Y 2013 Earnings Call

Company Participants

- Joel Kos, Chief Financial Officer
- Luis Fernando Porto, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Alexandre Falcao, Analyst
- Unidentified Participant

Presentation

Operator

Good morning and welcome to the conference call for the Release of the Results for Locamerica's Fourth Quarter 2013. At this time, all participants are connected in listen-only mode. Later, we'll have a session of the question-and-answers and further instructions will be given. (Operator Instructions) This conference call is being simultaneously translated into English and questions might be asked normally by participants connected abroad. Questions can also be made via Internet through our webcast platform. I'd like to remind you that this conference call is being recorded. The audio track will be available at the Company's website within 24 hours.

Should any of you need a copy of our release, you can access it through our website www.locamerica.com.br/ri. This conference call followed by a slide presentation is also being broadcast over the Internet and it can also be accessed through the Company's website.

Before we begin [ph], I'd like to remind you that forward-looking statements made during this call concerning the Company's business outlook as well as projections, financial and operating targets relative to the Company's potential growth, are based on forecasts and expectations from the Company's management, concerning the Company's future. Such expectations and assumptions depend on the Company's and the sector's performance and also on the performance of the Company as a whole and also on conditions of the market internationally and domestically. So they are subject to change.

With us today, we have Mr. Luis Fernando Porto, CEO and Mr. Joel Kos, CFO and IRO. I'd now like to give the floor over to Mr. Luis Fernando Porto. Please, sir, carry on.

Luis Fernando Porto {BIO 17590082 <GO>}

Good morning, everyone. It's a great pleasure that we'd like to thank you for participating at our teleconference today to talk about the results for the fourth quarter 2013. First of all, we shall highlight the global value of the new rental contracts signed during the fourth quarter 2013, we reached an all-time record accounting to an improvement in rental revenue growth, when compared to the last year and as early as the first half of 2014. That is possible due to strict administrative cost reduction and also due to our new hedge policy, which were implemented in the fourth quarter of 2013, which gave us a better competitive edge.

In January and February of this year, the new contracts remain robust and the commercial pipeline for upcoming months is also a record. This demonstrates the resilience of the fleet outsourcing industry. Sales of used cars also reached a record at 3,053 vehicles in the fourth quarter 2013, ensuring sales of 10,522 cars in the year, an increase of 49% in comparison to 2012 and going over the Company's sales target. This record performance led to a 27% decrease of the inventory of cars for sale, to 3,505 units against a peak of 4,800 units in the third quarter of 2013. In February, the inventory of used cars was at 2,952 units or 10.5% of the total fleet and in line with the Company's goal.

During the quarter, the Company completed a second phase of its cost retention program, which led to an estimated real decrease of 16% in the fixed costs and expenses expected for in year 2014, when compared with 2013, which represents a 20% decrease in administrative costs per car used in the pricing of contracts. That way, the Company starts 2014 with a more lean, dynamic, and competitive corporate structure.

In the fourth quarter of 2013, the Board of Directors approved a hedge policy, whose aim is to fix the capital cost of the new rental contracts, thereby protecting the profitability of the business in a scenario of macroeconomic uncertainty and possible new interest rate hikes. Currently, 90% of the Company's net debt is already hedged by the average term of the contracts.

Finally, with an extremely comfortable debt profile, with current duration of 4.8 years, the longest in the industry, a cash position of R$197 million, amortization in the next two years of only R$42 million. Hence, we estimate in order [ph] to resort to the debt market only 2016, either for investment or for re-accommodating the debt.

In the next three slides, before getting into our operating performance, we would like to briefly go over some trends in the industries, in our landscapes have seen during the fourth quarter of 2013. On slide number three, the new car sales totaled 3.6 million in 2013, down 1.6% from the previous years. Sales of used cars rose 4.7% in the same period, reaching 9.4 million units. On the chart on the right, we can see that in the year, the price of new cars rose by 3.5%, while there was a decrease of 2.4% in the price of used cars.

On the next slide, the sales per working days for new cars, fell by 2.4% in the first bi-months of 2014, when compared to the same period of the previous year, while sales of used cars showed a high of 4.8% in the same period.

