Q3 2015 Earnings Call

Company Participants

- Armando d'Almeida Neto, CFO & IRO
- Jose Isaac Peres, Chief Executive Officer

Other Participants

- Dan McGoey, Analyst

Presentation

Operator

Good morning. Welcome everyone to Multiplan Third Quarter 2015 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 Manager; and Mr. Franco Carrion, IR Manager.

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

Jose Isaac Peres {BIO 15388489 <GO>}

Good morning. Once again, I thank you for listening to our earnings conference call. As usual, we see our country (inaudible) of crisis and prosperity over the years. Now, we are experiencing another phase of economic adjustment, reflected on Brazil's productive activity. And at this moment, a large company shows its strength, its capacity of resilience and ability to cope with adversity. We look at Multiplan's main figures this last quarter and we see that our strategy in the recent years has given good results, with real increase in rent and an occupancy rate that remains stable at 98.1%.

Throughout our history, considering our strong track record in Brazil and some successful experiences abroad, we never failed to look at the crisis as an opportunity. During my life, I've sailed on troubled waters, I faced large storms with inflation of 800% per year, the confiscation of saving accounts, currency changes and other challenges that I will not go into details right now. But unlike previous crisis, today's Brazil is account for that while facing serious issues as the consumer market is much more vigorous than in the past. In the beginning, our malls were in the outskirts of dense areas.

We've moved to major centers and we're born facing great adversity with very limited population around them, much different of what we have now. Also, today we have a much more diverse mix of stores of vibrant services segment, which in this quarter grew sales by 6.3% in the same stores. Major retailers have passed through our portfolio and today no longer exist such as the (inaudible), and many others. They were replaced by new and talented retailers. Our malls are more complete and diversified. There is a high concentration of leisure activities, several new restaurants and fast foods with strong growth in services and new coming international retailers in almost every mall.

As the old saying goes, bread and circuses will never end, and that's why we suffer less as we provide to the public not only shopping and services, but also leisure and high quality entertainment. We have a dominant presence in the main capitals of the country, as examples, Sao Paulo, Rio and Belo Horizonte. We are expanding in the south where we have large projects. All this shows that despite the real and disseminated crisis, we at Multiplan are not in a crisis.

It's easier to understand looking at the following indicators: our net debt corresponds to 23.6% of the company's market value. If we take the fair value, the net debt represents only 12%. Sales in Multiplan's malls in the first nine months of this year reached BRL9.1 billion, corresponding to an increase of 4.7%. The same-store rent grew in the third quarter of 2015 and despite inflation, the occupancy cost remained stable at 13%. Same Area Sales in the first nine months expanded 3.4% and the increase in rental revenue was 8.3%. These results come from the company's additional efforts with investment in promotions and events to stimulate the traffic and therefore increased sales.

This Christmas, we will have one of the most aggressive campaigns by distributing hundreds of cars [ph] in our malls. Therefore, we expect sales in the fourth quarter to be higher than in 2014. It is worth noting that in our segment, the retail inflation is estimated at around 6% per annum. What is happening in Brazil today is what is known as creative destruction. New companies are bought [ph] and replace those that have failed to overcome difficult situations. This results in regeneration and certainly increased efficiency. They are the ones that produce more and better with less.

Alongside these remarks, our company has ongoing an approved shopping center project with an area of 156,000 square meters of GLA, planned expansion of existing shopping centers with over 162,000 square meters, indicating a growth potential of a total of 318,000 square meters of GLA without the need for investment in new land.

We are building ParkShopping Canoas in Rio Grande do Sul using our own team, that indicate a possibility of completing the work while saving 20% of the cost. We are ready to launch ParkShopping Jacarepagua with 42,000 square meters. And the approval of ParkShopping Global in Sao Paulo with 65,000 square meters is ongoing.

In addition, our malls have expansion plans that could result in a growth of 162,000 square meters in the coming years. Considering other types of real estate around our malls, the company has 23 projects, which lands are fully paid will building potential of 947,000 square meters of area, which trigger the development of a potential sales value of about BRL8.5 billion. By the way, the company stands firm in its policy of only developing real estate projects when markets are favorable, with gross margins of at least 30% compared to PSV. These projects could be launched over to next eight years. No less significant is the expansion project at Village Mall in Barra da Tijuca, Rio de Janeiro, which will receive a new corporate center with mall expansion of 14,000 square meters of area and office space of about 36,000 square meters. This project already approved is being modified to meet the reality of the current market.

