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Vesta Industrial Real Estate

Second Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Christianne Ibañez, *Investor Relations Officer*

Lorenzo Dominic Berhó, *Chief Operating Officer*

Juan Sottil, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Vanessa Quiroga, *Credit Suisse*

Javier Gayol, *GBM*

Roberto Waissman, *Bradesco*

Eduardo Alvizouri, *GBM*

Cecilia Jimenez, *Santander*

Andrea Lara, *Signum Research*

Froylan Mendez, *JPMorgan*

Alan Macias, *Bank of America Merrill Lynch*

PRESENTATION

Operator:

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

I would now like to turn the conference 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 Vesta's financial results for the second quarter of 2019. With us today from Vesta are Lorenzo Dominic Berhó, 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 July 26, 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. Berhó. Please go ahead.

Lorenzo Dominic Berhó:

Thank you, Christianne, and good morning, everyone. Thank you for joining our second quarter earnings call. We're excited to present solid second quarter results, in addition to an intense quarter of several exciting activities. On June 4, we hosted our Second Annual Vesta Day in part to thank the investment committee for each continued trust and support over the last five years. At the event, we proudly announced the conclusion and success of our Vesta Vision 2020 growth plan, which enabled us to double the size of our portfolio in five years while achieving profitable growth in terms of FFO and net asset value per share.

Our strong results during this period clearly demonstrated Vesta's ability to outperform the market and successfully execute on our long-term plan. We also unveiled the next phase of Vesta's growth plan, the Vesta Level III Strategy, designed to maximize total Shareholder return. Over the next five years, Vesta's Management team will focus on two key 2024 performance targets. $0.20 pretax FFO per share and $3 net asset value per share, while maintaining flexibility in funding sources, a strong balance sheet and a state-of-the-art property portfolio.

During the quarter, we executed our first portfolio sale for $109 million. Selling portions of our portfolio is an integral part of becoming a fully integrated real estate company, a model that gives us greater flexibility to drive value for our fellow Shareholders. Through this transaction, we successfully closed a stabilized portfolio's real estate cycle and without adversely affecting the composition of our remaining portfolio. It was done with a cap rate of 7.1% and approximately 20% premium above net asset value, which reflects the interest of institutional Investors in well-maintained quality real estate assets.

In addition to generating a return on capital via asset sales like this one, greater flexibility is achieved in terms of funding, opening up the private market as an alternative source of financing. In the near term, we will further explore and assess asset sales as well as potential joint ventures. In other words, we're now in a better position to reduce funding cost, and optimize our capital structure. To this end, we also raised $85 million through our dual-tranche private placement of investment grade unsecured notes in June.

We're also in the process of closing an unsecured syndicated loan for approximately $80 million and an unsecured revolving credit facility for up to $125 million. This refinancing has enabled us to prepay a $150 million loan that was due in 2021. As a result, we do not have any major debt due until 2024 and have extended Vesta's average debt maturity by one year to 7.2 years, while maintaining a competitive cost of debt at an average interest rate of 4.8%.

In addition to reducing our financing costs, we're diversifying and opening new funding sources, making Vesta a more resilient Company. Efficient and accretive capital allocation remains our main focus, which is why we chose to make additional share buybacks during the quarter. Given the greater than 30% discount to net asset value at which Vesta shares trade we saw share repurchases as the optimal way to employ capital, repurchasing 8.9 million shares during the second quarter.

The combination of positive actions has contributed to a 13% increase in Vesta's net asset value per share year-over-year, along with the strong execution and smart decisions that drove strong operating performance, healthy occupancy levels, accretive investments with high returns, and active buyback programs and profitable divestments.

Our focus remains on driving net asset value per share and FFO per share growth. We continue to be confident in our outlook based on market dynamics and our leadership in key markets. To give you an example; in June BMW opened an assembly plant in San Luis Potosi, which produces the company's popular 3-Series sedans. Most of the plant's production will be shipped to the U.S. In fact, Mexico exported 13% more vehicles during the first half of 2019 versus last year, according to data from Mexico's leading auto industry trade group. That figure represented just over 16% of the U.S. auto market and these exports are on pace to surpass last year's record level.

