16 June 2022 Corporates

TINE SA
Norway, Consumer Products

A- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2020	2021	2022E	2023E
Scope-adjusted EBITDA/interest cover	7.2x	9.9x	9.7x	8.5x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.1x	1.0x	1.1x	1.2x
Funds from operations (FFO)/SaD	83%	96%	82%	76%
Free operating cash flow (FOCF)/SaD	52%	50%	58%	52%

Rating rationale

The issuer rating reflects the company's relatively low industry risk, favourable regulatory environment and leading domestic market positions in its key segments, combined with a strong financial risk profile. No adjustment was made for supplementary rating drivers.

Tine's business risk profile benefits from its very strong domestic market positions within Norway's dairy segments. This partly mitigates its less diversified geographical diversification (around 83% of revenue generated in Norway). Moreover, diversification in terms of product offering, suppliers and distribution networks is adequate, and the company has a strong brand name domestically. Internationally, its Jarlsberg cheese brand is its most well-known brand and a further growth focus for the company. Although the low volatility in Tine's profitability margins is positive, the company slightly lags behind some of its peers in terms of overall group EBITDA margins.

We see the financial risk profile as stronger than the business risk profile. This is based on very conservative leverage ratios during the last two fiscal years, with a SaD/EBITDA ratio of around 1x. Furthermore, Tine is prudent with its investment spending, so we expect very solid FOCF/SaD ratios and strong financial flexibility in the medium term, indicating that leverage will remain below 1.5x in the short-to-medium term.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Tine will continue to hold strong positions in its key segments and maintain good dairy product diversification. Further, our Stable Outlook assumes a continuation of conservative leverage and strong cash flow metrics, exemplified by a stable operating environment and stable financial performance, resulting in Scope-adjusted leverage averaging around 1x in the absence of any major new growth investment plans.

A positive rating action could occur if we saw reduced investments and even more conservative financial targets in tandem with a move towards a net cash position. Could also happen if the company materially improve its diversification and/or profitability.

A negative rating action is possible if Tine's business risk deteriorated through weaker market shares and/or falling profitability. Less profitable international growth, could also trigger a negative rating action if combined with high capex and negative discretionary cash flow, leading to sustained Scope-adjusted leverage around or above 2x.

Rating history

Date	Rating action/Monitoring	Issuer rating & Outlook
16 June 2022	New	A-/Stable

Ratings & Outlook

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

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Related Methodologies or research

Corporate Rating Methodology; July 2021

Rating Methodology: Consumer Goods; September 2021

European consumer goods: ESG-linked credit risk focused on supply chains, brand value, safety

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Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Long and proven history of maintaining a conservative capital structure and generating strong FOCF over time • Very strong domestic market positions and strong brands in its main segments, with a clear number one position in Norway, while also serving as a market regulator for the dairy sector • Strong industry risk profile, characterised by low cyclicality, with some protection provided by import regulations and tariffs	• EBITDA margins are below the peer group average, although they have a stable track record. • Lower geographical diversification than some larger peers • Some ramp-up issues and lower profitability in its international business focus, and a lower amount spent on R&D/marketing overall compared to peers

Positive rating-change drivers	Negative rating-change drivers
• Introduction of even more conservative financial targets • Reduced growth and investment ambitions, while moving towards a net cash position • Improved business risk profile through higher profitability margins and/or increased diversification	• Scope-adjusted leverage around or above 2x on a sustained basis • Stronger growth ambitions with higher capex but without improved profitability, causing highly negative discretionary cash flow and higher debt

Corporate profile

Tine is Norway's largest producer, distributor and exporter of dairy products with a corporate history dating back more than 160 years. In addition to the dairy business, it is involved in the production of food products, such as juice, ice cream and fresh convenience dishes. This activity mainly takes place through wholly owned subsidiaries, such as Diplom-Is, and partially owned subsidiaries such as Fjordland. Tine has more than 1,300 product lines in its portfolio, produced at 30 dairies across Norway, and it has some operations in Ireland and the US. The majority of Tine’s international activity is in the US, Canada, Australia, Germany, Sweden and the UK, where the Jarlsberg cheese brand is its biggest export commodity. Total turnover was NOK 24bn in 2021, when the company had 5,240 employees. Tine is owned by 8,711 members (or almost 7,000 cooperative farms). The company also operates as a market regulator for milk on behalf of the Norwegian government. This role requires Tine to control milk stock volumes with the aim of keeping the average market price as close as possible to the target price.

