Q2 2012 Earnings Call

Company Participants

- Roberto Mendes, IR Officer, CFO
- Silvio Guerra, Director IR

Other Participants

- Daniel Spilberg, Analyst
- Daniela Bretthauer, Analyst
- Jordan Hymowitz, Analyst
- Michael Millman, Analyst
- Nicolai Sebrell, Analyst
- Steve Trent, Analyst

Presentation

Operator

Good morning. Welcome to the first-half and Second Quarter 2012 results conference call of Localiza Rent A Car. Hosting the event today are Mr. Roberto Mendes, Chief Financial Officer; Silvio Guerra, Investor Relations.

We would like to inform that the numbers in this presentation are stated in millions of Brazilian reals, and based on US 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 call during the Company presentation. Immediately afterwards we will start the Q&A session for analysts and investors, when further instructions will be provided. (Operator Instructions)

The audio of the conference call and the accompanying slide presentation are being broadcasted 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, Second-Quarter 2012 Webcast.

Before proceeding we would like to clarify that any statements made in the conference call concerning the business outlook of the Company, forecasts, and 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. They may lead to results materially different from those stated in this call.

I would like now to turn the presentation over to Mr. Roberto, who will begin the presentation. Please, Mr. Roberto, you may now begin.

Roberto Mendes {BIO 7289124 <GO>}

Good morning, and thanks for attending our conference call. On slide number 2 we present some highlights of the Second Quarter in 2012. The announcement of the IPI reduction for new cars from May 21 to August 31, raised a possibility to being extended past (inaudible) reflects in our business. With this drop in the expected residual value for the cars, BRL100 million were recognized as additional depreciation this quarter.

Right after the announcement of the IPI cut, the Company adjusted the price of its cars available for sale with -- combining with the lower interest rate and other measures announced by the government reflected on the increased (hot) demand for extended OnStar.

The sale of extended OnStar (inaudible) reached a historical record. 5,711 cars were sold. The Company expects that the reduction in the car sales price will be offset by the reduction into the purchase price of the new cars with the IPI cut, and therefore should not impact the fleet renewal CapEx, similar to what happened in 2009.

Other highlights of the quarter were the fleet utilization rating of Car Rental division. By (efficient) management the purchase, distribution and sale of cars, our utilization rate reached 74.2% contributing to the strong free cash flow of BRL242.3 million in the first half in 2012.

I will now turn the floor to Silvio, who will present the Second Quarter 2012 results.

Silvio Guerra

Good morning, everyone. On slide number 3 we present the growth evolution of the Car Rental division. Some moderation on the business volume growth is a result of the strong deceleration on the economic activities in Brazil. On the other hand, the increase of the average rental rate resulted in the increase of net revenues by 10.4% in the Second Quarter 2012 and 12.7% in the first semester of 2012. According to an article published by (inaudible) newspaper, the Brazilian Central Bank resumed the last couple of days a more optimistic tone, showing confidence that the monetary and fiscal incentives adopted in the last month should take the Brazilian economy to an annualized growth rate in the last quarter of this year of 4%, with inflation in the target of 4.5% and lower delinquency rates.

Interest rates have already fallen 450 base points since August 2011, and the Central Bank (inaudible) roughly BRL80 billion in deposit requirements in a strong reaction against the economic deceleration presented since the second half of 2011 on when the external crisis hit stronger.

According to the paper, with the deposit requirements still at high level, the government has room for more monetary policies, if necessary. In this scenario the higher speed of growth expected in economic activity by the end of the year should bring positive impact in Car Rental volumes.

On the next slide, slide number 4, we present the volumes and revenues of the Fleet Rental division. In this division the contracts are signed for long-term and have low elasticity to GDP. In the first semester of 2012 net revenues in this division reached a growth of 21.1%. In the quarter net revenues grew 18.7%. Contracts values reflect interest and depreciation premises at the time of the agreements.

In slide number 5, we present the evolution of the net investment in fleet. In the Second Quarter 2012, 14,504 cars were sold and 13,198 cars were purchased, reducing the capital invested by BRL10.3 million. Year to date the reduction on the capital invested amounted BRL134.2 million.

