S&P Global Ratings

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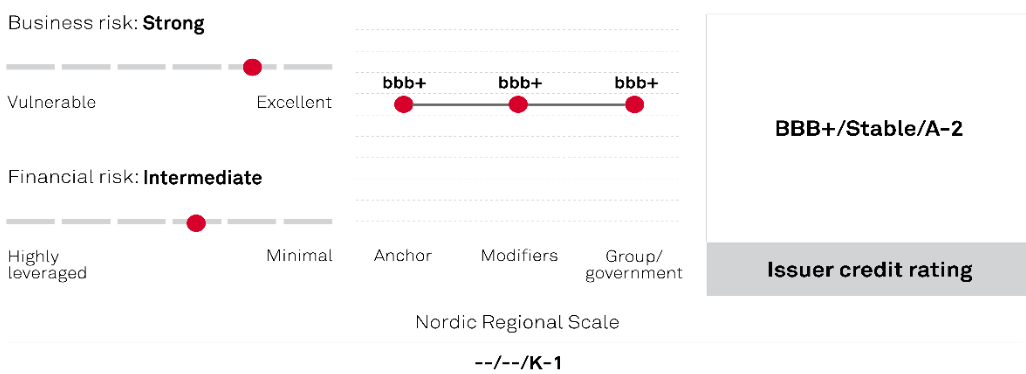
Essity AB

October 30, 2023

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
A product portfolio, including adult and baby incontinence products, consumer tissue, and professional hygiene, that is not subject to discretionary consumer spending.	Competitive nature of consumer tissue and personal hygiene markets mainly in Europe due to high penetration of private label offerings.
Leading position in the incontinence and professional hygiene segments with the TENA and TORK brands respectively.	Declining wood pulp costs, which should translate into a gradual reduction of Essity's sales prices from the second half of 2023 and, more importantly, in 2024.
Emerging leadership in the washable, absorbent underwear category through the KnixWear and Modibodi acquisitions.	Free operating cash flow (FOCF) of about Swedish krona (SEK) 9.5 billion in 2023 is constrained by working capital outflows.
Branded proposition and focus on innovative and sustainable products, which support price power and resilient EBITDA during inflationary periods.	Debt-funded acquisitions that could put pressure on S&P Global Ratings-adjusted debt to EBITDA, which we expect to be comfortably close to 2.5x this year.
A well-balanced geographic footprint, although exposure to emerging markets will reduce to 25%-26% as result of a strategic review of Chinese tissue manufacturer Vinda.	

The essential nature of Essity's product portfolio should prevent material sales volume declines, with the top line expected to increase 12%-14% in 2023 mainly fueled by prices. In the first nine months of 2023, Essity posted 8.7% organic sales growth, 16.1% on a reported basis, with a solid price and product mix development of 11.9%. Volumes declined 3.2%, which mainly reflect Essity's early termination of low-profit contracts in the incontinence, health care, and baby care categories, restructuring in professional hygiene, and high price competition. Overall, results are satisfactory since consumer demand remains resilient because Essity's product categories are seen as essential (mainly in developed markets). We do not expect consumers will reduce consumption of personal hygiene products; however, budget-conscious consumers could increasingly opt for private-label products to save money, which could hit Essity's volumes, mainly in Europe. In Western Europe, private labels accounted for 42% of the tissue and hygiene market in 2022 by retail value, according to Euromonitor. Other developed countries such as the U.S. have a lower proportion of private labels in the market, at 20%-25%.

Essity's portfolio review will reduce capital intensity, profit volatility, and emerging market contribution to 25%-26% of sales. Essity is reviewing its controlling 51.59% stake in Vinda and its European consumer tissue private-label business with the aim of reducing its exposure to tissue. We acknowledge the review includes various options and may result in divestments. Overall, the company's decision should result in improved profitability and lower profit volatility, given the relatively high exposure to pulp, which is subject to high price fluctuations, low margins in the private label operations, and the foreign exchange volatility inherent to emerging economies. Moreover, tissue manufacturing is highly intensive, so the outcome of the review is likely to lead to lower capital investment requirements. Because Vinda mainly operates in China and parts of Asia-Pacific, Essity's exposure to emerging markets will reduce drastically. Excluding Vinda (16% of Essity's sales in 2022), the European private label tissue business (6%), and the Russian business, disposed of due to Russian's invasion of Ukraine (2%), we calculate emerging markets would have accounted for 25%-26% of Essity's sales in 2022 versus the 37% reported. This should slightly impair growth prospects, given that market penetration of hygiene and health products is lower than in mature markets, and emerging markets are showing rapid development of urbanization, retail, and e-commerce infrastructure, as well as improving health care systems. As an example, Essity estimates that the usage of incontinence products in Asia is only about one-sixth that in Western Europe. Also, tissue consumption in Eastern Europe is only about one-third of that in Western Europe.

