Q4 2014 Earnings Call

Company Participants

- Jose Carlos Wollenweber Filho, Chief Financial Officer
- Luis Fernando Memoria Porto, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Unidentified Participant

Presentation

Operator

Good afternoon. Welcome to the Conference Call of Locamerica where the earnings release will be presented for the fourth quarter of 2014. Right now, our respondents are connected in listen-only mode. And later on the Q&A session will be open, when further instructions will be given.

In this quarter Locamerica will make some room, so that people from the press can ask questions after the market analysts. (Operator Instructions) This call is being simultaneously translated into English and questions could be asked normally by those who are attending from abroad. You can also ask questions on the webcast platform. Please be remind that this call is being recorded. The audio file will be available at the company website within 24 hours.

If you don't have the release copy of Locamerica, you can access the website of the company www.locamerica.com.br/ir and get the file. This conference call, as well as the slides are being webcast simultaneously at the company's website. Before proceeding, I would like to make sure you understand that any statements made during this call regarding the company's business, projections, operating and financial goals regarding its potential for growth are assumptions based on the company's expectation.

Such expectations depends on the performance of the industry, as well as the overall economic performance of the country and international and domestic market conditions and therefore, are subject to change.

Today with us, we have Luis Fernando Porto, CEO and Carlos Wollenweber, Financial officer and Investor Relations Officer. Now I would like to pass the floor to Luis Fernando Porto. Mr. Porto, you may proceed.

Luis Fernando Memoria Porto {BIO 17590082 <GO>}

Thank you. Good morning, everyone. It's a great pleasure to present today the operating and financial results of Locamerica and the fourth quarter and full year of 2014. Before talking about our results, I would like to briefly highlight some trends in the industry scenario observed during the year of 2014.

On slide number three, we showed that funds release to finance vehicles for individuals added up to BRL95.4 billion in 2014, a slight increase of 2.6% when compared to the previous year, but they represent as slow down when compared to the annual high of 3.6% seen in the first half of 2014.

On the chart, on the right, we see a steep drop of 14.7% in the production of passenger and light commercial vehicles in Brazil in 2014, as well as the significant reduction of exports from -- of 41.6%. Nevertheless, the inventory of vehicles remain high at 38 days of sale in January above the ideal figure of 30 to 35 days.

On the next slide, the sales of new cars have dropped by 6.9% in 2014, while sales of used cars have increased by 6.5% in the same period. As we already mentioned in previous reports this migration of demand from new cars to used cars can be explained by four main factors. The high spread between the price of new cars and used cars. Two, the return of IPI tax on industrialized products for cars, new cars. Three, the reduction of economic activity with a consequent decrease in the confidence level of consumers.

And finally, financing -- restricted finance for vehicles. On the chart, on the right, we see a new larger spread in the price of cars versus used versus new cars, which results an increase in the price of new cars by 4.6% in 2014, versus a drop of 2.1% for used cars in the same period. We are now show our performance, operating performance.

On slide six on the left, we see the overall value of new rental agreements signed in the fourth quarter of 2014, which remain quite robust. Totaling BRL88 million. While on the chart on the right, the commercial pipelines for the next three months said at more than 25,000 cars in dispute, against 22,000 in the fourth quarter of 2013. Which means in outsourcing market for fleet to access this fight, the challenging macroeconomic scenario.

In the next slide, we highlight an important gain and efficiency, which was the increase of the utilization rate to 95.3% in the fourth quarter of 2014 versus 94.5% in the same period of the previous year. On the chart, on the right, we see the average rate of operating fleet which ended the year at 16.9 months, 2.2 months below the 19.1 month of the fourth quarter 2013. And this is the lowest level in the last two years.

On slide eight, we show the fleet breakdown which ended the quarter with 30,424 cars. A growth of 7.6% when compared to 4Q '13. The operating fleet has grown by 4.8% when compared to the same period of the previous year, while the number of cars in deployment, which are the cars that are about to be included in the operating fleet grew by 33% to 3,505 cars.

On the chart, on the right, we see the inventory of cars for sale which reached 3,735 units, equivalent to 12.3% of our total fleet. This temporary increase in the inventory level is a result of the concentration of agreement we know there and therefore, the substitution of the fleet. This was already expected by the administration given the resilience of used car market and the open of two new retail stores in 2015. We expect a gradual return of inventory levels to historical levels in the future quarters.

I would now like to pass the floor to CFO -- our CFO, Carlos Wollenweber who will present the financial highlights.

Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Good morning everyone. Moving on to slide number 10, we would like to highlight the evolution of our rental net income. In the fourth quarter of 2014, we -- our revenue was 101 million, a growth of 25% in comparison to the same period in the previous year. This is a result of an increase of the monthly average rate, which increased 10% year-to-year and the growth of our rented fleet shown on the graph by the average number of days, which grew 13% year-on-year.

For the full year, our revenue was 374 million, 16% higher than 2013. The next slide shows our income as well as the used car results. In the fourth quarter of 2014 we showed net revenue for used cars of 76.8 million, a growth of 30% in comparison to the same period in the previous year. For the full year, our revenue was 255 million, a 17% growth in comparison to the previous year. It's important to highlight that our gross income and the segment was very close to breakeven in comparison to a loss of 4.5 million we suffered in 2013. The gross margin for used cars should continue to expand, reflecting an increase in the sales mix on the retail side and the resilience of expected demand for used vehicle for 2015.

Retail sales represented 29% of our total sales in comparison to 15% in 2013. In 2014, we opened two new stores and we currently have six-owned stores on the retail side. In 2015, we expect to open two additional stores and our goal is to increase the percentage of sales on the retail side to 50% on the next two years.

On slide 12, we have our EBITDA and EBIT results. For the fourth quarter of 2014 our EBITDA results was 55 million, 55% above the same for the fourth quarter in 2013. For the full year it was 201 million, a growth of 23%. Our EBITDA margin for the full year was 53.7%, an increase of 3.2%. For the fourth quarter it was 31.5 million, 87% higher than in the fourth quarter of 2013. For the full year, our EBIT results was 117 million, a growth of 34%. Our consolidated EBIT margin was 31.2% representing a 4.2% growth.

The next slide shows our net income and ROE. Our net book income was BRL25 million. However, if we disregard one-off expenses for the third quarter, our net income was 27.4%, a growth of 69% in comparison to 2013 which reflected a ROE of about 9%. On slide 14, we have our debt profile. Only 4% of our debt is short-term and we don't have any need to refinance the debt for 2015. Debt duration is currently at 4.3 years and we can see on the following slide, a substantial improvement in cost and collateral toward that.

Our average weighted debt cost for the fourth quarter was 1.7% year-on-year, and only 20% of our fleet was collateral for loans. And I would now like to open for questions-and-answers.

Questions And Answers

Operator

Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) I would like to remind you that journalists can ask questions shortly after we end the Q&A session with the market analysts. (Operator Instructions) Good morning. We have a question from (inaudible) about when we expect to reach 50% of our sales of used cars at the retail channel.

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

Well, three years ago we have started this project to create this new channel. We now reached 30% in 2014, and with the new -- two new stores being opened and the consolidation of the other stores we have open in 2014. Usually a store like that takes 6 to 12 months to mature depending on the market and region where it's located. And so as the stores become mature, the stores in 2014 -- overall opened in 2014 plus the stores that will be opened in 2015. We plan to advance another 5%, so 35% of our sales will come from the retail channel. And up to 26 -- 17 maximum we aim to reach 50% of sales from the retail channel.

Operator

Have another question asked online by Mr. Pedro Boucherie [ph]. And he is asking what the estimated impact of the IPI tax to the company's fleet in the first quarter.

A - Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Pedro, thank you for your question. For the first quarter our expectation is not yet to feel any changes from that sense. What we have been realizing is that there were -- there was an increase on the car prices, but since there is a low demand the price that's actually been used on used car stores still does not reflect a significant increase. So we are being more conservative right now as we have been last year to start our plans for 2015.

We are considering the price of used cars as a flat rate, we're not adding any values to that due to the IPI increase. Although doubtlessly if the increase is confirmed over the next month we can change and improve our prices for sales. But for now, we haven't been feeling that yet, it's still a sensitive moment for the new car industry. So we prefer to wait for some more time to see how the market dynamic will change. The good news is that since -- well, as we talked to a car manufacturers, our feeling with them on the actions that we will take have been showing that the most reasonable measure right now would be to reduced production. And not to reduce prices or anything like that. So for now the impact will be zero. And that is due to all of the reasons I've described here.

Q - Unidentified Participant

Thank you. And my warm greetings.

Operator

Additional question from Rodrigo Gularte [ph].

Q - Unidentified Participant

Question is, the company expects to reduce the leverage this year, what leverage levels that you proceed?

A - Unidentified Speaker

Thank you for the question. And before I answer it -- delve into that subject, I would like to just mention a very relevant topic for our business, which is investing and renewing and expanding the fleet. Our average fleet for the last three years in order to be positioned with a high percentage of sales on the retail channel.

