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Research Update:

# JSL S.A. Global Scale Rating Raised To 'BB-' On Larger Scale And Steady Leverage; Outlook Stable

**March 30, 2023**

## Rating Action Overview

- We expect JSL S.A. will continue expanding operations organically and via acquisitions, increasing revenues and operating cash flows. Additionally, the company will continue improving operating efficiency of acquired companies, supporting a gradual rise in EBITDA margin.
- JSL increased scale significantly since the IPO in 2020, reaching net revenue of R$6 billion and EBITDA of R$1 billion in 2022. It also diversified its business by entering new sectors and starting to expand internationally.
- We expect S&P Global Ratings-adjusted leverage to gradually decline, with debt to EBITDA close to 4x in 2023 and approaching 3.5x by 2024, even amid higher debt levels to support expansion.
- We therefore raised our long-term global scale rating on JSL to 'BB-' from 'B+'. We also raised our national scale issuer and issue ratings to 'brAA+' from 'brAA'. Our recovery rating on the senior unsecured debentures remains '3'.
- Our stable outlook reflects our view that JSL will continue growing, with improving profitability through gains of scale and strict cost control, while also adequately funding its growth.

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## Rating Action Rationale

**We expect JSL to continue increasing scale and diversification over the coming years.** JSL reported net revenue of Brazilian real (R$) 6 billion in 2022, up 40% compared with 2021, and almost doubled its size since the IPO in 2020, with greater diversification of clients and sectors served. Moreover, the company has a solid backlog and benefits from long-term contracts, leading to high cash flow predictability.

JSL's new contracts signed in 2022 amounted to R$6 billion (up 50% year over year), with an average term of 50 months. We expect backlog to continue increasing in the coming years as JSL consolidates its leadership position in the highly fragmented logistics transportation segment--both organically and via mergers and acquisitions. We believe the company's solid track record of high-quality services and assets allows for cross-selling for existing clients and enables the company to gain new contracts in a flight-to-quality move from clients. Moreover, JSL has exposure to sectors with somewhat limited demand volatility--such as food and beverage, automotive chain, pulp and paper, metals and mining, and chemicals--which supports our view of long-term growth prospects.

**EBITDA margin will continue gradually improving.** Even in a scenario of high inflation, JSL posted an EBITDA margin of about 17% in 2022, compared with 14.3% in 2021, mostly owing to its ability to pass through cost increases and keep strict cost management. Additionally, the company demonstrated an efficient integration of recent acquisitions, improving profitability through route optimization, digitalization, and integration between subsidiaries. Moreover, acquired companies are benefiting from a larger group to negotiate better terms with suppliers. We expect the EBITDA margin to expand to around 17.5%-18% in 2023 (our number already includes the recently acquired company, IC, from May this year) and above 19% in 2024. If we consider JSL on a stand-alone basis, without incorporating IC, the EBITDA margin would likely already reach 19% in 2023.

**We believe JSL will continue pursuing new acquisitions while maintaining credit metrics that are in line with the rating.** With seven acquisitions in the past two years, JSL diversified its portfolio of services and sectors served. Once concluded, the acquisition of IC Participacoes will increase exposure to road transportation of fuels and agribusiness (mostly fertilizers), as well as strengthen JSL's position in the transportation of bulks, gases, chemicals, and highly complex cargo. The company will continue financing growth with debt, but we expect it to keep a relatively prudent approach. Our forecast considers S&P Global Ratings-adjusted leverage will remain between 3x-4x and funds from operations (FFO) to debt between 12%-20%. Additionally, we expect JSL will stick to its financial policy targeting net debt to EBITDA around 3x. (Our adjusted leverage metric differs from the company's calculation.)

**We expect JSL to adequately fund growth.** Debt levels have been rising over the years to support capital expenditures (capex) and acquisitions. JSL ended 2022 with gross debt of R$4.2 billion, and we forecast an additional R$1.5 billion per year in the next three years to support capex. We don't incorporate new acquisitions in our base case. We expect free operating cash flow deficits over the next years owing to large capex planned and a higher interest burden amid tough financing conditions. Still, the company demonstrated good access to the domestic credit market and solid relationships with banks, issuing debt with long-term maturities and at reasonable costs over the past years. It could also finance a large portion of this year's capex with already signed credit lines from BNDES and BID, amounting to R$876 million by the end of 2022. And we believe there is some flexibility to reduce planned capex if needed, but this would also reduce the pace of growth.

## Outlook

The stable outlook indicates our view that JSL will continue pursuing new opportunities to expand its operations organically and via acquisitions, generating important revenue growth and operating cash flow over the next years. We also expect it to continue financing growth with new debt, compensated by continued focus on improving profitability. We expect JSL to post debt to EBITDA between 3x-4x and FFO to debt between 12%-20% in the next two years.

