

Q3 2014 Earnings Call

Company Participants

- Eric Alencar, Chief Financial Officer
- Raphael Horn, Chief Executive Officer

Other Participants

- Eduardo Silveira, Analyst
- Luiz Mauricio Garcia, Analyst
- Raphael Pinho, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Cyrela Brazil Realty Conference Call, in which we will be discussing the results of the Third Quarter of 2014. All participants are connected in listen-only mode during the presentation, and later we will have a question-and-answer session when further instructions will be given. (Operator Instructions)

As a reminder, this conference is being recorded and the audio will be available at the company's website www.cyrela.com.br/ir. This call has simultaneous translation into English and it is being broadcast simultaneously on the Internet. Questions may be asked by participants connected from abroad. The news release published yesterday November 13, after the closure of the BM&FBOVESPA trading session may also be accessed at the company's website.

Before proceeding, we would like to mention that forward-looking statement that might be made during this conference relating to the company's business perspectives, as well as projections, operating targets and relative to with growth potential. Our forecasts that are based on the company's expectations regarding the future of Cyrela and these forward-looking statements or expectations are highly dependent on the domestic market conditions, the general economic performance of the country, as well as international markets. Therefore they are subject to change. Today with us, we have Mr. Raphael Horn, co-CEO; and Mr. Eric Alencar, CFO and Investor Relations Officer. I'd like to give the floor now to Mr. Raphael Horn. Mr. Horn, you may proceed.

Raphael Horn {BIO 19714328 <GO>}

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Good morning, everyone. The third quarter of the year was marked by the non-typical concentration of events, both the World Cup and the uncertainty regarding elections brought about volatility. The company had a lower progress or slower progress, and our market was not different. July was the weakest month in terms of say, August and September bounce it back to previous levels. And what we have been seeing this year is that the real estate market became once again a market forward experts.

In the last few years, there was quite a lot of money in the sector, be it through the capital markets or national and international funds. With the economy and the real-estate market reaching stabilization, there was a reduction in the flow of funds into the sector, and the trend is that professional experts will continue to operate and adventurous so to say will probably lead the market.

A lot of money in any sector whatsoever is not very good for anyone. With less money opportunities may arise again, and we believe that the residential sector in Brazil will not come to a halt. Demographics and favorable financing conditions and a real demand for that. And as we said, with less (inaudible) to say in the market the selectivity will increase and professionalization of companies will become more intensive, and the delivery of the right product with the right quality will be relevant factors to differentiate any company.

In this scenario, with less liquidity, more added value to the -- for the client and that's hype is a scenario that we can really charter -- navigate, and everything depends on the adjustment of the economy. We know that an adjustment has to be carried out, but we do not believe there will be major crisis or recessions. Operation is prepared, well prepared for that and we have savings in our portfolio of construction sites, and corporate governance has already been established (inaudible) is more and more part of our DNA and new launches are being made with good margins.

It is not new that we still have to live with whatever comes from the past, and the main one is the volume of finished unit inventory, which is a concern in our minds. In this quarter, there was some impact of these leftover, so to say in this portfolio, we recognized legal provisions and we delivered projects with a high volume of finished units. And in spite of all that, we continue to generate cash consistently. We generated 187 million in cash this quarter only, 505 million for the year-to-date. Our endeavor to decrease allocated capital continues in the year between the buyback of dividend, and dividend, we distribute for 185 million and this strategy together to the improvement in our profits led us to have the highest earning per shares since the first quarter of 2012. It's important to say that we are not satisfied yet, but we are sure that we are on the right track.

Now let's start our presentation -- our slide presentation. On slide number five, we will be talking about the consolidated results of Cyrela. In Q3, we launched BRL780 million vis-a-vis BRL1,200 million in Q3 last year. In the year, the launches were BRL3,600 million, 9% lower than the volumes launched in the same period last year. The company's participation in the volume launched went up from 69% at the first nine months of 2013% to 85% in the same period this year. If we exclude the swaps and launches of Minha Casa Minha Vida Faixa 1, the volume launched for the Cyrela percentage in the nine months of 2014 increased by 8% on a year-on-year basis. In this quarter, we highlight the launch of Nobre Residencial into Rio de Janeiro with the sale -- good sales performance.

