



Javer 3Q16 Conference Call Transcript

October, 21 2016 @ 10:00AM CT

Operator: The following is a recording for Melanie Carpenter from i-advize on Friday, October 21, 2016, at 10:00AM Central. This is the Javer Third Quarter 2016 conference call. Hello, everyone, and welcome to the Javer conference call. All lines have been placed on mute to prevent any background noise, and this call is being recorded. For opening remarks and introductions, I will now turn the call over to Melanie Carpenter of i-advize Corporate Communications. Ma'am, please go ahead.

Melanie Carpenter: Thank you. Hello, ladies and gentlemen and welcome to Javer's third quarter 2016 conference call today, October 21, 2016. Joining us are Mr. Eugenio Garza, Chief Executive Officer of Javer; Felipe Loera, Chief Financial Officer; and Veronica Lozano, Investor Relations. There is a webcast presentation to accompany this discussion and the link is included in the earnings release. Management's comments will be followed by a question-and answer 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. 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 receive a copy or you require any assistance during the call, please contact us in New York at 212-406-3693. And now without further ado, I'm very pleased to turn the call over to Mr. Eugenio Garza for his presentation. Please go ahead, Eugenio.

Eugenio Garza: Thank you very much, Melanie. Good morning, everyone. Thank you for taking the time to be with us today. Our results for the third quarter of 2016 continue to show that our flexible business model has been the key to maintaining a stable performance under a continuously changing market environment. Although we registered a slight drop in home titlings versus last year, the deliberate changes we began to implement last year in terms of our geographies and product segment mix continue to drive profitability and attractive returns for our shareholders. I will go over the status of subsidies, review our performance and outlook before taking your questions.

Let's begin by turning to slide 3 to go over subsidies. During the third quarter, subsidy disbursements continued to decline as we had anticipated. At the close of the quarter, 6.9 billion pesos of the total 9.3-billion-peso budget had been spent, representing about 114,000 individual subsidy units. As of today, most of the budgeted resources have been utilized in the states where we have presence. We expect a relatively small disbursement to still be made in our states during the fourth quarter, with the last remaining resources barring any last minute state-by-state reallocation. Therefore, we will continue to shift our production focus on sales mix towards other segments that are contingent on this program.

Turning now to our results on slide 4, you will see that in the third quarter of 2016, we titled 3.7 percent less homes than last year, reaching 4,339 units, while our titlings for the first nine months were practically flat at 13,551 units. Residential sales, which was the segment that was able to deliver positive results for the quarter, were up 32 percent in the quarter and more than double in the first nine months. This is very encouraging as it helps to offset the declines in affordable entry level and the middle income segments for both periods. So as we mentioned in the report, this deliberate change in geographic and product segment mix continues to pay off for us.

Turning to slide 5, while we can see that unit sales declined, our improved sales mix, including a larger contribution from residential sales, as well as an almost 14 percent higher average sales price year-over-year, enabled us to offset some of this impact for the periods under discussion, added to the strict expense control strategies we have in place, we believe that we are well positioned to continue to mitigate some of this impact through the end of 2016. As such, net revenues increased 4.3 percent to 1,637 million pesos in the third quarter of '16, and for the first nine months, net revenues rose by 11.6 percent to 5.12 billion pesos in the nine-month period.

Turning to slide 6, we can see some of the performance of our subsidized sales. During the quarter, we actually posted an increase in sales of subsidized homes of nearly 50 percent versus the period last year, but if you recall, last year during the third quarter, dropped dramatically after the continuous titling mechanism was exhausted for most of the budget in the first half of the year. In that quarter, subsidies had represented only 19 percent of our total sales mix versus 29 percent this quarter.

Nonetheless, for the first nine months, we had a 23 percent drop in subsidized home sales, which now represent 42 percent of our total units sold compared to 54 percent last year. In both periods this year, vertical housing has been a source of significantly higher proportion of subsidies, representing 64 percent of subsidy sales in the third quarter and 41 percent for the first nine months.

