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Vesta Industrial Real Estate

Fourth Quarter and Full Year 2018 Earnings Conference Call

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PRESENTATION

Operator:

Good morning. My name is Dana and I'll be your conference Operator today. At this time, I would like to welcome everyone to Vesta's Fourth Quarter and Full Year 2018 Earnings Conference Call. All participants are currently in a listen-only mode. And as a reminder, today's call is being recorded.

I would now like to turn the call over to your host, Ms. Christianne Ibañez, Vesta's Investor Relations Officer. Please go ahead.

Christianne Ibañez:

Thank you for joining our call to discuss our financial results for the fourth quarter and full year 2018. With us today from Vesta in Mexico City are Lorenzo Dominique Berho, Chief Executive Officer, and Juan

Sottil, Chief Financial Officer. Following their prepared remarks, there will be a Q&A session, during which time we will answer your questions.

Yesterday, we discussed our earnings press release after market close. The release is also available within the Investor section of Vesta's IR website.

Before turning the call over to management, I'd like to remind you that this conference call includes forward-looking statements based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with cautionary statements and other information contained within the Company's earnings release dated February 14, 2019, and within the most recent regulatory filings for a discussion of those risks.

All figures included herein were prepared in accordance with IFRS and are stated in nominal U.S. dollars unless otherwise noted.

Let me turn now the call over to Mr. Berho. Please go ahead.

Lorenzo Dominique Berho:

Thank you, Christianne. Good morning, everybody, and thank you for participating in our earnings call today. I have been leading Vesta for a little over six months now, so it's personally gratifying to see our Company extend what is becoming a seven-year winning streak.

Two thousand eighteen was another year in which Vesta excelled. We surpassed our upper ranges of our performance guidance and generated the highest returns in our sector, as we remain disciplined in our approach to leasing and how we allocate our stakeholders' capital. We continue to leverage Vesta's market-leading position and strong balance sheet, as well as our deep customer relationships and strong presence in our chosen local markets, both of which give us unique visibility into emerging market trends and enable us to capitalize on the incremental growth opportunities we see on the horizon in existing and new markets.

As we continue building out and optimizing our property portfolio under the Vesta Vision 2020 strategic plan, the goal continues to be driving total shareholder return and net asset value expansion, as well as maintaining an attractive dividend policy. In fact, our Board of Directors recommended to its shareholders to approve within the next shareholders meeting a $52.2 million dividend payment, which is more than 10% higher per share than last year. In order to follow best practices globally for real estate listed companies, it will be distributed on an equal quarterly basis starting in April 2019.

We only invest in areas where there is high demand. Tijuana, Juárez, and Silao in Guanajuato are perfect examples of outstanding performance, with 16 new contracts being signed during the year, which represents around $1.2 million of total leasing activity with excellent multinational clients, such as DB Schenker, CURT, Nishikawa and AG Industries among others. Each development project within Vesta is carefully reviewed and vetted to ensure the investment will be accretive. Additionally, whenever we believe we can increase return, we will return it to our shareholders in the form of periodic share buybacks, as we have strong conviction on the value of our property portfolio and continue to have an eye on the discount at which Vesta shares trade relative to net asset value.

In light of Vesta's strong performance last year, steady client demand, healthy market conditions across the regions in which we operate, and a strong development pipeline, we are affirming our guidance for 2019. However, some macro challenges remain. There is uncertainty related to economic growth in the

U.S., Europe, and China, and it also remains to be seen how trade disputes are resolved and how new trade agreements are implemented. And here in Mexico, a new political environment is evolving, as the new administration finalizes its policies. Nevertheless, a strategic location, low labor costs, and highly skilled engineer talent, all continue to make Mexico a desirable hub for global manufacturers. Its appeal is also why we have seen demand related to investments by more Asian companies, such as ones from China.

A somewhat tenuous environment is another reason why our proximity to clients is so important. Using the superior market intelligence this unique position affords us, we continue to calibrate our investment plans. Our ability to lease large portions of spec space speaks to our ability to anticipate market demand to effectively manage risk as well as size opportunities to achieve higher levels of growth. Further, the diversity of Vesta's customer base lowers our risk in the event of any economic downturn in the future.

