Q3 2019 Earnings Call

Company Participants

- Ruy Kameyama, Chief Executive Officer

Other Participants

- Luis Stacchini
- Marcelo Motta
- Nicole Inui
- Nikolaj Lippmann

Presentation

Operator

Ladies and gentlemen, thank you for waiting. Welcome to this Conference of BR Malls to discuss the Results -- Operating Results for the 3Q 2019. Today, Mr.Ruy Kameyama; Mr.Frederico Villa are present to present the results. All the participants will only listen to the call during the management presentation and we will immediately open for the Q&A session. (Operator Instructions)

Before proceeding, we would like to clarify that any statements that may be made during the conference call regarding to the company's business forecast, projections, and operating and financial goals constitute the beliefs and assumptions of BR Malls management as well as information currently available to the company, future considerations are not guarantees of performance. They involve risks, uncertainties and assumptions as they refer to future events. And therefore depend on circumstances that may or may not occur.

I will now like to give the floor to Mr.Ruy Kameyama. You may proceed, sir.

Ruy Kameyama {BIO 16672412 <GO>}

Good morning to all. Thank you for participating in our in Q3, 2019 earnings call. We will begin with a presentation of the period highlights and then open for Q&A.

Beginning on Slide 3. We would like to highlight the long-term portfolio strategy and the recovery of short-term financial and operating results in July. We acquired an additional 25.5% stake in Iguatemi Caxias through dominant mall -- the predominant mall in Serra Gaucha. And in early August, we announced the sale uptake in seven malls that were outside of priority asset strategy and distribution of our proceeds from sale via dividends and interest upon equity which amounted to BRL696.4 million, transactions representing according its optimal goal of helping. Such actions represent an important step in our goal of sculpting our portfolio, enabling better capital allocation and freeing up time and attention to improve core malls. The higher exposure to Tier 1& 2 assets which went from 81% of NOI in 2017, to 93% of NOI at the end of the quarter, was key to the improvement of operating indicators which achieved significant growth in the period with a 8.9% in sales per square meter, 21.7% in rent per square meter, 25% in NOI per square meter.

Moving on to Slide 4, we present other operating indicators, the company's total sales excluding sold malls grew 6.6% totaling BRL4.7 billion in the third quarter, reflecting both better performance of outlets that opened over the 12 months and better market conditions. The core portfolio made up of our 24 core assets alone increased sales by 8%.

Same store sales growth was 2.2%. We highlight the performance of anchors satellites, which grew 4.4% and 2.8% respectively, driven by the telephony services and food segments.

Looking at the indicator by geographic region, we observed once again the Midwest with the highest growth of 5.7%, followed by the Northern region with 4%.

Same store rent indicator maintained its recovery trend, and recorded growth of 7.6% in this quarter, a positive variation of 4.3 percentage points versus last year. We attribute the improvements with the apparel, telephony and food stores, mainly.

On Slide 5 illustrates the effects of better market conditions and the consolidation of the mix renewal efforts, which continue to produce good results. Occupancy rate considering the average of malls in our core portfolio, reached 97% mainly driven by higher GLA demand and the financial recovery of several tenants. This result reflects the highest increase of the indicator, since the second quarter of 2015.

This quarter, net delinquency was 0% the lowest level in the company's history. Gross in delinquency was 4.7%, a decrease of 1.7% compared to last year and the best level since the fourth quarter in 2014. In the quarter, the PBD expenses totaled BRL4 million, a reduction of 59.2% in the quarter comparable to pre-crisis level.

On Slide 6, we present the company's financial indicators of BR Malls, NOI in our portfolio reached BRL292 million in the third quarter 2019, up by 7.5% over last year and 11.7% excluding malls that were sold, especially rental, parking and mall media revenues, the media line grew by 61.4% versus last year, excluding the sold assets driven mainly by the digital media strategy and increased media campaigns. Our EBITDA, adjusted EBITDA reached BRL247 million in the quarter, up by 11% or 16.8% when excluded sold malls.

On Slide 7, represent the company's capital structure. The company ended the quarter with a cash position of approximately BRL947 million, lower than the second quarter and this year resulting from the acquisition of Shopping Del Rey and Iguatemi Caxias. The payment of the second of the three installments related to the acquisition of 30% of BR investment in the share buyback and the BRL2 billion net debt. Even despite the variations of the net debt, adjusted EBITDA ratio updated semester into 2.1 times, we have maintained a commitment to have a portrait balance sheet, maintaining our leverage level very well with balance prepared for any type of scenario and without and with fiscal efficiency as part of our efforts in liability management. In the quarter, we have refinanced CRI in BRL536 million were TR previous cost plus 9.31%, and 3.33% in the third quarter and might reach a TR plus 5.90% as the Selic rate has reduced.

