RATING COMMUNICATION

Cerved Rating Agency S.p.A. upgrades

C.M.D. COSTRUZIONI MOTORI DIESEL S.p.A. public rating to **B1.2**

Nucleo Industriale Valle di Vitalba – Atella (PZ)

Cerved Rating Agency on 17/03/2022 has upgraded C.M.D. S.p.A. rating from B2.1 to B2.1

Date of first issuance of the rating: 27/02/2015

C.M.D. Spa (hereinafter the Company) has been operating since the 70s in the mechanical processing sector for the automotive and industrial markets; since 2000 it has started a process of production diversification that has resulted in 4 Business Units: (i) "Machining", CMD's core business, consists of, the Industrial and Automotive segments; (ii) "Marine Engines", which develops and manufactures engines for pleasure boating under the FNM brand; (iii) "Avio", which carries out R&D activities for the production of hybrid engines for light aircraft; (iv) Cogeneration, which develops solutions in the energy sector. Since 2020, it has also started the production of engines for the e-bike segment (BU E-mobility). C.M.D. enjoys consolidated partnerships with the Stellantis Group and FPT Industrial (CNH Group), with whom it achieves 70% of its turnover. The target market is mainly the US. Since January 2017, the Chinese-registered company Loncin Motor Co. Ltd (listed on the Shanghai Stock Exchange) has acquired the majority of the capital (67%), while shareholders Mariano Negri and Giorgio Negri hold 26.81% and 6.19% respectively.

KEY RATING FACTORS

The rating upgrade reflects: (i) the maintenance of operating margins thanks to the recovery of business volumes; (ii) the strong reduction in trade working capital compared to the track record due to the greater use of credit lines, generating adequate operating cash flows to cover current needs and investments. Efficient financial planning has enabled the Group to take full advantage of government actions to mitigate the impacts of the pandemic, limiting cash-outs from reimbursements in FY20-21. A further consolidation of turnover and margins is expected for FY22, thanks to the development of the order portfolio; from a financial point of view, despite a growth in net working capital (NWC/VoP expected to increase in a range of 16-20%), the NFP 2022 should remain below €35 million.

Recovery of business volumes and turnover - Based on pre-closing figures, C.M.D. closed FY21 with a VoP (Value of Production) up to €47.2 million (€25.7 million in FY20) thanks to the recovery of core business, which was heavily penalized by the lockdown in March-April 2020. In detail: (i) the Machining BU recorded an increase in volumes with approximately 264 thousand sold pieces (120 thousand pieces in FY20), achieving a turnover of €29.4 million (78% of VoP); (ii) the E-mobility BU, whose weight on the total VoP increased to 15%, reached a turnover of €5.5 million (€1.0 million in FY20) thanks to new partnerships with distributors for the large-scale retail trade; (iii) the Cogeneration BU (dedicated to the creation of the ECO20 micro-cogenerator), although still marginal, showed revenues of €0.8 million (€0.3 million in FY20). Lastly, while the Marine Engines BU still has not found a total recovery in recreational shipping traffic (-21% of turnover vs. FY19), for the Avio BU no design services were carried out for member of Loncin (which in FY20 had generated turnover of €1.7million). The financial year closed with a profit of €0.4million (€1.7million in FY20). It should be noted that also in FY21 the Company, by virtue of art. 60 of Legislative Decree 104/2020, suspended the depreciation of tangible assets (in FY20 the suspension concerned the depreciation of tangible and intangible assets for approximately (€7 million).

Maintenance of margin levels - Despite the significant growth in volumes, the Company recorded a decrease in *gross margin* (from 36,1% in FY20 to 27,1% in FY21) due to the sharp rise in raw material prices. The time misalignment between the revision of the purchase and sale price lists has caused a margin loss which is, on average, partly recovered in the following quarter/half. The adjusted EBITDA amounted to €8,7 million (€4,7 million in FY20) with an EBITDA margin of 18,4% (18,2% in FY20, benefiting from the use of the Covid Wages Guarantee Fund (CIG) with *a saving* of €0,8 million) thanks to a higher absorption of fixed costs, mainly personnel costs.

Improvement in operating cash flows and stability of NFP - Thanks to the recovery of margins and improved management of net working capital (NWC/VoP equal to 13.5% vs. historical average of 40%) due to greater use of factoring, both with and without recourse, C.M.D. achieved a positive Net Operating Cash Flow of approximately € 22.2 million (negative for € 1.2 million in FY20). The possibility of taking advantage of moratoria and the taking out of m/l-term loans guaranteed by SACE/MCC and with 24 months of pre-amortization allowed the Company to concentrate liquidity on production flows in the two-year period 20-21. Net of Capex for €19 million (from 2017 to date investments have been made for a total of €35 million), Debt Service Flow is positive for €1.4 million (negative for €14 million in FY20). The NFP adj, including tax and social security debt past due for €3.3 million and leasing debt for €1.6 million, is €32.6 million (€35.1 million at the end of 2020 and €21.5 million at the end of 2019), with NFP adj/EBITDA adj improving to 3.8x (7.5x at the end of 2020 and 2.7x at the end of 2019); the NFP adj/Net asset ratio remains below 1.0x. There are also non-interest-bearing shareholders' payables of €5.8 million (€5.6 million at end-2020).

FY22 projections and medium-long-term strategic drivers – Management's estimates predict an 11% year-on-year increase in VdP for FY22, due to growth in orders. Despite the rise in commodity purchase prices, the first margin (both in absolute value and percentage) is expected to increase due to volume growth. For FY23, the trend of revenue consolidation is estimated to be steady: on a backlog basis at the end of February 2022, the backlog/VoP hedge ratio is 80%; in addition, the pipeline ensures full coverage of estimates. The 2023 YoY margin forecasts are growing, thanks to the contribution of the Avio BU with the CMD22 and GF56 engines, characterized by a high margin (ca. 60%) and for which the Company is incurring significant R&D costs (€14 million since 2017). On the financial side, gross financial exposure is expected to be maintained, which will see the term-structure confirm its medium/long-term orientation, also in view of the refinancing of maturing debt (residual bond debt of €4.4 million). In FY22 and FY23, investments will continue (€7 million in the two-year period), the financing of which, while waiting to collect the recognized contributions of €10.3 million (Invitalia programme), will continue to be anticipated through operating cash flows (NOCF 2022 expected to be at least €9.5 million), bank debt and bonds. According to the Agency, the NFP adj/EBITDA adj sustainability ratio, while showing further improvement due to the recovery of margins, will remain at pre-pandemic levels at the end of 2023.

Rating sensitivities

- In the short term, the maintenance of the current rating class is expected as a positive scenario.
- The rating of C.M.D. may be downgraded if: (I) an increase in NFP not accompanied by an improvement in characteristic marginality; (ii) a deterioration in the ability to generate operating cash flows.

The applied methodology is published on Cerved Rating Agency’s website: www.ratingagency.cerved.com

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