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Weingarten Realty Investors (WRI)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Weingarten Realty Inc. Second Quarter 2017 Earnings Call. My name is Brandon and I'll be your operator for today. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note this conference is being recorded.

I will now turn it over to Michelle Wiggs. Michelle, you may begin.

Michelle Wiggs
Vice President-Investor Relations, Weingarten Realty Investors

Good morning and welcome to our second quarter 2017 conference call. Joining me today is Drew Alexander, President and CEO; Stanford Alexander, Chairman; Johnny Hendrix, Executive Vice President and COO; Steve Richter, Executive Vice President and CFO; and Joe Shafer, Senior Vice President and CAO.

As a reminder, certain statements made during the course of this call are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results could differ materially from those projected in such forward-looking statements due to a variety of factors. More information about these factors is contained in the Company's SEC filings.

Also during this conference call, management may make references to certain non-GAAP financial measures, such as funds from operations or FFO, both core and reported, which we believe help analysts and investors to better understand Weingarten's operating results. Reconciliation to these non-GAAP financial measures is available in our supplemental information package located under the Investor Relations tab of our website.

I will now turn the call over to Drew Alexander.

Andrew M. Alexander

President & Chief Executive Officer, Weingarten Realty Investors

Thank you, Michelle, and thanks to all of you for joining us. WRI's portfolio is performing well, much better than the message some of the media have reported over the last several months. We think retail is changing as always. What and how consumers are making purchases today is evolving. Our retailers along with our real estate is evolving as well.

The recent announcement that Amazon is purchasing Whole Foods is clearly a sign of that change and is confirmation that brick-and-mortar stores are an essential component of the omnichannel model of the future. Good retail real estate still has good value.

Our strategy over the last five years with the transformation, has been to create the best quality real estate portfolio, along with the best-in-class retailers. We are confident that we are well-positioned for the future.

We continue to be active underwriting acquisitions and would buy assets with the right risk growth profile, but given what we see half way through the year, we are lowering our acquisition guidance. Further, with the disconnect between Main Street pricing and our share price, we have increased our disposition efforts, and accordingly, increased our guidance.

We don't have a lot of significant changes in the new development area. Of possible interest to you, at Walter Reed, it appears that we are likely to transition from an equity ownership to the consulting role. We are discussing the details of this with our partners, and it's not certain, but it seems likely. After future new developments, we continue to work on projects, but are being cautious with our risk profile.

Redevelopment of the existing portfolio provides great returns on the invested capital and we continue to work those with great focus. Bottom line, the quality of our transformed portfolio is evident, given its solid performance. While retail had some headwinds, good retail real estate, like ours, continues to perform well.

Steve, the financials?

Stephen C. Richter

Chief Financial Officer & Executive Vice President, Weingarten Realty Investors

Thanks, Drew. I am pleased to once again report strong earning results. Core FFO for the quarter ended June 30, 2017, was $0.61 per share or an increase of 7% compared to $0.57 per share for the same quarter of last year. The increase in core FFO over the prior year was primarily due to increases in rental rates, the full-year effect of our 2016 acquisitions, and reduced interest expense from favorable debt refinancings. These increases were partially offset by the impact of our disposition program and the dilution from our common share issuance under our ATM in 2016. For the six months, core FFO was $1.22 per share for 2017, compared to $1.15 per share for 2016.

As to the balance sheet, we have had little activity on the financing front. Our balance sheet remains in great shape with minimal maturities over the next several years. At quarter end, our net debt-to-EBITDA was 5.8 times and our debt-to-total market cap was 37%.

Given our strong operating performance year-to-date, we are increasing our 2017 guidance for NAREIT FFO to a range of $2.34 to $2.40 per share, and increasing core FFO guidance to a range of $2.38 to $2.44 per share. Further, we are reducing guidance on acquisitions to $50 million to $150 million. As to dispositions, we are increasing guidance to a range of $200 million to $400 million. If we achieve this level of dispositions, it should have a minimal effect on 2017 FFO, as many of the transactions will close later in the year.

