EF1

INSTRUMENT RATING

Neu CP

Initiation date	30/11/2022
Rating date	06/07/2023

Contacts

Senior associate
Anne Guy
anne.guy@ethifinance.com

RATING ACTION AND RATIONALE

- EthiFinance Ratings has upgraded its short-term rating for the NEU CP programme of Verallia (of up to €400m), to EF1 (from EF2).
- This rating upgrade is mainly supported by Verallia's improving financial profile with strong cash-flow generation that contributed to the current deleveraging. EthiFinance Ratings net adjusted debt-to-EBITDA ratio amounted to 2.2x at year end 2022, and is expected to improve further by 2025; assuming no significant M&A.
- Verallia's rating remains also supported by (i) its solid position in glass packaging industry (n°3 worldwide), a capital-intensive industry with significant barriers to entry; (ii) good market positioning on premium packaging; and (iii) cost efficiency policy driving superior profitability.
- However, the rating remains constrained by Verallia's limited geographic diversification, as the group remains dependant on the European market. The fact that Verallia's main clients are concentrated on the food and beverage industry also constraints our rating, but to a lesser extent as diversification is quite good within that industry (wines, food, spirits, beers, etc.).
- In line with our methodology, the materials & chemicals industry has high ESG risks (heatmap score of between 4 and 5) given its impact on the environment, which constrains our industry assessment. However, we assess the company's ESG policy as advanced (company ESG score of between 0 and 1), which weighs positively on our financial assessment, offsetting the impact resulting from our industry assessment.

ISSUER DESCRIPTION

Headquartered in Paris, France, Verallia is the world's n°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. For FY22, the company reported revenues of c. €3.3bn, with EBITDA of €866m, registering an EthiFinance Ratings adjusted net debt-to-EBITDA ratio of 2.2x.

FUNDAMENTALS

BUSINESS PROFILE

INDUSTRY RISK ASSESMENT

- **Good growth fundamentals**

In recent years, demand for glass packaging has been driven by favourable structural market trends. These include (i) growing demand for European wines and spirits in Asia and the US, (ii) economic growth and its positive impact on consumption trends in general within Latin American countries, and (iii) the growing trend for replacing plastic with glass, largely due to the image of glass and the associated health and environmental benefits.

In Europe, in 2021, the glass packaging sector reported a 6.7% growth vs 2020 (and +5.4% vs 2019), with strong growth in all market segments (alcoholic and non-alcoholic drinks). However, the food packaging segment, which during the pandemic benefited from both lockdown measures and working from home, declined by c. 2.0%, but was still 6.7% above the 2019 level. In 2021, glass gained 1 pt of market share vs other packaging material for food & beverage. This trend has continued in 2022, with 1H22 European sales increasing by 8.2% in volumes vs 1H21.

Demand for Verallia's products is rather resilient, as demonstrated during the Covid crisis: in 2020, Verallia reported revenues down by only 1.9% with volume down by c. 1.4%.

- **Significant barriers to entry but some volatility in raw materials prices**

The glass packaging industry is highly capital-intensive. Verallia's activities necessitate elevated annual capex (c. 10% of sales per year) to maintain the quality of its assets, and to develop additional production capacities. Additionally, Verallia invests to reduce its carbon footprint in order to comply with its ESG strategy.

Furthermore, these activities require a significant amount of raw materials, including recycled glass and silica sand, as well as energy, the prices for which tend to be volatile. Following the energy crisis, energy costs increased in 2022 to c. 23% of the cost of sales (vs 17% in 2021), amounting to c. €580m (with c. 55% stemming from gas). The group has a comprehensive hedging policy in place, which somewhat mitigates the impact of energy price fluctuations, and has some ability to pass on cost inflation to clients.

In terms of volatility, demand is again rather resilient, as demonstrated during Covid.

Given the presence of the group in Latam, contributing c. 13% to consolidated revenues in 2022, its results may be negatively affected by adverse currency fluctuations.

Verallia's market share is reasonably well protected by high barriers for new entrants, as well as by a highly diversified portfolio of clients (more than 10,000 clients), with whom the company has strong and longstanding relationships.

COMPANY'S COMPETITIVE POSITIONING

- **Verallia has solid business positions & market share**

The company has a special focus on wine and spirits (around 60% of sales), being the n°1 glass packager in Europe and n°2 in Latam. This premium positioning delivers higher margins than competitors, while reducing substitution risks from other containers like metal and plastic. Over the long term, we expect Verallia to continue to benefit from this positioning, due to increasing exports from European wine and spirits producers, as well as from its presence in Latam, particularly in Brazil, Argentina and Chile.

