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Ratings

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Summary:
Coca-Cola HBC AG

Primary Credit Analyst:
Maxime Puget, London (44) 20-7176-7239; maxime.puget@spglobal.com

Secondary Contact:
Gerson P Brown, London + 02071763531; gerson.brown@spglobal.com

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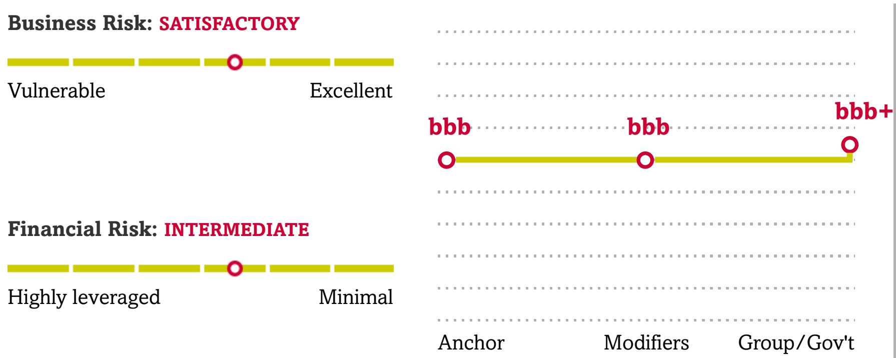

CORPORATE CREDIT RATING

BBB+/Positive/A-2

Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
• Leading market position in most of its 28 countries in Europe and Nigeria. • Portfolio of strong global and local beverage brands. • Large and efficient distribution and manufacturing footprint. • Significant exposure to the large but volatile Nigerian and Russian markets. • Demand decline for traditional sparkling beverages in Western Europe.	• Forecast stable free operating cash flow of €300 million-€350 million annually. • Forecast low debt leverage of 1.5x-2.0x in next two years, assuming increasing shareholder remuneration and no large debt-financed acquisitions. • Working capital- and capital-expenditure-intensive business. • Significant earnings in hard currencies enable to service the mostly euro denominated debt.

Outlook: Positive

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 months due to improved credit metrics. We anticipate a stable operating performance supported by volume growth in underpenetrated markets and changes in product and packaging mix offsetting some input cost increases. This is notably thanks to CCH'sstrong brand equity in sparkling beverages, control on working capital movements and ability to manage the historical high currency-exchange volatility in Russia and Nigeria.

Downside scenario

We could revise the outlook to stable if we see a deterioration in CCH's operating performance. For example, if the decline in demand for sparkling beverages in its established markets accelerated and was not offset by growth in low- and no-calorie soft drinks, or CCH was unable to raise prices in volatile markets such as Nigeria or Russia. Downward rating pressure could build if the adjusted debt-to-EBITDA ratio rose to 2.5x-3.0x and if FOCF to debt declined to about 15%-20%.

Upside scenario

We could raise the rating if we see CCH continuing to post stable cash flows over the next 12 months, despite volume growth challenges in its established markets and potential volatile earnings from Nigeria and Russia. We would also need to see the adjusted debt-to-EBITDA ratio remaining below 2.0x and free operating cash flow (FOCF) to debt comfortably and consistently above 25%. This would notably depend on the company's debt leverage tolerance regarding potential large debt-financed acquisitions in the beverage sector or increased shareholder remuneration.

Our Base-Case Scenario

Assumptions

Our base case for 2018-2019 assumes:

- Revenues of about €6.7 billion in 2018 and €6.9 billion in 2019. We see overall low-single-digit revenue growth driven mostly by low-to-mid-single-digit growth in Nigeria and Russia, low-single-digit growth in Central and Eastern Europe and flat revenues in Western Europe. In Europe we believe that CCH should be able to offset the decline in traditional sparkling beverages thanks to growth in –low-calorie beverages such as Coke Zero, changes in packaging and in customer mix (more sales to the hotel, restaurant and café channel). We see positive growth prospects in Nigeria, an underpenetrated market, but potentially offset by volatile foreign exchange movements.
- Adjusted EBITDA margin of about 14%-15%. This reflects positive effects of changes in product and packaging mix, lower sugar costs and more focus on margin versus volumes in Nigeria and Russia, offset by higher foreign exchange, energy and resin costs.
- FOCF of about €300 million-€350 million annually, with capital expenditure of about 6.5% of revenues.
- S&P Global Ratings-adjusted debt of €1.0 billion in 2018, rising to about €2.0 billion in 2019. We assume common dividends of €200 million in 2018 and €220 million in 2019 and a €1 billion exceptional dividend in 2019, which we see as compatible with management's medium-term debt leverage policy. We do not assume a large debt-financed acquisition in our base-case.

Key Metrics

	2017A	2018E	2019E
EBITDA margin (%)	14.8	14-15	14-15
FFO to debt (%)	72.9	70-80	35-45
FOCF to debt (%)	38.1	25-35	15-25
Debt to EBITDA (x)	1.1	0.9-1.3	1.8-2.2

A--Actual. E--Estimate. FFO-Funds from operations. FOCF--Free operating cash flow.

Company Description

Coca-Cola HBC AG (CCH) is a Switzerland-headquartered soft drinks, beverages, waters, and juices branded manufacturer. The company is an independent bottler of Coca-Cola beverages, produced and distributed under exclusive licence from The Coca-Cola Company (TCCC; AA-/Negative/A-1+).