The chart on the right, we see that the price of new cars have risen more than the price of used cars in 2014. We expect a steady stream of demand turning out of new car to used cars with positive prospects for the used car segment this year, mainly due to the gradual increase of the IPI taxes over industrialized products, economic downturn and also difficulty in accessing credit.

On slide number five, the default of the industry reached 5.2% at the end of 2013, the lowest level since November 2011, but it is a level which still contributed high to justify an improvement of credit for the industry. In fact in the year, the total funds released for auto financing to individuals remains stable at R$93 billion. In January 2014, the last available data, defaults remain at the same level of 5.2% after 10 consecutive months of decreasing levels.

Moving now to our operating and financial performance on slide number six, we shall breakdown of our fleet with a total of 28,265 cars at the end of the year, a 3.4% drop over the previous year, that due to a tighter competition in the industry and also the anticipated termination of contracts of an important client in the first quarter 2013.

In the chart on the right, starting at September, we chose to follow a more aggressive policy to reduce inventory of used cars, bringing it down to 39% inventory reduction, with a total of 2,952 cars in February 2014, i.e. 10.5% of our total fleet, when compared to peak of 17.1% in the third quarter 2013.

In the next slide, the land -- rental revenues increased by 6.3% in 2013 due to the increase in the average rate at 12.1%, which was partially offset by lower volumes by 5.5%. The growth far below our expectations was primarily due to an impact from fiercer competition in the industry throughout the year. In this scenario, we chose not to follow this movement, focusing our efforts on adjusting our operating and financial structure to allow for a recovery of growth and profit.

Indeed in the second half, we completed a major organizational restructuring and reduction of fixed costs, those resulted in a drop of 26% in our administrative cost per car, which prepared us to be much more competitive starting in the fourth quarter of 2013.

In the next slide, we can already see the benefit from such strategies. As highlighted in the chart on the left, the record number of volume of signed contracts in the quarter totaled R$111 million, an increase of 67% over the same period of the previous year. The chart on the right shows the commercial pipeline, which was also a record for the company which in December totaled more than 22,000 cars in disputes versus 14,000 cars in October 2013. It is noteworthy that approximately 30% of these cars were concerning companies with their own fleet which was switching to an outsourcing model.

The new hired, the new contracts, which remained robust in January and February and the strong pipeline for business in the coming months (inaudible) in our view to a quick recovery of the Company's top line, especially starting in the first half of 2014, competing a robust growth rate this year than the last year. And on the next slide, we can see the results of our strategy, concerning diversification and portfolio of clients. At the end of the fourth quarter, the mix of fleet represented by popular cars dropped to 57%, while in February 2014, we already had 354 clients, a growth of 20% over the same period of last year.

We believe that our diversification strategy becomes especially irrelevant in a scenario of an increasing competition in the industry, usually concentrated in large bids and contract. On slide number 10, we sold 3,053 cars in the first -- in the fourth quarter of 2013, an increase of 46.5% compared to the fourth quarter of 2012. For the year, sales totaled 10,522 units, which represent an annual growth of 49%, well above the average performance of the markets.

On the chart on the right, we highlight the average sales price for used cars, which was at R$90,300, an increase of 3.1% when compared to the fourth quarter of 2012, but down compared to the third quarter, mainly due to the use in the fourth quarter of 2013 of specific segments in the wholesale channel, which does not include the preparation of cars for sale, which brings prices down.

On slide number 11, the depreciation of cars in 2013 was at 8.1% of average fixed assets, versus 6.7% in 2012. In 2014, we estimate a depreciation of around 10% or 20% of net rental revenue. The increase in depreciation compared to previous levels mainly shown -- show mainly the change in mix of our fleet with increasing representation of mid-sized cars, executive cars, and heavy duty cars that have higher rates of depreciation and secondly, the continuous increase in the spread between price of new and used cars.

Slide number 12, our EBITDA totaled R$35.4 million in the quarter, a decrease of 15.9% over the fourth quarter 2012 and impacted by some extraordinary events such as; one the strategy of retrofitting the inventory of used cars with results, that is one off, that is negative of R$6 million to the positive impact of R$4 million related to getting into the participation of the Refis program.

