Q1 2015 Earnings Call

Company Participants

- Eric Alencar, Chief Financial Officer
- Raphael Horn, Co-CEO

Other Participants

- Fred Mendes, Analyst
- Luiz Mauricio Garcia, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to Cyrela Brazil Realty Conference Call for the Results of the First Quarter 2015. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-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 at www.cyrela.com.br/ri. This call is being simultaneously translated in English, and it being broadcast over the Internet. Questions can also be done by participants connected from abroad. The earnings release published yesterday, May 14, after the closure of the BM&FBOVESPA trading session can be accessed also on the company's website.

Before proceeding, we would like to mention that any forward-looking statements that may be made during this conference call relating to the company's business prospect and projections, operating targets and financial growth potential are based on management's expectations about the future of Cyrela. These expectations are highly dependant 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. Eric Alencar, CFO and Investor Relations Officer.

Now, we'd like to give the floor to Mr. Raphael Horn. Mr. Horn, you may now begin.

Raphael Horn {BIO 19714328 <GO>}

Good morning, everyone. We have been following up the economic measure that have been implemented by the government. We believe we are on the right track. There is no doubt this is the best path to put Brazil back on track. The long-term potential of Brazil is undeniable. We firmly believe the country and the market. Unfortunately, the short-term consequences show quite a challenging scenario. The forecast consolidated a slowdown in 2015 and increased unemployment rates undoubtedly affect consumer confidence and generate an increase in delinquency. Now (inaudible) this quarter may spend credit policy more restrictive and company's more selective access to credit. We believe our solid financial condition and credibility with bank is a uniqueness for us. If on the one hand, we have a lower demand. This scenario also brings significant drop in supply which will make the market more healthy in a mid to long-term basis.

In such environment, we will have a challenge to overcome this turmoil in a balanced manner and also get the company ready for the growth of the company. Our conservative financial approach should be combined to our vision for the future the pillars, people, culture and management, which are part of our company are critical for our success. This year the land purchase will be opportunistic and launches will be selective. With innovative products that meets the real demands of our buyers, I'm confident we have a very experienced team and we will be very aggressive with the launches in our land.

When it comes to our inventory management, our management considers it to be top priority. We've been trying to have relentless management product by product. We delivered all our projects in Salvador and

Florianopolis. In other words, inventories in these regions can only go down. Natal, sales are expected to be completed this year; altogether we delivered 31 projects which acts PSV of BRL2.5. Again, we've had significant cash generation, 402 million standing mainly from the strong delivery volumes in the fourth quarter of 2014 and first quarter of 2015 along with disbursement with land purchase. In addition to meet mandatory's dividend that will be distributed in June, we have already shares repurchase 50 million in stock.

Now let's move on to our operating results. On slide five, we'll be addressing Cyrela's consolidated results. In the first quarter of the year, we will launch BRL463 million vis-a-vis, BRL1.915 million in first quarter 2014. This quarter, the company focused its efforts to launch new phases of previously launched products. These projects account for 57% of the total PSV this quarter. The company stays with the volume launched went down from 90% in the first quarter of 2014 to 72% in the same quarter of 2015.

Excluding swaps and launches of MCMV Faixa 1, the volume launch in Cyrela share went down 72% quarter-on-quarter. This quarter, with high launches of Living Friends in the city of Rio which had already sold 50% and Verdant Valley also in Rio, both with good sales performance.

On slide six, we show Verdant Valley and Living Friends. Turning to slide seven, we'll be addressing our sales performance. In the first quarter of 2015, pre-sales totaled approximately BRL720 million vis-a-vis BLR1,500 million in the same quarter of 2014. Excluded swaps on MCMV Faixa 1, pre-sales totaled BRL570 million in the CBR stage, a drop of 35% when compared to the first quarter of 2014, mainly driven by the lower volume of launches this quarter. Pre-sales of Sao Paulo and Rio jointly accounts for 77% of our sales this quarter.

On slide eight, we'll be addressing our sales speed. Sales this quarter contributed for the company to reach an SoS, annual SoS of 42%. In terms of performance by vintage we sold 31% of the project launch this quarter. The product launch in 2014 have sold more than 50%.

On slide nine, we'll be addressing Cyrela's total inventories. By the end of the quarter, the inventory at market value totaled BRL6,900 million, a reduction of 6 vis-a-vis the previous quarter. A change in our inventory can be seen on the chart on the right. Finished unit reached 23% of our total inventory. This increase had already been seen by the company and shows deliveries of projects with high inventory levels with low performance of low demand ranges.

On slide 10, we'll be breaking down finished units. This quarter, we managed to sell 11% of finished units in the beginning of the quarter. Adding inventory of project delivered this quarter and appreciation of the unit with inventory at a hike of 13% vis-a-vis the fourth quarter of 2014 (inaudible) of the importance of this profit to the company and we'll keep on focusing our sales effort in this product. Regions, Northeast and Espirito Santo account to 40% of the company's finished unit. Natal accounts for almost 70% of finished unit in the Northeast.

