Transcription of the
1Q18 Earnings Conference Call
PDG Realty (PDGR3 BZ)
May 16, 2018

Operator:

Good morning. Welcome to PDG's 1Q18 earnings conference call. Mr. Vladimir Ranevsky, CEO, CFO and IRO, is here with us.

Please note that this conference call is being recorded and all participants will be in a listen-only mode during the Company's presentation. Then we will start the question and answer session for analysts, when additional instructions will be given. Should you need any assistance during the conference, please request the support of an operator by pressing *0.

We'd like to inform you that questions may be only asked by telephone. If you are connected via webcast, your question should be sent directly to PDG's IR team via e-mail at ri@pdg.com.br.

The audio and the slides of this conference call are being simultaneously transmitted over the Internet at www.pdg.com.br/ri, where the corresponding presentation is available for download on the webcast platform.

Before we proceed, we'd like to clarify that any statements that may be made during this conference call about PDG's business prospects, operating and financial projections and targets reflect the beliefs and assumptions of the Company's Executive Board and currently available information. They involve risks, uncertainties and assumptions because they pertain to future events and, therefore, depend on circumstances that may or may not materialize. Investors should understand that general economic and industry conditions and other operating factors may affect the future performance of PDG and lead to results that materially differ from those expressed in such forward-looking statements.

Now we'd like to give the floor to Mr. Vladimir Ranevsky, Chief Executive Officer, who will start the presentation. Mr. Vladimir, please proceed.

Vladimir Ranevsky:

Thank you. Good morning everyone, and thank you for joining this conference call in which we will discuss, or at least present, our 1Q18 results.

The first quarter marked an important phase: the beginning of implementation of PDG's reorganization plan. The first year of the reorganization plan is one of the most important for the Company because it envisages the payment of part of the amounts agreed upon in the reorganization plan as of the second half of 2018.

We also received the conclusion of the market study we commissioned to help us define the profile of clients and projects and the location for launches in the near future, thus fulfilling our commitment to fully resume our development activities.

Although the reorganization plan covers a large portion of our liabilities, we continue negotiating with banks to resume and complete unfinished projects, fulfilling our commitment to our clients, as well as adding more value to the Company's assets.

We will begin today's agenda with a summary of our operational highlights, then I will give you an update on the Company's court-supervised reorganization and its impacts, and, finally, we will discuss PDG's main operating and financial results.

Moving on to slide four, we will present the main events of the quarter.

General and administrative expenses fell 66% between 1Q17 and 1Q18. Financial revenues improved substantially, totaling R$29.6 million in 1Q18, versus a negative R$1.7 million in 1Q17. Financial expenses declined 27%, from R$173 million in 1Q17 to R$126 million in 1Q18. Meanwhile, the loss dropped 6%, from R$276 million in 1Q17 to R$260 million in 1Q18.

Moving on to slide six, we will talk about the status of the court-supervised reorganization. As I said, we are now taking the actions set out in the court-supervised reorganization plan.

We will have a capital increase related to the conversion of debt worth R$74.2 million into equity set out in the plan, which is in the final implementation stage, but has not yet been recorded in PDG's results because it will take place next quarter.

The period for shareholders to exercise their preemptive rights in the capital increase ended April 30, after the 45 days granted by the Company elapsed.

I would like to point out that, during the period for shareholders to exercise their preemptive rights in the capital increase, a number of investors exercised their preemptive rights and subscribed to the shares, avoiding their dilution, while showing confidence in the Company's reorganization process, which pleased us immensely.

The ratification of this increase should occur sometime in late May or early June, at which time we will provide the necessary information to the market. As of June, we will begin payments for classes 1, 3 and 4, totaling approximately R$100 million by the end of the year. Payments will be made in six installments starting in June.

Please note that the payments that will be made for classes 3 and 4 are only for those creditors who validly elected option A. Option A is cash payment, up to the limit of R$35,000 for class 3 and R$25,000 for class 4.

Let's go to slide seven, where we will talk about the changes in PDG's debt subject to the reorganization process. In the chart, we can see that debt adjusted to fair value, which totaled R$838 million at the end of 4Q17, ended 1Q18 at R$859 million, an increase of R$21 million, or 2.5%, as a result of monetary restatement in the period. This debt will continue to be restated over time, until it is fully amortized.

Moving on to operating and financial results, on slide 9, we have our sales performance in the period. In the first quarter, gross sales totaled R$49 million, down 40% from 1Q17 and 48% below the amount recorded in 4Q17. This decline was due to the Company's decision, for various reasons, to prioritize the sale of unencumbered units, which immediately generate cash, in addition to prioritizing the sale of units whose proceeds could be used to pay the expenses of the respective SPEs.

Since the beginning of 2Q18, we have also resumed sales of part of the encumbered units. This way, we will be able to observe an improvement in gross sales volume next quarter.

In 1Q18, cancellations totaled R$52 million, 63% less than in 1Q17 and 271% more than in 4Q17. Throughout 2018, we will maintain the strategy of prioritizing cancellations of unencumbered units with good liquidity, which immediately generate cash upon resale. As a result of the increase in cancellation volume in 1Q18, net sales were negative by R$3 million in the period.

