Q1 2013 Earnings Call

Company Participants

- Joel Kos, Chief Financial Officer and Investor Relations Officer
- Luis Fernando Memoria Porto, Chief Executive Officer

Other Participants

- Leonardo Francia, Analyst
- Marcos de Moura Souza, Analyst
- Murilo Freiberger, Analyst
- Renato Mimica, Analyst

Presentation

Operator

Good morning. Welcome to the Locamerica teleconference, where we will discuss the results for the first quarter of 2013. At this time, all participants are connected on listen-only mode. And later we will open the session for questions and answers, when you will be given further instructions.

In this quarter, Locamerica will also answer the media, shortly after the answers of their market analysts. (Operator Instructions) This call is being simultaneously interpreted into English, and questions can be made normally by all participants connected abroad. Questions can also be made over the Internet through the webcast platform.

Please remember this conference is being recorded, and the audio will be available on the company's website within 24 hours.

In case you need a copy of the Locamerica release released on Thursday, May 9, it is available on the company website, www.locamerica.com.br/ri. This conference is also available or aired simultaneously over the Internet at www.locamerica.com.br/ir or at www.ccall.com.br/locamerica/1T13.htm for Portuguese and www.ccall.com.br/locamerica/1Q13.htm if you need the English version.

Before proceeding, I would like to clarify that any statements that may be made during this conference call regarding the company's business prospects and projections, operational and financial targets related to its potential growth are merely forward-looking statements based on the current expectations of management in regards to the future of Locamerica. These projections depend on the performance of the sector, the overall economic performance of the country and the conditions of the national and international markets and they are therefore subject to change.

With us today, we have Mr. Luis Fernando Porto, who is CEO for Locamerica and Joel Kos, CFO and Investor Relations. Now I would like to give the floor to Mr. Luis Fernando Porto. Please Mr. Luis Fernando Porto you may proceed.

Luis Fernando Memoria Porto {BIO 17590082 <GO>}

Good morning, everyone. I am very happy to be here, thank you very much for attending this first quarter 2013 presentation. First of all, we highlight the net income of 9.4 million in this quarter, an increase by 18.8% compared to 1Q12. If we take out the effects of the IPI, the net profit would have been 12.7 million representing an increase by 60.9% over the same period last year, resulting in a net margin of 15.5% on rentals.

Consolidated net revenues increased 48.5% compared to the first quarter of 2012, due to an increase of 198% in sales of used vehicles and 9.3% in revenues from rental fleet. Sales in used vehicles during first Q of '13 were record totaling 2,857 vehicles accounting for an increase of 230.3% compared to 1Q12. Thus, in the first quarter of the year, we have already sold 33% of our needed sales for the entire year. This excellent performance is far above the national average is the result of investments in used vehicles platform, including the opening of two new dealership in retail in December of last year. And we have scheduled openings for another five retail dealerships this year.

Another highlight in the first quarter was the record of the overall value of new rentals in the company's history totaling R$93 million representing a growth of 102% over the same period last year. This trend is still felt in April with new contracts totaling 29.5 million, and we are currently experiencing the largest pipeline of business in the company's history. And this in our view puts us in a privileged position of growth potential in face of the macroeconomic uncertainties felt in Brazil.

Our EBITDA was also an record-high in the first Q of '13 totaling 46.8 million, representing a margin of 57% on rentals in line with our target operating margin for the year which was 55% to 57%.

Finally, in April 2013, Fitch raised our rating from A- to A. In response to the successful process of strengthening our financial profile which resulted in, number one, lengthening the duration of our debt that went from 1.7 to 4.4 years; number two, releasing our collateral with a percentage of the fleet falling from 68% to 36%; number three, reducing the spread of the CDI which went from 5.5% to 2.8%; and number four, reducing the company's leverage. In February of this year S&P had also raised our rating from A- to A.

In the next four slides, before we go on to our operating performance, we would like to go over our key indicators. Slide number three shows a growth of 48.5% of consolidated net revenues in 1Q13 compared to the same period of 2012, due primarily to an increase of 198% in revenues from sales of used vehicles and 9.3% in income from activities resulting from the rental fleet.

