

Q2 2018 Earnings Call

Company Participants

- Ephraim Horn, Co-Chief Executive Officer
- Ephraim Raphael Horn
- Paulo Eduardo Goncalves, Director of Investor Relations & Structured Finance

Other Participants

- Enrico Trotta, Analyst
- Gustavo Cambauva, Analyst
- Jorel Guilloty, Analyst
- Luis Stacchini, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcelo Motta, Analyst
- Renan Manda, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we will discuss the Second Quarter of 2018 Earnings Results. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and the audio will be available on the company's website, 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 August 9, after the close of the B3 trading session, can also be accessed on the company's website.

Before proceeding, we would like to mention that the forward-looking statements that maybe made during this conference call related to the company's business prospects and forecast, as well as 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 international markets, and therefore are subject to change.

With us today are Mr. Ephraim Horn, Co-CEO; and Mr. Paulo Eduardo Goncalves, Investors Relations and Structured Finance Officer.

I will now turn the conference over to Mr. Ephraim Horn. Mr. Horn, you may now begin.

Ephraim Horn

Good morning. The second quarter of the year was marked by an increase in uncertainties regarding the recovery of economic activity. The truckers strike that took place in May had an impact on the entire production chain and the debate about the elections added even more concern and caution to the domestic scenario. Our industry was also impacted by the World Cup and also by the temporary suspension of the protocol rights for products launched in the city of Sao Paulo.

Despite the adverse scenario, sales in the quarter totaled BRL1.1 billion, 40% higher year-on-year. The Minha Casa Minha Vida segment had a lot of participation in those numbers. The amount of cancellations dropped and the most recent developments had a great performance.

Another good news is the fact that the legal dispute regarding the protocol rights in Sao Paulo came to an end, which makes us optimistic about the products launched in the second half of the year. We will launch 16 new products, three in the South, three in Rio de Janeiro, and ten in Sao Paulo. They are great high-end and medium range projects located in the main neighborhoods of those cities. Thus we will reach our target level for our launches.

Our focus in the second half of the year beside selling our finished units is to make this new product a success. The highlight of the quarter was again the company's strong cash generation, which totaled BRL181 million. Additionally, we have virtually completed our entire funding plan for the year as estimated in late 2017. Depending on our cash generation in the second half of the year, we will discuss a new dividend distribution later this year.

Now we will comment on our operating results. On slide five we will address Cyrela's launches. In 2Q '18, we launched BRL981 million, 53% more year-on-year. In 2Q '18, launches amounted to BRL1.4 billion, a 13% growth year-on-year. We launched 12 new products in 2Q '18, eight in the city of Sao Paulo, two in Rio de Janeiro, one in the South and one in the city of Campinas. Eight of them are in the Minha Casa Minha Vida housing program, two are medium range and other two are high-end products. And we did not launch other high-end products in Sao Paulo due to the protocol rights that we already mentioned. Excluding swaps, the volume launched in Cyrela's share into 2018 was BRL856 million, down by 12% year-on-year. The company's share in the volume launched in 2Q '18 was 65% compared to 70% year-on-year.

On slide six, we highlight two launches. One is Living Privilege in Sao Paulo, which was over 70% sold in the quarter, and the other one is in Campinas, Living Elegance, which has been 50% sold in the month it was launched.

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On slide seven, we will talk about our sales performance. In 2Q'18, presales were BRL1,060 million, 50% higher -- actually 40% higher than the 750 million in 2Q '17. In the first half of the year, sales totaled BRL1.7 billion, up 31% growth year-on-year. Excluding swaps, pre-sales amounted to BRL1,050 million in Cyrela's share, a 13% increase year-on-year. The states of Sao Paulo and Rio de Janeiro jointly accounted for 92% of sales in the quarter.

On slide eight, we will address sales speed. The company's annual SoS was 37.9%. Looking at sales speed by period, projects launched in 2Q '18 has been on an average 50% sold, which is very good, because by the end of the year that percentage will increase very much.

