Felleskjøpet Agri SA
Norway, Agricultural

BBB- STABLE

Corporate profile

Felleskjøpet Agri SA (Felleskjøpet) is a Nordic agriculture cooperative headquartered in Lillestrøm, Norway. The company is owned by around 44,000 Norwegian farmers and has operations along the agricultural value chain. Its main segments are called Agriculture, Retail Nordics, Machines and Cernova. The latter is a 66%-owned bakery subsidiary of Felleskjøpet and includes Norgesmøllene, Norgesbakeriene, Mesterbakeren and Cernova Industri. In addition to its commercial business, the company is responsible for regulations in the Norwegian grain market. Revenues in 2020 was NOK 17.3bn, and today the company employs more than 4,000 people.

Key metrics

			Scope estimates	
Scope credit ratios	2019	2020	2021E	2022E
EBITDA/interest cover (x)	5.6x	6.1x	6.5x	6.4x
Scope-adjusted debt (SaD)/EBITDA	4.1x	3.1x	3.0x	3.1x
Scope-adjusted funds from operations/SaD	19%	24%	27%	22%
Free operating cash flow /SaD	18%	8%	11%	9%

Rating rationale

Scope Ratings has assigned an issuer rating of BBB-/Stable to Norwegian agricultural company Felleskjøpet Agri SA. Scope has also assigned a senior unsecured debt rating of BBB-.

The issuer rating benefits from a relatively stable and diversified business model supported by a cooperative company structure. Felleskjøpet's business risks are further reduced by protective measures for the Norwegian agricultural sector, including tariffs on selected foreign input factors. The rating also benefits from the company's leading position in the Norwegian grain market, where it purchases more than 50% of domestic production and serves as the market regulator. The company is also important in the overall farming value chain, with good market shares and high loyalty among customers as many are also company owners. Felleskjøpet's geographical diversification is limited to Norway (80% of revenues) and Sweden (20%). The geographical concentration results in a relatively strong dependency on the Norwegian agriculture industry and the economic strength of Norway's farmers, and we therefore highlight the risk arising from any changes in the agriculture sector's structure or regulation. Felleskjøpet has a diverse product offering along the agriculture value chain, reducing the reliance on any single product. Felleskjøpet's overall profitability margins are stable but low, with the picture more mixed on the segment level.

The financial risk profile is weaker than the business risk profile. Leverage ratios were somewhat high historically but have gradually decreased with the recent improvement in operating results, resulting in a more conservative capital structure. Last year's disposal of shares in Moelven (NOK 0.3bn) also helped by balancing out the increased working capital. Scope-adjusted leverage was around 3x as of Q3 2021, down from the 2017-19 average of more than 4x.

Ratings & Outlook

Corporate issuer rating BBB-/Stable

Senior unsecured rating BBB-

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Related Methodologies

Corporate Rating Methodology

Consumer Product Methodology

Retail and Wholesale Corporates

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Going forward, we expect the increased investment planned for the next few years to put some pressure on free operating cash flow and prevent further deleveraging. Therefore, we expect Scope-adjusted leverage of around 3x in the medium term and funds from operations/Scope-adjusted debt ratios of 20%-30%. We expect interest cover to remain largely unchanged and free cash flow cover to remain sufficiently positive following ambitions to modernise and expand several factories and grain plants. These plans should also make production more sustainable through lower energy consumption and emissions as well as create more efficient transportation.

Liquidity is deemed adequate based on good access to banks and domestic capital markets. As of Q3 2021, the company had NOK 1.8bn in cash and undrawn credit lines, which is above the reported short-term debt of NOK 1.3bn (of which only NOK 0.4bn comprises maturing bonds and bank debt).

