

Q2 2016 Earnings Call

Company Participants

- Eric Alencar, Chief Financial Officer, Investor Relations Officer
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Alex Ferraz, Analyst
- Daniel Gasparete, Analyst
- Daniel Malheiros, Analyst
- Guilherme Capparelli, Analyst
- Gustavo Cambauva, Analyst
- Marcelo Motta, Analyst
- Nicole Hirakawa, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we will discuss the Second Quarter of 2016 Earnings Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and the audio will be available at the company's website, www.cyrela.com.br/ri.

This call is being simultaneously translated into English and is being broadcast over the Internet. Questions can also be asked by participants connected abroad. The earnings release published yesterday, 9th of August after the close of the BM&FBOVESPA trading session can also be accessed on the company's website.

Before proceeding, we would like to mention that the forward-looking statements that may be made during this conference call relating to the Company's business prospects and projections and operating targets related to its financial growth potential are predictions based on management's expectations about the future of Cyrela. These expectations are highly dependent on domestic market conditions, the general economic performance of the country and the international markets, and therefore are subject to change.

With us today are Mr. Raphael Horn, Co-CEO; and Mr. Eric Alencar, CFO and IRO. I will now turn the conference over to Mr. Horn. Mr. Horn, you may now begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning. The financial markets can already see, at least, a partial improvement of our economy. The market consensus indicates controlled inflation and some growth of our GDP in 2017. We are truly hoping that this will be the beginning of the economy getting back on track. The financial market already indicates this change in perspective, and the most important indicator that we can see is future interest rates, that we have for January of 2019 goes to 12% per year.

We hope that this will come true, because savings accounts will stop losing so much reserve [ph], the interest rates for end consumers would go down and a higher credit availability would reduce the number of cancellations. On the one hand, we have positive perspective; on the other hand, our everyday activities continue to be challenging, restricted credit grants to individuals and the increase in unemployment rates affects our activity directly, both on growth sales and as well as cancellations. That is the main reason we are not generating -- we are not generating cash as we would like.

We'll keep an eye open for opportunities for good deals in all stages of the real estate market. Our strategy for the coming years focuses on having a lean balance in inventory and land bank, allocating cash surplus to our shareholders and improving ROE.

Now, let's comment on our operating results. On slide five, we will address Cyrela's consolidated results. In the second quarter of 2016, we launched R\$600 million compared to R\$1.1 billion year-on-year. In this quarter, we launched six new products (inaudible) in the State of Sao Paulo, but not in the City of Sao Paulo, one in the South, one in Rio and one in the City of Sao Paulo.

Excluding swaps and launches of the MCMV program level 1, the volume launched in the Cyrela's share was 840 million, down by 27% in comparison with the first half of 2015. The Company's share in volume launched was 83% in the second quarter of 2016 compared to 81% in the same period of 2015. In the first half, Cyrela's share in the launched projects was 75%.

On slide six, we would like to highlight the launch of the project, Castelo do Batel, in the city of Curitiba.

On slide seven, we will talk about our sales performance. In the second quarter of 2016, pre-sales totaled R\$560 million, 31% lower than the 800 million reached in the second quarter of 2015. In the first half, pre-sales amounted to R\$1.1 billion in comparison with R\$1.5 billion reached in the first quarter of 2015. Excluding swaps and the MCMV program level 1, pre-sales amounted to 800 million Cyrela's share, a 30% reduction year-on-year. The states of Sao Paulo and Rio jointly accounted for 83% of sales in the year.

On slide eight, we will address sales speed. The company's annual SOS was 30.1%. Looking at sales speed by launch period, projects launched in the second quarter of 2016 have been 42% sold.

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On slide nine, we'll address Cyrela's total inventory. At the end of second quarter, inventory at market value totaled R\$6.6 billion, 1.2% up quarter-on-quarter. The change in our inventory can be seen in the charts on the right.

On slide ten, we will have a breakdown of our finished units. We sold 3.7% of the finished units at the beginning of the period, adding the inventory of projects delivered along the quarter and pricing of the units, at market value, the finished units inventory increased by 7.7% quarter-on-quarter. We are aware of how important this matter is to the company, and we will keep on focusing our efforts on selling this product. Rio and the Northeast region account for 49% of the finished units.