On slide nine, we'll address Cyrela's total inventory. At the end of the quarter, inventory at market value totaled BRL5.8 billion, down by 2% quarter-on-quarter. The change in our inventory can be seen on the right.

On slide 10, you can see a breakdown of our finished units. In 2Q '18, we sold 7% of the finished units at the beginning of the period adding the inventory of projects delivered into 2018 along the quarter and pricing of units at market value, finished units inventory increased by 20% quarter-on-quarter. We are aware of how important this matter is to the company and will continue to focus our efforts on these products. Rio and the Northeast region accounts for 42% of the finished units.

On slide 11, we'll talk about delivered units. In 2Q '18, Cyrela delivered 17 projects, totaling 5,100 units. In the first half of the year, we delivered 8,300 units in 30 projects. The units delivered accounts for a PSV of BRL2,150 million, a 113% higher quarter-on-quarter.

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

Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Thank you, Ephraim. Good morning. On slide 13, we will present our financial results. Gross revenue was BRL658 million in the quarter, up by 42% quarter-on-quarter and 11% higher year-on-year. This increase was mainly due to higher net sales and the recognition of launches. In the first half of the year, gross revenue was BRL1.1 billion, down by 10% year-on-year.

Gross income in the quarter was BRL171 million, up by 37% quarter-on-quarter and 12% higher in the year-on-year comparison. Year-to-date, gross income reached BRL296 million, 16% lower year-on-year. The company's gross margin in the quarter was 26.8%, 0.9 percentage points lower than the 27.7% from the previous quarter. The reduction in our margin in this quarter is mainly due to the lower margins of the new sales in our product mix.

In 2Q '18, the results were affected by extraordinary items such as the cancellation of the purchase of a land plot in the South, new contingencies and repair costs in the Northeast.

Therefore, we have losses amounted to BRL28 million. In the first half of the year, losses totaled BRL80 million compared to losses of 137 million in the first half of 2017.

Please go to slide 14 to see our profitability. In 2Q '18, our return on equity measured as the net income of the past 12 months over the average shareholders' equity was a negative 0.7% and our EPS was a negative BRL0.07 per share.

On slide 15, we'll talk about our customers' financial solution. In 2Q '18, transfers, trust of deed and payoffs amounted to BRL940 million, 27% higher than first [ph] quarter and also in the year-on-year comparison. Considering units, transfers, trust of deeds and payoffs sold out 4,300 units, 23% higher quarter-on-quarter and 39% higher year-on-year.

Slide 16 shows the company's cash generation. In Q2 '18, our cash generation was BRL181 million versus BRL182 million quarter-on-quarter. Year-to-date cash, our generation was BRL363 million, up by 80% in comparison with 202 million we had last year in the same period.

On slide 17, we can see our debts. Gross debt at the end of the quarter was BRL2.4 billion. The cash position was 1.5 billion, thus our net debt was BRL0.8 billion. 45% of the total gross debt are related to loans for construction and 55% are long-term. We have virtually completed the entire funding plan for the year as estimated in late 2017 with the following operations: we issued certificates of real estate receivables in the amount of BRL300 million with a term to maturity of 49 months. We also issued real estate credit notes amounted to BRL300 million with a term to maturity of 4 years and we issued debentures in early July in the amount of BRL150 million, with a two-year term to maturity.

Our net debt to equity ratio was 14.4%, 2.4 percentage points lower quarter-on-quarter. Though that level confirms Cyrela's financial solidity and puts us in a privileged position to adjust our capital structure and improve returns to shareholders.

We will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Enrico Trotta with Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning. Thank you very much for your presentation. I have two questions. The first one is about finished units. Your performance was good in comparison with the first quarter with an increase of 20%, which can be explained by the deliveries that you had. Now looking forward and imagining that we're going to have deliveries that are going to actually dropped from now one. What is going to be the scenario for finished units? Is it going to go down? And also, I would like to know more details about how you are going

to sell finished units after the second quarter. I would also like to know some details about cash generation.

