Q2 2013 Earnings Call

Company Participants

- Luis Fernando Porto, Chief Executive Officer

Other Participants

- Alexandre Falcao, Analyst
- Matias Dietrich, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to Locamerica's conference call where we will be discussing results of the second quarter of 2013. As of now, all participants are connected in listen-only mode and later, we will open the Q&A session, when further instructions will be given.

In this quarter, Locamerica will open for questions from the press, soon after the analysts ask their questions. (Operator Instructions) This conference call is being simultaneously translated into English and questions may be asked by participants connected abroad as well. Questions can also be taken over the Internet by using the webcast platform.

We would like to remind you that this conference call is being recorded. The audio will be available at the company site in 24 hours. If you need a copy of Locamerica's release issued on August 14th, you may download it from www.locamerica.com.br/ri.

This conference call, together with the slides is being simultaneously broadcast over the Internet and also from www.locamerica.com.br/ri. Before proceeding, let me clarify that any forward-looking statements that may be made during this conference call, relative to the company's business outlook, projections, financial and operational targets, relative to its growth potential are based on premises, based on the management's expectations, relative to Locamerica's outlook.

These expectations depend on the performance of the industry on the general economic performance of Brazil and on the conditions of the national and international markets and are therefore subject to change. Together with us are Mr. Luis Porto, CEO and Mr. Joel Kos, IRO and CFO.

I would now like to turn this conference over to Mr. Luis Fernando Porto. You may proceed, sir.

Luis Fernando Porto {BIO 17590082 <GO>}

Good morning, everyone. I'm very happy to be here and happy to have you here in this Locamerica results webcast on the results of the second quarter of 2013. First of all, I'd like to report a net profit that reached R$9.5 million in this second quarter, an improvement of 32 million compared to the second quarter of '12.

If we exclude the effects of the IPI, the net income would have been of R$11 million when compared to a loss of 3.4 million in the same period of last year. ROE LTM, excluding the IPI effect was a record 16.8% in the second quarter of 2013. This was a result of the company's growth strategy.

In this quarter, the consolidated net revenue increased 18.3% over the second quarter of 2012 which is mirroring as an increase of 53.7% in the sales of used vehicles and 7.1% in the fleet rental revenues. Used car sales in the second quarter were record, totaling 2,222 vehicles representing an increase of 41.2% compared to the second quarter of '12. In this first half, the growth was 108.2% year-on-year.

EBITDA reached R$42 million, which was an increase of 17.8% year-on-year or 6% if we exclude the negative impact of the impairment recorded in the second quarter. In August, the company implemented an organizational restructuring and then improving efficiency in its processes and eliminating overlap. And the main goal of this restructuring process was to strengthen the activities that have direct impact in the satisfaction of our clients and the changes also will bring economy, totaling R$6 million for the 2014 period.

In June 14th, the company held its 7th issue of debentures, totaling R$100 million with the term of 7 years, thereby improving the marginal cost of the debt to 1.7% over the CDI versus 2.25% in the last debt raising.

The next four slides, before going to our operational performance, I'd like to talk about our main indicators. Slide 3, we show the growths of 18.3% in the consolidated revenue for the second quarter, compared to the same period of last year, especially due to the increase of 43.7% with the sales of used cars and also an increase in the net fleet rental revenue. In this half, the net revenues advanced 32.5%, mirroring the 101.6% and 8.2% in the rental revenues.

On slide 4, the EBITDA totaled R$42 million in the second quarter of 2013 and 88.8 million in the half, representing an EBITDA margin of 55% in line with our expectations for the year. In the next slide, you can see that in the second quarter, we had a net profit of 9.5 million which was an improvement of 32 million compared to the second quarter of last year. In this half, net profit totaled 18.9 million which is an improvement of 33.5 million, compared to last year.

In slide number 6, in the end of this first half, the total company fleet reached 28,723 vehicles, an increase by 1% compared to the same period of last year and this is still impacted due to the accelerated termination of a client that returned 1,300 vehicles after the first quarter. In the next four slides, we will see the other information for this quarter.

On slide 7, you will see that vehicles and light vehicles totaled 920,000 units, a growth by 7% versus this second quarter of '12. In the next slide, the market of used cars recorded an even better performance in the quarter with sales of 2.3 million units, a growth by 7.8% compared to the same period of last year.

On slide number 9, regardless of the default rates falling in the last 13 months, as you can see to the left, it is still relatively high at 6.1% in June of 2013. Therefore, the total resources for financing vehicles to private individuals dropped from 3.8% to 42.9 billion in the first half, compared to the same period of last year.

