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## Summary:

# Svenska Cellulosa Aktiebolaget SCA

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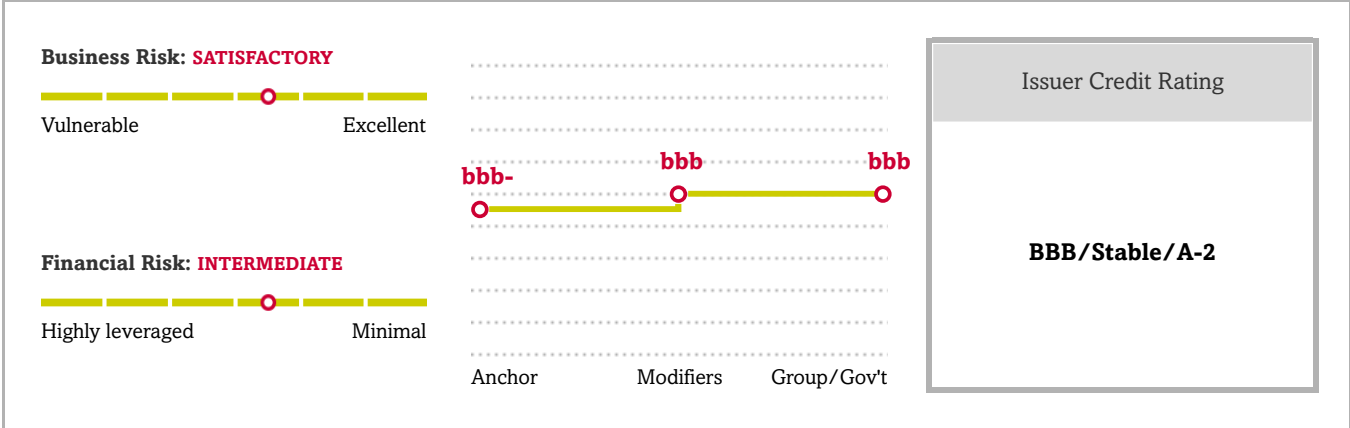
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Summary:

# Svenska Cellulosa Aktiebolaget SCA



## Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
<ul style="list-style-type: none"> <li>• Extensive forestland assets totaling 2.6 million hectares.</li> <li>• Well-invested and highly efficient industrial asset base.</li> <li>• Customizable logistics system, resulting in high efficiency.</li> <li>• Exposure to the volatile pulp and wood products segments.</li> <li>• Lack of downstream integration into packaging production.</li> <li>• Exposure to the declining publication paper markets (about 22% of sales).</li> </ul>	<ul style="list-style-type: none"> <li>• Strong operating cash flow (OCF) generation.</li> <li>• A conservative financial policy with a long-term track record of maintaining moderate leverage.</li> <li>• Very capital intensive, with maintenance capital expenditure (capex) amounting to 7%-8% of revenues.</li> <li>• Exposure to foreign exchange fluctuations (80% of net sales are exported), while cost base is almost entirely Swedish krona (SEK)-denominated.</li> </ul>

## Outlook: Stable

The stable outlook on Sweden-based forest products company Svenska Cellulosa Aktiebolaget SCA reflects our expectation that credit metrics will remain stable in 2018 while OCF is used to fund ongoing investments at Östrand. We expect strong earnings growth in 2019 and 2020, which will improve credit metrics. While we believe SCA will continue to pay dividends, we think that SCA will remain balanced in its financial policy, maintaining moderate leverage following the conclusion of the expansive investment phase in 2019.

### Downside scenario

We could lower the rating if operating performance deteriorated and the stable forest operations no longer compensated for the cyclicity in SCA's industrial operations. This could be triggered by a significant and extended downturn in both the solid wood product and Northern bleached softwood kraft (NBSK) pulp segments. We could also lower the rating if SCA's credit metrics significantly underperformed our forecasts for 2018 and 2019, as a result--for instance--of weaker profitability or cost overruns at Östrand. We view funds from operations (FFO) to debt below 30% over a prolonged period as commensurate with a lower rating.

### Upside scenario

We would consider raising the rating if SCA's financial risk profile improved with FFO to debt exceeding 45% on a sustainable basis. We would also expect the company's financial policy to support such stronger credit metrics.

