Q3 2012 Earnings Call

Company Participants

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

Other Participants

- Daniel Spilberg, Analyst
- Daniela Bretthauer, Analyst
- David Leifert, Analyst
- Marco LoCascio, Analyst
- Michael Millman, Analyst
- Stephen Trent, Analyst

Presentation

Operator

Good morning. Welcome to the conference call of Localiza Rent-A-Car with the nine-months and Third Quarter 2012 results. Hosting the event today are Mr. Roberto Mendes, Chief Financial Officer; Silvio Guerra and Nora Lanari, Investor Relations.

We would like to inform that the numbers in this presentation are stated in millions of reais 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 Third-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 and may lead to results materially different from those stated in this call.

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

Silvio Guerra

Good morning, everyone, and thanks for attending our conference call. On slide number two, we present some highlights of the Third Quarter 2012. The recovery in the economic activity reflected in the increase of the net revenue in the Car Rental division. Fleet Rental division is still presenting a good level of revenue growth. The Company is still increasing its Car Rental network. From the Third Quarter 2011 to the Third Quarter 2012, 29 rental locations were opened in new markets.

On slide number three, we present the growth evolution of the Car Rental division. The volumes in the Car Rental division were positively impacted by the improvement in the Brazilian economic scenario. Rental volumes grew 9.2% in the Third Quarter 2012 when compared to the Third Quarter 2011 and net revenues presented a growth of 12.2%, mainly due to the increase of the 1.5% in the average rental rate.

Market expects that the GDP will come back to growth at higher levels in the Fourth Quarter 2012 and 2013, which tends to benefit the Car Rental division that presents a strong correlation to the GDP and investments.

On the next slide, slide number four, we present the evolution in the number of rental locations. The Company ended September with 464 rental locations in Brazil, a growth of 15 branches when compared to the end of 2011.

On the next slide, slide number five, we present the volumes and revenues of the Fleet Rental division. Year-to-date, net revenues in distribution grew 19.5%. In the quarter, net revenues grew 16.4% due to the increase of 8.2% in the rental volumes and 5.8% in the average rental rate.

In slide number six, we present the evolution of the net investment in Fleet. In the Third Quarter 2012, the Company resumed Fleet increase with the addition of 3747 cars. 18,838 cars were purchased, and 15,091 cars were sold, resulting in an investment of BRL101.2 million. Year-to-date, Fleet was reduced by 2121 cars.

Car purchases were adjusted to improve Fleet productivity, which is shown in the next slide, slide number seven, where we present the evolution of the utilization rate in the Car Rental division. A more efficient management of the purchase, distribution and sale of cars resulted in a utilization rate of 70.8% in the Car Rental division in the Third Quarter 2012 when compared to 69.7% in the Third Quarter 2011.

Slide number eight presents the end of period Fleet. Fleet at the end of Third Quarter 2012 grew 6.3% versus a growth of 9.2% in the rental volumes, mainly due to the increase of the utilization rate of the Car Rental division, as mentioned.

Slide number nine presents the evolution of Seminovos' stores. The continuous increase in the number of stores supports the business model of the Company and generates cash for Fleet renewal. In the nine-month 2012, 11 stores were opened and four stores of small size were closed.

On slide number 10, we present consolidated net revenues evolution. In the Third Quarter 2012, the growth of 6.5% in consolidated net revenues derived from the increase of 13.6% in the rental revenues, while the Seminovos revenues have remained stable due to the lower car selling prices after the IPI reduction for new cars, even with the growth in the number of cars sold.

On slide number 11, we present the EBITDA evolution. EBITDA grew 7.7% in nine-month 2012, and in the Third Quarter 2012, EBITDA represented a growth of 3.5%. Car Rental division's EBITDA margin was impacted by the increase of the cost of minor value accessories that are now being expensed directly in the rental costs. Up to 2011, this amount was accounted into fixed assets and depreciated throughout the car's useful life. Moreover, the EBITDA margin was also impacted by the increase in costs and expenses with personal and property rentals, which were not offset by the economies of scale.

It is worth mentioning that in the Third Quarter 2011, BRL10.6 million in provisions were reversed, positively impacting the EBITDA margin of the quarter. The Seminovos EBITDA margin of 4.9% reflects the conservative position of the Company in depreciation costs, which are based on the estimated residual value of the cars at the end of its useful life net of selling expenses.

