BARCLAYS

Credit Research
European HY Food
19 January 2015

Premier Foods – Initiate at Market Weight

More firepower left

- We initiate coverage on Premier Foods (PFDLN) senior secured notes with a Market Weight rating. Despite the ongoing structural changes in food retail (price competition, reduction in promotions and SKUs), we view Premier Foods' strong competitive position in key categories as core strengths. We think the company is well placed to serve the multi-format retail environment (Discounters, smaller retailers, larger Food retailers and online channel). We remain confident in management's ability to drive future growth through innovation and via its scale, breadth of processes and packaging capabilities. Although we acknowledge that the revision of the growth for Power Brands was disappointing, we are confident about management's ability to meet guidance on profit for FY 14/15 given its focus on margins and profitability and savings in SG&A.
- Our ratings and fair-value rationale reflect PFDLN's deleveraging potential in FY 15/16, albeit from a moderate level of 3.7x (excluding pension deficit) to 3.8x in FY 14 and 3.3x in FY 15, on our estimates. We calculate that, adjusted for the pension deficit of £390mn (NPV of future post-tax cash flows), net leverage would be 6.2x.
- The company has stated its intention to reduce leverage to 2.5x in the medium term and given the reduction in deficit contribution of GBP161mn through the new pension plan, we believe there is a high degree of visibility on near-term cash use. Further, we note that Premier Foods' margins and free cash flow generation compare very favourably with most Food/Consumer issuers under our coverage given its leading positions in most of its categories, the scale and flexibility of its manufacturing facilities, its ongoing cost reduction efforts and well-invested assets.

Relative value

- Premier Foods' senior secured £'21 notes are currently quoted at £87.0 or 9.3% YTW, having traded in the £85.0-103.25 range since issuance and a mid price of £94.125. Premier Foods' secured notes are now trading cheap to the EUR HY Food index at 6.2% and to comparables such as Boparan £21s (£85.5, 8.4% YTW). In our view, recent underperformance was driven by: 1) the company's profit warnings on 17 June and 23 October 2014; and 2) fears of Tesco announcing further price cuts. We view PFDLN's Q4 results (due 23 January) as a better entry point on expectations of a weaker top line. We do not view the slow-down in Power Brands (brands with highest margins and growth potential) as structural as we continue to believe its leading position in key growth categories and diverse manufacturing processes are differentiating factors for retailers.
- We see better value in selling PFDLN 5y CDS at current levels (10.25/11.75pt UF) and note that PFDLN 5y CDS is currently flat to the notes despite the shorter duration and lack of upcoming maturity. We think that Premier Foods should trade at a discount of 250-300bp to the Food index reflecting its higher leverage (3.7x on a net debt over EBITDA basis and 6.2x adjusting for pension). More specifically, we think that Premier Foods should trade at a 100bp discount to Boparan £21s (currently 100bp, in line with current levels), reflecting its higher leverage (more than 1x, adjusting both leverage ratios for the pension deficit).

Food and Beverage
Market Weight
Unchanged

BAKKA 8 1/4 02/15/18
Overweight
Unchanged

BAKKA 8 3/4 06/15/20
Overweight
Unchanged

PFDLN 6 1/2 03/15/21
Market Weight
from n/a

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PLEASE SEE ANALYST CERTIFICATIONS AND IMPORTANT DISCLOSURES STARTING AFTER PAGE 12

Summary of ratings

Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials		
	Old	**New**
Food and Beverage	Market Weight	Market Weight
BAKKA 8 1/4 02/15/18	Overweight	Overweight
BAKKA 8 3/4 06/15/20	Overweight	Overweight
PFDLN 6 1/2 03/15/21	n/a	**Market Weight**

Source: Barclays Research

RELATIVE VALUE

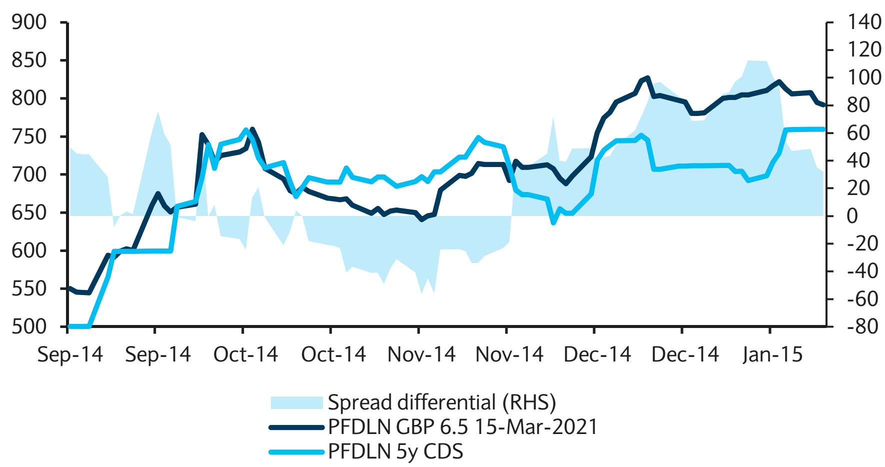
Relative value and recommendation

Premier Foods' senior secured £'21 notes are currently quoted at £87.0 or 9.3% YTW having traded in the £85.0-103.25 range since issuance and a mid price of £94.125. Premier Foods secured notes are now trading cheap to the EUR HY Food index at 6.2% and to comparables such as Boparan £21s (£85.5, 8.4% YTW). In our view, recent underperformance was driven by: 1) the company's profit warnings on 17 June and 23 October 2014; and 2) fears of Tesco announcing further price cuts. We view PFDLN's Q4 results (due on 23 January) as a better entry point on expectations of a weaker top line. We do not view the slow-down in Power Brands as structural as we continue to believe its leading position in key growth categories and diverse manufacturing processes are differentiating factors for retailers.

