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Research Update:

Luxembourg-Based JAB Holding Co. Affirmed At 'BBB+' On Definitive Agreement To Acquire Panera Bread; Outlook Stable

Primary Credit Analyst:

Carole Missoudan, Paris (33) 1-4420-6723; carole.missoudan@spglobal.com

Secondary Contact:

Per Karlsson, Stockholm (46) 8-440-5927; per.karlsson@spglobal.com

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Overview

- JAB Holding Company S.a.r.l. has entered into definitive agreement to acquire U.S. retail bakery-café Panera Bread for approximately \$7.5 billion.
- The transaction will be undertaken by a consortium of investors led by JAB, and we expect JAB's ultimate equity injection will be funded through a mix of cash and existing lines.
- We are therefore affirming our 'BBB+' rating on JAB and our 'BBB+' rating on its senior unsecured debt.
- The stable outlook reflects our expectation that JAB's management will contain the debt built-up sufficiently in line with a loan-to-value (LTV) ratio of 20%. However, we expect headroom under the LTV ratio to be limited.

Rating Action

On April 11, 2017, S&P Global Ratings affirmed its 'BBB+' long-term corporate credit rating on Luxembourg-based JAB Holding Company S.a.r.l. (JAB). The outlook is stable.

We also affirmed our 'BBB+' issue ratings on JAB's senior unsecured debt issued by JAB Holdings B.V. and guaranteed by JAB.

Rationale

The affirmation follows JAB's announcement that it would lead a consortium to acquire 100% of Panera Bread in a take-private transaction for a total consideration of approximately \$7.5 billion.

Panera Bread is a U.S.-based retail bakery-café company chiefly focusing on the U.S. market through its 2,000 store network and a minor presence in Canada. In 2016, the group generated just under \$3 billion in revenues and reported EBITDA of \$430 million.

We understand this proposed transaction will be financed through debt at Panera's level, and contributions from JAB, JAB Consumer Funds, and other investors. This type of financing is fairly similar to the one that JAB undertook less than 12 months ago for the \$13.5 billion Keurig Green Mountain

(KGM) acquisition. We think JAB's still-undisclosed contribution will be financed through a combination of cash and further drawing on its €2.6 billion existing lines due 2021. Despite the debt increase, we expect the loan-to-value (LTV) ratio to be sufficiently near our threshold for the rating of 20% or marginally above it for only a short period of time. If needed, we expect management will consider assets sales and use the proceeds to lower the LTV ratio. With a portfolio valued at about €21 billion as of April 10, 2017, which compares with net debt of €3.6 billion at year-end 2016, JAB currently enjoys very limited flexibility for further acquisitions. As per our calculations, and based upon current market prices, the company can accommodate a net debt increase of only €800 million before its LTV ratio increases from 17% to 20%.

We view the proposed acquisition as relatively aggressive, given the price of more than 17x EBITDA (year-end 2016), which represents a 30% premium versus the 30-day average share price as of March 31, 2017.

Some execution risk remains, with only 15.5% of the shareholders' approval secured at this stage through the voting agreement the founder has entered.

Should JAB complete this transaction, our view of its business risk profile would, however, weaken, since we believe both asset liquidity and quality have deteriorated lately. The average credit quality of JAB's portfolio has recently been impaired by Reckitt Benckiser undertaking a \$17.9 billion debt-funded acquisition of Mead Johnson, which resulted in our downgrading Reckitt Benckiser to 'A-' from 'A+' (see "Consumer Health Group Reckitt Benckiser Downgraded To 'A-/A-2' On Agreement To Acquire Mead Johnson; Outlook Stable," published March 15, 2017, on RatingsDirect).

Additionally, Coty's share price underperformed due to challenging integration of the P&G Beauty Business, and JAB's listed assets further decreased to less than 50% of the portfolio as of April 10, 2017.

JAB's significant involvement in its core assets further weighs on our liquidity assessments, since this could undermine their immediate tradability, in our view.

Such unsupportive developments were somewhat mitigated by KGM's improved creditworthiness (see "Keurig Green Mountain Inc. Upgraded To 'BB' From 'BB-'; Outlook Stable; Issue-Level Rating Actions Taken," published Jan. 26, 2017); Reckitt Benckiser and Coty maintaining their dividend policies; and continuous deleveraging of other key operating assets, including JACOBS DOUWE EGBERTS International B.V. (JDE), Peets, and Caribou Coffee, although uneven by operating assets.

We think Panera fits well in the group's investment portfolio by complimenting its €2 billion retail coffee adjacency assets, notably retail restaurants Caribou Coffee, Einstein Noah, and Peets. It will provide some portfolio diversification without necessarily impacting the weight of the top three assets, which have already improved since the KGM integration (representing about 60% compared to more than 80% at year-end 2015).

