
# KHC 3 06/2026 Corp

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KraftHeinz

# What is a Rising Star Bond?

## Overview

- Rising star bonds are bonds of companies which have been downgraded to high yield that have strong potential to be upgraded in the near future

- Amidst the global 2020 pandemic, credit rating agencies downgraded over $710bn of corporate debt. $154bn, or 20%, were fallen angels.

## Rising Star Examples

**Figure 1. The Fallen Angel Wave Set to Reverse**


**Figure 4: Index rating has retraced just 32% of recent downgrades**

The average index rating has been increasing since mid-April.

# Investment Overview

## Business Description

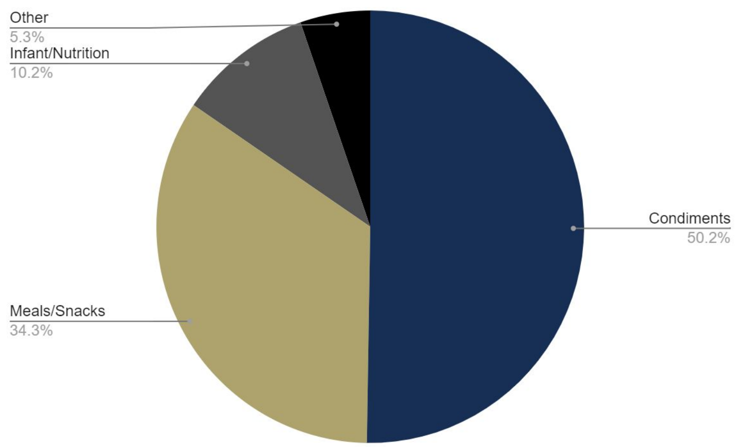
- KHC is a company with a focus on global food and beverage, producing condiments and sauces, cheese and dairy, meals, meats, refreshment beverages, coffee, and other grocery product worldwide.
- The majority of KHC's sales are made through long-term contracts with retailers and distributors using **in-house sales force**
- KHC operates through its own network of production, processing, and distribution facilities across the world (89 facilities)



## Company and Bond Statistics

| | |
|---|---|
| **Market Cap** | $45.0 B |
| **Yield to Maturity** | 1.99% |
| **Current Price** | $109.57 |
| **Effective Duration** | 5.073 Yrs |
| **G-Spread** | 90 bp |
| **Credit Rating** | BB+ |

## Revenue Breakdown




*https://www.fitchratings.com/research/corporate-finance/fitch-affirms-kraft-heinz-idr-at-bb-outlook-stable-17-09-2020*

# Recent News

- KHC unveiled a new strategic plan for its firm; emphasizing on more vertical integration
- Implementation of new operations center with potential cost savings of $2B annually
- Consolidation of brands will provide more capital to pay back creditors  through bond buyback and stronger liquidity


## KHC acquires Hemmer

- Kraft Heinz announced Thursday they will be buying Hemmer, a Brazilian company focused on condiments and sauces,
- This is an effort to increase global revenue of only ~20% in 2020

## What has KHC done since downgrade?

- Since downgrade, KHC has **improved earnings, reduced debt load** ($2.8b buyback of its bonds), and sold Planters snack brand for $3.35b
- Through earnings growth and $1.2 billion of debt repayment, KHC reduced debt/EBITDA below the maximum 4.5x that Moody's has said is tolerable for KHC at the Baa3 rating.
- "The stable outlook reflects the significant progress the company has made toward reducing financial leverage and improving its operating performance over the past year."

