Q1 2017 Earnings Call

Company Participants

- Antonio Emilio Clemente Fugazzar, Chief Financial Officer and Investor Relations Officer
- Hugo Soares, Manager of Controllership and Investor Relations

Presentation

Operator

Good day, ladies and gentlemen, at this time we will welcome everyone to EZTEC's First 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's Investor Relations website at www.eztec.com.br/ir, by clicking on the banner 1Q17 Webcast and in the Engage-X platform. The following presentation is also available for download on the webcast's platform.

The following information is stated in Brazilian real and in BR GAAP and IFRS applicable to real estate developers in Brazil, except or 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.

And now, I would like to 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.

Antonio Emilio Clemente Fugazzar

Thanks a lot. Good morning, everyone and welcome to our results presentation for the first quarter 2017. With me we have Augusto Yokoyama, Controllership Investor Relations Manager and Hugo Soares, Investor Relations Analyst for the release of EZTEC's operational and financial highlights.

The beginning of this year was marked by holidays and festivities that have hurt the inventory sales, particularly the very first weeks and during the weekend surrounding Carnival. Still we ended the first quarter of 2017 with positive net sales as well as cancellations and stability relative to the previous quarter.

Following to the sales efforts, the company has worked in preparation for launches for the next quarters as it has already been the case for the Brazil's first launch in April 2017.

In this way, please I ask you to observe slide number three. I will talk about EZTEC in the first quarter 2017. Other operational figures. There were no launches in the first quarter. The first launch was in April, with non-audited managerial numbers indicating that is a 41% sold. Contracted sales, net of cancellations reached BRL9 million. The land bank ended March with BRL5.6 billion in potential sales value. In the first quarter, the company delivered two of the five phases of the CIDADE MAIA project, the biggest project of the company going on.

Financial highlights, with a strict cost control, the company reported once again economies in construction that allow us to achieve a gross margin of 47.2%, and a gross profit of BRL46 million. Net income reached BRL32 million, with margin after 33%. EZTEC's cash generation reached BRL31 million in the first quarter 2017, ending with a net cash position of BRL241 million. In addition, it has BRL500 million in account receivables partly yielding 10% to 12% per year plus inflation and subjectable to securitization.

Our dividend distribution was approved in April 28 General Meeting amounting to BRL108 million and distribution representing BRL1.09 per share and 78% payout.

Let's listen to Hugo Soares, talking about the EZTEC's operational side. Please, Hugo go ahead.

Hugo Soares {BIO 19772261 <GO>}

Thank you, Emilio. I ask you now to move to slide number four. The bar chart shows the volume of deliveries launched in PSV. The yellow portion indicates the amount that has already been sold while the red indicates the portion of inventories. The dash line represents the volume of PSV cancelled in each period.

We can observe that by the end of 2017, we still have substantial deliveries. Thereafter, due to the low volume of launches over the past few years, there will be fewer project completions and therefore, a decrease in cancellations from 2018 on.

I ask you to look at slide number five, we ended the first quarter of the year with gross sales of BRL114 million, of which 80% is composed of ready units. Cancellations reached BRL105 million in the period remaining at the same level of the previous quarter, culminating in a BRL9 million of net sales in the period. Despite the seasonality hurting gross sales for the first quarter, we kept selling considerable volume of ready units which represents true sales in unilateral dissolutions. [ph]

In the chart below, we can see the evolution of the last 12 months accumulated sales and cancellations. Note that there is a trend of stability in the volume of calculations. Due to the large amount of deliveries for this year we have targeted efforts for the conversion of sales in cash or in mortgage.

Among such measures we highlight, one, in the Cidade Maia project, our main delivery for 2017 we have exchanged the financing agents and mortgage lenders through Caixa Economica Federal aiming to get better conditions of mortgage to the end customer. Two, the promotion of discount campaigns for clients who have put their outstanding balance using their own resources. Three, the payment of registration taxes by Ez Tec itself in the cases where such registration is issued within a pre-established time line. Finally, the mortgage financing through a statutory lien agreement with the company, whose total amount has reached BRL311 million in March 2017.

