Q3 2016 Earnings Call

Company Participants

- Armando D'Almeida Neto, Chief Financial Officer
- Daniel Cobucci, Analyst
- Franco Carrion, IR Manager

Other Participants

- Daniel McGoey, Analyst
- Ivan Enriquez, Analyst

Presentation

Operator

Good afternoon everyone, and welcome to Multiplan Third Quarter 2016 Earnings Conference Call.

Today with us we have Mr. Jose Isaac Peres, CEO; Mr. Armando d'Almeida Neto, CFO and IRO; Mr. Marcello Barnes, CIO; Mr. Hans Melchers, IR and Planning Director; and Mr. Franco Carrion, IR Manager.

Today's live webcast and presentation may be accessed through the Multiplan website at ir.multiplan.com.br.

We would like to inform you that this event is recorded and all participants will be in a listen-only mode during the company's presentation. After Multiplan remarks there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Multiplan management and on information currently available to the company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur.

Investors should understand that conditions related to the macroeconomic scenario, industry 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 Mr. Franco, who will read the message in the name of Mr. Peres. Mr. Franco, you may begin the conference.

Franco Carrion {BIO 16449361 <GO>}

Dear ladies and gentlemen, good morning. I'm pleased to disclose the company's results for the third quarter 2016. I'd like to highlight some of the most important events that occurred during this period. First, in a scenario where retail sales were quite weak we continue to grow, which in this quarter, the amount of BRL3.1 billion and in nine months, BRL9.4 billion which results in a sales growth of 2.9% in both compared periods.

VillageMall in Rio had sales growth of about 9% and New York City Center, also in Rio up 10.9%. Shopping Analia Franco in Sao Paolo presented sales growth of 5.5% in the quarter. We had some new retailers coming in, in the period, for those who like sports, I highlight the NBA store, the first in our country recently opened in BarraShopping.

We also had a supermarket opening in ParkShopping Campo Grande and an Almanara and Abbraccio restaurants in Shopping Analia Franco. Happy to say that the retailer standards in our malls continue to improve. The rental revenue in the quarter grew 7% which demonstrates the strength of our assets at a time of great uncertainty. In this sense, we have maintained a shopping center occupancy rate of more than 97%.

Now some comments on infrastructure works. In this last quarter, important renovation works were concluded at Getulio Vargas Parque in Canoas, a 220,000 square meter public area adjacent to ParkShopping Canoas. The Parque was fully renovated with the creation of a 7,000 square meter artificial lake with water fountains that create a fantastic show with light and music, the first of its kind in Brazil.

Another highlight is Parque das Artes or Park of Arts in Ribeirao Preto, an area of 68,000 square meters maintained by our own RibeiraoShopping. These are pioneering investments in the sector, which has the goal of bringing people closer to the malls, further integrating leisure and shopping areas.

Lastly on infrastructure works, we are completing in collaboration with the City of Sao Paulo, the construction of a modern skywalk connecting MorumbiShopping and Morumbi Corporate, about 100 meters long and equipped with escalators, elevators and air conditioning. It would be delivered by November 15. By the way Morumbi Corporate generated a rental revenue of BRL21.5 million in the quarter, and over the past 12 months, the towers added BRL81.1 million to the company's rental revenue.

Now some words about our latest acquisition. This quarter we've made a significant investment of BRL495.9 million in the stake acquisitions at BarraShopping and MorumbiShopping, two of the company's iconic assets, built 35 years ago. Yesterday, we have concluded the deals by signing the Public Deed of Purchase and by paying the remaining balance. In the last 12 months these stakes added a net operating income of BRL40 million. We are glad to repurchase minority stakes of high performance assets that we sold in the past in order to finance the company before Multiplan became publicly held. Other acquisition opportunities continue to be analyzed and studied by the company, which could also be transformed into new investments ahead.

Over to ongoing projects. We have recently obtained installation licenses from Rio's City Hall which allow us to start construction works at ParkShopping Jacarepagua. Nevertheless, we were already investing an important roadworks in the region, including the completion of a bridge that connects the R Lagoa avenue (inaudible) with (inaudible) in Jacarepagua neighborhood, facilitating and improving the access to Avenida (inaudible), an important access hub in the region.

