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Q3 2017 Earnings Call

Company Participants

- Armando d'Almeida Neto, Vice Chief Executive Officer and Investor Relations
- Franco Carrion, Investor Relations Manager

Presentation

Operator

Good morning. Welcome to everyone to Multiplan Third Quarter of 2017 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 Multiplan's 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 a message in the name of Mr. Peres. Mr. Franco, you may begin the conference.

Franco Carrion {BIO 16449361 <GO>}

Good morning. Thank you for listening to us. Today, I'll start with an expression used by the writer Paulo Coelho in one of his best-selling books "The Alchemist." First some quick background. When we were already an important company in the market 28 years ago, I decided to expand our investments outside the Brazilian borders. The first idea that came to me was to invest in a country that had language, habits, and culture similar to ours. So I quickly sensed that it should be Portugal. On a trip I made to Lisbon when I was already building cut sky [ph] shopping in a partnership with a group that had never developed a mall before. I thought, am I being too daring going to a country that I don't even know the market? But then I remembered the expression used by Paulo Coelho in his book and I quote him " when you want something, the entire Universe conspires to help you to achieve it." This has been my life for about 50 years Investing in Brazil and abroad. And today I'm even more certain that it's true.

I remind a story to tell you that in this moment of so much uncertainty, we keep on going. In the middle of a crisis, we built ParkShoppingCanoas in this city of Canoas next to Porto Alegre, a bold project with unseen features in the country. We're going to inaugurate it now on November 23rd, being 93% leased. It is an interactive mall that brings together retail, leisure, and nature. The thorough built area sums 120,000 square meters. For it's building size and features, I invite you to visit it after the 23rd.

The total investment in this project is close to BRL0.5 billion and it stands out for the beautiful park that we built integrated to the project for it's sustainability aspects, which has the goal of giving it's tenants great admirability and lower cost of condominium. We invested heavily in the urbanization of an area that has great consumption potential, and it reaches not only the city of Canoas, but the entire Bells Valley or Vale dos Sinos in Rio Grande do Sul, a region that was in many ways still unexplored. We've built 4 km of street and avenues, we've built parks and sidewalks, we illuminated the streets and created the new commercial mother revolutionary and renewed center in the region. Certainly, over the next few years, all of these renewals will lead Canoas and the neighboring cities to a faster growth because this mall will substantially transform that region.

This is what we have done in many places in the country such as Ribeirao Preto, the countryside of Sao Paulo for example. We are right there 39 years ago and continue to be responsible for major transformations and innovations in the city. Last August, we inaugurated a medical center fully integrated with the mall that has more than 30 clinics, a day hospital and a diagnosis center. It brings to the city a successful concept originated by us 23 years ago in BarraShopping.

We're also expanding two other malls, Patio Savassi, which stores are now being delivered in November, and VillageMall with delivery of the first phase scheduled for December. We took advantage of the crisis to move forward even when the economy was paralyzed. We continued to invest with a clear focus on conveying our clients what they really want. Better, we surprised them, we make reality become better than the dream. It is the characteristic of the Company to concentrate on the latest developments, all the knowledge that we have acquired over 50 years and that is renewed year-after-year. Now-a-days technology revolutionizes this world every year. Therefore, Multiplan will continue to be a predominantly entrepreneurial company investing and focusing on creating new experiences for the satisfaction of our consumers. In fact, our goal is to make people's lives more and more pleasant.

Now leaving philosophy and history aside, I want to communicate to you objectively that the results of the third quarter have already shown a significant recovery in the Brazilian economy. Rental revenue grew 9.4% in the third quarter, our tenant sales 8.1%, and our net income 30%. I'd like to point out some operations that have shown significant results. BarraShopping's tenant sales in Rio de Janeiro grew 12.6%, ParkShoppingCampoGrande also in Rio 18.9%, and ParkShoppingBarigui in Curitiba 12.8%.

Finally, once again, I want to congratulate the current government, especially it's economics staff and it's other participants, for the swift reversal of expectations when the country faced the worst recession in it's history in the last three years. If it weren't for the negligence of some institutions, we would certainly be celebrating the return to accelerated growth phase. Nevertheless, we are seeing a very low inflation, which I did not had the opportunity to see in my life and an adjustment without great traumas that brings to the economy a lower interest rate, very close to that practices in great developed nations, besides the other reforms and the others measures that will boost this country.

Thank you for having patiently heard me tell stories and we leave our past filled with challenges. But our spirit of adventure and creativity will always continue to grow stronger. I thank the Multiplan team that allow me to carry out this project improving people's quality of life and collaborating with all this development. I also thank all the investors who are with us in this journey in the last 10 years since the IPO and who have been relying on our work. I now pass the floor to Armando d'Almeida who will detail the results of the Company. Thank you.

