Research Update:

JAB Holding Company S.a r.l. Downgraded To 'BBB+' On Increased Leverage; Outlook Stable

October 29, 2020

Rating Action Overview

- JAB Holding Company S.a.r.l.'s (JAB, the company) reported pro forma loan-to-value (LTV) ratio increased to about 28% as of June 30, 2020 from 17% at year-end 2019.
- The LTV increase stemmed from a €2.8 billion decline in the value of its Coty shares, a €1.8 billion loan repayment for unwinding its Cottage special purpose vehicle (SPV), and cash outflows for share redemption of about €700 million.
- JAB received €1.9 billion of cash contributions from its investee assets in September 2020, only partly offsetting these losses.
- We do not expect JAB to be able to reduce its LTV well below our 20% threshold for an 'A-' rating by year-end 2020.
- We are lowering our long-term issuer credit rating on JAB to 'BBB+' from 'A-'. We are also lowering our issue rating on JAB Holdings B.V.'s notes, guaranteed by JAB, to 'BBB+' from 'A-'.
- The outlook is stable, reflecting our expectation that management will further reduce JAB's LTV in the next 12-15 months, maintaining it below 25% on a sustained basis by end-2021.

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Rating Action Rationale

JAB's LTV has reached a level that we no longer consider commensurate with an 'A-' rating. JAB unwound the Cottage SPV in April 2020, which resulted in JAB repaying a €1.8 billion loan with cash. The company also saw a €2.8 billion decline in the value of its Coty shares. Furthermore, over the first half of 2020, it made cash outflows of approximately €386 million related to redeemable shares, and we expect there will be redemptions for an additional €330 million by end-2020. As a result, JAB's LTV ratio has surged to about 28% as of end-September 2020, up from 17% at year-end 2019. We estimate JAB's net reported debt stood at about €6.2 billion as of end-September 2020--up from €4.2 billion at year-end 2019--taking into consideration net debt reaching €7.8 billion at the end of June 2020, an approximate €330 million share redemption, and cash proceeds totaling €1.9 billion.

In May 2020, JAB successfully carried out the initial public offering (IPO) of JDE Peet's N.V., which helped JAB maintain a portfolio value at about €24 billion, in line with year-end 2019. This level of leverage, hovering at about 28%, is well above the 20% LTV threshold we see as commensurate for an 'A-' rating.

Our 'BBB+' rating takes into consideration that JAB's management is actively putting in place actions to substantially reduce LTV in the next 12 months-15 months, maintaining a LTV ratio below 25% on a sustained basis by end-2021. We think JAB's plans to further develop its portfolio, along with the defensive nature of some of its assets in the consumer goods sector, should help JAB reduce leverage, provided management adheres to a more stringent financial policy and risk oversight.

JAB has publicly committed to reducing its LTV below 20% by end-2021 and has put in place a well-defined action plan to achieve it, which should enable the company to build up rating headroom in the next 12-15 months. We think this plan will take some time to materialize, but it should enable JAB to build up some headroom under our new LTV threshold of 25% for the 'BBB+' rating. Considering the uncertain market environment and based on our expectation that JAB may not shy away from growth opportunities in the pet care business, we think JAB's maximum 20% LTV target is a long-term target but not necessarily a sustainable one over the next two years.

There is now a significantly lower risk of leverage increase from redeemable shares. For 2020, JAB's cash out for redeemable share redemption reaches about €700 million. We understand JAB recently took actions so it can significantly limit cash outflows related to further potential redemptions of redeemable shares such that LTV would not increase above 20%. We also understand that it will be at JAB's discretion to decide whether it would redeem those shares with cash or in kind with shares of investee assets. As a result, we do not consider the redeemable shares as debt-like obligations in our LTV calculation. That said, we note that given the significant amount of outstanding redeemable shares, further redemptions in cash could limit JAB's ability to reduce its leverage if its LTV is below 20%.

As of the end of June 2020, JAB reported liabilities from redeemable shares of about €1.8 billion, down from €2.6 billion at the end of 2019. We understand that the value of the shares is directly linked to JAB's net asset value. We calculate that the net cash inflow related to redeemable shares was about €90 million on a cumulative basis over 2013-2019.

