Q2 2016 Earnings Call

Company Participants

- Antonio Emilio Clemente Fugazza, Chief Financial Officer and Investor Relations Officer
- Pedro Henrique Rocha Nocetti, IR Coordinator

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to EZTEC's Second Quarter 2016 Results Conference Call. Note that this event is being recorded and that all participants will be in listen-only mode during the Company's presentation.

After the Company's remarks are given, there will be a question-and-answer session when further instructions will be given. (Operator Instructions)

Today's event is available through a live webcast that may be accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner 2Q '16 Webcast.

The following presentation is also available for download on the webcast's platform. The following information is stated in Brazilian real and in BR GAAP and IFRS, applicable to real estate developers in Brazil, except where stated otherwise.

Before proceeding, let me mention that any forward-looking statements made in today's conference call regarding the business outlook forecast and financial and operating targets is based on the beliefs and assumptions of EZTEC's management and the information currently available to the Company.

Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of the Company and could cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Emilio Fugazza, Chief Financial and Investor Relations Officer, who will begin the presentation. Please Mr. Emilio, you may begin the conference.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much. Welcome everyone to our conference call of the results second Q 2016, first half 2016. Apart from myself, Mr. Pedro Nocetti, IR Coordinator of EZTEC to share this conference call with me. So, let's start talking that there has been one of the most challenged moments in our recent economic story in Brazil.

And that provides a way to run a company to bring some positive news from all sides of the company and that's why we start on page number three. I would like to say something about the first half 2016 highlights. First of all the greatest news for this quarter is the leasing, of 53% of the leasable area in EZ Towers - Tower B. So that's the very good news along with 39% of the inventory of EZ Mark.

I would like to say a little bit more about this subject in the next slide. So apart from that, launches in the second quarter, 2016, just one tower, just one project launch BRL91 million along with one project launched in the first Q 2016, reaching altogether BRL143 million in the first half.

Contracted sales reached BRL53 million in the first half but the good news is about the gross sales. Gross sales were very good in the first half, Pedro will talk a little bit more about that.

Land bank, the land bank position we own a land bank of BRL5.7 billion by the end of first half 2016. The last piece of land we bought was December 2014, so we are not -- we are not spending money on land bank acquisitions so far.

In terms -- in financial terms, I'd like to highlight the cash generation of BRL160 million in the first half 2016. I would like to remind you BRL92 million, all in the second quarter of 2016, and that's why we pay dividends early May 2016, without any kind of impact in our acquisition [ph]. And plus I would like to remind the performed receivables, performed receivables are receivables in our balance sheet.

We have been carrying on those receivables in order to provide financing to our clients, BRL337 million part of it adjusted by IGP-M plus 10% yearly and part of it adjusted by 12% yearly. All of them with agreements with our clients, without any possibility to lose money doing that.

In terms of gross profit, gross profit in first half BRL138 million, and a gross margin of 45%. Net income reached BRL112 million with a net margin reaching something around 37% and that brings an adjusted annualized return on equity of 9% in the first half 2016.

So before taking the presentation to Mr. Pedro Nocetti, I would like to comment on the slide number four, the leasing of EZ Towers and EZ Mark the greatest highlight of this quarter.

In terms EZ Towers - Tower B, I would like to remind you that Tower B, remains in our inventory, EZTEC's inventory and obviously the main reason to keep the tower on it, is because the Company is a developing Company. So our main purpose to develop a tower like, EZ Towers is to sell it, but obviously given the moment we have been passing through, I would like to say that it's better to try and to lease first to capitalize something to make more value on this tower to get the best possible -- the best possible price for it. And one option in order to do that is to lease the tower -- the tower at this moment to sell it, let's say in a short period of time.

The tenants are for this part of EZ Towers lease is Amil. Amil is a company, part of the group, UnitedHealth Group, so it is the biggest operator of health all over the world and they are in Brazil, it's called Amil. Amil was located in the city of Alphaville very close by Sao Paulo and now took the decision to move to Sao Paulo and they are moving to Sao Paulo and using EZ Towers.

