Q2 2019 Earnings Call Portuguese

Company Participants

- Mauricio Fernandes Teixeira, Chief Financial Officer
- Nora Lanari, Director, Investor Relations

Other Participants

- Alexandre Falcao, Analyst
- Andressa Varotto, Aanlyst
- Lucas Barbosa, Analyst
- Lucas Marquiori, Analyst
- Pedro Bruno, Analyst
- Stephen Trent, Analyst
- Thiago Casseb, Analyst

Presentation

Operator

Good afternoon. Welcome to Localiza Rent a Car's Conference Call of the Second Quarter of 2019. Hosting the event today are Mr. Mauricio Teixeira, CFO; and Ms. Marianna Catalina [ph], Investors Relations Officer.

We would like to inform you that the numbers in this presentation are stated in millions of Brazilian rials and are based on the IFRS. 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 have the Q&A session for analysts and investors when further instructions will be given. (Operator instructions)

The conference call audio and the accompanying slide presentation are being broadcasted simultaneously over the Internet at www.ri.localiza.com/en. This presentation can be downloaded at this same address by clicking on the banner 2Q '19 webcast.

Before proceeding, we would like to clarify that any statements made during 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 political and 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.

To begin the second quarter of 2019 teleconference, I will turn the floor over to the CFO, Mr. Mauricio Teixeira.

Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Good afternoon and thank you all for your presence. Once again, we had a quarter with solid operating and financial results accelerating the growth pace of both Rent a Car as well as Fleet Rental. We remain committed to growth with profitability and value creation to our shareholders. We continue to invest in innovation, improving productivity, customer experience and developing skills and competencies that are required to build the future of mobility.

I would also like to take this opportunity to thank you for the recognition reflected in the ranking published by Institutional Investors. We were elected first place in all categories evaluated both in the transportation sector and also among Latin American MidCaps. For comparability purpose, we present in the earnings release all the numbers and variations with and without the impact of IFRS 16 to have a fair comparison of the variation results. The summary of the impact by result line is available on Page 18 of our release.

Now moving on, on Page 2, we can see the operating highlights. In 2Q '19, RAC once again showed strong growth with a 29.2% increase in the average rented fleet year-over-year. In Fleet Rental, growth accelerated with a growth of 26.1% in the average rented fleet. Used car sales for Seminovos entered the quarter with the sales of more than 33,000 cars, accounting for 40.1% increase year-over-year, showing a fleet renewal capacity to support the growth of rental division. In this quarter, we achieved 276,804 cars in the fleet, representing a 32.7% increase year-over-year with the growth in all business lines. On Page 3, we can see the financial highlights. Compared to the same period last year, net revenue increased 36.8% and EBITDA increased 34.2%. The EBIT increased 21.7% and net income 34.9% totaling BRL191.4 million.

To present more details of the second quarter results, I will turn over to our Investor Relations Officer, Nora Lanari.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone. Giving a little more detail on the results of the quarter, I would like to start with the Car Rental division. As you can see on Page 4, in 2Q '19, the average rented fleet grew by 29.2%. There are almost 118,000 cars rented on average in the quarter. Net revenue increased 32.4% year-over-year. On Page 5, we see that the average daily rate in RAC increased by 2% year-over-year, the quarter that had been impacted by the truckers' strike. So year-over-year, the utilization rate increased by 1.8 percentage points, reflecting the efficient management of the fleet added to the strong demand reaching 78.8%.

On Page 6, we show that the network of owned locations increased by five branches in the first half. The Localiza System operates 599 branches in six countries in South America. In July, we announced the signing of a memorandum of understanding for the acquisition of the Localiza franchise car rental operation with six branches in the countryside of Sao Paulo and in approximate fleet of 3,000 cars. Now moving on to Page 7, in the Fleet Rental division, we increased our pace of growth with the average rented fleet growing 26.1% and net revenue increasing 21.7% year-over-year. Here, the average daily rate dropped by 2.8%, mainly reflecting the pricing of new contracts and renewal of existing contracts in the context of lower interest rates.

Moving on to Page 8, we show the fleet variation in the period. In the quarter, we bought 62,534 cars and sold 33,095 cars, an increase of over 29,000 cars and a net investment of BRL1.4 billion. Compared to 2Q '18, the volume of cars purchased increased 58.1%. In the first half alone the company bought over 99,000 cars and sold over 69,000 cars. On Page 9, we show the Seminovos network. We ended the semester with 109 stores in 71 cities and sales surpassed the mark of 11,000 cars per month, achieving 33,095 cars sold in the quarter. The 40.1% increase in 2Q '19 year-over-year was supported by the opening of nine stores in the past 12 months and a higher sales efficiency. Throughout the year, new stores will be opened to meet the need for fleet renewal.

