Q1 2016 Earnings Call

Company Participants

- Antonio Emilio Clemente Fugazza, Chief Financial Officer and Investor Relations Officer
- Pedro Henrique Rocha Nocetti, Investor Relations

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to EZTEC's First Quarter 2016 Results Conference Call. Note that this event is being recorded and that all participants will be in listen-only mode during the company's presentation.

After the company's remarks are completed, there will be a question-and-answer session when further instructions will be given. (Operator Instructions) Today's event is available through a live webcast that may be accessed through the EZTEC Investor Relations website at www.eztec.com.br/ir by clicking on the banner 1Q '16 Webcast. The following presentation is also available for download on the webcast's platform. The following information is stated in Brazilian real and in BR GAAP and IFRS applicable to real estate developers in Brazil, except where stated otherwise.

Before proceeding, let me mention that any forward-looking statements made in today's conference call regarding the business outlook, forecasts, and financial and operating targets is based on the beliefs and assumptions of EZTEC's management and the information currently available to the company. Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events. And therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of the company and could cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Emilio Fugazza, Chief Financial and Investor Relations Officer, who will begin the presentation. Mr. Emilio, you may begin the conference.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thanks very much. Welcome and everyone to our first quarter 2016 presentation of the results. I am Emilio Fugazza, CFO and IR from EZTEC, and apart from myself are Mr. Pedro Nocetti. We would like to inform you the operational and financial highlights from the company this quarter.

Since 2014, we have been talking about a challenge, a challenging market, challenging real estate market and the tough decisions we have to make. However, we established a commitment with our shareholders to deliver as good as possible outcomes to you guys with transparency and always thinking about the future of this company.

The results, the financial results in the first quarter 2016 shows the decisions we had to make in this tough cycle of the real estate market in the City of Sao Paulo, in the metropolitan region of Sao Paulo with not so good margins and not so good margins compared to the last year's. However, are lot superior from the average of the sector without putting in risk the health of the company, the financial health of the company. However, we started 2016 having a generation of cash, that generation of cash which came from managing receivables and trying to draft the delinquents from higher rates in the past to better rates now in the first quarter 2016. Apart from that trying to save budgets in our sites under construction and because of it, I'd like to show you the slide number three, would like to talk about some operational and financial highlights.

The company has launched Le Premier Moema in the south zone of Sao Paulo with 38 units of high end standards with a potential sales value of the company of BRL52 million. We launched this project in the first quarter, in March of the first quarter and we sold something like 32%, 34% of this project.

Sales; we had sales -- sales, BRL24 million of net sales in this first quarter and the land bank of the company ended up with a potential BRL5.8 billion in the potential sales value. From the financial side, the company stayed in 47% gross margin, the company stayed in 47% gross margin reaching BRL7 million to BRL1 million in the first Q 2016. The net income reached BRL74 million in the first quarter 2016, net margin reaching 49%. The adjusted unrealized return on equity of the company was 12% in the first quarter.

Let me remind you that the General Meeting of the shareholders was approved something like BRL155 million of dividends we already paid in May 10th 2016, representing a payout of 35.01%. Net cash; net cash position reached BRL235 million having generated BRL69 million in the first quarter 2016 plus performed receivables of BRL503 million, part of it adjusted by ITPM plus 10% or 12% p.a.

Let me hand over the presentation to Mr. Pedro Nocetti to talk a little bit about the operational highlights and then I will come back talking about the financial highlights. Pedro, please go ahead.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thanks, Emilio. Good morning, everyone. Please turn to slide number four, I'll talk about the land bank. As Emilio said, ended the period, ended March 2016 with some potential sales value part of the company, 5.8 billion, in which we have an average acquisition cost including costs with the expansion of the potential construction area of this project of 13%, BRL770 million, in which we have also 60 million to be paid for the -- is due to be paid for these pieces of land.

