Y 2017 Earnings Call

Company Participants

- Efraim Horn, Co-Chief Executive Officer
- Miguel Mickelberg, Chief Financial Officer
- Paulo Eduardo Goncalves, Director of Investor Relations and Structured Finance Officer

Other Participants

- Alex Ferraz, Analyst
- Gustavo Cambauva, Analyst
- Marcelo Garaldi Motta, Analyst
- Rodrigo Fraga, Analyst
- Unidentified Participant
- Victor Tapia, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty's Conference Call, where we will discuss Q4, 2017 Earnings Results. All participants are in a listen-only mode. Later we will conduct a Q&A session, and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded, and the recording will be available at the company's website at www.cyrela.com.br/ri.

This call is being simultaneously translated into English and is being broadcast over the Internet. Questions can be asked by participants connected abroad. The earnings release published yesterday March 22nd, 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 company's future. These expectations are highly dependent upon domestic market conditions, the general economic performance of the country and international markets and therefore, are subject to change.

We have Mr. Efraim Horn, Co-CEO; Mr. Paulo Goncalves, IR Director; and Mr. Miguel Mickelberg, CFO.

I would like to turn over to Mr. Efraim Horn, you have the floor, sir.

Efraim Horn {BIO 19714326 <GO>}

Good morning, ladies and gentlemen. Let -- let me start with the overlook of Q4, 2017, that has proven to show good economic results despite the uncertainties of the elections. We have seen indicators of the uptake of the company, 17 billion in 2017 after losing 100 billion in 2015 and '16 despite room to reduce interest rates even further, banks are not prone to give credit. Consumer confidence is again on the uptake and unemployment rates are stable. The industry is launching fewer and delivering fewer projects. Average prices have been stable for some months. Just in few areas, prices are picking up again. Gradually, we begin to feel that in our operations.

In 2017, net sales reached BRL3.3 billion, up 17.8% compared to the same period in the previous year. I would like to highlight, our delivered products sales, they reached almost 1 billion, 55% increase, when compared to 2016. This uptake could have been faster, if we had a solution for our number one problem, which is cancellations.

The highlight for the quarter and the year was cash generation. Company has reached 245 million in the quarter and BRL712 million for the entire year. When compared to losses of our cash of 115 in 2016, given our debt profile, which is very conservative. The company has decided to distribute extraordinary dividends amounting to BRL200 million to be confirmed in our next ordinary general meeting that's part of our strategic planning to optimize the company capital structure aiming at recovering our ROE.

I would like to share, that in the past two years, both Cyrela and (inaudible) have been improving substantially, in-depth every engineering projects, product suppliers, materials and design. By doing so, we have managed to differentiate our end product, so customers have that value perception. We can also make a difference both to sell our stocks that have that recognize quality, and at the same time, we can leverage our brand for newer projects.

Let me just share two stories with you that are part and parcel of our company, but it's not heard everywhere else, especially investors. We delivered a project called Classic Lapa in previous quarter in the district, in the neighborhood called Lapa. It's our entry-level product. One of the consumers, when he was receiving that project, he was surprised, very happy, that's not what I bought, it's much better, but you Cyrela, I am at the crossroads. I cannot invite my family to my apartment. And the engineer asked him, why is it that you cannot invite your family over? And he said, they'll think I'm rich. Everybody is going to ask me for a loan. This is way above of what they're used to, it's way above my own expectations. So the message was, we managed to surprise consumers, raising their expectations. It's easier to sell stores -- stocks rather.

There's yet another story. One of his family members purchased an apartment from our competition three years ago and the product was delivered just a month ago. And this worker that works in the engineering department at Cyrela was of course frustrated and he shared that story with us. I'm not going to take it, I must sell it. Why are you selling your apartment, we asked them -- him, and he said everything that what Cyrela live, I cannot be happy getting that apartment from another company. So that is the customers' perception, our workers' perception, so that reputation will be shared in the word of mouth to the marketplace.

All right. Let me move on to slide five in our presentation. Let me talk about the launches, the new projects. In Q4, 2017, we have launched BRL1.3 billion in line with Q4 of the previous year. For the year, new projects reached BRL3 billion up 4% when compared to 2016. In this quarter, we have introduced 19 new products, 16 in Sao Paulo, 2 in Rio and 1 in Southern Brazil in Porto Alegre. Excluding swaps, the volume launched in Cyrela's share was 2.1 billion, up 2% year-on-year. The company's share in the volume launched for the year was 70% compared to 75% in 2016.

