

Q3 2017 Earnings Call

Company Participants

- Miguel Mickelberg, Finance Director
- Paulo Goncalves, IR & Structured Finance Director
- Raphael Horn, Co-Chief Executive Officer
- Unidentified Speaker

Other Participants

- Alex Ferraz, Analyst
- Daniel Gasparete, Analyst
- Gustavo Cambauva, Analyst
- Jorel Guilloty, Analyst
- Marcelo Motta, Analyst
- Nicole Hirakawa, Analyst
- Rodrigo Fraga, Analyst
- Victor Tapia, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, welcome to Cyrela Brazil Realty Conference Call, where we'll discuss the Third Quarter of 2017 Earnings Result. At this time all participants are in a listen-only mode, later we'll conduct a question-and-answer session and instructions will be given at that time. (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 can be asked by participants connected abroad. The earnings release published yesterday 9th of August, after the close of the BM&FBOVESPA trading session, can also be accessed on the Company's website.

Before proceeding, we would like to mention that the forward-looking statements that may be made during this conference call relating to the Company's business prospects and forecasts and operating targets related to its financial growth potential are predictions based on the management's expectations about the future of Cyrela. These expectations are highly dependent on domestic market condition, 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; Mr. Paulo Eduardo Goncalves, Chief Investors Relation and Structured Finance Officer; Mr. Miguel Mickelberg, CFO.

I will now turn the floor over to Mr. Raphael Horn. Mr. Horn, you may now begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning. In the third quarter of 2017 we saw some improvement in economic indicators. The official inflation rate measured by the IPCA was 2.45% in the past 12 months, which is below the 3% target. Additionally interest rates continue to drop. The Selic rate was 7.5% in the beginning of the first quarter of 2017 below as it's been since April 2013 and very close to reaching lowest mark ever 7.25%. Even in this environment that is affected by the 2018 Presidential election, as economic activities seems to be ready to recover. We hope the improvement in macroeconomic indicators will also show in real economy with a sharper drop in interest rates and improvements in consumers' confidence, which are critical for the real estate market.

In the third quarter, the Company's operating result was similar to the second quarter. And the sale of finished units was a highlight accounting for 30% of total sales. Year-to-date the Company's net sales totaled BRL2 billion, a 20% year-on-year. The Company's cash generation was a major highlight in the quarter reaching 285 million. Our management continues to pursue cash generation inventory reduction and improved efficiency. So continue to focus on customer satisfaction excellence and win higher return to our shareholders.

Now, I'll comment on our operating results. On slide five, we will address Cyrela's launches. In the third quarter of 2017, launches amounted to 530 million, growth of 18% year-on-year. Year-to-date launches totaled 1.8 billion, 7% more year-on-year. In this quarter, we launched eight new products, six in Sao Paulo, one in Rio de Janeiro and one in the South. Excluding swaps the volume launched in Cyrela's share was 1.3 billion, a 21% increase year-on-year. The Company's share in the volume launched in the third quarter was 71% compared to 57% year-on-year.

On slide six, we highlight the launch of project Living Connect in Sao Paulo, which was 42% filled in the first month after launch. On slide seven, we'll take about our sales performance. In the third quarter of 2017, pre-sales amounted to 730 million, 27% higher than the 517 million of the third quarter of 2016. Year-to-date sales totaled BRL2 billion 20% higher year-on-year. Excluding Swaps, pre-sales amounted to 1.5 billion in Cyrela's share, a 19% increase year-on-year. The State of Sao Paulo and Rio jointly accounted for 85% of sales in the quarter.

On slide eight, we'll address sales speed. The Company's annual SOS was 32%. Looking at sales speed by period, projects launched in third quarter have been 50% sold. On slide nine, we'll address Cyrela's total inventory. At the end of the third quarter, inventory market value totaled 6.2 million, 3.6% down quarter-on-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 9% of finished units at the beginning of the period.

Adding the inventory of projects delivered along the quarter and pricing of unit at the market value, the finished units inventory increased by 8% quarter-on-quarter. We are aware of how important this matter is to the Company, and we'll keep on focusing our efforts on this product. Rio and the Northeast region accounted for 35% of the finished units.

On slide 11, we'll talk about delivered units. In the quarter, Cyrela delivered 14 projects totaling 4.5 thousand units. Year-to-date, we delivered 13.1 thousand units in 41 projects. Our PSV was 1.5 billion, 28% higher quarter-on-quarter.

I will turn the floor over to Paulo, who will present our financial results.

