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Vesta Industrial Real Estate

First Quarter 2018 Earnings Conference Call

April 27, 2018

C O R P O R A T E P A R T I C I P A N T S

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Juan F. Sottil, *Chief Financial Officer*

Lorenzo D. Berho, *Chief Operating Officer*

C O N F E R E N C E C A L L P A R T I C I P A N T S

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Vanessa Quiroga, *Credit Suisse*

Adrian Huerta, *JP Morgan*

Pablo Ordonez, *Itau BBA*

Eugenio Saldana, *GBM*

Marimar Torreblanca*,* *UBS*

Cecilia Jimenez, *Santander Bank*

Luiz Mauricio Garcia, *Bradesco*

Alan Macias, *Bank of America Merrill Lynch*

Alejandro Lavin, *Citigroup*

P R E S E N T A T I O N

Operator:

Good morning, my name is Matt (phon), and I'll be your conference Operator today. At this time, I'd like to welcome everyone to Vesta's First Quarter 2018 Earnings Conference Call. Vesta issued its quarterly report yesterday, April 26, 2018. If you did not receive a copy via email, the release may also be found on the Company's website within the Investor Relation section.

I'd like to remind you that Vesta will be making certain forward-looking statements during today's call. Such statements are based on assumptions of future events that may not prove to be accurate, and as such they involve risks and uncertainties. It is therefore possible that the Company's actual results may differ materially from forward-looking statements made today. We direct you to our cautionary statements in the press release filed on May—I'm sorry April 26, 2018.

Joining us today from Vesta in Mexico City is Lorenzo Berho, the Chief Executive Officer; Juan Sottil, the Chief Financial Officer; Christanne Ibanez, the Company's Investor Relations Officer. Also present on our call and available for your questions is Lorenzo D. Berho, Vesta's Chief Operating Officer.

I will now turn the call over to Mr. Berho. Sir, please begin.

Lorenzo M. Berho:

Thank you, Matt and welcome to our call today. Welcome everybody at our call today. As you read in yesterday's press release, we shared the news that our Board has approved the appointment of Lorenzo Dominique Berho Carranza, our Chief Operating Officer to become Vesta's new CEO. We are very enthusiastic about this appointment, as we enter a new and promising era that will benefit from Vesta's revitalised leadership.

Lorenzo Dominique, who has been with Vesta for 16 years and served for several years in his current role as COO… He also has made significant contributions to our Company in three important areas: expanding and developing our portfolio, establishing Vesta's long-term strategy, restructuring and strengthening our organizational structure to ensure we're well positioned for future growth. The separation of the roles of Chairman and COO at Vesta ensures that we maintain our consistently high standards of corporate governance with best practices throughout our Company.

We have also initiated the COO replacement process, which we expect to complete during the transition period. I will remain as Vesta's full-time Executive Chairman, and look forward to an active role within the Company overseeing our strategic direction and continuing to strengthen our relationship with key stakeholders.

Today's news was the result of an eight-month long process, led by Vesta's corporate practice committee and confirmed through a (inaudible) vote of our Board of Directors. I look forward to working closely with Lorenzo Dominique and our best-in-class Executive Team as we enter a new and promising era for our Company with continued growth and success.

Turning to Vesta's performance for the quarter, we're pleased to have delivered a record start of the year, which is a continuing affirmation of robust global demand for high quality industrial space in Mexico. We achieved first quarter 2018 occupancy levels that again reached historic highs with robust leasing activity that demonstrated solid progress on our strategic initiatives in addition to healthy market conditions.

In the first quarter, Vesta realized a 96.8% stabilized portfolio occupancy, reflecting a 210-basis point year-on-year increase and a 150-basis point rise on a sequential basis. This continues to be driven by strengthened leasing activity, successful incorporation of acquired space into our stabilized portfolio, as well as timely delivery of our build-to-suit properties. Absorption remains strong. In the past quarter, Vesta delivered build-to-suit facilities totaling 156,960 square feet to clients, including Bombardier Recreational Products, BRP and Nestle, developed at an estimated 10.6% weighted average return on cost.

This space was also added to our stabilized portfolio with $0.67 million expected revenue for our full year. Disciplined implementation of the Vesta Vision 2020 Plan ensures that our growth schedule remains on track. Our $129 million investment pipeline, totaling 2.8 million square feet will expand our total portfolio to approximately 30 million square feet by the end of the year.

