Q2 2014 Earnings Call

Company Participants

- Adalberto Pereira dos Santos, Chief Financial Officer and IRO
- Luis Fernando Porto, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Unidentified Participant

Presentation

Operator

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Good morning. You're welcome to Locamerica's Conference Call in which the results of the second quarter of 2014 will be presented. At this point, all participants are in listen-mode only. Subsequently, we will open the floor for a Q&A session and you will be given instructions on how to participate. In this quarter, Locamerica will also open the floor for media professionals to ask questions and then after market analysts.

(Operator Instructions) This call is being translated into English and questions can normally be asked by participants located abroad. Questions over the internet, may also be asked by using our webcast platform. In addition, you should be aware that this conference is being recorded and the audio will be available on the company's website within 24 hours. For those of you who do not have a copy of Locamerica's press release documents, it can be available on the company website www.locamerica.com.br/ir.

This call along with the slide presentation is being broadcast simultaneously over the Internet and access is also provided through the company website. Before proceeding, it should be pointed out that any statements that may be made during this conference call regarding business prospects of the company, projections, operational and financial targets relative to its growth potential are forward-looking projections based on management's expectations of Locamerica's future results. These expectations are based on the performance of the sector, the overall economic performance of the country and both domestic and foreign market conditions, therefore these expectations are subject to change. Today, we have Mr. Luis Fernando Porto, Chief Executive Officer, Adalberto Santos, CFO and IRO. Now I will give the floor to Mr. Luis Fernando Porto. Please, Mr. Porto, you may proceed.

Luis Fernando Porto {BIO 17590082 <GO>}

Good morning, everyone. It's a great pleasure to welcome you all to Locamerica's 2Q14 Earnings Call. This quarter was marked by the consolidation of our operational recovery, which started in 1Q14, this fulfills the promises made during our first quarter earnings release of a gradual recovery of our margins to achieve the company's historical margin levels even if we exclude the extremely positive repercussions following our adoption of the Refis debt program.

Our EBITDA nevertheless reached an all time high of BRL49.8 million, up 19% and 21% before the second quarter '14. And this means a 5.5 percentage points, or 560 basis points and a 54.6 percentage points. Our net income reached BRL7 million in the quarter, up 41.7% compared to high 1Q14. If you exclude exceptionally negative items which amounted to BRL2.9 million and this result would have been even better having reached BRL9.2 million.

We also highlight robust growth of our net feet rental revenue rising 14.6% compared to 2Q13. This was driven by a significant increase in the average rate of a 4.7% and sales volumes of 8.9%. The overall value of our new rental contracts signed in 2Q14 also increased which suggests sustainable revenue growth in the coming quarters. We should also stress better fleet utilization rate this quarter at 95.2% against 93.3% a year earlier. Major efficiency gains were also achieved in 2Q14. As regards to inventory of cars for sale falling to 2,702 units and this accounts for a new level. 9.0% of the total fleet compared to 15.8% in 2Q 13% and 10.6% in 1Q14. Lastly, we have maintained our policy for strengthening our debt profile. So, on July 17th, the company approved its 19th issue of debentures amounting to BRL230 million remunerated at CDI+1.7 per annum and prepaying debt totaling BRL160 million remunerated at CDI+2.0%. annually. As a result, our debt spread decreased further and the duration increased to our current 4.8 years, the industry's largest.

Before moving on to operating performance on the next two slides, we will see some trends in the car sector scenario that have developed throughout 2Q14. So on slide 13, sales of new cars fell 7.3% in the first half of 2014 year-over-year, while sales of used cars increased 3.7% in the same period. We believe this change in demand from new to used cars with great prospects for the used car segment this year, will continue to second half of 2014. This is mainly due to a recent increase in new car prices, slowdown in economic activity and consequently lower consumer confidence levels and tightening of credit markets.

The chart on the right shows that the drop in demand for new cars in Brazil as well as a significant reduction in exports 36.6% in the first half of 2014. This led to a decline in new vehicle production in the country. Having said that, the chart on the right hand side shows car inventory levels rising to 45 days of sales in 1H14, up from 39 days year-over-year and of course compared to the historical average of 35 days.

The next slide shows funds released for auto financing purposes in this country. The vehicles totals BRL78 billion and this is down 8.3% year-over-year. The charts on the right-hand side shows further increase in the spread between the price of new and used cars. As a result, new car prices rose 2.9%, against 1% increase in the same -- over the same period for used car prices.

