Citi 2019 Global Property CEO Conference: Weingarten Realty

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Christy McElroy: I am Christy McElroy with Citi Research, and we're pleased to have with us Drew Alexander, President and CEO of Weingarten Realty.

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Drew, I'll turn it over to you to introduce your company and your team and provide the audience three reasons why investors should buy your stock today, and then I'll kick off the Q&A.

Drew Alexander: Sounds great. Thank you, Christy. On my right, Steve Richter, our long-time CFO; and on my left, Michelle Wiggs, our Vice President of Investor Relations. Good afternoon, everybody, and thank you for your interest in Weingarten.

So giving some thought to the three reasons, I think people should look at our quality portfolio and especially how our strong demographics would be even better if people adjusted for cost of living and the fact that we tend to be in some of the lower cost of living states. Secondly, we have a fantastic balance sheet. And thirdly, I think we offer people a very good reward-risk profile with a very strong redevelopment pipeline. Basically, our portfolio has transformed in very strong supermarket-anchored centers averaging about $665 a square foot with pretty limited tenant risk. So happy to answer questions and those are the three reasons why I think you all should take a good look at Weingarten.

Christy McElroy: Did you say the three reasons?

Drew Alexander: Pardon?

Christy McElroy: You said the three reasons?

Drew Alexander: I did.

Christy McElroy: Okay, sorry.

Drew Alexander: Great portfolio, great balance sheet, good risk-reward with good redevelopment platform.

Christy McElroy: Got it. Perfect, perfect. Okay so the first question that we're kicking it off with. What's the biggest potential disruption to your business? And what are you doing to take advantage of it or mitigate the risk of it?

Drew Alexander: So I think one has to say that the biggest disruptor is e-commerce. It's the obvious thing that people are certainly aware of and have heard about. I think you should also pay attention to the fact that the millennial shopping patterns are very different for a whole lot of reasons. I think there's also some silver lining with the millennials. As they're getting older, we do see marriage, children and household formations, which is good.

And as far as taking advantage of it, I think it's all about good real estate. I'm a big believer in the bricks-and-clicks or the omni-channel model. And I think e-commerce, at the end of the day, makes good real estate better, but there will be some disruption, as we've already seen, as we get there.

Christy McElroy: So I think that with Q4 results, I think the Street was a little bit surprised by the continued dilution that you expect from the asset sales that you'll continue to do in 2019, although those are much pared back. But can you talk about why disposition volume remains heavy? And sort of how do you balance the desire to sell or the need to sell with the continued dilution to AFFO?

Drew Alexander: So appreciate the question and I appreciate that part of my job is not always easy and not always popular, but I think it's about doing the right long-term thing for shareholders. So I certainly appreciate that still having a strong, albeit, as we said, significantly less than the $600-something million we disposed of last year, I still think it's the right long-term thing. And it's -- we're blessed that, unlike a lot of peers, we don't have to so we can be very opportunistic about it, as I tried to talk about on the call. It is a range and it's a pretty wide range, and how much we do will be a function of how pricing comes out and if we're successful in taking risk off the table. Or if we, on the other hand, feel at the price is it's being underwritten, we might as well just hold it.

So we've been successful and think we can continue to have success basically selling the bottom of our portfolio, the assets with some risk, the more demographically-challenged, not as densely populated, selling the bottom of our portfolio at NAV when the stock is at a discount to NAV, a rather large discount depending what number one looks at, but a pretty significant discount to NAV. And again, while I appreciate the short-term headwinds, I just very much think that's the right long-term thing to do especially in this every-changing retail world.

Christy McElroy: So the idea is -- so it's dilutive to earnings, but in your view it's accretive to NAV.

Drew Alexander: Absolutely.

Christy McElroy: Right? I guess at the end of that -- so you're effectively relying on the public markets to give you that credit, right, to remark your NAV valuation and value you in the market at a higher level because of those asset sales. But you're effectively trusting the markets to do that. How do you think that happens?