For comparison purposes, the table in this slide presents the pro forma EBITDA margins considering the accounting of those accessories in the rental cost line for the previous years and excluding the reversal of the BRL10.6 million provision in 2011.

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 in May this year to reflect the expectation of lower residual value of the cars. In the Third Quarter 2012, BRL24.5 million were accounted as additional depreciation, being BRL20 million in the Car Rental division and BRL4.5 million in the Fleet Rental division. From the total of BRL180 million to be accounted as additional depreciation, BRL124.5 million were already booked.

Cars bought after the IPI reduction present much lower depreciation when compared to the average presented. In the Car Rental division, cars bought before the tax cut presented average depreciation of BRL4015.8. The cars bought after the reduction are presenting average appreciation of BRL1213.8. Roughly 40% of the fleet of this division is already renewed as this percentage increase depreciation should (inaudible) to present lower levels.

On slide number 13, we present the evolution of the Car Rental depreciation, excluding the accessories that are now being accounted in the cost line. From 2012 on, the Company started to account the minor value accessories directly in the Rental cost line. Before that, the accessories costs were accounted in the fixed assets and were depreciated with the car.

In this quarter, the average annualized depreciation of BRL1213.8 for the cars purchased after the IPI reduction is in line with the depreciation of 2010 and 2011, adjusted to exclude the accessories.

On slide number 14, we present the additional depreciation due to the IPI reduction for new cars. The table shows the accounting of the additional depreciation in the total amount of BRL180.5 million, announced to reflect the impact of the IPI reduction for new cars in the expected sale price of our Seminovos cars.

In the Car Rental division, BRL105 million were already accounted as additional depreciation, which represents 90.5% of the total amount to be accounted. In the Fleet Rental division, BRL19.5 million were already accounted. The other BRL45 million to be accounted will be diluted throughout the useful life of the cars in the fleet. In this division, contracts range from two to four years.

On slide number 15, we present the net income evolution. The drop in the net income of the quarter, the rise from the increase in car depreciation by BRL32.6 million being BRL24.5 million a result of the IPI reduction and BRL8.1 million a result of the increase of the average operating fleet.

The increase of depreciation was partially offset by the reduction of the financial expenses by BRL19.4 million due to the lower basic interest rates and slight increase of BRL7.5 million in the EBITDA. Excluding the effects of the additional depreciation, net income this quarter would have reached BRL87.6 million.

Now let us talk about the cash generation, which is shown in slide number 16. The Company is still presenting strong free cash flow, with BRL215.7 million generated year-to-date. The reduction in the used car prices due to the IPI cuts is being offset by lower purchase price, with no impact in the Fleet renewal CapEx, as it happened in 2009.

On slide number 17, we present the debt profile. The Company maintains a strong cash position and comfortable debt profile. In the Third Quarter 2012, the Company anticipated the payment of BRL230 million regarding the first debentures issuance of Total Fleet and part of working capital loans. In September 2012, the sixth issuance of simple debentures non-convertible into shares was approved in the total amount of BRL300 million, remunerated at CDI plus 95 basis points per year and final maturity of seven years.

In September 30, 2012, the all-in cost of the Company's debt was CDI plus 107 basis points. The current duration of 3.7 years will move to 4.1 years after the issuance.

On the next slide, slide number 18, we present debt ratios, which reflect the financial discipline of the Company. Net debt over EBITDA and EBITDA over net financial expenses ratios presented significant improvement.

In slide number 19, we present the spread between the return on invested capital and the cost of debt after-tax. The reduction of the basic interest rate allowed the Company to present a spread of nine percentage points, even with lower EBITDA margin.

Let us now move to the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Daniela Bretthauer, Raymond James.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Good morning, everyone. Silvio, a quick question on some of the comments you made during your presentation. For example, you mentioned that about 40% -- usually, Localiza renews 85% of the fleet. But you mentioned that so far this year -- correct me if I got this wrong -- Localiza has already renewed 40% of the fleet.

So I was just wondering, based on what you guys have estimated to buy and sell for the end of this year during the Fourth Quarter, how much of the fleet do you think you will achieve in terms of renewal? And how do you think this depreciation, both for -- if you could break down for Car and Fleet Rental will evolve? Both just in the short term, Fourth Quarter; and then if you could help us to give a guidance for 2013 in terms of the average depreciation per car, that would be helpful. Thank you.