Now I ask you to move to slide number six where I will speak of inventory. We ended the first quarter of 2017 with an inventory of BRL1.2 billion, 58% of which represents delivered units, ready units and 18% of which is in the commercial segment, not including the Tower B from the EZ Towers. It is important to note that only 30% of our inventory refers to residential developments in the city of Sao Paulo, which has become the focus of our launches for the coming quarters.

Please, ask you to move to slide number seven. In parallel to the sales efforts, we have worked in preparation for launches this year. As a subsequent event, we have already launched in April the projects Legittimo Vila Romana. It is a 54 unit project which -- with a PSV of BRL50 million, which according to non-audited managerial figures is already 41% sold. All of the following launches will occur in the city of Sao Paulo where three well located projects whose sum potential sales value reach about 241 million. Projects that are well positioned within the city of Sao Paulo and with a PSV no larger than BRL150 million represent the focus of the company's launching strategy for the coming quarters.

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

Antonio Emilio Clemente Fugazzar

Thank you very much, Hugo. Let's move on to slider number eight, financial performance. Let me start talking about net revenues, net revenues on the slide, on chart left, revenues this quarter are coming down to BRL97 million compared to BRL150 million first quarter 2016.

Obviously, it is kind of thing that is going to happen-- is going to happen in (inaudible) forward 2017, specifically because we have less construction work under construction right now.

Less construction work is ongoing right now. And the problem is apart from the construction -- so last projects launched in the last years, we have a lot of cancellations offsetting our gross sales quarter after quarter. That's a part of the story for 2017. And this kind of happenings are going to be for the second quarter and third quarter and fourth quarter, specifically because we have a lot of construction to be delivered this year.

And obviously, so with those constructions to be delivered, we can expect some cancellations over there. So, for 2018 specifically, we can expect a rebound in terms of net revenues, but not in 2017.

Talking about gross profit on the right, we can see BRL46 million of gross profits, following a gross margin of 47%. And it's important to bear in mind that compared to first quarter 2016, the margin is strictly the same, so it remains flat and this is the kind of price we are showing to you guys. Specifically because, we have a lot of discounts in our (inaudible). But we have some -- we can save some savings on our construction costs to offset the discounts we are providing to sell our apartments. So -- and obviously, you can understand that we have been talking about it in the last quarter.

The backlog margin can represent, I would say, in a very good way, what is happening with the margins of EZTEC. So the backlog is about 49%, the gross margin is about 47%. So we can understand that is a good way to understand what's going to happen in the next quarters in terms of gross margins.

Talking about the G&A and selling expenses. Firstly, G&A. In the back -- in the chart on the back left, you can see BRL20 million in the first quarter 2017, compared to BRL22 million in the same quarter 2016. There was a -- the G&A came down BRL2 million, which is something around 10%, adjusted by inflation, I would say, something close to 15%.

There is a trend. There is a trend specifically because we have in the same -- in the same month, the first months of the year, the moment we pay the property taxes, we pay the taxes over the land bank we have. So apart from that, obviously, there is some adjustments in terms of salaries, in terms of people working for the company.

And these kind of adjustments we can see over the engineering team. Engineering team because we are delivering the sites, delivering the construction and we have no construction to be start so far. So -- and that's why our team is -- the number of people in our team is coming down in the first quarter 2017.

But I think we can expect a rebound even though in this kind of expenses, because apart from the fact that we diminished the engineering team and obviously, we increased a lot the number of lawyers to deal with cancellations and credit recovery in the last quarter. We are going to see an improvement in terms of developers team, developers team because we started all over again developing new projects to launch in the next quarters.

In terms of selling expenses, the history is a little bit different. When you see the BRL16 million as compared to BRL13 million, the difference between one another is that the cost of maintenance and tax property we have to pay over the units in inventory we have to carry on our balance sheet.

So all the units coming from the project delivered -- that weren't delivered and remaining in inventory of the company, we have to pay the tax property and we have to pay them again (inaudible). So -- and all these expenses are booked on the selling expenses and that's why you can see an improvement of almost 30% from fourth quarter 2016 to first quarter 2017.