On slide numbers six, we highlight the 360 On The Park in Rio. On slide number seven, you can see that pre-sales contract reach approximately BRL1 billion, vis-a-vis 1.3 billion in the same quarter last year. In this quarter, we didn't sign any contracts for Minha Casa Minha Vida Faixa 1 project.

Year-to-date, the sales of the company reached BRL3,800 million, 22% lower than the BRL4.9 billion -- BRL4.9 billion in the same period last year, and this drop was partially offset by the increase in the CBR participation in sales that went from 70% in the first nine months of 2013 to 84% in the 2014 year-to-date.

Net of swaps and Minha Casa Minha Vida Faixa 1, the percent -- the sales of the CBR presented decreased 12% year-on-year. Sao Paulo and Rio jointly accounted for 80% of our sales for the quarter, and 80% for the year. On slide eight, we will be talking about our sales speed. The sales in the quarter contributed for the company to reach an SoS of 40%, and annual SoS of 48.5%, and net of Faixa 1 the SoS in the last 12 months would be 46.5%.

In terms of performance for vintage, we sold 32% of the project launch in this quarter. The chart on the right shows the sales performance per vintage. These performances are in lined which was projected in our feasibility studies.

On slide number nine, we talk about the total inventory of Cyrela. At the end of the quarter, at the market value, the inventory amounted to BRL6,900 million, a 1.6 drop on a quarter-on-quarter basis. The change in our inventory may be seen on the chart on the right. The finished units inventory was 18% of our total inventory, and this increase had already been mentioned by the company and reflects the deliveries with high number of projects, with high numbers of finished units and in areas where the demand is low.

In slide number 10, we talk about finished units. In this quarter, we were able to sell 18% of our finished units inventory at the beginning of the period, and considering these and the appreciation of the units, we had an increase of 14.6% on a quarter-on-quarter basis. We know about the importance of this subject for the company, and we'll continue to focus our sales efforts on these products.

The Northeast and Espirito Santo regions represented 35% of the finished units inventory of the company. Natal and Salvador, 69% of the finished units inventory in the Northeast.

On slide 11, we will talk about the units sold. In this quarter, Cyrela delivered 19 projects representing approximately 5,100 units. In the year, the company delivered 61 projects with 15,400 units delivered. The units delivered in the quarter represents a PSV of BRL1,600 million for the year, this amount was approximately BRL5 billion.

Now I would like to give the floor to Eric, he will be talking about the financial results.

Eric Alencar {BIO 18098474 <GO>}

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Thank you, Raphael, and good morning, everyone. On slide number 13, we'll be talking about the financial results. In this quarter, the company recognized the Reserva Golf Fase project launched in March in Rio, and as its PSV is BRL900 million. And the fact that this was bought in a swap operation, this brings some accounting impacts based on the accounting rules. The land swap PSV is considered as a revenue in the cost in the income statement with zero margin. Besides this PSV, it's used as the cost of the land for the evolution of the POC, and in this case, the initial POC of the product is 58%.

As a consequence, the development revenue for this quarter was positively impacted by the recognition of this project as well as our net income. Besides as the amount stocked [ph] has a zero margin, there was a decrease in the gross and the EBITDA margin and the net margin as well. When we compare with the previous quarters and the gross revenue reached 1.6 billion in the quarter, 16% higher on a quarter-on-quarter basis, and 13% higher on a year-on-year basis.

For the year, the gross revenue was 4.4 billion, representing a 6.8% growth over the nine first months of 2013. The gross profit of the company for the quarter was BRL583 million, 6% higher on a quarter-on-quarter basis, and 6% higher on a year-on-year basis. For the year, the gross income reached 1.4 billion, growing by 5.5% on a year-on-year basis. Gross margin for the company in the quarter was 29.9%, 3.5 percentage point below the 33.4% of the previous quarter, and also lower than the 32.8% margin in Q3, '13. For the year, gross margin 32%, 0.7% got lower than the first nine-months of 2013.

On the lower part of the slide to the left, we analyze the EBITDA. EBITDA for the quarter was BRL279 million, 3% higher to the EBITDA of the last quarter and 3% lower on a year-on-year basis. For the year, EBITDA 793 million, 3% lower than the 819 million of the first nine months of 2013.

Net income for the quarter was BRL179 million, 6% higher than the net income of Q3 '14 and 3% higher than Q3 '13. For the year, the company's net income was BRL511 million, a 5% drop vis-a-vis the first nine months of 2013. Thus our net margin for the quarter was 11.1% compared to a 12.4% margin in the Q2 '14 and 12.5% in Q3 '13. The margin for the year-to-date was 11.9% vis-a-vis 13.5% in the first nine months of 2013.

