Q2 2014 Earnings Call

Company Participants

- Eric Alencar, Chief Financial Officer
- Raphael Horn, Chief Executive Officer

Other Participants

- Eduardo Silveira, Analyst
- Enrico Trotta, Analyst
- Gillian Capparelli, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcello Marta, Analyst
- Marcello Milman, Analyst
- Nicoli Sitaguana, Analyst

Presentation

Operator

Welcome to Cyrela Brazil Realty earnings call to discuss the results of the second quarter of 2014. All participants are in listen-only mode. And later, we will hold a Q&A session, when further instructions will be given. (Operator Instructions) This call is being recorded and will be available on the company's website, www.cyrela.com.br/ir. The call is also being simultaneously translated into English via the Internet.

Questions shall be made by participants connected abroad as well. The results released yesterday, August 13th, after the market closed, are also available on the company's website. Before proceeding, let me mention that forward-looking statements that might be made during this call relating to Cyrela's business outlook, projections, operating and financial targets regarding growth potentials are based on expectations and assumptions of the management about the company's future. Those depend upon domestic market conditions, the country's performance and international markets, therefore, are subject to change.

With us today, Mr. Raphael Horn, CEO; and Mr. Eric Alencar, CFO and Investor Relations Officer. Now, I would like to turn the call over to Mr. Raphael Horn. Mr. Horn, the floor is yours.

Raphael Horn {BIO 19714328 <GO>}

Good morning, everyone. We start this call sadly. We are very sad by the tragedy that happened yesterday. Cyrela believes in Brazil and democracy and meritocracy and especially in the ability of the individuals of making a difference. Mr. Eduardo Campos would surely make a big difference in the Brazilian political scenario.

About the macroeconomic scenario, as we have forecasted in the beginning of the year, we have a challenging environment, but that's part of the economic cycle. And right now, we have cautious moments and other times we have more favorable moments. Our 50 years of history and the quality of our projects are on our advantage. We have advanced in the first quarter and in the second quarter. Our forecast for launchings for the remaining of the year is as planned. We are still launching products, but we might avoid the launches if that is needed. Our commitment with profitability will always be there.

In this half of the year, we focused a lot on sales on inventory sales and especially on the sales of finished units too. We focused a lot on the company, especially in the quarter, the major news in terms of operating results are the result of sales of these finished units. Unfortunately though, we are still living with the delivery of projects that have a high level of inventory, but the focus is there. The challenge that we have ahead is very high and we have to be always a step ahead. It is very important to say that we had a consistent cash generation in the quarter BRL159 million. The financial soundness of the company will always be our priority. Now, so, we have distributed to our shareholders a volume above our profit. The dividends and buybacks amounted to BRL425 million, just in this half of the year.

I would like to highlight is that in July, we have bought back already over BRL174 million. We are constantly working to have a company that is perfect in terms of execution, we try to be a reference point in all areas with efficiency and capital allocation and especially having better people working with us. We have to do that not only in saying, but also in management and the execution of all our actions. This is being done with a lot of awareness and in a very serious effort and those efforts will show results.

Now let's turn to the presentation. On slide five, we will look at Cyrela's consolidated results. In the second quarter of the year, we launched BRL890 million vis-a-vis BRL1.8 billion in the second quarter of 2013. Cyrela launches share on this quarter were of 91%, higher than the one we had in the second quarter of '13, which was 71%. In the year, launches amounted BRL2.8 billion that is 3% higher than the volume launched quarter-on-quarter.

The company's share in launched volume increased from 67% in the first half of 2013 to 90% in this first half of the year. Thus, excluding swaps and launches of Minha Casa Minha Vida Faixa 1, the volume launched on Cyrela's percentage on the first six months of 2014 increased 39% vis-a-vis last year. In this quarter all launches were made on the Southeast region, a special highlight to the following projects the Misti in Sao Paulo and Encontro Imigrantes from Living.

