Orkla ASA
Norway, Consumer Products

A- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	35.3x	42.5x	30.7x	13.9x
Scope-adjusted debt/EBITDA	1.2x	1.8x	1.9x	1.9x
Scope-adjusted funds from operations/debt	71%	48%	42%	39%
Scope-adjusted free operating cash flow/debt	44%	22%	10%	20%

Rating rationale

The rating affirmation reflects Orkla's good competitive positioning within consumer branded products in its home Nordic markets, business diversification into hydropower and specialty chemicals (Jotun) and still strong financial metrics despite inflation pressures and rising indebtedness.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that the current inflationary environment will continue pressuring profitability within the branded consumer goods core business also during 2023, partly compensated by Orkla's business diversification into hydropower and Jotun. The Stable Outlook also assumes that despite the shareholder-friendly remuneration policy and active M&A strategy, Scope-adjusted leverage will remain below 2x over time, amid the absence of transformational deals, but the headroom to a negative rating action has been reduced compared to our last assessment in January 2022. This 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
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-

Analysts

Eugenio Piliego, CFA
+49 69 6677389 15
e.piliego@scoperatings.com

Michael M Simonsen
+47 23 96 39 97
m.simonsen@scoperatings.com

Related Methodologies

Corporate Rating Methodology; July 2022

Rating Methodology: Consumer Products; November 2022

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

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 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% • Intensification of acquisitions over the past few years led to higher indebtedness and rising leverage • Weak organic growth trend in core business over the past years • Profitability slightly below large international peers and pressured by cost inflation within consumer product businesses • Rising competitive pressure from private labels in home markets of branded consumer products • 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 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, selected countries in Central Europe and India. Under the new operating business model, fully operative from March 2023, Orkla is redirecting itself into becoming an industrial investment company with a focus on consumer and branded products. Business areas will be split into 12 business units, plus the two financial investments in hydropower and real estate. Business units include: Foods Europe (incl. pizza, ketchup, soups, sauces, toppings, ready-to-eat meals, plant-based), India (previously included in Orkla Food), Food Ingredients (for bakery and ice cream mainly), Confectionary & Snacks, Health, Home & Personal Care, Pizza Out of Home (around 850 franchise outlets via Kotipizza, New York Pizza, Da Grasso), House Care, Health and Sports Nutrition Group, Pierre Robert Group (textile), Lilleborg (professional cleaning products), Jotun A/S (paints and coating manufacturer, 42.6% minority ownership, consolidated as equity).

Notable consumer brands in Orkla's portfolio include: 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.

The company is listed on the Oslo Stock Exchange, employs approximately 21,500 people worldwide and has around NOK 50bn in annual turnover. The largest owner is Stein Erik Hagen (Orkla's Chairman) and his family, with an aggregate 25% stake.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**LTM Sep 2022**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	35.3x	42.5x	31.1x	30.7x	13.9x	14.6x
Scope-adjusted debt/EBITDA	1.2x	1.8x	1.9x	1.9x	1.9x	1.8x
Scope-adjusted funds from operations/debt	71%	48%	44%	42%	39%	42%
Scope-adjusted free operating cash flow/debt	44%	22%	11%	10%	20%	26%
Scope-adjusted EBITDA in NOK m						
EBITDA	6,506	7,817	9,175	9,436	9,074	9,579
Jotun dividend	233	255	330	330	350	350
Scope-adjusted EBITDA	**6,739**	**8,072**	**9,505**	**9,766**	**9,424**	**9,929**
Funds from operations in NOK m						
Scope-adjusted EBITDA	6,739	8,072	9,505	9,766	9,424	9,929
less: (net) cash interest paid	-191	-190	-306	-318	-679	-679
less: cash tax paid per cash flow statement	-1,152	-907	-1,387	-1,686	-1,514	-1,603
add: dividends from associates	0	0	0	0	0	0
Other items (incl. write-down adjustments)	530	18	257	0	0	0
Funds from operations (FFO)	**5,926**	**6,993**	**8,069**	**7,762**	**7,231**	**7,646**
Free operating cash flow in NOK m						
Funds from operations	5,926	6,993	8,069	7,762	7,231	7,646
Change in working capital	672	-645	-2,615	-2,391	-420	237
Non-operating cash flow	0	0	0	0	0	0
less: capital expenditure (net)	-2,446	-2,606	-2,918	-3,000	-2,700	-2,700
less: lease amortisation	-489	-498	-500	-500	-500	-500
Free operating cash flow (FOCF)	**3,663**	**3,244**	**2,036**	**1,871**	**3,610**	**4,683**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	-162	-166	-271	-294	-655	-655
Interests on pension liabilities	-29	-24	-35	-24	-24	-24
Change in other items	0	0	0	0	0	0
Net cash interest paid	**-191**	**-190**	**-306**	**-318**	**-679**	**-679**
Scope-adjusted debt in NOK m						
Reported gross financial debt	10,023	14,334	17,980	18,034	18,034	18,034
less: subordinated (hybrid) debt	0	0	0	0	0	0
less: cash and cash equivalents	-3,213	-1,127	-1,075	-1,093	-1,149	-1,228
add: non-accessible cash	265	278	278	278	278	278
add: pension adjustment	1,272	1,204	1,204	1,204	1,204	1,204
Other items	0	0	0	0	0	0
Scope-adjusted debt	**8,347**	**14,689**	**18,387**	**18,422**	**18,366**	**18,287**

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 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%, scope 3 emissions by 30%; 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 will likely not be fully reached on time, but the company is continuously progressing on this front. 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.

