RAMCO

RAMCO
FQ2 2018 Earnings Call Transcripts

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RAMCO

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Vice President of Finance

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PRESENTATION

OPERATOR

Greetings, and welcome to the Ramco Properties' Second Quarter 2018 Earnings Call. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host Vin Chao, Vice President of Finance. Please go ahead.

VINCENT CHAO
Vice President of Finance

Good morning and thank you for joining us for RPT's second quarter 2018 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 second 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 second quarter 2018 earnings call. This morning, I would first like to talk about my rationale for coming to RPT, then I will discuss upgrades to our organizational structure as outlined in yesterday's press release, share my initial observations now that I am almost two months into this role, and finally touch on our near-term strategy and outlook for the balance of this year and going forward. Mike will then summarize our recent results and discuss our balance sheet. We will then open the call for your questions.

Let me begin by stating that we are very excited to share our vision for how we intend to create meaningful value for our shareholders. I want to thank our Board of Trustees for the opportunity to lead this terrific organization. My appointment as of June 15th marks the first CEO change in over 22 years, and I am both honored and humbled to lead RPT's next generation of success.

My decision to join RPT was based on several factors, but at the top of the list is the opportunity to unlock shareholder value within a portfolio that I believe is both misunderstood and undervalued, with a tremendous amount of potential upside.

I have spent the last 20 years focused solely on retail real estate, most recently at Rouse Properties and GGP, and I have always had a focus and passion for finding value both internally and externally. I understand the underlying real estate and surrounding locational attributes and have always worked to identify the highest and best use within the context of maximizing value for our shareholders. Throughout my career, I believe I have a developed a proven track record of successfully identifying, executing, and completing larger scale densification/mixed use projects. I will get into more detail later in the call, but we have some incredible assets where there is significant demand for residential and potentially even office. And then obviously it all comes down to leasing. Given my years of experience on the leasing side, my tenant relationships run deep. To this end, I have already had conversations with many tenants, existing and new, and they see RPT as a company with great real estate and are excited to grow with us.

Turning to the organizational structure. Following several recent hires, I believe we NOW have the right management team in place, to unlock the underappreciated value in this company. In addition to Mike, we recently announced the hiring of Tim Collier, who joined the Company on Monday as Executive Vice President of Leasing. Tim comes to us from his prior position as Head of Leasing for Acadia. We also recently hired, Jonathan Krausche as Senior Vice President of Development. Jonathan was most recently Vice President of Development at Westfield Corporation. He has over 23 years of experience in development and construction and has executed on an impressive list of large and complex, multi-million-dollar redevelopments including: the World Trade Center, Fulton Center and Corbin Building, and the Garden State Plaza.

We believe Tim and Jonathan's experience is complementary to ours and we are excited to have them on board. Tim, Jonathan, Mike and I understand the strong foundation and inherent opportunities that exist at RPT, and have the chance to build a first class, blue-chip retail real estate company. Together, we are cultivating a can-do culture at RPT to help us achieve our goals, while building a self-reinforcing and sustainable platform to ensure our continued success. The key components of that culture are urgency, innovation, entrepreneurial spirit, integrity, stewardship, discipline, collaboration, passion and humility.

Now I'd like to share my initial observations and outline our near-term strategic plan. Within my first 30 days, I visited over 95 percent of the properties, completed comprehensive portfolio, balance sheet and organizational reviews, and identified our strengths and opportunities for improvement. The portfolio reviews have resulted in a disposition pool that once completed, should result in lower credit risk, lower real estate risk and lower leverage that will better position RPT to operate effectively in the current retail environment and be ready to deploy capital as opportunities arise. I'll touch more on this topic later in my prepared remarks.

Our balance sheet review has given us comfort that there is no immediate pressure given the laddering of our debt, limited near term maturities and long duration. However, given the current retail environment, we believe it is prudent to reduce controllable risks by delevering.

Regarding the operating platform, there were certain inefficiencies that hampered performance, specifically in the small shop space. The previous two-region structure resulted in inefficiencies across process, consistency and communication. There was also no singular business intelligence tool, no formal lease committee charter or process, and no prioritization of leasing goals.

