Research Update:

Brazilian Car Rental Company Movida Participacoes S.A. Assigned 'B+' Issuer Credit Rating, Outlook Stable

January 25, 2021

Rating Action Overview

- Movida Participações S.A. (Movida) is the third-largest car rental and fleet management company in Brazil, while it has a large exposure to the more volatile rent-a-car (RaC) segment.
- The company has recently proposed to issue senior unsecured notes. We expect Movida to use part of the proceeds to fund a more aggressive fleet growth strategy. Still, the likely higher cash flows should compensate for the higher debt over the next few years.
- On Jan. 25, 2021, S&P Global Ratings assigned its 'B+' issuer credit rating to Movida. At the same time, we affirmed our 'brAA' Brazilian national scale. We also affirmed the 'brAA' issue-level rating on the company's senior unsecured local debentures, and kept a recovery rating of '3' (65%) on them unchanged.
- The stable outlook reflects our expectation of increasing cash flows over the next few quarters thanks to the debt-funded fleet growth, which should keep credit metrics relatively stable. We expect the company to post EBIT interest coverage at 2.0x-2.6x and funds from operations (FFO) to debt of 15%-20% in 2021 and 2022.

PRIMARY CREDIT ANALYST

Thais R Abdala
Sao Paulo
thais.abdala
@spglobal.com

SECONDARY CONTACTS

Luisa Vilhena
Sao Paulo
+ 55 11 3039 9727
luisa.vilhena
@spglobal.com

Felipe Speranzini
Sao Paulo
+ 55 11 3039 9751
felipe.speranzini
@spglobal.com

Rating Action Rationale

High exposure to the RaC segment implies risks of greater earnings volatility. Since Simpar S.A. 's (formerly JSL S.A.) acquisition of Movida in 2013, the company has been investing to expand its fleet substantially to meet the increasing market demand in the RaC and fleet management and outsourcing (GTF) segments. While the latter segment has been growing rapidly over the past few years, the RaC segment still represents about 60% of the company's total fleet. This reduces earnings predictability and raises risks of cash flow volatility due to the segment's following characteristics: short-term contracts, fierce competition, and cyclicality of demand among tourists and corporate customers.

Solid position in Brazil, but the company lacks the scale and diversification of larger players. We view Movida as well positioned in the Brazilian market, given that it's one of the three largest players with high brand recognition and increasing scale. Nevertheless, Movida operates only in Brazil, with much lower asset and revenue base than those of its peers, such as Localiza Rent a Car S.A. (BB+/Stable/--; brAAA/Stable/--) that has a leading position in the Brazilian market, and Enterprise Holdings, Inc. (A-/Stable/A-2), which is the world's largest car rental company. Movida also generates a lower share of revenue from the more stable GTF segment than its domestic competitor, Companhia de Locação das Américas (brAAA/Stable/--).

Ability to overcome the pandemic's effects. Despite the economic downturn and mobility restrictions stemming from COVID-19 last year, Movida protected its credit metrics and liquidity by quickly reducing its RaC fleet and increasing its used-car sales, while benefiting from the resilience of the GTF segment. The company's used-car sales' revenues increased close to 17% in the first nine months of 2020, allowing Movida to reduce its total fleet and recover the utilization rates close to historical levels of 80%, from 55%-60% during April and May when demand plummeted. Cash proceeds from the car sales, coupled with lower capital expenditures (capex), allowed Movida to maintain a solid cash position in 2020. A faster-than-expected recovery in demand also lifted average rates, which should help improve profitability. Still, we don't dismiss risks of new partial lockdowns and stalled economic recovery over the next few months, which could limit company's growth trend.

Additional debt to fund fleet expansion, but credit metrics to remain relatively stable. The company has been active in the domestic capital markets issuing debentures totaling R$800 million in the fourth quarter of 2020, mainly to fund fleet expansion. Movida also announced today its intention to issue senior unsecured notes to pay short-term debt as well as to fund fleet expansion. With the new debt issuances, we expect the company's net capex to rise significantly, to about R$2 billion in 2021 and close to R$3 billion in 2022, compared with close to R$1 billion in 2020. This should support a fleet increase of 55,000-60,000 cars until the end of 2022. Given that most of the new vehicles should be directed to the company's GTF segment, we expect stronger growth in cash flows over the next few years. Despite additional debt and a more aggressive capex plan, EBIT interest coverage should be 2.0x-2.6x and FFO to debt at 15%-20% in the next two years.

