Moody's Investors Service

Credit Opinion: Svenska Cellulosa Aktiebolaget SCA

Global Credit Research - 29 Oct 2009

Stockholm, Sweden

Ratings

Category	**Moody's Rating**
Outlook	Stable
Senior Unsecured MTN	Baa1
ST Issuer Rating	P-2
SCA Finans AB	
Outlook	Stable
Bkd Senior Unsecured	Baa1

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Key Indicators

Svenska Cellulosa Aktiebolaget SCA

Fiscal Year ending:	**31.12.2004**	**31.12.2005**	**31.12.2006**	[1]**12/31/2007**	**12/31/2008**
EBITA margin	**10.2%**	**8.0%**	**8.6%**	**13.1%**	**8.1%**
FFO / Net Debt	**28.3%**	**23.5%**	**27.3%**	**28.1%**	**20.7%**
Debt / EBITDA	**2.8x**	**3.2x**	**2.8x**	**2.3x**	**3.8x**
RCF / Net Debt [2]	**22.2%**	**17.9%**	**21.0%**	**21.5%**	**14.8%**
Total Coverage [3]	**5.1x**	**4.0x**	**4.2x**	**5.8x**	**2.9x**
FCF / Debt	**2.3%**	**-0.5%**	**1.1%**	**0.7%**	**-3.2%**

[1] EBITA-Margin, Debt to EBITDA and Total Coverage in 2007 benefit from one-off forestland revaluation
[2] RCF = Funds from Operations (FFO) - Dividends [3] Total Coverage = Ebit / Interest Expense

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Svenska Cellulosa Aktiebolaget SCA ("SCA" or "the company"), headquartered in Stockholm, Sweden, is among the largest global personal care and tissue manufacturers. The company also produces packaging solutions, publication paper, pulp and solid wood products. SCA is the leading private forestland owner in Europe and sells its products in more than 90 countries. In fiscal year 2008, its average workforce of around 52,000 employees generated revenues of SEK 110.4 billion.

Recent Developments

On 29 October 2009, Moody's changed the outlook for SCA's Baa1 rating to stable from negative. The outlook change reflects SCA's relatively robust operating performance throughout the currently challenging macroeconomic environment, reflected in strong cash flow and consequent credit metrics improvement, which Moody's expects to be sustained. Performance improvements in SCA's personal care, tissue and forest products businesses over the past few quarters have offset the impact of the underperforming packaging division. Indeed, free cash flow substantially improved and supported a recovery of SCA's credit metrics in line with Moody's requirements for the Baa1 rating category. Moody's also recognizes a shift in the company's financial policy towards cash preservation which should support the continued protection of credit metrics in line with our requirements for the current rating category going forward.

Rating Rationale

SCA's Baa1 senior unsecured rating takes into account (i) SCA's absolute scale and solid segmental diversification into consumer products, packaging, paper and forest products, with a high degree of vertical integration; (ii) its established market positions underpinned by a well diversified brand portfolio in its consumer products business; (iii) a track record of relatively stable profitability margins despite the volatility of its individual operations; (iv) ongoing implementation of cost structure improvement measures and price/volume mix improvements, which have helped to mitigate cyclical volume pressure; and (v) debt coverage potential from substantial forestland assets.

The Baa1 rating also takes into account the following challenges: (i) SCA's concentrated geographic diversification in the mature European market, which, however, is expected to steadily improve over the medium terms as a consequence of increasing penetration in emerging markets; (ii) its ability to defend pricing power for its innovative growth products, such as incontinence products; and (iii) the continuing challenge to preserve credit metrics in line with Moody's requirements for the higher end of the Baa rating category.

Rating Drivers

SCA's Baa1 senior unsecured rating is three notches above the rating indicated by Moody's global Packaged Goods Rating Methodology based on SCA's fiscal 2008 results and two notches above the methodology's indicated rating based on LTM 09/2009 results. The deviation can be traced back to the company's solid diversification beyond hygiene and tissue packaged goods (as the methodology only captures the diversification within the hygiene and tissue business areas), the partial vertical integration with a relatively high self sufficiency rate which supports margin stability relative to less integrated competitors but depresses asset efficiency ratios due to the capital intensity of the packaging and forest products business areas and the forestland ownership. The substantial debt coverage potential from the ownership of forestland is another factor which supports SCA's Baa1 rating.