Moving to slide number nine, you can see on the chart left the financial results of this company. And financial result means, something coming from the money we have in our savings accounts. (inaudible) the basic interest rate in Brazil, which is higher now. And part of this compensation is coming from -- this is kind of -- this is subject mentioned before by Mr. Hugo Soares which is the receivables -- the performed receivables we carry on our balance sheet. So BRL311 million means something around 1,500 units financed by this.

So we are providing mortgages through to our clients and carrying on those receivables yielding IGP-M plus 10 or IGP-M plus 12 can compensate our cash, so twice as much the return of the capital investment on our company. And that's why we keep going or keep using these specific [ph] to improve the return of capital for this company.

In terms of equity income, we have here on the top right revenues and properties coming from projects (inaudible) in partnership with our partners. But the problem is all the constructions we have in partnership are finishing, or are coming down, going to end and all the revenues coming from these projects are revenues from units sold, units from inventory sold.

Personally I think we are going to see a rebound in these numbers, but only in 2018. So far we have this huge decrement, this is typically because almost all the projects are finished in terms of construction -- and in terms of construction. There is our net income, the bottom line of this company is about BRL32 million obviously is a decrement, but comparing to the sector, comparing with these huge prices we have been passing through is a huge victory.

Obviously, when you see the track record of this company is our worst compared to two, three years before. But let me remind you that in the last seven to eight years we faced a huge booming market in the city and EZTEC took advantage of this booming market providing return on equity of 24% yearly for at least five to six years in a row.

Nowadays, is a difficult time, it's a hard time, it's a time to deal with credit recovery, deal with cancellations. And six Managing Director from that 10 Managing Directors at EZTEC nowadays are trying to deal with the clients in order to avoid cancellations personally. And that's why we can see less net revenues, but obviously, keeping the margins solely [ph] stable. So that's the kind of work, that's the kind of job we are trying to show you as differential compared to the other companies in Brazil.

And finally, results to be recognized are backlog. Backlog of this company is about BRL87 million. Backlog is kind of revenues, where you are going to see what kind of results you are going to see coming from units already sold under construction. So we haven't delivered it yet.

The highlight for this chart is about margins, 49% first quarter in 2017, compared to 49% for fourth quarter in 2016, so remaining flat. This is a very important trend in terms of margins coming from these units under construction right now.

Moving to slide number 10, the results -- (inaudible) results. Important to bear in minds, in terms of gross margins, since first quarter 2015 the LTM gross margin can be normalized, it can be something around 47%, that's the company's level so far. Used to be something around 50%, but 47% is a huge victory given the moment we have been passing through.

The other highlights we can see in this chart is about net cash. So even at the end we are providing a very good generation of cash from BRL210 million to BRL241 million. Also again, this is a trend, this is a trend because we have been -- what we launched in the last -- I would say, in the last few years what we launched are way less than we have done before and that's why so the money is coming back because we haven't invested yet.

My personal opinion, obviously, is about doing some launches, even doing some launches, we are not going to use this amount of money and that's why the Board of Directors of this company approved a payout -- an extraordinary payout and to a legal payout of 78%. So meaning BRL108 million. Even paying a BRL108 million, the company keep the net cash position.

Moving to my final two slides, to understand the potential value for this company. I have been discussing the potential every single quarter. You can see our book value for this company about BRL2.7 billion, which means something around BRL17 per share. But when you forecast what's going to happen in terms of booked value to be added, you can see inventory, and inventory is about BRL1.2 billion in potential sales value and at the current value, at the current value is very important.

So we are not trying to maximize value in terms of this inventory. We are trying to show you guys the real value we can -- actually can sell these apartments. And being sold those apartments we can provide something around BRL600 million in gross profit, which means BRL3.5 per share.

In terms of EZ Towers, these towers -- this is one of the best or I'd say the best asset the company can hold in its balance sheet. It's AAA building, 47,000 square meters of leasable area, 62% already rented, is a tower of BRL270 million of cost and the company asked something around BRL700 million of price. So selling this tower we can see more than R$400 million of gross profits, meaning to BRL2.5 per share, apart from the backlog itself -- but from the backlog -- the backlog result itself.

