S&P Global
Ratings

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Rumo S.A.

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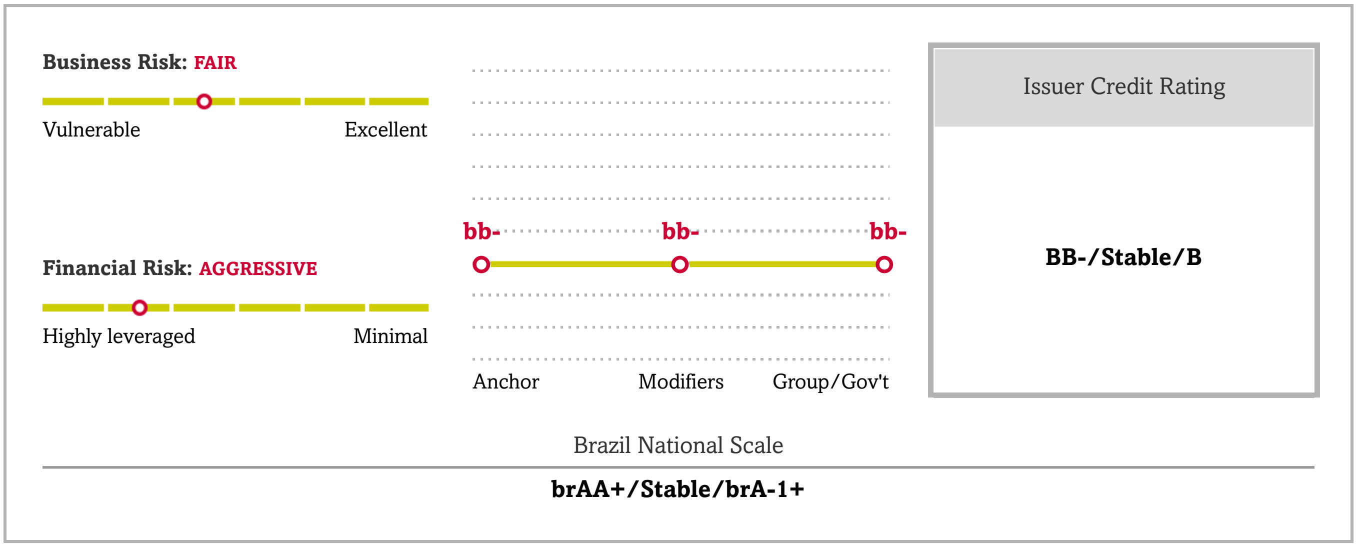
Table Of Contents

Rumo S.A.



Credit Highlights

Overview

Key strengths	Key risks
Among Brazil's largest rail networks, covering approximately 12,000 kilometers.	Exposure to climate and harvest conditions, given heavy reliance on agricultural cargo.
Ongoing investments should strengthen business position and improve operating efficiency.	Negative free operating cash flow expected until 2023
Relatively comfortable leverage metrics for the next three years, when investments are expected to peak.	Geographic concentration in Brazil.

'Norte-Sul' railroad network's expansion. In March 2019, Rumo S.A. won the bid the concession to construct and operate Norte-Sul network. The network will consist of railroads between Porto Nacional (TO) - Anápolis (GO) and Ouro Verde (GO) - Estrela D'Oeste (SP), both in the midwestern region of Brazil, an area that produces mostly grains and other agricultural products. Such an expansion of Rumo's railways network would demand R$15 billion between 2019 and 2023, and we expect revenue tonne kilometer (RTK) to grow 5 million - 6 million in 2021 (roughly 10% of current volumes), in line with our projections.

Operating efficiency marginally improving in 2019 and 2020. We expect Rumo's operations and EBITDA margins to continue expanding in the next two years. Capacity additions and the integration of the acquired operations of América Latina Logística S.A. (ALL) in 2016 would more than offset the pre-operational expenses for the Norte-Sul railroad.

Substantial capex would impair cash generation, but won't weaken metrics. Expansionary capex will be higher in the next few years, with total investments ranging from R$2.3 billion to R$4.2 billion. The higher investments would cause the company's free operating cash flows (FOCF) to turn negative until 2023. Nevertheless, Rumo should be able to maintain comfortable leverage metrics, with net debt to EBITDA below 3.0x.

Strong and consistent market dynamics. The higher operating efficiency will lift the company's market share, as Rumo increases its capacity over the next years. This is supported by Brazil's strong agricultural output potential that should guarantee predictable demand, given that Rumo's operations will be at significantly lower costs than for road transportation in the medium and long terms.

