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Barry Callebaut AG

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Barry Callebaut AG

Major Rating Factors

Corporate Credit Rating
BB+/Stable/--

Strengths:

- Position as leading global chocolate products supplier to the food industry
- Benefits of the favorable outsourcing trend in the food industry

Weaknesses:

- Exposure to commodity price and foreign exchange risks
- Political event risk in cocoa sourcing countries

Rationale

The ratings on Switzerland-based Barry Callebaut AG reflect its aggressive financial profile, offset to some extent by its enhanced position as the world's largest and sole independent global supplier of cocoa and chocolate products to the food industry.

Barry Callebaut's financial profile is currently in line with Standard & Poor's Ratings Services' expectations for the ratings. In fiscal 2008 ended Aug. 31, 2008, the company's adjusted funds from operations (FFO) to debt and adjusted EBITDA fixed-charge coverage were 21% and 4.0x, respectively, against our guidance of 18% and 4.0x. We expect debt protection measures to remain resilient over the next year. Because the company passed the peak of its capacity extension program in fiscal 2008, capital expenditure should decrease and help to improve free operating cash flow, which was negative in fiscal 2008.

Through Barry Callebaut's food manufacturers division, which accounts for more than one-half of total sales, the company is the world's largest manufacturer of industrial chocolate, with market shares of about 40% in Europe and roughly 25% in North America. Barry Callebaut remains poised to take advantage of the trend toward outsourcing in the food industry, as illustrated by its recent expansion of production capacity. Consequently, the company's top-line growth in 2009 should continue to exceed historic market growth of 2%-3%. In addition, the company's proven capacity to pass on input price volatility to its customers should mitigate pressure on margins. Although the consumer products and gourmet divisions are somewhat exposed to cocoa price volatility, they are able to adjust their selling prices about every six months. Besides, the company limits its overall exposure to cocoa price volatility through systematic hedging of commodity price risk.

Liquidity

Barry Callebaut's liquidity position is adequate for the ratings. The company benefits from a €850 million revolving credit facility maturing in 2012 and 2013. The facility includes financial covenants, with leverage, interest cover, and solvency ratios tested semiannually. As of Aug. 31, 2008, the company had Swiss franc (CHF) 35 million of cash and cash equivalents and more than CHF1 billion headroom under its revolving credit facility, against CHF457 million of short-term debt maturities. The company also raises cash through a trade receivables securitization program under which CHF363 million was outstanding at end-August 2008. In addition to revolving credit lines, Barry Callebaut's liquidity profile benefits from its general ability to raise financing against the company's significant cocoa bean inventory. Despite its negative free operating cash flow of about CHF62 million after fiscal

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year-end 2008--resulting from large capital expenditures and temporarily high working capital needs--the company has the necessary financial flexibility to meet upcoming funding requirements and should maintain adequate headroom under the bank loan's financial covenants.

Recovery analysis

We rate Barry Callebaut's €350 million senior unsecured notes and €850 million senior unsecured bank loan at 'BB+', in line with the corporate credit rating on the parent company. These bonds have a recovery rating of '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default. For our complete recovery analysis, see "Recovery Report: Barry Callebaut AG's Recovery Rating Profile," published on March 19, 2008, on RatingsDirect.

Outlook

The stable outlook reflects our expectation that Barry Callebaut's strong competitive position in its businesses with food manufacturers and retailers will continue to support its satisfactory business risk profile. We would consider a positive rating action if the company shows sustained improvement in its financial profile, to an adjusted FFO-to-debt ratio of about 25% and EBITDA fixed-charge cover of about 5.0x. Conversely, the ratings and outlook could come under pressure if the company does not maintain a financial profile commensurate with the ratings.

Business Description

Barry Callebaut is a vertically integrated and geographically diversified chocolate company (see charts 1 and 2), with operations including the sourcing of cocoa beans and the supply of cocoa-derived products to the food industry. More specifically:

- The cocoa division sources raw materials and supplies the company's other divisions with semifinished products of cocoa liquor and cocoa butter. Some business is with third parties.
- The food manufacturers division supplies industrial chocolate and ready-to-use fillings to food manufacturers.
- The consumer products division sells consumer chocolate to retailers under the group's own brands and private labels. The German market, where the general retailing environment is difficult, makes up about 70% of European sales.
- The gourmet and specialties division supplies premium and specialty products to artisanal users (chocolatiers, pastry chefs, bakeries, restaurants) and vending mixes (chocolate blends used in vending machines).