Car purchases were adjusted to improve fleet productivity which is shown in the next slide, number 6, where we present the evolution of the utilization rate in the Car Rental division. The more efficient management of the purchase, distribution and sale of cars resulted in an utilization rate of 74.2% in the Second Quarter 2012 in the Car Rental division.

Slide number 7 presents the end of period fleet. In spite of the increase of 9.4% in the number of cars rented in the first half 2012, fleet was reduced by 2.5%, resulting in an increase of utilization rate of the Car Rental, as mentioned before.

Slide number 8 presents the evolution of Seminovos network. Seminovos network is being expanded to sustain the Company's business model. In the second half of 2012 six new stores were opened and one small store was closed.

On slide number 9, we present the evolution of the average monthly car sales per street store. In June Seminovos reached its historical record of car sales in the month with a total of 5,711 cars sold. With the increase of the sales from the (50), went back to 82 cars sold per store per month, contributing to the reduction of the fixed cost per cars sold.

In slide number 10 we present consolidated net revenues evolution. In the Second Quarter 2012 the net revenue growth of 11.8% derived from the increase of 13.2% in the rental revenues and 10.4% in Seminovos revenues. In the first half of 2012 consolidated net revenue grew 12.7%.

On slide number 11 we present the EBITDA evolution. EBITDA grew 7.5% in the Second Quarter of 2012. Car Rental EBITDA margin was impacted by a nonrecurring expense of BRL3.2 million related to the complement of the provision for bonuses and profit-sharing related to 2011, and by expenses of BRL4.5 million in accessories of minor value for new cars in the first half 2012 that are now accounted directly in the cost line.

The cost benefits related to controlling accessories of minor value in the fixed assets justifies its accounting treatment directly in the cost line. Excluding the total adjustment of BRL7.7 million, net EBITDA margin in the Car Rental would have reached 42.7% in the first half of 2012.

In the Fleet Rental division EBITDA margin has remained stable. Seminovos' EBITDA margin of 5.1% reflects the conservative approach of the Company when revising the future residual value of the cars and the selling expenses, which are the base for calculating the book value of the car by the end of its useful life.

Let us now move to slide number 12, where we present the evolution of depreciation. Fleet depreciation was adjusted after the announcement of the IPI reduction to reflect the expectation of lower residual value of the cars. In the Second Quarter 2012, BRL100 million were accounted as additional depreciation. The Company still expects BRL80 million depreciation to be accounted through the remaining life of the cars. This amount might be reassessed due to any change in the market value of the cars.

The cars purchased after the IPI reduction have much lower depreciation than the average presented in the Second Quarter 2012.

On slide number 13 we present the net income evolution. The drop in the net income of the quarter derives from the increase in car depreciation by BRL122 million, being BRL100 million as a result of the IPI reduction and BRL32 million as a result of the increase of the average of rate increase.

The increase of the depreciation was partially offset by BRL60.5 million due to the increase of EBITDA, the reduction of financial expenses due to lower SELIC rate, and the reduction in the income tax. Excluding the effects of the additional depreciation, net income this semester would have reached BRL149.5 million.

Now let us talk about the cash generation which is shown in slide number 14. The Company is still presenting strong free cash flow with BRL242.3 million generated this semester. The reduction in the used car prices due to the IPI cut should be offset by lower purchase price, with no impact in the fleet renewal CapEx, as happened in 2009.

On slide 15 we present the change in the net debt this semester. The strong cash generation allowed the reduction of BRL108.5 million in the net debt of the period.

On slide number 16 we present the debt profile. The Company maintains a strong cash position and comfortable debt profile. In the first half of 2012 all-in spread was of 1.3percentage points above the SELIC rate. With the reduction of the basic interest rate to 8% our spread will be reduced to 1.14percentage points per year.

On the next slide, slide number 17, we present debt ratios which reflect the financial discipline of the Company. Net debt over EBITDA and EBITDA over net financial expense ratios presented significant improvement.

In slide number 18 we present the spread between the ROIC, return on invested capital, and the cost of debt after tax. Increasing average rental rates in both divisions, improving the utilization rate in the Car Rental division, and reducing its cost of debt contributed to the spread of 8.1percentage points.

In slide 19 we highlight the Company's ADR Level I program -- American Depository Receipts Level 1 program.