Drew Alexander: I think the market is pretty intelligent. I think folks can understand it. It's also something that we tried to be clear about; that a portion of the return and the investment thesis these days would be that some of that return will be coming in a special dividend. Don't expect to sell as much in '18 -- excuse me -- don't expect to sell as much in '19 as we sold in '18 and therefore don't expect as large a special dividend. But under most scenarios, we'll still have one. So I think the market can understand it. Hopefully, we've articulated it. Again, it's very opportunistic. Stock gets beat up, we would continue to, as we have in the past, entertain some share buybacks.

We do have some amount of development, redevelopment yet to fund. We're excited about the fact that our two big projects in Washington D.C., they're both very near the Amazon HQ2. We're going to start leasing up and we'll have some revenue coming on towards the end of '19 with a lot more in '20 and '21. So a lot of other redevelopments in the pipeline. So good uses for capital. Continue to look at acquisitions. It's hard. We are working on a few things. So we think the market can see it, understand it, and hopefully we've articulated it.

Steve Richter: I might just add one other thing that I think the market will realize more as we go through time is the quality of the portfolio, as we've disposed of the lower end. If you look at our tenant diversification, for example, very strong. We didn't have a lot of exposure to the recent bankruptcies and so forth. So I think as we produce better numbers going forward and very consistent, I think that the market will begin to understand the quality better.

Christy McElroy: And understanding that, earnings growth is still important, right, longer term. Can you remind us of your -- I mean it sounds like you'll continue to cull the bottom of your portfolio. But can you remind us of your longer-term sort of AFFO growth targets? And when do you sort of expect to get back to that kind of mid-single-digit range that I think in your business makes sense?

Drew Alexander: So I think the mid-single-digit range is the range and I think that a lot of that depends upon how the stock does, where we see the opportunities, where we see the ability to monetize the bottom. We can stop dispositions. We don't have to do it, as we talked about in the call. We had some significant deals that fell apart for a couple of reasons. A lot of what we're looking at in '19 is a little more back-end-loaded than we might have thought a couple months ago. So we will always work on more than we'll ever think about selling, which will give us the discipline to say no. So it's hard to say precisely when we'll choose to change it because it's hard to forecast how much change will there be in the retail world and how the markets and conditions adapt to it.

But I do think our same-property NOI, which I think is the most relevant number, we feel really good about this year. Our range is 2% to 3%. When we look at the lease-up of the Toys "R" Us boxes, which is largely complete, and those will come on in '19 and will have a full-year effect for '20, we feel pretty good about the same-property NOI performance. Certainly some tenants out there to be concerned about, but we don't see anything, knock on wood, on the near-term horizon that's as hurtful as the Toys "R" Us bankruptcy, which, long term, made us a lot of money. So from the same-property NOI growth perspective for both '19 and '20, we feel pretty good.

Steve Richter: I might just add one other thing. When you think about AFFO and overall growth, don't forget the development program. That is, as we articulated on the call, this year or '19 we have about $1 million of drag negative for the startup of the leasing cost for the two D.C. projects. And that begins to turn positive in '20. And then you begin to have the full-year effect of that or more of that in '20 and then in '21. So when you think about a $350 million program, or better, that's a lot of revenue that's going to come one. We're kind of in the, if you will, the low point, the most expensive point in the cycle relative to "I have all the costs and no income."

Christy McElroy: You've historically talked about operating in the "smile states". Have you been exiting whole markets with your disposition program? And maybe you can talk about the best markets that you think you want to be operating in today.

Drew Alexander: So we very much like the "smile states". We think we're very well-positioned to benefit from a lot of broader factors in immigration to the United States, we're in the more low tax states. It's been interesting at the conference just talking to people who have recently done their taxes that some of the impact of the changes in the tax bill and the SALT deduction has been noticed by people. So we feel very good about Florida, Texas, a lot of where the footprint it. I think California is unique place with its weather and its geography and natural beauty vis a vis some other places. So we love the core, the three biggest states in the portfolio and think the Southern and Western migration is good.

So we have left a lot of states. We've left Kansas, a lot of the Midwest. As I mentioned in the call, we've got one center left in Kentucky that we're working on, one in Arkansas, one in Utah that we're also working on that I would expect us to dispose of. But a lot of it is the opportunistic taking out risk. We sold a really strong Harris Teeter, which is Kroger center in a great coastal community in North Carolina. It's a good center. It will do very well. But given that it's coastal North Carolina, more of a beach community, it doesn't have the density. It's never going to show up well in a public environment. So it was two hours from our Raleigh office so it was close enough, but it still saves us some time.