Before I conclude, I want to reaffirm our belief in today's Brazil. It is not the same country as 30 years ago and now has an economic potential and a significant consumer market and also is among the 10 largest economies in the world. We believe that the fiscal adjustment at this time is necessary to recover the credibility of the national and international players in the Brazilian economy. Lastly, I wanted to say to you that quoting a Portuguese poet, Fernando Pessoa: To sail is necessary; to live is not necessary. We continue sailing despite the turbulent waters.

I close here thanking the interest of our shareholders and investor in the company. I also want to thank our officers and employees at Multiplan for your dedication. And finally, I also thank the analysts and the journalists for your interest in Multiplan. Now, I'll turn the call over to Armando that he will bring more details about the results. Thank you very much.

Armando d'Almeida Neto

Thank you Franco, thank you Mr. Peres and good morning everyone. This was another quarter of significant challenges with the consumer environment too much impacted by the political and economic news, and that influenced the company's operating result. While the Consumer Confidence Index hit a record low, sales in our shopping centers grew by 2.5%. Despite being below the average of recent years, we believe that to report sales growth in a challenging environment like the one we are going through, is already a victory.

In the nine months of 2015, sales were up 4.7%, representing an increase of 80.6% in a five-year time. Sales of satellite stores reached BRL26,144 per square meter in the past 12 months, reflecting the high productivity of the shopping centers we manage. If we translate that dollar per square foot, it would be equivalent of $611 per square foot in the exchange rate of September 30 of BRL3.97 per dollar. So, even after this strong currency loss we had in Brazil, we see that the metrics of $611 per square foot of sales is very strong when compared with other countries.

Same Area Sales grew 2.7% while Same Store Sales only 0.6%. If in one hand, the continuous effort to pursue the best stores and operations to the malls is reflected possibly on the difference between things of the same area and the same store. On the other hand, the necessary time in-between operations is the change in operation leaves a temporary vacuum of sales and also sometimes rents, which is reflected in our results.

This quarter, for example, we have around 1.7% of the total GLA or close to 12,500 square meters already leased, but were not yet in operation. The 98.1% occupancy rate, a vacancy of 1.9% only, which is likely lower than the second quarter of 98.4%, while the occupancy cost benefiting from the reduction of common expenses was slightly lower than last year; today 13% compared to 13.1% in the third quarter 2014.

While rent delinquency increased from 1.7% to 2.4%, losses were reduced by half from 0.8% to 0.4%. Gross revenue decreased 5.1% in this quarter due to the strategy of not launching this year new real estate for sales projects, resulting in an 85.4% decrease in the real estate revenue and compensated by rental revenue increase of 8.3%. If excluding real estate for sales activity, gross revenue grew 3.7% this quarter.

Speaking of the 8.3% rental revenue increase, the three components presented growth: base rent, percentage rent and merchandising. On top of the strong shopping center contribution to the increase in rental revenue, Morumbi Corporate contributed with BRL17.2 million in this quarter compared to BRL11.1 million last year. The occupancy rate is at 90%, 10% remaining, facilitating a potential revenue growth, a positive revenue growth. Same-store rent increased 6.8%, representing a real increase of 2.4%. In nine-month period, same-store rent increase is at 8% with real growth of 3.3%, not bad for a year with such challenges.

In relation to expenses, the shopping center expenses increased only 5.5% primarily due to the slightly lower occupancy rate, while expenses with offices for lease fell 66.4% due to the opposite effect, the increase in occupancy rate. The G&A expenses went up by 10.5% as a result in this quarter of wage adjustment and non-recurring labor expenses. Year-to-date shopping center expenses and office towers fell 5% and 17.2%, respectively, and G&A rose 6.5%, running below inflation.

Now, talking about results. The NOI + Key Money increased by 5% in the quarter and 14% in the last 12 months, with a margin of 88.4% in the quarter and 89% in 12 months, better by 87 and 318 [ph] basis points, respectively. If we look the last 12 months NOI + Key Money per share, as you can see on page 11 of the picture on the right, on the top right, we see a compounded annual growth rate of 14.1% reaching the mark of BRL5.00 per share.

