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Y 2018 Earnings Call

Company Participants

- Miguel Maia Mickelberg, Finance Director and Member of Board of Executive Officers
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Andre Mazini, Analyst
- Enrico Trotta, Analyst
- Gustavo Cambauva, Analyst
- Jorel Guilloty, Analyst
- Luis Stacchini, Analyst
- Marcelo Motta, Analyst
- Renan Manda, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, which will discuss Q4 Earnings of 2018. At this time, all participants are in a listen-only mode. Later, we'll have a Q&A session and further instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and that 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 on March 21st, after the closing of the B3 trading session can also be accessed on the company's website.

Before proceeding, we would like to mention that 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 are predictions based on management's expectations about the future of the company. 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.

We have Mr. Raphael Horn, Co-CEO; and Mr. Miguel Mickelberg, CFO, with us today.

I would now like to turn over the floor to Mr. Horn. Mr. Horn, you may now begin.

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Raphael Horn {BIO 19714328 <GO>}

Good morning. The outcome of last year's elections was certainly the most important event in Q4 2018, consolidated the recovery of economic agents' confidence and asset prices in the Brazilian financial market. Despite some caution regarding the approval of the pension reform, a key factor in the country's financial recovery, we are confident on Brazilian's economic upturn. The Cancellations Act was the most important event. After years of legal uncertainty, there are now clear rules for canceled purchases and delayed deliveries.

Concerning operating results, we begin to see the first signs of a rebound in inventory sales in late 2018 and early months in 2019. We'd also like to highlight Cyrela's launches, which sold well once again. Reducing inventory levels remains one of our highest priorities.

In addition to the improved micro -- macro and micro-economic environments, we had positive net income and cash generation in Q4. Our sound financial health and low leverage ratio allowed us to pay interim dividend totaling BRL230 million in December 2018, reflecting Cyrela's management commitment to adjust our capital structure. We are confident that the Cyrela's team is fully prepared for another year of successful launches and recovery in inventory sales.

Now, we'll comment on our operating results. On slide four, we'll address Cyrela's launches. In Q4, we launched BRL2.7 billion, 15% (ph) more than year-on-year. In 2018, launches amounted to BRL5 billion, 65% growth year-on-year.

We launched 29 new projects in Q4, 17 in Sao Paulo, four in Rio, two in South, two in Campinas and four in Minas Gerais. 17 are in the Minha Casa Minha Vida housing program, five medium range, seven high-end products. Excluding swaps, the volume launched in Cyrela's share is 47% higher than the previous year. The company's share in the volume launch in 4Q is 64% (sic) (67%) compared to 62% year-on-year.

Slide six highlights the launch of the Rio by Yoo in Rio, with PSV of BRL439.3 million and sales over 87% in the quarter.

On slide seven, it shows Cyrela Haus by YOO in Sao Paulo. Launched in October, PSV of BRL416 million and 100% sold. On slide eight, we'll talk about our sales performance. In Q4 2018, pre-sales totaled BRL2.4 billion, 95% higher than BRL1.3 billion reached in Q4 2017.

2018 sales totaled BRL5 billion, 55% growth year-on-year. Excluding swaps, pre-sales amounted to BRL3.2 billion in Cyrela's share, a 40% increase year-on-year. The states of Sao Paulo and Rio jointly accounted for 92% of our sales in the year.

On slide nine, we'll address sales speed. The company's annual SoS was 45%. Looking at sales speed, projects launched have been 66% sold.

On slide 10, we will address Cyrela's total inventory. At the end of the quarter, inventory totaled BRL5.7 billion, a 2% increase quarter-on-quarter. The change in our inventory can be seen in the chart on your right.

On slide 11, we'll talk about finished units. In this quarter, we sold 9.3% of the finished units in the beginning of the year. Adding to the inventory of projects delivered along the quarter, pricing of units and market value, finished units inventory decreased by 12.3% quarter-on-quarter. We are aware of how important this matter is to the company, and we'll continue to focus our efforts on these products. Rio accounts for 38% of our finished units inventory.