We have made no adjustment for supplementary rating drivers. The financial policy is conservative enough to maintain acceptable financial flexibility, and the company seeks to increase its headroom to the financial covenants going forward. With respect to ownership, governance and structure, some of the cooperative ownership elements were considered also under the business risk profile.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Felleskjøpet will continue to hold leading market positions and be important to the overall value chain of farmers. It also assumes no change to the cooperative structure as well as to the regulatory conditions and protective measures applicable to the Norwegian agricultural sector. Financially, we expect stable operating performance to result in a Scope-adjusted leverage of around 3x.

A positive rating action is possible if growth remains high and margins improve, especially in Nordic retail, resulting in increased group profitability and free operating cash flow generation and thereby a Scope-adjusted leverage sustained below 2.5x.

A negative rating action is possible if the business risk profile deteriorated through weaker market conditions and/or an unfavourable change in regulations. Increased costs and/or investment that result in a Scope-adjusted leverage sustained above 3.5x could also lead to a downgrade.

Rating drivers

Positive rating drivers	Negative rating drivers
• Leading position in Norwegian grain market (around 50% market share), and role as market regulator • High market shares overall in the agricultural segment, operating in a partly protected environment with high entry barriers • Stable and diversified business model supported by its cooperative company structure	• Low margins, partly due to cooperative mandate • Somewhat high leverage ratios in the past • Increased investment plans in the next few years putting pressure on free operating cash flow generation

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Increased profitability and free operating cash flow generation that result in a Scope-adjusted leverage sustained below 2.5x	• Weaker market conditions or adverse regulatory change resulting in a Scope-adjusted leverage sustained above 3.5x

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021E**	**2022E**
EBITDA/interest cover	5.6x	6.1x	6.5x	6.4x
Scope-adjusted debt (SaD)/EBITDA	4.1x	3.1x	3.0x	3.1x
Scope-adjusted funds from operations/SaD	19%	24%	27%	22%
Free operating cash flow/SaD	18%	8%	11%	9%
Scope-adjusted EBITDA in NOK m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	730	1,013	875	1,103
Operating lease payments in respective year	404	442	442	442
Other	-	-	228	-
Scope-adjusted EBITDA	1,134	1,454	1,545	1,545
Scope-adjusted funds from operations in NOK m	**2019**	**2020**	**2021E**	**2022E**
EBITDA	730	1,013	875	1,103
less: (net) cash interest as per cash flow statement	-134	-155	-155	-154
less: cash tax paid as per cash flow statement	-34	-84	-59	-94
add: depreciation component, operating leases	334	359	358	356
add: other cash items	-10	-40	228	-165
Scope-adjusted funds from operations	**886**	**1,094**	**1,248**	**1,045**
Scope-adjusted debt in NOK m	**2019**	**2020**	**2021E**	**2022E**
Reported gross financial debt (including leases)	3,475	3,277	3,517	3,255
less: cash and cash equivalents	-621	-634	-834	-477
add: cash not accessible	18	10	10	10
add: pension adjustment	181	204	204	204
add: operating lease obligations	1,649	1,654	1,697	1,740
Other	-	-	-	-
Scope-adjusted debt	**4,703**	**4,510**	**4,594**	**4,733**

Business risk profile

Industry risk

Different industry dynamics with a blended industry risk of BBB-

Felleskjøpet has four main segments with different business dynamics: Agriculture, Retail Nordics, Machines and Cernova. For that reason, we apply a blended industry risk assessment, separating the agriculture, retail/wholesale (Retail Nordics and Machines) and consumer goods (Cernova) segments. With a normalised EBITDA contribution by each segment estimated at respectively 35%, 45% and 20%, we have assigned a BBB- blended industry risk. For a detailed description of the industry and business risk drivers for the retail/wholesale and consumer goods segments, we refer to the sector-specific methodologies (linked on the first page of this report).

