Q3 2021 Earnings Call

Company Participants

- Nora Lanari, Investor Relations Officer
- Rodrigo Tavares Goncalves de Sousa, Chief Financial Officer and Investor Relations Officer

Other Participants

- Aline Gil
- Analyst
- Bruno Amorim
- Lucas Barbosa
- Pedro Bruno
- Regis Cardoso
- Rogerio Araujo

Presentation

Operator

Good afternoon, and welcome to the Localiza Rent a Car Webinar Referring to the Results for the Third Quarter 2021. Today with us we have Mr.Rodrigo Tavares, CFO; and Mrs.Nora Lanari, Investor Relations Officer. Those who need translation, the tool is available on the platform. Please click interpretation button using the globe icon on the bottom of the screen and choose your language of preference. You may also choose to mute or unmute the original audio by clicking the unmute original audio button. Please be advised that this webinar is being recorded and will be made available on ri.localiza.com/en/ where the complete material of our earnings release is available. You can also download the presentation from the chat icon.

For the Q&A session for analysts and investors, we advise you to signal your interest in participating through the Q&A icon on the bottom button of your screens indicating your name, company and language. When called on, a request to activate your microphone will appear on the screen. (Operator Instructions) To send your questions in writing via the Q&A icon at the bottom of your screens, we advise you to make them by indicating your name and company before your question. We inform you that the values of this presentation are in millions of reals and IFRS.

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Now, I'll hand over to Rodrigo, the company's CFO to begin the presentation.

Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Good afternoon, everyone and welcome to the Localiza results webinar. After the second wave of the pandemic in the second quarter, we felt the positive effect of the advances in vaccination, which contributed to the resumption of demand in all car rental segments. Even in the context of rising rental prices, which is especially necessary due to the increase in the value of new cars and maintenance costs, we have noticed a gradual and consistent increase in our volumes already higher than what we presented in 1Q '21 with the utilization rate back to historic levels. Increases in car prices and maintenance costs and the basic interest rates substantially impacted the entire mobility chain, but the demand resilience reinforces the position of rental as an affordable and viable transport option for the most diverse mobility needs.

The demand for long-term rental both from large companies as well as individuals and SMEs is currently strong resulting in the highest ever backlog. We continue to live in a context of limited car supply caused by insufficient supply of inputs in the chain especially the semiconductors. This scenario once again impacted purchases in the quarter and it should last with the perspective of normalization only as of the second half of next year. In this context, we are seeking better car allocation by segment according to the mileage and the needs of our customers thus managing to maintain the NPS at levels of excellence as well as monetizing the asset without losing sight of our long-term relationships and customer vision. In this way, we are reducing the impact of the postponement of the fleet decommissioning until purchase volumes return to higher levels.

We continue developing Localiza's journey of digital transformation and building the future of sustainable mobility. Our strategy is to develop our competence in technology and data science and to look at our echo system has been consistently evolving through the Localiza laps[ph]. We have intensified our efforts in the pursuit of innovation within the customer journey, efficient cost management and greater productivity on several fronts and we already have some important initiatives in the experimentation and expansion phase. We're coming close to 150,000 connected cars, and as a result, we have a daily generation of approximately 65 million data points and more than 9 million kilometers monitored per month which in addition to reducing delinquency rates is an important tool for theft reduction and increase in rate of recovery.

We remain diligent in the allocation of capital and we'll take advantage of this moment to look even more broadly at new opportunities that can enhance our business, whether by strengthening our competitive advantages, increasing our growth or return prospects.

Our balance sheet keeps strengthening with substantial reduction of leverage ratios. In addition, our fleet replacement cost is the lowest in the industry ensuring cash preservation, which is fundamental while going through a period of uncertainty and an increase in interest rates.

This quarter, we concluded a technical study that supported the review of the useful life of cars from the tax perspective, which accelerates depreciation and tax credit with a direct impact on results. Based on the technical report issued by a qualified entity by the Brazilian Revenue Service, the fiscal useful life of the cars was reduced from 48 or 60 months to on average 24 months for cars covered by the report. As a result, we had an increase in tax depreciation and the recognition of the corresponding PIS and COFINS tax credits impacting the quarter's EBITDA by about BRL320 million. Finally, in the last 12 months, we achieved a void of 16.8% and spread over debt after taxes of 13.9 percentage points.

To present the results, we will move on to Page 2 of our webcast. In 3Q '21, we show a growth of 54.1% in revenue from the car rental division year-over-year. Utilization rate was 81.3% and the average daily rate achieved BRL92 reflecting our pricing strategy and the mix of segments. Revenue from the fleet rental division has been growing sequentially and year-over-year shows an increase of 14.7% against 3Q '20 due to the combined effect of volume and prices with a stable utilization rate and an average daily rate 8.4% higher.

On Page 3, we show the financial highlights for 3Q '21. Compared to the same period last year, net revenue from car rental grew 43.3% and from Seminovos dropped 36.1% impacted by a lower car decommissioning volumes in the context of lower purchases. As a result, consolidated revenue decreased 9.6%. The EBITDA grew 33.1% year-over-year due to the higher operating result from both rental and Seminovos. EBIT advances 112.2% in the same comparison. Finally, we see 106.3% increase in net income for the quarter, which reached BRL671.4 million surpassing the BRL2 billion mark in the last 12 months.