# Bond Info & Performance

## Bond

CUSIP: 50077LAD8
Coupon Rate: 3%
Current Price: 104.94
Duration: 4.073 Years
YTM: 1.88%
YTW: 1.82% (Callable 3/1/26)
Maturity Date: 06/01/26
Frequency: S/A
Issuance/Outstanding: 1,998M/1,911M
Ratings: Baa3(Moody's), BB+(S&P)

## Bond Price, G spread


# Relative Valuation

| | | | Leverage & Coverage | | | Profitability | | | Liquidity | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Company** | **S&P Rating** | **Market Cap ($)** | **Total Debt / EBITDA** | **Financial Leverage** | **EBITDA / Interest Expense** | **YoY Revenue Growth** | **FCF Margin** | **ROIC** | **Current Ratio** | **Cash Ratio** |
| **KHC** | BB+ | 45.1B | 4.23 | 1.98 | 2.34 | 4.84 | 16.55 | 3.46 | 1.34 | .424 |
| General Mills | BBB | 36.13B | 3.47 | 3.57 | 9.00 | 2.84 | 13.53 | 10.51 | .70 | .18 |
| Kellogg | BBB | 21.82B | 3.66 | 6.07 | 8.45 | 1.41 | 10.76 | 9.73 | .67 | .08 |
| Kerry Group | BBB+ | 20.81B | 2.55 | 2.06 | 13.38 | -3.98 | 6.39 | 8.05 | 1.53 | .332 |
| Keurig | BBB | 48.21B | 3.95 | 2.11 | 5.37 | 4.48 | 17.17 | 4.90 | .31 | .03 |
| **Median** | BBB | 36.13B | 3.66 | 2.11 | 8.45 | 2.84 | 13.53 | 8.05 | 0.7 | 0.18 |

## G-Spreads (bps)

- **KHC 3 06/26: 81**
- GIS 3.2 02/27: 46
- K 3.4 11/27: 56
- KDP 3.43 06/27: 49

## Key Takeaways

- Solid recent growth and profitability relative to comps
- Strong Liquidity metrics combined with most recent earnings call show KHC has safe coverage for short term liabilities
- Only junk bond out of comp group and is trading at significantly wider on spreads

# Moody's Report

## How has KHC improved since downgrade?

- Rating revised to stable by Moody's
- Improved Operating performance over FY 2021
- Earnings growth and $1.2B of debt repayment
- Improved operating execution and partnership with major customers
- 2020 Sales and EBITDA growth of 6.5% and 10.5% respectively
- Further credit improvement could come from KHC's pending asset sales and sustained high rates of at-home dining

## Reason for Potential Upgrade?

- If Kraft Heinz sustains its improved operating performance
- Debt/EBITDA would need to be maintained below 4.0x and retained net cash flow to net debt would need to be at least 10%

## Reason for Potential Downgrade?

- If operating execution were to falter
- Debt/EBITDA is sustained above 4.5x
- If Kraft Heinz Co adopts a more aggressive financial policy involving M&A

# Factors that Lead to Upgrade

## Sustained Improvement in Operating Performance

- Sustained high rates of at-home dining
- A new strategic plan for KHC, emphasizes more vertical integration, will potential reduce cost of production and provide greater control over the production process
  - https://www.ft.com/content/268f73e6-31a3-11e7-9555-23ef563ecf9a
  - https://www.ft.com/content/021f2361-cd2b-4f57-b4bd-bbe7656e3b42
- Completed both the sale of Natural cheese business for $3.2 billion and is Planters business for $3.4 billion in the first half of 2021 (Source: Moody's report )

## Debt/ EBITDA sustained below 4.0x

- Requires KHC to pay down around $7 billion more  in debt from cash on hand and asset proceeds
  - Has bought back $2.8 Billion since downgrade Feb 2020
- Moody expects that a significant portion of $5 billion in after-tax proceeds from asset sales will be used to reduce debt and financial leverage

## At Least 10% retained cash flow / net debt

- Strong Liquidity metrics, comparing to KHC competitors - cash ratio of 0.424 (avg. is 0.18)
- Retained Cash Flow to Net Debt steadily increased during the last 3 years - doubled to 12% between 2019 and 2020 and in 2021 grew to 13% (Source: Bloomberg)

# Factors that Lead to Downgrade

## Major deterioration in operating performance

- Q2 gross margin down 150 bps Y/y - pantry loading in prior year helped boost margins
- Temporary supply chain/inefficiencies could last longer than management expects - partially be offset by $2B, 5 year savings plan that places emphasis on procurement, manufacturing, and logistics