In the next slide, we see the price developments of new and used vehicles in the last year. To the left, the price of new cars raised by 2.1% in the first half, which is mirroring the increase of the IPI, which went from 0% to 2% rate on (Technical difficulty) with accelerated termination of the major clients as we have said in the first quarter of 2013.

Joel, you are right, you see that the car for sales went from 4,544 cars totaling representing 15.8% of the total fleet and suffered a slight drop, compared to the first quarter of '13. The sound performance of the sales in the used vehicles sector should bring this fleet number into normal levels.

In the next slide, you can see the net revenues for rentals with a growth of 7.1%, due to the increase of the average raised to 14.5%, which was partially offset by the results in volume by minus 5.9%. This rate dropped due to a client at the end of the first quarter that terminated an agreement.

However, we still are very certain that our targets and projects for the year will be the same. And I'd like to highlight that the revenue in the first quarter was also positively impacted by the (Technical difficulty) for the period.

Today we have eleven used car shops and three retail shops. In 2013, we should open four retail shops in line with our strategy to diversify channels. On the right hand side, you see the average price of a used cars which rose for the second consecutive quarter which attest to an accommodation in the market on slide 16, because of the reduction in IPI in May last year.

We had to accelerate the depreciation curve of our fleet to reflect the new estimate of the residual value. On the left hand side, we see the impact of additional depreciation of the previous period and also the estimates for the next period. On the right hand side, depreciation of cars totaled 16.9 million or 8.8% of the average fixed assets. If we exclude the additional extraordinary depreciation of 2.3 million which was accounted for in the quarter, the recurring depreciation would have been 14.6 million which accounts for 7.6% of the average fixed assets in the quarter and flat quarter-on-quarter.

We remind you that the depreciation of the first quarter 2013 was also impacted by R$3 million, which has to do with the early return of 1,300 cars.

On slide 17, EBITDA was 42 million in Q2 2013 and 88.8 million in the semester. That is an EBITDA margin of 55%, well in line with our expectation. In the result, we see an improvement in the control of our maintenance cost, which was offset by a worsening in the trends for sale expenses, which has to do with bad debt provisions which was higher and expenses with salaries and rent of the used car stores.

On the next slide, our operating profit EBIT, excluding the effect of the IPI was R$26.7 million in the second quarter that is a margin over net rental revenue of 33.6%. The EBIT margin in the semester was lower because of the higher levels of depreciation in the period.

On slide 19, we report net income of R$9.5 million in the quarter, a 32 million increase relative to the loss of 22.4 million in 2Q 2012. If we exclude the effects of the IPI, the net income would have been R$11 million, a 14.5 million improvement relative to the loss of 3.4 million in Q2 2012. This represents a net margin over revenue from revenues of 14% net revenue.

On the right hand side, our ROE in the last 12 months, excluding the effects of IPI and early payment of debt achieved a record of 16.8% in the quarter which has to do with our strategy to grow while maintaining profitability. On slide 20, we see the investments in the fleet carried out by the company in the following years.

In the quarter, we acquired 3,119 vehicles and we sold 2,200 vehicles with a net investment of R$47.2 million. On the next slide is our IPO in April, 2012. We had two upgrades in the ratings from Fitch and S&P and the last upgrade took place at the end of April when Fitch upgraded our rating from A minus to A. This upgrades attests to the very well succeeded process to strengthen our financial profile which gave us the following benefits, lengthening of the debt, today 91% of our loans are longer term and the duration of our debts went from 1.7 years to 4.7 years.

On the second graph, a reduction in the spread from CDI+ 5.5% to 2.5% at the end of the second quarter of 2013.

On the third graph, a reduction in the percentage of the fleet which is in the part of third parties from 87 to 28%, which gives us greater flexibility to the company. Also, the company now perceives that having more liquidity on the spread.

On the next slide, in the middle of June, we issued our 7th debentures issuance and we raised R$100 million for 7 years with a grace period of 2 years. The cost of the operation was CDI+ 1.74%, which represents a reduction by 51 base points in the marginal cost of our debt, vis-a-vis our last fundraising in September 2012.

Our cash position is now 251.4 million, which accounted for 122% of the total maturities between 2013 and 2015. In the last slide, we show the increase in our leverage in terms of net debt over EBITDA to 2.9 times. This is a temporary effect, due to the lower growth of EBITDA in the quarter and the purchases of cars which increased our net debt but has not generated EBITDA.