Guidance on new development and redevelopment investments is decreased to a range of $125 million to $175 million, as we don't expect to add any new projects to the pipeline for the balance of the year.

Finally, we remain comfortable with our guidance on same property NOI, including redevelopments of 2.5% to 3.5%. All of these 2017 guidance changes are detailed on page 9 of our supplemental.

Johnny?

Johnny L. Hendrix

Chief Operating Officer & Executive Vice President, Weingarten Realty Investors

Thanks, Steve. We're very pleased with the results the company produced this quarter; strong leasing and occupancy increase of 80 basis points over the last quarter, new lease rent growth of 43% and continued advancement in our redevelopment program.

While negative headlines have dominated the media, our transformed portfolio continues to perform very well. 75% of our NOI comes from shopping centers, anchored by supermarkets. Those supermarkets' average sales of $632 per square foot, that translates to over 1 million customer visits to our shopping centers each year.

Many of our shop tenants are service oriented, providing products not available online. Many of our box tenants, including supermarkets are adjusting to current and future disruptions created by online merchants. This will probably lead to pressure to reduce costs, including rent paid to landlords. So, it's important to remember, rent is generally a fairly low percentage of overall cost to retailers.

As an example, Weingarten's supermarkets' average occupancy cost is only 1.6% of sales. We have great locations and competitive rents, so we believe the impact of the disruption will be manageable.

We are working through the bankruptcies of Payless, rue21, Gymboree and Alfred Angelo. These tenants represent 33 stores. If we lost all of them, it would be less than 0.6% of annual base rent. We don't expect they will close all the stores, so it's going to be very manageable. The guidance we are providing accounts for the closing of most of these units.

During the quarter, leasing was very strong. We executed leases for 373,000 square feet, representing $7.2 million in annual rent. This is the most productive quarter we've had over the last couple of years. The vast majority of the uptick was box leasing.

We executed leases with Marshalls in Burlington, for former Sports Authority spaces, and also leased the former Target we purchased late last year in San Antonio. The blend of shop tenants has remained consistent over the last several years. We are leasing to medical services, health and beauty services, fitness, quick service restaurants and wireless services. Mostly, we are leasing to Internet-resistant tenants, not impacted by online sales.

We have a good pipeline of leases through the rest of 2017, including leases for the last two Sports Authority boxes. There is no guarantee any leases get signed, but prospects are good. It's clear that negotiating leverage has generally [ph] swung (09:13) back in favor of our tenants, to [ph] supplies more for (09:17) boxes than shop tenants, but our locations are strong and we are optimistic we will continue to make progress.

Our overall rent growth for the quarter was a strong 13%. The headline is a 43% increase in new leases. That growth was heavily influenced by a single lease. Even eliminating the great rent increase in the one deal, the new lease rent increase is a very healthy 14%. Year-to-date, the company has produced spreads of over 10% on new leases and renewals.

Occupancy at quarter end was up nicely to 94.5%, that's 80 basis points over the last quarter. Most of that increase resulted from the leasing of those boxes I mentioned earlier. Regionally, Atlanta and Raleigh continue to be very strong at 96.6% and 96.4% respectively. Houston also continues to perform very well, with overall occupancy at 95.5%.

It's worth mentioning that occupancy will be negatively impacted next quarter, as we continue to re-merchandize the Shoppes at Memorial on Interstate 10 here in Houston. The property is a former industrial facility that we have been converting to retail over the last several years. The last industrial tenant, an 84,000 square foot electrical supply distributor, is terminating during the third quarter. Long term, it's a great story. We will improve the tenant mix and significantly increase the rent.

Same property NOI continues to be solid. During the quarter, we generated an increase of 2.6%, including redevelopments. Base minimum rent for that same pool of properties increased 2.7%. Year-to-date, we produced an increase of 3%, which is the midpoint of our guidance. For the rest of the year, we expect the fallouts to cost us about $1 million in net operating income, but this will be more than offset by leases coming online, which will contribute about $2.3 million in NOI. This leaves us comfortable with our guidance of 2.5% to 3.5% for 2017.

