CONSUMER SURVEY
PART 1

LatAm leisure spend potential growth driver for mall operators

- **Our latest survey of shopping mall consumer behaviour found diverse trends. While Brazilian respondents are shunning the mall to shop for clothing at cheaper retail outlets, and Argentines continue to resist shopping centres, Peruvian and Chilean respondents showed greater enthusiasm.**
- **Our survey suggests that malls with more entertainment offerings are likely to perform best, as leisure expenditure seems reasonably resilient and such services are becoming more integral to the mall experience in Latin America.**
- **Parque Arauco of Chile, which could soon acquire operations in Brazil, is emerging as a regional champion.**

Window shopping appears to be growing as a leisure pursuit in Brazil. Our recent survey of 6,500 consumers in Argentina, Brazil, Chile, Colombia, Mexico and Peru, including 1,500 Brazilians, found that as economic uncertainty has increased, Brazil's consumers are no longer indulging their clothes-buying habits in the region's shopping malls.

Clothing and apparel sales in the country were down 13.7% YoY in August, contracting even more sharply than overall retail sales, which fell 6.9% YoY. The percentage of Brazilian survey respondents saying the shopping mall was their primary destination for clothes shopping has fallen 10.7pp over the last two years.

However, while Argentines remain largely immune to the charms of the shopping centre, and Mexican interest has waned, elsewhere in the region the picture is brighter. The proportion of respondents that preferred shopping in malls for clothing remained stable in Chile and Colombia, and rose again YoY in Peru.

More importantly in terms of the prospects of mall operators, our survey found that spending on leisure activities has remained steady despite economic weakness. While the number of respondents who spend at least 6% of their household income on such activities fell slightly YoY, from 50.2% to 46.5%, it remains significantly higher than it was two years ago (39.6%). Leisure expenditure edged higher YoY in Peru, Mexico and, to a lesser extent, Colombia. Our survey data and research strongly suggest that those mall operators dedicating more space to entertainment and services are likely to outperform their traditional shop-focused rivals.

Consumer blues hit Brazil's regional malls

Our data for Brazil paints a very negative picture for mall operators. Fewer respondents said they went to the mall to buy clothes, eat and watch films in 3Q15 than a year prior (**LatAm Oct 30 2014, Consumer**). Only 20% of respondents cited the shopping mall as their primary destination for clothes shopping, down from 23.9% last year and 30.7% in »

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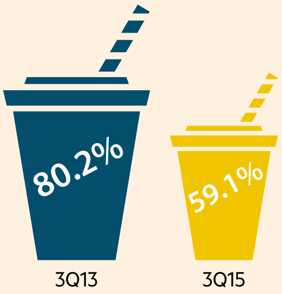


The share of respondents who said they visited mall-based food courts fell 21.1pp from our first survey in 3Q13

2013, with more turning to informal markets and second-hand stores (see chart 1). The share of respondents who said they visited mall-based food courts in 3Q15 declined a staggering 21.1pp from our first survey in 3Q13 to 59.1%.

Notwithstanding the sharp downturn, Brazilians still spend the highest percentage of their income on leisure in the region: 19.9% of respondents dedicated 11% or more of their income to leisure – down 1.4pp YoY – well above the regional average of 16% (see chart 2).

Our findings for Argentina are similarly negative. Just 7.6% of respondents in the country selected malls as their first choice for clothes shopping, down from 13.5% in 3Q13.

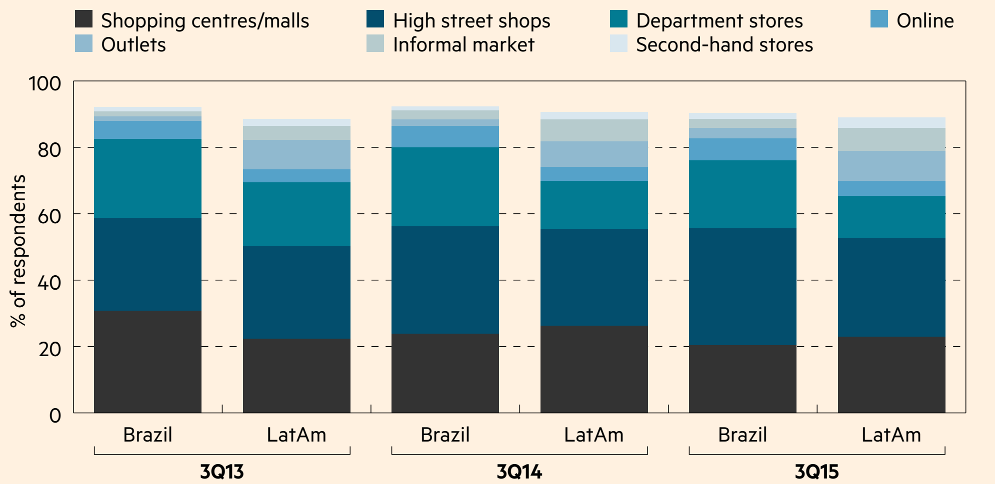
Andean shoppers attract international attention