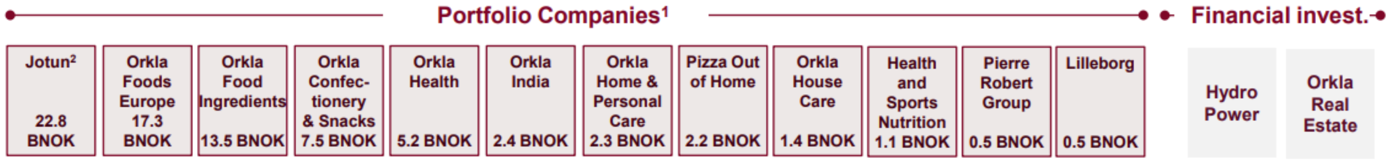
[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.
[2] During 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+

New organisational model announced in Q3 2022

During the Q3 2022 presentation, Orkla outlined its intention to become a ‘leading industrial investment company with a brands and consumer-oriented scope’, which resulted in the reorganisation of existing divisions into 12 portfolio companies – in addition to financial investments in hydropower and real estate. These companies will have a higher level of independence compared to the previous structure, while at the same time keeping synergies across the group in terms of procurement, IT and financial services.

Figure 1: New operating model from 01.03.2023 (Industrial Holding)



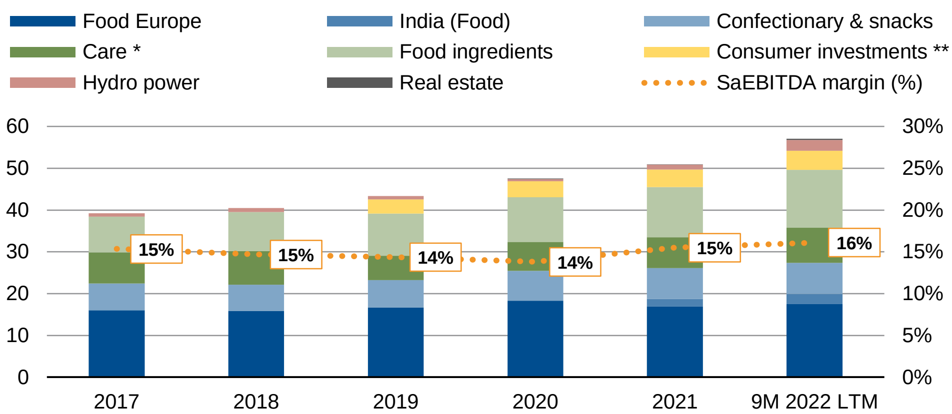
[1] Indicative revenues are R12M as at 30 September 2022 (adjusted for completed acquisitions)
[2] Jotun’s operating revenue represents the full company figure from 2021 (100%). Orkla has 42.6% interest in Jotun.

Sources: Orkla investor presentation

Blended industry risk profile: A-

Orkla is predominantly exposed to the consumer products industry and our analysis of the business risk profile therefore focuses on our consumer products methodology. EBITDA contribution from the non-core industries is deemed still relatively low, despite the hydro business posting exceptionally high operating profits during 9M 2022, they are not deemed sustainable with a negative impact expected from the retroactive effect of proposed government taxes, including a resource rent tax rate on hydropower rising from 37% to 45% effective Jan 2022 and a proposed windfall tax of 23% on power prices exceeding NOK 0.70/kWh. However, for the assessment of the industry risk we apply a blended assessment of A-. This reflects the main exposure towards non-durable consumer products (rated A), but also the smaller exposure to durable consumer products (rated BB; it includes Orkla house care, Pierre Robert and Lilleborg), to non-regulated power generation (rated BB; via the hydropower business) and specialty chemicals (rated A, via the minority stake in Jotun A/S). The real estate business is still not material on a group EBITDA level. While the blended industry risk is one notch below the non-durable consumer product industry risk, the benefits of business mix diversification are considered in the competitive position assessment.

