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## Research Update:

# Cyrela Brazil Realty S.A. Empreendimentos e Participacoes 'BB-' And 'brAAA' Ratings Affirmed; Outlook Remains Stable

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## Table Of Contents

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Rating Action Overview

Rating Action Rationale

Outlook

Company Description

Our Base-Case Scenario

Liquidity

Covenants

Ratings Score Snapshot

Related Criteria

Ratings List

## Research Update:

# Cyrela Brazil Realty S.A. Empreendimentos e Participacoes 'BB-' And 'brAAA' Ratings Affirmed; Outlook Remains Stable

## Rating Action Overview

- We expect Brazil-based homebuilder Cyrela to maintain solid cash flow generation over the next few quarters amid the increasing housing demand.
- We also expect the company to maintain relatively stable leverage, distributing excess cash as dividends.
- We're affirming our long-term 'BB-' global scale issuer credit rating and our 'brAAA' national scale issuer credit ratings on the company.
- The stable outlook reflects our view that Cyrela will increase launches at a moderate pace, while also focusing on selling its inventories. We expect debt to capital below 25% and funds from operations (FFO) to debt consistently higher than 12% in the next 12 to 18 months.

## Rating Action Rationale

On Nov. 29, 2018, S&P Global Ratings affirmed its long-term 'BB-' global scale issuer credit rating on Cyrela Brazil Realty S.A. We also affirmed our 'brAAA' national scale issuer credit ratings on the company. The outlook on both scales remains stable.

The affirmation reflects our expectation that Cyrela will maintain solid cash flows over the next few quarters. We believe that improving consumer confidence and lending from banks at lower interest rates should bolster housing demand. Under this scenario, we expect Cyrela's launches sales value to grow about 15% annually until 2020. While higher launches will gradually require greater capital than in the past years, we believe that cash generation from sales of current inventories and adequate sales speed will compensate for that factor.

We believe that Cyrela's revenue diversification between low-, mid-, and high-income housing segments should allow it to maintain lower volatility than its domestic peers, because the company can adjust its product mix depending on industry conditions. For instance, in the first nine months of 2018, the company's launches under the low-income government-housing program, Minha Casa Minha Vida (MCMV), represented 47% of total launches, higher than its historical average of about 30%. Given that this program has been more resilient to Brazil's weak economy over the past years and faces lower cancelations than mid-high income segments, we believe Cyrela will benefit

from higher earnings predictability.

Cyrela's 2018 FFO has been pressured mainly due to reparatory expenses in Sao Luis project of R\$94 million and still relatively high cancelation rates. Given that we don't expect other significant provisions starting in 2019, and we believe cancelations will continue to decrease to below R\$650 million in 2019 from R\$1.8 billion in 2017, higher FFO generation is likely. This would result in stronger FFO to debt of above 15%, compared with around 13% in 2017 and 2018. And while this ratio is currently somewhat weak for the rating level, the company's relatively low cash consumption for land acquisition and prudent approach to leverage, by maintaining debt to capital below 25%, mitigates this risk.

The ratings on Cyrela remain capped at the same level as Brazil (BB-/Stable/B). We stress the company under a hypothetical sovereign default scenario for Brazil, in which we don't believe the company would have sufficient sources of cash to cover its obligations. Given that the homebuilding industry is highly correlated and sensitive to macroeconomic conditions, and because homebuilders depend on the banking sector that provides financing for both construction and homebuyers, we believe that during sovereign distress, the homebuilders' operations would face significant bottlenecks.

## **Outlook**

The stable outlook reflects our view that Cyrela will continue generating solid operating cash flows, while maintaining its focus on selling its inventories and increasing launches at a moderate pace. The outlook also reflects our expectation that Cyrela will maintain a discretionary dividend policy, with payments based on cash flow generation. As a result, we expect debt to capital below 25% in the next 12-18 months, and FFO to debt consistently higher than 12%.

### **Downside scenario**

We would lower our ratings on Cyrela if we take the same action on the sovereign. We could also downgrade the company in the next 12 months if it presents consistently weaker credit metrics, such as FFO to debt below 12% and debt to capital above 40%. That could be a result of weaker business conditions, such as higher cancelations requiring the company to apply significant discounts over inventories, meaningful cost overruns and provisions, or slower sales' speed, which would ultimately erode cash generation.

