Q2 2018 Earnings Call

Company Participants

- Ruy Kameyama, CEO

Other Participants

- Enrico Trotta, VP of LatAm Real Estate
- Jorel Guilloty, Equity Analyst
- Luis Guilherme Braga Stacchini, Research Analyst
- Luiz Mauricio Garcia, Research Analyst
- Marcelo Garaldi Motta, Research Analyst

Presentation

Operator

Ladies and gentlemen, thank you for waiting. Welcome to BRMALLS conference calls to discuss the earnings results regarding the Second Quarter of 2018. With us today, we have Mr. Ruy Kameyama, Frederico Villa and Derek Tang. (Operator Instructions)

Before proceeding, we would like to clarify that forward-looking statements made during this conference call regarding the company's business, operational and financial projections and targets are based on beliefs and assumptions of BRMALLS' board as well as information currently available to the company. These statements are not guarantees of performance. They involve risks, uncertainties and assumptions since they refer to future events and therefore, depend on circumstances that may or may not occur.

Now I would like to hand it over to Mr. Ruy Kameyama. Mr. Ruy, you have the floor.

Ruy Kameyama {BIO 16672412 <GO>}

Good morning, to everyone. Welcome to the BRMALLS Earnings Conference Call for the Second Quarter of 2018. I will make a brief presentation of the highlights for this quarter, which you can follow on the website presentation. And then we'll go for questions.

Let's start by operating -- operational indicators this quarter was marked by some nonrecurring events that partially inhibited the ongoing macroeconomic recovery of retail in April. Two factors partially contributed that -- a stronger comparison base on 2018 Easter and the release of the FGTS fund. And this was able last year of 5.3%. During this quarter of 2018, we calculated minus 1.3%, which is compared with the Easter effect category 0.4%. In terms of total sales, we registered a downturn by minus 1.3%. We had a growth of 0.9%. This increase is related to the improvement of the store occupation. And we will talk about this. Nonrecurring effect as a consequence had a negative effect of 15.5% in comparison base. And while the same stores rent of the period, which registered a decrease of 1.1%. However, when excluding Easter, this indicator would have increased 0.5% increase.

Now when we go to our second slide. Our strategy has remained the mix of tenants still underway as a reflection of good execution. We presented a 1.4percentage point increase in our occupation rates since the Second Quarter of 2017 reaching 96.1%. If we consider our top 15 assets, the average occupancy rate was 97.6% during this quarter.

We continued with low net delinquency, which was 1.7% in this quarter. And the level of late payments continues to decline gradually. And it reached 7.8%, an improvement of 3percentage points when compared to the same period last year. In this way, the qualification of our mix also contributed to the company's cash generation.

On Slide 3, we noted that the net operating income increased by 0.6% on comparable basis, mainly due to the increase in the minimum rental line of 2.6%. This increase was partially offset by the 15.5% reduction of the percentage rate due to already mentioned nonrecurring effects.

The BDP level decreased by BRL 20 million or 64.1% in comparison to last year as a percentage of net revenue decreased 9.5% to 3.6%. When we compare it to the Second Quarter of 2017 closer to the precrisis level, the increase of the BDP regarding the First Quarter of this year is mainly justified by the seasonality of the new criteria adopted as of January 1 of 2018.

Regarding expenses. Our general expenses was dropped by 24%, mainly due to the reduction in share-based compensation, which reduced approximately to 85%.

Now going to Slide 4. We can see that the drop in expenses with administrative and general expenses had a growth of adjusted EBITDA of 5.6% compared to last year, reaching BRL 222.7 million, excluding the effects of participation. So growth was 13%. Our adjusted EBITDA margin was 73.6% and an increase of 8.6%.

On Slide 5, we show our growth of 106.1% of the adjusted funds from operation in the quarter and 60.3% year-to-date, reaching BRL 131 million in the quarter and BRL 285 million in the year. We continue our commitment to pursue improvements in AFFO, main metric action for a long-term value creation for our shareholders. And as a reflection of our efforts, we grew 36.3% during the first six months of 2018.

