Q4 2012 Earnings Call

Company Participants

- Nora Lanari, a
- Roberto Mendes, a

Other Participants

- Augusto Ensiki, Analyst
- Murillo Feiburg, Analyst

Presentation

Operator

Good morning. Welcome to the Fourth Quarter and the full year, 2012 conference call of Localiza Rent-a-Car. Hosting the event today are Mr. Roberto Mendes, Chief Financial Officer and Nora Lanari, Investor Relations.

We would like to inform that the numbers in this presentation are stated in the millions of Brazilian reals and based on the US GAAP until 2010 and based on the IFRS from 2011 on.

The presentation will be recorded and all participanst will only be able to listen to the conference call during the Company's presentation. Immediately afterwards we will start the Q&A session for analyst, investors when further instructions will be provided. (Operator Instructions)

The audio of the conference call and accompanying slides presentation are being broadcasted simultaneously over to the internet at the address, www.localiza.com/ir. The slide presentation can be downloaded at the same address by clicking on the banner 4Q '12 and 2012 webcast.

Before proceeding, we would like to clarify that any statements made in this conference call concerning the business outlook of the Company, forecasts and operating and financial targets represent the opinion and assumptions of the Company's management, which may or may not occur. Investors must comprehend the economic conditions and other operating factors may affect the Company's future and may lead to results materially different from those stated in this call.

I would like now to turn the presentation over to Mr. Roberto who will begin the presentation. Please, Mr. Roberto, you may now begin.

Roberto Mendes {BIO 7289124 <GO>}

Good afternoon, everyone, and thanks for attending our conference call.

2012 was a challenging year for Brazil. Economic activities grew at a lower stage and GDP presented a growth far below the 3% expected in the beginning of the last year. (Measuring), the commitment by the government were still not able to leverage the GDP.

Living in this depressed scenario, the (the curve) representing a grow of 8.5% in net revenues. The 7% reduction in IPI tax for new cars has reflected in the value of the cars sold. There were organized BRL144.5 million as additional depreciation in 2012. It is worth mentioning that the impact was (nail) through in cash generation. In fact, cash generation was record in 2012 and we reduced our net debt by 10%.

The Company has (stand in) 2012 a strong year to take advantage of the new rules opportunity. The expectation for 2013 is more favorable and will enable us to take advantage of getting our scale in our build platform. To present the First Quarter and two years results I will turn the floor to Nora. Please, Nora?

Nora Lanari {BIO 18838335 <GO>}

Good afternoon, everyone, and thank you for attending our conference. On slide number two, we present some highlights of the Fourth Quarter 2012. Car rental division posted a growth of 8.9% in net revenue while the fleet rental division grew 13%. Net income increased by 9.4% even with the additional depreciation effect after the ITI tax exemption still impacting the quarter.

The Company also presented a record free cash flow before growth in the amount of BRL528.5 million, representing a 27.2% growth.

On slide number three, we present the growth evolution of the car rental division. In 2012, rental volume grew 7.5%. Net revenue presented a growth of 11.5%, mainly due to the growth in rental volumes, some to the increase of 3.4% in the average rental rate.

The low level of growth of Brazilian economic activity reflected in a softer growth in the business volume of the car rental division. Markets expect GDP to resume a higher level of growth in 2013, driven by infrastructure investments.

On the next slide, slide number four, we present our partnership signed with GOL Linhas Aereas Inteligentes. Last week, Localiza announced the beginning of a partnership with GOL that will make possible to book a car rental during the process of buying an air ticket through GOL's websites.

In the first nine months of 2012, GOL transported roughly 30 million passengers that usually book their air ticket through their website. The Company expects that the gains of scales from the additional volume of car rentals from individuals should offset the discounts offered to those clients, once that should not have any increase in the cost of rental locations and call center of Localiza.

On the next slide, slide number five, we present the evolution in the number of rental locations. In 2012, 25 rental locations were added to Brazilian network that is now comprised of 474 locations. Moreover, Localiza operates 50 branches in other eight countries in South America, including the beginning of operations in Chile.

In the next slide, number six, we present the utilization rate in the car rental division. Utilization rate of the fleet rental -- of the fleet in this division increased by 1.9percentage points when compared to 2011, reaching 70.8% in 2012. The Improvement in productivity allows a growth of 8.7% in rental volumes with the end of period (six) actually stable.

