REFINITIV STREETEVENTS

EDITED TRANSCRIPT

ALEX.N - Q3 2022 Alexander & Baldwin Inc (Hawaii) Earnings Call

EVENT DATE/TIME: NOVEMBER 03, 2022 / 9:00PM GMT

CORPORATE PARTICIPANTS

Brett A. Brown *Alexander & Baldwin, Inc. - Executive VP, CFO & Treasurer*

Christopher J. Benjamin *Alexander & Baldwin, Inc. - President, CEO & Director*

Clayton K. Y. Chun *Alexander & Baldwin, Inc. - Senior VP, CAO & Corporate Controller*

Lance K. Parker *Alexander & Baldwin, Inc. - Executive VP & COO*

CONFERENCE CALL PARTICIPANTS

Wendy Ma *Evercore ISI Institutional Equities, Research Division - Research Analyst*

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

Stephen C. Swett *ICR, LLC - MD*

PRESENTATION

Operator

Good afternoon, and welcome to the Third Quarter 2022 Alexander & Baldwin 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.

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

Thank you, aloha, and welcome to our call to discuss Alexander & Baldwin's Third Quarter 2022 earnings. With me today for our earnings call are A&B's President and Chief Executive Officer, Chris Benjamin; our Chief Operating Officer, Lance Parker; and our Chief Financial Officer, Brett Brown; Clayton Chun, Chief Accounting Officer, is also present and will be available for the Q&A portion of the call.

Before we commence, please note that statements in this call and presentation 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 as well as the rapidly changing challenges with and the company's plans and responses to the Novel coronavirus COVID-19 pandemic and related economic disruptions. 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 to 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 risks associated with the COVID-19 and its impacts on the company's businesses, 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 risks. We do not undertake any obligation to update the company's forward-looking statements. Management will be referring today to non-GAAP financial measures during our call.

Included in the appendix of today's presentation slides is a statement regarding our use of these non-GAAP measures and reconciliations. Slides from this presentation are available for download at the Investors section of our website at www.alexanderbaldwin.com. Chris will open up today's presentation with a strategic update. He will then turn the presentation over to Lance for an update on real estate operations, and then Brett will discuss financial matters. Chris will return for some closing remarks, where upon we will open it up for your questions.

With that, let me turn it over to Chris.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thanks, Steve, and good afternoon to our listeners. The third quarter was another very good one for A&B. Our portfolio of high-quality retail, industrial and ground lease assets produced strong results yet again. And the marketing process to sell Grace Pacific is advancing with several indications of interest. This is the final major step in our strategic simplification. Lance and Brett will provide more details on our performance, but let me begin with a high-level summary of our results.

CRE revenue grew 5% over the prior year quarter. NOI increased by 3.3%. Core FFO per diluted share was up 4%, and we signed 50 leases during the quarter for about 105,000 square feet of GLA, achieving blended rent spreads of 4.2% for comparable leases. The performance of our CRE portfolio remains very strong, and we ended the quarter at 94.6% leased occupancy with industrial at 98% and retail at 93.3%.

We continue to benefit from Hawaii's economic growth. Domestic visitor arrivals have exceeded pre-pandemic levels for each of the 10 full months of 2022 and were up over 11% year-to-date over 2019. Further, international visitor arrivals are increasing. While total bookings for the upcoming holiday season are not yet at the pre-pandemic level, they continue to rebound and are expected to surpass last year's amount.

Visitor spending is also up nearly 8% year-to-date compared to 2019, another positive sign for Hawaii's economy. While our portfolio is community based and not directly dependent on tourist activity, increases in Hawaii tourism provide a broad benefit to the state's economy. The state's unemployment rate is down to 3.5% for September 2022, an improvement of 310 basis points from 1 year earlier and now in line with the national unemployment rate. As inflationary pressures and economic uncertainty arise nationally and here in Hawaii, we're confident we're positioned well with a high-quality needs-based portfolio that has proven to be resilient.

