Q2 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 EZTEC's second 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 for a live webcast that may be accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner 2Q17 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 the 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. Emilio Fugazza, Chief Financial and Investor Relations Officer, who will begin the presentation. Please Mr. Emilio, you may begin the conference.

Hugo Soares {BIO 20127334 <GO>}

Good morning, everyone and welcome to our results presentation for the second quarter of 2017. I am Hugo Soares, Investor Relations Analyst at EZTEC. And with me, I have Emilio Fugazza, the Chief Financial Officer and Investor Relations Officer; alongside Augusto Yokoyama, the Controllership and Investor Relations Manager for the release of the EZTEC's operational and financial highlights.

The period was marked by political turbulence by the middle of the quarter, which negatively impacted inventory sales speed. On the other hand, in April, we released our first launch of the year, the project Legittimo Vila Romana, located in the West Zone of Sao Paulo, which is 54% sold. Cancellation levels remained stable and we closed the period with a best net sales figure of the last six quarters.

In addition, the Company keeps working on further launches for the upcoming quarters, all of them located in the city of Sao Paulo and geared towards the mid-high and high income segments. In relation to deliveries, we concluded the third and fourth phases of Cidade Maia, the main product of the year. The construction process was completed in advance as well as with budget savings. Now I would like to pass the word to Augusto, who will speak of sales and cancellations. Augusto, please.

Augusto Yokoyama

Thank you, Hugo. Hello, good morning everyone. Please let's move to slide number four. We ended the first half of the year with gross sales of BRL263 million with 74% from finished units and 15% coming from launch. The cancellations summed BRL214 million during the period totalizing 49 million in net sales in the first six months of the year. In this chart below, we present the cumulative evolution of 12-month sales and cancellations. We can observe a tendency of decline in the solutions.

On the next slide, number five, we have the delivery PSV forecasted for the coming quarters. Brown bars represent the parts sold and the white ones, the inventory portion. The red line indicates the PSV canceled in each period. We can see that we should have an important reduction in cancellations from 2018 because we will have few deliveries from the 2015 harvest and with adequate prices and sales for higher income clients.

Now, I ask you to look at the slide number six. We ended the second quarter of 2017 with inventory of 1.2 billion with 67% of units completed and 18% in the commercial segment. It's important to note that only 28% of our inventory refers to the residential segment within the city of Sao Paulo, the focus of our launches for the next quarters. We expect to increase ready inventory sales as the client settle or finance the debts. Nowadays, a strong media campaign reinforces our ability to provide the direct financing to the client. This funding has been very important to sell concluded units, representing a significant portion of our sales.

Please, I ask you now to move to slide number seven. In parallel to the sales forecast, we have worked in preparation for new launches for the coming quarters. As a subsequent event, we launched this week the project In Design Liberdade in Sao Paulo with a PSV of 67 million and 114 units. The initial numbers indicate cumulative sales of 19% in the first week. The two upcoming launches should be in the South and West Zone of Sao Paulo; Verace Brooklin with a PSV of 82 million and 54 units and the Clima Sao Francisco with a PSV of BRL75 million and 121 units. This well located project designed for the mid-high and high income segments represent the profile of our next launches for the coming quarters. In addition, we will inaugurate soon a sales center of the projects of the southern area of Sao Paulo, which will contribute a lot to new sales in the region.

Now, I would like to give the word to Emilio who will talk about the financial figures. Emilio, please?

Emilio Fugazza {BIO 16474296 <GO>}

Thank you so much, Augusto. Hello, everyone. Good morning. I'd like to say something of our financial performance in slide number eight. First of all, net revenue. Net revenue on the chart, on the top left of the slide number eight, come in second quarter 2017, coming to BRL106 million. Our net revenues 9% increment compared with first quarter 2017. So it's important to bear in mind and not just because of the net revenues but because of the gross profit.

Gross profit second quarter was BRL50 million, coming up 9% compared to first quarter 2017 and gross margin of 47%. It is important to bear in mind that the results we are getting today, part of it is because we have some cost savings on constructions being delivered for our clients in the second quarter, especially two phases of a bigger project called Cidade Maia. Cidade Maia project is a project in the city of Guarulhos of 2,000 units; two phases of it, we delivered on the second quarter.

It's important to mention that the cost saving was about BRL10 million; BRL10 million, but approximately 70% to 80% the stake sold can represent something around BRL7 million to BRL8 million in impact over this gross profit. For the rest of the year, the second half of the year, we are going to have seven projects to be delivered. From these seven projects, two outside Sao Paulo and the remaining five in the city of Sao Paulo; all of them, very well sold. We are talking about something around 70% sold and that's it. That's going to be the whole impact in revenues for the rest of the year.