Elsewhere though, the picture is less gloomy. Indeed, leading European and US fashion retailers such as H&M (HM-B:STO), Gap (GPS:NYSE) and Zara, owned by Inditex (ITX:MCE), have stepped up their exposure to the region. Zara has opened 15 new stores in Latin America so far this year, increasing its storecount to 30 by 1H16.

Our survey found that Colombians and Chileans are still keen to shop for clothes in malls. 74.2% of respondents in Colombia said they went to the mall at least four times a month to »

1. Brazilians turn away from malls as economy slides

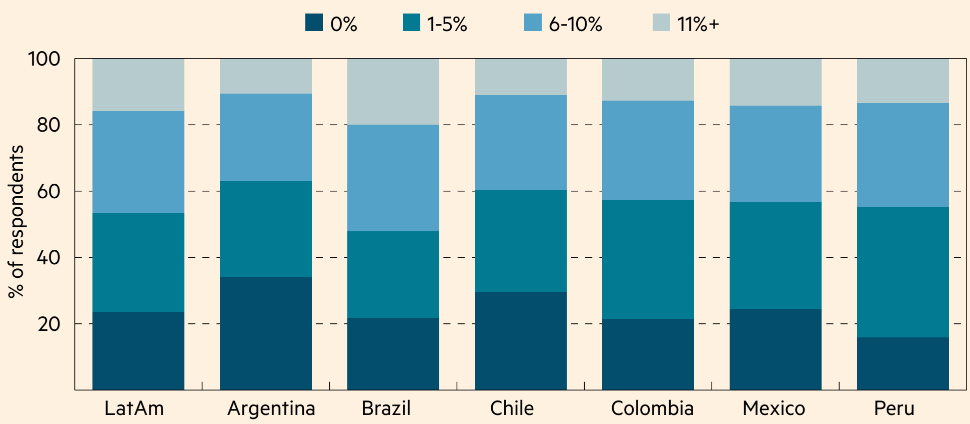
In what type of outlet do you spend more money when shopping for clothes?



Source: FT Confidential Research

2. Brazilians still biggest regional leisure spenders

What percentage of your monthly post-tax income does your household spend on leisure?



Source: FT Confidential Research

13.4%

Of Mexicans who said they spend 11% or more of their household income on leisure activities

purchase clothes, up from 73.2% in 3Q14 and above the regional average of 62.4%. Meanwhile in Chile this figure rose 1pp YoY to 73.9%.

Andean respondents were also enthusiastic users of mall-based cinemas. 79.1% of Colombian respondents went to these cinemas in 3Q15, up from 72.9% in 3Q14, while 76.8% of Peruvians said they did, up 3.8pp YoY. Further north, the percentage of Mexican respondents visiting such cinemas remained robust, declining just 1.1pp YoY to 76.6% – still well above the regional average of 65.8%.

Leisure spending a growth driver

Indeed, even as clothing spend weakens, leisure spending remains relatively robust.

