Y 2019 Earnings Call

Company Participants

- Eduardo Fischer Teixeira de Souza, Chief Executive Officer
- Rafael Nazareth Menin Teixeira de Souza, Chief Executive Officer
- Ricardo Pinto Paixao Rodrigues, Chief Financial and Investor Relations Officer

Other Participants

- Elvis Credendio
- Gabriel Mosquera Simoes
- Gustavo Cambauva
- Luis Stacchini
- Marcelo Motta
- Nicole Inui
- Victor Tapia

Presentation

Operator

Ladies and gentlemen, good morning, and thanks for waiting. Welcome to the conference call for analysts and investors of MRV about the earnings of the fourth quarter 2019. Today with us are Rafael Menin and Eduardo Fischer, and also the company's CFO and IR Officer, Ricardo Paixao.

We would like to inform you that all participants are going to be in listen-only mode during the company's presentation. We then start the Q&A and further instructions will be provided. (Operator Instructions)

Now we are going to give the floor to MRV's CEO, Mr.Rafael Menin. Please, sir.

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

Good morning, everyone. Thanks for attending our earnings release for the fourth quarter '19, and whole year of '19. I'm going to start with a mea culpa from our management. 2019 was a year that was different from what we had expected, results were good, but were not exceptional. MRV has a tradition to surprise the market positively and unfortunately, we're not able to deliver the numbers that we would have liked to last year.

I would say low income is the main factor. We had some difficulties because of the Social Factor and the reduction of the LPV at a moment in which MRV has been investing heavily in products, products that were increasingly better, and therefore, we lost an important share of the markets. So those clients from BRL2,000 to BRL2,800 lost acquisition power in our portfolio and that's why we had a difference in sales for construction. MRV, after so many years generating cash, had cash burn. We also had a small reduction in the gross margin. So obviously, it was not a dream year for us.

Eduardo and myself have been head of the company for six -- five years. So the most important point is that we are very optimistic. MRV, in recent years, created a unique platform of economic housing. Our product within Minha Casa Minha Vida is the product with the best quality compared to our competitors. We are the only company that operates in Minha Casa Minha Vida now with the launch of the ESSENTIAL LINE with a portfolio from BRL2,000 to BRL5,000, product with high quality, excellent location. And the brand MRV makes a whole

of a difference.

In addition, we expanded our portfolio with a PREMIUM LINE, which is going to gain attraction this year. And with this new scenario of SBPE and interest of 7% a year, surprisingly, we are at -- for those that are on the top of Minha Casa Minha Vida will increasingly be interested in the product. And in terms of the fourth quarter, we closed the sale of the first FI with four developments, three of them fully rented. We are going to start the fourth in April or May and so it was an absolute success. We have a line -- wait line in the two first. We are going to deliver results a bit better than what's promised. And I'm sure that this is going to be an extremely important avenue work growth for MRV. In addition, MRV has a unique geographic operation. We are present in more than 160 cities nationwide. This is very expensive and complex. I can highlight the investment of more than BRL0.5 billion in IT in recent years, far more than any other competitor.

And basically, we have a very important body of executive officers, more than 40 offices to take care of such complex operation. But obviously, it's not to burdens only. We have bonuses as well of operating in such a large market. Once again, as I mentioned, because of our -- being spread throughout Brazil, have the highest line of Minha Casa Minha Vida, Luggo and PREMIUM, we are the company that is the most prepared to grow in Brazil at a scenario of lower interest rates. We have all the leverages in place to be there. I would say that today, MRV is the company that has more triggers to be unlocked in the next years. And we are going to grow a lot as of now.

And of course, I have to talk about the transaction we closed in February, AHS. This is a unique company that operates in a giant market, in a market segment with little competition and very high demand. AHS is a company that's still small, but in some years it's going to be quite representative in the MRV business.

So that's the word, optimism. The company is very prepared. And both Eduardo and myself are very confident that we are going to deliver growth, strong growth in next years with margin recovery, AHS gaining momentum and return to our shareholders even greater than in the past.

So now I'm going to turn to Ricardo Paixao.

