

Q3 2017 Earnings Call

Company Participants

- Jose Antonio de Souza Azevedo, Chief Financial Officer & Investor Relations Officer
- Luis Fernando Memória Porto, Vice Chairman & Chief Executive Officer

Other Participants

- Lucas Marquiori, Analyst
- Renato Hallgren, Analyst
- Samuel Alves, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon. We'd like to welcome you to the conference of Locamerica where we will discuss the results of Q3 2017. Right now, all the participants are connected as - in the listen mode only. And then after, we will have the Q&A session.

During this quarter, Locamerica will have some space for press professionals to ask questions right after the market analysts have asked their questions. This teleconference has simultaneous translation into English and questions may be asked normally by participants connected in other countries. You can also send questions through the Internet via webcast.

We'd like to remind you that this teleconference is being recorded. The audio will be available in the company's website in up to 24 hours. If you don't have a copy of the release, you may obtain it on our website, www.locamerica.com.br/ri. We will have a slide presentation. It is being transmitted simultaneously through the Internet and can be accessed through the company's website.

Before we proceed, I would like to say that any declarations made during this call concerning business perspectives of the companies as well as projections, operational goals, and financial goals concerning its growth potential are forecast based on expectations of management. These expectations depend on the performance of the sector and the general economic conditions of the country and market conditions both in Brazil and abroad. Therefore, they are subject to change.

With us, we have Mr. Luis Fernando Porto, Chairman (sic) [Vice Chairman] (01:55); and Mr. Jose Azevedo, CFO and Investor Relations Officer.

Now, I'd like to pass the floor to Mr. Luis Fernando Porto. Sir, you may proceed.

Luis Fernando Memória Porto {BIO 17175861 <GO>}

Good afternoon to all. It is with great pleasure that we begin one more results conference of Locamerica, and this is the first time that we will have the consolidated finance of Auto Ricci and Locamerica. Once again, we're very satisfied with the performance of the company in line with the objectives anticipated by management. During this release, we would like to stress that the numbers that we will show year-to-date include nine months for Locamerica and Auto Ricci as of May.

Before we approach the main financial and operational indicators of the company, I would like to say briefly that the record results obtained by the company both in value and in margin are the result of the initiatives for value creation that we made in the past and which have been improving as we have - as we can see an improvement in operational efficiency and also expense control, administrative and general expense control, and also the improvement of results in Seminovos, and the first gains of synergy with the inclusion of Auto Ricci.

Now, going on to slide number 4, we see the highlights of the quarter. On the upper left, we see the positive of evolution of Seminovos, cars with up to three years of age, in Q3 2017 with a record profit and record gross margin, reaching BRL 19.8 million and 13.4%, respectively, 5.6 percentage points higher than the margin in Q3 2016. On the graph on the right, we see the evolution of the EBITDA of Locamerica which, during this quarter, reached its record in value and margin, reaching BRL 107.2 million and 68.4%, respectively, 6.6 percentage points higher than the margin of Q3 2016.

Here, on the lower left, to facilitate your understanding, we show the reconstruction of recurring net profit based - beginning with the net profit reported of BRL 15.2 million. We are excluding non-recurring expenses concerning the anticipated payment of the 10th and 11th emission (04:40) of debentures, which had been issued at less competitive costs than the recent 13th issuance made in August. These expenses are the prepayment of the 10th and 11th issuance of debentures worth BRL 3 million and the costs which are for market-to-market, MtM, of hedge operations linked to the 10th and 11th issuance of debentures worth BRL 4.4 million, totaling, thus, BRL 4.9 million net without taxes.

As a result of the adoption of the company of Hedge Accounting practices, CPC 38, the market-to-market amount should really be considered when and - as debt anticipation as financial debt going back to equity at the end, cancelling the negative effect in the next quarters. We'd like to stress that it is an accounting effect which does not include any disbursements. This practice adopted by the company aims at protecting our cash due to the volatility of the interest rates in the market.

On the graph on the right, we can observe the net profit of Locamerica worth BRL 20.1 million, representing a growth of 150.4% in comparison with the profit in the previous year. Even more important, we see that the fourth consecutive quarter, Locamerica reached a net margin upwards of 12% consolidating, thus, a new level of rent profitability.