On slide 11, we'll be addressing the units delivered. This quarter, we rather delivered 31 projects, approximately 7,000 units vis-a-vis 5,500 in the previous quarter. The units delivered in this quarter accounts for PSV of BRL2,500 million. In the beginning of the year, we delivered the last project under construction in Salvador and Florianopolis.

Next, Eric will be addressing the financial results.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Raphael. Good morning everyone.

On slide 13, we will be addressing the financial results. The growth revenue was 1.1 billion this quarter, 32% below the revenue of the previous quarter and 21% below the same -- the revenue of the same quarter of the previous year due to lower sales volume this quarter. Gross income was BRL361 million, 27% lower than the previous quarter, and 18% lower year-on-year. The company's gross margin in this quarter totaled 34.8%, 1.6 percentage points above 33.3% in the previous quarter, and higher than the margin of 32.3% year-on-year. The increase in gross margin this quarter is due to the higher stake of project launched over 2014 with higher margins and also due to the lower sales volume of finished units this quarter.

At the bottom of the left, we analyze EBITDA. EBITDA this quarter was BRL154 million, 40% lower than EBITDA in the previous quarter, and 37% lower than EBITDA in the same period of the previous year. Net income this quarter totaled BRL101 million, 33% lower net income in Q4 2014, and 39% lower year-on-year. This drop in income this quarter was mainly due to the lower level of revenues. In addition, the company's net income was negatively affected by provision for legal claims amounting to BRL21 million. This was -- our net margin this quarter was 9.7% compared to a margin of 9.8% in Q4 2014, and 12.4% year-on-year.

Turning to slide 14, we'll be addressing our profitability. In the first quarter 2015, our return on equity measured as net income on its last 12 months over average equity of 10.6%. In line with our strategy to generate returns to shareholders, in 2015 we repurchased 47 million and approved in the shareholders meeting, dividend of 157 million to be paid in June this year, adding to a total of BRL204 million of pay off up to now. The company's earnings per share was BRL0.27 this quarter vis-a-vis BRL0.39 in Q4 2014, and $0.41 in the same period of the previous year.

On slide 15, we will be addressing the customer's financial solutions. In the first quarter of 2015, transfers payoffs and trust deed totaled BRL844 million, 7.7% higher than Q4 2014 and 13.1% higher than the first quarter of 2014. The number of units totaled 3.7 thousand, 7.6% higher than the previous quarter and 1.9% lower year-on-year. The volume of transfers and payoffs remains at healthy levels in line with the company's delivery level.

On slide 16, we'll be addressing cash generation. This quarter the company had record cash generation. This quarter, operating cash generation was BRL403 million. The strong cash generation this quarter is explained, number one, by higher inflow of funds due to the strong delivery volumes in previous quarters and due to the strong volume of finished units in the fourth quarter of 2014. Number two, inflow of BRL75 million by swap fund and number three, lower expenses with land.

On slide 17, we'll be addressing indebtedness. The gross debt at the end of the quarter totaled BRL3.8 billion. The cash position was BRL2 billion. As a result, our net debt was 1.7 billion. Of its total growth debt, 60% relates to financing for construction and 73% is long-term. Our net indebtedness over equity ratio was 27% vis-a-vis 32.8% in the previous quarter. This low indebtedness level combined with cash generation confirm Cyrela's financial sound principle and place us in a privileged position to benefit from opportunities in the real estate market.

We can open for questions now. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we're starting now the question-and-answer session. (Operator Instructions) The first question is from (inaudible) Itau BBA.

Q - Unidentified Participant

Good morning, everyone. Thank you for the call. I have two questions. The first question is about finished units. It is doing off a lot, but I'd like to better understand the measures that are being taken. You mentioned in previous quarters that you already given more stimulus for brokers to sell and this had an impact on the commercial expenses, but what I want to find out is precisely the maximum level of finished units that you can get before, for instances, start giving discount? We don't want to have a mark down of availability on a region, so I want to understand your mindset about the sentiment or is there are other techniques to bring finished units to an end -- in addition to discount?

The second question is about level of revenues this quarter. There was a slight flop, but what I want to understand is considering that part of the gross came from lower sales, what is the bottom half? So if a guy visits and he is willing to buy, does he really have long mark financial or mortgage, so in each one of the three phases do you have a stronger bottom line that affect sales for you this quarter? This quarter when it comes to the structure to the business, I'd like to understand we might expect this level to the future of -- one of circumstance? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Ario [ph], Raphael speaking. Your first question is about finished units. We had already given signs about it. Unfortunately, we'll keep on delivering in 2015, the ranges in which we have lower demand. We want that it will be up and it is. We know this is bad and we are far from zero which is good inventory.

