Q2 2015 Earnings Call

Company Participants

- Antonio Emilio Clemente Fugazza, Chief Financial and Investor Relations Officer
- Pedro Henrique Rocha Nocetti, Investor Relations Coordinator

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Other Participants

- Fred Mendes, Analyst
- Marcelo Motta, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, I would like to welcome everyone to EZTEC's Second Quarter 2015 Results Conference Call. Note that this event is being recorded and that all participants will be in a listen-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session when further instructions will be given. (Operator Instructions)

Today's event is available through a live webcast that may be accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner 2Q15 Webcast. The following presentation is also available for download on the webcast platform. The following information is stated in Brazilian real and in BR GAAP and IFRS applicable to real estate developers in Brazil, except where stated otherwise.

Before proceeding, let me mention that any forward-looking statements made in today's conference call regarding the business outlook, forecasts, and financial and operating targets is based on the beliefs and assumptions of EZTEC's management and the information currently available to the company. Forward-looking statements are no guarantee of performance. 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 general economic conditions, industry conditions and other operating factors could also affect the future results of the company and could cause results to differ materially from those expressed in such forward-looking statements.

Now I would like to turn the conference call over to Mr. Emilio Fugazza, Chief Financial and Investor Relations Officer, who'll begin the presentation. Mr. Emilio, you may begin the conference.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thanks very much. Hello, everyone. Welcome to our presentation of the results second quarter 2015 and first half 2015. Apart from myself, Mr. Pedro Nocetti, our IR Coordinator, to show the main highlights of this period's EZTEC's results.

Efficiency is always a basic statement for EZTEC, meaning that it doesn't matter how challenged is the scenario, but this administration has been always trying to search alternatives to keep quality and profitability to our shareholders, saying that the results coming from the second quarter 2015 and first half 2015 show EZTEC trying to keep profitability in higher levels, even considering the challenges we have been passing through in the Brazilian economy currently.

Please, I ask you to observe the slide number three. I'll talk about some operational and financial highlights from the first half 2015. First of all, the launches of the company. In the first half, the company launched BRL293 million in own PSV. In the second quarter itself, we launched three projects, Massimo Carrao and two phases of Jardins do Brasil, the phase Noronha and Atlantica projects that the total amount of PSV was BRL221 million.

In terms of sales, we are strongly focused on inventory. We reached BRL304 million in the period. Two-thirds of the total amount of units launched in prior years from 2015. In terms of land bank, land bank ended up the quarter in a potential sales value of BRL5.9 billion. In this period, there was no way -- there was no focus to acquire new piece of land. It's simply because we have been keeping in our land bank more than five years of launches ahead.

In financial terms, all the efforts, we are struggling to keep the gross margin in line with prior periods. So in that sense, saying that we have been delivering some sites under construction, delivering the keys to our clients, and the budgets, we have been saving budget on average 2 percentage points of the booked costs when we started it. The construction allowed us to reach a gross margin of 54% in the first half 2015, 2 percentage points above the same period of the last year, generating a gross profit of BRL220 million.

In terms of net income in the first half, we reached BRL235 million, 8% above the first half 2014, and specifically, our return on equity annualized superior of 20% yearly. In terms of generation of cash, we generated this quarter -- specifically this quarter, second quarter 2015, BRL40 million, ended up June in a net cash position of BRL357 million. At this moment, it's quite important to show this amount of generation, and besides the fact that we have been carrying BRL410 million, yielding IGP-M plus 10 to 12% yearly with possible securitization, if you want to turn this amount of receivables in cash.

There is a lot of importance to this generation in specifically this period because we can take advantage of opportunities coming from the market or even paying more dividends or even trying to open a buyback program in the months ahead. Nothing about it is decided yet, but obviously with a strong net cash position, allow us to understand what is better to compensate our shareholders.

