

Q3 2013 Earnings Call

Company Participants

- Elie Horn, Chief Executive Officer
- Eric Alencar, Financial Director and Investor Relations Director
- Raphael Horn, Chief Operating Officer

Other Participants

- David Lawant, Analyst
- Luiz Mauricio Garcia, Analyst
- Rafael Pinho, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting, and welcome to the Cyrela Brazil Realty conference call where the results of the third quarter 2013 will be presented.

All participants are connected only as listeners and later on there will be a Q&A session for which instructions will be given. (Operator Instructions) We remind you that this conference call is being recorded and the audio will be available on the company website upon completion at www.cyrela.com.br/ri.

This call will be translated into English and is being transmitted by Internet simultaneously. Overseas participants connected through the Internet can ask questions using the webcast platform. The results published yesterday, September 13, after closing of the BM&FBOVESPA Stock Exchange is available at the company site at www.cyrela.com.br/ri.

Before we proceed, we would like to clarify that any statements made during this call regarding the company's business prospects as well as projections, operational and financial goals concerning its potential for growth are all forecasts based on the expectations of the management for the future of Cyrela. These expectations are highly dependent on domestic market conditions, on the general economic performance of Brazil and on international markets, and are therefore subject to change.

We have with us Mr. Elie Horn, CEO; Mr. Raphael Horn, COO; and Eric Alencar, Financial Director and Investor Relations Director.

I will give the floor to Mr. Elie Horn.

Elie Horn {BIO 1823000 <GO>}

Good morning, everybody. So, we are coming to the end of 2013. There are very few days left for this year to end. In recent months, apart from focusing on launches and sales, we've invested a lot of time to discuss our projects for the next few years. We believe that, apart from planning for the future, it's very important to prepare for the future. This preparation is a continuous process. We have to be in the market, we have to buy the right lots, we have to develop the best products, and consistently, we have to improve operations and improve the effective cost management.

As you know, we are a long-cycle business and the key word is consistency. Consistency is a simple word, but it demands a great deal of focus and discipline. We have a very sound base. We have developed recognized brands with a platform that enables good business. And apart from that, we have an excellent team and a strong structure. Our ambition is to become a benchmark in real estate business, also including esthetics in everything we do. We want to have a company, which is client facing in this very competitive market and this is our competitive edge. So, we have to work and roll up our sleeves. We have to also confess with our customers and brokers, and keep an eye on the competition.

Only through coming close to the client will we be able to develop innovative products and sell to customers. We want to grow with quality and sustainably and profitably, which means having access to opportunities and working with responsibility.

I would like to reinforce the equation of our company, which is people plus culture plus profitability equals Cyrela. We will not be resting on our laurels. We will lead this market.

Thank you very much and now I'll give the floor to my colleagues.

Raphael Horn {BIO 19714328 <GO>}

Good morning. We're going to look at slide 5, where we will comment on the Cyrela Group's consolidated results. In Q3 2013, we launched R\$1,234 million. There were no launches in band-1 of MCMV in this quarter. Cyrela's share of the launches this quarter was 74%, an increase on the third quarter 2012, which was 60% for the year. Launches came to R\$3,952 million, 13% up on the same period last year.

Cyrela's share in launches for the year was 69%. Leaving aside band-1 of MCMV, Cyrela's percentage was 73%, which is slightly up on the 72% for the same period last year. For the course of the following launches stand out, 925 Independencia in Portale (inaudible), the Bosque do Horto subdivision in Sao Paulo and Duetto Residencial & Lazer in Rio de Janeiro.

Going to slide 6, we will discuss our sales performance. Contracted sales for the quarter came to approximately R\$1,400 million for 3,300 units sold. The company sold R\$4,900 million worth in the year, up 14% on the same period for 2012. The states of Sao Paulo and

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Rio de Janeiro together accounted for 75% of our sales in the quarter. The good sales performance of the Northeast Region, accounting for 8% of the volumes sold is worth mentioning.

Let us now go to slide 7. Sales for the quarter helped the company achieve an annual sales over supply of 54%. Leaving aside band-1, SOS came to 49%, sales over supply. Sales of stock accounted for 61% of sales in the quarter. In terms of performance per crop or vintage or season, we have sold 44% of products launched this quarter. The chart on the right hand side shows the sales performance by vintage of launch. These performances are in line with what was projected in our feasibility study.

In slide 8, we will address inventory. At the end of the quarter, inventory at market value came to R\$6.2 billion, stable as regards the previous quarter. The graph on the right shows inventory movements. In the quarter, we sold R\$800 million worth of inventory. Ready inventory or furnished units account for 15% of total inventory.

