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Research Update:

South Africa-Based Super Group Ltd. 'zaAAA/zaA-1+' Ratings Affirmed Amid Challenging Trading Conditions

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Overview

- Transport firm Super Group's financial performance remained resilient in fiscal year (FY)2019 (ended June 30, 2019) benefitting from diversity of its business segments and operating efficiency gains.
- However, we believe Super Group will face difficulty maintaining its profitability if challenging trading conditions continue, and this could weaken its credit quality over time.
- We are affirming our 'zaAAA' long-term and 'zaA-1+' short-term South Africa national scale ratings on Super Group. The ratings are sensitive to further weakness in trading conditions over the next 12 months.

Rating Action Rationale

We expect that Super Group's earnings will remain under pressure given challenging trading conditions across all business segments. Super Group maintained adjusted EBITDA margins of about 10.9%, while growing adjusted EBITDA to South African rand (ZAR)4.1 billion in FY2019 from ZAR3.9 billion in FY2018. The company benefitted from business segment diversification in FY2019, with earnings from strong volumes in its commodity supply chain operations more than offsetting revenue and profitability pressure in other business segments, including industrial and consumer supply chain operations in South Africa and Europe, the SG Fleet division, and auto dealerships.

We see trading conditions remaining muted in FY2020 due to weak economic growth in South Africa, low consumer confidence in Australia, and uncertain global macroeconomic events related to Brexit and U.S.-China trade tension. We also believe commodity transport volumes, primarily coal, will decline from a peak in FY2019 as coal stockpiles improve at South African power utility Eskom.

Its industrial and consumer supply chain segment has secured new contracts to date, and we believe there is potential to win more customers owing to competitor weakness, but we believe profitability in its Supply Chain Africa division will remain constrained by tight consumer spending and weak growth in South Africa, which will lead to tighter margins across the supply chain. The Supply Chain Europe division continues to face several issues, related to emissions testing standards and U.S.-China trade wars, which reduced production in the German automotive sector.

We expect that poor consumer sentiment and tough retail conditions in Australia will weigh on demand for new or renewed lease contracts at SG Fleet. We also expect it will be impacted by a change to regulation in Australia, which spreads insurance product revenue across the life of the lease, rather than being realized up front.

The South African Dealerships segment is likely to face further revenue declines because of macroeconomic weakness and falling new car sales in South Africa. Although the business managed costs well to maintain its profitability in FY2019, we believe declining sales volumes will inevitably weigh on profitability. The U.K. Dealerships segment will continue to be affected by emissions standards testing and Brexit uncertainty, albeit we expect performance to remain resilient thanks to its brands being in demand.

We forecast that Super Group will maintain funds from operations (FFO) to debt marginally above 45% on average, with growth from bolt-on acquisitions. Super Group has maintained S&P Global Ratings-adjusted FFO to debt above 45% over the past three years. Our forecast reflects our expectation that, despite macroeconomic challenges in South Africa, depressed consumer sentiment in Australia, and Brexit-related uncertainties, the company will keep positive free operating cash flow (FOCF) before acquisitions, which supports credit metrics remaining commensurate with the 'zaAAA' rating.

We believe Super Group will continue its selective acquisition strategy of buying entities that can be bolted on to existing business segments. Although the uncertain magnitude and timing of any acquisitions means that we do not factor them into our forecasts, we anticipate that the company's acquisitive strategy will help improve its earnings diversification and will be the main growth driver.

We anticipate that Super Group will prioritize allocation of excess FOCF toward organic growth and bolt-on acquisitions, before considering opportunistic purchases of SG Fleet or Super Group shares.

We could lower our rating on Super Group in the next 12 months. Intense competition, adverse business conditions, or unexpected operational issues that leads to a downward revision of its business profile, sustained deterioration of credit metrics, or weaker liquidity could lead us to lower the rating.

Although we forecast FFO to debt will weaken to 40%-45% in FY2020, we anticipate Super Group will maintain this core metric above 45% on average, alongside adequate liquidity. However, weaker-than-anticipated operating conditions could arise over the next 12 months, which could result in deterioration of Super Group's business and financial profiles. As a result, we believe there is a one-in-three chance that we could lower our rating on Super Group in the next 12 months.

We could lower the rating if weak operating conditions result in a material decline in profitability or margins, or if S&P Global Ratings-adjusted FFO to debt falls sustainably below 45%. We could also lower the rating if Super Group's acquisitive strategy or opportunistic share repurchases lead to weaker credit metrics without tangible prospects for recovery. This could also happen if, for example, greater-than-expected capital expenditure (capex) associated with an acquired company led to negative FOCF for more than 12 months.