We will now turn to our operating and financial performance. On slide five, we have our fleet breakdown, which we covered a level of approximately 30,000 cars, a 4.1% increase compared to 2Q13 levels. Operational fleet grew 8.6% year-over-year, while the number of cars in deployment that is those about to be added to the operational fleet grew 62.1% amounting to 2,875 cars. The chart on the right highlights a new inventory level of cars for sale, dropping to 2,702 units. This represents a new level of 9% of the total fleet.

On the next slide, a major efficiency gains and increased utilization rate of 95.2% in 2Q14, this came as a result of sustained improvement effort put into our processes and operations. The chart on the right hand side shows the average age of the operating fleet falling further to 18.3, down from a peak of 19.1 months in 4Q13. It should be pointed out that as the fleet has resumed growth, we are expecting continuous decline in the average age of the fleet and as a result, a drop in maintenance costs.

The next slide presents a rise in net fleet rental revenue amounted to 14.6% in 2Q14 and this restricted by increasing the average rental rate of 4.7% and in volumes 8.9%.

Unidentified Speaker

On slide 8, on the left chart, you see that the total value of new contracts signed in 2Q14 increased 42.3% and 20.3% compared with second quarter 2013 and the first quarter 2014 respectively. While in the right hand side chart, the commercial pipeline for the next three months remained at historical record levels with more than 29,000 cars in this period against 24,000 in 1Q14, which signals a sustainable and a robust growth in rental revenue over the coming quarters.

This performance and good prospects of rental revenue, are a result of our growing competitiveness in the market, due to one lower fixed cost with actual 16% reduction this year. Two, solid capital structure with price falling and increasing durations, we consolidated and stable sales team providing perhaps the largest commercial pipeline in this industry. And four, geographic capillarity thus enabling diversification of the customer pay, which grew from 23% up to 397 customers in the second quarter of 2014.

On slide 9, show the performance of the used car segment. On the left chart, revenue rose 24.6% in comparison to 2Q13 due to the increase in volume of 23.8% and average selling price by 0.6%. Also importantly, the increased mix of vehicles sold in the retail channel, doubled to 23.4% of total sales, compared to 12% in 2013.

The chart on the right shows that as expected, the gross income of used vehicles also return to the company's historic breakeven level. After changes made to our inventory, which resulted in the significant isolated loss during the 4Q13.

Slide 10, our EBITDA reached a record of BRL49.8 million in the quarter, even disconsidering the extraordinary positive impact of BRL4.1 million related to the adoption of the new Refis, that was 20.6% growth compared to the first quarter in 2014, which represented a margin expansion of by 560 basis points to 54.6%.

This important improvement is in line with our this quarter for 1Q14 and can mainly be explained by the following factors: one, benefits of the fixed cost reduction program implemented as of the second half 2013. Two, lower maintenance costs due to fleet increasingly newer. And three, improvement in the used vehicle segment results.

On the next side, in excluding the aforementioned positive extraordinary effect, EBIT would be BRL30.2 million, up 34.8% compared to the first quarter in 2014, representing a margin of 33.1% growth of 6.5 and 2.4 percentage points compared to the first quarter 2014 and second quarter in 2013, respectively.

On slide number 12, we recorded a net profit of BRL7 million in the quarter, an increase of 41.7% compared to 1Q14. And if we consider the extraordinary impact, that total to negative 2.9 million, a 2.9 million loss mark-to-market of swaps on 3.6 million and the positive impact of Refis totaling BRL0.7 million. The net profit would be BRL9.2 million. The significant improvement in the financial performance -- rather in the financial performance. But the company reflects the gradual and steady recovery in operating margins with the sequential growth in rental revenue of 8% being amplified, which are amplified by efficiency gains in fleet cost a reduction of 4 [ph] percentage points in the same period, and improvement in SG&A. As a result, recurring EBITDA advanced 20.6% EBIT 34.8% and net profit 41.7% compared to 1Q14.

I would now like to turn the call to Adalberto Santos, our CFO.

Adalberto Pereira dos Santos {BIO 16803045 <GO>}

Good Morning, everyone. Beginning now with slide 13. We will talk about our current debt profile considering our 9th issuing of debentures approved on July 17, 2014 this year and settled yesterday this operation we raised to 230 million bearing interest at CDI of 1.70 per year, second lowest cost in the industry, maturing within six years. The amount collected will be used to prepay debts in the amount of BRL160 million and with a CDI rate of 2%, this has strengthened our cash position to 230 million our net cash and extended the debt term to 4.8 years the longest in the industry.

