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Holmen AB

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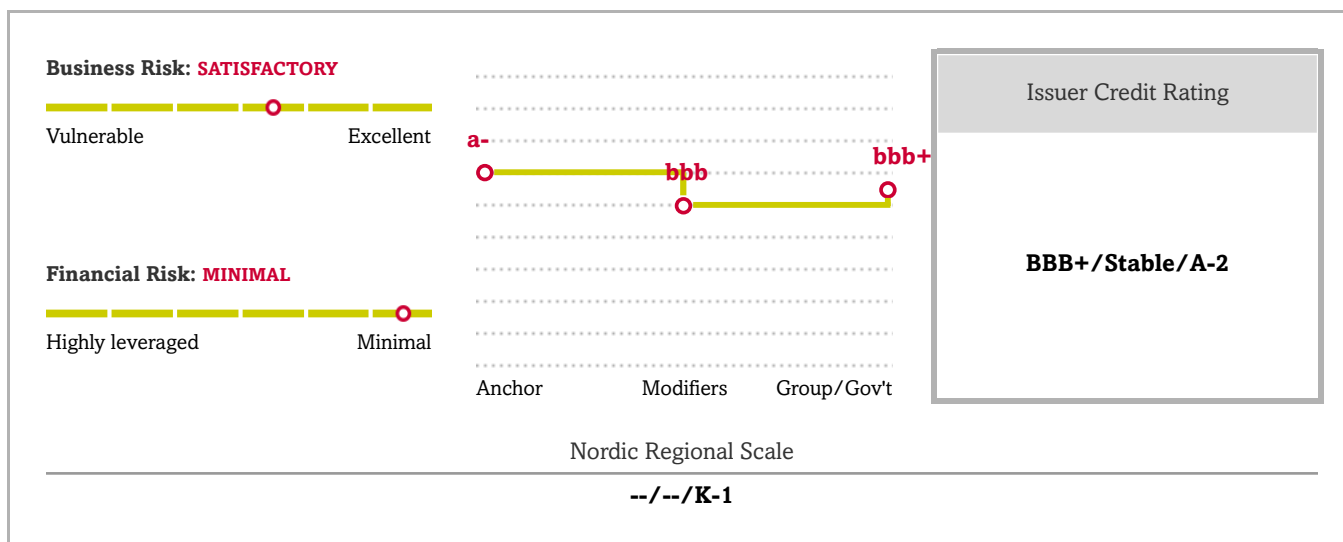
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Holmen AB



Credit Highlights

Overview

Key strengths	Key risks
Strong market position in the stable paperboard segment.	Small size compared with peers.
Vertical integration into forest and energy assets.	Exposure to the structurally declining publication paper market.
Resilient cash flow generation.	Limited geographical diversification.

We believe that the wood products segment will support Holmen's 2021 performance. We expect that Holmen's wood products division will see strong growth in 2021, as demand from the construction and do-it-yourself industries remains robust. This has resulted in a steep price increase that will support the company's profitability. We expect this segment's revenues will reach about SEK5 billion (up from SEK2.2 billion last year) and EBITDA margins of 30%-33%. Holmen will benefit fully from the booming market conditions because it has just completed a capacity expansion in its Braviken sawmill and the acquisition of Swedish wood products firm Martinsons.

Though a declining market, we anticipate some recovery in the demand for Holmen's paper products in 2021. As the effects from the pandemic soften, we expect some demand for paper products to return in 2021, but prices to remain low throughout the year. We forecast that the efficiency of Holmen's paper segment will recover in 2021, as the mills are now running at full capacity, but this recovery will be partly offset by higher electricity costs.

We anticipate that free operating cash flow (FOCF) generation will remain strong in 2021 despite heavy investments. We expect that Holmen's FOCF will increase to Swedish krone (SEK) 1.5 billion–SEK1.6 billion in 2021, compared with SEK1.3 billion in 2020. This is due to the strong momentum of the wood products division, despite the high investments the company is making to develop the new Blåbergsliden wind farm in the north of Sweden. Holmen plans to invest about SEK800 million in this project in 2021; total capital expenditure (capex) for the year would amount to SEK1.8 billion. We believe that FOCF will continue to improve to around SEK1.9 billion in 2022, on the back of lower capex of SEK1 billion and the EBITDA contribution of the wind farm, which Holmen expects to commission by year-end 2021.

