Q1 2016 Earnings Call

Company Participants

- Efraim Horn, Co-Chief Executive Officer
- Eric Alencar, Chief Financial Officer and Investor Relations Officer

Other Participants

- Daniel Cobucci, Analyst
- Daniel Gasparetti, Analyst
- Daniel Malheiros, Analyst
- Enrico Trotta, Analyst
- Guilherme Capparelli, Analyst
- Gustavo Cambauva, Analyst
- Luiz Garcia, Analyst
- Nicole Hirakawa, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call where we will discuss the First Quarter of 2016 Earnings Results. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and the audio will be available at the Company's website, www.cyrela.com.br/ri.

This call is being simultaneously translated into English and is being broadcast over the Internet. Questions can also be asked by participants connected abroad.

The earnings release published yesterday, 10th of May after the close of the BM&FBOVESPA trading session can also be accessed on the Company's website.

Before proceeding, we would like to mention that the forward-looking statements that may be made during this conference call relating to the Company's business prospects and projections and operating targets related to its financial growth potential are predictions based on management's expectations about the future of Cyrela. These expectations are highly dependent on domestic market conditions, the general economic performance of the country and international markets, and therefore are subject to change.

With us today are Mr. Efraim Horn, Co-CEO; and Mr. Eric Alencar, CFO and IRO.

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

Efraim Horn {BIO 19714326 <GO>}

Good morning. Considering the scenario that we had at the beginning of 2016 with cost and changes in the political context and an economic deterioration, which has been worsening since the beginning of 2015, we need to constantly reevaluate our planning. Despite of these difficulties, we are certain that our Company is solid and that we have every tool at hand to tackle this difficult moment should it last.

Cyrela has always known when to slow down when facing challenges and speed up to grasp an opportunity. When we look at what is happening, we can see that the routine has become harder. It is unprecedented, and it can last a few more quarters. To be more specific, the number of contract terminations has not dropped. Unfortunately, our legislation is still fragile concerning that the whole segment is ready and working on clearer, fairer and more predictable rules.

In April, we took the first step towards a new partnership with a number of trade and legal associations, consumers' protection agencies and governmental bodies. That is the path we need to thread to get a uniform regulation for the sector in the whole country when it comes to contract termination. When it comes to sales, consumers are more hesitant and waiting for a more stable economic scenario to take decisions, which is normal.

Performance was poor in January and February, which had an impact on our results. In March, the sales volume increased. Adding the fact that 2016 will represent a peak in deliveries for the sector, we have braced ourselves for a very difficult year. As a short-term strategy, we may give some discount in specific cases, but Cyrela will now wade into the price where that some companies are at. Since we have financial solidity and we believe in our products and quality sales.

Some prices that were inconsiderable -- inconceivable in the past remain justified by unique products. In this quarter, even with this economic situation that we are going through, we sold two Pininfarina units at BRL28,000 per square meter. We sold two One Sixty units at BRL26,000 per square meter also in Sao Paulo and two Riserva Golf in Rio, that is right behind Golfe Olimpico at BRL20,000 per square meter. That shows that special products and quality sales are still going to have elevated prices than in the good years. We still believe that these projects will sell at a good price in all sectors; low, medium and high-end. The products launched in this quarter bear witness to that.

We have launched two low-end products with Cury, one high-end product in Sao Paulo, Le Premier and a commercial product specific for physicians that we call MedPlex in Belo Horizonte. All of them had a great sales performance. In the coming years, the delivery volume in the sector will go down, as well as the supply. The volume of launches in the sector already dropped by nearly 40% in 2015 and may fall another 40% or 30% in 2016.

Combining that with possible improvements in demand when credit interest [ph] recover, we will go back to a more virtual cycle for our sector and for Cyrela.

The demographic bonus in Brazil indicates the suppressed demand in real estate. That means that if we hold on to our policy of financial solidity, working hard and making the necessary adjustments in operations with special projects for the neighborhoods and for those customers and also having in mind those adjustments that are necessary in operations, which we constantly do, we will reap benefits in the medium and long-term.

Now we will comment on our operating results. On slide five, we will address Cyrela's consolidated results. In the first quarter of 2016, we launched BRL600 million compared to BRL460 million year-on-year. In this quarter, we launched six new products, four in Sao Paulo, one in Rio de Janeiro and one in Minas Gerais. Excluding swaps and launches of the MCMV program level 1, the volume launched in Cyrela's share was BRL400 million, up by 23% quarter-on-quarter. The Company's share in volume launched was 67% in the first quarter of 2016, compared to 72% in the same period of 2015.

