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ISSUER IN-DEPTH
1 February 2018

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RATINGS

JAB Holding Company S.a r.l.

Long term issuer rating	Baa1
Outlook	Stable

JAB Holdings B.V.

Backed Senior Unsecured	Baa1
Outlook	Stable

Source: Moody's Investors Service

KEY METRICS:

JAB Holding Company S.a r.l.

	2016	2017 PF	June '18 PF
Portfolio Assets MV Leverage	17%	16% (1)	>18% (2)
(FFO + Interest expense) / Interest expense	1.9x	2.5x	3.5x (3)

(1) Pro-forma disposal of luxury assets

(2) Pro-forma Keurig Dr Pepper closing and disposal of €1 billion of assets

(3) June 2018 (PF) interest cover includes the equivalent of 6 months of Dr Pepper dividend

Source: Moody's Investors Service; JAB Holdings

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JAB Holding Company S.a r.l.

Merger of Keurig and Dr Pepper will strengthen JAB's investment portfolio, despite increasing leverage

Summary

- **The merger of JAB Holding Company S.a.r.l.'s (Baa1 stable) US coffee business Keurig Green Mountain, Inc. (Ba2 stable) with US soft drink company Dr Pepper Snapple Group Inc. (Baa1 stable) will strengthen JAB's investment portfolio.** It creates an integrated beverage company with exposure to a wide range nonalcoholic packaged beverage market categories and a broad distribution network. The new business will have a good split between low growth carbonated soft drinks and juices, where scale is very important because growth is limited, and faster growing categories such as coffee, ready to drink tea and coffee, sport and energy drinks as well as still water. JAB and Dr Pepper expect $600 million of cost synergies as a result of the merger. However, there are execution risks achieving large working capital improvements and cost synergies, and potential business disruption as changes and cost cuts are implemented, although the proposed Keurig Dr Pepper management team has a strong track record in managing these processes. Access to Dr Pepper's distribution system in the US market will improve the distribution of JAB's consolidated coffee assets.

- **The merger will increase JAB's market value leverage but interest cover will improve.** JAB's equity contribution to the transaction will be funded from cash on balance sheet and additional debt. This will result in an increase in market value leverage to at least 18% pro forma the closing of the transaction, from estimated 16% as at 31 December 2017, assuming JAB makes up to €1 billion from asset disposals. The increase in leverage will also depend on the share price development of Dr Pepper until the transaction closes. At the same time, we expect JAB's interest cover to improve as a result of a strong dividend stream from Dr Pepper. JAB also has a stated commitment to reduce market value leverage to its 15% target during the next 12 to 18 months.

- **JAB swaps a 43% stake in a Ba2 rated asset for a smaller stake in a higher rated, larger and more defensive Baa2 rated business, a longer term credit positive.** The merger will improve the liquidity of JAB's portfolio through a higher share of listed assets in the portfolio. The contribution of the listed assets to the overall value of the portfolio will increase pro forma the transaction, although the exact split will depend upon the market's assessment of the value of the new Keurig Dr Pepper.

Keurig and Dr Pepper merger will strengthen JAB's investment portfolio

On 29 January, privately held investment holding company JAB Holding Company S.a.r.l. (Baa1 stable) announced that it will merge its US-based coffee business Keurig Green Mountain, Inc. (Ba2 review for upgrade) with the US-based non alcoholic soft beverage company Dr Pepper Snapple Group Inc. (Baa1 review for downgrade).

Under the proposed transaction, JAB and other investors will pay Dr Pepper shareholders a dividend of around $103.75 a share, or around $18.7 billion in cash. Keurig will then be merged into Dr Pepper to form Keurig Dr Pepper, or KDP, which will be listed on the New York Stock Exchange. Existing Dr Pepper shareholders will retain a 13% stake in the new company, Mondelez approximately 13%-14%, leaving around 73%-74% for JAB, JAB Consumer Fund and other investors. The proposed transaction will be funded with $12 billion of new debt for the combined entity and about $9 billion of equity from JAB and other investors. The proposed merger remains subject to regulatory and shareholder approval.

