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Essity AB

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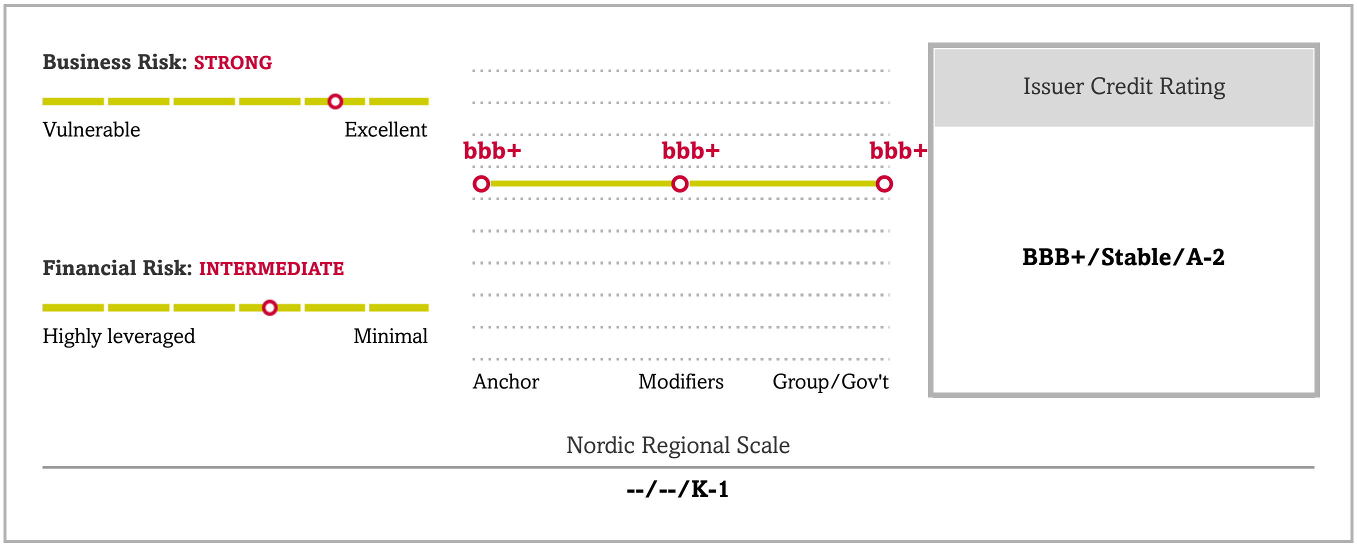


Credit Highlights

Overview

Key strengths	Key risks
Essity competes mostly in non-discretionary product categories such as personal care, consumer tissue, and professional hygiene.	Exposure to volatile input costs including pulp and oil-derivative materials will pressure operating margins in 2021.
Essity's focus on sustainable product innovations underpins its global leading position in the incontinence and professional hygiene segments through TENA and TORK brands respectively.	Fierce price competition in the European consumer tissue and personal care markets.
Global presence, with about 63% exposure to developed countries and 37% to fast-growing emerging markets.	Ongoing challenges in the professional hygiene business, which was heavily affected by COVID-19-related restrictions.
Solid track record of S&P Global Ratings-adjusted debt to EBITDA of 2x-3x over the last few years.	Larger-than-expected debt-funded acquisitions could push leverage above 3.0x.

Essity's first-half results showed some top-line volatility and erosion of profitability, which will result in S&P Global Ratings-adjusted EBITDA margin contracting to 16%-17% in 2021 according to our estimates. First-half 2021 sales declined by 9.1% on a reported basis (including negative 7.4% foreign exchange [FX] headwinds and a 0.7% impact from divestments and deconsolidation). Therefore, organic sales declined only 1%, showing a sound performance in second-quarter 2021 considering the 10% organic sales contraction in the first quarter. Top-line growth volatility came from exceptional demand in first-quarter 2020 when retailers and consumers stockpiled amid the pandemic and restrictions in areas such as restaurant, hotels, airports, and schools. Conversely, Essity's EBITDA margin of 16.7% in second-quarter 2021 deteriorated further compared with 18.8% in the first quarter. Essity's reported EBITDA margin in first-half 2021 decreased 260 basis points (bps) to 17.7% compared with 20.3% in first-half 2020. This decline was driven by a lower average sales price in first-half 2021 compared with last year and the preliminary impact of increasing raw material costs since the beginning of the year. In particular, surging prices for pulp, energy, recovered paper, and oil-based materials are expected to dent Essity's operating profits in 2021. We estimate its S&P Global Ratings-adjusted EBITDA margin will reduce to the higher end of 16.0%-17.0% compared with the historical peak of 19.8% in 2020. To compensate for raw materials price hikes, Essity has been increasing sales prices since the beginning of this year. However, given the time lag to fully pass them on to customers, we acknowledge profitability will likely recover by the end of first-quarter 2022 and we expect its S&P Global Ratings-adjusted EBITDA margin will return to about 18% by end-2022.

We expect price competition to intensify mainly in Europe. Other global players such as Kimberly Clark and Procter & Gamble have announced a general increase of sales price for their products and we understand private label manufacturers will do the same. We believe the timing and the magnitude of the price increase could intensify competitive pressures, mainly in Europe. This is because of the large presence of private label manufacturers--mainly in the consumer tissue, baby care, adult incontinence, and feminine care categories--leading to intensified promotion activities. We understand price increases are relatively quick to be enforced in some emerging countries in LATAM and Eastern Europe, compared with some countries in Europe. For instance, in France negotiations with retailers are typically held only annually.