We expect Holmen's credit metrics to remain commensurate within the current rating. We forecast that debt leverage will reduce to about 1.2x in 2021, from 1.5x in 2020, due to high EBITDA generation and strong market conditions in some divisions. We forecast that debt leverage will remain at a similar level in 2022 because the EBITDA contribution from the new Blåbergsliden windfarm would be compensated by some correction in the wood products market. In addition, we expect funds from operations (FFO) to debt to improve to over 70% by December 2021 (compared to 53% in 2020), and to remain broadly unchanged in 2022.

Outlook

The stable outlook reflects our view that Holmen's credit metrics will remain strong over the next two years, supported by dynamic market trends and a strong balance sheet. That said, we expect that the credit ratios will remain in line with the current rating.

Downside scenario

We could lower the rating if:

- Holmen increases its leverage to above 2x over a sustained period;
- FFO to debt falls sustainably below 45%; or
- Holmen's financial policy becomes less stringent, for example, through a more aggressive approach toward shareholder remuneration.

Upside scenario

We could consider raising the rating if Holmen's financial policy tightens, and it commits to maintaining leverage below 1.5x on a sustained basis, and to taking a prudent approach to investments and shareholder returns.

Our Base-Case Scenario

Assumptions

- Growth in eurozone GDP of 4.4% in 2021 and 4.5% in 2022. In Sweden, where Holmen generated 26% of its revenues in 2020, we expect GDP to grow by 3.0% in 2021 and 2.8% in 2022.
- Revenue growth of about 19% in 2021, driven by the full-year contribution of Martinsons, which Holmen only consolidated for one quarter in 2020, and the sharp increase in wood product prices. Revenue growth will also be supported by higher demand for sawlogs and recovery in the deliveries of paper products. In 2022, we expect a modest revenue drop of 1%-3%, as we forecast some correction in wood product prices. Sales will also be undermined by the sustained decline of the publication paper business.
- S&P Global Ratings-adjusted EBITDA margins of about 19%-20% in 2021, compared to 17.1% in 2020, supported by the wood products segment's higher prices and the full ramp-up of the Braviken mill. We expect the adjusted EBITDA margins to reduce to 17%-18% in 2022, undermined by lower wood products prices. We believe this would be partly offset by slightly higher prices in the paperboard segment and a resilient performance in the forest segment.
- A working capital outflow of SEK40 million in 2021 in line with revenue growth, and SEK20 million in 2022.
- Capex of SEK1.8 billion in 2021, including about SEK800 million for the development of the Blåbergsliden windfarm. We expect capex of SEK1 billion in 2022.
- A dividend payment of about SEK1.7 billion in 2021, reflecting regular dividends of SEK7.25 per share and extraordinary dividends of SEK3.5 per share. In 2022, we assume a total dividend payout of about SEK1.3 billion.

Key Metrics

Holmen AB--Key Metrics*

	--Fiscal year ended Dec. 31--			
	2019a	2020a	2021e	2022f
(Bil. SEK)				
Revenue growth (%)	5.6	(3.9)	19.0-20.0	(1.0)-(3.0)
EBITDA margin (%)	15.2	17.1	19.0-20.0	17.0-18.0
Capital expenditure	1.0	1.2	1.8	1.0
Dividends	1.1	0.6	1.7	1.3
Debt to EBITDA (x)	1.5	1.5	~1.2	1.0-1.2
FFO to debt (%)	60.9	53.0	70.0-75.0	70.0-75.0
FOCF to debt (%)	43.0	28.4	30.0-35.0	45.0-50.0

