

# Orkla ASA

## Norway, Consumer Products



**A-** STABLE

### Corporate profile

Orkla ASA is a leading Norwegian supplier of branded consumer goods to the grocery, out-of-home, specialised retail, pharmacy and bakery sectors. Orkla's main operative markets are the Nordics, the Baltics and selected countries in Central Europe, but the company also has operations in other countries. Orkla's main business areas are: Foods, Care, Confectionary & Snacks and Food Ingredients. Consumer & Financial Investments consists of other operations and financial holdings. This segment includes a 42.6% ownership in Jotun ASA, and the consolidated hydro power business. Notable consumer brands in Orkla's portfolio include: Abba Seafood, Felix Abba, Göteborgs Kex, Møllers Tran, Kims, Lilleborg, Nidar, OLW, Panda, Stabburet, Sætre, Pierre Robert, TORO and Jordan. The company is listed on the Oslo Stock Exchange, employs approximately 21,500 people worldwide and has about NOK 50bn in annual turnover.

### Key metrics

Scope credit ratios	2019	2020	Scope estimates	
			2021E	2022E
EBITDA/interest cover (x)	37.1x	39.2x	41.0x	33.5x
Scope-adjusted debt (SaD)/EBITDA	1.3x	1.2x	1.9x	1.8x
Scope-adjusted funds from operations/SaD	68%	72%	44%	47%
Free operating cash flow /SaD	44.2 %	50.2 %	27.3 %	27.8 %

### Rating rationale

**Scope Ratings GmbH (Scope) has assigned an issuer rating of A-/Stable to Norwegian consumer product company Orkla ASA. Scope has also assigned a senior unsecured debt rating of A- and a short-term rating of S-1.**

The issuer rating reflects the company's relatively low industry risk and leading position in its key segments and markets, combined with a strong financial risk profile.

Orkla's business risk profile benefits from the company's strong positions in its main markets. 80% of revenues are generated by branded consumer products, with brands holding number one or number two positions in their home markets. This partly mitigates Orkla's less diversified geographical diversification (which is, however, improving), as the company is mainly present in the Nordics (approx. 70% of revenue). Diversification in terms of product offering, suppliers and distribution networks is good. Orkla has over 300 brands, of which some are targeted for a more international focus and expansion. Although we view positively the low volatility in profitability, the company is slightly lagging some of its larger international peers in terms of group EBITDA margins.

The company's financial risk profile is stronger than its business risk profile. This is based on a conservative capital structure with Scope-adjusted debt (SaD)/EBITDA well below 2x in recent years. Furthermore, Orkla has also reported very solid FOCF/SaD ratios and shown strong financial flexibility. Although leverage has increased in 2021, due to recent acquisitions, we expect it to remain at 1-2x in the short to medium term.

### Ratings & Outlook

Corporate issuer rating	A-/Stable
Senior unsecured rating	A-
Short-term rating	S-1

### Analysts

Henrik Blymke  
+47 21 09 38 36  
[h.blymke@scoperatings.com](mailto:h.blymke@scoperatings.com)

Michael M Simonsen  
+47 23 96 39 97  
[m.simonsen@scoperatings.com](mailto:m.simonsen@scoperatings.com)

### Related Methodologies

[Corporate Rating Methodology](#)

[Consumer Product Methodology](#)

### Scope Ratings GmbH

Karenslyst allé 53  
N-0279 Oslo  
Phone +47 21 623142

### Headquarters

Lennéstraße 5  
10785 Berlin  
Phone +49 30 27891 0  
Fax +49 30 27891 100

[info@scoperatings.com](mailto:info@scoperatings.com)  
[www.scoperatings.com](http://www.scoperatings.com)



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Our estimates assume that the company will be slightly more growth focused (as expressed at its Capital Markets Day in November 2021) and maintain an active M&A ambition within its pre-defined growth areas. As a result, our base case incorporates a certain amount of expansionary investment, but no divestments, while noting that Orkla may be open to this.