As you can see, the trajectory of AFFO per share went through a positive action. And during the first semester, we had the greatest AFFO per share in the last year.

On Slide 6, here, we have our closing leverage levels of the quarter at 1.8x net debt of our adjusted EBITDA, allowing high investment capacity and it was 12%. And we are comfortable with our level of leverage and debt profile. We can face greater scenarios of volatility. We increased from 1.6x to 1.8x in relation to the last quarter is mainly due to the share buyback plan, which had been active since March of this year. And so far, we have invested BRL 226.1 million, representing 2.6% of the company's total shares, which are in treasury.

On Slide 7. In relation to our greenfield project adaptation, we've made progress in Second Quarter of 2018. The inauguration forecast is for the second half of this year. And the project is on schedule with 94% of physical work done and more than 90% of this lease GLA will be the biggest mall in the state. And we will have mix of -- we will have a concept of foothold uniting culture gastronomy in one sole environment.

On the next slide, we will talk about important long-term initiatives.

On Slide 8, we have the update of our culture. Last year, we strengthened our team. We aligned compensation. And this year, we aligned our culture and improved it. The improvement had greater engagement of our employees. And we developed a sense of purpose. Then, we want to make malls a place of happiness and opportunity. We also -- we view our value, giving more emphasis to customers, cooperation and long term.

We also updated our visual identity so that people can understand the changes. And all our actions, part of our long-term improvement strategies in terms of culture and team.

Now Slide #9. We present the new partnership with Cubo ItaÃº that is the largest center of technological entrepreneurship in Latin America. This building that will be opened in August. And will have over 200 startups. And we'll be focused in certain industries. And we will have an exclusive vertical for retail. And BRMALL will be an exclusive partner in this development. This is where BRMALL startup and retail everybody (comes with) new technologies in retail solutions that will benefit consumers, our tenants and our malls.

We will have a team dedicated to the startup follow-up, the development of projects and to identify new projects and opportunities. As last, we -- Mr. Bruni is no longer part of our management. We proud you, Bruni. We thank him for his long dedication to BRMALLS' administration. We close our presentation.

And we're available to answer any questions.

Questions And Answers

Operator

(Operator Instructions) Our first question is from Mr. Enrico Trotta from ItaÃº BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Two questions. I would you like to elaborate on your shop owners or tenant turnover. It started increasing in 2017. And now during the Second Quarter, we see a turnover of (20) tenants that has dropped. I would like to understand if this is during the Second Quarter of turnover something very specific, or is this reflecting the mix adjustments are closer to the final? And I would like to understand, do you believe that we'll see a greater drop during the second semester? And while same-store rental, it has been negative for the first time in nominal terms when we see the percentage rate. But when we see good part of them had dropped year-on-year. And I see that certain days of the Second Quarter of last year is stronger. What I would like to understand is, how much do you need for the assets to be readjusted and to be normalized in terms of rental per square meter? How much -- what do you have to do so that you can have the occupation of your assets at a current level, at a good level?

