Q3 2014 Earnings Call

Company Participants

- Luis Fernando Memoria Porto, Chairman, Chief Executive Officer

Other Participants

- Renato Mimica, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon. Welcome to Locamerica's Conference Call, we will presenting our earnings for the third quarter 2014. All participants are in listen-mode only. Later we will have a Q&A session and you will be given instructions on how to participate. This quarter, Locamerica will allow media professionals to ask questions followed by market analysts. (Operator Instructions) This conference call is being translated into English and questions may be asked normally by participants abroad. Questions may also be asked through Internet through a webcast platform. This conference call is being recorded. The audio will be made available on the company's website in up to 24 hours. If you don't have a copy of Locamerica's release, you may obtain them on the company's website locamerica.com.br/ri. Both this conference call and the slide presentation is being broadcast simultaneously on the Internet and also through the company website.

Before proceeding, let me mention that statements made during this conference call relative to the business outlook of the company, as well as forecasts, operational and financial targets relative to its potential growth are predictions based on Locamerica's management expectations with regards to Locamerica's future, but these expectations depend on the center's performance of the country, the economic performance and of both domestic and foreign conditions, economic conditions and they are subject to change.

We'll now hand to our CEO, Luis Fernando Porto, who will have the floor. So, you may have the floor.

Luis Fernando Memoria Porto {BIO 17175861 <GO>}

Good afternoon, everyone. Thank you for participating in Locamerica's conference call on the earnings of the third quarter of 2014. Our 3Q, '14 earnings were in line with our expectations and showed significant improvement compared to the same period last year.

Our net income increased 48% against 3Q, '14 or 120% on a recurring basis. Our EBITDA and EBIT rose 31% and 45% over the same period last year, with a margin expansion rate of 390 bps and 48 bps respectively.

Meanwhile top-line growth remains robust. With net fleet rental revenues accelerating 21% year-over-year, driven by a significant tariff increase of 7.7 in this period. In addition, strong used car sales in this quarter coincided with rising average selling prices up 5% sequentially in the third quarter of 2014. This quarter saw a consolidation of efficiency gains observed in the 2Q, '14 with average utilization at 95% up 200 bps year-over-year.

And the inventory of cars for sale reached a new record low of 47.4% amounting to 2,531 units or 8.4% of the total fleet.

In the next two slides, before discussing our operational performance, some sector trends will be shown, which we noticed in 3Q '14. On slide three, new car sales fell 8.7% in the first 10 months of 2014, up to October year-over-year, whilst used car sale increased 5.7% in the same period. As mentioned in previous reports, this demand flow from new to used cars can be explained by three major factors; one, a high spread between new and used car prices; two, economic slowdown and consequently decreased consumer confidence indices; and finally a tight car financing market.

The chart on the right shows further increase of the spread between new and used car prices. This is a result of higher new car prices, which was 8.2% [ph] in '10 and '14 compared to 8.1% increase in used car prices over the same period.

On the next slide, you can see that the funds released for auto financing purposes. In Brazil, our individuals totaled BRL68.5 billion in line end of '14, up slightly 2.7% over the same period last year. This is a slowdown as compared to a 3.6% high in the first half of 2014. The last graph on the right hand side shows a drop in demand for new cars in Brazil, as well as a significant reduction in exports of 41.2% in '10 and '14. As a consequence a 16.6% decrease was observed in the production of cars and (inaudible) vehicles in Brazil. Notwithstanding vehicle inventories remained high at 45 days of sales in October, but with an ideal number of 30 to 35 days. We will now discuss our operating and financial performance.

Slide five provides a breakdown of our fleet, which recovered a level of 30,000 cars up 7.9% compared to 3Q '13. Now, the operational fleet increased 9.4% over the same period last year, while the number of cars in deployment, which are the cars that would be added to the operational fleet shortly grew nearly five-fold to 2,885 cars. The chart on the right shows a new low in the number of car inventories for sale amounting to 2,531 units and this is a new level, it represent 8.4% of the total fleet, compared to 17.1% in 3Q, '13 and 9% in 2Q, '14.

On the next slide, the highlight is another important gain in efficiency, this is a growth in the utilization rate to 95% in 3Q, '14, compared to 93% a year earlier. The chart on the right hand side show the average age of operation fleet falling again to 17.6 months below a peak at 19.1 months in 4Q, '13. And this represents the lowest level in the last two years. It should be pointed out that as the peak grows, we're expecting a continuous decline in the average age of the fleet and consequently a decrease, relative decrease in maintenance cost.