Liquidity is adequate based on good access to bank and bond markets. As of Q3 2021, Orkla had NOK 9.7bn in cash and undrawn credit lines, well above reported short-term debt of NOK 4.6bn. Although the company has a rather high portion of short-term debt at the moment, it is more than sufficiently covered by undrawn committed back-up lines.

We have made no adjustment for supplementary rating drivers. Orkla's financial policy is conservative and prudent, with well-established financial targets that mitigate potential growth risks and a too high leverage. Ownership, structure and governance are credit neutral, resulting in no supplementary rating adjustments.

### **Outlook and rating-change drivers**

The Stable Outlook reflects our expectation that Orkla will continue to hold leading positions in its key markets and maintain a good product diversification mix offering of non-durable consumer goods. The Stable Outlook also assumes higher expansionary investment in the medium term (compared to Orkla's recent history up until 2020), but a continuation of strong leverage and cash flow metrics, exemplified by a stable operating performance, resulting in Scope-adjusted leverage averaging 1-2x over time.

A positive rating action is currently seen as remote due to the company's focus on expansion, as well as its M&A ambitions. This is assumed to be more important to management than steering towards a very conservative capital structure, that will significantly improve the financial risk profile. A positive rating action could however be warranted in the longer run if the company introduce even more conservative financial targets in the future.

A negative rating action is possible if Orkla's business risk profile deteriorates through weaker market shares and/or falling profitability margins. Additionally, an increased M&A and growth focus above our expectations, resulting in sustained Scope-adjusted leverage above 2x could also lead to a downgrade.

#### Rating drivers

Positive rating drivers	Negative rating drivers
<ul style="list-style-type: none"> <li>• Strong positions in main markets, with 80% of revenues from brands with top two market positions in their respective markets</li> <li>• Good diversification within product mix; very wide offering of non-durable consumer goods; more than 300 brands</li> <li>• Strong industry risk profile, characterised by low cyclicity</li> <li>• Prudent financial policy and long history of maintaining a conservative capital structure over time</li> </ul>	<ul style="list-style-type: none"> <li>• Moderate international reach, with lower geographical diversification than some larger peers</li> <li>• Margins slightly below the peer average (but stable)</li> <li>• Slightly underinvested in marketing, advertising and brand R&amp;D (measured by % of sales)</li> </ul>

#### Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> <li>• Introduction of even more conservative financial targets</li> <li>• Reduced focus on expansion and M&amp;A that will significantly improve the company's financial risk profile on a sustained basis</li> </ul>	<ul style="list-style-type: none"> <li>• Higher debt-financed expansion growth with sustained Scope-adjusted leverage above 2x</li> <li>• Deterioration in business risk profile due to weaker market shares and/or falling profitability margins</li> </ul>



## Financial overview

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover	37.1x	39.2x	41.0x	33.5x
Scope-adjusted debt (SaD)/EBITDA	1.3x	1.2x	1.9x	1.8x
Scope-adjusted funds from operations/SaD	68%	72%	44%	47%
Free operating cash flow/SaD	44.2 %	50.2 %	27.3 %	27.8 %
Scope-adjusted EBITDA in NOK m	2019	2020	2021E	2022E
EBITDA <sup>1</sup>	6,270	6,506	6,745	7,275
Dividend received from Jotun	182	233	413	400
Scope-adjusted EBITDA	<b>6,452</b>	<b>6,739</b>	<b>7,158</b>	<b>7,675</b>
Scope-adjusted funds from operations in NOK m	2019	2020	2021E	2022E
EBITDA	6,270	6,506	6,745	7,275
less: (net) cash interest as per cash flow statement	-174	-172	-174	-229
less: cash tax paid as per cash flow statement	-1,129	-1,152	-1,222	-1,312
add: other items (incl. div received and write-down adjustments)	683	744	562	562
Scope-adjusted funds from operations	<b>5,650</b>	<b>5,926</b>	<b>5,911</b>	<b>6,297</b>
Scope-adjusted debt in NOK m	2019	2020	2021E	2022E
Reported gross financial debt (including leases)	8,586	10,023	14,359	13,359
less: cash and cash equivalents	-1,669	-3,213	-2,360	-1,324
add: restricted cash	176	181	180	180
add: pension adjustment	1,163	1,272	1,272	1,272
Other	-	-	-	-
Scope-adjusted debt	<b>8,256</b>	<b>8,263</b>	<b>13,451</b>	<b>13,487</b>