In Porto Alegre, after seven years of negotiations with the City Hall licenses were granted which will enable us in the future to develop the Golden Green Porto Alegre, a project with 250,000 square meter of area in an area of 180,000 square meters. It will be a fantastic upscale residential condominiums adjacent to BarraShoppingSul. We have a high quality urban design facing the Guaiba River, one of the most beautiful spot of Porto Alegre. We have also signed contracts with the city's Jockey Club regarding the acquisition of these areas.

Now over to expansion works, I'll start by highlighting RibeiraoShopping where we are implementing a medical center, similar to what we did in BarraShopping with 33 clinics. The first stage with 21 clinics in 4,200 square meters is already 90% leased and will be completed in the second quarter of 2017. With this project we are adding to RibeiraoShopping and to the local community important and much needed services. This is the mall's ninth expansion, which by the way has just completed 35 years as well.

We are also developing construction works on the second phase of the expansion in Patio Savassi in Belo Horizonte by adding 2,300 square meters of GLA composed of (inaudible) market and also a Renner store as well as the expansion of the two box stores and 95 new parking spaces in two underground floors.

I feel like I could go on describing dozens of other projects that we could and may develop in the coming years. But as you can see the company continues to work, developing renovation and important projects which in the near future should bring excellent results to Multiplan.

Finally, I wanted to say that I'm positive with the measures taken by the current government, which are covering the thrust [ph] and upgrading the development expectations in our country. In particular we are encouraged to make new and important projects in view of the transformation that we begin to see in Brazil.

I like to thank our whole team in Multiplan as well as our tenants and all those who work with us in this continued growth process. I also thank the shareholders for believing in our project and the analysts and journalists who join us today.

I'll now pass the floor over to Armando d'Almeida, who give you more details from our financial results. Thank you.

Armando D'Almeida Neto

Thank you, Franco, thank you, Mr. Peres. Good morning, everyone. I believe, we have to two important highlights this quarter, the profit, this operating performance and the capital structure that allowed us to take advantage of growth opportunities.

So let's go to our comments on the operational performance. In this third quarter, our shopping center sales increased 2.9%, keeping in the positive territory, not just in this quarter but in each and every quarter since the company IPO in 2007.

In the first nine months of the year, sales growth was also at 2.9%. And same-store sales have increased 2.8%, 50 basis points better than the second quarter of this year and 220 points better than the same quarter of last year. Same area sales grew 3.2%, exceeding once again the same-store sales. This growth represents an increase in the same area sales of over BRL1,000 per square meter for the past 12 months. Interesting in this quarter was that all tenant segments showed same-store sales growth, in both anchor and satellite stores, driven by the strong performance of pharmacies, travel agencies, and mobile phone stores, the servicing [ph] segment was the one with the highest growth with an 8.6% increase in the same-store sales.

The occupancy rate remained virtually unchanged at 97.12%, was 97.6% before, in the second quarter of 2015. As a result of an increase of the rent and common charges, higher than the sales growth, the occupancy costs went up 50 basis points to 13.5%. An important highlight, we had a reduction in the gross and net delinquency rates. Gross delinquency fell from 4% last quarter to 3.1% while net delinquency fell from 2.4% to 1.1%. The gross revenue grew 2.9% this quarter without having any real estate for sale achievement [ph]. In the first nine months of the year, the increase was up 4.5%.

Rental revenue increased 7%, while the same-store rent rose 8.4%, the highest growth since the first quarter of 2015. Here we have many highlights with some malls contributing with double digit increases. Another highlight is the Morumbi Corporate towers, they have contributed in the past 12 months with BRL81.1 million, an increase of 34.8% when compared to the same period in September 2015. The towers have today 92.1% of the leased area in usage [ph] and NOI margin of 92.3%. Parking revenue was also a feature with a growth of 7.5%.