Let us to change our fleet mix. So we went from a construction of popular low-end vehicles, being more seriously used to a fleet directed for sectors that used average two executive cars, then this was done over the last three years. It demanded a net CapEx which was much higher, because when you have to change a popular car contract, you have to compliment from the CapEx of a popular car plus the difference of a different mix, whether it is for an average size for a pickup truck for an executive car.

So demanded larger CapEx over the last few years and this has been concluded now in 2014 with a slight part left over for 2015. Once this is finished our CapEx for fleet renewal will be much lower than what we had over the last three years. You will proceed that from now quarter to quarter our leverage cost will be reduced. Our target is to come close to 2.5 and to be stable for the next years and we will expect a significant reduction of the leverage levels for 2015.

More importantly, we -- since our cash generation and just going back to free cash flow. For the first time since the IPO the company expect that in 2015 we will be able to have a positive cash flow which means that our cash generation will pay for all our expenses, debt and also an investment for the fleet which will be met in 2015. This means we'll reduce the needs to capture resources and we'll have an improvement in our margins. So the leverage should drop to a level under three or something closer to our target which is 2.5. Thank you for your question.

Operator

We have another question. The question is, what is the trend for the prices of new cars and used car for 2015?

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

Well. What we expect right now is to see more clear positioning of the brand new cars industry. As I said in the previous -- in the response to the previous question. OEM manufacturers, they don't have much room to decrease the prices of cars, we don't see the government willing to reduce the IPI on cars again. And so, we will have new car prices stabilize or going up more or likely to remain stable, and if that happened, the dynamic of the market would be for used cars to remain stable as well, accompanying the prices of new cars. The trend for new car prices.

So, this decrease that happen in the first and second month of the year for the prices of brand new cars was quite fleet [ph]. And according to our observations, the price drops in March will be the same or even higher. So we expect prices of used cars and new cars to remain stable throughout 2015.

Operator

There is another question.

Q - Unidentified Participant

With the increase in interest rates, is the company comfortable in transferring the increase in cost to the contractor agreements.

A - Unidentified Speaker

The answer is, yes. In our case, we have a pricing committee that realigns cost [ph] on a monthly basis. So we implement the cost that we are having at the moment, and all of that is transferred to our pricing tables. That doesn't necessarily mean a price increase because we may have cost that are increasing, another they have been reduced. However, the increase in interest rate was quite high and obviously we are transferring that to cost since the first increase in interest rates until the one that was most recent. Yes, we do transfer that to the agreements. It's impossible to seek a good return and improvement on margin. If you don't closely monitor costs and transfer to our pricing tables such increase in interest rate.

Operator

We have another question.

Q - Unidentified Participant

Which is, please elaborate on the margin for this year, given the economic activity scenario.

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

Well. What we expect from our margins for 2015 is an improvement. Locamerica has three main cost centers that are very clear.

The first one is depreciation. And as we have seen and explain in the previous question, we think that the prices of cars will remain stable for new cars, as well as the used cars, which gives us -- in this cost center a scenario of greater stability than when compared to 2014. As for interest rates, we had a very high, very big high in interest rates -- when compared to 2014, and that could have a significant impact on our business.

However, we have a hedging policy that's been implemented since 2013. And our debt is hedged which decreases such impact on our figures. However, when you compare this year to 2014 financial expenses will be higher, although as you have seen in our presentation this spread is lower. It's impossible with such an increase in (inaudible) interest rate to support the stable cost, but we are ready for this and the impact is within what we expected in our budget.

And finally, we have operating and administrative cost centers. And then, since 2013 the company has been reducing these two costs. In administrative area, we did several internal restructuring, we invested in assets in restructuring have improved our delivery terms, sales terms and everything is giving us a better competitiveness, as well as a strong reduction in SG&A. In terms of operations, all the investments we have made in 2013 and 2014, as well as our efforts they will remain in 2015. We are obtaining an important reduction in operating costs. So given this cost scenario, and the revenue that has possibility of growing.

We believe that we'll be able to deliver better margins throughout 2015 despite the unfavorable macroeconomic scenario that is becoming worse every day. But it's still early to say so, so far these are our expectations for the year. And so far we have not had many surprises when compared to what we expected. This crisis was something everybody knew about and was talking about it. We're just waiting for about when it would happen and the size of it, let's say, it's a bit bigger than what we all expected, but not much different from what everyone was discussing. So as I said, we are prepared, we are much more cautious, but all our pillars are under control, and we haven't had any major surprises so far despite all the changes and macroeconomic effect that we are experiencing in the country.

