

Svenska Cellulosa Aktiebolaget SCA

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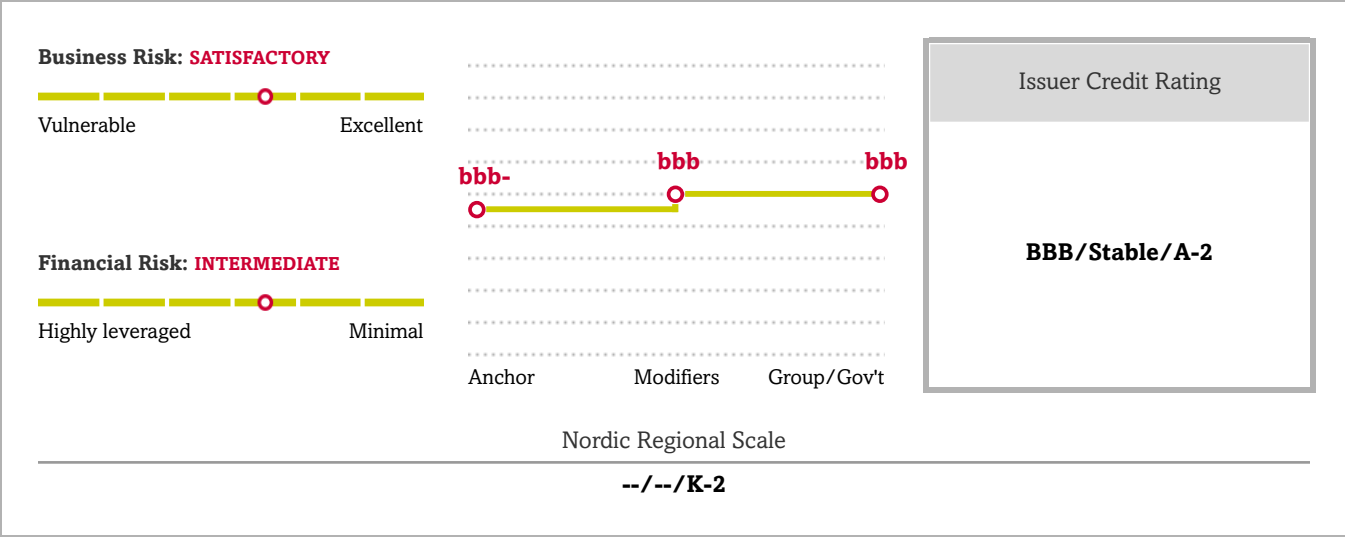
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Svenska Cellulosa Aktiebolaget SCA



Credit Highlights

Overview

Key strengths	Key risks
Extensive forestland holdings.	Volatility in pulp, wood, and paper prices.
Well-invested, efficient asset base.	Structural decline in demand for publication paper.
Strong operating cash flow generation.	Exposed to foreign exchange fluctuations.

S&P Global Ratings anticipates resilient demand for pulp and kraftliner this year, as well as weaker demand for graphic paper and wood products. In 2020, we expect to see a material increase in pulp production, as Svenska Cellulosa Aktiebolaget SCA (SCA)'s Östrand pulp mill operates at full capacity. Demand for SCA's pulp is supported by its resilient end-markets; over 70% of its pulp volumes relate to tissue and hygiene products. In the first quarter of 2020, demand for kraftliner was supported by strong demand for food and consumer products. We continue to monitor both segments, but so far, the impact of COVID-19 on the pulp and kraftliner segments has been limited.

However, we think demand for solid wood products will be negatively affected by the COVID-19-related lockdowns, and the reduced activity in the construction and renovation industry. Demand for graphic paper has also been negatively affected as many people have worked from home during the lockdowns, while corporate advertising spend has been put on hold. SCA curtailed part of its production temporarily.

Overall, we expect SCA's revenue to decline by about 4.0%-4.5% in 2020.

In our view, lower selling prices will reduce EBITDA margins in 2020. We forecast S&P Global Ratings-adjusted EBITDA margins of 18.0%-18.5% for 2020. This primarily reflects our expectation of lower average selling prices for pulp, paper, and wood products in 2020 (compared with 2019), as a result of the economic slowdown. We expect prices to recover in 2021, as the economy returns to positive growth.

