Y 2019 Earnings Call

Company Participants

- Ruy Kameyama, Chief Executive Officer

Other Participants

- Andre Mazini, Analyst
- Jorell Guilloty, Analyst
- Luis Stacchini, Analyst
- Marcelo Motta, Analyst
- Nicole Inui, Analyst
- Victor Tapia, Analyst
- Ygor Altero, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Conference Call of BR Malls to discuss the Results of the Fourth Quarter 2019. Here with us to discuss the results are Ruy Kameyama; Frederico Villa; and Derek Tang. We would like to inform all participants will be in listen-only mode during this conference call. Later on, we'll open the Q&A session when further instructions will be provided. (Operator Instructions).

Before proceeding, let me mention that any forward-looking statements that may be made during this conference call related to the business perspectives of the company, projections, goals, operational and financials are promises of brMalls' management team, as well as information currently available to the company.

Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and promises because they refer to future events and therefore depend on circumstances that may or may not occur.

I would now like to turn the call over to Mr. Ruy Kameyama. Mr. Kameyama, you may proceed.

Ruy Kameyama {BIO 16672412 <GO>}

Good morning, everyone. Thank you very much for attending our conference call to discuss the results of the fourth quarter 2019. I'll start the presentation with highlights for the year, and then we will open the Q&A session. We'll start the presentation from slide three.

Here we show the main events of 2019, that contributed to the consolidation of our portfolio strengthening strategy. In this strategy, we decided to reduce exposure to non-core assets, smaller malls in smaller cities, in which we do not have an active management, and we increased exposure to core assets. We sold stakes in eight malls, Plaza Macae, Ilha Plaza, Osasco Plaza, Capim Dourado, Contagem, Gourmet, Londrina Norte, Sete Lagoas, and increased stake in two dominant malls, Shopping Del Rey in Minas Gerais and Iguatemi Caxias. As a result, we ended the year with 93% of our NOI exposed to assets classified as Tier 1 and 2 compared to the 86% we had disclosed to the same categories in 2018.

In addition, in February 2020, we acquired stake in two more assets in Sao Paulo, Shopping Villa-Lobos 5% and Shopping Piracicaba 38.4%. In relation to the retrofit project, we will bring important recruitment and attractiveness, especially in NorteShopping, Tijuca, Plaza Niteroi, Villa-Lobos and Center Shopping Uberlandia. The retrofit projects of Shopping Tambore are also moving towards solid deliveries in 2021 and 2022.

In the following slide number four, we present the capital structure of brMalls. The company ended the fourth quarter with a cash position of approximately 787 million and a gross debt of 2.8 million, a reduction of 77 million when compared to 2018. Net debt at the end of the quarter was 1.9 billion, which kept the net debt over adjusted EBITDA 12 months stable at 1.9 times. The average cost of the company in 2019 decreased from 8.8% in the Q4, '18 to 7.0, and the average term extended by 0.7 years due to the improvement of our liability management efforts, which also reduced our exposure to TR, and increased our exposure to CDI by 45.3.

We refinanced a CRI in the amount of approximately 610 million, TR plus 8.3% to 113% of the CDI, with the debt being extended from February 2025 to October 2026. We maintain our commitment to have a very strong and solid balance, with a leverage in the fourth quarter that reflect an excellent fiscal balance prepared for any situation.

On the following slides, we highlight three important initiatives carried out in 2019, that highlight our commitment to make the company more oriented towards customers, innovation and long-term. In 2019, we had the first partnership before Mercado Libre and Delivery Center promoting our sales channel allowing customers to have access to same-day deliver using the mall as a local distribution hub. We want to extend to five other shopping malls in Sao Paulo.

In January 2020, brMalls together with Multiplan made a new investment in the delivery center in the amount of 69 million, with the purpose of improving the technology of integrating inventories and connecting it to marketplaces and also to accelerate the expansion of units to new cities. In the opposite direction to bring online sellers to physical stores.

