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## Research Update:

# Coca-Cola HBC Outlook Revised To Positive On Lower Debt Leverage; 'BBB+' Rating Affirmed

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## Research Update:

# Coca-Cola HBC Outlook Revised To Positive On Lower Debt Leverage; 'BBB+' Rating Affirmed

## Overview

- Switzerland-incorporated Coca-Cola HBC AG (CCH) has repaid debt in 2015; its interest expenses should further decrease following the recent issue of senior unsecured notes.
- Despite our forecast revenue decline of about 2% for 2016, credit metrics should improve thanks to steady cash flow generation.
- We are therefore revising our outlook on CCH to positive from stable, and affirming the corporate credit ratings at 'BBB+/A-2'.
- We are also raising our long-term issue rating on the senior unsecured debt to 'BBB+' from 'BBB' to reflect lower levels of priority liabilities.
- The positive outlook reflects our view that the stable free cash flow base should support further debt leverage reduction.

## Rating Action

On May 19, 2016, S&P Global Ratings revised to positive from stable the outlook on Switzerland-based soft drinks bottler Coca-Cola HBC AG (CCH). We also affirmed the long-and short-term corporate credit ratings on CCH at 'BBB+/A-2'.

At the same time, we raised the issue ratings on CCH's senior unsecured debt instruments to 'BBB+' from 'BBB' and affirmed the 'A-2' short-term issue rating on the commercial paper program.

## Rationale

The positive outlook reflects our view that CCH's credit metrics and free cash flow generation should continue to improve in 2016-2017, following about €400 million of debt repayment in 2015 and the recent issuance of 8.8 year, €600 million, 1.875% senior unsecured notes, which materially reduce CCH's interest expenses.

Debt leverage decreased to 1.8x in 2015 and is projected to remain below 2.0x over the next two years. Meanwhile, free operating cash flow (FOCF) generation is projected to be about €350 million a year (€397 million in 2016), leading to FOCF of close to 25% in 2016-2017. We consider this just below the level expected for a modest financial risk profile.

Our base-case financial projections for 2016-2017 assume:

- Revenues of about €6.2 billion in 2016 and 2017. We assume relatively

flat to slightly positive volume growth overall offset by the impact of weak currencies in Nigeria, Russia, and Ukraine. We anticipate that most volume growth will be in Nigeria, and that Russia and mature European markets will have slightly lower volumes. Competitive pressures, especially from European retailers, should persist, but CCH should retain its pricing power, particularly in emerging markets.

- EBITDA margin of about 13%, with negative currency-exchange movements and rising input costs (notably sugar) offset by price increases and cost savings in selling and distribution.
- FOCF of about €350 million, with stable capital expenditure (capex).
- S&P Global Ratings-adjusted net debt of €1.3 billion-€1.4 billion, assuming a stable dividend payout ratio and no large debt-financed acquisitions or asset disposals. We apply a 15% haircut to cash balances to reflect our assessment of restricted cash levels.

Based on these assumptions, we arrive at the following credit measures:

- Funds from operations (FFO) to debt of 40%-50%.
- FOCF to debt of about 25%.
- Debt to EBITDA of 1.5x-1.7x.

CCH is a Switzerland-headquartered soft drinks, waters, and juices bottling group that operates in 28 countries, mainly in Europe and Africa, reaching about 600 million consumers. In 2015, CCH had total revenues of €6.3 billion and S&P Global Rating-adjusted EBITDA of €826 million. It produced 2 billion unit cases in 59 manufacturing plants and its main markets are Russia, Italy, and Nigeria.

In our view, the group benefits from the very strong brand equity of its sparkling beverage product portfolio (including Coca-Cola, Fanta, Sprite, and Monster) and its leading market shares (40% on average) in sparkling beverages. It has good geographical diversity, with a presence in 28 countries, including emerging markets like Nigeria where demand is growing compared with Europe. It operates on a large industrial scale, producing 2 billion unit cases annually. This enables it to maintain good purchasing and pricing power overall. It also has a wide presence across distribution channels.

CCH's business strategy is primarily to defend its leading market shares in sparkling beverages in existing markets and grow in countries where consumption of sparkling beverages is low, for example, Nigeria. CCH also wants to diversify its product offering in mature markets by expanding its offering of low-calorie soft drinks, waters, and energy drinks. It also plans to revive volume growth by launching new packaging formats for consumption outside the home, which provide higher sales per unit.