SCA's credit metrics should remain commensurate with the current rating, despite a slight increase in leverage in 2020.

SCA maintained strong credit metrics in 2019; S&P Global Ratings-adjusted debt to EBITDA was 2.1x in December 2019. Although we anticipate a weaker operating performance for 2020, we expect leverage (about 3x) at year-end 2020 to remain in line with the current rating category. Investments relating to the Obbola project are expected to constrain free operating cash flow (FOCF) generation in the next three years. We forecast that SCA will only start reaping the benefits from this investment from 2023 onward, when the plant is due to start operations.

Outlook: Stable

The stable outlook on SCA reflects our expectation that although credit metrics will likely deteriorate, we expect them to remain in line with the current rating category.

Downside scenario

We could lower the rating if operating performance and credit metrics deteriorated, resulting for example in FFO to debt below 30% over a sustained period.

Upside scenario

We could consider raising the rating if SCA's FOCF's generation improved and FFO to debt remained above 45% on a sustainable basis. We would also expect the company's financial policy to publicly commit to such credit metrics.

Our Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> Negative real GDP growth in the eurozone of 7.3% in 2020, and +5.6% in 2021. Our base-case assumptions remain very uncertain and subject to ongoing revision, given the uncertain spread of the pandemic. There are a number of uncertainties which include currency fluctuations and ongoing social-distancing and lockdown measures globally. We expect revenue to decline by about 4.0%-4.5% in 2020 due to lower average prices in all segments. We expect this to be only partly offset by higher pulp deliveries following the full ramp up of the Östrand mill. We assume sales growth of about 5.5%-6.0% in 2021 due to improved prices and a recovery in demand for wood products and 		2019a	2020e	2021f
	EBITDA margin (%)	22.3	18.0-18.5	22.5-23.0
	FFO to debt (%)	39.4	~28	~30
	Debt to EBITDA (x)	2.1	~3.0	~2.8
	a--Actual. e--Estimate. f--Forecast.			

publication paper.

- A weaker adjusted EBITDA margin of 18.0%-18.5 in 2020 due to lower selling prices (in pulp, kraftliner, and wood). In 2021, we expect EBITDA margins to improve to 22.5%-23.0% as sales prices recover.
- Working capital inflow of about Swedish krona (SEK) 300 million in 2020 and an outflow of about SEK200 million in 2021.
- Capital expenditure (capex) of SEK2.7 billion in 2020. Thereafter, we expect annual capex to increase to SEK3.5 billion over 2020-2022, due to the construction of a new kraftliner machine in Obbola. Annual maintenance capex is forecast at about SEK1.2 billion.
- Forestland acquisitions of SEK200 million in 2020 and SEK500 million in 2021. This reflects SCA's plans to acquire 100,000 hectares of forests in the Baltics over the next four years
- Annual dividend payments of SEK1.4 billion in 2020 and SEK1.6 billion in 2021.

Base-case projections

The large Obbola paper mill investment will constrain FOCF generation in the medium term. Until 2023, SCA is investing SEK7.5 billion in the new paper machine and related infrastructure, with about SEK900 million spent in 2019 and about SEK1.5 billion expected in 2020, in addition to maintenance capex of about SEK1.2 billion annually.

Company Description

SCA is a Swedish forward-integrated forest products company. It is Europe's largest private forest owner with about 2.6 million hectares of forestland (of which 2.0 million hectares are productive). The market value of the forest in Sweden and the Baltic countries is estimated at over SEK69 billion.

In 2019, SCA generated revenues of SEK19.6 billion and adjusted EBITDA of SEK4.4 billion. About 47% of its external sales relate to paper (kraftliner and publication paper); over 32% to wood; and the remainder to pulp.

The group is the third-largest kraftliner manufacturer in Europe. Although kraftliner prices are volatile (and somewhat correlated to testliner prices), we expect e-commerce, the transition to environmentally friendly materials from plastic packaging, and food safety regulations to continue fueling growth in the medium to long term.

