



Tegma Logística S/A
First Quarter 2020 Earnings Results
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TEXT version of Transcript

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Corporate Participants

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* Marcos Antonio Leite De Medeiros

Tegma Gestão Logística S.A. - CEO

* Ramon Perez Arias Filho

Tegma Gestão Logística S.A. - CFO, IR Officer

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Conference Call Participants

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* Lucas Marquiori

Banco BTG Pactual S.A., Research Division - Research Analyst

* Pedro Bruno

Santander Investment Securities Inc., Research Division - Research Analyst

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Presentation

Operator [1]



Good day, and thank you for waiting. Welcome to Tegma Gestão Logística S.A.'s conference call to review first quarter 2020 earnings results. Today, we have Mr. Marcos Medeiros, CEO; and Mr. Ramon Perez, CFO and IRO.

We would like to inform you that this event is being recorded. (Operator Instructions) A replay of this event will be available right after the end of the conference call for a period of 7 days.

Before proceeding, let me mention that forward-looking statements that might be made during this conference call relative to Tegma's business perspectives, projections and operating and financial goals are based on the beliefs and assumptions of Tegma's management and on information currently available to the company.

Forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and assumptions because they relate to future events and, therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Tegma and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference call over to Mr. Marcus Medeiros, Tegma's CEO, who will start the presentation. Mr. Medeiros, you may begin.



Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [2]

Good afternoon, everyone. Once again, we are here to discuss Tegma's results. Myself, Marcos Medeiros, CEO of the company, and Ramon Perez, CFO and IRO, will be presenting the most important highlights of the first quarter of 2020 in terms of our earnings, cash flow and indebtedness. Also, we shall comment on the impact that the COVID-19 pandemic has been having on our business as well as the measures that we are adopting to protect our employees, partners and the company itself from this unprecedented crisis.

To begin on this topic, we would like to inform you that to the present moment, 3 Tegma employees have tested positive for COVID-19 and are receiving full attention and being monitored by our personnel department and by our occupational physician.

As regards preventive measures, our corporate areas continue to work remotely. Functional operations are taking all necessary precautions recommended by health care authorities, such as face mask, gel hand sanitizers, private transportation in addition to keeping the minimum recommended distance. Moreover, we are providing psychological support via telemedicine to our employees. We are mindful and we are caring for our greatest asset, our people. As you all know, the rapid spread of COVID-19 pandemic had an extensive negative impact on the global economy, making the business environment extremely volatile and adding uncertainty to all statements that one can make at this point. Tegma is providing information valid for the date of this webcast and reserves expressly the right not to update any forward-looking statements contained in this presentation.

Moving to Slide 3. We can see how the coronavirus crisis impacted the company's divisions differently and the characteristics and measures adopted related to our results and capital structure. The vehicle logistics division was seriously impacted



in the second half of March when automakers completely halted their car and light commercial vehicle operations in the country. When governments declared a state of public calamity, which restricted the opening of car dealers almost everywhere in Brazil, with that our transportation operation was heavily affected and is operating intermittently and marginally, merely transporting the automakers inventories. Our logistics services operations heavily dependent on production and imports were also negatively impacted.

Most vehicle logistics costs are variable, such as trade costs and such, which gives us great flexibility to adjust to this moment of crisis. Considering the fixed expenses of the transportation operation, personnel expenses were reduced on account of shorter shifts and labor contract suspensions as of the second half of April. In addition, some operational employees were dismissed. We also reviewed nonessential expenditures that are not special and subject to cuts, such as IT, consulting and training as well as some yards used for logistics services that were returned.

The integrated logistics division, in turn, showed a greater resilience as it provides services considered to be essential. The chemicals operation was not impacted by COVID-19 because it operates mainly for companies manufacturing personnel and household care products. The operation for the home appliances industry was stopped in the beginning of April, but resumed activities before the end of that month, albeit with a reduced shift. The warehouse operation has also maintained normal activities as we have food and e-commerce clients, both more resilient to the current crisis.