So that kind of honing we can do some things. But I wouldn't -- technically, we exited the market of Wilmington, North Carolina, but I would call it more we honed the Raleigh portfolio and more focused on core Raleigh versus far suburban. So there's those kind of honing things that is some of where we'll look to continue to de-risk.

Christy McElroy: Going back to capital allocation. You've talked about the potential for share repurchases. You didn't do any in the second half even when the stock really dipped. I mean can you talk about why that is and sort of how you think about share repurchases in '19?

Drew Alexander: So honestly, frankly, bluntly, at year end some of it was just logistics when the stock got that depressed. And other than that swoon, the stock was at decent levels. So I mean it's something that we'd want to feel comfortable with a 20-ish% and more on the 20-plus than just 20 because we do think it is a long-term commitment. So it is something that we would look at going forward.

Christy McElroy: And you have been selling assets. You are putting it back into redevelopment and development, but you're also doing, as you mentioned, special dividends. You do consider buybacks as a tool. So you're effectively returning capital back to shareholders as well. Under what circumstances would you consider selling the whole company?

Drew Alexander: Somebody makes me a compelling offer. They know how to get ahold of me.

Christy McElroy: I mean you made the point of sort of this arbitrage and creating NAV through selling well below where you're assets are being valued in the public market.

Drew Alexander: We're a public company. We're for sale every day. We would always entertain offers. I mean Michael gave me the nice shout-out at lunch that I've been here 24 years, which I don't know that it's quite that high, but it's close. But we would always do the right long-term thing for shareholders.

Christy McElroy: Okay. Any questions from the audience at this point? Go ahead, Sam. Yes, Sam and then over here.

Sam: A follow-up on the capital allocation question. What percent of your portfolio today do you guys think is non-core?

Drew Alexander: So again, I appreciate and will do the best I can to answer it. But it's not like it's a bright-line boundary. Our center in Kentucky is very good. Our center in Little Rock is very good. But those two centers it probably doesn't make sense for us to own. So the portion that is real non-core is pretty small. A lot of the rest of it is more about honing; that we're in Southern California, but we're maybe not as close to the ocean as one would like. So it's much more of a shades of grey versus a black and white. But the real non-core is really pretty small at this point.

Sam: This year you've kind of put out the disposition guidance. So there was that amount of assets that you felt were sort of non-core or assets that you felt that you wanted to exit long term for XYZ reasons. I mean is there any way to sort of get a sense of is it 10%, is it 15% or is it very asset-specific or market-specific?

Drew Alexander: It really is very asset-specific. So last year we sold $635 million. Our guidance this year is $250 million to $350 million. So it is significantly less than. And again, it's very asset-specific, very opportunistic, if it makes sense.

Sam: And maybe last one. Would you consider -- your balance sheet leverage is quite good. Would you consider taking up leverage to fund some of the redevelopment program rather doing so through asset sales?

Drew Alexander: We certainly can. We have that option. It is -- in the ever-changing retail world, it we think is the best thing to do to be cautious. But certainly on an interim basis, certainly, as Steve mentioned, factoring in that we're at close to the worst point on the development pipeline that we will have that revenue coming on, which very much hurts the ratio. So increasing leverage for a short period of time, especially until those developments stabilize, would, I think, still be very, very cautious and very doable.

Steve Richter: I might just follow up with one comment. We're not going through the disposition program purely to fund redevelopment or development. We clearly have the balance sheet to do that. It's really the opportunistic side of the disposition given the broader market environment.

Christy McElroy: You had a question over here. Yes.

Unidentified Audience Member: When you're kind of looking at your centers and putting CapEx in, particularly around the grocers, thinking about how that model may be changing or how Amazon will continue to try to make some inroads, how is the CapEx profile changing when you do go to re-sign leases? I understand a lot of your grocers have very long leases and low rent so I get that. But when they are looking for you to help them, say, change a store, what are the key things they're looking at? And how is that changing the capital intensity?

