Q2 2017 Earnings Call

Company Participants

- Luiz Eduardo Falco Pires Correa, CEO, Member of Board of Executive Officers & Director
- Luiz Fernando FogaÃ§a, Administrative VP, CFO, IR Officer & Member of Board of Executive Officers

Other Participants

- Robert Erick Ford Aguilar, MD in Equity Research

Presentation

Operator

Good afternoon. Welcome, everyone, to CVC's Second Quarter 2017 Results Conference Call. Today, with us, we have Mr. Luiz Eduardo Falco, Chief Executive Officer; and Luiz FogaÃ§a, Chief Financial Officer.

Today's live webcast and earnings release may be accessed through CVC's website at www.cvc.com.br/ir. We would like to inform you that this event is recorded and all participants will be in a listen-only mode during the company's presentation. (Operator Instructions) We have simultaneous webcast that may be accessed through the company's website. The slide presentation may be downloaded from this website. Please feel free to flip through the slides during the conference call.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of CVC management and on information currently available to the company. They involve risks and uncertainties because they relate to future events and, therefore, depend on circumstances that may or may not occur. Investors should understand that conditions related to the macroeconomic scenario, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Luiz Eduardo Falco, Chief Executive Officer. Mr. Falco, you may begin your conference.

Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Thank you very much. Good afternoon, everyone. We are pleased to begin our conference call to discuss the CVC Group results of the Second Quarter. Regarding today's agenda, as usually, first we will go to talk about the main events of the Second Quarter. Then we will present the financial results. And lastly, we will begin the Q&A.

To begin, I would like to talk about the highlights of the Second Quarter, starting on the Slide #4. In the Second Quarter of '17, CVC Group bookings growth accelerated to 14%, in line with the recovery trend seen over the year. Three main factors helped this growth: first was the growth on the leisure segment; second was the corporate segment in RexturAdvance due to increase on the average ticket; and third, the booking of Submarino Viagens recovered. All the 3 support this booking growth.

CVC leisure growth was driven by same-store sales, which grew about 13.4%. And a strong growth on the cruise segment, more than 100% in comparison with the Second Quarter of '16. CVC opened 32 stores on the Second Quarter, increased the total number of stores open on the last 12 months to 105, being 95 net opening.

In the first half of this year, Experimento grew more than 30%, with 4 new Experimento stores and also more 3 additional stores on CVC IntercÃ¢mbio brand, which convert to Experimento.

In June, we acquired 49% of RexturAdvance's stake, reaching now 100% of the company. We also introduced NPS, Net Promoter Score, a widely used methodology, to measure the customer satisfaction at the time of the purchase and also after the travel.

On Slide #5, I will talk about the recent acquisitions. As mentioned before, CVC acquired the remaining 49% of RexturAdvance and now reached 100% of the shares. This 49%, 1/3 of it of this stake was paid in cash and 2/3 approximately shall be paid in CVC shares. The shares will have a lock-up period of three years. And we will have 1/3 every year.

Right after the elaboration of the appraisal report, a general meeting shall be covered -- covenant to approve the stake to be paid in shares. It is meant to be concluded in September. We are very glad to announce that Marcelo Sanovicz, current CEO of RexturAdvance, will continue to leading the company and much more aligned with the group objectives, being now an important CVC shareholder.

Regarding Grupo Trend's acquisition on July 2017, CADE, the antitrust agency in Brazil, filed a registry of the operation, which is still being evaluated. We expect an update until the end of August. It is important to say that the corporate restructuring of Trend Group is expected to be finished within this month.

On Slide #6, we will talk about the main financial indicators of CVC Group that showed growth in the main metrics. CVC Group bookings has a total of BRL 2.47 billion in the Second Quarter '17, a growth of 13.8% versus the Second Quarter '16 pro forma.

In earlier days, 2017 group was 12.8%, reaching more than BRL 4.8 billion in bookings. Regarding the financials, adjusted EBITDA grew 21%, adjusted earnings grew 56% versus the 2nd quarter of '17 pro forma. And in earlier days, the first half of '17, adjusted EBITDA grew 14.4% and adjusted earnings grew 15% against the pro forma 2016.

