PDG Realty

Conference Call Transcript
3Q11 Results
PDG Realty (PDGR3 BZ)
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Operator:

Good morning, ladies and gentlemen and thank you for waiting. At this time, we would like to welcome everyone to PDG's 3Q11 earnings conference call.

We would like to inform you that this call and the slides are being broadcast in the Internet at the Company's website www.pdg.com.br/ri, and that a presentation is available to download at the investor information section.

Also, this event is being recorded and 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. At that time further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of PDG management, and on information currently available to the Company. 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 PDG and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. José Grabowsky, CEO. Mr. Grabowsky, you may begin your conference.

José Antonio Grabowsky:

Thanks. Good morning everybody. Thanks for your attention today. I am here with our IR team to talk about the third quarter results and also about our thoughts for the remainder of 2011 and for 2012. The quarter results were, once again, consistent and according to the expectations, and I will let Michel, Julia and Pedro Thompson talk more about them soon.

The main point to highlight was the cash generation, better than expected and much different than the number for the 1Q and 2Q of this year. With this cash generation we were able to reduce significantly our net debt to equity ratio, also very good news.

Talking about the recent highlights and events, first page of the presentation, first of all, let us say thanks again for your votes, we were very proud to be very well positioned in the Institutional Investor Awards, not only the Company, the CEO, CFO, IR, so we really did a home run this year thanks to you, and I think, let us say, and I hope this is a reflect that the relationship that we have with our investors is very positive and we plan to continue with that.

The second point, we already mentioned that we were discussing that with them, the renewal of the job contract for Milton and Paulo from Goldfarb, we finalized the negotiations with them, and we extended their contracts for more years, until the end of 2015.

Also, we did a renegotiation of the share-swap mechanism that we have in place to create two more years of alignment of interest. So, the final portion of the payment for the acquisition of Goldfarb will reflect, instead of only the year of 2011, will reflect 2011, 2012, and 2013 years.

So we believe this was positive and created a longer term and a stronger alignment of interest with the two of them, and on top of that extended period to 2015, they agreed to have an obligation of, up until 2020, between 2015 and 2020, to not work for any of the public companies, our competitors, in the residential development sector. So I think this is positive, and that is also good news.

The other fact that occurred recently, we increased our stake in AGRE Urbanismo, in reality the idea, as we become 100% owner of the company, is to make it the vehicle inside PDG for any land parceling that we can do in the future, not only for the sale of individual lots, as it does today, but probably more in the direction of creating new areas for the development of residential units for PDG as a whole.

We believe that, for a company of the size of PDG, it is important to have a vehicle in that segment to keep creating new areas instead of just depending on acquisition of already urbanized lots, sites.

The other line, talking about the PDG Securitizadora, we continue on a quarterly basis to do new issues of receivables through the securitarization company, and we plan to continue with that activity more and more, we believe interest rates going down as they are going now, and they look like will continue to go next year. Let us say, this will be a good business for us.

The next issue, partnership with Marriott, let us say, we did another step in that direction. We were able to present numerous deals to Marriott, they chose five projects in five different cities and we are now going into more detail in those five projects, going through the projects approval, and the budget definition, and we have between 90 to 180 days to finalize the contracts with them to sell the projects or the hotels for Marriott, or Marriott's investors.

So, we now need the approvals and need the final budget to get to an agreement with Marriott and go forward with the construction itself. Just to remind you, as we already talked about, PDG will not be investing on the hotels, we will be providing development and construction services to Marriott or Marriott's investors.

The final point, which is the most important, let us say, talking about our guidance for 2012. We defined, together with our Board of Directors, the new guidance for 2012, between R$9 billion and R$11 billion of launches for next year.

So, this guidance is consistent with our priority of continuing to be cash flow positive throughout 2012, with a 10% to 20% growth in our launches. The idea of establishing a wider range, starting with R$9 billion, which is probably going to be the exact number of 2011 launches, is just to be a little bit more conservative, considering that we do not know exactly how the European economic crisis will develop and if it will affect the Brazilian economy, and how. So, that is why, instead of doing a more narrow guidance that would be probably R$10 billion to R$11 billion, we decided to make a wider range to be conservative.