On Page 10, we show the end of period fleet, which was a major highlight for this quarter achieving 276,804 cars, showing a 37.5% growth in car rental with a fleet above the mark of 200,000 cars and a 24% growth in Fleet Rental with more than 59,000 cars. Turning to Page 11, we see that the consolidated net revenues for the quarter increased 36.8% year-over-year. Net revenues from rentals increased 29.5% in the quarter while Seminovos increased 42.6% given the 40.1% increase in sales volume in 2Q '19 and an increase of 1.9% in average prices.

Moving forward to Page 12. The consolidated EBITDA increased 34.2% in 2Q '19 year-over-year. The EBITDA margin of RAC had an increase of 5.7 percentage points, and reached 37.7%. in the Fleet Rental division, the margin was 59.9% in the quarter, down 4.7 percentage points year-over-year. Seminovos had a margin of 2.5% in this quarter, reversing the downward trend and being 0.8 percentage points higher compared to 1Q '19. The margin recovery reflects the increase in the depreciation level observed in recent quarters adjusting to the reality of the car sales market.

In the semester, consolidated EBITDA was almost BRL1 billion as a result of growth in cost and expense management, as well as process and productivity improvements. Car Rental EBITDA margin increased by 5.9 percentage points in the first half, while the Fleet Rental division's EBITDA margin increased by 0.4 percentage points, even with the decrease in average rental rate due to lower interest rates.

On Page 13, we show the evolution of depreciation per car in the business division in RAC the NOIs average depreciation of cars in the semester was BRL1,623, 60.3% higher compared to the average of 2018. However, more stable compared to 1Q '19. In Fleet Rental division, the average depreciation per car in one half '19 was BRL4,128. The increase in depreciation was mainly a result of the selling prices of cars in the market and the use of the SOYD method in accounting depreciation in this division.

On Page 14, consolidated EBIT for 2Q '19 achieved BRL337 million, representing a growth of 21.7% when compared to the same period last year. This is a 34.2% increase in EBITDA, partially offset by the increase of 83% in the depreciation line. The EBIT margin of the Car Rental division was 30.8% in 2Q19 representing an increase of 0.6 percentage points compared with 2Q18. In the Fleet Rental division, the EBIT margin was 42.6%, a reduction of 9.2 percentage points year-over-year. The lower margin in Fleet Rental division is a result of the lower EBITDA margin and higher car depreciation. The lower interest rate allows for a lower EBIT margin with the spread remaining at healthy levels, which on a larger capital basis results in an increase in our value generation.

On Page 15, second quarter net income was BRL191.4 million, an increase of 34.9% year-over-year, mainly resulting from the increase of over $118 million in EBITDA, partially offset by the BRL58.7 million increase in car and other depreciation. In addition, this quarter, we had approximately BRL7 million in financial expenses relating to mark-to-market swap contracts as well as expenses with the pre-payment of the debentures of the 7th, 8th and 10th issuance.

On Page 16, we show cash generation before growth of BRL488.2 million in the first half of 2019. Net CapEx for growth totaled more than BRL1 billiondue to the increase of 29,731 cars in the fleet. In the semester, the company consumed BRL742.8 million of cash.

As can be seen on Page 17, there was a 15.7% reduction in net debt in the semester. The capital increase completed in February allowed for a reduction in leverage and the maintenance of growth.

Now, I would like to turn the floor over to Mauricio again to talk about our capital structure.

Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

As you can see on Page 18 that at the end of the second quarter of 2019, we had a comfortable debt profile with approximately BRL2.4 billion in cash. During the quarter, we concluded the 15th issue of debentures in the amount of BRL1 billion. And the proceeds were used for early settlement of Localiza 7th, 8th and 10th debenture emissions, improving the cost extending the amortization profile. The chart below shows the pro forma debt profile, considering fleets 7th issuance concluded in July after the end of the quarter. We continue to have a strong cash position and few maturities over the next three years. On Page 19, we see that the net debt over EBITDA ratio this quarter was at 2.3 times, a healthy level to continue our growth plans.

