Q2 2014 Earnings Call

Company Participants

- Luiz Eduardo Falco Pires Correa, Chief Executive Officer
- Luiz Fernando Fogaca, Administrative Vice President, Chief Financial Officer and Investor Relations Officer

Other Participants

- Andrea Teixeira, Analyst

Presentation

Operator

Good morning, and welcome everyone to CVC's Second Quarter 2014 Results Conference Call. Today with us we have Mr. Luiz Eduardo Falco, Chief Executive Officer; and Luiz Fernando Fogaca, Chief Financial and Investor Relations Officer.

Today's live webcast and earnings release may be accessed through CVC website at www.cvc.com.br/ir. We would like to inform you that this event is recorded and all participants will be in a listen-only mode during the company's presentation. After CVC's remarks there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions)

We have simultaneous webcast that may be accessed through the company's website. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call.

Before proceeding let me mention that forward-looking statements are based on the beliefs and assumptions of CVC management and on information currently available to the company. They involve the risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur.

Investors should understand that conditions related to the macroeconomic scenario, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Luiz Eduardo Falco, Chief Executive Officer. Mr. Falco, you may begin your conference.

Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Thank you very much. Good morning, everyone. I'm pleased to host the conference call to discuss the results of the second quarter 2014. For today's agenda, we will start talking about the second quarter and the year-to-date 2014 results. Then we will go over the modifications of the third and fourth option plans informed to the market last Friday. And finally, we will open to Q&A.

We'll start on slide number three. During the second quarter of 2014, we continued to foster our sales channels to the opening of additional 15 stores on the second quarter, meaning 91 stores in the last 12 months.

In this quarter, adversely impacted by the location of the 2014 FIFA World Cup in Brazil.

Historically, we have observed a slightly decrease in bookings for travel in June and July during previous FIFA World Cups. Nevertheless, the location of the 2014 FIFA World Cup in Brazil negatively impacted the travel, leisure, and retail industries and added further pressure on CVC's bookings due to the following factors. The first one is that, fewer business days during -- due to holidays and days with reduced working hours related to World Cup matches. And second, a decrease in bookings for travel in June and July, primarily for domestic destinations.

Regarding our online platform, this quarter marked the first anniversary of launch of CVC's new online platform. During this period, we have invested the online channel resulting significant increase in numbers of visits and online conversion rates, which led year-to-year growth rates of 78.6% and 46.9% in bookings in the first half and second quarter of 2014 respectively.

As for our product portfolio, we have continued to leverage our longstanding relationships with our suppliers to improve the value proposition of our travel packages for our customers. We held several promotions, which we call Mega Promos with TAM, Gol, American Airlines, Iberia and Copa Airlines, and developed new commercial agreements with partners such as Rede Atlantica, Transamerica and Conrad in Uruguay.

We have also continued to increase the breadth of our product portfolio, launching high-end packages including business class seats with companies such as TAM, American Airlines, Emirates, Etihad, Iberia and Lufthansa.

Currently, we have been focused on negotiations with airlines and hotels for the high season comparing the period from December '14 to March '15. We have seen signs of recovery during the month of July, and we believe August and September are likely to offer further evidence of this positive trend.

Going to slide number four, with the bookings decreased year-over-year by 4.3% in the second quarter 2014 and increased 6.7% in the first half of '14. As previously mentioned, bookings in second quarter '14 were negatively impacted by the FIFA World Cup in Brazil, with the impact most pronounced for our sales on the domestic travel packages.

Regarding the online channel, we posted significant growth rates due to several measures applying to foster this channel, such as improvements to user experiences. Such as improvements to user experience, the implementation of more robust analytics for customer data and increase on the breadth of our product portfolio, including short trips, which represent a new segment for CVC.

Now we are going to slide number five. Regarding our bricks and mortar, we opened 35 exclusive stores on the first six months of 2014, 15 of which were opened on the second quarter. Our expansion plan is based on geographical models run by over our special team and field knowledge provide by our local master franchisees with the objective to capture additional market share and generate profitable growth for our franchisees.

Beside the FIFA World Cup effect, same-store sale was negatively impacted by the higher comparison base in 2013, in which bookings increased 25% versus the prior year.