Two thousand and seventeen marked a historical milestone for Vesta, with record financial results that enabled a MXN1.49 dividend per share distribution, representing a 24% increase year-on-year. We have delivered a strong start to 2018, which is a promising sign that we'll remain on track for another record year as we continue to successfully execute on our strategy.

Turning to key financial metrics, first quarter revenues rose 22.1% year-on-year to $31.4 million, as we incorporated new GLA into our stabilized portfolio. This increase resulted in a 97% NOI margin, representing a 62 basis point increase compared to the same period last year, which exceeded our guidance by 200 basis points. EBITDA margin reached 85.7%; a 25-basis point year-on-year increase, also exceeding our guidance by 270 basis points.

While NAFTA remains under renegotiations, last week the European Union and Mexico reached an agreement in principle of a modernized EU-Mexico Global Agreement, which can be considered an important achievement for both parties in the face of increased protectionism from some other countries. This modernized free trade agreement is part of a broader strategy to diversify Mexico's trade partnerships and commercial platform, while increasing investment in both regions. We look forward to leveraging this potential new demand to drive opportunities for Vesta's state-of-the-art industrial real estate, further broadening Vesta's roster of European clients.

In summary, it was another excellent quarter. Looking ahead, Vesta's future looks bright. Today, Vesta is thriving with one of the most capable Management teams in the industry. Lorenzo Dominique has done an excellent job as Vesta's Chief Operating Officer, and will prove to be an outstanding leader, as we move into our Company's next growth phase. We will continue growing and diversifying our portfolio to better serve our clients, while creating value for our Shareholders. We're confident that Vesta will continue strengthening its role as a prime pure play industrial real estate developer in Mexico.

As always, thank you very much for your continued support, and I will now turn the call to Mr. Juan Sottil, our CFO.

Juan F. Sottil:

Lorenzo, thank you. Good morning, everyone, and thank you for joining us. As Lorenzo discussed, we had a solid start of the year, as the quality of our industrial portfolio, the healthy leasing activity we're seeing in today's market and a low rate of vacancy, again, reflective of sustained demand for our quality industrial facilities. Further, our recent refinancing means our balance sheet is strengthened to support future growth. These factors, along with supportive industrial fundamentals, place Vesta in a strong position for the year ahead.

Strong demand for Vesta's state-of-the-art industrial real estate drive absorption in the double-digit growth regions, where Vesta is present. We have had tremendous success with our leasing strategy, reflected in Vesta leasing activity for the first quarter totaling 1.8 million square feet, while adding exciting new international clients such as General Motors, Volkswagen and Avery Dennison, to name a few, and vacant space absorbed through repeat business with existing clients, Harman, Daimler and Grupo Antolin, among others, have signed early release agreements driving 2018 maturities of occupied GLA to 3% and 2019 maturities to 7.2% (phon), resulting in a total lease maturity profile of 5.6 years.

Existing clients represented 25% of new leases during the quarter. Vesta also renewed 1.2 million square feet of the Company property portfolio. Our stabilized portfolio grew 17% in the first quarter to 26 million of square feet from 22 million in the first quarter of last year. The stabilized rate for the first quarter of 2018 increased by 210 basis points to 96.8% from 94.7% over the same period last year.

Vesta delivered three build-to-suit facilities, totaling 156,000 square feet during the quarter to existing Vesta clients such as Nestle CPW in the Bajio, to Bombardier Recreational Products, which also extended its lease agreement in Ciudad Juarez up to 2030. These facilities were developed at a 10.6% weighted average return on costs and have been incorporated into our stabilized portfolio.

We ended the quarter with a total 2.8 million square feet in both build-to-suit facilities and inventory buildings under construction. For our 128 million—sorry, 128 total investment, which is expected to contribute $14.2 million to rental revenue once the projects have stabilized. As Lorenzo commented, first quarter revenue increased by more than 22% year-on-year to $31 million in the first quarter of the year, due to the increase in our stabilized portfolio that I have described.

First quarter operating cost as a share of rental income decreased 73 basis points year-on-year, due to a decrease in expenses from properties that generated rental income year-on-year. Net operating income rose by just under 23% to $30.4 million, representing an increase both on a sequential and on a year-on-year basis due to continued strong demand for our quality industrial facilities. NOI margin decreased by 62 basis points to 97, due to higher rental revenue, exceeding guidance by 200 basis points.

