Q1 2012 Earnings Call

Company Participants

- Leonardo Guimaraes Correa, CFO
- Rubens Menin Teixeira de Souza, CEO
- Unidentified Speaker, Unknown

Other Participants

- Adrian Huerta, Analyst
- Matthew Neal, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning. Welcome, everyone, to MRV's First Quarter of 2012 Results Conference Call.

Today, we have with us Mr. Rubens Menin Teixeira de Souza, CEO, Mr. Leonardo Guimaraes Correa, CFO, Mrs. Monica Simao, Chief Investor Relations Officer. And Mr. Gershon Mazer, Investor Relations Executive Manager.

We would like to inform you that this event is recorded and all participants will be in the 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 in the MRV's investor relations website.

Before proceeding, let me mention that forward-looking statements are based on 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 the 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. Rubens Menin Teixeira de Souza, CEO, who will begin the presentation. Mr. Souza, you may begin your conference.

Rubens Menin Teixeira de Souza {BIO 15387481 <GO>}

Good morning, everyone. I would like to thank you for attending our call today for MRV's earning release of the First Quarter of 2012. It is known that the First Quarter of the year brings several challenges to the real estate company, since we have few working days, summer vacation and an intense rainy season.

With this stated of [ph] results in this period were behind of our usual standard [ph]. We also had some non-incurred divest [ph] factors that ended up impacting our results such as an increase on the numbers of off-site infrastructure to city halls and authorities. Apart from that, we continue to be optimistic about the year of 2012.

Due to market trends and MRV's capacity to deliver what was promised which had already been demonstrated. Our management is naturally conservative. MRV's top management has a long-term commitment which means that the time is not here to run and scream [ph] but to run a marathon.

We reiterate that MRV does not have budget over hung [ph] and debt. All the budget updates are done during the quarter. Proof of our conservative are the provisions made for the amount of BRL163 million for future maintaining worth [ph] on our operation [ph], very distinctive from the industry. On the first three months of 2012, we had up-to-date our budgets, divesting additional costs which price [ph] delivers due to (inaudible) relative in our country, our new client citizenship [ph] policy.

We are leaving a percentage (inaudible) moment at MRV with sustainable growth forecast (inaudible) with cash generation still in 2012 and we are doing this by slowing down offers [ph]. Currently, 85% of our construction site, are ahead of the schedule. And we expect to reach 100% by the end of the year, as is [ph] the case and et cetera [ph].

We highlight our subsidiary, loss [ph] commercial profits, excellent performance with high proximity and gross index, plus gross is increasing its relevance on MRV and there is an important (inaudible) value not yet notices by the market. I would like to pass the word to Leonardo Correa.

Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Good morning, everyone. You can follow my comments with the presentation uploaded in our website.

We have lower margins comparing this quarter to all of these three. Before addressing our quarter, I think it's important to picture the whole industry environment. The demand, it is still strong due to demographic factors and to the increase of purchasing power originated from real estate financing.

Like in any sector, consumers guide the business. They are more and more demanding on the unit's quality and the delivery terms agreed on the moment of the sale. MRV is sensitive to those demands and have been acting in a way to respond to them. Even more, we have a long-term perspective. Therefore, the brand identification and recognition are sources of great value for us.

Constructive activity growth also puts a weight on the municipalities and local governments. Responding to the new unit demand, new areas have to be incorporated into the city bringing along infrastructure costs such as for new street sewage systems, et cetera.

Part of that deal has been purchased to the private sector. Lastly, general cost pressures and those related to the attraction and training of labor force are part of the game. This point has been pressing our costs.

Let us now go back to our results. Our growth margin came in lower in the quarter compared to the previous ones, a drop of approximately BRL5 million [ph] on the quarter. This amount is explained by a combination of extra offsite infrastructure works required by city halls or other authorities while renting the leasing permit. Also, by quality and improvement expenditures on ending or ended projects. And lastly, partially in reviewing budget assumptions.

Our initiatives on quality control are already bearing fruit. They started to be implemented about a year ago. By enhancing our focus on quality, we shall achieve optimum quality with a much lesser impact in our costs.

Our budget reviews continue to happen quarterly. The cost new reality is already incorporated. New and unexpected facts such as new offsite infrastructure or judicial demands are incorporated to the project's cost when they materialize.

The quarter's bright side is the construction volume. We have produced 10,000 equivalent units and very importantly with much better quality parameters than the previous quarters.

Lastly, on slide four, we highlight the amount of BRL163 million provisioned as clients warrant and for future maintenance. The combination of the delivery to construction quality as well as the amount provisioned leave us completely at ease. If compared to the industry's average, you can see that MRV is one step ahead.

Let us now turn to slide five where we discuss our selling general and administrative expenses. Our EBITDA margin drop cannot be explained only by the decrease of our gross margin. Our G&A expenses increased 34% over the same quarter last year. But decreased if compared to the previous quarter.

What we want to stress is that our expenses will no longer grow as they did in 2011. We engaged in several new cities and consolidated our shared services center including our customer service. The revenue from these new cities will help us to dilute this increased expenses. The stronger presales, we will also dilute this increased cost.

