

Q1 2017 Earnings Call

Company Participants

- Raphael Abba Horn, Co-Chief Executive Officer
- Unverified Participant

Other Participants

- Enrico Trotta, Analyst
- Luis Stacchini, Analyst
- Victor Tapia, Analyst
- Wilfredo Jorel Guilloty, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we'll discuss the first quarter of 2017 earnings results. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time. 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, May 11, after the close of the BM&FBOVESPA's 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 the 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 international markets, and therefore, are subject to change.

With us today are Mr. Raphael Horn, Co-CEO; Mr. Paulo Eduardo Gonçalves, (00:30) Chief Investor Relations and Structured Finance Officer; and Mr. Miguel Mickelberg, CFO.

I will now turn the floor over to Mr. Raphael Horn. Mr. Horn, you may now begin.

Raphael Abba Horn {BIO 19714328 <GO>}

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Good morning. At the beginning of 2017, the reforms proposed by the government were the main political discussions. Such reforms are undoubtedly essential for the country's fiscal health. We hope they will be approved without major compromises.

Looking at the macroeconomic scenario, interest rates have already dropped by 250 bps (02:43) in the first quarter and they can decrease even further. And consumers are starting to see lower interest rates, but the decrease was still modest. When the unemployment rate stabilizes and financing interest rates drop, then the environment and the sector will become healthier.

In this quarter, the company delivered 13 projects with 1 billion PSV. Cancellations are still high, totaling BRL 500 million in the quarter. We continue to adjust our landbank, cancelling or selling parts of land that are not compatible with our core interest and purchasing landbanks selectively. We have more construction savings with an impact of BRL 29 million on our revenue.

The highlight in this quarter was cash generation. With a positive position of BRL 115 million and we hope this trend will continue along the year. This is our priority to keep on adjusting our capital structure.

Even in such a difficult environment, we have been launching products assertively. In this quarter, the highlights was Heritage projects and the (03:48) neighborhood in São Paulo in a partnership with Cyrela and (03:52). It is an extremely high-end project, an icon in the city of São Paulo. Let's now present our financial results.

On slide 5, we'll address Cyrela's consolidated results. We launched BRL 600 million, the same volume year-on-year. We launched three new products, two in the city of São Paulo and one in Rio. Excluding swaps, the volume launched in Cyrela's share was BRL 530 million, up by 34% year-on-year. The company's share and the volume launched in the first quarter was 88% compared to 67% year-on-year.

On slide 6, we highlight the launch of the Heritage project in São Paulo. As I already mentioned, this is an unique project and it will become an icon in the city.

On slide 7, we will address sales speed. The company's SoS and the higher sales were BRL 520 million, 4% lower year-on-year. Excluding swaps, sales amounted to BRL 370 million in the Cyrela's share, a 9% reduction year-on-year. São Paulo and Rio accounted for 86% in our sales in the quarter.

Now on slide 8, we'll address sales speed. The company's annualized SoS was 29%. Looking at sales speed by period, projects launched in 2016 have been over 60% sold.

On slide 9, we'll address Cyrela's total inventory. At the end of the quarter, inventory at market value totaled BRL 6.6 billion, up by 1.7% or 2% quarter-on-quarter. The change in our inventory can be seen on the chart on the right.

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On slide 10, we have a breakdown of our finished units. In the quarter, we sold 8% of the 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 increased by 2% quarter-on-quarter. We are aware how important this matter is to the company and we'll keep on focusing our efforts on this product. Rio (06:30) on the Northeast region accounted for 39% of the finished units.

On slide 11, we'll talk about delivered units. Cyrela delivered 13 projects and 4,400 units. In the quarter, the delivered units accounted for PSV of BRL 1 billion, down by 56% quarter-on-quarter.

I will turn the floor over to Paulo (06:53) now, who will present our financial results.

Unverified Participant

Thank you, Rapha. Good morning. On slide 113, we'll present our financial results. Gross revenue was BRL 712 million in the quarter, down by 25% quarter-on-quarter, and 14% lower year-on-year. Gross income in the quarter was BRL 215 million, down by 19% quarter-on-quarter and 24% lower year-on-year.

