

Q3 2020 Earnings Call

Company Participants

- Miguel Mickelberg, Chief Financial Officer
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Elvis Credendio, Analyst
- Enrico Trotta, Analyst
- Marcelo Motta, Analyst
- Nicole Inui, Analyst
- Raul Grego, Analyst
- Thais Alonso, Analyst
- Ygor Altero, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we'll discuss the Third Quarter of 2020 Earnings Results. At this time, all participants are in a listen-only mode. And later we'll 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 at 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 the participants connected abroad. The earnings release published yesterday on November the 12th, after the closure of the B3 trading session, can also be accessed at 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 forecasts and operating targets related to its financial growth potential and prediction based -- are predictions based on the management's expectations about the future of Cyrela. And those expectations are highly dependent on the domestic market conditions, the general economic performance of the country and international markets and, therefore, are subject to change.

With us today, we have Mr. Raphael Horn, the Co-CEO; and Mr. Miguel Mickelberg, our CFO. I will now turn the conference over to Mr. Horn. Mr. Horn, please, you may now begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning. Well, although the third quarter of 2020 was still marked by the pandemic, the coronavirus situation improved slightly in Brazil in comparison to previous months. The number of recorded cases dropped, allowing social isolation to decrease partially and the economy to reopen accordingly. As a result, most industries in Brazil recorded increased activity.

In addition, the financial and monetary authorities introduced cash transfer programs and liquidity injection measures with a significant impact in the Brazilian economy. Driven by the improved situation, the civil construction industry performed very well during the third quarter of 2020, even though no permanent solution for the global health crisis has been reached. During the quarter, our operating data improved significantly. Launches totaled BRL2.6 billion, 46% higher compared to the same period last year. Sales rose even higher during the same period by 58%, equivalent to BRL2.5 billion.

As far as earnings are concerned, Cyrela reported net income of BRL1.4 billion, driven by sound operating results and nonrecurring revenues. In this regard, a major highlight in 3Q '20 was the successful IPOs for primary and secondary distribution of common shares of the joint ventures over the last few years: Lavvi, Plano & Plano and Cury. In addition, those IPOs boosted cash generation in the quarter, which totaled BRL745 million.

With interest rates at unprecedented low levels in Brazil and commercial banks cutting mortgage rates for clients, we are moving towards quarter four and '21 with good prospects. As the civil construction industry recovers, we are well prepared and positioned to create value for our shareholders and make Cyrela an increasingly profitable, sound and long-lasting business.

Miguel Mickelberg {BIO 20023910 <GO>}

Now I will comment on our operating results. Thank you, Raphael. Good morning. Slide 5 will address Cyrela's launches in the 3Q '20. We launched 28 new products with a PSV of BRL2.589 billion, 46% higher than year-on-year. Excluding swaps, the volume launched in Cyrela's share in 3Q '20 was 3% lower year-on-year. Company's share in the volume launched in 3Q '20 was 73% compared to 70% year-on-year.

On Slides 6 to 9, we would like to highlight the main launches. All of them were at least 50% sold during the quarter.

On Slide 10, we will talk about our sales performance. In the 3Q '20, presales came to BRL2.446 billion (sic) BRL2.456 billion [ph], 58% higher year-on-year. Excluding swaps, presales amounted to BRL3.1 billion in Cyrela's share, a 2% decrease year-on-year. And the state of Sao Paulo accounted for 72% of our sales.

On Slide 11, we'll address the sales speed. The company's annual SoS was 53.7%. And looking at the sales fee per period, projects launched in 3Q '20 have been 57% sold.

On Slide 12, we'll address Cyrela's total inventory. At the end of the quarter, inventory at market value totaled BRL59 billion (sic) BRL5.9 billion [ph], 3.2% higher quarter-on-quarter. The change in our inventory can be seen in the chart to our left.

On Slide 13, you can see the breakdown of our finished units. In 3Q '20, we sold 19% 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 decreased by 6% quarter-on-quarter.

On Slide 14, we'll talk about delivered units. In 3Q '20, Cyrela delivered 17 projects, totaling 4,400 units and a launch PSV of BRL1.2 billion. Year-to-date, over 10,000 units were delivered in 39 projects, which represented a launch PSV of BRL2.5 billion.

