Tomra Systems ASA
Norway, Capital Goods

SCOPE A- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	51.5x	57.2x	35.5x	28.6x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	1.0x	0.6x	0.9x	1.0x
Funds from operations/SaD	81.4%	169.2%	93.3%	81.5%
Free operating cash flow/SaD	62.6%	89.9%	10.9%	-4.0%

Rating rationale

Scope has assigned a first-time issuer rating of A-/Stable to Tomra Systems ASA. Our rating reflects the company's satisfactory business risk profile (assessed at BBB+), a result of positive industry dynamics, the company's strong positions within all its segments, the stable and growing demand for the company's products and their large share of recurring revenues.

The company is the clear global market leader in reverse vending machines (RVMs) for beverage collection with about 81,000 installed machines in over 60 markets. It also holds leading positions in sensor-based sorting equipment for recycling and mining, with market shares of 55%-60%. Lastly, it holds strong positions in the global food sorting market. These strong market positions and operational proficiency have led to high Scope-adjusted EBITDA margins sustained at around 20%-22%. Furthermore, half of revenues within the collections segment comes from service contracts, which adds stability to earnings and cash flow. Historical revenue growth has been around 10% yearly, reflecting growing demand for recycling driven by legislation, end-user demand and industry initiatives. This positive trend is expected to continue and benefit the company in the environmental, social and governance area.

Diversification by geographies, customers and end-markets constitutes an additional strength. However, the company's products being based on the same technology, combined with its absolute size and niche focus, somewhat limits the business risk assessment.

The company's financial risk profile (assessed at A) reflects low leverage with a Scope-adjusted debt (SaD)/EBITDA of 0.7x-1.3x over the past five years. The low debt levels can be explained by strong cash flow generation, medium capex needs, moderate M&A, and a prudent financial policy (dividend payout of 40%-60% of earnings).

Our base case assumes that Tomra, as the leading provider of RVMs globally, will continue to win tenders, also in new countries, over the medium term. It also factors in capex related to the company's newly announced adjacent businesses (the segments Plastic Recycling, Reusable Packaging, Textiles and Digital). Lastly, we have assumed dividends paid will align with their stated earnings per share of 40%-60% annually. We believe strong operational performance will compensate for most of the increased expenditure in the medium term, even with the decreased profits so far in 2022 caused by supply chain disruptions and inflationary pressure. In sum, we foresee only a slight increase in SaD/EBITDA to 1.0x in the medium term (0.5x at March 2022), which is still strong. Lastly, we also see some pressure on free operating cash flow (FOCF) following the increased capex.

Rating & Outlook

Issuer	A-/Stable
Short-term debt	S-1
Senior unsecured debt	A-

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Related Methodology

Corporate Rating Methodology; July 2021

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Outlook and rating-change drivers

The Stable Outlook reflects Tomra's strong market positions within their established segments, which Scope believes will continue to shape the company's performance in the mid-term. It also reflects our expectations of stable service revenues from an increased installed base. Further, it assume that Tomra will still keep the leverage at a conservative levels, despite higher capex related to the company's new adjacent businesses.Positive industry dynamics will also benefit the company, including EU recycling directives that will trigger new tenders for RVMs, a segment where the company is well positioned.

A rating upgrade may be warranted if investments in the medium term were lower than expected, leading to a SaD/EBITDA of less than 1x sustained.

A rating downgrade could be warranted if investments in the medium term were higher than expected, leading to a SaD/EBITDA moving towards 2x.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
23 June 2022	New	A-/Stable

Positive rating drivers	Negative rating drivers
• Strong market positions within most segments • Solid foundation of service revenues from 81,000 installed RVMs with an average life of 10 years • Stable and solid historical profitability with SaD-EBITDA margins of around 20% for the past five years • Demand propagated by megatrends and favourable legislation • Historically prudent financial governance, resulting in low leverage ratios and solid cash flow	• Foreign exchange exposure within top line and equity positions • Operations within a somewhat narrow market • Demand often dictated by legislation, which can be slow moving and unpredictable • Some cyclicality in certain end-segments • Execution risk linked with new adjacent businesses in the medium term

Positive rating-change drivers	Negative rating-change drivers
• Lower-than-expected investments in the medium term, leading to SaD/EBITDA of less than 1x sustained	• Higher-than-expected investments in the medium term, leading to SaD/EBITDA towards 2x

Corporate profile

Tomra is a leading global supplier of smart machinery for the collection and sorting of beverage containers, food, waste and minerals. The company was founded in 1972 with the design, manufacturing and sale of RVMs for the automated collection of used beverage containers.