The second question is about your pipeline for launches in the quarter and what you expect for the second half of the year, since you don't have the protocol. You don't have that protocol right, a claim ending anymore. And I would like to know more about the projects that you intend to launch in the third and fourth quarter? And also your opinion about the demand, because we have a lot of uncertainty around the elections.

A - Ephraim Raphael Horn

Good morning, Enrico. This is Ephraim. You asked us about finished units. Yes, it's going to go down if we are not going to be able to sell them. We believe that we have reached the peak of finished units in July and June. We delivered projects in December and November 2017, and in the last quarter, all of them were finished units and we were not able to sell that amount of finished units from November and December to June and July, because we would have to -- have failed to finish selling the finished units that we have. And now, we are able to have special sales and promotions to bring the numbers down.

In June and July, we had some sales and promotions of finished units and those units were delivered in December and November, and they were blocked before that. And those finished units are now going to drop a lot and we are not going to have any other new deliveries. We are only going to have new launches now. So there's only way for finished units and that is down.

Now in the next quarters, we are feeling a sort of decompression after the second quarter. We have been working hard for two years now to purchase land plots in Sao Paulo, in Rio, and in the South. We can adjust the price of the products, but we are living through a crisis, right now, you know. Unfortunately, we were not able to launch any products here in Sao Paulo. We have many projects to be launched along the year in Sao Paulo, but we had to do that and postpone that to the second half of the year only, but now, we are going to be able to really launch them and start building them.

We're not scared of the elections for one reason. We are not launching products for speculation and they are not very big. We have already purchased those products thinking that we are going through a crisis. So it really doesn't matter what happens in the economic scenario from now on. Of course, we have to be careful about our strategy in terms of price and product, but I believe that we have done our homework already. Now we are going to launch these 16 projects that we mentioned before and not concerned about the specifics of these projects in terms of the elections.

Q - Enrico Trotta {BIO 16742911 <GO>}

Thank you very much.

Operator

The next question comes from Luis Stacchini with Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning. I also have two questions. The first one is about credit. What do you think about the appetite of the banks to provide credit? We had some changes for 2019, but I would like to know, if you think that we're going to have improvements in saving accounts? So I would like to know, if you have seen an improvement whatsoever in credit? I'm not asking specifically about the rates and the fees, but other strategies to increase the credit for purchasing real estate, because I know that we are not going to see so many transfers anymore. So I would like to understand margin [ph] sales about that?

And the second question is about the dividend distribution. Many candidates are thinking about taxing dividends to increase the amount that the government collects from taxes. So I would like to know what you think about that and what you can do to avoid that sort of impact? Do you intend to return to a larger level in terms of the equity value of the company?

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

Good morning. This is Paulo. I'm going to answer your two questions. The first one was about credit. In the beginning of the year, banks are now more aggressive and they are becoming more aggressive now when it comes to credit to individuals. We still think that we have room to decrease interest, but when it comes to restrictions, for example, in some cases, banks are less restrictive. We are able to have more transfers than what we had last year and the beginning of this year. Now, when it comes to the resolution of the Monetary Council, we had improvements in savings accounts. We believe that that is going to be very positive but only in the long term. I believe that is going to happen in six years time.

In some cases, it will be linear, but I'm sure that this is very positive for our industry. Now, when it comes to your question about taxing dividends, we have been talking a lot about this issue here in Cyrela. We are paying attention to what is happening, but there are a lot of uncertainties here. We don't know if that tax is going to incur on the accumulated cost for our future profit and that is very relevant for Cyrela. I'm sure that we are going to pursue the better tax efficiency in that region [ph].

Q - Luis Stacchini {BIO 18717891 <GO>}

Okay. Thank you very much, Paulo.

Operator

The next question comes from Luiz Mauricio Garcia with Bradesco.

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

Good morning. I have two questions, the first one is about contingencies. This is one point in Cyrela's results that are still high. I know it is very difficult. There are always new factors that make things harder to predict, but I believe that there are two main points here in this topic. The first one is, what do you expect, considering that there are many surprises that

arise from time-to-time? And the second one is, what have you been doing to try and be more proactive to reduce those risks?

