

Q2 2014 Earnings Call

Company Participants

- Eduardo Fischer Teixeira de Souza, Co-Chief Executive Officer
- Leonardo Guimaraes Correa, Chief Financial Officer
- Rafael Nazareth Menin Teixeira de Souza, Co-Chief Executive Officer

Other Participants

- Eduardo Silveira, Analyst
- Enrico Trotta, Analyst
- Luiz Mauricio Garcia, Analyst
- Nicole Hirakawa, Analyst
- Paola Mello, Analyst
- Rafael Pinho, Analyst

Presentation

Operator

Good morning. Welcome everyone to MRV's Second Quarter of 2014 Results Conference Call for analysts and investors. Today with us we have Rafael Nazareth Menin Teixeira de Souza, Co-CEO; Eduardo Fischer Teixeira de Souza, Co-CEO; Leonardo Correa, CFO; Monica Simao, IR Officer; and Matheus Torga, IR Executive Manager.

We would like to inform you that this event is being recorded and that all participants will be in a listen-only mode during the company's presentation. After MRV's remarks, there will be a session of questions and answers for investors and analysts only, when further instructions will be provided. (Operator Instructions) Today's live webcast may be accessed through the Internet on MRV's Investors Relations website.

Before going on, we would like to let you know that any forward-looking statements made during this conference call, relative to the company's business outlook, projections and operating and financial goals are based on the beliefs and assumptions of MRV's management and rely on information currently available to the company. They involve risks and uncertainties since 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 MRV and lead to results that differ materially from those in such forward-looking statements.

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Now, I will turn the conference over to Mr. Menin, Co-CEO of MRV, who is going to begin the presentation. Mr. Menin, you may go on.

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

Good morning, everyone. It is a pleasure to communicate the results of MRV this quarter with consistent results focus on our work with continuity. As for the indicators reported, I would love to talk about the evolution of gross margin, excellent cash generation and the good results reported by LOG. As gross margin grows, we had a very significant increase. Basically, we reduced the number of older projects and increased the number of younger projects in our company.

We had a very important effort to grow, which happens, what we had have is that we have more developments of newer cities. Then the company went through a less accelerated pace and together with this operation, we will be able to pass on prices above the inflation. This together led to results of higher margins.

The second indicator I would like to mention is the generation of cash of BRL210 million, recently [ph] from the first half when we had disability of banks, now we had a very good number of transfers to -- of clients to banks. With this we have an evolution of our cash flow.

The third aspect of the business that deserves attention is LOG. As of this quarter, we are accounting the assets at fair market value. We recorded a gain of 706 million in LOG, 265 million reflected in monthly results. Finally, I'd like to mention that the market continues strong, and because of that I'm confident that we're going to continue to have very good results in the future.

Now I'm going to turn the call over to Eduardo Fischer.

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

Thank you, Rafael. I'm going to talk a bit more about our operating performance in the quarter. As Rafael mentioned, we had a very strong quarter in all of the company's operating areas. In the commercial area, again, we had a very good quarter, and more important than that, we are seeing a market with a lot of demand and little competition reflects of that is a growing sales performance. In real estate credit, we also had a very good credit -- quarter, sorry. Even with the fact of the World Cup in the month of June, we had an increase of 45% in the volume of transfers in the second quarter compared to the first quarter, reaching a volume of almost 11,000 units transferred [ph]. We kept our focus on cash generation, seeking continuous improvement in the receiving cycle. This efficiency enabled us to have a potential operating free cash flow of 210 million in the second quarter.

As for cancellations, we had an increase in this quarter, because the banks are being restricted. But as of the second quarter, the analysis of our client is suitable to the new

reality of banks. In addition, the increased demand for ready or semi-ready units has enabled us to be less (inaudible) with clients.

Also important to highlight is that most of our cancellations take place during construction, therefore, we can resell the units canceled is still during the development of the project. Also we continue this quarter with the implementation of the SICAQ/SAC project, which basically is a sale conditioned to the transfer of the clients to the bank. Sales already account for 22% in volumes monthly. And also this project will enable us to reduce the levels of cancellations in the future, minimizing risks to the company.

Finally, in our production areas, this quarter we had a pickup of production levels with a substantial increase of units produced and units completed. More recent projects, that are also more profitable, already start to impact positively the company results. And this is a trend that we see for the next quarter. We closed the quarter with 273 production construction plots and labor of 24,000 men.

Now I'm going to turn the call over to Leo.

Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Well, thank you very much, and thanks for attending this call. First I'm going to talk about the LOG. LOG's Board [ph] has been thinking about how to better record and report its operations. An annual inflation of 5% to 6% for a long period provokes distortions in the balance sheets of property companies. Rental contracts are corrected by the IGP-M index, but the price of properties and the value of depreciations are not corrected. We looked into several models or alternatives and concluded that answering the books as properties for investments, marking the amount of the property up or down better represents the activities of LOG. LOG had gaining a profit of 704 million with MRV share amounting to 267 million. This was only possible because of the quality of the properties brought and incorporated and reflects the generation of value of LOG.

