

CREDIT OPINION

19 December 2017

Update

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RATINGS

Barry Callebaut AG

Domicile	Switzerland
Long Term Rating	Ba1
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Ernesto Bisagno +44.20.7772.5403
VP-Sr Credit Officer
ernesto.bisagno@moodys.com

Yann P Grandemange +44.20.7772.1727
Associate Analyst
yann.grandemange@moodys.com

Marina Albo +44.20.7772.5365
MD-Corporate Finance
marina.albo@moodys.com

Paolo Leschiutta +39.02.9148.1140
VP-Sr Credit Officer
paolo.leschiutta@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Barry Callebaut AG

Update to credit strengths and challenges

Summary rating rationale

[Barry Callebaut AG's](#) (Barry Callebaut) Ba1 rating reflects (1) the company's leading market position as a manufacturer of both chocolate and cocoa products; (2) its geographical footprint, with an established presence in all major global markets and growing contributions from emerging markets; (3) the stable nature of the chocolate market, which exhibits steady growth rates; (4) the company's resilient profitability in the chocolate segment owing to its pass-on mechanism/hedging strategy for commodity risk.

The company's rating is constrained by (1) volatility in its cocoa segment, both in terms of operating performance and working capital requirements; (2) the current relatively high financial leverage, although improving; and (3) the risk of cocoa supply disruption owing to instability in the producing countries.

Barry Callebaut's gross leverage is on an improving trend owing to the positive free cash flow generation on tighter working capital management and stronger earnings. As of fiscal 2017, Barry Callebaut's leverage stood at 3.4x, positioning the company more solidly in the Ba1 rating category. This was sensibly down from 4.6x reported in fiscal 2016, which, however, was inflated by the company's exceptionally high cash balances as it pre-funded most of its €350 million bond maturing in July 2017 before the end of the year.

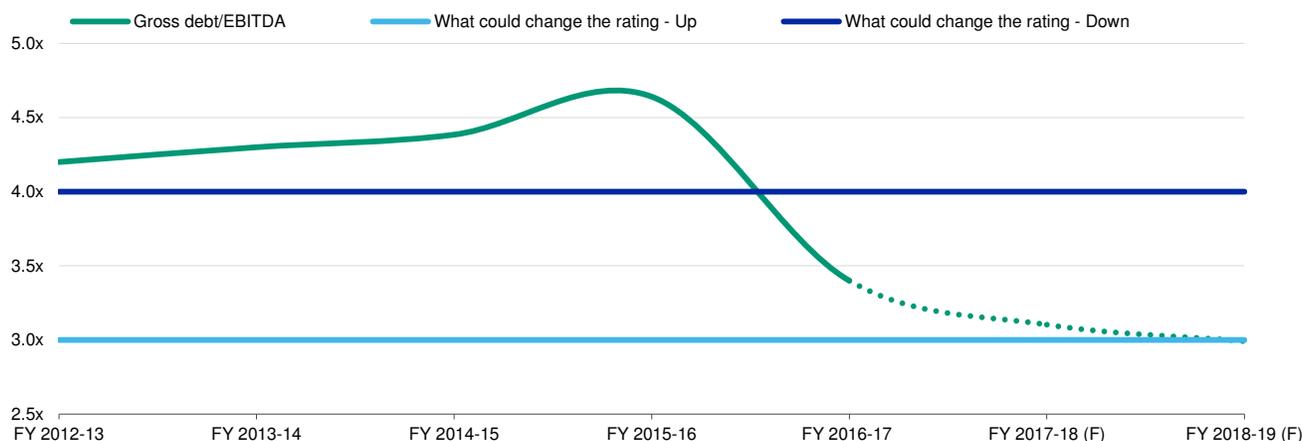
We expect the company's earnings to continue to increase in the high-single-digit levels in percentage terms in the next 12-18 months, driven by a volume increase of 4%-6% in the chocolate segment, combined with the implementation of the profitability-enhancement strategy, as well as the stable underlying market conditions in the cocoa segment.