The company collectively refers to the food manufacturers and cocoa divisions as the industrial business segment, while grouping the consumer and gourmet divisions under the retail and food services business.

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Chart 1

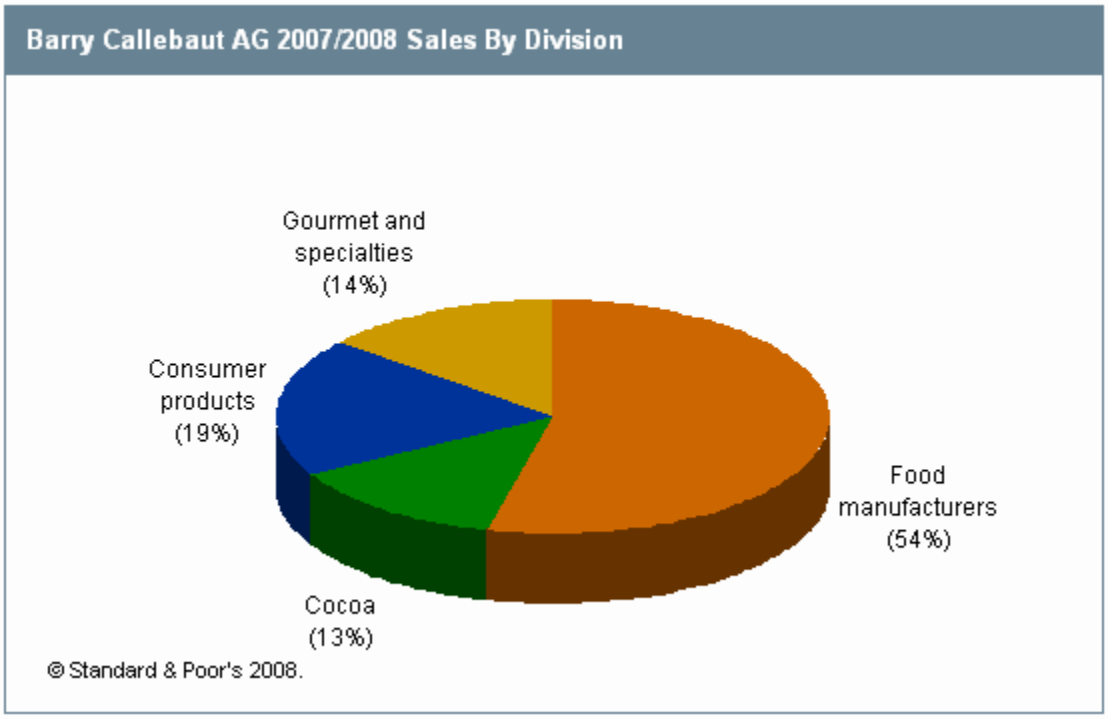
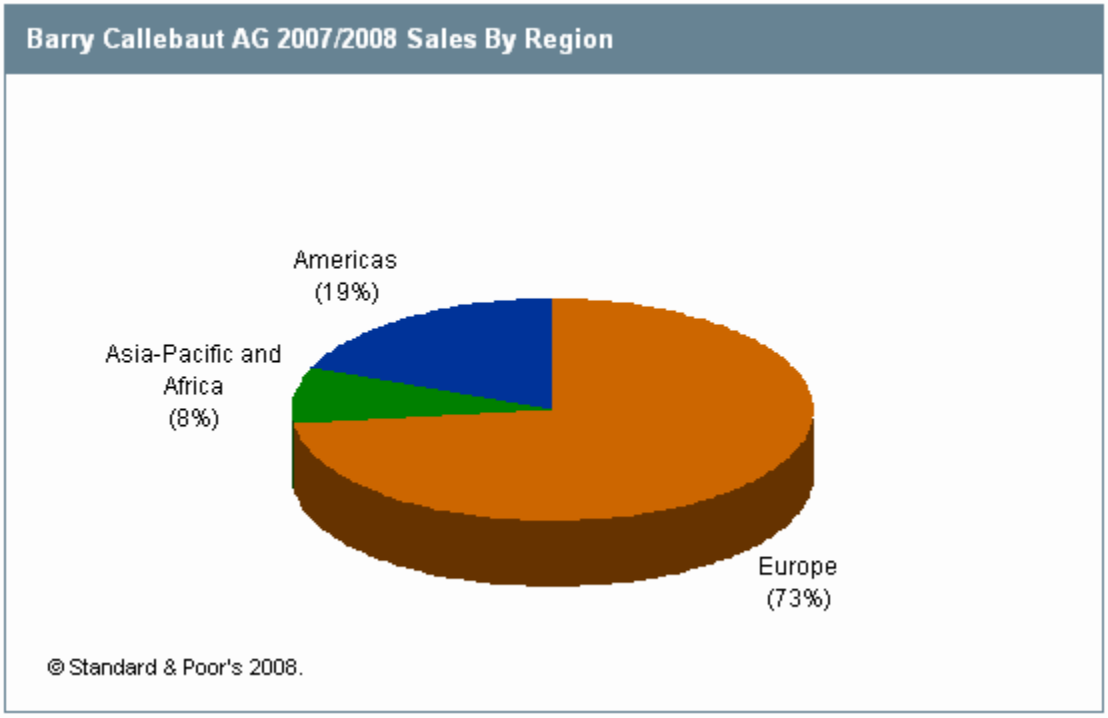


