Research Update:

Swiss Chocolate Maker Barry Callebaut AG Upgraded To 'BBB' On History Of Stable Operating Performance; Outlook Stable

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Rating Action Overview

- Barry Callebaut AG (BC), the world's largest chocolate producer and cocoa processor, has demonstrated a long track record of stable operating performance and cash flows.
- We see positive revenue growth prospects for the business thanks to new outsourcing contracts, penetration of emerging markets, and expansion of the gourmet division. BC's leading capabilities in innovation and sustainability should continue to support its pricing power.
- BC is also likely to continue a consistent shareholder remuneration policy, which should translate into stable credit metrics with adjusted debt to EBITDA of 2.0x-2.5x over the next two years and a solid positive free operating cash flow (FOCF) base of about Swiss franc (CHF) 300 million annually.
- We therefore raised our ratings on Barry Callebaut AG and on its senior debt instruments to 'BBB' from 'BBB-'.
- The stable outlook reflects our view that the group should continue to expand profitably over the next two years notably thanks to its ability to quickly pass on higher raw materials costs.

Rating Action Rationale

We expect BC to maintain its resilient operating performance. The upgrade reflects our view that BC has demonstrated stable operating performance over the past four years and appears well positioned to continue to pursue profitable growth. BC enjoys leading market positions in the chocolate manufacturing and cocoa processing sectors. It benefits from strong supply chain capabilities and operating cost controls thanks to its vertically integrated operations. It also serves a wide and diverse industrial client base of food manufacturers, located in large consumer markets, notably in Europe and North America.

We forecast the company will continue to maintain very stable adjusted EBITDA of 10.5%-11.5% as it has over the past five years. This projection even factors in costs and loss of earnings associated with the temporary closure of the Wieze factory in fourth-quarter (Q4) 2021/2022. BC's profit stability stands out versus most agribusiness peers that we rate and can be explained by more than 70% of volumes being sold under a cost-plus pricing model that enables BC to pass on raw materials costs (which account for 80% of variable costs) in a timely manner to its customers. We understand that the remaining volumes are sold under a price list that has already been updated several times in 2022 in reaction to the high operating cost inflation. Although not all operating costs are thus passed on to consumers via this pricing model, we think the vertical integration, overall lean operating cost structure, and high manufacturing capacity utilization allows BC to absorb most other operating costs.

For the next two years, we see revenue growth accelerating to 5%-8%. This is thanks to BC's ability to quickly pass on price increases and cover all price points in chocolate products as well as the positive volume growth prospects from BC's capacity to capture new outsourcing chocolate contracts from a still-large captive market (60% of chocolate is still produced in-house), increased penetration in emerging markets, and expansion of the gourmet business. We believe the chocolate industry is only moderately cyclical--with positive volume growth prospects in emerging markets--and we see segments of growth in mature markets, with a rising number of consumers switching to certified sustainable products, or vegan or dairy-free alternatives.

The good-track record in operating performance has also been supported by the strong sourcing capabilities of cocoa-beans from high-risk countries like Ivory Coast (40% of cocoa world production). Although we see concentration risk to this commodity and these growing regions, we think this is mostly offset by BC's long-established relationships with local farmers and governments there and increasing geographical diversification to other continents like South America (a new cocoa processing plant opened in Ecuador in 2022) and Asia to offset this concentration risk.

We continue to believe BC's focus on sustainability and innovation will be key for profitable growth. In our view, BC's innovation capabilities and sustainability efforts also strengthen its pricing power. The group has capacity for large product innovation and continues to introduce new products that cater for changing consumer preferences. These include products with lower sugar and fat content, as well as plant-based, vegan, and sustainably sourced products. For example, Evocao--a chocolate 100% made from the cacao-fruit or NXT--a plant-based, dairy-free, vegan chocolate. BC is also developing new products for bakery or ice-cream makers like high-value fillings and inclusions.

We believe strong sustainability credentials are important for BC to retain pricing power in a competitive industry and sell more premium products to chocolate manufacturers. BC is one of the few global players who can certify that 43% of its products are now made of 100% sustainable cocoa, with the goal to reach 100% by 2025. The group also aims to reduce child labor in its supply chains by educating and providing financial and technical assistance to local farmers. Strong sustainability credentials are also an important component of the product mix of the high-margin gourmet product segment, which expanded by about 30% in the first six months of 2022 compared with last year, rebounding well after COVID-19-related lockdowns.