The key drivers currently influencing SCA's rating are as follows:

SCALE AND DIVERSIFICATION

The rating is supported by SCA's considerable scale, reflected in revenues of SEK112 billion as of LTM 09/2009, which is more in line with the A rating category. The relatively large scale increases the company's bargaining power against strong retailers and offers a solid platform for leveraging costs. In addition, the rating benefits from an improving level of regional diversification, as most recently evidenced by the announced bolt-on acquisition of Algodonera Aconcagua, the largest player in the Argentinean market for feminine care. However, Moody's understands, that about two-thirds of total sales and profit are still related to its European stronghold. In addition, SCA shows a good level of product line diversification, which balances and offsets exposure to the volatility of any one segment as evidenced in SCA's relatively stable operating performance over recent quarters.

FRANCHISE STRENGTH

SCA is an international player in the consumer products markets, with leading positions and well established brands in some regions, particularly in incontinence care, where it is the global market leader with its Tena brand, as well as in away-from-home and consumer tissue, where the company holds the number three/four position on a global scale. In the paper and forest products business areas, SCA holds solid market positions in Europe in both paper production (mainly newsprint and magazine) and packaging, and the company is also a leading private forest holding investor in Europe.

SCA has shown a history of organic growth in recent years of around 3-4% annually. Moody's notes that SCA needs to continue to innovate and create new products as wells as increase penetration in certain markets to drive growth in both sales and market share. However, SCA has a good track record of innovation and an ability to leverage its brand names through its premium priced brands and a portfolio of product extensions and new product categories, which should be beneficial in preserving its market position going forward.

DISTRIBUTION ENVIRONMENT AND PRICING FLEXIBILITY WITH RETAIL

SCA's retail exposure is moderate as, particularly in Europe, SCA supplies a broad variety of retails chains under SCA's brands as well as private label retail brands. The growing market penetration of private label products that compete directly with branded products, typically at lower price points, has placed pressure on consumer products margins in recent years, especially in the tissue operations.

ASSESSMENT OF COST EFFICIENCY AND PROFITABILITY

SCA's operating performance was markedly resilient over the past quarters. Although also SCA was challenged by declining volumes, especially in the packaging and wood products division, impacting sales by -9%, the company was nevertheless able to slightly improve profitability in terms of EBITDA margins from 13.9% as of 12/2008 to 14.4% in the first 9 months of 2009, with a positive quarterly momentum so far.

Drivers of this resiliency have largely been the overall stable personal care business area as well as improvements in the tissue segment on the back of internal efficiency measures, new product launches and benefits from the realization of synergies resulting from the acquisition of Procter & Gambles European tissue operations in late 2007.

Going forward, we would expect continuing performance stability in SCA's personal care and tissue businesses, despite constant structural pressure on pricing in the very competitive consumer products market. Further positive contribution should come from growth in emerging markets and innovative products as well as a performance recovery of the packaging business which should preserve the group's consolidated performance stability. Although structural challenges in the European packaging industry remain significant, given the additional capacity coming on stream, the division's performance should benefit from a cyclical stabilization in demand and pricing, in addition to benefits from implemented cost reduction measures. However, Moody's anticipates that pressure on SCA's forest products division may intensify over the coming quarters, primarily due to intensifying pricing pressure for publication papers.

FINANCIAL POLICY AND CREDIT METRICS

During the course of 2009, SCA has reversed the increasing financial leverage evidenced in 2008, driven by positive impact from the improved operating profitability as well as better cash generation.