Slide four shows EBITDA hitting a record-high of R$46.8 million in the first quarter. And this already had a margin of 57% on rentals, which is significantly above the average of 53% to

54% in the second half of last year.

In the next slide, we show the net income of R$9.4 million, which represents a growth of 18.8% compared to the first quarter of '12. At the end of the first quarter, the company achieved a total fleet size of 27,813 cars, which is down by 2.9% compared to the same period in last year. This was mainly impacted by the early termination of a major customer of the banking sector which returned 1,365 cars at the end of the quarter. Recently, this client has undergone major restructuring of its business and car financing, so significantly reducing its sales force and strength.

We experienced a record-high new contract during the first quarter and the record pipeline points to a rapid recovery of the rental fleet in the coming quarters.

The next four slides, we will briefly see some of the trends in the sector in the last quarter. Slide seven shows the sales of cars and light commercial vehicles totaling 788,000 units in this first quarter, which is an increase by 1.9% compared to the same period of last year. The projections of some of the industry associations show an expected growth varying from 1% to 3% on the record number of sales in 2012. In April, sales were a record for the month, we sold 317,000 units, a growth by 29.4% over April 2012.

In the next slide, slide eight shows the used car market also registering a positive performance in the quarter with sales of 2.1 million units, which was up 0.8% compared to first quarter of '12. Earlier this year, the price of new cars suffered an increase of more than 2%, increasing the relative competitiveness of used cars.

On slide nine, the default of car loans has remained persistently high and this inhibits any significant increase in the supply of financing from the country's largest private banks. The average spread of financial funding remained at a historical minimum until March, but should also rise in line with the recent increase in the basic interest rate in Brazil.

In the next slide, we show the evolution of new cars development in Brazil in the last years. To your left, we see a steady increase in the spread between the price of the new and the used car. To your right, you can see the new car price rising by 2.4% in first quarter of 2013 reflecting an increase of the IPI from 0% to 2% in January 1st of this year. On the other hand, the price of the used cars suffered a mild deflation of 0.2% in the same period.

On slide 11, we provide a breakdown of our fleets which totaled 27,813 cars by the end of the quarter, a decrease of 2.9% compared to the first quarter of '12, mainly impacted as we have said, by the early termination of a major customer in the banking sector. In the chart on the right, you can see that the number of cars in the inventory for sale consequently rose to 4,505 cars by end of the quarter. But the sound sales performance of the used segment should bring that number of fleet demobilization to the normal levels by the end of the third quarter of this year.

On the next slide, we highlight net rentals with annual growth of 9.3% due to an increase in the average ticket to 11.3% partially offset by lower volumes at minus 3.1%.

On slide 13, the total value of contracts signed was R$93 million and hit a company record representing a growth of a 102% over the same period of last year. This strong pipeline of deals closed in the first quarter, which is holding up in April totaling 29.5% in terms of new signed contracts should ensure a top line in line with the budget forecast.

In the next slide, you can see we follow a strict policy of diversification of markets and customer portfolio focusing on more profitable segments of small and medium businesses and decentralizing revenues in the hands of the top 10 customers. Thus at the end of 1Q13, the company recorded 309 customers, an increase of 34% compared to the same period of last year. And the representativeness of the 10 largest companies in total revenues for rentals was 39.5% in the first quarter of this year, compared to 44.5% in 2012.

On slide 15, we have sold 2,857 used vehicles in 1Q13, a new record-high in terms of sales representing an increase up 230.3% and 37.1% compared to 1Q12 and 4Q12 respectively. In April, sales held up in line with our planning. And in the chart on the left, the average selling price rose in 1Q13, partially due to the sales mix in the quarter and the stabilization of the prices of used cars.

In the next slide, we highlight the strategy of growth in the used car business. Currently, we have 11 used car dealerships, eight in the wholesale segment and three in retail. In 2013, we are expected to open five new dealerships in the retail segment in line with our strategy of diversifying our channels.

And with the investments in the used car platform, today for the first time in the history of the company, our sales capacity of used vehicles is above the need of sales. And this enable us to carry out a strategic renewal of the fleet of some customers even before the end of the contract, helping to reduce the average age of the fleet.

