MOODY'S INVESTORS SERVICE

CREDIT OPINION
24 August 2020

Update

Rate this Research

RATINGS

Essity Aktiebolag

Domicile	Sweden
Long Term Rating	Baa1
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Essity Aktiebolag

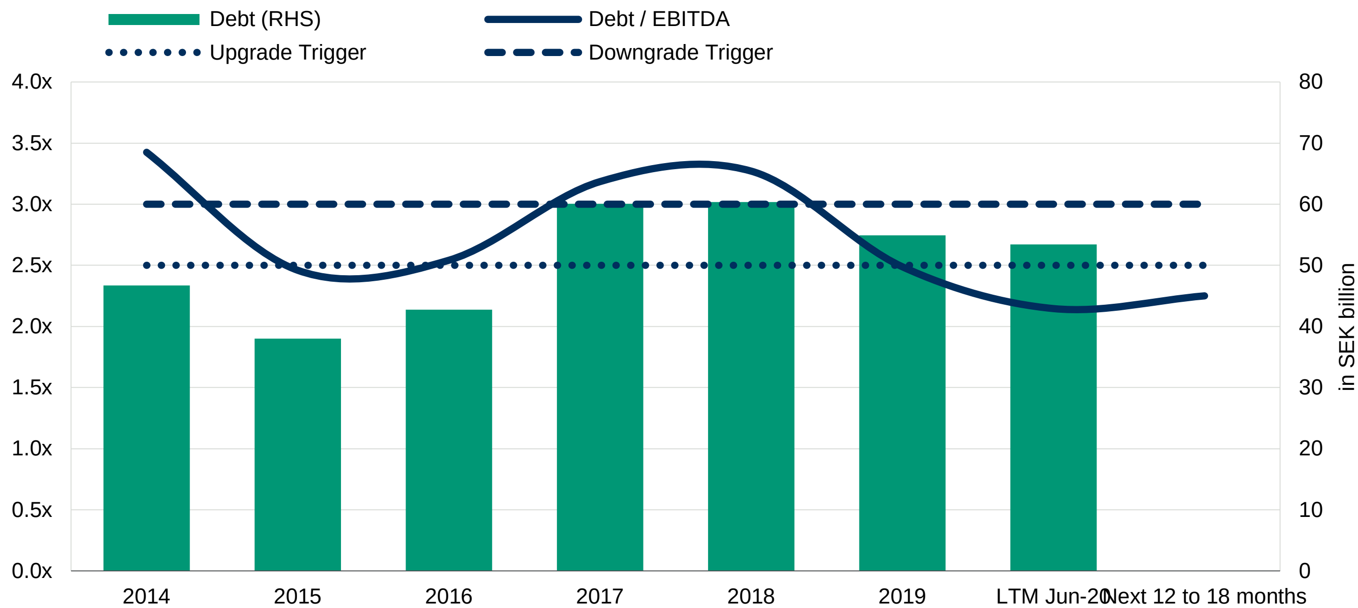
Update following H1 2020 results

Summary

The Baa1/P-2 ratings of Essity Aktiebolag (Essity) with a stable outlook primarily reflect the company's large scale, with revenue of SEK128 billion for the 12 months that ended June 2020 (around $13 billion), and a broad product portfolio; its leading market positions, with well-recognised brands and a good track record of innovation; its global footprint, with the faster-growing emerging markets representing roughly one-third of its revenue; the fairly good underlying growth and the stable demand for its products; and its financial policies, which are aimed at protecting its solid investment-grade rating, and a track record of significant positive free cash flow (FCF) that the company can use for deleveraging, if needed.

Essity's ratings are primarily constrained by the company's exposure to volatile input costs, pulp in particular, which can be passed through only with a significant delay; its somewhat below-average profitability compared with that of most of its similarly rated peers, such as Kimberly-Clark (K-C, A2 stable) or Procter & Gamble (P&G, Aa3 stable), with a Moody's-adjusted EBIT margin of 13.5% for the 12 months that ended June 2020; its strained operating environment because of the coronavirus pandemic-related lockdowns; and a certain degree of debt-funded M&A risk, which, however, falls within the company's commitment to maintaining a solid investment-grade rating.