Turning to our Materials & Construction segment. Operating profit and adjusted EBITDA improved from both the preceding quarter and the third quarter of 2021. Most significantly, as we announced last quarter, we have commenced a marketing process to sell Grace Pacific. We have several indications of interest and are advancing to the next phase of the process. We will provide more updates on timing as we move forward, but I cannot comment on the process beyond that at this time.

On the ESG front, we have completed a 1.3-megawatt solar PV installation at Pearl Highlands and have identified Kakaako Commerce Center as the next property for our rooftop PV initiative. Additionally, in August, we published our third annual corporate responsibility report, highlighting our efforts and progress on all ESG matters.

Now I will turn the call over to our Chief Operating Officer, Lance Parker, to review our recent CRE highlights and other portfolio activities. Lance?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & COO*

Thank you, Chris, and aloha, everyone. Beginning with operations, our CRE portfolio continued to perform well in the third quarter. NOI was up 3.3% year-over-year and same-store NOI was up 2.8%. Overall leased occupancy and same-store leased occupancy at quarter end were 94.6%, unchanged from 12 months earlier. Same-store retail leased occupancy was up 10 basis points to 93.3% and same-store industrial leased occupancy was 97.9%, down 10 basis points from the third quarter of 2021. Economic occupancy at quarter end was 93.1%, up 110 basis points from 12 months earlier. Retail economic occupancy was up [180] (corrected by company after the call) basis points to 91.3% and industrial economic occupancy was up 20 basis points to 97.6%.

We executed 50 leases for approximately 105,000 square feet during the third quarter and achieved spreads of 6.4% for new leases and spreads of 3.9% for renewal leases. This activity included 3 leases at Kaneohe Bay Shopping Center for approximately 38,000 square feet and 17 leases related to properties in Kailua, including Aikahi Shopping Center, for approximately 24,000 square feet. We're pleased with our portfolio performance. Our well-located properties are experiencing higher foot traffic this year compared to pre-pandemic 2019 according to Placer.AI, and most of our tenants are also reporting higher sales. Following several quarters of significant reserve reversals related to COVID deferred rent collections, our performance improvement in the third quarter was primarily driven by elevated economic occupancy.

With regard to growth, our investment team is pursuing acquisition opportunities that are complementary to our current portfolio. While markets are dynamic due to challenges in the financial markets and global uncertainty, we will remain creative and disciplined in our approach and believe our deep market knowledge, relationships and ample liquidity will serve us well in the pursuit of growth. In the meantime, we continue to pursue internal growth opportunities such as development or redevelopment, where we can better control investment timing and yields.

In the third quarter, construction commenced at Manoa Marketplace to improve the visitor experience while incorporating sustainable design and building elements, including LED lighting, water-efficient fixtures and EV parking stalls, among other sustainable features. Also, construction of the 1.3-megawatt rooftop solar installation at Pearl Highlands Center has been completed and the system is now delivering power. We will soon be commencing another rooftop solar installation at Kakaako Commerce Center and are evaluating additional opportunities across our portfolio associated with our goal of advancing portfolio sustainability.

Turning to our land sales. The third quarter was quiet after several quarters of significant activity. We're in active discussions with interested buyers for certain of our non-core land holdings and expect to make additional monetization progress this year.

I'll now turn the call over to Brett for financial details. Brett?

Brett A. Brown - *Alexander & Baldwin, Inc. - Executive VP, CFO & Treasurer*

Thank you, Lance, and aloha, everyone. Starting with our financial results. For the third quarter, we recorded net income available to shareholders of $6.3 million or $0.09 per diluted share, FFO of $15.3 million or $0.21 per diluted share and core FFO of $18.9 million or $0.26 per diluted share. The benefit of reserve reversals is diminishing as expected and contributed only $400,000 this quarter compared to $600,000 in the same quarter last year. Demonstrating, as Lance mentioned, that the performance improvement in the third quarter this year was primarily driven by an increase in economic occupancy. On a year-to-date basis, net income was $20.8 million or $0.29 per diluted share. We generated FFO of $48.2 million or $0.66 per diluted share and core FFO of $60 million or $0.82 per diluted share. For additional details on our results, including comparisons to 2021, please see our earnings release and supplemental information package.