In the second quarter, Cyrela delivered 17 projects, totaling 5,800 units. Our PSV was R\$2.1 billion versus 1.9 billion year-on-year. We delivered 10,200 units with a launch PSV of R\$4.1 billion.

Now Eric will talk about financial results.

Eric Alencar {BIO 18098474 <GO>}

Thank you, and good morning. On slide 13, we'll present our financial results. Gross revenue was R\$662 million in the quarter, down by 21% quarter-on-quarter and 43% lower year-on-year. Our revenue in the quarter was affected by lower net sales and also by the Reserva Golf transaction. In the first half of the year, gross revenue came to R\$1.4 billion, down by 33% in comparison with the first half of 2015.

Gross income in the quarter was R\$254 million, 10% down quarter-on-quarter and 36% lower in the year-on-year comparison. In the first half of the year, gross income reached R\$536 million, 29% lower year-on-year.

The company's gross margin in the quarter was 39.6%, 4.8% higher than the 34.8% from last quarter, and 4.5% higher than the 35.1% margin from the second quarter of 2015. This quarter's gross margin reflects a positive effect on our gross income, resulted from the Reserva Golf transaction. If we were to exclude such effects, our gross margin would have been 33%. In the first half of 2016, the company's gross margin was 36.9%, 1.9% higher in the year-on-year comparison.

In the chart, in the bottom left hand corner, we analyze our EBITDA. EBITDA in the quarter totaled 63 million, 46% down quarter-on-quarter and 73% down year-on-year. In the first half of the year, our EBITDA totaled R\$180 million, 54% down year-on-year.

Net income in the quarter reached R\$45 million, 27% down quarter-on-quarter and 62% down year-on-year. The decrease in the company's net income is mainly due to our lower revenue, and also due to contingencies totaling R\$30 million. In the first half of 2016, gross income reached R\$106 million, 52% lower in the year-on-year comparison. Thus our net margin in the quarter was 7% compared with the 7.6% margin quarter-on-quarter and 10.4% in the year-on-year comparison. In the first half of the year, net margin was 7.3%.

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Please go now to slide 14 to see our profitability. In the second quarter of 2016, our return on equity, which is measured as the net income of the past 12 months over the average shareholders' equity was 5.7% and our EPS was R\$0.12.

On slide 15, we will talk about our customers' financial solution. In this quarter, transfer, trust of deed and payoff amounted to R\$792 million, 21% higher quarter-on-quarter and 11% lower year-on-year. In the first half of the year, transfers, trust of deeds and payoffs amounted to R\$1.4 billion, down by 16% year-on-year. Considering units, transfers, trust of deeds and payoffs totaled 3.5 thousand units, 20% higher in the quarterly comparison and 23% lower year-on-year. In the first half of the year, transfers, trust of deeds and payoffs totaled 6.4 thousand units, 20% down year-on-year.

Slide 16 shows the company's cash generation. In the second quarter of 2016, our cash used reached R\$29 million versus R\$13 million quarter-on-quarter, and a cash generation of R\$219 million year-on-year. It is worth mentioning that the company made two investments that had an impact on cash of R\$40.9 million. The first one was the acquisition of an equity stake in the amount of R\$30 million in an SPE in Rio de Janeiro; and the acquisitions for R\$10.9 million of a portfolio of receivables from finished units.

On slide 18, we present our indebtedness. Gross debt at the end of the quarter was R\$3.5 billion. The cash position was 1.9 billion. Thus our net debt was R\$1.6 billion. Of the total gross debt, 68% related to loans for construction and 67% is long-term. The average cost of our corporate debt is still below 100% of CDI. Our net debt over equity ratio was 24.1%, 1.9% higher quarter-on-quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged position to take advantage of the opportunities in the real estate market.