Essity's innovative pipeline ensures sustainable long-term growth. In our view, Essity's established brand portfolio and its strategy centered on product innovation will help it successfully navigate the short-term challenges as well as support long-term top-line growth. New product launches will support higher sales prices on average and see a relatively quick recovery from raw material price headwinds. In 2020, Essity invested roughly SEK1.6 billion (1.3% of sales) in R&D and we expect it will maintain similar spending levels. Essity's innovation strategy helps it to meet emerging consumer preferences while ensuring a more sustainable environmental footprint. This is achieved with digital innovations like Tena SmartCare, a reusable digital wearable sensor for improved continence care. It helps carers to recognize urinary patterns of patients to optimize change frequency and reduce waste.

Essity's innovative solutions also include washable underwear for feminine care and adult incontinence and the use of alternatives to pulp fibers such as wheat straw pulp. The latter reduces dependence on volatile virgin pulp fiber as well as improves the company's environmental footprint given that it is an agricultural residue and requires less water and energy in the production phase. Essity has a commitment to launch at least 50% sustainable innovations per year leading to social and/or environmental improvements. It has consistently exceeded this target in the last three years.

Essity's leverage will remain 2-3x despite the acceleration of M&A activities. Essity has a positive track record of maintaining conservative credit metrics, specifically S&P Global Ratings-adjusted debt to EBITDA of 2x-3x. This is despite some volatility in raw material prices experienced in the last few years.

Its credit metrics were particularly solid at the end of 2020. Our adjusted ratio was 1.8x, reflecting the expansion of its EBITDA amid temporarily favorable conditions like pulp prices stabilizing at lower levels than 2019, on average, and high selling prices due to delays in renegotiating and adapting prices with retailers.

Since the end of 2020, Essity has therefore accelerated its acquisition strategy. It has integrated two associated companies--Asaleo in Australia and Familia S.A. in Latin America. We calculate about SEK9.5 billion considerations for these two acquisitions in 2021.

Despite these acquisitions we expect the company will be able to report S&P Global Ratings-adjusted debt to EBITDA of 2.5x-3.0x at the end of this year.

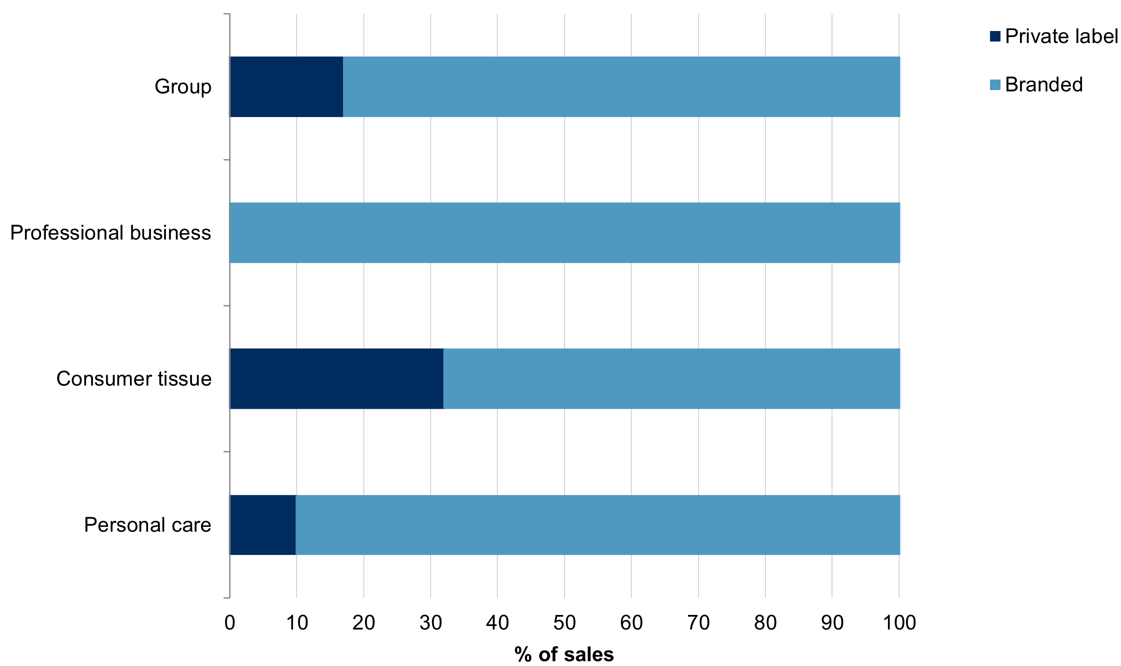
Our base case does not incorporate any other large acquisitions this year. However we understand the company is actively looking for further acquisitions mainly in the medical segment, which offers good growth prospects.

Essity's plan to separate its private label European consumer tissue business will strengthen its focus on the branded offering, in our view. The new division generated SEK6.7 billion of sales last year, about 5% of the company's sales and 13% of the consumer tissue division's total sales. Essity expects the private label European consumer tissue division will be fully independent by the end of this year, with seven manufacturing facilities.

We understand there are limited costs associated with the separation activities because the manufacturing operations have been relatively independent since 2017. In the private label division, Essity's competitive advantage will primarily come from improving customer service, time to market, and the quality of products manufactured according to retail partners' specifications. With this separation, we believe the company will optimize the performance of its private label consumer tissue business while further strengthening its focus on its core branded operations (83% of group sales in 2020).

Chart 1

Split Of Essity's 2020 Sales Branded Versus Private Label



Source: S&P Global Ratings.

Outlook: Stable

The stable outlook reflects our view that Essity will be able to manage raw material price hikes through sales price increases and product innovation. We believe Essity's operating performance will improve in the coming quarters thanks to the gradual reopening of the professional channel as well as early effects of sales price increases. We project its EBITDA margin to decline to the high end of 16%-17% in 2021 from 19.8% in 2020. We also expect the group will maintain solid cash generation and credit metrics, with adjusted debt to EBITDA of 2.5x-3.0x.

