Y 2018 Earnings Call

Company Participants

- Leonardo Guimaraes Correa, Chief Financial Officer
- Rafael Menin e Eduardo Fischer, Chief Executive Officer Region II
- Rafael Nazareth Menin Teixeira de Souza, Chief Executive Officer, Region I
- Ricardo Paixao Pinto Rodrigues, Director - Investor Relations & Financial Planning

Other Participants

- Andre Mazini, Analyst
- Luis Stacchini, Analyst
- Marcelo Garaldi Motta, Analyst
- Renan Kato Manda, Analyst
- Victor Tapia Migliorin, Analyst
- Wilfredo Jorel Guilloty, Analyst

Presentation

Operator

Ladies and gentlemen, good morning. Thanks for standing by and welcome to MRV Engenharia conference call. We would like to inform you 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 Q&A session when further instructions will be provided. (Operator Instructions)

We'll now turn the call to Mr. Rafael Menin. Please Mr. Menin, you may go on.

Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

Good morning, everyone. First of all, I would like to thank you all for attending our call to release the earnings of the fourth quarter '18. We are very happy with the indicators, be them operating or financial. It was the best year for the company. We did very well in all indicators. We had growth of 10% in net revenue; gross margin continues stable, and MRV, as you know, has been showing performance with very low volatility, constant margins. So it is unique in the construction industry in Brazil.

Another key aspect is that our profits continue to grow. The company grows, but expenses grow at a lower level. With that, profitability and profit continue to grow. And finally, on the first page, this indicator is very important. Our ROIC, which was 10.5% in '16, closed the year at 16.5%, an extremely healthy indicator compared to the industry benchmark. ROIC had important growth because of the company's increasing profitability, as I mentioned before, but also the reduction in the company's balance sheet when we had the merger of LOGG3 and (inaudible)

Another aspect to be considered is that MRV has been investing in the last five years in the landbank. Today we have a landbank with BRL50 billion with extreme quality, spreading more than 150 cities in which MRV operates. If you think of MRV's share in the market, it's only 12%. Despite it being the largest company in the segment, it's still very low, which shows the potential growth of our business.

On the other hand, when we take a look at the cities we have been for longer, for example, Uberlandia, (inaudible) Ribeirao Preto, our share is close to 70%. MRV has been delivering a product that stands out in the market. It is more modern, more sustainable, and it delivers on time with extremely high quality materials, which makes our product to be desirable in this economic segment. So the share is not a surprise to us.

Another aspect that is quite important is that we started a restructuring process in 2014. We started with the two CEOs, myself and Eduardo Fischer and the plan has matured from then on. And the next step is the merger of some areas. We have already announced that a few months ago and we have (inaudible) he has been with the company for 12 years, developing beautiful work and he is going to the Board and Ricardo Paixao is going to take over (inaudible) position.

In addition to this move that we understand as important for the company and really to bring new air to the company, make it more agile, dynamic and modern, we have implemented a row of innovations. MRV has been investing heavily in innovation. For you to have an idea, in '17, we spent BRL35 million in innovation, and this year, '18, we spent BRL43 million with an increase of 22%. On the other hand, the G&A ex went from 5.97% to 5.6%. So what's the message here? MRV is a company that is becoming lighter. We are diluting our investments, but digital investments are growing and we believe this is the right move to go.

Today, I can say that MRV is the only constru-tech in the world market. We have very important investments in hardware in the way we build the properties more automated, more industrialized, but also we're investing how we relate to customers from the time they buy their property to the follow-up during construction, to transfer credit to banks and post construction. So it is the only constru-tech, that is a technology construction company in the world.

And we know that our clients are young. Consumption habits are changing and MRV is preparing to offer to clients, within this full housing platform, different ways of consuming properties. They will be able to buy a property or perhaps rent property or maybe buy into a consortium pool. So these digital investments are going to be crucial for us to have a flexibility to offer the product clients will want at any point in time. And another important aspect is working in SQUADs. Today we have several SQUADs going on. This is a modern, assertive, agile model of operation and which is not very much used in the industry in which operate and once again we are ahead in the digital transformation process.