Let us now move to the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Nicolai Sebrell, Morgan Stanley.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

I have a quick question on fleet utilization. It was very high obviously this quarter, 74%. Does that represent any challenges in terms of peak versus trough utilization rates? In other words, are you at 100% utilization for meaningful periods when there are no more cars to rent, and therefore figuratively speaking you are leaving some money on the table? That is my first question.

And the second question has to do with the composition of your fleet. Has it changed at all? In other words, as you have seen pricing change in the market, have you changed the composition of your fleet towards economic cars or in any other way? Just curious to know. Thank you.

A - Silvio Guerra

Thank you for a question. And let's start by the first one with regards to the challenge of fleet utilization. As you mentioned, the fleet utilization is always a challenge for the Company. We aim at the 70% utilization or more, and we expect to get into that level by adjusting the flexible model that we have, the (box of water), in terms of buying cars and selling cars.

You know that we are able to adjust to peaks of demand or periods when we don't have such a high demand. So the final answer is that we are always being challenged by the fleet utilization, and we aim long term at least 70% or more.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Okay, but if you are aiming for 70%, might it argue that you should raise your prices to reduce the utilization rate to 70% or should I think of it another way?

A - Roberto Mendes {BIO 7289124 <GO>}

Utilization is very important, but we have other -- a lot of other important costs involved. The main cost that you have is the fixed cost. So the utilization is important to reduce depreciation interest, so your true cost after EBITDA.

But before the EBITDA you have -- direct cost is very important, very strong in deal division. So the main goal is to have gain of scale and increase our number of major renters. This is the main goal that you have.

In long term I can say that we believe it will happen. And utilization rates could increase a little more, but for this year it is at least at 70% or more.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Okay.

A - Silvio Guerra

The other one is on regards to the composition of the fleet for Car Rental division, and it hasn't changed through all times. It is around the same level of subcompact, intermediate and executive cars.

Q - Nicolai Sebrell {BIO 7321622 <GO>}

Great, thank you.

Operator

Daniel Spilberg, Barclays.

Q - Daniel Spilberg {BIO 16863949 <GO>}

My question I wanted to concentrate actually on the competition. We saw that Localiza has been increasing tariffs, or at least in other words reducing the discount, to face a scenario of higher depreciation, partially offset by lower financing costs. In that sense is the competition also following your price increases? How do you expect this to evolve over time? Thanks.

A - Silvio Guerra

What we know is that competition usually charge less than we charge. But we don't have top of mind the exact difference that they charge against our price.

A - Roberto Mendes {BIO 7289124 <GO>}

It is important to mention you have all the very important competitive (inaudible) in this data. You have our brand. Our brand is top of mind. You have our distribution. We have the know-how. We have the (inaudible) in this area. So it is not only price is the only important thing that you need to have to attract other customer.

Q - Daniel Spilberg {BIO 16863949 <GO>}

Okay. Thank you.

Operator

Jordan Hymowitz, Philadelphia Financial.

Q - Jordan Hymowitz {BIO 1501428 <GO>}

A question -- first of all, what are you guiding for depreciation per car for the second half of this year? And second, we are hearing that a number of the larger banks, Itau and Bradesco specifically, have dramatically tightened their lending towards used cars, financing almost half the amount they have financed on a year-ago basis. Is that impacting the depreciation per car?

A - Silvio Guerra

Thanks for our question. On regards to the depreciation for the first-half 2012, as we mentioned in the earnings release, it shows the impact of the ITI reduction on cars. So in that sense the level -- generalized level for the Car Rental division, BRL5,400, and also BRL5,400 in the Fleet Rental division.

The new cars bought after the IPI reduction, they presented the depreciation, which is much lower than the average depreciation of the Second Quarter of 2012. The whole fleet is being renewed. The average depreciation per car should turn back to the previous level before the IPI reduction. So we believe we are in the right track in both ways.

Take into account the full charge of the BRL100 million that we took for this quarter and BRL80 million that are going to be spread over the next years for the Fleet Rental division, and now to the First Quarter 2013 for Car Rental, and also on regards to the equivalent gain that we are going to have when we come back to the previous level.

