S&P Global
Ratings

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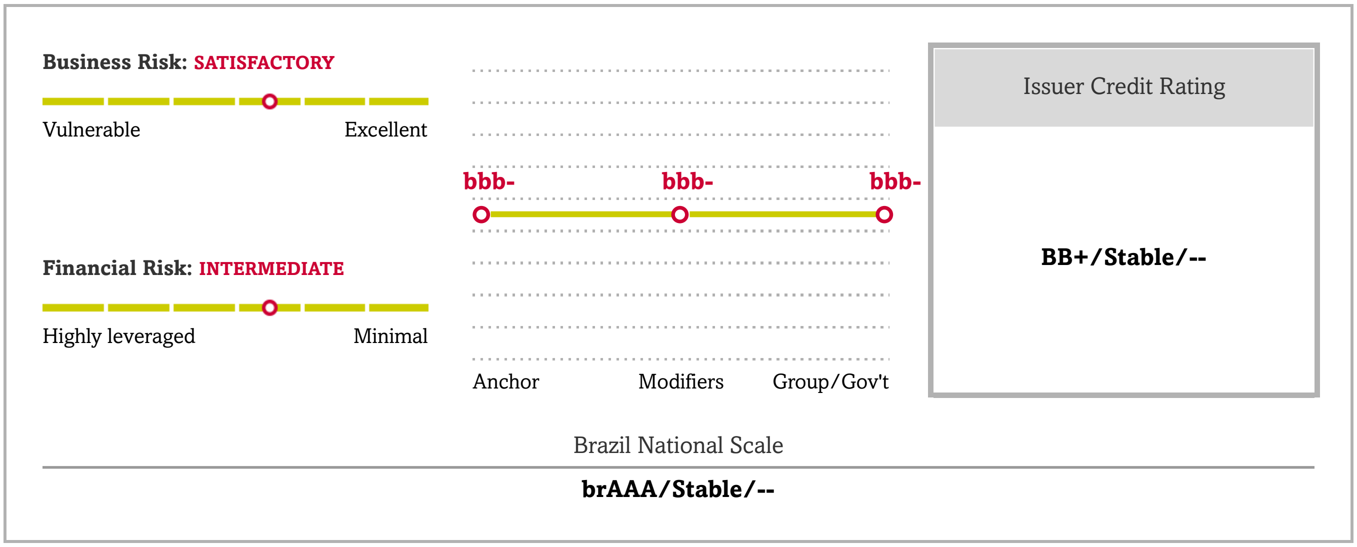
Localiza Rent a Car S.A.

Primary Credit Analyst:
Felipe Speranzini, Sao Paulo + 55 11 3039 9751; felipe.speranzini@spglobal.com

Secondary Contact:
Luisa Vilhena, Sao Paulo + 55 11 3039 9727; luisa.vilhena@spglobal.com

Table Of Contents

Localiza Rent a Car S.A.



