

## Södra Skogsägarna ekonomisk förening

Full Rating Report

## LONG-TERM RATING

BBB

## OUTLOOK

Stable

## SHORT-TERM RATING

N-1+

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## RATING RATIONALE

Our 'BBB' long-term issuer credit rating on Swedish forestry cooperative Södra Skogsägarna (Södra) reflects the company's healthy long-term profitability, which compares favourably with that of its peer group thanks to its cost-efficient operations and extensive geographic scale. The rating also reflects the company's healthy cash flows and moderate financial leverage, which result in a low leverage ratio and strong debt servicing. The current business model and ownership structure help to moderate risk and liquidity is strong.

The rating is constrained by the forestry sector's historical earnings volatility, which is mainly due to unstable prices, especially in the more commoditised product categories, and unhedged currency exposures. Environmental, social and governance (ESG) issues have a neutral impact on the rating.

## STABLE OUTLOOK

The outlook is stable, reflecting our view that Södra's profitability will remain strong and cash flows healthy over our forecast period (2021-2023). The company has already witnessed a strong rebound in volumes and prices since the outbreak of COVID-19 and structural demand for forestry products remains intact. In our view, there is insufficient new supply to cause market instability in the near term and we predict that prices will remain stable.

## POTENTIAL POSITIVE RATING DRIVERS

- Long-term improvement in pulp and wood prices.
- Improved operational efficiency triggered by better process economics.
- Increased diversity via investments in new products such as biofuels.

## POTENTIAL NEGATIVE RATING DRIVERS

- A broad economic downturn resulting in weaker prices and volumes.
- A marked appreciation of the Swedish krona against relevant currencies.
- Unexpected mill outages over a long period, impacting costs and volumes.

Figure 1. Södra key credit metrics, 2017-2023e

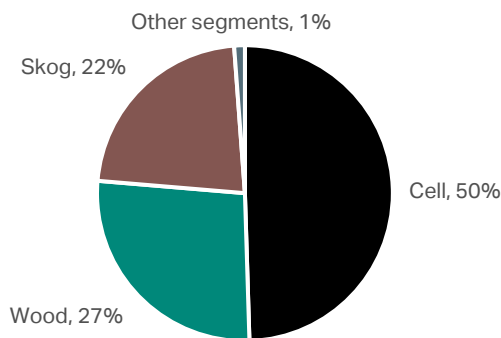
| SEKm                             | 2017   | 2018   | 2019   | 2020   | 2021e  | 2022e  | 2023e  |
|----------------------------------|--------|--------|--------|--------|--------|--------|--------|
| Revenue*                         | 20,708 | 24,602 | 23,502 | 20,837 | 23,508 | 23,504 | 23,754 |
| NCR-adjusted EBITDA              | 2,929  | 5,453  | 3,737  | 1,934  | 3,561  | 3,918  | 3,903  |
| NCR-adjusted net debt            | 4,274  | 5,022  | 4,127  | 4,196  | 3,684  | 3,801  | 3,192  |
| Total assets                     | 23,104 | 27,094 | 29,337 | 29,253 | 30,940 | 31,735 | 32,883 |
| NCR-adjusted debt/EBITDA (x)     | 1.5    | 0.9    | 1.1    | 2.2    | 1.0    | 1.0    | 0.8    |
| NCR-adjusted EBITDA/interest (x) | 49.6   | 92.4   | 54.2   | 27.2   | 48.7   | 55.3   | 56.9   |
| NCR-adjusted FFO/debt (%)        | 65.6   | 99.6   | 83.6   | 43.4   | 90.1   | 96.6   | 114.1  |
| NCR-adjusted FOCF/debt (%)       | 9.8    | (6.4)  | 66.6   | 16.9   | 18.4   | 25.6   | 54.3   |

Based on NCR estimates and company data. e–estimate. FFO–funds from operations. FOCF–free operating cash flow. All metrics adjusted in line with NCR methodology. \*Includes other revenue.

### ISSUER PROFILE

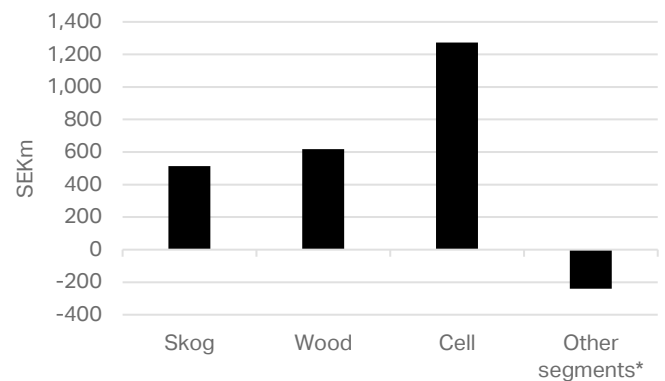
Södra is a leading Swedish forestry cooperative and exporter. It was founded in 1938 following a merger of regional forestry associations in southern Sweden, where most of its forests are still located. Södra is owned by 53,000 associate members, which own 2.7m hectares of forest land. The company is organised into four segments: Cell, Wood, Skog (Forest), and Other. Cell, Wood and Other are manufacturing segments producing pulp, co-generated energy, sawn wood products, and biochemicals/biofuels. From the first quarter of 2021, most operating units within Other will report as a new segment named Innovation. Skog is effectively a trading company, buying timber from associate members on behalf of the other three segments. The associate members operate in 19 regional units across southern Sweden and have an option to sell their timber to Skog.

Figure 2. Södra revenues by segment, 2020



Based on company data.

Figure 3. Södra EBITDA by segment, 2020



Based on company data. \*Includes corporate functions.

### BUSINESS RISK ASSESSMENT

Business risk assessment is 'bb+'

Our business risk assessment reflects the volatility of the operating environment as well as the company's relative strengths in terms of its large scale, sector and regional concentrations, role on behalf of its members, and robust operating efficiency.

#### Volatile operating environment due to economic cyclicity and strong competition

Operating environment scores 'bb'

Our assessment of Södra's operating environment considers the differences in the company's primary segments and competitive and operational conditions. As Södra Skog is mainly a facilitator for the manufacturing segments, our analysis of the operating environment focuses on the external business conditions for pulp and sawn wood, and to a lesser degree energy.

Södra Cell produces pulp of various quality and sells it on the open market. It also produces co-generated electricity and district heating. The segment competes with dedicated and integrated producers located both in the Nordic region and elsewhere. It is a price taker in a volatile market, where, for example, bleached softwood pulp prices fell sharply in 2019 and 2020 from an historical peak in 2018 (see Figure 5). The segment's main pulp export markets are Europe (about 70%) and Asia (about 27%), where China has a pronounced pricing impact. The segment's energy business is also volatile, and dependent on pulp production levels, prices, and weather. Prices fell sharply in 2020 but high demand for district heating amid cold weather at the start of 2021 has led to record prices. The outlook for pulp is positive given high near-term demand and low volumes of new supply predicted soon. The long-term outlook for energy sales is positive and electricity prices have been higher so far in 2021 than in 2020.

