Q2 2019 Earnings Call

Company Participants

- Ruy Kameyama, CEO

Other Participants

- AndrÃ© Chaves Mazini, Assistant VP
- Gabriel Mosquera Simoes, Research Analyst
- Jorel Guilloty, Equity Analyst
- Luis Guilherme Braga Stacchini, Research Analyst
- Marcelo Garaldi Motta, Research Analyst
- Nicole Inui, VP
- Roberto Waissmann, Research Analyst

Presentation

Operator

Ladies and gentlemen, thank you for waiting. Welcome to the conference call to release the results regarding Second Quarter 2019 of BR Malls. Today with us, we have Mr. Kameyama, Frederico Villa (sic) (da Villa). And Derek Tang. (Operator Instructions)

Before proceeding, I would like to explain that any remarks made during this conference call regarding the company's prospects, projections and operating, financial goals are based on the assumptions and beliefs of BR Malls' management as well as on information currently available to the company.

Remarks about the future are not a guarantee of performance since they (event) involve events and assumptions that depend on future events and, therefore, depend on events that may or may not occur.

And now I would like to give the floor to Mr. Kameyama. Please continue.

Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Good afternoon, everyone. Thank you very much for attending our conference call for the Second Quarter of 2019. We'll make reference to the presentation made on Investor Relations website and then we'll open for the Q&A session.

Starting on Slide #3, we highlight some factors about our operational recovery. In terms of total sales, the portfolio had a growth of 8.9% and 9.8% when excluding divested asset of shopping Sete Lagoas that was sold in the quarter, contributing to a 0.3percentage points reduction in the occupancy cost when compared to the Second Quarter of 2018.

We also highlight the sale of core portfolio; that is, the current portfolio minus 7 malls that were sold.

Shoppings are acquired (on lease via Brazil in addition to BTG), at the core portfolio, the total growth of sales was 9.5% versus the last year.

In terms of same-store sales, we had a result -- our current result is 4.6% increase in the Second Quarter of this year with the satellite stores as the quarter's highlight increasing by 6.5% and also North and South regions were the fastest-growing regions in our portfolio.

In terms of malls for the portfolio, core portfolio was over 4.5% in this quarter.

For the same-store rent, we had the fourth consecutive quarter in recovering from this indicator with a 9 of -- 9.9% growth and 9.7% in the core portfolio.

Moving on to Slide #4, we had a development of delinquency rate, both gross and debt that is reflects of the mix improvement strategy. That's been constantly improving the delinquency rate since 2017, providing a better cost for -- in the long term. It -- the core portfolio was 0.8% in net delinquency.

For bad debt provision, we had 2.2% when compared to the net revenues of the company, which is a level closer to pre-crisis.

On Slide #5, we see the financial indicators. In this quarter, we had a NOI of BRL 291 million with a growth of 9% ex sales and for the core portfolio, plus 8.8%. For the adjusted EBITDA, we have reached BRL 242.6 million, a growth of 9.5% when excluding the divested asset.

Increase (bavy) by a reduction of 33% in BDP, or bad debt provision. And a growth of 9% in net revenues.

On the #6, capital structure. We highlight in this quarter the development of the debt profile, (earning) an improvement. We are less 7.1% exposure to TR. And we had a cash profile of almost BRL 45 million and a leverage over net debt over EBITDA -- adjusted EBITDA of 1.9x. And after the sale of portfolio (we achieved) of 2.1x.

On Slide #7, the adjusted FFO and how it improved. We have grown 17.9% when compared to last year. And the main factors that contributed to this growth were operational recovery, liability management, share purchase -- repurchase program that we held last year and greater tax efficiency. The adjusted FFO per share grew 20.1% when compared to last year. And that's the main metric we are pursuing for long term for our shareholders.

On Slide #8, we talk about our omnichannel strategy and its development. We had an update. The BR Malls participation or share reached 38% after Multiplan entered the -- it is -- we are present -- Multiplan is present in several malls, including -- in 18 malls, 5 of which are owned by BR Malls, 3 in Rio de Janeiro and 2 in SÃ£o Paulo.