Credit Highlights

Overview

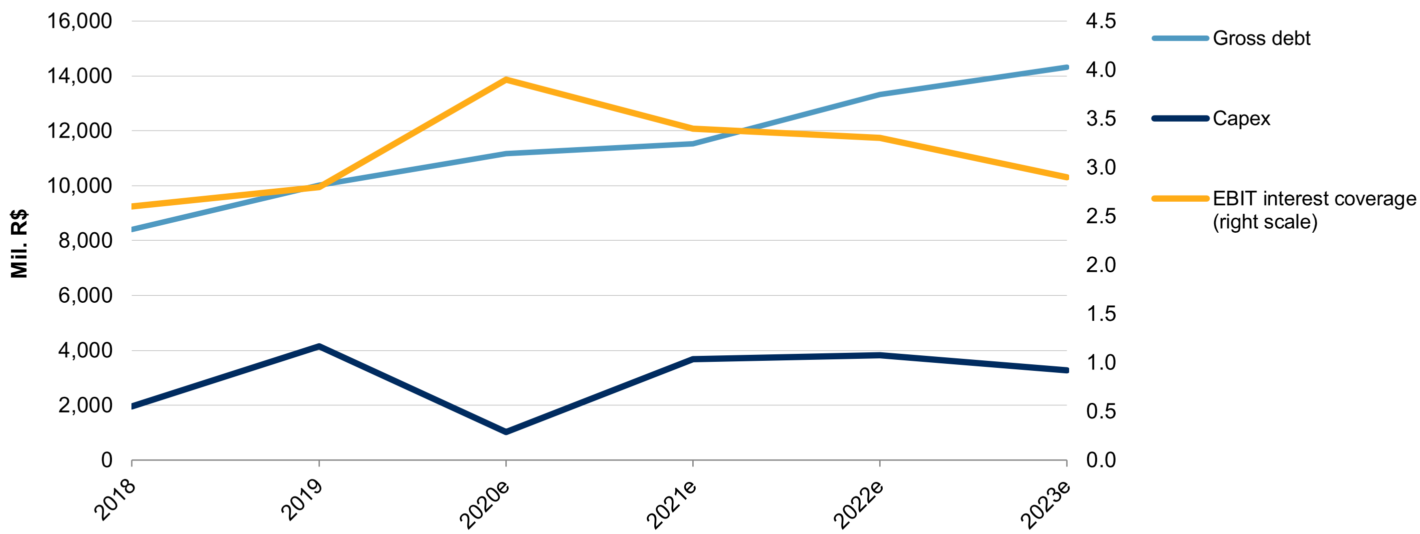
Key strengths	Key risks
Largest Brazilian player in the rental car industry.	Interest rate volatility could pressure cash flow and EBIT interest coverage ratios because the majority of the company's debt has a floating rate.
Well-positioned to capture the industry's growth momentum.	Fierce competition and rapid expansion of the car fleet weaken profitability.
Long record of solid execution and profitability.	The Brazilian real's weakness pressures EBIT margins and used car sales.
Consistently strong liquidity position, with conservative financial policy even amid rapid growth.	We cap our ratings on Localiza up to two notches above the ratings on Brazil.

Resilient operations, despite challenging business conditions, allowed Localiza to maintain robust leverage metrics. The pandemic-related containment measures took a lower-than-expected toll on the sector and on Localiza's cash flows during 2020. The company kept its leading position in the Brazilian car rental industry. Moreover, although the company reduced its fleet by about 29,000 vehicles (9.6% of its total fleet in 2019), it posted 1.1% revenue growth in 2020 thanks to its efficient operations and robust used car sales. We expect fleet expansion, tariff increases on fleet management and rent-a-car (RaC) segments, and strong used-car sales to result in revenue growth of about 15% and EBITDA margin close to 23% in 2021. Localiza's ability to maintain used-car sales at a brisk pace during mobility restrictions and the consequent adjustment of its fleet size provide additional cushion to credit metrics.

We expect higher growth and maintenance of strong credit metrics. Despite uncertainties over auto manufacturers' capacity to meet the rising demand for new cars, our base-case scenario assumes that Localiza will expand its fleet by 30,000 - 40,000 cars in 2021, which will allow it to return to the 2019 fleet level. With the fleet growth pace in the next years slower than prior to the pandemic, we expect the company to maintain robust credit metrics, with EBIT interest coverage at 3.0x-3.5x during the next three years, compared with 2.0x-3.0x until 2019.