Please, looking at the chart on the top right, 68% of this land bank was acquired since -- was acquired after 2011 -- since 2012. Looking at the slide, or looking at the chart on the bottom left, 76% of the land bank (inaudible) to the residential from the middle end it turned to the high end, served at 23% to the commercial segment, in which we -- in which comprises projects, corporate projects like EZ Towers and other types of commercial projects should be launched, should be developed in -- when we see a better scenario in terms of Brazilian economy.

And finally, looking at the chart on the bottom right, the location of our land bank, 93% of it in the Sao Paulo metropolitan area, including the City of Sao Paulo. Also, this is something that I have been saying considering the last conference calls, we keep our confidence in the region. We are actually -- we keep our confidence in the Sao Paulo metropolitan area. We understand that in a huge City like Sao Paulo there are good opportunities to be taken by the company, in different segments, in different neighborhood, there are demand even in a tough scenario like this and these demands are -- we will be -- we will take advantage of these demands, as I would -- I was -- tell you further we will -- we have already launched in 2016 and we will launch again in 2016, as I will tell further. First of all, I would talk about the first quarter in terms of launches. Please turn to slide number five. We see the project Le Premier Moema launched in March, as Emilio said, with a PSV part EZTEC of BRL52 million and now has 34% of the total 38 units, high-end units already sold.

We, looking at projects like these, after almost 45 days after the launch, it is already 34% sold, it's performing well, in the view of the management is performing well. And projects like this are something that we will try to repeat along the year 2016. And I will talk a little bit more about them in the slide number six, you see the upcoming launches. First of all, the project is Splendor Brooklin, when hard to say, all those projects, they are located in the City of Sao Paulo and in the south zone of Sao Paulo in different neighborhood, but in the south zone of Sao Paulo, most of them, that's into the high-end segment and one of them, that's into the middle high-end segment, the focus of the company in the -- along the year of 2016.

First of all, the Splendor Brooklin is 99 million of own PSV, after that the project in the street, Joaquim Guarani, the piece of land called Joaquim Guarani with 85 million of PSV, quite important to say, the Splendor Brooklin has -- more than 200 square meters per unit. The project Joaquim Guarani has more than 100 square meters. And the project per unit -- and the projects in the street Santa Catarina has something like 67 square meters per unit comprising total PSV of BRL71 billion. And finally, to be launched more close to the end of the year the project in the road Cotovia, those -- this project is -- has smaller units like 26 square meters to 47 square meters per unit totaling a PSV of BRL122 million.

Now please turn to slide number seven, I would talk about the contracted sales in the first quarter. As Emilio said, it ended the period with a total of BRL24 million, liquid of cancellations and 62% of those sales refers units launched in 2015.

Looking at the chart on the bottom right, you see the inventory by launch date. You can see that 41% of our inventory is -- has already been concluded. Looking at the units which that are under construction, units launched after 2013, they are more than 70% sold. And finally, the units that the company launched in the last 12 months, they have -- they, on average, they have achieved, its 50% sold after six months from the date, from the day it was launched. So we still feel confident about this inventory, which ended the period with BRL1.19 billion. We still feel confident about our inventory, but the fact is that's the way we manage the company.

Being more aggressive in terms of price has the right time, it's not something that we can do, we can do always. So we prefer keeping our receivables from the sales done in the previous years in order to turn them into cash. And we are -- we have been successful in terms of doing that as we -- as Emilio said, we generated 69 million in terms of cash in the first quarter.

We prefer guaranteeing those receivables, then accelerating the sales speed by giving huge discount on all, on the whole inventory. Therefore, it means that in some periods, we will have lower sales speed, but we feel confident about what we have in our assets in terms of our receivables.

By saying that I will ask you to turn to slide number eight, I will talk about the sales turnover before handing back the presentation to Emilio. You are seeing that this slide, you are seeing a chart that we have been presenting in the last three quarters. You can see that the cancellations, on average, looking at year of launch, the cancellations that have -- the variation has been from 15% in 2007 to 24% comparing to the unit launch in 2012 and that have already been delivered.

