REFINITIV STREETEVENTS

EDITED TRANSCRIPT

MRVE3.SA - Q3 2022 MRV Engenharia e Participacoes SA Earnings Call

EVENT DATE/TIME: NOVEMBER 10, 2022 / 1:00PM GMT

CORPORATE PARTICIPANTS

Eduardo Fischer Teixeira de Souza *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Rafael Nazareth Menin Teixeira de Souza *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

CONFERENCE CALL PARTICIPANTS

André Chaves Mazini *Citigroup Inc., Research Division - Assistant VP*

Bruno Mendonca *Santander Investment Securities Inc., Research Division - Former Head of Real Estate*

Fanny Oreng Avino *Santander Investment Securities Inc., Research Division - Research Analyst*

Gustavo Cambauva *Banco BTG Pactual S.A., Research Division - Research Analyst*

Marcelo Garaldi Motta *JPMorgan Chase & Co, Research Division - Research Analyst*

Pedro Hajnal *Banco Bradesco BBI S.A., Research Division - Former Research Analyst*

Ygor Gomes Altero *XP Inc. - Equity Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, good morning. Thank you for holding. Today with us, we have the CEO of the company, Mr.Rafael Menin; and Mr. Eduardo Fischer; and the Chief Financial Officer, Mr. Ricardo Paixao. We would like to inform that all participants will be in lesson-only mode during the company's presentation. After the company's remarks -- now I would like to turn over the floor to Mr. Rafael Menin. Mr. Rafael may proceed.

Rafael Nazareth Menin Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Good morning. I would like to thank you again for your presence. Those of you who are with us all the quarters every quarter. And I would like to say that this has been a very tough quarter, certainly the toughest quarter in the history of the company. This is due to a series of negative factors, the first of them being the gross margin of MRV that remains low. We have planted the seeds to harvest better results we didn't sell any product from Resia, which had positively contributed to the results of MRV and Co, and we didn't sell any Luggo projects. As you may know, these 2 companies have a very different cycle of the usual cycle of MRV. We start construction. We build the projects we rent and then we sell.

And that's when we recognize the results and the cash generation from the projects. And since there was no sales either in Luggo or Resia, we didn't appropriate the results or the financial results of these 2 companies. So all these factors together caused MRV and Co to have a large cash burn, much larger than in previous quarters and the income statement that was not good either. So it's important to highlight, however, that the income statement is more of a picture of the past of the company than of the present. If we analyze each line of business of MRV or its subsidiary, we are sure that we are on the right track.

Now when we talk about Incorporation Brazil, which is MRV and Sensia, the 2 development companies of Brazil, and these have a gradual and continuous recovery in the sales price. As we disclosed the gross margin at the end of the quarter reached 28%, which is a good level going from a margin of 17%. In the end of last year, we reached 28%. We still have a long way to run to reach the usual margin of the company that from 2014 to 2019, our gross margin was between 31% and 34%, and we understand that this is the percentage that is healthy. This margin includes interest. So that adds 3 to 4 percentage points. So it's a gross margin of 33% and which means an ex interest of 37%. So this is the level we are reaching for, aiming for. And of course, if we have several healthy seasons, then the operation, again, will generate cash and have a much healthier income statement.

Going back to Brazil, Urba remains with good operations. The company is growing with a healthy gross margin. Of course, now that we have a higher leverage in the balance sheet, we will be more conservative from now on. So the growth of Luggo will be a bit slower, although we know that the market has an opportunity to absorb this product, which is enormous. This is what Brazilians desire the most to buy their plot of land and build their own house. especially with Urba products that are very high quality when compared to the prices we have sold the projects. So this is a company that will grow with the current capital structure of the company. And if it requires more capital from MRV, it would be very little, not significant. But Urba has capacity to grow with its own funds with its own balance sheet.

