

Y 2016 Earnings Call

Company Participants

- Claudio Carvalho de Lima, Legal Director
- Miguel Maia Mickelberg, Financial Director
- Paulo Eduardo Goncalves, Investor Relations and Structured Finance Director
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Daniel Gasparete, Analyst
- Enrico Trotta, Analyst
- Gustavo Cambauva, Analyst
- Jorel Guilloty, Analyst
- Luis Stacchini, Analyst
- Luiz Garcia, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call where we'll discuss the fourth quarter of 2016 earnings results. At this time, all participants are in a listen-only mode. There will be a Q&A session later. Instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and the audio 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 also be asked by participants connected abroad. The earnings release published yesterday, 23rd of March after the close of the BM&FBOVESPA's trading session is also available 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 projections 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, the general economic performance of the country, and the international markets. Therefore, they're subject to change.

Here's the list of attendees; Mr. Raphael Horn, Co-CEO; Paulo Eduardo Goncalves, Chief Investor Relations Officer, Investor Relations Manager, and Miguel Mickelberg, Financial Director.

I'll now turn to -- the conference over to Mr. Raphael Horn. You may now begin Mr. Horn.

Raphael Horn {BIO 19714328 <GO>}

Good morning, everyone. The late 2016 was marked by economic turmoil, but a renewed trust on the economy of the country. The approval of recent economics and the prospect of approving several matters have improved the economy. We expect these reforms are approved. That's the only way out for the country.

The economic activity and unemployment levels haven't reacted yet, but the results of the downturn dampened inflation and dropped interest rates. Lower interest rates and more economic activity are key to recover credit and trust, two key pillars in our industry. As a consequence of this crisis here, the company had the largest volume of cancellation in its history and it impacted net sales and net revenue and we had to use 37 million in our cash.

This environment show -- the company proved it has access to banks and capital markets, not only to collect resources, but at lower costs. A proof of that was the CRI issuing at 98% CDI rate. In 2016, the company delivered a large volume, over 8 billion. All of the deliveries in the Northeast region have been concluded.

Savings contributed to maintain our gross margin. For 2017, this more positive outlook will be reflected in the real economy. Of course, lower interest rates will provide more credit and less unemployment will bring trust. We are concentrated in improving our operational efficiency, reducing inventory, generating cash and to have greater return on capital.

Now over to our operational results. We'll be talking -- on slide five, we'll address Cyrela's consolidated results. In the fourth quarter of 2016, we had BRL1.2 billion vis-a-vis or compared to 760 million in the fourth quarter 2015; nine in Sao Paulo; three in other cities; two in the South and one in Rio. We launched 32 products in the year. Excluding swaps, the volume launched in Cyrela's share was 2 billion, down by 9% year-on-year. The company's share in the volume launched in the fourth quarter was 81% compared to 87% year-on-year. In 2016, Cyrela's share in the launched projects was 75%.

On slide six, we highlight the launch of the Medplex Eixo Norte project in Porto Alegre, 51% of which have already been sold.

On slide seven, we'll talk about our sales performance. In Q4 of 2016, pre-sales totaled BRL1.1 billion, 29% higher than the 840 million reached in the fourth quarter of 2015. In 2016, pre-sales reached BRL2.8 billion against BRL3.4 billion in 2015. Excluding swaps, pre-sales amounted to 2 billion in Cyrela's share, a 21% reduction year-on-year. The states of Sao Paulo and Rio jointly accounted for 75% of sales in the year.

On slide eight, we'll address sales speed. The company's annual SOS was 29%. Looking sales speed by period, projects launched in the fourth quarter of 2016 have been 50% sold.

On slide nine, we'll address Cyrela's total inventory. At the end of the quarter, inventory market value totaled BRL6.5 billion, up by 2% quarter-on-quarter. The change in our inventory can be seen in the chart on the right.

On slide 10, we have a breakdown of our finished units. In the quarter, we saw 13% of the finished units at the beginning of the period. Adding the inventory projects delivered on the quarter and pricing of units at market value, finished units inventory increased by 12% quarter-on-quarter. We are aware of how important this matter is to the company and we will keep on focusing our efforts on these products. Rio and the Northeast region accounted for 43% of the finished units.