Next slide, fleet rental revenues increased by 21% in the third quarter '14, compared to the same period of last year. And in the next slide, we see this was because of the significant increase in the average tariff by 7.7% and in volumes by 12.3%. The increase in the average tariff is largely due to three factors; number one, contracts being adjusted for inflation; number two, the strategy to diversify market and client portfolio; and three; the strategy to increase margin.

On slide nine, on the chart on the left, we see that that total amount of new rental contracts signed in the third quarter of '14 remain robust, totaling BRL96 million, increased by 102%. On the chart, on the right, the commercial pipeline for the next three months was at more than 25,000 cars in dispute against 14,000 vehicles in the third quarter of '13.

This signals that the market for fleet outsourcing is still booming. Despite strong competition we're still growing and obtaining new contracts, at the same time we are exceeding our return target concerning the new contracts, due mainly through the following factors; number one, an increase in competitiveness as a result of (inaudible) our fixed cost by 13%. Number two, we had a consolidated and localized commercial team, we tend towards maybe the best commercial pipeline in the sector and thus enable to diversification of the client portfolio, which grew by 23% growing up to 419 clients in 3Q '14. And number three, a sound capital structure was spread falling and the highest tax duration in the sector.

On slide 10, we show the used vehicle business. Through the left, used vehicle income increased by 19.6% compared to 3Q '13, due to an increase in volume by 18.1% and of the average total price increasing by 1.3%. In terms of the mix of vehicles sold in retail, there was a two-fold increase to 23.6% of total sales compared to 12% in 2013. Most importantly, on the right, the used vehicle segment had a positive growth result totaling BRL1.1 million during the quarter. And this was in line with our expectations and concerning the trends in increase and profitability in the segment, which began in the first year of '14.

On slide 11, we show the EBITDA rising by 30.8% compared to the third quarter of '13 and hitting BRL50.7 million and representing a margin increase from 3.9% to 52.3%. This significant improvement can be explained largely by the advantages of the program to cut fixed costs, which was implemented in the second half of '13. And also due to the improvement in demand from the segment of used vehicle.

In the next slide, EBIT picked up 44.5% in the third quarter compared to the third quarter '13. There was 4.8% margin increase over the same period going to 29.4%. In the nine months of '14, EBIT grew by 21% over the same period of the previous year and represent an increase in margin of 2.2% to 31.3%.

On slide 13, net income increased 48.2% in 3Q '14 year-over-year to BRL5.4 million. If we do not consider the non-recurring impact totaling BRL3.9 million in fines and deferred fees due to the prepayments of BRL160 million in debt, the result would have reached the 8 million figure, which represented a increase by 120.2% year-over-year. The noticeable financial improvement in the company mirrors the increase in operational margin reflected by the 21% growth in net revenue for fleet rental compared to the increase in EBITDA and EBIT by 30.8% and 44.5% respectively.

In the next slide, we show the breakdown of the debt in July of 2014. The company approved the ninth issuance of debentures totaling BRL230 million with remuneration of CDI plus 1.7% per year and a period of six years. The amount obtained was due to prepay other debt totaling BRL160 million with remuneration of CDI plus 2%. As such we have ended the third quarter with BRL165 million in cash and only 33 million in debt maturing in the next two years, 2014, 2015. The duration of the debt was at 4.6 years.

The last slide. We believe that this comfortable capital structure is a growing competitive advantage for the company with 97% of the loans maturing in the long-term. This spread of the debt continues to decline and today is at 2% versus 2.4% a year ago. And the percentage of the fleet offered as collateral is already at 83% [ph] in this current quarter.

And having said this, we can now move on to the Qs and answers session.

Questions And Answers

Operator

Ladies and gentlemen, we will start our Q&A session. (Operator Instructions) Our first question comes from Samuel Alves, BTG Pactual.

Q - Renato Mimica {BIO 15374054 <GO>}

Hello. This is Renato of BTG. Thank you for the call. Luis, you have mentioned and we saw that in the release too, that you have a relevant hotline [ph] of agreements and that new contract at record levels. Can you tell us about the evolution of the scenarios is competitive and have you had gradual improvement with less aggressive players. Can you expand on this scenario, please?

A - Luis Fernando Memoria Porto {BIO 17175861 <GO>}

Thank you, Renato. Good afternoon. Our perception close to the elections worse that the decisions, while some of our customers were postponed. They were concerned about the macroeconomic scenario of Brazil, but it was not that radical or strong. So, what we now see that things are working again and we expect to have a good quarter in terms of contracts about the competition.

