Barry Callebaut

14th April, Piri Muthu
BARY; Baa3 Neg/BBB- Stable

mil CHF	FY20	FY21	FY22	FY23	FY24	**FY25 Forecast**
adj. EBIT	491	567	625	659	704	**775**
YOY		*15%*	*10%*	*6%*	*7%*	*10%*
EBIT	483	567	553	659	446	**575**
YOY		*17%*	*-2%*	*19%*	*-32%*	*29%*
FCF	317	355	266	113	-2,331	**-1,947**
Net Leverage	1.9x	1.6x	1.5x	1.5x	5.5x	**7.2x**
ICR	4.7x	5.6x	4.5x	5.3x	2.2x	**1.6x**

Source: MNI
Leverage and ICR against statutory (unadjusted) EBIT(DA). Assuming unchanged Cocoa prices (yoy) in the 2H.

Outside the sharper volume decline of -4.7% and **FY revision down to MSD decrease in volumes (prev. LSD)** not much else is unexpected in the 1H numbers. As we warned from primary day, it was always going to see a large WC swing (Cocoa has doubled yoy and it stocks most inventory in the 1H after the harvest period). It also pushed back the benefits of its cost saving programme by one year **(was to be +CHF187.5m/yr bottom line benefit).**

When it was in primary, we modelled leverage and interest cover on a conservative statutory EBIT and EBTIDA from last year. **Statutory EBIT is up +66%yoy** and it has **kept guidance unchanged for double digit adjusted EBIT growth.** But below that **net profits still more than halved** on rising financing costs - again something we modelled to conservative CHF330m (+43%yoy). It saw CHF197m (+174%) financing cost over 1H - the rise is higher than we expected on rising margin costs on the exchange. But it says this will be less severe in 2H and **sees FY financing costs around CHF350m**.

We did see downgrade into HY as very likely mostly from Cocoa staying elevated for longer than rating agencies expected. Moody's today has indicated it is willing to wait and is likely looking at Cocoa now down on last year's levels as support for credit metrics. Co continuing to guide to dividend growth (paid CHF160m last year) will not help ratings - small in relative sense but we would have thought it would show better governance after issuing €1.75b (CHF1.62b) on steps (will cost CHF8m/notch if raters move in sync).

On FV level here **investors should focus on longer term trends**, keeping in mind if Cocoa prices stay flat yoy change in WC will reverse to zero and remove the largest drag of FCF. The remaining question then will be if it can remain competitive on the higher capital base (pass-through of costs including interest leaves a more expensive service for its clients). **The reference to increased insourcing trend from clients is not nice to hear** but it played it down as a temporary reaction. Re. medium term volume trends, **the 6-9month delay between spot to shelf pricing means more pain may be ahead as consumers react to the Dec/Jan spike**. Finally, any renewed spot cocoa increases (yoy) should not be taken lightly.