On slide six, we would like to show you the projects that we have in Sao Paulo, Le Premier in the neighborhood of Moema and MedPlex in Belo Horizonte. Both of them have an excellent sales performance.

On slide seven, we will talk about our sales performance. In the first quarter of 2016, pre-sales totaled BRL540 million, 25% lower than the BRL720 million year-on-year. Excluding swaps of the MCMV program level 1, pre-sales amounted to BRL400 million in the CBR share, a 29% reduction when compared to the same period of 2015. The states of Sao Paulo and Rio de Janeiro jointly accounted for 88% of sales in the quarter.

On slide eight, we will address sales speed. The Company's annual SOS was 32%. Looking at sales speed by period, projects launched in the first quarter of 2016 have been 38% sold.

On slide nine, we will address Cyrela's total inventory. At the end of the first quarter, inventory at market level totaled BRL6.5 billion, 1% down quarter-on-quarter. The change in our inventory can be seen in the chart on the right.

On slide 10, we have a breakdown of our finished units. In the quarter, we sold 6% of finished units. Adding the inventory of projects delivered along the quarter and pricing of the units at market value, this inventory increased by 20% quarter-on-quarter. We are aware of how important this matter is to the Company, and we will keep on focusing our efforts of sales on these products. They are our main focus.

On slide 11, we will talk about delivered units. In the quarter, Cyrela delivered 19 projects, totaling 4,400 units. In the quarter, the delivered units accounted for a PSV of BRL2 billion versus the BRL1.2 billion quarter-on-quarter.

I will turn the floor over to Eric, who will present our financial results.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Efraim. Good morning. On slide 13, we will present our financial results. Gross revenue was BRL833 million in the quarter, down by 21% quarter-on-quarter and 22% lower year-on-year. This drop is mainly due to the lower sales volume in the period, especially of finished units. Gross income in the quarter was BRL282 million, 19% down quarter-on-quarter and 22% lower in the year-on-year comparison. The Company's gross margin in the quarter was 34.8%, 0.9% higher than the 33.9% from last quarter and equal to the 34.8% of the first quarter of 2015. This increase is mainly due to the net construction savings.

On the chart in the bottom left-hand corner, we analyze our EBITDA. EBITDA in the quarter totaled BRL93 million, 35% down quarter-on-quarter and 39% down year-on-year.

Net income in the quarter reached BRL61 million, 30% down quarter-on-quarter and 39% down year-on-year. The decrease in net income is due to lower revenue as a result of a drop in sales over the year. Thus, our net margin for the quarter was 7.6% compared with the 9.5% margin quarter-on-quarter and 9.7% in the year-on-year comparison.

Now, please go to slide 14 to see our profitability. In the first quarter of 2016, our return on equity measured as net income LTM on the average shareholders' equity was 7% and our EPS was BRL0.16.

On Slide 15, we will talk about our customers' financial solutions. In this quarter, transfers, trust of deeds and payoffs amounted to BRL657 million, 7% less quarter-on-quarter and 22% less year-on-year. Considering units, transfers, trust of deeds and payoffs totaled 2.9 thousand units, 10% less in the quarterly comparison and 23% less year-on-year.

Slide 16 shows the Company's cash generation. In this quarter, our cash used totaled BRL13 million versus BRL28 million quarter-on-quarter and a cash generation of BRL403 million year-on-year. The main reason for cash used in this quarter was the lower results of inflow owing to the lower finished unit sales and a longer-term for signing transfer agreements.

On slide 18 [ph], we present our indebtedness. Gross debt at the end of the quarter was BRL3.6 billion. The cash position was BRL2.1 billion. Thus, our net debt was BRL1.5 billion. Of the total gross debt, 64% relate to loans for construction and 70% is long-term. The average cost of our corporate debt is still below 100% of CDI. Our net debt over equity ratio was 22.2%, equal to last quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged situation to take advantages of the opportunities in the real estate market.

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

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Daniel Malheiros with Votorantim Bank.