Among our scale advantages is Vesta's balance sheet, which we continue to strengthen, and which have a loan-to-value ratio of 35% at year-end. As we do this, we enhance Vesta's strong position in the credit markets, where interest rates have been rising and our ability to borrow comparatively favorable terms.

Now, I'd like to discuss certain areas, Vesta's fourth quarter and full year performance, before turning the call over to Juan to discuss some of the details of our performance.

Despite volatile macroeconomic conditions, Vesta generated net asset value growth of just over 4% in 2018, resulting in a 6.6% net asset value per share annual growth for the last three years. Total shareholder return was just over 16% for the year, to which our solid dividend policy contributed. Robust leasing activity, 43%, which came from new world-class clients and a historically high occupancy level of just over 97% in our stabilized property portfolio, are what drove a 21% increase in annual revenues. This growth delivered a 96.3% NOI margin, while continued disciplined expense management also contributed off an expansion of Vesta's EBITDA margin, which rose to just 85% for the year. Higher taxes at the end of 2018 mostly led to a nearly 2% decline in Vesta's FFO.

On the investment front, we expanded Vesta's property portfolio to nearly 30 million square feet, a 12% increase in our GLA. Aside from an opportunistic acquisition in Tijuana, 96% of this growth was organic. Our expansion plans remain focused on Mexico's most dynamic markets. As always, we emphasize accretive long-term leases with high-quality tenants from diverse industries and geographies. While we invest to generate new sources of growth, we never lose sight of optimizing Vesta's existing portfolio. The local teams of our newly appointed portfolio officer remain methodical in their approach to optimization. They also work hard to continually cultivate relationships with longstanding clients who occupy a large portion of Vesta's properties. It's why approximately 50% our leasing activity is repeat business.

Before I turn the call over to Juan, I would like to announce that on June 4, 2019, we will be holding our Investor Day Conference in New York City. During that day, other members of our Management Team as well as some Board members will also present to give you a deeper insight into how we intend to continue building on Vesta's success. They are an integral part of our ongoing efforts to optimize corporate governance, best practices, current property portfolio and the selective expansion to capitalize on the growth opportunities we see ahead in our current markets and in new ones. This will also be an opportunity to present to our investors our strategic plan for the years after the execution of our 2020 plan. Please look out for further details that our Investor Relations team will be sending in the coming days.

Now, I will turn the call over to Juan to discuss the details of the quarter and the year.

Juan Sottil:

Thank you, Lorenzo. Good morning, everyone. As Lorenzo noted, we exceeded the upper range of our 2018 revenue guidance and delivered a net operating income margin of 96% and an EBITDA margin of 85%. We were also above our target. I'll provide additional details on Vesta's strong performance, as well as insights into what drove it, with an emphasis on the final quarter of the year.

The 21% increase in fourth quarter revenues to just over $35 million was mainly due to our strong leasing activity and steadily improving prices. We had a nearly 8% increase in monthly rent per square foot, which reaches an historical high of $0.415. The nearly 862,000 square feet of lease renewals in the quarter drove 2019 and 2020 maturity to 4.8% and 5.9%, respectively. Our lease maturity profile remains at 5.3 years with scattered maturities.

Vesta's net operating income grew just over 19% to $33.5 million, and although our operating margin decreased approximately 100 basis points versus last year's quarter, we finished the year with more than 100 basis points above our original target for the year. Year-over-year margin compression was due to a non-cash structural maintenance provision that we have introduced to our financials for future maintenance cap ex needs. Costs in fourth quarter 2017 did not consider such provision.

Administrative expenses rose slightly to just over $4.5 million, with the margin expense remain unchanged. This, coupled with the strong interest, increase in revenues, resulted in a 24% increase in EBITDA and a 224 basis points expansion to our EBITDA margin. It was just over 83% for the quarter. Due to the repurchase of around 5 million shares during the quarter, EBITDA per shares rose 24%. Forty one million shares have been repurchased under Vesta's buyback program and 25 million shares are currently in the process of being cancelled, and we will continue to cancel shares on future potential buybacks.

Moving further down the income statement, there was a 45% increase in interest expense totaling $9.6 million, which reflect the management efforts to lever the Company to its healthy capacity using marginal debt increases, along with sustained earnings to fund Vesta's development pipeline.