Luggo has been renting at very good levels. Vacancy is close to 0. We have been able to raise rental prices above inflation. It's a very desired product. It's very innovative, unique in Brazil. There is no other product in Brazil with this value proposition of Luggo, the type of leasing, the number of services that we add to the apartments, we make a modern democratic product. And we are absolutely sure that it was the right bet. And of course, in the short run, the growth of Luggo must be sacrificed because this is a company that if we decide to grow very quickly, it has an important impact on capital allocation.

So we will have to hold its growth for a while. And when we have a leverage higher balance sheet and the cost of capital much higher than it was in the previous 2 years. But in terms of operations, the company is doing very well. Now talking about HSIA, which is the last subsidiary of the company. And looking again at its operations, it's going very, very well. Rental prices continue to go up. The current level is much higher than what we had planned 1 or 2 years ago that brings a very healthy yield on cost despite the inflation that we signed in the United States, which was too high in the last 2 years. And now the pressure of inflation in the U.S. starts to diminish. So new loan cost is very healthy.

The markets that we operate in the south of the U.S. there's a high demand. And the interest for mortgage went from 3% to 7%. Companies have had a harder time to buy a home. So rental now becomes the easiest or a more feasible way to have a home in the U.S. And we also saw people who used to rent larger apartments now migrating to Resia products. So we are absolutely sure that the market in terms of geography and demographics was the buffet choice. But of course, in a scenario of higher interest rates, the recycling of Resia assets will be done at a higher cap the gross margin that we presented was above 40%.

At the current scenario, gross margin will be close to BB that we showed at the moment of repurchases, which was 28%. So we will see transactions for the next 12 months, be between -- around 25% more or less. This, again, in a scenario of stress in interest rates, something unseen in the last 20 years. And of course, when inflation rates in the U.S. go down, that interest will go down, cap will go down and gross margins will go up again. We are absolutely sure about that. In the case of Resia, we do not have any sales expenses. So a gross margin of 25% is equivalent to a gross margin of operations in Brazil of around 34%. So it's a fantastic return.

In addition, we invest a little equity in the project. So the return on invested capital is very, very high, even in the 25% scenario. So we are at the most critical moment in the U.S. market. And even so, we are renting the apartments at a very high speed. Today, the project that is in stabilization. We are around renting 40 apartments per month at rentals much higher than we expected, and we'll sell the project most likely at the end of this year. Since it hasn't been signed, yet, we can maybe move to January, but it's very likely that we'll sell this project at the end of the year with a margin that's lower than we would like and then we expected 6 months ago. But it's still a gross margin that is very healthy because there is no sales expenses. So the net margin is very high. Well, this has been a very tough year, as I said. And we are very confident that we are on the right track.

The main leverage of sales price, it has increased a lot throughout the year. We have established a gross margin of 28% for sales, and it should get close to 32%, 33% and the growth of MRV and Co, which was something we established last year and in 2020, we verbalized that growth was a goal of the company and it is no longer the case. Our priority 1, 2, 3, 4, 5 and 6 is to generate cash, deleverage the company and once again have the gross margins that we understand to be healthy, which is the level that we always reported. MRV, after the IPO is the company that has delivered the most consistent figures with less rupture, either up or down. It was the really stable company for 14 years. We can say that with peace of mind, and we're very proud of that performance. And this year, that is not according to our historical background, but we are sure that everything we're doing we'll have the breakeven in terms of cash generation next year, and the gross margin of new sales will continue to grow. But the income statement margin, there is a natural delay for that, but it will grow again, too.

Inflation is much more under control now. So this combination of prices going up and stable costs will certainly cause the margin of the company to be healthier. So our focus and #1 priority is to remain in the same size. In Brazil, we are a company of 40,000 apartments per year. We don't need to decrease in size to generate cash for next year, the operation or for '22, it will be close to 40,000 units. And for the next 2 years, slightly lower than that to deleverage the balance sheet and generate cash. Now Kakao will talk about the financial indicators, and then we'll move to the Q&A.

