MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades JAB's LT issuer rating to Baa2, outlook stable

31 Mar 2020

Frankfurt am Main, March 31, 2020 -- Moody's Investors Service, ("Moody's") has today downgraded the foreign and local currency long term issuer rating of JAB Holding Company S.a r.l. ('JAB') to Baa2 from Baa1. Concurrently the agency has downgraded the backed senior unsecured rating of JAB Holdings B.V. to Baa2 from Baa1. The outlook on all ratings changed to stable from negative.

RATINGS RATIONALE

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The investment holding company sector has been one of the sectors most significantly affected by the shock given its exposure to asset valuations volatilities and sensitivity to consumer demand and sentiment. More specifically, the weaknesses in JAB's credit profile, including its exposure to volatile asset prices have left it vulnerable to shifts in market sentiment in these unprecedented operating conditions and JAB remains vulnerable to the outbreak continuing to spread. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. Today's action reflects the impact on JAB of the breadth and severity of the shock, and the broad deterioration in credit quality it has triggered.

The downgrade was, however primarily, prompted by JAB's decision to unwind the wholly owned Special Purpose Vehicle it has established during the course of 2019 to tender shares of Coty Inc. and to repay the term loan B that funded the purchase of the tendered shares. The unwind comes at a time when the share price of Coty has fallen sharply and JAB would have been forced to sell shares or contribute cash to the SPV to comply with the LTV covenant of the term loan. The repayment of the term loan will be funded through cash on balance sheet of JAB Holding Company S.a r.l. This will lead to an increase in net debt. Pro forma of the repayment, JAB's net debt will increase by close to 40% to around €5.8 billion. The increase in net debt is accompanied by pressure on asset values due to the outbreak of the coronavirus. The combination will lead to a deterioration in market value leverage. Pro forma MVL of JAB ranged between around 25% and more than 30% over the last 30 days to 24th March based on the variations in price of JAB's listed assets (assuming year-end 2019 valuations for private assets, which is an optimistic assumption). We note that even based on valuations of JAB's portfolio as per 31st December 2019, the pro forma MVL of JAB stood at around 23%, a level that is not commensurate with the Baa1 rating anymore.

We also believe that JAB might have to support some of its levered private assets such as Pret a Manger, Panera Bread or Bally through equity injections. Due to severe trading disruptions those companies might be in need of equity as a result of the coronavirus outbreak. This will add to the pressure on JAB's MVL. Lastly the cash dividend flow to JAB might reduce during the course of 2020 as a result of challenging trading conditions in some assets of the group. In this respect Coty has announced that it will offer its dividend in scrip and JAB has opted to take the dividend in shares.

While JAB remains committed to the maintenance of a strong investment grade rating some of the options that the issuer has in order to delever its balance sheet bears execution risks and might be weakening the group's overall business profile. More specifically we see material execution risk on the IPO of JDE/Peets and on the sale of Coty's professional beauty business and Brazilian operations at least in the short term. The potential postponement of the IPO will also delay the partial repayment of preference shares that have been issued by Acorn Holding to investors including JAB Holding, the JAB Consumer Fund and other investors. Acorn Holding is an intermediate holding company that owns JAB's shares in key companies such as Keurig Dr Pepper or JDE. The repayment of these preference shares has been one of the key pre-requisite for the maintenance of the Baa1 rating in the past. The Baa2 rating will be weakly positioned at the outset but encompasses the expectation that JAB will swiftly and forcefully restore metrics that would be in line with the current rating even in a market environment earmarked by declining asset values.

JAB's Baa2 rating remains supported by the company's strong investment portfolio comprising cash-generative and typically defensive global consumer businesses. Its investments in JDE/Peets and KDP, which accounted for approximately 65% of JAB's portfolio value at year-end 2019, should continue to protect the group's credit quality. We expect trading conditions and valuations of these two businesses to remain more resilient than other assets in the portfolio during the coronavirus outbreak notwithstanding that valuations will certainly come under pressure in a protracted market downturn.

While JAB has started to simplify its intermediate structures with the removal of the Cottage SPV, JAB's rating remains held back by the company's complex organisational structure and leveraged capital structure at intermediate holding companies, an elevated point in time market value leverage and a history of aggressive financial policies.

RATIONALE FOR THE STABLE OUTLOOK

JAB will be weakly positioned in its rating category pro forma of the unwind of the Cottage SPV. The stable outlook is supported by the issuer's commitment to restore swiftly and forcefully credit metrics in line with the current rating. While some of the measures JAB is working on bear material execution risk at the current juncture, JAB has several options at its disposal to improve its MVL in due course.

LIQUIDITY

JAB's liquidity is deemed solid pro forma of the SPV unwind. Pro forma of the term loan repayment JAB will have access to €800 million of cash on balance sheet and to €3 billion availability under a committed revolving credit facility (maturity: 2024 with two 1-year extension options).

JAB has a well spread maturity profile. JAB has no upcoming maturities in 2020 and only approximately €1.1 billion of cumulative maturities evenly spread over 2021/2022. JAB's access to listed investments (around 53% as per 31 December 2019) further supports the company's financial flexibility in the short to medium-term.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Investment Holding Companies and Conglomerates published in July 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1125855. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Factors that would lead to an upgrade or downgrade of the ratings:

Positive rating pressure could build if JAB's net MVL would drop sustainably to around 15%, the interest cover would increase sustainably to around 3.0x. A more transparent corporate structure and less aggressive financial policies would support positive rating pressure over time if coupled with stronger credit metrics.

Negative pressure would build on the current rating if the net MVL is not brought back below 20% in due course. An interest cover falling below 2.0x and a weakening liquidity profile would also exert negative pressure on the rating. Finally the failure to list JDE/Peets well before preference shares, equity warrants or other debt instruments would have to be purchased or redeemed could also exert negative pressure on the rating of JAB Holding.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1133569 .

At least one ESG consideration was material to the credit rating outcome announced and described above.

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