Vesta Industrial Real Estate

First Quarter 2019 Earnings Conference Call

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PRESENTATION

Operator:

Good morning, my name is Matt and I'll be your conference Operator today. At this time, I would like to welcome everyone to Vesta's First Quarter 2019 Earnings Conference Call. All participants are currently in a listen-only mode. As a reminder, today's conference is being recorded.

I would now like to turn the call over to your host, Ms. Christianne Ibañez, Vesta's Investor Relations Officer. Thank you. You may begin.

Christianne Ibañez:

Thank you, Matt, and thank you for joining our call to discuss Vesta's financial results for the first quarter of 2019. With us today from Vesta are Lorenzo Dominique Berho, Chief Executive Officer, and Juan

Sottil, Chief Financial Officer. Following their prepared remarks, there will be a question-and-answer session, during which time we will answer your questions.

Yesterday, we issued our earnings press release after market close. This release is also available via 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 April 25, 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.

I will now turn the call over to Mr. Berho. Please go ahead.

Lorenzo Dominique Berho:

Thank you, Christianne, and thank you, all of you, for being part of this conference today.

After a strong 2018, where Vesta outperformed the market, both for total shareholder return performance as well as operating results, we continue to maintain our momentum and are progressing well toward a strong 2019 as we execute the final stage of our Vesta Vision 2020 strategic plan.

The U.S. economy continues to support our growth. Mexico's non-oil exports to the U.S. increased nearly 5%. Total exports increased nearly 12% sequentially, after a slower growing January, with manufacturing, among the sectors that led non-oil exports. Broadly speaking, our clients continue expanding, and this was reflected in our business with them during the first quarter, in terms of new leasing activity, renewals, as well as growing long-term leases.

Another important indicator is foreign direct investment in Mexico. New investment by U.S. businesses last year was close to the five-year average, as was total for indirect investment, according to the most recent government statistics. These figures make clear that our country remains one of the world's leading production hubs for global companies. Although these economic and investment indicators are encouraging, we remain cautious, in part because Mexico's new administration has yet to finalize its economic policies.

With regard to the global economy, a number of risks also remain, as the U.S. and China have still not reached a trade agreement and the health of Europe's economy remains tenuous. As always, we closely monitor economic trends within and outside Mexico, and interest rates, in particular. Also, we benefit from market intelligence that we glean through deep and extensive customer relationships, information that allows us to stay on top of changing conditions in each of our regional markets, which underpins Vesta's agility to adapt to a changing environment with anticipation.

Although the economic and policy pictures remain unclear, Vesta will continue to find the opportunities to keep creating value for our shareholders. Even if the economies on which rely were to moderate, our strategy and business model account for such a scenario and would still allow us to deliver solid operating performance and high levels of growth.

A 16% increase in revenue, another increase in net effective rent and a nearly 24% increase in FFO this reporting period demonstrate yet again our ability to consistently grow quarter-over-quarter and year-over year. In the last three years, Vesta's rent per square foot has grown at a compounded annual rate of 4%, and as a much larger company today, we are more resilient than ever to any market volatility.

Another point I would like to emphasize here is that we have no major renewals due within the next 12 to 18 months, which reduces our exposure to vacant space, while reinforcing our ability to maintain high occupancy rate in our portfolio. Further, we remain disciplined in our approach to leasing and the build-out of Vesta's property portfolio, and we continue to operate in the right markets in Mexico in terms of current and future growth potential. In fact, our markets continue to perform well. We successfully maintained a high occupancy level of 96.8% in our stabilized portfolio this quarter, while increasing total portfolio rent per square foot by a 4% CAGR in the last three years.

Developers have remained disciplined in the markets and, combined with solid demand and limited supply, is a dynamic we expect will continue for the foreseeable future. To date, we still have a good balance of logistics enlightenment affecting customers. Also, renewal levels and a still strong pipeline indicate that clients remain committed to our industrial properties.

