

Q1 2017 Earnings Call

Company Participants

- Eduardo Fischer Teixeira de Souza, Co-Chief Executive Officer
- Leonardo Guimarães Corrêa, Chief Financial & Investor Relations Officer
- Rafael Nazareth Menin Teixeira de Souza, Co-Chief Executive Officer & Director
- Ricardo Paixão, Director-Investor Relations & Financial Planning
- Unverified Participant

Other Participants

- Alex Ferraz, Analyst
- Daniel Gasparete, Analyst
- Marcelo Motta, Analyst
- Nicole Hirakawa, Analyst
- Victor Tapia, Analyst
- Wilfredo Jorel Guilloty, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good afternoon. Thank you for waiting. I welcome you to the conference call of MRV Engineering. I would like to inform that all participants will be in listening-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session where further instructions will be given.

Now, I would like to turn the floor to Mr. Rafael Menin. Please, Mr. Rafael, you may proceed.

Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good afternoon to all. It is a pleasure to announce today good quarter results. We reached our record level for the first quarter, and we sell 7% more in the first quarter than compared to 2016. It is also important to point out that all our financial indicators as gross margin, EBITDA margin, net profit improved when compared to the first quarter 2016.

It is important to point out that MRV is the only company that currently can deliver consistent results despite operating in more than 200 cities in Brazil. This result throughout the years associated with the economic potential of the market for the coming years allowed us to grow more than the level of 40,000 units a year.

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In the last three years, we executed an ambitious plan to reach an even better result in the future, 60,000 units a year. The first step has already been executed because we already doubled our land take in the last years. It is important to point out the differentials of this land take which was constructed in a moment of severe crisis of the housing market in Brazil. The second step in this strategy is to bring these to a different level than that of the last year's.

Because of the maturity observed in the current land take, we are convinced that this year we will launch a larger volume than in the previous years. This is the result of an increased volume of launchings due to the market of few offer and high demand. Because of this, we will have a larger sales level than the last semesters. We already have a structure that is ready to operate on a level of 60,000 units a year. So we will only need a slight adjustment in our structure to reach our main goal, 60,000 units a year.

And now, I pass the floor to Leonardo Corrêa.

Leonardo Guimarães Corrêa

Good afternoon and thank you for participating in our conference. Well I recall our last general assembly. I would like to thank our councilors, Levi Henrique and Fernando Fonseca, who honored us with their participation throughout a number of years and now leave the council. And I would now like to welcome our new councilors, Betania Tanure and Sinai Waisberg, two professionals with specific background and excellency in their areas of activity who will enrich our board or council.

Still going back to the assembly and back to the financial aspects, we approved the capitalization of 50% of the profit, and the remaining 50% will be distributed. The first half of this dividend will be paid in June and the other half will be paid in the near future as long as the macroeconomic picture is under the same conditions of temperature and pressure. In market last year, we distributed BRL 130 million, and MRV will try to keep this percentage level in dividend distribution.

Regarding cash and debt, we will continue to keep a conservative level with a gross cash margin which is very large. We will try to continue to lengthen our debt. We understand that this is a good policy in this market which is very volatile and has a long cycle.

Still talking about the balance but still now looking at the active cash flow, I would like to talk about the projects in aluminum. The higher diversity of construction of this material will have a positive impact and improve our cash flow.

And finally, we're going to talk about non-payment in our portfolio. We are increasing our level of pro-soluto. We reduced our loss when compared to the previous quarter. This provisional volume should not be very volatile. The concession of this credit is part of our business model, more specifically of the associative credit. We will continue to improve our tools to reduce our losses.

And now, I open for Q&A.

Q&A

Operator

Thank you. We will now start the Q&A session. And there is one question from Victor Tapia, Bradesco BBI.