Figure 2: Group revenues (NOK bn) including divisional 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
‘Sa’=Scope-adjusted

Sources: Orkla, Scope

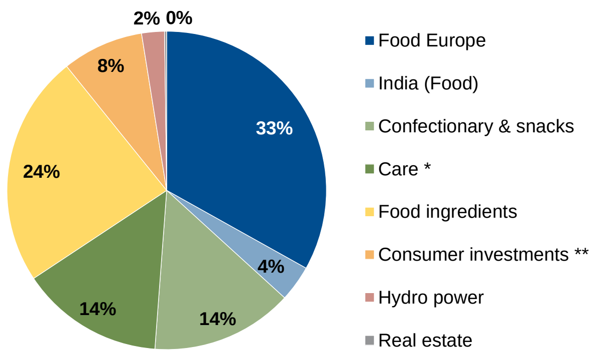
The 42.6% ownership in Jotun (an international chemicals company which deals in decorative paints and performance coatings for various industries) is accounted for using the equity method. The other non-consumer product investments (properties and hydro power) are fully consolidated. Orkla's real estate arm has a book value of NOK 1.9bn (including its headquarters), while the hydropower business generates approx. 2.5 TWh p.a. The latter business consists of wholly owned power plants in Sarpsfoss and leased power plants (until 2030) through Orkla's 85% interest in AS Saudefaldene.

Competitive positioning

Orkla's competitive position is mainly influenced by:

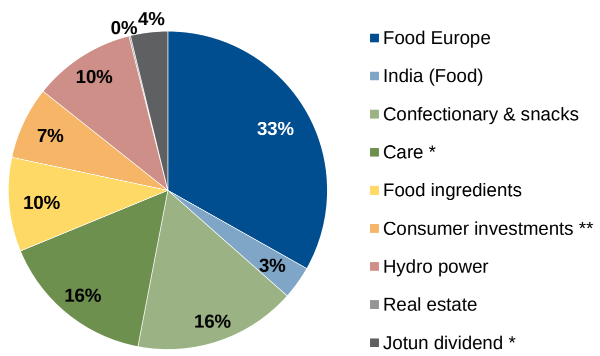
- Strong positions in its main markets, with 80% of revenues from brands with top two positions in their respective markets
- Business diversification, increasingly expanding its scope within consumer products and having interests in chemicals (Jotun), hydropower and real estate
- Good product mix diversification, 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 3: Revenue split by business (2021)



Source: Orkla, Scope

Figure 4: Reported 'adjusted' EBIT split by business * (2021)



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

Source: Orkla, Scope

The company operates with 12 main portfolio companies, with the core business being consumer branded goods. Each of these companies 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, with whom it competes within its home markets.

Strong, leading market position in the Nordics within branded food and house care

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, especially within foods (e.g. pizzas, ketchups, soups and sauces), confectionary & snacks (chocolates, chips and biscuits) and house care. 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 internationals peers and is also competitive on price. This is expected to continue and is a key competitive advantage in our view.

Competitive positions in other business units are also significant, albeit not as strong as the core branded food and house care products. For example, Orkla has dominant positions in specific categories such as omega-3, but it still has a less rich portfolio than larger international peers within consumer health. Within food ingredients, the recent acquisition of Denali Ingredients in USA (~NOK 1.1bn yearly turnover) is a relevant move to reinforce the ice cream business, but Orkla is still looking for a business partner in this business unit to strengthen its position.

Plant-based, pizza chains and consumer health are the selected growth areas

Orkla has targeted strategic growth areas that it intends to develop over time, namely plant-based, pizza chains and consumer health; these are expected to benefit from key megatrends of sustainability, urbanisation and health consciousness. As the potential for long-term growth in these markets is attractive for many, competition is elevated and there could be – in our opinion - some margin dilution for Orkla in order to strengthen its presence and gain market shares. Nevertheless, we take comfort from Orkla's track record of acquiring companies with already established leading positions in their own markets which should mitigate the risk. In general, we should expect Orkla to deliver on further acquisitions in each of the growth areas over the next years.

Within pizza chains, the company has already made some material acquisitions: after acquiring Kotipizza in 2019 in Finland, Orkla has expended the portfolio with the recent acquisitions of New York Pizza in 2021 (leading in the Netherland) and Da Grasso in 2022 in Poland, bringing the total number of franchise outlets around 850 with the long-term aspiration of becoming a leader in the European pizza market, yet still far from the leader Domino. Under the new structure, the Pizza Out of Home division has been carved out of the consumer investment division and made into one the portfolio companies with expected revenues in excess of NOK 2.5bn with its current size.

In consumer health (~NOK 5.2bn yearly revenues), the most relevant recent acquisitions were NutraQ in Norway (supplier of subscription-based health and wellness products) and Healthspan in UK (dietary supplements), which extend the product portfolio as well as increase the exposure to direct-to-consumer sales, with the potential – in our view – of supporting Group margins.

Regarding the plant-based business (FY 2021 revenues NOK 1bn, aiming to triple it by 2025), which is included mostly within food, we expect Orkla to channel significant resources to further develop its own brands (e.g. Naturli, Annamma), in addition to looking for potential targets.