Paulo Goncalves {BIO 20026167 <GO>}

Thank you, Raphael, good morning. On slide 13, we'll present our financial results. In the comparisons between different periods, we'll use pro-forma numbers from previous periods, including MAC through the equity method. Gross revenue was BRL613 million in the quarter, up by 4% quarter-on-quarter and 26% lower year-on-year. Year-to-date gross revenue was BRL1.9 billion, 16% lower year-on-year. Gross income in the quarter was 147 million, 14% lower quarter-on-quarter and 40% lower in the year-on-year comparison.

Year-to-date, gross income reached 498 million, 33% lower year-on-year. The Company's gross margin in the quarter was 24.6%, 2.2% lower than the 26.7% from the previous quarter. In this quarter the Company incurred losses amounting to BRL7 million. Year-to-date, losses stood at 144 million in comparison with 120 million profit from the same period of 2016. Please go to slide 14 now to see our profitability. In the third quarter 2017, our return on equity measured as the net income of the past 12 months over the average shareholders' equity, was minus 1.9%, and we lost 0.02 per share.

On slide 15, we'll talk about our customers' financial solution. In this quarter, transfers, trust of deed and payoffs amounted to BRL858 million, 16% higher quarter-on-quarter and 24% higher year-on-year. In unit transfers, trust of deed and payoffs totaled 3.9 thousand units, 25% higher in the quarterly comparison, and 27% higher year-on-year.

Slide 16 shows the Company's cash generation. In the third quarter 2017, our cash generation totaled BRL285 million versus 64 million quarter-on-quarter. In this quarter, besides the increase in the Company's recurring cash generation, there was a cash inflow related to the sale of equity interest, totaling 103 million. Year-to-date our cash generation reached BRL467 million against the cash burn of 237 million year-on-year.

On slide 18 we'll address our indebtedness. Gross debt at the end of the quarter was BRL3.1 billion. The cash position was 1.6 billion, thus our net debt was 1.4 billion. Of the total gross debt 61% relate to launch period construction and 57% is long-term. Our net debt over equity ratio was 22.8%, 4.5% lower quarter-on-quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged position to take advantage of the opportunities in the real estate market.

Now Raphael, Miguel and I will answer your questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Gustavo Cambauva with BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Hello, good afternoon, I have actually two questions, the first one is about sales, the sales of SPE in the third quarter, and there was also an announcement about the selling of lands to Hyne [ph]. So my question is, I would like to know if you have in the company any stronger initiatives to sell assets and generate more cash. Or if that was just the spot situation in the opportunities that you saw. And also I would like to know if you are changing your perspectives when it comes to dividends, you are accelerating the sales of assets to start distributing more dividends in a faster fashion.

And my second question is related to the market in general, I would like to know what is year looks like, what the end of the year looks like. Historically the fourth quarter is stronger when it comes to launches and at the same time I feel like the market is improving a little bit. So I would like to know what is happening in terms of sales in your perspectives for the end of the year. Thank you.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Hello, good afternoon Cambauva, this is Miguel. First when it comes to the sales of interest, it was actually an operation, a spot operations, we had two lands in Rio de Janeiro that was going to be used for projects, but we decided to sell them. And we also sold our equity interest in that Company, so they had a cash and that caused the cash generation of 103 million. Now answering your question about Hyne, actually there was no impact on this quarter. And it is important to make it clear that these operations are isolated. So the CPC and SPE operations was just a spot situation, and with Hyne, it's just a partnership that we have because we are taking advantage of some opportunities that we can see here.

A - Raphael Horn {BIO 19714328 <GO>}

Now when it comes to the market and this is Raphael, I believe it's undeniable, the market has been improving. It was a very tough crises so recovery will take time, but yes, we can see some improvements in the atmosphere, we can see that in our sales as well at least in some cities. But even though we can see some improvements in our sales, this sector is still suffering a lot. We are still struggling a lot, it's hard to compete with other international players. And our legislation does not help us a lot. So yes, we can see some potential in terms of sales, but cancellations are still very tough to deal with. We are more excited because we are selling better, but unfortunately cancellations are still a problem that we have to deal with.

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Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay. Raphael, still when it comes to the market, I would like to know about your deliveries, you delivered around 200 million and your inventory dropped by 50%, right. I would like to know more about the market in Rio de Janeiro, maybe I am too optimistic, but have you seen a significant improvement in Rio or did you start any sales initiatives? Did you do anything to that end?

A - Unidentified Speaker

Yes, I think you're being too optimistic, Rio is a very tough market, our challenges there are huge, we did not see any significant improvements in Rio, we cannot see that happening right now.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay, thank you very much.

