

Q2 2019 Earnings Call

Company Participants

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

Other Participants

- Alex Ferraz, Analyst
- Andre Mazini, Analyst
- Elvis Credendio, Analyst
- Marcelo Motta, Analyst
- Roberto Waissmann, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call where we'll discuss the Second Quarter of 2019 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. (Operator Instructions) As a reminder, this conference is being recorded and the audio will be available in 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 8th of August, after the close of the B3 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 forecasts and operating targets related to its financial growth potential are predictions based on management's expectations about the future of Cyrela. These expectations are highly dependent on domestic market conditions and general economic performance of the country and international markets and, therefore, are subject to change.

With us today are Mr. Raphael Horn, Co CEO; and Mr. Miguel Mickelberg, CFO.

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

Raphael Abba Horn {BIO 19714328 <GO>}

FINAL

Good morning. In 2Q '19, Cyrela posted robust operating results again. We were successful in our launches once again with a sales speed of 57%. The high end and mid-high segments were the highlights, accounting for most of launches in 2Q '19. Sales almost reached BRL2 billion in the quarter, and the number of cancellations fell compared to recent years. The Brazilian Lower House passed the pension reform in the first round of votes in July, confirming the financial market expectation. It was the main driving of Brazilian asset prices during the period. As a result, Ibovespa, the main index of the Sao Paulo Stock Exchange, remained above 100,000 points and future interest rate projections dropped.

Slow growth and low inflation worldwide have led to current outlook of lower interest rates outside Brazil, even though the recent trade tensions between the US and China persist. We remain confident that Brazil can take the path to renewed growth and development, although volatility may delay or slow down this process.

In 2Q '19, Cyrela's cash generation was BRL196 million and net income are BRL114 million. Operating and financial indicators improved slightly compared to previous quarters, reflecting not only a better overall economic situation, but also management's internal efforts. We are confident Cyrela's team is fully prepared to ensure our future launches are successful and inventory sales keep recovering.

Now, we'll comment on our operating results. On slide five, we'll address Cyrela's launches. In 2Q '19, we launched 21 new products with a PSV of BRL2.087 billion, 113% more year-on-year. Excluding swaps, the volume launched in Cyrela's share in 2Q '19 was 130% higher year-on-year. The company's share in the volume launched in 2Q19 was 83% compared to 65% year-on-year.

On slides six to nine, we highlight some of the major releases in the quarter, all of them were at least 80% sold in the quarter. They are Skyline Jockey, Mooca and the other ones that you can see on the slides.

Now on slide 10, we'll talk about our sales performance. In 2Q '19, pre-sales were BRL1.917 billion, 81% higher year-on-year. Excluding swaps, pre-sales amounted to BRL2.090 billion in Cyrela's share, a 99% increase year-on-year. The state of Sao Paulo accounted for 68% of sales.

On slide 11, we'll address sales speed. The company's annual SoS was 52%. Looking at sales speed by period, projects launched in 2Q '19 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 BRL5.211 billion, up by 4% quarter-on-quarter. The change in our inventory can be seen in the chart on the right.

On slide 13, you can see a breakdown of our finished units. In 2Q '19, we sold 11% 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 8% quarter-on-quarter. We are aware of how important this matter is to the company and we'll keep continuing on focusing our efforts on these products.

On slide 14, we'll talk about delivered units. In 2Q '19, Cyrela delivered 12 projects, totaling 3,015 units. Units delivered accounted for a PSV of BRL832 million, 61% lower year-on-year. In the first half of 2019, 4,900 units were delivered with a PSV of BRL1.190 billion.

I will turn now the floor over to Miguel Mickelberg, who will present our financial results.

Miguel Maia Mickelberg {BIO 20023910 <GO>}

Thank you, Raphael. Good morning.

On slide 16, we'll present our financial results. Net revenue was BRL937 million in the quarter, 13% higher quarter-on-quarter and 47% higher year-on-year. In the first half of the year, it was BRL1.8 billion, 62% higher year-on-year. Gross income in the quarter was BRL293 million, up by 18% quarter-on-quarter and 71% higher year-on-year. In the first half of 2019, gross income was BRL542 million, 83% higher year-on-year. Our net profit was BRL114 million with a net margin of 12% compared to a profit of BRL48 million in 1Q '19 and losses of BRL28 million in 2Q '18. In the first half of the year, net income reached BRL162 million.

Now on slide 17, you can see that in 2Q '19, our return on equity was a positive 2.9% and our EPS was BRL0.30.

