Q2 2014 Earnings Call

Company Participants

- Nora Lanari
- Roberto Antônio Mendes

Other Participants

- Kevin M. Kaznica
- Mark Bickford-Smith
- Victor Mizusaki

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and welcome to the Second Quarter 2014 Conference Call of Localiza Rent A Car. Hosting the event today are Mr. Roberto Mendes, CFO; and Nora Lanari, Investor Relations Director.

We would like to inform that the numbers in this presentation are stated in millions of Brazilian real and based on U.S. GAAP until 2010 and based on the IFRS from 2011 on.

The presentation will be recorded, and all participants will only be able to listen to the conference call during the company's presentation. Immediately afterwards, we will start the Q&A session for analysts and investors, when further instructions will be provided.

The conference call audio and the accompanying slide presentation are being broadcast simultaneously over the Internet at the address, www.localiza.com/ir. The slide presentation can be downloaded at the same address by clicking on the banner, 2Q14 Webcast.

Before proceeding, we would like to clarify that any statements made in the conference call concerning the business outlook of the company, forecast, as well as operating and financial targets, represent the opinions and assumptions of the company's management which may or may not occur. Investors must comprehend that economic conditions and other operating factors may affect the company's future and may lead to materially different results from those stated in this call.

I would like now to turn the presentation over to the IR Director, Nora Lanari, who will begin the presentation.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon everyone, and thank you for attending our conference call.

On slide number 2, we present some highlights of the quarter. Car Rental Division's net revenue presented double-digit growth in the second quarter 2014 in spite of the slow growth of economic activity. The decrease in business trips was compensated by an increase in leisure trips.

This quarter, consolidated net revenues increased 11.3%, being 6.6% in Rental revenues and 16.5% in Seminovos that maintained a good level of sales. Utilization rate in the Car Rental Division increased from 67.1% in the second quarter 2013 to 70.7% this second quarter. This was a result of our discipline in managing the fleet size, aiming at maintaining high ROIC levels. As a result, the company's annualized ROIC was 18.7% in the first half 2014, 11 percentage points above the cost of debt, in spite of the significant increase in the SELIC rate within the period.

On slide number 13 (sic) [3] (03:29), we present the growth evolution of the Car Rental Division. This semester, daily rental volumes presented 10.4% growth when compared with the same period last year. The higher volume combined with a 2.5% increase in the average rental rate resulted in the growth of 11.4% in net revenues.

As for the quarter, net revenues increased 13% in the second quarter 2014 due to a 10.6% growth in daily rental volumes and 3.6% in the average rental rate, when compared with the second quarter 2013. The World Cup effect in June was as expected by the company with the increase in leisure trips compensating the decrease in business trips.

On the next slide, slide number 4, we present the evolution of the Car Rental network. This semester 15 new locations were added to Localiza's corporate network. Localiza and its franchisees currently hold 534 locations in 9 countries in South America.

In the next slide, slide number 5, we present the Car Rental Division's utilization rate. Fleet optimization allowed a significant increase in the utilization rate of the Car Rental Division that went from 66.9% in the first half 2013 to 71.4% in the first half 2014.

In the next slide, slide number 6, we present the volumes and revenues of the Fleet Rental Division. This semester daily rental volume reduced 5.9% in relation to the same period of last year. The increase of 4.7% in the average daily rate partially offset the volume reduction and resulted in a net revenue reduction of 2%.

As for the second quarter 2014, net revenues in the Fleet Rental Division reduced 4.8% when compared with the second quarter 2013, due to a 7.4% decrease in volumes and a 3.8% increase in the average daily rate. The lower growth in daily rental volumes was mainly due to the competitive pricing environment. The company maintains its conservative approach in order to provide return on invested capital, adding value for the shareholders.

On the next slide, number 7, we present the fleet net investment evolution. This quarter, 8,295 cars were added to the fleet, and the net investment totaled R$260.8 million.

