Q3 2013 Earnings Call

Company Participants

- Joel Kos, Chief Financial Officer
- Luis Fernando Porto, Chief Executive Officer

Other Participants

- Marcos de Moura e Souza, Analyst
- Murilo Freiberger, Analyst

Presentation

Operator

Good morning. Welcome to the Locamerica's teleconference where we will discuss the results of the Third Quarter of 2013. At this time, all participants are on listen-only mode and afterwards, we will open for questions-and-answers where you will receive further instructions.

In this quarter, Locamerica will also provide room for the press to make questions just after the questions of market analysts. (Operator Instructions) This teleconference is being simultaneously translated to English and questions may be asked in English or Portuguese.

Questions can also be made through the Internet via the webcast platform. I would like to remind you that this teleconference is being recorded. The audio will be responsible at the website of the Locamerica Company in 24 hours.

If you do not have the copy of the Locamerica release which was published on Monday, you can obtain it at the website www.locamerica.com.br/ri. This teleconference together with the slides is being aired simultaneously over the Internet, also you can access through the website of Locamerica.

Before continuing, I'd like to clarify that any statements made during this conference call regarding the company's business prospects and projections, operational and financial targets related to its potential growth are forward-looking statements based on the expectations of management regarding the future of Locamerica. These expectations depends on the performance of the industry, the overall performance of the country and the conditions of the national and international markets, therefore they are subject to change.

With us today is Mr. Luis Fernando Porto, CEO and Mr. Joel Kos, CFO and IR. Now I would like to give the floor to Mr. Luis Fernando Porto. Please Luis, you can go on.

Luis Fernando Porto {BIO 17590082 <GO>}

Good morning. We thank you very much for attending Locamerica's conference call to announce the results for the third quarter of 2013. First of all, we would like to highlight our net revenue which grew 7.6% vis-a-vis the third quarter of 2012 driven by an increase of 10% in the sales of used vehicles and 6.1% in fleet rental revenues. Year-to-date, the net revenue increased 23% over the same period of 2012, a result of the 57.8 increase in the sales of used vehicles and 7.5% in fleet rental revenues.

During this quarter, our EBITDA reached R$38.8 million impacted by a few extraordinary events which then added totaled R$3.3 million. Excluding these effects, EBITDA would be R$42.3 million, a 52.7% margins on rentals in line with Q2 '13.

Our net revenue reached R$3.6 million in the quarter impacted primarily by extraordinary items and greater financial expenses linked to an increase in the Selic rate. YTD, the net income totaled R$22.5 million, up R$29.6 million compared to a loss of R$7.5 million in the same period for 2012.

On October 29, in line with our policy to strengthen our debt, we captured R$225 million with our eight issuance of debentures with an average cost of CDI+2.25%. Thus on November 4th, we prepaid our sixth issue of debentures in the amount of R$160 million and with the cost of CDI+2.25% and thus the current debt duration rose to 4.8 years and we estimate that the cash position and expected cash generation for the next year will be enough to finance our investment plans for 2014. We want to need to resource to the debt market up to 2015.

On the next four slides before talking about our operating performance, we would like to briefly go through some of the trends in the industry during the last quarter. Slide number three, we see that the cars and light commercial vehicles sales totaled 931,000 units, down 10% versus 3Q12. Year-to-date the new car sales totaled 2.6 million, a decrease of 1.1% compared to the same period of last year.

On the next slide, the used car market recorded a better performance in the quarter with sales of 2.5 million units, up 3.6% vis-a-vis in the third quarter of 2012. During the year, the used car vehicles grew by 4.1% to 6.9 million units.

Slide number five, on the chart on the left, we see that the industry default reached 5.7% in September, the lowest level since November 2011, but still high to say that there has been a significant improvement in the default rate scenario in the industry. Actually, year-to-date, the total resources for financing individual vehicles dropped 4.4% to R$65.6 billion vis-a-vis the same period in the last year.

On the next slide, we show the prices for new and used cars development in recent years. In the chart to the left, the new car prices rose 2.7% year-to-date, a result of an IPI increase from 0% to 2% which happened on January 1st, 2013. The price of used vehicles has suffered a deflation of 2% for the period. In the chart on the right, we observe the spread between new and used cars which continues to show an upward trend.

