S&P Global Ratings

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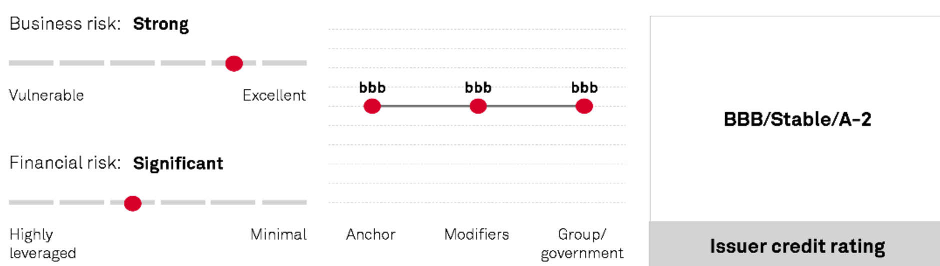
Koninklijke FrieslandCampina

May 31, 2022

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
One of the largest global dairy groups with good product, channel, and geographical diversity.	Exposure to volatile raw materials and supply chain costs can be mostly passed through to clients, but with delays.
Portfolio of well-known local and global brands provide pricing power.	Exposure to high-risk countries like Nigeria bring foreign exchange volatility.
Large presence in Asia and Africa allows positive volume growth prospects.	Declining total demand and high competition in China for infant milk formula.
Changes in capital structure should help deleveraging to below 4.0x in 2022-2023.	Profitability affected by ongoing efforts to optimize cost structure and drive operating efficiencies.

Continued consumer demand and recovery in out-of-home consumption set the stage for revenue growth in Koninklijke FrieslandCampina's (Royal FrieslandCampina or RFC) food and beverage business. Revenues from this division grew by 4.3% in 2021. This was mostly supported by the gradual recovery in out-of-home consumption, strong e-commerce demand, and price increases. In 2021, revenue from the food and beverage business included about 1.5% of adverse currency impact, and the disposal of RFC's Russian consumer activity. For the professional channel, we forecast that RFC will benefit from the likely reducing COVID-19 restrictions on out-of-home consumption in 2022 and 2023. We estimate that RFC can capture the growing demand from this channel thanks to its relationship with hotels, restaurants, and cafés, which is supported by its wide product range across pizza, coffee and tea enhancers, cream, and desserts. We also expect RFC's recent product introductions--such as the Debic cream plus mascarpone for pastry chefs in several European countries and Valess vegetarian nuggets in the fast-food segment--to support revenue growth in this channel.

RFC's exposure to emerging markets and innovation capabilities provides further growth opportunities, in our view. In its consumer channel, RFC aspires to capture the growing consumer demand in emerging markets for nutritious dairy breakfast products, which we think it can achieve thanks to its exposure to Africa, the Middle East, Asia, and Oceania regions for 40%-45% of 2021 revenues. In more mature markets, we consider that RFC's innovation capabilities to meet evolving consumer expectations will drive further revenue growth opportunities. Examples of recent innovations include the Campina Réveil Malin high-protein breakfast dairy products in France, and the Valess vegetarian burgers. Overall, we forecast RFC's revenues from the food and beverage division to grow by 4%-5% in 2022. Our base case considers new price increases that the company can achieve to mitigate the ongoing cost inflation thanks to its strong brands and its relationship with its professional clients.

We anticipate that difficult market conditions for infant nutrition in China will continue to weigh on RFC's performance in the specialized nutrition and ingredients divisions. In 2021, RFC's revenue in the specialized nutrition market declined by about 3.5% and revenue in the ingredients division grew moderately by 1.5%. These divisions are exposed to the difficult conditions in China's infant nutrition market caused by heavy regulations, pandemic-related border closures with Hong-Kong, intense competition with local and international participants, and the declining birth rate. To counteract this, FrieslandCampina is looking to benefit from the growing demand for adult nutrition and sport nutrition thanks to new product introductions, such as the recently launched plant-based protein sport product under the Plantaris brand. The infant nutrition market is also subject to the premiumization trend, which the company can benefit from thanks to its Friso Prestige brand. The company's focus on growing its online sales and expanding its reach to smaller cities in China provides further growth opportunities, in our view. We forecast stable revenue from the specialized nutrition and ingredients divisions in 2022 and 2023, between negative 1.5-positive 1.5 annually, amid continued difficult market conditions. In December 2021, RFC announced that it is exploring strategic options for its infant nutrition activities under the Friso brand. We will update our forecast when the strategic review completes, and we can evaluate the effect on business prospects.