On the next slide, slide number seven, we present the volumes and revenues of the fleet rental division. Year to date, net revenues in this division grew 17.7%, due to the growth of 10.4% in business volume and 5.7% in average rental rate. In the quarter, net revenue posted a growth of 13%.

In slide number eight, we present the fleet's net investment evolution. In the Fourth Quarter 2012, fleet was increased by 4,132 cars, 17,896 cars were bought and 13,764 were sold, resulting in a net investment of BRL131.8 million. In the year, fleet was increased by 2011 cars.

In 2012, the purchases were reduced by 2.2% when compared to last year. After the IPI tax cuts for new cars, demand increased with (inaudible) (in terms) of OEMS. With lower inventories, the delivery of cars were delayed, impacting in the number of cars the commission for fleet renewals. In spite of more modest used car sales volume, the age of cars sold from the car rental division was reduced from 15.8 months in the Third Quarter 2012 to 15.3 months in the Fourth Quarter that year.

On slide number nine, we present end of period fleet. Localiza ended 2012 with 97,190 cars, a growth of 0.9% when compared to 2012. Including franchisee fleet in Brazil and abroad, fleets total 111,735 cars.

Slide number 10 presents the evolution of SemiNovos store. Used car sales network supports the business model of the Company, allowing direct sales to define a consumer thus generating cash for fleet renewals. In 2012, 11 stores were opened, and four stores were closed with a net addition of seven stores.

On slide number 11, we present consolidated net revenues evolution. In the year, the growth of 8.5% in consolidated net revenues derived from the increase of 13.6% in the rental revenues while SemiNovos revenues had grown 3.5%. 11.6% growth in the number of cars sold was partially offset by the drop in the used car prices, a result of the IPI exemption for new cars.

The 3% growth in net revenues in the Fourth Quarter derived from the growth of 10.3% in the car and fleet rental revenues, partially offset by a decrease of 4.6% in SemiNovos' revenues, due to the delays from the OEMs on delivering new cars which impacted the number of used cars sold in the period. The used car sales net revenue were also impacted by a decrease in the average price of cars sold as a result of the IPI tax exemption as mentioned before.

On slide number 12, we present the EBITDA evolution. EBITDA grew 6.6% in 2012 and 3.7% in the Fourth Quarter 2012. In the year, car rental division EBITDA margin was impacted by the increase of the cost of minor value accessories that are now being expensed directly in the rental cost line. Up to 2011, these amounts was accounted in the fixed assets and appreciated throughout the useful life of the car.

Moreover, the EBITDA margin was also pressured by the increasing cost and expenses with personal and property rentals, which were not offset by operational average in a year of a more modest pace of growth.

Is it worth mentioning that in the Third Quarter of last year, BRL10.6 million in provisions were reversed positively impacting the margins in EBITDA in a comparative of the year.

In the fleet rental division, the EBITDA margin was practically stable in the year with slight improvement in the Fourth Quarter when compared to Fourth Quarter 2011, excluding the accessories effect.

The SemiNovos EBITDA margin above 3% reflects the conservative position of the Company in depreciation costs, which are based on the estimated residual value of the cars at the end of its useful life, net of selling expenses.

For comparison purposes, the table in this slide presents the pro forma EBITDA margin, considering the accounting of those accessories in the rental cost line for the previous years and excluding the reversal of the BRL10.6 million provision in 2011.

Let us now move to slide number 13, where we present the addition of depreciation accounted through the year. Fleet depreciation was adjusted after the announcement of the IPI tax exemption on May 2012, to reflect this taxation of a lower residual value for the cars. From a total adjustment of BRL180 million to be accounted as additional depreciation, BRL144.5 million were already recognized.

In the Fourth Quarter 2012, BRL14.8 million was accounted as additional depreciation, being BRL6.2 million in the car rental division and BRL7.6 million in the fleet rental division.

On slide number 14, we present the evolution of depreciation in the car and fleet rental division. In 2012, average depreciation for car in the car rental division was of BRL3,972, this is impact of the tax cut. In the last quarter of the year, average depreciation had already been reduced to BRL2,044, as most of the fleet was already renewed.

In the fleet rental division, average depreciation per car totaled BRL5,408 in the new year. In the last quarter, average annualized depreciation per car was of BRL4,996. In this division the effect of the additional depreciation is lower due to the fact that the additional depreciation is recognized to follow the useful life of the cars, tied to contracts ranging from two up to four years.

On slide 15, we may see that the depreciation of the cars bought after the IPI reduction in the car rental division is up BRL1,317, in line with the previous years. 61% of the current fleet on this division is comprised of cars bought after the IPI tax cut.