The competition scenario, when I said in the last quarters, we noticed that our major players have grown more mature. This has become manifest, when we compare these quarters to 2014 and 2013 and '12, in previous years, we had two or three players growing rapidly and this puts pressure on the market as a whole. Now the situation this year is a competition as well, but then it's less fragmented, you may lose some contracts, but not just to a single player. So, the same situation is still on and we do not have a particular or specific, we're exclusively growing rapidly at a fast rate. We have a lot of business (inaudible) player or two achieving good contracts, a large contract may grow, but it's not as like one player taking 70% or 80% of all bids, there is no longer, he is no longer there, we'd keep monitoring it.

Q - Renato Mimica {BIO 15374054 <GO>}

Thank you.

Operator

(Operator Instructions). Excuse me. Since there are no further questions, we are now closing the Q&A session with market analysts. Before we will move on to the Q&A session, but first I would like to give the floor to Mr. Luis for his final remarks.

A - Luis Fernando Memoria Porto {BIO 17175861 <GO>}

Again, I'd like to thank you all for participating. It is important to highlight a number of factors, over the last three quarters to be able to tell you what will be happening in the next period. We have come from a year, where a lot of uncertainty currently [ph] in the market, and maybe what we can say in terms of the future is that the uncertainty may still be here for the time and even in that scenario with a low GDP growth, we still have a strong demand for fleet rental. The main reason that we think it happens is because in our case, we provide our clients, the possibility of cutting cost, in addition to enabling them to exchange the normal kind of funding to the rental terms. And companies that are looking for a reduction in cost and improvements of their balance sheet, fleet outsourcing is a real and actual possibility for this movement. We think this will happen and will continue to boom in 2015. So there is a possibility of growth even in certain, uncertain periods, such as the one we are experiencing.

Locamerica and the possibility of the market is very committed to growth and looking for profitability. We see a lot of talent, because we have inflation affecting all kinds of business. So we expect starting 2015, this is what we did this year, that we are able through efficiency internal in-house and efficiency program to improve our processes, integrating management and technology, where we intend to know the hardship brought to us by inflation.

Another factor which is worth mentioning and may affect our business is the hike in interest rate. We have been preparing ourselves for the government, much of our debt is hedged and all the investments we have done through across 2014, we have hedged all our agreements. So two items that may scare or concern most of the companies for the next period, next year, we understand that we have done our homework and we have prepared our self for the future and we have the possibility of facing this macro scenario in a way that will affect us less.

So, hedging our debt and focusing on management and processes and efficiency, in order to know the impact and even improving our figures for 2015. So, the scenario that we see is (inaudible) is difficult, so we are well prepared. We have a long-term debt with rates that fall. Today we don't have assets as collateral, which is good and improved our cost and it improves our operation and this is how Locamerica has been working and has worked in 2014. We will end this year during the same thing. And in 2015, we intend to keep our financial discipline and operational discipline and this is the main focus for the following quarters, in order to improve our margin and to focus on (inaudible). Thank you very much to all of you and see you next quarter.

Operator

We will now have a Q&A session with media professionals. (Operator Instructions). So, the first question comes from (inaudible).

Q - Unidentified Participant

Good afternoon. This is just a reminder of some data you mentioned before, and then a specific question. So, first you were talking about the average age of the fleet, you're talking about fleet, you said that rate was close to the lowest level in the last two years. What was the index? Can you remind me, what this index was? And finally the last month we wrote a story [ph] about you and we were discussing the expectations of the company investments, should have, to 500 million this year. So, what about the investment expectation for next month, will it be higher than this amount for 2014?

A - Luis Fernando Memoria Porto {BIO 17175861 <GO>}

Good afternoon, (inaudible). Thank you for your question. Index that was the lowest in the last two years was the average age of the fleet, and it reached 17.6 years, that was the average, 17.6 months.

Q - Unidentified Participant

Months, okay.

A - Luis Fernando Memoria Porto {BIO 17175861 <GO>}

As for investment, we believe that we will really reach this target for 2014 and next year we're expecting to invest around the same level. More specifically, in fleets or helping you in units, are you doing the same thing this year to focus of the contributions next year, we'll have a focus on fleet for 2015, we should also open some new stores for used cars, used car sales. For rental services, we've already stopped expanding, a 100% of that market, a peak market. The big market is taken by our stores in terms of management. So there is little investment to be made in rental services and new stores. So our major focus next year is opening used car stores, retail stores, and also to invest in our fleet. Thank you.

Operator

(Operator Instructions). Since there are no further questions, we will now close the Locamerica's teleconference. We thank you for your time and have a nice day.