

Q3 2014 Earnings Call

Company Participants

- Eduardo Fischer Teixeira de Souza, Co-Chief Executive Officer
- Leonardo Correa, Executive Director for Finance
- Rafael Nazareth Menin Teixeira de Souza, Chief Executive Officer

Other Participants

- Daniel Gasparete, Analyst
- Eduardo Silveira, Analyst
- Fred Mendes, Analyst
- Luiz Mauricio Garcia, Analyst
- Nicole Hirakawa, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon. We welcome to the audio conference for analysts and investors of MRV Engenharia e Participacoes. We will talk about the third quarter of 2014. We have Mr. Rafael Menin Teixeira de Souza, Co-CEO; Eduardo Fischer Teixeira de Souza, Co-CEO; Leonardo Correa, Executive Director for Finance; Monica Simao, Executive Director for Investor Relations.

We inform that this event will be recorded and during the presentation of the Company, all the participants will be in listen-only mode. After that we will begin the Q&A session only for analysts and investors. (Operator Instructions) The audio has been presented simultaneously on the web in the sites for relationship with investors of the Company.

Before we would like to clarify that any declarations that may be made during this conference concerning business perspectives of MRV projections and operational goals, our assumptions of the Board of the company, and also for based on information currently available. They involve risks, uncertainties and assumptions. And therefore they depend on circumstances that may or may not happen.

Investors should understand that general economic conditions of industry and other factors may affect the performance of the Company in the future, and some results that may differ.

Now I'd like to pass the floor to Mr. Rubens Menin, Chairman therefore makes his presentation. Mr. Rafael Menin, Chairman that will make his presentation. Mr. Rafael, you have the floor.

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

Good afternoon. I would like to highlight in today's call the main brain reasons that have made us pretty comfortable with the presence and optimistic with the future of the Company. Initially, I would like to confirm our perception about the market where we work. We believe it is a strong and resilient market and where we see credit, where we have credits, low competition and demographic conditions have a very favorable part from a low level of unemployment in the income level of our product.

Concerning MRV, we're proud to have a consolidated brand, which affects the trust and credibility of our public. Also, we have shown that our operation is matured in structure in more than 120 cities, where we are present. And we have made great efforts in human resources and finance in the future.

Now we can reap the fruits, the rewards. Another aspect is, what's really differentiates us. We are a company with a strong vision for the future and while we want to perpetuate our business. We have a strong controlling shareholder that has a relevant role in the company and also very experienced and committed executives.

It's important to say that associated to our experience and maturity of the business we have the necessary innovation in the process and focus on the customer service and satisfaction. A good treatment given to all our 25,000 employees and consumer sustainability in all the aspects; social, environment, economic.

I'd like to stress that in the month of October, we formed the MRV Institute, with which we will increment our social activities. We're operating with greater and greater efficiency and in a balanced way.

To finalize, our team believes that we're prepared for the future in a challenging situation or in a favorable scenario. Now, I'd like to pass the floor to Eduardo, he will comment on some of the operational results of the third quarter.

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

Good afternoon. Let's talk about our operational performance in -- like in the previous quarters, we continue to have a good operation and balanced operation in all the areas. But with a good evolution in each one of those, beginning with the sales commercial area, we the strong performance in sales. We closed the first nine months with 20% more sales or with the growth of 20% in relation to the previous year. This is due to low competition and excellent timing and also for sales and strategies.

Concerning the launches in the period, we have the same level as the previous quarter with good inventory. As of the next quarter, we should have an increase in launches really

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to take advantage of the most favorable period of the year.

Also in terms of sales, we had an increase in expenses quarter-after-quarter. This is because of the strategy to compensate the brokers directly to have more efficiency in volumes and pricing and to mitigate any questioning concerning the payment of commissions to clients. These increase in commercial expenses will be compensated by price increases.

We continue also to evolve in simultaneous sales, which are the sales that's simultaneous sales making the transfer directly to the bank after the sale, reaching 56% of the sales made in September. This is the most important project in progress in the company and will bring us a more balanced and efficient operation. We'd like to see that the quality of sales is much better than in the past because of this project. Now in terms of credit for housing, even with the strike in September, we had a very good quarter continuing to transfer to the bank 10,000 units per quarter.

Now talking about cash generation numbers, we had a robust result of R\$136 million in the period, totaling R\$330 million in the year, a result of this excellent operational balancing.