We anticipate a positive free cash flow of CHF80 million – CHF 100 million each year after dividends but before M&A activity, on the back of (1) steady earnings progression; (2) moderate increase in capital spending, with the company expecting to invest around CHF240 million in fiscal 2018, slightly up from CHF220 million in 2017; and (3) a predictable dividend policy with gradually increasing dividends in case of de-leveraging. Assuming stable gross debt, leverage would decline towards 3.0x over the next 12-18 months, subject to the cocoa prices to remain around the current level.

Exhibit 1

Barry's financial leverage is trending down

Moody's-adjusted debt to EBITDA



Fiscal year ends in August. Gross leverage in fiscal 2015-16 is inflated owing to the unusually high cash position available on the balance sheet because the company pre-funded most of the €350 million bond maturing in 2017.

Source: Moody's Financial Metrics™, Moody's Investors Service forecasts

Credit strengths

- » Leading market position as a manufacturer of both chocolate and cocoa products
- » Steady growth rate in the chocolate segment
- » Hedging strategy and cost-control initiatives underpin margin predictability
- » Cocoa Leadership Project and smart growth to support profitability
- » Improving credit metrics, driven by steady earnings progression and positive free cash flow

Credit challenges

- » Operating performance in the cocoa segment, which remains volatile and might result in significant working capital swings
- » Relatively high dividends payout mitigated by improving metrics
- » Cocoa supply disruption risks, which are inherent to the industry

Rating outlook

The company is well positioned in the rating category. The stable outlook reflects the improvements in Barry Callebaut's key credit metrics and Moody's expectation that ongoing earnings progression combined with positive free cash flow generation will further help the company reduce its leverage. However, the volatility in cocoa prices, which are currently at the minimum level, could result in up to CHF200 million-CHF300 million of working capital needs, impacting the level of funded debt. In this respect, the stricter control on working capital might lead to lower cash-generation volatility than in the past.

Factors that could lead to an upgrade

Positive rating pressure could develop if, in conjunction with satisfactory liquidity, Barry Callebaut (1) enhanced its adjusted EBITDA margin towards double-digit levels in percentage terms; (2) further reduced its adjusted gross debt/EBITDA towards 3.0x; and (3) maintained its retained cash flow/net debt ratio above 20%.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody.com for the most updated credit rating action information and rating history.

Factors that could lead to a downgrade

Negative pressure in the next 12-18 months is unlikely and could be exerted on the rating if (1) the company failed to maintain its adjusted EBITDA margin at high-single-digit levels in percentage terms; (2) its credit metrics weakened, with adjusted leverage above 4.0x and retained cash flow/net debt below mid-teens in percentage terms on an ongoing basis; (3) supply risk were to renew; or (4) the company's liquidity deteriorates.

Key indicators

Exhibit 2

Barry Callebaut AG					
US Millions	Aug-13	Aug-14	Aug-15	Aug-16	Aug-17
Revenue	5,222.7	6,527.4	6,556.3	6,798.5	6,883.2
CFO / Net Debt	17%	1%	8%	32%	38%
Debt / EBITDA	4.2x	4.3x	4.4x	4.6x	3.4x
Net Debt / EBITDA	4.0x	4.2x	4.1x	3.8x	2.7x
EBITA / Interest Expense	4.2x	3.7x	3.5x	3.4x	4.2x
EBITDA Margin	10%	9%	9%	8%	9%
RCF / Net Debt	16%	12%	11%	16%	25%

All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) or Projections (proj.) are Moody's opinion and do not represent the views of the issuer. Periods are Financial Year-End unless indicated. LTM = Last 12 Months.

Source: Moody's Financial Metrics™

Profile

Headquartered in Zurich, Switzerland, Barry Callebaut AG is the world's leading supplier of premium cocoa and chocolate products by sales volume, according to the company, servicing customers across the global food industry. Barry Callebaut is fully integrated, from the sourcing of raw materials, through the production of semi-finished products, to the production of industrial chocolate products. The company is divided into three strategic business units: (1) Food Manufacturers, which produces industrial chocolate products for consumer companies or fast-moving consumer goods companies (65% of the company's fiscal 2017 sales); (2) Cocoa Products, which sources cocoa beans and processes semi-finished cocoa products (23%); and (3) Gourmet and Specialties, supplying to restaurants, bakeries and hotels (12%).

