FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Simpar's Senior Unsecured Bond 'BB-'; Outlook Stable

Tue 09 Feb, 2021 - 11:40 AM ET

Fitch Ratings - Rio de Janeiro - 09 Feb 2021: Fitch Ratings has assigned a 'BB-' rating to the proposed benchmark sized unsecured notes to be issued in Brazilian Reais by Simpar Finance S.a.r.l, a wholly owned subsidiary of Simpar S.A. (Simpar). The notes will be unconditionally and irrevocably guaranteed by Simpar. Proceeds will be used to refinance existing debt and general corporate purposes. Fitch currently rates Simpar's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) 'BB-'/Outlook Stable.

Simpar's ratings reflect its strong business profile, supported by a leading position in the Brazilian logistics industry and diversified service portfolio, as well as its track record of resilient operating performance throughout various economic cycles. The company's high consolidated leverage, which mostly relates to its ongoing strong growth strategy, is partially mitigated by its above-average financial flexibility and the company's ability to generate positive FCF through adjustments to its capex spend. Simpar maintains a strong liquidity position, which, together with the proposed notes, reduces refinancing risks.

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Fitch expects Simpar to continue to take advantage of market opportunities to grow its business while managing its capital structure to a consolidated net adjusted debt/EBITDA ratio of around 4.0x in 2021 and 2022. Simpar's rating also incorporate management's commitment to maintain adequate liquidity and a manageable debt maturity profile. Growth strategies that elevate the company's leverage or the sale of relevant equity stakes, in any operating company that reduces Simpar's unrestricted access to cash without materially lowering leverage, may lead to a change in Fitch's consolidated rating approach and could pressure credit quality.

KEY RATING DRIVERS

Diversified Business Portfolio: Simpar's diversified service portfolio reflects a strong business profile, supported by a leading position and resilient operating performance in the Brazilian logistics, supply chain management, passenger and general cargo transportation industries. JSL Logistica focuses on supply chain management, passenger and general cargo transportation. Movida is a rent-a-car and fleet rental company; Vamos, a heavy vehicles and equipment rental business; CS Brasil a fleet rental company focused on the public sector; and Original, a vehicle dealership business. As of September 2020, JSL Logistica (73.6% stake) represented 19% of consolidated EBITDA; Vamos (79.1% stake) 28%; Movida (55% stake) 36%; CS Brasil (100% stake) 15%; and the dealerships (100% stake) only 2%.

Strong Market Position: Simpar has a leading position in the Brazilian logistics industry with a diversified portfolio of businesses and a relevant presence in multiple sectors of the economy. The company's strong market position, strategic and operational nature of the service it provides, coupled with long-term contracts for most of its logistic and heavy vehicle rentals, minimizes the company's exposure to more volatile economic cycles. The company's significant operating scale has made it an important purchaser of light vehicles and trucks, giving it a significant amount of bargaining power versus other competitors in the industry.

Robust Operating Cash Flow: Simpar group presents a strong and reasonably predictable cash flow generation, based on long-term contracts. The company has delivered solid and improving margins, while growing its rentals businesses, Vamos and Movida. Fitch expects to see margin evolving from pre-crises levels in 2021-2022, as these two businesses regain traction after the worst period of lockdown restrictions. Fitch also expects JSL Logistics to grow, to improve margins and to become a more asset light operation. Fitch forecasts Simpar's consolidated EBITDA at BRL2.1 billion (21% margin) in 2020 and BRL2.7 billion (23%margin) in 2021, from BRL1.9 billion (20% margin) in 2019.

Growth to Continue to Pressure Leverage: Simpar's consolidated net leverage, measured by total net debt/EBITDA, should be 4.2x in 2020 and 4.0x and 3.9x in 2021 and 2022. These levels of leverage compare with 4.9x in 2017, 4.3x in 2018 and 4.0x in 2019. In Fitch's view, a more moderate growth strategy or a faster improvement in operating cash flow

Feedback

generation in the logistics and in the vehicle rental business would be required to temper medium-term leverage.

FCF is expected to remain negative, on average, at BRL1.7 billion in the three-year period from 2020 to 2022, pressured by annual average growth capital expenditures of BRL2.2 billion. Considering maintenance capex only, Simpar's operating cash flow from operations (CFFO) would be positive. Excluding growth capex, Simpar generated, approximately, an average of BRL743 million of positive CFFO during 2016-2019.

Coronavirus's Limited Impact: Simpar's strong presence in logistics and fleet and heavy vehicles and machinery rentals, and its associated long-term contracts with corporate clients helped it to mitigate its exposure to social distancing and mobility restrictions applied during the coronavirus pandemic. Moreover, contracts maturing in 2020 represented between 15% and 20% of total revenue - historical renewal rates have been over 80% on a normalized basis. During the worst period of lockdown restrictions, contract cancellations and the slight increase in delinquency were not meaningful.