Regarding the latter, we will always favor organic funding in addition to being disciplined with capital allocation. The current tax on Vesta's operation resulted in a $4.22 million gain, a combination of a gain related to the exchange-rate related portion of the current tax and a minor current operating tax.

Funds from operations in the quarter increased 6% over the last year to $23.8 million, aided by the positive current tax that I explained earlier. On a per-share basis, FFO was $0.0393, increasing 5.8%, taking into account our share repurchase during the quarter.

We remain on track with our cap ex plan, which calls for $125 million of investment per year, or 3 million square feet. Capex for the quarter reached $37 million, primarily for the construction of new inventory and build-to-suit buildings in the north and the Bajio region.

During the fourth quarter, we added four inventory buildings to our operational portfolio, expanding GLA to approximately 750,000 square feet, of which nearly 30% is occupied. We added one build-to-suit building, expanding GLA nearly 215,000 square feet.

Vesta development portfolio was just over 1 million square feet of GLA. The weighted average cost for this project was 11%. We also expanded Vesta land bank, which increased nearly 12% sequentially to 37.5 million square feet with 17 million square feet of potential buildable GLA.

At the end of the year, the total value of Vesta investment property portfolio was approximately $1.9 billion, a nearly 11% year-on-year increase. During the fourth quarter, our satellite portfolio expanded just over 9% to 27.9 million square feet, while occupancy in this portfolio increased 192 basis points to 97.2% compared to fourth quarter 2017, while our same store portfolio grew 20% to 25.5 million square feet and occupancy in this portfolio rose to 276 basis points to 98.2% compared to the same period of last year. Both occupancy levels are historical highs for our company.

Vesta's total property portfolio increased 12% to nearly 30 million square feet of GLA year over year, with the addition of 11 properties that brought the total to 184 properties, while our vacancy rate finished the year at 8.2%, despite the 2.2 million square feet of inventory that we added this year.

As Lorenzo's stated earlier, our 2019 guidance remains unchanged: a 12% to 14% increase in rental revenues; a 96% NOI margin; and an 85% EBITDA margin.

Operator, that concludes our prepared remarks. Please open the call for any questions.

Operator:

We will now 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.

Our first question comes from the line of Pablo Monsivais with Barclays. Please proceed with your question.

Pablo Monsivais:

Hi guys. Good morning. I have just one quick question. Can you please elaborate on the optimization plans you are referring to? Are you thinking on selling assets? If so, can you please give us more details on size and timing? Thank you.

Lorenzo Dominique Berho:

Hola, Pablo. This is Lorenzo Berho. Thank you for being on the call. Definitely, I think optimization of our portfolio is a key strategy in order to have the best type of buildings in the right locations with the right type of tenants with a good mix of different industries and that's what we have been working in a very disciplined way over the years. This isn't something new.

Additionally, what we have not done in the past has been asset capital recycling through asset sales, and as we have expressed in the past, that is something that we will be analyzing in order to finance part of our funding needs, and we will be doing that in the near future. Nevertheless, as you know well, we are still focused on the growth of the Company on having better operating metrics, increasing occupancy, extending the leases, having more and better credit-rating tenants and that's, in the end, what we have been working on in order to optimize the portfolio. As you can see, we have currently record high occupancy levels in same stores in stabilized portfolio. And in total portfolio, it's basically the new buildings that we're putting into the market, the ones that are vacant, which are currently in a lease-up stage. And that's the nature of our business and we're still—we will be focusing on leasing of those buildings in the strategic markets that we have identified.

Pablo Monsivais:

Okay. Thank you.

Lorenzo Dominique Berho:

Gracias.

Operator:

Our next question comes from the line of Eugenio Saldaña with GBM. Please proceed with your question.

Eugenio Saldaña:

Hi, Chris, Juan, Loren. Good morning. Congratulations for the overall 2018 results. Thank you again for taking my questions. First one, I would like your view on the industrial real estate market cycle. We've heard from other participants that they fear supply might be surpassing expected absorption. You added two build-to-suits to your development roster this quarter. Do you share this decision with the markets or is this decision related to the fact that you feel comfortable that the Vesta 2020 expansion plan is 90% completed and you wanted to slow down development? The second one, and related to this expansion plan completion that I just mentioned, what are your next strategy steps or what are you envisioning doing for the next, let's say, five years, and if you are considering changing your dividend policy going forward? Thank you very much.

