FINAL

Bloomberg Transcript

Q2 2015 Earnings Call

Company Participants

- Eric Alencar, CFO & IRO
- Raphael Horn, Co-CEO

Other Participants

- Bruno Mendonca, Analyst
- Daniel Gasparete, Analyst
- Fred Mendes, Analyst
- Marcelo Motta, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call to discuss Second Quarter 2015 results. At this time, all participants will be in listen-only mode and later we will conduct a question-and-answer session; at that time further instructions will be provided. (Operator Instructions) As a reminder, this conference call 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 may be asked by participants connected abroad. The earnings release published yesterday, August 13, after the closure of BM&FBOVESPA trading session may be accessed also at the company's website. Before proceeding, let me mention that forward-looking statements that might be made during this conference call relating to the company's business prospects and projections, operating targets and relative to its financial growth potential are 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 international markets, and therefore are subject to change.

With us today are Mr. Raphael Horn, Co-CEO; and Mr. Eric Alencar, CFO and IRO. Now, I'll turn the conference over to Mr. Raphael Horn. Mr. Horn, you may begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning everybody. It's not new that the political and economic situation of the country is going through adjustments. Since our last conference call, the fiscal surplus goal was reduced from 1.13% of the GDP to 0.15%. Standard & Poor's placed the Brazilian rating with a negative perspective and many competitors threatened that we will lose investment grade. Official inflation in the last 12 months was 9.5% and it is the highest since 2003. SELIC rate increased again and it is now at 14.25% per annum, down from custom [ph] $3.50, the highest price in 12 years. Therefore, these financial statements of the company has always been and will continue to be one of the pillars [ph] of our management. We are in a comfortable debt level with a net debt-over-net equity ratio of 25%. Although the environment is more difficult, we are not facing any shortage of credit. We generated more than 600 million of cash this year. Year-to-date, we have BRL2.3 billion in cash and 100 million of our corporate debt will be maturing by year-end.

Our challenge is to lift the company, ready to face this challenging environment with operating, tactic and strategic measures that will ensure its perennity. We believe that the current, and despite of cycle, and we have to be ready to benefit from good opportunities that may arise.

In the real estate market, the reduction in the supply of new launches is really showing signs of reduction which makes (Technical Difficulty) in the mid to long term. In this half year, there was a 30% lower PSV launched in the metropolitan region of Sao Paulo and 80% less in Rio de Janeiro when compared to last year. Fortunately, we perceive that in the current scenario the real demand for real estate still exists. We need to be prepared for a forward sale speed, we need to make an effort to delight our clients in our launches.

In this quarter, we are launching selectively our new products with innovative concepts that will meet the demand of the buyers. Products launched in the quarter had on average 36% of sales. One of the points that disappointed in the quarter was our inventory sales that put pressure on our net revenue. We are aware that selling our inventory should be our priority. In this environment, it is fundamental to have a relentless management product-by-product, particularly our finished units.

On the positive side, after Salvador and Florianopolis, we delivered all of our constructions in Natal. Altogether, 22 projects that had a PSV of BRL1.9 billion. In addition, we have obtained some construction figures, particularly in Sao Paulo and Rio. More and more, we have concentrated our portfolio in more recent and higher margin projects.

Now, we will comment on our operating results. On slide 5, we will address Cyrela's consolidated results. In the second quarter of '15 we launched BRL1.1 billion compared to 900 million in the second quarter of 2014. In the first half, we launched BRL1.5 billion versus BRL2.8 billion in the first half of last year. In this quarter, we launched 11 new products and opened four new phases of the successful projects. Of the new launches, nine are in Sao Paulo and two in Rio de Janeiro. The company's share in volume launched dropped from 91% in the second quarter of 2014 to 81% in the same quarter of 2015. In the first half, CBR share was 78% compared to 90% in the first six months of 2014.

Excluding swaps and launches of the MCMV program income (1), volume launched in Cyrela's share dropped by 39% in the half year comparison. In this quarter, we highlight the launch of Cyrela Cypriani in the city of Sao Paulo and Living Moovie in the countryside of Sao Paulo, both with good sales performance.