Going to slide number six, Although long holidays in second quarter '14 such as Easter and Tiradentes, as well as Sao Jorge holidays in Rio de Janeiro have adversely impacted bookings in this period, they positively affected consumed bookings, which grew 29% in April and May and 15% on the second quarter of 2014 due to this gap between the dates of booking, the dates of bookings and the dates of travel. Consumed bookings on this period were also favorably impacted by strong bookings growth in previous quarters.

Now we'll go to slide six, and for the financials I will give to our CFO, Mr. Fogaca.

Luiz Fernando Fogaca {BIO 18466257 <GO>}

Good morning. On page seven, we look over net revenue. Net revenue was 130.7 million in second quarter of '14 and 316.4 million in the first six months of 2014, increases of 12.1% and 12.8% from the respective periods in 2013. Net revenue as a percentage of consumed bookings was 16.6% in second quarter '14 and 14.8% in first semester 2014, representing a decrease of 40 and 60 basis points from the second quarter and first semester 2013 respectively.

The decrease in both periods was mainly related to the higher percentage of international bookings, which currently offer lower margins relative to the domestic segment despite having a higher average ticket prices.

Average international margins were also negatively affected by a higher proportion of sales to US theme/amusement parks; in example, Disney, Sea World and Universal; more standard products which reached approximately 5% of total international sales in first semester 2014, compared to less than 1% in first semester 2013.

Moving to slide eight, we'll cover EBITDA and adjusted EBITDA. As a consequence of the items mentioned before, our EBITDA totaled 42.5 million in second quarter 2014, 62% higher than second quarter '13. Adjusted EBITDA was 48.6 million in second quarter '14, an increase of 10% as compared to 2013 second quarter.

As a percentage of net revenue, adjusted EBITDA represents a 37.2%, 70 basis point decrease versus 2013 second quarter. EBITDA and adjusted EBITDA totaled R$140 million and R$149.2 million in first semester 2014 respectively, representing increases of 30.3% and 13.2% compared to 2013. As a percentage of net revenue, adjusted EBITDA reached 47.2%, 20 basis points higher than first semester of 2013.

Non-recurring expenses decreased to R$6.1 million in the second quarter 2014 from R$18.0 million in second quarter '13 and were related to one-time events. In second quarter 2014, non-recurring expenses were limited to stock options and extraordinary bonuses. Non-recurring expenses in the first semester 2014 totaled R$9.2 million, a 62% decrease when compared with the same period of 2013.

Moving to the next slide, page nine. As a result of the items mentioned above, net income totaled R$8.2 million in second quarter of 2014 as compared to a loss of 1.8 million in second quarter 2013. While adjusted net income increased 14.3%. Net income and adjusted net income in first semester totaled R$47.5 million and R$60.4 million respectively, representing increases of 38.9% and 10.8% versus first semester 2013.

On slide 10, we look over cash flow generation. In second quarter of 2014, the cash flow generated by operating activities declined from R$106 million in the second quarter '13 to R$71.1 million in second quarter of '14, driven mainly by the shift in the mix of airline seats from charter flights and block charters to regular flights mainly during the World Cup.

During this period, regular flights offered more favorable pricing, but this came at the expense of less favorable payment conditions than charters and block charters.

The decrease in cash flow was also attributable to the implementation of prepayment initiatives with selected national hotels, in which prices were significantly reduced in exchange for payment prior to check-in, but still after the sale of the corresponding travel package.

On slide 11, we look over investment and return on investment. As a result of CVC's asset-light business model, we have invested R$9.4 million in first semester 2014, mainly in infrastructure, connections with suppliers and the CVC website. Return on invested capital was 33.7% in the last 12 months, an improvement of 30 basis points with the previous period, driven mainly by the improvement of operational results.

On next slide, we will look over indebtedness -- net debt and financial expenses. Net debt at June 30, 2014, and June 30, 2013, were R$171 million and R$160 million respectively. Taking factored receivables into account, net debt was R$353 million at June 2014, and R$414 million at June '13. The decrease in factored receivables was related to the cessation of factoring bank slips and checks. Currently, we factor credit card receivables at lower rates and tenors and only in the amounts that is needed.

