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Summary:
Barry Callebaut AG

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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Summary:

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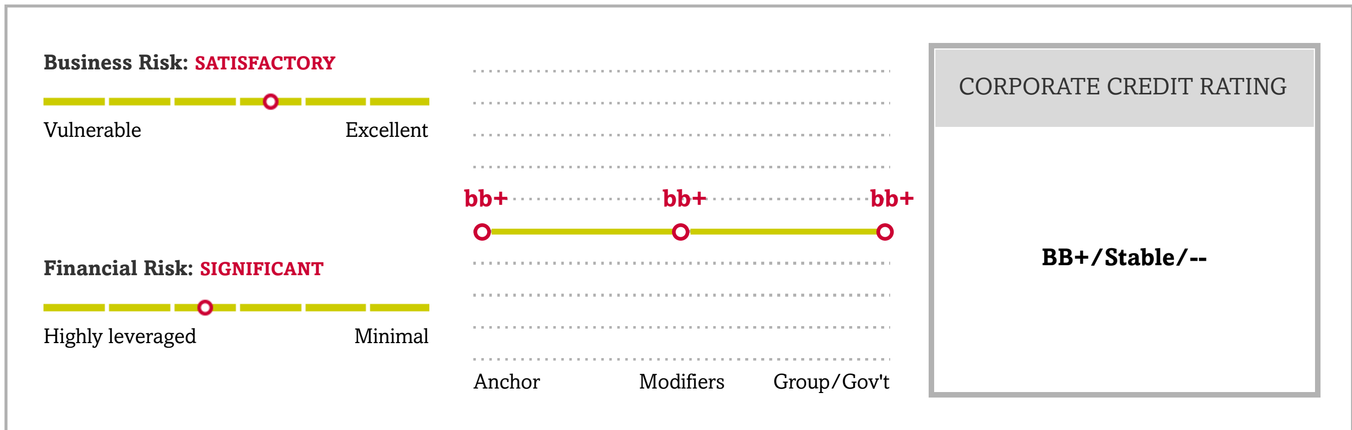

Rationale

Two anchor outcomes (,'bbb-', and ,'bb+'') are listed for the given combination of Barry Callebaut's business risk profile and financial risk profile assessments. Based on the "significant," financial risk profile, and the comparative strength of the group's cash flow/leverage (which we view as at the lower end of the significant category), the anchor is the lower of the two scores.

Business Risk: Satisfactory	Financial Risk: Significant
• Leading global chocolate and cocoa products supplier for the food industry. • Strong competitive position, benefitting from outsourcing trends in the food industry. • Good geographic diversification. • Very stable profitability margin. • The grinding division has lower profitability and higher working capital needs.	• Exposure to commodity price volatility, which causes significant swings in working capital needs. • Capital-intensive business model constrains free cash-flows generation. • Financial metrics at the low end of the "significant" category, with limited ability to reduce leverage as discretionary cash flows are not substantial.

Outlook: Stable

The stable outlook reflects our view that Barry Callebaut's key financial ratio--debt to EBITDA--will likely be about 4x in fiscal 2015. The range that we consider commensurate with the current financial risk profile is 3x-4x. According to our base-case scenario, this ratio will continue to be in the high end of the range. 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 on a permanent basis.

Upside scenario

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

Standard & Poor's Base-Case Scenario

Assumptions

- EU GDP growth of 1.6% in 2015 and 1.9% in 2016, U.S. GDP growth of 2.4% and 2.8% in the same years, and China GDP growth of 6.9% and 6.6%, respectively.
- Revenue growth of about 6.5% in 2015 and at least 3% in 2016. .
- A reported EBITDA margin of about 9% in 2015 and 2016, with a positive contribution coming from the gourmet division and a dilutive effect from the grinding business.
- Tangible and intangible capital expenditure (capex), which we project at about Swiss franc (CHF) 220 million per year.
- Dividends of about Swiss franc (CHF)85 million, about CHF20 million acquisitions in 2015, and no significant acquisitions in 2016.

Key Metrics

	2014	2015f	2016f
Revenues Growth	20.1%	6.5%	3%
Reported EBITDA Margin	9.1%	About 9%	About 9%
Adjusted Debt/EBITDA	4.1x	3.9x	3.8x

f--Forecast. e--Estimate.