Stable margins, FFO to debt sustainably above 50%, and adequate liquidity would support the current rating.

Company Description

Super Group is a provider of supply chain logistics, commodity transport, fleet solutions, and auto dealerships. It is headquartered in South Africa and posted revenue of ZAR37.9 billion (US$2.6 billion) in FY2019.

The company's operating segments consist of:

- Supply chain (Supply Chain Africa and Supply Chain Europe);
- Fleet solutions (Fleet Africa and SG Fleet Ltd., which is listed in Australia and 59.2% owned by Super Group); and
- Dealerships (based in South Africa and the U.K.).

Our Base-Case Scenario

Our base-case assumes:

- Real GDP growth in South Africa of 1.1% in FY2020 and 1.8% in FY2021, with consumer price index (CPI) inflation of 4.6% and 4.8% in the respective fiscal years.
- Real GDP growth in Australia of 1.7% in FY2020 and 1.0% in FY2021, with CPI inflation around 2.9% in both years.
- Revenue decline between 0%-1% in both FY2020 and FY2021, after acquisitions, primarily due to reduced commodity transport and new vehicle sales volumes.
- Adjusted EBITDA margins between 9.8%-10.2% in both FY2020 and FY2021, from 10.9% in FY2019.
- Capex of about ZAR2.3 billion in FY2020 and ZAR2.1 billion in FY2021, from ZAR2.4 billion in FY2019.
- Proceeds from fleet asset disposals of around ZAR600 million in both FY2020 and FY2021.
- Working capital outflows of around ZAR550 million in FY2020 and ZAR350 million in FY2021.
- Announced and committed acquisitions of about ZAR780 million in FY2020. We do not assume further acquisitions in our forecasts.
- We do not anticipate any dividend payments to Super Group shareholders in the next 12 months, based on the company's guidance. However, we do expect SG Fleet to pay dividends of at least ZAR180 million a year to its minority shareholders.

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures for the company:

- FFO to debt between 40%-45% in FY2020, improving to 45%-50% in FY2021, from 53% in FY2019.
- Adjusted debt to EBITDA of about 1.6x in FY2020, improving to 1.5x in FY2021.
- Positive FOCF before acquisitions.

Liquidity

The short-term issuer credit rating on Super Group is 'zaA-1+', based on the 'zaAAA' long-term issuer credit rating and our assessment of the company's liquidity.

We assess Super Group's liquidity as adequate because we forecast that sources will cover uses by around 1.6x for the 12 months beginning July 1, 2019. We consider that the company has improved access to the capital markets, given its issuance of ZAR750 million in unsecured notes in October 2019, ZAR1 billion in June 2019, and ZAR450 million in September 2018. Potential bolt-on acquisitions and opportunistic purchases of SG Fleet shares and repurchases of Super Group shares are a possibility, although we believe the company will maintain at least adequate liquidity.

We calculate the following principal liquidity sources for the 12 months started July 1, 2019:

- Cash and cash equivalents of ZAR3.6 billion.
- Available committed bank lines with maturities greater than 12 months of about ZAR1.3 billion.
- Annual forecast cash FFO of about ZAR2.5 billion.
- Issuance of bonds with varying maturities totaling ZAR750 million completed in October 2019.
- Annual proceeds from fleet asset disposals of about ZAR600 million.

For the same period, we calculate the following principal liquidity uses:

- Scheduled debt maturities and amortization of about ZAR1.65 billion.
- Capex of about ZAR2.3 billion.
- Working capital outflows of around ZAR550 million.
- Dividends to minority shareholders, primarily of SG Fleet, of at least ZAR180 million.
- Committed bolt-on acquisitions of about ZAR780 million.

Covenants

We understand that the general banking facility documentation includes minimum capital adequacy; net interest coverage ratios; and net debt-to-EBITDA covenants, which are measured quarterly after deconsolidating SG Fleet. We expect that headroom under these covenants will remain adequate and that the group will be able to meet its cash needs from internally generated funds.

Other Credit Considerations

The 'zaAAA' long-term South Africa national scale rating incorporates our view of Super Group's acquisitive strategy. We see a risk that Super Group could make large debt-funded acquisitions on an opportunistic basis, resulting in ratios falling short of our base-case forecasts and rating-commensurate levels, with limited prospects of improving within a year after the acquisition.

