

Q3 2015 Earnings Call

Company Participants

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

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we'd like to welcome everyone to EZTEC's Third Quarter 2015 Results Conference Call. Note that this event is being recorded and that all participants will be in a listen-only mode during the company's presentation.

After the company's remarks are completed, 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 maybe accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner Third Quarter 2015 Webcast.

The following presentation is also available for download on the webcast 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, forecasts, 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'll 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>}

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Thank you very much. Hello, everyone. Welcome to our third quarter 2015 presentation of the results. Apart from myself, Mr. Pedro Nocetti, IR Coordinator, to show some highlights of this period in our operation.

Let's say that the third quarter is a very good example of the challenges we have been facing ahead. In a strict moment of our political situation and economic situation, we have been taking decisions to search alternatives to keep efficiency in our company and trying to deal with the challenges ahead.

In that sense, I would like to say that, the launches we have suspended the first phase -- the sixth phase -- I'm sorry, the sixth phase of the project in Noronha. Noronha is the sixth phase of the bigger project, which are leased to Brazil. And in that, because of it, in nine months 2015, launches reached BRL197 million, EZTEC paid.

I'd like to say that, our focus this quarter is to sell inventory. In that, because of it, sales reached BRL331 million, 68% of the units launched in years before 2015.

In terms of Land Bank, Land Bank reached BRL6 billion by end of the third quarter 2015. I remind you that -- I'd like to remind you that 100% of the Land Bank, almost 100% already paid, and obviously no swaps in there.

In financial terms, and because of some savings in our site under construction, we have 53% of gross margin on average 2015. That means that we reached a gross profit of BRL331 million.

In terms of net income, net income of BRL340 million, very close to the same period of 2014. Talking about return on equity, we have a return on equity annualized superior of 19% per year, which means that we have been dealing with the company, trying to get at least 150% the base interest rate in Brazil.

In terms of business, I'd like to remind that first date of the third quarter, we have repaid BRL163 million of business. Trying to exclude this effect [ph] in our position of cash, we end up the nine months -- we end up September in a net cash position of BRL223 million, plus performed receivables of BRL345 million.

Although all those performed receivables are adjusted by IGPM plus 10 or IGPM plus 12%, perfectly ready to securitization, if we need, if we will need this cash this time.

Now I'd like to talk with Mr. Pedro Nocetti to say something about operational highlights. Please Pedro, go ahead.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thank you so much, Emilio. Good morning, everyone. I would like you to please turn the presentation on Page 4, where I will talk about the Land Bank, which ended the third quarter with 6 billion of own PSV with an average cost of acquisition of 12.6% of this PSV.

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Important to say, this volume of potential sales value in our Land Bank is able to launch at least five years in terms of PSV. So, let me talk a little bit -- let me open a little bit information about this Land Bank.

On the chart on top-right, you can see that, 70% of our Land Bank was acquired since 2012 for the right cost and which can allow the company to keep results like we have been obtaining [ph].

On the chart on the bottom-left, you can see that, 79% of this Land Bank is fastened to the residential segment and 20% to the commercial segment. This 20% can provide with a fact there were lot of good projects, corporate projects like that are in when we see a better scenario in the Brazilian economy.

Finally on the chart on the bottom-right, you can see that 93% of our Land Bank is located in Sao Paulo metropolitan area including City of Sao Paulo. It's very important to say that we keep our confidence and our focus on Sao Paulo and Sao Paulo metropolitan area, so as we trust [ph] as we are very confident about the quality of the projects which are under development.

Although we have not been launching and we are not looking at launches as priority, our areas responsible for development of these projects, they're working hard in order to review and to improve the quality and the capacity of these projects to have liquidity and profitability.

Saying that, I would like you to please turn to Slide Number 5, where we'll talk about EZ Towers. You can look at this picture and you can see that EZ Towers is almost finished in which their total cost incurred through September was 96%.

At this moment, delivery of Tower B is predicted to happen through the end of this year when we recognize all the cost and 100% of the revenues of Tower A sale. Tower B is kept in our inventory at a cost of 250 million. And very important to say, in this month of November, a lot of agreement is finished. And, at this moment, we are ready to ramp Tower B and we have already received some proposals that are being analyzed by the company.