We will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Hirakawa with Credit Suisse.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Good morning, everyone. I have a question about cash generation. In the presentation, we saw that the volume of transfers, trust of deeds and payoffs had an increase quarter-on-quarter. I think it was 415 [ph] in difference, but cash generation didn't follow that. The construction volumes in this quarter was lower as well. Could you please comment a little bit about that? What affected cash generation in this quarter? And also, I would like to know what would make sense for the second quarter, since we are now going through better times, better situation as regards savings accounts, the CaixaBank [ph] is going to grant better credits for the customers, so I would like to know your expectations for the second half of the year?

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A - Eric Alencar {BIO 18098474 <GO>}

Hello, Nicole. This is Eric. I'm going to answer your question. Indeed, there was an increase in transfers, but the receipts of money happened when customers are registered. And that happens after 60 days to 120 days after the transfer, so this period of time varies. Cash generation quarter-on-quarter depends on what? It depends on our construction, depends on the discounts, the indemnification, the cancellations. So we have to put that all together to calculate the cash generation.

Now let's talk about our perspective. The bad guy for us here is cancellation, because that happens when we are generating cash. Cancellations in Cyrela happens at 86%. So almost all cancellations happen when we are going to deliver the units. If we go from our level that we have now of 750 million per quarter, and if we talk about 300 million, for example, we are not going to generate cash, and we are going to have 400 million more in cancellations.

So the CaixaBank is willing to help customers and receive spot initiative here and there. But in order for us to have a positive perspective, we need interest rates to go down. So we have a decrease in cancellations as well. This is a perspective we don't know if it's going to become truly in the second -- in the second half. Some think that is going to become true only in the next year, but we still know that we have a lot of cancellations and we need to know how to deal with our cash generation in our current scenario.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Okay. Thank you very much, Eric.

Operator

Our next question comes from Gasparete with Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Good morning. Thank you for the presentation. I would like to piggyback on what Eric said about cancellations. I would like to know about deliveries in the second half of the year, could that help a little bit in terms of cancellation?

And my second question is related to gross sales, especially finished units. I would like to know about your expectations regarding the market appetite, or if there is a higher demand, and how that could help cash generation in the second half or next year? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Gasparete, this is Eric. I'm going to answer your first question and Raphael will answer the second one. Cancellations in the second half tends to be similar to the first one, because deliveries profile will be similar. In the North and the Northeast regions, especially the North region is due to so many units being delivered. Unfortunately, the North has a high cancellation rate for many reasons.

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In the first half of 2017, we are not going to deliver units in the North region, and the level of cancellations tends to drop a lot, regardless of the changes in the scenario. The macro scenario tends to be similar to the first half of the year. So we are going to have a stable perspective until the end of the year and an improvement in the next year.

When it comes to sales, you asked about gross sales, right, and finished units. In the macro scenario, we have high rates of cancellations in the delivery space and gross sales when the units are finished. We believe that's going to continue. We are still going to sell finished unit.

We had actually an improvement. July is traditionally a weak month and we had an impact on August, due to the Olympic games, the population is watching the Olympics and the beginning of August was not a good period. So we are going to have to wait a little bit to see an improvement in our reality. We hope it is going to improve, the market ratifies that perspective. And -- but in August, we haven't seen an improvement, but let's hope that the perspective improves.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Daniel Malheiros with Banco Votorantim.

Q - Daniel Malheiros {BIO 18660708 <GO>}

Good morning. I would like to know about cash generation and cash consumption. In this quarter, you had two investments. One was the acquisition of an SPE for 30 million; and the acquisition of receivables portfolio. I would like to know a little bit more about that, the rates of that -- our portfolio as well. And I also would like to understand the rationale behind that.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Daniel. I wouldn't like to name names because it doesn't make any difference actually. Our biggest investment was the acquisition of an SPE. In our opinion, we are trying to take advantages of the crisis if we can. So, it was actually about liquidity. It is in our SPE, we managed this SPE and someone needed liquidity, and we did our math. We thought it was a good operation, a good transaction, and it is a very easy way of taking advantage of crisis. And if it is a low risk, we are going to take those advantages and take those opportunities. We know this SPE and we thought that would be a profitable operation.