In the Q4, 2019, we opened a Trama Lab at Shopping Tijuca, a physical laboratory that brings together new brands in the online universe displaying a high market potential. More than just offering real estate, Trama Lab provides services, including inventory management, labor, visual merchandising in a retail-as-a-service format, which will help in the convergence between online and physical retail and will create a new category of demand for shopping malls.

Last year, we placed our bets in the digital media, in the OOH media, and created a midiaMALLS, which is the company for the Group focused on the commercialization of digital media in shopping malls. Currently, it has a portfolio of more than 60 malls and operates not only in the malls of brMalls, but also in third-party malls, which reinforces the importance of the benefits of network effect. In the release that was published yesterday, we will provide more details about the progress on digital media.

On slide six, we show how the recycling of our portfolio, which was our strategy that generated greater exposure to Tier 1 and 2 influenced in a positive way our operating indicators. When compared to the fourth quarter of 2019, we observed a significant growth in sales per square meter 12.4%, rent per square meter 12% and NOI per square meter at 12.8%.

On slide seven, we present the performance of other operating indicators, the total sales of the company excluding the mall stores grew by 6% totaling 6.2 billion in the fourth quarter 2019, reflecting both the better performance of tenant, who opened in the last 12 months and the improved market conditions. The core portfolio, which comprises our 29 core assets showed sales growth of 6.3%.

Same store sales growth was 3.7%. We highlighted the performance of the satellite stores in this result that grew 6.2%. And then we look at same store sales, we see that the growth was 6.2%, followed by the Southeast region with 3.3%.

The same store rent indicator reported in the quarter, a growth of 6.9%, a positive variation of 2% in comparison to the fourth quarter of last year, above the average of the last four years. We attribute these results mainly due to the performance of supermarkets, sporting goods, convenience and services.

On slide six-- on slide eight, we present the operational indicators with excellent results. The occupancy rate considering the average of malls in our core portfolio reached 97.3%, mainly driven by the increase in demand for GLA and the recovery of the financial health of several tenants. This result represented the highest increase in the indicators, since the fourth quarter of 2014.

In relation to delinquency rate, we have seen a steady improvement in figures, since 2017 due to the commercial strategy to optimize our mix. And in Q4, 2019, we recorded a negative value of minus 0.5% in net late payment, the best level ever recorded in a quarter in the company's history. Late payments amounted to 3.8%, the best levels since the third quarter, 2014. In addition, in the quarter expenses with the provisions for bad debt amounted to 3.3 million, a reduction of 76.4% when compared to the fourth quarter

2018. This improvement is associated with optimization of the tenant portfolio and the reduction of net late payments to negative value.

On slide nine, we present the financial indicators of brMalls. Our NOI of our portfolio reached 317.6 million in the fourth quarter, an increase of 7.3% compared to the fourth quarter 2019 excluding the most of those. And the media line was a highlighted with a growth of about 25% over the same period of last year, excluding the milestones. It was driven by the progress in the digital media strategy in the increase in the Media segment. Adjusted EBITDA reached 257 million in the fourth quarter, an increase of 26.6% excluding mobile phones for 13.7 considering the fourth quarter 2018 portfolio.

On the following slide, slide number 10, we present AFFO for shares for the quarter and year-to-date results. The main metric for the creation of long-term value for our shareholders. Even with the sale of the seven assets of our portfolio in the third quarter 2019, where we raised about have a 100 million, that was fully distributed as dividends and interest on equity. And as a consequence, did not generate additional financial revenues. We recorded growth of 5.4% compared to the fourth quarter 2018. Year-to-date the AFFO per share grew by 22.1% reaching the highest AFFO share and the compensation. This FFO amounted to 699.1 billion. The main effect that contributed to the growth, where the operational improvement are efforts in liability management, the share buyback program and greater total efficiencies.

On slide 11 and reference to the interest on equity and dividends, we present all our earnings played out this year. We'll commit to always generate greater returns for our shareholders, aiming at the best allocation of capital throughout 2019. We distributed total of it BRL821 million. Of this amount, we distributed 196 million in dividends and 225 million interest on equity. On the last slide of our presentation, we show a summary of what has been done in the company over the past three years. We managed to strengthen our portfolio with increased sales of non-core assets and retrofit. We strengthen our balance sheet through liability management efforts, improving our bad debt profile and reducing our leverage. We opened our digital transformation office reinforcing our commitment to innovation and the development of new solutions to serve our tenants and customers.