So we rented to them 53% of the total amount of leasable area we own over there, which means 24,700 square meters leased. The leasing period is about 15 years, along with 608 parking lots and the contract is adjusted by IGP-M.

So, the average cap rate of this operation, take it in mind all of it is that investment is about 15%. So 15% nowadays is more than return on equity of the whole Company, which can provide a little bit more results to the moment.

In terms of EZ Mark, EZ Mark was a building developed only to sell -- that EZ Mark. EZ Mark is a building of small offices. It's a premium building. It's not a triple way building, but it's a premium building of small offices of 40 to 50 square meters.

So, but Itau Bank took the decision to use three floors of those building -- of this building and three floors. So we dealed [ph] with Itau an open space to adjust whatever they want in order to use for 10 years, so the leasing period of this contract is about 10 years. The total amount of the area of square meters leased is about 4,500 square meters including a 102 parking lots and just like the EZ Towers, however the contract is adjusted by IGP-M.

Let me remind you that both contracts -- both lease contracts are going to provide accounting revenues, in the third quarter -- for the third quarter 2016, and on, because of the regulation in Brazil. In the (inaudible) -- on the moment, you are receiving the money, you are going to book -- you are going to defer the revenues, you are going to book the revenues as soon as you sign the contract.

Saying that, I would like to pass the presentation to Mr. Pedro Nocetti. Pedro? Take that.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thank you, Emilio. Good morning, everyone. I would like you to please turn to slide number five. I'll talk a little bit about the land bank. Again, very important to say, we are over -- over one year we felt acquiring new piece of land, but, we are still holding potential in terms of PSV of something like BRL5.7 billion in the end of the second quarter 2016.

We have costs of acquisition including costs with expansion of the potential construction of BRL752 million, 13% of the PSV. Looking at the chart on the top right, you see that 69% of the piece of land were acquired after 2012. We have got the best [ph] cost even in a scenario like this Brazil is leasing right now -- like the real estate market is leasing right now.

Looking at the chart on bottom left, you see that 38% of our land is focused on the segment on the standards -- residential standard of Middle High-End to High-End standard, where we have been focusing our last launches and where we expect to keep this focus in the coming months.

24% of the land bank is back into the commercial segment, to develop projects -- that can provide developing projects like EZ Towers in a better Brazilian economic scenario.

Finally, looking at the chart on the bottom right, you see that 92% of our land bank is located in the Sao Paulo metropolitan area, where it's very important to say again, we keep our confidence in the quality and in the capacity of absorption of this market. And we have a land bank that can provide us good launches with good margins as I'm going to say further.

But at this moment I would talk about the launches done until June 2016 in the slide number six. After expanding a bit in the second half of 2015, we stopped launching any project. We started launch in 2006 with the project, Le Premier Moema in March, 2006. In the second quarter of the year, we continued to launching the project Splendor Brooklin in a fancy area of the south zone of the city of Sao Paulo. The project has a PSV BRL92 million and until the closure of this release, was 26% sold.

What you can expect about EZTEC is to keep exploring a specific site, specific part of the market. Developing and launching projects with good liquidity -- potential of liquidity in which -- in areas in which we cannot see enough supply. So it's part of the strategy to fill this supply with good launches with projects -- in terms of projects that are not over supplied. Therefore we expect to keep our inventory in healthy levels.

About the upcoming projects I would talk in the slide number seven. The project Magnifico Brooklin located also in the south zone of Sao Paulo that's in to the high-end segment but (inaudible) of 88 square meters. It has a positional PSV of R$78 million. And the project Santa Catarina also in the south zone of Sao Paulo, middle high end segment with potential sales value of BRL59 million.

Looking at slide number eight, I will talk a little bit more about sales, which finished the first half of the year with BRL23 million. Of course a lower volume of sales compared to previous periods but it's very important to say that it was a choice of the measurement to give priority to receive -- to get the receivables from the sales that were done in previous periods.

And besides doing that we are -- we are focusing our efforts on commercializing units of projects that do not have any risk of showing new cancellations.