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

Peer Comparison

Table 1

Holmen AB--Peer Comparison					
Industry Sector: Paper/Forest Products					
	Holmen AB	Metsa Board Corp.	Mondi Plc	UPM-Kymmene Corp.	Svenska Cellulosa AB SCA
Ratings as of Aug. 24, 2021	BBB+/Stable/A-2	BBB-/Stable/A-3	BBB+/Stable/--	BBB/Stable/A-2	BBB/Stable/A-2
--Fiscal year ended Dec. 31, 2020--					
(Mil. SEK)					
Revenue	17,607.0	18,982.7	66,939.2	86,198.2	18,410.0
EBITDA	3,019.0	3,335.4	13,361.7	13,201.0	3,214.0
Funds from operations (FFO)	2,408.0	2,764.8	10,840.1	11,332.4	3,046.0
Interest expense	43.0	113.5	1,014.7	351.6	126.0
Cash interest paid	42.0	116.5	833.9	411.9	133.0
Cash flow from operations	2,455.0	3,089.3	12,447.5	10,056.5	3,683.0
Capital expenditure	1,165.0	1,547.1	6,932.0	8,750.4	2,644.0
Free operating cash flow (FOCF)	1,290.0	1,542.1	5,515.5	1,306.0	1,039.0
Discretionary cash flow (DCF)	723.0	685.2	3,034.0	(5,887.2)	1,039.0
Cash and short-term investments	346.0	2,149.9	3,837.7	17,279.8	1,273.0
Debt	4,546.0	2,467.4	19,622.1	7,715.9	8,529.0
Equity	42,516.0	13,902.2	44,023.4	95,571.5	72,163.0
Adjusted ratios					
EBITDA margin (%)	17.1	17.6	20.0	15.3	17.5
Return on capital (%)	4.1	13.0	13.3	7.4	1.3
EBITDA interest coverage (x)	70.2	29.4	13.2	37.5	25.5
FFO cash interest coverage (x)	58.3	24.7	14.0	28.5	23.9
Debt/EBITDA (x)	1.5	0.7	1.5	0.6	2.7
FFO/debt (%)	53.0	112.1	55.2	146.9	35.7
Cash flow from operations/debt (%)	54.0	125.2	63.4	130.3	43.2
FOCF/debt (%)	28.4	62.5	28.1	16.9	12.2
DCF/debt (%)	15.9	27.8	15.5	(76.3)	12.2

SEK--Swedish krona

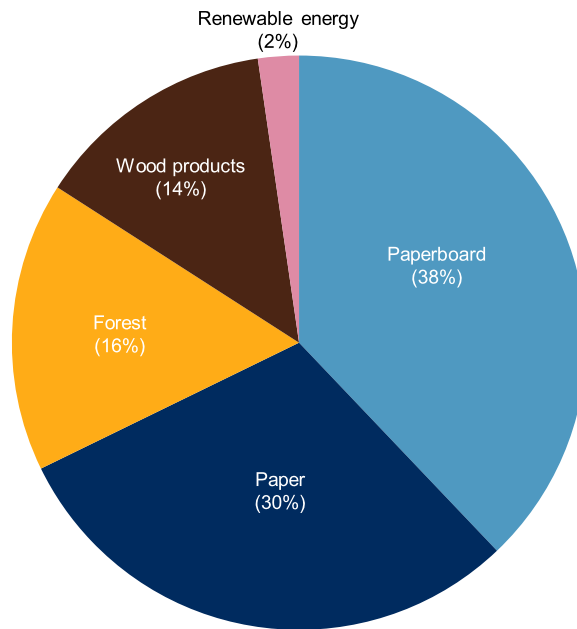
Company Description

Holmen is a Sweden-based producer of paperboard, paper, wood and forest products, and renewable energy. It owns

1.3 million hectares of forest land in Sweden, of which over 1.0 million hectares are productive. Holmen generated SEK17.6 billion in revenues and SEK3 billion of adjusted EBITDA in 2020.