Benefits of business diversification

Diversification is generally a supporting factor for Orkla. While the company is quite well diversified within the consumer product core sector, the presence of investments in unrelated businesses such as hydropower, chemical and to a lesser extent real estate provide additional support to the diversification assessment. The main constraint is driven by its geographical concentration of sales to the Nordics.

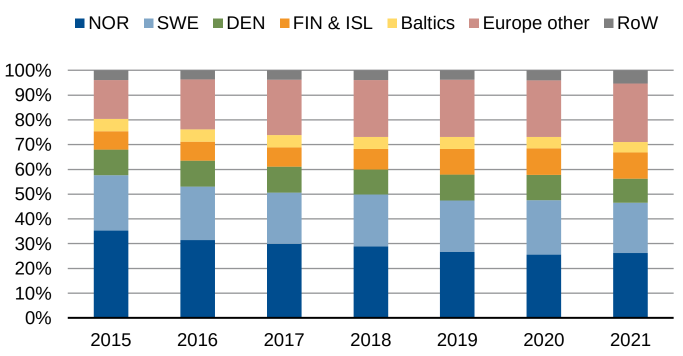
Broad product diversification

Within branded consumer goods, Orkla offers a wide range of products, which reduces its reliance on any single product. We view product diversification as solid, with products sold via more than 300 different brands. The envisioned organisational structure has at least ten different target segments. We see Orkla's effort in its three strategic areas as positive for diversification: in terms of products, we believe it will help by complementing the target customer range with the current one, for example plant-based is more focused on younger age groups, consumer health towards adults, while Pizza Out of Home complements the grocery-based products. We also view the out-of-the home pizza and health businesses as relatively little cyclical.

Geographical concentration on few Scandinavian countries

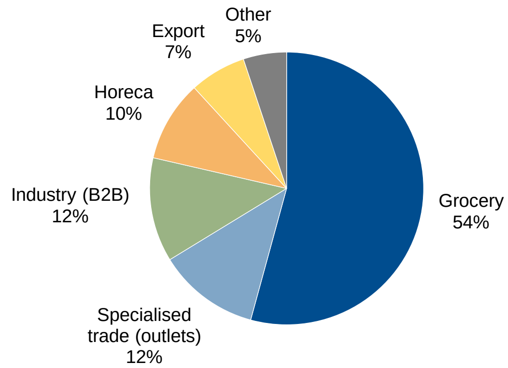
As touched upon previously, the group is moderately diversified geographically. Although it has made structural and strategic changes that increased activity in major European Markets as well as India, the majority of its turnover stems from the Nordic countries; the relative dependence on the Nordics has only moderately decreased over the last 10 years from around 80% to current 70%, with Norway covering around a quarter of sales, while Sweden has over 20%. Expansion in the strategic growth areas, in particular pizza chains, will increase the exposure towards Europe and benefit the geographical split.

Figure 5: Split of sales by geography (%)



Source: Orkla, Scope

Figure 6: Channel diversification (2021)



Source: Orkla, Scope

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 more than 50% of its turnover from grocery chains, although there is no major single-name dependency.

Established distribution network

Overall, we assess the distribution network as well established, consisting of grocery chains, wholesalers and e-commerce within certain segments (for example Orkla care). While on an aggregate level, grocers account for over 50% of branded consumer goods' sales, their weight in the food and confectionery & snack division is close to 80%, while they are much less relevant for the other businesses, which rely heavier on specialised trade (e.g. Orkla care) or HoReCa sales (food ingredients and Pizza Out of Home) or industrial sales (e.g. for professional cleaning products). Further growth within out-of-home pizza and consumer health will gradually reduce some of the concentration on grocers, in favour of HoReCa and online. In the medium term, the company has a target to double its revenues from 'digital and direct online sales' from around 7% to around 15%.

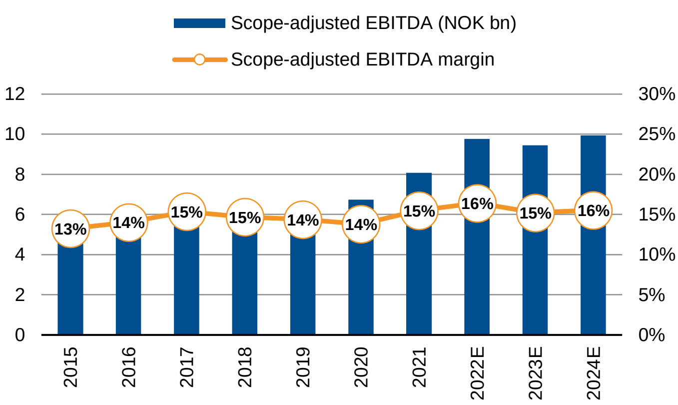
Operating margins below larger peers reflect business mix and size