Unidentified Company Representative

Thank you, Rafa. Good morning, everyone. I would like to start by talking about the income statement of the development part. We had a whole of 5% increase with the stabilization of commercial expenses, gross margin, and this is linked to an improvement in financial results, which was the swap of the repurchase of shares and the net income of BRL 61 million in the period. Another point that I would like to highlight is the importance of our recovery of gross margin of new sales and increasing 19% of the average pricing units in the first 9 months of '22, which more than 1/3 was in the first quarter plus the Inflation impacted new sales, which reached 28%, 9 percentage points higher than in the end of '21. This result, of course, will be reflected in the income statement as this become relevant. Now let's talk about the Resia transaction in the U.S. You may have noticed that in our release, we try to inform in detail the impacts of interest rates rise in the United States. One of the most immediate effecst is to increase in the cost of real estate financing, and the demand remains high. We see a high speed of leases and low vacancy, and we can increase the rental prices. This movement can be seen in the work in play in the development that is ready. And it has reached the mark of 67% of occupancy.

The cap rate of exit of properties that now is becoming higher. This is explained because investors who buy the properties use a leverage structure. As the interest rates of this leverage goes up, the cap of exits also goes up. In this current context, the main goal of Resia will be to develop projects in the lands that have been paid and purchased and work in play account for PSV of $1.5 billion or BRL 8 billion. On Page 4 of the release, we have a chart that shows $700 million of this PSV being completed in 2023 and a similar amount completed in 2024. It's worth highlighting that the funding model of Resia is the funding of construction plus partner equity plus joint venture and own equity.

It's important to highlight that the financing, construction and limit of partner equity, do not have an impact on MRV and Co equities covenants or debt covenants HSIA has 2 safety measures for its operations to happen. One of them is we only start construction when we have the real estate financing, which is 65% of the total cost and 20% of third-party equity is contracted. That, plus the 15% of our own equity that is basically land and initial costs, only when we have all that identified, we start a new construction. So if there's no recycling, we don't have the capital, and no new construction has started. We don't foresee any further investments of in Resia. So after the completion of the development, we may continue with the debtor's balance for construction for another 24 months. So there's no hurry to transfer the business.

Resia also has a permanent loan. It's a nonrecourse loan that doesn't have an impact on the holding company balance sheet. And the long-term project that allows to pay the construction and return the third-party equity and return the equity that Resia invested. The G&A of Resia has gone up with 2 important impacts. The first one is that part of the G&A rate is allocated to construction. Since there were fewer units produced, there was an increase in non-allocated expenses. Resia's operation was structured for a larger operational growth cycle. Since this will be slower, there will be a reduction in the structure, which will reduce G&A in the future. the MAV of Resia is $765 million, which is above 100% of our invested capital. Now let's move on to the Q&A session.

QUESTIONS AND ANSWERS

Operator

Let's now start the Q&A session. (Operator Instructions) First question comes from Gustavo Cambauva.

Rafael Nazareth Menin Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

This is Rafa speaking. Your audio is chopped. Is it better now? Oh, yes. No, it's good.

Gustavo Cambauva - *Banco BTG Pactual S.A., Research Division - Research Analyst*

Okay. I'm sorry. I was going to ask 2 questions. The first one is regarding Resia. Kaka mentioned. I would like to understand a bit more how you see the market from the sales point of view, sales of properties? I mean, you have a project that is ready and that it's very good rental rates. And next year, there are some deliveries adding up to about $800 million. So I'd like to understand how you see the possibility of selling these projects? Kaka mentioned that the caps have worsened a bit. But is there still a market to recycle such capital or maybe the strategy is to keep those properties for longer? And the second question is about costs in Brazil. You mentioned a margin on the new sales and the RAF also shows that your margin has grown. We've heard from some companies that there is still some pressure on costs in terms of concrete and cement. But apparently, were you able to offset something with some other savings? Or it's just the price increases, improving your margins. I would like to understand how the margins of Brazil are working.