To present the details of the third quarter results, I would like to hand the floor over to our Investor Relations Officer, Nora Lanari.

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone. Starting with the car rental division as you can see on Page 4. In the third quarter, the number of daily rentals increased by 11% and revenue grew by 54.1% year-over-year, which is a reflection of the volumes resumption from the vaccination against COVID evolution and the higher level of fleet utilization rate. We also continue to adjust our rental rates in all segments to accommodate new car price increases and higher interest rates. We see a resilient demand with consistent growth in all segments, which reinforces our confidence in rental growth avenues for the coming years.

On Page 5, we show the result of the efficient management of prices and mix. In the context of low car supply and growing demand, the car rental division needs a utilization rate above 81% and an average daily rate of BRL92.

On Page 6, we show that the network of own branches was expanded by nine in the last 12 months or 2021 from 442 to 451 branches, which reinforces our confidence in growth opportunities. The company has been increasing convenience for its customers and getting ready to accelerate volumes as car delivery returns to more robust levels.

Moving on to Page 7. In the fleet management division, we see the average rented fleet increase by 7.5% and net revenue increase by 14.7% compared to 3Q '20. In this comparison, rates have increased by 8.4% reaching BRL1,753 per month per rented car and reflecting the pricing of new contracts in a context of rising new car prices and interest rates. We're excited about what we've seen in the demand and results of Localiza Meoo and fleet management. The number of orders continues to increase in fleet rental and has a backlog of over 20,000 cars, but we're still being affected by the scenario of restricted production of new cars.

Moving on to Page 8. We show the balance of cars purchased and sold. The quarter was affected by lockdowns in Malaysia, which aggravated the semiconductors global crisis resulting in further suspensions in the production of cars in Brazil. In this context, we bought 22,437 cars and reduced car decommissioning, which resulted in the sale of 21,620 cars, an increase of 817 cars between purchase and sale and a net investment of BRL327.5 million. Our average purchase price was BRL72,700 compared to a sales price of BRL60,500 resulting in a replacement effort of BRL12,200 per car showing the importance of maintaining discipline when buying cars.

On Page 9, we show the used car network or Seminovos. At the end of 3Q '21, we had 132 points of sale and 21,620 cars sold, a reduction of 52.5% in volumes sold year-over-year. The average price was 34.5% higher than the prices charged in the same period of the prior year and reflect the context of a sharp increase in the price of new cars, which we were able to capture in our decommissioning.

On Page 10, we show the fleet at the end of 3Q compared to the prior year. In car rental, we ended the quarter with a fleet of 2,100 -- 7,550 cars, a reduction of 4.1%, while in fleet rental the end of period fleet increased by 6.5%. On a consolidated basis, the fleet decreased 1.7% reflecting the lower number of cars being activated and decommissioned in addition to the lower number of vehicles available for sale.

Moving on to Page 11, we see that the consolidated net revenue of the quarter dropped 9.6% year-over-year. Net rental revenues increased by 43.3% with a 54.1% increase in the car rental division and 14.7% in fleet rental while Seminovos dropped 36.1% impacted by the lower car decommissioning in sales volume partially offset by higher prices.

On Page 12, we see that EBITDA grew 83.1% in 3Q '21 year-over-year reaching BRL1,187 million with a strong contribution from car rental and used vehicles. The positive performance in car rental is due to the increase in revenue resulting from higher volumes and rising rental rates in addition to higher margin benefited by a greater recognition of the credits of PIS and COFINS taxes, the result of a study that culminated in the reduction of the fiscal useful life of the cars object of the report issued. The average fiscal useful life of these cars approached 24 months compared to 48 months that was previously used to obtain PIS and COFINS credits.

It's worth noting that the credit recovered from these cars practically doubled. The higher volume of credit should be recurring as we obtain new reports of updating the fiscal use life full of -- useful life of new cars entering the fleet. Despite the expansions, some effects still have negative impact on the car rental EBIT in the margin especially the maintenance line, property tax, slicing and others, which remains high as the fleet age continues, increases in the price of cars and parts, and larger theft recognition.

Another line impacted was profit sharing reflecting higher increased provision due to the strong result of the company. Finally, margins have been impacted by continued investments in the brand and in the technology and data teams preparing the company for the next growth cycle and a more prominent presence in the mobility echo system. These combined effects resulted in advance of 22.4 percentage points in the car rental EBITDA margin.

Moving on to the Fleet Rental division, the EBITDA margin decreased by 12.6 percentage points mainly due to the increase in maintenance costs due to the fleet aging in addition to increase in expenses with chain technology, advertising for Localiza Meoo. Last year's basis of comparison is helped by the lower personnel costs associated with MP-926, reduced maintenance cost due to lower usage of the fleet and reduced expenses with marketing and consulting during the beginning of the pandemic.