Demand for publication paper is in structural decline, but SCA's position is supported by a very competitive cost structure (it operates the third-largest publication paper mill).

SCA also operates five sawmills that transform the most valuable parts of trees into sawlogs. It has invested heavily in its sawmills, which are sizable and efficient. Its wood products are sold to wood converters and traders (such as manufacturers of furniture, doors, and windows) and the building materials trade.

Following the expansion of Östrand's annual pulp production capacity to 1,000,000 tonnes, the volume of SCA's produced pulp increased significantly in 2019. SCA mainly focuses on northern bleached softwood kraft (NBSK) pulp, used for packaging, tissue, filter, and publication paper applications. The group also produces 100,000 tonnes of chemically pre-treated mechanical pulp (CTMP) used in hygiene and packaging products.

SCA rents a small area of its forestland to wind-power operators, and is diversifying into the production of wood-based biofuels (largely used in its own plants).

Business Risk: Satisfactory

Our business risk assessment reflects SCA's leading market positions in the kraftliner and publication paper segments, its cost-efficient asset base and logistic operations, and its large forestland holdings.

The volatility of its product segments (kraftliner, publication paper, wood, pulp) partially mitigates these strengths. Furthermore, SCA has a small scale compared with industry giants such as UPM-Kymmene and Mondi Group, leading to lower economies of scale. SCA's business risk also remains constrained by the structural decline in publication paper.

Peer comparison

Table 1

Svenska Cellulosa Aktiebolaget SCA -- Peer Comparison				
Industry Sector: Paper/Forest Products				
	Svenska Cellulosa Aktiebolaget SCA	Holmen AB	UPM-Kymmene Corp.	Metsa Board Corp.
Ratings as of May 27, 2020	BBB/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	BBB-/Stable/A-3
--Fiscal year ended Dec. 31, 2019--				
(Mil. SEK)				
Revenue	19,591.0	18,314.0	107,328.9	20,251.8
EBITDA	4,369.0	2,784.0	19,205.6	2,954.2
Funds from operations (FFO)	3,614.0	2,603.0	17,014.5	2,593.6
Interest expense	113.0	48.0	471.8	159.3
Cash interest paid	103.0	34.0	346.0	170.9
Cash flow from operations	3,296.0	2,881.0	19,320.9	2,101.9
Capital expenditure	2,288.0	1,044.0	4,182.9	988.6
Free operating cash flow (FOCF)	1,008.0	1,837.0	15,138.0	1,113.3
Discretionary cash flow (DCF)	(221.0)	(727.0)	7,873.0	32.5
Cash and short-term investments	454.0	483.0	16,102.5	1,406.9
Debt	9,163.0	4,271.0	2,411.3	3,339.3

Table 1

Svenska Cellulosa Aktiebolaget SCA -- Peer Comparison (cont.)				
Equity	68,510.0	40,111.0	106,658.0	14,026.8
Adjusted ratios				
EBITDA margin (%)	22.3	15.2	17.9	14.6
Return on capital (%)	4.3	4.6	12.7	10.1
EBITDA interest coverage (x)	38.7	58.0	40.7	18.5
FFO cash interest coverage (x)	36.1	77.6	50.2	16.2
Debt/EBITDA (x)	2.1	1.5	0.1	1.1
FFO/debt (%)	39.4	60.9	705.6	77.7
Cash flow from operations/debt (%)	36.0	67.5	801.3	62.9
FOCF/debt (%)	11.0	43.0	627.8	33.3
DCF/debt (%)	(2.4)	(17.0)	326.5	1.0

SEK--Swedish krona.

We view SCA's business risk profile as similar to that of Swedish peer Holmen. Both companies are of similar size with Nordic production assets and large forestland holdings. We believe SCA's exposure to expanding markets, such as kraftliner paper and NBSK pulp, is an advantage.

UPM-Kymmene is substantially larger than SCA, and much more diverse in terms of products and customers. However, UPM has a much larger exposure to publication paper, and is less profitable than SCA.

SCA's business risk profile is stronger than Finnish peer Metsä Board due to a more-efficient asset-base, reflected in its superior profitability.