Selling expenses also increased significantly if measured percentage-wise against presales. But this growth represents an investment in our own teams. This cost will be diluted from a greater volume of quarterly presales as well.

On the next slide, the number six, we approach the topic cash. The highlight of the quarter was the number of units transferred to the banks especially taking into account the fact that it is a quarter affected by summer holidays and the month of February to be short.

In conjunction with mainly Caixa and Banco do Brasil, we are advancing quarter-to-quarter and are very close to achieving an adequate level of quarterly transfer of clients to the banks. The achievement of this variable lead us to a positive cash flow.

On the next slide, I want to stress out two points. We have issued debentures in the amount of BRL500 million, with an average maturity of 4.5 years. The purpose of this issue is to roll over debt maturing in June and in the beginning of next year.

From the standpoint of corporate debt, our activity should now be restricted to managing this debt and rollover at the appropriate time. Another important point in our strategy of funding is connected to the construction financing provided by Caixa and Banco do Brasil. These loans have a very appropriate cost tenures in line with the construction cycle and it is facilitating the client's financing. We will continue to use these financing lines for our projects.

Finally, before closing, I would like to make some more brief comments on log at slide seven. We delivered 74,000 square meters of growth leasable area totaling at the end of Q1, 165,000 square meters of GLA in operation. The great market demand combined with the potential portfolio of 1.1 million square meters support the aggressive expansion plan to consolidate the Company as a leading industrial properties player in the country.

This operational growth with a high yield on cost will make the results of log more and more repetitive and will accumulate quickly added value to its assets.

Thanks. And let's go now to the Q&A session.

Questions And Answers

Operator

Thank you. (Operator Instructions). Our first question comes from Adrian Huerta from JPMorgan. Please go ahead.

Q - Adrian Huerta {BIO 1749060 <GO>}

Hi. Good morning, everyone. I just wanted to see if you can give us more color on EBITDA margin expectations for the rest of the year considering what happened this First Quarter and considering the guidance that you have for the year. Thanks.

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

Good morning, Adrian. We -- looking forward, of course, the quarter was not as we had expected. The -- looking forward, what we see is we have positive pressures in the sense of we have been raising prices of the units and that movement we did on the First Quarter already.

We see it going forward. We're seeing good demand. We're seeing taking into account the new prices that we have raised for our units. The second important aspect is that with more construction and larger presales the revenue will grow more -- much more than the expenses especially the G&A expense.

So with the combination of the increase on prices, something that we have already started doing on the First Quarter. And we have continued on doing. Plus, the more revenues that will be able to take us there.

The -- it has become a challenge to achieve a more harder challenge given the level. We -- I think it's important that we still see pressures on the -- on the label cost and some pressures on the cost side. But we view that the -- let's say, the more positive ones that we're seeing will be able -- or will be enough to overcome the negatives that we have been taking.

Q - Adrian Huerta {BIO 1749060 <GO>}

Thank you, Leo. And just a final question, given the growth that we saw this point on revenue as year-over-year of around 26%, should we expect kind of a similar growth for the full year in terms of revenues?

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

I think it's going to be more. It's going to be -- for the year, it's going to be on that and might be a little bit higher.

Q - Adrian Huerta {BIO 1749060 <GO>}

Perfect. Thank you.

Operator

Our next question comes from Javier Gayle [ph] from GPM.

Q - Unidentified Participant

Hi. Good morning. And thanks for the call. Just wondering in this infrastructure cost you had during the quarter, are these a one-time effect or will you continue to have this cost pressuring margins over the year? Thank you.

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

Let me -- good question. Let me segregate in two aspects here. There was one large special event related to some project at the Campania city [ph]. We -- the general -- we had all the projects approved and the -- but the General Attorney asked the City Hall to increase the number of the requests from the home builders in terms of the infrastructure.

This was not only related to MRV, to all their home builders as well. But let's talk specifically about the MRV. The amount of that request money-wise was around BRL30 million, not all of that BRL30 million flew or went through the income statement, given that not all the units have been sold and given that not all of the units are -- have already been 100% completed.

The percentage of completion in some of the projects are around 50% and there still other project still to be launched on the launching phase. But what is important is that that effect, that BRL30 million that has to increase our expenses, has a big impact on the quarter where -- when it's registered and a lesser impact on the following quarters and on the following quarters what we'll see is just that for those projects specifically the margin is going to be lower than the previous one.

That was approximately around BRL15 million, that is impact that came through our income statement on the quarter. The other aspect or the other points that have influenced our income statement is the fact that we have been investing more on the -- on the quality of our -- of the products that we have delivered to our clients and the -- and therefore, we have encouraged in more cost than we have incorporated into our budget some of these costs that we're seeing.

It is important that we deliver, let's say, a good quality. We are -- our product is in a way is a mass product and it's important that the clients perceive that way.

Q - Unidentified Participant

Okay. Thank you, very much.

Operator

Our next question comes from Matthew Neal from Invesco. Please go ahead.