As regards our balance sheet and liquidity, we can summarize our situation in the following manner. Our March cash position added to our April borrowings would be BRL 216 million, excluding the strong positive impact of working capital released, given our reduced operations. Our monthly OpEx amounts to around BRL 26 million. Of these, BRL 22 million are related to the automotive division, which is currently halted, and corporate, an amount which does not yet consider the cost reduction measures adopted. Gross profit of Tegma's operations, which remain active, totaled around BRL 10.4 million in Q1 2020.



Debt maturing in the second and third quarters of 2020 amounted to about BRL 79 million. And lastly, 2020 approved and expected CapEx corresponding to improvement works in progress in IT investments, fundamental for the company's security, amounts to approximately BRL 10 million. In other words, even if the company chooses not to roll over our debt during the short term, although this is not our strategy, the company is in a rather solid position to enjoy market rally when it comes.

On Slide 4, we present the highlights for the quarter. Given the adoption of IFRS 16, in our view, EBITDA no longer represents the adequate proxy for operating cash generation. So Tegma decided to focus its explanations regarding operating efficiency on operating income/EBIT. Still, we will continue to reconcile the EBITDA in the annex to the earnings release as well as in our historical series.

The second highlight has to do with the fact that Fitch reaffirmed Tegma's assignment of corporate rating A (bra) on the Brazilian national scale, with a stable outlook. This decision results from a set of actions and characteristics of our business model. And it also results from our discipline proven by our history of cutting costs and expenses in recent crisis, and lastly results from our conservative approach to liquidity, which the company has always had -- a focus the company has always had.

With that, we now move to the discussion of our quarterly results themselves. And so I turn the floor over to Ramon, who will take it from here.

Ramon Perez Ariaz Filho, Tegma Gestão Logística S.A. - CFO, IR Officer & Member of the Executive Board [3]



Thank you, Marcos. Let us move now, continue with the slide where we show the main operational highlights of the automotive market and of our vehicle logistics division. The 8.2% reduction in domestic sales of vehicles is explained by weak first 2 months of the year added to the gradual interruption of sales as of the second half of March when the impact of the COVID-19 pandemic intensified. Production dropped a lot more than domestic sales, and the same applies to imports on account of the already mentioned crisis and of the relatively high inventories, which in March were 266,000 vehicles in the hands of the industry, not much different than the April number, 237,000. The previously mentioned effects were more strongly felt in retail sales dropping 11.3% in the quarter. The quantity of vehicles transported by Tegma followed wholesale sales in the period, which reflected a stable market share in the annual comparison. In the quarter, the only positive piece of news was a 7.1% increase in average distance traveled for domestic deliveries, given Tegma's sales mix deliveries.

As a result of what was explained in Tegma's operating highlights on the following slide, please, we can see this impact on the division's result, whose revenues was 7.2% lower in the yearly comparison. The sudden drop in automotive logistics revenue in the second half of March, without a proportional reduction of personnel and fixed costs, impacted gross margin by 100 basis points. In addition, higher expenses related to consulting services and attorney fees related also to the change of external auditors and the provisions for legal claims, all explain the contraction of 560 basis points in operating margin. Even excluding the expense related to Operation Pacto of BRL 3.3 million, the loss in margin would have been 460 basis points.

Moving to the next slide, please. Fortunately, as regards the integrated logistics division, the effort put into this division has borne fruits for the company, even in this difficult moment that we are now facing in this crisis. Despite a modest growth rate for this division in the past 2 quarters, the growing profitability trend is explained by cost control measures and a better services mix. Higher gross and operating margins reflect this work that was done. And in the first quarter 2020, we posted a record operating income margin of 22% higher than Q3 '19 excluding nonrecurring events.



In our consolidated results on the following slide, the slight improved results of integrated logistics, the impact of the auto market retraction or slowdown and of COVID-19 on the automotive logistics division were responsible for the 6% reduction in consolidated gross revenue as well as for the 290 basis points drop in adjusted operating margin, which was 10.7% in Q1 2020.

