Q3 2014 Earnings Call

Company Participants

- Nora Lanari
- Roberto Antônio Mendes

Other Participants

- Kevin M. Kaznica

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and welcome to the third quarter of 2014 conference call of Localiza Rent A Car. Hosting the event today are Mr. Roberto Mendes, CFO; and Ms. Nora Lanari, Investor Relations Director. We'd like to inform you that the numbers in this presentation are stated in million of Brazilian reals based on U.S. GAAP until 2010 and based on IFRS from 2011 on.

The presentation will be recorded and all participants will only be able to listen to the conference 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 broadcasted simultaneously over the Internet at the address localiza.com/ir. The slide presentation can be downloaded at the same address by clicking on the banner 2Q14 Webcast (sic) [3Q14 Webcast] (01:09).

Before proceeding, we'd like to clarify that any statements made in the conference call concerning the business outlook of the company, forecasts 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.

Now, I'd like to invite the company CFO, Ms. Roberto Mendes to start the teleconference of the third quarter of 2014.

Roberto Antônio Mendes {BIO 7289124 <GO>}

Good afternoon, everyone, and thank you for attending our conference call. We would like to share with you an important (01:58) for the future of the company. On this October 1st, we concluded a SAP roll-out. We revised our process and procedures according to the best practice. We came accounting on - and even more robust (02:18) for decision-making and to support our future growth.

The implementation was a success with no impact on our operation. This quarter's solid results in a diverse market scenario displayed, first, our discipline in efficient capital allocation and a search (02:47) for operation efficiency to maximize our return on investment capital.

I'd like now to turn the floor to our IR Director, Nora Lanari, who will begin the third quarter 2014 results presentation.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone, and thank you for attending our conference call. On slide number two, we present some highlights of the quarter. In the third quarter this year, the net revenue level continue its consistent expansion in the Car Rental Division growing 12.3% in comparison with the same period last year. This quarter's consolidated net revenues increased 7.6% being 7.5% in rental revenues and 7.8% in Seminovos that maintained a good level of sales.

The number of cars sold for fleet renewal totaled 18,815 cars, an average of 85 cars per store per month, contributing to fixed cost reduction per sold car. The company's annualized ROIC increased 1.5 percentage points in the nine months 2014 compensating the increase in the basic interest rate in the period. This spread remains well above 8 percentage points reinforcing the company's discipline in adding value to the shareholders.

On slide number three, we present the growth evolution of Car Rental Division. In the nine months 2014, daily rental volumes presented 9.4% growth when compared with the same period last year. The higher volume combined with 3.7% increase in the average rental rate resulted in a growth of 11.7% in net revenues.

As for the quarter, net revenues increased 12.3% due to 7.5% growth in daily rental volumes and 6% in the average rental rate, when compared with the third quarter 2013. Average rental rate of R$88.20 this quarter was greater than the average of R$86.60 in the first half of 2014. Additional demand due to the election period in the third quarter 2014 was not as relevant as in the previous elections.

On the next slide, slide number four, we present the evolution of the car rental network. In the nine months 2014, 16 new rental locations were added to Localiza's corporate network. Localiza and its franchisees currently hold 534 locations in nine countries in South America.

In the next slide, slide number five, we present the Car Rental Division's utilization rate. Fleet optimization focus has allowed a significant increase in the utilization rate of the Car Rental Division that went from 66.4% in the nine months 2013 to 70.5% in nine months 2014.

In the next slide, slide number six, we present the volumes and revenues of the Fleet Rental Division. In the nine months 2014, daily rental volumes reduced 5.6% in relation to the same period of last year. The increase of 4.5% in the average daily rate partially offset the volume reduction and resulted in a net revenue reduction of 1.8%. As for the third quarter 2014, net revenues in the Fleet Rental Division reduced 1.5% when compared with the third quarter last year due to a 4.9% decrease in volumes and 4.2% increase in the average daily rate.

The lower growth in daily rental volume was mainly due to the competitive pricing environment. The company maintains its conservative approach in order to provide return on invested capital adding value to the shareholders. However, it is important to highlight an evolution in the contracted revenue from R$647.3 million in December 31 last year to R$724.3 million in September 30 this year, a growth of roughly 12%.

