RPT

RPT REALTY
Q1 2019 Earnings Call Transcript

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PRESENTATION

VINCENT H. CHAO
Vice President of Finance

Good morning and thank you for joining us for RPT's first quarter 2019 earnings conference call. At this time, management would like me to inform you that certain statements made during this conference call, which are not historical, may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Additionally, statements made during the call are made as of the date of this call. Listeners to any replay should understand that the passage of time by itself will diminish the quality of the statements made. Although we believe that the expectations reflected in any forward-looking statements are based on reasonable assumptions, factors and risks that could cause actual results to differ from expectations are detailed in the first quarter press release.

I would now like to turn the call over to President and CEO, Brian Harper and CFO, Mike Fitzmaurice for their opening remarks, after which we'll open the call for questions.

BRIAN L. HARPER
President, CEO & Trustee

Good morning and thank you for joining RPT's first quarter 2019 earnings conference call. This morning, I would like to provide highlights from our quarterly results, provide a brief update on our strategic initiatives, and lastly, discuss recent Board changes. After that I will turn the call over to our CFO, Mike Fitzmaurice who will provide more details regarding our first quarter operating and financial performance and our expectations for 2019.

Overall, I am quite pleased with this quarter's performance. We believe these strong results are an early reflection of the changes to our portfolio, people, processes, and focus that have been instituted at RPT over the past few quarters. We also believe our size is an advantage in today's market that is allowing us to adapt quickly to the evolving landscape and to show progress in our performance quickly. With that said, our new leasing team is firing on all cylinders and produced another strong quarter of results, signing 60 leases, covering 483,000 square feet in a seasonally slow quarter. This level of activity drove our leased rate up 120 basis points year-over-year to 94.8% and our small shop leased rate up almost 300 basis points to 89.6% keeping us well on track to achieve our 91-92% small shop occupancy goal over the next 2 years. We also achieved a blended rent spread of 16.7%, a post-recession quarterly high. In fact, for our negotiated new and renewal leases, we achieved a blended releasing spread of 25%, another indicator of our ability to drive rent. Our record first quarter re-leasing spreads are indicative of the improved quality of our assets, as nearly 100% of our rents are now derived from the top 40 MSAs following the completion of our strategic disposition program.

Same property NOI exceeded our expectations for the quarter coming in at 4.6%, which benefited from earlier than expected rent commencements and unexpected bankruptcy recoveries largely tied to Mattress Firm that Mike will discuss in more detail. Importantly, same property NOI growth excluding these recoveries was still ahead of our forecasts, fueled by base rent growth of 4.2%.

Our strong leasing activity in the quarter drove a 40 basis point increase in our leased versus occupied spread that ended the quarter at 3% representing approximately $5.8 million of ABR, of which $5.5 million is expected to commence as we move through 2019. This activity puts us on solid footing to achieve our operational goals for the remainder of 2019 and positions us for an expected return to earnings growth in 2020. Represented in this signed activity is the progress that we continue to make on our targeted remerchandising efforts. As we discussed last quarter, we identified 20 spaces, 75% of these were already vacant. At end of the quarter, 16 of these 20 identified spaces have already signed leases. Beyond these opportunities, our leasing pipeline remains robust as we continue to actively mine the portfolio for additional earnings and NAV accretive opportunities to drive rent and occupancy, as well as proactively upgrade our tenant roster.

Turning to dispositions, during the quarter and as previously disclosed, we completed the sale of East Town Plaza and The Shoppes at Fox River for gross proceeds of $69 million. With the first quarter sales, our strategic disposition plan that we laid out on our third quarter 2018 earnings call, is now complete. As we discussed these sales in-depth last quarter, I won't go into further detail, but would simply reiterate that we are extremely pleased with both the timing and results of our disposition program, which has improved our internal growth profile, reduced operational and tenant risk, and, importantly, provided us with ample liquidity to fund our business plans over the next few years.

As we move beyond the needs-based disposition phase of our plan, we are increasingly looking for value-creation opportunities via opportunistic acquisitions in target markets like Nashville, Minneapolis, Raleigh, and Miami. Given our cost of capital, any potential future acquisitions will be match-funded with a like amount of dispositions. Our rigorous investment framework is focused on enhancing our long-term growth profile, improving our portfolio quality, and, at a minimum, maintaining our near-term earnings trajectory on a leverage neutral basis, while furthering our strategic objectives.

