

Research Update:

Forest Products Group Holmen AB 'BBB+/A-2' Ratings Affirmed; Outlook Stable

July 12, 2023

Rating Action Overview

- We believe Swedish forest products group Holmen AB, which generated Swedish krona (SEK) 8.4 billion in EBITDA last year, will retain meaningful headroom under our rating, despite our anticipation of weaker market conditions for 2023.
- Holmen's satisfactory business risk profile, which reflects its strong vertical integration, competitive cost base, and leading market position in paperboard, support the rating, as do Holmen's strong credit metrics, with expected leverage of roughly 0.5x and funds from operations (FFO) to debt above 150% for year-end 2023.
- Holmen's limited size compared with rated peers, its asset concentration in Sweden, and exposure to the declining paper market constrain the rating.
- We therefore affirmed our long- and short-term issuer credit ratings on Holmen at 'BBB+/A-2'.
- The outlook is stable because we see Holmen's credit metrics remaining commensurate with the current rating over the next two years, supported by a strong balance sheet and despite weaker market conditions and higher growth investments, as well as owing to our positive view of its main shareholder, L E Lundbergforetagen AB (Lundberg; A+/Stable/A-1).

PRIMARY CREDIT ANALYST

Lina Sanchez
Frankfurt
+4901622104469
lina.sanchez
@spglobal.com

SECONDARY CONTACT

Desiree I Menjivar
London
+ 44 20 7176 7822
desiree.menjivar
@spglobal.com

Rating Action Rationale

In 2023 we anticipate lower S&P Global Ratings-adjusted EBITDA margins of about 24%-25% compared with 31.5% in 2022. In 2023, we assume weaker pricing conditions in the paper and paperboard segments and softer demand. We expect S&P Global Ratings-adjusted EBITDA margins to decline to 24%-25% owing both to lower volumes in those segments and lower wood prices. We expect Holmen's S&P Global Ratings-adjusted EBITDA margins to remain robust in 2024, despite our anticipation of a further decline to 22%-23% as paper prices decline.

We assume free operating cash flow (FOCF) of about SEK3.0 billion–SEK3.5 billion in 2023 compared with SEK4.1 billion last year. We expect lower EBITDA and higher capital expenditure (capex) to weigh on S&P Global Ratings-adjusted FOCF in 2023. This will be partly offset by a SEK500 million working capital inflow (versus SEK1.3 billion outflow in 2022) due to lower

receivables and inventories, thanks to lower prices for wood products. We assume capex will increase to SEK2 billion (from SEK1.4 billion in 2022) because of capacity expansion and productivity enhancement projects. Despite this, we forecast Holmen's FOCF to debt will exceed 100% in 2023. This leaves ample rating headroom for expansionary investments.

We forecast Holmen will retain comfortable rating headroom in the next 18 months. With debt to EBITDA forecast at about 0.5x and FFO to debt in excess of 150% in December 2023, we anticipate the group's rating headroom will remain ample. We also forecast that credit metrics will remain commensurate with the rating in 2024, despite potential large expansion projects.

Our satisfactory business risk assessment is supported by Holmen's strong vertical integration, leading market positions in paperboard, and cost-efficient structure. Holmen is fully self-sufficient in pulp, 60% self-sufficient in wood, and 50% self-sufficient in energy. This results in a competitive cost structure and barriers to entry, and secures Holmen's access to key raw materials, such as wood and energy. It also provides Holmen with a competitive advantage over smaller peers in the paper and paperboard markets in Central and Southern Europe. Our assessment also reflects the positive long-term growth trends for wood products and paperboard, where Holmen has strong market positions.

The business risk assessment is constrained by Holmen's limited scale and geographical diversification, as well as its exposure to the structurally declining graphic paper segment. Holmen is smaller than Mondi PLC (A-/Stable/--) and UPM-Kymmene Corp. (BBB+/Positive/A-2). In 2022, Mondi reported EBITDA of €1.9 billion and UPM-Kymmene of €2.5 billion, while Holmen recorded SEK-equivalent EBITDA of roughly €755 million. We also view Holmen's asset concentration in Sweden as a constraint to our assessment. Moreover, Holmen's exposure to graphic and publication paper (used for magazines, books, and advertising) is credit negative, given these segments are in structural decline. That said, Holmen is gradually increasing its exposure to segments with higher growth prospects, such as packaging. We view Holmen's business risk profile at the weaker end of the satisfactory category and reflect this via a one-notch negative comparable rating analysis modifier.

We reflect the possibility of Holmen increasing its leverage above levels commensurate with a minimal financial risk profile in a one-notch negative financial policy modifier. Although we do not believe them likely in the near term, we acknowledge that Holmen's financial policy allows it to pursue sizable debt-funded investments or shareholder returns. This could result in a significant increase in leverage. We thereby apply a negative financial policy modifier to Holmen's stand-alone credit profile (SACP) that lowers our anchor by one notch.