Downside scenario

We could consider lowering the rating if, due to the current inflationary environment, consumers become a lot more sensitive to price and shift to white-label and unbranded products. Under this scenario we would expect Essity's market position to deteriorate and operating performance would likely weaken, translating into adjusted debt to EBITDA rising to above 3x and remaining so.

We could also consider a negative rating action if we were to observe an aggressive financial policy that led to increased financial leverage, because of large debt-funded acquisitions or unexpectedly large shareholder distributions, pushing debt to EBITDA above 3x for a prolonged period.

Upside scenario

We could consider an upgrade if, thanks to a consistently robust performance in its three divisions, Essity generates very solid free operating cash flow and uses it to improve its leverage ratios, with debt to EBITDA approaching 2x. Achieving these targets consistently also depends on the group's willingness to adapt its future debt-funded acquisitions to said targets.

Our Base-Case Scenario

Assumptions

- Essity's reported sales declining by about 1.5%-2.0% in 2021. Our assumptions include very limited organic growth of 0.5%-1.0%, a roughly 1.0% positive impact from the integration of Asaleo (six months consolidation), and negative 3%-4% FX headwinds. In our view, Essity's organic growth will be primarily driven by higher average sales prices in the consumer tissues and personal care segments to neutralize input-cost hikes. In the professional hygiene division, we expect the sales rebound to continue in the third and fourth quarters, given less stringent lockdown measures in some of Essity's end markets such as hotels, restaurants, catering, commercial buildings, and schools and universities.
- We believe consumers will keep focusing on hygiene, which will favor Essity's product categories in the next few years. We therefore estimate Essity's top line will expand 4.5-5.0% in 2022 on the back of more normalized activities in the professional hygiene business and the full year consolidation of Asaleo.
- Given the current trends in raw material prices, we expect the S&P Global Ratings-adjusted EBITDA margin to contract to the high end of 16%-17% in 2021 (19.8% in 2020). In our view, Essity's proactive approach to increasing sales prices and launching new products will contain further profitability erosion. We also factor in annual cost

savings of SEK500 million-SEK1,000 million (lower end of range). This includes the early effects of the Manufacturing Roadmap, leading to optimization of the production structure, productivity improvements, and raw material and energy savings that will be more evident from next year. These savings will be partly offset by costs associated with Essity's digital transformation plan (SEK1.4 billion over 2021-2024).

- S&P Global Ratings-adjusted EBITDA margin to increase to about 18% in 2022 as the group benefits from sales price increases and ongoing cost savings.
- Capex of SEK7.0 billion-SEK7.5 billion over the next two years (about 6% of sales then reducing to around 5% from 2023). Our assumptions include SEK1.2 billion investment to support Essity's digital transformation, enabling value chain automation and greater predictability based on high-quality data collection and advanced analytics.
- SEK11 billion-SEK11.5 billion to be invested in acquisitions this year including the finalized transactions to fully acquire ABIGO (25% remaining shares of SEK225 million), ASALEO for a total consideration of about SEK3.5 billion (63.8% of remaining shares), and the increased ownership in Productos Familia (acquiring 45.8% additional shares to reach 95.8% ownership) for about SEK6 billion. Therefore, our base case assumes additional small deals totaling SEK1.3 billion-SEK1.8 billion this year. We estimate SEK5.0 billion in annual acquisitions from 2022 onward.
- Dividends of about SEK5.1 billion including SEK366 million paid to minorities in 2021. In 2022 we assume dividends to Essity's shareholders to grow 5%-10% to SEK5.0 billion-SEK5.2 billion, from SEK4.7 billion in 2021.

Key metrics

Essity AB--Key Metrics*

	2019a	2020a	2021e	2022f	2023f
(Mil. SEK)					
Revenue	128,975	121,752	119,500	125,000	128,300
Adjusted EBITDA margin (%)	17.0	19.8	16.5-17.0	~18	18.0-18.5
Reported capital expenditure	5,811.0	6,544.0	7,000-7,500	~7,500	6,500-7,000
Reported free operating cash flow (FOCF)	13,433	11,212	9,000-10,000	~10,000	~12,000
Dividends	4,374	4,813	5,000-5,500	5,000-5,500	5,500-6,000
Acquisition	143	668	11,000-11,500	5,000	5,000
Adjusted debt to EBITDA (x)	2.4	1.8	2.5-3.0	2.0-2.5	2.0-2.5
Adjusted FOCF to debt (%)	24.2	25.5	~18	~19	23-24

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. SEK--Swedish krona.

Company Description

Essity is a Swedish health and hygiene group created when Svenska spun off its hygiene division in 2017. It produces, markets, and sells personal care and tissue products in over 150 countries worldwide. Its top brands include TENA for incontinence products, Tempo for consumer tissues, TORK in the professional business, and Leukoplast in the medical business.