In the North Region, Ciudad Juarez and Tijuana are outperforming, with high levels of leasing activity, solid pricing conditions and a strong pipeline, primarily due to an expansion of U.S. activity. We leased a property there that has yet not been completed and which continues to reflect the strength of our chosen markets for development, as well as our reputation and customer relationships.

In the Bajio Region, the occupancy remains at healthy levels. While there was not any significant activity in this region during this particular quarter, our pipeline is still very strong and we anticipate signing leases with existing and new potential clients in the upcoming quarters.

We signed just over 257,000 square feet of new leases with existing and new international clients, such as Harman, Freudenberg and DB Schenker. We also signed 1.4 million square feet of lease renewals, bringing stabilized occupancy to 96.8% at the end of the quarter, despite a 9% increase in this portfolio's GLA. To date, we have renewed 65% of leases that will expire this year and the next, with re-leasing spreads positive above 2%, compared to in-place rent.

Returning to capital allocation, Vesta's record financial results in 2018 enabled us to pay a dividend of PS$0.45 per share in the first quarter of 2019. This dividend payment represents a 13.7% increase over last year's quarterly payment.

Last, but not least, as announced earlier this week, we entered into a definitive agreement with an institutional investor to sell a property portfolio of 1.6 million square feet for a total of $109 million and with a blended cap rate of 7.1%. The portfolio is comprised of eight industrial properties, 60% of which are located in Querétaro and 40% in Toluca. The proceeds of the transaction will allow us to continue strengthening Vesta's balance sheet, while providing additional financial flexibility. More specifically, it helps us to continue diversifying the allocation of capital by continuing to invest in property development, while maintaining a favorable stance toward share repurchases.

The transaction marks the first time that Vesta has divested property. Importantly, it demonstrates our ability to successfully close a stabilized portfolio's real estate cycle through a sale, and to do so without adversely affecting the composition of our portfolio. At a price that is 20% above our net asset value, the sale also clearly demonstrates our ability to now secure financing via the private market to fund our growth initiatives in an accretive way.

Before I turn the call over to Juan to talk more about Vesta's first quarter performance, I would like to remind you that on June 4, we will host an Investor Day in New York City. During the event, we will discuss our strategy for Vesta's next phase of growth. We're excited about the opportunities we see next year and beyond, and are keen to share our plans with you. In addition to other senior executives of Vesta, certain Board Directors will also be present. We hope you can join us that today. If, for some reason, you have not received an invitation, please contact our Investor Relations Department.

Juan, now over to you. Thank you.

Juan Sottil:

Thank you, Lorenzo, and good day, everyone. Starting with Vesta's income statement, revenues increased 16% year-over-year, as Lorenzo noted, to $36.3 million. Much of this increase was the rental of new space that had been previous unoccupied. Nearly 85% of the first quarter revenues continue to be denominated in U.S. dollars.

On the expense side, operating costs increased to $1.6 million, due to higher expenses at the new properties in our portfolio. Vesta's net operating income increased 15% to $35 million, while our operating margin decreased 68 basis points to 96.3%, due to higher costs at the income-generating properties. Administrative expenses increased 11% at the quarter for $4 million, primarily due to higher auditing, legal and consulting expenses, while property appraisal fees increased, and employee benefits.

Moving further down the income statement, Vesta's EBITDA increased 16% to $31 million, while the corresponding margin was unchanged at 85.7%. This is a result of an increase in revenues, while the margin of administrative expenses remained constant.

Due to Vesta's higher debt balance this quarter, net interest expense rose 25% to $9.2 million. Early, Lorenzo touched upon our balance sheet. It remains strong, with a loan to value of 35%, and with any reduction in interest rate, we might take opportunity to restructure Vesta's debt to lower interest expense and extend our maturities.

Also, in the quarter, we recorded a foreign exchange gain of $1.2 million, and a $12 million gain on the value of our investment properties, an increase of 65%, compared to the gain we reported on the first quarter of 2018. Vesta's before tax profit increased 12% to $34 million.

