Credit Benchmark®

Supply Chain Crisis: Food Producers Credit Trends

October 2021

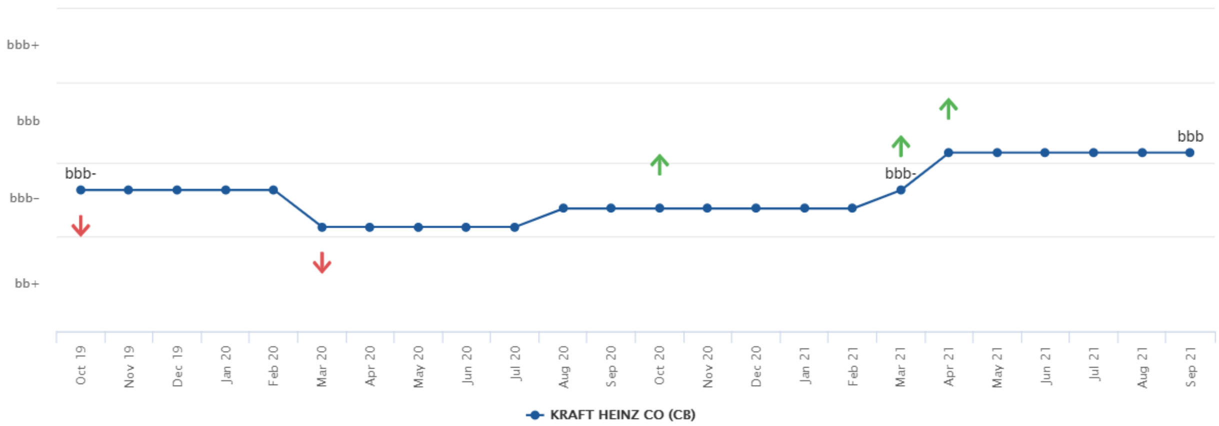
Kraft Heinz CEO, Miguel Patricio, says consumers need to get used to higher food prices.

The immediate cause is pandemic-driven stockpiling, reduced planting and a lack of suitable labour. But climate change is a growing issue: poor harvests in Brazil, drought in Russia, and (literally) a plague of locusts in parts of Africa. These factors, combined with fertilizer shortages, higher energy costs and shipping challenges have pushed global food prices to a 10-year high[1].

For broadline, consumer-led food producers, the pandemic brought some benefits: a revival in home cooking boosted demand for basic ingredients aimed at the retail market – even the humble tin of baked beans. And while hospitality is now recovering, eating patterns are changing; there is a growing awareness of the environmental and health impacts of food choices, increasing demand for plant-based products, a focus on food waste, and a push for more visibility over sources and ingredients.

In theory, this creates opportunities for firms like Kraft Heinz provided they can predictably source ingredients in sufficient volume, of the right quality, at reasonable cost. Figure 1 shows the credit profile for Kraft Heinz over the past two years.

Figure 1: Kraft Heinz Co Credit Trend



Kraft Heinz are currently rated BB+ by S&P and Fitch, but the consensus shown here is **bbb**, putting them comfortably into investment grade territory. This suggests that the world's food challenges may – at least temporarily – benefit firms like Kraft Heinz; US Producers benefit from domestic agriculture, with the US importing just 15% of its food supply. The UK imports about 45% - mostly from the EU, where truck driving and CO2 shortages are compounded by the adjustment to new post-Brexit paperwork.

But according to Patricio, the elephant in the room is a more intractable problem: world population is rising, while the stock of agricultural land is static.

According to a recent Chatham House report :

> *"To meet global demand, agriculture will need to produce almost 50 per cent more food by 2050. However, yields could decline by 30 per cent in the absence of dramatic emissions reductions. By 2040, the average proportion of global cropland affected by severe drought will likelt rise to 32 per cent a year, more than three times the historic average."*

There is certainly no shortage of proposed solutions to this. Plant based food is high on the list: the same amount of land can feed ten times as many people if they are willing to follow a vegetable-based diet. Agro-technology – another possible panacea – can make land more productive and increase food shelf life.