In the last quarter, we have seen the order backlog increase, which should contribute to the gradual acceleration of growth and cost dilution as vehicle deliveries advance. The tailwind continues at Seminovos and contributes to a higher EBITDA due to the strong improvement in prices even with less volume of cars sold. In the annual comparison, the Seminovos margin goes from 6.3% in 3Q '20 to 18.6% this quarter. As a result, the consolidated EBITDA margin reaches the level of 80.9%.

On Page 13, we see that in rack the annualized average depreciation per car advances sequentially to BRL938. In the Fleet Rental division, the average annual depreciation for car is similar, BRL975. The higher renewal of rack cars as well as the fewer cars sold with an impact on the lower dilution of fixed cost explain the advance in depreciation in this division. Anyhow the depreciation at low levels in the two business divisions is a result of the increase in new car prices and consequent impact on used car sales prices intends to advance slowly while the pace of fleet renewal remains low.

On page 14, we can see that the consolidated EBITDA in 3Q '21 reached BRL1,069 million representing an increase of 112.2% year-over-year. The EBIT margin of the car rental division was 72.7% representing an increase of 39.9 percentage points compared to 3Q '20 mainly explained by the effects the effects that impacted the EBIT. In the Fleet Rental division, the EBIT margin was 73.6%, an increase of 0.2 percentage points year-over-year mainly explained by the reduction in depreciation and higher margin on the sale of cars in this division.

Net income for the quarter on Page 15 grew 169.3% year-over-year reaching BRL671.4 million. In addition to the EBIT variation described above, financial expenses increased 77.6% especially due to the increase in CDI and income taxes, which increased by 143.2% due to the higher EBT and higher rate.

On Page 16, we show a cash consumption of BRL208.8 million in the 2021 explained mainly by the reduction of BRL851.3 million in the automakers account.

As can be seen on Page 17, net debt increased by BRL541.7 million ending quarter at BRL6.7 billion.

On Page 18, we can see that we ended the quarter with a strong debt profile and strong cash position including the issuance of BRL2 billion in debentures made in October. In the pro forma analysis, the company has almost BRL5.5 billion in cash. The chart below shows the cost structure of our debt also considering the pro forma analysis. The total gross debt about 16% are prefixed from being hedged by derivatives and showing profitability contracting in the Fleet Rental division, another 28% are indexed to 109.5% of the CDI and the remaining 56% are indexed to CDI plus 1.68%.

Additionally, as a mitigator of the interest rate increase, the availability of cash is fully applied to the percentage of the CDI, which helps to protect the company from the increase in interest rates. The efficient management of the cost of debt maintaining protection for long-term contracts in Fleet Rental and the prioritization CDI plus instead of a percentage of the CDI makes Localiza relatively well position for a scenario of higher interest rates.

On Slide 19, we can see that the net debt over EBITDA ratio for the last 12 months was at 1.9 times, a level that gives us peace of mind to finance our short-term growth with third-party capital.

I would like to turn the floor back over to Rodrigo to present our work spread.

Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Thank you, Nora. On Page 20, we present the evolution of the ROIC spread versus the cost of debt. In 3Q '21, considering the last 12 months, we see an increasing spread, which reached 13.9 percentage points. We emphasize that despite the high level of short-term returns, the current context highlights the importance of decision making thinking about the complete rental cycle as well as the replacement cost of the cars. That's why we maintain our austerity in capital allocation certain that we are making the decisions with a long-term vision seeking growth with value creation.

Finally, in terms of sustainability, this quarter is an important milestone in the history of Localiza. The company launched the Localiza Institute to drive social transformation by supporting projects that facilitate young peoples access to education and fosters entrepreneurship in communities. We also made progress in other important sustainability initiatives such as signing the form for companies with refugees, an important step towards advancing the company's diversity agenda.

We also launched Frota Experience, an education platform aimed at fleet rental customers with a focus on traffic safety. In the environmental pillar, we completed the greenhouse gas emission inventory reporting for the first time the complete scope 3 with customer emissions which has already been audited. We are aware of the relevance of the sustainability journey and the path ahead, but we are also proud of the progress we have made in recent years.

We are now available to answer your questions.

Questions And Answers

Operator

(Question And Answer)

For Q&A, please inform that you are interested by clicking on the Q&A icon on the bottom of your screen, including your name, company and language. When you're called on, a pop-up will appear to unmute. (Operator Instructions) To submit your questions in writing, use the Q&A icon on the bottom of your screen and fill out with your name and institution or company before the question. Our first question is from Regis Cardoso. Regis, you can ask the question.

Q - Regis Cardoso {BIO 20098524 <GO>}

Hi, Nora and Rodrigo. Can everybody hear me well?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, we can.

Q - Regis Cardoso {BIO 20098524 <GO>}

Okay. Thank you. Congratulations on your results. I'd like to touch on a couple of points that we're in doubt about here and maybe the main one is related to GTF or even margin pressure in the period. So, it seems like the margin pressure was driven by costs and expenses given that the revenues went up. So is that fully a reason from maintenance and moving forward and therefore it would have to come through rate increases or am I interpreting that wrong? Is there another driver?