Customers include major grocery retailers, sovereign governments, food processors, recycling plants and mining companies. The company has around 4,600 employees with 100.000 installations in over 80 markets worldwide. Its turnover was NOK 10.9bn (EUR 1.05m) in 2021. It is headquartered in Asker, Norway and listed on the Oslo Stock Exchange. Its biggest shareholder is Swedish investment company Investment AB Labour, with a 21% share.

The company's three main segments are Collections, Recycling and Food. Tomra also recently announced it will pursue additional adjacent business opportunities (Plastic Recycling, Reusable Packaging, Textiles and Digital). Areas in which the company has expertise but that are significantly different from the core business. Although the new businesses may eventually impact the company's risk profile, the short- and medium-term effects are limited.

Collections is the company's largest segment, contributing 53% of turnover and 59% of EBITA in 2021. Every year, this segment facilitates the collection of more than 40bn empty cans and bottles. Main customers are big global retail chains and states/governments. Demand for these machines is largely driven by legislation on recycling and circularity. Most noticeably, the EU's green initiative has led many European countries to implement return deposit schemes (RDSs), with Tomra the preferred provider. As of 2021, Collections had an installed base of approximately 81,000 RVMs across 60 markets. Tomra is the world leader with an estimated market share of 70% of the global RVM market.

Food is the company's second largest segment by revenue contribution (30% as of 2021) but the smallest by EBITA contribution (19%). This segment provides optical sorting and processing technology for the fresh and processed food industry. This is the biggest global market in terms of gross revenues. At the same time, however, the market is also the most fragmented and complicated because a machine made for sorting one food (e.g. peanuts) may not be suited for sorting another (e.g. melons). This has resulted in many strong niche players within this segment. Demand within Food is largely linked to global food production, which is relatively non-cyclical. High wage inflation also boosts demand as more automation is sought. As of 2021, Tomra had around 11,000 sorting installations globally and an estimated 25% market share within its Food sub-segments.

Recycling is the smallest segment by revenue contribution (17% as of 2021) but second largest by EBITA contribution (22%). Recycling consists of the development, installation and servicing of automated machines for sorting waste. The machines perform an extensive range of sorting tasks and can prepare various types of waste for material recycling or energy recovery. As of 2021, Recycling had an estimated market share of 55% and an installed base of around 6,500 units across 40 markets. The main customers were recycling plants and governments. Recycling demand benefits from legislation on circularity as well as commodity prices. Mining consists of the development, installation and service of automated machines for the efficient processing of industrial minerals, diamonds/gemstone recovery and metal recovery from slag. As this process is energy-intensive, demand is often driven by the price of energy and of the sorted mineral. As of 2021, Mining had an estimated market share of 40%.

Adjacent businesses incorporate Plastic Recycling, Reusable Packaging, Textiles and Digital. Tomra has identified these areas as in line with its overarching goals and vision on circularity and sustainability, but also areas where it has a competitive advantage and are likely to profitable over time.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	53.5x	51.5x	57.2x	35.5x	28.6x	32.8x
SaD/Scope-adjusted EBITDA	1.4x	1.0x	0.6x	0.9x	1.0x	1.0x
Funds from operations/SaD	58.3%	81.4%	169.2%	93.3%	81.5%	85.5%
Free operating cash flow/SaD	27.1%	62.6%	89.9%	10.9%	-4.0%	-2.5%
Scope-adjusted EBITDA in NOK m						
EBITDA	1,949	2,167	2,407	2,170	2,437	3,151
Capitalised R&D expenses	-59	-65	-103	-63	-63	-63
Scope-adjusted EBITDA	**1,890**	**2,102**	**2,304**	**2,107**	**2,374**	**3,088**
Funds from operations in NOK m						
EBITDA	1,949	2,167	2,407	2,170	2,437	3,151
less: (net) cash interest paid	-35	-41	-40	-59	-83	-94
less: cash tax paid per cash flow statement	-250	-274	-312	-307	-347	-478
add: dividends from associates	6	5	15	0	0	0
Change in provisions	-153	-187	398	-63	-63	-63
Funds from operations	**1,517**	**1,670**	**2,468**	**1,740**	**1,944**	**2,516**
Free operating cash flow in NOK m						
Funds from operations	1,517	1,670	2,468	1,740	1,944	2,516
Change in working capital	-238	147	-658	-443	-307	-390
Lease amortisation	-242	-261	-267	-267	-267	-267
less: capital expenditure (net)	-573	-531	-499	-827	-1,466	-1,932
Free operating cash flow	**464**	**1,025**	**1,044**	**203**	**-96**	**-73**
Net cash interest paid in NOK m						
Net cash interest per cash flow statement	-61	-55	-53	-59	-83	-94
add: interest component, operating leases	26	14	13	0	0	0
Change in other items	0	0	0	0	0	0
Net cash interest paid	**-35**	**-41**	**-40**	**-59**	**-83**	**-94**
Scope-adjusted debt in NOK m						
Reported gross financial debt	2,982	2,518	2,019	2,119	2,965	3,365
less: cash and cash equivalents	-460	-532	-632	-316	-643	-485
add: non-accessible cash	12	8	8	0	0	0
add: pension adjustment	69	58	64	64	64	64
add: operating lease obligations	0	0	0	0	0	0
Other items	0	0	0	0	0	0
Scope-adjusted debt	**2,603**	**2,052**	**1,458**	**1,866**	**2,386**	**2,943**