We are committed to maintaining this metrics between 2 and 2.5 times. On the right hand side, we show that our net financial expenses accounted for 15.6% of the net revenue from rentals in the second quarter of 2013. That is 12 percentage points below the second quarter of 2012. This has to do with the reduction in interest rates and the lower spread of the debt between periods. This was achieved after we optimized our capital debt in September 2012.

We can now move to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now open up for questions-and-answers. (Operator Instructions) I'd like to remind you that the press may make questions shortly after the question & answer session of market analysts. Please hold. (Operator Instructions) Thank you.

Our first question comes from Mr. Matias Dietrich from Solidus. Please proceed, sir.

Q - Matias Dietrich

Good morning, everyone. First of all, concerning optimizing the fleet, you see that's around 93%. I'd like to know if you consider -- what is the ideal rate and what is your target and how much of it do you think you can reach? Also, I'd like you to talk a little bit more about competition, how competition has behaved in the fleet segments and what do you think Unidas and Ouro Verde[ph] going public will impact you and impact in the margins? Thank you.

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

Good morning, Matias. Thank you very much for your questions. Your first question, our usage rate, we think usage rate a good would be around 95%, maybe even reaching 96%. In this quarter, specifically, the impact of this little bit worse rate is that when we will receive a lot of vehicles at once what happens, then this happened in the last quarter, we need a period where we have to collect these vehicles and this operational aspects impacted this profit due to the high quantity of vehicles that we were not expecting.

However, in the short term, we will go back to the 95%, 96% level. Concerning competition, we are in a standard scenario, we have five or six medium-sized and big players that hold a share of about 50% of the market and other 2,000 players that hold the other 50% of the market. So, it is a market that is very fragmented still. However, it is growing strongly, we have two or three big projects that are being studied for own-fleet model migrating to third party fleet.

So, with that fragmented market and a growing market, I believe everyone can grow. However, it is undeniable that there are five or six medium-sized and big players that have a very good financial structure and who also have growth potential. So, today, in terms of pricing and rentals for us it's stable, it's not going up. And we throw the pressure for cost that showed me that we can improve in terms of pricing in the next quarter, because Locamerica like its competitors are experiencing a high level of interest rates, we see a scenario where depreciation is stable.

And even in terms of inflation, we probably will have more inflation beside as being more or less more stable now. So our business is a cost-based business and we of course, look for more efficiency and more speed. We highlighted in my talk that three or four months ago, we started analyzing and studying on a daily basis overlap we may--tried to obtain some gains in synergy and with the main goal of improving the efficiency and of course, the focus on our clients' needs and bringing economies and savings to the business.

So what we are doing to improve our margins or to keep them in a scenario where the competition is the way it is, is for us to give improvements in terms of cost and efficiency. So, we are reducing our spread, we are improving our management cost and also our operational cost with these efficiency gains we're doing.

Lastly, the IPO of Unidas and Ouro Verde, we understand that in terms of competition, this will not change the current scenario because they already have a financial and operational structure that makes them a strong competitor. We believe that this will not change. What we'll see, what we'll notice is that these movements.

What will happen is probably that naturally in our sector, what already happened in other sectors and we have been expecting is that there might be a consolidation movements and those who will suffer more are the small-sized and medium companies which they move away from our current conditions due to capital structure, they have higher cost in debts and then they acquire vehicles, we have a lot of advantage over the small companies and medium companies and they have a smaller volume of cars than ours.

That's why we're not very much concerned with this. We understand that besides the IPO, they have capitation costs and capital structures which are very similar to Locamerica. So in terms of competition, we're not concerned. And if the IPOs actually take place with new players, the consolidation movement will speed up and those who will suffer will be the small and medium-sized companies.

Q - Matias Dietrich

Thank you.

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

Thank you, Matias.

Operator

(Operator Instructions) Thank you. Our next question comes from Alexandre Falcao with HSBC. You may proceed, sir.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you very much and good morning to all. My question has to do with movements that we see here, BRF. I think all major companies are looking at that bid and I would like to understand two things. What is your competitive position and if you should win that bid, thinking about your leverage strategy? Then you will have to provide 6,000 cars. Can you give us some more color about this?

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

Good morning, Falcao. Thank you very much for your question. I didn't understand the first part of your question. I understood the leverage issue, but what about the first?

Q - Alexandre Falcao {BIO 5515455 <GO>}

I wanted to understand your positioning for BRF. This is a huge contract before BRF had their own fleet, you owned that contract, right? If I want to take it. How I use the position? How aggressive will it be in that bid? Just give us an outlook on that.

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

Oh, now I got your question. It's a great pleasure, as I said in the previous answer, it's a great pleasure when a client move to having their own fleet and they come back to the contracting of the fleet. This is very good for the sector as a whole and for our business as well. We are very happy with the BRF move.