- **Verallia's diversification is satisfactory but still highly dependent on a few European countries**

In terms of geography, Verallia has rather limited diversification, with Europe contributing to c. 87% of consolidated revenues in FY22 and Latam to c.13%. The European concentration revolves around 9 countries (o/w France, Italy, Spain and Germany representing c. 77% of consolidated revenues in FY22). It recently extended its geographic reach to the UK, following the acquisition of Allied Glass in November 2022.

In terms of product diversification, Verallia supplies various segments with glass packaging for food & beverages. Wine contributed to c. 35% of 2022 revenues, followed by food (c.16%), spirits (c.13%), beer (c.13%), sparkling wine (c.12%), and soft drinks (c. 11%). It is particularly well positioned in the premium segments.

- **No major risks identified related to Russia & Ukraine**

Verallia reported 2% & 4% of sales in Ukraine & Russia respectively in 2022. In our view, the exposure to Ukraine remains manageable, as is that to Russia, which was mostly a local market.

GOVERNANCE

- **Shareholders**

Verallia has been listed on Euronext Paris since October 2019, and is owned by BWSA (c. 28.0%), BPI France (c. 7.5%), and employees (c. 3.8%), with a free-float of c. 56.55% at end-December 2022. As of 26 June 2023, it had a market capitalization of € 4.1bn.

We consider that it has a rather prudent financial policy, characterized by a strong improvement in its net leverage ratio over the past few years, as well as relatively strong ESG policies in place.

- **Management quality**

We consider that the group's management has a strong track record, as highlighted by the gradual improvement in profitability, with EBITDAR (EBITDA adjusted for leases pre IFRS 16) margin increasing from 20.4% in FY16 to 25.8% in FY22. The improvement in profitability was concurrent with a decrease in indebtedness; the EthiFinance Ratings' net adjusted leverage ratio for Verallia decreased from 5.0x at end-2016 to 2.2x at end-2022.

- **ESG policy**

Verallia's ESG strategy is based on quantified targets that aim to reduce its environmental impact as well as that of the glass industry. This is centered around three core pillars, (i) enhance the circularity of glass packaging, (ii) significantly reduce CO_2 emissions and (iii) provide a safe and inclusive place to work. It aims at reducing its CO_2 emissions (Scope 1&2) by 46% by 2030, vs 2019 through greater use of cullet, lower use of carbon-based materials, reduced energy consumption for glass melting, and higher use of green energy. As of December 2022, Verallia reported a decrease of 10.8% vs 2019; in its CO_2 emissions (Scope 1&2).

FINANCIAL PROFILE

CASH-FLOW AND LEVERAGE

- **Strong FY22 results & good start of the year**

Verallia posted a strong growth in revenues for FY22. of 25.3% to €3.3bn. Organic growth was 26.5%, of which 1.4% was related to higher volume growth, and 25.0% to increased prices & the product mix. Volumes were however impacted by reduced capacity, linked to furnace renovations. Overall, the group reported organic growth in all its geographic divisions, driven by a favourable product mix and an increase in selling prices linked to inflation.

The group was able to preserve its profitability despite inflation with an EBITDA margin of 25.8% (vs 25.3% in FY21). EBITDA increased by 27.2% with c. 19.9% linked to the price / mix improvement along with productivity gains (c. 5.0%), despite the negative FX effect in Latam.

Verallia generated c. €179m of free cash-flow, with dividends amounting to c. €123m. Free cash-flow was impacted by increased capex (c. 11% of revenues) linked to the construction of new furnaces. Adjusted for the financing of the Allied Glass acquisition (EV of £315m), FCF was negative for the year. However, our net adjusted leverage decreased from 2.6x (FY21) to 2.2x (FY22).

Verallia posted a strong performance for the first quarter of 2023, with a 34.7% organic increase in revenues, and EBITDA margin of 29.2% (vs 24.4% same period last year). The net reported debt-to-EBITDA ratio was reduced to 1.3x in Q1 (from 1.7x at year end 2022). EBITDA in Q1 increased by 67.8% (organic growth), with c. 73.8% linked to the productivity gains, along with the favourable product mix & margin improvements (c. 7.0%). This is while volumes were lower than the same period last year (c. -9.1%). Verallia has reaffirmed its 2023 EBITDA guidance of more than €1bn.