Q - Matthew Neal {BIO 17098412 <GO>}

Hi. Thank you for quantifying the impact of the infrastructure investments to the quarter. I was hoping you could give a little bit of a further breakdown just to reconcile the 500 basis point margin compression and gross margin for the quality improvements and budget reviews. What was the breakdown there?

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

Okay. And before I'll give you a further breakdown, let me just make one point clear. The -- this big impact that we had in this project Campinas, that was unexpected and expected in the sense that we had all these projects approved and all -- of course, all the costs were already budgeted. But the new -- the new action coming from the attorney general from that city changed the cost.

The point that I want to make is that there's no other thing or there's no other discussion of that size, of that magnitude money-wise on our radars. The quantifying the -- coming back to your question, approximately BRL15 million are related to the -- to this Campinas project.

Approximately BRL12 million are related to enhancing quality and that is money we had spent, plus some changes on budgets going forward. But that have an impact on the current one. And approximately, a little less than BRL10 million on actual change on budgets, or new budget assumptions that will flow into the future income statements.

Q - Matthew Neal {BIO 17098412 <GO>}

Okay. And could you just discuss some of the quality enhancements that you're doing? Did you indicate that this is happening to projects that were already finished? Are you having to -- educate me on the enhancements.

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

Yes, let me -- let me step back and say the following: It has been more than a -- than a year that we have initiated this quality project. Basically, we have created a quality team within MRV. The quality team is the one that, let's say, as we -- as we've -- the engineer that finished the construction before delivering to the client has to go to this quality team and the quality team is the one that goes there and checks everything, see if there is anything further that we can do that can enhance whatever related to all aspects.

Just, let's say, good quality or just providing more gardening or other things that may increase the quality and the positive perception from the clients. The -- we do not want -- we want to deliver, let's say, a very good project, a very good quality. We don't want to have these things flowing in through the -- the clients coming later to us and asking for maintenance or repairing on the units.

We want to make sure that what they are getting is much better product. That is important because on the -- of course on the construction, it's from a cost standpoint of view. It's much better if you already, let's say, deliver a good product and that you do all the work that you have to do on the construction side before clients come in instead of having to come later and do whatever you have to do to either to repair or even though if that repair doesn't, you know -- the warrant that the clients have -- do not -- are not covered.

But anyway, you have to send your team, your team have to check on what are the clients demands. So on and so forth.

Q - Matthew Neal {BIO 17098412 <GO>}

Okay. And what percentage of the quality enhancements will be recurring or what are one-time?

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

The -- we have -- what we have done is to incorporate those into the budget as well and this is something that is going to be flowing, flowing in the sense of we have more than 300 construction sites. Some of them are 100% all ready and this is more, let's say, a way to do rather than doing much more -- a way to doing the sense of doing it right with good quality since day one and not having to go back and to redo the work.

And so we have a very large percentage of the sites already working that way. We have 40 people on the head office taking care of this and on every construction site there is one specific person in charge of looking at those issues.

Q - Matthew Neal {BIO 17098412 <GO>}

Okay. Thank you, very much.

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

You're welcome.

Operator

Our next question comes from Han Vizolis [ph] from MG Investments. Go ahead.

Q - Unidentified Participant

Good morning, Leonardo. And Rubens. I noted you highlighted real estate maintenance. How much that you are putting aside and how does this affect your income statement?

A - Unidentified Speaker

The provision for maintenance is something that we have highlighted. First, there is nothing different that has occurred on this quarter, the reason that we are -- we are calling the attention on this quarter specifically. And you can have all the details in the sense of what is the money that we have -- that added to that provision, how much -- what is spent on that provision on that quarter.

Each and every quarter we open those figures on the income statement. I believe it's note 18 [ph]. The -- but there is nothing different on this quarter than what we have been doing before. The reason why we are highlighting, it is because I think that in a way in general, the industry, some analysts, are not paying enough attention to those items in relation to the industry in general.

We noticed that we have been much more conservative than the industry in general by provisioning a larger amount of money for future disbursement. In fact, I expect to revert back to the income statement coming as a revenue some of -- some of those provisions given the -- you know, the quality project that I -- that I have described.

The more that we had advanced on that, the last that we need on the provision. But the point was that I think that the industry in general was not looking properly at those numbers. We are substantially in advance in comparison to the peers, to the industry in average. And so that was the reason why we brought to your attention at this quarter.

Q - Unidentified Participant

Okay. Okay. Thank you, very much.

Operator

(Operator Instructions). Thank you. The Q&A session is now closed. I'll turn over the call to Mr. Rubens Menin for final consideration. Mr. Rubens, you may give your final considerations now.

A - Rubens Menin Teixeira de Souza {BIO 15387481 <GO>}

Okay. I'd like to thank you very much for joining us on this call and I would like to highlight some things, very specific things. The real estate market in Brazil are healthy and have very big room to play on it.

I think that MRV company is playing very well and we are very optimistic with the future of this company. And we work very hard in the 2012 year and will be a good year for us. And then we join with you in the next quarter to give the notes that I think will be better than this quarter. Thank you, very much.

Operator

Thank you. This concludes today's MRV's 1Q '12 Earnings Conference Call. You may now disconnect your lines at this time.