So we are paying keen attention and we are also very much concerned and very uncomfortable with our finished unit, but once we are delivering this kind of region, there is no margin, there is not much we can do. It is a fact. Now, it's up to us double our attention, our efforts, our focus and methodology to fix the problem. We want to solve it all in 2015, maybe we can do it on 2016 going forward. We are trying to have zero finished units, but we have far from our goal and objective. Discount is not the only (inaudible) there are many other things that can be done, basically divide down to management, focus, the mission, motivation, campaign, many things can be done. Investments for the unit value by bank and we are going to do it all.

The second part is about the movement of our brokerage. Well, in our third quarter, we sold less, but we have been also launched much less, inventory by inventory. Organic base, let's focus on organic goods sold, it remain the same year-on-year, virtually the same. The answer is yes. There is move, there is demand, but this is very challenging. Customers come to us, they ask questions, but we believe we'll keep on selling. So that's the challenging moment, it's applied to double our effort. There are ups and downs in the market, this is definitely not (inaudible) and we have to keep on doing our job.

Operator

The next question is from (inaudible) Merrill Lynch.

Q - Unidentified Participant

Good morning, everyone. Thank you for the call. My first question is about the reduction in working capital. Cash generation in the first quarter was very much delayed into reduction in receivables. In this quarter, it was very much affected by a reduction of the land bank. Seeing there is more to take away from receivables in terms of working capital and what about the user proceeds, you have 7% (inaudible) how do you feel that, what about buy back, what about this scenario?

Could you comment on mortgage you mentioned in the beginning of that call that you will be more cautious that scenario is more challenging. Then what about the outlook of launch for the year? Could it be converted in purchase of land. There is a benefit cash generation, but basically what I want to understand is your cash generation going forward.

A - Eric Alencar {BIO 18098474 <GO>}

(inaudible) Eric speaking. Let me start by answering your question about working capital, because we delivered 3.5 billion for sales, 700 million, this is at a higher level compared to the sales (inaudible). We still have -- lower receivables through cash generation and -- working capital the main focus of the company has two directions. The most important is semi-finished and finished units. If you're going down this idea, this generates cash, revenue and it reduce allocated capital. As every day we talk about finished unit's interest, that's a consequence of delivering the work and in advances.

You also asked about land. For land, we still have land bank and we have the land bank ready for future use which doesn't mean you won't buy any more. Our raw materials is less, but we are becoming more opportunistic. As in the loan scenario, (inaudible) focused company that -- customers we understand into half loan for higher cost definitely. At the end of the day, we want to have this opportunities. This barrier entry by other companies to our benefits and also applicable to that.

Operator

The next question is from (inaudible).

Q - Unidentified Participant

Good morning. (inaudible) speaking. I think my question were already answered, but I would like to know more about the scenario of launches, sales and SoS for the first half of the year?

A - Eric Alencar {BIO 18098474 <GO>}

Good morning. Launches, we've been selective already. For the last recent years, that will be even more selective over 2015. It is a challenging market, you have to cautious, and only launch what will profitable, be very selective . At the SOS, we don't give a guidance for SOS. As we can generate a best SOS we can. This is it. The market is challenging and will be focusing on increasing our efforts foreseeing even better results in the future.

Q - Unidentified Participant

Okay. Thank you.

Operator

The next question is from Luiz Mauricio Garcia, Bradesco.

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

Good morning. My first question is about the swap fund? What do you expect to be generated to the company. And sales can be more significant down the road that may be swap funds could offset that, because it might generate a lot of benefits. So could you give us an order of magnitude more in the pipeline in addition to the 75 million[ph]. What should we expect in the future as to the use of the speed Eric. Do you also still the need that will have a higher liquidity reserves also to finance customers, which isn't moving the past [ph] and considering the current scenario half company with a lot of liquidity to do that and it might be a solution for a more credit restricted moment.

Second question, could you quantify the savings and how much is really benefited the gross margin in some of your projects and do you see more opportunities for projects in the future. We will consider you might have lower cost in some lines like (inaudible) could slow down? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Eric speaking. How are you? Let me start by answering your question about the swap fund. The swap fund is very hard to do the forecast of what else we can do, but for the next two years we expect to have another 100 million for the funds. And to the right churn, we don't have to say anything, because we don't know what the debt line will be. As for the use of proceeds, you're right, the new credit scenarios, some companies might have condition different from customers and it might be a possibility for Cyrela, particularly Asians will have 60% (inaudible).

So maybe we can have finance for IGPM as well. This has to be discussed with the company and let me tell you why, because credit is not over yet, we don't see a closing, we have interest rate, but we haven't got into that yet because we do have loan in the market for customers and we believe it will keep on happening for both customers.