We anticipate that RFC will offset most cost inflation across milk, packaging, other materials, and labor with price increases, which can happen with some delays in certain business divisions and geographies. RFC's relationship with professional clients in the food and beverage and ingredients businesses allow for some contractual pass-through of the raw material cost increases, although this can happen with delays in some jurisdictions. In its consumer business, RFC is actively engaging with its retail partners to apply its pricing strategy, which we think it can successfully implement thanks to its portfolio of branded products and innovation capabilities. We also consider that the company can efficiently pass the higher cost of dairy through in its trading business. On the other hand, we think that the strong regulatory environment for infant nutrition results in limited pricing power, although the growing demand for super-premium products that have a higher margin could partly mitigate the effect of higher costs.

We forecast that RFC's higher investments in marketing and the cost of reorganization will pressure its profit margins in the next 24 months. RFC is stepping-up its marketing effort to support its pricing strategy. Investments in advertising and promotion represented about 4.4%-4.5% of sales in the past two years, and we forecast them to increase to 4.5%-5.0% in 2022 and 2023. Additionally, the company announced several reorganization projects to optimize its organization and cost structure, such as the merger of the Dutch production and logistic assets for fresh dairy and the closure of two milk powder towers in the Netherlands. The company has already stated that the above initiatives will result in approximately €45 million of exceptional costs. Overall, we forecast RFC to achieve an S&P Global Ratings-adjusted EBITDA margin in the 6.0%-6.5% range in 2022 and 2023, lower than the 7.1% achieved in 2021.

We forecast RFC to continue generating substantial annual free operating cash flow of at least €100 million in 2022 and 2023, despite planned investments to increase capacity and ensure continuity of supply. Our base case includes €450 million-€460 million of capital expenditure (capex), of which about €150 million is for the maintenance and efficiency of the current network. Growth capex will support investments in new dairy factories in the Netherlands, Malaysia, and Indonesia. We also anticipate about €25 million-€30 million of annual working capital requirement to support the growing revenues, reflecting the impact of inflation on inventories and trade receivables. We consider that the company's decision to increase its inventories provides some protection against the risk of shortages caused by ongoing pandemic-related supply chain disruptions and the Russia-Ukraine conflict.

The new member financing framework provides a greater balance between member's capital and milk delivery, and increases rating headroom. In January 2022, RFC issued €752 million of milk certificates, of which €584 million comes from member bonds converted into milk certificates. The remainder is from member farmers that use their owned liquidity to acquire milk certificates and from the company granting a deferred payment scheme over a 12-year period to smooth the transition. Member bonds continue to be part of the capital structure. Farmers need to hold a certain level of milk certificate for a predefined volume of milk delivered to the cooperative, which helps with balancing member's capital with their milk delivery, in our view. We consider that fewer member bonds in RFC's capital structure reduces its debt burden and will result in improved credit metrics. We forecast RFC to achieve an adjusted debt leverage ratio of 3.5x-3.7x in 2022 and 2023, compared with 4.1x in 2021. The company has amended its financial policy with the introduction of supply certificates so that 40% of profits will be paid as supplementary cash payment to farmers, and 60% will be kept as retained earnings.

We anticipate limited immediate effects from the Russia-Ukraine conflict on RFC's operations, but we think that it could drive long-term challenges depending on the length of the conflict. The group disposed of its Russian consumer operations in 2021 amid its initiatives to optimize its cost structure and divest noncore assets and has no direct operations in Russia or Ukraine. RFC currently has marginal exposure to the Russian market through sales distribution and we do not anticipate any material effect on its revenues. In case of prolonged conflict, we consider that challenges could arise and reduce the group's profitable growth prospects. Major risks include continued high inflationary pressure and regulatory uncertainty, which could accelerate the decline in the number of dairy farmers and ultimately decrease the volumes of milk supplied to the group.