Pretty much like the first two quarters this year, the shopping center expenses increased 31.8%. In return, the G&A expenses presented a small increase of just 0.3%. As a result, the net operating income increased 4.9% over the third quarter of 2015 and grew 4.4% when considered the last 12 months. EBITDA increased 1.2% in the quarter with a margin reduction of -- to 68.3%, while the last 12 months EBITDA increased 2.6% with a margin increase to 72.1% reaching BRL805.8 million.

Net income in the quarter fell by just 0.9% mainly due to the increase in gross debt and higher taxes in the last 12 months. Sorry I was distracted with the phone ringing. Net income in the quarter fell by just 0.9% mainly due to the increasing gross debt and higher taxes. In the last 12 months, it grew -- net income grew 4.5% to BRL364.5 million. For the same reasons the FFO fell 6.3% in this quarter and increased 1.4% in 12 months reaching BRL526.2 million. Moving now to the capital structure, net debt-to-EBITDA showed a slight decrease from 2.43 times in the second quarter of this year to 2.4 times. Gross debt however, increased by 14.4% due to the new funding related to the acquisition of minority stakes that we will speak -- that we'll speak about it shortly.

For three years in a row, the weighted cost of gross debt was below the base rate in Brazil called the Selic rate. In this quarter, the difference was 75 basis points from 14.25% of the Selic rate to 13.5% of the quarter's gross debt.

In many conference calls you heard our comments about having a capital structure that allow us to continue to invest and allow us to take advantage of acquisition opportunities, and thus continue to grow even in challenging times. And that's what we showed in this quarter with the acquisition of a minority interest in the two malls with higher productivity of our portfolio, MorumbiShopping and BarraShopping. We invested BRL495.9 million buying 12.5000 of gross leasable area, and net income when considering the past 12 months of BRL40.3 million, the size of a large mall in Brazil.

In addition to the acquisitions, we continue to expand clearly our newest mall in Canoas, north of Brazil, building an expansion of shopping Patio Savassi in the State of Minas Gerais and the new expansion in RibeiraoShopping in the City of Ribeirao Preto, (inaudible) Sao Paulo where we are adding two medical centers, new services operations.

In total, we have 54,500 square meters of the gross leasable area to be delivered next year. Considering the investment made until September for these acquisitions we have invested BRL704 million this year alone. In spite of all the economic challenges, we have been able to deliver growth, whether operational, financial or in areas, gross leasable area. I will finish here to leave more time for questions.

Before moving back to the operator I would like to thank the participation, interest and confidence of investors, analysts and journalists participating in this conference call. I would like to turn back to the operator for Q&A session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Our first question comes from Ivan Enriquez, HSBC.

Q - Ivan Enriquez {BIO 17654188 <GO>}

Thank you. Hello, Armando, hello, Franco. Thanks for the call. I have a couple of questions. The first one would be regarding traffic in shopping centers in Brazil. The information that I have is that it's being decreasing recently in the last quarter. I want to know from your perspective. I know you have a premium asset, but how is -- what are the numbers regarding traffic in your shopping centers and also want to know a little bit more about the expenses related to the share-based compensation that made your EBITDA margin to decrease by 100 basis points on a year-over-year basis.

If you can give me more details about this share based compensation, it will be great. And finally I saw that your occupancy cost reached 13.5% which -- I mean it's the highest figure that we've seen over the last quarters. So I just want to help from you, what level would be something to watch out in terms of the risk that some of your tenants become unprofitable. I mean, the smaller tenants, or the fixed [ph] tenants, those are some of my questions. Thanks, Armando, thanks Franco.

A - Armando D'Almeida Neto

Ivan, thank you so much for your questions. Yes, in regard to traffic, we've seen pretty much a stable traffic. I mean, it can vary one way or the other, let's say minus 1%, plus 1%. I would say flattish that's the answer throughout the past months, so let's say the past 12 months. So don't forget, we have some malls that are very consolidated, very high traffic and we have some malls which is still in consolidation phase, adding new consumers every day. That's why, as a trend, I agree that's why we are really in the press [ph] but we see stable traffic in our malls.