On Slide 9, we can see the evolution from operating income all the way to net income. The fall of operating income was the major factor explaining the 27.6% reduction in net income year-on-year at BRL 19.3 million in Q1 2020. Now, of course, we should not forget that we were impacted by an abnormal increase in some of our expenses, as was the case with the change to a new audit company. Worth of note is the BRL 3.3 million in attorney fees that is considered an extraordinary event, as mentioned earlier by Marcos. This result happened despite the significant improvement in equity, which reflects the growth of the joint venture, GDL, in the quarter. The financial result remained practically unchanged in the quarter, and the income tax rate was 26.2%.

On the next slide, we show you that our free cash flow amounted to BRL 59.2 million in Q1 '20, higher year-on-year, mainly due to the use of PIS/COFINS tax credit in the amount of BRL 18 million. The increase cash-to-cash cycle to 46 days resulted from renegotiations of longer payment trends for clients. These renegotiations occur in most cases because of the inclusion of new services rendered or renewal of commercial contracts. The release of working capital in this quarter also had a positive contribution. Tegma's net debt of only BRL 7.6 million in this quarter represents the combined effect of the factors described earlier, in other words, of a significant cash generation.

Despite a low net debt, aiming to strengthen our cash position even more, in early April, the company took on 2 loans, which together amount to BRL 90 million at the rate of approximately CDI plus 4% to be paid over 12 to 24 months. We are prepared to weather the storm of this difficult period that we all have ahead of us, and we are confident in the company's solid foundation.

On the next slide, on the top left-hand corner, we present the evolution of our return on invested capital, which was 41.1% (sic) [40.4%] in the first quarter of



2020 or 32.1%, excluding the PIS/COFINS tax credits recognized in Q3 '19, which impacted the company's NOPAT by BRL 50.4 million. The reduction in ROIC compared with the beginning of 2019 reflects reduced growth of vehicle sales in Brazil and investments in a yard for vehicle operation due to contract obligations, and that did not bring any additional revenues for the company.

In 2020, Tegma's shares underperformed against the Ibovespa index, and this was because of uncertainties regarding the growth of vehicle sales in Brazil and because of the impact of the coronavirus outbreak on the automotive industry. In turn, amid so many uncertainties, multiples are not applicable as sell-side earnings estimates are all pre-COVID-19.

With that, I turn the floor back to Marcos.

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [4]

Thank you, Ramon. Once again, thank you all for joining us. And now we will move to the Q&A.

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Questions and Answers

Operator [1]

(Operator Instructions) Mr. Medeiros will read the questions coming from the webcast. Our first question comes from Pedro Bruno, Santander.

Pedro Bruno, Santander Investment Securities Inc., Research Division - Research Analyst [2]

I Have two, the first has to do with the automotive division. Marcos briefly mentioned the operation as operating intermittently and marginally. My question has to do with the impact on volume, considering the crisis and thinking about April and May. In April, we saw ANFAVEA numbers of wholesale numbers with a 92% reduction year-on-year. And I would like to hear from you about May. Is the ANFAVEA data reflecting what we should expect in terms of volume for this crisis period? I know it's very hard for everyone to imagine how long the crisis will last. But I'd like to have some color on what's your thinking? Is May going to be similar



to April? And is the ANFAVEA number a good number for us to use as an assumption? This is my first question. I'll ask the second question later.

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [3]

Pedro, thank you for the question. It is always very hard to predict. Like I said, there are many uncertainties. In April, sales were 77% down. When we look at May, from the information coming from our clients, the automakers and some of them are resuming production. In the first half of May, almost no return; in the second half, some return; but the biggest volume will come in June. This is information from the automakers. A forecast from me is that it will be very similar to April, could be a little better, a little worse. It will depend on the automakers production in the first half of May.

Now the May production is more focused on vehicles for exports. So it's very hard to predict the impact in Brazil domestically in terms of volume. But I would say that May -- we should expect May to be very similar to April. In April, there was some inertia from the March volume. In May, on the other hand, we see some resumption of production. So we believe that they are going to be very similar.