Exhibit 1
We expect Essity's leverage to remain well below our downgrade trigger after the integration of BSN Medical



All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Forward view represents Moody's view and does not incorporate any material divestments and acquisitions (following the integration of BSN Medical).
Source: Moody's Financial Metrics™

Credit strengths

» A strong business profile, with a broad portfolio of well-positioned global (Tork and Tena) and regional brands

» Fairly good underlying growth and stable demand for most of its products even after the outbreak of the coronavirus pandemic

» A financial policy that is aimed at protecting its solid investment-grade rating

Credit challenges

» Exposure to volatile input costs such as pulp and recycled paper

» Ongoing need for innovation in the personal care and tissue businesses to preserve pricing levels

» Professional care product demand to be hurt by the coronavirus pandemic-related lockdowns

» Event risks, such as debt-funded M&A or shareholder-friendly actions

Rating outlook

The stable outlook reflects our expectation that Essity will continue to operate with solid credit metrics that are commensurate with the Baa1 ratings during next 12-18 months, with its Moody's-adjusted debt/EBITDA remaining well below 3.0x.

Factors that could lead to an upgrade

» EBIT margin consistently above 12% in the company's business areas

» Retained cash flow/net debt above 25%

» Debt/EBITDA well below 2.5x

» Continued positive FCF, which is applied towards debt reduction

Factors that could lead to a downgrade

» A decline in the company's EBIT margin to below 9%

» Retained cash flow/net debt falling below 20% on a sustained basis

» Failure to maintain debt/EBITDA below 3x

» FCF turning negative

» Erosion of the company's solid liquidity

Key indicators

Exhibit 2
Essity Aktiebolag

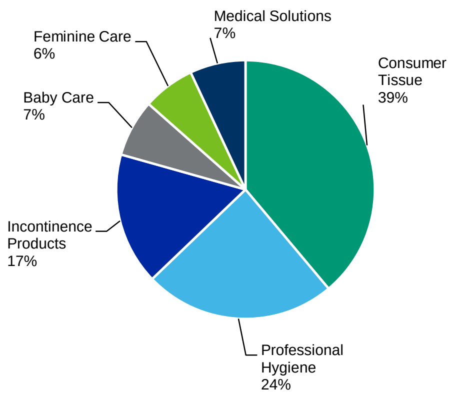
	12/31/2016	12/31/2017	12/31/2018	12/31/2019	6/30/2020(L)	Next 12 - 18 months
Revenue (USD Billion)	$11.8	$12.8	$13.6	$13.6	$13.3	$13.5 - $14.5
EBITA Margin	11.3%	12.2%	10.5%	12.2%	14.4%	13% - 14%
Debt / EBITDA	2.5x	3.2x	3.3x	2.5x	2.1x	2.0x - 2.5x
RCF / Net Debt	28.0%	25.1%	20.5%	22.2%	33.8%	25% - 30%
EBITA / Interest Expense	9.2x	9.1x	8.2x	10.2x	12.7x	11.5x - 13x

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
This represents Moody's forward view, not the view of the issuer, and does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Profile

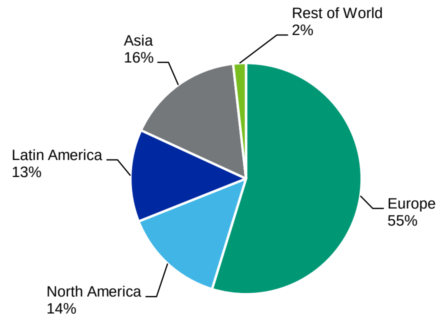
Headquartered in Stockholm, Sweden, Essity Aktiebolag (Essity) is one of the leading global hygiene and health companies, with sales of SEK128 billion for the 12 months that ended June 2020 (around $13 billion). The company develops, produces and sells a wide range of products, including incontinence products, baby diapers, feminine-care products, consumer tissue, away-from-home tissue, and products for wound care, compression therapy and orthopaedics. With a workforce of roughly 46,000 employees, Essity operates in about 150 countries worldwide under a number of well-recognised brands. Essity was formed in 2016 and spun off in June 2017 from Svenska Cellulosa Aktiebolaget (SCA). The company is listed on the Stockholm Stock Exchange, with a market capitalisation of around SEK206 billion as of 13 August 2020.

