Q3 2017 Earnings Call

Company Participants

- Augusto Yokoyama, Controllership and Investor Relations Manager
- Emilio Fugazza, Chief Financial Officer and Investor Relations Officer
- Hugo Soares, Investor Relations Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to the EZTEC's Third Quarter 2017 Results Conference Call. Note that this event is being recorded and that all participants will be in listen-only mode during the Company's presentation. After the Company's remarks are completed, there will be a question-and-answer session, when further instructions will be given. (Operator Instructions).

Today's event is available through a live webcast that may be accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner 3Q17 Webcast. The following presentation is also available for download on the webcast platform. The following information is stated in Brazilian real and in BR GAAP and IFRS applicable to real estate developers in Brazil, except where stated otherwise.

Before proceeding, let me mention that any forward-looking statements made in today's conference call regarding the business outlook, forecasts and financial and operating targets is based on the beliefs and assumptions of EZTEC's management and the information currently available to the Company. Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Company and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Hugo Soares, Investor Relations Analyst, who will begin the presentation. Please Mr. Hugo, you may begin the conference.

Hugo Soares {BIO 20127334 <GO>}

Good morning, everyone, and welcome to our results presentation for the third quarter of 2017. With me we have Emilio Fugazza, CFO and IRO; and Augusto Yokoyama, Controllership and Investor Relations Manager for the release of EZTEC's operational and financial highlights.

The period has been marked by the sale of Tower B from the EZ Towers project, thus ending the cycle for the Company's largest commercial project in a positive way. Apart from rewarding shareholders with an excellent financial-economic result, with a gross margin of 47.1% on the sale of Tower B, the EZ Towers project also rendered gains for stakeholders at large, as is the case for the City of Sao Paulo as a whole, the environment, the acquirers, and the Company and its collaborators, who now can count on two towers with a differentiated architecture and efficient use of its space, located in a corporate center with rising infrastructure. Moreover, the EZ Towers projected EZTECs engineering standard to a new level, rendering a technical legacy that will be made use of in the near future in a similar project, adding value to the Company's business model.

Please ask you to move to slide number four. This is regarding the Tower B. We ended the initial nine months of 2017, with launches at BRL192 (sic) million and net sales at BRL 114 million. I n the third quarter, the Company acquired three land plots in the City of Sao Paulo, contributing with an estimated BRL174 million of PSV to the Land Bank at an average cost of 18% of the -- of the same PSV.

There were three projects delivered in the third quarter, totaling a PSV of BRL186 million or 222 units. The accumulated net income by the end of the first nine months of the year, was a t BRL333 million, with a net margin of 37%. Including the sale of Tower B, the accumulated cash generation in the year was BRL803 million. In September, BRL180 million were distributed in dividends, representing a payout of 78%. These figures reinforce the strength of the Company and so EZTEC can make prominent position at a time when several companies are experiencing financial difficulties.

I ask you to observe slide number five, where Augusto will discuss sales and cancellations.

Augusto Yokoyama

Good morning, everyone. We ended the third quarter of the year with accumulated drop in sales at BRL1.1 billion, 650 million of which regard the sale of Tower B. Cancellations added up to BRL340 million in the same period, culminating in a net sale of BRL764 million. The graph below, represent the progression of sales and cancellations, in last 12 months figures, in terms of units and PSV. The red bar and the red line, you see a downward trend for cancellations.

In the next slide, represent the PSV schedule to be delivered in the following quarters. The drop portion of the bar stands for the portion of the project should be delivered that has already been sold. The white portion represents that which is soon (inaudible). Below the red line represents the canceled PSV in each period. It's possible to note that there should be a significant reduction in cancellation from 2019, a year in which we will have few deliveries and the deliveries that do happen will be from the launches of 2015, which have of the file better suited for the recent economic conditions.

Therefore we should observe an increase in net sales based on already [ph] increase in our gross sales composed of units located in the best neighborhoods in the City of Sao Paulo, and its metropolitan region. Two projects with differentiated architecture, (inaudible) equipment and space is what you see with income quest that is aspired to have. I would like to call your attention to the fact to -- to the fact that in 2017, we delivered 1.3 billion worth of PSV. Deliveries are more likely to suffer from cancellations. However, in 2018, the amount delivered is around 350 million in PSV. What you should see in 2018 is a sharp drop in cancellations and an increase in net sales.

Moving to slide number seven, we ended the third quarter of 2017 with an inventory level at BRL1.26 billion, of which 71% is composed of units and 18% of which are in the commercial segment from the overall inventory. Only 28% of its residential [ph] projects in the state's capital, which is the profile where we will focus our launches for the following quarters. We recently inaugurated sales stores in the south zone of Sao Paulo, where we are offering, as we were one of the regions' able [ph] projects, which should help our gross savings.