Finally concerning our production area. We increased once again the number of units produced with a highlight to the delivery of apartments that have reached 36,000 units until October this year. We closed the quarter with 262 job sites in production and a work force with over 25,000 men.

Thank you and I'd like to pass the floor to Leo.

Leonardo Correa {BIO 15387486 <GO>}

Good afternoon and thank you for the floor, Eduardo. Now my comments. I would like to begin talking about our subsidiaries. The great highlight along in this quarter is the record in the volume of rental. We added another 165,000 square meters. Even in this economic environment, the well located sheds for industrial use have pounds, a company is interested in renting, we're evolving. Also we made the first launch in Urbamaís, Araraquara amounting 22 million to 23 million.

The project was well received by the public with a good sales velocity. This launch is relatively small with the numbers of MRV and shows the beginning of the sales of this new company. The land bank of Urbamaís has more than 2 billion, with more and more launches happening as of now, that will happen as of next year. Concerning MRV, I will talk about the cash cycle repurchase and return on shares. So as a result of our improvements in operations, we have a shorter operational cycle.

This evolution is gradual, but continuous. The cash generation has been very regular quarter-after-quarter. The cash generated is directed to reduce the level of debt, and above all to shareholders in the form of dividends and repurchase.

Here nothing changes, we continue with the same strength, strategy and same practice. The repurchase has been an excellent economic proposal for shareholders. The average price of repurchase was inferior to book value by 27%. We have decreased number of shares by 7% in 2014, without any loss for the Company's operation.

If you look at the profit per share only with the main activity of MRV, it has gone up quarter-after-quarter. So, things will continue this way.

Thank you. And now we will have the Q&A session.

Questions And Answers

Operator

Thank you. We'd like to begin the Q&A session for investors and analysts. (Operator Instructions) Our first question comes from Mrs. Nicole Hirakawa from Credit Suisse.

Q - Nicole Hirakawa {BIO 18242556 <GO>}

Good afternoon. I have two questions. The first is about commercial expenses, sales expenses. I'd like to understand, is this stabilized? Is it a stabilized less -- is it higher? And please detail more the reasons for this decision to pay directly to the brokers?

And second question, could you talk more about the leverage of logging -- sorry Urbamais. Please talk more about the company, more details about the company Urbamais. Could you update on the situation there? Thank you.

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

Nicole, Fischer speaking. I will talk about our commercial expenses. This decision that we made, we have two movements. We internalized a good part of the sales force. And in parallel, we began to compensate all the sales force and not the clients paying the sales force.

What was the logic? We understood that we can have a much better performance, and also have a better product when we have under our management, the sales team. So the buyer no longer pays the sales force. Thus, with these commissions there is a questioning in the market concerning the obligation to pay this commission.

Although the market has been working like this for a long time, we understood that with our volume of clients it would be a way to mitigate future risks as in practice -- since in practice this won't affect our results.

We began to implement immediately on a large-scale concerning the level of this expense. We have done all the adjustments, so it shouldn't go much higher than what you are seeing today. And we have seen this, as I mentioned in the opening comments.

And concerning Urbamais, Rafael will talk about this.

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

Nicole, hello. Well, concerning Prime, this is a recurring topic in the last calls. I'd like to stress that we had Prime and Merrier, LOG and Urba. Prime in the past had a good performance, 2007, 2012 was a good performance. LOG also has reported exceptional results. And even in the second quarter, we had an extraordinary profit, many of you consider this as a non-recurring results. And well, Urba is another company of the Group. It's beginning now with a great potential, Urba, growth margin.

But also talking about Prime, Prime works in the most difficult part of Brazil, Midwest. We launched in 2011 a product of R\$500 million. The market is very bad, very bad. We also had a performance that was lowering production. It became more expensive, took more time. So the convergence of negative factors in the main project in the Midwest and it is very relevant and in relation to Prime, most of it is in the project.

It will be concluded in January, the project. So the great impact is already in the past, during 2014, and we selected high level executives. We sent them to the Midwest to place the operation of Prime at the same level as MRV. Also Prime is no longer launching products in this way. We're avoiding products in Brazil, in the Midwest. So we're only launching products now there, like those of the government program Minha Casa Minha Vida.

We should have some more things in the first quarter of 2015 and then it will converge to the results of MRV and the other subsidiaries. For example, the company in Rio de Janeiro had results in line with MRV. So the worst is in the past, it's over, everything that had to be done was done and I'm sure that it will give us a lot of joy in the future. We made a study about receivables and Prime accounts payable and the result of the company is positive.