On Slide 16, we'll present our financial results. Our net revenue was BRL1.164 billion in the quarter, 99% higher quarter-on-quarter and 6% higher year-on-year. Year-to-date, net revenue amounted BRL2.279 billion, 9% higher year-on-year. Gross income in the quarter was BRL379 million, up by 114% quarter-on-quarter and 72% higher year-on-year. Year-to-date, gross income was BRL729 million, 14% higher year-on-year. Our net profit totaled BRL1.403 billion in 3Q '20 compared to a profit of BRL68 million in 2Q '20 and BRL104 million in 3Q '19. Year-to-date, our net profit totaled BRL1.499 billion.

Please go to Slide 17 to see our profitability. In 3Q '20, our return on equity was 29%.

On Slide 18, we can see our debt. Gross debt at the end of the quarter was BRL2.432 billion. The cash position was EUR2.396 billion; thus, our net debt, BRL36 million. 76% of the total gross debt is long term. Our net debt over equity ratio was 0.5%, 15.4 percentage points lower quarter-on-quarter. This low debt level confirms Cyrela's financial solidity and puts us in the right path to maximize return to shareholders.

Slide 19 shows our company's cash generation. In 3Q '20, our cash generation totaled BRL745 million versus a cash consumption of BRL61 million in the previous quarter.

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

Questions And Answers

Operator

Ladies and gentlemen, we shall now start the question-and-answer session. (Operator Instructions) Our question comes from Ygor Altero from Santander.

Q - Ygor Altero {BIO 21419045 <GO>}

Hi, there, folks, good morning. Thank you for your presentation. And the first point that I would like to talk to you about was with regards to the plots of land, prices in Sao Paulo and which of the neighborhoods do you still see as attractive alternatives.

And the other point is about the gross margin dynamics because we do see a rather dynamic market, but you've been increasing prices. So what is the dynamic for the future? Do you think that this price dynamic could have an impact on the cost increment? That's what I had to say. Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Ygor, this is Raphael here. Thank you for your question. Well, those questions about neighborhoods in Sao Paulo, I'm not that sure how strategic it is. We really cannot foresee which neighborhoods will interest more than the other. But of course, we know -- we all know that there is a lot of competition, and there is a fierce competition. So we knew that this was going to be like that, and it's good for people to just stick to their opportunities, being disciplined. There's no magic trick. There is no silver bullet to it. It's just really being focused and doing things accordingly.

Many of the IPOs actually were shortened. And if we do, in the near future, have many IPOs in Sao Paulo, then the competition will grow even fiercer. And the main players who are capitalized, we all know who they are, but they are the same as always, but nothing really has changed much. And the higher your cash flow, the more powerful you are. And it's never been easy. So it will keep on like that.

Now on the margins, indeed, we think that the prices are going up by the margin. So for the high middle class, it doesn't seem that the INCC is going to be the great boom. And for the Minha Casa, Minha Vida, the transfers might reduce and margins can go down. Anything to add?

A - Miguel Mickelberg {BIO 20023910 <GO>}

No. I think that the cost pressure is reflected here at the INCC. And the operational leveraging, certainly, allows us to transfer that to mid- and high-income ranges. And that's why we have been seeing the significant price increase lately. And at Minha Casa, Minha Vida, it's even harder for us to contain the inflation thrust.

Q - Ygor Altero {BIO 21419045 <GO>}

Thank you, Miguel. Thank you, Raphael.

Operator

Next question comes from Elvis Credendio from BTG Pactual.

Q - Elvis Credendio {BIO 20084266 <GO>}

Good morning, Raphael. Good morning, Miguel. Two questions in my end. First, on capital allocation, because we've seen this very strong cash generation at the quarter. And so if you could comment on that, how do you see this capital allocation from now onwards? Do you think in investing on plots of land or increasing the emission of dividends or any other destinations to this capital? It would be good to know your intentions.

And my other question is about Vivaz. I'd like to know what is the size and the magnitude of your operation in terms of launches from now on. And do you need to buy more plots of land in order to reach that level? And hooked up to that, how do you intend, if you do intend, to procure more plots of land? Is this also involving more cash? Or do you have any other plans for that?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Elvis, this is Miguel speaking. With regards to the capital allocation, indeed, with the cash generation we had in the last quarter, pretty driven by the IPOs, we now have leveraging, which is lower than the target that we are used to working. But we understand this is somewhat temporary. And we know that the flip side of having leveraging is that you have a lower -- have your balance, which is slightly harder for us to profitabilize. But we see that the market is rather positive. We have many capitalized players, as Rapha just mentioned. So in time, we hope to adjust the structure to levels that we think are more adequate. And that can happen either through cash consumption or dividend distribution, but we still don't have an exact time line to do that.

