



ISSUER RATING

Short-Term

Initiation date 28/11/2022
Rating date 10/11/2023

Contacts

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RATING ACTION AND RATIONALE

- EthiFinance Ratings has reaffirmed a short-term corporate rating of EF3 for Sodiaal International. Sodiaal International is the main industrial and financing holding of the Sodiaal group, but financial statements are produced for Sodiaal Union, the ultimate parent holding which is a cooperative. Since most production assets are owned directly or indirectly by Sodiaal International, and most financial debt is located in Sodiaal International, our rating for Sodiaal International is considered to be equivalent to the rating of Sodiaal Union as per our methodology.
- Our rating factors in Sodiaal's good market share and brand image in France and elsewhere in Europe through its main brands Candia, Entremont, and Yoplait. Despite the economic environment over the past 18 months, as post-Covid recovery gave way to high inflation and rising interest rates, Sodiaal's EBITDA margin suffered less than expected in 2022, and will probably improve in 2023, resulting in expectations of significantly higher EBITDA for 2023 compared with that in 2022. In addition, net adjusted debt is expected to be broadly stable in 2023. Consequently, we expect the EthiFinance Ratings-adjusted net leverage ratio to improve again, to 4.7x at end-2023 (from 6.6x at end-2021 and 5.7x at end-2022). Product diversification is also a positive driver of our rating as Sodiaal has extensive know-how and covers a wide range of milk-derived products.
- Our rating is, however, still constrained by rather poor credit metrics. Despite being on a positive trend, our net adjusted leverage ratio is still high and constrained by Sodiaal's limited room for margin improvement. FFO is rather low and almost never covers the level of capex needed in such a capital-intensive sector. In addition, Sodiaal has extensive recourse to factoring, which weighs on its adjusted net debt. As a result, the FFO/net debt ratio is particularly poor. Geographic diversification, albeit a direct consequence of Sodiaal's cooperative status, is also a constraining factor as the group is largely focused on the French market and therefore relies on food trends in the country and the purchasing power of French consumers.
- According to our methodology, the agribusiness sector has medium-to-high ESG risks (heatmap score of between 3.5 and 4) given its impact on the environment, which slightly constrains our industry assessment. Our assessment of the company's ESG policy is neutral (company ESG score of between 1.5 and 3.5), resulting in our rating being slightly constrained by industry-related ESG considerations.

ISSUER DESCRIPTION

Headquartered in Paris, Sodiaal Union is a French cooperative specialized in the collection of milk and then its transformation and conditioning into various dairy products. It is one of the largest milk producers in France, with over 16,000 producers collecting around 4.3 billion litres of milk annually. The collected milk is used to produce a wide range of dairy products, including fresh milk, cheese, butter, and milk ingredients, to name a few, under well-known brands such as Candia, Entremont, and Yoplait. For FY22, Sodiaal Union reported revenues of €5.5bn, up 18.4% from FY21, largely as a result of higher dairy product prices more than offsetting a decline in the volume of milk collected, and EBITDA of €148m. Our EthiFinance Ratings-adjusted net leverage ratio was 5.7x at end-2022.

FUNDAMENTALS

BUSINESS RISK PROFILE

INDUSTRY RISK ASSESSMENT

- Long-term growth supported by resilient demand and related to GDP and population growth**

Dairy products are central to people's diets and are consumed daily in different forms. The importance of milk derivatives supports demand, and the market is therefore quite

resilient to economic downturns. The sector's main growth drivers are changes in per capita consumption and growth of the global population. In Europe, per capita consumption is expected to remain rather flat in the years ahead, whereas population growth is expected to be 1.5% between 2022 and 2026, according to Statista. However, in some emerging markets in North Africa or the Middle East, with rising incomes and increasing populations, dairy consumption is expected to be stronger in the years ahead. Overall, we estimate that growth for the industry will probably be much in line with GDP growth.

- **Stringent regulations and high capital requirements constitute strong barriers to entry**

Due to the health sensitivity of dairy products, the industry is subject to stringent food safety regulations. Players must comply with rules through the entire production process, as breaches may result in fines or even suspension of production. Companies in the sector also face high capital requirements in order to build or to renovate factories, to respond to the evolution of demand and safety regulations.

- **The overall profitability of the food industry is good, but characterized by some revenues volatility, as both average selling price and costs are driven by commodity prices, partly mitigated by the French EGALIM law.**

The overall profitability of the food industry is quite good with average EBIT margins around 13% (equivalent to a score of BBB+ for the profitability criterion). Sodiaal's revenues are usually driven by trends in milk prices and the volume of milk collected from its farmers, with profitability also impacted by production costs, especially prices for grains and energy. Sodiaal purchases its milk from its farmers, whose production costs are correlated to the costs of feeds. Energy prices constitute a significant part of costs as Sodiaal is responsible for organizing the collection of milk through trucks and processing it in its factories. Commodity prices are affected by various factors, such as adverse weather or war, as evidenced by the surge in prices in 2022 following the start of the war in Ukraine. Milk prices usually follow commodity prices but with a time lag. The strong correlation between selling prices and the volatile commodity markets adds to the high level of uncertainty in revenues - and to some extent profitability - of the sector. However, under the new EGALIM law in France, negotiations occur to ensure fair pricing along the value chain, which reduces price volatility but does not prevent some lag between increases in production costs and Sodiaal's ability to pass them through to customers after negotiations.