We see better value in selling PFDLN 5y CDS at current levels (10.25/11.75pt UF) and note that PFDLN 5y CDS is currently flat to the notes despite the shorter duration and lack of upcoming maturity. We think that Premier Foods should trade at a discount of 250-300bp to the Food index reflecting its higher leverage (3.7x on a net debt over EBITDA basis and 6.2x adjusting for pension). More specifically, we think that Premier Foods should trade at a 100bp discount to Boparan £21s (currently 100bp, in line with current levels), reflecting its higher leverage (more than 1x, adjusting both leverage ratios for the pension deficit).

FIGURE 1

PFDLN basis (bp)



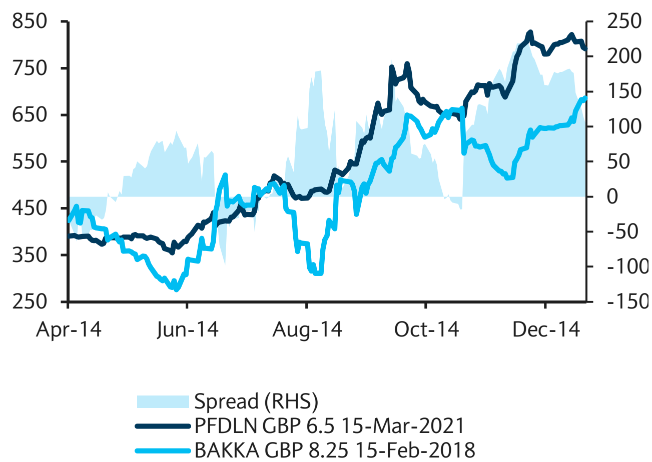
Source: Barclays Research

Although we expect competitive pressure to prevail in the Food retail space, we argue that Premier Foods benefits from its strong competitive position in key categories and is well placed to serve the multi-format retail environment (Discounters, smaller retailers, larger Food retailers and online channel). We remain confident about management's ability to drive future growth through innovation and via its scale, breadth of processes and packaging capabilities. Although we acknowledge that the revision of the growth for Power Brands was disappointing, we are confident about management's ability to meet guidance on profit for FY 14/15 mostly as a result of its focus on margins and profitability and savings in SG&A. As we argued in *The reality of a price war, 12 June 2014*, we think that: 1) overall levels of promotions in food/retail have declined y/y; 2) pricing pressure has predominantly affected produce products given the higher price transparency and has not impacted prepared meals or branded food thus far (mostly financed by retailers to date); 3) stocking the best brands (categories captains) is essential for retailers as it enables them to drive footfall and push more sales of own-label products as customers can perform pricing comparisons.

Our ratings and fair-value rationale reflect Premier Foods' deleveraging potential in FY 15/16, albeit from a moderate level of 3.7x (excluding the pension deficit) to 3.8x in FY 14 and 3.3x in FY 15, on our estimates. We note that, adjusted for the pension deficit of £390mn (NPV of future post-tax cash flows), net leverage would be 6.2x according to our calculations.

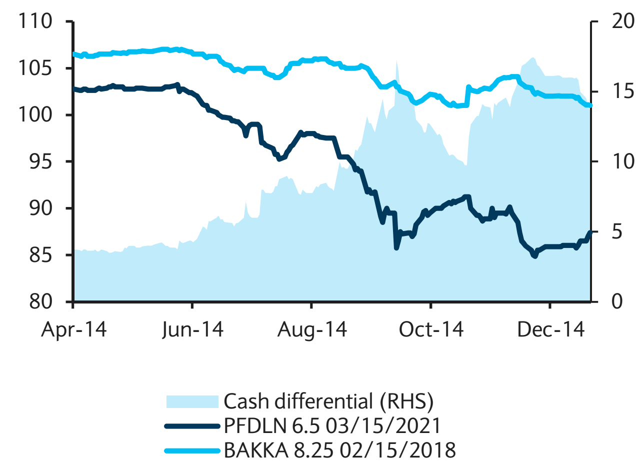
We think Premier Foods should trade at least 150bp wider than Bakkavor £20s, reflecting on the negative side Premier Foods' longer duration and higher net leverage (adjusted for pension) and on the positive side its larger equity cushion, stronger deleveraging potential, lower headline leverage and better rating with S&P (B versus B- in the case of Bakkavor). Similarly, we see fair value at 100bp wider to Boparan £21s (on additional leverage offset by better free cash flow and higher implied equity cushion). We recommend investors switch out of BPRLN £21s (£85.5, 8.4% YTW or 702bp) and into Premier Foods £21s (£87.0, 9.3% YTW, 802bp STW), lose 1.5 points in cash, and pick up c.1% in extra yield and 100bp in z-spread.

FIGURE 2
BAKKA 18s and PFDLN 21s: spreads (bp)



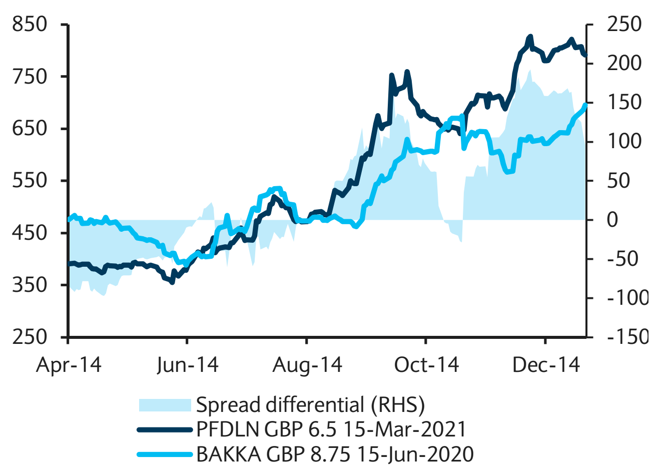
Source: Barclays Research

FIGURE 3
BAKKA 18s and PFDLN 21s: cash (pt)