A - Raphael Horn {BIO 19714328 <GO>}

On the Vivaz question, well, we are far from being the most focused company on planning and on guidance. In other words, we don't want to launch on two B1, three B1s [ph] or so on. We are more -- much more bottom-up than from top down. So we have no targets for Vivaz or living or middle class. It's just hard work and love for the plots of land. So -- and the name of the segment really makes no difference to us. So we are in Sao Paulo, and we are present in every segment. So we are on the streets and working. So the important -- the name of the segment really makes no difference to us. It's really rolling up our sleeves. And if we look at the plot and we like it, we procure it. We buy it, and it's pretty much the same for high end or middle class. And it's not because we don't want to do that for the market. It's just that internally, we don't work with those figures. This is how we are. We try to do our best, and that's it. So we don't really have this ambition or this size commitment or anything.

Q - Elvis Credendio {BIO 20084266 <GO>}

Okay. Thank you, Raphael for clarifications. And Miguel, thank you.

Operator

Next question comes from Enrico Trotta, Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Raphael. Good morning, Miguel. Two other questions and slightly more specific about the results. First, with regards to your commercial expenses and the sales expenses, we could see that in the quarter and year-over-year, sales are relatively low compared to the growth margins of the launches and the sales in the Q3. So what I'd like to understand in this first question, is there anything which has been sort of trapped? Or do we really have to expect lower sales expenses? Is this something because of the -- and so that is question number one.

The second question is more specifically about the financial results, and that was pretty strong. And then you basically explained the cash made. And could you just explain this impact on the financial results? Why is it that you think that the impact was so impressive right now? And what is it that we can expect for the next moves?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Enrico, this is Miguel speaking. As for the cash and the commercial expenditures, we were indeed pretty surprised by the efficiency part because the sales were very good, in part, because we were able to optimize the expenses in the online. Hard to say that this is a trend. Over the next launches, we'll keep using and resorting to the same budget. We don't know whether we'll have those savings, but a good market definitely helps. We'll keep on imagining that the businesses stand mixed with online. So it's a bit too early to say whether the level is going to change.

With regards to the cash made, we had an expressive volume of financial revenues that involved some subordinated premium operations, some accounting issues. But indeed, the result was slightly higher if compared to our run rate. But that's what I think. The operation has been growing, and this should contribute more to our results.

Q - Enrico Trotta {BIO 16742911 <GO>}

Thank you, Miguel. Thank you very much. Good morning.

Operator

(Operator Instructions) Next question comes from Nicole Inui, Bank of America.

Q - Nicole Inui {BIO 17757166 <GO>}

Good morning. Thank you for your call. Congratulation for the results. I have two questions. The first one is with regards to the finished units that you were able to accelerate the sales over the Q3. How do we envision that from now onwards and in the fourth quarter?

And the other one is about the gross margin. I would like to understand, how do you see this line from now onwards? Thank you.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Hi, there, Nicole. Good morning. This is Miguel. With regards to our finished units, we had a good quarter, but it's hard to give a forecast from now on, and it's because of the volatility. Last year, we had beautiful third and fourth quarters with finished units, and the first quarter of this year was pretty weak. So there was some catch-up in Q3 vis-a-vis to the first and the second quarters. Now looking ahead, we don't have this many deliveries. We had the delivery of Heritage last October. So we should see a decrease on the finished goods.

With regards to the gross margins, Nicole, the dynamic's pretty much the same. What we launched in 2019 and '20, we had an accrued gross margin of 36%. And our balance gross margin is pretty impacted by the old -- those deliveries. So accordingly, as the new deliveries represent a larger chunk of our revenue, the gross margin will converge to this higher level.

Q - Nicole Inui {BIO 17757166 <GO>}

Great, Miguel. Thank you very much, Miguel.

Operator

Next question comes from Marcelo Motta, JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. Two quick questions. The first is on the feasibility study. As Raphael mentioned, the price increases and the land -- plots of land costs, are you incorporating more optimistic premises for the prices vis-a-vis to the beginning of the year?