Ricardo Pinto Paixao Rodrigues {BIO 22108148 <GO>}

Thank you, Rafael. Good morning, everyone. First, I would like to draw your attention to our consistent performance along years. Even with the crisis that really changed the economy of the country and the industry as a whole, we had growing revenues and net income, small variation in gross margin, but still at very high levels. We know that this is difficult to be reached, and we are proud of what we accomplished.

As for Luggo, this is an operating company with prospecting lands and units under construction to be completed in the end of this year, beginning of next year. As Rafael mentioned, in December '19, we had the first public offer of Luggo portfolio. This is the first real estate investment fund in Brazil, with the fourth -- first developments of Luggo. With that, we completed the first cycle of business development with Luggo. That's why we had a very good line of other operating revenues for '19.

And we expect this to be a recurring event with a manual periodicity as of now. AHS, as Rafael talked about the potential of its return, I would like just to do the math because we have that in our release. We have a business plan for AHS, growing construction getting to 5,000 units annually for lease and later sale of assets. Revenues and profits of this operation can be extremely relevant for MRV, getting to almost BRL5 billion a year. This account is then 5,000 units a year, an average price of 22 -- $220,000 and then converted into reais. That's it.

Questions And Answers

Operator

Question And Answer

Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) Our first question comes from Gabriel Simoes from Itau BBA .

Q - Gabriel Mosquera Simoes

Thanks for your presentation. I have two questions, the first talking about the pro soluto after the handing of keys. We see the line growing compared to other quarters. Do you think this is because the increase of units that you have in SBPE? Or do you have other factors that influenced this line? And also about the gross margin of the company. We saw a trend of drop in recent quarters but stable in '19. Do you think it has reached the floor? Or do you think that it can go further down. Thank you very much.

A - Eduardo Fischer Teixeira de Souza {BIO 17580321 <GO>}

Okay, Gabriel. This is Fischer speaking. Okay, let's start from the last part, gross margin. When we had our release of the third quarter, we broke down what had caused the drop of margin in our prospects. And at the time, we said that we thought that would be our floor and that, as of then, we would have stable and growing margins going back to our levels. And this is exactly what is happening. There was a small positive oscillation but almost flat. And what we can see along the next quarters is a slow growth towards our traditional margin. So I would say that the worst has passed. We are quite optimistic. The operation is doing well. The factor that worried us, which was the migration for our own labor, I don't know if you remember that, has been addressed. And the indicators that we see in the beginning of the year are already better. So we are quite optimistic about what we are going to deliver in terms of margin. We have already reached the floor, and now we are going to grow. We are quite confident about that.

As for pro soluto, well, to answer your question directly, no, it has nothing to do with SBPE. It was more of our traditional normal operation. And what we did along last year was to grant a bit more credit because of the difficulties we had. And Rafael mentioned in the beginning, it was harder for Caixa to grant credit and somehow, we addressed that by means of granting pro soluto. What we see in the first two years of the year is that the market is a bit warmer. People are deciding to buy a bit faster, and we started to address the granting of credit following this rationale. So in January and February, we already have a lower granting of pro soluto than we had in the end of last year. One of our challenges for 2020 is precisely that to have this line stop growing, then getting flat and then eventually dropping. So pro soluto, the beginning of this year is one step down the level we closed last year.

Q - Gabriel Mosquera Simoes

Okay. Perfect, Fischer. Thank you very much.

Operator

Our next question comes from Nicole Inui from Bank of America.

Q - Nicole Inui {BIO 17757166 <GO>}

Good morning. Thanks for the your call. I would like to know if you could give us a bit more color about what to expect from AHS and Luggo for this year. Luggo, in your release, you're talking about building 2,300 units and having the sale in the end of this year or in the beginning part of first quarter of next year. Do you want to build and sell all the units in this period, as just part of these units? And also, as for AHS, when you're talking about number of built units a year, I would like to know the same. Do you expect to sell any of these units this year? I suppose that some of them are already leased. When are we going to actually see sales coming from AHS this year and beginning of next year? Thank you.

