The Navigator Company

The Navigator's exit from the pellets business is credit positive

From Credit Outlook

Last Monday, The Navigator Company (Ba2 stable) announced that it had expected to receive $135 million for the sale of its pellets business to a joint venture managed and operated by an affiliate of Enviva Holdings. The sale, which The Navigator and Enviva agreed late last year, will free up capital that the company can reinvest in its pulp and tissue operations, which we think have more robust underlying demand and where the company has stronger competitive advantages. The agreed price also will fully recover the amount initially invested into the business.

Entering the pellets business was an opportunistic investment in line with The Navigator’s strategy to diversify its operations beyond uncoated woodfree paper, which is experiencing a structural decline. The company invested roughly $120 million in a state-of-art wood pellet plant in the US state of South Carolina, with an annual capacity of 500,000 tonnes. The plant began production in fourth-quarter 2016 and the first pellets were sold in the first half of 2017.

As of end of the third-quarter 2017, the project has not yet reached breakeven EBITDA, although that trend is improving, and reported only €12 million of sales for the nine months to September 2017, equal to around 1% of the group’s turnover. Even though the sale will positively affect The Navigator’s EBITDA margin, the improvement will not be material for the company because the project has not yet reached its full potential and is still margin dilutive.

We do not think that the exit from the pellets business marks a change in the company’s strategic direction. We expect that The Navigator will continue to invest well above its maintenance capex needs of €30-€40 million annually to diversify beyond paper. Additionally, although the final allocation of the proceeds has not been determined yet, we expect that the company will use the funds to facilitate the diversification strategy, while keeping net reported leverage below 2.0x (it was 1.9x for the last 12 months to September 2017).

We expect that The Navigator will focus on further strengthening its pulp and tissue operations. The company plans to invest €380 million during 2017-19, which includes expansions of €120 million in tissue and €85 million in pulp expansion, and furthering its forest plantation project in Mozambique, with an investment pace of €10 million annually.

The tissue expansion relates to a new tissue mill in Cacia, Portugal, with an expected annual capacity of roughly 70,000 tonnes. The new mill, together with the current capacity in Vila Velha de Rodão, Portugal, of around 60,000 tonnes per year, would already make The
Navigator one of the leading tissue producers in Iberia, with a backward integration into pulp, an important competitive advantage, and profitability above the market average. The key project on the pulp side includes an increase of pulp capacity at its Figuera de Foz mill in Portugal by roughly 70,000 tonnes per year.

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