Unidentified Company Representative

This is Kaka speaking. Let's talk about Resia first. Yes, we do believe that there is a purchasing market for those assets. There's a high demand. We are in negotiation with a very likely to complete the sale of this project until the end of this year. Unfortunately, the margin will not be 40%, 42% that used to obtain, but it will still be a very high margin with the gross margin around 25%, 26%, we can expect that, which accounts for a very high net margin since we don't have any sales expenses. For next year, we'll complete many projects. There is a large amount of projects to be completed and the decision whether to sell or hold the projects before recycling will be decided on a case-by-case basis. But we do see that the market is in demand for the assets that we make in the U.S.

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

This is Fischer. In terms of costs, as you've seen for the whole year, there has been a very steep increase in prices accompanied by an increase in costs in this last 12 months. What we started to see in the third quarter was some stability. One item that is very important is concrete and it still got higher in terms of price in the third quarter in October, there was some stability. And what has helped us to stabilize cost and decrease if you consider that the entire basket has some items that have prices had reduced. So the prospects are good because we'll continue to raise prices, maybe with a less steep curve, but it will continue. And we also see costs stabilizing, specifically about concrete and cement. This is a very fragmented industry. So the pressure happens in some markets that has more demand such as Sao Paulo and less in others. So on average, we can see stability of costs, especially in October. So we are relatively confident that the stability of cost or even reduction of costs may happen in the future. I hope I have answered your question.

Operator

Pedro Hajnal will ask the next question

Pedro Hajnal - *Banco Bradesco BBI S.A., Research Division - Former Research Analyst*

Hello, everyone. Thank you for the question and for the presentation. I have 2 questions. Now based on the previous question, starting with HSIA, I think you've mentioned that there was an increase in the cap rate negotiated. I believe that since the transaction is still under negotiation, you can't disclose the terms, but looking at the region as a whole or projects that are similar to Resia projects. What has been the cap in similar transactions? I mean how much has it increased thinking about higher interest rates in the U.S. And the second question, could you give us some color on the difference of RAP margin when compared to the margin of new sales? What does that mean?

Unidentified Company Representative

Pedro, this is Kaka, we were able to sale to sell and the exit cap was 4.5%. And now this level got up 100 bps with 5 or 5.5 in the markets we look at. We believe this will stay like this for some time, and then the market will adjust and the cap goes down again. And the question is about half margin. Could you repeat it?

Pedro Hajnal - *Banco Bradesco BBI S.A., Research Division - Former Research Analyst*

You explained the difference between RAF margin and the margin of new sales.

Unidentified Company Representative

When you look at the margin of new sales, it has everything that we have sold, and that's still to be executed, not what only is under in progress. Why is RAF margin lower than new sales? Or rather, why is RAF margin higher? Because there are some corrections we have to make to the figure, removing interest incurred ahead as well as provision for technical expenses. So this will grow in the future.

Operator

Next question comes from Bruno Mendonca.

Bruno Mendonca - *Santander Investment Securities Inc., Research Division - Former Head of Real Estate*

Thank you for your presentation. I have 2 questions. Rafael has commented clearly on the strategy of being a bit more cautious in terms of new launches to focus more on cash generation. In this context of focusing on cash generation, what do you envisage to be the recovery curve for Brazil cash? In the end of last year, beginning of this year, discussed a lot to anticipate the purchase of inputs, and it would be which was one of the offenses for cash generations in the past. But more recently, the conversation has been around pressure on margins. And so from now on, do you believe we should expect the cash generation recovery to be based on recovery of margins? Or is there anything of advanced purchases of inputs of previous quarters that could accelerate cash generation? And the second question is about Luggo. It has been published in the press lately that there could be new negotiations or to increase that agreement with Brookfield. So the question is, should we expect any acceleration in Luggo production or some agreement in the future, thank you.

Rafael Nazareth Menin Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

This is Rafael speaking, Bruno. Well, in terms of about generation, the inputs that happened in 2 quarters last year, we tried to purchase more in advanced because of very high inflation, we bought steel and other inputs, but this is no longer happening because as Eduardo said, prices are more stable now. So it doesn't make sense to purchase inputs ahead in advance. So the company, again, has an inventory value according to its historical levels. So we won't have any losses or gains coming from that side. Today, our operation works in the following way. We sell a unit, transfer it.