On slide 11, we'll talk about delivered units. In the fourth quarter, Cyrela delivered 24 projects totaling 7,300 units. In the quarter, delivered units account for a PSV of BRL2.4 billion, up by 74% quarter-on-quarter. In 2016, Cyrela delivered 21,300 units with a launch of PSV of BRL7.9 billion.

I will turn the floor over to Paulo who will present our financial results.

Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Thank you, Raphael. Good morning. On slide 13, we'll present our financial results. Gross revenue was BRL948 million in the quarter, up by 12% quarter-on-quarter and 10% lower year-on-year. In 2016, gross revenue totaled BRL3.3 billion, down by 26% in the year -- on year-on-year comparison.

Gross income in the quarter was BRL265 million, up by 1% quarter-on-quarter and 24% lower in the year-on-year comparison. In 2016, gross income reached BRL1 billion, 29% lower year-on-year. The company's gross margin in the quarter was 28.8%, 2.9% lower than the 31.7% from the previous quarter. In the year, the company's gross margin was 33.3%, 1.3% lower in the year-on-year comparison.

On the chart in the bottom left hand corner, we analyze our EBITDA. EBITDA in the quarter was BRL95 million, 38% higher quarter-on-quarter and 34% down year-on-year. In 2016, our EBITDA totaled BRL343 million, 54% down year-on-year.

Net income in the quarter reached BRL31 million, up by 114% quarter-on-quarter and down by 68% year-on-year. In 2016, gross income reached BRL151 million, 66% lower in the year-on-year comparison. Thus, our net margin for the quarter was 3.4% compared with 1.1% margin quarter-on-quarter and 9.5% in the year-on-year comparison. In 2016, net margin was 4.7%.

Let's now go to slide 14 to talk about our profitability. In the fourth quarter of 2016, our return on equity, measured as the net income of the past 12 months over the average shareholders' equity, was 2.5% and our EPS was BRL0.08.

On slide 15, we'll talk about our customers' financial solution. In this quarter, transfers, trust of deeds and payoffs amounted to BRL872 million, 26% higher quarter-on-quarter and 24% higher year-on-year. In 2016, transfer, trust of deeds and payoffs amounted to BRL3 billion, down by 7% year-on-year. Considering units, transfers, trust of deeds, and payoffs totaled 3,800 units, 23% higher in the quarterly comparison and 18% higher year-on-year. In 2016, they totaled 13,600 units, down by 10% year-on-year.

Slide 16 shows the company's cash generation. In Q4 of 2016, our cash used reached BRL156 million versus 225 million quarter-on-quarter and 28 million year-on-year. In 2016, our cash use reached BRL111 million against 893 million quarter-on-quarter.

On slide 18, we'll address our indebtedness. Gross debt at the end of the quarter was BRL3.4 billion. The cash position was 1.7 billion. Our net debt was 1.7 billion. Of the total gross debt, 62 relate to loans for construction and 67% is long-term. Our net debt over equity ratio was 25.1%, 2.3% lower quarter-on-quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged position to take advantage of the opportunities in the real estate market.

We'll now begin the Q&A session. Thank you.

Questions And Answers

Operator

Excuse me. We'll now begin the question-and-answer question. (Operator Instructions) Gustavo Cambauva from BTG.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Good morning. My question is about your view on the market. What are your expectations for 2017? Could you elaborate on the demand side? Do you think the worst is behind us or do you believe it's going to be a difficult year? If you could talk about your delivered or finished units in the cities where you have more inventory. What's the mood like? Have you noticed any positive signs or is it too soon? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Cambauva. This is Raphael. There are no two ways about it. After the economic downturn we've had, coming out of the downturn won't be easy. It's going to be a slow recovery. We believe the second half of the year will be better. Just like Mirallas [ph] is saying, maybe later down the year, it will be better. But today, we have a good feeling. The outlook looks better, but in actual fact, it hasn't improved that much. It was a very economic crisis or very deep economic crisis. If you think everything's going to be wonderful in May, June, July, I'm talking about the Rio state market, of course, it won't happen. It's going to be a slow recovery, but there is some hope in the air. We didn't have that last year.

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As to the finished units inventory, I think we can sell that inventory at a good speed in several cities. The problem that the -- what we delivered in October-December is going to happen now.