Operator

Next question comes from Alex Ferraz with Itau BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

Good morning, Miguel and Raphael, thank you very much for your presentation. I have two questions, the first one is about your strategy. We know that you showed interest in Tecnisa as well, so I would like to know more about your strategy when it comes to that. You are going to gradually sell assets and stakes. And the second question is about transfers, I saw some slight improvement in the volume of transfers in the third quarter, so when it comes to financial transactions, do you think that the processes are becoming more effective. Do you think that, that is going to have an impact in the next quarters, did it have an impact in the third quarter?

A - Unidentified Speaker

Good morning, Alex, now when it comes to Tecnisa, the Board is thinking about what our position should be, they are considering what position we should take here. And you also asked about capital distribution right, again when it comes to dividend and cash generation, everybody asks us about that. And to be quite honest with you, we want to distribute dividends as much as you do and we are working hard to that end. We want to decrease the Company's capital to increase profitability, so we expect to generate 300 million per quarter and pay the dividends.

We want that as much as you want. And we are working hard to when we deem possible, we are going to distribute dividends. And the shareholders will be happier, the analysts will be happier and we will be happier as well. Alex, when it comes to your question pertaining to transfers, well, the banks are now using lower rates, not much has changed between the previous quarter and this quarter. The banks are now less restrictive when it comes to fees and rates, but we believe that there is still room for improvement.

Q - Alex Ferraz {BIO 19294308 <GO>}

Okay, thank you very much.

Operator

Next question comes from Nicole Hirakawa with Credit Suisse.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Hello, good afternoon. My question is related to the Hynes operation. Do you intend to have more partnerships similar to that. I believe that, that increase Cyrela's participation in the project. But we know good projects are finite, so I'd like to know if that makes sense to have more partnerships like that. And the second question is about cancellations. Deliveries [ph] dropped significantly over 35% year-on-year and cancellation have dropped less than that. So I would like to know your perspectives for the future when it comes to cancellation.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Nicole, this is Raphael. Well, the Hynes transaction was not even announced by us -- was not included in our results. So many people are asking us about that transaction, that operation, but it is not an official one yet. And when it is official, we are going to make comments on that. The point is, we are concerned in transforming asset in cash, but we want to turn inventories into cash. Our finished units need to turn into cash. If we sell two or three lands and purchase five, that's business as usual, this is not any reason to cause so much curiosity from you. So when the transaction becomes official, we are going to provide you more information, but this is not a strategic formula, this is not something that's going to make our results explode, no, we still have a lot of land bank.

In 2016 we sold lands to (inaudible) amounting to 50 million, but again this is not our strategy, nothing is happening in our land bank in a structured way, quite the opposite, business go on as usual. Now, when it comes to cancellations, cancellation rates are still very high unfortunately, and the dynamics that we forecast two years ago is that, cancellations would only go down if we don't have any more finished units to deliver. So, in our opinion it's not that the economy is improving, and therefore cancellations are going to go down, or because interest rates are decreasing a little bit.

This is still a very concerning problem regarding legislation. And the scenario is still the same. So cancellations will go down as soon as we deliver the units, they will go down and we believe that in the next cycle, the customers purchase the real estate, but in Brazil it's such a tough economy that customer will be more prone to cancel the agreement. Now, if the economy improves, that is not going to happen so often. So in 2018, we are going to have fewer cancellations, because we are going to deliver fewer units. This is not going to happen because gradually the legislation improved, it is terrible to work in such a tough scenario.

This is the worst country in the world to work in the real estate market. We struggle every day. I believe that in 2019, we are going to improve a little bit, because customers are now

purchasing the units when the projects are still in the launching period. And gross sales will be more similar to net sales, but this a gradual and very slow process. We have been struggling for such a long time, but we still have to face a long period of struggle.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Okay, thank you very much .

Operator

Next question comes from Rodrigo Fraga with Citi.

Q - Rodrigo Fraga {BIO 20043127 <GO>}

Good afternoon. I have a question about cancellations and the reduction of deliveries in the next quarters. How is that going to affect your plans for 2018? You said that in '19, you believe that you are going to struggle less, but what is your plan look like for 2018 since you are going to launch fewer units. Is that going to affect your pipeline?

A - Unidentified Speaker

Good morning, Rodrigo. We launched few projects this year, but we are going well, we are selling well in those projects that we did launch, not considering the low income market, that market is doing a lot better. But we are selling well. As I said we feel that the market is improving, is recovering not in all regions, but in those regions where the market is improving, if we feel there is a demand and if we feel there is a potential for profitability, we are going to launch projects in those regions.

