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ALEX.N - Q2 2023 Alexander & Baldwin Inc (Hawaii) Earnings Call

EVENT DATE/TIME: JULY 27, 2023 / 9:00PM GMT

## CORPORATE PARTICIPANTS

**Clayton K. Y. Chun** *Alexander & Baldwin, Inc. - Executive VP, Treasurer & CFO*

**Kit Millan** *Alexander & Baldwin, Inc. - SVP of Asset Management*

**Lance K. Parker** *Alexander & Baldwin, Inc. - President, CEO & Director*

## CONFERENCE CALL PARTICIPANTS

**Alexander David Goldfarb** *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

**Mitchell Bradley Germain** *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

**Stephen C. Swett** *ICR, LLC - MD*

## PRESENTATION

**Operator**

Good afternoon, and welcome to the Alexander & Baldwin Second Quarter 2023 Earnings Conference Call. (Operator Instructions) Please note that today's event is being recorded. I would now like to turn the conference over to Steve Swett of Investor Relations. Please go ahead, sir.

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**Stephen C. Swett** - *ICR, LLC - MD*

Thank you. Aloha, and welcome to our call to discuss Alexander & Baldwin's Second Quarter 2023 Earnings.

With me today for our earnings call are A&B's Chief Executive Officer, Lance Parker; and our Chief Financial Officer, Clayton Chun. We're also joined by Kit Millan, Senior Vice President of Asset Management, who is available to participate in the Q&A portion of the call.

During our call, please refer to our second quarter 2023 supplemental information available on our website at investors.alexanderbaldwin.com/supplements.

Before we commence, please note that the statements in this call that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statements. These forward-looking statements include, but are not limited to, statements regarding possible or assumed future results of operations, business strategies, growth opportunities and competitive positions.

Such forward-looking statements speak only as of the date the statements were made and are not guarantees of future performance. Forward-looking statements are subject to a number of risks, uncertainties, assumptions and other factors that could cause actual results and the timing of certain events that differ materially from those expressed in or implied by the forward-looking statements.

These factors include, but are not limited to, prevailing market conditions and other factors related to the company's REIT status and the company's business results of operations, liquidity and financial condition and the evaluation of alternatives by the company related to its Materials & Construction business as well as other factors discussed in the company's most recent Form 10-K, Form 10-Q and other filings with the SEC. The information in this call and presentation should be evaluated in light of these important risk factors.

We do not undertake any obligation to update the company's forward-looking statements. Management will be referring to non-GAAP financial measures during our call today. Please refer to our statements regarding the use of these non-GAAP measures and reconciliations included in our second quarter 2023 supplement.

Lance will open up today's presentation with an overview of the quarter and provide an update on real estate operations. And then Clayton will discuss financial matters. Lance will return for some closing remarks, but where upon we will open it up for your questions. With that, let me turn it over to Lance.

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thank you, Steve, and Aloha, everyone. Beginning with our commercial real estate portfolio in the second quarter, we again generated excellent results for our shareholders. Our portfolio, consisting of high-quality retail, industrial and ground lease assets produced strong results and continued our momentum from the first quarter in 2022. CRE revenue was up 7.6% in the second quarter compared to the year ago quarter, driven primarily by higher base rent, the impact of removing certain tenants from cash basis revenue recognition and higher expense recoveries. Same-Store NOI was up 4.6%, accelerating from the first quarter.

These strong results reflect the quality of our diversified portfolio and the focused efforts of our team. Our performance continues to benefit from a robust local economy. Hawaii added nearly 20,000 jobs over the past 12 months, an increase of 2.7%. Nonfarm wages increased 2.7% in June 2023 as compared to the prior year. And the unemployment rate at the end of June, adjusted for seasonality was 3%, continuing its downward trend.

Throughout our market, we are seeing solid economic activity across most sectors, including the large construction and tourism industries. As we have said before, our portfolio is generally community-based and less dependent on tourist activity, but tourism supports the state's overall economy.

Turning to our CRE portfolio leasing metrics. Same-Store leased occupancy at quarter end was 94.3%, a decrease of 30 basis points from 12 months earlier. Same-Store retail leased occupancy was up 90 basis points to 94% and Same-Store industrial leased occupancy was down 260 basis points to 95.8%.

As we noted last quarter, the decrease in overall portfolio and industrial leased occupancy year-over-year was primarily due to an expected tenant move-out at Kaka'ako Commerce Center in the first quarter of 2023. Same-Store economic occupancy at quarter end was 92.3%, down 20 basis points from 12 months earlier. Same-Store retail economic occupancy was up 120 basis points to 91.8% and Same-Store industrial economic occupancy was down 330 basis points to 94%.