Scope-adjusted EBITDA is slightly higher than reported figures as we include the contribution of the recurring Jotun dividend. Orkla's Scope-adjusted EBITDA margin (excl. Jotun dividend) averaged around 14-15% in the past five years. Although the EBITDA margin is below the larger international peers, this is in our view primarily justified by the product mix and to a lesser extent by its smaller scale; the food ingredient business has significantly lower margins than the group's average given its high exposure to B2B's distribution business, although we expect the recent acquisition of Denali ice cream ingredients to be margin supportive (Orkla is looking for a business partner within ingredients). Due to its high scalability, we also see the Pizza Out of Home business needing larger size in order to increase profitability closer to the historically higher performing businesses of confectionery & snacks, care and foods.

Stable margins over time

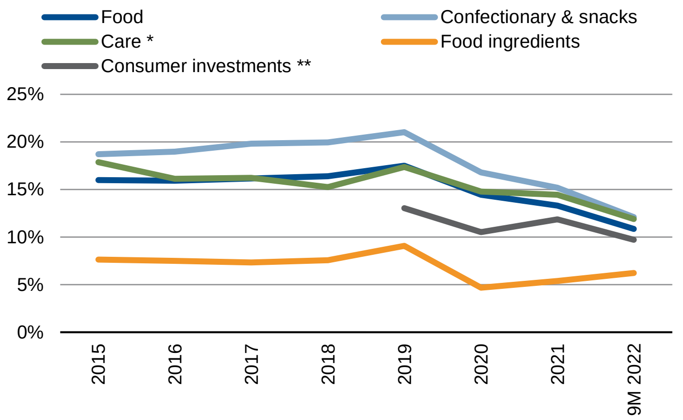
Regarding margin development, we favour the relative stability of group margins over time. Within its core consumer goods businesses, Orkla consistently generated a reported EBIT adj. margin between 11% to 12%, except for 2022. This indicates that Orkla is generally able to increase its prices thanks to its strong local market positions and brands, which have so far ensured high customer loyalty and lower price sensitivity. Moreover, the diversification in unrelated businesses further supports margin stability: the profitability decline in core branded consumer goods over the last two years driven by cost inflation has been more than offset by the strong performance of hydropower, which showed inversely related performance, a sort of natural hedge (at least on a pre-tax basis) for increasing energy prices.

Figure 7: Scope-adjusted EBITDA development



Source: Scope estimates

Figure 8: Reported 'adjusted' EBIT margin across consumer good divisions (*)



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

Source: Orkla, Scope

Solid EBITDA margin during 9M 2022 on hydropower performance

9M 2022 organic sales growth for branded consumer goods was +9.6% driven by pricing effects despite declining volumes. In terms of profitability, Orkla improved its Scope-adjusted 12-month average EBITDA of NOK 9.5bn, including Jotun's dividend of NOK 328m, corresponding to a Scope-adjusted EBITDA margin of 16.3% (margin is calculated excluding Jotun dividend), compared to NOK 8.1bn and 15.5% margin as of FY 2021. The improvement is almost entirely due to the extraordinarily strong performance of the hydropower business (9M 2022 reported EBIT adj. NOK 1.7bn vs. NOK 287m one year earlier), which produces and distributes hydroelectric power and therefore strongly benefited from higher energy prices. However, the core business of branded consumer goods experienced a decline in margins in almost all the divisions (foods Europe, confectionery & snacks, Orkla care, consumer investments) amid rapidly increasing raw material, packaging, energy and freight costs not offset in time by higher selling prices; only food ingredients was able to moderately improve margins.

Scope-adjusted EBITDA margin expected around 16% over time

Assuming a revenue growth close to 15% for the current year, we forecast Scope-adjusted EBITDA of around NOK 9.8bn in 2022, resulting in a Scope-adjusted EBITDA margin moderately above 16%, which factors in the negative impact of the introduced windfall charges on the hydro business (23% on power prices exceeding NOK 0.70/kWh to be applied from 28 September 2022) as well as continued cost inflation, the latter estimated in the high-teens for the entire year. For 2023 and 2024, our base case is a decline in the Scope-adjusted EBITDA margin to the range 15% to 15.5%. This reflects primarily a gradually diminishing contribution from hydropower driven by some price stabilisation after the highs from 2022 but also in view of the government's introduced increase in the resource rent tax rate on hydropower (impacting EBIT) from 37% to 45%

from Jan 2022, in addition to the windfall charges. Conversely, we see the profitability within branded consumer good business for 2023 broadly in line with 2022 amid a slight easing in inflationary cost pressures and supply chain constraints but still sluggish volume growth and moderately higher operational costs amid organisational changes taking place during 2023. We see some gradual recovery in the EBITDA margin for the consumer good business from 2024 on gradually improving economic conditions and improving product mix (higher exposure to health, declining portion of distribution business within food ingredients) and increasing synergies within Pizza Out of Home; this translates into a Scope-adjusted EBITDA between NOK 9.4bn and 9.9bn during 2023/24 with a margin of about 16%, supported also by the recurring dividend from Jotun assumed at around NOK 330-350m p.a.