Moreover, in October this year, we negotiated a different rate for another CRI of approximately BRL650 million. In the previous rate of the TR was plus 8.34% to 113.5% of CDI. Rate and extension of the debt to February 2025 to October 2026. After this change, we reduced the exposure to TR debt from 42.5% to approximately 20%.

On the next slide, we present the adjusted FFO, which registered a 50.4% growth totaling, BRL192 million in the third quarter 2019. On the right-hand chart, we demonstrated AFFO per share, main metric to create value in the long term for shareholders, the indicator grew by 51.9%, totaling BRL0.23 cents per share. When analyzed this indicator in the past month, the FFO per share totaled BRL0.82 above BRL0.68 in 2018 and higher level than what was registered in the previous years for the company. The key facts that contributed to this growth were improvement in operations with a 5.2% growth in net revenue and 11% adjusted EBITDA, the efforts of liability management, the share buyback program and higher tax efficiency.

On the last slide, we announced Taste Lab, we may collective in NorteShopping or food trial of pioneering positive Brazil has proven a success case in the state of Cuiab and therefore we decided to expand the project to other assets in our portfolio.

We looked at international trends and inspiration to provide our clients with the best place to eat and drink and the purpose of Taste Lab to provide culinary experiences and makes the astronomy, democratic, it should open in 2020 and will have operations in 1,700 square meters, the initiative illustrates our strategy to stand out and improvement for improving the new consumer experience, which we have focused on over the past two years.

With this, we will now close our presentation and we will be available to answer questions. Thank you.

Questions And Answers

Operator

(Question And Answer)

Thank you. We will now open for questions. (Operator Instructions) Our first question is from Mr.Nikolaj Lippmann for Morgan Stanley. Mr.Nikolaj you may proceed.

Q - Nikolaj Lippmann {BIO 16943405 <GO>}

Good morning to all. I have two questions. I would like to ask you to elaborate -- well, we're reaching a tipping point in terms of ROI growth. I would like to ask you to describe this type of growth. If you see this as stepwise move a one off in terms of growth? Or if, in your view, is the beginning of the growth cycle moving forward specifically, our portfolio?

The second part of the question had to do with sales. Sales were somewhat lower than expected. And therefore, I would like to get a better understanding of your prospects going forward for sales? And we have, if we have reached rock bottom in terms of sales growth and are also reaching the tipping point? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Good morning, Nikolaj. Good morning, and thank you for your question. Well, in answering your question about different points in trends going forward. Over the past year, the company focused its efforts to improve the quality of the logistic portfolio. And at the same time, increasing the quality of our assets and improving relationships with the tenant. We believe that we will gradually see effect, actually going forward taking shape and we will have a clear understanding and work as up with trends of ROI income going forward.

And for the breakdown of NOI, we had an important growth in minimum leasing or rent with 76% in the indicator including sales, media 27% rent, 14% parking, 10%, therefore and transfer rates also grew by over a 100%. Therefore, I would say the business did not concentrate on one single line. We had highlighted media, but the quality of the distribution of growth and other lines indicates consistency, which makes us feel reliability over the next semester. You're quite assured, we see the NOI will recover over the next year. So the trend reflecting the demand trends and the economic outlook.

And answering the second part of your question, the sales trends going forward, it is hard to predict for every quarter what will happen. But in terms of our investment decisions and capital allocation decisions, this is what we're looking at and we're not looking at long-term trends, we're considering that in the short-term. We expect for the quarter to have better results, October produced good results. We also have the FGTS effect, also leveraging consumption and retail.

And as for next year, we believe that we will have a low inflation rate, higher employment level, salaries also on the rise, lower interest rates and we do believe that these factors will leverage the economy consumption and retail. This will have an impact on B2C, if we think about sales. And also if we think about the demand in B2B for GLA, we also want to highlight that. Since, we also had changes in the logistic in portfolio, important changes, we should consider not only those store sales, but also the total gross volume.

And looking at the core portfolio from the 29 assets, we will have in the long run, we had an 8% growth, so the 2.2% for store sales, but we also have to look at the total sales volume because the new stores and new tenants are also performing very well and leveraging sales, driving sales output and bringing more competition to the retailers that were already set.

I don't know if cannibalization is the right term, but well, we should consider these factors internally CSFS, but also at the total sales volume very closely, because both combined will give us an indication of what is happening in our malls. So this is what we have for the long-term. But in terms of for the short-term for the long run, we do believe that the outlook is positive. It will depend on the economy, but it signals point to this direction as the economic recovery going forward. Thank you.

Q - Nikolaj Lippmann {BIO 16943405 <GO>}

Thank you and congratulations.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you, Joel.

