Kepler Cheuvreux | Credit Research

Selecta

Netherlands | Capital goods

11 September 2020

Hold (under review)

S&P	CCC- wn
Moody's	Caa3 n
Fitch	NR
Bloomberg	SELNP FP

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A better-than-feared proposed restructuring deal

Selecta announced earlier this week that it has agreed a recapitalisation transaction with its shareholders, lenders under the RCF and a substantial portion of its bondholders. This proposal will be put to the vote of all creditors and more than 75% (by value) will have to approve the plan for it to be implemented. We review below the key elements.

A "great" company?

Selecta hosted a conference call to discuss the recapitalisation transaction that will be put to the vote of its creditors. The new management team (CEO and CFO) was on the call, but it was Executive Chairman Joe Plumeri who clearly stole the show, in our view.

While this debt restructuring symbolises the company's inability and failure to address the effects of the COVID-19 crisis, the Chairman talked throughout the call about how "great" Selecta is: according to our estimates, Mr Plumeri used the word "great" more times than Colin Farrell said the F-word in the movie "In Bruges". And this is no small feat…

Anyway, bondholders are unlikely to be thrilled about the losses they will suffer from having invested in the bonds of this "great" company, even if the pandemic is the main (but not only) culprit. N.B. Selecta badly disappointed with its Q4 2019 and Q1 2020 results, prior to the pandemic.

The restructuring plan would see KKR inject another EUR125m in addition to the EUR50m already provided last March (a good surprise), lenders under RCF would amend and extend the EUR150m facility, while senior secured bondholders would exchange their bond holdings due in 2024 for a mix of 1st lien bonds and 2nd lien bonds due in 2026, as well as preference shares. Let's delve into more details.

What's the plan?

We summarise below the key elements of the restructuring that we find noteworthy. First and foremost, holders of the bonds will be asked to exchange their EUR865m 5.875%, EUR375m E+537.5bps FRN and CHF250m 5.875% senior secured bonds due in 2024 (EUR1,480m plus accrued interest of an estimated EUR43m up until 1 October) into a mix of:

- EUR693m 1st lien notes maturing on 1 April 2026 and paying 3.5% cash+4.5% PIK until Jan 2023, 8% cash afterwards.
- EUR240m 2nd lien notes maturing on 1 July 2026 (i.e. three months later than the 1st lien) paying 10% PIK prior to Jan 2023 then either 9.25% cash or 10% PIK at the issuer's discretion; and

- EUR241m in preference shares to be issued by a new Holdco and bearing a dividend accruing at 12% a year, and whose redemption date would be 1 October 2026.

In brief, each bondholder would exchange a EUR1,000 bond for EUR470 of 1st lien (47%), EUR163 of 2nd lien (16.3%) and EUR164 of preference shares (16.4%).

As far as RCF lenders are concerned, they have agreed to amend and extend the existing EUR150m RCF until 1 January 2026 (i.e. maturing 3 months before the 1st lien notes), while covenants were also revised with a minimum liquidity of EUR20m and super senior net leverage below 1.5x in particular.

Finally, the key element that should convince bondholders to support the plan is the injection by shareholder KKR of EUR175m of new capital (EUR125m of new money plus the EUR50m that was provided last March as a super senior credit facility by KKR) in the form of preference shares issued by the new Holdco.

In terms of seniority, the RCF will rank senior to the 1st lien notes, which will themselves rank senior to 2nd lien notes in terms of proceeds of enforcement of security. Preference shares (holdco level, outside the restricted group) are unguaranteed, unsecured and will be subordinated to all these notes.

Bondholders that have not taken part in the discussions should decide by 15 September on whether to accept the proposal in order to receive an early-bird lock-up fee of 25bps and thereby also be bound by the lock-up agreement. The transaction is expected to be completed in the coming weeks, with an effective date and implementation of the new capital structure around late October.

