Orkla ASA
Norway, Consumer Products

A- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022	2023E	2024E
Scope-adjusted EBITDA/interest cover	42.4x	25.0x	10.6x	10.4x
Scope-adjusted debt/EBITDA	1.8x	2.0x	2.0x	1.8x
Scope-adjusted funds from operations/debt	48%	41%	38%	41%
Scope-adjusted free operating cash flow/debt	22%	9%	18%	21%

Rating rationale

The rating affirmation reflects Orkla's continued strong credit metrics despite inflationary pressures on profitability and rising interest expenses. Moreover, the rating is supported by Orkla's good competitive positioning within consumer branded products in its home Nordic markets, presence in numerous product categories as well business diversification into specialty chemicals (via the participation in Jotun) and hydro power.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that profitability will slowly improve for Orkla's consumer products companies starting from 2024 amid declining but still elevated input cost prices, with a forecasted Scope-adjusted EBITDA margin returning above 14%. The Stable Outlook also assumes that Scope-adjusted leverage will remain around or below 2x over time, amid the absence of transformational deals. The headroom to the negative rating action remains rather low. The outlook also incorporates our expectation that Orkla will likely not use its leverage potential to the maximum leverage ratio as defined by the company (net debt/EBITDA) of 2.5x over the foreseeable future.

A positive rating action is possible if the company reduced its growth and M&A-ambitions and focused on paying down debt, resulting in a Scope-adjusted leverage sustained below 1x. In the longer run, a positive action could stem from increased international market presence and global brands, while at the same time increasing profitability on a sustained basis.

A negative rating action is possible in case of sustained M&A activity beyond our expectations and/or materially declining margins, which could result in a Scope-adjusted leverage sustained above 2x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
10 Jan 2024	Affirmation	A-/Stable
11 Jan 2023	Affirmation	A-/Stable
11 Jan 2022	New	A-/Stable

Ratings & Outlook

Issuer	A-/Stable
Short-term debt	S-1
Senior unsecured debt	A-

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Related Methodologies

General Corporate Rating Methodology; October 2023

Consumer Products Rating Methodology; November 2023

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Strong competitive positions in main markets, with 80% of revenues from brands with top two market positions in their respective markets • Moderate business diversification into hydropower ('natural hedge' for energy costs) and chemicals, supporting margin stability • Strong financial metrics, with leverage still expected to remain at or below 2x • Wide product offering across food and non-food consumer products, with more than 300 brands • Strong blended industry risk profile, characterised by low cyclicality • Portfolio of numerous highly recognised local brands, yet no global brand • Track record of prudent financial leverage policy	• Geographical concentration of sales in the Nordics of around 70% • Profitability in consumer products pressured by elevated input cost inflation in past few years • Increasing interest rates, weakening interest cover metric • Higher indebtedness in past few years driven by acquisitions and working capital requirements • Weak volume growth trend, with rising competitive pressure from private labels • Shareholder-friendly approach, with dividend payout ratio between 50-70% of previous year's net profit, which limits quick deleveraging

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA down to below 1x on a sustained basis • In the long run, improvement in business risk profile increasing international presence and/or rising EBITDA margin	• Scope-adjusted leverage above 2x amid higher debt-financed M&A or decline in profitability

Corporate profile

Orkla ASA is a Norwegian industrial investment company, focusing its activities on brands and consumer-oriented enterprises. Orkla is a leading supplier of branded consumer goods to the grocery, out-of-home, specialised retail, pharmacy, and bakery sectors. Its primary operational markets include the Nordics, the Baltics, and selected countries in Central Europe and India.

Orkla's portfolio comprises 12 companies, along with two financial investments in Hydro power, Orkla Eiendom (real estate) and Orkla Ventures. The portfolio companies are as follows: Foods Europe, India, Food Ingredients, Confectionery & Snacks, Health, Home & Personal Care, The European Pizza Company, House Care, Health and Sports Nutrition Group, Pierre Robert Group, Lilleborg, and Jotun A/S (with a 42.7% minority ownership, accounted for using the equity method).

Orkla owns over 300 brands, with notable ones including Felix, MTR, Abba Seafood, Sætre, TORO, Stabburet, Grandiosa, Eastern, Idun, Hame, Beauvais, Naturli, Anamma, Göteborgs Kex, Kims, Nidar, OLW, Panda, Taffel, Adazu, Møllers, Define, Jordan, Nutrilett; Bodystore, Gymgrossisten; Blenda, Grumme, Jif, Sun, Zalo, Harris, and Oslo Skin Lab. The company is listed on the Oslo Stock Exchange, employs over 20,000 people globally, and generates approximately NOK 66bn in annual turnover. The largest owner is Stein Erik Hagen (Orkla's Chairman) and his family, holding an aggregate 25% stake.