On slide 12, we'll talk about delivered units. In the quarter, we delivered eight projects, 2,500 units. In 2018, we delivered 14,300 in 48 projects. Units delivered in Q4 accounts for a PSV of BRL4.3 billion, 22% more (sic) (less) than year-on-year.

And Miguel will now talk about financial results.

Miguel Maia Mickelberg {BIO 20023910 <GO>}

Thank you, Raphael. Good morning. On slide 14, we'll talk about financial results. Gross revenue amounted to BRL1,331 million, 84% and 65% higher year-on-year.

In Q4, we had -- net revenues were impacted by BRL254 million. The increase in net revenues, excluding the provision for cancellations was mainly due to a higher volume of launches recognition in the year. In the year, net revenue totaled BRL3.1 billion, 20% growth year-on-year. Gross income in the quarter was BRL334 million, 63% quarter-on-quarter and 53% higher year-on-year.

In 2018, gross income reached BRL835 million, 16% higher year-on-year. The company's gross margin in the quarter was 21.5%, 3.2 percentage points lower than the previous quarter and 1.9 points lower than the same quarter in '17. Gross margin in 2018 was 26.5%, compared to 27.4% in 2017.

Our profit totaled BRL116 million in the quarter with a net margin of 8.7%, compared to BRL121 million recorded in losses in the previous quarter and a profit of BRL49 million year-on-year. 2018 losses totaled BRL84 million, compared to BRL95 million in 2017.

On to slide 15, our profitability. In Q4 2018, our return on equity measured as the net income over the past 12 months over the average shareholders' equity was minus 1.6% and our EPS was BRL0.30 per share.

On slide 16, we'll talk about our customers' financial solutions. In the quarter, transfers, trust of deed and payoffs amounted to BRL732 million, 13% down quarter-on-quarter and 14% higher year-on-year. Considering units, transfers, trust of deed and payoffs totaled 3,800 units, 8% lower quarter-on-quarter and 37% higher year-on-year.

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On slide 17, we'll talk about debt. Gross debt at the end of the quarter was BRL2.4 billion. Cash position was BRL1.5 billion. Thus, our net debt was BRL820 million. Out of that total, 32% of the total gross debt are related to loans for construction, 88% long-term. Our net debt over equity was 14.8%, 1.9% higher quarter-on-quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged position to adjust our capital structure and improve return to shareholders.

On slide 18, we'll talk about cash generation. In Q4 2018, our cash generation was BRL137 million versus BRL303 million quarter-on-quarter, BRL311 million year-on-year. In 2018, cash generation was BRL803 million.

We will now begin the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Enrico Trotta with Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Raphael. Good morning, Miguel. Thank you for the presentation. I have actually two main questions. The first one has to do with cash generation dynamics. Looking to the year, when you look at Q4, finished units sales picked up when compared to Q3. Looking at 2019, given the ramp up you had of those launches. In Q3, you may have increases in construction costs. What's the cash generation dynamics in 2019?Selling more finished units, but at the same time, spending more on construction given this investment in new launches.

And the second question, I would like to ask, when you look at the backlog margin, it's now flat in Q4 when compared to Q3 at the 40% level despite higher launch volumes in Q4. And we, of course, expect these launches that have better margins than those of previous projects. Shouldn't that margin have gone up because these new launches would have better margins? I would like to better understand that dynamics.

What can we expect about that margin for new projects? Thank you.

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Good morning, Enrico. This is Miguel. Let me talk about cash generation first. Cash flow in 2019, it's a more challenging scenario this year than last year. Let me point out that in Q4 2017 we had BRL1.7 billion worth of deliveries. It had a positive base for transfer in early 2018. We don't have that effect now.

Investing more in marketing, construction and land, and less transfers, the cash scenario is more challenging despite the sales of finished units. This is a weaker year for cash

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generation. There will be positive cash generation still. But our focus is to keep our capital structure plan, paying out dividends despite lower cash generation.

As to the backlog margin, the rate is high, 43% ex-interest and launches are not giving better margins. There are few exceptions, but it was acknowledged as the equivalent, so there is no impact in the backlog. But we don't see that rate increasing in the future. Thank you.