Now, we'll pass to our CFO, Mr. FogaÃ§a, who is going to talk about the financial results of the company.

Luiz Fernando FogaÃ§a

Good evening, everybody. Moving to Slide #8. We'll cover bookings in the group. CVC leisure and Experimento bookings totaled BRL 1.5 billion in Second Quarter '17 representing growth of 15.7% against 2016. In the first half of 2017, we reached more than BRL 3 billion in bookings or 15.8% growth in the period. CVC bookings growth was driven by international and cruise segment and same-store sales improvement. CVC Group bookings totaled BRL 2.5 billion, growing 13.8% during the quarter and reached BRL 4.8 billion in the first half of 2017, representing 12.8% growth versus 2016.

RexturAdvance bookings grew due to higher average ticket and the improvement in the performance of Submarino Viagens, also supported CVC group bookings growth.

Moving to the Slide #9, we will talk about bookings breakdown. Strong performance in the exclusive stores and independent agent channel also supported bookings growth in the quarter. The online channel, which includes the website cvc.com and call center, presented declining bookings as a function of the call center migration process to the franchisees, which has started in the Second Quarter. In the last 12 months, same-store sales grew 10%, surpassing inflation of that period of 3.6%. The actual trend indicates that the observed gap of the last two years, due to the crisis, should be totally offset by the end of this year.

Moving to Slide #10, we will cover net revenue. Net revenues of CVC and Experimento were BRL 178 million in the quarter and BRL 422 million in the first half of the year, representing 10.5% and 7.8% growth respectively to 2016. The percentage of net revenues after normalizing the extraordinary effects was 15.9% in the quarter, 30 basis points lower than last year, as a consequence of a higher mix from the International segment. The normalization refers to the prepayments made to suppliers in 2016, which resulted in better commercial terms. Net revenues of CVC Group totaled BRL 234 million in the Second Quarter and BRL 532 million in the first half of the year, representing growth of 7.5% and 5.9% compared to 2016.

The percentage of CVC Group net revenue after the normalization of the items already mentioned was 11.6% in the quarter, 20 basis points below 2016, once -- due to the higher international mix.

Moving to Slide #11, we will present the new criteria for nonrecurring expenses. From now on, we will treat as nonrecurring only 3 items: first, the compensation of the CEO and the 2 Vice Presidents. The amount that surpassed the new plan that was presented and proposed by Mercer that will become effective in the beginning of 2019. The amount that surpassed this compensation of -- based on market standard will be treated as nonrecurring expense since -- until the end of 2018. The amortization of the master franchise contracts paid in 2012, that will be amortized for P&L purpose until 2022. Important to mention that there is no cash effect since those payments were fully made in 2012.

And lastly, the operations of Rio de Janeiro stores. When we finalized the contract with the master franchisee in Rio, we bought 22 stores from which 18 of them we have already resold to franchisees in the region. So it is an operation that will be ended this year.

Historical results were normalized based on this new criteria.

Then we will cover the next slides. We'll incorporate this new criteria for nonrecurring expenses for 2017 and also 2016.

In Slide 12, we will cover operational expenses. The recurring operational expenses were stable in Second Quarter in nominal terms we had due to tight control of expenses and synergies derived from the acquisitions.

Selling expenses dropped 5.6% as a consequence of the optimization of marketing investments and lower insolvency rate among customers financing through CVC.

General and administrative expenses in Second Quarter increased 11% due to the annual salary increase -- mandatory annual salary increase defined with the union, expenses with mergers and acquisitions and recovery of social welfare credits in 2016. If we normalize these expenses, general and administrative expenses would grow 6% below previous year's salary and will increase. Other expenses and operational revenues were affected by higher incentives from GDS, Global Distribution system, the companies that provide the connections between the market and the airline company for international flights, resulting from International segment higher growth. And a reduction of charge-back expenses from credit card.

The nonrecurring expenses in Second Quarter grew BRL 7.6 billion versus last year, due to the approval of the new incentive plan, long-term incentive plan for CEO, CFO and retention bonus for the Commercial and Project Vice President. The long-term incentive plan for the company, including all executives, is considered as a recurring expense and that plan was approved in the second part of 2017.