As a result of lower real estate for sale contribution, EBIDTA fell 2.2% in the quarter, but with an increase in margin of 238 basis points to 69.4%. In 12 months, we had an increase of 10.9%, despite non-recurring revenues in 2014 of BRL21.4 million that happened in my report in the first and second quarters last year. The margin was 70.9% [ph], 220 basis points higher. The property EBITDA, i.e., excluding the real estate for sale, rose 2.2% in the quarter and 12.2% in the last 12 months, with a margin of 75.4%, better by 220 basis points. FFO fell 12.7% mainly for the same reason, the reduction in real estate for sale revenue and also the increase in interest rates. In the last 12 months, FFO grew 8.4%. The same applies to net income, lower by 14.1% in the quarter, but growing 15.8% in the last 12 months.

In regards to the indebtedness, we see no significant changes. Net debt represented 2.44 times EBITDA at the end of June this year and now stands at 2.42 times, practically unchanged. The weighted average cost of gross debt was at 12.81% per annum or in order words 144 points lower than the base rate, the Selic Rate in Brazil, which was at 14.25% per annum. We invested this year until September BRL227.1 million, of which approximate BRL170 million of this amount was for new malls and mall expansions, especially the development of ParkShopping Canoas and land purchase.

During the third quarter, we opened two mall expansions in ParkShopping Barigui in Curitiba and Patio Savassi in Belo Horizonte, both to accommodate the first Forever 21 store in these cities. Also, we are preparing to deliver the expansions of the medical center in Barra Shopping, here in Rio, that is already 97% leased.

In short, even though it was a challenging quarter, we continued presenting operational resiliency, growth and efficiency increase that were reflected in better margins. Even though we are confident that our profit portfolio is already well prepared to face the quarters to come, we are constantly looking for ways to further improve our tenant mix and to provide a better shopping experience to our consumers.

I will stop here, so we can start the Q&A session, but before I want to thank you all for your confidence and interest in Multiplan. I will turn back to the operator to check if we have questions today. Thank you very much.

Questions And Answers

Operator

Thank you. The call is now open for questions. (Operator Instructions) Our first question comes from Dan McGoey, Citibank.

Q - Dan McGoey {BIO 1539496 <GO>}

Hi gentlemen. Good afternoon and thanks for the call. Couple of questions, just on the increase in rent, the rent increases were considerably ahead of the sales pace and you mentioned that this was due to controlling the common charge cost. I'm wondering if you could elaborate a little specifically on some of the things you're doing to help reduce common charges to enable those rent increases? And how much additional room you think you have?

A - Armando d'Almeida Neto

Yes. Thank you for your question. First, I want to just better explain our views. We don't think that rent increase is direct consequence of common charges reduction. We think that there are contractual rent increases, there are rent increases that are due to overage with the percentage rent. But we are very focused on providing our tenants in the difficult moments of the Brazilian economy is going through right now, with a situation in which we can have good results in our portfolio. So, a way to do it -- one of the ways to do it is making an effort to reduce the common expenses and that's a plan that we implemented by the end of 2014 and created the effect in 2015.

So, when you put together the rent increase, again, contractual, overage and other things, the new rents that are higher, the business spread for the new rents, so what you get, you get a total occupancy cost that this year so far has been at or below last year. So, we think this is the contribution to the tenant health in our portfolio. But we don't think that it is just an exchange rate. So, you reduce common expenses and you can charge more. It's not a direct and immediate consequence of that.

Also we already are working on when if necessary, what else can we reduce in terms of common expenses. So, how can we reduce further the common expenses, but we are not considering the strategy of having a shopping center experience for our consumers. We don't want to provide a lower quality service in order to achieve a lower common cause. What we've been doing is working on the main components of the common expenses and one of them energy, trying and bringing expertise to have -- buying energy with better prices and cheaper agreements, so that we can provide tenants, just an example of the energy only, but provide tenants with a lower impact or a reduction most of the cases in their common expenses.

We see room further to reduce, but again we don't want to commit or change the quality of we provide to consumers in the malls today. I hope I answered your question.