COMPANY'S COMPETITIVE POSITIONING

- **Leading player in the French dairy industry with a special business model**

Sodiaal is a leading player in the French dairy industry and one of Europe's 10 largest dairy companies. The group enjoys a significant market share in France, behind Lactalis and Danone. The group also owns some brands that are popular not only in France but also in other countries, such as Yoplait. However, Sodiaal is a cooperative, a special business model as the company's suppliers, the milk farmers, own the company. As a consequence, Sodiaal cannot switch to lower-cost sources, and is compelled to collect milk from its farmers, sometimes in remote areas. Additionally, competition is fierce in the dairy industry in France. As a consequence, Sodiaal's EBITDA margins are significantly lower than those of its main competitors (Sodiaal's EBITDA margin was 3.6% on average over 2020-22).

- **Great range of product offerings but with limited geographic diversification**

As a leading player in the dairy market, Sodiaal has a wide range of products to offer, ranging from everyday food and beverages - such as milk, cheese, and yogurts - to nutrition products and food additives. However, the group lacks diversification on the geographic side as more than 90% of its sales are generated in Europe, with a significant concentration on the French market.

GOVERNANCE

- **Shareholder profile: a cooperative owned by milk farmers**

Sodiaal Union's shares are owned by its milk producers. The farmers elect 25 milk producers to sit on the board, which supervises the executive committee. The unique holding structure may give incentives to the producers, but it also constrains the company's margin by limiting its ability to source from lower-cost milk suppliers, unlike some of its peers.

- **Management quality: neutral financial policy with average track record**

We view Sodiaal's financial policy as 'neutral'. Although it has not conducted many M&As, unlike its peers, the group has a relatively high net leverage ratio. Sodiaal managed to limit the loss in margins during the pandemic, showing the group's resilience, but its track record is characterised by only average credit metrics.

- **ESG policy: building a sustainable farming system**

Sodiaal's ESG strategy focuses on building a sustainable system that supports its different stakeholders. On the environmental side, more than half of its farmers voluntarily conduct ecological assessments and work on solutions to reduce emissions; the group is also committed to improving animal welfare and responsible procurement. The group has set clear targets which are reported in its integrated report. For instance, it targets a reduction of 30% of its scope 1 & 2 emissions between 2019 and 2030, and had already achieved a reduction of 16% at end-2022. The group also targets a reduction of 25% of its water consumption between 2019 and 2025, and had already achieved a reduction of 14% at end-2022.

FINANCIAL RISK PROFILE

RESULTS AND PROFITABILITY

- **Strong increase in revenues but no reflection in EBITDA margins so far**

Sodiaal reported €5.5bn of revenues for FY22 (+18% vs FY21). The increase actually reflected contrasting trends: on one side, revenues were lifted by a strong price effect owing to the consequences of several rounds of negotiations with clients to pass on commodity price increases; and on the other, there was a decrease of 2.5% in milk collection. As expected, the lag between the increase in commodity prices and the pass-through to clients offset the expected improvement in margins resulting from cost-cutting measures over recent years. As such, adjusted EBITDA margin has remained stable around 3.6% between 2021 and 2022. Going forward, as prices normalise, we expect margins to improve and to lie in the range 4.2-4.4% over our forecast period (2023-25).

CASHFLOW AND LEVERAGE

- **Below average credit metrics a reflection of Sodiaal' specific business model**

Sodiaal's credit metrics derive from its business model, one which constrains its EBITDA, thereby resulting in a rather high EthiFinance Ratings-adjusted net leverage ratio (5.7x as of end-2022). We have forecast a gradual improvement in our adjusted net leverage ratio over our forecast period, to 4.1x at end-2025. We also expect some slight improvement in other credit metrics, such as the FFO/net debt and interest coverage ratios, on the back of improved EBITDA and adjusted FCF.

CAPITALIZATION AND LIQUIDITY PROFILE

- **Well-spread maturities but a significant recourse to factoring**

As of December 31, 2022, Sodiaal's gross reported debt stood at €820m. It mainly

comprised private placements such as USPPs or Shuldscheins, as well as a €700m RCF. Maturities of Sodiaal's debt are rather long and well spread. Our debt adjustments amounted to €635m as we added back several items we consider debt-like, such as employee benefits, operating leases, and factoring (€382m, equivalent to 62% of total receivables at end-2022). Net adjusted debt was €1.1bn at end-2022.