Please, I ask you to move to slide number eight. In the third quarter, we had launched the In Design Liberdade project, with a PSV of 68 million and 33% of these units are already sold. Regarding a subsequent event, we have recently launched the project Verace Brooklin, which appears to bring [ph] up 82 million and 48 units. Initial managerial figures indicate sales as 35% within 10 days from its launch.

The next launch should occur in the West Zone of Sao Paulo, whose sales attained is already open, and the project already approved. Its approximate PSV is of 75 million and 121 units, between 66 or 86 square meters large. These projects are well located within the City of Sao Paulo and are directed to the mid, high and high income segments, which continue to be the focus of the company's remaining launches for the following quarters.

Now I would like to give the word to Emilio Fugazza. Emilio, please.

Emilio Fugazza {BIO 16474296 <GO>}

Augusto, thank you very much. Hello, everyone. Let's talk about financial performance in slide number nine. Let's start with net revenues, who impacted by the total (inaudible) sale of Tower B from EZ Towers project. It's important to bear in mind, that this kind of deal is stopped just one year ago. Just one year ago, we try to negotiate with more than 10 kinds of players of real estate property players in the City of Sao Paulo, in order to give the best kind of deals to all the EZTEC shareholders specifically talking about EBITDA.

And finally, in the third quarter 2017, we could get with best deal for the Tower, even comparing to the deal we made with Sao Carlos, when we sold the Tower A for them. In this case, the price we could get was over than BRL14,000 per square meter, compared to the sale where we have done with Sao Carlos of around BRL12,000 per square meter. That was the moment we have done, in order to generate gains to generate network for 2017, specifically because this is a huge one. This company is trying to do which is selling approximate to final users, if it kind of deal we have facing a lot of cancellations -- we have been facing there a lot of cancellations in the last eight quarters.

Talking about this, I'd like to move to gross profit, getting something around 45% of gross margin. 45% of gross margin mostly because of the (inaudible) Tower B, the gross margin was up around 47%, say 47% and obviously the regular business we have done was about 38%, 37%.

Let me remind you that it is not so usual, because in fact we bought some projects, we got a control of some projects in partnerships, trying to consolidate these projects. But when you buy the control of the project, you have to recognize at once the net profit of the units we haven't sold yet. So -- and that's why, when you recognize the profits, the moment you sell the units you have to recognize the costs, you have to recognize the revenues and the costs. And it seems like you are selling the units result in kind of profit, regards in kind of net profit. But instead of this, you have already recognized the profits before, and that's why it seems like gross margin is growing now, but is not sure.

In the next quarters, you're going to see gross margins much more close to -- the start of the gross margin is 12 percentage of gross margins, probably around 40% of around, a little bit more than 40% in my personal opinion.

Talking about the G&A and selling expenses, starting with G&A. G&A third quarter 2017 was BRL20 million. BRL20 million compared to the second quarter was down BRL2 million, it seems like the Company trying to pick to hold the G&A expenses, in terms of our hiring new professionals or trying to keep the services without any kind of increment, because of the moment we have been leaving in our kind of business here in Brazil.

Trying to say something about selling expenses. Selling expenses were BRL21 million, compared to BRL15 million in the second quarter of 2017. It seems like over half an incremental of BRL8 million, but it is not true. The BRL8 million more than the second quarter 2017, mostly because of some kind of fees, some kind of brokerage fees of the rental services divided by the moment we had to rent the Tower B offices [ph] towers. As we sold at once, the Tower B offices [ph] towers, we have to recognize at once all the fees, or all the brokerage fees we have to pay to rent -- to get rent the 72% [ph] of the Tower B. This is an undercover event. You are not going to see the same effect in the next quarters.

Moving to slide on page number 10, financial results. Financial result nowadays is about BRL11 million for the quarter of 2017, compared to the second quarter worth BRL8 million. Let me remind you, both in the second quarter and third quarter, we were impacted by deflation, specifically the kind of index reduce to just our contracts of mortgages, we provide to our clients is IGP-M. An IGP-M in the last six months was mostly negative deflation we faced in our economy. And that was in fact because deflation can -- has the power to impact the all account receivables we have from the specific clients.

Let me remind you, nowadays we have booking in our balance sheet something around of BRL350 million, representing something around 1,500 units of [ph] the company and which the company is providing mortgage to our clients. A BRL11 million of financial result and represents (inaudible) from this mortgage and (inaudible) from the cash, the net cash position we can carry in our balance sheet.