Total comprehensive income for the first quarter of 2018, was $36 million from $74.8 million in the first quarter of last year due to a lower non-cash gain on the revaluation of investment properties, significantly offset by a higher EBITDA in the first quarter of 2018. We also remain focused on strengthening Vesta balance sheet. In the first quarter of the year, Vesta secured additional funding to a $26.6 million recapitalization of its existing secured MetLife facility at a 4.70% fixed interest rate, providing additional firepower to complete our Vesta Vision 2020 growth plan.

Today, Vesta's loan to value is 32% and the Company will continue to identify opportunities for funding at attractive rates and parameters to optimize our capital structure. Today, Vesta has one of the industry's most competitive balance sheets. With this new loan, Vesta's debt profile is comprised of $609 million in total debt at a 4.61% weighted average fixed interest rate and a 6.7 weighted average maturity, and a 32% leverage ratio, in line with the Company's efficient debt management policy.

We look to the year ahead with confidence, that Vesta will continue to successfully execute its Vision 2020 Growth strategy. As Mexico leading industrial real estate Company, we have a strong balance sheet, state-of-the-art facilities and are dedicated to producing sustainable long-term growth for all Shareholders.

Thank you, again, for joining us today. That will conclude our prepared remarks. I will now open the floor for questions. Matt?

Operator:

Thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question is Gordon Lee from BTG Pactual. Please go ahead.

Gordon Lee:

Hi, good morning, and thank you very much for the call. First of all, congratulations to both Lorenzos on the new role. Good luck to both of you. Two questions, the first one on that, actually, I was wondering whether, you expect the CEO—COO role to come from external sourcing or are you looking internally as well to fill that role?

Then the second question is I (inaudible), but you mentioned that Mexico and EU signed their renewed free trade agreement. It looks like NAFTA finally is getting close to that as well. I was wondering as the market seems to be assuming that a NAFTA 2.0 does happen, are you seeing an increase in the pace or the seriousness of RFPs from your clients, and is that changing at all the way you're thinking about the speeds on the pipeline? Thank you.

Lorenzo M. Berho:

Okay, well, thank you very much, Gordon, and thank you for being here and thank you very much for the question. Yes, we are very enthusiastic about this decision that the Board took yesterday. I just wanted to highlight how the—how institutional this process was. It took eight full months, corporate practice worked really hard. We developed association policy, we incorporated everything we needed to do in a process and selection and that ended up with the decision we announced yesterday.

Now, on the other hand, of course, the COO is another position that we are really open to analyze that from now. Too, we believe the—overstress also that's enough time for us to explore and do whatever it takes to get the kind of talent that we need for that position, either internally or externally. We're open to that. It's a key position and we will replace that, as we have done in the past, with other positions with the best talent that we can find in the market, and internally.

Related with the second questions, yes, well, as we mentioned, yes, we were—actually, I was in Germany for the Hannover Fair, and a day before in Brussels they announced the agreement in principle, which was great. I think the timing was great. It shows how committed the government and the private sector is to find out solutions to the gaps that any renegotiation presents. I believe that Europe was a strong partnership. Mexico was invited at the fair at the Latin America guest countries for the first time, and it was amazing the support, the European companies, especially German companies gave to Mexico. It was all over the news, but we felt that directly, and that shows how much interest there is in keeping developing these investments and partnership and transfer of technology and the potential they see, especially in Mexico. We were very active in those days.

Now related with NAFTA, we have also felt, as you said, we are tracking the news every day and we know that our leaders are—our government is very active in trying to finish the different tables, in different subjects each time, and I believe it looks like they're making a good progress on that. That is reflected also in the leasing activity and pipeline that we have had. I would say that, that shows that expectation is there, but also that the demand is there and companies are expanding and making decisions, looking forward for improving their positions and production in Mexico.

Gordon Lee:

Great, thank you very much.

Lorenzo M. Berho:

Thank you very much, Gordon.

Operator:

Our next question is from Vanessa Quiroga from Credit Suisse. Please go ahead.

Vanessa Quiroga:

Yes, thank you and thank you both for this important change for the Company. My first question that I have is regarding the positive momentum that we are seeing in your portfolio and your market. I was wondering, if you think with a NAFTA resolution, you can actually accelerate the developments that you have right now, or even start more developments than you were planning. If you think that's a possible scenario?

The second one, if there is a vision beyond the Plan 2020, given that it's already quite on track and we are close to that year. If you have a general idea of what could be the next headline objective of the Company beyond that year? Thank you.