Q - Daniel Malheiros {BIO 18660708 <GO>}

Good morning. Thank you for the presentation. As regard to the adjusted gross margin, there was an increase due to construction savings, but I imagine there is a limit for that since you had an increase in the finished unit sales. I would like to understand a little bit more about the progress of this margin along the year and also comments that we had a cash used in this quarter that was below what we expected. I would like to know about the Company's strategy to create a different scenario to refer that, since we had a different scenario in the last quarter.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Daniel. This is Eric. First, let's talk about construction savings. As you mentioned, it was very expressive, we have BRL58 million in impact, which is around 5% in the margin. There is a trend for an increase in construction savings. We cannot tell you anything about the figure, because everything that we know is already in our balance sheet. But with the model that we are going through right now with an access in providers and they are lowering the prices, I know we are going to have an impact. The impact on gross margin will depend on finished units, because finished units have a margin lower than 30%. If we sell finished units, our gross margin will be lower, but the comparison between the two figures will depend on the sales over the year.

Now about cash generation. This is one of our priorities. If we take a look at our cash flow, the impact in the inflow was lower inflow due to lower sales, because net sales were low in this month or because transfers are taking longer now. We know that for 2016, cash generation will depend on net sales, especially of finished units, we will depend on that figure to establish that cash generation. For 2017, the scenario changes, because if we do not sell anything, we are still going to have a positive result. So for 2016, cash generation will still depend on net sales of finished units and in 2017, the scenario is positive due to this construction savings. Did I answer your question?

Q - Daniel Malheiros {BIO 18660708 <GO>}

Yes. Thank you very much.

Operator

Our next question comes from Guilherme Capparelli with Citi.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Good morning. My question is about revenue recognition that is below the last quarter's figure. I would like to know your expectations. Are you going to keep the same level in the next quarters, and if we consider difficult finances and difficult season sales?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Guilherme. 70% of revenue recognition comes from our margin. The other 30% that makes the difference between the actual and the forecast comes from the finished units. It is difficult for us to tell you a trend, because we know that January and February had a poor performance. March is better. April is going to keep on the March numbers, but we need to be patient, try to understand the current market and understand that if we have low sales in finished units, I believe we are going to have to -- have the same figures that we had in the first quarter.

Q - Guilherme Capparelli {BIO 21476330 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Enrico Trotta with Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Efraim and Eric. Thank you for your presentation. My first question is related to Daniel just mentioned, I would like to know a little bit more about the trade -- transfers performance. The sector had a decrease in transfers in this quarter, because it is taking longer for them to -- for the banks to decide if they're going to grant the transfers now or not. Do you know how much this decrease had an impact on your results in the quarter and how long -- exactly how many days does it take for a transfer to be granted in the first quarter compared to what we had in the last quarters and the last year? And I would like to know about the impact of that in your cash generation. What do you expect for cash generation for the rest of the year?

And the second question is about the equity method line item. We have a good performance compared to the fourth quarter of last year, and I would like to understand if there was any specific reason for that, was it related to Cury's performance? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Enrico, this is Eric. I am going to talk to you about the transfers' figures, but I would also like to tell you what we are going through in the sales team, so that you'll have a clearer image of what the scenario is like for transfers. We are going to receive for finished units something around BRL1.1 billion and now it increased to BRL1.3 billion. It is not related to fiduciary sales. It is related to transfers.

In the past, when there was a transfer, the banks wanted to get that customer and the process for transfer was exclusively a process in operational. Today, the banks are no longer wanting that customer. Now, we have to send -- to submit the transfer request to three or four banks, since the interest rates increased as well. And there is a request -- a requirement for a family household income 20% higher, we need to identify the best interest rate to fit that customer. So the transfer process that used to take two months, now takes four months.

Now we have to use twice the amount of effort that we used to use in the past, and the volume of transfer was 22% lower than last quarter. What happened is that, our transfers simply [ph] to be stronger to the tough reality that we are going through.

Now about the equity method, Cury accounts for a huge part of our line item and there was a product in the city of Fortaleza, that had a loss of BRL1 million. So what are we expecting now? Cury will account for 80% or 90% of this line item, and we know that Cury generates a profit of BRL120 million per year, so that's what we expect for the rest of the year.

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay. Thank you, Eric.

Operator

Our next question comes from Hirakawa with Credit Suisse.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Good morning. I have two questions. First, about the additional BRL50 million in the first quarter, and I would like to understand a little bit more about that. Was it related to the construction volumes? Is it short-term or is it a preparation for future growth? I would also like to know about this reality in Cury?

My second question is about the finished unit sales in the second quarter and transfers as well. Do you think there was an improvement in the second quarter when it comes to that or is the situation actually got worse?