We expect Essity's leverage will reduce close to 2.5x in 2023 from 3.3x in 2022, supported by prudent financial policy. Essity's commitment to the current rating will likely translate into a cautious approach to capital allocation. Therefore, we do not expect any significant debt-funded acquisitions in 2023, supporting a reduction in leverage comfortably close to 2.5x this year, within the required range for the current rating. Essity's strategy in the medium to long term remains unchanged and it envisages annual sales growth higher than 5%, including organic growth and acquisitions. In our view, areas of interest in terms of acquisitions are in the medical solutions segment and in adjacent categories of incontinence, feminine products, and professional hygiene.

Outlook

The stable outlook reflects our view that Essity's established brand portfolio and product innovation will continue to support sales this year. EBITDA margins should expand to 14.5%-15.0% this year from 12.9% in 2022, thanks to less challenging input cost conditions, mainly for pulp, and a more efficient supply chain. Since we do not expect significant acquisitions this year, we believe S&P Global Ratings-adjusted debt to EBITDA should reduce close to 2.5x in 2023 from 3.3x in 2022.

Downside scenario

We could consider lowering the rating if we see consumers becoming a lot more price sensitive and shift to private-label products, causing Essity to lose market share or adopt high promotions that depress profitability. In this scenario, we would expect Essity's market position and operating performance to deteriorate, translating into adjusted debt to EBITDA staying higher than 3.0x.

We could also consider a negative rating action if we were to observe Essity adopting an aggressive financial policy, leading to large debt-funded acquisitions or unexpectedly large shareholder distributions, pushing debt to EBITDA above 3.0x for a prolonged period.

Upside scenario

We could consider a positive rating action if Essity generated solid FOCF across its three divisions and used it to improve its leverage ratios, with debt to EBITDA approaching 2.0x. Under this scenario, the group would need to size its debt-funded acquisitions to ensure that it can maintain leverage at this level.

Our Base-Case Scenario

Assumptions

- Real GDP growth of 2.3% in 2023 in the U.S. compared with 2.1% in 2022; lower real GDP growth in the eurozone of 0.6% versus 3.6% a year earlier; and while reducing, inflation remaining elevated at 5.6% in the eurozone and 4.1% in the U.S. compared with 8.4% and 8% a year earlier, respectively.
- In our base case, we still consolidate Vinda and the European private label consumer tissue division.
- Essity's reported sales increasing by 12%-14% in 2023 mainly due to the full-year impact from higher sales prices across the three divisions and foreign exchange tailwinds. Consumer demand shouldremain resilient, but volumes are expected to decline primarily because of the strategic exit from certain unprofitable contracts, mainly in the baby diaper category in Latin America, incontinence health care, and restructuring of the professional hygiene business. Top-line expansion will also be supported by the full-year contribution from Modibodi and Knixwear, acquired in September 2022. For 2024, we currently estimate flattish sales growth due to the expected reduction of sales prices in light of declining raw material costs, primarily for pulp. We also took into consideration the full-year impact of the Russian business disposal and exit from unprofitable contracts.
- S&P Global Ratings-adjusted EBITDA margins increasing to 14.5%-15.0% in 2023 and 15.5%-16.5% in 2024, from 12.9% in 2022. While sales prices are expected to gradually reduce in some product categories such as consumer tissue, we also expect that Essity's focus on high-value products and contracts, and innovative products, should support profitability. Furthermore, the company aims to realize savings in different areas, such as

energy and raw material rationalization, improved sourcing conditions, and waste reduction.

- Capital expenditure (capex) of about SEK8 billion over the next two years (about 4.5% of sales). This includes investment to support Essity's digital transformation.
- Dividends of about SEK5.2 billion, including SEK300 million paid to minority shareholders in 2023. In 2024, we assume dividends will increase to about SEK5.4 billion.
- SEK1.2 billion in proceeds from the divestiture of the Russian business received in 2023.
- No acquisitions in 2023 and about SEK5 billion of annual spending on acquisitions from 2024.

Key metrics

Essity AB--Forecast summary

Period ending	**Dec-31-2019**	**Dec-31-2020**	**Dec-31-2021**	**Dec-31-2022**	**Dec-31-2023**	**Dec-31-2024**	**Dec-31-2025**
(Mil. SEK)	2019a	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	128,975	121,752	121,867	156,173	175,000-177,000	175,000-177,000	179,000-181,000
EBITDA	21,973	24,120	19,958	20,112	25,500	28,500	29,900
Capital expenditure (capex)	5,811	6,544	7,263	6,872	8,000	8,000	8,000
Free operating cash flow (FOCF)	12,526	11,212	7,126	5,340	9,500	14,500	12,500
Dividends	4,374	4,813	5,312	5,312	5,200	5,400	5,600
Discretionary cash flow (DCF)	8,152	6,399	1,814	28	4,500	9,500	6,500
Debt	51,769	44,011	54,931	65,703	61,500	58,500	58,500
Adjusted ratios							
Debt/EBITDA (x)	2.4	1.8	2.8	3.3	2.5	2.0-2.5	2.0-2.5
FFO/debt (%)	38.2	43.9	28.2	25.6	30-35	35-40	35-40
FOCF/debt (%)	24.2	25.5	13.0	8.1	20-25	20-25	15-20
DCF/debt (%)	15.7	14.5	3.3	0.0	5-10	10-15	5-10
Annual revenue growth (%)	8.8	(5.6)	0.1	28.2	12-14	(0.0)	0-2
EBITDA margin (%)	17.0	19.8	16.4	12.9	14.5-15	15.5-16.5	16.5-17.5