Our rating on Holmen is supported by group influence from its majority shareholder, Lundberg. We view Holmen as a moderately strategic subsidiary of Lundberg, a Swedish investment holding company that held 34.3% of Holmen's capital and 62.4% of the votes as of May 31, 2023. 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.

We revised our liquidity assessment to strong from adequate. We expect liquidity sources will exceed uses by more than 2.0x in the next 12 months and more than 1.5x in the subsequent 12 months. Our updated assessment is supported by Holmen's track record of liquidity sources exceeding liquidity uses by at least 1.5x in the past three years. The improved liquidity assessment

is also supported by the cash it has accumulated in recent years and its reduced reliance on commercial paper (short-term funding). Holmen's liquidity is underpinned by SEK5 billion equivalent available under committed credit facilities, a sizable SEK3.2 billion cash balance, and forecast FFO generation of SEK4.6 billion in the next 12 months.

Outlook

The stable outlook reflects our view that Holmen's credit metrics will remain in line with the current rating over the next two years, supported by a strong balance sheet and despite weaker market conditions or growth investments. Our outlook assumes that the group influence from Lundberg will continue to provide a one-notch rating uplift.

Downside scenario

We believe that the possibility of a downgrade is remote in the absence of any transformational events. Nevertheless, we could lower the rating if:

- Holmen increased its debt to EBITDA to above 2x over a sustained period or FFO to debt fell below 45% on a sustainable basis, for example, as a result of a debt-funded transformational acquisition; or
- Holmen pursued a more aggressive financial policy via, for instance, large debt-funded shareholder distributions.

Upside scenario

We see rating upside as limited, due to Holmen's business risk profile positioning relative to peers. That said, we would consider raising the rating if Holmen's scale and geographical diversification improved in line with those of higher-rated peers, without deterioration of its financial policy.

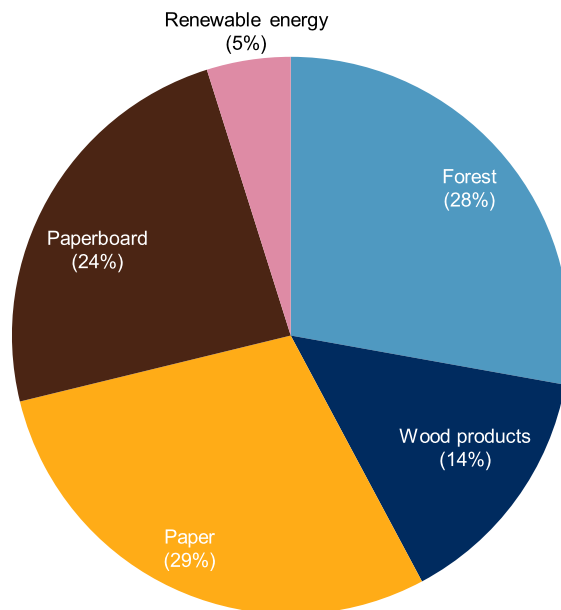
Company Description

Holmen is a Sweden-based diversified player mainly operating in the forest and paper industry. It owns 1.3 million hectares of forest land in Sweden, of which over 1.0 million hectares are productive. Holmen generated adjusted revenue of SEK26.7 billion and adjusted EBITDA of SEK8.4 billion in 2022.

Holmen has been listed on the Stockholm Stock Exchange (Nasdaq Stockholm) since 1936. Its main shareholder is Lundberg, which held 34.3% of Holmen's capital and 62.4% of the votes as of May 31, 2023. Lundberg is a Swedish investment holding company.

Holmen AB--Net sales by business segment

First-quarter 2023 revenue



Source: Company report.

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Our Base-Case Scenario

Assumptions

- In 2023, we anticipate a 15% revenue decline, mainly due to the paper and wood products divisions. In paper, we forecast a 20% decline in deliveries and broadly flat prices, as some price hikes implemented in 2022 show results in 2023. In wood products, we assume lower prices than in 2022 throughout 2023, and flat volumes. This will only be partly offset by an increase in revenue in the forest segment, supported by higher timber prices. In 2024, we assume a minor revenue decline of 1%, largely because of lower paper prices. This would only be partly compensated by a recovery in demand for wood products and paperboard.
- S&P Global Ratings-adjusted EBITDA margins between 24%-25% in 2023 (from 31.5% in 2022) reflecting low wood product prices and a decline in fixed-cost absorption in paper and paperboard due to lower volumes. In 2024, we assume EBITDA margins of 22.5%-23.5%, reflecting the price normalization in the paper segment.
- Capex of SEK2 billion per year in 2023 and 2024, which includes the expansion of its paperboard capacity at its mill in Iggesund, new product development in the paper segment, and efficiency improvements at the Braviken mill. We note that capex could increase markedly,

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especially in 2024, if Holmen is awarded new wind farm projects or if it develops the new sawmill in Rundvik.