Exhibit 3
Revenue split by product
As of full year 2019



Source: Essity

Exhibit 4
Revenue split by geography
As of full year 2019



Source: Essity

Detailed credit considerations

Wide product portfolio, with a number of leading positions globally

Essity's Baa1/P-2 ratings reflect the fact that with sales of close to SEK130 billion, the company is one of the leading global hygiene and health companies, active in around 150 countries. Among others, the company is the global leader in incontinence products under the Tena brand and in professional hygiene under the Tork brand. In addition, the company has strong brands and market positions within the markets for baby diapers, feminine care and consumer tissue, as well as regional and global brands. Essity also has leading market positions in wound care, compression therapy and orthopaedics, with brands such as Jobst and Leukoplast. Overall, the company holds the first or second position within at least one product segment in around 90 countries.

Exhibit 5
Overview of market positions and key brands

	Global	Europe	North America	Latin America	Asia	Key Brands
Incontinence Products	#1	#1	#4	#1	#3	Tena
Baby Care	#5	#2	n.a.	#6	#6	Drypers, Pequenín, Libero, Lotus Baby
Feminime Care	#6	#3	n.a.	#1	#10	Libresse, Saba, Nosotras, Bodyform, Nana
Medical Solutions	#4	#1	#12	#3	#2	Jobst, Leukoplast, Cutimed, Delta-Cast, Actimove
Consumer Tissuer	#2	#1	n.a.	#3	#1	Edet, Lotus, Regio, Tempo, Vinda, Zewa, Plenty
Professional Hygiene	#1	#1	#2	#4	#3	Tork

Source: Essity

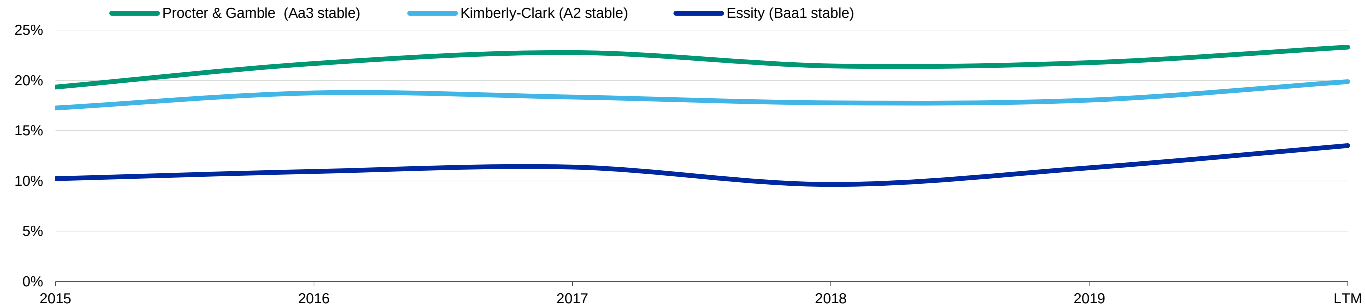
The personal care and tissue markets are fairly competitive, and subject to periods of temporary oversupply, which require producers to continuously focus on innovation to protect brand strength and optimise costs. In the tissue business, which is generally more competitive and less profitable, Essity competes primarily with Georgia-Pacific LLC (A3 stable), Hengan, K-C and Sofidel. In the personal care business, Essity's key competitors are K-C, P&G and Unicharm. In April 2017, following the debt-funded acquisition of BSN Medical for €2.7 billion, the company entered the market for medical devices with low technology content, such as wound care and compression therapy, which benefits from robust and stable demand and above-average profitability.

We expect Essity to focus on growing its personal care and medical device product offerings while further increasing the efficiency of its tissue operations. This strategy will help narrow the profitability gap with the company's more-profitable competitors, especially K-C and P&G, which benefit from a higher share of the more-profitable personal care business and the generally more-profitable US market.

