Q1 2016 Earnings Call

Company Participants

- Jose Carlos Wollenweber Filho, Chief Financial Officer and Investor Relations Officer
- Luis Fernando Memoria Porto, Chairman and Chief Executive Officer
- Unidentified Speaker

Other Participants

- Mario Bernardes Junior, Analyst
- Renato Salomone, Analyst
- Rodrigo Glatt, Analyst
- Unidentified Participant

Presentation

Operator

Good morning. We welcome you to Locamerica' teleconference where we will present the results for Q1 2016. Right now all the participants are connected in the listening mode only, later on we will have the Q&A session where we will give additional instructions so you can participate.

In this quarter, Locamerica will have -- will also allow press professionals to ask questions after the market analysts. (Operator Instructions) This teleconference has simultaneous translation in progress into English and questions may be asked normally by participants from abroad. You may also send your questions through the Internet through the webcast platform.

We would like to remind you that this teleconference is being recorded. The audio will be available in the Company's site in up to 24 hours. If any of you does not have the copy of the release, you may obtain it at our website www.locamerica.com.br/ri. This teleconference together with the slide presentation is being transmitted simultaneously through the Internet and can also be accessed at our website.

Before we continue, I would like to clarify that any declarations that may be made during the teleconference concerning business perspectives of the Company, and also projections, and also the potential of growth are forecasts based on management's expectations concerning the future Locamerica. These expectations depend on the performance of the sector, the economic performance of the country, and market conditions both in Brazil and abroad. Therefore, they are subject to change.

Together with us, we have Mr. Luis Fernando Porto, Chairman; and Mr. Carlos Wollenweber, CFO and Relations with Investors. Now I would like to pass the floor to Mr. Luis Fernando Porto. Sir, you may continue.

Luis Fernando Memoria Porto {BIO 17590082 <GO>}

Good morning. It is with great satisfaction that we released the operational and financial results of Locamerica in Q1 2016. Before talking about the results, I would like to stress, highlight briefly some trends in the market that we have observed in the quarter.

On slide number three, we see a scenario with restrict -- restrictions in credit for vehicles with an increase of 0.5 percentage points in the default rate, which were 3.9% in Q1 2015 and 4.4% in Q1 2016. On the graph on the right, you can see the volume of financed vehicles dropped 18.6% in Q1 2016 in comparison with the same period last year.

This lower availability of credits as we can see on slide four had a direct impact on the sale of new vehicles. On the upper left corner, we see that the sale of light -- new light vehicles dropped 28% in Q1 2016 in comparison with Q1 2015. Also on the same graph we see that the sales of used vehicles suffered a reduction of 5% in the same period. We believe that part of that difference between new cars and used cars may be explained apart from the lower availability of credits also can be attributed in the increase of the price of new cars in the last 12 months, there was an increase of 0.8%, while the price -- average price of used cars dropped 5.3% in the 12 months ending in March, 2016.

The increase in this spread between new and used cars has motivated the migration of demand towards used cars. As can be seen clearly in the lower graph on the left, we can see that the relationship between used cars and new cars reached 4.8 times, highest level in the history. On the graph to the right, we see the number of vehicles sold by Locamerica. Our market share is only 0.13%. In other words, with the softening of demand for used cars, we would be able to compensate the current sales volume by increasing our market share.

On slide number five, we show the breakdown by aging of vehicles -- of used vehicles sold in Brazil. In spite of the reduction of 4.4% in the number of used cars sold in the Q1 2016, we had an expressive growth of 23.8% in the sale of cars with an age of up to three years, which represents 36% of total sales of used vehicles in the quarter.

Now, going onto the operational highlights, we see on slide seven, we see the global value of new rental contracts signed in Q1 '16 totaling 45 million and 1,157 cars. The sales pipeline for the next three months is approximately 19.9 thousand cars in tender. We would like to remind that, in spite of the drop, the pipeline of sales remains high. The high level of uncertainty in the economy has resulted in the slowness on the part of companies to close contracts. And this has really delayed the signing of contracts.

On slide number eight, we show the breakdown of our fleet, which closed the quarter with 29,309 cars with a drop of 3.1% in comparison with the same result of the previous year. Although, we have a reduction in the total fleet, the Company has a better usage of the fleet, with operational fleet reaching 24,455 vehicles, a growth of 9.9% in comparison with Q1 2015. On the graph on the right, in line with the reports of management's in previous quarters, we saw in the first quarter of 2016 a normalization of the demobilization of the fleet, which reached 7.2% of the total fleet in March, lower level than in the first quarter of -- in Q1 a reduction of 7 percentage points as a -- in relationship to the peak of 14.2% in the first quarter of 2015.