Outlook

The stable outlook on Movida reflects our expectation of ongoing fleet expansion over the next few quarters, increasing cash flows. Although we expect higher debt to fund this growth, credit metrics will likely remain relatively stable. We expect the company to post EBIT interest coverage at 2.0x-2.6x and FFO to debt of 15%-20% in 2021 and 2022.

Upside scenario

A positive rating action in the next 12 months could result from a consistent growth trend, with an increasing share of revenue coming from fleet management, which would lower cash flow volatility and improve profitability. The upgrade would also depend on our view of lower risks of weakening or changing consumer sentiment and demand, stemming from the pandemic and from the trend of economic recovery. A positive rating action would also depend on strong used-car sales. In this scenario, we expect EBIT interest coverage close to 2.4x and FFO to debt close to 20% on a consistent basis, and the maintenance of adequate liquidity. We could also upgrade Movida following a similar action on its parent, Simpar.

Downside scenario

A downgrade is unlikely at this point because it would require simultaneously a lower SACP for Movida and a downgrade of Simpar. If we were to downgrade Simpar to 'B+', ratings on Movida wouldn't change because its SACP is now at the same level as the group credit profile. And if we were to revise downwards Movida's SACP to 'b', assuming no change in Simpar's credit quality, the final rating on Movida would still be 'B+' due to expected support from the higher rated parent.

We could revise downwards Movida's SACP in a scenario of worsening macroeconomic conditions or an abrupt shift in consumer behavior, leading to much weaker cash flow generation. In this scenario, we would expect EBIT interest coverage below 1.7x and FFO to debt below 12%. We believe this is unlikely in the next 12 months, given the comfortable headroom on company's credit metrics.

Company Description

Movida is one of the top three car rental companies in Brazil, offering car rental and fleet management services, with a total fleet of 118,285 cars at the end of 2020. We expect the company to record consolidated revenue of about R$4.1 billion and EBITDA close to R$900 million in 2020. The Brazilian transportation group, Simpar S.A. (BB-/Stable/--; brAA+/Stable/--), holds a 55% stake in Movida. The remaining shares are free-floating. We expect Movida to contribute 35%-40% of the group's revenue and EBITDA in 2020.

Our Base-Case Scenario

- Brazil's inflation of about 3.5% in 2021 and 3.4% in 2022, affecting labor-related and fleet maintenance costs.
- Average policy rates of 2.44% in 2021 and 3.94% in 2022, compared with 2% at the end of 2020, affecting funding costs and rates of new fleet management contracts.
- Total fleet rising to 140,000-145,000 cars in 2021 and to 170,000-175,000 cars in 2022 from about 118,000 at the end of 2020. The share of fleet allocated for RaC to drop close to 55% in 2022 from about 60% at the end of 2020.
- Average daily rate in the RaC segment of R$87-R$92 in the next two years.
- Average monthly GTF tickets of R$1,300-R$1,330 in the next two years.
- Sales of used cars close to 70,000 in 2021 and 95,000-100,000 in 2022 (compared with about 57,000 in 2020), with an average price of R$47,000-R$49,000.
- Consolidated EBIT margin increasing to 10%-15% in 2021 and 2022 from close to 7% in 2020 when depreciation increased significantly.
- Net capex increasing to close to R$2 billion in 2021 and R$3 billion in 2022 from about R$1.1 billion in 2020, mainly for fleet expansion and renewal.
- Interest expenses increasing to R$270 million - R$280 million in 2021 and above R$400 million in 2022 from about R$215 million in 2020, given higher debt to fund fleet growth.

- Dividend payment of 40% of previous year's net income.

Based on these assumptions we expect:

- Net revenue of R$5.6 billion – R$5.8 billion in 2021 and R$7.5 billion – R$7.9 billion in 2022, compared with about R$4.1 billion in 2020.
- Adjusted EBIT of close to R$700 million in 2021 and R$850 million - R$1 billion in 2022, compared with close to R$285 million in 2020.
- FFO of close to R$1 billion in 2021 and R$1.3 billion – R$1.4 billion in 2022, compared with about R$690 million in 2020.
- EBIT interest coverage of 2.4x-2.6x in 2021 and 2.0x-2.4x in 2022, compared with about 1.3x in 2020.
- FFO to debt of 15%-20% in 2021 and 2022, compared with about 15% in 2020.