Now I would like to briefly touch on our redevelopment program, where we continue to make good progress on the entitlement front, while pursuing parallel paths to value creation through ground leases with residential developers, partnerships, parcel sales and more. As we evaluate our options, we will always seek to maximize shareholder value by solving for the highest RISK-ADJUSTED return solution. That said, we remain energized by the potential in the portfolio and the demand we are seeing for our projects from both retailers and potential investment partners. As the year progresses, we look forward to sharing additional details on a few of our larger densification projects, such as Rivertowne Square in Miami, Webster Place in Lincoln Park Chicago, Shops at Lane Avenue in Columbus, Ohio, as well as others.

Before I end my prepared remarks, I wanted to comment on the recent changes to our Board of Trustees. At our recent annual meeting, our shareholders elected another outstanding Trustee, Joanna Lau, who brings a wealth of knowledge from the technology and retail industries. With Joanna's election, we have now added three new Trustees over the last eight months that bring a fresh perspective and a diversified mix of experience to complement our existing team, creating what I believe is a best-in-class Board that will provide governance and guidance to RPT as we enter the next phase of the company's evolution. Joanna's addition also brings our Board into gender balance, while reducing the average tenure to 6 years from over 18 years at the end of the second quarter of 2018. This is a significant achievement and I applaud the other Trustee's for their contributions towards these efforts.

With that I will turn the call over to our CFO, Mike Fitzmaurice.

MICHAEL P. FITZMAURICE
Executive Vice President, CFO & Secretary

Thanks Brian and good morning.

Today, I will discuss our balance sheet and quarterly results, provide some commentary on the lease accounting change, and end with a discussion of our updated outlook for the balance of the year.

Starting with our balance sheet, our liquidity position remains a source of strength with $85 million in cash and full availability on our $350 million credit facility and no debt maturities in 2019, providing us with flexibility as we turn the page on dilutive asset sales and focus on earnings growth. We ended the quarter with net debt to annualized proforma adjusted EBITDA at 6.6x, which was in line with our expectations. As I noted last quarter, we expect our leverage to remain near the mid-6's over the next few years, before falling towards our longer-term goal of roughly 6x. As Brian noted, we completed our strategic asset disposition program this quarter and, subsequent to quarter end, we utilized a portion of the sales proceeds to repay our $29 million, 6.1%, junior subordinated note bringing our floating rate exposure to ZERO. Looking forward, we are already exploring options to refinance our term loans and recast our revolving line of credit well ahead of their scheduled maturities in 2020, 2021, and 2023, as we look to lock in the continued low rate environment and to minimize interest expense uncertainty during a time when we expect an acceleration of our operating performance.

Turning to results, Operating FFO for the first quarter was $0.27 per share, down five cents from $0.32 per share in the same period in 2018. The change in operating FFO per share was primarily driven by 2018 and 2019 disposition activity, partially offset by increases in same property NOI. Exclusions from operating FFO this quarter were modest at about $154,000 mainly related to a beneficial mark-to-market of a performance award associated with the Company's former CEO.

Same property NOI growth was an above-plan 4.6% for the first quarter, driven by a 4.2% increase in minimum rent and unexpected bankruptcy recoveries of $420,000 or a 110 basis point benefit to same property NOI growth. Excluding the bankruptcy recovery income, same property NOI growth of 3.4% was slightly ahead of our internal projections, driven by earlier-than-expected lease commencements and lower-than-expected bad debt.

Before discussing our updated outlook, I wanted to point out that effective this quarter, we adopted the new leasing standard. As we previously discussed, the most significant change is the expensing of certain leasing costs, which resulted in approximately $700,000 of non-recoverable expense during the quarter that was capitalized last year. Regarding financial presentation changes, we provided details on geography changes to our income statement and balance sheet in the press release that I won't rehash, but I wanted to make note that we will continue to maintain the same level of transparency into our business and have modified our disclosure to continue to show the breakout of minimum rents, percentage rents, recovery income and other property income. In addition, we will show the breakout of the provision for credit losses, which historically has been shown as bad debt expense and now will be categorized as a contra-revenue item to minimum rent. This updated disclosure is on page nine of our quarterly supplemental. Finally, there are new rules for determining and presenting what used to be called bad debt expense and the allowance for doubtful accounts. For RPT, this resulted in the recognition of an immaterial amount to retained earnings upon adoption of the new standard which had zero impact on our income statement.