Financial overview

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	7.2x	9.9x	9.7x	8.5x
SaD/Scope-adjusted EBITDA	1.1x	1.0x	1.1x	1.2x
FFO/SaD	83%	96%	82%	76%
FOCF/SaD	52%	50%	58%	52%
Scope-adjusted EBITDA in NOK m	**2020**	**2021**	**2022E**	**2023E**
EBITDA	3,375	3,129	2,844	2,853
Operating lease payments in respective year	152	146	140	140
Other (including gain on sale of assets)	-239	-27	0	0
Scope-adjusted EBITDA	**3,288**	**3,248**	**2,984**	**2,993**
Scope-adjusted FFO in NOK m	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA	3,375	3,129	2,844	2,853
less: (net) cash interest paid	-97	-77	-60	-100
less: cash tax paid as per cash flow statement	-119	-136	-138	-134
Adjustment: operating lease interest (estimate)	-33	-31	-30	-30
add: other cash items	-	-	-	-
Scope-adjusted FFO	3,039	3,004	2,757	2,730
SaD in NOK m	**2020**	**2021**	**2022E**	**2023E**
Reported gross financial debt	4,745	4,033	3,549	3,455
less: cash and cash equivalents	-1,710	-1,496	-796	-451
add: cash not accessible	3	3	3	3
add: pension adjustment	-	-	-	-
add: operating lease obligations (estimated, NPV)	642	591	590	590
Other	-	-	-	-
SaD	**3,679**	**3,131**	**3,346**	**3,597**

ESG profile[1]

Environment		Social		Governance	
Resource management (reduced water, energy, raw materials consumption, emissions reduction, fuel efficiencies, etc.)		Labour management		**Company control:** supervisory boards, key person risk	
Efficiencies (production process, etc.)		Safety		**Clarity/transparency** of financial disclosures, transparency of communication/ability to communicate	
Product innovation (costs of transition, substitution of products & services, green buildings, clean tech, renewables, etc.)		Clients and supply chain (geographical/product diversification)		**Corporate structure:** complexity	
Physical risks (business/asset vulnerability, diversification, etc.)		Regulatory & reputational risks		**Stakeholder management:** shareholder payouts & respect of creditors	

Legend

Green leaf (ESG factor: credit positive)

Red leaf (ESG factor: credit negative)

Grey leaf (ESG factor: credit neutral)

Clear ESG targets

Tine has put sustainability high on the agenda, and it is tracking how it can best use its resources in a more sustainable way. This includes the entire value chain in the production of milk-related products, including farmers and transporting products to customers. The company uses large quantities of plastic and cardboard packaging, and it is committed to only using recycled or renewable material by 2025. In production and transport, it will use 100% renewable energy sources and fossil-free fuel by 2030. It is also dedicated to reducing food waste by 50% by 2030 and aiming to reduce the saturated fat in its products. Some of its targets are linked to the margin on its sustainability linked revolving credit facility, and we see this as a sign of strong commitment.