We generate a portfolio of about 15% and of the amount of that unit. And in the past, these figures were accumulated and postponed the cash generation of the company. We're able to address that issue. So in this last year, we have done almost in all quarters, the sale of our portfolio. So this line in the balance sheet is no longer growing. So there is no pressure to increase cash generation or to postpone it. The new items were able to sell. So the volume that remains in the balance sheet according to our plan will not grow or there will be a small decrease. So what remains is from the gross margin? That is accumulation of the margin from the seasons and the gross margin that is healthy.

The gross margin of new sales should generate cash has to be around 25%. Today, we are above that level. It has reached 28%, and we want to end the year close to 30%. And next year, reaching 32% to 34%. So it's expected that we have last season next year. And we sold seasons of as of

2022, rather 2020/'21 with a margin of 18%. And since the cost of the company, including expenses, SG&A, financial expenses, taxes and other expenses, the breakeven would be at 25%. But in the last 3 to 4 months, the gross margin has been above that level. So now piling up gross margin seasons with higher gross margins.

And naturally, in some quarter, will start to generate cash, actual cash generation, not operation. I don't know if I was clear in my explanation, but this is the path we are -- the track we're taking. As for Luggo, we have an agreement with Brookfield that's been working well. We have increased that agreement. But if we accelerate too much Luggoâ€™s operation, even with the guaranteed sale of the property, there is a cash burn. So we have to set the right pace given the current scenario of higher cost of capital, leverage balance sheet. So we have to be a bit more cautious in the growth of Luggo. And at some point in time next year, we expect the real estate funds to have a very good performance again because that's closely linked to interest rates. Today, our fund is quoted at 80% of its face value.

So the consensus is that interest rate will reach the end of next year, close to 10%. And then we'll have a second option to recycle the assets of Luggo from our funds. So the idea is to continue to sell at a good high prices, the operation has to be healthy. And to have these 2 exit doors looking in the middle term, make us sure that we are in the right market with the right product. And then the growth of Luggo's operation or not will be determined by the growth of the cost of capital of the company and the profitability at which we're able to sell the asset.

Bruno Mendonca - *Santander Investment Securities Inc., Research Division - Former Head of Real Estate*

Okay. That's right pace that you mentioned for Luggo. Is there a number for that? Like 1,000 units, does it seem reasonable.

Rafael Nazareth Menin Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Slightly more than that, Bruno, but it's not too much. What we do will make this year probably likely to for next year. But scenarios change, for example, SELIC interest rate ends next year at 9%, and we generate cash, again, the company has structured to grow. As I said in the opening remarks, growth is not the name of the game. The idea is to keep the size of MRV Co in Brazil and Resia as well and now top priority 1, 2, 3, 4, 5 and 6 priorities is generating cash and recovering our gross margin.

Operator

Next question comes from Ygor Altero.

Ygor Gomes Altero - *XP Inc. - Equity Research Analyst*

I have 2 questions. Going back to the gross margin of new sales in the quarter, are you capturing some of the upgrades that we saw from Casa Verde Marella, the FGTS funding. And with return of Lulaâ€™s for presidency, do you believe that he will help this area with next year, starting with the lower income brackets, encouraging that growth. In terms of mix, are you looking to those lower income brackets more attentively.

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

This is Fischer speaking. First question. Well, in fact, these changes that have been implemented during the second half of this year were very helpful, especially in the recovery of prices. And consequently, the gross margin for new sales without those changes, we might have had more difficulty to maintain the volume and increase prices as much as we did. There is future GPS that's something for next year that will increase the affordability of customers from group one. So we believe that this will benefit us as this new decision or ordinance takes effect. But it will help us more in the speed of recovery of prices, either decreasing volumes or maintaining the volumes we intended, but increasing prices as we did.