Q - Dan McGoey {BIO 1539496 <GO>}

You did. Thank you. And a second one, if I may. If you look through the sales by shopping mall, they're providing unusual really some of the weaker or some of the lower sales growth figures were in some of the flagship malls like Village Mall or Barra Shopping Mall or Morumbi. And I'm wondering, I know Village Mall is a somewhat of a specific example, but even in others Barra and Morumbi, I'm wondering if those low-single digit growth figures are reflective of the actual consumer slowdown or if you would attribute it more to higher incidence of tenant turnover that I think you mentioned in the call?

A - Armando d'Almeida Neto

No. Again, thanks for the question. Different answers, similar somehow but different answers. Village Mall; Village Mall last year presented a sales increase in the third quarter of 66%. So, it's not easy to roll on top of a 66% increase in the past year. We're also taking advantage of this weaker scenario, economic scenario to change the mix. So, if you walk down the aisle in Village Mall, you're going to see many stores that are not ready yet, but they already have the name. One example, we're pleased to have a (inaudible) for Dolce & Gabbana. It's not ready. We've placed many stores, they are being ready to open before the Christmas, but I did not have them before. So, these create a temporary gap in terms of sales and the base comparison doesn't help.

Morumbi; different aspect, not much on the mix change now, but especially on the base comparison from last year. If you recall early last year, we opened many new operations in the mall that created a strong sales increased in Morumbi shopping. For this year, it's growing on top of a very high base. That's the reason why there's not strong sales growth. Did you mean the figure here, it was at 15% sales increase in the third quarter last year for Morumbi.

And BarraShopping basically, it's the opening of our expansion, so there are different reasons, (inaudible) expansion that happened in the last phase of second quarter last year, that created a temporary, I would say dilution, in terms of sales, the change in mix that is being happening on this particular expansion, that is normal as you know. So that's the three different reasons.

Then, we have a mall like New York City Center, as you know it is side-by-side malls, but New York is going down 7.4 because of a change in mix and a good change in mix because we took out a large store and we are replacing for a smaller operation in a different segment. One was a (inaudible) and the other one (inaudible), but that means increasing a lot, but there is no way. And you've to break the egg to do the omelet, to prepare the omelet.

So, in many of the malls that we are changing the mix for Barra at BarraShopping through the same store, recreating a large tenant for two major operation, mega stores but with much better quality of what we need through the mall in terms of rack improvement, but it is not in operation yet, we have to tear in their spaces. So, that's the reason why.

Q - Dan McGoey {BIO 1539496 <GO>}

Understood. Thanks for the answer.

A - Armando d'Almeida Neto

Thank you.

Operator

(Operator Instructions) Now, I'll turn over to Mr. Armando d'Almeida Neto for final considerations. Mr. Armando, you may proceed.

A - Armando d'Almeida Neto

Well, like we did in this past few times, just to share, we have a very rich questions calling (inaudible) so we have to leave it because of the time. There were too many questions, but just one of the questions and that's coming three times based on Mr. Peres' speech of enhancing the market campaign for year-end. So, just before talking about that, there's an explanation. A frequently asked question during this year was rent breaks and discounts. Rent breaks and discount is not our destination, it's just a bridge.

So, answering very openly that, what we want is to help our tenants, that's the beauty of the mall manager as well, not just mall owners, to help our tenants to outperform in our portfolio. And if you provide them rent breaks, you are not helping, you are helping again on the short run, but you are not helping to tap the most important point, that is to outperforming sales.

So, what we've been doing then and back to the comment was to prepare a very strong marketing campaign through the shopping centers and we expect that the impact should accompany, will be various malls or even zero, these are new, because we're doing that based on the marketing funds that we have already budget to the tenants, but don't expect that, oh, this will increase the occupancy cost. No, it was what was budget from the end of last year through 2015 and also the use of merchandising in the mall. And with that we believe we can prepare very aggressive strong market campaign that will help tenants to outperform, that's the idea. And a few questions came, just to understand better what the market campaign was based on and also the impact to the company cost side.

And as I mentioned that we expect to have no cost to the company now. I'll stop here. So, I want to thank you all for your patience. We remain available on our IR team for any questions that might arise at any time. And thank you very much for your continued interest in the company all the time. Thank you and have a good day.

Operator

And this concludes today's Mulitplan third quarter 2015 earnings conference call. You may disconnect your lines at this time. Thank you