The good news is that we have solved for these challenges, and instituted best practices to streamline decision making, and focus the platform on top priorities. The near-term strategy is as follows:

1) Sell out of non-core markets without scale to strengthen the growth profile and geographic mix of the portfolio.
2) Increase small shop occupancy.
3) Mine the portfolio for meaningful mixed-use densification and repurpose opportunities.
4) Re-imagine the operating platform. And,
5) Reduce leverage and position the balance sheet for internal and external growth opportunities

Beginning with dispositions, we have taken a long-term view of the growth prospects in our portfolio and have identified assets in non core markets without scale, that are not long-term holds. As we finalize our plan and sales target, we will update you on specifics, but overall, we expect to execute on these dispositions by the end of 2019. We are aware of the impact on near-term earnings, but we believe that solving for sustainable, high-quality cash flow growth is the best path for long-term value creation. Rest assured, we will endeavor this undertaking with discipline and farsightedness.

Once we right-size the portfolio we are going to be extremely disciplined about which markets we will operate in. Our existing markets where I can eventually see further scale are as follows: Minneapolis, Chicago, Columbus, Miami, Tampa, Nashville and Jacksonville. Potential new markets would have similar characteristics as these markets: high growth, significant density, and large enough to operate with efficient scale. We will be judicious with the reinvestment of our capital into new markets. When the timing is in our favor, we will seek high growth opportunities utilizing our deep industry relationships.

Turning to leasing. Leasing the existing small shop vacancy is our greatest and quickest return on invested capital. Today our small shop leased rate stands at 87%. Our goal is to drive that to 91-92%, which would add about $3-4 million in ABR. We are adopting a local leasing approach, with strong internal governance, which together will allow us to drive the lease-up of this higher ABR/higher growth space. Additionally, we will fully-leverage the strong tenant relationships that both Tim and I have developed over our long careers with a focus on a cohesive portfolio strategy every time we sit across from a potential tenant.

Beyond small shop leasing, we view redevelopment as another existing lever to generate long term growth. Going forward, our priorities in this regard will focus on densification and high-impact projects – understanding today's multi-faceted retail environment - versus one-off pad development. We are already working with architects on densification opportunities for several existing assets. A few examples are as follows:

Webster Place – Arguably sits on the best real estate in the Lincoln Park neighborhood of Chicago, immediately at the front door of the 30-acre redevelopment called Lincoln Yards. The existing retail that sits on the property today is an extremely high performing Regal Theaters and a Barnes and Noble that expires in a year, with no options. We are working with Gensler, a premier architectural firm known for its mixed-use development design, on a large-scale densification redevelopment that will involve residential. We are also in early conversations with several renowned residential developers/operators to partner on that component. To say the least, the demand is high.

Next is Shops on Lane in Columbus, Ohio. This asset is uniquely positioned in the upscale Upper Arlington market. One-mile average household income is approximately $148,000 and the property is also one mile from The Ohio State University. Whole Foods is the major anchor at the property and they do extremely well, plus they are a terrific community partner. Co-hatch, a shared office space operator, was recently added to take over a second-floor space that had been vacant since the time the shopping center was acquired in the mid-2000's. Tenant demand is strong as is the demand for residential and office. We are working with a leading architect on a master plan of the site that will maximize the demand for all the uses in a thoughtful, mixed use environment.

Centennial Shops – located in Edina, Minneapolis, one of Minnesota's wealthiest areas with a 3-mile average household income of approximately $106,000. This center has phenomenal visibility and access off France Road which is the top retail corridor in the state. Again, there is a large demand for residential and we are in the preliminary stages of plans/design with a leading architectural firm.

Rivertown Square – located in Deerfield Beach, Florida. This is a tired asset that sits on 14 acres in a high barrier to entry market. The asset includes a Winn Dixie and Bells. The current configuration and in-place tenants are not the best use for the real estate. Given the density, access and limited new housing supply, we are in the early innings of collaborating with a leading residential operator on creating a dynamic grocery anchored mixed use center with upwards of 300 Class A residential units.