Exhibit 6

Essity's margins have been below those of its main competitors, but the gap narrowed in 2019

Moody's-adjusted EBIT margin



All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Good underlying demand growth, especially in emerging markets

Essity benefits from the underlying growth in demand for its products, supported by megatrends such as population growth and higher disposable income, as well as the increased prevalence of people with chronic diseases. While mature markets continue to experience modest annual growth in the low-single-digit percentages, the growth potential in emerging markets is substantial, and we estimate the annual growth in these markets to be in the high-single-digit percentages. This is because the per capita consumption of tissue and personal care products in emerging markets is significantly lower in an environment where living standards are rapidly improving.

To benefit from this development, Essity had focused on growing its presence in emerging markets over the past decade. This was done both organically and through M&A, most recently through an acquisition of a majority stake in the Hong-Kong-based tissue company Vinda in November 2013. Currently, emerging markets represent roughly one-third of the revenue, and we expect this share to increase further.

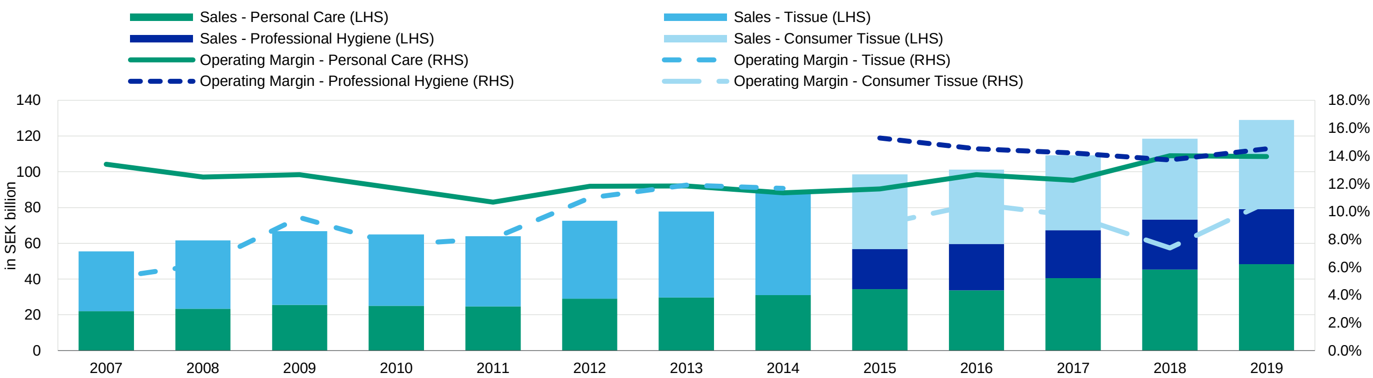
Profitability has exposure to volatile input costs

The demand for Essity products has historically been fairly good stable through the cycle. Even during the 2008-09 global economic downturn, which was unprecedented in its magnitude, the company hardly faced any decline in organic sales, and margins for both the tissue and personal care businesses, the latter one in particular, remained robust. Nevertheless, the coronavirus pandemic severely affected demand for professional hygiene products because of the resulting lockdown measures taken by governments. This prevented consumers from purchasing services as usual because larger events were cancelled and restaurants were shut down. However, the continued increase in demand for tissue products signals an ongoing megatrend towards increased use of hygiene products.

The profitability for both the tissue and personal care operations has been fairly stable over the last decade, which also indicates Essity's ability to manage its key input costs. Some of the input costs, such as pulp (17% of total operating expenses at the group level in 2019) and recycled paper (4%), have fairly high volatility, and price increases can be typically passed on to customers only with delays of up to one year. Even in an environment of substantially increasing pulp prices in 2017 and the first half of 2018, the company delivered a fairly robust performance, with less volatility than that of its key tissue peers in Europe.