The other point is about gross margin. Are you going to have a new strategy for selling finished units? You said that you're going to have some promotions but some launches have higher gross margin. So how are you going to balance that? How are you going to balance the gross margin with the discounts that you are going to have? Is it going to go down? Is it going to go up? What do you expect since you're going to have some discounts in order to lower the number of finished units?

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

Hello, this is Paulo. As you well said, it is very hard for us to predict contingencies. We went through some turmoil last year and we still have to deal with the impact of that. We can see a trend to lower the finished units because -- and the contingencies, because we're not building any new products right now. It's been a while that we have been strengthening our legal team to fight the excess of contingencies that we have, but that's just part of our business. The main point here is that we have a trend. We can see a trend to lower the amount of contingencies.

The recent launches, especially last year and this year, they have a higher margin. What you say is exactly in line with what happened this quarter, we have been working with higher margins -- margins in some products, but some products need lower margins and the result is very volatile. So the effect of sales have a larger impacts when you look at the gross margin. Now looking forward, since we are going to decrease the number of finished units, we believe that the margin is going to start growing, not significantly but gradually.

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

Even now that you're going to make an effort to decrease the number of finished units, even so, are you going to be able to increase gross margin?

A - Ephraim Horn

This is Ephraim. I'm going to share with you some news and it is actually a reality that we can see in the country right now. When you deliver a new building around 120 days before it is delivered and to five months after it is delivered, it's not that we cannot give any discounts. We can't do it, because the sales that we had eight months before it was delivered, they are going to be in the same price. So I don't believe that we're going to have a reduction of the gross margin after we have the new launches, I don't know if you understand the system. So the problem is that, we cannot lower the prices and change the margin, because we have to use the same prices that we had before the launch. Now we're going to have more organic launches, so the gross margin tends to go up.

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

Okay. Thank you.

Operator

The next question comes from Gustavo Cambauva with BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Good morning. I would like to talk about the deliveries that you had in the second quarter and know more details about what is going to happen in the number of cancellations moving forward. You said that you reached the peak of finished units in the second quarter, but do you believe that the products that were delivered in 2Q '17, do you think that you're going to have many cancellations or you don't have that risk, because those units have not been sold yet? And also, I would like to know, what is your expectation in terms of cancellations in the next 12 months?

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

Hello, this is Paulo. When it comes to cancellations, we are going to have a lower delivery level. So if you deliver less, you have fewer cancellations as well, but the conditions are better. The price stopped dropping for a while now. The credit conditions as we said to Luis, are improving. So our expectations is that we are going to see some drops in the number of cancellations. Last year, we had 1.8 billion in cancellations, and for this year, I believe that it's going to be around 1 billion, it is a very significant reduction.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay. Thank you.

Operator

Next question comes from Jorel Guilloty with Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning. I have two questions. Do you see any differences in the demand for finished units and new units? Do you have more people interested in finished units due to credit or prices? And the second question is about the new launches. Do you believe that we are going to have a strong increase in the new units in medium range and high-end? Do you think there the competition is going to be very tough from the new -- the other competitors?

A - Ephraim Raphael Horn

Hello, this is Ephraim. This is a very -- a very difficult question to answer. We had new launches in Sao Paulo and the finished units tends be sold more slowly. And that happens because there are many finished units. If you have finished -- if you have 300 finished units, it is going to take a year to sell them all. So it really depends on the number of finished units that you have.

Now the launches are not related to demand. We had terrible [ph] launches in Sao Paulo. So it's not really about the general demand, it is more about getting the product right in

terms of location and price and having a lower volume of units.

And your second question was about the competition in Sao Paulo, right?

Q - Jorel Guilloty {BIO 18291521 <GO>}

Yes.

A - Ephraim Raphael Horn

Do you believe the competition -- the competition is going to get tougher in the second half of the year? Do you believe that the competitors are going to launch more products in the high-end and medium range? The question -- the answer is yes, because the competitors could not launch anything in the first half, so they're going to do it in the second half and the competitors are more similar now even when it comes to the size of the units and the type of product.

