

Q1 2015 Earnings Call

Company Participants

- Leonardo Guimaraes Correa, Chief Financial and Investor Relations Officer
- Rafael Nazareth Menin Teixeira de Souza, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Daniel Gasparete, Analyst
- Daniel Malheiros, Analyst
- Eduardo Silveira, Analyst
- Frederico Mendes, Analyst
- Lucas Dias, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcelo Motta, Analyst
- Nicole Hirakawa, Analyst

Presentation

Operator

Good morning. Welcome to the conference call for analysts and investors of MRV Engenharia e Participacoes SA first quarter of 2015 Results. Today with us, we have Mr. Rafael Nazareth Menin Teixeira de Souza, CEO; Mr. Leonardo Correa, Chief Financial and IR Officer; and Mr. Matheus Torga, IR Executive Manager.

We would like to inform you that this event is recorded and now participants will be in a listen-only mode during the Company's presentation. After MRV's remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given. (Operator Instructions). Today's live webcast may be accessed through the Internet on MRV's Investors Relations website.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of MRV's management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of MRV and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Rafael Menin, CEO of MRV who will begin the presentation. Mr. Menin, you may begin the conference.

Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good morning, ladies and gentlemen. I would like to highlight the main reasons for the resilience of our operations, which makes us quite comfortable with the situation of the Company. The segment in which we operate continues with a strong demand and low competition. In addition, our operation is mature, has flexibility and extensive geographic presence which allows us to operate in several markets, making us flexible and competitive. We continue to operate in the same levels with a good gross margin and balance.

We have strong operational indicators with a volume of close to 40,000 units per year [ph] in all business units. Only in the first quarter of 2013, we sold more than 10,000 units. It's important to mention the maintenance of credit conditions of My House My Life. Currently 83% of our sales are done within this program with the low interest rate and available funds.

Simultaneous sales have reached 79% in the first quarter of 2015 and in April they accounted for 90% of our gross sales. This is a figure important for the Company because it gives us the comfort that results coming from new sales will be at much lower levels than the current ones. As I mentioned in the last conference call, we have launched the Austerity Project and we can already see the effect of this project in the reduction of G&A. There are several actions in course, which will also contribute to reduced sale expenses throughout the year.

It's also worth highlighting the increase in the (inaudible). The improvement in this retail area could have been even better because we had a non-recurring event in the SPE in Campinas. To finish, we believe that the Company is ready in terms of capital structure and prepared also in terms of human resources to face the unfavorable economic conditions or whether it is really favorable. If it changes, we can step on the gas and improve our sales.

Now I would like to pass the floor to Leo.

Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Good morning, ladies and gentlemen. I will talk about three topics; cash generation and allocation of cash, sources of financing for customers and their costs, and return to shareholders. We have generated almost 150 million in the quarter. This is the 11th sequential quarter with a positive cash generation. We continue to keep the size of our sales -- our operations in terms of sales, constructions and delivery of keys meaning that we have consistent and measures focused on improvement of operating condition.

We repurchased less than 10% of the capital and reduced our total debt as well as in 2014, this cash will be directed to shareholders. Given the challenging financial and

economic environment, we will leave this funds accumulated in the balance sheet and will allocate them in a timely manner. As for the funding of our debt, it comes mainly and also the source of financing of our customers, it comes mainly from FGTS, the unemployment guarantee fund in Brazil. When I say majority, I mean something close to 80%.

My House My Life levels two and three which are the markets we operate in continue to function normally with funds coming from FGTS. So we remain confident as to the availability of such sources of funding. And the cost of construction is very competitive. So the average weighted cost of debt of MRV is around 100% of CDI.

And finally, I would like to highlight the increase in the earnings per share when compared to the first quarter of 2014. We have increased earnings per share by 40%. This is an improvement -- result of an improvement of income, but also of the capital through repurchases or share buyback. We continue to improve the return to shareholders.

Now we move on to the Q&A session.

Questions And Answers

Operator

Thank you. We will now start the Q&A session for investors and analysts. (Operator Instructions). Mr. Daniel Gasparete from Merrill Lynch will ask a question.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Good morning, ladies and gentlemen, thank you for the call. I have two questions. First the cash generation. I would like to know from you how do you see the recovery from cash generation from the second and third quarters given the volume of units under construction remain the same. So could we expect something around 24 million like the last quarter? And the second question is about the funding FGTS. There will be a change in the savings account's compensation or interest rates. So, I would like to know how you see that.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good morning, Daniel. This is Rafael speaking. As for the cash generation, we expect to present a good cash generation throughout the year. Of course, there is a volatility in this figure. We won't necessarily have the same figures we had in the fourth quarter, but the second quarter will be somewhat higher or lower, but the trend is to have a good cash generation. Because the way our business is structured, it continues -- it allows for a continued cash generation. So if we will have decreasing in the leveraging of the Company, at the right movement we'll allocate the surplus of cash of the Company the best way possible.