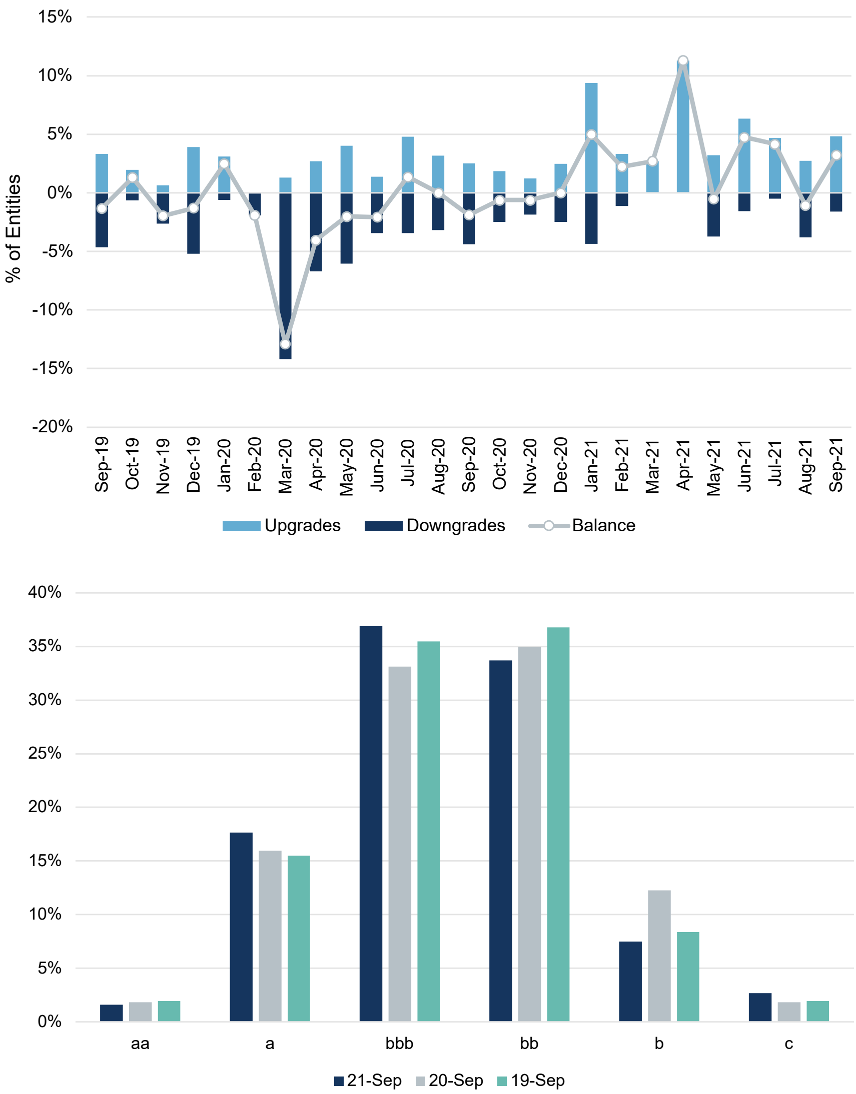
[1] UN Food and Agriculture Organisation

The food scarcity problem is intertwined with the climate problem: for example, switching towards locally sourced ingredients helps the environment, but usually at a higher price and reduced choice. Agro-technology is also problematic – increasing crop yields may have unintended consequences on broader biodiversity.

One peculiar side-effect of the pandemic is the enormous increase in dog ownership. Pet food is high margin, high in airmiles, and almost exclusively meat based. While humans are reducing their meat intake, the growing canine population is taking up the slack.

How has this gloomy picture affected the credit quality of food producing companies? Figure 2 shows the balance of upgrades vs. downgrades as well as changes in the credit distribution for about 230 US food producers over the past two years.