Barry Callebaut reported annual sales of CHF6.8 billion (around €5.8 billion) and EBITDA of CHF638 million (€547 million) in fiscal 2017. As of 31 August 2017, the company sold products in 140 countries, operated 55 production facilities and employed 11,000 people. As of the same date, the company had a market capitalisation of around CHF7.6 billion (€6.5 billion), with the investment company Jacobs Holding having a majority stake and around 41% of the capital being floated.

Detailed rating considerations

Leading market position as a manufacturer of both chocolate and cocoa products

Barry Callebaut is a fully integrated business, sourcing cocoa beans directly from farmers, converting them into cocoa ingredients (butter, liquor and powder) and manufacturing chocolate, chocolate fillings, decorations and compounds, and nut-based products. In a highly concentrated market, the company is the market leader in both industrial chocolate and cocoa grinding capacity, ahead of the significantly more diversified [Cargill, Incorporated](#) (A2 stable) and Olam International Limited. Despite being much larger, Cargill, Incorporated is diversified in other commodities and is the second-largest company in terms of cocoa sourcing, with less than half of Barry Callebaut's market share in chocolate.

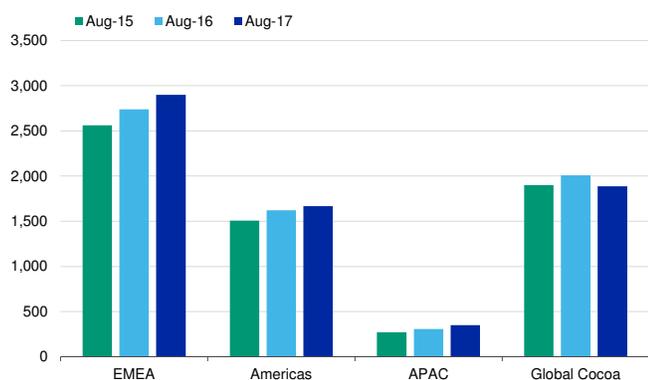
Steady growth rate in the chocolate segment, ahead of the market, and recovery in global cocoa business

Barry Callebaut posted another year of strong volume growth in the chocolate business, with overall volumes up 4.4% in fiscal 2017. This growth was materially higher than the total market, which grew 0.1% according to Nielsen data, and broadly in line with the company's target of volume growth between 4% to 6%. The company's volume growth continued to be driven by positive contributions from (1) emerging markets, with volumes up 5.9%, representing 34.5% of the group's total volumes sold; (2) long-term outsourcing agreements, driving volumes up 9.3%, representing 34.1% of total group volumes; and (3) the company's Gourmet and Specialties unit, with volumes rising 9.7%, representing 11.7% of total group volumes. EMEA remains Barry Callebaut's biggest source of revenue, with a contribution to sales volumes of 45%, and in fiscal 2017 displayed above-group-average growth of 6.4%. Asia-Pacific, in contrast, represents only 5% of the group's volume, but grew 19.1% in the previous year.

Exhibit 3

Good growth across all regions

Revenue from external customers in CHF million

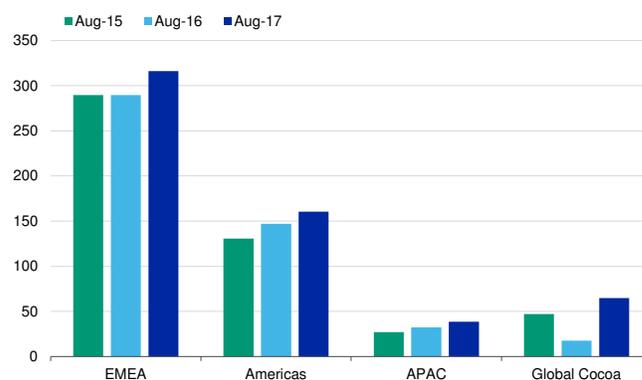


Source: Company's annual reports

Exhibit 4

The cocoa business remains volatile but contributes a small part of the overall profit

Operating profit in CHF million



Source: Company's annual reports

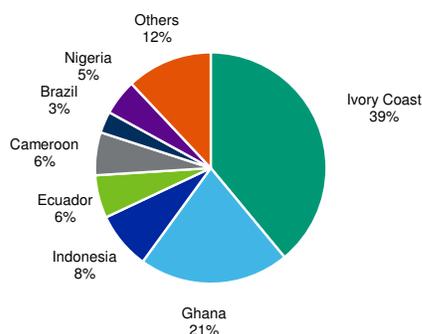
The company's operating performance in the global cocoa segment remains volatile. After a difficult fiscal 2016, the company's performance improved significantly in fiscal 2017, with EBIT up to CHF64.9 million, almost 4.0x compared with a year earlier. This improvement was on the back of the easy comparison against the 2016 EBIT of CHF17.0 million (one of the lowest profits reported by the division in recent years), the company's effort to improve efficiency through its Cocoa Leadership Project and more favourable market conditions (see also below).

