Research

Research Update:

Manutencoop Facility Management Ratings Lowered To 'B-' And Kept On Watch Negative On Potential Contract Cancellation

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Overview

- Subsequent to the Italian Competition Authority's decision to levy a €48.5 million fine on Italy-based facility services provider Manutencoop Facility Management (MFM), Consip SpA has notified MFM of its intention to assess the potential termination of MFM's current school cleaning contract.
- Moreover, Consip may also decide to exclude MFM from future contracts put out to tender for cleaning services for Italian schools. There is still material uncertainty over how Consip will conclude both matters.
- However, we believe that the decision to initiate proceedings could have material reputational damage for MFM and could hamper the company's ability to refinance.
- We are therefore lowering the long-term corporate credit rating on MFM to 'B-' from 'B' and maintaining our CreditWatch with negative implications.
- The negative CreditWatch reflects our view of further downside risk arising from the possibility that MFM will have to pay the assessed fine by the end of April, or a significant deterioration in MFM's operating environment, resulting in an unsustainable business or capital structure.

Rating Action

On Feb. 12, 2016, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Italy-based facility services provider Manutencoop Facility Management SpA (MFM) to 'B-' from 'B'. The ratings remain on CreditWatch with negative implications.

We have lowered our issue rating on MFM's €425 million senior secured notes (outstanding nominal value of €293 million) to 'B-' from 'B', in line with the downgrade of MFM to 'B-'. The issue rating remains on CreditWatch with negative implications. The recovery rating on these notes is unchanged at '3', with recovery prospects in the upper half of the 50%-70% range.

Rationale

The downgrade follows Consip SpA's decision to initiate a procedure to determine whether the Italian Competition Authority's (ICA) decision to levy a €48.5 million fine on MFM entitles it to terminate MFM's current school cleaning contract. As part of the process, Consip may also decide to exclude

MFM from future tender offers within the Italian school cleaning contracts system. We understand that Consip will take a decision within the next 30 days. We believe an extended period of significant uncertainty could have an influence on MFM's operating environment and could result in contract losses and modest new contract wins.

We also believe that the reputational damage could also influence the group's efforts to arrange new long-term committed facilities to address its liquidity needs, including the potential €48.5 million ICA fine and €24.5 million in performance bonds relating to the school cleaning contract termination.

Consip is an important central purchasing body in Italy, in charge of procurement for national and local government bodies, and the scope of its role has expanded in recent years as various public administration bodies are encouraged to consolidate their procurement needs.

We understand Consip:
- Accounted for about €140 million of MFM's revenues during financial year 2015 (including €42 million relating to Consip's school cleaning contract);
- Accounts for about €300 million of MFM's €2.8 billion contract backlog (including €68 million relating to Consip's school cleaning contract); and
- Accounts for about €1.7 billion of MFM's €2.4 billion pipeline (There are no contracts relating to school cleaning in the pipeline).

While we acknowledge that Consip has not yet made a final decision, we believe that Consip's decision to initiate proceedings could have significant reputational implications for MFM. There is material uncertainty over the outcome for MFM should Consip decide to exclude the company from school cleaning tender and the effect this could have on other contract tenders managed by Consip. It is also probable that Consip may decide to postpone its decision until the final appellate court hearing relating to the ICA fine. This, we believe, could extend the period of uncertainty, which in turn, could have an influence on the group's operating environment.

MFM stated it will appeal to the Italian administrative tribunal (TAR) against the merits of the ICA's decision and will also seek suspension of the €48.5 million penalty payment until the appeal process is completed. Given the material uncertainty about the likely outcome of TAR's decision, we have not included the payment of a fine in our base-case assumptions. However, there could be a scenario where the TAR (first appeal) and the Council of State (second and last appeal) rule not to suspend the paying of the fine, resulting in MFM having to pay the penalty amount before the end of April 2016. We consider the probability of this scenario as less likely, but if this is the case, we believe that MFM would be subject to a liquidity shortage unless additional new committed sources of funding are put in place.