In slide 17, due to the reduction of the IPI in May of last year, it was necessary to accelerate the depreciation curve of our entire fleet to reflect the new estimates in terms of residual value. On March 30, the government announced the IPI maintenance at 2% until December 2013, when it was previously expected to increase to 3.5% between April and June and 7% as of July 1st.

Please note that we do not foresee any impact in terms of additional depreciation resulting from this announcement from the government. As in our conservative view, an increase in the price of the used cars was expected even with the return of -- sorry, it was not expected even with the return of the IPI.

In the chart to the right, the depreciation of cars totaled 10.5% and 20 million and was the result of two out of the ordinary events; number one, 3 million of additional depreciation due to the return in advance of 1,300 vehicles. And number two, the additional extraordinary depreciation due to the reduction of the IPI of R$5 million.

On slide 18, our EBITDA was record in first Q of '13, totaling 46.8% representing a margin of rentals of 57%, in line with our operating margin for the year.

On the next slide, we have our operating income EBIT. Excluding the effects of IPI totaled 31.2 million in the first quarter of 2013, representing a margin on net rentals of 38%, a continuous improvement since the IPO.

On slide number 20, we show net income -- net profit, excuse me, of 9.4 million in the quarter, an increase of 18.8% compared to the first quarter of 2012. The reduction of the net profit compared to the third quarter of 2012 has to do with the line of tax, income tax, when due to certain accounting credits the company reported a credit, a negative rate in the fourth quarter of 2012. While in the first quarter of 2013, the rate of tax income had been normalized at 26.7%. Hence, it is worth mentioning that the quality of reported earnings continued to improve since the profit before taxes increased 34.8% in first quarter 2013 compared to the fourth quarter of 2012.

In the graph on the right, our ROE for the last 12 months excluding the effects of IPI and prepayment of debt, remained stable at 59% in the quarter. And still at the top of profitability after the company's IPO in April 2012.

With that in mind, I want to get the word, pass the floor to our CFO, Joel Kos, who will speak on our investments and capital structure.

Joel Kos {BIO 17590108 <GO>}

Good morning, everyone. On slide 21, we show the fleet investments made by the company. In the quarter, we acquired 1,699 and sold 2,857 vehicles with negative investment of 7.9 million. In 2013, the company expects to invest approximately 400 million in acquisition and renovation of vehicles, that's gross value.

On the next slide, we talk about the recent increase in the rating of the company. In February, Standard & Poor's raised the rating on the national scale of Locamerica in its debentures from A- to A with a stable outlook. This increase will reduce by 0.25% the spread of some debentures which today they are linked to the rating on the amount not redeemable at 160 million. On April 30, 2013, Fitch ratings also upgraded the national long-term company ratings from A- to A with a stable outlook as well.

The next slide 23, the elevation of those ratings comes in response to the successful process of strengthening our financial profile completed in September 2012, which resulted in, for the first graph reducing spread of CDI plus 5 current at 5.5% to 2.8%; for the second graph, in decreasing the percentage of the fleet alienated, the alienated fleet from current 68% to 36% providing greater operational and financial flexibility to the company as well as increasing the perceived company's liquidity in times of stress; and for the third graph, lengthening debt which today is at 89% of loans maturing the long-term versus 68% at the end of 2011.

For the next slide, we have lengthened and softened the annual maturities to 2019 and the duration of the debt also increased significantly from 1.7 to 4.4 years. The concentration in 2016 includes an amount not redeemable of 160 million.

For the last slide, we show the significant deleveraging obtained with our net debt/EBITDA at 2.7 times versus 3.4 times at the end of first quarter 2012. The major result of the debt restructuring was a reduction of 41% of our net financial expenses for the first quarter versus the same period of last year, which now already accounts for 16.2% of our net rental revenue in the quarter, compares to a historical level at 30% before the IPO.

With that in mind, we can now open the session to questions and answers.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) We would like to remind you that media professionals can ask questions after the closing session of questions and answers with analysts. Our first question comes from Mr. Murilo from Merrill Lynch.

Q - Murilo Freiberger {BIO 17385357 <GO>}

Good morning, Luis and Joel. Well, I just have a question related to the contract that was cancelled for the first quarter. We see a high volume of sales of used cars which is great. And because of this contract, where we see that the inventory of car increase the reaching 16% of the fleet. I would like to know what is your outlook in terms of reduction that to get to a level that would be normal from 8% to 12% from what we usually see?