Drew Alexander: So in the grocery world, it's not too significant. Our grocers tend to do extremely well. Those tend to be very long-term leases with options that vast, vast majority of the time you just exercise the option and it's very simple. We always take a very long-term view with our grocers. We came out the grocery business. We know it. We understand it. So we're always happy to work with them whether it's making room for a click-collect or a small expansion or a drive-through pharmacy or anything we can. But the capital intensive nature of the supermarket is very low. Typically, when they want to spend capital, they might want some more term, which we're happy to work with them on. But generally speaking, their cost of capital is lower than ours so they'll generally put the TI in rather than consider paying us for it.

Christy McElroy: Go ahead.

Unidentified Audience Member: In several of the previous mall presentations, we've heard them saying that the saving graces are the supermarkets of the world. Or you look at your junior anchors, TJ Maxx, Ross. I'm looking at your top tenant portfolio here and there's a lot of exposure there. So how do you prevent the candle burning from both ends where the retailers themselves are pressuring you to lower rents while also getting the threat of the mall operators go and putting money in and redeveloping their spaces for these retailers?

Drew Alexander: So again, our company grew out of a regional supermarket chain and way back in the day we had a few stores in malls. And I don't see supermarkets going into malls in a large way where our portfolio is in the Southern and Western United States. A lot of the factors that drove the supermarkets away from the malls are still true today. There's no cross-shopping. Access is tough. Parking feels tough. Everything is exterior, exterior-focused versus the mall is interior. So don't see it that much.

In terms of the big box stores, our locations are quite strong and quite insulated and therefore the situations where TJ is going to leave us to go trigger the new construction in a mall, it just doesn't happen. And again, it's all about the quality of the locations. It's all about being in densely populated, generally urban areas where the new construction cost of building those things out just doesn't make sense for a strong mall. But that's -- we're not in the periphery. We're not in the small towns where those competitive pressures are much, much worse.

As an example, Houston, our hometown, about 70% of our rents in Houston come from within five miles of The Galleria, one of Simon's strongest malls. That's not atypical for our portfolio. So it does -- it's all about supply-demand, but you don't see those kind of mall desperation moves where we compete.

Christy McElroy: We do have some questions online on Veracast. You guys are awesome. You're like doing my job for me. Can you talk about grocer demand over the intermediate term since even the better grocers like Kroger have seen EBIT margins decline to the low-single digits? And what is the average store profitability or occupancy cost for a typical grocer?

Drew Alexander: So our supermarket sales average $665 a square foot. So our supermarket occupancy cost, I don't know the specific average, but it's in very good shape. Generally speaking, we get concerned when a supermarket occupancy cost is above, say, 3%, and we don't have that many concerns in the portfolio.

So it's absolutely accurate that grocers are not investing a whole lot in new bricks. They're investing a lot more in their logistics, their supply chains, making their existing stores better, the various click-pick alternatives. So that just makes our existing locations all that much stronger.

And as far as new supermarket demand, we have seen a lot of niche activity, did several Sprouts deals over the past several months. I think they're a very strong company that has a wonderful niche. As well as some of the other specialty operators. But it is one of those plus-minuses that there's not a lot of brand-new suburban Krogers or any of that ilk. But that's fine because our centers are more close-in and they're putting money into making those more viable.

Christy McElroy: Another one on here, going back to the dispositions. Would it be fair to expect that Weingarten's future asset sales will be concentrated in the 23% of the assets that are non-grocery anchored, 9% of which are power centers?

Drew Alexander: So we'll certainly take a look at that, and that is certainly something that we would look to very, very closely. And it's almost sort of a burden of proof is the other way. As you know, Christy, following the company as well as you do, we have a number of non-supermarket anchored centers that are super-duper strong like Post Oak and Westheimer right across the street from The Galleria, Mueller Center in Austin, pretty near the UT campus. So these are up the street from federal is Pike and Rose in suburban Maryland. So while these are not supermarket, they're very, very strong.

But other, more general run-of-the-mill is where, yes, it is something that we'd look pretty closely to and something that you could see us reduce the exposure at. Because I think when people get under the hood of these things and they study them, they see that they are good. The tenants are doing well. And that's where it comes back to the arbitrage that we can sell those centers often times that we have ranked at the bottom of portfolio at underlying NAV and it makes long-term sense. It makes the company, that metric better.