- **Strong improvement in profitability leading to a reduction in the net adjusted leverage, we expect this to continue over our forecast period**

We expect Verallia to continue to generate positive free cash-flow after dividends over 2023-25 (our forecast period), and to report an EthiFinance Ratings' net adjusted leverage below 2.0x, assuming no significant M&A.

SOLVENCY

Verallia had €1.9bn of gross reported debt at year end 2022, which included €1.0bn of sustainability linked-notes (with maturity in 2028 & 2031) and €0.5bn of term loan maturing in October 2024. In April 2023, Verallia extended the maturity of its senior facilities, by refinancing its term loan until 2027. This was with a one-year extension option, and its undrawn RCF until 2028 with a two-year extension option. Verallia also slightly increased their amounts to €550m (from €500m) each, and linked both to ESG criteria.

Our adjusted gross debt amounted to c. €2.2bn, and included c. €0.4bn of adjustments related to the company's off-balance sheet factoring program; along with employee benefits (c. €80m at year end 2022).

LIQUIDITY

We assess the liquidity profile of Verallia as "Superior", reflecting its strong refinancing profile and the high availability of liquidity.

These feature the large undrawn revolving credit facilities, a long-term debt schedule profile with diversified maturities, and a high cash on balance sheet. We expect Verallia to continue to generate strong free cash-flow.

RATING MODIFIERS

- **Controversies**

Over the course of our review, we found no notable controversies regarding Verallia.

- **Country risk**

Verallia is rather well diversified, mainly in Europe, and therefore does not have significant country risk exposure.

Credit Metrics Expected Evolution (CMEE)

Our CMEE is Stable, reflecting our expectations that Verallia's credit metrics will remain broadly unchanged over the next twelve months.

MAIN FINANCIAL FIGURES

Main financial figures. €m.	2020	2021	2022	22vs21
Turnover	2 536	2 674	3 352	20,2%
EBITDA	627	681	866	21,4%
EBITDA Margin	24,7%	25,4%	25,8%	1,5%
EBIT	318	396	559	29,2%
EBIT Margin	12,5%	14,8%	16,7%	11,2%
Interest expenses	(44)	(37)	(36)	-3,0%
EBT	272	339	478	29,1%
Total Assets	3 336	3 817	4 443	14,1%
Equity	578	800	1 067	25,1%
Total Financial Debt	2 227	2 255	2 216	-1,8%
Net Financial Debt	1 751	1 761	1 885	6,6%
Equity/TFD	25,9%	35,5%	48,2%	26,4%
NFD/EBITDA	2,8x	2,6x	2,2x	-0,4x
Funds From Operations	505	518	710	27,0%
FFO/NFD	28,8%	29,4%	37,7%	21,9%
EBITDA/Interest	14,3x	18,2x	23,8x	5,7x

RATING SENSITIVITY

Factors that may (individually or collectively) impact the rating:

Positive factors (↑).

A rating upgrade to EF1+ would derive from several upgrades of long-term rating, resulting from significant improvements in credit metrics (notably EthiFinance Ratings-adjusted net leverage ratio below 0.5x). Considering Verallia's current financial policy and the capital intensity of its activities, we do not expect a rating upgrade in a coming future.

Negative factors (↓).

A downgrade to EF2 could be entailed by a deterioration in Verallia's financial profile. In particular, a significant M&A transaction weighing on credit metrics (Verallia's EthiFinance Ratings-adjusted net leverage ratio around 3x) would entail a rating downgrade.

REGULATORY DISCLOSURES

LEI: 5299007YZU978DE0ZY32

Rating initiation: Yes, at EF2 on November 30, 2022

Last rating action: Initiated at EF2 on November 30, 2022

Rating nature: Solicited NEU CP instrument rating

With rated entity or related third party participation: Yes. This rating report was published after having been reviewed by the issuer.

With access to internal documents: Yes

With access to management: Yes

Ancillary services provided to the entity: In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has provided ancillary services to related third parties of the rated entity, but not to the rated entity. However, according to our Conflict of Interest Policy, it does not involve a conflict of interest, since the aggregate sale does not exceed 5% of net turnover.

Name of the rating committee chair: Marc Pierron, Senior Director

Material sources used to support the rating decision:

- Annual and quarterly reports
- IPO registration document
- Discussions with Verallia management

Limitation of the Rating action:

EthiFinance Ratings believes the quality and quantity of information available on the rated entity is sufficient to provide a rating.

EthiFinance Ratings has no obligation to audit or verify the accuracy of data provided.

