Research Update:

JDE Peet's N.V. Upgraded To 'BBB-' On Stronger Credit Metrics; Outlook Stable

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Rating Action Overview

- JDE Peet's N.V. (JDEP), the parent of the world's largest pure-play coffee group, demonstrated resilience during 2020 thanks to the leading brand equity of its portfolio across product categories and different geographies.
- Notwithstanding our expectation of a continued tough environment in the out-of-home channel, we project that the group's annual free operating cash flow (FOCF) will return to above €900 million from 2021, supporting its deleveraging progression. The group has a supportive financial policy with company-reported target debt leverage of about 2.5x.
- We therefore raised our long-term issuer credit rating on JDEP to 'BBB-' from 'BB+', and revised our outlook to stable from positive. We also withdrew our ratings on its subsidiary, Jacobs Douwe Egberts International B.V., and discontinued our issue-level ratings on its debt facilities that were refinanced in March 2021.
- The stable outlook indicates that the group's strong market position in the growing global coffee category and prudent cash management will allow it to reach and maintain S&P Global Ratings-adjusted debt to EBITDA below 3.0x and FOCF-to-debt comfortably in the range of 15%-25%.

Rating Action Rationale

We expect continued solid annual free cash flow generation coupled with debt reduction in line with the group's financial policy. During 2020, JDEP demonstrated a relatively resilient operating performance despite the pandemic-related headwinds. For the full-year 2020, excluding negative foreign exchange movements, the overall revenue base remained broadly flat (down about 0.2% versus 2019), while adjusted EBITDA margins (after restructuring costs) improved year-on-year by 120 basis points (bps), to 22.2%. The improvement in profitability was in part supported by a temporary reduction in advertising and promotion (about 28% lower versus 2019), as the group benefited from its leading brand equity across key geographies. FOCF remained strong at around €750 million, despite extra costs related to the public listing (June 2020) and some tax prepayment cash expenses. The group's performance supported the debt reduction with an S&P Global Ratings-adjusted debt to EBITDA of 3.7x (down from 4.9x in 2019).

Under our base case, we forecast a sound rebound in revenue growth to 6%-8% in 2021, mainly stemming from product mix and volume. We anticipate 5% organic revenue growth, in line with the upper end of the company's guidance, supported by a partial rebound in the out-of-home channel (about 10% of total 2020 sales) which should support volume growth. We also anticipate recent world green coffee bean price increases to support revenue growth in 2021. Our expectations for continued debt reduction incorporate broadly stable adjusted EBITDA margins of 21%-22%, as advertising and promotion expenses normalize toward the higher end of 5%-6% of total revenue, in our view. In terms of FOCF generation, we expect a return to over €900 million in 2021, rising to over €1 billion in 2022. These levels should be supported by continued working capital inflows and low capex requirements. This should translate into S&P Global Ratings-adjusted debt to EBITDA of about 3.0x-3.1x in 2021, improving sustainably below 3.0x in 2022, a level that better entrenches the group in the 'BBB–' rating.

JDEP's capital allocation policy supports an investment-grade rating, in our view. We estimate that JDEP's target debt leverage of net debt to adjusted EBITDA at about 2.5x (according to company calculations) translates into about 2.7x-2.8x on an S&P Global Ratings-adjusted basis. In our adjusted debt calculations for 2020, we included about €300 million of reverse factoring utilizations (supply chain financing as of December 2020), €228 million of operating lease obligations, and €2.4 million of debt-like guarantees. We net €389 million of unrestricted available cash against debt. Our adjustment for reverse factoring reflects the estimated amounts that result in different payment terms for the group's payables beyond our general and standard assumption of 90 days. Following the ongoing reduction we have seen in the past few years, we expect the overall utilizations of supply chain financing to reduce further in the future.

In terms of capital allocation priorities, we understand that organic growth reinvestments and debt reduction are the group's priorities, while large acquisitions and share buybacks will not be considered before debt leverage reduces to the company's target level. For this reason, we think large acquisitions are unlikely in the near to medium term, and the group will likely be spending on selected bolt-on acquisitions focused on complementing existing product offering, with a view to expand scale in certain growing geographies, such as Latin America and the Asia-Pacific region. Our forecasts assume annual acquisition spending of about €200 million in 2021 and €300 million beyond that, levels that can be absorbed relatively easily by the group's sound FOCF generation.

