

Q3 2016 Earnings Call

Company Participants

- Paulo Eduardo Goncalves, Chief Investor Relations Officer and Structured Operations Officer
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Alex Ferraz, Analyst
- Bruno Mendonca, Analyst
- Daniel Gasparetti, Analyst
- Guilherme Capparelli, Analyst
- Gustavo Cambauva, Analyst
- Marcelo Motta, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we will discuss the Third Quarter of 2016 Earnings Results. At this time, all participants are in a listen-only mode. Later, we will 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, www.cyrela.com.br/ri.

This call is being simultaneously translated into English and is being broadcast over the Internet. Questions can also be asked by participants connected abroad. The earnings release published yesterday, 10th of November, 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 projections and operating targets related to its financial growth potential are predictions based on management's expectations about the future of Cyrela. These expectations are highly dependent on domestic market conditions, the general economic performance of the country, and the international markets, and therefore are subject to change.

With us today are Mr. Raphael Horn, Co-CEO; and Mr. Paulo Eduardo Goncalves, Chief Investor Relations Officer and Structured Operations Officer.

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

Raphael Horn {BIO 19714328 <GO>}

Good afternoon. In the past months, there have been clear signs of a potential economic recovery and the political chair [ph] a Provisional Presidential Decree related to The House of Representatives expenses was passed and the economics here we saw the first decrease in interest rates in four years here. We hope this is the start of a solid economic recovery, but it is going to take time, the biggest drop in the interest rate and the rising confidence have been crucial for the recovery of this segment.

As for this quarter, it's important to mention our launches, which have been 61% sold. I also would like to highlight some important engineering achievements. In the third quarter, we completed all of the construction works in the Northeast. We also have had construction savings in our portfolio with an impact of BRL31 million on our revenue. The high cash consumption in the third quarter is mainly due to cancellations in the past two quarters.

Unfortunately, our legislation is feeble concerning this matter and it is in urgent need of modification, still we are in a comfortable financial position and prepared for a strong cash generation in case our economy does jump back on its feet.

Now let's move on to our operating results. On slide five, we will address Cyrela's consolidated results. In the third quarter of 2016, we launched BRL450 million compared to BRL6 million in the third quarter of 2015. In this quarter, we launched five new products, three in Sao Paulo, one in Rio de Janeiro and one in Minas Gerais. Excluding swaps from launches of the MCMV program level 1 the volume launched and Cyrela's share was BRL1 billion, down by 32% year-on-year. The Company's share in the volume launched in the quarter was 57% compared to 83% year-on-year. Year-to-date, Cyrela's share in the launched project was 70%.

On slide six, we'd like to highlight the launch of the project Living Wish in the Southern Sao Paulo, which has been 51% sold.

On slide seven, we'll talk about our sales performance. In the third quarter of 2016, pre-sales totaled BRL570 million, 43% lower than the BRL1 billion reached in the third quarter of 2015. Year-to-date pre-sales amounted to BRL1.7 billion in comparison with the BRL2.5 billion reached in the third quarter of 2015. Excluding swaps of the MCMV program level 1, pre-sales amounted to BRL1.2 billion in Cyrela's share, a 36% reduction year-on-year. The states of Sao Paulo and Rio de Janeiro jointly accounted for 81% of sales in the year.

On slide eight, we will address sales speed. The Company's annual SOS was 27%. Looking at sales speed by period, projects launched in the third quarter of 2016 have been 61% sold.

On Slide nine, we will address Cyrela's total inventory. At the end of the quarter, inventory and market value totaled BRL6.4 billion, 2% 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 8% of the finished units at the beginning of the period adding the inventory of projects delivered along the quarter and pricing of the units at market value. The finished units increased by 1.6% quarter-on-quarter. We are aware of how important this matter is to the Company and we will keep on focusing our efforts on these products. Rio and the Northeast account for 46% of the finished units.