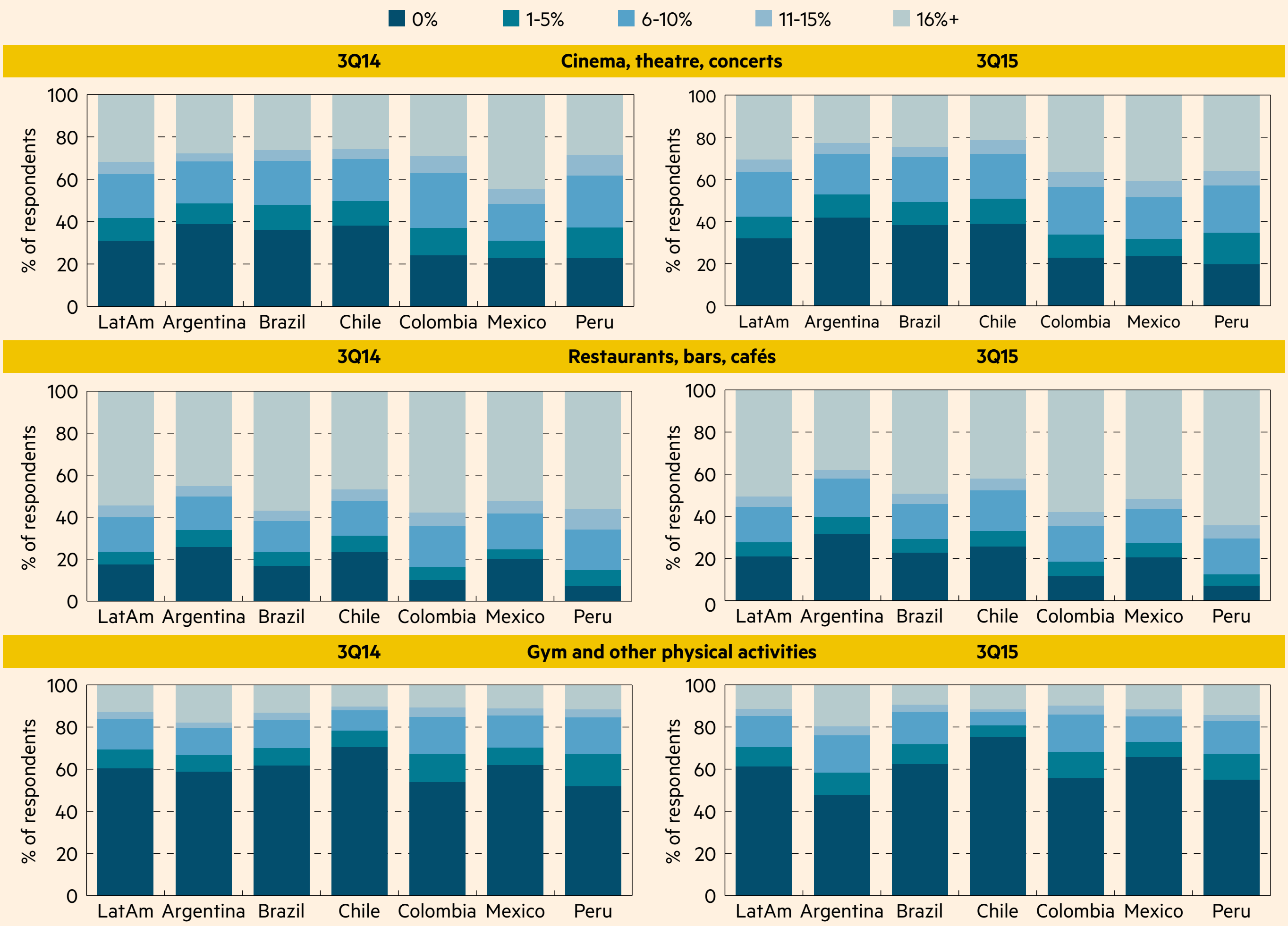
This is most apparent among Mexican and Peruvian respondents. The percentage of Mexicans who said they spend 11% or more of their household income on leisure activities rose 0.8pp YoY this quarter, from 13.4% to 14.2% of respondents, almost double the 8.6% recorded two years ago.

Peruvians choosing to spend this higher percentage on leisure rose 1.2pp from 12.3% to 13.5%. They are spending more on going to restaurants, bars and cafés. The share of Peruvian respondents who said they spend 16% or more of their total leisure budget on eating out increased 8.1pp YoY to 64.4% in 3Q15 (see chart 3).

Colombians, meanwhile, are heading to the cinema, with the percentage spending over »

3. LatAm leisure expenditure

What percentage of your monthly leisure budget do you spend on these activities?



Source: FT Confidential Research

Of Colombian respondents spending over 16% of their household leisure budget on cinema, theatre and concert tickets rose 7.9pp YoY

16% of their household leisure budget on cinema, theatre and concert tickets rising 7.9pp YoY to 36.9% in 3Q15.

Poor urban planning and high levels of crime in many Latin American cities mean that the shopping mall, rather than the traditional high street, is becoming the place to eat and seek entertainment.

Brazilian mall operator Multiplan (MLT3:SAO) is substituting underperforming clothing retailers for service providers, including hair salons, mobile phone shops, pharmacies and drop-in medical centres, and this seems to be helping to support consumer traffic, maintain high levels of occupancy and keep rents high.