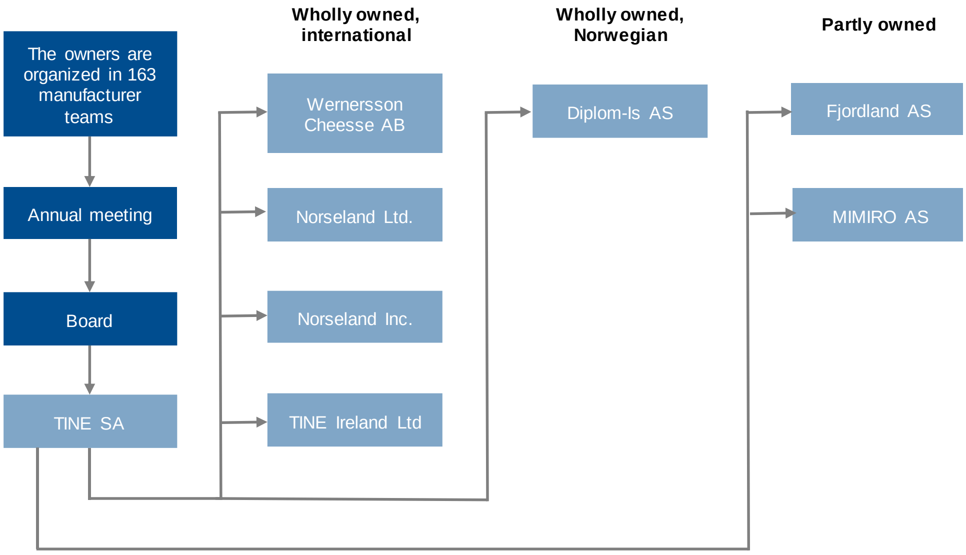
[1] The ESG profile only evaluates the extent to which ESG factors are credit-relevant. Our evaluations are not mutually exclusive or collectively exhaustive as these factors overlap and evolve. We only consider an ESG factor to be relevant to our credit rating process if it has a ubiquitously discernible and material impact on the rated entity's cash flow profile and, by extension, on its overall credit quality.

Business risk profile: BBB

Business risk profile rated BBB

Tine is predominantly exposed to the consumer products industry. Our industry analysis therefore focuses on this industry. Since Tine is a dairy cooperative and a market regulator in Norway, we also look at important structural aspects that impact the company.

Figure 1: Simplified organisational overview



Source: Company

Industry risk

Nondurable consumer products industry rated A

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

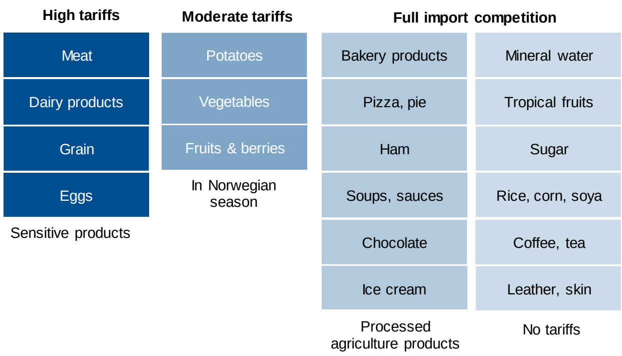
For a detailed description of the industry risk drivers for consumer product segments, see our sector-specific methodology (link on the first page of this report).

Competitive positioning

Tine's competitive position is influenced by its exposure to the Norwegian agriculture market and the political conditions in Norway. Hence, we also examine the structural aspects that affect demand and the competitive landscape. These include the following elements:

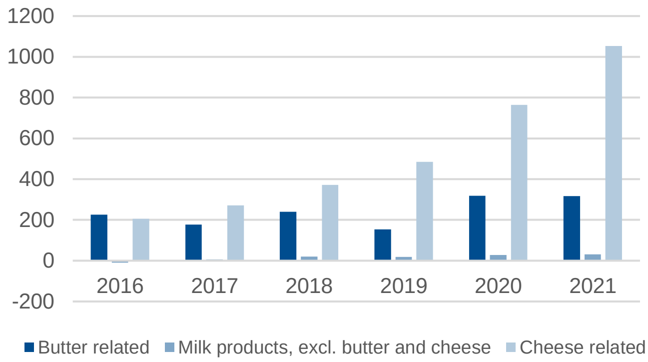
- Norway's agribusiness is greatly influenced by protective measures imposed by the government, such as subsidies and import tariffs (Figure 2). We expect these will continue to apply.
- Current policy aims to maintain a large domestic food supply to minimise import dependency and preserve arable land and agricultural traditions across the country.
- Agribusinesses are becoming larger but fewer in number, while production output is expected to remain at historical levels.