Lorenzo M. Berho:

Okay. Well, thank you, Vanessa, for being with us today, again. Thank you for your questions. Let me start by the second one, if you allow me, and I would say that, yes, we have been working, as we did in the past with our Vesta Vision 2020 Plan and we share a vision that ends up in the year 2020, December 2020, so we're getting closer. It's interesting to be able to analyze how accurate that plan has been throughout this year and that we are on track. We're working on that and we are very happy of the progress on and the results obtained.

Now, as you said—as I mentioned, too, when we celebrated our fifth anniversary as a public Company last July, we are also working in our Vesta Vision 2040 plan, and we will start sharing some information of that in July, when we celebrate our 20th anniversary of Vesta, which, by the way, you would be—of course, all of you will be invited, in Mexico. I believe that it would be a good opportunity for us to give you some visibility of how we see the future and what we are looking out and approaching.

But definitely, it looks that the potential of Mexico, the potential of the sector in which we participate, and the kind of the speed that the investments are coming to Mexico and the results that companies are having, are a key indicator of the opportunities that we see ahead. We will start sharing that, as I told you, in our—one quarter from now, which is July 26.

Vanessa Quiroga:

Excellent. Thank you, Lorenzo.

Lorenzo M. Berho:

Thank you very much, Vanessa.

Operator:

Our next question is from Adrian Huerta from JP Morgan. Please go ahead.

Adrian Huerta:

Hi, thank you. Good afternoon and congrats, as well, Lorenzo and Loren for your new positions. One question, also related to Vanessa's question, how do you feel on the level of greenfields under construction that you have at the movement of 260,000 square meters considering that you might be reaching probably close to 400,000 of absorption in the year? Does that look low to you? Should you start new construction soon or are you waiting to have a bit more visibility on NAFTA, elections, et cetera?

Lorenzo M. Berho:

Hello, Adrian. This is Lorenzo Berho, CEO and thank you very much for being on the conference call. Definitely, I think that Vesta has been always very close to its market, identifying opportunities and particularly identifying when we should start construction or when we should control the pace of the construction pipeline that we may have. I think that by being very close to the markets has given an edge to really tap into interesting opportunities and being able to close very important leases, particularly in the last couple of years where times have been a little bit more uncertain than others. That advantage, we're going to keep on—keep on taking an important position.

Currently, we have a strong pipeline of 2.7 million square feet, which corresponds to a large amount of investment, currently almost at $130 million and we believe that as long as we keep on with this strong leasing activity that comes from existing companies expanding, as well as new companies entering the markets where we're at, we're going to keep on with the same momentum. It is important to identify the opportunities and to identify them in advance.

I think that the other important topic to mention is that we are currently developing infrastructure in certain industrial parks, or let's say raw land, that we acquired recently, and we are putting together the infrastructure, so that when new projects might come, we already have the infrastructure in place, so that we can start build-to-suit projects. As you might have perceived, the markets are still very strong. Vacancy rates are very low in most of the markets where we're at. A very good example is Tijuana. Tijuana has a vacancy rate below 1%.

Those are the markets where we still want to be cautiously aggressive, and taking advantage of good opportunities, that may rise in the market.

Adrian Huerta:

Thank you, Lorenzo, and what are these places where you are building this infrastructure?

Lorenzo M. Berho:

Sure. This is an industrial park in Queretaro—it's the Vesta Park Queretaro, where we are almost about to finish the infrastructure very close to the Aerospace Park and we're going to tap the logistics market, aerospace market and automotive market. It's a 100-hectare park which we will have two available buildings for this quarter and it will be a very interesting park that we would like you to visit it someday.

Another important project is in San Luis Potosi where we started the infrastructure right next to BMW. We recently announced an investment of $90 million, right, which will be a supplier park mostly dedicated to BMW since they will start operations in 2019. The other infrastructure we are investing on is in an industrial park in Aguascalientes, which is roughly 90-hectare park, where we are going to have two available buildings in the next quarter.

This is very close to the Daimler and the Nissan plant. In the end, I think this is where Vesta is good at, taking advantage of being able to acquire well located plots of land, putting the right infrastructure in place, doing it at attractive costs and then turning everything into good leases at very attractive returns. Therefore, we will continue doing so as long as we still see good demand.

Adrian Huerta:

Very, clear. Thank you, Loren.

Lorenzo M. Berho:

Gracias.

Operator:

Our next question is from Pablo Ordonez from Itau. Please go ahead.