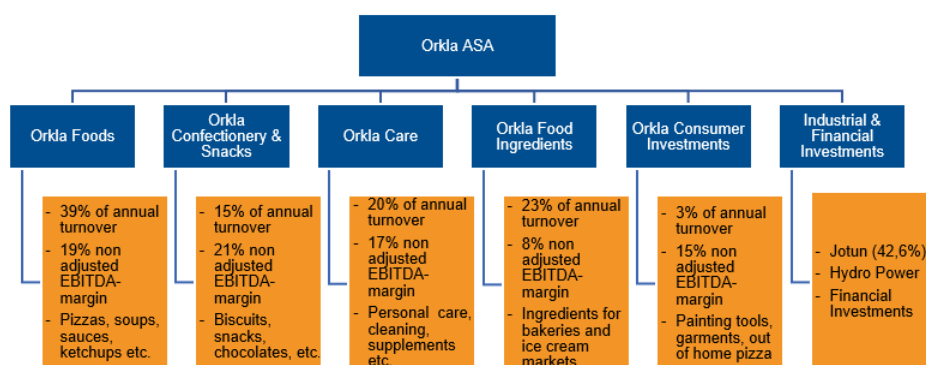
<sup>1</sup> Including some write-down expenses

### Business risk profile

Orkla is predominantly exposed to the consumer products industry. Our analysis therefore focuses on this industry. The company's three main investments outside consumer products are hydro power, real estate assets and the ownership in Jotun. We deem these neutral to the overall business risk profile assessment, as their EBITDA contribution is relatively low. At the same time, we consider them slightly positive for Orkla's financial risk profile due to the financial flexibility they provide.

The 42.6% ownership in Jotun (an international chemicals company which deals in decorative paints and performance coatings for various industries) is accounted for using the equity method. The other non-consumer product investments (properties and hydro power) are fully consolidated. Orkla's real estate arm has a book value of NOK 1.8bn (including its headquarters), while the hydro power business generates approx. 2.5TWh p.a. The latter businesses consists of wholly owned power plants in Sarpsfoss and leased power plants (until 2030) through Orkla's 85% interest in AS Saudefaldene.

**Figure 1: Simplified organisational/segment structure**



Source: Company

### Industry risk

**Non-durable consumer products industry is rated A**

We rate the non-durable consumer products industry at A. It is characterised by low cyclicity, in part because the consumption of essential foods and beverages is less susceptible to macroeconomic drivers and changes in consumer confidence. Despite the generally moderate capital investment needed to sell consumer goods, we consider the barriers to entry to be medium because of the efforts needed to attain the required economies of scale and establish a customer base. At the same time, substitution risk is low, reflecting the generally non-discretionary nature of these products and services.

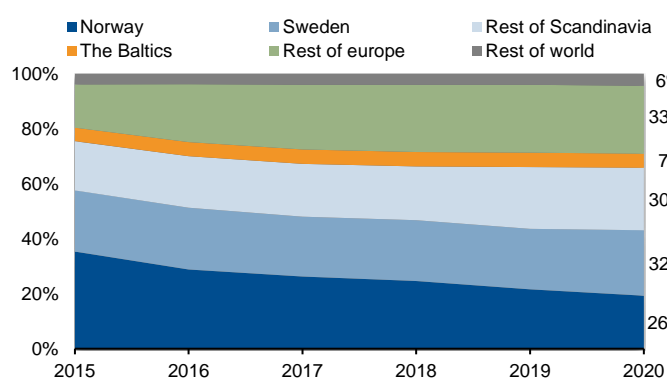
For a detailed description of the industry risk drivers for consumer product segments, please refer to our sector-specific methodology (linked on the first page of this report).