Outlook

The stable outlook reflects our view that RFC will achieve an adjusted debt to EBITDA ratio of 3.5x-4.5x in the next 24 months, thanks to the recent implementation of its new member financing framework. We also forecast the group to generate substantial free cash flow and achieve a funds from operations (FFO) to debt ratio of 15%-25% over the same period, which should enable the group to self-fund its business expansion 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 if, for example, RFC is unable to pass on the high inflationary costs in raw materials, energy, labor, and the supply chain to its retail and foodservice customers, resulting in lower profitability and greater working capital requirements compared with our base case. This could also happen in case of material setbacks in the company's expansion projects that would result in lower operational efficiencies and higher capex requirements for a prolonged period.

Upside scenario

We could raise our ratings if RFC improves its adjusted debt-leverage ratio to below 3.5x and its FFO to debt ratio sustainably exceeds 25%. This could happen, for example, if RFC successfully captures the growing consumer demand for high-protein dairy and growing out-of-home consumption, and if the group applies an efficient pricing strategy, such that its EBITDA and profitability exceed our base-case expectations. Under this scenario, we anticipate that RFC will generate materially higher free cash flow than our base case.

Our Base-Case Scenario

Assumptions

- Revenue growth of 2%-4% in 2022 and 2023. We anticipate that RFC will capture the growing demand for high-protein dairy and benefit from growing out-of-home consumption, thanks to its innovative capabilities and its relationship with hotels, cafés, and restaurants. We forecast that continued difficult market conditions in China's infant nutrition market will likely hinder revenue growth in the specialized nutrition and ingredients divisions.
- EBITDA margin of about 6.0%-6.5% in 2022 and 2023, lower than the 7.1% achieved in 2021. Our assumption considers that raw material and labor inflation, and planned investments in marketing and restructuring costs will be partly offset by price increases and the operational efficiencies from recent initiatives to optimize costs and divest noncore assets.
- Capex of about €450 million-€460 million in 2022 and 2023 to support planned investments in new factories.
- Working capital requirement of €20 million-€30 million to support the growing revenue, considering the effect of raw material inflation on inventories and trade receivables.
- Supplementary cash payment to farmers of €10 million-€20 million in 2022.
- We include in our base case up to €30 million annually for potential bolt-on acquisitions in the food and beverage division.
- Adjusted debt of €2.75 billion. This mostly comprises €1.14 billion of borrowings, €180 million-€200 million of lease liabilities, €200 million-€210 million of postretirement liabilities, €150 million hybrid instrument (out of the €300 million deeply subordinated perpetual bond for which we grant intermediate equity content), and €1.2 billion of member bonds.

Key metrics

Koninklijke FrieslandCampina--Key Metrics*

Mil. €	2020a	2021a	2022f	2023f	2024f
Revenue	11,140	11,501	11,750 - 11,950	12,100-12,300	12,300-12600
Revenue growth (%)	(1.4)	3.2	2-4	2-4	2-4
EBITDA	806	818	710- 770	730-800	750-850
EBITDA margin (%)	7.2	7.1	6.0-6.5	6.0-6.5	6.0-7.0
Free operating cash flow (FOCF)	300	217	~100	100-120	110-140
Debt to EBITDA (x)	4.5	4.0	3.5-3.7	3.5-3.7	~3.5
FFO to debt (%)	17.2	19.3	20-23	20-23	20-23

*All figures adjusted by S&P Global Ratings. a--Actual. f--Forecast.

Company Description

RFC is a dairy company that is fully owned by Dutch dairy cooperative Zuivelcoöperatie FrieslandCampina U.A. The latter counted 15,703 members, which are dairy farmers from the Netherlands, Belgium, and Germany and supplied close to 10 billion kilograms of milk in 2021.

