MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Essity's Baa1/P-2 ratings; stable outlook

14 Nov 2024

Milan, November 14, 2024 -- Moody's Ratings (Moody's) has today affirmed the Baa1 long-term issuer rating and the P-2 short-term issuer rating of Essity Aktiebolag (Essity). Concurrently, we have also affirmed the (P)Baa1 rating of its senior unsecured MTN programme, the Baa1 rating of various senior unsecured and backed senior unsecured bonds issued under the programme by Essity Aktiebolag as well as affirmed the Baa1 backed senior unsecured rating and the (P)Baa1 backed senior unsecured MTN programme rating of Essity Capital B.V. The outlook for both entities remains stable.

"The affirmation of Essity's ratings reflects the company's strong business profile and improved credit metrics following the recovery in operating performance since 2023, as well as our expectation that the company's free cash flow (FCF) and liquidity position will remain solid over the next 12-18 months" says Giuliana Cirrincione, Moody's Ratings lead analyst for Essity. "The recently increased financial flexibility following the sale of its subsidiary Vinda International Holdings Limited (Vinda) and the prudent financial policy are key factors which solidly position the company in its current rating category", added Mrs. Cirrincione.

RATINGS RATIONALE

Essity's Baa1 issuer rating reflects its leading market positions globally, underpinned by its large scale and broad product portfolio, as well as well-recognised brands and a good track record of innovation. Essity's credit profile also benefits from a fairly good underlying growth of and stable demand for its products and its prudent financial policy, aimed at protecting its solid investment-grade rating. The track record of solid credit metrics combined with its good FCF and the additional financial flexibility granted by the proceeds from the recent divestment of its subsidiary Vinda, will support debt reduction and funding of future tuck-in acquisitions.

Essity's ratings are however constrained by its exposure - albeit recently reduced - to volatile input costs, pulp in particular, and by its somewhat below-average profitability compared with that of similarly rated peers. We also take into account a degree of debt-funded M&A risk, which, however, is mitigated by our expectation that the company will maintain a prudent financial policy.

Essity has bolstered its liquidity reserves to manage the risk stemming from the fact that few bondholders have demanded the early repayment of certain bonds due between 2029 and 2031. These bondholders believe Essity violated the "cessation of business" term within the EMTN programme by selling its 52% ownership in Vinda. Following legal consultation, Essity determined that selling its Vinda shares does not represent a business cessation. The probability and timing of these bonds being accelerated and paid in full prior to maturity remain unclear. Nonetheless, adhering to a prudent financial strategy, Essity has undertaken steps to enhance its liquidity. This includes securing a committed credit facility worth SEK34 billion (€3 billion), with an option for extension at the company's discretion until June 2026. Coupled with Essity's solid cash reserves, access to additional liquidity sources, and robust FCF, these measures provide a good cushion. This gives the company the time to potentially adjust its capital structure, if necessary, and to maintain a suitable maturity schedule for its financial obligations.

LIQUIDITY

Essity's liquidity has traditionally been good, underpinned by our expectation of consistently positive FCF. As of the end of September 2024, the company reported cash and cash equivalents of around SEK11.8 billion, of which around SEK 3.7 billion was in countries with currency restrictions. In addition, the company had access to various undrawn credit facilities, totalling roughly SEK56 billion. These include the SEK34 billion (€3 billion) revolving credit facility (RCF) which the company put in place in 2024 as a contingency liquidity line in case of bonds acceleration, if any. The company's debt maturity profile is generally well spread, with an average maturity of around 4 years.

RATIONALE FOR THE STABLE OUTLOOK

Essity is currently solidly positioned in its rating category, reflected by its stronger balance sheet following the recent disposal of Vinda, which resulted in cash proceeds of around SEK19 billion. The stable rating outlook reflects our expectation that, alongside debt reduction, Essity will also apply a significant portion of these proceeds to increase shareholder distributions and M&A activity when it regains momentum. The stable outlook also assumes that Essity will maintain a prudent financial policy commensurate with the current rating, with credit metrics likely to improve moderately over the next 12-18 months.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

We could upgrade the rating if the company achieves Moody's-adjusted EBITA margins consistently above 15%; retained cash flow to net debt is consistently above

25%; continued strong FCF generation; and its Moody's-adjusted debt/EBITDA remains well below 2.5x on a sustained basis.

We could downgrade the rating if Moody's-adjusted EBITA margins decline below 10%; retained cash flow to net debt is below 20% and its Moody's-adjusted debt/EBITDA increases above 3.0x on a sustained basis. Negative pressure could also materialize in case of negative FCF and erosion of the company's solid liquidity.

The principal methodology used in these ratings was Consumer Packaged Goods published in June 2022 and available at https://ratings.moodys.com/rmc-documents/389866. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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