On slide number 16, we present a net income evolution. The drop of 17.4% in net income of the year, derived mainly from the increase in fleet depreciation by BRL175 million, mainly due to a 6% increase in the average operating fleet and the accounting of BRL144 million as additional depreciation after IPI reduction.

The increase of the depreciation was partially offset by the increase of BRL54.3 million in EBITDA and the reduction of the financial expenses by BRL40.3 million due to the lower interest basic rate and the reduction of our net debt. Excluding the effect of the additional depreciation, net income in 2012 would have reached 30 -- BRL336.3 million, a 15.3% growth.

Now, let us talk about the cash generation, which is shown in slide number 17. In 2012, Localiza presented a record free cash flow of BRL356.1 million. In spite of impacting the full year net income, the reduction in the used car price due to the IPI tax cut has neutral effect on the CapEx for renewing the fleet.

On slide number 18, we present the change in 2012 debt. After a year of strong cash generation, net debt was reduced by BRL132.2 million, or 9.7% reduction.

On slide number 19, we present debt profile on December 31st. Company is still presenting strong cash position and comfortable debt profile.

Next slide, slide number 20, we present debt ratios which reflect the financial discipline of the Company. Localiza present improvements (north) of our ratios and it is prepared for the next chance of growth.

In slide number 21, we present the spread between ROIC and the cost of debt after tax. The reduction of the basic interest rate allow the Company to present a spread of 9.8percentage points, even with a lower EBITDA margin in the car rental division.

Let us now move to the Q&A session.

Questions And Answers

Operator

Excuse me, ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) And our first question comes from Mr. Augusto Ensiki with Morgan Stanley.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi, Nora. Good morning. First question is regarding your depreciation rate. Is the -- looking for this year, is the Fourth Quarter average depreciation per car, rather the decrease what you see now in terms of a larger percentage of your cars with the IPI reduction in it, is that what we should expect for most of this year going forward?

A - Nora Lanari {BIO 18838335 <GO>}

Thank you, Augusto, for participating and thank you for your question. The depreciation we see in the Fourth Quarter is probably at the level you should expect going forward. As a matter of fact, it is similar to the previous year, 2010 and 2011 and should remain in this level.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Is that -- well is it -- when you say the (foresee) rate, is this the BRL2,044 or the lower one, the BRL1,317?

A - Nora Lanari {BIO 18838335 <GO>}

Yes. The BRL1,317 is more of the expectation going forward.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, so that's the good rate. And has the situation with the car manufacturers normalized? I mean you said that delays at the OEMs were what was preventing you from renewing your fleet more aggressively, but are they now able to deliver the cars that you need?

A - Nora Lanari {BIO 18838335 <GO>}

I -- not in January. January, they still had inventory without the IPI tax or with the IPI tax reduction, so we saw a record month in terms of new car sales being January. We believe that this inventory -- or the inventory of the OEMs should normalize -- second and third months of the year, especially because of the coming back of the IPI. That may affect the demands for cars in the short term.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, so then for -- so then for the First Quarter, still we should expect for you guys another month of maybe lower used car sales?

A - Nora Lanari {BIO 18838335 <GO>}

Yes, especially considering January. Let's see how fast OEMs will be able to improve their inventories and how will that translate in more deliveries in February and March, but so far we are seeing a low pace on the deliveries.

A - Roberto Mendes {BIO 7289124 <GO>}

(Eduardo) -- Augusto, just to --.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi.

A - Roberto Mendes {BIO 7289124 <GO>}

Just to (inaudible) that we in this quarter, we expect to reduce some cars -- usually we do not buy car in the First Quarter of the year, but this year will be different because you need to -- to the cars to (inaudible) the quarter, the renew -- the pace -- to renew the (plate). So we do not think it will be a problem this year in 2013.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. Great. And thank you very much, I'll let other people ask questions too.

Operator

(Operator Instructions) And our next question comes from Mr. Augusto Ensiki, with Morgan Stanley.

Q - Augusto Ensiki {BIO 15988025 <GO>}

A couple more questions, if you don't mind. The first one, regarding the EBITDA margins of the car rental division. You say that the summarizing costs -- summarizing operating costs are the result of that decline sequentially. So does that mean that looking forward as well, that normalized -- let's say a normalized rate -- a normalized EBITDA rate for car rentals should be more in line with the 40% instead of the 42% to 43% we've seen in the past?