We started the cultural transformation of the Company aiming to have a culture oriented to the long-term focused on the customer and a culture that could promote innovation. And we have strengthened our corporate governance with higher IFRS rating level. This initiative resulted in a reduction in the company's total risk level. And about the impacts of Coronavirus.

We would like to say that this is a priority on our agenda and we have adopted measures to protect the health of our employees and customers. Nevertheless our business fundamentals and long-term strategies remain unchanged and we are excited about future opportunities. We close our presentation and we are open to any questions you might have.

We are now going to start the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Nicole Inui with Bank of America.

Q - Nicole Inui {BIO 17757166 <GO>}

Good morning. Thank you very much for the call. I would like to understand your views on the flow of your shopping malls, considering the beginning of the year in comparison to the previous years. So we are in the middle of March. And with the advent of Coronavirus, I would like to know which are the impact or the flow of movie theaters and the traffic that we have at the malls. And the second question is related to the leverage. I understand the liquidity rate is very high. I would like to understand how do you feel in terms of the market. I would like to know with the M&A pipeline will undergo any changes and which are the opportunities. That's it. Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Nicole, good morning. Thank you very much for your question. As to the shopping mall traffic in January and February were regular months. February gave us a positive surprise and March started well and now we have an expectation of what is going to happen on the days to come. I think the evolution of Coronavirus situation was something that happened presently.

And I believe it's going to depend on how the virus evolve in the main cities and what are the guidelines that the government is going to give to us. It's difficult to make a prognosis at this time. So far the traffic was normal, but we are getting ready for any possible scenario. Scenario may change abruptly considering everything that is happening now.

As to M&A as you all know it's part of our strategy and we are happy and it's very important to have seen that we made advances in the sale of our non-core assets and we understand that there are so many uncertainties ahead of us and it's very pleasant for us to have a very solid portfolio in comparison to the previous years. And this all allows us to focus on the assets we have and we are perfecting our portfolio looking for solutions.

We are always on the look out considering the existing shopping malls and also other shopping malls which are external to our portfolio. We continue alert. I believe that the weeks to come will be very hard because of the market uncertainties I think people will be more careful and not major decisions will be made and we are also going to be very careful, so that we can understand the scenario more accurately.

The M&A continues to be something very attractive to us. We continue the following strategy of strengthening our portfolio focusing on Tier 1 and Tier 2. And we also continued prospecting and we are always watching the opportunities and we also will consider, which will be the most continued environment for us to operate.

Q - Nicole Inui {BIO 17757166 <GO>}

Okay, thank you.

Operator

Our next question comes from Mr. Luis Stacchini with Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Hello. Good morning. Thank you very much for the presentation. I have two points to raise. First, about the delivery strategy. Something related to the market. I understand -- can you tell me what are the prospects for the half of the year. First half of the year, what would be the valuation for this new round? And after last investment, what would be the future plans and looking at net income we can see the reduction level on the gross revenue has changed a lot. And I can see the figures of 8%. So this was -- this is an number that was related to pre-billing or are there other revenues that should need -- should be considered?

A - Ruy Kameyama {BIO 16672412 <GO>}

Luis, good morning. Thank you very much for your questions. Could you repeat the second question I could not understand it well.

Q - Luis Stacchini {BIO 18717891 <GO>}

Yes, of course. It was an increasing reductions of the gross income of taxes and reduction on revenue 9.5%. And usually this is related to discounts, but this as far as my memory goes. It was related to pre-billing. I would like to know what would have caused this increase?

A - Ruy Kameyama {BIO 16672412 <GO>}

Okay, Luis. Now it is clear now. As to the first point of delivery centers that you asked. The accounting issue I saw that the line is not the marking of the market. This was an accounting impact because of the entry of new partners that happened last year and how we see the future. What do you believe that would be from the theoretical viewpoint.

