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Research Update:

SCA 'BBB+/A-2' Rtg's Affirmed On Planned Acquisition Of Georgia-Pacific European Tissue Operations; Outlook Stable

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Overview

- Global hygiene and paper products group Svenska Cellulosa Aktiebolaget (SCA) has offered to acquire the European tissue operations of Georgia-Pacific LLC.
- We believe that the group's business risk profile will be moderately strengthened by the acquisition, and that SCA will maintain an intermediate financial risk profile, despite an initial weakening due to acquisition debt.
- As a result, we are affirming our 'BBB+/A-2' long-term and short-term corporate credit ratings on SCA.
- The stable outlook reflects our expectations that SCA's financial performance will not materially deteriorate as a result of the acquisition.

Rating Action

On Nov. 11, 2011, Standard & Poor's Ratings Services affirmed its 'BBB+' long-term and 'A-2' short-term corporate credit ratings on Sweden-based global hygiene and paper products group Svenska Cellulosa Aktiebolaget SCA (SCA) as well as the 'K-1' Nordic national scale rating. The outlook is stable.

Rationale

SCA said on Nov. 10, 2011 that it had delivered a binding offer to acquire the European tissue operations of U.S.-based Georgia-Pacific LLC (A-/Stable/--) for €1.32 billion (about Swedish krona (SEK) 12 billion). We understand that the acquisition would be debt funded, and that closing would be subject to consultations with employee representatives, as well as approval from the EU competition authorities.

Furthermore, on Nov. 4, 2011, SCA announced that it had established a joint venture in its existing Australasian tissue and personal care business with Pacific Equity Partners (not rated), effectively divesting 50% of its equity stake. SCA said it will receive SEK3.2 billion as a result of the transaction.

If the transactions are closed as planned, we would view the effect on the group's business risk profile as moderately positive. We base this primarily on SCA's strengthened market position in the European tissue sector (well above 30% on a pro forma basis) and, to an extent, the prospects for

synergies. We would also view the increased proportion of group sales relating to hygiene products as supportive, because the group's packaging and publication paper businesses are less stable. We view the divestment of 50% of the Australasian business as largely neutral from a business risk perspective.

In our financial base case, we believe that adjusted funds from operations (FFO) to debt on a pro forma basis would drop slightly below 30% (about 33% in the 12 months to Sept. 30, 2011) in 2011, but for a limited period, as we believe the company is inclined to replace acquisition debt funding with strategic financing. We consider a ratio of 30%-35% to be commensurate with the current rating level. We consider the financing of the acquisition to be aggressive from a financial policy point of view. A mitigating factor is that the group is disposing of assets, thus cushioning the impact of the acquisitions on its credit metrics. As a result, we believe that SCA can maintain average credit measures which are in line with its current intermediate financial risk profile.

The ratings on SCA continue to reflect the group's strong business risk profile, supported by a diverse earnings base, leading positions in core hygiene and packaging markets, high level of integration, and our assessment of the financial risk profile as "intermediate". On Sept. 30, 2011, the group had adjusted debt amounting to about SEK40.8 billion.

Liquidity

The short-term rating is 'A-2', reflecting our view that the group's liquidity position is strong. Large backup facilities support liquidity, balancing SCA's substantial exposure to short-term financing. We estimate that the group's ratio of liquidity sources to uses over the next 24 months exceeds 1.5x. We understand that SCA has put in place finance arrangements for the announced acquisition.

As of Sept. 30, 2011, SCA's liquidity position was supported by:

- Cash and cash equivalents of about SEK2.9 billion.
- About SEK21.7 billion of unused long-term committed syndicated and bilateral credit facilities (SEK2.5 billion of these expire in the second quarter of 2013). SCA's main long-term credit facilities consist of a €1 billion facility maturing in 2014 and a €1 billion facility maturing in 2016. The facilities carry no financial covenants or material adverse change clauses that would restrict SCA from drawing under them.
- Operating cash flow generation, which we expect to continue to exceed working capital and capital expenditure needs over the short term. Furthermore, we assume that SCA has a degree of flexibility in terms of capital expenditure, if necessary, to offset any potential liquidity pressure.

These liquidity sources compared with reported short-term debt of about SEK9.6 billion, of which SEK7.1 billion consisted of outstanding commercial paper maturing within 12 months.

Outlook

The stable outlook reflects our expectation that SCA's financial performance will not deteriorate significantly as a result of the announced acquisition, and that the group can maintain a ratio of funds from operations to debt of 30%-35%. It also reflects our belief that the group's medium-term operating performance will benefit from the relatively stable characteristics of a large proportion of hygiene related businesses.

The rating could come under pressure within the next 6-12 months if adjusted FFO were to deteriorate further than slightly below 30%, or if we were to believe that it could remain below our guidance levels for a lengthy period of time. We would, for example, not consider FFO to debt falling significantly below 30% on a pro forma basis to be commensurate with the current rating level. Ratings leeway is currently limited, and we would view sharp increases in outgoings such as spending on further acquisitions, dividends, or capital expenditure as additional triggers for negative rating changes.

Ratings upside over the short term is limited, on the basis of our current assessment of the group's business risk and financial risk profiles. Over the medium term, we could take a positive rating action if SCA were to improve its financial performance on a sustained basis, for example by raising FFO to debt sustainably to 35%-40%.

Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- Key Credit Factors: Criteria For Rating The Forest Products Industry, Dec. 11, 2009
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011

Ratings List

Ratings Affirmed

Svenska Cellulosa Aktiebolaget SCA

Corporate Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Commercial Paper	K-1

SCA Finans, AB

Senior Unsecured*	BBB+
Commercial Paper*	K-1

*Guaranteed by Svenska Cellulosa Aktiebolaget SCA

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