

Tear Sheet:

Essity AB

May 2, 2023

Essity's deleveraging is on track, and we expect its S&P Global Ratings-adjusted debt to EBITDA to fall into the 2.5x-3.0x range in 2023, from 3.3x in 2022. We believe this will be primarily thanks to EBITDA growth, as the group has managed to recover input cost increases, such as for pulp and energy, through the sales price adjustments it implemented last year. Essity's reported EBITDA stood at Swedish krona (SEK) 6.3 billion in the first quarter of 2023, compared with SEK4.5 billion in the first quarter of 2022, resulting in an EBITDA margin of 14.7%, 160 basis points higher than in the first quarter of 2022. As Essity focuses on prioritizing high-value product ranges and we foresee a reduction in input costs (mainly for pulp), we expect that the group's EBITDA margin could rise to 14.5%-15.5% in 2023 from 12.9% in 2022. This includes some charges for restructuring the manufacturing footprint in the professional hygiene division and higher staff costs and spending on advertising and promotions. Higher EBITDA and an improvement in working capital compared with last year should support healthy free operating cash flow (FOCF) generation of SEK8 billion-SEK9 billion in 2023, up from about SEK6 billion last year.

Essity's first-quarter 2023 net sales increased 25.1% versus the first quarter of 2022, with higher prices and an improved product mix accounting for 18.6% of this. Volumes declined 2.6%, while acquisitions and favorable exchange rates accounted for the remaining 1.2% and 7.9% of the growth in net sales, respectively. We view the volume decline as a resilient performance in the current environment, with support from Essity's well-known brands, innovation, and the essential nature of the products. Half of the volume decline was due to the discontinuation of the baby diaper business in Latin America and the announced exit from Russia (3% of sales in 2022). In addition, Essity is discontinuing unprofitable contracts in the consumer goods division in Europe. We estimate that Essity's sales could grow 7%-9% to SEK167 billion-SEK170 billion in 2023, thanks to higher prices on average compared with 2022 and only limited volume erosion caused by consumer affordability constraints.

The announced strategic review of Chinese hygiene company Vinda and the European private-label consumer tissue division aim to reduce Essity's exposure to volatile input costs. These businesses accounted for 16% and 6% of Essity's net sales, respectively, in 2022. Essity has 51.59% ownership of Vinda, which is listed on the Hong Kong Stock Exchange and had a market capitalization of about SEK34 billion on April 25, 2023. Essity consolidates 100% of Vinda, meaning that a divestiture would reduce Essity's sales by about SEK25.1 billion (83% of sales of tissue and 17% of personal hygiene products) and its EBITDA by SEK1.1 billion, according to the 2022 results. The strategic review aims to reduce Essity's exposure to the volatile tissue business--which is subject to pulp price fluctuations and recent hikes in energy prices--and thereby its capital intensity. On the negative side, the share of sales from fast-growing emerging markets will contract materially to 25% from 37%.

PRIMARY CONTACT

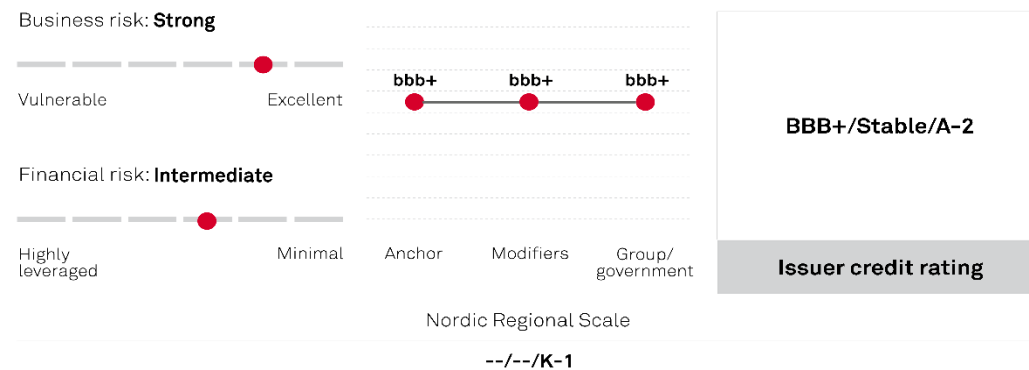
Salvio Cascarino
Milan
00390272111303
salvio.cascarino
@spglobal.com

SECONDARY CONTACT

Rocco A Semerano
London
44-20-7176-3650
rocco.semerano
@spglobal.com

Ratings Score Snapshot

Essity AB



Recent Research

Essity AB, Sept. 2, 2022

Company Description

Essity is a Swedish health and hygiene group that was created when Svenska Cellulosa spun off its hygiene division in 2017. Essity produces and sells personal care, tissue, and health and medical products. In the 12 months ended Dec. 31, 2022, Essity posted roughly SEK156.2 billion in sales (up about 28.2% versus 2021) and reported EBITDA of about SEK20 billion, with an adjusted EBITDA margin of 12.9%.

