

Q3 2018 Earnings Call

Company Participants

- Miguel Mickelberg, Chief Financial Officer
- Raphael Horn, Co-Chief Executive Officer

Other Participants

- Andre Mazini, Analyst
- Enrico Trotta, Analyst
- Gustavo Cambauva, Analyst
- Luis Stacchini, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcelo Motta, Analyst
- Renan Kato Manda, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call, where we will discuss the Third Quarter 2018 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, November 8, after the close of the B3 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 forecasts 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. Raphael Horn, Co-CEO; and Mr. Miguel Mickelberg, CFO.

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

Raphael Horn {BIO 19714328 <GO>}

Good afternoon. Early 3Q '18 was very different from late 3Q '18. The quarter was marked by chaos and polarization during the elections, which impacted the prices of assets in financial markets due to the electoral uncertainties. However, towards the end, when the results came more defined, market players regained confidence. Although, the international scenario struggled in early 4Q '18 with emerging country stocks hitting a 10-year low in October, the Brazilian market followed the opposite path due to the positive expectations of major structural economic reforms. In civil construction, the situation was no difference still impacted by uncertainties, inventory sales did not recover in 3Q '18. We hope the regain of consumer confidence, the drop in unemployment rates and persistently low interest rates in the coming months, will help the inventory sales regain momentum. Once again the main highlights of the company, was a robust cash generation of BRL303 million. We were able to resume our plan to accelerate strategic launches in good locations and again had high sales speed.

Now I will comment on our operating results. On Slide 5, we'll address Cyrela's launches. In 3Q '18, we launched BRL918 million, 73% more year-on-year, year-to-date launches amounted to BRL2,334 million, a 31% growth year-on-year. We launched 12 new products in 3Q '18, 7 in the City of Sao Paulo, 3 in Rio, 1 in the South and 1 in Campinas. 6 of them are in the Minha Casa Minha Vida housing program, 3 are medium range and 3 are high-end products. Excluding swaps, the volume launched in Cyrela's share in 3Q '18 was BRL1,499 million, up by 13% year-on-year. The company's share in the volume launched in 3Q '18 was 77% compared to 71% year-on-year.

On Slide 6, you can see two projects. The first one is Move Tijuca in Rio de Janeiro with sales reaching over 80% of the market was launched and Living For Consolacao in Sao Paulo with sales reaching over 95% in the quarter.

On Slide 7, you can see Cyrela Haus by Yoo in Sao Paulo, high-end project launched in early September with a PSV of BRL191 million and over 40% sold.

On Slide 8, we'll talk about our sales performance. In 3Q '18 pre-sales were BRL943 million, 29% higher than the BRL730 million in 3Q '17. Year-to-date, pre-sales amounted to BRL2,617 million, a 30% growth year-on-year. Excluding swaps, pre-sales amounted to BRL1,690 million in Cyrela's share, a 16% increase year-on-year. The State of Sao Paulo and Rio de Janeiro, jointly accounted for 92% sales in the year.

On Slide 9, we will address sales speed. The company's annual SOS was 39.4%. Looking at sales speed by period, projects launched in 3Q '18 have been 49% sold or 50% sold.

On Slide 10, we'll address Cyrela's total inventory. At the end of the quarter, inventory at market value totaled BRL5.6 billion, down by 3.7% quarter-on-quarter. The change in our inventory, can be seen in the chart on the right.

On Slide 11, you can see a breakdown of inventories. In 3Q '18, we sold 5% of the finished units at the beginning of the period. Adding the inventory of projects, delivered along the

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quarter and pricing of units at market value, inventory dropped by 8.4% quarter-on-quarter. We are aware of how important this matter is to the company and we will continue to focus our efforts on this product. Rio and the Northeast account for 41.4% of finished units.

On Slide 12, we'll talk about delivered units. In 3Q '18, Cyrela delivered 10 projects totaling 3,500 units. We delivered 11,800 units in 40 projects. Units delivered accounted for a PSV of BRL3,791 million, 1% lower year-on-year.

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

Miguel Mickelberg {BIO 20023910 <GO>}

On Slide 14, we will present our financial results. Gross revenue was BRL745 million in the quarter, up by 13% quarter-on-quarter and 21% higher year-on-year. The increase was mainly due to greater recognition of launches. Year-to-date, gross revenue was BRL1,866 million, flat year-on-year. Gross income in the quarter was BRL205 million, up by 20% quarter-on-quarter and 39% higher year-on-year. Year-to-date, gross income reached BRL501 million, 1% higher year-on-year. The company's gross margin in the quarter was 28.3%, 1.5 percentage points higher than the 26.8% of 2Q '18 and 3.6 points higher than the 24.6% in 2Q '17. The margin increase in the quarter can be explained by the higher margin of new launches. In 3Q '18, the results were impacted by extraordinary items such as the impairment loss related to a land plot in Rio, new contingencies and reserve costs analysis in the Northeast. Therefore we have losses amounted to BRL121 million.