Talking a little bit about the G&A and selling expenses, I would like to start with G&A. G&A on the bottom left was about BRL22 million, increasing approximately 10% from the first quarter 2017. That means, the increment was one and only event which was legal issues regarding workers. Workers sue to have to provide specifically because in this time of economic traps, economic issues we have been facing in our operation, I would say, can provide some kind of legal issues regarding people we fired in the last two years. BRL2 million was the impact in the second quarter, just to get iceball [ph] a quick comparison, the whole year of 2016, we got something around BRL8 million in legal issues.

Talking about selling expenses, selling expenses was in the second quarter of 2017 BRL13 million; BRL13 million, down 19% compared to first quarter 2017. The best explanation for this decrement from the first quarter was that it's normal in our operation when you have some new projects to be launched. We prepare the stand-up sales, a small place to get people over there, calling clients to sign agreements, to sign the sales proposals. In this case, specifically, we took the decision -- in the second quarter, we took the decision to use a very good piece of land we have in the South Zone of Sao Paulo in a piece of land called Marcus [ph] Farmhouse in our land bank in order to build a kind of store, it's not a sales stand, it's a kind of store. In this store that I can provide a sort of apartment, a sort of model, apartment model to sell, I would say, two, three, four projects to be launched in the next six months.

So, trying to use the same place, the same space without having to build every time sales stand in the piece of land we are going to see the project. So, this idea -- at the end, this idea is a little bit different of the sales stand because the sales stand in terms of the calendar semester in Brazil, the sales stand is selling expenses, but when you make a store, when you build a store, it's a little bit different, you pick up from expenses, you are turning this store in a kind of asset, in a kind of non-current assets in our balance sheet. And that's why we have BRL3 million less of selling expenses compared to the first quarter 2017.

Apart from this, obviously, we are much more cautious about using the money to provide sales. It's simply because it's one of the worst time ever in our economy and we know that it's almost impossible to improve sales speed only using or pushing with money, new advertisement campaigns. So that's why we try to stop expanding money to selling expenses and trying to invest money in the construction of a very special place to have the sales done.

So, let's move on to slide number nine, talking about the financial results on the top left, the chart on the top left. That was the huge impact we have in our results -- in our second quarter 2017 results. So compared to the first quarter, the decrement was about 65% from BRL23 million to BRL8 million. The explanation for this decrement is because -- it's due to the fact that the inflation in Brazil was negative for three months in a row. And all the assets we have, all the receivables, especially the portfolio of receivables we have. So, receivables coming from units ready to leave and receivables means that we are funding our clients to get the keys of those apartments. So those receivables are adjusted monthly by IGP-M which is inflation in Brazil plus, for instance, 10% yearly or 12% yearly. So all the receivables, adjusted by IGP-M was impacted by negative inflation for three months in a row and even in the third quarter, we have, again, we are going to see again the negative impact of this inflation. So, negative impact means that all the amount of money owned by EZTEC and due by our clients faced the impact of that, decreasing something around BRL9 million to BRL10 million in financial results.

Apart from that, we have obviously all the units we are packed into the banks or transfer into the banks or we are delivering to our clients in order to negotiate to assure that our clients are going to keep those units, keep those sales. Obviously, we have to offer some sort of discounts to them and this sort of discounts to them impacted by BRL3 million to BRL4 million this quarter. So making a long story short, one of the best this trend of this Company, which is the financial results coming in an average of BRL20 million in the last four quarters, this quarter impacted negatively in our -- the impact was negative in our results.

Moving to equity income, equity income is the result coming from the projects we have with our partners. The control of the projects are shared with our partners. Nowadays we are coming to an end on these projects. Coming to an end means that we are delivering the constructions. The remaining units on inventory we have over there are the units with a potential to generate revenues, to generate profits for this Company. So, the result coming from this equity income was only BRL4 million and obviously the result decreasing also because we are buying stakes from our partners on this projects too, which means that the results are coming to approximately zero in the next quarters due to the fact that

-- our declining projects 100% controlled by EZTEC compared to the past projects controlled with our partners, alongside with our partners.

Finally, I would like to say something about our net income. Net income was BRL22 million; BRL22 million or 21% of net margin, decreasing 31% mainly because of the impact of the financial results. Obviously, part of the explanation, passed through the fact that our revenues are coming down. Revenues coming down can be seen on the chart on the bottom right of this slide, results to be recognized or backlog. You can see backlog here, second quarter BRL54 million, which means that -- so all the units we have sold and we haven't delivered yet, all the results coming from those are top BRL54 million and the gross margin is 44%, coming down from 49% in the previous quarter. I would like to say something more about this; it's a second chart, which is backlog results on page number 10.