## Our Base-Case Scenario

Assumptions	Key Metrics																		
<ul style="list-style-type: none"> <li>• European economic growth of 2.1% in 2018 and 1.9% in 2019</li> <li>• Increased capacity for NBSK pulp and solid wood production, following investments made at Östrand, Tunadal, and Bollsta.</li> <li>• Increased prices for kraftliner paper and NBSK pulp in 2018, in line with current market conditions.</li> <li>• Net sales of SEK17.4 billion in 2018 and an S&amp;P Global Ratings-adjusted EBITDA margin of 20.5%, as a result of a positive pricing environment for SCA products, somewhat offset by the planned shutdown at the Östrand pulp mill.</li> <li>• Annual maintenance capex of about SEK1 billion, in addition to expansion capex of about SEK1.8 billion in 2018 and SEK600 million in 2019.</li> <li>• Continued dividend payments in 2018 and onward, in line with income growth.</li> </ul>	<table border="1"> <thead> <tr> <th></th> <th>2017A</th> <th>2018E</th> <th>2019E</th> </tr> </thead> <tbody> <tr> <td>EBITDA margin (%)</td> <td>22.0</td> <td>20.0-21.0</td> <td>21.0-22.0</td> </tr> <tr> <td>FFO to debt (%)</td> <td>41.5</td> <td>35</td> <td>33-35</td> </tr> <tr> <td>Debt to EBITDA (x)</td> <td>2.2</td> <td>2.6</td> <td>2.3-2.5</td> </tr> </tbody> </table>				2017A	2018E	2019E	EBITDA margin (%)	22.0	20.0-21.0	21.0-22.0	FFO to debt (%)	41.5	35	33-35	Debt to EBITDA (x)	2.2	2.6	2.3-2.5
		2017A	2018E	2019E															
	EBITDA margin (%)	22.0	20.0-21.0	21.0-22.0															
	FFO to debt (%)	41.5	35	33-35															
Debt to EBITDA (x)	2.2	2.6	2.3-2.5																
A--Actual. E--Estimate. FFO--Funds from operations.																			

## Company Description

SCA was founded in 1929 as a forest products company operating in Sweden. After expanding into adjacent activities (paper-based personal care and health products), the company refocused on forest and paper products in 2017, with the sale of its hygiene business, Essity. It is now Europe's largest private forest owner, with 2.6 million hectares of forestland (2.0 million hectares of which are productive). The book value of this forestland is about SEK31 billion. The value of its forest has historically increased every year, with more trees planted than harvested. SCA is forward integrated with industrial operations in the pulp, paper, and wood products segments. In 2017, sales were SEK16.7 billion and EBITDA was SEK3.7 billion.

## Business Risk: Satisfactory

Our business risk assessment reflects SCA's conservative business model and its large forestland holdings. Forestland is similar to real estate assets in that it produces stable cash flow and tends to appreciate in value (replanting exceeds harvesting). In addition to harvesting logs for the pulp, wood, and paper industries, forestland can be rented out to wind-power or holiday cabin operators. Timber and its by-products are also increasingly used for biofuels. SCA possesses a well-invested and highly efficient asset base, as demonstrated by its strong margins. For example, SCA's saw mills are equipped with advanced scanning systems that optimize the cutting process of logs based on their properties, maximizing the value of the timber. SCA uses Xray technology at its sawmills to identify the portion of

heartwood in a log and optimize its end-use. SCA also uses a highly efficient customizable logistics system.

These strengths are partly mitigated by some exposure to the more volatile pulp and wood segments. SCA has a small scale compared with industry giants such as UPM-Kymmene and Stora Enso, leading to a lesser ability to achieve economies of scale and scope. We also view SCA's business risk to be constrained by its exposure to the declining publication paper segment and its lack of downstream integration into the more stable packaging segment.