Financial overview

				Scope estimates		
Scope credit ratios	**2021**	**2022**	**LTM Sep 2023**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	42.4x	25.0x	10.7x	10.6x	10.4x	12.0x
Scope-adjusted debt/EBITDA	1.8x	2.0x	2.0x	2.0x	1.8x	1.8x
Scope-adjusted funds from operations/debt	48%	41%	36%	38%	41%	43%
Scope-adjusted free operating cash flow/debt	22%	9%	18%	18%	21%	23%
Scope-adjusted EBITDA in NOK m						
EBITDA	7,817	9,154	9,211	9,228	9,776	10,173
Disposal losses (gains) from sale of fixed assets	-10	-74	-37	-53	0	0
Jotun dividend	255	328	367	369	380	380
Scope-adjusted EBITDA	**8,062**	**9,408**	**9,541**	**9,544**	**10,156**	**10,553**
Funds from operations in NOK m						
Scope-adjusted EBITDA	8,062	9,408	9,541	9,544	10,156	10,553
less: (net) cash interest paid	-190	-376	-895	-897	-979	-882
less: cash tax paid per cash flow statement	-907	-1,400	-1,871	-1,502	-1,594	-1,693
add: dividends from associates	0	0	0	0	0	0
Other items (incl. write-down adjustments)	28	46	117	0	0	0
Funds from operations (FFO)	**6,993**	**7,678**	**6,892**	**7,145**	**7,583**	**7,978**
Free operating cash flow in NOK m						
Funds from operations	6,993	7,678	6,892	7,145	7,583	7,978
Change in working capital	-645	-2,595	-139	-412	-269	-113
Non-operating cash flow	0	0	0	0	0	0
less: capital expenditure (net)	-2,606	-2,777	-2,718	-2,800	-2,900	-3,000
less: lease amortisation	-498	-547	-570	-570	-570	-570
Free operating cash flow (FOCF)	**3,244**	**1,759**	**3,465**	**3,363**	**3,844**	**4,295**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	-166	-353	-832	-874	-956	-859
Interests on pension liabilities	-24	-23	-63	-23	-23	-23
Change in other items	0	0	0	0	0	0
Net cash interest paid	**-190**	**-376**	**-895**	**-897**	**-979**	**-882**
Scope-adjusted debt in NOK m						
Reported gross financial debt	14,334	19,068	21,487	22,100	18,215	18,215
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents	-1,127	-1,502	-3,554	-4,476	-1,215	-989
add: non-accessible cash	278	414	278	414	414	414
add: pension adjustment	1,204	916	916	916	916	916
Other items	0	0	0	0	0	0
Scope-adjusted debt	**14,689**	**18,896**	**19,127**	**18,953**	**18,330**	**18,555**

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Table of Content

Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

ESG credit-neutral

While Orkla is exposed to a series of relevant ESG factors, we believe those to be credit neutral. In general, the key environmental risks for a consumer products company derive from the intensive energy and water consumption during production, carbon emissions and circular economy. On the social side, major risks concern the trend towards healthier food (which requires product innovation) as well as reputational/litigation risks related to product safety and sustainable sourcing.

Environmental factors

The ESG strategy of Orkla for 2025 targets tackles all the relevant material ESG risks. On the environmental side, key targets include: i) over 60% renewable energy in own operations; ii) reduction of scope 1 & 2 greenhouse gas emissions[2] by 65% (70% by 2030); iii) 30% reduction in energy and water consumption; iv) 50% reduction in food waste; v) 100% recyclable packaging; vi) 75% of packaging made of recycled materials.

Trend of healthier diet

On the health side, Orkla is increasing the portion of products that promote a healthier diet (16% in 2021). Its stated goal of reducing salt and sugar consumption by 15% by 2025. Moreover, Orkla is increasing its product offering towards plant-based dairy and meat alternatives.

Supply chain considerations

On company-specific risks, we also see Orkla exposed to supply chain risks since two key raw materials are cocoa (primarily sourced in Africa) and palm oil (which is linked to deforestation risk). In both cases, but also for sourcing in general, Orkla has established a framework for verifying its suppliers and promoting sustainable agricultural practices.

Overall, no drivers of the credit rating are considered ESG-related factors with a substantial impact on the overall assessment of credit risk.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.
[2] During 2022 the targets for GHG emissions have been revised and approved by SBTi (Science-Based Target initiative) including Net-Zero target for 2045. At the same time, the base year for both scope 1&2 and scope 3 was changed to 2016. The targets are still the same.

Business risk profile: BBB+

The business risk profile is supported by: i) very good competitive positions, with 80% of revenues originating from brands with top two positions in their respective markets; ii) strong business diversification, increasingly expanding its scope within consumer products and having interests in chemicals, hydropower and real estate; iii) good product mix diversification, with a wide offering of non-discretionary consumer goods and more than 300 brands, including numerous traditional local brands. Constraints for the business risk profile include moderate international geographical reach and profitability levels that are comparatively lower than those of larger global peers in the consumer product industry.

Industrial holding business model since 2023

Since 2023, Orkla has adopted a new organisational model, becoming a 'leading industrial investment company with a focus on brands and consumers.' This shift led to the reorganisation of existing divisions into 12 portfolio companies. Additionally, there were financial investments in hydro power and real estate. These portfolio companies will operate with a higher level of independence compared to the previous structure, while still maintaining synergies across the Group in terms of procurement, IT, and financial services.

Figure 1: Orkla's portfolio companies

	Sales (2022) in NOK bn	Stake	Scope Industry risk	Products	Orkla's Investment strategy
Orkla Foods Europe	**17.8**	**100%**	Non-discretionary consumer products	Pizza, ketchup, soups, sauces, toppings, ready to eat meals, plant-based meat and dairy replacement	Anchor
Orkla Food Ingredients	**14.7**	**100% ***	Non-discretionary consumer products	Ingredients mainly for bakery and ice creams	Grow and build
Orkla Confectionery & Snacks	**7.6**	**100%**	Non-discretionary consumer products	Confectionary, biscuits, snacks	Anchor
Orkla Health	**5.4**	**100%**	Non-discretionary consumer products	Food supplements, Omega-3, wound care, oral care	Grow and build
Orkla India	**2.5**	**100%**	Non-discretionary consumer products	Food (spices, breakfast and sweet mixes)	Grow and build
The European Pizza Company	**2.3**	**100%**	Non-discretionary consumer products	Over 800 franchise outlets via Kotipizza, New York Pizza, Da Grasso	Grow and build
Orkla Home & Personal Care	**2.2**	**100%**	Non-discretionary consumer products	Cleaning and personal care	Transform or exit
Orkla House Care	**1.4**	**100%**	Discretionary consumer products	Paint accessories	Transform or exit
Health and Sports Nutrition Group	**1.1**	**100%**	Non-discretionary consumer products	Sport nutrition, health food, fitness equipment	Transform or exit
Pierre Robert Group	**0.6**	**100%**	Discretionary consumer products	Textiles	Transform or exit
Lilleborg	**0.5**	**100%**	Discretionary consumer products	Professional cleaning products	Transform or exit
Jotun	**27.9**	**42.7%**	Specialty Chemicals	Paints and coatings	Anchor