A - Ricardo Pinto Paixao Rodrigues {BIO 22108148 <GO>}

Hi, Nicole. This is Ricardo Paixao. Okay, first, AHS. In the normal cycle of AHS, you have the building, then lease, the sale of assets. So yes, we have expectations of -- have some sales of AHS projects this year. We don't know if it's two, three, four or five projects. Some are a bit more mature, others not as much. So we are probably going to see sales in the second half of this year. For Luggo, we have different stages of execution right now. We have eight developments to be carried out this year. Last year, there were four, so we doubled size. Obviously, not all of them are going to be completed this year. So we are probably going to have a follow-on of the fund, LUGG11, not for all the units, probably part of them this year, part of them next year. So it's a growing plan. We are betting on this business a lot. The company already has a prospected land bank but also new prospections going on. So we are going to see Luggo at least doubling in the next year-on-year.

Q - Nicole Inui {BIO 17757166 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Marcelo Motta from JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good morning, everyone. I also have two questions. First, if you could talk about the outlook for cash generation. The first quarter you did have some problem in terms of transfers to banks of Minha Casa Minha Vida. I would like to know if you are back to normal in this post-Carnival period. We did not have as many work days in February. And also in terms of disbursements, we had investments in aluminum land. So for 2020, shall we expect a deceleration of sales or continue with the same levels of 2019? Thank you.

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

Hello. This is Rafael Menin. As far as cash generation, the first quarter, indeed is being impacted by the reduction of volume transferred to Caixa in January. February was a bit better. There was an allowance released from UGU that enabled for more units to be closed, and now a new volume of money that was released. So we're expecting March to transfer an important part of our backlog, not everything. Our first quarter is going to be slightly below expectations. But what is most important is what Eduardo mentioned, our indicators, free conversions have been better. So our raw material to be transferred is growing. If you compare the first quarter 2020 to the first quarter 2019, the raw material units sold is stronger. So we expect, if we do not have a very good cash generation in the first quarter, we might have a postponement of transfers in the second quarter. But along the year, I'm sure we are going to have cash generation way better than last year.

As for land, it's going to be similar. We have an ambition plans of getting to 60,000 units, expanding portfolio, continue buying land for Luggo and for the PREMIUM LINE. And we are going to see land at about BRL700 million a year, which is an important investment, but that has to happen for a company that gets -- wants to get to 60,000 units. As for the aluminum molds, we have very much -- many expenses last year. And this year, probably it's going to be a little less than last year. It's not such an important line. We spent BRL140 million last year. Probably, we are going to spend BRL30 million to BRL40 million less this year for the aluminum molds specifically. But once again, what's most important is to speed up sales. We had some matches of transfers and produced units that was important, almost 7,000 units. And we expect we do not have the mismatch this year. And with that, we are going to have good revenues better than last year and, consequently, a positive cash generation, which what we have been working on since 2013. So if there are no other interruptions in terms of transfers, there is no reason for us not to generate cash along the year.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay. Perfect. Thank you very much.

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

Thanks, Marcelo.

Operator

Our next question comes from Elvis Credendio from BTG Pactual.

Q - Elvis Credendio {BIO 20084266 <GO>}

Good morning. Hi Rafael. Hi Eduardo. I also have two questions. The first, you talked about sales of 2019 that were affected by the Social Factor and the drop of LPV. What is MRV strategy to accelerate sales now? Gross margin, as you mentioned, is going to grow in the coming quarters. What would be the strategy to accelerate the VSO that did have a drop in the quarter? And my other question is about the new product line that you announced. Could you give a bit more color about the ESSENTIAL LINE average ticket? What kind of margins that they are similar to other MRV products? Because I think it is a product for the 1.5 tier in Minha Casa Minha Vida. And you said that this is a product that has the population that was most affected by the decrease in subsidies in Minha Casa Minha Vida. So could you give us a bit more information on that?