On Slide 11, we will talk about delivered units. In the third quarter, Cyrela delivered 15 projects, totaling 3,700 units. In the quarter, we delivered units accounted for a PSV of BRL1.4 billion, the same volume year-on-year. Year-to-date, we delivered 13,900 units with a launch PSV of BRL5.5 billion.

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

Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Thank you, Raphael. Good afternoon. On slide 13, we'll present our financial results. Gross revenue was BRL847 million in the quarter, up by 28% quarter-on-quarter and 28% lower year-on-year. Year-to-date gross revenue came to BRL2.3 billion, down by 31% year-on-year. Gross income in the quarter was BRL261 million, 3% higher quarter-on-quarter and 34% lower in the year-on-year comparison.

Year-to-date, gross income reached BRL798 million, 31% lower year-on-year. Gross margin in the quarter was 31.7%, 7.9% lower than the 39.6% from last quarter and 3% lower than the 34.7% from the third quarter of 2015. Year-to-date, gross margin was 35%, 0.1% higher in the year-on-year comparison.

On the chart in the bottom left-hand corner we analyze our EBITDA. EBITDA in the quarter totaled BRL69 million, 9% up quarter-on-quarter and 68% down year-on-year. Year-to-date, our EBITDA totaled BRL249 million, 59% down year-on-year. Net income in the quarter reached BRL14 million, 68% down quarter-on-quarter and 89% down year-on-year. Year-to-date, gross income reached BRL120 million, 66% lower in the year-on-year comparison. Thus, our net margin in the quarter was 1.8% compared to the 7% margin quarter-on-quarter and 11.5% year-on-year. Year-to-date, net margin was 5.3%.

Please go to slide 14 now to see our profitability. In the third quarter of 2016, our return on equity measured as the net income of the past 12 months over the average shareholders' equity was 3.7% and our EPS was BRL0.04.

On slide 15, we'll talk about our customers' financial solutions. In this quarter, transfers, trust of deed and payoffs amounted to BRL690 million, 13% lower quarter-on-quarter and 15% lower year-on-year. Year-to-date, transfers, trust of deed and payoffs amounted to BRL2.1 billion [sic], down by 16% year-on-year.

Considering units, transfers, trust of deeds and payoffs totaled 3,100 units, 11% less in the quarterly comparison and 24% less year-on-year. Year-to-date, we sold 9,800 units, 18% down year-on-year.

Slide 16 shows the Company's cash generation. In the third quarter of 2016, our cash use reached BRL225 million, BRL152 million if we do not include the acquisition of the equity stake in Tecnisa versus BRL29 million quarter-on-quarter and a cash generation of BRL219 million year-on-year. The main reasons for such cash assumption in the quarter was the lower volume of resources inflow, mainly due to a high volume of cancellations in the second and third quarter.

On slide 18, we present our indebtedness. Gross debt at the end of the quarter was BRL3.4 billion. The cash position was BRL1.6 billion.

Thus, our net debt was BRL1.8 billion. Of the total gross debt, 65% relate to loans for construction and 60% is long term. Our net debt over equity ratio was 27.4%, 3.3% higher 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.

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

Questions And Answers

Operator

Ladies and gentlemen, we'll now begin the question-and-answer session. (Operator Instructions) Our first question comes from Alex Ferraz from Itau BBA.

Q - Alex Ferraz {BIO 19294308 <GO>}

Hello. Thank you for the presentation. I have two questions. The first one, you have already mentioned in the introduction it's about cash consumptions. I'd like to know if that's related only to cancellations or transfers are taking longer and the customers don't want to carry out the transfers and has an impact on cash inflow, so I would just like to know about your expectations for the fourth quarter and also next year in terms of cash generation?

And also I would like to know about the Company's performance in the month of October. Do you see any recovery from September to October and I would like to know your perspective on this?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hello, this is Paulo. I'm going to answer your first question. As regard to cash generation, the main impact comes from cancellations. For a while now, we have been seeing transfers that are taking longer, especially because the banks are more restricted now

and that shouldn't improve by the end of the year, we don't have high expectations about that, but for the next year if the economy recovers that is going to improve as well.