We have many competitors, of course, but our obligation as a company is to predict the opportunities that we have and making those opportunities free of competition. So we are launching products with many other developments all around it, but the type of the product is different, so that we don't have that competition. We are trying to escape the competition by having a smart strategy when it comes to the type of product.

Operator

Next question comes from Renan Manda with Santander.

Q - Renan Manda {BIO 20347216 <GO>}

Good morning. I have two questions. The first one is related to the launch of the FIFA [ph] brand. I would like to know more about the rationale behind this new units, this new brand and I would like to know about the location where you're going to work with this brands, the type of projects that you are going to develop and I also would like to know the difference between the new brands in Plano & Plano and Qari [ph]?

The second question is about the effect of the injunction. The process approvals by the municipality of Sao Paulo takes awhile, right? So I would like to know if those projects that were in the old plan are now being approved by the municipality of Sao Paolo. So I know -- I understand the risks for launches in the second half of the year.

A - Ephraim Horn

Our position and the position of many other companies as well has been -- being prepared for the new plan of the city of Sao Paulo that allows for the -- the construction of Minha Casa Minha Vida projects. In land plots, they have already been purchased. We have some land plots in which we can develop Minha Casa Minha Vida project. We are developing those projects in our joint ventures and we actually wants to increase the launch volume in that program, in Minha Casa Minha Vida program. Because now you can find those projects in good locations in the city of Sao Paulo.

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The new plan of the municipality of Sao Paulo allows us to increase that volume. Now since Cyrela does not have a brand to work in that segment and we didn't want to use an existing brand, we decided to create a new brand to use those land plots that are right in the middle of the city, that are in great locations, using our methodology as possible in each neighborhood in the city of Sao Paulo. And now our intention is to be -- is to be here in Sao Paulo and not smaller cities in those projects, in the Minha Casa Minha Vida segment.

And the second question was about the city plan. Now that the protocol right fight has ended, the municipality of Sao Paulo started approving the project. Five of them have been approved already, and one of them has already been launched and this -- we can't - - we are going to have three others launches in August. We're going to have one in the South as well and one in Rio. So the scenario is normal and we are going very well.

Q - Renan Manda {BIO 20347216 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) The next question comes from Marcelo Motta with JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning. I have two quick questions. The first one is about launches. We can say that the company is focused on Minha Casa Minha Vida program and medium range products. Do you believe that that is going to be the trend for the rest of the year or if we are going to have more high-end and medium range products in the second half of the year?

And the second question is about dividends. In the presentation, you said that, you intend to pay additional dividends until the end of the year. We had 200 million already. Do you believe that the dividend distribution is going to be in line with the cash generation in the second half of the year? Thank you.

A - Ephraim Horn

You asked about the launches mix. I believe that we have a high concentration in lower-end products, because of one reason. Sao Paulo did not allow us to launch the Living and Cyrela projects in the first half of the year. Now in the second half of the year, we are going to launch 10 projects in Sao Paulo and over 90% of those launches are in the high-end and medium range segments and we're also going to have Minha Casa Minha Vida as well. And in the coming quarters, we are going to decrease the number of Minha Casa Minha Vida projects, considering the whole mix of products.

Now answering your second question about the dividends. So far everything is in line with what we had planned. In the beginning of the year, we said that we had two challenges, cash generation and combined with our funding plan. Now with the three debts that we

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acquired in the second half, we completed the funding plan that we had for the year. So it's very -- it is very likely for us to approve our second dividend distribution in this year.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) There are no more questions. I would like to turn the floor over to Mr. Horn for closing [ph] remarks.

A - Ephraim Raphael Horn

Thank you. We are very optimistic for the second half of the year. We are not concerned about the elections, because now we can put our plans in action in the market. We were very upset in the first half of the year because we did not have launches here in Sao Paulo and that has an impact on our results, of course, but now we are going to go back to our targets. We are going to improve the margins of the company and keep Cyrela growing and improving the margins. So thank you very much. Have a good day.

Operator

That concludes Cyrela's conference call for today. Thank you very much for your participation.

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