As to the different cities that you asked about, I would say that Rio is going to be more complicated for us. It's a very important region, but the situation is bleak. Excluding Rio then, and Curitiba, that's a very tough market for us, there is a lot of supply, but I think we are doing okay. In the Northeast, Salvador, we have no inventory. Recife, we're done. Belem and Sao Luis, we are about to finish that maybe later down this year. So these are the most important areas. I think we can do fine in Sao Paulo as well. Well, the problem is Rio in terms of the finished units inventory. I hope I have answered your question.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Yeah, that was very clear. Thank you. Good morning.

Operator

The next question comes from Mr. Enrico Trotta from Itau.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Raphael, Paulo, Miguel. I have a couple of questions actually. Let me just follow up on what Cambauva asked you. We've seen some signs of improvement in sales of -- in Q4, especially new launches, but I would like to better understand the sales context looking forward to 2017. What to take, what are the expectations for gross sales for the year? We are now almost in April. What have you seen so far in Q1?

And what about cancellations? You are not delivering anything else in the Northeast, but you still have Rio. What are your expectations for cancellations in 2017? Rio, it will be important to -- let me ask a second question. You were talking about TECNISA. You now have a stake in TECNISA. Could you elaborate on that situation with TECNISA? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Enrico. Your first question was about Q1, right? I'm going to answer just like I did to Cambauva. There are major differences between the months. It was a terrible economic crisis. It's too soon to tell. The scenario for 2017 is still difficult. I wish I were wrong. Second semester will be better than the first. That's the trend. That's not the right time to talk about Q1. We're not looking at the month of March only. We shouldn't be -- or we shouldn't have high hopes on the short term. Paulo will be talking about cancellations. We'd like to capital TECNISA, but we still have a couple of issues to address. And as soon as we have addressed them, we'll be talking about it.

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

So here is Paulo. As to the cancellations or dissolutions, the outlook is very similar to that of last year. It is better than Q2, Q3, but the volume is relevant still, but when you look at the year, there are two important things we have to take into account as far as deliveries

go. In 2016, we delivered 7.9 billion. Out of that, 1.6 was in the North and Northeastern regions.

In 2017, we'll be delivering less. Just to give an idea, last year, 71% of our cancellations came from products delivered by 2016. Just by the fact that delivering less, we're going to reduce the cancellations in absolute terms. When you look at the regions we are delivering in 2016, you don't have North and Northeastern regions. So we believe there will be a reduction in absolute terms.

A - Raphael Horn {BIO 19714328 <GO>}

That's perfect, Paulo. Thank you. Thank you. So Paulo talked about cancellation, but I'm Raphael. I'd like to comment on that. There won't be any magic tricks coming out of cancellations. We do not expect so many cancellations. Just because we're delivering less, but the economic dynamics is still there. It won't change dramatically, but 2018, things will be different, definitely.

Then, buyers won't be complaining about the price they pay. The economic dynamics and our regulations get in the way. We've been fighting the legislation as an industry. We are the worst country in the world in terms of dissolution regulations and that gets in the way for all of us.

The government have been talking about reforms and microeconomic reforms, there is a ministry to talk about it, we're talking about improving productivity, but our industry is very unproductive. We work for three to four years. We believe we've sold, but then you find out you didn't. It's the -- we are all paying that price in this industry. But we have to look forward, we have to keep on working to try to improve the legislation. That's it. And we're going to have more -- reduce, we have to try to reduce the number of cancellations.

And I believe that next year will be better, if these measures are actually approved. Otherwise, we're going to have a rough road ahead. Paulo talked about the deliveries right in 2016. It's going to go down in 2017.

Q - Enrico Trotta {BIO 16742911 <GO>}

Of the deliveries of 2017, how much will come from Rio?

A - Raphael Horn {BIO 19714328 <GO>}

In 2016, we delivered about BRL2 billion in Rio. In 2017, it's 1.6 billion.

Q - Enrico Trotta {BIO 16742911 <GO>}

All right. Perfect. Thank you. Thank you, folks.

Operator

Next question comes from Mr. Luis Stacchini from Credit Suisse.

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Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning, everyone. I have two questions actually. First, I would like to understand launches for 2017. Should we wait about for the low income JVs? What's your sales performance? Could that impact your cash flow throughout the year? My second question is about that moving out of non-strategic cities. What's the lead time, what's the G&A reduction, what's the outlook? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Hi, this is Raphael, Luis. Good morning. Again, 2017, I'm just going to harp on the same thing. You're looking for good news when you haven't got any good news. You hope the economy is improving. We're saying no, no, no. That's not the case. It's a challenging year. If it gets better, wonderful, but new launches for 2017 will be similar to that of 2016. Our focus is to sell our inventory and try to monetize our high inventory levels. These are not expressive launches for this year. This is halftime launches, if I may.