On slide ten, you can see general and administrative expenses, as well as the Company's headcount. General and administrative expenses fell 66% year on year, in line with the Company's goal of constantly adjusting its structure and increasing the operation's efficiency.

Between 1Q17 and 1Q18, there was a 57% reduction in headcount. We closed the first quarter with 261 employees. Selling expenses increased 16% over 1Q17, due to commission expenses related to cancellations recorded at the end of 1Q18.

On slide 11, you can see we closed 1Q18 with total inventory of R$2.1 billion, of which 60% refers to residential products, excluding *Minha Casa Minha Vida* units, land plots and commercial units.

Also, 40% of this inventory has already been performed and, therefore, generates cash immediately. Of this inventory, 62% is located in São Paulo and Rio de Janeiro. Regarding performed inventory, 92% is concentrated in projects that are more than 60% sold, which means they sell well.

On slide 12, we see the Company's financial result, with a significant improvement in financial revenues in 1Q18, totaling almost R$30 million, compared to a negative R$1.7 million in 1Q17. This improvement was due to the increase in the monetary restatement of receivables from finished units.

Another point I would like to highlight is the 27% decline in financial expenses, which went from R$173 million in 1Q17 to R$126 million in 1Q18. This decrease was due to the reduction in the debt amount and lower rates, both of which have been restructured as set out in the Company's reorganization plan. Accordingly, the impact of the financial result on the Company's result was R$78.6 million lower.

On slide 13, we will talk about first priority debts, which are those that are not subject to the court-supervised reorganization plan. At the end of 1Q18, our gross debt totaled R$2.8 billion, 3% more than the R$2.7 billion recorded at the end of 4Q17. This increase was the result of the interest accrued in the first quarter, totaling R$106 million. In this same period, we amortized approximately R$25 million.

I would like to point out once again that almost all these first priority debts are backed by guarantees, including fiduciary alienation, assignment of credit rights, mortgage or equipment, as you can see in the box to the right.

On slide 14, we will talk about the income statement, in which the main variations are: the decline in real estate sales, due to the reasons I mentioned on slide nine; the 66% reduction in general and administrative expenses, also mentioned on slide ten; and a R$35 million increase in depreciation and amortization, as a result of the write-off of property and equipment and intangible assets, as well as the depreciation of software useful life.

Other operating expenses increased R$60 million, mainly due to inventory impairment in the amount of R$37 million and an increase of R$23 million in contingencies. I have also already commented on the improvement in the financial result on slide 12.

Lastly, considering all the impacts mentioned above, PDG was able to reduce its net loss by 6%, from R$271.8 million in 1Q17 to R$262.7 million in 1Q18.

This concludes our presentation. We will now begin the question and answer session.

Marcelo Motta, JPMorgan:

Good morning. Could you please talk a little about sales in the second quarter? You mentioned in the earnings release that you started selling units that have some type of encumbrance. I would like to understand if, in fact, there is a significant improvement in gross sales now that there is a little more flexibility in sales.

Could you also comment on the outlook for cash generation? How do you see this? This sudden slight increase in sales speed should lead to higher cash generation, shouldn't it? Thank you.

Vladimir Ranevsky:

Good morning, Marcelo. As I mentioned, we are now able to include all our inventory for sale. This will obviously increase the supply of PDG assets and we expect that these sales will actually take place.

As I mentioned, it is important to work on this front now because of our financial commitments until the end of the year to comply with the court-supervised reorganization plan. Also, the fact that we have access to PDG's entire inventory is something very positive.

Some market colleagues with whom we have discussed and we at PDG do not see a spectacular market, but we can see a slight recovery in real estate purchases, at least in São Paulo.

Unemployment is still very high, so I think it is highly unlikely that we will have any kind of boom this year, but we are very optimistic about the properties, because these properties have a good sales appeal, and also, as I said, we have greatly increased our supply.

Marcelo Motta:

Perfect. As a follow-up question, can we expect the gross margin to improve at the beginning of the year? Does this marginal improvement result in a little lower discount, or is it too soon to think about this?

Vladimir Ranevsky:

We expect to at least maintain the margin we have today. Since the market, as I have mentioned, is not having an extremely positive reaction, we hope to at least maintain these margins and, as far as possible, adjust prices, at least according to the variation in the costs inherent in the appreciation of the properties on the market.

Marcelo Motta:

Perfect. Thank you.

Operator:

The question and answer session is now closed. I would like to give the floor to Mr. Vladimir Ranevsky for his final remarks.

Vladimir Ranevsky:

Before we wrap up, I'd like to make a disclaimer. I think we have made great progress on all fronts. We are complying with our obligations and what was set out in the reorganization plan in 2018. Once we are able to meet our obligations this year, a very important year in which we will pay most of the amounts that are expected for this year, the next debt will mature 20 years from now.

So I believe we are on a very positive path of recovery, and also, in parallel to the implementation of the plan, we are working to raise new funds for the Company to invest in recovering the business.

As a result, we have been in touch with funds and investors that have shown an interest in the opportunities that exist inside PDG. I think it is important to get this message across to you because, in fact, we see the Company's prospects improving in a very positive way.

Thank you all for joining us. See you in our next conference call.

Operator:

PDG's 1Q18 earnings conference call has come to a close. You may disconnect now. Have a nice day.