In the next slide, number seven, we present the fleet net investment evolution. This quarter, 1,141 cars were reduced to the fleet and net investments totaled R$48.3 million due to the mix of cars purchased. In the nine months, 585 cars were added to the fleet.

Slide eight presents car sales evolution. In the third quarter 2014 18,815 cars were sold. This is equivalent to 6,300 (08:26) cars per month or 80 cars sold per store per month. The 16.8% increase in car sales volume in the nine months 2014 was achieved without a reduction in the average sales price and contributed to reduce the fixed cost per sold car.

In the next slide, slide number nine, we present the end of period fleet evolution. By the end of September, fleet was comprised of 103,563 cars, plus 12,800 cars of our franchisees, totaling 116,363 cars. The average rented fleet in the Car Rental Division grew 9.9% in the nine months 2014 compared with only a 3.4% growth in the average operating fleet reflecting productivity gains of approximately 4 percentage points in the utilization rate.

On September 30, the number of cars in the Fleet Rental Division totaled 33,072 cars versus 31,814 in the beginning of the quarter. This fleet included 1,583 cars in preparations to be delivered to our customers, much higher number than the 444 cars being prepared on June 30.

Slide number 10 presents consolidated net revenues evolution. In the third quarter 2014, company's net rental revenues grew 7.6% in comparison with the same period in 2013, due to a 7.5% growth in both Car and Fleet Rental revenues and 7.8% increase in cars sold for fleet renewal. In the nine months 2014, company's net rental revenues grew 12.4%.

Slide number 11 presents the EBITDA evolution. EBITDA in the third quarter 2014 totaled R$241.5 million, a 1.4% growth. With the SAP rollout, the overhead appropriation was reduced. Previously, those expenses were appropriated to the Car Rental Division and the Fleet Rental Division. Starting this quarter, they are also appropriated to Seminovos.

In the Car Rental Division, the EBITDA margin was 39.6% in the third quarter. If the R$10.6 million effect of the change in the SG&A appropriation criteria were excluded, together with the extraordinary expense with consultancy companies, EBITDA margins would have been of 37.5%, 1 percentage point below that of the third quarter 2013 due to increases in maintenance cost, passing through of inflation to the lease of the rental location and labor litigation provision.

In the Fleet Rental Division, the EBITDA margin of 61.1% in the quarter would have been 59.5% with the same adjustment. The 5.7 percentage point reduction when compared with the third quarter 2013 was mainly due to higher volumes and average age of cars sold, which implies on higher maintenance cost and preparation cost of the decommissioned car. We know that higher maintenance cost in this division is offset by lower depreciation cost since the depreciation methods using in the division is the sum of the years' digit.

The conservative position of the company on estimating the residual value of its cars was once again demonstrated in the Seminovos' EBITDA margin.

Let us now move to slide number 12 where we present the average deprecation for car in both Car Rental Division and Fleet Rental Division. This quarter annualized depreciation per car in the Car Rental Division was R$1,232 and R$3,954 in the Fleet Rental Division. The sales expenses reduction per car due to the increasing productivity percent in our store associated to the purchase and sales conditions led to a reduction in depreciation expenses, that contributed to increased ROIC in the nine months this year.

On slide number 13, we present the net income evolution. The company presented a net income of R$308.3 million in the nine months 2014, a 4.7% increase. In the third quarter 2014, net income was R$101.9 million, is stable in comparison with the third quarter 2013. The EBITDA increase and lower depreciations were compensated by R$14.3 million increase net financial expenses due to the increase of SELIC rate from 8% to 11% in the period.

Slide number 14 presents the free cash flow in the nine months 2014. This year, the company presented a free cash flow before investments in the new headquarters of R$332.7 million. This year, R$28.9 million were spent in the new headquarters construction, and R$90 million out of the funded amount is being held in escrow account to be invested in the construction. The 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 in this nine months was enough to pay interest, dividend, and investment on the new headquarters construction, and the debt remains stable.

On the next slide, number 16, we present debt ratio, which reflect the financial discipline of the company. Localiza has very comfortable levels of investments. We are prepared for growth and consolidation opportunities in the Car Rental market.