Income taxes totaled $12 million, compared to a $5 million income tax gain last year's first quarter. There were higher current and deferred taxes in the first quarter of this year due to a higher operating tax and increasing foreign exchange tax that stemmed from the peso appreciation during the period. Higher income taxes and interest expense, coupled with a lower foreign exchange gain, mostly accounted for the 42% year-over-year decline in our comprehensive income line.

On a per share basis, Vesta's funds from operations increased 23.7%. The operative pre-FFO tax, which excludes current taxes, increased 13% to $22 million. The current tax of $11.2 million consisted of $6.4 million in operating tax and $4.7 million was the exchange-related portion.

Cap ex expense during the quarter was $20 million, primarily investments in construction of new buildings in Cuidad Juarez, Tijuana and San Luis Potosi. A total of 950,000 square feet of inventory and build-to-suit buildings are currently being developed.

Vesta's average debt balance reached—was $700 million, 99% of which are long-term liabilities. One hundred percent of our debt is denominated in U.S. dollars and paid at fixed exchange rate—interest rates.

As Lorenzo noted, the GLA of Vesta's stabilized portfolio increased 9%, while occupancy remained at 97%. Our same store portfolio expanded 17% during the quarter, with occupancy increasing 50 basis points to 98%. At the end of the quarter, Vesta's total GLA was 30.4 million square feet, while total vacancy stood at 9.2%. Land reserves totaled 37.8 million square feet, a 1% sequential increase.

This concludes our prepared remarks. Matt, could you please open the call for questions? Thank you.

Operator:

Great, 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 key. One moment, please, while we poll for questions.

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

Marimar Torreblanca:

Hey, guys, good morning, thanks for the call, and congratulations on the quarter and on the asset sale. My question is related to the asset sale, if you can give us a bit more color on how the process was done, how many interested parties you saw, was it difficult to find a buyer that was willing to pay for this kind of cap rate, or do you think that there was enough demand at this level of evaluation; and also if you could walk us through your cap rate calculation, because looking at the numbers that you published in the original material, after you announced the sale, it seems to be that the cap rate should be lower than that, but I'm not sure if you're assuming in this cap rate growth with a forward cap rate, or anything I'm missing. Thank you.

Lorenzo Dominque Berho:

Thank you, Marimar, and thank you for being in the conference. Yes, as you know, we announced on Monday the transaction. The transaction, as you know, is still pending from a couple of regulatory items, COFECE and other minor ones. We believe it will be finally closed in the next days. This is the first time we do a sale of a portfolio. Even though this was a smaller sized transaction, with only eight properties in only two markets of Vesta, in this case we did an internal process with potential institutional investors. We touched based several investors that are looking into good-quality buildings, with good-quality leases, long-term leases, and that are able to identify institutional-class real estate. Out of the ones that we touched, we identified a potential investor that was very interesting in doing that transaction with us, and that's how we entered into a transaction.

We have to highlight that there is still—and we were surprised at how much interest there still is in Mexico from private markets, on top of the publicly names that all of you already know, and I believe that this really is an opening stage in the Company, where we're going to be able to still find good ways to keep on financing growth, and probably now through the sale of stabilized portfolios.

We think that cap rates globally have decreased, as well as interest rates, but there is a high interest for industrial real estate globally, and we believe that Mexico is also being part of that. Even in a volatile environment, through the capital markets, with listed companies, as well as with other political situations, we believe that there is very strong demand towards high-quality industrial real estate, and that global trend has been impacting also Mexico. I'm not surprised on the cap rate. I think that this is merely a consequence of being—of good capital chasing for good properties.

Juan Sottil:

On the second question, I think that—regarding on the cap rate, well, as you know, cap rate is only one indication we use. The way we calculate it, is you're seeing a 12-month forward NOI divided by the value of the transaction, which I think is the way to go. Nevertheless, another way to see it would be from a net asset value perspective or a price per square foot. These particular buildings, the value of them, the net asset value of them was close to $57 per square foot and the transaction price was close to $69 per square foot. That would be another way to see that we are selling at a premium to our net asset value, which, in the end, is what we believe is very accretive for shareholders. We will still be looking for these types of transactions, where we can recycle capital, while finding accretiveness for our shareholders.