Outlook: Stable

The stable outlook on Rumo reflects that its intrinsic credit quality (or stand-alone credit quality [SACP]), which we assess as 'bb-', will remain fairly healthy despite the considerable investment plan, with debt to EBITDA and funds from operations (FFO) to debt of about 2.5x and above 25%, respectively, in 2020.

Downside scenario

A downgrade of Rumo is unlikely, because even if the SACP were to deteriorate, we're very likely to keep ratings unchanged, due to the group support coming from Cosan Ltd. (BB-/Stable/--). The two scenarios that could trigger a downgrade of Rumo are a sovereign downgrade, which would prompt us to lower rating on Cosan and Rumo, or a weakening of Rumo's SACP by more than three notches, assuming no changes to our assumption on group support and on the group's credit quality. We could lower SACP in the next 12 months if the company adopts a more aggressive investment plan and increases shareholders' remuneration, which could weaken its cash flows and liquidity. In this scenario, FFO to debt would be persistently below 20% and debt to EBITDA above 4.0x, with negative FOCF pressuring liquidity.

Upside scenario

An upgrade of Rumo is unlikely at this point, given that the group's ratings limit those on Rumo, which are in turn capped at Brazil's rating level. An upgrade of Cosan could occur only if it would reduce drastically its exposure to the Brazilian economy, lifting the group's capacity to be rated above the sovereign, or if we were to raise the foreign currency rating on Brazil. We could revise Rumo's SACP upwards in the next 12 months if the operating efficiency were to consistently improve in the next few quarters, with an operating ratio below 75% and less volatile margins, which would bolster cash flows. This could improve the company's credit metrics, while prompting us to revise our business risk profile to a stronger category. In this scenario, we would also expect the company to maintain FFO to debt above 30% and debt to EBITDA below 3.0x, while FOCF to debt would be consistently above 5%.

Our Base-Case Scenario

Assumptions

- A 0.8% GDP growth for Brazil in 2019, 2.0% for 2020, and 2.2% starting in 2021, increasing volumes for cargo in the domestic market, although domestic GDP expansion doesn't affect the bulk of the demand for agricultural products;
- Inflation to increase from 3.5% in 2019 to 3.8% in 2020 and 4% in 2021, raising costs and tariffs;
- The average exchange rate to gradually increase in the next few years, with R$3.95 per $1 in 2019, R$4.12 in 2020, and R$4.17 in 2021, increasing fuel costs;
- Brent prices of about $60 per barrel (bbl) in 2019 and 2020 and $55/bbl starting in 2021;
- Transported volumes of about 62 million RTK in 2019, 68 million RTK in 2020, and 74 million RTK in 2021, reflecting greater transportation capacity thanks to the investments in the operations and the start of the new concessions;
- Ongoing diversification of transported products, with the rising share of fertilizers, pulp, and containers;
- Capex for the "Norte-Sul" concession: about R$2.3 billion in 2019, R$2.5 billion in 2020, R$2.8 billion in 2021, and R$3.2 billion in 2023;
- Dividends at 25% of the previous-year net income.

Key Metrics

	2018A	2019F	2020F
EBITDA margin (%)	52.1	52-56	53-57
FFO to debt (%)	24.3	25-30	25-30
Debt to EBITDA (x)	3.1	2.5-3.0	2.5-3.0

Company Description

Rumo was established in 2016 through Rumo Logística's incorporation of ALL. The company offers rail transportation services, port elevation, and warehousing mainly in southern Brazilian states, São Paulo and Mato Grosso. It operates approximately 12,000 kilometers of railroads through four concessions and controls two terminals in the Santos port and stakes in four port terminals including Paranaguá. In 2019, Rumo won the right to operate two stretches of the 'Norte-Sul' public railway, boosting its agricultural and grain cargo driven business. Cosan controls Rumo. The group currently holds a 28.47% stake of the company and seeks to increase it over the following years.

Business Risk: Fair

Rumo operates the largest railroad network in Brazil, connecting the most important agricultural states with several port terminals. The company controls 52% of the network that transports agricultural products to the Santos port. In addition to the Norte-Sul railroad, Rumo operates four rail networks, divided in two main regions: North and South concessions. The North operation consists of the Norte and Paulista networks. Although this operation represents only 25% of the company's total railroad network, it accounts for nearly 85% of the company's EBITDA and 71% of the volumes transported. The South operation consists of the Sul and Oeste networks in the three southern states: Paraná, Santa Catarina, and Rio Grande do Sul. Both operations have a similar ix of transported cargo, with soybean representing 45%-50% of the total.