Three, R$0.5 million of non-recurring expenses related to the second stage of restructuring completed in November. Not including among these effects our EBITDA would be at R$37.9 million, representing a margin of 46.8% on rentals. In 2013, EBITDAs totaled R$162.9 million, up 6.2% and representing our margins over rentals of 50.5%. This year, we expect a gradual recovery in EBITDA margins to Company's historical levels.

On slide number 13, we recorded a net loss of R$6.3 million in the quarter, mainly impacted by extraordinary items mentioned above and greater financial expenses, related to rising interest rates in the country. In 2013, the net income or the net profit totaled R$16.2 million, an improvement of R$12.5 million or 336% compared with 2012. This year, we expect a strong recovery in our profitability.

I would like now to pass to Joel Kos, our CFO.

Joel Kos {BIO 17590108 <GO>}

Good morning, everyone. On slide number 14, we talk about our current debt profile in 2013 and the fourth quarter of 2013. We completed another stage of optimization and strengthening of our capital structure, capturing two of our seventh and eighth debentures and an amount of R$325 million and prepaying 240 million of more expensive debt and lower average term, including even in the (inaudible) October, that's the duration of our debt -- to 4.8 years, the longest in the industry versus 4.5 at the end of 2012 and in 2013, we had 197 million in cash and only 42.1 million of debt maturing in the next two years, that is 2014, 2015. Thus we estimate that, current cash added to the expected cash flow of the business, our expectation to still finance the investment plans of the company requiring access to the debt market only from 2016 on.

In the last slide, we believe that this considerable capital structure will be an increasing competitive edge for the company as 95% of debt in the long term, with a spread of debt reduced to 2.2 by the end of 2013 versus 3.1 till the end of the previous year and the percentage of the collateral fleet that is 20% versus 38% in 2012. The less charge, our leverage in terms of net debt to EBITDA, reached 3.1 times by the end of 2013.

And we expect it to reach at the top of our target, which is close to 2 to 2.5 times more than what we will have at the end of the year. And at the end of the quarter, the Board approved a hedge policy, that prefixed a cost of our capital for new contracts of rentals, protecting our profitability and business and allowing us to deal with a possible new hikes and also the interest rates, it actually brings us a competitive edge and also considering the current market rates.

And now I'd like to pass to questions-and-answers.

Questions And Answers

Operator

Ladies and gentlemen, we'll start now our question-and-answer session. (Operator Instructions) Our first question comes from Mr. Gustavo (inaudible) HSBC.

Q - Unidentified Participant

Good morning. Thank you for the call. I would just like to understand a bit better, how much to this rental rate increase, you got from an increase and in terms of -- to what extent the responsibility comes from renting cars that are more expensive, in other words, less popular cars?

A - Unidentified Speaker

Could you repeat that question, it was not clear.

Q - Unidentified Participant

Well, the increase we see, that's the average monthly tax is quite higher, nearly 11% in the last year. I just want to understand how much of this increase is due to rent of less popular cars and there was actually an increase of -- a real increase in the average rate that? You're welcome.

A - Unidentified Speaker

Well, the increase was about 12%. All our contracts are using the IGP-M and we believe that half, about 5% to 6% is of re-adjustments because of the increase of the rate, so there is an adjustment there and the rest is because of a new type of our fleet profile.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions)

A - Unidentified Speaker

Well, answering for the (inaudible) from GTI, about the price of shares and the market value of the company and how we see that. Well, at this point we have a situation where the price of the shares despite all the factors related to the market and to the current position of the company since it's much below in terms of what we would consider fair and based even on that fact that our profit and loss today if we discount fleet less debt, we would have PL totally in cars, which is an inventory of the company in a very good to have as our net assets. So we would have that as an option.

From the Company's standpoint, we have a concern related to meet our goals first based on the pillars to leverage our cash management, extending our debt, which we are currently analyzing the possibility of such, but we've don't see that the money of the company is there to be used based on the speculation of our shares. As shareholder and controllers we are buyers and we are then analyzing all the hypothesis to be able to well re-buy part of the position we have today. There is no way date for that, no term and we do not want to commit ourselves to that, but we would say that effectively in terms of these levels and even further higher levels, we are future buyers of our share.