Marimar Torreblanca:

Thank you.

Operator:

Our next question is from Eugenio Saldaña from GBM. Please go ahead.

Eugenio Saldaña:

Hi, and congrats on your results. I have three questions. The first one, I'd like to hear from you where is the limit in terms of vacancy to stop developing spec buildings in certain regions. I mean, when do you decide to stop or what's your floor? That's the first one.

The second one is, considering the 5% reduction in GLA due to the already mentioned transaction, are you considering updating your 2019 guidance, or does the previous guidance consider this potential disposition happening?

The third one is regarding the transaction that you announced. Was there any broker involved in this transaction whatsoever? Thank you very much.

Lorenzo Dominique Berho:

Thank you, Eugenio, for being in the conference and thank you for your questions. I will answer the first and last question. The first question regarding the vacancy, I think that we pretty much—as you can see, our portfolio today is pretty much leased, all of the portfolio. The vacant space that we have is the buildings that we consider in a lease-up stage, which are—most of them are brand new buildings that we have developed recently in the last periods. Normally, it's not a matter of how much vacancy we have. We identify how much the pipeline is, how much we have available, and if we think that in the next six months, which is the time that it takes us to build, that we're going to be able to lease that particular space up, that's when we start the new buildings. We're very cautious in each of the markets. As you can see, today, we have some available space in some markets, and that's when we normally do not develop, we put a pause, but when we start leasing, we start again with construction of buildings. Remember that the development risk in industrial real estate is pretty low, because we can manage the timing and we can manage the pace at which we want to keep on developing. It's honestly a very—it's an easy way to track, depending on how we are, in each of the markets.

Regarding the third question on the broker, there were no third parties involved. As you know, we have had a long-term relationship with the investment community and we touch base with international institutional investors, global investors, and that's how we found the transaction.

Juan Sottil:

On guidance, Eugenio, look, I think the transaction will close in the next 10 days or so. After that, and probably on Investor Day, it will be a good way to give some oomph, additional oomph to Investor Day. If necessary, we will revise guidance. We typically, if necessary, revise guidance, as we have done in the past, but it will be good to talk about that on Investor Day, if necessary.

Eugenio Saldaña:

Okay, thanks, guys. Congrats, again.

Lorenzo Dominique Berho:

Thank you.

Operator:

Our next question is from Froylan Mendez from JP Morgan. Please go ahead.

Froylan Mendez:

Hello, guys. Thanks very much for taking my questions. First, how should we see reflected the income from the administration contract from the portfolio that you sold? Specifically, how much NOI should we expect from this administration contract? Then, what should we expect on the tax side going forward, especially after this asset sale? Thank you very much.

Juan Sottil:

Froylan, good morning. Thank you for being on the call. Look, the admin income would be reflected as other income. It would be around $200,000, upward. It is contingent on the roll-overs of the portfolio. As you know, we have a very high roll-over rate, so it's upward of $200,000.

The other question would be—that you asked me about taxes. The tax impact of this portfolio is around $6 million. It's a very efficient—it's 6%. It's a very efficient—we have a very efficient tax base for the sale of the portfolio and, therefore, it was a very good sale from a tax point of view.

I don't know if I answered both of the questions you posed.

Froylan Mendez:

Yes, and going forward, and including the impact from the asset sales, how should we think about the cash taxes going forward? Because they have been increasing in time, I just wanted to understand what the run rate of cash taxes should be for Vesta going forward.

Juan Sottil:

Look, on taxes going forward, we're highly contingent on FX developments, so it's particularly difficult to forecast taxes because of the FX component of our income statement, due to the fact that taxable income depends on the peso value of our dollar debt. On an operating level, we do have a substantial tax shelter due to appreciation of our properties on a tax level, so I think that between 15% and 20% of effective tax rate, I think it's a good way to look at Vesta in the future, but, again, FX volatility will have a high impact.

Froylan Mendez:

Perfect. Thank you so much, and congrats.