The company's redevelopment pipeline continues to generate strong results. We currently have 17 active projects, with anticipated investments of $240 million. The incremental return should be around 8%. By far, the largest redevelopment is the Driscoll at River Oaks, which will include a 30-story residential high-rise and 10,000 square feet of retail. Excluding the Driscoll, the return on redevelopments is over 10%.

We are very active, pursuing potential acquisitions, but we've been very selective. We will continue to look for great assets with good growth. It seems to us that core assets have remained very competitive with cap rates between 5% and 6%, slightly lower in coastal markets. Valuations of non-core assets have slipped a little since the beginning of the year. Underwriting standards are tightening, with buyers very sensitive to risk of box renewals and potential over market rents.

While our operations have some challenges ahead, I remain confident our tenants and our portfolio will adjust and continue to produce strong results.

Drew?

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

Thanks, Johnny. Another great quarter, and I am very pleased with how we've started the year. The media has painted a more dire picture for retail than what we are experiencing in our centers. We have always been known as great shopping center operators, and now we have the added benefit of a significantly transformed higher quality portfolio of properties. So, I remain confident that we will navigate our way through this unsettled environment.

[ph] Recall (13:23), 75% of our rents come from centers with a grocery component and those grocers average a strong $632 per square foot in sales, bringing thousands of people to our centers each month. While the Amazon, Whole Foods deal will drive change in the grocery sector, we believe that it will be a positive for our real estate long term.

Our supermarket operators will adapt and evolve as well, and we will assist them with our great locations. WRI was formed from a supermarket company almost 70 years ago. Thus, we have seen a lot of change and evolution in the retail business, especially the supermarket space. The media told us Webvan would eliminate the need for bricks-and-mortar locations, and when that didn't transpire, they told us Walmart and the membership clubs would eliminate the need for our shopping centers.

I believe, we will continue to evolve. Our shopping centers will become the launching pad for the last mile for e-commerce, while continuing to provide our tenants, many of whom are restaurants and service-oriented, with great locations for their business. Great people, great properties and a great platform equals great results.

I thank you for joining the call today and for your continued interest in Weingarten. Operator, we'd now be happy to take questions.

QUESTION AND ANSWER SECTION

Operator: Thanks, Drew. We will now begin the question-and-answer session. [Operator Instructions] And from Citi, we have Christy McElroy. Please go ahead.

Katy McConnell
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. This is Katy McConnell on for Christy. Given the amount of box leasing you did during the quarter, can you talk about the level of demand you are seeing today versus a year ago, in terms of the number of retailers interested in any given space? And then, can you also discuss the increase in TIs this quarter and whether that was one-off or if we should expect more elevated levels, as you continue to work through the bankruptcy space?

Johnny L. Hendrix
Chief Operating Officer & Executive Vice President, Weingarten Realty Investors

A

Good morning, Katy. This is Johnny. Let me answer the – I guess the last question first. I expect that over the next several years, we will see increased levels of TI for boxes. In this particular situation, there are really two leases that heavily skewed the number, and without those two leases, it would have been [ph] $22 (15:57). So, we feel good. We got great increases on where we spent the money. So, I think it was a good investment.

As to leasing boxes going forward, I think we are about where we were a year ago. Really, as we work through the Sports Authority boxes, we came to see a little bit less demand from retailers, particularly hard goods. We still have great interest from T.J. Maxx, Ross, the pet stores, the fitness stores, some of the others have fallen off. But it's about the same. It does appear that the leverage on their part has improved, and we will just have to see, as we go along, if we are able to continue to work through that.

Katy McConnell
Analyst, Citigroup Global Markets, Inc.

Q

Okay, that's helpful. Thank you.

Operator: From Baird, we have R.J. Milligan. Please go ahead.

William E. Harman
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, good morning. This is Will Harman on for R.J. Just a quick question about Walter Reed, you mentioned moving to more of a consulting role. I was hoping if you could just provide a little bit more color on that decision?