Now, let's go to slide number 14, where we show our profitability. In Q3 '14, we delivered a return on equity measured as a net income of the last 12 months over the average payoff of 12.3%. In line with our strategy of generating value for our shareholders in 2014, we have already paid out BRL484 million, being 171 as the minimum mandatory dividend and BRL313 million in share buyback.

As a consequence of the strategy and the improvement in our net income, the earnings per share of the company reached BRL0.46 in the quarter. This is the highest amount since the first quarter of '12 in our common shares, and it's higher to the BRL0.43 of the last quarter, and the BRL0.42 in the first quarter of last year -- of the third quarter of last year, year-on-year.

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And now slide 15, financial solutions for the client. In Q3 '14, we transferred, we sold and we settled 941 million, 3% less than Q2 '14%, and 3% less than the Q3 '13. In terms of units, 4.4000 [ph] 4% lower than the previous quarter and 17% lower than the same quarter last year. In the year, we transferred, we sold and we settled the volume of BRL2.6 billion, a 10% reduction vis-a-vis the 3 billion realized in the same period of 2013. The volume of transfers and settlements continue at healthy levels in line with the delivery levels of the companies.

Slide number 16, cash generation. In this quarter, we delivered an operating cash generation of BRL187 million, higher by BRL28 million to the previous quarter, and 222 million higher on a year-on-year basis. Year-to-date, we have already generated BRL505 million vis-a-vis BRL335 billion generated in the same period last year.

On slide 17, we would be talking about indebtedness. Gross debt at the end of the quarter amounted to BRL4.2 billion, the same amount as the last quarter, cash position BRL1.8 billion. So our net indebtedness was BRL2.4 billion. Of the total of our gross debt, 57% referred to financing of the Brazilian Housing Finance System and 73% long-term. Our net debt over the P&L reached 37% vis-a-vis 39.4% in the previous quarter. And this low indebtedness together with the cash generation that we had ratify the sound finance shows of Cyrela and place us in a very good position to take advantage of the market.

Now, I would like to start our Q&A session.

Operator

Okay. Okay.

Questions And Answers

Operator

Ladies and gentlemen, once again, now we would like to start the question-and-answer period. (Operator Instructions) Our first question comes from (inaudible) from Credit Suisse.

Q - Unidentified Participant

My question it has to do with cash generation. Good morning. What do you see as recurring cash generation.

A - Raphael Horn {BIO 19714328 <GO>}

Could you repeat the question please it's very low, the volume is very low says the speaker.

Q - Unidentified Participant

I would like to understand what you see as a recurrent level for cash generation, mainly taking into account. What you expect, in terms of disbursements regarding the acquisition of land and the delivery of units?

A - Eric Alencar {BIO 18098474 <GO>}

Luiz [ph], this is Eric. As you know, cash generation quarter-on-quarter is very volatile. You can see that it is very good this quarter. And the long-term trend given our delivery schedule is to continue to be cash positive -- cash flow positive. However, this is not the guidance, mainly because of the variation of the price of land and quarter-on-quarter we can have a big variation in this quarter more specifically, practically the whole cash generation occurred in the last month in September.

So, we see that we spend about 800 million per year in land and this number tends to be constant in order to replenish our land bank, and our expectation for 2015 is to have positive cash generation.

Q - Unidentified Participant

Thank you.

Operator

Our next question comes from Luiz Mauricio Garcia from Bradesco.

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

Good afternoon. I have two questions. One about contingencies that have been impacting your results. Could you please tell us when you expect the change in this cycle, when do you expect contingencies to go down, and when could we expect not to see any contingency left over from your legacy? Could you give us a timeline about contingencies and provisions that have been impacting you overall?

A - Eric Alencar {BIO 18098474 <GO>}

They're non-recurring, but that although they are non-recurring they have been happening every quarter. And the second question has to do with the market.

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

What about the campaign for new launches for Q4? Could you please talk about that? Sales over-supply and what have you been doing in order not to have an increase in your finished units inventory, because you're making quite a lot of new launches, and giving the scenario of excess supply in the Vila Clementino [ph] region. How do you see the Baja market in Rio de Janeiro and the neighboring region?