So saying that, when I look at the market cap of the company, which is below BRL2 billion, I'm not seeing classified, an asset like Tower B of EZ Towers, which is ready to be ramped and which the sales value can surpass BRL700 million, and which can provide an event in terms of distribution for the company, if the Board of Directors approve.

So I'd like you to please turn to Slide Number 6, I'll talk about launches through September of 2015, as Emilio said before, we have decided not launching at the third quarter -- in the third quarter of 2013 [ph] and we opted for suspending the project Noronha of Jardins do Brasil.

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And it's very important to say some theories about the suspension. The phase Noronha commercialized between its launch and the most of August of 2015, and it commercialized 20% of this 1,059 units.

And looking at the movement of the company and the needs in terms of directing commercial efforts, through inventories, the company took what was seen as a bad decision with work suspending the launch.

It's very important to say, Jardins Atlantica, which was launched together with Noronha, is now 58% sold. And the project Jardins do Brasil, considering all of its sale is more than 78%, so -- and also very important to say, managerial data, they point -- they show us that, about 20% of the clients of Noronha, they decided to acquire other units in Noronha phase of Jardins do Brasil. Therefore, we are pretty confident, not only about Atlantica, we are confident about Jardins do Brasil, all the phases of the project, and we are very confident about all the projects that we launched in the year of 2015. They are being so, one of them (inaudible) very well so, so we are very comfortable about its liquidity, about its quality, and about its profitability.

So regarding all the year of 2015, EZTEC launched 197 million of volume, which is below volume launched in 2013 and 2014. It's very important to point out the efforts of the commercial department of EZTEC in terms of reaching healthy levels of inventory, in terms of selling the projects with profitability, without needing to destroy margin in order to do that.

And so, it means, controlling the inventory, controlling the supply in order to focus on the other projects of the company. As I told you before, we have Land Bank enough for more than five years of launches in good projects, projects that are capable to provide the company good results and good profitability.

These projects will be launched at the right moment in order to provide consistent results without (inaudible) of the inventory of the company.

Now I would like you to please turn to Slide Number 7. I will talk a little bit about the sales, which in the nine months of 2015 accumulated 331 million. And, very important to say, 226 million of this volume corresponds to sales of units launched before 2015. This sales of inventory is very close to the sales of inventory of 2014.

And also very important to say, we launched much less than we launched before, so we sold less than we sold before that. We sold with good margins, margins that are very close to the margins that we reported in 2014, for example.

Therefore, we ended the month of September with 1.2 billion in inventory, in which 34% of it corresponds to delivered units from inventory, units that are under construction at this moment, 70% of it, they're sold. And, very important to say, from the project that we launched in 2015, they will correspond to 7% of the inventory. These units were more than 50% commercialized in the month of October. That's what will keep our confidence on

what we have -- on what we are selling on the strategy that we have adopted, and on the quality of our project.

So finally, I would like you to turn to Slide Number 8. I will talk a little bit about the turnover of the sales. Turnover, I'm talking about sales and cancellations. You can see that since 2007 the percentage cancelled compared to each exercise of launch has not surpassed 21%. And in 2011 -- the units launched in 2011 have not surpassed 21% cancellations [ph].

And, it's natural to the business to have sales cancellations, to have recessions [ph]. Our job is to deal with it, being very active in terms of treating with the clients, in terms to be close of the clients, in terms to find options to the client in order to keep the quality of our receivables and in order to keep the turnover of sales in line with what we have been working recently.

So therefore, we keep our confidence on what we are doing, we keep our confidence on selling those units that are in inventory, but we will do that at the right moment and we will do that for a margin that can provide us good profitability, that justifies the operations.

Saying that, I will hand back the presentation to Mr. Emilio Fugazza, which will talk about the financial performance. Emilio, please.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much, Pedro. Let's go to Financial Performance I, Page Number 9, on the chart on the top-left. Left part with net revenues, and I'd like to say that this chart can provide you a better explanation in a company that even with less pace of sales as we saw in the third quarter, only BRL38 million [ph] of net sales, you can see very good performance in terms of financial performance, net revenues, and gross income.