Chart 2



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Business Risk Profile: Satisfactory, And Outpacing Market Growth

Barry Callebaut's satisfactory business risk profile reflects the company's market position as the world's leading vertically integrated chocolate producer. The company stands to enhance its market position over time, as it profits from current outsourcing trends in the industry.

Volatile supply, mature demand in the industry

With a small number of West African countries (mainly Ivory Coast, Ghana, Nigeria, and Cameroon) producing 70% of global cocoa, the cocoa price is highly exposed to political event risk and/or harvest conditions in these countries, which have replaced Latin America as the world's main cocoa producers since the 1980s. A further 15% of global cocoa production comes from Asia (primarily Indonesia), and the remainder from Latin America. The bulk of demand still comes from developed and developing markets, where retail volume growth is about 2%-3% per year generally, with mid-single-digit growth in Eastern Europe and Asia Pacific and about 1%-2% growth in more mature markets in Western Europe and the U.S. in recent years.

Consequently, to be successful, industry players have to protect themselves from shortfalls in raw material supply or volatility while maximizing operating efficiency to support profitability in primarily mature consumer markets. Geographic expansion into developing countries and health- or convenience-related innovations are further ways to increase growth potential.

Presence along the entire value chain bolsters competitive position

Cocoa sourcing well diversified.

As the processor of about 15% of the world's cocoa bean production, Barry Callebaut has strong purchasing power. The group's sourcing--about 70% from West Africa, roughly 15% from Asia, and the remainder from Latin America--closely matches worldwide cocoa bean production. This good geographic diversity limits reliance on any given producer, particularly those in politically unstable countries and with exposure to crop-quality changes. In addition, diversified sourcing enables the company to offer a broad range of tastes that appeal to different consumers.

Although cocoa bean prices are very volatile, driven by instability in producing countries and poor harvests, price fluctuations have only a limited impact on Barry Callebaut's profits. This is because some contracts set both cocoa prices and volumes at the same time, so subsequent price movements have no effect. However, price fluctuations do affect the company's working capital requirements. A price movement of £100 per ton (prices are quoted in British pounds) has an impact of about CHF50 million on the company's working capital.

Cocoa requirements hedged.

Although exposure to cocoa bean price movements is limited for the industrial divisions, the mismatch in retail between when customers commit to orders and when Barry Callebaut sets the price--about every six to 12 months--exposes the group to some commodity price risk. The company consequently hedges all its cocoa bean requirements for six to 12 months ahead. Although the cocoa futures market enables the company to do this, the sector's concentration, in particular the elimination of intermediaries, has substantially reduced volumes traded, making it harder for companies like Barry Callebaut to find counterparties matching the volumes and maturities needed for their hedging requirements. The upturn in the group's working capital needs in the first half of fiscal 2008, due to required prepayments of cocoa deliveries, illustrated the difficult cocoa market environment during the period.

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Apart from the risk exposure resulting from cocoa price volatility, the company is also exposed to price volatility of other commodities necessary in the cocoa production process, such as hazelnuts and milk. However, Barry Callebaut's substantial risk management experience is set to continue to offset the company's above-average exposure to foreign exchange and commodity price risks.