Pablo Ordonez:

Hey, hi, good morning, congratulations, Lorenzo and Lorenzo Dominique, on your new roles. My question is regarding your profitability margins, which were above the guidance. Do you think that these levels are sustainable and if this were in-line with your budgets, when you issued guidance last year? Also, a question on this is, if the salary expenses already reached a level required related to your new focus on the asset management company? Thank you.

Juan F. Sottil:

Thank you for the question. This is Juan Sottil, Pablo. Look, yes, when we provided the forecast and the guidance on revenues and EBITDA, perhaps I was a little bit restrained in my optimism for the Company. I do believe that we have an outstanding EBITDA growth and an outstanding EBITDA margin. I believe that we will be comparable to this quarter throughout the following quarters. Of course, you have to remember that as our pesos, our administrative and marketing costs are basically based on pesos, so exchange rate is a factor in those. However, the strong growth in sales gives me a lot of optimism to continue to feel that we will be more than exceeding our margins.

As regarding on salary and costs, two items are important to take note. One is we have increased the head count of the Company to be offering best-in-class asset management services. I believe that we have achieved the necessary economies of scale. There will be positions here and there that we'll need to continue to hire. Every time we open a new park in a new location, we need to staff that park with the proper people but that's on the margin. The thrust of the head count, I think it's in place.

As our profitability and performance in the Company—in the operating metrics of the Company, as well as in the total return, performance of our share price, that will also impact our—the performance of the respective bonuses performance of our officers and that can become a factor now. But again, as you'll recall, based as—our bonuses, our main bonuses—our long-term incentive is really aligned to the Shareholders. We basically base our long-term incentive in a total relative return of our stock prices. As our Stockholders benefit, our top Management will benefit as well.

The key operating metrics that we use for bonuses performance metrics on our—the rest of our staff basically motivate them to excel on these operating activities. I think that also shows on the numbers we have provided to the market over the last quarters.

Pablo Ordonez:

Very clear. Thank you, Juan.

Operator:

The next question is from Eugenio Saldana from GBM. Please go ahead.

Eugenio Saldana:

Hi guys, congrats on your results, Lorenzo congrats on your new appointment. Following up on the Mexico and the European Union Trade Agreement, that you were mentioning before, I mean, do you have a figure, an idea of how many of your tenants or how much of your GLA benefits from these new trade agreement, I mean, as of today? Regarding your 2020 Plan, I mean, what's the part for 2018, is it already funded, or do you think, I mean, you're going to need any further capital? That would be all. Thank you very much.

Juan F. Sottil:

Let me start by the second and then Lorenzo will address the trade agreement impact on Vesta. On the second, Eugenio, our balance sheet is quite strong. We only have, roughly speaking, a 38.4, whatever, loan-to-value. Our balance sheet has sufficient leveragability to fund our growth throughout the Vesta Vision 2020. Furthermore, I don't think that the Vesta Vision, the end of the Vesta Vision 2020 implies any dramatic change in our balance sheet. I think that—the fact that we are not a fee (phon)—the fact that we can retain earnings implies that we can sustain quite a good pace of growth without any implications.

We also are taking the steps this year to finalize the funding of our development property. If you see our balance sheet, we have close to $90 million in cash and equivalent, and we have a revolver facility, which is totally unused for another $100 million. We basically have financial flexibility of close to $200 million. That gives us a lot of time to look for new funding opportunities that become long-term funding mechanisms of debt for the Company, not to rely our growth on a short-term measure like a revolver facility. We feel quite comfortable, the maturity profile of our debt is quite staggered. We don't run any interest rate risk, all of our debt is fixed at a very attractive cost. We feel very comfortable in that regard.

On the first question, Lorenzo will—

Lorenzo M. Berho:

Yes, Eugenio, thank you, again, for your question, and let me tell you, related with the agreement, and the agreement in principle reach, I would say that the most important part that I foresee is the signal that is sent to Europe, and as—Europe coming from Mexico, of the potential that Mexico has for European companies. In this regard, I want to tell you again, the reason why we were in Hannover, we had a booth within the ProMexico stand, which was a huge stand. We participated in several panels.

The fact that they recognized Vesta as a company that understands more Industry 4.0 and what's happening with the Fourth Industrial Revolution, combined with the signal sent of an agreement, or in principle, reached within these days, is the opportunity that we needed, because Daimler, BMW, many European companies, really, they want to increase their plants in Mexico and they look after a serious company that understands, that speak the same language, that has the quality, that delivers and especially state-of-the-art buildings.