CCH produces 2 billion unit cases annually in 55 manufacturing plants. It has operations in 28 countries with its main markets being Russia, Nigeria, and Italy. In 2017, CCH generated total revenues of €6.5 billion and S&P Global Ratings adjusted EBITDA of €967 million.

Business Risk: Satisfactory

CCH's business benefits from the low cyclicality of soft drinks and water, the very strong brand equity of its sparkling beverage product portfolio (Coca-Cola, Fanta, Sprite, Monster) and its leading market shares (>40% on average) in the category. We believe this enables CCH to maintain strong pricing power against retailers and branded competitors. The company is overall well diversified geographically with a presence in 28 countries. We see a good balance between main mature markets such as Italy and Switzerland (together 20% of revenues in 2017), which are stable and profitable, and emerging markets such as Nigeria (8% of revenues), which benefit from positive growth prospects as underpenetrated markets. CCH has also a large presence in the relatively flat and very competitive Russian market (17% of revenues). CCH operates on a large manufacturing scale, producing 2 billion unit cases annually in 55 plants. It has a wide presence across all distribution channels including the profitable and growing hotel, restaurant and café channel. We understand that the long-term franchise agreements with TCCC in its main countries are not due for renewal until 2023.

CCH's business strategy is primarily to defend its leading market shares in sparkling beverages in existing markets and grow in emerging markets like Nigeria where the population is growing and consumption of sparkling beverages is still low. CCH is also diversifying its product offering in mature markets to appeal to changing consumer preferences by expanding in low-calorie soft drinks like Coke Zero, waters, and energy drinks. CCH also plans to launch new brands in tea and plant-based beverages. It is also increasing revenue growth in Europe by launching smaller and more premium packaging formats for consumption outside the home, which support higher sales per unit.

Business challenges in our view include CCH's significant presence in Russia and Nigeria (together 28% of volume sales in 2017). Although these consumer markets are large and underpenetrated, earnings can be affected by volatile macroeconomic conditions and currency-exchange fluctuations. We also note that competition in Russia makes it hard for CCH to raise prices and is hampering revenue growth. Also CCH's business scope remains concentrated in sparkling beverages (69% of volumes, including low-calorie products). Consumer demand for traditional sparkling beverages has been declining in CCH's established markets such as Italy and Switzerland due to weak demographic trends, changes in consumption habits, and stricter health regulations. To offset this, CCH has been expanding in higher-growth product categories such as low-calorie soft drinks and energy drinks, and has diversified in waters (19% of volumes in 2017).

Financial Risk: Intermediate

We view positively CCH's good record in generating stable annual free operating cash flows of €300 million-€400 million and forecast it to continue over the next two years. That said we think cash flow growth will remain limited by the fact that bottling is a relatively capital-intensive business, that there are large working capital movements due to seasonality effects linked to the summer season in Europe, and that the company continues to invest in sales and distribution in emerging markets.

In terms of debt structure, CCH benefits from a relatively low average cost of debt and bears no large debt maturities until 2020 when the €800 million senior notes mature. We believe there is limited refinancing risk given that the company has substantial cash balances and good access to capital markets and bank financing. CCH's main currency risk exposures are to the Russian rouble, Nigerian naira, and to a lesser extent the Ukrainian hryvna. We understand that transaction risk in developing markets is partly hedged for the next 12 months (considering that raw materials costs like sugar and aluminium are paid in hard currencies). We also note that about half of the operating cash flow is generated in hard currencies (euros and Swiss francs), which enables CCH to maintain a good ability to service its mostly euro-denominated debt.

In terms of financial policy we understand that the company's priority is to grow organically in underpenetrated markets in Nigeria and Central and Eastern Europe (including Russia). That said, we believe that CCH is also looking at opportunities to expand in new emerging market territories in the EMEA region, potentially via acquisitions. In terms of dividend policy we note the stable payout target of 35%-45% but believe it is likely that CCH would slightly releverage its capital structure to 2.0x S&P Global Ratings-adjusted debt/EBITDA via an increase in shareholder remuneration, absent large debt-financed acquisitions in the next 12 months.

Liquidity: Strong

We assess CCH's liquidity position as strong and its short-term rating as 'A-2'. We forecast that liquidity sources should exceed liquidity uses by more than 1.5x in the next 12 months and greater than 1.0x in the next 12-24 months. CCH has €800 million senior notes due in 2020 but we believe the company holds large cash balances and retains good access to capital markets and bank financing. There are no maintenance financial covenants on the senior debt.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and cash equivalents of €723.5 million at Dec. 31, 2017. • Undrawn committed credit lines of €500 million maturing in 2021. • Forecast cash funds from operations of about €780 million in 2018-2019.	• €166 million of debt due within one year as of Dec. 31, 2017, and about €7 million in the next 12-24 months. • Our estimate of €150 million of maximum working capital intra-year movements annually. • Our forecast of total capital expenditure of about €435 million annually. • Our forecasted of cash dividends of €200 million-€220 million in 2018-19.

Other Credit Considerations

Group Rating Methodology

We assess CCH as moderately strategic to The Coca-Cola Co. (TCCC; AA-/Negative/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 if needed. 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.

Subordination risk

The senior unsecured notes are rated 'BBB+', in line with the issuer credit rating. This is because we see limited structural subordination as total secured debt and debt held at operating companies is well below the 50% criteria threshold.

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)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (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 from SACP)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Corporates - Industrials: Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com