## Debt/ EBITDA sustained above 4.5x

- Historically had high net debt to ebitda - however, management's target is for 4x and currently around 3x
- Management emphasized their focus on buying back debt to improve net leverage

## Aggressive finance strategies, including pursuing a large debt-financed acquisition

- Q2 earnings call: not lowering leverage target to leave flexibility for either M&A or shareholder-friendly activity in the future
- Analyst (GS er) says unlikely they will do this until they are upgraded to IG especially in a higher-rate environment
- Management seems more focused on buying debt and maybe doing small acquisitions in EM, but nothing that will drastically affect leverage ratios

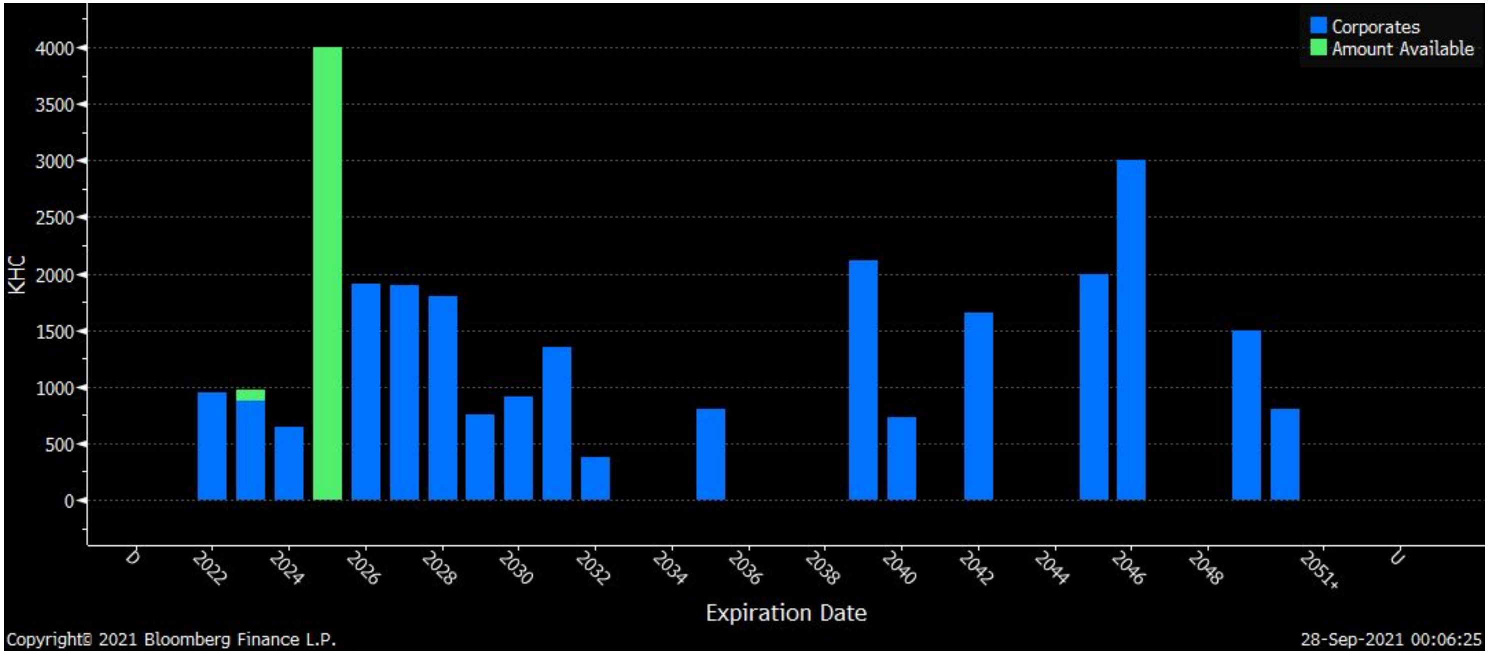
# Risks: Duration and Debt Maturity

## AGG vs KHC:

| | Yield: | Effective Duration: |
|---|---|---|
| AGG | 1.83 | 6.50 |
| KHC | 1.97 | 4.87 |

With lower duration, KHC has less interest rate exposure than the AGG

## Debt Distribution for KHC:



# Timeline and Comparison to the High Yield ETF

## Timeline

-KHC was downgraded to junk in February 2020. The long term average for upgrades is 3.4 years, with the average declining since 2015.

