

## Q1 2018 Earnings Call

### Company Participants

- Eduardo Fischer Teixeira de Souza, Chief Executive Officer Region II
- Leonardo Guimarães Corrêa, Chief Financial & Investor Relations Officer

### Other Participants

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

## MANAGEMENT DISCUSSION SECTION

### Operator

Ladies and gentlemen, good morning. Thank you for holding and welcome to the conference call of MRV Engineering. We would like to inform 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 section.

Now, I would like to turn the floor to Mr. Eduardo Fischer. Please, Mr. Eduardo, you may proceed.

### **Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Good morning to all. Thank you for your participation in our result for this conference call for the first quarter 2018. Some important things about this first quarter and expectation for 2018. So, let's see. We had first quarter that was very good. The first better quarter and some important landmarks, we had a record of net sales, record in income, in revenues and in net profit.

So, the first better quarter, first quarter, in a long time, we're estimating we're starting 2018 with our right foot. We continue delivering all the growth that we had during 2017 that we started planning three years ago. But this growth is coming almost full from city where operations have been consolidated for some years already. What is important about this? Within the concept of stores and occupying, increasing our penetration in the markets where we are already - we're able to grow the operation.

We are generating pressure and if we start to see this dilution of G&A and commercial fixed expenses, this is a movement that will continue as we continue growing with this. In our strategy, this growth will continue coming from the increase in penetration of markets where we are present and this dilution of fixed expenses will continue.

We're quite comfortable with what we planned, what we've been thinking since 2014, 2015 as a strategy of growth and it has been relevant, 2017 and it continues occurring in 2018. And we look at the next quarters with great optimism.

The demand continues quite strong. This is a year that despite the World Cup and elections, presidential election, this is not affecting us. We have operations that are going very well. Demand is great. Demand is growing. We see the behavior of customers with little hesitation. The closing of sales is happening in shorter terms and in shorter times than in the past. This is a sign of confidence and we have had the perception of our team.

Another important aspect that was questioned was our volume of launches in the first quarter. Yes, we have launched less than we had forecasted initially. But, I would like to reinforce that this does not affect our planning for the launches of 2018. We are going to the month of, middle, the second quarter of the year and the launch, the second quarter will be more robust than the first one.

We have to remember that traditionally, the second semester is a semester that is more agitated, let's say, it has more launches than in the first. Nothing that happened in the first quarter will affect the launches or sales for the year. We are probably delivering in 2018 a robust volume and a higher volume in launches and sales than in 2017.

An important point that I would like to highlight as well, we have been implementing our construction method more and more. The concrete walls, we should reach the plentitude 100% of concrete walls. And it's an important aspect, because this has been showing a reduction in the cycle, which is another gain potential. We've been talking about it a little. We've been talking a lot about growth, about demand, of how to absorb markets better, markets where we are. But we have a further opportunity, which is the reduction of the construction cycle.

Our business cycle has been shortening. An example, between the first quarter of 2017 and the first -- 2018, we had a behavior in the cycle of four months in average. In my perception, we have the potential to be able to go further. If you look at this, you are able to see opportunities of growth coming from a growth of profitability due to the increase in the company production, sales and launches and a great opportunity in the shortening of the cycle, which is also very relevant.

You see what has been happening with our ROE, which has been growing and our expectation and this will continue improving. So, just to conclude we had a first quarter that was very, very good in my vision, with some important marks. 2018, I'm very optimistic.

We have closed April very well and good re-launches as well. The expectation is that we, during 2018, we can generate a higher cash than 2017. Leo is going to talk about this return to shareholders. We're very comfortable with 2018.

We're on track to reach all goals that we established and we're going to deliver a growing profitability. Leo is going to talk about dividends and other.

## Leonardo Guimarães Corrêa

Good morning to all. Some detailing here, some more specific detail. We entered the period of accounting changes, rules, rule-changing. MRV is in mainstreaming these modifications that were launched by the specific authorities, adopting the new standards. So, it's important that MRV does not foresee impacts on our statements because of the change in the rules.