(*) Orkla agreed to sell 40% of Orkla Food Ingredients to Rhône in October 2023

Sources: Orkla, Scope

Strategy 2023-2026

During the recent Capital Market Day investor presentation in November 2023, management outlined targets for the years 2023 to 2026, with the main goal being an annual total shareholder return between 12% and 14%. The presentation also detailed distinct investment strategies for each portfolio company. Some were designated as 'anchor' investments (Foods Europe, Confectionery & Snacks), representing businesses with long-term leading positions in mature markets. These businesses are expected to generate a steady operating cash flow to fund the group's dividends and support other portfolio companies. Other companies were classified as investments to 'grow and build'

(Food Ingredients, Health, India, European Pizza company), with the objective of achieving organic growth through bolt-on acquisitions. The remaining companies were categorised as businesses to 'transform or exit' (Home & Personal Care, House Care, Health and Sports Nutrition Group, Pierre Robert, Lilleborg).

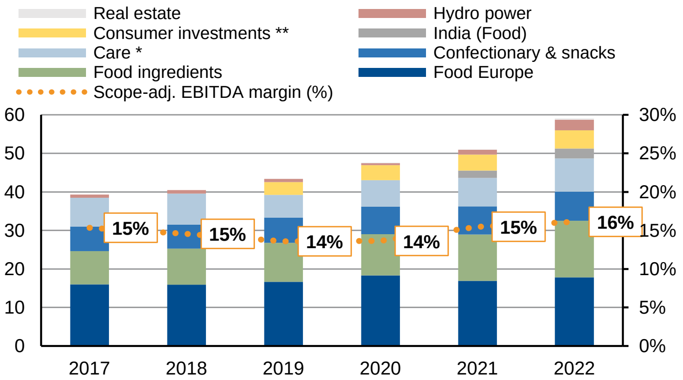
Blended industry risk profile: A-

Orkla primarily operates within the consumer products industry, and our analysis of the business risk profile is consequently based on the Consumer Product methodology. The EBITDA contribution from non-core industries is perceived to be relatively low, despite the Hydro business reporting exceptionally high operating profits in 2022, which is viewed as a temporary occurrence.

In evaluating the industry risk, we employ a blended score of A-. This score reflects the primary exposure to non-discretionary consumer products (rated A), alongside a smaller exposure to discretionary consumer products (rated BB), non-regulated power generation (rated BB, through a financial investment in the Hydro power business), and specialty chemicals (rated A, via a minority stake in Jotun A/S). The Real Estate business has yet to have a material impact on EBITDA at the Group level.

Although the blended industry risk is one notch below the industry risk associated with the non-discretionary consumer product industry, the advantages of diversification in the business mix are taken into consideration in the assessment of competitive positioning.

Figure 2: Group revenues (NOK bn) including business split and group Scope-adjusted EBITDA margin (%)

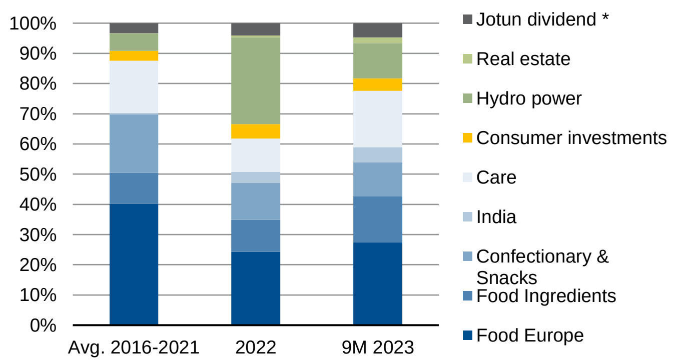


* Orkla Care includes Orkla Health, Orkla Home and personal care, Health & Sports Nutrition Group

** Consumer Investments includes Pizza Out of Home, Pierre Robert Group, Lilleborg

Source: Orkla, Scope

Figure 3: Reported 'adjusted' EBIT split by business *



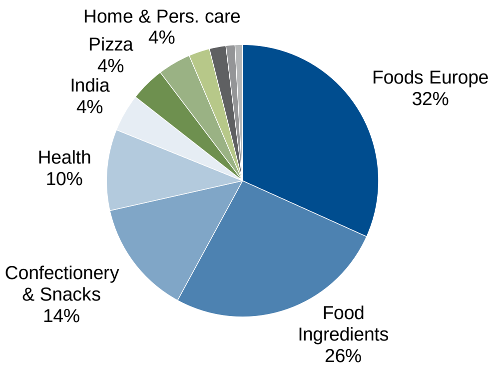
* Jotun's dividend has been added to the adjusted calculation although it is not included in the reported EBIT

Source: Orkla, Scope

The 42.6% ownership stake in Jotun is accounted for using the equity method. However, it's important to note that the relationship between Jotun and Orkla spans decades, and Jotun is listed as one of Orkla's 12 industrial investments, providing recurring dividend payments. This underscores the long-term perspective Orkla maintains regarding this investment.