Essity operates through three main divisions:

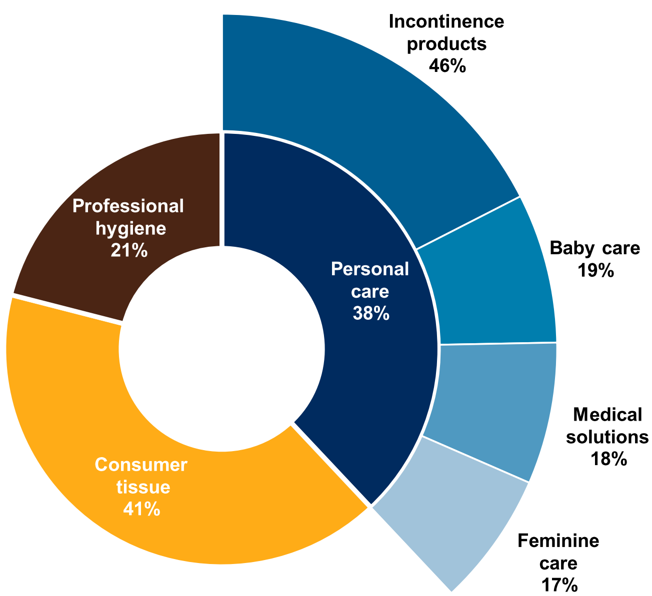
- Personal care (38% of 2020 sales). It includes adult incontinence products (global market leadership), baby care (such as baby diapers, pant diapers), and feminine care products (pads, panty liners, tampons), as well as medical solutions (wound care, compression therapy, and orthopedics) following the BSN acquisition in 2017. Its global and regional brands include Libero, Libresse, Nosotras, Saba, TENA, Leukoplast, and Jobst. Roughly 10% of the personal care sales are generated through retailers' brands (private label). It distributes personal care products through the retail trade, online sales, pharmacies, care institutions, hospitals, and e-commerce.

- Consumer tissues (41% of 2020 sales). Essity is the world's second-largest supplier of consumer tissues and offers toilet paper, household towels, handkerchiefs, facial tissues, wet wipes, napkins, and face masks. The group's own brands include Lotus, Tempo, Zewa, and Vinda, and it also offers retailers' brands (32% of consumer tissue sales). It sells consumer tissue products through retailers and e-commerce.
- Professional hygiene (21% of 2020 sales). The group develops and markets complete hygiene solutions under the global leading brand Tork. These include toilet paper, paper hand towels, napkins, hand soap, hand lotion, hand sanitizer, tissue, soap, hand lotion, dispensers, cleaning and wiping products, and service and maintenance for companies and office buildings, universities, healthcare facilities, restaurants, hotels, and other public venues.

Essity shares are listed on Nasdaq Stockholm. Essity's market capitalization was US$22.7 billion as of August 2021.

Chart 2

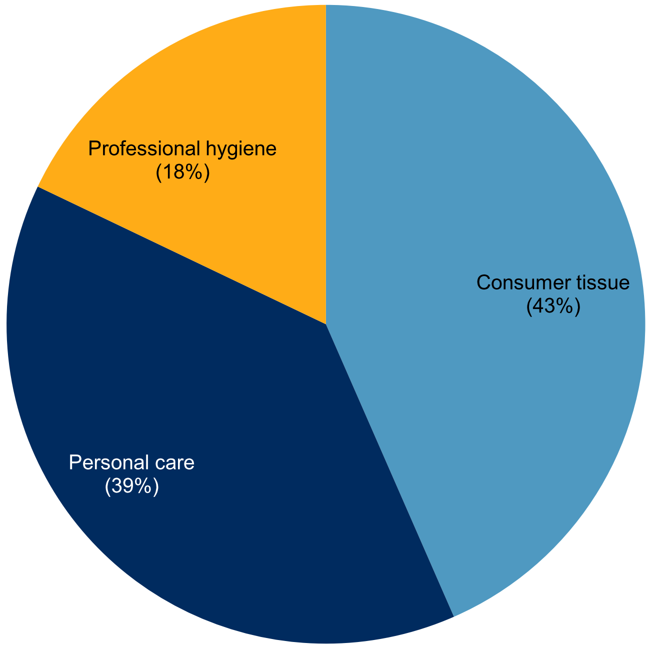
Net Sales By Business Area



Source: S&P Global Ratings.

Chart 3

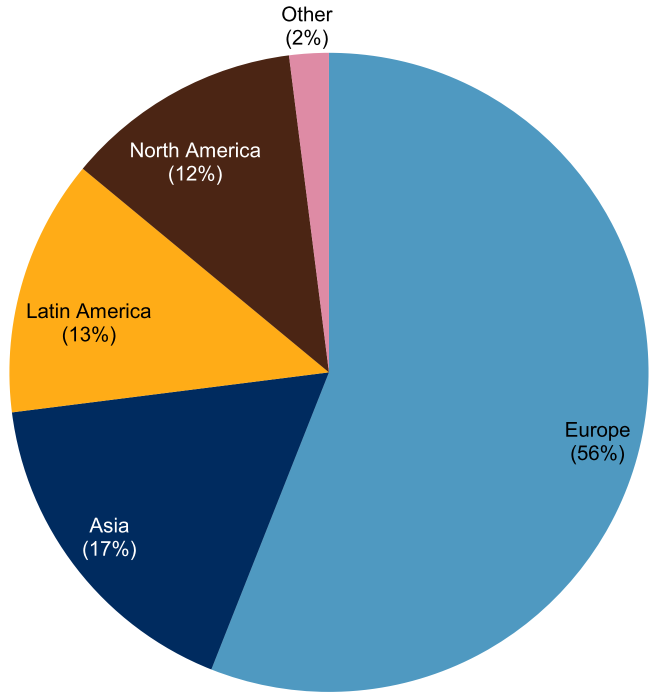
EBITA 2020 By Division



Source: S&P Global Ratings.

Chart 4

Sales 2020 By Region



Source: S&P Global Ratings.