To be quite specific, the line that brought greater changes was related to the provisioning of - we passed from a provisioning based on the track record, past track record to prospective provisioning according to the rule. In 2018, we have an estimate of losses and credit at the sale from the point of view DRE, the volume provision quarter per quarter which should not be materially different from what we've been provisioning quarter to quarter in the last year. The way of measuring is different, but the economic facts - the company do not change. We are going to continue being transparent, conservative in our reports as we are in the other expense and provisioning lines.

Eduardo has mentioned our operating performance. I'm going to emphasize that the growth of launch brings growth in sales. And now, we're seeing these results pass-through demonstration increasing profit and our ROE. Increase our ROE is our objective.

We understand the points related to cash and FGTS, our equation (00:08:59) always with some collateral noise, but with the - really the focus on residential launching. We're seeing the deposits in savings increase creating more liquidity to banks and consequently for the real estate market as a whole.

Our equivalence line continues improving even with some volatility and improvement (00:09:30) subsidiaries to MRL and LOG. PRIME has entered generation of cash, therefore, diminishing, decreasing debt. It's initially slow, but a clear direction. We have delivered 25,000 square meters and revenues already coming in the second quarter. So we're going to close below 7%. Capitalizations are already committed with expansions to respond to the demand of clients. It's e-commerce showing its force.

The last point that I would like to emphasize is that related to dividends. We have announced an extraordinary dividend. It was paid already in April. We have dividends paid in June. And as we said (00:10:22) create a fixed rule and/or change our status. We want to have consistency and deliver. And in this year, we have a table on what we've been paying shareholders. Four years ago, we were returning 50% of results even in very upsetting moments, economically speaking. We're going to continue this practice, more important than talking and promising is to continue delivering.

Now, we are going to pass to the questions.

## Q&A

### Operator

Thank you. The floor is now open for Q&A. First question comes from Enrico Trotta from Itaú BBA.

#### Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Cicero (00:11:20) and Leo. I have two questions. The first one related to land banking and land acquisition. I think the land bank – it's the first quarter that land bank has grown. I want to understand if we reached the ideal land bank size and from now onwards, increase launching and the turnover of land and expand ROE of the company over the company (00:11:53). I would like to know how much you expect in the impact of cash with the land bank.

And the second question, here is more to next week. On the 16th there is a meeting of the FGTS board, it's the Fund for Length of Service (00:12:14). We have been talking about the government having even thinking about increasing line 1, 1.5. I would like to know if this is true and this should be taken to the meeting, to the board meeting. And if it's line 1, where do resource of funds come from? Is it from the treasury or the Funded Length of Service (00:12:38) FGTS? I would like to know if you're aware of this discussion.

#### A - Eduardo Fischer Teixeira de Souza {BIO 16644318 <GO>}

Thank you. First question about the land bank. Yes, we made a great effort in last three years and we made investments and in my vision very relevant for two reasons. First one is that we took benefit of many opportunities in the market that was squeezed. And we made very excellent business. It will be a very good pillar for profitability in the future. This is a point. Another one is to be able to face the strategy of greater penetration in the markets where we are. And third this is the strong movement we made in last year in 2018. Our perception is that some practices have greater competition, especially the capital metropolitan areas. The opportunities of good business has decreased.

In other play (00:13:36) locations, no, you have the medium or smaller cities that have excellent opportunities. We should have a year of less active purchases land banking (00:13:50). It's not only replacement. We should be above this. But the expense we made with land bank is not only in the purchase. Sometimes you started installment. (00:14:04) cash comes with purchases (00:14:07) previous years, we should have a disbursement of cash more or less equal to last year.

In regard to FGTS, lots of debate. Leo mentioned this in his opening speech, especially this year where there is a greater more active movement in the treatment of low-income market. Yes, we have been following this very closely. And we are hearing movements that want to be made or are being thought about by the government. An important message is talking to the curating board and CEO, the cash economic that comes from

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the habitational (00:15:02) market. We can't do anything that is disruptive. The stability in the long-term exists in all agencies that are discussing this. So, if there will be a part of increasing line one-and-a-half, I am not worried about this. If there's economic stability, which is the basic premise (00:15:28) being very positive. Second, if you look at the absolute figures, today is the great players of the one-and-a-half line. It's a good operation. And we had a greater operator of the one and a half in Brazil.