The strong brand equity and diversified product portfolio should support resilient performance. The resilience of the group's extensive brand portfolio covering all pricing points was evident in 2020. According to Euromonitor International, JDEP maintained its overall market share (at about 10%) of the global coffee industry. It is the second-largest player globally behind Nestle. Most of the group's brands have either maintained or further increased its market share across key geographies. For example, in the premium product offering, such as capsules, L'Or continued to gain market share in Western Europe, with Illycafe's capsules also contributing strongly. The group is also seeing continued growth in premium beans and instants, as well as instant mixes. We understand that for 2021 and 2022, the group will prioritize growing the market shares of its own brands, while executing on selective value-accretive partnerships, such as the recently announced liquid coffee partnership with J.M. Smucker in the U.S foodservice sector.

We expect to see a continued trend toward premiumization in the global coffee market. During the pandemic, the global coffee market saw growth in value terms (about 3.4% compared with 2019, to about $92.2 billion), offsetting volume decline due to subdued foodservice consumption that typically accounts for about 20% of total sales volumes for the industry. The category has grown by about 3.2% on a constant adjusted growth rate (CAGR) basis since 2015, notably driven by premiumization trends toward higher-margin single serves, led by Western Europe. We think that this trend will likely continue in the near to medium term, and as global vaccination progresses, we think that it should support JDEP's organic growth and debt reduction prospects.

JDEP is expanding its geographical diversity with selected investments outside Europe. In recent years, JDEP's reported EBIT margin in its core European markets (52% of total 2020 sales) has risen remarkably, exceeding the 30% mark in 2020 (compared with 26% in 2017), driven by strong premiumization trends thanks to growth in capsules and premium beans. In light of the past three-year improvement, we believe that there is limited further potential for margin increase in Europe. The group is now targeting growth potential in different markets, including the U.S. and China. JDEP has a relatively small overall market share in North America (2% estimated by Euromonitor International) and we believe that the market could provide incremental growth owing to growing premiumization trends in the region, which has generally trailed Europe in recent years.

In China, which is still a very small market for the group, JDEP intends to increase its coffee store footprint to more than 150 (from about 35), while pushing through its at-home premium beans offering through both retail and digital channels. In terms of the planned coffee store expansion, we understand that the prime targets will be high-density locations (both residentially and commercially) in China, where per capita coffee consumption is rising fast. That said, these investments will likely take time to translate into higher margins from a regional perspective, and we think that the company's profitability levels in Asia and the U.S. will continue to trail the European segment by a considerable margin in the medium term.

JDEP's credit profile is constrained by single-commodity exposure, and to a lesser extent by regional earnings concentration. Coffee represents 85% of the group's sales. Globally, the coffee industry is characterized by high sourcing risk with the top-five exporters globally (Brazil, Vietnam, Columbia, Indonesia, and Honduras) accounting for about 72% of total global production. Brazil, the world's largest exporter, and Vietnam (second largest) account for about two-thirds of JDEP's green coffee bean supplies. While global coffee prices ticked up in recent months, as of April 2021 they were still about 11% below the average level for the past 10 years, according to data from the International Coffee Organization. The prolonged low coffee prices reportedly result in hardship for millions of farmers around the world, particularly those located outside the top-three producers (Brazil, Vietnam, and Colombia), where the cost of production tends to be higher. While we think that industry participants are taking steps toward alleviating this pressure on their supply chain, we believe coffee is exposed to long-term sustainability risks.

To a lesser extent, JDEP's credit profile is constrained by its reliance on the core European markets. In Europe, JDEP's top-three countries in terms of sales are Germany, France, and the Netherlands, generating 34% of total annual sales. JDEP is a very small player in the U.S., and is not among the top players overall in most of the emerging markets of Asia-Pacific.

Outlook

The stable outlook reflects our view that JDEP will continue to exhibit a strong performance amid the ongoing pandemic, thanks mainly to the solid positioning of its diverse branded portfolio covering all pricing points. This should enable it to maintain stable annual FOCF, translating into FOCF-to-debt comfortably in the range of 15%-25%, which we consider supportive of the 'BBB-' rating level. Sound cash flow conversion supports the expected organic deleveraging trend, with debt to EBITDA falling below 3.0x on an adjusted basis by the end of 2022.