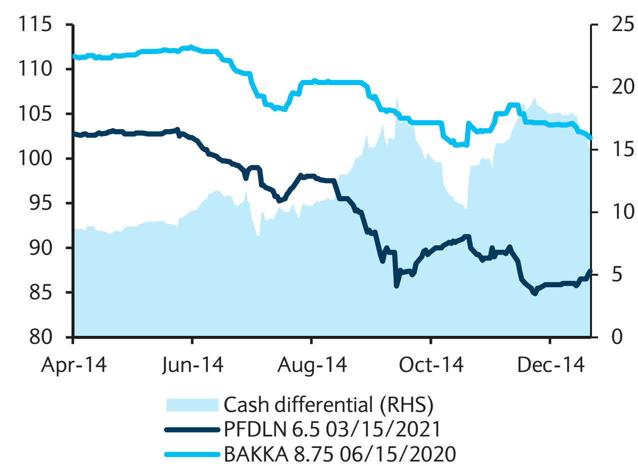
Source: Barclays Research

FIGURE 4
BAKKA 20s and PFDLN 21s: spreads (bp)



Source: Barclays Research

FIGURE 5
BAKKA 20s and PFDLN 21s: cash (pt)



Source: Barclays Research

Covenant highlights

- RCF facility: A 5y £272mn multi-currency revolving credit facility (RCF) which could be increased further by £50mn through an accordion facility. Up to £80mn of the RCF may be utilised by way of ancillary facilities such as overdrafts and letters of credit and the facility matures on 3 March 2019. The facility is secured by first ranking fixed charges over certain real estate and intellectual property rights (including trademarks), floating charges over all of the assets and undertakings of each Guarantor and share security over shares of the Issuer and each Guarantor (other than the Parent). However, no security will be granted over assets within the Hovis JV. The facility shares security with hedging banks up to £20mn, commodities hedging and other hedging as well as the pension Trustees for up to a maximum of £450mn (to amortise from 1 April 2016 as a result of payments made to the RHM and a minimum of £350mn). Financial covenants include minimum interest coverage ratio and maximum leverage ratio tested on a half-yearly basis starting from 2.3x and 5.35x respectively on March 2015 (reflecting the proposed change to YE to March) and stepping up to 2.5x and 4.95x in March 2016 (please see Figure 6). Note that the group is considering changing its financial year-end to March (please refer to Figure 6 for a relevant covenant schedule).

FIGURE 6

Covenants schedule test

Period	Interest coverage	Leverage ratio
31 March 2015	2.30:1.0	5.35:1.0
30 September 2015	2.45:1.0	5.20:1.0
31 March 2016	2.50:1.0	4.95:1.0
30 September 2016	2.60:1.0	4.85:1.0
31 March 2017	2.65:1.0	4.35:1.0
30 September 2017	2.70:1.0	4.25:1.0
31 March 2018	2.75:1.0	3.90:1.0
30 September 2018	3.00:1.0	3.80:1.0

Source: Offering Memorandum

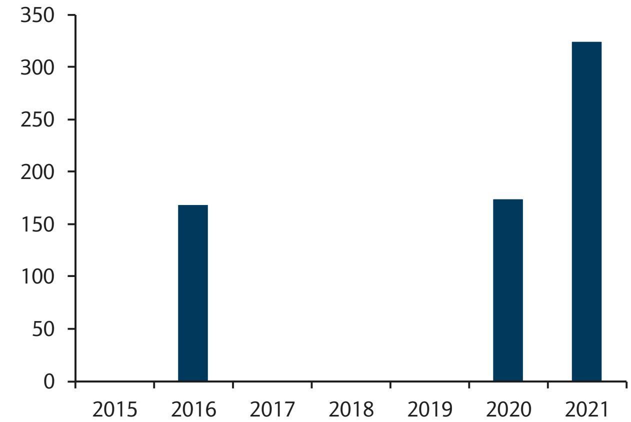
7NC3 Senior secured notes due 2021: GBP500mn senior secured notes consisting of GBP325mn 6.5% due 2021 and GBP175mn FRN due 2020 with: 1) a change-of-control put at GBP101, defined as more than 50% of voting power; 2) equity claw of 35% at 106.5 for the fixed notes; 3) total RP capacity of GBP40mn, limitation on incurrence, restricted payments including indebtedness under credit facilities at GPB350mn, indebtedness under securitisation financing of up to GP120mn, capital leases at GBP30mn and indebtedness of disqualified stock of the parent of GBP50mn; 3) asset sales and sale leasebacks subject to a fixed-charge coverage ratio test; and 4) callable in 2017 with early redemption at a T+50 make whole premium.