JAB's solid track record in creating market leaders, above-average portfolio rotation, and defensive nature of its investee assets sustain the company's rating positioning. In May 2020, JAB orchestrated JDE-Peet's N.V.'s IPO. This was the first IPO globally since the COVID-19 pandemic began, and the largest European consumer and retail IPO since 2006. This follows JAB's successful IPO of Keurig Dr Pepper (KDP) in 2018. Moreover, notwithstanding the pandemic, we expect JAB's 2020 cash dividend income to be in line with €334 million recorded in 2019, demonstrating the average resilient operating performance of its investee assets and the less cyclical nature of JAB's consumer goods concentration. We think the low correlation of JAB's investment results also sustain the company's cash dividend income. We understand about 80% of JAB's portfolio is performing in line or above management's expectations. JAB's investee assets' average credit risk is 'bb+', sustained by KDP. We expect JAB to continue actively managing its portfolio in the medium term, favouring new business combinations and IPO processes, among other ventures. Unlike highly rated entities, JAB's asset portfolio is concentrated in a few assets, similar to Exor, and KDP represents about 50% of the overall portfolio value, which we currently estimate at about €24 billion.

Thanks to JAB Consumer Fund (JCF) co-investments, JAB directly manages equity value of about €40 billion-€50 billion and effectively controls its investee assets. We continue to see JCF as a supporting factor for JAB's credit profile. JCF is a separate equity portfolio that solely invests in JAB's proposed investments. JCF acts as passive investor, with JAB's management proposing the investment strategy and possessing the mandate to execute. Moreover, we understand the JCF board comprises JAB's partners. We therefore think JCF's portfolio roughly mimics JAB's investments, essentially doubling JAB's portfolio size and influence. We therefore estimate that the total investments JAB manages reaches about €40 billion-€50 billion.

JCF recently raised commitments for about $6 billion that it will deploy along with JAB in the coming few years. Additionally, thanks to the co-investment strategy with JCF, JAB retains control of all its assets, meaning it can influence dividend streams and future investee asset policies.

JAB is streamlining its organization structure, which will be leaner at the intermediate level, supporting its LTV and potentially making it less volatile. Management recently initiated a rationalization program to reduce the overall structure complexity and make metrics more transparent. It is also focusing on reducing the level of debt present in the intermediate holding structure, which is not part of our adjusted debt. However, this is included in the asset value that the company discloses. As of end-December 2019, debt at the intermediate holding company reached €4.8 billion--excluding Cottage--about €4.0 billion of which sat at Acorn Holding B.V. We understand JAB intends to minimize the recourse of those structures, which would in turn reduce the structure's leverage.

Outlook

The outlook is stable, reflecting our expectation that management will substantially reduce its LTV in the next 12 months-15 months, maintaining it below 25% on a sustained basis by 2021.

Downside scenario

We could lower the rating on JAB by one notch over the next six to 12 months if its LTV does not stay well below 25%.

Upside scenario

We consider an upgrade unlikely. However, we would consider raising the ratings on JAB if management builds a track record of adhering to a more conservative financial policy, with more prudent risk management resulting in LTV well below 20% during the economic cycle. An upgrade would also depend on JAB further improving its portfolio diversity.

Company Description

JAB is an investment holding company with a focus on defensive and fast-moving consumer goods and services, consumer retail assets, and, following the acquisition of NVA, veterinary health care services. JAB seeks to build global leader and challenger companies. Unlike other holding companies, it focuses on actively managing most assets, with significant control and influence over their capital structure and dividend flows.

JAB is a privately held company. All shares are fully paid and are not listed on any stock exchange.

Agnaten SE and Lucresca SE hold an approximate 90% majority through JAB's wholly owned subsidiary Joh. A. Benckiser B.V. (formerly Donata Holdings B.V.). Management and other investors hold the remaining approximate 10%.