Well, to answer one more question about our pipelines of contract and if we expect to get more market share at this point, we have the longest pipeline that we've ever had in our history. We believe that some clients are anticipating there by because of a high price scenario because of the IPI tax increase, will expect to increase the price of cars and we have a higher interest rate and also the cost pressure.

So we believe there is a shift in terms of accelerating the purchases and also because in situations of turmoil companies who visit their costs and alternatives of outsourcing their fleet, so undoubtedly that does bring an advantage and reduction of cost for companies that have their own fleet.

These two situations make us have the longest pipeline in our track record, together with a greater competitiveness of Locamerica because of the restructuring of our administrative costs because of our capital structure and our hedge policy is effectively, we do believe that we can have an increase, that will be greater than what we saw last year.

To actually gain greater market share, is not something I clearly have mind -- my mind made up in terms of that, because we don't know how much the market will grow. What we can say about Locamerica itself and Locamerica because of everything I've already mentioned. We do expect to have an increase, that will be greater than what we saw last year.

Operator

(Operator Instructions)

A - Unidentified Speaker

In answer to another question, which was made over the Internet in terms of (inaudible). The question is about the used cars market and also about an improvement in the sale of used cars.

Now, that's a normal effect as we see it, and there is a chance, an increase of prices for new cars, which just happened for two reasons. The first one was the industrialized tax and also because to a mandatory ruling that makes us install airbags in all cars. So all new cars had the prices increased and in this scenario, we see it as normal that consumers will look for advantage in the used car market.

On top of that, we can see some financing data that Brazilians are now starting to finance cars in a shorter term, which feels that they are concerned about that level there. They are trying to adjust their installments to the economic reality that they face. So those two trends led to a higher attractiveness for the used car market. And we expect that if the government maintains the increasing IPI and if automakers keep on rising their prices, we will go through a period of much better results in terms of used cars.

In terms of our sales, I have two reasons. The first we have been for over two years now investing in a new sales channel, the retail channel. We had at the end of 2013, and at the beginning of 2014, we had twice as many stores selling cars in the retail market, then -- which gives us a very strong sales potential. Besides that, we also see an improved market and also that also helps us. So the sum total of all those factors led us to believe that we'll achieve better sales, more robust sales than we had up until the third quarter of 2013.

Operator

(Operator Instructions) Our next question comes from Mr. Alexandre Falcao from HSBC.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Good morning, everyone. I'd like to understand a little better the competitive environment, we did last year -- we had a year, which was especially busy in terms of competition, because we had auto industry [ph] -- two different offers from two important competitors.

Now, to those -- who know how those can work and we know how aggressive companies can be, unless you know it's something, anything has changed, concerning that as back in (Technical Difficulty) of the year, if you see a competitive environment, which is a little more favorable to the credit company and also with height in interest. Where does the competition stand concerning prices and you have just -- you participated in different bids, so a little more color on that competitive environment, please?

A - Unidentified Speaker

Thank you, Alexandre. As the question is talking a bit about the competitive environment, we see that there is some accommodation, we do not see an improvement yet, we do not expect it to happen in the short term, we have six or seven mid to large competitors who have investment capacities. So as we see it, this scenario should remain as it is. Of course, the scenario is more or less competitive to what it is, but it's been working like this for over 10 years, with those different players fighting for this market.

So what I can see right now, and it's only natural that in a moment that we have high interest rates, an increase in car prices and other cost pressures which are characteristics of the business, it is only natural for companies to review their pricing strategy, their projects. So I view that at this moment, we are going through a calmer period if you will because of that. We are not going through a period where the market is adjusting according to different cost pressures. So the competitive scenario, I see is like this, concerning the hike in interest rates, there is no doubt that this element might go from 15% to 30% of cost for the companies depending on the level of leverage that you have, so it is a very significant cost and the higher its debts, no doubt the higher the likelihood that will be passed on to the rental prices -- rental rates.