Turning to guidance. As noted in our press release, we are increasing our 2019 guidance and now expect 2019 operating FFO per share of $1.04 to $1.07, up from $1.03 to $1.07. Regarding our same property NOI growth outlook, we are increasing the range to 2.25% to 3.25% up from the 2.00% to 3.00% range. These positive changes are a direct result of tenants opening sooner than expected, a more favorable renewal retention rate, and the outperformance in the first quarter. As a reminder, starting in 2019, our same property NOI growth assumption now excludes the impact of major redevelopments, which we believe provides a better view of the underlying performance of our core portfolio. Also, though we are pleased that our portfolio has remained relatively insulated from recent store closure announcements, with limited exposure to struggling tenants and categories, our same property NOI growth assumption continues to embed 60 basis points or about $220 thousand of bad debt per quarter over the balance of 2019 to account for unplanned closures.

While we do not provide quarterly guidance, we think it's important for investors to understand the trajectory of our same property NOI growth and OFFO per share over the course of the year. With this in mind, we expect second quarter same property NOI growth and OFFO per share to decelerate due to a tougher year-over-year comp and the unexpected bankruptcy income in the first quarter that we do not expect to recur and given the full quarter impact of first quarter dispositions on OFFO. Importantly, the deceleration expected in the second quarter is NOT driven by a change in operating momentum and we expect reacceleration of same property NOI growth and OFFO per share in the second half of the year.

In closing, with over 85% of our 2019 leasing plan already complete, our rising backlog of signed but not commenced leases at the end of the first quarter that totaled $5.8 million of annualized rent, or seven cents per share, and an entirely fixed rate debt stack, we have great confidence and great visibility in our outlook for the remainder of 2019 and the trajectory of growth heading into 2020.

With that, operator, please open the line for questions.

QUESTION & ANSWER

OPERATOR

[Operator Instructions] Our first question here is from Derek Johnston, Deutsche Bank. Please go ahead.

DEREK JOHNSTON
Deutsche Bank AG, Research Division

Good morning everyone. Could you give us an update on tenant or retailer sentiment and that's in terms of leasing or demand, especially given your strong spreads? And how has it changed over the last couple of quarters or even past few months?

BRIAN L. HARPER
President, CEO & Trustee

Hi Derek and good morning. We're really seeing demand across the board. And it really comes down to a few things. I do think the remained co., if you will, after the dispositions and top 40 MSAs is a big deal. And Tim and I are at retailers' offices all the time as with our retail team and there is a flight to quality and there is a flight to these larger markets. So, not having that tertiary exposure is a big -- I think you see a lot in the results. Two, there's obviously the haves and have nots. The discounters are doing very well, we're doing a lot of deals with them. Grocery, we're seeing a resurgence of expansion with them, especially when you see Amazon. And then the fitness and the three F’s as I like to say, the fitness and the fabulous which you say is cosmetics with Sephora and we're doing a lot with Athleta. It's really broad based and I couldn't be prouder of the leasing team. They're clicking on all cylinders. The leasing team is pretty much entirely new and that is a lot of what you've seen in the results.

DEREK JOHNSTON
Deutsche Bank AG, Research Division

Okay. Okay, great. And guys, I've gotten a few questions about the dividend and payout ratios. Could you please just address the sustainability of the dividend and how you guys think about it?

BRIAN L. HARPER
President, CEO & Trustee

Sure. Thank you for the question. And obviously we have a new board that I'm very proud of and as I said in my prepared remarks, I do believe this is a best-in-class board and I'm proud of the fact that this is now gender equal. Regarding the dividend, we believe in this plan. We have tremendous visibility and that's evidenced really by the past few quarters, especially this quarter but past two quarters 4% NOI growth. We do, and that's speaking on behalf of the board, myself and management see a clear path to improved dividend coverage.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes, and Derek this is Mike. The only thing I would add there in terms of AFFO payout ratio, as we've discussed on previous calls, it will be heightened in 2019 and then begins to slow into '20 and then be right-sized in '21 based on the plan in front of us, given the small shop occupancy upside that we have that we continue to deliver on. We delivered on quite a bit in this first quarter. And then the re-box -- de-boxing initiative that we have. We have identified 20 boxes last quarter. We already have 16 signed activity on those boxes. So great visibility in front of us and we should see that AFFO payout ratio come down over time.

DEREK JOHNSTON
Deutsche Bank AG, Research Division

Good stuff. Thank you.

BRIAN L. HARPER
President, CEO & Trustee

Thanks, Derek.

OPERATOR

Our next question is from Collin Mings, Raymond James. Please go ahead.

COLLIN MINGS
Raymond James Ltd., Research Division

Thanks and good morning. First question from me. Can you just maybe expand on the leasing momentum, particularly on the small shop front? Again, you just noted there have been meaningful changes for the team but have there been any other adjustments in terms of incentive structure, the tenants you're targeting or any other drivers of some of the momentum on that front?