Lorenzo Dominique Berho:

Perfecto. Gracias, Eugenio, and thank you for being on the call. This is Lorenzo Berho again. Definitely one of the things we track very well and very detailed is exactly how the markets are performing and how the fundamentals are weighting in each of the markets. And that's how we have defined our strategy towards developing spec buildings, acquiring land. What we have seen in the past is that companies are still leasing up space, and companies are still expanding operations. And that together with still a lack of Class A industrial supply is that we have been able to capitalize in order to be able to close deals. I think that in our business it's very—I think we have a very clinical type of analyzing things, and we have been able to anticipate to demand. Whenever demand slows down, we can also be able to anticipate that.

So I think we feel comfortable with the amount of our space that we're developing currently because we have been able to lease it up. And a sign of that is the last eight quarters. So looking forward, we'll keep an eye on it. If it slows down, we can react very rapidly. If it still keeps up as we have been seeing, we can also speed up if needed. Currently, there's volatility at the macroeconomic level, there's volatility on uncertainties in Mexico, and those are things that we are still—we're being very cautious on those things. Nevertheless, if our clients, if potential clients are expanding, we will follow them. I'll give you an example.

Recently, we developed two buildings in San Luis Potosí and in a new park. It's Vesta Park in San Luis Potosí, which is across the street from the BMW plant, which will start operations this year. Before finishing the building, we'll lease it up for Continental, which is a great supplier in the auto industry, a German company which we have done business in the past. They are expanding operations, and we leased up a logistics facility, even before finishing the building. I'm pretty sure that if that base keeps on, we're going to be able to develop another building as long as we see good demand and have a good pipeline.

But again, I think that our strategy has always been to have a good eye on the market, be cautious, and if there's an opportunity, to capitalize it.

Regarding the plan going forward, definitely, we have been very successful executing the Vesta Vision 2020 plan. But you're right. We're almost done with it. We are pretty much on track with it. We're going to take opportunity of the investor day to present the new strategy after the 2020 plan. I have already sent some signals on what we would like to achieve. It's pretty much in line to what we have done, doing better what we have done well, and learning and doing better with some things that we have learned in the past. So in the end I think that we think we have a good strategy. And looking forward, I think that the Company's going to be very well positioned for a good plan.

Juan Sottil:

Regarding the dividend - it's Juan Sottil - let me just elaborate a little bit. Eugenio, one of the great benefits of being a C-corp in a REIT world is that retention of profit, it really allows us to continue to grow without diluting our shareholders, and we will take full advantage of that. As we have talked in the past, in my model, a modest retention of profit, provided we have some additional debt levels, will allow us to continue to fuel our growth.

Eugenio Saldana:

Thank you, guys. I don't know, my line went down. I don't know if this happened for everybody, but I just heard Juan's remarks and the very last statement from Loren. But I don't know if this was general or just me. If that is the case, I mean, I will read the transcript. No worries.

Lorenzo Dominique Berho:

Operator, were you able to listen?

Operator:

Yes. Our next question comes from the line of Roberto Waissmann with Bradesco BBI. Please proceed with your question.

Roberto Waissmann:

Hello, guys. Thanks a lot for the call. I had two questions here. The first one is that on both same store field portfolio we saw a decrease on Central Mexico occupancy. If you could comment a little bit on that? My second question is, we saw that you had increase of 8.3% in rent per square foot growth, which to record high rent per square feet. I would like to know how much was the impact of new GLA from acquisitions and developments on this and how much would be the levels of same store rent per square foot growth. Thank you.

Lorenzo Dominique Berho:

Okay. Thank you, Roberto. I think—I kind of didn't hear the last part of it, but let me answer the first part of your question regarding the Central region. You're right, we have one building which was vacated during the year. This is a building in the State of Mexico, in Mexico City area, in Naucalpan, and this is a building that we are currently in marketing mode. This was a building that was leased for 15 years. The tenant moved out, and we're currently trying to target last-mile clients for this kind of building. If you're familiar with Mexico City, this is only eight minutes away from Polanco, which is a fantastic destination.

