

## CREDIT OPINION

11 August 2021

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 2021 results

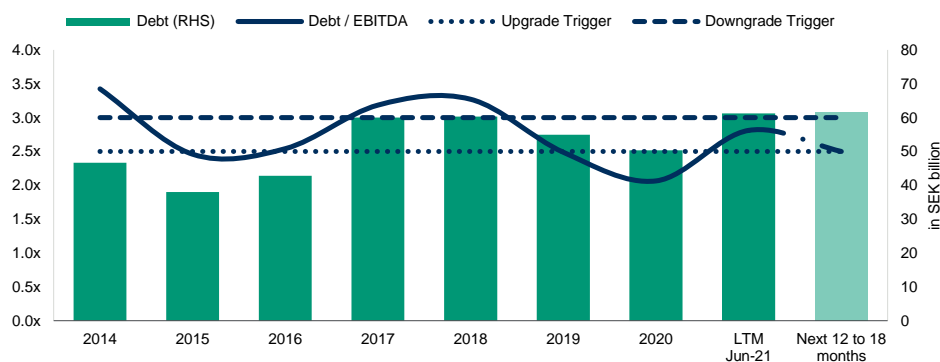
### Summary

[Essity Aktiebolag's](#) (Essity) Baa1/P-2 ratings with a stable outlook primarily reflect the company's large scale, with revenue of SEK116 billion for the 12 months that ended June 2021 (around \$13.5 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; its financial policies, which are aimed at protecting its solid investment-grade rating; and Essity's track record of generating significant positive free cash flow (FCF), which it tends to use for tuck-in acquisitions and can be used to reduce leverage, if needed.

Essity's ratings are primarily constrained by its 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 Corporation](#) (K-C, A2 stable) or [The Procter & Gamble Company](#) (P&G, Aa3 stable), with a Moody's-adjusted EBITA margin of 13.5% for the 12 months that ended June 2021; 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 (see Exhibit 1 below).

Exhibit 1

**We expect Essity's leverage to remain well below our downgrade trigger after the acquisition of additional shares in Productos Familia S.A. (Familia) and in Asaleo Care Ltd.**



All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

The forward view represents Moody's view and does not incorporate any material divestments and acquisitions.

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

## Credit challenges

- » Exposure to volatile input costs, such as for pulp and recycled paper
- » Ongoing need for innovation in the personal care and tissue businesses to preserve pricing levels
- » Professional care product demand hurt by the coronavirus pandemic-related lockdowns and restrictions
- » Event risks, such as debt-funded M&A or shareholder-friendly actions

## Rating outlook

The stable rating outlook reflects our expectation that Essity will continue to operate with solid credit metrics that are commensurate with the Baa1 ratings during the 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 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

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Essity Aktiebolag

	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	LTM Jun-21 [1]	Next 12 - 18 months
Revenue (USD billion)	\$11.8	\$12.8	\$13.6	\$13.7	\$13.3	\$13.4	\$14.6-\$15.2
EBIT Margin %	10.9%	11.4%	9.7%	11.3%	13.7%	12.5%	12.5%-15.5%
EBITA Margin %	11.3%	12.2%	10.5%	12.2%	14.7%	13.5%	13.5%-16.5%
Debt / EBITDA	2.5x	3.2x	3.3x	2.5x	2.1x	2.8x	2.3x-2.8x
RCF / Net Debt	27.8%	24.7%	20.0%	22.0%	29.6%	12.5%	20%-40%
FCF / Debt	14.6%	10.5%	3.0%	14.9%	10.9%	-6.5%	10%-20%
EBITA / Interest Expense	9.2x	9.0x	8.1x	10.2x	15.2x	17.6x	10x-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.

[1] RCF/Net Debt is calculated at 20.8% as of LTM Jun-21 when excluding the postponed 2019 ordinary dividend payment made in November 2020, instead of April 2020.

Source: Moody's Financial Metrics™, Moody's Investors Service estimate

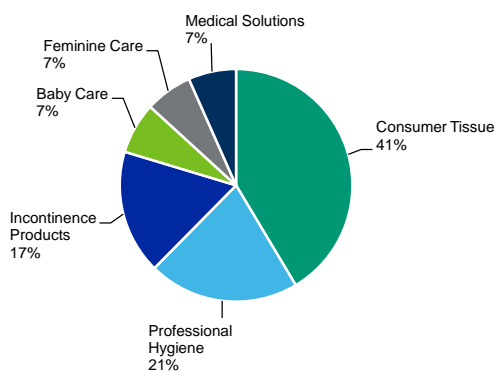
## Profile

Headquartered in Stockholm, Sweden, Essity Aktiebolag (Essity) is one of the leading global hygiene and health companies, with sales of SEK116 billion for the 12 months that ended June 2021 (around \$13.5 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 SEK196.6 billion as of 4 August 2021.