Exhibit 7

Essity has had fairly stable demand patterns and profitability through the cycle



Change in reporting segments in 2017 with retrospective changes until 2015. The segment previously named tissue is now split into professional hygiene and consumer tissue.
Data as reported by the company (that is, without Moody's adjustments).
Sources: Essity financial reports and former Svenska Cellulosa Aktiebolaget segmental reporting

M&A risk, but within the limits of Essity's financial policies, which target a solid investment-grade rating

Essity's financial policies are centred around its commitment to retain a solid investment-grade rating, which drives its capital allocation priorities, including dividend payouts as well as M&A. Although we believe that in the next couple of years the company will continue to complement organic growth with M&A, especially in the area of medical devices with low technology content, where the market is still relatively fragmented, at this point, there is still limited capacity for debt-funded growth. We expect the company to refrain from any major M&A until it improves its credit metrics to the levels commensurate with a Baa1 rating.

Following the acquisition of BSN Medical in April 2017, Essity's leverage remained high, with Moody's-adjusted debt/EBITDA above 3x during 2017 and 2018 and improving to below 3x in second half of 2019, positioning the company weakly in the Baa1 category for some time. However, we believe that Essity will be willing and able to operate with a leverage of below 3.0x through the cycle, supported by both EBITDA growth, as the company continues to pass through high pulp prices to it customers, and actual debt repayments. Taking into consideration Essity's capital spending of 5%-6% of sales and dividends typically of around 50% of net income, we expect the company to continue to generate positive FCF in the high-single-digit percentages of Moody's-adjusted gross debt, which could be used for debt repayments. We will assess further smaller acquisitions within the limits of the company's FCF on a case-by-case basis.

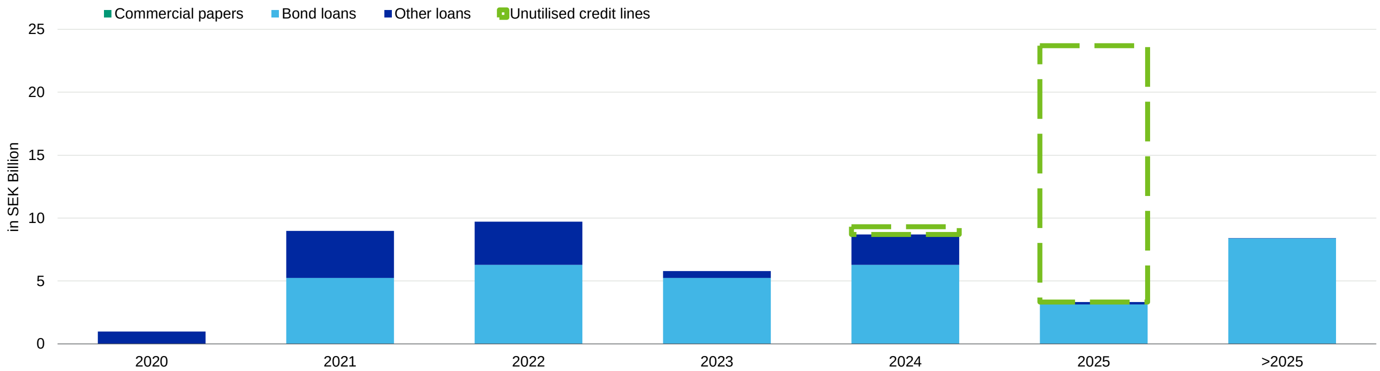
Liquidity analysis

We consider Essity's liquidity good, primarily based on our expectation that the company will continue to generate significant positive FCF over the next four to six quarters. As of the end of June 2020, the company reported around SEK5.5 billion of cash and cash equivalents, roughly one-third of those in countries with currency restrictions. In addition, the company has access to various largely undrawn credit facilities, totalling roughly SEK21 billion, consisting primarily of two syndicated facilities, each of €1.0 billion, maturing in 2025 with the later one having an extension option to 2026. The facilities are of high quality, without material adverse change clauses and other conditionality language, and have also served as backstop facilities for the company's commercial paper programme, which has been a central source of Essity's short-term funding needs. As of the end of June 2020, the company reported roughly SEK8.4 billion in short-term debt, which includes around SEK5 billion in Swedish krona and euro bonds. The company's maturity profile is generally well spread, with an average maturity of around four years.