So we believe that there will be some e-commerce potential users that require a good facility, in a last-mile facility, and if the e-commerce trends continue we think that we're going to be able to market that in the upcoming quarters. And that's why—that was the only building that was vacated that we have not been able to release as of today, and it's in the Central region. For the rest, we were able to renew 90% of the leases, of the 12 of the portfolio, which is a sign that the companies are still confident in their operations all throughout Mexico.

Regarding your—what I understood of your question was regarding the increase in rents, and I think that so far what you have seen is that we were able to increase the rents per square foot of the total portfolio. The average today stands at $0.415 per square foot per month, which is, I think, 8% higher to what we had last year. So this is a very important increase. We believe that it's—we think that it's coming from increasing rents, market rents in most of the markets where we are because the markets are tight. As I mentioned before, supply is limited for Class A buildings, so we've been able to achieve better rents in dollar terms in those dynamic markets where we operate, which everything translates into great returns of our investments.

We're currently developing our pipeline. Today, we're still very disciplined in achieving a return of cost of above 11% on average, which we think is very accretive considering the stabilized cap rates that we're seeing in the markets, which are around the 8%. There's a good opportunity to create value still through development.

Roberto Waissmann:

Okay, thanks a lot. But what would be the levels, approximately, of the same-store rent per square foot increase or decrease?

Lorenzo Dominique Berho:

What would be the increase in same-store portfolio in rent per square foot? Is that what you asked, sorry?

Roberto Waissmann:

Yes, exactly. Yes, yes.

Lorenzo Dominique Berho:

I think it could pretty much in line to what we have in the total portfolio, if not higher. But anyway, it's not something that we have been distributing to shareholders. Let me take some homework, do some homework, and probably next quarter get back to you with more information and detail on the total—on all of the portfolios.

Nevertheless, what we are confident is that we have a very high occupancy level, record-high occupancy level on the same-store portfolio, and we're excited about it….without having to give concessions to renewals. Renewals regularly tend to renew at market or inflation above the in-place rent, which is between 2% and 4%, depending on the currency.

So, I think it's a very good trend, and it's helping us definitely to increase rents to our portfolio.

Roberto Waissmann:

Very clear. Thank you so much.

Lorenzo Dominique Berho:

Pleasure.

Operator:

As a reminder, we please ask that you limit yourself to one question.
Our next question comes from the line of Pablo Ordóñez with Itaú BBA. Please proceed with your question.

Pablo Ordóñez:

Yes. Hi, good morning, Lorenzo, Juan and Christianne. Thank you for the call. A couple of questions from my site. Lorenzo, can you share with us how are the prospects for leasing activity this year for the 1 million square feet that you will be delivering in your development pipeline? Are you seeing the same number of request for proposal relative to last year? Juan, can you comment on these non-cash provision for future maintenance Capex, what should we expect ahead? How much are you provisioning as a percentage of revenues? And finally, also for Juan, is your current development pipeline already pondered with the level of debt or will it be hiring more debt? Thank you.

Juan Sottil:

Let me answer first. This is Juan Sottil. Regarding the debt, look, we have cash on hand of around $60 million. By the latter part of the year we may increase the debt on a marginal basis, meaning $75 million, maybe $60 million. With that, we will fund our development pipeline. As you know, the quarterly rental income that we receive is significant. You won't see Vesta accessing the debt market on big transactions. We're going to be very cautious on debt levels and reaching earnings, as I said before, provide a good fuel for our portfolio.

The provision, look, we're talking about a $60,000 provision. We want to be prudent. Our portfolio's fairly new. We have the youngest portfolio among the industrial real estate in Mexico. However, I do want to begin to build a provision for future maintenance. I think it's prudent. Again, we're talking about $60,000, so it's nothing to really scare ourselves, no? It's just being prudent for the future.

Pablo Ordóñez:

Thank you.