Christy McElroy: Going back to your same-store growth projection for this year, 2% to 3%, 2.5% at the midpoint. Right now your lease to commence occupied gap is about 200 basis points. To what extent do you expect growth to be driven by a narrowing of that gap? And as we sit here and think about all of the, not just the bankruptcies that have occurred, and you've had multiple box retailers since 2016 file, but there's still a lot of at-risk tenants there. So the question is; do you expect a narrowing of that gap? Or is 200-or-so basis points the new norm when you have a higher level of turn among your box tenancy?

Drew Alexander: So I think we expect a narrowing of the gap. And I think a lot of that is around Toys "R" Us and some of the other big boxes. And while there have been a lot of announced closures, most of those don't affect us. A lot of them are smaller tenants. A lot of them are more mall-oriented tenants. We only have two Kmarts in the portfolio, one of them in Placerville, California, outside of Sacramento, which is currently closed. We expect to get that back. ESL is marketing it. If somebody takes over that, that would be a short-term win for us. The other is in Raleigh, North Carolina, and that's part of their long-term plan, whatever that means.

So we had very, very limited, as we see it, near-term exposure. When you look through a lot of the other at-risk tenants, the Ascenas, the Payless's, those are all very manageable to us. And we certainly pay attention to lots of other stores. But in terms of catalysts over the next 18 months, again knock on wood, I don't see anything that's as tough as the Toys "R" Us. And we have the headwinds of -- excuse me -- the tailwinds of those commencing, which will be helpful to same-property NOI both in '19 and even more so in '20.

Christy McElroy: So you don't see a headwind sort of offsetting that embedded tailwind? And I guess just combining that with a question on Pier 1. Like that's certainly a risk for this year. How do you think about that in the context of the buffer that you have embedded?

Drew Alexander: We don't have that many Pier 1s. We have five Pier 1s. So 0.28%. That's our total exposure. So again, it's also important to note, as we sit here in the first part of March, that we are sort of getting close to past prime bankruptcy season. In my opinion, the best day to file bankruptcy is March 2nd, which was Saturday. So the fact that we woke up this morning and our phones didn't blow up with a lot of filings, it's not like totally celebrate, but you start to feel better that merchants, having to put stuff in the store for the holidays, if they don't have the cash to do that, they're already in trouble. If they haven't filed by now, then they may not file this year. And even if they did file shortly, they more than likely would pay us rent for a good portion of '19.

So I'm not saying that there aren't issues to deal with. But Pier 1, at 0.28%, is nowhere near as hard to absorb as Toys "R" Us, which, surprising even to them, ended up liquidating. And some of that could be that they didn't handle it altogether perfectly through the bankruptcy court. But most people expected they would reorganize, as, throughout time, most tenants do as opposed to liquidate.

Christy McElroy: Go ahead.

Unidentified Audience Member: Yes. So when you're thinking about some of your centers, particularly as delivery, especially in affluent areas, seems to be really taking off, has there been any when you're working with towns or any sort of pushback as some of your tenants maybe are looking to add more sort of delivery ability to their stores where maybe the municipalities start to become worried about the traffic flow or the types of vehicles or anything like that?

Drew Alexander: I haven't heard anything about that. I mean we've got a number of centers in California, in San Jose, East Bay, that are more active municipalities than Houston. But no, I have not heard any pushback from the municipalities.

Christy McElroy: Another question on Veracast. For tenants that have declared bankruptcy, what percentage of the termination fees have you been able to recover? Is it material to P&L -- is it material to your P&L that you recover all of these termination fees?

Drew Alexander: So it's, of course, not really a termination fee. It's claiming in bankruptcy court. And no, it's not. It's not material. Circuit City is sort of unique one that has still continued to pay out to this day. But the amount of claim that the landlord is able to make is pretty small. And then that claim, if you get $0.20 on the dollar, is pretty good. So it's not significant.

Christy McElroy: Remind how you were treating the -- you guys had some Mattress Firm closures, right?

Drew Alexander: Just three.

Christy McElroy: Okay. And was it material to --

Drew Alexander: No.

Christy McElroy: Yes, I mean there were -- okay.