Now talking about our operating and financial performance, on slide number seven, we provide a breakdown of our fleet which totaled 28,067 cars in the quarter, down 2% compared to the same period in 2012 and which was mainly due to tougher competition in the industry and to our decision not to follow the aggressive pricing of some players.

On the right, we see that the inventory of cars for sale rose to 4,813 cars, 17.1% of the total fleet at the end of the quarter. Starting September, we adopted a policy of reducing inventories even if this means lower margins for the time being. It's worth noting that after record sales of 1,305 cars in October, we managed to lower our inventories by 15%. So we should start 2014 with an equalized inventory.

On the next slide, we highlight the net revenue in fleet rental with annual growth of 6.1% due to higher average ticket price of 11.7%, partially offset by lower volumes at 4.8%.

Slower growth rate in the third quarter was due to a scenario of competition that was more aggressive in outsourcing fleet in the last six months and some players practiced unsustainable prices as we see, below the market average by 15%.

In this scenario, we chose not to follow this movement because we do not believe in these prices and because we are focused on our growth path.

On slide 9, due to the serious competition we have already mentioned, the overall value of contracts signed in the quarter was R$47 million, a decrease of 34% compared to the same period last year.

In the chart on the right and line in line with our policy of diversifying markets and customer portfolio, the total number of customers grew by 27% to 341 this quarter compared to the third quarter of '12.

In the next slide, we show the results of our diversifying strategy at the end of the 3Q13. The share of the fleet represented by compact cars dropped to 58% whereas the share of the ten largest customers in terms of total revenue in car rental was 38% in the third quarter of '13.

On slide 11, we sold 2,396 cars in this quarter down by 5.8% compared to the third quarter of last year. Year-to-date, sales totaled 7,475 units, up by 50% year-on-year and well above the market average.

In this chart on the right, we highlight the average sales price of used car vehicles which rose for the third consecutive quarter mainly due to the sales mix in the quarter.

On the next slide, we show the development of the number of used vehicle dealership. Today, we have 12 own stores including 8 in wholesale and 4 in retail. So this year, we intend to open two more dealers in retail in line with our strategy of diversifying our channels.

In the chart on the right as already mentioned from September, we decided to boost the sales of used vehicles seeking to adjust our inventory of cars through sales. In October, the sale of used cars peak at 1,305 cars which was 15% higher than our average sales rate.

On slide 13, the depreciation of cars totaled R$18.3 million or 9.3% of average fixed assets. The increase in depreciation relative to previous levels mainly reflects the change in the mix of our fleet with increasing the share of mid-sized, executive and heavy vehicles which have a higher depreciation rate.

On slide number 14 , our EBITDA totaled R$38.8 million impacted by some extraordinary events such as layoffs, stock transfer from Locarvel to Locamerica and the strategy to adjust the stock of used vehicles, which totaled R$3.3 million. Excluding these effects, EBITDA would be R$42.3 million representing a margin of 52.7% in line with the second quarter of '13.

In the first nine months of '13, EBITDA totaled R$127.6 million, up by 14.7% or 17.6% excluding the effect we have already mentioned which accounts for a margin of 54.2%.

On the next slide, our operating income EBIT totaled R$19.8 million in this third quarter representing a margin on net rental of 24.7%, 2.5 percentage points below the same period last year, mainly due to the effect of higher levels of depreciation between these periods.

For the year, EBIT totaled R$70.4 million, up by 40.1% and representing a margin of 29.1%, 6.8 percentage points above the same period last year.

On slide 16, our net income was R$3.6 million in the quarter, mainly impacted by extraordinary items and higher financial expenses linked to the increase in the basic interest rate in Brazil. In the first nine months of this year net income totaled R$22.5 million, an improvement of R$ 29.6 million compared to a loss of R$ 7.5 million in the same period of last year.

Now I would like to give the floor to Joel Kos, our Chief Financial Officer.

Joel Kos {BIO 17590108 <GO>}

Good morning, everyone. In the next slide, slide 17, you have a debt breakdown. Between June and November 2013, we decided to seize market opportunities capturing through our seventh and eighth debentures a total of R$325 million with which we prepaid R$240 million of our debt with lower average term. Thus the duration of the current debt rose to

4.8% and it is estimated our cash position and expected cash generation for next year will be sufficient to fund our capital expenditures in 2014 without the need to access the debt market by 2015.