They believe that Vesta is a perfect match for them. I would say that we more than, in fact, figure, what we will see is that the more we get into some—into these kind of a success by getting and reaching to an agreement after so many months of negotiations are sending the right signals. We hope that—the same happens with NAFTA and so on, with other elements around. But I believe that the fact that Mexico was invited, the fact that, by the way, as Loren was mentioning, that we announced this 90 million investment in San Luis Potosi. It was because many governors were there, including the Governor of San Luis Potosi. That has never been a representation of Mexico, as the one that was hold this week in Hannover. I'm very positive on that and Vesta is in the right niche, in the right time and with the right product and services.

Eugenio Saldana:

Thank you very much.

Lorenzo M. Berho:

Gracias, Eugenio.

Operator:

Our next question is from Marimar Torreblanca from UBS. Please go ahead.

Marimar Torreblanca:

Hey guys, thanks for the call and congratulations on your new roles as well. My question is regarding the M&A arena, we saw you more active on M&A late last year, and I wanted to know if you've seen anything this year and if you felt a change in sentiment from the sellers or from yourselves, if you're seeing differences in cap rate levels, anything that has changed so far for potential M&A? Then, the second one is, if you could discuss what's your view on capital recycling at this point and if you think that there's an opportunity that's significant for you for doing more on this area?

Lorenzo M. Berho:

Hola, Marimar, this is Lorenzo again, and thank you very much for being on the call. Definitely, we have always been analyzing potential acquisitions, always in an opportunistic manner. Last year, we were able to close an interesting transaction in a market that we like a lot which is Tijuana. We were able to acquire a portfolio below replacement cost, and an attractive return, with very interesting tenants and good quality assets. We'll keep on doing so. Nevertheless, we believe that we can—we will only pursue those transactions that we believe add value to our existing portfolio, and that are in line with the quality of assets that we have put together and the quality of the portfolio.

As long as that keeps on tying up to what we are currently developing, I think that we will still be pursuing some more M&A. We are currently looking at some. Some of them are smaller. Nevertheless, I think that today we are in a position where we can keep on with our strong development pipeline at very attractive returns with brand new assets in very high growth markets as we have been doing lately. Also, analyzing the—still in an opportunistic manner, the acquisition opportunities. We want to keep being very, very disciplined on that.

Regarding your second question on capital recycling, definitely we were entering into a new stage of the Company. We currently own 30 million—we're about to get to 30 million square feet portfolio. If you remember, we started being as a public Company with only 11 million square feet. This has been a very important growth, and looking into the future definitely there will be some capital recycling, through a sale of some of the assets. Nevertheless, I think that this is going to be—this could be minor events and not necessarily will there be any sales of assets in the short term. This could probably be more closer to a new strategy, probably more in the mid-term. Nothing for the moment, and at some point, we will let you know.

Marimar Torreblanca:

Thank you.

Lorenzo M. Berho:

Gracias.

Operator:

Our next question is from Luiz Garcia from Bradesco. Please go ahead. I'm sorry, sir, your line is live. We move on to next question here from Cecilia Jimenez of Santander Bank. Please go ahead.

Cecilia Jimenez:

Thanks. Hi, Loren, Juan. Good morning, thanks for taking my question and, of course, congrats on the appointment. I have a question regarding construction cost, and I would like if you can share with us, how much has construction costs increased for you on a per square or per meter basis over the past, I don't know, two years? Related to that, whether you have able to pass that increase in construction cost to rent prices in order to keep the margins? That would be my first question. Thanks.

Lorenzo M. Berho:

Hola, Cecilia, thank you very much for being on the call. I'll start with construction cost, construction costs in terms—in peso terms have increased since cement has increased and also steel. Nevertheless—in the last six years, five years, whatsoever—nevertheless, in U.S. dollar terms, because of the devaluation of the peso, we have actually seen that construction costs have diminished. There has been a roughly, let's say a 10% to 15% reduction in construction costs in U.S. dollar terms, because of the foreign exchange rate effect.

Then the rents that we have seen—still, particularly in the markets where we are strong at, which is the Bajio region in the north part of Mexico and Central Mexico, Toluca and Puebla—the rents are still strong and holding in U.S. dollars mostly, and rents have been either flat or even increasing in some of the markets. If you still make the—if you consider the combination of having still good rents, sometimes even hiking, and lower construction costs, our profitability and our returns are actually higher than before. If you look at the development portfolio and the development pipeline that we currently have, the 2.7 million square feet we have estimated at a return on cost of 11%.