Going on to slide number 6, we comment briefly on the scenario of the auto industry. As we can see here on the left, in Q3 2017, the sales of vehicles, new vehicles, had a growth of 14.7% which, in our opinion, is due to the weak sales of the previous year, although it's good news for the sector as a whole. Even more important, we'd like to stress not only the growth of the used car market and also especially the strong expansion of Seminovos, cars with up to three years of age, which grew 19.3% as we can see on the graph below.

On slide number 8, we show some commercial and operational indicators of the company. On the first graph on the left, we see that the pipeline of opportunity remained strong with the demand upwards of 24,000 cars to be rented, which represents a growth of 24.9% in relation to the same period of the previous year. On the graph on the right, we can see the success in more - the rental of more than 1,900 cars which represents a growth of 110% in relation to Q3 2016. In the graphs below, we see the evolution of the average age of our fleet which, after the renewal process in Q1 2017, we reached the level of 18.8 months of average age in this quarter. Finally, the consolidation of the utilization rate of the company at 97.1%, a level seen as excellent by us for our activity.

We'd like to thus close (08:27) the operational highlights showing the evolution of our fleet. The company closed Q3 2017 with a fleet of 44,600 cars. We'd like to stress that the operational fleet, the one that generates billing grew 4.4 percentage points (sic) [4.4%] (08:44) in relation to the previous quarter using as a metric the sum of the fleets of Locamerica and Auto Ricci in Q2 2017, for the comparison.

Now, on the right, we show the evolution of the cars and inventory which, when compared as a percentage of the total fleet, increased 2.3 percentage points in relation to Q2 2017, going back to the ideal level of 5%. We'd like to say that this indicator is comfortable for the company, both in terms of product portfolio in our stores as well as speed in all the process to collect, prepare, and transport the cars that are demobilized and sent to sale.

To comment the financial results, I'd like to pass the floor to Jose Azevedo, our Investor Relations Director at Locamerica.

Jose Antonio de Souza Azevedo {BIO 20187090 <GO>}

Thank you, Luis. Good afternoon. It's an enormous pleasure to really inform the results at such a special time for the company. Here on slide 11, we see the net revenue from rental. It had an increase of 53.7% in Q3 2017 when compared to the same period last year, and especially due to the increase of 65.7% in the number of daily rentals. The reduction in the average rates - we had a reduction in the average rate of 7.4%. This is due to the inclusion of the fleet of Auto Ricci. The mix of cars of this company and also their rates were a little inferior to those of Locamerica.

Going on to the next slide, we see the performance of Seminovos, cars with up to three years of age. Here, we see a very strong performance, with a growth in billing, 48.7% in relation to the previous quarter, in the previous year. We'd like to stress the importance of the growth of 88% in the retail sales, and this represented 64.6% of the revenue of

FINAL

Seminovos, increasing its relevance in this segment. On the graph on the right, we show the consolidation of our company strategy. We closed Q3 2017 with a gross - record gross profit of BRL 19.8 million, a margin of 13.4%, the highest level in the company's history.

On slide 13, we show the EBIT margin. In this quarter, we had a gain of 0.4% both in operational cash costs and also SG&A when compared to net revenue of rental, and especially when we see the inclusion of Auto Ricci. Additionally, I'd like to reinforce, as Luis Fernando said, that the average age of the fleet dropped to 18.8 months. And due to this, we expect to have a reduction in maintenance expenses in the next quarters. As a result, EBITDA and EBIT - recurring EBITDA and EBIT margins reached 68.4% and 42.7%, respectively, both with record - at record levels in the company's history.

Now going on to slide 14, we see here on the upper left the evolution of the financial result of the company. We'd like to remind you that we're excluding non-recurring expenses concerning the costs of prepayment of MtM concerning the 10th and 11th debentures, as mentioned previously. In Q3 2017, the financial result consumed 25% of the rental revenue, a drop of 3.5 percentage points in comparison with the previous year.