Lorenzo Dominique Berho:

Pablo, regarding your question on the pipeline and the spec buildings that we're developing, as you can see on the development pipeline, the development portfolio section in the supplemental package, we're developing a couple of buildings in Ciudad Juárez, one is an inventory building, one in Silao, San Miguel de Allende and San Luis Potosí. As I mentioned, San Luis Potosí, we have been very active developing this new project, so we are confident that we're going to find a good client in the logistics supply chain.

San Miguel de Allende is another success story that we have been leasing every year a couple of buildings. This is a project that we started developing three years ago, and there have been plenty of European companies taking space in this area and committing for long term. We recently signed a lease for Carcoustics, a German supplier of the auto industry. It's a long-term lease, and they pretty much took everything we had available. That's why it's, for us, important to keep developing.

Silao is another success story. We're fully leased in the park in Puerto Interior. That's why we're developing another building, and we have a strong pipeline on it. And Ciudad Juárez, it's the same case. We're fully leased in Ciudad Juárez, in the Vesta Park Juárez, and that's the reason why we were developing these two new buildings.

Remember that these are spec buildings, very flexible, very easy to accommodate multitenants in the buildings, and we are still seeing a very good pipeline in this market. Some of the growth might come from existing clients that have required expansions and some is coming from new tenants who are looking for this type of high-quality buildings.

Operator:

Our next question comes from the line of Armando Rodriguez with Signet Research. Please proceed to your question.

Armando Rodriguez:

Hello. Good morning everyone. Thank you for the call and congratulations on the results. Well, my question is mainly about your monthly rent that reached historical highs. My question here is if you could give us a little bit more detail by region how it compares this level to the market average. Thank you very much.

Lorenzo Dominique Berho:

Okay. We do this analysis very often to analyze where we're standing regarding the market rent. We believe the Vesta portfolio, in general terms, is very close to market or probably slightly above market, but this is slightly. I would consider that in general terms this is the same situation. Probably the only area where we could be a little bit below market is in Tijuana, where the rent prices have increased in an important way in the last quarters. We did an acquisition on a portfolio last December—I'm sorry, December 2017, which was below market rent. That was our main driver of why—one of the drivers of why we were doing the acquisition, because we thought that there was a good opportunity to bring up rents to market and therefore generate a greater return on the acquisition.

Nevertheless, besides that, I think that most of the markets where we're at, we're very close to market. I think that, at some point, since we have a leading position in many of the markets that we operate, I think that we are good drivers of where the market rents are going.

Armando Rodriguez:

Okay. Perfect, Lorenzo. Thank you very much and congratulations again.

Lorenzo Dominique Berho:

Gracias.

Operator:

Our next question comes from the line of Vanessa Quiroga with Credit Suisse. Please proceed with your question.

Vanessa Quiroga:

Hello. Thank you, and congrats to the Vesta team for the results. I would like to know about the absorption that you saw during 2018, your different markets. Do you think net absorption was stable compared to 2017, for example? And then the other question is if you can be more detailed on the dynamics that you see based on requests for proposals, also, in each of your main markets? Thank you.

Lorenzo Dominique Berho:

Gracias, Vanessa, and thank you for being on the call. The market in 2018, the net absorption was different in the different markets. I would say that Tijuana was higher than in 2017, Ciudad Juárez was higher than 2017, the Bajío region was slightly lower. Nevertheless, 2017 was a record year for the Bajio, and Central Mexico has been even higher than 2017.

So overall, I think that it was slightly below 2017 levels. Nevertheless, we think that, in the end, these were pretty good numbers. The result of that is the amount of leases we were able to close, which is pretty much in line to what our peers have been also doing and closing in the last quarters or even in the last years.

So the industry is still performing well. We don't think that it might be increasingly—there will be high increases in terms of net absorption compared to other years, but as long as it maintains and remains in a good position, in a good rate, I think that it's going to be good for us, and even some of our peers will also benefit from good market dynamics. And currently, our pipeline, it's very similar to what we have been seeing in the past. As you know, many of these transactions take longer to close, so we have been working on some of them that we think will mature in the next couple of quarters.

Nevertheless, I think that it's hard to anticipate what will happen in the long term, but we have confidence that, in the short term, we're going to be able to close important transactions and keep on with the good results that we have been having in the last quarters.

