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Research Update:

Swiss Chocolate Producer Barry Callebaut Outlook Revised To Stable On Improved Credit Metrics; 'BB+' Ratings Affirmed

Primary Credit Analyst:
Barbara Castellano, Milan (39) 02-72111-253; barbara.castellano@standardandpoors.com

Secondary Contact:
Nicolas Baudouin, Paris (33) 1-4420-6672; nicolas.baudouin@standardandpoors.com

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Overview

- Barry Callebaut's sales are increasing and the operating margin is fairly stable, thanks to the chocolate industry's resilience.
- The group's credit metrics weakened somewhat after it acquired Petra Foods last year, but we believe they should stay in line with our significant category, provided there are no new large acquisitions.
- We are therefore revising our outlook on Barry Callebaut to stable from negative and affirming our 'BB+' long-term ratings on the group.
- The stable outlook reflects our view that Barry Callebaut will maintain an adjusted debt-to-EBITDA ratio of 3x-4x and EBITDA interest coverage in the 3x-6x range.

Rating Action

On July 29, 2014, Standard & Poor's Ratings Services revised its outlook on Swiss chocolate producer Barry Callebaut AG to stable from negative. At the same time, we affirmed our 'BB+' long-term corporate credit rating on Barry Callebaut.

We also affirmed our 'BB+' rating on the company's senior unsecured debt. The recovery rating remains at '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default.

Rationale

The outlook revision reflects our anticipation that Barry Callebaut's financial metrics will stay in line with our "significant" category, thanks to revenue growth and a steady operating performance. Sales over the past nine months show positive organic growth--6.8% in revenues and 2.4% in volumes--excluding Petra Foods.

We view the group's business risk profile as "satisfactory," reflecting our view of the agribusiness' industry risk as "intermediate" and Barry Callebaut's country risk as "low," given the group's geographic focus on developed countries. We believe that the group has a solid competitive position, based on its comfortable leading open-market share of 40% and its strong geographic diversification, further enhanced by its acquisition of Petra Foods at the end of the last fiscal year.

The group supplies multinational and national branded consumer goods manufacturers, including major chocolate manufacturers, through long-term agreements. Barry Callebaut is vertically integrated and it supplies the entire food industry, from industrial food manufacturers to professional or artisanal users of chocolate. We also note the group's proven ability to pass on raw materials price hikes to its customers.

These strengths are mitigated by Barry Callebaut's limited ability to convert new contracts and increased production capacities into cash-flow generation. Ongoing capital expenditure (capex) and continuous increases in working capital have weighed on the group's earnings for the past five years, and we have not seen any significant deleveraging from the cash generated internally.

Our view of Barry Callebaut's "significant" financial risk profile reflects the group's debt-to-EBITDA ratio, which peaked at 4x as of the fiscal year ended Aug. 31, 2013 (fiscal 2013), and is likely to improve in fiscal 2014. We understand that cash conversion is limited by frequent swings in working capital and investments in new capacity to support revenue growth. The ratio of capex to revenues has stayed at about 4.5% in past years, and we expect it to improve slightly and stabilize below 4% in 2014 and beyond.

For our base case, we assume:

- EU GDP growth of 1.1% in 2014 and 1.6% in 2015, U.S. GDP growth of 2.5% and 3.2% in the same years, and China GDP growth of 7.2% in both years.
- Revenue growth of about 20% in 2014 and roughly 5% in 2015, including Petra Foods.
- A reported EBITDA margin of about 8.5% in 2014 and 8.5%-9% in 2015, with a slight effect from the Petra Foods acquisition.
- Tangible and intangible capex, which we project at about Swiss franc (CHF) 230 million per year.
- Dividends of about CHF80 million, no significant acquisitions in 2014, and acquisitions costing about CHF40 million in 2015.

Based on these assumptions, we arrive at the following credit measures for Barry Callebaut:

- An adjusted five-year average debt-to-EBITDA ratio of about 3.7x (including two historical and three forecast years).
- Five-year average EBITDA interest coverage of about 4.4x (including two historical and three forecast years).

Liquidity

We assess Barry Callebaut's liquidity as "adequate," under our criteria, and estimate the ratio of sources to uses at about 1.4x in 2014 and 2015.

The company's principal liquidity sources are:

- Annual positive funds from operations of at least CHF350 million;
- Cash and cash equivalents of about CHF86 million as of Feb. 28, 2014; and
- An undrawn revolving credit facility (RCF) of €600 million maturing in 2019, of which €60 million were drawn as of Feb. 28, 2014.

Principal liquidity uses comprise:
- Working capital outflows of about CHF150 million;
- Short-term debt of about CHF245 million;
- Annual capex of about CHF225 million in 2014;
- A dividend payment of about CHF80 million; and
- No acquisition spending in 2014.

We expect Barry Callebaut's headroom under its RCF covenant to exceed 15%.

Outlook

The stable outlook reflects our view that Barry Callebaut's key financial ratio--debt to EBITDA--will likely be about 3.8x in fiscal 2014. The range that we consider commensurate with the current financial risk profile is 3x-4x. According to our base-case scenario, this ratio will likely improve slightly over the next few years. However, we do not assume significant deleveraging due to the potential negative impact of working capital on cash generation and the need for new investments to support the increase in operating activity.

Downside scenario

We could take a negative rating action if Barry Callebaut's operating environment deteriorated significantly, due for example to unexpected adverse market conditions; or if the combined effect of negative working capital and large, unexpected investments or new acquisitions push debt up, with the leverage ratio exceeding 4x.

Upside scenario

We could consider a positive rating action if we were to see enhanced cash conversion, and if the debt-to-EBITDA ratio improved significantly and we expected it to remain steady at about 3x.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Satisfactory
- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Recovery Analysis

- The 'BB+' issue ratings on Barry Callebaut's €600 million RCF due 2019, €350 million notes due 2017, €250 million notes due 2021, and $400 million notes due 2023 are in line with the corporate credit rating. Each instrument is senior unsecured. The recovery rating is '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default.
- The guarantee package, as well as the group's satisfactory business risk profile and market strength, support the recovery rating. However, we consider the obligations structurally and contractually subordinated to the €275 million receivables securitization facility and various financing facilities made available to subsidiaries.
- Each of the senior unsecured obligations rank pari passu due to the similar guarantee package.
- We understand that the obligations' documentation include a negative pledge covenant restricting permitted security to 35% of total tangible net assets.
- In our hypothetical default scenario, we contemplate a default stemming from weaker operating performance, potentially because of a more competitive operating environment, resulting in lower revenues.
- We value Barry Callebaut as a going concern, given its market position, well-known customer base, and long-term contracts with established players in the chocolate industry.

Simulated default assumptions

- Year of default: 2019
- EBITDA at emergence: CHF260 million
- Implied enterprise value multiple: 6x
- Jurisdiction: Switzerland

Simplified waterfall

- Gross enterprise value at default: CHF1.56 billion
- Administrative costs: CHF140 million
- Net value available to creditors: CHF1.42 billion
- Priority liabilities: CHF820 million
- Senior unsecured claims: CHF2.2 billion*
- --Recovery expectation: 30% to 50%

*All debt amounts include six months of prepetition interest.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Agribusiness And Commodity Foods Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Barry Callebaut AG		
Barry Callebaut Services N.V.		
Corporate Credit Rating	BB+/Stable/--	BB+/Negative/--

Ratings Affirmed

Barry Callebaut Services N.V.		
Senior Unsecured*	BB+	
Recovery Rating	4	

*Guaranteed by Barry Callebaut AG.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com