A - Efraim Horn {BIO 19714326 <GO>}

About the sales in the second quarter, we started the year with an economic and political scenario where as surprising as it may seem was uncertain even more than last year, and that had an impact on the customers. They were very hesitant. However, depending on the situation, we reorganized our strategy. In March, our performance was great. As if we were living in a different year, it was completely different from February and January. If we keep that strategy for each region and for each product, April was good too. We believe that along the year, we are going to have something similar to March and April than February and January, especially if the scenario fall in -- if the political scenario changes.

Now, when it comes to Cury, there is a dividend forecast, and it is in the equity method line item. It comes from our investments account and goes to a different line item. It can be interpreted the way you mentioned, but it is just a dividend allowance.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Okay. Thank you very much, Efraim.

Operator

Our next question comes from Luiz Garcia with Bradesco.

Q - Luiz Garcia {BIO 17432519 <GO>}

Now about finished units, which is present in all variables? It is important for our margin and what we saw was that you delivered products in Rio de Janeiro and in the Northeast Region and, of course, it is more challenging for us to get to a few customers, because there is going to be an increasing demand in the second quarter. But specifically about finished units, I would like to know why you think about the growth in finished units, which is still good, due to the deliveries volume, but what do you think? Do you think it's just about timing? Do you think the situation is going to lessen [ph] to these impacts are observed or do you think that in some regions have a critical dynamic regardless of the political scenario, for example, in Rio and in other cities as well?

Do you think they require different practice, a more aggressive approach when it comes to prices? What do you think about our strategy for finished units?

A - Efraim Horn {BIO 19714326 <GO>}

Hello, Luiz. This is Efraim. Actually, Brazil differs a lot depending on the region. Since Cyrela has finished units in different regions, Northeast, Rio, Sao Paulo and the Southern Region, I would like to answer your question specifically for each region and not as a whole.

When it comes to Sao Paulo, since we had a decrease in the launches in the last two years, we believe that we don't have any problems. It is natural for us to deliver a building and take one year to sell all the units. I believe that's going to be our path in Sao Paulo. Our finished units will be sold in the next year after the launch.

When we think about North and Northeast, maybe that number will increase to two years or three years, because we depend on the acceptance of the customers by the banks. If the interest rate goes down, this number can change, but it is not that much when we think about Cyrela's finished units in the North and Northeast. So I believe that in two years and a half, this problem will be solved taking into account the changes in interest rates.

In Rio, due to oil and the public, the number of public servants there, I believe this number is going to be more similar to the North and Northeast numbers than Sao Paulo's. In the Southern Region, the situation is more similar to Sao Paulo. I hope I answered your question specifically, but the overall results will depend on each PSV for each region.

Q - Luiz Garcia {BIO 17432519 <GO>}

So do you think you're going to have a more aggressive approach?

A - Efraim Horn {BIO 19714326 <GO>}

Okay. Answering that part of your question, I believe that in many regions, it is not about giving discounts, because other companies will add 10% more in the discount because they have to pay their debt. So we don't believe that in the macro scenario, giving discounts will sell more because the customers are not full. They accept to pay 90, but two months later it becomes 80, but the competition will be the same.

So for the micro situations that we analyze, we have to take into account the regional demands. Other companies are selling finished units, but their performance is still poor. So we don't believe that it's not all about price, it is about the micro strategy of the sales teams of the products and as a whole, in general when we need to give discounts, the terms for payments will be those that I detailed to each region. But I need to highlight that our main focus is on selling finished units. This is our main focus. This is our main concern too. And I hope that we are going to improve each quarter.

Q - Luiz Garcia {BIO 17432519 <GO>}

Okay. Thank you, Efraim.

Operator

Our next question comes from Daniel Cobucci with Banco do Brasil.

Q - Daniel Cobucci {BIO 19076093 <GO>}

Good morning. Thank you for the presentation. I have two questions related to allowances. I'd like to understand a little bit more about them. They were stable, but there was a change in the composition of the allowances. Especially when it comes to labor claims, those allowances decreased. And also the terminations allowances that had an increase of around 7%, was that related to the increasing number of cancellations and terminations, and what do you expect for the future?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Daniel. This is Eric. As you saw, the variation in the allowances is natural, because every quarter our legal team settles huge and they make allowances for the issues that are still pending. So you are going to notice a fluctuation between the line items. In the legal department, we know that we are not -- we are delivering our products on time, so that allowance is going to decrease. Even though this figure was practically stable, there was an impact of more than BRL20 million in impact, because BRL17 [ph] million were used in compensation.