FIGURE 7
Capital structure

£mn	LTM	xEBITDA
	Jun-14	
Cash	(69)	
RCF £272mn	129	
Senior secured FRN Mar-20	175	
Senior secured £6.5% Mar-21	325	
Securitization facility	41	
Other	(28)	
Net debt	572	3.7x
Net debt - pension adjusted	962	6.2x
Adj. EBITDA	156	

Source: Barclays Research

FIGURE 8
Maturity profile (£ mn)



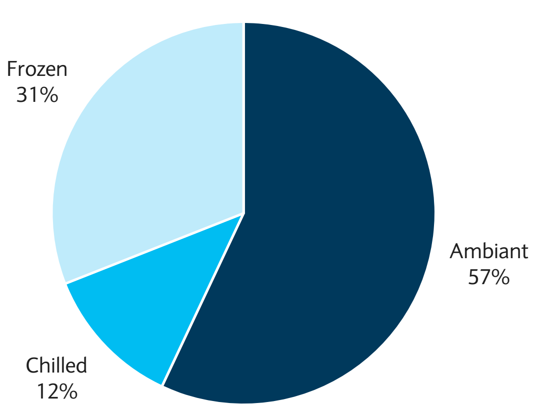
Source: Barclays Research

Company description

Premier Foods is one of the UK's largest food producers in terms of revenue. It manufactures, distributes and sells a wide range of branded and non-branded food products. Premier Foods' margins compare very favourably with peers given that most of its products are typically market leaders in their categories. Premier Foods benefits from a broad customer base which includes the "Big Four" supermarkets (Tesco, Asda, Sainsbury and Morrisons), multiple retailers including Waitrose and the Co-operative Group, discounters such as Aldi and Lidl, as well as convenience stores. We view the latter as a key strength especially in light of the structural shifts in the food retail industry triggered by the growth of the discounters.

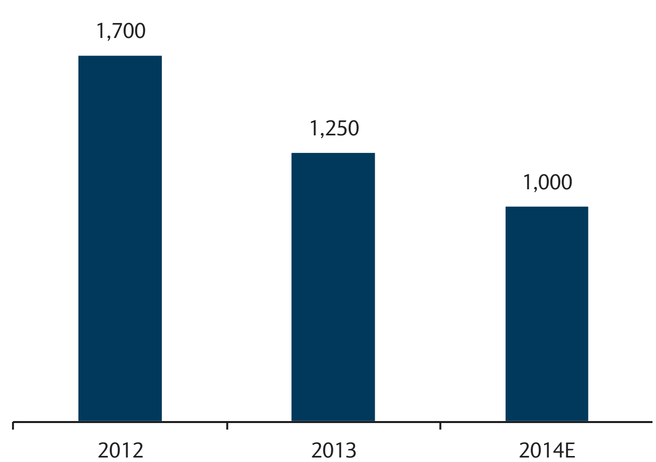
Similar to most food businesses under our coverage, Premier Foods suffered from higher inflation, customer disputes and higher promotions in the UK mostly in 2010 and in 2011 with EBITDA declining 24.6% from GBP285mn to GBP215mn. The company embarked on a stabilisation strategy in 2012 which involved: 1) the selective divestment of businesses such as Brookes Avana and Irish Brands; 2) the focus on its eight Power Brands (Ambrosia, Hovis, Sharwood's, Loyd Grossman, Mr Kipling, Bisto, Oxo and Bachelors); and 3) right-sizing and reducing the company's cost base and refinancing the business.

FIGURE 9
Revenue segments (LTM)



Source: Company reports

FIGURE 10
Reduction of c.41% of SKU in three years



Source: Company reports

Within its grocery division, the group pursues a "category-based strategy" with a key objective to grow sales in the five product categories in which Premier Foods currently operates, namely: Ambient Cakes, Ambient Desserts, Cooking Sauces & Accompaniments, Easy Eating, and Flavourings and Seasonings. Within these five product categories, the group focuses on growing its seven Power Brands, Ambrosia, Bachelors, Bisto, Loyd Grossman, Mr Kipling, Oxo and Sharwood's. These are the brands the group considers to have the highest growth potential and most attractive gross margins. In addition, the group has a portfolio of many other branded food products ("Support Brands") and a non-branded food business, which manufactures food products in conjunction with many of the UK's leading food retailers.

In February 2014, Premier Foods implemented a holistic re-financing plan which involved: 1) a comprehensive pensions deal which reduces deficit contribution by GBP161mn over six years; 2) GBP353mn in new equity to reduce net leverage to 3.3x PF Grocer EBITDA; 3) GBP500mn senior secured 7y notes to diversify the company's sources of funding; and 4) a simplified and reduced RCF of GBP272mn. Given the lack of any significant debt maturity before 2019, the current capital structure provides Premier Foods with a platform to deliver its category growth strategy.

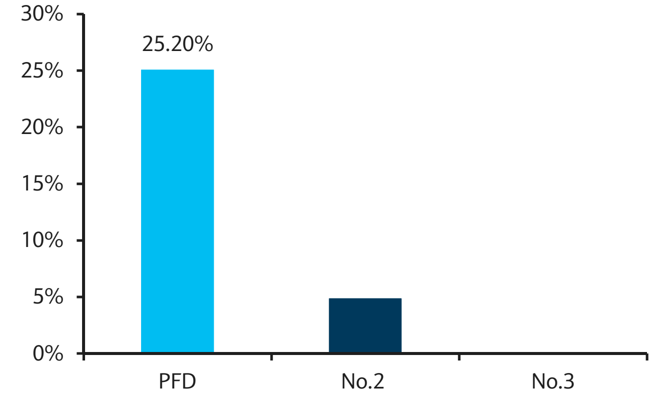
Positives

Leading market share positions in attractive segments

Premier Foods currently holds the number one sales position in each of the five product categories in the ambient grocery segment in which it operates, as the figure below shows. In our view, this approach provides Premier Foods with a differentiated and defensive business positioning through its focus on a portfolio of trusted British brands within categories which are not generally core to multinationals (thus limiting competitive threats) and via its multi-category scale. According to Kantar Worldpanel (as per a recent company presentation), Premier Foods is the fourth largest food and drink supplier in the UK with a 1.8% share of the market behind Mondelez International (2.2%), Nestle UK (2.0%) and Unilever (1.8%) (source: Kantar Worldpanel, 52 weeks ending 5 January 2014). We view Premier Foods' strong market share by product and by channel as well as its high share of consumer spending as key strengths versus less diversified businesses such as Moy Park, for instance. Most of the product categories in which Premier Foods operates have benefited from above-industry growth with the ambient sector growing at 2.3% in the 52 weeks ending 29 November 2013 and outperforming growth in both the chilled and frozen segments which grew respectively at 1.7% and 0.7% in the corresponding period. In addition, we note that certain categories in which Premier Foods operates within the ambient sector have benefited from above-market growth such as the "savoury meal making" segment and "sweet foods" segment. These grew by 4.4% and 3.2% respectively in the 104 weeks ending 9 December 2013, as disclosed in the Offering Memorandum.