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Q - Enrico Trotta {BIO 16742911 <GO>}

Thank you. Thank you, Miguel. Good day.

Operator

Next question, Mr. Gustavo Cambauva from BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

I actually have two questions. Could you please talk about the sales of finished units? What -- how is that dynamics playing out? You had very strong results in the quarter, driven more from launches. Can you explain the expectations of finishing sales? Have you conducted any specific actions? Have you adjusted the market value of your finished units? Are you conducting any promotion or anything of that sort to help boost finished unit sales?

And my second question is about commercial expenses. I think it's low. Given the amount of launches, expenses were low or limited. Can you further explain what is the level of commercial expenses in the future? Will you be making some adjustments? Is it going to be higher or lower? Thank you.

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Good morning, Cambauva. This is Miguel. Let me talk about the commercial expenses. Yes, we had BRL6 million increase in Q3. And you look at the expense, you have the accountable because that is also immobilized and we added BRL3 million instead. The average is about BRL13 million. So, that generates expenses effects in the next quarters in media and stand (ph) expenses, will boost commercial expenses. But on the other hand, we expect reducing maintenance of finished units inventory because sales are picking up. Overall, we don't expect no increases in SG&A.

I'll turn it over to Raphael to talk about SOS.

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A - Raphael Horn {BIO 19714328 <GO>}

Good morning. As to the inventory, SOS should improve because cancellations are dwindling. Year-on-year, they're going down. And as a consequence, SOS -- net SOS will go up. It doesn't have to go up to make SOS grow up to -- and inventories will end eventually. For receivables (ph), we had a problem, so it's only natural. In terms of inventories, it's a little bit better.

In '19, we'll have better inventory performance than that of 2018. I think we are heading in the right direction. It's a positive outlook. Rio de Janeiro is still a problem area and also Rio Grande do Sul. We had a few products that are somewhat closed. Commercial, offices, hotels, these are more troublesome projects because they have lower speeds. But overall, inventory will go up and down. The market is getting better, inventory will move along the way.

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Q - Gustavo Cambauva {BIO 17329406 <GO>}

Thank you. Let me just ask about the inventory. In terms of price, what's the impact of price on margins? Do you believe that you may consider price increases, or do you have to give discounts to still keep on selling? What are the more challenging areas? What's the price dynamics in those places?

A - Raphael Horn {BIO 19714328 <GO>}

I think it depends on the region. Once you give a discount, the discount is the new price. We are not giving more discounts. We have been giving discounts for three to four years and we have been suffering a lot. But I think we've reached the bottom end. But in some areas, we can think about a change of inventory prices a little, not everywhere, but in few places.

As the economy improves, the cycle improves. We are at a better position to operate. We're not there yet, but we can consider some price increases. It won't affect the gross margin, but the cycle is in upswing. We were suffering in the past three to four years. Now, we can begin to think about -- we have some leeway to change prices.

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Q - Gustavo Cambauva {BIO 17329406 <GO>}

Thank you. Thank you very much. Have a good day.

Operator

The next question comes from Luis Stacchini from Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning, Miguel, Raphael. Thank you for the presentation. I actually have two questions too. My question is about size. Situation is somewhat favorable and even changing prices, as Raphael said. But most companies are actually looking to expand to benefit from these more positive outlook in real estate impairments. In the case of Cyrela, you are still maintaining that the scores to have a BRL4 billion mark. But are you considering increasing their targets a little bit more, when you have a more positive outlook? It's not something that you're going to do forever, but maybe to benefit from this good moment in time to launch new projects and benefit from it?

And the second question is somewhat connected to the first one. Should you adopt a more aggressive stance? Is it because of the competition? So, here's my question. What is the outlook for launches for medium-sized project, especially in the city of Sao Paulo? Can you talk about that market dynamics? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning. Hey. It's not a boom. I wouldn't use the word. We can't detect any kind of boom for an explosion of sales. Boom doesn't necessarily means something good. It can mean chaos. Prices go up, land prices go up, it's just crazy. But it's nothing of that sort. We've been struggling in the past four years. The market is picking up a little, but based on a very depressed baseline.

