PRESS RELEASE

Spread Research assigns its SR3 short-term rating to the €250m NEU CP program of Verallia with a stable outlook

Lyon, July 17th, 2018 – Credit rating agency Spread Research assigns its SR3 short-term rating to the NEU CP instrument of Verallia with a stable outlook. The short-term instrument rating is part of the financial documentation of the NEU CP program issued by Verallia for up to €250m.

Rating rationale
Spread Research has analysed the short term credit profile of Verallia in order to assign its short-term rating. The outcome is an SR3 short-term rating, the fourth-highest grade in Spread Research's rating scale.

Credit profile
Verallia has a solid business profile, with strong market positions in Europe and South America as well as resilient sales volumes thanks to its exposure to the non-cyclical food and beverage industry. Our rating is supported by the industry's high barriers for new entrants and switching costs for clients, as well as by the group's strong know-how and highly diversified portfolio of clients with strong and long-standing relationships. Furthermore, we value Verallia's strong focus on premium products such as wine and spirits, which entails higher margins than competitors while reducing substitution risks from other containers. We note, however, a stronger cyclicality than for commodity products. Although limited by the group's high exposure to the mature West European market, the growth potential is real in our view thanks to increasing exports from European wine and spirits producers.
Verallia's business is highly capital-intensive, requiring a significant amount of raw materials, the prices for which tend to be volatile. There are also potential operational risks that could affect profitability. Mitigating this, the group has a satisfactory track-record of preserving its profitability through hedging instruments against raw material prices volatility, and regular investments to maintain the quality of its assets.
Our rating also factors in Verallia's high leverage, resulting from the LBO in 2015 and the financial policy led by shareholders, with two large dividend distributions since then. Recently, the group has made some efforts to reduce its indebtedness. Although this is welcomed, we would assess the visibility as still limited given uncertainties regarding shareholders' strategy.

Liquidity profile
Liquidity is strong. This assessment is driven by the large undrawn revolving credit facility, the long-term debt maturity profile, and our expectation that Verallia will generate strong free cashflow after dividends.

Credit outlook

Our Stable outlook reflects our expectation that credit metrics will slightly improve over the next twelve months, supported by EBITDA growth as well as good free cashflow generation.

Our methodology for short-term ratings, published on January 7th, 2016, is available at www.spreadratings.com/Short-term_rating_methodology.

Verallia

Verallia, third global producer of glass packaging for food and beverages, offers innovative, customized and environmentally friendly solutions to more than 10,000 customers around the world. In 2017, Verallia achieved sales of 2.5 billion euros and produced approximately 16 billion bottles and jars intended mainly for still and sparkling wines, spirits, food products, beers and nonalcoholic beverages.

Verallia's operational model is based on the combination of the strength of its international network (industrial presence in 11 countries, 5 technical and 13 product development centers) and the proximity maintained in its relations with customers through approximately 10,000 employees.

Spread Ratings

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Our analysts are sector specialists and the team produces credit opinions for investors as well as private and public credit ratings. Our ratings are recognized by the EU banking (EBA) and insurance (EIOPA) regulators. Spread Research is one of the few rating agencies approved by the Bank of France to provide financial ratings for NEU CP (short-term) and NEU MTN (medium-term) programs.

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NEU CP Instrument rating
Initiation report

