

Rating Action: Moody's assigns B2 rating to Lecta's new senior secured notes, B2 CFR affirmed, outlook stable

Global Credit Research - 19 Jul 2016

Frankfurt am Main, July 19, 2016 -- Moody's Investors Service, ("Moody's") today assigned a B2 (LGD4) rating to the proposed new senior secured notes of Lecta S.A. (Lecta) aimed to refinance its existing debt. Moody's also affirmed Lecta's B2 Corporate Family Rating (CFR) and the B2-Probability of Default Rating (PDR). The outlook on all ratings remains stable.

The proceeds from the proposed up to EUR590 million bond issuance, issued in two tranches of Floating Rate Notes due in 2022 and Fixed Rate notes due in 2023, will be used to extend the debt maturity profile by redeeming the existing EUR390 million secured floating rate notes due in 2018 and the existing EUR200 million secured fixed rate notes due in 2019. Concurrently, the existing and currently undrawn EUR80 million revolving credit facility due in 2018 will be replaced by a new 6-year EUR65 million revolving credit facility, that can be increased to EUR80 million.

RATINGS RATIONALE

Despite its improving while still weak credit metrics for the assigned rating level, the B2 CFR is reflective of the group's market leading positions in coated wood free and specialty paper in its main markets of Southwestern Europe and second in terms of market share for CWF in Western Europe behind Sappi. Lecta's forward integration into its own distribution business in Spain, France, Italy and Portugal has helped to stabilize sales volumes in recent years while continuous restructuring including substantial headcount reductions since 2006 had been necessary to adjust the business profile to market demand. Moreover, Lecta has undertaken successful efforts, particularly since 2013, in diversifying and converting production capacities towards specialty paper.

Conversely, the rating is constrained by the small scale of Lecta as indicated by sales of about EUR1.47 billion during LTM 2016 as well as regional geographic concentration with about 75% of sales in Europe, predominantly Southern Europe (49%). In addition, Lecta's still narrow product focus on the structurally challenged coated wood free paper market is amplified by its inherent cyclical nature. Notwithstanding, Lecta's partial integration (30%) into pulp has mitigated some of the cost volatility in the past. We also caution that the price competitive nature of the industry is exacerbated by periodic demand supply imbalances while highly volatile input costs add to margin volatility.

Lecta's current business plan envisages substantial growth investments over the next couple of years to help transform the business and diversify away from CWF. Following deleveraging from 12.2x in 2013 to 7.9x as per March 2016 in terms of Moody's adjusted debt/EBITDA, the rating agency expects that leverage will remain above 6.0x through 2017 given the largely non-amortizing debt structure and only moderate gradual improvements in profitability. Leverage of above 6x positions Lecta weakly in the B2 rating category. In addition, free cash flow generation is expected to remain negative through 2017 as a result of mentioned ongoing investments. Today's rating affirmation of the group's B2 CFR hinges on our expectation that Lecta will return to positive free cash flow generation in the short-to medium term following successful execution of its transformation activities.

Lecta maintains a solid liquidity position, supporting the current rating level while predicated on recovery to positive free cash flow generation following temporarily increased capital expenditure related to strategic projects in the coming years. The issuer's two main internal liquidity sources are cash and cash equivalents of EUR137 million as of March 2016 and funds from operations of around EUR48 million during the next 12 to 18 months. In addition, the company will have access to a EUR65 million revolving credit facility, that can be upsized to EUR80 million, maturing in 2022. The facility does not contain any material conditionality language such as maintenance financial covenants. These sources are deemed to be sufficient to cover expected cash outflows related to capital expenditure which we estimate at around EUR60 million for the next 12 to 18 months as well as moderate seasonal working capital swings. Following the envisaged refinancing there will be no material debt maturities before 2022 when the RCF matures.

The B2 rating of the EUR590 million senior secured notes is in line with the group's corporate family rating, reflecting the limited amount of priority debt ranking ahead of these notes, relating to the EUR65 million super priority Revolving Credit Facility. The secured notes have been issued by Lecta S.A., a holding company and are guaranteed on a secured basis by all major subsidiaries and are secured by share pledges, certain bank accounts and receivables. The Revolving Credit Facility benefits from essentially the same guarantee and collateral package as the proposed notes, but has priority access to enforcement proceeds in a default scenario.

Lecta's continues to be weakly positioned at the B2 rating level, however the stable outlook reflects Moody's expectation of an improving performance through 2016. The stable outlook is despite Lecta's credit metrics currently not aligned with Moody's expectations for a B2 rating, i.e. mid-single digit EBITDA margins and debt/EBITDA above 7x (6% and 7.9x per LTM March 2016). Moreover, we expect moderate to negative free cash flow generation during 2016, partly a function of elevated capex and continued restructuring costs, while profitability is expected to improve gradually. This is due to improved operating rates and gradual switch towards the higher margin specialty paper grades as well as continued industry wide production capacity adjustments in CWF during 2015 and 2016.

At this stage unlikely, we would consider a positive rating action if Lecta's operating performance was to improve and the company successfully executes its commercial strategy and cost cutting plans, resulting in improving profitability through 2016 and better visibility for marked improvements. Quantitatively, a positive rating action would be considered if EBITDA margins were to improve towards 9% (per LTM-March 2016: 6%), debt/EBITDA to below 6x (7.9x), all metrics as adjusted by Moody's.

The ratings could be subject to negative rating action as a result of decline in financial performance and Lecta being unable to timely substitute declining volumes in coated wood free products with a rising share in higher-margin specialty papers. Quantitatively, we could downgrade the ratings if Lecta's debt/EBITDA as adjusted by Moody's was to remain above 7x (per LTM-March 2016: 7.9x), EBITDA margins below 6% (6%) and prolonged negative FCF generation resulting in accelerated cash consumption affecting Lecta's liquidity profile.

Following is a summary of Moody's rating actions on Lecta:

Assignments:

..Issuer: Lecta S.A.

....Senior Secured Regular Bond/Debenture due in 2022, Assigned B2 (LGD 4)

....Senior Secured Regular Bond/Debenture due in 2023, Assigned B2 (LGD 4)

Affirmations:

..Issuer: Lecta S.A.

.... Probability of Default Rating, Affirmed B2-PD

.... Corporate Family Rating, Affirmed B2

Outlook Actions:

..Issuer: Lecta S.A.

....Outlook, Remains Stable

The principal methodology used in these ratings was Global Paper and Forest Products Industry published in October 2013. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Lecta, with legal headquarters in Luxembourg and operating headquarters in Barcelona (Spain), is a leading coated fine paper manufacturer in Italy, France and Spain. The company also has a specialty paper division and operates a 234,000 metric ton pulp mill in Spain, which provides approximately 30% of its overall pulp requirements, as well as a distribution business in Italy, Spain, Portugal and France. During the last twelve months (LTM) period ended March 2016, Lecta generated more than EUR1.47 billion of sales. The company is controlled by private equity funds managed by CVC Capital Partners since 1997.

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