Cocoa supply disruption risks inherent to the industry

Barry Callebaut's operations remain exposed to significant raw material concentration. The main cocoa growing area is West Africa, representing around 70% of the world's supply according to the International Cocoa Organization, followed by South America and Southeast Asia. The cocoa market is very concentrated, with the Ivory Coast accounting for around 39% of the global cocoa bean output (see Exhibit 6). In addition to the risk of plant disease epidemics and unfavourable climate, which can hamper crop yield, the political risk in the main producing countries is a consideration when assessing the credit strength of the manufacturers of cocoa and chocolate products. As a result, cocoa prices are extremely volatile (see Exhibit 7). Although higher cocoa bean prices are fully passed on to customers in the chocolate business or mitigated by the company's hedging strategy, the high volatility can increase the company's working capital needs.

Exhibit 5

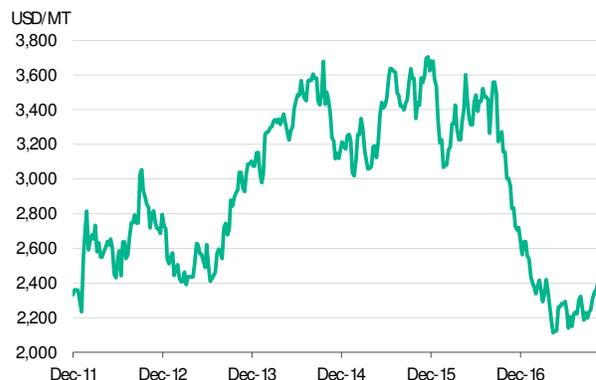
Ivory Coast is by far the main cocoa bean producer in the world Market share by country of the global production of cocoa beans



Source: International Cocoa Organization estimates, 2015-16 harvest

Exhibit 6

Cocoa prices stabilised in 2017 Price for the Ivory Coast cocoa beans on the ICE market



Price expressed in US dollars per 10 metric tonnes

Source: Factset

In 2016-17, the cocoa bean crop reached a record level owing to favourable weather conditions. This led to average prices in the year being around 21% lower than a year earlier, ending a three-year period of high prices.

Despite Barry Callebaut's efforts to diversify its sources and build strong business relationships with cocoa farmers, the company's reliance on politically unstable countries for cocoa bean supply is credit negative, although we recognise that it is an industrywide, rather than a company-specific, issue. The acquisition of Petra Foods Cocoa Ingredients Division has helped to diversify the company's sourcing of cocoa beans into Asia and Brazil but we expect the business and the industry in general to remain reliant on the Ivory Coast, and the company will remain exposed to volatility in cocoa prices.

Hedging strategy and cost-control initiatives underpin margin predictability for the chocolate business

Barry Callebaut's rating is supported by the company's track record in terms of operating margin predictability in the chocolate segment, despite volatile cocoa bean prices (see Exhibit 8). The company hedges cocoa price risks via physical beans or futures contracts from the time the customer has signed the contract. The selling price established for the client at the delivery date is based on the forward price at the contract date, thereby eliminating risks associated with cocoa price volatility.

Barry Callebaut's cost-plus business model, which covers the majority 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 volatility.

The operating performance in the cocoa business is more volatile owing to the exposure of the spread between cocoa bean and cocoa butter/powder prices. However, despite the intrinsic volatility, the company's cocoa business is beneficial to its chocolate business because it allows the company to control quality better and coordinate the delivery of raw materials or other supplies.