Annualized base rent attributable to signed but not opened, or SNO, leases at quarter end were $3.1 million. This compares to $3 million from 12 months earlier and $2.3 million last quarter.

During the second quarter, we executed 72 leases in our improved property portfolio. For approximately 220,000 square feet and achieved blended spreads of 5.8%, with spreads for industrial leases at 6.6% and spreads for retail leases at 5.6%. This activity included 20 leases related to properties located in Kailua, including Aikahi Park Shopping Center, totaling approximately 31,000 square feet of GLA and $1.3 million of ABR. One lease at Pearl Highlands Center totaling approximately 35,000 square feet of GLA and $1 million of ABR and 4 leases at Queens' MarketPlace totaling approximately 13,700 square feet of GLA and $700,000 of ABR.

In addition to improved property activity, we also executed the ground lease renewal at Windward City Shopping Center, which renewed on a fair market value reset to $3.9 million from $2.8 million for a spread of 39%. We are pleased with the continued pace of leasing activity and pipeline of active deals.

Turning to growth. As previously noted, during the quarter, we acquired a 33,200 square foot industrial property in a sale-leaseback transaction for $9.5 million or approximately $286 per square foot. The property is 24-foot clear height, dock-high loading and is located in the Kapolei submarket on Oahu in close proximity to our other industrial assets.

Based on the 10-year lease, the going-in cash cap rate is 5.6% with 3% annual increases in base rent. Our investment team continues to pursue opportunities that are complementary to our portfolio. Similar to other markets in the country, we have seen wide bid-ask spreads, but we continue to remain disciplined and believe our deep market knowledge will help us execute nimbly when accretive opportunities arise.

In the meantime, we continue to pursue value creation opportunities within our portfolio. Our refresh at Manoa Marketplace, the only grocery-anchored neighborhood center in the Manoa area, remains on track for completion in the third quarter. We believe this refresh focused mainly on cosmetic improvements to enhance customer experience will result in higher rental rates over time. We continue to evaluate additional opportunities within our portfolio for capital deployment to drive long-term growth in cash flow and value.

With that, I'll turn the call over to Clayton for financial details. Clayton?

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**Clayton K. Y. Chun** - *Alexander & Baldwin, Inc. - Executive VP, Treasurer & CFO*

Thanks, Lance, and aloha, everyone. Starting with our consolidated metrics on Table 7 of our supplemental. For the second quarter of 2023, net income available to shareholders was $13.3 million or $0.18 per diluted share.

Turning to FFO and core FFO. Second quarter FFO was $19.8 million or $0.27 per diluted share. Core FFO was $21.3 million or $0.29 per diluted share. Each of these metrics for the second quarter of 2023 benefited from collections of amounts reserved in prior years of approximately $600,000 or $0.01 per diluted share as compared to $1.8 million or $0.02 per diluted share in the second quarter of 2022.

The quarter-to-date metrics also benefited from $1.3 million or $0.02 per diluted share resulting from the removal of certain tenants from cash basis in the second quarter of 2023. There were no tenants removed from cash basis in the second quarter of 2022. For additional details on our results in comparison to prior periods in 2022, please see our earnings release and supplemental information package.

Let me now turn to our Commercial Real Estate segment on Table 8. For the second quarter, CRE revenues increased 7.6% or $3.5 million over the prior year quarter to $49.5 million. This increase from the year ago quarter was driven primarily by higher base rents, the impact of removing certain tenants from cash basis and higher expense recoveries.

CRE Same-Store NOI increased 4.6% or $1.3 million to $31.1 million compared to the same period last year. Excluding collections of previously reserved amounts in both 2022 and 2023, Same-Store NOI growth would have been 9.2% for the second quarter.

Turning to land operations presented on Table 18. Adjusted EBITDA was $1.7 million in the second quarter of 2023 compared to $53 million in the same quarter last year. The change was due primarily to the $54 million gain on sale of noncore assets on the island of Kauai that occurred in the second quarter of 2022.

G&A is highlighted on Table 2. For the second quarter of 2023, G&A expenses were $9.9 million compared to $9.3 million in the second quarter of 2022. The higher G&A was primarily a result of one-time management transition related costs.

We reported income from discontinued operations of $4.2 million in the second quarter, which is made up primarily of Grace Pacific operations. Grace remains in discontinued operations as we work to complete the sale of the entity. We continue to make progress on this goal, but we cannot provide additional details at this time.

Turning to our balance sheet and liquidity metrics on Table 6. At June 30, 2023, total debt outstanding was $506.9 million and we had total liquidity of $441.1 million, made up of approximately $8.2 million in cash and $432.9 million available on our revolving credit facility.