Strong local brands, but no global ones

Orkla has a wide portfolio of around 50 main brands selling hundreds of different products, most of them leading the market in Norway and Sweden (e.g. Felix, Kims, Stabburet, Toro, Grandiosa), where the group has its strongest foothold and its products are associated with high quality. Orkla also owns top brands within selected segments in other countries within Scandinavia, Baltics, India (MTR, Eastern) and other countries in Europe. Compared to international consumer good giants, Orkla does not have brands known internationally, but they rather have local resonance. On the other hand, there is no major dependency on any single brand.

Advertising and R&D expenses vary across products and brands

The group spends approximately 5% of revenues on advertising and R&D activities with a gradual increase over the last years. While their media footprint is large in Scandinavia, the comparison with their 'best in class peers' shows some underinvesting in brands. This is partly explained by Orkla's comparatively higher portion of B2B business with limited advertisement needs which dilutes the ratio. Nevertheless, we assess their overall adverting spending as below average and we expect the trend of increasing relative advertising spend to continue amid continued weak volume growth and competition from private labels.

Financial risk profile: A-

Scope adjustments

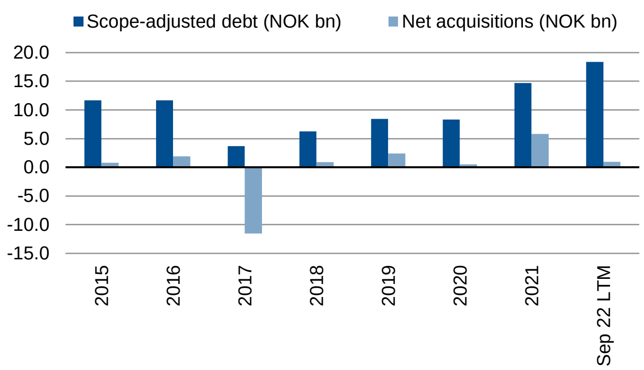
Key adjustments made on financial items:

- EBITDA adjusted for: Jotun dividend (around NOK 330-360m p.a.). Although it is an associate company, the relationship between Jotun and Orkla tracks back decades and Jotun has been recently assigned as one of the 12 portfolio companies of Orkla, to highlight the long-term view.
- Net cash interest paid adjusted for pension interests of about NOK 24m p.a.
- Debt adjusted for future unfunded pension obligations, discounted at 50% (around NOK 1.2bn p.a.).
- Debt adjusted for restricted cash of around NOK 280m 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. Restricted cash 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.
- Free operating cash flow adjusted for lease payments of around NOK 500m p.a.

Recurring M&A activity has an important role on credit metrics

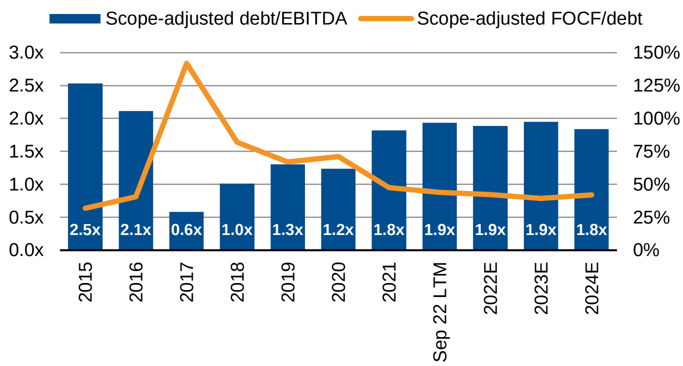
Because of the acquisition-driven nature, development in Scope-adjusted debt is closely related to M&A activity. Orkla experienced a strong deleveraging in 2017 upon the sale of its 50% stake in Sapa, resulting in a Scope-adjusted debt/EBITDA leverage below 1.0x. Since then, whilst still keeping strong credit metrics, the company has gradually increased its debt levels given the ample headroom under its explicit target of maintaining a net leverage below 2.5x. After several years of slow organic growth below 2% in the branded consumer core business, Orkla intensified its M&A activity from 2021, increasing Scope-adjusted debt to around NOK 15bn and causing an increase in leverage. The company spent a significant NOK 5.8bn in acquisitions (net of disposals) in 2021, including NutraQ in Norway (leading supplier of subscription-based health and beauty products in the Nordic region), Eastern Condiments in India (food and spices), New York Pizza chain (Netherlands/Germany). In 2022 M&A spending amounted to NOK 0.9bn spent (net of disposals) as of September 2022, including investments Healthspan and Vesterålen Marine Olje focused on health. Yet, the amount will more than double by year end when including the announced notable acquisitions of Denali Ingredients (ice cream ingredients) in USA and Da Grasso (franchise pizza chain, 193 outlets) in Poland.