Peer Comparison

Table 1

Essity AB--Peer Comparison				
Industry sector: Personal care and household products				
	Essity AB	**Kimberly-Clark Corp.**	**Henkel AG & Co. KGaA**	**Procter & Gamble Co.**
Ratings as of Aug. 9, 2021	BBB+/Stable/A-2	A/Stable/A-1	A/Stable/A-1	AA-/Stable/A-1+
	--Fiscal year ended--			
	Dec. 31, 2020	**Dec. 31, 2020**	**Dec. 31, 2020**	**June 30, 2020**
(Mil. $)				
Revenue	14,824.9	19,140.0	23,548.1	70,950.0
EBITDA	2,936.9	4,547.0	3,790.9	19,611.0
Funds from operations (FFO)	2,351.4	3,752.0	2,938.3	15,588.7
Interest expense	111.0	269.0	80.7	503.3
Cash interest paid	108.6	262.0	96.6	472.3

Table 1

Essity AB--Peer Comparison (cont.)				
Cash flow from operations	2,162.0	3,880.0	3,798.3	17,711.7
Capital expenditure	796.8	1,217.0	874.6	3,073.0
Free operating cash flow (FOCF)	1,365.2	2,663.0	2,923.6	14,638.7
Discretionary cash flow (DCF)	779.2	512.0	1,931.6	(555.3)
Cash and short-term investments	606.6	667.0	2,112.6	16,181.0
Debt	5,358.9	8,930.0	2,503.0	26,389.7
Equity	7,712.7	869.0	21,869.8	46,878.0
Adjusted ratios				
EBITDA margin (%)	19.8	23.8	16.1	27.6
Return on capital (%)	15.2	37.6	9.8	21.5
EBITDA interest coverage (x)	26.4	16.9	47.0	39.0
FFO cash interest coverage (x)	22.6	15.3	31.4	34.0
Debt/EBITDA (x)	1.8	2.0	0.7	1.3
FFO/debt (%)	43.9	42.0	117.4	59.1
Cash flow from operations/debt (%)	40.3	43.4	151.7	67.1
FOCF/debt (%)	25.5	29.8	116.8	55.5
DCF/debt (%)	14.5	5.7	77.2	(2.1)

U.S.-based Kimberly Clark (KC) is Essity's closest peer. It is the No. 2 player in tissues and hygiene products, while Essity is No. 3 globally. KC's EBITDA margin of 22%-24% is structurally higher than Essity's 17% on average over the last five years. We believe this is partly explained by KC's domestic market being more profitable than several of the European countries in which Essity operates. In fact, private labels have a lower market share in the U.S. than in Europe, which allows U.S. players to maintain higher prices. KC has five "billion-dollar" brands, while Essity has two (TENA and TORK). KC has, over time, maintained more conservative credit metrics as its average adjusted debt to EBITDA has stayed close to 2.0x while Essity's was closer to 3.0x in 2017 and 2018, then 2.3x in 2019 and slightly below 2.0x in 2020 boosted by favorable raw material prices.

German company Henkel is larger and more diversified than Essity in terms of products--it competes in home care, personal care, and adhesive technologies. Henkel is the global leader in adhesive technologies, whereas in home care and personal care it usually ranks No. 2, No. 3, or lower, behind big peers like P&G, Unilever, or L'Oreal. Competitive pressures in core segments like home care and personal care led to EBITDA margin deterioration to 18% or lower from year-end 2019 compared with 19% over 2017-2018; Henkel maintains a very conservative financial risk profile and its adjusted leverage is below 1.5x. However our 'A' rating incorporates Henkel's ambition for external growth and a potential increase in leverage.

U.S.-based P&G competes with Essity across its core tissue and personal care categories where it holds global leading market positions. P&G is larger in scale and operates with a more extensive personal care and household product portfolio supporting adjusted EBITDA margin of 25%-30% and a more favorable business risk profile compared with Essity. P&G has strong cash generation and conservative adjusted leverage of below 2x.

Business Risk: Strong

Essity enjoys global leading market positions in adult incontinence and professional hygiene. Essity ranks no. 1 in the retail adult incontinence market through its core brand TENA with approximately 17.5% global market share (by retail value) at end-2020 according to Euromonitor. Essity competes fiercely with KC, whose market share is similar across its three main brands Depend, Poise, and Plenitud, with a combined market share of approximately 18.5%. The adult incontinence market shows stronger growth prospects than other product categories in the personal care division; it is expected to grow 9%-10% CAGR over 2021-2025 according to Euromonitor. This is supported by aging populations in mature markets and increasing awareness of incontinence issues in young adults.

Similarly, Essity leads the away-from-home tissue market (professional division) with its brand TORK. The pandemic hit this market the most because of lower demand in the customer segments of hotels, restaurants, commercial buildings, schools, and universities. Essity's sales in this division contracted roughly 15% organically in 2020, which is in line with the market average decline. Euromonitor estimates the market will recover to pre-pandemic levels by 2023 and we expect Essity will lead the growth.

Essity's diversified brand portfolio ensures local leadership in many product categories according to Euromonitor data. Essity leads the consumer tissue market in Western Europe with an approximately 14% market share through established brands like Lotus (leading brand with 3.7% market share), Zewa, and Tempo, among others, while Kimberly Clark (Andrex) and Sofidel (Regina) rank second and third. According to Euromonitor in China, Essity enjoys a very high 10% market share in the retail channel of the tissue market (it excludes the professional business) through its Vinda brand. Chinese-based Hengan International Group Co. Ltd. has comparable market share thanks to its Hearttex brand.

In Europe, Essity is market leader in the medical solutions segment with its Leukoplast and Jobst brands, among others. The company generates roughly 7% of its sales in this segment which was created following the 2017 acquisition of BSN and further developed with the acquisition of ABIGO Medical AB completed in 2021. The market offers positive growth prospects due to aging populations and increasing demand for chronic wound and compression treatments. This is despite the temporary disruption caused by various lockdowns and restrictions mainly in orthopedics and compression therapy.

In diapers and feminine care, Essity leads the market in certain regions, but not globally. For example, it is the leader in Latin America in feminine care through its local Nosotras brand. In the baby care segment, it is No.2 in Europe with its Libero and Lotus brands, and no. 1 in Malaysia with its Drypers brand (45% market share according to management). In baby care we observe slower growth prospects mainly due to slowing birth rates in mature countries. However, we understand disposable pants are predicted to outperform diapers and nappies due to their comfort and convenience features.