The other one was the acquisition of our receivables from finished units portfolio, and the risk is very low as well, and the rates were very good. And we did that for R\$10 million. It is always a good idea to take advantages of the opportunities in a crisis, crisis are not there only to make us lose money.

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Q - Daniel Malheiros {BIO 18660708 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Ferraz with Itau BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

Thank you very much for your presentation. I have two questions. First one is related to launches. We have a good sales performance in launches. And I would like to know if this good performance, especially related to Batel, I would like to know about the profile of customers. (inaudible) high end, low -- high end customers and do you think they are going to keep on with this good performance?

And the second question is about indemnification and compensation. Do you think we're going to keep with the same level? Do you think we are still going to have a high level of compensation? And when do you expect to see any improvement in that indicator?

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Alex, this is Raphael. We have been trying to launch products that are good, that have liquidity and that are not going to cause any harms to our cash generation. When you see good performance launches. It doesn't mean necessarily that the market is in a good position, but it means that we are making reasonable choices here. The market is tough, but it's not dead. And it's not going to die. So good products at good prices are always going to sell.

We have been trying to choose the best products, and the market is tough, it's not dead, but it's tough. We still have gross sales in a good level if the products are good. Of course, sales are lower than the good times, but it's not dead, the market is not dead, it's just tougher. And it is not related to income, the customers' income. If the product is good, it's going to sell even in a tougher environment.

A - Eric Alencar {BIO 18098474 <GO>}

Now, this is Eric. I will talk about compensation. I am going to talk about short, medium and long-term. You can see that our allowance is around 200 million. In the short-term, the 10 million per month that we have in compensation may repeat itself because the allowances are similar to the ones that we had in the last quarter and we are going to use those allowances to settle claims.

In the medium and long-term, this number will certainly drop. And why am I saying that? I am saying that because in 2015, the number of additions to the balance of new allowances for claims amounted to 200 million. And now this is around 26, it dropped by 50%. In this half, we had a high level of volatility and we had 18 million. So I believe those compensations are going to keep the same level, but we can see an evident trend of a decrease in the future because the number of claims is dropping by 50%.

Q - Alex Ferraz {BIO 19294308 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Motta with JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. I have two questions. I would like to know a little bit more about Reserva Golf operation and why did you do it? Are you going to do the same thing in other land bank -- in other land and in other launches? I would like to understand a little bit more about this transaction? And also I would like to know a little bit more about the CADE, the antitrust authority approval. And I would like to know a little bit more about what we can expect for the future?

A - Raphael Horn {BIO 19714328 <GO>}

I'm going to answer the first question. The Reserva Golf transaction was not an opportunistic one. We decided to change swaps per money [ph], we gained liquidity and we also gained a positive shareholders' equity. It is a win-win situation, and we want to cease those win-win opportunities. Since it was a very big transaction with a very big impact on the balance sheet, it is going to happen again in the future, and it is not a new operation in our history. Now, Eric will talk about setting reserves [ph] -- actually Raphael is going to talk about setting reserves.

I would like to know again exactly why you asked.

Q - Marcelo Motta {BIO 16438725 <GO>}

I would like to know your expectations for this operation timeline. Do you think you're going to complete this operation by the end of this year or only next year?

A - Raphael Horn {BIO 19714328 <GO>}

Well, it was approved by the antitrust authorities, and in the next 20 or 30 days, this operation will be completed. There is not much to say, actually, I believe, it's going to be completed in this half of the year, in the next 20 days.

Operator

Our next question comes from Cambauva with BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

I have two questions. First, let's go back to Reserva Golf. In broader terms, what do you think about investing in projects of partners in comparison with buying Cyrela's shares performing a buyback for example. You had Plano & Plano operation, and Tecnisa as well, Reserva Golf. As Raphael mentioned, you could take advantage of the market situation,

but Cyrela's situation now is good in the book -- in terms of book value. So I would like to understand a little bit more the rationale behind this movement in satisfying purchases -- of purchasing shares.