Exhibit 7

The EBIT stability of the chocolate segment support the rating

CHF million

Cocoa	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Revenues - Cocoa	1,112	1,335	1,127	1,756	1,900	2,008	1,888
EBIT - Cocoa	77	65	42	82	47	18	65
EBIT margin Cocoa	6.9%	4.9%	3.7%	4.7%	2.5%	0.9%	3.4%
Chocolate	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Revenues - Choco	3,348	3,495	3,757	4,110	4,341	4,669	4,917
EBIT - Choco	341	352	388	422	447	469	515
EBIT margin - Choco	10.2%	10.1%	10.3%	10.3%	10.3%	10.0%	10.5%
Total EBIT	418	417	430	504	494	487	580

Source: Company's annual reports

Cocoa leadership project and smart growth to support profitability in the medium term

In response to the challenging cocoa market environment, in 2015, Barry Callebaut's management started the Cocoa Leadership Project, which helps leverage the company's global scale and expertise in cocoa and improve the profitability of the global cocoa segment. Under the project, the company aims (1) to reduce the commodity product offering and focus more on differentiation and premiumisation of the cocoa powder range; (2) to centralise some key strategic activities and decision making, such as the management of the combined ratio, which was previously done regionally; and (3) to optimise the cocoa manufacturing footprint and the global products flow with the objective of having the lowest global cost position.

Barry Callebaut maintains its medium-term average sales volume growth forecast of 4%-6% per annum until fiscal 2019, recently extended by one year, and remains focused on disciplined (SMART) growth targets. Volume expansion will continue to be driven by the company's three key growth drivers: (1) Increasing demand for chocolate products in emerging markets; (2) continued growth in its Gourmet and Specialties product range; and (3) to a lesser extent, additional outsourcing agreements and strategic partnerships. Particularly with regard to the last growth driver, the company targets more selective, profitable growth, mainly coming from partnerships with regional entities in emerging markets.

In 2015, the company's management also outlined a project to reduce its working capital by CHF300 million in three years, mainly through a reduction in inventories both in terms of beans and cocoa products, as well as through better planning for the chocolate inventories. The company overachieved this target by reducing working capital by more than CHF190 million in both fiscal 2016 and fiscal 2017. However, this reduction was also supported by the low cocoa prices in 2017 and the unusually low inventory of cocoa beans owing to the bad quality of the crops in Brazil and Indonesia in 2016. For fiscal 2018, the company targets a modest increase of working capital levels.

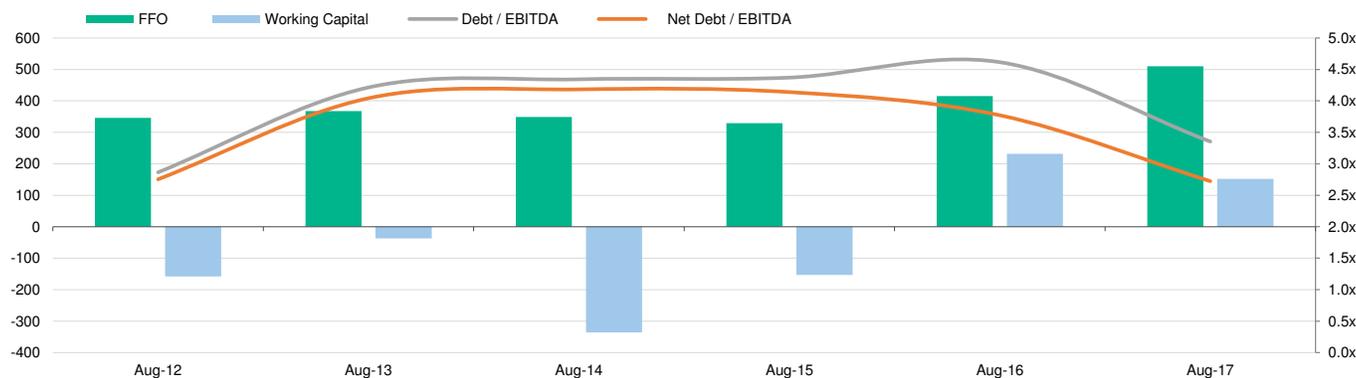
Improving credit metrics, driven by positive free cash flow

Barry Callebaut's leverage increased significantly in 2013, following the acquisition of Petra Foods Cocoa Ingredients Division for a total consideration of \$860 million (around CHF882 million). Following the acquisition, the company's financial leverage remained relatively high until fiscal 2015 owing to soft trading conditions and significant working capital absorption arising from the volatility in cocoa prices and production. Over the last two years, however, free cash flow generation has turned positive owing to working capital improvements (see Exhibit 9). As explained above, this resulted from the company's greater focus on working capital efficiency and more favourable market dynamics for cocoa.