Our Base-Case Scenario

In our base-case scenario, we assume:

- Continuous prudent investment policy and proactive management actions aimed at reducing the LTV from current levels of above 25%.
- Cash dividend and interest income for 2020 in line with the €334 million recorded in 2019, with some potential for improvements for 2021, which we currently forecast at about €350 million.
- No material increase in operating costs, which we expect will be about €50 million per year.
- Interest expense of about €150 million-€200 million per year, in line with 2019.
- Ordinary distributions to shareholders of about €150 million per year, up from €100 million in 2019.
- Our cash flow adequacy ratio does not consider the net cash share redemptions on redeemable shares, which started to surge from 2019. For 2020, we expect a cash outflow of about €700 million, up from about €90 million in 2019 and about €65 million in 2018.

Key Metrics

Table 1

JAB Holding Company S.a.r.l. -- Key Metrics

	Year-end Dec. 31	Year-end June 30	Pro forma Sept. 30	Year-end Dec. 31	Year-end Dec. 31
	2019a	**2020a**	**2020a**	**2020f**	**2021f**
(Mil. €)					
Reported portfolio value	24,863	24,046	22,455	N/A	N/A
Reported debt	6,800	8,375	8,375	N/A	N/A
Cash out for share redemption	--	--	333	--	--
Pro forma debt	--	--	8,708	--	--
Reported cash	2,585	610	610	N/A	N/A
Cash in from investee assets	--	--	1,900	--	--
Pro forma cash	--	--	2,510	--	--
Reported net debt	4,215	7,766	6,199	N/A	N/A
LTV reported (%)	17.0	32.3	27.6	~25.0	<25.0
Cash flow adequacy ratio (x)	1.4	N/A	N/A	About 1.5	1.5-2.0

All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast. LTV--Loan to value. N/A--Not applicable. Source: S&P Global Ratings.

Liquidity

We assess JAB's liquidity as strong. We estimate that JAB's liquidity sources exceed its needs by 4.7x for the 12 months from June 30, 2020, and by almost 4.7x for the following 12 months. Nonrecurrent cash inflow recorded in September 2020, along with JAB's strong ties with banks and open access to debt market, support the company's liquidity, which was 1.5x at end-2019. We think management is committed to supporting strong long-term liquidity. We also think JAB would likely absorb a high-impact event with limited need for refinancing. For JAB, such a scenario would likely be a severe correction of market values for its listed shares, such as that seen in COVID-19 market conditions.

We expect principal liquidity sources in the 12 months from June 30, 2020, will include:

- Cash and cash equivalents of approximately €610 billion as of end-June 2020;
- Dividend inflows of about €240 million-€270 million per year after our assumption of a dividend drop of 30% from our estimated levels;
- Access to its €3.0 billion committed revolving credit facility (RCF) maturing in November 2025 with a one-year extension option; and
- €1.8 billion one-off cash contribution from investments.

We expect principal liquidity uses over the same period will include:

- Operating expenses of about €45 million-€50 million per year;
- Interest expenses of about €150 million-€200 million per year;
- We have assumed the full repayment of the €485 million outstanding under the RCF for the remainder of 2020, and €550 million for 2021;
- Dividends of €150 million-€200 million per year; and
- Cash out for the redemption of redeemable shares of €330 million by end-2020.

Issue Ratings - Subordination Risk Analysis

Capital structure

JAB Holdings B.V. is the financing subsidiary of JAB. It is 100% owned through an intermediate holding company. At the holding level, gross debt totaled €8.4 billion in June 2020, represented by bonds and €485 million RCF drawn. JAB does not have any debt on a stand-alone basis. It guarantees in full all the debt issued by JAB Holdings B.V. The syndicated RCF and the notes rank pari passu.

Analytical conclusions

In our view, there are no significant elements of subordination risk present in the capital structure, and we rate the senior unsecured debt 'BBB+', in line with the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/--

Business risk: Satisfactory

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers

- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 Notch)

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 | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, 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: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; Outlook Action

	To	From
JAB Holding Company S.a r.l.		
Issuer Credit Rating	BBB+/Stable/--	A-/Negative/--

Downgraded

	To	From
JAB Holdings B.V.		
Senior Unsecured	BBB+	A-

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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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