So far, in the 4Q, our launches and sales base continues to be similar to the 3Q, and we are very confident to achieve the R$9 billion or R$9 billion and something launches for 2011, with a good speed of sales in the 4Q as well.

We have been launching many projects so far, the idea is to stop the launchings for sure before Christmas, so, by the second week of December, and to achieve very comfortably our guidance in the 4Q.

The other priorities, talking about 2012, or important points that we are going to be tracking for next year, are the following: first of all, the implementation of SAP in AGRE, which will allow us a deeper integration in the back office and provide some gains of scale in the G&A side. That is something to be happening by the end of the year, beginning of next year. So, this is something very important for 2012.

The second point, let us say, is the delivery of units from projects with big delays and that are usually with cost overruns and poor margins. We have been delivering a lot of those projects so far in 2011, we will continue to do in the remainder of the year, as we achieve our 33,000 to 35,000 units delivered for 2011, and we will finalize to deliver those projects in the 1Q and 2Q of next year.

So, for sure, for the 2H12 the mix inside of our accounting numbers will be much better than today's mix, because, let us say, the numbers from those old projects will not be having influence any longer on our balance sheet.

So, with all that in place, our expectation for 2012, especially in the 2H of the year, is to become more efficient and with better margins, and with the return on equity growing towards our 20% benchmark that we had in the past.

Now, I will pass to Julia to continue with the numbers for the 3Q.

Julia Martins:

Hi. Good morning, everyone. Since you are already familiar with the operational data, I will cover it briefly and focus only on the main points.

So, going to slide five, the slide five presents data on launches, so we reached R$2.65 billion this quarter, up by 30% compared to the same period last year. Over the past nine months, we launched R$6.5 billion, 32% higher than at the same period last year.

Taking in to consideration the initial guidance points of R$9 billion, this shows that we have already reached 72% of the guidance for the full year, se we are comfortable, as José said, to reach the guidance this year.

During the quarter, we launched 8,109 residential units, totaling 25,000 units during the first 9M of the year, 35% less that the same period of last year. The trend this year is to launch around 35,000 units of residential units by the end of this year, maintaining the same handover levels reflecting the same internal production capacity for PDG.

Moving to the next slide, with more details on sales, we sold R$1.9 billion this quarter, with sales over total supply at 27%. 55% of these sales consisted of units in inventory. Consequently, the outlook is that we will continue to hold a very good inventory, in a very good level, indicating sales over total supply at around 25%. At our current sales rate, we can liquidate our inventory in less than three quarters.

You can see in slide seven that the income bracket and geographical distribution remain unchanged, meaning that our launches are located in the right place targeting the correct segment and confirming that we are offering products that are suitable for specific locations. Thanks to our flexibility, we are selecting the best place for these launches.

An important event this quarter was the launch of two commercial projects offering small offices for sale, accounting for 17% of our total PDG launches. Over the last 9M, the business segment accounted for only 7% of the total launches and we still intend to launch 70% to 80% as residential unit prices under R$500,000. The rest will be residential units above R$500,000, commercial and land parceling project. However, our goal is to focus on the funding provided by Brazil's housing finances system, SFH, and My House, My Life funding.

Moving on, the next slide shows the unit delivery schedule. By October, we delivered 20,500 units reaching 71% of the initial scheduled point. As you can see, this confirms our commitment for delivery keeping in mind that commitment is vital in order to keep our firm control over the cash flow.

The next slide presents our land bank with no major changes. During the quarter, we bought around R$1.7 billion in PSV with 85% through swaps and 15% in cash. We thus continued with the same approach of limited cash exposure with a land bank with 2.5 to 3 years of operations.

Our goal today is to generate cash for the Company with a very comfortable land bank. And it is worthwhile stressing that we have not revised the price of the projects in our land bank and if the PSV of land acquired before 2009 were updated, this would represent more than 49% of our land bank. That is our number today. And these would provide us better gross margins because of the inexpensive and old land bank.