Anecdotal evidence suggests that the balance of supply and demand remains healthy in the select markets where we operate. While the northern regions of Mexico continue demonstrating high-levels of demand and attractive rents, we saw further increases in demand in the Bajio region. Of the contracts signed this quarter 60% came from the Bajio region with new clients like Schlemmer, a German auto components manufacturer in Puebla and repeat business with market-leading companies such as 3M, Daimler and Daewoo, just to name a few.

Turning to our performance, we continued to maintain momentum during the second quarter and remain as disciplined with leasing as we are with portfolio development, focusing on high quality clients on long-term leases. Total leasing activity during the quarter was just over 1 million square feet with nearly 700,000 square feet of new leases and renewals and releases, with other high quality clients accounting for approximately 350,000 square feet. While most of this leasing activity was concentrated in the north at the beginning of the year, it was more balanced during this second quarter. The market conditions that I touched upon earlier continue to support occupancy levels of rents.

Our stabilized occupancy declined slightly to 95.4%. Compared to last year's quarter, on average rent per square foot increased nearly 5% to $0.42, which contributed to an 11% increase in rental income and reflects the further strengthening of our portfolio in terms of quality as well as our disciplined approach to leasing. An increase in occupied space also drove rental income, which was $36 million for the quarter. At the same time, we maintained a 5.3 year weighted average lease maturity profile, which remains the highest in our sector.

Overall, we're pleased with our performance this quarter and we strongly believe our Level III strategy is the right one to capitalize on Mexico's tremendous attractiveness as a global manufacturing and logistics hub. I will now turn the call over to Juan, who will review our financial and operating results in more detail.

Juan Sottil:

Thank you, Lorenzo, and good day, everyone. As Loren noted, we grew revenues 11% to $36 million mostly due to $4.5 million in income from renting new space that has been vacant in the second quarter of 2018. This increase was partially offset by a $1.2 million decrease related to leases that have been expired and were not renewing, among other offsets. During the quarter, Vesta's operating cost increased 30% to $1.8 million, reflecting higher expenses at our new property. Those related to investment properties generating rental revenues increased 58% to $1.7 million, primarily due to an increase in the number of these properties.

Second quarter net operating income rose 9.4% to $34 million, while the corresponding margin decreased 139 basis points to 95.3%, mostly due to the cost increases related to new properties. Administrative expenses increased 22% to $4.6 million, mainly due to higher employee benefits.

Vesta EBITDA rose 9% to $30 million, while our margin contracted 143 basis points to 84.2%. The margin decline was due to the sale of the property portfolio, which resulted in lower revenues while margin of administrative expenses remained constant.

Due to the portfolio sales and higher gain from the reevaluation of investment properties, other income increased $27 million to $38 million in second quarter. The gain on the sale was $16 million, which represents the $109 million in cash generated by the sale, less $93 million cost of the properties that comprise the portfolio. The gain of the reevaluation on the properties was $32 million, primarily due to the use of lower discount and exit cap rates in the appraisal of our investment property.

Due to a higher balance of debt, our net interest expense increased 35% to $11 million. Also noteworthy during the quarter was a small foreign exchange gain that we reported versus a loss of approximately $5 million in the second quarter of last year. This variance is explained in detail in our press release.

Other income primarily drove the 76% increase in profit before taxes, which was $67 million in the second quarter. Vesta's income tax increased—I'm sorry, Vesta's income tax decreased 32%, during the sale of a portfolio, which resulted in lower deferred taxes during the quarter. We incurred a $12 million increase in current tax due to a higher operating tax related to the taxes paid on the sale of the property portfolio that amounted to $6 million. For the quarter, total comprehensive income was $51 million compared to $7.3 million last year, in the same quarter.

Our pre-tax FFO was $19.1 million, down from $19.4 million year-on-year. The decrease was due to a lower income that resulted from the portfolio sales as well as an increase in interest expense that reflects the amortization of the syndicated loan that was prepaid during the second quarter. Cap ex totaled $18 million in the quarter primarily from—for the construction of new buildings in the north and Bajio region. Total debt at the end of the second quarter was $698 million of which 91% is long-term debt and slightly less than 50% is secure. All of our debt is denominated in dollars, and bears a fixed interest rate.

