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Research Update:

Italy-Based Manutencoop Facility Management Upgraded To 'B' On Improved Liquidity Profile; Outlook Stable

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Research Update:

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Overview

- On Oct. 14, 2016, Italy's Administrative Regional Tribunal (TAR) ruled that Manutencoop Facility Management SpA (MFM) had violated competition rules in 2012 relating to a tender arranged by Consip for cleaning services in school buildings. But the TAR upheld MFM's appeal about the quantum of fines and requested Italian Competition Authority (ICA) to reassess lower its previously imposed €48.5 million of fines.
- In our view, MFM's liquidity profile has improved given its cash balance as of June 30, 2016 and the TAR ruling to reassess the fines. Therefore, we are revising our assessment of MFM's liquidity to adequate from less than adequate. Furthermore, we no longer include our previous adjustment of €172 million--relating to a put option liability that existed in MFM's majority shareholders' accounts--in our leverage ratio calculation.
- We are therefore upgrading MFM to 'B' from 'B-'.
- The stable outlook reflects our view that the group's FFO to debt will stay above 15% and our assessment that the group's liquidity profile has strengthened and should provide a buffer for any unexpected liquidity needs.

Rating Action

On Oct. 26, 2016, S&P Global Ratings raised its long-term corporate credit rating on Italy-based facility services provider Manutencoop Facility Management SpA (MFM) to 'B' from 'B-'. The outlook is stable.

At the same time, we raised the issue rating on MFM's €425 million senior secured notes (outstanding nominal value of €300 million) to 'B' from 'B-'. The recovery rating of '3' incorporates our expectation of meaningful recovery in the lower half of the 50%-70% range in the event of a default.

Rationale

The upgrade reflects our view that MFM's financial flexibility has improved, helped by: the TAR decision to uphold MFM's appeal about the fine amount; the group's healthy cash balance of about €167 million as of June 30, 2016; and the extinguishing of the put option, totaling €172 million, at the parent level (which we previously included in our adjusted debt computation).

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The reassessed fine (which the ICA will calculate based on the direction prescribed in the TAR ruling) is likely to be materially lower than the current €48.5 million provision MFM recognizes in its accounts. We calculate the reassessed fine will be about €15 million-€20 million.

Although the TAR has asked the ICA to reassess the fine amount, it says that MFM has committed some of the violations noted by the ICA. MFM is likely to appeal the TAR's verdict in the second appeal court (the State Council) within the next 90 days. In our view, the TAR's verdict has exposed MFM to reputational risk, which may affect its ability to win new contracts with private sector corporate clients. The verdict is also impairing its market standing; MFM faces potential pressure from competitors relating to client retention, and may have to lower prices to maintain its existing customer base. We factor these additional risks into our business risk profile assessment, along with the group's geographical concentration in Italy, the weak macroeconomic environment in Italy, and the competitive nature of the fragmented facility management industry.

These risks are partly offset by MFM's current leading position in Italian facility management (with estimated reported EBITDA of about €95 million-€100 million for financial 2016); its order backlog of about €2.8 billion; and the multi-year structure of its contracts, which provides some revenue visibility.

Under the new agreement between MFM's largest shareholder, Manutencoop Società Cooperativa (MSC) and its remaining minority shareholders (comprising numerous private equity companies), agreed in July 2016, there will no longer be a put option obligation on MSC. Therefore, we no longer include the €172 million put option obligation in MFM's adjusted debt computation and we forecast the group's credit metrics for FY2016 will be commensurate with an aggressive financial risk profile, compared to highly leveraged, which was our previous expectation.

We believe the recent establishment of the new supervisory and management boards, along with the appointment of a new CEO, shows the group's intent to strengthen its internal controls and governance structure. However, the impact of the TAR's verdict on MFM's ability to win new contracts tendered by Consip remains to be seen. We will be monitoring this over the next few quarters.