And another topic in that sense. Is that in the third quarter, quarter-over-quarter, there was no daily rate increase? That stood out to me there was even a slight drop and that stood out to me because I know that you have a strong backlog in this segment. So, I'd like to understand that, why weren't you able to increase the rates in the quarter? Is it about contracts that are -- that have come to an end and you can't replenish vehicles because it's you have a completely new product line, which is Meoo that adds to that?

And lastly, if you can comment as your peers did, the book value -- different book value for your fleet. And also compared to peers, do you have any understanding of lower car prices or purchases that evolved. Sequentially, does that have an effect on the mix effect? Thank you.

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Thank you, Regis. Let's talk about margins first. In fact, when you look at the margins, first you have some non-recurring effects, when you look at the profit sharing given the record profit. So, we do -- we've increased the profit-sharing that's why we have a provision for that and contingencies that give us a margin of 41%.

The main driver of that, it's in maintenance line, but actually it's theft. We have an increase in criminal activities, and that's why we decided to significantly shorten our (inaudible) to recognize the theft, and that's what affects our margins in rental cars. In fleet management, we have robust investments, not only in brand, in marketing for new customers to actually form Localiza Meoo, and therefore, the margin in fleet management in the short term is lower.

In relation to the rates and fleet management, we have a renewal, and we do have low deliveries coming from the automakers. The new contracts are being priced at much higher rates than the historical rates that we have here in our portfolio. So, as that turnover has been a bit slower given the lack of deliveries from automakers, the rate is not going up as much, and there's also the mix effect for each contract of fleet management and reflecting future purchases and cars commercial conditions to have a spread on the cost of debt. So it has to do with the portfolio turnover.

About the purchase price, that's already part of our strategy. The replenishment cost is something critical. We've been working with lowest levels in the industry pretty much half when you look at the difference in the sale price and replenishment price. That's why we are affected with the less -- with lower production volumes from the automakers. About the fleet -- about the book value of the fleet, we don't disclose that figure, but I'd say that we have a book value that's the lowest among the entire market and our sales prices is one of the highest sales prices in all of the market. So when you look at that ratio, it's highly positive compared to market price and prices that are booked.

Q - Regis Cardoso {BIO 20098524 <GO>}

Thank you, Rodrigo. Just a quick follow-up. In the theft theme also showed up or stood out in this quarter and last quarter, so there's a mismatch between fleet growth and/or the number of purchases in sales, right? So fleet is dropping more than what you would expect in purchase and sales. So I'd like to know if it's related to that effect that you mentioned.

And if you allow me, another follow-up about fleet management. More -- I was talking about more about volume than rate and that's related to the car price, car purchase price, because there's some repressed demand in fleet management, which is a market that from the start, let's you price cars more expensively and lower discounts and contracts.

But in the sequential comparison, there was no growth. Is that something a one-off for this quarter or will it continue?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

About theft, as I mentioned, there was a strong shortening in that role of recognition and has to do with that purchase and sale of the fleet. What you said is correct. About fleet, I thought you were focusing on the rate, apologize for that. So volume, it's the same logic. Since you have less deliveries from the automakers, you have a backlog like I mentioned of over 20,000 cars, and that may lead to a slower renewal not only affecting the rates but also the volumes.

A - Nora Lanari {BIO 18838335 <GO>}

I'd like to add Regis, the takeaway is, we by taking advantage of the Seminovos tailwinds, and accelerating the PIS and COFINS credit, we've invested in brand, technology, data, robustness of our team, and the new ecosystem.

So, what's important -- stood out here is theft, and maintenance includes licensing, vehicle tax and others. So, licensing is more expensive because of the car prices and same as fuel prices, but the main detractor there was theft. In the second quarter, we had an increase in theft partially explained by the increase in criminality, and also by reviewing the roller [ph] that still affects the third quarter. So we should see that number lowering as recovery and a normalized run rate. And we see the amount of theft dropping, but the important takeaway is company has been increasing in speeding up investments to expand its presence in ecosystem and it affects not only rental rates, fleet management and taking advantage of the good results of the Company and that tailwind from Seminovos.

About the book value, we've seen the comparisons in relation to the FIPE or Blue Book list in Brazil. What Rodrigo mentioned is that our book value is the lowest for two reasons because the lower price and purchase and a slower renewal of the fleet. When we compare the book value in the balance sheet to the car sold, we have an important advantage based on the replenishment cost of cars. As we mentioned at approximately 12,000, it's the most relevant effort from our history, but less having to consume less or burn less cash compared to other peers in the industry. That's important so that we can face a year where the interest rates are considerably increasing.

Q - Regis Cardoso {BIO 20098524 <GO>}

Great. Thank you, Rodrigo and Nora. Good morning to you all.

Operator

Our next question from Bruno Amorim, Goldman Sachs. Bruno?

Q - Bruno Amorim {BIO 17243832 <GO>}

Good morning. Can you hear me?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, we can.