In terms of leverage, we maintained our healthy credit metrics below six times net debt-to-EBITDA and 40% loan to value thresholds. Leasing activity during the quarter drove our 2019 maturities down 2.5% and our 2020 maturities to 6.6%. Vesta Stabilized portfolio grew nearly 2%, approximately 27.5 million square feet with the corresponding occupancy rates reaching 95.4, as Lorenzo noted. Our total GLA responded roughly 3% to 29.3 million square feet. Total occupancy fell slightly to 91.2% with the addition of two inventory buildings.

Finally—the 8.9 million shares that we repurchased during the quarter brought total buybacks to 48.2 million shares to date. The buybacks were executed at an average 30% discount to NAV thus far; 25.3 million of these shares have been cancelled. The balance and any additional buyback will also be cancelled. We also allocated capital for our quarterly dividend, which thanks to the shares repurchased, increased 15% per share at $0.43 per share.

Operator that concludes our prepared remarks. Could you please open the call for question? Thank you.

Operator:

Certainly, 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.

Our first question comes from the line of Vanessa Quiroga with Credit Suisse.

Vanessa Quiroga:

Thank you. Good morning. My question is regarding more on the demand--more details on the demand that you're seeing in Brazil and the rest of the country. On the one hand, you mentioned that you still see good demand for industrial space in your market, but on the other, you are not adding new projects in the second quarter in your pipeline. So, I just want to understand better, what do you see in terms of demand in the market and your expectation for rent? Thank you.

Lorenzo Dominic Berhó:

Hola, Vanessa, thanks. This is Lorenzo. Thank you very much for your question, and participating on the call. Clearly, we're very close to the market dynamics, and we are seeing different dynamics in each of the markets as I mentioned. The north part of Mexico has been very active, particularly Tijuana, and Ciudad Juárez. Ciudad Juárez has been posting record net absorption numbers in the last four quarters. Nevertheless, we like to keep a very close eye to each of the markets. While there's good dynamics, we also try to anticipate and develop spec buildings in order to anticipate to market demand.

Nevertheless—and but nevertheless, in the rest of the—the rest of the markets have shown some minor slowdown compared to other years but there's still some good demand from existing clients and existing companies that are requiring expansion space. It's probably the newer tenants that have no presence in Mexico yet, that has slowed down the most.

Nevertheless, even with a slowdown in demand, we still have a strong pipeline that we are trying to address. I'm sure that we're going to be able to have some important leases in the next upcoming quarters. With that, we have a very disciplined approach towards development. The development, this is—yeah, this is a quarter where we did not start anything. Nevertheless, we did start some things in the last quarter. We will start some projects in the next—in the next third quarter in as long as we're able to lease up the existing space that we have. Remember that part of our strategy is always to have some inventory buildings in some of the markets. We believe that currently we have several markets that are in lease up stage, are in marketing stage. As long as we lease them up, we will start developing new buildings.

So, that's pretty much the dynamic so let's see how the next quarters evolve, and with that we can keep on making decisions in either to develop more inventory buildings, or probably only wait for build-to-suits. We can—this is very easy, very dynamic and very easy to manage the speed of development according to the portfolio occupancy and market dynamics.

Vanessa Quiroga:

Okay, thank you Lorenzo. That's very helpful. Regarding rents, do you have a view that they will continue increasing—I mean, market rents, or do you see them flattening. Thank you.

Lorenzo Dominic Berhó:

Thank you Vanessa. No, definitely there is there's still probably more demand than supply, there's pretty much limited supply in many markets. So we have seen some interesting rate—rental rate increases in several markets such as particularly Tijuana and Ciudad Juárez. Probably the Bajio region has had a slighter increase than the rest of the markets. I think that the demand for good space is always there and there's not necessarily enough supply of good space. So I think that lease rates are going to be still increasing at a moderate pace.

Vanessa Quiroga:

Excellent. Thank you, Loren.

