Koninklijke FrieslandCampina N.V.

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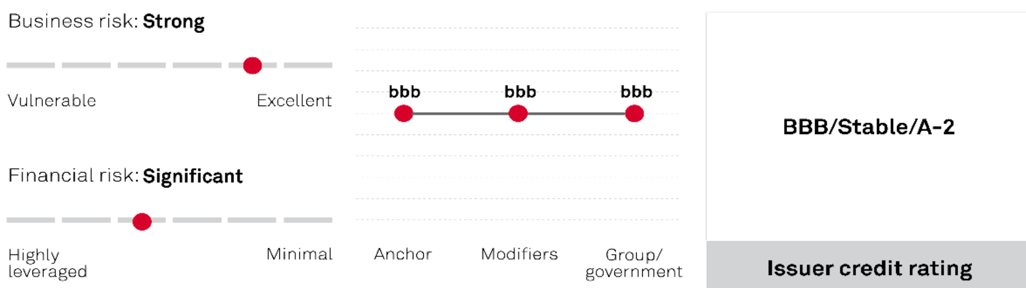
Ratings Score Snapshot



Credit Highlights

Overview

Key strengths	Key risks
One of the largest global dairy companies, with good product, channel, and geographic diversity.	Increasing scrutiny in the Netherlands around dairy farms' nitrogen emissions could weigh on dairy product businesses' profits.
Portfolio of well-known local and global brands and private label product offering provide profitable growth opportunities.	Weak consumption trends in mature markets and in volatile markets like Nigeria limit the performance of the branded dairy business.
Large presence in Asia and Africa with positive volume growth prospects.	Negative demographics and high competition in China limit growth prospects of the highly profitable infant milk formula business.
Prudent financial policy supporting an S&P Global Ratings-adjusted debt leverage ratio close to 3.5x.	Exposure to commodity dairy prices which can move sharply and impact profitability.

A sharp decline in dairy commodity prices and a difficult consumer environment have impacted Koninklijke FrieslandCampina N.V.'s (Royal FrieslandCampina's; RFC's) operational performance in 2023 and reduced its rating headroom. RFC's revenue declined by 7% in 2023, primarily reflecting an 8% revenue decline in its food and beverages division. This came from lower consumer demand for dairy products as consumers look for more affordable private-label alternatives amid high inflation and a lower purchasing power. Revenue also declined by 11% in the ingredients division, reflecting lower sales of ingredients for early life nutrition, due to the negative demographic trend in China, and for adult nutrition, as customers reduced their safety stocks. We also note that revenue were also hit by unfavorable foreign exchange movements and by the sale of part of RFC's consumer dairy activities in Germany. Excluding the adverse foreign exchange movements, the company estimates that revenue would have declined by 3.2% in 2023. The company achieved an S&P Global Ratings-adjusted EBITDA margin of 4.2%, materially lower than the 7.7% achieved in 2022. Profitability was negatively impacted by a sharp decline in dairy commodity prices last year, which weighs on profitability in the professional channel, and because inventories produced at expensive costs were sold at lower market prices. Our calculations also include €131 million one-off restructuring costs to implement the new business strategy, and €58 million for the termination of a long-term service contract. On the other hand, profitability increased in the specialized nutrition segment, thanks to a positive shift in product mix, and in the ingredients segment, thanks to strong demand for adult nutrition and sport nutrition applications. RFC achieved an S&P Global Ratings-adjusted debt to EBITDA ratio at 4.6x and funds from operations (FFO) to debt at 14.6% in 2023, which was a material weakening from the 2.7x and 30.1% achieved in the prior year. Still, the company reported positive free operating cash flow (FOCF) of €306 million in 2023, materially better than the negative €201 million reported in 2022, thanks to supportive working capital developments this year, reflecting lower cost of inventories and lower trade receivables.

