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Research Update:

Simpar S.A. Outlook Revised To Positive On Increasing Scale And Diversification, 'BB-' Global Scale Ratings Affirmed

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Rating Action Overview

- Brazil-based transportation group Simpar S.A. will likely deliver revenue growth above 40% in 2021, organically and through acquisitions, and we expect this trend to continue, along with broadening business diversification.
- Although the group has been raising debt to fund a sizable chunk of this growth, we expect it to be offset by stronger cash flows, resulting in fairly stable credit metrics.
- On Dec. 21, 2021, S&P Global Ratings revised the outlook on its ratings on Simpar to positive from stable, and affirmed its 'BB-' global scale and 'brAA+' national scale ratings. We also affirmed our issue-level ratings on the group, at 'BB-' and 'brAA+', while the '4' recovery rating on them remains unchanged.
- The positive outlook reflects the possibility of an upgrade in the next 12-18 months if the company continues to gain scale and diversification while maintaining adequate profitability with EBIT margin of about or above 20% and EBIT interest coverage close to 2x.

Rating Action Rationale

The group will likely maintain a solid growth over the next few years. Simpar's scale and business diversification has widened considerably in the past year across all of its main subsidiaries. Although we expect Brazil's economy to worsen in 2022, because of high inflation, higher interest rates and limited economic growth, we forecast Simpar to post another year of solid revenue and EBITDA growth, above 50%, as it consolidates acquired assets and thanks to a solid contracted backlog.

- Movida Participacoes S.A. 's (close to 40% of consolidated revenue and about 50% of EBIT) fleet will likely continue growing over the next few years. Its fleet management segment will likely account for about 60% of the company's fleet, which provides more predictability to cash flows due to the longer term of contracts than those in the rent-a-car (RaC) segment (one to three years, versus daily or monthly rates). Much higher prices of Movida's used-car sales, amid the automakers' supply problems, is boosting the company's revenue and cash generation. We expect higher-than-historical margins in this segment at least for 2022, given that we might see a normalization of the supply chain in the second half of the year.

- The group's truck leasing subsidiary, Vamos Locação de Caminhões, Máquinas e Equipamentos S.A. (Vamos; about 20% of consolidated revenue and 25%-30% of EBIT), has also posted solid fleet growth, and we expect this to continue going forward. The company raised equity and debt this year to fund about R$3.4 billion of capital expenditures (capex) in 2022, up from R$2.8 billion in 2021, primarily for fleet expansion, and to a lesser extent, for fleet renewal. The subsidiary's long-term contracts provide more cash flow predictability for the group.

Consolidation strategy supports gains of scale and diversification. Simpar is a leading transportation company in Brazil, which provides it scale gains and bargaining power with suppliers, allowing the group to grow above industry average and generate higher margins. Apart from the internal growth, the group also maintains an active M&A strategy. JSL S.A., Simpar's logistics subsidiary, completed five acquisitions since the end of 2020, increasing scale and diversification of its segments and types of services, and its geographic footprint across the country. Also, in the past two months, the group announced the acquisitions of two dealerships through its subsidiary, Original Concessionárias, which will likely result in revenue closer to R$3 billion in 2022, sharply up from about R$700 million in 2021. The recently approved incorporation of its sister company, CS Infra, also illustrates group's gradual business diversification. CS Infra controls Ciclus do Brasil Ambiental S.A., a solid urban waste management company. We expect the group to continue targeting acquisitions in these segments. However, given that we forecast high growth for Movida and Vamos, they would likely continue to represent more than 70% of group's consolidated EBIT in the next two-three years.

A relatively prudent approach to leverage, despite high capex and acquisitions. Apart from a recent public commitment from management to gradually reduce leverage at the end of each year and to reduce it below 3.0x, Simpar also has financial covenants that require net debt to EBITDA-A (EBITDA plus cost of vehicles sold) below 3.5x and EBITDA-A to net interest above 2.0x. Our ratings on the group incorporate potential volatility in credit metrics amid the substantial growth through acquisitions, but assume leverage will remain controlled. Still, we expect that any large deal would be done through share exchange or by raising equity at the subsidiaries' level. Simpar and its subsidiaries have been raising debt to fund the bulk of its expansion plan, but we expect it to be offset by stronger cash flows, leading to relatively stable credit metrics.

Outlook

The positive outlook reflects a one-in-three chance of an upgrade in the next 12-18 months if Simpar maintains its accelerated growth pace with solid profitability and cash flows, allowing it to maintain relatively stable credit metrics despite its higher debt and elevated interest rates in Brazil.

Upside scenario

We would raise the ratings if Simpar continues to benefit from the diversification of its various business segments amid the expected economic slump next year, while it continues pursuing growth, maintaining EBIT margin above 20%. An upgrade would also depend on EBIT interest coverage remaining close to or above 2.0x and funds from operations (FFO) to debt above 15% in a three- to five-year moving average. The upgrade would also depend on the maintenance of comfortable liquidity, with limited debt maturities and other short-term obligations, which would allow us to rate Simpar above the 'BB-' sovereign rating on Brazil.