Let me now turn to our Commercial Real Estate segment. For the third quarter, CRE revenues increased by 5% or $2.2 million over the prior year quarter to $46.2 million. CRE NOI increased by 3.3% or $900,000 to $29 million compared to the same period last year. This increase from the year ago quarter reflects the strength of our tenants and portfolio and as previously mentioned, driven by economic occupancy.

Our land operations business generated an adjusted EBITDA loss of $2.2 million in the third quarter of 2022. The decline in year-over-year performance was partly attributable to the loss of recurring income streams following the strategic monetization of approximately 18,900 acres of non-core land holdings and renewable energy assets on Kauai that were sold in the second quarter of 2022.

When we sold the energy assets, as we previously stated, we lost approximately $4 million of annualized EBITDA related to the hydroelectric power facilities. Net income would naturally have diminished over time as power purchase agreements expired and the sale resulted in a substantial reduction of long-term liabilities and potential risks, thus making it a very important step in our simplification efforts.

Our Materials & Construction segment posted an operating profit of $1.8 million for the third quarter compared to an operating loss of $300,000 in the same period last year. Adjusted EBITDA was $2.7 million in the third quarter, up from $2.2 million in the third quarter of 2021. As we have stated, during the third quarter we commenced the process to sell Grace Pacific and will provide updates as the process moves forward.

For the third quarter of 2022, G&A expenses were $12.7 million compared to $12.6 million in the third quarter of 2021 and in line with expectations. Turning to our balance sheet and liquidity metrics. At September 30, 2022, our total debt outstanding was nearly $470 million, and we had total liquidity of more than $506 million, including over $7 million of cash and near full capacity on our $500 million credit facility. At quarter end, net debt to trailing 12-months consolidated adjusted EBITDA, excluding land operations and M&C adjusted EBITDA and M&C noncontrolling interest, was 5x. Including EBITDA contribution of those segments, net debt to trailing 12 months consolidated adjusted EBITDA was 2.5x. Our debt to total market capitalization stood at 28.1% at quarter end, and our floating rate debt exposure was just 1% of total debt.

You'll note, we repurchased a modest amount of stock during the quarter when the shares were at a significant discount to NAV, and we added nearly 81,000 shares in October. As we have stated before, our share repurchase plan provides an additional capital allocation tool, which we may use from time to time. However, this modest tactical investment in our stock at an attractive valuation does not signal any lack of confidence in our ability to find and invest in commercial real estate growth opportunities. With respect to our dividend, our Board plans to declare a fourth quarter dividend in December with payment in January 2023.

Finally, turning to guidance. We are raising our full year 2022 guidance a third time with core FFO per share at a new range of $1.07 to $1.11 per share, up from the prior range of $1.05 to $1.11 per share. This increase is due to an improvement in our outlook for CRE same-store NOI growth. We now expect CRE same-store NOI growth within a range of 4.5% to 6.5% from our prior range of 4% to 6%. CRE same-store NOI growth, excluding prior year reserve reversals is increased to 4% to 6% from our prior range of 3.5% to 5.5%.

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

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Thank you, Brett. Before I make my closing remarks, I want to acknowledge that this is Brett's last call with A&B and Clayton Chun will become CFO on December 1. I want to thank Brett for his many contributions to A&B over the past 3.5 years as we matured as a REIT and for his help in facilitating a smooth transition to Clayton.

As you've seen, the third quarter again demonstrated the quality and strength of our CRE portfolio with high occupancy and solid growth. We remain active in pursuit of growth opportunities that deepen our presence in the Hawaii market and that are complementary to our existing portfolio. Market dislocations have historically played to our strength. Further, we have commenced a process to sell Grace.