On slide 18, you can see our debt. Gross debt at the end of the quarter was BRL2 billion. The cash position was BRL1.5 billion. Thus, our net debt was BRL474 billion. 27.2% of the gross debt are related to loans for construction and 86% is long term. Our net debt-over-equity ratio was 8.3%, 3.7 percentage points lower 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.

Slide 19 shows the company's cash generation. In 2Q '19, our cash generation was BRL196 million versus BRL150 million in 1Q '19 and BRL181 million in 2Q '18.

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

Questions And Answers

Operator

Ladies and gentlemen, we'll now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Ferraz with Itau BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

FINAL

Good morning Raphael and Miguel. Thank you very much for the presentation. I have two questions. The first one is about the capital distribution outlook. If we look at the company's leverage level today and the cash generation perspective, I think it's stronger now because the debt level over shareholders' equity is 2.9. But now, what do you think about the lower CDI rate? Do you think that you are going to increase the number from 300% to 400%? And the second question is about gross margin. It was almost flat quarter-on-quarter, backlog dropped a little bit. So I'd like to know about your expectations for the margin. Do you think you're going to accelerate it with a new period for launches and the land bank that you bought in more favorable times? What do you think about your gross margin in the future quarters?

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

This is Miguel. Well, for the first question, we should stress that after the distribution that we carried out in July, our leverage level was now 13.6%. So the BRL3 million distribution increased our leverage, but we are not thinking -- we're not considering accelerating that volume. And since we already have the plan for the entire year, we're going to keep similar levels, maybe a little bit less depending on the sales of inventory and launches, but it is not in our radar to increase the volume of distribution. Now, when it comes to the backlog margin, we have been talking about that for a while and we have been saying that it was higher than launches due to two major projects with high margins. It was One Sixty and Heritage. They now account for a smaller share of our backlog margin and our margins now are lower in the new projects, and there was a small -- a slight decrease.

So, we believe that the gross margin for our launches is a little bit above the other margins and we believe that we are going to see some decreases but not too much, just slight decreases.

Q - Alex Ferraz {BIO 19294308 <GO>}

Okay, thank you, Migeul.

Operator

The next question comes from Mr. Credendio with BTG Pactual.

Q - Elvis Credendio {BIO 20084266 <GO>}

Good morning, Raphael and Miguel. I have two questions. The first one is about our basic interest rate. Some banks announced that they are decreasing their rates for real estate fundings. What do you think about the banks' appetite for funding -- providing funding for real estate? And also, about the demand for finished units, do you think it is increasing?

The second question is about purchasing land bank. We know that you purchased a lot of -- lots of lands in Sao Paulo with exchanges, with swaps. But we know that the prices are increasing, do you think it makes more sense to purchase land banks using cash to try and absorb the good prices that we have now?

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

Good morning. I'll start with the first question. We know that there's a drop in the rate, around 8%, which is lower than the previous month and we know that banks are more aggressive. I don't know exactly how much that will translate into demand for finished units, but it is positive for us because customers can purchase units using less of their savings account.

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

Good morning, that was a very good question, using swaps or cash, and I still cannot answer which one is better after so many years in this field. But I believe that land bank, if it's good, we are going to purchase one way or the other. The main point is that our Triple 4 plan allows us to purchase land bank and we don't have to rush. We don't have to rush into things and start purchasing a land bank without putting a lot of thought into it. We have to be calm and don't rush into what other companies are doing.

Q - Elvis Credendio {BIO 20084266 <GO>}

Okay, thank you very much.

Operator

The next question comes from Mr. Waissmann with Bradesco BBB.

Q - Roberto Waissmann {BIO 20589306 <GO>}

Good morning. Thank you for taking my questions. The first question is about your expectations for sales and launches for the year and the second one is about the prices of high-end launches. Are customers still paying 30% of the price during the construction and the rest after the construction? Do you think that is going to change? Do you think maybe those changes will help you in your cash generation?

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

Good morning, this is Miguel. I'm going to talk about the prices first. We are not changing our policies. We are not reducing the percentage of savings accounts because we know that banks are providing better rates now. But we don't think it's healthy to change that for the customers because maybe when we deliver the units, banks are more aggressive and then the cancellations rates would be higher. That's why we are requiring a higher level of payments before the delivery of the units, but there are customers that pay a higher percentage of that, higher than 30% and we provide discounts if that's the case, but we have not changed our policies.