FIGURE 11

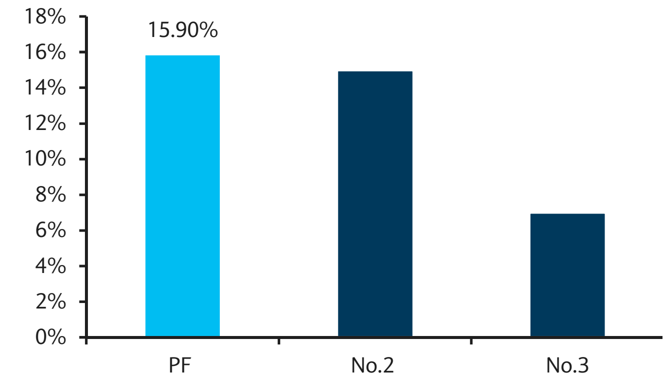
PFD number 1 in Ambient cakes (market value £954mn)



Source: Company reports

FIGURE 12

PFD number 1 position in Cooking Sauces & Accompaniments (market value £1,155mn)



Source: Company reports

We view Premier Foods' leading market share and diversified distribution channels as a key strength especially in the context of the price investments implemented by the Big Four. In our view, suppliers with a leading market share (such as Premier Foods) will ultimately benefit from Tesco's decision to reduce SKUs and cut complexity within pricing through an increase in shelf space and a reduction in promotional levels.

Strong margins supported by a solid track record of cost savings

Premier Foods features one of the highest levels of profitability among sector peers (FY 13 EBITDA margin of 18.4% as of FY 13) partially supported by the company's successful cost optimisation programs and category-based approach. The Group has a strong track record of cutting costs and reshaping its business to drive manufacturing and distribution efficiency. From 2011 to 2013, Premier Foods reduced SG&A from £147mn to £83mn (5.5% as a percentage of sales in FY 13 from 7.4% in FY 11) and reduced manufacturing costs from £100mn in FY 11 to £89mn in FY 13. This has enabled it to grow its margins (from 17.3% in FY 12 to 18.4% in FY 13) while reinvesting most of the savings into targeted consumer marketing to further support its Power Brands, where marketing expenditure as a percentage of revenue from Grocery Power Brands was approximately 4.7% in FY 13 (compared to c.5.8% in FY 12 and c.2.5% in FY 11 (restated)). Importantly, the Group restructured its Bread division in 2013, resulting in the removal of approximately 130 distribution routes, the closure of three distribution centres and the restructuring of outsourced logistics operations to optimise the new network ahead of the creation of a Bread JV transaction which was finalised in 2014. This restructuring plan is expected to yield further benefits following the additional investment in the Bread Business as a result of the Bread JV Transaction. We expect Premier Foods' margins to benefit from a more favourable mix as the company reduces its exposure to private label (13.1% of continuing operations revenues in FY 13) given that Brand sales typically attract higher margins than non-branded sales. We note that private label sales typically have margins of 5-7%, while branded sales can benefit from margins of more than 20% in certain leading categories. We estimate Power Brand margins at around 15%. We think that the improvement in product mix provides Premier Foods with a degree of margin elasticity which could be further invested, along with savings from SG&A and input costs, into pricing and marketing.

Improving cash flow profile

Historical cash conversion has compared very favourably with industry peers, in our view. EBITDA-capex/EBITDA improved from 58% in FY 11 to 73% in FY 13 mostly on the back of the improvement in EBITDA (£31mn y/y improvement in EBITDA in the corresponding period). We expect free cash flow to benefit from: 1) the low capex needs (in line with depreciation at £18-30mn) as well as the reduced pension contribution as per the new schedule (£9mn contribution in FY 15 versus £35mn in FY 14 and £42mn in FY 16). In addition, we expect working capital to benefit from the reduction in SKUs and in suppliers (Premier Foods reduced its suppliers from 3,300 in FY 12 to 2,460 in FY 13 and management expects to reduce the supplier base further to 1,860 in FY 14). We note that working capital management and capex in FY 15 will compare favourably with FY 14, on our estimates, as FY 14 cash flow reflects an additional £20mn expenditure on cakes as well as a £30mn outflow from working capital resulting from the Bread JV.

Negatives

High leverage when including the pension deficit

In conjunction with its refinancing plans in 2014, Premier Foods entered into a new pension framework agreement which reduced the pension contribution by £156mn versus the old plan and provided for no change in the schedule of contribution before 2020. We note that the next triannual valuation is due in 2016. The agreement provides certainty on pension contributions over the medium term in that they will not be altered until the end of 2019. The agreed contributions are deficit payments totalling £33.4mn in 2014, £7mn in 2015, £40mn in 2016, £47.5mn in 2017, £42.5mn in 2018, £40mn in 2019, £50mn in each year from 2020 to 2022 and £60mn per annum from 2023, increasing at 3% per annum. Premier Foods will pay administration costs and Pension Protection Fund levies in addition (c.£8-10mn per annum on our calculations). The group's pension trustee has a secured claim for up to £450mn which ranks pari passu with the notes and with the RCF, although this claim does not have any voting rights and cannot trigger a default. We calculate the current pension deficit at £390mn using discounted future cash flows (versus the actuarial valuation of £1,062mn as of April 2013 based on a discount rate of gilts of 1%). On that basis, we calculate total net leverage at 6.2x which compares unfavourably with comparables such as Bakkavor at 4.2x and Boparan at 4.9x (including the pension deficit). Premier Foods' current EV/EBITDA is 7.2x compared with 9.3x in FY 13, implying an equity cushion of just over 1x based on our adjusted leverage calculation and 3.7x based on the reported net leverage.