Although Rumo diversifies its cargo in 2018 by adding pulp, fuels, and containers to its portfolio to mitigate the exposure to climate and harvest conditions, 75% of the total transported volume still relies on corn, soybean, and to a lesser extent, sugar. Since the acquisition of ALL, Rumo has been improving its operational ratio by investing in rail improvements, and new trains and wagons. Currently the company has 1,000 locomotives, 25,000 wagons, in addition to storage and distribution centers.

Peer comparison

In Brazil's railroad transportation segment, MRS Logistica S.A. is Rumo's closest peer. Although both companies operate in the São Paulo state and Santos port, Rumo has a much larger coverage area and diversified services such as warehousing and port-related services than MRS. However, a larger share of take-or-pay contracts and better operating efficiency generate more stable profitability and lower volatility for MRS compared to Rumo. In addition, while MRS transports mainly metals commodities, Rumo's bulk cargo consists of agricultural products. Compared with global peers, Brazilian companies are smaller. CSX Corporation is one of leading railroads in North America, operating in 23 U.S. states and Canada, and Kansas City Southern operates in both the U.S. and Mexico.

Table 1

Rumo S.A. -- Peer Comparison

Industry Sector: Railroad Transportation

	Rumo S.A.	**MRS Logistica S.A.**	**Kansas City Southern**	**CSX Corp.**
Ratings as of Sep. 4, 2019	BB-/Stable/B	BB-/Stable/--	BBB/Stable/A-2	BBB+/Stable/A-2
	--Fiscal year ended Dec. 31, 2018--			
(Mil. R$)				
Revenue	6,584.9	3,726.4	10,506.8	47,423.7
EBITDA	3,429.6	1,870.3	5,420.6	24,160.9
Funds from operations (FFO)	2,551.9	1,459.4	4,105.3	18,512.7
Interest expense	1,326.4	296.5	479.1	2,593.8
Cash interest paid	877.6	287.3	459.7	2,497.0
Cash flow from operations	1,835.5	1,336.6	3,837.1	18,090.7
Capital expenditure	1,996.7	688.0	2,396.3	6,755.5
Free operating cash flow (FOCF)	(161.2)	648.6	1,440.7	11,335.3
Discretionary cash flow (DCF)	(164.5)	429.6	(73.0)	(9,655.0)

Table 1

Rumo S.A. -- Peer Comparison (cont.)				
Industry Sector: Railroad Transportation				
	Rumo S.A.	**MRS Logistica S.A.**	**Kansas City Southern**	**CSX Corp.**
Cash and short-term investments	2,984.6	276.7	389.1	4,301.0
Debt	10,518.2	4,411.9	10,708.9	56,453.5
Equity	8,294.6	3,844.2	19,870.3	48,701.2
Adjusted ratios				
EBITDA margin (%)	52.1	50.2	51.6	50.9
Return on capital (%)	11.6	13.0	12.7	18.4
EBITDA interest coverage (x)	2.6	6.3	11.3	9.3
FFO cash interest coverage (x)	3.9	6.1	9.9	8.4
Debt/EBITDA (x)	3.1	2.4	2.0	2.3
FFO/debt (%)	24.3	33.1	38.3	32.8
Cash flow from operations/debt (%)	17.5	30.3	35.8	32.0
FOCF/debt (%)	(1.5)	14.7	13.5	20.1
DCF/debt (%)	(1.6)	9.7	(0.7)	(17.1)

Financial Risk: Aggressive

Rumo reduced its leverage, and consequently, its interest burden in the past two years as a result of its operational improvements. We expect the company to continue investing in productivity improvements, transportation capacity, and line expansion in the Norte-Sul concession during the next five years, which would result in operating cash deficits. In addition, risks arising from the Brazilian real's depreciation and its effects on fuel costs can pressure Rumo's profitability and cash flows, increasing leverage metrics' volatility. In this context, we expect a minimum dividend payment of 25% of the previous-year net income. We project the company to post net debt to EBITDA of 2.5x-3.0x in 2019 and about 2.5x in 2020. FFO to debt should remain between 25% and 30% for the next two years.