Södra Wood is also price taker as the sawn wood market has lower barriers to entry than the pulp market. Prices are volatile due to economic cycles and vary by product category. The segment's main markets are Sweden (22% of revenues), the UK (33%), and the Netherlands (9%). The past five years have been characterised by sawmill overcapacity, while demand has fluctuated. Sawn wood prices declined by an average 3% in 2020 (compared with a fall of 20% in 2019) as a positive trend in DIY and home building offset the initial negative effects of COVID-19. The outlook is positive even though the pandemic could worsen. DIY is likely to see more normalised demand in 2021, while construction

volumes appear to have gained momentum so far in 2021. Total Swedish exports of wood products rose 11% in 2020, while inventories were at 20-year lows. Accordingly, prices are likely to improve in the short term.

Figure 4. Average spot exchange rates, 2000-2021

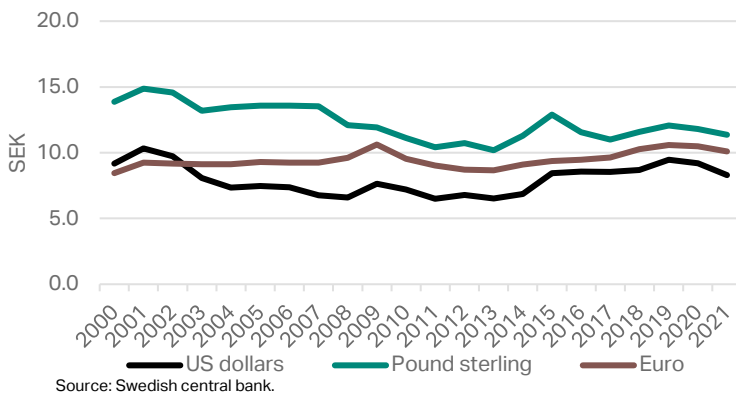


Figure 5. Bleached softwood pulp prices (per tonne), 2000-2021



Market position scores  
'bb+'

**Strong market shares but confined by product homogeneity**

Södra's market position varies across its core markets and is supported by its internal wood sourcing, large and efficient mills, and strong logistics connections. The Cell segment ranks third in terms of Nordic region softwood pulp volumes behind peers Stora Enso and UPM, but ahead of Svenska Cellulosa (SCA), BillerudKorsnäs, and Holmen. It is also an important exporter. The segment is also a niche provider of electricity in southern Sweden as pulp mill co-generation produces surpluses that can be sold at market prices. In municipalities near the mills, the segment has a strong presence in energy sales as it sells hot water to district heating networks. The Wood segment ranks among the top three producers in Sweden in terms of overall wood supply, subject to demand for certain products, factory uptime, and capacity utilisation. The segment is also a major exporter of sawn wood and has market shares of about 10% in the UK and the Netherlands.

Most of Södra's output is homogenous and most products, except for certain grades of wood, are considered bulk products. Brands and trademarks are consequently of less importance than those of peers with end-market exposure to paper and packaging. Despite the homogenous nature of pulp, Södra has good collaboration with customers, specifically hygiene and specialty product manufacturers, which buy about 65% of the company's output. However, these customers are generally larger than Södra and therefore have a stronger negotiating position. Although electricity is a homogenous product, Södra's output is fossil free, creating a competitive advantage. District heating is a local product with prices set according to regulated tariffs and no realistic substitutes.

Figure 6. Södra external sales by country/region\*, 2020

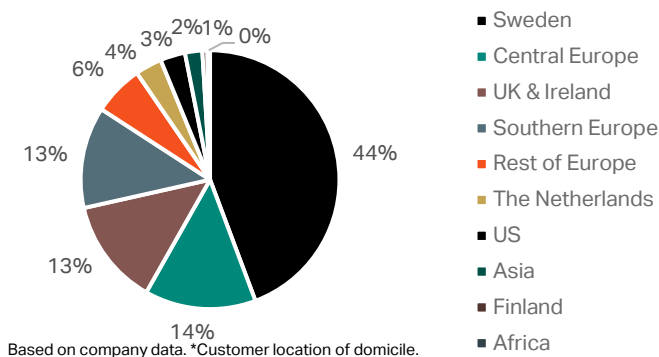
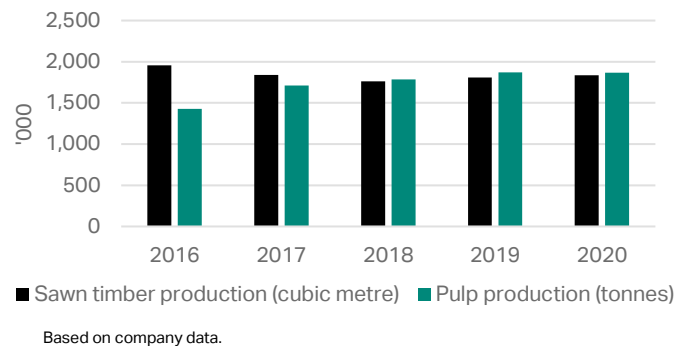


Figure 7. Södra output by product type (Wood and Cell), 2016-2020



Size and diversification scores 'bbb-'

**Great scale and good scale economics but somewhat limited diversification**

Much of Södra's competitiveness lies in its operational scale, not least in the Cell segment as pulp production is complex and energy intensive. The Cell segment has 1.9m tonnes of combined annual pulp capacity, 1.8 TWh of electricity capacity, 385 GWh district heating capacity, and 5,250 tonnes of annual bio methanol capacity. The segment's mills are modern and among the 10 largest in the Nordic region. Södra is the only pulp mill owner wholly located in the southern part of Sweden, which means it has shorter transport distances to other parts of Europe and more logistics alternatives than other domestic pulp producers. The company has a major mill at Värö in southwestern Sweden where pulp capacity is scheduled to increase by about 18% by 2025, making the plant one of the largest in the country subject to successful ramp-up. Scale is critical in the pulp industry and the Cell segment is markedly larger than non-integrated competitor Rottneros, which primarily manufactures market pulp, and which relies on external raw material supplies.