- **Excellent liquidity profile with strong refinancing capacity**

Sodiaal's liquidity profile is 'superior' as per our methodology, as the company can repay all its upcoming debt without refinancing for more than two years. We also believe the company can get financing from financial institutions relatively easily, especially considering its pivotal role in the French dairy market, but may struggle to get financing through capital markets because of its special business model.

MODIFIERS

- **Controversies**

Over the course of our review, we have found one controversy regarding an ongoing investigation launched in 2022 by the French anti-trust authorities regarding possible collusion on prices between competitors. At this stage of the investigation, our rating has not been impacted by controversies as Sodiaal has not received any fines or been instructed to change its business model. EthiFinance Ratings will continue to monitor the situation and will adjust its controversy score based on the results of the investigation.

- **Country risk**

Sodiaal mainly operates in France and in Europe, and therefore does not present any specific country risk.

MAIN FINANCIAL FIGURES

Main financial figures, millions of EUR					
	FY20	FY21	FY22	21vs20	22vs21
Turnover	4,835	4,668	5,527	-3.4%	18.4%
EBITDA (adjusted)	172	167	197	-3.2%	18.0%
EBITDA Margin	3.6%	3.6%	3.6%	0.0pp	0.0pp
EBIT	22	35	25	62.2%	-28.4%
EBIT Margin	0.4%	0.8%	0.5%	0.3pp	-0.3pp
EBT	-35	-5	-70	86.4%	n/a
Total Assets	2,351	2,841	2,820	20.9%	-0.7%
Equity	728	729	580	0.1%	-20.4%
Total Financial Debt (adjusted)	1,218	1,508	1,446	23.9%	-4.1%
Net Financial Debt	959	1,102	1,129	14.9%	2.5%
Equity/TFD	59.8%	48.3%	40.1%	-11.4pp	-8.2pp
NFD/EBITDA	5.6x	6.6x	5.7x	1.0x	-0.9x
Funds From Operations	96	70	94	-2.1%	35.1%
FFO/NFD	12.9%	8.9%	11.3%	-4.1pp	2.4pp
EBITDA/Interest	5.0x	4.2x	4.4x	-0.8x	0.2x

EBITDA is adjusted for operating leases, dividends received under the equity method (mainly before the acquisition of Yoplait), and profit sharing (until 2021).

Total adjusted debt is mainly adjusted for the capitalisation of operating leases, factoring and the provision for pensions.

CREDIT METRICS EXPECTED EVOLUTION (CMEE)

- **Stable CMEE**

We have assigned a Stable CMEE as we expect the group's credit metrics to remain broadly unchanged in a years' time.

RATING SENSITIVITY

- **List of ratings:**
 - **ST Corporate Rating: EF3**

- **Short-term rating positive factors (↑)**

With a Stable CMEE and 'superior' liquidity profile, an upgrade of our short-term rating would result from a two-notch upgrade of our long-term rating used as a reference, which is improbable in the near future in the current economic environment, and because of Sodiaal's specific business model. Such an upgrade would indeed require a significant improvement in the financial risk profile, with notably a sustainable net adjusted leverage ratio around 3.0x.

- **Short-term rating negative factors (↓)**

A deterioration of our short-term rating would require a two-notch downgrade of our long-term rating used as a reference, all things being equal, or a one-notch downgrade associated with a Negative CMEE or a deterioration of the liquidity profile to 'adequate'. Such a deterioration of the long-term reference rating could occur should the net adjusted leverage ratio return to 6.0x on a sustainable basis or should our controversy score be revised to higher or equal to 4/5.

REGULATORY INFORMATION

LEI: 549300HXJ1AT1KPDWE81

Initiation report: No

Rating initiation: EF3 on November 28, 2022

Last rating action: Initiated at EF3 on November 28, 2022

Rating nature: Solicited, short-term, public rating

With rated entity or third-party participation: Yes, the rating was issued after having been reviewed by the issuer.

With access to internal documents: Yes

With access to management: Yes

Ancillary services provided to the rated entity: In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.

Name of the rating committee chair: Rosa Maria Santiago Maldonado, Co-Head of Corporate Ratings Spain

Material sources used to support the rating decision:

- Consolidated financial statements 2020, 2021, 2022
- Company presentation and 2022 annual and integrated reports
- Call with Sodiaal Head of Financing

Limitation of the Rating action:

- EthiFinance Ratings believes that the quality and quantity of information available on the rated entity is sufficient to provide a rating
- EthiFinance Ratings has no obligation to audit the data provided

The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the short-term and long-term corporate rating methodologies that can be consulted on <https://www.ethifinance.com/en/ratings/methodologies> and according to the short-term corporate rating scale available at <https://www.ethifinance.com/en/ratings/ratingScale>

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