Another thing to highlight and that has to do with our concern with customer experience. We have reached NPS of 43 and we want our NPS to continue growing in the coming years. We know how important our profit, it is for customers, they spent 12 hours consuming our products. So having an experience that is positive is crucial for the success of our business. And now the relevant aspects and I have already told that before is the [ph]NFB deal and we will continue to operate in the economic segment, but assessing other funding sources and EPS is healthy. Last year, we realized a positive investment in the system, interest rates that were about 11% to 11.3% [ph] plus interest rates are now at 8%.

So we realized that the market approach -- it's still lagging behind and MRV once again wants to introduce new business models, highly modern product for this market niche. That comes right after Minha Casa Minha Vida program, and just an indicator, 5% of the launches in 2018 were in the segment and this is going to be growing. We went to get to 60,000 units a year, out of which 10,000 are going to be at this year, which processes about 250,000 compared to Minha Casa Minha Vida which is 150,000. So at some point in the coming years, the 60,000 project will be implemented and this year, of this segment is going to be about 25% in volume of sales for the segment.

Another important aspect is that the company got 40 awards in 2018. Customer experience, digital investors, sustainability, so we are very proud -- the MRV team is very proud of having been awarded 40 times in the year. And finally, I would like to mention that the first two months of the industry brought some setbacks. This is normal, when there is a change in administration. So the month of January was not very good in terms of credits. February started to coming back to normal. And according to the instruction released last Friday, we expected that as of March, funding goes back to normal.

So the quarter should have a very small impact with regards to a transfer of individual credits to banks. And we are feeling that '19 is an year that starts with a more robust pipeline in terms of launches. We expect to launch more than '18 and if we launch more -- with the best -- better economy for the country. We can sell more more, transfer more customers to banks and build more units. In doing so, we should have greater revenue and (inaudible) indicators at better levels than '18.

Now I'm going to turn the call to Leonardo Correa.

Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Good morning, everyone. First, I would like to thank you all for attending the call. This is the last call of MRV as CFO. I'm going to continue on the company day-to-day for very long time, but at the level of the Board at Directors. Ricardo Paixao is taking over my position. He has excellent training and education, focused on the area of processes, which he acquired, before coming to the MRV and he has been with us for 11 years, after being in different areas of the company, knowing the company details and he has been already working as IR Officer and CFO for two years. So we are going to have a very smooth transition, letting people accommodate in their different positions and optimizing the company's financial management even further.

Rafael talked about the financial indicators, specifically our ROE. So I would like to address other topics and I would like to draw your attention to the chart that we have in our earnings release. Capital structure, we returned BRL3.2 billion to our shareholders, which is a lot higher than what was allocated in the capitalization structures. With that have achieved our customer satisfaction, but also have been compensating our shareholders. In this contest, we paid out BRL456 million in dividends in '18 and perhaps a change that you haven't notice that is important to highlight. For many years, we have been capitalizing about 50% of the results. Now, we are changing the proposal, which is to increase the payout to 75%. The message is objective and clear, the normalization of the economic activity in the country aligned to optimum capital management in the process to continue growing and making available a greater part of the results to our shareholders.

I thank you all for the support for many years and now we are going to open for the Q&A session.

Questions And Answers

Operator

Thank you. We will now start the Q&A session. (Operator Instructions) Our first question comes from Luis from Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Hello, good morning, everyone. Thanks for taking my question. I have two questions. The first is with regard to your payout, Leo mentioned a bit about that. You were thinking of increasing it to 75%. I would like to know if this increase can be considered recurrent. Last time you increased to 50%, you had already been practicing the 50% for a long time and based on this payout, could you say that the pace in the buying of land is going to be a bit more moderate from now on?

