

# Standard & Poor's Research

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## **Research Update:**

Barry Callebaut Outlook Revised To Positive On Signs Of Sustainably Improving Financial Profile; 'BB+' Rating Affirmed

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## **Table Of Contents**

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

## **Research Update:**

## Barry Callebaut Outlook Revised To Positive On Signs Of Sustainably Improving Financial Profile; 'BB+' Rating Affirmed

#### Overview

- After the end of Barry Callebaut's capacity extension cycle in 2009, its financial metrics now exceed the levels we consider adequate for the current ratings.
- The absence of larger capacity extension and external growth should further support improving financial metrics, mitigating the impact of high and volatile commodity prices.
- Consequently, we are revising the outlook for Barry Callebaut's ratings to positive from stable and affirming the 'BB+' long-term rating.

## **Rating Action**

On Feb. 14, 2011, Standard & Poor's Ratings Services revised its outlook on Switzerland-based cocoa supplier and processor Barry Callebaut AG to positive from stable, due to an ongoing trend of improving financial metrics and resilient positive free cash flow generation, despite the recent price hikes for cocoa, sugar, and other relevant commodities. We affirmed our 'BB+' long-term corporate credit ratings on Barry Callebaut.

#### Rationale

The ratings on Barry Callebaut continue to reflect our view of the company's "significant" financial risk 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.

After its latest capacity extension cycle ended in 2009, Barry Callebaut's capital expenditure-to-sales ratio has contracted to 3% in the fiscal year ended Aug. 31, 2010, which we regard as close to the group's maintenance investment level. This has enabled the company to improve its financial metrics to a level that is beyond what we consider adequate for the current ratings. For fiscal 2010, the company's adjusted funds from operations (FFO) to debt was about 28% (against 22% in the previous year) and its adjusted EBITDA fixed-charge coverage about 5.0x (against 4.0x in fiscal 2009). Against this, the company's reported free operating cash flow (FOCF) declined to Swiss franc (CHF)32 million due to working capital financing needs, after CHF96 million achieved in fiscal 2009. Unless the company decides to ramp up its production capacity again or to broaden its business through external growth opportunities, these trends should support Barry Callebaut's need for

financial flexibility to finance temporary increases in working capital needs, resulting from volatile commodity prices. Assuming ongoing high prices for commodities, we see limited yet steady potential for further improvements in Barry Callebaut's debt protection metrics going forward.

Over the past quarters, Barry Callebaut's sales volume growth has exceeded 2%-3% world market growth, based on healthy growth conditions in emerging markets and slowly recovering economies of developed markets. Against this, skyrocketing price increases for some key raw materials may account for a widening gap between volume and revenue growth. Future profitability trends will hinge on Barry Callebaut's ability to entirely pass on potentially volatile and rising input prices to its customer base. We do not exclude some dilution of the company's profitability metrics over time (its reported EBITDA margin was 9% in fiscal 2010, ended Aug. 31, 2010), possibly mitigated by management's ongoing focus on cost efficiency. This said, the company's cost-plus model enables it to pass on the lion's share of raw material price volatility to its customers.

#### Liquidity

Barry Callebaut's liquidity position is generally adequate, in our view, but could come under pressure if commodity price volatility were to lead to increased financial indebtedness and tightening headroom under financial covenants.

The company benefits from a €850 million revolving credit facility (RCF), of which about 83% matures in 2013, and the remainder in 2012. The facility includes financial covenants, with leverage, interest cover, and solvency ratios tested semiannually. At the end of fiscal 2010, the company had CHF17 million of cash and cash equivalents and more than CHF800 million headroom under its RCF, against CHF190 million of short-term debt maturities. The company also raises cash through a trade receivables securitization program, under which about CHF255 million was outstanding at end-August 2010. 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. We believe that 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 senior unsecured debt at 'BB+', in line with the corporate credit rating on the parent company. The 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 "Barry Callebaut AG's Recovery Rating Profile," published April 30, 2009, on RatingsDirect, which will be updated in due course.

## Outlook

The positive outlook reflects our view that, subject to the absence of M&A-driven growth and major capacity extension programs, Barry Callebaut will likely be in a position to sustain positive free cash flow generation, and ultimately to further enhance its financial metrics over time. This should, in our view, enable the company to offset potential impacts on its financials arising from ongoing high and volatile commodity price levels which could dent the company's gross margin over fiscal 2011. From today's perspective, we think that the company's gross margin would have to decline by about 120 basis points from fiscal 2010 levels to cause Barry Callebaut's adjusted FFO to debt to fall below 25%.

We could raise the ratings if the company sustains an adjusted FFO-to-debt ratio in a corridor of 25%-30% and an EBITDA interest cover of 5x, and continues to support its financial flexibility through positive free operating cash flow generation. We could take a negative rating action if these financial metrics fall below 20% and 4.0x, respectively.

### Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Key Credit Factors: Business And Financial Risks In The Branded Consumer Products Industry, Sept. 10, 2008

## **Ratings List**

Ratings Affirmed; CreditWatch/Outlook Action

To From

Barry Callebaut AG

Barry Callebaut Services N.V.

Corporate Credit Rating BB+/Positive/-- BB+/Stable/--

Barry Callebaut Services N.V.

Senior Unsecured BB+ BB+ Recovery Rating 4 4

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