These are just a few quick examples of some of the tremendous opportunities to unlock value within our portfolio. While these projects are in the preliminary stages, we are extremely excited and expect to share our progress as we move forward. These assets are just the beginning of our new densification program with more to come. Suffice it to say, we view redevelopment as one of the key catalysts that will transform RPT into a blue-chip REIT.

With that goal in mind, we are reimagining our optimal organizational structure. Last week, we made several changes that will generate significant recurring cost savings, improve efficiency, create urgency, and strengthen our banking, tenant and investor relationships. In summary, here are the highlights of those changes:

1) The dissolution of the centralized two region structure that was in place since mid-2015. Instead, we will focus on decentralizing our leasing, property management and development teams to leverage local knowledge in our key markets.
2) An immediate streamlining of staffing to eliminate redundancies, including but not limited to those created by the two-region structure, as we position the Company for the future. In total, we expect these actions to result in approximately $2 million in annual net cash savings.
3) The creation of a New York office to open next month for key leadership team members and the planned rightsizing and rebranding of the corporate Farmington Hills office in 2019. Both offices will be designed to foster the collaborative, entrepreneurial, and innovative culture that we are creating at the new RPT.
4) And lastly, we have already implemented several oversight and review processes to ensure proper governance over investments. These include an Executive Lease Committee, where I approve every deal before it enters into a lease, legal tracking calls to assure accountability as well as urgency, and

bi-weekly portfolio reviews to foster collaboration between all departments. We are also in the midst of creating a more comprehensive business intelligence platform. I like to say, “data is the new oil”. Having real time data is not an option, but a requirement for prudent investment decisions. These new practices will provide the governance necessary to ensure the decisions we make are in the best interests of our investors. Careful stewardship over shareholder’s capital is my number one responsibility. All capital allocation decisions going forward will be highly-scrutinized to ensure every invested dollar provides the right risk adjusted return potential to our investors.

With that, let me shift gears and briefly summarize our financial and operating results and outlook for the balance of the year. I am pleased with our results. We posted strong same property NOI growth with redevelopment of 3.1% and operating FFO per share of $0.40 for the second quarter. We signed leases for over 515,000 square feet of space, achieving blended comparable re-leasing spreads of 12%, which were primarily driven by our comparable new releasing spreads of 84%. We continued to improve our portfolio leased rate, now at 93.9%, up 30 basis points sequentially. Notable leases signed during the quarter were At Home at Crofton Centre, which backfilled a former Kmart location and Aldi at Parkway Shops located in Jacksonville. As it relates to redevelopment, we completed one of the outparcel developments at our Front Range Village shopping center in Fort Collins, Colorado. Here we added a 28,000 square foot TruFit Athletic Club and earned over a 10% return on cost. And lastly, the new management team initiated 2018 operating FFO guidance of $1.35 to $1.39 per share. I am confident we are on solid footing heading into the second half of the year. Mike will provide more details regarding our results in a moment.

With less than 60 days on the job, I am enthusiastic by how much has been accomplished. I plan to spend the next 60 days collaborating with my new team, meeting with many of you as well as the tenant community, fine-tuning our long-term business plan, quantifying potential dispositions and adding substance to the various ways we will be implementing positive change at RPT. I am confident that on our third quarter call, we will be able to provide meaningful context to our longer-term business plans.

And with that, I will now turn the call over to Mike.

MICHAEL P. FITZMAURICE
Executive VP, CFO & Secretary

Thanks Brian, and good morning. I would like to thank our Board of Trustees and Brian for inviting me to help usher in the next exciting chapter for RPT. Also, I’d like to thank our employees for being so welcoming as my family and I take on this new, amazing adventure. I am coming to this role with nearly 20 years of public REIT experience and I want to ensure all of you that one of our primary mandates is to provide best-in-class transparency and disclosure along with unparalleled access to senior management. When it comes to the shopping center space, we understand investors have many choices and our focus is on creating long term shareholder value. We believe that if we do that, we will earn your attention, and justify your investment.