So now saying that, I'd like to turn the presentation to Mr. Nocetti to start talking about operational highlights. Pedro, please go on.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thanks, Emilio. Good morning, everyone. I would like you to please turn to slide number four. I will talk a little bit about the land bank, which, as Emilio said, ended the second quarter 2015 with 5.9 billion in own PSV, more than enough for at least five years of launches with an average acquisition cost of 12.7%. It's very important to say that as we have land bank for more than five years of production, it's not our focus at this moment to search to find new pieces of land to launch.

Then I would like you to see slide -- not slide, the chart on the top right. You see the acquisition period of our land bank, which 71% of it was bought after the year of 2012. They can provide good margins, they can provide good profitability when launched. Second thing, in the chart on the bottom left, you see that 77% of this investment to the residential segment and 23% is (inaudible) to the commercial segment. This 23% has a lot of quality and can provide -- when we have a better view of Brazilian economic condition, Brazilian economic environment, it can provide very good project as EZ Towers is.

In the chart on the bottom right, 93% of it is located in the City of Sao Paulo and Sao Paulo Metropolitan Area. This exposure to the Sao Paulo Metropolitan Area, including the City, is not seen as a risk to EZTEC, but it needs to be seen at a place where we have all the know-how, the expertise, to know where are the demands and what types of project, what segment of project, what standard of project can fit in each region and then get good price with good liquidity.

Then I would like you to please turn to slide number five. I would talk a little bit about EZ Towers, which ended the first half of the year with 94% of the costs incurred. The Tower B is predicted to be delivered by the end of this year and it has a cost incurred of 246 million. We see -- we are very impressed that as we are seeing our market value about 2 billion and we have an asset like Tower B that can provide a good margin, good profitability and can provide revenues of 700 million. We are very impressed that it's not classified [ph] in our market value.

So now please, I would like you to slide number six, I would talk about launches. As Emilio said, 221 million in the second quarter of 2015. Three projects, the project Massimo Vila Carrao in the east zone of the City of Sao Paulo, middle, high-end segment, 53 million of own PSV, 33% sold. Two phases of Jardins do Brasil project located in Osasco, Sao Paulo Metropolitan Area. The phase Atlantica with 72 million of PSV, 39% sold; the phase Noronha, 96 million of PSV and 19% sold. Considering the launches in the first quarter of the year, we have 293 million launched in the first half of the year.

For the second half, it's very important to say new launches are not the priority of EZTEC. Our focus now is on inventory and we will keep focusing on it until we not see it reducing, until we not see a better -- until we not get a better view of Brazilian economic scenario and until we do not see an improvement in terms of mortgage offering.

Please turn to slide number seven, I would talk about sales. In the second quarter of 2015, we got 143 million of sales, and considering the whole first half of the year, we have 304 million of sales, in which more than 66% of it came from units launched until 2014. We got more sales on inventory than we had in the first half of 2014. 77% of the sales in the first half were done by the TEC Vendas. And we ended the quarter with an inventory of 1,362 million. Very important to say, a great part of this inventory come from units that's under construction or recently launched. We had 29% of our inventory of performance units, but we are keeping the focus on selling them.

Please turn to slide number eight. I would talk a little bit about TEC Vendas. We see in TEC Vendas a very important part of the operation. And when we say it's important, we say that now they are responsible for almost all of the sales of units in inventory. They were responsible for gross sales of more than 800 million in the last 12 months. They are able to generate revenue and income for the company. And even in a more challenging year like this, they sold more than 370 million in the cities of Sao Paulo, Osasco and Guarulhos. So they are a very strong brokerage house and they are very important for EZTEC.

Finishing, I will ask you to turn to slide number nine, I would talk a little bit about the turnover of sales. In this chart, you will see -- you can see the units launched in each year, the amount of units that are still in inventory and the ratio of cancellations for the units launched in each period. We can conclude that we have never had more than 20% of cancellations in the unit -- with the units that we launched. You can see that the units that are under construction, they have a lower ratio of cancellations. They are under construction and we do not expect this ratio of cancellations to increase until they are delivered, but as you can see, the historical -- the history of the cancellations have never surpassed 20%.

