Q3 2015 Earnings Call

Company Participants

- Eric Alencar, Chief Financial Officer and Investor Relations Officer
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Daniel Gasparetti, Analyst
- Enrico Trotta, Analyst
- Guilherme Capparelli, Analyst
- Gustavo Cambauva, Analyst
- Marcelo Motta, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we will discuss Third Quarter 2015 Earnings Results. At this time, all participants will be in listen-only mode. Later, we will conduct a question-and-answer session. At that time, further instructions will be provided. (Operator Instructions) As a reminder, this conference is being recorded and the audio will be available at the Company's website at www.cyrela.com.br/ri. This call is being simultaneously translated into English and is being broadcast over the Internet. Questions may also be asked by participants connected abroad. The earnings release published yesterday, November 12th, after the closure of BM&FBOVESPA trading session may be accessed also at the Company's website.

Before proceeding, we would like to mention that forward-looking statements that might be made during this conference call relating to the Company's business prospects and projections, operating targets and relative to its financial growth potential are 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. Raphael Horn, Co-CEO and Mr. Eric Alencar, CFO and IRO. Now, I will turn the conference over to Mr. Raphael Horn. Mr. Horn, you may begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning. The third quarter of 2015 continued with the same trend as the first half of the year. We saw the political crisis deepen in Brazil with some challenging economic consequences. The country lost investment grade by Standard & Poor's and had it's rating downgraded by Fitch. The expectation of a negative GDP growth for 2016 is already accepted.

Our challenges continue to be complex. On one hand we intensify our sales efforts and work hard for the new launches to delight our customers. On the other hand, we are working to improve cost control and to prioritize operating efficiency. Fortunately, recently launched products showed that differentiated projects still are in good demand.

Our projects launched in the third quarter are on average 47% sold. In the third quarter, we will able to sell more of our finished units when compared to the second quarter. We highlight the Northeastern region accounting for 25% of sales of our finished units.

In the engineering front, we were able to generate more net savings on construction costs with a positive impact of BRL35 million in the company's revenue. Delayed projects and those that are located in low demand regions are already at a final delivery phase.

Our cash generation once again proved to be robust totaling 219 million in the quarter and 841 million year-to-date. Our priorities remain unchanged. We're committed to be financially sound. We will maintain a high cash position and will be conservative in using this cash until the economic environment becomes less turbulent.

Additionally, we need to keep focused on reducing capital allocation in our balance sheet and reducing finished units is an administrative way to achieve this goal. To that end, we monitor and track daily our sales strategy for every type of product. In the current economic environment, (inaudible) to be agile regarding possible changes in our course of action.

We will now move to our operational results. On slide five, we will address Cyrela's consolidated results. In the third quarter of 2015, we launched BRL600 million compared to BRL800 million in the third quarter of 2014. Year-to-date, we launched BRL2.1 billion versus BRL3.6 billion in the first nine months of last year. In this quarter, we launched six new products. Of the new launches, three were in Sao Paulo and two in Rio de Janeiro.

The Company's share in volume launched increased from 65% in the third quarter of 2014 to 83% in the same period of 2015. Year-to-date, CBR share was 79% compared to 85% in the first nine months of 2014. Excluding swaps and launches of the MCMV program level 1, volume launched year-to-date and Cyrela's share was BRL1.6 billion, down 30% year-over-year. In this quarter, we highlight the launch of Cyrela Gran Cypriani and of Atmosfera, both high-end projects located in the City of Sao Paulo and both with good sales performance.

On slide six, we show Gran Cypriani located in Ipiranga neighborhood and Atmosfera in Saude neighborhood.

Please go to slide seven, where we will talk about our sales performance. In the third quarter, pre-sales totaled BRL1 billion, slightly more than the BRL990 million posted in same quarter of 2014. Year-to-date, pre-sales reached BRL2.5 billion against BRL3.8 billion in 2014. Excluding swaps in MCMV program level 1, pre-sales year-to-date amounted to BRL1.9 billion in the CBR share, a 26% reduction, when compared to the first nine months of 2014. The states of Sao Paulo and Rio de Janeiro jointly accounted for 77% of the sales in the first nine months of the year.