### Competitive positioning

Orkla's competitive position is mainly influenced by:

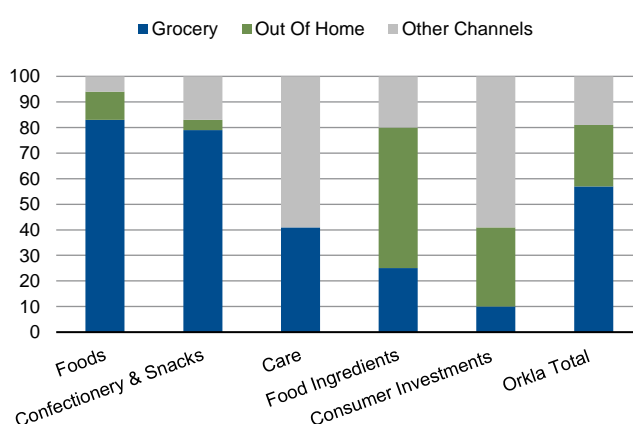
- Strong positions in its main markets, with 80% of revenues from brands with top two positions in their respective markets
- Good product mix diversification, with a wide offering of non-durable consumer goods and more than 300 brands, of which many have strong positions in their key markets
- Moderate international geographical reach, and lower profitability than some larger peers

**Figure 2: Geographic segmentation over time**



Source: Company reports, Scope

**Figure 3: Segmented sales channel split 2020**



Source: Company capital markets day 2021

The company operates with five main segments, with the core business consisting of Foods, Confectionery & Snacks, Food Ingredients and Care. Each of these segments has a large number of brands and hundreds of individual products. With an annual turnover of around EUR 5bn, Orkla is a large consumer product company on a Nordic scale, but more moderately sized compared to the big international players.

We consider Orkla's high local market shares to be a key competitive advantage, with brands and products that are deeply embedded in local preferences and traditions. Therefore, their market positions in the Nordics are very strong. Within these geographies the company generally holds market leading positions in most subcategories: Orkla Foods (e.g. pizzas, ketchups, soups and sauces) and Orkla Confectionery & Snacks (confectionary, chips and biscuits).

These strong local market positions result from a local presence and understanding of customer needs, but also a critical size, allowing economies of scale. In its main markets, Orkla generally holds stronger market positions on its various product levels than its bigger international peers, and are also competitive on price. This is expected to continue and is a key competitive advantage in our view. Still, over time the company has made structural and strategic changes that increases its presence outside the Nordics as well, i.e. making its relative dependence on the Nordics decreasing from around 81% in 2010 to 69% in 2020.

Based on current megatrends like sustainability, increased urbanisation and greater health consciousness, we expect Orkla's growth areas of plant-based, out-of-home and consumer health products to be reasonable. These areas should have potential for long-term profitable growth and contain products with international marketability. The company is also expected to channel increased marketing and R&D spending into specific products

**Strong, leading market position in the Nordics**

**Plant-based, out-of-home and consumer health products are growth areas**

in order to strengthen existing market positions and build new international ones. We believe that some brands have this capability, which if successful, will improve brand strength, diversification and operating performance in the longer-term.

#### Broad product diversification

Orkla offers a wide range of products, which reduces its reliance on any single product. We view product diversification as solid, as the company produces a huge amount of non-durable consumer products and has more than 300 different brands. This reduces the risk of significant profit or demand fluctuations, as confirmed historically and more recently during the Covid-19 pandemic.

The company has also ventured into the European out-of-home market for pizzas, with two large acquisitions. In addition to growth and potential synergies with other Orkla Food business, this also diversifies the group geographically. We view the out-of-the home pizza business as a relatively low cyclical business.