Moving on to slide six, let me highlight new -- two new projects that were very successful in Sao Paulo. One is called Living Exclusive in the Socorro neighborhood sold 90% [ph] in the quarter and the other one is called Quadra Greenwich 47% sold by December. It's a little above that today.

On to slide seven now. Let me talk about sales performance. In Q4 '17, pre-sales totaled BRL1.3 billion, 15% higher than Q4 of 2016. In the year, sales reached BRL3.3 billion, up 18% when compared to 2016. Excluding swaps, pre-sales amounted to 2.3 billion in the Cyrela's share, a 14% increase year-on-year. The states Sao Paulo and Rio jointly accounted for 87% of our sales in the year.

On slide eight, we will address sales speed. The SOS was 34% compared to 29% in 2016. Looking at sales speed by period, projects launched in this quarter have been 44% sold.

On to slide nine, total inventory. At the end of Q4, 2017 inventory market value totaled BRL6.2 billion down by 0.6% when compared to the previous quarter. The change in our inventory can be seen in the chart on your right.

On slide 10, we have a breakdown of our finished units. We have -- we sold 11% of our finished units at the beginning of the period. Adding the inventory of projects delivered along the quarter and pricing of units at market value, finished units inventory decreased by 3% quarter-on-quarter. We are aware of how important this matter is to the company and we're going to continue to focus our efforts on these products. Rio and Northeastern Brazil account for 33% of the finished units inventory.

Moving on to slide 11, I'll talk about delivered units. In the quarter, Cyrela delivered 14 projects totaling 6,500 units. We delivered 20,000 units in 55 different projects. Units delivered account for a VGV of BRL1.7 billion, up 9%.

I'll turn over to Mr. Paulo Goncalves to talk about financial results.

Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Thank you, Efraim. Good morning. On slide 13, I'll talk about our financial results. In order to compare the two periods, all numbers in the previous periods are going to be presented in a pro forma style considering MAC of the equity equivalence method. Gross revenue amounted to BRL832 million, down 8% quarter-on-quarter and 35% higher year-on-year. Gross revenue was 2.7 billion, 14% less than 2016. Gross income in the quarter was BRL219 million, down by 13% quarter-on-quarter and 48% higher than the gross income year-on-year. In the year, gross income reached 717 million, down 28%. The company's growth margin in the quarter was 27%, 2.4% above the 24.6% of the previous quarter. In this quarter, the company showed a profit of BRL49 million, losses of BRL95 million in the year against a profit a BRL151 million in 2016.

On to slide 14, let's talk about profitability. In Q4'17, our return on equity measured as the net income of the past 12 months over the average shareholders' equity was minus 1.6%, and our EPS was BRL0.13.

On slide 15, I'll talk about our customers' financial solution. In the quarter, transfer, trust of deeds and payoffs amounted to BRL641 million, 25% lower quarter-on-quarter and 27% lower year-on-year. Considering units, transfers, trusts of deeds and pay-offs totaled 2,800, 30% lower in the quarterly comprising, 27% lower year-on-year.

Slide 16, I'll talk about cash generation. In Q4, 2017, our cash generation was BRL245 million versus a BRL285 million quarter-on-quarter. Let me point out that in this quarter, in addition to the company's strong recurring cash generation, there was a cash inflow related to the sale of equity interest totaling BRL66 million. In 2017, our cash generation reached BRL712 million against a cash burn of BRL115 million year-on-year.

On slide 18, (sic - slide 17) I'll address our indebtedness. Gross debt at the end of the quarter was BRL2.6 billion. cash position was 1.4 billion. Our net debt was BRL1.2 billion. 60% of the total gross debt are related to loans for construction and 50% is long-term. Our net debt over equity ratio was 18.8%, 4% lower than the previous quarter. Given the consistent cash generation and the comfortable level of indebtedness of the company, the Board approved an extraordinary dividend distribution to be approved in our assembly -- in our general meeting, amounting to 200 million, we are providing better ROE for our shareholders.

Now I, Efraim and Miguel are available to answer any questions, you may have.