To conclude, I would like to highlight the evolution of the ROIC versus cost spread, which can be seen on Page 20. In this quarter, ROIC achieved 12.5%. Compared to the cost of debt, which was 4.9%, the spread was 7.6 percentage points, pretty much stable compared to last year. This result demonstrates our ability of execution. Therefore, we will continue to make all our efforts to ensure always improving operating excellence and thus achieving growth with value generation.

We are now open to answer your questions.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the Q&A session. (Operator Instruction). Our first question is from Pedro Bruno from Santander.

Q - Pedro Bruno {BIO 19082978 <GO>}

Good morning, everyone. Thank you for taking my question. I'd like to start off with the question about net financial expenses. I had the impression that the main surprise that you may have had to the bottom line was the operating line. And in financial expenses maybe two things, one relating to leverage as you mentioned, Mauricio about 2.3 times for the quarter of relevant increase compared to the first quarter and then also like to hear about cash generation in the second quarter specifically, maybe the working capital and payment of cars that were bought, end of last year. So I'd like to hear about that. And also about the mark-to-market in the swap contracts. So if you can give us some flavor about the impact of that on the second quarter compared to the first quarter. I know we have the data year-over-year, but I'd like to hear quarter-over-quarter. So you can explain that variation, those are the two things. Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Thank you for your question, Pedro. In fact, based on car purchases, we had a lot of payments to vendors in this quarter and in the first quarter, we had compared to growth, it was very strong because many things at the end of the first quarter were paid in the second quarter, which consumed our cash flow, but that was expected. And in the recent comment, we have to look at it longer term, and the first is usually cash generator, but now we had to pay those things, and we're still growing at a strong rate. And we know that growth consumes cash flow, but we're at a very comfortable level 2.3 times of the EBITDA ratio. And now we started to leveraging relationship growth. So the fact is, in financial expenses for NTM, throughout the second quarter 2019, we had a drop in the interest rates and the curves and that reflects our results through mark-to-market. That impact is approximately BRL7 million. In addition, all the pre-payments that were made for BRL1 billion in the older issuances by capturing through the 15th Issuance there was a prepayment fee of BRL4 million. So there were two events, one relating to the prepayment of some debt BRL4 million and the other one, the drop of future interest that immediately reflects on our bottom line and now, the bottom line is adjusted to the interest rate reality. So I believe that those were the two effects that weren't forecasted, and that took place in this quarter.

Q - Pedro Bruno {BIO 19082978 <GO>}

Okay, thank you.

Operator

Our next question is from Alexandre Falcao from HSBC.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Good morning, everyone. I have a question about that car prices trend, used car prices how do you see that? Are you comfortable with the depreciation levels, because now there was an increase in depreciation and the rates are higher. So do you think that with the lower sale prices and even production for the second half. Are you comfortable about this, or do you think that there should be another growth in depreciation of cars? Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Thank you for your question, Falco. We're very comfortable actually with the depreciation levels. We've done that movement since the end of last year. We've seen that the market reality wasn't that easy in terms of car prices. So we were increasing depreciation in the fourth quarter, maintained that in the first quarter this year and now in the second quarter. And proof of that is that the Seminovos margin is recovering. So we're at levels higher than 2% already. So that reflects that our strategy was right to increase depreciation. And with the same depreciation levels of the last quarter, we had a margin -- higher margin in the sale of Seminovos. So we're very comfortable debt margins at the point that we wanted and depreciation level as well.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Okay, great. Thank you.

Operator

Our next question is from Lucas Marquiori from BTG Pactual.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Good morning, Nora, Mauricio, thank you for taking my question. I have two questions about RAC. First of all, about the rates, if you can comment the drop quarter-over-quarter which had more of an impact, was it the seasonality of the second quarter or is it still the introduction of new products for more urban mobility app so could you give us some flavor, which impacted more or each one of them if you can give us some details on that.

And the second one about RAC -- about Localiza drivers, can you explain to us if there is still driver in the app fleet that have been converted to the new product yet. So I mean, the ratio of drivers that could move on to the new app and now that the app is running, do you plan on changing Uber pricing now that you know the product more and understand the risks? So those are my questions. Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Hi, Lucas. Thank you for your question. About RAC. great, because there is two things, the seasonality implies change in mix. So, the first quarter is stronger for individuals because of summer vacation.

And the second quarter, the mix moves onto longer duration segments that made the average rate go down. So, the seasonality impact that. That's why there is a drop quarter-over-quarter of the rates. Historically, you'll see that along the past years that you have a drop from the first quarter to the second quarter, so it's a result of that seasonality.

