

Research Update:

SCA Outlook Revised To Stable On Improved Performance And Market Conditions; 'BBB+/A-2' Ratings Affirmed

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Overview

- Sweden-based global hygiene and paper products company Svenska Cellulosa Aktiebolaget (SCA) has seen an improvement in market conditions over the past 12 months.
- SCA's credit measures have stabilized at levels which we consider commensurate with the rating, and we believe that the risk for underperformance has declined.
- We are revising the outlook on SCA to stable from negative.
- The outlook is stable and reflects our expectation of a continued improvement in operating performance and credit measures over the medium term.

Rating Action

On Sept. 27 2010, Standard & Poor's Ratings Services revised the outlook on Sweden-based global hygiene and paper products company Svenska Cellulosa Aktiebolaget (SCA) to stable from negative. At the same time, all ratings, including the 'BBB+' long-term corporate credit rating, the 'A-2' short-term corporate credit rating and the 'K-1' Nordic national scale rating, were affirmed.

Rationale

The rating action reflects SCA's improved operating and financial performance as a result of improved market conditions and cost savings through internal efficiency programs. This has resulted in credit measures which are in line with our base-case assumptions, and which we consider to be commensurate with SCA's 'BBB+' rating. Furthermore, in our view, the risk of renewed severe or prolonged underperformance is materially reduced, although high input costs may create short-term challenges.

SCA's performance in the first half of 2010 demonstrated a continuation of the improvement that began in the first quarter of 2009. The company's 12-month adjusted operating margin as of June 30, 2010 reached 15.5%, unchanged from the result in the 12 months ended March 31, 2010, but an improvement quarter on quarter to 15.7% from 14.7%. The group's ratio of adjusted funds from operations (FFO) to debt stood at about 30% for the 12 months ended June 30, 2010, which was down from about 31% in the previous quarter. On a quarter-on-quarter basis, however, FFO increased by almost 18% on the back of the improvement in operating performance. Despite further working capital

outflows in the second quarter of 2010, SCA continued to generate healthy positive free operating cash flow.

We continue to believe that SCA's hygiene products divisions will perform well over the rating horizon. We view the non-cyclical demand patterns for hygiene products, as well as SCA's established position in emerging markets, as favorable factors in this respect. Furthermore, we assume that the group's packaging division will continue to reap near-term benefits of improved market conditions and implemented cost saving efforts. Currently high input costs (mainly for pulp and recovered paper), however, may create near-term challenges and could temper profitability improvement unless the group can continue to increase selling prices. We are currently forecasting a steady or improved financial performance in 2010 and 2011, primarily based on continued positive free operating and discretionary cash flow generation which could lead to adjusted debt reduction and improved credit measures. Besides operating challenges and macroeconomic risk, we believe that downside risk to SCA's financial performance could result from fluctuations of the Swedish krona against the euro or U.S. dollar which may cause volatility in the group's debt levels, profitability, and cash flow.

The ratings continue to reflect SCA's diverse earnings base, leading positions in its core hygiene and packaging markets, high level of integration, and our assessment of the group's "intermediate" financial risk profile.

Short-term credit factors

The short-term rating is 'A-2', reflecting our view that the group's liquidity position is adequate, bordering on strong. Liquidity is supported by large backup facilities, which balance SCA's substantial exposure to short-term financing.

In our opinion, SCA's liquidity resources comfortably cover its liquidity needs over the next 12 months. In addition, we expect SCA to refinance its upcoming debt maturities and expiring backup facilities over the near term and well ahead of maturity.

As of June 30, 2010, SCA's liquidity position was supported by the following sources:

- Liquid funds of about SEK4 billion;
- About SEK29.5 billion of unused long-term committed syndicated and bilateral credit facilities. SCA's main long-term credit facilities consist of a €1.1 billion facility maturing in 2012, a €1 billion facility maturing in 2014, and bilateral credit facilities totaling about SEK8 billion (the majority of which expire in 2010, 2011, and 2013). In addition, the group signed a SEK3 billion bilateral credit facility in December 2009. The facilities have no financial covenants or material adverse change clauses that would restrict SCA from drawing under them; and
- Operating cash flow generation, which we expect to continue to exceed working capital and capital expenditure needs over the short term. Furthermore, we assume that SCA has a degree of flexibility in terms of

capital expenditure, if necessary, to offset any potential liquidity pressure.

These sources compared with reported short-term debt of about SEK18.8 billion, of which SEK7 billion consisted of outstanding commercial paper with maturities of up to five months. The remainder related to maturities in 2010 and 2011 which amounted to about SEK4.2 billion and SEK8.5 billion, respectively. Debt maturities in 2012 and 2013 are about SEK3.3 billion and SEK4.3 billion, respectively.

Outlook

The stable outlook reflects our expectation of a continued improvement in SCA's operating performance and credit measures over the medium term. For example, we expect FFO to adjusted debt to average 30%-35%.

Downside risk would primarily arise from deteriorating operating performance as a result of, for example, macroeconomic pressure. Increased outgoings beyond our current expectations including, for example, expansionary capital expenditure, shareholder dividends, or spending on acquisitions, would create additional downside risk.

Upside potential is currently limited, and would require a recovery in operational performance combined with a strengthening of the group's financial profile beyond current expectations. Given the group's existing business risk profile, SCA's FFO to adjusted debt would need to average about 35%-40% on a sustainable basis for an upgrade.

Related Criteria And Research

Use Of CreditWatch And Outlooks, Sept. 14, 2009

Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Svenska Cellulosa Aktiebolaget SCA		
Corporate Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2
Commercial Paper	K-1	
SCA Finans, AB		
Senior Unsecured*	BBB+	
Commercial Paper*	K-1	

*Guaranteed by Svenska Cellulosa Aktiebolaget SCA

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