Q2 2015 Earnings Call

Company Participants

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

Other Participants

- Frank Barker, Analyst
- Mario Bernardes Junior, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, thank you for standing by, and welcome to Locamerica's Conference Call to discuss the Second Quarter of 2015 Results. We would like to inform that during the company's presentation, all participants will only be able to listen to the call. We will then begin the Q&A session when further instructions will be given. In this quarter, Locamerica will have some space for press professionals to also ask questions.

(Operator Instructions) This conference is being simultaneously translated into English and questions may be asked normally by any participants connected from abroad. Questions may also be asked online through the webcast platform. This conference is being recorded. Audio will be available in the company's website up to 24 hours. If any of you do not have a copy of Locamerica's release, you can obtain it from the company's website, locamerica.com.br/ri. This conference and the slide presentation is being simultaneously broadcast online and can also be accessed by the company's website.

Before we proceed, we have to clarify that any statements that can be made during this teleconference about the company's business perspectives, as well as, forecast, financial and operational goals about its growth potential are predictions based on the management's expectation towards Locamerica's future. These expectations depend on these sectors' performance, the country's overall economic performance, and the international and national market conditions, and are therefore subjected to change. We have with us today, Mr. Luis Fernando Porto, CEO; and Mr. Carlos Wollenweber, CFO and Investor Relations.

We would now like to give the floor to Mr. Luis Fernando Porto. Mr. Luis, you may proceed.

Luis Fernando Memoria Porto {BIO 17590082 <GO>}

Good morning to everyone. It's a great satisfaction to present today, the operational and financial results of Locamerica in the second quarter of 2015. Before moving to our results, I'd like to briefly highlight some sectorial trends we observed during the quarter.

On slide three, we see that the credit scenario is still restrictive for vehicle financing plans, despite a significant drop of 1% in this segment's default rate which went from 4.9% in Q2 '14 to 3.9% in Q2 2015. We can see on the right that the funds available for financing dropped 11.3% in the second quarter year-on-year. This is due to the larger level of credit restriction adopted by bank. To discuss the automobile market, on slide four, we can see that the sales of new cars dropped 23.1% in the second quarter, while the used car market has proven to be very resilient despite the macroeconomic scenario. On the second quarter of 2015, the amount of used cars sold grew by 6.3% year-on-year.

Now, on the upper right-hand graph, we see that despite a slowdown in demand, the automobile industry has been forced to increase new car prices due to the reinstatement of the IPI and the depreciation of the Brazilian real. And according to IBGE, during the first quarter new cars became 4.7% more expensive on average while used car prices were stable.

The increase of prices in new cars have shown a migration of demand towards used cars, which can be observed on the lower left hand graph. Currently in Brazil four used cars are sold for every new car, which is way above the historical average of 2.7. It's important to highlight that despite the current boom that the used car market is going through, we are continuing to invest in reinforcing our retail network, which accounts for 27% of our sales. In this quarter, we opened our seventh retail store in Sao Bernardo do Campo.

Moving to the operational highlights of Locamerica in slide six, we are showing on the left the overall rental contract signed -- value signed for the second quarter of 2015, a total of 70 million. Although the commercial pipeline for the next three months has remained robust with around 20,000 cars in tender as we can see on the right, we still think that companies are taking longer to approve new contract, as they review budgets and downsize.

On slide seven, we see a breakdown of our fleet. At the end of the quarter, we had 29,016 cars, a 3% drop quarter-on-quarter, and the operational fleet decreased by 6.6% over this period, a total of 22,722 vehicles at the end of June. This reduction in the operational fleet can be explained by the expiration and non-renewal of some contracts which have segments out of the company's action scope due to its heavy vehicle use. We hope to increase the volume of operational fleet cars at the end of deployment in which we will have 2,600 cars, which are now being customized to meet our clients' needs. As we will see further on, in this quarter we were able to offset this drop in the operational fleet with efficiency gains based on higher utilization rate.

On the right graph, we see that in the second quarter, there was a reduction of the fleet in decommissioning both in absolute terms minus 685 vehicles, as well as the share of in the total fleet, which at the end of June reached 12.5%, a reduction of 1.7% in comparison to the first quarter.

We can see on slide eight that during the second quarter, the company once again achieved record sales of used cars, which was 3,456 sold cars, while the number of decommissioned cars dropped by 45% in comparison to the fourth quarter of 2014 going back to the same levels as the first nine months of 2014.