On slide six, we highlight some projects launched on the quarter. Now let's turn to slide seven. In this quarter, pre-sales reached around BRL1.25 billion vis-a-vis BRL2.2 billion quarter-on-quarter. It is important to stress that in this quarter, there were no launches of projects of Minha Casa Minha Vida Faixa 1, which represented the BRL492 million in the second quarter of last year and BRL695 million on the first half of 2013. In the year, company sales reached BRL2.8 billion, 21% lower than the BRL3.5 billion of the first half of 2013. The drop was partially offset by an increase of Cyrela's shares on sales that went from 68% on the first half of 2013 to 87% in 2014.

Excluding swaps and sales of Minha Casa Minha Vida Faixa 1, sales went down 7.5% quarter-on-quarter. The states of Sao Paulo and Rio together accounted for 79% of total sales in the quarter and 81% of 2014 sales. On slide eight, we will talk about our sales speed. Sales in the quarter allowed the company an annual sales oversupply of 49% excluding Faxia 1 as was of the last 12 months with a 48%. Considering performance by the vintage, we sold 33% of projects launched in the quarter. At the end of July, products launched in the second quarter of 2014 were already 41% sold. The chart to your right shows sales performance by vintage launches. Those performances are aligned to our forecast.

On slide nine, we will turn to Cyrela's total inventory. At the end of the quarter market value, inventory totaled BRL7 billion, 2.5% lower vis-a-vis the prior quarter. Change in inventory is represented on the chart to your right. Finished units account for 15% of our total inventory. This scenario is stable vis-a-vis the prior quarter.

On slide 10, we will go into details about finished units. On this quarter, we sold 24% of finished units in the beginning of the period, taking into account finished units delivered in the quarter, and appreciation of units, volume remained stable vis-a-vis the prior quarter in nominal terms. We are aware of the importance of this matter to the company and we will continue focusing our sales efforts on those products. Northeast and Espirito Santo account for 37% of the company's finished units. Natal and Salvador represent 80% -- 86% [ph] of the finished units in the Northeast.

On slide 11, we'll talk about delivered units. On this quarter, Cyrela delivered 23 projects that is around 5,400 units. In 2014, the company has delivered 42 projects with 10,000 units delivered. Units delivered on the quarter represents a PSV of BRL1.8 billion. And year to date, this amount totaled around BRL3.4 billion. Next to Eric, who will talk about financial results.

Eric Alencar {BIO 18098474 <GO>}

Thank you, Raphael and good morning everyone. On slide 13, we will present the financial results. Gross revenue totaled 1.4 billion in the quarter, 3% higher than the first quarter of 2014 and 1% below the revenue of the second quarter of 2013. In 2014, gross revenue totaled 2.7 billion, an increase of 3.3% vis-a-vis the first half of 2013.

Gross profit was of BRL454 million, 4% higher than 1Q14 and 1% higher than the one of 2Q13 and 2014 gross profit amounted BRL891 million, an increase of 5.5% over the first half of 2013. Gross margin of the company was of 33.4%, 0.1 percentage point above the 33.3% of the prior quarter and also higher than the margin of 32.6% of the second quarter of 2013. In the first half of the year, the gross margin was of 33.3%, 0.7 percentage points above the margin of 32.6% of the first six months of 2013.

Now to the lower left chart, we analyze the EBITDA. EBITDA in the quarter was of BRL271 million, 11% above the EBITDA of the first quarter of 2014 and a 1% lower at the EBITDA of first Q, 2013. In the first six months, we had an EBITDA of BRL515 million, 3% below the BRL533 million quarter-on-quarter. Net income was of BRL169 million, 33% above the first quarter of 2014 and 8% lower than the one of the 2Q13. In the year, net income amounted 332 million, 8% drop vis-a-vis the same period in 2013.

In this quarter, in addition to the impact of BRL3 million due to land contract cancellation or sale, there are also expenses of BRL10 million through legal provisions for fines regarding the late constructions and late deliveries from poor performing vintages and despite of its non-recurring nature, those items may happen again in future quarters due to delayed construction work, pending deliveries and also to the company's efforts to reduce the allocated capital. All of those, which may incur in above the average land contract cancellations, along the second half of 2014. Therefore, our net margin in the quarter was up 12.4%, same as first Q, 2014 and 13.3% in the second quarter of 2013. The margin for the year was of 12.4% vis-a-vis 14% quarter-on-quarter.

