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HOTEL*.MX - Q2 2018 Grupo Hotelero Santa Fe SAB de CV Earnings Call

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CORPORATE PARTICIPANTS

Max Zimmerman *Grupo Hotelero - Investor Relations Director*

Francisco Zinser *Grupo Hotelero - Executive Vice-President*

Francisco Medina *Grupo Hotelero - CEO*

Enrique Martinez *Grupo Hotelero - CFO*

PRESENTATION

Operator

Hello and welcome to Grupo Hotelero Santa Fe's Second Quarter 2018 Conference Call.

[Operator Instructions]

It is now my pleasure to turn this call over to Max Zimmerman, Investor Relations Director for Grupo Hotelero. Sir, you may begin.

Max Zimmerman - *Grupo Hotelero - Investor Relations Director*

Thank you, operator, and good afternoon, everyone, and thank you for joining us today. My name is Max Zimmerman, Investor Relations Director of Hotels and I would like to welcome you to the company's earnings webcast for the second quarter of 2018.

On the line, we have Francisco Zinser, our Executive Vice-President, Francisco Medina, our CEO, Enrique Martinez, our CFO, and Alberto Santana, our Administration Director. Francisco Zinser and Francisco Medina are joining the call from remote locations, so they will give an introduction, and afterwards will participate in the Q&A.

The presentation slides we will follow during the call are available on our webcast, which you can find in our investor relations section of our website. Before we begin, I would like to remind you that this call is being recorded and that information discussed today may include forward-looking statements regarding the company's financial and operating performance.

Our projections are subject to risks and uncertainties and actual results may differ materially based on a number of factors. Please refer to the detailed notes in the company's press releases regarding forward-looking statements.

At the end of the presentation, we will open the call to any questions you may have. We will now begin with the presentation and I will pass the mic to Francisco Zinser. Pancho, please.

Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

Hello, everyone. Thank you for joining our call. In fact, we have announced a restructuring, a corporate restructuring of the company. And basically, this is to create more focus in growth and day-to-day operations.

Paco Medina, who has been the Deputy CEO of the company is now the CEO of the company. Paco and I have been working together for over 20 years and I am not afraid to say that Paco is the best hotel operator in the country and has done an extraordinary job in Grupo Hotelero and I'm sure will do an extraordinary job as CEO as well after being the Deputy CEO.

Paco's structure has been reinforced due to the growth of the company. Since this company was created, we have basically tripled the size. So in order to be ready for future growth and to capture the opportunities that we see ahead of us, we want to have a clear division in terms of focus and responsibilities.



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So Paco is going to take care of the operations and the day-to-day of the company, having a Director of Operations for Resorts and a Direction of Operations for Urban Destinations to reinforce the operation of the properties. He will as well have key administration, sales and marketing, purchasing, human resources, and IT under his direct responsibilities.

In my case, as Executive Vice-President of the board, I will look at -- overlook the strategies, the growth of the company, and continue to look at opportunities to better prepare Grupo Hotelero for the growth that we expect to have.

Under my responsibility is the CFO of the company joining this call, Enrique Martinez, as our legal counsel, is our investor relations, Max, who heads the call, is our Constructions & Development Director, internal audit and sustainability.

We truly believe that having this structure will prepare the company to better take advantage of future opportunities and growth that we see ahead of us.

My position, although being Executive Vice-President is not board member because we see that it is much clearer, since I hold executive responsibilities, not to mix the board members with the executive team. So having said that, I would ask Paco to please take the call.

Francisco Medina - *Grupo Hotelero - CEO*

Thank you, Pancho. Good afternoon, everyone. I am very happy and motivated and committed with this new responsibility as CEO of the company, and I thank Pancho Zinser for it.

Now, let me briefly talk about the quarter, we posted summary results in the first half of 2018. All the revenue and EBITDA growth rates ended below guidance as we saw for the second quarter came in lower than expected due to external and internal factors.

Regarding external factors, we observed a reduced number of tourist arrivals in both resort and urban destinations. During the quarter, resort destinations were affected by a decrease in tourist traffic from the USA attributable to a higher perception of insecurity in the run up to general elections in Mexico.

On the other hand, in terms of local travel, we have a negative effect of Holy Week which was in the first quarter this year compared to second quarter of last year, combined with practices of certain companies reducing their expenditures during the electoral time affected urban destinations.

We expect that both factors will have a minimum to no effect on our results towards year-end considering their transitory nature.

