MOODY'S
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Credit Opinion: Barry Callebaut AG

Global Credit Research - 08 Jan 2015

Switzerland

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba1
Barry Callebaut Services N.V.	
Outlook	Stable
Senior Unsecured -Dom Curr	Ba1/LGD4

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Key Indicators

[1]**Barry Callebaut AG**

	8/31/2014	8/31/2013	8/31/2012	8/31/2011	8/31/2010
Total Sales (USD Billion)	$6.5	$5.2	$5.2	$4.9	$4.3
CFO / Net Debt	0.4%	16.8%	13.7%	15.9%	14.7%
Debt / EBITDA	4.4x	4.3x	2.9x	2.4x	3.0x
EBITA / Interest Expense	3.7x	4.4x	5.2x	5.9x	5.1x
Debt / Book Capitalization	56.6%	53.9%	51.2%	50.7%	50.4%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. 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

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

- Emerging markets presence and outsourcing trends support volume growth targets

- Cocoa supply disruption risks inherent to the industry constrain rating

- Hedging strategy and cost-control initiatives underpin margin predictability

- Recent spike in cocoa prices resulting in material working capital outflows

- Petra acquisition and investments for outsourcing deals have weakened credit metrics

Corporate 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 material through the production of semi-finished products to the production of industrial chocolate products. The company is divided into three strategic business units: Cocoa Products (sourcing cocoa beans and processing semi-finished cocoa products), Food Manufacturers (production of industrial chocolate products for consumer companies or FMCG) and Gourmet & Specialties (supplying restaurants, bakeries and hotels).

Barry Callebaut reported annual sales of CHF5.9 billion (around EUR4.9 billion) for the financial year (FY) 2013/14 (ended 31 August). As of 31 August 2014, the company was present in over 35 countries, operated 51 production facilities and employed around 9,319 people.

SUMMARY RATING RATIONALE

Barry Callebaut's Ba1 rating reflects the fact that the recent Petra acquisition, infrastructure investments and costs associated with outsourcing contracts have weakened its key credit metrics and we expect that the rating will remain in high-yield territory for the foreseeable future. Barry Callebaut is reliant on countries with a history of political instability, such as Ivory Coast, for the sourcing of cocoa beans. While we recognise that the political situation in Ivory Coast has stabilised since the turmoil in 2011 and that Barry Callebaut has begun diversifying to countries with a more stable political environment such as Malaysia, Indonesia and Brazil through the Petra acquisition, the company remains significantly exposed to political instability. Supply disruption risks are inherent to the industry.

Additional volatility in cocoa prices reflects concern that the Ebola virus could spread to Ivory Coast or Ghana, which together account for around 60% of global cocoa production. Cocoa prices have recently moderated from peak levels on the expectation that the cocoa market in FY2014/15 would be well supplied. However, in the medium term, the International Cocoa Organization (ICCO) expects supply deficits, which could result in additional upward pressure on cocoa prices.

More positively, the rating also reflects Barry Callebaut's established presence in all major global markets and its focus on diversifying the current Europe-based revenues towards new markets such as Brazil, Russia, India, China and Mexico, which typically display higher growth prospects. Through the Petra acquisition, Barry Callebaut will further expand its operations in South East Asia and South America.

There is also now less uncertainty around Petra's integration, showing management's ability to turn around the acquired business. From an operating loss of CHF12 million, Petra contributed around CHF24 million to Barry Callebaut's operating profit for the FY2013/14.

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 sales volume, has proved successful in recent years and has enabled it to sustain fairly stable operating margins levels, despite volatile cocoa bean prices. An additional positive consideration is Barry Callebaut's lack of any material long term debt maturities which are well spread and with no significant refinancing needs over the next 12-18 months. However, as a result of the higher working capital needs on the back of the increased cocoa prices, the company has increased its utilization of the CP programme. This weakens the company's overall liquidity profile, which Moody's views as a critical consideration for a high yield issuer since CP issuance may not be fully covered by alternate liquidity.

DETAILED RATING CONSIDERATIONS

LESS EXECUTION RISK BUT PETRA ACQUISITION STILL EXERTS PRESSURE ON LEVERAGE

Barry Callebaut completed the acquisition of the Cocoa Ingredients Division of Petra Foods Ltd. (Petra) on 30 June 2013 for a total consideration of USD864.3 million (approximately CHF821.5/EUR674.2 million). To finance the transaction Barry Callebaut issued an USD400 million bond with maturity in 2023, entered into an EUR175 short term loan with maturitiy in 2016 and raised CHF279 million (approximately USD318 million) of common equity.

The acquisition has (1) made Barry Callebaut the largest global cocoa processor in terms of sales volume, increasing the company's grinding capacities by 60%; (2) augmented Barry Callebaut's existing production of semi-finished products; (3) secured alternative sources of cocoa supply, as well as capacity for existing and prospective outsourcing contract wins; and (4) increased the company's presence in cocoa powders and in emerging markets, where market growth rates are highest.