Financial Risk: Intermediate

We expect SCA's credit metrics to deteriorate in 2020, with adjusted leverage at about 3x and adjusted funds from operations (FFO) to debt at about 28% by year-end. Despite a significant increase in pulp deliveries, we expect unfavorable price decreases to weigh on profitability. For 2021, we forecast a recovery in prices, and we also anticipate graphic paper and solid wood products demand to be healthier than in 2020, supported by a rebound in economic activity.

In the coming years, SCA expects to gradually increase harvesting. In our view, this will support EBITDA and cash flow generation. However, FOCF will be constrained until 2023, due to significant investments related to the Obbola project. We anticipate that SCA will partly finance this capex by raising additional debt. In addition, SCA is planning further forest acquisitions in the Baltic countries. As a result, we expect only modest improvement in credit metrics, with adjusted debt to EBITDA of about 2.8x and adjusted FFO to debt of about 30% by year-end 2021.

Financial summary

Table 2

Svenska Cellulosa Aktiebolaget SCA -- Financial Summary					
Industry Sector: Paper/Forest Products					
	--Fiscal year ended Dec. 31--				
	2019	2018	2017	2016	2015
(Mil. SEK)					
Revenue	19,591.0	18,755.0	16,664.0	117,314.0	115,316.0
EBITDA	4,369.0	4,800.0	3,662.0	19,579.0	19,338.5
Funds from operations (FFO)	3,614.0	4,421.4	3,364.6	14,675.2	15,792.6
Interest expense	113.0	116.6	234.4	1,157.8	1,405.9
Cash interest paid	103.0	149.6	267.4	1,104.8	1,337.9
Cash flow from operations	3,296.0	3,663.4	3,066.6	15,943.2	14,378.6
Capital expenditure	2,288.0	3,058.0	3,555.0	9,318.0	7,506.0
Free operating cash flow (FOCF)	1,008.0	605.4	(488.4)	6,625.2	6,872.6
Discretionary cash flow (DCF)	(221.0)	(448.6)	(4,702.4)	2,397.2	2,969.6
Cash and short-term investments	454.0	648.0	538.0	4,482.0	5,042.0
Gross available cash	454.0	648.0	538.0	4,482.0	5,042.0
Debt	9,163.0	8,304.0	8,151.6	37,116.5	31,405.6
Equity	68,510.0	39,062.0	36,753.0	79,519.0	75,691.0
Adjusted ratios					
EBITDA margin (%)	22.3	25.6	22.0	16.7	16.8
Return on capital (%)	4.3	7.3	2.7	12.4	12.5
EBITDA interest coverage (x)	38.7	41.2	15.6	16.9	13.8
FFO cash interest coverage (x)	36.1	30.6	13.6	14.3	12.8
Debt/EBITDA (x)	2.1	1.7	2.2	1.9	1.6
FFO/debt (%)	39.4	53.2	41.3	39.5	50.3
Cash flow from operations/debt (%)	36.0	44.1	37.6	43.0	45.8
FOCF/debt (%)	11.0	7.3	(6.0)	17.8	21.9
DCF/debt (%)	(2.4)	(5.4)	(57.7)	6.5	9.5

SEK--Swedish krona.

Liquidity: Strong

SCA's liquidity remains strong, supported by available cash of SEK867 million, fully available revolving credit facilities (RCFs; SEK6.6 billion), SEK1 billion from a new loan raised in April 2020, and our expectation of strong operational cash flow generation. We anticipate that the company's liquidity sources will exceed liquidity uses by at least 1.5x in the next 12 months. We also expect SCA to maintain a conservative financial policy and ensure strong liquidity coverage.

Principal liquidity sources

- Available cash balance of SEK867 million as of March 31, 2020;
- Access to SEK6.6 billion under RCFs;

- Proceeds of SEK1 billion from a new loan in April 2020;
- Working capital inflow of SEK300 million; and
- Forecast FFO of about SEK2.9 billion-SEK3.0 billion in the next 12 months.

Principal liquidity uses

- Capex of SEK3.2 billion; and
- Debt maturities of SEK3.8 billion.