Relating to your second question about the drivers, to-date, we don't have drivers outside the product. The entire base is already pretty much already moved into that product. And we've had very positive results in terms of indicator improvement for that segment. But we're still -- we still haven't changed the pricing for that segment.

Q - Lucas Marquiori {BIO 17907247 <GO>}

Okay. Thank you. Nora.

Operator

Our next question is from Andressa Varotto from UBS.

Q - Andressa Varotto {BIO 20092249 <GO>}

Good morning. Thank you for taking my question. I have two. The first one is the improvement in the spread between the price of purchase and price of sale one year ago indicate those conditions or is it just a mix and should get better in the upcoming quarters?

And the second one, if you can talk more about the fleet rental rates compared to the first quarter? Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Thank you, Andressa, for your questions. The purchase and sales spread, we don't see a drop in our efficiency not in sale or in the purchase. We've gained scale since 2015, the number of cars from Localiza almost tripled. And we've been making very good purchases. Not as important as -- the volume is what you buy. So in terms of sale, we've been increasing our sales volume. And in the market, we've been able to grow over 30% in sales, which helps us in terms of diluting our fixed cost structure for Seminovos.

However, we're coming out of a cycle in the past years of a stronger price increase in new cars. So when that happens, there is a lag but then we transfer that cost increase to our Seminovos. So from maybe 2014 to 2016, even beginning of 2017, we had this difference between the spread purchase and sales spread that's more spread out. And now, I would say that it's more normalized that they're not increasing the prices of new cars as much as they used to as they were in the past.

In relation to the fleet margin, I believe that in a certain way, it should have been expected, at least to some extent because fleet is renewing contracts at lower average rates. And that is explained by the fleet contract cycle, which is usually three years. So the contracts that will be removed in 2019 wwere contracts signed in 2016 with the interest rates back then were two-digit interest rates, approximately 12%, 14% and now we're at a interest rate close to 6.5% that will now go down to 6%.

So we priced fleet contracts. And according to that and that impacts and drops the average rate. Since there is less fixed cost, there is not that much dilution. So we should see some impact to that margin and then happened in the second quarter. Said that, Andressa, the second quarter we'll start investing more in fleet and improving processes. So we have additional expenditures, especially with IT that are impacting the business margin and should impact the margin for a while, the investments are starting now.

So, in the first quarter, the margin that you saw there is not a margin that we expect. It's not a reference margin. So the rate drops and pressures the margin and the investments that should be in OpEx will tighten the margin.

And to conclude. It's worth noting that we are obviously seeing a lower ROIC in fleet, but that's following the trend of lower interest rates. So that doesn't mean that we are losing spreads in that product.

Q - Andressa Varotto {BIO 20092249 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) Our next question will be in English and it's from Stephen Trent from Citi.

Q - Stephen Trent {BIO 5581382 <GO>}

Yes. Thank you very much everybody and good afternoon. Two questions from me. The first is, what sort of color do you have with respect to longer-term market share trend in the Car Rental segment? And two, can you talk about your capital structure targets with respect to how much net debt you plan to maintain that fixed rate? Thanks very much.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Okay. I am going to switch to Portuguese. So Steve asked about the market share trend gain in Rent a Car in the capital structure. So we believe that the market has a strong trend to consolidate the scale of our business growth grew in a considerable manner and that increases our competitive edge compared to smaller players. The advantages that the market already knows and capturing REIT resources and how in buying and rental in relation to the quality of the fleet and quality of service measured by the NPS where it's the highest in the industry compared to other players. And last, the competitive advantages in Seminovos that enables us to be able to renew our fleet in an efficient manner at a reasonable cost, therefore, contributing to a lowest depreciation in the industry. So it's very hard for a small player without scale to be able to compete in this market. And in more mature markets, we can see that the consolidation level is much higher in advance. So we believe that that trend will continue in the upcoming years. Just to remind you, we went from 29% of share three years ago to 37.7% market share in 2018. And we believe that that trend will continue.

Regarding capital structure, we have leveraged 2.3 times the EBITDA ratio, which is very comfortable, especially if we consider the scenario of low interest rates in Brazil, something that we haven't seen for a while. And even an outlook that that would drop even more in the future. Back in the past when we had two-digit interest rates and we had 2.5 -- last year, we achieved 3.3 times in lower interest rates. And now we're very comfortable in capital structure and even very efficient to up to 3 times net debt EBITDA so we can continue our growth.