Now I would like to pass the floor to our CFO, Carlos.

Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Good morning. First, I'd like to stress the resilience of the rental segment for fleets. In spite of the economic crisis of the country, the Company has delivered growth in revenue. On slide 10, we see the net revenue from rental totaling 99 million in the Q1, representing an increase of approximately 3% as a result of the higher or greater daily rentals.

On slide -- on the next slide, we see the volume of cars sold by Locamerica in Q1 totaling 2,763 units, which brought revenue from used cars of 73.5 million cars, representing a 5% drop in relation to the same period of last year. This drop is due to -- can be explained by the lower number of vehicles sold in the quarter. Nevertheless, we have a lower volume of cars returned in the same period, and the inventory vehicles available for sale total only 2,118 units or 7.2% of the total fleet representing a reduction of 51% in relation to the inventory of the Company in Q1 2015.

We'd like to show on slide 12, significant improvements in used cars we delivered in Q1. A net gross profit of 2 million, representing a margin of 2.8% and consolidating three consecutive quarters with a positive gross margin. This sustainable improvement in the profit can be explained by the greater participation of sales in retail and lower number of cars with severe usage in the fleet and the greater -- and a more conservative policy for depreciation.

On slide 13, we see the comparison [ph] between the margins of Q1 '16 versus Q1 '15. Our maintenance costs dropped 3.3 percentage points, due to an improvement in fleet management. SG&A expenses increased 0.7 percentage points, due to an increase in the sales team for retail, but with the positive results in gross results of growth in used cars. Our EBITDA reached a record level of 61% and EBIT 36.4% an improvement of 5 percentage points in relation to Q1 '15.

On slide 14, we see the average age of the Company's fleet, which is 16.4 months, and we reached a utilization rate -- usage rate of 96.8%, the highest since Q1 2011.

In the next slide, we see the financial results. Financial expenses increased 30% in relation to Q1 '15, due to higher interest rates and a more conservative liquidity policy reflecting the increase in the cost of cash. Q1 '16, we delivered a net profit of 5.5 million, a drop of 13.5% in relation to the same period 2015, especially due to the increase in financial expenses.

On slide 16, we show the variation of net debt during the last 12 months. An increase of 36 billion in net debt is due to the reduction in accounts payable to suppliers. We'd like to say that we reduced our leverage from 3.1 to 3 times debt EBITDA -- slash EBITDA. We'd like to -- we closed the quarter with 306 million in cash, representing 1.2 times our schedule. We closed now the quarter with 306 million, as we said, in cash representing 1.2 times our schedule of amortization of debt in the short-term. Therefore, with the very comfortable liquidity position, now our average cost of debt is CDI plus 1.7% and the percentage of vehicles that are given us guarantee are only 10%.

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

Questions And Answers

Operator

Ladies and gentlemen, we would like to begin our Q&A session. (Operator Instructions) Our first question comes from Mr. Mario Bernardes Junior, Banco do Brasil.

Q - Mario Bernardes Junior {BIO 17363553 <GO>}

Good morning, Luis Fernando, Carlos. Thanks for the opportunity. I remember that you were cleaning up your client portfolio to have a more -- a better quality in the portfolio. My question, have you finished cleaning up the portfolio, are all the clients that you have now, do they all have a good credit quality? If not, how long will it take to improve the quality of the portfolio clients?

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

Good morning, Mario. Thank you. Thanks for the question. Yes, today we have already finished this process. Carlos reinforced our team as we said in December 2014. So, we have been in this process for a year and half. Of course, the macroeconomic scenario shows us a scarcity of (inaudible) strong reduction in credit. So we have to continue monitoring daily our portfolio.

Now in terms of what we had identified, we already cleaned up the portfolio. We are very comfortable with the current portfolio, both concerning credits and also the usage of the vehicles. So, this process has ended and now we are monitoring to maintain the current profile.

Q - Mario Bernardes Junior {BIO 17363553 <GO>}

And have you been working on the accruals, have you decreased the accruals, the provisions to -- in order to be adequate with this new profile?

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

Yes. For the time being, our accruals or provisions have stabilized. And we will have to increase only if we have new events in this scenario reaching one of our clients.

Q - Mario Bernardes Junior {BIO 17363553 <GO>}

A quick question, you are having a strong recovery in margins, good profitability in the last two years. Now, from now on, competition maybe more fierce. What can we expect from now on in terms of margins? Can we expect the current levels or low [ph] profit growth?