Now let’s turn to our second quarter results. Operating FFO for the quarter was $0.40 per share compared to $0.35 per share in the same period in 2017. The increase in operating FFO was driven by the acceleration of a non-cash below market lease intangible of $0.06 per share and a decrease in interest expense of $0.01 per share. These were partially offset by a decrease in NOI from other investments of $0.04 per share primarily related to our 2017 asset sales. The non-cash below market lease intangible was related to an unexpected early termination of a former Kmart location that has already been fully backfilled with the tenant At Home, which we expect to open in the fourth quarter of this year. Downtime was minimal at five months and the releasing spread was over 140%.

Nonoperating items this quarter were largely related to non-recurring charges associated with the reorganization of the executive management team. Further, as Brian mentioned, we did streamline the organization at the end of July. While these changes will result in approximately $2 million of ongoing annual net cash savings, we expect to recognize a non-recurring severance charge of approximately $1.3 million during the third quarter that will impact NAREIT FFO, but will be excluded from Operating FFO.

Same property NOI growth with redevelopment was 3.1% in the second quarter driven by higher rental income of 160 basis points and an increase in operating expense recovery of 200 basis points. These were partially offset by lower other property income of 30 basis points and higher non-recoverable expenses of 30 basis points. You'll notice on page nine of our supplemental that our second quarter same property operating expense recovery ratio was 91.8% for the quarter, 560 basis points higher, year over year. The outsized increase is due to a combination of timing and better than expected recovery rates at a handful of properties. Moving towards the back half of the year, we expect this ratio will moderate into the high 80's.

Turning to balance sheet management, our strategy will be to maintain a strong, opportunistic balance sheet that will support our growth initiatives. We will continue to be low levered, unsecured, highly liquid, and in due course, an investment grade rated issuer. As I evaluated the balance sheet over the last several weeks, I took comfort in the fact that as of the end of the quarter, our net debt to EBITDA was 6.2x, debt duration was over 6 years, less than 10% of our debt was floating, 90% of our NOI is unencumbered and only roughly 10% of our debt matures through 2020. While there isn't immediate pressure to strengthen the balance sheet, that doesn't mean we will sit idle. We would like to see our net debt to EBITDA trend down to the 5.5 to 6.0 range over time and we will take opportunities to use asset sales as currency to be redeployed into the balance sheet. We have already done the diligence on our asset sale candidates in terms of studying tax and debt prepayment fee implications and suffice it to say, we will be able to use all the net sale proceeds to repay debt.

Consistent with the pace that Brian alluded to several times in his prepared remarks, we were able to quickly get our arms around what to expect for earnings for the second half of the year. Given that we are still finalizing our disposition plans, we have excluded asset sales from our guidance assumptions. Our new operating FFO guidance was initiated at $1.35 to $1.39 per share. In last night's release, we provided a midpoint reconciliation from the previous management team's Operating FFO guidance of $1.34 per share to our expected $1.37 per share. The $0.03 increase is due to the acceleration of the sizable below-market lease intangible of $0.06 that I described in my earlier remarks, partially offset by the removal of acquisitions from our 2018 plan of $0.02, and lower same property NOI with redevelopment of $0.01. Also, we established our same property NOI with redevelopment growth assumption of 1.75 – 2.75%, which is 75 basis points lower, at the midpoint, from the previous management team's outlook due to our revised expectations around rent commencement dates for certain tenants. As for the trajectory of our same property NOI growth with redevelopment, we expect to decelerate into the third quarter and then sharply reaccelerate in the fourth quarter. Our deceleration in the third quarter is due to the impact from the Toys bankruptcy and the normalization of the same property operating expense recovery we mentioned earlier. And the reacceleration in the fourth quarter is largely driven by the lease-up of vacant anchor locations. Of note, at quarter end, we had approximately 300 basis points of signed not commenced space, representing $5.2 million in economic ABR, of which $4.5 million will be commencing rent in the second half of 2018.