A - Silvio Guerra

Thanks for the question. I would mention first with regards to volumes or regards to the volumes that you mentioned, the exit number, after the IPI was enacted, was a total amount of 40%. On regards to the volumes of cars being sold for the whole year, we are comfortable to having the 60,000 cars at the end of the year.

A - Nora Lanari {BIO 18838335 <GO>}

Just adding to what you have mentioned, the 40% renewed was the one bought after the IPI reduction. Plus we renewed some of them up to May, when the IPI tax cut was announced.

So answering the second question on regards to the percentage of the fleet to be renewed in the Car Rental, we estimate the number close to the 80%, which is the normal number (multiple speakers).

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay.

A - Silvio Guerra

Regards to the second question about the average depreciation per car moving forward, I would like you to refer to page number 13, that shows that the perspective for cars being bought after the IPI, the (inaudible) for Car Rental, was a number at around BRL1213. And this is good news for the Car Rental division.

On regards to the expected depreciation for the Fleet Rental division, I would mention that it is a longer process because it would take up to four years for having the depreciation of the cars in the Fleet Rental division. But the average would be like BRL5000 per car -- moving from BRL5000 to BRL (multiple speakers) per car.

A - Roberto Mendes {BIO 7289124 <GO>}

According to the (inaudible), BRL5800. But after they renew all the fleet that we bought before the IPI reduction, the average depreciation per car in the (inaudible) be close to BRL5000. It is a little higher than BRL4000 that it was in 2011, because we do not expect that the price of the car will move up after the IPI reduction finished -- after they finish the IPI reduction.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

But just to see if I got this correct, for the Fourth Quarter, we should use roughly a depreciation in the Car Rental of BRL1200 per car, and for Fleet Rental BRL5000? And should we keep this figure that low for the year of 2013?

A - Roberto Mendes {BIO 7289124 <GO>}

In this quarter, you have BRL11,000 to be recognized as -- as additional depreciation. So probably in this quarter, this Fourth Quarter, the depreciation -- (inaudible) depreciation will be a little higher than this average (inaudible) in the Car Rental. I need to calculate the (build-in) and say it to you later, but is just a -- we need just some time to calculate it. But it will be much lower than it was in the third -- Second Quarter and also in the Third Quarter.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay. Thank you very much.

Operator

Stephen Trent, Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Good morning, everybody. If I may, one question about the competitive backdrop. I thought you guys did very well in the quarter given all the headwinds. I am just curious as to what you are seeing from the competition with respect to how they are behaving regarding price.

A - Silvio Guerra

What we are seeing is that we face the new competitors, and we keep focused on our policy of having growth with profitability. And you could see that in terms of growth, when you have been able to double the pace of growth from the previous Second Quarter of 4.9% to 9.2% in the Car Rental division, which means if you compare with the 1.5% GDP growth, it is a good number -- six times GDP in terms of volume.

And in regards to Fleet Rental, we also have been able to grow, but at a smaller pace. And this also relates to the competitive environment.

We believe that our competitors we are facing -- our competitors that are, let's say, important competitors, we respect all of them, and we follow them closely. But we are going to focus in the Fleet Rental division with our (inaudible), keep growing at a pace that allows us to have the 66% EBITDA margin Fleet Rental and 9% return on invested capital -- nine percentage points return on invested capital.

Q - Stephen Trent {BIO 5581382 <GO>}

Great. Thanks, Silvio. And just one more quick question. You mentioned that on the Seminovos side, you closed, I think, four stores as you opened several new ones. On the four stores you closed, any color as to how long they were open? Were these stores that were open a long time or a relatively short amount of time, if you are able to tell us? Thanks.

A - Silvio Guerra

Those let's say shops that were closed, they relate mainly to the shopping center. They were the smallest ones. And we are going to keep opening bigger stores in order to keep achieving our objective of selling at least the 60,000 cars for the year. In overall terms we you keep aiming at the end of the year for having 78 stores for Seminovos.

Q - Stephen Trent {BIO 5581382 <GO>}

Very helpful, and thanks very much, Silvio.

Operator

Michael Millman, Millman Research.

Q - Michael Millman {BIO 1494618 <GO>}

Thank you. I guess I have a couple questions. Could you talk about what your contracted -- on the Rental Car -- current contracted rates that you are getting with corporations compared to, say, what has been? Then I have some other questions.

A - Silvio Guerra

You are talking about the contracts of Car Rental in terms of the pricing? What are the -- what is the question?