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

We believe there is some space to improve margins; this level can be considered as the new level for the Company above 60% EBITDA. This is the new level, but we will definitely try to improve during this year, especially in our project for the Seminovos used cars. We haven't reached the full potential, the peak for Seminovos.

We still have some stores for sale of used cars being improved. This month we will inaugurate two new stores for the sale of used cars. This should really help us to increase the share of the sale in retail. With this, we hope to improve a little more our consolidated margin, as a result of the sale of used cars in retail. Yes, we can say this is the new level and we will try to improve in the next quarters based on this concept of that the used car sector is not at its peak, we're still in the ramp-up -- wrapping up.

Q - Mario Bernardes Junior {BIO 17363553 <GO>}

Thank you. Congratulations for the management.

Operator

The next question comes from webcast. It's from the line of (inaudible) from BNP Investment.

Q - Unidentified Participant

Good morning. Could you explain the debts of April BRL105 [ph] million, and was this an impact in cash?

A - Unidentified Speaker

Good morning, Eduardo [ph]. Thank you for the question. We have a very strong cash position, as you saw. These debts that you mentioned is, one, it was the first debenture where we had no conditions to have prepayments, no flexibility in negotiation and we had to maintain it during the whole period. It was the most expensive debts of the Company. So with the liquidation, we hope we will improve the average spread and the cash position of the Company. Even if we have this cost, we don't intend to change this cash position.

We understand that it's a type of insurance apart from having to this cash position that covers more than the short-term; we are also a Company that is growing with a positive cash generation -- free cash generation. Therefore, cash guarantees us some debt payments or problems in accounts receivable. So it's very comfortable. I can say, we know that this is expensive, but we will maintain a robust cash position, it is a Company policy.

And we understand that this is very important for a business like ours, where we always have to look at the capital. We will continue with this policy.

Operator

The next question comes from Renato Salomone, Itau BBA.

Q - Renato Salomone {BIO 17292431 <GO>}

Good morning, Luis Fernando, Carlos. The first question is about the purchase of vehicles. We saw during the first quarter at least in the item inflation of strong acceleration in inflation in the increasing price of new cars. I'd like to know, do you see this as a trend for the rest of the year, the inflation of new cars to continue between 0% and 2% or do you believe there -- the automobile companies may increase prices at a higher level?

A - Unidentified Speaker

Good morning. Thanks for the question. Well, in conversations at the end of the year, at the beginning of the year with the automobile companies, they said, that they would really increase the cars price according to inflation. We had a strong decrease at the beginning of the year in car prices. The 2017 models are arriving and these launches will go up to August, September. We believe that there may be more price increases due to the new models, 2017 models.

On the other hand, I believe nor the automobile companies or anyone else expected such a weak market as the one we have had until now. So I believe that due to slow sales, they may increase prices equal to inflation or even less. More than that, I don't believe there is a sequential [ph] for that.

There were some strong increases at the beginning of the year. We have expectations that they may due -- or they may have more increases for the 2017 models, but I believe we're at the end of this price increase. It makes sense to increase the price, because their cost went up because production went down, they had inflation -- impacts of the inflation on their cost, the automobile companies, also the exchange rates, the higher exchange rates puts pressure on the cost of the automobile companies and it becomes impossible to continue with the same prices. But there is also the following; sometimes it's no use in increasing prices. I believe we're at this point and from now on, I believe we will have zero or a very small price increases for the reasons that I presented.

Q - Renato Salomone {BIO 17292431 <GO>}

Thank you. Is there a relevant part of clients to decrease their fleets or change the mix of their fleets, which in order to spend less or it mostly this has already been done?

A - Unidentified Speaker

In our case, it's over. That's in the past. We're noticing now, during 2016. This year, we see less of this in relation to the previous year. So, this shows that companies are doing their best to balance their results, reducing cost, but there comes a time, when it's no longer possible. Otherwise, they would have to sacrifice, especially in our case, our cars are used basically for three areas; sales, delivery, or benefits for executives, directors. So it's no use -- after a certain point, no use decreasing the sales team, delivery to an executives too, there is a time when you can't reduce anymore because they have the minimum amount of executives. So for these reasons we believe that this has been much lower than what we noticed last year, as far as we have seen.

Q - Renato Salomone {BIO 17292431 <GO>}

Thank you.

Operator

Thank you. The next question comes from Rodrigo Glatt, GTI Investments through webcast.