And talking about value generation, I would like to talk about Urbamais. Our more recent corporate initiative already had its first launch in August with excellent sales results, launching the Atlanta project in the city of Araraquara in Sao Paulo with a vis-a-vis of BRL233 million. We have a very robust land bank with 12 projects in more 10 towns. The company is setting at its foundation, preparing its infrastructure for the next year and the idea is more than triple vis-a-vis of 2014 and really pay for definite growth.

Our plots are directed to classes B and C in the Brazilian criteria. And in terms of product line, they are an alternative that competes very little taller apartments. It's a different audience. Initially, Urbamais numbers are relatively small compared to our MRV, but I can assure you that Urbamais and LOG will generate substantial value for MRV's shareholders.

Also to penalize, I would like to talk about cash flow, buyback and ROE. As I mentioned, our home business is being more and more optimized, not only in terms of costs, but also in working capital. The core of our business is really transferring our clients to banks fast during the construction work. The cash generated last year was directed to amortizing

debt. We are now at the level that we want, about 30% if you think of net debt over our equity.

The cash generated this year is being directed to shareholders in the form of additional dividends paid in June and buyback. We already spent BRL162 million, buying back 22.9 million shares until the end of the first half 2014. We have a buyback program open and we're going to continue to implement it. This is the most objective, clear way that shows how MRV management sees the future of the company. We are positive about the margins and returns that we have planted in recent years and that's why we are buying back our own shares. After June the 30th, we bought an additional 2 million shares.

I would like to thank you very much and open for Q&A now. Thank you.

Questions And Answers

Operator

Thank you. We will now start to the Q&A session for investors and analysts. (Operator Instructions) Enrico Trotta from Itau BBA would like to ask a question.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, everyone. Thanks for your presentation. I have two questions. The first is that you saw an improve in your gross margin in the second quarter. I would like to understand what do you expect in terms of evolution of gross margin in the second half of 2014? If you give us a color what is the average gross margin that you'll have for the projects that are being delivered, just for us to have an idea how this compares to these new projects that are being launched?

And also, and this is my second question, if you could please comment a bit on Minha Casa Minha Vida program? We now had news that the third phase is going to start, but we haven't had many details about that. Do you have an idea of timing when they're going to start giving more -- give more details and when Minha Casa Minha Vida program is going to be running smoothly?

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

Enrico, this is Rafael. Good morning. How are you?

Q - Enrico Trotta {BIO 16742911 <GO>}

Thanks. Fine, thanks.

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

Well, in terms of gross margin, as I mentioned in the call, we expect a further recovery of gross margins in the second half of 2014. We have been saying that for a while now the margin of more recent projects is a lot healthier. We have a great effort in the company and all the problems we had until 2011, we have already overcome all the problems. The

company is a lot more mature. We were able to transfer or pass on the prices to customers above inflation. And so gross margin is going to grow on the next half of the year. So we expect our second half of the year that is healthier than the first half.

As for guidance, I cannot give you precise numbers. But what we see is that the gross margin should be close to 30% or slightly more than that, but I cannot give you a precise number.

Q - Enrico Trotta {BIO 16742911 <GO>}

Could you just say what the gross margin of the projects that are being delivered now, not necessarily of the new projects that you're going to launch, but the projects that are being delivered now?

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

Well, again, the first information, I don't have to say much here. From older projects we have healthy margins, but slightly smaller than what we have for newer projects. I think what is important is that these newer real estate projects will have more relevant margins that will lead the gross margin to get better. And as well as next year, we want to have the gross margins in line with what we've reported in the past.

As for Minha Casa Minha Vida program Phase 3, the government has been discussing intensely with companies. We have an open channel of communication. MRV, because it's very important in the industry, has taken active part in the discussion. The government is sensitive to the program. It is a successful program. It generated income, satisfaction, taxes, jobs, so we are sure that the program is going to continue.

As for the changes it's going through, I think that we have already advanced a lot. Now, timing in terms of when it's going to be announced in terms of details, if it is for next month or next year, I really don't know. I know that we have been talking constantly to the government, and we expect at any point this to happen. But what is most important is that the government is being sensitive to the demands of the companies and the industry and that gives us the confident that we are going to have a well thoughts and well planned program. Okay?

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay, Rafael, thank you very much.

Operator

Nicole Hirakawa from Credit Suisse would like to ask a question.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Hello, good morning everyone. My first question is about the volume of transfer to clients. You have -- increasing over the next quarters more than 10,000 units. I think the backlog of those units that had been sold not transferred has decreased [ph]. Could you tell how

many units you have in this situation now? And are these units more recent, therefore, they do not run the risk of cancellation or are they older units?