Questions And Answers

Operator

We'll start the Q&A session (Operator Instructions) Our first question come [ph] Gustavo Cambauva from BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Good morning, everyone. I actually have two questions. (Technical Difficulty) almost 450 million in the quarter. Is this increase in your receivables come from transfers and you're going to have a very strong cash generation effort in 2016? Or is it Cyrela's portfolio, selling your inventory based on the company's own financial schemes. So what's your take as cash generation for 2018?

And here's my second question, has to do with the marketplace rather. Efraim started out by saying that he can detect a gradual improvement on the demand side new projects. Could you elaborate on your take for your inventory sales? And also newer, or new projects. Is it going to remain the same or do you foresee any kind of improvement in that area?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hi, Cambauva, this is Paulo. Let me address your first question and then I'll turn it over to Efraim to answer the second question. As to receivables, there is no increase in our financial projects, it's about BRL420 million, BRL430 million. What happened was that we have deliveries concentrated towards the year's end. Two major projects Varanda Tatuape and Panamerica, they were both delivered at year's end. And we sold a lot of finished units towards the end of the year too.

When you talk about our cash generation projections, there is a good level, that's what was performed as you mentioned, we have managed to sell a lot of finished units, almost BRL300 million worth for the year, almost a BRL1 billion. So we have a 2.6 billion inventory to convert that into cash. Construction front, the most difficult deliveries have already been concluded. Slowly banks are (Technical Difficulty) the cash generation outlook is positive. Let me just (Technical Difficulty) say that when you talk about cash generation 2017, we had a (Technical Difficulty) on the creativity of coining the term Tombini [ph].

Your questions about inventory sales and new projects. Inventory sales maybe a little above what we had last year. And the reason is for the net position because most of the inventory units we are going to sell. They are not -- they are clean of the cancellations effect, so we believe that the net result will be better. Last year, I think we sold inventory units on the overall, but we had a lot of cancellations. So the net number was a little worse. This year there won't be that many cancellations.

As to new projects, since Cyrela has a higher number, in the beginning of last year, there were some political uncertainties, especially in Sao Paulo and we expect to introduce or to launch many more projects. But the political outlook and the legal outlook must, of course help. But we have to overcome some of these legal issues to launch newer projects.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Thank you. Thank you very much. Good morning.

Operator

Rodrigo Fraga from Citi.

Q - Rodrigo Fraga {BIO 20043127 <GO>}

Good morning, everyone. Thank you for your presentation. (Technical Difficulty). Let me piggyback on what Cambauva asked. I think you have improved sales, but you also talked about a contribution (Technical Difficulty) that reduction of cancellations as a percentage of the gross revenues. Major drops are expected to take place in the (Technical Difficulty) first quarters of 2018 just by reducing the number of cancellations.

And my second question is about the uptake in sales. I would like to better understand, what's more important to you today? Is this something that you're doing internally, that you're going to explore even further? Or is it a better perception on part of consumers? What or whether more credit with lower interest rates?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Rodrigo, this is Miguel. Let me answer your first question, then Efraim will address the second. We expect that cancellations are going to be more compared to the four -- Q4 last year, but this is a volatile number, we still have major deliverers to conclude. So when you model our revenues, our volume of constructions is slowly decreasing because we are delivering more than we're introducing or launching. So we are going to reduce that, that impact will be revenue line. Looking forward this year's sales will be a bit bigger depending on the number of sales, but we are dependent on the number of sales for the year.

The uptake of selling inventory units, let me address that question in two parts. Most of the inventory sales depend on its seasonality. The worst period is, the last six months before the delivery because consumers have to put a down payment and they don't have their perception of the end product. The construction is still dirty so to speak. When the product is ready they can see the reality, the quality of the project so that helps them make a decision.

So in this year, especially in Sao Paulo, you have very -- many projects that had been recently delivered, it's not that the last six months before the delivery that's the worst decision time that that's where we are six months ago, especially in Sao Paulo. So improving rates, of course, helps, but we believe that can improve even further, inventory units in Rio, we know that the economic situation in Rio is somewhat different. The speed there won't be as fast as it is in Sao Paulo.

Q - Rodrigo Fraga {BIO 20043127 <GO>}

Thank you. Thank you very much.

Operator

Next question, Alex Ferraz from Itau BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

Good morning, Efraim, Miguel, and Paulo. Thank you for making the presentation. I have two questions. My first is about the announcement of extraordinary dividends. My question is, do you believe that you are going to do that in 2018 some smaller dividends or -- but more often every two quarters, depending on the cash generation performance.