Q - Michael Millman {BIO 1494618 <GO>}

Yes. Talking about the contracted prices -- corporate contracted prices for new contracts now compared to what it has been (multiple speakers).

A - Silvio Guerra

In overall terms -- thank you for your question -- in overall terms, for the Car Rental division, we keep having our same policy that has been in place for many, many years and we keep our list price flat. And the reason for having the 1.5% increase in rental rates was due to a mix, just a matter of mix. We didn't raise our price.

On regards to the contracts for the Fleet Rental division, the corporate contracts, they have grown at around the level of inflation, because the contracts are adjustable to IPCA or IGPM indexes in terms of the Fleet Rental division. And those are the two policies that we have, keeping price flat, to curb competition and to keep them at bay; and in terms of the fleet ramp-up, we have the inflation-adjusted prices for our corporate contracts.

Q - Michael Millman {BIO 1494618 <GO>}

Okay. Looking at leisure travelers, can you talk about both the volume of leisure travelers and the pricing that you are getting from leisure travelers?

A - Silvio Guerra

In overall terms, the leisure travelers, they represent just 20% of our business in the Care Rental division. 80% of the Car Rental division business is business-related. And we expect a good mix by the end of the year. We have the concentration of our summer vacations at the end of the year, and throughout the year, we depend 80% in corporate contracts, and it's moving up. GDP has a close correlation to our business in the Car Rental division (multiple speakers).

Then January and February, yes.

Q - Michael Millman {BIO 1494618 <GO>}

So are you saying that your leisure business is moving up related to the GDP?

A - Silvio Guerra

Well our leisure division is doing very well, and of course, the leisure business relates to per capita income, per capita GDP. And as Brazil has seen an increase in real salaries and the unemployment rate is very low, we believe at the end of the year we are going to be seeing a good leisure demand.

Q - Michael Millman {BIO 1494618 <GO>}

Could you possibly quantify what you're seeing in pricing for the leisure division? (multiple speakers)

A - Silvio Guerra

In terms of our pricing for the leisure division, for the leisure part, we remain with our previous policy of keeping our prices flat -- the list price of Localiza remains flat throughout the high peak season.

Q - Michael Millman {BIO 1494618 <GO>}

And the list price -- and this is the list price actually the price that you receive, or some discounts from that?

A - Silvio Guerra

We operate with a list price, and depending on the competitive position in each airport and in each location, we provide some sort of discount to keeping our market position, our market share. Localiza is a premium company, and we evolve towards having our position in the market.

Of course, the corporates represent 80% of our business and they bring higher volumes. In the leisure part, we try to use our network, which is the -- we are bigger than the second, the third and the fourth competitors combined. In that sense, we do not have -- we do have, let's say, flexibility in terms of not losing market share.

Q - Michael Millman {BIO 1494618 <GO>}

So that would suggest that you would have at least been competitive on discounts (inaudible). Really trying to get an idea if the competition has increased for the discounting -- what the discount level is compared to what it may have been a year ago or in recent quarters.

A - Silvio Guerra

Well I would say that our policy remains the same for the last eight years. We are not changing the policy. But please remember that in high peak season, usually you do not offer a discount because it is high peak season, and Localiza is one of the few car companies that are able to provide cars using our Seminovos to provide for this extra demand that happens by year's end.

Q - Michael Millman {BIO 1494618 <GO>}

Okay. Thank you.

Operator

Daniel Spilberg, Barclays.

Q - Daniel Spilberg {BIO 16863949 <GO>}

Good morning, Silvio. Good morning, everybody. I wanted to ask about the competitive landscape following Stephen Trent's question. With lower interest rates in Brazil, we have learned from some of your competitors that they announced (inaudible) to lower their tariffs.

Because car depreciation is increasing and it is difficult to assess residual values in one or two years from now, and you've always been more conservative and focused on profitability, are you seeing that the difference between your tariffs and the tariffs from your competitors is increasing?

A - Silvio Guerra

Daniel, regards to our competitors and their policy on depreciation, we feel that our competitors remain aggressive. We respect them, but they remain aggressive in pricing policies throughout the year. And of course, when you mention depreciation, depreciation is a big item. If you have a difference -- a small difference on the residual value of the car, you do have a huge difference in the profitability of the contract. But we feel that our competitors remain aggressive in the market.