Vertically integrated business model underpinned by grinding operations.
Cocoa grinding is a concentrated market, with three independent producers-- Cargill Inc. (A/Stable/A-1), Archer Daniels Midland Co. (A/Stable/A-1), and Barry Callebaut--accounting for more than 40% of total cocoa volume ground. Barry Callebaut's grinding division is the most integrated, with 75% of volumes supplying the needs of the company's other business units. Barry Callebaut sells excess output of semifinished products on the commodity market or to other food manufacturers. Implied processing margins fluctuate widely according to market prices, supply and demand, and capacity utilization in the cocoa-pressing sector.

Leading market position in chocolate production.
About 55% of worldwide industrial chocolate production is captive, in other words integrated within large food manufacturers who process their own beans to use in their consumer products. The remaining 45% constitutes the "open" or "free" market. Barry Callebaut's 40% share of the open market makes the company the world's largest producer, with about 18% of global output.

Industry cooperation enhances customer base.
Barry Callebaut has a wide client base reflecting its "preferred supplier" position in the industry. The 10 largest customers account for about 30% of sales, and no single customer accounts for more than 8%. Most clients are very large food manufacturers or retailers, which have strong bargaining power but present little credit or payment risk. Since 2007, Barry Callebaut has been further capitalizing on its position to secure outsourcing contracts with the big food manufacturers, while reducing sales of semifinished products. Many food manufacturers are focusing more on value-generating domains such as branding and limiting capital-intensive activities such as cocoa processing, which supports the trend toward outsourcing. Increased penetration of customer-label products also supports the trend. Only a large independent manufacturer like Barry Callebaut has the ability to smooth demand variations by combining the orders of many customers. The arrangements with Nestlé S.A. (AA/Stable/A-1+), The Hershey Co. (A/Negative/A-1), and Cadbury PLC (BBB/Stable/A-2) entered into in 2007 reflect Barry Callebaut's unparalleled market position in this field. These contracts accounted for about 75,000 tons of volume growth in fiscal 2008, representing more than 6% of total volume sales.

Profitability: Outsourcing trend boosts volume growth, but may squeeze margins

Barry Callebaut's profitability essentially hinges on raw material price trends, which account for about 70% of its cost structure, and the capacity utilization of its 40 processing plants. Barry Callebaut's EBITDA margin was about 9.8% for the 12 months to Aug. 31, 2008, compared with 10.7% at the end of fiscal 2007. This reflects the impact of new production capacity, which the company has installed in line with its new outsourcing contracts. This spells slight margin contraction at the inception of the new capacities' operations but gradually should bring improving profitability over the next few years as capacity utilization increases.

In addition, high commodity prices may temporarily dilute profitability because raw material price increases can only be passed on to consumers with a time delay of at least six months. However, over fiscal 2008, the company successfully passed on the entire impact of raw material price increases to its customers, underlining the robustness of Barry Callebaut's business model.

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On balance, although current market conditions compromise prospects for wider margins, the downside risk for Barry Callebaut's operating performance is nevertheless limited. The positive impact of price increases and ongoing cost efficiency measures should sustain current margin levels in the future. In addition, Barry Callebaut's long-term supply contracts with branded food manufacturers strongly improve the company's transparency on future volume growth. Given that each manufacturer has its own recipes, the costs for manufacturers to switch from one outsourcer to another are high. The enhanced market position stemming from these contracts further curbs the downside for Barry Callebaut's profitability.

Financial Risk Profile: Aggressive, With Flexibility To Fund Working Capital And Investments

Barry Callebaut's aggressive financial risk profile reflects the company's track record of debt-funded expansion, as shown by its current leverage. A mitigating factor is the company's enhanced financial flexibility following its refinancing moves undertaken in summer 2007.

Accounting: Reporting under IFRS

Barry Callebaut presents its accounts according to International Financial Reporting Standards. Standard & Poor's adjusts the reported numbers for securitized trade receivables, post-tax pension liabilities, operating lease commitments and share-based compensation expense (see table 1).