Exhibit 3

### Revenue split by product

As of full year 2020

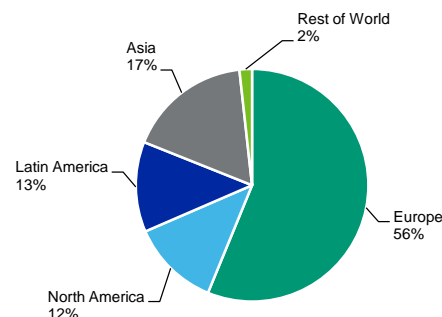


Source: Essity Annual Report 2020

Exhibit 4

### Revenue split by geography

As of full year 2020



Source: Essity Annual Report 2020

## 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 SEK120 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**

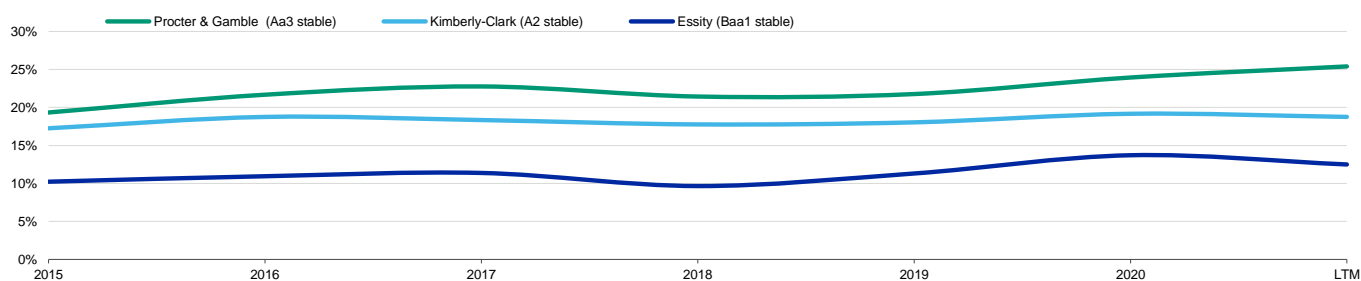
	Global	Europe	North America	Latin America	Asia	Key Brands
Incontinence Products	#1	#1	#4	#1	#3	Tena
Baby Care	#5	#2	n.a.	#6	#6	Drypers, Pequenín, Libero, Lotus Baby
Feminine Care	#5	#3	n.a.	#1	#10	Libresse, Saba, Nosotras, Bodyform, Nana
Medical Solutions	#4	#1	#12	#3	#2	Jobst, Leukoplast, Cutimed, Delta-Cast,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

Source: Essity Annual Report 2020

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 International Group Company Limited, K-C and Sofidel S.p.A. In the personal care business, Essity's key competitors are K-C, P&G and Unicharm Corporation. In 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. In this context, Essity acquired additional shares in Asaleo Care Ltd. (Asaleo Care) and Productos Familia S.A. (Familia), during the first half of 2021, for a total cash consideration of around SEK9.4 billion, which was partially debt-funded. 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****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 record modest annual growth in the low-single-digit percentages, the growth potential in emerging markets is substantial, and we estimate that the annual growth in these markets will 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 while living standards are rapidly improving.

To benefit from this development, Essity focused on growing its presence in emerging markets over the past decade. This was done both organically and through M&A, most notably through the acquisition of a majority stake in the tissue company Vinda — based in Hong Kong SAR, China — in November 2013, along with the recent stake increase in Asaleo Care and Familia. Currently, emerging markets represent roughly one-third of Essity's revenue, and we expect this share to increase further.