### Downside scenario

We could lower the ratings in the next 12-18 months if JSL fails to improve profitability and leverage, with debt to EBITDA consistently above 4x and FFO to debt below 12%, and if lower cash flows harm the company's liquidity. That could result from higher cost of debt pressuring the company's cash flows or a more aggressive acquisition strategy. A downgrade could also happen amid much weaker economic conditions in Brazil, deteriorating JSL's operational performance, with lower volume of new contracts or inability to pass through cost increases.

### Upside scenario

An upgrade is unlikely in the next 12-18 months. We could consider an upgrade in the future if we see increasing scale and profitability combined with lower leverage. In this scenario, we would expect to see debt to EBITDA below 3.5x, FFO to debt trending to above 25%, and positive free operating cash flow.

Moreover, an upgrade would depend on the same rating action on its parent, Simpar S.A. (BB-/Positive/--; brAA+/Positive/--), and on the company maintaining a solid liquidity position that would allow it to comfortably pass our stress test for rating above the sovereign. Our sovereign rating on Brazil is BB-/Stable/B.

## Company Description

JSL is the main provider of logistics services and freight transportation in Brazil. The company provides services to more than 16 sectors with no significant revenue concentration. Its portfolio consists of asset-light and asset-heavy contracts, accounting for 55% and 45% of its total revenues in 2022, respectively. JSL posted net revenue of about R$6 billion and EBITDA of R$1 billion in 2022. JSL is a subsidiary of the Brazilian transportation group Simpar S.A., which owns 71.9% of the company. JSL contributed 25% and 15% of the group's total revenue and EBITDA, respectively, in 2022.

## Our Base-Case Scenario

### Assumptions

- Brazil's GDP growth of 0.8% in 2023, 1.7% in 2024, and 2.0% in 2025
- Average inflation of 4.8% in 2023, 4.5% in 2024, and about 3.6% in 2025, affecting costs and expenses, along with contract prices and rates on existing contracts, owing to clauses that allow for inflation pass-through
- Average policy rate of 13% in 2023, 10.8% in 2024, and about 8.8% in 2025, affecting mostly cost of debt
- Revenue from services increasing 30%-35% in 2023, due to full-year consolidation of recently acquired companies, and around R$1.1 billion of additional revenue considering that IC Transportes will be consolidated in May 2023
- Continued solid organic growth through signing of new contracts and exposure to sectors with resilient demand or recovering demand post pandemic

- Revenue from services forecasted to expand around 25% in 2024 and 15% in 2025--mostly from new contracts and prices adjustment in line with cost inflation
- Revenue from asset sales of about R$300 million-R$350 million in the next three years
- Gradual margin expansion thanks to higher profitability at the acquired companies and to synergies, reflecting JSL's greater bargaining power to negotiate terms with suppliers and vehicle purchase, as well as JSL's strict cost management
- Cash outflows for the signed acquisitions of R$192.6 million in 2023 (including R$60 million at the signing of IC) and around R$90 million in 2024 and 2025
- Net capex for the expansion and renewal of the fleet and maintenance of larger operations after several acquisitions
- Dividend distribution of 25% of the previous year's net income
- New debt issuances of about R$1.5 billion per year to support capex

## Key metrics

### JSL S.A.--Key Metrics*

| | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **Mil. R$** | **2021a** | **2022a** | **2023e** | **2024f** | **2025f** |
| Revenue | 4,296 | 6,022 | 7,800-8,300 | 9,700-10,200 | 10,000-11,500 |
| EBITDA margin (%) | 14.3 | 17 | 17.5-18 | 18-19 | 19-20 |
| Funds from operations (FFO) | 423.3 | 593.4 | 740-780 | 1,000-1,200 | 1,400-1,500 |
| Capital expenditure, net | 695.1 | 734.9 | 1,400-1,600 | 1,400-1,600 | 1,400-1,600 |
| Free operating cash flow (FOCF) | (241.5) | 261.7 | (1,000)-(500) | (700)-(500) | (400)-(300) |
| Debt to EBITDA (x) | 5.6 | 4.1 | 3.5-4.0 | 3.0-3.5 | 3.0-3.5 |
| FFO to debt (%) | 12.2 | 14.2 | 10-15 | 15-20 | 20-25 |
| EBITDA interest coverage (x) | 1.7 | 1.7 | 1.5-2.0 | 2.0-2.5 | 2.5-3.0 |

*All figures adjusted by S&P Global Ratings. We add leases and acquisitions payable, and deduct cash to JSL's reported debt. a--Actual. e--Estimate. f--Forecast.