So at this moment, starting the first quarter of 2014, we will be going through moments where we'll have to increase prices and the main reason for that -- the main driver is that, everybody incurs in those costs, interest costs are the same for everyone when we have the selic rate increase and it's the same for everyone. The spread is different, but their interest rate is same for everyone and we see the market now going for higher spreads.

So when we have a higher spread and a higher selic rate, that's an important factor. On the other hand, we also have inflation impacting administrative costs, inflation is going up. So with all of those pressures in terms of costs, and an increase in the price of cars, which makes us increase our investment, I can tell you there will be an increase in the price of rentals, that's only natural.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you, just one more thing. Would you say that after the elections later this year, when we have the IPI -- the tax on industrialized products resuming its previous levels, what would you see happening with your balance sheet and the industry as a whole? Can we expect to see previous levels being recovered, if it's good for used cars and now, how do you see that happening after the election?

A - Unidentified Speaker

The more expensive the car gets, it's the better price. Of course our main inventory elements and assets are cars, so the higher the prices, it's better for us because even though we have to make larger investments, we have a better balance in our inventory. Every increase in price, we have to pass that on to our spreadsheets and to the market and if we are buying cars at the higher prices, the client will go through the same experience.

Prices go up across the board. So if the prices of cars continually increase and if we have the IPI back, we will have a better picture in terms of balance sheet. What we do not see happening is that even if the government increases, we don't see automakers sustain the higher prices for a long time, because demand will drop. We see that happening right now. Car prices went up and subsequently demand slowed down.

When we don't have a better scenario in terms of financing, we do not expect a hike in prices. So even if the government increases IPI in our projections, and as we see, we are still pricing our new cars at the same level, well it's slightly higher and using stable level of spread. There is no sign as of now, but makes this lower the price of used cars. And that happens because we are already at a very high level, the highest level in the history of the industry.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you.

A - Unidentified Speaker

Thank you.

Operator

(Operator Instructions)

A - Unidentified Speaker

Good morning we will try to answer Marco Martine's [ph] which was sent over the internet and the question is, if we are going to deduce our leverage level in the coming years. Our intention is to tube [ph] a leverage level of 2 to 2.5 times net debt over EBITDA, up until the end of the year. We expect to get to the top of that range and in the coming years, we will try and remain within that range; 2 to 2.5 times.

We have made a restructuring of our capital structure and that requires strict discipline. And this was implemented throughout the last 12 [ph] years and once we achieve those levels, we intent to remain within that range. So that's our target and we are trying -- working very hard to implement a discipline required to achieve that.

Operator

(Operator Instructions) We would like now to close the session of Q&A, I'd like to pass to Mr. Luis, so he can start his final considerations.

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

Well, once again, I'd like to thank you all for taking part in this teleconference and going through a global analysis of 2013, for the first time in the beginning of the year, we had a big return of fleet of declines that was really big learning to us. In terms of our business, we did not only move the turnover from that clients that had been ensured to the year, at that time, brought us many operational problem in terms of high inventory of cars, you need to collect them, you need to prepare them. So we had never gone through that before, so it was a year of great learning.

And thinking about last year, we did the best on a competitive scenario and a macroeconomic scenario that would be less tough than actually it came through where. So we were overly optimistic, I guess in some aspects and all of that unfortunately, we've got something that was all depending on us and what we can do and it's under our control which is cost, expenses, the fixed costs and administrative costs is what the company use as a remedy to fight back the fierce scenario of reduction of revenue and a weak macroeconomic scenario.

So we understand all that, we've done our homework, we are more competitive and we are going through a moment that is very special in terms of our hedge policy, our administrative costs and specifically related to our capital pillar, having a capacity of investing, with no need to resort to the market when it's at a higher price and tougher. So we are well prepared, we came into 2014 much more competitive and we expect for this year a recovery and that is our biggest goal, a definite recovery that will be gradual for the next quarters of our historical margins and we also expect a growth better than what we had last year, because we are now more competitive and now, we have a compensation scenario. For us, it's much better than what we see with the others in the market. So once again, I'd like to thank you all.

And those are my final considerations for the year and for the next year 2014. Thank you very much and see you next time.

Operator

Locamerica's teleconference is now closed. I'd like to thank you all for your participation. Thank you. Good morning.