Q2 2021 Earnings Call

Company Participants

- Iuri Campos, Investor Relations Senior Manager
- Raphael Horn, Co-President Director

Other Participants

- Alex Kolberg Ferraz
- Aline Caldeira
- Elvis Credendio
- Jorel Guilloty
- Marcelo Motta
- Pedro Fonseca
- Pedro Hajnal
- Renan Manda
- Thais Alonso

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for standing by. And welcome to Cyrela's Conference Call to discuss the Second Quarter of 2021 Results. Today with us, we have Raphael Horn, Chief Executive Officer; and Iuri Campos, Investor Relations Senior Manager. We would like to inform that during the company's presentation all participants will only be able to listen to the call. We will then begin the Q&A session, when further instructions will be given. (Operator Instructions)

We would also like to inform that the conference call in Portuguese will be presented by the company's management, and the English conference there will be simultaneous translation. This event is also being broadcast simultaneously on the internet via webcast.

This conference call contains forward-looking statements that are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as of the date they are made and the company is under no obligation to update them in the light of new information or future developments.

I will now turn the conference over to Mr.Raphael Horn. Please, Mr.Horn, you may proceed.

Raphael Horn {BIO 19714328 <GO>}

Good morning, everyone. Cyrela, once again had a positive operational performance reaching solid volumes in sales and launches. This was driven by the favorable interest rate scenario that remains below historical average rates. In Brazil, in addition to the fact that we are better prepared to face issues related to COVID-19 which impacted the beginning of the year with restrictions in the main cities we operate. Recent advances in vaccination and the gradual economic recovery in the country contributed positively to this quarter's figures and make us optimistic about the remaining of the year.

With the reopening of sales stands, launches in the quarter grew 358% with compared to the first quarter of 2021. Combined with a resilient performance in sales of the company's inventory, which emphasizes the quality of our products and interest rates that are attractive to our clients.

We reported pre-sales performance of 1.5 million in the quarter, 51% higher than the great first quarter we had. The company's net revenue increased by 96% in the six months period and there was a growth in margin, driven by operational results. The reported net income amounted to 267 million, in addition we had positive cash generation for one more quarter, maintaining the debt ratio at a low and healthy level, keeping Cyrela ready for future challenges.

Looking forward, our challenges are the industry inflation measured by INCC, which is above the last 12 months average. And the upward trend in interest rates in Brazil, which is likely to have an impact on the final rates paid by our customers. Nevertheless, we are confident that these adjustments are temporary and necessary to reach an adequate economic balance. And that interest rates will remain attractive to our customers and our business environment. The outlook for completing the vaccination of the entire adult population in Brazil in coming months is positive. And even if with the first dose, and we continue to have an optimistic view of the industry, seeking to achieve the best results for our stakeholders to create value for shareholders.

Let's now hear the operational results from Iuri.

Iuri Campos {BIO 18647647 <GO>}

Thanks, Raphael, and good morning everyone. On Slide 5, let's comment on the launches of Cyrela. In the second quarter this year, we launched 19 new products with a PSV of BRL1,929 million 659% higher than the same quarter of last year. Excluding swaps and the percentage of Cyrela. The launched volume amounted to 612% higher than 2020. The stake of the company in the launched volume was 84%.

Slide 6 to 8 has the main launched of the company, N.A.U Villa Mariana, Arpoador in Rio de Janeiro, and Cyrela by Pininfarina in Porto Alegre.

Slide 9, we have the sales performance. In the second quarter 2021, pre-sales contracted reached BRL1,560 million, 205% higher than 2Q '20, excluding swaps, BRL1,248 million, a

180% higher than the second quarter '20. In the state of Sao Paulo that accounted for 56% of our sales.

Slide 10, let's talk about sales oversupply. The annual sales oversupply was 55.4%. Looking at the sales oversupply by season of sales, the projects launched in this quarter are 40% sold.

Slide 11, let's talk about the total inventory of Cyrela at the end of the quarter. The inventory at market value add amounted to BRL5.5 billion a growth of 12% when compared to the previous quarter driven by launches in the period. Movements of inventory could be seen in the chart on the left.