Q - Stephen Trent {BIO 5581382 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Lucas Barbosa from Morgan Stanley.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good morning, Mauricio and Nora. Thank you for taking my question. Actually I have two. My first one is about the fleet segment. You've increased growth in this quarter. I would like to hear some flavor about the type of customer that you have more specific information and some flavor about how much of a rate drop that you expect, given the lower interest rates in Brazil. That's my question. Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Hi, Lucas. Thank you for your question. We have a dedicated team to capture business opportunities in fleet, so I'm not going to signal which ones we are capturing, but it's still a market with low penetration. So there is still a lot of opportunity to grow in fleet management, and we've been able to capture part of those opportunity in an extremely competitive market in terms of price. So we've been able to attract new customers and convince new customers to outsource their fleet.

Relating to the rate chart and quote-unquote, without just considering the profitability measured by spread, Lucas. So we still have a very healthy spread with fleet relating to your questions about rate drops considering that the fleet cycle is approximately three years and interest rates are started to drop strongly as from the second half of 2017. Then we still have maybe one year to cover and renewing contracts at lower average prices. So you may see that rate dropping a little, and mid-2020, we may see the impact of inflation.

Our contracts are adjusted according to inflation, so part of that being transfered to price. But we're still in the cycle to reviewing prices downward, and so that all depends on how the interest rate curve will move forward and it's still on a dropping trend.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Okay. Thank you, Nora. My question -- second question is about depreciation. So you had a drop of approximately 9% in Fleet and in RAC it was stable. So, the depreciation drop in fleet, is that because of change the fleet mix or you're selling better cars than you expected? Is it a different model type car?

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

RAC is a one-year cycle. So we have to make adjustments that are stronger to be able to cover that change in level in fleet. The cycle is longer so that it's more diluted. And just a comment here, to remind you that in fleet we still use the SOYD method for depreciation. So it decreased a little, but with the growth, we still had higher depreciation because of the SOYD method.

Our depreciation assumption, not only for RAC but also for fleet already considers the market expectations forward, not just car price -- car sales price, but also the cost to sell. So, I think that for fleet is about the cycle length, and it already had a higher depreciation for a while. So now we're comfortable in saying that it drops a little. RAC not so much, it's different in that sense so we calibrate that according to a more relevant manner in the first quarter and we maintain that in the second quarter.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Okay. Thank you. Nora. if you allow me just a third quick question? You mentioned investments in IT systems in the fleet segment and that affected the margin a little. By any chance, is there a system relating to leasing for individuals?

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Yes, we're reviewing our processes in general. I think we can capture productivity in fleet. We're still not addressing fleet for individuals. We have a product for individuals, it's called the FLEX monthly, it's inside RAC, but there are some problem at process improvements and the solutions that we deliver to our customers but that's still focused on corporate customers.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Okay. Thank you very much, Nora and Mauricio.

Operator

Now, we have Thiago Casseb from Credit Suisse.

Q - Thiago Casseb {BIO 20503269 <GO>}

Good afternoon, everyone. Thank you for taking my question. My question is about the Seminovos operation used cars, so we see a relevant improvement to gross margin. And in SG&A, we see an increase relating to the first quarter even with lower sales volume, a little lower. Can you comment the reasons behind increase in SG&A and what's going to happen moving forward? I'd like to understand in the second half with an increase in sales volume, we can see the distribution of fixed cost in Seminovos and maybe a margin increase because of that. Thank you.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Thank you, Thiago, for your question. When we look at Seminovos, there is a relevant fixed cost structure that's personnel and stores. When we compare second quarter to the first quarter, we sold less cars back in fact impacts the dilution of those fixed costs.

So the operating margin improved because we adjusted depreciation, and that affects the profit of cars. But based on less dilution of fixed cost, the SG&A in Seminovos will go up. We imagine that -- well, we've been investing in increasing stores, and that already affects our bottom line. And we'll also have to open more stores in the second half. So, to assist us in the ramp-up of Seminovos sales so we can support the growth of RAC and fleet that continue to grow. So we should open a significant amount of stores in the second half, that's why we don't envision a higher dilution of fixed costs. On the other hand, we will sell more volume, but we'll also have more stores to support all that volume.

Q - Thiago Casseb {BIO 20503269 <GO>}

Thank you very much.

Operator

(Operator Instruction) Since we have no further questions, I'll hand over to Mr. Mauricio Teixeria.

A - Mauricio Fernandes Teixeira {BIO 19758664 <GO>}

Thank you very much, everyone, for your presence. And our IR team is available for any further clarification. Have a great day. Thank you.

Operator

The Localiza conference call is now over. Thank you for your participation and have a great day.