Research Update:

Brazilian Car Rental Company Movida Outlook Revised To Positive On Growth Prospects, 'BB-' Ratings Affirmed

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Rating Action Overview

- Brazilian car rental company Movida Participações S.A. (Movida) has grown considerably in scale. We expect most of growth in the next few years will be in the company's fleet management segment, raising cash-flow predictability.
- Even though we expect credit metrics to slip in 2022, the fleet management unit's long-term contracts and the industry's favorable momentum will allow Movida to generate solid operating cash flows, despite Brazil's worsening economy next year.
- On Dec. 21, 2021, S&P Global Ratings revised the outlook on its ratings on Movida to positive from stable and affirmed its 'BB-' global scale and 'brAA+' national scale issuer credit ratings on the company.
- The positive outlook indicates a one-in-three chance of an upgrade in the next 12-18 months if the company's growth doesn't pressure credit metrics, resulting in funds from operations (FFO) to debt above 20% and EBIT interest coverage close to 2.0x on the average of the next three years.

Rating Action Rationale

The company's stronger competitive advantages support the positive outlook. Movida has expanded its market share in the past year through a broader presence and diversification of end markets and clients, and increasing the size of its fleet close to 170,000 vehicles as of September 2021 from 108,000 as of September 2020. In addition, after the incorporation of CS Frotas in July and other smaller acquisitions, the fleet management's share of total revenue rose to 55% this year from the historical level of 35%-40%. We expect this ratio to reach more than 60% starting in 2023. This will increase cash-flow predictability due to the segment's long-term contracts and countercyclical nature, unlike the rent-a-car (RaC) segment, operations of which are volatile and depend upon discretionary demand. The company's competitive advantage in new vehicles sourcing has risen, amid automakers' supply-chain disruptions, allowing Movida to increase its fleet organically. Moreover, we don't assume major changes in competitive conditions in the car rental industry following the merger of Movida's two major competitors, Localiza Rent a Car S.A. (global scale: BB+/Stable/--; nationals scale: brAAA/Stable/--) and Unidas S.A. (brAAA/Stable/--) next year. Once that occurs, Movida will be the second-largest player in the industry.

Due to these factors, we revised our assessment of the company's busines risk profile to fair from weak. On the other hand, the final rating remains the same, because credit metrics will be somewhat pressured next year mainly due to much higher base interest rates. If Movida expands its scale without weakening credit metrics beyond our expectations or its profitability, we could raise the ratings in the next 12-18 months.

Expected growth despite Brazil's weakening economy in 2022. We expect the car rental industry in Brazil to continue growing despite likely feeble economic growth, uncertainties due to presidential election, and higher interest rate and inflation. We understand that the company can ramp up, because we continue to see stronger rates and demand in the RaC segment, high prices for used cars, and the resilience of Movida's fleet management segment. Moreover, the company has improved its used-car sales unit and that its current scale and its focus on the fleet management segment would allow it to grow even if industry conditions weaken.

Higher interest burden to be offset mainly in 2023. Movida issued more than R$10 billion in debt during 2021, consisting of the notes issuance, and add-on to the existing notes and debentures in the local market. Most of the company's issuances are to fund capital expenditures (capex) in 2022, given potential uncertainties in credit markets. We forecast the company's net debt to jump close to R$6.1 billion in 2021 and R$9 billion - R$10 billion in 2022 from R$2.8 billion in 2020, given higher capex for fleet growth. This, coupled with significantly higher interest rates in Brazil, will increase the company's interest burden significantly, weakening credit metrics in 2022. But we expect the latter to improve starting in 2023, assuming declining interest rates and as the company's expansion gains strength.

Outlook

The positive outlook reflects a one-in-three chance of an upgrade if Movida consolidates its business position in the fleet management segment while its RaC and used-car sale units remain profitable. We expect the company to maintain margins in the 20%-25% range in the future, declining somewhat compared with current levels, but still higher than historical figures, given still profitable used-car sales structure even if vehicle prices return to normal levels. We expect EBIT interest coverage close to 2.0x and FFO to debt of about 20% in the next three years.

