

Q3 2013 Earnings Call

Company Participants

- Nora Lanari, IR
- Roberto Mendes, CFO, Officer

Other Participants

- Michael Millman, Analyst
- Satyendra Singh, Analyst
- Stephen Trent, Analyst

Presentation

Operator

Good morning. Welcome to the Third Quarter of 2013 Conference Call of Localiza Rent A Car. Hosting the event today are Mr. Roberto Mendes, Chief Financial and Investor Relations Officer and Nora Lanari, Investor Relations.

We would like to inform that numbers in this presentation are stated in million of Brazilian Real 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's presentation. Immediately afterwards, we will start the Q&A session for analysts and investors when further instructions will be provided.

If anyone requires assistance during the conference call, please request help from the operator by pressing star zero on your telephone. The conference call audio 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, 3Q13 webcast.

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

Roberto Mendes {BIO 7289124 <GO>}

Good afternoon, everyone and thanks for attending our conference call. On slide number two, we present some highlights of the Third Quarter in 2013. Despite of the low GDP growth and strong competition that presented more aggressiveness in prices, the Company net revenue grew 16% this quarter due to the revenue growth of 6.8% in car rental, 5.5% in fleet outsource division, and 26% in used car sales for fleet renewal.

The graph represents fast bottom line growth of 43%. Localiza is prepared to take advantage of opportunities. As soon as the market starts presenting stronger economic activity growth level, which are most likely to be based on investments include infrastructure. And to present more details of the Third Quarter 2013 results, I will turn the floor to our head of IR, Nora Lanari.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone and thank you for attending our conference call. On slide number 3, we present the growth evolution of the Car Rental division. In the Third Quarter 2013, rental days grew 2.4%, still reflecting the weak performance of economic activity in last year's comparison basis which was positively impacted by demand increase due to the election campaign in the Third Quarter 2012.

The average rental rate grew 4.9% in the Third Quarter 2013 due to the business mix. As a consequence, rental net revenue presented a growth of 6.8% higher than the 6.1% presented in the Second Quarter 2013 and the 5.7% in the First Quarter 2013.

On the next slide, slide number 4, we present the evolution of the car rental network. In the nine months 2013, 14 rental locations were added to Localiza's own network in Brazil. Twelve new locations were added to our franchisees network abroad by taking advantage of the growth in the countries we operate. Localiza system currently holds 539 locations in 9 countries in South America.

On the next slide, slide number 5, we present the volumes and revenues of the Fleet Outsourcing division. In the Third Quarter 2013, net revenues increased 5.5%, leveraged by the growth of 1.4% in business volumes and 3.9% in average rental rate. The lower growth in the Third Quarter 2013 daily rental volume is mainly due to the increased aggressiveness of competitors in pricing. The Company maintains its conservative approach in order to sustain a growth that does not compromise the future results.

In the next slide, number 6, we present the Fleet Net investment evolution. This quarter, fleet was reduced by 470 cars. In the Third Quarter 2012, it grew 3,747 cars. 17,569 cars were purchased and 18,039 cars were sold. This represented a net investment of BRL30.8 million for fleet renewal. Car volumes at Seminovos stores were restored and sales reached a level above 6,000 cars per month.

Slide number 7 presents car sales evolution per quarter. The lower decommissioning level due to the OEMs' delays on cars delivered changed sales levels starting on the Fourth

Quarter 2012 until the Second Quarter 2013. As deliveries were normalized, Seminovos re-established the volume of cars on the lot and reached a new sales record in the quarter by selling 18,039 cars.

In the next slide, slide number 8, we present the end of period fleet evolution. The Company ended the quarter with 103,215 cars, a 10.6% growth when compared with the same quarter of last year. Including franchisees fleet in Brazil and abroad, fleet totaled 117,200 cars.

The commissioning and sale of the cars that had been used for a longer period allowed the average age of cars sold from the car rental division to reduce from 15.8 months in the Second Quarter 2013 and in the Third Quarter of 2012 to 14.7 months in the Third Quarter 2013.