Liquidity

We assess Movida's liquidity as adequate. We forecast cash sources over uses above 1.2x in the 12 months after Sept. 30, 2020. The company's sizeable cash position, used-car sales, and flexibility to reduce capex provide a comfortable liquidity position and ability to absorb high-impact, low-probability events with limited need for refinancing. Movida also has sound relationship with banks and a track record in accessing the local credit markets in the past three to four years.

Principal liquidity sources

- Cash position of R$1.63 billion as of Sept. 30, 2020;
- Expected FFO close to R$980 million in the 12 months after Sept. 30, 2020; and
- Proceeds from two debentures issued at the end of 2020 totaling R$800 million.

Principal liquidity uses

- Short-term debt of R$713.7 million as of Sept. 30, 2020;
- Working capital outflows of about R$120 million in the next 12 months;
- Net capex of about R$1.7 billion in the 12 months after Sept. 30, 2020;
- Payment of R$230 million of suppliers financing (carmakers); and
- Dividends distribution of about R$46 million.

Covenants

Movida's financial flexibility is limited by payment acceleration covenants on its debentures and promissory notes, which require the maintenance of net debt to EBITDA below 3.5x and EBITDA interest coverage above 1.5x, measured quarterly. The covenants also establish a cap of 50% of the total value of the company's vehicle fleet for liens on its vehicles. We expect Movida to maintain a cushion of 15%-20% in the net debt to EBITDA ratio and 50% in interest coverage in the next two years.

Other Credit Considerations

We view Movida as a highly strategic subsidiary of Simpar. We believe Movida is very important to the group's long-term strategy and highly unlikely to be sold. We expect Simpar to provide support to Movida under almost all foreseeable circumstances. This has been the case in 2018, for instance, when Simpar increased its stake in the company through a capital increase. When acquired by JSL in 2013, Movida was linked to the parent's long-term strategy of increasing diversification in strategic sectors, following its already existing operations of fleet management of trucks and other heavy vehicles. Still, Movida's operations are managed independently, with different executives and administrative functions, and we don't view it as closely linked to the group's name and brand.

Issue Ratings - Recovery Analysis

We're keeping the '3' recovery rating on Movida's senior unsecured debentures issued in the domestic market. We expect an average recovery of 65%, resulting from our jurisdiction cap for recovery expectations.

Key analytical factors

- We assess recovery prospects using a simulated default scenario, with a discrete asset valuation (DAV) approach. We value the company on a going concern scenario, because we believe the company would be restructured given the long-term nature of its fleet management contracts, thereby generating greater value for its creditors.
- Our default scenario incorporates a combination of factors such as high delinquency rates in Movida's contract portfolio, a sudden drop in vehicle prices and demand for used cars in Brazil, in addition to an increase in interest rates. These factors would severely reduce the company's cash generation and limit its access to debt refinancing.

Simulated default assumptions

- Country of insolvency: Brazil (Jurisdiction B), resulting in a '3' jurisdictional cap for unsecured debt
- Simulated year of default: 2025
- We apply a 15% haircut to the fleet value as the company would need to apply a discount to liquidate those assets under a stress scenario.
- Dilution rate of 20% and then a haircut of 30% in receivables, simulating potential drop in contracts' renewal rate and an increase in delinquency rates.
- 100% haircut to the company's cash position as it would be consumed up to default point.
- The above premises lead to a general haircut of about 36% to Movida's total asset base value, resulting in an estimated gross enterprise value at emergence of R$6.1 billion.

Simplified waterfall

- Net EV after 5% of administrative expenses: R$5.8 billion
- Priority secured debt: R$99 million
- Debt at subsidiaries: R$1.4 billion
- Senior unsecured debt at the holding company: R$4.5 billion
- Recovery expectations: between 50%-70% (rounded estimate 65%)

Note: All debt amounts include six months of prepetition interest.

Ratings Score Snapshot

Issuer credit rating: B+/Stable/--

Business risk Profile: Weak

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

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: b+

Related Criteria

- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

New Rating; CreditWatch/Outlook Action	
Movida Participacoes S.A.	
Issuer Credit Rating	B+/Stable/--
Ratings Affirmed;	
Movida Participacoes S.A.	
Brazil National Scale	brAA/Stable/--
Movida Participacoes S.A.	
Senior Unsecured	brAA
Recovery Rating	3(65%)