The company's prudent treasury and financial policy also stabilize the financial position. We consider BC's very good track -record of stable positive FOCF over the past years, averaging over Swiss franc (CHF) 300 million annually, a level which we forecast BC will maintain over the next two years. Despite the inherent large working capital swings, notably in its cocoa processing business, the business is actually moderately capital expenditure (capex) intensive (3.5%-4.0% of revenues on average) with a large share spent on expanding production capacities. We have factored in some working capital inflation over the next months as the company has been stocking up to prevent supply-chain disruptions, but we believe this will reverse and have only slightly depress FOCF overall.

Funding policies remain prudent with the group maintaining large cash balances, undrawn committed credit lines, and a diverse range of debt instruments that allow to adequately fund its business needs, notably the large seasonal working capital needs. Upcoming main debt maturities (US$400 million senior notes due in June 2023 and €450 million senior notes due in May 2024) appear manageable. The acquisition strategy is focused on small to midsize acquisitions toward local chocolate producers (Inforum in 2019, GKC Foods in 2020, and Europe Chocolate Company in 2021) with annual spending at less than CHF150 million over the past six years, which complements the expansion capex. We think BC is unlikely to pursue another large debt-financed acquisition like the 2013 deal for Petra Foods' cocoa ingredients business for $860 million.

BC has maintained a consistent common dividend policy (35%-40% of net profit annually) with no use of share repurchases or extraordinary dividends. We view positively the long-standing and stabilizing presence of Jacobs Holding with a 30% stake in the company. That said, the stake has reduced in recent years with now most free float shares being held by institutional shareholders.

Outlook

The stable outlook reflects our view of that our ratings on BC will continue to be supported by its solid operating performance with stable profitability metrics. BC's established leading market positions, positive volume growth prospects, and the ability to quickly pass on price increases to offset raw materials cost inflation should notably continue to retain profit stability.

Under the current rating we project BC will maintain S&P Global Ratings-adjusted debt to EBITDA of 2.0x-2.5x and funds from operations (FFO) to debt above 30% over the next two years. We also project the group to retain a comfortable FOCF cushion of around CHF300 million annually.

Downside scenario

We could take a negative rating action if over the next two years we see adjusted debt to EBITDA rising sustainably above 3.0x.

This could stem from a deviation from our understanding of the company's financial policy, such that the group pursues a large debt-financed acquisition or materially increases its shareholder remuneration.

We would also view negatively a weaker-than-expected operating performance possibly driven by more intense competition in key markets, unforeseen supply chain disruptions, or slower-than-expected expansion of the higher-margin gourmet division.

Upside scenario

We would also consider raising the rating if adjusted debt to EBITDA sustainably decreases to below 2.0x and FFO to debt rises to 45%-60%, supported by a larger FOCF base. This is contingent on the company adopting a more conservative financial policy to maintain the above credit metrics.

We could also consider raising the ratings if BC profitably expands its business (and reduces commodity concentration) beyond cocoa processing and chocolate production.

Company Description

Headquartered in Switzerland, BC is the world's largest manufacturer of industrial chocolate, with about a 40% market share in volume terms, and the largest processor of cocoa beans. Its large production capacities, with full vertical integration from origination to manufacturing, and well-spread production footprint enable the group to achieve economies of scale and be close to end markets.

For the 2020/2021 reporting year, the group generated revenue of CHF7.2 billion (2.2 million tons of sales volume) and adjusted EBITDA of CHF812 million.

BC operates in three main segments:

- Food manufacturers: CHF4.3 billion of revenues (59% of total sales) generated from the sale of chocolate products to food producers.
- Global cocoa: CHF1.8 billion of revenues (25% of total sales), generated from the sale of cocoa products to food producers. It also generates CHF2.4 billion of revenues from internal transactions with other divisions for procuring key ingredients for chocolate production.
- Gourmet and specialties: CHF1.1 billion of revenues (16%) generated from the sale of chocolate products to artisans, chocolatiers, food chains, and distributors.

BC operates mostly in Europe, the Middle East, and Africa (60% of EBIT) and the Americas (33%), Asia-Pacific (10%) while its cocoa processing activities, Global Cocoa, account for 15% of revenues. The group operates 64 factories selling products in over 137 countries.

BC is listed on the Zurich Stock Exchange, with about 64.9% of its shares in free float. Most of the shares are held by institutional investors but the largest shareholder by far remains family holding company Jacobs Holding, with 30.1% of the share capital and voting rights. Renata Jacobs of the Jacobs family also owns 5% separately.

