Q1 2014 Earnings Call

Company Participants

- Eric Alencar
- Raphael Horn

Other Participants

- Enrico Trotta
- Luiz Mauricio Garcia
- Rafael de Pinho

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to the Cyrela Brazil Realty Conference Call, where the Results for the First Quarter of 2014 will be discussed. 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.

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 broadcasted over the Internet. Questions can also be made by participants connected abroad. The earnings release published yesterday, May 14, after the closure of the BM&FBovespa trading session can be accessed also on the company website.

Before proceeding, we would like to mention that forward-looking statements may be made during this conference call relating to the company's business prospects and projections, operational targets, and relative to its financial growth potential are constituted in 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, therefore, are subject to change.

With us today are Mr. Raphael Horn, Co-CEO; and Mr. Eric Alencar, CFO and Investor Relations Officer. Mr. Horn, you may now begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning, everyone. As from this quarter, I will be with you with the opening remarks of this conference call and mention some of the highlights. And to begin, I'd like to emphasize that our main message is continuity and continuity. After all the measures that were taken in the company to regain its original path, I believe that the Cyrela of today is better prepared to face the challenges of our market, which are many.

The consolidation is in our capacity to execute in strengthening our DNA and focusing in our segment of action and the directions that we've always had strengthening the culture of the company and corporate governance as well. We have to have the culture of hands-on, excellence in execution, and always seeking better profitability. We have to be benchmark in all the areas where we operate.

In addition to that, it's essential to focus on culture and people. Our market has unique characteristics, which increases the contribution of each person. We also know that if we want to make a company long-lasting, we need leaders that share the same culture and the same values.

For some years now, we have initiated a more intense work in developing our leaders and meritocracy. In relation to the market itself, the year began a bit more challenging with many uncertainties in the macroeconomic scenario meaning that we have to adapt and that the focus in selling our inventory will become more and more intense.

We believe that at this time – in a volatile time, the financial solidity of Cyrela will be a highlight to act in the market. We have to be consistent and to always maintain a step ahead so we will have the competency that's always set us apart in launching innovative products especially in the high standard segment.

At the end of this quarter, we launched the Riserva Golf at Barra da Tijuca in Rio de Janeiro. It's one of the most beautiful products that Cyrela has created. You can see the ocean, you can see the lagoon and the future Olympic golf course. The excellence of this development will be difficult to be replicated because of the view and of the privileged area. It is an icon in the city and it will change the level of Barra, and it's worth visiting.

In terms of the results, we were able to generate R$160 million in the quarter in addition to improving the gross margin and maintaining the levels of G&A and commercial expenses. And we had some specific aspects as well as – since 2013 was better than 2012, 2014 will be better than 2013 with higher profitability for the company.

Now, moving on to the results, I will start on with slide number five. For the first quarter of the year, we launched R$1.915 billion. This volume was driven by the launch of two projects in Rio de Janeiro, the Riserva Golf at the end of March with a PSV of R$900 (sic) [R$902] million and Lead Américas also in Barra da Tijuca, which took place in February with a PSV of R$381 million, both 100% CBR.

For that quarter, there were no launches in the Faixa 1. Cyrela's share in the quarter launches was 90%, higher than the same quarter last year which was 59%. Specifically this quarter, some projects launched had a higher swap portion than the company's historic average. It is worth noting that even when disregarding the swaps and Faixa 1 products, the launch volume had 100% increment compared to 1Q 2013. All the launches this year were in São Paulo, Rio de Janeiro and the South.

On slide number six, we will highlight some of the projects launched in the quarter. Riserva Golf, which I mentioned in my speech, and Lead Américas, a commercial development in Barra da Tijuca, which is already 70% sold. These are examples of really differentiated products with Cyrela's DNA.

Moving on to slide seven, we will talk about our sales performance. This quarter pre-sales totaled approximately R$1.5 billion, a 14% increase compared to 1Q 2013. If we disregard the quarter launch swap and the Faixa 1 products, the volumes sold increased from R$1.1 billion in 1Q 2013 to R$1.050 billion, a decrease of 4.4%. At the same time, in the same comparison, the percentage of CBR increased from 70% to 84%.

Inventory sales represented 41% of the quarter's sales, reaching R$638 million, of which R$137 million resulting from the sale of finished units. The States of São Paulo and Rio de Janeiro together account for 82% of the sales for the quarter.

Moving on to slide eight, we will talk about our sales speed. Quarter sales contributed so that the company reached an annual SoS of 53%. If we disregard Faixa 1, SoS for the past 12 months is 49%. In terms of performance percentage, we sold 47% of projects launched this quarter. The chart on the right shows the sales performance per vintage launch. This performance is in line with the forecast of our feasibilities.