Financial summary

Table 2

Rumo S.A. -- Financial Summary					
Industry Sector: Railroad Transportation					
	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
(Mil. R$)					
Revenue	6,584.9	5,946.3	5,014.6	4,037.9	915.4
EBITDA	3,429.6	2,968.7	2,250.3	1,856.0	373.4
Funds from operations (FFO)	2,551.9	1,734.2	1,074.7	1,058.5	280.4
Interest expense	1,326.4	1,510.3	1,503.6	1,235.9	87.4
Cash interest paid	877.6	1,234.6	1,175.5	795.3	57.9
Cash flow from operations	1,835.5	1,084.7	288.1	738.2	29.0
Capital expenditure	1,996.7	2,045.4	1,699.2	1,405.5	273.6

Table 2

Rumo S.A. -- Financial Summary (cont.)					
Industry Sector: Railroad Transportation					
	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
Free operating cash flow (FOCF)	(161.2)	(960.7)	(1,411.1)	(667.2)	(244.6)
Discretionary cash flow (DCF)	(164.5)	(962.8)	(1,412.8)	(968.7)	(494.6)
Cash and short-term investments	2,984.6	3,330.4	1,181.0	581.3	85.5
Gross available cash	2,984.6	3,330.4	1,181.0	581.3	85.5
Debt	10,518.2	10,249.4	11,589.0	12,201.9	917.9
Equity	8,294.6	8,019.4	5,682.3	3,844.2	1,331.6
Adjusted ratios					
EBITDA margin (%)	52.1	49.9	44.9	46.0	40.8
Return on capital (%)	11.6	10.5	6.6	12.9	11.9
EBITDA interest coverage (x)	2.6	2.0	1.5	1.5	4.3
FFO cash interest coverage (x)	3.9	2.4	1.9	2.3	5.8
Debt/EBITDA (x)	3.1	3.5	5.2	6.6	2.5
FFO/debt (%)	24.3	16.9	9.3	8.7	30.5
Cash flow from operations/debt (%)	17.5	10.6	2.5	6.1	3.2
FOCF/debt (%)	(1.5)	(9.4)	(12.2)	(5.5)	(26.6)
DCF/debt (%)	(1.6)	(9.4)	(12.2)	(7.9)	(53.9)

Liquidity: Adequate

We continue to view Rumo's liquidity position as adequate. The company's sources over uses of cash will remain above 1.2x in the next 12 months and positive even if the forecasted EBITDA were to decline 15%. This is due to the ongoing deleveraging, improvement of the capital structure, along with higher EBITDA as a result of the operational improvement in the company's concessions.

Principal Liquidity Sources	Principal Liquidity Uses
• Short-term investments, cash, and cash equivalents of R$2.9 billion; and • FFO of about R$2.4 billion for the next 12 months.	• Short-term debt maturities of approximately R$1 billion; • Working capital needs close to R$800 million; • Capex of about R$2.3 billion in 2019, given the expansion project for the new concession; and • Dividends payments at 25% of the previous-year net income.

Covenant Analysis

Compliance expectations

We expect the company to comfortably meet its covenant requirements in the next 12 months.

Requirements

Rumo is subject to covenants under its debt contracts, regarding leverage level, debt service coverage, and capital composition:

- Net debt to EBITDA of less than 4.0x;
- Minimum interest coverage ratio (EBITDA to financial results) of 1.4x; and
- Minimum composition (equity/total assets) of 0.25x.

In addition to bank debt and bonds, the debt metrics include financial leasing, derivatives, and real estate receivables certificates.

Group Influence

We continue to view Rumo as a strategically important subsidiary of Cosan Ltd. Although the latter owns only 28.47% of Rumo's shares, the subsidiary currently contributes roughly 50% of Cosan's EBITDA and, in our view, has a potential for further growth and cash flows for the group. Cosan provides support, as seen in capital injections made in the past. The rating on Rumo doesn't benefit from the group support, given that currently Rumo's SACP and Cosan's ratings are at the same level.