As for the cost, yes, this discussion is ongoing as you mentioned. Personally, I find it very unlikely that things happen as they are on the news because there is a policy for the low-income market. And we believe that this is more protected and the government will

consider this market. So in our understanding funds available for FGTS will be mostly directed to the low-income market. The funding available will continue and we believe that this market won't have a stronger effect or won't suffer many consequences in the short and medium term.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Can I have another -- ask another question about the cancellation? On page nine, we have a difference of prices between units sold and units canceled. This is a difference we see every quarter. I would like to know how do you see this given there is marginal increase in cancellations? Thank you.

A - Unidentified Speaker

Daniel, in the past if you compare the prices of 2012 and 2013 and '14, the Company was able to really transfer the rise in inflation to prices. What we expect from now on is to be in line with inflation and the units that were cancelled are those that were not signed with the bank. So we believe cancellations figures will be close to those of the first quarter. And the trend remains the same. We will lose some money with cancellations, but the gains we had with cancellations in the years of 2013 and 2014, we won't lose money but we won't make money on it as we did in the past.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Okay. Thank you. Rafael, have a good day.

Operator

Mr. Luiz Mauricio Garcia from Bradesco will ask a question.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Good morning. I have two questions. One, coming back to FGTS, as it is on the media today, instead of correction by the savings account, you were going to share the surplus with employees. Another news we are seeing is the increase in the ceiling of financial operations under FGTS to BRL300,000 and the paper has even said that that might be discussed in the next meeting of FGTS board. So what do you expect for the limit of funding of FGTS in the short term that would include the 20% of your units that are not qualified for FGTS right now?

And the second is about pro-soluto. When do you think we can see a change in the growth of pro-soluto after keys? Before keys, it continues to grow, but the after keys is not. So given a harder sales scenario when do you think that this inflection point will occur?

A - Unidentified Speaker

Hello, Luiz Mauricio. I will comment on your first question. First thing I would like to remind you is that, of course that FGTS is widely discussed right now, but we don't believe in a quick harsh change in the short run. The fund has a high liability in (inaudible). So if there is

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a change, this will be a gradual change for new deposits. And this will happen in the middle and long run, if it happens.

We do not believe that they will -- we at the Company do not believe, we have been part of these discussions, we don't believe they will increase the ceilings of FGTS for other levels. There's been a wide discussion about it. FGTS has always been directed to the lower income population and this trend probably will not change. As for the pro-soluto, I will start and then Rafael can continue. We're close to the volume of pro-soluto regarding receivables, very close to what we will be. We have had growth in the last three quarters since we became more aggressive in transfers, which as a consequence of these transfers to banks that are quick the pro-soluto volume grows. But we are close in terms of percentage of receivables. We're close to the level at which it will remain.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Luiz, good morning. Now completing what Leo said, pro-soluto is part of our business. Financing has a maximum of 70%, so the Company has to carry a portfolio financing.

In terms of post key pro-soluto, we still have a reasonable amount of units that have a higher pro-soluto post key. As we are able to implement the simultaneous sales project all over the Company then the transfers will happen shortly and the backlog of units that have a higher pro-soluto are finished, naturally pro-soluto will continue to happen. Today it's around 14% of the volume of units. But since we sell quickly and transfer quickly, the post key pro-soluto will decrease in the long run. But it's closely related to the cleaning of the backlog at units that had at higher values.

So if you allow me to make a comment regarding the first question, since you don't expect a correction of FGTS, so there wouldn't be any correction that could come -- any change in the ceiling maybe lower than 300,000 but something higher.

As for the second question, you mentioned the inflection, but as to considering the scenario for sales, you don't see a need for pro-soluto to continue to grow. So you see the inflection upon close, the turning point. Well, as for the market of My House My Life, I cannot say the true date.

(inaudible) has been in conversations with the government. Given the importance of the My House My Life government and the fact that the levels, the ranges for My House My Life qualification are a bit -- they haven't been corrected for inflation, adjusted for inflation, we believe that this adjustment will happen. We believe we will be close to the 20%. And the sales of products is a bit lower. Considering the expected limits in many towns we believe that we'll increase the speed of sales.

Regarding the pro-soluto, the Company is not granting more credit. The current rules of the Company are the same that we had one year ago regarding financing. We plus FGTS have to add to this -- complement this 20% of the value of the unit since now funding from FGTS is limited to 80%. So as to sales and we have some more losses on our side, we won't relax in terms of a pro-soluto. We will continue to work with the same model we have been working in the last months.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Okay, thank you.

