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Research Update:

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

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Overview

- Swiss-based chocolate producer Barry Callebaut's operating performance has improved in terms of volume growth, cash flow generation, and profitability. All markets regions are contributing to the company's growth. In addition to these positive performances, the company also benefits from the reduction in cocoa raw material prices over the past 12-18 months.
- The company has recently closed two bolt-on acquisition transactions--D'Orsogna Dolciaria and Gertrude Hawk Ingredients--which should enable it to enlarge and consolidate its presence within the food manufacturers and gourmet and specialties markets.
- We are therefore revising our outlook on Barry Callebaut to positive from stable and affirming our 'BB+' long-term rating on the company.
- The positive outlook reflects our expectation that the company will continue to outperform the industry in volume growth terms, and will maintain an S&P Global Ratings-adjusted debt to EBITDA of 2.5x-3.0x. We anticipate that Barry Callebaut will maintain sound cash conversion, with positive discretionary cash flow after working capital changes, capital investment, and dividends.

Rating Action

On Dec. 22, 2017, S&P Global Ratings revised its outlook on Swiss chocolate producer Barry Callebaut AG to positive from stable. 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 is unchanged at '4', with a rounded estimate of recovery expectation of 40% in the event of default.

Rationale

The outlook revision reflects our expectation that Barry Callebaut's S&P Global Ratings-adjusted debt on EBITDA will remain 2.5x-3.0x, and that it will continue to post positive discretionary cash flow generation going forward. In our view, the company has demonstrated a good track record of converting cash flows thanks to its constant focus on working capital optimization.

During the financial year ending in August 2017, Barry Callebaut posted profitable volume growth of 4.4%, well above the flat growth reported for the chocolate industry as whole. The company also completed the voluntary phasing out of less-profitable contracts in the global cocoa division, and started to ramp up its recent strategic partnerships with GarudaFood (Indonesia) and to extend its agreement with Mondelez International (Belgium).

Its operating performance also benefits from external factors such as the lower cocoa bean price; this has helped it to maintain cash flow conversion and profitability level.

The group's business risk profile is supported by its leadership position in the global chocolate and cocoa market, where it has a market share of about 40% in the industrial chocolate market and a demonstrated ability to grow faster than the industry.

The company has long-term relationships with a diversified base of multinational and national branded food manufacturers that gives stability to its operating performance. Barry Callebaut also experiences very low volatility in terms of margins, thanks to its effective cost plus pricing mechanism, which helps it pass the changing cost of raw materials on to its customers.

That said, the lower profitability of the global cocoa segment, which comprises 23% of Barry Callebaut's total sales volume, weighs on its profitability. We assume the company will post a total EBITDA margin e of 9%-10% over 2018-2020.

The company is also exposed to volatile agribusiness raw material prices and this could materially affect its cash flow conversion.

Our assessment of Barry Callebaut's financial risk profile reflects our estimate that adjusted debt to EBITDA will remain about 2.5x-3.0x over the next two years. Under our base case, we forecast that the company will gradually reduce its leverage, mainly through a moderate strengthening in its EBITDA and recurring positive cash flow generation.

In our base case, we assume:

- Revenue growth of 2%-4% for FY2018 and FY2019, mainly derived from further penetration in emerging markets, contributions from the recent acquisitions, and product innovation.
- Modest and gradual improvements in profitability, with reported EBITDA margins of 9.5%-10.0% following the phasing out of less-profitable contracts and higher contributions from the specialties and gourmet markets.
- Annual capital expenditure (capex) of about Swiss franc (CHF) 240 million–CHF230 million, including expansion and maintenance during 2018 and 2019.
- Acquisition spending for recently closed acquisitions (D'Orsogna and Gertrude) and no further material acquisitions going forward.

Based on these assumptions, we arrive at the following credit measures:
- Adjusted debt to EBITDA of 2.5x-3.0x over the next two years.
- Adjusted discretionary cash flows to debt of 4%-6% over 2018-2019.

Liquidity

We assess Barry Callebaut's liquidity as adequate and estimate that the company's ratio of sources to uses will remain above 1.2x over the next 12 months due to the absence of a material near-term maturity. We also consider the group's ability to absorb a low-probability, high-impact negative events to be limited.

We estimate that Barry Callebaut's principal liquidity sources over the next 12 months will include:
- Cash and cash equivalents of about CHF400 million at closing of FY2017;
- Annual cash FFO generation of about CHF520 million–CHF530 million; and
- CHF875 million (€750 million) in a committed revolving credit facility (RCF) maturing beyond 12 months.

We estimate that the company's principal liquidity uses over the same period will include:
- Short-term debt of CHF400 million, including commercial paper;
- Cash absorbed by working capital change of about CHF100 million–CHF110 million;
- Annual capital investment of about CHF240 million, in line with company's guidance;
- Dividend distribution for FY2018 of CHF110 million–CHF115 million; and
- Cash out related to the closing of two recent acquisitions in the specialty business segment.

Outlook

The positive outlook reflects our expectation that the company will continue to outperform the industry in growth terms, and will maintain an S&P Global Ratings-adjusted debt to EBITDA of 2.5x-3.0x over the next 18-24 months. We anticipate that Barry Callebaut's profitability will improve further thanks to a higher contribution from the specialties and gourmet division and the phasing-out of less-profitable contracts in the global cocoa division.

Upside scenario

We could upgrade the company by one notch if Barry Callebaut continues to demonstrate a positive track record of cash conversion, for example, through structurally lower working capital requirements. An upgrade would also require commitment from the company to maintain a financial policy in line with an investment-grade rating.

Downside scenario

We could revise the outlook to stable if the company reports deterioration in its operating performance, due, for example, to shrinking volumes or strong competition on prices; or if the effect of negative working capital, large acquisitions, and significant shareholder distribution lead to structurally negative cash flow generation.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Positive/--

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)

Issue Ratings

Recovery Analysis

Key analytical factors
- The senior unsecured debt (comprising €750 million RCF, €250 million 5.625% notes due 2021, $400 million 5.5% notes due 2023, and the €450 million notes due 2024) is rated 'BB+', with a recovery rating of '4'. The recovery rating is supported by a good guarantor package (from the parent as well as subsidiary companies), but constrained by the unsecured nature of the debt.
- Our hypothetical default scenario envisages increased competition and a dip in the quality of cocoa produced owing to the politically unstable environment in Africa.
- We value Barry Callebaut as a going concern, given its prominent market position and long-term contracts with leading customers of the chocolate industry.

Simulated default assumptions
- Year of default: 2022
- Jurisdiction: Switzerland

Simplified waterfall

- EBITDA at emergence: CHF252 million
- Cyclicality adjustment is 10%, in line with standard assumption for the industry
- Operational adjustment is 0%, in line with standard assumption for the industry
- Minimum capex represents 2% of sales, the standard assumption for the industry
- Multiple: 5.5x to reflect the value of company's business to business brands, leading market position, and vertically integrated business model
- Net recovery value for waterfall after administrative expenses (5%): CHF1,315 million
- Priority debt claims: CHF405 million
- Estimated senior unsecured debt claims: CHF2,187 million*
- Recovery expectation: 30%-50% (rounded estimate: 40%)

*All debt amounts include six months' prepetition interest. RCF is assumed to be 85% drawn.

Related Criteria

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Corporates - Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry, Jan. 29, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Barry Callebaut AG		
Barry Callebaut Services N.V.		

Corporate Credit Rating	BB+/Positive/--	BB+/Stable/--
Ratings Affirmed		
Barry Callebaut Services N.V.		
Senior Unsecured	BB+	BB+
Recovery Rating	4(40%)	4(35%)

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.