Figure 1: Blended industry risk rating grid

	Agriculture	Cyclical retail/wholesale	Non-durable consumer products
Industry risks	BBB	BB	A
Revenue %, normalised	45%	45%	10%
EBITDA %, normalised	30%	45%	25%
Blended industry risk		**BBB-**	

Source: Scope Ratings

Cyclicality

Cyclicality in agribusiness is high: growing seasons are affected by variations in weather conditions while output is influenced by plant and animal diseases. Cyclicality in retail can vary widely depending on the segment, for example, consumer goods tend to be non-cyclical. Most retail segments are cyclical, however. As such, we have applied the latter approach with medium cyclicality. However, the company's non-durable consumer products have low cyclicality, in part because the consumption of essential food and beverages is less susceptible to macroeconomic drivers and changes in consumer confidence.

Market entry barriers

We deem market entry barriers in agriculture as high. This reflects the limited availability of resources (e.g. land, infrastructure and skilled workers), the relative difficulty of replicating the physical property and plant of competitors, and the importance of high-productivity intellectual property rights (proprietary animal and plant attributes). Within retail/wholesale, we consider entry barriers to be low. The retail sector is generally not subject to highly restrictive legislation or the need for significant industrial know-how or patents to operate. Consumer product industries have medium barriers to entry for both durable and non-durable segments.

Substitution risks

For agribusinesses, substitution risks are low, reflecting the non-discretionary products, the importance of trustworthy suppliers and the reluctance among customers to change vendors, especially among those with health concerns. Substitution risk within the retail sector and non-durable consumer goods industries are also low, as new purchasing behaviours are systematically integrated into the retail industry. Food and beverages especially are non-discretionary in nature despite the large differences in quality, brand and price.

Competitive positioning

Felleskjøpet has a large exposure to Norwegian agriculture. Its revenues largely depend on demand from farmers for input factors such as seeds, feed, fertilisers and machinery. As such, we examine the structural aspects that affect demand and, in turn, Felleskjøpet's competitive positioning. These include the following elements:

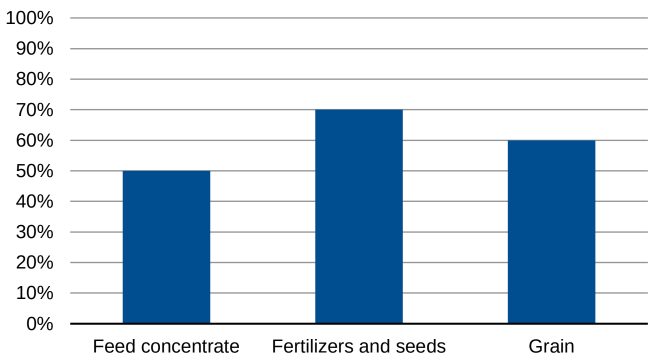
- Norway's agribusiness is greatly influenced by protective measures by the government such as subsidies and import tariffs (figure 2). We expect these will continue to apply.
- The current political aim is to keep domestic food supply high to minimise import dependency as well as to preserve arable land and agriculture traditions across the country.
- Agribusinesses are becoming fewer in number but larger, while production output is expected to remain at historical levels.

Figure 2: Grouping of Norwegian import tariffs

High tariffs	Moderate tariffs	Full import competition	
Meat	Potatoes	Bakery products	Mineral water
Dairy products	Vegetables	Pizza, pie	Tropical fruits
Grain	Fruits & berries	Ham	Sugar
Eggs	In Norwegian season	Soups, sauces	Rice, corn, soya
Sensitive products		Chocolate	Coffee, tea
		Ice cream	Leather, skin
		Processed agriculture products	No tariffs

Source: www.regjeringen.no, Scope

Figure 3: Felleskjøpet's estimated market shares in Norwegian agriculture segments



Source: Felleskjøpet, Scope estimates

Strong and leading market position within agricultural segments

Felleskjøpet is the market leader in Norwegian grain and important to the farming value chain. In the past, the company has purchased more than half of Norwegian grains produced. The company uses a large share of the grain in its own production of feed concentrate. Feed account for most revenues in the agriculture segment and around 50% of the market in Norway. The market share for the sale of input factors such as fertilisers and seeds are around 70%, according to the company. Thus, Felleskjøpet leads the Norwegian agricultural market for grain, feed concentrate, and selected fertiliser and seed supply.