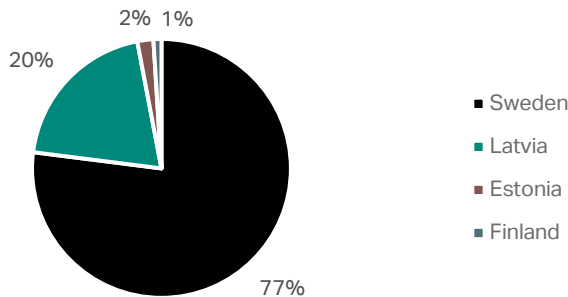
The Wood segment has streamlined its operations over the past four years by restructuring and closing sawmills and now operates seven mills with annual capacity of 1.88m cubic metres of sawn wood, which is large in comparison with most peers. Södra operates a combined model and the largest sawmills are located at the sites of the Cell segment's pulp mill operations, enabling cross-utilisation of energy supply, manpower, warehousing, and transport, while lowering waste. Residuals from wood processing generate sales of about 1,000 GWh of energy. The Cell segment's total annual capacity for producing tall oil for use in biodiesel is 46,000 tonnes, larger than most of its peers. In addition, Södra aims to increase the output of biofuels within the Other segment to 4,000 litres a day through its Silva Green Fuel joint venture.

Södra's geographic diversity is somewhat limited given the locations of its forest assets and mills. The company's geographic concentration increases the risk of spruce beetle damage, which negatively impacted both operations and financial results in 2020, though we believe the bulk of the related risk is borne by Södra's members, which own the forest properties. The Wood segment operates sawmills in different locations in southern Sweden with focus on supply chain optimisation as well as varying wood species, log sizes and end-product grades.

To increase product diversity and earn more from its existing processes, Södra has increased its focus on production of high margin biofuels, biochemicals, and cross-laminate products as well as value-added services such as in-forest monitoring for members. We expect the company to increase its use of manufacturing residuals in the production of biochemicals to increase revenues. Södra has announced a SEK 500m co-investment in Silva Green Fuels, to expand a biofuel unit in Norway.

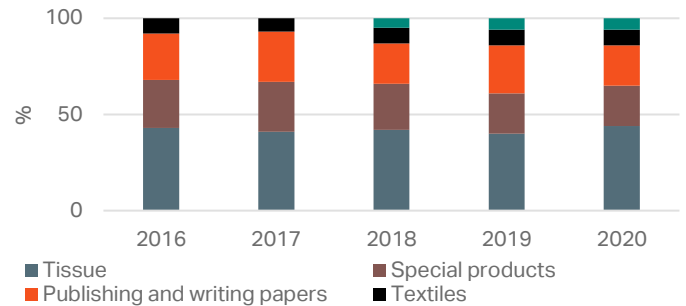
Customer concentrations differ by product line. The Cell segment's customers are larger companies such as European and other international tissue manufactures with production units in western Europe where relatively little softwood pulp is produced. The segment's top five customers account for about 30% of revenues and its electricity sales target a variety of business-to-business and business-to-consumer customers. The Wood segment generates mixed revenue streams from the DIY market, builders, and makers of wood structures. Moreover, it has substantial sales (78% in 2020) to the rest of Europe, Asia and Africa. Specialised products, such as cross-laminates, make only a minor contribution and are generally sold domestically but add some diversity.

Figure 8. Södra assets by geography, 2020



Based on company data.

Figure 9. Cell segment pulp end-market split 2016-2020



Based on company data.

Operating efficiency scores 'bb+'

**Good operating efficiency but limited ability to adjust to cyclical changes**

As a major Nordic operator, Södra generates efficiencies and advantages of scale in its two key areas of production. Efficiency is added by the proximity of the company's premises to its supplies of pulpwood and sawn timber, and sources of energy. Both the Cell and Wood segments operate at close to full capacity and generate high revenues and output per employee in comparison with peers. Södra's weak 2020 EBIT margins of 7% and 3% in the Wood and Cell segments, respectively (2019: 5% and 20%) do not stand out in comparison with those of its peers and are due to market fluctuations associated with the company's operating environment. We note that because of the nature of the forestry business and the high fixed costs involved, Södra is extremely sensitive to fluctuating prices and, to some extent, volumes. As a result, reported returns on invested capital stood at 13% and 2% in 2020 for the Wood and Cell segments respectively (2019: 8% and 19%).

Södra has a long-term return on capital employed target of 10% at group level. By comparison, the company's integrated peers such as Holmen, SCA and Stora Enso consistently average about 12%. We note that Södra has had an average EBITDA-margin exclusive of fair value adjustments of 15% since 2016, which places it as average within its Nordic peer group. Given the trend of prices for pulp, sawn wood, and other forest products, most of the peer group saw improvements in EBITDA margin until 2018 followed by a weakening in 2019 and then a sharply pronounced downturn in 2020 as a result of COVID-19. Södra's significant earnings in euro and US dollars make margins sensitive to currency fluctuations. The company's high fixed cost base results in substantial volume dependence to meet its financial profitability targets, requiring high utilisation rates as inadequate production volumes would quickly translate into losses and negative cash flows. The company's volume dependence indicates a limited ability to quickly adjust the cost base to reflect lower demand associated with cyclicality and supply issues related to operational disruptions.

In addition to pulp and wood production, Södra enjoys a natural hedge for its electricity costs and can generate revenues from waste products and the Cell segment's mills, with almost 100% of energy sold co-generated either as electricity or hot water. Although energy sales are not sufficient to fully offset negative operating leverage, they add some cushioning to margins. Södra is subject to limited oil price risk as it purchases oil products such as diesel from an unhedged position. Given the recent recovery in oil prices, which has had an impact on the cost of other products such as chemicals, we project that Södra's cost of goods sold will increase from the levels of 2020, while other costs should remain relatively unchanged.

We project that average softwood pulp and sawn wood prices will increase by 15% and 3%, respectively over the forecast horizon, translating into revenue growth of 16% at the group level. In turn, this results in an average gross profit margin of 41% and an EBITDA margin of 17% for the group.