I would like to address the topic of the new lease accounting standard. Under the new guidance, only costs that are a direct result of the specific lease being executed can be capitalized. When we adopt the new guidance at the start of 2019, we expect to have an approximately $2.5 - $3.5 million impact to FFO, which represents roughly 2 - 3% of our expected 2018 Operating FFO. Importantly, this change will have no impact on AFFO. At this point, we are still evaluating how this expense will be allocated between G&A and operating expense within NOI. We will update you as our analysis continues.

Finally, I would like to welcome our new VP of Finance, Vin Chao to RPT. I have worked with Vin as a sell-side analyst for over 6 years and know he will be a fantastic addition to the Company. He is already a perfect cultural fit who brings a wealth of experience and will be able to quickly plug in and add tremendous value to our investor relations, corporate finance and capital markets activities.

Now I will turn the call back to Brian for his closing remarks. Brian?

BRIAN L. HARPER
President, CEO & Trustee

Thank you Mike, as I said earlier, I came to here to make a difference for our shareholders. We understand your frustrations with RPT over the past several years and we are working with an elevated sense of urgency to get our company on the right path. We are not afraid to make tough decisions and are working hard to change the narrative at RPT. My team and I have the knowledge, enthusiasm and determination to take RPT's solid foundation and transform it into a best-in-class real estate platform. Thank you all for joining us and I very much look forward to meeting with many of you over the next few months.

And with that, we'll be happy to answer your questions. Operator, we are ready for our first question.

QUESTION AND ANSWER

OPERATOR

[Operator Instructions] Our first question comes from R.J. Milligan with Baird.

RICHARD JON MILLIGAN
Robert W. Baird & Co. Incorporated, Research Division

Obviously, a lot of changes here turnover in the C-suite and appreciate your comments about Ramco sort of being a new company in a new direction, however, the boards remain relatively unchanged. Can you talk about the dynamic between the new C-suite and the legacy board going forward?

BRIAN L. HARPER
President, CEO & Trustee

Well, at first, I'll apologize for technical difficulties here. We had an outage. And thanks, R.J., for the question and good to hear your voice. The board's been very appreciative, very proactive and very excited on this new plan. And couldn't be happier with their involvement.

RICHARD JON MILLIGAN
Robert W. Baird & Co. Incorporated, Research Division

Okay. I know you didn't go into too much detail about the markets you're looking to exit. Can you give any more color there as to what specific markets you're looking to exit?

BRIAN L. HARPER
President, CEO & Trustee

Yes, at this time I'm not disclosing exact targets, as we're still in the process of finalizing our plan. But we'll share more specifics with you in due course. But it's safe to say these are more of your tertiary markets and noncore that I didn't mention on this call.

OPERATOR

Our next question comes from Todd Thomas with KeyBanc Capital Markets.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

First question, Brian, you commented on how you've streamlined leasing a little bit and talked about the plan to drive internal growth through increasing occupancy and rents. On the small-shop side, how long do you anticipate that it might take to get to 91% to 92% from 87%? How long to mine that $3 million to $4 million base rent opportunity?

BRIAN L. HARPER
President, CEO & Trustee

I'll get back to you on timing next quarter. But suffice to say it's going to be about 100 basis points by the end of this year. But going through our budget, as we are right now, I'll get better clarity as to how long to that -- hit that 91%, 92%. I can tell you that already I've seen a greater efficiency, given the lease committee we put in, the lease charter process, the legal tracking where the urgent pace is felt throughout the organization, the efficiencies are felt, both with asset management leasing and really with all finance as well.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay. And when you look at the portfolio today, you said you've visited 95% of the property and have been doing some research and obviously, spending the time here. I mean, when you look at this portfolio today, where do you think physical occupancy for this portfolio could peak?

BRIAN L. HARPER
President, CEO & Trustee

Physical occupancy totaled mid-90s. I can see that very, very easily mid-90s. And then as I said shop from 91% to 92%. And our goal is obviously to beat that as well.

MICHAEL P. FITZMAURICE
Executive VP, CFO & Secretary

Yes, this is Mike, Todd. I can give you what the 2018 outlook looks like. We're expecting to be between 93% and 94% at the end of the year with physical, which infers about 94% to 95% on a leased rate basis.