I don't see this movement as something to be worried about. Funding is the most important thing. It's our oxygen for the operations and we follow this very closely and it's not something that is worrying me now, because we participate in the discussions and I can tell you there's nothing decided in regards to the increase of one and a half or there's going to be any addition.

**Q - Enrico Trotta** {BIO 16742911 <GO>}

Thank you very much Cicero (00:16:13).

**Operator**

Next question from Bradesco, Luiz Garcia.

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

Good morning. Two questions. First if you could talk about the rhythm of launchings, the pace the launchings will take because of new financing, funding, it seems there's no volatility. It happens every year. But now if sales and launches continue having the pace, this was expected with the strong rhythm, the strong pace we saw in the first quarter.

Second question, about the drop in the status. You have been touching upon this and what we can expect from this quarter, there's always some seasonability. What could we expect ahead and also include another point which is adoption of IFRS 9 (00:17:24). We saw direct provision for assets. So, I want to know if this provision is the percentage of the portfolio suffers any change or not? What could we expect on provision on sales with the adoption of the IFRS (00:17:50)?

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Let me talk about launches, the commercial and then we will have provision and (00:17:57). Let's see, launches as I said in the opening, the launches, April was good. The perspective is good. Nothing that happened in the first quarter really move me away from the goal. I'm very comfortable whether we have many things (00:18:28) mature and the launch is not a preoccupation. We have been addressing this. I think it's going to be very important.

The grey market, these are important in the second quarter, because it starts this year a good move. The market was very good. So, everything indicates that we will have a good behavior in sales adding to the big market. You have more launches, so I continue believing that we're going to have 2019, even stronger than 2018. I am going to talk about this type (00:19:18).

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So, when we talk about the status, we say that we have been addressing since the implementation, so we accepted more dissolutions than our present. We expect 8% to 10% (00:19:42) 12% to 15%. So we made a further step. It's guaranteed sale. We only - a sale cancellation or dilution is value zero. So, what we've even seen, yes, we've been decreasing this quarter per quarter. There's a little volatility if we see the trend in cancellation, much smaller. The tendency is to be much smaller than we have 12% to 14%, something around this range. And for next year, with this full implementation, the guaranteed sales still this year, we're going to see below 5% of cancellation.

## A - Leonardo Guimarães Corrêa

Luiz, good morning. So, first of all, there was a change in the rules. The rules start to be in place in the first quarter 2019. But in terms of comparability, you start to have to work 2018 within these rules. We had a standard which was an older standard. We look at the track record. The portfolio remains - had a default. We started to move. And if the client - the customer would pick, we could make a positive registration.

The way or the norm requires that you make a prospective provision. And I have to reemphasize the most important thing for us is the number that we saw a provisioning quarter per quarter was about 20%, 25%, even higher quarter per quarter is what we're going to continue seeing from now onwards. If sales increase more, this number will probably grow a little bit more because it ends up being percentage of the sale. What do we do or what (00:21:55). The company has worked greatly (00:22:01) all credits that we grant our clients and understand who our customers are to really cut this default rate. We have an - we don't have an exact number. We have an overall rule and we've been studying customer per customer. There are some profiles that have higher 00:22:26), higher tendency to be default. For this we have higher provision. For others who have a profile that is, call it, more secure, we make a smaller provision. These things vary according to the enterprise or with enterprises with great demand, very well. So, we close a bit the credit line. We grant shorter term, not only demand, but also the credit.

We've been using and incorporating tools, artificial intelligence tools. The objective is really to try and understand for whom or to whom we are granting credit and doing it in the best way possible and having the lower loss possible. It is inherent in this portfolio. We know this, but the less we can lose, the better.

If I have a very rough rule, it's about 1.5%, the value of sale. This is what we've been provisioning and we'll continue provisioning in the following quarters. And this number is not an overall. It's really made individual, per individual, but the track record we've been seeing is this. And at the moment, as things are changing, the rule is changing, we wanted to make the year 2018 completely comparable to 2019. So, we have decided since now to implement it immediately.