On the graph below, we see the evolution of recurring net profit, this considering all the extraordinary items and showing a substantial growth of 150.4% in the quarter in relation to the same period in the previous year, together with the evolution of ROI, the main metric for REIT (13:02) - for management. As we can see, the last five quarters were marked by a positive evolution in the return on investment of the company which closed Q3 2017 at 17.5% on annual - on an annual level, thus, showing a new level of profitability and value creation for the shareholders.

On slide 15, I'd like to show that - how our debt is now with longer maturity dates worth the amount BRL 250 million at a cost of CDI plus 1.4% per annum. And this was a landmark for the company. It is the first debt operation with total distribution in the market. With this, we can observe on the graph on the right, here on the lower part, the comfortable cash position. On the upper part, we can see that even with the recent operation of debentures, the strong growth of EBITDA allowed us to have a deleveraging effect reaching the index of 2.43 times net debt in relation to EBITDA. Thus, we see on the left, the evolution of the net debt reaching BRL 961 million at the end of the period.

Also in line with the best practices for corporate governance and increasing transparency, the company makes available the DRE below together with Locamerica and Auto Ricci concerning Q3 2016 for comparison with the DRE of Locamerica On a consolidated basis in Q3 2017.

Now, I'd like to pass the floor to Luis Fernando.

Luis Fernando Memória Porto {BIO 17175861 <GO>}

Now, we'd like to begin our Q&A session.

Q&A

Operator

Ladies and gentlemen, we'd like to begin the Q&A session. We remind you that press media professionals may ask questions after the meeting with market analysts. Our first question comes from Lucas Marquiori, Safra Bank.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Good morning - good afternoon, actually. Thank you for the call. Two questions. The first, we saw a strong increase in the number of retail stores. You have between 4,000 and 5,000 vehicles sold in this quarter. The opening - will you continue to open new retail stores? And what is the sales capacity of used vehicles with up to three years that you want to reach selling 25,000 years (16:00)? What is the capacity do you want? That's the first question.

The second, Luis Fernando, could you explain the projects for new products? You had mentioned previously to migrate to shorter-cycle products. How are the plans for these new projects and new products? Thank you.

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Lucas, thank you for being with us. The increase in the number of retail stores now, we will try to stay close to 70%. We're close to 65% of sales being made in retail sales. We're increasing the stores to increase this. It gives us a better return to the company, and that is why we are opening new stores - retail stores.

Also, with the number of stores working, opening more stores is easier than in the past because we have the process, customization of stores, marketing, everything is ready, logistics, and to replicate this model is very easy now. So our idea is to improve the sales - retail sales through these stores, and this expansion during the last quarter - this will also happen in Q4 is - this is to prepare the whole structure to be ready and working in the beginning of next year.

During the last few years, we have been opening stores during the year and this, concerning the impact during the year, it has a smaller impact than opening at the beginning of the year. So in truth, we're anticipating this, and the main objective of these stores, retail stores are these.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Also, there's - have you increased the number of vehicles sold, upwards of 20,000?

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

We believe that around 20,000 to 22,000 - 20,000 to 21,000 vehicles to be sold - used cars, next year. We reached 5,000 during this quarter, 5,000 cars sold. So we want to increase the exposure in the retail channel. So, there will be some expansion in volume,

FINAL

also price. Because, for example, here, with sales that you sell at a discount and here at peak prices, this should improve the average ticket (19:09) and also the volume. But you can expect upwards of 20,000 cars. More than 20,000 cars, used cars to be sold next year.

And also concerning new products, you asked about new products. As we said in the previous quarter, now the company strategy to grow organically will include the launching of new products. We want to have products that will be close to what we are already doing in terms of the operation for selling cars. So it's not that new in terms of the operation. And also, the cycle of the product - we will have shorter cycles, as you mentioned, yes.

So, there - our clients had asked to - for us to sell cars that would be newer - cars with up to one year of age, up to 12 months. So these promotion cars, clients - some clients use the cars for three, four months and clients were asking us to sell cars with up to 12 months of usage. So we will be offering these products to our clients. And if all goes well, with the expected profitability, we can offer this to the market as a whole, first to clients and then to the market as a whole.