In regard to the phantom stock option, this is a compensation program to the manager and up, contributes to the company, in which we have a benchmark to the stock price, it's settled in cash, not in stocks. So we have a benchmark to the stock price. We saw an increase of least 66% in the past 12 months. So that's why on a mark-to-market basis we have this comparison, just to provide myself 66% increase year-to-yesterday.

So occupancy cost, yes, you are right. This is the highest figure we saw for the sample presented. If you look back prior to what we have published here since the third quarter of 2012 we saw figures beyond 14%, I believe even 15%, that has came down dramatically in the past 10 years due to the successful sales increase we had and also the reduction in common charges.

In this quarter, however, we have both rental and common charge related to maintenance and electricity, and I believe on marketing as well, with (inaudible) increasing a little bit the common charge expenses. And so rent and common charges have a -- with a higher occupancy rate. It was a question before this call, [ph] it's a concern for us. We are always concerned about our costs, that's true.

But I wanted to compare, the productivity that we have in our malls with all the malls around the world and then compare the occupancy cost. And we have seen that it is not high, it is not, that we are on the top range when you compare with other malls around the world with the same productivity. So no one. We believe we have room to grow. I think -- did I answer all your questions, Ivan?

Q - Ivan Enriquez {BIO 17654188 <GO>}

Yes, that's fantastic, Armando and Franco just, I mean, I would like to ask you one more question, if possible. Naturally there is other people in the line. So I can wait till you proceed to [ph] people in the line.

A - Armando D'Almeida Neto

Please go ahead.

Q - Ivan Enriquez {BIO 17654188 <GO>}

This is basically regarding temporary discount, that I've seen other shopping center operators to grant to tenants who have plans, let's say, alleviate their financial situation during this tough economic conditions in Brazil. But I couldn't see any sort of reference to these temporary discounts in your press release. So wanted to know if you are having or are granting this temporarily discounts to your -- to some of your tenants? And how much would be this discount? Thanks, Armando.

A - Armando D'Almeida Neto

Yeah, thank you, Ivan for your question. Well we certainly are. I mean we have mentioned that before in many calls and again in the Portuguese version of the call, there was question specific about which of tenant distribute [ph] is well distributed or are monitoring, distribute [ph] or being more concentrated in each or other segment.

And the fact that we are not increasing the rent over inflation or the inflation adjustment index that we use, it's a fact that we are also providing with temporary discounts. You didn't ask, but just to share my thoughts with you. Do I think that a worse is part of the best [ph], I do. I don't think that the recovery will be in this shape, will be gradual and slowly we expect, we have a more positive constructive view to the Brazilian economy. So we expect that to reflect also in sales and constant currency [ph] and tenants in our malls who are interested in what we prepare sales when (inaudible) of discounts and delinquency. Yes, we don't look at tenants that somehow they are going to pay rent on the mall center. But a business partner that we aim, we try to help them to overcome this challenging environment in Brazil in a successful way. So rent increase will be a consequence. We have to work hard at this time.

Q - Ivan Enriquez {BIO 17654188 <GO>}

Okay, thanks so much, Armando and Franco and nice talking to you. Thank you.

A - Armando D'Almeida Neto

Thank you so much, Ivan.

Operator

Our next question comes from Daniel Cobucci with Banco Do Brazil.

A - Daniel Cobucci {BIO 19076093 <GO>}

Hi, everyone. Thank you for the presentation. I have two quick questions. The first one is regarding the income tax, so a increase of 23% and lower deferred income tax. I would like, if you guys can explain a little bit over this. And the second question is regarding the shopping center expenses. I would like to know if -- how much of this increase is recurrent or we see the delinquency already falling, and how much of this increase is related to the higher provisions, how much would be recurrent base line. Thank you very much.