And my second question is about projects approval. We are keeping track of the legal issues. My question is, even in the projects that we have acquired according to the new zoning laws, have you had any approval issues before a resolution is made. So here -- here are my two questions.

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hi, Alex. This is Paulo. Let me address your first question. We have been saying that we're going to reduce and adjust our capital structure. This is already happening. So we did that for the first semester and we may do something else in the second semester, but that will be dependent upon how things evolve. We have two major challenges for the year, you have just talked about one of them, cash generation. We must see that happens and we have several debts, 1.5 billion [ph] of corporate debt and this is an election year, don't forget that. If we can take some credit throughout the year that may happen and if we can actually generate the cash, we expect, we may distribute dividends once again in the second semester.

As to the second question about the approvals of our projects and new projects portfolio. Cyrela has for the year, a very varied portfolio. Protocol projects and projects according to the new zoning laws. We believe and we expect that the country is reasonable enough to overthrow that injunction that will prohibit these protocol projects because the law is clear. When you have a transition period of -- number of months, every protocol project are going to be assessed by this new law. This has been happening and we hope there is -- they're reasonable. It may not happen and then, in that case, we will have to postpone about 30% of our projects in Sao Paulo alone because that affects Sao Paulo for the next year or the next semester and we're trying to anticipate those projects that were initially allocated to a more distant future to try to cover that gap, of course, it affects us, but the entire market too. But Cyrela has many plots of land to introduce new projects not related to the protocol and we have to speed up those projects to replace the other ones, if the injunction is maintained.

Q - Alex Ferraz {BIO 19294308 <GO>}

That's it. Thank you.

Operator

Thank you. Next question, Victor Tapia from Bradesco BBI.

Q - Victor Tapia {BIO 20566083 <GO>}

Good morning, everyone. The first issue, I'd like to address is about a recent decision that was announced by the legal authorities in Rio de Janeiro, cancellation of a specific project, you have and you are going to return part of what was withheld maybe 75 [ph], a 9%

retention of what buyers had already paid before that cancellation. My first question is, can you give me more color on that case.

And my second question, I believe this is an old project right? And maybe the impact of that decision is not substantial to Cyrela, but what's your take on that becoming jurisprudence in Rio de Janeiro because there was the legal authorities was the Ministerio Publico, they are the District Attorney's office that determine that. Do you believe it can become a jurisprudence to impact the company further.

And my other question is about, you have about 89 projects underway and you have been reporting cost savings for construction that had -- has been happening -- has been helping your margins. What are your expectations to get even further construction savings to get even better impact in the company results?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Victor. This is Miguel. About the DA's office, that decision was about one project, it's an old project called Pouso Real in Rio de Janeiro. We don't believe it's going to become a jurisprudence case. It's within the state environment. I don't believe it's going to impact. It will depend on a decision made by federal courts. We don't believe there won't be any further impacts on cancellations.

And about construction savings, yes, that's true. Construction costs reduced dramatically, 30% less compared to 2016 and looking beyond savings won't amount to that much. We have fewer construction sites that are active today and we have signed several contracts and we have replicated those savings in our results already.

Let me just comment on the construction savings. We hope we don't get no further construction savings and why is that. The reason behind it was the slowdown of the economy, but as long as we can reduce the number of construction, of course, consumers will be just as strong and construction is 34% of VGV everything you save in construction. We wouldn't give the discount, so the benefit is bigger. Of course, you have a direct impact in margin, but all the way we're losing money because consumers can get that in the marketplace as well.

Q - Victor Tapia {BIO 20566083 <GO>}

That makes sense.

A - Miguel Mickelberg {BIO 20023910 <GO>}

It's a good sign, when you have no further construction savings because we'll be able to boost prices as well.

Operator

Next question, (inaudible) from Morgan Stanley.

Q - Unidentified Participant

Good morning. I have two questions. Cyrela's sales in 2017, is that a trend in 2018. Can you talk about the more new projects in the markets, where we are? Do you see that competition speeding up the number of new projects? Or is it a more conservative growth that you expect?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Overall, that's a yes. We believe that sales will be bigger than newer projects, our newer projects and also the competitions are being sold very well right off the bat. 100% in one weekend in one of the cases. And the name of the neighborhood is called Soc'oho [ph], which means health. It should be called Paradise. And of course, we want to sell more because organically last year, especially in Sao Paulo, we did not launch as many projects as we would like because things are difficult at the beginning of the year. We would like to introduce more, to launch more there that legal issue of the protocol, 30% of our projects will have to be changed very quickly in order to launch everything according to plan. There will be more launches in 2018 with or without that protocol issue.