Now I will hand back the presentation to Emilio Fugazza who will talk about the financial highlights. Emilio, please.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much, Pedro. What Pedro said so far is about some operational highlights, and every single point he said has an impact on our financial performance. So starting on slide -- page number 10, on top left, net revenues, you can see that comparing first half 2014, first half 2015, the net revenues dropped on average 7%, specifically because on the second quarter, in which we had less sales of performed units helped to drop 23% in our revenues.

But it's important to bear in mind that when you go deeply in our balance sheet, in our statement of profit, you can see that cancellation revenue remained a little bit stable compared to the last -- first half 2014. Look, first half 2014, we had cancellations in revenues about BRL65 million; in first half 2015, something around BRL64 billion, so remaining a little bit steady.

But saying that, it's important to bear in mind when we cancel units ready to deliver to our clients, I am canceling the whole revenues coming from these units, completely different to when we cancel a unit 10% or 20% constructed. So in that sense, only 10% or 20% of the revenues are being -- are dropping in our net revenues.

So that has -- saying that, it's important to say that in the quarters ahead, we are not expecting a growth in the revenue. This is specifically because so for the next two, three, four quarters, given the scenario, given the economic and political scenario, so the efforts we have been doing to sell the apartment is more than in the past. So in that sense, we expect revenues remaining stable comparing with this quarter.

Saying that, let's go to the gross income. Gross income first half 2015 was about BRL220 million in a gross margin of 54%. Specifically in terms of second quarter 2015, 50% gross margin, we have here a lot of good news. There are two main points to show. First of all, in terms of margins coming from the projects completely under control of EZTEC, we have 50% of margins, but the projects, the residential projects nowadays are showing something close to 50% as we disclosed in our release of results. So 50% compared with 49% in the first half 2014. So that shows that we are not practicing huge discounts to sell the apartment so far.

And they are not a kind of thing, which is very good effect. When you look at this second quarter 2014 margins, 56%, that was a margin compensated by the construction of EZ Towers and other commercial buildings we had been doing at that moment. Nowadays, something like 70% to 75% of our revenues are coming exclusively from residential projects and residential projects with very good margins indeed.

So on bottom left, you can see G&A expenses. From G&A expenses, it's important to say, as I mentioned before, there was an adjustment in our G&A team. So that's why because in the first half 2014 we had on average under construction something like 33 sites under construction and nowadays something like 25 sites under construction.

In that sense, organically we have to reduce team of engineers, team from people in planning areas, in supply areas and back office areas. So in that sense, nowadays only exclusively in the second quarter, the G&A expense came from BRL30 million to almost BRL26 million. And even in the second quarter, BRL26 million is polluted with some figures coming from compensations to people who we fired this quarter. So in that sense, the amount of reduction we expect to G&A in the quarters ahead is even more than you saw this quarter. Compared half and half, we are almost stable, but as I mentioned before, we are expecting some reductions coming in the quarters ahead.

In terms of sales -- selling expenses, it's important to say that obviously we are expanding a little bit more than in the past. So you can see in second quarter, BRL2 million more in terms of selling expenses because obviously we are struggling to sell apartments ready to live, which is a little bit more complicated than launches that we have, a huge amount of apartments to sell advance.

But including in these figures, I have to mention that all the costs we have in terms of maintenance the units, the performed units and even taxes we have been paying to the government in terms of delivered units, but not sold yet, are included in selling expenses.

So that's why you can see more selling expenses this half and this quarter than in the past. And my personal forecast for these figures is to remain at the same ratio of 6% quarterly.

So next move to -- next move on to page number 11, talking about financial results on top left. Obviously financial results is coming better than in the past. This is simply we are net cash position, we are getting better in terms of cash because we are generating cash because all the financials -- all the financing we have is in production line. So we are capitalizing those in our cards [ph]. So in that sense, all the financial positive results we can see here is because of the cash yielding something like 14% yearly and because we have been carrying BRL400 million in performed receivables yielding IGP-M plus 10 to 12% yearly. So that's why I think it's going to be an increment in financial positive results in the quarters ahead.