Financial expenses grew only 5.8% on the second quarter 2013, mainly as a result of lower interest rate on debt, attributable to the decrease in the principal amount due to the founding shareholder, lower factoring receivables expenses related to the change in the company's receivables management policy.

On the other hand, financial services fees associated with bank slips and checks increased 5%, which along with exchange variation expenses led to net financial expenses of R$21.6 million in second quarter 2014.

Net financial expenses totaled R$50.7 million in first semester, 18.1% above first semester 2013, principally as a result of; an increase in financial services fees due to higher bookings paid through bank slips and checks, exchange rate variation; and a decrease in financial revenue due to a lower cash balance, which is attributable to a change in the company's receivables management policy.

Finally, on slide 13, we will cover the modification of the third and fourth options plans informed to the market last Friday. The relation to the third and fourth stock option plan strike price has been adjusted to R$11.82 and the total number of options were reduced by 10%. The stock options held by the CEO, Luiz Eduardo Falco, has been modified such that they vest ratably over four years from the grant date, with no provisions for accelerated vesting or connection to the sales of shares held by BTC Fundo de investimento em Participacoes.

In addition to that, Mr. Falco, our CEO; and Mr. Patriani, our Sales and Products Vice President have committed to serving as officers, (Technical Difficulty) which ensures continued strong leadership at the top of the organization.

These amendments will not change the estimated stock option compensation expense in the period from 2014 to 2018.

In addition to that, we have also served the transfer of shares from Controlling Shareholders of the company's CEO and Sales and Vice President of Products, Valter Patriani. Because the public offer was the second offer, the cost of these additional compensation will be borne entirely by the Controlling Shareholders. And those shares will vest also over four years from the grant date.

In summary, all the changes proposed in the third and fourth quarter options plan. We reinforced the retention of the key executives of the company, allowing the hiring of the new executives from the market in a balanced structure compared to the conditions of the current executives of CVC assuring a minimal period of three years of Mr. Luiz Eduardo Falco and Mr. Valter Patriani at CVC management, plus two additional years at Fortaleza, totaling five years.

At the same, create a succession plan that will be linked to the vesting of part of their options. And finally, none of those changes will result in additional expenses for the company.

Once again, thanks for attending this conference call. We will now start the questions-and-answers session.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Ms. Andrea Teixeira from JP Morgan would like to make a question.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi. Good morning, everyone. I just want to ask more about -- I know you've touched on demand that things are starting to improve and I guess Falco mentioned that on the call, but I was just curious of when -- in previous event where you have some capacity, excess capacity over -- after the events are over that you see the suppliers kind of giving out a little bit more of the deals and how you can be able to confront those? Obviously from the second quarter numbers reporting, we're going to have a horrible third quarter, how we can be able to offset that behavior and how you're seeing demand?

And the second question related to the financial expenses, obviously you're trying to shift away risks to your -- to the banks. But if you can explain to us how below the line you're going to be compensating, you have a help from the earn-out not being correct -- this specific last quarter, but in terms of financial expenses do you see fees coming down or not necessarily and you're going to continue to look out this policy with the higher rates and higher fees as a banks charge? Thank you.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Okay. Andrea, thank you. Regarding the World Cup question, basically what we have seen is the spread on the demand. We have seen strong boardings in April and May on the levels of 30%, which is very high. And of course June was not that level, but when you -- it was even a much lower, but when you see the quarter you see that even though we have a very good number of 17.2.

When you go through the third quarter, of course you have impact on July which is a very strong month, but you also can see as we have disclosure on our last disclosure some good momentums from August and September and that shows you that with the big event of World Cup just caused bigger spreads on the demand.

Of course, the bookings for the second quarter was 4.3 below the last year and that's the result of the World Cup.

Saying that, we see that -- I mean things are coming back to the normal. We have had previous experience on World Cup, we have a lot of World Cups here on CVC, it's a long history company, but specifically this one was a deeper impact with some changes on the dynamics, mainly for the holidays.

When you look for the school holidays, which normally held on the last two weeks of July, this year were completely mixed in Brazil, some states starting June or the other ones give even a longer holidays for the schools, some of the states keep the two last weeks of July and this, let's say, our profit on the behavior from the holidays just made this kind of spread on the traffic and the result is that during the FIFA World Cup in Brazil, most of the people was not very much incentivized to make their holiday travels.