On Slide 12, let's detail the finished inventory. In this quarter, we sold 19% of finished units inventory in the beginning of the period, adding the inventory of delivered units versus the pricing of units at market value, the finished inventory had a drop of 12% when compared to the same period of last year.

On Slide 13 [ph], let's talk about financial results. We had a totaling 13 -- six new projects, 1,300 units with a PSV of launches BRL392 million, with a launch PSV of BRL791 million.

Now Slide 15, financial between. The net revenue of the company reached BRL1,182 million in the quarter, 18% higher than the first quarter '21, a 102% higher than the same quarter of last year. In the semester revenue of BRL2,186 million, 96% higher than the first six months of '20. Gross income BRL432 million, 144% higher than first Q -- the previous quarter and 25% then first Q '21 in the first six months. Gross income was BRL779 million, 123% higher than this semester. In the quarter net income of BRL267 million compared to BRL68 million in the previous quarter and a BRL192 million in the first quarter '21. In the semester the net income reached BRL459 million.

Slide 16 talks about profitability, in the second quarter 2021 return on equity amounted to 39.3% on the last 12 months.

Slide 17, let's talk about indebtedness. Gross debt at the end of the quarter was BRL3,339 million, with the cash position of BRL2,781 million, our net debt amounted to BRL558 million, the total gross debt 82% is long-term. Our net debt to equity ratio was 8.9%, 5.1 percentage points above the last quarter, mostly driven by dividends we pay. This low rate ratio of indebtedness places Cyrela at the right place to maximized returns for shareholders.

Finally, on Slide 18, let's talk about cash generation. In the quarter, we had a cash generation of BRL87 million compared to BRL70 million in the previous quarter.

Now Raphael and I will move on to the Q&A session. Thank you.

Questions And Answers

Operator

(Question And Answer)

Thank you. Ladies and gentlemen, we will now begin the Q&A session. (Operator Instructions) First from BTG Pactual, Elvis, Please go ahead.

Q - Elvis Credendio {BIO 20084266 <GO>}

Good morning, Raphael and Iuri. Thank you for the question. I have two questions. First, regarding launches and sales, what are -- could you give us an update what are sales like in the first half of the third quarter? And also what your expectations for new launches in the six-month period? More high-end since low-income customers have suffered because the construction costs are higher.

Also the other point is the construction costs. What do you expect to be the price of construction materials for the second half of the year in recent conversations with your suppliers? What is the sentiment that will be the further transfers especially steel prices that are expected to increase in the third quarter? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning. Thank you. You asked about sales of launches in the third quarter, fourth quarter and product mix. We haven't launched a lot here yet in the third quarter, we have a lot to be launched still and we are reasonably excited, but let's see the fact that this was very high in the last two or three months, will create a more prudent market so to speak, because we have to be more careful or pay more attention.

It's good that Cyrela had a very good period recently, but the level of attention and prudence must be high now. Because the INCC, it was certainly very high and there was that increase in the construction inflation rate has been transferred to prices.

So, if you're close to INCC, that would be margin. If it's not margin, then it's the INCC. So, all in -- everyone in the industry should be more prudent and attentive to that. But again, Brazil is Brazil, as usual. When things are very good, all foreign investors come, then it's not so good and I know we're used to that scenario.

The idea is not that it's not so good that everyone comes to the market but not so bad either. So Brazilians unstable, it goes -- going through several things, we remain optimistic, as long as we can do a good work and keep our feet on the ground deeply rooted. But we feel comfortable because we have improved, the company is quite flexible.

We have shown -- thanks to our great team that we are able to play around and do things well, it's not that we will leave low income segment, no. We'll work with all the segments and -- but connected -- paying attention to the profitability of every segment. We privilege good products that are well accepted by buyers and profitability, so the criteria is profitability, not the segment.

Clearly, we need to have a good team in each segment to deliver good projects, and we have good teams. So profitable products will be given priority. Profitability is the main driver and Iuri will talk about the rest.