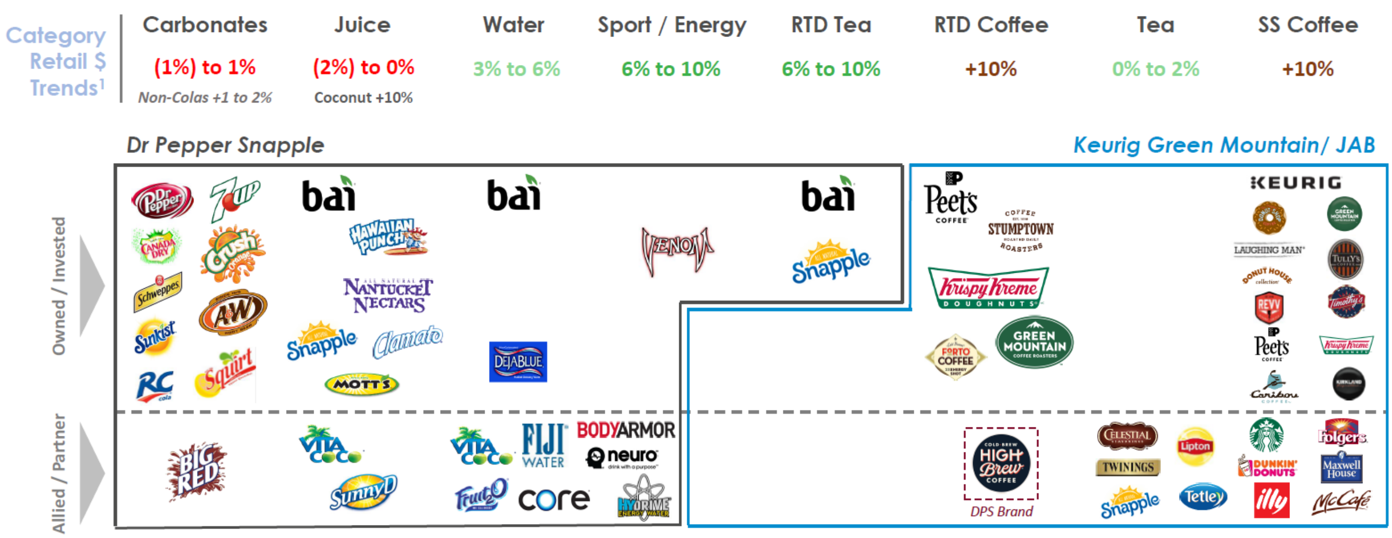
The merger of Keurig and Dr Pepper will create an integrated beverage company with exposure to a wide range of nonalcoholic packaged beverage market categories and a broad distribution network. Dr Pepper brings a large scale, stable, profitable and cash flow generative portfolio of brands focused on carbonated soft drinks and juices. Keurig brings a single serve and ready to drink coffee and tea business with stronger growth prospects.

The new group will be the only global soft beverage company with exposure to all beverage categories apart from milk, but milk is less profitable than other categories. We consider this stronger horizontal integration a competitive advantage against larger peers The Coca-Cola Company (Aa3 stable) and PepsiCo, Inc. (A1 stable) which are more focused on carbonated soft beverages, juices and waters. They have only recently started expanding their portfolios in the higher growth categories of ready to drink coffees and teas and away from carbonates and juices, where growth is slowing. Nestle S.A. (Aa2 stable) is largely focused on tea, coffee and bottled water and does therefore not have the same depth of distribution network of its three competitors.

Exhibit 1

New KDP group will have a diverse range of beverage categories and a good mix of mature and growth categories

New company's portfolio of brands across beverage categories



Source: Dr Pepper Snapple Group

However, JAB is merging its growing coffee business Keurig into Dr Peppers' mature business which has little in the way of growth prospects. This leaves only the generation of cost synergies as a means to generate additional value from combining the two businesses, versus keeping Keurig as a stand alone company.

While JAB argues that the beverage market is a single market, we believe that there are distinct market dynamics in JAB's coffee businesses and the soft beverage market. The latter is more resilient because the US market is heavily consolidated, with Coke, Pepsi and Dr Pepper controlling more than 75% of the US market. The soft beverage market is also protected by very high barriers to entry because companies need a broad route to the market system to be able to compete successfully.

JAB portfolio companies' access to Dr Pepper's deep route to market system will benefit both the newly merged company and JAB. Dr Pepper will be able to distribute a large portfolio of JDE and JAB Beech Inc.'s retail coffee and tea brands. This will boost top line growth prospects of these brands, which include Peet's Coffee, Coffee Stumptown, Mighty Leaf and Tea Forte.

Both companies also expect the transaction to generate cost synergies, which they have estimated at $600 million. This accounts for about 5.5% of the pro forma revenue of the new KDP group. About 80% of the cost synergies will be from cost of goods sold (COGS), selling, general and administrative expenses (SG&A) and distribution savings. JAB also has very ambitious working capital reduction targets.