Figure 9: Debt development and acquisitions



Source: Orkla, Scope

Figure 10: Leverage metrics



Source: Scope estimates

Key base case assumptions

Our base case includes: i) revenue growth of +14% in 2022 (vs. +16.2% as of 9M 2022); ii) 2023/24 growth conservatively assumed at 3% to 4%; iii) Scope-adjusted EBITDA margin above 16% for FY 2022, declining to around 15%-15.5% during 2023/24 with Scope-adjusted EBITDA between NOK 9.4bn to 9.9bn; iv) the dividend from Jotun at NOK 330-360m p.a.; v) the average interest rate increasing from around 2% in 2022 to close to 4% in 2023/24; vi) capex of NOK 3.0bn in 2022, down to stable NOK 2.7bn in 2023/24; and vii) M&A spending of NOK 3.1bn in 2022, between NOK 1bn-2bn during 2023/24.

Increase in Scope-adjusted debt in past years

Scope-adjusted debt increased to NOK 18.6bn as of September 2022 from NOK 14.9bn in Dec 2021 on materially higher net working capital and acquisitions. Scope-adjusted debt levels are more than doubled compared to NOK 8.5bn in Dec 2020, with the NOK 6.0bn spent in acquisitions during 2021 being a major driver.

Leverage expected to stay close to 2x

As a consequence of increased indebtedness, the Scope-adjusted debt/EBITDA 12-month average stood at 1.9x as of Sep 2022, representing a small deterioration compared to 1.8x as of Dec 2021. We forecast Scope-adjusted debt/EBITDA to remain at 1.9x on Dec 2022. This factors in the assumption that while working capital needs remain high for the year driven by a combination of more expensive stocks and supply chain restrictions – the latter driving the decision to build up inventory to secure deliveries – we expect some destocking in Q4 to reduce expected net working capital needs to around NOK 2.4bn. Moreover, the M&A spending for 2022 is estimated at around NOK 3.0bn (close to NOK 1.0bn until Q3 2022), including the acquisitions of Denali Ingredients in the US and Da Grasso pizza chain in Poland that were completed in Q4. For the years 2023/24 we see leverage remaining slightly below 2.0x amid some margin pressure but gradually improving working capital situation. This level is moderately below the company's stated financial policy target of net debt/EBITDA below 2.5x. Our capital allocation assumptions include dividends between NOK 3.0bn–3.1bn during 2022/24, while net acquisition spending is moderately reduced to the range NOK 1.0bn to 2.0bn during 2023/24.

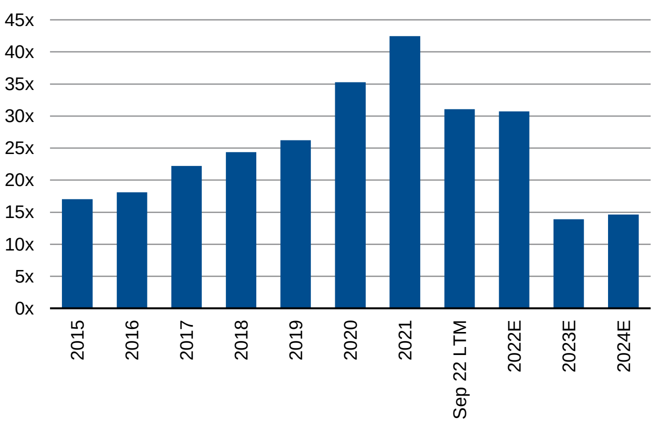
Scope-adjusted FFO/debt between 40-45%

Similarly, Scope-adjusted funds from operations/debt fell from the excellent levels above 60% pre-2021 and we project it to oscillate between 40% to 45% over the forecasted horizon. In our view, the new organisational structure also facilitates a potential sale process of one of its portfolio companies.