Now I'll talk about slide number nine. At the end of the quarter, the market value inventory totaled R$7.2 million (sic) [billion], a 7% increase year-over-year. The main reason for the increase was the concentration of launches at the end of the quarter. Of the total volume launched this quarter, 60% was in the second half of March. You can see inventory evolution on the chart on the right. Finished units represent 15% of our total inventory.

On slide 10, we will provide more details about finished units. Finished units inventory represents R$1.1 billion, a 13% increase quarter-over-quarter. Sales speed of finished units remains stable. This quarter, the company sold 14% of its finished units in the beginning of the period.

On the other hand, the delivery volume, which was high with a strong contribution of the developments in the Northeast added R$260 million to the inventory. On the chart on the right, we can see that 41% of finished units are mainly in the Northeast and the State of Espírito Santo, places with a reduced demand which we expect a slower sales speed.

On slide 11, we will address delivered units. This quarter, Cyrela delivered 19 projects, which represents approximately 5,000 units. The units delivered in the quarter represents a PSV of R$1.5 billion.

Now Eric will talk about the financial results.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Raphael, and good morning, everyone. On slide 13, we will address the financial results. Gross revenue reached R$1.4 billion in the quarter, 6% lower than revenues for the last quarter and 8% higher year-over-year.

Gross profit for the quarter was R$438 million, 4% lower than the gross profit for the last quarter and 10% higher than that presented in the first quarter last year. The company's gross margin for the quarter reached a significant level of 33.3%, 0.4 percentage points higher than the 32.9% in the four quarter 2013 and 0.6% higher than the gross margin of 32.7% in the first quarter of 2013.

In the lower left hand chart, we will analyze the EBITDA. EBITDA for the quarter was R$244 million, 14% lower than the EBITDA of last quarter and 6% lower than the R$259 million year-over-year. The EBITDA margin reached 18.5% in the quarter.

Net income for the quarter was R$163 million, 10% lower than the net income of 4Q 2013 and 9% lower than 1Q 2013. This quarter, there were some specific events that negatively impacted our net profit: a decrease in the amount of equity accounting mainly resulting from lower bottom line, dissolution of landbank ownership in the Northeast with the impact of R$10 million and write-off of taxes to be recovered with a remote possibility of recovery and a net effect of R$7 million.

Additionally, the legal provisions resulting from delayed delivery fines of some of the works belonging to these problem vintages totaled R$8 million. Therefore, the net margin for the quarter was 12.4% compared to a 13.1% in 4Q 2013 and 14.7% in 1Q 2013.

Moving on to slide 14, which is about return on equity. In 1Q 2014, return on equity measured as the net profit in the past 12 months based on an average P&L was 13%. In line with our strategies to create value for our shareholders, it is worth noting that in the addition to the R$321 million distributed in 2013, not only as a minimum mandatory dividend, an extraordinary as in stock buyback.

In 2014, the company remains active in its buyback program and has already executed another R$54 million in buybacks up to the end of March. In slide 15, we address the customer's financial solution. In 1Q 2014, R$746 million were transferred, paid off, and became trust deeds, 11% less than 4Q 2013 and 30% less than 1Q 2013.

In terms of units, the total was 3,800, 14% lower than 4Q 2013 and 19% lower than year-over-year. The volume of transfers in trust deeds remains at healthy levels and in line with the company's delivery level.

On slide 16, we will talk about cash generation. The company's operating cash generation for the quarter was R$159 million. This amount is compared to the cash generation of R$215 million in 1Q 2013 and cash burn of R$134 million in 4Q 2013, or generation of R$84 million disregarding the Terra Encantada land effect.

On slide 17, we will talk about indebtedness. The gross debt at the end of the quarter totaled R$4.5 million against R$4.2 billion in the first quarter of 2013. The cash position also showed increase going from R$1.7 billion to R$2.2 billion. Both the gross debt increase and the increase of cash position, occurred especially due to operational procedures to pay corporate debt in the second quarter of 2014. That totaled R$500 million.

Of the total of the gross debt, 52% are financing with construction with the SFH and 80% is long term. Our net indebtedness in regards to P&L reached 37.8% compared to 39.6% in the previous quarter. This low level of indebtedness together with the cash generation is about the solidity of Cyrela's financial results.

Now we will go to questions and answers.

Q&A

Operator

The first question is from Enrico Trotta from Itaú.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning, Eric and Raphael. I have two questions. First in regards to the landbank, you cancelled four plots this quarter that represents a PSV of R$3 billion. How many plots do you intend on dissoluting during the year, and what is the impact on the ER, if there is one?