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you very much to your question. Regarding the turnover, we calculated in the past quarter a slowdown. And we believe that this will be a trend for normalized level. Basically, there are 2 things that we see. We carried a mix adjustment cycle. Since last year, we've been discussing it with you. In order to have greater qualification and also to promote growth of tenants that couldn't pay, there was a lot of delinquency. And this was an adjustment process that started last year. We exchanged tenants. And there were evictions. And we believe that this part -- we've already done more than 50% of this adjustment process. And we are lowering this gradually from the internal efforts point of view. This is our point. Now from the external point of view, we have also observed signals of improvement in the market. We can see that many of the shop owners that were facing difficulties, now they can -- they are in a better situation because they did their homework, they improved their margin, they could refinance their debt. So the tenants have shown to be more resilient this year. And therefore, this accelerate the exit or the change. So I believe that this gradually will take us back to a lower turnover level. Regarding your second question, how we see same-store rent. Well we had a same-store rent minus 1%. We had the Easter effect. And we also have a mix that suffered a bit more with the effects of percentage rate. And when there is a recovery of the market, we capture the upside. So we had the nonrecurring effects of a strike from the truck drivers, the World Cup as well. And we had a number of movies -- in the -- the movies that did not help, the films didn't have good box office sales. Nevertheless, again, the -- reflects our efforts when we change the tenant mix. And as you know, we have also talked about the spread. This was negative during the past 3 quarters. So there is a comparison base in same-store rent. We are reassured this was something that we were anticipated. And we tried to offset. So we tried to increase on occupation rate. And there was an increase in the average value between same-store rent 1% and the improvement of occupation rate was the growth of minimum rent of 2%. So we were able to offset same-store rent with the occupation. And this was a good effort. And we were able to qualify our rent, our mix and to improve our cash flow.

Operator

Our next question is from Mr. Luis Stacchini from CrÃ©dit Suisse.

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

Two questions here. I would like to understand how you see your assets and mix. And in the upcoming quarters, we will have the impact on your rents. You have anniversaried during the second semester. And I believe that -- and if you will have any improvement in terms of expenses, how are you going to transfer this increase of 7% of rent? Or do you believe that this will be something to implement. And this will affect your vacancies? And well, about you delivering this less than BRL 2 million in the short period of time? Could you give us details regarding the role out of your initiative? When will it be full and running? And do you believe that the delivery center will deliver this results and have a stabilized situation?

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you very much for your question. One, regarding the transfer, we have 60% of our contracts ending during the second semester. And then accumulated the higher than what we have had. We expect to transfer the inflation readjustments to our tenants. This is highly inline. It's going to depend on their capacity to sustain this through sales. But what we have observed in the past months is a drop in discounts in comparison base. And gradually, we believe that the shop owners are being able to recover themselves and carry out the adjustments that they had to carry out during a challenging retail scenario. We want to transfer this in our contract now. We will test the limits in the upcoming months as the retail strike, there is still a lot of uncertainty. So when we see the next 2 quarters, well, we still have uncertainties. We have elections. The trust of the consumer is highly reticent. But when we see to the future, we can see a greater balance between supply and demand. We can see perhaps that the retail Brazil is stabilizing itself after the worst recession of history. And our occupation rates will be 96%, 97%. When see the long-term, we see a scenario of offer, supply and demand, I believe. We will have very few new shopping malls opening in Brazil. We always have to remember that supply and demand, this will not only (favor us) in transferring also the inflation. Now regarding the delivery centers. The rollout, the project is according to schedule. We're being able to integrate the tenants that we wanted -- or the shop owners that we wanted. In our portfolio, we already launched it last month in Tijuca Shopping. During the Third Quarter, we will go in Mooca Shopping and Plaza NiterÃ³i. And the idea is that in 2019 to roll that out in SÃ£o Paulo gradually. So the strategy from the Delivery Center, it is very difficult to calculate what will be the impact on the middle long run. But we believe that the impact, if everything works out, if there is good compliance from a retailer, if the consumer behavior goes according to what we expect, we believe the e-commerce in Brazil, that is great, that it represents high freights and presents a high logistics. And this could be very, very convenient because the hub is going to be central. And I believe there has been great support from the retailers. We believe this model from -- ship from -- mall ship from store can be a highly attractive model not only to optimize the cost of freight but also inventory. They wouldn't have to double their structures and something that exists with e-commerce. So the rollout is according to schedule.

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

This BRL 1.6 million regarding Tijuca, or there are other revenue lines that are contributing to this?

A - Ruy Kameyama {BIO 16672412 <GO>}

In reality that operationally like any startup there is an negative EBITDA contribution during the deployment stage, a very little volume and higher fixed costs. What happened here on equity shareholder, there was new investment that caused the dilution in our participation. And this dilution generated a gain regarding the cost of our investment. So this is considered equity. Mark-to-market was only the part that was diluted.