Figure 2: Grouping of Norwegian import tariffs



Source: Company reports, Scope

Figure 3: Net import (export) of dairy products in Norway 2016-21 (in NOK m)



Source: Company, SSB

The government protects the sector through several mechanisms. The main four are import regulations (tariffs), market balancing measures (subsidies), agricultural cooperatives as market regulators, and annual agricultural agreements.

Certain products are more protected than others. The level of protection depends on their sensitivity to foreign competition and their sector's importance in keeping Norway's rural areas alive and well.

In the case of milk, the target price is a measure to provide farmers with price stability and enough revenue to sustain their operations. As a market regulator TINE aims to achieve a price of raw milk as close to the target price as possible, through the equalisation scheme. Historically, this has resulted in higher prices for Norwegian agricultural products than in many other countries.

Tine benefits from economies of scale, a strong market position and direct access to feed stock. To maintain diversity in the Norwegian market, the government uses subsidies to even out differences and support Tine's smaller competitors.

Prior to 1996, the company had a government-protected monopoly on dairy operations in Norway. Since then, Tine has faced increased competition domestically and internationally. However, it has retained its leading position with an estimated 70% share of the Norwegian dairy market.

Very strong leading market position in Norway

We consider Tine's large domestic market shares to be a key competitive advantage, with brands and products that are rooted in local preferences and traditions. These strong local market positions also result from a local presence and an understanding of customer needs. Although international sales have increased somewhat, Norway remains Tine's most important and most profitable market.

Net imports of dairy products in Norway (largely cheese related) have increased over the last five years, showing slightly increased competition on certain products. Domestically, Q-meieriene (Norway's second largest dairy company) is considered a competitor.

Looking at the market shares of individual products, we see that traditional milk and yoghurt have been declining during the last five years while flavoured milk and cheeses have held up well or increased.

Consumer health products are focus areas when developing its broad product diversification

Based on current trends, such as sustainability and greater health consciousness, we expect Tine to continue renewing and developing its product portfolio to remain an attractive company for end customers. Product diversification is seen as relatively strong, with more than 700 distinct products across 32 brands. This reduces reliance on any single product, and thus we view product diversification as solid within its nondurable consumer product portfolio.

Limited geographical diversification

In terms of geographical diversification, it is slightly constrained to Norway (83%). The second largest market is the US, which contributes 10%, whilst Europe and other markets account for around 7%.

In Norway, Tine has a large and established network of 30 dairy plants throughout the country. These plants are usually located in the vicinity of populated areas, which enables the company to provide products at a lower cost. Tine drives its fresh dairy products straight from the dairy to shops. We expect Tine maintain its current distribution platform, which is based on efficiency consideration and current framework conditions.

Solid customer and supplier diversification

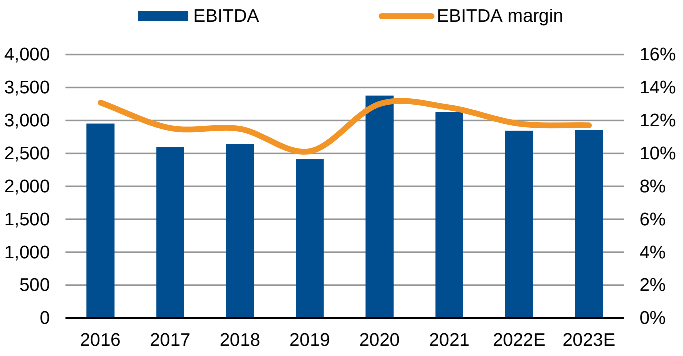
In terms of customer diversification, we note that grocers, kiosks and gas stations contribute around 75% of sales, while industrial kitchens, catering and B2C activities contribute the remaining 25% of sales. Tine's strong brands in a wide range of categories mean that chain stores depend on its products to attract customers. Industrial kitchen customers look for long-term partnerships with suppliers to create growth. We believe Tine has succeeded in the catering market by working closely with customers to offer long-lasting, codependent relationship solutions beyond product, price, and discounts.