In terms of JVs, that's different. It's an industry that is driving. There is money from compensation funds. It's better than the projects for the middle class. Well, this is something that, thank god, is better than our industry for middle class and more expensive projects. We earn a lot with this new project. Well, but again, I'm not going to talk about it yet. Another product, we are careful about it, we worked hard for it and let's hope it's going to do well. We haven't got any numbers, results, gross margins, nothing. We'll have to wait, and we'll see whether these expectations can be proven.

As to moving out of non-core areas, we've been moving out of these regions, as you know. You can't do that overnight. Our G&A, salaries more specifically, have been going down year-on-year. We are shrinking so that we can focus on more profitable areas, but it doesn't happen overnight. Impacts of G&A can't be detected. You may have seen it, you may not like it, but salaries and their impact, we have been able to reduce that.

There is some delay. When you move out, you have to keep on, you have to deliver, you have to be there, you have some technical assistance in engineering that has to be there. So it doesn't happen overnight. But in 2018, 2019, our salaries will have lesser of an impact, and delays have been the bad guy in our balance sheet and we hope this is going to stop soon and -- to have negative impacts.

Q - Luis Stacchini {BIO 18717891 <GO>}

Thank you. Good morning.

Operator

Next question from Jorel Guilloty from Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning. Let me talk about other things other than results. What's your take on the impact of the regulation on cancellations that has been discussed in Brazil? What effects

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you may find in short-term sales? Is it going to be neutral? Do you believe it's going to reduce sales if they have higher penalties, if buyers are subject to higher penalties?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Jorel. Claudio will be answering that question. He is our Legal Director. He is working with (inaudible) on these issues.

A - Claudio Carvalho de Lima {BIO 17266664 <GO>}

Good morning, Jorel. This is a discussion that has been going on for quite some time. We've been discussing with the government and other agencies, but unfortunately, we haven't come to an agreement, which is very bad to the market, because it's a systems risk. Before we have a definition, companies will be having a hard time in results, higher cancellation levels, almost 50% compared to sales of last year.

Our expectation is not to do away with everything all at once. We believe we can reach a consensus based on -- everything's based on jurisprudence. The Law 4591 was simply destroyed. Jurisprudence is very bad to us in a nutshell. There should be some more balance so that we can have security and reliability. This lack of security, no one launches, no one wants to buy land, nobody wants to do anything. So it's a very serious situation. And the government is backing down. We don't see it as a positive sign. They're just favoring a minority. They don't know anything about the business. It should be addressed quickly.

A - Raphael Horn {BIO 19714328 <GO>}

Let me just answer that question again. The government has been talking about productivity a lot. So we hope that the government, sooner or later, will look at us. We need productivity. The cancellation law is a joke when it comes to productivity or anything. We are the worst country in that regard. And we hope the government will look at us.

They're doing the right thing in terms of productivity, towards favoring capitalism, reforms and we hope that sooner or later they look at us. That's what we are rooting for. We haven't seen that happen. We still have the worst legislation in the world. Great companies, good entrepreneurs, but there's no law.

A - Claudio Carvalho de Lima {BIO 17266664 <GO>}

But what if the regulation is approved? What would be the impact on sales? Do you believe that it can go up?

A - Raphael Horn {BIO 19714328 <GO>}

Well, if they approve, what's the effect, it's going great. If there is a good law, it's going to be just great, but we're just daydreaming. Once they approve the law, we can talk about it. We have no laws whatsoever. If they approve it, both reforms will be great, the welfare reform and the cancellation reforms. The way things are, the government is going to be -- well, the cancellation law will get better because the economy is better, not because the

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legislation is helping us. It's not even helping. A legislation that is right for business people, be them from any industry.

Operator

(Operator Instructions) The next question comes from Mr. Luiz Garcia from Bradesco.

Q - Luiz Garcia {BIO 17432519 <GO>}

Good morning. I have two questions. This is the first call of the year. I would like to talk about the company's strategy. You talked about moving out of non-core cities, the JVs, but looking forward, the company will have a more diversified platform. Plano & Plano, after the JV dissolution and when you look at the results, this strategy will remain for quite a long time once you have a contingency, for example. And the management has to be involved with other companies, not only with the operations core.