We consider that RFC's strategy to profitably grow its private label proposition and to expand in emerging markets will support an improved operational performance in 2024 and further in 2025. RFC launched in 2023 its new strategic program called Expedition 2O3O, which aims to drive future growth for each business division and achieve significant cost savings. On Jan. 1, 2024, the former food and beverage division was split into five new segments with specific products, customers, and brands. In the new Europe division, RFC leverages on its strong market position and portfolio of consumer brands to gain market share in the region. In the new Middle East, Pakistan, and Africa and Asia divisions, RFC can capture the growing demand for nutritious and affordable dairy products and supportive demographic trends thanks to its portfolio of locally produced dairy products and brands. In the new Retail and Americas division, RFC is looking to build a profitable private label proposition and successfully distribute it thanks to strategic relationships with retailers and discounters in Europe, North America, and South America. The new Professional and Trading division will enable RFC to capture demand from restaurants, fast-food chains, and bakers, among other professional clients, and to achieve a flexible valorization of milk. We estimate that the new business strategy will enable RFC to successfully grow its revenue in the next two years, especially thanks to a relevant private label proposition and to supportive demographic trends in emerging markets. We estimate, however, that the strategy in Europe will be more challenging as consumers are currently looking for affordable private label propositions to protect their purchasing power. This underpins our forecast of moderate revenue decline in 2024 and growth of 2%-4% in 2025.

The new business strategy entails cost-savings initiatives that support our forecasts of improving profitability through 2024 and 2025. RFC targets cost savings of €400 million-€500 million from 2026 with significant savings to be achieved in 2024. It is looking to achieve this thanks to a more efficient supply chain, which entails the optimization of its product portfolio and harmonization of recipes to generate manufacturing efficiencies. The rest of the cost savings will come from the elimination of 1,800 jobs, which we estimate that the company can sustain thanks to an efficient manufacturing footprint. RFC paid €136 million for severance costs in 2023, which we don't expect to repeat in the next two years. The benefits from the cost savings and material reduction of restructuring costs will be partly offset, in our view, by product mix developments due to the growing share of private label offerings, which has lower margins than branded products. Therefore, we forecast RFC to post an S&P Global Ratings-adjusted EBITDA margin at 6.0%-6.5% in 2024 and 6.5%-7.0% in 2025, which is a material step-up from the 4.2% achieved last year.

RFC is well positioned, in our view, to continue its profitable growth trajectory in the Specialized Nutrition and Ingredients divisions. Those two divisions together represented 19% of 2023 revenue and generated operating profit margins of 18.9% and 11.2%, respectively, which was higher than the 3.3% achieved by the company as a whole. We view the Chinese market for specialized nutrition, especially infant nutrition, as strongly regulated and highly competitive due to the presence of local competitors and large multinationals. Additionally, the country displays negative demographic trends due to declining birth rates. We note, however, that RFC can capture demand for super-premium products thanks to its Friso Prestige brand and continues to expand into smaller cities in China. Since 2023, RFC focuses on a small number of important markets where it has a competitive edge: China, Vietnam, Malaysia, Greece, and Mexico. In the Ingredients division, RFC looks to capture the growing demand for healthy nutrition, especially medical and sport nutrition for adults. The company is looking to capture this via investments in production capacity of value-added ingredients, such as the announced project to double the capacity of its plant in the Netherlands that produces whey protein isolate.

FOCF will be constrained by planned investments to support RFC's capacity expansion and optimization plans in 2024 and 2025, yet we see the group well positioned to meet its short-term funding needs. We forecast that RFC will invest about €500 million-€550 million in capital expenditure (capex) in 2024 and 2025 to achieve its ambitions to increase production capacity of sport and infant-nutrition ingredients, as well as to support its production efficiency and sustainability projects. We also forecast working capital utilization of €50 million-€90 million in 2024 and 2025 led by higher inventories and receivables to support the growing volumes in the Ingredients and Specialized Nutrition divisions. As such, we forecast RFC to achieve an FOCF of €30 million-€50 million in 2024 and of about €100 million in 2025. Regarding capital allocation, RFC did not distribute supplementary cash payments to farmers over the weaker-than-expected operational performance in 2023. We include in our base case up to €100 million annually for potential bolt-on acquisitions to strengthen the group's portfolio of dairy brands. The company has issued €400 million and $100 million environment, social, governance (ESG)-linked notes in February 2024 on the U.S. private placement market, which it will use to repay debt due in 2024. Consequently, the new issuances enhance RFC's debt maturity profile as the instruments have maturity dates in 2032, 2034 and 2036.