Exposure to consumer preference/weather

Similar to most food producers, Premier Foods faces risks such as changing consumer preferences and market acceptance of new products. As a branded business, the ability to innovate and remain competitive while continuing to appeal and be relevant to customers is paramount to Premier Foods' success, in our opinion. As such, given the ongoing changes in consumer preferences and behaviours, we view Premier Foods' ability to innovate as key. Premier Foods allocates significant resources to the development of new products (12.9% of group sales in FY 13) and to research and development; however, we note that poor acceptance of new products can ultimately result in lower sales and adverse working capital movements. Recent changes in consumer preferences have included dietary concerns, an increasing preference for fresh and chilled foods, ready prepared foods, snacking formats, indulgence products and organic foods. Food producers are also facing structural changes such as the growth of Discounters as well as concerns about the health impacts and nutritional value of certain foods resulting in increasing pressure to produce products with reduced levels of salt, sugar and fat and to eliminate trans-fatty acids and certain other ingredients. Unseasonal weather could also negatively impact the consumption of certain foods, and to that extent, we note that ambient soup sales were down 12% in H1 14 given the warmer weather. We view Premier Foods' innovation capabilities and NPD pipeline (Bisto Simply Casserole, Bisto Rich Gravy Paste, Oxo Herbs) in a positive light, although we note that the NPD pipeline has been heavily skewed to H2 14 and FY 15 with benefits expected in FY 15. In addition, the company has relaunched Mr Kipling following a widereaching marketing campaign and we will be very keen to hear the feedback from the marketing campaign and packaging re-design. Lastly, we view Premier Foods' diversified distribution channel as a key strength and note that the growth of the High Street Discounters/Discounters represents an opportunity for Premier Foods Support brands.

Recent results

Premier Foods' H1 results were broadly in line with our estimates. They showed a decline in sales of 6.1% to £364mn reflecting mostly the negative impact from the weather (the milder weather had a significant impact on category performance such as soups), the structural change in channel mix, price deflation, as well as a more disciplined approach to margins (negative impact on volumes y/y). Power Brand sales (66% of H1 revenue) were down 4.9% to £240.8mn, while support brands (22.8% of H1 revenue) were down 9.2% y/y to £83.3mn. Non-branded sales were down 6% to £40.3mn, reflecting the company's strategic decision to reduce its exposure to the lower-margin private label segment. In an effort to protect margins, management opted to reduce the level of promotions (promotions ROI increased from 36% in H1 13 to 48% in H1 14), boosting the average realised pricing and maintaining its net pricing with customers. On the positive side, gross profit was down 3.2% to £126.3mn while gross margin improved to 34.7% from 33.6% the prior year. Trading profit was up 2.1% y/y at £48.1mn (within the underlying business), reflecting a timing difference in marketing spend (delay in the Kipling campaign). Trading profit for continuing operations was up 0.1% at £48.6mn and reported EBITDA was flattish y/y at £55.6mn versus £55.8mn within the underlying business. EBITDA came in at £56.1mn within continuing operations and compared with £57.2mn the prior year. Net debt was £571.9mn (post the equity injection of £340.2mn). Other cash and non-cash items include the net of financing fees associated with the completed capital refinancing plan of £28.7mn and write-off of previous debt issuance costs and amortisation costs of £16.6mn. Recurring cash flow (as reported by the company) was an outflow of £30.2mn in H1 14 following a pension contribution of £37.2mn, capex of £19.2mn and a working capital outflow of £9.9mn. We calculate net leverage at 3.7x and 6.2x adjusted for pensions.

Q3 interim management statement (23 October 2014)

Sales were below management's expectations as of Q2 with branded sales down 4.1% in Q3. In particular we note that Power Brands (70% of Q3 revenue) were down 5.1% y/y at £119.5mn, while Support Brands (22% of Q3 revenue) were down 0.9% y/y at £40.4mn. Similar to H1, non-branded sales were down 10.3% to £17.1mn, reflecting the strategic decision to reduce the exposure to lower-margin, non-branded sales (mostly in cakes and desserts). Management commented that the branded sales mix increased by 60bp to 90.4% in the quarter, which helped support overall gross margins (favourable product mix and benign cost inflation). In line with trends seen in H1 14, management continues to move away from certain loss-making promotion. While this is having a negative impact on volumes, we note that the average realised pricing remained stable and return on investment from promotional activity remained higher than the prior year, according to management. Commenting on the various categories, management explained that cooking sauces and accompaniments category continued to be highly competitive which held back sales of Sharwood's and Loyd Grossman. Homepride has enjoyed good sales uplifts following its first television advertising campaign in 10 years, featuring the iconic 'Fred' character which supported the launch of its new cooking sauces range. In the quarter, Mr Kipling benefited from a major brand re-launch, including an extensive advertising campaign, new packaging re-design, in-store shopper marketing initiatives and targeted social media activities. As a result, management commented that sales of Mr Kipling grew in the quarter and were accompanied by market share gains following the re-launch. Ambrosia continued to build steadily on its strong market position in the UK, gaining share in the quarter.