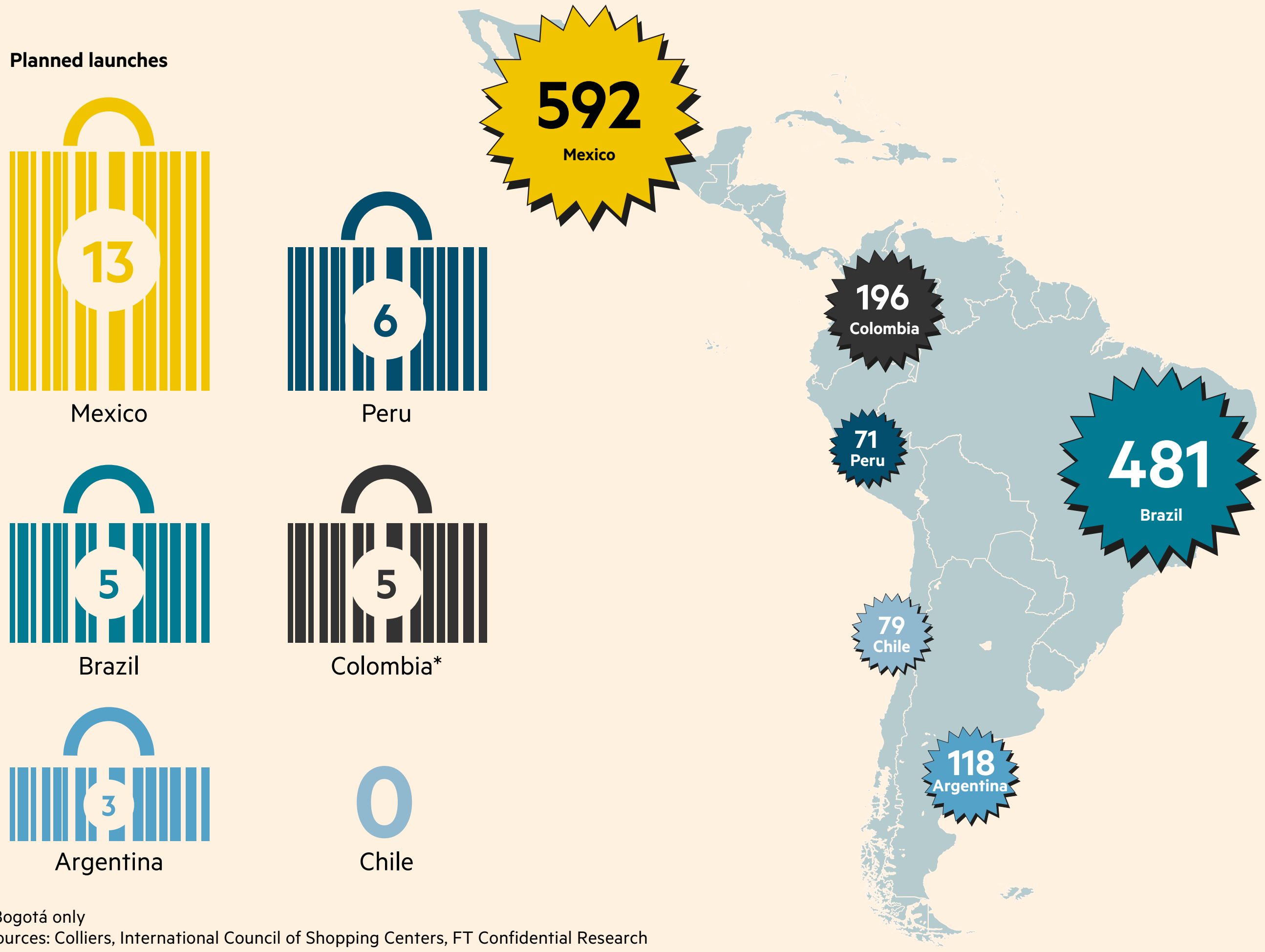
It has also started – along with several of its rivals – to integrate gyms into its malls, tapping into rising spending on working out. Our survey found this was especially true among generally mall-shy Argentines. The share of respondents in Argentina spending 16% or more of their leisure budget on a gym membership or similar physical activities rose to 19.6% in 3Q15, up from 17.9% a year prior. Expanding gym facilities could therefore potentially be one way to draw Argentines into malls.