Juan Sottil:

Thank you.

Lorenzo Dominique Berho:

Gracias.

Operator:

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

Luiz Garcia:

Good morning, guys. I have two questions. The first one is on the Bajio Region. We have been seeing the region suffering a lot, a huge drop in terms of year-over-year vacancy in the region, and when talking to the brokers, they are also concerned, and they're mentioning some institutional investors developing the region. The question is what do you expect for the region going forward and if we could see additional occupancy drops in the region, in terms of occupancy?

The second question is on grace periods. Especially, given what is happening in the Bajio region, are you seeing clients asking for more grace periods in contracts being renewed? What are you seeing in terms of grace periods, especially these states, the asset sale located in the Bajio Region?

Lorenzo Dominique Berho:

Thanks, Luiz. Thank you very much for your questions and for participating. We think that the Bajio Region has been incredibly active the last five years, and that has led to having, today, a way more robust industrial base, which we believe that will benefit in the long run for the region, which is considered as, today, one of the most competitive regions in Mexico, and has been one of the most competitive regions in Mexico, is one of the most competitive regions even globally. These are global clusters and global manufacturing logistics hubs.

We have seen—and this question regarding the Bajio has been particularly in the last couple years, and it's amazing how much activity we have had in the last couple years. Nevertheless, I think that we have to be cautious on how much development is being done in the area. We still see that developers have been disciplined in developing inventory building. Actually, the vacancy rates are still low in the area, 6% pretty much, in Guanajuato, Querétaro, which are the largest ones, as well as San Luis Potosi. It's a very healthy number. Fourth quarter was very strong in terms of absorption in Querétaro particularly. I wouldn't only look at certain—only a few quarters, I would analyze the whole cycle, probably longer, probably in a year-round.

I think that Bajio has its own dynamic. I think that Bajio has maintained very good rates for rental rates. What surprised me a lot is how much the land values in the Bajio have increased. If you consider Querétaro, for example, Querétaro's land prices in the last five years has almost threefolded. I have never seen this in any other market in Mexico. I think that is also a signal of how much appetite in the long term there is still for this area, where there is still good demand for industrial space, and not only industrial space, but land well located, with the right infrastructure, with the right quality, because these are high-quality tenants, or high-quality clients demanding good-quality space, too. In the end, I think that, looking forward, we're still optimistic on the region, while being also always very disciplined and cautious on the development.

Luiz Garcia:

Okay, and how about grace periods?

Juan Sottil:

We're not giving any rental concessions either on roll-overs or in new leases. I mean, the markets are tight, so we're being very disciplined on—it's at the market rate when you enter the building,

Lorenzo Dominique Berho:

Remember, probably, one of the things I'd like to highlight here is that remember that Vesta is very disciplined in really having high-creditworthy tenants, and sometimes we prefer to even wait a little longer to have the right tenant and have the right long-term lease with high-creditworthy tenants, instead of just leasing out space. Remember that we like U.S. dollar-denominated leases, and in this market sometimes you have to be a little patient and cautious in order to find the right quality tenants, and in the end, I think that discipline has paid off very well in Vesta's strategy.

Luiz Garcia:

Okay, thanks.

Operator:

Our next question is from Cecilia Jimenez from Santander. Please go ahead.

Cecilia Jimenez:

Good morning, thanks. Congrats on the results and thanks for taking for my question. My question is actually on the asset sale announced earlier this week, just on the confirmation side. Although it's possible to see this type of transaction going forward, the main core or the main strategy of Vesta remains growing through development, I just wanted to hear your thoughts on that, and just confirm growing for the future is still there beyond the 2020 plan. I know you have the Investor Day, but if you can give us a hint of what's after 2020, that would be great—thank you very much—on the growth side. Thank you.

Lorenzo Dominique Berho:

Gracias, Cecilia, and thank you very much for your call—for your questions, sorry, and being on the call. I think that—definitely, I think that this is a strong signal that Vesta has the ability to close a real estate cycle, where we can still develop, lease at attractive returns, stabilize portfolios, and sell at attractive price, and with that, we think we can create a lot of value for our shareholders.