I can say that it was very important to have new partners such as Multiplan and Cyrela and two of the main developers operating the market. And this helped us to strengthen our interest of network. Expect both to attract more marketplace in order to bring more tenants and new network. This new investment will allow us to review this volume to accelerate the integration of technology and I believe that in the past two years, it was clear to us that shopping malls are a hub of -- distribution hub for food restaurant equally. But for food, we see this as the new frontier and this is where we see opportunities.

And delivery center will focus on increasing the technology teams and the technology connection. So that we can integrate all this and have seamless integration of the inventories of the tenants and connect all marketplaces. The delivery center is currently located to iFood, Uber Eats, Rappi, Meta Delivery in four major marketplaces. And we expect to reach 10 marketplaces until the end of the year. So it's a multi-channel strategy.

And at the same time, this investment will allow us to multiply the number of people. So that we can accelerate the inventory integration and so that we can be able to offer more products. So this is a topic of supply and demand to increase the demand by means of marketplace by increasing the number of marketplaces and increase the supply of available projects. And to that end we need to invest in technology. So this is the update we would like to have in relation to the delivery centers.

The new networks will -- have been joining us and this has becomes ever more attractive and I believe this is going to be very important in the medium term. All those retailers to use those channels. As to deductions and the discounts are not applied there. And on the fourth quarter, we are going to have a regime, which will use the taxes and now discounts.

The level of discount is very well controlled. We have been operating in a more macro level upto 2014. The discount level was lower until it reached the peak in 2016, 2017, 2018 it dropped to 3%. At present we are operating at a level of two point something. And there is room for improvement for this level that used to be lower than 2%. So the discount have been dropping along the last years and we still see room for improvement in the future.

Operator

Our next question comes from Mr. Victor with Bradesco BBI.

Q - Victor Tapia {BIO 20566083 <GO>}

Good morning, everyone. I have two questions in relation to the investment with Multiplan related to the delivery center. I believe that the major challenge would be to integrate the inventory with the tenants. But I would like to try to understand better when you started the delivery center platform as far as I can remember. The delivery center was in foods and we have seen an increase, a double-digit increase for the store and when we see the total sales of the shopping malls, there was an increase of 1%. With this strong development for good, can you see any metrics ahead of any differences in sales so that we can understand better what could be the impact? Another point that I would like to raise and I would like to just see it whether or not you can give more details is related to expansion you mentioned something in the BR Malls Day, but I would like to know more specific information in terms of area and prices?

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Victor. Good morning. Thank you very much for your question. The first point is the following. The delta sales or incremental sales that delivery center can sell and generate to food. It's still very early to have any estimates. What we have seen is that the increase was between 10% to 12% an increase of about 1% and the total sales of the shopping malls.

And for foods we also noticed that this increase oftentimes is more than having a contact with the tenant. When the tenant has installed fixed cost, we can improve that margin and we also provide them with a strategy to capture new clients. So there is a direct benefit with incremental sales and also to improve their strategy and access new consumers.

And for us, we have seen that it's very important -- very interesting for our mix because some restaurants do not see us as priority and when they saw that we were working with multichannel, they looked at us differently and they included in their activities.

We have challenge of integrating inventories and we have to understand how far we are going to go there that and how current all the activities that are going to be. We have no doubt of the impact is going to cost and we also understand that the top-line and the bottom line of the tenants are also going to be significant.

But it's also very relevant in the long-term. Above all we want to make our properties, which are already relevant, even more relevant to the tenants. So that we can offer more solutions. We do not have projections of the growth. We still need more time for more accurate figures and when we have more information we will resume this discussion.

As for expansion we understand this is part of our strategy. We have been growing year-by-year. We have this strategy of increasing our main assets and we identified expansion opportunities in Tijuca, Plaza Niteroi, Tambore and Estacao Curitiba. And all this information is in the BR Mall Day that was held last year. And together they represent about to 16,000 [ph] GLA.

So these are specific expectations from those shopping malls that would amount to about 15,000 square meters. There are also some other items in the pipeline and this information is also available in our releases and when we have more information we provide this information in a more structured manner. Thank you.

