Q1 2014 Earnings Call

Company Participants

- Nora Lanari, Head of Investor Relations
- Roberto Mendes, CFO

Other Participants

- Bernardo Carneiro, Analyst
- Bruno Bernier, Analyst
- Darius Dejaro, Analyst
- Stephen Trent, Analyst

Presentation

Operator

Good afternoon. Welcome to the First Quarter 2014 conference call of Localiza Rent A Car. Hosting the event today are Mr. Roberto Mendes, CFO, and Nora Lanari, Investor Relations.

We would like to inform that the numbers in this presentation are stated in million of Brazilian real and based on U.S. 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's presentation.

Immediately afterwards, we will start the Q&A session for analysts and investors when further instructions will be provided. If anyone requires assistance during the conference call, please request help from the operator by pressing star and then zero.

The conference call audio 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 1Q14 Webcast.

Before proceeding, we would like to clarify that any statements made in the conference call concerning the business outlook of the company, forecasts, as well as 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 materially different results from those stated in this call.

I would now like to turn the presentation over to the head of the IR, Nora Lanari, who will begin the presentation.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone, and thank you for attending our conference call.

We'd like to (represent) some highlights of the First Quarter 2014. In spite of the low GDP growth, Localiza presented stronger growth in the car rental division in the First Quarter 2014, when compared with 2013.

Moreover, the efforts of the company to increase business productivity reflected into the First Quarter results. Net revenues grew 19.1%, being 6.9% from the rental activities. Utilization rate in the car rental division increased from 66.6% in the First Quarter 2013, to 72.2% this quarter.

Consolidated EBITDA was BRL249.1 million; 14.7% growth in relation to the First Quarter 2013. Net revenue was a quarter record, totaling BRL105.8 million. As a result, the company's ROIC was 18.9%, an 11.3percentage point increase above the cost of debt, in spite of the significant increase in the SELIC rate.

In slide number three, we present the growth evolution of the car rental division. Daily rental volumes and revenues presented approximately 10% growth in the First Quarter 2014, despite the low economic growth scenario.

In the next slide, slide number four, we present the evolution of the car rental network. In the First Quarter 2014, 15 new rental locations were added to Localiza's owned network. Localiza's system currently holds 540 locations in nine countries in South America.

In the next slide, slide number five, we present the volumes and revenues of the fleet rental division. In the First Quarter 2014, revenues grew 1%. The 5.7% increase in the average daily rental rate was partially offset by the 4.3% decrease in business volume.

The lower growth in daily rental volumes was mainly due to the competitive price environment. The company maintains its conservative approach in order to provide return on invested capital, adding value to the shareholders.

In the next slide, slide number six, we present the fleet net investment evolution. This quarter, the company sold 6,569 cars, above the volume of cars purchased, to adjust the fleet after the summer vacation high peak season.

The result of such measure was a net divestment of BRL168.7 million. That did not impact revenue growth and contributed for the ROIC maximization.

Slide number seven presents car sales evolution. In First Quarter 2014, 17,444 cars (sic -- see slide 7, "17,449") were sold. This is equivalent to 5,800 cars per month, or 79 cars sold per store, per month. Volumes are (adequated) to the company's needs and are being achieved without a reduction on the average sales price.

In the next slide, slide number eight, we present the utilization rate evolution. Fleet optimization allowed a significant increase in the car rental division's utilization rate that went from 66.6% in the First Quarter of 2013 to 72.2% in the First Quarter of 2014.

Such increase in the utilization rate results in lower depreciation and financial expenses, among others, contributing to the ROIC increase.

In the next slide, slide number nine, we present the end of period fleet evolution. We began the First Quarter 2014 holding 103,526 cars and reduced fleet to 96,651 cars by the end of the quarter. Owned fleet was reduced by 6,875 cars by the end of summer vacation high peak season.

We improved the utilization rate in the car rental division, without compromising the 10.1% daily rental volume growth in the First Quarter 2014, aiming at an ROIC maximization.

Slide number 10 presents consolidated net revenues evolution. In the First Quarter 2014, consolidated net revenues grew 19.1%, due to the increase of 6.9% in the car and fleet rental revenues, and 33.5% in Seminovos the commissioned car sales for fleet renewal.

Slide number 11 presents the EBITDA evolution. EBITDA in the First Quarter 2014 totaled BRL249.1 million, 14.7% growth compared with the same period last year. In the car rental division, the EBITDA margin of 40.2% in the First Quarter 2014 was 4.6percentage points above that of the same period of the previous year.

There were gains of scale, by SG&A increasing 2.2% and (mass) car rental revenues growing 9.9%. Management remains with a strategy of maintaining car rental rates stable, aiming at market consolidation, as long as it does not compromise the targeted spread between ROIC and cost of debt after taxes.

In the fleet rental division, the EBITDA margin was 62%, presenting a decrease of 3.9percentage points when compared with the same period last year. Such reduction is mainly due to higher maintenance and preparation for the commissioning costs.