The company's gross margin in the quarter was 31.1%, 2.3% higher than the 28.8% from the previous quarter. Net income in the quarter was BRL 4 million, down by 87% quarter-on-quarter and down by 93% year-on-year. Thus, our net margin for the quarter was 0.6% compared with a 3.4% margin of the fourth quarter of 2016 and the 7.6% margin of the first quarter 2016.

Please go to slide 14 now to see our profitability. In the first quarter of 2017, our return on equity measured as the net income of the past 12 months over the average shareholders' equity was 1.6%, and our EPS was BRL 0.01.

On slide 15, we'll talk about our customers' financial solutions. In this quarter, transfers, trust of deeds and payoffs amounted to BRL 742 million, 15% lower quarter-on-quarter and 13% higher year-on-year. Considering units, transfers, trust of deeds and payoffs totaled 3,200 (08:43) units, 60% lower quarter-on-quarter and 11% higher year-on-year.

Slide 16 shows the company's cash generation. In the first quarter of 2017, our cash generation reached BRL 158 million versus BRL 156 million quarter-on-quarter and a cash consumption of BRL 13 million year-on-year.

On slide 18 we address our indebtedness. Gross debt at the end of the quarter was BRL 3.5 billion. The cash position was BRL 2 billion, thus, our net debt was BRL 1.5 billion. Of the total gross debt, 61% relate to loans for construction and 66% is long term. Our net debt over equity ratio was 22.7%, 2.4% lower 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.

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

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Enrico Trotta with Itaú BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Hello. Good morning, Paulo, (10:51) Miguel and Rapha. I have two questions. First one is related to finished units. It improved in the first quarter 2017. You said there was a higher level of sales ever since 2015. So I would like to know the main reason for that. I would like to know if that is related to the economy, scenario or if you have a more aggressive policy now in terms of discounts to accelerate the finished units. So that would be my first question. But I would also like to know about your expectations in terms of finished units and what do you expect for the second quarter of 2017 and the other quarters as well?

The other question is related to Cury. Cury had a good performance in this quarter, so I would like to know more details as well about Cury's first quarter. And also your project pipeline. I would like to know what we can expect for Cury along the year?

A - Raphael Abba Horn {BIO 19714328 <GO>}

Hello. Good morning, Enrico. This is Rapha. When it comes to finished units, you asked if we increased discounts, and the answer is no. We are keeping the same policy. We have been keeping this policy for a long time. We are pragmatic.

I believe this is the beginning of a new trend. We are getting more and more finished units, and most cancellations occur along the year. Our delivered units will decrease, and the finished units will increase, so we are always able to sell finished units, but our inventory is increasing more and more. But it is natural that they will be sold over time, and that is our focus. We want to generate cash selling finished units, so this is going to start happening. But the major problem is those delivered units. That's where we have the cancellations, and no one in the sector can seem to solve this issue, but the finished units will be sold eventually. I believe that is a trend. Cash generation will come exactly from that point. I believe I answered your question.

Now, when it comes to the second quarter, unfortunately, April was a really tough month. Many holidays. So this was a very tough month, and that happens with every sector. So the second quarter started in a tough position, but maybe we'll recover in May and June.

Now, Paulo (13:51) will answer your question about Cury.

A - Operator

Now, when it comes Cury, the result was BRL 7.5 million in the equity income, very similar to the first quarter of 2016. So you can expect of results similar to those that we have in 2016.

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay. Thank you very much, Rapha and Paulo. (14:15)

Operator

Our next question comes from Nicole Hirakawa with Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Hello, this is actually Luis, not Nicole. I also have a couple of questions. The first one is related to the constructions. You said it was one of the main drivers for cash generation and constructions will drop along the year. So I would like to know more details about that. I imagine the delivery dynamics will be different along the year and the construction expenses will drop even more. So I would like to know about your expectations in terms of keeping the income coming in so that you can generate more cash along the year.

And the second question is related to an update of what you think is going to happen in terms of the bank's appetite. Do you see an improvement in the financing conditions, maybe the interest rates are dropping, I would like to know what is happening in the banks, the savings accounts, dynamics are getting better, are improving. But on the other hand, in the first quarter, we saw a drop in the number of financing. So I would like to know what do you expect in the month of May or what happens in April. So I'll let you know of more details about that.