Moving to Slide 13, we will cover EBITDA. CVC Group adjusted EBITDA totaled BRL 94 million in Second Quarter and BRL 256 million in first semester, representing 20.9% and 14.4% growth versus 2016. EBITDA margin increased from 35.7% in Second Quarter to 40.2% in Second Quarter '17, mainly due to expense dilution. In first semester, the EBITDA margin reached 48.2% compared to 44.6% in 2016.

In Slide 14, we will cover earnings. Adjusted net earnings totaled BRL 22 million in the quarter and BRL 87 million in the first half of the year, representing growth of 56.1% and

15.5% versus 2016, respectively. Second quarter earnings growth was driven by EBITDA improvement and stable financial expenses.

Moving to Page 15. CVC Group generated BRL 172 million of operational cash in the quarter, BRL 28 million higher than 2016 quarter -- Second Quarter. The greater cash generation in the quarter reflect working capital improvement as a consequence of consumers' decision to anticipate the purchase of their travel from 72 days in 2016 to 77 days in 2017.

In the first half of the year, CVC Group reported a cash consumption of BRL 93 million impacted by the negative effect of working capital in the First Quarter as a consequence of higher booking with regular air travel payments in which the payment is made after the booking, whereas the -- in charter flights and block charter, the payment is made only after the boarding and also due to prepayments made to suppliers.

Moving to Page 16, we will cover return on investment. The return on invested capital was 27.5% in the last 12 months. Then in June, 290 basis points better than March, due to the improvement in the working capital.

Moving to Slide 17. We will cover net debt and financial expenses. Net debt in June was BRL 451 million. Taking into consideration the anticipation of receivables and acquisitions, the net debt was BRL 1,042,000,000, representing 1.8x EBITDA. For accounting purpose, the value of BRL 190 million relative to the stake of RexturAdvance that will be paid with CVC shares, must be treated as debt until such payment is approved in the general meeting.

After normalizing the debt with that effect, the leverage would reduce to 1.5x EBITDA. The net financial expenses of CVC Group dropped 21%, mainly due to increase in financial revenue due to prepayment made to suppliers. If we consider expenses with bank fleet and exchange variations, the financial expenses grew 3%.

We would like to thank everyone for the participation in this conference call. And now, we are going to start the Q&A section. Thanks.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Robert Ford from Merrill Lynch.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

Guys, I thought you did a good job in terms of showing the sequential improvement that you posted so far this year. And I think very few people would have expected that. And I was hoping maybe you could discuss the operating trends that you anticipate, right? We've already seen some pretty good bookings, I would assume. Most certainly we have seen good bookings from the Second Quarter. You've got good visibility into the beginning of the third. And given kind of the pressure you've had a little bit on revenue margins and some of the accounting changes, if you could discuss the anticipated impacts in the second half of that as well, please?

A - Luiz Fernando FogaÃ§a

Hi, Bob, it's Fogaca. We believe that the -- we have been seeing this impact of growth in -- since Fourth Quarter. In terms of CVC, the bookings growth in leisure is practically the same, slightly better in the first half of this year than Fourth Quarter. In the case of Rextur, we have been seeing an improvement that has started in the end of 2016, mainly -- it's totally correlated with the GDP of the industry, which is opted to be rated at least and is growing slightly in the recent months. And also, average ticket increase for the business rival, which is less sensitive. The industry -- airline industry has increased prices. And of course, that converts into bookings and additional revenues to Rextur. In terms of margin, we had this effect in both CVC and also Rextur in 2016 that we have made anticipations for our suppliers. At the end of the day, that has favored both the supplier and CVC that we are able to have better prices. But we had also slightly better commercial conditions that offset the financial cost. This year, we are moving more to treat those operations as financial operations in line with the negotiations with the supplier, which is more, I think, easy to understand for comparison purpose. And of course, this is an operation that is not continuous with opportunities that appears sometimes. So I think that will help to understand the trends of the margins for the future. The International grew, of course, which has lower take rate affect the average take rate of the company, 30 basis points in the first half of the year. Probably, that effect will continue in the second half. But less pronounced because we believe that as we saw in 2016, that International suffered much more in the first half and started to recover in the Third Quarter. And mostly in Fourth Quarter, we believe that, that could put less pressure in the take rate, especially in the end of the year. But of course, we have been working in the expense side, knowing that in advance, we were able to present double-digit growth in EBITDA and earnings, even having this dilution effect in the margin.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

So FogaÃ§a, would it be fair to say that there is no real deterioration in operating momentum early in the second half?