Downside scenario

We could take a negative rating action if, contrary to our base case, we see adjusted debt to EBITDA sustainably above 3.0x. In our view, this would most likely stem from a material change in the group's financial policy with a marked step-up in discretionary investments, such as mergers and acquisitions (M&A) or higher shareholder distributions.

Upside scenario

We could upgrade our ratings on JDEP if the group materially outperformed our base case, with stronger organic sales growth and profitability translating into a leverage ratio approaching 2.0x on an adjusted basis. At the same time, we would expect the group's financial policy to commit to these lower credit metrics on a sustainable basis.

Company Description

Netherlands-based JDEP is the nonoperating holding company which consolidates the operations of the world's largest pure coffee and tea producer. It comprises Netherlands-domiciled JDE and U.S.-based Peet's. JDE was formed in July 2015 through the merger of the coffee business of Mondelez and DE Master Blenders 1753. Peet's was founded in 1966 in Berkeley, California. JDEP procures green coffee beans for its coffee-related product offerings from farmers and commodity trading powerhouses. The group is directly responsible for about 8% of global coffee procurement.

JDEP's product portfolio includes roast and ground coffee, single serve, instant, and other types of coffee-related product (85% of 2020 revenue), tea (3%), other beverages and food products (10%), and ancillary services (2%). Notable brand names include Jacobs, Douwe Egberts, Pilao, Moccona, Gevalia, Kenco, L'Or Espresso, Tassimo, Senseo, Super, Essenso, OldTown, Intelligentsia, and Stumptown. The group is present across all main distribution channels, with retail accounting for 76% of sales in 2019, out-of-home 16%, retail coffee stores 5%, and online 3%.

JDEP reported revenue of about €6.65 billion in 2020 (€6.95 billion in 2019) and S&P Global Ratings-adjusted EBITDA of about €1.48 billion (€1.46 billion in 2019). In 2020, Peet's accounted for about 12.6% of total reported revenue and 7.7% of company-adjusted EBIT, while JDE accounted for the remainder.

JDEP is partially listed on the Amsterdam Stock Exchange. It is majority owned (55.35% of share capital) by private investment management group JAB Holdings (through Acorn Holdings B.V.), with Mondelez holding a further 22.9% of JDEP's share capital. BDT Capital Partners and Quadrant Capital Advisors hold further 7.1%, while the remaining shares are free floating. The group boasts total market capitalization of about €16.6 billion.

Our Base-Case Scenario

Assumptions for 2021 and 2022:

- Total revenue of about €7.05 billion–€7.2 billion in 2021 with expected potential annual growth of 6%-8% compared with 2020. This factors in about 5% organic growth, and the rest through small acquisitions. For 2022, we assume 5%-6% growth, reflecting about 4% organic growth and the rest through bolt-on acquisitions. We estimate the out-of-home channel to be broadly back to pre-pandemic levels by the end of 2023, with sequential improvement starting from the second half of 2021.
- Broadly stable adjusted EBITDA margins of 21%-22% in 2021 and 2022. This factors in partial operational deleveraging from rebound in out-of-home consumption, partially offsetting growth investments. We assume Asia-Pacific and Peet's coffee margins to improve relative to their 2019 baseline, reflecting growth investments in Asia and the U.S. coffee store optimization effort at Peet's.
- FOCF of over €900 million in 2021, rising to over €1 billion in 2022. We assume annual capex of about €300 million-€310 million in 2021, moderating to €250 million-€260 million in 2022, and continued working capital inflows, supported by utilization, albeit decreasing, of reverse factoring.
- Split €350 million of common ordinary dividends related to 2020 net income, €175 million of which payable in 2021 and the rest in January 2022. We assume progressively increasing dividend payments in line with earnings growth thereafter.
- Potential acquisitions of about €200 million in 2021, and €300 million thereafter.
- No share buybacks.