Figure 2: Credit Distribution, US Food Producers, 2019-2021



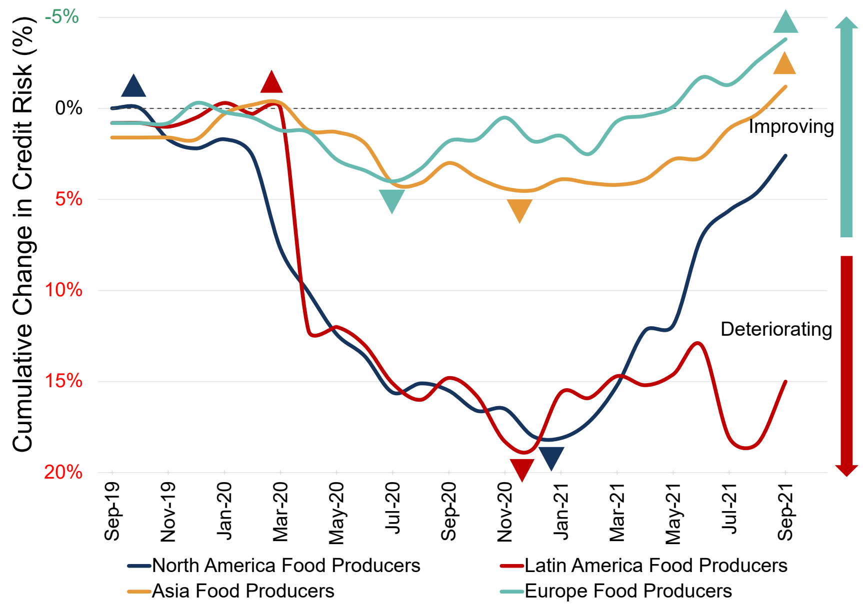
Downgrades reached a maximum in March 2020, and have been on a generally improving trend since then. Upgrades peaked in April this year, after an earlier spike in January. The balance has been in positive territory for most of the past year.

The main change in the 7-category credit distribution[2] is the modest increase in the **a** and **bbb** categories, with both rising by a few percentage points. These changes are mainly driven by a reduction in the **bb** category and – over the past year – in the **b** category as well. There has been a very slight increase in the **c** category over this period.

Figure 3 shows regional credit trends for the Food Producers sector over the same period.

[2] There are no companies in the aaa category so it is not plotted.

Figure 3: Credit Trend, Regional Food Producers, 2019-2021



Source: Credit Benchmark

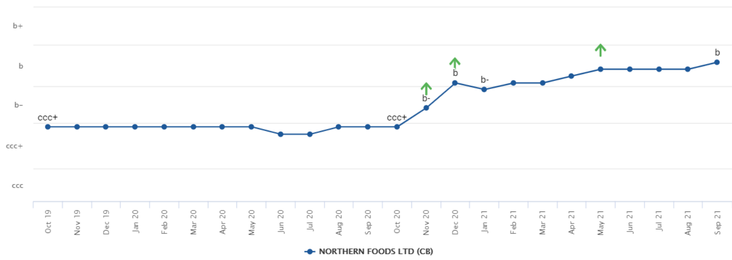
Europe and Asia show a very modest decline during the pandemic and have been recovering for most of 2021. In North America, food producer credit risk rose by nearly 20% but has now recovered most of that, with a sharp improvement that began in late 2020. Latin American food producers so far show little improvement – suggesting that the pandemic and recent climate effects have had a major negative impact.