On slide number 17, we present the cash and debt amortization profile. The company constantly monitors the financial and capital markets on a regular basis, adjusting its debt portfolio, aiming at better debt profile and financing costs. In that sense, the company issued R$500 million in local debentures with six years term and prepaid working capital loans with principal amount totaling R$173 million in maturities in 2014, 2015, and 2016. The remaining amount has strengthened the company's cash position. Localiza is still presenting strong cash position and comfortable debt profile.

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

Roberto Antônio Mendes {BIO 7289124 <GO>}

Thank you, Nora. Localiza is actively working to prepare itself for the adverse scenario expecting for the next year and therefore (16:32). Market expects the next year to have inflation on the top of the target brand, high interest rates, and low GDP growth. We need to constantly seek new procedural gains and focus on the results aiming at a stable growth. And our revenue activity resulting (17:03) on our discipline can be seen on slide number 18 where despite the lack of GDP growth and inflation pressure, the company presents 18% ROIC in the first nine months of this year. The 1.5 percentage point increase contributed to offset in the rise of interest rate to maintain a spread much above 8 percentage points.

Let us now move to the Q&A session.

Q&A

Operator

Our first question comes from Mr. Kevin Kaznica with Citi.

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

Good morning, guys. Just a couple quick questions. What are your thoughts on 2015 sales volumes for the Car Rental and the Fleet Rental Divisions? Do you think they'll all be going at the same trend or do you think it will come down a little bit?

A - Nora Lanari {BIO 18838335 <GO>}

Kevin, thank you for the question. We do not provide guidance. But our expectations for 2015 is that this year is going to be a challenging year in terms of macro scenario in Brazil, but we do expect some level of growth in the Car Rental Division.

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

Okay. And what are your thoughts on, I guess, the OEM market growth in 2015? It's been pretty weak this year, but I guess recently there has been signs of improvement. Do you think that is like short-term and overall prices will remain depressed in 2015 - or actually you're looking for like fleet renewal - you're looking at lower prices?

A - Nora Lanari {BIO 18838335 <GO>}

2015 is going to be a challenging year for Brazil. So we do not expect much of an improvement for the OEMs. So we do expect similar purchase and sales condition as we saw this year.

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

Okay. And then sorry, just one last question. You were talking about, I guess, positioning yourself for maybe some consolidation. Are there any projects in the pipeline that you're looking at? Any like M&A activity on the horizon? Are there some weaker competitors that you could absorb?

A - Nora Lanari {BIO 18838335 <GO>}

Yeah. Thank you for the question Kevin. We have a challenging year, eventually presents good opportunities for us to consolidate the market, but we analyze all the options that the company has, but so far, we do not have anything in the pipeline to announce.

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

Okay. Thank you very much. I will get back in the queue.

Operator

Our next question comes from Mr. Kevin Kaznica with Citi.

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

All right, so, finally, I guess my last question will be, what's your long-term target regarding your - what percentage of debt should be fixed rate versus variable rate?

A - Nora Lanari {BIO 18838335 <GO>}

Today, our current net debt equity ratio is around 1.4 times Kevin. Our covenants are four times. So we are more than comfortable to lever, but we can reach net debt-to-EBITDA of around 2 times to 2.5 times. So we still have room to improve, leverage the ratio.

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

Okay. Really how much of that I guess should be - like what do you guys wanted, I mean, your ideal optimal fixed versus like variable rate debt?

A - Nora Lanari {BIO 18838335 <GO>}

The debt, usually Kevin the debt we like to fix is the debt related to the fleet rental division. So today, roughly one-third to 40% of our debt is fixed; the other 60%, 70% is floating. So usually the debt related to the fleet rental where we are locked into two-year, three-year contract.

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

Okay. So this serves as a (22:23) function of your fleet rental then. Fleet rental versus rental mix.

A - Nora Lanari {BIO 18838335 <GO>}

Sorry. Come again? I missed you Kevin.

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

So your optimal level like is going to change based on your fleet level versus your kind of rental mix?

A - Nora Lanari {BIO 18838335 <GO>}

Pretty much. Pretty much.

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

Okay, okay. Thank you. Very helpful.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you.

Operator

This concludes today's question-and-answer session. I'd like now to invite Ms. Nora Lanari to proceed with her 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 queries. Thank you.

Operator

This concludes Localiza Rent A Car audio conference for today. Thank you very much for participation and have a good day.