I want to step back for a moment and review the significant and strategic transformation that we've accomplished over the past several years. We sold all of our mainland commercial real estate assets, raising approximately $600 million to help transform A&B into a pure-play Hawaii commercial real estate company. We deployed approximately $1.1 billion into high-quality commercial real estate assets in Hawaii, becoming the premier commercial real estate company in the state and quadrupling our Hawaii commercial real estate NOI over the past decade. We converted to a REIT structure and built a world-class team of CRE professionals, bringing all external functions in-house and enhancing our operating and reporting systems.

We sold approximately $600 million of non-core assets since 2016, including Maui ag lands, Kukui'ula, the Kauai lands, McBride and through those sales reduced our leverage by 60% over the past 3.5 years, and we have the liquidity now to be opportunistic acquirers as we look ahead. The sale of Grace will be the final step. Some of these steps were painful in the short term, but eliminating unprofitable or non-income producing assets from our company, not only fueled our CRE portfolio growth but simplified our company, allowing our team to focus on our core business and allowing us to meaningfully reduce leverage and G&A.

I want to thank our team for all their hard work and diligence through this process. Going forward, predictable and steady operating results and growth are in sight. The Hawaii acquisition market is dynamic. Our balance sheet and liquidity are our strength. And as a company with a geographically-focused portfolio of great assets, we believe we can attract a much broader array of investors in the future as we live out our mission as "Partners for Hawaii."

With that, we'll now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question comes from Connor Mitchell with Piper Sandler.

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

I have a couple. So I guess the first one. You guys mentioned the share buybacks, redevelopment, development and then acquisitions as well. So could you just shed a little light and maybe provide some color on how you guys think about use of capital and whether you want to continue to repurchase further shares or acquisitions and developments? Just how you think about balancing your approach to the use of capital.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes, Connor. Let me start that -- this is Chris. Thanks for the question. I'll start and then if anyone else wants to jump in, I welcome that, especially from sort of how we're underwriting strategic investments. But that's where I would start. And we always start with strategic investments to grow our commercial real estate portfolio, and that's our highest priority. And I believe that we will be successful in continuing to grow the commercial real estate portfolio. We have made some investments this year and over the past year, some small acquisition investments and some number of internal development investments, and those are always our priority. However, at the same time, we do look at all the tools that we have and all the investment opportunities we have and with the market pulling back of late, we did evaluate the merits of reinvesting in our stock.

Now as Brett indicated, it was a modest and as he characterized as a tactical investment. A small amount of capital. We think it was a good investment at a depressed price, and we'll certainly keep that as an arrow in our quiver going forward. But it certainly does not -- as he said, it does not signal any lack of confidence in our ability to be making strategic investments into the commercial real estate portfolio. And so I'd leave it there and then see if anyone wants to jump in on other thoughts related to our investment process.

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & COO*

I would go ahead and add, Connor, this is Lance. Capital allocation, we think of it sort of on a risk-adjusted basis and a menu of opportunities. Chris and I both used the word dynamic to describe the acquisition market right now. And I think that word is very appropriate, obviously, given rising interest rates and our view on the need as a result of that to get higher yield. We're starting to see some signs of sellers appreciating that need as well as constrained capital markets, specifically on the debt side. And I think we'll see some opportunities start to make some sense on the acquisition front, but it has been challenging just from a price discovery perspective. And so really, where we've been focusing are on some of our internal growth opportunities that we feel are still very compelling.

So things like Manoa Marketplace where we can get low to mid-teen type IRR returns on an unlevered basis, photovoltaic at Pearl Highlands, which gave us very compelling returns as well as stock buyback to the extent we get to a price where we think that's compelling as well. So just having the balance sheet strength now to make those decisions and to deploy capital across all appropriate investment types, I think, we're well positioned to take advantage of the market.

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

Okay. Yes, that's very helpful. Another question I would just like to ask is just some of the non-core items, land sales, materials & construction, how might we think about those moving forward with maybe land sales really slowing down to mostly immaterial amount or maybe they still hold up for a little bit into '23. Just any one-off items in some of the non-core, some of the non-core business-related items, if do you guys think and can give any insight as to what you might expect for that moving forward into the next year.