Q - Bruno Amorim {BIO 17243832 <GO>}

Thank you, Nora. I have two questions. The first one is a follow-up about the purchase price, sale price, and the implication that that has for company profitability moving forward. Forgetting the short term, looking at 12-18 months when these cars that are being purchased now will be sold, we see an increase of 55% of the cars purchased year-over-year. Sold prices in -- of car sold increased 29 in the same period, when we look at the cap gap between purchased price and sold, it's BRL17,000 per car, it used to be BRL5,000, BRL6,000 per car in the past. So, first of all, I'd like to understand from you, if that doesn't imply that in 12 or 18 months, you're contracting much worse Seminovos margin and depreciation that when we were seeing before in 2019? That's the first question.

And the other is the scenario for racks specifically. Once again, imagining a post restrictive world in new car supply, imagining that in the next 12-18 months, new car sales will go back to normal so that you and your competition can put more cars into the market. Do you believe that you can grow in rack maintaining the current price levels that in a way are higher and rewarding the higher car prices or to go back to growth that you had in the past that you would have to have -- that the prices in the market would have to settle down a little?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Thank you, Bruno. So about replenishment cost, like we mentioned, it's an increase, it's BRL12,000 significantly lower than the market. That's why we've been extremely diligent in capital allocation. We know that the rental car business is very capital-intensive. Depreciation costs and the cost that we'll have in car resale highly affect the investment cycle and return cycle, that's why we were truly focused on cars with a lower total cost of ownership. And that's one of the reasons why we've been adopting the mentioned strategy. So, we can expect an increase in depreciation, yes, it could take a little longer depending on the dynamics of car supply restriction, its supply grow faster, depreciation will also grow faster with replenishment in those cars, otherwise we'll still see low depreciation compared to historical levels.

Same as for Seminovos margin, but that one has a lag, it takes a little longer to feel the effect. It only feels the effect, when the new cars purchased are decommissioned. So the first effect that we should start seeing is an increase in depreciation depending on the fleet renovation rate, to then talk about the drop in the Seminovos margins.

A - Nora Lanari {BIO 18838335 <GO>}

Bruno, I'd like to add to Rodrigo's comment. When you compare the price increase of 55% year-over-year of 30% for sale, it's worth mentioning that the auto makers had downtime even with the entry cars. So, you're comparing the price of one year ago and what you're bringing in today. So there is a mix effect in addition to what Rodrigo mentioned that we can't disregard it, so that the effect on the sale price will lag compared to the price of purchase. So, depreciation will increase as the cars that are 100% depreciated in our fleet, they will be sold and the new cars will have depreciation levels that I would call more back to normal.

Q - Bruno Amorim {BIO 17243832 <GO>}

Nora, just a follow-up to clarify. The number that we see here is impacted by the mix, but you mentioned BRL12,000 per car. I imagine that that's comparable already. Can you give us an idea of what that number was in the past so we can understand how much it got worse?

A - Nora Lanari {BIO 18838335 <GO>}

The 12 that we gave you is consolidated, Bruno, it's different than the 17, I don't know if you're separating rack and fleet to get to the 17. So we buy at BRL72,200 and selling at 60,500. So that's the 12,000 that I mentioned. In consolidated, we have some mix effect. So the first one, auto makers shut down, the ones that deliver the cars that are most sold in the country. So they were closed, and there's an effect of the 12,000 consolidated, there's also the Localiza Meoo affect, it's the subscription and is starting off with SUVs, which is what the market is telling us. SUVs compact, medium compact -- compact SUVs, medium-sized SUVs, and that's also part of the mix. I'm not sure if the math you did, you separated rack from fleet.

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

You had a question about the demand. In relation to the demand, we see that most segments are under penetrated. So, we believe that there's still a potential to grow in most, if not in all rent-a-car segments and fleet management. So, with the growth of the cost of acquisition, and interest rate, price transfers have already been occurring. But we still see a robust demand for those segments at those price levels. It's worth noting that when compared to the past, the rates are still highly competitive.

When we look at a scenario, not just one or two years, but we go back to five or six years, you'll see that today's rates are still competitive and that's why there's a latent demand in our rental -- fleet rental segments.

Q - Bruno Amorim {BIO 17243832 <GO>}

Yes, of course. Thank you.

Operator

Pedro Bruno, XP, next question from you. You can unmute.

Q - Pedro Bruno {BIO 19082978 <GO>}

Good morning, Nora. Can you hear me?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, we can.

Q - Pedro Bruno {BIO 19082978 <GO>}

Okay. Thank you for taking my question. I'd like to know about the recent announcement of Kozen [ph] entry in car rental segment and the joint venture with Porto Seguro. Can you comment on how you see any potential impacts to the industry separately by the three potential segments?