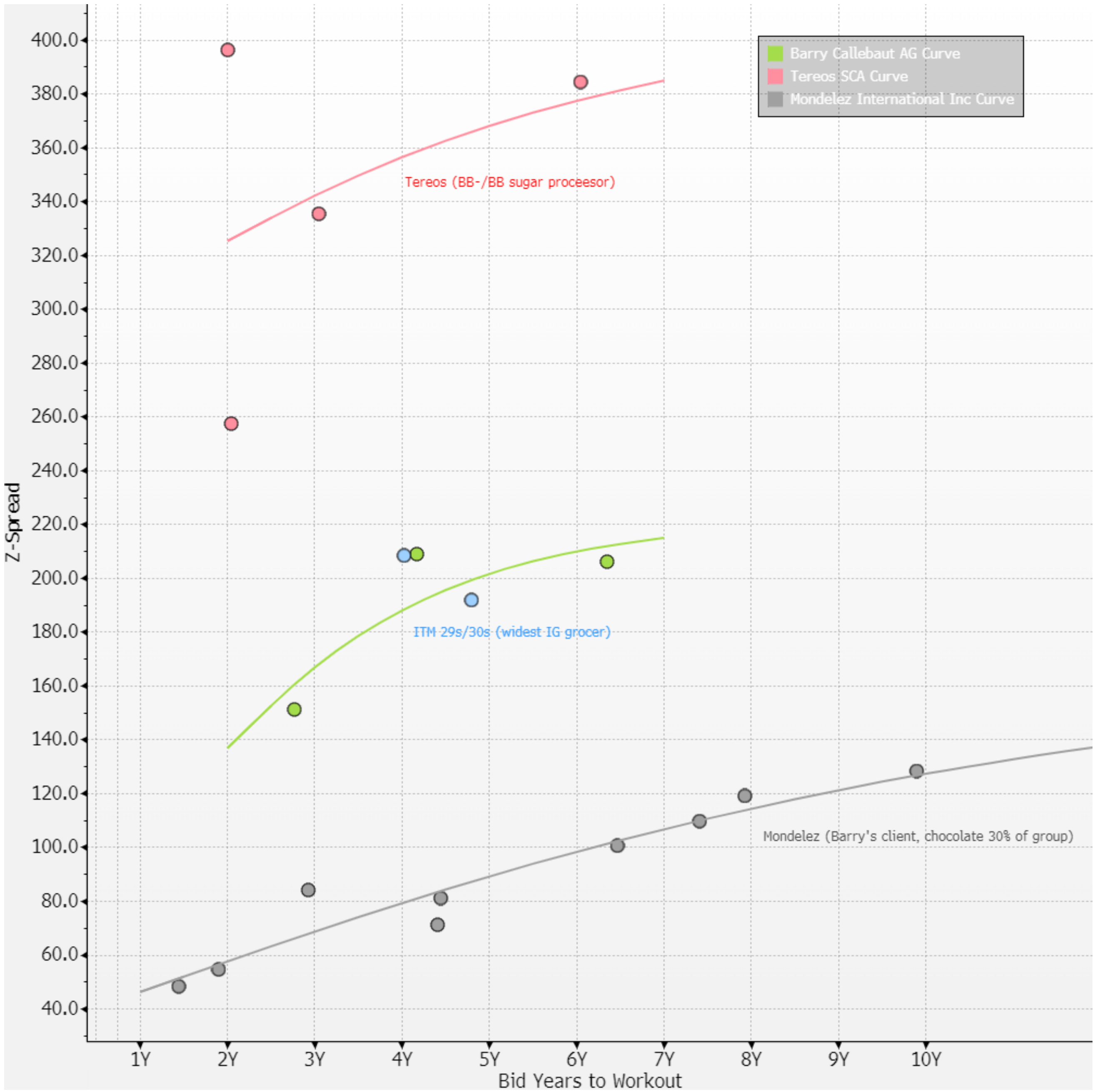
Regarding non-step 29s we got some pushback for setting 28/31s FV in primary tight to it yet 28s have gone from -19bps to -60bps inside it since. The step is standard, terms from the final prospectus below;

- 0.25% per notch AND per agency (Moody's and S&P) step up AND step down – applicable below Baa3/BBB-.
- The adjusted rate is applicable from the first interest payment date following the rating event.
- Max increase of 1.5% (if both agencies move together protected up to Ba3/BB-). Note coupon step-downs will account for any downgrades beyond the max 1.5% when being upgraded back up.
- Coupon adjustments (in either direction) will cease to apply if notes are rated Baa2 and BBB or higher by BOTH agencies.
- No handling for final year (i.e. no coupon adjustments for rating changes in final year).
- For as long as notes are outstanding company will use all reasonable efforts to maintain a rating from both agencies.