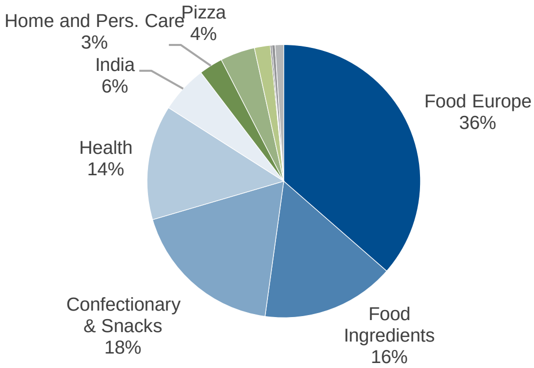
In contrast, the financial investments outside the non-consumer product industry are fully consolidated. Orkla's real estate development arm, which also manages the Groups' headquarters, has a book value of NOK 2.0bn as per 2022. The hydro power business generates approximately 2.5 TWh per annum. This investment encompasses wholly owned power plants in Sarpsfoss and leased power plants (until 2030) through Orkla's 85% interest in AS Saudefaldene.

Figure 4: Revenue split by portfolio companies (2022)



Source: Orkla, Scope

Figure 5: Reported 'adjusted' EBIT split by portfolio companies (2022)



* Jotun's dividend has been added to the adjusted calculation although it is not included in the reported EBIT

Source: Orkla, Scope

Strong, leading market position in the Nordics within branded food, confectionery & snacks

With an annual turnover of approximately NOK 66 billion, Orkla is a significant producer of consumer products on a Nordic scale, albeit more moderately sized compared to the major international players with whom it competes in its home markets. We consider Orkla's high local market shares to be a key competitive advantage, with brands and products deeply embedded in local preferences and traditions. Consequently, their market positions in the Nordics are robust, particularly within Foods (such as pizzas, ketchups, soups, and sauces), Confectionery & Snacks (including chocolates, chips, and biscuits), and house care, all of which are mature markets.

These strong local market positions result from a local presence and understanding of customer needs, coupled with a critical size that allows for economies of scale. In its main markets, Orkla generally holds stronger market positions on various product levels compared to its larger international peers and remains competitive on pricing. This is expected to persist and is a key competitive advantage in our view.

Orkla Health dominant on only few categories

While the competitive positions in other Orkla portfolio companies are significant, they may not be as strong as the core branded food products. Despite each company owning brands with top 1-2 market positions in distinct product categories at the domestic level, Orkla Health, for instance, has dominant positions in specific categories such as Omega-3 but possesses a less extensive portfolio than larger international peers within consumer health. Orkla Health is set for further growth and has already made relevant acquisitions in recent years, such as NutraQ in Norway (a supplier of subscription-based health and wellness products) and Healthspan in the UK (specializing in dietary supplements). These acquisitions extend the product portfolio and increase exposure to direct-to-consumer sales, potentially leading to higher margins.

Orkla Food Ingredients

In Orkla Food Ingredients, the acquisition of Denali Ingredients in the USA in 2022 strengthened the ice cream business. However, the company is poised for further organic growth following the announcement in October 2023 that Orkla agreed to sell 40% of Orkla Food Ingredients to the private equity firm Rhône.

Selected growth areas: consumer health, pizza chains, plant-based

Orkla has targeted strategic growth areas for development over time, namely consumer health (mentioned earlier), pizza chains, and plant-based dairy and meat replacements. These areas are expected to benefit from key megatrends of sustainability, urbanisation, and health consciousness. While the potential for long-term growth in these markets is attractive, competition is elevated, and there could be some margin dilution for Orkla to strengthen its presence and gain market shares. Additional challenges include slowerthan-initially-expected market growth for plant-based products and operating a very different business model, as seen in the case of pizza outlets.

Nevertheless, we find comfort in Orkla's track record of acquiring companies with already established leading positions in their markets, which should mitigate the risk. In general, we expect Orkla to deliver on further bolt-on acquisitions in each of the growth areas over the next few years.

Growth of pizza outlets

The European Pizza Company has already made some significant acquisitions in recent years. After acquiring Kotipizza in 2019 in Finland, Orkla expanded the portfolio with the acquisitions of New York Pizza in 2021 in the Netherlands and Da Grasso in 2022 in Poland, bringing the total number of franchise outlets to well over 800. The company also targeted the German market by buying and converting small independent chains into New York Pizza franchises. The long-term aspiration is to become a leader in the European pizza market, although Orkla is still far from the leader Domino's.

Favourable demographic trend at Orkla India

Orkla India is another company targeted for growth due to favorable demographic dynamics. The company owns two main iconic brands, MTR and Eastern (Eastern Condiments was acquired in 2021), with number one leading positions in selected Indian regions within spices, breakfast, and sweet mixes.

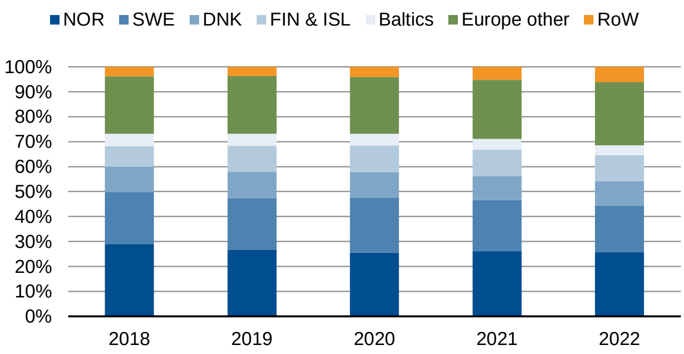
Benefits of business diversification

Diversification serves as a supporting factor for Orkla. The company is well diversified within the consumer product core sector. Additionally, investments in unrelated businesses, such as hydropower, chemicals, and to a lesser extent, real estate, further contribute to the diversification assessment. The primary constraint arises from the geographical concentration of sales in the Nordics.