The increase in average fleet age, the number of decommissioned cars within the period, and higher expenses with IPVA tax for the cars from contracts that have already matured but were not returned by clients. Such tax was fully recognized in January.

Seminovos' EBITDA margin remains in healthy levels, reaching 6.6% in the First Quarter 2014, highlighting the company's conservative position on estimating the cars' residual value.

Let us now move to slide number 12, where we present the average depreciation per car in both car rental and fleet rental divisions. In the First Quarter 2014, average annualized depreciation per car in the car rental division was of BRL1,396. In the fleet rental division, it was BRL4,508. That is on the same level as last year's.

On slide number 13, we present the net income evolution. Company presented a record net income for BRL105.8 million in the First Quarter 2014; 19.1% growth in comparison with First Quarter 2013, despite increase in interest rates. Productivity gains contributed to increase EBITDA by BRL31.9 million. On the other hand, the hike in interest rates contributed to a net interest expense increase of BRL11.3 million.

Slide number 14 presents the free cash flow in the Fourth Quarter 2014. Operational efficiencies and fleet adjustments after summer vacation peak of demand contributed to a free cash flow generation of BRL176 million.

On slide number 15, we present the change in debt. The strong cash generation shown in the previous slide contributed to a net debt reduction of BRL124.9 million in the quarter.

In slide 16, we present the debt amortization profile. The company continues to present strong cash position and a comfortable debt profile.

Next slide, slide 17 presents debt ratios, which reflect the financial discipline of the company. Fleet optimization measures added to the strong cash generation contributed to the company's debt ratios improvement. Localiza is prepared for growth and consolidation opportunities of the car rental market.

I would like now to turn the presentation over to our CFO, Mr. Roberto Mendes, who will present the ROIC.

Roberto Mendes {BIO 7289124 <GO>}

Thank you, Nora.

On slide number 18, we present the evolution of the spread between ROIC and cost of debt after tax. This slides sums up everything we have (reached). We highlight (revenues increased) in car rental division with gain of scale in SG&A, reflecting an EBITDA margin improvement.

(inaudible) productivities gain reflected in higher car rental utilization rate. Car sales volume consistent, resulting in (inaudible) price, which resulted in car sales (expense and drop from 10.2% to 8.3%); the strong cash generation and record net income.

The result, 2.4percentage point ROIC increase partially compensating by the 1.6percentage point increase in cost of debt after tax. Spread between ROIC and cost of debt reached 11.3percentage points.

(As of that), I'll now move to the Q&A session.

Questions And Answers

Operator

(Operator Instructions)

Bernardo Carneiro, Deutsche Bank.

Q - Bernardo Carneiro {BIO 4037872 <GO>}

Hi. Good morning, everyone.

My first question relates to the net fleet decrease, actually, more sales of secondhand cars than acquisitions of brand new cars that you sold net of purchases 6,600 cars in the period.

My question is how do you plan to continue depreciating new cars along the quarters in the year, so we can better forecast the fleet expansion and the utilization rate? So I believe First Quarter was a one-off in terms of fleet reduction, in terms of net sales of secondhand cars. Thank you.

A - Nora Lanari {BIO 18838335 <GO>}

Bernardo, thank you for the question.

As a matter of fact, every First Quarter we reduce our fleet after the peak of demand, so it's the natural course of our businesses. Going forward, we expect to keep renewing plus adding some of our cars to our fleet, depending on the pace of growth.

Q - Bernardo Carneiro {BIO 4037872 <GO>}

Yes. But we have like a rough number I would say; flat, zero net purchases with net sales of secondhand cars or do you expect a slight addition to your fleets?

A - Nora Lanari {BIO 18838335 <GO>}

Bernardo, we do not have an official guidance policy, so we cannot provide you any expectations on that number. It will depend, of course, on the level of the growth of demand. You have also to take into consideration eventual gains of utilization rates.

You remember that last year we operated with roughly 67% utilization rate, so there might have some improvement on that sector as well.

Q - Bernardo Carneiro {BIO 4037872 <GO>}

Okay. Thank you.

Operator

Stephen Trent, Citigroup.

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. Good morning, everybody, and thanks for taking my question. And I apologize if I'm repeating something. I had trouble with my phone, so I may have missed one or two things you said.

But two questions from me, if I may. The first one is when I think of your debt balance, I recall that you had done some interest rate hedging and what is the strategy on that going forward? You know, that's my first question.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you for the question, Stephen.

You are right. Back in 2012, we decided to swap our debt related to the fleet rental division. The swap was made with the same term of the ending of the contract, so in that sense, we might have most of them ending in the second -- Third Quarter of this year.

June to September we will have them ending. But the new contracts signed on the fleet rental division are already being signed on a fixed rate.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. So your fleet rental contracts, you're locking in a fixed rate on that, but once the swaps on the current debt expire in the second half of this year, is the idea at least that you go back to 100% floating rate or this might be a strategy going forward, to do more interest rate swaps?