A - Iuri Campos {BIO 18647647 <GO>}

Hello, Elvis. Thank you for your question. It's hard to say what will happen in the second half of the year. It's hard to project INCC, no one can do that. Apparently, the worst is over. The Central Bank is raising interest rate to curb inflation. The foreign exchange rates are going up. Apparently, the worst is over, the worst phase is over, talking to engineering team, we don't foresee any expected increase in steel prices in the second half of the year. So it's hard to get it right, but apparently, the worst phase is over. There are external factors that affect Brazil. It depends on iron ore prices and all. But it seems that it's going to be calmer.

Q - Elvis Credendio {BIO 20084266 <GO>}

Okay. Thank you, Raphael.

Operator

The next question comes from Alex Ferraz from Itau BBA.

Q - Alex Kolberg Ferraz {BIO 18651758 <GO>}

Good morning, Raph and Iuri. I have two questions. First, about the margin. We continue to see a margin that continues strong in a scenario of cost retention. How has been the margin of this last season of launches? And how does it relate to margin of low-income products, who have -- which have suffered more like Vivaz. So how can you reconcile both margins to understand this 36%, 37% of gross margin that you present?

And the second question is about regional diversification. If we compare this last six months accrued figures with last year, Sao Paulo has locked a bit of share 56% of launches, but we see other areas such as Rio de Janeiro and Rio Grande do Sul becoming more relevant. Do you see more interesting prospects outside of Sao Paulo state, where the competition is higher?

A - Iuri Campos {BIO 18647647 <GO>}

Thank you, Alex, for your question. I'll answer your question about margin and Rafael will answer the second one.

The margin of our launches is similar to the margin that you can find at the release. The gross margin that is reported is a mix of several factors. Say, all of older finished units products and margin of launches. Maybe there was a greater share of launches in revenue as well as in gross margin and with this RAC [ph] margin that I -- similar to RAC that I mentioned that helped out margin to stay to be a bit higher in this quarter.

In terms of segmentation, the low-income margin, I mean, there's no miracle here. As we said in the last quarter, we lost a bit of margin, net debt will depend on how much time the INCC will remain high. And then the market's capacity to absorb price increases. Once again, we don't have much room in this segment. So, it's normal for medium and high-end products to have a higher margins than low-income products. Raphael?

A - Raphael Horn {BIO 19714328 <GO>}

Well. We're only present in three cities, Sao Paulo, Rio and the South. We operate bottom-up. It's a team. Each team is competent, each one in their region, it's bottom up for land, the good land with good profitability. We have a team that's very good committed and we see opportunities and that's how we do our launches. So, I hope this to be successful, but we don't have a target for Rio, Sao Paulo and the South.

We're less worried about the regional aspect and more about the good opportunities. I don't know if I answered your questions. But we don't -- we like to see things bottom up and not top down.

Q - Alex Kolberg Ferraz {BIO 18651758 <GO>}

Thank you, Raph and Iuri. That's very clear.

Operator

Next question comes from Thais Alonso from Citibank.

Q - Thais Alonso {BIO 21979935 <GO>}

Good morning, everyone. Congratulation on your results. Excellent. I would like you to comment, please. On future launches, when we look at prices -- sales prices of you, we see that high-end has grown by 23% and low income is going down, up to when can you use high-end products to offset margins? Do you intend to continue to launch products in that segment? And with that, are you going to decelerate (inaudible) and try to balance the number of land bank that you need? Is there any pending amount still outstanding?

A - Raphael Horn {BIO 19714328 <GO>}

Hello. How are you? Our plans for 2021 and 2022 is pretty much settled. I mean, it's a very good mix and it's not so flexible. And INCC of 5 point or 10% above -- I mean, 10 percentage points above expectations will not change our blend mix of products. 90% or 95% of them will be able to absorb some one-off adjustments such as that, including Vivaz. Vivaz projects remained and high-income projects remained. We don't have so many cards to shuffle and throw some away, we have one set of cards that we play with.

And as I told you before, we're able to operate in all segments with good profitability. Vivaz is operating and we will continue with its plans and the sum of land bottom up that we bought. So for '21, '22, we are okay about Cody, our commitment to pay land. We have an annual account. We met last year's figures, this year's figures, we haven't yet met. We have to pay the full amount of '20, '21, '22, '23, five years. So we have four years to deliver to [ph] Cody.