And the second question that I would like to ask, so with the FGTS budget and you said that your properly going to get back to normal as of March, we had an interview last week about that. So what makes sense in terms of impact of launches and transfers to banks this quarter if any? If you were thinking of already have a greater number of launches post carnival, so if you could talk a bit -- give a bit more color with that regard?

A - Rafael Menin e Eduardo Fischer {BIO 20621966 <GO>}

Well, this is Fischer. Good morning. Well, first payout, your first question. We have been talking for -- about that for some time now, when we migrated to 50%, we started to execute that. Our level of leverage is slow. Every quarter, we reinforced the point that we generate cash -- we have been generating cash for 26 quarters in a row, so it does not make sense to have a position that comfortable and not paying out dividends. So this is sign that our payout is growing and it tends to be recurrent, it's a new level as of now.

As for landbank, we have already mentioned that in different occasions. We have made heavier investments in the buying of land in the four or five years until now. The market was doing well and it made sense to make these investments. As of now, we are going to more think of replacements. Rafael mentioned that we are aiming at growth, so the trends -- the trend as far as this landbank to grow slightly, compared to what we are launching, but at a level that is lower than what it has been in the past four years. So I don't know if it's clear. We are going to buy a bit more than we are launching, but not as much as we were in recent years because of market opportunities.

And your last question about the workers compensation funds, the FGTS, we had a bit more impact on January. February closed yesterday at a much better level, not back to normal, but better than January; and we expect -- and even because of the news on Wednesday that March is going to be quite robust and that some how offsets a weak January. But more important than that, we have to look forward at the level of rationality that we have in this government, that understands the importance of housing, in terms of employment, payment of taxes. The government understands that the industry needs investments and the project has to go on, and I think the actions this week suggests a reflex of that.

So I'm quite optimistic about the remaining of the year. Rafael said that in the beginning of the year, we want to deliver growth and I think the news this week are proof of that. So we are quite optimistic for the remaining 10 months of the year.

Q - Luis Stacchini {BIO 18717891 <GO>}

Okay. Thank you very much, Fischer, for your answers.

Operator

Our next question comes from Andre from Citibank.

Q - Andre Mazini {BIO 20377100 <GO>}

Well, thanks for the call. Well, first, congratulations, Ricardo Paixao for the changes in the company. My question is a bit of follow-up on the last question about Minha Casa Minha Vida Tier 2. There was a piece of (inaudible) newspaper that the Tier 2 investments would be a lot lower this year. I don't think that it will come to an end, but if it were the case, I think that today you have from 70% to 80% of your volumes on Tier 2. If Tier 2 is ended and investments go to Tier 3, how would be your speed of sales? I think less people would have the money to buy the units, because you would have less subsidies. So hypothetically speaking, if Tier 2 is abandoned, how do you work with the scenario? Thank you.

A - Rafael Menin e Eduardo Fischer {BIO 20621966 <GO>}

Well, I did not read the news that you're mentioning. But what happened at the turn of the year, there was a higher reduction to Tier 1.5. It is true. It's a bit tougher and what you're going to see is that the share of 1.5 in our portfolio decreasing, which honestly, to me, it is good. 1.5 Tier, had it's advantages, but in the long term, it kind of imbalanced the game, especially with smaller cities. In the inland of the state of Sao Paulo, it consumed too much subsidies. So I think that for a balance of the system this hardening of 1.5 is positive. But I do not see any restrictions to Tier 2. What happens is that 1.5 will migrate to 2 and I think that's what you're going to see is a higher share of our operations in Tier 2. And we have part of our operation in Tier 3. So I don't not see the movement, I don't know if I answered your question, but that's what I feel.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay Fisher, it's quite clear. If you could talk about the speed of up sales of 2 and 3 and the delta in each one of them?