As we can see on the left-hand graph, since the first quarter of 2014, the company has entered another sales level, currently close to 1,110 cars sold for a month. We highlight that already in quarter one and two 2015, we had fewer cars returned in comparison to the previous quarters. Based on the used car market's resilience, we hope that the sales pace will be kept, going back to the stock levels of previous times with no need to change pricing.

I would now like to give the floor to Carlos, our CFO, who will talk about the financial highlight.

Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Good morning to all. It's a satisfaction to present our financial highlights for the second quarter. Moving on to slide ten, we have our net rental revenue, which was R$98 million on the second quarter and 195 million in the first half, a growth of 7.5% and 11% respectively. This is a reflection of our increase in the monthly average rate, which was about 10.6% in this semester.

The next slide shows the number of cars sold by Locamerica, total of 3,456 in the second quarter, a growth of 25% in comparison to the same period last year. The average price of sale grew by 7% year-on-year to 22,900 per car showing the change in our fleet's profile to higher value added vehicles. As a result, our net revenue for used car was R$79 million and R$156 million in the first half, a growth of 36% and -- 34% and 36% respectively. Retail sales for final consumers is already 27% of our total sales. As Luis Fernando said, we opened a new store in Sao Bernardo do Campo and our goal is to continue to increase our share in retail sales.

Slide 12 shows a comparison of our margins in the first half of 2015 and the same period last year. As we can see, maintenance expenses represented 28.9% of our net revenue for rental, 1.9% lower than the first half of 2014. This is due to a reduction of the average age of the fleet and higher operation efficiency.

The expenses with SG&A represented 14.5%, a 2.1% reduction in comparison to last year. This is a reflection of the company's work in reducing its administrative costs. The used car results was marginally lower in the period with taking 1% of our EBITDA margin. As a result, our EBITDA was 55.6% in the semester, a 3.7% above the same value in the first quarter of 2014. This was offset by higher depreciation expenses as a result of the greater share of vehicles with higher value added in our fleet. Our expansion for this semester was 0.7% in EBIT, reaching 30.7%.

The next slide shows a reduction in the average age of our fleet to 15.8 months, 2.5 months below the average age for the first -- sorry, the second quarter of 2014 which is a positive impact in terms of maintenance cost. We also had a utilization rate of 96%, the highest since 2011.

Slide 14 shows a growth of 9% in recurring EBITDA, which was R$55 million in the second quarter. In this semester, we had a growth of 18% in recurring EBITDA, a total of R$108 million and a margin of 55.6%. The graph on the upper right-hand side shows an increase in the depreciation rate from 9.4% to 10.5% in this semester. Financial expenses grew by 2.1% in the semester due to rental revenues or reflection in the interest rates.

It's worth highlighting that our investments in CapEx are 100% hedged and Locamerica is now using Hedge Accounting. Our net income was R$11.8 million which is stable Q-on-Q.

On slide 15, we see that our consolidated net debt increased by 62 million in the second quarter due to a reduction in supplier payments of R$76. Without this effect, we generated R$14 million in cash this trimester.

Finally slide 16 shows the last issuance which raised R$10 million with the deadline of 4.5 years at a cost of CDI plus 2.5%. The main goal for this issuance is lengthening our debt profile and strengthening our cash reinforcement.

We will now begin our Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Bernardes from Banco do Brasil.

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

Good morning to all. Thank you very much for this conference call and congratulations for the results. I have two brief questions. You had a very high result in terms of rates, monthly rates you did really well in comparison with the other players. And you said you changed the car mix strategy. Is this sustainable, should it continue throughout the second semester? This is my first question.

A - Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Good morning, Mario. Thanks for your question. We believe that we are almost at the end of our cycle that was designed to change the level of our fleet. And because of this we can say that in the next few quarters, you will see our nominal rates remaining flat. They are not going to be higher, but they are not going to be lower. And this has an impact on the net CapEx per car. We had been buying more expensive cars and we have been selling low cost budget cars. So we needed more net CapEx. But as of the second semester, and especially in the next few quarters in the year, the net CapEx will be normalized and will be lower than they used to have. We are going to be able to deleverage the nominal rates for the next few quarters; we will require smaller CapEx because we are at the end of this change in the fleet, which we began some years ago.