Specialised on retail

The company has more than 200 physical retail stores split evenly between Norway and Sweden. The company also sells products through its webpage, but these generate only a small part of its revenues. The stores offer diverse products, but they predominantly relate to farming, gardening and animal care. Although Felleskjøpet is one of the largest retailers in Norway and Sweden within its segments, it is small in the overall retail market, which is fragmented. Competition from e-retail is increasing, but the company's customers are loyal as many are also company owners (i.e. farmers and their families and relatives).

Consolidated machine/tractor market

The Machines segment is wholesale of agriculture, lawn care and other machinery to farmers and other commercial customers. The segment also includes post-sale services such as repairs and maintenance. For farming equipment, the company is Norway's exclusive dealer of the American premium brand John Deere. At the end of 2020, the company also became the exclusive dealer of Sampo threshers, which targets smaller agribusinesses. The tractor market in Norway is dominated by three companies: Felleskjøpet (John Deere), A-K Maskiner (New Holland and Case IH) and Eiksenteret (Massey Ferguson, Fendt and Valtra). Combined, these control approximately 84% of the market.

Majority-owned Cernova operating in a more fragmented market

The subsidiary Cernova (owned 66% by Felleskjøpet) supplies baking ingredients (e.g. flour) and finished bakery products to bakeries, supermarkets, catering services and industrial customers. Competition in this market is high. The assessment is positively affected by a strong domestic presence for flour and bakery products through the agreement with REMA 1000 (top-three supermarket chain in Norway) as well as the leading position in flour (Møllerens brand).

We derived the overall market position by combining the various segments' market shares, but also accounted for segment connection and customer loyalty. The company's combined offering is appealing to farmers, and we consider the company to be a reliable partner to the Norwegian agriculture sector.

Geographical diversification limited to Sweden and Norway

Felleskjøpet's geographical diversification is limited with Norway accounting for more than 80% of revenues. The remaining revenue comes mostly from Sweden through the Granngarden brand. Geographical diversification is also low compared to companies with more international profiles. A major risk for Felleskjøpet is structural and/or regulatory changes in the Norwegian agriculture sector.

Diverse product diversification

Felleskjøpet offer a diverse range of products along the agriculture value chain, which reduces the reliance on any single product. Still, much of its business depends on Norwegian agriculture and the economic strength of farmers.

Solid customer and supplier diversification

Customer and supplier diversification is good for most segments. Felleskjøpet collects grain from farmers across Norway. Shortfalls in domestic seasonal volume are substituted with imports (market regulator decision), which mitigates volume and price risks (in a normal year, imported grain would be cheaper than domestic grain without the import fees). For the Machines segment, we note the supplier risk in relation to John Deere, but this is mitigated by Felleskjøpet's very strong relationship with the supplier, which dates back to 1977. In retail, supplier risk is low due to a diverse offering of products that can be easily substituted.

With around 38,000 registered farms in Norway, the customer base for agricultural and machine products are well diversified. The trend towards fewer but larger agribusinesses is likely to increase concentration risk going forward, but this risk is reduced by the close ties with the many farmers that are also owners of Felleskjøpet. In retail, the company has warehouses covering both Norway and Sweden, which combined, provide the company 16m potential customers. The company's bakery customers are also diverse, although large commercial customers pose some concentration risk.

Increasing profitability trend helped by efficiency program

Felleskjøpet's profitability margins have improved in recent years, reaching above 8% last year[1] from around 6% in 2014. This was helped by the profitability enhancement programme, which ended last year. The dip in 2018-19 was the result of an extreme drought in the summer of 2018, leading to a 43% decrease in domestic grain volumes. Still, Felleskjøpet's profitability margins, while low, are stable. However, the picture on segment level is more mixed.