Our Base-Case Scenario

Assumptions

- Revenue of CHF7.6 billion-CHF7.9 billion in 2022 and about CHF8.0 billion-CHF 8.2 billion in 2023. We assume revenue growth will rebound versus last year thanks to price increases from pass-through contract mechanisms in addition to volume growth from new outscoring contracts and expansion in emerging markets. We factor some revenue loss in 2022 due to the temporary closure of the Wieze factory.
- S&P Global Ratings-adjusted EBITDA margin of 10%-11% EBITDA for 2022 (from 11.3% in 2021) and about 11.0%-11.5% in 2023. We assume a slight margin erosion in 2022 versus 2021 from high operating cost inflation outside raw materials (labor, supply-chain, energy), from costs associated with the closure of Wieze factory (cleaning and loss of production). We see the group as well positioned with a large product range to maintain high capacity utilization and

cost controls should growth in the high-margin gourmet division slow over the coming months.

- FOCF of about CHF260 million-CHF280 million this year and CHF300 million-CHF325 million next year, with negative working capital movements year-on-year, and capex of about 4.0% of revenue.
- Adjusted net debt of about CHF1.9 billion-CHF2.0 billion in 2022 and 2023. We notably assume about CHF1.2 billion of reported net debt, CHF360 million of trade receivable securitizations, CHF266 million of lease liabilities, and CHF97 million of net pension deficit. We assume about CHF150 million-CHF170 million of annual cash dividends and about CHF100 million of acquisitions annually. We estimate restricted cash of about CHF90 million for the group. In line with our criteria, we do not net from debt readily marketable inventories like cocoa beans as they are held for processing.

Key metrics

Barry Callebaut--Key Metrics*

	--Fiscal year ended Aug. 31--				
Mil. CHF	**2020a**	**2021a**	**2022e**	**2023f**	**2024f**
Debt to EBITDA (x)	2.6	2.3	2.0-2.5	2.0-2.5	close to 2.0
FFO to debt (%)	30.3	35.5	30-35	close to 35	close to 40
FOCF to debt (%)	19	16.8	close to 14	15-17	16-18

*All figures adjusted by S&P Global Ratings. CHF--Swiss franc. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess BC's liquidity as adequate under our criteria. We forecast that liquidity sources will exceed uses by 1.2x over the next 12 months. Even if EBITDA declined by 30%, we believe net sources would remain positive. We also value the strong banking relationships, diverse debt sources, and significant headroom under financial covenants.

Principal liquidity sources as of end of February 2022 include:

- Unrestricted cash and equivalents of CHF 733 million.
- Fully undrawn committed €900 million revolving credit facility (RCF) maturing in October 2026.
- Forecast FFO (before working capital movements) of around CHF700 million for the next 12 months.

Principal liquidity uses as of end of February 2022 include:

- CHF307 million of debt due within one year.
- Estimated maximum working capital outflows about CHF 250 million-CHF300 million.
- Estimated capex spending of CHF300 million for the next 12 months.
- Estimated cash dividends of about CHF160 million for the next 12 months.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are an overall neutral consideration in our credit rating analysis of BC. BC is one of the most advanced agribusiness companies globally in terms of level of disclosure and proactively addressing environment risks. Notably, since 2016 it has been implementing a comprehensive strategy to improve the sustainable sourcing of cocoa (as well as other raw materials) and preserve biodiversity.

We believe the observed progress of the implementation of this program should help limit loss of business volumes for BC when its main customers and end consumers become increasingly sensitive to these issues in their purchasing decisions. BC's initiatives include the digital mapping-- and thus improved traceability--of all the cocoa farms in its main origin regions of West Africa. In terms of social risks, the company is running a comprehensive program to reduce child labor in farming communities in Africa. BC also supports the professionalization of the cocoa farmers with the aim to improve their productivity and increase income.

Issue Ratings--Subordination Risk Analysis

Capital structure

BC issues most of its senior debt through Barry Callebaut Services N.V., its group financing vehicle. Most of the long-term debt instruments are senior unsecured and guaranteed by Barry Callebaut AG (BBB/Stable). We currently rate the 2023 and 2024 senior notes as well as the 2026 RCF.

Analytical conclusions

We rate the long-term senior unsecured debt 'BBB', in line with our issuer credit rating on BC. This is because we assess limited structural subordination in the capital structure as total secured debt and debt held at the operating companies is below our 50% threshold.

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

Issuer Credit Rating	BBB/Stable/--
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:	bbb

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded

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

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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; or Stockholm (46) 8-440-5914