A - Rafael Menin e Eduardo Fischer {BIO 20621966 <GO>}

They are very similar. Obviously, Tier 3 is slightly lower, but the family income for 3 is higher. So we will work on Tier 3 in capitals, where you virtually have a greater demand. So if you think of MRV's average, they have very similar numbers. In Sao Paulo, the state of sales in 2 is a bit higher, but not really standing out. I would say that the averages are quite equivalent.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Victor from Bradesco.

Q - Victor Tapia Migliorin

Good morning, everyone. Well, first, I think I would like to ask you, almost as a follow on of the first question. The answer was a bit qualitative. In terms of hard numbers, what do you think the impact can be for the first quarter? We have launches that are coming a bit below, so I would like to know for the quarter and for the year, what you expect in terms of margins, inventory levels, recurrent inventory, inventory of finished units, and G&A if it's going to continue to go down? And another thing I would like to know, if you could give us a bit more color is about the write-off in the pro-soluto? If you could tells us how much you have that is more than 12 months behind that could be written off in the next 12 months? Thank you.

A - Ricardo Paixao Pinto Rodrigues {BIO 21232785 <GO>}

Well, this is Ricardo speaking. Okay. First, the write-off. I handed BRL13 million completely provisioned in our balance sheet, no impact whatsoever. So what we did is that we got all installments that had matured more than two months -- two years ago, that it's 24 months and written -- and wrote them off, impact zero. And this is what we are going to continue to do. As far as the dilution of SG&A, we want to continue to dilute our SG&A. What is important is that sometimes we're compared to some companies that are listed and now our SG&A, the classification of expenses is different in between companies. So -- and you can get that by adding SG&A and other operating expenses. And if you do that, you're going to see that we are the most effective in the industry. So, we are going to continue to dilute our SG&A, our inventory stable 9% with a nominal growth of BRL80 million, if you include of the closing of the ventures that were funded by Banco do Brasil, especially in the Northeast. And there is an upside to it, when we sell this and we transfer to banks, it is cash generation direct to the company. And the other point that you asked, first quarter impact on launches, we had no impact on launches. We cannot disclose numbers so far, but we are going to close first quarter of '19, way about the first quarter of '18. Thank you.

Q - Victor Tapia Migliorin

Okay. Thank you very much. Just a follow-up with provision of what you have in your portfolio. Could you break down what that is more than 12 months behind? Can you provide some kind of disclose?

A - Ricardo Paixao Pinto Rodrigues {BIO 21232785 <GO>}

No, this is not a disclosure that we will make. But you're going to see, every time that this past two years is going to be written off. But more important than the write-off is the provisioning policy that we have that remain the same. So the net amount again will have no impact on our numbers.

Q - Andre Mazini {BIO 20377100 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Jorel from Morgan Stanley.

Q - Wilfredo Jorel Guilloty

Good morning, everyone. I have two questions. The first, recent numbers of (inaudible), saying that launches for Minha Vida grew by 57%, reaching 85,000 units. In Sao Paulo, there was a three-fold squeeze in the last year. At the same time, the investments of FGTS are decreasing. We thought today that to you reassured that we want to get to 50,000 units in Minha Casa Minha Vida. Given these facts, I was trying to understand, do you think it is difficult to reach this target especially for competing more for funds? My second question, you mentioned that your share in the market today is 12%, and that you want to increase your market share. Does it include Tier 1 and what is your target? Thank you.