We think that JAB would structure Panera's funding in a moderately aggressive way, in line with the leverage of other operating assets in the portfolio; we anticipate adjusted debt-to-EBITDA ratios in the range of 3.5x-5.0x for Coty, Keurig, and JDE by year-end 2017. Consequently, we anticipate average asset quality will deteriorate to the 'BB' category. However, this is subject to Panera's eventual weight in the overall portfolio value. We expect JAB's financial policy will remain conservative and that debt at Panera will remain nonrecourse to JAB's debt and not pose cross-default risk.

In our opinion, JAB's financial risk profile is supported by the management's ability to enhance the portfolio value with discipline, sustainably sticking to an LTV ratio of 20%. With the integration of new portfolio lines being accompanied by the contribution from JAB Consumer Fund, the holding can retain its spending while maintaining an LTV ratio in line with 20%. If the LTV ratio exceeds 20% upon closing of the transaction, we would expect management to take action to restore it to the level required for the current rating.

JAB favorably compares with a number of other investment holding companies with no debt maturities within the next four years. What's more, the group has a track record of maintaining cash flow coverage of at least 2x; pro forma Panera, we would expect some uplift in cash flow coverage.

Under our base case, we assume:

- An equity injection in Panera funded through a mix of cash and debt that would allow JAB to maintain its LTV ratio below 20%;
- Mitigating actions from management should the LTV ratio threaten to exceed 20% for a sustained period of time;
- Dividend inflows from its respective operating assets to improve by at least 10%, given dividend announcements; and
- No debt maturities before 2021.

Based on these assumptions, we arrive at the following credit measures:

- An LTV ratio in line with our current threshold for the rating of 20%; and
- Cash flow coverage of at least 2x in 2017 and 2018.

Liquidity

We view JAB's liquidity as strong, anticipating that the group's sources of liquidity will exceed its needs by more than 1.5x for the 12 months ending Dec. 31, 2017. The indicative liquidity uses don't capture the Panera transaction, given the undisclosed amounts of JAB's ultimate equity injection at this stage.

We estimate liquidity sources include:

- Cash of about €181 million as of Dec. 31, 2016;
- About €1.8 billion available under the group's €2.6 billion revolving credit facility;
- Expected dividends from portfolio companies in excess of €270 million (primarily from Reckitt Benckiser and Coty).

We estimate liquidity uses include:

- Operating expenses of approximately €35 million-€40 million;
- Interest expenses of €80 million-€90 million; and
- About €65 million-€70 million in returns to shareholders, in line with JAB's internal target.

As of Dec. 31, 2016, the group showed adequate headroom under its financial covenants.

Outlook

The stable outlook reflects our expectation that upon closing of the Panera Bread transaction, JAB's LTV ratio will remain in line with the 20% threshold we deem commensurate with the current rating. While the LTV ratio could marginally exceed 20% for a short period, we expect management to be proactive and take appropriate measures, such as asset rotation, if needed. Since we consider that the current ratings cannot accommodate any more debt, we expect JAB will generally finance further significant acquisitions through disposals.

Downside scenario

We could consider a negative rating action if JAB's LTV ratio rose above 20% for a prolonged period of time, without management taking actions to reduce it. Ratings pressure could be triggered in case of a material decline in JAB's equity values, or if its listed assets were below 60% of total assets for an extended period of time and absent clear commitment from management to consider asset monetization through an IPO within the next 18 to 24 months.

Upside scenario

We consider ratings upside to be remote at this stage, since it would necessitate improvements in the portfolio's characteristics, including a greater emphasis on asset diversity and higher liquidity of held shares. Assuming broadly unchanged portfolio characteristics, we could raise the ratings if JAB reduced leverage over time, and proved its commitment to an LTV ratio sustainably below 10% over our rating horizon.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Stable/--

Business risk: Satisfactory

- Country risk: Low
- Industry risk: Intermediate
- Investment position: Satisfactory

Financial risk: Modest

- Leverage/Cash flow: Modest

- Funding and capital structure: Neutral

Anchor: bbb+

Modifiers

- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

Related Criteria

- Criteria - Corporates - Industrials: Methodology: Investment Holding Companies, Dec. 01, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Consumer Health Group Reckitt Benckiser Downgraded To 'A-/A-2' On Agreement To Acquire Mead Johnson; Outlook Stable, March 15, 2017
- Keurig Green Mountain Inc. Upgraded To 'BB' From 'BB-'; Outlook Stable; Issue-Level Rating Actions Taken, Jan. 26, 2017

Ratings List

Ratings Affirmed

JAB Holding Company S.a r.l.
Corporate Credit Rating

BBB+/Stable/--

JAB Holdings B.V.
Senior Unsecured

BBB+

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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