Now turning to slide 14 with return on equity. On the second quarter of 2014, return on equity, that is net income of the last 12 months, over average P&L was of 12.5%, in line with our strategy of generating value to shareholders. In 2014, 425 million have already been distributed. Of those, 171 million as a minimum mandatory dividend and 254 million in shares buyback. In 2013, the company distributed 321 million as minimum mandatory or extraordinary dividend or as shares buyback.

On slide 15, we will describe that client financial solution. In the second quarter of 2014, we have transferred paid or in trust of deeds BRL971 million, 30% higher than the first quarter of 2014 and 4% above the second quarter of 2013. In units, there were 4,600, 21% above the prior quarter and 6% lower quarter-on-quarter. In the year, we transferred to 1.7 billion, a drop of 14% vis-a-vis BRL2 billion transferred in quarter-on-quarter. Regarding units we transferred 12% less in the year to date vis-a-vis the first six months of 2013. The volume of transfers and payoffs is still in healthy levels and aligned to delivery rates of the company.

On slide 16, we'll have cash generation. In this quarter, operating cash generation was of BRL159 million, same as the prior quarter and BRL5 million higher when compared to the second quarter of 2013. In 2014, we have generated already BRL318 million vis-a-vis BRL369 million on the same period of last year.

On slide 17, we'll talk about that. Gross debt at the end of the quarter amounted BRL4.2 billion compared to BRL4.5 billion of the prior quarter and BRL3.7 billion of the second quarter of 2013. Cash position totaled BRL1.8 billion. Gross debt decreased due to a significant volume of debt that matured along the second quarter, therefore, our net debt reached BRL2.5 billion. Over the total net debt, 57% are related to SFH construction financing and 79% are long-term debt. Our net debt over P&L totaled 39.4% vis-a-vis

37.8% on the prior quarter. The low debt level and the cash generation (inaudible) improve Cyrela's financial soundness principal and places in a privileged position to seize opportunity in the real estate market.

Now, let's turn to the Q&A session. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we'll now start the Q&A session. (Operator Instructions) Our first question comes from Mr. Marcello Milman from BTG Pactual.

Q - Marcello Milman {BIO 7252528 <GO>}

Good morning, everyone. My question has to do with the market and Cyrela. As you mentioned the quarter was lighter, we had a strong first quarter. You also mentioned that you would not have a problem to hold back launches if the demand is not that good. Can you give us a -- the EBITDA of the pipeline for the year as a whole or for the second half of the year because now you might have a better idea now, and obviously this is important because I would like to know the volume of launches from now on, some idea would be very interesting? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Good morning, Milman. This is Raphael. Just like we said in the call, the first quarter, and we think the situation is the same. Good launches by the right price and good areas and good project, we are selling those. So this quarter we have launched Misti Morumbi. It was very good in sales. Of course, it's not very good speed sales, but these are 30%, 40%, 50% sales on launching that is what we consider a good speed and that is going to ensure the margins, the company wants to reach. So that's one, the Morumbi was good. The one that we launched Imigrantes, the Living, was also good. We have one also in North region of Rio. It's a large project. We believe that we are going to have good return there. So, like we said, if we have good products at the right price, we sell. And we are still launching all products. We don't think that we have a low demand yet so far everything that we have launched is going good. We think the scenario is there and it is going to be there, but that applies for the second half of the year as well. But if there is any change in the macroeconomic scenario, we will have to review our plans. We are not going to just launch by launch products, but today the probable scenario is the one that we have already mentioned.

Q - Marcello Milman {BIO 7252528 <GO>}

Thank you. In the third quarter, you have already launched anything that was significant or not yet or are you going to launch it by the end of this quarter?

A - Raphael Horn {BIO 19714328 <GO>}

Well, in the first quarter, we just had July -- for the third quarter and we did not want anything in July. We had the World Cup, and half of the country was on vacation, but we will start doing it now, we're starting to have some launches, but launches should happen in more in September. We're working out the launchings in September.

Q - Marcello Milman {BIO 7252528 <GO>}

Okay, thank you.