Rated Entity: **Verallia Packaging**
Sector: **Packaging**

Short-term rating: **SR3**
Credit outlook: **Stable**

Rating rationale

- We initiate coverage on Verallia and assign an SR3 short-term rating, the fourth-highest grade in our rating scale, to its €250m NEU CP program.
- Based in Paris, France, Verallia is the world's No. 3 manufacturer of glass packaging. The group produces a wide range of glass bottles, containers and jars for around 10,000 customers, ranging from local wine producers to global food and beverage brands. It generated €2.5bn and €504m of sales and EBITDA respectively in 2017.
- Our rating is supported by the group's solid business profile. Verallia holds strong market positions in Europe (88% of sales) and South America (12%), serving the non-cyclical food and beverage industry, which is characterized by stable demand. The group's sales volumes have been resilient over recent years, despite strong competition from Owens-Illinois (No. 1), Ardagh (No. 2) and local players. We would argue that Verallia's market shares are quite well protected by high barriers for new entrants, strong know-how and switching costs for clients, as well as by a highly diversified portfolio of clients with strong and long-standing relationships. On the flipside, the group's growth potential is limited by its very high exposure to the mature West European market.
- Verallia has a strong focus on wine and spirits (59% of sales), being the No. 1 glass packager in Europe. This premium positioning entails higher margins than competitors while reducing substitution risks from other containers like metal and plastic. We, though, note a stronger cyclicality than for commodity products.
- Looking ahead, we believe that there is potential for growth, thanks to increasing exports from European wine and spirits producers, notably to Asia, as well as further diversification towards South America via bolt-ons and greenfield projects.
- The glass packaging industry is highly capital-intensive. Verallia needs a significant amount of raw materials, including recycled glass and silica sand, as well as energy, the prices for which tend to be volatile. However, we would argue that the group is satisfactorily hedged against energy price fluctuations, with the use of swap instruments and pass-through mechanisms included in some contracts.
- Verallia is also subject to operational risks with any defects in the use and maintenance of its furnaces capable of affecting its profitability. That said, Verallia has a satisfactory track record of ((i) maintaining the quality of assets thanks to high maintenance CapEx (8% of sales or around €200m), (ii) improving its EBITDA margin to a record-high 20.8% as of March 2018 from 18.0% in 2012, with only one compression in 2014 following production issues, and (iii) generating positive free cashflow before dividends despite high maintenance CapEx.
- Our rating also factors in the group's high leverage (net adjusted debt/EBITDAR) of 5.2x as of March 2018. This results from the LBO in 2015 and the financial policy pursued by Apollo (90% stake) and BPI France (10%), which has favoured shareholders' interests with two large dividend distributions in 2016 and 2017. The use of cash to repay €100m of term loan B in November 2017 and high-yield bonds next August (alongside the issuance of some new debt) is evidence of the group's efforts to reduce indebtedness. Although this is welcomed, we would assess the visibility as still limited given uncertainties regarding shareholders' financial strategy.

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Capital structure

Verallia issued in June 2018 a new €550m term loan B plus €80m of commercial paper. The proceeds, alongside €116m of cash, will be used to repay this August the €500m 5.125% 2022 secured and €225m 7.25% 2023 unsecured bonds.

Pro forma of the transaction (as of March 2018), total reported debt reaches €2.0bn, including (i) term loan B for a total amount of €1.8bn with maturities ranging from 2022 to 2025, (ii) NEU CP instrument for €80m and, (iii) recourse factoring and other bank debt for €51m. In addition, the group benefits from €325m of undrawn revolving credit facility. Including cash in hand, net reported debt stands at €1.9bn, or a reported net leverage of 3.7x.

Adjusted for the €350m PIK toggle notes issued by the top entity outside of the restricted group, operating leases, pension deficits and non-recourse factoring lines, our adjusted net leverage stands at 5.2x.

Strong liquidity profile

The liquidity profile is strong. This is driven by the large undrawn revolving credit facility, the long-term debt maturity profile, and our expectation that Verallia will generate strong free cashflow after dividends.

Credit outlook: Stable

- Our Stable outlook reflects our expectation that credit metrics will slightly improve over the next twelve months, supported by EBITDA growth as well as good free cashflow generation.

Rating sensitivity

- Verallia is weakly positioned in the SR3 category, making an upgrade to SR2 only a distant prospect. This could, however, result from a material improvement in profitability leading to a sustainable reduction in net adjusted debt/EBITDAR below 4.5x as well as sustained evidence of a more prudent financial policy.
- A downgrade to SR4 could be triggered by a sustainable deterioration in profitability following production issues and/or inability to pass on volatile raw materials prices to clients, as well as any increase in net adjusted debt/EBITDAR above 5.5x.

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SPREAD RESEARCH assigns ratings and as such is regulated by ESMA.

REGULATORY DISCLOSURES

Initiation report on NEU CP Instrument rating

Rating nature: Solicited short-term public rating (the rating report was issued after being reviewed by the issuer)

Limitation of the Rating action:
Spread Research believes the quality and quantity of information available on the rated entity is sufficient to provide a rating. Spread Research has no obligation to audit or verify the accuracy of data provided.

Principal methodology used in this research: Short-Term Ratings Methodology available at
http://www.spreadresearch.com/uploads/pdf/user/methodo/SRshorttermratingsmethodology-08jan16Public.pdf

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