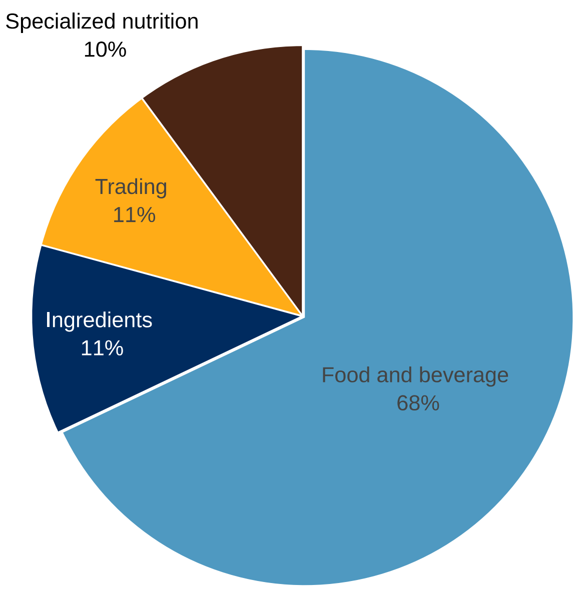
The company generated €11.5 billion of revenue and €818 million of adjusted EBITDA in 2021. RFC is among the top 10 largest dairy producers globally alongside companies like Danone S.A. (BBB+/Stable/A-2), Dairy Farmers of America Inc. (BBB/Stable/A-2), and Fonterra Co-operative Group Limited (A-/Stable/-2). RFC operates in four business divisions:

- Food and beverage: producing dairy products, including milk, yoghurt, condensed milk, cheese, butter, and cream, that are sold through the consumer and professional channels.

- Specialized nutrition: providing dairy products for specific customer groups, including infant nutrition and adult nutrition during different stages of life.
- Ingredients: producing ingredients for infant nutrition and ingredients for adult nutrition relating to medical and sport nutrition.
- Trading: producing and selling commodity dairy products such as cheese, butter, milk powder, raw milk, and milk concentrate. The company leverages on its trading capabilities to protect against dairy price volatility risks.

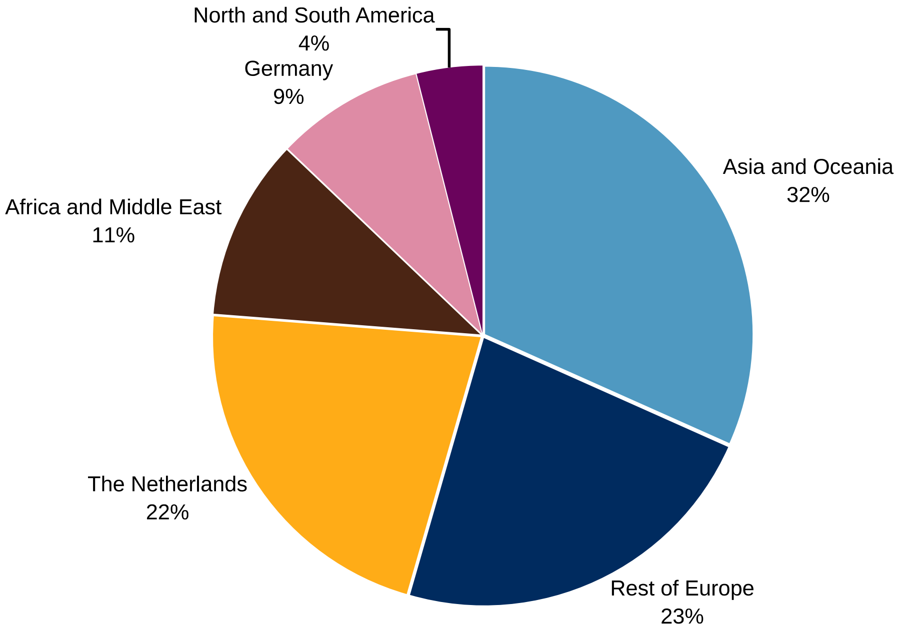
RFC operates in 32 countries and exports to more than 100 countries.

RFC--2021 Revenue By Business Division



Source: Company disclosures.