Business challenges, in our view, include the significant exposure to Russia and Nigeria (29% of volume sales in 2015), which currently affects top-line growth and earnings. The product range relies on sparkling beverages: 70% of volumes, including low-calorie beverages. That said, CCH has diversified in

waters (19%) and juices (7%). We see low volume growth prospects for sparkling beverages in mature European markets due to weak demographic trends, changes in consumption habits, and stricter health regulations.

We assess CCH as moderately strategic to The Coca-Cola Co. (TCCC; AA-/Stable/A-1+), as a "dedicated purchaser." We apply an upward adjustment of one notch to CCH's 'bbb' stand-alone credit profile to reflect the potential extraordinary support TCCC could provide to CCH in case of need. We take account of CCH's significant long-term contractual arrangements with TCCC and the brand equity and reputational risks associated with the Coca-Cola name.

### **Issue ratings**

We have raised the 'BBB+' issue rating on the long-term senior unsecured debt to reflect that the level of higher-ranking liabilities in our analysis of structural subordination decreased at the end of 2015. Mitigating factors include the absence of debt at the operating subsidiary level, the high diversity of operating assets (more than 28 countries), and the concentration of the debt in the group financing vehicle (Coca-Cola HBC Finance B.V.).

### **Liquidity**

We anticipate that the ratio of liquidity sources to uses will be greater than 1.5x in the next 12 months and greater than 1.0x in the next 12-24 months, signifying a strong liquidity position. CCH has no maintenance financial covenants. It has maintained good access to capital markets, as demonstrated by the issuance of 8.8 year, 1.875%, €600 million senior unsecured notes in March 2016.

We anticipate the company will have the following principal liquidity sources over the next 12 months:

- €487 million of cash balances at Dec. 31 2015;
- €500 million undrawn committed credit line maturing in 2020; and
- S&P Global Ratings-forecast cash FFO of €620 million annually for 2016 and 2017.

We anticipate the company will have the following principal liquidity uses over the same period:

- €182 million of debt due in the next 12 months and €25 million of debt due between 12-24 months (we exclude the fully refinanced €600 million notes from the liquidity ratio calculation);
- €150 million of forecast annual seasonal working capital movements;
- S&P Global Ratings-forecast €340 million of capex annually; and
- €146 million of proposed dividend payments in 2016 and €158 million in 2017.

## Outlook

The positive outlook reflects our view that there is at least a one-in-three chance that we could raise the ratings on CCH over the next 12-24 months due to improved credit metrics. We anticipate that, despite top-line pressures and likely rising input costs, CCH should maintain stable profitability through its pricing power, cost savings, and ability to manage the currency-exchange volatility in Russia and Nigeria. Steady free cash flows, thanks to good control over capex and a consistent financial policy, should enable CCH to reduce leverage in the capital structure further.

### Upside scenario

We could raise the rating if we see CCH continue to grow profitably over the next 12-24 months, despite volume growth challenges in Europe and volatile foreign-exchange currencies in emerging markets. We would also be looking to raise the ratings if its adjusted debt-to-EBITDA ratio remains below 2.0x and FOCF/debt moves firmly above 25% on a consistent basis.

### Downside scenario

We could revise the outlook to stable if we see a deterioration in operating performance, for example, a 300 basis point decline in EBITDA margin, due to an acceleration in the declining demand for sparkling beverages in mature markets or an inability to raise prices in highly inflationary markets like Nigeria or Russia. If the adjusted debt-to-EBITDA ratio weakens to above 2.0x and FOCF/debt declines to below 25%, we would consider it negative to the ratings.

## Ratings Score Snapshot

Corporate Credit Rating: BBB+/Positive/A-2

Business risk: Satisfactory

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)

- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb

- Group credit profile: bbb+
- Entity status within group: Moderately strategic (+1 notch)

## Related Criteria And Research

### Related Criteria

- Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

Upgraded

|   | To   | From |
|---|------|------|
| Coca-Cola HBC Finance B.V.<br>Senior Unsecured* | BBB+ | BBB  |

Ratings Affirmed; CreditWatch/Outlook Action

|   | To                | From            |
|---|-------------------|-----------------|
| Coca-Cola HBC AG<br>Corporate Credit Rating | BBB+/Positive/A-2 | BBB+/Stable/A-2 |

Ratings Affirmed

|  |     |
|--|-----|
| Coca-Cola HBC Finance B.V.<br>Commercial Paper | A-2 |
|--|-----|

\*Guaranteed by Coca-Cola HBC AG.

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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [spcapitaliq.com](http://spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings public website at [www.standardandpoors.com](http://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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