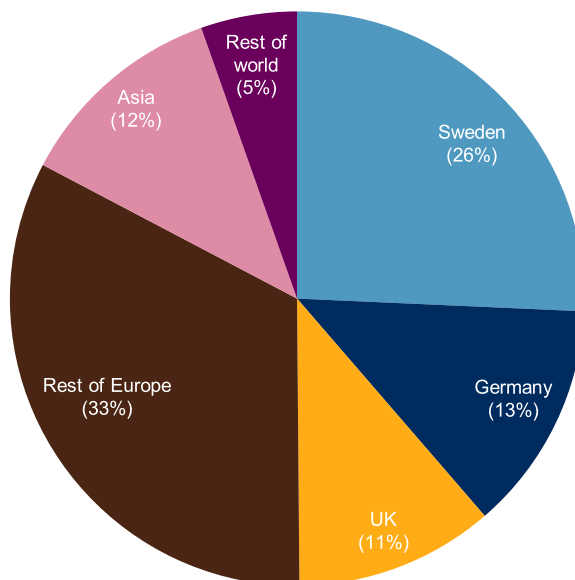
Chart 1

Revenue by Business Segment
2020



Source: Holmen, 2020 Annual Report.

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Chart 2**Revenue by Geography
2020**

Source: Holmen, 2020 Annual Report.

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Business Risk: Satisfactory

Our business risk assessment on Holmen is supported by the company's leading market position in the relatively stable virgin-fiber-based paperboard market. Holmen has a strong market position in the manufacture of premium paperboard for consumer packaging. We believe that the demand for these products is resilient and supported by an increased focus on sustainability, especially in the food segment, where paperboard is considered a suitable alternative to plastic packaging.

Holmen's business risk profile is also underpinned by its strong vertical integration. The company is fully self-sufficient in pulp, 60% self-sufficient in wood, and 50% self-sufficient in energy. This results in a competitive cost position and acts as an entry barrier.

Holmen's relatively small size and scope and limited geographical diversity constrain our assessment. Our assessment also indicates the company's exposure to the declining publishing paper segment, despite successfully increasing its presence in higher-growth and profitable paper segments.

Financial Risk: Minimal

We expect Holmen's credit metrics to improve in 2021, as the negative impact of the pandemic subsides, with adjusted leverage of 1.2x (from 1.5x in 2020) and FFO to debt of around 70%, compared with 53% in 2020.

We forecast that net debt will remain at about SEK4.7 billion by December 2021 (compared with SEK4.6 billion in 2020). Additional debt raised by the company to partly fund a large dividend distribution and high capex needs during the year will be partly offset by robust cash generation, in our view.

Holmen aims to cap its debt-to-equity ratio at 0.25x. The company's reported leverage ratio has consistently been well below this threshold, falling to just 0.1x by year-end 2020. This indicates Holmen's capability to make large (potentially debt-funded) investments, dividend payments, acquisitions, or share buybacks. This relatively loose, publicly stated leverage target leads to our negative assessment of Holmen's financial policy.

Financial summary

Table 2

Holmen AB--Financial Summary					
Industry Sector: Paper/Forest Products					
	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
(Mil. SEK)					
Revenue	17,607.0	18,314.0	17,339.0	17,269.0	17,072.0
EBITDA	3,019.0	2,784.0	3,061.5	2,796.5	3,050.5
Funds from operations (FFO)	2,408.0	2,603.0	2,625.7	2,568.2	2,537.4
Interest expense	43.0	48.0	49.8	64.3	68.1
Cash interest paid	42.0	34.0	39.8	7.3	9.1
Cash flow from operations	2,455.0	2,881.0	2,332.7	2,544.2	1,997.4
Capital expenditure	1,165.0	1,044.0	1,134.0	701.0	772.0
Free operating cash flow (FOCF)	1,290.0	1,837.0	1,198.7	1,843.2	1,225.4
Discretionary cash flow (DCF)	723.0	(727)	106.7	835.2	343.4
Cash and short-term investments	346.0	483.0	278.0	356.0	210.0
Gross available cash	346.0	483.0	278.0	356.0	210.0
Debt	4,546.0	4,271.0	3,527.3	3,112.3	4,205.7
Equity	42,516.0	40,111.0	23,453.0	22,035.0	21,243.0
Adjusted ratios					
EBITDA margin (%)	17.1	15.2	17.7	16.2	17.9
Return on capital (%)	4.1	4.6	7.7	7.0	7.7
EBITDA interest coverage (x)	70.2	58.0	61.5	43.5	44.8
FFO cash interest coverage (x)	58.3	77.6	67.0	354.1	278.8
Debt/EBITDA (x)	1.5	1.5	1.2	1.1	1.4
FFO/debt (%)	53.0	60.9	74.4	82.5	60.3
Cash flow from operations/debt (%)	54.0	67.5	66.1	81.7	47.5
FOCF/debt (%)	28.4	43.0	34.0	59.2	29.1

Table 2

Holmen AB--Financial Summary (cont.)

