FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Localiza's and Upgrades Unidas's Ratings

Wed 20 Jul, 2022 - 2:33 PM ET

Fitch Ratings - Rio de Janeiro - 20 Jul 2022: Fitch Ratings has affirmed Localiza Rent a Car S.A.'s (Localiza) Long-Term Local Currency (LC) and Foreign Currency (FC) Issuer Default Ratings (IDRs) at 'BB+' and 'BB', respectively, and the Long-Term National Scale Rating of Localiza and its wholly owned subsidiary Localiza Fleet S.A. (Localiza Fleet) at 'AAA(bra)'. In addition, Fitch has upgraded the Long-Term National Scale Rating of Companhia de Locacao das Americas - Locamerica (Locamerica) and its wholly owned subsidiary Unidas S.A. (Unidas), collectively Unidas, to 'AAA(bra)' from 'AA+(bra)' and removed the Rating Watch Positive. The Rating Outlooks are Stable.

The rating actions follow the conclusion of the business combination of Localiza and Unidas (now collectively Localiza), respectively, the largest and second largest car and fleet rental companies in Brazil. The event strengthened the market position of the combined entity, which benefits from expected synergies. The ratings also reflect the resilient operating performance of both companies throughout economic cycles and a group with solid capital structure and strong liquidity position. The sovereign Country Ceiling at 'BB' caps Localiza's FC IDR.

KEY RATING DRIVERS

Solid Leading Market Position: The business combination, which comprised the share merger of Unidas's into Localiza's, further strengthened Localiza's leading and prominent business position within the car and fleet rental industry in Brazil, underpinned by its even larger scale, proven operating expertise, national footprint and a strong used car sale operation. As of March 2022, Localiza's and Unidas's total fleet of 494,656 vehicles, consisting of 294,587 in rent-a-car (RaC) and 197,069 in fleet management (GTF), secured the combined entity a comfortable leadership in both markets. As a result, the company will have a stronger bargaining power with original equipment manufacturers (OEM) and be able to better capture economies of scale. At YE 2022 and 2023, Localiza's own total fleet should be around 524,000 (already excluding the 49,000 vehicles carve out) and 559,000 vehicles, respectively.

Strong Operating Performance: Rating case scenario presents robust consolidated EBITDA based on moderate organic growth and improving margins. Healthy demand dynamics should continue to allow tariffs adjustments, which is crucial to face cost inflation, higher asset purchase prices and increasing cost of capital. Localiza should reach consolidated net revenue of BRL21.6 billion and EBITDA at BRL7.8 billion (36% margin) in 2022 and BRL28.5 billion and BRL8.5 billion (30% margin) in 2023, from pro forma (Localiza plus Unidas) BRL17.5 billion and BRL6.4 billion (36% margin), respectively, in the LTM ended in March 2022. Forecasted EBITDA considers lower margins coming from asset sales.

Moderate Leverage: Margin expansion at the RaC and GTF segments resulting in higher return on invested capital (ROIC) and a ROIC spread over the cost of debt at levels in line with historical numbers should enable Localiza to cope with high interest rates and asset inflation - allowing the company to conciliate its growth and fleet renew with a moderate financial leverage. Localiza's consolidated net leverage (IFRS-16 adjusted), measured by net debt/EBITDA, should be between 2.5x and 3.0x on the rating horizon, comparing with Localiza's average of 2.7x in the last three years.

Manageable FCF: The capital-intensive nature of the rental industry, which demands sizable and regular investments to grow and renew the fleet, pressures Localiza's cash flow. FCF should remain negative, on average, at BRL4.3 billion from 2022 to 2024, pressured by annual average growth capex of BRL4.5 billion. Funds from operations (FFO) and cash flow from operations (CFFO) should be, on average, BRL900 million and BRL1 billion, respectively, in the same period. The new group has room to postpone fleet renewal and reduce expansion capex, if needed.