So, it's public about what they mentioned entering car subscription which is pretty obvious, as it already existed in Porto Seguro but potentially with fleet rental and then even rental cars. So could you comment about these three areas that would be interesting? And a second question about the same thing. Do you believe that these signs could be a confirmation of your claim that this market has a low barrier to enter? And even positive that could lead to a positive analysis from the Brazilian antitrust agency CADE?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Without a doubt, there is low barrier to entry and that movement does confirm that. So the industry, you can buy a car, the car is available to everyone. A service has a defined period and you don't have any barriers to enter, any new players. The market is growing that also attracts players and I believe that Kozen together with Porto Seguro reinforced this, reinforced that they have capital, they're well managed, we highly respect them as competition in the industry. And in the subscription cars, they should advance faster given the experience of Porto Seguro. It's still a market that's growing strongly. We believe that there're advantages there. So definitely, it's a market that they're going to be able to compete.

In fleet management, that would be a natural consequence of entering the market. It's a corporate market, it's more competitive, they should enter as well and become another competitor in the market that it's extremely disseminated among many players and still in profitability can support themselves. Rent-A-Car should be the last one, the last segment that they will enter. But they do have huge capillarity. So, they could also have the ability of entering in the rental car segment, confirming that there isn't barrier to entry when you're a big player like Kozen and Porto Seguro.

Q - Pedro Bruno {BIO 19082978 <GO>}

Okay, thank you.

A - Nora Lanari {BIO 18838335 <GO>}

We have a question from Anchor, an HSBC analyst. I'll translate it and we can answer it. Quite a resilient performance in the context of supply chain constraints. I have few questions. What was the reason for the sequential decline in the EBITDA margin for the car rental segment?

Second question. What is the reason for the higher tax rate in the quarter? And three, have you been able to retain the fleet mix amidst varying level of supply chain constraints faced by different automakers? And lastly, can you elaborate on the impact of the interest rate increase on Localiza from the perspective shift from car ownership to your subscription model?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Thank you, Anchor. So, the first question, when you exclude the non-recurring effects, especially of profit-sharing in other positions, we have a slight EBITDA margin increase that would reach 41% instead of the 37% in disregarding the tax credits, because then the margin was 66 %, which is strong quarter-over-quarter. So, if I consider all these items that were so to speak extraordinary, we're talking about a slightly higher margin. But as we mentioned, the main factor was the increase in criminal activities, in shortening that will of recognizing theft and which increases the expenses associated to theft. That's the main reason for margin. So even though it increased when you eliminate those aspects that I mentioned.

So income tax varies with the sale of Seminovos cars. You have book value that's depreciated, you can have a variation of income tax quarter-over-quarter, but there's nothing significant that we should expect for upcoming quarters. Even the point of view of cash, accelerated tax depreciation would help us in cash. It wouldn't affect the result, but a very positive effect based on cash in the income tax item. Our mix has changed to more premium cars, SUVs reflecting auto maker production. But within that context, I believe that we were able to sustain our mix closer to the original one, that's why our acquisition cost is much lower than the market.

When we look at interest rate, so we're talking about capital intensive business. The interest rate has an effect on the business, but does not have an effect on competitiveness. So, when you look at ownership versus rent, the interest rate part may even help us the spread start going up, the cost of having a car, and carrying that car goes up, not only for companies but also individuals, cost of financing for individuals goes even -- increases even more than the corporate cost. So, the interest rate increase, although it affects the business, it could actually increase the appealingness and the attractiveness of the rental solution instead of actually owning a car.

A - Nora Lanari {BIO 18838335 <GO>}

We have the next question from Rodrigo Faria from SulAmerica Investment which is very similar to the previous question. Could you talk about the vehicle purchase mix in this quarter compared to first quarter, second quarter? That's a mix effect. Rodrigo will talk about that and the total cost of ownership that's worth noting as well.

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

As I mentioned, the mix for this quarter was a more premium mix. So the auto makers where we have a higher share suffered a little more in this quarter and that said October was the best month in the year in relation to car receipt with some of our partner -- important partners coming back. That's why our mix for the third quarter was richer, more expensive with the share of not only SUVs, but large pickups compared to the first and second quarter. That explains a great part of the price variation that we had in the second quarter. But that said, we are also able to maintain a competitive mix in the market. Related to TCO, as Nora mentioned, we're highly focused in having a higher share and more competitive cars regardless of their entry price. Obviously, sometimes there is a relationship there, but not necessarily. So we're not only focused in having a higher percentage of SUVs or mainstream cars, but also having a higher percentage in cars that will have a higher return with lower depreciation and consequently more competitive Seminovos margin.

Operator

Next question, Victor Mizusaki from Bradesco. You can ask your question. I think Victor is having an issue with his audio, so I'm going to move on to Lucas Barbosa from Santander. Lucas, go ahead.

Q - Lucas Barbosa {BIO 20835372 <GO>}

Hi, Nora. Can you hear me?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, Lucas, we can. How are you doing?