Drew Alexander: A lot of it is --

Christy McElroy: How would you treat something like that? So The Mattress Firm, there was a, I mean relative to the rents, there was a meaningful sort of claim that -- proceeds that were there.

Drew Alexander: There was a decent, as a percentage, because they reorganized, but strategically a lot of the locations they closed didn't have very much term left. So while you got a higher percentage of the pie, the pie was pretty shrunk. So it wasn't that much money.

Christy McElroy: Do you treat something like that -- I mean just theoretically, do you treat something like that in same-store NOI or does that flow through lease term fees?

Steve Richter: I think those were all in same-store, were they not?

Unidentified Participant: We didn't get any of those payments

Steve Richter: But she's saying if we would have -- if it's in same-store, it would go through sa-store NOI.

Unidentified Participant: (inaudible).

Steve Richter: Well, but it's not a fee. It's rent.

Christy McElroy: I only ask because there have been a few of your peers that are treating a little differently. So it's not as meaningful for you.

Steve Richter: If it's a termination fee, it's clearly out.

Drew Alexander: But it's not a termination fee. I think it's a recovery of bad debt.

Christy McElroy: Yes, recovery. Exactly. A bankruptcy claim, not necessarily a termination fee in the context of -- okay, we're belaboring the point. So you've obviously ramped up your mixed-use pipeline, investing capital into your assets. How do you think about sort of driving incremental value? You have a traditional asset base. When you're thinking about sort of densifying and redeveloping your assets, how do you think about driving incremental value there?

Drew Alexander: So we look at a lot of different things. As Christy mentioned, we have two big mixed-use projects in the Washington D.C. area, both Harris Teeter, which is Kroger-anchored, both near Amazon HQ2. And then we're adding a residential tower, about $150 million investment at our River Oaks Center in Houston, which is probably the third-oldest shopping center anywhere. And then lots of more simple floater buildings here, adding on to a building there. So I would say we look at everything and try to, again, make the right long-term decision.

We do occasionally, and our Winter Park project that we've talked about as a good example, occasionally we find ourselves with a tough long-term, short-term trade. So in the case of this project at Winter Park Corners, we had an empty box. We had the opportunity to do a Sprouts deal. And we could have done -- which is what we ended up doing; a nice simple deal, adding some shop space. Or we could have densified it, done some apartments over the supermarket. That would have necessitated a multi-year entitlement process and a fair amount of anxious concern about how cycles can change. So in that case, we opted for the short, simple deal. So we always run that calculus and make the best decision.

We've got an exciting redevelopment project in San Jose that we're hopeful to get entitlements on early next year. It lends itself to a much more componentized project. So our forecast at this point is we will do the retail and we'll sell off residential. There will be both some for-sale townhomes, it looks like, as well as some for-lease apartments, probably a hotel or two and probably a senior living. And the nature of the site is such that it lends itself to being more componentized.

But somebody asked me, Christy, following on some of your questions, "What would you do differently if you were private?" And I said, "Private, I'd do the whole thing." But it's something that we look at all those different factors and try to make the best decision given the facts on the ground.

Christy McElroy: And there's another question here on Veracast if you're able to answer it in under 30 seconds. Can you discuss how your Houston assets have historically performed in prior oil market downturns?

Drew Alexander: Fabulously. Again, 70% of our Houston rents come from within five miles of The Galleria. So oil is a lot less important percentage of jobs in Houston than it was 30 years ago. Even in Texas in the late '80s, our Houston portfolio stayed over 90%. So Houston is great, very comfortable with it.

Christy McElroy: All right. Great. We'll go to rapid fire. Will the strip center sector have more or fewer companies a year from now?

Drew Alexander: Fewer.

Christy McElroy: What will same-store NOI growth be for the strip center sector overall in 2020?

Drew Alexander: 2.5%.

Christy McElroy: What will -- overall?

Drew Alexander: For the strip center sector, 2.5%.

Christy McElroy: What will the 10-year Treasury yield be one year from today? Today, it's 2.75%.

Drew Alexander: 2.95%. And I get credit for last year. I predicted it wouldn't be higher.

Christy McElroy: In what year will the U.S. enter a recession?

Drew Alexander: I'm going to go with 2021.

Christy McElroy: Thank you. Thank you so much.

Drew Alexander: Thank you, Christy.