Barry Callebaut has turned around Petra's business from an operating loss of CHF12 million to an operating profit around CHF24 million in fiscal year FY2013/14 and expects additional synergies from the integration of the acquired assets of around CHF30 million. As a result, EBIT per tonne has increased to CHF242.4 from CHF223.4 with management reiterating its guidance that EBIT per tonne will reach its pre-acquisition level of CHF256 by FY 2015/16.

However, given the significant size of the acquisition and that it was primarily debt-financed, the Petra transaction has had a negative effect on Barry Callebaut's key credit metrics and financial flexibility.

THREE GROWTH DRIVERS TO SUPPORT SALES VOLUMES

Barry Callebaut achieved 11.8% volume growth in FY2013/14 primarily driven by 12-months contribution from Petra's acquired assets. Sales volume excluding contribution from the acquisition were up 2.9%, driven by outsourcing agreements up 8.7%; volumes in the emerging markets up 18.3%; and gourmet and specialties up 7.3%. Although Europe remains Barry Callebaut's biggest source of revenues, contribution to sales volumes declined to 43% FY2013/14 from 48% in the previous year, reflecting the contribution from Petra with around 60% of sales volumes in the emerging markets.

Barry Callebaut continues to target mid-term average sales volume growth of 6%-8% per annum, with volume expansion to be supported by the same three growth drivers: (1) additional outsourcing agreements and strategic partnerships; (2) increasing demand for chocolate products in emerging markets; (3) continued growth in its gourmet and specialties product range.

Most notable examples of outsourcing trends include Barry Callebaut's outsourcing agreements with Unilever (A1 stable), Grupo Bimbo (Baa2 negative), Mondelez (Baa1 stable) and Industria de Alimentos dos en Uno S.A., a subsidiary of Arcor S.A.I.C. (B2 stable), The Hershey Company (A1 stable) and others. Branded consumer goods companies are increasingly outsourcing part of their production against a background of constraints on return on assets, working capital volatility and increased focus on brand marketing.

In fiscal year 2013/14, capacity utilization of Barry Callebaut in chocolate was 87% (target: 82%-85%) and in cocoa processing 84% (target: 90%-92%). Capacity constraints in chocolate in Europe had an impact on volumes in the region (volumes were down 1.2% vs the underlying market up 1.2%). However, despite the lower volumes, EBIT in Europe increased by 5.3% given the focus on optimizing customer and product segmentation with increased production of higher margin products. Barry Callebaut is addressing the shortage of capacity in Europe and added nearly 10% new liquid chocolate capacity. Management also guided for further investments in capacity extensions over 2014-15.

COCOA SUPPLY DISRUPTION RISKS INHERENT TO THE INDUSTRY CONSTRAIN RATING

The main cocoa-growing areas are West Africa (around 72% of world supply, according to ICCO 2014), South America and South East Asia. The cocoa market is very concentrated, with Ivory Coast accounting for 40% of the global cocoa bean 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 consideration when assessing the credit strength of manufacturers of cocoa and chocolate products. Despite Barry Callebaut's efforts to diversify its sources and to build strong business relations with cocoa farmers, the company'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. The acquisition of Petra has helped diversifying Barry Callebaut's sourcing of cocoa beans into Asia and Brazil, but we expect that the business and industry in general will remain reliant on Ivory Coast.

HEDGING STRATEGY AND COST-CONTROL INITIATIVES UNDERPIN MARGIN PREDICTABILITY

Barry Callebaut's 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 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 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 volatility. In addition, we view positively Barry Callebaut's constant focus on reducing operation costs. Although Barry Callebaut has proven its ability to sustain stable operating profits through periods of cocoa price volatility, its business remains vulnerable to supply shortages. We however note that so far the company has well managed supply disruptions.

BUT LIMITED DELEVERAGING AFTER PETRA ACQUISTION

Following the Petra transaction, Barry Callebaut's financial profile is less conservative than it has been historically. In addition, Barry Callebaut's heightened level of acquisition and investment activity reveals that it is more willing to increase its financial leverage and be financially aggressive than was incorporated in our previous ratings.

Despite improved operating performance as a result of the successful integration of Petra, free cash flow in FY2013/14 turned negative on the back of a working capital outflow of CHF279 million driven by higher cocoa prices, as well as increased investments in production capacity. As a result, leverage at FY2013/14, as measured by adjusted debt/EBITDA, slightly increased to 4.4x from 4.3x as of FY2012/13 and the company's retained cash flow (RCF)/net debt has worsened to 11.3% as of FY2013/14 from 16.1% as of FY2012/13.