On slide 8, we will address sales speed. The Company's annual SoS was 39%. Looking at sales speed by vintage, projects launched in the third quarter of 2015 have been on an average 47% sold. Projects launched in 2014, on average, already have sold more than 60%.

On slide nine, we will address Cyrela's total inventory. At the end of the third quarter, inventory at market value totaled BRL6.8 billion, 6% down quarter-on-quarter as a result of higher sales volume compared to the prior quarter. The change in our inventory can be seen in the chart on the right.

On slide 10, we have a breakdown of our finished units. In the quarter, we sold 11% of finished units in the beginning of the period. Adding the inventory of projects delivered along the quarter and pricing of the units at market value, this inventory decreased by 2.7% compared to the second quarter of 2015.

The highlight in this quarter goes to sales in the Northeast, which accounted for 24% of the sales of finished units. Thus, Northeastern region accounts for 32% of Company's finished units and finished units in Natal accounts for 60% of the Northeast finished units. We are aware of how important this matter is to the Company and we will continue to focus our efforts to sell these projects.

On slide 11, we'll talk about delivered units. In the quarter, Cyrela delivered 19 projects, which correspond to almost 7,000 units. Year-to-date delivered units accounted for a Pre-Sales Value PSV of BRL5.7 billion, up BRL750 million if compared to the same period of 2014.

I will turn the floor over to Eric, who will present our financials.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Raphael and good morning. On slide 13, we present our financial results. Gross revenue was BRL1.2 billion in the quarter, up 0.6% quarter-on-quarter and 28% lower when compared to the third quarter of last year. In the nine months comparison, gross revenue was BRL3.4 billion, down 22% from BRL4.4 billion in the first nine months of 2014.

Gross income in the quarter was BRL395 million, 1% down from the gross income of last quarter and 18% lower in the year-on-year comparison. Year-to-date, gross income is BRL1.1 billion, 16% down from the BRL1.4 billion that we posted in the first nine months of 2014.

The Company's gross margin in the quarter was 34.7%, 0.4 percentage point lower than the 35.1% gross margin in the second quarter of 2015 and 4.8 percentage point higher than the 29.9% of the third quarter of 2014. In this quarter, the Company again posted a new construction savings with a positive impact of BRL35 million on our revenue. Year-to-date, the gross margin was 34.9%, 2.9 percentage point up over the 32% of the third quarter of 2014.

In the chart on the bottom left hand corner, we analyze our EBITDA. EBITDA in this quarter totaled BRL214 million, 9% down quarter-on-quarter and 23% down year-on-year. Year-to-date, EBITDA was BRL605 million, down 24% from BRL793 million in the first nine months of 2014.

Net income in the quarter reached a BRL131 million, 11% up from second quarter and 27% down from third quarter of 2014. Year-to-date, net income totaled BRL350 million, 32% lower than that of the same period of 2014. Thus, our net margin for the quarter was 11.5% compared with 10.4% margin in the second quarter of 2015 and 11.1% margin in the third quarter of 2014. Year-to-date, net margin was 10.6%, 1.3 percentage point lower than the first nine months of 2014.

Please go to slide 14 now to see our profitability. In the third quarter '15, our return on equity measured as net income of the last 12 months over average net equity was 8.6% and our earnings per share was BRL0.35.

On slide 15, we will talk about our customers' financial status. In the quarter, transfers, trust deeds and payoffs amounted to BRL816 million, 8.2% less quarter-on-quarter and 13.3% less year-on-year. Year-to-date, this volume amounted to BRL2.5 billion, 4.1% lower vis-a-vis the same period of 2014.

Considering units, transfers, trust deeds and payoff totaled 4,000 units, 4.1% less in the quarterly comparison and 8.7% less compared to the third quarter of 2014. Year-to-date, this number totaled 12,000 units, 7% less than in the first nine months of last year.

Slide 16 shows the company's cash generation. In the quarter, operating cash generation amounted to BRL219 million, totaling 841 million in the last nine months, about [ph] 67% higher when compared to last year. Cash generation remains sustained by the high volume of deliveries in the last month and by a lower disbursement to purchase new plots of land. The launch PSV that we delivered in the first nine months of 2015 was BRL5.7 billion.