Armando d'Almeida Neto

Thank you, Franco. Thank you, Mr. Peres. And good morning, everyone. As in previous quarters, I will comment on the most relevant topics without necessarily following the order of the presentation. Starting with the operational part. As an (inaudible) clear sign of the complete economic recovery, tenant sales are growing at a faster pace. In this quarter, they grew 8.1%, almost three times the 2.9% growth recorded in the same quarter last year. It was no different with the same-store sales growing 7.3% in the quarter compared to 2.8% in the same quarter last year. In fact it was the higher same-store sales increase since the fourth quarter 2014. Also, important surpassing the same-store rent growth, something that had not happened since the first quarter of 2014. Same area sales were even higher increasing 7.7% in the period. All store segment showed growth highlighted by the Home & Office and Services segments. It was also positive the balance same-store sales growth between anchor and satellite stores.

The occupancy rate was practically unchanged at 97.5%. Gross delinquency rate slightly reduced to 2.8% and net delinquency was at 2.2%. Gross revenue grew 7.6% leveraged by the 9.4% rental revenue growth. The increase in same-store rent was 6.7% representing a real increase 1.3% over the inflation adjustment effect of 5.3%. This is the second quarter in a row growing in real terms above inflation adjustment effect and not seen since 2015.

Passing on to the financial results, the comments on the financial results. Even with an increase in owned GLA of almost 5%, mall expenses were 1.2% lower while expenses with office towers for lease were 25.9% lower. Adding up those -- these two expenses, the property expenses were reduced 2.3% and combined with 9.4 % rent increase resulted in NOI growth of 8.3% in the quarter with a margin increase of 124 basis points to 86.7%. In the nine months of this year, the NOI accumulated a 10.6% growth. Headquarter expenses increased by only 0.9%, therefore well below inflation. On the other hand, we had BRL6.5 million pre-operational expenses incurred during the quarter and related mainly to the key delivery ceremony in Canoas that we had in August this year and the delivery of the medical center, the opening in fact of the medical center in the city of Ribeirao Preto, RibeiraoShopping.

Before I move into EBITDA, FFO, and net income, I want to comment on the accounting effect of the share price -- this linked -- the share price linked compensation that is paid in cash, the Phantom stock option. Accounting legislation in Brazil imposes that all Phantom stock options programs be mark-to-market on a quarterly basis even though -- what in our case, they will be fully exercisable only in 2020.

However -- or the flip side of the coin would be that this (inaudible) shares, they're not -- there is supposed to work as a partial hedge is not mark-to-market according to same legislation.

As a result, the good news of the share price increase of 12.3% from June 17 to September 17 was a -- about BRL8.1 meant that provisions increased in the quarter affecting the result lines. For demonstration purpose only we will show both with and without the share-based compensation adjustment. The EBITDA increased 7.3% after the share-based compensation adjustment or came in 1.8% lower before the adjustment, pretty much result of the Phantom Stock Option mark-to-market and the pre-operational expenses that we have.

The announcement of the distribution of BRL65 million in interest on shareholders' equity brought a 66.1% reduction in income tax in the quarter benefitting the FFO and net income. The adjusted FFO then grew 41.1% or 26% if you not consider any adjustment.

Net income even with the increase in the depreciation due the acquisitions of minority interest that happened in the fourth quarter of last year and first quarter this year increased 53.6 % after the adjustments or 30.2% before.

Now the capital structure, we presented a small reduction in financial leverage from 2.4 to 2.35 times net debt to EBITDA ratio. It is good to see the weighted average cost of gross debt falling to a single digit, now at 9.18% per annum with an average maturity of 50 months. Just for comparison purpose, if we use the interest rate curve or the CDI curve for the same tenure of our gross debt, our cost of funding would be below under the CDI curve equivalent to 99% of the CDI rate.

In this quarter, we also extended the debt profile a little further bringing even more comfort to the amortization together when compared to the current cash position and the cash flow generation measured by the funds from the operations, the FFO. The goal was to create a very -- to create more free cash flow on this coming year start '17, '18, '19 creating -- giving the company more flexibility either to invest or to take advantage of the weakness in the economy with any when and if acquisition opportunity or even to return more money to shareholders and from 2020 and on you see that the amortizations scheduled so far, they are not greater or at -- at the size of the FFO currently generated in the company we're talking years -- a gap of years from 2017 September last 12 months to what we are going to do in 2020, 2021, and 2022. So creating pretty much room for the Company to continue to invest supporting the growth strategy of Multiplan.

Mr. Peres has already commented on the busy delivery schedule of new areas throughout the second half, representing a 7% growth in total GLA. It's not small at all, it's meaningful, which has come to an investment of almost BRL100 million, BRL98.5 million in the quarter and BRL350.5 million in the first nine months of the year.

To conclude, the country begins to benefit from the effects of a controlled inflation, historically low levels positively affecting consumption, financial cost, leverage capacity among others. This encourages to do more, to keep growing. I will stop here by thanking all for your interest in Multiplan and passing on to the Q&A session. Operator, back to you.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) I'll turn over to Mr. Armando d'Almeida Neto for final considerations. Mr. Armando, you may give your final considerations now.

A - Armando d'Almeida Neto

Thank you so much. It looks like we have a very shy crowd here in this conference call today. So at least compensate a little bit for the -- the numerous questions we have on the Portuguese version of the call the earlier call we had. Anyway as we always do, we'd like to share some of the questions we had, at least some of the most relevant questions.