Upside scenario

We could raise the ratings in the next 12-18 months if Movida's scale, revenue, and cash flows grow without pressuring credit metrics. In this scenario, we would see FFO to debt of more than 20% and EBIT interest coverage close to 2.0x. Additionally, an upgrade would depend on the same rating action on its parent company, Simpar S.A., and on solid liquidity position that would allow Movida to withstand a hypothetical sovereign default scenario of Brazil (BB-/Stable/B).

Downside scenario

We could revise the outlook to stable if the company's growth pace doesn't materialize due to lower-than-expected demand for the RaC and fleet management segments, along with lower activity in used-car sales. In this scenario, we would see weaker cash flows, resulting in EBIT interest coverage below 1.7x and FFO to debt closer to 15%.

Our Base-Case Scenario

- Brazil's GDP growth of 4.8% in 2021, 0.8% in 2022. and 2.0% in 2023, influencing overall demand and pricing power in fleet management business.
- Brazil's average inflation of about 8.2% in 2021, 7.7% in 2022, and 4.0% in 2023, affecting labor-related and fleet-maintenance prices.
- Average short-term policy rates of 5.6% in 2021, 10.3% in 2022, and 9.6% in 2023, compared with 2.4% at the end of 2020, affecting funding costs and rates of new fleet management contracts.
- Total consolidated fleet at year-end of about 170,000 cars in 2021, 190,000 in 2022, and 210,00 in 2023. We consider that the company will continue allocating 55%-60% of its vehicles to the fleet management segment and 40%-45% to the RaC unit in 2022, but to increase consistently to 60% and 40%, respectively, starting in 2023.
- Average capacity utilization rate in the RaC business of about 90% in the next few years.
- Fleet management rates to increases about 5% in 2021, 8% in 2022, close to 20% in 2023, and continue increasing afterwards, as the company is expanding its fleet, impacting pricing of renewal contracts.
- Average RaC daily rates growing 15% in 2021, above 30% in 2022, and close to 20% in 2023, reflecting the strong demand in the sector, but also a more premium vehicle mix.
- Net capex of about R$5.2 billion in 2021, R$5.3 billion in 2022, and R$4.2 billion in 2023 to support fleet expansion.
- Used-car sale revenue of about R$2.6 billion in 2021, close to R$5 billion in 2022, and R$8 billion in 2023.
- Dividend distribution of 25% of the previous years' net income in the next few years.

Based on these assumptions, we arrive at the following credit metrics:

- Net revenue of R$5.4 billion in 2021, R$9.7 billion in 2022, and R$14.2 billion in 2023, compared with about R$4.1 billion in 2020.
- Adjusted EBIT of close to R$2 billion in 2021, R$3 billion in 2022, and R$3.2 billion in 2023, compared with close to R$540 million in 2020.
- FFO of close to R$1.3 billion in 2021, R$1.6 billion in 2022, and R$2.5 billion in 2023, compared with about R$646 million in 2020.
- EBIT interest coverage of 2.7x in 2021, and 1.7x-2.1x in 2022 and 2023, compared with 2.6x in 2020.
- FFO to net debt of close to 22% in 2021, 15%-18% in 2022 and 19%-22% in 2023, compared

with about 22.6% in 2020.

Ratings Score Snapshot

Issuer credit rating:

- Global Scale: BB-/Positive/--
- National Scale: brAA+/Positive/--

Business risk Profile: Fair

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk Profile: Significant

- Cash flow/Leverage: Significant

Anchor: bb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bb-

ESG Credit Indicators: E-2 S-2 G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Movida Participacoes S.A.		
Issuer Credit Rating	BB-/Positive/--	BB-/Stable/--
Brazil National Scale	brAA+/Positive/--	brAA+/Stable/--
Movida Locacao de Veiculos S.A.		
Issuer Credit Rating		
Brazil National Scale	brAA+/Positive/--	brAA+/Stable/--
Ratings Affirmed		
Movida Participacoes S.A.		
Senior Unsecured	brAA+	
Recovery Rating	3(65%)	
Movida Europe		
Senior Unsecured	BB-	
Recovery Rating	3(65%)	