On slide 7, we are going to talk about our sales performance. In the second quarter of 2015, presales totaled approximately 800 million compared to 1.3 billion in the same quarter of 2014. Year-to-date, presales reached 1.5 billion against 2.8 billion in the first half of 2014. Excluding swaps and income (1) of the MCMV program, presales in the first six months amounted to 1.2 billion in the CBR share of 37% reduction when compared to the first six months of 2014. The states of Sao Paulo and Rio jointly accounted for 79% of our sales in the first half of the year.

On slide 8, we'll address sales speed. The company's annual SoS, Sales over Supply, was 38%. Looking at sales speed by vintage, vintage launched in the second quarter of 2015 has been on average 36% sold. Projects launched in 2014 on average already have sold more than 50%.

On slide 9, we'll address Cyrela's total inventory. At the end of the second quarter, inventory at market value totaled 7.3 billion, 5% up quarter-on-quarter. The change in our inventory can be seen in the chart on the right. Finished units accounted for 25% of our total inventory. This increase had already been hinted by the company and reflects deliveries of projects with a high inventory level in regions with a low demand.

On slide 10, we have a breakdown of our finished units. In the quarter, we sold 4% of finished units in the beginning of the quarter. Adding the inventory of projects delivered along the quarter and depreciation of the units, this inventory increased by 15% compared to first quarter.

We are aware of how important this matter is to the company and we will continue to focus our efforts to sell these products. The Northeast region and Espirito Santo account for 39% of the company's finished units. Finished units in Natal account for close to 70% of the Northeast finished units. In this quarter, we delivered the last projects which were under construction in the city of Natal.

On slide 11, we will talk about delivered units. In the quarter, Cyrela delivered 22 projects which correspond to approximately 6,000 units. In the half year, delivered units accounted for a PSV of 4.4 billion. I will now turn the floor over to Eric who will present our financials.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Raphael, and good morning everybody. On slide 13, we present our financial results. Gross revenue was BRL1.2 billion in the quarter, up 10% quarter-on-quarter and 17% lower when compared to the second quarter of last year. In the half year comparison, gross revenue was BRL2.2 billion, down 19% from BRL2.7 billion in the first half of '14. Gross income in the quarter was BRL399 million, 11% up from the gross income of last quarter and 12% lower in the year-on-year comparison.

Year-to-date gross income is BRL760 million, 15% down from 891 million that we posted in the first half of 2014. The company's gross margin in the quarter was 35.1%, 0.3 percentage point higher than the 34.8% gross margin in the first quarter '15 and 1.7 percentage point higher than the 33.4% of the second quarter of '14. Year-to-date, the gross margin was 35%, 1.7 percentage point up over the 33% of the first quarter of 2014. The higher gross margin in the quarter stems from a higher share of sales and PoC of projects launched as of 2013, which have on average higher margins and from net construction savings of around BRL11 million.

In the chart, on the bottom left hand corner, we analyze our EBITDA. EBITDA in this quarter totaled BRL236 million, 54% up quarter-on-quarter and 13% down year-on-year. Year-to-date EBITDA was BRL390 million, down 24% from 515 million in the first six months of 2014. This quarter saw an increase in interest expenses due to an early settlement of a dollar-denominated debt. The equity income line increased quarter-on-quarter resulting from the recovery of Cury's result. There was no need for a legal provision at this point.

Net income in the quarter reached BRL118 million, 17% up from first quarter of 2015 and 30% down from second quarter of 2014. Year-to-date net income totaled BRL219 million, 34% lower than that of the first half of 2014. Thus, our net margin for the quarter was 10.4% compared with a margin of 9.7% in the first quarter 2015 and 12.4% in the second quarter of 2014. Year-to-date net margin was 10.1%, 2.3 percentage points lower than the first half of 2014.

Please go to slide 14 to see our profitability. In the second quarter of 2015, our return on equity, measured as net income of the last 12 months over average net equity, was 9.5% and our earnings per share was BRL0.31.

On slide 15, we talk about our customers' financial status. In the quarter, transfers, trust deeds and payoffs amounted to BRL889 million, 5.4% more quarter-on-quarter and 8.4% less year-on-year. Year-to-date, this volume amounted to BRL1.7 billion, 1% higher vis-a-vis the first half of 2014.

Considering units, transfers, trust deeds and payoffs totaled 4,200 units, 12% more in the quarterly comparison and 9% less compared to the second quarter of 2014. Year-to-date, this number totaled 7,900 units, 6% less than in the first half of last year.