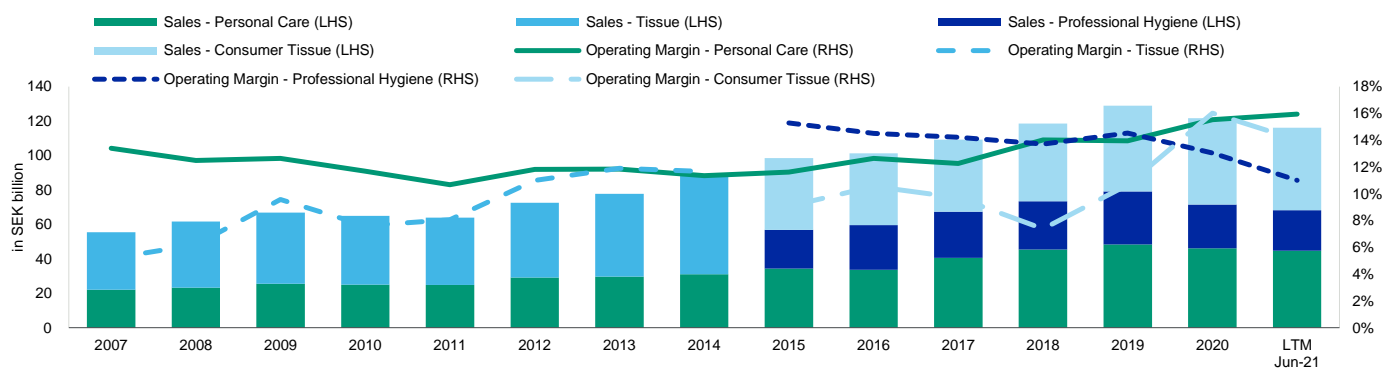
### Profitability exposed to volatile input costs

The demand for Essity's products has historically been fairly 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 the margins for both the tissue and personal care businesses, the latter one in particular, remained robust. Nevertheless, the coronavirus pandemic significantly hurt demand for professional hygiene products because of the resulting lockdown measures 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 indicates an ongoing megatrend towards the increasing use of hygiene products, although it was temporarily normalised during H1 2021 when revenue in the consumer tissue segment declined by 9% compared with H1 2020 driven by lower prices and the fact that consumers were stockpiling tissue products during the outbreak of the coronavirus in Q1 2021.

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 (14% of total raw materials and consumables, and around 6% of total operating expenses at the group level in 2020) and recycled paper (4% of total raw materials and consumables, and around 2% of total operating expenses), 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 H1 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 the 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 the company will continue to complement organic growth with M&A in the next couple of years, especially in the area of medical devices with low technology content, where the market is still relatively fragmented, at this point, there is some capacity for debt-funded growth.

Essity's leverage has been well in line with its current rating level with Moody's-adjusted debt/EBITDA of 2.1x in 2020 and 2.8x for the 12 months that ended June 2021, positioning the company solidly in the Baa1 category. We believe that Essity will be willing and able to operate with a leverage below 3.0x through the cycle, supported by both EBITDA growth, as the company continues to pass through high pulp prices to its 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 to low-double-digit percentages of Moody's-adjusted gross debt, which could be potentially used for debt repayments. We will assess further smaller acquisitions within the limits of the company's FCF on a case-by-case basis.

## Environmental, social and governance considerations

### Environmental 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 the industry's exposure to environmental risks 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 the environmental impact and resource consumption throughout the life cycle of its products and services.

### Social considerations

Social considerations are predominantly related to work conditions and support to employees. Essity has set specific goals under its 2030 Targets framework and fosters diversity and inclusion and gender equality along with safe and healthy working conditions. The group also develops and supports community involvement by promoting programmes that bring added value to local societies.

### Governance considerations

Corporate governance at Essity is centred around ensuring the company's commitments to all of its stakeholders. Essity has a well-established governance structure, which is state-of-the-art for a publicly listed company of its size and supports the company's long-term strategy, market presence and competitiveness. The company has committed to legal compliance and ethical practices as the main pillars and foundation of its operations.