Figure 10. Södra sales, EBITDA and EBITDA margins 2016-2023e

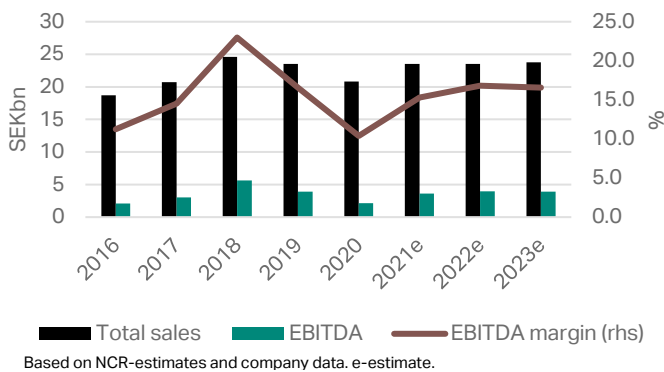


Figure 11. Södra segment and consolidated EBITDA margins, 2016-2023e

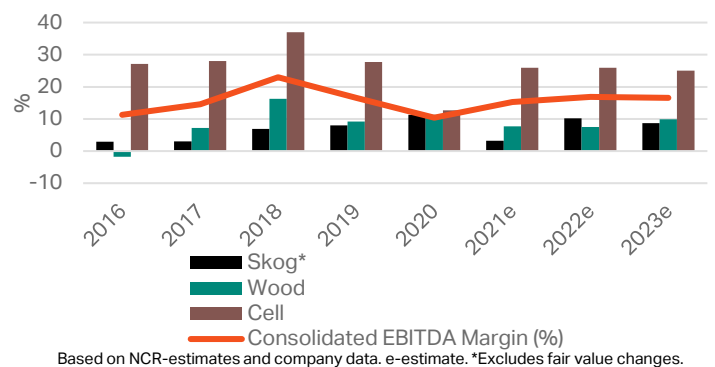


Figure 12. Wood segment peer margins, 2016-2020

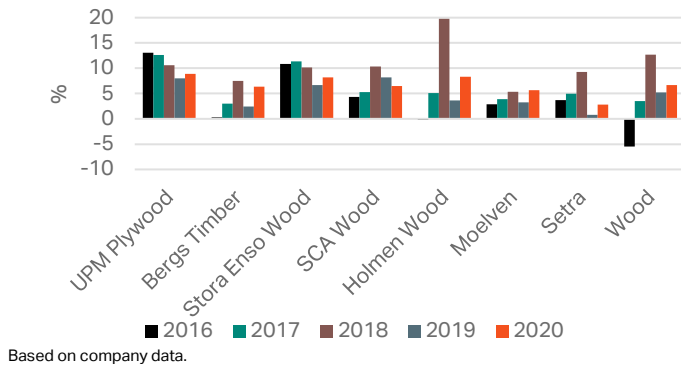
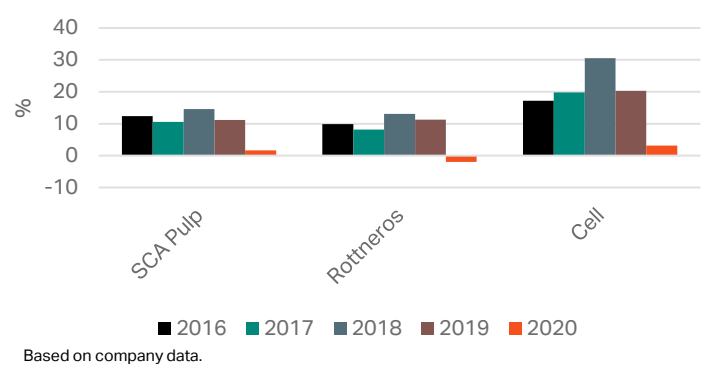


Figure 13. Cell segment peer margins, 2016-2020



## FINANCIAL RISK ASSESSMENT

Financial risk assessment is 'a'

Our financial risk assessment reflects Södra's moderate leverage, robust cash flow and debt servicing, and strong interest rate coverage. Despite the risk arising from, for example, unhedged currency exposure and limited access to financial markets, we believe that the company's risk appetite is adequate and reflects its associate members' interest in maintaining financial prudence.

### Moderate leverage and strong debt servicing

Ratio analysis scores 'a'

In our calculations of Södra's credit metrics, we include non-current- and current leasing liabilities and retirement benefit obligations in net debt and deduct 100% of cash holdings as well as 75% of short-term liquidity positions. We do not adjust cash holdings given that most of the cash serves as a liquidity buffer in case of a large withdrawal of member loans, which make up the bulk of Södra's gross debt.

In our base case for the forecast period, we assume:

- Revenue growth of 15% in 2021, 0% in 2022, and 1% in 2023;
- Gross profit margin of 39-41% in 2021-2023;
- An EBITDA margin of 15-17% in 2021-2023;
- Capital spending of SEK 2.3bn in 2021, SEK 2.7bn in 2022, and SEK 1.9m in 2023 associated with maintenance and new investments in the Varö mill;
- An increase in pulp production capacity at the Värö mill to 780,000 tonnes by end-2021 and 850,000 tonnes by end-2022;
- An increase in production of cross-laminated timber at the Värö mill by 100,000 cubic metres in the second quarter of 2022;
- No acquisitions or divestment of operations;
- A utilisation rate above 95% at production facilities;
- Electricity prices in line with SE3 Nordpool futures;
- Stable district heating prices;
- Net forest growth (by volume) of about 1.3%;
- Marginally higher sales, general and administrative costs relative to 2020;
- Depreciation and amortisation of about 0.6x capital spending;
- Stable member loan volume; and
- Refinancing of a SEK 1bn bond during 2021.

On the basis of these assumptions, we estimate the following metrics for 2021-2023:

- Adjusted debt/EBITDA of 0.8-1.0x;
- Adjusted EBITDA/interest of 49-57x;
- Adjusted FFO/debt of 90-114%; and
- Adjusted FOCF/debt of 18-54%.