Slide number 9 presents Consolidated net revenues evolution. In Third Quarter 2013, consolidated net revenues grew 16% due to the increase of 6.8% in the rental revenues from car rental, 5.5% from fleet outsourcing and 26% in Seminovos cars for fleet renewal.

Slide number 10 presents the EBITDA evolution. In the Third Quarter 2013, EBITDA totaled BRL238 million, 6.5% higher compared with the same period last year presenting a growth in line with rental revenue growth.

Car rental division's 38.5% EBITDA margin presents a 3percentage point recover when compared with the two First Quarters of this year. Management remains with a strategy of maintaining car rental rates stable, aiming at market consolidation as long as it does not compromise the targeted spread between return on invested capital and cost of debt after tax.

Since the base interest rate has increased and may continue to increase, management has been working on new productivity gains to postpone the increasing rental rates as long as it does not compromise the spread.

In the fleet outsourcing division, the EBITDA margin was 65.2% presenting a decrease of 1.5percentage points when compared with the same period last year. Such reduction reflects the increase in the average age of the fleet in 1.7 months and maintenance cost. Such increase was compensated by lower depreciation proportional to the pattern in which the expected future economic benefits produced by the car are consumed.

Seminovos sales continues to present margins above the 2% level presented in 2009, 2010, and 2011. In the Third Quarter 2013, over 80 cars were sold per store per month in average showing productivity gain.

Let us now move to slide number 11 where we present the average depreciation per car in the car rental and fleet outsourcing division. In the first nine months of this year, average annualized depreciation for car in the car rental division was BRL1,388. And in the fleet outsourcing division, it was BRL4,661.

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Lower depreciation in fleet outsourcing is due to the lower growth this year. By having a lower quantity of new cars added to the fleets, average depreciation tends to be lower considering the use of the exponential depreciation method that presents the higher share of depreciation in the beginning of the car's useful life and lower at the end of it.

On slide number 12, we present the net income evolution. In the Third Quarter 2013, the Company presented a net income of BRL102 million, 43% increase compared with the same period last year. Excluding the BRL24.5 million addition of depreciation expense, net of the income tax accounted in the Third Quarter 2012 due to the IPI tax reduction for new cars, growth would have been up 16.6%.

Net income increase procured due to the BRL14.5 million EBITDA increase added to the BRL2.3 million decrease in net financial expenses and BRL31.6 million decrease in cars depreciation, partially offset by the BRL17.1 million increase in income tax and social contribution line. In the nine months 2013, the Company presented a net income of BRL294 million, a record for the period.

Slide number 13 presents the free cash flow in the nine months 2013. In the first nine months, Localiza presented a free cash flow before growth of BRL366.6 million. Such cash generation was more than enough to increase fleet by 6,514 cars. Cash generation after growth was BRL168.3 million.

On slide number 14, we present the change in the nine months 2013 debt. We started the year with a net debt of BRL1.231 billion. BRL168 million of free cash flow were generated. The Company paid BRL72 million of financial expenses, BRL51 million of dividends and BRL36.8 million of Company's share buybacks. We ended the quarter with a total net debt of BRL1.223 billion, a reduction of BRL8.3 million in the nine months.

On slide number 15, we present the debt amortization profile. On October 9th, 2013 the Company concluded the issuance of BRL500 million debentures and the BRL30 million prepayment of a loan. The second series of the fourth debenture issuance in the amount of BRL130 million was also prepaid. The remaining BRL340 million reinforced Localiza's cash position. The Company currently holds a BRL1.131 billion cash position in a comfortable debt amortization profile.

On the next slide, slide number 16, we present debt ratios which reflect the financial discipline of the Company. The moderate growth scenario this year allows a strong cash generation and an improvement of the leverage indexes. Company's prepared for growth opportunities as soon as the economic activity accelerates.

In slide number 17, we present the spread between ROIC and the cost of debt after tax. ROIC remains stable in comparison to 2012. Lower cost of debt with third parties due to a lower interest rate in the beginning of the year allowed the spread improvement of 1.1percentage points reaching 10.9percentage points. Let us now move to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question and answer session. (Operator Instructions) Our first question comes from Mr. Michael Malone with (urban) Associate. Excuse me, Mr. Malone, your line is open.