Single name examples

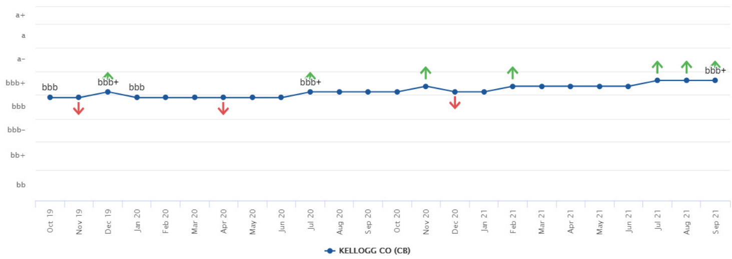
The improving trend is apparent in most regions, especially in large generalist firms but in many small specialists as well, and across the credit spectrum. The examples in Figure 4 below plot a few of the many companies currently showing improvements. (Similar charts for the full set of nearly 1000 food producers globally is available on the CB Web App as well as on Bloomberg)

Figure 4: Credit Trends for Various Food Producers

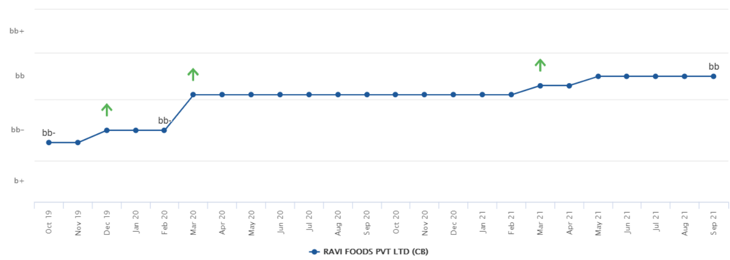
Northern Foods Ltd (UK)



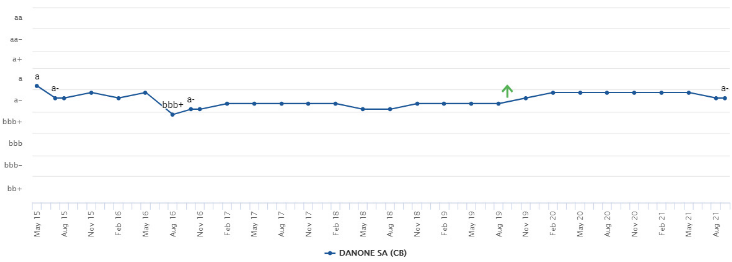
Kellogg Co (US)



Ravi Foods PVT Ltd (India)



Danone SA (France)

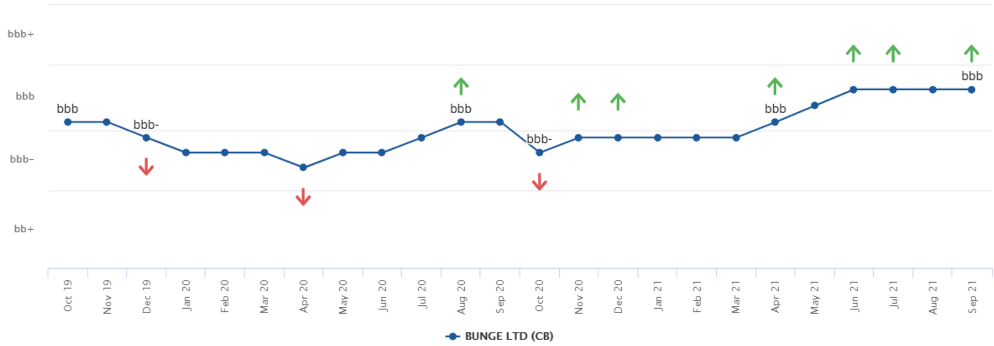


Both Kellogg and Danone have consensus ratings above their S&P equivalents; the same applies to Kraft Heinz, General Mills, Kroger, Campbell, Modelez, Unilever, and Tyson.

Northern Foods and Ravi Foods are unrated by S&P or Fitch; other unrated food companies include Baxters, Britvic, AB Foods and Princes – most of these have investment grade consensus ratings.

The trend towards plant-based food has been positive for soybean exporter Bunge Ltd. Figure 5 shows the credit trend over the past two years.