Q - Victor Tapia {BIO 20566083 <GO>}

Good morning, everybody. Thank you for the opportunity. I have two questions. You have been emitting CCBs at a low cost considering the fiscal exemption, but it called our attention that the cost of the debt of non-emission of debentures, which was BRL 750 million, and a series of CDE and EPCA, 0.25 (6:49), and the cash of the company was BRL 2.9 billion. On the 10th series, you informed that considering the short-term credits that you expect, don't you think that the company would be able to work with the cash expectancy of BRL 1 million to reduce the financial risk of the spread?

And my second question is regarding the LOG. We see a spin-off as an alternative, and we would like to know your opinion about this.

A - Operator

Hello, Victor. Good afternoon. Well regarding cash, yes we had some emissions. I will try to step back so that you understand the strategy of the company regarding the debt. Our cycle is long. We are talking about between the purchase of a land and delivering the entire construction. We have five years and then there is another five years of guarantees. This is a long cycle. This operation of CRI and the markets, these are very short operations. We cannot consider to have any debts with a two-year period. It is difficult to match the economic cycle to determine what is going to happen to the country. So what we want to do is to transform this into long-term debt.

Until the end of the year, we have more than BRL 800,000,000 (8:46) which, in the first emission of debentures, we rolled all these dues. Not all of these we could prepay. And because of this, they were still in the balance sheet. Next year, we will still have a large number of amount due, and what we are trying to do is to anticipate these dues. And what happened in the last emission of debentures, we want to enlarge, to enlong (9:25) this period to 10 years. If I have a 5 to 10-year period, I can consider a net debt level that is different from that I have today for the company. But if I have a very short time of the debt, the debt of the company will be close to zero.

In this first quarter, we had already BRL 500 billion to BRL 600 billion which were due and debentures. So the gross cash volume will fall in the next month. The next due days on the principals are next year. And if the market is good, we might anticipate this but we will always try to anticipate all of these, and we want to have a large gross cash. And finally, we capitalized part of our interest rate. In this quarter, we directed this cash flow operations and this cash volume so that it became only cash flow and is not possible to use for capitalization. As we do this migration, the volume of capitalized interest rates will fall. This is a soft movement throughout time. But I already anticipate this.

Regarding LOG, I cannot talk a lot about LOG but there are a number of companies that are interested. The shareholders are supporting LOG. In April, we had the smallest vacancy rate since the last five years, since 2012, and this proves our business model in LOG where we are outside of the high-density market. LOG is more present in the countryside of São Paulo. There are some people interested, and the shareholders will take the best decision regarding LOG.

Q - Victor Tapia {BIO 20566083 <GO>}

Thank you.

Operator

The next question is from Daniel Gasparete, Bank of America Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Good afternoon to all of you. Thank you for the call. My question is associated to the wrap-up of launchings and how you are structuring the pipeline throughout 2017. What are the bottlenecks? How do you plan to avoid the bottlenecks?

And the second question is regarding the cash flow. We had the lowest level of the history of the company, and I would like you to tell us about the potential of optimizing the cycle of cash flow and how aluminum could help you.

A - Operator

Hello. Regarding your first question, our lien bench (13:10) is more mature. We had a considerable effort. We bought BRL 800 million in land which is spectacular. We had very small competition and now we are present in 144 cities. And in most of them, there is little offer but a lot of demand. The market in general, there are few offers today. We have high demand, but little offer. So our main projects for the next quarters and for the next years is to launch a higher percentage than what we're doing. So when we're launching more, the sales will also rise, production must also rise, and this is the project of the company.

We have done our homework regarding recost, IT, people, training, and recovery of the gross margin. We are at a very good operational level and we are assured that we can take the next step to offer up to 60,000 units a year. First, to go from 40,000 to 60,000, we must go from 40,000 to 45,000, to 50,000 to 55,000, and then to 60,000, but our aim is 60,000 units a year. And from now on, we plan to launch more. So the dynamics will be basically this. In the second quarter, third quarter, and fourth quarter, we will see better results than in the first quarter regarding the cash flow.