Downside scenario

We would change the outlook to stable if the group's cash flows are pressured amid higher interest rates and unexpected eroding market conditions for its largest subsidiaries, Movida and Vamos, or if Simpar adopts a more aggressive growth strategy funded with debt. In this scenario, we would see EBIT interest coverage below 1.7x and FFO to debt trending down to 12%.

Company Description

Simpar is a privately-owned entity headquartered in Sao Paulo, Brazil. The group was founded in 1956, and through its subsidiaries, provides transportation and logistics services in Brazil and internationally. Simpar operates through seven subsidiaries: JSL, Movida, Vamos, CS Brasil, Original Concessionárias, BBC Leasing, and CS Infra, the latter of which will soon be incorporated. We expect the group to post consolidated revenue of about R$14 billion and EBITDA close to R$4 billion in 2021, with the following breakdown: Movida (51%), Vamos (27%), JSL (18%), and others the remainder.

- Movida is one of the three main car rental companies in Brazil, offering RaC and fleet management services.
- Vamos is a Brazilian truck, machinery, and equipment rental company, also operating 37 new truck and equipment dealerships and 11 used ones across the country.
- JSL is the main provider of logistics services and freight transportation in Brazil.
- Original Concessionárias covers the group's authorized car dealerships.
- BBC Leasing offers leasing, freight payments, and financial services.
- CS Brasil provides fleet management and outsourcing services to the public sector as well as public passenger transport, along with collection and transportation of household, commercial, and industrial waste.
- CS Infra controls Ciclus do Brasil Ambiental, a company that engages in solid waste management in the metropolitan area of Rio de Janeiro. CS Infra will soon take over Cs Brasil's concessions

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, although the group has been growing above GDP growth rate in the past years.
- 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, raising funding costs and rates of new fleet management contracts.

- Consolidated revenue growth close to 40% in 2021, above 60% in 2022, and about 25% in 2023, considering only internal growth and acquired entities to be consolidated.
- Net capex of R$8.7 billion in 2021, R$9.4 billion in 2022, and R$8.5 billion in 2023, mostly at Movida and Vamos for the purchase of new vehicles.
- Cash outflows for recent acquisitions totaling R$590 million in 2021, R$730 million in 2022, and R$75 million in 2023.
- Dividend payout of 25% of previous-year net income.

Key Metrics*

	2020A	2021P	2022E	2023E
(Mil. R$)				
Revenue	9,807	~13,900	22,000-24,000	28,000-30,000
EBITDA	2,357	~4,000	6,500-7,000	8,000-9,000
EBIT	1,804	~3,650	5,500-6,000	6,500-7,500
FFO	874	~2,080	3,000-3,500	4,200-4,700
EBIT interest coverage (x)	1.7	~2.2	2.0-2.4	2.0-2.4
FFO/Debt (%)	9.1	~13.5	13-17	15-18
Debt/EBITDA (x)	4.1	~3.8	3.0-3.5	3.0-3.5

*Adjusted

Simpar S.A. -- Financial Summary

	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
(Mil. R$)					
Revenue	9,807	9,686	8,075	7,256	6,739
EBITDA	2,357	2,135	1,698	1,321	1,286
EBIT	1,804	1,525	1,257	850	832
Funds from operations (FFO)	874	994	808	451	679
Interest expense	1,073	1,042	934	839	793
Cash flow from operations	1,821	1,043	1,254	740	995
Capital expenditure	3,358	3,039	2,139	938	438
Free operating cash flow (FOCF)	(1,537)	(1,997)	(885)	(198)	557
Discretionary cash flow (DCF)	(1,640)	(2,061)	(890)	(195)	314
Cash and short-term investments	5,845	3,848	2,998	2,433	1,043
Debt	9,566	8,204	7,210	5,943	5,685
Equity	3,224	2,380	1,248	1,189	609
Adjusted Ratios					
EBITDA Margin (%)	24.0	22.0	21.0	18.2	19.1
EBIT Margin (%)	18.4	15.7	15.6	11.7	12.3

Simpar S.A. -- Financial Summary (cont.)

	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
Return on capital (%)	15.4	16.0	16.1	12.7	13.6
EBIT interest coverage (x)	1.7	1.5	1.3	1.0	1.0
Debt/EBITDA (x)	4.1	3.8	4.2	4.5	4.4
FFO/Debt (%)	9.1	12.1	11.2	7.6	11.9
Cash flow from operations/debt (%)	19.0	12.7	17.4	12.5	17.5
FOCF/Debt (%)	(16.1)	(24.3)	(12.3)	(3.3)	9.8
DCF/Debt (%)	(17.1)	(25.1)	(12.3)	(3.3)	5.5

Liquidity

We view Simpar's liquidity as adequate. The group's sources of cash comfortably exceed its liquidity needs in the next 12-24 months, mostly due to high cash holdings and extended amortization profile. We forecast the sources-to-uses ratio around or above 2.0x, despite considerable expansion capex. In addition, we believe that Simpar has proven access to funding from banks, and diversified its financing by tapping capital markets this year, through its and Movida's international bonds. Although the group has shown a prudent approach to new debt issuances in 2021 to avoid the likely more volatile market conditions next year, during presidential election will occur, we would need to see the group maintaining solid liquidity cushion amid acquisitions in order to revise our liquidity assessment to a stronger category.