Ratings Score Snapshot

South Africa National Scale Rating:	zaAAA/--/zaA-1+
Business risk:	Fair
Country risk:	Intermediate
Industry risk:	Intermediate
Competitive position:	Fair
Financial risk:	Modest
Cash flow/Leverage:	Modest
Modifiers:	
Diversification/Portfolio effect:	Neutral(no impact)
Capital structure:	Neutral(no impact)
Financial policy:	Negative (-1 notch)
Liquidity:	Adequate (no impact)
Management and governance:	Fair (no impact)
Comparable rating analysis:	Neutral(no impact)

Related Criteria

- 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: 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed	
Super Group Ltd.	
South Africa National Scale	zaAAA/--/zaA-1+

Regulatory Disclosures

Super Group Ltd.

- Primary Credit Analyst: Rishav Singh, Associate
- Rating Committee Chairperson: G.Andrew Stillman
- Date initial rating assigned: Aug. 20, 2013
- Date of previous review: Oct. 25, 2018

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Materials Used In The Credit Rating Process: Sufficient information in general consists of both (i) financial statements that describe the Issuer's financial condition, results of operations and cash-flows, and (ii) a description of the activities and obligations of the entity including of its governance and legal structure.

This credit rating was disclosed to the rated entity or related third party before being issued.

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Glossary

- Business risk profile: This measure comprises the risk and return potential for a company in the market in which it participates (its industry risk), the country risks within those markets, the competitive climate, the company's competitive advantages and disadvantages (its competitive position).

- Comparable rating analysis: This involves taking a holistic review of a company's stand-alone credit risk profile (SACP), because each of the subfactors that ultimately generate the SACP can be at the upper or lower end, or at the midpoint, of such a range. It may also touch upon the overall comparative assessment of an issuer in relation to its peers across industry and jurisdiction and may capture some factors not (fully) covered, such as a short operating track record, entities in transition, unusual structures, or contingent risk exposures.
- Competitive advantage: The strategic positioning and attractiveness to customers of the company's products or services, and the fragility or sustainability of its business model.
- Competitive position: Our assessment of a company's: competitive advantage; operating efficiency; scale, scope, and diversity; and profitability.
- Country risk: This measures a country's influence on the overall credit risks for a rated company with regards to a country's economic, institutional and governance effectiveness, financial system, and payment culture/rule of law risks.
- Creditworthiness: Ability and willingness of a company to meet its debt and debt-like obligations; measured by assessing the level current and future resources relative to the size and timing of its commitments.
- Diversification/portfolio effect: Applicable to conglomerates. An assessment of the extent to which an entity's multiple core business lines are correlated and whether each contributes a material source of earnings and cash flow.
- Earnings: Proxy for profit or surplus yielded by an entity after production and overhead costs have been accounted for in a given period.
- EBITDA margin: This is EBITDA as a fraction of revenues.
- EBITDA: This is earnings before interest, tax, depreciation, and amortization.
- Efficiency gains: Cost improvements.
- Financial headroom: Measure of deviation tolerated in financial metrics without moving outside or above a predesignated band or limit typically found in loan covenants (as in a debt-to-EBITDA multiple that places a constraint on leverage) or set for the respective rating level. Significant headroom would allow for larger deviations.
- Financial risk profile: This measure comprises our assessment of a company's cash flow/leverage analysis. It also takes into account the relationship of the cash flows the organization can achieve given its business risk profile. The measure is before assessing other financial drivers such as capital structure, financial policy, or liquidity.
- Free operating cash flow (FOCF): Cash flow from operations minus capital expenditure.
- Funds from operations (FFO): EBITDA minus interest expense minus current tax.
- Group rating methodology: The assessment of the likelihood of extraordinary group support (or conversely, negative group intervention) that is factored into the rating on an entity that is a member of a group.
- Industry risk: This addresses the major factors that affect the risks that companies face in their respective industries.
- Issuer credit rating: This is a forward-looking opinion of an obligor's overall creditworthiness (A national scale rating is also an issuer credit rating).

- Leverage: The level of a company's debt in relation to its earnings before interest, tax, depreciation, and amortization.
- Liquidity: This is the assessment of a company's monetary flows, assessed over a 12 to 24 month period. It also assesses the risk and potential consequences of a company's breach of covenant test, typically tied to declines in EBITDA.
- Management and governance: This addresses how management's strategic competence, organizational effectiveness, risk management, and governance practices shape the issuer's competitiveness in the marketplace, the strength of its financial risk management, and the robustness of its governance.
- Operating efficiency: The quality and flexibility of the company's asset base and its cost management and structure.
- Profitability ratio: Commonly measured using return on capital and EBITDA margins, but can be measured using sector-specific ratios.
- Scale, scope, and diversity: The concentration or diversification of business activities.