In terms of equity income, on top right, you can see 65% [ph], a huge increment in this quarter from BRL22 million second quarter 2014 to BRL35 million in the second quarter 2015. And the explanation, that's why we sold many apartments coming from projects. We delivered units, we delivered in sharing control with our partners, and even because we have been building in much more accelerated pace since last year projects in which we share control with our partners. So the trend for these figures quarters ahead is to remain steady at the pace of BRL35 million in terms of equity income coming.

So on the bottom left, you can see net income. Net income came BRL102 million, mostly because obviously we saw a fall in revenues coming this quarter even saving G&A expenses. So the revenues dropped something like 23%, but we can save in G&A expenses and better financial results helped us to reduce the net income only 17%.

In the first half, we have an increment of 8% coming from the first half 2014 and the good news obviously is the margin, the net margin coming 8 percentage points above the first half 2014. It's important to say that BRL235 million provided a 20% return on equity. That's quite important because even reducing the level of launches, even reducing the level of sales, we are trying to do everything in order to keep the profitability, to keep the gross margin in order to provide return on equity of 20% or above, which is the internal target we have been trying to achieve to keep the investments the EZTEC new projects to show the Board of Directors to come with new investments the quarters ahead.

So -- and finally on the bottom right, the results to be recognized, the backlog margin and the backlog results. We have BRL490 million and a backlog margin of 49%, completely stable -- completely flat compared to the previous quarters, which show that all the apartments we sold, but we have to recognize yet of in the same margins we have been releasing so far.

Let's move to slide number 12, which is a sum up of everything I mentioned before. That is only to show that first of all from below, the red line is the net cash position showing that we generated cash from the first quarter to the second quarter, generation of BRL46 million in cash. That's why we have been passing our receivables to the banks without any kind of problem even in the scenarios not trying to reach bottlenecks of LTV or reduction in interest rates.

In terms of margins, you can see on the top of the chart, 55% is the net margin. We have been seeing, we have been releasing in the last 12 months, on average in the last 12 months, is the first moment we surpassed net margin in terms of gross margin. So the last 12 months net margin is 55% and the last 12 months gross margin, 54%, showing that even this scenario -- we can keep margins above 50% since the third quarter 2011, and that's not forecasted to see drops in those margins to this year.

Let's move on to slide number 13, the final slide of this presentation. And this final slide is only to show what is happening, what is going to happen with the price market cap and shareholders' equity and the possible value to add at EZTEC shares. So let's see. First of all, it's important to understand the market cap of the company nowadays is about BRL2 billion, and the shareholders' equity of this company is about BRL2.6 billion at a share price of BRL13 per share. So I've mentioned that we are talking about something like 0.7, 0.8 times the market value compared to the shareholders' equity.

But the problem is, inside of this market cap, we have -- we own the Tower B of EZ Towers, which is a tower that we can easily get something close from BRL600 million to BRL700 million, providing something like BRL400 million in net income coming from Tower B. And that's why taking out Tower B from our equity, so the whole company, the value of the whole company nowadays is something like 0.6 times the shareholders' equity of the company, providing an average return on equity for this company of 24% on average in the last seven years.

Apart from it, and not mentioning new launches, but apart from it, let's say, inventory. Inventory is hard to sell in a good piece of sales, but we keep selling this inventory and we keep selling this inventory in very good margins. So the whole inventory of the company can provide something like BRL700 million in net income, adding something close to BRL4 per share.

And apart from it, the backlog results, units sold, but we have delivered yet. So when we come with these revenues to our statement of profit, can add another BRL400 million to BRL500 million in gross profit to our total results, so which means another BRL3 per share. So all in, without, bear in mind, the new launches, at least we are talking about another BRL2 billion in shareholders' equity to add in the next two to three years.