On regards to your second question, about the availability of finance, in the auto loans market, Brazil has an overall auto loan market of BRL200 billion. And Itau and (inaudible) and Banco do Brasil are very important in those (groups); they hold around 25% each of those. And the rest of it goes into Bradesco, as you mentioned.

And the President of Bradesco announced they are cutting back the pace of growth of the Bradesco position from the level of 15% to 18%, 19% to the level of 12%, to 14%, 15% pace of growth. It has affected of course all the credit sectors, but also the auto loan finance.

What we do have in terms of the auto loan? We see (inaudible) of credits from all the banks. And we have major partners. We have (Sumto Bear), we have (PanAmericano), and we also have Bradesco. So we rely on those partners, besides Banco do Brasil and (Botarenci) in order to adjust the requirements of our customers in terms of purchasing cars with the finance that is provided by them.

Q - Jordan Hymowitz {BIO 1501428 <GO>}

So what would you say would be the depreciation for the second half of this year? If you had to guess a range, what would be the highest it could be, what would be the lowest it could be based on what you see today?

A - Silvio Guerra

Well if you look at the earnings release, you can see that we mentioned in (inaudible) release the difference which represents the reflex of the reduction of the IPI. So if we move out for the second half on page eight is (inaudible) 22 of the earnings release, we forecast that we are going to come back to the previous level before the IPI charge that we did of BRL100 million in the Second Quarter of 2012.

Q - Jordan Hymowitz {BIO 1501428 <GO>}

So approximately BRL2,100 per car?

A - Silvio Guerra

I will say that it should be around the BRL2,000 to BRL2,100, as you mentioned.

Q - Jordan Hymowitz {BIO 1501428 <GO>}

Okay. Thank you.

Operator

Michael Millman, Millman Research Associates.

Q - Michael Millman {BIO 1494618 <GO>}

I want to ask about competition, and broken down into new entrants -- newly dependent entrants and to franchisees of US and European companies, and into ownership positions by US and European companies. And you might also discuss whether some of these companies have tried to buy your company.

A - Silvio Guerra

Thanks for the question. In regards to competition, we do have in Brazil around 2,000 small, independent car rental companies that compete with Localiza.

On regards to the major chains, Localiza is expressed and in 315 cities throughout the country. And we have a widespread network to compete with the franchising of the

European companies and the US companies that you mentioned.

They are present in most of the capitals, but they do not have the same network that we have. We have not been approached by these companies to be bought by those companies up to now.

Q - Michael Millman {BIO 1494618 <GO>}

Have the companies -- the franchisees attempted to increase their rate of growth? Are they adding more recently than they added in the past, and is that affecting the market in some way?

A - Silvio Guerra

The competition from those franchisees have not expanded very strongly throughout the last years. They have not grown very fast. So Localiza has grown around 20 to 25 new agencies per year, expanding our network, both in corporate locations and also through our own franchisees.

We are -- today we are present in most of the cities. All the cities above 5 million, above 3 million, above 1 million inhabitants. And today we are prospecting cities of 30,000 to 50,000 inhabitants in order to expand our network.

A - Roberto Mendes {BIO 7289124 <GO>}

I think I would like to add that many international brands are present in Brazil. They have not increased the number of brands here. And there is a lot of brands. (Foreign) is 42% of this business nowadays in Brazil.

So this international brand is in part performing. But this 2%, 1% comes from South America. So the other 1% comes from -- (a year ago) from America. So for us what is important is the local market that represent 92% -- 98% of our business. And it is top of mind -- our brand is top of mind here in Brazil.

Q - Michael Millman {BIO 1494618 <GO>}

Okay. Thank you very much.

Operator

(Ryan Santos), Citigroup.

Q - Steve Trent {BIO 5581382 <GO>}

It is actually Steve Trent from Citigroup. Silvio, I apologize as I dialed in a bit late and had trouble accessing your presentation, so if this is a question you have already answered, my apologies.

But I was just curious, I saw that of the used car Seminovos stores that you opened that you ended up, I believe, closing one small store. And if you could just refresh my memory as to what occurred there. Was this a fairly old store in a mature area or was it one of the new ones that the Company had launched?