In terms of internal factors, delays in expected opening date of the Hacienda Hilton Puerto Vallarta and the delayed remodeling of rooms at the Krystal Grand Puerto Vallarta weighted on our results for the second quarter.

The Hacienda Hilton Puerto Vallarta, which has 192 rooms, opened in June instead of its original scheduled opening date which was April.

The remodeling of 216 rooms at the Krystal Grand Nuevo Vallarta was delayed, rather 50 percent of these rooms are already in operation since early July and the rest will be ready by September this year.

We believe that the negative impact in the quarter is mostly transitory in nature. And we expect to observe the gradual positive effects related to our partnership with [AM Resorts] during the third period 2018.

In relation to tourism sector in Mexico, according to figures from the Mexican tourism industry sector, Mexico's international visitors spent on other 5% less in the first five months of 2018 compared to the same period last year.

Going onto quarterly operating results, please go to slide two where I will pass the call back to Max Zimmerman.



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Max Zimmerman - Grupo Hotelero - Investor Relations Director

Thank you, Paco. During the quarter, total revenue increased 28% to 575 million pesos driven by a 23% growth in room revenue, 55% growth in food and beverage revenue, 11% in other revenue which partially compensated a 26% decrease in third party hotel management fee driven by the sale of the Krystal Grand Reforma by a third party last year.

Room revenue was driven by the growth of the Krystal Grand Los Cabos, Krystal Grand Nuevo Vallarta, and Krystal Grand Suites Insurgentes.

The performance of the Krystal Grand Punta Cancun considering the opening of the new Altitude Tower and the performance of stabilized hotels including Krystal Urban Ciudad Juarez.

Food and beverage revenue increased 55% to 167 million pesos in the quarter, mainly driven by the growth of the Krystal Grand Los Cabos and the Krystal Grand Nuevo Vallarta, which are in the early stages of stabilization. And the performance of the Krystal Grand Punta Cancun considering the opening of the Altitude Tower I just mentioned.

Management fees related to third party-owned hotels decreased by 26% compared to 2Q17 due to the combined effect of an 8% reduction in the number of rooms under operation and a 14% contraction in RevPar per during the period. The number of rooms in operation declined due to a sale of the Krystal Grand Reforma.

Now, please move to slide three. Moving on to our key operational metrics, on a consolidated level this quarter, we posted a 6.9% decrease in RevPAR which is comprised of an ADR increase of 0.1%, basically flat, and a 4.7 percentage point reduction in occupancy driven by the inclusion of the Krystal -- of the Altitude Tower at the Krystal Grand Punta Cancun and the Krystal Grand Suites, which are in the early stages of stabilization, which amounts for over 250 rooms that are at the beginning of the stabilization stage.

Now, please move to page four and I will hand the call over to Enrique Martinez, which will guide you through our financial results.

Enrique Martinez - Grupo Hotelero - CFO

Thank you, Max, and good morning everyone. EBITDA in the quarter reached 133 million pesos, a 21% increase compared to first quarter of 2017.

This result was driven by the combined effects of revenue growth, the growth of the Krystal Grand Los Cabos and Krystal Grand Nuevo Vallarta as company owned hotels and the performance of the Krystal Grand Punta Cancun due to inclusion of the Altitude Tower.

EBITDA margin in the quarter was 28.9% compared to 29.8% in second quarter of '17. Moving on, the operating income we reached 77 million pesos compared to the 55 million pesos in second quarter in '17. The increase was driven by the factors I just mentioned.

Now, please move to slide five. Net debt was 2,225 million pesos at the end of the second quarter '18 which represents a total debt to EBITDA last 12 months ration of 3.4 times.

Total debt is mostly US dollar-denominated, 86% to be exact and this tranche of the debt has an average cost of 4.4%, while the remaining portion of 13% is peso-denominated with an average cost of 10.4%, having a [competitive] overall debt of 5.2%.

Additionally, I would like to mention that over 96% of debt maturities are long-term. The Mexican peso depreciated 8% by the end of the quarter and had a negative impact in our financial costs.

Also, our [short] US dollar position by the end of the quarter was \$95 million equivalent to 1,884 million pesos. Now, please move to slide six. And I will pass the call to Max, who will talk about our recent deal with AMResorts.



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Max Zimmerman - *Grupo Hotelero - Investor Relations Director*

Thank you, Enrique. A month ago, we announced the signing of a strategic alliance with AMResorts. As a result, a co-branding was implemented between Reflect Resorts & Spas brand and Krystal Grand brand for the hotels in Punta Cancun, Los Cabos, and Nuevo Vallarta, which jointly account for over 1300 rooms.