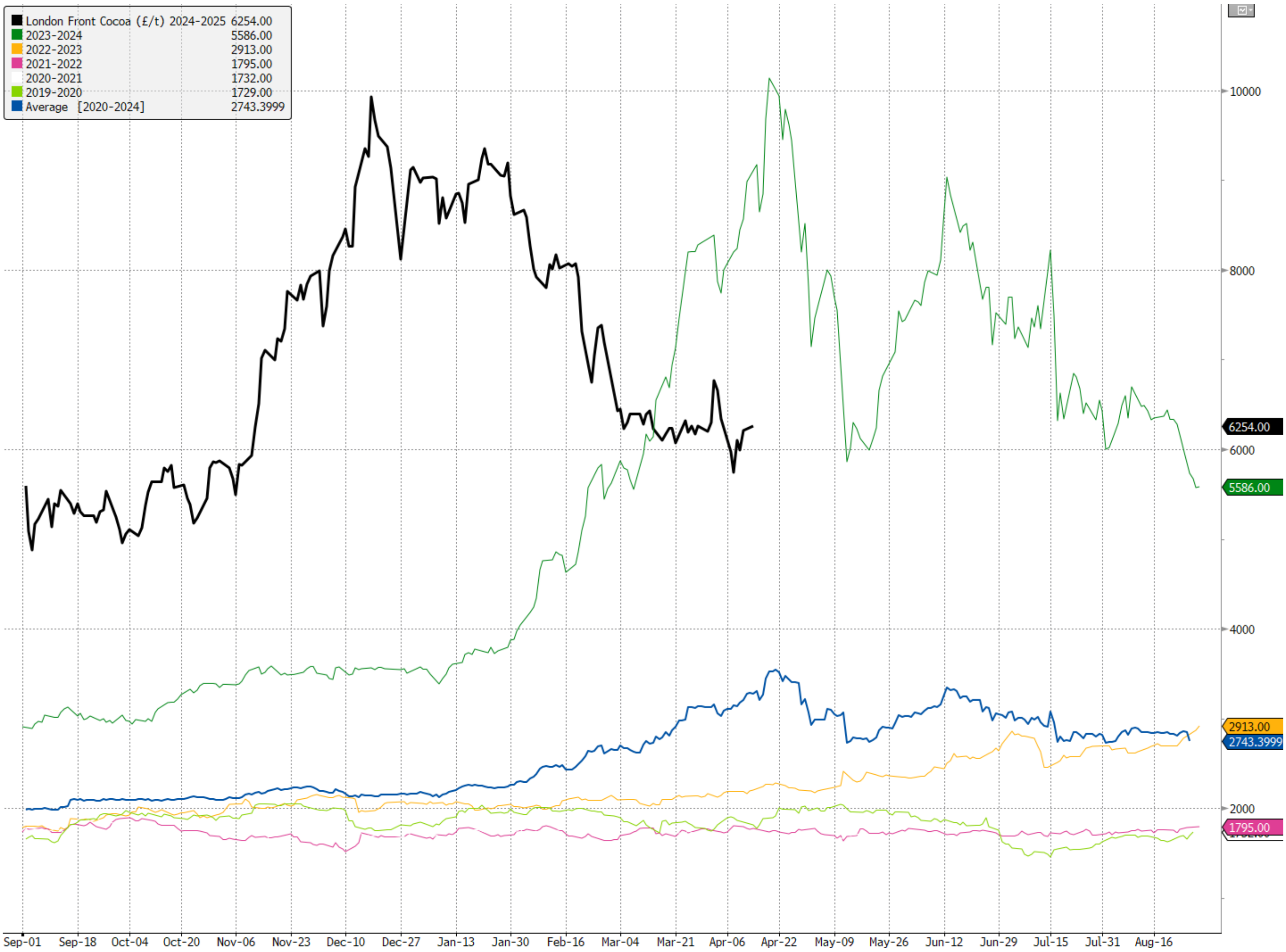
Three potential scenarios and their associated value shown below. Cocoa spot price remains in the driver seat for credit and hence which rating path we see. Those that see more bearish outcomes will still see value in rotating from the 29s into the 31s (i.e. continued flattening). We struggle to see value in the 29s, particularly at these levels (all three have room to rally if IG ratings kept).