Vanessa Quiroga:

Okay, that's great. And just last question on the team in terms of the SG&A. Do you expect to have to expand the team, and therefore SG&A, for the next couple of years, or for now you think the structure is appropriate?

Juan Sottil:

Vanessa, this is Juan Sottil. Let me tackle your question. Look, we believe that we have the right people in place throughout the country to take advantage of client opportunities, as well as development, as well as asset management. I don't think that we're going to increase in any way our headcount in the coming years. Please take note that our administrative expenses have come down as a proportion of revenue. I have always talked about the benefit of economies of a scale, and I think that we're beginning to see those. I mean, 85.5, 85.1 EBITDA margin, it's a good number to have, and it has been increasing, no?

So, look, I think that we have the right people in the right place, we have tight control on expenses, and I don't think that we're going to increase headcount for the future.

Vanessa Quiroga:

Great. Thank you for the answers, Juan and Loren. Bye.

Operator:

Our next question comes from the line of Guillermo Diego with Santander. Please proceed to your question.

Guillermo Diego:

Yes, hello. First, congratulations on the results, especially on the operational performance. Just on the asset sale, can you repeat the amount you're expecting to get from this and maybe the timing, and just the implicit exit cap rate of this asset sale?

Lorenzo Dominique Berho:

Sure. Well, as mentioned before, the good thing about of Vesta is that we have the flexibility on financing or getting financing, funding from different sources, and one of them is definitely asset recycling, which we have not done in the past. Definitely, as I mentioned before, we are still working on the identifying if we should be able to sell something what we would be selling and even the sizes. So I don't think that if we do any sales it would be a larger sale. Definitely our growth plan continues to be finance by debt. We have retained earnings. If there is some asset recycling, we could have other alternatives on financing. But today, we don't have major financing needs in order to comply with the investment plan that we have.

I think that if we do an asset recycling, it would be more to signal that there's a cycle into real estate, where we develop to an 11% return on cost, where we stabilize assets, and that we can sell at a cap compression closer to our net asset value, which could be somewhere in the range of the 8%. We think there's still a lot of demand for institutional class assets, like the ones that we have. We have currently 30 million square feet of great buildings that any institutional investor would be interested in acquiring. It's just part of a new stage of the Company where we are going to be starting to recycle capital through asset sales.

Guillermo Diego:

Great. Thanks.

Operator:

Our next question comes from the line of Cecilia Jimenez with Santander. Please proceed with your question.

Cecilia Jimenez:

Thanks. Hi guys. Good morning. Congrats on the results. I had a follow-up, actually, on the potential of the sale, that it has to do with the tax treatment that it may have. So just to confirm, hypothetically, that you sell something from your portfolio today, that it's valued at 100, and the price you use to calculate the tax on the sale would be the price the asset is valued but the broker give you the estimated value of the amount. That would be the initial price, and then the final price, obviously, the price its selling at, and that's multiplied at the 30% tax level. Is that a reasonable assumption? Can you calculate the tax implications of any potential sale? That would be my first question.

Juan Sottil:

Cecilia, this is Juan Sottil. Thank you for your question. Look, like in every country, everybody pays taxes in Mexico, and we certainly do. Look, our properties have a physical value that's derived from the construction cost, plus all the things that we do on development, you have an inflation adjustment to that price by the Mexican tax code. That integrated cost, vis-à-vis the sales price, was taken into account the particular company tax benefit, if any, will allow us to—that difference, you do pay the statutory tax rate.

Bear in mind that in the past, we have sold on both properties among our subsidiaries. Therefore, the actual physical cost of the properties is not necessarily the development cost that we had when we developed the properties five or seven years ago, which is our average life of our properties. There are variations.

In many asset sales, in any asset sales recycling, what you try to do is to optimize the tax burden, and that's what we will certainly do. The strategy of the Company to develop Vesta Parks and ideally this, let me call them, horizontal condominiums should attract a lot of interest from global institutional investors, and we have been careful to have a cost basis that is favorable to optimize the tax burden. But yes, your calculation is correct, taking into account what I said, and we seek to minimize the tax burden within the margins that the law gives us.