Financial highlights/estimates

The business is seasonal with the most important trading period historically in terms of sales, operating results and cash flow being the colder periods (winter)/Christmas period. The majority of the Group's sales come from the major United Kingdom retailers, such as Tesco, Asda, Sainsbury's, WM Morrison, Waitrose and The Co-operative Group, each of which stocks the Group's brands and their own non-branded products, some of which are produced by the Group. The Group also makes sales to discounters (such as Iceland and Poundland), wholesalers, smaller convenience stores, professional kitchens (through the Group's food service sub-division), food producers (which use the Group's products, such as flour, in their manufacturing processes) and other UK retailers. Most of the Group's sales to major UK retailers are made on a daily demand basis. As per industry-wide practices, Premier Foods does not have written contractual commitments to supply such customers on a long-term basis or any written contractual arrangements governing the terms of supply (including price) of the Group's products. This provides the company with a degree of pricing flexibility (mostly on input costs). However, the lack of such contracts reduces revenue visibility, in our view. We estimate sales will decline by 5-6% in FY 14, in line with YTD results and estimate FY sales at £796mn. We estimate FY 15 sales as lightly up y/y reflecting on the positive side benefits from new product launches and on the negative side the ongoing reduction in promotional levels as well as the reduction in SKUs. We estimate gross profit at £282.6mn (reflecting mostly the lower sales), as the company improves its margins mostly on better product mix and reduced input costs thus helping offset some of the negative impact from lower sales; and we currently estimate FY 14 EBITDA at £148mn reflecting additional marketing costs. We estimate a small improvement in EBITDA in FY 15 at £150mn mostly on better product mix. Our free cash flow estimates in FY 14 include a working capital outflow of £30mn, capex of £40mn, pension deficit contribution of £45mn and cash interest of £46.7mn. We estimate net leverage at 3.8x and 6.5x adjusted for pensions. We expect free cash flow to improve in FY 15 on the back of the lower pension contribution, a more favourable movement in working capital as well as reduced capex. We calculate free cash flow in FY 15 at £64.1mn reflecting a lower capex at £25mn, a neutral working capital movement and lower pension contribution of £9mn. We expect net leverage to reduce markedly in FY 15 to 3.3x (-0.5x versus FY 14) through the notes and to 5.9x (from 6.5x in FY 14) including pensions.

FIGURE 13

Premier Foods HY model (£ mn)

P&L	FY 11	FY 12	FY 12*	H1 13	H2 13	FY 13	H1 14	H2 14E	FY 14E	FY 15E
Power Brands	512.6	533.1	533.1	253.2	290.3	543.5	240.8	281.0	521.8	532.2
% change	*NA*	*4.0%*	*0.0%*	*NA*	*NA*	*2.0%*	*(4.9%)*	*(3.2%)*	*(4.0%)*	*2.0%*
Support Brands	214.6	206.3	206.3	91.8	104.4	196.2	83.3	103.1	186.4	195.7
% change	*NA*	*(3.9%)*	*0.0%*	*NA*	*NA*	*(4.9%)*	*(9.3%)*	*(1.3%)*	*(5.0%)*	*5.0%*
Non-branded	100.3	126.6	126.6	42.9	67.2	110.1	40.3	47.6	87.9	79.1
% change	*NA*	*26.2%*	*0.0%*	*NA*	*NA*	*-13.0%*	*-6.1%*	*-29.1%*	*-20.1%*	*-10.0%*
Retained grocery sales	827.5	866.0	866.0	387.9	461.9	849.8	364.4	431.7	796.1	807.0
% change	*NA*	*4.7%*	*4.7%*	*NA*	*NA*	*-1.9%*	*-0.1*	*-6.5%*	*-6.3%*	*1.4%*
Total continuing sales	1,999.5	1756.2	1070.9	393.5	462.7	856.2	364.7	431.4	796.1	807.0
% change	*NA*	*(12.2%)*	*(39.0%)*	*NA*	*NA*	*(20.0%)*	*(7.3%)*	*(6.5%)*	*(6.3%)*	*1.4%*
Cost of sales	-1,445.0	-1261.2	-721.6	-263.0	-293.1	-556.1	-238.4	-275.1	-513.5	-519.7
Gross profit	554.5	495.0	349.3	130.5	169.6	300.1	126.3	156.3	282.6	287.3
Sales, marketing & distribution	-263.3	-262.5	-141.6	-56.6	-55.3	-111.9	-54.1	-49.4	-103.5	-104.9
Administrative & other costs	-466.8	-132.2	-123.5	-68.7	-66.9	-133.5	-82.3	-42.7	-125.0	-123.1
Exceptionals/other	-0.7	-4.0	-0.5	0.0	0.0	-2.1	0.0	-2.1	-2.1	-2.1
Operating profit	-176.3	96.3	83.7	5.2	47.4	52.6	-10.1	9.6	52.0	57.2
Operating profit margin %	NA	11.1%	7.8%	1.3%	10.2%	6.2%	(2.8%)	2.2%	6.5%	7.1%
% change	*NA*	*NA*	*NA*			*(37.2%)*	*NA*	*(79.7%)*	*(1.2%)*	*8.8%*
EBITDA										
Adj EBITDA - Continuing operations	156.2	150.1	182.5	57.2	99.6	156.8	56.1	38.1	148.1	150.1
Adj EBITDA margin (%)	18.9%	17.3%	21.1%	14.7%	21.6%	18.5%	15.4%	8.8%	18.6%	18.6%
Cash Flow summary										
EBITDA	230.1		182.5	57.2	99.6	156.8	56.1	92.0	148.1	150.1
Working capital	16.6		(62.7)	(23.3)	18.4	(4.9)	(10.7)	-19.3	(30.0)	0.0
Cash flow from operations	246.7		119.8	33.9	118.0	151.9	45.4	72.7	118.1	150.1
Capital expenditures	(78.9)		(66.6)	(19.5)	(20.9)	(40.4)	(19.4)	-20.6	(40.0)	(25.0)
% of sales	3.9%		7.7%	5.0%	4.5%	4.8%	5.3%	4.8%	5.0%	3.1%
Cash interest	(113.4)		(52.5)	(22.6)	(13.3)	(35.9)	(21.4)	(25.3)	(46.7)	(37.0)
Cash taxes	(2.4)		(5.3)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pension	(117.4)		(23.7)	9.3	(25.6)	(16.3)	(22.2)	(22.8)	(45.0)	(9.0)
Other/restructuring	(42.6)		(34.1)	(28.8)	16.6	(12.2)	(17.4)	12.4	(5.0)	(15.0)
FCF	(108.0)		(62.4)	(27.7)	74.8	47.1	(35.0)	16.4	(18.6)	64.1
Disposals	400.2		312.4	90.9	14.7	105.6	16.3			
Reported FCF	292.2		250.0	63.2	89.5	152.7	(18.7)			
Capitalisation							PF			
Cash & cash equivalent			53.0			157.0	69.1	85.5	85.5	149.6
Senior bank loans							128.0	128.0	128.0	128.0
Senior secured notes							500.0	500.0	500.0	500.0
Other							41.3	41.3	41.3	41.3
Gross secured debt			1,004.0			988.0	669.3	669.3	669.3	669.3
Net debt			951.0			831.0	600.2	583.8	583.8	519.7
Reported net debt							571.9	555.5	555.5	491.4
Pension deficit NPV			390.1			483.0	390.1	390.1	390.1	390.1
Total net debt			1,341.1			1,314.0	962.0	962.0	962.0	881.5
LTM debt ratios										
PF Adj EBITDA			182.5			156.8	155.7	148.1	148.1	150.1
Total debt/EBITDA			5.5x			6.3x	4.3x	4.5x	4.5x	4.5x
Net sr secured debt/EBITDA (ex rentals)			5.2x			5.3x	3.7x	3.8x	3.8x	3.3x
Net second-lien debt/EBITDA			7.3x			8.4x	6.2x	6.5x	6.5x	5.9x