On slide 18, we present our indebtedness. Gross debt at the end of the quarter was BRL4 billion. The cash position was BRL2.5 billion. As a result, our net debt was BRL1.5 billion. Of the total gross debt, 60% relates to loans for construction and 68% is long term. The average cost of our corporate debt is already below 100% of CDI.

Our net debt over equity ratio was 21% compared to 25% in the prior quarter. This low debt level coupled with the cash generation presented confirms that Cyrela is financially sound and puts us in a privileged situation to enjoy opportunities in the real estate market.

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

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, Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

I have two questions. I guess, the first has to do with cost savings. We saw this happening in the second quarter, in the third quarter again and we've seen this in other players. So, my question is how recurrent are these cost savings looking forward? You always say that these cost savings comes from projects that are being delivered, but in the industry, we see that negotiations with suppliers, materials and labor are doing quite well as well. So, how recurrent are the cost savings? How frequently will we see this happening in the results looking forward?

My second question has to do with the fourth quarter and 2016. How do you see the operating environment? And that's very hard to say, but perhaps you could elaborate on your pipeline of launches and what you are expecting in terms of sale of finished units and how you are working with the finished units?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Enrico, this is Eric. I will answer the first part and then Raphael will talk about operating performance. Indeed there were a cost savings amounting to 35 million, which had a 2% impact on our balance sheet. Now, what do we see for the future. The trend is that, we'll have more savings, but at Cyrela, as a policy, whenever we have savings, we have to book these immediately in our balance sheet, in our construction costs. Given this, all of the savings we've derived so far have been considered in the numbers disclosed. So its very hard for us to give you an order of magnitude of the future savings. But with this market situation, for sure, we tend to have more savings than go over the budget.

A - Raphael Horn {BIO 19714328 <GO>}

This is, Raphael. Hello, Enrico. I think that in Brazil today it's very hard to give you any forecast. You asked about 2016, we don't forecast given the current scenario in Brazil. We have to live quarter-after-quarter. We're focused on the beginning of the quarter, on the end of the quarter, in getting the best possible results. In the fourth quarter, it will be no different. In the third quarter, we were able to have good sales. We'll have to focus to continue to sell well in the fourth quarter, but we know it's not easy.

As for launches, I guess that we had been quite selective in terms of our launches. It is surprising but the market still responds well to good launches. So, thank god that we are launching not very much, but we have been very selective [ph]. This was so in the third quarter and in the fourth quarter, we intend to continue with the same pace, and in 2016 we will continue to be very selective. We will only be launching what we think there is a market for us. This is the approach. It hasn't changed, it will not change. In every quarter, we'll need to base [ph] ourselves for what's coming.

Q - Enrico Trotta {BIO 16742911 <GO>}

Specifically [ph] to Raphael and Eric, if you'll allow me, I'll ask a third quick question regarding the equity income line item. It continues strong because of Cury. How do you see this line item next year given that the revenue recognition of MCMV program level 1 from Cury should lose some momentum. So what do you expect in terms of the equity income for next year?

A - Raphael Horn {BIO 19714328 <GO>}

In this quarter, the increase came almost exclusively from the profits of Cury. So next year there will be a reduction in level 1, but we have to understand what Cury is all about. Cury is our partner, specialized in low-cost of construction, working with FGTS funding. If we do not have MCMV level 1, it will go to level 2 and level 3. Cury has been preparing for this. It has an opportunity wave in level 1, but now with the MCMV program 3, Cury is very well positioned to maintain the current profit level. It's very hard for us to give you what's going to happen in Brazil given the current scenario, but if there is one line item that does not confront Cyrela at this point, its this one, given that Cury is prepared to act on level 1 as well as in the other levels of the MCMV the program.

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay, thank you very much. Have a good day.

Operator

Our next question comes from Luis Stacchini with Credit Suisse.

Q - Unidentified Participant

Hi, this is Nicole speaking. I have two questions. When considering [ph] Enrico's question, I would like to understand what is the expectation to sell finished units. I know that this is not an easy discussion, but the quarterly performance was good and apparently the company didn't have to give up on its margin. So perhaps you could elaborate more on what was done in terms of the commercial strategy in this quarter, that would be great.