Cecilia Jimenez:

Perfect. That's very clear, Juan. Thank you. I have another question which is maybe more on a strategic point of view for further growth. Just regarding geography, when you—growth with your current clients, which is part of the development growth you had in the past, have you seen any change in the trends where geographies are, where the footprint is located toward further expansions? Meaning, are you seeing any stepping out the current regions to go somewhere else, taking into consideration a lot of things under new administration are being drawn in the southeast part of the country? So are you seeing a trend move there, or you are just continuing to see investments in your core geography? That's my second question. Thanks.

Juan Sottil:

I couldn't understand all the facets of your questions, but let me—I just got a couple. So let me try to answer.

No, no, no, don't worry. Let me try to answer those, Cecilia. Look, we follow demand. We think that all the areas of Mexico have potential, but we follow what our clients need. If our client goes to the southeast of the country, you can bet that Vesta will follow, within reason. So we have close contact to the markets we operate. If there is demand in the Maya Peninsula or what have you, we will be there. We are going to be careful about the implications of those expansions in our administrative cost, meaning, people that we have on the ground. One of the greatest advantages of Vesta is the local knowledge that we gather from our offices on the ground. So we balance destinations with the local economy of a scale that we can achieve.

So those are the considerations that management takes into expansion into new regions, no? So I guess that's kind of how we approach it. And remember that the message that I want to give you is, we will always grow on a very disciplined fashion. If there's an opportunity, we have to see that it makes sense, that it's accruing for the Company on a return on the investments, whether that be buildings or administrative investments that we do in situ.

Cecilia Jimenez:

Okay, perfect. Thank you, Juan, and congratulations guys on the results.

Operator:
As a reminder, if you would like to ask a question, please press star, one on your telephone keypad. One moment, please, while we poll for more questions.

Our next question comes from the line of Francisco Suarez with Scotiabank. Please proceed with your question.

Francisco Suarez:

Hi. Thank you. Good morning. Congrats on the results. Impressive delivery, guys. Fantastic job. The question that I have is, have you got any concern on your tenants from the strikes that are emerging along the U.S. border now? Anything that might concern your tenants in your view?

Lorenzo Dominique Berho:

Francisco, thank you for being on the call and from having that creative front line on your research report, which certainly grow us in knowledge.

Francisco Suarez:

It's only love.

Juan Sottil:

It was a lovely headline, let me put it that way. Look, our tenants—foreign investments, the tenants that use our services really come to Mexico because there's a big opportunity of manufacturing in Mexico. For the global economy, clearly, the U.S. is one of our primary destinations of our tenants. We don't see that they are hesitating right now. We think that they consider that Mexico, U.S., and Canada relations into the U.S. and whatever the name, new name is, as just normal friction between three great partners. They continue to invest in Mexico. They continue to seek opportunities. On the social side, they don't seem to have any concerns. They continue to invest with gusto in the Northern region and in the Bajio area. So, look, so far so good, that's the way I can put it, no?

Francisco Suarez:

So in other words, the strikes that have been emerging in the northeast of Mexico that potentially could actually go to places like the Juárez or the like by this group which seems to be sponsoring this. You don't think that is something that is on the radar screens of your tenants at the moment?

Juan Sottil:

Well, we don't really operate on the northeast part of Mexico really; we have one facility. This type of worker movements tend to be very local, where new organized labor seek an opportunity to enter. On the markets we operate, and we have been—we have asked this question to our local guys in Juárez and Tijuana. They tell us that, look our tenants have very good labor relationships. They seem to have good workers, and they don't—the tenants have not been voicing any concerns at all in those regions, no? So that's what we hear. That's what we've seen as of today, no? Now, it is a changing landscape, certainly.

Francisco Suarez:

Fantastic. Thank you so much, gents. Congrats again.

Lorenzo Dominique Berho:

Thank you.

Operator:

There are no further questions. I'd now like to turn the call back over to Mr. Berho for concluding remarks. Please go ahead, sir.

Lorenzo Dominique Berho:

Thank you, Dana. Before we end our call, I would like to again remind everyone to be on the lookout for the information on our Investor Day, and we hope to see you there. As always, we thank you for the trust that you place in our management team and in Vesta's employees. Together, we remain committed to Vesta's continued success.

Operator:

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