In our base case, we assume:

- Italy's GDP to remain flat in 2016.
- MFM's forecast revenue to decline by 2%-4% over 2016 due to competitive pricing, potential contract cancellations, and the company winning fewer new contracts.
- Forecast reported EBITDA could decline to about €90 million-€95 million (after deducting €5 million provision for risks and non-recurring expenses). We understand that management's forecast for revenue and EBITDA are somewhat higher than our base case.
- We have included the ICA fine of €16 million as a debt adjustment for financial 2016 and related cash out flow in financial 2017.
- We continue to include a vendor loan of €55 million on MSC's balance

sheet in our adjusted debt calculation.

Based on these assumptions, we arrive at the following credit measures:
- Funds from operations (FFO) to debt of about 17% for financial 2016; and
- Reported free operating cash flow (FOCF) of about €20 million-€25 million.

Liquidity

We are revising the group's liquidity to adequate from less than adequate, and we calculate sources of liquidity will exceed uses by more than 1.2x.

Principal liquidity sources over the next 12 months include:
- Available cash balance of about €167.2 million as of June 30, 2016;
- Committed revolving facility of about €4 million;
- Forecast unadjusted FFO of about €55 million; and
- Modest working capital inflows.

Principal liquidity uses over the next 12 months include:
- Expected debt repayments of about €30 million, including mostly short-term uncommitted facilities;
- Estimated annual capital expenditure of about €30 million;
- Payment of the ICA fine of €16 million; and
- Estimated €10 million payments relating to restructuring.

While we do not quantitatively include the group's new factoring facility in our liquidity analysis, we recognize that this new facility does provide some additional flexibility.

We do not include payment of performance bonds of €24 million in our liquidity calculation as we do not expect it to be paid out within next 12 months. However, if the group were required to pay the performance bond, it will not affect our liquidity assessment.

We do not factor any bond buyback into our base case. We would reassess the group's liquidity if it were to undertake material bond buyback, which could leave the group exposed to low-probability but high-impact liquidity events.

Outlook

The stable outlook reflects our view that the group's credit metrics are currently comfortably aligned with an aggressive financial risk profile, with adjusted FFO to debt of about 15%-18%. It also incorporates our view that the group's strengthened liquidity profile will likely buffer against any unexpected liquidity needs.

Upside scenario

Upward rating pressure could build within next 12 months if we see sufficient evidence that the TAR ruling has not influenced MFM's ability to win new contracts tendered by Consip. We could also consider a positive rating action if the group demonstrated improving credit metrics commensurate with a significant financial risk profile, namely FFO to debt above 20%.

Downside scenario

We could lower the rating if the credit metrics were to deteriorate for a sustained period to levels that we consider commensurate with highly leveraged, including FFO to debt below 12%. Additional rating triggers could arise from weakened liquidity due to acquisitions or bond buybacks that left the group unable to finance a low-probability, high-impact event.

Ratings Score Snapshot

Corporate Credit Rating: B/Stable/--

Business risk:
- Country risk: Moderately High Risk
- Industry risk: Intermediate Risk
- Competitive position: Weak

Financial risk:
- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Recovery Analysis

Key analytical factors

- We have raised our issue rating on Manutencoop's €300 million outstanding senior secured notes to 'B' from 'B-', in line with raising the corporate credit rating to 'B'.
- The recovery rating remains '3'. It is supported by our going concern valuation of the company but is constrained by the factoring facility and the employee termination indemnity, as well as other priority debt including finance lease and bank debt. Recovery prospects are in the lower half of the 50%-70% range.
- 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: 2019
- EBITDA at emergence:€55 million
- Implied enterprise value multiple: 5.0x
- Jurisdiction: Italy

Simplified waterfall

- Gross enterprise value at default: €278 million
- Administrative costs: €14 million
- Net value available to creditors: €264 million
- Priority Claims: €107 million
- Secured debt claims: €305 million
- Recovery expectation: 50%-70% (lower half of the range)

- *All debt amounts include six months of prepetition interest.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments - January 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Recovery: Revised Revolver Usage Assumptions For Recovery Analysis In Corporate Ratings - November 20, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Business And Consumer Services Industry - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- Criteria - Corporates - Recovery: Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt - August 10, 2009
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Ratings List

Upgraded; CreditWatch/Outlook Action

	To	From
Manutencoop Facility Management SpA		
Corporate Credit Rating	B/Stable/--	B-/Negative/--
Senior Secured	B	B-
Recovery Rating	3L	3L

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