Slide 16 shows the company's cash generation. In the quarter, operating cash generation amounted to BRL219 million, totaling 622 million in the half year of volume, 95.4% higher when compared to last year. Cash generation remains sustained by the high volume of deliveries in the last 12 months. The large PSV that we delivered in the first half of 2015 was BRL4.3 billion.

On slide 17, we present our indebtedness; gross debt at the end of the quarter was BRL3.9 billion. The cash position was BRL2.2 billion. And as a result, our net debt was BRL1.7 billion. Of the total gross debt, 59% relates to loans for construction and 70% is long-term. Our net debt-over-equity ratio was 25% compared to 27% in the prior quarter.

This low debt level coupled with the cash generation presented confirms that Cyrela is financially sound and puts us in a privileged condition to enjoy opportunities in the real estate market. We will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, now we will begin the Q&A session. (Operator Instructions) Our first question comes from (inaudible) Goldman Sachs.

Q - Unidentified Participant

Thank you, Raphael and Eric, for the presentation and thank you for the opportunity. I have two questions. Starting with the first point, I would like to understand what is that you expect in terms of cancellations because most of the projects for 2015 have been delivered. I read in the earnings release that you have 6.8% of vintage to be delivered in 2015. So, do you think it makes sense that we are going to have fewer cancellations by year-end?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, this is Eric. You see, although we have delivered many of the projects in the first half of the year, cancellations normally occur three to four months after deliveries. And those are the points that we try to transfer to many, many banks and could not. So, our expectation for the next six months is that cancellations, terminations of contracts will remain at the same level. We don't see any signs that this number will increase or decrease. So, we basically expect the level to be stable.

Q - Unidentified Participant

Thank you. My second question has to do with cash generation. I would like to understand two points that might perhaps help us try to estimate what the cash generation will be for the second half, if it will be stable compared to what we've seen in this quarter. So, I would like to understand in particular what you have had and what you of disbursements for land purchases for the second half of the year, and what are you doing to try to solve or mitigate the problem of finished units because as you mentioned in the earnings release, a good deal of the finished units are located in the Northeast region and in Espirito Santo. So, what can we expect from the company to try to reduce finished units and preserve cash generation for the second half of the year? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

This is Raphael. I'm going to talk about finished units and then Eric will address your other points. I do think that we had a good quarter in terms of finished units. I guess in terms of the general inventory, we're not doing that well. We can't do any magic tricks. We are doing what we have always been doing, focusing product-by-product, good relationship with the banks and taking care of our customers; there is no magic trick. The allocations and regions where the demand is very low, so what we can do is work hard. I believe that we had a quarter that fell a little below our expectations and we will work to improve these numbers. But that said, we didn't do that well in terms of finished units.

A - Eric Alencar {BIO 18098474 <GO>}

This is Eric. In terms of what you can expect for cash generation and the land bank, in the beginning of the year, we were expecting to spend 600 million to purchase land. We have disbursed 200 million in the first half, but apparently our projections will not achieve 600 million for the simple reason, the payment of many parts of land is linked to their approval and launches, which in many cases did not happen. So, it will be a little bit less and we expect something ranging from 550 million to 500 million. Cash generation will be volatile quarter-on-quarter.

The trend is that it will be a little lower in the second half because, as Raphael mentioned, our sales were reduced in the first half and the terminations of contracts normally occur three to four months later after the deliveries.

Q - Unidentified Participant

Thank you.

Operator

Our next question comes from Daniel Gasparete with Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Good morning, everybody. I have two questions also in terms of cash, a follow-on question to (inaudible). I just want to understand, cash generation was quite strong despite the sale of finished units being smaller. So I'd like to know, do you think there is any room to reduce your accounts receivable. It's 4.1 billion at this point. Do you think that it can drop to 3.5 billion, maybe? And in terms of the sale of finished units, do you envision any recovery now that the Central Bank is providing more funding, have you felt any rally regarding that?

And my second question have to do with the use of proceeds of the cash. You have a low debt, 25% net debt-over-equity ratio. So I would like to understand how are you planning to use this cash and proceeds. Thank you very much.