So page number 10, you can see a chart comparing second quarter 2017 to fourth quarter 2015. So fourth quarter 2015, the total amount of revenues we can see is about BRL752 million and nowadays it's about BRL123 million due to the fact that there was a reduction -- a giant reduction in the number of launches in the last two years and the reduction of launches means that we sold last units to other constructions right now. So, we have less units under construction, less results to be recognized from those units and the projects launched in the two years are coming with a margin which is below than the average recognized in the previous quarters.

So, again, when you see 2015, you can see better revenues and you can see better margins to be recognized. In this example, in this chart, 51%. Nowadays, you can see 44%. So, the main point here is we are coming to an specific trend which is in the next couple of quarters we are going to see very shrinking in the amount of revenues, you are going to see in our profit and loss statement. It's specifically because we have less units under construction and finally, you are going to see a new standard of gross margin coming from our operations. So, compared with the standard, the tax standard which is something around 50%, nowadays we are going to see something around between 40% to 45%. Nowadays, my personal forecast, which is backlog, is about 44%. That is the trend, that is my message to understand that volume of the revenues to be recognized next quarters are coming down, are coming with a margin, which can be between 40% to 45%, nowadays about 44%.

So, moving on to the slide number 11. So part of the information coming from this slide, I told you before, so margins -- gross margin remained stable even with the discounts we have to provide to our clients, even to a decrement, a huge decrement in the operations volume, you can see a huge effect this quarter. We can provide the same margin because all the discounts that can provide can be offset by the cost savings we can watch coming from the engineering department and the technical department of this Company. So from the side, coming from the side of margins, so we are safe. Coming from the side of net revenues and net income, we are impacted by that decrement of this operation, but it's important to compensate this idea, it is important to say something about the position of cash. In the last four quarters, we have been generating cash and we have been generating cash specifically because we are delivering our estimates, we are passing the confidence [ph] to the bank. We are trying to offer deals to our clients like offering discounts over 5% or 6% to clients paying advance our unit.

So all-in-all, we can generate cash from that and the generation of cash could be even better if we're not trying to push our client to buy units -- to push our clients buying units at a little bit faster, offering them funding coming from the EZTEC shareholders equity. So when you see in our balance sheet pro forma receivables, you can see something that EZTEC from the shareholders equity of EZTEC, we are providing the funding to our clients and this funding is provided in an interest rate of around 10%, adjusted by inflation, so 10% plus IGP-M and this is -- the loan-to-value is about 80% to 70% and the duration is about 240 months. So something around 20 years. So -- and this is a kind of operation -- so this is a kind of sales operation in our Company that can provide a compensation, that can offset the worst result coming from the operational side, can provide a little bit return on equity because it's better than the return on equity it can provide from the projects we have ongoing right now.

So moving now to the slide number 12, the last few slides of today's presentation, so the potential cash generation. In slide 12, you can see starting on the left side, in the left side you can see BRL293 million of net cash which means BRL638 million of cash and BRL345 million in debt. Let me remind you that all these debts, 100% this debt is coming from project finance. So I have no working cap. So I have no external working cap, so I have no hard money. I have only in this Company project finance and all this project finance with on average whenever taking interest rate over around 9% plus GI. GI is over 1.5% or 1.25% yearly.

So apart from that, I have a kind of debt which is the approved dividends. The approved dividends in the last General Meeting of Shareholders was BRL180 million due to our shareholders. So we are going to pay this in the third or the fourth quarter 2017. Performed receivables, I mentioned before, BRL658 million. From this, a half of it is with the agreement signed with our clients. So we are providing funding to our clients indeed and half of this are receivables, we are in the middle of the process of transfer those receivables through the banks. Unperformed receivables are receivables that we are under construction right now. In some point of this year or 2018, we are going to transfer those receivables through the banks or providing funding to our clients. All the construction obligation we have in our operation is about BRL109 million, which means all the sites under construction. Right now, we have done those sites with more BRL109 million, which is not a problem. All the results coming from the projects we have with our partners is about BRL255 million coming from the delivery of the construction and -- or the selling of the inventory. So all-in-all, first the balance 1 can provide you an interesting idea which is, without selling any inventory we can see BRL1.2 billion of generation of cash or of extra cash.

Obviously, I am not counting on using this money to buy new piece of land or buy new stakes on the projects we have in partnerships. So, it's only to show you the potential we have in terms of cash in this Company without selling any extra units from our inventory, but selling extra units in inventory including here, the Tower B from our project called EZ Towers, we can see BRL1.9 billion in potential generation of cash. So all the inventory, market value of this inventory, including Tower B of EZ Towers can generate a potential cash of BRL1.9 billion. So all-in-all, the balance 1 plus the inventory we can sell can generate -- the moment we have this inventory sold can generate a potential BRL3 billion in this Company. It is only to show you the strength of our cash generation of our balance sheet. So simply because the only debt we have is BRL345 million, we have net cash and we have the potential generation of BRL3 billion in cash for this Company.

