S&P Global
Ratings

RatingsDirect®

Research Update:

Barry Callebaut AG Upgraded To 'BBB-' On Sustained Stronger Metrics; Debt Rating Raised To 'BBB-'; Outlook Stable

Primary Credit Analyst:
Rocco A Semerano, London +44 20 7176 3650; rocco.semerano@spglobal.com

Secondary Contact:
Barbara Castellano, Milan (39) 02-72111-253; barbara.castellano@spglobal.com

Table Of Contents

Research Update:

Barry Callebaut AG Upgraded To 'BBB-' On Sustained Stronger Metrics; Debt Rating Raised To 'BBB-'; Outlook Stable

Overview

- Switzerland-based chocolate manufacturer Barry Callebaut has improved its credit metrics. Its weighted-average S&P Global Ratings-adjusted debt to EBITDA remains close 2x and it is generating positive free annual cash flow for debt repayment.
- Our analysis assesses the company's improved operating performance in terms of profitability and cash flow generation. The growth is the result of Barry Callebaut's ongoing momentum in emerging markets (generating about 35% of sales in 2018) and above-industry-average volume growth in mature markets such as Europe and the U.S.
- We are raising our long-term issuer credit rating on Barry Callebaut AG to 'BBB-' from 'BB+'. At the same time, we are raising the issue-level ratings on its senior unsecured facilities to 'BBB-' from 'BB+'.
- The stable outlook reflects our expectations that Barry Callebaut's operating performance will remain resilient over the next 18-24 months, with an adjusted EBITDA margin close to 10.5%-11.5% and positive free operating cash flow (FOCF) generation.

Rating Action

On Nov. 14, 2018, S&P Global Ratings raised its long-term issuer credit rating on Switzerland-based chocolate manufacturer Barry Callebaut AG to 'BBB-' from 'BB+'. The outlook is stable.

At the same time, we raised our issue-level ratings on group's senior unsecured debt to 'BBB-' from 'BB+' (comprising a €750 million revolving credit facility [RCF] due 2023, €250 million 5.375% notes due 2021, $400 million 5.5% notes due 2023, and the €450 million notes 2.375% due 2024).

Rationale

The upgrade reflects Barry Callebaut's stronger financial credit metrics and our view that the improvement is sustainable. Over 2019-2020, we expect the company will maintain S&P Global Ratings-adjusted debt to EBITDA close to 2x, and positive annual free operating cash flow (FOCF) above Swiss franc (CHF) 200 million.

The company recently announced its results for the 2018 financial year (ending Aug. 31), reporting a solid performance in all divisions and regions. The company's volume reached two million tons, with a volume growth rate (6.3% year-on-year) significantly above the global confectionary market as a whole (1.8% year-on-year according to Nielsen data). All of the company's key growth drivers contributed, including emerging markets (providing 35% of total volumes) and gourmet and specialties (12% of total volumes). Barry Callebaut also benefited from the successful integration of two recently acquired entities and its long-term outsourcing partnerships with global food manufacturers (accounting for about 34% of volumes).

At the same time, the company reported further improvements of about 100 basis points (bps) in its reported EBITDA margin while posting FOCF of about CHF300 million (excluding proceeds from disposals). The margin has been mainly supported by a better product mix (with growth in the profitable gourmet and specialties division), coupled with ongoing rationalization of general corporate costs.

We note that despite the very high volatility in the price of cocoa beans, the average price during financial year 2018 was about 7% lower than the previous year, which contributed to FOCF generation due to lower inventory cash absorptions.

Barry Callebaut's strategy is to continue growing in emerging markets (where chocolate per capita consumption is still very low when compared with Europe), to innovate with the gradual introduction of new products and varieties (such as ice cream, vegan offerings, low-sugar products, and others), and to increase manufacturing capacity to secure long-term underlying growth.

The company has recently announced the acquisition of a leading Russia-based business-to-business chocolate manufacturer Inforum to expand in the large chocolate confectionary market in Russia. In September 2018, Barry Callebaut also announced a long-term supply agreement with Burton's Biscuit Company (the U.K.'s second-largest biscuit manufacturer). The latter agreement includes the acquisition of Burton's chocolate manufacturing assets in Moreton, England.

In our view, the company's business risk profile is supported by its leadership in the global chocolate and cocoa market, with an estimate market share of more than 40% in the industrial chocolate market, and a demonstrated ability to grow faster than the industry overall.

The company has long-term relationships with a diversified base of multinational and national branded food manufacturers that give 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.