Increasing scrutiny around greenhouse gas emissions from dairy farms and potential new environmental regulation represent downside risks to our base case notably for volume growth prospects and potential new restructuring. We estimate that potential new regulations from the EU and, in particular the Netherlands, where RFC is headquartered and has a sizeable share of its manufacturing footprint, increase the risk that some member farmers might quit the industry or significantly reduce the size of their livestock. We assume that RFC can manage a gradual decline in milk volumes by reducing trading volumes and gradually downsizing its dairy product manufacturing assets. This is likely to have a negative impact on profitability, but RFC is taking measures to proactively address the potential supply risk. It has opened the cooperative to new farmers, which reduces the risk that comes with potentially drastically decreasing membership numbers. RFC is also working with member farmers to progress on environmental matters for its scope 3 emissions, for example by providing them with feed additives for ruminants to reduce greenhouse gas emissions. RFC is progressing well with its target to reduce its scope-3 member milk emissions by 33% by 2030 compared with 2015, which it managed to reduce by 4.3% in 2023 versus 2022. Even though dairy products are a core business, we note that the company has relatively diversified business operations in many geographies outside the Netherlands and the EU.

Outlook

The stable outlook reflects our view that RFC will successfully restore profitable growth in 2024 and 2025 thanks to a targeted business strategy by business division, a more efficient supply chain, and lower overhead costs. This should support a lower leverage to about 3.5x in the next two years. We also forecast the company will generate positive FOCF and achieve an FFO-to-debt ratio of 15%-25% over the same period, which should enable RFC to self-fund its business expansion and sustainability projects.

Downside scenario

We could lower the ratings if RFC's operational performance deteriorates, such that its debt leverage ratio increases to 4.5x or above and its FFO-to-debt ratio decreases to 15% or below. This could happen, for example, in the case of an unexpected sharp decline in consumer and professional demand for dairy products, resulting in manufacturing inefficiencies that the company is unable to offset with cost-savings initiatives. We would also view negatively any material delays in the implementation of the new business strategy that could lead to high restructuring costs and or to negative FOCF for a prolonged period.

Upside scenario

We could raise our ratings if RFC's adjusted debt leverage ratio improves to below 3.5x and its FFO-to-debt ratio exceeds 25% on a sustained basis. This could happen, for example, if RFC successfully increases the profitability of its private label product offering and successfully captures supportive demographic trends in emerging markets, and if its restructuring efforts translate into greater cost savings than forecast, such that its EBITDA and profitability exceed our base-case expectations. We would also need to see that RFC had fully taken care of the environmental regulation related supply risk in the Netherlands. Under this scenario, RFC would also generate materially higher FOCF than we anticipated in our base case.

Our Base-Case Scenario

Assumptions

- Revenue to decline moderately by 1.5% in 2024 on the back of lower market prices in Dairy, a shift to private label sales, and the impact of disposal of the consumer business in Germany in the first quarter of 2023. We forecast revenue to grow by 2%-4% in 2025 supported by higher volume of private label dairy sales in Europe and the Americas, supportive demand for sport ingredients and adult nutrition, continued rollout of the infant nutrition strategy in China, and assuming stable prices.
- Adjusted EBITDA margin of about 6.0%-6.5% in 2024 and 6.5%-7.0% in 2025, against 4.2% in 2023, mainly driven by a significant decline in reorganization costs, complemented by cost optimization benefits from lower overhead costs and supply chain efficiency. We forecast cost optimization benefits will be partly offset by negative product mix led by a growing share of private label sales, which are less profitable.