Looking forward, we will continue to focus on our capital allocation, to optimize capital allocation, and in order to have the most out of our capital allocation, we still have to—we still want to keep on developing at attractive returns, and when I say "attractive returns," this is yields above 11%, which we have been doing in the last years. Also, finding acquisitions in an opportunistic way. Whenever we believe there's value to be created, we're going to keep on doing acquisitions, and if acquisitions that are too high prices, we're going to pass on them, as we have done in the past. We have passed on many operations, many acquisitions, which, honestly, we're glad that we did not do. Thirdly, I think that our buyback program has been also been pretty successful and we will continue to do so.

Looking forward, we believe that the name of the game will still be capital allocation through development, through acquisitions and through buyback in—repurchase shares in a buyback program. Hopefully, we can keep on creating value for our shareholders the same way looking forward.

Cecilia Jimenez:

Thanks, Lorenzo.

Lorenzo Dominique Berho:

Gracias.

Operator:

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

Gordon Lee:

Yes, hi, good morning, and thanks very much for the call. Two quick questions. The first, I have a question on the Juarez market. If you look at your numbers and you look at many of your peers' numbers, it almost looks like it's sold out, like Juarez is sold out, and, obviously, given the advantages it has versus other markets, it seems like it would be a good place to put capital to work, but Juarez has a tendency, I guess, because of the availability of land, to become oversupplied pretty quickly. I was wondering what your view is on Juarez, what you're thinking about in terms of what you're seeing on the supply side and whether you think that you'll have that risk of oversupply at some point in Juarez again.

Then, the second question is related to the questions that you've had on the asset divestment and the reallocation of that capital. At this point, when you look at opportunities in the market either for development, acquisition or stock buybacks, how do those stack up? How attractive does your stock look right now relative to what you could get on the M&A market, let's say? Thank you.

Lorenzo Dominique Berho:

Great, thank you, thank you very much, Gordon, for your question. This is Lorenzo. Definitely, I think that—I am very happy that we are currently discussing about Juarez on the positive side, because Juarez currently is experiencing a lot of demand. Currently, vacancy rates are close to 3% or 4%, which is very, very healthy. After Juarez having had a very tough period, particularly after the U.S. recession, there was—it was tough times for many of their businesses, and today it's experiencing exactly the opposite.

We believe that—first of all, we like to understand markets very well. We have had a very good presence in Juarez in the last years and that's why we have been able to gain a very important part of the market share in that area. Nevertheless, looking forward, we think that we're going to keep on developing particularly, because many of—as you remember, most of the growth from Vesta, over 50% comes from existing clients. The good thing about developing these types of properties, which are very multi—multi-tenant buildings are very flexible—is that we can accommodate our tenants according, in many cases, to their growth. Whenever we develop, it's because we already feel that we could have a potential pipeline that can support and then can underwrite the decision of growing in this particular market.

Nevertheless, I take your comment very well on how cautious and disciplined we have to keep on through development, because there could be other peers that also are developing. It's matter of seeing how we can differentiate from our peers. In markets like Juarez, I think that it is important to see what the quality of the buildings are, which locations you are developing, the type of amenities or, let's say, additional infrastructures that you can offer. In our case, we are trying to development Vesta Parks, which you know that have a different type of quality and different type of things on offer, compared to single assets. In that regard, I think we can differentiate well in Juarez, which is the thing that we have done also in other markets where we think that some high-quality tenants are really looking for these types of buildings and assets.

Juan Sottil:

On the capital allocation, Gordon, look, it seems to me that if we're selling at a 7.1% cap rate, it's a nice cap rate and our stock is above 9%, what we're going to do is we're going to be very aggressive on repurchase, no? It seems to me that that's the correct approach. We will continue to develop buildings, of course, and we will always be very cautious about acquisitions. Remember that the objective of our capital allocation has always been increases in net asset value, and I believe that Vesta has been a stellar performance in our track record of increasing net asset values since we came into the public markets.