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

So, does it make sense then to assume that depreciation is going to be lower?

A - Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

No, the depreciation should remain flat and for two reasons. The first one is that with more expensive cars the depreciation rate is higher. And at this time in the midterm at least, the scenario is going to be challenging especially relative to new vehicles. We don't know what the size of the market will be and what the carmakers are going to do to increase sales. So we prefer at this time not to reduce the depreciation rate. We believe depreciation will remain in the same level and the rate of course is an expectation. We realize income or loss and we can be assertive relative to that rate when we sell the car.

Therefore, having a higher rate at a certain point in time does not mean that we are not realizing all we could. We're just keeping a more comfortable position given that this scenario is very challenging and undefined at least for the next six to 12 months.

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

Please allow me one last question. When you decommission these higher value cars, are you going to decommission them at the same rate, at the same speed, or is there any difference?

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

The public for those cars, the audience is different. When we designed the project to change our fleet, we thought about the stores, our retail stores and we have stores that are ready to sell those cars. And of course we are going to expand our network of stores as of 2016. And the new stores will also be designed in line with these new needs to sell these new cars. We will have products of better quality that will be sold through a channel that has better margins.

So, we want to have an equal or better turnover, but with a higher return. So in the next few quarters, this is what you're going to see. Our idea is that, for the next two to three years, we should go from 27% of our sales being in the retail to 40%, 45%. So we already have stores that are ready to receive these new products and our expansion has to do with being in those places where consumers look for this type of car.

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

Congratulations again for the presentation.

Operator

(Operator Instructions) Our next question comes from Frank Barker from Bank of America Merrill Lynch.

Q - Frank Barker {BIO 7292430 <GO>}

Good morning. I wanted you to give us a little bit more color about the competitive environment. The scenario was very difficult in 2014 and at the end of 2013 with a deterioration in the competitive environment. And now, I think this trend is being reversed. The economy is even more challenging and being some more complicated, growth is slowing down, but the competitive scenario seems to be better than it used to be.

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

Good morning, Murillo, and thank you very much for your question. Yes. What you said is right. I mean, what we see is exactly what you said. The costs at banks and the spreads of banks are going up, and also the environment is more restrictive, especially for those companies that don't have very healthy balance sheets in the short-term and that have higher leverage. So there is the costs are being driven upwards, but we also see that banks as very restrictive especially for small and medium-sized companies whose balance sheets are not as healthy and this makes environment better in a way because many of the competitors are driven out of the market.

We have been feeling that, but on the other hand, companies are taking longer to close deals, some downsizing, some require fewer cars, but it's still a good scenario in terms of demand, which once again a test to the fact that our business is not linked to the variations in the GDP, but as regard to competition that's exactly what we see.

Q - Frank Barker {BIO 7292430 <GO>}

Thank you, Luis.

Operator

(Operator Instructions) Seems there are no further question, and Q&A session for analysts is now ended. Before we move on to the Q&A session for the press, I would like to turn the floor over to Mr. Luis Fernando Porto for his final remarks.

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

Once again, I would like to thank you all for participating in our conference call to discuss the results of the second quarter of 2015. We are now beginning the second half of the year and we see a deterioration in the macroeconomic scenario, and this is happening faster than we all expected. The company is acting very cautiously in terms of the next steps. And what we did in the past is instrumental in helping us improve our EBITDA margins. This will allow us to weather the crisis, whilst increasing profitability. We've focused very much on the financial pillar and the most important thing for us is to maintain long-term debt at reasonable costs, with a robust cash position. This is what we just did by racing this debentures, by issuing this debentures and this is also important in a scenario, where the car market for the mid-term is selling unpredictable. And to counter that, we are strengthening our sales teams, we are increasing the number of stores and we are trying to sell although the market may be more difficult in the next few months.

We are seeking to maintain profitability and we are acting with a lot of caution in the next few months. Despite all of that, Locamerica believe that it can grow in a profitable manner. And we might see a small increase in the rental revenue and a strong increase in the used car business because of the new sales structure, and because of the scenario. The scenario of used cars is of sales above last year's.

Once again, thank you all very much for attending. And we reaffirm our commitment to grow with profitability, despite the challenging scenario.

Operator

We will now move to the Q&A session with the press. (Operator Instructions) Since there are no questions, the conference call is now ended. Thank you very much for participating and have a nice day.