Apart from it, we have the land bank. The land bank is a land bank indeed. We are talking about a land bank we paid BRL800 million, no swaps agreement. And nowadays to sell, even this scenario, even this challenged scenario, to sell this land bank, we can add at least 40% more in value that we paid for this land bank. So all in, we are talking about more than BRL2 billion to add in terms of shareholders' equity in the next two years to the company. In that sense, we have to mention BRL13 per share is quite low to compare a company providing an average return on equity of 24% in the last seven years.

So saying that, we are completely open to further questions from our shareholders and we thank a lot your audience today. Thanks.

Questions And Answers

Operator

Ladies and gentlemen, at this time, we'll begin the question-and-answer session. (Operator Instructions) Our first question comes from Fred Mendes from HSBC. Please go ahead with your question.

Q - Fred Mendes {BIO 17221617 <GO>}

Good morning everyone, and thanks for the call. Actually I have two questions here. Number one, you were talking about keeping the ROE above 20%, but when you look at your capital structure and the amount of cash you have, net cash position, 357 million or almost 18% of our current market cap, it seems quite hard to do this considering that there will be no growth in terms of launching. So you did speak a little bit about a possible -- possibility of opening a repurchase program. So if you could give us more detail on that, this would be great. This is my first question.

And then the second one, I mean, when you look at finished inventory representing 29% [ph] of your total inventory and that you are starting now to finance the buyer given the more restricted credit, I mean, how comfortable are you financing these buyers in a scenario of -- in a very challenging scenario for the economy and especially considering the delinquency rates are likely to increase? So how comfortable are you with this scenario of financing the buyer, to be straight? Thank you.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Hello, Fred. Good morning. Thank you very much for your question. Fred, in fact, so this company is trying to find a return on equity of 20% because we think that 20% in the years we have been passing through was a return on equity enough to compensate our operation, in terms of reinvest our capital in a very good way, so -- but obviously nowadays, we have some alternatives, some alternatives to think about it. So far we have been trying to sell apartments, to sell in good prices, to sell in that amount to provide revenues enough, trying to keep with the G&A expenses, not so hard in order to avoid holding our net margin and providing good return on equity.

But apart from that strategy, we have tried obviously -- we have been thinking about a lot of things. This -- the second quarter, we approved an extra dividend of BRL50 million. That was a very good message in terms of, if there is no way to invest this capital, to compensate in a very good way our investors, we are going to pay more dividends every time. So that's a kind of thing, is on our mind.

In terms of buyback program, obviously the Board of Directors, the directors, they have been thinking about it, but nowadays given the scenario, given the economic scenario, given the scenario that to provide new sales, it's important to keep a strong position of cash in some point to provide financing to our clients, we are trying to understand a little bit better what is going to happen in politics, what is going to happen in terms of bottlenecks in credit, in SFH credit, in mortgage credit to show, the alternatives to show the direction to keep the return on equity so high. So far we achieved 20%; so far. And our mindset for the third quarter and fourth quarter this year is to sell more than we sold before and we are struggling to do that. So far that's the idea.

In terms of inventory, it's important to say that we are trying to open alternatives to our clients. Obviously we know very well that providing financing, yielding IGP-M -- charging IGP-M plus 10 plus 12% yearly is expensive, but it's important to understand that on the other side of the banks, coming from the banks, we have some restriction nowadays. One of them, for instance, is the equity that the client has to provide to buy a delivered unit. So in that sense, we are trying to say, we want 20%. We charge IGP-M plus 10 or plus 12. It depends on the type of the apartment or the commercial offices, but it's a kind of bridge lower [ph].

At the moment, the conditions of the market start getting better. Obviously, the client can go to the bank, taking advantage of better interest rates and that alternative we started doing in last June proved very good because we sold residential apartments, we sold commercial offices using this program. So our idea, our main idea is to keep this program eventually to push harder, to incentive with more money this program in order to getting better our piece of sales. So far it's doing well, but the priority of the company is to sell the merchandise without dropping hardly -- without hurting hardly our margins as you could see in the second quarter, Fred.