- Therefore we can expect KHC to be upgraded in the next 6-12 months as they work towards to goal mentioned in past slides by Moody’s

- Will do reval in Spring 2022 if not upgraded by mid semester

FIGURE 9. **Average Years Spent in the High Yield Index for Bonds That Eventually Returned to the US Corporate Index**


## Comparison to SHYD

| | Yield | Duration |
|---|---|---|
| KHC 2026 | 1.89% | 4.05 Years |
| SHYD | 1.84% | 4.31 Years |

- Ability to have a strong credit company with promising upgrade potential
- We do not need to be experts on all companies ina  fund, but rather choose a strong contender with positive upside
- Recession hedge being in consumer discretionary sector

# Investment Thesis

## Buy KHC 3 06/2026 at 1.25% of Allocation

- KHC is a phenomenal investment opportunity as a rising star play. An upgrade by the rating agencies will lead to a compression of its debt driving returns.
- KHC is well-capitalized to pay back creditors with strong short-term liquidity
- Strong hedge for portfolio in the event of a recession with exposure in the consumer staple sector
- Well-managed and growing business that should continue to generate stable cash flows without fears of a sudden ill-timed acquisition

## Why buy KHC over holding the AGG:

- Significant portion of fixed income portfolio is invested in AGG, (4% of 14%), leaving us more open to potential duration risk in higher-rate environment

- KHC provides diversification into consumer staples sector while decreasing portfolio duration and delivering tremendous upside as a rising star

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# Financials

| ($ in millions) | 2017 | 2018 | 2019 | 2020 | TTM |
|---|---|---|---|---|---|
| **Total Business Revenue** | **$ 26,076.00** | **$ 26,268.00** | **$ 24,977.00** | **$ 26,185.00** | **$ 26,389.00** |
| % Growth | | 1% | -5% | 5% | 1% |
| Cost of Goods Sold | $ 16,579.00 | $ 17,195.00 | $ 16,782.00 | $ 17,014.00 | $ 17,031.00 |
| **Gross Profit** | **$ 9,497.00** | **$ 9,073.00** | **$ 8,195.00** | **$ 9,171.00** | **$ 9,358.00** |
| % Margin | 36.4% | 34.5% | 32.8% | 35.0% | 35.5% |
| Total Operating Expanses | $ 2,172.00 | $ 2,713.00 | $ 2,627.00 | $ 3,284.00 | $ 3,337.00 |
| **EBITDA** | **$ 7,626.00** | **$ 7,343.00** | **$ 5,785.00** | **$ 6,856.00** | **$ 6,667.00** |
| % Margin | 29.2% | 28.0% | 23.2% | 26.2% | 25.3% |
| **Total CAPEX** | **$ (1,194.00)** | **$ (826.00)** | **$ (768.00)** | **$ (596.00)** | **$ (769.00)** |
| % of Toal Revenue | 5% | 3% | 3% | 2% | 3% |
| **Levered Free Cash Flow** | **$ 2,815.90** | **$ 2,815.90** | **$ 4,637.40** | **$ 2,757.10** | **$ 2,583.40** |
| % Conversion | 37% | 38% | 80% | 40% | 39% |
| Interest Expense | $ 1,234.00 | $ 1,284.00 | $ 1,361.00 | $ 1,270.00 | $ 1,337.00 |
| EBITDA/Interest Expense | 6.18 | 5.72 | 4.25 | 5.40 | 4.99 |
| Total Debt | $ 31,503 | $ 31,168 | $ 29,845 | $ 28,916 | $ 25,155 |
| Total Debt/EBITDA | 4.13 | 4.24 | 5.16 | 4.22 | 3.77 |
| Debt Repayment | | | | | |
| Change in Net Working Capital | $ 874.00 | $ 2,494.00 | $ (1,736.00) | $ 580.00 | $ 482.00 |
| % Change in Sales | | | | | |