The second question is, well, in fact, if you look historically, my house, my life started in 2009, it from the second administration of Lula, 2 administrations of Jim, Tim and then Bolsonaro's under a different name. But the structure of the program is the same. So it has been on for several administrations and improving at each administration. That's what happened lately. Of course, the Lula government has a more social focus. So there will be some improvement to the program, maybe looking at lower income rates, income brackets, though all those things that have been done so far has been for lower income groups. But we do understand that probably this will be the priority.

There is a discussion in terms of tax fiscal impact, there are mechanisms to do that with a complementary subsidy without having to go to Level 1 as it was in the past. All those discussions will take place. And we believe that looking at 2023 and '24, these lower income brackets will be more privileged in these discussions. And of course, this is our DNA. We have in-house an enormous portfolio of products and a land bank that has been built to address that and accelerate that line of products, if necessary. So we are very optimistic because our industry will certainly have a positive impact as of the beginning of next year.

Operator

Next question comes from Andre Mazini.

André Chaves Mazini - *Citigroup Inc., Research Division - Assistant VP*

First question is a follow-up about this new government. We see some news about the introduction of social rental. Some members of the new government are speaking to some industries, Abrainki, et cetera, to make that feasible. Do you have any idea of how the social rental would be implemented. We need to know the final idea for the program like that. But Luggo internationally, you do have the know-how for this rental market. So how do you see that project. And the second question is about HSIA. The day before yesterday, there was a voting for midterm elections in the U.S. and in Orlando, they voted in favor of rental control. Of course, this is not a binding vote because law would have to be changed, and it doesn't change. But if this were to happen in Florida, it's not very likely because the Governor of Florida has been reelected. He's a Republican. But if this becomes true, how would that change your business model?

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Good morning. So about this new administration. In fact, this proposal was mentioned. At first, we don't see the social rental market in a very good way because if there are funds from the government for this program, I believe there are much better usage for those funds. And at first, this is not a market we'll participate in. We already have Luggo, and we believe that the correct source of funding other funds, the real estate funds will continue to make the developments going back to Minha casa Minha vida, the FGTS funding, housing programs. And if there is any additional benefit for the program, great, but we're not counting on those changes for our plan. But in fact, the social rental is not something that we consider to be good because government increasing its participation in a program that works so well. Let's wait and see. But entering that business is not on our radar at all.

Now talking about Resia, the U.S. market, it's part of their culture. They're a liberal country. So some states have that working, and it's a complete disaster. What happens is that companies no longer invest in that state and the rental market gets worse instead of getting better, not only in the U.S. but in other countries, the experiences that have occurred are very bad. And we do not expect it to occur in a large scale. Of course, it could happen in 1 or 2 states. We are in the states that are Republican and therefore, more liberal. And so this is not so much of a concern for us. We believe it will be restricted to 1 or 2 regions in the U.S. And if that change is implemented, the population may benefit from that in the short run. But in the long run, it's a disastrous impact because the country is very intelligent and agile in terms of public policies. When there's something wrong, they pivot the strategy. And so this is not a source of concern for us. What's important for us is that the demand for housing in the workforce segment is huge, and there's no way to address that in the many years to come still. So we still remain very optimistic about the rental market in the states we operate in. Okay.

Operator

Next question from Fanny.

Fanny Oreng Avino - *Santander Investment Securities Inc., Research Division - Research Analyst*

Hello. I have 3 questions about Resia. The first one is, -- could you talk about the outlook for yield on cost? We know that as important as the cap rate is that you on cost that you're developing properties. And today, in the U.S. market, there is some drop in the single fab blood, the multi-fab is a bit flat. So what do you think will happen in terms of cost? It's my first question. Second question about the cap rate, you've talked about that a lot, but there is a level of cap rate that you won't go. Let's say, historically, 2008, the cap rates on the markets you operate was 7.5%, almost 8%. Is there a cap rate level that you won't operate in and then you will hold the properties? And the third question is in a scenario in which you hold the properties how is the size of delay -- what's the size of delay in Resia that you need to have.