Pedro Bruno, Santander Investment Securities Inc., Research Division - Research Analyst [4]



Okay. Great, Marcos. My second question has to do with integrated logistics. Initially, there was an interruption in April in the home appliances contract, but they resumed activity in the end of the month. Could you say that this was the main negative impact of the coronavirus outbreak on the integrated logistics division? Could you give us color on the current status of the main contract that Tegma has in the home appliances segment?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [5]

Okay, Pedro. Well, actually, this was the only impact on integrated logistics. The news is good in the integrated logistics division, but this home appliances client, well, they interrupted production for approximately 20 days, but then they resumed production on the 27th of April. So we started organizing our operations to serve this client. And just this week, we learned that they will resume full speed operation as of May 18. And this was the only negative impact for the integrated logistics division. The other operations, industrial operations, chemical operations, warehouse operations, since they are all related to products considered to be essential, they all had volumes actually above normal, which, in a way, partially offsets that loss of revenue from the home appliance segment.



Operator [6]

Next question from Lucas Marquiori with BTG Pactual.

Lucas Marquiori, Banco BTG Pactual S.A., Research Division - Research Analyst [7]

I have 2 quick questions. First, could you elaborate on the use of the asset? When thinking about the total availability of parking places in the yard, so what is the occupancy rate of these assets, slots in parking lots and the fleet? I just want to get a sense of how much of the asset is being used. That's my first question. And the second question, if you could give us some color on what you expect for the rest of the year? I know you have annual contracts. Should we expect a flat yield for the post crisis period? Or will you be adjusting your prices to the automakers some kind of compensation? What do you expect in terms of average yield for the rest of the year?



Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [8]

Lucas, thank you for the questions. Regarding the fleet, we are operating, like I mentioned, with marginal volumes and intermittently. We are adjusting the fleet, we are mobilizing the fleet from rental companies, and we might be transporting some balance of production, so the volume would be around 10%. Now regarding yard occupancy rate, I haven't got this indicator here because you see this changes a lot from branch-to-branch, from yard-to-yard. It's very dynamic. Particularly now with this low volume, it's very hard to say what the volume is. The most relevant is our fleet that is operational, I'd say between 10% and 15%.

Regarding your second question, well, regarding adjustments, of course, this is a difficult year for everyone for us to think about adjusting prices. Actually, people might be asking for some discount. Fortunately, it hasn't happened until now. We are considering flat prices and very similar to what we have considered in the budget, but this will depend on the one-to-one negotiations, and it will depend on the whole scenario, which, unfortunately, we cannot predict.

Operator [9]

(Operator Instructions) Next question from [Rafael Maissonave from Tarpon]

Unidentified Analyst, [10]

I have 2 questions. I'd like to know how do you see the maturing of the debt maturing in 2020? And also, I want to get a sense of what you're thinking about your headcount at this moment when we don't really know when the car dealers will be reopening and when the automakers will be resuming full production?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [11]

Rafael, this is Marcos speaking. Thank you for the questions. I'll start with the second question, and then I'll turn the floor to Ramon to answer your first question. Regarding our staff, our headcount, as we mentioned, yes, we had a dramatic reduction in volumes. And since we have an estimate of return below our operating capacity, we thought to do a set of actions. We started giving them a vacation, then we suspended labor contracts for 30 days and 60 days, and we reduced the working shifts with possible salary reductions. And lastly, while we were gauging these measures week after week. And as our forecast was getting worse, and the visibility of the market and forecast, unfortunately, we had to make adjustments in



our headcount, very similar to what some other companies are doing at this point. We expect by now we have an adequate headcount for when the market rallies. And I'll turn the floor to Ramon to answer your question about our debt.

