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Rating Action: Moody's places Localiza's Ba2/Aa1.br ratings on review for upgrade following approval of merger with Unidas

20 Nov 2020

Sao Paulo, November 20, 2020 -- Moody's America Latina ("Moody's") placed Localiza Rent a Car S.A. ("Localiza") Ba2 global scale and Aa1.br national scale corporate family ratings on review for upgrade.

The review process follows the approval on November 12 by Localiza and Unidas S.A.'s shareholders to combine both companies' operations through a share swap that will result in the incorporation of Unidas by Localiza. The share swap ratio will be of 0.446824 of Localiza's share for each 1 share of Unidas. The transaction still pends approval from Brazil's antitrust authority, Conselho Administrativo de Defesa Econômica (CADE).

Ratings placed on review for upgrade:

..Issuer: Localiza Rent a Car S.A.

.... Corporate Family Rating, Placed on Review for Upgrade, currently Ba2/Aa1.br

....Outlook, Changed To Rating Under Review From Negative

RATINGS RATIONALE / FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Moody's review will focus on Localiza's resulting business and financial profile at the closing of the transaction, including: (i) the resulting leverage and capital structure of the combined entity; (ii) the potential restrictions imposed by CADE and its impact on the company's scale, competitive position and synergy potential in the Brazilian market; (iii) Brazil's economic trajectory and the operating environment for rent-a-car and fleet management companies when the merger is concluded; and (iv) the company's liquidity profile, financial policies and growth strategy during the execution of the integration of the businesses.

The ratings could be upgraded if Localiza's resulting business profile proves to be sustainably stronger after the merger, with higher profitability levels derived from synergies, such that Localiza's credit metrics improve and adjusted gross leverage moderates to around 4x from 4.8x in the twelve months ended in September 2020. The maintenance of a strong liquidity profile, including a significant amount of unencumbered assets that provide a liquidity backdoor in stress scenarios, and of a conservative financial management after the business combination would also be required for an upgrade. Finally, evidences of a dominant market position and of significant financial flexibility that provides Localiza some insulation from Brazil's economic environment and local debt market would also be required for the company to be rated above Brazil's sovereign rating.

Potential synergies coming from the merger between Localiza and Unidas include a reduction in general and administrative expenses, the benefits of Localiza's proven track record of low fleet maintenance requirements, high utilization rates, attractive discounts from OEMs and expertise in the used-car sale market in Unidas' businesses, and a continued ability to quickly reduce car purchases or increase used car sales to generate cash and cover extraordinary outflows to mitigate integration and execution challenges and the strain in credit metrics during market downturns. We believe Unidas receives a smaller discount than Localiza in car purchases, and only the equalization of discount levels would already bring significant savings for the combined entity, enhancing its overall profitability.

The transaction can reduce Localiza's leverage depending on its synergy potential. Unidas' 4.3x total debt/EBITDA is slightly lower than Localiza's, and any benefit coming from cost synergies would improve the combined entity's profitability and reduce leverage. The liquidity profile of the resulting entity would be good, with a combined cash position of BRL6.8 billion that covers all debt maturities through 2022, plus a total fleet with a market value of BRL19.3 billion, which covers total reported debt by 1.2x. Liquidity would remain adequate even assuming some haircut to the fleet's market value and the potential BRL425 million reduction in Unidas' cash position coming from an extraordinary dividend payment to its current shareholders.

The ratings could be confirmed if there are no material changes to the company's current credit metrics or competitive position after the merger, such that the potential for synergies or of a strengthened business and financial profiles coming from the transaction abate. A continued debt-funded growth strategy without the corresponding EBITDA benefit, or a deterioration in current market conditions that overshadow the benefits of the merger could also result in a confirmation of the ratings.

Given the current review, a downgrade of Localiza's ratings is unlikely. However, downward pressure on the ratings or outlook could emerge if Localiza's liquidity deteriorates because of weakness in operations and inability to sell used cars, or if its car rental utilization rate decline to below 60% for an extended period of time. A sustained deterioration in credit metrics, measured by gross debt/EBITDA above 4.5x and EBITDA interest coverage falling below 3.0x without prospects of improvement could also lead to a downgrade. A downgrade of Brazil's sovereign rating could also result in a downgrade of Localiza's ratings.

The principal methodology used in these ratings was Equipment and Transportation Rental Industry published in April 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1061773. Alternatively, please see the Rating Methodologies page on www.moodys.com.br for a copy of this methodology.

Founded in 1973 and headquartered in Belo Horizonte, Minas Gerais, Brazil, Localiza operates car rental and fleet rental businesses and has a used car sale business to deploy and renew its fleet in Brazil. The company also franchises rental car operations in Brazil and in five countries in South America. As of September 2020, the company had a total fleet of 268,128 company-owned cars and 11,757 cars at franchisees in Brazil and five other countries. The company is the market leader in Brazil in terms of car rental, with the largest number of car rental locations and presence in all main Brazilian airports. In the 12 months ended September 2020, the company reported net revenue of BRL10.4 billion ($2.2 billion) and net income of BRL875 million. Unidas is the second largest rent-a-car and the largest fleet management company in Brazil, with a total fleet of 156 thousand cars at the end of September 2020. The company reported BRL5.2 billion in revenues and a 24% reported EBITDA margin in the twelve months ended September 2020.

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