Table 1

Reconciliation Of Barry Callebaut AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. CHF)*

	--Fiscal year ended Aug. 31, 2008--								
Barry Callebaut AG reported amounts									
	Debt	**Shareholders' equity**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**	**Capital expenditures**
Reported	1,079.3	1,175.9	445.6	445.6	341.1	97.3	164.9	164.9	226.6
Standard & Poor's adjustments									
Trade receivables sold or securitized	363.0	--	--	--	--	10.9	--	--	--
Operating leases	69.3	--	13.8	4.5	4.5	4.5	9.2	9.2	17.8
Postretirement benefit obligations	132.4	0.5	3.1	3.1	3.1	4.7	5.4	5.4	--
Surplus cash and near cash investments	(36.1)	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	16.9	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	4.3	--	--	--	--

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Table 1

Reconciliation Of Barry Callebaut AG Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. CHF)* (cont.)									
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	3.1	3.1	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	151.8	--
Minority interests	--	0.4	--	--	--	--	--	--	--
Total adjustments	528.6	0.9	16.9	24.5	12.0	20.1	17.7	169.5	17.8

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	1,607.9	1,176.8	462.4	470.1	353.1	117.4	182.6	334.4	244.3

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts. CHF--Swiss franc. D&A--Depreciation and amortization.

Barry Callebaut has an acquisitive track record, but its recent increase in capital expenditure is focused on higher production capacity. The company is the product of a 1996 merger between Barry S.A., a French cocoa bean processor, and Callebaut AG, a Belgian industrial chocolate manufacturer. Standard & Poor's expects potential future add-on acquisitions, if any, to be funded from the company's discretionary free cash flow or divestment proceeds, and debt measures consequently to remain broadly unchanged.

The company's stock has been listed since 1998 but members of the Jacobs family have retained a controlling 59% stake. There is only limited information available on the financial conditions of the controlling shareholders, who also hold a 29% interest in Switzerland-based staffing industry player Adecco S.A. (BBB/Stable/A-2). However, our ratings include the expectation that the financial obligations of Barry Callebaut's controlling shareholders will not have a material adverse effect on the company's dividend policy or its financials.

Cash flow adequacy: Declining capital expenditure to turn free cash flow positive

Barry Callebaut's debt protection measures are currently in line with our expectations for the ratings. In the 12 months to Aug. 31, 2008, adjusted FFO to debt was about 21%, versus our guidance of 18%. On the other hand, the impact of increased working capital needs, resulting from seasonality effects and higher raw material prices, together with the expected increase in capital expenditure, contributed to turning Barry Callebaut's free operating cash flow negative.

Working capital requirements, particularly for inventories, are a material part of Barry Callebaut's indebtedness. Variations, particularly those linked to cocoa price swings and seasonality, can cause significant temporary changes to indebtedness. The working capital hikes are temporary and tend to normalize as soon as sales price increases feed through. Standard & Poor's does not adjust debt for inventories because the company is fundamentally a cocoa bean processor, not a trader, and therefore needs inventories to operate. We recognize that the inventories give the company some flexibility because financing could be raised against them.

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Barry Callebaut's capital expenditure needs should decline in the current fiscal year, in line with the end of the company's capacity extension cycle. Nevertheless, the group's investment program will continue to weigh on Barry Callebaut's ability to generate free cash flow during 2009. As we do not expect the group's dividend policy to change, and in the absence of further asset disposals, the company's capacity to pay back debt will remain marginal during the current fiscal year. Beyond, we expect the group's free cash generation to improve as volume driven sales growth should contribute to higher cash inflows while capital expenditure needs should decline further.

Capital structure/Asset protection: Enhanced financial flexibility through 2007 refinancing

Barry Callebaut's debt leverage remained broadly stable in the range of 3.0x-3.5x in fiscal 2008, as EBITDA growth on the back of sales volumes balanced the small increase in financial indebtedness. We do not expect this stable trend to change materially for the current fiscal year, unless unforeseen working-capital-related increases in short-term financing have a negative effect on group debt.

Barry Callebaut anticipated the financing needs for its current capital expenditure program and refinanced its debt in summer 2007, resulting in extended maturities and improved financial flexibility. The company's €350 million, 10-year senior unsecured notes maturing in 2017 and the €850 million unsecured syndicated credit facility, maturing in 2013, are rated 'BB+', the same as the corporate credit rating, reflecting the low level of priority obligations. Both financings are guaranteed by the parent and by operating subsidiaries that comprise at least 65% of Barry Callebaut's tangible assets and 70% of EBITDA.