Parent and Subsidiary Linkage: Localiza Fleet, Locamerica and Unidas's ratings reflect Localiza's strong incentive to support them, according to Fitch's Parent and Subsidiary Rating Linkage Criteria, which equalizes the ratings of the four companies. The subsidiaries will operate under a common brand and compose a synergic vehicle rental ecosystem, benefiting from greater bargaining power when buying and selling vehicles and negotiating with customers. Localiza also guarantees 100% of Localiza Fleet's debt.

DERIVATION SUMMARY

Compared with Localiza, Simpar S.A. (Simpar, FC and LC IDRs BB/Stable) has lower scale on GTF and RaC businesses and a weaker financial profile - with higher leverage and more pressured FCF. Positively, Simpar presents a more diversified business portfolio through operations in logistics and rental of heavy vehicles. Compared with Ouro Verde Locacao e Servico S.A. (Ouro Verde, FC and LC IDRs BB-/Stable), Localiza has a much stronger business profile, higher liquidity, better access to credit market and lower leverage.

Compared to CEMEX, S.A.B. de CV. (LC and FC IDRs BB+/Stable), Localiza has a more diversified business profile, higher profitability, less volatile cash flow generation and a more liquid/tradable asset base. On the other hand, CEMEX has higher scale, a historic of positive cash flow generation and relatively similar leverage on the rating horizon.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for Localiza

--Total fleet growth around 7% on the next three years;

--Average ticket for RaC increasing 19% in 2022 and 4% in 2023;

--Average ticket for GTF increasing 10% in 2022 and 6% in 2023;

--Net capex around BRL5.7 billion in 2022-2023;

--Dividend payout around 25% throughout the rating horizon.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A positive rating action for Localiza's FC IDR will depend on an improvement on Brazil's Country Ceiling;

--An upgrade on Localiza's LC IDR would depend on the ability to further improve its business profile and/or to bring its consolidated leverage ratios to more conservative levels, with net debt-to-EBITDA ratio moving towards 2.0x on a recurring basis;

--Upgrade not applicable to the National Scale ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Failure to preserve liquidity and inability to access adequate debt funding;

--Prolonged decline in demand coupled with company inability to adjust operation, leading to a higher than expected fall in operating cash flow;

--Increase in total leverage to more than 4.5x and in net leverage to more than 3.5x on a regular basis;

--A negative movement on Brazil's Country Ceiling could result in negative rating action for Localiza's FC IDR.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Robust Liquidity Profile: Localiza's robust liquidity position, ample access to different sources of funding, and track record of a proactive liability management are key credit considerations, with cash covering its short-term debt by an average over 3.0x during the last three years. The group's expected negative FCF, a result of its growth and fleet renew, should be financed by a combination of cash and additional debt in the rating scenario.

As of March 2022, on a pro forma basis, Localiza and Unidas had BRL7.9 billion of cash and equivalents and BRL24.9 billion of total debt, with BRL3.4 billion due in the short term. Localiza's financial flexibility is enhanced by the its ability to postpone growth capex to adjust to the economic cycle, if needed, and by the considerable number of the group's unencumbered assets, with a book value of fleet higher than its net debt.

ISSUER PROFILE

Localiza is the largest rental car company in Brazil, either by fleet size or revenue. It operates in the Rent a Car, Fleet Rental and Used Car Sale segments and fully owns Localiza Fleet, Locamerica and Unidas, among other not rated operating companies.

SUMMARY OF FINANCIAL ADJUSTMENTS

--Growth capex was moved from the CFO to the CFI,

--Effects of IFRS 16 reversed,

--Capex funded by OEM payables affecting FCF but not FFO.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Unidas S.A.	Natl LT Upgrade	AAA(bra) Rating Outlook Stable	AA+ (bra) Rating Watch Positive
Localiza Fleet S.A.			

senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra)
Companhia de Locacao das Americas - LOCAMERICA				
Localiza Rent a Car S.A.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Stable
	Natl LT	AAA(bra) Rating Outlook Stable	Affirmed	AAA(bra) Rating Outlook Stable
senior unsecured	Natl LT	AAA(bra)	Affirmed	AAA(bra)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Metodologia de Ratings em Escala Nacional (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Localiza Rent a Car S.A.	EU Endorsed, UK Endorsed

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