Stable operational performance

Tine's profitability margins (expressed in terms of EBITDA margins) have averaged around 12% historically. Its absolute margin percentage is therefore below its most profitable peers, but we favour its relatively stable group margins over time, and we expect them to continue given Tine's strong market share and industry/regulatory dynamics.

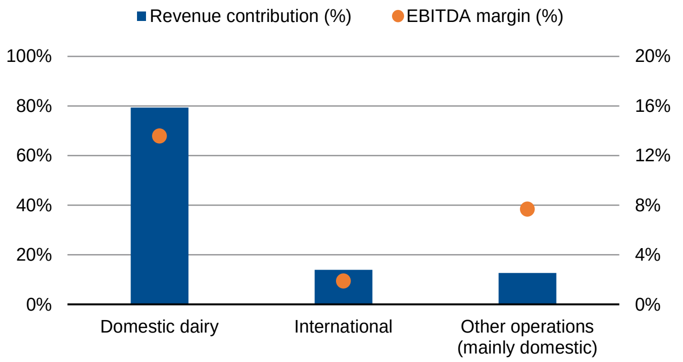
The stability of its profitability is influenced by its market regulator role, which is set by the Norwegian government. Currently, we see that the reopening of the society after the pandemic years is reducing some volumes for private consumer in stores, while cost inflation on energy, transportation, ingredients and packaging, is expected to reduce the profitability margin in 2022 compared to last year. Still, we believe that Tine's longer term underlying cost efficacy focus is good, driven by internal efforts to reduce costs to strengthen competitiveness.

Figure 4: EBITDA (in NOK m, LHS) and margin development (RHS)



Source: Company reports, Scope estimates

Figure 5: Revenue share and EBITDA margin by segment (five-year historical average)



Source: Company reports

Domestic footprint of brands is adequate, but cautious spending

Tine represents 32 different brands with a range of more than 711 products, from milk-based drinks and products derived from milk to drinks derived from fruits and cereals. Products have varying levels of visibility in the market. The biggest and best-known brand is Jarlsberg, which is one of the few brands marketed internationally.

The company spends less than average on advertising and R&D. Its media footprint is large in Norway, with advertisements on most platforms. We anticipate that it will not necessarily increase overall spending going forward but be more targeted on certain products. Moreover, a desire to continually improve efforts to address environmental and social issues should translate into the impression of a solid brand in terms of both quality and sustainability.

Financial risk profile: A+

Prudent financial risk profile with more than adequate financial flexibility

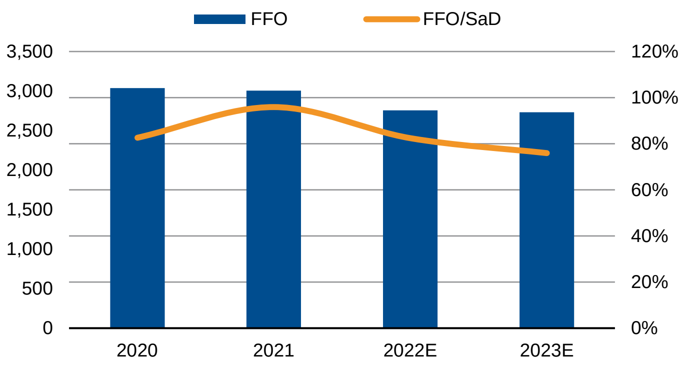
Given an SaD/EBITDA ratio that has averaged around 1x during the last two years, we consider Tine's capital structure to be conservative. The company has maintained good financial flexibility versus its maximum leverage ratio target of 2x. The financial risk profile also benefits from strong cash generation (except in 2019, which brought major investments in a new production facility in Ireland and headquarters in Oslo) and more-than-sufficient liquidity.