BRIAN L. HARPER
President, CEO & Trustee

With that occupancy to we're proactively replacing lower rent payers to drive growth as well as lower performing retailers. So I think that 95%, 96% would be a good number to use.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay. And then just circling back to the dispositions. I understand you're still kind of working through some preliminary plans there, but you've talked about the noncore asset sales as part of the strategy here, having that largely I guess completed by the end of '19. I mean, can you provide some parameters around what you're considering? How many assets maybe book end the gross value in terms of proceeds? And maybe just help us understand what we should expect in terms of the magnitude of asset sales here over the next 6 quarters I suppose?

BRIAN L. HARPER
President, CEO & Trustee

I'll get back to you on specific target, but I can tell you that the deal size, roughly on average, is around $20 million. So these are smaller and allow me to have greater assurety on executing this, just given the liquidity in that pool. I'll get back to you on exact quantity at a later date.

MICHAEL P. FITZMAURICE
Executive VP, CFO & Secretary

Yes. And then Todd I'll go back to my prepared remarks just a few minutes ago. To give you an idea of what the proceeds could look like, we want to get the balance sheet leverage down to 5.5x over the long term, but we want to operate between 5.5x to 6x. We expect to get there with the use of disposition proceeds.

TODD MICHAEL THOMAS
KeyBanc Capital Markets Inc., Research Division

Okay. And just a last one if I could. Brian, I was just wondering if you could comment on the dividend policy today. As you look at the current level at $0.88 a share annualized here. I mean, how do you feel about that? In the -- your effort to maximize shareholder value, is there any considerations about making a recommendation to the board regarding the dividend policy relative to where it's at today?

BRIAN L. HARPER
President, CEO & Trustee

Yes, I mean Todd, it's obviously a board's decision, board reviews on a regular basis. Board has been comfortable with the distribution policy in our outline -- of what we've outlined to them. I can't speak to the future dividend policy, as it's clearly a board's decision.

MICHAEL P. FITZMAURICE
Executive VP, CFO & Secretary

Yes, and the only thing I would add Todd, I think you've kind of hit it on the head with a -- the AFFO payout ratio it's mid-80s at the end of the quarter. It will pick up just a bit in the second half of the year given our leasing progress that we're aiming to get to toward the end of the year. As we lease up the small shop space and bring on some additional redevelopment that's active and what's in the portfolio we should grow back down into the 80 percentile range.

OPERATOR

[Operator Instructions] Our next question comes from Mike Mueller with JPMorgan.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

Quick question on the development and redevelopment size. About how much -- I understand you're going to lay out expected dollar volumes over the near term, but just if you think about the platform overall, I mean how much do you think you can handle at any one time given the size of the platform there? I mean is there a few hundred million dollar pipeline? Is it less than that?

BRIAN L. HARPER
President, CEO & Trustee

Again, I'll get back to you in third quarter. These are very preliminary drawings and plans and sitting down with municipalities already. It's just been 60 days. And I think already we're mining a very value-added portfolio. We'll get back to you. I would say guidance $50 million to $100 million per year. Some of these, as I said the densification. We're not going to be doing the residential ourselves nor will we be doing office ourselves. We would be doing this with a partner. So that obviously takes out some of the manpower, if you will.

MICHAEL WILLIAM MUELLER
JP Morgan Chase & Co, Research Division

Got it. And then just one quick operating question. Mattress Firm, can you talk about the exposure there?

BRIAN L. HARPER
President, CEO & Trustee

Yes, we have 8 Mattress Firm deals, roughly $1 million in ABR. I could tell you that of the 8, 50% of them are on pads and 50% are in line. We have very, very low overlap with their existing locations whether that's Sleepy's or other Mattress Firms within a 1-mile radius, which we've talked with them, which is going to be an indicator for them on their closure list. The Mattress Firms that we have, have been some pretty high performers. I feel comfortable with the real estate that Mattress Firm occupies today.

OPERATOR

That concludes our question-and-answer session. Thank you for joining the call today. You may now disconnect.