Operator

Our next question is from Mr. Luiz Mauricio Garcia, Bradesco.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

A follow-up on rent. You talked requalification process. And you're in the half of this process. Could you break out what is concession? And what you see a negative in this requalification of mix? Do you have a target profile? And what would be a churn of a tenant that doesn't present performance? Can you break out a little bit these effects just so that we can understand what could be a future impact? And my second point would be, now you had shareholders restructuring last year due to the tax burden and part of this benefit was (destined) to the sale of assets at the end of the year -- and now that you don't have such a high tax burden, do you believe that it's going to work with greater leverage? Or do you believe that you will have an acquisition? I don't know if you could give us an update, how you see this in the long-term? How do you see capital?

A - Ruy Kameyama {BIO 16672412 <GO>}

Luiz Mauricio, for your questions regarding rentals, what we can say here is we had a strong impact that was the same driver of the recession of same-store rent that was 15%. And remember that during the Second Quarter last year, same-store rent had a very high level of 7.5%. When we compare them, we suffered in percentage rent minus 1%. And this is what mostly impacted the same-store rents of the quarter, which we consolidated minus 1%. The leasing spread is also impacted. I would say that this spread went downwards. We were renewing -- our renewals were negative. But this has stabilized. We are closer to 0. This makes us a bit more reassured regarding the future because we believe that this effect will drop throughout the period. And at the same time, we believe direct delivery express will help us. And also we will have less discount. That will also help us. So the combination of these factors resulted on this minus 1%. But the percentage rent dropped 15%. And last year, we had increased a lot. And that drove the same-store rent to 7%. And when we compare -- when we only see the effects of Easter, we will have -- we would have had a 5% same-store rent increase. And when we see the rent trend, well, during the last years, we have made a great efforts to optimize our fiscal situation. This has generated results that we expected last year, we were able to accelerate the process of portfolio recycling where we incorporated tax benefit. We're during our fine-tuning. And we are working on this. And in terms of -- we worked entity per entity to see what was the best composition. And how can we maintain an optimized tax rate. And this is a continuous process. There are no major novelty. We will also pay attention to our leverage levels, tax efficiency, because this is very complex because we have different entities with different tax regimes. This is a highly detailed effort that we plan to try to maximize this entire process. Now we continue analyzing possibilities. This is a burdensome obligation that we have since 2011, a high cost. And this isn't something that -- this creates value for our shareholders. This is something that we're analyzing together with our partners to see there's something interesting to us and makes sense.

Operator

Our next question is from Mr. Guilloty from Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

I have 2 questions regarding the occupation cost. There was a -- the sales percentage dropped 20 basis points year-on-year. But rent increased 20 basis points year-on-year. So the occupation rate is flat. I would like to know more about the dynamic. Why this rate percentage drop it was? Because of the percentage drop, do you understand that you are in the right level in terms of cost of occupation, I don't know 11% or do you believe that this figure can go up a bit?

A - Ruy Kameyama {BIO 16672412 <GO>}

Jorel, thank you very much for your question. Regarding the occupation cost, we also have pressure of condominium readjustments. And we have always -- we always have analyzed efficiency optimization in terms of expenses. So now we have factors that we cannot control like light bills. Some -- so we always have condominium. And once you are efficient, we have a lower (margin) to work with them. We cannot compromise the quality of our developments. There is a little bit of the effect of the condominium and the percentage rent. So -- when it ceases. And there is also -- slightly affects the condominium and very specific drop of percentage rent. Now of course, we also have rents with a certain level of discounts. This is something that we are working on. And you mix -- and I blended to your second question, 11% -- 11.2% was an efficient level. It's difficult to know what is the limit because the limit depends on the situation of the retailers, of their perception of improvement of the market. If they feel confident. And what their level of resilience is. But I believe that this is a level that is adequate. I believe that perhaps we can be a % upwards, downwards or some basis points less. But this level reflects the current situation of market. And an increase of cost of occupation would only be possible if we could see an improvement in retail sales. I believe that the market on the current -- at the current level I believe this is a level that where we can operate or something very close to this.