- Capex of about €500 million-€550 million in 2024 and 2025 to support RFC's production capacity of sport and infant nutrition ingredients, as well as its production efficiency and sustainability projects.
- Cash outflow from working capital of €50 million-€90 million in 2024 and 2025 led by higher inventories and receivables to support growing revenue in the ingredients and specialized nutrition divisions.
- We include in our base case up to €100 million annually for potential bolt-on acquisitions to strengthen the group's portfolio of dairy brands.
- Adjusted debt of €2.7 billion-€3.0 billion comprises €1.4 billion of borrowings, €150 million-€160 million of lease liabilities, €165 million-€185 million of postretirement liabilities, €150 million of hybrid instruments (out of the €300 million deeply subordinated perpetual bonds to which we assess intermediate equity content), and €1.1 billion of member bonds and cooperative loan

Key metrics

Koninklijke FrieslandCampina N.V.--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. EUR)	2020a	2021a	2022a	2023a	2024f	2025f	2026f	2027f
Revenue	11,140	11,501	14,076	13,072	12,878	13,216	13,564	13,922
EBITDA	806	818	1,083	553	784	887	965	1,018
Funds from operations (FFO)	625	645	873	363	608	680	731	768
Free operating cash flow (FOCF)	299	213	(201)	306	36	101	149	173
Debt	3,630	3,240	2,902	2,541	2,767	2,970	3,335	3,687
Adjusted ratios								
Debt/EBITDA (x)	4.5	4.0	2.7	4.6	3.5	3.3	3.5	3.6
FFO/debt (%)	17.2	19.9	30.1	14.3	22.0	22.9	21.9	20.8
Annual revenue growth (%)	(1.4)	3.2	22.4	(7.1)	(1.5)	2.6	2.6	2.6
EBITDA margin (%)	7.2	7.1	7.7	4.2	6.1	6.7	7.1	7.3

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. f--Forecast. EUR--euro.

Company Description

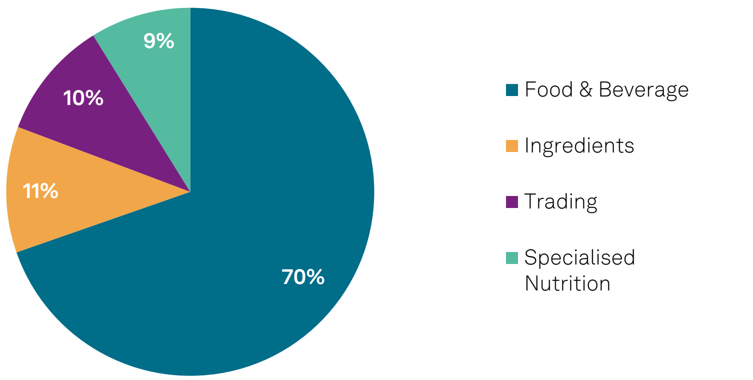
RFC is a dairy company that is fully owned by Dutch dairy cooperative Zuivelcoöperatie FrieslandCampina U.A. It generated revenue of about €13.1 billion and S&P Global Ratings-adjusted EBITDA of €553 million (4.2% margin) in 2023. In 2023, RFC operated through four business divisions:

- Food and Beverage: produces dairy products (including milk, yoghurt, condensed milk, cheese, butter, and cream), sold through consumer and professional channels. This division was split into five business groups in January 2024: Europe, Retail and Americas, MEPA (Middle East, Pakistan, and Africa), Asia, and Professional and Trading.
- Ingredients: produces ingredients for infant nutrition and offers specific innovations and applications for adults relating to medical and sports nutrition.

- Specialised Nutrition: provides dairy products for specific customer groups, including infant nutrition and adult nutrition for different stages of life. RFC produces and sells the infant nutrition brand Friso in China, Vietnam, Malaysia, Greece and Mexico
- Trading: produces and sells commodity dairy products such as cheese, butter, milk powder, raw milk, and milk concentrate. The company leverages its trading capabilities to reduce dairy price volatility risks. This division was combined with the professional division in January 2024.