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

This is Rafael. Okay, what's happening really is that we have a higher volume of launches in Sao Paulo for the Minha Casa Minha Vida program. Jorel, MRV has the advantage of operating throughout Brazil. So some cities will have more competition, others have no competition at all. And that's the beauty of our business. Is it complicated to do the operation with all geographic dispersion? Yes, it is, but we did our homework. We are more resilient than the many of the market. And market shares like this -- in some cities, we have a market share of 60%, 70%, that's quite high. But other important cities including Sao Paulo, Rio de Janeiro, Curitiba, we have a market share that is not as high. So that shows that we have room to grow, aiming at Casa Minha Vida, and that's quite reasonable. We bought from (inaudible) a landbank that is very qualified throughout Brazil. And as we launch a better product, with a better location in cities where we have our lowest share, we will naturally sell more, even supposing and I agree with you the size of Minha Casa Minha Vida that is 400,000 units a year will be flat, even if the economy gets better, there is an evolution in income and employment. But the demand is higher than the funding, which is good for us. So our homework has been done and from now on, we have more days to launch more in the cities in which we have a lower share. Let's see how interesting this is. We have this target of 45,000 units, a bit more than that.

We want to grow little in Minha Casa Minha Vida and get to 50,000, we don't believe this is very complicated. You're going to 46,000 to 50,000. In many cities, we have a fantastic landbank with a very low share and grow end market segments that are not as representative, which is the floor of the FGTS. So little growth in Minha Casa Minha Vida despite the low share and our higher growing FGTS, which is a match up with the same profile, a slightly larger apartment, slightly better location. But we are very comfortable that this two movements will happen and we will be successful. And finally Tier 1, is not our DNA. We are not going to work with Tier 1. We want to work to Tiers 2, 3 and FGTS. And just to add Jorel, our growth of market share is going to be compared to a smaller, informal contractor, Caixa Economica Federal is controlling quality more. They receive complaints and that affect their portfolio. They have a portfolio of apartments for 20 to 30 years, which is the time of the mortgage and they are trying to improve quality. So the small contractor that are too informal, that don't collect taxes and do not meet the past construction parameters are probably going to go down and we are going to gain market share from them.

Q - Wilfredo Jorel Guilloty

Okay, it's very clear. So your market share, this 12%, is it for Tier 2 and Tier 3 and not Tier 1, Tier 2, and Tier 3?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

it is Tier 1.5, Tier 2 and Tier 3. These are the three segments that are market segments. An important data that we always talk about -- there is this concern with Treasury and [ph]USU . Last year USU provided BRL9 million for Tiers 1, 2 and 3. But this is a market of BRL80 billion, so you see BRL900 million of investments from the public sector to a vis-a-vis of BRL80 billion, so we are very comfortable. The program is important for the government. It is directly and indirectly responsible for 1 million jobs for the GDP and what we see in the new administration is the will to do more. Funding today is a barrier, but you have leader that is going to work with that segment once notch up, FGTS, so we are optimistic. Economy went through a horrible period. MRV went through the crisis growing little, but improving margins, gaining share and as the winds starts to flow in our favor, our process of getting to 60,000 is completely doable. Again MRV has geographic drivers know-how, differentiate product, investment in technology, consolidated brands, a landbank of BRL50 billion. So the company has the confidence that it will deliver in the mid term.

Q - Wilfredo Jorel Guilloty

Okay, thank you very much.

Operator

Our next question comes from Marcelo Motta from JPMorgan.

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

Hello, good morning. I have two questions. The first is, if you could talk about your gross margin trends in the beginning of our presentation, it continues to be quite favorable year-on-year. But, within the year, we see it slightly higher than going down in the second term, maybe be explained by the Tier 1.5, given that we are not going to see as much Tier 1.5. Do you think it makes sense to expect margins to go back to the levels close to 37%. So what is the gross margin trend for the year? And also if you could talk about your experience with funds from FGTS. Considering the GDP this year, you would be talking about BRL1.5 billion, BRL1.6 billion in investments, would you transfer all that to (inaudible)? What you think of growth for this line of business?

A - Rafael Menin e Eduardo Fischer {BIO 20621966 <GO>}

Okay. Motta, this is Fischer speaking. First, about gross margin, indeed level 1.5 Tier impacted our product significantly. We didn't have a product, it was exclusive to the 1.5 Tier. It was similar to Tier 2 and we would -- at that in some series for Tier 1.5 and that affects the gross margin. We are probably going to be -- to have a much lower rate of Tier 1.5 and we should expect resuming the gross margin for this year, perhaps not as high, but certainly for next year.