In the last slide, we highlight the strengthening of our financial profile with 92% of the loans maturing in the long-term. The spread of the debt reduced to 2.2% in November. The percentage of the fleet already showed is already at 24% and our leverage in terms of net debt/EBITDA at 3.1 times and we remain committed to lowering these levels to 2 percentage points to 2.5 percentage points in the medium term.

Now we can move on to the question-and-answer session.

Questions And Answers

Operator

Ladies and gentlemen, we will now start our Q&A session. (Operator Instructions). Our first question comes from Murilo Freiberger from Bank of America.

Q - Murilo Freiberger {BIO 17385357 <GO>}

Good morning Luis, Joel, Mr. Ronald. I have two questions. The first one, you could you please elaborate on this new policy that you are adopting for used vehicles? What is the strategy? What is the sales volume that you expect to reach? Should we see in the fourth quarter the inventory going back to the target levels?

The second question has to do with the growth for next year. We see a good increase around 34% in terms of closed contracts. What is the volume that we should expect for next year? So these are my two questions.

A - Luis Fernando Porto {BIO 17590082 <GO>}

Good morning, Murilo. Thank you for your questions. The first one, the strategy which has been our strategy for two years now is to strengthen our sales structure. So today we have dealership -- retail dealerships being opened and investments are being channeled to this channel. A sales channel that accounts for 10% to 12% of our sales and we should reach 40% to 50% in the next year.

Besides, we follow a wholesale models for sales where we prepare our vehicles and so we have until August to reach 100% of our sales. What we did after September was to open a new sales channel. A sales channel which is very much used by smaller dealers, who don't have a good structure for used vehicles. We are not investing in this and a wholesale market where you see middlemen buying more vehicles. We actually haven't had access to this market for a long time because this is less profitable market and we do expect that in the next 2 to 3 months by accessing this market we will be able to sell more cars, thus striking a balance of our inventory by the end of the year.

So this is our sales strategy. We are tapping this market. We haven't had access to it before because we had a structure prepared to sell a number of cars without losing any margins. But right now, what we see is that looking especially at the second half of the year being different from what we expected and what the market expected in terms of sales of vehicles, we expected a more stronger market with better sales, better financing and this hasn't happened.

So, we have closed these lower sales for used cars and for new cars with an impact on our business. So, unfortunately we had also a return of 1,300 change cars which increased our inventories above what we had expected and above that which our sales structure allows.

So, we consider this to be a temporary effect because we only need to sell in this market because our inventory levels are high.

So for the time being, we need to sell 1,500 cars for lower prices. On the other hand, the money from the cars that were stocked in the inventory will enter our cash and if we manage to have new rentals, we will be able to make a profit out of this money, otherwise we will reduce our debt thus incurring into lower financial costs.

There is also an administrative and operating cost for maintenance of these cars, parking and maintenance and if these cars were not to be sold, the depreciation and the IPVA tax costs would be very high. That's why we decided to go back to this market again and we expect that in the next 2 to 3 months we should spend between 2%, 5%, maximum 10% of our inventory amounts.

So it's really a tool that we are resorting to and the cost/benefit ratio is close to zero. But unfortunately, we wanted to avoid the impact that we've killed.

So, we wanted this second question has to do with the growth for the next year. We did feel a very fierce competition in the first half of the year and this had an impact on the third quarter and we believe we are at the lowest level as far as price concerned as competition.

Right now, we do think it's possible that the market will go on putting the prices down. Its interest rates are up, all the expectations are that there is a space for growth. The depreciation or rather inflation regarding administrative and operating cost is also very high. So and we are also feeling a low to very low depreciation.

So we do believe that this is the lowest level. We are at the bottom, at the lowest price in terms of the rental prices, as well but we would rather be conservative because we don't want to fight in prices, we don't want to grow through lower prices. We want to have profitability. So for the next year profitability -- so for the next year, we expect to grow around what we have grown this year 6% to 7%, maybe reaching 10% tops. We don't expect 10% to 15% as we used to unless we see a substantial improvement in the having competition. And if we can use our capital structure which is prepared to grow much more than that at the cash level, cash generation, we do have cash to make other investments, but the competitive scenario does not allow us.

So this is what we expect for the next year.