And in terms of margins, I would like to know about margins of projects that are being launched? In Minha Casa Minha Vida Phase 2 program, we had some rules, but it's a bit older now. So I would like to know how about these new projects, what kind of margins are you going to have, what do you expect in the future? Thank you very much.

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

Hi, Nicole, this is Fischer speaking. Well, let me talk a bit about the transfer of clients to banks. Well, we improved a lot in those aspects and we still have a backlog of 20,000 to 24,000 units. Obviously, because we are in a very accelerated pace of sales, and as I mentioned in the beginning, we have a new project going on. This is going to be retrofitted every month. So we are at the very good pace and we should see the numbers kept at this level.

As for margins, Rafael is going to give you a more color on that.

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Hi, Nicole. Well, about margins, it's just what I mentioned recently, newer real estate projects have healthier margins. This little by little will go to our income statement in 2015. We are going to see much more clearly the current operation of the company. As for the Minha Casa Minha Vida project indeed some towns with more than 100,000 inhabitants, we are a bit more limited. We removed some units from Minha Casa Minha Vida program, if you compare to 2013 for instance, you're going to see a difference there. So in this series, we have units up to 130,000.

Then with average size towns that you are an average of 170,000, this is a lot more comfort for us. For the price of construction, the price we buy, plots of land, we'll report healthier margins. Of course, if this is not corrected in one year, two years, the margin starts to get pressured. But this is not what we think is going to happen. We believe that the ceiling is going to be corrected at some point, but for now, we don't see it as a threat for future margin.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Okay, thank you very much.

Operator

Luiz Mauricio Garcia from Bradesco would like to ask a question.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Good morning, everyone. I have two questions as well. The first is about your financial results. I saw an increase that you had in this quarter, the financial results were at positive 9 million, in the past quarter you had 15 million and you have 35 million. And when we take

a look at your expenses, you did have a reduction of financial expenses, they are smaller in this quarter, and we saw there was an increase in the debt of working capital and a decrease in production debts and consolidated was 7 million, which could even cause an increase in financial expenses.

And in terms of revenues, we also saw very high increase coming from clients from -- revenues from clients. But not necessarily having a good dynamic between units that were completed and transferred in that transient project. So I would like to know why your financial results went up so much? It was a substantial increase, BRL35 million, which is quite above the average of the previous quarters.

And second, I would like to know from the point of view, what strategy operations. What do you think the company is going to be like in terms of macroeconomic scenario? We see that our problems in terms of employment. Thinking of 2015, there are some segments of the economy that are not performing very well, the industry is not performing well. So this is important data. But what do you see is going to happen? Do you think that your segments are all resilient, some are more resilient than others? Do you think of migrating to some segments that are more resilient? So, just give us an overview of the scenario, your strategic position there and if there is any factor to mitigate a possible adverse scenario?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Hello, good morning. As far as the financial results, well, in this quarter, we have a bit more INCC than we had in the previous quarter, which makes the difference. Major INCC, which is off May, will come in the second quarter. But this quarter already shows an impact and the previous quarter had this influence. The INCC is the national construction cost index. We also had finalized units that help in the financial results. Because, remember, the financial results that we put today is the result of those units that are completed. The INCC of units under construction goes directly into revenues, so this is a bit of those reflects of the completion of a larger number of units.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

So INCC, so what is that?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

So it goes up when the unit is under construction. When the unit is completed, it just turned into financial revenues.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

And when it goes down, do you have any parts that corrects this index by the IGP-M or any other index? You do have a bit of IGP-M, but it is very, very little, it's not significantly. It really does not have an influence there. So, which is like a balance and since it hasn't grown much and the financial result almost doubled, it went from 7 to 15, this is more than double. Do you have any other factor behind?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

No, it is what I mentioned. INCC, the national construction cost index, really causes very big difference and variations from quarter-to-quarter are not insignificant. Again, that we are going to have this huge increase in the month of May, that is going to be seen in the third quarter.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

So in terms of expenses, you didn't have any major change?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Well, we repaid debentures in the beginning of the second quarter, we are having a smaller amount, and proportionally, we are having more financing to construction, which is also cheaper, and construction financing is directly allocated in the PLC.

As for the macroeconomic scenario, well, for some time now, we have been at -- about how come we have a growth in sales with the economy not doing well. The retail segment is really complaining about our economic status and this has implied lower sales, more difficulties. And in our site, we have been showing a growth of net sales. What I say is that the segment is resilient, again, there is a drop of supply in the segment with an increasing demand. So we have a less competitive market and with that we were able to grow sales and have a good performance.