The question about growing or not growing. Here is our point. We are not moved by numbers BRL4 billion, BRL5 billion, BRL3 billion. We purchased nice pieces of land that we like. If it's for business line, if it's BRL4.5 billion, it's BRL3.5 billion or -- it doesn't matter. And we are not changing. Or if the market conditions are better, we're not going to do BRL7 billion. We cannot buy BRL7 billion worth of quality land for any reasons. We cannot do it. And we're not trying to.

We can sell BRL7 billion worth of land (ph). And we'll be all regretting that strategy for three years in a row. No, that's not the point. It's important to maintain quality. And just by chance, it's BRL4 billion and our equity has to be compatible. If we get to BRL5 million, fine, but we're not concerned that much about it.

We're not speeding up our capital structure. And of course, we want to give ROI, that is an interesting number. Not launching new projects, we're going to give a terrible ROI. So, we still have our challenge, but our mindset is the same. We cannot operate with quality and yield BRL6 billion. It may happen in one year out of chance because we've found great opportunities, great land and that's it. But it will be by chance.

It's not going to be a pre-defined strategy to reach that number. The most important thing is the mindset. The number is the consequence. And we are very optimistic with the team, with the culture and the cycle we are about to enter. We are more optimistic, but we are maintaining our feet on the ground with the same culture.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you, Raphael. As to the launches, can you talk about the launches in Sao Paulo to see higher number of new projects, new launches and how are you operating in this scenario?

A - Raphael Horn {BIO 19714328 <GO>}

In 2018, our grade was bigger than 2017, not because the market was bad because we had good plots of land. Given the zoning laws in Sao Paulo, it's taking time to approve the projects in the second semester. Our evaluation for 2019 is better, the market is getting better. We are very optimistic with the conditions. But again, with our team, people talking about the boom -- the market boom, I don't see that happening. The market had been bad for so long. Things, we'll have to live in a crisis wherever. Except for Argentina, everyone is growing. We're not going to remain in that turmoil forever.

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Three, four years of downtime and we are getting out of it, but it's not a market boom yet. I wouldn't call it that way. And we are happy we are no longer in that crisis scenario and launches are better and more numbers. But it's far from being called a market boom. We're just changing the curve. The down was very deep. We're just beginning to pick up and on the rise again.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you. Thank you very much. Have a good day.

Operator

Next question is from Mr. Andre Mazini from Citibank.

Q - Andre Mazini {BIO 20377100 <GO>}

Thank you for your call. My first question is about revenue booking of projects launched in Q4. Three of them were booked, more than 50% Moema, Haus by YOO and Rio. So basically, these projects were already in a more advanced construction phase. So, that's why you have so much revenue in one quarter. So here is my -- this is the first question.

The second question is about the accounting changes. You have now provision cancellations. Before it was the low gross income and it's going to be above now. And you had an on-off revenue increase for the Q4 because of this new classification. Can we expect lower gross margins, vis-a-vis, when that provision changes? Thank you.

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Good morning, Andre. This is Miguel. As to the booking, the three projects you mentioned, did not have construction. This is our high-end lands with swaps at higher prices. So the land accounts for more than 50%. That's the cost of the -- so, we didn't have any construction expenses that are relevant before launch.

As to the changing of the provision criteria, actually cancellations provision provided positive impact in the gross margin, about 1%. We added BRL15 million in revenue and BRL86 million of gross income. So, it's more than the average margin for the company. It was positive, not negative.

Looking forward, since the cancellations margins are little higher than the average margin, as we revert those provisions, you can have positive impact in our gross margin depending on the mix of the quarter, of course. But the impact is not as high as in this quarter because we reverted four quarters in one. So, it accounted for the entire year.

Q - Andre Mazini {BIO 20377100 <GO>}

I understand. Thank you.

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Next question, Mr. Jorel Guilloty from Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning. I have two questions. The first one, the provision for cancellations in our P&L, 50% of our sales will be canceled, right? Having said that, can this level be considered too high?