Broad product diversification

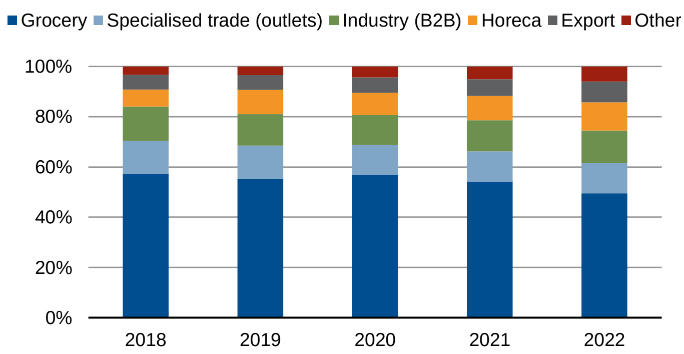
Within branded consumer goods, Orkla operates in numerous product categories, offering a wide range of predominantly non-discretionary products sold under over 300 different brands. Consequently, we perceive product diversification as robust. Moreover, Orkla's efforts in its strategic growth areas are viewed positively for diversification. In terms of products, we believe it will complement the target customer range with the current one. For example, plant-based products are more focused on younger age groups, consumer health targets adults, while Pizza chains complement grocery-based products in terms of channels.

Figure 6: Split of sales by geography (%)



Source: Orkla, Scope

Figure 7: Channel diversification (%)



Source: Orkla, Scope

Geographical concentration on few Scandinavian countries

As mentioned earlier, the group maintains a moderate level of geographical diversification. Despite implementing structural and strategic changes that expanded its presence in major European markets and India, the majority of its turnover still originates from the Nordic countries. The relative dependence on the Nordics has moderately decreased over the last 10 years, shifting from around 80% to the current 70%, with

Norway contributing to about a quarter of sales and Sweden accounting for around 20%. The expansion into strategic growth areas, particularly health and pizza chains, is expected to increase exposure to Europe and enhance the geographical distribution.

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 close cooperation with suppliers and sometimes the ability to accumulate inventory when necessary. As regards Orkla's key customers, the company derives around 50% of its turnover from grocery chains, with no major single-name dependency.

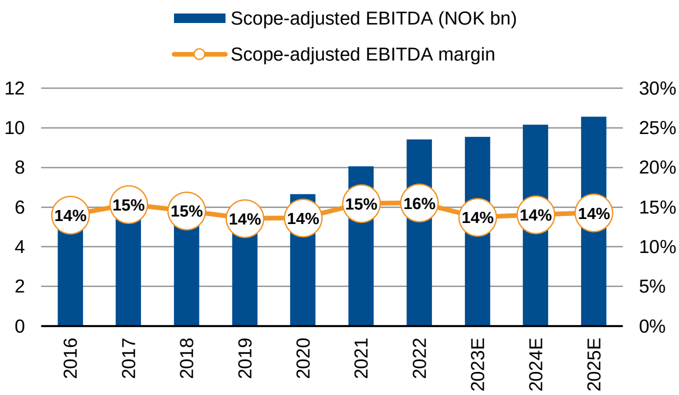
Established distribution network

Overall, we evaluate the distribution network as well-established, comprising grocery chains, wholesalers, and e-commerce within certain segments (such as Orkla Care). While, at an aggregate level, grocers contribute to over 50% of sales in branded consumer goods, their significance in the food and confectionery & snack division approaches 80%. They are less relevant for other businesses, which have a heavier reliance on specialised trade (e.g., Orkla Care), HoReCa sales (food ingredients and pizza chains), or industrial sales (e.g., for professional cleaning products). Further growth within pizza chains and consumer health will gradually reduce some of the concentration on grocers, in favour of HoReCa and online channels.

Relatively stable EBITDA maring around 14%-15%

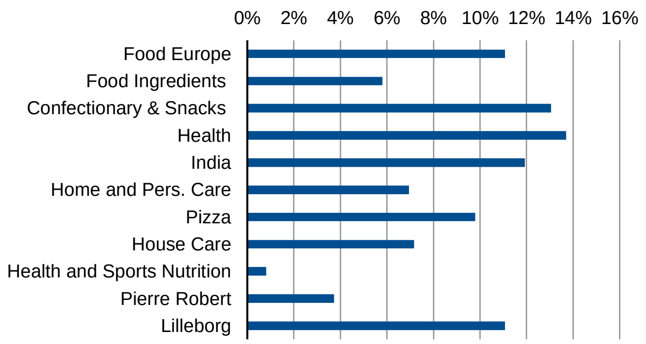
Scope-adjusted EBITDA slightly surpasses the reported EBITDA figure as we include the contribution of the recurring Jotun dividend. Orkla's Scope-adjusted EBITDA margin (excluding the Jotun dividend) averaged around 14-15% in the past five years. We appreciate the relative stability of group margins over time, supported by business diversification, including unrelated sectors. In fact, the inflation-driven decline in profitability within branded consumer goods over the last two years has been compensated by the overperformance of the hydro power business. This demonstrated an inversely related performance, serving as a sort of natural hedge (at least on a pre-tax basis) against increasing energy prices.