Q - Unidentified Participant

And what about the markets where we operate? Our competitors boosting their new launches too or, are they more conservative?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Let me be specific on a market-by-market basis. In the South, it's the same. There are few competitors, it's a smaller market. In Rio, the entire market is of course in a -- at a crossroads, very, very occasional projects, it's not the case, competitors are not going to introduce more projects. In Sao Paulo, competitors have changed, but there are several smaller companies now ready to launch, but there are other competitors.

Q - Unidentified Participant

Thank you.

Operator

Thank you. Next question, Marcelo Motta from JP Morgan.

Q - Marcelo Garaldi Motta {BIO 16438725 <GO>}

Good morning. I have very two quick questions. Could you comment on disbursements of purchasing land? What's your take for next year? You talked about deliveries and the cash generation scenario. Can you talk also about what happened to Cury and to take a closer look at their results too?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hi, this is Paulo, let me address your first question, and Miguel address the second. Disbursements to purchase land, we are going to reduce that. In 2016 they amounted to

BRL210 million, in 2017, they were 889 million, Q4, 70 million, but for the year 189 million. When we look at 2018, the trends will be the same. We have a reasonable stock of land, we must replenish that, but there shouldn't be any major increases in that area.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Marcelo. Let me talk about Cury. Their Q4 was very strong, as you could see. They had sales of BRL200 million and that results contributed to our P&L in 201 [ph] million. For 2018, we hope they launch even more and they will have even better results than they had in 2017. In 2017, they had sales of BRL700 million and their net profit was 120 million.

Q - Marcelo Garaldi Motta {BIO 16438725 <GO>}

Great. Thank you.

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Thank you.

Operator

Thank you. Next question is from (inaudible) from Credit Suisse.

Q - Unidentified Participant

Good morning, everyone. Thank you. I have three questions actually. First, I would like to better understand the outlook for margin. On one hand, finished unit sales is what you have less impact on the cancellations, and you already have all the savings -- construction savings and you're going to have greater margins. When making all that calculation, you're going to have fewer impact of finished unit sales.

My second question (Technical Difficulty) you can (Technical Difficulty) measure between one launch and a finished unit in places with similar conditions.

And finally, my last (Technical Difficulty) is on third parties. I thought there would be an even further drop by reducing finished units inventory. I'd like to better understand what's the recurring level as of now?

A - Miguel Mickelberg {BIO 20023910 <GO>}

This is Miguel. Good morning, Juan. As to margins, these are the major factors, you put it perfectly. We believe that launches helps us going to up to gross margins to 35, but construction savings caused a negative impact, only 9 million in this past quarter when compared to 2016, the average was 50, 40 -- 40 odd by quarter and margins were even better than the other quarters because of cancellations. So I believe the net effect is positive and margins are going to gradually increase this year and the following years up until we'll reach our objective.

As to commercial expenses, we believe that for 2018, volumes will be a bit smaller than that of 2017, maybe bigger than the annualized of last quarter, that involves commissions and bonuses, sometimes are outside and sometimes inside the contract. We may have a lot of reductions we'll be stable. There'll be some more media and long term demands (Technical Difficulty) major impacts to come.

And about the finished units in the secondary market, it's very difficult to address that because that depends on the region that we measure.

Q - Unidentified Participant

That's perfect. Thank you.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Thank you very much.

Operator

(Operator Instructions) Since there are no further questions, I'd like to give the floor to Mr. Efraim Horn. You have the floor, Mr. Horn.

A - Efraim Horn {BIO 19714326 <GO>}

Several industries have shown growth and there is -- there is mismatch of sales numbers when compared to early last year. We see that in the auto industry, logistics, freight. We have a very clear expectation that this year will be much better than last year, and of course, better than the past three years. We're starting a new cycle, cycle that was very harmful to Brazil and our industry overall. That's it. Thank you very much.

Operator

That concludes Cyrela's conference call for today. Thank you very much for taking part at this -- in this conference.