Tuesday, October 05 2010

NorgesGruppen ASA

Official Ratings: Not rated

DnB NOR Markets*:
Issuer Rating: A-
Unsecured issue rating: A-

* Note that the credit ratings are not official ratings, but ratings assigned by DnB NOR Markets Credit Research with the purpose of indicating the credit risk on a scale comparable to what the official rating agencies use

Covering Analyst:
Åse Haagensen

Sector:
Retail

Company Management:
CEO: Sverre Leiro
CFO: Sverre R. Kjær

DnB NOR Markets Credit Research:

Ole Einar Stokstad
Head of Credit Research
Financials
☏ +47 22017837
ole.einar.stokstad@dnbnor.no

Mikael Løkken Gjerding
Offshore
☏ +47 22017762
mikael.lokken.gjerding@dnbnor.no

Åse Haagensen
Industrials & Real Estate
☏ +47 22017693
ase.haagensen@dnbnor.no

Thomas Larsen
Offshore
☏ +47 22017736
thomas.larsen@dnbnor.no

Knut Olav Rønningen
Oil & Gas, Utilities and Renewables
☏ +47 22017784
knut.olav.ronningen@dnbnor.no

Håkon B. Teigland
Shipping
☏ +47 73846003
hakon.teigland@dnbnor.no

The corporate credit rating on NorgesGruppen ASA (NG or the Company) reflects the company's strong to excellent business risk profile with a number one market position within grocery retail and wholesale in Norway. The Company's financial risk profile is viewed as significant with a predictable cash flow generation and a track-record of stable key credit metrics despite minor margins. Going forward, NG's strong credit rating could be deteriorated if growth ambitions are met through investments in riskier asset classes than the non-cyclical grocery retail segment or countries associated with higher risks than Norway.

Unsecured bonds are assigned the same rating as NorgesGruppens corporate credit rating, because recovery expectations are high in a default scenario.

Credit Strengths

- Strong number 1 market position within the non-cyclical Norwegian grocery retail and wholesale market
- Strong retail names and high brand recognition
- Track-record of continued growth, both organic and acquisition-based
- Diversified retail exposure through different segments and a diversified wholesale mixture of products with strong market positions

Credit Weaknesses

- Relatively low margins characterize the grocery retail industry
- Future growth prospects are probably limited to domestic non-core operations and countries with a higher country specific risk than Norway
- Historical investments in non-core operations, mitigated by the relatively minor proportion of these investments

Business Description

The private company NorgesGruppen ASA is Norway's largest grocery retail player. The Company was established in February 2000, as a result of the merger between the Joh.Johannson family-owned wholesaler and different retailer owned grocery stores and chain stores.

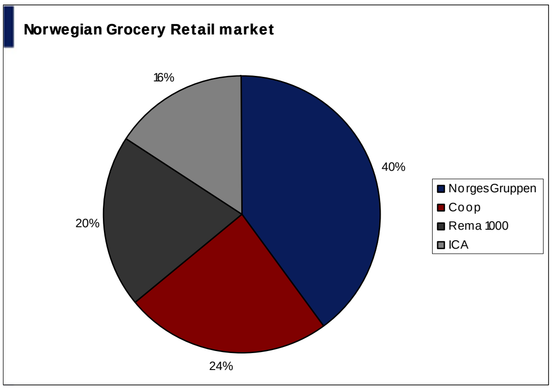
NorgesGruppen owns Kiwi, Meny, Joker, Ultra and Spar amongst others and increased its dominating market share within the grocery retail segment further last year. The Company held a market share of 40 percent for this segment as of year-end 2009. The other major area of operations for NG is wholesale, which includes the ASKO companies, which deliver goods to NG's grocery and convenience stores, petrol stations and restaurants. NGs Wholesale operations are organised through 9 regions with 13 ASKO companies and a central warehouse and a cross stocking terminal at Vestby, Akershus. NG co-manufacture private label goods such as FirstPrice, Eldorado, Jacobs utvalgte, Slaktern, Fiskemannen, Unik and Smart (animal food).

Business Risk Profile

NG's operations are primarily within the grocery retailing industry, through wholesaling and grocery stores/Supermarkets selling grocery staples. This subsector of retailing industry represents a fairly non-cyclical segment, with lower exposure to economic cycles than the retail industry in general. The wholesale industry is highly competitive with substantial economies of scale. NG's wholesale operations provide NG's retail operations with approximately 75 percent of delivered goods. Consequently, NG's wholesale operations have approximately the same non-cyclical end-user exposure.