Operator

Our next question comes from Mr. Andre Mazini with Citibank.

Q - Andre Mazini {BIO 20377100 <GO>}

Thank you very much for the call. And the first question is related to the malls and the strategy to have third-party malls for the media. And you didn't used that with the third-parties. So this is something new. And I would also like to know what Amazon did in shopping malls. So these are partnerships. So now talking about Coronavirus. We understand that the shopping malls may undergo some impact during this crisis and the delivery centers could be something we can look at?

A - Ruy Kameyama {BIO 16672412 <GO>}

Mazini, thank you very much for your questions. As to midiaMALLS, we really changed the strategy in what we saw.

Media has always been a focus for the company, but when we started the impact and the opportunities that digital assets could bring to the media and also considering the directions of the market considering everything that is happening in terms of change of the habits of consumers, moving away from traditional media, newspaper moving on to digital means, we understood that there is a very important opportunities especially creating a specific player for the shopping center mall.

There are other companies whose portfolio is very large. But we do not see anyone with an expertise, which is focused on shopping malls. We also saw that our portfolio had a very relevant scale. The opportunities to bring in more people would to offer more comprehensive portfolio. This is related to network effect more offer for higher demand and this is like one retrofit to the other.

So about 70 shopping malls that are being commercialized using midiaMALLS and this would allow any company which is willing to publicize their products in easy way. And an example that you showed is to bring those who didn't use to publish in shopping mall such as Netflix, Amazon. We noticed that the public, they want to reach are at shopping malls. And what's the fee of the physical world.

It's a very interesting world and this attracts the digital players and the marketplaces and digital maker brands. And coming into the shopping malls it is an opportunity to gain consumers in a very efficient manner and we are favored both by what we receive in terms of sales.

In addition to that, our portfolio is much more attractive for those who are interested in selling products. So this media movements to migrate from traditional media to digital media is a trend that's going to last for the year to come.

And if we provide good services to the brands in an accessible, easy and pleasant to the consumers. I believe this is something that would benefit all our business, all the tenants and also, it's also very attractive to all consumers.

As to Coronavirus impact. We have to see how this plays out in the next week. And what would be the government guidelines in terms of the traffic, the measures are not very clear. Everything is so new to the governance, to us and all retailers are making plan, so that we can understand how we're going to operate.

As for multi-channel and marketplaces and next mile. These are all going to be interesting alternative that would make everybody's life easier. And those who are connected to those tend to be favored by this considering larger demand.

Q - Andre Mazini {BIO 20377100 <GO>}

Perfect. And the last point, the current breakdown, can you provide some color on this?

A - Ruy Kameyama {BIO 16672412 <GO>}

I do not have the accurate number off hand in the order of magnitude would be nine to 10. Food plus goods share, which is increasing. And we consider the shopping malls, which are already participating in this pilot. We can see that the speed of growth has been very significant.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay, thank you.

Operator

Our next question comes from Jorell Guilloty with Morgan Stanley.

Q - Jorell Guilloty

Good morning, everyone. I had two questions. The first is about Coronavirus. Could you give more information about the point here discussing with your tenants. Is there any possibility of interrupting the supply chain. Do you think they are prepared? Do you think they are working on their inventories? In addition considering the recent volatility and the headwinds that you can see related to Coronavirus at a macro level or whatever. What are the variables you're considering? What is happening now? Do you think there will be any changes in the fixed or variable income and how do you see it now?

A - Ruy Kameyama {BIO 16672412 <GO>}

Good morning. Thank you very much for your question. As to Coronavirus, you -- as far as how we see this. We have been talking to the tenants, everybody is getting prepared and everybody is trying to understand what will be the scenario and how intense all the scenario is going to materialize in Brazil and preparing ourselves.

The internal measures include internal discussions, when we understand team redundancies, the current time strategies and accelerate the policy, the more restrictive policy for travels, cleaning and hygiene. So we are getting prepared. But it's not very clear. I don't think the tenants had it very clear in terms of how large this impact is going to be. So we are trying to get our operations prepared for any evolution that may happen to our business environment. It's not very clear what's going to happen to the supply chain. What we see is that the retail model in Brazil sometimes they are very organized in some cases, but we need some level of deputation.