Slide number 8 presents car sales evolution. In the second quarter 2014, 15,889 cars were sold. This is equivalent to 5,300 (06:51) cars per month or 72 cars sold per store per month. In spite of Seminovos car sales being impacted in June by the World Cup, volumes are adequate to the company's needs and are being achieved without a reduction in the average sales price.

In the next slide, slide number 9, we present the end of period fleet evolution. By the end of June, fleet was comprised of 105,095 cars, plus 12,991 cars of our franchisees, totaling 118,086 cars. Better utilization in the Car Rental Division allowed fleet to grow only by 3.3% even with volume growing 10.4% in the first half 2014.

Slide number 10 presents consolidated net revenues evolution. In the first half 2014, company's net rental revenues grew 15.1% in comparison with the same period in 2013, due to a 6.8% growth in both car and fleet rental revenues and 24.8% increase in cars sold for fleet renewal. The 25.3% increase in car sales volume this semester was helped by the low comparable base of the first half 2013. In the second quarter 2014, company's net rental revenues grew 11.3% in comparison with the same period in 2013, due to 6.6% growth in both car and fleet rental revenues and 16.5% increase in cars sold for fleet renewal.

Slide number 11 presents the EBITDA evolution. EBITDA in the second quarter 2014 totaled R$241.6 million, a 7.3% growth. In the Car Rental Division, the EBITDA margin of 38.1% in the second quarter 2014 was 2.2 percentage points above that of the same period of last year, mainly due to a 13% growth in net revenues and costs growing only 3.3%.

The SG&A increase in the Car Rental Division was mainly related to expenses with consultancy and greater personnel expenses due to the employees promotion and progression program that occurred in May and an increase in labor litigation provision.

In the Fleet Rental Division, EBITDA margin was 61.5% in the quarter presenting a decrease of 4.7 percentage points when compared with the same period last year. Such reduction was mainly due to the increase in average age and volume of the cars decommissioned, which implies on higher maintenance cost in decommissioning.

Expenses with strategic consultancy and greater provision of civil nature also impacted EBITDA in this division. The increase in maintenance costs was compensated by the reduction in cars depreciation. Once again, the conservative position of the company on estimating the residual value of the cars was demonstrated in the Seminovos EBITDA margin.

Let us now move to slide number 12, where we present the average depreciation for car in both Car Rental and Fleet Rental Divisions. In the first half 2014, annualized depreciation per car in the Car Rental Division was R$1,361 and R$4,105 in the Fleet Rental Division. In the Fleet Rental Division, the higher maintenance cost in the end of the cars' useful life are compensated by lower depreciation expenses since the depreciation method used in this division is the sum of years' digits, SOYD.

On slide number 13, we present the net debt – the net income evolution. The company presented a net income of R$100.6 million in the second quarter 2014, 2.7% reduction in comparison with the second quarter 2013. The R$16.5 million EBITDA increase and the R$3.1 million depreciation reduction were not enough to offset the impact of the SELIC hike. Financial expenses increased R$21.5 million mainly due to the increase of SELIC rate from 7.5% to 11% in the period.

Slide number 14 presents the free cash flow in the first half 2014. This semester the company presented free cash flow before investment in the new headquarters of R$217.2 million. This semester, R$18.8 million were spent in the new headquarters construction, and R$87.5 million out of the funded amount is being held in an escrow account to be invested in the construction. This amount is invested in long-term securities and therefore is not considered cash equivalent.

On slide number 15, we present the change in debt. The strong cash generation this semester was enough to pay interest, dividends, and the investment for the new headquarters construction. The net debt remains stable.

On slide number 16, we present the cash and debt amortization profile. The company monitors the financial and capital markets on a regular basis, adjusting its debt profile, aiming at better debt profile and financial costs. For that reason, the company took some measures this quarter. In one of the deals, Localiza prepaid R$258.8 million loan that would mature in 2016. Such anticipation led to a call of R$4.1 million, which is lower than the carrying cost of the cash until maturity.