Figure 14. NCR's adjustments to Södra's credit metrics, 2017–2023e

| SEKm  | 2017   | 2018   | 2019   | 2020   | 2021e  | 2022e  | 2023e  |
|---|--------|--------|--------|--------|--------|--------|--------|
| EBITDA (reported)                           | 3,009  | 5,654  | 3,897  | 2,164  | 3,600  | 3,954  | 3,937  |
| Fair value adjustments of biological assets | -6     | -158   | -125   | -348   | 0      | 0      | 0      |
| Share of profit in JVs and associates       | -74    | -43    | -35    | 118    | -39    | -36    | -34    |
| NCR-adjusted EBITDA                         | 2,929  | 5,453  | 3,737  | 1,934  | 3,561  | 3,918  | 3,903  |
| Cash and cash equivalents                   | 1,122  | 873    | 2,072  | 2,300  | 2,678  | 2,428  | 2,904  |
| Short-term liquidity placements             | 200    | 199    | 938    | 887    | 887    | 887    | 887    |
| Less 25% short-term liquidity placements    | -50    | -50    | -235   | -222   | -222   | -222   | -222   |
| NCR-adjusted cash and equivalents           | 1,272  | 1,022  | 2,776  | 2,965  | 3,343  | 3,093  | 3,569  |
| Gross interest-bearing debt                 | 5,222  | 5,630  | 6,097  | 6,483  | 6,350  | 6,216  | 6,083  |
| Non-current leasing liabilities             | 0      | 0      | 210    | 259    | 139    | 139    | 139    |
| Current leasing liabilities                 | 0      | 0      | 118    | 96     | 76     | 76     | 76     |
| Retirement benefit obligations              | 324    | 414    | 477    | 463    | 463    | 463    | 463    |
| Leasing liabilities in assets held for sale | 0      | 0      | 0      | -140   | 0      | 0      | 0      |
| NCR-adjusted cash and equivalents           | -1,272 | -1,022 | -2,776 | -2,965 | -3,343 | -3,093 | -3,569 |
| NCR-adjusted net debt                       | 4,274  | 5,022  | 4,127  | 4,196  | 3,684  | 3,801  | 3,192  |
| Net interest                                | -59    | -59    | -69    | -71    | -73    | -71    | -69    |
| NCR-adjusted net interest                   | -59    | -59    | -69    | -71    | -73    | -71    | -69    |
| Adjusted EBITDA                             | 2,929  | 5,453  | 3,737  | 1,934  | 3,561  | 3,918  | 3,903  |
| Adjusted net interest                       | -59    | -59    | -69    | -71    | -73    | -71    | -69    |
| Current taxes                               | -65    | -391   | -219   | -42    | -167   | -175   | -193   |
| NCR-adjusted FFO                            | 2,805  | 5,003  | 3,449  | 1,821  | 3,321  | 3,672  | 3,642  |
| Capital spending                            | -1,606 | -4,380 | -1,128 | -1,549 | -2,274 | -2,702 | -1,877 |
| Changes in working capital                  | -782   | -944   | 429    | 439    | -368   | 4      | -33    |
| NCR-adjusted FOCF                           | 417    | -321   | 2,750  | 711    | 679    | 975    | 1,732  |

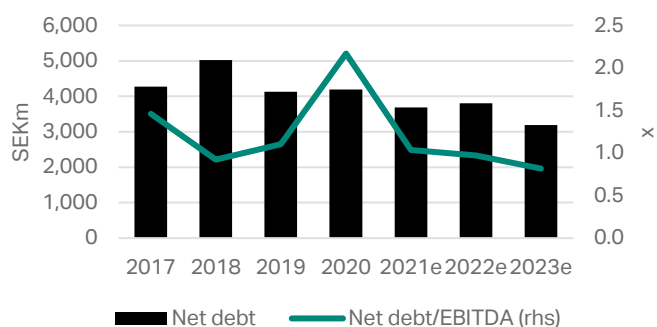
Based on NCR estimates and company data. e–estimate. JVs–joint ventures.

Figure 15. Södra key credit metrics, 2017–2023e

|                                  | 2017 | 2018  | 2019 | 2020 | 2021e | 2022e | 2023e |
|----------------------------------|------|-------|------|------|-------|-------|-------|
| Reported debt*/EBITDA (x)        | 1.3  | 0.8   | 0.9  | 1.7  | 0.8   | 0.8   | 0.6   |
| Reported EBITDA/interest (x)     | 51.0 | 95.8  | 56.5 | 30.5 | 49.2  | 55.8  | 57.4  |
| Reported FFO/debt* (%)           | 69.2 | 114.4 | 85.3 | 51.4 | 110.7 | 117.8 | 145.3 |
| Reported FOCF/debt* (%)          | 28.0 | 18.3  | 52.3 | 9.0  | 34.9  | 31.1  | 70.4  |
| NCR-adjusted debt/EBITDA (x)     | 1.5  | 0.9   | 1.1  | 2.2  | 1.0   | 1.0   | 0.8   |
| NCR-adjusted EBITDA/interest (x) | 49.6 | 92.4  | 54.2 | 27.2 | 48.7  | 55.3  | 56.9  |
| NCR-adjusted FFO/debt (%)        | 65.6 | 99.6  | 83.6 | 43.4 | 90.1  | 96.6  | 114.1 |
| NCR-adjusted FOCF/debt (%)       | 9.8  | (6.4) | 66.6 | 16.9 | 18.4  | 25.6  | 54.3  |

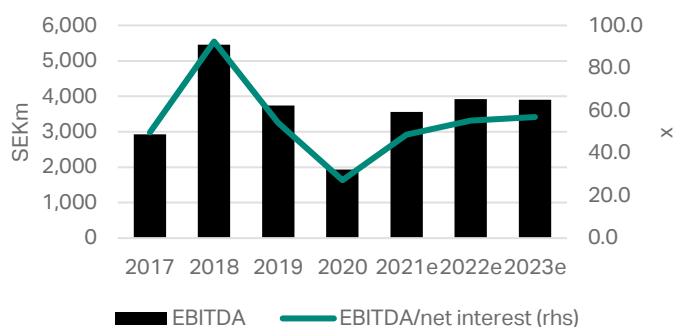
Based on NCR estimates and company data. e–estimate. All metrics adjusted in line with NCR methodology. \*Södra reports gross debt including leasing liabilities and net debt, net of cash and short-term placements.

Figure 16. Södra net debt/EBITDA, 2017–2023e



Based on NCR estimates and company data. e–estimate.

Figure 17. Södra EBITDA/net interest, 2017–2023e



Based on NCR estimates and company data. e–estimate.

Figure 18. Södra FFO/net debt, 2017-2023e

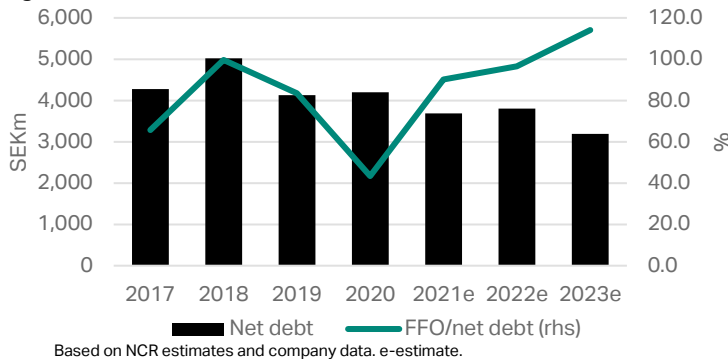
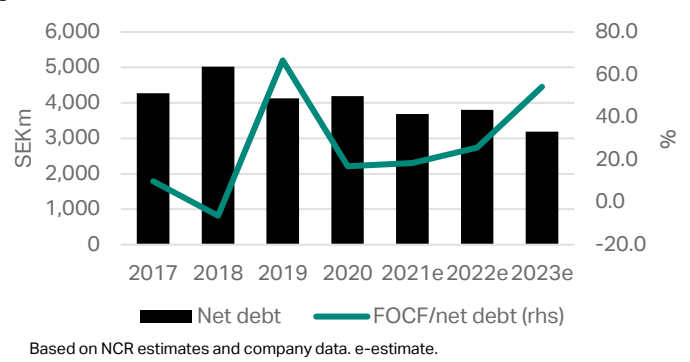