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

So, you're not expecting changes in terms of percentage since - these more conservative rules. But if you have more 1.5% lines (00:24:49) as a percentage of sales, are you estimating a stable percentage, both the portfolio? Is there a change in the size or the pace of growth of the portfolio?

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## A - Leonardo Guimarães Corrêa

There are two variables to be considered. You talked about greater volume, 1.5% means a smaller portfolio. But on the other hand, an acceleration of the cycle means a bigger portfolio because I'm constructing more quickly. Therefore, I give less time for the customer to pay, especially what we call (00:25:37), which is the post keys, let's say after the delivery on keys. And the two variables, one is contrary to the other, one is expanding, one is decreasing. So, it becomes neutral at the end. At the end of the day, yes, I imagine neutral.

## A - Eduardo Fischer Teixeira de Souza {BIO 16644318 <GO>}

Just to complement what Leo is saying, if you think about order provision, provision is something we take very seriously into account. We're not allowed to play with this. We cannot afford it, be it provision for technical services, we take it very seriously and in a very conservative manner. If you consider all provision, almost BRL 600 million provision, perhaps this does not happen. We might even have a gain here. The vision is that this in here even because of the nature of our business and its cycle, it requires for us to be very conservative and very fierce in dealing with it. Summarizing what Leo was saying if you get the entire sum, it's lots of money allocated to provision, because we have this vision, this conservative look, it's very necessary to a business such as ours.

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

Thank you very much.

## Operator

Next question from Jorel from Morgan Stanley.

## Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning and I have two questions. First of all a question about your goal for launches. From what I understood you have a goal of 50,000 units to be launched in 2018, but to reach this number you should launch per quarter plus 50,000 in an annualized manner. Could you give me more details of what brings you this confidence of this goal, especially in terms of flow - of approval flow of the government? Just to confirm the credit portfolio, MRV portfolio, you understand that the percentage of sales of 18%, you believe this will continue forward or will become - or will remain stable?

## A - Eduardo Fischer Teixeira de Souza {BIO 16644318 <GO>}

Good morning. I could answer to the first question. Yes, I am confident that we will fulfill the launches this year, because the land bank that was constructed during the last three years is very big, very robust, and with a high degree of maturity. This is not my concern.

I think that in the second quarter, we're going to have a more robust number. It will continue in the second, third and fourth. As I said earlier, the second semester tends to be stronger always in terms of launches. So, I'm confident that this will be fulfilled. And what is really valid for us at the end of the day is sales. The sales are coming strongly. We

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have a stock and inventory we can work on and there's a robust land bank and more and more mature and closer to legalization. There's a great part of this land bank that is already legalized, would be ready for launch. So I'm very confident that the second, third and fourth quarters will be very robust in launches.

In terms of the portfolio, as we have been growing sales, the portfolio has been growing. It's natural. As a percentage, I don't see a great change. Obviously, there's a certain volatility, because of the factors that I just mentioned, greater volume for the 1.5 line means a smaller portfolio, but a more rapid cycle with a portfolio of pro-solute B (00:29:52) that is a bit higher. As a percentage, there's no significant change.

**Q - Jorel Guilloty** {BIO 18291521 <GO>}

Thank you very much.

## Operator

Next question comes from Luis Stacchini, Credit Suisse.

**Q - Luis Stacchini** {BIO 18717891 <GO>}

Good morning to all. Thank you. My doubt has to do with conciliation. I would like to understand from you the reconciliation of the stock at market value, looking at the stock, the fourth quarter as a percentage and subtract net sales, I have a higher stock that's been reporting. Are you having some change because of re-pricing?

Looking only the fourth quarter and removing sales, I get BRL 5.2 billion and you reported something BRL 4.7 billion. Could you explain to me this gap, if there was a reclassification of project from Line 2 to Line 1.5? Thank you.

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Hi, Luis. There is a part. There are two or three factors. One is linked to Line 1.5 with the price drops and other reclassifications, smaller reclassifications. There is no great difference, but I can (00:31:38) detail with you - if you want more details outside the call.