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Yes. Thanks, Connor. This is Chris again. I think the reality is we want you to be thinking about those as little as possible, and that's the whole point of simplification. We want to get to the point where all our investors and our team are thinking about is commercial real estate, and we feel like we're just on the door step of that reality. And I think that with the sale of Grace, which we certainly hope will happen in the relatively near term, we will be at a place where we really are just a commercial real estate company. Now you did point out that we still have some non-core assets. We have a relatively small, certainly compared to where we were a few years ago, we have a relatively small amount of acreage that is non-core sort of former agricultural lands. And yes, we will trickle some of those out.

We do have some sales that could take place this year, early next year. They're not going to be needle movers. They're not going to be anything close to the scale of what we had in 2018. We sold $0.25 billion of land. They're going to be smaller chunks. Again, they're not going to be needle movers. They will help -- they'll help generate some cash that we can then redeploy into commercial real estate investments. So they'll be nice, but they're not going to be needle movers. And really, I'm hoping that within the next 6 months or so, we're at a point where we're talking almost exclusively about commercial real estate, and there's not a lot of, I guess, noise or other movement in our financials beyond that.

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

Yes, that's helpful. And then, I guess, getting back to the core business. You guys talked about the occupancy driving the NOI growth. So I was just wondering how you guys might think about the balancing of the increasing the occupancy and then growing rents on top of that and where you might see occupancy when you really think you can push rents?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Lance, do you want to take that?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & COO*

Sure. I think we're pleased with the performance of our portfolio from an occupancy standpoint. I would say, Connor, that there is opportunity within the portfolio on what we've sort of termed some strategic vacancies that still exist in the portfolio. So some larger spaces predominantly on the neighbor islands where we do have deal activity currently ongoing. And so that really would provide really both an opportunity to improve occupancy, particularly on the retail side, where these vacancies exist, but also on the rent. So I think that just speaks to our continued perspective and confidence in the market with regard to tenant interest. So just in terms of deal flow coming in particularly on some of our larger vacancies. So really viewing that as more of an opportunity in the near term.

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

Okay. So I guess, just one more follow-up question is, so in the near term, you would see kind of the occupancy continue to drive the growth rather than pushing the rents, correct?

Lance K. Parker - *Alexander & Baldwin, Inc. - Executive VP & COO*

I think that's a good way to sum it up. Yes. Certainly, on a relative basis.

Operator

The next question is from Wendy Ma with Evercore.

Wendy Ma - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

Just on the G&A expense. So you mentioned that it is in within your expectations. So I'm just curious how should we think about that going forward, like for 4Q and maybe into 2023?

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

No. Go ahead, Brett. Go ahead.

Brett A. Brown - *Alexander & Baldwin, Inc. - Executive VP, CFO & Treasurer*

I was going to say, we're not providing '23 guidance, but I think as we've indicated, it is in line. We kind of expect obviously, once we would sell Grace, you'd see a significant reduction there. But right now, we're kind of trailing or tracking in line on a quarterly basis and would expect to end the full year at least below last year's even. So we're making slow-steady progress currently, and the biggest impact will be the sale of Grace.

Wendy Ma - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

Okay. And for your current leverage level, so that's relatively low compared to the historical levels. So are you comfortable staying in this range? Or what's your target net debt-to-EBITDA range going forward?

Clayton K. Y. Chun - *Alexander & Baldwin, Inc. - Senior VP, CAO & Corporate Controller*

Can I take that? So Wendy, this is Clayton. So our target is to have our net debt to adjusted EBITDA to be in the 5 to 6x ratio. And so where we stand today, we are in a good position on our balance sheet, and we think that it's enabling us to fund the growth opportunities as they arise.

Operator

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

Christopher J. Benjamin - *Alexander & Baldwin, Inc. - President, CEO & Director*

Well, just in case Steve has lost his connection.

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

I'm here, Chris. Yes, thanks. Thank you, Debbie, 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. You may now disconnect your lines. Thank you for joining.