The personal hygiene market is highly competitive due to the increasing presence of private label manufacturers and local brands. Competition in the tissue and hygiene markets has intensified globally over the last few years. Given the commoditized nature of products, private label manufacturers and local brands have been able to grow and gain market shares against international brands thanks to their affordability and comparable quality.

The rise of local manufacturers has been more evident in emerging markets in Asia Pacific and the Middle East and Africa where private labels are still limited. Conversely, potential risks in Western Europe and North America come from the growing penetration of private label operators. We anticipate the current inflationary environment could lead consumers to trade down to more affordable local brands or private labels. We believe the risk is higher in emerging countries where personal hygiene products are seen as less essential compared with developed markets.

Essity's recent acquisitions of Asaleo and Familia will support its growing market positions in Asia Pacific and Latin America thanks to their solid local brand portfolios.

Additionally, we believe Essity's growth in the medium term will be supported by consistent product innovations.

COVID-19 has increased consumer awareness of health and hygiene, supporting Essity's long-term growth. We believe some consumer behaviors will likely remain post-pandemic, meaning that demand for personal hygiene products will be higher than before. We expect people will maintain frequent cleaning routines to avoid diseases and the spread of infections. This will support growth in the consumer tissue channel as well as an improvement in the professional segment once the situation normalizes. In fact, we understand Essity's sales of dispensers in public locations are growing as customers are replacing air dryers with more hygienic alternatives such as tissues. Also, there is increasing demand for soap and hand sanitizers.

Furthermore, the pandemic has accelerated the transition to e-commerce, primarily in the baby care category (nappies, diapers, and pants), contributing to nearly half of the ecommerce expansion in 2020 within retail hygiene, according to Euromonitor. We expect the penetration of e-commerce will increase further as consumers embrace online shopping alternatives such as subscription models or click-and-collect. However, we believe Essity holds a relatively solid position in e-commerce, accounting for roughly 13% of total sales in 2020 (10% in 2019). This is slightly higher than the 11.7% e-commerce penetration in the global tissue and hygiene market in 2020 according to Euromonitor (9.4% in 2019).

The personal hygiene and tissue markets are exposed to volatile raw material prices, which Essity plans to mitigate with structural improvements to its cost structure. Both tissues and incontinence products are exposed to the volatility of raw materials costs--mainly pulp, recovered paper, and oil-based materials. Pulp represents the largest component of operating expenses as it accounted for 14% of the total in 2020. As a result, Essity's profitability has been exposed to some degree of volatility over the last few years; its S&P Global Ratings-adjusted margin declined 210 bps in 2018 to 15.4%, from 17.5% the previous year, due to raw material headwinds. This is because there is usually a gap between the increase in raw materials and pass-through on final prices as the price mechanism is rigid. It is possible to revise prices once or more per year in the retailer channel (61% of sales in 2020), but not in the health care sector (18% of sales). This sector uses an auction system and contracts that usually last three years, during which prices cannot be renegotiated. In the business-to-business sector (21% of the sales) the conditions are customized.

Essity is actively working to mitigate volatility of profitability via actions aiming to structurally improve its cost competitiveness.

In 2020, it launched its new Manufacturing Roadmap to optimize and streamline its 60 production facilities to improve cost efficiency, quality, and customer proximity. We see limited execution risks behind this plan as the company completed a similar program in its consumer tissue division in 2016-2017 with its Tissue Roadmap. The new initiative will contribute to its target to achieve annual cost savings of SEK500 million-SEK1,000 million. In addition, it will help Essity meet its sustainability targets to reduce its use of fossil fuels and electricity, improved product design, and optimize resource utilization.

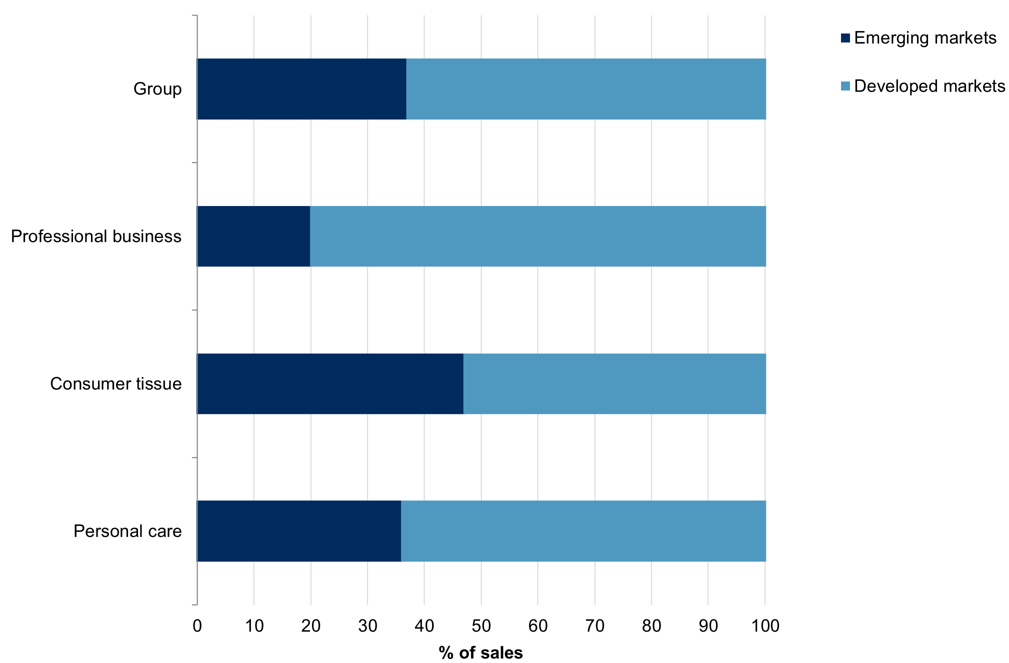
Furthermore, Essity is investing in a new platform to accelerate its digital transformation (SEK2.6 billion investment of which SEK1.2 billion will be reported as capital expenditure). We believe digitalization should enable more efficient processes in sourcing, production, and logistics with positive effects on costs, working capital management, and customer service.