Low but stable margins within agricultural business

The Agriculture and Machines segments have the lowest margins, partly explained by the company's purpose as a cooperative to serve the agriculture sector (its owners) rather

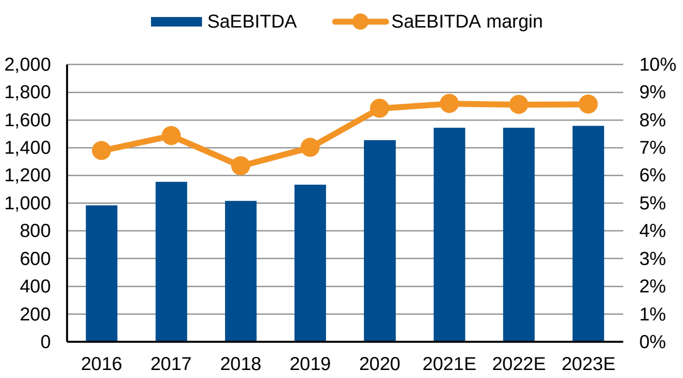
[1] Using Scope-adjusted EBITDA as a reference

than to maximise profits. Regarding grains, the company can use imports to replace any shortfall in the domestic supply of grains used in its production of feed and bakery products. Tariffs typically ensure prices are similar between imported and domestically produced grain. For other commodities used in feed production (e.g. soya, corn), we also assess a low volume risk but slightly higher price risk in the absence of tariffs. Still, we expect any increase in import prices to be largely passed on to customers, which reduces this risk and keeps margins more stable.

Higher EBITDA margins in retail and Cernova

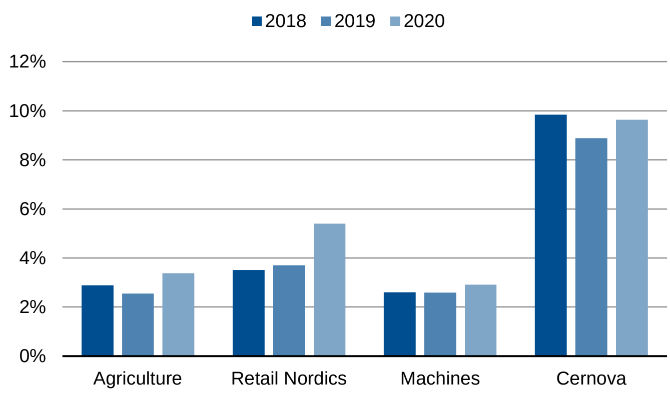
The Retail Nordics and Cernova segments have higher margins. For Retail Nordics especially, margins improved in 2020 and 2021, helped not only by the pandemic but also by more efficient operations in Sweden (Granngarden).

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



Source: Felleskjøpet, Scope estimates

Figure 5: EBITDA margin by segment



Source: Company reports, Scope estimates

Assume stabilisation of EBITDA margin going forward

Going forward, we expect margins to remain relatively stable (excluding the provision relating to the Infor court case), with Scope-adjusted EBITDA margins in 2021-23 estimated to remain at around the current level of 8.5%. We believe the higher margins compared to previous years' levels can be sustained due to the increased sale of higher margin products in retail and continued cost-effectiveness from operating initiatives relating to logistics solutions, amongst others.

Financial risk profile

Increased operating results led to more conservative capital structure than in the past