A - Luiz Fernando FogaÃ§a

Yes. It's -- I think it's a good statement. Of course, we have all this news in Brazil. Every week, there appears something new. But so far, we are seeing that the trend is maintained.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

Okay. That's good to hear. Then with respect to e-commerce, Falco touched on the earlier call with respect to some of the platform upgrades and functionality. But when do you expect these improvements to really stabilize and gel? And as it does, how should we think about your client acquisition strategy to try to leverage those improvements and educate consumers?

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Okay, Bob. This is Falco speaking. Basically, we have at this moment 2 specific channels: One is cvc.com. CVC.com now is almost merging with the stores in terms of strategy. We are pretty much going to what everybody says the digital clients or omnichannel. And we are trying to mix the intelligence for people navigating the internet as well as when they are inside those stores. Then CVC will be a kind of window for the stores. The customers can buy whatever he wants, of course. The mix of product will be more depleted for the channel. But they will talk very, very close on each other. And we'll not be -- cvc.com will not be a normal OTA like you see on the marketplace. It would be a mess if we lose the opportunity to leverage our Internet with our stores as well as it will be a mess to do not leverage our stores with the Internet traffic. Then what we are doing now is to merge these platforms. And that's why CVC is now changing, again the technology. We can now see the customers as the same customers in different touch points.

The point here is, how can we move more money for the same customers and give him the service that he wants at any point that he want to buy. And try to understand what are the flow start on the Internet and on the stores. Of course, taking into consideration the customers' needs. In other words, our CRN will be much wider. And we will be able to pile up these 2 things. And we will see these 2 companies growing regardless which point that people will buy.

On the Submarino, the strategy is completely different. Submarino is pure mobile with pure (pochette). And now Submarino, you can see they've recovered. They started to recover. They are not linked with the stores. They're more to compete with the normal online travel agents and also to be a kind of outlet from CVC Group. We have a lot of offers on different channels and CVC and Submarino will be our outlet. Submarino will play alone on this market and CVC.com will play together with the stores, as you can see, most of the omnichannels. Important to say that we renegotiated with all the franchisees and now the franchisees, they have -- we returned back the telephone sales to the franchisees because makes much more sense with the integrated intelligence. We don't have a place where we hook the phones and we talk with the customers. We try to attract the customers to the near stores because we think the near stores has more chance for conversion rate because they understand the market locally. And the -- we also pay a percentage of the e-commerce to these specific franchisees, which means that they're perfect at laying loose this strategy for the company. Saying that, you can see for the stand-alone Submarino start to increase. And we hope to see some increase on the third part of Submarino. So they say we'll take a quarter longer because it is a little bit more complicated with integration. But we are very happy to take this direction.

A - Luiz Fernando FogaÃ§a

Just to add on Falco's comment, Bob, I think we have, Falco mentioned, different channels for online or brands. And we have started -- for instance, we rolled these new features and platforms with Livelo product. Livelo has already sold record months in the last 2 periods, which is a sign that it is working better. Submarino is still in the old one. But we have been adapting the platform with features -- new features. And as Falco mentioned, we have been improving, First Quarter, Second Quarter. And we expect to present bookings growth in Third Quarter. And also, good news that we have reached EBITDA breakeven at Submarino. So I think the trend, of course, it's a good sign.

Operator

(Operator Instructions) I'll turn it over to Mr. Luiz Falco for final consideration. Mr. Falco, you may give your final considerations now.

A - Luiz Eduardo Falco Pires Correa {BIO 2070861 <GO>}

Okay. Ladies and gentlemen, thank you very much for your audience. Our team is available anytime for any doubt. And hope you have a very good afternoon. See you on the next call. Bye-bye.

Operator

Thank you. This concludes today's CVC Second Quarter 2017 Results Conference Call. You may disconnect your lines at this time. And have a nice day.