Chart 1

Localiza's Debt And Capex



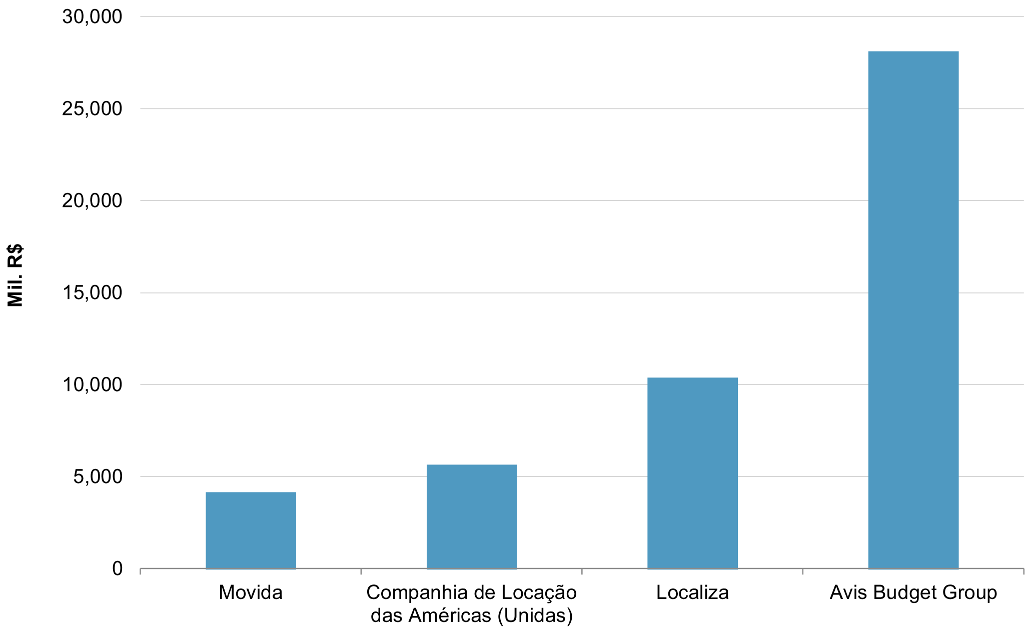
e--Estimate. Capex--Capital expenditure. R$--Brazilian real. Source: S&P Global Ratings.

Combination with Companhia de Locação das Américas S.A. (Unidas; brAAA/Stable/--) should strengthen Localiza's business position.

Localiza's competitive advantages could increase as a result of the potential merger with its second largest competitor, Unidas. The announced deal, if the Brazilian antitrust authority approves, could reduce the gap between Localiza's scale and those of its global peers, such as Enterprise Holdings, Inc. (total fleet of 2 million vehicles) and Avis Budget Group, Inc.(660,000 vehicles) by creating a company with about 500,000 vehicles. In addition to the operational synergies, it could create a significant market position increase in both RaC and fleet management businesses, enlarging access to the regional market and improving suppliers' negotiation. Given both companies' profile, we assume Localiza's leverage would be manageable thanks to EBIT interest coverage of 2.5x-3.5x in the next few years. We expect the antitrust approval to occur by the end of 2021.

Chart 2

Net Revenue Comparison
For 12 Months Ended Sept. 30, 2020



R$--Brazilian real. Source: S&P Global Ratings.

The sovereign rating caps the one on Localiza. The stable outlook on the global scale ratings on Localiza reflects the same on Brazil, because we cap the ratings on the company up to two notches above the 'BB-' sovereign rating and at the 'BB+' transfer and convertibility (T&C) assessment of Brazil, while Localiza's stand-alone credit profile (SACP) is 'bbb-'.

Outlook: Stable

The stable outlook reflects the company's cash-flow resiliency during the pandemic and capacity to rapidly adjust its strategy. Given that we cap our rating on Localiza at two notches above the sovereign rating level, the outlook on the company reflects the one on Brazil. We expect Localiza to maintain EBIT interest coverage and funds from operations (FFO) to debt above 3.0x and above 20%, respectively, in the next 12-24 months, and keep its strong liquidity cushion.

Upside scenario

A positive rating action would follow an upgrade of Brazil, given that the rating on Localiza is currently one notch below its SACP because of the two-notch cap above the sovereign rating on Brazil. We could revise upward the SACP if the company posts substantial scale growth while maintaining strong operating efficiency and controlling leverage. That could occur if its merger with Unidas is completed without major difficulties, resulting in considerable synergies.