Key metrics

JDE Peet's N.V.--Key Metrics*

	--Fiscal year ended Dec. 31--		
	2020a	**2021e**	**2022f**
(Mil. €)			
Revenue	6,651.0	7,050-7,183	7,519-7,590
EBITDA margin (%)	22.2	21-22	21-22
Capital expenditure	252.0	300-310	250-260
Acquisitions	5.0	~200-220	~300
Free operating cash flow (FOCF)	750.0	>950	>1050
Debt to EBITDA (x)	3.7	3.0-3.1	~2.8
FFO to debt (%)	17.6	~24	26-27
FOCF to debt (%)	14.7	~20	23-24

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations.

Liquidity

We have raised our assessment on JDEP's liquidity profile from adequate to strong. This reflects the solid cash balances and very large RCFs, with no near-term material refinancing needs. We calculate that sources of cash should exceed uses by more than 1.5x over the next 24 months, and note that the group is no longer subject to any financial maintenance covenants following the amended terms of its debt facilities with its core group of banks. All debt facilities now benefit from cross-guarantees at JDEP level and are senior unsecured in nature.

Principal liquidity sources over the next 12 months include:

- €389 million of available unrestricted cash balances as of Dec. 31, 2020;
- €1.5 billion of available committed RCF maturing beyond the next 12 months following the refinancing of facilities in late March 2021;
- Annual cash FFO forecast of €1.1 billion-€1.2 billion; and
- Continued annual net working capital inflows supported by reverse factoring utilizations.

Principal liquidity uses over the same period include:

- €58 million of lease obligation payments due in the next 12 months; €319 million of short-term debt in the subsequent 12 months, including €300 million backstop facility that has two further six-month extension options;
- Projected capex of about €250 million-€350 million; and
- Annual dividend payments of about €350 million, split in two equal instalments payable in July 2021 and January 2022.

Debt maturities

The group's next sizable maturity is its €3.67 billion senior unsecured term loan A due November 2023. The €300 million senior unsecured backstop facility that is due in March 2022 has two six-month extension options that could prolong the maturity until March 2023.

Covenants

Following the amendment of the debt documentation in late March 2021, the group's debt, including the RCF, does not contain any financial maintenance covenants.

Environmental, Social, And Governance

We view environmental and social factors for JDEP as broadly in line with those of industry peers. Global demand for coffee has positive growth trends, thanks to its increasing penetration in emerging economies and different methods of preparation (for example, powder, capsules, and soluble). This growth in demand represents expansion opportunities for JDEP. However, such growth is constrained by sustainability risks in the coffee supply chain, with about 85% of JDEP's revenue coming from coffee-related products.

We see sustainability risks emerging for JDEP primarily in two ways: its concentrated geographic sourcing footprint; and the physical effects of climate change on coffee bean production. JDEP sources approximately two-thirds of its coffee beans from Brazil and Vietnam. Such a concentrated supply chain could constrain JDEP's ability to procure coffee, should a stochastic or black swan event occur in these regions. Similarly, the physical effects of climate change could have an outsized impact on coffee compared with some other soft commodities. Coffea arabica, which accounts for 75% of cultivated coffee globally, is grown at high altitudes. Because of its prescriptive growing conditions, it is estimated that more than 75% of the land area currently suitable for Coffea arabica cultivation will be lost to climate change by 2050. Though JDEP acknowledges this risk in its 2020 annual report, it is unclear what steps JDEP and the wider industry are taking to address this systemic risk. Compounding this physical climate risk is JDEP's sourcing strategy—two-thirds of overall coffee procurement comes from Brazil and Vietnam. Though we acknowledge that the risk of child or forced labor occurring in the coffee supply chain is high, we see this reputational risk as having a little effect on the business, at present. Positively, we regard JDEP's aspirations to engage directly with 500,000 coffee farmers by 2025 (380,000 were reached in 2020) as showing a willingness to comprehensively address the social and environmental risks that exist in its supply chain.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

Country risk: Low

- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no additional impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- 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: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- JDE Peet's N.V., Parent Of Jacobs Douwe Egberts, Rated 'BB+' On IPO Completion; Outlook Positive, June 26, 2020

Ratings List

	To	From
Upgraded; Outlook Action		
JDE Peet's N.V.		
Issuer Credit Rating	BBB-/Stable/--	BB+/Positive/--
Not Rated Action		
JACOBS DOUWE EGBERTS International B.V.		
Issuer Credit Rating	NR/--	BB+/Positive/--
Senior Secured	NR	BB+
Recovery Rating	NR	3(60%)