RFC--2021 Revenue By Geography



Source: Company disclosures.

Financial Risk

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-31-2021									
Company reported amounts	1,140	3,635	11,501	834	355	37	818	594	42	326
Cash taxes paid	-	-	-	-	-	-	(132)	-	-	-
Cash interest paid	-	-	-	-	-	-	(35)	-	-	-
Lease liabilities	205	-	-	-	-	-	-	-	-	-

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
Intermediate hybrids (equity)	151	(151)	-	-	-	5	(5)	(5)	(5)	-
Postretirement benefit obligations/ deferred compensation	208	-	-	(46)	(46)	4	-	-	-	-
Accessible cash and liquid investments	(385)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	-	-	2	(2)	(2)	-	(2)
Dividends from equity investments	-	-	-	17	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	30	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(51)	-	-
Noncontrolling/ minority interest	-	326	-	-	-	-	-	-	-	-
Debt: Guarantees	56	-	-	-	-	-	-	-	-	-
Debt: Contingent considerations	4	-	-	-	-	-	-	-	-	-
Debt: Put options on minority stakes	65	-	-	-	-	-	-	-	-	-
Debt: other	1,797	-	-	-	-	-	-	-	-	-
Equity: other	-	(1,797)	-	-	-	-	-	-	-	-
EBITDA: Business divestments	-	-	-	13	13	-	-	-	-	-
Interest expense: other	-	-	-	-	-	42	-	-	-	-
Dividends: other	-	-	-	-	-	-	-	-	38	-
Total adjustments	2,100	(1,622)	-	(16)	(3)	53	(174)	(58)	34	(2)

S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**

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
	3,240	2,014	11,501	818	352	90	645	537	76	324

Liquidity

We assess RFC's liquidity position as adequate. We forecast that liquidity sources will cover uses by more than 1.2x in the next 12 months, and that liquidity sources will exceed liquidity uses if EBITDA declines by 15%.

Principal liquidity sources

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

- €507 million of cash as of December 2021;
- €1.0 billion of undrawn credit facility available until 2024; and
- €500 million-€550 million forecasted positive cash funds from operations in the next 12 months.

Principal liquidity uses

We estimate that liquidity uses over the same period include:

- €189 million of debt maturing in 2022;
- Estimated €350 million of maximum seasonal working capital requirement, which the company manages with its commercial paper program and anticipated €20 million-€30 million annual requirement; and
- €450 million-€460 million of capex forecasted in 2022.

Covenant Analysis

Requirements

RFC shall maintain a net debt to EBITDA ratio below 3.5x and shall maintain an EBITDA to net interest ratio above 3.0x.

Compliance expectations

In our base case we forecast that RFC will maintain more than 15% headroom under the financial covenants.

Environmental, Social, And Governance

ESG Credit Indicators

N/A--Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental factors are a moderately negative consideration in our credit rating analysis on Koninklijke FrieslandCampina because environmental risks (including climate change, water scarcity, and biodiversity) are inherent to the agribusiness industry and can cause high degree of profit volatility. As a large producer of dairy milk from farmers, the group is indirectly exposed to CO_2 emissions given that dairy cows are large methane producers. RFC actively engages with its member farmers on environmental matters by, for example, providing them with feed additive for ruminants that contribute to reducing greenhouse gas emission. Social and Governance factors are a neutral consideration in our rating analysis, although we note that the group is providing income and support to local farmers in the Netherlands by selling their dairy milk.

Issue Ratings--Subordination Risk Analysis

Capital structure

The debt structure comprises mostly unsecured instruments issued at the parent level. Priority debt accounts for well below 50% of the group's total debt. The only rated instrument in RFC's capital structure is the deeply subordinated €300 million perpetual bonds for which we grant intermediate equity content.

Analytical conclusions

The deeply subordinated perpetual bonds are rated 'BB+', two notches below RFC's issuer credit rating, reflecting subordination risk and optional interest deferability.

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	Satisfactory (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

Ratings Detail (as of May 31, 2022)*

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
07-Sep-2017	BBB+/Stable/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.