Q - Daniel Spilberg {BIO 16863949 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) Marco LoCascio, Equinox Partners.

Q - Marco LoCascio {BIO 17362784 <GO>}

Good morning. I wanted to ask about the decline in the pro-forma margins in the Car Rental division. So ignoring the accounting change and the reversal of the provision, but just the increase in the property and personnel costs that you mentioned, I'm wondering what rate of growth do you think you need in that business to offset the increase in expenses?

A - Silvio Guerra

Well you (already guessed) the pace of growth of those two items, property and personnel, look a little increase -- has increased our personnel -- number of people, our headcount, in the last year at around 14%. And the increase in salaries has been around 6%, because it is tied to inflation.

In regards to the rental contracts, the property has gone up, and the level of growth that we need to achieve in terms of -- to gain scale in order to circumvent those increases would be something at least at around, I'd say, 15% or 20% between -- among those numbers.

Q - Marco LoCascio {BIO 17362784 <GO>}

And that level of growth in headcount and in salaries and property expenses should continue in the coming quarters.

A - Silvio Guerra

Say it again.

Q - Marco LoCascio {BIO 17362784 <GO>}

Is the rate of growth in the expenses what we should expect in the coming quarters?

A - Silvio Guerra

We don't expect to have -- we want to keep our EBITDA margins for the Car Rental division at around 42%. We now are facing a new environment where Brazil has lower interest rates and the profitability of the -- objective of 8percentage points for return on invested capital, we are able to have this sort of profitability with 42% EBITDA margin in Car Rental and 66% EBITDA margin in Fleet Rental.

So in overall terms, we expect to achieve the same profitability that we are showing. Add that to the new current environment, which is a low interest-rate environment in Brazil.

A - Nora Lanari {BIO 18838335 <GO>}

Marco, just to add something to that, going forward to the next quarters, we expect both expenses to grow close to inflation. In the beginning of the year, those expenses grew a little above the inflation level, and that is why you haven't seen any economies of scale.

Q - Marco LoCascio {BIO 17362784 <GO>}

Thank you.

Operator

Michael Millman, Millman Research.

Q - Michael Millman {BIO 1494618 <GO>}

Thank you. Take my next question. You've in the past indicated that off-airport is a significant growth -- has significant growth potential for you. Could you talk about what you have been seeing there and what you've been doing there in the off-airport market? Thank you.

A - Silvio Guerra

Thanks for the question, Michael. Regards to the off-airport, it represents an option for extending our network in order to occupy the spaces throughout Brazil. We are opening up more branches in order to increase our leadership and to increase our market share. In airports, we are already present in 100% of the airports, and this is our policy, to attack the off-airport market and take advantage of our already largest distribution. We are bigger than the second, the third, and the fourth competitors combined, and our aim is to use the off-airport market with an objective of consolidating our very fragmented market there, which have more than 2000 car-rental companies.

Q - Michael Millman {BIO 1494618 <GO>}

And could you talk about -- or give some clarification of what is -- what you've been doing recently?

A - Silvio Guerra

In overall terms, the off-airport market relates to the pace of growth of investments scattered throughout the country. So we follow both the per capita GDP and the GDP and investments related items that we can benefit from. So Localiza keeps alive in prospecting cities and places where we can open, following these trends on current investments here in Brazil.

Q - Michael Millman {BIO 1494618 <GO>}

Thank you.

Operator

(Operator Instructions) David Leifert, Weiss.

Q - David Leifert {BIO 17953261 <GO>}

Good morning. Just a very quick question. I read some things about the impact that the municipal elections had on your volumes for the Third Quarter, a positive impact. I don't know if you maybe have any comments on how much that helped in your growth in volumes, just ballpark of what you feel the impact was.

A - Silvio Guerra

David, are you talking what pace of growth?

Q - David Leifert {BIO 17953261 <GO>}

What the impact of municipal elections was on your, yes, pace of growth.

A - Silvio Guerra

Okay, it was 2.5% over our rented fleet. This was impacted, it was reported by Barclays also in their report. It is 2.5%.

Q - David Leifert {BIO 17953261 <GO>}

Okay, just checking, that is how you think of it. Okay. Thank you.

A - Silvio Guerra

You are welcome, David. Thanks for your question.

Operator

(Operator Instructions) 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 you all for the attendance to our conference call and to inform 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 Localiza Rent-A-Car audio conference for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.

FINAL

Bloomberg Transcript