Downside scenario

A downgrade is very unlikely given the company's higher SACP than the final rating. It could happen amid much weaker credit metrics such as EBIT interest coverage below 1.3x and FFO to debt below 12%. We could revise downward the company's SACP to 'bb+' if lower cash flows reduce EBIT interest coverage below 1.7x. That could occur as a result of higher-than-expected debt-funded growth, lower rental car rates than in 2020, and weaker-than-expected used-car sales. Such a scenario is possible if mobility restrictions in Brazil are reinstated or if customers' purchasing power falls amid lower government stimulus and high unemployment rate this year.

Our Base-Case Scenario

Assumptions	Key Metrics
• Brazil's GDP growth of about 3.2% in 2021 and 2.6% in 2022, supporting demand for car rentals and fleet leasing; • Inflation rate of 3.5%-4.0% in 2021 and 2022, affecting the company's cost base and tariff adjustments in fleet-leasing contracts; • Base interest rates in Brazil to average 2.4% in 2021 and 4.0% in 2022, influencing funding costs and contract rates for new fleet leases; • Fleet expansion of about 40,000 cars per year in 2021 and 2022; • purchases of about 200,000 of new vehicles in 2021,	• Revenue close to R$13 billion in 2021 and R$14.5 billion in 2022, compared with about R$10.8 billion in 2020; • EBIT interest coverage of 3.0x-3.5x in 2021 and 2022, compared with about 3.9x in 2020; • FFO to debt close to 25% in 2021 and 2022; and • Debt to EBITDA of 2.7x-3.0x over the next couple of years.

220,000 in 2022, and 230,000 in 2023;

- Used-vehicle sales of 160,000 units in 2021, 180,000 in 2022, and 200,000 in 2023;
- Average rented fleet of about 210,000 vehicles in 2021, 225,000 in 2022, and 250,000 in 2023;
- Gross capital expenditures (capex) for vehicle acquisition of about R$10 billion in 2021, and R$11 billion - R$13 billion in 2022 and 2023;
- Shareholder remuneration of about 30% of previous year's net income; and
- Total debt issuance of R$500 million - R$1 billion in 2021, and R$1 billion – R$2 billion in 2022 and 2023 to fund the capex plan.

Base-case projections

Capex will gradually increase during 2021. Although we saw a significant recovery in demand in Brazil's RaC business during the second half of 2020, we estimate that Localiza's fleet expansion will be constrained by auto manufacturers' production difficulties in the next few months. Given this factor, along with higher vehicle prices due to real's depreciation, we expect fleet growth to be limited in 2021 and the company to benefit from tariff increase in the first months of 2021. As a result, the company's EBIT margins will be 16%-18% in 2021 and 2022. During the second half of 2021, we expect fleet growth to accelerate, and fleet volume at the end of the year to reach the same level as in 2019. Considering all these aspects, Localiza should still present EBIT interest coverage at comfortable levels, above 3.0x, in our view.

Company Description

Localiza is the leading Brazilian car rental company with a total fleet of about 278,000 vehicles, operating in the RaC, fleet management, and used-car sales segments. Its net revenue reached R$10.3 billion in 2020.

Business Risk: Satisfactory

Localiza has kept its leading market position in Brazil, with strong brand reputation and sound operating efficiency in both the RaC and used-car sales segments. Its significant scale and brand equity in the domestic market provide Localiza competitive advantages and very competitive funding costs, supporting margins and return over investment.