Operator

(Operator Instructions). Mr. Lucas Dias from Fator Bank would like to ask a question.

Q - Lucas Dias {BIO 19078862 <GO>}

Good morning. Please comment on simultaneous sales. Do you believe it will stabilize around 90% that we saw in April or do you consider a possibility to increase to 100% in the short-term? Thank you.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Lucas, good morning. This is Rafael speaking. When we talk about a project that is relevant for the operation, the project that started at the end of 2013 and since the second half of last year, the increase in simultaneous sales became more important in our business. The first quarter of 2015, it reached 80%; in April close to 90%. We expect that this percentage will continue to grow and will be close to 100% in the third quarter, not a 100%, but close to in the third quarter of 2015. We are making all efforts towards that.

Q - Lucas Dias {BIO 19078862 <GO>}

So you think that -- how much is the transfer to banks around now?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

The profit in the transfer to banks is much faster. We are able to transfer most of sales within 90 days, nine-zero. So that will accelerate cash generation. Because the longer we take to transfer, the greater the chance for customers to give up or lose their credit capacity. So it's essential to transfer that as shortly as possible from the sale date.

Q - Lucas Dias {BIO 19078862 <GO>}

Okay. Thank you.

Operator

(Operator Instructions). Mr. Daniel Malheiros from Votorantim will ask a question.

Q - Daniel Malheiros {BIO 18660708 <GO>}

Good morning every one. My question is related to cancellation. We see cancellations growing year-on-year, quarter-on-quarter, if you could give us some comments on what you see for the future. And in terms of transfers from Banco do Brasil and Caixa, in the first quarter and how this used to be in the past? If you could disclose these figures it will be very interesting? Thank you.

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A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Rafael speaking, Daniel. Regarding cancellations, the Company is not worried about cancellation. In our opinion, cancellations are an opportunity to generate cash. As the market remains active, we are able to cancel, resell and transfer those units very quickly. So while the scenario remains like this, cancellations are not much of a concern for us. We have a backlog from banks.

Regarding the savings account, in the past we had a change in the policy. So the Company has a backlog of units that we're having a more of a hard time transferring. So we're being more aggressive, having less tolerance for these customers because the market remains strong and active. So we're still able to resell slightly above the original contract price. So cancellations, for us, are not a problem, are an opportunity for us now.

As about the cash division between Caixa and Banco do Brasil, we try to keep it 50%-50%. That varies quarter to quarter. It depends on whether contracts are signed with one bank or the other. But both banks are very close to 50% in terms of financing.

Q - Daniel Malheiros {BIO 18660708 <GO>}

Okay. Thank you.

Operator

(Operator Instructions). Nicole Hirakawa from Credit Suisse has a question.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Good morning everyone. I know that pro-soluto has been widely discussed. But I would like to have an update regarding default and receivables post keys and the total amount. And also about cancellations, I would like to ask that there is a backlog of units that pending -- that have been cancelled and there are pending of transfers, right, if you could quantify that how does this figure compare to one year ago? Thank you.

A - Unidentified Speaker

Nicole, we try in terms of duration, we're trying to place all units in terms of pro-soluto. We try to sell them during the construction phase. Those that are cancellations, of course, we cannot do that, because the units have a longer-term. But this is an analysis we do very specifically for each sale and each contract, but we go up to 24 months in some specific cases.

We have not seen any major change in the default of pro-soluto. It remains at the same levels, but once again it's important because the income level for people who we sell have a clean financial profile, not having being in default, it's very important for these people.

As for cancellation, the Company expects to have a volume of cancellations in 2015 close to what we had in 2014. This backlog includes customers that love the capacity of being

transferred and this will look comparing 2015 to 2014, the major change is the growth in simultaneous sales. Simultaneous sales with cancellations, we have a good background. The cancellations of simultaneous sales is below 20%. So as simultaneous sales grow and the backlog of these former sales decrease, cancellations go to the same level of simultaneous sales. But this won't happen in 2015. In 2015, we have the results similar to what we had in 2014. In 2016, figures will gradually improve reaching the figures that I mentioned earlier, below 20.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Okay. Thank you.

Operator

(Operator Instructions). Mr. Fred Mendes from HSBC has a question.

Q - Frederico Mendes {BIO 19832788 <GO>}

Good morning. I have two questions. First regarding the provisions for this quarter, 2 million. So I would like to then in theory this -- an informed buyer of MRV wouldn't go to court. So what can we expect regarding delay in construction?

And the second question, the allowance for customers increasing 25 million, there's been a change in IGP-M, you're transferring quicker. We thought that this -- you don't have INPC but it has been increasing. So if you could say something about that, it would be great. Thank you.