A - Armando D'Almeida Neto

Daniel, thanks for the question. First, regard to the -- the higher bracket, higher income taxes, if you, if you look at the past quarter and look at this quarter, you can see that we have some deferred taxes that are now in current taxes and the main reason for that is some expenses like provisions and cost related to the phantom stock option, they are non-deductible for tax purposes. So we basically increase your tax base, thank you so much for that, the tax base this quarter compared to the past quarter.

In regard to shopping center expenses, I would say the main highlights for the decrease in shopping center expenses were provisions, provisions related to the delinquency, to delays, rent delays that happened in the first and second quarter primarily in the first quarter, that we provisioned after six months according to our tax and accounting standards. So some companies they will provision after 12 months. We do in a different way, we provision after six months. So all the delays that you saw, the (inaudible) that you saw in the first quarter, not all -- all of it, hit the balance sheet now, the fully [ph] provisioned, that's what happened.

So in this sense, is this a one-off, yes it is. Is delinquency over, certainly not. We think we are going to be well behaved, we think again like sales that we will gradually improve, like we see for two quarters in a row the improvement, but we don't think, it's over.

A - Daniel Cobucci {BIO 19076093 <GO>}

Okay. Perfect. Thank you very much, Armando.

A - Armando D'Almeida Neto

Thank you, Daniel.

Operator

Our next question comes from Dan McGoey, Citigroup.

Q - Daniel McGoey

Good afternoon, gentlemen. Thanks for the call. Just a follow-up on the shopping center expenses. I understand the increases for provisioning six months after the increase in delinquencies. But can you explain a little bit about what's happening with those tenants, are -- is that why we are seeing such a pick-up in the turnover of those tenants, are those provisions that you in some way are looking to work out and the tenant remains? Can you give a little bit of additional color about some of this?

A - Armando D'Almeida Neto

Sorry, I couldn't hear. Dan you break through at the finish you -- what in the finish you said. Can you please repeat?

Q - Daniel McGoey

Sure. These provisions is that, are those charge-offs that you don't to expect to recur or are those tenant that remain in the mall that you're looking to recover that money and bring them current?

A - Armando D'Almeida Neto

Yeah, Dan, I will give you some information as an answer to that. First, when you look at net delinquency, there is some misunderstanding, not misunderstanding. Let me rephrase, there are different standard to require a delinquency. Some companies call delinquency as what we call net delinquency. So that's why we came a couple of quarters ago with net delinquency indicator.

So net delinquency is basically what we can recover from past quarter in this quarter, okay. So just to better explain the indicator for our (inaudible). So if you look at the net delinquency, it's coming down even faster. So indicating to me that annual targets, paying back what we own to the company in order to stay in the mall. And I think that's a quality indicator.

So these are high productive malls we have. I think that we are holding [ph] our tenants in good shape and also proven by the occupancy rate. So the occupancy rate basically remained unchanged. The 20 basis points different, explained by known mix change in our malls, in (inaudible) one of the (inaudible) we are transforming the area to support different service operations that we need in the mall. So that's why I think there was a temporary slow [ph] demand for space in malls. Again, we have a constructive view but we think that, that recovery slowly, gradually improving as the economy, hopefully will also improve.

Q - Daniel McGoey

Okay, great. Thank you.

Operator

(Operator Instructions) I'll turn the conference over to Mr. Armando d'Almeida Neto for final consideration. Mr. Armando you may give final considerations now.

A - Armando D'Almeida Neto

Thank you. Thank you so much for your time. As indicated, it was a -- this was another important quarter in which we presented stable results, in which we were able to grow the company further. We are very excited about the opportunity to buy-back part of the two most productive malls we have. The development by the company in the early 80s and so it's an opportunity to buy back space in these malls.

Well nonetheless, we see many opportunities to grow the company further, not just through acquisition but also through mall expansions and new greenfields. So and the company did not slow down the development area. On the contrary we are using the [ph] time to have better products, to preparing products for new opportunity which certainly will rise.

I want to thank you all and say that we remain available for any questions that you might have on this or any other quarter through our IR team. Thank you so much and have a good day.

Operator

Thank you. This concludes today's Multiplan Third Quarter 2016 Earnings Conference Call. You may disconnect your lines at this time.