Looking at the units launched since 2013, we expect -- which we don't expect then the cancellations of those units should increase much, until those units are delivered. Therefore, we can expect an increase in terms of cancellations from the units launched in 2013 as we are delivering them right now. But I don't expect a huge increase in terms of the units launched in 2015, for example, because we still have the cycle of life of the project in which great part of the consolidations usually come when you are delivering the project.

Very important to say, in the last quarter, fourth quarter, I mentioned that we did a provision for cancellations in the amount of 25 million. Nowadays, looking at the first quarter 2016, there was no need to increase this provision for cancellation. So we are dealing with the clients, we are dealing with the cancellations every day, and we have been successful. We have been decreasing the ratio of the fall of the company and this is being done by hard work, by dealing with each client finding tailor-made solutions and keeping the health of the receivables of the company.

By saying that, I will hand back the presentation to Mr. Emilio Fugazza, who will talk about the financial highlights of the company, please Emilio.

Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much, Pedro. Let's talk about financial performance on slide number nine, starting with the net revenue on the chart on the top left. Net revenue came at BRL150 million first quarter 2016, compared to 232 first quarter 2015. So this huge drop, a drop of 35% was presented because, essentially because of a huge increment in cancellations this quarter. Let me remind you that the gross revenue came only 12% less than first quarter 2015, but net revenue there was a drop of 45% mainly because of the increment in the cancellations.

And let me explain a little bit more about cancellations this time. Cancellations, they occur because specifically people are not -- they lost their affordability to get the financial -- to get the financing from the banks, mainly because of their losing their jobs or mainly because the price of the apartment is dropping a little bit in some regions of the City, of the metropolitan region of Sao Paulo. It's that because it -- essentially people who are selling those units for prices -- minus prices than in the past, but because the banks, I go into that place, looking at it and thinking that there are huge inventory on that area and because of this mainly some real estate developers have to sell their apartments for prices, less prices than in the past.

And because of it, obviously instead of offering a financing of 80% of the total amount of the debt the client has, they offer something close to 70% or 60% and when the client has no condition to fulfill this difference with the real estate developer, with the developer -- to the developer, obviously, we have to deal with the situation, and in some cases the bottleneck is going to be cancellations on this unit.

This is happening with the units launched in 2012, 2013, mainly units we delivered in 2015 or we are delivering in 2016. So that is one of the main factors come in to show you that the delinquents dropped from 6% for first quarter '15 to 1.86% in 2016. So many of those cases, we are solving or we solved in the first 2016.

So seeing that, let's talk about gross margin and gross income on top right. Gross income came at BRL71 million, a drop of 47% in first quarter compared to first quarter 2015. Margins remain steady coming from fourth quarter '15, represent something close to 47%. So 47% is almost in line with the backlog margin showed you since the fourth quarter 2015. So, in my personal opinion, we have to bear in mind that we are, in one side, selling the apartments with less price than in past. But on the other side, we are saving money during our construction. So every single site under construction, we have been -- we have done in the last two years or 18 months, we have been releasing some savings over this construction. And that can offset the discounts we are providing to our clients, to our new clients, in new sales we have been doing.

Talking a little bit about expenses; expenses from G&A or from selling, let's talk from G&A on the bottom left. Bottom left, you can see BRL22 million in expenses first Q 2016, G&A expenses, which is a drop, nominally a drop coming from the first Q 2015. And, but this is -- in this BRL22 million, you can count on adjustments we have been doing since 2014, but we have also non-recurring event like some labor costs, because of these adjustments. So the recurring G&A expenses, this couldn't be a little bit better than BRL22 million. My personal opinion, to 2016, we could plan something close to BRL19 [ph] million for G&A expenses adjusted by all the fired people we have been doing since 2014.