Through this strategic alliance which started at the beginning of July of this year, we expect to significantly boost our sales of these three hotels.

In addition to the opportunity to expand this partnership to more properties, it is important to note that AMResorts is responsible for the commercialization, sales, and marketing of the property enabling the company to attain a higher growth on international sales.

Therefore, higher foreign currency denominated sales percentages at these hotels as well as better customer acquisition thanks Apple Leisure Group's distribution network, one of the largest global operators for leisure travel to Mexico.

Furthermore, Hotel maintains the ownership and control of operations of the hotels. This strategic alliance gives us access to a more direct, diversified, and profitable distribution channels, which combined with our proven capability as best hotel operator in Mexico, will enhance the results of these properties.

Now, please move to slide eight. I would like to highlight that we have an additional four hotels under construction in Mexico. First, the Krystal Grand Insurgentes, which is scheduled to open at the end of next year, which will have 250 grand tourism rooms in a prime location across from the World Trade Center in Mexico City.

Also, we have the Curio Collection Zacatecas, AC by Marriott Distrito Armida, and Hyatt Place Aguascalientes, which are third party owned hotels, which will begin operating in the second half of 2018, the second quarter of 2019, and the first quarter of 2019 respectively.

Now, before I open up for questions, I would like to mention that we have demonstrated how to grow profitably while being disciplined with valuation.

We also consider that we are in a unique position to continue taking advantage of the growing hotel industry in Mexico and to become the leading hotel operating company in the country. With that, I would like to open the call for questions and answers. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you very much. Ladies and gentlemen, at this time, we would like to open the floor for questions.

[Operator Instructions]

Our first question will come from [Adramina Lago] from GBM.

Unidentified Participant

Hi, Pancho, Max, everyone. My first question about guidance, are you comfortable with your estimates or the effects in the quarter could affect it considerably?

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Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

We do not perceive to have any change in the guidance as of today. Obviously, we are looking very closely into how the market ends up reacting to the elections and to what has happened in the country, but at this point, we do not think we should provide any change in guidance.

Unidentified Participant

Okay. Thank you. And about your development pipeline, I mean the Insurgentes, Hyatt, and so forth hotels, are you concerned about any delays or is everything supposed to be on time?

Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

No, we are not -- we don't have any concerns about delays and they should be running within the timeframes that Max has mentioned before.

Operator

Thank you. Our next question will come from [Daniel Goldstein] for Symmetrica.

Unidentified Participant

Good morning, everybody. This is [Daniel Goldstein]. Just two quick questions. What goes into non-recurring expenses?

And the second question is, there seems to be a disparity between the percentage of long-term debt you're holding in dollars, which is roughly 5% of total debt, and the percentage of revenues in dollars, roughly 35% of revenues. Any future plans to close that disparity or that difference?

Unidentified Company Representative

Yes. Enrique, can you please answer the question?

Enrique Martinez - *Grupo Hotelero - CFO*

Yes, the first question (inaudible) are expenses related to the expansion and (inaudible) something like that basically.

Max Zimmerman - *Grupo Hotelero - Investor Relations Director*

Perfect. In terms of the second question, [Daniel], hi, this is Max. I think it's also important when you look our long-term debt, what we normally do inside the company is compare it to our operating cash flow.

And if you look at our press release, it's going to be on page 13, you will see that this quarter, we had 85% of our cash flow denominated in dollars.

Why is this? Because as you well mentioned, we have one-third of our revenues in dollars, however, the vast majority of our expenses are in pesos. So what does that mean?

That that third percent of our revenue based in dollars remains in dollars and therefore, the majority of the operating cash flow is in dollars. So for the quarter, we had 85% of operating cash flow in dollars and for the year-to-date up to June 30th of this year, we've had almost 91% in dollars.



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So if you compare that to our debt, which as Enrique mentioned, is currently 85% in dollars, we feel really comfortable because we are, if you want to put it this way, naturally hedged with the position that we have in dollars.

And also, lastly, I would like to mention that we have never had to buy dollars in order to pay principal or interest from our debt.

Unidentified Participant

All right. Paco, can you please add to what Max said, what we expect from the AM deal in terms of generating more foreign currency?

Francisco Medina - Grupo Hotelero - CEO

Sure. One important issue to add about Max's explanation is that AMResorts throughout Apple Leisure Groups just bought the other main (inaudible) Vacations and now they are doubling the size of the position to Mexico.