And on the last slide, we believe that this sound capital structure is a growing competitive advantage for the company with 98% of loans maturing in the long run, the spread of the debt continuously declining now at 2.1% versus 2.5% a year earlier, and the percentage of the fleet that is used as collateral at 21% in this quarter. The last chart, we see our leveraging, our leverage in terms of the net debt to fleet value, which fell by 4.5 percentage points to its lowest historical level of 59%. And now, I believe we can have our Q&A session. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen we will now begin our Q&A session. (Operator Instructions). Excuse me, our first question is from (inaudible), Bank of America.

Q - Unidentified Participant

Good morning, everyone. Thank you for the call. I have two questions, the first one is about the environment of competition, you had considerable improvement in the second quarter. In this year's of course, the result of your work in reducing costs in this competitive environment seems to have improved, but this is not what we see in the companies in the same sector. So, can you expand on the environment its competition levels, how it has been developing, how it compares to last year and what you see in the upcoming three quarters.

My second question is more isolated it's about the average purchase price of vehicles which has risen considerably to almost 38,000. So was this a mix or an isolated purchase of a particular vehicle than what we should expect for the next quarters in terms of the car purchases?

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

Good morning. Thank you (inaudible) for your question. First, competitive environment, our current competitive environment is better in our view than in the previous years, 2012 and 2013. This is typical of our sector. We have about 5 or 6 average over a large size companies vying for this market. And of course, this is a great challenge, a very competitive environment. What I believe makes Locamerica stand out from the crowd, is that, last year we restructured our fixed administrative cost.

As a result, our cost has lowered and our competitiveness level has risen. Although this is a very fierce environment it is better than in the previous years. So, our growth rate has been lot a good when you compare it to our estimates in our budgets for 2014. As for our vision for the future, I strongly believe in maintaining or improving this scenario. As companies grow more mature and become more professional, the pricing trend is would be closer and closer to reality. So, costs are of course, it had every company, so before a company has a better cost benefit ratio, it will not grow as fast as needed. Now, as the market gets increasingly more consolidated with mergers or acquisitions or with smaller company that won't grow as much. This trend is expected to well, point to a more realistic pricing levels than the current level or previous levels.

So, in my view that's what we have in terms of competition, it is better now, better than last year, better than 2012, which were the worst years in our industry, at least in Locamerica's opinion. So, an improvement in this respect is what we'd expect and also higher competitiveness levels and this is very good for us in Brazil's competitive scenario. As for car purchase prices, the average price maybe an isolated price. We have signed some contracts in this quarter and there have been purchases of heavier duty cars and trucks as well. And that increases car purchase price, but these are isolated contract. They're not there, all the time. So, we're expecting about BRL28,000 or BRL30,000 will be our average car purchase price.

Q - Unidentified Participant

Thank you very much Luis for your answers.

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

Thank you.

Operator

(Operator Instructions) Our next question is from Mr. (inaudible)

Q - Unidentified Participant

How are you all? And thank you very much for the conference call. I have a question about the pricing pressures, in a normal not competitive environment, that the pricing, which is should be higher or in line with (inaudible) what you expect for the next year in a scenario for normal competition and if these good shape of higher prices cars should also increase your prices?

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

This was a question about price. Sorry, so you have a question about car rental prices. In the 2015 scenario I'm not sure I heard it perfectly.

Q - Unidentified Participant

Yes, the question is about the price increases in a scenario of lower competition, if they could be in following the growth of inflation, but right now, we see it is lower.

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

No. Thank you for your question. Our opinion is that 2015 will present a rather hard harsh scenario in Brazil. We expected our Presidential Election results, all governments will have to make adjustments and this will of course impact the macro economy. In this scenario, our company seems rather resilient, fairly resilient. For other companies, this scenario may be harsh, but for us, this is an opportunity.

There are some items here that are important. If you have low growth levels, companies start to revisit their cost and have rental - start renting fleets, because they want to reduce costs or their CapEx. So, this will be an advantage to our clients. And you see the economy is not so good. As a result, we have been growing. So, it's a moments of hardship, difficulty, our revenue is not attached to GDP growth.