In the other credit operation, the company raised R$190 million loan for the new headquarters construction, which will mature in seven years. R$87.5 million of it is being held in an escrow account and will be disbursed according to the construction schedule, starting from the 12th month. The company is still presenting strong cash position and comfortable debt profile.

On the next slide, number 17, we present debt ratios, which reflect the financial discipline of the company. The company kept its ratios in very comfortable levels. Localiza is prepared for growth and consolidation opportunities in the car rental market.

I would like now to turn the floor over to Roberto Mendes, our CFO.

Roberto Antônio Mendes {BIO 7289124 <GO>}

Good afternoon everyone, and thank you for joining our conference call. As you heard from Nora's presentation, Localiza has actively worked to prepare itself for the adverse scenario and opportunities that may arise in 2015. We aim at increasing revenue and also reduce cost, improve utilization rate in our debt profile. Localiza's stand is totally engaged in increased ROIC to mitigate interest impact in 2014 and 2015.

Regardless who wins the presidential election, (15:34) for 2015 inflation on the top of the price band (15:38) and low GDP growth. Localiza work hard in areas that had or had improved good results and will also provide a legacy for the next year.

We are aware that we need to constantly seek the strategic (15:58) gains and sustainable growth. We have improved a lot, and we work today better than we did before, but we are sure that tomorrow we can do it even better than we are doing today.

And the result of all these works can be seen on slide number 18 that we presented the evolution of the spread between the ROIC and cost of debt after-tax. The 2.2 percentage point increase of ROIC is a result of this work and offsets the rise of 1.7 percentage point in cost of debt.

Let us now move to the Q&A session.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Stephen Trent with Citigroup.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Hi. Good morning, guys. This is Kevin Kaznica. Stephen Trent's overseas right now. It seemed like a good quarter. But I just had a few questions, like, I guess looking forward, what is your, I guess, best guess for I guess you've had SELIC rate pressure, but what is your best guess going forward for the rest of the year, maybe into 2015; do you think you're going to see rising interest rate expenses due to that?

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Kevin. Sorry, we were not able to listen to the end of your question. Our best guess in terms...?

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Yeah, best guess on, like I guess, just like the interest rate structure going forward, like perhaps 2014 and maybe into 2015. Do you think you're going to see continued pressure from the SELIC rate, or do you think that will moderate?

A - Nora Lanari {BIO 18838335 <GO>}

Well, thank you for the question. We are using a focused bulletin here, and market expects interest rate this year at 11%, going up for 2015 to around 12%. This is not unanimous. We do have some expectations of interest rates going down next year, but our base-case scenario is 12% SELIC rate for next year.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

And do you hedge interest rates at all or do you just...

A - Nora Lanari {BIO 18838335 <GO>}

To-date, roughly 50% of our debt, net debt is already fixed, and we still have the other half on a floating base.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Okay, very helpful. And also, do you, I guess just kind of jumping off of that, do you expect to move more toward a fixed rate, like I guess, the ratio; you said about half is fixed. Would you expect to move more towards fixed or more towards floating I guess, since interest rates are so high right now or would you want, I mean like more floating so you can adjust it when they go down, or do you think that balance is where you want to be right now?

A - Nora Lanari {BIO 18838335 <GO>}

Yeah. Our goal Kevin is to fix the debt related to the Fleet Rental Division where we signed two year, three year, four year contracts and we're locked into the monthly rate. So the goal is to fix the debt related to the Fleet Rental and the Car Rental. We can maintain it on a floating basis.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

Okay. I just had – I guess I had a quick question on escrow account as well; is that something that you expect to keep, like I guess, provisioning into the future, or do you expect that to come down as construction progresses?

A - Nora Lanari {BIO 18838335 <GO>}

It will come down as construction progresses, but after this – the 12 months of the construction. So we will still have this R$87.5 million throughout (20:39) one year.

Q - Kevin M. Kaznica {BIO 17875244 <GO>}

For about one year. Okay. Thank you very much for the call.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Kevin.