A - Eduardo Fischer Teixeira de Souza {BIO 17580321 <GO>}

Okay. This is Fischer. Your two questions have a similar answer. As for the first question, what we can see is that the first two years of the year, January and February that had already closed were better than the first two years of '19. More demand, more quantity of bids and the VSO was higher. So we have a higher volume of sales this year, which is a result of our efforts, especially as of the last quarter, the last half of last year, managing teams, training, preparing everyone, having more suitable product for those that have lower income. So it is something that we started in the second half of last year and is now starting to turn into numbers for this first two months of the year. And the ESSENTIAL LINE was born from this need. Roughly speaking, 25% of the customers that come to us have this income that is going to be served by this essential product. As Rafael mentioned in the opening remarks, along '19, we were a bit penalized because those customers lost their acquisition power. And we took a little to react with regard to that.

In the second half of the year, especially with the creation of this essential product, what we did was exactly to bring back this customer base that wanted to do business with us and that were out. So this ESSENTIAL LINE captured this population that was the past 1.5 but also a low two, again, a product with MRV products quality, a bit less leisure but that can capture these customers that come to see us and does not close other kinds of products.

So the VSO is better already in 2020, which is a reflex of the actions that we started to take after the second half of last year, specifically the fourth Q. And in this year, we are already having important things. We have launches in the essential product as of the next quarter, and with that, we are going to have a much higher VSO this year, which is one of our targets for 2020. So I hope I have answered your question.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Yes, it's quite clear. Thank you very much.

Operator

Our next question comes from Victor Tapia from Bradesco BBI.

Q - Victor Tapia {BIO 20566083 <GO>}

Good morning, everyone. The first question I had is about the produced units. You accelerated production quite a lot. You are growing by 7%. But when you get completed units year-on-year, full year '19, '18, you see a drop in completed units. First point, I would like to understand why. If you were accelerating construction, so why aren't you completing them? And second as they are completed, could we see some other negative impact in margins? Or should the margin stay at the 29%, 30% level that was reported this year? And then another point that I had is about the equity equivalents, the BRL10 million non-recurring, because when you get MRL, Prime, they are already profitable. But then there is that group of almost 80 SPEs that are still at a loss. Again, could you give us a bit more color about these non-recurring adjustments? Thank you very much.

A - Ricardo Pinto Paixao Rodrigues {BIO 22108148 <GO>}

Hi, Victor. This is Ricardo speaking. As for production, this is just a coincidence that the amount of completed units is smaller than the amount of reduced units. There is nothing really exceptional about that. This is just a change of numbers. This is not an operation that we should see from here on. We are going to see the number of production and the number of completed units at the same level. This is a seasonal effect into production. Gross margin, we see gross margin as the floor. We do not expect the gross margin to drop further on. Our finished inventory is at about 4%. We do not see any projected scenario in this number growing a lot. So we are quite comfortable about margin and the pace of production. As for the equivalent, that is a very interesting. Prime and MRL already have healthy results. The non-recurring impact in equity equivalents does not come from Prime and MRL, comes from other two partners that we had: one was a reduction of budgets that happened in the fourth quarter and the others, because they were not having the adjustments of the prospected bad credit in the beginning, and then they had to calculate it for the last two years. So we had a greater impact. We had an analysis of this development, and we are not expecting a negative result.

Q - Victor Tapia {BIO 20566083 <GO>}

Okay. Thank you. If I may, can I ask you just one more question? In the ESSENTIAL LINE, as a whole of the operation, what share do you think it will have?

A - Ricardo Pinto Paixao Rodrigues {BIO 22108148 <GO>}

Well, we have that in our report. It's 20%.

Q - Victor Tapia {BIO 20566083 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Our next question comes from Luis Stacchini from Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good morning, everyone. I have two questions. The first, if you could explore your strategy to try to reach the 60,000 units given the current spot inventory level. Do you think this is a barrier or not for you to go and try to get to 60,000 units? So how do you see the dynamics? Does it already make sense accelerating the level of launches vis-a-vis your inventory levels? Or if -- with the speeds that you are with the -- in the beginning of the year, it makes sense to accelerate even further? And the second question more related to results, specifically. G&A line, we saw a drop, especially with salaries. You had an average of BRL75 million and went down to BRL60 million. I would like to know if this is recurring. And in other expenses and revenues, even if we do not consider the Luggo impact, we still see a very relevant positive impact. Other revenues were about BRL18 million. If you could explain what this impact is. Is there anything different or that could, I don't know, be repeated further on? So these are my questions. Thank you.