Moving to equity income, the equity income results. You can see BRL7 million in the third quarter 2017, compared to BRL 4 million in the second quarter 2017, so something better than the last quarter. And these kind of result [ph] is because that the amount of sales we can see, we can provide a gross margin of around 40%. So 40% is a little bit more than the second quarter and means that all the revenues having from the projects we have in partnerships are doing -- I'll say very well.

And let me remind you, that the -- at the end of the third quarter 2017, and beginning of the fourth quarter 2017, we bought a very good state, a very large part of two big projects we have been carrying in our balance sheet, both projects, what we call -- we call them (inaudible) Brazil, products that we have been carrying, inventory, ready inventory to leave and receivables, for some of the receivables and a part of it, one piece of land to get the launching -- the project launches by the end of the first half of 2018.

So we bought something around of 75% of PSV, already launched towards the PSV rate, are going to launch by the end of the first half 2018. Something around of 20%, 20% to 22%, the return of the project -- that the return on equity of the project we take to our partners.

In terms of net income, we got -- we came out with net income of BRL280 million representing something around BRL333 million of net income for 2017, or nine months 2017, net margin up 41%. Obviously, fully impacted by the sale of EZ Towers. But let me remind you that this kind of operation we have done so far selling the Tower B is absolutely top of the business as usual, we have been doing since that the IPO in 2007. So the company is -- it's completely specializing on developing.

Real estate, residential real estate, commercial properties and commercial units to sell. Part of it, obviously some moments, given the ups and downs, we have in our economy, and part of the time is much more, I'd say, interesting to sell apartments to final users, because the prices are going up and you can get much more net profit coming from these kind of operations.

In other time, and on the other hand, best in time, you have to develop something that you invest a lot of money on the project. You develop, taking in your mind that the generation of cash and the end of the project is going to take time, in order to appreciate value as you thought before. And that's the case of EZ Towers. EZ Towers, it's follow up to one of 100% controlled company called Garicema belonging to EZTEC. And the whole project coming from Garicema is a project for two towers, EZ Towers Tower A and Tower B, towards the (inaudible) structure we launched in 2009. And we believe, we get Towers 2011 and 2012.

All in all, we got something around of BRL800 million of net profits coming from these projects. We started this project in 2007, ending those projects in 2017, so 10 years, and the return on equity of these projects is something around 30%. So that is the EZTEC mindset in terms of the long run development real estate in Brazil, that's important to be -- to bear in mind.

Finally, on -- say, in Slide number 10, the result to be recognized. Let me remind you that result will be recognized or revenues coming from units under construction, but we happen to delivered those units yet. So, as we have been launching last quarter compared to past -- compared to the past, so now the volume to be delivered in the next two years, obviously it's going down. So the reap up in terms of revenues and results to be recognized or it can -- for all it can turn to the positive side in the next quarter, the quarter's coming, when the launch, the new projects to be launched can be better -- can better seen by the company -- can increase at the company's to be, I would say towards enough to get units sold as we are launching the projects without creating inventory on the new projects to add to the old projects.

So on page number 11, moving to page number 11, only to understand the results of the last 12 months. The last 12 months we are carrying the company with a gross margin of 47%. Obviously, that's the last year of EZ Towers can get a better result to the last 12 months, as we are providing 47% of gross profit -- gross margin at this kind of deal. But obviously, in the next -- in the quarters coming, the units we have on inventory can impact gross margin by 40%. I would say, gross margin coming from our inventory is up around 40%. So is not guidance, but we can expect from the company's operations something around 40% of the gross margin coming from the inventory whether to leave out the inventory and the construction we have in our balance sheet.

So moving to slide number 12, the potential cash generation. I'd start talking about the net cash position, from the left side to the right. The net cash position is about BRL834 million, representing something around BRL1.1 [ph] billion in cash and the debt of the company of around BRL300 million. And these debts, this BRL300 million coming only from project, so is a project that had compensated by -- of around 9% plus the average is almost nothing. So 9% plus tax is the costs of the debt -- cost of the capital from our company, from our company so far.

Let me remind you that disposition of cash, net cash position is after the impact of the famous -- of BRL108 million of dividends, we paid the last September. And let me remind you that this company, so far since 2007, when we did our IPO raising BRL542 million in cash, we have already paid something around BRL1.1 billion in dividend so far. So is one of the fast and greater cases of real estate company in terms of generation of return on equity and payment of dividend.

Apart from that, apart from the net cash position, we have to perform the receivables. The total receivables are BRL600 million, represent that part of it of around BRL350 million is volatile, mortgages what we're providing to our clients. Is a kind mortgages, we provide in order to speed up sales, in order to the clients -- to the clients guess. The teams of their units faster than using their regular system, their commercial systems, the commercial mortgages coming from the bank.