Exhibit 8

Working capital improvements in recent years benefit FCF generation

CHF million on left axis; leverage turns on right axis



FFO represents cash flow from operations before working capital and capital spending.

Source: Moody's Financial Metrics

Moody's adjusted EBITDA increased to CHF634 million in fiscal 2017 (+17% y-o-y) as a result of stronger volumes, a good product mix, as well as the improvement of the cocoa profitability driven in part by the Cocoa Leadership initiative and by more favorable market conditions. Reported operating cash flow improved to CHF684 million (CHF621 million in 2016) due to stronger earnings and improved working capital management partially offset by negative movements on the hedging books. Total capex was stable at CHF219 million (CHF201 million in 2016) and dividends at CHF85 million (CHF80 million in 2016) and therefore reported free cash flow was CHF378 million (CHF339 million in 2016). As a result, reported net debt declined to CHF1.1 billion (CHF1.4 billion in 2016).

Gross reported debt declined to CHF1.5 billion mainly as a result of the repayment of the €350 million bond which matured in July 2017¹ and Moody's adjusted debt at CHF2.1 billion, mainly including CHF395 million adjustments for the securitization. As of fiscal 2017, financial leverage stood at 3.4x, positioning the company more solidly in the rating category and sensibly down from 4.6x reported in fiscal 2016.

Good earnings visibility over 2018-19

We expect the company's earnings to continue increase in the high-single-digit levels in percentage terms in the next 12-18 months, driven by a volume increase of 4%-6% in the chocolate segment, combined with the implementation of the profitability-enhancement strategy, as well as the stable underlying market conditions in the cocoa segment.

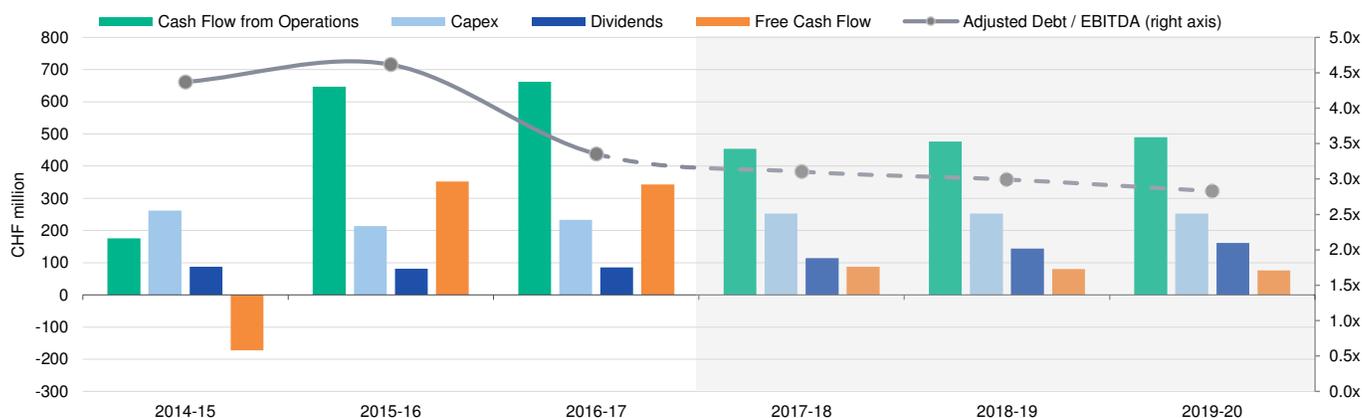
Despite the stronger operating performance, we expect a more modest improvement in cash flow in fiscal 2018 because of some build up in working capital. In addition, there will be some additional outflows due to the acquisition of D'Orsogna Dolciaria and Ingredients Division of Gertrude Hawks Chocolates U.S.