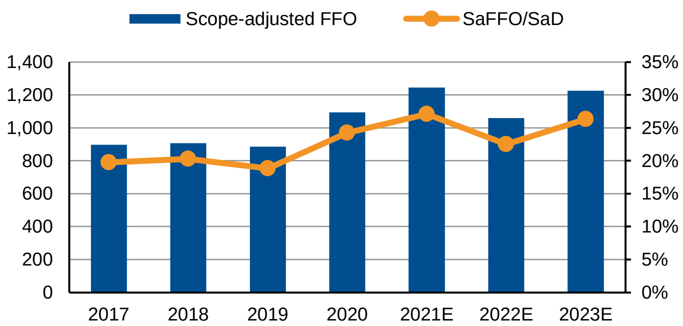
With the improved operating results recently, Felleskjøpet has been able to gradually decrease its leverage ratio and achieve a more conservative capital structure. With Scope-adjusted leverage around 3x as of Q3 2021 (down from the 2017-2019 average of more than 4x), the company has gained some more financial flexibility. Last year's disposal of shares in Moelven (NOK 0.3bn) also helped by balancing out the increased working capital.

Debt adjusted for pensions and operating leases

We have made the following adjustments when calculating Scope-adjusted debt, based on the company's Norwegian accounting standard reporting:

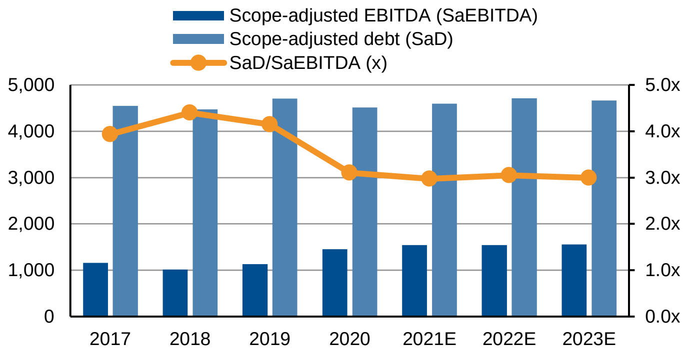
- An adjustment for operating leases, as the company has more than 300 real estate properties (40% is owned and 60% is leased)
- 100% of the deposited amount from owners and employees classified as short-term interest-bearing debt due to no minimum tenor on these deposits (although they have shown to have longer maturities in practice, based on historical track-record)
- Added half of net pension liability in accordance with our methodology as the ratio of plan assets exceeds annual defined pension payments by more than six times

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



Source: Scope estimates

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



Source: Scope estimates

Increased investment to modernise several plants

Our base case foresees capex to increase compared to levels in the last few years, by more than 30% on average. Major capex projects include the expansion of grain plants and feed production facilities in Mid-Norway, which is expected to save costs and improve the appeal to customers. Efficient harvesting and new requirements for raw materials affect the food production value chain and are thus important for the company's customers and farmers. Thus, over the next few years, Felleskjøpet will modernise several factories and grain plants, which should also make production more sustainable through lower energy consumption and emissions as well as more efficient transportation.

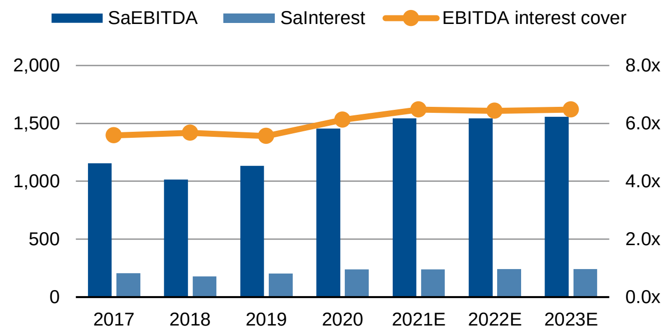
No further disposals assumed, but potential excess value in some real estate holdings

Our projections exclude divestments, but we are aware that the company could sell a large grain plant (Stavanger Havnesilo) as its location is no longer optimal. This would generate a substantial cash inflow if the plant is repurposed for normal housing. A likely prerequisite for the sale is the addition of equivalent capacity to other existing plants.