Operator

Our next question comes from Victor Mizusaki with UBS.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Hi. Good morning. Just a quick question; what do you think about the Brazil economy this year, next year, probably be very challenging in terms of GDP growth? And last year, given the, I mean similar scenario and the weaker volume growth, Localiza started to pay a special dividend. So I'd like to know if you have any plans to do that this year.

A - Nora Lanari {BIO 18838335 <GO>}

Victor, thank you for your question. We hold a strong cash position nowadays, as we did last year. We increased a little bit the investment this quarter, raising debt here to the construction of the headquarter. Our goal here is to grow organically and to use this cash to grow organically, but we need to look to the opportunities that arise.

Operator

Our next question comes from Mark Smith with Charlemagne.

Q - Mark Bickford-Smith {BIO 2026957 <GO>}

Hi. I'm wondering about the margin on the used car business. Do we think that's sustainable over time or as the environment improves, should we expect that to commensurately shrink back to where the 4% to 5% to 6% range that it's been in the recent years?

A - Nora Lanari {BIO 18838335 <GO>}

Thank you for the question. We do expect this margin to converge more towards a normalized level; 3%, 4% level is a more reasonable level. But this should happen in the long-term. We do not expect this margin conversion this year already.

Q - Mark Bickford-Smith {BIO 2026957 <GO>}

So why is it so elevated at the moment; is that a reflection of the poor economic environment and lower new car sales?

A - Nora Lanari {BIO 18838335 <GO>}

As a matter of fact, we've been able to sell very good volumes of Seminovos, maintaining prices pretty much stable. So the scenario is actually positive in selling Seminovos cars. Other thing that helped margins this quarter is the fact that the SG&A of selling cars was diluted by the volume of cars sold, helping the margins to be a little bit stronger than the normalized levels.

Q - Mark Bickford-Smith {BIO 2026957 <GO>}

Okay. I guess what I'm driving at is, if people are – in a poor economic environment, if people are less willing to buy new cars, is it that they are as a result more willing to accept a cheaper second-hand car and thus making it easier to sell on your used cars?

A - Nora Lanari {BIO 18838335 <GO>}

Yeah, it's a fair assumption. Yeah, so we saw weaker new car market, but we are seeing Seminovos in used car market growing by roughly 5% overall. So we do see this environment positive to us, because we saw a little bit of a shift of demand towards the Seminovos car, which has been posting very – very decent numbers. But again, we cannot count on this favorable scenario in the longer run since we already started deceleration in the new car market, credit is more expensive and selective nowadays. So we need to be realistic here on forecasting our depreciation, and this is how we prefer to run the business.

Q - Mark Bickford-Smith {BIO 2026957 <GO>}

Okay. And Nora, just while I'm on the – I've got the microphone, can I just ask about free cash flow; I'm not too sure I quite followed and understood. It's down because funds have been put aside for the building of the headquarters. Is that the reason?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, Stephen (25:47), what we try to do here was segregated the free cash flow to show you the impact of the new headquarter. So in the first half of this year, the free cash flow, excluding the impact of the new headquarter, was R$217.2 million, a pretty good level of free cash flow generation. But we raised R$100 million to the construction of the new headquarter; R$100 million of these funds was already released. But roughly R$90 million, they are accounted in an escrow account, and they will be released according to the schedule of execution of the construction. So we do have R$90 million set aside for the construction. The release of this amount should start after the 12th month of construction.

Q - Mark Bickford-Smith {BIO 2026957 <GO>}

Okay. Thanks.

Operator

This concludes today's question-and-answer session. I would like to invite Ms. Nora Lanari to proceed with the closing statements. Please go ahead, madam.

A - Nora Lanari {BIO 18838335 <GO>}

We would like to thank you all for participating in our conference call and to inform that our IR team is available for any further query. Our interim financial statements for the second quarter 2014 will be filed on Friday, July 25. Thank you.

Operator

That does conclude the Localiza Rent A Car audio conference for today. Thank you very much for your participation and have a good day.