The second question is about other operational expenses that are still heavy because of provisions with some construction works that are delayed. What should we expect in the next quarters considering that you still have a lot of projects to deliver and part of the vintages that are considered more problematic? I would like to understand if we still have a lot to provision for for the next quarters. That's basically it. Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning. Enrico, its Raphael. I'm going to talk about the management landbank and then Eric will talk about the accounting part. Our landbank is huge. It's R$50 billion and in many cities and we have many plots. So, we are very active in these landbank operations.

We're always in the market checking if it's good or bad and it's normal in a landbank of 50 billion in the management have this type of variation. So it's not very significant. What's important to say is that our capital is allocated in the landbank. That's why we're very careful. So we take active role in managing. We'll always have a variation in the landbank because of its size.

A - Eric Alencar {BIO 18098474 <GO>}

Enrico, its Eric. It's worth mentioning that the effect of these 10 million were in the non-cash flow. We're going to continue buying these plots and in effect of the balance sheet, we might even have some profit if we sell something we don't want anymore.

In regards to the provisions, today the likelihood for expenses were all provisioned. Since we're still delivering several units from the problematic vintage, we might have to provision more case by case. That's something we do monthly with our legal department and at the moment this is what we think we're going to lose.

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Mr. Nicoli Sirawana (18:46) from Credit Suisse.

Good morning. It's Nicoli (18:50). I have two questions. The first about Cury, which contributed a little less in the equity income. We have very little visibility in this one. So, if you could comment a bit what you're seeing as a trend for this year in terms of contributions for next year? The other question is about (19:18) GBA, and if there's any room to optimize, if you work with any internal goals for G&A.

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Nicoli (19:36). It's Eric speaking. So, the first question was about Cury. Cury is our greatest representative in equivalents and the results in this first trimester was that way because they decided to start works in Faixa 1 in terms of service. They have to recognize that cost and they didn't build that with Caixa. They will do it in the second quarter and this effect of not having this income brings this result. This is very specific. They will increase their profitability by the end of the year because Cury is a company that has a profitability of R$80 million per year.

In regards to G&A, our G&A for this quarter was a little bit lower than the previous quarter. But if we take out the employee part, it went from R$103 million to R$107 million, so it increased R$4 million. The payroll is what we have more control over and volatile aspects like hiring, legal counseling. So if we look forward, Nicoli (20:59), what you can expect are similar levels to those previous two quarters.

Q - Operator

Okay. Eric, just a follow-up question about Cury. About not being able to invoice, does that have anything to do with the delays of transferring funds from the government getting...

A - Eric Alencar {BIO 18098474 <GO>}

No, no, that has nothing – that was a decision, a curious decision that it was best for the company to begin the works and then invoice one, two months later. It was very conscientious. The issue with Caxia is practically resolved, the funding from Caixa.

Q - Operator

Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

You're welcome.

Operator

Our next question is from Mr. Rafael Pinho from Morgan Stanley.

Q - Rafael de Pinho {BIO 15321539 <GO>}

Good morning, everyone. Eric, I'd like to go back to the question about finished units. We already know your position very well about that, but I'd like to understand if you have any idea about how much that inventory costs you per quarter in terms of the property tax, condominium tax, fees and paralyzed capital. So I'd like to know if you have a way to measure that for us.

And the second question, I'd like to go back to Enrico's question about the additional provision for delays. So I'd like to understand how many works were – is there any legacy of the works of any potential delays? So for how much longer will we have to deal with that type of problem? I don't know if you have that information. If you can share that with us, that would be great.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Rafael. This is Raphael speaking. Well, the issue about the finished units, we are as worried as you are. We're focused on that all day long. We have about R$1 billion in finished units and the cost that you mentioned about condo fees and land taxes is about R$40 million a year just for those units. And that's very expensive because the capital cost of Cyrela, the interest effects on top of R$1 billion is R$150 million.

So for us, it's very clear that there's the cost of opportunities. So we sold R$140 million and we delivered R$180 million. So unfortunately, we won't be able to reduce finished units, because we're delivering a lot and in places that are very difficult to sell. But all the company's efforts are focused on that topic. So it goes through campaigns, through focus, a new – a compensation model that we have that's connected to the finished units delivery. So we're taking all these measures to address that topic.

We know that our profitability will only be back to the returns that we wish when we actually address that issue of the finished units. So we do agree with you. It is a problem and we are 100% focused on that problem to solve it. It does cost a lot to the company and it takes out a lot of the company's profit and capital. So we go to bed thinking about that.

Q - Rafael de Pinho {BIO 15321539 <GO>}

So you mentioned that there's R$1 billion, maybe in 2014 (24:41), the R$1.3 billion you would have 35% of your inventory in finished units or almost finished units, so that's why it's such a concerning issue for us here. Thank you for your answer.

A - Raphael Horn {BIO 19714328 <GO>}

Yes, I agree 100% with what you are saying. There's no discussion about it. It's a fact that we don't want it to be like that, but it is a fact so it's up to us to turn it around and focus our efforts on it. We know that it's a major area for devaluating Cyrela, so if we solve that problem, then that's solved as well.