Now, when it comes to cash flow for 2017, the main driver for improvement in cash generation in 2016, 2017 rather is the improvement in sales, especially in finished units. So the increase in gross revenue and lower level of cancellations is going to improve our position. Besides that, for the next year, we are going to see a natural reduction in working capital. If we take a look at our situation in December of 2015, our expectation would be BRL3 billion for receivables and BRL2.2 billion in construction costs, so we had a match of BRL800 million.

Now for 2017, our receivables amounts to BRL2.2 billion and costs around BRL1 billion and that gives us BRL1.2 billion. So if that is the case, the cash generation will be good in 2017, but that depends on the economy.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Alex. Good afternoon. About the question, related to the recoveries on September to October, our situation is similar to other companies and many other sectors in Brazil. The financial market sees some improvement and some recovery, but in reality, right now is not that good. So, it's not any news for us, the retail companies are disclosing their results and we can't see any improvements right now, we expect to see some improvements in the future, but it's going to take a while. We were not expecting a big recovery in the economy, it hasn't happened yet, but we hope it will happen in 2017, but it's going to take time and it's not going to be an explosive recovery.

Q - Alex Ferraz {BIO 19294308 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Guilherme Capparelli with Citibank.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Hello, good afternoon. I have two questions, the first one is related to the reduction in the real estate financing announced by Caixa Bank, do you think that is going to relieve the pressure over cancellations? And also from your conversations with banks, do you think they're going to decrease and reduce those amounts?

Now related to the market in the City of Sao Paulo, we find the news that they're going to review the plan of the city after the election of the new Mayor, do you think that is going to happen, do you think that is feasible? And also, I'd like to know the negotiations that you are having about that?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hello, Guilherme, good afternoon. I'm going to answer your first question. More important than the intensity, it is important to notice that we have some indication towards that matter. Of course we need the SELIC rates to go down and the savings accounts to be stabilized, but there may be a delay because we need the interest rates to go down, but that period may be short which is very important for our sector. When we talk to other private banks, we can see that they expect to be more or less restrictive, actually if that actually happens.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Guilherme, about the change that we are going to have next year with the new Mayor, we don't have any news about that. It is speculation, we don't know anything about that, but when we see changes we are going to study them and communicate them to you, but right now it is just speculation.

Operator

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

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Hello, good afternoon. I have two questions. The first one is about the market in general, especially for selling finished units, I know you have been focusing on that and I would like to know the dynamics of discounts, have you've been granting discounts to the customers? And also about the margins, do you think that they are going to decrease in the third quarter, or do you think that you can keep on the same level of discount rates?

And also do you have any expectations about the volume of launches for next year if the economy recovers and interest rate goes down and the level of cancellations improve, do you think that you are going to increase the number of launches in comparison with 2016 or do you think it's too early to have any expectations about that?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hello, Gustavo. Your first question is about finished units, right? The market is still tough, it's harsh. We can sell finished units. We sell them even better than the units that are still under construction, but it is not easy and it's not easy for any sector in Brazil, we are part of that economy and we are prepared to face the reality, but we're going to find some bumps along the way.

Finished units are more easily sold, because the customers are going to move right into that new unit, so it's easier to sell them. I believe the discount margins are going to be the same if you are going to keep the same level. We haven't been granting many discounts, but we are very pragmatic, we want to monetize our assets.

Now about your second question, about launches in 2017, our main focus is selling units, we have a high level of finished units inventory and we don't think that 2017 is going to bring a sharp recovery. Our focus again, is selling finished units. Of course, we have been launching good products in 2016, we are still going to launch some products in 2017, we

are going to launch some good products, and we are actually going to do it. But our main focus is on monetizing the inventory and we hope economy is going to help us on that.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay. Thank you very much. Good afternoon.

Operator

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

Q - Daniel Gasparetti

Good afternoon. Thank you for the conference call. I have two questions. The first one is related to cancellations for next year and the launches mix for next year, and do you think that the number of cancellations will go down? And also, I would like to know about the deliveries and the behavior of cancellations.