And with regards to the construction, we have many companies struggling to increase the efficiency, changing initiatives, changing methods. So I just would like to understand what is it that you can see. And that obviously can be affected by the price. But is there anything that you can see for the construction that could help you with the savings?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Hi, there, Marcelo, well, the figures that went up, this was a CIS [ph] report, so that was pretty public, that the Sao Paulo prices went up 15%, and the sales prices went up 10% in the country as a whole. So prices went up, and that's what I said. Prices went up. That doesn't mean that we need to add up on 10% to 15% more because, yes, I was speaking from the rear mirror. And so otherwise, it's going to be too easy to buy plots of land. So we haven't changed the way we do our maps to buy plots of land, and the feasibility hasn't changed. But yes, prices are up. And now you will have your expectations where we stand on the side or where we are. But I don't really want to publicly disclose what we think of it because number one, we can be wrong. And number two, that each company has its own assessment of where we stand on our own cycle.

But objectively, no, we don't think that the prices will keep on. Obviously, the plots that we have already procured maybe two years, three years ago, obviously, the margins will go up, the ones that we haven't launched. So if the prices have gone up, and this is a public knowledge, in theory, our margins, the margins for the projects that we have procured and purchased and haven't launched, this will obviously compensate the higher rates of INCC.

Now on the -- we don't -- on your third question, we don't really have much to add on the evolution of that. It's really our bread and butter. We really don't have much novelty. We have a good player that has announced quite a few launches, but we don't really have much to add. And that's it. Thank you.

Operator

Our next question comes from Raul Grego, Eleven.

Q - Raul Grego {BIO 20134068 <GO>}

Good morning, friends. From my end, two quick questions. With regards to your strategy outside Sao Paulo, within Sao Paulo, it's pretty clear, the launches, your prices, your price dynamic. But outside Sao Paulo, Rio de Janeiro and the South region, you have a lot of finished inventory. And I'd like to hear from you how your sales dynamics, prices and demand.

And in terms of your plots bank, that there is a significant share of banks and particularly with regards to Rio de Janeiro. So I'd like to understand what is going through your mind right now for the launches, if you envision a good demand already or a return of the clients in the Rio de Janeiro market more specifically.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good morning, Raul, Miguel speaking. Indeed, our strategy was pretty more focused in Sao Paulo because that was naturally a market with more resilience and a more solid demand, so 73% to 75% of the company. So in Rio, we have increased a little bit of our launches, especially at the Vivaz -- under the Vivaz flag. We did a couple of launches in Baja with good performance. So that was a market that we stopped launching in 2015. Since then, we hadn't done any new launches. But that is a market that we consider good, although small. So we do launches there. And as we said before, we try not to give any guidance. But we are there. They are part of our core business. But Sao Paulo would end up -- will end up being most of our businesses.

Q - Raul Grego {BIO 20134068 <GO>}

Thank you.

Operator

Next question, Thais Alonso from Citibank.

Q - Thais Alonso {BIO 21979935 <GO>}

Hello, there. Good morning. I'd like to first ask you, what is the destination of your IPO cash? Is that a rebuy? Is it dividends, cash flow? And the second one is on the indemnifications. Could you explain a little bit better on what happens in this indemnifications area?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Hi, Thais. Good morning. This is Miguel speaking. With regards to the cash destination, I mentioned this briefly. Indeed, we have very little leveraging at the company. So that is temporary. And in due time, we should get back to our leveraging levels, previous leveraging levels. But we haven't fully defined yet whether we will fully spend this cash

flow in our operations by procuring new plots of land or whether we will share dividends or do rebuy. We haven't defined. We are following the market. We have very big capitalized players, and Cyrela wants to be well positioned to enjoy the cycle.

With regards to indemnifications, this is mostly from the tort and labor ones. And those are old enterprises and old developments, especially outside Rio and Sao Paulo. We have a couple of old deliveries that might still be subject to court expert assessments, and we might have some committed values for indemnifications for the future. But in the -- on the mid and long run, we hope to have a drop on the indemnifications values. Thank you.

Operator

(Operator Instructions) There are no more questions. And I would like to turn the floor now to Mr. Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Well, thank you once again for your interest in Cyrela Brazil Realty. And we shall see each other in our next call.

Operator

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

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