Q - Thais Alonso {BIO 21979935 <GO>}

But what's the volume of this pending amount?

A - Raphael Horn {BIO 19714328 <GO>}

There was BRL1.5 billion. I'd say 400 and 500. I'd say we're liking -- still pending BRL1 billion around that.

Q - Thais Alonso {BIO 21979935 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Renan Manda from XP.

Q - Renan Manda {BIO 20347216 <GO>}

Good morning. Thank you for the question. My question is about gross margin. We see a considerable improvement in this quarter. Backlog margins going -- and this improvement, it's a contribution. Were there specific projects that had a higher margin in this season or launches planned for the second half of the year have similar margin? And then we could expect the gross margin to stabilize at that level. Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Renan, good morning. Thank you for your question. Once again, the margin of our launches, company like Cyrela that has launched 19 projects this semester, of course, every launch has a different margin, because land was purchased in a different way. But the margin of launches in general, as I said, in the first question is very close to our REC. So on average, it has been so in the last three quarters and it will be likely to continue at the same average rate.

The gross margin in this quarter specifically, the contribution of launches, the gross margin of launches that had a higher, positive weight on it. But looking forward, it will depend on the volume launch in each quarter. Each quarter is a different story, so that varies.

Q - Renan Manda {BIO 20347216 <GO>}

Perfect. Thank you.

Operator

Our next question comes from Aline Caldeira from Bank of America.

Q - Aline Caldeira {BIO 20890902 <GO>}

Good morning, Raphael and Iuri. Congratulation on the results. Thank you for my question. My question is more about your view about the price transfers and how much that would reach in middle and high-end products? So far you had -- you were successful in transferring price increases. But considering that the interest rate of banks are still low but they're starting to increase it already.

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Aline, how are you? Well, I hope that it stops there. And if it does so, like I said, it's hard to say what we expect for the future, it's so dynamic. If we have INCC of 20% per year, things will be very hard. I mean, we don't expect INCC to be so high all the time. We expect it to go back to regular levels soon. We don't like to increase prices and we hope that we won't need to do that often. That's it. We have to dance according to the music. So far the music is playing, all right. Like I said, it was wonderful, margin has decreased a bit, but it's still okay for those who know to -- how to navigate it -- through it and operate well.

Q - Aline Caldeira {BIO 20890902 <GO>}

Okay. Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

I think it's important for everyone to understand that we need to operate at a reasonable profitability. Of course, the INCC that is so big may damage the margin of -- or some, let's say four -- three or four plots of land, but you can't think that a company the size we operate, high INCC will end the margin. We have to operate with healthy margins and we do that. Of course, the high INCC gets in the way a bit, but it doesn't ruin our projects. If you operate with the margins that are very much at the limit, of course, the high INCC would throw you off your path, but that's not our case.

Operator

The next question comes from Jorel from Morgan Stanley.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Good morning, everyone. I have two questions. One is a bit more general. How do you see the tax reform? How could it possibly affect your business in this scenario depending on changes? And what do you think about that?

And the second question has to do about your land bank. How do you see it today? What -- does it have room for launches in the next one or two years? What is missing? These are my two questions. Thank you.

A - Iuri Campos {BIO 18647647 <GO>}

Thank you for your question, Jorel. The audio was not so good. Let me see if I understood it well. It's about tax reform and the impact it would have in it, please correct me if I'm wrong.

Okay. About that everything that's been designed and talked, discussed has -- does not impact our industry so much, because we don't have a benefit of interest and equity, intercompany transactions, it seems to be well taken care of. So we're okay with that. There is -- that issue of taxing dividends today we have a low leverage ratio, which is below the historical average. So if it is the case, we have room to pay dividends in the short to medium-terms. We have meetings with banks every week, we discuss this topic in the company often, if this is the case, we'll be prepared. Raphael will answer the other question.

A - Raphael Horn {BIO 19714328 <GO>}

How are you? Land bank, I mentioned it quickly, for 2021, we have a complete mix and as well as for 2022. For 2023, most of it is taken care of already is complete. And '23 -- '22 is almost complete and '23 is, we're getting in the way, still a few land -- pieces of land to buy but we're on the right track. Of course, for 2024, we don't have anything and it's better not to. The cost of capital is increasing, so we have to work with the short-term.