On Slide #9, we see Mercado Livre and BR Malls. We have been working on it for more than a year to make available to users at Mercado Livre a 10-day delivery solution.

We've got the Villa-Lobos Mall, the users of Villa-Lobos or of Mercado Livre through the website and Mercado Livre platforms are able to purchase products and delivery logistics from Villa-Lobos.

It's all integrated at the Delivery Center. And here, we have an example of how it works.

On your left side of the slide, you may see what comes with a search of the word wine, when we see many results. After clicking on those who will arrive today, that's highlighted in red, the filter brings only 30 options out of 224,000 options that would be delivered by shopping Villa-Lobos.

This solution will be an important development in line with expectations from customers. And they account for an important development in e-commerce in Brazil that offers convenience through malls.

Our intention is to deepen this in the segment of Villa-Lobos malls and then spread it over to other BR Malls.

On Slide #10, we see the main aspects of the subsequent event after the sale of assets to the BTG real estate fund. We sold 7 malls, received BRL 696 million. And we'll distribute that to shareholders, BRL 696 million or BRL 170 million as interest on capital and the rest in dividends. There will be a cap rate between 9% and 9.2% on an accrual basis.

Depending -- on Slide 11, we see the quality development of our portfolio.

As we commented in the beginning of this week, the quality of our portfolio will substantially improve because our exposure to Tier 1 and 2 has evolved to -- from 81% to 87% of the NOI of the company and will reach 93% of the NOI.

On Slide #12, this is the long-term agenda. And as we already commented, it is -- the strategy of selling the noncore portfolio will help us concentrate on the core portfolio and improve our strategies for the long term of the company, among which we highlight improvement of assets through retrofits and expansions and revitalization; the differentiations of the mix with an up-to-date tenant mix with new concepts; an increase of exposure to dominant assets, either by acquiring new assets in existing malls or acquiring interest in other malls; new solutions given by new different models, omnichannels, technology, same-day delivery, ecosystems and the development of our team and culture; and also keep our balance sheet very strong and flexible for any opportunities that may arise.

We are very optimistic about the current development and improvement of the company and about the future that expect -- that awaits.

And here, at the end, we -- I would like to thank you all for attending and open for the Q&A session.

Questions And Answers

Operator

(Operator Instructions) The first one is from Gabriel Simoes from ItaÃº BBA.

Q - Gabriel Mosquera Simoes

(Interpreted) Well your partnership with Mercado Livre, could you give us some more details. I know that Ruy on his presentation talked about the partnership. But I would like to understand how much you think this operation will be in a trial period at the mall? And how long it will take for -- to be rolled up in the other malls of the company? Also the delinquency drop in the period and also we see the turnover of store owners decreasing as well. So there is a lot of changes still to happen in the mix of the company's portfolio, or is that stable right now?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Gabriel, thank you for your question. About Mercado Livre, as I mentioned, we are implementing in another segment, more in-depth, started to one segment to test the tool. It has been a very good and functional tool and the feedback of store owners and consumers is also good. The effect of having an integrated solution between Delivery Centers, BR Malls and Mercado Livre simplifies execution a lot. I'll give you an example of how these efforts become real when we combine online and off-line aspects.

We believe on the marketplace, (these as) both our own marketplace as well as third-party's marketplaces. And naturally, Mercado Livre is the main marketplace in Brazil. And I think this will be a very strong and beneficial combination.

It's good for Mercado Livre because they can offer same-day delivery solutions and for store owners as well because they can increase sales with this additional channel.

We do not have a specific date as for the rollout, of course, we have to enhance some features. This is a pilot project, we're learning a lot from it. But we look at the impact it could have in the medium and long term.

If we (consolidate) a good pilot here and are able to roll out to other malls afterwards, it will open a very important opportunity for development of malls as well as for marketplaces that will consolidate the efficiency of delivery on the same day, which is a very high expectation for customers. So -- and it's very hard to find.

So we look at the medium term because we are sure we are doing something that will be very important for the development of the company. So we're not in a hurry and we have to test it very well.

As for your other question, we did have a very good efficient in terms of delinquency in net terms but also in the gross terms as well.

