Research Update:

Investment Holding Company JAB Outlook Revised To Positive On Jacobs Douwe Egberts-Peet's Combination

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Rating Action Overview

- Jacobs Douwe Egberts (JDE), the second largest global coffee roaster, will combine with Peet's Coffee, the U.S.-based premium retail coffee brand, and explore an IPO, creating a champion with leading positions in more than 20 major markets.
- The potential IPO would materially increase the liquidity of the assets held by JAB Holding Co. S.a.r.l, which will be the controlling shareholder of the combined entity.
- We are therefore revising our outlook on JAB Holding to positive from stable and affirming our 'A-' long-term on the company, as well as our ratings on debt issued by JAB Holdings B.V.
- The positive outlook indicates that we could upgrade JAB once the IPO of JDE-Peet's is finalized, which we expect will happen in 2020, assuming that JAB maintains a loan-to-value (LTV) ratio below 20% and that there will be stronger evidence of a turnaround at Coty.

Rating Action Rationale

The IPO would materially increase the liquidity of assets in JAB's portfolio. Listed assets in JAB's portfolio represent approximately 55% of gross asset value. At this time, we consider under listed assets only JAB's stake (approximately 38%) in Keurig Dr Pepper (KDP), held via intermediate holding Acorn. We view the shares in Coty as not readily available to JAB's bondholders, and to this extent, similar in nature to non-listed assets. With the potential IPO of JDE and Peet's, the proportion of listed assets would exceed 75%, with material benefits for the holding company's business risk profile, all other factors remaining unchanged. At the same time, we do not expect the transaction to have an immediate impact on the portfolio's diversity as long as KDP continues to represent more than 40% of the portfolio. Furthermore, we do not believe the potential IPO of the combined JDE Peets would have a material impact on asset quality, which would still be dominated by KDP. We estimate the LTV ratio at around 17% at present and believe it should remain in the 15%-20% range once the IPO is final.

Outlook

The positive outlook stems from our view that the liquidity of JAB's assets could increase with the IPO of JDE and Peet's.

Upside scenario

We could raise our ratings on JAB once the IPO closes, which we expect will happen in 2020. An upgrade is contingent on evidence of a turnaround at Coty and on JAB maintaining an LTV ratio below 20%.

Downside scenario

We could revise the outlook to stable if the IPO does not go through or if, after it closes, we believe JAB would engage in further acquisitions implying that JAB's commitment to keeping LTV below 20% is no longer sustainable. In addition, lack of evidence of a clear turnaround at Coty could lead us to revise the outlook to stable.

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, JAB focuses on actively managing most of its assets, allowing it 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 the dividend streams, and limiting the total leverage at JAB. 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 for JAB over its peers, and reflect this in the rating on JAB.

Our Base Case Scenario

In base case for JAB, we expect the LTV ratio to remain below 20% and cash flow adequacy ratios to exceed 2x over the next two years. This is based on our assumption that the funding of any future transformative acquisitions would benefit from the substantial contribution of JCF, which would allow JAB to keep leverage in line with its LTV target of below 20%. We also assume that the unwinding of Cottage, the special purpose vehicle (SPV) holding 450 million Coty shares, would leave JAB with more than the 300 million shares it contributed to secure the $1.75 billion debt raised to tender 150 million shares in the market. This is likely to happen if the Coty share price were higher than the tender price at the SPV unwinding, because debt repayment would rely on the sale of shares and on dividends paid by Coty over the life of the transaction. Currently Coty shares are trading slightly below the tender price ($11.65).

Liquidity

We assess JAB's liquidity as exceptional because, following the recent refinancing, there are no material debt maturities in the next two years. We estimate that JAB's liquidity sources exceed its needs by 3.8x x for the 12 months from Sept. 30, 2019, and by 16x 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 would be 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, which we consider manageable in view of its relatively low LTV ratio.

For the 12 months from Sept. 30, 2019, we estimate that JAB's principal liquidity sources comprise:

- Cash and cash equivalents of approximately €1.8 billion;
- Dividend inflow of about €400 million per year on average; and
- Access to a €3.0 billion (increased after Sept. 30, and free of covenants) committed RCF maturing beyond one year, currently undrawn.

For the same period, we estimate that JAB's liquidity uses comprise:

- Operating expenses of €30 million-€40 million;
- Interest expenses of €140 million-€150 million;
- Dividends of about €100 million; and
- Acquisition of a minority stake in NVA for €1.1 billion.

In December 2019, JAB issued through JAB Holdings B.V. €1.5 billion of debt instruments with various maturity dates to refinance short-term debt due in 2021 and 2022.

Issue Ratings--Subordination Risk Analysis

Capital structure

JAB Holdings B.V. is the financing subsidiary of JAB, and is 100% owned by JAB through an intermediate holding company. On a holding company basis, gross debt, represented by bonds, totaled €6.0 billion at year-end 2019.

Analytical conclusions

JAB has relatively low gross debt, and we assess its financial risk profile as modest. The syndicated RCF and unsecured bonds rank pari passu. As a result, there are no significant elements of subordination risk 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-/Positive/--

Business risk: Satisfactory

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

- JAB Holdings B.V Proposed Notes Rated 'A-',

Ratings List

Ratings Affirmed; Outlook Action		
JAB Holding Company S.a r.l.		
Issuer Credit Rating	A-/Positive/--	A-/Stable/--
Senior Unsecured	A-	
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.