While there is sound strategic rationale for the transaction, there is execution risk in improving working capital and achieving cost synergies. We put Dr Pepper's rating under review for downgrade on 28 January, because we expect to downgrade its rating by one notch to Baa2 with a negative outlook once the transaction has closed, if the deal is structured as it has been announced. A downgrade would reflect Dr Pepper's higher pro forma leverage after the merger, as well as the execution risk of achieving relatively large working capital improvements, synergies and cost reductions over the next few years, which are needed if Dr Pepper is to reduce leverage quickly. Our review will also consider the potential for business disruption as changes and cost cuts are implemented as part of its review process.

The proposed transaction will increase JAB's market value leverage but interest cover will improve

We expect JAB to fund its €1.5 billion-€2.0 billion equity contribution to pay for the dividend to Dr Pepper's existing shareholders and for the increase in common equity of the new group through cash on balance sheet and drawings under the group's revolving credit facility. JAB has also committed to asset disposals totaling up to €1.0 billion to reduce the net cash funding of its equity contribution to a maximum of €1.0 billion maintaining market value leverage, measured as the value of JAB's investment portfolio divided by the group's reported net debt, within JAB's financial policies.

As a result of the transaction, we expect JAB's market value leverage to increase to at least 18% pro forma the closing of the transaction from estimated 16% as at 31 December 2017, pro forma the disposal of JAB's luxury businesses, announced in 2017. However, the increase in market value leverage will largely depend on the equity market's assessment of the value of the new Keurig Dr Pepper group. We would expect to gain more clarity over the next few weeks on the market's assessment of the value of JAB's stake in Keurig Dr Pepper.

An increase in market value leverage will be partly offset by improved interest cover because the increase in dividend from Dr Pepper will more than compensate the marginal increase in JAB's net interest expense resulting from the modest increase in net debt. We expect JAB's interest cover to improve to around 3.5x in 2018 pro forma the transaction from around 2.5x in 2017. Interest cover will improve further in 2019 as a result of the dividend flow from Dr Pepper.

JAB has also stated its commitment to bring down its market value leverage to around 15% within the next 12 to 18 months to support its current rating. The ability of JAB to restore its market value leverage to 15% will also depend on the pro forma market value leverage at closing of the Keurig Dr Pepper transaction as the higher the market value leverage gets the more difficult it will become to bring it back to 15% in an acceptable time frame.

JAB will increase its net debt to approximately €4.5 billion (pro forma the Keurig Green Mountain transaction and including up to €1 billion of asset disposals), from around €500 million in 2012, or around nine times since 2012, without a material deterioration of market value leverage. This is because valuation multiples of both listed and private assets have increased materially, in line with the overall market. However, the portfolio's underlying earning growth has been lower than the increase in net debt. Consequently we believe that JAB is fairly exposed to a material correction in the equity stock markets — even if its portfolio of investments is resilient and earnings volatility remains relatively limited through the macroeconomic cycle.

Smaller stake in stronger business is a longer term credit positive

As a result of the proposed merger, JAB will swap a stake in a Ba2 rated company — although one with a positive outlook prior to the announcement of the transaction — for a higher rated asset albeit under review for downgrade following the announcement of the transaction. The new group will account for a relatively material portion of the overall value of JAB's investment portfolio, providing a significant lift to its overall creditworthiness.

The Baa2 credit rating of Keurig Dr Pepper will be supported by the group's large scale, earnings and cash flow resilience, strong profitability and JAB's commitment to reduce leverage quickly after the transaction closes.

Beyond the positive impact on the overall credit worthiness of JAB's investment portfolio, the merger will also address JAB's other relative weaknesses.

The contribution of the listed assets to the overall value of the portfolio will increase pro-forma of the transaction although the final share of listed / unlisted assets will ultimately depend on the market’s assessment of the value of Keurig Dr Pepper. This will improve the liquidity of JAB's investment portfolio because it is much easier to sell a stake in a listed asset than it is in a private asset. The higher share of listed assets will also improve the transparency of the valuation. Lastly the transaction will improve the breadth of JAB's investment portfolio and diversify its sector exposure.

Second, the swap of a private asset for a listed asset will also improve the transparency of the investment's valuation.

Moody's related publications

Methodology:

» Investment Holding Companies and Conglomerates, 31 December 2015

Issuer Comments:

» JAB Holdings' Market Value Leverage Will Improve with Jimmy Choo Sale, 27 July 2017

» JAB's Acquisition of Panera Bread Will Substantially Increase Leverage, 10 April 2017

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