So, in 2018 the projects -- actually in 2017 we've launched projects in those cases that we thought were feasible and in 2018 we are going to do the same thing, if we think there is a demand and if the price is good, we are going to launch those projects. We are still working in a recovering economy, but we are going work gradually. We don't have a macro target, we do not have any commitment in terms of PSV and volume, if there is a demand we are going to do it, if there is not, we are not going to do it. That's our strategy.

Actually for 2018 there are some products that we wanted to launch in 2017, so may be in 2018 we are going to have a more robust pipeline. But that's not related to the cycle or the recovery in the economy, it's simply related to the projects that were not approved for 2017 and they are going to be launched in 2018

because, we think they are feasible projects. It's not related to any macroeconomic or economic recovery thesis. This is a bottom-up operation, this is our daily operations business as usual.

Q - Rodrigo Fraga {BIO 20043127 <GO>}

Okay, thank you very much.

Operator

Next question comes from Victor Tapia with Bradesco BBI.

Q - Victor Tapia {BIO 20566083 <GO>}

Good afternoon. I have two questions. The first one is related to margin. Margin has been dropping due to cancellations and discounts in units. So, I would like to know your perspectives for margins in the future. Do you think it is going to improve, it is going to recover? And the second question is related to the low income segment. Kouri [ph] has got some impacts in Cyrela's results. So I'd like to know if the management of Kouri is going to change, do you think that could trigger any changes in the structure between Cyrela and Kouri? And with strong cash generation that Cyrela is presenting, is there any intention to use that cash generation to purchase equity interest and additional stakes in Kouri? Thank you.

A - Miguel Mickelberg {BIO 20023910 <GO>}

Good afternoon, this is Miguel. When it comes to gross margin, since there was a drop in construction, cancellations had a larger impact this year than they had last year on our gross margin. We believe that our backlog margin is still high, it actually increased a little bit as a result of the launches they have good margin. So we believe that as cancellations go down, we are going to recover our margins. They are going to be more similar to what we had in previous periods. Victor, when it comes to Kouri, I don't believe anything has changed, it's a good, great joint venture, it provides us with very good results and that's it. And with our cash generation I don't think we are going to increase our stakes in this joint venture, it is a 50:50 joint venture and that's how it's going to continue.

Q - Victor Tapia {BIO 20566083 <GO>}

Okay. Thank you.

Operator

Next question comes from Daniel Gasparete with Bank of America Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Thank you very much for the presentation. Nicole had asked something related to cancellations and I would like to talk about demand. In your opinion what do we have to do to increase gross sales? Do you think we need more funding, is it about pricing or is it about confidence, trust? Yeah, when it comes to cancellation, in the beginning of the year we felt like cancellations went down because the volume of launches, but also it was related to the mix.

But we did not see that, cancellations and delivery percentage are still very flat. So I'd like to know why cancellations haven't gone down yet, not only in the Northeast region, but other regions as well. Now, when it comes to cash, actually I would like to know about the medium income range of the segment. What do you think that we need to do to see a more drastic improvement in the sector?

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A - Raphael Horn {BIO 19714328 <GO>}

Hello, this is Raphael. You are asking about gross sales, right, I believe that our biggest problem is not gross sales, it's net sales. And everyone knows that gross sales are going slow, they are weak, but our biggest problem is not sales. I believe that we need stronger signals related to the 2018 Presidential Elections and the situation in Brazil in the long-term. So I believe that customers are not confident in us. Again, we can see some improvements. Our GDP is improving, the economy is improving, so we can see those results as well. But to be quite honest again, Brazil needs a more consistent recovery and we are still very far from that. If you do get there, of course, those numbers are going to improve. We can see some improvement, but it's a gradual one.

Now again in terms of cancellations, cancellations go down as units are delivered, people say that we only deliver units in Sao Paulo, Rio and in Porto Alegre and that does not lead to cancellations, that's not our strategy. We always think that if bank loans are too expensive, cancellations will happen, it's hard to find a formula to finish, to decrease cancellations. If we deliver units, that's when cancellations are going to end. The problem is legislation, the law is the biggest issue here. The law is the same across all regions, so that is our main issue. And it is going to be to -- continue to be our main issue.