Lorenzo Dominic Berhó:

Thank you.

Operator:

Our next questions are from the line of Javier Gayol with GBM.

Javier Gayol:

Hi, thank you for taking my question. I just want to understand better the—as you mentioned the benefit for employees increased throughout quarter. Just wanted to understand is this something that we should expect to be at these same levels, or is this sort of a one-time thing that has happened in this quarter.

Juan Sottil:

Javier, good morning. Thank you for taking the question. This is Juan Sottil. Last year on the last quarter if you recall we had a pop up in some benefit that were not accrued properly. So what we're doing is we're accruing them over the whole year, so that we don't have any more pop ups. That's basically the increase. The compensation level for the Senior Management as well for the employees is not significantly changed from last year. In fact, it has not changed for the last two years.

Remember that the long-term incentive plan is share-based, contingent on the end of the year valuation of the share. So what we do, we do an actuarial reevaluation of the compensation given the performance of the shares vis-à-vis the level of two years ago, and this year that actuarial estimate grew a little bit. So those two effects are the ones that you're seeing, nothing else important.

Javier Gayol:

Okay, that's fair. Thank you.

Juan Sottil:

So yes, to summarize there were no material change in compensation for the Senior Executives and all the staff of the Company.

Javier Gayol:

So just to be clear, on a year-on-year basis it should be roughly similar, is similar what we should expect?

Juan Sottil:

Yes, on a year-to-year basis, yes, but please consider that one important component which is the share compensation because it depends on the yearend estimation of the share price, it's like an option based estimation. So that does vary from year to year but the plan doesn't change, the plan is the same as the last two years.

Javier Gayol:

Yes, and referring to the—excluding that compensation, like the one that goes directly to the SG&A figure, that's the one I am referring.

Juan Sottil:

Yes.

Juan Sottil:

That's very helpful. Thank you, Juan.

Juan Sottil:

Thank you.

Operator:

Our next questions are from the line of Roberto Waissman with Bradesco.

Roberto Waissman:

Hello guys, thank you for the call. My question for you is about the portfolio sale. I mean quite excited on Toluca. Given th part of the portfolio in Bajio. I'd like to understand how you expect to complete these investments, specifically in this region or no. If you're looking for the investments in other regions given that Bajio is currently your biggest stake your lower occupancy here how do you expect this region's performance going forward. Thank you.

Lorenzo Dominic Berhó:

Thank you, Roberto for the call. This is Lorenzo. We decided to—we sold 1.6 million square feet which were basically in Queretaro, 1 million square feet and 600,000 in Toluca. The decision of doing it in these markets was because first of all we saw that this was not going to change our remaining portfolio and we wanted to—these were buildings that were built some of them before the IPO and some of them at a later stage. We sold—out of Queretaro, we have roughly 7 million square feet. We sold a million square feet, which is not changing materially our presence. The same for Toluca, we only sold 600,000 out of 5 million square feet that we had in Toluca.

We decided to sell in these particular markets because we foresee some good opportunities to keep on developing and expanding and kind of repeat the same business model or the same business cycle as we have done with the assets that we sold.

We currently have in Queretaro, we have a lease up portfolio—we have currently a project under development, which is at Vesta Park Queretaro. There are—we have developed more than 500,000 square feet, which are currently in a lease up stage. In Toluca we're currently looking for more land. As you know Toluca has land scarcity, we're looking for land, and we're going to keep on developing in Toluca similar to what we have done in the past.

We see good demand for this market. Queretaro has been showing interesting increases in terms of pipeline. It's a very well diversified market between aerospace, automotive, logistics and other industries. Toluca is also a very well diversified market, very close to Mexico City, which in the end represents a good opportunity to keep on developing Class A buildings for companies requiring higher standards properties at a very—to proximity to Mexico City.

Roberto Waissman:

Okay, and just a follow—thanks for the answer, and just a follow-up question here. Looking to your current levels of cap rate, running over the 9% currently, is this 7%, 7.1% cap rate, the blended cap rate at present a cap rate you would target or would something closer to 8% make sense for selling your new assets?

