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## Summary:
# The Navigator Company S.A.

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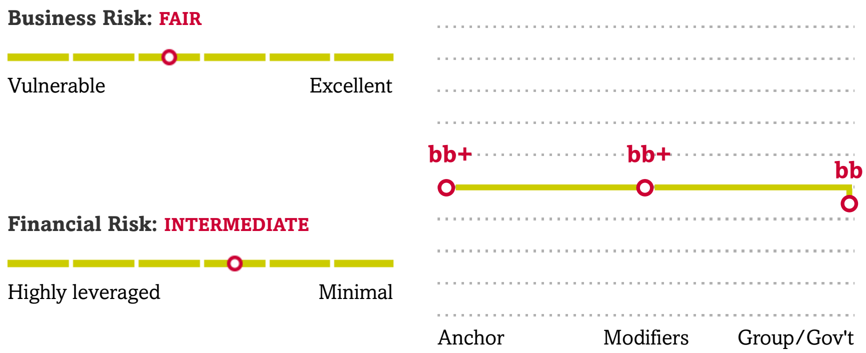


CORPORATE CREDIT RATING

**BB/Stable/B**

## Rationale

| Business Risk: Fair | Financial Risk: Intermediate |
| --- | --- |
| • Strong market position as the largest UWF paper producer in Europe.<br>• Strong margins underpinned by a well-invested asset base, high utilization rates, focus on premium paper grades, good access to raw materials, and relatively low labor costs.<br>• Recent diversification into largely backward-integrated tissue operations in Europe.<br>• Exposure to highly competitive European forest products markets.<br>• Significant exposure to challenging uncoated woodfree (UWF) paper.<br>• Relatively limited size, scope, and product diversity.<br>• Asset concentration, with a large part of earnings derived from three mills. | • Strong cash flow generation; well-invested asset base allows for low maintenance investments.<br>• Cyclical cash flow generation because of volatile paper and pulp prices.<br>• An expectation of ongoing high dividend payments to support deleveraging at parent company Semapa S.A.<br>• Higher investments compared to 2017 due to focus on expansion projects in pulp and tissue. |

**Outlook: Stable**

The stable outlook on Portugal-based pulp and paper group The Navigator Company S.A. reflects our expectation that the company will continue to benefit from strong operating performances at its mills in Portugal. It also reflects our belief that, despite declining demand in its core UWF paper segment, the company will continue to maintain its profitability thanks to highly efficient paper operations. We expect the company to continue to invest in its tissue operations, thereby boosting cash flows and enhancing Navigator's product diversification.

### Downside scenario

We could lower the ratings if Navigator's operating performance deteriorated, with EBITDA margins falling significantly below 20%. This would impair the performance of the whole Semapa group. This could result from an economic decline, coupled with input cost inflation or an operational issue at one of the company's mills in Portugal. We could also lower the ratings if Semapa's liquidity deteriorated, possibly as a result of increasing dividends or a greater reliance on short-term debt.

We could also take a negative rating action on Navigator if we observed an increase in financial risk at Semapa, with additional debt-funded investments, extraordinary dividends, or share buybacks that caused debt to EBITDA to rise sustainably above 4x and funds from operations (FFO) to debt to drop below 20% on a sustained basis.

### Upside scenario

We could raise the ratings if we thought that the consolidated Semapa group's the financial risk profile had improved significantly, with debt to EBITDA below 3.0x and FFO to debt above 30%, on a sustained basis. We view such a scenario as unlikely in the coming years, given Semapa's current high indebtedness.

## Our Base-Case Scenario

**Assumptions**

- Eurozone GDP growth of 2.0% in 2018 and 1.7% in 2019. Portugal GDP growth of 2.3% in 2018 and 2.0% in 2019.
- We assume that EBITDA growth will be supported by new pulp (70k tonnes will be fully operational by end-2019) and new tissue capacity (70k tonnes from year-end 2020 onward). Our base case assumes a favorable pulp price environment in the near term as well as a marginal increase in paper volumes and quasi-flat paper prices.
- We thereby assume sales growth of 2.25% to 2.50% in 2018 and 2019, respectively.
- Adjusted EBITDA margins of 24%, supported by efficient paper operations, higher pulp prices, and cost-containments.
- Capital expenditure (capex) of €200 million in 2018, largely for the expansion of tissue capacity (Cacia mill) and pulp capacity (Figueira da Foz mill). We assume capex of €100 million for 2019, including €10 million for the Mozambique project.
- Dividend payments of about €200 million annually.

**Key Metrics**

| | **2017A*** | **2018E** | **2019E** |
|---|---|---|---|
| Adjusted EBITDA margins (%) | 24.2 | 24.0 | 23.7 |
| Adjusted Debt to EBITDA (x) | 1.9x | 2.0x | 2.1x |
| FFO to Debt (%) | 50 | 40 | 38 |

A--Actual. E—Estimate. FFO—Funds from operations.

*2017 data based on unaudited preliminary results.

## Company Description

Navigator is a Portugal-based pulp and paper manufacturer. In 2017 it generated sales of about €1.6 billion and S&P Global Ratings-adjusted EBITDA to €395 million. Integrated pulp and paper sales accounted for more than 83% of sales. Operations are split between UWF Paper (73% of revenues), a stand-alone pulp business (11%), the production of tissue paper (5%), and energy (10%).

The group relies on four sites: Cacia (pulp), Figueira da Foz (integrated pulp and paper), Setúbal (integrated pulp and paper) and Vila Velha de Ródão (tissue). The company's production capacities are as follows: 1.6 million tons of uncoated wood free (UWF) paper, 1.5 million tons of pulp, 70k tons of tissue production capacity. About 80% of its pulp capacity is integrated into paper operations.