In our base case, we assume:
- Italy's GDP will increase by 1.3% in 2016;
- Forecast revenue to decline by 5%-10% in the financial year ending Dec.

31, 2016 (FY16) due to competitive pricing, the potential contract cancellation, and the company winning fewer new contracts; and
- Forecast reported EBITDA could decline to about €75 million-€80 million. We understand that management's forecast for revenue and EBITDA are relatively higher than our base case.

Based on these assumptions, we arrive at the following credit measures:
- Adjusted ratio of debt to EBITDA of about 5.7x-6.0x for FY16.

At this juncture, we continue to consider that MFM's capital structure is sustainable.

Liquidity

We currently calculate that the group's sources of liquidity will exceed its uses by more than 1.2x. However, during the period of working capital investments--namely the first and third quarters--we anticipate that this ratio will decline to below 1.2x but above 1.0x. For this reason, we assess liquidity as less than adequate.

Principal liquidity sources over the next 12 months include:
- Available cash balance of about €55 million as of Sept. 30, 2015;
- Forecast unadjusted funds from operations of about €35 million; and
- Working capital inflows of about €5 million.

Principal liquidity uses over the next 12 months include:
- Expected debt repayments of about €35 million, including mostly short-term uncommitted facilities;
- Estimated annual capital expenditures of about €30 million; and
- Estimated payments of €7 million relating to payments for restructuring.

We do not include uncommitted, short-term facilities or factoring facilities as sources of liquidity. There are no covenants on the €425 million senior secured notes.

We could revise down our assessment of liquidity further if MFM is unable to arrange the financing of the fine and honor the school cleaning contract's performance bonds upon an unsuccessful outcome of the appeal process.

CreditWatch

The negative CreditWatch reflects our view that we could lower the ratings further due to the possible repayment of the ICA fine by the end of April or if there is significant deterioration in the company's operating environment, resulting in unsustainable business or capital structure.

We could affirm the ratings if MFM is able to put in place new committed funding to meet any potential payment of fines and performance bonds, or if there is a favorable decision from TAR, the fine is materially reduced, or

Consip decides against cancelling MFM's contract.

Ratings Score Snapshot

Corporate Credit Rating: B-/Watch Neg/--

Business risk: Fair
- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Highly Leveraged
- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (minus one notch)

Recovery Analysis

Key analytical factors

- We have lowered our issue rating on Manutencoop's €293 million outstanding senior secured notes to 'B-' from 'B', in line with the downgrade of MFM to 'B-'. The issue rating remains on CreditWatch with negative implications.
- The recovery rating remains unchanged at '3'. It is supported by our going concern valuation of the company but constrained by prior-ranking debt, mainly including finance leases, pension obligations, and bank debt. We note that recovery prospects for bondholders could further decrease if the company were to put in place a factoring facility because we would consider it as ranking prior to the notes in a default scenario.
- Our hypothetical default scenario envisages significant indebtedness, combined with the negative effects of a slowdown in MFM's home market of Italy. This, coupled with customers seeking better prices, increasing competition from smaller players, or reputational issues, would squeeze margins and lead to liquidity issues.
- We value Manutencoop as a going concern based on its leadership position in its home market.

Simulated default assumptions

- Year of default: 2018
- EBITDA at emergence: €53 million
- Implied enterprise value multiple: 5x

- Jurisdiction: Italy

Simplified waterfall

- Gross enterprise value at default: €265 million
- Administrative costs: €15 million
- Net value available to creditors: €250 million
- Priority claims: €56 million
- Secured debt claims: €306 million*
- Recovery expectation: 50%-70% (upper half of the range)

*All debt amounts include six months of prepetition interest.

Related Criteria And Research

Related Criteria

- Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Recovery: Revised Revolver Usage Assumptions For Recovery Analysis In Corporate Ratings, Nov. 20, 2014
- Industrials: Key Credit Factors For The Business And Consumer Services Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Recovery: Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
Manutencoop Facility Management SpA		
Corporate Credit Rating	B-/Watch Neg/--	B/Watch Neg/--
Senior Secured	B-/Watch Neg	B/Watch Neg
Recovery Rating	3H	3H

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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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.