Q - Jorel Guilloty {BIO 18291521 <GO>}

Okay. That's very clear. Thank you.

Operator

Our next question comes from Pedro Fonseca from Banco Santander.

Q - Pedro Fonseca {BIO 22387053 <GO>}

Good morning, Raphael and Iuri. Congratulations on the results. You're talking about the price transfers and breakdown expected for the next quarter. What about the transfer on low-income projects that the average price is lower. Do you see any possibility of transferring in cost increase and the PSO or rather a sales oversupply. Do you consider price increases? Maybe a customer that will take longer to make a decision due to several factors or do you expect a sales oversupply to remain at the same levels? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

About the transfer of low-income projects, price transfers, it's a bit more sensitive and less elastic. But good land, good properties in the good locations, in the cities we operate, you're able to sell the product at higher price. So maybe you go to level four or five and not level three. So these are pieces of land we can -- that be maneuvered.

You can either build a product that's Minha Casa, Minha Vida or at level four or five. The pyramid is a bit shorter, but we operate everything from bottom up. It starts with a good property with a good piece of land and it's important not to operate -- it's important to operate with the safe margin, not very short, but the high INCC does not make our macro strategy bad.

I think it is expected to -- we should expect a bit slower sales oversupply in time. Because it makes sense to expect a lower sales of a supply after an outstanding period like the one we had recently. Thank you.

Operator

Our next question comes from Marcelo Motta from JP Morgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you. I have two questions. This sales oversupply question, I would like to know whether these -- in credit facilities, these increases in interest rates from private banks, is there any decrease in conversion? People may be interested, but end up not buying due to affordability. And the second question is about partnerships. With this increase in the interest rate -- in Selic interest rate, is that -- are those partnerships with Canada decrease or maybe you're interested with other partners or other projects?

A - Raphael Horn {BIO 19714328 <GO>}

Hello. How are you? About the interest rate increase affecting sales. In the launch phase, customer have a reference of what the interest rate will be when the keys are delivered. So it's still a -- customer will still have one, two or three years to get the keys. So although interest rate has increased, it is still at considerably reasonable levels, of course, it impacts affordability. But clients are still comfortable. I mean, they're good for Brazil. For Brazil, it's historically low. So the decrease in interest rates or the worsening of interest rates is still non-significant. As for Canadian partnership, it's doing well. I think it will continue. I cannot speak for them, but I according to my understanding things are going well and the partnership remains valid. We made some good projects together and we plan to continue to do so in the coming months.

Q - Marcelo Motta {BIO 16438725 <GO>}

Okay. Thank you, Raphael.

Operator

Our next question is from Pedro Hajnal from Credit Suisse.

Q - Pedro Hajnal {BIO 21159036 <GO>}

Good morning, everyone. I had a technical problem in the beginning. So if someone has asked my question, please do not answer it. I would like to see how you see the pressure of inflation in -- on labor. Since we still have a strong amount of launches in the second half of this year in 2022 in Sao Paulo, what do you expect along those lines? And now so do you feel any pressure about that in this last quarter? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Hi, Pedro. Thank you for your question. No, no one asked that. That's all right. As about the inflation on labor, we monitored that because this was one of our main issues in the past cycle. But currently, up to now, it's under control. INCC -- the component of labor in INCC is behaving well, but we do monitor it. That's the point of attention always.

We don't see any problems in that area so far, but we have to monitor because we're starting construction works in town.

Q - Pedro Hajnal {BIO 21159036 <GO>}

Thank you.

Operator

Ladies and gentlemen, this concludes the Q&A session. I would like now to hand the floor to Raphael Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you all very much for your attention, for attending the call, that's been a good quarter. And I would like to thank God first and secondly, praise the team, they make a difference. The team -- congratulations on the team, all Cyrela's associates, also to the partners. Okay. Let's work -- keep working for everything to be successful and see you next time.

Operator

Okay. Thank you. This concludes Cyrela's conference call. You may now disconnect and have a good day.