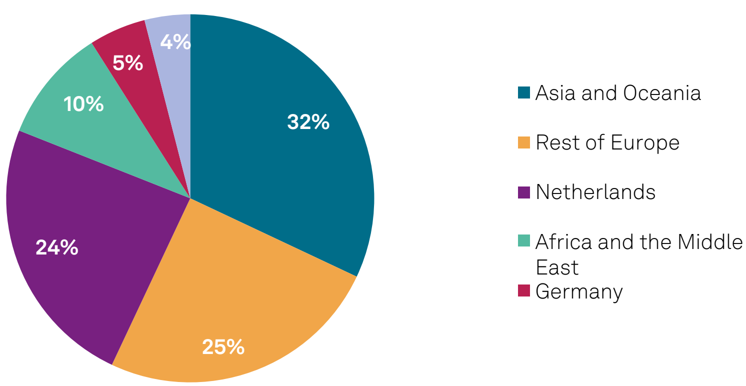
The company has branches across 29 countries and exports to more than 100 countries worldwide. In 2023, it purchased 9 billion kilograms of milk from its 14,634 cooperative members which are in the Netherlands, Belgium, and Germany.

RFC-- 2023 revenues by business division



Source: Company disclosures.

RFC--2023 revenue by geography



Source: Company disclosures.

Financial Risk

Koninklijke FrieslandCampina N.V.--Financial Summary

Period ending			Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	--	--	2020a	2021a	2022a	2023a
Display currency (mil.)	--	--	EUR	EUR	EUR	EUR
Revenues	--	--	11,140	11,501	14,076	13,072
EBITDA	--	--	806	818	1,083	553
Funds from operations (FFO)	--	--	625	645	873	363
Interest expense	--	--	95	90	75	150
Cash interest paid	--	--	51	42	42	79
Operating cash flow (OCF)	--	--	688	537	256	774
Capital expenditure	--	--	389	324	456	468
Free operating cash flow (FOCF)	--	--	299	213	(201)	306
Discretionary cash flow (DCF)	--	--	196	137	(284)	91
Cash and short-term investments	--	--	466	507	421	557
Gross available cash	--	--	466	507	421	557
Debt	--	--	3,630	3,240	2,902	2,541
Common equity	--	--	1,812	2,014	2,813	2,305
Adjusted ratios						
EBITDA margin (%)	--	--	7.2	7.1	7.7	4.2
Return on capital (%)	--	--	5.4	6.6	11.9	2.1
EBITDA interest coverage (x)	--	--	8.5	9.1	14.5	3.7
FFO cash interest coverage (x)	--	--	13.4	16.5	22.0	5.6
Debt/EBITDA (x)	--	--	4.5	4.0	2.7	4.6
FFO/debt (%)	--	--	17.2	19.9	30.1	14.3
OCF/debt (%)	--	--	18.9	16.6	8.8	30.5
FOCF/debt (%)	--	--	8.2	6.6	(6.9)	12.1
DCF/debt (%)	--	--	5.4	4.2	(9.8)	3.6

Reconciliation Of Koninklijke FrieslandCampina N.V. Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

		Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2023										
Company reported amounts		1,376	3,374	13,072	525	75	79	553	831	166	471
Cash taxes paid		-	-	-	-	-	-	(111)	-	-	-
Cash interest paid		-	-	-	-	-	-	(71)	-	-	-
Lease liabilities		152	-	-	-	-	-	-	-	-	-
Incremental lease liabilities		4	-	-	-	0	0	(0)	(0)	-	-
Intermediate hybrids (equity)		151	(151)	-	-	-	5	(5)	(5)	(5)	-

Reconciliation Of Koninklijke FrieslandCampina N.V. Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Postretirement benefit obligations/ deferred compensation	176	-	-	9	9	5	-	-	-	-
Accessible cash and liquid investments	(557)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	-	-	3	(3)	(3)	-	(3)
Dividends from equity investments	-	-	-	17	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	26	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(49)	-	-
Noncontrolling/ minority interest	-	296	-	-	-	-	-	-	-	-
Debt: Guarantees	12	-	-	-	-	-	-	-	-	-
Debt: Contingent considerations	1	-	-	-	-	-	-	-	-	-
Debt: Put options on minority stakes	12	-	-	-	-	-	-	-	-	-
Debt: other	1,215	-	-	-	-	-	-	-	-	-
Equity: other	-	(1,215)	-	-	-	-	-	-	-	-
EBITDA: Business divestments	-	-	-	2	2	-	-	-	-	-
Interest expense: other	-	-	-	-	-	58	-	-	-	-
Dividends: other	-	-	-	-	-	-	-	-	54	-
Total adjustments	1,165	(1,070)	-	28	37	71	(190)	(57)	50	(3)
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	2,541	2,305	13,072	553	112	150	363	774	216	468

Liquidity

We view RFC's liquidity as adequate, indicating that we expect its sources of cash will cover uses by at least 1.2x over the next 12 months. Even if EBITDA were to decline by 15%, we believe net liquidity sources would remain positive.