Q - Michael Millman {BIO 1494618 <GO>}

Hello. I'm not sure if you pronounced. This is Michael Millman from Millman Research Associates. I was interested in inbound volume. Could you talk about what -- if you're seeing growth there, how much growth, what's the revenue per day and what competition is doing regarding inbound volume? I have some other questions.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you for your question, Michael. We haven't seen any big change in terms of inbound. Inbound does not represent a big portion of our business, 80% of our business is business related, only 20% is leisure related. And most of our leisure business derives from domestic tourists. So we haven't seen any much of a different trend, both from our volumes as well as competition standpoint.

Q - Michael Millman {BIO 1494618 <GO>}

In terms of competition, for example, Avis has now taken over its bankrupt franchisee, have you seen any differences there and I think Enterprise is also now in Brazil or a franchisee of Enterprise, could you talk about what you see them doing and how competitive they are.

A - Nora Lanari {BIO 18838335 <GO>}

Again, not much of a change in the scenario. As a matter of fact, Avis franchisee was struggling with chapter 11. The parent company bought half of the company to continue servicing their customers traveling to Brazil, so no big change. In terms of the partnership between Unidas and Enterprise, it's an exchange inbound and outbound but again, not of a big number on regards to inflow of tourists in Brazil.

Q - Michael Millman {BIO 1494618 <GO>}

Okay and you talked about earlier the changes in volume and price, was -- I assume that was total. Could you break that down for the leisure part of the business?

A - Nora Lanari {BIO 18838335 <GO>}

Yes. We do not provide -- when we told about the 80-20, the 80% business related in terms of revenues and 20% leisure related. But we do not provide the breakdown of the volumes of the three major segments we have. But in terms of total revenues, 80% business related, 20% leisure related.

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Q - Michael Millman {BIO 1494618 <GO>}

Is most of that leisure daily rental and most of the business long term or monthly rental?

A - Nora Lanari {BIO 18838335 <GO>}

Business relates to corporate trips, also insurance replacement and the monthly rental. This is only for the car rental division. This excludes the long-term contracts of the fleet rental division.

Q - Michael Millman {BIO 1494618 <GO>}

I see, thank you very much.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Michael.

Operator

Excuse me. Our next question comes from Mr. Stephen Trent with Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Hi, good day everybody and thanks for taking my question. Just one or two quick ones from me. Certainly as we look out into 2014, it seems like you have some interesting triggers with the elections in October and the World Cup and I'm curious how we just think about the World Cup, some other transportation companies have telegraphed anyway that they see to some extent World Cup fans replacing business travelers over this period.

And I'm wondering in Localiza's case how we should think about the potential upside in the car rental segment, thank you.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Steve. Thank you for your question. Our view is similar to the other transportation companies you mentioned, we see an uptrend in the leisure curve but a down trend in the business curve. So it's similar to what happens during vacation in Brazil.

A - Roberto Mendes {BIO 7289124 <GO>}

Just to add, we expect a positive balance of this more (driven) than the drop in the business travel.

A - Nora Lanari {BIO 18838335 <GO>}

Yes, leisure should more than offset the drop in the business volume those two months.

Q - Stephen Trent {BIO 5581382 <GO>}

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And could it even be the case like maybe what Localiza does sometimes perhaps during Carnival or the New Year's holiday where in some cases, they might -- you might take some of the cars out of the Seminovos lot and temporarily put them back into the car rental pool.

A - Nora Lanari {BIO 18838335 <GO>}

Definitely, Steve. This is something that we do on a yearly basis during peaks of demand and we can do the same and we'll probably do the same during the World Cup.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, very helpful. Thanks Nora and Roberto. I appreciate that.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Steve.

Operator

Our next question comes from Satyendra Singh with McLean & Partners.

Q - Satyendra Singh {BIO 18251675 <GO>}

Hi, thanks for taking my question. I have in fact four questions. The first one is about rental revenues. In the past, you have always said that in fact you expect it to grow by 5.5 times of GDP multiple and with GDP gradually improving in Brazil, we see rental growth is not swinging back like you grew by 6.8%, 6.68% in this quarter. So like how we are going to model this, based on this GDP growth going forward?