So -- and finally, to add in our book value I would say something like (inaudible) to be the balance which is our land bank. Our land bank is priceless, is priceless because when you think that we have -- we hold in our balance sheet more than 50 piece of land, and 50 piece of land in the City of Sao Paulo, in the metropolitan region of Sao Paulo mostly in the middle high and higher income classes.

So -- and we already paid for this land bank and the potential -- and the grants to add potential construction on these land bank, potential area on this land bank. All of them something around BRL700 million. And no swap agreements in our land bank, BRL700 million in cash paid can be developed to achieve BRL2.5 billion in gross profit.

So if BRL5.6 -- BRL5.5 billion of potential sales value in our merchandise, our apartment to achieve to reach BRL2.5 billion in gross profit. So this is only -- this point is about BRL15 per share toward land -- this land bank could be developed again.

And finally, in terms of potential cash generation. Potential cash generation in another highlight for this company. It's another highlight because the company's net cash already is net cash. So, but -- and obviously because of it the Board of Directors approved in the General Meeting of Shareholders approved BRL108 million of this cash to be paid on the next month. And even paying those dividends we can remain net cash position. BRL500 million of performed receivables. As Mr. Hugo Soares mentioned before, performed receivables which means 311, we have the agreements signed with these clients.

So these performed receivables are not subject to cancellation anymore because of the agreements signed with our clients. And the remaining BRL109, so our receivables coming to the -- going to the bank to have -- to turn into cash or to be signed with our clients to keep secured, to keep it stable as performed receivables.

And unperformed receivables -- unperformed receivables mean that we have receivables from units already sold, but are units under construction. So those receivables are adjusted by inflation. So, obviously, they are subject to calculations. And let's say that 20% of those receivables, they are performed receivables can be cancelled, 20%, 25%. So those receivables will come from this specific line from performed receivables to inventory and when we sold -- when we sell these receivables, again -- they come back again to be -- to turn it into cash.

Finally, all the construction we have in our company, we can do it for a price of -- for a cost of BRL162 million. So, all the construction we have going right now, we can be done -- we can have done this construction with a cost of BRL162 million. So, almost nothing.

All in all, the final result -- the final balance, the balance one for this is a certain math I provide to you guys is to have cash, a potential cash of almost BRL1.2 billion. So, BRL1.2 billion is the potential cash generation for the next, I would say, 18 months to two years. Apart from it we have the inventory. Inventory at market value which is BRL1.2 billion and to EZTOWER Tower B, the calling price, the asking price we have is about BRL700 million. So, selling the EZTOWER, selling the inventory in the next two, three years, we are going to see in our balance sheet a new generation of cash potentially reaching something around BRL3 billion. So, saying that, I would say some final words for this presentation.

Still suffering with the repercussions of the crisis in the middle of challenged conjuncture, the management has done its homework, controlling costs and expenses, looking for alternatives to mitigate cancellations, renting and preserving the values of our assets. We have been, no doubt, through a period of strong learning. Surely, we will continue these efforts along 2017. However, we see conditions to gradually return to develop new projects and activity that we perform with a lot of expertise, and then it will boost definitely the company back to growth again.

Thanks to the competence and experience of the directors of its Board, EZTEC has managed to overcome the issues and giving a solid cash position. In this sense, it is worth mentioning, the approval of the Annual General Meeting of April 28, the distribution of dividends in the amount of BRL180 million equivalent to a payout of 78%. We expect a gradual recovery of the economy in the coming quarters and we are in position to the resumption (inaudible) that guide and support the company in the long-term, product quality, profitability and financial health.

Now we will be available to answer any further questions from our listeners. Thank you so much.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the question-and-answer section. (Operator Instructions) And we are showing no questions, I'd like to hand the conference back over to Mr. Emilio Fugazza for any closing remarks.

A - Antonio Emilio Clemente Fugazzar

Thank you very much again. Apart from myself, Mr. Hugo Soares, Mr. Augusto Yokoyama, we are all available to answer any further questions you have. Thank you very much. See you next time.