the correct, the right mix better meet expectation from the users. So in terms of break-down rent that's not very different from the rest of our portfolio. The Midwestern region have shown to be more resilient throughout the recession because as I said, our exports in agri business. And when we talk about the Campo Grande mall, not only for the past quarters but for past years, it has performed consistently low. And also the same goes for the Goiania shopping mall. So it is a regional issue, no doubt. And of course, that made us confidence to decide to invest in the Cuiaba project and also let us choose the correct mix. The retailers, of course, have sourced, spread -- threat in the region. So it was interest and attractive to them to invest in Cuiaba. So that was the context for our project in Cuiaba.

Q - Nicole Inui {BIO 17757166 <GO>}

Okay, thank you. Just to understand the difference between same-store rents and same-store sales, so just confirming it, especially for megastores, the same-store rent went up more than 65% but same-store sales was weaker. I'd like to understand that gap, is that a specific case (inaudible) for this quarter.

A - Ruy Kameyama {BIO 16672412 <GO>}

Okay. Thank you for rephrasing, I forgotten about the second question. Nothing specific about megastores. I think, it's rather a seasonal issue. Sometimes, we have contract maturing at different date and not all complex, doesn't place monthly adjustments. So there might be -- there might have been some time shift but it's nothing structural.

Q - Nicole Inui {BIO 17757166 <GO>}

Okay, thank you. Thank you very much.

Operator

(Operator Instructions) The next question comes from (Inaudible) from BTG.

Q - Unidentified Participant

Good morning, Ruy and every one. Only one question about preferred taxes. Could you give us some more color on the reversal fiscal liabilities, having reassess that. And how does that relate with non-cash tax. Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

I'll give the floor over to Fred to address your question.

A - Frederico Villa {BIO 18677215 <GO>}

Hi, Elvis [ph], this is Fred. As for the deferred income taxes, I think, the most important thing to us to look is the current tax rate. Since 2007 [ph] on, we have income tax rate on growth income of around 7.5% that we are maintaining that, that's what a deferred income tax, we can explain because of the following. In 2007, we adjusted property for investment, and then we had adjustment for deferred income tax. In 2018, we didn't have the same adjustment. And that effect comes from deferred income tax only affect depreciation. And then we have the fair value for property, we need to consider the depreciation of assets. So there was a temporary adjustment for the third quarter. So in the fourth quarter when we have the fair value of the property that depreciation value is not present. So it is important to analyze the different seasons of the effective rate in the previous years, which has to be in line for the third quarter 2018. But throughout the year, as a whole, the level was similar.

Q - Unidentified Participant

Okay, thank you.

Operator

(Operator Instructions) We have no more questions. I would like to turn the floor back over to Ruy for closing remarks.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you all for participating in our call, myself and Fred and all of the IR team remain available. Have a nice day everyone.

Operator

The audio conference of BR Malls is now over. Thank you all for participating. Have a nice day everyone.