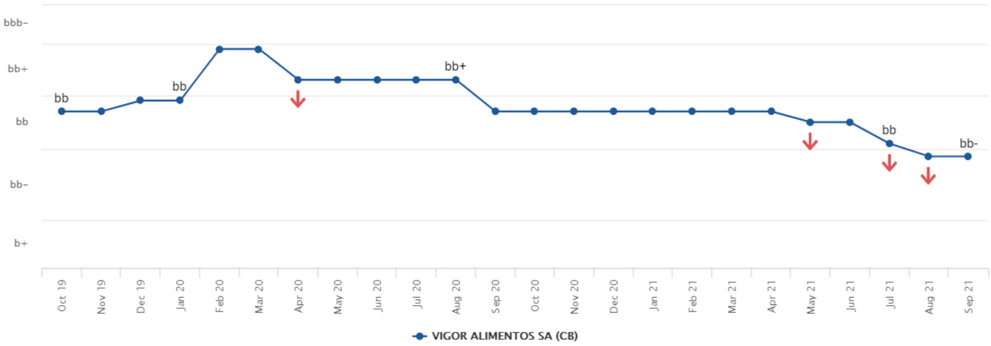
Figure 5: Credit Trend for Bunge Ltd (US)



The consensus of **bbb** is in line with S&P, but the series of positive like-for-like opinion changes suggest that a full notch upgrade is possible soon.

Latin America is one region where food producer credit has languished. Figure 6 shows the trend for Vigor Alimentos (unrated by S&P or Fitch).

Figure 6: Credit trend for Vigor Alimentos (Brazil)



After a brief improvement just before the pandemic took hold, the trend has been down with a cluster of like-for-like negative opinion changes from various banks in recent months.

Conclusion

Food Producers have weathered the pandemic fairly well, and credit trends have been positive for some time with only Latin America lagging.

For some firms, the pace of credit improvements seems to be accelerating; and a many of the largest food producers – especially in the US – have consensus ratings that are one or two notches better than the S&P equivalent.

Many well-known but niche food brands do not have S&P ratings, but do have a consensus; most of these are investment grade.

Recent acute food input shortages and the challenges of global logistics have not dented revenues; rising prices, more home cooking and a growing population point to continued stability or strength in balance sheets.

CB USA
12 East 49th Street, 9th Floor
New York, NY, 10017
Telephone: +1 646 661 3383

CB UK
131 Finsbury Pavement, 5th Floor
London, EC2A 1NT
Telephone: +44 (0)207 099 4322