Many units to be sold and as we do this, the company will have a better performance. I'm sure that in 2015, the results of Prime will converge and be the same as MRVs. Thank you.

Operator

Our next question comes from Luiz Mauricio Garcia from Bradesco Bank.

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

Good afternoon. Two questions. Could you talk about the trends for gross margin. The company is improving, but when we compare with the backlog, there is a large gap, especially in the past 2012 and this never recovered and now there is a difference again, a 11 percentage points between adjusted gross margin and the backlog. So I'd like to understand, why this is happening again since those projects would lower profit margins should are becoming less significant. So please comment on these points, why this gap, why this gap is so large, this was answered in the past, but I'd like to know now, and the market? Rafael, Leo, mentioned this today, the media is talking about jobs in industry

unemployment in industries, civil construction had a record unemployment in the last quarter.

How do you see this scenario in the future, while we have the offer below demand and what is the balance looking into the future 2015, which will be a year of many adjustments?

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

Luiz, yes, concerning the first question, gross margin, yes, in fact, the gross margin has recovered quarter-after-quarter. Its gradual, we have been saying for some time. The MRV has a margin above the current. We will be over 30% and this difference between the margin of the backlog and the gross margin.

As mentioned previously, it's a little different. We have to consider the leverage of the company, the taxes and apart from this as we report the sales of the units with the commission the unit therefore has had this result of a higher backlog. And the gross margin will -- is converging, is getting closer to the backlog. But there will be a relevant difference between the two margins, especially due to taxes, leverage, and a little small impact from inflation.

The trend that we see is recovery, gradual and continuous recovery of the gross margin concerning the market. In fact, the country is going -- the economy is in a challenging situation. 2015 will be kind of complicated, but our sales continued strong, the level of employment is good. We have data, unemployment levels are low. Our clients have credit, they have jobs, and a lot of young people getting married, forming families, and in the fourth quarter we expect to have good sales numbers. I don't see any reasons to make our sales drop. So, we have good launches. So, the expectation is to have good sales in line with the previous quarters.

Just to supplement, we have seen two things, we have seen our audience, our clients are strong, you can see this in sales, we have already good sales. The market is very strong, a very good demand.

Operator

Thank you. Our next question comes from Mr. Adiale [ph] from Itau BBA.

Q - Unidentified Participant

Good afternoon. Thank you for the call. Two questions. First, I'd like to understand better the results in society re-participations which is negative in this quarter. You could talk about Prime. Is this another SPE or is this only because of Prime?

And the second question concerning cancellations. It improved in this quarter. How much of this is recurring and how much comes from the impact from the past? Thank you.

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

Adiale, Rafael. Concerning equivalence, Prime is the great company responsible for this performance in this area. As I said to Nicole, Prime's problems were addressed and the products that have brought this negative performance are behind us, are in the past high number of cancellations. Now what we are expecting a recovery and the Midwest market is high income level and has had many launches in the last four years. What we saw in the last year, a low number of launches, new projects. So we believe we will get to a balance in terms of demand at the end of 2015. You can see this, this is happening by the end of next year, the market will go back to be a more healthy market. Ed why don't you talk about cancellations.

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

Cancellations, our project began this year and reached 56% in September, it begins to suffer some impact of cancellations, but we don't see it going below the numbers we have today.

We saw this in the first. We believe this will continue in the first semester. These are units that we sold in the past in project and then we began to do simultaneous sales, but this affects only more recent sales.

So what we saw is a little of the result of the new projects simultaneous sales, transferring the sales directly to the bank at the time of sale. Thank you.

Operator

Our next question comes from Mr. Fred Mendes, HSBC Bank.

Q - Fred Mendes {BIO 17221617 <GO>}

Good afternoon. I have two questions here, the first units sold, I see here well below the others are in line transferred to the bank. So please talk about this increase 5.7%, it's not something that worries, but if you could talk more about this?

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

Good afternoon, I will talk about the issue of the units. This is a historical number. These are projects that we sent to the Federal Savings Bank at Bank of Brazil Caixa Economica Federal Bank of Brazil.