A - Eric Alencar {BIO 18098474 <GO>}

Gasparete, this is Eric. Well, in terms of accounts receivable, the trend is that they will decrease because the delivery volume is higher than the volume of launches and sales. And since we are transferring 96% of the contracts within the year, the trend is that accounts receivable will be reduced. The good news is that it will be reduced to generate cash. So, it's the realization of accounts receivable. As for the funding, the liquidity -- funding, to us, we didn't feel much of an impact because although some banks became more restrictive, we were able to deviate the demand to other banks. It was more a little bit intensive, but there was no immediate impact. I guess that this helps avoid a faster reduction in credit. As for the moment, we have to work with prudence. We're generating cash. We still have a positive trend, but any action related to buyback or distribution needs to have a guarantee that we are going to have sufficient cash to face this challenging moment in Brazil.

So, with the Board and the management, as always or are always discussing, but we have nothing to communicate to you at this point.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Thank you, Eric. Thank you very much.

Operator

(Operator Instructions) Our next question comes from (inaudible).

Q - Unidentified Participant

Good morning everybody. Congratulations on the results. I would like to know about the third quarter. We are practically halfway through the third quarter. So I would like to know about sales performance. Could you give us an update on that? If your could, it would be quite interesting to us. Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Good morning, Daniel. I think that the market overall, the economy in general in almost all of the industries remain at the same level of the second quarter. You see, the outlook is the same, the macroeconomic, microeconomic conditions remain unchanged. So, I think that the competent companies will have better results. So, the macro scenario remains the same. So, I guess that the trend remains more or less the same.

Q - Unidentified Participant

Okay. Thank you.

Operator

Our next question comes from Mr. Fred Mendes with HSBC.

Q - Fred Mendes {BIO 17221617 <GO>}

Good morning. I have two questions. The first, I would understand a little bit about the revenue. It's a little bit higher than what I had and when you calculate the finished units, it dropped by half, total sales kind of flat, slight increase, but basically flat. So, was there any savings in construction costs that had a positive impact on revenue because we had a higher revenue than expected. That's my first question.

Second question has to do with provisions in the fourth [ph] quarter amounted to 40 million in 2014 when we talked. The outlook for 2015 would be something around 80 million. In this quarter, we had a positive impact of 10 million reduction, which actually helped your bottom line. So, was there any change, is the legal department being a little bit more conservative because in the first quarter just 12 million, which is positive. I just want to understand this number in the second quarter. Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Fred, this is Eric speaking. As for the revenue, indeed there was a savings of about 11 million which helped revenue, but what was really positive was the milling [ph] of some construction that helped and the recognition of new launches. So with these items, we were able to generate this revenue which was somewhat offset, as you said it yourself, by lower-than-expected sales of finished units. Had we sold furnished units as expected, gross revenue would be even higher.

As for provisions, given the payment of indemnities for labor claims and the reclassification of some provisions, we did have a positive result in that line item in the quarter. But you see, this is the volatile item. Our legal department continues to work on litigation as one of the priorities. So quarter-on-quarter, our legal department looks at all of the claims in the jurisprudence, the case law for each agreement, they see how much that they can provision for the agreement and they gives us an amount. This quarter, we had good news. Next quarter, it will be more of less in keeping with what we saw this quarter.

Q - Fred Mendes {BIO 17221617 <GO>}

Thank you, Eric. If I may ask a follow-up question, still in the accounting part. Cury came in strong this quarter and calculated a profit of 56 million versus 6 million in the first quarter. Any one-off event going against the macro outlook, what happened there?

A - Eric Alencar {BIO 18098474 <GO>}

This is Eric again, Fred. What happened was Cury this year was similar to what happened last year. Given the type of project of Cury, the recognition of milling is very low in the first quarter and the recognition of milling was much high in the second quarter and that's why we saw this difference. If you look at the first quarter of last year -- actually the second quarter of last year and this second quarter, they were basically the same. The profit of Cury will be more or less the average of the first and the second quarter of this year for the next quarter.

Q - Fred Mendes {BIO 17221617 <GO>}

Thank you very much.

Operator

Our next question comes from (inaudible), Itau BBA.

Q - Unidentified Participant

Good morning, Raphael, Eric and everybody. Thank you for the presentation. I guess I have two questions. The first one is more in line with Fred's question. I like you to elaborate where the savings coming from, what kind of project they are coming from and what can we expect in terms of savings along the second half of the year? Perhaps the labor cost is little lower after you negotiating with suppliers to generate some savings. So, my second question is, well, I want to understand the commercial strategy of the company now because your finished units continue to increase, you have finished units in the Northeast, how does the company intend to sell the finished units along the -- how does the company intend to address the finished units in the second half because they tend to increase and in the macroeconomic environment, we should not see great improvement in the sales of finished units? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Good morning, Enrique [ph]. About your first question, construction savings, I think that it is normal with a slowdown of all of the Brazilian economy. Pressure on price that we felt in recent years is now being inverted.