#### Solid customer and supplier diversification

Orkla has a large base of around 25,000 suppliers, located close to its key markets and globally. The risk of higher costs and the scarcity of raw materials and resources is mitigated through a close cooperation with suppliers and sometimes the ability for an inventory build-up in some areas. As regards Orkla's key customers, the company derives more than 50% of its turnover from grocery chains. This concentration risk is well known and is partly mitigated by long-lasting co-dependent relationships. We also note positively that Orkla is taking advantage of recent changes in the grocery market to increase its sales via new channels. Diversification is improving with new channels like 'out of home' (HORECA) and e-commerce growing larger relative to grocery.

Overall, we assess the distribution network as prudent and well established, consisting of grocery chains, wholesalers and e-commerce within certain segments. In the next three years, the company wants to double its revenues from 'digital and direct online sales' from around 7% to around 15%.

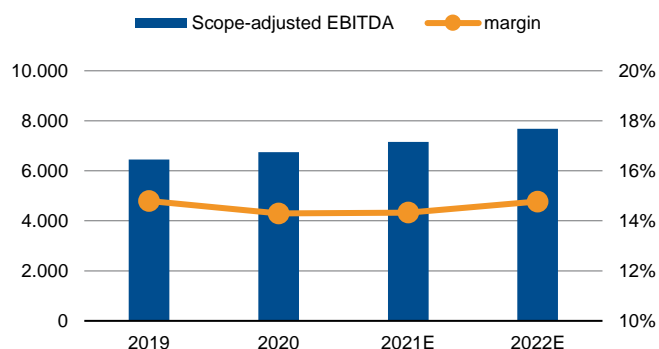
Furthermore, Orkla's strong brands in a wide range of categories means that chain stores are dependent on having its products to attract customers. This mitigates some of the negative effects from lower sales channel diversification than international peers.

#### Stable operational performance

Orkla's profitability margins (expressed in terms of EBITDA margins) have been averaging around 14% in the last couple of years. Although the absolute margin percentage is below the most profitable international peers, we favour the relative stable group margins over time.

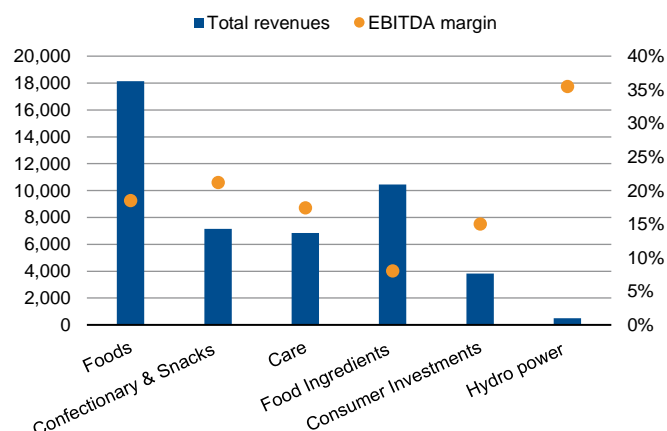
This year we have seen large increases in several raw materials prices (e.g. vegetable oils, grains, meat, vegetables and dairy products), packaging and transport, which will have a temporary negative effects on Orkla's costs, before they are being passed on to the customers. Our assumption, based on historical track record, is that Orkla is generally able to increase these prices based on its strong local market positions and brands, helped further by high customer loyalty and lower price sensitivity.

Figure 4: Scope-adjusted EBITDA in NOK m (LHS) and margin development (RHS)



Source: Company reports, Scope estimates

Figure 5: EBITDA margin by segment (FY 2020)



Source: Company reports, Scope estimates

### Cost inflation and future price increases

Going forward, we expect margins in 2022 to be slightly held back by the increased cost inflation, before improving towards the second half of the year as Orkla raises its prices. Moreover, a more streamlined organisation, increased synergies across business units and a continued focus on cost saving measures should contribute positively to operational performance.

### Advertising and R&D expenses vary across products and brands

Historically, Orkla has spent around 5% of revenues on advertising and R&D activities. With thousands of different products and brands, the level of investment varies greatly from product to product. The company's advertising footprint is predominately in the Nordics, via different platforms. However, Orkla's overall spending in this area slightly lags that of larger and more international competitors, and there have been some minor declines in certain market shares. While Orkla benefits from solid and high local market positions, this fairly low spending could affect its competitive position in the future. We therefore view positively the company's recent indications that there will be a renewed focus on advertising and R&D, which should increase for selected brands, e.g. Møller and Jordan, targeted for international growth.