	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
DCF/debt (%)	15.9	(17.0)	3.0	26.8	8.2

SEK--Swedish krona.

Reconciliation

Table 3

Holmen AB--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

--Fiscal year ended Dec. 31, 2020--								
Holmen AB reported amounts (mil. SEK)								
	Debt	Revenue	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Capital expenditure
	4,505.0	17,666.0	3,072.0	2,479.0	41.0	3,019.0	2,457.0	1,167.0
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(569)	--	--
Cash interest paid	--	--	--	--	--	(40)	--	--
Reported lease liabilities	287.0	--	--	--	--	--	--	--
Accessible cash and liquid investments	(246)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	2.0	(2)	(2)	(2)
Income (expense) of unconsolidated companies	--	--	6.0	--	--	--	--	--
Nonoperating income (expense)	--	--	--	11.0	--	--	--	--
Revenue: Profit on disposals	--	(59)	(59)	(59)	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	(579)	--	--	--	--
Total adjustments	41.0	(59.0)	(53.0)	(627.0)	2.0	(611.0)	(2.0)	(2.0)
S&P Global Ratings' adjusted amounts								
	Debt	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Capital expenditure
	4,546.0	17,607.0	3,019.0	1,852.0	43.0	2,408.0	2,455.0	1,165.0

SEK--Swedish krona.

Liquidity: Adequate

The short-term rating on Holmen is 'A-2', reflecting the long-term issuer credit rating and our assessment of the company's liquidity as adequate. Based on our calculations, we believe that the company's liquidity sources will exceed its liquidity needs by 2.0x over the next 12 months from June 30, 2021. Our view of Holmen's liquidity primarily reflects the availability under long-term committed credit facilities, FFO generation, and a lack of material debt maturities in the next 12 months.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • Availability of about SEK5.0 billion under committed credit facilities, of which SEK1.0 billion is available until 2024 and SEK4.0 billion until 2026; • Our forecast of FFO of about SEK3.1 billion; and • Cash on balance sheet of SEK643 million. 	<ul style="list-style-type: none"> • SEK1.5 billion of debt maturities; • About SEK1.4 billion in capex over the next 12 months; and • About SEK1.3 billion for dividend payment.

Other Credit Considerations

We believe that Holmen's leverage is likely to increase materially from its current level, because its financial policy allows it to increase debt-funded investments or shareholder returns significantly. Consequently, we apply a negative financial policy modifier to Holmen's stand-alone credit profile (SACP) that adjusts the 'a-' anchor downward by two notches to 'bbb'.

Group Influence

We view Holmen as a moderately strategic subsidiary of its majority shareholder, L E Lundbergforetagen (Lundberg; A+/Stable/A-1). Lundberg is a Swedish investment holding company that held 34.1% of Holmen's capital and 62.3% of the votes as of Dec. 31, 2020.

Lundberg has a significant influence over Holmen's financial policy and strategic plans. We believe that this has resulted in a track record of strong credit metrics, even when market conditions have been weak. This assessment results in a one-notch uplift from the SACP of 'bbb' to arrive at the 'BBB+' issuer credit rating.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Very low
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

Financial risk: Minimal

- **Cash flow/leverage:** Minimal

Anchor: a-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-2 notches)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Group credit profile:** a+
- **Entity status within group:** Moderately strategic (+1 notch from SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

Business Risk Profile	Financial 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 August 25, 2021)*

Holmen AB

Issuer Credit Rating	BBB+/Stable/A-2
<i>Nordic Regional Scale</i>	--/--/K-1

Issuer Credit Ratings History

10-Jul-2017		BBB+/Stable/A-2
14-Jul-2016		BBB/Positive/A-2
01-Oct-2014		BBB/Stable/A-2
10-Jul-2017	<i>Nordic Regional Scale</i>	--/--/K-1
09-Dec-2009		--/--/K-2
09-Nov-2009		--/Watch Neg/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.

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