

**Credit Opinion: Barry Callebaut AG**

Global Credit Research - 25 Jun 2012

Switzerland

**Ratings**

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa3
<b>Barry Callebaut Services N.V.</b>	
Outlook	Stable
Senior Unsecured -Dom Curr	Baa3

**Contacts**

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**Key Indicators**

Barry Callebaut AG[1]	2/29/2012(L)	8/31/2011	8/31/2010	8/31/2009	8/31/2008
CFO/Net Debt	12.2%	15.9%	14.7%	23.3%	10.5%
Debt/EBITDA	2.9x	2.4x	3.0x	3.3x	3.8x
RCF/Net Debt	16.3%	20.2%	21.6%	16.0%	15.3%
EBITA/Interest Expense	5.6x	5.8x	5.1x	3.3x	3.1x
(RCF - CAPEX)/Debt	2.2%	4.9%	9.9%	6.9%	-0.1%

[1] All ratios are calculated using Moody's Standard Adjustments. Source: Moody's Financial Metrics"

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

**Opinion**

**Rating Drivers**

Emerging markets presence and outsourcing trends support volume growth targets

Cocoa supply disruption risks inherent to the industry

Hedging strategy and cost-control initiatives underpin margin predictability

Recent infrastructure investments have weakened credit metrics and indicate a high appetite for expansion

**Corporate Profile**

Headquartered in Zurich, Switzerland, Barry Callebaut AG is the world's leading supplier of premium cocoa and chocolate products, servicing customers across the global food industry. Barry Callebaut is fully integrated, from the sourcing of raw material through the production of semi-finished products to the production of processed industrial chocolate products. The company is divided into three strategic business units: Cocoa Products (sourcing cocoa and processing semi-finished products), Food Manufacturers (production of industrial chocolate products for packaged food manufacturers) and Gourmet & Specialties (supplying restaurants, bakeries and hotels).

Barry Callebaut reported annual sales of CHF4.6 billion (around EUR3.8 billion) for FY2010/2011. The company is present in 27 countries, operates 40 production facilities and employs around 6,000 people.

### **Rating Rationale**

Barry Callebaut's Baa3 issuer rating continues to reflect the company's established presence in all major global markets, and its focus on diversifying the current Europe-based revenues towards new markets such as Brazil, Mexico, Russia, China and India, which typically display higher growth prospects. The company's rating also reflects the resilience of its hedging policy to volatile cocoa bean prices. Barry Callebaut's cost-plus business model, which covers around 80% of its sales volumes, has proved successful in recent years and enabled it to sustain relatively stable operating margins levels, despite volatile cocoa bean prices.

However, the rating remains constrained by the company's reliance on politically unstable countries such as Côte d'Ivoire for the supply of cocoa beans. Whilst we recognise that the political situation in Côte d'Ivoire has stabilised since the turmoil last year, and that Barry Callebaut has begun diversifying to more stable political countries such as Malaysia and Indonesia, the company remains significantly exposed to politically unstable countries. This adds to existing supply disruption risks, although these are inherent to the industry. In addition, recent infrastructure investments and costs associated with outsourcing contracts have weakened metrics.

The EUR350 million and the EUR250 million senior unsecured notes issued by Barry Callebaut Services NV, a subsidiary of Barry Callebaut AG, are rated Baa3.

### **DETAILED RATING CONSIDERATIONS**

#### **EMERGING MARKETS PRESENCE AND OUTSOURCING TRENDS SUPPORT VOLUME GROWTH TARGETS**

Barry Callebaut continued its high mid-single digit volume growth in FY2010/2011 and first half FY2011/2012. This was driven by increasing demand for chocolate products in all territories (although mainly from emerging markets) and by new outsourcing agreements.

Although Europe remains Barry Callebaut's biggest source of revenues, accounting for more than half of total sales, the company is focusing on emerging markets, where it has built new capacity. We view these investments as opportunities for the company to geographically diversify its revenues and to support its growth strategy.

Branded packaged food manufacturers such as The Hershey Company (A2 stable) are increasingly outsourcing part of their production against a background of constraints on return on assets, working capital volatility and further focus on brand marketing. This outsourcing trend is also mirrored in Barry Callebaut's recent additional outsourcing agreements with Unilever (A1 stable), Grupo Bimbo (Baa2 stable), Kraft (Baa2 positive) and Chocolates Turin (unrated).

Given the continued attractive growth in chocolate consumption outside of mature markets, as well as the volume ramp-up from recent outsourcing contract wins, we anticipate that the company will be able to achieve its growth target of 6%-8% volume growth per annum, on average, for each of the four years during 2009/10-2012/13.