Figure 19. Södra FOCF/net debt, 2017-2023e



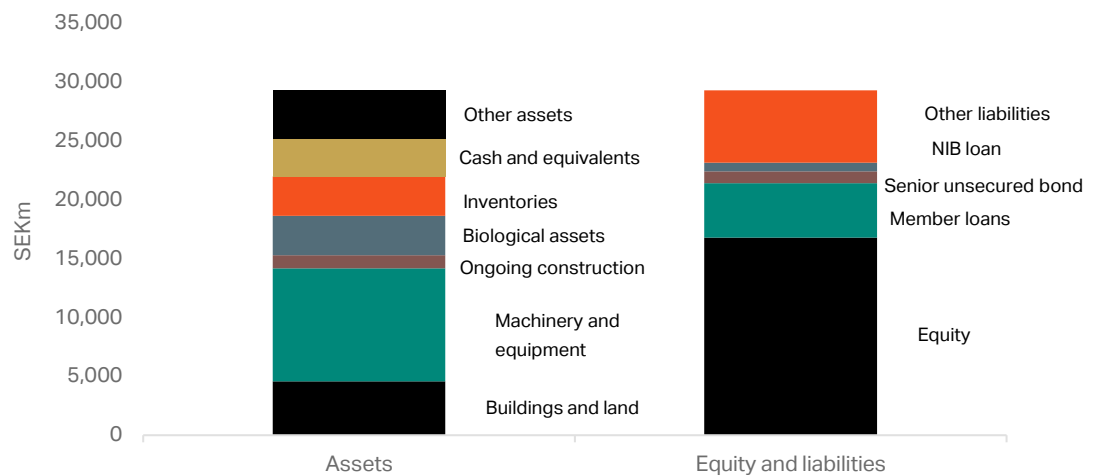
**Adequate risk appetite in line with financial metrics**

Risk appetite scores 'a'

Södra finances its operations through a mix of equity, member loans, senior unsecured bonds, and Nordic Investment Bank (NIB) loans. The company's SEK 16.8bn equity is made up of SEK 1.8bn in paid-in member capital, SEK 3.1bn in issued member capital, and SEK 11.9bn in other equity.

As of 31 Dec. 2020, total interest-bearing debt was SEK 6.5bn, of which SEK 4.6bn consisted of short-term cancellable member loans. These loans could appear to be a significant contributor to refinancing risk, but historically have been held beyond their maturity dates. Nevertheless, to meet the unlikely event of substantial withdrawals, Södra has obtained a total of SEK 3.5bn in unutilised credit facilities, thereby managing the refinancing risk associated with almost all member loans. In addition to member loans, Södra has a SEK 1bn senior unsecured bond with maturity in June 2021, an amortising unsecured NIB loan of SEK 732m with final maturity in 2026, and SEK 126m in other interest-bearing bank debt.

Figure 20. Södra asset-liability split, 2020



Based on company data.

Södra's interest-bearing debt is governed by two covenants and we note that the company has historically maintained sufficient covenant headroom. Furthermore, Södra's financial policy stipulates targets for equity ratio, profitability, and dividends. We deem the company's minimum 55% equity ratio target as adequate given the high cyclicality in the sector. However, we note that Södra, as an association, does not have clearly outlined procedures for equity injections, which clearly reduces its ability to restore the equity ratio should it fall below target.



Figure 21. Södra financial covenants, policies and reported metrics

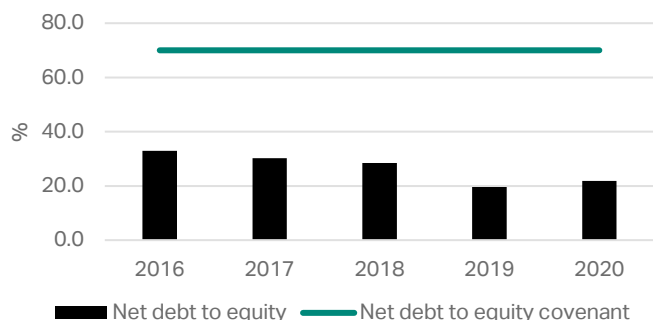
| Metric                                       | Covenants | Financial policy targets | Reported 31 Dec. 2020 |
|--|-----------|--------------------------|-----------------------|
| Net debt/equity ratio                        | ≤0.7x     | -                        | 0.2x*                 |
| Equity ratio                                 | ≥40%      | ≥55%                     | 57%*                  |
| Return on capital employed                   | -         | ≥10%                     | 11%**                 |
| Dividend, as percentage of profit before tax |           | ≥50%                     | 47%**                 |

Based on company data. \*Unadjusted, as reported by Södra. \*\*Average of last five years.

Södra aims to pay out 50% of pre-tax profit in dividends over the long term and has historically paid out substantial dividends in the past, even following years with reported losses. Dividends are split into three parts: interest on member capital, compensation to members for wood deliveries, and new issues of member capital. The latter is a form of value transfer, converting collectively owned equity to individually owned equity. The new issue of member capital does not affect Södra's cash flow. Furthermore, dividends on member capital and wood deliveries are paid to member accounts with favourable interest rates, and members have an option to leave the dividends with Södra in their member accounts, further reducing the negative effect on the company's cash flow.

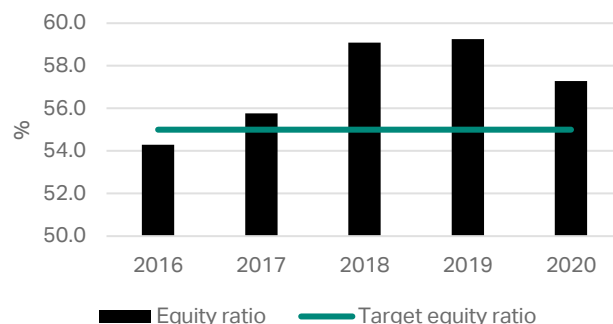
Since pulp prices are denominated in US dollars, while many of Södra's paper-manufacturing customers are in the euro area, both currencies are major drivers of financial performance and stability. As the UK is an important market for sawn wood, Södra also has significant exposure to sterling. Despite its significant currency exposure, Södra does not typically hedge currency risk, other than as part of its regular translation exposure. The company's view is that, thanks to a strong balance sheet, it can deal with any difficulties that arise due to currency fluctuations. In addition, the company's pulp price exposures are unhedged, a practice common among most of its integrated peers.

Figure 22. Södra debt/equity and covenant\*, 2016-2020



Based on company data. \*Unadjusted as reported by Södra.