Q - Fred Mendes {BIO 17221617 <GO>}

Perfect, Emilio. Very clear. Thank you.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much, Fred.

Operator

Our next question comes from Marcelo Motta from JP Morgan. Please go ahead with your question.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you very much. Two questions as well. The first, just a follow-up on Freddie's question. If you could mention how much was already use in direct financing. If I'm not mistaken, the company has mentioned about like BRL100 million in the first initiative. So just wondering how much was used.

And another interesting part on your release, you mentioned about the delinquency level on the portfolio of receivables, you mentioned that it is around 5.8 and you also say it's lower than in previous quarters. So would like to know if you could give us a broad sense of how this rate has been changing over the quarters and the year, I mean, what was the peak, what was the lowest level, just for us to have an idea of how this 5.8 compares to like a time series of delinquencies.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Good morning, Marcelo. Thank you very much for your question. So first of all, in terms of the program we opened last June, first, it's important to bear in mind that we have been doing financing to our clients, we have been providing financing to our clients since ever. Since 1979 when the company starts developing real state, we have been doing this kind of thing. So prior June, we carried something like BRL400 million, in which -- BRL400 million of performed receivables, in which at least BRL200 million from these performed receivables yielding IGP-M plus 12% yearly are receivables to the long-term, so long-term, more than five years financing our clients, so BRL200 million.

What we have done was to open a special program targeting 20% equity performed units and yield -- and charging IGP-M plus 10, specifically just to understand what is going to happen. And only in June, only in June, we took advantage of it using at least 25% of this amount of money, providing financing to our clients. But obviously July and August, we keep selling in this program. So it proved to EZTEC a very successful program because it's providing into an interesting credit line to clients that there was no more than 20% equity to start buying an EZTEC unit.

And in terms of delinquency, let me break down the subject in three parts. First of all, it's important the number the accountancy reports, when you mentioned 5.8%, this figure is provided because we have some part of our clients obviously is delinquency indeed, but the greatest part of this number is coming from clients that are largely coming from EZTEC to the banks.

So if we deliver the keys, let's say, in April and the banks are providing financing mortgages to our clients in June, so there is a delinquency here at the moment, but it's a technical delinquency. It's not delinquency indeed. Receivables come in from EZTEC through the banks without any kind of problem. The delinquency indeed to EZTEC is less than 1.5% the total amount of receivables of units under construction. That's quite important.

So let's go to the second subject. When I mentioned the cancellations in our balance sheet, when you look deeply in gross revenues cancellations in net revenue, you can see that cancellations remained almost flat compared to the first half 2014. So that means that we provided 65% in cancellations, revenues cancellations -- canceled in the first half 2014 to 65% revenues canceled in the first half 2015, so completely stable, completely flat. We are not forecasting something different than that.

And the third part of the subject is the slide that Pedro mentioned, the turnover of the units. That's quite important because we have been seeing an increment in the turnover of our inventory, turnover of sales from 115% to 119%. So there was an increment of 4 percentage points. 4 percentage points in that scenario is very good, is very good, a controlled situation to EZTEC. And we have been paying a lot of attention in this problem.

And one very large part of our clients is not cancellation indeed. We are trying to do the downsizing and the downsizing work. So someone bought an apartment of three bedrooms and nowadays wants to change to apartment of two bedrooms or one bedroom, in different neighborhoods, in order to use the advantage of the total amount of money we paid, so we are trying to do that, and obviously you can see in our margins, it's working, keep working. So that's the situation, Marcelo.

Q - Marcelo Motta {BIO 16438725 <GO>}

Perfect. Thank you very much.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you, Marcelo.

Operator

(Operator Instructions) And ladies and gentlemen, at this time I'm showing no additional questions. I would like to turn the conference call back over for any closing remarks.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much everyone. Let me remind you, apart from myself, Mr. Pedro Nocetti, IR Coordinator, we are completely available in EZTEC office to answer any further questions. Thanks a lot.

A - Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thank you so much. Bye-bye.

Operator

Ladies and gentlemen, that does conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.