That is because, when you have a company and products launched prior, our very goods sold, we can see recognizement [ph] of the revenues quarter-by-quarter. And apart from it, some savings in the costs regarding the cost of the construction could impact positively in our gross margin.

Saying that, you can see that, net revenues dropped 20% from third quarter 2014 to third quarter 2015. The whole year nine months 2015, the drop was 11%.

Although you can see on the top-right, you can see gross income and gross margin, in the quarter, 54% to 49%. The explanation for this drop specifically [ph] is because some cancellations we have been facing are provided from commercial units launched and now are under the moment of the deliveries and people cancelling those units in a gross margin of 60% or 65%, which remains only the residential properties being recognized in our results.

The residential properties, you can see the residential, you can see gross margins on average of 49% and that's why average margin of the third quarter '15 is about 49%.

much more from the residential side than the commercial side.

Let me remind you that, in the third quarter 2014 and the whole year of 2014, one great part of our result were coming from EZ TOWERS. And EZ TOWERS nowadays is only up something close to 4% to 5% of the total amount of our results.

In terms of nine months 2015, you can see 53% gross margin, almost flat compared to nine months 2014. Only the gross income dropped a little from BRL354 million to BRL311 million.

Talking a little bit about expenses, G&A -- SG&A expenses. Let me start with G&A expenses. G&A expenses in the third quarter was about BRL22 million; in the whole year BRL74 million.

It's important to say, given some adjustments we have been doing since January 2014, we are going to see those expenses dropping in the quarters ahead. BRL22 million, we have been carrying some weight, given the contracts we are cancelling with our employees; in that sense, BRL22 million. But, with some more efforts, we are going to see something better in the next quarters.

For this year, the nine months, BRL74 million; my personal forecast is about BRL100 million of G&A expense comparing to something close to BRL110 million, BRL115 million 2014 and getting better.

In terms of selling expenses, it's a little bit tricky. It is simply because selling expenses in our accountancy methods is not only the selling expenses it tells but shows [ph] kind of things more; one of them, the maintenance cost and tax property [ph] of the units ready to sold -- finished and ready to sold.

So, let me use an example, a building that I have remaining an inventory of 10% of this building, let's say, 20 apartments of this building, all the costs regarding maintenance of these 20 units or maybe the tax property we have to pay year-by-year to our government, to our municipality, I am using these expenses, I am booking these expenses as selling expenses.

Apart of this, all the brokerage fees, so there was a turn, very important turn in terms of brokerage fees since the beginning of the year, so -- of around 50% of the brokerage fees now, we are charging our clients and paying directly to our brokers; in that sense, we have to book at selling expenses. And that's why the ratio between selling expenses and net revenues increased from 4.8% to 5.7% for year and for qtr.

Let's go to Slide Number 10, over the chart on the top-left, Financial Results. Before that I have to say that the Financial Results obviously because of the pace due to which rates in Brazil have increased so much since 2013, 2014, we are -- we have been facing a huge increment in the zone of Financial Results. So from BRL9 million to almost BRL20 million, so -- and the whole year, we are talking about BRL60 million, of about 20% -- 18% to 20%

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of the total amount of net income coming from our company. So that's a trend. I have to say, that's a trend. That's a trend, simply because the whole 2015, we are non-GAAP [ph] position.

So in that sense, let's move to equity income on the chart on the top-right. The top-right, let's say, equity income, it's -- all the results come -- the whole result is coming from partnerships we have been doing, so mostly because of the projects launched in the metropolitan region of Sao Paulo.

We have in our earnings release, Page Number 14, a complete breakdown of those results of the equity income. So, when you see, comparing the whole year -- the whole nine months 2014 to nine months 2015, we can see gross margin coming from 41.3% to 50.1%, which means, 8.8 percentage points just in a one-year time, which can show you that the metropolitan region of Sao Paulo can be much more resilient than the city of Sao Paulo itself.

We can see in all the lines of the profit and loss demonstration statement. So, in cancellations, we can see less cancellations than last year. Better margins than the last year. Less commercial expenses than last year. And finally, a much better net margin, 14.2 percentage points above last year.