My second question has to do with cash generation. I would like to understand the volume of disbursement to buy plots of land in the third quarter and how it compares with your expectations for the coming quarters? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Nicole, you asked the question like we have a secret or a magic trick, but honestly we don't have any. We don't do any magic trick. What we did was we worked hard. We were focused. The second quarter was poor and we worked hard and in the second quarter, we understood how (inaudible). It took a while to understand the scenario. And then we doubled our efforts and doubled our attention and the results came in the third quarter and we'll try to do the same in the fourth quarter, but like I said, every quarter in Brazil looking forward will be different in my opinion.

The current context is not easy and there are no signs of short-term improvement from the economic front. So, every quarter will be a war and we're bracing ourselves for this war. But again, there was no magic trick and I think that we'll try to continue to sell our inventory without changing the margins. Margins might oscillate a little up or down, but I think that the goal is to sell with no significant margin reductions. Now, oscillations are obviously part of our business.

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Nicole, this is Eric. You asked about our cash generation. We've been presenting and posting a positive cash generation in the recent quarters. We know that this is a very volatile item, but as for the future, the answer is, how much of finished units we'll sell, if we don't sell many of those, cash generation will be low and the opposite is also true. Finished units generate immediate cash. So, our focus to reduce capital allocated has a positive effect on cash generation and the biggest variable, the silver bullet, is finished units.

Q - Unidentified Participant

Okay, thank you Raphael and Eric.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you.

Operator

Our next question comes from Mr. Gustavo Cambauva with BTG.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Hello, I have one question. The amount [ph] of the line item, other expenses, in the last two quarters, it's been behaving quite well. And my question is, with you having delivered the majority on almost all of the projects in some of your Northeastern cities, the ones that had more delays in the construction et cetera, should we see this line item with no great increases in provision or perhaps this improvement in the last two quarters, second and third quarter, came perhaps more as a one-off event and perhaps we'll have to do something additionally in the future to maintain it like that?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Cambauva, this is Eric. As you saw on this line item, it behaved well. But, when you look in our deliveries in the north and northeastern regions, like you said, we have to look at this line item in the SG&A line item that talks about indemnifications. So, we already had a good provision, but now we've started signing many agreements and given the big payment of indemnifications, there was a positive impact on this line item or reduced provisions.

New clients came along, but they didn't increase the provision because a lot of the indemnifications have been paid already. So, still our litigations are a priority for 2015 and we'll continue to be so in 2016 and this line item is only behaving well, intends to continue to behave well, because we're increasing the indemnification line item. So, there is always a negative impact in our income statement.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

I understand, Eric. When I look at your SG&A, it was higher than expected, but even if I add both things, it's better than the first quarter of 2015 or 2014. Should we expect this positive trend?

A - Eric Alencar {BIO 18098474 <GO>}

Well, we don't think it's doing a lot better. In this quarter, its increasing 10 million the indemnifications including civil and labor claims. So, there was an increase by 10 million, but the trend is that (inaudible) stay at this level.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Mr. Daniel Gasparetti with Merrill Lynch.

Q - Daniel Gasparetti

Good afternoon, everyone. Thank you for the call. You said that you were living quarter-by-quarter and adding to Nicole's question, you had a strong cash generation in the quarter, even with a low level of sales of finished units. During this quarter, like you said yourself, sales improved quite a lot. So how do you see cash generation for the fourth quarter? Should we expect a similar level? And how do you relate it with a reduction in the volume of deliveries that you had in this quarter? What should predominate in the very short term?

And then, my second question would be, looking more towards the future, the strategy to purchase land, is it higher? Is it difficult to predict or are you happy with the land bank that you already have for the expected launches in the future? Are you comfortable with your land bank?

A - Eric Alencar {BIO 18098474 <GO>}

Hi, this is Eric. I'll try to address the first part of your question and Raphael will answer the question about the land bank. As for the very, very short-term cash flow, at Cyrela, we prefer not to give a guidance of the short-term cash flow because we don't want to generate expectation regarding an item that has a lot of volatility month by month.

What are the items that account for this variability? The first is transfers. If we have a large amount of transfers and registrations, this changes totally the cash generation for the quarter and the other element is the payment for land. Many of those plots of land are only paid for when the project is approved and approval varies from month to month. So we prefer not to give those guidance and to stress that there is an upward trend and the biggest variable here in the mid-term is the sale of finished units.