The level of growth -- the delinquency is still higher. But we'll be able to collect more than one payment slip that will happen in the future. But we're pleased with this path and the level of net delinquency.

We're still above what we used to be off pre-crisis period. But gradually and slowly, it will decrease and be closer to prior levels.

So we don't have a specific expectation on what quarter it will meet the levels that used to have pre-crisis. But what's important is to have a sustainable (back-up) decrease in a downward trend. And when we look at the total sales level, in terms of same-store sales, in some quarters, we see total sales that are substantially higher than same-store sales. And we're confident that we're doing the right things in building a healthy portfolio for the company in the long term.

Operator

The next question comes from Roberto Waissmann from Bradesco BBI.

Q - Roberto Waissmann {BIO 20589306 <GO>}

(Interpreted) First question. 2 about the Mercado Livre deal. Do you have any impact on -- study about the impact on sales? And also have you studied the (star vision) model in the mall? Is it being discussed at all today?

And the second question, at the provisions for bad debt level, the BRL 7 million that we see today, is it a normalized level that we can expect to remain for the future given your current performance? Or there is room for further reduction?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Roberto, thank you for your questions. About Mercado Livre, our expectation in terms of sales increase, we do not have the answers still. Since this is very recent, we still need some quarters to wait for it to mature. This is new for store owners, it's new for consumers. In Brazil, we see very few references of connecting large volume marketplaces to malls. So we don't know yet what impact it will have. But as I mentioned, we believe it's going to be very important in the long term, both for our store owners as well as for expectations from customers.

As for your second question, we see this as an opportunity, as a natural expansion of our business because we do have real estate and logistics solutions. So it's an adaptation that can be made and Delivery Center already have a whole building for that business model. So this is something that could be adapted to malls.

And the third question about bad debt provision, we believe that the level of BRL 7 million in the Second Quarter is a reasonable level to expect for the future with a few fluctuations. But in terms of general level, this is what we expect to maintain from now on.

Operator

The next question is from Nicole Inui from Bank of America.

Q - Nicole Inui {BIO 17757166 <GO>}

(Interpreted) I have 2 questions. Could you give us some more details because the NOI is following (sic) (falling) year-on-year, you mentioned on the note that there's been an increase in vacancies. Is that a specific case? Or whether that will continue? And when do you think these malls will have a positive NOI?

And the second question is about retrofit. Could you give us an update on the retrofit at the mall? If we could expect an acceleration of investment since you have closed 7 malls, do we think -- could we expect the retrofit project to grow a bit faster from now on?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Nicole, thank you for the questions. About NOI of NiterÃ³i -- Plaza NiterÃ³i, there is nothing special. We had a small decrease of the occupancy rate in this quarter when compared to last year, which caused the loss -- resulted in a loss of some minimum rent. Some stores that left the mall. And it's taking us a bit longer to get new stores to compose the ideal mix for the malls. So this is a temporary issue with no major concerns. I think that until the end of the year, it will go back to the usual levels.

As for the retrofit, we've had advancements on areas of -- that users complained the most according to our researches, were parking and the comfort of restrooms. So every time we did a retrofit, we made improvements in those areas. Then we go on to other parts of the mall, such as the facade and the priorities coming from feedback of -- from consumers. In the malls that -- the one where most (advanced launch of) shopping. In the Second Quarter, we expect to accelerate retrofit projects in all the malls and also during next year.

Operator

The next question is from Jorel from Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

(Interpreted) Two questions. First about the omnichannel Delivery Center. Do these platforms have or will have access to the malls? Will they know the inventory levels in real-time? And also I would like to learn a bit more about the performance of the malls that have received investments such as Plaza NiterÃ³i, Villa-Lobos. And the idea is to change stores or should we expect an acceleration in annual performances for the next year? That's it.

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Jorel, thank you for your questions. About omnichannel, we -- there are several inventory integration models. Some are more complete, others simpler. We do not give further details but what's important is to start.

In principle, we start with simpler models and we add sophistication to integration as we move on. But inventory information is very important for this model to work and we have developed some solutions for that to happen.

