



Javer 2Q16 Conference Call Transcript

July 22, 2016 @ 10:00AM CT

Operator: Good day ladies and gentleman. Welcome to the Javer conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session, and instructions will be given at that time. For opening remarks and introductions, it is now my pleasure to turn the call over to Melanie Carpenter of I-Advize Corporate Communications. Ma'am, please go ahead.

Melanie Carpenter: Thank you, Operator. Hello, ladies and gentleman and welcome to Javer's second quarter and first half 2016 conference call on today, July 22 of 2016 for our recording. Joining us are Mr. Eugenio Garza, Chief Executive Office of Javer, Felipe Loera, Chief Financial Officer, and Veronica Lozano, Investor Relations. There is a webcast presentation to accompany this discussion, and the link was included in the earnings release. Management's comments will be followed by a Q & A session for investors and analysts only, and questions from the media will not be taken. Please note that some comments made today may include forward looking statements, so please refer to the disclaimer in the quarterly report, which went out yesterday afternoon, for guidance regarding these types of comments. If you didn't get a copy, or you need any assistance during the call, please contact I-Advize in New York at 212-406-3694. And now without further ado, I'm very pleased to turn the call over to Mr. Mr. Eugenio Garza, CEO for his presentation. Please go ahead, Eugenio.

Eugenio Garza: Thanks very much, Melanie. Good morning to everyone. Thank you for taking the time to review our second quarter results. We are extremely pleased with our strong operating performance and our positive results shown on all fronts, absolute operating profit levels, returns on capital, and free cash flow. All of these prove that the proactive strategic decisions we've made, over the past few years, with our land purchases and our inventory position have really started to bear fruit.

Let's turn to slide three and begin with subsidies. As of the midyear about half of the federal budget has been disbursed with about 82,000 subsidies, totaling roughly 5 billion pesos. Subsidies are still being administered under the queue system that I talked about last quarter which replaced the "continuous titling" mechanism that was used previously. During the second quarter, monthly queue displacement rates remained at the guided levels nationwide, with the exception of the month of May when roughly twice the regular disbursements were granted. On a state-by-state level, and within certain segments, there have been some disparities with regards to the advance of the program. But given the current remaining budget on a state-by-state basis, and current queue levels, we expect that the budget will be exhausted by the end of the third quarter in most of our markets with a chance for an additional month, if there are reallocations from other underspent portions of the national budget.

We believe that the "stop-and-go" nature of the queue system in subsidy disbursements affects both the demand and supply sides of our market in important ways. First, customers who are not guaranteed certainty of a subsidy usually defray their purchase decision, and developers attenuate our inventory investments given this availability uncertainty. Total new homes sold in the Infonavit system are down 6.9 percent in the first half of 2016, with a particularly concerning drop of 16.4 percent in the less than 2.6 times minimum wage segment where the subsidy effect accounts for a substantial majority of the market. As of now, we still have very little visibility on what subsidy availability will be during the fourth quarter of 2016 or in 2017. Nonetheless, given the diversification of our business model, we will be able to quickly adapt to any scenario that eventually plays out.

Turning now to our results on slide four, we titled 3 percent more homes than last year for 4,599 units, while our titling's for the first half were practically flat at 9,212 units. Residential sales contributed much more to our sales than last year, while affordable entry level sales remained flat, and middle income declined. This year, we have eleven active residential projects versus just seven for last year.

On slide five, you can see how the contribution of residential helped boost our revenue growth up 20 percent in the quarter and more than 15 percent in the first half. Turning now to slide six, you will see the drop in subsidized sales continues and is now below 50% of our

total sales. Vertical housing absorbed 38 percent of total subsidies during the quarter, compared to about 34 percent last year. In the first six months of 2016, this figured dropped more than 20 percentage points compared to the same period of 2015. We expect this trend to continue in the second half.

On slide seven, we show strong growth in key figures, mainly EBITDA which increased by almost 30 percent in the second quarter to 224 million pesos and was up 15 percent in the first half to 431 million pesos, thanks to higher margins resulting from our sales mix and a higher average sales price. SG&A was up around 22 percent in both periods, given the rise in commission expense in line with our revenue increase, as well as the continued effects of personnel increases in the State of Mexico and Quintana Roo, investments in new IT systems, and expenses related with the regulatory requirements that Javier must now comply with to become a publically traded entity. Due to a shift in our sales mix, our average home sales price continues to increase in high double-digits which has helped improve our margin.

Turning to slide eight, our working capital cycle improved to 288 days as we were able to improve our collections and maintain efficient inventory management.

On slide nine, you can see that in the second quarter we were Free Cash Flow positive for 249 million pesos and 321 million in the first half as we benefit from lower interest expenses coming from our debt reduction exercise and an optimization of our collections and inventory and construction spend.

Turning now to slide ten, our leverage ratios and debt profile remain stable. Unfortunately, at this point we have no updates on the refinancing of our 2021 notes, but we continue working with a number of financial institutions on a strategy that will balance cost, currency risk, and operational flexibility.

I will now go to slide 11 for some thoughts on what we expect for the second half of 2016. We believe the government subsidy budget for most of Javier's market will be exhausted by the third quarter with the possibility of getting additional allocations from unspent portions in other regions. We really don't have any visibility at this time as to how things will play out in the fourth quarter and next year.

Regarding Hipoteca Verde, Infonavit is currently discussing a number of changes to its Hipoteca Verde program. For example, they are contemplating a reduction in the credit awarded for certain water and heating related elements, which would force developers to switch to alternative elements to meet the minimum underwriting standards for all Infonavit loans. We're still unclear as to how these changes will play out and whether or not they will have an impact on costs, similar to what we saw with last year's elimination of the energy efficient lightbulbs from the Hipoteca Verde menu. Nonetheless, we feel confident that we will, once again, be able to navigate through these changes through our flexible operating model.

On the new development front, we began titling four new developments during the first half of 2016. We continue to experience permitting delays on three developments which we were expecting to already provide titleable units in the first half but continue to offset this impact through a better mix and expense controls. During the second half of this year, we still expect to open a total of seven new developments.

Continuing on to slide 12, we are hoping to have a news soon regarding our refinancing plan for the 2021 notes, as we are in the midst of evaluating our best options. I am also happy to report that we carried out the second installment payment of our dividend three days ago and reiterate that 100% of the total 1.7053 pesos per share dividend for the year will be fully funded by our free cash flow. This amount gives us the highest dividend yield for any non-fibra company listed on the Mexican Stock Exchange, and it puts us in the top three when compared to fibras, which, unlike us, pay dividends on a pretax basis. This is proof positive that we continue our legacy of maintaining financial prudence while driving value for all of our stakeholders.

In closing, we are pleased with our results for the first half. We feel confident that despite permitting delays and lack of significant subsidies, we can meet at least the lower end of our guidance for homes titled at around 20,000 for the year while maintain our EBITDA and free cash flow target. We must continue to effectively manage our inventory, balance our product mix, and optimize our operating efficiencies, and we believe that we have the right team and business model to accomplish this. This concludes our prepared remarks.

Thank you very much all for participating today and for your continued interest in Javer. If you have any other questions, please don't hesitate to contact either Felipe, Veronica, or myself. Thanks again. Have a great day, and a wonderful weekend.