Company Description

Essity is a Swedish health and hygiene group that was created when Svenska Cellulosa spun off its hygiene division in 2017. Essity produces and sells personal care, tissue, and health and medical products. In the 12 months ended Sept. 30, 2023, Essity posted roughly SEK174.2 billion in sales (up about 18.9% versus the same period a year earlier) and reported EBITDA of about SEK24.7 billion, with an EBITDA margin of 14.2%.

Essity operates through three main divisions:

- Consumer goods (60% of Essity’s sales as of September 2023). This division sells adult incontinence products (global market leadership with the TENA brand), baby care products (such as baby diapers and pants), feminine care products (pads, panty liners, and tampons), and consumer tissue products (toilet paper, household towels, facial tissues, wet wipes, napkins, and face masks), via the retail trade channel and online.

- Professional hygiene (24% of sales). This division develops and markets complete hygiene solutions under the leading global brand TORK. These include toilet paper, paper hand towels, napkins, hand sanitizer, tissues, and dispensers. The division also provides services and maintenance for companies and office buildings, universities, health care facilities, restaurants, hotels, and other public venues.
- Health and medical (16% of sales), comprising wound care, compression therapy, and orthopedics products. Essity has established a solid presence in this market following its acquisition of BSN in 2017. Its global and regional brands include Leukoplast and Jobst, among others.

Essity is present in more than 150 countries globally, with Europe accounting for 53% of total sales as of Dec. 31, 2022, Asia-Pacific 17%, Latin America 14%, and North America 13%. Other countries account for the remaining 3%. Essity is listed on the Nasdaq Stockholm exchange, with its largest shareholder being AB Industrivärden, with about a 10.2% stake on Sept. 30, 2023. Essity's market capitalization was about $15.6 billion as of Oct. 30, 2023.

Peer Comparison

Kimberly Clark (KC) is Essity's closest peer. It is the No. 2 player globally in tissues and hygiene products, while Essity is No. 3. KC's EBITDA margin has been challenged by the inflationary environment in the last two years, but was 21% on average over 2019-2022, structurally higher than Essity's, 16.5% over the same period. We believe this is partly explained by KC's U.S. domestic market accounting for roughly half of its sales and being more profitable than several of the European countries in which Essity operates. In fact, private labels have a lower penetration in the U.S. than in Europe, which allows U.S. players to maintain higher prices. KC has five "billion-dollar" brands, while Essity has two (TENA and TORK). KC has, over time, maintained more conservative credit metrics than Essity, with S&P Global Ratings-adjusted debt to EBITDA expected to be below 2.0x over 2023-2025.

German company Henkel is larger and more diversified than Essity in terms of product categories. It competes in home care, personal care, and adhesive technologies. Henkel is the global leader in adhesive technologies, whereas in home care, laundry care, and beauty care it usually ranks No. 2, No. 3, or lower, behind large players such as Procter & Gamble (P&G), Unilever, or L'Oreal. Henkel’s profitability is less subject to the volatility of raw materials than Essity's. However, competitive pressures in the consumer brands division, mainly in beauty care, as well as inflationary pressures, and restructuring costs to merge its consumer goods businesses, explain the deterioration of its EBITDA margin to about 12% in 2022 compared with 16% in 2020 and 2021. Henkel maintains a very conservative financial risk profile and its adjusted leverage is well below 1.5x. However, our 'A' rating incorporates Henkel's ambition for external growth and a potential increase in leverage.

U.S.-based P&G competes with Essity in many countries in the personal care market. However, it is much larger and operates with a more extensive personal care and household products portfolio, so it is much more diversified. These factors, coupled with much higher profitability in the 25%-30% range, contribute to our more favorable view of P&G's business risk. P&G also has stronger metrics, with leverage generally in the 1.0x-1.5x area.