Principal Liquidity Sources:

- Cash reserves of R$11.7 billion as of September 2021;
- Vamos' revolving credit line of R$480 million;
- Cash FFO of R$3.4 billion in the next 12 months; and
- The ability to contract uncommitted secured funding of to up to 70% of operating leasing subsidiaries' net capex related to the vehicle purchases.

Principal Liquidity Uses:

- Short-term debt maturities of R$1 billion as of September 2021;
- Capex of R$9.2 billion in the next 12 months from September 2021;
- Working capital outflows of R$80 million for the next 12 months;
- Cash outflows from acquisitions of R$700 million in the next 12 months; and
- Dividend payments of R$300 million.

Covenants

Simpar's financial flexibility is limited by debt-payment acceleration covenants on its debentures and notes, which require:

- Net debt to EBITDA-A of 3.5x and EBITDA-A to net interest at a minimum of 2.0x. These covenants apply to the local debentures and CRA, and are of debt payment acceleration type.
- Net debt to EBITDA below 4.0x. This is applicable to the group's bond issuance. It doesn't trigger debt acceleration, it's an incurrence covenant that limits the ability to contract additional debt.

We expect the company to comply with a cushion of more than 50% in the net debt to EBITDA ratio and 70% in interest coverage in the next two years.

Issue Ratings - Recovery Analysis

We rate the group's senior unsecured bond and local market debentures at 'BB-' and 'brAA+', respectively, the same as our issuer credit ratings, along with a '4' recovery rating. The latter rating reflects our expectation for average (30%-50%; rounded estimate 35%) recovery in the event of a payment default, considering the expected recovery at each of Simpar's subsidiaries as well as the resulting debt structure of the non-operational holding.

Key analytical factors

Our simulated default scenario contemplates a payment default in 2025. The simulated default scenario encompasses a combination of high default rates at Vamos and JSL's portfolio of contracts, lower utilization rates of Movida's RaC business, and a severe weakening of Brazil's used-car and truck market, resulting in the group's lower cash generation and limited asset sales activity, hampering its capacity to service interest and principal payments. We also account for limited access for refinancing amid a long period of fragile credit conditions.

We value the group considering a combination of EBITDA multiple and discrete asset valuation (DAV) approach. We value its logistics and other business using a 6.0x multiple applied to our projected emergence-level EBITDA, reflecting Simpar's high growth prospects, given recent M&As and internal growth. The projected emergence-level EBITDA is of R$903 million, resulting in estimated gross emergence value of about R$5.4 billion. We have valued Simpar's operating lease business segment by the DAV approach, applying an overall haircut of close to 50% to those subsidiaries' asset base, arriving at a stressed valuation of about R$15.8 billion.

We assume that the secured debt and the debt at the subsidiaries, JSL, Vamos, CS Brasil, CS Infra, and Movida, have priority to Simpar's unsecured debt in a hypothetical default scenario, because those subsidiaries are not guarantors of the debt at the holding level.

Simulated default assumptions

- Year of default: 2025
- Jurisdiction: Brazil

Simplified waterfall

- Enterprise value (net of 5% admin. expense): R$20.1 billion, out of which R$9.7 billion attributed to Movida, R$5.3 billion to Vamos, R$3.6 billion to JSL, and the remaining R$1.5 billion among other subsidiaries
- Debt position and minority interest at subsidiaries: R$19.3 billion

- Value remaining to unsecured claims at the holding level: R$1.1 billion
- Senior unsecured debt: R$3.0 billion
- Recovery expectations: 30%-50% (rounded estimate: 35%)

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

Ratings Score Snapshot

Issuer Credit Rating:

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

Business risk: Fair

- Country risk: Moderately High Risk
- Industry risk: Intermediate Risk
- Competitive position: Fair

Financial risk: Aggressive

Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/Portfolio effect: Neutral
- Capital structure: Neutral
- Financial policy: Neutral
- Liquidity: Adequate
- Management and governance: Fair
- Comparable rating analysis: Neutral

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 | 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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
Simpar S.A.		
Issuer Credit Rating	BB-/Positive/--	BB-/Stable/--
Brazil National Scale	brAA+/Positive/--	brAA+/Stable/--
Ratings Affirmed		
Simpar S.A.		
Senior Unsecured	brAA+	
Recovery Rating	4(35%)	
CS Brasil Participacoes e Locacoes LTDA.		
Senior Unsecured	brAA+	
Recovery Rating	4(35%)	
Simpar Europe		
Senior Unsecured	BB-	
Recovery Rating	4(35%)	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.