In slide 9, we address finished units. The inventory of finished units accounts for R\$936 million, up 11% over the previous quarter. In this quarter, the company sold 18% of inventory that was finished at South (inaudible) and added R\$162 million to its inventory, above all by delivering projects in the state of Espirito Santo. On the right hand side, we see the 41% of finished inventory is concentrated in the Northeast and Espirito Santo, markets with reduced demand, where we expect slower sales speed.

Now going to slide 10, we will discuss units delivered. Cyrela delivered 25 projects in this period, approximately 6,500 units. Units delivered in the quarter represented a sales volume of R\$1.5 billion, coming to R\$4 billion for the year.

Eric will now discuss the financial results.

Eric Alencar {BIO 18098474 <GO>}

Good afternoon, everybody. In slide 12, we will present the financial results. Gross revenue came to R\$1.4 billion for the quarter, 2% up on the revenue, both for the previous quarter and for the same quarter last year. The gross profit for the quarter was R\$457 million, 2% up on the previous quarter and 7% up on the same quarter last year.

The company's gross margin for the quarter was 32.8%, virtually stable in regards to the margin for the previous quarter, 1.1 percentage points higher than the gross margin for 3Q12.

On the bottom left, we analyze EBITDA. EBITDA for the quarter was R\$287 million, 5% up on the R\$274 million for 2Q13, 17% up on the R\$246 million for 3Q12. EBITDA thus came to 20.6% for the quarter. The EBITDA margin for the year leapt from 17.8% in the preceding nine months of 2012 to 20.6% for the nine months accumulated in 2013.

Net income for the quarter was R\$175 million, 4% down on the previous quarter, but 16% up on 3Q12. For the year, net income came to R\$536 million, up 31% over the R\$411 million for the same period last year.

Net margin for the quarter was 12.5%, below the 13.3% margin for the last quarter while higher than the 11.1% margin for 3Q12. Net margin for the year rose from 9.8% in the preceding nine months of 2012 to 13.5% for the nine months of 2013.

Going to slide 13, we will discuss return on equity. In 3Q13, we achieved 15% return on equity, which is measured as net income for the last 12 months over the average shareholders' equity. The indication remains stable in regards to the previous quarter.

Going to slide 14, where we will discuss financial solutions for the clients for the 3Q13 in transfers, pay-offs and trust deeds. There were R\$973 million and 5,300 units. Our transfer operation remains efficient, coming to a good volume of units transferred in the period. In this period, we can highlight the Dominio Marajoara project in Sao Paulo and transfers from Cury, which together accounted for 24% of all transfers.

Yes, there was R\$100 million fall [ph] in the percentage of consolidation in this quarter compared with 2Q13, going from R\$737 million to R\$637 million, above all as a result of the Dominio Marajoara and Cury, which are not consolidated.

Slide 15 addresses cash generation. The company presented an operational cash burn of R\$35 million this quarter. This is comparable to cash generation of R\$90 million in 3Q12, R\$154 million in 2Q13. The variation vis-a-vis the previous quarter distributed is as follows. Firstly, increased expenditures with the purchase of lots to the tune of R\$15 million.

Secondly, a lower volume of transfers in the percentage of consolidation adding approximately R\$100 million. And thirdly, a distribution of dividends with partners, that is 100% consolidated, coming to R\$20 million. This difference is part of the operational volatility of the industry and does not reflect the company's expectations for the future. For the year, cash generation came to R\$335 million as opposed to a sum of R\$44 million in the same period of 2012.

In slide 16, we have data on liquidity and debt. Gross debt for the quarter was slightly up on the previous quarter. Gross debt at the end of quarter came to R\$3.8 billion as opposed to R\$3.7 billion of the previous quarter and the R\$4 billion or 4Q12. Of our total debt, 47% is for SFH financing or building, 77% is long-term. The cash and cash equivalent position was R\$1.6 billion at the end of the last quarter, remaining stable in comparison with the preceding quarter. Our net debt remains low in this quarter. Our net debt remains at comfortable level, where we have leveraged 35%.

Now, we will go to Q&A. Thank you once again for your interest in Cyrela Brazil Realty.

Questions And Answers

Operator

Ladies and gentlemen, we will now be beginning the Q&A session. (Operator Instructions)
Our first question is (inaudible) from Credit Suisse.

Q - Unidentified Participant

Well, good morning, everyone. I have two questions, the first one is about the strong sales volume in the Northeast. So, if you could please comment on how much is actually added to the improvement [ph] of some specific markets and how much is related to discounts or promotional campaigns?

