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Research Update:

Pro.Gest SpA Downgraded To 'CCC+' On Ongoing Liquidity Concerns; Outlook Negative

June 9, 2020

Rating Action Overview

- We view the liquidity of Italian paper packaging group Pro.Gest SpA as vulnerable and think the company could breach its financial covenants in December 2020.
- We are therefore lowering our ratings on Pro.Gest and its fixed-rate senior unsecured notes to 'CCC+' from 'B-'.
- The negative outlook reflects a one in three likelihood that we could lower the ratings if we saw a further deterioration in liquidity in the short term or if a covenant breach in December 2020 seemed inevitable.

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Rating Action Rationale

We think Pro.Gest's liquidity will remain vulnerable in the next 12 months. We anticipate that large scheduled debt repayments of €69 million and a high amount of capital expenditure (capex) payables will continue to undermine the company's liquidity position in 2020. So far this year, liquidity has benefited from the receipt of €30 million in cash from an associated company--Pro.Gest expects to receive a further €10 million in the fourth quarter of 2020--and from an extension in the payment terms of the company's antitrust fine payments. We also understand Pro.Gest will receive about €11 million in government subsidies and loans by the end of the year. Nonetheless, we expect liquidity to remain vulnerable to unforeseen events.

We expect low cash levels during 2020-2021. Pro.Gest has generated negative free operating cash flows (FOCF) in each of the past three years (2017-2019). In 2019, this reflected a sharp decline in containerboard prices combined with a large working capital outflow. In 2020, we expect high capex, along with the payment of capex incurred in 2019, to undermine the company's FOCF. We now expect the sale of its plant in Monza for about €50 million to complete in 2021. The group's liquidity position in 2021 will depend greatly on the successful sale of the Monza site and on the ramping up of operations at the reopened Mantova mill.

We think Pro.Gest might breach its covenants in December 2020. In March 2020, Pro.Gest obtained waivers relating to the breach of the December 2019 leverage covenants under its minibonds and other various bilateral lending agreements. We think the company is likely to breach these covenants again in December 2020. In 2020, the COVID-19 pandemic and a limited contribution from Mantova--which we expect to restart in the second half of 2020--will undermine EBITDA and cash generation. Nevertheless, we think lenders could again waive such a breach, especially now that the reopening of the mill at Mantova has been approved.

Outlook

The negative outlook reflects a one in three likelihood that we could lower the ratings if we saw a further deterioration in liquidity in the short term or if a covenant breach in December 2020 seemed inevitable.

Downside scenario

We could lower our rating on Pro.Gest if we thought there was an increased risk of default in the next 12 months. For example, this could stem from:

- Deteriorating liquidity leading to a shortfall in the short term; or
- A covenant breach by year-end 2020.

Upside scenario

We could revise the outlook to stable if liquidity improved on a sustained basis and the group generated positive FOCF on a sustained basis.

Company Description

Pro.Gest is an Italian vertically integrated producer of containerboards (31% of 2019 revenue), corrugated cardboard (32%), and packaging and other solutions (37%). The company was founded by Bruno Zago in 1973 and is now run by his son, Francesco Zago. Pro.Gest is headquartered in Treviso, Italy, and has about 1,036 employees. All of its 23 plants are in Italy. In 2019, revenue amounted to €449 million and S&P Global Ratings-adjusted EBITDA was €71 million.

Our Base-Case Scenario

Assumptions

- Revenue growth of about 2% in 2020 due to the full-year contribution from the Tolentino Tissue division and Mantova's reopening. We assume the mill in Mantova will operate for four months in 2020. We expect revenue growth of about 11% in 2021, supported by the full-year contribution of the plant in Mantova.
- Adjusted EBITDA margin of 17.5% in 2020 due to lower exceptional costs--in 2019, these costs were related to the shutdown of the plant in Mantova and maintenance repairs at the Villa

Lagarina plant. We expect EBITDA margins to improve to about 18% in 2021 as production ramps up at the Mantova plant.

- Capex of about €48 million in 2020, about €40 million of which relates to payables for capex incurred in 2019. We expect capex of about €15 million in 2021.
- An inflow of about €5 million related to working capital, since we expect the company to reduce some of its accumulated inventory.

Key metrics

- Adjusted debt to EBITDA of approximately 5.0x in 2020, improving to about 3.7x in 2021.
- Adjusted funds from operations (FFO) to debt of about 13% in 2020, improving to about 18% in 2021.

Liquidity

We continue to assess Pro.Gest's liquidity as less than adequate and expect liquidity sources to cover uses by only 1.2x in the next 12 months. Our assessment continues to reflect the company's weak FOCF generation, no availabilities under committed credit facilities, and a low cash balance.

We expect principal liquidity sources for the 12 months from March 31, 2020 will include:

- Cash balance of €63 million;
- Cash FFO of about €39 million;
- Government subsidies and loans for €11 million, forecast to be received by December 2020; and
- Payables from an associated company of €10 million, which Pro.Gest expects to receive in November 2020.

We expect principal liquidity uses over the same period will include:

- Capex of about €40 million, including €32 million of capex payables due in 2020; and
- Debt repayments of about €66 million.

Covenants

Pro.Gest received waivers for the covenant breaches of December 2019 and June 2020. Some of Pro.Gest's minibonds and bilateral loan agreements include a leverage covenant, set at 4.0x for December 2020. We think the company could breach its financial covenants in December 2020. Should that be the case, we do not rule out a successful covenant waiver by lenders.

Issue Ratings - Recovery Analysis

Key analytical factors

- We are lowering our issue rating on the €250 million 3.25% fixed-rate unsecured notes due

2024 to 'CCC+' from 'B-', in line with the rating action on the issuer credit rating. The recovery rating remains '4' and reflects our expectation of average recovery (30%-50%; rounded estimate: 40%) in the event of payment default.

- Due to restrictions under the Cartiere Villa Lagarina (CVL) bilateral facility agreements, the unsecured notes are not guaranteed by CVL, which accounts for 34% of Pro.Gest's EBITDA. Furthermore, these restrictions prevented CVL from making dividend payments before September 2019, and greatly restricted payments thereafter.
- Some of Pro.Gest's bilateral debt agreements cap leverage at 4.0x in December 2020. We think the company could breach this covenant in December 2020, as it did in December 2019 when it was waived by lenders.
- Our hypothetical default scenario assumes continued cash burn, worsening liquidity, sustained weak market conditions, and an ongoing stoppage of production at the Mantova plant. Because of this, we assume the company would not be able to meet its scheduled debt repayments in a hypothetical default scenario.
- We value Pro.Gest as a going concern, given its leading niche position and longstanding customer relationships.

Simulated default assumptions

- Year of default: 2021
- Emergence EBITDA after recovery adjustments: €56.6 million
- Implied enterprise value multiple: 5.5x
- Jurisdiction: Italy

Simplified waterfall

- Gross enterprise value at default: €312 million
- Net recovery value after administrative expenses (5%): €296 million
- Estimated priority claims (mainly bilateral facilities and mini-bonds): €185 million*
- Remaining recovery value: €111 million
- Senior unsecured debt claims: €274 million*
- Recovery range: 30%-50% (rounded estimate: 40%)
- Recovery rating: 4

*All debt amounts include six months of prepetition interest.

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
- General Criteria: Post-Default Ratings Methodology: When Does S&P Global Ratings Raise A Rating From 'D' Or 'SD'?, March 23, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Pro.Gest SpA		
Issuer Credit Rating	CCC+/Negative/--	B-/Watch Neg/--
Senior Unsecured	CCC+	B-/Watch Neg
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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.