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Environmental, social and governance (ESG)[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Strong and clear ESG profile; inherently environmentally friendly products

In addition to its inherently environmentally friendly products, Tomra prioritises maintaining a strong and clear ESG profile both internally and externally. This is done through an internal sustainability function as well as the embedding of sustainability and circularity in strategy. The company's stated ambition is to be world leader in the 'resource revolution' and aims to utilise its unique market positions in reverse vending, material recovery, food and recycling achieve this.

The company is also a member of the UN Global Compact and aims to embed the principles around sustainability and social responsibility within its organisation practices.

Lastly, the company aims to conduct business ethically and responsibly, and has zero tolerance for corruption and/or breaches of any applicable laws and regulations.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

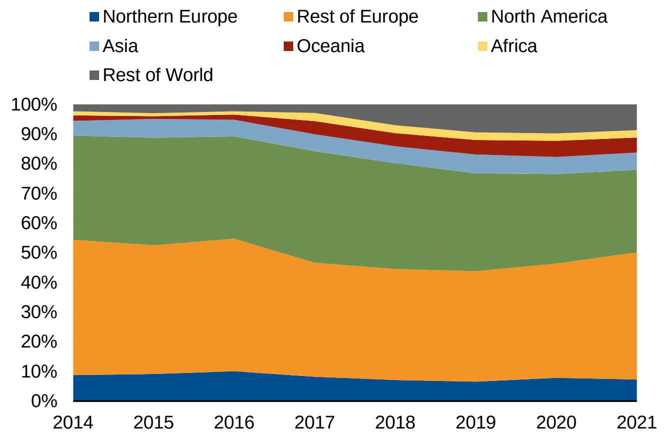
Business risk profile: BBB+

Industry risk profile: BBB, in line with the capital goods industry

Tomra is a capital goods company. The capital goods industry risk is assessed as BBB based on the cyclicality, entry barriers and risk of substitution all being medium. Industry cyclicality is largely driven by changes in the global economy, business confidence and industrial production. Capital intensity, economies of scale, product patents and access to distribution channels and markets constitute potential entry barriers for new entrants. Capital goods are often used in specific applications with limited options for customers to achieve a desired output. There can be a displacement risk, however, due to technological advances, competition or changing legislation.

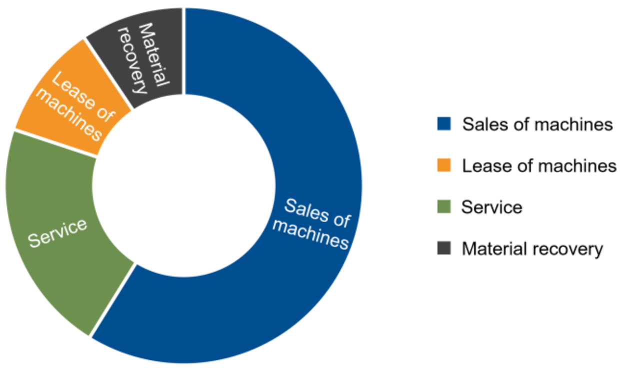
Tomra's business risk profile (assessed at BBB+) reflects positive industry dynamics; strong market positions in key segments and markets; stable and growing demand for the company's products and services; geographical diversification (Figure 1); a satisfactory share of service revenues (Figure 2); and strong profitability.

