Research Update:

JAB Holding Company S.a r.l. Outlook Revised To Negative; 'A-' Rating Affirmed

April 22, 2020

Rating Action Overview

- JAB Holding Company S.a.r.l.'s (JAB's) unwinding of the Cottage special purpose vehicle (SPV) by repaying the $1.77 billion loan with cash marks the end of another failed attempt to revive Coty's equity and credit story.
- We still expect the proposed JDE-Peet's Coffee initial public offering (IPO) to happen in 2020, which would benefit the liquidity and diversity of JAB's portfolio.
- We expect liquidity will remain robust in 2020, but estimate that the loan-to-value (LTV) ratio is currently above the 20% threshold we see as commensurate with the current rating.
- Therefore, we are revising the outlook to negative from positive and affirming the 'A-' issuer credit and issue ratings on JAB and debt issued by JAB Holdings B.V.
- The negative outlook reflects the risk of a downgrade if we estimate that JAB is unable to reduce its LTV well below our 20% threshold by year-end 2020, for example, due to weaker performance at its businesses following the recent material downward revision of our economic forecasts for the U.S. and Europe.

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Rating Action Rationale

JAB announced it will unwind the Cottage SPV by repaying the $1.78 billion used to finance the partial tender offer for Coty in early 2019. The repayment of the loan with JAB's own liquidity marks the end of another failed attempt to revive Coty's equity and credit story. The planned loan repayment brings JAB's LTV above 20% from 16% at year-end 2019, which is above our current threshold for the 'A-' rating.

We also assume COVID-19-linked market turmoil will potentially hold back the IPO of JDE and Peet's Coffee, although we still expect the transaction this year in our base case. The transaction would be positive for portfolio liquidity and could somewhat improve currently weak diversity, but challenging market conditions may push these benefits back to the medium term. We also note that the unwinding of the Cottage SPV makes the 60.2% stake in Coty available again to JAB's lenders, which benefits asset liquidity.

We believe liquidity will remain robust during 2020, supported by a healthy cash position of €2.6 billion at year-end 2019. Liquidity will also be supported by the recent €1 billion bond issue, which adds to €1.5 billion available under the €3 billion liquidity facility maturing in 2024, and dividend income from the coffee and beverage platform. At the same time, our LTV estimate for JAB, based on KDP and Coty market value and a conservative estimate of unlisted assets, is more than 20%. As before, we acknowledge JAB has sufficient financial flexibility, including support from separate equity portfolio JCF, to steer LTV back to below the 20% threshold by year-end 2020.

Our revised base case on JAB is built on discounted values for nonlisted assets. When reviewing our model for JAB, we have conservatively discounted all unlisted assets in the portfolio based on listed peers' equity market performance. These peers have suffered valuation declines of roughly 30% since the start of the COVID-19 pandemic.

Our significant downward revision of GDP forecasts for the U.S. and eurozone could negatively affect valuations of investee companies, particularly in the former. On April 16, 2020, we significantly revised down our forecasts for U.S. and eurozone GDP and now expect declines of 5.2% and 7.2%, compared with 1.3% and 2.0% declines previously (see "COVID-19 Deals A Larger, Longer Hit To Global GDP," published on RatingsDirect). Although JAB's European and U.S.-centric businesses have shown resilience so far, we see the risk of deterioration triggered by a sharp decline in economic conditions, particularly in the U.S.

JAB intends to repay Cottage debt via its liquidity sources. In our updated base case for JAB, we include in our net debt calculation the Cottage loan ($1.78 billion), which JAB has said it is willing to pay out of its own liquidity sources.

Outlook

The negative outlook reflects that JAB's LTV is currently above our 20% threshold as well as the recent material downward revision of our economic forecasts for the U.S. and Europe.

Downside scenario

We would downgrade JAB if we expect that it is unlikely to reduce its LTV well below the 20% threshold, or if we conclude that the group's portfolio management strategy is unlikely to maintain an LTV ratio below 20% at all times--such as during current market turmoil.

Upside scenario

We could revise the outlook to stable if JAB reduces its LTV toward 15% in 2020. We could raise the rating if we observed a significant improvement in the diversity of the portfolio, which we currently assess as weak. We deem this scenario unlikely in the short term, however.

Company Description

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

Another distinguishing factor is JAB's access to JCF, a separate equity portfolio managed by JAB executives that roughly mimics JAB's investments and provides third-party equity. Through such a partnership, JAB is able to undertake large and transformative transactions, such as the reverse takeover of KDP, while maintaining control over dividend streams, and limiting total leverage. In our base case, we believe that JCF represents not only an investment partner, but also an opportunity for JAB to address temporary market weaknesses and maintain its long-term LTV target below 20% without losing control over its assets. We see this as a unique advantage over peers, and reflect this in the rating on JAB.

Our Base-Case Scenario

- The planned JDE-Peet's Coffee IPO is successfully rolled out during 2020.
- Cottage is unwound after JAB repays the $1.78 billion loan used to finance the tender offer on Coty, which prompts us to reconsider Coty shares as accessible by JAB's lenders.
- We estimate current LTV ratios exceeding 20%, up from 16.1% at year-end 2019.

Liquidity

We assess JAB's liquidity as solid. We estimate that JAB's liquidity sources exceed its needs by 1.5x for the 12 months from Dec. 31, 2019, and by almost 3x for the following 12 months. We consider that JAB's strong ties with banks support its ability to quickly obtain bank financing, if needed. We also believe it likely that JAB is able to 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 current conditions.

Principal liquidity sources include:

- Cash and cash equivalents of approximately €2.58 billion as of year-end 2019.
- Dividend inflows of about €400 million per year on average.
- Access to approximately half of the €3.0 billion committed revolving credit facility (RCF) maturing in 2024.
- The recent €1 billion bond issuance.

Principal liquidity uses include:

- Operating expenses of about €40 million.
- Interest expenses of about €150 million per year.
- Dividends in the €100 million-€150 million range.
- Repayment of the Cottage loan ($1.77 billion).
- Cash out for the acquisition of the PET business (NVA) in first-quarter 2020.
- Potential capital injections to support, on a selective basis, smaller assets in JAB's portfolio in the low-to-mid hundreds of millions of euros.

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 €6.2 billion in April 2020, represented by bonds.

Analytical conclusions

JAB has a relatively low level of gross debt, and we assess its financial risk profile as intermediate. The syndicated RCF and unsecured bonds rank pari passu. As a result, there are no significant elements of subordination risk present in the capital structure, in our view, and we rate the senior unsecured debt 'A-', in line with the issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating: A-/Negative/--

Business risk: Satisfactory

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

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

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

Stand-alone credit profile: a-

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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16 2020
- How Is COVID-19-Related Market Volatility Affecting Investment Holding Companies?, March 12, 2020

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
JAB Holding Company S.a r.l.		
Issuer Credit Rating	A-/Negative/--	A-/Positive/--
JAB Holdings B.V.		
Senior Unsecured	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.