Essity operates through three main divisions:

- Consumer goods (61% of Essity's sales as of December 2022). This division sells adult incontinence products (global market leadership with the Tena brand), baby care products (such as baby diapers and pants), feminine care products (pads, panty liners, and tampons), and consumer tissue products (toilet paper, household towels, facial tissues, wet wipes, napkins, and face masks), via the retail trade channel and online.
- Professional hygiene (23% of sales). This division develops and markets complete hygiene solutions under the leading global brand Tork. These include toilet paper, paper hand towels, napkins, hand sanitizer, tissues, and dispensers. The division also provides services and maintenance for companies and office buildings, universities, health care facilities, restaurants, hotels, and other public venues.
- Health and medical (16% of sales), comprising wound care, compression therapy, and orthopedics products. Essity has established a solid presence in this market following its acquisition of BSN in 2017. Its global and regional brands include Leukoplast and Jobst, among others.

Essity is present in more than 150 countries globally, with Europe accounting for 53% of total sales as of Dec. 31, 2022, Asia-Pacific 17%, Latin America 14%, and North America 13%. Other countries account for the remaining 3%.

Essity is listed on the Nasdaq Stockholm exchange, with its largest shareholder being AB Industrivärden, with about a 10.2% stake on March 31, 2023. Essity's market capitalization was about \$20.6 billion as of March 31, 2023.

Outlook

The stable outlook reflects our view that Essity's established brand portfolio and product innovation will continue to support sales this year, while less challenging input cost conditions, primarily for pulp, and falling energy and distribution expenses should support an EBITDA margin expansion to 14.5%-15.5% this year from 12.9% in 2022. This should help adjusted debt to EBITDA fall comfortably into the 2.5x-3.0x range from 3.3x in 2022, absent any large acquisitions.

Downside scenario

We could consider lowering the rating if, in the current inflationary environment, consumers become a lot more price sensitive and shift to private-label products, causing Essity to lose market share or adopt high promotions putting pressures on profitability. In this scenario, we would expect Essity's market position to deteriorate and its operating performance to weaken, translating into adjusted debt to EBITDA permanently exceeding 3x. We could also consider a negative rating action if we were to observe Essity adopt an aggressive financial policy that led to large debt-funded acquisitions or unexpectedly large shareholder distributions, pushing debt to EBITDA above 3x for a prolonged period.

Upside scenario

We could consider a positive rating action if Essity generated solid FOCF across its three divisions and used it to improve its leverage ratios, with debt to EBITDA approaching 2x. Under this scenario, the group would need to size its debt-funded acquisitions to ensure that it could maintain leverage at this level.

Key Metrics

Essity AB--Key Metrics*

MIL. SEK	2021a	2022a	2023e	2024f	2025f
Revenue	121,857	156,173	167,000- 170,000	170,000- 173,000	171,000- 174,000
EBITDA margin (%)	16.4	12.9	14.5-15.5	16-16.5	16.5-17
Reported capital expenditure	7,358	6,949	8,000- 8,500	8,000- 8,500	8,000- 8,500
Reported free operating cash flow (FOCF)	7,309	5,925	8,000- 9,000	11,000- 12,000	12,000- 13,000
Dividends	5,312	5,312	5,000- 5,500	5,000- 5,500	5,000- 5,500
Acquisitions (including minority interests)	10,363	4,797	~5,000	~5,000	~5,000
Debt to EBITDA (x)	2.8	3.3	2.5-3.0	around 2.5x	2-2.5
Funds from operations to debt (%)	28.2	25.6	25- 30	30-35	30-35
FOCF to debt (%)	13	8.1	10-15	15-20	15-20

*All figures adjusted by S&P Global Ratings, unless differently stated. a--Actual. e--Estimate. f--Forecast.