And the other question is (inaudible) cash flow. As you mentioned, there was some volatility in this quarter. I just didn't understand one of the items with the distribution of dividends that you consolidated 100%. So, given that you consolidated as (inaudible) it shouldn't affect [ph] the cash flow regarding the dividends, I don't know if I understood that, and I'd like to know about the volatility levels that we should expect for cash generation in the upcoming quarters, is the next quarter, you still expect to transfer many projects that you have (inaudible)?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Nicole, this the Raphael speaking. About the Northeast, you asked if the market improved. I don't think we can in fact say that it did, but we are focusing on that and as time goes by, inventory is observed. So, you have to be cold-blooded because you know that someday, these products will sell. So, time is going by, we're selling, but the markets in the Northeast, for instance, and the state of Espirito Santo are still very difficult, as you know. So, there wasn't too much of a market improvements there.

A - Elie Horn {BIO 1823000 <GO>}

Hi, Nicole, the second question, Eric is going to answer.

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Nicole, how're you doing. In relation to cash generation, the 35 million consumed, the 20 million that we explained during the call is because we can't consolidate 100%. In our participation, our share is lower. It's not for shareholders, it's for the companies that are part of the Cyrela holding. So, the part that is distributed to shareholders that are not Cyrela are considered as cash consumption based on the consolidation map, for instance, MAP.

Q - Unidentified Participant

Eric, could you tell me about what you think about for volatility for the upcoming quarter, if the transfer volume is going to have to do with the JVs?

A - Eric Alencar {BIO 18098474 <GO>}

Well, yes, the volatility is part of the nature of our business. This quarter, specifically, there were 100 million less in transfers and 15 million in reinvesting in landbank, and that's good news. In the future vision, we see a very positive 2014 with cash generation and as you mentioned, in the next quarter, because of the volatility we rather not make any predictions.

Q - Unidentified Participant

Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

You're welcome.

Operator

Our next question is from Luiz Mauricio Garcia from Bradesco.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Good afternoon. I have a question that's more in line with the business part. So, I'd like to know if the company could comment about what it sees for launches for the upcoming quarter for 2014, and if you can go into some details among the expectations that's going to be divided among the JVs that the company had. So -- and what is Cury's opinion about the Minha Casa, Minha Vida Program and the pipeline for the Faixa 1 launches for next year and how does the company see the approvals that are going on in Sao Paulo, if Sao Paulo City Hall is slowing down and there are approval rates based on the scenario that's going on there.

I know that there are different areas, maybe it might be contaminating this area that they approve the project. So, will that affect the company? So, just an overview of the business, that's all I'd like to hear, about volumes and talking about the different segments?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Luiz, this is Raphael speaking. We don't give our guidance launches for 2013, 2014 and we don't plan on giving that. But said that, 2013 is almost over and we still strongly believe that our launch schedule that we expected for 2013 is going to happen. Today, the information is much more real than an outlook because we are in fact already in November. But we are very comfortable with our 2013 schedule. For 2014, we are not going to provide the guidance, volume guidance; we're not -- just not going to give that.

The approval rates in Sao Paulo is doing fine. We can't say that City Hall is getting in the way today. Quite on the contrary, City Hall is helping out and that's going well. So, if it doesn't launch, it's not City Hall's fault, they're doing well there.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Okay.

A - Raphael Horn {BIO 19714328 <GO>}

In relation to Cury and the Faixa 1, Cury and Cyrela, we really like the Faixa 1 program and we're trying to take advantage of that program when it has favorable conditions, which in fact it has right now. Cury is trying to get some more projects and we're trying to increase our volume in that segment. So, while we have the opportunity to grow that segment, we're going to speed that out.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

And how about an eventual Minha Casa, Minha Vida (MCMV) Programs 3, do you expect that Cury will continue to focus on Faixa 1 on Bracket 1?

A - Raphael Horn {BIO 19714328 <GO>}

Yes, definitely.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

And this, I have an important question for free cash, well, about free cash flow, which is about the swap program for landbank. So, one of the points that impacted the free cash flow was that you bought more landbank in Sao Paulo, which was cash and Sao Paulo is in the last phase the structuring that flop [ph] funds for the landbank. So, I believe that it should benefit you in 2014. So, in addition to the strong cash allocation in 2014, this swap fund could contribute to that as well. Can you comment on that? Is the swap fund closed, it was expected to close at the end of October, and if in fact we can expect that the swap fund will start to acquire land for the company in the beginning of 2014, and what amount of funding did you obtain?

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Luiz, this is Eric speaking. This swap fund is already official, it's closed. We still haven't put any land in yet, we're trying to look at their land now and what you can expect is using the swap fund in 2014. We're going to buy land in the swap fund and outside as well. The volume is around 350 million.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Thank you. Great, thank you.

Operator

Our next question is from Mr. Rafael Pinho from Morgan Stanley.