Our methodologies used for this rating are available at:

https://files.qivalio.net/documents/methodologies/CRA_190_V3.CorporateRatingMethodology_Long_Term.pdf

https://files.qivalio.net/documents/methodologies/CRA_191.Corporate_Rating_Methodology_Short_Term-202303.pdf

EthiFinance Ratings SL

Calle Velázquez nº18

28001 – Madrid

Conditions of Use for this document and its content:

For all types of Ratings that ETHIFINANCE RATINGS, S.L. (the "AGENCY") issues, the User may not, either by themselves or via third parties, transfer, sublease, sublicense, sell, extract, reuse, or dispose of in any other way the content of this Document to a third party, either for free or for consideration.

For the purpose of these Conditions of Use, any client who might have subscribed for a product and/or a service that allows him to be provided with the content of this Document as well as any privileged person who might access the content of this Document via www.ethifinance.com shall be considered as a User.

Nor may they alter, transform or distort the information provided in any way. In addition, the User will also not be permitted to copy and/or duplicate the information, nor create files which contain the information of the Document, either in its entirety or partially. The Document and its source code, regardless of the type, will be considered as the elaboration, creation, or work of the AGENCY and subject to the protection of intellectual property right regulation. For those uses of this Document which are permitted, the User is obliged to not allow the removal of the copyright of the AGENCY, the date of the Document's issuance, the business name as established by the AGENCY, as well as the logo, brands and any other distinctive symbol which is representative of the AGENCY and its rights over the Document. The User agrees to the conditions of Use of this Document and is subject to these provisions since the first time they are provided with this Document no matter how they are provided with the document. The Document and its content may not be used for any illicit purpose or any purpose other than those authorised by the AGENCY. The User will inform the AGENCY about any unauthorised use of the Document and/or its content that may become apparent. The User will be answerable to the AGENCY for itself and its employees and/or any other third party which has been given or has had access to the Document and/or its content in the case of damages which arise from the breach of obligations which the User declared to have read, accepted and understood upon receiving the Document, without prejudice to any other legal actions that the AGENCY may exercise in defence of its lawful rights and interests. The Document is provided on the acceptance that the AGENCY is not responsible for the interpretation that the User may make of the information contained. Credit analyses included in the Document, as well as the ratings and statements, are to be deemed as opinions valid on the date of issuance of the reports and not as statements of fact or recommendations to purchase, hold or sell any securities or to make any investment decision. The credit ratings and credit rating prospects issued by the AGENCY are consider to be its own opinion, so it is recommended that the User take it as a limited basis for any purpose that it intends to use the information for. The analyses do not address the suitability of any value. The AGENCY does not act as a fiduciary or an investment advisor, so the content of the Document should not be used as a substitute for knowledge, criteria, judgement or experience of the User, its Management, employees, advisors and/or clients in order to make investment decisions. The AGENCY will devote every effort to ensure that the information delivered is both accurate and reliable. Nonetheless, as the information is elaborated based on data supplied by sources which may be beyond the control of the AGENCY, and whose verification and comparison is not always possible, the AGENCY, its subsidiaries, and its directors, shareholders, employees, analysts and agents will not bare any responsibility whatsoever (including, without any limitations, loss of revenue or income and opportunity costs, loss of business or reputational damage or any other costs) for any inaccuracies, mistakes, noncorresponding information, incompleteness or omission of data and information used in the elaboration of the Document or in relation to any use of its content even should it have been warned of potential damages. The AGENCY does not make audits nor assume the obligation of verifying independent sources of information upon which the ratings are elaborated. Information on natural persons that may appear in this document is solely and exclusively relevant to their business or business activities without reference to the sphere of their private life and should thus be considered. We would like to inform that the personal data that may appear in this document is treated in accordance with Regulation (EU) 679/2016, on the protection of natural persons with regard to the processing of personal data and the free movement of such data and other applicable legislation. Those interested parties who wish to exercise the rights that assist them can find more information in the link: www.ethifinance.com in the Privacy Policy page or contact our Data Protection Officer in the mail dpo@ethifinance.com. Therefore the User agrees that information provided by the AGENCY may be another element to consider when making business decisions, but decisions will not be made based solely on it; that being the case the AGENCY will not be held responsible for the lack of suitability. In addition, the use of the information before courts and/or tribunals, public administrations, or any other public body or private third party for any reason shall be solely the User's responsibility and the AGENCY shall not be held responsible for any liabilities on the grounds of inappropriateness of the information's contents. C/ Benjamín Franklin S/N, Edificio Camt, 1º Izquierda, 18100, Granada, España C/ Velázquez nº18, 3º derecha, 28001 - Madrid