In 2021, domestic profitability performance continued to show good margins, while international markets showed good top line growth but much weaker profitability. Jarlsberg cheese is a key driver of performance in the international market. The Ireland production plant is still in the start-up phase, and this could preserve some negative impacts on the result this year before starting to make a more positive contribution.

Our adjustments to financial figures

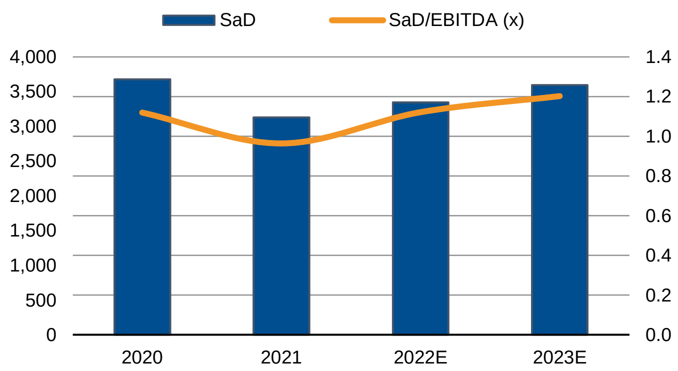
Our adjustments to Tine's financial figures include an adjustment for operating leases as the company does not apply IFRS accounting. However, we make no adjustment for its overfunding of pension assets versus liabilities.

Figure 6: FFO (in NOK m, LHS) and FFO/SaD (RHS) development



Source: Scope estimates

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



Source: Scope estimates

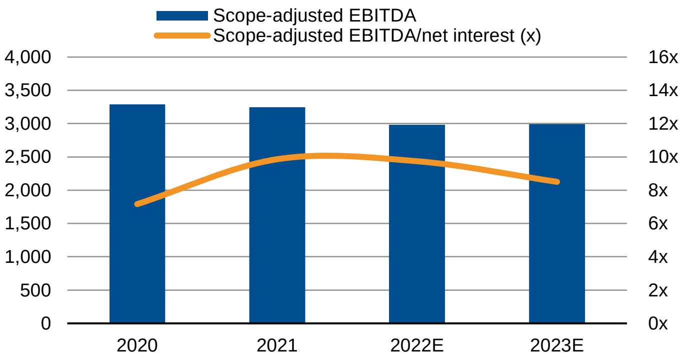
Our base case expectations show stable development

Our base case expects declining revenues in 2022 as grocery sales get back to more normal levels following strong performance in 2021 due to the pandemic. From 2023, we expect a largely flat top-line growth trajectory, with domestic sales weaker than export sales. The EBITDA margin is expected to continue to average around 12%. The regulated target price for milk, combined with volume and demand patterns from consumers, is more important for Tine than the cost inflation it sees in the market. Moreover, we have assumed that Tine will continue to experience positive effects from cost efficiency initiatives as well.

Increased capex is manageable

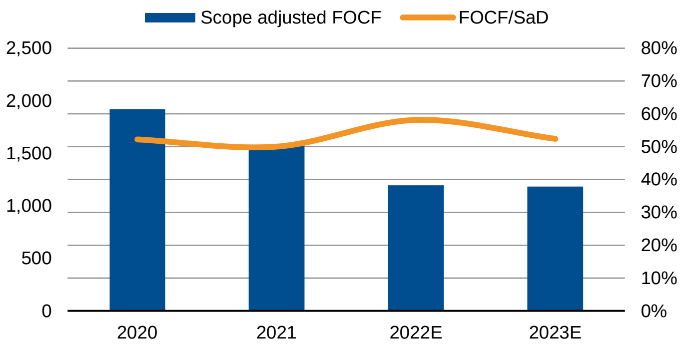
Capital expenditures are expected to be higher in 2022 and 2023 than during the last two years because the company is planning some expansionary and strategic investments. We have not included any major M&A, but given its increased financial flexibility lately, we assume that large strategic investment initiatives are likely. No disposals have been assumed. Dividend payouts or repayments to owners are assumed to be at the higher end of their official guidance of 50%-75% of net income.