Essity has a well-diversified geographic footprint by sales with a focus on fast-growing emerging markets. At the end of 2020, China represented Essity's largest market, accounting for 13% of total sales. Germany and the U.S. accounted for 11% of sales each while France and the U.K. for 8% and 7%. Other countries generated less than 5% of total sales each. We evaluate positively Essity's ambition to further expand its penetration in emerging markets, which accounted for 37% of its sales in 2020 (unchanged from 2019). This is because of better growth prospects as market penetration of hygiene and health products is lower than in the mature markets. As an example, Essity calculated usage of incontinence products in Asia is only about one-sixth of those in Western Europe. Also, tissue consumption in Eastern Europe is only about one-third of that in Western Europe.

Furthermore, emerging markets are showing rapid development of urbanization, retail, and e-commerce infrastructure and improving health care systems. We understand that Essity plans to prioritize growth in selected emerging markets such as China, Southeast Asia, Latin America, Eastern Europe, and Russia.

Chart 5

Split Of Essity's 2020 Sales In Emerging Markets And Developed Markets



Source: S&P Global Ratings.

Financial Risk: Intermediate

Despite Essity's acquisitive strategy and volatility of raw material costs such as pulp, recovered paper, and oil-based materials, its S&P Global Ratings-adjusted debt to EBITDA was 2.0-3.0x over 2016-2019 with a temporary spike to 3.1x in 2018. In 2020, despite the challenges in the professional business caused by COVID-19 restrictions, the company was able to post solid credit metrics with reported FOCF of about SEK11.2 billion and S&P Global Ratings-adjusted debt to EBITDA of 1.8x.

This leverage is not sustainable in the long term given the above-mentioned volatility in raw material prices and Essity's acquisition strategy. Therefore, we assume our adjusted leverage will increase to 2.5x-3.0x in 2021 given the recent spike in raw materials prices as well as the acquisitions of Asaleo and Familia. We expect the company will continue to post S&P Global Ratings-adjusted debt to EBITDA of 2.0x-3.0x, absent any large acquisitions. Essity has indicated interest in acquisitions mainly in the medical solutions segment, but also in the adjacent categories of incontinence and feminine products, and professional hygiene businesses. We assume that external growth will be commensurate with the headroom at the current rating level as management has clearly communicated that the maintenance of the current rating is part of its strategy. We assume that Essity will stay focused on cash generation despite increasing capex to finance its new digital platform over 2021-2022. We expect FOCF generation will remain at SEK9.5 billion-SEK10.5 billion over 2021-2022. We assume Essity will continue to ensure growing shareholder remuneration with increasing annual dividend payments in line with cash flow generation growth. We acknowledge Essity has further flexibility to increase shareholder returns with its share buyback program. However, we do not anticipate any share purchases in our forecasts, in line with historical trends.

Financial summary

Table 2

Essity AB--Financial Summary					
Industry sector: Personal care and household products					
	--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**
(Mil. SEK)					
Revenue	121,752.0	128,975.0	118,500.0	109,265.0	101,238.0
EBITDA	24,120.0	21,973.0	18,266.0	19,075.5	16,219.0
Funds from operations (FFO)	19,311.0	19,755.0	14,760.2	15,070.9	11,374.5
Interest expense	912.0	1,126.0	1,116.8	1,206.6	1,143.5
Cash interest paid	892.0	1,088.0	1,039.8	1,033.6	1,062.5
Cash flow from operations	17,756.0	18,337.0	13,698.2	13,083.9	13,094.5
Capital expenditure	6,544.0	5,811.0	6,882.0	6,119.0	6,289.0
Free operating cash flow (FOCF)	11,212.0	12,526.0	6,816.2	6,964.9	6,805.5
Discretionary cash flow (DCF)	6,399.0	8,152.0	2,381.2	6,679.9	2,577.5
Cash and short-term investments	4,982.0	2,928.0	3,008.0	4,107.0	4,244.0
Gross available cash	4,982.0	2,928.0	3,008.0	4,107.0	4,244.0
Debt	44,010.8	51,768.7	57,147.2	54,150.1	37,008.4

Table 2

Essity AB--Financial Summary (cont.)

Industry sector: Personal care and household products

	--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**
Equity	63,342.0	62,801.0	54,899.0	49,570.0	39,580.0
Adjusted ratios					
EBITDA margin (%)	19.8	17.0	15.4	17.5	16.0
Return on capital (%)	15.2	12.9	10.7	14.5	14.1
EBITDA interest coverage (x)	26.4	19.5	16.4	15.8	14.2
FFO cash interest coverage (x)	22.6	19.2	15.2	15.6	11.7
Debt/EBITDA (x)	1.8	2.4	3.1	2.8	2.3
FFO/debt (%)	43.9	38.2	25.8	27.8	30.7
Cash flow from operations/debt (%)	40.3	35.4	24.0	24.2	35.4
FOCF/debt (%)	25.5	24.2	11.9	12.9	18.4
DCF/debt (%)	14.5	15.7	4.2	12.3	7.0

SEK--Swedish krona.