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

A

Sure, this is Drew. It's a great location, and we have a wonderful relationship with the different partnerships. But it appears, and again, I try to give the signal, because nothing is certain, but it appears that it makes sense to everybody. It has to do with the vertical integration of the project and how the use is mixed together, that it just seems having one capital source, could be just a better way to approach it for all concerns. So, it's a very cordial discussions, very collaborative. As I said, it's early, but it hinges around the complexity, the mixed use, the integrated mixed use nature, and it seems likely that we will move to more of a consulting role. So, hopefully that helps. It is early, but something I wanted to give everybody heads up on.

William E. Harman
Analyst, Robert W. Baird & Co., Inc.

Q

That's helpful. And then, on pages 12 and 13 in the supplement of this quarter, where you disclosed your development, redevelopment projects and their expected [ph] yields (18:16), looks like you've made some slight downward revisions to your targeted yields for both developments and redevelopments. Could you just talk a little bit about those downward revisions and what has changed over the past quarter and how you've underwritten these projects?

Stephen C. Richter
Chief Financial Officer & Executive Vice President, Weingarten Realty Investors

A

Good morning, Will. This is Steve. On page 12, both for Q1 and for Q2, the new development information is presented there. Quite frankly, if you look at the 5.7 return that we have for the three projects, that number has remained consistent.

In footnote number 1, we show the breakout for the different types of projects – the different components of the project between retail, resi and office. Quite frankly, we made a mistake in Q1. Those numbers in the footnote 1 were incorrect. [ph] When one runs (19:10) the numbers, it basically doesn't equate back to the 5.7 return, and we corrected that in the footnote 1 in the second quarter, and everything is fine going forward. So, we apologize for any confusion.

William E. Harman
Analyst, Robert W. Baird & Co., Inc.

Q

And then just that overall active redevelopment yield, it was 8% to 10% last quarter, it's down 50 bps this quarter to 7.5% to 9.5%, any color on that?

Johnny L. Hendrix
Chief Operating Officer & Executive Vice President, Weingarten Realty Investors

A

Hey, Will, this is Johnny. Yeah, we've actually changed the scope of the redevelopment at Winter Park and at Sunset 19. Again, I think these are going to be very positive. We brought forward a little bit of work on [indiscernible] (19:52) and parking lot as part of the redevelopment on one, and increased the – had another tenant on another one. So, that's really what's going on there.

William E. Harman
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And just last one for me, property taxes were a little bit higher in the quarter, up around $4 million compared to the run rate of around $17 million. Just curious what drove the spike and what we should be modeling for the run rate going forward?

Stephen C. Richter
Chief Financial Officer & Executive Vice President, Weingarten Realty Investors

A

Yeah. Well, this is Steve. Quite frankly, that's just the valuation of the properties in our annual adjustment. If you look at the offset, you also have an increase in recovery. So, it really doesn't flow to the bottom line that significantly.

William E. Harman
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thanks, guys.

Operator: From UBS, we have Nick Yulico. Please go ahead.

Greg McGinniss
Analyst, UBS Securities LLC

Q

Yeah, good morning, everyone. This is Greg McGinniss on for Nick. I was just hoping you could elaborate a bit on the shift in transactions, in terms of what you are seeing in the acquisition market? Is it just too crowded or the assets you want no longer available?

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

A

Good morning, it's Drew. We are very active. We have participated in many deals, underwritten a lot of deals. Then if you will, the [ph] brides made a lot of (21:06) the stalking horse. But we do find things very competitive. Last year, we had a fabulous year, and I think we said at the time, there was a little luck and a few breaks. We remain active in the target markets where we are and I am optimistic that we will find some things.

We are very focused on growth, as I have said before, and I think it does support what Johnny said that the good centers, the quality centers that we want to buy are very much in demand, and the pricing is very strong on those. So, – while we love to win more, it does make us feel very good about the value of the portfolio.