My second question. We have a very strong leverage position, BRL1.5 billion in cash. At the same time, you're beginning a new construction cycle. What are the special dividend perspective in the context -- in a growing scenario?

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Hi, Jorel. This is Miguel. Cancellations provisioning is about 50%. You're right. First is to consider when the law is valid in principle for new contracts, and we have no evidence that cancellations will be lower than 50% for every project we deliver. So, we're maintain the same provision. If we have proof that the percentage is lower, we can review that number.

So, it may be conservative, but we don't see any evidence to change that number. As to the dividends, you're right. Our leverage is below 50%. It's lower than what we worked in our strategic plan. And we may have more leverage in distributing dividends. Our focus is 444 (ph) to have our P&L smaller.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Thank you.

Operator

(Operator Instructions) Next question comes from Mr. Marcelo Motta from J.P. Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. Actually, I have two questions. Can you elaborate on your launch mix? 2018 was concentrated in Minha Casa Minha Vida, grades two and three. Do you think that participation will go down, when you have higher end launches? Then you talk about provisions too. It was more troublesome quarter, the end of cancellations and inventory changes. You talked about Sao Paulo and Rio, South. When you look at general data, Rio is a lot worse than Sao Paulo. Can you please elaborate on these two issues? Thank you.

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Good morning, Marcelo. This is Miguel. As to the mix of Minha Casa Minha Vida, it accounts for 27% of our launches in 2018. It's not that high. And we always say that we like that segment, but it won't account for a large portion of Cyrela's business. The ballpark is about a third of the launches, was a little lower, and our strategy is to be present in that segment.

As to provisions, yes, it was a heavier quarter. We had that legal contingencies. They are impacting negatively our numbers and we had revenue from land. But we don't expect these higher numbers looking forward. Everything we know have been booked in our balance sheet, but we don't expect any major changes in the future.

Q - Marcelo Motta {BIO 16438725 <GO>}

Perfect. Thank you.

Operator

Next question, Mr. Renan Manda from Santander.

Q - Renan Manda {BIO 16845063 <GO>}

Good morning, Raphael. Good morning, Miguel. Thank you for taking my question. Let me talk about contingencies a little bit more. Was their concentration in one specific project or something more across the board?

And about the reclassification of that project in the Northeast. Have you reviewed that amount provision for that project? That is my second question. How is the finished units sales this year, early this year? What about the Minha Casa Minha Vida changes? Have they changed your planning? Thank you.

A - Miguel Maia Mickelberg {BIO 20023910 <GO>}

Good morning. Let me talk about provisions and contingencies. Of the BRL40 million and legal (ph) BRL30 million, BRL20 million of those BRL30 million were for two specific cases basically. That was the concentration. The rest is across the board as to impairment, for the inventory impairment. Rio, a little bit in (inaudible), in (inaudible) Alegria, in South and land mostly in Rio. The cancellations impact was mostly from Rio.

As for launches, Raphael will answer that question.

A - Raphael Horn {BIO 19714328 <GO>}

We've talked a lot about launches and finished unit sales. You are keeping track of quarterly sales of everyone and ours included. That's the way it is. It's fine. We can survive. It's not a market boom again, but we are happy with what we have. The team is good. We've purchased good land, and we are optimistic. But that's not it. The market is wonderful. No, that's not it.

Good land will sell. Bad land will miss out. I will only consider market boom when you can sell projects in bad land. As to low-income is impacting our chances now. Most of the low-income projects, we do it through partners. They operate. We do that very little. There's no impact, whatsoever, our partners this year. We believe that things will go back on track. And they're going to be doing what they had planned for the year.

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Q - Renan Manda {BIO 16845063 <GO>}

All right. Thank you.

Operator

(Operator Instructions) Since there are no further questions, I'll turn over to Mr. Raphael Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you for taking part in our call. This is a better context, and we have to keep on working day in, day out and hope the government gets the approval on what they -- what it has to do. And this is going to be a good year. Thank you. Have a good day.

Operator

This concludes Cyrela's teleconference. Thank you for participating. Have a good day.

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