Essity AB--Peer Comparisons

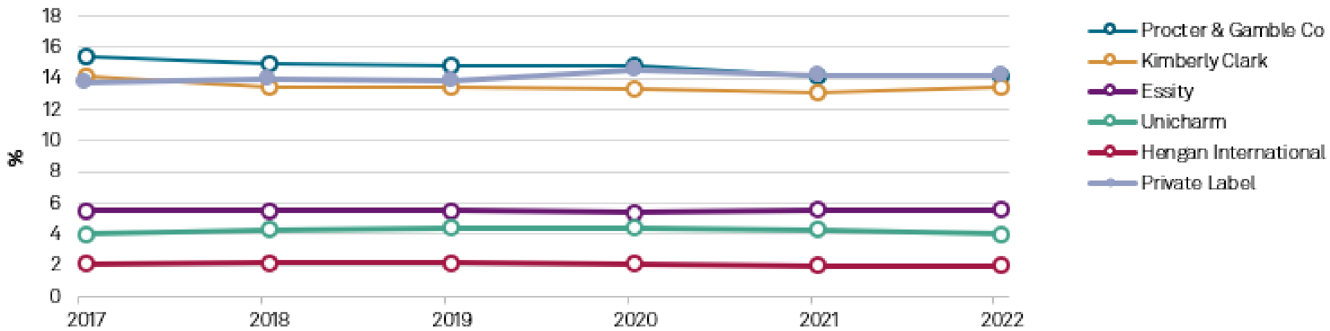
	Essity AB	Kimberly-Clark Corp.	Henkel AG & Co. KGaA	Procter & Gamble Co.
Foreign currency issuer credit rating	BBB+/Stable/A-2	A/Stable/A-1	A/Stable/A-1	AA-/Stable/A-1+
Local currency issuer credit rating	BBB+/Stable/A-2	A/Stable/A-1	A/Stable/A-1	AA-/Stable/A-1+
Period	Annual	Annual	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-12-31	2023-06-30
Mil.	SEK	SEK	SEK	SEK
Revenue	156,173	210,303	249,514	884,707
EBITDA	20,112	39,569	30,246	233,168
Funds from operations (FFO)	16,824	31,716	21,312	178,932
Interest	997	3,100	590	8,461
Cash interest paid	862	2,975	1,014	8,084
Operating cash flow (OCF)	12,212	29,840	15,847	183,927
Capital expenditure	6,872	9,131	6,606	33,034
Free operating cash flow (FOCF)	5,340	20,708	9,241	150,893
Discretionary cash flow (DCF)	28	2,404	(8,617)	(25,518)
Cash and short-term investments	4,288	7,245	12,121	88,961
Gross available cash	4,288	7,245	14,394	88,961
Debt	65,703	91,177	28,550	312,349
Equity	76,564	7,297	224,548	507,752
EBITDA margin (%)	12.9	18.8	12.1	26.4
Return on capital (%)	9.0	28.9	8.5	24.7
EBITDA interest coverage (x)	20.2	12.8	51.2	27.6
FFO cash interest coverage (x)	20.5	11.7	22.0	23.1
Debt/EBITDA (x)	3.3	2.3	0.9	1.3
FFO/debt (%)	25.6	34.8	74.6	57.3
OCF/debt (%)	18.6	32.7	55.5	58.9
FOCF/debt (%)	8.1	22.7	32.4	48.3
DCF/debt (%)	0.0	2.6	(30.2)	(8.2)

Business Risk

Essity ranks No. 3 in the global tissue and personal hygiene market with a stable 5.6% market share by retail value at year-end 2022. The global tissue and hygiene market was worth U.S.$205.2 billion by retail value at that time, according to Euromonitor, showing 2% annual growth rate versus 2021. Euromonitor estimates the market will expand by mid-single digits on average over 2022-2027. P&G and KC are the largest industry players with a 14.2% and 13.4% market share, respectively, at the end of 2022.

Market Share Evolution: Global Tissue And Hygiene Market (2017-2022)

Top 5 Players



Footnote. Euromonitor 2023

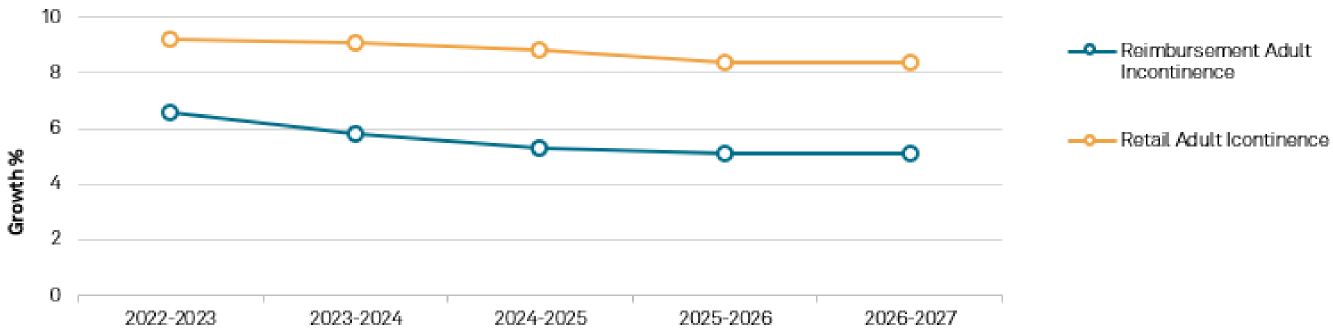
Adult incontinence products have solid growth prospects globally, with a compound average growth rate (CAGR) of 8%-9% over 2022-2027 in the retail channel, according to Euromonitor. The adult incontinence category accounts for about 16% of Essity's sales as of 2022, according to our calculation. Growth rates are slightly higher in the moderate to heavy incontinence product area, compared with light incontinence. Demand is supported by aging populations in mature markets, increasing awareness, and fight against the stigma of incontinence issues in young adults. In addition, product improvements in terms of comfort and flexibility make these products more attractive to consumers than sanitary protection products.