We expect that operating performance will continue to improve in FY2014/15 with EBIT growing in the mid-single-digit range with the company progressing well toward its target of increasing the EBIT per tonne to its pre-acquisition level of CHF256 by FY2015/16. Together with the additional synergies from the integration of Petra coming on stream, most of the improvement in the EBIT per tonne will be driven by the growth in the gourmet and specialties, which is the highest margin segment. Additional improvement in profitability would also depend on the company's ability to achieve higher scale effects through better capacity utilization in cocoa processing, and to maintain overhead costs flat; among the others, management guided a cost freeze and an increased focus on headcount, with the general rule being no new hiring for the FY2014/15.

Although Barry Callebaut intends to improve its financial leverage over the next few years to be consistent with investment-grade levels, we expect that free cash flow will be constrained by the material investment programme. However, we note that the company has some leeway to curtail its capex if needed as around 50% relates to growth projects. Barry Callebaut's ability to generate positive free cash flow will also depend on the volatility in cocoa prices, which could result in additional material working capital outflow.

Liquidity Profile

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 FY2013/14, results in unfavourable swings in working capital, requiring credit facilities to cover variable and unpredictable needs. Whilst CP is used to fund working capital needs, Barry Callebaut's committed liquidity sources consist of a EUR600 million revolving credit facility (EUR525 million was undrawn as at FY2013/14) and EUR275 million in asset-backed security programmes (EUR31 million available as at FY2013/14). However, because of working capital volatility CP issuance may not be fully covered by alternate liquidity at all times. As a speculative grade issuer, this exposes the company to short term market dislocations.

In June 2014, the company amended and extended the EUR600 million revolving credit facility (originally signed in June 2011) from June 2016 to June 2019. The facility incorporates a EUR75 million swing-line 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) (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, end-August 2014, the company was in compliance with its covenants, with headroom under its covenants broadly in line with the testing date end February 2014. Positively, the revolving credit facility does not include any leverage covenants, giving Barry Callebaut more flexibility to cope with unfavourable swings in working capital.

More positively, we understand that management is exploring other options which could enhance the liquidity profile and increase headroom to cope with working capital swings: conversion of some facilities from uncommitted to committed and upsizing of the EUR275 million ABS programme.

Structural Considerations

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

Rating Outlook

The rating outlook is stable, reflecting Barry Callebaut's solid business profile and operating performance despite elevated leverage following the Petra acquisition and the ongoing pressures of working capital needs on liquidity management. It reflects our expectation that the company's key credit metrics will gradually improve but the pace of improvement will be constrained by working capital and capex needs. More positively, with diminished integration risk of Petra's acquired assets, Barry Callebaut has more flexibility to improve its financial profile.

What Could Change the Rating - Up

Although not expected in the short term, positive rating pressure could develop if, in conjunction with improved liquidity and increased diversification of raw materials supply, Barry Callebaut (1) improved its adjusted EBITDA margins towards double-digit levels in percentage terms; (2) further reduced its adjusted gross debt/EBITDA ratio towards 3.0x; and (3) increased its RCF/net debt ratio above 20%.

What Could Change the Rating - Down

Negative pressure could be exerted on the ratings if (1) the company failed to maintain its adjusted EBITDA margins at high single-digit levels in percentage terms; (2) its credit metrics remained weak, with RCF/net debt in the mid-teens in percentage terms or adjusted leverage not returning below 4.0x by the end of FY2014-15; (3) we had renewed concerns with regard to supply risk or (4) liquidity further deteriorates.

Other Considerations

Methodology grid: In assessing the credit quality of Barry Callebaut, we apply the Global Protein and Agriculture Industry Methodology (last updated in May 2013). The methodology grid outcome for Barry Callebaut is Ba3, based on the company's last full year results to 31 August 2014. The rating from the grid is two notches below the final rating as the financial metrics as at FY2013/14 have been negatively impacted by a material working capital outflow on the back of high cocoa prices, which is however mitigated by the hedging of inventories; the financial metrics have been also affected by the Petra acquisition.

Rating Factors

Barry Callebaut AG

Protein and Agriculture Industry Grid [1][2]	**Current FY 8/31/2014**		[3]**Moody's 12-18 Month Forward ViewAs of 1/6/2015**	
Factor 1 : SCALE & DIVERSIFICATION (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Total Sales (USD Billion)	$6.5	Ba	$6.6 - $6.9	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	Baa	Baa
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	0.4%	Ca	10% - 13.5%	B
b) Debt / EBITDA	4.4x	B	4.0x - 4.3x	B

c) EBITA / Interest Expense	3.7x	Ba		4.0x - 4.1x	Ba
d) Debt / Book Capitalization	56.6%	Ba		54% - 55%	Ba
Rating:					
a) Indicated Rating from Grid		Ba3			Ba2
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 08/31/2014; Source: Moody's Financial Metrics [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.

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