## Liquidity

In our view, JSL's sources of cash exceed uses by more than 1.2x over the next 12 months, and we expect they'd remain positive even if EBITDA were to decline 15%. We expect the company to continue to rely on adequate funding sources to support its growth, reducing cash flow pressures. We believe JSL could have the ability to postpone part of its renewal capex, if needed, as happened in the beginning of the pandemic, in order to keep a comfortable liquidity position. However, we don't think it would reduce expansion capex significantly--so as to not jeopardize growth, which is linked to new contracts.

Principal liquidity sources are:

- Cash and cash equivalents of R$873.2 million as of Dec. 31, 2022;

- Available credit lines amounting to R$876 million as of Dec. 31, 2022 (mainly BNDES and BID);
- The consolidation of IC Participacoes' cash position;
- Expected cash FFO generation of about R$678 million in 2023; and
- New bank loans of R$46.6 million raised in January 2023.

Principal liquidity uses are:

- Short-term debt of R$332.8 million as of Dec. 31, 2022;
- Working capital needs of around R$47.7 million in 2023;
- Capex of R$1.2 billion (around 80% of our base case, as the company could delay renewal of fleet if needed to support liquidity);
- Short-term acquisitions payable of R$83.4 million;
- Payment of R$60 million at signing for IC's acquisition; and
- Dividend payment of R$67.5 million in 2023.

## Covenants

JSL has the following covenants on its debt: maximum net debt to EBITDA-A of 3.5x and minimum EBITDA-A to net interest of 2.0x. EBITDA-A is EBITDA plus the residual accounting cost from the sale of assets. These covenants apply to the local debentures and CRA and are of debt acceleration type.

We forecast relatively comfortable cushion of more than 15% over the next years.

## Group Influence

We view JSL as a highly strategic subsidiary of Simpar. We expect JSL to benefit from the group's long-term commitment because the subsidiary represents a portion of consolidated revenues and EBITDA, and given the historical link of JSL's brand with the group. Therefore, JSL is likely to receive support during stressed conditions.

## Environmental, Social, And Governance

### ESG credit indicators: E-2, S-2, G-3

Governance factors are a moderately negative consideration in our credit rating analysis of JSL. The chairman of the board and indirect controlling shareholder, as well as some related companies, have been implicated in alleged fraud and bribery in bidding for public contracts. Although such allegations could increase reputational risks and eventually result in fines for the parent, Simpar, two civil lawsuits haven't been ruled on yet, while others were dismissed. Also, the group currently has processes to monitor and mitigate the key risks related to its public bidding activities, such as independent third-party audits. Environmental and social factors are a neutral consideration.

## Issue Ratings--Recovery Analysis

### Key analytical factors

- We rate JSL's 15th senior unsecured debentures 'brAA+', at the same level as the national scale issuer credit rating on the company, with a recovery rating of '3' (65%), indicating our expectation for significant recovery prospects to creditors.
- Our simulated default scenario encompasses a combination of high delinquency rates on JSL's portfolio of contracts and a significant increase in interest rates.
- We have valued the company on a going-concern basis because we expect it would be restructured following a default scenario, generating higher value to creditors.
- We value the company using a 6.0x multiple applied to our projected emergence-level EBITDA. JSL's multiple is higher than the standard for the sector (5.0x) to capture its strong growth prospects in the coming years.
- The projected emergence-level EBITDA is R$760 million, resulting in an estimated gross emergence value of about R$4.6 billion.

### Simulated default assumptions

- Simulated year of default: 2027
- Jurisdiction: Brazil
- EBITDA at emergence: R$760 million
- Implied enterprise value (EV) multiple: 6.0x
- Estimated gross EV at emergence: R$4.6 billion

### Simplified waterfall

- Net EV after 5% administrative costs: R$4.3 billion
- Senior secured debt: R$565.5 million (Finame)
- Senior unsecured debt: R$3.9 billion (debentures and other bank loans)
- Expected recovery of unsecured debt: 65% (rounded estimate)

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

## Ratings Score Snapshot

Issuer credit rating: BB-/Stable/--

Business risk: Fair

- Country risk: Moderately High

- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: bb-

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

Stand-alone credit profile: bb-

## 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 | 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

**Upgraded; CreditWatch/Outlook Action**

| | To | From |
|---|---|---|
| **JSL S.A.** | | |
| Issuer Credit Rating | BB-/Stable/-- | B+/Positive/-- |
| Brazil National Scale | brAA+/Stable/-- | brAA/Positive/-- |

**Ratings Upgraded**

| | To | From |
|---|---|---|
| **JSL S.A.** | | |
| Senior Unsecured | brAA+ | brAA |
| Recovery Rating | 3(65%) | 3(65%) |

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.