Covenant Analysis

The group is not subject to any maintenance covenants under its loan agreements.

Other Credit Considerations

In our view, the value of the company's extensive forestland assets is not fully incorporated in our anchor. We therefore apply a one-notch positive comparable ratings analysis modifier. 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.

The change in the accounting method for valuing SCA's forest assets has not had a material impact on our credit assessment.

Environmental, Social, And Governance

As a forest products company, environmental concerns are paramount to SCA. As Europe's largest private forestland owner, the group promotes sustainable forest management, and its growing forest binds a net of 5 million tonnes of carbon dioxide (CO₂) annually, which makes SCA a net absorber of carbon dioxide emissions.

SCA also continuously invests in improving the energy efficiency of its industrial assets. The Östrand pulp mill, for example, is a net seller of green electricity and heating.

SCA is also seeking to expand its renewable energy generation. In addition to biofuels production, the company leases out forestland for wind power projects.

We view governance as a supporting factor for the ratings, reflecting management's experience and expertise, governance in line with best practices, and the balance of different stakeholders' interests.

Issue Ratings - Subordination Risk Analysis

SCA's capital structure has no material prioritized obligations and an intermediate financial risk profile. Therefore, we consider there is little risk that any lender will be significantly disadvantaged compared with other lenders.

Capital structure

The SEK9.9 billion debt (at March 31, 2020) included bank loans, bonds, commercial paper, and leases. Except for the SEK835 million in leases and SEK20 million in chattel mortgages, all of the debt is unsecured.

Analytical conclusions

With no contractual subordination and an intermediate financial risk profile, we rate SCA's unsecured obligations 'BBB', in line with the issuer credit rating.

Reconciliation

Table 3

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

--Fiscal year ended Dec. 31, 2019--

Svenska Cellulosa Aktiebolaget SCA reported amounts (mil. SEK)	Debt	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Capital expenditure
	8,763.0	4,602.0	19,665.0	112.0	4,369.0	3,297.0	2,289.0
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	(652.0)	--	--
Cash interest paid	--	--	--	--	(102.0)	--	--
Reported lease liabilities	854.0	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	--	15.0	15.0	--	--	--	--
Accessible cash and liquid investments	(454.0)	--	--	--	--	--	--
Capitalized interest	--	--	--	1.0	(1.0)	(1.0)	(1.0)
Income (expense) of unconsolidated companies	--	14.0	--	--	--	--	--
Nonoperating income (expense)	--	--	20.0	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	(202.0)	(202.0)	--	--	--	--
EBITDA: Other	--	(60.0)	(60.0)	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	-16,759	--	--	--	--

Table 3

Svenska Cellulosa Aktiebolaget SCA--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (cont.)							
Total adjustments	400.0	(233.0)	(16986.0)	1.0	(755.0)	(1.0)	(1.0)
S&P Global Ratings' adjusted amounts							
	Debt	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Capital expenditure
	9,163.0	4,369.0	2,679.0	113.0	3,614.0	3,296.0	2,288.0

SEK--Swedish krona.

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)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate

Issuers, Dec. 16, 2014

- Criteria | Corporates | Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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
Satisfactory	a/a-	bbb+	bbb/bbb-	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-

Ratings Detail (As Of May 27, 2020)*

Svenska Cellulosa Aktiebolaget SCA

Issuer Credit Rating	BBB/Stable/A-2
<i>Nordic Regional Scale</i>	--/--/K-2
Senior Unsecured	BBB

Issuer Credit Ratings History

07-Apr-2017	<i>Foreign Currency</i>	BBB/Stable/A-2
20-Dec-2016		BBB+/Watch Neg/A-2
21-Feb-2014		A-/Stable/A-2
07-Apr-2017	<i>Local Currency</i>	BBB/Stable/A-2
20-Dec-2016		BBB+/Watch Neg/A-2
21-Feb-2014		A-/Stable/A-2
07-Apr-2017	<i>Nordic Regional Scale</i>	--/--/K-2
20-Dec-2016		--/Watch Neg/K-1
18-Oct-2010		--/--/K-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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