Gordon Lee:

Perfect, thank you, that's all very clear. Thanks very much.

Operator:

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

Vanessa Quiroga:

Thank you. Congrats on the results. Just to continue on the review of the different markets, I would like to ask you also about Toluca, how you're seeing that market right now and going forward; and, in general, I think it would be interesting to hear from you if, year-to-date, you have seen any change in the way your tenants and potential prospects make a decision regarding choosing properties and signing contracts, how you're seeing the Requests for Proposals, and how much time is it taking for tenants and prospects to sign a contract. Thank you.

Lorenzo Dominique Berho:

Thank you, Vanessa. This is Lorenzo. Thank you for being on the call. Yes, Toluca has been one of our leading markets. We have a large part of our portfolio in this region, we know it very well, and I think that this particular market currently has experienced some good opportunities for growth. Nevertheless, I think that today the restrictions that it has is that land availability is scarce, it is currently lacking. The land that you would think that could be available has its difficulties, since many of it is owned by Ejidos, or some of it is private land, but does not have the right infrastructure or the right zoning. Nevertheless, that has been a challenge for Vesta today, to find the right land, and also at the right price, because in order to create value, we've got to buy land at the right price. Otherwise, we would be only developing at a margin, which we believe is not exactly the way to create value.

Currently, I think that we have a fully leased portfolio, clients are doing well. We have recently been able to renew at attractive rents. We have been seeing that the rents have been increasing in the market.

Remember that we—in Toluca, one of the things that we have seen is that there's many developers who are asking peso rents and we are very disciplined on holding to the dollar rent. Today, I think there's a large spread between what we are renting and what some of our peers are renting in pesos, because many of them did rent five years ago when the peso was at 13, so there is still a big difference, a big gap between some of the existing in-place rents from some of our peers and what we have today. Hopefully, other developers can also be—try to be more disciplined in trying to get rents closer to the market, which we believe that is the one that Vesta would have in its portfolio.

Vanessa Quiroga:

Great, Lorenzo, and regarding the Request for Proposals and time to make—to sign contracts, in general, for your portfolio?

Lorenzo Dominique Berho:

Okay. So, okay, probably, in general, it would better to anticipate. We are very active in terms of Request for Proposals and possible signing of leases. In terms of timing, I think that companies today are not necessarily taking that much longer. I think they have taken out the uncertainty risk regarding the USMCA, or the previous NAFTA. They are taking out risks regarding the political situation in Mexico. I think that in that regard, they feel more comfortable in making long-term commitments. That's why we have seen transactions like the ones we closed this quarter with a German company, being Freudenberg, with an American—actually, a Korean/American company, being Harman, which is a subsidiary of Samsung, making long-term commitments, also, in Querétaro, or DB Schenker, a logistics company, which has operations for Microsoft and Cisco Systems in Juarez, they're still growing and they are making long-term commitments, and I think that's a signal that despite the uncertainties that there still are, they are committed long-term in Mexico, and we think that this is a little bit—most of the feeling in global companies towards the country. Hopefully, this mood remains and that more companies keep expanding in the country.

Vanessa Quiroga:

Excellent. Thank you Vesta team.

Lorenzo Dominique Berho:

Gracias.

Operator:

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

Alan Macias:

Hi, good morning, and thank you for the call. Just one question regarding potential Chinese tenants, if you have seen a pickup in that area. Are you still seeing interest by Chinese companies coming into Mexico? Thank you.

Lorenzo Dominique Berho:

Thank you. Definitely, I think that's an important trend that we are seeing recently. There are some Chinese companies entering the market, actually, pretty much all regions, from Puebla to State of Mexico, to the Bajio, as well as the north of Mexico. Nevertheless, I think that it's not only Chinese companies, but it's companies in China, that these could be global companies, that are already looking back into Mexico as being an important manufacturing hub. Remember that many of the companies in China are European or American, that have established themselves 10/15 years ago, and currently, because of other global situations, they are thinking of expanding their operations outside of China, too, and this could be Southeast Asia, for example, Vietnam, or this could be places like North America, and clearly North America, the place that could make the most sense is Mexico. We'll keep an eye more on Chinese companies, because we believe that they will be an important and a relevant player in the Mexican market.