Now, when there are crisis, when there is a crisis, banks tend to be tighter, especially with regards to companies whose balance sheets are more leveraged with short-term debt. So, banks become more selective. And as a result, our environment gets more competitive. In other words, we're expecting a very harsh situation in 2015, but then, there will be little impact on our figures. And with this scenario, I imagine rental prices that will have gains about the inflation in the long run. So, I believe this is possible as long as these macroeconomic expectations do occur.

The best time for hiring in history was post 2008 in both financial crisis in 2009 and 2010. In these years, there was low liquidity levels on the market, and so companies such as ours with robust balance sheets and with a consolidated capital structures stand out. The cars -- we have no fundraising problems or cost problems unlike for the other companies on the market. So, if these expectations come true, we do believe that rental prices may improve further in 2015.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions)

Q - Unidentified Participant

Good morning. So, in answer to Rodriguez's question of GTI investments. Rodriguez's question is when you consider the average fund raising cost if you reduce with leverage to the EBITDA what is the cost level in the Company's margin that he believes we can fall to.

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

It's not easy to give you a precise figure. Our goal is clear. However, this was defined in our IPO in 2012 and we have been working on this. We are extremely disciplined. We wanted to grow with maximal leverage, following the levels that we set then. And we will still extend our debt, reduce the collaterals and then by having all these factors together, we will certainly improve our spread figures. We're expecting over time, we're expecting that if we achieve all this and reach this level, we will improve and we can, of course try to raise lower levels -- at lower levels.

Q - Unidentified Participant

What level we will reach?

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

It is very hard. We have no expectations about a precise level.

Operator

Now answering another question from the Internet again by Rodrigo.

Q - Unidentified Participant

When you consider the recovery of our margins this quarter. Can we see the EBITDA margin, our rental EBITDA margin reaching over or more than 55 in the first quarter '14?

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

Yes, yes, when we reach such a level of any margin or operating rate, we of course have a goal of going beyond this. So, as long as we reach this level of 55 to which we are very close, we can try of course better levels. As I said before, Locamerica has been in the capital market for two years and in the last few years, the company has invested in many projects including its preparation for the IPO and this has high costs, restructuring all our software and hardware platforms as well, that was required with very high extremely high IT investment.

We've also invested in new platforms both in our rental-commercial area as well as in our used car sales platform and all these projects in our view, are still gaining scale and margin. So, a new project such as ours in our opinion may seek higher margins over the next few years.

Operator

(Operator Instructions) If there are no further questions, the Q&A session is closed. Now, we will continue with this Q&A session with the press. (Operator Instructions) Excuse me, if there are no further questions, I will now give the floor to Mr. Luis for the final remarks.

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

Well, once again, I would like to thank you all for joining us here on our earnings for the second quarter -- well we are very happy with the results with earnings we had in the quarter because we began reversion cycle to revert, important issues, operating issues in the company in the second half last year. And we have reached a very special point. We have actually had a 25% growth in our used cars revenues and have reached historical margins for the company as we had actually predicted in the second quarter of 2013.

This is therefore, a very important time for us and we wish to maintain high volumes with ideal margins that we -- as we have attained so far. We have also increased our EBITDA margins, the company's EBIT and have had gains in all of the company's groups. We have increased our use rate, a key point to increase our ROIC. And at the same time well, of course we have driven up to challenges to a complex scenario, which comes to show that our industry and our business is quite resistant when it comes to facing challenges as we have. And of course, it's always worth repeating, (inaudible) that in regards to the macro economy -- economic scenario for this year and 2015, we are going to see a lot of volatility, it's going to be a complex scenario as Locamerica decided to be careful and to compare by having one of the best historius [ph] capital structures in the sector with a robust and sound cash and to invest with moderation seeking to privilege our margins and our revenues. But of course, at the same time when we see the opportunity in the industry and if we're prepared for that, we want to grow in moments of economic challenge to show that, yes we are resilient to (inaudible) to those challenges.

We once again we would like to say that we are committed to gaining margins, increasing our margins, to retaining our historic margins by the end of the year and at the same time to go further to -- go beyond when it comes to operating and administrative projects focusing on of course, our revenues, our earnings, earnings we've had and we'll continue to have over the next year.

Thank you all and have a good day.

Operator

This call is now closed. Thank you all for joining us and have a good day. Thank you.