Let's turn to slide 7 so we can see the growth in the key figures. First of all, EBITDA increased by nearly 12 percent during the third quarter to 218 million pesos and was up 14 percent in the first nine months to 649 million pesos due to our more diversified sales mix and higher average sales price during the year. SG&A was up by only 1 percent to 230 million pesos in the third quarter and 15 percent to 767 million during the nine-month period due to the effect of additional personnel in the State of Mexico and Quintana Roo, as well as investments in the new IT systems and expenses related with regulatory requirements that Javier must comply with now that we are a publicly-traded company. I also want to mention that there was a non-cash charge of 12 million pesos during this quarter that we mentioned in the report. This was due to an accelerated depreciation of assets we no longer are using given our recent move of the corporate headquarters to a new building.

Thanks to the shift in our sales mix, our average home sales price continues to rise by double digits, which has contributed to our margins. For the quarter, average sales price rose by 10 percent and nearly 14 percent for the accumulated nine-month period. You can see the table on slide 7 for the breakdown of sales price within our segments for each period under discussion.

Let's move to slide 8 for a discussion of the Company's working capital cycle. Our cycle and all of its components remained relatively flat over the previous period, thanks to our efficient inventory management and our ability to maintain collections in check.

On slide 9, you can see that in the third quarter, we were free cash flow positive for 63 million pesos and 385 million pesos for the nine-month period, which is more than double the amount generated in the first nine months of 2015. This, as you know, is the result not only of the higher EBITDA but also the efficient inventory management and lower interest expense related to the deleveraging of our balance sheet after the IPO.

Turning to slide 10, our leverage ratios and debt profile remain stable. We have total debt of about 2.9 billion pesos, which was 1.98 billion pesos in net debt after cash in our mark-to-market derivative positions. At this point, we still have no updates on the refinancing of our 2021 notes but we continue working with a number of financial institutions on the right strategy. We are confident that we will find the right solution in due course and will be able to update the market on changes there.

On slide 11, we will discuss our outlook for the remainder of 2016 and the short-term future. On subsidies, we expect subsidies to be 30 percent lower for 2017. As a reference, 2016 subsidies are going to be about 9.3 billion pesos so we're looking about 6.5 billion for next year. The reality is that the federal government is under extreme pressure to continue its austere fiscal stance, which will definitely affect social programs such as this one. But we believe that more than the absolute amount of subsidies, the most important part of the program will be the detailed operational rules. As such, we expect that there will be changes in the maximum amount per home allowed, priority assignments and other rules in order to maintain and maximize the social impact of the program within the absolute peso amount constraints.

We continue to lobby housing authorities as an industry to release those policies in advance so that we are able to prepare our production plan accordingly. We are hoping that these policies will include the exercise of the program until resources are exhausted rather than the current queue system that is currently being employed. Notwithstanding this, we are confident that our operational capabilities will allow us to profitably deliver solid results under any scenario that ends up playing out. In terms of permits, we continue to experience permit delays in a couple of our expected openings for 2016. These delays have already caused titlings to be below our expected levels to date and will likely also affect fourth quarter volumes.

Nonetheless, we have been able to recoup these losses so far with a better mix and expense controls, and we are confident that we will be able to do so, at least partially, to continue to mitigate this impact through the end of 2016. On a final note, we want to highlight an exciting new pilot initiative we just launched in conjunction with CONAVI, the German Corporation for International Cooperation, as well as the State of Nuevo León. Through subsidies provided by the multilateral institutions and CONAVI, we will be building a cluster of 52 residential units within our Bosque Boreal project in Monterrey, which will be constructed under the NAMA Facility Guidelines with advanced eco-friendly technologies and building materials which reduce energy consumption and CO2 emissions. These energy savings are aimed at providing customers with a higher purchasing power, as well as quality of life improvements. We are confident that these kinds of initiatives are the beginning of an innovation in building materials and practices that will not only benefit the environment but will also benefit everyone involved in the industry.

And finally, just a quick note on dividends. I'm happy to report that the third dividend installment of \$0.26 per share was distributed on October 18th, 2016. All dividend payments to date have been more than 100 percent funded with the free cash flow we generated during the year. The final installment will be expected in January 2107.

In closing, we are pleased with the results achieved so far this year despite the permitting delays and the lack of significant subsidies. We will continue to maintain extreme discipline of our investments and working capital to be able to translate this increased profitability into free cash flow. We feel confident that our flexible business model will allow us to mitigate the effects of changing market environments and our operational capabilities will allow us to profitably deliver solid results under any scenario that ends up playing out over the next year.

This concludes the remarks. Thank you for your attention.