Exhibit 8

Essity's debt maturity profile is generally well spread

As of 30 June 2020



Source: Essity

Environmental, social and governance considerations

Despite the fact that the pulp and paper industry is a fairly large consumer of energy and water in the production processes, with occasional environmental incidents, we score it as moderate risk in our Environmental risks heat map. This score means that we believe that the industry's exposure to environmental risk is broadly manageable, or it could be material to the credit quality in the medium to long term (five or more years).

Sustainability is one of the company's strategic priorities as the global awareness about the issue increases. Therefore, Essity promotes sustainable consumption by being innovative in how it meets the needs of its customers, and aims to develop solutions for a sustainable and circular society. The company strives to reduce environmental impact and resource consumption throughout the life cycle of its products and services.

Methodology and scorecard

The principal methodology used in rating Essity is the Global Packaged Goods rating methodology. The methodology grid indicates a weak A3 rating for the metrics achieved for the 12 months that ended June 2020, as well as for our 12-18-month forward-looking view. The one-notch difference is mainly attributed to a weak positioning of Essity in the A category for the Geographic Diversification, Category Assessment, relatively low profit margin and Financial Policy subfactors.

Exhibit 9

Rating factors

Essity Aktiebolag

Consumer Packaged Goods Industry Scorecard [1][2]	Current LTM 6/30/2020		Moody's 12-18 Month Forward View As of 8/13/2020 [3]	
Factor 1 : Scale (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$13.3	A	$13.5 - $14.5	A
Factor 2 : Business Profile (30%)				
a) Geographic Diversification	A	A	A	A
b) Segmental Diversification	Baa	Baa	Baa	Baa
c) Market Position	A	A	A	A
d) Category Assessment	A	A	A	A
Factor 3 : Profitability (10%)				
a) EBITA Margin	14.4%	Ba	13% - 14%	Ba
Factor 4 : Leverage and Coverage (25%)				
a) Debt / EBITDA	2.1x	A	2x - 2.5x	A
b) RCF / Net Debt	33.8%	Baa	25% - 30%	Baa
c) EBITA / Interest Expense	12.7x	Aa	11.5x - 13x	A
Factor 5 : Financial Policy (15%)				
a) Financial Policy	A	A	A	A
Rating:				
a) Scorecard-Indicated Outcome		A3		A3
b) Actual Rating Assigned				Baa1

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
This represents Moody's forward view, not the view of the issuer, and does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics™

Ratings

Exhibit 10

Category	Moody's Rating
ESSITY AKTIEBOLAG	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
ST Issuer Rating	P-2

Source: Moody's Investors Service

Exhibit 11
Peer comparison

	Essity Aktiebolag Baa1 Stable			Kimberly-Clark Corporation A2 Stable			Procter & Gamble Company (The) Aa3 Stable		
(in US millions)	FYE Dec-18	FYE Dec-19	LTM Jun-20	FYE Dec-18	FYE Dec-19	LTM Jun-20	FYE Jun-18	FYE Jun-19	LTM Mar-20
Revenue	$13,649	$13,649	$13,324	$18,486	$18,450	$18,844	$66,832	$67,684	$70,346
EBITDA	$2,125	$2,335	$2,584	$4,412	$4,387	$4,713	$17,449	$17,799	$19,698
Total Debt	$6,805	$5,865	$5,734	$8,648	$8,424	$8,750	$40,156	$39,430	$45,132
Cash & Cash Equiv.	$348	$313	$590	$539	$442	$1,448	$2,569	$4,239	$15,393
EBIT Margin	9.7%	11.3%	13.5%	17.8%	18.0%	19.9%	21.4%	21.8%	23.3%
EBIT / Int. Exp.	7.5x	9.5x	11.9x	10.5x	11.5x	13.3x	19.2x	20.7x	27.3x
Debt / EBITDA	3.3x	2.5x	2.1x	2.0x	1.9x	1.9x	2.3x	2.2x	2.3x
RCF / Net Debt	20.5%	22.2%	33.8%	16.9%	22.2%	27.9%	11.7%	20.8%	27.9%
FCF / Debt	3.0%	14.9%	24.8%	9.7%	1.8%	16.2%	9.9%	11.2%	12.9%