I think that this is a trend. I think it's happening with all of the players in the industry and we don't see this trend changing because there will be a reduction in demand. So, I think that, that is the trend.

As for the strategy, I believe Cyrela's focus is, have always been, to sell finished and semi-finished units. So, this is obligation and it is our commitment. As we said, the outlook is not very rosy, but it is what we have; we have to focus on our finished units. We will launch one project or another for which we believe there is a good demand. If it's good, if it's big, so we will launch. There is always a market for some projects, but our focus is to sell finished units and not on launches.

Q - Unidentified Participant

Thank you. And a follow-up to my first question regarding cost savings. When you got the 11 million of construction cost savings in the second quarter, where is this coming from, from a project that you launched six to eight months ago, that is running at a lower cost than expected or is part of this coming from projects that you have just delivered and that perhaps you brought delivery a little forward and you're running at a lower-than-expected cost. Could you just perhaps break down the 11 million of construction cost savings?

A - Eric Alencar {BIO 18098474 <GO>}

This is Eric. As for where the savings are coming from, it varies a lot. We have hundreds of construction sites, so it's hard to say where exactly this is coming from, but normally savings come at the end of the project because that's when we are certain that we can recognize the savings. It's very difficult to recognize savings at the very beginning of the project. It's more towards the mid-to-end projects more in Sao Paulo and Rio.

Q - Unidentified Participant

Okay, Eric. Thank you very much.

Operator

(Operator Instructions) Our next question comes from Mr. Bruno Mendonca, Santander.

Q - Bruno Mendonca {BIO 16313094 <GO>}

Good morning. I have two questions, very quick ones. When about the land bank have you discussed any new trends in terms of contract cancellations relative to the land bank, do you intend to keep the whole land bank in the company. So, that's my first question.

My second question is about the financing outlook for new projects. Do you see availability of credit or loans, any relevant changes in the rates and how risky is this for launches in the next 12 months?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Bruno. I guess that our land bank is reasonably big and what we do is, managing this product by product, plot of land by plot of land. It is normal to have some parts of land leaving the land bank, this is normal and it will continue to happen. And this has to be analyzed on a case-by-case basis. We can't tell you what's going to happen, it's a case-by-case.

As for financing, I think Eric can give you more detail, but I think that there will always be loans for good launches. I think that the main issue for the new launches is the demand. Customers, they're not really financing for projects. For good companies, there will always be financing at rates which we consider reasonable and decent.

Q - Bruno Mendonca {BIO 16313094 <GO>}

Thank you very much.

Operator

Our next question comes from (inaudible), Banco Safra.

Q - Unidentified Participant

Good morning. I would like to go back to contract cancellation. The comment is that they normally happen three to four months after delivery and that they should remain at a flat level. What is this flat level, is it 15% of sales, 10% of sales? Could you comment on that? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Christiane [ph], this is Eric. How are you doing? Well, our cancellation with a more strict loans increased, but here at Cyrela, we see these as cancellations of sales. Now, this percentage varies a lot -- these percentages vary a lot, around 25%, some regions 10%, 15%, some particularly in the north regions, Northeast regions, close to 40%.

Q - Unidentified Participant

Okay. Thank you.

Operator

Our next question comes from Mr. Marcelo Motta with JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. A quick question, perhaps you gave a comment on the carrying cost of inventory. Some companies are seeing that sales expenses are pressurized and not only by the sales effort, but also for the cost, the carrying cost. I would like to know how you see this line item. And this is considered in others, commercial expenses or is it being posted elsewhere?

A - Eric Alencar {BIO 18098474 <GO>}

Hello Motta, it is exactly what you said. It is in others of sales under carrying cost. In addition to the financial, our net 110 of CDI, the part of maintenance taxes amounts to around 10 million per quarter, 14 [ph] million a year, it's a relevant amount.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) There are no more questions. I would now like to give the floor back to Mr. Horn for his final statement.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you very much and I expect to hear from you in the next conference call.

Operator

That does conclude Cyrela's conference call for today. Thank you very much for your participation. Have a good day. Thank you.