A - Nora Lanari {BIO 18838335 <GO>}

Augusto, what we find back in 2012 was cost growing above inflation and we were not passing anything to prices. Since 2012 was a soft year in terms of growth, we haven't seen some pressures in our EBITDA margins. For 2013, we expected a more -- a stronger pace of growth, which it might help to take up some of those pressures. Okay? In terms of the EBITDA margins.

On the other hand, we will have the benefit of a lower interest rate that should help us to maintain the spread stable at that level.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. What -- I'm sorry, last question, what GDP rate are you guys working with internally for this year?

A - Nora Lanari {BIO 18838335 <GO>}

We need the GDP forecast for 2013 of roughly 3%.

Q - Augusto Ensiki {BIO 15988025 <GO>}

3%. Great. Okay. Thank you very much.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you.

Operator

And our next question comes from Mr. (Murillo Feiburg), Merrill Lynch.

Q - Murillo Feiburg

Hi, Nora, Roberto. Just a follow up from the previous questions. Regarding the margins on the car rental division that were compressed in this year due to lower scale and all the issues -- and account of the issue that we already discussed. What do you think that is going to be the normalized level for car rental and fleet rental, EBITDA margins for 2013 and onwards? And if you think that another fleet, given the fact that the Company didn't renew its fleet in 2012 properly, could also pressure margins in the long term? Just these two questions.

A - Nora Lanari {BIO 18838335 <GO>}

Starting from the last question, Murillo, thank you for those questions. We do not believe that the delays under renewal should put more pressure on the EBITDA margin, especially because of the fact that the age of the cars being sold actually decreased in the Fourth Quarter. So we were talking about a 15.8 month average age of cars sold in the Third Quarter, and now we are looking for a number of 15.3, okay? So it's not a matter of demand, demand is really hot, is a matter of good delivery.

We believe that as soon as this normalizes, the deliveries and the inventory of OEMs normalized, we will be able to maintain a very healthy pace of fleet renewals.

On regards to your other question on the EBITDA margin, we do not have a policy of giving any guidance, but as (mentioned to our) (inaudible) we might see it will lower pace of growth, less pressure than our EBITDA margin in 2013 when compared to the average of 2012. Okay? So we might see some good signs on that on -- and mostly because of the pace of growth.

Some of the costs that impact 2012 EBITDA margin should now grow more in line with inflation and not above inflation as we saw, for instance, the property -- the real estate rental cost. Okay? So we believe this should help us to take some of the pressures in the EBITDA margin that we saw in 2012.

Q - Murillo Feiburg

Thank you, Nora, very clear. Just one final question. Your fleet rental unit is performing really well in terms of top line growth and margins resilience. Do you think that maybe in 2013 we may see some scenario that is a little bit different with car rental growth increasing and the fleet rental growth accelerating? Or do you think that probably the fleet rental will maintain the same pace that we saw on 2012?

A - Nora Lanari {BIO 18838335 <GO>}

Murillo, we haven't seen any new changes on the competitive environment, different from what you saw throughout 2012. Of course, in the last three or four years, we presented a very strong growth in the fleet rental division, which usually grows in a pace lower than car rental division, because there are less entrants for years in this division. So we should go back to the more normalized pace of growth, as you started to see already by the end of 2012.

A - Roberto Mendes {BIO 7289124 <GO>}

Murillo, I'd like to add, that in -- last year, 2012, we saw a growth in the average rating but for this year, 2013, we believe it is not possible to see it again because the interest much lower this year. So (inaudible) we can see something in the same leverage -- but in the same level, but in rate in revenues, you do not expect a growth in the rate, in the average rate. Okay?

A - Nora Lanari {BIO 18838335 <GO>}

Just to remind you, Murilo, that the contracts of fleet rental are adjusting according to inflation, but the new contracts should be priced at a lower level, because now we have a lower interest rate.

Q - Murillo Feiburg

Sure, thank you very much for the answers Nora and Roberto.

A - Nora Lanari {BIO 18838335 <GO>}

Thank you.

Operator

(Operator Instructions) Excuse me, this concludes today's question-and-answer session. I would like to invite Ms. Nora Lanari to proceed with her closing statements. Please go ahead.

A - Nora Lanari {BIO 18838335 <GO>}

We would like to thank you all for participating in our conference and to inform that our IR team is available for any further queries. Thank you, all.

Operator

That does conclude the Localiza Rent-a-Car's audio conference for today. Thank you very much for your participation and have a good day.