Lorenzo Dominic Berhó:

Great. Well, let me—that's a very good question. Let me remind you that the way that we assess our net asset value is based on our—the appraised value that we get from third parties. We currently have Jones Lang LaSalle and Integra Realty as part of our appraisers. We—our total portfolio is roughly speaking valued at an 8% cap rate. We sold at roughly a 7% cap rate, which is pretty much in line to what we have been seeing in other comparable transactions.

I think that also answers to—or that's a result also of high demand from institutional class Investors, who are currently have very competitive cost of capital—a competitive cost of debt, and are targeting this type of facets and we believe that this is a cap rate it also makes sense for institutional Investors to keep investing.

Looking forward, we see that for these types of assets, we're going to be able to get attractive cap rates and attractive pricing. I think that in that regard, there's going to be a good opportunity for Vesta to keep on capitalizing on our development skills, keep on growing the portfolio, and at some point, still strategically keep on selling assets at attractive prices.

Roberto Waissman:

Okay. Very clear. Thank you.

Lorenzo Dominic Berhó:

Gracias.

Operator:

Our next question's from the line of Eduardo Alvizouri with GBM.

Eduardo Alvizouri:

Hi. Thank you for the call. I would like a question on the development side. We notice long lead development projects. So you are expecting this to change for the second half of 2019. Regarding that, which market do you consider are the most valuable to develop? We're seeing a strong north, and your operating metrics shows a high occupancy. So that's our estimate for the future developments from this.

Lorenzo Dominic Berhó:

Thank you. Yes. Thank you Eduardo for your call. Definitely, we've pretty much seen a good demand for good quality assets pretty much across all regions. As we noted, we recently leased a building in Puebla, where we have the Vesta Park Puebla, which is a very high quality industrial park. Also, we were very active in the Bajio region. We recently had the opening ceremony for the Vesta Park San Luis Potosi, which is right across the Street from the new BMW plant, which is showing some good dynamics as well.

We had our opening ceremony in Vesta Park Ciudad Juarez where we have been also very active in—not only leasing, but pre-leasing some of the buildings we had under construction, as you were able to see that in our quarter, second quarter results. So in—and Tijuana, we still have projects currently under construction in Alamar, which is one of the most desirable submarkets in Tijuana.

We're going to keep on being a very keen on the different markets and see how the dynamics behave, but we still think that most of the markets where we have presence are going to be showing interesting demand looking forward and we're going to keep on developing on these markets.

Eduardo Alvizouri:

Great, thank you.

Lorenzo Dominic Berhó:

Thank you.

Operator:

Our next question is from the line of Cecilia Jimenez with Santander.

Cecilia Jimenez:

Hi, good morning, guys. Thanks for the call, for taking my question and congrats on the result. I have basically, two questions. You already mentioned on pricing, but if you could develop a little bit more, basically, the stronger pricing that we are seeing. My question is does it come from a mix on the growth from a geographic point of view, or you are seeing across the portfolio increases in the different regions. I believe some are higher than others, but is it across the portfolio trend or just some fewer specific geographies that are driving the average price much higher. That's one.

The second question is regarding growth M&A and divestment in terms of asset. You have already presented the five-year plan and the divestitures are in that horizon. My question is are you also considering including potential M&A, you buying something on the future, is that an option or is not probably one of the first alternative regarding growth. Those are my two questions. Thank you.

Lorenzo Dominic Berhó:

Good afternoon, Cecilia. Thank you very much for being on the conference. As to your first question regarding pricing, we still see that pretty much across all regions there's opportunity to keep prices increasing for good quality assets. We think that a moderate increase throughout all regions is something easy to expect.

So—and that's pretty much what we have been seeing in the last cycle where growth has been growing, market rent has been slightly above inflation in the last, I don’t know, probably five to ten years. We foresee the same happening in dollar terms, that—which is very important and we foresee the same happening in the upcoming, in the near and mid-future. So we see that pretty much over different regions, particularly because we still think that there has been a lot of discipline from developers to not over develop in many of the markets where we operate. Today fundamentals are still very strong.