Moody's notes that SCA generated positive free cash flow of SEK5.0 billion in the last twelve months ending September 2009, compared to minus SEK1.9 billion in 2008. The positive free cash flow was supported by the strengthening of underlying funds from operations, and was also due to working capital releases, lower dividend payouts and a more disciplined capital expenditure programme. As a result, RCF to net debt improved to a level of slightly above 20% in the same time period, in line with Moody's requirements for a Baa1 rating.

Strong cash generation translated into improved leverage metrics which improved from 3.8 times as of 12/2008 to 3.4x as of 09/2009. However, it has to be noted that leverage ratios per year end 2008 were negatively impacted by adverse FX movements, which have to some extent reversed over 2009.

Liquidity

Moody's considers SCA's liquidity profile to be adequate. SCA's liquidity profile is backed by about SEK5.0 billion in cash as of 30 September 2009. The liquidity profile is further strengthened by a number of revolving facilities without MAC clauses and other conditionality language, the core of which are two syndicated facilities of EUR1.2 billion (maturing in 2012) and EUR1.0 billion (maturing in 2014). These lines are currently undrawn and serve as a backstop facility for the commercial paper program which is a central source of SCA's short term funding needs. Along with access to a SEK2.0 billion bilateral committed credit facility maturing in 2010, a SEK3.0 billion bilateral committed credit facility maturing 2011 and a committed SEK2.5 billion credit facility maturing in 2013 among other sources, these liquidity sources sufficiently cover daily operational uses, such as working cash, working capital and capex, as well as dividends and scheduled debt repayments.

These instruments should also be sufficient to cover funding needs should SCA be unable to draw on its commercial paper program or roll-over maturing commercial papers within the next 12 months. SCA's funding strategy historically has been strongly reliant on commercial paper issuance, with SEK13 billion commercial papers outstanding at end of September 2009. However, we have also noted that SCA was continuously able to roll over maturing commercial papers through the financial crisis over the past quarters.

Major cash outflows over the coming 12 months are related to capital expenditure, which we expect to be in the range of about SEK8 billion, maturing debt of about SEK5 billion (excl. commercial paper maturities) as well as dividend payments which have amounted to SEK2.5 billion in 2009. These cash uses should be covered by operating cash flow and cash resources on balance sheet.

Rating Outlook

The stable outlook reflects SCA's relatively solid operating performance in a challenging operating environment with improving credit metrics in line with Moody's requirements for the higher end of the Baa rating category which are expected to be sustained going forward

What Could Change the Rating - Up

Positive rating pressure could emerge if SCA builds up a track record of performance stability throughout all business areas, reflected in (i) the EBIT margin being improved towards 12%, (ii) RCF/Net Debt increases clearly above 25% and (iii) continued material positive free cash flows applied towards debt reduction.

What Could Change the Rating - Down

The rating could be downgraded if SCA's financial profile weakens as indicated by a decline of EBIT margins to below 7%, RCF/Net debt falling below 20%, free cash flow turning negative or an erosion of the company's solid liquidity profile.

Rating Factors

Svenska Cellulosa Aktiebolaget SCA

Packaged Goods IndustryFY 2008	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Scale & Diversification							
a) Total Sales			16.012				
b) Geographic Diversification				x			
c) Segmental Diversification (# Segments)				x			
Factor 2: Franchise Strength							
a) Market Share			x				
b) Organic Revenue Growth				x			
c) Qualitative Assessment of Portfolio			x				
Factor 3: Distribution Environment & Pricing Flexibility							
a) Retailer Exposure			x				
Factor 4: Cost Efficiency & Profitability							
a) Qualitative Assessment				x			
b) EBITA Margin					8.1%		
c) Return on Assets (EBITA / Avg. Assets)							5.8%

Factor 5: Financial Policy & Credit Metrics							
a) Financial Strategy			x				
b) FFO / Net Debt				20.7%			
c) Debt / EBITDA					3.8x		
d) RCF / Net Debt					15%		
e) EBIT / Interest Expense					2.9x		
f) Free Cash Flow / Total Debt							-3.2%
Rating:							
a) Indicated Rating from Methodology				Ba1			
b) Actual Rating Assigned				Baa1			

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