We acknowledge growth in the health care channel is predicted at a 5%-6% CAGR globally, which is lower than in the retail channel primarily because many developed markets impose stricter reimbursement regulations due to budget constraints. A lengthy reimbursement process, coupled with a narrow range of products available mainly in the premium product segment, is pushing patients into the retail and online channels where they can find wider product offerings and promotions.

Essity's TENA brand ranks No. 1 in the global retail adult incontinence market with a 16.4% share in 2022 by retail value. We note that KC has a 19.3% share versus 17.4% for Essity. This is because KC has a balanced and diversified brand portfolio comprising Depend, Poise, and Plenitud, among others.

Growth Prospects In Adult Incontinence

Split Between Reimbursement And Retail



Footnote. Euromonitor 2023

Leading market shares in many product categories and regions. As of Sept. 30, 2023, Essity generated 60% of its sales in the consumer goods division, with a presence across multiple categories distributed mainly through retail trade and online. Consumer tissue accounted for about 67% of the consumer goods division (including Vinda and European private-label tissue businesses under strategic review), feminine care 14%, incontinence products retail 11%, and baby care 8%. Essity ranks No. 1 in Western Europe in the consumer tissue market with a 13.9% share at year end 2022. However, last year its main brand Lotus (3.6% market share) has lost its leadership against KC's brand Andrex whose market share rose to 4% at year-end 2022 from 3.7% a year earlier.

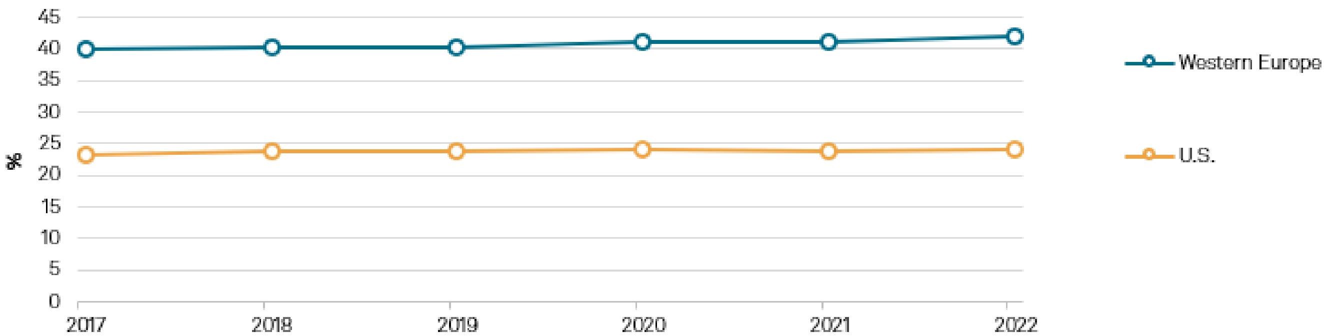
Essity is the leader in Latin America in feminine care through its local Nosotras and Saba brands. In the baby care segment, it is No. 2 in Europe with its Libero and Lotus brands, and No. 1 in Malaysia with its Drypers brand (about 45% market share according to management).

Global leading position in the professional hygiene segment (about 24% of Essity's sales) through its brand TORK. Demand in the customer segments hotels, restaurants, commercial buildings, schools, and universities, affected by pandemic-related restrictions partially recovered in the first nine months of 2023. As of Sept. 30, 2023, Essity's sales in the division had expanded by about 19%, of which about 12% was organic, 7.4% from foreign exchange tailwinds, and 0.3% from divestments/acquisitions. Volumes were negative 4.6%, affected by the restructuring of business in Europe and U.S., leading to an exit of non-profitable contracts. These initiatives have helped the company's reported EBITA margin to increase 560 basis points to 15.5%.