Secondly on your second question regarding asset sales and M&A, we believe that at 7% cap rates we're more sellers than buyers and I think that these are pretty the cap rate where many of the transactions are going to be a closing at in the upcoming future. We believe that we can create way more value by finding opportunities at a double digit return on costs, 10% to 11% redevelopment return on cost. I think that we have to remain disciplined at doing so. Of course whenever there's—opportunistically, there is an alternative different to that as we have done in the past where we have been able to acquire in Tijuana, a larger portfolio and sometimes some off-market transactions, single assets above 10%, I think we're going to keep on doing so.

That's why—but we have to be patient and we have to really find the markets and the opportunities that really match our strategy. In terms of quality of portfolio, quality of assets, in terms of regions, so we don't see ourselves rushing out to find more M&A opportunities and—but we believe that there will be so, there will be some in the near future. That's why having a strong balance sheet is going to be very important. If we have a strong balance sheet and as we have been doing lately and we can extend our maturities, our debt profile and our maturities and have low cost of debt, we're going to be capture more opportunities, but we got to be patient to find the right ones that really create value for our Shareholders.

I will take the opportunity to mention how important it is for us to make accretive investments because our main drive is to keep on growing our net asset value per share. This has been something difficult to achieve but we have shown that we have been able to increase our net asset value per share over the years. This is clearly what we believe is going to, in the end, drive up our stock price and in the end will be driving up the value for our Shareholders in the long run.

Cecilia Jimenez:

Okay, thank you, Loren. That's very clear.

Lorenzo Dominic Berhó:

Gracias.

Operator:

Our next questions are from the line of Andrea Lara with Signum Research.

Andrea Lara:

Hi, guys. Thanks for the call. I have two questions. First, could you give us more guidance on the Vesta Level III strategy? I also would like to know why the pretax EBITDA margin decreased so much during the quarter. If we could expect an improvement in the following quarter in this matter?

Lorenzo Dominic Berhó:

Thank you, Andrea for being on the call. Yes, we were very excited to be able to present the Level III strategy back in June in our Investor Day. Just to be brief on the successful Vesta Vision 2020 plan, we were able to increase our portfolio in terms of size. We were able to capture interesting opportunities through development and acquisitions over the last cycle.

Nevertheless, even one year before we defined a new plan, which is the Level III strategy, which will focus mostly in having a world class full integrated real estate platform. As you know, currently, we're starting to recycle capital through asset sales. We're managing now third party properties, which in this case, is a PSP who was the buyer of the portfolio, which we're going to keep on managing. This is going to start to be an important source of revenue for the Company.

Secondly, our objective is not going to be towards growing the Company or the size of the portfolio, per se but it's growing in terms of net asset value, and it's growing in terms of a pretax FFO per share. That's going to be the main driver of the Company to focus on profitability, to focus on these particular performance targets. We think that for the next five years until 2024, this is something achievable.

So many of the actions that we're going to take are going to be focused towards this. We're going to keep on selling assets. We're going to be disposing $1 out of every $2 that we invest. If we think about the next five years where we think that we're going to be able to invest $600 million, we are going to be able to also divest accretively $300 million in the same period.

With that we think that our—we're going to we're going to be able to maximize total Shareholder return. That's why the Level III strategy is taking us to a new mature stage of the Company. We're going to take different actions enabled to maximize total Shareholder return.

Juan Sottil:

If I can comment on your FFO question, if you look at it on a per share basis, our pretax FFO per share, on the quarter was down slightly. I mean, last year was—same quarter last year was $0.0324 per share. This year is $0.0321 per share. Well, so we didn't have any growth. That's understandable given the fact that we dropped some sales due to the asset sales, some revenue, and our administrative costs kind of remain fixed as well as our liabilities and our interest expense. As we re-deploy that money into new buildings, which is the intention or accretively buyback shares, the number will regain its growth momentum.

I think that the correct metric is pretax, because that will make us comparable to the rest of the industry both locally and globally. Post-tax, well, there is a biased for the fact that we sold some properties and we do pay taxes on behalf of our Shareholders, and that although the sales were quite tax efficient that explains the post-tax FFO drop. I don't know up if that answers your question.