Table 2

Barry Callebaut AG Peer Comparison*

(Mil. €)	Barry Callebaut AG	Suedzucker AG	Tate & Lyle PLC	PPR S.A.	Cadbury PLC
Rating as of Dec. 15, 2008	BB+/Stable/--	BBB/Negative/A-3	BBB/Negative/A-3	BBB-/Stable/A-3	BBB/Stable/A-2
Fiscal year ended	Aug. 31, 2008	Feb. 29, 2008	March 31, 2008	Dec. 31, 2007	Dec. 31, 2007
Revenues	2,977.0	5,779.6	4,296.1	19,761.0	10,854.1
EBITDA	290.6	448.5	434.5	2,300.0	1,445.9
Net income from continuing operations	128.7	19.5	121.7	1,058.0	551.5
Funds from operations (FFO)	206.7	487.3	156.9	1,786.2	1,248.9
Capital expenditures	151.6	517.1	340.1	1,509.7	604.4
Free operating cash flow	(38.8)	(722.0)	(225.9)	506.5	611.8
Debt	994.0	2,318.3	1,647.4	8,934.8	4,818.8
Equity	727.5	2,950.3	1,192.0	10,661.4	5,758.6
Adjusted ratios					
EBITDA/revenues (%)	9.8	7.8	10.1	11.6	13.3
Operating income (before D&A)/revenues (%)	9.6	8.1	10.5	13.4	14.0
EBIT interest coverage (x)	3.0	1.3	2.7	3.8	3.8
EBITDA interest coverage (x)	4.0	2.9	3.7	4.8	5.0
Return on capital (%)	12.9	4.0	11.0	9.4	9.4
FFO/debt (%)	20.8	21.0	9.4	20.0	25.9
Free operating cash flow/debt (%)	(3.8)	(31.1)	(15.9)	5.7	11.9
Debt/EBITDA (x)	3.4	5.2	3.8	3.9	3.3
Total debt/debt plus equity (%)	57.7	44.0	58.0	45.6	45.6

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. D&A--Depreciation and amortization.

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Table 3

Barry Callebaut AG Financial Summary*

	--Fiscal year ended Aug. 31--				
(Mil. CHF)	**2008**	**2007**	**2006**	**2005**	**2004**
Revenues	4,815.4	4,106.8	4,261.9	4,061.1	4,048.9
EBITDA	470.1	455.7	411.0	309.1	363.6
Net income from continuing operations	208.2	207.0	183.0	68.3	115.6
Funds from operations (FFO)	334.4	286.6	222.6	220.8	241.1
Capital expenditures	244.3	175.1	91.8	121.6	90.7
Free operating cash flow	(61.7)	73.1	133.9	90.2	170.9
Debt	1,607.9	1,505.2	1,415.6	1,363.8	1,253.9
Equity	1,176.8	1,066.4	994.1	827.0	803.6
Adjusted ratios					
EBITDA/revenues (%)	9.8	11.1	9.6	7.6	9.0
Operating income (before D&A)/revenues (%)	9.6	11.1	9.6	7.7	9.1
EBIT interest coverage (x)	3.0	3.3	2.8	1.5	2.2
EBITDA interest coverage (x)	4.0	4.5	3.9	2.9	3.5
Return on capital (%)	12.9	13.2	12.5	7.1	11.0
FFO/debt (%)	20.8	19.0	15.7	16.2	19.2
Free operating cash flow/debt (%)	(3.8)	4.9	9.5	6.6	13.6
Debt/EBITDA (x)	3.4	3.3	3.4	4.4	3.4
Debt/debt and equity (%)	57.7	58.5	58.7	62.3	60.9

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. CHF--Swiss franc. D&A--Depreciation and amortization.

Ratings Detail (As Of December 15, 2008)*

Barry Callebaut AG	
Corporate Credit Rating	BB+/Stable/--
Senior Unsecured (2 Issues)	BB+
Corporate Credit Ratings History	
28-Feb-2003	BB+/Stable/--
Business Risk Profile	Satisfactory
Financial Risk Profile	Aggressive
Debt Maturities	
Aug. 31, 2009: CHF457 million	
Aug. 31, 2010: CHF3 million	
Aug. 31, 2011: CHF3 million	
Aug. 31, 2012: CHF3 million	
Aug. 31, 2013: CHF54 million	
Thereafter: CHF558 million	
Related Entities	
Barry Callebaut Services N.V.	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured (1 Issue)	BB+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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