Issue Ratings - Recovery Analysis

Key analytical factors

The issue-level global scale rating on Rumo Luxembourg's senior unsecured notes due 2025 and 2024 is the same as the issuer credit rating on Rumo. The recovery rating on the 2025 senior unsecured notes is '4' because Rumo solely guarantees them, which we believe are structurally subordinated to debts of the operating subsidiaries. The recovery rating on the 2024 senior unsecured notes is '3', because Rumo and Rumo Malha Norte guarantee the notes. Rumo Malha Norte is Rumo's most significant concession in terms of cargo transported and cash generation. In a default scenario, we assume Rumo would receive around 65% of the its value (about R$6 billion). This value, minus priority claims of R$645 million, is higher than the total senior unsecured debt (including the 2024 notes) at Rumo Malha Norte, which explains the notes' high recovery expectation. We analyze the recovery rating using multiples for valuation under a going concern assumption. We assume the company would restructure rather than be liquidated. We believe Rumo is economically important to the region where it operates and that, due to the size of its operations, it's unlikely that other players in the railroad segment or in competing transportation modes, such as trucking, would immediately replace Rumo. We've valued Rumo using a 5.5x multiple applied to our projected emergence-level EBITDA of R$1.8 billion, arriving at a stressed enterprise value of about R$9.9 billion.

Simulated default assumptions

- Year of default: 2023
- EBITDA at emergence: R$1.8 billion
- Implied enterprise value multiple: 5.5x

Simplified waterfall

- Gross enterprise value at default: R$9.9 billion, of which 65% corresponds to Rumo Malha Norte
- Administrative costs: 5%
- Net value available to creditors: R$9.4 billion
- Secured debt claims: R$1 billion (mainly consisting of BNDES loans)
- Unsecured debt claims: R$10 billion, of which R$5 billion is at Rumo Malha Norte, including the notes due 2024; and Rumo's R$3 billion, including the 2025 notes and the proposed debentures issuance. The remaining debt is located among the other operating subsidiaries.
- Recovery expectation for unsecured debt at guaranteed by Rumo Malha Norte: 50%-70%.
- Recovery expectation for unsecured debt at Rumo with no guarantees from operating subsidiaries: 30%-50%.

Reconciliation

Table 3

Reconciliation Of Rumo S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$)

	--Fiscal year ended Dec. 31, 2018--						
Rumo S.A. reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
	11,147.7	8,028.2	3,231.9	1,740.6	1,099.6	3,429.6	2,704.7
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(875.5)	--
Operating leases	28.6	--	8.5	2.2	2.2	(2.2)	6.3
Accessible cash and liquid investments	(2,984.6)	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	208.3	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(875.5)
Noncontrolling interest/minority interest	--	266.4	--	--	--	--	--
Debt: Derivatives	(892.5)	--	--	--	--	--	--
Debt: Tax liabilities	10.3	--	--	--	--	--	--
Debt: Other	3,208.6	--	--	--	--	--	--

Table 3

Reconciliation Of Rumo S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$) (cont.)							
EBITDA: Other income/(expense)	--	--	(29.2)	(29.2)	--	--	--
EBITDA: Other	--	--	218.5	218.5	--	--	--
Depreciation and amortization: Other	--	--	--	12.6	--	--	--
Interest expense: Other	--	--	--	--	224.6	--	--
Total adjustments	(629.6)	266.4	197.7	412.2	226.8	(877.6)	(869.2)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
	10,518.2	8,294.6	3,429.6	2,152.8	1,326.4	2,551.9	1,835.5

Ratings Score Snapshot

Issuer Credit Rating

BB-/Stable/B

Business risk: Fair

- **Country risk:** Moderately high
- **Industry risk:** Low
- **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-

- **Group credit profile:** bb
- **Entity status within group:** Strategically important

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Railroad And Package Express Industry, Aug. 12, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	Significant	**Aggressive**	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	**bb-**	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of October 4, 2019)*

Rumo S.A.	
Issuer Credit Rating	BB-/Stable/B
Brazil National Scale	brAA+/Stable/brA-1+
Senior Unsecured	

Ratings Detail (As Of October 4, 2019)*(cont.)		
Brazil National Scale		brAA+
Issuer Credit Ratings History		
06-Oct-2017		BB-/Stable/B
16-Aug-2017		BB-/Negative/B
23-May-2017		BB-/Watch Neg/B
24-Jan-2017		BB-/Negative/B
11-Jul-2018	*Brazil National Scale*	brAA+/Stable/brA-1+
06-Oct-2017		brA+/Stable/brA-1
16-Aug-2017		brA+/Negative/brA-1
23-May-2017		brA-/Watch Neg/brA-2
24-Jan-2017		brA-/Negative/brA-2
Related Entities		
Cosan Ltd.		
Issuer Credit Rating		BB-/Stable/--
Senior Unsecured		BB-
Cosan Lubrificantes e Especialidades S.A.		
Issuer Credit Rating		BB-/Stable/--
Cosan S.A.		
Issuer Credit Rating		BB-/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.