One of them was talking about Rio and the economic situation of the state and we discussed that about a year ago in our conference call, we said that our properties are very strong, and we were confident that they will go through this state situation and growing. And I think that 2017 pretty much shows that. In nine months 2017 period, BarraShopping grow upwards of 13.6%, New York City Center that is integrated to BarraShopping 5.2%. ParkShoppingCampoGrande is growing at 19.8% sales and VillageMall basically flat at 0.2% growth. That shows the resilience of the profits we have.

And then also (inaudible) question about VillageMall, about we doing expansions in VillageMall and the mall is not growing as strong as the other one. And we were explaining that the VillageMall being passing through a turnover that I specifically in this quarter there are many stores that are ready -- they are almost ready to open, but did not open in the third quarter, they're still making their stores, preparing their stores for Christmas. New names, international names, they're opening in the malls for the first time in Rio, new operations, new concepts. And we -- these expansions allow us to better change the segment in the shopping centers. So we're very confident that we are doing right thing on the long run with VillageMall that'd be able grow so stronger in this past -- these initial five years of operation.

We also had questions related to rent breaks. If we were able to reduce rent rates especially when we're growing at 1.3% real same-store rent. And the answer is no, no yet. Of course, here and there in one or two malls we could be successful -- successfully reduce rent rates, but in general terms we're not seeing rent rates decelerate, no, compared to last year, compared to the past quarters. but we could not unwind then, yes, it's not -- was not time yet.

Also questions regarding same-store sales, the different segments, so congratulating for the Apparel performance that was underperforming before and there were many questions regarding segments and especially Home & Office as well. And we're just highlighting what I mentioned during my speech that gladly so -- all -- not just all the segments are performing --are performing well, growing in the positive territory, no segment was underperforming at all in terms of negative growth, but also the balanced growth between anchors and satellite stores. This is another way to look at this economic recovery and encourages to do more. When you link that to the 93% occupancy rate we have in Canoas right now, it encourages us that the economy is recovering, that the (inaudible) for space is coming back, that we can be prepared to do more. And that was another question, is the so far successful stage of Canoas that we open the doors on November 23rd -- sorry November 24th, November 23rd is the -- is just a -- is a ceremony for guests, on the 24th will be opened for public, on the Black Friday by the way. If that's encouraged to do more, and answer was, from Mr. Peres, absolutely yes, and we are preparing to do more.

What else I think on the highlight in terms of, there was on the other non-operating line others, large expenses this quarter mostly related to consulting companies and minor part to donations. The consulting company was, just to clarify, that was not border specific, but like a tweak of the well-known big names around the world consulting companies that we're using -- we could dedicate between the second to the third quarter that all the top management was -- in the company here especially considered that the (inaudible) that we have with (inaudible) in the fourth quarter should go through mainly strategical thinking, strategical exercises, and meetings, some of them looking for the long-term prospects of the Company in terms of process, in terms of systems, efficiency, structures and the property levels or in the headquarter levels. We also had companies helping us to use like a bridge to what we think is the mall of the future, what we have to do, so we highlighted the challenge we have, responsible for the leadership that will take care of that, and we also have people looking to help the others understand around the world what is going on with the model of the shopping center, again thinking about the mall of the future, planning about the future that we have the vision and appetite to do it, to do it more.

I think that the last point to highlight was regarding parking. While we did not raise the rates of parking this year, I would say that the focus of this company are consumers as you heard us say so it so many times, and Mr. Peres added a little for that, that consumers are the kings for us. So we didn't think it's the right timing to do it. Those are short-term decisions that you can like scratching the common cost reduction in condominiums, but you end up losing consumers, that's not the strategy we have in this Company, that's not the long-term view we have in this Company, so we didn't think it was appropriate timing to raise rates of parking in our malls. So -- but that doesn't mean that we cannot have the decision, right?

So -- and the last point was regarding expansions. So I mentioned about that before in terms of appetite, we during these past two years, challenging years in the economic front, we launched, if I'm not mistaken, six expansions, and we successfully delivered them. But there was questions related to, who are interested to expand in Brazil in terms of tenants, if any special segment? And the answer we gave was that primarily was we seeing the largest groups in Brazil, the largest retail stores taking advantage of the weakness and expanding their size on exclusive locations making their (inaudible) spaces bigger, stronger. For that we also show many new names of international -- many names on international front taking advantage of this weakness to expand and to open new stores as I just mentioned, one in VillageMall, there were many in our malls. And last but not least, the shuffle in segments, just reallocation space for segments also allowed for many names to come. There are -- we also perceive as many new brands, many new operations (inaudible) and coming to the market. I think that was a shorter version of the questions we have in the Portuguese call. I want to thank you all for your attention, patience to listen to us and interest on Multiplan. So see you next year now with the fourth quarter in early 2018. So, thank you so much.

Operator

Thank you. This concludes today's Multiplan third quarter of 2017 earnings conference call. Have a nice day.