ACRA

Principles of Assessing Industry Factors in the Rating Analysis of Non-financial Corporations

Agribusiness

This document is part of the Methodology for Assigning Credit Ratings to Non-financial Corporations under the International Scale (hereinafter, the Methodology) and describes the specifics in conducting rating analyses of the operational and financial profiles of agribusiness companies.

The document provides lists of indicators used, factor weights, assessment score boundaries for quantitative factors, and the principles of assessing qualitative factors for the agribusiness industry.

1 Industry Companies

The assessment approaches described in this document are applicable to companies whose main activities are related to the production and processing of agricultural raw materials, as well as the creation of final agribusiness products. In particular, companies in this industry produce animal products (beef, pork, poultry, eggs, etc.) or plant products (vegetables, fruits, legumes and oilseeds, including their processed products (oil), tobacco, sugar crops and their derivatives (sugar), cocoa beans and their derivatives (chocolate) etc.). In addition, companies in this industry sell both primary and processed agricultural products. Vertically integrated food or retail groups can also be analyzed using this Methodology if their activities are dominated by agricultural operations.

2 Rating Factor Structure

Creditworthiness analyses of rated entities in the agribusiness industry are based on assessing eight indicator blocks, which are combined in two profiles and have their own weights totaling 100%. The weights presented in Table 1 are base weights, i.e., they may change depending on the assessment scores derived for factor blocks (see subsection 4.1.3 of the Methodology for a description of the floating weights concept).

Table 1. Scorecard for agribusiness companies

Profile	Factors	Factor weighting	Sub-factors
Operational Profile	Business profile	30%	Product and geographic diversification
			Degree of vertical integration and share of high value added products
			Market share
	Financial policy and corporate governance	10%	Financial policy
			Corporate governance
Financial profile	Size	15%	Revenue (USD bln)
	Profitability	10%	EBIT margin
			Qualitative profitability assessment
	Leverage	10%	Total debt to funds from operations (FFO) before interest payments
			Qualitative leverage assessment
	Coverage	15%	FFO before interest payments to interest payments
	Liquidity	5%	Liquidity ratio
			Qualitative liquidity assessment
	Cash flow	5%	Free cash flow (FCF) margin
			Qualitative assessment of FCF stability

Source: ACRA

3 Operational Profile

The following describes the basic factors in the rating analysis of the operational profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess operational profile qualitative indicators for rated entities in the agribusiness industry, ACRA uses a set of characteristics specific to the industry that translate into a qualitative assessment category. Operational profile indicator weights are shown in Table 6.

3.1. Business Profile

The business profile assessment is based on a qualitative analysis of a number of indicators, including product and geographic diversification, degree of vertical integration, the share of products with high added value, and the company's market share.

Demand for industry products mostly correlates with demographic trends and the growth of consumer wealth and is not subject to significant fluctuations because of the basic need for agribusiness products. Factors that may limit demand are the particularities of regulation in various countries and particularities in observing sanitary norms. In general, high product standardization and limited added value in final products are typical for the industry. Nevertheless, the financial performance of the companies in the industry is highly volatile in terms of cash flow generation, which is primarily due to supply and demand fluctuations and high fragmentation in the industry. Volatility in the indicators of livestock producers is additionally influenced by fluctuations in cost, which depends on feed prices. In addition, agribusiness production is exposed to the adverse effects of uncontrollable factors, including adverse weather conditions, epidemics, etc. Safety and quality can also contribute to additional risks for the industry, as some products can spoil if temperature conditions are not observed or if not stored properly.

The competitive advantages of companies, such as vertical integration, a large share of products with high added value, high geographic and product diversification, and strong market positions, increase their financial stability.

The business profile is assessed taking into account the following subfactors subject to qualitative assessment.

3.1.1. Product and geographic diversification

Making several types of agricultural produce can help reduce risks associated with the price volatility of raw materials and finished products, risks related to the yield of certain crops or to diseases of certain animal species, or the financial and operating performance of companies. Product diversification also helps mitigate the risk of declining sales by volume, especially in the absence of correlation between supply and demand for various product categories.

Geographic diversification is assessed both in terms of production and in terms of sales. Location of production assets in several regions helps mitigate the potential impact of adverse weather conditions, animal diseases and other risks associated with production.

Geographic diversification of sales, in turn, reduces a company's dependence on the economic cycle stage in the region of presence. Selling products in more mature markets with stable demand has a positive effect on a company's creditworthiness.