Now let's see our profitability. Our return on equity, measured as the net income of the past 12 months over the average shareholders' equity was a negative 2.7%. And our EPS was minus BRL0.31. In 3Q '18, transfers, trust of deed and payoffs amounted to BRL842 million, 10% down quarter-on-quarter and 2% lower year-on-year. Considering units transfers, trust of deed and payoffs totaled 4,100 units, 3% lower quarter-on-quarter and 5% higher year-on-year.

Slide 17 shows the company's cash generation. In 3Q '18, our cash generation was BRL303 million versus BRL181 million quarter-on-quarter and BRL285 million year-on-year.

On Slide 18, you can see our debt. Gross debt at the end of the quarter was BRL2.9 billion. The cash position was BRL2.1 billion. Thus, our net debt was BRL0.7 billion. 31% of the gross debt are related to loans for construction and 70% is long term. The company settled in advance loans obtained through bank credit notes in the amount of BRL134 million originally maturing in February 2019. Our net debt over equity ratio was 12.9%, 1.5% lower quarter-on-quarter. The low debt level confirms Cyrela's financial solidity and puts us in a privileged position to adjust our capital structure and improve returns to shareholders.

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) The first question comes from Mr. Cambauva with BTG Pactual.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Good morning. I have two questions. The first one is about your expectations related to launches for the next year. I believe that with better macro scenario, I would like to know if you are more excited about launching new products? So, first I would like to know about your pipeline, your project pipeline that you may have approved or they maybe under the process of approval?

And the second part of the question is more related to your feelings and your expectations. Do you think that we're going to have a stronger improvement in the market? Are you optimistic or are you more conservative when it comes to launches? And the third part of the question is about Reserva Golf project, you delivered it in the second quarter and you have to transfer the units, or maybe you have some cancellations. So I would like to know your expectations when it comes to finished units. Can you estimate the time it would take to sell all of them and also, what has the performance been like in the past few months for that project?

A - Raphael Horn {BIO 19714328 <GO>}

Hello, good afternoon. This is Raphael. Last year, we said that in 2018, we would increase launches. And we had good project in Sao Paulo. We had good land plots. We were excited about the project. And in the third -- the first quarter, everything was very frustrating due to protocols and et cetera. We were able to launch more in the third quarter, but it was below our potential. We are increasing the number of launches in '18 in comparison to '17 but still we're not there yet.

Now in the last quarter, we are going to be very strong in terms of margins. We are excited, I would say so. And of course that's relative. Because the market is still very selective. I am excited about our products and our launches, but that doesn't mean that the market is incredible. We bought good land plots for good prices in good locations and that of course, excites us. Now with the new President, I believe that Brazil is going to be in a better situation. And the site that the market was rooting for one, and that brings some optimism.

For 2019, we have good projects. And as I said before in '18 and '19, we would launch great products and the ones that we didn't launch in '18, we are going to launch in '19. So our pipeline is going to be larger than the one that we had in 2018. So yes, we are excited. Sao Paulo is still better than the other markets. And it's not about thinking that the market is in a great place right now. It's all about finding good projects and good prices,

and of course that the market is going to accept larger volumes than the ones that we had during the crisis. But we're not there yet. But yes, we are excited.

Now in Golf, we don't have any units left. In October, we sold 3.5. And we want to sell better than the volume that we sold this year. That's what we're going to do in 2019.

Q - Gustavo Cambauva {BIO 17329406 <GO>}

Thank you. Thank you very much.

Operator

Next question comes from Mr. Trotta with Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good afternoon, Miguel and Raphael. I have two questions, and they are related to land plots. We had impairment losses related to swaps of a project that was not going to be launched in the time that was initially agreed. Do you have any other land plots that could be subject to impairment loss, especially in Rio de Janeiro, since it is a tougher market for launches right now? And maybe the projects that you wished to launch are not going to be launched in the time that you had expected before? So this is my question about impairment losses related to land plots.

The second question is about the new brands with us. It is in the Minha Casa Minha Vida housing program. So I would like to know what you expect in terms of size of these operations, considering a more competitive market because of funding [ph] and also considering the Minha Casa Minha Vida may suffer some changes. Thank you.