Business Risk: Satisfactory

We view the group's business risk profile as "satisfactory," based on its comfortable leading open market position of 40% and its strong geographic diversification, further enhanced by its acquisition of Petra Foods in 2013.

Barry Callebaut is the world's leading manufacturer of high-quality cocoa and chocolate products, operating around 54 production facilities in Europe, Africa, North America, Latin America, and Asia-Pacific. Its business model shields the group against raw material price hikes thanks to indexation provisions on long-term contracts, which allow the group to pass the bulk of cocoa bean price hikes on to customers.

The company serves multinational and national branded consumer goods manufacturers, including major food manufacturers such as Nestlé, Unilever, Hershey, and Mondelez. The group's capacity to maintain long-term agreements with all these major players, combined with many new contracts, underpins Barry Callebaut's unparalleled position in the cocoa and chocolate markets. The group also offers a range of services in the fields of product development, processing, training, and marketing. As a business-to-business company, it serves 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 material price hikes to its customers thanks to the cost-plus contracts with customers.

These strengths are mitigated by Barry Callebaut's inability to convert new contracts and increased production capacities into cash flow generation. Ongoing capex and continuous increases in working capital have weighed on the group's earnings for the past five years, and reported EBITDA has not materially grown despite the increase in volumes, although this may also stem from the strengthening of the Swiss currency. After the Petra acquisition, Barry Callebaut has increased the cocoa grinding activities and while this has improved the diversity and reduced the dependence on external suppliers, it has also increased exposure to the volatility of the cocoa prices, with direct effects on the working capital needs.

Our business risk assessment also incorporates our view of the agribusiness industry risk as "intermediate" and Barry Callebaut's country risk as "low," reflecting the group's geographic focus on developed countries.

Financial Risk: Significant

Our view of Barry Callebaut's "significant" financial risk profile reflects the group's debt-to-EBITDA ratio, which peaked at 4.1x at the end of the last fiscal year. However, we expect the five-year weighted average target ratio to remain within the 3x to 4x range, which our criteria have set as the boundaries for a "significant" financial risk profile. We believe that it will stay in the upper end of the range, due to the negative effects on working capital of the cocoa price volatility.

The group's track record in discretionary cash- low generation has been poor so far because of significant capex and a substantial increase in working capital linked to the rising price of cocoa and the increased exposure to the grinding activity. Consequently, the leverage reduction we contemplate should be gradual and based on EBITDA increase rather than debt reduction.

Liquidity: Adequate

We view Barry Callebaut's liquidity as "adequate," with a ratio of sources to uses slightly above 1.2x for the next two years, as of Aug. 31, 2014. We base our liquidity assessment on the following sources:

Principal Liquidity Sources	Principal Liquidity Uses
• Annual positive FFO generation of about CHF420 million. • Cash and cash equivalents of about CHF85 million as of Aug. 31, 2014. • CHF640 million of committed undrawn revolving credit facility maturing in 2019.	• Working capital outflows of about CHF120 million. • Short-term debt of about CHF480 million including the outstanding commercial papers. • Annual capex of about CHF220 million in 2015. • A dividend payment of CHF85 million.

Covenant Analysis

The company has financial covenants on the revolving credit facilities. These are the interest coverage, the profitability ratio, and the net worth ratio. We believe that there is sufficient headroom under both of them.

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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bb+

Recovery Analysis

Key Analytical Factors

- The senior unsecured debt have issue rating of 'BB+' and recovery ratings of '4' reflecting the unsecured character of the debt facilities and significant prior ranking debt.
- Our hypothetical default scenario contemplates a default driven by weaker operating performance, which potentially stems from a more competitive operating environment, contamination or lower quality of cocoa produced.
- We value Barry Callebaut as a going concern, given its good market position, well-known customer base, and long-term contracts with established players in the chocolate industry.

Simulated Default Assumptions

- Year of default: 2020
- EBITDA at emergence: CHF243 million
- Implied enterprise value multiple: 6x
- Jurisdiction: Switzerland

Simplified Waterfall

- Gross enterprise value at default: CHF1.46 billion
- Administrative costs: CHF131 million
- Net value available to creditors: CHF1.33 billion
- Priority liabilities: CHF411 million
- Senior unsecured claims: CHF2.3 billion *

-Recovery expectation: 30% to 50% (higher half of the range)*All debt amounts include six months of prepetition interest.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Agribusiness And Commodity Foods Industry - January 29, 2015
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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

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