All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics™

Exhibit 12
Reconciliation of debt

(in SEK Millions)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	LTM Ending Jun-20
As Reported Debt	**34,008**	**36,149**	**54,124**	**53,742**	**51,227**	**49,749**
Pensions	2,917	4,662	3,804	3,830	4,133	4,133
Operating Leases	2,043	2,626	2,328	3,334	0	0
Non-Standard Adjustments	-977	-673	-195	-570	-461	-461
Moody's-Adjusted Debt	**37,991**	**42,764**	**60,061**	**60,336**	**54,899**	**53,421**

Source: Moody's Financial Metrics™

Exhibit 13
Reconciliation of EBITDA

(in SEK Millions)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	LTM Ending Jun-20
As Reported EBITDA	**15,552**	**14,809**	**18,036**	**17,500**	**21,941**	**24,777**
Pensions	149	134	-14	10	21	21
Operating Leases	681	696	776	980	0	0
Unusual	-736	1,346	230	20	160	181
Non-Standard Adjustments	-198	-157	-169	-63	-60	-86
Moody's-Adjusted EBITDA	**15,448**	**16,828**	**18,859**	**18,447**	**22,062**	**24,893**

We define EBITDA as pretax income + gross interest expense + depreciation and amortisation.
Source: Moody's Financial Metrics™

Exhibit 14
Overview of key metrics

	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	LTM Ending Jun-20
INCOME STATEMENT						
Revenue	$11,688.2	$11,841.1	$12,807.6	$13,648.5	$13,649.3	$13,324.2
EBITDA	$1,832.7	$1,968.2	$2,210.6	$2,124.7	$2,334.8	$2,583.8
EBIT	$1,195.4	$1,296.2	$1,457.6	$1,317.9	$1,543.5	$1,800.6
Interest Expense	$152.4	$145.6	$172.1	$175.4	$163.0	$151.5
BALANCE SHEET						
Cash & Cash Equivalents	$577.7	$471.8	$532.8	$347.5	$312.8	$590.3
Total Debt	$4,506.4	$4,707.3	$7,335.6	$6,805.5	$5,864.6	$5,733.9
Net Debt	$3,928.7	$4,235.5	$6,802.9	$6,457.9	$5,551.8	$5,143.5
CASH FLOW						
Capex = Capital Expenditures	$740.3	$806.0	$799.2	$888.2	$713.9	$656.2
Funds from Operations	$1,430.0	$1,283.6	$1,674.3	$1,859.9	$1,686.6	$1,701.7
Dividends	$25.6	$22.2	$33.4	$510.8	$462.9	$21.4
Retained Cash Flow	$1,404.3	$1,261.4	$1,640.9	$1,349.0	$1,223.7	$1,680.3
RCF / Net Debt	35.7%	28.0%	25.1%	20.5%	22.2%	33.8%
Free Cash Flow (FCF)	$579.6	$730.9	$736.6	$209.5	$867.0	$1,376.2
FCF / Debt	12.9%	14.6%	10.5%	3.0%	14.9%	24.8%
PROFITABILITY						
% Change in Sales (YoY)	12.0%	2.8%	7.9%	8.5%	8.8%	4.0%
EBIT Margin %	10.2%	10.9%	11.4%	9.7%	11.3%	13.5%
EBITDA Margin %	15.7%	16.6%	17.3%	15.6%	17.1%	19.4%
INTEREST COVERAGE						
EBIT / Interest Expense	7.8x	8.9x	8.5x	7.5x	9.5x	11.9x
EBITDA / Interest Expense	12.0x	13.5x	12.8x	12.1x	14.3x	17.1x
(EBITDA - CAPEX) / Interest Expense	7.2x	8.0x	8.2x	7.0x	9.9x	12.7x
LEVERAGE						
Debt / EBITDA	2.5x	2.5x	3.2x	3.3x	2.5x	2.1x
Debt / (EBITDA - CAPEX)	4.1x	4.3x	5.0x	5.6x	3.6x	2.9x
Net Debt / EBITDA	2.1x	2.3x	3.0x	3.1x	2.4x	1.9x

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Source: Moody's Financial Metrics™

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