At quarter end, net debt to trailing 12-months consolidated adjusted EBITDA was 4.7x. For comparative purposes, we were at 2.4x last year, primarily because of the gain on the sale of the noncore assets on Kauai. Net debt to trailing 12 months consolidated adjusted EBITDA, excluding land operations, was 5.3x at the end of the quarter compared to 4.9x in the second quarter of 2022.

We paid a second quarter dividend of $0.22 per share on July 5 and our Board recently declared a third quarter dividend of $0.22 per share that is payable on October 4. We are pleased with our results and are raising guidance for the year. We expect core FFO in the range of $1.10 to $1.14 per diluted share due primarily to an improvement in our outlook for CRE Same-Store NOI performance. We expect Same-Store NOI growth within the range of 2.5% to 4.25% and Same-Store NOI growth, excluding prior year reserve reversals, within a range of 5.5% to 6.75%.

With that, I'll turn the call over to Lance for his closing remarks.

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thanks, Clayton. The second quarter again demonstrated the strength of our portfolio, the depth and experience of our team and the ongoing health of the Hawaii market.

As we look to the remainder of the year, we believe these factors will continue to drive our performance. I want to thank our entire team for their contributions to our success. I would also like to thank the team for their dedication to environmental, social and governance-related matters.

Today, we focused on our operational results. But our fourth annual corporate responsibility report will be published in August highlighting our commitment to ESG, and I'm just as proud of what we have accomplished for partners for Hawaii.

Finally, as you know, this is my first earnings call as CEO. I want to thank Chris Benjamin for his friendship and mentorship over the many years that we have worked together and thank the Board for the opportunity to lead this fantastic team into the future. With that, we'll now open the call up to questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) At this time, we will take our first question, which will come from Alexander Goldfarb with Piper Sandler.

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**Alexander David Goldfarb** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So just a few questions, and I think it was part of your no comment, but I have to ask. The latest on Grace and do you feel comfortable that it will be exited by year-end? Or do you think this will drag into next year?

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

This is Lance. So we are still engaged in a formal process with Grace. So I can't comment specifically on buyers' price or timing for the integrity of that process. But what I can say is that the disposition of the Grace business is an absolute priority for us.

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**Alexander David Goldfarb** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay. Okay. The next question, I think you guys said your signed but not yet open is about $3 million, which in sort of rough numbers sounded like it was the same that it was previously. A number of your peers that signed but not yet commenced seems to grow every quarter. And I'm just curious, given the strong portfolio performance that you guys talked about, the fact that I think you still have like 25% or something of the top 20 or top 30 retailers on the Mainland, not yet in Hawaii, I would expect that number to sort of grow. So maybe you could just talk a little bit more about the signed but not yet commenced, maybe you're just putting people in spaces much quicker. So that delayed pipeline just doesn't grow because you're quicker at leasing? Or maybe there are just other dynamics in there?

**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. Maybe I'll start with just the general comment, and then I'll ask Kit to provide some color. So -- our $3.1 million of SNO for Q2 is about the same year-over-year, but it did improve pretty dramatically sequentially. And so just with that general statement, Kit, maybe you can provide some additional color.

**Kit Millan** - *Alexander & Baldwin, Inc. - SVP of Asset Management*

So the spread between leased and economic, it's a really healthy 190 basis points right now, and that is up 40 basis points sequentially. So it was $2.3 million in Q2, and it's now $3.1 million. So that is pointing to some significant ABR that's coming online in the next few months. And to your question about retailers that are not here yet, we're engaged in many discussions with many different retailers. We have brought on some new ones in the recent past, ones like Chick-fil-A, and we continue to do so. And we're seeing some strong interest from some other anchors in the market.

**Alexander David Goldfarb** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay. And just the final question is insurance has definitely been a big topic in REIT land. We don't hear much about what's going on in Hawaii on the insurance market. But just curious what you guys are seeing both from the property level and then from your tenants. So, meaning obviously, you guys have an ability to absorb insurance increases, I would imagine better than your mom and pops, and clearly, you need viable mom-and-pops. So just want to get a sense from A&B's perspective, what you guys are seeing on property insurance premiums and renewals? And then two, what your tenants are seeing in as far as their ability to sustain that or if there's a way for you guys using the corporate wrapper to sort of help provide economies of sale, if you will, to be able to bought -- for the tenants to buy insurance via your wrapper.

**Clayton K. Y. Chun** - *Alexander & Baldwin, Inc. - Executive VP, Treasurer & CFO*

So with respect to insurance, that is a cost that -- significant cost that is part of our overall property operations. And like everyone else, we are monitoring what's happening with the insurance rates in general. We are currently in a position where I think, overall, it hasn't had an impact to our historical results, but what I would say is that we are closely monitoring. We are hearing. We have our agents out there that are helping us keep apprised of trends. And so that's something that we will continue to manage our way through.