If we see some major changes in scenario, then we can see some changes in our cancellations as well. If it's fair enough, that's not for us to discuss. This is a problem that really bothers us and if that legislation doesn't change, nothing will change in terms of cancellations as well. Now, when it comes to the margins, my impression is that, it's not very clear yet to everyone how bad cancellations are to our business. It is impossible to deliver good margins with this volume of cancellations, it's impossible mathematically because half of what we sell comes back to us. So our revenue is cut in half, we have to work in a much lower base of revenue, so there is no chance to deliver good, decent gross margins. If the level -- the volume of cancellations are so high, it is a recurring question, but that's simply impossible, the volume of cancellation makes it impossible for us to deliver any decent gross margins.

Gasparete, when it comes to the Caixa Bank and the transfers, it is harder now for us to have transfers with that bank. Any transfer in Caixa demands more time from our team than with other banks, but our results with Caixa were very good in this quarter. We had a result that is very close to the average in September and October. So we expect the level to continue the same, we have to work hard of course. But we are looking at some alternatives in case that is not possible.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Okay, Paulo and Raphael, thank you. Now, piggybacking on what Raphael said about regaining customer's confidence. Do you think that a decrease in interest rates on bank loans is not going to have such a huge impacts on the demands right, it depends on the political scenario of next year, right?

A - Unidentified Speaker

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Well, we need more confidence of course, interest rates will help us a lot, it's still helping us, we can see improvements in Sao Paulo for example. Now for a gradual improvement, we are already on track. We can see a better atmosphere, we are selling more, so of course lower interest rates help us a lot. Not having such a huge offer [ph] supply here in Sao Paulo also helps us. But for us to have a strong improvement, we need some more economic recovery, a more stable scenario, but we are in such a depressed condition that -- I believe that everything that is happening economically is going to take us to a better level of course. Lower inflation rates, lower interest rates, growing by 2% or 3% in our GDP next year, of course that will help us.

The banks are more willing to help the customers, which is a good sign as well. So we can see a recovery happening. But after three years of crisis, our situation right now is extremely depressed. And we hope that we are going to go to a good or very good level now, that is going to take a lot of time. Now if we expect to go to an okay level, I believe that we are already on track.

Q - Daniel Gasparete {BIO 17999254 <GO>}

Okay, thank you very much.

Operator

Next question comes from Marcelo Motta with JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

This is a quick question about cancellation, I believe that legislation and regulations are very tough right now. But we believe to that some new laws would be passed recently, if that happens, is that going to change the scenario that we have right now. If you could make comments on regulation, I would appreciate it. Is that going to be a good surprise for us, what is your opinion about that?

A - Unidentified Speaker

Good afternoon Marcelo, now when it comes to regulations, there are always discussions in Brasilia, but I have a dream, I dream of working in Brazil with fair laws and similar conditions to what they have in Argentina, for example, that's not a developed country. So any country in the world has normal regulations and legislation, so that is my dream to work in a country like that. But it's a dream, if that's going to happen in the short-term or long-term, I don't know. I hope it happens in the short-term, but we do not work based on that scenario.

We are still facing economic turmoil and if Brazil is not in a good position, we are going to see cancellations going up. We work the sector is united to work to improve legislation, I have a dream and I hope that dream will come true someday. Now when it comes to gross margins -- no actually that's it.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you.

Operator

(Operator Instructions) The next question comes from Jorel Guilloty with Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

I have two quick questions. The first one is about cancellations. I would like to know the percentage of cancellations that happened due to customers not getting transfers. The second question is, your expenses with finished units is around 19 million, do you believe that is going to increase?

A - Paulo Goncalves {BIO 20026167 <GO>}

Hello, Jorel. This is Paulo. About cancellations, around 55% of our cancellations happen due to credit issues. Now when it comes to finished units maintenance, our cost to maintain finished units is around 3% of the price of the finished units. So our finished units will increase, so that cost will increase as well and as we decrease finished units that cost reduces naturally.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Thank you.

Operator

If there are no more questions, this session is finished. I will now turn the floor over to Mr. Raphael Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you very much for the questions. We can see some improvements in the real estate market. It is a gradual and slow improvement. And I am sorry to get a little excited when it comes to cancellations. We have been working for such a long time and it is very hard for any company as large as ours to live with such high cancellation rates. So my indignation is more related to the fact that this country does not allow the sector to work decently.

You were asking a lot about margins, and when we look our margins, we have to look at our cancellations as well and do the math. So that's just me sharing the drama that we have to live with (inaudible) with you. And this is not just about Cyrela, it's the whole market. We have to fight for a better country. If we see improvements in legislation or not, we are going to see decreases in cancellations. We are going to generate more cash and pay more dividends. So thank you very much. See you in the next conference call.

Operator

That concludes Cyrela's conference call for today. Thank you very much for your participation. You may now disconnect. Have a good weekend.

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