In many of the inventory buildings, which we believe has been a very smart strategy, in most of the inventory buildings in the Bajio region are—the average is even closer to 11.2%. This is a sign that costs are more competitive in dollar terms and that the rents are still holding and sometimes even hiking, because of the strong market fundamentals in this particular market. Therefore, we believe the development strategy will be something key looking into the future for us.

Cecilia Jimenez:

Perfect, thanks, Loren. I have a second question related to leasing activity, if you can share with us which are the main areas or the main sectors that have been driving strong leasing activity? I don't know if it's been across the portfolio, or if you have seen particular areas that are actually growing faster. That's it. Thanks.

Lorenzo M. Berho:

Sure. Definitely, and it's very interesting times because we are seeing that, across the country, there has been a pretty strong and solid demand and it's mostly coming from multi-national companies that are expanding. There are new companies also entering the market. Most of them, because they are strongly tied to the automotive industry, which is still growing at a very fast pace… As you know, there are many of the OEMs that have not started operations as BMW. It will start in 2019. Daimler will start in 2018. Japanese companies will start 2020, 2021.

We have actually, just this quarter, we closed nine leases with companies from Germany, companies from the U.S., companies from Japan, mostly in the automotive industry, but also in the electronics industry, in the medical device industry and also in the logistics industry. It's still very well diversified and the markets are holding extremely well. We believe that actually this momentum we'll keep on looking into the next quarters. We have a very strong pipeline of requests for proposals that could turn into leases in the next quarters.

Therefore, our strategy has been to keep on developing inventory buildings and capture all the demand that we have identified and needs to enter the—that needs to open new operations in Mexico.

Cecilia Jimenez:

Perfect, thanks. I have a final one, if I may, just on this regard. We have heard some players mentioning increasing competition, particularly the Guadalajara, Monterey Market from local players and also from larger players. I'd like to hear your view on this, whether you have seen increasing competition, particularly in Guadalajara region. Thanks.

Lorenzo M. Berho:

Sure. As you know we are—the markets where we're at, we want to take leading positions in those markets, particularly Bajio region, as well as Juarez, State of Mexico and Tijuana. Nevertheless, we always analyze other potential markets. You're right, I mean, markets like Monterrey is very fragmented, with different players, local players, institutional players. There is a lot of land available. Therefore, I think the developers have—need to have a different—let's say different ways to differentiate. Guadalajara has not that many players as Monterrey has. Nevertheless, I think that competition is still strong and demand is not necessarily as strong as other markets like the ones that we are seeing in the Bajio.

The Bajio region, for example, I think that there is some competition. Nevertheless, I think that Vesta is very well positioned, as a larger developer, as a leading developer in some of these markets. We have very good inside information of what's really happening because of our tenants or because of the relationships we have with potential tenants. Therefore, we believe that even with some competition, there could be strong demand and there could be good opportunities to close on potential leases even with some smaller competition that may arise, particularly in the Bajio market.

Cecilia Jimenez:

Okay. That's very clear, Loren. Thanks for the explanation.

Lorenzo M. Berho:

Gracias.

Operator:

Our next question is from Luiz Garcia from Bradesco. Please, go ahead.

Luiz Mauricio Garcia:

Thank you. My question is actually on the same topic you just discussed. Maybe last year and after '16 U.S. elections, we saw a slowdown in your development and what (phon) you've just discussed about the new competition carrying that, my point is that, you are—do you expect an even stronger pace of new developments taking, starting now taking off, mainly after the Mexican elections, so not only in the regions you just mentioned but also in other regions, given that the internal rate of return of Mexico is so attractive and the pipeline is good. What do you expect in terms of supply going forward? If demand is also expected to keep following supply, definitely is not an issue, but what is your view about this given that we are seeing many other players who start looking to increase development in Mexico?

Lorenzo M. Berho:

Great, thank you. Thank you, Luiz, for being here and thank you for your questions. Definitely, we think that there is—there are many developers that are just waiting to see what will happen. In order to make decisions, we internally have decided to go a little bit deeper and analyze in each of the markets, to analyze where the demand is going and our decision has come mostly when we see that there could be strong potential demand and there could be more opportunities and that's when we make decisions on starting construction, for example.

As you can see, we have—currently, we have the highest level in terms of occupancy and this is only a reflection of strong leasing activity that is coming from strong demand in certain markets. Therefore we believe that as long as there is good demand and there is good companies tapping the market, we will still be developing. We currently not necessarily are only dependent on, let's say, exogenous matters as political issues. We're more concentrated on our clients and the potential of our clients to keep on growing and just servicing them as we have done in the past. As you remember—as you might know, more than 50% from our growth comes from existing clients. As long as our clients keep on growing, I think that we're going to be closer to them to serve them.