In terms of selling expenses, however, the situation is not the same, so came from BRL12 million to almost BRL15 million, that's because when you see 15, is including some fees to pay to the brokers, because in the past, all the fees we have to pay to our brokers, we paid apart from the regular sale. And nowadays, we are almost 50% of the total amount of fees, nowadays we are paying [ph] inside the price of the units and apart from it, all the costs like tax and maintenance costs of the inventory ready to leave -- the inventory ready, we have to count all the selling expense. Just to bear in mind, we have been spending something like BRL1 million per month to support something close to 1,400 units ready and all the costs and taxes are passing through the selling expenses.

So, compare it to the G&A expenses, which I forecast some drop in the coming quarters. In terms of selling expenses, I'm forecasting remaining steady or a little bit higher than we are watching this quarter, this first quarter 2016.

On page number 10 you can see the financial results coming a little bit higher is simply because of two sides, one of them is the performance of receivables, we have more sites under construction being delivered and because of it one part of it is a bridge loan waiting for the moment to bring these receivables to the banks.

In the meantime, they are passing through our balance sheet. They are compensated by IGP-M plus 12% yearly, which means fairly something close to 18% to 19% yearly. And apart from it, the amount of compensations in our net cash position. So the average position of cash we have in the first quarter was something close to BRL450 million and from this we have compensations of 100% of the base interest rate in Brazil, which means 14.25% and almost nothing about to pay in terms of income tax. So and because of it, so more cash, more compensation, more yields and because of it, an increment in financial results.

Let me remind you -- let me remind you that they -- just one week ago, we paid a BRL155 million in dividend and because of it, the total amount of financial results for the coming quarters is not going to be the same of the first quarter, because one part of this cash was paid by dividends.

In terms of equity income on top left -- on top right, I'm sorry, in terms of equity income, they are representing much more from our net income than in the past. So, used to be 22% of the total amount of net income of the company is coming from equity income; nowadays, close to 31%. Let me show you that in fact, results coming from equity income are nowadays being benefitted by very good savings on construction, constructions delivered in this quarter, delivered in the first quarter 2016. And those savings resulted in a gross margin of something close to 66% in equity income, in constructions shared with our partners. And because of it, obviously, BRL22 million being a percentage of 30% of our net income.

In terms of net income, on the bottom left, you can see 49% of net margin as a result -- is a total result of BRL74 million, is easy to explain, because something close to 45% less net revenues coming to almost 30% less -- I'm sorry, 45% less net income. So, in the mean -- in between the expenses and the financial results, we have a offset coming to no additional loss in terms of net income. In terms of the results to be recognized, the backlog margin remains the same, 51%, is staying at BRL308 million. This show you that the results -- the gross results for the coming quarters is going to be the same you are watching today.

Let's go to page number 11, only to see that from year-to-date -- I'm sorry, from the last 12 months, the margin, the gross margin of the company is about 48%, the net margin of the company about 52%, and the good news is about the generation of cash. The generation of cash coming from the fourth quarter 2015 end at BRL69 million, meaning that all the constructions we are delivering to our clients, we have been delivering with contracts, with financing from the banks, turning those receivables in cash to the company, in a higher level than the past quarters.

Let's go to page number 12 only to show you that from the results of 2015, the General Meeting of the shareholders approved BRL50 million additional dividend coming to 155 total amount of dividend already paid at the beginning of May, which means that the pay-out this year coming from 2015 paid in 2016 was 35%, almost the same of 2014, which means that no additional investments due in [ph], coming -- going forward for the company. We are trying to pay a little bit more dividends to compensate a decrement in operational results.

Apart from it, let me explain one extraordinary situation towards the capital increase by the law in Brazil. When earnings reserves surpass the capital of the company, we have to choose between increment this capital with the difference coming from the earnings reserves or eventually paying as extra dividends to our shareholders. So the decision of the company was to capitalize, also to do the capital increment of BRL136 million from this earnings and we choose doing that with the issuance of almost BRL8 million of common share, new common shares without any kind of dilution of our shareholders. The cost of this issuance of the shares, of this common share was BRL13.21 per share, which means the cost of the shareholders equity, the value of the shareholders equity.