Larger Brazilian operators still strong

The region's largest economy, Brazil, has been at the forefront of the region's shopping centre buildout – ranking second only to Mexico in terms of the number of shopping malls (see chart 4). However, the market appears saturated by the 481 malls that dot the country, and as demand falls, second and third-tier cities face huge oversupply. »

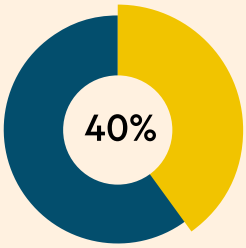
4. Brazil and Mexico lead mall expansion in LatAm

No. of shopping malls and planned launches for the rest of 2015



*Bogotá only

Sources: Colliers, International Council of Shopping Centers, FT Confidential Research



Of the total gross leasable area of Brazil's malls is operated by the big four companies

And this differentiated story is reflected in mall operators' performance. The so-called big four – the largest publicly listed mall operators: Multiplan, BR Malls (BRML3:SAO), Aliansce (ALSC3:SAO) and Iguatemi (IGTA3:SAO) – are primarily concentrated in top-tier cities, and seem largely unaffected by the downturn.

These four operate roughly 25% of the malls in Brazil, but because they are larger malls in prime locations, they account for 40% of the total gross leasable area.

Net operating income (NOI) for Multiplan, with a portfolio of 14 malls, rose 11.3% YoY in 2Q15 to R$227m ($59.8m), and tenant sales were up 4.8% YoY in 2Q15 (see chart 5). This YoY growth is particularly impressive given a high base in 2014, when sales soared in the run-up to the football World Cup. BR Malls' NOI rose 3.7% in the same period to R$320m, with tenant sales up 3.6%, while Aliansce's NOI also improved, rising 1.6% YoY to R$109m in 3Q15. Its tenant sales improved 3.3% over the same period.

Lower-tier operators under pressure

The picture is very different for second-tier malls. These properties – predominantly in private ownership – have been by far the worst performers in 2015. A larger proportion of their revenue comes from overage rent (basic rent plus a percentage of total sales) and as sales decline, revenues are tumbling.

Research from São Paulo-based MC15 Consultoría, part of the International Council of Shopping Centers, highlighted two particular cases where a mall built this year has yet to begin operating. At those already open, store vacancies are rising. A third of the malls that opened in 2015 are operating with at least 35% of their retail space vacant. There are some centres, said Carlos Ruótolo, head of the consultancy, where as much as 60% of space is empty.

Revenue from "key money" – the fee charged to retailers to open shops in a mall – is also falling. High vacancy rates make it impossible for operators to continue charging this premium. In fact the practice is almost "non-existent" among smaller operators today, says Mr Armando Netto, head of investor relations at Multiplan.

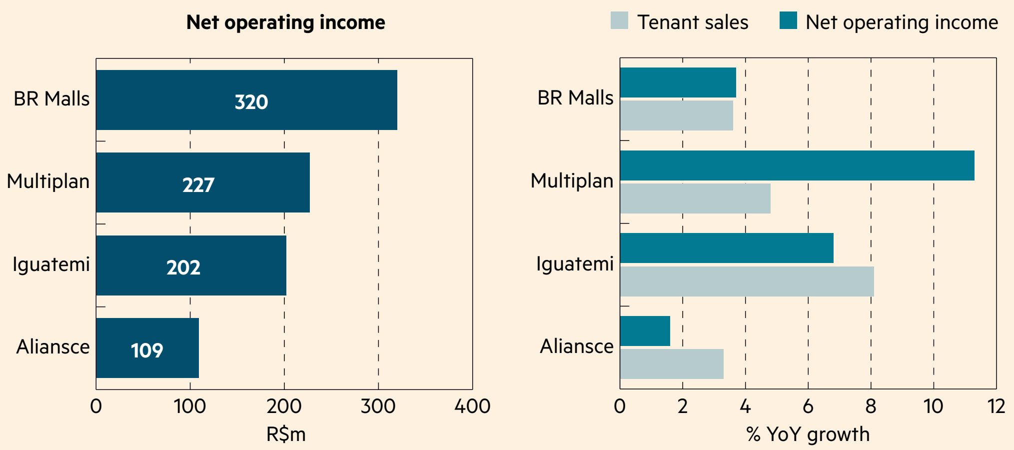
The big four, operating mature malls in prime locations, still charge key money. In some locations the charge has even risen, developers told FT Confidential Research, as retailers scramble to get access to the best malls, which are more resilient in a downturn.

A Colombian challenge

Outside the core territories of Brazil and the still-buoyant Chile, mall developers' attempts to enter Colombia are being slowed by the country's use of an old leasing model.