Loss in the long-running Infor legal dispute to result in a cash outflow next year

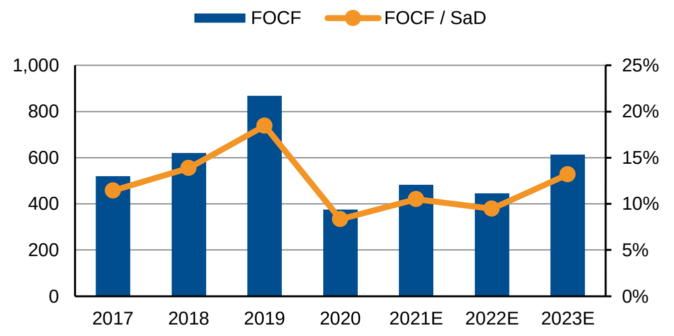
We also note that the supreme court rejected the appeal by Felleskjøpet in December 2021 relating to Infor[2] court case, which means that the court ruling requiring Felleskjøpet to pay Infor around NOK 130m in compensation and legal costs remains. Although provisions of NOK 206m already had been taken by H1 2021, the company announced that further provisions will be taken in Q4 to cover accrued interest. Scope expects the negative cash effect in 2022 to be around NOK 165m.

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

Capital structure expected to remain more conservative than in the past

Given the assumptions above, we expect a Scope-adjusted leverage of around 3x in the medium term and a funds from operations/Scope-adjusted debt ratio in the 20%-30% range. We also expect interest cover to remain largely unchanged, and free cash flow cover to be weaken slightly in the short term (but remain sufficiently positive) due to higher investments planned than in the last couple of years.

The liquidity position is deemed adequate based on good access to banks and domestic capital markets. At the end of Q3 2021, the company had NOK 1.8bn in cash and undrawn credit lines, which is above the reported short-term debt of NOK 1.3bn (of which only NOK 0.4bn comprises maturing bonds/CPs and bank debt).

[2] An IT company. The dispute was about an ERP system to Felleskjøpet. Legal proceedings started in 2016. Felleskjøpet won the first round but lost the second.

Supplementary rating drivers

Financial policy

Sound and prudent financial policy, but no rating adjustment

We make no adjustment for Felleskjøpet's financial policy, which we assess as conservative enough to maintain financial flexibility going forward. The company has financial covenants[3] in its loan agreements, and we understand that it aims to improve headroom to these going forward to maintain a conservative capital structure and an investment grade profile.

The company does not have a target dividend pay-out ratio but usually paid a dividend or bonus of NOK 60m-90m in most of the years during 2012-20. In 2020, however, the dividend was significantly reduced to NOK 12m due to Covid-related uncertainties, which indicates flexibility and a desire to preserve the capital structure.

Ownership, structure and governance

Owned by 44,000 Norwegian farmers

Felleskjøpet is a cooperative owned by around 44,000 farmers. Its purpose to ensure the strength of its members' finances, whether in the short term or the long term. The company is managed according to democratic principles. The members are divided into regions and choose representatives at the annual meeting (the group's highest governing body).

The type of owners means equity injections are less likely in times of need. However, cooperative peers have shown that partial equity instruments like subordinated hybrid bonds can be used as an alternative. We see the membership capital as stable, based on historical track record, and note also that a potential exit repayment (to a farmer) is paid out over 5 years.

We also highlight that the company serves political and public interests, directly through its responsibility for regulations in the Norwegian grain market and indirectly by helping Norway's aim to be adequately self-sufficient regarding food production and security. As a result, we argue that some of the company's activities are likely to be positively benefiting from regulations, as they allow the government to reach its ambitions without providing explicit financial support to companies in the industry.

We therefore conclude that no supplementary rating adjustments are justified for ownership or for governance and structure.

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

The senior unsecured debt rating is in line with the issuer rating. Felleskjøpet Agri SA is also the bond-issuing entity.

No short-term debt rating assigned

Felleskjøpet has five outstanding Norwegian krone bonds totalling approximately NOK 2.2bn and maturing between 2022 and 2026.

[3] I) Equity / Book Capitalization > 25% (currently 35%), Debt / EBITDA < 4.5x (currently around 3x)

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