Andrea Lara:

Yes, that's was helpful. Thanks.

Lorenzo Dominic Berhó:

Thanks Andrea.

Operator:

Okay and our next question are from the line of Froylan Mendez with JPMorgan.

Froylan Mendez:

Hello, guys, thank you very much for taking the question. I have two questions. Going forward, what should we expect regarding your capital allocation strategy? I mean, could we expect to see a full allocation towards buybacks or even dividends if the large discount to NAV remains? That's my first question.

Secondly, I guess the timing of the economic slowdown is actually positive towards the stage where the Company is. What has changed in the development decision process under this new stage of the Company? Do you feel comfortable having no Greenfield projects at some point? Or do you still have a minimum size of delay that you want to have under development at any given time?

Lorenzo Dominic Berhó:

Great, thank you, Froylan. Could you please clarify your first question?

Froylan Mendez:

Could we expect a full allocation of capital towards buybacks or even dividends if large discount to NAV remains?

Lorenzo Dominic Berhó:

Great, great, Froylan. Well, regarding capital location, and I think that we want to keep on the same—the same way that we have done in the past. We want to keep on buying back shares, whenever we find attractive, as we did this quarter. We bought almost nine million shares. I'm pretty sure that we're going to keep on—at these price levels, we're going to keep them buying more. Remember that we have $100 million buyback program, which we have executed, I think, almost 60% of it. So we can keep on buying almost $40 million more. I am pretty sure that we're going to keep on being active on that, because of the price levels where we see the Company is attractive for Shareholders.

Secondly, I think that in terms of dividend, we have a very good dividend policy. I think that the level of dividends that we have today is also very attractive for Investors. We don't want to be the one with the highest dividend as we have noted in the past. We believe in total Shareholder return and total Shareholder return is comprised of dividends and stock appreciation too. We believe the net asset value increase per share is driven mostly from capital—from the capital appreciation.

So therefore, we still want to keep on delivering dividends, but probably, at an increase of roughly 5% per year roughly speaking. There's no particular policy to that. We will revise that every year. Nevertheless, we think that today, we already have a very, very good dividend for Shareholders to have an attractive return.

Secondly, to your question regarding development, we think that it's the same strategy as we have kept in the past. As long as we see demand, we're going to keep on developing. We think that we have currently very well located land reserves, in Vesta Parks, which is—which has been our main target to develop Vesta Parks in different regions. So as long as we see demand, we will keep on developing. As long as we lease up, we're going to start new projects. So we're going to be very cautious on how much we develop. Clearly, we don't want to over develop. If there is an opportunity, we will try to anticipate to the market.

So the good thing about industrial real estate development is that the pace of growth is very manageable. Currently all of our portfolio, if you could see our same store portfolio, which is pretty much the largest part of it is at 98% occupancy. It's very high. Pretty much the only buildings that we have currently available are the ones that have been recently developed, which are in the natural lease up stage.
So as long as we see more, more leasing activity, we're going to keep on developing more buildings. So there has not been any change to (phon) our strategy.

Froylan Mendez:

In that sense, if it comes to a situation when where you see a very good lease up activity, but still these sort of discounts to NAV where will you choose to allocate capital to development or to buy back share?

Lorenzo Dominic Berhó:

It's not one or the other. We believe that both of them create value for Shareholders. So that's why we don't have to go to one or the other. We can still do both. Remember that currently, we have—since we did an asset sale of over $100 million, we have good cash in hand. So we can use our resources to any or the other as long as it creates value. That's what we have been doing in the past.

Froylan Mendez:

Perfect. Thank you so much, and congrats on the results.

Lorenzo Dominic Berhó:

Gracias.

Operator:

Our next questions are from the line of Alan Macias with Bank of America.

Alan Macias:

Hi, good morning, and thank you for the call. Just one question regarding e-commerce, what is the demand you're seeing in that segment of the business? If you can remind us what is your exposure to that sector, and what is your strategy in order to take any opportunity you are seeing in that logistics segment. Thank you.