Q - Lucas Barbosa {BIO 20835372 <GO>}

Good afternoon, Rodrigo, Nora and (inaudible). Congratulations on your results. I'd like to know about recognizing the PIS and COFINS credits. You recognized an amount that's higher than normal. But you have a positive effect on EBITDA that will shorten the term for the credits that you will recognize. You weren't able to use the entire credit because you had 48 to 60 months to recognize that, but now at 24 months, you're able to recognize a large part or if not the entire credit if you operate two years in rack which is less likely and that in a faster way and you can generate higher NPV. So my doubt is, how much an EBITDA can you generate recurringly moving forward looking at the operation removing that one-off? How much can you generate in EBITDA more because of that? You also mentioned the technical study of one part of the rack. Is there any other extraordinary recognitions that we can consider moving forward?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Well, that's very technical. Let me try to explain that and give you more clarity in relation to that. So we contracted a report by an entity that was registered with the federal -- Brazilian federal income tax service, and they considered 200 cars that were in rental car, but until February 28th, all cars in the company from up to February 28 were covered by this report. So, there are four effects that are more complex. The first one is on the 250,000 cars you have a retroactive credit since the beginning of the year. So, for each one of the cars individually, you'll ascertain how much the credit should have been then and how much we had.

And then you -- it's a one-off entry. In addition to the cars that weren't fully depreciated still of the 250,000, part of them were depreciated. You speed up the credit receipt once it was 1 over 48 and now it's 1 over 24. So, a large amount of those 250,000 cars aren't fully depreciated and on that amount you can speed up the recovery of PIS and COFINS credits until the 24th month.

In addition, the cars purchased after February could have the same benefit provided that we have new reports be it them cars that are already in our fleet or be them cars that we will buy in the future. If all cars that have been part of the report until today, we would have an additional recognition of BRL24 million, but they were being newer cars and most of that speeding up would come from the future before getting to the 24th month. In addition, you're speeding up tax depreciation, which leads to a high deferral in income tax and social contribution. You don't have an effect on the bottom-line. It's going to lower the book value in tax terms and then when you sell it, you'll recognize the tax. But you do have enough of relevant cash effect by deferring that portion.

Operator

Now, let's go on to Aline Gil from BTG. Aline, you can ask your question.

Q - Aline Gil

Hi, everyone. Good afternoon. Can you hear me?

A - Nora Lanari {BIO 18838335 <GO>}

Yes.

Q - Aline Gil

My question is about fleet growth. You mentioned that in October you had the best month in fleet supply and we saw news in the Valor Daily that ANFAVEA is talking about these problems in the auto maker's chain going up to 2023. So, can you give us some more flavor and expectation about fleet growth and renewal for the next quarters? Thank you.

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Thank you, Aline. In fact, the supply restriction should last. Nobody really has the exact date for that. Most believed that as of the second pass, we should have an improvement. That said, we always have to compare that in relative terms. One is historic levels coming back to normal. Another thing is an improvement in relation to what we've been seeing in the second and third quarter. The quarter was especially because of Malaysia that affected the semiconductor, it was the worst quarter in the year and that wasn't expected. The fourth quarter started off as a stronger quarter and we still expect restrictions, which shouldn't be a strong quarter yet, but we expect it to be the best quarter in the year in relation to renewal. For next year, the perspectives that the automakers are giving us are more positive, but still not in relation to the annuality that we had before the pandemic. So, we expect a gradual improvement, especially after the second half and completely normal in 2023.

A - Nora Lanari {BIO 18838335 <GO>}

Aline, to add, I think it's worth noting and we wrote that in the press release that in conversations with automakers, we have signs of different volumes than we had in 2021, that already guarantees growth for next year, and potentially some efforts to make our fleet younger. So, we would grow the fleet, make it younger and our escape valve would be how fast we can make the fleet younger, depending on the car supply for next year.

Q - Aline Gil

Okay, great. Thank you.

A - Nora Lanari {BIO 18838335 <GO>}

We have a question from Philippe from Citi. He talked about the mix. I think that was answered. A second one. How is the debt portion positioned which is not linked to the CDI? How have -- what is your strategy to allocate the debt in pre and post fixed rates? Has that strategy changed the company capital structure somehow?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Well, thank you, Philippe. Most of our debt is in CDI plus, I mean some sort of spread. When we contract debt that is not such as issuance of a debenture in PCA or debt in foreign currency, we swap it to transform it into CDI plus. There's a relatively small portion that's in CDI, very low 109% that if even lower than the yield that we are able to allocate our cash in the investments that we may make and that's the best hedging that we have. So, our debt is basically on the spread on the fixed CDI.

And in fleet management, as we price the contract with a duration of two, three or four years already locking in the spread, what we do is with derivatives, I can lock up that difference and transform my floating debt into pre. So my CD plus debt can be transformed into prefixed debt, which is exactly the interest rate that we use to price that contract in for the next two or three years. So the portion of the debt that's priced is actually hedging our contracts in fleet management. That means if interest rate goes up, we're hedged. And I can guarantee that spread and yield in fleet. It's not a change in strategy or capital structure because of that, that's always what we've done. But now that we're having a stronger interest rate rise, we've seen the derivative instruments playing their role and protecting or hedging that variation, that's why we have benefited in that short-term.

Operator

We have another question here from Rogerio Araujo from UBS. You can unmute.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Hi, everyone. Can you hear me?

A - Nora Lanari {BIO 18838335 <GO>}

Rogerio, your audio is choppy.