Also another product we want to bring you is rental for individuals with one-, two-, or three-year contracts. Today, nowadays, Locamerica rents only to companies and now we're getting ready to really rent cars to individuals instead of buying. We believe that this should be in operation by the first quarter of next year.

So what we can tell you are these two new products. The capacity - our sale capacity is greater than our need which gives us comfort and we can, therefore, launch new products. We will not have an increase in inventory. We will have greater added value because these products are retail products. So, we will also avoid extra expenses to launch these products because the current administrative and operational structure can have this growth without growing the physical structure of the company. So, this is a new vision of the company, and we believe that this can help us to grow a little more and with more profitability. Thank you.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Thank you, Luis Fernando.

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Thank you.

Operator

Our next question comes from Samuel Alves, BTG Pactual Bank.

Q - Samuel Alves {BIO 18720076 <GO>}

Good afternoon. Two questions in reality, the first concerning the growth opportunity, considering the new contracts, 2,000 extra cars, the new contracts you signed, and record purchases of 6,000 cars. What is behind this number please? Is this a stronger strategy to renew the fleet and longer rental contracts?

And also concerning Seminovos, cars with up to three years of usage. Could you please share with us the margin considering the sales expenses, if you have a positive EBITDA margin with this record gross margin?

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Well, thank you, Samuel. The first question concerning the growth, what we have said in the last quarters is that we were getting to the time when all the initiatives involving improvements in all the fronts were already there. And after that, this - we would have two advantages.

First, a new capacity to grow because the structure supports more cars without growing the costs, and this also brought us a different competitiveness when you begin to have like us (24:11) reduction in administrative costs, and also a reduction in operational costs when we're able to buy at lower rates, and also when we reach a scale with the inclusion of Ricci, Auto Ricci. This brings us to a new level of competitiveness.

For the second consecutive quarter, we have been able to have a higher number of cars rented than we had in the past. And also, maybe now I can say that some projects involving some clients are now becoming new contracts. So, the scenario is more positive. So, that is growth. We're more competitive, and now, being more competitive, we can also have more contracts.

Concerning the purchase of cars, that's a virtuous (25:18) cycle because now we made an acquisition of two small rental companies in December and March, then the merger with Ricci, Auto Ricci. And now with the new stores and Seminovos project, we also accelerated the renewal of the fleets of these companies that we acquired.

So with greater speed of renewal, we have three important gains. The first, the more cars you buy, the greater the chances to have more discounts, deeper discounts. With a new fleet, the cost of maintenance also is lower. And finally, depreciation rate can also be lower. In the case of the depreciation rate, as you saw during the presentation, we are preferring to maintain this level although we know that we could lower a little this rate of depreciation. But we're always conservative. We prefer to maintain a high depreciation rate. The main objective of the large purchase of (26:33) number of vehicles is to renew the fleet to give support to this growth in the last two quarters.

Well, concerning the margin of Seminovos, Used Cars with up to three years of age. When we talk about sales cost, they represent roughly 2% to 3% of our billing. So it's a cost that is still low, yes. And it should rise a little in the next quarters because the cost of sales in retail cost (27:15) is higher. It is higher than the cost in wholesale. You have more margin, more gross profit but also more cost with the sales. So it's our idea in management here. Maybe in the next quarter or the first quarter of 2018, greater

discount when demobilizing, selling used cars. And for the time being, you can imagine that we're talking about 3% - 3.5% of costs of sales.

Q - Samuel Alves {BIO 18720076 <GO>}

Thank you.

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Thank you.

Operator

Our next question comes from the Renato Hallgren, Bank of Brasil.

Q - Renato Hallgren {BIO 17989415 <GO>}

Good afternoon. Thank you. This last answer from Luis Fernando clarified some points. I'll try to be more specific here. When you say now with more purchasing power, you're getting higher discounts. These discounts are in relation to the prices that Auto Ricci paid. Were you able to improve the purchasing price - to lower the purchasing price because of the higher scale? And looking forward with the recovery of credit, when we will see the recovery of new car sales? When you mentioned the possibility of increasing market share in the sale of Seminovos, cars with up to three years of age, how do you see this market? Luciano (29:16) explained this, that you have - that you can also work on the depreciation. What is the strategy to increase market share for Seminovos Used Cars when credit improves?