Now about launches, I believe that for this year, we are going to be a bit above that. 10% to 20% above that. It's going to be between 10% and 20%. We are moving forward with the Triple 4 [ph] plan, and we are going to launch more products this year. It doesn't mean that we are changing our plans for 2020 or 2021. We are sticking to the Triple 4 plan. Maybe it happens if we find good land bank, but our main goal is improve the company's capital and that cannot change. We don't want to bring money from dividends

to purchase more land bank and launch more, that's not going to happen, but we are not changing our guidance at all.

Q - Roberto Weissmann {BIO 20589306 <GO>}

Okay, thank you.

Operator

The next question comes from Mr. Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. I have two questions. The first one is about your income with Cury and Sky, the Sky project. So I would like to know exactly how that is going to translate to income for the rest of the year, especially the third quarter. I would like to know some details about what to expect for the third quarter.

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

This is Miguel. Cury had a very good result with BRL80 million in net income and if we don't have restrictions for the Minha Casa Minha Vida housing program, Cury will still bring good and solid results. And you should also pay attention to a project that we launched last year, Ibirapuera. We are going to start constructions in the next quarter. So you're going to see the results.

And in Skyline Jockey, we recognized the sales on launches and we recognized it initially, but you're going to see some impacts later on in the future coming from that project. I believe that for the third and for first quarters, well, the first quarter was good. We did what we wanted to do. The second quarter is good, too. We're going to launch more the -- we're going to continue with the projects that we have already announced. And we're excited for the next quarters. We don't know exactly how much our results are going to improve in the next quarters, but I believe that the third quarter is going to be very good.

Operator

The next question comes from Mr. Mazini with Citibank.

Q - Andre Mazini {BIO 20377100 <GO>}

Good morning. My question is about the plots of land that you purchased, and you have to cancel the purchase and you sold four plots. Do you have more cash out of those transactions? And also, I have a second question. It's about the price of land here in Sao Paulo. It was increasing. There are many private equity companies investing on that. So what do you think in terms of acquiring land bank in the future? If the prices start increasing, is there more -- maybe it would be worth purchasing land banks now before they start increasing. What do you think about that?

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

This is Miguel. We didn't see much impact from the cancellations of the land banks and the disposal of the other plots of land. We didn't see much impact from that. Now, Raphael will comment on your second question.

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

About land bank, again I think I answered a similar question before. That's why we are following the Triple 4 plan. We have better and worse cycles in the market. That happens. It's normal. What we want to do is keep on sticking to our Triple 4 plan. We are going to continue with it. We know that there are unusual years, but we are not going to purchase too much to launch products in 2021. We are not going to speculate on that. We believe that we can work with those numbers in a more competitive environment. We're going to face that, that's normal, but we are comfortable with working with those numbers without putting excessive demands on our team, excessive pressure on them.

This is a good number, a profitable number, so we are following our strategy. We want to purchase with good transactions, good prices and not just purchase it because we have to launch products. If there's something that disrupts our business in relation to the competition, we will let you know, but we don't think that's going to happen. And it's a lot to do with the cycles. Cycles tend to be reasonably long. I believe that we are starting a new cycle with a very good and excited team.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay, thank you.

Operator

(Operator Instructions) The next question comes from Mr. Figueiredo [ph] with Credit Suisse.

Q - Unidentified Participant

Good morning, Raphael and Miguel. Thank you for the presentation. This is a very short question. We observed the gap of around BRL1 billion between sales and revenue and an increase of BRL400 million in your backlog. Was that related to a specific project and with the cash generation, what do you think about dividends for the next quarters and years? What is going to happen? What are your expectations?

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

When it comes to the increase in backlog, that is related to projects that we recognize in our results. So the other projects that are in the suspension clauses are not in the backlog. Almost every one that we launched in the quarter -- or almost every project that we launched in the quarter was recognized in the backlog. So that's the impact of BRL400 million that you saw in our results.

Now, when it comes to cash generation, we expect this year to have a weaker cash generation than 2018. We had BRL800 million in 2018 and we had -- we've had BRL350

million in the first half of the year and we believe that the second half will be more challenging because we will have less receivables of units and because we are going to have some disbursements, especially for land bank. But we have a low leverage rate. So our plan for the year is strong.

Q - Unidentified Participant

Okay, thank you very much.

Operator

Excuse me, if you have no more questions I would like to turn the floor over to Mr. Raphael Horn for his final remarks.

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

Thank you very much for your attention. Actually, he is here with us and he asked us to tell you that he misses you. And this was a good quarter, a good half of year. We are going to continue working hard for the next half of the year and next year, too. Thank you very much and have a nice day.

Operator

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

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.