A - Raphael Horn {BIO 19714328 <GO>}

Hi, Gasparetti. Your question regarding the bank -- the land bank. I guess we're happy with our land bank. But the related question is, to beat CDI today, its quite hard. CDI is at 15. If we pay land to get 15 plus a little less, not the easiest thing. So we have to be more and more selective than ever. There will be opportunities, we intent to capture them, but these opportunities need to be a lot better than 15% a year. So, we don't think that buying plots of land cash will be a big trend looking forward as long as the situation remains like this but we're paying -- our eyes and ears open to opportunities and they will appear.

Q - Daniel Gasparetti

Okay, thank you.

Operator

Our next question comes from Mr. Guilherme Capparelli with Citibank.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Good morning. My question is a lot broader regarding the market. The macro economic context has pointed to some indicators. In Sao Paulo, people talked a lot about restricted supply with the director plan, the master plan for the city but we don't see nothing like that, not only you but other construction companies and development companies also have a lot of inventory and a big land bank. So considering the current price scenario that is showing a real drop and very low nominal increase, why do you think that supply will be more restricted and that prices will be able to recover in Sao Paulo more specifically? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Guilherme, well, first, we cannot give you an accurate answer. If we could, we would make a lot of money. But I think there are couple of things there. Yes, there are many competitors out there lowering prices. This is not good for the market. Its not good for the industry and undoubtedly, it does not help bringing prices to a fair and better value. So as long as they are lowering the prices, there will be a pressure on our prices. We don't like this kind of sale. We are not retail, we are not a supermarket. We have to treat real estate as property but this hurts the market. In Sao Paulo, we did not have an oversupply, not significantly, so this is good for Sao Paulo. We can say -- actually, we can say that Sao Paulo continues to be resilient. It is a difficult market but a resilient one(inaudible).

In addition -- in addition to the micro real estate, there is that macro real estate market. With interest rates and the economy as it is, (inaudible) everything. So to answer your question, I really don't know. The economy is not going to help us. At the micro level, there are lot of supply at low prices. So, its complicated but it will eventually improve. We don't know when it will improve and it will not be soon.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Okay, so the impact of the city master plan is more to the long-term?

A - Raphael Horn {BIO 19714328 <GO>}

Well, the master plan of the city is a topic that will be debated in the future. It will not be debated in 2016.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Okay, thank you very much.

Operator

(Operator Instructions) Our next question comes from Mr. Marcelo Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good afternoon. Could you comment on loans? We still see people withdrawing money from their savings accounts. Do you have any expectation regarding direct to consumer loans? Will this have an impact on sales? I just want to hear your opinion on this. Credit is not at the very best moment.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Motta, this is Eric speaking. I will divide this answer into some parts. In savings, account reduction impacts finance to companies, teleco entities as well as credit to consumers, to individuals. In terms of the credit to legal entities, (inaudible) looks good because when there is a credit crunch, there is a quality flight and to us, there is no restriction of real estate financing. We see in the market there, there are companies suffering from restrictions. To us, this is good because the competition is reduced. Its a positive. On the other hand, for individuals, its very negative when a good customer is not able to get a loan and what we have seen at this moment, given the increase in the interest rates, up almost 20%, that excludes a lot of customers, and in a difficult credit rating by some banks, it is a little bit more difficult to get consumer loans and financing.

We have direct financing, but it is important to understand that it has an economic aspect where we finance a customer who is not able to get a loan from the bank, but it also has a sales related aspect which is, (inaudible) from Cyrela is sure that in the future if they have good loans, they will not really depend on the variability of the banking market and that's why we use direct financing. Actually, direct financing is not very well accepted. In this quarter, we had less than 200 trust deed contracts which shows that this will not change the rules of the game but when the moment comes to buy, Cyrela customers feel more comfortable because they know they will never have to return a unit due to lack of banking credit.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay, thank you.

Operator

(Operator Instructions) There are no more questions. So I would like to turn the floor to Mr. Raphael Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Once again, thank you very much and I'll see you in 2016. Have a good end of year and good holiday season.

Operator

Cyrela's conference call is closed. So we would like to thank all of you for participating. Have a good day. Thank you.