Q - Jorel Guilloty {BIO 18291521 <GO>}

I would like to better understand the dynamic of the new contracts from your tenants. New contracts are higher number of the active contracts? So you have more percentage rent now vis-Ã -vis the past. How do you compare the -- your new contracts in terms of old contracts, when you we think about rent?

A - Ruy Kameyama {BIO 16672412 <GO>}

The new contracts are very similar minimum rent condominium promotions front, sales front, the readjustments every two years. What has happened is that they started a lower level. As the retailers see a great deal of uncertainties, they want us to give them greater concessions in the rent of the first year. And then we should observe what will happen, or we believe that as of the third year, Brazil would have already recovered if someone compares it to the current scenario. And it's not a change of percentage rate. And it's the impact of the rent of the first year that has driven downwards our spread. This is how negotiations have taken place.

Operator

Our next question is from Mr. Garaldi Motta, JPMorgan.

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

Marcelo here. Two questions to -- if you could elaborate on condominium discounts. Is this related to the improvement-type of occupation? Do you believe that this figure can increase? Or do you believe you will have some type of discount, or if there will be a grace period? And another -- what about your projects in CuiabÃ¡, you said that you have invested almost BRL 300 million of CapEx of BRL 410 million and that you have 94% of the physical work done. I would like to know if your figures makes sense? Or if we could expect the inauguration of this project for 2019?

A - Ruy Kameyama {BIO 16672412 <GO>}

Yes. I will answer, CuiabÃ¡. But then I'm going to ask you to repeat the first question. Regarding CuiabÃ¡ the CapEx is according to our projections. We expect to end the project with BRL 410 million. Now the commercialization is at 90%. But the financial side is at a level close to 94%. And this investment time line that we show in our release that is about BRL 409 million, BRL 410 million is the total CapEx that we expect to spend. There was a slight increase in the expected CapEx because we adjusted mix, we had to change the layout of some plan -- some areas that have been built, halls, areas. And we have to readjust these areas, we have to change some installations, some construction work were more complex. And we wanted to accelerate as well, some innovation pilots, like parking lot automation. We have a kids' park, halls, restaurants. So we tested some new concepts in order to renovate. And this made our CapEx to go up a little bit. First question, can you repeat it, again?

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

The follow-up on CuiabÃ¡, BRL 100 million for the upcoming quarters -- for the upcoming 2 quarters. So this is according to your pipeline, right?

A - Ruy Kameyama {BIO 16672412 <GO>}

Yes. For the second semester, it's BRL 100 million. Yes.

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

My first question was about cost of condominium is, did it drop because there is better occupation? Do you believe at this level of BRL 12 million, BRL 13 billion could it drop a bit more? I don't know. Are you going to have a discount -- a discount in condominium, some grace period. So you could have lower vacancies so you would have more tenants.

A - Ruy Kameyama {BIO 16672412 <GO>}

The condominium cost dropped approximately 11.5% vis-Ã -vis last year. And fundamentally, the impact of the drop in vacancy. Vacancies, as you know, we contribute condominium and property taxes when we cannot rent the stores. When we, of course, improve our occupancy rate, we will be able to contribute more with condominium. We believe that this will also depend on the continuity of the drop in vacancies and less because of our grace period to pay condominium. We do not offer grace periods here at discount. So it's fulfilling the vacancies from hereon. We believe that this is the answer.

Operator

(Operator Instructions) As we have no further questions, we will hand it over to our speakers for their final comments.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you, to all for your participation. Fred, Derek and myself are at your disposal. And have a very good day.

Operator

BRMALLS' conference call has come to an end. We would like to thank you for your participation. And have a very good today.