The lead time of product that require import will probably need some change. But I believe that the retail in Brazil is very well organized along different prices that we have -- they're gone. We know how to get adapted to different scenarios.

And this also something which is very important. I believe that is very important for us to go back to our fundamentals and try to see behind so much mess was there. And on our side, we are quite calm because we understand that in the past three years, we have been making our portfolio much stronger.

The balance sheet is much stronger. What we call the fortress balance sheet with a high liquidity level. Our default rate is negative. So we have a network coverage. So we are very well prepared with occupancy rate, which is very healthy in terms of tenants and with our reinforced store mix in comparison to the previous year.

And we're also looking at new solutions, multi-channel strategies. And we are going to start developing new solutions for the logistics areas. So when we look at the capacity for our company to be prepared for any scenario. We have a strong company, which is financially from the team and inventory viewpoint.

We are prepared for the scenario. So we feel very comfortable. We understand there will be uncertainties ahead of us. But the internal guidelines is for us to keep to our fundamental look in the future in the long-term help our stakeholders.

And at the end, this is not the first major challenge we had to face and it's not going to be the last. We have to be calm at this time and we have to defend our stakeholders. We have to defense our businesses and keep focus.

Q - Jorell Guilloty

My second question is related to how you feel in terms of the proportion of the fixed income and variable income or revenue. So how do you see that? Would anything change in terms of your strategy?

A - Ruy Kameyama {BIO 16672412 <GO>}

I believe this is one characteristics of our business. So we have the minimum rent, which quite expressive and this is part of our business. But at the same time, our company is interested in developing new lines of revenue such as media as we mentioned or encouraged actions that can capture more higher presentation in rent.

So this is part of the nature of our business to have core business, which would be related to the rent. But we also see opportunities and this -- of everyone's interest to have new lines of revenue that would be a complement to the minimum rent. So our strategy will not change.

So Coronavirus will generate uncertainty. We are going to be alert, but our strategy will not change. Our fundamentals will remain unchanged both for our tenants and our customers.

Q - Jorell Guilloty

Okay, thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you.

Operator

Our next question comes from Mr. Ygor Altero with Santander.

Q - Ygor Altero {BIO 21419045 <GO>}

Good morning. Thank you very much for answering my question. My question related to costs and expenses. You did a very good job in terms of provisions for bad debt. But it's -- the base of comparison is a bit more difficult for 2020. So I would like to know what you expect for 2020? And I would also like to understand how should we look at the EBITDA if the EBITDA levels seem to be kept at the same?

A - Ruy Kameyama {BIO 16672412 <GO>}

Hi, Ygor. Thank you very much for your question. Last year, we made great effort in terms of provision for bad debt. And they start -- this is an effort that started three years ago when we decided to change the profile of our tenants and has more accelerated mix change. New stores that would have a better sales performance and then we had a negative blow in 2017.

But on the other hand, we understood that more modern and better stores have better sales opportunities and their capacities of payment is also better. So we suffered a lot when we were making adjustments to our portfolio. But we made the right decision in terms of the long-term strategy.

When we started to mix, we understand that the default rate was lower and the level of provision for bad debt was also improved. When we look ahead, we understand that the provision for bad debt level is very positive and the improvement in delta will be more difficult to be captured. But we understand that this level is very efficient at the moment.

As far as administrative and general expenses we understand that it's very similar to what we had in 2019. And when we look ahead we do not provide specific guidance in terms of numbers of percentage. What we focus on are on the major topics of the company because we believe that we have the right structure in terms of team and organization.

And looking ahead we understand that the digital information may undergo some changes because this is mainly importance for the company. When we think about more relevant changes that can bring more relevant impact, this would be the vector for us to be more sensitive.

Q - Ygor Altero {BIO 21419045 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Marcelo Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. I have two quick questions. First related to (inaudible) value. You mentioned (Call Ends Abruptly)