Q - Unidentified Participant

More questions about when the company expects to have a positive operational cash generation. And, because it has been lower and the leverage levels have been increasing.

A - Unidentified Speaker

Well. We've answered this already. We have been changing our mix which demanded a higher net CapEx for those migrations. This has been concluded and in 2015 we already expect to have a positive cash flow generation with a significant reduction on our leverage. This is our perspective for the year.

Q - Unidentified Participant

Well. We have two more questions, related to the competitive scenario and our strategy on focusing on smaller, more profitable contracts. Talk a bit about competition?

A - Unidentified Speaker

Historically, when we have difficult macroeconomic scenario, such as the one we're going through right now. It's very difficult for a smaller and medium sized competitors to compete due to a natural restriction that banks have for these players. Therefore, our expectation is that 50% of the market, 40% to 50% of the market which faces this competition should have a rougher time than average and larger companies like. So we expect that the competitive scenario will be the same as 2014.

Q - Unidentified Participant

And why is that? Well. If this market is less aggressive then why is it the same?

A - Unidentified Speaker

It's the same, because now we have five to six medium to large players, which as we understand are ready to grow and take the opportunities that the market is providing. So we expect this to be a stable markets just like last year and we also expect that for the next few months, we'll be able to monitor those factors a bit more closely. But our expectation is that the market will continue to be stable as it was in 2014, not as aggressive in 2012 and '13, but it won't be much better than what we went through in 2014.

On our strategy. We have a strategy of dissemination, in -- sorry, few years ago we were able to double our portfolio without losing our major clients. The main idea was to spread clients -- spread between clients and sectors which would make us more comfortable in case any focus problem should arise for a major sector or client. We'll continue to do that is within our interest and of course, we will see larger fleets and focusing on fleets which have the lowest level of competition. This is also on the hands of the smaller players, and that's where our competitive edge lies.

Operator

Next question comes from Joy Morrison, [ph] Bank of America.

Q - Unidentified Participant

Thank you for the call. I'm sorry, I wasn't able to listen to the entire call. So I am sorry if this has been answered already. First is about the level of inventories, the car for sales. We have seen a significant increase in that figure in this quarter, if you could give us some more detail. After that and mainly, if you could tell us what is -- when you expect inventory levels to come to a normal. When is that expected. First half of the year, for example. In terms of prices we know that the average rental rate comes from different mixes. As you probably mention already, so if I exclude the mix effect, what would be an increase or decrease in the rate. Can you give us more factors on that?

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

Joe, thank you for your question. The first, about the inventory level. Our inventory level has raise to 12% differently from what we had in the past. This was expected, as you probably have seen the new contracts we have signed every quarter. When we have a concentration of contracts signed in one quarter, two or three years later these cars come back on a concentrated manner. So what I'm saying, that was different from what happened in 2013, and you will see that in the first half of 2015.

When we will probably have sales much larger than the first quarter of 2014 with the margins of used cars stable. So we won't need to reduce price drastically in order to reduce the inventory. So this is all expected by the company, we didn't have any returns and concentrated in terms of contract in force as it happened in 2013. What we had was a concentration of contract that ended in the first quarter.

This will probably happened in the first quarter of 2015 as well. So we will have two more quarters at such levels and as of the third quarter, you will see a decrease in inventory and until the end of the year we'll go back to the levels of inventory that we used to have. And we believe it's important for the company to remain at that level it is -- which is from 8% to 9%. So this is what happened. And just to remind you, we are monitoring the main contract for a long time now. This is the goal we have implemented starting with the effect that happened for the first time in 2013.

This too monitors that 14 main contracts we have. So 6 to 12 month from the date of renewal of such contracts we monitor them. So, if there is any movement of anticipated return of this cars from the customers we are able to implement action plan in order to prevent this strong effects on our balance sheet as it happen in the past.

Of course, this is an estimate, if the market for used cars remains with the current dynamics it has presented in the last three months we may reach lower inventory levels much sooner. However, for now we think this will happen gradually because we are monitoring the dynamics of used cars and new cars for the next three months, so that we can see the dynamic of these markets for 2015. It's too early to say more than that. But so far, our expectations are in line -- the market is in line with our expectations. So overall, this is what happened and this is what we're doing.

Also, I would like to add that we are seeking to develop other sales channel. And in 2015, we'll start testing new channels, such as the web and wholesale channels seeing there is view don't operate in and we believe that these channels can improve our sales and our turnover of inventory. And so, we are looking for new alternatives in terms of sales channels, so that when there is a concentrated number of contracts with the return of cars as we're having in the fourth quarter of 2014 and the first quarter of 2015, we can sell the inventory of the company faster.