Q - Rafael Pinho {BIO 15321539 <GO>}

Good morning, everyone. My question is about inventory. We think the company demonstrates certain discipline in holding inventories, so not giving discounts. But as you've seen in the release, this inventory is being sold as time goes by and at a pretty good margin for the company. It seems like the company doesn't have to grant any discounts or decrease the margin to be able to sell that inventory.

So, my question is, how much longer do you expect the hold on to the inventory. So, what's the idea in your opinion and would it make sense at some point to simply speed up cash generation and offset landbank purchases by trying to sell that inventory, existing inventory easier?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Rafael, this Raphael speaking. Because you asked what math do we do for the inventory, ideally, for us, finished units, we want zero, right? But since we already have inventory, since you see that we can -- we do have finished units, the math is what's the best net present value that we're going to get. We're not going to burn NPV just to generate cash. We don't believe in that, we don't do that.

Obviously, we don't give discounts because we want to burn. We're not theoretical, some things we have to adapt, and we do it possible, trying to give the company the best NPV. I don't -- sometimes we do have to lower prices, otherwise we won't sell anything, but the math is based on NPV.

We like to generate cash. We want to generate cash, but we're not going to lower our prices just to generate that. We're going to maximize our NPV, but we want zero finished units; that's theory for now.

A - Elie Horn {BIO 1823000 <GO>}

This is Elie speaking, the ideal would be 0.7. Today, we're at 1 in inventory sales and we hope to reduce that in upcoming years. 1.71, historically speaking, 0.7 is sales per year. The idea is to reduce that one if we can.

Q - Rafael Pinho {BIO 15321539 <GO>}

Thank you very much.

Operator

Our next question is from Ms. Pauline Mellow [ph] from Citibank.

Q - Unidentified Participant

Good morning, everyone. I think my question is to Eric. I'd like to know what the INCC impact was to the gross margin in the quarter. Most companies had a positive gain and your margin was relatively flat quarter-over-quarter. Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Pauline, how're you doing? Okay. So, the INCC had a positive impact, but it was very small for Cyrela and that happens because in most of our contracts [ph] with our customers, we have an M minus 1 and the market works at M minus 2. So, that's why there is a difference compared to the market. We did sort -- part of that in the prior quarter. Said that, our margin is flat because there was also a positive impact of the INCC and

some inventory sales had a lower margin than the average margin, which generated 32.8 result for the quarter.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions) Our next question is from Mr. David Lawant from Itau BBA.

Q - David Lawant {BIO 16370172 <GO>}

Good afternoon, everyone, thank you for the presentation. My question is about backlog margin. It was approximately 35% throughout last year. This year, it was close to 38% and flattened out. So, I'd like to know is this level is something that you believe is good, if it should remain at that reflecting a 33%, 34% gross margin or if you believe that it's negatively affected because of older vintages?

A - Eric Alencar {BIO 18098474 <GO>}

Hi, David, this is Eric, again. In relation to our gross margin, there is two things that we have to understand. The first, that we're at 38%, which is adjusted for the FFH program and the (inaudible) program, which is technical support goes up to 33%. The new projects have higher margins, but inventories and sales, especially the almost finished units have a negative impact that offset the (inaudible). We're always working to increase the company's profitability. So, the profitability will show with a change in level in the long-term as we decrease the number of the amount of interest, the (inaudible) that we have.

Q - David Lawant {BIO 16370172 <GO>}

Okay. If I could ask another question, I'd like to talk about sales expenses that are approximately R\$113 million in the quarter or perhaps approximately 8% of sales, for launches, it's a bit more. So, I'd like to understand what is the ideal level? I do understand that you can't look at that figure just for the quarter, but instead in the stabilized base. So, what do you think would be an ideal level for sales expenses?

A - Eric Alencar {BIO 18098474 <GO>}

David, like you said, it varies from quarter-to-quarter, but we can try to understand what happened in this quarter. The 10 million increase is a direct result of campaigns and awarding for selling inventory, that's where media and (inaudible) aren't very effective. So, we spent 6% in the last -- in the year. We're taking many actions to decrease sales expenses, but it's very effective for inventory sales. And when we talk about the level, we prefer to give an award or a bonus instead of a discount. So, if we see that the NPV is positive, we're going to do that. So, that's what you can expect. It's pretty much going to maintain the figures that you've seen in the past quarters.

Q - David Lawant {BIO 16370172 <GO>}

Okay, thank you very much.

Operator

(Operator Instructions) Since there are no further questions, I'd like to pass the floor to Mr. Elie Horn for his final remarks.

A - Elie Horn {BIO 1823000 <GO>}

Well, we've been in very tough ocean since 2008 to 2011, and now, we've had -- we expect positive results and more energizing results for the future. Thank you very much.

Operator

The Cyrela's conference call is closed. Thank you for your participation. Good morning and thank you.

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