A - Silvio Guerra

Thank you for your question. On regards to the Seminovos proposition, we are sustaining the pace of growth, that we started the year with 66 stores and intend to end the year with an expansion of 14 stores. And maybe we might be closing one or two, which would represent a net of around 78 stores.

And of course, we are always (testing) the stores. This one was a minor one, a small one, and I mean that is just what we need. We want to have a distribution that would allow us to be able to sell the average of 65,000 to 67,000 cars, which is our aim for the year in terms of selling the cars for the renewal of our fleet.

Q - Steve Trent {BIO 5581382 <GO>}

Great. Great. Thanks, Silvio. And just one more question. As we look at increasing automobile ownership penetration per capita in Brazil as a result of government initiatives and this kind of thing, any updated thoughts as to potential growth we could see in Brazil's insurance replacement market with respect to either the growth in the number of insured, as well as people potentially buying better insurance? Any thoughts there over the next, let's say, 18 to 24 months?

A - Silvio Guerra

Well right now Brazil represents between the fifth and sixth position worldwide in sales of car production. And this relates to the penetration of inhabitants per car. In the last five years Brazil has, let's say, increased its penetration from 8 inhabitants per car to 5.5 inhabitants per car.

This, of course, was a result of the conditions of better income per capita since 1994. We have seen an increase in the average salary much above and beyond the inflation, and that allowed bigger net incomes for our population. Another thing, the amount of investments of the automakers.

And another important point was credit availability. Credit availability in the economy increased a lot. So car penetration has increased the ratio of car penetration to 5.5. Right now we see our position there, the market is not growing as fast as it was growing before. We have an amount of investment -- a significant amount of investment of around ($6.4 billion) by many automakers. But the pace of growth has not remained the same as it was in the last five years.

On regards to the insurance, the insured people -- people have become more keen to take a look in their position of insurance, because usually a person that buys a new car they usually insure the car. So we are seeing the number of cars with insurance growing because of the growth of those new cars being produced.

A - Roberto Mendes {BIO 7289124 <GO>}

I would like to add about (inaudible) reported that they estimated between 17 million to 18 million individuals that are able to buy a car nowadays in Brazil. So we have a big market to take (advantage) (inaudible).

Q - Steve Trent {BIO 5581382 <GO>}

Okay, very helpful. Thank you for the color, and I will let someone else ask a question. I appreciate that.

Operator

Daniela Bretthauer, Raymond James.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Good morning, everyone, and also apologies I joined the call a bit as well. In the Portuguese call you mentioned that the volume of cars sold in July is still holding nicely. So are you quite confident then that you will be able to meet your -- it is not a guidance, but your commented target of 64,000 to 67,000 cars?

And also has it changed a bit in terms of spreads, because your spread was actually pretty decent in the second Q in Car Rental? So could you comment also on the spreads? Thank you.

A - Silvio Guerra

Thanks for the question. The current car market in Brazil is still hot. We do have a good demand for our cars. And the issue we have today, at least, don't have as many cars available in our stores, in our inventory. But the market in overall terms it has remained a good market.

On regards to the spread, could you repeat the question?

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Yes, of course. The spread, I thought it was -- it was a slightly positive spread between the price you bought and sold the cars in Car Rental despite the reduction in IPI prices. But do you think that spread is going to hold for the rest of the year or is it likely to become negative?

Then if I may add a follow-up, are you planning to then accelerate your car purchases so that you have enough cars to meet the demand or that maybe some sort of bottleneck for you this year?

A - Silvio Guerra

Well on regards to the spread in the Car Rental division, we believe this spread is sustainable because of the conditions we have and the way it has been through all times.

On regards to a possible acceleration in purchases, also it is possible, because we may take advantage of the IPI cut that we have seen, and this would be an opportunity for us to speed up the process of buying cars.

On regards to the -- I would like just to add that when we talked about the number of cars that is a hot market -- in hot demand we refer to new cars and also Seminovos. You know that Seminovos, the preowned car market, they relate each other.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Excuse me, this concludes today's question and answer session. I would like to invite Mr. Silvio Guerra to proceed with his closing statements. Please, sir, go ahead.

A - Silvio Guerra

We would like to thank the attendants to our conference call, and to inform you that our investor relations department is available for any further questions. Thank you, all and have a good day. Bye-bye.

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.