I don't see anything very different going on. The third quarter is growing basically on the same line, so we see the same type of situation. There is always one market that has more or less supply, but again, this is a dynamic that sometime changes from quarter-to-quarter from city-to-city. There is eventually a competitor in a specific city that is giving discounts on the remaining inventory. But quarter-on-quarter, this situations kind of normalize.

For the next year, we are not expecting anything much different than this year. If you think our forecasts from other banks and even from the focus, we are looking into cities that do not have much inventory if we launch in these towns. We are going to have a demand, so we are working much more on a micro scenario. And this economy with the level of employment that we have, we believe that we can extract value and have a very good level of activity.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

As for segments, you did mention something, but you don't see any other differentiation there. Anything out of the ordinary?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

No, things are going on. What is out of the program, is what Rafael mentioned, it is the same product, the same market, but eventually price goes up and sometimes the price is no longer a price that is compatible to the program and then it has to leave Minha Casa Minha Vida.

In terms of the construction of our activity of the final product to be a cash economic or not or having a disconnection or not, or a cancellation, I'm sorry, or not, it makes no difference.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Okay, thank you.

Operator

Rafael Pinho from Morgan Stanley would like to ask a question.

Q - Rafael Pinho {BIO 15321539 <GO>}

Hi, good morning. I would like to go back to the financial revenues. We saw that this line of clients is a lot stronger and you mentioned that you generally pass on the impact of INCC of May in the third quarter. So could you say how much the impact of the INCC was both in revenues and financial revenues, just for us to consolidate accounts better?

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Rafael, I have the number, it's very easy for me to break down this number, but I don't have the numbers here. I think that in May it was 205 and because contracts are sold with the database in the mid of the month, you'll have this percentage to 205 that is pro rata in the second half of the year. But the impact is one-thirds of 205 in the first quarter and two-thirds in the second quarter.

Q - Rafael Pinho {BIO 15321539 <GO>}

Okay. I'm going to do the math and then if I have a question, I'll come back to you. Thank you.

Operator

Paola Mello from Citibank would like to ask a question.

Q - Paola Mello {BIO 17712227 <GO>}

My question was already answered. Thank you very much.

Operator

Eduardo Silveira from Espirito Santo would like to ask a question.

Q - Eduardo Silveira {BIO 16201252 <GO>}

I have two questions. I would like you to talk a bit about your equity equivalents. I would like to know if -- even what the LOG is better, you have this line a bit stable and also I would like to know about cancellations, they are bit high, so I would like to know why?

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

Hi, Eduardo, this is Rafael speaking, how are you?

Q - Eduardo Silveira {BIO 16201252 <GO>}

Fine, thank you.

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

Well equivalence, we had a second quarter that was quite complicated in terms of sales, free sales in the Midwest, which is a region that is performing slightly worst in terms of operations. MRV had some executives placed in the area. They are addressing the problems there. But net sales were very low and that has affected the results of Prime [ph]. We have a very large project in Brasilia. This is a market that is not good. The product is outside Minha Casa Minha Vida. We have an important inventory of this product and we had a higher volume of cancellations, fewer sales.

For the second quarter in the Midwest, we had performance below expected. What we see from now on is that the operation transferred to clients, buying out plots, this was all adjusted, but the markets are bit saturated, lots of launches, specifically in Brasilia, in recent months we see that there were not so new launches. So the market naturally is going to adjust. The formal income in the region is very good, but the market is still depressed. So we expect that 2014 is going to be bad in this region in the Midwest, but if you think percentually in MRV operation, this is not that consistent, but anyway we have to wait a bit for the next quarters.

As for cancellations, Leonardo is going to answer.

A - Leonardo Guimaraes Correa {BIO 15387486 <GO>}

Well, cancellations went a bit up, you are right, because of banks being a bit more strict in terms of granting credits. We don't see cancellations to go up, it is go I think to be a bit more stable until the beginning of next year. But what happens in the second quarter was not something again extraordinary or unexpected.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Okay, thank you very much.

Operator

(Operator Instructions) Thank you. Our Q&A question -- session is now closed. I'm going to turn the floor to Mr. Menin and Mr. Fischer for their final considerations. Please, you may go on.

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

Well, first of all, I'd like to thank you all for joining us in this conference call. And reinforce that we are very optimistic with our operation. MRV has reached its maturity. We have

been building, transferring clients, selling our units at very comfortable level. We are, with a heated market, our brand is recognized by our clients. So we are quite optimistic about the mid and long-term in the company. The seeds has been planted and we're starting to reap the fruit of all our efforts. Thank you very much.

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

This is Fischer. I also thank you for joining us. And once again, this quarter was excellent. The machine is really running smooth. We are all very well balanced. And what we are going to see now is the reflex of this smooth operation. Thank you very much and regards.

Operator

Thank you. MRV's conference call on their earnings of the second quarter is now closed.

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