We continued to operate in major sales capitals all over Brazil and where gains of scale can be obtained with fair competition. And I would like to remind you that 90% of the projects in our land bank consist of residential units priced at under R$500,000, maintaining our exposure in this segment.

And now, I pass the word over to Pedro Thompson, who will talk about the financial earnings.

Pedro Thompson:

Thank you, Julia. Good morning, everyone. In this slide, we see the key financial indicators. The most relevant issue in our financial figures was the net revenue in R$1.8 billion. Our adjusted gross margin is 37.1%, showing an increase over the last quarters. Our adjusted net income is R$265 million this quarter. The EBITDA for 9M period is R$1.2 billion with a margin of 25%, one of the best in the industry.

Now, I will pass to Michel.

Michel Wurman:

Hi, everybody. I am going to page 11 of the presentation to talk about the indebtedness, and actually the most important point here is really to talk about the cash flow.

As you saw, we generated a positive cash flow of R$165 million and this was really based on several things that worked very well in our strategy since the beginning of the year, one important thing, much lower CAPEX in terms of land bank acquisition. On average, we had around 30% to 40% on cash payments in our land bank. This quarter, this amount was lower than 15% on the land bank, so we invest less cash in the land bank.

Secondly, we are improving quarter over quarter the cash management of the cash that we have in each one of the developments that we have. And the third thing is really regarding to clients approved by the banks. Remember that in the 2Q when we released the number, the number was a negative cash flow around R$520 million. We stressed at that point that several developments that we had completed in terms of construction from AGRE, we did not get the approval from the banks by that time.

This amount in part was because the projects were delivered to the area that deals with the clients' approvals by the end of the quarter and on top of debt, we had to improve a lot the quality of this platform within AGRE. What we did, as we said in our last conference call, in the 2Q results, we integrated the AGRE management team together with Goldfarb management team that has been dealing with that for PDG overall in the beginning. This area has a strong expertise on that, so we have been able to get these delays under the clients' approvals in the bank.

That generated for us R$200 million, around R$200 million of cash in the quarter. The question that arises is really how do you see the next quarter? This is a one-off of R$200 million or do we have more of that? For sure, it is very difficult to predict if it is more R$100 million or less R$100 million in terms of cash really because if we have the deliveries of the unit within the beginning of the quarter, more of the deliveries are in the beginning it is easier to get most of that cash by the end of the quarter. If most of the deliveries are concentrated by the end of the quarter, it is more difficult to have this cash within the quarter.

So, what we see for the next quarter is really around cash flow neutral and some cash flow generation really depends on the delivering of these units. One important thing to highlight is, so far, we delivered 23,500 units. We expect to deliver by the end of this year, something around 33,000 units. With that amount of units, we have a very large excess of cash of potential receivables to be approved by the banks and generate excess cash on PDG or in the other site cancelation of construction debt with the banks.

So, what is the movement on PDG? And why are we optimistic for the short term and mainly the long term? We are delivering a lot of units. With that, we have enough money to come back. So, one year ago, we had the volume of 20,000 units by the whole year of 2010. This year, we will have 33,000 units. On top of that, the units that we got from AGRE, they are on average twice more expensive than our past units from PDG. So, that is where the money coming from the cash flow.

The other important thing, what is the next question that arises? For next year, if you grow 20%, are capable of growing, generating cash, doing between R$9 billion to R$10.5 billion, we do not need to have any additional cash invested on the CAPEX side more than predicted. So, we are very comfortable with that. If we want to do more than R$10.5 billion, we will need to invest something around R$200 million in cash. But, we will still generate a lot of free cash flow in the operation.

So, having said that, what is the conclusion? We started the quarter with a net debt to equity, excluding securitization, at 57.6% and we finished, we finalized the quarter with 53.6%. If we consider depreciation within that site, we started the quarter or we ended the 2Q with 77.5% of net debt to equity and we decreased that level to 71.5% of net debt to equity. So overall, I believe that as a company, we have much more, I believe that we are crossing the bridge in terms of being cash flow neutral, and started to generate excess of cash flow to be really free cash flow company in the coming quarters within PDG.