Strong interest cover by rising interest expenses

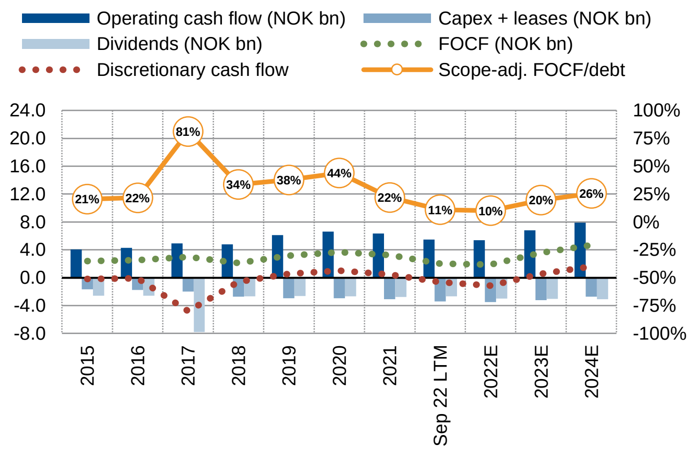
Interest cover remains one of the strongest financial metrics for Orkla, it is constantly well above 10x. Nevertheless, a large part of Orkla's debt is variable rate and the current interest rate environment will negatively impact interest expenses over the next few years. As of Dec 2021, 4% of the group's interest-bearing liabilities (excluding leases) were at fixed interest rates for periods exceeding one year (43% as of Dec 2020) having used currency and interest rate derivatives to further increase the exposure to variable rates. This brought net interest average costs down to a low 1.6% in 2021, an improvement compared to previous years. For 2022 we expect net interest costs to moderately increase to NOK 320m, equal to an average interest rate around 2%, which is set to significantly rise to close to 4% from 2023. We conservatively project Scope-adjusted interest expenses to more than double to around NOK 650–700m during 2023/24. Such higher expenses will result in an interest cover still strong at around 14x during 2023/24, yet a material decline compared to the levels above 30x until 2022. Orkla may decide to hedge its interest rate risk if the debt substantially exceeds the net leverage target of 2.5x.

Figure 11: EBITDA interest cover (x)



Source: Scope estimates

Figure 12: Scope-adjusted FOCF/debt and cash flow sources vs. uses



Source: Scope estimates

Cash flow cover ranging from 20% to 25%

Despite Orkla having a strong recurring FOCF generation, the increased indebtedness has brought the Scope-adjusted FOCF/debt ratio below 25% in 2021 after lying consistently above 30% in the years 2017-20 after the Sapa disposal. For 2022 we project elevated working capital needs at around NOK 2.4bn and high capex at NOK 3.0bn, which brings cash flow cover below 15%. Afterwards, we expect an improvement in the net working capital after the peak in 2022, while capex should normalise towards NOK 2.7bn after the large investments over the last few years, including a new biscuit factory in Latvia (ready in 2023) and investments in ERP systems. However, since we do not envisage Orkla materially reducing its indebtedness from current levels, Scope-adjusted FOCF/debt is set to range between 20% to 25%.

Adequate liquidity

Liquidity is adequate based on good access to bank and bond markets. As of Q3 2022, the company had aggregated NOK 9.0bn in cash and undrawn credit lines, well above reported short-term debt of NOK 3.7bn. The fairly high portion of short-term debt at the moment is a result of the opportunistic issuance of commercial paper over the past two years due to relatively favourable conditions.

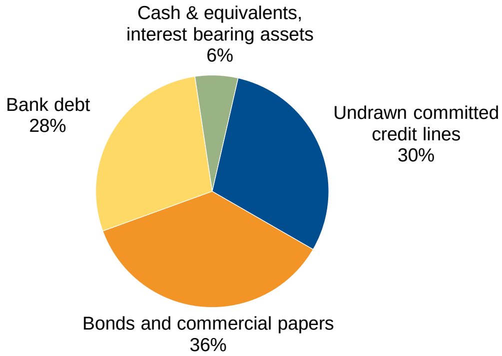
While our model assumes a rollover of the commercial paper over time, it is possible that Orkla will gradually reduce its short terms maturities via long-term refinancing or repayment from positive free operating cash flow.

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 covenants attached to their financing and the average debt maturity (excl. lease liabilities) as of September 2022 was 3.4 years.

In addition, 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.

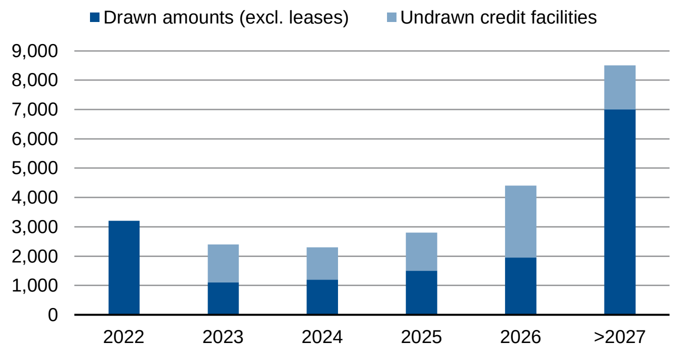
Figure 13: Funding sources* (in %), as of Q3 2022



* It excludes lease liabilities – which amounted to NOK 1.9bn as of Dec-2021

Source: Orkla

Figure 14: Debt maturity profile (NOK m), as of Q3 2022



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	2022E	2023E	2024E
Unrestricted cash (t-1)	850	816	872
Open committed credit lines (t-1)	7,200	7,200	7,200
Free operating cash flow (t)	1,871	3,610	4,683
Short-term debt (t-1)	3,603	3,875	3,875
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 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.

Short-term debt rating: S-1

The short-term debt 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

Frankfurt am Main

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

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com