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Q3 2023 Alexander & Baldwin Inc (Hawaii) Earnings Call

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CORPORATE PARTICIPANTS

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Lance K. Parker *Alexander & Baldwin, Inc. - President, CEO & Director*
Steve Swett *ICR, LLC - IR*

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Connor Mitchell *Piper Sandler & Co., Research Division - Research Analyst*

PRESENTATION

Operator

Welcome to the Alexander & Baldwin Third Quarter 2023 Earnings Conference Call. [Operator Instructions]. Please note, this event is being recorded. I would now like to turn the conference over to Steve Swett, Investor Relations. Please go ahead.

Steve Swett ***ICR, LLC - IR***

Thank you, aloha, and welcome to our call to discuss Alexander & Baldwin's Third 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 are 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 third quarter 2023 supplemental information available on our website at investors.alexanderbaldwin.com/supplementals. Before we commence, please note that 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 to 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 to differ materially from those expressed in or implied by the forward-looking statement. 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 conditions 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 statement regarding the use of these non-GAAP measures and reconciliations included in our third 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, where upon we will open it up for your questions. With that, let me turn the call over to Lance.

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

Thanks, Steve, and aloha, everyone. Our high-quality commercial real estate portfolio of retail, industrial and ground lease assets again generated strong results in the third quarter, continuing our momentum from the first half of 2023. Quarterly CRE revenue was up 3.7% compared to last year, driven primarily by higher base rents and same-store NOI was up 6.3%. While the economy in Hawaii continues to demonstrate its resilience, the human and economic impact of the Maui wildfires continues to be felt. Much of Maui is open. However, certain areas of the island, particularly those directly impacted by the fire remain closed. In the wake of the wildfire, Maui has seen an expected decrease in tourism, while activity on the other islands has increased.

Although total state-wide visitor counts in September 2023 were lower than 2022, year-to-date numbers are still up compared to last year. Most reports estimate limited spillover to the broader economy in Hawaii. This is supported by the fact the state's unemployment rate at the end of September was 2.8% compared to 3.5% a year earlier. 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 94.5%, 10 basis points lower than 12 months earlier, Same-store retail leased occupancy was 70 basis points higher at 94%, and same-store leased industrial occupancy was 130 basis points lower than the third quarter of 2022 at 96.7%. For comparative purposes, same-store industrial leased occupancy in the third quarter of 2023 was 90 basis points higher than the second quarter of 2023. Same-store economic occupancy at quarter end was 92.8%, down 30 basis points from 12 months earlier, Same-store retail economic occupancy was up 60 basis points to 91.9%, and same-store industrial economic occupancy was down 170 basis points to 95.8%.

Annualized base rent attributable to SNO leases at quarter end was $3.1 million. This compares to $2.5 million 12 months earlier and $3.1 million last quarter.

During the third quarter, we executed 62 leases in our improved property portfolio for approximately 150,000 square feet and achieved blended spreads of 11.2%, with spreads for industrial leases at 4.1% and spreads for retail leases of 13.8%. This activity included 14 leases related to properties located in Kailua, including Aikahi Park Shopping Center, totaling approximately 25,000 square feet of GLA and $900,000 of ABR and 4 leases at Queens Marketplace totaling approximately 12,000 square feet of GLA and $400,000 of ABR. We are pleased with the continued pace of leasing activity and pipeline of active deals.

Our refresh at Manoa Marketplace, the only grocery-anchored neighborhood center in the Manoa area was substantially completed in the third quarter, with only final punch list items remaining.

With bid-ask spreads and higher interest rates limiting transaction activity, we remain disciplined when evaluating capital deployment options as we identify opportunities that drive long-term growth in cash flow and value. And now I'll turn the call over to Clayton for financial details. Clayton?

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 supplement. For the third quarter of 2023, net income available to shareholders was $14.6 million or $0.20 per diluted share. FFO was $21.1 million or $0.29 per diluted share. Core FFO was $21.8 million or $0.30 per diluted share. Each of these metrics for the third quarter of 2023 benefited from collections of amounts reserved in previous years of approximately $500,000 or $0.01 per diluted share. For comparative purposes, in the third quarter of 2022, collections of amounts reserved in previous years was $400,000 or $0.01 per diluted share. We expect collections of previously reserved amounts to decrease to normalized amounts in future quarters. 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 results on Table 8. For the third quarter, CRE revenues increased 3.7% or $1.7 million over the prior year quarter to $48.2 million. This increase from a year ago quarter was driven primarily by higher base rent this year as compared to last year. CRE operating profit increased $300,000 or 1.5% to $20.6 million. CRE same-store NOI increased 6.3% or $1.8 million to $30.8 million compared to the same period last year. As I previously mentioned, collection of amounts reserved in previous years had a minimal impact to same-store NOI growth in the third quarter, and we expect the collections of amounts reserved in prior years to normalize in the coming quarters. As a result, we expect our same-store NOI growth to normalize from the outsized increases experienced in the period of economic recovery post COVID.

Turning to land operations presented on Table 18. Adjusted EBITDA was $2.9 million in the third quarter of 2023 compared to a negative $1.3 million in the same quarter last year. The change was due primarily to the increased sales of unimproved property in the third quarter of 2023. There were no such sales in the third quarter last year.