Operator

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

Q - Nicole Inui {BIO 17757166 <GO>}

Good morning. Thank you for the call. I would like to ask some questions. I was quite impressed with the new media lines result and the media efforts. Could you elaborate on that what is driving growth? Is it actually the fact that you have more malls in your strategy, your media strategy? Or is it that companies are paying more for the media campaign? And could you also give us an overview of the future scenario in your malls and third party malls in terms of media strategy? And there's one more question about Cascavel, can you also say a few words about trade operation, commercialization in global? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hello, Nicole. Good morning, and thank you for your question. As far as media growth over this year, we have had a consistent line that has driven the company's growth. We have also focused on this opportunity, because it brings long-term growth opportunities. And I would also say the consumer experience is also positive directly, because we firmly believe that this is part of the digital transformation efforts to business. We followed this discussion earlier, but when we think about digital transformation, we of course have to hone the network effect of large scale in digital media, media efforts have over the past quarter focused well.

Some of the factors, there are three factors that have driven our media efforts. First, we have deployed our digital circuit in some of our malls in the third quarter this year. We ended up with 19 malls with digital circuits when compared to last year. The third quarter in 2018, there were only eight. So this was one factor, a key factor and we're also providing these services to third parties to other malls that complement the circuit. So it's a network effect model that is leveraged by this circuit digital model.

Thirdly, we have over the past years also recruited key team members in the media department. This has also driven our efforts, our digitalization efforts. Well, the demand is also growing and this is a good thermometer that indicates market trends. During the recession, the downturn will be the media income for advertisers were meant marketing expenses. So everyone was holding back. Media investment during the downturn and now since the economy is recovering, advertisers have more appetite and our portfolio is better prepared, our team is more specialized for this execution.

I would say these are the factors, it is hard to predict to forecast what will happen going forward, but we are prepared for this future scenario, focusing on these three drivers and strengthening our team, focusing on digital circuit and we will keep focusing those efforts and we believe that demand will continue to grow over the following quarters and advertisers will be back. And the long-term trend, I would also say, when we look at media efforts and traditional media channels open, TV channels and newspapers and magazines, out of home media and especially media when it's close to the purchasing decision, activations, media campaigns, closer to those carries really bring value.

And answering your second question about Cascavel, it's a project that is on the map. We do not have a specific date that we have defined to continue construction, but the area is a booming agribusiness area. So there's an interesting demand and we need to focus further on the commercialization of the satellite. We do not -- we have not set a specific date, but we're still focusing on commercialization at the right pace for us.

We're also looking at that closely, because we want to be certain that rental leasing, levels are appropriate and we have to get the right timing to capture value going forward and looking at all of these factors. This is the trajectory that we have planned and when we have more details as with the opening, we will share them with you. Thank you very much. Thank you, Nicole.

Operator

Our next question is from Luis Stacchini from Credit Suisse. Please proceed, Mr.Stacchini.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning, and we thank you for the presentation. I would like to ask the following question. One with regard to the EBITDA margin, probably well is quite lower striking to see the efficiency rate and maybe with a more homogeneous more portfolio and could you please tell us on Europe side and looking at productivity levels in media, what would -- should we expect in terms of EBITDA margin for stability in the brMalls portfolio? You have reached BRL80 billion, could there be something that's feasible?

Second, the question regarding to marginal capital allocation. The leveraging factor is going down and maybe besides the renewal pipeline for core malls, there isn't a major project that is taking up investments at the moment. I'd like to know what you have on the map? Maybe will you reduce leveraging further and the payout? Could we expect position allocations announcement in terms of GLA increases? And what are your priorities in terms of capital allocation? And the short run on the last 12, 15 months?You focus on distribution right? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hello, Luis. Good morning. Thank you for your question. For the EBITDA margin this quarter, we reached 75%. In the third quarter 2018, we had 71.6%, so reduced also to 72%. We had an improvement in the EBITDA margin. And in the past, our margin was looking at the company history was around 75%, maybe getting closer to 80% -- in 2013, 2014. And now during the recession, the downturn, it reached 65% in 2017 last year, reaching 62%. In the third quarter now 55%. Do you believe that the this level? Well, we can really gravitate around this level. This quarter, we also had zero delinquency, net delinquency which contributed greatly. It was a record in the company's history, which we recovered what had happened earlier. And in terms of position levels,it was very low. So we will have to look at trends on the next quarter. but overall, 75% is a reasonable number that we could use as a reference.

On capital allocation, the leveraging levels, well, gives some necessary flexibility and the tax efficiency that is needed going forward. We'll have to look at our pipeline, we have retrofit expansion for the next year's development and the other options stemming from acquisitions, maybe with higher stakes or further external acquisitions of other assets. And in terms of the leveraging level, we feel comfortable at this level and we have flexibility and we might consider further opportunities in the future and consider the payout levels of the company. Therefore, we don't have a specific particular guidance in this regard, but just to give you an idea of what we have in mind, we want to have a solid balance, core balance sheet to have the flexibility and be prepared for further opportunities that we might arise and to have the tax efficiency on the other side. Investment pipeline, well, we expect to have cash generation and then determine the appropriate level for capital distribution or dividend payout to our shareholders. This is the rationale.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you. May be well below two, do you think you will have the buffer, you need to increase the payout? Would you say that?