When it comes to terminations allowances, what we do in our balance sheet is based in the old default rates and since that was stable, there were no changes in that line item. We expect the line item to remain stable. We believe that we are already at a higher termination rate. We don't think that this rate is going to increase more, because it is already very high.

Q - Daniel Cobucci {BIO 19076093 <GO>}

Okay, Eric. Thank you very much.

Operator

Our next question comes from Gustavo Cambauva with BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Good morning. I have two questions. First, I would like to know about the difficulties in transfers. Do you think that you are going to grant more finances to the customers instead of giving discounts? Is this a possibility for you to increase your own financing portfolio?

And the second question is related to launches. What do you expect for volume of launches for this year? Or are you still hesitant, are you still waiting for the next months to come, so that you have a forecast for your sales for the year?

A - Eric Alencar {BIO 18098474 <GO>}

This is Eric. I'm going to answer the question about financing, and Efraim is going to answer your question about financing. Well, we still want to grant finances to our customers and now the good customers are not getting financing from banks, we are granting them those financings. The negative side of that doesn't mean that if we offer a financing, it doesn't mean that we are going to grant it. The term is short. 30% of the income will have to go to the financing, so it is hard to get customers there. So it is not our thorough solution for solving the transfers' problem. We need a capital market that is more evolved for customers to get financings in banks.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Just piggybacking on your comments, out of your total receivables portfolio with BRL1.4 billion, how much do you have for transfers?

A - Eric Alencar {BIO 18098474 <GO>}

It is around BRL500 million. Last year, we had BRL500 million payoffs, and it is very little compared to our transfers' volume.

A - Efraim Horn {BIO 19714326 <GO>}

Now answering your second question. We never gave you any guidance about launches. Cyrela sees launches as opportunities. We don't launch products just for the sake of it. What I can tell you is that, in January, our scenario was so uncertain that even though we had a pipeline for land bank established for the year, we took every step very carefully and still we launched a few products and we mentioned them today.

If we had good news in the sector and if this is going to hopefully happen soon due to the decrease in political crisis, I believe for the second quarter, we are going to have a more promising scenario than the first quarter. So objectively, we don't have a plan. We are going to analyze each opportunity at a time and if it makes sense, we are going to launch a product. In the macro scenario, I believe that the second quarter will be a more promising than the first one.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Okay. That is very clear. Thank you very much. Good morning.

Operator

Our next question comes from Daniel Gasparetti with Merrill Lynch.

Q - Daniel Gasparetti

Good morning. Thank you for the conference. Now, I would like to ask you something about demand. Now with these in political scenario, the situation can improve. And what do you expect for that even if we have a change in the political scenario, what do you think that is going to happen? Do you think we are going to have an improvement in the savings account in the outflows? I would like to understand a little bit about that.

A - Efraim Horn {BIO 19714326 <GO>}

This is Efraim. I believe that we are going to break your question into two parts. I'm going to talk about demand and Eric will talk about the savings account. We know that there is a demand, and there is a demand for medium and high-end apartments and it is not related to banks interest rates, but it is related to a more clearer economic and political scenario. The Cyrela products that are medium and high-end, there is a huge demand for that. Many people are trying to understand about the products and are negotiating, but they are not closing the deals. We believe that they are going to close the deals.

For the leasing segment, the low-end segment, there is a high demand, but it doesn't depend on the political situation. We have a more acceptable interest rate or those customers are not going to get financing from banks. So in this segment, we depend on a change in the financing rate, not only on the political situation. There is a demand, we feel it. And if we have a lower interest rate, we are going to sell more in the low-end segment as well.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Gasparetti. In the first quarter, we had more than 32 million that were withdrawn from savings account. In our daily routine, we know that the banks are overly allocated for real estate finances. What we see now is that credit is more difficult, especially for informal income customers and in the interest rate that is above 1.5%. The scenario is more difficult now, and this is going to improve for individuals only when interest rate goes down. We are expecting interest rates to go down, because we know that is going to help us a lot in our funding allocation.

For legal entities, the situation is good for us in Cyrela. Since we are good payers, bankers like to loan money to us. So it is actually a barrier for our competition. The biggest problem in our market, especially for Cyrela, is not getting money for us, but for our customers and that is not going to improve in the next quarter. Did I answer your question?

Q - Daniel Gasparetti

Yes, you did. Thank you very much, Eric and Efraim.

Operator

(Operator Instructions) That does conclude Cyrela's conference call for today. Thank you very much for your participation. You may now disconnect.