As a result, we anticipate a positive free cash flow of CHF80 million – CHF 100 million each year after dividends but before M&A activity, on the back of (1) steady earnings progression; (2) moderate increase in capital spending, with the company expecting to invest around CHF240 million in fiscal 2018, slightly up from CHF220 million in 2017; and (3) a predictable dividend policy with gradually increasing dividends in case of de-leveraging. Assuming stable gross debt, leverage would decline towards 3.0x over 2018-19, and adjusted RCF to net debt would remain around 24%.

Exhibit 9

Leverage to continue to improve modestly over 2018-19

Evolution of Barry's adjusted leverage



Source: Moody's Financial Metrics and Moody's Investors estimates

However, the volatility in cocoa prices, which are currently at the minimum level, could result in up to CHF200 million-CHF300 million of working capital needs, which might impact the level of funded debt. In this respect, the stricter control on working capital might lead to lower cash-generation volatility than in the past.

Liquidity analysis

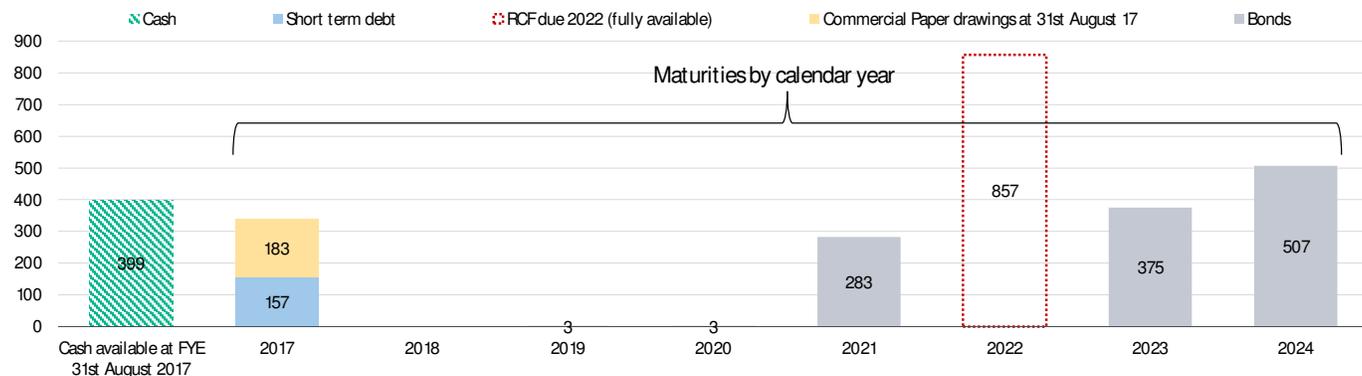
Liquidity is adequate, underpinned by (1) cash and equivalents of CHF399 million at 31 August 2017; (2) €750 million committed fully undrawn revolving credit facility maturing in June 2022; (3) expectations that the company will remain free cash flow positive over the next 12-18 months. Refinancing requirements are modest with no significant maturities until 2021 when the EUR 250 million bond matures. As of the end of August 2017, the company had around CHF339.5 million of short-term debt, including around CHF182.8 million in a commercial paper programme which Moody's expected will continue to be rolled over.

However, Barry Callebaut's liquidity requirements could vary and difficult to predict over quarters 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 over 2013-15, resulted in unfavourable swings in working capital, requiring credit facilities to cover variable and unpredictable needs.

Exhibit 10

Short-term debt amply covered by current availability

CHF million



Source: Company's annual report

Barry Callebaut uses the commercial paper programme and bank overdrafts to fund working capital needs and uses the revolving credit line to provide alternative liquidity. In addition, the company has CHF456 million (€400 million) in an asset-backed securitisation programme, of which CHF395.4 million was utilised as of fiscal 2017.

The revolving credit facility has been recently increased to €750 million and extended to 2022. The facility is subject to the following maintenance covenants (to be tested on a semi-annual basis) (1) an interest coverage ratio, (2) a profitability ratio, and (3) 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, as of the end of August 2017, the company maintained ample capacity against its covenants. Positively, the revolving credit facility does not include any leverage covenants, giving Barry Callebaut more flexibility to cope with unfavourable swings in working capital.