Note: Not adjusting for change in YE to March. *Pension cost in FY 14 includes financing fees and costs of £10mn in addition of the £35mn scheduled contribution. *FY15 contribution of £10mn included in otherSource: Company reports, Barclays Research

Analyst Certification

We, Thierry Anid and Karine Elias, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Overweight (OW):

For sectors rated against the Barclays U.S. Credit Index, the Barclays Pan-European Credit Index, the Barclays EM Asia USD High Grade Credit Index or the Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to exceed the six-month excess return of the relevant index.

For sectors rated against the Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials or the Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to exceed the six-month total return of the relevant index.

Market Weight (MW):

For sectors rated against the Barclays U.S. Credit Index, the Barclays Pan-European Credit Index, the Barclays EM Asia USD High Grade Credit Index or the Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be in line with the six-month excess return of the relevant index.

For sectors rated against the Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials or the Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be in line with the six-month total return of the relevant index.

Underweight (UW):

For sectors rated against the Barclays U.S. Credit Index, the Barclays Pan-European Credit Index, the Barclays EM Asia USD High Grade Credit Index or the Barclays EM USD Corporate and Quasi-Sovereign Index, the analyst expects the six-month excess return of the sector to be less than the six-month excess return of the relevant index.

For sectors rated against the Barclays U.S. High Yield 2% Issuer Capped Credit Index, the Barclays Pan-European High Yield 3% Issuer Capped Credit Index excluding Financials or the Barclays EM Asia USD High Yield Corporate Credit Index, the analyst expects the six-month total return of the sector to be less than the six-month total return of the relevant index.

Sector definitions:

Sectors in U.S. High Grade Research are defined using the sector definitions of the Barclays U.S. Credit Index and are rated against the Barclays U.S. Credit Index.

Sectors in U.S. High Yield Research are defined using the sector definitions of the Barclays U.S. High Yield 2% Issuer Capped Credit Index and are rated against the Barclays U.S. High Yield 2% Issuer Capped Credit Index.

Sectors in European High Grade Research are defined using the sector definitions of the Barclays Pan-European Credit Index and are rated against the Barclays Pan-European Credit Index.

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To view sector definitions and monthly sector returns for Asia, EEMEA and Latin America Research, go to https://live.barcap.com/go/RSL/servlets/dv.search?pubType=4511&contentType=latest on Barclays Live.

Explanation of the Barclays Research Credit Rating System

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Overweight (OW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to exceed the six-month expected excess return of the relevant sector.
Market Weight (MW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be in line with the six-month expected excess return of the relevant sector.
Underweight (UW): The analyst expects the six-month excess return of the issuer's index-eligible corporate debt securities to be less than the six-month expected excess return of the relevant sector.
Rating Suspended (RS): The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Overweight (OW): The analyst expects the six-month total return of the debt security subject to this rating to exceed the six-month expected total return of the relevant sector.
Market Weight (MW): The analyst expects the six-month total return of the debt security subject to this rating to be in line with the six-month expected total return of the relevant sector.
Underweight (UW): The analyst expects the six-month total return of the rated debt security subject to this rating to be less than the six-month expected total return of the relevant sector.
Rating Suspended (RS): The rating has been suspended temporarily due to market events that make coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.
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Overweight (OW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to exceed the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively.
Market Weight (MW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to be in line with the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively..
Underweight (UW): The analyst expects the six-month total returns of the issuer's rand-denominated fixed rate notes or floating rate notes (as applicable) to be below the six-month expected total returns the South African Credit Fixed Market Index (CFIX95) or the South African Credit Floating Market Index (CFL020), respectively..
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