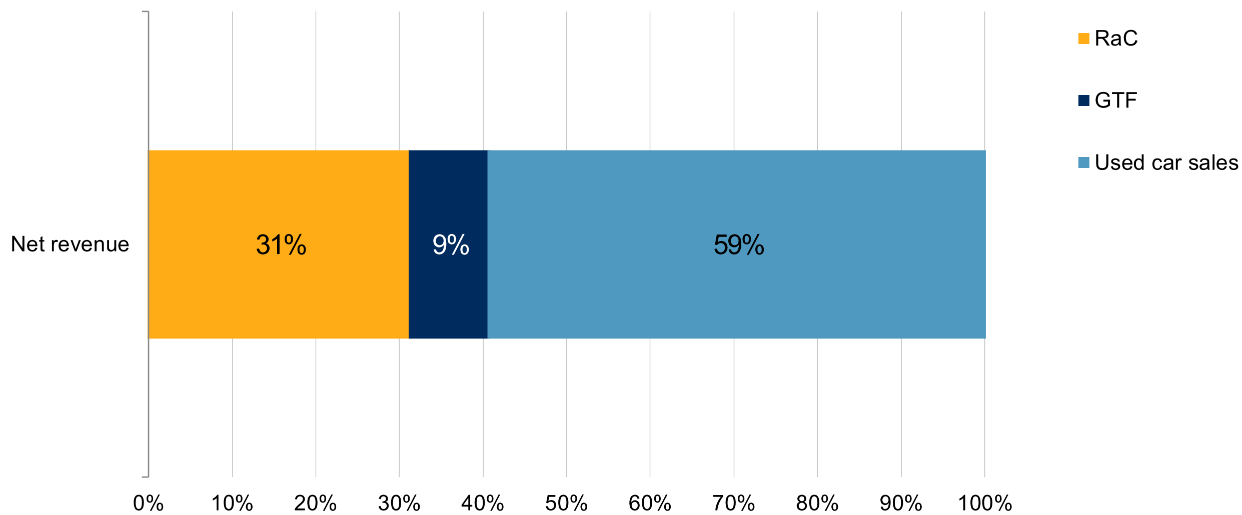
The above factors somewhat offset the risks associated with the higher volatility in the company's RaC business that represents about 75% of its fleet. This segment faces more intense competition and is exposed to more cyclical demand from travelers and corporate clients. However, we also see increasing demand from car-hailing apps and individuals renting vehicles, due to changes in consumer habits with lower interest in car ownership.

Given the very short cycle of Localiza's assets that demands quick monetization, the company benefits from a robust and liquid secondary market for used cars in Brazil, as well as an efficient resale structure.

We expect Localiza's consolidated EBIT margins to remain at 16%-18% in the next few years. Such a level reflects favorable used-car prices and the increasing share of car sales in the consolidated results. We expect Localiza to maintain low margin volatility even amid the likely recovery in its fleet growth.

Chart 3

Net 2020 Revenue By Business



Source: S&P Global Ratings.

Peer comparison

Table 1

Localiza S.A.--Peer Comparison

Industry sector: Misc. transportation

	Movida Participacoes S.A.	**Companhia de Locacao das Americas S.A.**	**Localiza Rent a Car S.A.**	**Avis Budget Group Inc.**
Business Risk Profile	Weak	Fair	Satisfactory	Satisfactory
Country Risk	Moderately High	Moderately High	Moderately High	Very Low
Industry risk	Intermediate	Intermediate	Intermediate	Intermediate
Competitive Position	Weak	Fair	Satisfactory	Satisfactory
Financial Risk Profile	Significant	Significant	Intermediate	Highly Leveraged
Ratings (as of January 2021)	B+/Stable/--; brAA/Stable/--	brAAA/Stable/--	BB+/Stable/--; brAAA/Stable/--	B+/Negative/--
	--Fiscal year ended Dec. 31, 2020--			
(Mil. R$)				
Revenue	4,085.3	5,591.8	10,307.6	28,053.8
EBITDA	717.2	1,326.5	2,468.1	9,555.5

Table 1

Localiza S.A.--Peer Comparison (cont.)