So moving to slide number 13; 13 is a slide just to make sure -- apart from the cash that I told you before, just to make sure, which kind of potential value we can provide to this Company next years. So let's start talking that the book value of this Company is about BRL16.70 per share and the share price nowadays is about -- is of around BRL20 per share. So obviously, the market value of our Company is a little bit more than 1.2 times our book value. This is simply because we have something that our shareholders can expect. For instance, selling a little bit more our inventory, selling the Tower B of EZ Towers or even providing the results of our backlog which is coming down, but when you see our land bank, this is a kind of price listing. Price listing because this land bank is a land bank located on the city of Sao Paulo, more than 70% of this land bank is in the city of Sao Paulo and the remaining land bank is in the State of Sao Paulo, specifically on the shore or some cities in the metropolitan region of Sao Paulo.

And we are talking about the majority of the projects, the majority of the piece of land dedicated to the middle income segment -- the middle, high income segment or higher income segments. Apart from it, in this land bank, you can see a piece of land which is about -- something around 15% of our land bank, a piece of land located right in front of the EZ Towers, right in front of the best project. The one and only project we made so far was EZ Towers. We have a piece of land right in front. The potential value of this project is over BRL1 billion. It is a project of two corporate towers; two corporate towers, AAA towers in I would say in the best location to develop a new project of corporate towers in the city of Sao Paulo.

And just to remind you, this EZ Towers project, the Tower B which remains in our balance sheet is a tower that -- the cost of this tower to tax [ph] is about BRL300 million. BRL300 million and we are right in the south in a cap rate to this Company to the investment we made -- we made so far. The cap rate is over 15% and the tower is approximately 70% rented. So we have 70% of this tower rented, only AAA clients -- AAA clients, good price, good clients, good tenants and all the guarantee we need to assure that we are going to receive the money from our tenants.

So saying that -- I'm just saying that because the piece of land right in front of the tower is a piece of land to provide just a new project exactly like this one. A new project with the same quality, the same potential of EZ Towers and this project is a project that we are going to start this project, start the construction of this project something around one year from now. All the project, all the license, all the decontamination process are going through in order to assure that we are going to make this construction. We are going to start this construction one year from now. So, all-in-all, talking about the land bank, which includes the projects, this corporate projects and other residential projects, we can add in the last years something around BRL2.5 billion in new projects to our book value.

So saying that, I would like to make my final message because it's important to say something about what is best and true in this moment in our country. So, as the political instability, the country is showing signs of slight economic improvement. It is very slight, but it is an economic improvement. Decrease in interest rates is important to mention. All the private banks are funding clients -- funding EZTEC clients in a one single digit interest rate to real estate, which is good enough. Let me remind you that just one year ago, the interest rates coming from the private banks to fund our clients was something around 11% to 12%, plus GI. Now this we're talking about something that around 9%, 9.5% plus GI. So it's a very deep decrement we are facing. Apart from that controlled inflation. So it's a very first moment in our history, since I was born and raised in Sao Paulo in Brazil, I've never seen three, four months of negative inflation in a row, which can show you that the movement of the economic theme in Brazil right now are turning the, I would say, the operation -- the operation of the inflation in Brazil in a very good way and that is impacting so deep the improvement over the unemployment rate.

Obviously, sectors of this economy like the real estate sector, real estate development are going to face unemployment in the next, I would say in the next 18 months, but other sectors of our society, especially sectors from the industry and services are getting better a little bit. And obviously in terms of real estate, we also -- we just can see recovering in prices specifically in the city of Sao Paulo, I'm not talking about the metropolitan region of Sao Paulo, I'm talking about the city of Sao Paulo. So compared to 2011, 2012, (inaudible) the prices of real estate of Sao Paulo were in the top high, the highest point ever.

Nowadays, 2017, we can see the prices coming to the same comparison recovering from the inflation. So we are not getting gains over 2011 or 2012, but following the inflation we are in the same level, which is good enough to push, to provide the new launches as Mr. Augusto Yokoyama mentioned before. The perfect storm the sector is navigating through has been a learning process which certainly left the Company more prepared for adverse times. We are very well structured for this complex scenario and at the same time, getting -- preparing for a resumption of new investments to push the Company back to growth, always keeping the values that guide and support the Company in the long term; product quality, profitability and operating and financial help. So now we will be available to answer questions from our listeners and thank you all so much.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the question-and-answer section. (Operator Instructions) This concludes the question-and-answer section at this time. I would like to turn the floor back to Mr. Emilio Fugazza for any closing remarks.

A - Emilio Fugazza {BIO 16474296 <GO>}

Thank you very much everyone for following this call today and apart from myself and Mr. Augusto Yokoyama, Mr. Hugo Soares, we are all available for any further questions. Thank you so much, see you next quarter.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time and have a nice day.