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100+
Countries

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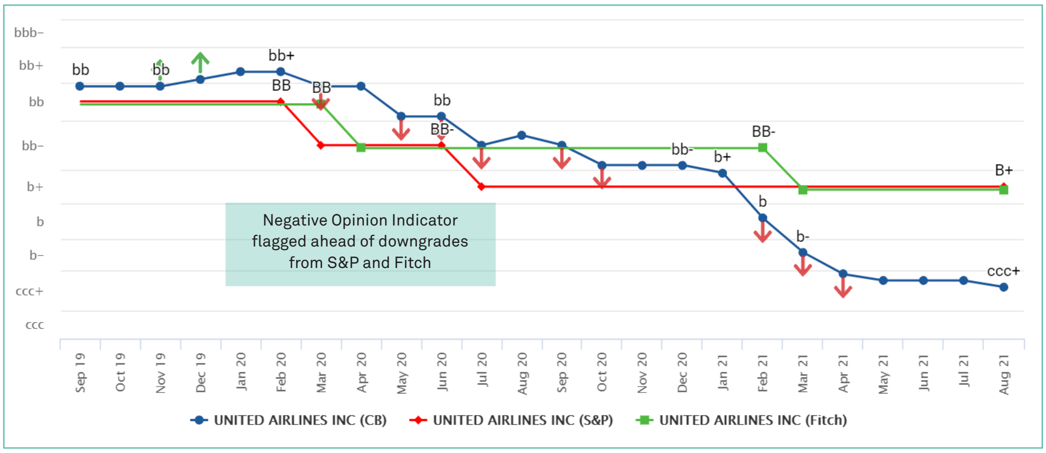
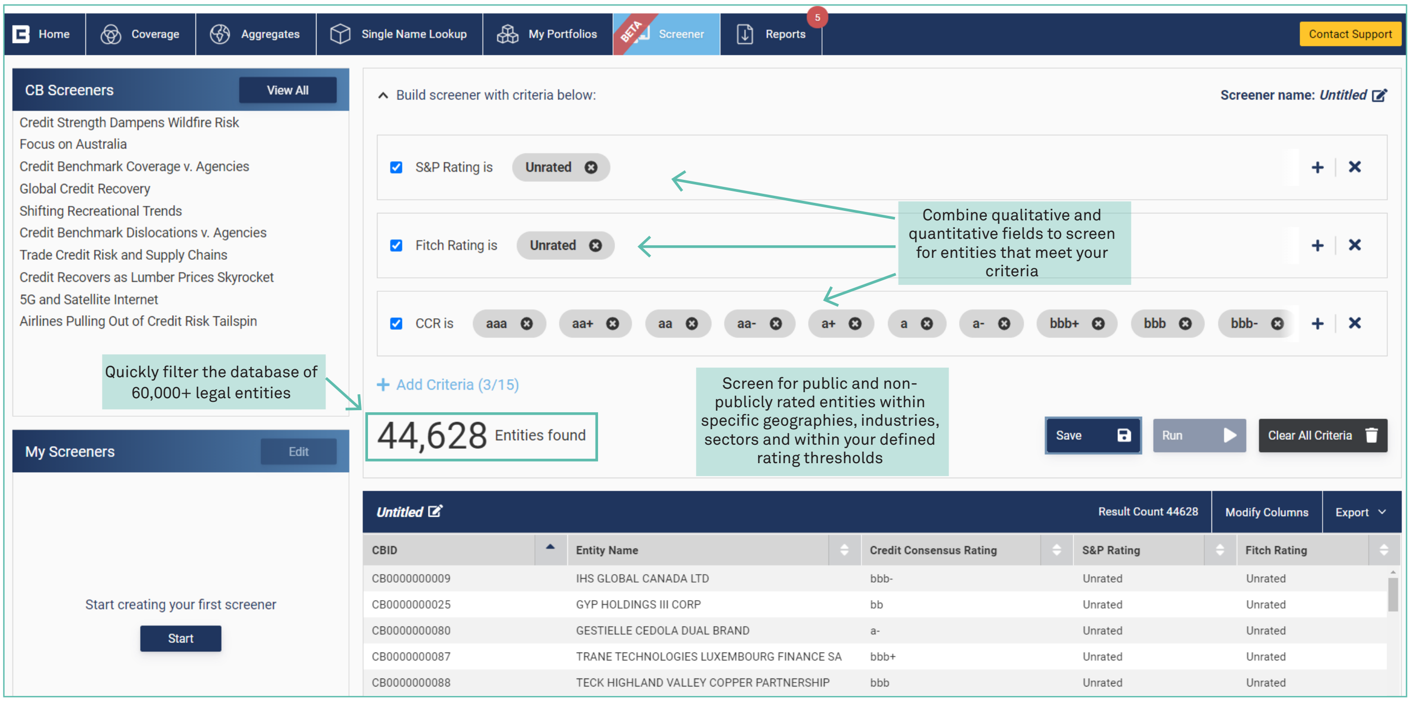


Credit Benchmark Web App: Entity-Level Data Sample

Credit Consensus Rating: Unique measure of creditworthiness based on the views of 40+ leading global financial institutions

Consensus Analytics: Insights into the depth, dispersion, movement, and directionality of the Credit Consensus Rating's underlying views

Opinion Indicator: Month over month observation-level net downgrades or upgrades



Credit Benchmark Web App: Data Screen Sample

Data that works for you:

Credit Benchmark data is available via our Web App, Excel add-in, API, flat-file download, and third-party channels including Bloomberg.

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For more information, visit www.creditbenchmark.com or contact us:

Email:
info@creditbenchmark.com

UK Office (London):
+44 (0)20 7099 4322

US Office (New York):
+1 646 661 3383