Unidentified Company Representative

Fanny, this is Kaka speaking. First about yield on cost. We believe that the future inflation will decrease. So there will be an increase in construction materials that will be lower. And even if we have a decrease in the increase of rentals, the yield on cost around 7%, 7% something for the future is what we see for the future. As for the exit cap, we have to make our calculations what is the projects to be started? What is the -- we won't sell it at a loss, so selling at a cap that is above the yield doesn't make sense.

If that historical figures that you have for 2008, it was 7 or 8. But then in 2009, it had gone back again to six something. So it makes a lot more sense to hold that, either by postponing payments of construction financing are entering into a permanent lower scenario. So in that case, it would make more sense to sell it at a lower cap with a better profitability. As for Resia, we are finishing the studies, and we'll adjust the size of operation. There is an impact on the rental of reduced units. So since we will probably have a lower growth, it we should expect a reduction in comparison to the current G&A of Resia

Fanny Oreng Avino - *Santander Investment Securities Inc., Research Division - Research Analyst*

Okay, Kakar. So you believe that we're talking about $7 million G&A for resi for this quarter. Do you think -- or rather $2 million for this quarter. You don't think that it will be stabilized in this level?

Unidentified Company Representative

No. Most of the G&A is due to the development of new projects rather than maintaining the property rent who are leased or rented.

Operator

Next question is from Marcelo Motta.

Marcelo Garaldi Motta - *JPMorgan Chase & Co, Research Division - Research Analyst*

Two quick questions. First, when you look at the speed of sales that there is a balance between sales price and sales over supply is this level -- does it make sense? Is this the bottom? Or could it be improved in the fourth quarter? And the second question is about leverage. You said that the cash generation will increase with time, the margins will recover. But what is the path to reach breakeven? Maybe you have a cash burn still in the first 6 months. What comes from Resia still has a large impact. Is there any other initiatives to try to decrease leverage, maybe selling land bank or increasing the land bank size less, maybe you could accelerate the sales of receivables to do something to lower leverage.

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

This is Fisher speaking, Motta. I'll answer the first question and Kaka the second one. In terms of sales of our supply, we started the year with a need to increase prices very high, and we implemented that. There are 2 issues when you do that at a speed in which we did. First, the evaluations. You know that Caixa economic of the bank finances the customer with the lowest value between the assessment and the evaluation and the sales price. And we only sell what Caixa approves. And if there is a mismatch is not good because when you increase the prices and evaluation of property increases to, they're always lagging behind the valuation prices. And that makes it that poses the difficulty on the sales oversupply. As evaluations reach the prices and even exceed that the dynamics is more favorable for us.

And this is what we expect for now. Also, when prices increase too quickly as we did, all your sales funnel that was prepared for customers with a certain income level, is compromised. So you often have to go back to the funnel and look for new customers. So that's also a problem. So this rapid price increase that happened in the last 9 months causes an imbalance in these mechanics of sales. Now looking forward, fourth quarter and onward, since we believe that the pace will decelerate a bit, these dynamics will be more favorable. And secondly, the launches we expect to have from now on, start with a better margin. And without these ruptures that happened in these projects that had been launched and were sold this year.

So as we recover the cruise speed in terms of launches, I think that new projects will be created at a better level. This is the outlook. And as I said in the previous question, all the movement that was made by the government in the first half of the year to adjust the program helped us make this movement and maintain a certain volume of sales. As of now, these benefits remain. They will be added to future FGTS and within a scenario of much better launches and much better evaluations. So we believe that the speed of sales over supply will recover in the future. Kaka will answer about leverage.