Mall operators tend to sell the rights to retail space in Colombia, unlike elsewhere in the region, where space is leased. Jorge Lizan of Lizan Retail Advisors says 85% of the 196 malls »

5. Top listed mall operators' financial performance, 2Q15



Source: Company reports

currently under operation are sold as condominiums, while just 15% are leased. This more capital-intensive model drags on the opening of new stores or retail concepts.

Furthermore, international brands are unable to find the spaces they want because retailers that bought up shop space 30 years ago are reluctant to sell. "The international retailers are wary of this model and find the environment very challenging," said Mr Lizan.

However, there is optimism that the market is changing. Certain enterprising local businesses are purchasing sections of malls and then leasing them out. Meanwhile, the expansion of Chile's Parque Arauco (PARAUCO:SGO) in the country – employing a leasing model – will likely put pressure on other operators to shift away from selling retail space.

INSIGHT: **Parque Arauco – a solid regional mall play**

Parque Arauco – a 30-year-old veteran of mall operations – is in robust health. With revenue up 16.6% YoY in 2Q15, to CLP34.7bn ($51.5m), and tenant sales up 16.2% YoY, Parque Arauco is set to further its regional expansion – it has already expanded into Peru and Colombia – by looking to exploit industry turmoil in Brazil (see chart).

FTCR has learned it plans to snap up a smaller Brazilian operator with a small portfolio of malls, a move made particularly attractive by this year's depreciation of the Brazilian Real.

"Prices are looking ridiculously low in Brazil," said Samantha Zerbe, head of investor relations for Parque Arauco. "M&A opportunities are abundant and there are lots of potential partnerships that could play out."

Ms Zerbe said some Brazilian operators have lost 50% of their value since August 2014. Hitherto, Brazil's unfavourable tax structure and a lack of a strong department store culture had dissuaded Parque Arauco from entering the country. Now, however, with valuations more attractive and Brazilians reportedly warming to department stores, it feels the time is right, though Brazilian operators interviewed by FTCR cautioned that it would be difficult for Parque Arauco to enter such a crowded market without a local partner, even if prices do look attractive.

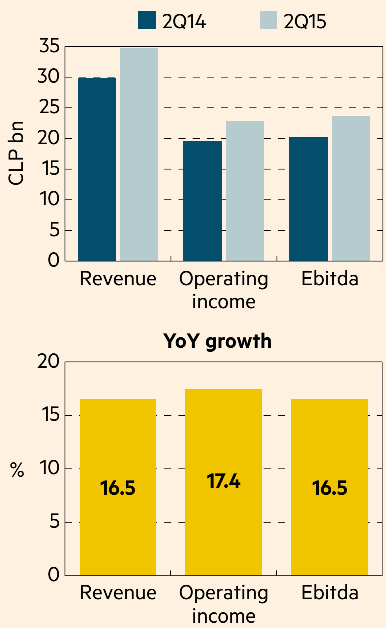
However, we think the Chilean firm has business advantages that could help it stand out. Unlike local operators, it does not charge key money, which could prove hugely attractive, particularly for international retailers looking to enter the LatAm market for the first time. Parque Arauco also has secure contracts with top international brands, which help drive consumer traffic for its properties. A relatively flexible leasing model means every tenant pays a variable rent that is either a percentage of the retail floorspace or a percentage of sales, on top of a fixed base rent.

Elsewhere, the ability to expand during a downturn has real advantages for the firm. The cost of construction of two new malls in Colombia – set to open by the end of 2016 – is falling in line with lower material, borrowing and labour costs. Its premium outlet mall in the capital Bogotá will bring its total portfolio of malls in Colombia to four. In Peru, counting a new project in the city of Jaen, the total will be seven by the end of 2H16. Colombia and Peru contributed 37.9% of company revenue in 2Q15, up from 34% a year earlier.

Other Chilean operators have already expanded into Brazil. In 2013, Falabella (FALABELLA:SGO) bought a 50% stake in Dicico, a home improvement chain, while supermarket conglomerate Cencosud (CENCOSUD:SGO) signed a deal in 2010 with Bretas Supermarkets. Indeed, Manual Puig, retail services partner at Cushman & Wakefield, a commercial property and real estate consultant thinks that Brazil is a natural expansion partner for Chileans.

We believe Parque Arauco offers the best regional play for investors looking to tap into the revival in spending expected as economies stabilise.

Financial performance



Source: Company reports