High inflation supports demand for private-label products, which accounted for 14.2% of the global tissue and hygiene market in 2022, according to Euromonitor. The growth of the personal hygiene market stems primarily from increasing awareness of the health benefits of maintaining cleanliness and personal hygiene. The outbreak of COVID-19 led consumers to increasingly adopt better hygiene practices that could reduce infections and the spread of viruses. Overall, we believe that personal care products are an essential consumer product category, mainly in developed countries, and we do not expect a material contraction of demand, despite higher prices due to higher raw material costs. However, we anticipate potential changes in consumer shopping habits in light of a general increase of the entire grocery shopping basket. In this context. private label manufacturers, as well as small and niche manufacturers, could gain momentum since they can benefit from cost competitiveness, good quality, innovation, and improved sustainability credentials. According to Euromonitor, over 2017-2022, private-label manufacturers reported higher growth, with the CAGR at 4.1%, exceeding the 3.5% organic growth reported by Essity, 2.4% of KC, and P&G's 1.7% over that period. In Western Europe, expansion of private-label business has been faster than in other regions and, at the end of 2022, this segment accounted for 42% of the market, up from 39.9% in 2017. In the U.S., private label penetration remains low, and was 24% of the total U.S. tissue and hygiene market in 2022, only slightly higher than 23.3% reported in 2017. Essity currently generates 6% of sales from private labels in Europe, but it has announced a strategic review and the potential divestiture of this business in the short term.

Evolution Of Private Label Penetration--Global Tissue And Hygiene Market (2017-2022)

In Western Europe and USA



Footnote. Euromonitor 2023

Essity has an energy-intensive business model and is exposed to volatile pulp prices, translating into EBITDA margin volatility. Pulp is the largest component of Essity's cost structure, accounting for 15.5%-16.0% of sales in 2022 after 13%-14% in 2021. While we observe a significative reduction in pulp prices, the price of energy (6.5% of sales), super absorbents, and non-woven materials (4.0%-5.0% of sales in 2022) remains high. Over the past few years, Essity has been able to contain profitability erosion, thanks to sales-price management, an improved product mix, and recurring cost savings through optimization of manufacturing capacity and active development of new fiber sources. In 2022, the S&P Global Ratings adjusted EBITDA margin declined 350 basis points. However, the absolute amount of EBITDA at around SEK20 billion remained resilient, at a similar level as in 2021 thanks to sales-price increases. We estimate the S&P Global Ratings-adjusted EBITDA margin at 14.5%-15.0% in 2023 and 15.5%-16.5% in 2024. Despite multiple sales price increases implemented over 2021-2022 in the retail channel, there is still some delay in adjusting prices, mainly in the health and medical division. This is because contracts are based on an auction system and agreements usually last three years, during which prices cannot be renegotiated.

Essity's commitment to launch at least 50% sustainable innovations per year provides competitive advantage. Essity embeds sustainability throughout the organization, from manufacturing processes to marketing and product development. For instance, Essity's tissue manufacturing, using pulp from wheat straw, reduces carbon emissions, water, energy, and chemical use. At the same time, it allows Essity to diversify the types of fiber used in its production, which could partly mitigate the impact of volatile raw material prices such as for pulp from fresh wood-based fiber. Also, the focus on global health and wellbeing leads the company to continuously communicate on topics perceived as a social stigma, such as incontinence, menstruation, and personal hygiene. Essity's product portfolio is suited to address those topics and offers the group the opportunity to develop products in high-growth categories such as adult incontinence and washable (reusable) absorbent underwear, mainly through the recent acquisition of Knix and Modibodi. Essity's focus on innovation translated into SEK 1.6 billion of research and development expenses at year-end 2022, up from SEK 1.5 billion in 2021.

Online sales are expanding, up 20% to SEK23 billion in 2022 compared with the previous year and accounting for 15% of sales. This is broadly in line with the overall market penetration, since the online channel represented 15.9% of the global hygiene and tissue market by retail value, according to Euromonitor. This is significantly higher than before the pandemic, when e-commerce accounted for less than 10% of the market. We believe consumers are likely to continue shopping online, owing to the convenience, budget-friendly deals, and good range of options offered. This trend is particularly evident in retail adult incontinence, since e-commerce provides discretion in the delivery of these products.