Full Ownership MitigatesStructural Subordination: The full ownership or relevant majority stake in most of the operating companies, excluding Movida, mitigates the structural subordination of the debt at the Simpar level. It allows Simpar to determine the business and financial strategies of the operating companies, selecting their management and managing their cash -- as there is no restriction on upstream dividends or intercompany loans. The absence of cross default provisions and upstream guarantees are credit negatives, but not sufficient, to notching down the bond's rating at this point.

Major Equity Sale May Change Rating Approach: The sale of relevant equity stakes in any operating company, that reduces Simpar's unrestricted ability to access cash without materially lowering leverage, may lead to a change in Fitch's consolidated rating approach. It may also lead to the agency's view of Simpar as a dividend receiving holding company with debt that would be structurally subordinated to that of the operating companies; its credit profile on a stand-alone basis may be considered weaker than that of the operating companies.

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DERIVATION SUMMARY

Simpar's ratings reflect its leveraged capital structure and solid business profile, supported by a leading position in the Brazilian logistics industry and a diversified and resilient portfolio of businesses. The company's large business scale provides important bargaining power with automobile and equipment OEMs, and is a key competitive advantage compared with peers in the Brazilian market.

Fitch believes that Simpar's bargaining power and business position tend to be relatively closer to the industry's benchmark, Localiza Rent a Car S.A. (BB/Negative), and much stronger than that of Ouro Verde Locacao e Servico S.A. (BB-/Stable). Compared with Localiza, Simpar has a weaker financial profile with higher leverage and relatively higher refinancing risks. Compared with Ouro Verde, Simpar has higher leverage and similar liquidity position, but a much better business profile and access to credit markets.

Simpar's ratings compare well with other peers in the Brazilian transportation segment. Simpar and Rumo S.A. (BB/Negative) share similar business risks, considering their respective business traits, but Simpar's leverage is higher. Compared with Hidrovias do Brasil S.A. (BB/Negative), Simpar's business position is stronger but its leverage profile and refinancing risks are relatively weaker.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within the Agency's Rating Case for the Issuer:

--Average consolidated annual revenue growth at 13% from 2020 to 2022;

--Consolidated EBITDA margin at 23%, on average, from 2020 to 2022;

--Consolidated net capex at around BRL2.2 billion, on average, from 2020 to 2022;

--Cash balance remains sound compared to short-term debt;

--Dividends at 25% net income;

--No large-scale M&A activity or equity sale.

RATING SENSITIVITIES

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

--An Upgrade on the ratings is unlikely in the short to medium term, given the group's consolidated high leverage and fairly aggressive growth strategy.

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

--Equity sale of any operating company that reduces Simpar's unrestricted ability to access their cash, without materially lowering leverage;

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

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

--Increase in net adjusted leverage to more than 4.0x beyond 2021;

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

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.

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LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: Simpar's adequate liquidity position, relative its short-term debt, is a key credit consideration, with cash covering short-term debt by an average of 1.2x during the last four years. The company's expected negative FCF, a result of its growth strategy, will be financed by debt in Fitch's rating scenario. As of Sept. 30. 2020, Simpar had BRL5.2 billion of cash and BRL12.8billion of total adjusted debt, BRL1.7 billion of which is due on the short-term debt (3.2x cash coverage ratio). These figures exclude the BRL1.9 billion credit-linked note.

Excluding Movida's cash and short-term debt, Simpar's cash-to-liquidity position is also adequate with BRL3.5 billion of cash and BRL0.8 billion of short-term debt (4.3x cash coverage ratio). The company's debt profile is mainly comprised of local debentures, promissory notes and CRA issuances (64%), bond issuance (31%) and FINAME and leasing operations (5%). Currently, about 11% of Simpar's debt is secured. Additionally, Simpar's financial flexibility is supported by the group's ability to postpone growth capex to adjust to the economic cycle and to the considerably number of the group's unencumbered assets, with a book value of fleet over net debt at 1.5x.

SUMMARY OF FINANCIAL ADJUSTMENTS

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

--OEM receivables related to vehicle acquisitions added to capex;

--Total debt was adjusted by net derivatives, floor plan and accounts payables referred to acquisitions;

--The CLN and NCE transactions were removed from cash and debt, respectively.

DATE OF RELEVANT COMMITTEE

06 August 2020

SOURCES OF INFORMATION

Simpar S.A.

ESG Considerations

Simpar has an Environmental, Social and Corporate Governance (ESG) Score of '4' for Governance Structure. Simpar has a concentrated ownership and control structure along with a complex group structure that weakens both the company's corporate governance.

This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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.

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.

RATING ACTIONS

ENTITY/DEBT	RATING		
Simpar Finance S.a.r.l.			
• senior unsecured	LT	BB-	New Rating

VIEW ADDITIONAL RATING DETAILS

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