Additionally, I think that it's not easy to start construction or to just, let's say, restart construction whenever you want. One of the advantages that we have is that we have very well located land with—and as I mentioned, and in some cases land that we're putting infrastructure in place so that when demand comes, we are ready to start construction and for other developers, this will take them a while. For the ones that have stopped developing for the last couple of years, it will still take them a couple of years probably to start.

Luiz Mauricio Garcia:

Okay. No pressure on lease price expected in—even if the supply starts increasing?

Lorenzo M. Berho:

We don't feel it right now. We don't feel it right now. We are very close to understanding how the demand is and how supply is and therefore, currently, we don't see that as a threat.

Luiz Mauricio Garcia:

Okay. Great, thanks.

Operator:

The next question is from Macias Alan from Bank of America. Please go ahead.

Alan Macias:

Thank you for the call. Just one quick question at this point in time, how should we be thinking about dividends per share for next year given the solid dividends per share you paid this year? Thank you.

Juan F. Sottil:

Alan, thank you for the question. Look, our dividend policy is quite—I believe it is—we have been quite transparent. Basically, what we do is, it is based on FFO. It is not based on yield. Basically, we are committed to this previous FFO minus capital repayments for those debt that amortizes, minus certain prudent reserves for maintenance and/or broker payments. Out of that number, which is quite similar to adjusted FFO, we basically distribute up to 75%. If you look at our track record, based on this formula we have never distributed less than 70% and we have sometimes paid as much 75% of the formula.

We are keen on continuing healthy distributions. Our repurchase program have helped to boost the dividend per share, of course; that's one of the big purposes of the repurchase program. Next year, if our

FFO continues to grow, as I believe it will, then you can look forward to a very nice dividend payment. That's more or less the thrust of the point now.

Alan Macias:

Great. Thank you.

Operator:

Once again, as a reminder, if you'd like to ask a question, it is star, one. Our next question is from Alejandro Lavin from Citigroup. Please go ahead.

Alejandro Lavin:

Hi, good morning, everyone. Thank you for the call, congrats on the results and the new appointments. I have a follow-up question on dividends. Obviously you're posting very strong numbers, you seeing strong fundamentals. You could even have macro tailwinds if NAFTA goes well, et cetera. At the same time, you have a very strong development pipeline. You're also looking at M&A opportunistically and even buyback opportunistically. Right. There are plenty of attractive opportunities out there.

My question is, then, why pay dividends? I mean, isn't it best to reinvest this money in all these good opportunities?

Juan F. Sottil:

Alejandro, I love your question, because we actually have a very active dialog between Management, Lorenzo, Lorenzo Dominique and myself, and we have an incredibly strong argument in our Board meetings when we make the dividend decision. Not only the dividend decision, but also the repurchase decision. At the end of the day, we see our role as managers or as the key promoters of our correct capital allocation process. Every time we do a built-to-suit or an inventory building, we evaluate that decision against capital repurchases.

Every time, at the end of the year that we know the FFO number, we try to guide the percentage between, as I mentioned 70% to 75% or it could be up to 75%, against the opportunities that we see on the market. I believe that the sense of paying dividends is best represented by our desire for our Shareholders to understand that we will have always a discipline of returning money to them when there is no better allocation in our core business.

At the same time, when the necessities are of being a little bit more restrictive on dividend payments, we will also be quite clear on why we will be paying lesser percentage than the previous year, because we see a substantial opportunity to grow the Company in a profitable direction. We will be—transparency will be our guiding thought and we will be quite forthcoming on the explanation. But, yes, we ask ourselves and we have active discussions in the Board if we should continue to be aggressively growing the dividend. That's the bread and butter of every Board meeting.

Alejandro Lavin:

Okay, understood. Muchas gracias.

Operator:

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

Lorenzo M. Berho:

Well, thank you, Matt, and thank you, everybody, for participating in Vesta's first quarter 2018 conference call. These are exciting times for our Company. We will continue to update you on our progress as it unfolds. If you have any questions in the meantime, please do not hesitate to contact our Investor Relation department. I would also want to remind you about our 20th anniversary in July 26. We will let you know and give you the details. We would love to have you with us and celebrate together. Thank you, everybody, and have a great day.

Operator:

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