

Research Update:

Freight Forwarder SGLT Holding I LP Assigned 'B' Rating; Outlook Stable

October 4, 2019

Rating Action Overview

- SGLT Holding I LP (SGLT) is a freight forwarder and logistics provider with a strong presence in the Nordics and North America and a focus on complex projects and tailor-made solutions.
- In our view, SGLT's relatively small scale and scope, low profitability, and highly leveraged capital structure constrain its creditworthiness. That said, we expect the company will start generating positive free operating cash flow (operating cash flow after working capital changes and capital expenditures; FOCF) this year and maintain solid liquidity, partly offsetting these constraints.
- Given SGLT's track record and strategy to expand through complementary acquisitions, the company has limited room for debt reduction, but we expect SGLT's S&P Global Ratings-adjusted debt to EBITDA will stay below 6.5x thanks to management's financial discipline.
- We are assigning our 'B' long-term issuer credit ratings to SGLT and its finance subsidiary SGL TransGroup International A/S, and our 'B' issue rating to the proposed senior secured bonds to be issued by SGL TransGroup International.
- The stable outlook reflects our view that SGLT will maintain above-industry-average revenue growth and gradually improve its EBITDA margins, resulting in adjusted debt to EBITDA staying below 6.5x, while generating positive FOCF and keeping an ample ratio of liquidity sources to uses.

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Rating Action Rationale

Our assessment of SGLT's business risk profile reflects the company's position as a small-to-midsize asset-light freight forwarder and logistics services provider in the highly fragmented and price-competitive logistics industry. SGLT's relatively small scope of operations is reflected in its predominant presence in the Nordics and North America and concentration on trade flows between Asia and Northern Europe in its air and sea freight-forwarding businesses. These businesses combined account for close to 60% of SGLT's revenue. The company generated absolute adjusted EBITDA of \$39 million (reported \$24 million) in 2018, which is about half that of

its next-largest and rated logistics peer, Germany-based Logwin AG (BB+/Stable). This figure is also much smaller than that of the fourth-largest global freight forwarder, Danish DSV (BBB+/Stable), with \$1.3 billion, and of the eighth-largest, France-based CEVA Logistics AG (B+/Stable), with \$547 million. We view the company's modest absolute level of EBITDA as a weakness because it provides limited protection against market fluctuations and high-impact and low-probability events, such as a significant economic downturn in China or the loss of major customers. In addition, SGLT's small scale compared to its generally much larger customers limits the company's bargaining power, in our view.

SGLT's track record of relatively low and volatile operating margins constrains our profitability assessment. That said, we also take into account the company's asset-light business model, partly flexible cost base, and minimal capital expenditure (capex) needs. SGLT generates an EBIT margin of 2%-3%, which is relatively thin compared to the broader range of global peers from the railroad and package express industry, such as DSV with 7%-8% and XPO Logistics Inc. and Logwin with 5%.

Although SGLT's focus on high-end specialized and often time-critical logistic solutions does not benefit the company's overall profitability measures, which we view as weak, it limits the customer churn rate. Indeed, we view SGLT's existing customer stickiness as the main credit support. The 20 largest customers have been with the company for eight years on average, while the relationship with the largest client goes back more than 40 years. Furthermore, SGLT has a strongly diversified customer base comprising more than 20,000 clients, with the top 20 clients accounting for about 30% of total revenue and no single customer accounting for more than 3%, and there is limited correlation between individual customers and end-industries. This provides critical protection to SGLT's topline revenue. We also understand that SGLT's earnings are to a large extent shielded from the fluctuations in shipping and air freight rates. This is because SGLT has only a limited number of fixed-price contracts and it can pass on the fluctuations in rates and currencies to its customers with some delays.

SGLT has long-term expertise and an established presence as the global leading provider of tailor-made multi-modal solutions in challenging regions--such as areas of armed conflict, natural disasters, landlocked countries, and countries with poor infrastructure--on behalf of various aid and humanitarian organizations such as the United Nations. Accounting for 13% of SGLT's revenue, these operations are not the largest revenue contributor, but they are recurring in nature and we understand that they generate above-average returns.

Our financial risk profile assessment reflects SGLT's highly leveraged capital structure. We expect the company's adjusted debt to EBITDA to be 5.0x-5.3x in 2019 (an improvement from 6.8x in 2018), with leverage remaining at about 5.0x in the following 12 months on gradually expanding earnings and margins. Given the potential for growth and market opportunities in SGLT's core markets of North America and the Nordics, as well as the company's ambitions to opportunistically expand into new regions via bolt-on acquisitions, we think the scope for material improvement in credit ratios beyond our base-case forecast is rather small. We understand that SGLT and its shareholders have limited appetite to leverage the company to a level significantly above the aforementioned debt-to-EBITDA range. We understand that the company is considering issuing a new secured bond to refinance the existing bond and to include an option of a tap to finance potential acquisitions. We think such potential acquisitions would contribute to SGLT's EBITDA and support its debt-to-EBITDA ratio.