This subfactor assesses the accessibility of markets and the diversification of suppliers of raw materials for a company. A smaller distance to target markets than competitors can have a positive effect on a company in terms of minimizing transport expenditures and their impact on cost. High concentration of suppliers, especially in one area, strengthens their bargaining power and assumes greater influence of operational risks, including adverse weather conditions, on the raw materials purchased by a company.

The qualitative assessment category for product and geographic diversification is determined according to Table 2.

Table 2. Qualitative assessment of product and geographic diversification

Assessment category	Main features
I	Very low concentration of sales on individual markets/regions (less than 20% of sales in one region); sales mainly take place in developed markets; highly diversified production by region; maximum achievable degree of product diversification, well-diversified portfolio (operating in more than five product segments); high diversification in raw material suppliers
II	Low concentration of sales on individual markets/regions (less than 50% of sales in the same region); sales take place in stable and developed markets; production is diversified across regions; well-diversified portfolio (operating in more than three product segments); moderate concentration of raw material suppliers
III	Moderate concentration of sales in individual markets/regions (less than 70% of sales in the same region); sales primarily take place in a large and stable market; insignificant diversification of production by region; moderately diverse portfolio (operating in at least two product segments); moderately low concentration of raw material suppliers
IV	High concentration of sales in individual markets/regions (over 75% of sales in the same region); majority of sales are in a stable market, the rest in smaller volatile markets; production is mostly concentrated in one region; portfolio diversification is insignificant (operating in one or two product segments with concentration on one segment); moderately high concentration of raw material suppliers
V	Very high concentration of sales in individual markets/regions (over 75% of sales in the same region); sales primarily take place in volatile emerging markets; production is concentrated in a single region; a producer of one product with highly volatile sales profitability; high concentration of raw material suppliers

Source: ACRA

3.1.2. Degree of vertical integration and share of high value added products

Vertically integrated companies that own or control all or a substantial part of the production chain can ensure a faster production process, as well as optimize capacity utilization and operating expenditures thanks in part to the effects of scale. In addition, vertical integration of production can help strengthen a company's position in negotiations with suppliers and buyers.

Agribusiness companies deliver both primary products and products with higher added value, exhibiting lower volatility in prices and demand. A producer's brand reputation and strength are important, and so is an innovative product line, i.e., the ability to respond to changes in consumer preferences.

The qualitative assessment category for the degree of vertical integration and the share of high value added products is determined according to Table 3.

Table 3. Qualitative assessment of the degree of vertical integration and the share of high value added products

Assessment category	Main features
I	Full production cycle (from producing raw materials to storing them to making the final product), including logistics and sales Very high share of products with high added value; strong global brand and innovation leadership
II	Vertically integrated production (partial cycle) High share of products with high added value; well-known regional brand with innovation potential, but vulnerable to increasing competition or changing consumer preferences
III	Minimum vertical integration of production Moderate share of products with high added value; key sales are concentrated around primary products, susceptible to fluctuations in demand and changes in consumer preferences; weak brand
IV	No vertical integration Low share of products with high added value; key sales are concentrated around primary products, susceptible to fluctuations in demand and changes in consumer preferences; increasing competition pressure
V	Highly specialized activity, totally dependent on contractors Very low share of products with high added value; key sales are concentrated around highly volatile primary products, susceptible to strong fluctuations in demand and changes in consumer preferences; high competition pressure

Source: ACRA

3.1.4. Market share

The qualitative assessment category for market share is determined according to Table 4.

Table 4. Market share qualitative assessment

Assessment category	Main features
I	Global player and market leader in all product categories; notably surpasses the nearest competitor in market share
II	Global player, at least No. 2 in all product categories
III	Large (at least second largest) player in regional markets for all product categories
IV	Notable (at least third largest) player in regional markets in most product categories
V	Player with a small share in a regional market or a niche producer

Source: ACRA

3.2. Financial Policy and Corporate Governance

To assess the financial policy and corporate governance of rated entities in the agribusiness industry, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all industries (for a general description of the concept of the corporate governance qualitative assessment, see Section 5 of the Methodology). The assessment of financial policy and corporate governance is carried out according to Table 6.

4 Financial Profile

The following describes the basic factors in the rating analysis of the financial profile, the degree of their influence when determining the credit rating of a non-financial corporation, and assessment specifics.

To assess the qualitative indicators in the financial profile of rated entities, ACRA uses a common set of characteristics that translate into a qualitative assessment category for all industries (for a general description of the qualitative assessment of financial profile indicators, see Section 6 of the Methodology).