I can see that it's normal. These two banks are in line with us and wanting new projects in the government housing program, Minha Casa Minha Vida. In the fourth quarter, we will see a higher volume of these units. I can tell you one thing nothing abnormal in the past, we had high volumes, we have this in the past, there were many projects like this in 2014.

What, I want to make this clear, it's totally normal and you will always see a large volatility quarter-after-quarter pro salute to is a result, the sooner we transfer the client to the bank, so the more we will have in this area, it should continue to grow but not very much,

we're getting close to the normal level. Supposing the sales will continue on this level, we believe the credit will continue. But in terms of accounts receivable there will be some growth but small.

Operator

Thank you. Our next question comes from Eduardo Silveira from Espirito Santo Bank.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Good afternoon. I have two questions concerning other operating expenses with an increase of R\$8 million, and this could increase if it continues in the fourth quarter. How do you see this in the future? Another concerning taxes. I understand that you have a credit. Do you have more credits that we can consider in the future? And the last you mentioned the inventory of Prime; could you quantify this in unit sales, the number of units?

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

Eduardo, first concerning other expenses, that's an item that has a certain volatility. As a result of some action, the growth was normal. We're on the high side of normal activities. This number will drop in the next quarters. So it will not continue, we won't have this continuously.

Concerning REFIS, we look at all our payments and accounts receivable until 2012. We noticed that there were some discrepancies, we decided to correct this, adjust this. REFIS, the government program for paying taxes was very good for the company to pay older debts in the tax area, and this really allowed us to correct these areas.

We have an accumulated loss. Now-a-days our projects are doing well. We have the taxes -- we still have some expenses concerning these taxes in the holding company. This loss does not surprise the balance sheet and the reason is that we don't we believe we should do it in this conservative way, because we don't have a clear vision. Hence, we will not be able to use these losses in taxes immediately.

So, we may have some benefits in the future as credits related to these taxes. Soon this will be normalized and the projects will be taxed at a rate of 4%.

Now, talking about Prime, we have an inventory in number of units, some under construction worth 700 million.

Operator

Thank you. (Operator Instructions) Our next question comes from Mr. Daniel Gasparete from Bank of America Merrill Lynch.

Q - Daniel Gasparete {BIO 17999254 <GO>}

I don't know if my question was answered already. It's about your cash generation, we notice that most of the cash generation from operations was used in buying plots of land 200 million. How do you see this, is it comfortable, how do you see this and also in the future. Can we presume that the cash generation will be higher than this in the next quarter?

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

Daniel, concerning the disbursement to buy land, we increased our accounts payable and we used cash. We sometimes we prefer to exchange plots of land for apartments, but sometimes there is volatility, according to the opportunities that come up.

So we had an increase in the accounts payable for plots of land, we disbursed close to R\$60 million for plots of land. I don't see any great change in these levels.

We have a land bank that is the size that we want to have with the current economic conditions, sometimes a little more or less it depends on the opportunity, if we have a good opportunity, we want to take advantage of it.

But we have had a good bargaining power too than offering to buy plots of lands in exchange for apartments, units, would like to talk about the currency accounts.

It is part of the system. We have talked about the plot of the operational cycle. So as we improve operations this currency and account should drop and we may have quarters where we have a cash generation that is normally high, because as we have success in transferring clients to the bank and also certify these contracts in another Republic's and decreasing complexity.

I'd like to stress, I'd like to highlight that this transit accounts is a source of cash generation, we consider that it should be lower in normal situations, we should have less and as we go in this direction, this will improve cash generation in some quarters, perhaps supplementing this account had a variation in the last 12 months of R\$200 million. As I said, if we have a better performance, we should see in the quarter stronger cash generation.

Operator

Thank you. (Operator Instructions) Thank you. The Q&A session is concluded. Mr. Rafael Menin and Mr. Eduardo Fischer will say their final words.

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

Well, I'd like to thank you all for your presence in the call. Once again, the company is very satisfied in reporting results. We have a very good operations. The market is strong. The operation is more and more mature. Therefore, we see very good future for the company, we're seeing here positive issues, positive effects and we're sure that we will have good results in the next quarters. Thank you.

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

I'd like to reinforce what was said. We see important movements during this year. Movements to make the operation have an even better level of excellence, more balance, and with a more brilliant future. These efforts consume a lot of energy internally on our part, but we understand that this will make an even greater difference in 2015-2016.

We are very optimistic and we believe that we're very well prepared for -- in a favorable scenario for our product and we will continue on this journey. Thank you.

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