DnB NOR Markets

In 2009 the total grocery retail market held a market value of NOK 134 billion, according to AC Nielsen. The Norwegian grocery retail market is highly consolidated, as the graph to the right illustrate. Please note that the market share include turnover generated by franchised stores and associated stores as well as the players own grocery retail stores. The 40 percent market share represent a contribution of NOK 53.7 billion from NorgesGruppen, of which 53 percent was generated by owned stores. Size matters, and generate significant economies of scale as well as product and segment diversification for NG. The increased market share for NG and Rema 1000 (post acquisition of Lidl) is made at the expense of ICA's diminishing market share the last few years. The consolidated grocery retail market is characterized by relatively high barriers to entry, somewhat illustrated by Lidl's exit in 2008. The relatively small Norwegian market size and geographically scattered population might also be less attractive for foreign competitors.

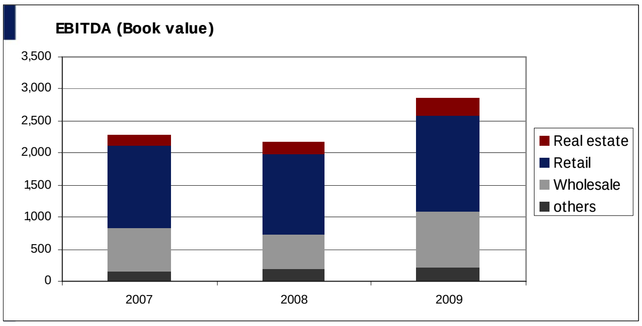


Source: AC Nielsen

Since establishment in year 2000, NG has experienced considerable growth organically and through acquisitions, continued growth is an important company strategy. The Company's largest acquisition during 2009 was Joh.Johannson Kaffe AS in January for NOK 478 million from the Johannson family. The wholesale-based Johannson family controls 70 percent of NG. The remaining 30 percent is owned by a number of current retailers and former retailers.

The Norwegian grocery retail market is associated with minimal risk, as demand for staples and groceries are fairly non-cyclical. We believe that future growth opportunities could be limited to foreign countries associated with a larger country specific risk than Norway or riskier asset classes. As few other asset classes are less cyclical than the grocery retail segment and NG's dominating domestic exposure within grocery retail market could be constrained, given NG's present 40 percent presence. We believe that such investments could deteriorate NG's credit quality in spite of increased retail segment and geographical diversification.

Relatively low EBITDA margins characterize the grocery retail and wholesale industry. NG has only experienced minor EBITDA margin fluctuations despite continuous growth since establishment, with EBITDA margins between 5.1-6.4 percent. The grocery retail proportion of book EBITDA is dominated by Kiwi (35 percent) and Meny/Ultra (15 percent) at year-end 2009. The "Others" bar above is dominated by operations within the service industry as convenience stores and fast-food restaurants. Service industry exposure increases NG's turnover cyclicality, partly because of competition from low-price grocery retail stores with expanded opening hours. NG's convenience stores with sole ownerships are Mix, Fresh, Deli de Luca, Le Cafè, Dolly Dimple's and Jafs. the Company also holds a 50 percent share of Kaffebrenneriet, Big Horn Steak House and Bon Appètitt.



Source: DnB NOR Markets and the Company

NG's real estate portfolio consists of approximately 600,000m^2 and the portfolio is dominated by warehouses (350,000m^2). The remaining 250,000m^2 consists of grocery retail stores and shopping centres, of which 60 percent of the real estate portfolio measured in square metres has external tenants with an annual lease of NOK 223 million (2009). The portfolio is dominated by small regional shopping centres in the eastern parts of Norway which NG bought through Kjøpesenter Holding AS in 2004.

DnB NOR Markets

Financial Risk Profile
We assess NG's financial risk profile as significant with total interest bearing debt relative to EBITDA at 4.1x for 2009 (4.5x in 2008), when we adjust for the Company's substantial off-balance-sheet liabilities. Please find an overview of adjustments made to financial figures below. Historical track-record, with stable key credit metrics and predictable cash flow generation and continued growth, supports NG's credit quality. NG's reported turnover related to wholesale operations is limited to turnover generated by third parties, internal wholesale generated revenue represented approximately 40 percent of total revenue from wholesale operations, and are not included in the group accounts.

The ratio of Funds from operations (FFO) relative to net debt illustrates how many years it will take for a company to repay all debt, under the stylistic assumption that the company's operations are constant with no new investments and generated funds are restricted to repayment of debt. NG's FFO relative to total interest bearing debt has improved to 19 percent since the less favorable year 2008 (12 percent). This indicates that it would take the company approximately 5 years to repay interest bearing debt, under the unrealistic assumption of constant operations.