## Financial risk profile

Prudent financial policy and historically good financial flexibility

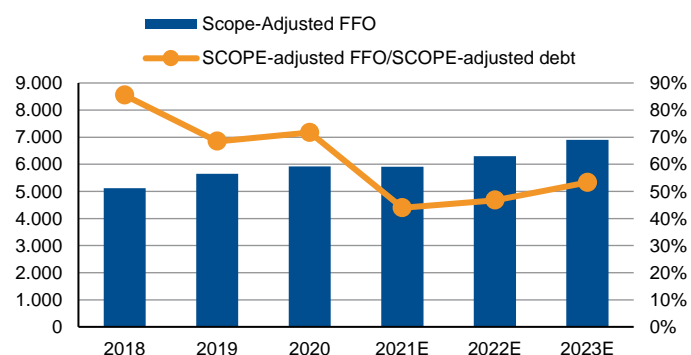
With the SaD/EBITDA ratio averaging around 1x in the last few years, Orkla's capital structure has been conservative, and the company has maintained good financial flexibility vs its maximum leverage target of 2.5x. Orkla's financial risk profile has also benefitted from strong cash generation, high interest cover and more than sufficient liquidity.

In 2021, the company has intensified its expansion with larger than normal acquisitions. These significantly increased net debt levels from YE 2020 to Q3 2021. Acquisitions of companies totalled around NOK 6.9bn (enterprise value) and the main acquisitions was the purchase of 100% of the shares in NutraQ, 67.8% of the shares in Eastern Condiments and 75% of the shares in New York Pizza. In addition, expansion investments were also high, largely consisting of greater production capacity for plant-based products in both Orkla Foods and Orkla Food Ingredients, as well as investments made to raise production capacity in Central Europe.

As a result of all these investments in 2021, leverage has increased and is expected to end the year closer to 2x. This is still within the normalised leverage range of 1-2x which we apply for Orkla. Our adjustments to Orkla's financial figures include: i) the addition of half of the net pension liability in accordance with our methodology as the ratio of plan assets exceeds annual defined pension payments by more than six times; ii) the inclusion of the dividend received for Jotun in Scope-adjusted EBITDA, as we see it as a predictable and long-term investment.

Our adjustments to financial figures

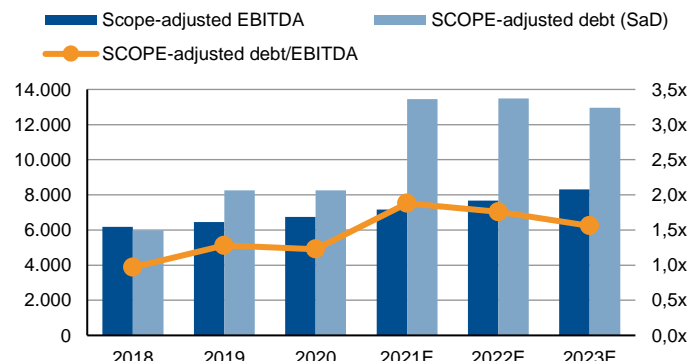
**Figure 6: Funds from operations (NOK m, LHS) and funds from operations/SaD (RHS) development**



Note: SaEBITDA=Scope-adjusted EBITDA.

Source: Scope estimates

**Figure 7: SaD (NOK m, LHS) and leverage ratio (RHS)**



Source: Scope estimates

We expect growth rates and leverage to be higher than historical levels

Our base case expects Orkla to achieve operational improvement compared to historical growth figures. We believe the company is well positioned to attain above market growth in its three prioritised growth areas: i) plant-based; ii) out-of-home; and iii) consumer health products.

