Moody's
INVESTORS SERVICE

Rating Action: Moody's downgrades Pro-Gest's CFR to Caa1 from B3; negative outlook

19 Dec 2019

Milan, December 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 Caa1 from B3, its probability of default rating (PDR) to Caa1-PD from B3-PD and the rating on the company's €250 million guaranteed senior unsecured notes due 2024 to Caa2 from Caa1. Pro-Gest is an Italian vertically integrated producer of recycled paper, containerboard, corrugated cardboard and packaging solutions. The outlook remains negative.

"The ratings downgrade follows the company's weaker than expected Q3 results, which have led to a further deterioration of its credit metrics and liquidity," says Donatella Maso, a Moody's Vice President -- Senior Analyst and lead analyst for Pro-Gest.

"The rating action also reflects the uncertainties around (1) the ongoing negotiation of covenant waivers with the lenders and overall plans to shore up liquidity sources; (2) the authorization to resume production activities in the Mantova plant; (3) the timely provision of the guarantee for the payment suspension of the €47.5 million antitrust fine imposed in August 2019; and (4) the operating performance recovery in 2020 in a context of pricing pressures due to tough competition", continued Ms. Maso.

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

RATINGS RATIONALE

Pro-Gest's operating performance in Q3 2019 has been weaker than Moody's expectations due to difficult trading conditions with low selling prices, higher costs from the suspension of the Mantova plant and the acquisition of Papergroup, and the extraordinary maintenance shut-down of the Villa Lagarina and other key plants during the month of August, which led to €6.5 million EBITDA loss. The company's reported EBITDA in Q3 stood at €10 million down from €23.5 million in Q3 2018. As a result, leverage (as adjusted by Moody's) increased to around 7.1x on an LTM basis September 2019 from 5.9x in June. Pro-Gest also continued to burn cash during the quarter reducing its cash balances to €60 million from €78 million in June.

As the operating environment remains challenging and the authorization to start the production in Mantova is still under review by the relevant authorities, Moody's does not expect any meaningful recovery in profitability in the next 12 months. This will result in a breach of the company's financial covenants included in the documentation for €144 million of aggregate debt outstanding (mainly the €75 million mini bonds and €69 million bank loans) at the end of September.

Although the company has sought external advice to approach lenders for a covenant waiver and to more broadly address its liquidity needs, Moody's believes that the status of these negotiations could be negatively affected by further delays in the environmental review process of the Mantova paper mill, which the company expects to receive in Q1 2020.

Furthermore, while Pro-Gest has obtained the suspension of the payment of the €47.5 million antitrust fine for engaging in alleged anti-competitive practices until a hearing scheduled for the 8th July 2020, such suspension is subject to the provision of a guarantee by the 7th of January. Failure to providing such guarantee may lead to a payment of the fine in 20 monthly instalments (as granted by the antitrust authority) ahead of the July hearing.

The continued uncertainty over the resumption of production at Mantova, as well as the negotiation of the covenant waivers and the payment of the fine, poses further pressure on the company's liquidity, which is already very weak owing to a deteriorating operating performance and the cash burn primarily linked to larger than anticipated working capital outflows.

Moody's would like to draw attention to certain environmental and governance considerations with respect to Pro-Gest. The lack of authorization to produce at its Mantova mill resulted from environmental issues mainly linked to the building of an incinerator in the plant. The suspension of operations in Mantova lead to running costs of around €10 million in 2019, depressing the company's EBITDA. However, Moody's notes that Pro-Gest has, in its most recent formal proposal, given up the possibility to build such incinerator in an effort to resolve the matter and to resume production at Mantova, and the administrative procedure is ongoing on this new basis. From a corporate governance perspective, Moody's has factored in the company's weak liquidity management, at a time when operating performance has deteriorated.

LIQUIDITY

Moody's considers Pro-Gest's liquidity as weak. Given the lack of committed lines, the company relies on the €60 million of cash held on balance sheet at the end of September 2019, €100 of uncommitted short term facilities (€72 million utilized at the end September) and factoring arrangements, and the potential sale of certain non-core assets to withstand its near term liquidity needs such as mandatory debt repayments, committed investments, the payment of the antitrust fine and part of its debt in case of a waiver on covenants is not granted. Assuming the waiver on the covenants is granted, Moody's expects that the company will deplete its cash balance in Q3/Q4 2020, unless it secures additional liquidity sources in the coming months.

STRUCTURAL CONSIDERATIONS

The Caa1-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 Caa2 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, reduce its expansion capital expenditures and improve its free cash flow generation; (2) its ability to timely renegotiate its financial covenants and address its liquidity needs; (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 RATINGS 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 resumption of activity in Mantova resulting in (1) its profitability (EBITDA margin) to be maintained around the high teens in percentage terms; (2) Moody's adjusted debt/EBITDA to stay below 7.0x debt/EBITDA on a sustainable basis; (3) improved free cash flow generation; and (4) the setup of a stronger and more permanent liquidity platform.

Downward pressure on the ratings could develop if the company's performance and liquidity continue to deteriorate, for example if the company fails to agree on a covenant waiver on a timely manner, or if it fails to secure additional liquidity sources in the coming months.

LIST OF AFFECTED RATINGS

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

Downgrades:

....Probability of Default Rating, Downgraded to Caa1-PD from B3-PD

....Corporate Family Rating, Downgraded to Caa1 from B3

....Backed Senior Unsecured Regular Bond/Debenture, Downgraded to Caa2 from Caa1

Outlook Action:

....Outlook, Remains Negative

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 September 2019, Pro-Gest reported core revenue of around €450 million and EBITDA of €77 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.

REGULATORY DISCLOSURES

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Donatella Maso
Vice President - Senior Analyst
Corporate Finance Group
Moody's Italia S.r.l
Corso di Porta Romana 68
Milan 20122
Italy
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Ivan Palacios
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Italia S.r.l
Corso di Porta Romana 68
Milan 20122
Italy
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454