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

Hi, Luis. This is Rafael speaking. Okay. First, the 60,000, it's not going to be for 2020. This is a project in the midterm. But it is our goal. We want to get there, and we have all the means to get there. You, yourself, said that the VSO of the company is getting better, not only because we have the right products in the right market but also because the economy is gradually improving. Customer confidence is improving. The interest in SBPE are going down, even going into Minha Casa Minha Vida. It is what I said in the opening remarks. It was not a good year. Eduardo and I were very much pressured. Our team is very much pressured. And obviously, we make changes when results do not come. So we changed a lot in the second half, and results are starting to show. I'm not worried about inventory. Indeed, last year, we had a marginal growth of inventory, but as of now, the inventory is going to go down. We are going to launch this year. We expect to launch more than last year and to sell more than we sold last year, getting close to the 60,000. Once again, we talked about the 60,000, but as we change mix, we have more premium product, Luggo product with a much higher average ticket. We can also expect the average price of our product to go up in the next three years, which is important.

So to summarize, we are quite comfortable. We have this unique position, nationwide coverage, very high quality

portfolio, very high-quality land bank, a brand that is perceived differently from the consumers, the increase of the SBPE premium line, the improvement of Luggo. All these leverages together with a better economy, not much better or better as if we expected but much better than last -- than in the past, we are sure that we can get to the 60,000. As for other revenues and expenses, the major impact was Luggo, BRL17 million in the results. Ricardo talked about that. And then as of then, this impact is going to be higher. This year in the fourth quarter or the first quarter of next year, we are going to have another follow-on of the fund, a volume twice as much as we had in the first issuance. And we had other things, the sale of a plot of land, a smaller things that together had an impact of almost BRL10 million in the first quarter. This impact is not going to be recurring, and the Luggo sale is not going to happen either. So again, what is important is to analyze the balance sheet as a whole with better indicators, a recovered gross margin, slowly but getting better. And the company expects that we are going to have better metrics all around. Okay?

Q - Luis Stacchini {BIO 18717891 <GO>}

Yes, certainly. Thank you very much.

Operator

Our next question comes from Jorel Guilloty from Morgan Stanley.

We are now closing the Q&A session. For the final remarks I'm going to turn the floor to the CEO, Eduardo Fischer. Please, Mr.Fischer you may go on.

A - Eduardo Fischer Teixeira de Souza {BIO 17580321 <GO>}

Well, first of all, I would like to thank you all for attending. I would like just to highlight two of the things that I mentioned in the Q&A session. First, we are starting the year well. Perhaps the greatest challenge was sales performance. Last year it really lit a red light that, in a way, drove a series of actions that are starting to show effects. So we are starting 2020 in a much stronger way that we started 2019. So that's important. And second, I also talked about gross margin. We had a floor in the third Q, a small positive oscillation in the 4Q this year. And as we are going back to our natural level of efficiency in production, we are going to see this number going up. And we are optimistic that we are going to resume to traditional levels. And we made the point in mentioning that in the opening remark, that the company is -- has clockwise operations with consistent results along from more than a decade of operations.

And finally, I didn't mention it in the call, but last year was also a year of turmoil in terms of messages for the continuity of the Minha Casa Minha Vida program, and that created some noise. What we are starting to hear now, with the turn of the year and beginning of 2020, is legitimate interest in having an even more robust program that we had in the past 10 years. Conversations are quite mature, and I suppose that very soon we are going to have positive news in this regard that are going to be just one more trigger for our growth and will bring some stability in this issue that was such a turmoil. So we are optimistic about 2020. We are starting it better than 2019. And along the year, we are going to see quite positive results. This is our challenge, and this is what we are working for. Thank you very much for joining us, and I wish you a good day.

Operator

And MRV's conference call is now close. So thank you very much for your attendance, and wish you a good day.