The company was formerly known as Portucel, S.A.; it changed its name to The Navigator Company S.A. in February 2016.

## Business Risk: Fair

Our assessment of The Navigator Company's business risk profile reflects its market position as the largest UWF paper producer in Europe and the high profitability it has sustained over the past few years. The company derives its strong margins from a well-invested, modern asset base, high capacity utilization, a focus on premium paper grades, good access to raw materials, and relatively low labour costs.

In 2017, revenues were supported by higher pulp and paper prices, which more than offset a marginal decline in paper volumes. Lower energy and wood costs were offset by forest fires and challenging performance in the U.S pellets business. The recent announcement of divestment of the U.S. pellets business is unlikely to have a material impact on profitability going forward as EBITDA contribution remained negative in 2017 and our previous base case forecast was for limited contribution from this business. However, estimated cash proceeds of €75 million from the divestment will support credit metrics in 2018.

The company's strong EBITDA margins reflect that it is one of the most cost-efficient European UWF paper producers. We expect capacity additions in pulp and tissue to boost sales in 2018 and 2019. They will also improve its overall diversification and reduce exposure to the structurally declining UWF paper segment. The tissue operations only account for 5% of sales.

Navigator's business risk profile is constrained by its high exposure to the highly competitive and cyclical paper and pulp market, as well as its small size and scope and limited product diversification. Office paper accounts for 73% of revenues; the rest relates to pulp, tissue, and energy. We also view its asset concentration (its few production sites are all in Portugal) as a constraint.

## Financial Risk: Intermediate

Our assessment of the financial risk profile reflects Navigator's strong and relatively stable stand-alone credit metrics. The company had S&P Global Ratings-adjusted FFO to debt of about 50% and debt to EBITDA of about 1.9x in 2017 (based on preliminary numbers). Despite its cash generation, we expect these measures to weaken in 2018 due to high investments and dividend payments to the highly leveraged Semapa group. In 2018, we anticipate adjusted FFO to debt of 40%, alongside 2x debt to EBITDA. This assumes cash divestment proceeds of about €110 million, including about €75 million in 2018 and remaining over the next five years.

The company continues to invest in higher growth areas (tissue, pulp) and reduce its exposure to UWF paper. Growth capex will mainly relate to new tissue capacity at the Cacia mill and additional pulp capacity at the Figueira da Foz mill. The company also continues to invest in forestlands in Mozambique, although we understand that a mooted industrial pulp mill project is unlikely to come to fruition in the next 10 years.

## Liquidity: Adequate

We assess Navigator's liquidity profile as adequate, reflecting our forecast that its sources of liquidity will exceed uses by more than 1.2x over the next 12 months. Navigator benefits from strong FOCF generation, limited medium-term debt maturities, and ample covenant headroom.

| Principal Liquidity Sources | Principal Liquidity Uses |
|---|---|
| • Estimated cash and equivalents of €125 million as of Dec. 31, 2017;<br>• FFO of €300 million in 2018;<br>• Unused committed bank and commercial paper facilities totaling €225 million maturing in 2020 to cover short-term usages; and<br>• €75 million of divestment proceeds. | • €20 million debt repayments;<br>• Capex of €200 million in 2018; and<br>• Dividend payments of €200 million, although we understand that payments could be significantly lower in a stress scenario. |

## Group Influence

We continue to view Navigator as strategically important for the Semapa group, which owns 69.4% of voting rights. Navigator contributes to a substantial proportion of Semapa's revenues and profits. Semapa relies on Navigator's dividends to service its own debt.

In our view, on a consolidated basis, Semapa has weaker credit metrics than Navigator, primarily because of its higher leverage and the lower profitability and creditworthiness of its other businesses (notably cement company Secil). We expect Semapa to maintain an adjusted leverage ratio of around 3.4x and FFO to debt of about 23% in 2018. These ratios could improve slightly, depending on the amount of dividends that Semapa pays out and Secil's operating performance. We assume no additional dividend payments from the divestment proceeds that Navigator is due to receive in 2018 and 2019.

Overall, we assess the group credit profile (GCP) of the consolidated Semapa group as 'bb'. Although we view Navigator's stand-alone credit profile at 'bb+', Navigator's corporate rating is capped by the GCP of the consolidated group. This reflects Semapa's strong influence on Navigator's financial policy.

## Ratings Score Snapshot

### Corporate Credit Rating

BB/Stable/B

### Business risk: Fair

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

**Financial risk: Intermediate**

- **Cash flow/Leverage:** Intermediate

**Anchor: bb+**

**Modifiers**

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

**Stand-alone credit profile : bb+**

- **Group credit profile:** bb
- **Entity status within group:** Strategically important (-1 notch from SACP)

## Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

**Business And Financial Risk Matrix**

| Business Risk Profile | Financial Risk Profile | | | | | |
|---|---|---|---|---|---|---|
| | Minimal | Modest | **Intermediate** | Significant | Aggressive | Highly leveraged |
| Excellent | aaa/aa+ | aa | a+/a | a- | bbb | bbb-/bb+ |
| Strong | aa/aa- | a+/a | a-/bbb+ | bbb | bb+ | bb |
| Satisfactory | a/a- | bbb+ | bbb/bbb- | bbb-/bb+ | bb | b+ |
| **Fair** | bbb/bbb- | bbb- | **bb+** | bb | bb- | b |
| Weak | bb+ | bb+ | bb | bb- | b+ | b/b- |
| Vulnerable | bb- | bb- | bb-/b+ | b+ | b | b- |

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