The other question about the average rate or tariffs. We do measure separately, what comes from mix and what comes from price transfers. It would be very difficult to do that, because as I told you, we have a monthly pricing committee and all our costs either worst or better than the previous months are automatically transferred to our price tables and cost tables, which makes it very difficult to distinguish what come -- what increases come from the mix and what increases comes from cost increases.

Obviously, we believe that the large part of that is given by the cost increase. In our business throughout 2014, we had an increase of over 40% in (inaudible) interest rate, which has a high implants in our business and price table and a strong inflation as well in Brazil.

In depreciation, nothing much different. Although, the change in the mix increases the depreciation rate as well. This is the way we don't have a precise figure. As I told you, that large part of this increase is given by transfer of prices, because unfortunately our main cost now have an upward trends and we need to transfer that to the market if we want to have a better margin on our business, which is the main purpose of the company for the future.

Q - Unidentified Participant

Thank you.

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

Thank you, Joe.

Operator

To answer questions that in the (inaudible) have to ask online. What is the CapEx for the opening of the two retail store?

A - Jose Carlos Wollenweber Filho {BIO 16884477 <GO>}

Well. It can vary a bit according to the location and the station which the store is. If we find a store that is already built and we only need to add our decoration in our brand it would cost about BRL250,000 to BRL300,000 and if we're going to build it from scratch, it can be about BRL1 million. So 250,000 to 1 million depending on location and size and how much we have to customize the store.

So regarding the total investment of the company and opening stores, it's not very high capital expenditure, but of course, you don't only invest to have successful story. Also need to have a very well trained staff, you have to select a location very well, you have to know what is the right inventory for that region, and for that store. And therefore, we're being more careful in expanding our network. We are focusing on having a better performance first store then expanding the number of stores per site. So this is the average expense for first store that we should get from the additional two that are being opened in 2015.

Operator

(Operator Instructions) If there are no further questions, the Q&A session is closed. Before we continue to the Q&A session with the press professionals, I'd like to give the floor to Mr. Luis for his closing statements.

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

Well. Today we are especially satisfied with our results for 2014. We know it was a rough year with the macroeconomic scenario that was very negative and became worse over time. But in our view, we were able to make the right decisions to minimize the effect suffered by our business. Of course, we're not satisfied with the returns that the company has had.

We think that we still have a lot to do, and we've been making a huge effort for that to take place as soon as possible. What you can expect for 2015 is this. A business that despite going through all of the macroeconomic challenges that we've been facing will aim to improve itself constantly and improve its margins in EBIT and EBITDA as well as its net income.

Our company aims to reach a much higher return on our investment. We are very well prepared for this, as I've said previously, and as I always like to remember these macroeconomic effect that Brazil is going through are something that have already been discussed, but we didn't know how intense they would be.

Locamerica therefore seeks to get prepared for that. Today, we have a very robust investment in technology and management, which will reduce these administrative costs significant despite inflation being high. This is under implementation for more than 1.5 years, and we'll continue to do this very strongly over the next few years. We have a high investment in reviewing the fleet and in disseminating that fleet to make our assets more efficient. And also to reduce maintenance costs and depreciation for our cars.

On the financial side, we seek to make that longer to reduce collateral which comes at a high cost and which also create a red tape for sales and connected to debt we hope to see a reduction in our spread. So longer debt, lower spreads, less collateral, this is what we've been able to do and what we'll continue doing over time.

Another piece of good news for you and for us is that this year our cash flow will be a generation and no longer a demand for cash. And our forecast is to have a 10% growth in 2015. So we are prepared, we don't need to capture more cash, this is a complicated moment for the market both on the cost and the demand side. We have all the cost factors close monitored, but of course, we have to be concerned about the economy, it's still very early to talk about the year since -- such a doubtful moment right now.

However, we are starting the year on the right foot and this could have been a disaster for any business. So we are being very careful. We're going to preserve our liquidity and they are focused on increasing margins, but being careful and patient because we believe that we have not yet come to the end of the macroeconomic challenges that the country will face.

So once again, I'd like thank you for listening and participating and we hope to see better margins and better returns to our shareholders over the next few semesters [ph]. This is the goal for our company. Thank you.

Operator

We'll now move on to the Q&A session for press for journalists. (Operator Instructions) As there are no further questions, the Locamerica conference call has now ended. Thank you very much for attending. Have a good day. Thank you.