In addition, growth prospects appear more favourable after Barry Callebaut completed the sale of its European Consumer Products business in September 2011 to Belgian family owned Sweet Products/Baronie Group (unrated). The European Consumer Products division, which offered private label and branded chocolate products to food retailers and represented around 10% of the company's total sales volume, had been under pressure for the past couple of years owing to strong competition from value retailers, especially in Germany. The company received disposal proceeds of EUR132.2 million and this cash was used to reduce short-term borrowings (commercial paper) by EUR98.3 million. It also helped finance approximately EUR22 million of plant expansions and upgrades in Europe, also announced in September 2011, as well as recent acquisitions including 100% of La Morella Nuts S.A., a Spanish company which manufactures nut-based ingredients, and Mona Lisa, a leader in the manufacture of chocolate decorations. Both companies will support the further growth of Barry Callebaut's global Gourmet business.

It is likely that surplus cash disposal proceeds from European Consumer Products divestiture, however small, will be used to help grow the business.

#### **BARRY CALLEBAUT'S RATING IS CONSTRAINED BY COCOA SUPPLY DISRUPTION RISKS INHERENT TO THE INDUSTRY**

The main cocoa-growing areas are West Africa (around 70% of world supply), South America and South East Asia. The cocoa market is very concentrated, with Côte d'Ivoire accounting for around one third of the global cocoa beans output. In addition to the risk of plant disease epidemics and unfavourable climate, which can negatively affect crop yield, the political risk in the main producing countries is a factor.

Despite Barry Callebaut's efforts to diversify and to build strong business relations with cocoa farmers, the company's business profile remains constrained by its heavy reliance on several politically unstable countries for sourcing cocoa such as Côte d'Ivoire. The political uprising in Côte d'Ivoire and the consequent EU ban on that country's cocoa exports, which lasted from January 2011 to April 2011, was imposed after the main crop was harvested, and therefore had only a limited impact on Barry Callebaut's operations. Barry Callebaut's reliance on politically unstable countries for cocoa beans supply is credit negative, although we recognise that it is an industry-wide rather than a company-specific issue.

#### **HEDGING STRATEGY AND COST-CONTROL INITIATIVES UNDERPIN MARGIN PREDICTABILITY**

Barry Callebaut's Baa3 rating is supported by the company's track record in terms of operating margin predictability, despite volatile cocoa bean prices. The company hedges cocoa price risks via futures and forward contracts from the time the customer's order is received. The selling price established for the client at the delivery date is based on the forward price at the order date, thereby eliminating risks associated with cocoa price volatility.

Barry Callebaut's cost-plus business model, which covers approximately 80% of its sales volumes, enables the company to pass raw material price increases onto its clients and therefore limits its exposure to raw material cost inflation. In addition, we view positively Barry Callebaut's constant focus on reducing production costs. We expect that Barry Callebaut's operating profitability will further improve with the step up in capacity utilisation as volumes from outsourcing agreements rise. Although Barry Callebaut has proved its ability to sustain stable operating profits through periods of cocoa price volatility, its business remains vulnerable to supply shortage.

#### **RECENT INFRASTRUCTURE INVESTMENTS HAVE WEAKENED CREDIT METRICS AND INDICATE A HIGH APPETITE FOR EXPANSION**

Barry Callebaut recently announced a number of costly programmes aimed at improving productivity whilst, at the same time, incurring significant costs to ramp up new contract wins, as mentioned above. In March 2012, the company launched a cocoa sustainability initiative called 'Cocoa Horizons' which aims to boost productivity on cocoa farms, increase crop quality and improve family livelihood in key cocoa producing countries. For this, the company will invest CHF40 million (approximately EUR33 million) over 10 years in farmer training, infrastructure and community education as well as health programs. Also in March Project Spring was announced, aimed at streamlining their internal processes to improve service levels and to create a competitive cost advantage. This carries a EUR30 million capex and opex requirement over the next two years, with potential annual savings of around EUR10 million as of year three. In addition, in June 2012 Barry Callebaut announced EUR22.5 million of capacity expansion projects in North America and a EUR15.4 million investment requirement in Japan for a contract extension. Whilst we recognise these actions are credit positive over the medium to long term, during the next 12-15 months we anticipate that metrics will remain weak for the Baa3 rating category. We estimate that, based on half-year results to February 2012, Barry Callebaut's adjusted last 12 months RCF/net debt ratio has deteriorated to around 16.3% from 20.2% in FY2011, its debt/EBITDA ratio to around 2.9x from 2.4x, and its operating margin to around 8.8% from 9.5%. However, we acknowledge that the first-half has always been more working-capital intensive, and we expect credit metrics to move more in line with the rating category by FY 2011/2012. Further, we expect Barry Callebaut to balance business expansion, and its related capital investment requirements, with a visible improvement in credit metrics in the medium term: lack of progress in this regard could put pressure on the rating.