Figure 8: Scope-adjusted EBITDA development



Source: Scope estimates

Figure 9: Reported 'adjusted' EBIT margin across portfolio companies in 2022 (*)



* It excludes impact of HQ costs and eliminations, as well as restructuring and other non-recurring items

Source: Orkla, Scope

Operating margins below larger peers reflect business mix and size

While the EBITDA margin is below that of larger international consumer staples peers, we believe this is primarily justified by the product mix and, to a lesser extent, by its smaller scale. For instance, Orkla Food Ingredient plays a significant role in the group's operating profits but maintains lower margins than the group's average due to its substantial exposure to B2B distribution. However, future business growth may support synergies and partly reduce the margin gap compared to more profitable companies, such as Orkla

Confectionery & Snacks, Orkla Food Europe, Orkla Health and Orkla India. Conversely, the smaller size relative to larger international peers acts as a constraint, in our view, on the profitability within Orkla Home and Personal Care, as well as Orkla House Care. Given its high scalability, we also perceive the European Pizza Company as requiring a larger size to enhance profitability.

Profitability in consumer product pressured by inflation

Scope-adjusted EBITDA LTM reached NOK 9.5bn as of September 2023, slightly above NOK 9.4bn posted in 2022. Profitability in Orkla's branded consumer product companies has been noticeably subdued in the past two years, driven by elevated input cost inflation in the mid-to-high teens in 2022, and persisting, yet moderating, at around 10-12% during 2023. Delays in the construction and ramp-up of the new biscuit factory in Latvia led to higher costs in recent years. However, their impact is expected to be sensibly reduced going forward since the factory has started stock building in 2023, and existing technical issues related to packaging should be gradually resolved.

Contribution of hydro power played a role on group's profitability

Inflationary pressures on raw materials were only partially offset by the strong price increases applied since mid-2022, which came at the expense of lower volumes for consumer products. Despite this, Orkla Group's Scope-adjusted EBITDA margin of around 15.5% in 2022 was still in line with 2021, thanks to the record performance of the hydro power business, whilst profitability margin in consumer goods businesses declined by around 200 bps. Hydro power reported an 'adjusted' EBIT of NOK 2.3bn (from NOK 0.7bn a year earlier) thanks to high energy prices, compensating for the challenges in branded consumer products. During 9M 2023, however, the Scope-adjusted EBITDA margin declined to around 13.5% because of the lower contribution of hydro power (reported EBIT for hydro power was NOK 0.7bn in the first nine months). We note that the profitability of the branded consumer products companies during 9M 2023 remained in line with 2022, but this - as previously mentioned - was significantly lower than 2021 (reported EBIT margin around 200 basis points lower). Conversely, Jotun dividend increased further to around NOK 370m in 2023 from NOK 328m in 2022, as the chemical company posted resilient results and benefited from its high exposure to fast-growing geographies.

Mild recovery in profitability recovery over the next few years

Under the new strategy highlighted in the Capital Market Day presentation in November 2023, the group targets a Total Shareholder Return of 12-14% during 2024 to 2026. Implicitly, this indicates a yearly EBIT growth between 8% to 10% and a margin expansion of at least 150 – 200 bps (potentially more if raw material prices decline significantly). All in all, we forecast Scope-adjusted EBITDA to grow from NOK 9.6bn in 2023 to NOK 10.6bn in 2025, with the margin slowly improving and returning above 14% in the medium term.

Strong local brands, but no global ones

Orkla owns a diverse portfolio of approximately 50 main brands offering a wide array of products, most of which dominate the market in Norway and Sweden (e.g., Felix, Kims, Stabburet, Toro, Grandiosa). These products are associated with good quality in the regions where the group has its strongest presence. Orkla also possesses top brands in specific segments in other countries within Scandinavia, the Baltics, India (MTR, Eastern), and various European countries. Unlike international consumer product giants, Orkla's brands lack global recognition but hold significant local resonance. The absence of major dependency on any single brand is a strength.

We estimate that Orkla allocates approximately 5% of revenues to advertising and R&D activities, with a consistent increase over the past few years to ward off competition from private labels and support volume recovery. While their media footprint is large in Scandinavia, the comparison with larger international peers shows some underinvesting in brands; however, this is partly explained by Orkla's comparatively higher portion of B2B business with limited advertisement needs which dilutes the ratio.

Financial risk profile: A-

The financial risk profile is assessed at A- and reflects strong credit metrics, including Scope-adjusted debt/EBITDA leverage kept within 2.0x, cash flow cover returning around 20% in the short term, and a weakened but still strong EBITDA interest cover above 10x.

Scope adjustments

Key adjustments made on financial items:

- EBITDA adjusted for: Jotun recurring dividend (around NOK 370-380m p.a.).
- Interests adjusted for pension interests of NOK 23m p.a.
- Debt adjusted for:
  - future unfunded pension obligations, discounted at 50% (around NOK 0.9bn p.a.).
  - restricted cash of NOK 414m p.a., reflecting security deposits for sales of hydroelectric power, margin deposits for share derivatives, as well as deposits to meet statutory solvency requirements in Orkla Insurance. It also includes a portion of the cash in Orkla companies with minority shareholders and in Orkla Insurance, which are available only to a limited extent to the rest of the Group.