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



Source: Scope estimates

Figure 9: Scope-adjusted FOCF (in NOK m, LHS) and Scope-adjusted FOCF/SaD (%, RHS)



Source: Scope estimates

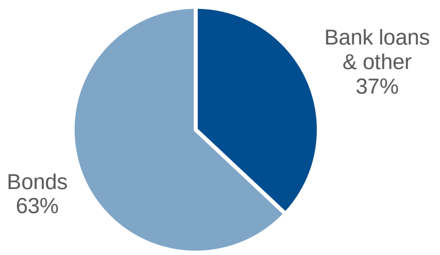
Leverage expected to stay around 1x

Given the assumptions above, we expect Scope-adjusted leverage to average slightly above 1x in the medium term and the funds from operations/SaD ratio to remain very strong at above 60% on average. The same is true for interest cover and free cash flow generation. As a result, the overall credit ratios translate into a strong A+ financial risk rating category according to the ranges defined in our Corporate Rating Methodology.

We also look at discretionary cash flows, given Tine's SA corporate structure and its ambition to repay profits (dividends) to its owners. Over time (using the six-year average), we see that this number also has been positive.

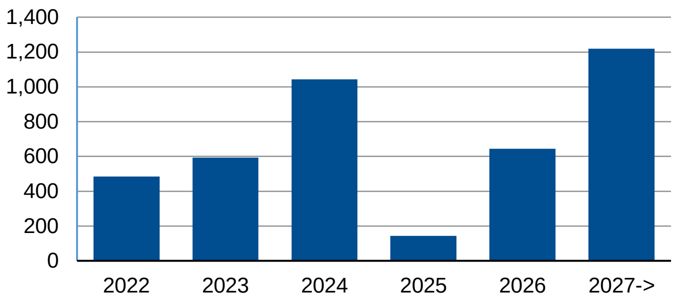
Tine's main funding sources are bilateral loans from its relationship banks as well as bonds and commercial papers in the Norwegian bond market. Liquidity is adequate based on good access to banks and domestic bond markets. As of YE 2021, the company had NOK 2.7bn in cash and undrawn credit lines, which was well above reported short-term debt of NOK 0.5bn.

Figure 10: Funding sources, as of YE 2021 (excl. leases)



Source: Company, Scope

Figure 11: Debt maturity profile, as of YE 2021 (in NOK m)



Source: Company, Scpope

Supplementary rating drivers

Financial policy

Financial policy is prudent but does not warrant rating adjustment

We make no adjustment for Tine's financial policy, which we assess as well established and prudent. Tine aims to keep its net debt/EBITDA ratio below 2x, its equity ratio above 45% and its dividend policy (or repayments to members) in the 50%-75% payout ratio range (although the latter is subject to its equity ratio being in compliance first). The company's other financial policies with respect to currency, interest rate and liquidity risks are also seen as neutral.

Ownership, structure and governance

Cooperative ownership structure with prudent governance

Tine is a cooperative owned by around 8,711 members (or around 7,000 cooperative farms) that receive part of its profit based on their sales, not invested capital. The advantage for owners is guaranteed milk sales that aim to achieve the highest possible payment for the raw ingredient, plus democratic control over the company. The members are divided into production units, and they choose representatives at the annual meeting (the company's highest governing body).

The SA ownership structure 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 view membership capital as stable based on the historical track record, but we also note that it represents an insignificant share of overall capital in the event of potential exits.

In addition, we highlight that Tine serves political and public interests. It does so through the responsibility it bears for milk regulations and through implementing agricultural policies. Ordinary market competition rules do not fully apply, but the authorities have tools to ensure the cooperatives do not abuse their position. We consider the structure to be well proven and stable, but we do not conclude that any supplementary rating adjustments are justified based on ownership, governance or structure.

Long-term and short-term debt ratings

Senior unsecured debt rating: A-

The senior unsecured debt rating is in line with the issuer rating. Tine (TINE SA) is also the bond-issuing entity.

S-1 short-term debt rating

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

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