A - Ricardo Paixão

This is Ricardo speaking. What has happened? Our receivables have reduced because of the simultaneous sales strategy while we are able to pass on these units much faster than before. We reduced it from 10 months average sales time to 2 months, and aluminum is a

new strategy that we are using and it has increased its share participation in our projects. As you know, the faster we build them the faster I get paid. And just to close, yes we have a potential to reduce our receivables. Our short sales process help us in this. So simultaneous sales and guaranteed sales help us to launch more, to build more, and with this I will get more money.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Thank you. Thank you for the call.

Operator

The next question is from Alex Ferraz, Itaú BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

Good afternoon, ladies and gentlemen. Thank you for the presentation. I have two questions regarding the banks. Did you have the impression that the banks are restricted regarding the (16:51) line and that they are remanaging the Minha Casa Minha Vida project. So have you felt anything regarding the banks? And regarding the (17:05), you only launched one phase but what was demand like? And the remainder of the projects, BRL 1.7 billion, when do you plan to launch this? This year or next year? It's just for me to have a clearer view of this topic.

A - Eduardo Fischer Teixeira de Souza {BIO 16644318 <GO>}

Alex, good afternoon. This is Fischer talking. Regarding the first question, the behavior of the banks. Throughout the last two years, we have mentioned this before. The banks have become more restrictive regarding the credit lines to our clients. And since our sales depend on this concession, this has disturbed our sale dynamics. What we noticed in the bank behavior in 2017, there was nothing different then from 2016. We have two partner banks, one of them is no longer very relevant in the operation because of this excessive restriction, but we noticed that both institutions that we worked with show an interest in operating at levels that they did in the past. So I look at 2017 with an optimistic view. This first semester is not comparable to the last semester of last year. But in this year, our talk to both institutions show us very positive perspective. I only see an improvement in the scenario.

Regarding (18:40), yes, there is the first phase and it was launched in March. We are now in May, and we already enter in four businesses. It is a very exceptional product. It corresponds to our initial planning. The expectation is that we will be able to sell all the units in two years which is very good. And what is most relevant for a project of this size and all indicators of the (19:23) are higher than the average of MRV today. We have a higher margin, we have a higher expected margin. And with this, we will reach the end of the project, adding a lot to the results of the company.

Q - Operator

Hello. This is Enrico Fernando (19:44). Just a follow-up on the first question of Alex which is the payment to the banks. What do we expect for the second quarter? Is there going to

be an impact in the second quarter?

A - Eduardo Fischer Teixeira de Souza {BIO 16644318 <GO>}

Well the operations are normal. This procedure is still ongoing. There has been no rupture. We had a problem with financing of corporate individuals at the beginning of the year. This is no longer happening in the second quarter. So we believe that everything will be normal from now on. Cash flow is associated with what we receive and what we spend. We have been spending more in acquiring more lands than in the first quarter. Because all of what we created in this last two years, we have a payment trigger which is associated with the leases. As soon as we start to have the leases last year, so the trigger to get money back on these lands has started. We will continue to have these expenses in the second quarter so our cash expectancy for the year is robust, but it will improve in the next quarters.

Q - Operator

Thank you, Fischer.

The next question is from Nicole Hirakawa, Credit Suisse.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Hi. Good afternoon to all of you. I have two questions. The first is regarding the hiring demand. This is associated with the hiring of corporate individuals. You mentioned that this is a bottleneck. In the last 12 years, the number of units hired is 20,000 and I would like to understand the main factors associated to this difficulty. And you mentioned that the scenario as a whole improved. So could you tell us what happened recently?

And the last question is regarding the gross margin which is an average level that would make sense. There is a non-recurring component. What could we use to project a gross margin in the future?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Hello, Nicole. This is Rafael. Regarding the corporate individuals, in January one of the banks changed one of the criteria to release corporate individuals. Today, we have a stock of PJ (22:59) of hired corporate individuals. So this is not a concern for us. This metric is a little bit shorter. This is only temporal. It has nothing associated with our operations.