#### **Liquidity**

Barry Callebaut's liquidity requirements are significant and difficult to predict because of the volatility of cocoa prices, which can be affected by weather conditions, investor speculation and political events. A material and sharp increase in cocoa prices, as experienced in recent years, often results in unfavourable swings in working capital, requiring

credit facilities to cover variable and unpredictable needs. Barry Callebaut's liquidity sources consist of a EUR600 million revolving credit facility as well as EUR400 million commercial paper and EUR275 million asset-backed security programmes, which we consider sufficient to fund its growth strategy and cover potentially high levels of working capital due to fluctuations in cocoa prices.

The revolving credit facility, signed June 2011, has a tenor of five years, with two one-year extension options at the discretion of the banks, and incorporates a EUR75 million swingline facility for general corporate and working capital purposes. It also includes an 'accordion' option (at the discretion of the banks), potentially increasing the facility amount to EUR750 million.

The revolving credit facility is subject to the following maintenance covenants (to be tested on a semi-annual basis) (i) an interest coverage ratio; (ii) profitability ratio; and (iii) minimum tangible net worth. This set of covenants provides Barry Callebaut with greater flexibility given the absence of cash-based ratios which can fluctuate with working capital cycles. As of the last testing date, end-February 2012, the company was in compliance with its covenants, with headroom under its profitability ratio being the tightest.

### Rating Outlook

The stable outlook reflects our expectation that the company will maintain its solid market position and improve its credit metrics in line with its rating category, including a prudent dividend policy.

### What Could Change the Rating - Up

Positive pressure could be exerted on the ratings or the outlook could be changed to positive from stable if the company (i) improves its operating margins close to double-digit levels; (ii) further reduces its adjusted gross debt-to-EBITDA ratio to below 2.5x; and (iii) increases its retained cash flow-to-net debt ratio to above 25%; all in conjunction with increased diversification of raw materials supply.

### What Could Change the Rating - Down

Negative pressure could be exerted on the ratings (i) if the company fails to maintain its operating margins at high single-digit levels; (ii) in case its credit metrics deteriorate with retained cash flow-to-net debt ratio below the high teens or the debt-to-EBITDA ratio exceeding 3.0x on a sustainable basis; or (iii) in the event of renewed concerns over supply risk.

### Other Considerations

Methodology grid: We apply the Global Food - Protein and Agriculture Industry Methodology (last updated in September 2009). The methodology grid outcome for Barry Callebaut is Ba1, based on the company's audited accounts to 2011 (year-end August 2011) and the last-twelve-months to end-February 2012. This is one notch lower than the final rating assigned and the gap reflects our expectation that the company's credit metrics will improve in the near to medium term and move towards the Baa range.

## Rating Factors

### Barry Callebaut AG

Global Food - Protein and Agriculture Industry [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa
<b>Factor 1: Size, Scale &amp; Diversification (22.50%)</b>							
a) Total Sales (USD Billion)				\$5.3			
b) Geographic Diversity -- Sales			X				
c) Geographic Diversity -- Raw Materials				X			
d) Segment Diversification						X	
<b>Factor 2: Franchise Strength &amp; Growth Potential (11.25%)</b>							
a) Market Share				X			
b) Organic Volume Growth				X			
c) Product Portfolio Profile				X			
<b>Factor 3: Earnings Volatility (7.50%)</b>							

a) Worst 1 Year Change in EBITA over past 5 Years			X				
<b>Factor 4: Liquidity Under Stress (11.25%)</b>							
a) % Earnings Covenant Cushion and Available Credit Facilities & Cash						X	
<b>Factor 5: Financial Policy (7.50%)</b>							
a) Financial Policy Assessment				X			
<b>Factor 6: Financial Measures (40.0%)</b>							
a) CFO / Net Debt (3 Year Avg)						18.1%	
b) Debt / EBITDA (3 Year Avg)					3.1x		
c) RCF / Net Debt (3 Year Avg)					18.3%		
d) EBITA / Interest Expense (3 Year Avg)					4.5x		
e) (RCF - CAPEX) / Debt (3 Year Avg)						5.7%	
<b>Rating:</b>							
a) Indicated Rating from Grid						Ba1	
b) Actual Rating Assigned					Baa3		

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 2/29/2012(L); Source: Moody's Financial Metrics



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