The issuance of the 8 million new shares which means 5% bonus shares for shareholders. The meaning of that is only to ordinary people not companies, not asset management, but ordinary people to have a tax benefit, specifically in Brazil. And at this time, we have been counting on 8,000 -- 8,000 ordinary people as shareholders of this company. We thought that it was a very good decision to provide this and providing this tax benefit to our shareholders.

Page number 13, as we have been doing every time in this conference, the potential value for EZTEC. Nowadays, on the yellow box, you can see the shareholders equity of the company almost 100% of the share price. So, the shareholders' equity is about BRL2.7 billion and we can provide -- we can see only from numbers, from figures that coming for an operational -- our operation and now we can see inventory, Tower B of EZ Towers in backlog with a potential additional BRL7 per share without doing much more we have been doing now.

So, the selling inventory -- selling inventory, selling Tower B of EZ Towers and finishing the construction of the company bringing the backlog to the results, we can add almost BRL7 per share. And apart from BRL7 per share, the moment with economy provides, a room for improvement in terms of new launches, we can add something close to BRL16 per share in new launches coming only from our land bank. A land bank, almost 100% percent paid, so that provides all-in-all BRL23 per share for the next couple of years as we could see economy improving, new launches, new sales to the company.

And finally, slide number 14, which is very important to mention. Apart from all the operation we have, future operation we have, we have -- we can own our net cash position, which is BRL235 million, but also performed receivables of BRL500 million, unperformed receivables coming from units, we haven't finished yet of BRL900 million adjusted by INCC and all the construction we have from sites under construction from enterprise, 100% belong to EZTEC, BRL400 million to finish those construction and from those -- from these equity income, the balance of the equity income BRL300 million to come. So all in all, we can see, we can provide BRL1.5 billion in cash generation in the next two years. So apart from that, BRL1.8 million is we count on the selling of Tower B of EZ Towers and all the inventory of the company. So ending up in a BRL3.3 billion of potential cash generation. So all of this without debentures, without working debt from -- or working debts from the company. And because of that situation, I would like to say that all the healthier balance sheet you could see from EZTEC is going to be turned in a generation of cash to be reinvested on our operation or paid as extra dividends in the years ahead.

And that brings me to the final comments over this company, over this first quarter 2016 results. So the company is a company of 37 years old, a company in that because of a long time working on this real estate market passing through ups and downs in our economy, we know very well that in the quarters ahead, we're going to see a better situation for selling inventory and selling new launches without so much pressure in prices. We know that we can do that without doing some -- without investing so much money, because all of the lands and all of the rights to increase the potential we already paid.

And that's why we paid extra dividends reaching 35% of the net income of the -- from 2015, reaching BRL155 million of dividends. We have plenty of confidence in the value of the company, namely quality of our assets. So, and because of it, our Board of Directors have no satisfaction constantly, no satisfaction of the results, and we are working hard to try to provide you a better scenario for the next quarters. So far we have been working hard to provide selling with gross margin, administration with net margin. So all in all, to provide better results that the majority of the other companies in our sector. That's it. Thank you very much for your audience today and we are completely available to questions. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now initiate the questions-and-answer section. (Operator Instructions) It appears that there are no questions at this time. This concludes the question-and-answer section. At this time, I would like to turn the floor back to Mr. Emilio Fugazza for any closing remarks.

A - Antonio Emilio Clemente Fugazza {BIO 16474296 <GO>}

Thank you very much for your audience today. Let me remind you that apart myself and Mr. Pedro Nocetti, we both are completely available to further questions in our office. Thank you very much and see you on next quarter.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time. Have a nice day.