Operator

Excuse me, our next question comes from Mr. Enrico Trotta from Itau BBA.

Q - Enrico Trotta {BIO 16742911 <GO>}

Good morning everyone. Thank you for the presentation. I have two quick questions. I would like to understand first, your inventory as you said you had a strong performance on inventory in the quarter but you have a volume of finished units and that did not change much due to the deliveries. What do you expect to see of those finished inventory along the second half of the year considering what you have to deliver?

And also if you can mention this finished inventory, it was very strong in the quarter. What is happening? Are you applying any type of discounts or a specific strategy? How is that impacting the margin of the company? And my second question, you mentioned in the call also you were still focusing on cancellations or to sell land to increase the capital allocation efficiency of the company. I would like to understand what we could expect in terms of land cancellations from now on and if those contracted solutions will have any cash impact that is relevant to the company? Thank you.

A - Raphael Horn {BIO 19714328 <GO>}

Enrico, this is Raphael. About finished inventory, what we are saying and we are discussing is focus, retool, follow-up, really to work on it. This takes a lot of time and a lot of concentration from the company, because we know how this is important. Unfortunately, we have already told you our finished units are not going to drop in volume for the next half of the year. We are selling those yes, but we are delivering them, those are not as easy to be sold.

This is a reality, it's not good, but it is reality. And what can we do, we are going to focus on those and try to work on the problem and we have heard the difficulty. We have been able to sell. We have been able to have liquidity, but this is no magic and the figure is not going to drop in the short-term, we expect that in 2015, we have a different reality but we still have some time to get here. About discounts, we do not like that generalized discount practice of 20 to 35 of discount. We do not like that, you know it very well.

We are very pragmatic and we need to make our efforts to sell. It has more to do with commission, with awards, with motivation, management and that helps a lot. Obviously, a little bit of price depending on the product, we could have a discount here and there, but that's not where we work, that was not what was responsible for the success of this quarter. Obviously, we do have good products, quality products and those have liquidity. And thankfully, our engineering team delivers good products and that helps to sell the quality make the difference. About Lands, I'll turn to Eric.

A - Eric Alencar {BIO 18098474 <GO>}

Enrico, hello. This is Eric. Well, it's part of our business to purchase and to sell land. We now are looking for higher profitability in the company. So what we are doing is it related focus in all lines that are below the minimum profitability of the company. We are canceling those contracts. It is difficult to know how much we are going to make on the next quarter or half of the year because that's going to depend on the market on sales opportunities for different pieces of land. But I can tell you two things, one, the cash impact is not relevant but most of time it is even positive. And for the next quarters, we surely have cancellation of lands, but it's difficult to know how much that is going to impact on the balance sheet. And just adding to that some cities, we did have land and we are no longer present on those cities. So, we are managing it, so that we can have the money coming back to the cash of the company. This is something important for the company and it needs to be done.

Thank you very much Rahael and Eric.

Operator

Our next question comes from Mr. Nicoli Sitaguana from Credit Suisse.

Q - Nicoli Sitaguana

Good morning. I have two questions. First, can you tell us what was the volume of disbursement with buying land in the quarter? And second, considering the perspective of this strong cash generation trend I would like to understand what are you thinking about defining a clear dividend policy? Do you increase an increase -- do you foresee an increase of payouts for one time? Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Nicoli. This is Eric. About land disbursement, in this first quarter, we have disbursed BRL300 million in land. And we have a possibility or a perspective up to the end of the year. We should have over around BRL500 million still disbursed. About cash generation, I don't know if Raphael wants to comment on that, but an important item is that we have generated a consistent cash in the last two half of the year's, but it is natural to our business the volatility in cash generation. Once, we have the cash generation, the menu is still the same that we've been talking about, that is we will be buying land that are good, that is a good opportunity.

We are very comfortable with our debt level and also distribution. Future distributions are much less a matter of the policy, but more a matter of the volatility of the market and not being able to generate cash. Did I address your question, Nickel?

Operator

Excuse me, our next question comes from Mr. Luiz Mauricio Garcia from Bradesco.