Lorenzo Dominic Berhó:

Gracias, Alan. Thank you very much for being on the call. This is Lorenzo. E-commerce is clearly the main driver of growth for industrial real estate assets globally, mostly in developed world, particularly in Europe, U.K., Germany and other larger countries. The U.S. has had its own dynamic, particularly with Amazon which takes almost one out of every—one of every two spaces is taken by Amazon. We believe that Mexico is still lagging the developed countries and we think that there has been some e-commerce opportunities.

Nevertheless, we are still some years behind and what we have been doing in Vesta is really trying to be close to many of these players and to try to identify what their own strategy might be.

Mexico—currently all e-commerce represent—out of all retail sales, represent roughly speaking 3%, whereas in the U.S. represents 14%, which is a major change. We have been close to some of these larger e-commerce players and I think they themselves have not finalized their own strategy towards entering Mexico. I'm pretty sure that as long as they require expansion across all different regions, and as long as they require good quality space in good locations, I am pretty sure that there could be opportunities for Vesta to keep on growing in the e-commerce sector.

Nevertheless, the analysis that Vesta has is that even if we grow at an important pace, our portfolio in terms of e-commerce for the next five years—we think that it will still be something in the range of no more than 10% of total portfolio. In the end we believe that other industries are also going to keep on growing, which is logistics, which is aerospace, which is medical devices and of course automotive industry, which are larger in terms of size, in terms of economically. There will be also good demand from these other industries.

Alan Macias:

Thank you. Very helpful.

Lorenzo Dominic Berhó:

Thank you.

Operator:

Once again as a reminder you may press star, one to ask a question at this time. Our next questions are from the line of Javier Gayol with GBM.

Javier Gayol:

Hi, thanks guys. Thank you for taking the follow-up question from me. You mentioned that at certain cap rates you will be more sellers than buyers. I was wondering maybe if you could give us a little bit of color as to how do you see the buyers' market. Which players are entering that market and do you see enough potential on the buyers' market to continue the investment on the portfolio going forward?

Juan Sottil:

Javier, it is market and you know real estate there is opportunistic—there is windows of opportunity. Right now with the window of opportunity of the demand of industrial real estate, professional institutional Investors globally are keen on having good quality asset with good name, with a long-term lease and they are keen on penetrating Mexico. We happen to have assets of that kind. So we will be keen on tapping on them. It is a window, it is an opportunity and we will be taking advantage of that as Loren says, to fund our $600 million deployment over the next five years.

Now I don't see Vesta at all buying any type of properties at cap rates hovering around 8%. That is not our strategy. Our strategy is to create value by developing property at cap rates—returns on cost higher than that. We will not be buying property at cap rates of 8%, 7%. That's not our strategy and we will be keen on being close to the private market where these global entities see a lot of value in good quality names, good buildings and long-term leases. There is lot of value for them because of the way they manage their portfolios and I think it's a good opportunity to tap.

Javier Gayol:

Okay, that's helpful. Thank you, Juan.

Operator:

Okay. Thank you. There are no further questions. I'd now like to turn the call back to Mr. Berhó for concluding comments.

Lorenzo Dominic Berhó:

Thank you. Thank you very much everybody for being on today's call. Following the success of our Vesta Vision 2020 plan, we have set out a new growth plan under our new Five Year Level III strategic plan. We aim to become a best in class full-integrated real estate Company through disciplined and efficient capital allocations, smart asset recycling and portfolio optimization, all while continuing—strengthening our balance sheet and expanding our sources of funding.

Importantly, we're self-advised, self-managed, avoiding conflicts of interest. The recent sale of a portfolio and the refinancing both of which have enhanced our financial flexibility and balance sheet strength, clearly demonstrate our ability to execute on our Level III strategy and ultimately achieve our vision and ambitious 2024 growth targets.

Before ending the call, I would like to congratulate Juan and our Investor Relations team as Institutional Investor Magazine ranked both as well as our ESG program first among midcap real estate companies in Latin America. We're honored to have the best Management team in our sector. Together, we remain focused on raising the bar for Vesta's future endeavors. Thank you again for joining us on today's call and for your ongoing support for our Company.

Operator:

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