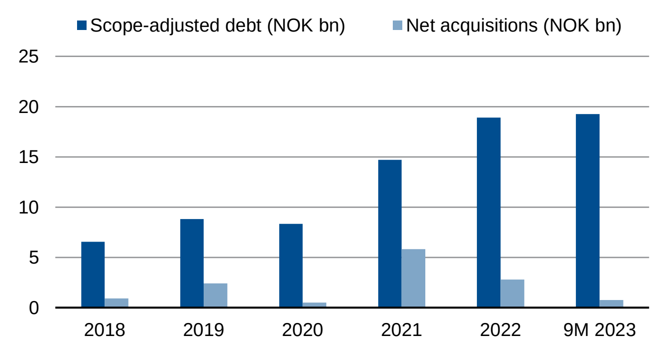
M&A activity

Due to the acquisition-driven nature, changes in Scope-adjusted debt closely correlate with M&A activity. In 2021, M&A activity was robust, with spending for acquisitions (net of disposals) reaching NOK 5.8bn, including notable acquisitions such as NutraQ (Health) in Norway, Eastern Condiments in India, and New York Pizza in The Netherlands/Germany. Subsequently, and in light of the more challenging financial conditions, yearly acquisition spending reduced to NOK 2.8bn in 2022, with main targets being Denali Ingredients in the US and Healthspan in the UK. During 9M 2023, acquisition spending further decreased to only NOK 0.7bn, with the primary acquisition being Bubs Godis in Sweden (Confectionery & Snacks).

Sold 40% of Orkla Food Ingredients

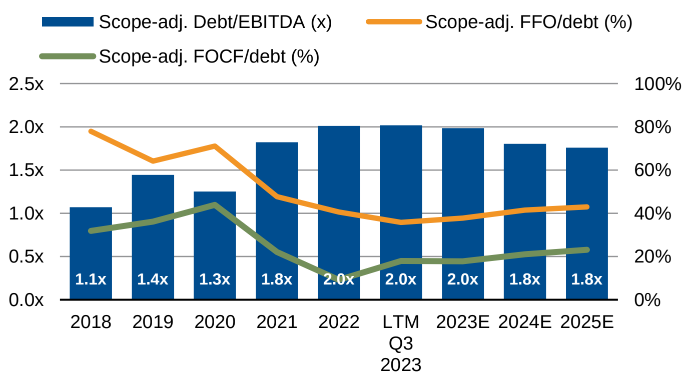
As earlier mentioned, in October 2023 Orkla announced the sale of 40% ownership in Orkla Food Ingredients (OFI) Rhône for an equity value of NOK 6.5bn on a 100% basis. By closing of the transaction, expected in Q1 2024, OFI will replace existing financing from the holding Orkla ASA with a NOK 6.4bn committed bank facility with no recourse to Orkla ASA, containing net debt to EBITDA and interest cover covenants (only applicable at standalone level). OFI will continue to be consolidated in Orkla's accounts. The net proceeds from the transaction – calculated at around NOK 2.5bn - will be used for net debt reduction at Orkla ASA and for future investments.

Figure 10: Debt development and acquisitions



Source: Orkla, Scope

Figure 11: Leverage and cash flow metrics



Source: Scope estimates

Increase in Scope-adjusted debt in past years

Scope-adjusted debt at around NOK 19bn as of September 2023, more than doubling from approximately NOK 8.5bn in December 2020. Although the variation since December 2022 is negligible, the increase in the previous two years was mainly driven by acquisitions, especially in 2021, and higher net working capital, particularly in 2022.

Leverage expected to stay close to 2x

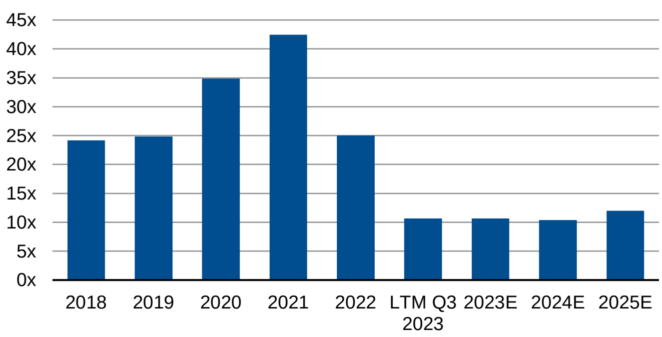
Scope-adjusted debt/EBITDA LTM remained stable at 2.0x as of September 2023 compared to December 2022. The announced sale of 40% of Food Ingredients will be beneficial for leverage since the company announced that proceeds will be primarily used for debt reduction. Therefore, we expect Scope-adjusted debt/EBITDA to remain moderately below 2.0x over the forecasted period, despite profitability still constrained by inflation and uncertain economic growth prospects. Similarly, Scope-adjusted FFO/debt to continue to oscillate around 40%. For reference, Orkla has a financial policy target of net debt/EBITDA below 2.5x. Our capital allocation assumptions include dividends between NOK 3.0bn–3.1bn during 2023 to 2025 while net acquisition spending in the range between NOK 1.0bn and 2.0bn.

Interest cover weakened to 10x amid rising interest rates

After several years of excellent EBITDA interest cover at above 25x, the metric deteriorated to just above 10x as of 9M 2023 due to higher interest expenses from rising rates. This rapid change was caused by the entirety of Orkla's debt being at a variable rate. The net interest average cost is calculated at 2.4% for 2022, up from 1.6% in 2021, and we expect it to further increase to close to 5% in 2023.