And going back to cash generation, I'd like to know about your exposure to cash according to each region, how many projects are financed by Caixa Bank and if the customers have an account in Caixa, are you going to grant any discount, is this a benefit for the customers and where do you see the major opportunities related to that?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Okay. Now, relating to your first question, we have two points related to deliveries. The volume of deliveries for next year is going to go down. For this year, we are going to deliver BRL7.5 billion and this number will go to BRL6.5 billion or BRL7 billion.

Most deliveries, most products were delivered in the Northeast and Rio, but we have also delivered BRL2.4 billion in Sao Paulo. For 2017, the number is going to be the same in Sao Paulo BRL4 billion. We are not going to deliver anything else in the North and Northeast region, and we're going to have a larger volume of deliveries in Rio. Our volume is going to increase from BRL1 billion to BRL2 billion in 2017. Even though Rio is still a challenging region for 2017, the cancellation levels in Rio are lower than North and Northeastern region levels.

Now, when it comes to your second question related to Caixa Bank. In the projects that we have 30% are financed by Caixa Bank. Most projects are located in Sao Paulo and Rio. So in this scenario, any improvement is going to help us a lot and that improvement in the Caixa Bank is also going to help us a lot.

Q - Daniel Gasparetti

Okay. Thank you very much, Paulo.

Operator

Our next question comes from Mr. Bruno Mendonca with Santander.

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FINAL

Q - Bruno Mendonca {BIO 16313094 <GO>}

Good afternoon. Paulo, you were talking about the deliveries in the Northeast region. From now on and after the transfers, are you going to change your strategies to sell those finished units in the Northeast region and I would like to know if the regions are sensible to a pricing strategy? That is my first question.

The second question is, I would like to have a broad idea about expenses and legal allowances, I would like to know that amount and if the cancellation goes down, which is our expectation, do you think that we are going to see a reduction in that line item in the next year? Thank you.

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

Hello, Bruno. Our finished units in the Northeast region is low. We have finished the construction works and this year was very good, especially in the cities of Recife and Salvador. So by the end of the year, we are going to sell all of those units. We are still going to have some units in the city of Fortaleza and Natal. Those cities are still a little bit challenging for us. In Fortaleza, we still have some units and in Natal as well. So for us 2017, we are still going to have inventory in those two cities.

The good news is, Salvador and Recife, we are going to finish selling our units in those two cities. Now Bruno, related to contingencies, in this quarter the impact of this contingency on our results was BRL27.5 million and that has an impact on our results that is going to continue in the next quarters, but most of these contingencies are related to delays in construction work. The period that were more challenging in relation to delays with delays over six months, they have been delivered. So we expect that these contingencies are going to decrease next year, we are still to see if that's going to happen or not.

Q - Bruno Mendonca {BIO 16313094 <GO>}

Do you have any idea about the number, the amount of the decrease?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

We can't tell you anything about that, because we have (technical difficulty)

Q - Bruno Mendonca {BIO 16313094 <GO>}

Okay. Thank you.

Operator

Our next question comes from Marcelo Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

I would like to know about equity income that you carried out in the third quarter? I would like to know what you can expect in terms of the transactions that you carried out with

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Tecnisa and the equity stake that you acquired, so I'd like know if we are going to see any changes in equity income in the long-term and the short-term as well?

A - Paulo Eduardo Goncalves {BIO 20026167 <GO>}

So about Tecnisa, we made an investment and we still believe it was a good investment, we are excited about it, but we are going to see the results in the mid-term. We believe that in the mid-term, it is going to be a good transaction, I'm not focused on seeing results every quarter, but we believe that we are going to see cash generation in excess of what we paid for that equity stake.

Operator

(Operator Instructions) Excuse me, there are no more questions. Now, I will turn the floor over to Mr. Raphael Horn for any final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you, again, for your interest and see you in the next call. We hope Brazil is going to recover. Thank you.

Operator

That concludes our conference call for today. Thank you very much for your participation. You may now disconnect.

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