Chart 1: Summary of the proposed captical structure post-transaction

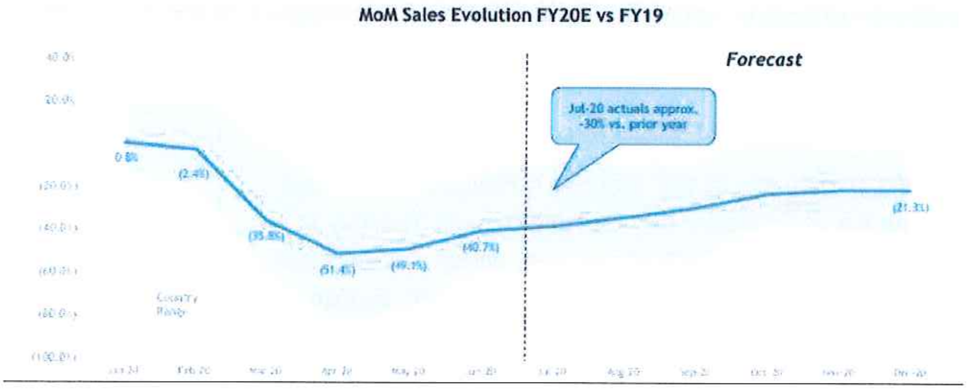
Instrument	Amount	Ranking	Maturity	Interest	Key covenants
RCF	EUR175m	Super Senior	01-Jan-26	E+350bp, 25bp uplift in FY23	Minimum liquidity at EUR20m, SS net leverage<1.5x
1st lien notes	EUR693m	Senior vs. 2nd lien	01-Apr-26	350bp cash+450bp PIK in FY21/FY22 800bp cash thereafter	Min liquidity at EUR25m, net leverage, tightening of baskets
2nd lien notes	EUR240m	Junior vs. 1st lien	01-Jul-26	10% PIK in FY21/FY22 PIK toggle thereafter (9.25% cash/10% PIK)	Same as 1st lien
Preference shares	EUR241m EUR175m	Class A Class B (KKR money)	01-Oct-26 01-Oct-26	12% PIK 12% PIK	No security, no guarantee, non-voting

Source: Selecta, Kepler Cheuvreux

A full recovery remains illusory

How fast Selecta can return to past revenue levels remains anybody's guess. Selecta's vending machine business remains highly dependent on employees returning to offices, as well as people commuting (tube, train) and travelling (airports). It is fair to say that there will be increased working from home on a structural basis, especially for large corporates. Sales were still down 30% YOY in July, continuing their recovery off the lows of April and May (down 50% YOY) but still a long way off normal (2019) levels.

Chart 2: MoM Sales Evolution in 2020 (H1 actual, H2 forecast)



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Management expects to be able to achieve high single-digit EBITDA margins if sales recover by Q4 2020 to 20% below pre-COVID levels, through a mix of workforce restructuring and machines taken off the field. This should be just about enough to cover capex needs (before interest expenses) from Q4 2020 onwards, driven by significant IT spend planned for the next couple of years along with the renewal of existing machines.

Time will tell whether the degearing of the capital structure as a result of this debt restructuring will be sufficient to put Selecta on a sustainable path.

Chart 3: Selecta's roadmap to deleveraging

Source: Selecta

Investment conclusion

Although we would fall short of calling this plan a "great" restructuring package, this might represent a best-case scenario for bondholders given that more support from sponsor KKR was far from a done deal in light of the extraordinary challenges the company is currently facing due to the impact of the COVID-19 crisis on the very nature of its business model.

The evolution of the pandemic will, to a great extent, determine how fast people go back to working, commuting and traveling like it was 2019, which will be a major driver for Selecta's recovery prospects going forward. In the meantime, restructuring and cost-cutting will remain the name of the game for the company, in an industry which was already mature before the crisis, with low growth prospects outside acquisitions in a still highly fragmented European vending machine industry.

We recommend that investors participate in the proposed transaction and take advantage of the early lock-up fee of 25bps by participating by next Tuesday (15 September). Positive announcements on COVID-19 vaccines within the next six months should provide a better opportunity for investors to sell their exposure, given the company's high sensitivity to the sanitary situation.

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Stock	ISIN	Currency	Price
Selecta		EUR	

Source: Factset closing prices of

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Name of the Research Analyst(s): Cyril Benayoun, CFA

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Research ratings

Rating ratio Kepler Cheuvreux Q2 2020

Rating Breakdown	A	B
Buy	49%	48%
Hold	35%	34%
Reduce	13%	10%
Not Rated/Under Review/Accept Offer	3%	8%
Total	100%	100%

Source: KEPLER CHEUVREUX
A: % of all research recommendations
B: % of issuers to which material services of investment firms are supplied

12 months rating history

The below table shows the history of recommendations and target prices changes issued by KEPLER CHEUVREUX research department (Equity and Credit) over a 12 months period.