As for the malls' performance, there is an issue with the speed of the retrofit, which causes a positive impact on sales in the long term as well as for us as well in the long run. And there are also some more specific issues when we think of the portfolio of Rio de Janeiro Plaza, the smallest mall. And there is -- it's a mall -- it's a market that is more challenging than others in Brazil. And sales in this quarter have shown an improvement in (all) shopping and in other ones. But in the next quarters, we believe that they will return to usual levels.

It's hard to say exactly what quarter. But we see a recovery in the state of Rio de Janeiro are due to the positive impacts of the retrofit, we're very confident in an -- that will be an improvement in these assets in the medium and long run.

There was a specific event caused by the -- in Villa-Lobos by the closing of that bridge over the (malfineros). But that was one-off event. And that had a negative impact on the performance of the mall but it's now over. It was temporarily -- a temporary effect. And it's going to resume its usual performance. And this is a mall that's also receiving investments. So we believe that in the medium and long run, we'll be able to increase the level of that mall as well.

Operator

The next question comes from AndrÃ© Mazini from Citibank.

Q - AndrÃ© Chaves Mazini

(Interpreted) My question is about omnichannels (most of them -- both of them). In China, there is Alibaba, (whole foods). So my question is does it make sense to look at foreign experiences and try to replicate something that worked abroad here? Or is Brazil very different due to taxes logistics and we do have to tropicalize it? And do you see anything in the international market that would make sense to make here as well?

And the second question is about reverse logistics with the Mercado Livre. Do people -- will people be able to return the product? How will that work? So not having a reverse logistics would be good for the mall because you could go -- you would have to go to the mall and then you end up buying something else. But there is a tradeoff as well. So what is the optimum point in terms of logistics, in terms of going back to the mall later or not?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Thank you, AndrÃ©, for your questions. About the omnichannel model, we believe that for sure, we have to look at all possible references from other markets. Either in the U.S. market, Europe, Asia, India, online versus off-line, O2O, is something very strong that technology will contribute to speed up.

So it's important to look at all of these markets, what happen in all of these markets. And we must adapt it to Brazil because something -- our challenge is (red campor) labor in Brazil is more affordable than in other developed markets renders these logistics through deliveries more feasible than in the United States. So that's a positive. On the same -- at the same time, we do have specific franchise-franchisee issues that we must adapt to a reality that's unique to Brazil. So having as reference omnichannel models from other countries. And at the same time a strong relationship with our store owners and a capacity to adapt to how the Brazilian market works, we're able to adapt or tropicalize the solution, as you mentioned, or develop solutions that probably will work better in Brazil.

As for reverse logistics, I think that's an additional service that could be rendered for sure because we have a last mile or last-mile network working around the malls. So it's almost a natural development of the solution in order to solve for consumer distant points that exist. There is a balance between what this will mean to malls in terms of bringing customers to malls. But if we solve -- if we make it more convenient for consumers, we'll have loyalty of customers in the long term. And this is a service that the mall renders, therefore our customers will be loyal to the mall.

In the roadmap, when we look towards the future, it's something that could be evolved to a reverse logistics as well.

Operator

The next question is from Luis Stacchini from CrÃ©dit Suisse.

Q - Luis Guilherme Braga Stacchini {BIO 18717891 <GO>}

(Interpreted) I have 2 questions. First related to your view of the retail market as a whole. How do you see the store owners' appetite? Now that the political scenario is improving a little bit after the pension reform, how do you see this appetite? Is it growing at all? And do you see any sales parameters that could be more favorable than we saw, let's say, one year ago? Do you see any interest from international store owners or different store owners?

And the second point, you talked about the assets in the entire core portfolio, the growth of sales, the top 10 group, except for Macae that's performing very well, the top 10 malls are not outperformers. The middle group of your core assets are growing a lot more. Could you explain why, maybe a more comfortable occupancy cost? Which group with the needed recovery of NOI that you consider standard in this core asset group?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Thank you for your question. Well in terms of how we see the retailer scenario and their appetite, we undoubtedly see an evolution because since it became clear that the pension reform would be approved and would pass in Congress, we see that things are more accelerated. And we see in our conversations that our people are more interested than they used to be some months ago. So everybody sees that the path is of recovery, at the same time, the lack of certainty limited investments. And now we see that these plans are being unlocked and the trend is to have a favorable business volume in the next month if all things -- all the rest is confirmed, of course.