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

Good morning, everyone. Two questions, first, still talking about distribution, you had mentioned dividend and buyback that has been very strong. I am thinking about the company's point of view, do we still have a very uncertain macroeconomic scenario? And wouldn't it be wiser for the company to have a distribution policy and to leave the time and decision to each investor or the controlling shareholder should decide to invest in the beginning in the market, should -- might decide to invest later on, so the company would focus on the operation and leave the decision of the investment to the shareholders?

Therefore instead of buyback, you would focus on a distribution policy based on a range of net equity and a percentage of distribution of the remaining portion because some companies are defining payment policies twice a year. That would be the first question.

And my second question is considering Cyrela is operating in different segments (inaudible) with low income and is able to have an overview of the market, I would like to understand which market do you believe is the most resilient right now in the macroeconomic scenario and how flexible can you be to really focus on that market, like you mentioned in the north region of Rio de Janeiro?

I believe there you have a different position in Rio considering Baja also offers strong competition. But I would like to understand if you see flexibility to migrate to some segment that could be more resilient and therefore to be able to keep the volume of business that you expect. So, I would like to understand the strategic aspect of the operations.

A - Raphael Horn {BIO 19714328 <GO>}

Luiz, this is Raphael. About dividends or buybacks, we believe that and the Board also believes that the best use of cash, what we can do at those prices to maximize the value for a shareholder is to buy back shares. We trust in the company and we like that option. So the Board believes on that, but also we believe this could be done, so considering dividends and buybacks at this price, we rather do the buyback.

No matter the scenario, obviously the macroeconomic scenario is challenging, but we believe the buyback is very good and that's why we're buying back and good opportunities come up in complicated scenarios. And so the scenario of having difficult times is one of opportunities and according to what we're generating in terms of cash and if we can generate cash, we are going to use that money to buyback shares.

About the scenario or better about which market is doing better and which is not doing that good and segments, if you can mention those, yes. 03 is a segment in which we haven't done anything (inaudible) this year. But that's a segment that depends on hires from the government, and we were not hired this year yet and we hope next year or maybe for the second half of the year, we expect to be hired again. It's a segment that for those who know how to operate, it's a very good one. And if we can't be hired (inaudible) at segment, we will do it. This is a very good segment, therefore. And whatever we are able to do, we will do.

About mid income, high income or low income, we have small variations around those areas. But what is really key that a good product at a good price really sells. The North region of Rio that I mentioned is not low income, it's BRL7,000 a square meter at BRL7,500. It's a good product, and we feel very comfortable there. So this Living segment is going very well. The medium and high-end, we have more competition. So it's more difficult, of course. But we have been able to work there.

And I believe that our tradition and the segment really helped us. So under the current scenario, we do not expect to see significant volume reductions. Now, we'll be able to keep our volume in the segments in which we work. Our perspective is that, yes. In the current scenario, obviously, we should have maybe more -- something happens, radical changes could apply.

We have (inaudible) in Rio. It is a segment that is reacting well, it's medium to high end. And Living also is having a good reaction, obviously it's very much within the context. So while we have that we are going to bat in all segments that we like and on those that we know how to work on.

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

But anything that you mentioned on Living and this projects of medium and high end or -- but a little bit more affordable. Do you think they took ahead or were those a little bit less?

A - Raphael Horn {BIO 19714328 <GO>}

Well, we still have everyone employed. So if we do not have unemployment of those segments respond well. People purchase real estate because they need, so if we do not have unemployment in the country that is a good segment, the segment Living. Is that clear?

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

Yes. Very clear. Thank you very much.

Operator

Excuse me, our next question is from Mr. Gillian Capparelli from Citibank.

Q - Gillian Capparelli

Good morning. My question is about commercial expenses and administrative expenses. You have several non-recurring items that you had in the SG&A of this quarter and also commercial expenses that were almost 10% of sales. For the second quarter, are we going to take -- or the second half of the year are we going to take into account what you have been reported and what is the flexibility that you have to reduce those expenses taking into consideration the sales and launches scenario that could be worse in the future. Thank you.