Q - Rogerio Araujo {BIO 17308156 <GO>}

How about now?

A - Nora Lanari {BIO 18838335 <GO>}

No Rogerio, sorry. If you don't mind, set it in the chat please. Victor, we received your question. We're going to read it. Do you want to try to unmute again? Otherwise, I'll read it here. So the change in ascertaining the PIS and COFINS credit has a relevant impact to profitability. What have you done for that change? Is there any risk that the revenue will understand the tax ascertainment in a different way?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

Well, first of all, what motivated us is the fact that our useful life for the car is not 48 months. So in rent a car or ride sharing, it's 48 months that it doesn't have an adequate useful life. If you're talking about cars that would have 250,000 kilometers and for those purposes. So what -- the reason for that was a technical matter.

About the revenue service, we looked -- we talked to an agency that's recommended by the IRS to assess the useful life of any property plant or equipment. So, it was conservative but it did come from a characteristic of the business because that car is not a car that was made to last 48 months and that's why according to the technical agency, they deemed that the useful life of the car in rental is 24 months. And that's what motivated getting the tax credits in 24 instead of 48 months. Obviously, they could challenge us on that but we are -- we do have the legal and tax grounds if they challenge us.

Q - Analyst

I have a follow-up, Rodrigo, about that. So for instance, I think it was in the second quarter, when the Supreme Court judged that and there was case law and a number of companies recognized it. In this specific case, it was no judgment, right, or a formal consultation with the IRS or an event that would give you the legal security to not have any issues with that?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

We based ourselves on Article 320 of the Income Tax Regulation. It sets forth the entity or agency that will tell you about the useful life of property, plant or equipment. So once again, based on the legal opinion, we have many -- we have the grounds to make that change.

Q - Analyst

Okay, great. Thank you.

A - Nora Lanari {BIO 18838335 <GO>}

We have a question. Rogerio, I'll get back to you. We have a question from Guilherme Mendace from J.P. Morgan. Supposing that there's the worst thing from the automakers, what's the limit of fleet age and use utilization that we would consider?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

We don't have a magic number or a limit. We're going to have to do the math in relation to car replenishment and extension of its useful life. What we're doing to preserve the quality of the experience of our customers is reinforcing maintenance protocols and changing, how we do that. And when you look at a car with 30,000, 40,000 kilometers, it's not necessarily an old car. A well cared for car can remain in the fleet for a pretty long period. Obviously, there's no limit or special number that we can mention. And in addition, it's important to note that there are different limits depending on the segment. So a ride-sharing driver for instance is already using and already buys used cars with over 60,000 kilometers on it. So if I offer them a 40,000, 45,000 kilometer car, that's actually positive in their opinion.

What might be a little different when you have a premium agency, right, or branch. So we're very much aware of those limits, not only for the global fleet but also individually for each segment, in relation to perception of value and perception of quality that that specific customer has.

With that Guilherme, we've been able to maintain the NPS per segment at excellent levels. Let's try to go back to Rogerio. Can we hear your question, Rogerio? Let's try.

Q - Rogerio Araujo {BIO 17308156 <GO>}

Is it better now?

A - Nora Lanari {BIO 18838335 <GO>}

No, still not good, Rogerio. Well, we have your question in the chat. Let me read it. So, the expectations of the spread of purchase and sale of course to that change. So price -- sales and purchase price expectations are still the same? And second question. What part for (inaudible) did you consider the accelerated depreciation? What would be an ideal assumption on that?

A - Rodrigo Tavares Goncalves de Sousa {BIO 21760011 <GO>}

The spread expectations of purchase and sale considering a restriction scenario are actually tougher negotiations. So, when you look at the replenishment cost, you expect a higher depreciation than what we see today, without a doubt. About the rack percentage, as I mentioned, there were 203,000 cars that were part of that report versus the current fleet.

Once again, by understanding the technical side, we'll request reports for the cars that are currently in the fleet and for future cars as well. That will enter the portfolio. So, I can't say -- can't mention the percentage because these reports are individually drafted from that competent agency to confirm the useful life for the new cars that will enter the Localiza portfolio and defined according to license fleet. Don't forget that 203,000 cars of the first report, it's accelerated for the ones that weren't completely depreciated.

A - Nora Lanari {BIO 18838335 <GO>}

Rogerio, about your first question about the spread of purchase and sale cars, compared to pre-COVID, yes, it did change. We're in a context where the restriction of inputs added to the exchange rate evaluation affected new car prices. So, when you look at the history, the company used to sell a car at approximately 104% of the purchase price. And then there's the cost -- sales expenses and depreciation. And now the spread is much more positive because not only lower depreciation but also an EBITDA and Seminovos higher-margin. It should come back to normal at some time, but we still have FX pressure and inputs pressures, so it's really hard to be accurate when these levels would go back to normal of the 104%, 105% that depends on future car price increases and future negotiations as Rodrigo mentioned.

I think that was our last question in the chat. So with that the Localiza conference call is now over. The IR team and Rodrigo, we are at your disposition available for you, if you have any additional questions. Good afternoon, everyone.