Industry sector: Misc. transportation

	Movida Participacoes S.A.	Companhia de Locacao das Americas S.A.	Localiza Rent a Car S.A.	Avis Budget Group Inc.
EBIT	356.1	829.5	1,899.1	(1,546.2)
Funds from operations (FFO)	468.8	1,082.5	1,794.2	6,002.0
Interest expense	202.2	304.7	483.3	3,387.4
Cash interest paid	229.4	202.2	423.8	3,325.1
Cash flow from operations	887.0	1,134.8	2,166.0	6,874.4
Capital expenditure	908.2	1,528.2	1,021.4	(16,919.5)
Free operating cash flow (FOCF)	(21.2)	(393.4)	1,144.6	23,793.9
Discretionary cash flow (DCF)	(80.9)	(508.7)	695.0	23,175.9
Cash and short-term investments	1,692.5	3,690.5	3,966.6	3,593.7
Debt	4,556.2	4,035.0	7,193.9	71,243.9
Equity	2,358.7	4,186.3	6,052.7	(804.9)
Adjusted ratios				
EBITDA margin (%)	17.6	23.7	23.9	34.1
EBIT margin (%)	8.7	14.8	18.4	(5.5)
Return on Capital (%)	5.8	10.8	14.7	(1.9)
EBIT interest coverage (x)	2.1	2.5	3.2	(0.2)
FFO cash interest coverage (x)	3.0	6.4	5.2	2.8
Debt/EBITDA (x)	6.4	3.0	2.9	7.5
FFO/debt (%)	10.3	26.8	24.9	8.4
Cash flow from operations/debt (%)	19.5	28.1	30.1	9.6
FOCF/debt (%)	(0.5)	(9.7)	15.9	33.4
DCF/debt (%)	(1.8)	(12.6)	9.7	32.5

R$--Brazilian real.

According to our internal estimates, Localiza has currently a leading position in the Brazilian market with a 35%-40% market share (measured by gross revenues) and 8%-12% share in fleet management. Despite fierce competition given sharp growth of local peers, the company has maintained widescale operations and efficient contracts with auto manufacturers.

Compared with global peers, the Brazilian RaC companies experienced a less severe disruption from mobility restrictions last year. Car rental rates in Brazil remained resilient given the longer-term type contracts and lower dependence on air travelers. In addition, Localiza's capacity to rapidly adjust its fleet, increase used-car sales, and reduce purchases enhanced financial flexibility by expanding the liquidity cushion.

Despite its leading position in Brazil, Localiza's business risk profile is somewhat weaker than those of global players such as Avis Budget Group, Inc. (B+/Negative/--) and Enterprise Holdings, Inc. (A-/Stable/A-2) because of its smaller fleet and narrower geographic diversification. This could change if the merger with Unidas occurs without major problems. Still, leverage and credit metrics are the main aspects that leading to rating differentiation among Localiza, Avis, and Enterprise.

Financial Risk: Intermediate

The company's credit metrics reflect its low funding costs and sound operating efficiency, translating into solid operating cash flows. Localiza has aggressively expanded over the past several years until 2020, adding debt to its capital structure, but this remained manageable thanks to the equity follow-on. Last year, Localiza reduced its fleet acquisition and maintained robust used-cars sales as demand fell amid the pandemic. That enabled the company to maintain sound liquidity position and very comfortable credit metrics.

Due to the industry's capex-intensive nature, we give a higher weight to the interest coverage ratio to assess Localiza's financial risk profile. In the past 12 months, Localiza somewhat improved this metric, which edged up to 3.9x in December 2020 from 2.8x in December 2019.