Principal liquidity sources

We estimate that liquidity sources for the next 12 months include:

- €557 million of available cash as of Dec. 31, 2023;
- €1 billion of undrawn credit facility maturing in more than one year;
- €550 million-€570 million of forecast positive cash FFO in the next 12 months; and
- €400 million and $100 million of new debt issued in February 2024.

Principal liquidity uses

We estimate that liquidity uses over the same period include:

- €658 million of debt maturing in the next 12 months;
- Working capital requirement of up to €400 million, of which we estimate €350 million to be the maximum intra-year working capital requirement;
- Capex of about €350 million-€400 million for maintenance and sustainability projects; and
- No acquisitions, dividends, share repurchases.

Covenant Analysis

Requirements

RFC shall maintain a net-debt-to-EBITDA ratio below 3.5x and an EBITDA-to-net-interest ratio above 3.5x.

Compliance expectations

The company met its financial covenants in 2023. In our 2024 base case, we forecast that RFC will maintain more than 15% headroom under the financial covenants.

Environmental, Social, And Governance

Environmental factors are a moderately negative consideration in our credit rating analysis of RFC. Environmental risks, including climate change, water scarcity, and biodiversity, are inherent to the agribusiness industry and can cause high profit volatility. As a large producer of dairy milk, the company is indirectly exposed to carbon dioxide emissions, given that dairy cows are significant methane producers. RFC actively engages with its member farmers on environmental matters, for example by providing them with feed additives for ruminants that contribute to reducing greenhouse gas emissions.

Social factors are a neutral consideration in our rating analysis, although we note that the company provides income and support to local farmers in the Netherlands by selling their dairy milk.

Governance factors are a neutral consideration in our analysis. The new CEO of RFC joined in June 2023 and has subsequently presented its new business strategy aiming at supporting sustainable growth and improving profitability. The former food and beverage division was split into five business segments with specific customers, products, and markets, and entailed restructuring costs in 2023 to achieve lower overhead costs.

Issue Ratings--Subordination Risk Analysis

Capital structure

RFC's debt structure comprises mostly unsecured instruments issued at the parent level. Priority debt accounts for less than 50% of the RFC's total debt. We rate the €1 billion commercial paper program and the deeply subordinated €300 million perpetual bonds, for which we grant intermediate equity content until first call date.

Analytical conclusions

The deeply subordinated perpetual bonds of €300 million are rated 'BB+', two notches below our issuer credit rating on RFC, reflecting one notch for subordination risk and one notch for optional interest deferability. We assess the hybrid bonds have intermediate equity content (50% equity, 50% debt) until the first call date.

The commercial paper program is rated 'A-2', and is derived from the 'A-2' short-term issuer credit rating on RFC.

Rating Component Scores

Foreign currency issuer credit rating	**BBB/Stable/A-2**
Local currency issuer credit rating	**BBB/Stable/A-2**
Business risk	**Strong**
Country risk	Low
Industry risk	Intermediate
Competitive position	Strong
Financial risk	**Significant**
Cash flow/leverage	Significant
Anchor	**bbb**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb**

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Industry Credit Outlook 2024: Consumer Products, Jan. 9, 2024
- Bulletin: Lower Dairy Product Profitability And New Restructuring Costs Reduce FrieslandCampina's Rating Headroom, Oct. 18, 2023

Ratings Detail (as of July 01, 2024)*	
Koninklijke FrieslandCampina N.V.	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated	BB+
Issuer Credit Ratings History	
25-Jun-2021	BBB/Stable/A-2
19-Apr-2019	BBB/Negative/A-2
25-Apr-2018	BBB+/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.