NG has a track-record of investing cash flow from operations, supporting NG's ambitious growth. The wholesale industry is capital intensive, and capacity additions require a substantial timeframe and capex, as expansions must be planned well ahead of new facility availability. Accumulated investments since 2002 are approximately NOK 11,600 million, and total assets have more than doubled during this time frame.

Inventory is the major working capital component for a company such as NorgesGruppen. Reported working capital changes from year-end to year-end has been substantial the last few years between NOK 500-1,000 million. We also believe intermediate working capital fluctuations exceed figures reported at year-end. However, financing of any working capital initiated needs is not a concern in our opinion due to solid liquidity.

Intra-year fluctuations do not affect relevant bank loan covenants as these are based on a 12 month rolling average. Bank loan covenants are not disclosed apart from a conditional negative pledge clause, with a minor proportion of pledged assets relative to total assets (1 percent) at year–end 2009.

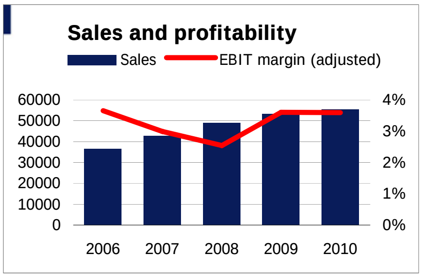
The Company's solidity remains stable and strong, with an equity share of 29 percent of total assets (adjusted), the corresponding book value is 37 percent at year-end 2009. The adjusted equity ratio has remained stable around 27-29 percent since 2003.

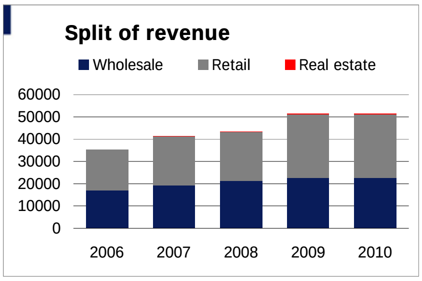
We view NG's liquidity position as strong. Cash and un-utilized credit facilities relative to short-term interest bearing debt was 1.7x, based on an available un-used long-term credit facilities of NOK 4,789 million at year-end 2009.

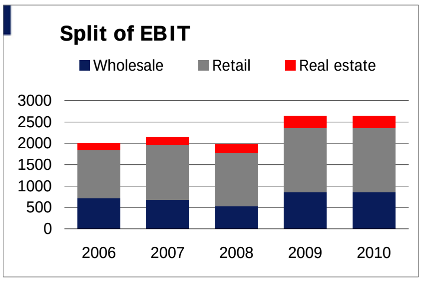
Adjustments to reported book figures
DnB NOR Markets adjusts book figures according to guidelines published by the rating agencies (particularly S&P), in order to increase the comparability between companies that have financed their producing assets in different ways. Operating leases constitute a significant liability that does not show on the balance sheet, but is stated in the notes to the financial statement.

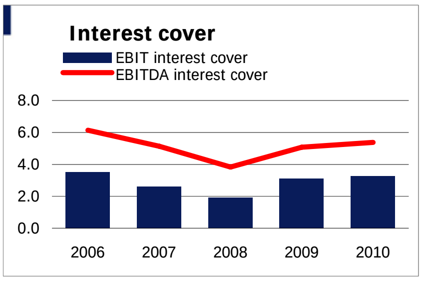
DnB NOR Markets Credit Research has estimated the net present value (NPV) of NorgesGruppen’s non-cancellable rent agreements to be approximately NOK 6,000 million (which is added to book total debt when we calculate total adjusted debt) at year-end 2009. The interest component (NOK 347 million in 2009) of the NPV of operating leases is added back to the adjusted EBITDA (which is increased from the book value). Non-recurring items are removed from the adjusted EBITDA (e.g. gain on sale of assets is removed).