More importantly, we forecast SGLT will start generating positive reported FOCF from 2019 despite this year's capex peak, which is largely related to certain IT infrastructure upgrades. Consequently, we forecast only marginally positive FOCF this year, increasing gradually to a positive \$10 million-\$15 million by 2021 thanks to improving EBITDA and structurally low capex

needs of up to an average of \$5 million per year in 2020-2021. Positive FOCF will underpin SGLT's liquidity while providing a financial cushion for potential bolt-on acquisitions. We view the continuous positive FOCF generation as one of the conditions for the current rating.

We note that SGLT is planning to issue a bond denominated in euros, a currency that is different from the functional currency of the company's business (primarily the Danish krone and U.S. dollar). We view the currency risk as sufficiently mitigated by management's commitment to hedge material currency mismatches to ensure that sufficient funds in the same currency are available to service the bond. Further mitigating factors are the fact that about 30% of the company's revenues are generated in Danish kroner, which is pegged to the euro, and our view that the U.S. dollar, which accounts for about 40% of revenues, is a stable currency.

Outlook

The stable outlook reflects our view that SGLT will maintain above-industry-average revenue growth and gradually improve its EBITDA margins, resulting in adjusted debt to EBITDA staying below 6.5x, while generating positive FOCF and keeping an ample ratio of liquidity sources to uses.

Downside scenario

We would lower the rating if SGLT's EBITDA generation trends significantly below our base-case forecast and FOCF remains negative without any prospects for a near-term recovery, hampering liquidity and credit measures such that adjusted debt to EBITDA exceeds 6.5x. This could happen due to unforeseen operating adversities, such as the loss of a few key customers and reduced demand from existing clients; aggressive external growth initiatives involving increased use of debt not compensated for by the corresponding growth in earnings; or unexpected material shareholder remuneration. We could also downgrade SGLT if the company's liquidity deteriorates such that the ratio of liquidity sources relative to uses falls below 1.2x for the coming 12 months.

Upside scenario

We view an upgrade over the next 12 months as unlikely since SGLT's financial sponsor ownership and acquisitive track record preclude sustained leverage reduction, while SGLT's limited scale, low absolute EBITDA, and thin profit margins constrain its business profile. However, we could consider raising the rating in the medium term if the company significantly increased its scale and scope of operations--organically and via profitability-enhancing complementary acquisitions--and improved its profit margins. An upgrade would also require SGLT to demonstrate a prudent financial policy and reduce leverage on a sustainable basis. In this respect, we would need to see adjusted debt to EBITDA fall and remain well below 5.0x, while also supported by the owners' commitment to maintain a financial policy that would sustain such improved ratios on a long-term basis.

Company Description

Registered in the Cayman Islands, SGLT is a small-to-midsize freight forwarder and logistics services provider with a focus on delivering tailor-made solutions on niche complex projects for about 20,000 midsize-to-large customers, primarily in the Nordics and North America. The company generated about \$955 million in revenue and about \$26 million in reported EBITDA in 2018 (after special operating items but before the pro forma impact of completed acquisitions),

almost equally distributed across its Denmark-based and U.S.-based operating subsidiaries, Scan Global Logistics (SGL) and TransGroup Global Logistics. SGLT specializes in consumer, manufacturing, aid, development, and industrial projects, and food additives verticals. It is also increasing its focus on the high-end automotive segment (not bulk volumes), enhanced by the acquisition of the German based IQS Group in 2019.

With 67.5% of voting rights, the private equity firm AEA Investors controls SGLT, directly owning 28.9% of the SGLT's share capital. Management and other investors hold the remainder.

Our Base-Case Scenario

In our base case*, we assume:

- Revenue to increase to \$1.0 billion-\$1.1 billion in 2019 from \$955 million in 2018, signifying a 10% growth rate year on year. This is supported by solid growth of 14.6% in the first half of 2019, which was driven by the organic growth of the U.S.-based subsidiary (15% in the second quarter [Q2] of 2019 and more than 20% in 2018) and the consolidation effects on the SGL-level following the acquisition of IQS Group in 2019. We expect the revenue growth of about 10% to persist in 2020 and 2021, also supported by SGL's growth of 6% in Q2 2019, returning to its pre-2017 levels. We do not factor any impact from potential acquisitions into our revenue assumption. The above-average organic growth compared to the overall industry stems from the niche nature of SGLT's freight forwarding solutions, and hence lower dependency on the general GDP-driven volume developments, as well as its small size, when an additional larger customer win can have a significant revenue boost. This was the case in the U.S. in 2018, when a new customer contributed to about one-third of the subsidiary's organic growth.
- The positive EBITDA trend to continue. We expect reported EBITDA (after operating special items) to increase to about \$37 million in 2019 from about \$26 million in 2018 (and from a depressed level of \$17 million in 2017). EBITDA expansion will stem from the organic revenue growth and consolidation of IQS Group, which provides higher-margin logistics solutions to the specialty automotive sector. Accordingly, we expect the 2019 EBITDA margin to continue recovering to about 3.5% from about 2.7% in 2018 and 2.0% in 2017. For 2020 and 2021, we expect the EBITDA margin to remain largely flat, factoring in SGLT's relatively small size constraining its bargaining power vis-à-vis large customers and competitive industry pressures in general.
- Capex of \$6.9 million in 2019, with more than half of it for the IT infrastructure upgrades, normalizing at \$3 million from 2020.
- No cash deduction from total adjusted debt due to SGLT's financial sponsor ownership.
- Restriction on shareholder remuneration under the terms of the proposed bond issuance.

Based on these assumptions, we arrive at the following credit measures:

- Weighted-average\$ adjusted debt to EBITDA of about 5.3x in 2018-2021.
- Weighted-average\$ adjusted funds from operations (FFO) to debt of about 10% in 2018-2021.
- Marginally positive FOCF in 2019, before increasing gradually to a positive \$10 million-\$15 million by 2021, thanks to improving EBITDA and structurally low capex needs.

*We base our historical financial analysis on the audited consolidated schedules, which do not include notes and are not fully equal to the audited consolidated financial accounts. However, we think the company provided us with sufficient additional information to close the information gap

with the detailed International Financial Reporting Standard disclosure.

§We base our ratio weighting on one historical year (2018) and three forecast years. We exclude 2017, since the data on operating leases were not readily available for this year. We do not net cash off our adjusted debt number.

Liquidity

We assess SGLT's liquidity as adequate, primarily reflecting a ratio of liquidity sources to uses of about 2.0x in the 12 months from June 30, 2019. The bullet nature of the majority of the company's debt supports our liquidity assessment. There are no maintenance covenants in SGLT's existing or proposed debt documentation.

Principal liquidity sources:

- About \$16 million of cash on balance that we view as readily available for debt repayment.
- About \$17.5 million in an undrawn and committed facility from Bank of America available for more than one year.
- Our base-case forecast of FFO of about \$18 million.

Principal liquidity uses:

- Working capital outflows of \$4 million, with potential intra-year volatility of up to \$15 million.
- Gross capex of about \$5 million, including a material investment in IT infrastructure upgrades.

Issue Ratings - Recovery Analysis

Key analytical factors

- We have assigned a 'B' issue rating to the proposed €210 million-€215 million senior secured bonds to be issued by SGL TransGroup International. The recovery rating is '4', indicating our expectation of average recovery (30%-50%; rounded estimate: 40%) in the event of a default.
- The recovery rating is restricted by the relatively weak security package, given the asset-light nature of the business model and the presence of prior-ranking liabilities, such as revolving credit lines.
- The documentation includes a minimum material group company coverage test (85% of EBITDA), a security package comprising a pledge over the shares of material subsidiaries, subordinated loans and intercompany loans, as well as customary clauses, including negative pledge and cross default clauses.
- Our hypothetical default scenario assumes an economic slowdown, difficulty in implementing key projects, and operational issues leading to loss of major customers. We value the company as a going concern, given its long-term relationships with its customers who rely on its niche expertise in executing special complex logistics projects in various geographies, including those with difficult political environments.

Simulated default assumptions

- Year of default: 2022
- Jurisdiction: Denmark

Simplified waterfall

- Emergence EBITDA: \$30 million
- Minimum capex: 0.5% of revenue
- Cyclical adjustment: 5%, standard for the sector
- Multiple: 5.0x
- Gross recovery value: \$149 million
- Net recovery value for waterfall after admin. expenses (5%): \$141 million
- Priority claims: \$44 million
- Value available for secured claims: \$97 million
- Senior secured claims: \$243 million*
- Recovery range: 30%-50% (rounded estimate: 40%)

*All debt amounts include six months' prepetition interest. The super senior RCF is assumed to be 85% drawn.

Ratings Score Snapshot

Issuer Credit Rating: B/Stable/--

Business risk: Vulnerable

- Country risk: Very low
- Industry risk: Low
- Competitive position: Vulnerable

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b-

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: FS-6 (no additional impact)

- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- Criteria - Corporates - Industrials: Key Credit Factors For The Railroad And Package Express Industry, Aug. 12, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment 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

New Rating	
SGLT Holding I LP	
SGL TransGroup International A/S	
Issuer Credit Rating	B/Stable/--
New Rating	
SGL TransGroup International A/S	
Senior Secured	B
Recovery Rating	4(40%)

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. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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