Financial Summary

Essity AB--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	SEK	SEK	SEK	SEK	SEK	SEK
Revenues	109,265	118,500	128,975	121,752	121,867	156,173
EBITDA	19,076	18,266	21,973	24,120	19,958	20,112
Funds from operations (FFO)	15,071	14,760	19,755	19,311	15,486	16,824
Interest expense	1,207	1,117	1,126	912	815	997
Cash interest paid	1,034	1,040	1,088	892	838	862
Operating cash flow (OCF)	13,084	13,698	18,337	17,756	14,389	12,212
Capital expenditure	6,119	6,882	5,811	6,544	7,263	6,872
Free operating cash flow (FOCF)	6,965	6,816	12,526	11,212	7,126	5,340
Discretionary cash flow (DCF)	6,680	2,381	8,152	6,399	1,814	28
Cash and short-term investments	4,107	3,008	2,928	4,982	3,904	4,288
Gross available cash	4,107	3,008	2,928	4,982	3,904	4,288
Debt	54,150	57,147	51,769	44,011	54,931	65,703
Common equity	49,570	54,899	62,801	63,342	68,507	76,564
Adjusted ratios						
EBITDA margin (%)	17.5	15.4	17.0	19.8	16.4	12.9
Return on capital (%)	14.5	10.7	12.9	15.2	11.2	9.0
EBITDA interest coverage (x)	15.8	16.4	19.5	26.4	24.5	20.2
FFO cash interest coverage (x)	15.6	15.2	19.2	22.6	19.5	20.5
Debt/EBITDA (x)	2.8	3.1	2.4	1.8	2.8	3.3
FFO/debt (%)	27.8	25.8	38.2	43.9	28.2	25.6
OCF/debt (%)	24.2	24.0	35.4	40.3	26.2	18.6
FOCF/debt (%)	12.9	11.9	24.2	25.5	13.0	8.1
DCF/debt (%)	12.3	4.2	15.7	14.5	3.3	0.0

Peer Comparison

Essity AB--Peer Comparisons

	Essity AB	Kimberly-Clark Corp.	Henkel AG & Co. KGaA	Procter & Gamble Co.
Foreign currency issuer credit rating	BBB+/Stable/A-2	A/Negative/A-1	A/Stable/A-1	AA-/Stable/A-1+
Local currency issuer credit rating	BBB+/Stable/A-2	A/Negative/A-1	A/Stable/A-1	AA-/Stable/A-1+
Period	Annual	Annual	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-12-31	2022-06-30
Mil.	SEK	SEK	SEK	SEK
Revenue	156,173	210,303	249,514	821,720
EBITDA	20,112	39,569	30,246	218,929
Funds from operations (FFO)	16,824	31,716	21,312	174,911
Interest	997	3,100	590	4,769
Cash interest paid	862	2,975	1,014	4,892
Operating cash flow (OCF)	12,212	29,840	15,847	173,354
Capital expenditure	6,872	9,131	6,606	32,341
Free operating cash flow (FOCF)	5,340	20,708	9,241	141,012
Discretionary cash flow (DCF)	28	2,404	(8,617)	(51,365)
Cash and short-term investments	4,288	7,245	12,121	73,926
Gross available cash	4,288	7,245	14,394	73,926
Debt	65,703	91,177	28,550	276,604
Equity	76,564	7,297	224,548	480,139
EBITDA margin (%)	12.9	18.8	12.1	26.6
Return on capital (%)	9.0	28.9	8.5	24.1
EBITDA interest coverage (x)	20.2	12.8	51.2	45.9
FFO cash interest coverage (x)	20.5	11.7	22.0	36.8
Debt/EBITDA (x)	3.3	2.3	0.9	1.3
FFO/debt (%)	25.6	34.8	74.6	63.2
OCF/debt (%)	18.6	32.7	55.5	62.7
FOCF/debt (%)	8.1	22.7	32.4	51.0
DCF/debt (%)	0.0	2.6	(30.2)	(18.6)

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	E-3	E-4	E-5	S-1	S-2	S-3	S-4	S-5	G-1	G-2	G-3	G-4	G-5
- N/A					- N/A					- Risk management, culture, and oversight				

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Governance factors are a moderately positive consideration in our credit rating analysis of Essity. Essity's management has proven well prepared to address environmental and social factors such as waste and pollution; access to health-related products, thanks to its new product development strategy; and sustainable manufacturing processes. Environmental and social factors are a neutral consideration overall. Essity has consistently exceeded its target of at least 50% of launches being of sustainable innovations and leading to social and/or environmental improvements. Essity's leading innovations around reusable personal care products, as well as its increasing focus on recycled and renewable raw materials, seek to address rising environmental risks, and ultimately, will result in a competitive advantage over peers. In our view, Essity will benefit from increasing consumer demand for personal hygiene products in its core markets. The group's product ranges address all demographics and a variety of health needs.

Rating Component Scores

Foreign currency issuer credit rating	BBB+/Stable/A-2
Local currency 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+
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Strong (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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