As for the FGTS funding, we're just starting. It's a pilot that we have with Santander Bank. This is a product that we have been working with cash economic that's been offered for some time now, if they have been our partner for long. It's not probably not going to be BRL1.5 billion, BRL1.6 billion for this year. This is a plan for the next two, three years to get to 25%.

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

Okay, thank you very much.

Operator

Our next question comes from Renan from Santander.

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

Good morning, everyone, and thanks for taking my call -- my question. Without going too much detail on numbers. I would like to know what are your sales like in the beginning of the year? You reduced your curve in the end of last year and I would like to know if any changes in parameters have affected -- has affected your speed of sales for January and the sales that you are completing if they have more pro-soluto or not? So what is the situation after the changes at the end of last year?

A - Rafael Nazareth Menin Teixeira de Souza {BIO 16905756 <GO>}

This is Rafael speaking. We are in the middle of the first quarter. It's been two months. So a bit more than mid quarter. But behavior is good, sales are good. The changes in Tier 2 were very small. In Tier 3, no changes. Tier 1.5 was indeed a bit more impacted. But because it accounts for a lower share in our portfolio, the impact for MRV is really very little significance. So, we expect a first quarter that is good. First quarters are never as good as the fourth quarter, when you compare the first quarter to the fourth quarter. In the first quarter, you have the Carnival and everything and the year actually begins after that. So -- but we can say that, mainly the visits to our stands, we are having a very good first quarter, better than last year. And again, we are quite optimistic. We expect an year that is best than last year. Consumers want to buy more. They feel more confident, employment and income will still grow little, but will be better and once again the company has a small share. We work in many cities with a very qualified landbank with very good profit and we still have a small share. We haven't explored the market fully. All that said, we believe we have very high chances of even of having an year, even more positive than '18. And the year started well. I think transfer of credit to banks will be better in March, will resume to good levels, and which (inaudible) the quarter going on. We cannot say it's going to be better or worse, but it seems that this is going to be better than last year. And pro-soluto, finally, because we were working with clients with a slightly higher income than Tiers 2, 1, 1.5, our pro-soluto roles have remained unchanged. So we don't expect any changes in portfolio. Today, we are -- we have 13% of the [ph]vis-a-vis in pro soluto and I think this is what is going to remain for the rest of the year.

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

Okay, thank you very much.

Operator

(Operator Instructions) We are now closing the Q&A session. We are going to turn the call back to the company management for their final consideration.

A - Rafael Menin e Eduardo Fischer {BIO 20621966 <GO>}

Well, this is Fischer speaking. One thing I said that in 2018, that we would have shorter cycles and the results of the fourth quarter show that -- with a bit more strength. We are still selling at the higher speeds that we built. The numbers are getting better throughout '18 and the revenue in the fourth quarter show a successful initiative. The pace of construction is increasing, but below the speed of sales. And with that we can reach everything that Rafael said in the beginning, higher dilution, better returns, that is our objective. The year starts well with record -- people visiting and looking for our products, the launches in the first quarter will be better than the first quarter of '18 and so we are starting the year quite optimistic that we are going to deliver a larger operation than '18 and we will enjoy the benefits that this will bring us. We thank you very much and I'm going to turn the call back to Leonardo for the closing, and thanks for attending.

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Well, once again everyone, I would like to thank you all for joining us in this call. I would like to thank Rubens, who invited me to be a Executive VP of the Board, and remember I'm going to continue on the day-to-day of the company, following the work of Ricardo being available to you all. We have the contact, you have my contact and I'm still available. If you have any questions about the business, about our prospects, if you want to discuss strategy, what we are going to do, we are here for you. Thank you very much.

Operator

And MRV Engenharia conference call is now closed. We thank you very much for attending and wish you a good day.