Figure 1: Geographical diversification and revenues per market (%)



Sources: Tomra Systems ASA, Scope

Figure 2: Revenues by type, FY 2021



Sources: Tomra Systems ASA, Scope

Strong global market position in RVMs for beverage collection

Tomra is the clear global market leader in RVMs for beverage collection, with an estimated global market share of over 70% and about 81,000 installed machines in over 60 countries (100,000 installed machines in over 80 countries for all three business segments combined). It can defend its market position well in this segment thanks to a superior networks for sales, distribution and service. Tomra is also the global market leader in sensor-based sorting equipment for recycling, with a market share of 55%-,and is one of the market leaders in the food and mining industries.

Strong industry dynamics driven by growth in recycling and focus on process efficiency

Historical revenue growth has been around 10% yearly, reflecting growing demand for recycling driven by legislation, end-user demand, and industry initiatives. This positive trend is expected to continue (positive ESG factor). Demand is also driven by megatrends, such as a growing middle class, higher consumption, increasing urbanisation, and greater focus on sustainability and resource management.

Legislation for deposit return systems drives demand for RVMs

Growth in the RVM market depends on legislation for deposit return systems. Political processes are often slow and unpredictable and therefore demand can be hard to predict. However, the EU's Single-Use Plastics Directive, passed in 2019, is likely to provide the company a steady stream of major opportunities. The directive targets for EU member states to recycle 77% of plastic beverage containers by 2025 and 90% by

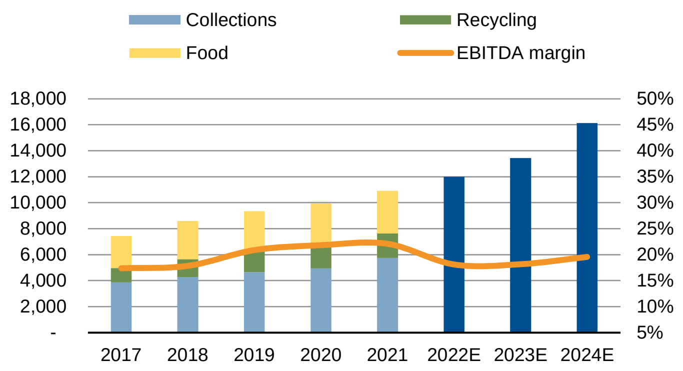
2029[2]. There is clear evidence that deposit return systems are effective at increasing collection rates[3]. At year-end 2021, more than 10 European countries announced the intention, or passed legislation, to implement deposit return systems. For some of these countries Tomra is already involved. We also believe the company, with its strong competitive position, is well positioned to win the remaining tenders.

Good diversification by geography, customer and end-market

Tomra's business is organised in three business segments: Collections (59% of EBITA), Recycling (22%) and Food (19%) (Figure 3). These segments all have somewhat different demand drivers, which contributes to stable and strong operations. For instance, during Q1 2022, Recycling saw a 56% increase in revenues despite supply chain constraints and inflationary pressure – because those same dynamics made it more attractive to recycle materials and/or replace expensive labour with automation.

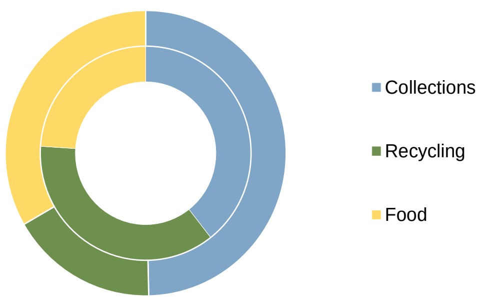
All products being based on the similar technology provides economies of scale in technological development but limits diversification. Diversification by geographies, customers and end-markets constitutes a strength, whilst the company's absolute size and niche focus somewhat limit the overall business risk assessment.

Figure 3: Revenues (NOK m) & EBITDA margin (%)



Sources: Tomra Systems ASA, Scope (estimates)

Figure 4: Revenue (outer ring) & EBITA (inner) contribution per segment, FY 2021



Sources: Tomra Systems ASA, Scope

Strong market positions and stable end-markets reflected in robust margins

The strong market positions and economies of scale are reflected in a strong and stable EBITDA margin of around 20%-22% (Figure 3). Margin contributions are highest in Collections, where the company has the strongest market position (Figure 4). As most RVMs are sold under sales and service contracts and have an average machine life of around 10 years, around half of Collections revenue stems from more stable service contracts. We also consider a large share of the customers and end-markets to be stable and largely unaffected by economic cycles, including grocery chains, recycling plants and governments. With Tomra's machines developed in Norway but produced mainly by third parties in Poland and China, most expenses are in euro and US dollar, and the impact of foreign exchange on earnings is relatively modest.