Structural Considerations

Barry Callebaut's Ba1 senior unsecured instrument rating is in line with the corporate family rating. This reflects the lack of significant structural subordination and that bonds are fully guaranteed by Barry Callebaut. The company's probability of default rating of Ba1-PD reflects the use of a 50% family recovery rate, consistent with a bank and bond capital structure.

Rating methodology and scorecard factors

Methodology grid: In assessing the credit quality of Barry Callebaut, we apply the Global Protein and Agriculture Industry rating methodology (last updated in June 2017). The methodology grid outcome for Barry Callebaut is Ba1 in line with the assigned rating. We revised the score for market share to "A" from "Baa" to account for the company's leader position in the chocolate and cocoa markets.

Exhibit 11

Barry Callebaut AG

Protein and Agriculture Industry Grid [1][2]	Current FY 8/31/2017		Moody's 12-18 Month Forward View As of 12/8/2017 [3]	
	Measure	Score	Measure	Score
Factor 1 : SCALE & DIVERSIFICATION (20%)				
a) Total Sales (USD Billion)	\$6.9	Ba	\$7.1 - \$7.4	Ba
b) Geographic Diversification	Baa	Baa	Baa	Baa
c) Segment Diversification	B	B	B	B
Factor 2 : BUSINESS POSITION (25%)				
a) Market Share	Baa	Baa	A	A
b) Product Portfolio Profile	Baa	Baa	Baa	Baa
c) Earnings Stability	Ba	Ba	Ba	Ba
Factor 3 : FINANCIAL POLICY (15%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Factor 4 : LEVERAGE & COVERAGE (40%)				
a) CFO / Net Debt	38.3%	Baa	25.4% - 27.8%	Ba
b) Debt / EBITDA	3.4x	Ba	3x - 3.1x	Ba
c) EBITA / Interest Expense	4.2x	Ba	4.5x - 4.7x	Ba
d) Debt / Book Capitalization	48.2%	Ba	44.2% - 46%	Ba
Rating:				
a) Indicated Rating from Grid		Ba1		Ba1
b) Actual Rating Assigned				Ba1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 08/31/2017. [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Financial Metrics™

Appendix

Exhibit 12

Moody's-adjusted EBITDA breakdown

Barry Callebaut AG

(in US Millions)	FYE Aug-12	FYE Aug-13	FYE Aug-14	FYE Aug-15	FYE Aug-16	FYE Aug-17
As Reported EBITDA	520.4	481.4	590.2	570.9	535.0	643.7
Pensions	-1.9	0.1	-2.8	-2.1	0.0	-2.1
Operating Leases	13.7	15.3	20.3	17.6	16.0	16.7
Interest Expense – Discounting	0.0	0.0	0.0	-0.5	-0.5	-0.5
Unusual	0.3	17.2	2.5	-5.0	1.0	-16.5
Non-Standard Adjustments	0.0	0.1	0.1	-0.1	-0.2	-0.2
Moody's-Adjusted EBITDA	532.4	514.0	610.3	580.7	551.3	641.2

All figures are calculated using Moody's estimates and standard adjustments

Source: Moody's Financial Metrics™

Exhibit 13

Moody's-adjusted debt breakdown

Barry Callebaut AG

(in US Millions)	FYE Aug-12	FYE Aug-13	FYE Aug-14	FYE Aug-15	FYE Aug-16	FYE Aug-17
As Reported Debt	1,047.1	1,724.1	2,064.9	1,918.5	1,943.6	1,571.6
Pensions	110.5	124.8	142.1	142.0	167.1	140.7
Operating Leases	77.1	76.3	72.6	65.4	68.5	88.9
Securitizations	247.4	247.3	321.0	372.6	364.0	411.4
Moody's-Adjusted Debt	1,482.2	2,172.5	2,600.6	2,498.5	2,543.2	2,212.6

All figures are calculated using Moody's estimates and standard adjustments

Source: Moody's Financial Metrics™

Ratings

Exhibit 14

Category	Moody's Rating
BARRY CALLEBAUT AG	
Outlook	Stable
Corporate Family Rating	Ba1
BARRY CALLEBAUT SERVICES N.V.	
Outlook	Stable
Senior Unsecured -Dom Curr	Ba1

Source: Moody's Investors Service

Endnotes

1 Company had prefunded last year and therefore 2016 cash balance was exceptionally high

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