It is very feasible and also very good from an operational point of view. As regards to our position, we maintain the position of ensuring profitability, this is a very important bid for the industry and for the winner, of course. We will be one of the players who will be chosen by BRF because of the history[ph] of the client. We've provided services to these clients for more than three years.

We were the first to provide vehicles under the outsourcing scheme of Sadia their predecessor company. So we know how they work on a daily basis. We have a good technology that we use to manage their 63 bases and this will give us a level of knowledge that will allow us to mitigate risks.

Our positioning therefore will be that of a competitive player was observing our conditions. One of them is profitability. This is our main focus. As regards leverage, we won't have to leverage more yet with 6,000 cars. But the delivery of these cars is spread over 18 months or 24 months, not a project that require a huge investment upfront of R$150 million but requires R$150 million to be invested in 18 to 24 months.

The initial batch is 2,000 cars and this initial delivery of 2,000 cars will require an investment of R$60 million, according to our estimates. This is not that relevant to the level of investments of Locamerica. This year we expect to invest in our projects R$400 million. The first delivery between 10%, 12% of our total investments. And for no client, for no contract or no opportunity in the markets are we going to move away from the pillars, we believe should underpin our performance and those pillars have profitability and growth with controlled leverage.

We are reaching the benefits of 3 percentage points over the total of our debt by deleveraging by lengthening the debt profile and by reducing the collateral and we are not going to give that up. Our position will be that of a strong competitive player in view of such an important bid for the sector and for Locamerica.

Q - Alexandre Falcao {BIO 5515455 <GO>}

If you could follow on, you were talking about cost reduction and the efforts you have been doing to eliminate overlapping than redundancies. What is the most obvious opportunity to reduce costs? What would be the sustainable level of costs?

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

What happened, Falcao we said in the last 2 or 3 years we had a restructuring project of our operational, financial and management platforms, in order to prepare ourselves for the IPO to experience more robust growth, stronger vehicles and planning for the mid-term and long-term in a supported way.

Of course this is expensive. We had developed and implemented all the financial modules of SAP, we have restructured specific areas to take care of projects aiming at the IPO and after we finalized this project, we can now take out these areas that were especially created for some projects and change them and transform our management platform into a platform which is more in line with what we had in the past and were worked very well and has been working very well for 20 years.

So the main opportunities that we saw were in this sense and they were part of a project that had been previously thought about and implemented since we began in the private equity in 2008. So to give you an idea, we have a board of officers that were focused on management pillars, IT pillars. We had specialists in these areas that today we can now cut down significantly on these areas, because now we already have an implemented management model and an operation that has been going on for more than two years.

And in IT's, we have also built a project to implement SAP. So now we need to customize and improve on a daily basis and that also led to a significant reduction in terms of 30% of the number of directors and officers in order to go back to the Asian[ph] cost and maintain the efficiency. And we also have a very strong focus in customer service, strengthening our operational bases, focusing on the capitals of the country which are Sao Paulo, Belo Horizonte and Rio and they all of them give support to the personnel in over 30 branches that we have.

Concerning the levels, what we see is that we are experiencing some pressure in costs in general, inflation and another pressure in terms of interest rates and what we're doing is building up other pillar in terms of cost to maintain our focus. We have our EBITDA around 55% to 57%.

So, what we're doing is, we are changing our total cost platform, in order to maintain because that at this margin 55% to 57%. So, with these kinds of movements, we might not improve our project but we will maintain the project we have within the margins and profitability we expect, of course using the several cost platforms that we already have. Thank you very much.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you.

Operator

(Operator Instructions) The Q&A session with analysts has now ended. We will now move on to the Q&A session with the press. (Operator Instructions) If there are no questions, I would like to turn the conference over to Mr. Porto for his final remarks.

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

Good morning to you all. Thank you very much for attending our conference call to discuss the results of the second quarter of 2013 and I would just like to stress that we are moving towards maintaining our strategy to growth with profitability and to reaffirm our commitment towards maintaining the levels of leverage and all the pillars that we set in the last 5 years.

We understand that this is totally feasible. We don't envisage any dramatic change, although it is a difficult moment for the Brazilian economy. We attest to the resilience of the contract of our business and also the predictability of our revenue. We believe that we will be able to maintain the profitability and growth even in difficult times. This is our motivation and this is what drives us to maintain our position as players focusing on consolidation in this industry and in this economic activity.

Thank you very much.

Operator

Locamerica's conference call is now ended. Thank you very much for participating and have a nice day.