Juan Sottil:

Probably as an additional note, we have actually some Chinese tenants, but it's interesting how they acquire European companies that have been in sector industries for a while, and through these European companies, they establish themselves in Mexico. At the beginning, you would think that these are German companies, for example, but in the end its Chinese capital, because they have been able to do M&A of great engineering companies and they are growing through their—with their footprint. This is another trend that I think we'll be seeing more looking forward.

Alan Macias:

Thank you, and just one more question. Have your tenants experienced any problems with labor unions, that we saw in the market in the past in Mexico, any issues there? Thank you.

Lorenzo Dominique Berho:

Thank you. Definitely, that was an issue that we were monitoring very close since the beginning. Particularly, this was in the beginning of the year, January. As of today, we have no clients today that are facing any issues. At some point we heard from our tenants—from some of our tenants and other industries and other companies that were having issues in this regard, but, nevertheless, I think they got into agreements with their unions. I think that—let's say on the positive side, I think that that sends another signal that companies are actually more willing to be open to negotiate, rather than just saying, "I will leave the country." I think that they want to commit long-term, they want to work better with the labor unions, and I think by entering—by being able to negotiate, I think that sends a signal that they want to commit for a long run in Mexico.

Alan Macias:

Thank you, great.

Lorenzo Dominique Berho:

Thank you.

Operator:

Our next question is from Ramon Obeso from Scotiabank. Please go ahead.

Ramon Obeso:

Hi, hello, guys, good morning, and thank you so much for taking my questions. It got my attention that your development pipeline in the Bajio Region is just 33% versus 60% in Q4, and the rest is in northern

Mexico. Perhaps, this is just the result of cooling off in the Bajio Region, or are you just being more cautious, and should we expect this trend going forward?

Lorenzo Dominique Berho:

Thank you, thank you very much for your question. I think that the picture that we see on the development pipeline every quarter, I think it's a very, I will say, static picture of only one particular moment. Remember that the real estate cycles are longer. If you consider, when to buy land, when to put the infrastructure in place, when you start the building, when you lease it up, it's a long time, it takes a while. I think that today, what you see on the picture is not necessarily a reflection on how it will be looking forward. I think, actually, that actually looking back, it has always been changing and shifting. There's sometimes where you see more construction in one region and less construction in other regions. I don't think that this is something that we would have to consider as holding the same looking forward. I think this is—this follows more the dynamic on the mid-term in each of the regions.

In the end, out of the three regions, we feel comfortable with all three. The north of Mexico is being very active, so we will keep on developing in the north. We started a building in Tijuana recently, because we are almost fully leased in Tijuana, and I'm pretty sure that we will start more buildings in Juarez soon that are not reflected in today's pipeline. The same with the Bajio. Probably, we are—we are in the lease-up stage of some of the buildings. As long as we lease them up, we will start construction of more. The Central Region, actually, I think that it's a similar situation. Probably, the main challenge we're having in the Central Region is to buy land at attractive prices. As long as we can be able to find land, we're going to be able to develop more. But, in the end, I think it's a—we will pretty much keep on with the same balance that we have been having in the past.

Ramon Obeso:

Thank you so much, and congratulations on your results.

Lorenzo Dominique Berho:

Thank you.

Operator:

As a final reminder, if you would like to ask a question, it is star, one.

As there are no further questions, I'd like to turn the floor back to Mr. Berho for any closing comments.

Lorenzo Dominique Berho:

For all of you for being in the conference. I would like just to—as I noted at the beginning of my remarks, we are executing our final stage of the Vesta 2020 Plan in a strong way, and we are excited to share the next phase of growth of the Company in our Investor Day. With that in mind, we hope to see you all at the June 4 Investor Day in New York. Thank you, again, for everybody for joining today's call and for your ongoing support. Have a great day.

Operator:

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