Saying that, I would like you to look at the chart on the bottom right, you see the inventory of the Company -- the distribution of the inventory of the Company, and I would like to say that BRL1.26 billion of inventory and 52% of it came from concluded units.

Also from the units that are under construction, more than 76% of that are sold and from the projects that we launched recently, on average all of them are showing -- or we will show -- or can show 50% sold after six months from the period -- from the moment of the launch.

Saying that I would like to please turn to slide number nine, a new slide, it will talk about a little bit about gross sales and cancellations. Looking at the chart on the bottom -- on the bottom right, I can tell you that there was an intense cycle of delivery along the last quarters and these deliveries came from the greater cycles of launches of the Company between 2011 and the first half of 2013.

Considering -- regarding the current scenario of in our base and some weakness in terms of the capacity of getting mortgage by the final user -- by the final user of the unit, the amount -- the volume of cancellations grew in a superior level compared to the historical levels of the Company.

But if we see the chart on the top right, you see that the amount of deliveries to come in the next five quarters, it's something like 40% lower compared to the launch deliveries [ph] in terms of units. Therefore, what we can expect is -- and the provisional cycle in which cancellations may not increase anymore and also on provisional cycle in which gross sales coming from the concluded inventory of the Company that has quality and value can contribute more to cash generation of the Company.

Saying that, I'll turn back the presentation to Mr. Emilio Fugazza, who will talk about the financial highlights. Please, Emilio.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much, Pedro. I'd like to comment the financial performances starting on the net revenue on top left. Look at the second quarter 2016 slightly 11% less than second quarter 2015, but it's important to say that -- that not tell us the whole story of revenues in our Company. The real story as we mentioned in our earnings release, you can see that the gross revenue increased 18% compared to second quarter 2015.

That's why the site under construction, a 100% belonging to EZTEC, the whole site are doing fine, both in terms of schedule, in terms of costs are doing fine. But obviously, the second part is about sales, and there has been a huge cancellation moment. And those cancellations is because, obviously as Pedro mentioned before, we have delivered the greatest harvest of projects -- of project launches in the last three years.

And that's why the moment that people are going to get financing from the banks, they are facing troubles and the bottom line of the cancellations. And that's why from the increment of 18% in gross revenues, we are facing 11% in net revenues.

Apart from that going to gross income and gross margin on top right, I would like to mention 43% of gross margin and a drop of 23% in terms of gross income. But again, I'd like to note something more over that. One of the -- when we break up these margin between commercial and residential, we can see a different kind of stories. One of them in terms of commercial.

Commercial in the first half 2015, the gross margin were 64.4% -- 64.4%, but as we delivered a lot of commercial projects with the small offices, and we are facing the moment and the basic interest rate raises a loss [ph] and people are trying to avoid buying those commercial offices.

We had to sell those commercial offices in a gross margin of 36.4%. That was the story of the gross margin this quarter. A huge drop on the margins of the commercial project is specifically on the small losses. Otherwise when we pay a little bit more attention on retention, in the first half 2015, we saw 50% gross margin and in the first half 2016, we can see -- we can provide 45.9% of gross margin.

So the huge impact is about commercial not about the residential and the residential is the majority of inventory we earn nowadays.

So, let's move to administrative expenses and selling expenses. First of all administrative expenses, on the bottom left of the slide on page number 10. When you see quarter-over-quarter, second quarter over second quarter, we can see BRL3 million less administrative expenses than the second quarter 2015, but again we are not -- we are not telling you the whole story.

In fact, if you break up a little bit this amount of administrative expenses, you can find out salaries and benefits dropping 36% over the same quarter last year. So, 36% represents the whole effort of this Company to adjust administrative expenses to the new reality of the market and of the Company.

So taking out no recovering events to the program of firing people at this moment, the whole economy would be BRL3 million, more BRL4 million in benefits we had to pay in order to reduce the people and expenses this quarter. So, to the quarter and on to the next quarter we are going to see administrative expenses dropping even more.

In terms of selling expenses on bottom right, I would like to mention that when you pay attention carefully, on our earnings release, apart from the huge increment in expenses. In fact, in terms of sales (inaudible) and advertisement, we are pretty much flat. The huge increment of expenses -- selling expenses were in two different sides.