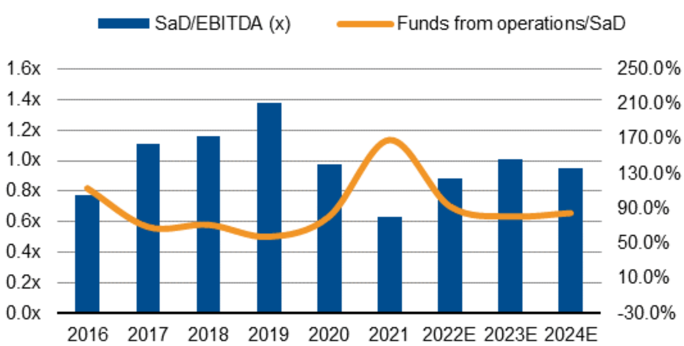
[2] https://ec.europa.eu/environment/topics/plastics/single-use-plastics_en
[3] https://innowo.org/userfiles/deposit%20refund%20systems%20Manual%20ENG.pdf (DRS Study 2019 – Deloitte)

Financial risk profile: A

Investment grade credit profile projected despite higher investment going forward

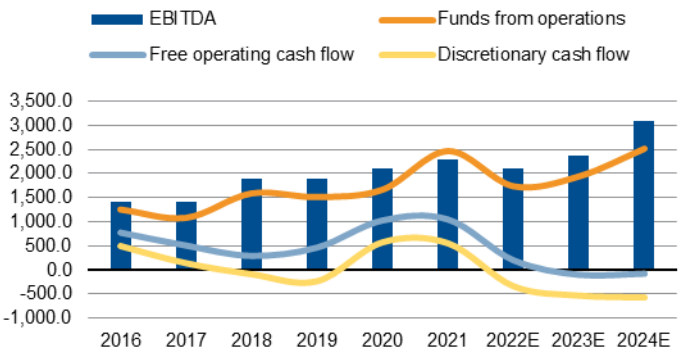
The company's financial risk profile (assessed at A) reflects low financial leverage with SaD/EBITDA of 0.7x to 1.3x over the past five years (Figure 5). The low debt levels can be explained by strong cash flow generation, medium capex, moderate M&A, and a prudent financial policy (dividend payout at 40%-60% of earnings). The company has been able to fund growth, capital investment and shareholder distributions largely through free operating cash flow, without the need to raise external capital. The company aims to have an investment grade credit profile with a net interest-bearing debt/EBITDA of below 2.0x – as of Q1 2022, the figure was 0.5x. Therefore, we believe the company will maintain its strong profile despite the higher investment going forward.

Figure 5: Scope-adjusted leverage



Sources: Tomra Systems, Scope (estimates)

Figure 6: Scope-adjusted cash flows

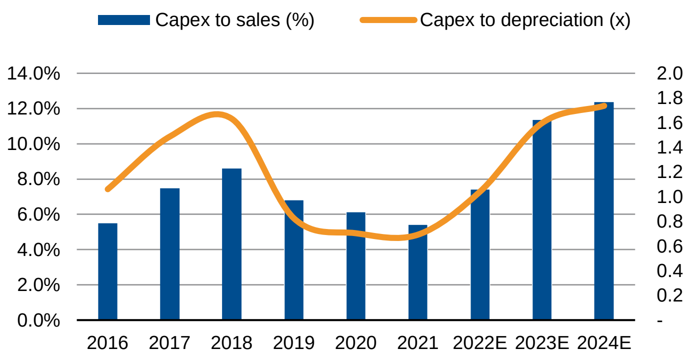


Sources: Tomra Systems, Scope (estimates)