A - Unidentified Speaker

Okay. Starting with the financial revenue, the difference is IGP-M, yes, it's true that we are transferring more. This portfolio is the same size, but with inflation and so on, if it continues as it is, it would grow. Yes, it will be the same, but IGP-M has been much higher in this quarter.

As for civil, the court contingencies, lawsuits, yes, our customer is well-informed. They are in the social networks. These expenses with lawsuits and we have construction works that did not finish in 2012, 2013, it take some time for customers to file a lawsuit and then we have the case solved.

We have this allowance that is there for things that will happen in the next quarters. I don't think this figure will decrease in the next quarter or the following one, but what's most important is that we're no longer creating these liabilities. So these provisions and expenditures will happen now, but we are not creating any problems for the future. So it's very important to have everything aligned with the banks and transferring the financing to banks quicker. This will happen at the right time. It won't create further problems for us.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

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This is Rafael speaking, complementing on Leo's answer, it's important because the Company is paying commission on sales. The main cause for lawsuits against the Company is lawsuits for commission payment. So the transfer is made, the commission was paid by the customer and that gave rise to a high level of contingencies regarding lawsuit. In the half of last year, we changed the procedure, but of course, we still have this large liability of units that were sold into last year.

So despite the fact that the contract is very clear regarding this topic, in some areas of the country, courts have a different understanding. And we still -- we'll have this liability for quite a while regarding these commission.

To making it more clear, in some regions decisions from court are favorable, in other regions are not favorable. So decisions are not the same all over the country.

Q - Frederico Mendes {BIO 19832788 <GO>}

Okay, thank you. Rafael, if you allow me to make a quick follow-up on the provisions, so just to understand, when you mentioned brokerage fee or commissions, now that you have changed this process, now when you say brokerage fees because the construction was late and then the customer just file a lawsuit encompassing everything or is the lawsuits just for the payment of brokerage fees?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Fred, we have all kinds of situations. Our main issue is regarding brokerage fee. In some cases, the customers want us to pay brokerage fees, the penalties for delaying payments. But most of the cases are regarding brokerage fees, payment of brokerage commissions for past sales.

Operator

(Operator Instructions). Marcelo Motta from JP Morgan has a question.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. A quick question, if you could detail what has happened in this project in Campinas, the SPE because you mentioned as a non-recurring item. Could you tell us exactly what happened in that project first to understand?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Marcelo, this is Rafael speaking. We have launched a large development in Campinas some years ago. We had all the documentation, everything, but Campinas is a difficult city, not only MRV, but many construction companies had issues because there was a local lawyer from the government and they really stopped the construction for three years and we made an agreement with some customers that had purchased the items. So this agreement was made 50% with SPE and we had this non-recurring effect given this fact.

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(Operator Instructions). Mr. Eduardo Silveira from Banco Espirito Santo has a question.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Good morning. I have two follow-ups. First regarding other expenses line. We see a level of 25 million per quarter. I know there is no guidance. But if you could give us an idea of what trend for 2015 for that line? And the equity income, I know that the project in Campinas may have had an effect, but about Prime [ph] to 6 million negative in the quarter, what is the expectation for the remaining of the year? Thank you.

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

We don't give guidance, but this line of other expenses and revenues will probably remain at the same level during the year. It will decrease throughout the year, but it will be a slow process.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good morning. This is Rafael speaking. Regarding equity method, equity income, Prime has had a better performance this quarter than in the previous quarter. Prime has a large development in Brasilia. The market of Brasilia is awful, absurd levels of cancellations. We sell with prices lower than the original price, but with the closing or finishing the construction from now on, we see an improvement in this line. Prime in one area, for example, Cuiaba, has a much better performance. It has improved throughout last year. We have the group of executives of the Company in the midwest of the country to really work on execution. So we expect Prime to perform better throughout this year regarding the equity income.

As for other subsidiaries and the local performance, we haven't had any major surprises regarding this non-recurring event in SPE in Campinas in the first quarter of 2015. So summarizing, we expect a development, an improvement in the equity in the earnings of affiliates line of our balance sheet throughout this year.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Okay. Thank you.

Operator

Thank you. The time for the Q&A session has ended. I would now like to pass the floor to Mr. Rafael Menin for his final remarks.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

So first, I would like to thank you all for attending this call. As we always say, the Company remains optimistic about the future. All the business areas continue to operate at very good levels. The Company has made good launches, selling well. We are keeping our construction levels. We are transferring -- we have a healthy operations, good profitability. We continue to generate cash. 2015 is a challenging year. The Company entered this year with a very strong, with a low leverage. So we are ready to go through this challenging

year in a good way. And as soon as we have a better economic condition, we will be ready to accelerate our growth. Thank you very much for attending. Have a good day.

Operator

Thank you. The earnings release conference call for MRV for the first quarter of 2015 has now ended. We thank you very much for attending. Have a good day.

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