Reconciliation

Table 3

Essity AB--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK)

	--Fiscal year ended Dec. 31, 2020--							
Essity AB reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
Reported	43,359.0	54,352.0	24,429.0	16,758.0	860.0	24,120.0	17,819.0	6,587.0
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(3,917.0)	--	--
Cash interest paid	--	--	--	--	--	(892.0)	--	--
Trade receivables securitizations	917.0	--	--	--	--	--	--	--
Reported lease liabilities	3,531.0	--	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	1,124.8	--	(113.0)	(113.0)	34.0	--	--	--
Accessible cash and liquid investments	(4,282.0)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	18.0	--	--	--
Capitalized development costs	--	--	(43.0)	14.0	--	--	(43.0)	(43.0)
Dividends received from equity investments	--	--	31.0	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	(94.0)	--	--	--	--	--

Table 3

Essity AB--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. SEK) (cont.)								
Nonoperating income (expense)	--	--	--	108.0	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(20.0)	--
Noncontrolling interest/minority interest	--	8,990.0	--	--	--	--	--	--
Debt: Derivatives	(639.0)	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(113.0)	(113.0)	--	--	--	--
EBITDA: Other	--	--	23.0	23.0	--	--	--	--
Depreciation and amortization: Impairment charges/(reversals)	--	--	--	197.0	--	--	--	--
Total adjustments	651.8	8,990.0	(309.0)	116.0	52.0	(4,809.0)	(63.0)	(43.0)
S&P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
Adjusted	44,010.8	63,342.0	24,120.0	16,874.0	912.0	19,311.0	17,756.0	6,544.0

SEK--Swedish krona.

Liquidity: Strong

The short-term global scale rating is 'A-2' and the short-term Nordic scale rating is 'K-1'. We assess Essity's liquidity as strong as we expect liquidity sources to cover uses by more than 1.5x over the next 12-24 months. Our assessment is supported by its track record of high standing in credit metrics, solid relationship with its diverse and creditworthy banking groups allowing frequent bond issuance and commercial paper availability. Specifically, Essity relies on SEK15 billion Swedish commercial paper and €1.2 billion Belgian commercial paper programs. At the end of June 30, 2021, SEK5.4 billion commercial paper were used.

Regarding the committed acquisitions (listed in "Principal liquidity uses" below), we understand that they have been temporarily funded with usage of the existing commercial paper program (not included in the "Principal liquidity sources" below).

Principal liquidity sources	Principal liquidity uses
• Cash available of SEK7.9 billion on June 30, 2021; • Cash funds from operations of SEK16.0 billion-SEK16.5 billion in the next 12 months and SEK17.5-18.5 billion after that; and	• Debt maturities of SEK11.5 billion-SEK12 billion in the 12 months from June 30, 2021; • Working capital outflows of SEK300 million-SEK500 million including intra-year requirements;

• Two undrawn bank lines maturing in 2025 and 2026 of SEK20.2 billion (€2 billion).	• Annual capex of SEK7.0 billion-SEK 7.5 billion in 2021 and 2022; • Committed acquisitions of associated companies of about SEK9.0 billion-SEK9.5 billion; and • Dividends of SEK5.0 billion-SEK 5.5 billion in the next 12 months.

Debt maturities

- 2021: SEK7.2 billion
- 2022: SEK9.3 billion
- 2023: SEK6.1 billion
- 2024: SEK9.3 billion
- Beyond 2024: SEK21.5 billion

Here are the maturity details of Essity's outstanding notes:

- €600 million notes with 0.625% coupon due 2022
- €500 million notes with 2.5% coupon due 2023
- €600 million notes with 1.125% coupon due 2024
- SEK850 million notes with 0.5% coupon due 2025
- SEK2.15 billion floating rate note due 2025
- €300 million notes with 1.125% coupon due 2025
- €500 million notes with 1.625% coupon due 2027
- €300 million notes with 0.5% coupon due 2030
- €700 million notes with 0.25% coupon due 2031

Environmental, Social, And Governance

We see environmental and social factors for Essity as broadly in line with major international peers competing in the personal hygiene industry. The group's portfolio includes nondiscretionary items like consumer tissues, medical solutions, incontinence products, and baby and feminine care products, whose growth is supported by rising living standards in emerging economies. We evaluate positively Essity's sustainability disclosures and its strategic plan and actions implemented in the field of sustainability. In our view, Essity's solid focus on ESG will underpin its ability to generate profitable growth in the coming years and maintain its competitive advantage. Essity's innovations around reusable personal care products as well as its increasing focus on recycled and renewable raw materials will mitigate environmental risks derived from the sustainability of resources (for example, virgin pulp) and the disposal of products like baby diapers and incontinence products. We assess Essity's management and governance as satisfactory, reflecting consistency in its executed strategies, clear rules on governance, and the board's independence.

Issue Ratings - Subordination Risk Analysis

We do not see any structural subordination because Essity AB is the issuer of the majority of the debt, which mainly comprises unsecured notes.

Analytical conclusions

We rate Essity's debt 'BBB+' in line with our issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Low
- **Competitive position:** Strong

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:** Neutral (no impact)

Related Criteria

- 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 | Industrials: Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- ARCHIVE - General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- ARCHIVE | General Criteria: Group Rating Methodology, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Essity's Solid Financial Profile Can Absorb Acquisition Debt And Quarterly Performance Volatility, April 23, 2021
- Essity's Debt Headroom Can Absorb The Impact Of The Proposed Asaleo Transaction, Dec. 15, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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 September 6, 2021)*		
Essity AB		
Issuer Credit Rating		BBB+/Stable/A-2
Nordic Regional Scale		--/--/K-1
Senior Unsecured		BBB+
Issuer Credit Ratings History		
10-Apr-2017		BBB+/Stable/A-2
10-Apr-2017	*Nordic Regional Scale*	--/--/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.