BRIAN L. HARPER
President, CEO & Trustee

Collin, good morning. We've been on the road. And again I really come back to three things. I come back to people, and that's the people we have with the leasing. I come back to properties and the top 40 MSAs. We're going to see a flight and we've seen that in past sectors. Retailers are very much focused on these top 50 MSAs. You have more demand. And then that comes down to the processes of what we've installed from the get-go. And that's from executive lease committees, where I'm personally approving every new and renewal deal to help drive rents and keep consistency between the retailers, but also the legal tracking and the pipeline calls space by space. So from a -- it's very broad-based. As you've seen, we're doing a lot of business with Athleta. We're doing a lot of business with the Ultas of the world and Sephoras of the world. We are doing a lot of business with T.Js. They're very high-quality tenants where we're replacing a lot of low-performing or at risk credit tenants in a very proactive way where now we only have two Pier 1s left. This is a proactive measure from day one. We signed this past quarter an Ulta deal at Tel-Twelve that replaced a Pier 1 proactively. Last quarter we signed CycleBar and Athleta to replace Pier 1. These are tenants that would be three-to-four times the volume and also have a magnificent spread. So this is really broad based and I am very -- very pleased obviously with our leasing results and very pleased with the pipeline for future quarters.

COLLIN MINGS
Raymond James Ltd., Research Division

Okay, all right. So again, it sounds like the personnel component here is the driver, but there is a number of other things that you guys have implemented that have really helped drive some of this leasing momentum.

BRIAN L. HARPER
President, CEO & Trustee

Yes, it’s personnel and its business plan -- each property has its business plan and the team has marching orders for every space. We are here to maximize shareholder value. And as I said, this is a leasing, leasing, leasing company.

COLLIN MINGS
Raymond James Ltd., Research Division

Okay. Maybe just taking this a step further. Can you maybe just expand on the tenant improvement costs and allowances on new leases in the quarter? Seems like a relatively big number, was there anything particularly driving that? And then just bigger picture, how are you thinking about kind of the use of capital to help improve occupancy, if you will?

BRIAN L. HARPER
President, CEO & Trustee

Sure. And obviously it's a quarter to quarter. We'll have movement given the volume of deals expiration and particularly our size, Collin. I do think it's important to think about TI in the context of the rent generated, the quality and credit, right, of the new tenants, the overall payback period, which, on these deals for this quarter, was roughly 2 to 3 years, but more importantly, these deals reduced our exposure to riskier tenants. As I mentioned the Pier 1 deals previously. These new tenants that we signed this quarter are producing 3x of sales. And just to be clear, this is not an overspend but a reflection of a targeted business plan by every asset remerchandised small shop lease-up initiative where this was an under-managed portfolio. This is exactly, I mean from day one, what I knew was going to happen these type of results and there is more of that. And for this quarter, just really getting granular on the $81 a square foot, there were really three deals. It was a Ulta deal at Tel-Twelve replacing a Pier 1 and then we replaced a underperforming freestanding restaurant, where we had to sub divide the outparcel to a high volume fast casual restaurant and a Sleep Number. So just to give you a little context on that, that $81 spend equates to a releasing spread of 16.7%. And we are getting a yield of roughly 10% on that, that’s pretty damn good business.

COLLIN MINGS
Raymond James Ltd., Research Division

Got it. No, that's extremely helpful color there. Thank you. One last one and I'll turn it over. Just a lot of comments today on the call just about the board refreshment. Obviously a lot of changes there. At this point, do you feel like that refreshment is complete or could there be some additional changes as we look forward here?

BRIAN L. HARPER
President, CEO & Trustee

I think it's complete. And these are -- I'm sure you've looked at the bios, these are professionals, both from our existing board and new board and I'm honored, I'm humbled. We have a lot of new exciting ideas, we have a lot of new perspective. This board meeting this past week was one of the best we've ever had. So it's at a very exciting new page to this new chapter of RPT.

COLLIN MINGS
Raymond James Ltd., Research Division

Okay, thank you.

BRIAN L. HARPER
President, CEO & Trustee

Thanks, Collin.

OPERATOR

Our next question is from Michael Mueller, JPMorgan. Please go ahead.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

Hi. A quick question on renewal spreads and new leasing spreads. I know you touched on like an example or two of the tenants that got relet. But how broad based would you say the pickup in renewal spreads was throughout the portfolio? And if we compare it to last year's reported results, how much of it would you associate to a mix change from the asset sales versus just same store spreads getting better, if you would?