**Alexander David Goldfarb** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

And what about your tenants? Are they having any challenges with insurance or it's really not the issue that is out there that we see on the mainland?

**Kit Millan** - *Alexander & Baldwin, Inc. - SVP of Asset Management*

So I think nobody is immune to it, for sure. And at the portfolio level, we have done a lot to restructure and look at different ways to take advantage of that sale. Cost structure overall, we've heard, is an issue for tenants. And that's been true for the past year or so. But the good news is that customer traffic is significantly up. It's up 7% over last year, and that's translated into higher tenant sales in both in terms of anchors as well as our in-line tenants.

**Operator**

And our next question will come from Mitch Germain with JMP Securities.

**Mitchell Bradley Germain** - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Can you hear me?

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes.

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**Mitchell Bradley Germain** - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Sorry about that. My apologies. I'm curious about leasing trends. I guess it probably is a little bit of mix, but some of the spreads declined quarter-over-quarter. Is there anything to read into there? Or is it really just mix of leases that rolled?

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

I'll let Kit maybe get into some of the details on spreads specifically, Mitch. But what I would say is the strength of the leasing market continues. We had good activity in 2022. We had good activity in Q1. And in Q2, we had very strong activity just in terms of total number of leases signed, ABR, GLA. And in real time, as we've talked about in the past, just through our lease committee process that we use on a weekly basis, we do get sort of real-time visibility into demand. And I would say that tenant demand for space remains strong. So maybe with that backdrop, Kit, you can speak specifically to spreads.

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**Kit Millan** - *Alexander & Baldwin, Inc. - SVP of Asset Management*

Sure. So we exceeded expectations overall in terms of volume, GLA, ABR and spread. About 65% of the deals in the quarter were in the retail portfolio. And what we're really, really happy about is that new deal volume has been significant and far higher than we anticipated and that points to future gains in economic occupancy.

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**Mitchell Bradley Germain** - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Okay. That's super helpful. How would you characterize the activity at that newly vacant property that you referenced?

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**Lance K. Parker** - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. So just by way of some background, Kaka'ako Commerce Center is -- it's about a 200,000 square foot industrial building that we own in urban Honolulu. It's a multi-story facility. So while it is 5 of the 6 floors are industrial, the sixth floor was converted quite some time ago, pre-acquisition for us, to office. And that's where the vacancy occurred. So we had about 25,000 square feet with this single tenant, which represented about 12.5% of vacancy to the building, and you can see it flowing through the industrial asset class as well as the portfolio.

The office market here is stable, but I wouldn't say it's certainly not as strong as industrial. So we will likely have to -- it will take a little bit of time for us to backfill the space from what is our preferred use, which would be a backfill of an office tenant, but we would consider converting that space to other uses depending on tenant demand.

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**Mitchell Bradley Germain** - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Super helpful. Last question on guidance. If I'm correct, you've done $0.29 for the last 2 quarters. If I just look at annualizing that number, it looks like it's going to trend above the high end of your core FFO range. What am I missing in the back part of the year that could bring the numbers down?

**Clayton K. Y. Chun** - *Alexander & Baldwin, Inc. - Executive VP, Treasurer & CFO*

Hi Mitch, it's Clayton. So as far as our core FFO, we have commented when we provided our original guidance that there are a couple of different factors that are influencing our overall results for this year, one of which is G&A. There is also impact of the reserve reversals that occurred in last year. And so as we look forward to the second half of the year, there is still some level of uncertainty. And I think that in terms of our ability to execute on the second half, those factors will continue to affect our overall results. And -- but on the whole, the fact that we had our performance year-to-date and second quarter for Same-Store NOI, we felt good about where we are trending. And as a result, we had increased the core FFO guidance to where we ended up.

**Mitchell Bradley Germain** - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Okay. That's helpful. So it just appears as if you're just baking some conservatism on the macro backdrop for now, and let the year progress and revisit as each quarter as you proceed. Is that the way to think about it?

**Clayton K. Y. Chun** - *Alexander & Baldwin, Inc. - Executive VP, Treasurer & CFO*

Yes. I think that's fair.

**Operator**

And this concludes our question-and-answer session. I'd like to turn the conference back over to Steve Swett for any closing remarks.

**Stephen C. Swett** - *ICR, LLC - MD*

Thank you, operator, and thank you all for joining us today. If you have any follow-up questions, please feel free to call us at (808) 525-8475 or e-mail us at investorrelations@abhi.com. Aloha, and have a great day.

**Operator**

The conference has now concluded. Thank you very much for attending today's presentation. You may now disconnect your lines, and have a great day.