Ramon Perez Ariaz Filho, Tegma Gestão Logística S.A. - CFO, IR Officer & Member of the Executive Board [12]

This is Ramon. I'd like to start saying and make it very clear, our strategy is to roll over our debt that matures in July and in August. Now, we entered this crisis in a very, I should say, robust situation. And as we have explained, we strengthened our cash position even further with the recent borrowings. Now those funds were taken to strengthen our cash and not to make payments, so we are preserving that cash. We think it is also important to mention and to underscore because we said it before that recently we had the confirmation of our rating with a stable outlook by Fitch, and I think that this is a very relevant fact. Think about it, amidst this whole process, this whole crisis that we are living right now, this confirms the market's perception of our credit rating. Only I was hoping to emphasize these 3 points; our strategies to roll over the debt, we have a very solid position and a robust cash, and we had reaffirmation of our credit rating. Why do I say all that? Because that places us in a situation that we can even choose not to roll over the debt. If we think that the costs are excessively high or in case our internal projections, because of course we have them, do not materialize, or if they are better than the conservative approach that we are adopting. So in a nutshell, we are in a very comfortable situation. We believe that we have a credit rating that will allow us to renew, roll over our debt smoothly. Also, it is possible also to decide not to roll over the debt, if we think that the costs do not payout. So our strategy, initially, is to roll over the debt.



Operator [13]

Next question from the webcast. A question by Gustavo. What is the status of the Electrolux contract? Was it renewed?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [14]

Well, Gustavo, yes, we have ended the negotiations. All commercial provisions have been discussed. We are now starting to discuss contract details. We are talking about the renewal of a 5-year contract, we started negotiating it for 3 years. So this is good news from integrated logistics.

Operator [15]



There is another question by Gustavo. How was it possible to increase the margins of integrated logistics division in this quarter though revenue has not increased a lot?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [16]

Well, here, Gustavo, this was a set of positive effects. We had increased revenue of almost 3 percentage points, and we also had a cost reduction. So the revenue increased in this quarter, the costs were reduced because we did heavy internal work on processes, on reorganization, so we worked on costs and expenses. And more relevant than the revenue increase in the cost reduction, which amounted to over 4% was the work that we did on yield management. Now we are offering our clients services with added value. Of course, we cannot do this in greater scale at this point. But in some cases, in some negotiations, we can add value to our results.

Operator [17]



There's another question by Andre Prax. How will tegUP subsidiary be impacted in this scenario of reduced CapEx for the rest of the year?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [18]

Well, Andre, what we did in the case of tegUP -- because we believe a lot in that business unit, so what we did was we adjusted the CapEx, but the CapEx for tegUP is small. It is more of an intellectual investment because we built partnerships with many companies to help them with their pains and our clients' pains. So it is a lot more in intellectual investment than a financial investment, but still the necessary investment to run the project for 2020 was maintained -- was optimized, but it was maintained. By year-end, we expect results from our tegUP business unit.

Operator [19]



(Operator Instructions) I am going to read a question. The question is, whether we should expect more expenses related to Operation Pacto putting pressure on the margins in the coming quarters?

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [20]

It is hard to predict. The answer is, yes, we should have some additional expense. But I'd like to explain this. These expenses related to Operation Pacto are divided into 2 types. It is public knowledge. We have announced this that we formed, as ordered by the Board of Directors, an internal investigation committee, an independent investigation committee with committee members who are independent. So we have costs linked to that initiative. And the other category, we have costs linked to our representation in Operation Pacto, which is running in the court. So the cost related to the independent investigation committee should end in the coming quarter because this process is very close to coming to an end. So in terms of expenses, the impact should be lower because these costs will seize in the next quarter, we should have a better -- we should have the results of these internal investigations. Now regarding the court proceedings, there's an investigation, and it can extend for longer and we might incur some additional expense, most likely a lower expense than what we had in this quarter. This is what I can tell you about this.



Operator [21]

This concludes today's question-and-answer session. I would like to invite Mr. Medeiros to proceed with his closing statements. Go ahead, sir.

Marcos Antonio Leite De Medeiros, Tegma Gestão Logística S.A. - CEO & Member of the Executive Board [22]

We would like to thank all of you for participating, particularly in this very complex moment of our lives, both professional and personal. We are confident, and we are committed to adopt all necessary measures to care for our people and to care for the company so that we can lead this crisis even stronger. I wish you all the best. And I stress that myself, Ramon, and our IR team are always available. Have a good day.

Operator [23]



This concludes Tegma's conference call for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.

[Statements in English on this transcript were spoken by an interpreter present on the live call.]