Before, they had 3.1 million passengers, now they will have 6.2 million passengers. And that will be a main, main contribution for our hotels, in first of all Puerto Vallarta --Krystal Grand Puerto Vallarta, Los Cabos, and Cancun.

Also, we are expecting that 80% of the prediction or 90% of the prediction will be coming mainly from the markets in USA, compare that before that we had 65 from USA and 35 from Mexico, now will be in the case of (inaudible) 80% from American market and that will bring obviously more rates in dollars and more contribution in dollars.

Operator

Thank you very much.

[Operator Instructions]

Our next question will come from [Kia Modiago] (inaudible).

Unidentified Participant

Hello, this is [Rafael]. Thank you, Pancho, Paco, and Max. Two questions. First is if you could tell us if there's additional CAPEX to be invested besides Insurgentes, out of the development pipeline if there's anything left on CAPEX to be seen in the next quarters.

And my second question is, how much do you think the margins could expand once these recently developed hotels start maturing, for example, in a couple of years if there are no further acquisitions? What is the stabilized margins for Hotels?

Francisco Zinser - Grupo Hotelero - Executive Vice-President

Thank you, [Rafa]. Thank you for participating for your question. I'd like to address the second question. As you know, we cannot provide any forward-looking statements, but I can tell you that we do believe that with these additions and what Paco just mentioned regarding the increase of mix in foreign currency, that there is room for margin expansion.

We cannot put a number on that, but we think that there will be an expansion in the margin. And Enrique, can you please address the CAPEX question?



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Enrique Martinez - *Grupo Hotelero - CFO*

Yes. In the CAPEX question, the remaining CAPEX (inaudible) is 700 million pesos. Okay? And we shall be developing this 700 million pesos in the next 18 months. Okay?

Unidentified Participant

This is your portion or the or the future partner?

Enrique Martinez - *Grupo Hotelero - CFO*

Includes our part.

Unidentified Participant

Okay. And besides Insurgentes, there's nothing else left?

Enrique Martinez - *Grupo Hotelero - CFO*

Nothing left.

Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

But one important thing, [Rafa], is that we are obviously looking at opportunities that we hope can reach conclusion. So there is a growth pipeline but at this point, committed CAPEX is what Enrique just said.

Operator

Thank you. Our next question will come from [Pablo Duarte] (inaudible).

Unidentified Participant

Hi, guys. Thanks for the call. Congrats, Pancho, Paco, for your new positions.

Unidentified Company Representative

Thank you.

Unidentified Participant

(inaudible) the resort segment, would you be exploring any possibility to recycle some of your stabilized assets in the near future?



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Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

It is not planned at this point to do any asset recycling. We still have value to capture in many of our assets today in terms of reaching stabilization. So we do not see any asset disposal at this point and we're not pushing any changes in asset ownership other than acquiring more assets.

And Paco probably can explain the maturity process, the hotels that will be -- that are in stage of stabilization and that will continue to grow. Paco, if you want to explain on that.

Francisco Medina - *Grupo Hotelero - CEO*

Sure. I looked at about what (inaudible) mentioning. This is not the essence of the company to recycle or sell this property mainly because as Pancho was mentioning, we just started out this year in 2018 and we expect that in two years, we'll be stabilize these properties (inaudible) of possibilities to have excellent (inaudible) with the addition of the production and the strategy alliance with AMResorts. And I will say that we'll see more in the future to add more resorts and recycle resorts.

Unidentified Company Representative

Exactly.

Francisco Medina - *Grupo Hotelero - CEO*

Yes, exactly.

Operator

Thank you very much because at this time we have no further questions in the queue so I'd like to turn this conference back over to Max Zimmerman.

Francisco Zinser - *Grupo Hotelero - Executive Vice-President*

Max, before, I would just like to thank everyone for participating, thank everyone for their continued support in Grupo Hotelero, thank all of our associates and all the people that work in Grupo Hotelero, which makes these results possible and make everything possible because this company is made of people and it's our most important asset.

I also thank our guests that continue to favor us with their choices and reinforce and reinstate our commitment to be very profitable and to be a very good investment for all of you.

Max Zimmerman - *Grupo Hotelero - Investor Relations Director*

Thank you, Pancho. And with that, we finish our conference call for second quarter 2018. Have a great day, everyone.

Operator

Thank you very much. Ladies and gentlemen, at this time, this conference has now concluded. You may disconnect your phone lines and have a great rest of the week. Thank you.



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