

Research Update:

Pro-Gest SpA Downgraded To 'CCC' On Increased Risk Of Distressed Exchange; Outlook Negative

December 18, 2023

Rating Action Overview

- Pro-Gest's SpA (Pro-Gest)'s financial performance continued to deteriorate in the first nine months of 2023, pressured by poor customer demand amid a challenging macroeconomic environment, and we do not forecast a meaningful improvement over the next few quarters, with weak adjusted EBITDA and minimal cash generation for 2023 and 2024.
- Pro-Gest faces imminent refinancing risk given its €250 million senior unsecured notes are due in December 2024, and its high leverage and poor track record of positive adjusted free operating cash flow (FOCF) lead us to believe there is heightened risk of a distressed debt restructuring or a missed interest payment in the next 12 months.
- We therefore lowered our long-term issuer credit rating on Pro-Gest to 'CCC' from 'CCC+' and our issue rating on the €250 million senior unsecured notes to 'CCC-' from 'CCC'. The recovery rating on the notes remains '5' (10%).
- The negative outlook reflects the risk of a distressed exchange or a liquidity shortfall in the next 12 months, when meaningful debt maturities fall due.

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Rating Action Rationale

Pro-Gest continues to face a tough macroeconomic environment and soft demand through year-end 2024. Following the release of the company's third-quarter 2023 results, we revised down our forecasts for 2023 and 2024. Demand for containerboard remains weak due to destocking and weak economic conditions. This is compounded by excess capacity in the industry and weak prices. We now expect adjusted revenue will decline 33% in 2023, versus 4% growth in 2022, driven by both lower volumes and prices. This will result in S&P Global Ratings-adjusted EBITDA of only €40 million-€44 million from €61 million in 2022. We forecast just a modest recovery in revenue of 5% and adjusted EBITDA to €50 million-€60 million for 2024. Revenue visibility remains limited, and any improvement is highly reliant on a recovery in demand and improvement in economic conditions.

We expect minimal FOCF for 2024. We anticipate that the bulk of the group's adjusted EBITDA will be consumed by interest expenses and capital expenditure (capex). Cash generation will remain insufficient, despite our anticipation of some inventory sales of €20 million–€40 million. We understand that Pro-Gest could also proceed with some minor noncore asset sales, but have not reflected these in our forecasts.

Liquidity is expected to remain weak in the next 12 months. Pro-Gest's cash balance shrank to €47 million as of Sept. 30, 2023, from €76 million as of year-end 2022, with operating cash flows insufficient to cover capex needs and scheduled debt amortizations. We understand that the group's cash balance was close to €40 million at the start of November--equal to the minimum cash balance required to run the business. The group has no availability under committed credit lines. Any further earnings decline could lead to a liquidity shortfall.

We view the company's current capital structure as unsustainable. Pro-Gest needs to refinance about €450 million of debt in the next 24 months, including the €250 million senior unsecured notes due December 2024 and €200 million private placement notes due 2025. Given the weak track record of generating positive FOCF, we believe there is high risk of a default or distressed capital restructuring in the next 12 months.

Outlook

The negative outlook reflects the risk of a distressed exchange or a liquidity shortfall in the next 12 months, when meaningful debt maturities fall due.

Downside scenario

We could lower the rating if we see an increased likelihood of a distressed debt restructuring. We could also lower the rating if Pro-Gest faces a liquidity shortfall, including (but not limited to) missing a scheduled interest payment or debt repayment.

Upside scenario

A positive rating action on Pro-Gest is unlikely in the next 12 months. It would only be possible if the company successfully addresses its upcoming debt maturities.

Company Description

Pro-Gest is an Italian family-owned vertically integrated producer of containerboards, corrugated cardboard, packaging, and other solutions. The company's two main divisions--paper mills and corrugated packaging--each represent about 50% of revenue.

Pro-Gest is headquartered in Treviso (Italy). All its 27 manufacturing facilities are in Italy, where it has about 1,400 employees.

In 2022, the company posted revenue of €826 million (€747 million in 2021) and S&P Global Ratings-adjusted EBITDA of €109 million (€86 million).