So what do you think about? What's the positioning strategy? You've been trying to reduce and concentrate more on the core business, but the investment in TECNISA gets in the way. So what's your take of this strategy of adopting a more diversified platform, higher income projects, and you are now having to resort to lower income projects as well. What's your take on that?

My second question is about contingencies. In the RPR, we've seen that possible contingencies have gone up; tax, civil and labor contingencies over 300% year-on-year. These are not provisioned. Can you elaborate on why it has gone up so dramatically, especially in labor, could that impact -- could that have future impacts?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Luiz. This is Raphael. Well, in terms of strategy, we want to be compact, streamlined and very profitable. In 25 -- between 2005 and 2015, that's what we did. That's the guidance at least.

Q - Luiz Garcia {BIO 17432519 <GO>}

For middle class and higher income projects, you said that you have several JVs and higher income projects.

A - Raphael Horn {BIO 19714328 <GO>}

Yes, that's true. But middle class and higher income just for organic purposes. We have very good JVs or all JVs that are very good. They yield good results, they remain there because they're compact, streamlined and profitable. If they follow those three criteria, be it organic or not, it doesn't matter. It fits, but from now on, we're not going to resort to JV for organic purposes, for middle class and higher income project because it doesn't make sense. But those that are within, that are good, they'll remain.

If they are streamlined, compact and profitable for lower income, we believe that that's a good moment. We have two excellent partners that can operate in that segment with --

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they are more prone to that segment. So it makes sense to have a Plano & Plano, to have a Cury, it makes sense, companies that master that segment and a segment that is doing much better than ours.

And that's true. It takes time to get out of it. The expansion cycle just like the one we had in the past, it takes time to move away from those and there are impacts on expenses, compensation, delays in construction and -- but that's going to come to an end.

And the strategy to reduce the company's size, yes, that's right, to have more profitable cash, more profitable inventory and pay dividends and work in the segment we are competent to give good shareholder returns, 2% to 3% a year, if that does make sense. Over to Miguel.

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

Good morning, Luiz. As to labor contingencies, actually in 2016, we concluded several projects, our record in deliveries and we moved out of non-core regions. Contingencies are classified just like previous quarters. And the risk may be reclassified once you have an agreement, if you can settle the case.

Q - Luiz Garcia {BIO 17432519 <GO>}

But you have no idea, but because -- you're delivering a lot of units, do you believe that this pressure will continue?

A - Raphael Horn {BIO 19714328 <GO>}

Well, Luiz, we have reduced the number of deliveries in part because of the deliveries in the North and the Northeastern regions. And in Sao Paulo, it's much smoother because we have several other projects starting. So there is no major impact on the horizon.

Q - Luiz Garcia {BIO 17432519 <GO>}

Thank you.

Operator

Next question comes from Mr. Daniel Gasparete from Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Good morning, everyone. Thank you for having the call. A very quick question about the P&L. My question is about the top line trends. A strong growth quarter-on-quarter; my question to you is, about the possibility of reducing cancellations. Could you have a similar level? My second question is about the user procedure of cash generation. There is a positive sign for the entire year. How are you going to use that cash? Are you going to invest in paying, in the debt in the first semester?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

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Hi, Gasparete. This is Paulo. As to the top line, there is an issue here as to the backlog revenue. In late 2015, we were at 3.5; we are now at 2.1 billion. There is an offset because our cancellations marked an increase; 70% in late 2015, now it's at 75%. Our top line maintenance must -- or depends on our net sales that can be through higher gross sales or reduced cancellations.

As to user procedure, we want to monetize the company, we want to generate more cash. It's good to generate cash for two reasons. We reduce debt, which is not -- it's no good for anyone, and you can pay dividends or you can buy land, if you have good land available. We would be extremely happy if we could generate cash in the next three years and pay out dividends, reduce our debt level and buy some good land, but of course, we believe we should streamline the company and improve its profitability.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Thank you.

Operator

(Operator Instructions) There are no more questions. I would like to give the floor to Mr. Raphael Horn.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you for attending this call. These aren't very positive news, but we are more hopeful for the future. Every businessman is hopeful and we are going -- we hope the economy can get back on track. We are hopeful, but still that's not the reality. Thank you for attending this call.

Operator

That concludes Cyrela's conference call. Have a nice day. Thank you.

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