VALUE AND PRICE; THE AUTHENTIC TRUTH ABOUT SHOPPING CENTERS

Hernán San Pedro
LAR ESPAÑA
Director of Investor Relations and Corporate Communication

In August, during probably the most atypical vacation period of our lives, those who have continued to read newspapers will have come across several headlines about the imminent apocalypse about to engulf shopping malls. By dint of repetition, these catastrophic predictions have created a sub-genre narrative for a sector that various experts have been dismissing persistently for too many years. Fortunately, with much more effort than tangible results.

This sub-genre began by claiming that the severe crisis in the United States and the United Kingdom sectors was leading to the disappearance of centres and parks in the rest of the world as well. They took the part for the whole, but they generally forgot the very high saturation of these two markets, their age and their strong ties to department stores, while in countries like Spain the sector has always remained at more than reasonable levels in terms of commercial density, with extraordinary modernization and adaptation to the times, as well as a clear capacity for growth year after year.

Then there was the rise of e-commerce, which for the experts of scaremongering was destined to end the retail business model in one fell swoop. The reality is that in Spain the inexorable rise of digital sales platforms still represents no more than 10% of total commercial transactions. Furthermore, their growth has been focused on segments such as travel and transport, which do not compete with the big stores. It is true that other sectors, such as fashion, are also experiencing significant growth, but even in this case, the level of returns and the cost of the *"last mile"* puts the supposed success of this into perspective.

At the same time, it must be agreed that *"the need for shop windows"* means that shopping centres have become strong allies, both of these platforms and of those that have been creating traditional brands. It is the large commercial areas that enhance customer loyalty and generate effective shopping experiences based on the intrinsic value of each brand. Far from being enemies, e-commerce, parks and shopping malls are already beginning to experience a friendly and very fruitful relationship.

Now in 2020, many voices have been saying that the pandemic would kill off retail. It is true that the exceptional nature of the crisis has strained practically all business sectors, including real estate, but results have shown that many of the shopping centres and parks are not among the main victims, except in the case of those companies already over-indebted before the crisis. Strong and well managed assets, with good commercial and experiential offers, have demonstrated a resilience beyond all doubt. As in everything, quality makes the difference.

In the case of Spain, nearly a quarter of most centres remained open during the state of alarm in order to supply citizens with essential goods. During those weeks and the following ones, measures were announced to anticipate and control people flows, to manage physical distancing and other additional security measures that parks and centres already applied long before the pandemic, and which they intensified during the state of alarm and afterwards. The result has been that the vast majority of customers perceive the centres as safe places where they can stock up, walk, shop and enjoy a family experience in a calm and reliable manner as well as a safe place to satisfy their socialization and leisure needs, an indisputable part of the character of the Spanish people.

However, in August some very alarming visitor data was circulating. There was some confusion between data and trends relating to the lockdown easing. It seems that the inclusion of the data from March to May has given an overview that does not correspond, by any means, to those of the end of September. It is clear that not all centres behave the same way, but those that are usually qualified as dominant, that is, those that exclusively cover a wide and highly populated area commercially, have generally recovered visitor numbers and remain at similar levels to those reached previously.

During the lockdown and the subsequent easing, the major national retailing groups have intensified dialogue, collaboration and agreements with the immense majority of tenants. Good relations with tenants and owners have always been one of the keys to this business. From now on it will be even more so. Landlord and tenant are going to be involved in making each centre more dynamic, with a more participative and coordinated sense of each commercial mix and its offer. Multi-channel capability and the formula of fusion between the physical and the digital, is going to make next-generation retail more efficient.

An alignment of interests simplifies the logistical needs of merchants, reduces the distance between the two worlds and favours experiential attraction and loyalty through a visit to an emblematic physical store, while also enhancing the brand image of merchants and personalized customer experience.

This mutual interest explains for example how, after the first effects of the crisis of Covid-19, Lar España Real Estate has to date achieved rental agreements for more than 95% of the gross rentable area of its 15 centres, extending contract lengths in line with discounts, increasing variable rents in some cases and maintaining excellent relations with our trader clients. This has allowed us to reach occupancy levels in the vicinity of 95%, also maintaining total affordability rates for tenants well below the sector average.

However, despite all that has been said so far, and as usually occurs in so many areas of life, the consistent reality has not managed to overcome the prejudice and perceptions that are as wrong as they are repeated ad nauseam. I don't believe that there is a sector where the distortion between sensations and reality is as pronounced as it is in the world of retail.

In an extremely difficult year for everyone, the shopping centre business has responded in Spain with maximum flexibility, adaptation and modernization, but the market does not fully appreciate this. It prefers to maintain the stigma that we are a rigid business and at risk of extinction, when the reality is that we are the best example of evolution, innovation and adapting to the times.

In the market as a whole, the gap between fact and opinion is constantly growing. In the real estate sector, accounting valuations of the assets of the different companies had begun to top out at the end of last year. This was predictable, after several consecutive years of growth. However, this moderate adjustment in valuations has been magnified. If until June the average adjustment of sector-wide valuations of retail companies was only 3.5%, the discount in the Stock Exchange on the net value of their assets was 75.8%. Confusing value and price has never usually been considered a good idea, but it seems the retail world has been the exception in recent years.

But despite the impact of Covid-19 there are companies that have strong operational and financial fundamentals, continue to generate recurring revenues, maintain significant rentals and have been able to preserve high occupancy rates in their shopping centres, among which some have recovered more than 90% of their normal average people flows before lockdown. These are companies with healthy balance sheets, highly controlled leverage ratios and solid cash positions to meet their obligations. They have invested to adapt their assets to the latest retail trends, because they believe that multi-channels, technology, safety and sustainability are key to ensuring an absolutely differential experience for each customer. All this certifies that the quality of the assets, the operational and financial management and the quality of the service always result in the best destination.

Even so, the discount at which the real estate sector in general, and retail in particular, both trade is so disproportionate and constant over time that, far from being a threat, it should begin to be considered an opportunity. Several investment managers have begun to recommend a return to value criteria in the selection of share portfolios. And there are many analysts whose buy recommendations and target prices are far above the market. In other words, the time seems to have come for those companies that are undervalued on the basis of fundamentals and also offer high payouts. In short, the excessive penalization and the exaggerated discount to which the retail world quotes have already turned it into an excellent opportunity.

With so much apocalypse it seems inevitable that the sector will end up living its own apotheosis. In my modest opinion, the time for a sector comeback should be ever closer. Meanwhile, and as Mexican Juan Ruiz de Alarcón expressed in La verdad sospechosa, also in the world of retail *"the dead you kill are in good health"*. Or, to use the popular saying, *"only the foolish confuse value with price"*.

In short, when you read about retailing in Spain from now on, remember that if your companies enjoy healthy balance sheets, operational strength, relevant valuations, high dividends, solid relations with tenants and continuous innovation with the usual incorporation of the latest technological solutions, then we must conclude that its health and future prospects are worthy of much more appreciation. ■