Financial summary

Table 2

Localiza Rent a Car S.A.--Financial Summary						
Industry sector: Misc. transportation						
		--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**	**2015**
(Mil. R$)						
Revenue	10,307.6	10,195.6	7,895.8	6,058.3	4,439.3	3,928.1
EBITDA	2,468.1	2,212.8	1,733.4	1,364.9	1,129.3	1,037.9
Funds from operations (FFO)	1,794.2	1,451.0	1,132.1	733.6	562.4	548.2
Interest expense	483.3	602.4	575.2	507.3	466.8	386.2
Cash interest paid	423.8	615.7	470.0	522.9	473.7	379.0
Cash flow from operations	2,166.0	1,525.0	937.4	866.0	852.9	704.0
Capital expenditure	1,021.4	4,147.8	1,958.0	2,120.9	1,124.0	783.4
Free operating cash flow (FOCF)	1,144.6	(2,622.8)	(1,020.6)	(1,254.9)	(271.1)	(79.4)
Discretionary cash flow (DCF)	695.0	(2,896.0)	(1,189.7)	(1,419.6)	(435.6)	(246.1)
Cash and short-term investments	3,966.6	2,830.9	2,442.8	2,613.9	1,692.3	1,385.1
Gross available cash	3,966.6	2,830.9	2,442.8	2,613.9	1,692.3	1,385.1
Debt	7,193.9	7,191.3	5,962.2	4,400.9	2,620.9	2,211.1
Equity	6,052.7	5,447.5	3,094.5	2,600.7	2,197.0	1,941.6
Adjusted ratios						
EBITDA margin (%)	23.9	21.7	22.0	22.5	25.4	26.4
Return on capital (%)	14.7	15.8	18.3	20.4	22.4	24.1
EBITDA interest coverage (x)	5.1	3.7	3.0	2.7	2.4	2.7

Table 2

Localiza Rent a Car S.A.--Financial Summary (cont.)						
Industry sector: Misc. transportation						
		--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**	**2015**
FFO cash interest coverage (x)	5.2	3.4	3.4	2.4	2.2	2.4
Debt/EBITDA (x)	2.9	3.2	3.4	3.2	2.3	2.1
FFO/debt (%)	24.9	20.2	19.0	16.7	21.5	24.8
Cash flow from operations/debt (%)	30.1	21.2	15.7	19.7	32.5	31.8
FOCF/debt (%)	15.9	(36.5)	(17.1)	(28.5)	(10.3)	(3.6)
DCF/debt (%)	9.7	(40.3)	(20.0)	(32.3)	(16.6)	(11.1)

R$--Brazilian real.

Liquidity: Strong

We view Localiza's liquidity as strong, with sources of cash exceeding uses by more than 2.0x in the next 12 months, and remaining above 1.0x in the following year even if EBITDA were to decline 30%. We expect the company to continue to rely on its operating cash flows and ability to access funding sources for its investment needs to reduce cash flow pressures. Meanwhile, Localiza's debt maturity profile remains smooth.

Principal Liquidity Sources	Principal Liquidity Uses
• R$4.0 billion of unrestricted cash as of December 2020; • FFO of R$2.5 billion; and • About R$1.5 million of assumed uncommitted secured financing for acquisitions of new equipment.	• R$1.6 billion in short-term debt as of December 2020; • Net capex of R$2.2 billion for fleet renewal and expansion capex; and • Dividend distribution of about R$200 million over the next 12 months.

Covenant Analysis

Localiza is subject to acceleration financial covenants under some of its debt contracts that require net debt to EBITDA to remain below 4.0x and EBITDA net interest coverage of at least 1.5x. We expect the company to continue meeting these covenants with headroom close to 30%.

Rating Above The Sovereign

We consider the auto sale and rental industries to be highly sensitive to a sovereign default: these business lines are closely correlated to economic activity, consumer purchasing power, inflation, and credit availability. In order to evaluate whether we can rate Localiza above Brazil, we apply a stress test to the company's cash flows and liquidity. In our stress scenario, we consider a GDP contraction of about 10%, and doubling of inflation and interest rates. We also apply a 10% haircut on the company's cash and bank deposits and 70% on short-term investments.