Company Name	Date	Business Line	Rating	Target Price	Closing Price
Credit research does not issue target prices. Left intentionally blank.					

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Equity research

Rating system

KEPLER CHEUVREUX equity research ratings and target prices are issued in absolute terms, not relative to any given benchmark. A rating on a stock is set after assessing the twelve months expected upside or downside of the stock derived from the analyst's fair value (target price) and in the light of the risk profile of the company. Ratings are defined as follows:

Buy: The minimum expected upside is 10% over next 12 months (the minimum required upside could be higher in light of the company's risk profile).

Hold: The expected upside is below 10% (the expected upside could be higher in light of the company's risk profile).

Reduce: There is an expected downside.

Accept offer: In the context of a total or partial take-over bid, squeeze-out or similar share purchase proposals, the offer price is considered to be fairly valuing the shares.

Reject offer: In the context of a total or partial take-over bid, squeeze-out or similar share purchase proposals, the offered price is considered to be undervaluing the shares.

Under review: An event occurred with an expected significant impact on our target price and we cannot issue a recommendation before having processed that new information and/or without a new share price reference.

Not rated: The stock is not covered.

Restricted: A recommendation, target price and/or financial forecast is not disclosed further to compliance and/or other regulatory considerations.

Due to share prices volatility, ratings and target prices may occasionally and temporarily be inconsistent with the above definition.

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Unless otherwise stated in this report, target prices and investment recommendations are determined based on fundamental research methodologies and relies on commonly used valuation methodologies such as Discounted Cash Flow (DCF), valuation multiples comparison with history and peers, Dividend Discount Model (DDM).

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Credit research

Recommendation system (issuer or instrument level)

Buy: The analyst has a positive conviction either in absolute or relative valuation terms and/or expects a tightening of the issuer's debt securities spread over a 6 months period.

Hold: The analyst has a stable credit fundamental opinion on the issuer and/or performances of the debt securities over a 6 months period.

Sell: The analyst expects of a widening of the credit spread to some or all debt securities of the issuer and/or a negative fundamental view over a 6 months period.

No recommendation: The analyst does not provide formal, continuous coverage of this issuer and has not assigned a recommendation to the issuer.

Restricted: A recommendation, target price and/or financial forecast is not disclosed further to compliance and/or other regulatory considerations.

