MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Pro-Gest's CFR to B3 from B1; negative outlook

19 Sep 2019

Milan, September 19, 2019 -- Moody's Investors Service, (Moody's) has today downgraded Pro-Gest S.p.A.'s ("Pro-Gest" or the "company") corporate family rating (CFR) to B3 from B1, its probability of default rating (PDR) to B3-PD from B1-PD and the rating on the company's €250 million senior unsecured notes due 2024 to Caa1 from B2. Pro-Gest is an Italian vertically integrated producer of recycled paper, containerboard, corrugated cardboard and packaging solutions. The outlook on all ratings has been revised to negative from stable.

"Today's action was prompted by the sharp deterioration in the company's performance and liquidity due to lower selling prices which led to a build-up of its inventory, the uncertainty on when the production activities in Mantova will be resumed and the recent €47.5 million fine from the Italian anti-trust authority," says Donatella Maso, Moody's lead analyst for Pro-Gest. "The rating downgrade and negative outlook also reflect a potential breach of financial covenants at year end on part of the company's financial debt", continued Ms. Maso.

A list of the affected ratings can be found at the end of this press release.

RATINGS RATIONALE

Weaker demand in both Italy and across Europe and the consequent contraction in selling prices combined with higher fixed costs due the suspension in the production at Mantova were the main causes for the 17% fall in the company's reported EBITDA (before the provision related to the antitrust fine) over the first six months of 2019. This led the company's leverage (as adjusted by Moody's) to rise to around 6.0x on an LTM basis June 2019. Even though the selling prices seem to have stabilised, the trading environment remains challenging and Moody's does not expects any EBITDA's recovery in 2019.

In an effort to protect its profitability margins Pro-gest decided to reduce sale volumes for containerboard and corrugated board and to increase the stock levels. This move translated in a significant rise in inventory which absorbed significant cash through June with no visibility as to whether the company will be able to unwind part of working capital in the second half of the year.

As a result of the weakening performance and the negative free cash flow generation, the rating agency expects the company to breach its net leverage financial covenant of 4x as of December 2019. Financial covenants are included in the company's bank loans and mini-bonds documentation for an aggregate debt of approximately €150 million. Moody's understands that some debt, including the export credit facility, does not include any cure rights or a grace period. In Moody's view, the company will therefore have to successfully renegotiate its covenants in order to avoid having to repay such debt in 2020.

Furthermore, last August, the company was fined with €47.5 million from the Italian competition authority for engaging in alleged anti-competitive practices. The fine becomes due on the 4th of November. Moody's understands that Pro-Gest will appeal this decision to the regional administrative court on 4th of October, which could potentially suspend the payment of the fine until final appeal. Pro-Gest will also seek to repay the sanction in 30 installments starting in 2020. Despite the uncertainty regarding the final amount, timing and terms of the payment, it could represent a significant drain on the company's liquidity sources, at a time when liquidity has weakened owing to the cash burn linked to the negative working capital move, and the potential breach of financial covenants.

Moody's would also like to draw attention to certain governance considerations with respect to Pro-Gest. The company's approach to the ramp-up of the Mantova facility and to liquidity management at a time when operating performance has weakened are risks that have been factored into Moody's assessment of the credit risk associated with Pro-Gest.

LIQUIDITY

Pro-Gest's liquidity has deteriorated during Q2, mainly because of the significant working capital build-up which has absorbed large amount of cash and it will unlikely unwind during the remainder of the year. Given the lack of a committed revolving facility, the company will have to rely on the €78 million of cash held on balance sheet at the end of June 2019 and uncommitted lines, estimated to be available for around €80 million, to withstand its near term liquidity needs such as mandatory debt repayments, committed investments, the potential payment of the antitrust fine and part of its debt in case of a waiver on covenants is not granted.

STRUCTURAL CONSIDERATIONS

The B3-PD PDR is in line with the CFR. This is based on a 50% recovery rate, as typical for transactions with both bond and bank debt. The Caa1 rating on the senior unsecured notes due 2024 is one notch below the CFR, reflecting the large amount of debt sitting in the operating subsidiaries that are not guaranteeing the notes and considered senior to the notes. The capital structure includes an export credit facility of €40 million, medium-and long-term facilities of €104 million, Italian mini bonds of €85 million, and finance leases of €18 million.

The 2024 notes are unsecured and guaranteed by the issuer and certain subsidiaries, which accounted for 60% of total assets on an aggregated basis, 79% of consolidated revenue and other income, and 62% of EBITDA on an aggregated basis (gross of intragroup transactions) as of June 2019.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook on Pro-Gest's ratings reflects the uncertainty on the prospects for both operational and liquidity improvement, including (1) the company's plans to unwind the significant working capital build-up and improve its free cash flow generation; (2) its ability to timely renegotiate its financial covenants; (3) the amount, timing and terms of the payment of the antitrust fine; and (4) the authorisation to restart the activities at its Mantova facility.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward pressure on the ratings is unlikely in the near term but could arise over time if Pro-Gest's operating performance were to improve driven by increasing volumes and selling prices and the resume of Mantova resulting in (1) its EBITDA margin to remain around the high teens in percentage terms; (2) Moody's adjusted debt/EBITDA to stay below 6.0x debt/EBITDA on a sustainable basis; (3) sustained positive free cash flow generation; and (4) an adequate liquidity profile.

Downward pressure on the ratings could develop if the company's performance and liquidity continue to deteriorate, for example if financial covenants are breached and the company fails to agree on a waiver on a timely manner. Quantitatively, we could downgrade the ratings if (1) Moody's adjusted debt/EBITDA rises above 7.0x on a sustainable basis; (2) Pro-Gest is unable to improve its free cash flow generation to at least break-even levels; and (3) is unable to reduce its reliance on uncommitted and short-term funding.

LIST OF AFFECTED RATINGS:

Downgrades:

..Issuer: Pro-Gest S.p.A.

.... Corporate Family Rating, Downgraded to B3 from B1

.... Probability of Default Rating, Downgraded to B3-PD from B1-PD

.... Backed Senior Unsecured Regular Bond/Debenture, Downgraded to Caa1 from B2

Outlook Actions:

..Issuer: Pro-Gest S.p.A.

....Outlook, Changed To Negative From Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Paper and Forest Products Industry published in October 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Treviso (Italy), Pro-Gest S.p.A. is an Italian vertically integrated producer of recycled paper, containerboard, corrugated cardboard and packaging solutions. The company operates three recycling plants, six paper mills, four corrugators, eight packaging plants, and two tissue converting plants or overall 23 production facilities, all located in Italy, and employs over 1,100 people.

For the last twelve months ended 30 June 2019, Pro-Gest reported core revenue of €466 million and EBITDA of €91 million (Moody's adjusted before the provision for the antitrust fine). The company is family owned, and Bruno Zago, who founded Pro-Gest in 1973, is also its CEO.

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