And my second question is related to this contract cancelled, if they would have to pay any type of penalty or fine from having cancelled the contract before the term expected?

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

Good morning, Murilo, thank you very much. Well, the first question is that, we have another two quarters which we believe we will get to the normal level. As we said in our presentation, we have a greater capacity from our sales need that means -- and for that reason we really believe that by the third quarter we will get back to normal.

And the second question. Yes, all our contracts are protected by penalty and they are there to protect our investments. For that reason, we will definitely have that come through.

Q - Murilo Freiberger {BIO 17385357 <GO>}

Okay. Thank you, Luis.

Operator

(Operator Instructions) Excuse me, we had an interruption in the Locamerica teleconference. So, I would like you to please wait and we will get back to the conference.

Excuse me. Please just wait to get our speakers reconnected.

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

Hello?

Operator

You are connected.

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

Is there any other questions?

Operator

Yes. Our next question comes from Mr. Renato Mimica from BTG Pactual.

Q - Renato Mimica {BIO 15374054 <GO>}

Good morning, gentlemen. Luis, Joel, thank you for the call. I would like to pose a question that is more a high-level question starting from new contracts that we saw. When we compare the global size of revenue of these net contracts with the number of cars, we can see that there is a clear trend of change of mix.

And I would like to understand a bit more, if that is actually part of the positioning of the company or is it just a specific situation perhaps and if in the next quarters, we should actually see a change in the mix that would be more focused perhaps on an average rate also increasing. Can we expect that -- shall we expect that? That's my first question.

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

Good morning. Thank you very much. Yes, the company has adopted about a year and a half or two a strategy of searching for new industries focused on executive and middle range cars. And for that reason, we believe that our average rate might increase slightly. And the reason for which we believe that that is something we should do is that for the next two or three years there is a shift in the car market in the search for fully equipped cars with a higher power engine, also because of the increase of income of our population and that is a trend in the car industry and that is what we are searching, to be positioning our cars with clients that at the end of the contract will bring us an inventory of used cars aligned with the trend.

In the last 12 months, we see that the participation of low-income cars went from 68% to 61% and that is a trend -- a strategy, and we have spotted that. And we believe that for the company's purchase capacity; we are quite competitive in buying midsized cars and executive cars for the level of purchase of our company.

So, we got ourselves ready and we have a policy aligned with the perspective of sales of our used cars and also our strategy for buying new cars, as we have been doing in the last few years.

Q - Renato Mimica {BIO 15374054 <GO>}

Thank you very much, Luis. And also related to used cars, as you mentioned about performance, I would also like to understand from you, if in terms of an improvement in average price and also volume of sales of used cars, do you actually feel that the worst scenario is something from the past where we see an expectation or actually a positive result?

And even when it comes to purchase, have you seen any aspects related to period of deliveries from the carmakers in terms of the car they purchase or do you feel that is something from the past, now that we have better organized inventories from carmakers standpoint?

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

Well, to talk about the sales of the used cars, there is nothing that is new to us, that is something that we had already forecasted. And we have been for the last two years planning and investing greatly in our used car platforms as a whole, and even looking for new channels to flow out our inventory. And that is what we are reaping from our investments and we have actually been able to reach that point.

And what we see in the market is a stability in terms of price, also in terms of volume. It is natural to see that after the first impact of IPI in brand new cars, where many buyers of the used cars are more likely to buy brand new cars. Over time, we are going to have a dissipation of such impact and we'll get back to have a normal market scenario.

So, what we expect is to see a market in terms of price and in terms of volume stable for the next few quarters. And the worst scenario from our view is something for the past. And even the government's policy of not increasing IPI takes away the demand for us to have to take drastic measures that could have an impact in our market.

So for us, it is a new level that the company has reached and that's something we have been investing on and talking about for some time. So, we believe that from 12,500 cars to 13,000 cars at a new level of the car because of the investments. And in terms of markets, we expect a stability in terms of volume and price.

And to purchase cars, the company has been in the last five to six years purchasing high volume and also constant purchases despite the economic turmoil or market shift. Locamerica, since our business is resilient and contracts are renewed and growth is ongoing, we have relationship with the major carmakers that has been quite established.