And then we mainly perform the receivables, our receivables in projection to the banks. Unperformed receivables, in fact, we have BRL201 million, in receivables that are under construction right now. So are fully adjusted by INCC, which is the construction index of inflation adjusted.

When you see, when you can feel a passion [ph] of the balance 1, the sharp balance, the brown bar of the balance 1, you can see BRL1.7 billion in cash, we are about to generate within something around as well (inaudible) demand. So, part of it is something around 50% of it, already generated by the sale of these Towers.

And two, generate the remaining cash is only the construction application of less than BRL100 million. So if a company with the balance sheet solid enough to provide cash, to provide cash result in a kind of that generation. So all the debt we have that cash to pay, all the construction obligation is less than a BRL100 million. A part of it, we might, we have almost BRL1.3 billion in inventory at market value. And this inventory at market value, I would say 80% already built. So means that all the sales we can provide from this inventory are going to generate cash inflow to the company, to improve investments or to improve the payment of business.

Let's move to slide number 13, the last one. In this slide of the potential value, for EZTEC here gives you the book value of the company, which is around BRL3 billion and meaning BRL18.41 per share.

And at the next slide of the brown bar, we provided as breakdown of assets and liabilities of this company. And you can see, the total amount of assets of this company is about BRL3.5 billion in assets. Of those BRL1.1 billion, one-third of the total part of the assets is cash, means that we provided cash with the sale of EZ Towers. But apart from these, you can see for instance, BRL721 million in Land Bank, BRL721 means that we have already paid for these Land Bank. We are talking about a Land Bank of great quality in the City of Sao Paulo, we are talking about more than 50% of this Land Bank is in the South Zone, or the City of Sao Paulo, the most, I would say the most rich and the most profitable area zone of the City of Sao Paulo.

And this is the Land Bank, you can see providing a potential gross profit of BRL2.2 billion, as you can see in this soft brown bar on the right side of the chart, meaning something around BRL13 per share towards the book value of the company in the country [ph] at the moment we launched -- at the moment we're launching these projects.

So coming back to the breakdown of the assets, so apart from the Land Bank, we have in terms of inventory, ready to leave or in construction, we have something around BRL500 million, so BRL500 million, the cost of a total loss of inventory at the market value of BRL1.2 billion. So we can see here more than up -- we can see here more than clear, more than 40% of gross margin coming from our inventory.

And finally, the performed receivables and the receivables of the company of around BRL700 million. So as you can see, the total amount of assets of BRL3.5 billion and BRL500 million are liabilities. In liability more than 50% of it, we are talking about the best coming from the projects, we have to pay the moment we deliver the projects with the unit we sold to our clients. So it is a company -- we put it on a company that it is -- that the position of the company is completely healthy without any kind of swap even [ph] back in the worst moment of our economy in the last 30 years.

Saying that, I would like to conclude, I would like to deliver the management's message to you all. We believe that the signs of macroeconomic recovery, as the lowering base interest rates, the improvement in confidence levels, and the inflation levels in check allows for an expectation of improved conditions in the sector for the following quarters. It is worth highlighting the Company's diminishing inventory size, the improving prices in sales in the City of Sao Paulo, and the lowering mortgage rates offered by the largest private commercial banks that combined with a drastic drop in deliveries which in its term brings a reduction in cancellations. So trigger, great and great in our net sales which will lead this to strong revenues and cash generation.

We have more than 20 projects, been approved in Sao Paulo's back locations. These projects have [ph] a feasibility analysis to be launched within the next 15 months. We should also start the construction of (inaudible) project, which is another commercial project, another three, four way commercial project right in front of (inaudible) project, in one of the best regions of the cities. We go on analyzing the best strategic opportunities to do businesses in the City of Sao Paulo, making news of our adequate capital structure and administrative expertise.

We will now make ourselves available to answer our listener's questions. Thank you all.

Operator

Ladies and gentlemen, we will now initiate the question-and-answer section. (Operator Instructions). I'm seeing no questions at this time. So, I would like to turn the conference back over to Mr. Emilio Fugazza for any closing remarks.

Emilio Fugazza {BIO 16474296 <GO>}

Thank you all. We thank all of our listeners today, and I make myself available, apart from myself, Mr. Hugo Soares, Mr. Augusto Yokoyama, we are all available to answer any sort of questions you may have. Thank you very much. Bye, bye.

Operator

Thank you. This concludes today's presentation. You may now disconnect your line at this time and have a nice day