A - Eric Alencar {BIO 18098474 <GO>}

Rafael, this is Eric. You are correct. The provisions are mainly coming from the developments of these problem vintages. And the problem vintage started to deliver units in 2013. Its delivering most of them now in 2014 and some will remain until 2015. So we will have to deal with, in the years of 2014 and 2015, with the provisions of the deliveries of the problem vintage, which was the works of partners that we had to take back in regions that we didn't know very well.

Q - Rafael de Pinho {BIO 15321539 <GO>}

Okay, that's clear. Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Thank you very much and have a good day.

Operator

Our next question is from Mr. Luiz Mauricio Garcia from Bradesco.

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

Good morning. Two points. One, if you could talk about finished units. But you don't expect to speed up sales but if you can talk about inventory in general and how you see the demand throughout the second quarter and consequently, what your expectations are for the rest of the year, volatility, how do you see the market, talking a bit about launches and also about inventory in general from the sales speed of what's finished and what's not.

And the second one is about the capital structure. As you mentioned many times before, it also depends on these initiatives to bring back the cash flow to the company, but how do you see the continuity of streamlining the capital structure, focusing on the leveraging on landbank? Will that make you hold on to initiatives for a longer time? There is the buyback. Do you plan on continuing that or stopping it? So how are you thinking about the capital structure based on the given scenario and your expectations for the year as well?

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Luiz. I'm going to talk about the scenario. I think this isn't new to anyone. The market is very selective and we've been talking about this for a while now. It's still the same and there's no thinking that it's going to get better. And we're going to have to deal with that scenario and that's what we're already dealing with.

The finished units, it depends on where. So, in general, our main concern is the finished units and then the ongoing units. There are places that are more difficult and we already know that. And even in the main places, the market still isn't the way it was in the boom that we had two years or three years ago and that's nothing new either. So our difficulties are increasing.

And now we're going to have to pull up our sleeves, do some campaigns, promotions, better management and increase our responsibility. Up to now, it's according to schedule. The inventory and you've seen it wasn't very strong. April was better, much better. Thank God that April was a lot better. So let's see how May and June will go. So that's the market. It's a tough market, it's a hard market but we can work in it and we can earn money if we do things right. The market has room for good products in the right place.

In relation to the launches, we had some launches in the first quarter and in all of them, we sold over 50% except for Riserva Golf, which we sold about 30% but it's a very high end product. And so the speed will be slower. In Campinas, it was 100%. In Porto Alegre, Curitiba, we launched two with 50% of sales and in Morumbi, 70%, EG (29:57) was 70%.

So we have very good products and we are selling these products very well. So there's room in the market for products with differentiators. So it's back to the market that we had in the pre-boom. So that is our history. That's our culture. This is the type of product that we have to offer. It's a difficult market, but we like to work in it. So the product does make a difference.

In regards to the capital structure, we are not happy with our return either. We don't work for that - to have only 3% of ROE. We know that we're only going to get a better ROE, if we solve our capital structure. So, yes, we already bought back some of the shares, and we're releasing capital to improve our return.

So if we don't put effort in our capital structure, we're not going to go where we want to be. So you can expect that, yes, we're very aware that we need more capital to give more capital to the shareholders to get the ROE that we want.

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

Looking at the launching dynamics, you launched many projects in the first quarter. But how do you see the possibility of stepping back a little bit and focusing more on the inventory or that's not something that you think about and you're going to continue to launch projects in a more selective way?

A - Raphael Horn {BIO 19714328 <GO>}

Well, Luiz, well, the market for launching is still good. So if we launch and we can sell well and that's what's happening today, we're going to continue to launch new projects. If the situation changes, we'll stop launching. But I think that's not what's happening today.

Today, if you launch well, you sell well. So we're going to continue to launch new projects. If the situation changes, we'll stop launching. But I think that's not what's happening today. Today, if you launch well, you sell well. So we're going to continue to launch. That doesn't mean that we're not going to focus on inventory.

This is more specific but if you want to keep a motivated sales force, brokers, et cetera, with launching, you keep everyone motivated. So it's important to have this mix of launchings and inventory so that everyone can sell well. That's important to the dynamics, but if the market changes, we will rethink it but that's not what happens today.

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

Okay. Thank you very much.

Operator

If there are no further questions, I would like to pass the floor to Mr. Raphael for his final comments.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you, everyone, for following our call and what we would like to say is that we're very aware of our challenge in selling inventory and launching and our challenge with the ROE. That's what we're working for, so that we can present both to us and to the shareholders a better ROE. So, we have our very good team to reach that point. So thank you and I'll see you in the next call.

Operator

Cyrela's conference has finished. Thank you very much.