So that's a trend because we have a lot of projects to be delivered in the quarters ahead. And I would say, the majority of them with some phase-ins and costs should be recognized. So, we have very good news to come from this side. That's a very good news.

In terms of net income on the bottom-left, you can see BRL340 million, almost flat compared to the last year's BRL343 million, and with a net margin coming from 51% one year ago to 58%, mostly because of this lift, because we have a flat performance in gross margin but better performance in financial results and better performance in equity income projects. So, I would say, BRL340 million is a very good result, ending up in a return on equity of 19%, almost 150% of the basic in [ph] Brazil in terms of return on average, which can be far from all the competitors in the Brazilian real estate market.

Finally, financial performance in the slide. On the bottom-right, you can see the backlog result. Backlog in the third quarter is about BRL449 million, with a backlog margin of 50%. 50% you can say -- I would like to say that, when you (inaudible) simply means that the gross margin I had can be almost flat specifically because apart from the discount we have provided in some of the apartments we are delivering, some savings on cost cannot set this effect.

So in that sense, 50% is far from others in our sector and can keep flat the margins of the company in the next quarters -- in the upcoming quarters.

Let's move to Slide Number 11. Slide Number 11 can show you only this record of the company. If you check it out, on gross margin, coming from third quarter or fourth quarter, it's 40%, which was the lowest point of the company in terms of -- regarding gross margin

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in the last year. You can see a resilient 53% over the last 12 months, with a net margin position of 56%, mostly because the way you account the equity income project in the Brazilian accountancy methods.

In terms of net cash position, since the first quarter 2015, we returned from net debt to net cash because of the delivery, the EZ TOWERS delivery, and obviously in the third quarter -- at the very beginning of the third quarter, we paid BRL163 million in dividends.

And apart from that side, we have generated something close to BRL30 million in net cash even in this scenario. So, let's move to Slide Number 12, a slide I like to enhance and explain how much value we have in company.

Let's start talking about book value. So, the book value of the company, the yellow bar is about BRL2.7 billion, the book value. And let me remind you that, if you go deeply in this book value, you are going to reach just some of easy things like BRL800 million paid in cash to Land Bank, in a Land Bank of BRL6 billion of potential sales value, a Land Bank in the city of Sao Paulo and metropolitan region of Sao Paulo, as Pedro mentioned, in a very good neighborhood, very good projects, at least gross margin of 40%. And my personal opinion, on average, I would say, 47% on average gross margin.

Apart from this, we have EZ TOWERS. EZ TOWERS' Tower B now has booked BRL250 million of costs. And thinking about a gross sale of Tower B of BRL636 million, we can provide another almost BRL400 million in gross profit to add to our book value.

Apart from that we have our inventory. So by costs, if you sell the inventory you can provide to adding current prices, you can provide another BRL600 million in gross profit to add to our book value.

And finally the backlog results, so units we sold but we haven't delivered yet, we haven't built yet. In that sense, the backlog is about BRL449 million, gross margin of 50%, can add another stage in our book value.

So apart from this, the final stage is the Land Bank. BRL800 million costs, BRL6 billion price to sell, BRL2.7 billion is the potential gross profit of this Land Bank.

All in, I would say, we have a potential BRL26 per share to add in a book value of almost BRL16 per share. So it's a not fair value we are trading now. We are trading at almost BRL2 billion, 30% discount to our book value. And obviously in a company that the average return on equity was 24% [ph] in the last seven years. Given the fact that we sold only BRL38 million this quarter, and even though releasing BRL104 million of net income, I think, we are far from the right value to trade this company.

And because of it, we are trying to show you this slide to help you in order to understand better what can be agreed in the next quarters if the economy side respond, answer to our calls in order to have a better environment to come in order to launch new products again.

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So that's it. We are completely open to your questions. Thank you very much for your participation [ph] today.

Questions And Answers

Operator

Thank you. Ladies and gentlemen, we will now initiate the questions and answers section. (Operator Instructions) Showing no questions. This concludes the question and answer section. 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 very much everyone for your audience today, and let me remind you that, apart from myself and Mr. Pedro Nocetti, we are completely available to answer your further questions. Thank you very much today.

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

Thank you very much.

Operator

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

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