In the stress scenario, inflation would increase the company's operating costs, while it would have a limited ability to adjust service prices. We believe Localiza would try to reduce capex and maximize vehicle sales in order to maintain adequate liquidity, lowering the total fleet by about 30,000 cars.

In this stress scenario, we expect Localiza's liquidity sources to remain above its uses, reflecting its ability to manage its fleet according to its cash flow needs.

Issue Ratings - Recovery Analysis

Key analytical factors

We rate Localiza's senior unsecured debt 'brAAA', reflecting our national scale issuer credit rating on the company. Given Localiza's low leverage and liquid asset base, we expect meaningful recovery of 50%-70% (rounded to 65%) in a default scenario. The company's capital structure includes mainly senior unsecured debentures and working capital loans. Our analysis considers a stress scenario in which low demand, and rising inflation and interest rates would hurt the company's profitability. We base our valuation of Localiza on discrete asset valuation, on a going concern basis, because it's likely that the company would be restructured given its size, geographical footprint, and brand recognition.

Simulated default assumptions

- Year of default: 2026
- We apply a 15% haircut to fleet value, given that the company would have to sell vehicles under distress, providing greater discounts
- Dilution rate of 20% and then a haircut of 30% in receivables, simulating a potential fall in clients' renewal rate
- We apply 100% haircut to the company's cash position with the assumption that it would be consumed up to default point
- The above assumptions lead to a general haircut of about 30% to Localiza's total asset base value, with estimated gross enterprise value at emergence of R$11.8 billion

Simplified waterfall

- Net enterprise value after 5% administrative costs: R$11.1 billion
- Secured and priority debt: R$345 million
- Senior unsecured claims: R$11.5 billion
- Expected recovery of unsecured debt: 50%-70%

Reconciliation

Table 3

Localiza Rent a Car S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$)

	`--Fiscal year ended Dec. 31, 2020--				
Localiza Rent a Car S.A. reported amounts					
	Debt	**Operating income**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
Reported	10,497.7	1,801.7	2,468.1	483.3	108.1
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	(250.1)	--	--
Cash interest paid	--	--	(423.8)	--	--
Reported lease liabilities	662.8	--	--	--	--
Accessible cash and liquid investments	(3,966.6)	--	--	--	--
Nonoperating income (expense)	--	97.4	--	--	--
Working capital: Other	--	--	--	6,513.3	--
Operating cash flow: Asset disposals	--	--	--	(5,599.9)	--
Operating cash flow: Other	--	--	--	769.4	--
Capital expenditure: Other	--	--	--	--	913.3
Total adjustments	(3,303.8)	97.4	(673.9)	1,682.7	913.3
S&P Global Ratings' adjusted amounts					
	Debt	**EBIT**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
Adjusted	7,193.9	1,899.1	1,794.2	2,166.0	1,021.4

R$--Brazilian real.

Ratings Score Snapshot

Issuer Credit Rating

BB+/Stable/--

Business risk: Satisfactory

- **Country risk:** Moderately high
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb-

- **Rating above the sovereign:** (-1 notch from SACP)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - Industrials: Key Credit Factors For The Operating Leasing Industry, Dec. 14, 2016
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Recovery: Methodology For Applying Recovery Ratings To National Scale Issue Ratings, Sept. 22, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 1, 2021)*

Localiza Rent a Car S.A.		
Issuer Credit Rating		BB+/Stable/--
Brazil National Scale		brAAA/Stable/--
Senior Unsecured		
Brazil National Scale		brAAA
Issuer Credit Ratings History		
19-May-2020		BB+/Stable/--
19-Mar-2020		BB+/Watch Neg/--
12-Dec-2019		BB+/Positive/--
12-Jan-2018		BB+/Stable/--
16-Aug-2017		BB+/Negative/--
23-May-2017		BB+/Watch Neg/--
12-Jan-2018	*Brazil National Scale*	brAAA/Stable/--
16-Aug-2017		brAAA/Negative/--
23-May-2017		brAA+/Watch Neg/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.