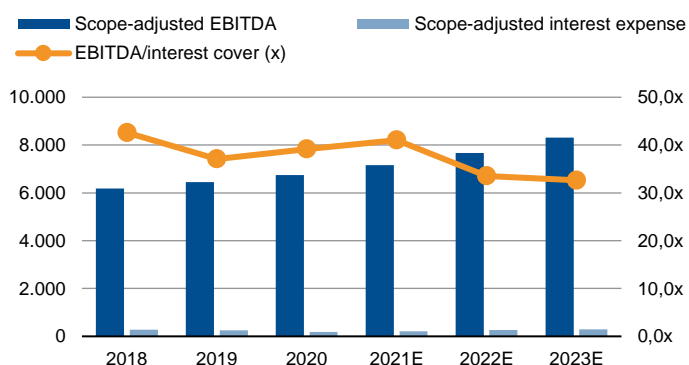
Orkla also recently announced that sales of plant-based products are targeted to reach NOK 3bn in 2025 (from below NOK 1bn today). Following the recent pizza acquisitions, Orkla also aims to be one of Europe's leading companies for franchised pizza outlets. In consumer health, the goal is 50% growth in sales by 2025, equivalent to a sales turnover of NOK 7bn. We expect growth in all three areas to be achieved through a combination of organic growth and acquisitions.

We do not assume that any specific disposals will be made

Although our projections incorporate a certain amount of expansionary investment, we have not factored any major M&A activity into our base case. Nevertheless, we assume that Orkla's leverage in the medium term is likely to be higher than in its recent history up to 2020. We also assume that the company is firmly committed to not taking on too much

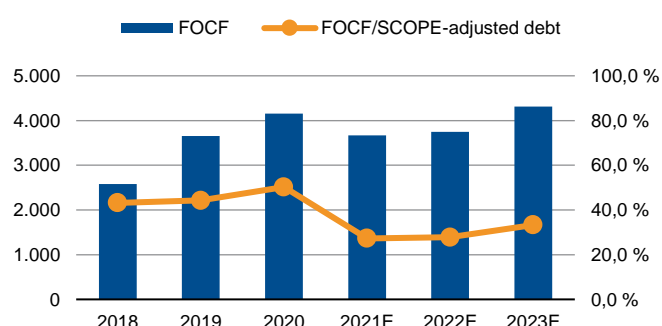
debt, which also could result in divestments if they were to prove necessary or beneficial. Although our projections exclude divestments, we acknowledge that Orkla is open to selling down its interest in or listing some businesses should it prove advantageous to do so.

**Figure 8: Scope adjusted EBITDA (NOK m, LHS) and interest cover (RHS) development**



Source: Scope estimates

**Figure 9: Scope-adjusted free operating cash flow (FOCF) on LHS (in NOK m) and SaFOCF/SaD (%) on RHS**



Source: Scope estimates

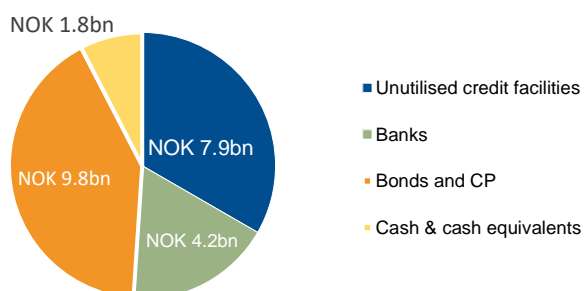
#### Leverage expected to stay in the 1x-2x range

Given the assumptions above, we expect Scope-adjusted leverage of around 1x-2x in the medium term and a funds from operations/SaD ratio to average above 45%. We also expect interest cover to remain largely unchanged, and free cash flow cover to weaken but stay above 25%. These credit ratio expectations translate into an 'A' category financial risk rating according to the ranges defined in our Corporate Rating Methodology.

Orkla's main funding sources are bilateral loans from its relationship banks as well as bonds and commercial papers in the Norwegian bond market. Some of the company's funding strategy is to seize attractive opportunities when they arise, with available funding on competitive and non-restrictive terms. Thus, Orkla has actively used commercial paper in 2021 (given the attractive funding conditions), but always sufficiently backed by undrawn committed back-up lines.