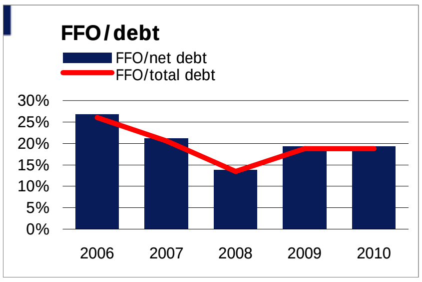
Profit&Loss (M)	**2006**	**2007**	**2008**	**2009**	**2010e**
Total sales	36,620	42,678	49,016	53,232	55,468
Total cost	34,524	40,396	46,846	50,371	52,554
EBITDA (book)	2,096	2,282	2,170	2,861	2,913
EBITDA (adjusted)	2,343	2,504	2,489	3,135	3,273
Depr./amort	981	1,195	1,104	1,195	1,250
EBIT (adjusted)	1,337	1,275	1,244	1,919	1,993
Interest expence (adjusted)	382	488	651	617	610
Income before tax (adjusted)	1,184	1,128	910	1,495	1,550
Tax	312	361	294	415	434
Book net income	872	825	620	1,148	1,116
Balance sheet					
Goodwill	2,764	3,576	3,634	4,260	4,260
Tangible fixed assets	5,324	6,918	8,228	8,891	9,711
Investments in associated companies	917	1,217	1,294	1,637	1,637
Cash and securities	199	280	325	324	318
Total assets (book)	14,091	17,545	20,002	22,110	23,602
Total assets (adjusted)	18,218	22,777	25,568	28,103	29,595
Equity (book)	5,156	6,939	7,145	8,165	8,508
Interest bearing debt (book)	2,648	3,891	5,666	6,304	6,604
Interest bearing debt (adjusted)	6,979	9,360	11,534	12,566	12,866
Cash flow					
EBITDA	2,096	2,282	2,170	2,861	2,913
Net interest	105	169	277	236	234
Tax payable	261	337	291	234	350
Funds from operations (FFO)	1,815	1,928	1,549	2,359	2,420
Increase in working capital	171	459	663	494	300
Cash flow from operations	1,644	1,469	886	1,865	2,120
Capex	1,433	2,463	2,321	1,695	2,000
Free operating cash flow	211	-994	-1,435	171	120
Dividend paid	255	294	348	222	300
Key ratios (adjusted)					
Interest coverage					
EBITDA interest coverage (x)	6.1	5.1	3.8	5.1	5.4
EBIT interest coverage (x)	3.5	2.6	1.9	3.1	3.3
(EBITDA-CAPEX)/interest coverage (x)	2.4	0.1	0.3	2.3	2.1
FFO interest coverage (x)	4.8	4.0	2.4	3.8	4.0
Financial gearing					
Net debt/EBITDA (x)	2.9	3.6	4.5	3.9	3.8
Total debt/EBITDA (x)	3.0	3.7	4.6	4.0	3.9
FFO/total debt (%)	26%	21%	13%	19%	19%
Solidity					
Total debt/(total debt+book value equity) (%)	58%	57%	62%	61%	60%
Equity/total assets (%, lease adjusted)	28%	30%	28%	29%	29%
(Equity-goodwill)/(total assets-goodwill) (%)	15%	18%	16%	16%	17%
Performance					
Sales growth (%)	16%	17%	15%	9%	4%
EBITDA margin (%, lease adjusted)	6%	6%	5%	6%	6%
Net income from continuing op./sales (%)	2%	2%	1%	2%	2%
Increase in working capital/sales (%)	0%	1%	1%	1%	1%

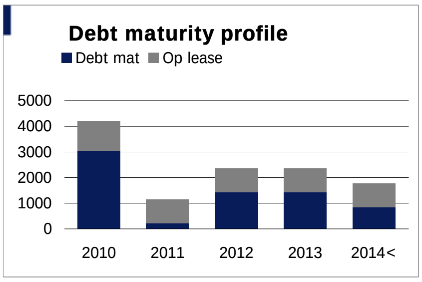












Please note that estimated 2010 figures are based on DnB NOR Markets' own estimates

Definitions Of Key Financial Ratios - Formulas

Net income from continuing operations=	Net income after tax excluding nonrecurring items
Total debt =	Total interest bearing debt including financial lease obligations, plus present value of operating lease liabilities, tax adjusted underfunded pension liabilities and guarantees to associated companies
EBIT interest coverage =	Earnings from continuing operations* before interest and taxes / Gross interest incurred before subtracting (1) capitalized interest and (2) interest income
EBITDA interest coverage =	Adjusted earnings from continuing operations** before interest, taxes, depreciation and amortization / Gross interest incurred before subtracting (1) capitalized interest and (2) interest income
Funds from operations(FFO)/total debt =	Net income from continuing operations plus depreciation, amortization, deferred income taxes, and other noncash items / Total debt
Free operating cash flow/total debt =	Funds from operations (FFO) minus capital expenditures, minus (plus) increase (decrease) in working capital (excluding changes in cash, marketable securities, and short-term debt) / Total debt
Discretionary cash flow/total debt =	Funds from operations (FFO) minus capital expenditures, minus (plus) increase (decrease) in working capital (excluding changes in cash, marketable securities, and short-term debt), minus common and preferred dividends / Total debt
Operating income/sales =	Sales minus cost of goods manufactured (before depreciation and amortization), selling, general and administrative, and research and development costs / Sales
Total debt/capitalization =	Total debt / Total debt plus shareholders' equity (including preferred stock) plus minority interest
Total debt/EBITDA =	Total debt / Adjusted earnings from continuing operations before interest, taxes, depreciation and amortization

*Including interest income and equity earnings; excluding nonrecurring items.