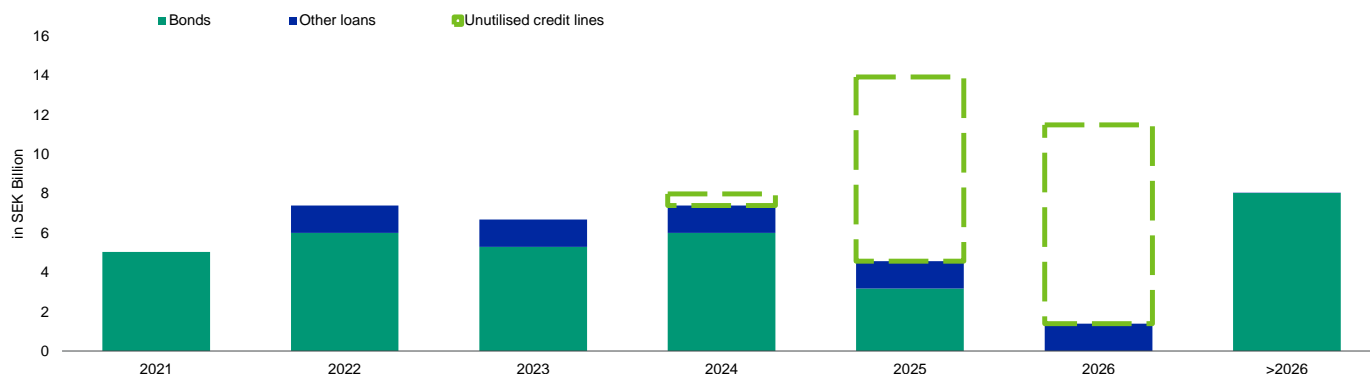
### Liquidity analysis

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 2021, the company reported around SEK8 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 SEK20 billion, consisting primarily of two syndicated facilities, each of around €1.0 billion, maturing in 2025 and 2026 respectively, the latter with one year extension option. 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 2021, the company reported roughly SEK14.3 billion in short-term debt, which includes SEK6.1 billion Eurobonds along with SEK5.4 billion under Essity's commercial paper program. 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 31 December 2020



Source: Essity Annual Report 2020

## Methodology and scorecard

The principal methodology used in rating Essity is our [Consumer Packaged Goods Methodology](#), published in February 2020. The scorecard-indicated outcome indicates an Baa1 rating for the 12 months that ended June 2021, and A3 for our 12-18-month forward-looking view. The one-notch difference is mainly attributable to a weak positioning of Essity in the A category for the Geographic Diversification, Category Assessment, and relatively low profit margin.

Exhibit 9

### Rating factors

Essity Aktiebolag

Consumer Packaged Goods Industry Scorecard [1][2]	Current LTM 6/30/2021		Moody's 12-18 Month Forward View As of 8/5/2021 [3]	
	Measure	Score	Measure	Score
<b>Factor 1 : Scale (20%)</b>				
a) Revenue (USD Billion)	\$13.5	A	\$14.6 - \$15.2	A
<b>Factor 2 : Business Profile (30%)</b>				
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
<b>Factor 3 : Profitability (10%)</b>				
a) EBITA Margin	13.5%	Ba	13.5% - 16.5%	Baa
<b>Factor 4 : Leverage and Coverage (25%)</b>				
a) Debt / EBITDA	2.8x	Baa	2.3x - 2.8x	Baa
b) RCF / Net Debt	12.5%	B	20% - 40%	Baa
c) EBITA / Interest Expense	17.6x	Aa	10x - 13x	A
<b>Factor 5 : Financial Policy (15%)</b>				
a) Financial Policy	A	A	A	A
<b>Rating:</b>				
a) Scorecard-Indicated Outcome		Baa1		A3
b) Actual Rating Assigned				Baa1

[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of LTM 6/30/2021.

[3] 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
<b>ESSITY AKTIEBOLAG</b>	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
ST Issuer Rating	P-2

Source: Moody's Investors Service

Exhibit 11

## Peer comparison

(in USD million)	Essity Aktiebolag			Procter & Gamble Company (The)			Kimberly-Clark Corporation		
	Baa1 Stable			Aa3 Stable			A2 Stable		
	FYE Dec-19	FYE Dec-20	LTM Jun-21	FYE Jun-19	FYE Jun-20	LTM Mar-21	FYE Dec-19	FYE Dec-20	LTM Jun-21
Revenue	13,649	13,265	13,549	67,684	70,950	74,870	18,450	19,140	18,984
EBITDA	2,335	2,654	2,541	17,865	19,950	21,840	4,387	4,613	4,205
Total Debt	5,865	6,125	7,160	39,366	44,246	39,352	8,424	9,096	9,816
Cash & Cash Equivalents	239	450	922	4,239	16,181	10,007	442	303	306
EBIT margin %	11.3%	13.7%	12.5%	21.8%	23.4%	25.0%	18.0%	19.2%	17.4%
EBIT / Interest Expense	9.5x	14.2x	16.4x	20.8x	25.5x	26.6x	11.5x	13.2x	11.8x
Debt / EBITDA	2.5x	2.1x	2.8x	2.2x	2.2x	1.8x	1.9x	2.0x	2.3x
RCF / Net Debt	22.0%	29.6%	12.5%	21.0%	30.7%	34.9%	22.2%	24.3%	17.1%
FFO / Debt	29.0%	37.0%	27.0%	37.8%	37.1%	46.6%	37.8%	39.4%	31.7%