A - Operator

Hello, Luis. This is Paulo. (15:49) Now answering your first question about cash generation, what happens is, we are decreasing receivables due to the drop in sales, but the construction expenses are going to drop even further. So it would take our position in the December of 2016, for example, our cost for the next 12 months was BRL 2.2 billion. Now December 2016 was BRL 1.4 billion, now March 2017, it is BRL 1.3 billion. So our construction expenses are driving a lot, and that is one of the main cash generation drivers. Of course, we need to sell finished units to generate cash as we expect. But everything is going as plan, and as we had mentioned in the conference call of the fourth quarter of 2016.

Now when it comes to the bank's appetite. Well, if we look at the situation from a macroeconomic perspective, the basic interest rates is dropping. The savings accounts are not dropping as they did last year, and we delivered many projects in the previous year. And that has many - that generates many payoffs, and that contributes to a drop in interest rate.

In some cases, we can see some reductions. For example, Bank of Brazil, Banco do Brasil, announced a project - actually two projects in Santos and in San Bernardo, and there is

another private bank that has announced lower rate as well for some products. So this is not a quick change. It is not going to happen overnight, but it is already happening.

Q - Luis Stacchini {BIO 18717891 <GO>}

Okay. Thank you very much, Paulo. (17:51) Have a good day.

Operator

Our next question comes from Jorel Guilloty with Morgan Stanley.

Q - Wilfredo Jorel Guilloty

Hello. Good morning. I have two questions. The first one is about cancellation. What are the regions where you have higher cancellation rates? And when do you believe that those rates are going to decrease? And what is going to drive such decrease?

A - Raphael Abba Horn {BIO 19714328 <GO>}

Hello, this is Rapha. Cancellations in Brazil as a whole – in the U.S., we don't have as many cancellations. But here in Brazil, the dynamics are very similar. Well, actually, we can't see a region that has higher rate than the others. This is a general problem. The economy, the regulations, and many other issues are involved. And we are suffering because of that.

In São Paulo, in Rio, in the Southern region, the dynamics are very similar. Maybe in the North and Northeast we have higher rates. But, in our case, that's not the case anymore, because in the North and Northeast, we already have all finished units, so, we don't have cancellations in finished units.

In São Paulo, Rio, and the Southern region, everything is the same. It really depends on the segment and the income of the customers. But in terms of region, everything is very similar. Now, our expectations for improvement, it really depends. If regulations change, it may improve sooner. But if we don't have any changes in the regulation, cancellations are going to drop only in absolute numbers, because we are decreasing deliveries. So we are going to have a fewer cancellations because we are delivering fewer units. In 2017, we are going to have fewer cancellation because our volume dropped in comparison to 2016.

Now, the more recent the period and the launch is the lower will be the price and that may drive decrease in cancellations because those who purchased units in 2016, we are going to see fewer cancellations. And the third reason is the economy, if the situation improves, if the reforms are approved, and if we have a good administration in 2018, naturally, the economy is going to get back on its feet and cancellations will decrease.

Interest rates may help us as well. So we have many different scenarios involved, first, regulation, and the second is fewer deliveries, and therefore, fewer cancellations, and then the recovery of the economic scenario, then naturally cancellations will drop. I hope I answered your question.

Q - Wilfredo Jorel Guilloty

Yes, you did. Thank you very much. And the second question is about landbank. You were still purchasing plots of land. You acquired eight in the first quarter. So you have a landbank of around BRL 50 million. So I would like to know your pipeline for Rio de Janeiro. What is your vision about the launches in Rio to use the landbank. When do you think you're going to be able to develop landbank?

A - Operator

Can you please repeat your question?

Q - Wilfredo Jorel Guilloty

Well, the question is about landbank because you have a potential PSV of BRL 50 million and most spots of land are in Rio de Janeiro. So I would like to know basically when you expect that you're going to develop the landbank in Rio de Janeiro? When are you going to start constructions?

A - Operator

Okay. I'll answer both questions. Many people said that we have been purchasing many plots of land, but that is not true. That's not the case. People in the market say that - I don't know if you heard about 444 rule, but the idea is to reduce our asset, our property and pay dividend, generate cash and launch around BRL 3 billion or BRL 4 billion. So that is our strategy, and that is not aligned with purchasing a lot of plots of land.