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Thank you very much for the questions. One first, in the first round, we were able to have the same discounts for Ricci as the ones we have for Locamerica. Now, we're buying for the whole group. And we have hope that during the next year and from now on, with more scale, we will be able to really get deeper discounts when buying cars. We're discussing the contracts. We have a good relationship with the auto industry long-term. 50% to 60% of our cars, we buy through contracts. The others, we have spot purchases according to the needs during the year.

So normally, this is done during the last quarter and the first quarter of the next year. So we're beginning now to purchase, but for the time being the discounts have been larger for Ricci. We hope to have better discounts next year because, you saw, we are - we have BRL 24 million in purchases - car purchases and Locamerica in the past, the maximum that we got to was 13,000 vehicles. So almost twice the amount we used to buy from 13,000 to 24,000 cars.

Now, your other question, we are working for two, three months with new car sales improving in the country, especially in comparison with last year. It's - so, last year, the sales were depressed for new cars. We haven't had a fantastic recovery. Although the

FINAL

volume has been strong, the sales volume has been strong for new car sales, we believe this should continue or improve a little more.

What we have been noticing is that even with an improvement in new car sales, cars with up to three years of use continued to sell very strongly. We see no signs in the market to hurt the sales or prices of cars with up to three years of age, and we don't believe this will happen even if new car sales go up. Why? Because in our vision, what happened in the last four years was the following: we had a greater distance, not in the depreciation of Locamerica, but the market as a whole. So, the depreciation rate in relation to new cars and used cars expanded, and this brings an advantage to consumers.

So, we haven't seen that the improvement of credit and also the new car sales, they have not hurt used cars with up to three years of age. But even if something happens which is different from our perspective, we understand that Locamerica has, today, conditions to compete in this market of Seminovos. A good competition because we have small stores that sell used cars and dealerships. Most of the market is - buys from small stores, multi-brand small stores. These stores that sell used cars have lost credibility. Many of these small stores closed. They have problems with documents and many other problems.

So what we said concerning market share is the following. We have today a good share in the market in comparison with small stores because with the product we have, with the price we have, and the scale we have, Locamerica has a competitiveness that is superior to the small stores.

We are on - we have our stores on large avenues where we have dealerships and small stores. And thus, having a participation of 0.39% of our sales in relation to the market of Seminovos, this gives us a really - this gives us the trust that with the gains in scale, we will have a growing - we will grow more than the market in sales.

And with three months, we already see a (35:12) new situation in terms of an increase in the sales of - new car sales and we are very well. And we haven't seen anything different, and we believe that this situation should continue in the future. Thank you, Renato.

Operator

Since there are no more questions, the Q&A session with analysts is ended. Before we go on to the Q&A session with press professionals, I'd like to pass the floor to Mr. Luis for his final comments.

A - Luis Fernando Memória Porto {BIO 17175861 <GO>}

Well, I would like to use this opportunity to thank you all for your participation, which is so important for Locamerica. We understand that in - that Q3 2017 brings Locamerica to a new level of profitability coming from our management with focus on results, operational efficiency, gains in scale and also improvements of the process, also through our new rental contract and by strengthening also the sale of Seminovos specially due to investments in the retail channel. After the merger with Auto Ricci, we had a benefit with the gains in financial synergy. But we believe that the results of operational synergies that

are being implemented will give us an important increase in competitiveness to allow us to continue to grow.

We'd like to reinforce that in this quarter, which was the first when we have consolidated demonstration of results with Locamerica and Auto Ricci, we improved. We had gains in all operational and financial and administrative indicators showing the company's capacity to grow organically and inorganically.

I'd like to say that our Investor Relations team is available to all of you, and I would like to wish you a good afternoon. Thank you.

Operator

Now we will begin the Q&A session with media professionals. Since there are no more questions, Locamerica's earnings conference - it has ended. So, please disconnect the lines. Have a good day.

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