BRIAN L. HARPER
President, CEO & Trustee

I think most of this is spreads getting better and the processes and the people. I do think some, it all comes back to the assets and tenant demand. But this is broad based, Mike. This was -- this is broad based across the spectrum. And if you look at our renewal spreads that were not contractual options were what 25%. So this is very focused again business plan for each and every asset that we have great transparency between all the different business units from leasing and asset management. This is a combination and this wasn't just 1, 2, 3, this was multiple tenants across the portfolio.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

Okay. Okay. That was it. Appreciate it.

BRIAN L. HARPER
President, CEO & Trustee

Thanks. Have a good day. Thank you.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

You too.

OPERATOR

Our next question here is from Todd Thomas, KeyBanc Capital Markets. Please go ahead.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Hi, good morning. Mike, you mentioned the 110 basis point benefit from the bankruptcy settlement that flowed through the same store. So the 3.5% excluding that income still a solid print, but can you reconcile that a little bit with the roughly flat occupancy in the same-store year-over-year and the 1.7% growth in ABR per square foot? Look like the expense recovery ratio is roughly unchanged. So maybe you could comment a little bit on some of the other drivers there.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes. Sure, Todd. First, I'll give you the contributions of what drove same-store, particularly the 4.2% of minimum rent that fueled that 4.6% print that we had. Just over 200 basis points came from occupancy gains, 160 basis points came from contractual rent increases and another 50 came from renewal re-leasing spreads. So that gets you to the 4.2%. In terms of the occupancy on the same property front, where you saw flat which is what we had in the supplemental, there were really 2 things that I would point to on that. The first is that the occupancy shown is at the end of the quarter and not average occupancy, which was actually up year-over-year and a contributor to our same property NOI growth. The second ties to the inclusion of several smaller modest outlots and expansion GLA that we delivered in '18 that we do not qualify as redevelopments at our new criteria and therefore are included in our same property NOI. And while this activity is small in nature and immaterial at the property level, it can add up for a portfolio of our size.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay, that's helpful. So with regards to some of those expansion and outlot projects, those will -- the new GLA there will be included in the same-store. Does that create some additional volatility in the metric going forward as you look at the model? You still have a bunch of future projects and in-process projects. Should we continue [indiscernible].

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

No, no it should not create any volatility. I did comment in my prepared remarks that we will decelerate a bit in the second quarter, but that's really the structure related to what occurred in 2018 and that will re-accelerate in the back half of the year, which is really tied to our signed not commenced rents that we’re set to deliver over the course of the year. So, no, you shouldn't expect any volatility with the change in definition here. And I would remind you that 46 of our 48 assets are included in our same property NOI definitions, which is a very pure number and representative of our entire portfolio almost.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay, that's helpful. And then can you talk a little bit about the current leverage profile of the company. So you ended the quarter at 6.6x on a net debt to EBITDA basis and you've completed the disposition program. So I'm just curious what the current thinking is around leverage, what the current target leverage level is and if there are plans to reduce leverage further from here.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

Yes, I think over the next couple of years we're going to hang around the mid 6s given the capital we're going to put to use towards our leasing initiatives and also our bigger redevelopment projects. And then once we stabilize the portfolio and start to bring online some of our redevelopment opportunities like Webster Place and Rivertowne that Brian mentioned in his prepared remarks, we'll get down closer to 6x. But it's a process to get there.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Ok, got it. Alright, thank you.

MICHAEL P. FITZMAURICE
Executive Vice President, & CFO

You bet. Thanks.

OPERATOR

This concludes the question-and-answer session. I'd like to turn the floor back over to Mr. Harper for any closing comments.

BRIAN L. HARPER
President, CEO & Trustee

Before ending the call, I want to highlight what we believe are the key takeaways from the quarter. First, the portfolio and organizational changes that have been implemented over the past few quarters are starting to bear fruit as evidenced by our strong base rent growth of 4.2% in the quarter. Our new operational teams are in place and firing on all cylinders. Second, we have good visibility on our business given our strong backlog of signed but not commenced leases totaling $5.8 million. And finally, our completed disposition program has put us in an enviable liquidity position with which to execute on our plans with $85 million of cash at the end of the quarter and full availability on our line of credit. While we are encouraged by our progress, we remain diligent in our execution and will continue to operate with the same sense of urgency that you have grown accustomed to. Whereas 2018 was all about laying the foundation for the future, 2019 will be all about leasing, leasing and leasing. Thank you for joining us this morning. We look forward to seeing many of you at ICSC and NAREIT in the coming weeks. Have a great rest of the day.

OPERATOR

This concludes today's teleconference. You may disconnect your lines at this time. Thank you again for your participation.