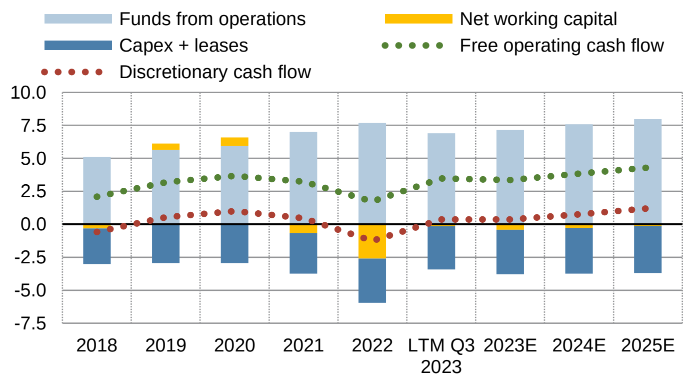
We project Scope-adjusted interests to more than double to around NOK 0.9bn-1.0bn during 2023 to 2025, resulting into an interest cover still above 10x. We take comfort from the likely repayment of a material portion of the debt in 2024.

Figure 12: EBITDA interest cover (x)



Source: Scope estimates

Figure 13: Cash flow sources and uses (NOK bn)



Source: Scope estimates

Cash flow cover around 20%

Scope-adjusted FOCF/debt experienced a significant decrease to 9% in 2022 from 22% a year earlier. This drop was attributed to the exceptionally high net working capital needs of NOK 2.6bn in 2022, due to elevated inflation and inventory build-up amid supply chain shortages. We deem such elevated inventory levels as a one-off, and during 9M 2023 we already noticed a significant improvement in net working capital amid easing inflation. We therefore forecast the cash flow metric to return towards 20% already in 2023 and remain at similar levels in the medium terms amid assumed yearly capex investments between NOK 2.8 and 3.0bn.

Adequate liquidity

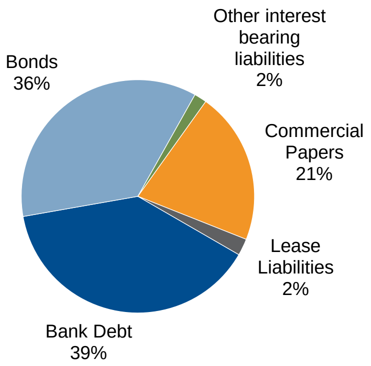
Liquidity is adequate based on good access to bank and bond markets. As of September 2023, the company had aggregated NOK 10.1bn in cash and undrawn credit lines, well above reported short-term debt of NOK 5.7bn. The fairly high portion of short-term debt is a result of the issuance of several commercial papers, which was a cheaper source of liquidity for the company compared to using undrawn long-term RCF lines. We expect the amount short-term debt to reduce in Q1 2024 as partly repaid by the net proceeds from the Food Ingredients' transaction.

The company's funding policy dictates that cash and undrawn committed credit lines should cover debt maturities and known capital needs by a sufficient margin 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.

Balanced debt maturity profile

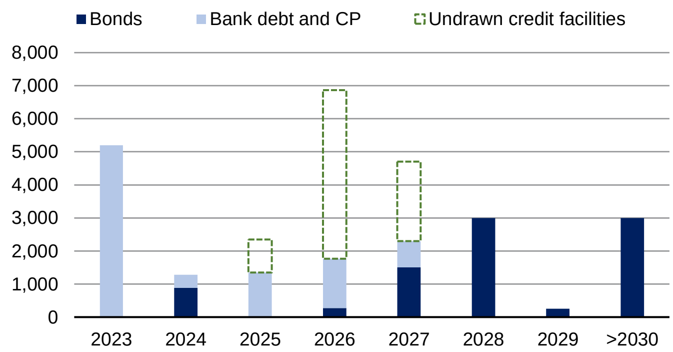
Orkla's main funding sources are bilateral loans from its relationship banks as well as bonds and commercial papers in the Norwegian bond market. In terms of financial structure, Orkla keeps a good degree of financial flexibility, short-term as well as long-term. The group does not have any financial covenants attached to their financing (as mentioned, Orkla ASA has no recourse to OFI's standalone financing) and the average debt maturity (excl. lease liabilities) as of September 2023 was 3.0 years.

Figure 14: Gross debt split as of December 2022



Source: Orkla

Figure 15: Debt maturity profile (excl. leases), as of September 2023, in NOK m



Source: Orkla

The group's internal liquidity ratios were negatively impacted by the increased use of short-term commercial paper, however the (external) liquidity ratio including undrawn credit lines remains sound. Furthermore, the group has a very good standing within the banking and capital markets.

Balance in NOK m	2023E	2024E	2025E
Unrestricted cash (t-1)	1,089	4,063	801
Open committed credit lines (t-1)	7,068	8,468	8,468
Free operating cash flow (t)	3,363	3,844	4,295
Short-term debt (t-1)	3,651	5,389	1,504
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Financial policy

We apply no adjustments for Orkla's financial policy, which we assess as rather prudent. The company has a long history of maintaining a conservative capital structure consistent with a strong investment grade profile.

Although the new CEO Nils Selte (appointed in April 2022) announced a change in the operating model which may suggest an intensification of M&A activity, the company remains committed to its existing financial target of keeping a net debt/EBITDA ratio below 2.5x. In line with its track record, we expect Orkla to continue being involved in bolt-on acquisitions while keeping some headroom compared to its stated leverage target.

Likewise, Orkla keeps its capital allocation unchanged, including a predictable and shareholder-friendly dividend payout ratio between 50%-70% of the previous year's net profits.

Parent support and corporate governance are credit-neutral

Orkla is a publicly listed company and with a strong focus on corporate governance. As we see these factors as credit neutral, they do not warrant any supplementary adjustment.

Long-term and short-term debt ratings

Senior unsecured debt rating: A-

The senior unsecured debt rating stands at A-, in line with the issuer rating. Orkla ASA is also the bond-issuing entity.

Short-term debt rating: S-1

The short-term debt rating of S-1 is based on the A-/Stable issuer rating and supported by adequate liquidity, strong banking relationships and a well-established capital market standing.

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