A - Miguel Mickelberg {BIO 20023910 <GO>}

This is Miguel. About the impairment loss, we had that impact in the quarter. It was a large land plot with an SOS. That was very large. But the legislation changed and the location was not very good. The prices were low there. So we were no longer confident about the launch of that project. We always evaluate our inventory and we may have impaired losses, again, it's part of the business, so when you have information about that, we are going to disclose them, of course.

A few conference calls ago, when we did something similar in Brazilian, I said that we may have other one or two impairment losses. These cases are not very frequent. We try to avoid those situations as much as we can. We only confirm things that we can actually launch. And in this case in Rio, we were going to launch the project. But then, we had the crisis. And in three months time we launched four other projects on the same street and they were very successful. Now in the first -- the fifth project actually, we were not so lucky. But we don't purchase land plots with the obligation to pay for swaps. We had two or three cases, I don't even actually know if we had a third case and the other two, the previous two were already disclosed in our balance sheet.

Now our Minha Casa Minha Vida strategy always includes partners, Cury and Plano, for example. They are our partners in the low and -- the low income market. We already have land plots and when we can, we also launch those low income project. But Cury and Plano & Plano are the companies that are stronger in those markets. And Cyrela does a little bit of everything, but not that much. We are not that strong in the low income market. But if the land plots are good and if they are cheap, we can build those projects, we know how to do them. But we don't have major high guidelines in terms of growing in those markets.

Q - Enrico Trotta {BIO 16742911 <GO>}

Okay, thank you very much. Good afternoon.

Operator

The next question comes from Mr. Garcia with Bradesco.

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

Good afternoon. The first question is about construction and contingencies with 94 million in Northeast. And since this is the second occasion in two or one or two years you have that other case that was actually under the responsibility of your partners, but you actually have to take care of what happened there. So I would like to know if you have been able to audit all of the project during that period with higher risks of having those contingencies. That is the first question.

The second question is, I believe that will happen in the Northeast started with the agreement with the prosecution office and you actually found problems in other projects as well. But my question is, why didn't we see those risks in the contingencies that have been approved? We can't find them. But it was probably something that you already knew that was likely to happen. So I would like to know why that risk did not appear even remotely in the documents?

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Luiz, this is Raphael. Well, we are not here to justify that type of loss. It's a lot of money. It's the second event, second time it happened as you well said. So it's about learning from our mistakes. The expansion -- accelerated expansion that we did last year was not good. We suffered from them. And we are responsible adults, if we make a mistake, we have to pay for them and learn from them. And we have to try and not be as incompetent "the next time". So we had many constructions during that expansion period.

I believe that the worst is gone and we cannot guarantee that we are not going to find those types of problems in other projects. Because we don't know exactly everything that's in there. But I believe that we have paid for most of our mistakes, BRL200 million in two events, that's a lot. But I believe that we are over that stage. And of course if something new happens, you will know about it. But I don't know -- I don't think that we're going to have that type of situation again.

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A - Miguel Mickelberg {BIO 20023910 <GO>}

Okay. This is Miguel. When it comes to the technical question, we followed exactly what CPC 25 says and provides for. When we were able to quantify the event, we registered the contingency, the allowance. Our engineers were to the field -- went to the field and when they were able to measure the loss, that's when we decided to provide for that amount in our balance sheet.

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

Okay. As a conclusion, do your engineers, are they doing that type of assessment now? And from what I understand, you are not conducting broader audits right now, are you?

A - Raphael Horn {BIO 19714328 <GO>}

Well, I am not going to go into details, but what happened in Vitoria was extremely serious. We had a collapse there and of course that is extremely serious, we didn't audit to understand what happened and the calculations were all okay. So, yes, we conducted an audit, and in other projects as well to see if we had similar risks elsewhere. Now in the second event, it was completely different. And I can give you details later. But it was not about any risks of collapsing. So the two events are related to two different problems. I cannot give you more details about those events because there are many clients involved, but the drama that we are facing now is different from the one that we had in Vitoria. So we don't have to conduct any audits right now, because the building is not under threat of collapsing. Those are different problems that we have to solve and audits are not going to solve them. But you can call me later and I am going to give you more detail.

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

Okay. Thank you very much.

Operator

The next question comes from Mr. Stacchini with Credit Suisse.

Q - Luis Stacchini {BIO 18717891 <GO>}

Good afternoon and thank you for the conference call. I have two questions. The first one is about launches that are going to increase and also finished units. I would like to know how have you been working to be able to manage the larger amount of project? And if you expect to see any impact on sales speed of finished units? And the second question is about the new initiatives and what do you think is going to happen with that business? Do you believe that we are going to see some streams of funding coming in the next months?