	28s	29s	31s
no step level (current)	**150**	**205**	**205**
additional spread (Z)			
1-notch downgrade at both raters before next coupon date, followed by no upgrade	+ 35	+ 0	+ 48
1-notch downgrade at both before next coupon date, followed by upgrade by both in the following period	+ 18	+ 0	+ 9
1-notch downgrade at both before next coupon date, followed by another notch downgrade at both in the following period	+ 50	+ 0	+ 86

'Next coupon date' is 19th February 2026 for the 28s and 19th August 2025 for 31s. Coupons annual from those dates.
Source: MNI



Source: MNI, Bloomberg



Graph set to match Barry Callebaut FY (starting September)
Source: MNI, Bloomberg

12th Feb; common questions we get

Barry has taken a view on Cocoa and it has not played out

- **Barry does not take a view on Cocoa**, it simply buys, processors and then sells the finished product. In that process the amount of money it needs to initially buy the Cocoa and hence the amount of capital that is tied up in inventory (the 'capital base') is dependent on cocoa prices. This is what has increased and this is why it has been tapping debt markets for funding.

Barry 29s widened because Cocoa price increases eat into profits

- **Actually the opposite**. If you open Barry's financial statements and only look at the income statement you will see a healthy company. If you then look at analyst or rating agency forecasts you will see revenue growth and EBIT margin expansion forecasted for the year ahead. This is the power of pass-through contracts it has with most (~70%) of clients - paired with hedging on inventory held till it sells. Again the issue is on the balance sheet - a large increase in value of inventory and associated debt funding to purchase it. These are still relevant for credit and they do creep into the income statement from higher interest costs.

Barry's leverage is too high so it may be downgraded

- Barry's leverage is well outside IG already. In fact as of December, **Moody's had leverage in CCC territory and interest cover in single-B**. It's holding onto IG ratings because raters believe that the market will autocorrect supply and demand to bring cocoa prices down. Paired with this is company's guidance for double digit adj. EBIT growth (adjusted for costs related to efficiency program). **We see FY25 leverage if Cocoa remains elevated at £9k/t at net 7.5-10x (upper end if you assume no earnings growth)** (all including the CHF200-250m it will spend on cost efficiency programme).

If Cocoa stays flat at ~£9k/t working capital/FCF will reverse positive and it will be fine

- **No the WC reversal will only occur if Cocoa prices fall. Otherwise it will need to maintain the higher capital base** to continue buying Cocoa at the elevated prices. What it will mean though is no more negative FCF - it will revert to normal operating cash flows minus the more elevated interest costs. This can be a tool it uses to delever net leverage (we see ~CHF0.5b in FY26).

12th Feb; the larger concerns we do have

- **Unforeseen weather events** - 70% of global Cocoa comes from west Africa (Ivory coast 44%, Ghana 14%, Cameroon 6%, Nigeria 6%). Poor weather for crops has been one of the largest drivers already.
- **Industry invests more on cocoa-free chocolate alternatives** (while Barry has little room for R&D). Hershey CEO last week; "*We have been seeing some increased global demand across the market for cocoa alternatives*" and re. cellular agriculture "*It's something we're watching very closely. I don't think it is necessarily near-term, but I think it can be a game-changer and it's certainly getting a lot of investment right now. So I think it's something to watch*."
- **Threat of insourcing** - i.e. clients like Mondelez process the Cocoa themselves. It says this is happening with some big clients but is being offset by outsourcing from clients who struggle more in this volatility. Net net it sees it balanced.
- Supply does not do its part and **demand falls more than the low-single digit volume decrease** it has guided to (and is currently experiencing). This could start pressuring the guidance for double digit EBIT growth.