Continued momentum and adjacent businesses to ramp up capex in the medium term

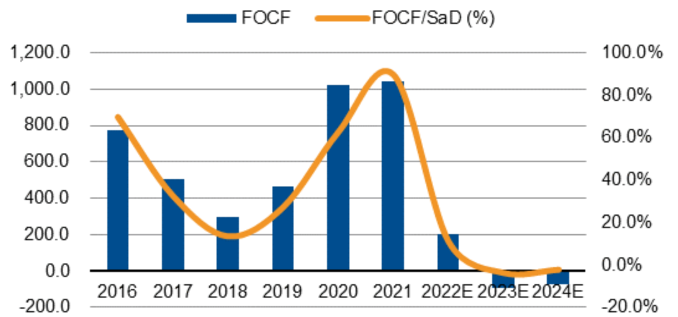
Our base case assumes that Tomra, as the leading global provider of RVMs, will continue to win tenders, also in new countries, for the implementation of deposit return systems over the next few years, maintain its strong market position for RVMs and sustain its historical revenue growth of around 10% yearly. The base case also assumes additional capex related to the newly announced adjacent businesses will be moderate at the start before ramping up towards the end of our forecast period (Figure 7).

Figure 7: Capex to sales and depreciation



Source: Company, Scope

Figure 8: Free operating cash flow generation



Source: Company, Scope

We do not expect large-scale M&A in the collections business, since the company holds such a strong global market position. Organic horizontal and vertical growth is more likely through adjacent businesses , Recycling or food.

Leverage assumed to remain strong under rating base case

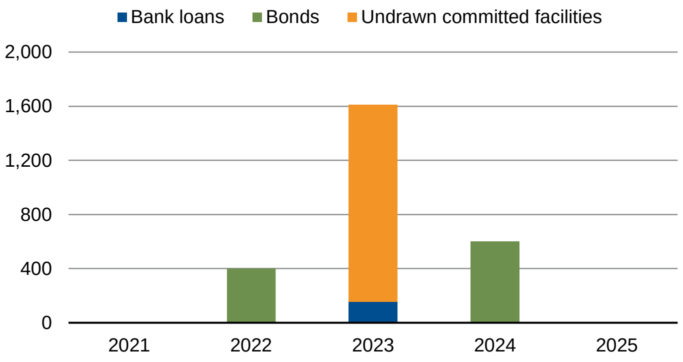
We project that the company's medium-term performance will generate enough cash flow to finance day-to-day investments, most of the new adjacent businesses and dividends. We have therefore assumed that the company will uphold its dividend goal of 40%-60% per year in the medium term.

Nevertheless, cash flows are likely to come under some pressure from the higher capex. Therefore, we expect FOCF decreasing and leverage ratios to increase slightly, from a very low SaD/EBITDA of 0.6x at Q1 2022, towards a still strong 1.0x in the medium term (Figure 5). This is also well within the company's stated leverage goals (i.e. in line with investment grade).

Strong liquidity underpinned by committed credit lines and no short-term debt

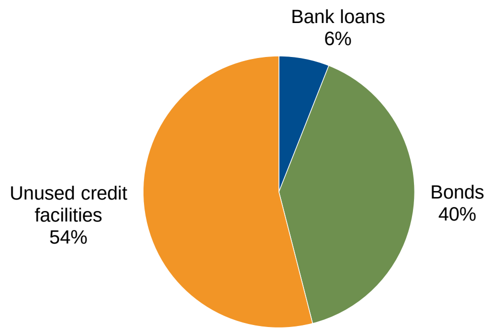
Liquidity is adequate. At Q1 2022 the company had NOK 620m in cash reserves as well as ~ NOK 1.6bn in unused committed credit facilities, and only one short-term maturity of NOK 400m (excluding leasing). The company has ample headroom under its financial covenant of a minimum equity ratio of 30% (at March 2022, actual figure of 52.9%).

Figure 9: Debt maturity profile, Q1 2022



Source: Company, Scope

Figure 10: Funding sources, Q1 2022



Source: Company, Scope

Balance in NOK m	2021	2022E	2023E
Unrestricted cash (t-1)	524	624	316
Open committed credit lines (t-1)	1457	1600	1600
Free operating cash flow	1044	203	-96
Short-term debt (t-1)	0	400	154
Coverage	**N/A**	**607%**	**1182%**

Long-term and short-term debt ratings

Senior unsecured debt rating: A-

The company had NOK 1bn of senior unsecured debt as of June 2022. Tomra Systems ASA is the issuer of all outstanding bonds. All senior unsecured debt has a negative pledge and pari passu conditions. We therefore rate these in line with the issuer rating, at A-.

Short-term debt rating: S-1

We have assigned an S-1 short-term rating, based on supportive internal and external sources of liquidity (e.g. access to credit facilities and cash on hand), positive cash flow generation, strong access to capital markets, and Tomra's long-term issuer credit rating.

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