We also account for the company's relatively large operations, with a consolidated revenue base close to CHF7.0 billion and balanced revenue diversification by geography, with EMEA accounting for 46% of volume sales in 2018, the Americas 27%, and Asia-Pacific 5% (excluding the global cocoa division).

Our business assessment is constrained by the lower profitability of the global cocoa segment (production of semi-finished products), which still weighs on Barry Callebaut's profitability despite a reduction in its contribution to 22% of total sales volume from 28% in 2015. We assume the company will post an adjusted EBITDA margin of 10.5%-11.5% over 2019-2020.

The company is also exposed to volatile agribusiness raw material prices (such as cocoa bean prices) and this could materially affect its cash flow conversion.

Our assessment of the group's financial risk profile reflects our estimate of S&P Global Ratings-adjusted debt to EBITDA close to 2x over the next 18-24 months, and adjusted funds from operations (FFO) to debt above 30%. We expect the company to post positive FOCF, albeit less than in the past two years. The lower FOCF is mainly because of higher annual capital expenditure (capex) associated with IT investments, product innovation, and increased production capacity.

For the fiscal year 2018, management's proposed dividend of CHF24 per share (20% versus previous year) represents a payout ratio of 37% on net income. In our base case, we expect the company to maintain a stable payout ratio of around 35% over the next three years.

Our base case assumes:

- Annual revenue growth of 3%-4% during the next couple of years, supported by ongoing momentum in emerging markets, the integration of recently acquired entities, and positive underlying growth for the entire global chocolate confectionary market.
- Relatively stable adjusted EBITDA margin of 10.5%-11.5% (due to the general cost plus pricing mechanism of the company) supported by a better mix, innovation, and general cost reduction.
- Annual capex of about CHF280 million for fiscal year 2019 and a more normalized level of CHF250 million going forward mainly associated with investment in more production capacity.
- Dividend payout ratio of about 35% of net profits.
- No sizable acquisitions.

Based on these assumptions, we arrive at the following credit measures during the next two years:

- Adjusted debt to EBITDA close to 2.0x; and
- Adjusted FFO to debt above 30%.

Liquidity

We continue to assess Barry Callebaut's liquidity as adequate. This is based on our view that the ratios of sources to uses will be higher than 1.2x over the next 12 months. Additionally, the company demonstrates good access to financial markets. We also consider the group's ability to absorb a low-probability, high-impact negative event as limited. Finally, we note the company has substantial readily marketable inventory on its balance sheet (such as cocoa beans, and others) that could provide some additional financing flexibility if needed.

We estimate that Barry Callebaut's principal liquidity sources over the next 12 months will include:

- About CHF406 million cash on the balance sheet as of Aug. 31, 2018;
- Annual cash FFO of about CHF550 million (before working capital movements); and
- An undrawn RCF of €750 million maturing in 2023.

We estimate that Barry Callebaut's principal liquidity uses over the same period will include:

- Short-term debt of CHF285 million, including commercial paper;
- Annual capital investment of about CHF280 million;
- Cash absorbed by working capital changes of about CHF80 million;
- Dividend distribution of about CHF130 million; and
- Cash out related to the closing of two recent announced acquisition transactions in Russia and the U.K.

Outlook

The stable outlook on Barry Callebaut reflects our expectation that the company's operational performance should remain resilient over the next 18-24 months. We expect adjusted debt to EBITDA to remain close to 2.0x, and adjusted FFO to debt above 30%. We project the company will generate positive annual FOCF above CHF200 million during the next two years, with some tolerance for short-term working capital effects caused by cocoa prices temporarily driving up inventories.

Downside scenario

We could take a negative rating action if the group leverages its capital structure, with adjusted debt to EBITDA rising above 3.0x. This could stem from a large debt-funded acquisition, for example, or from a significant worsening of the operating environment due to increased raw material prices, shrinking volumes, or higher price competition.

Upside scenario

Although an upgrade appears remote at this stage, we could raise the issuer credit rating if Barry Callebaut demonstrates a track record of strong organic profitable growth with growing recurring annual cash flow generation, improves the diversity of its earnings by division and by region, and increases its EBITDA margin by about 200 bps on a sustainable basis. We would also consider raising the rating if the company's adjusted debt to EBITDA fell below 1.5x, accompanied by rising FOCF generation.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers

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

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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

Upgraded; Outlook Action

	To	From
Barry Callebaut AG		
Issuer Credit Rating	BBB-/Stable/--	BB+/Positive/--
Barry Callebaut Services N.V.		
Issuer Credit Rating	BBB-/Stable/--	BB+/Positive/--
Senior Unsecured	BBB-	BB+

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

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 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.