Q - Murilo Freiberger {BIO 17385357 <GO>}

Thank you.

A - Luis Fernando Porto {BIO 17590082 <GO>}

Thank you and have a good day.

Operator

(Operator Instructions). Since there are no further questions, I would like now to give the floor to Mr. Luis Fernando Porto for his final remarks.

A - Luis Fernando Porto {BIO 17590082 <GO>}

Good morning again. There is another question before my final remarks, thank you

Operator

We have a question from Mr. Marcos de Moura e Souza who is from Valor Economico Newspaper.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

Luis, Joel good morning.

A - Joel Kos {BIO 17590108 <GO>}

Good morning Marcos.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

I would just like you to explain a little bit more about this strategy in terms of sales of used vehicles. So you are tapping your sales channel right? And I would like a little bit more color on this. Are you speaking of some capital cities? What are you focusing on? How are you accessing the market? In which regions in the country?

A - Luis Fernando Porto {BIO 17590082 <GO>}

Well we do not think this is an informal market, we think this is a wholesale market for larger volumes where these buyers purchase the vehicles as they are returned by our clients. We do not have to prep them, the cars are therefore cheaper.

These clients buy these cars that we partly prepare and then in resell to other dealers and they are usually positioned as far as located in Sao Paulo, Rio, Belo Horizonte, the capital cities.

They are large buyers who buy cars in the state, they prepare these cars and then they distribute them to dealerships in the interior of the country. It's not a parallel market, it is a market that exists and it's very much used by many average and small-sized rental companies and in the case of Locamerica, two and a half or three years ago, we decided as a business strategy to invest in the retail and wholesale platforms where we prepare the cars, we sell smaller volumes directly to clients, to dealerships which get the cars that we have prepared and put them directly in their shops. So this is a market that buys cars as they are and that is why they are cheaper.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

Just one more thing. When you mentioned that you lost clients, I believe 1,300 cars were returned?

A - Luis Fernando Porto {BIO 17590082 <GO>}

Yes this was in first quarter.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

But this is an impact with third quarter, did it?

A - Luis Fernando Porto {BIO 17590082 <GO>}

Actually what happened was, we had a loss, this loss in first quarter. At that time both Locamerica and the market and the industry had a perspective of a better half in terms of the first half of the year. The economic expectations in terms of improvement, financing, everything we saw would improve in the first half. We also had new dealerships coming out and we thought that with a greater market and with a better structure we would be able to sell our cars in our platform without having to tap these clients. So that is why we only felt the effect now.

Since the market has not materialized, we had to tap this new market and this is what we have to date. But it's more due to expectations of the market and our expectations than the effects.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

And lastly, you have well -- do you have a target for the end of the year? You have to sell X vehicles by the end of the year, by December, or you do not have this target or is it flexible?

A - Luis Fernando Porto {BIO 17590082 <GO>}

Our idea is to end this by December and bringing our inventories to historical levels, which is around 10% to 11% of the total cars or vehicles that we have.

Q - Marcos de Moura e Souza {BIO 6178488 <GO>}

Thank you very much, Luis.

A - Luis Fernando Porto {BIO 17590082 <GO>}

Thank you, Marcos.

Operator

In case there are no more questions, I would like to give the floor to Mr. Luis Fernando Porto for his final remarks.

A - Luis Fernando Porto {BIO 17590082 <GO>}

Well once more thank you very much for attending our conference call. Our final remarks have to do once more with our commitment or long-term commitment. As you saw in our industry highlights, we operate into two very pulverized markets, very competitive markets. On the other hand, these are markets that even during very hard moments, hard economic issues or economic problems that we faced in Brazil is still active and growing.

So we have great expectations to be able to consolidate this market minimizing a predatory competition a tougher competition, we have seen in the last month and when this happens we are sure that we will have better and more substantial margins than today.

So, actually what we are doing right now is taking actions where we have the control in our administrative and operating areas, so that by the beginning of next year, we can recover the margins lost and so that we can go back to our growth path that we hope to thread in the next years.

So this is our long-term view and we are focusing on this. We are focusing on what we can do in terms of mitigating costs, of course due to economic issues we are undergoing some difficulties.

But thank you once more for attending the call. Have a good day.

Operator

Locamerica's conference for the third quarter of 2013 now concluded. Have a nice day.