Figure 23. Södra equity ratio, 2016-2020



Based on company data.

### ADJUSTMENT FACTORS

Adjustment factors are neutral

Adjustment factors are assessed as neutral and have no effect on the stand-alone credit assessment.

Liquidity assessed as adequate

#### Liquidity

We assess Södra's liquidity as adequate given the company's sources to uses ratio of 1.8x. Liquidity is supported by the company's sound financial performance in 2020, implying positive FFO and strong cash and cash equivalents as well as a large unutilised credit facility. In addition, Södra has the ability to issue new unsecured debt within an existing SEK 4bn medium-term note (MTN) programme, providing it remains covenant compliant.

We estimate the following primary liquidity sources for the 12 months ending 31. Dec. 2021, totalling SEK 7.0bn:

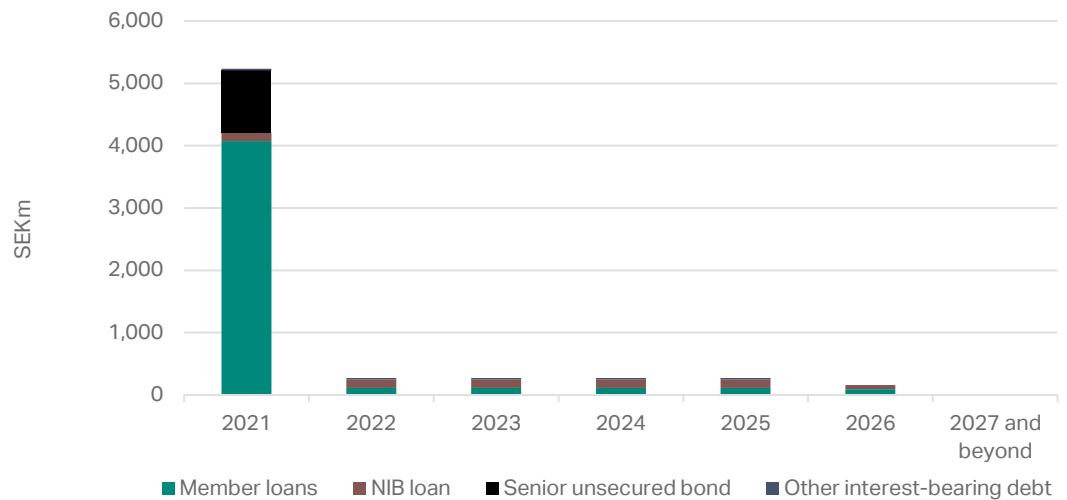
- SEK 2.3bn in unadjusted cash and cash equivalents;
- SEK 0.7bn in short-term liquid placements;
- SEK 2.5bn, equal to 75% of FFO; and
- SEK 1.5bn in unutilised credit facilities.

This compares with the following uses of liquidity, totalling SEK 3.8bn:

- SEK 1.1bn from bond maturities and amortisation of NIB loans;
- SEK 2.3bn in committed capital spending; and
- SEK 0.4bn in working capital needs.

In our view, Södra is unlikely to see substantial withdrawals from member accounts in 2021 despite theoretical short-dated maturities of SEK 4.6m in member loans (see Figure 24). Accordingly, we have excluded member loans from our calculation of uses of liquidity for the year. Instead, we consider Södra's strong cash position, and an additional SEK 2bn credit facility primarily aimed at covering member accounts, as adequate protection in the unlikely event of a run on those. We also exclude dividends from our liquidity analysis as no payment for 2020 has yet been decided and because dividend payments generally have only a limited short-term negative effect on cash.

Figure 24. Södra debt maturities, 2021-2027



Based on company data.

**Supportive environmental, social and governance factors**

ESG factors assessed as adequate

Södra's ESG efforts are supportive of its overall competitive position. The company publishes an annual externally audited sustainability report that follows the principles of the Global Reporting Initiative. Transparency is highly regarded by stakeholders in the materials sector because of the high risk of direct environmental impact, especially in terms of sustainable forestry and resource efficiency.

In terms of green financing, Södra has issued a SEK 1bn green bond within an externally approved framework.

Forestry is part of the EU's Sustainable Finance Taxonomy but the final form of the project is currently unclear in view of likely objections to proposed thresholds or screening criteria. Södra sources certified wood according to defined standards and carries out sustainable harvesting at levels that are well within approved limits. The company generally scores well in terms of impact of its activities on soil and water, while other parameters such as energy use also have improved. The company's own energy use generates net zero CO<sub>2</sub> emissions although external emissions such as those from transport are increasing. Importantly, Södra generates more energy in total than it consumes and is a net seller of fossil free energy. In addition, the company's handling of residuals is becoming more efficient due to an increased focus on circularity. However, overall waste levels have increased.

Södra plays an active role in its members' communities. The company takes health and safety issues seriously and in recent years sick leave and occupational injury levels have decreased but need improvement to reach target levels. Södra works actively to increase the proportion of female employees but has not reached its target of 30% (currently 23%). In our view, the company faces no extraordinary governance risks, and we perceive domestic regulatory overview as transparent. Södra publishes an annual report specifically on matters relating to its cooperative ownership but does not make it publicly available through its annual report.

Figure 25. Södra measurable ESG considerations

| Issue   | Risk  | Mitigating efforts  | Result  |
|---|---|---|---|
| Direct impact on biodiversity.                                | Forest biodiversity could be affected by large scale harvesting with unsustainable methods.   | Working actively with members and external forest owners towards sustainable harvesting (targets 95% approved "green" harvest sites) via codes of conduct and targets sourcing only certified wood (FSC and PEFC).  | In 2020 the share of approved "green" harvest sites was 79% while 77% of suppliers and 97% of total value of purchases complied with the code of conduct. Two-thirds of wood sourced from members was certified, while the area of forest set aside for conservation was stable.  |
| Total emissions from processes.                               | Contribution to climate change and health issues via CO <sub>2</sub> emissions and air, land, soil, and water pollution.                        | Investment, new processes, products and technology, and external suppliers. Targeted fossil free operations by 2020 and fossil free transport by 2030. Targets lowering use of total energy from 2015 levels.   | Has net fossil free status due to biomass accumulation but still emitted 70,000 tonnes of CO <sub>2</sub> in 2020 even though this was down by 15% from 2015. Transport emissions were up 18% at 227,000 tonnes over the same period. Concerning harvest sites, 89% were deemed satisfactory in terms of soil and water impact. |
| Biological, weather-related, and other external risk factors. | Risk to forest assets and the end-products of the Wood segment due to insect infestation and unpredictable weather events such as major storms. | Actively works to help members counter serious infestation through selection of plants, monitoring, mechanical measures, and specific harvesting techniques. The company has also introduced a specific assortment of second-class wood products affected by the spruce beetle. | Spruce beetle remains a major issue. An inventory in 2020 showed a 25% increase in Q4 from Q3. The long-term effects are unclear. No major storms resulting in wood oversupply in recent years.   |
| Incident and other health and safety risk.                    | Incidents which could halt production and fatal accidents, increasing costs, possibly closing units, and lowering volumes.                      | Plans to reduce injuries by 15% from 2015 levels. Targets maximum 3% sickness absence. Other target measures seek to secure compliance.   | Injury metrics show a declining trend in 2020 (down 25% from 2019). Sick leave, however, increased year on year to 3.8%.  |
| Regulatory risk including governance matters.                 | Regulatory breaches and cancellation of approvals, certifications, and licenses, negatively impacting production, and exports.                  | Active dialogue with members and other stakeholders. Codes of conduct to mitigate conflicts of interest. External audits. Whistle blowing function.   | No major incidents reported as of 2020.   |