G&A is highlighted on Table 3. For the third quarter of 2023, G&A expenses were $7.6 million compared to $9.6 million in the third quarter of 2022. The G&A reduction was due primarily to lower personnel-related expenses.

We reported income from discontinued operations of $3.9 million in the third quarter, primarily related to Grace Pacific. 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 in Table 6. At quarter end, total debt outstanding was $507.6 million, and we had total liquidity of $429.7 million made up of approximately $11.8 million in cash and $417.9 million available on our revolving credit facility. Approximately 84% of our debt is fixed, and given the continued high interest rate environment, we are taking proactive steps to increase our percentage of fixed rate debt as well as ladder our maturities.

Net debt to trailing 12-month consolidated adjusted EBITDA was 4.4x. Net debt to trailing 12 months consolidated adjusted EBITDA, excluding land operations, was 5.1x at the end of the quarter compared to 4.9x in the third quarter of 2022.

During the quarter, we repurchased approximately 92,000 shares of stock at an average price of $16.72 per share. As we have said before, our share repurchase plan provides an additional capital allocation tool, which we may use from time to time. With respect to our dividend, we paid a third quarter dividend of $0.22 per share on October 4. Consistent with our normal practice, we expect our Board to declare a fourth quarter dividend in December.

We are pleased with our results and are again raising guidance for the year. We expect core FFO in the range of $1.13 to $1.16 per diluted share due to better-than-expected G&A for transition-related costs. We expect same-store NOI growth within a range of 2.75% and 4.25%, and same-store NOI growth, excluding prior year reserve reversals within a range of 5.75% to 6.75%. With that, I'll turn the call over to Lance for his closing remarks.

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

Thanks, Clayton. The third quarter, again, demonstrated the strength of our outstanding team and the quality of our retail, industrial and ground lease assets. Before we conclude our prepared remarks, I would like to take a moment to acknowledge the devastating wildfire in the town of Lahaina on Maui, the island where our company took root more than 150 years ago. None of our assets were physically damaged from the wildfire, and we are thankful that our employees are physically safe. However, the tragedy does hit close to our hearts with losses that include lives, homes and livelihoods of members of our extended family. The immediate and continued selfless response to the Maui community continues to reinforce my belief that Hawaii's people share a deep commitment to each other and to the islands we call home. With that, we'll now open the call up to questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. [Operator Instructions]. The first question is from Connor Mitchell of Piper Sandler.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

So thinking about a big picture. During the pandemic, there's a lot of residents that were moving from the mainland to the islands. Do you guys see maybe a constant stream of this? Or has it slowed a bit since the original pickup in the movement?

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

Connor, it's Lance. I would say it's probably slowed. I mean there was a lot of people that were moving either from a more -- on a transient basis for a period of time during COVID or more on a permanent basis. But we really haven't seen a major demographic shift, if you will, in terms of inflow of population from other areas.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

Okay. And then you touched on tourism a little bit, and I know it's been a topic on previous calls and discussions. So since Japan has lifted some restrictions, travel restrictions, I think back in May, have you seen any uptick in Japanese tourists or maybe signs of more to come?

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

Yes. I would say that Japanese tourism, if we compare it to 2019 pre-pandemic time frame, still down about 67%. So still down significantly. But if we look at just September numbers, 2023 compared to September of 2022, they're up about 2.5x, so we're starting to see a really big improvement in the Asian tourism market. And just given how far it's still down from 2019, the bright side of that is that there's still plenty of room to go.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

Okay. And then, Clayton, you touched on the guidance increase. And forgive me if I misheard you, but it sounded like it was primarily due to the lower G&A. Does the higher base rent and the healthy spreads you guys saw in this quarter have any impact on the guidance? Maybe that's in the CRE NOI increase as well?

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

It does. Yes. Yes, Connor. The guidance that we had provided - the updated guidance for same-store NOI - does reflect the better-than-expected year-to-date performance, and that also flows through into Core FFO. But as I did mention in the call, Core FFO, the increased guidance is also reflective of, I guess, better-than-expected G&A overall. And so it's contemplating both the same-store as well as this G&A effect.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

Okay. Appreciate that. And then maybe one last one for me as well. You touched -- Lance, you touched on the transaction market, the bid-ask being a little bit wider. And then you guys also talked about the stock buyback. So thinking about capital allocation going forward with the higher rates and some debt maturing in the next year, how do you guys think about your capital allocation strategy with the tighter transaction market, rising rates and then maybe increasing a stock repurchase program.

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

Yes. I would say that clearly, the high interest rate environment has not helped availability of opportunities and certainly hurdle rates as well. And so that's put a damper a little bit in terms of external transactions. But really for us, capital allocation is really sort of across the board. And so given the current environment, I think we're going to continue to lean toward internal opportunities where we can control timing and also get higher yields that are accretive to our cost of capital. So whether it's repositioning of assets like Manoa Marketplace, whether it's continued photovoltaic within our portfolio or to the extent that our stock is underappreciated in the market, that will be another opportunity for us to invest.

Connor Mitchell ***Piper Sandler & Co., Research Division - Research Analyst***

Okay. That's all from me.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Steve Swett for closing remarks.

Steve Swett ***ICR, LLC - IR***

Thank you, Kate, 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 for attending today's presentation. You may now disconnect.