- A working capital inflow of SEK500 million in 2023, reflecting the decline in selling prices. We assume a SEK50 million outflow in 2024.
- FOCF of SEK3.4 billion in 2023 (SEK4.1 billion in 2022) due to lower EBITDA and higher capex. This is only partly compensated by a working capital inflow (versus a SEK1.3 billion outflow in 2022). In 2024, we forecast SEK2.1 billion.
- Dividend payments of SEK2.6 billion in 2023, reflecting an ordinary dividend of SEK8 per share and an extraordinary dividend of SEK8 per share. In 2024, we assume dividend payments of SEK1.9 billion-SEK2 billion.
- Share buybacks for about SEK1 billion in 2023 and SEK200 million in 2024, assuming Holmen fully executes the announced share repurchase program.

Key metrics

Holmen AB--Forecast Summary

Industry sector: Paper/forest products						
(Mil. SEK)	--Fiscal year ended Dec. 31--					
	2019a	2020a	2021a	2022a	2023e	2024f
Revenue	18,314	17,607	20,849	26,661	22,636	22,401
EBITDA (reported)	2,799	3,072	4,528	8,450	5,503	5,039
Plus/(less): Other	(15)	(53)	(385)	(44)	0	0
EBITDA	2,784	3,019	4,143	8,406	5,503	5,039
Less: Cash interest paid	(34)	(42)	(45)	(48)	(45)	(45)
Less: Cash taxes paid	(147)	(569)	(662)	(1,639)	(600)	(815)
Funds from operations (FFO)	2,603	2,408	3,436	6,719	4,858	4,178
Interest expense	48	43	49	61	45	45
Capital expenditure (capex)	1,044	1,165	1,707	1,391	2,000	2,000
Dividends	1,134	567	1,741	1,862	2,591	1,943
Share repurchases (reported)	1,430	0	0	0	1,000	200
Discretionary cash flow (DCF)	(727)	723	(225)	2,231	(233)	(15)
Debt (reported)	4,470	4,505	4,618	3,934	3,441	3,441
Plus: Lease liabilities debt	184	287	244	247	254	262
Plus: Pension and other postretirement debt	0	0	0	0	0	0
Less: Accessible cash and liquid Investments	(383)	(246)	(407)	(1,835)	(1,035)	(974)
Debt	4,271	4,546	4,455	2,346	2,660	2,729
Cash and short-term investments (reported)	483	346	507	1,935	1,135	1,074
Adjusted ratios						
Debt/EBITDA (x)	1.5	1.5	1.1	0.3	0.5	0.5
FFO/debt (%)	61	53	77	286	183	153

Holmen AB--Forecast Summary (cont.)

Industry sector: Paper/forest products						
(Mil. SEK)	--Fiscal year ended Dec. 31--					
	2019a	2020a	2021a	2022a	2023e	2024f
FFO cash interest coverage (x)	78	58	77	141	108	93
EBITDA interest coverage (x)	58	70	85	138	122	111
FOCF/debt (%)	43	28	34	175	126	78
DCF/debt (%)	(17)	16	(5)	95	(9)	(1)
Annual revenue growth (%)	6	(4)	18	28	(15)	(1)

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. SEK--Swedish krona.

Liquidity

We now assess Holmen's liquidity as strong (compared with adequate previously) and anticipate that sources of liquidity will exceed uses by more than 2.0x in the next 12 months and more than 1.5x in the subsequent 12 months. Our improved liquidity assessment is supported by Holmen's track record of liquidity sources exceeding uses by more than 1.5x in the past three years, significant cash accumulated in recent years, and a decreased reliance on commercial paper, which reduces its recourse to short-term funding. We expect Holmen's cash balance, availabilities under revolving credit facilities (RCFs), and FFO generation will support liquidity sources exceeding uses by more than 1.5x sustainably.

The main liquidity sources for the next 12 months started April 1, 2023, include:

- Undrawn committed credit facilities of SEK5.0 billion maturing beyond 12 months (SEK1.0 billion available until 2025 and SEK4.0 billion until 2027);
- Forecast cash FFO of about SEK4.6 billion; and
- Cash and liquid investments of SEK3.2 billion as of March 31, 2023.

The main uses of liquidity for the same period are:

- Dividend payments of about SEK2.6 billion;
- Capex of about SEK2 billion;
- Our assumption of share repurchases of about SEK1 billion; and
- Debt maturities of about SEK500 million.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are an overall neutral consideration in our credit rating analysis of Holmen. We believe Holmen benefits from its extensive forest assets in Sweden. Its 1.3 million hectares of forest land sequestered 1.3 billion tons of carbon dioxide (CO2) in 2022; additionally, about 200,000 hectares

are destined for nature conservation. That said, like other industry peers, Holmen faces long-term risks related to climate change that could potentially affect its forests. We see environmental risks coming from Holmen's pulp and paper operations, since these require significant amounts of energy, water, and chemicals. These risks are partially compensated by the CO2 sequestration in its tree plantations and its use of fossil-free energy sources.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
Business risk:	Satisfactory
Country risk	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 (-1 notch)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Negative (-1 notch)
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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Ratings List

Ratings Affirmed

Holmen AB

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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