**Q - Luis Stacchini** {BIO 18717891 <GO>}

We talk later then. Fine. Thank you.

## Operator

Next question from Christian Fantini (00:31:51) from Banco Safra.

Good morning. Please I would like you to recapitulate what you did for losses to be reduced in 2016. And you started to present profit in 2017. (00:32:16) has been presenting an improvement in the operations. It's been some time a recognition of income of revenue has to do with the report. It goes to DRM as enterprises are being constructed. Another thing as the PRIME has a great leverage has to do with the SELIC (00:32:41) rate

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and for several following months, continuous months is really bringing cash after paying the taxes, paying interest rates. It's a slow movement, but with the right direction.

Next question comes from Marcelo Motta from JPMorgan.

**Q - Marcelo Motta** {BIO 16438725 <GO>}

Good morning. My question in terms of images (00:33:12) gross margin, do you expect the thresholds that you have seen in the last quarters. And also you mentioned at the beginning of the call, more dilution of cost and having a concentration in launches in cities where the company is already present. Diminishing, cutting these operational costs, operational expenses, is the tendency, the same to the margin?

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Okay. Our gross margin, I think should remain flat during 2018 and perhaps 2019, I see no movement in the gross - has a sound level. I don't see it growing much more. You have some oscillation, some ups and downs, but it should remain on the level it is. In regards to dilution, yes, our expectation is that this growth that started to happen is not completely May, but it will continue in 2018-2019. We'll continue generating dilution and therefore increasing return. As I had said before, our G&A and our fixed expenses is already there for operations that we planned back in time.

As I said in the opening, our growth is coming full with operations that are consolidated. So, yes, my expectation is that during the year 2019, we still show an improvement with the decrease in the other two lines.

**Q - Marcelo Motta** {BIO 16438725 <GO>}

Perfect. Thank you.

**Operator**

Next question comes from Renan Manda from Santander.

**Q - Renan Manda** {BIO 16845063 <GO>}

Good morning. I would like to know if there was any advance in the conversations with banks in terms of re-price sales to the premium line if you have anything about this product.

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Refunding (00:35:32) yes, we've been talking with banks in terms of - okay, two ways, one is approval permits, et cetera. This is being worked on. And this is something that will occur more to at the end of the year.

And from point of these banks, we continue talking to private banks and both official banks, Banco do Brasil and Caixa Econômica are interested, especially we're seeing drop,

continuous drop in funding rate of the FGTS and the entrance of money in the savings will bring more liquidity to the market.

## Operator

Next question comes from Raquel Costa from Bradesco Assets. Raquel, your line is open.

**Q - Raquel Costa** {BIO 20101374 <GO>}

Good morning. I would like to know about the LOG capital, if this had been planned and if new capital is coming in. Talk about the expectations.

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

This capital from Log last, I think in January, LOG has an expansion plan. It means more entrance of funds as it has a strong demand. This is a great probability. MRV will not contribute in LOG.

**Q - Raquel Costa** {BIO 20101374 <GO>}

Thank you very much.

## Operator

I would like to turn the floor to (00:37:57) for final consideration.

**A - Eduardo Fischer Teixeira de Souza** {BIO 16644318 <GO>}

Well, I am going to close and just to reinforce my message, we started 2018 well. We are continuing to deliver that return evolution that we were talking about with increase in operation, increase in expenses, dilution, this is the expectation we have for 2018 and 2019. I think most of the challenge, the greatest challenge was back there we decided to have a high and robust land bank. We've bought in very good conditions. We have a scale to grow with stability and a very round, very smooth operation. I'm very optimistic in regards to 2018. 2019, my idea is delivering more and more robust results. Everything is showing this. The first quarter is the first step in this direction. Just to highlight something that I consider very important is one of the differentials in MRV. MRV has an approach in regards to provisioning that is very conservative, very serious and therefore we have a company that does not deliver surprise, especially negative surprises, always positive, stable company, almost a retail company. We have this concern. And when we look at the consistency of our results during the years and the quarters, it is demonstrated. Thank you very much for your participation. And we meet in the next call. Thank you very much.

## Operator

The conference call for MRV is finished. Thank you very much and have a nice day.

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