A - Ruy Kameyama {BIO 16672412 <GO>}

Well below two times, we might not reach the tax efficiency that we expect. So we will have to consider the efficiency for the quarter.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you. Thank you very much.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you, Luis. Good day.

Operator

Our next question Mr.Marcelo Motta from JP Morgan. Please proceed, Mr.Motta.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning to brief question. Just a quick question. Can you give us an update on the partnership with Mercado Livre, how it is evolving? It's been over a quarter slightly over a quarter, just give us an idea of the returns? Maybe, but it you're going to expand to other regions below but inclusive[ph] If you could also talk about the orders expansion of the project and these initiatives, how they have driven sales and your forecast for the next quarter? Thank you.

A - Ruy Kameyama {BIO 16672412 <GO>}

Hello, Motta. Good morning. Thank you for your question. And as far as Mercado Livre goes, it is an important pilot for us and we -- there are many takeaways for us,t he things that we've been learning. And of course, we want to represents and replicate them and other parts of the as portfolio, not only with Mercado Livre, but other marketplaces. So what we have learned so far the key takeaways are that, there is an existing demand. The value proposition is very interesting both for users of Mercado Livre, the e-commerce users as for our tenants, our retailers and for us as well.

So I would say that, if we consider the end user, we need to consider if there's a value or not. According to feedback and ratings, the perceived value is very high on users and we are looking closely at this opportunity considering long-term plans. As for segments, some segments have significantly superior performance than others, maybe caused by consumer habits, which actually shop and search in online segment supplements, vitamins were positive. Supplies and others are more challenging, lingerie for example, underwear. Well, users do not normally shop online, maybe because of the briefing or the particularity of the product. So it is more challenging to predict how online sales will happen there. What we have perceived is that when we are to prioritize our efforts and decide which will be the key segments that we will focus on in terms of information and advertising, there's an ABC curve, a learning curve that is very important for us now.

And the third factor I would consider, that is also aligned to the center priority. We have to look at the inventory levels and this is key for us to have a higher activity, greater activity with marketplaces also Mercado Livre, including Mercado Livre, not only Mercado Livre. Looking at the availability of regional inventories, maybe in the future. We'll consider pay back delivery dated seven days or more. When we consider that, we need to look at the inventory levels that are available and should be available for Cuiab. In marketplaces will look at this information to have more efficiency and faster delivery and we are actually making efforts. And there have been announcements to the market of this partnership. In the third quarter was linked with links and the health center are now working together to roll out and have a rollout of the inventory center is also already being used for other retailers that are tenants at the mall. This will bring us scale and to them as well to accelerate the process. So this is this is another key takeaway, we have to join that for the living center of project that continues to be very important for food. It is ever more consolidated, both for retailers and consumers. And should be -- we should probably see further integration with marketplace to drive the demand there and focus more on inventory levels, inventory management and I mentioned the partnership was playing now. So we are moving forward in this regard. We want to become more effective and operate in other sectors to go beyond.

Food is a priority for 2020. These are important opportunities and avenues for growth. So this is the current status as far as deliver and center. And we are also in the seats now and they're very important, we are not concerned with the short term impact now.

We consider that we are creating a new avenue for growth, the infrastructure that will be key for marketplaces, for retailers and consumers. So the data infrastructure and the last mile logistics infrastructure. And this new avenue of course, there are not many vehicles there. For now, the demand is still low. The inventory levels are still low. However, we are considering the highway it might become in five years' time when the demand grows and the capacity grows, more retailers are connected and more marketplaces will be connected are well right now is to create this highway, this roadway for growth to later drive the demand.

And we believe yes, this project, all in all, will grow strongly. We're not focusing on sales impact at the moment, we are focusing more importantly on having the right infrastructure in place to be operational to create the ecosystem, to later be able to connect the marketplaces. We want to reduce friction we wanted to be-fraction-less for retailers and to build the last mile efficiently for consumers to be satisfied and delighted. And once we have all of these things in place, it will be just a matter of time for things to happen. So it's long-term project, long-term efforts and you mentioned something that is key is yes, there are the learning curve. There are many takeaways and we are looking at the long-term here.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you. Perfect. Perfect, thank you.

Operator

(Operator Instructions) Since there are no further questions, we would like to give the floor back to the speakers for final consideration.

A - Ruy Kameyama {BIO 16672412 <GO>}

Thank you to all for participating in the earnings call. The full team will be available for further questions you might have. Good day to all.

Operator

Thank you, all for participating. And we wish you a good day.