A - Raphael Horn {BIO 19714328 <GO>}

Hello, Luis. The question about finished units and launches is actually an endless question. There are always problems related to that situation. We do believe that we have found a balance. But of course there are dilemmas. But to sum it up, we do believe that the

situation is improving. We believe that our launches are extremely good. We're delivering them. Brokers are excited because there are customers coming to them, there are customers that are interested and we sell more finished units, because there are more customers. Sometimes they prefer to buy finished units. So everything brings oxygen into the context.

So we are not saying that we are not going to launch anything because we are focusing only on finished units. At the end of the day, we do believe that launching is a good option to bring some oxygen into our portfolio and sell both finished units and new units. Because the market is out there, the land plots have already been paid for and if the customers don't buy our units, they will buy someone else's units. So, yes, there is a dilemma, but it is our mission to solve that problem.

Now about cash needs. We are still in the first step. We are focusing on conducting few and good operations to ensure good returns and a low rate of default. And -- but it's too early to talk about our plans there. The most important thing right now is still we make money and not lose money with bad credit.

Q - Luis Stacchini {BIO 18717891 <GO>}

Okay, thank you very much. Good morning.

Operator

The next question comes from Mr. Manda with Santander.

Q - Renan Kato Manda {BIO 16845063 <GO>}

Good afternoon. Thank you for taking my questions. My question is about the city plan in Sao Paulo. It was announced a few years ago and there were flexibilization of parameters to allow for larger projects. And if I'm not mistaken, that flexibilization would end next year. Do you know anything about the possibility of extending that term? And if not, how that affect the medium and long term future projects?

A - Miguel Mickelberg {BIO 20023910 <GO>}

This is Miguel. Yes, indeed this topic is being discussed and we are following those discussions. If we have any news, you're going to hear about them.

Q - Renan Kato Manda {BIO 16845063 <GO>}

Okay. Thank you.

Operator

The next question comes from Mr. Mazini with Citi.

Q - Andre Mazini {BIO 20377100 <GO>}

Good afternoon. Thank you for the conference call. My question is about dividend. You're selling finished units and that's important for cash generation. So, I would like to know more about the timing and the amount if it's going to be in the first quarter of next year and your expectations about that.

A - Miguel Mickelberg {BIO 20023910 <GO>}

This is Miguel. Good afternoon. We are discussing that topic and in fact cash generation was very strong in the past quarters. We are going to have a Board Meeting and we are probably going to have that if not late this year, early next year. The amount, we don't know yet, we are going to discuss that with the Board. We have some debts maturing in the short term. So we are probably going to be very conservative, but we don't have the amount yet.

Operator

(Operator Instructions) The next question comes from Mr. Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Good afternoon. I have two questions. The first one is about the Northeast. You still have to spend some cash in the Northeast. I would like to know if that's going to happen in the short or long term? And you mentioned about Cury and Plano&Plano. Do you think that you have a competition, if the competition is tougher in the low-income market and maybe you are going to create a new brand to face that competition?

A - Miguel Mickelberg {BIO 20023910 <GO>}

Hello, this is Miguel. When it comes to allowances, we have around 60 million to spend in the short term till March to April, most or all of that amount will be spent.

A - Raphael Horn {BIO 19714328 <GO>}

This is Rafael. It's what I said before, the market is there and it's good. We have funding, the segment is performing better than the other ones. So what's our bottleneck there, it's not knowing how to purchase a land or not knowing how to build. When you have good opportunities, you have to seize them. But we are not moving to new towns or cities to be in the Minha Casa Minha Vida market. We are not making any extra effort to go to other markets. If we find good opportunities and good plots of land, we seize those opportunities. And if you know how to work in the high-end and medium range markets, you just need good people to work in the low-income market. We have those people. So when we find good opportunities, we seize them, but we are not going to compete with other companies that are focused on the low-income market and they have more potential in that market.

So we are not going to move in that direction. If we find customers and if we have the right opportunities, we take them. But we have partners for that market and we also have partners in the medium-range and high-end markets. So that dynamic is natural. We are partners with SKR. We have many different partners in the medium range and we have been living with them in the market for a long time very peacefully.

Operator

(Operator Instructions) Excuse me. There are no more questions. So I would like to turn the floor over to Mr. Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Our results were not that good and we suffer as well. We are paying the price for our accelerated growth that we had in past. We are excited about the new situation in Brazil. And we expect to see a positive path, not only for Cyrela, but for the sector as a whole. The past three and four years were extremely tough for everyone. And I think it is likely that the entire market will feel things taking a turn for the better. I hope that our next call we will have better results and better news. So let's keep up with the hard work.

Operator

That concludes Cyrela's conference call for today. Thank you very much for your participation. You may now disconnect.

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