## Peer comparison

Table 1

Svenska Cellulosa Aktiebolaget SCA -- Peer Comparison					
Industry Sector: Paper/Forest Products					
--Fiscal year ended Dec. 31, 2017--					
	Svenska Cellulosa Aktiebolaget SCA	Holmen AB	Stora Enso Oyj	Mondi Group	UPM-Kymmene Corp.
Rating as of May 8, 2018	BBB/Stable/A-2	BBB+/Stable/A-2	BB+/Stable/B	BBB+/Stable/--	BBB-/Positive/A-3
<b>(Mil. SEK)</b>					
Revenues	16,664.0	17,269.0	98,705.1	69,727.3	98,361.1
EBITDA	3,662.0	2,796.5	14,999.3	14,465.5	16,602.5
FFO	3,374.7	2,289.8	11,896.5	11,799.4	13,330.9
Net income from cont. oper.	1,547.0	1,668.0	6,141.4	6,593.4	9,561.0
Cash flow from operations	3,124.7	2,575.8	12,190.0	10,974.0	16,082.2
Capital expenditures	3,555.0	701.0	6,465.7	6,632.7	2,987.2
Free operating cash flow	(430.3)	1,874.8	5,724.3	4,341.2	13,095.0
Discretionary cash flow	(4,644.3)	866.8	2,855.0	1,442.5	8,113.1
Cash and short-term investments	538.0	356.0	5,964.6	373.4	7,035.6
Debt	8,151.6	3,112.3	37,237.7	17,359.2	13,327.1
Equity	37,359.1	22,049.2	59,498.2	39,688.4	85,135.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	22.0	16.2	15.2	20.8	16.9
Return on capital (%)	4.1	5.7	10.2	17.3	11.0
EBITDA interest coverage (x)	15.6	43.5	7.7	16.7	14.8
FFO cash int. cov. (X)	28.4	1,177.0	9.9	15.3	44.6
Debt/EBITDA (x)	2.2	1.1	2.5	1.2	0.8
FFO/debt (%)	41.4	73.6	32.0	68.0	100.1
Cash flow from operations/debt (%)	38.3	82.8	33.0	63.2	120.7
Free operating cash flow/debt (%)	(5.3)	60.2	15.6	25.0	98.3
Discretionary cash flow/debt (%)	(57.0)	27.9	7.9	8.3	60.9

FFO--Funds from operations. SEK--Swedish krona.

## Financial Risk: Intermediate

Our financial risk assessment for SCA reflects our expectation of steady to improving credit metrics across 2018-2020. We forecast S&P Global Ratings-adjusted FFO to debt to remain comfortably above 30% and debt to EBITDA to remain well below 3.0x in 2018-2020.

### Financial summary

Table 2

Svenska Cellulosa Aktiebolaget SCA -- Financial Summary					
Industry Sector: Paper/Forest Products					
--Fiscal year ended Dec. 31--					
	2017	2016	2015	2014	2013
Rating history	BBB/Stable/A-2	BBB+/Watch Neg/A-2	A-/Stable/A-2	A-/Stable/A-2	BBB+/Positive/A-2
<b>(Mil. SEK)</b>					
Revenues	16,664.0	117,314.0	115,316.0	104,054.0	89,019.0
EBITDA	3,662.0	19,579.0	19,338.5	16,664.0	13,835.5
FFO	3,374.7	13,901.0	16,011.4	13,307.1	10,460.5
Net income from continuing operations	1,547.0	5,570.0	7,002.0	6,599.0	5,547.0
Cash flow from operations	3,124.7	16,224.0	14,525.4	12,459.1	9,783.5
Capital expenditures	3,555.0	9,318.0	7,506.0	5,692.0	5,514.0
Free operating cash flow	(430.3)	6,906.0	7,019.4	6,767.1	4,269.5
Discretionary cash flow	(4,644.3)	2,678.0	3,116.4	3,203.1	1,067.5
Cash and short-term investments	538.0	4,482.0	5,042.0	3,815.0	3,649.0
Debt	8,151.6	37,116.5	31,511.6	40,274.9	37,901.4
Equity	37,359.1	79,733.6	76,527.6	72,872.0	66,304.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	22.0	16.7	16.8	16.0	15.5
Return on capital (%)	4.1	11.2	11.3	9.8	8.5
EBITDA interest coverage (x)	15.6	16.9	13.8	11.0	9.2
FFO cash int. cov. (x)	28.4	15.9	14.5	11.2	9.4
Debt/EBITDA (x)	2.2	1.9	1.6	2.4	2.7
FFO/debt (%)	41.4	37.5	50.8	33.0	27.6
Cash flow from operations/debt (%)	38.3	43.7	46.1	30.9	25.8
Free operating cash flow/debt (%)	(5.3)	18.6	22.3	16.8	11.3
Discretionary cash flow/debt (%)	(57.0)	7.2	9.9	8.0	2.8

FFO--Funds from operations. SEK--Swedish krona.