Overall, that is the highlight that we have on the cash flow and that I wanted to highlight for the presentation. Another important thing that José remind me is really regarding for next year is return on equity. It is an important question that has been arising from our investors. I believe that it will be in a range up to 20%. Probably it will range in between 18% to 20%, as though as we deliver this old unit from AGRE that by the end of the 1H of next year all of them are delivered. We will have a company with an outstanding margin much higher than the current one. We really have a room to have 200 bps of higher margin than what we have today with the new projects that AGRE has been delivering, has been launching under PDG.

So now, I will pass to the Q&A and then, we will conclude the conference.

Marcelo Motta, JPMorgan:

Good morning, everyone. Congratulations for the results. My question is regarding revenue growth. During the 1H, we saw revenues growing year over year around 35%, 30%, and this quarter, it grew only 19%. Just wondering if it is a trend or it is related to the cash generation this quarter, so PDG decided to have a better management of construction, it is slowing down a bit, I mean, just wondering if you could comment a little bit on this.

Julia Martins:

Hi, Motta. The revenue is just a case that now we are recognizing that project because the growth that we saw last year was the growth that we did in 2007 up to 2009 that was more in terms of participation of growth than when we were doing in 2008 to 2009. So, this growth changed a little bit our revenue this year if you compare to last year, in the case of our launches, growth in launches in 2009 up to 2010, and 2007 up to 2008.

Marcelo Motta:

Perfect. Thank you.

Felipe Rodrigues, HSBC:

Morning, guys. I was wondering if you guys would be able to give some colors on the expected cash flow for 2012. Let us say, for launch of R$10 billion next year, what would be a good range of cash flow expected? Thanks.

Michel Wurman:

Hi, Felipe. Good question. But like internally, we were working to have between R$400 million and R$800 million of free cash flow for next year and so it really depends if we are doing R$10 billion and below or R$10 billion or more of launches next year.

José Antonio Grabowsky:

Because of the land bank acquisition for the future.

Michel Wurman:

Yes.

José Antonio Grabowsky:

Yes, the bigger difference will depend on how much we spend in cash for land bank acquisitions. So, if we see that the launches are more above R$10 billion towards R$11 billion, and we want to increase the land bank faster, that might be the case that we spend more cash, more swaps than in the past. And that we think that the overall activity for the sector will probably not be increasing a lot for next year, probably the land bank acquisition will also be a little bit easier next year than this year.

So, I would say we would probably not be doing a lot of cash investment for land bank next year. So, this range that Michel mentioned probably will be more towards the mid of the range or above. Thank you.

Felipe Rodrigues:

And would you still be comfortable with three years of land bank? Or are you thinking about increasing that eventually going forward if you are able to do more swap than cash?

José Antonio Grabowsky:

I would say three years is more than enough and we are always comfortable with the 2.5 to 3 years of land bank. It might be some cases, let us say, if we are able to develop bigger areas, maybe through the land parceling company, the Urbanismo that we now have 100%, might be the case, then in some areas, we have a longer-term land bank if *[unintelligible]* we do and the overall land bank in three years is more than OK.

Felipe Rodrigues:

Great, José, thanks for the answer.

Operator:

Thank you. This concludes the question and answer session. At this time, I would like turn the turn floor back to Mr. Grabowsky for any closing remarks.

José Antonio Grabowsky:

OK, thanks everybody for the attention. I hope the discussion was good for you to understand better what we are planning for 2012. We continue to see a very positive scenario for real estate in Brazil in the coming years. So, for sure let us say, the banks continue to be very aggressive on the mortgage financing business, not only Caixa Econômica Federal and Banco do Brasil from the government-owned side, but all the major private banks as well, they continue to be very positive, and let us say helping us speed up the transfer of clients to them which would be for sure very important to us next year.

So, we continue to be very positive. And as usual, please feel free to call us with your questions, with your suggestions, so the IR team is here for that. Thank you very much.

Operator:

Thank you. This does conclude today's presentation. You may disconnect your lines at this time, and have a nice day.