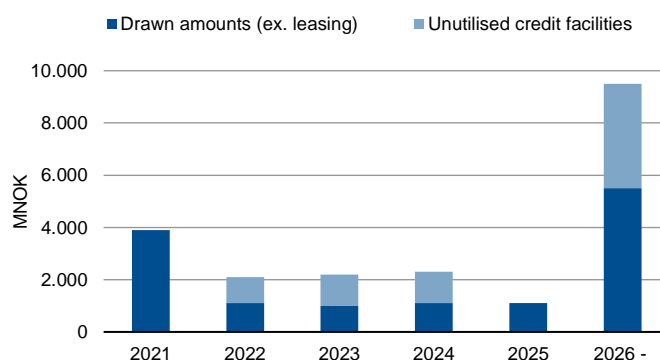
Liquidity is adequate based on good access to bank and bond markets. As of Q3 2021, the company had NOK 9.7bn in cash and undrawn credit lines, well above reported short-term debt of NOK 4.6bn. The fairly high portion of short-term debt at the moment is a result of the issuance of several commercial papers to finance recent acquisitions. We expect Orkla to gradually reduce this via refinancing and repayment from positive free operating cash flow.

**Figure 10: Funding sources, as of Q3 2021**



Source: Company capital markets day 2021

**Figure 11: Debt maturity profile, as of Q3 2021**



Source: Company capital markets day 2021

**Financial policy is sound and prudent and does not warrant a rating adjustment**

## Supplementary rating drivers

### Financial policy

We make no adjustment for Orkla's financial policy, which we assess as conservative and prudent. The company has a long history of maintaining a conservative capital structure consistent with a strong investment grade profile. Further, Orkla aims to keep its net debt/EBITDA ratio below 2.5x and maintain a predictable dividend policy (50%-70% pay-out ratio).

In addition, the company's funding policy is oriented towards having high financial flexibility and keeping liquidity sufficient. The policy stipulates that cash and undrawn, committed credit lines should cover (by a sufficient margin) debt maturities and known capital needs over the next 12 months. This means that Orkla's credit facilities are normally refinanced one year before maturity and that short term interest-bearing debt is at all times covered by unutilised long-term credit facilities.

**Publicly listed company with focus on ESG**

### Ownership, structure and governance

Orkla is a public listed company and with a strong focus on corporate governance. As we see these factors as credit neutral, they do not warrant a supplementary rating adjustment. We note however, that the company aims to be the leading sustainability player in its home markets. Orkla has set clear ESG quantifiable targets for 2025, which include reducing its own greenhouse gas emissions by 65% and making all the packaging it uses 100% recyclable.

**Senior unsecured debt rating: A-**

### Long-term and short-term debt ratings

The senior unsecured debt rating is in line with the issuer rating. Orkla ASA is also the bond-issuing entity. Bond documentation includes a negative pledge, pari passu and no financial covenants.

**S-1 short-term debt rating**

The short-term rating of S-1 is backed by adequate liquidity, strong banking relationships and Orkla's well-established capital market standing.



## Scope Ratings GmbH

### Headquarters Berlin

Lennéstraße 5  
D-10785 Berlin

Phone +49 30 27891-0

### Oslo

Karenslyst allé 53  
N-0279 Oslo

Phone +47 21 62 31 42

### Frankfurt am Main

Neue Mainzer Straße 66-68  
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

### Madrid

Paseo de la Castellana 141  
E-28046 Madrid

Phone +34 91 572 67 113

### Paris

23 Boulevard des Capucines  
F-75002 Paris

Phone +33 6 62 89 35 12

### Milan

Via Nino Bixio, 31  
20129 Milano MI

Phone +39 02 30315 814

## Scope Ratings UK Limited

52 Grosvenor Gardens  
London SW1W 0AU

Phone +44 20 7824 5180

[info@scoperatings.com](mailto:info@scoperatings.com)  
[www.scoperatings.com](http://www.scoperatings.com)

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