Quantitative indicators in the financial profile are assessed in points based on being part of a particular range, with qualitative indicators based on qualitative assessment categories according to Table 7.

4.1. Size

To assess the business scale of companies in the industry, ACRA uses the size of their revenue. Company size is essential because it is one of the things that defines performance. Large companies are more stable when going through economic cycles thanks to, inter alia, stronger positions in negotiations with customers and suppliers.

4.2. Profitability

The profitability of companies in the industry is assessed based on EBIT and its volatility. ACRA believes that the EBIT margin reflects a company's ability to manage operating costs efficiently. The volatility factor is evaluated in terms of stability and the predictability of profitability indicators during periods of cyclical changes in the economy.

The qualitative assessment category for profitability is determined according to Table 5.

Table 5. Qualitative profitability assessment

Assessment category	Main features
I	Stable and predictable profitability margins that do not exhibit short-term volatility
II	Stable and predictable profitability indicators on a long-term horizon, partly exhibiting short-term volatility due to fluctuations in demand and prices for primary products or due to cyclical processes in the economy
III	Moderately stable and predictable profitability indicators on a long-term horizon, exhibiting short-term volatility due to cyclical fluctuations in the economy; short periods of negative profitability followed by rapid restoration of previous indicators
IV	Volatile and difficult-to-predict profitability indicators, highly dependent on cyclical fluctuations of the economy; prolonged periods of negative profitability associated with low levels of operational efficiency, with subsequent restoration of previous indicators
V	Highly volatile and difficult-to-predict profitability indicators during periods of cyclical fluctuations in the economy; prolonged periods of operating at a loss caused by low operating efficiency

Source: ACRA

4.3. Leverage

The leverage assessment is a key factor in analyzing the financial sustainability of companies in the industry.

To assess leverage, ACRA uses an indicator calculated as the ratio of total debt to FFO before interest payments. Qualitative characteristics are also used to assess leverage.

4.4. Coverage

To assess the coverage factor for rated entities in the industry, ACRA uses an indicator calculated as the ratio of FFO before interest payments to interest payments.

4.5. Liquidity

In order to assess liquidity of rated entities in the industry, ACRA uses the short-term liquidity ratio and qualitative characteristics.

4.6. Cash Flow

To assess the cash flow of rated entities in the industry, ACRA uses the FCF margin indicator, as well as the qualitative assessment of FCF stability.

The ability to fund an investment program with operating cash flow is important to companies in the industry, especially in unfavorable pricing environments. Dividend payouts made by the company are analyzed separately. Amid high capital costs, high dividend payouts can exert significant pressure on FCF.

Table 6. Operational profile factors

Factors	Sub-factors	Sub-factor weighting	Sub-factor score				
			5	4	3	2	1
Business profile	Product and geographic diversification	40%	V	IV	III	II	I
	Degree of vertical integration and share of high value added products	40%	V	IV	III	II	I
	Market share	20%	V	IV	III	II	I
Financial Policy and Corporate Governance	Financial policy	50%	V	IV	III	II	I
	Corporate governance	50%	V	IV	III	II	I

Source: ACRA

Table 7. Financial profile factors

Factors	Sub-factors	Sub-factor weighting	Sub-factor score				
			5	4	3	2	1
Size	Revenue (USD bln)	100%	[0; 1)	[1; 5)	[5; 10)	[10; 30)	[30; ∞)
Profitability	EBIT margin	70%	(−∞; 0%)	[0%; 5%)	[5%; 10%)	[10%; 20%)	[20%; ∞)
	Qualitative profitability assessment	30%	V	IV	III	II	I
Leverage	Total debt to FFO before interest payments	70%	(7; ∞)	(5; 7]	(3; 5]	(2; 3]	[0; 2]
	Qualitative leverage assessment	30%	V	IV	III	II	I
Coverage	FFO before interest payments to interest payments	100%	(−∞; 1)	[1; 3)	[3; 6)	[6; 10)	[10; ∞)
Liquidity	Liquidity ratio	50%	(−∞; 0.8)	[0.8; 1)	[1; 1.25)	[1.25; 1.5)	[1.5; ∞)
	Qualitative liquidity assessment	50%	V	IV	III	II	I
Cash flow	FCF margin	50%	(−∞; −10%)	[−10%; 0%)	[0%; 5%)	[5%; 10%)	[10%; ∞)
	Qualitative assessment of FCF stability	50%	V	IV	III	II	I

Source: ACRA

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