A - Nora Lanari {BIO 18838335 <GO>}

Thank you for your question. As a matter of fact, we have seen today the release of Central Bank mentioning the Third Quarter GDP is coming probably lower than expected by the market. So we haven't seen any much of acceleration in terms of economic activity yet.

In terms of modeling, we believe that we still have years ahead of the same level of correlation in real terms, we've been growing 4.5 times GDP in the last years. We believe that the market is still fragmented so as to present strong growth opportunities going forward.

Q - Satyendra Singh {BIO 18251675 <GO>}

And the second one is about your free cash flow, right. In this quarter, we have generated a free cash flow of around BRL8.6 million and in the last quarter, it was BRL83.2 million. So what had changed in this quarter?

A - Nora Lanari {BIO 18838335 <GO>}

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Yes. This quarter as a matter of fact, what we've been seeing is we sold more cars, but you also bought a relevant number of cars this quarter. Usually, the pace of growth relies on how many cars we are buying and selling.

So you asked about the free cash flow after interest and (inaudible) at page 10 of our earnings release we presented here nine-month figures, free cash flow before growth of BRL366.6 million and it's still very strong level. If we exclude the growth here 6,500 cars purchased, the free cash flow after the growth was BRL168.3 million. Comparing 2012 and 2013, we should expect slightly lower free cash flow generation because the growth in 2013 is going to be higher than the growth presented in 2012.

Q - Satyendra Singh {BIO 18251675 <GO>}

And the next question is about your utilization rate, like it has come down if you compare with your last quarter and year over year, it is down by almost 5% so, is it due to just like (an upfront) in fleet size or is there any other factor driving this change?

A - Nora Lanari {BIO 18838335 <GO>}

Sorry, I missed the beginning of the question, you asked about utilization rate, right?

Q - Satyendra Singh {BIO 18251675 <GO>}

Yes. That's right.

A - Nora Lanari {BIO 18838335 <GO>}

Sorry. Well in the car rental division, what we saw this quarter as a matter of fact was a picking up in the used car sales volumes due to the reestablishment of the volumes of cars being decommissioned and sent to Seminovos. So we sold a very healthy level of cars of around 6,000 per month.

On regards to the purchase, we still received a relevant number of cars from the OEMs and utilization rate by the end of the day is a function of the cars we buy, the cars we sell, or the demand. So demand came slightly below our expectations and we also received some cars. We agreed to receive anticipated number of cars without paying. We'll increase the terms to pay to the OEM. So we didn't have any big impact in our cash.

In that sense, utilization rate hasn't reached the level we want. Usually, we target a level of around 70%. This year, this is the first half of the year and the delay of the OEM will not get the 70%. But the goal for the next year is to get back to a level close to the 70%.

Q - Satyendra Singh {BIO 18251675 <GO>}

Okay, that's great. And my last one is about your purchase price of the new cars. If I look at the price increase for these cars, it has gone up by 14%. So can you throw some light on this part?

A - Nora Lanari {BIO 18838335 <GO>}

Yes. When we look to the purchase price per quarter, we might see some deviation in the center because of a mix effect. So we tend to look or we prefer to look on a 12-month basis. If -- an increase in car prices do not derive of actual price increases might relate to the mix of cars being purchased. So we are assuming car prices are still flattish.

Q - Satyendra Singh {BIO 18251675 <GO>}

Okay. Great, thank you.

Operator

(Operator Instructions)

A - Nora Lanari {BIO 18838335 <GO>}

We do have a question here from our website. The question is do you think the large amount of cars you sold was a major factor in the weakness in the Brazilian new car market the past two months?

No. We don't believe. As a matter of fact, we were running on the opposite side of the market because of our lack of inventory in the first half of this year. As our inventory at Seminovos was refilled, we were able to accelerate the pace of sales.

Operator

(Operator Instructions)

This concludes today's question and answer session. I'd like to invite Mrs. Nora Lanari to proceed with her closing statement. Please go ahead, ma'am.

A - Nora Lanari {BIO 18838335 <GO>}

We would like to thank you all for participating in our conference call and to inform you 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 your participation and have a good day.

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