You also asked about construction of projects savings. Net savings was 6 million, particularly in region in Sao Paulo and Rio. Whenever I say this, we immediately account that in our balance sheet, but I cannot give you a forecast, because if I had it, I would have included in the balance sheet today. But I can tell you that with this drop in the economic activity, it will have a move, it will be motivated savings than to have in an access in projects.

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

A follow-up question about loan. About project financing with plenty of cash. How do you feel this and the managing to offset this with order banks, in addition to Kaisha [ph] you also had some projects that moved by Kaisha, some it is right, but how do you feel this, do you consider other banks?

A - Eric Alencar {BIO 18098474 <GO>}

Let me tell you about our operation. Whenever we have the transfer, the customer always had the credit approved by two or three banks. And with these two or three banks, we have the approvals. So we always have one open door, regardless of the bank involved in transfer. Yesterday there was an increase interest rate by bank.

We have to see what the impact will be, anyway its going to lower affordability (inaudible). For the moment regardless of the bank Kaisha, Itau, we still manage to approve loan for individual. And we don't have an increase in termination rates for credit regions or for a better facility, up to now, the main reason why we did not have an increase in termination rates because you've always or customers have been through more than one bank, one bank finally and always approve the customer. And on a monthly basis, we check for changes that both are within the scenario in basis [ph] for the future.

We tend to have good customer loan policy. So we expect not to be so much affected. We expect customers to have loan approval. This has not affected us yet and we hope it won't affect us in the future event.

Operator

The next question is from Fred Mendes from HSBC.

Q - Fred Mendes {BIO 17221617 <GO>}

Good morning, everyone. Most of my question were already answered. I think I have just two questions. First question, G&A quarter-on-quarter an 18%, do you have any possible reduction in personnel. Second one which is very striking and it is the suitable provision which is nearly flat. Labor claims have increase, it makes sense a lot of deliveries in technology, then now people try to benefit, because they don't have so much to be delivered, but double claims were flat? Could you tell us something about the future? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hi, Fred, Eric speaking. Let me begin by talking about G&A, and later on we can talk about litigation. You're, right. The internal part of our G&A has been going down. You are being doing internal efforts to lower rate for the last three years. So this quarter we don't have anything significant, but compared to the previous year, salaries from 46 million to 42 million, and this quarter specifically there is something that we also reduce our stock option 6 million to 1 million compared to last year. So this helps us. Our philosophy is having G&A adopt to the size of the company and not the other way around. So we always want to have a link company.

Please be reminded that less than one third of the company's expenses are related to the business. So whenever we have this volatility in launch, it doesn't necessarily need that you have immediate G&A reduction. It is has to be ongoing. As to provision our legal claims, this quarter as of you can see an explanatory note 19. several claims were flat. You're right. But I'd like to let you know that, it doesn't mean it will be a trend [ph]. Every quarter, our lawyers will visit all legal claims, considering previous agreement or (inaudible) In the civil area what happen this quarter is that they realize it was a little bit higher considering some agreement, and they manage to lower some provisions from affordable to possible ordinary, it also bit happened in labor. We must work a little bit higher than expected, calling for an increasing provision.

For 2015, there is no new events that shows provisions to the business compared to 2014. So when we try to think about the future for civil and labor level should be similar to the previous year.

Q - Fred Mendes {BIO 17221617 <GO>}

Okay, fine. Perfect. Thank you, Eric.

Operator

The next question is from Lucas Junior, Bank of (inaudible).

Q - Unidentified Participant

Good morning, everyone. I would like to just to get a comment about JVs performance, particularly according to this quarter, any better cash generation improving the consolidated results? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Lucas, Eric speaking. If you want to know about JV's results, particularly in Cury, I couldn't hear it properly. Yes you're right. Cury is our equivalent tool. 6 million profit at 6%, but it was low considering the company's size. This is mainly due to the low (inaudible) in January and February. This is common in Cury, it also happened last year. 5 million last year in the first quarter, and they closed the year with 135 income. So our forecast at Cury is profitability, -- profitability, but in the third quarter, we usually have this.

Operator

Thank you. Next question is from us Marcelo Motta, JP Morgan.

(Operator Instructions) Thank you. Excuse me, there are no further questions. I would like to give the floor back to Mr. Raphael for the closing remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you all for joining us. Rest assure, we will be doubling our effort. We always have a better and worse scenarios, but that's no excuse, selling less is no excuse. We'll have to try to boost our sales and we'll be cautious, prudent for the solid approach, always search for the better, obviously with more selected launches. When it comes to an inventory, we simply have to sell and boost our sales and that's what we do this year. Thank you very much. See you in our next call.

Operator

This concludes Cyrela's conference call. Thank you all for joining.