And the second question is related to your gross margin. If it is adjusted by the transaction of Reserva Golf, we can see that it dropped. I would like to know a little bit more about the discount volume, was it higher or maybe you now have decreased the construction savings than you had in the past. So I would like to know in general, a little bit more about your gross margins.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Cambauva, this is Eric. I'm going to talk about the gross margin, and then Raphael will answer your question about Reserva Golf. If you exclude Reserva Golf from the gross margin, it amounts to 33%, which is a drop, and that drop is natural, because it is related to sales of good products and bad products. And cancellations in this quarter were related to high gross margin products. And what you can expect is to see a volatility of 2% higher or lower. A low gross margin means that we're actually selling the tougher inventory, the tougher units. It is important for us to generate so much cash as we can.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

So you had cancellations more in good products, right, in the region of Sao Paulo?

A - Eric Alencar {BIO 18098474 <GO>}

No, actually, those were the products that had a good gross margin. If the product was that good, the cancellation rates would be lower, where those products were sold with a good gross margin. In the North regions, as the complement, the products have a good gross margin and cancellation rates there in the first half of the year was very high in comparison with the other year, just as an example.

A - Raphael Horn {BIO 19714328 <GO>}

Hello Gustavo. We performed the transaction that we mentioned to take advantages of the crisis, but Reserva Golf transaction was not bad. We had a long-term relationship with them. It was a win-win situation and it was not an opportunistic situation. It was good for us, it was good for them, but it is not being opportunistic. The PSV values are very high and that was just that it's not related to the crisis at all.

But why should we invest in an SPE instead of repurchasing shares? Well, the company is alive. We're doing our math. We should have purchased shares when it was at the level of seven. But we are still alive and if we see good opportunities in the market, it is an advantage for us. We are going to do it. But again we are talking about 400 million or 500 million for a half of the year if we spend 20 million here or 30 million there, before [ph] ask us about those expenditures, but this cash generation is not substantial. What we won here is, you have 500 for half of year, and also with a good cash generation, of course, the 500 millions are important. But we really want to generate cash, not only 10 million per quarter. But I would concentrate, I would focus on the actual cash generation, not only

in the 10 million operations that we do here and there. And those are just part of our everyday life in the company.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Actually my intention was to understand a little bit more the rationale of those transactions. I'd like know, what exactly you think about Tecnisa and Cyrela, and I would like to understand a little bit more about your future use of cash? Today, we have a low cash generation rates, but in 2017 it is going to increase. I would like to know how much is going to be distributed, how much is going to be invested in new businesses? But I understood your answer and thank you very much for your answer.

Operator

Our next question comes from Capparelli with Citi.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Good morning. I will piggyback on what Gustavo said. The improvement in the macro scenario gives us an expectation to a cash increase, to a cash generation increase. And are you thinking about dividend distribution to improve ROE, are you thinking about that?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Guilherme. This is Eric.

A - Raphael Horn {BIO 19714328 <GO>}

Actually Eric is going to answer your question, but I am going to talk a little bit about what you asked. As a nice strategy for next year, our goal will -- to have a land balance for land bank and inventory and allocating the dividends to our shareholders and improving ROE. Even though we have spot situations and spot opportunities, we are aware that our equity level is large in comparison to what it should be.

We are going to have decreases and cancellations and that is going to improve cash generation. And at some best point onward, we are going to follow our philosophy of distributing dividends. We don't have a 100% guarantee, because we don't place our best on one opportunity. And if we have cheap shares, we're going to buy them back; and if the Board of Directors decide to distribute that money, that's what we are going to do, but our philosophy is in line with what you mentioned. If we generate cash, we can distribute it.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Okay, thank you very much.

Operator

The question-and-answer session is now finished. And I would like to turn the floor over to Mr. Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you again for this opportunity. And we are hoping that Brazil is going to get back on track. The market is growing, that is saying that we are going to go back on track. We haven't seen that happening yet, but we are hoping that Brazil will come back on track. And thank you very much. We'll see you again in the next conference call.

Operator

That concludes Cyrela's conference call for today. Thank you very much for your participation. Good morning, and you may now disconnect. Thank you for using Chorus Call.

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