**Excludes interest income, equity earnings, and nonrecurring items; also excludes rental expense that exceeds the interest component of capitalized operating leases. Including amounts for operating lease debt equivalent, and debt associated with accounts receivable sales/securitization programs.

Source: Standard & Poor's

DISCLAIMER

This report must be seen as marketing material unless the criteria for preparing investment research, according to the Norwegian Securities Trading Regulation 2007/06/29 no. 876, are met. This report has been prepared by DnB NOR Markets, a division of DnB NOR Bank ASA. The report is based on information obtained from public sources that DnB NOR Markets believes to be reliable but which DnB NOR Markets has not independently verified, and DnB NOR Markets makes no guarantee, representation or warranty as to its accuracy or completeness. Any opinions expressed herein reflect DnB NOR Markets' judgment at the time the report was prepared and are subject to change without notice. Confidentiality rules and internal rules restrict the exchange of information between different parts of DnB NOR Markets/DnB NOR Bank ASA and this may prevent employees of DnB NOR Markets who are preparing this report from utilizing or being aware of information available in DnB NOR Markets/DnB NOR Bank ASA which may be relevant to the recipients' decisions. This report is not an offer to buy or sell any security or other financial instrument or to participate in any investment strategy. No liability whatsoever is accepted for any direct or indirect (including consequential) loss or expense arising from the use of this report. Distribution of research reports is in certain jurisdictions restricted by law.

This report is for clients only, and not for publication, and has been prepared for information purposes only by DnB NOR Markets - a division of DnB NOR Bank ASA registered in Norway number NO 984 851 006 (the Register of Business Enterprises) under supervision of the Financial Supervisory Authority of Norway (Finanstilsynet) and Monetary Authority of Singapore, and on a limited basis by the Financial Services Authority of UK. Information about DnB NOR Markets can be found at dnbnor.no.

Additional information for clients in Singapore

This report has been distributed by the Singapore branch of DnB NOR Bank ASA. It is intended for general circulation and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. You should seek advice from a financial adviser regarding the suitability of any product referred to in this report, taking into account your specific financial objectives, financial situation or particular needs before making a commitment to purchase any such product.

Recipients of this report should note that, by virtue of their status as "accredited investors" or "expert investors", the Singapore branch of DnB NOR Bank ASA will be exempt from complying with certain compliance requirements under the Financial Advisers Act, Chapter 110 of Singapore (the "FAA"), the Financial Advisers Regulations and associated regulations there under. In particular, it will be exempt from: - Section 27 of the FAA (which requires that there must be a reasonable basis for recommendations when making recommendations on investments).

Please contact the Singapore branch of DnB NOR Bank ASA at +65 6212 0753 in respect of any matters arising from, or in connection with, this report.

We, the DnB NOR Group, our associates, officers and/or employees may have interests in any products referred to in this report by acting in various roles including as distributor, holder of principal positions, adviser or lender. We, the DnB NOR Group, our associates, officers and/or employees may receive fees, brokerage or commissions for acting in those capacities. In addition, we, the DnB NOR Group, our associates, officers and/or employees may buy or sell products as principal or agent and may effect transactions which are not consistent with the information set out in this report.

In the United States

Each research analyst named on the front page of this research report, or at the beginning of any subsection hereof, hereby certifies that (i) the views expressed in this report accurately reflect that research analyst's personal views about the company and the securities that are the subject of this report; and (ii) no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in this report.

This report is being furnished upon request and is primarily intended for distribution to "Major U.S. Institutional Investors" within the meaning of Rule 15a-6 of the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934. To the extent that this report is being furnished, or will be disseminated, to non-Major U.S. Institutional Investors, such distribution is being made by DnB NOR Markets, Inc., a separately incorporated subsidiary of DnB NOR that is a U.S. broker-dealer and a member of the Financial Industry Regulatory Authority and the Securities Investor Protection Corporation. Any U.S. recipient of this report seeking to obtain additional information or to effect any transaction in any security discussed herein or any related instrument or investment should call or write DnB NOR Markets, Inc., 200 Park Avenue, New York, NY 10166-0396, telephone number 212-681-3800 or fax 212-681-4119.