Q - Rodrigo Glatt

Good morning. What is the Company's expectation for the used car markets and the Company's margins for the rest of the year? Thank you.

A - Unidentified Speaker

Good morning, Rodrigo. Thank you for the question. First of all, I'd like to talk about the market's expectations. The used car markets has showed a small drop -- has had a small drop, a marginal drop. In the case of used cars, we have seen a growth in the cars up to three years of age. So even with the deterioration of the economy continue or remaining at this level for some time, we believe that the market for cars up to three years of usage should be equal or higher than last year.

Now, the used car market as a whole, we believe it will drop, it will suffer a drop in relation to last year. So in terms of markets, what we have seen, this is the situation. We are in a market that is suffering less than the market for new cars. I'm talking about our Company, our expectation is the growth in relation to last year, because as I said, in a previous question, we're investing in the platform for the sale of cars with up to three years of age, and it is not fully operational.

Today, we have seven retail stores, we inaugurated two. So we will have nine, in the next -- another three by the end of the year. So we will practically double our stores for selling cars in retail without decreasing the other platform. So our expectation for the Company is a year of growth in relation to last year too.

Operator

(Operator Instructions) The next question comes from Rodrigo Glatt from the webcast.

Q - Rodrigo Glatt

After the payment of loans in April, what is the cash level that the Company intends to maintain? Concerning the level PTB [ph] should we see accruals -- more accruals in the next quarter?

A - Unidentified Speaker

Good morning. Thank you. The cash level, as I said previously, we intend to maintain a level that will cover at least 1 or 1.5 times the short-term debt. This has been defined as our Company policy and we will maintain these cash positions, not only in the next quarters but also in the long-term position.

Now, concerning your second question, as I said, in the current portfolio, we have a performance that the Company understands has been normal. And from now on, obviously, we will continue monitoring, because we know that the macroeconomic effect may interfere in our clients cash flow and that would bring us new problems. But right now, we have normal situation but we are monitoring, this may happen.

What we have done? We increased the criteria, the policy for credits, we reinforced our credit team in order to identify good clients, when we sign new contracts and we also increased our effort for collections. Today, our clients that doesn't pay the bill at the end of the month, in some cases we ask them to return the cars immediately to mitigate the possibility of problems in the future. So these two measures, extreme care, we are extremely careful with new contracts with clients. And in the short-term in -- and also looking at clients who don't pay the monthly bill. I believe we should have a lower amount of problems than we had in the past in this area.

Operator

The next question comes from Mario Bernardes Junior, Banco do Brasil.

Q - Mario Bernardes Junior {BIO 17363553 <GO>}

Well, I'd like to ask you about bps [ph]. We believe there is a concentration of companies with problems. Have you seen this situation in the bps?

A - Unidentified Speaker

Thank you, Mario. Well, what we are noticing in the bps is in line with what you said, more than half of the market today has a typical [ph] balance sheet with short-term debts, weak cash position. So this is a scenario where the banks are not lending more with those companies have this type of balance sheet. And we see there is a high percentage of our market in this situation. So obviously, these decreases -- the exposure -- we're decreasing the exposure to these companies. And it's a polarization for five companies after the same market, the five largest companies.

So we have been able to grow our revenue, on the other hand what we notice is, there are deals, of course, our business is resilient, yes. We are a business that's due to save cost we take opportunities to clients to spend less, especially those that don't have rented fleet. But this uncertainty in the markets is uncertainty. In the macro mix company slower in deciding looking for alternatives, because they need to really pass on to clients the price increases we had. And on the other hand, the companies want to reduce their cost. That's what we noticed. Yes, there is a polarization among the large and some mid-sized companies in the bps end. On the other hand, we -- it is taking longer for clients to decide due to the economy. Thank you.

Operator

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

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

Before anything else, I'd like to thank you all for your participation and interest [ph] with the Company. We'll continue to work on minimizing the impact of the macroeconomic scenario in our results. We continue to believe that we have resilient market days on a value proposal that is very objective. Apart from presenting an alternative of funding for our clients and we also, we allow them to cut costs and expenses.

The year of 2016 has been very challenging; we will continue to take [ph] the necessary measures to guarantee a greater operational efficiency and the maintenance of the differentiated capital structure. We would like to have you in our next call and we're available for any clarifications. We wish you a good day.

Operator

Now we will have the Q&A session for press professionals. (Operator Instructions) Since there are no more questions, the teleconference will finish. We thank you, and we wish you a good day.