A - Eric Alencar {BIO 18098474 <GO>}

Luiz, good morning. I will be talking about the contentious side of your question. What we have is civil litigation that continues because of the legacy and the deliveries will continue

over 2015, and no longer in 2016. And of course at Cyrela, we provision for all the suits against the company, but as we are still delivering these projects from the legacy, we might have some new provisions in the future. But as with the end of the delivery of these projects, we believe that in 2016 there will be a turning point. So we could expect new provisions for 2015 because of that Sao Paulo and Rio are already delivering on time. But in other regions of the legacy, we will still have some delays.

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

And what about the land bank, does it continue?

A - Eric Alencar {BIO 18098474 <GO>}

Do you mean provisions or you mean cancellation of land contract?

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

Yes.

A - Eric Alencar {BIO 18098474 <GO>}

Well, this is just business as usual. It's our daily work and it has to do to have with our strategy of having a faster assets turnover, and some plot, we will end up divesting from them or canceling the contract, okay. But our provision is higher then. You asked a few questions about the market.

Our SoS for the third quarter is the following, and these faces also have SoS that is lower and they sell very well. So we do not have any improvement there, any increases. And you asked about the campaign in Sao Paulo for new launches. We are encouraged, and we are enthusiastic and we have already launched one of them. In 30 units, we have already sold 12. In Vila Clementino [ph] for a high-end product very good. We launched one and we use this quarter. In 120 units, we sold 54 already, so far so good. So we are very excited with everything that we have in our pipeline and already being offered. And we think that the market is becoming more and more selective, more and more professional and you have to know what you're doing and do what right, so you have to buy the land at the right price and sell the right product. We are not afraid of the scenario and you asked about our launches and our finished units.

If you're -- we are assertive. When we deliver the product, we expect not to have any finished units left, and as these more problem areas. So the finished units, we expect not to have any additional finished units inventory and it's not because we still have some finished inventory that we will not make any new launches.

And you ask about Rio also, what we see for Rio? Rio is a market where our competition is very fierce, but if you have a good price and a good product you end-up selling your product. The game is tough and we have our internal targets and we track all the targets for all the product, and in Rio we're being able to sell with good margins for the company.

Okay. So, the game is tough, but we're going ahead. This is the market situation, the market is professional, it is more selective and the residential market will not come to a halt in Brazil. But you have to be careful you have to be cautious or you cannot be adventurous.

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

But in Rio, do you believe the market is becoming more difficult vis-a-vis Sao Paulo or not so much so?

A - Eric Alencar {BIO 18098474 <GO>}

Well, we don't get into this kind of detail because it has to do with our own internal real estate intelligence, but nothing to do with the elections. The whole year in Rio, the market is difficult, but you can operate. And at Sao Paulo is the same, the market is really difficult, a lot of competition, but if you have a good product at the right price, so life is not easy today, but if you have the right product, I think we can always make money with this scenario.

Operator

Raphael Pinho, Morgan Stanley.

Q - Raphael Pinho

Good morning, everyone. Raphael, I would like to understand, what kind of scenario are you taking into account macro scenario for 2015 and what about the scenario being the basis for your decisions. I'm not asking you to get into anything that you cannot inform us, but how do you see 2015, how are you planning for 2015? This is my first question.

The second question, Eric has to do with the evolution of SG&A for 2015. Do you expect any reduction in your SG&A, can you give us some color vis-a-vis the scenario that you are taking as the basis for your planning?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Pinho. Good morning. I will answer about the SG&A and then Raphael will answer the other question. SG&A is as follows. Very often, mainly when you have the finished units, it's better to invest in sales than giving discount. So, next year we will have a relatively stable condition vis-a-vis the finished units for this year. In the sales line, I think what you are seeing this quarter will be the trend for 2015 as well.

When you talk about G&A in the last few years, we have been controlling the issue related to salaries in the company and we want to keep the company very lean, and approximately 15 million of G&A came from payment of legal fees and those agreement made regarding the litigation suits. For next year, we see stability in sales, and we also see stability in G&A, not because of the internal reasons, but referring to external fees paid to third parties.