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Gillian. This is Eric. I will divide this in two parts. I will start talking about sales and then G&A. As you said, the expenses had an increased sales and sales the increase of 5 million in the quarter had a main reason which was an increase in awards that we provided and sales products. This was the counterpart of the excellent figure we had our finished unit sales. To be able to sell, we made a lot of campaigns and one of the items of the campaigns were the awards. And now for 7 million that we have with major expenses of the product that were launched. And they are not accounted for in the balance sheet, yet, as you may see, (inaudible) that these are going to be accounted for next quarter.

About G&A, we did have an increase, we had 2 million of a consulting services for processes and two of adjustments in payments. And also we had lawsuits, civil and labor lawsuits. Just to give you an idea, you should use this quarter's figures because the current quarter is more representative of the new reality of the company because -- talking about sales will continue having this award policy because it's bringing sales results.

And about G&A, the indemnities considering the deliveries that we've been having from poor performance vintages, they tend to be there along the next year and to drop in the next and mid and long term. So the best projection is the one that you make based on this quarter. Thank you.

Q - Gillian Capparelli

But considering a lower sales scenario, would you consider some type of reduction on those processes or that's not under your radar yet?

A - Raphael Horn {BIO 19714328 <GO>}

In terms of sales, we consider that an investment to sell more. But clearly, Gillian, if we sell that, we would have to adjust our SG&A. It's important to say that G&A is not only for expenses and the office, we also have a strong control in indemnities for instance and that has a good impact on our management. And we will have to adjust everything to the volume of launches and sales of the company in the future.

Q - Gillian Capparelli

Thank you very much.

Operator

Excuse me, our next question is from Mr. Eduardo Silveira from Banco Espirito Santo.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Good morning, everyone. I have a question about performed receivables. We had an increase of R$250 million in the quarter and can we expect more of those increases? And if the company has done a review its policy, are you going to keep those -- and the portfolio?

A - Eric Alencar {BIO 18098474 <GO>}

This is Eric. Hello. So this is not a policy of the company to work with securities. And we did have delivery of products due to long-term portfolio, but this amount is important to say that we have transit transfers and this is something that could decrease in the future. But about the portfolio, we have we do not securitize it. This is a good portfolio, good profitability so the securitization is not our policy.

Q - Eduardo Silveira {BIO 16201252 <GO>}

Okay. Thank you.

Operator

Our next question is from Mr. Marcello Marta from JP Morgan.

Q - Marcello Marta

Good morning. My question is about the margins. We see gross margin is very resilient and despite of the challenging scenario. You have the inventory, a slower economy and good parts of the expenses. And it's not the discount but an award for sales. And going through selling, I would like to understand it better. Maybe the best would be really two years effect -- the second quarter as a reference but really the EBITDA margin and gross margins should remain in that level or could we have another type of pressure along the second half of this year?

A - Eric Alencar {BIO 18098474 <GO>}

Hello, Marta. This is Eric again. That's exactly what you said the margin is resilient. The products that we're selling in despite of having finished units with the gross margin a little bit lower than our average, our discount policy is not strong. So the sales of finished units is not impacting that much on margin. That has also been offset by the increase of share of products that have higher profitability. In fact the counterpart that we have of that sale is much more focused on sales expenses than on gross margin that comes from a discount policy. From now on, it's within 31 to 35 maybe in the next quarter. The gross margin drops a little bit not impacting profit due to the accounting of (inaudible) that has a lower gross margin, and that's going to impact the balance sheet. But that is positive because it is going to bring a lot of revenue to the company due to its swap, which is very big.

Q - Marcello Marta

Thank you very much.

Operator

Excuse me. (Operator Instructions) We don't have further question. I would like to turn the floor to Mr. Raphael Horn for his final remarks.

A - Raphael Horn {BIO 19714328 <GO>}

Thank you all for your participation. It's important to make it clear that we are not happy about our results. Our return on capital is not what we expected and -- but that is every day's work we need to be patient and to bet on our people. We are on the path already and I hope we can make you all pleased a long time. So, we will keep on working to improve our result and to provide better results for our shareholders. Thank you.

Operator

The earnings results call of Cyrela is completed. We thank you all for your participation. Have a nice day. And thank you very much.