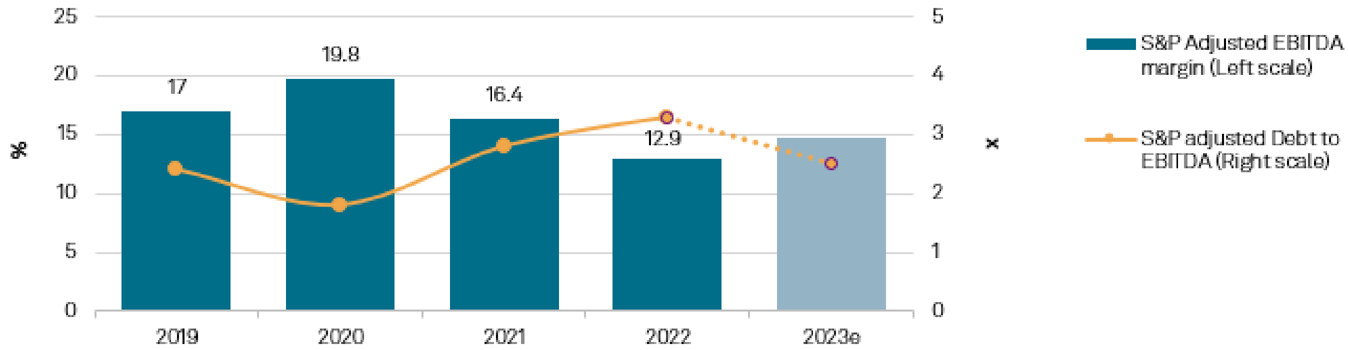
Financial Risk

Essity's S&P Global Ratings-adjusted debt to EBITDA has been 2.0x-3.0x over the past few years, with very few exceptions such as in 2022 when the ratio stood at 3.3x. We evaluate as positive the limited fluctuation in the leverage ratio in light of the structural volatility of Essity's operating profits relative to fluctuations in the cost of its main raw materials, such as pulp and recovered paper; as well as recent increases in the price of oil-based derivatives and energy. We foresee Essity's leverage staying close to 2.5x in 2023 and gradually reducing toward 2.0x-2.5x in 2024.

Essity has communicated its target to keep the current rating. As a result, we anticipate prudent capital allocation in terms of acquisitions, as demonstrated by Essity's cautious stance since the end of 2022. Once the company has rebuilt enough debt headroom, we expect it to resume its acquisition strategy in the medical solutions segment and in adjacent categories of incontinence, feminine products, and professional hygiene.

FOCF will strengthen to almost SEK9.5 billion from about SEK6 billion in 2022, despite working capital outflow. We anticipate cash flow generation could exceed again SEK10 billion starting from 2024. We assume Essity will continue to ensure increasing annual dividend payments, in line with FOCF growth. Essity has further flexibility to increase shareholder returns with its share buyback program, in our view. However, we do not anticipate any share purchases in our forecasts, in line with historical trends.

S&P Global Ratings Adjusted EBITDA Margin And Debt To EBITDA Evolution (2019-2023E)



Source: S&P Global Ratings

Debt maturities

As of Sept. 30, 2023.

- Remainder of 2023: SEK7.4 billion
- 2024: SEK12.6 billion
- 2025: SEK9.7 billion
- 2026: SEK7.8 billion
- Thereafter: SEK30.8 billion

Essity has the following notes outstanding:

- €600 million notes with 1.125% coupon due 2024
- SEK850 million notes with 0.5% coupon due 2025
- SEK2.15 billion floating-rate notes due 2025
- €300 million notes with 1.125% coupon due 2025
- €500 million notes with 3.0% coupon due 2026
- €500 million notes with 1.625% coupon due 2027
- €600 million notes with 0.250% coupon due 2029
- €300 million notes with 0.5% coupon due 2030
- €700 million notes with 0.25% coupon due 2031

Essity AB--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	SEK	SEK	SEK	SEK	SEK	SEK
Revenues	109,265	118,500	128,975	121,752	121,867	156,173
EBITDA	19,076	18,266	21,973	24,120	19,958	20,112
Funds from operations (FFO)	15,071	14,760	19,755	19,311	15,486	16,824
Interest expense	1,207	1,117	1,126	912	815	997
Cash interest paid	1,034	1,040	1,088	892	838	862
Operating cash flow (OCF)	13,084	13,698	18,337	17,756	14,389	12,212
Capital expenditure	6,119	6,882	5,811	6,544	7,263	6,872
Free operating cash flow (FOCF)	6,965	6,816	12,526	11,212	7,126	5,340
Discretionary cash flow (DCF)	6,680	2,381	8,152	6,399	1,814	28
Cash and short-term investments	4,107	3,008	2,928	4,982	3,904	4,288
Gross available cash	4,107	3,008	2,928	4,982	3,904	4,288
Debt	54,150	57,147	51,769	44,011	54,931	65,703
Common equity	49,570	54,899	62,801	63,342	68,507	76,564
Adjusted ratios						
EBITDA margin (%)	17.5	15.4	17.0	19.8	16.4	12.9
Return on capital (%)	14.5	10.7	12.9	15.2	11.2	9.0
EBITDA interest coverage (x)	15.8	16.4	19.5	26.4	24.5	20.2
FFO cash interest coverage (x)	15.6	15.2	19.2	22.6	19.5	20.5
Debt/EBITDA (x)	2.8	3.1	2.4	1.8	2.8	3.3
FFO/debt (%)	27.8	25.8	38.2	43.9	28.2	25.6
OCF/debt (%)	24.2	24.0	35.4	40.3	26.2	18.6
FOCF/debt (%)	12.9	11.9	24.2	25.5	13.0	8.1
DCF/debt (%)	12.3	4.2	15.7	14.5	3.3	0.0