A - Nora Lanari {BIO 18838335 <GO>}

No. As a matter of fact, the new contracts being signed in the fleet rental division are already using fixed-rate debt, so the idea going forward for the fleet rental is maintaining the debt on a fixed base.

A - Roberto Mendes {BIO 7289124 <GO>}

Steve, this is Roberto.

I do not -- we do not want to take risk in these long-term contracts. So the risk in these contracts (is it in a bigger figure), so interest fluctuation will not affect our results for the next year.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, now I understand; appreciate that. Thanks, Roberto.

And just one other question; I'm also curious to what extent the company's view on acquisitions may or may not be evolving.

A - Nora Lanari {BIO 18838335 <GO>}

Steve, thank you for the question.

You understand that we have a strong cash position. Acquisitions have not been part of the strategy of the company, but we have cash in hand. We will try to use this cash to invest in our own business to grow internally.

We might also be thinking on eventually distributing cash through a special dividend or shares buyback.

A - Roberto Mendes {BIO 7289124 <GO>}

Excuse me. But of course, we (will look all the opportunity that we will have to -- that we -- that someone offer to us. We are not -- so far, these conditions didn't make sense, but it does not mean that we will never do this.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay, understood, appreciate the color on that and that's all my questions for now. Thank you.

Operator

(Operator Instructions)

Bernardo Carneiro, Deutsche Bank.

Q - Bernardo Carneiro {BIO 4037872 <GO>}

You mentioned on the press release on these results that the new level of profitability of the fleet rental business is 62%. That's considerably below three or four years ago, which used to be 68%, 65%, 66%, so is that stemming from competition and pricing pressure?

And do we expect margins to improve one or two years from now, after the competition eases, or do you think this is a really -- a lower profitable segment because of competition and the low barrier of entry? Thank you.

A - Nora Lanari {BIO 18838335 <GO>}

Bernardo, thank you for the question. Just to make it clear that the 62% has some nonrecurring effects, such as the ITCI, the licensing tax we paid in January for the cars already matured.

Apart from that, we are seeing more -- a tougher competitive scenario in terms of pricing, but our main focus is the ROIC and the spread of the ROIC over the cost of debt. So we are aiming at this spread and we are still very comfortable with the level of spread presented by this division.

We cannot say for sure if the margins will go up eventually. We keep an eye on the spread, competitive and still being aggressive in prices and we cannot forecast how long it will take until they change to more sustainable pace of growth and profitability levels.

Q - Bernardo Carneiro {BIO 4037872 <GO>}

Okay. Thank you.

Operator

(Operator Instructions)

(Bruno Bernier), (Genway)

Q - Bruno Bernier

Yes, my question is about your utilization rate evolution. At 72.2% in the First Quarter, it seems obviously very high and that's contributing, obviously, to the fairly high return; ROIC, I mean.

Do you see this utilization being sustainable or do you see it coming back down a bit to a more average level, around 70% or 69% to 70%?

A - Nora Lanari {BIO 18838335 <GO>}

Bruno, thank you for your question.

If you look back, previous years, we were able to keep utilization rates very close to the 70% level, so 72% is a good level of utilization and we aim to maintain at least around 70% going forward.

Q - Bruno Bernier

So this is likely to come down a bit, going into the second and third, Fourth Quarter; right?

A - Nora Lanari {BIO 18838335 <GO>}

Might come back slightly, but our goal is to maintain a minimum of around 70%, so we'll keep working to maintain high levels of utilization rates in a year that interest rates are going up, so we need to provide a stronger ROIC to maintain the spread over the cost of debt after tax.

Operator

(Operator Instructions)

(Darius Dejaro), Genway.

Q - Darius Dejaro

Okay, hello, thank you.

Can you give us maybe a feeling on how the conditions in terms of pricing have changed when you buy new cars and sell used cars, compared to last year?

A - Nora Lanari {BIO 18838335 <GO>}

Thank you for your question. We haven't seen much of a change in our conditions. We do see a lower pace of growth in the new car market. Used car sales market in Seminovos are quite consistent, so we haven't seen much of a difference. You saw the depreciation numbers in the First Quarter and we are not assuming anything much different from what we had last year, both in the car rental and fleet rental divisions.

Q - Darius Dejaro

All right. Thank you.

Operator

(Operator Instructions)

This concludes today's question-and-answer session. I'd like to invite Miss Nora Lanari to proceed with her closing statement. Please go ahead, madam.

A - Nora Lanari {BIO 18838335 <GO>}

We would like to thank you all for participating in our conference call and to inform that our IR team is available for any further questions. Our interim financial statements for the First Quarter 2014 will also be filed today, after market close.

Thank you.

Operator

This concludes Localiza Rent A Car (Auto) conference for today. Thank you very much for your participation and have a great day.