So we are not purchasing landbank, we are being very selective. But obviously, if we have a good landbank at a good price, of course, we are going to consider it. But the 444 rule makes sense for us. Now in terms of launching products in Rio, that is a more complicated question. Rio de Janeiro, in the neighborhood Barra da Tijuca, is in a deep crisis right now. And it is not going to finish anytime soon. So that is not going to generate launches for us in the short term.

Q - Wilfredo Jorel Guilloty

Okay. Thank you very much.

Operator

Our next question comes from Rodrigo Fraga (23:52) with Citi.

Hello. Good morning. Thank you for the presentation. My question is related to your perception when it comes to the prices in the market. Are they flat? Are they stable? And in some regions, we see lower prices. How can you relate that to your products? Are you going to focus specifically on one segment and what do you think about the reaction of the market in terms of discounts? Do you think that would be a strategy to get discounts to self-finished units? Will that be a strategy for you in some region?

FINAL

Hello. Good morning, Rodrigo. When it comes to prices, I believe this is more related to our feeling. Our impression is that prices cease to drop unless in nominal terms, not only in relation to the inflation rates and (25:10) drop. Now, if prices are going to keep up with the inflation rates or not I can't tell anything about that. But now, I believe that we are stable at 8%, now if 8% is going to keep up with the inflation rates, I don't know, but inflation rates are not going to be at that high, but again, this is just about our feeling.

Now, when it comes to finished units, I believe that we have already talked about that extensively. This is a pragmatic strategy. Prices drop in nominal terms, in Rio terms. So, of course, this is a constant trend. We want to have the most appropriate pricing that we can have, but of course, the prices have dropped. We all can see that, but we are not going to do anything different in the second quarter or in the first quarter. It's the same thing that we have been doing for the past two or three years. We are going to add value to the shareholders, but we need to adjust to the reality of the Brazilian market as well. So we don't have anything special about that and that's it.

Okay. Thank you very much.

Our next question comes from Victor Tapia with Bradesco.

Q - Victor Tapia {BIO 20566083 <GO>}

Hello. Good morning. Thank you for taking my questions. Now, going back to the landbank, I saw on your release that you acquired eight plots of land and two of them are in Rio de Janeiro. I would like to know more about the profile of the products to be built in those plots of lands especially in Rio de Janeiro because we have a challenging situation there. So I would like to know about the selection of the products. Are they going to be low income?

A - Operator

Well, we are not going to disclose much information about the segments and what we are going to do, because that is confidential information. That is really to our strategy. But in the macro scenario, the crisis that we have in Barra da Tijuca neighborhood in Rio is very serious. So, of course, in that neighborhood, there is nothing we can do in our opinion for a long time. So we are not going to do anything there.

Now, in the other regions of Rio, they have a similar dynamics, it is similar to the rest of the country. For example, São Paulo in comparison with Barra da Tijuca, São Paulo is performing better and the Southern region as well. Now if we think about the rest of the market in Rio, excluding that neighborhood, everything looks the same. And excluding that neighborhood, the market is regular. It is a market of a country in crisis.

We have opportunities and challenges and et cetera, so we need to be very selective and we need to think about Rio de Janeiro and that neighborhood specifically separately. It doesn't mean that the market in Rio is good, it is as tough as the rest of the country. But that neighborhood is having a poor performance than the rest of the country.

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Q - Victor Tapia {BIO 20566083 <GO>}

Okay. Thank you very much.

Operator

If there are no more questions, I would like to turn the floor over to Mr. Horn for his final remarks.

A - Raphael Abba Horn {BIO 19714328 <GO>}

Thank you again for your interest in Cyrela. Cyrela, as any Brazilian company, is excited about what has been happening in the country. And again, things are still not good. They are far from being good, but I believe we are getting back on our feet and we should be hopeful. This is our current scenario of the market itself. We are going through a deep crisis, but I believe that all Brazilians are getting excited about the future, so let's hope the reforms are approved. Let's hope Brazil gets back on its feet and let's try to do our best in this scenario. Thank you very much. See you in the next call.

Operator

That concludes Cyrela's conference call for today. Thank you very much for your participation. You may now disconnect. Thank you.

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