## Liquidity: Strong

Our assessment of SCA's liquidity profile remains strong. We expect the company's liquidity sources will exceed liquidity uses by at least 1.5x over the next 12 months. We also believe that the company will maintain a conservative

financial policy and ensure strong liquidity coverage.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• Cash balance of SEK538 million as of Dec. 31, 2017;</li> <li>• Access to SEK7.4 billion under revolving credit facilities; and</li> <li>• Forecast unadjusted FFO of about SEK3.1 billion in 2018.</li> </ul>	<ul style="list-style-type: none"> <li>• Capex of SEK2.8 billion;</li> <li>• SEK3.5 million commercial paper maturities; and</li> <li>• A potential working capital increase of about SEK600 million, largely due to increasing raw material inventory resulting in higher production volumes.</li> </ul>

## Other Credit Considerations

We apply a one-notch positive comparable ratings analysis modifier to account for the value of the company's extensive forestland assets, which we believe our anchor does not fully reflect. We view SCA's 2.6 million hectares of forestland as credit enhancing, because it could provide a potential liquidity buffer. Although SCA views its forestland as core and does not intend to sell it, we believe it could be readily monetized at significant value in a distressed situation.

## Ratings Score Snapshot

### Issuer Credit Rating

BBB/Stable/A-2

### Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

### Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb-

### Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)

- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

## Reconciliation

Table 3

### Reconciliation Of Svenska Cellulosa Aktiebolaget SCA Reported Amounts With S&P Global Ratings-Adjusted Amounts

--Fiscal year ended Dec. 31, 2017--

	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Capital expenditures
<b>(Mil. SEK)</b>								
<b>Svenska Cellulosa Aktiebolaget SCA reported amounts</b>								
Reported	7,177.00	36,751.00	3,031.00	2,511.00	72.00	3,031.00	2,755.00	3,577.00
<b>S&amp;P Global Ratings adjustments</b>								
Interest expense (reported)	--	--	--	--	--	(72.00)	--	--
Interest income (reported)	--	--	--	--	--	11.00	--	--
Current tax expense (reported)	--	--	--	--	--	(59.00)	--	--
Operating leases	1,517.62	--	474.00	140.39	140.39	333.61	333.61	--
Postretirement benefit obligations/deferred compensation	--	606.05	40.00	40.00	--	35.13	58.13	--
Surplus cash	(538.00)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	22.00	(22.00)	(22.00)	(22.00)
Nonoperating income (expense)	--	--	--	11.00	--	--	--	--
Noncontrolling interest/minority interest	--	2.00	--	--	--	--	--	--
Debt - derivatives	(5.00)	--	--	--	--	--	--	--
EBITDA - income (expense) of unconsolidated companies	--	--	(1.00)	(1.00)	--	(1.00)	--	--
EBITDA - restructuring costs	--	--	118.00	118.00	--	118.00	--	--
D&A - asset valuation gains/(losses)	--	--	--	(617.00)	--	--	--	--
D&A - impairment charges/(reversals)	--	--	--	4.00	--	--	--	--
EBIT - income (expense) of unconsolidated companies	--	--	--	1.00	--	--	--	--
Total adjustments	974.62	608.05	631.00	(303.61)	162.39	343.73	369.73	(22.00)



Table 3

### Reconciliation Of Svenska Cellulosa Aktiebolaget SCA Reported Amounts With S&P Global Ratings-Adjusted Amounts (cont.)

S&P Global Ratings-adjusted amounts								
	Debt	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Capital expenditures
<b>Adjusted</b>	8,151.62	37,359.05	3,662.00	2,207.39	234.39	3,374.73	3,124.73	3,555.00

SEK--Swedish krona.

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- European Forest And Paper Companies Harvest Upgrades, Oct. 19, 2017

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
<b>Satisfactory</b>	a/a-	bbb+	<b>bbb/bbb-</b>	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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