Unidentified Company Representative

It's worth looking at 2 scenarios separately. The rent scenario, we have to look at the goals that we have in the U.S. We have our own competitors with a higher leverage than we operate. The main indicator would be the total debt over the evaluation property of total valuation value of properties. And in that, we have room to grow Resia. When we mix it to Brazil's operation, the features are different. Only 25% of the debt financing of construction of Resia recourse on holding. So looking as a group is not the way that makes those indicators clear. When we come to Brazil's operations, we have reduced the purchase of land. We sometimes bought 80,000 units per year. in 2 from 3 years, we bought 80 this year, we bought 30,000 to 40,000.

So it's a lower volume, more compatible with the size of the company in the medium term. So this line of payments for land will have a lower impact on cash disbursement in the future. In the sales of receivables, we have reached a good volume. We may accelerate that a bit as we are able to solve some operational issues of having the terms of that concession sign more quickly. But that's not very substantial. This increase that we see coming. And the main issue here is that as we see the gross margin of new sales developing and as we start to build those units, we start to have more gross margin in the cash, which will mean our breakeven. So at some point in time next year will be a cash generator. Maybe in the beginning of the third quarter or the end of the second quarter of next year, then we'll again be a generator of recurring cash.

Operator

Next question from George.

Unidentified Analyst

I have 2 questions quickly. You commented on the participation of Group 1 of Minha casa Minha vida. If the conditions are adequate, if this is the case, could you provide what would be the size of your participation in terms of future launches? And second question is about Resia. You have published an assumption for completion of projects with the schedule. I would like to understand how would that apply to the expected CapEx? In other words, what is your expected CapEx for Resia for the end of next year?

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Sure, this is Fisher. I'll answer the first question. There are 2 concepts there. What I said before is that Group 1 of current Casa Verde e Amarela. The group one is for properties for families whose income is up to BRL 2,400. And the measures that will be implemented, especially the next one, the future FGTS, there will be only for Group 1 for the same bracket of income will navigate very well. This is Group 1 of Casa Verde e Amarela, yellow and green housing program. What the elected government is saying is about the Faixa 1, of the old Minha casa Minha vida, which are contracted directly with the construction companies and delivered to the families. These products of Level 1, the interest in that is 0. We never took part in those projects in the past. And if it comes back in the same format as it used to be, MRV will not take part in that. Were you able to understand? Kakao will answer your second question.

Unidentified Company Representative

Well, there is a need for EUR 450 million to EUR 500 million in CapEx for next year. It's important to say that Resia's share, which is the land and development of projects. Part of that is given. We already have the land in-house. It's been purchased. So it doesn't mean more these expenditures and funding or financing comes apart from our equity that's given and apart from construction financing and the other part that comes from a limited partner, strategic partner. So these are the values we have for next year, and it will only happen if there is a favorable market.

Operator

(Operator Instructions) This ends the Q&A session. For the final remarks,

Eduardo Fischer Teixeira de Souza - *MRV Engenharia e Participações S.A. - CEO & Member of Executive Board*

Well, a quick remarks, closing remarks, we talked about Resia. That's an important point in the growth strategy of MRV. But let's go back to the Brazil operation. I mentioned our strategy during the call to go back to launching new projects. Our projection for 2023 is a company that doesn't seek to grow, but we'll launch for the levels that we used to have because this will bring higher margins and cash generations. A second point we didn't cover here is about defaulting customers. We have started a strong work 3 to 4 years ago and having more sophisticated receivables. Now there is a bank, Banco amor a have is the credit analysis, and it's very sophisticated.

So that has allowed us to keep delinquency levels very low at a right growth. So we're now harvesting the fruit of something we have planted for 3 years. And the second point is, as we discussed a lot this year, we now consider projections for inflation in our margins so that we are not caught or surprised in terms of inflation. So we project future inflation in terms of what we're going to execute. And what we start to see now is INCC at a level that is below the one that we consider in our future margins. It's still too early to say because this has started recently, but if it proves to be true, we'll have higher margins than what we disclosed. This is just an additional comment, given the level of protection that we have included in our margins for the future. Thank you very much for attending the call, and we'll see you in the next quarter.

Operator

The conference call from MRV has now ended. We thank you all for attending, and have a good day.