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A - Raphael Horn {BIO 19714328 <GO>}

Pinho, this is Raphael. We believe 2015 will be similar to 2014, it will be -- it will not be very different. We have to limit ourselves to reality and we of course we had that boom for six, seven years, but now the boom is over. And now it's the reality, real life, real consumers and of course the adventure have already left the market. And it is -- with this scenario that we work. In this scenario, the client wants to buy for the right price and the right quality, either the land or the apartment. So you have to be very careful because you have to buy the right product, the right land, market, quality, client satisfaction, name, brand, reputation. These are all drivers that now make all the difference once again. So we do not expect an improvement in the market for 2015 vis-a-vis 2014.

Q - Raphael Pinho

Thank you, Raphael. Thank you, Eric.

Operator

(inaudible), Itau BBA.

Q - Unidentified Participant

Good morning. About cash generation, Luiz also asked about that. For some time you are mentioning that -- you have been mentioning that you would have a cash disbursements with land acquisition in the second half. I think it was BRL500 million give or take, if I'm not mistaken. Of these BRL500 million that you mentioned, that would have the impact on your cash with the purchase of land in the second half of the year, how much will be spent in -- how much was spent in Q3, because we see that there is no big change in this line item in your balance sheet. So, could you please tell us about the impact on your cash and what we could expect for Q4 in terms of the impact on your cash due to land acquisition?

A - Eric Alencar {BIO 18098474 <GO>}

(inaudible), this is Eric. This is exactly what you said. In the first and the second quarters, we invested 150 million per quarter, and we said that we would be spending about 500 million in the second half, which would be more or less 250 million per quarter and this is what exactly what happened in the second half. We had an increase of 100 million in our expenses with land acquisition vis-a-vis the last quarter, but it was offset by a 150 million more in our revenues.

Mainly in September, when we had a very good cash flow -- inflow, so we invested the 250 and we estimate to invest 250 additional in Q4, but this was partially offset because of a higher revenue generation for the long term. It is the same that we said to Luiz, cash generation with volatility on a quarter-on-quarter basis.

Q - Unidentified Participant

Thank you.

Operator

Mr. Eduardo Silveira from Banco Espirito Santo.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Good afternoon. I have two questions. The first is the following. Could you talk about equity, what was the contribution in terms of net income for the first -- for the first nine months that is to say year-to-date and also in this quarter for the net income of Cyrela? And what is your strategy to increase your ROE year, more active in buyback. So do you have a minimum payout or is there a figure in terms of leverage and as of that figure or higher than this figure you will be increasing dividend payout?

A - Eric Alencar {BIO 18098474 <GO>}

Eduardo this is Eric. I will start by answering equity, about equity. The net income was 21 million and before 28, and then five before. So the contribution was practically stable in relation to the first -- to the previous quarter ended. This line went up in equity income, the line item of equity income, (inaudible) is a company that gives us between 80 million and 110 million, and we believe next year it will be the same with the recognition of level one -- Faixa one, level one.

Now regarding the buyback of our shares, we are very actively believe this is adventure -- advantageous to our shareholders and we also talk about our menu, which is composed of buying land, and buying back and paying dividends, buying back shares and paying dividends. And we will continue buying, we are not going to stop neither or we going to accelerate. We have this plan with an additional 200 million of buyback, and then we have to sit with the board to see what is the next step it could be distribution or -- and it could be more buyback. So it is a discussion that we have almost every single week at the company. So this is why I cannot say anything more clear than that or more detailed than that.

Operator

(inaudible) from HSBC.

Q - Unidentified Participant

Good morning. What do you see for your gross margin for 2015. We already know about the finished product inventory, but what do you expect regarding your gross margin for 2015?

A - Eric Alencar {BIO 18098474 <GO>}

Hi, this is Eric once again. Due to the major volatility of our operation and you saw what happened in this quarter with (inaudible) so we would rather give you like a bracket between 31 and 35 for this year. And for next year, we expect something around the same level. We're working to increase gradually. Gradually increase this margin on a quarter-on-quarter basis, but we have to check this situation of sale of finished units because this has a major impact on our margin and this is what we would define, whether it will be closer to 34 or to 35 or to 32.

Q - Raphael Pinho

Okay. Thank you.

Operator

(Operator Instructions). Thank you. Well, we thank you all very much for participating in our call. As there are no more questions, I would like to give the floor back to Mr. Raphael Horn for his closing remarks.

A - Raphael Horn {BIO 19714328 <GO>}

We would like to thank you all very much and see you next quarter, and I wish you all a very good end of year.

Operator

Cyrela's conference call is closed. We thank you for participating.

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