Because today, we start with our core portfolio of occupancy rate of 97%, 96.9%, we closed in the Second Quarter. So this is an occupancy level that's very favorable, that has helped us in our faster recovery. This has been an indicator in which we suffered during the recession, that's been gradually recovered in the Second Quarter. We managed to level it.

We went from negative. So that's no longer negative. During the crisis, it had a significant impact. But in the Second Quarter, we offset the (pre-stress) level of our portfolio.

The evolution of the NOI, in the Second Quarter, we had a strong performance in some malls as you mentioned. Mooca, Campo Grande, Jardim Sul, MaringÃ¡, Piracicaba, GoiÃ¢nia and these were the malls that helped to drive the growth of the company.

So there's nothing very specific about them, actually. I think it's the consistency and consistency of work in terms of qualification of leads, optimization of opportunities in terms of kiosk mix. There is a recovery on store traffic as well that's measured. And this is one of the features that are positive about the BR Malls portfolio. We have some more mature malls or located in areas that could grow less. However, we have a higher exposure in other area, in the interior, or certain capitals that are benefiting from this more favorable economic moment.

So the teams -- our teams are trying to make what is more correct to create value in the long run for our assets. But on a consolidated form, we are very pleased with our growth in the last quarters.

Q - Luis Guilherme Braga Stacchini {BIO 18717891 <GO>}

(Interpreted) So just an update, this level of zero or positive towards the future. So looking at the second half of the year, does it makes sense to see revenues from rent growing in line with IGP or more? Could we infer that?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Well Luis, gradually, there will be a recovery in the minimum rent revenue.

If you look at this latest quarter, this is the revenue that has been growing. And we expect it towards the future, a combination of several factors. We had this credit issue, took us backward and gradually, we are already sitting on that because when we look at the supply and demand for the next year, it tends to be favorable to us and will help us in pricing and leasing spread.

Also some stores, there is a percentage leaving or percentage rent and inflation. This is for installed base as well as a reduction of vacancy. So in an economic recovery scenario, any of these variables, except for inflation that we cannot control so much, the trend is an upward trend, a positive one when we think of a scenario of low vacancy and an increase in demand from store owners. So when we look at portfolio of largest productivity, the core portfolio that is the most desired by store owners, we see a very favorable trend in the medium and long run.

Operator

The next question from Marcelo Morgan (sic) (Motta) from JPMorgan.

Q - Marcelo Garaldi Motta {BIO 16438725 <GO>}

(Interpreted) I have 2 questions. If you could first talk about EBITDA margin. We see a recover year-on-year. When we look at the second half of the year, where could an improvement come from? Or at the level that's more stable for this year? Is everything stabilized or is there anything new in terms of cost improvement or reduction in NOI or improvement in NOI margin, things that contribute to the EBITDA?

And will we have more interest on equity with sales of further assets or cash disbursement? I would like to understand whether it makes sense to think that way, if it could remain as such for the next years? If you think about '20 or some other rate of cost?

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Thank you for your questions, Marcelo. For EBITDA margin, I think it's reasonable. We have reached the level that we believe to be a level that could be repeated for the future. We don't foresee major changes, maybe small fluctuations. But the level won't change very much towards the future.

As for payment of taxes, the team has done a very good job in terms of tax optimization.

Now looking forward, we want to maintain this efficiency level, also interest and equity in the Second Quarter. As you well mentioned, there was an interest and equity payment for the sale of asset in the Third Quarter. So we'll continue to look for tools to make a further tax improvement in the future.

Operator

(Operator Instructions) Since there are no further questions, we now turn the floor over to the speakers for their final remarks.

A - Ruy Kameyama {BIO 16672412 <GO>}

(Interpreted) Thank you for attending, everyone. And we remain available to answer any other questions you may have. Thank you. Good afternoon.

Operator

This concludes the BR Malls conference call. We thank you all for attending. And have a good afternoon.

(Statements in English on this transcript were spoken by an interpreter present on the live call.)