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KEPLER CHEUVREUX, Sucursal en España	Comisión Nacional del Mercado de Valores	CNMV
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KEPLER CHEUVREUX, Milan branch	Commissione Nazionale per le Società e la Borsa	CONSOB
KEPLER CHEUVREUX, Amsterdam branch	Autoriteit Financiële Markten	AFM
Kepler Capital Markets SA - Switzerland, Zurich branch	Swiss Financial Market Supervisory Authority	FINMA
Kepler Capital Markets, Inc.	Financial Industry Regulatory Authority	FINRA
KEPLER CHEUVREUX, London branch	Financial Conduct Authority	FCA
KEPLER CHEUVREUX, Vienna branch	Austrian Financial Services Authority	FMA
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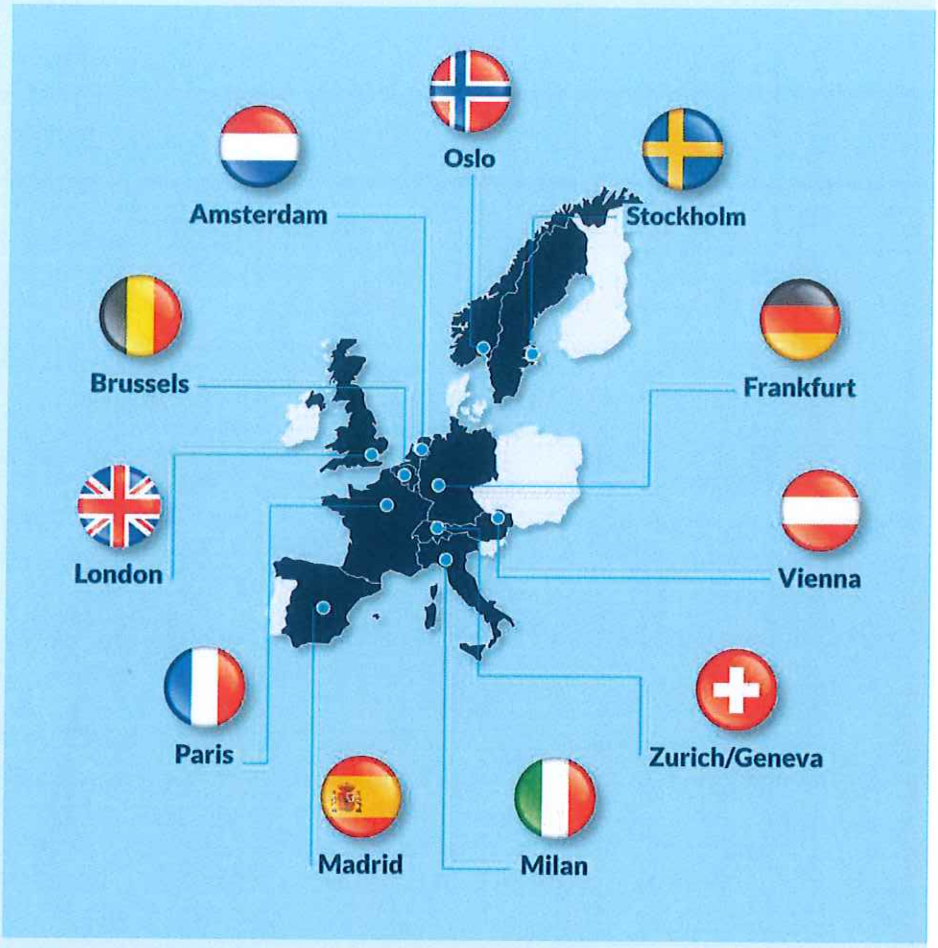

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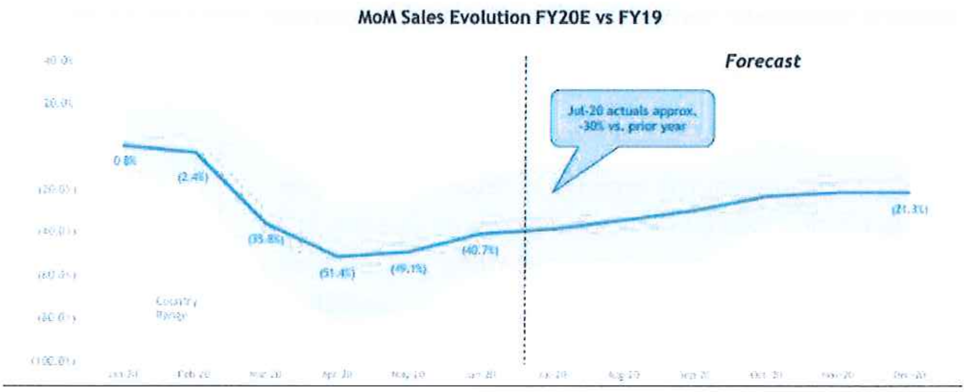

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Name of the Research Analyst(s): Cyril Benayoun, CFA

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Rating ratio Kepler Cheuvreux Q2 2020

Rating Breakdown	A	B
Buy	49%	48%
Hold	35%	34%
Reduce	13%	10%
Not Rated/Under Review/Accept Offer	3%	8%
Total	100%	100%

Source: KEPLER CHEUVREUX
A: % of all research recommendations
B: % of issuers to which material services of investment firms are supplied

12 months rating history

The below table shows the history of recommendations and target prices changes issued by KEPLER CHEUVREUX research department (Equity and Credit) over a 12 months period.

Company Name	Date	Business Line	Rating	Target Price	Closing Price
Credit research does not issue target prices. Left intentionally blank.					

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Equity research

Rating system

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Hold: The expected upside is below 10% (the expected upside could be higher in light of the company's risk profile).

Reduce: There is an expected downside.

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Credit research

Recommendation system (issuer or instrument level)

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Hold: The analyst has a stable credit fundamental opinion on the issuer and/or performances of the debt securities over a 6 months period.

Sell: The analyst expects of a widening of the credit spread to some or all debt securities of the issuer and/or a negative fundamental view over a 6 months period.

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