Reconciliation Of Essity AB Reported Amounts With S&P Global Adjusted Amounts (Mil. SEK)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2022									
Company reported amounts	67,234	67,346	156,173	20,076	9,479	884	20,112	12,874	5,312	6,949
Cash taxes paid	-	-	-	-	-	-	(2,426)	-	-	-
Cash interest paid	-	-	-	-	-	-	(811)	-	-	-
Trade receivables securitizations	1,685	-	-	-	-	-	-	(585)	-	-
Lease liabilities	4,281	-	-	-	-	-	-	-	-	-

Reconciliation Of Essity AB Reported Amounts With S&P Global Adjusted Amounts (Mil. SEK)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Postretirement benefit obligations/ deferred compensation	-	-	-	59	59	62	-	-	-	-
Accessible cash and liquid investments	(2,788)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	-	-	51	(51)	(51)	-	(51)
Capitalized development costs	-	-	-	(26)	4	-	-	(26)	-	(26)
Dividends from equity investments	-	-	-	9	-	-	-	-	-	-
Income (expense) of unconsolid. cos.	-	-	-	(38)	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	173	-	-	-	-	-
Noncontrolling/ minority interest	-	9,218	-	-	-	-	-	-	-	-
Debt: Derivatives	(4,709)	-	-	-	-	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	32	32	-	-	-	-	-
D&A: Impairment charges/ (reversals)	-	-	-	-	2,150	-	-	-	-	-
Total adjustments	(1,531)	9,218	-	36	2,418	113	(3,288)	(662)	-	(77)

S&P Global Ratings adjusted	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from Operations	Operating cash flow	Dividends	Capital expenditure
	65,703	76,564	156,173	20,112	11,897	997	16,824	12,212	5,312	6,872

Liquidity

The short-term global scale rating is 'A-2' and the short-term Nordic scale rating is 'K-1'. We assess Essity's liquidity as strong because we expect liquidity sources to cover uses by more than 1.5x over the next 12 months-24 months. Our assessment is supported by Essity's track record of a high standing in credit markets, solid relationship with its diverse and creditworthy banking groups allowing frequent bond issuance, and commercial paper availability. Essity relies on its SEK15 billion commercial paper and €1.2 billion commercial paper programs (not included in the liquidity sources below). On September 30, 2023, SEK6.2 billion of commercial paper was used.

Principal liquidity sources

- Available cash of about SEK6.4 billion on Sept. 30, 2023.
- Cash funds from operations of about SEK20 billion.
- Two undrawn bank lines maturing beyond 12 months totaling SEK23.6 billion (about €2 billion).
- Working capital inflows expected at about SEK 2 billion in the next 12 months.

Principal liquidity uses

- Debt maturities of about SEK17.2 billion in the 12 months from Sept. 30, 2023, including commercial paper.
- Annual capex of SEK8 billion.
- Annual dividends of about SEK5.5 billion.

Environmental, Social, And Governance

Governance factors are a moderately positive consideration in our credit rating analysis of Essity. Essity's management has proven well prepared to address environmental and social factors such as waste and pollution; access to health-related products, thanks to its new product development strategy; and sustainable manufacturing processes.

Environmental and social factors are a neutral consideration overall. Essity has consistently exceeded its target of at least 50% of launches including sustainable innovation and leading to social and/or environmental improvements. Essity's leading innovations on reusable personal care products, as well as its increasing focus on recycled and renewable raw materials, seek to address rising environmental risks and, ultimately, will result in a competitive advantage over peers. In our view, Essity will benefit from increasing consumer demand for personal hygiene products in its core markets. The group's product ranges address all demographics and a variety of health needs.

Issue Ratings--Subordination Risk Analysis

Capital structure

We do not see any structural subordination because the debt mainly comprises unsecured notes issued by Essity AB and the financial vehicle Essity Capital B.V.

Analytical conclusions

We rate Essity's debt 'BBB+' in line with our issuer credit rating.

Rating Component Scores

Foreign currency issuer credit rating	BBB+/Stable/A-2
Local currency issuer credit rating	BBB+/Stable/A-2
Business risk	Strong
Country risk	Low
Industry risk	Low
Competitive position	Strong
Financial risk	Intermediate
Cash flow/leverage	Intermediate
Anchor	bbb+
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Strong (no impact)
Comparable rating analysis	Neutral (no impact)
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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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 Detail (as of October 30, 2023)*

Essity AB	
Issuer Credit Rating	BBB+/Stable/A-2

Ratings Detail (as of October 30, 2023)*

Nordic Regional Scale		--/--/K-1
Senior Unsecured		BBB+
Issuer Credit Ratings History		
10-Apr-2017		BBB+/Stable/A-2
10-Apr-2017	*Nordic Regional Scale*	--/--/K-1
Related Entities		
Essity Capital B.V.		
Senior Unsecured		BBB+

*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.