Our Base-Case Scenario

Assumptions

- A 33% decline in adjusted revenue in 2023, driven by weak demand and low prices, and a 5% volume-driven recovery in 2024.
- S&P Global Ratings-adjusted EBITDA of about €40 million-€44 million in 2023 and €50 million-€60 million in 2024.
- Cash interest payments of €41 million-€44 million per year.
- No cash tax payments.
- A €10 million working capital outflow in 2023 and a €20 million-€40 million inflow in 2024 amid inventories reduction.
- Capex of €33 million in 2023 and €26 million in 2024, including €10 million per year for maintenance.

Key metrics

- S&P Global Ratings-adjusted debt to EBITDA of above 12x in 2023 and 10x-11x in 2024.
- Adjusted funds from operations (FFO) to debt is negative in 2023 and minimal at 1%-2% in 2024.
- EBITDA interest coverage and FFO cash interest coverage of 1.0x-1.2x in 2023 and 2024.
- Minimal adjusted FOCF of €3 million-€4 million in 2023-2024.

Liquidity

We revised our liquidity assessment to weak, from less than adequate, to reflect our expectation that the company will face a material cash shortfall in the next 12 months. We anticipate that its liquidity sources will remain negligible in light of large upcoming debt maturities, with the €250 million senior unsecured notes due in December 2024. We also believe that the group's standing in credit markets, which we view as weak, has so far hampered its efforts to refinance upcoming debt maturities.

Principal liquidity sources in the next 12 months include:

- About €46 million of cash as of Sept. 30, 2023; and
- €11 million in cash FFO.

Principal liquidity uses over the same period include:

- €250 million of senior unsecured note repayments;
- About €20 million in other debt amortization;
- Working capital outflows estimated at €4 million; and

- Capex of €28 million.

Covenants

The documentation of the €200 million privately placed notes includes a financial covenant, which caps net leverage at 4.25x in December 2023 and subsequent years. The covenant is tested semi-annually. Absent a waiver, a covenant breach would be highly likely.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Pro-Gest. We view environmental risks in the paper industry as sizable given its high water, chemicals, and energy usage. We believe this could expose companies in the sector to tighter environmental regulation. Pro-Gest is less favorably positioned than peers because Italy's jurisdictional and political landscape carries greater regulatory uncertainties. Local authorities suspended operations at Pro-Gest's containerboard mill in Mantova in 2019 on concerns about its environmental impact. The mill was idle for 17 months until the company abandoned its original request for an on-site waste incineration plant.

Governance factors are also a negative consideration. Our assessment of the company's management and governance reflects the €47.5 million fine from Italian anti-trust authorities in 2019 for the company's alleged participation in an industry-wide price-fixing cartel. We understand that payments related to this fine kicked in from mid-year 2021. Besides this, we account for a track record of business underperformance compared to stated targets.

Issue Ratings - Recovery Analysis

Key analytical factors

- We lowered the issue rating on the €250 million, 3.25% fixed-rate, unsecured notes due December 2024 to 'CCC-'. This reflects our belief that the company will seek to restructure its debt (including this instrument) via a distressed transaction. The unchanged recovery rating of '5' reflects our expectation of modest recovery (10%) in the event of payment default. The rating is constrained by the high amount of prior-ranking liabilities, including the €200 million private placement notes due 2025.
- In our hypothetical default scenario, we assume weak demand, low prices, and a failure to pass input cost increases on to customers. We believe this would lead to further negative cash generation and a deterioration in liquidity. We assume the company would be unable 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: 2024
- Jurisdiction: Italy

- Emergence EBITDA after recovery adjustments: €76.7 million
- Maintenance capex assumed at 4.5% of sales: €30.2 million; cyclical adjustment factor of 10%; and 10% operational adjustment.
- Distressed EBITDA multiple: 5.0x

Simplified waterfall

- Gross Enterprise value: €421.7 million
- Net recovery value for waterfall, after 5% administrative expenses: €400.2 million
- Estimated priority claims: €374.1 million
- Senior unsecured debt claims: €254 million*
- Recovery: 10%-30% (rounded estimate: 10%)
- Recovery rating: 5

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded

	To	From
Pro.Gest SpA		
Issuer Credit Rating	CCC/Negative/--	CCC+/Stable/--
Senior Unsecured	CCC-	CCC
Recovery Rating	5(10%)	5(10%)

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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