One of them were the brokerage fees. Nowadays, compared to the last year, nowadays we are charging the brokerage fees, straight directly in the price of the apartment we sold to our client and we pay those brokerage fees, passing through the selling expenses and apart from these, the tax property and the maintenance costs of the units in the inventory.

So in the past, one year ago, we had now -- the same amount of the units ready to leave, and units ready to leave mean, that we have to pay property tax monthly and maintenance costs monthly. And those expenses are booked directly on the sale, as the sales expenses of the company by regulation. So, that's why you saw this quarter a huge increment in sales expenses.

Move on to slide number 11, talking about the financial highlights. Financial results on top left, I'd like to remind you that as we pay the dividends of the Company from the general meeting of shareholders, held on last April, they decided to pay in May. So, early May we paid a BRL155 million in dividends. And that's why so the result, the financial -- the positive financial result is a little bit -- it is slightly negative from the compared to the second quarter 2015.

But even though we are reaching almost BRL42 million in positive financial results, coming from both sides and both side of -- one of them is cash. The cash the Company is owning, nowadays receiving something around 14% yield. And apart from it, a half of it we are talking about the performed receivables coming from our clients adjusted by IGP-M plus 10% or IGP-M plus 12% yearly.

Let's move to equity income, results of equity income on top left. On top left you can see straight to the point that the equity income was pretty much zero. And zero means that all the sites under construction or the projects we have controlled with our partners in partnerships, we delivered -- 80% or 70% of those projects were delivered in the last eight to nine months and that's why facing huge cancellations over those sales.

All the results coming from the sites under construction were offset by those cancellations. That means, we are not losing -- we are not losing income from these projects, we are postponing those -- this income to the moment or to a new moment we're going to sell again -- we're going to resell those units to another people.

So -- but in the first half, in fact we faced a lot of cancellations and that was the main reason to come up with almost zero in terms of net income from equity income. But as we sell again, as we have sold again those units obviously, the result from the equity income will come back again.

In terms of net income in our Company, we reached -- we reached BRL39 million and in the first half 2016, we are talking about a BRL112 million. Let me remind you that, the moment we are patient -- we have been patient, is its very dangerous, very complicated, even though we are providing such good result in terms of net income, even facing the worst moments ever of cancellations in our economy in the real estate sector.

And better than that, let me use with the help [ph] of this slide to remind you that just one-third, just one-third of these net income results is coming from financial results. So two-third of this result is from the operational side, which can keep confidence -- keep confidence in our Company that in the quarters ahead we are going to see improvement in this result as soon as we can sell a little bit more or keep controlling a little bit more the cancellation in our Company.

And finally, this slide on bottom right, I'd like to highlight the results to be recognized. Margin -- backlog margin is the greatest highlight because all of units we sold -- we have sold in last three years the gross margin of those units is about 52%. So the quarter's [ph] come in we are going to see those units come in with a margin of 52% counterbalancing -- trying to counter balance the units sold recently with gross margin, trying to make a balance in a margin, in a gross margin average a little bit is slightly positive than 40%.

Let's move on to the slide number 12, to see just two kind of things. One of them is -- that is the gross margin of the last 12 years -- the last 12 months. So the gross margin of the last 12 months are running of around 47%, so 47% is far a ways ahead from the average gross margin of the sector. So we are comparing the sector, were right in Brazil, the city of Sao Paulo and (inaudible) of about -- of around something like 23%, 24%. But EZTEC is working now, is running now with a 47% of margin in the last 12 months. That is remarkable even in this kind of scenario.

And when you see the red line, the red line below all the line you can see the net cash, so company -- the EZTEC is keeping the net cash position even paying the dividends of BRL155 million, because of the generation of cash. But these generation of cash came out this moment because part of the gross sales -- apart from the fact that net sales are very bad -- in a bad situation right now, the gross sales were very good.

Right in the first half of 2016, the gross sales were very good and more than half of these gross sales were sales of performed units. So performed units can bring not only the revenues but 100% of the cash of those units are generated from this side.