Regarding the gross margin, we are recovering the margins quarter-by-quarter. In 2013, we had our negative peak or, let's say, our valley. We reached the valley. It was almost 26%, and we are recovering quarter-by-quarter and reached the margin of 33%. There is still margin for a gain of operation and efficiency. We hope to have an improvement, a small improvement because most of the work has already been done. We have followed a very positive path in the last three years, and now there is a marginal increment in this gross margin.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Just a quick follow-up. The hiring volume of corporate individuals, you expect a normalization. And since you already have BRL 2.5 million of projects with RIE (24:18), the chances of non-delivery are very modest or are very small, right?

A - Operator

Well this is associated to the licenses. This will be limited by the licenses and not by the corporate individuals. Our cycle is normal. First, we have the license then the RE (24:44), and then the PJ (24:45). The PJ (24:48) takes a little bit longer. So we depend much more on the licenses than on the PJ (24:56). We would like to have launched more in the first quarter, but we did not achieve this because these licenses has not been issued, and because of this we were not able to launch anything in the first quarter of 2017. So, PJ (25:20) is something natural. It's a continuous flow. We depend more on licenses.

The next question is from Jorel Guilloty, Morgan Stanley.

Q - Wilfredo Jorel Guilloty

Good afternoon. My question is regarding your target to launch 60,000 units a year. Do you believe that all units will be available for the use of the FGTS, and will this change your leverage metrics and...?

A - Operator

This target of 60,000 is feasible. We have talked about it today but it is something that we, inside the company, have been talking about for a long time. In the last three years, we stabilized the company on an operational level that is very high and very dispersed in terms of geography. Today, we feel comfortable to take different steps to reach this target. This target does not have a fixed date. We want the company to be able to construct, to sell, and to receive. We have very good planning for this. This target is feasible. There are challenges on the way, but we started 2016 with a good step forward in order to meet this.

Regarding the FGTS, it's part of our strategy that people will be able to use this fund to pay for the units. This is where most of the demand is in Brazil, so that makes no sense to change this strategy, and 60,000 units is possible using the FGTS. Regarding the leverage, we have mentioned that we understand that we are a business that generates cash. We understand that we grow by generating cash. An example of this is that in the last two years we have invested in land and we did not stop generating robust cash. So we are focused on cash generation, and this will cause the operation to grow without burning cash. This is our aim.

The next question is from Marcelo Motta, JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

I would like you to comment on the equity income. Last week, we have been seeing MRV guaranteeing some of the debt. I would like to understand if this is still a leverage problem. In the last call, the gross margin of these projects was already positive and that

it was only a question of time to see profits. So I would just like to know if this is still the same projection or if there is any change in these?

A - Operator

Marcelo, that's exactly what you described. The operation of the MRV and Prime are improving in terms of gross margin and sales speed, and cash generation in both is improving in Prime. It is much clearer, but it takes some time for us to remove the leverage of these companies and to produce a higher difference in the equity of these companies.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you.

Operator

As there are no questions, I would like to close the Q&A session. I would like to turn the floor over to the President for final considerations.

A - Unverified Participant

Thank you for participating in this call. I would like to point out something that has been disclosed in the Q&A, which is our target of 60,000 units. Some very important things happened recently which improved our interest to take this step. We have seen positive development in the project Minha Casa Minha Vida. Brazil is recovering and is reaching a balance. We noticed that there is a response to the banks. They are already more positive regarding the future. Everything that we constructed in the last two or three years, it has been very positive. And the operational area of the company which has been trained in order to reach this aim regardless if we are in the commercial area prospection, all of these make us confident that we are on the right path to reach this goal. We started 2016 in line with our planning, and we are on the correct path to reach our target.

Thank you very much, and I would like to have you back in the next call next quarter. Thank you.

Operator

The conference call of MRV Engineering is closed. We thank you for your participation. Have a nice day.

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