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

## Essity Aktiebolag

(in SEK million)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20	LTM Jun-21
<b>As Reported Total Debt</b>	<b>36,149</b>	<b>54,124</b>	<b>53,742</b>	<b>51,227</b>	<b>46,096</b>	<b>57,025</b>
Pensions	4,596	3,622	3,830	4,133	4,207	4,207
Leases	2,626	2,328	3,334	0	0	0
Non-Standard Adjustments	(673)	(195)	(570)	(461)	0	0
<b>Moody's Adjusted Total Debt</b>	<b>42,698</b>	<b>59,879</b>	<b>60,336</b>	<b>54,899</b>	<b>50,303</b>	<b>61,232</b>

Source: Moody's Financial Metrics™

Exhibit 13

## Reconciliation of EBITDA

## Essity Aktiebolag

(in SEK million)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20	LTM Jun-21
<b>As Reported EBITDA</b>	<b>14,809</b>	<b>18,036</b>	<b>17,500</b>	<b>21,941</b>	<b>24,517</b>	<b>21,938</b>
Pensions	134	(14)	10	21	(155)	(155)
Leases	696	776	980	0	0	0
Unusual Items	1,346	230	20	160	0	0
Non-Standard Adjustments	(157)	(169)	(63)	(60)	0	0
<b>Moody's Adjusted EBITDA</b>	<b>16,828</b>	<b>18,859</b>	<b>18,447</b>	<b>22,062</b>	<b>24,362</b>	<b>21,783</b>

We define EBITDA as pretax income + gross interest expense + depreciation and amortisation.

Source: Moody's Financial Metrics™



Exhibit 14

## Overview of key metrics

Essity Aktiebolag

(in SEK million)	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20	LTM Jun-21
<b>INCOME STATEMENT</b>						
Revenue	101,238	109,265	118,500	128,975	121,752	116,129
EBITDA	16,828	18,859	18,447	22,062	24,362	21,783
EBIT	11,082	12,435	11,442	14,585	16,691	14,511
Interest Expense	1,243	1,472	1,533	1,540	1,179	887
<b>BALANCE SHEET</b>						
Cash & Cash Equivalents	3,975	3,209	1,866	2,236	3,699	7,889
Total Debt	42,698	59,879	60,336	54,899	50,303	61,232
Net Debt	38,723	56,670	58,470	52,663	46,604	53,343
<b>CASH FLOW</b>						
Capital Expenditures	(6,891)	(6,819)	(7,712)	(6,746)	(7,504)	(8,273)
Funds from Operations (FFO)	10,974	14,284	16,148	15,937	18,617	16,519
Dividends	190	285	4,435	4,374	4,813	9,829
Retained Cash Flow (RCF)	10,784	13,999	11,713	11,563	13,804	6,690
RCF / Net Debt	27.8%	24.7%	20.0%	22.0%	29.6%	12.5%
Free Cash Flow (FCF)	6,249	6,284	1,819	8,192	5,483	(3,981)
FCF / Debt	14.6%	10.5%	3.0%	14.9%	10.9%	-6.5%
<b>PROFITABILITY</b>						
% Change in Sales (YoY)	2.8%	7.9%	8.5%	8.8%	-5.6%	-9.5%
EBIT margin %	10.9%	11.4%	9.7%	11.3%	13.7%	12.5%
EBITDA margin %	16.6%	17.3%	15.6%	17.1%	20.0%	18.8%
<b>INTEREST COVERAGE</b>						
EBIT / Interest Expense	8.9x	8.4x	7.5x	9.5x	14.2x	16.4x
EBITDA / Interest Expense	13.5x	12.8x	12.0x	14.3x	20.7x	24.5x
(EBITDA - CAPEX) / Interest Expense	8.0x	8.2x	7.0x	9.9x	14.3x	15.2x
<b>LEVERAGE</b>						
Debt / EBITDA	2.5x	3.2x	3.3x	2.5x	2.1x	2.8x
Debt / (EBITDA - CAPEX)	4.3x	5.0x	5.6x	3.6x	3.0x	4.5x
Net Debt / EBITDA	2.3x	3.0x	3.2x	2.4x	1.9x	2.4x

All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics™

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