So that's the good news, that's the news we are going to try to improve in the next quarters. Selling units from performed -- from performed inventory, but inventory ready to leave in order to generate not only the revenues but also the cash which is (inaudible) for the moment.

Let's move to slide number 13, slide number 13 is about potential value for EZTEC. Well we've been talking about the potential value of the Company, because in fact faced in a tough scenario we are now in a confident book value and the share price and then the market cap is pretty much the same. But apart from being pretty much the same, we earn a lot of kind of things, a lot of strides [ph] of the Company trying to generate -- trying to make money and generate the results to our shareholders.

One of them, obviously is EZ Towers - Tower B. So that's a very good news, because first of all, so it's leased -- its 53% leased. The result of this leasing we're going to see, just in the third quarter and fourth quarters of -- from the third quarter and on, we're going to see revenues come from this quarter. But apart from it, so the tower is open, so as we stopped the leasing in 53%, nowadays we can make more effort to lease the remaining stake of the tower, without fearing the property taxes, all of the maintenance costs. So we are going to -- we could face without leasing at least 0.5% of this all.

So, and that's, so in my personal opinion, in a short period of time we are going to see that these towers better leased than in the second quarter [ph] generating -- generate revenues to our balance sheets, to our shareholders.

So all-in-all we have a confident all this thinking in mind, the inventory, the EZ Towers - Tower B and the backlog result we've a potential -- a potential BRL7 or BRL8 per share to add to -- to complement, to fulfill the book value of the Company in the quarters ahead.

Saying that I'd like to go to the final slide of this presentation with the number 14. The potential cash generation. It is always good to see a company unlike EZTEC itself in a net cash position. So we have -- the true shareholders' equity, apart from the accounting shareholders' equity, the true shareholders' equity of the Company, as you can see in our earnings release in the net asset value statement we released is about BRL4 billion. So BRL4 billion compared to a gross debt of BRL280 million. So BRL4 billion compared to a gross debt of BRL280 billion, so of around 5% to 6% gross debt to equity to real effort -- to true effort [ph] in our Company.

Nowadays net cash position BRL170 million, performed receivables used in IGP-M plus 10 or using IGP-M plus 12. But the good news when would you compare -- when we compare performed receivables against construction obligation we are on almost barely BRL3 of receivable for each BRL1 we have of construction obligation to face ahead.

So even with cancelations, even with worst moment facing, we have no problem to finish all the construction to pay all the debt of the Company without struggling -- without punishing the balance sheet of the Company.

So all-in-all we have BRL1.3 billion of possible cash generation for the quarters ahead and apart from this, better and all, we own BRL1.8 billion of inventory. But let me remind you from this inventory we have BRL600 million of EZ Towers - Tower B, BRL1.2 billion of this inventory from units, retail units. So 0.5% of these units went to lease, 0.5% of these units under construction.

So when we are talking about units ready to live, we are talking about very good -- very good apartments, very well located, in a very good neighborhood, in south zone of Sao Paulo and in east zone of Sao Paulo, but apartments that people have the real desire to live on that kind of project, on that kind of neighborhood.

So there no fear of having this inventory sold in the next years and that's why we try in this second quarter 2016 presentation, provide you -- we try to provide you real feeling that the Company remains completely confident. The Board of Directors remain completely confident that the situation, nowadays is completely under control.

We are running the Company in order to get the best result possible in the -- facing this scenario and as still as the current situation could make some spark -- some feelings that confidence of the entrepreneurs and the people, I agree that we are going to see a very good result as a bottom line for this Company, for EZTEC itself.

So, thank you very much all for the audience today and we are open to your questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the question-and-answer section. (Operator Instructions). We have no more questions at this time. This concludes the question-and-answer portion. At this time, I would like to turn the floor back to Mr. Emilio Fugazza for any closing remarks.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you all for your audience today. Apart from myself, Mr. Pedro Nocetti, we are available at the Company to answer any further questions. Thank you very much.

A - Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thank you so much. Bye-bye.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Bye-bye.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time and have a nice day.