Greg McGinniss
Analyst, UBS Securities LLC

Q

Great, thanks. And then, with the increase in dispositions, but the decrease in redevelopment fundings, wondering what that cash is going to be used for?

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

A

So, that's something we will certainly keep in mind. Some of it is a definite long-term strategy that we think, there is a major disconnect in terms of the public valuations, and where the assets are worth, we certainly want to stay in a leverage neutral, and in all our projections, it's very challenging. But distinctly possible that we will have some sort of special dividend, given the age of some of the properties and a lot of that of course relates to what sort of success we have in acquisitions, and what – if anything, we can 1031, which is really hard to forecast. So, we do want to be leverage neutral, after the special dividends. So, we've got some debt certainly that we could look at, as well as other things, and a lot of it is a right long term, given the stocks at some amount of discount to NAV.

Greg McGinniss
Analyst, UBS Securities LLC

Q

Great, thanks. And just a final question, what's your expectation on closing the gap between signed and commenced occupancy?

Stephen C. Richter
Chief Financial Officer & Executive Vice President, Weingarten Realty Investors

A

Hey, Greg. We are about 270 basis points between signed and commenced today, which is – it was a big number for us. And that represents about $13 billion in annual rent, and about $8 million in annual rent will come on board in the second half of this year. So, we would look towards the first half of 2018, to really kind of get back to what I would think would be a normal number in that [ph] 150 basis points to 180 basis points (23:43) range.

Greg McGinniss
Analyst, UBS Securities LLC

Q

All right, great. Thanks so much. Appreciate it.

Operator: [Operator Instructions] And from Hilliard Lyons we have Carol Kemple. Please go ahead.

Carol L. Kemple
Analyst, J.J.B. Hilliard, W.L. Lyons LLC

Q

Good morning. In your conversations with retailers, are you seeing them try to get more concessions and are they having any luck with that or do you just have better options and you are letting them go?

Johnny L. Hendrix
Chief Operating Officer & Executive Vice President, Weingarten Realty Investors

A

Good morning, Carol. We have had that circumstances [indiscernible] (24:13) with the company. Retailers are always fun and they are always looking to reduce their costs and they have always been looking to reduce the rent and get more TIs. We have great locations, and so I think we've been very competitive on the rents we have been able to get, and I think that, that's going to be pretty consistent going forward.

So, we haven't seen much in the way of "rent reduction requests," other than tenants who are currently bankrupt. And again, that's something we've seen for years. But I really haven't seen as much as I would have actually thought, based on all the news that I have read. We were at [ph] ICSC (25:05) in May, tenants said that they were aware of this leverage shift. But again, we haven't seen it at this point.

Carol L. Kemple
Analyst, J.J.B. Hilliard, W.L. Lyons LLC

Q

That's good to hear. Thanks.

Johnny L. Hendrix
Chief Operating Officer & Executive Vice President, Weingarten Realty Investors

A

Thank you.

Operator: [Operator Instructions] And from SunTrust, we have Anthony Hau. Please go ahead.

Anthony Hau
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good morning. Thanks for taking my questions. I am just curious, if you have looked at net effect of rent spread for new leases? Given that you mentioned we might see an increased level of TI going forward, and what would that number look like compared to the 43.4% spread?

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

A

Anthony, good morning, it's Drew. It's something that we look at. I think there is a variety of ways to do it. The TIs are certainly disclosed. As Johnny said, except for the two deals, it's pretty normal at the [ph] $20 something (26:00) a square foot. So, it's certainly something that we are cognizant of and look at. But I think there is a lot of different ways to put a number to it.

Anthony Hau
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you.

Operator: And standing by for any further questions. It looks like no further questions at the moment. Drew, we will turn it back to you for closing remarks.

Andrew M. Alexander
President & Chief Executive Officer, Weingarten Realty Investors

Thank you, Brandon. Just want to let everybody know, we will be around all day, if there is any other further questions. I hope you have a great weekend and a great summer, and thank you very much for your interest in Weingarten. All the best.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for joining. You may now disconnect.