So, we have not seen that impact. And obviously there are some products, specific ones that can be delayed to be delivered. But in any case, we are always positioned through agreements, short-term agreements of one-year term for most of the fleet that we need to buy and that will ensure to us at any point. The obvious continuous delivery of cars, so we can deliver that to our clients at that point in time they wish to get them.

And since there is a decrease in the retail level that will get to a normal standard in the market for everyone. But Locamerica is specifically is quite comfortable because what we have developed with carmakers is not just a buy-and-sell relationship, it's a long mid-term relationship, where we have structured of this relationship through buying car parts and services.

We have the whole chain paired with them and partnered with them. And that has never been a problem for us. And we believe, this is a risk that we would run, if we do not maintain such partnership and commitment, and that's how we have been acting with the carmakers.

Q - Renato Mimica {BIO 15374054 <GO>}

That is very clear, Luis. Thank you. Have a good day.

Operator

(Operator Instructions) Excuse me. The question-and-answer session with analysts is closed. We'll now proceed with the question-and-answer session with media professionals. (Operator Instructions) Our first question comes from Diario do Comercio, Mr. Leonardo Francia.

Q - Leonardo Francia

Good morning, Luis, Joel, thank you for the opportunity. During your talk Luis, you said Locamerica is expected to open five new dealerships this year. Where will these dealerships be? Is there going to be one in Minas Gerais, and what is the size of the investment?

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

Good morning, Leonardo. For this year, we still are not expected to open any new dealerships in Minas Gerais. They will be opened in the states of Sao Paulo and Rio de Janeiro. And the investments are expected to be around R$5 million.

Q - Leonardo Francia

Thank you very much.

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

We have opened a new dealership in Minas Gerais in December of last year.

Q - Leonardo Francia

Where was that?

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

In Contagem.

Q - Leonardo Francia

Thank you very much, Luis.

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

Thank you. Have a nice day, Leonardo.

Operator

Our next question comes from Mr. Marcos de Moura Souza from Valor Economico.

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

Luis, Joel, good morning. I would like to ask you a question concerning the rental business. The main clients today, have you -- what are their assessments concerning the economy this year? And to what extent, is there a pessimism on their point of view, on the client's point of view concerning the growth of the GDP in their own businesses? Is already having you to rethink or maybe reassess your plans for 2013?

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

Good morning, and thank you, Marcos for your question. Well, our clients in their majority use their fleet for their sales force, or generally for their deliveries, or as a benefit for their executives and officers. For this reason, we don't have a business that is directly connected to the growth of the economy or to the mood of the economy at that particular moment.

Therefore, for the time being, we have had no signs from our clients concerning they are reducing the pace of their activities for this reason. Actually, one of our main clients has demanded more fleet in the last four months, because he is expanding his plants and the businesses in general.

Therefore, yesterday, you have the information of the sector, we had a strong growth of almost 14% in the fleet sector last year. And what we have noticed is that, in difficult times and when you have doubts and uncertainties such as now, companies look for cost reductions and mechanisms to make them more competitive and efficient. And us, as an outsourced company, we can present solutions and improvement to the cost of these companies.

Therefore, on one side, this moment or this time is not very favorable, but we offset this process and this pessimism and the outsourcing movement in our country is gaining momentum, because if you check the calculations you can see that there is an immediate cost reduction attached to it. And this results in efficiency and in the search of efficiency the client is outsourcing his fleet. And that we are going through a very generous moment, and we will continue to grow I believe. What we noticed is this what I have just told you and for all of these reasons.

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

Thank you very much, Luis.

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

You are welcome.

Operator

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

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

Well, again, thank you so much for being here and taking part in our conference call. For us it's an honor to disclose our results of growing profits and income in such a sensitive and uncertain moment in Brazil's economy.

We are very happy to have a business which is resilient and is well-structured in a sector that is growing much above the GDP. And this gives us a lot of peace of mind to be in the certainty that the company will continue in the path of growth. And we have major challenges of, of course, being the best option -- consolidated option in such a fragmented market. Thank you very much, and have a nice day. And see you next quarter.

Operator

Locamerica audio conference is now closed. Thank you very much for being here. Have a good day.