### **Upside scenario**

An upgrade is unlikely in the next 12 months because we currently don't believe that Cyrela could pass the stress test to be rated above the sovereign. But we would raise the rating if we take the same action on Brazil.

## **Company Description**

Cyrela is one of the largest homebuilders and real estate developers in Brazil, operating through own brands and via partnerships. The company has diversified operations in terms of end-markets, operating in the low-, middle-, and high-income segments. In the first nine months of 2018, Cyrela launched total pre-sales value of R\$2.2 billion and net sales reached R\$2.6 billion in the 12 months ended Sept. 30, 2018..

## **Our Base-Case Scenario**

In our base-case scenario, we assume:

- Brazil's GDP growth of 1.4% in 2018, 2.4% in 2019, and 2.5% in 2020.
- Brazil's inflation rate of 4.4% in 2018, 4.1% in 2019 and 4.0% in 2020.
- Basic interest rate (average) at 6.5% in 2018, 7.5% in 2019, and 8.5% in 2020.
- Launches of R\$2.4 billion in potential sales value in 2018, increasing to R\$2.8 billion in 2019, and to R\$3.2 billion in 2020. This reflects our expectation of demand recovery in line with higher consumer confidence.
- Cancellations reaching about R\$980 million in 2018 and below R\$650 million in 2019. This decline is a result of lower deliveries and better market conditions.
- Net revenue of R\$2.6 billion in 2018, close to R\$3.0 billion in 2019, and R\$3.3 billion in 2020.
- Gross margin of 33%-35% over the next few years, with an improving trend due to both lower cancellations and need for discounts because of reduced inventories of finished units.
- Cash disbursement related to one-time reparatory expenses (Grand Park and Sao Luis projects of roughly R\$100 million in 2019).
- Annual operating cash flow of R\$1.1 billion - R\$1.2 billion for 2018-2020, incorporating increasing cash inflows from launches and sales of inventory, and lower levels of cash disbursement for land acquisition.
- Starting in 2019, we assume the company will distribute 75% of its free operating cash flow (FOCF) as dividends, as long as Cyrela maintains stable leverage and comfortable liquidity.
- Gross debt close to R\$2.8 billion in 2018 and falling to roughly R\$2.35 billion by 2020, assuming some amortization with cash flow generation and new debt to finance future projects.

These assumptions result in the following credit metrics:

- FFO to debt of 12%-15% in 2018, 15%-18% in 2019, and more than 30% in 2020, compared with 13.2% in 2017;
- Operating cash flow (OCF) to debt of more than 55% for the next few years, compared with 30.7% in 2017; and
- Debt to capital of 20%-25% in the next few years, compared with 22.9% in 2017.

## **Liquidity**

We assess Cyrela's liquidity as adequate because we expect the company's sources of cash to comfortably exceed uses by more than 20% for the next 12 months, and sources to exceed uses even if EBITDA declines 30% from our forecast. Cyrela has sound bank relationships, satisfactory access to local capital markets, and we expect the company to maintain an ample cushion for its financial covenants.

Principal liquidity sources:

- Cash position of R\$2 billion as of Sept. 30, 2018;
- Forecasted cash FFO close to R\$100 million in the next 12 months;
- Forecasted working capital inflows around R\$1 billion in the next 12 months; and
- Contracted project loans not yet disbursed of R\$174 million.

Principal liquidity uses:

- Short-term debt of R\$884 million as of Sept. 30, 2018;
- Capital expenditures (capex) of R\$45 million during the next 12 months;
- Land acquisition payments of R\$280 million over the next 12 months;
- Seasonal working capital needs of around R\$220 million annually; and
- Dividend payments of approximately R\$800 million during the next 12 months.

## **Covenants**

Cyrela is subject to various financial covenants on its loan agreements, including net adjusted debt to equity of maximum of 0.7x, receivables (including properties for sale) to net adjusted debt of minimum of 1.5x, and EBIT to net interest expenses higher than 1.5x (or lower than 0). The company is in compliance with its financial covenants as of Sept. 30, 2018, with cushion, and we expect this to persist in the next two years.

## Ratings Score Snapshot

Corporate credit rating:

Global scale: BB-/Stable/--

National scale: brAAA/Stable/--

Business risk: Fair

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb

Modifiers:

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb

## Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Ratings List**

### Ratings Affirmed

Cyrela Brazil Realty S.A. Empreendimentos e Participacoes	
Issuer Credit Rating	
Global Scale	BB-/Stable/--
Brazil National Scale	brAAA/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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