Saying these, we have seen things coming back to the normal. We had good signs on July, we will wait for August and September to give a good guidance for our shareholders. And of course, we have some extra infrastructure on the country. If you look to Rio de Janeiro, for instance, we have of course some hotels left for this big event. We have 90 new hotels in Rio, which will try to capture this -- to try to sort the market on what we call the short trips, mainly if you're in Sao Paulo and Rio.

Yes, there is a lot of opportunities, there is rest of the year to work. We are seeing things coming back to the normal pace, they are supposed to be. For the question of the financial, Luiz Fogaca will follow [ph] that.

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Good morning, Andrea. In relation to the financial expense in the second quarter, first the effect on the -- now, to which was negative as its linkage to the IGP-M and the IGP-M was negative in that period, that compensated the high IGP-M that we saw in the first quarter that affects the negative financial expenses in the first quarter.

Of course, when we look forward, the third and fourth quarter, part of the financial expenses, the ones that are related to bank slip and check are linked to the bookings. So at the second quarter, the booking were below last year 4%, that's a reduced financials expenses. Of course with higher bookings in the third and fourth quarter the financial expenses tends to be higher than the one that we observed in the second quarter.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Yeah. Just coming back -- thank you for the question, but coming back just for what's the outcome, I'm confused still what you are trying to convey in terms of the demand, because I understand that things are obviously because of the World Cup, but as we see the boarding down, the concern -- I mean the bookings and the boarding will be likely down as well in the third quarter or if there is anything if being able to revert this trend within the third quarter? In other words, you're doing more promotions and if you are getting the suppliers to come along and refers that negative trend in third quarter for boardings?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Yeah, Andrea. (Technical Difficulty) When we released the June growth, we have showed that from future boardings from August until December, we were presenting at the time a volumes increase of more than 20%. Of course, when we see signs of recovery in July in terms of bookings, we expect that the sales [ph] in July, August and September if you continue with that trend that we will reduce the impact in third quarter booking volumes.

And so if the trend of July continues on August and September, we can minimize the impact of third quarter. And of course we can capture the majority of that positive trend in the boardings of fourth quarter.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Yeah. Now I understand the bookings of July and August, but the boardings, we don't know exactly as the community doesn't know where -- as the community doesn't where the people are boarding. So while you're saying that even though the bookings picked up, also the corresponding boardings will be -- is still within the third quarter. That's what I want to make it clear.

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

Basically, if we assume historical curve of bookings and boardings considering the numbers that we have presented on the second quarter, we would be -- even though the bookings of second quarter were 4% below, we would at that time, the -- in the levels of flat numbers of boardings compared to 2013. But, of course --

Q - Andrea Teixeira {BIO 1941397 <GO>}

Flat bookings -- flat boardings you're saying?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

From third-party. Of course, that was in the end of June, that will depend on their bookings of the third quarter now.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Perfect. Thank you very much for your answer. And back on the -- just on the financial expense, I understand of course they have to do with demand, but the fees also -- did the fees go up and obviously the rates went up, so how we should expect, as you said, in the third and the fourth and to follow the demand or to follow the boardings?

A - Luiz Fernando Fogaca {BIO 18466257 <GO>}

The fees are not going up, the fees are stable at 4.1% in average, the bank fee for bank slips and checks. Of course, if you separate the components of the financial expenses are now basically IGP-M with that we found it will be CDI 2% per year. And on the bank slips and checks, those will increase according to bookings.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay. Perfect. Thank you so much.

Operator

(Operator Instructions) As there are no questions, I will turn over to Mr. Luiz Falco for final considerations. Mr. Falco, you maybe give your final considerations now.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Okay. Once again, thank you very much to everybody in our conference call. And we would like to just say once more that we have our Relations team with Fogaca and all the employees on the company. And if you have any further question do not hesitate to ask them, we are here to remove your doubts. Thank you very much. Have a nice day. Good day for everybody.

Operator

Thank you. This concludes today's CVC's Second Quarter 2014 Results Conference Call. You may disconnect your lines at this time.