Source: Company. FSC–Forest Stewardship Council. PEFC–Programme for the Endorsement of Forest Certification.

### OWNERSHIP ANALYSIS

Ownership assessed as neutral

We view Södra's ownership as supportive of the company's relatively low-risk strategy and solid financial position, which we factor into the rating through the financial risk profile. In our view the cooperative structure generates solid financial results for the associate members while maintaining a balanced approach to risk. Generally, many of the associate members have little debt and a significant part of their wealth is tied up in forest assets with limited alternative use, suggesting there would be mutual benefit to supporting Södra should a need for new equity arise. While Södra has paid dividends even in years of weak performance, we believe the risk of sharply increased debt in a single year is small.

### ISSUE RATINGS

Our rating on Södra's outstanding senior unsecured debt is in line with the 'BBB' issuer rating. It is indicative of our likely rating on any further issuance within the MTN programme.

Figure 26. Södra key financial data, 2017–2020

| SEKm   | 2017          | 2018          | 2019          | 2020          |
|--|---------------|---------------|---------------|---------------|
| <b>INCOME STATEMENT</b>                        |               |               |               |               |
| Revenue*                                       | 20,708        | 24,602        | 23,502        | 20,837        |
| Gross profit                                   | 8,616         | 10,934        | 9,287         | 7,798         |
| EBITDA   | 3,009         | 5,654         | 3,897         | 2,164         |
| EBIT   | 1,917         | 4,508         | 2,582         | 891           |
| Net financial items                            | -87           | -77           | -87           | -145          |
| Pre-tax profit                                 | 1,830         | 4,431         | 2,495         | 746           |
| <b>Net profit</b>                              | <b>1,571</b>  | <b>3,730</b>  | <b>2,172</b>  | <b>142</b>    |
| <b>BALANCE SHEET</b>                           |               |               |               |               |
| Property, plant and equipment                  | 14,259        | 17,598        | 17,726        | 18,384        |
| Intangible assets                              | 384           | 391           | 393           | 107           |
| Other non-current assets                       | 289           | 419           | 686           | 659           |
| Non-current assets                             | 14,932        | 18,408        | 18,805        | 19,150        |
| Cash and cash equivalents                      | 1,122         | 873           | 2,072         | 2,300         |
| Other current assets                           | 7,050         | 7,813         | 8,460         | 7,803         |
| Total current assets                           | 8,172         | 8,686         | 10,532        | 10,103        |
| <b>Total assets</b>                            | <b>23,104</b> | <b>27,094</b> | <b>29,337</b> | <b>29,253</b> |
| Total equity                                   | 12,884        | 16,011        | 17,382        | 16,759        |
| Long-term borrowings                           | 2,482         | 2,465         | 2,368         | 1,248         |
| Non-current leasing liabilities                |               |               | 210           | 139           |
| Deferred tax liabilities                       | 1,188         | 1,478         | 1,554         | 1,624         |
| Retirement benefit obligations                 | 324           | 414           | 477           | 463           |
| Other non-current liabilities                  | 160           | 141           | 178           | 107           |
| Non-current liabilities                        | 4,154         | 4,498         | 4,787         | 3,581         |
| Current liabilities                            | 6,066         | 6,585         | 7,168         | 8,913         |
| <b>Total equity and liabilities</b>            | <b>23,104</b> | <b>27,094</b> | <b>29,337</b> | <b>29,253</b> |
| <b>CASH FLOW STATEMENT</b>                     |               |               |               |               |
| Pre-tax profit                                 | 1,830         | 4,431         | 2,495         | 746           |
| Adjustments not in cash flow                   | 867           | 783           | 419           | 1,132         |
| Cash flow before changes in working capital    | 2,697         | 5,214         | 2,914         | 1,878         |
| Changes in working capital                     | -782          | -944          | 429           | 439           |
| Operating cash flow                            | 1,915         | 4,270         | 3,343         | 2,317         |
| Cash flow from investment activities           | -1,559        | -4,412        | -1,116        | -1,671        |
| Cash flow from financing activities            | 12            | -117          | -1,036        | -404          |
| Cash and cash equivalents at beginning of year | 758           | 1,122         | 873           | 2,072         |
| Valuation change of liquid assets              | -4            | 10            | 8             | -14           |
| <b>Total cash flow for year</b>                | <b>368</b>    | <b>-259</b>   | <b>1,191</b>  | <b>242</b>    |
| Cash and cash equivalents at end of year       | 1,122         | 873           | 2,072         | 2,300         |

Based on company data. \*Includes other revenue.

Figure 27. Södra rating scorecard

| Subfactors                           | Impact | Score       |
|--------------------------------------|--------|-------------|
| Operating environment                | 20.0%  | bb          |
| Market position                      | 10.0%  | bb+         |
| Size and diversification             | 10.0%  | bbb-        |
| Operating efficiency                 | 10.0%  | bb+         |
| Business risk assessment             | 50.0%  | bb+         |
| Ratio analysis                       |        | a           |
| Risk appetite                        |        | a           |
| Financial risk assessment            | 50.0%  | a           |
| <b>Indicative credit assessment</b>  |        | <b>bbb</b>  |
| Peer comparisons                     |        | Neutral     |
| ESG                                  |        | Adequate    |
| Liquidity                            |        | Adequate    |
| <b>Stand-alone credit assessment</b> |        | <b>bbb</b>  |
| Support analysis                     |        | Neutral     |
| <b>Issuer rating</b>                 |        | <b>BBB</b>  |
| Outlook                              |        | Stable      |
| <b>Short-term rating</b>             |        | <b>N-1+</b> |

Figure 28. Capital structure ratings

| Seniority        | Rating |
|------------------|--------|
| Senior unsecured | BBB    |

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