FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Simpar's IDRs at 'BB'; Outlook Negative

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Fitch Ratings - Rio de Janeiro - 28 Aug 2024: Fitch Ratings has affirmed Simpar S.A.'s (Simpar) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB' and downgraded its Long-Term National Scale Rating to 'AA+(bra)' from 'AAA(bra)'. Fitch has also affirmed the senior unsecured bond issuances of Simpar and its financial vehicles at 'BB'. The Rating Outlook has been revised to Negative from Stable.

The Negative Outlook reflects that Simpar's consolidated financial leverage has been consistently above Fitch's expectations and not consistent with the current ratings. The higher for longer leverage, a result of greater capex and lower return on invested capital, has also hurt the company´s ability to convert EBITDA to cash flow.

The National Scale Rating downgrade reflects Simpar's credit profile deterioration within the 'BB' rating category. Simpar's 'BB' IDRs reflect its large scale, robust business profile and strong competitive position within the Brazilian rental and logistics industry. Simpar group continue to benefit from a diversified service portfolio and long-term contracts for a significant part of its revenues, resulting in higher cash flow predictability.

KEY RATING DRIVERS

Pressured Capital Structure: Fitch expects Simpar to keep its consolidated financial leverage at levels inconsistent with a 'BB' rating. Fitch expects consolidated net adjusted debt/adjusted EBITDA to remain on the 4.5x-5.0x range until 2026. Consolidated net adjusted leverage was 5.0x in 2023 and 5.1x the last twelve months (LTM) ended on June 2024, comparing with an average of 4.6x from 2019 to 2022, a result of Simpar historically aggressive growth strategy. Positively, total adjusted debt/adjusted EBITDA has come down after it peaked at 8.6x in 2021 to 6.5x in the LTM ended on June 2024, mainly as a result of EBITDA expansion.

Strong Business Profile: Simpar's large scale and leading position in the Brazilian rental and logistics industry allow for competitive advantage on assets purchase and operating costs relative to peers. The group's credit profile also benefits from its diversified service portfolio and presence in multiple sectors of the economy. Simpar' strategic and operational nature of the service it provides, its competitive cost structure and a revenue stream based on long-term contracts for most of its rental and logistic businesses minimize its exposure to more volatile economic cycles in Brazil.

Movida (32% of net revenue and 45% of EBITDA, the second largest player) focuses on light vehicles and fleet rental; JSL (23% of net revenue and 20% of EBITDA, the market leader) concentrates on supply chain management and transportation; and Vamos (18% of net revenue and 33% of EBITDA, the market leader) focuses on heavy vehicles and equipment rentals.

Solid and Growing EBITDA: Fitch's rating case scenario presents consistent and gradually improving consolidated EBITDA mainly based on organic growth. Balanced demand and supply dynamics should continue to allow adequate rental and service rates, resulting in a gradual recovery of Simpar's return on invested capital (ROIC) to historical levels. Simpar should reach consolidated adjusted net revenue of BRL32.6 billion (+27% over 2023) and adjusted EBITDA of BRL9.2 billion (28% margin and +22% over 2023) in 2024 and BRL39 billion and BRL11 billion (28% margin) in 2025, from BRL26 billion and BRL7.5 billion (29% margin), respectively, in 2023.

Negative FCF: The capital-intensive nature of the rental industry (75% of Simpar's EBITDA), which demands sizable and regular investments to grow and renew the fleet, pressures the group's cash flow. FCF should remain negative, on average, at BRL12 billion from 2024 to 2026, after annual average total capex of BRL15 billion, partially funded by the sale of used vehicles from rentals. Cash flow from operations (CFFO) should reach BRL1.5 billion in 2024, BRL2.8 billion in 2025 and BRL4.3 billion in 2026, benefitting from stronger EBITDA and decreasing interest expenses and working capital needs.

DERIVATION SUMMARY

Simpar's business profile is superior to that of Localiza Rent-a-Car S.A. (Localiza; Foreign and Local Currency IDRs BB+ and National Long-Term Rating AAA(bra), all with a Stable Outlook). Simpar has a scale similar to that of Localiza, a more diversified service portfolio, but a weaker financial profile -- with higher leverage and more pressured FCF, which pressure the rating.

Compared with Unidas Locações e Serviços S.A. (Unidas; Foreign and Local Currency IDRs BB- and National Long-Term Rating AA(bra), all with a Stable Outlook), Simpar has a much stronger business profile, greater liquidity, and better access to the credit market. These advantages are partially offset by slightly higher leverage compared to Unidas.

KEY ASSUMPTIONS

-- Average consolidated annual revenue growth at 20% from 2024 to 2026;

-- Consolidated EBITDA margin at 28%, on average, from 2024 to 2026;

-- Average annual capex at around BRL15 billion from 2024 to 2026;

-- Cash balance remains strong compared with short-term debt;

-- Dividends at 25% net income.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Consolidated net adjusted debt/EBITDA below 3.5x on a sustainable basis;

--Strengthening of the group's scale and profitability, without further deterioration of its capital structure.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Limits to Simpar's unrestricted ability to access the operating companies' cash;

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

--Prolonged decline in demand coupled with company inability to adjust operations;

--Consolidated net adjusted leverage above 4.5x on a sustainable basis;

--Material deterioration on the group's fleet rental and logistics businesses.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Simpar's robust consolidated liquidity position is a key credit consideration, with cash covering short-term debt by an average of 3.2x during the last four years. The group's expected negative FCF, a result of its growth strategy, will be financed by debt in the rating scenario as the group benefits from ample access to different sources of funding. Simpar had BRL11.7 billion of cash and equivalents and BRL55 billion of total adjusted consolidated debt (approximately 2% secured), with final maturity at 2037. Around BRL9.4 billion is due in the short term (1.3x cash coverage ratio), an additional BRL3.5 billion at the second half of 2025 and BRL8.9 billion in 2026 as of June 2024.

At the holding level, Simpar had BRL3.4 billion of cash and equivalents and BRL7.9 billion of total adjusted debt, BRL600 million due in the short term, an additional BRL2.9 billion maturing up to 2030 and BRL4.4 billion in 2031. Simpar's board control and relevant ownership stakes in its operating companies mitigate the structural subordination of its debt, with no upstream dividends or intercompany loans restrictions that a majority board vote cannot overcome.

The group's consolidated debt profile is mainly comprised of local debentures (40%), bank loans (35%) and fully hedged U.S. denominated bonds (13%). Simpar's financial flexibility is also supported by the group's ability to postpone growth capex to adjust to the economic cycle and the groups considerable number of unencumbered assets, with the market value of the fleet over net debt at around 1.2x.

ISSUER PROFILE

Simpar is a non-operational holding company that controls and manages seven independent companies that provide mainly rental, logistics and mobility services, focused on long-term contracts. The company is listed on the Brazilian stock exchange and its main shareholder is JSP Holding S.A. (59.04%), the Simoes family holding company.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
Simpar S.A.	LT IDR BB Rating Outlook Negative Affirmed	BB Rating Outlook Stable
	LC LT IDR BB Rating Outlook Negative Affirmed	BB Rating Outlook Stable
	Natl LT AA+(bra) Rating Outlook Negative Downgrade	AAA(bra) Rating Outlook Stable
senior unsecured	LT BB Affirmed	BB
senior unsecured	Natl LT AA+(bra) Downgrade	AAA(bra)
Simpar Europe		
senior unsecured	LT BB Affirmed	BB

Simpar Finance S.a.r.l.

senior unsecured	LT	BB	Affirmed	BB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

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

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Simpar Europe	EU Endorsed, UK Endorsed
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Simpar S.A.	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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