



SCA – Sell-side Rebuttal

Viceroy break-down assumptions driving SOTP, DCF & growth valuations on the sell-side.

PLEASE READ IMPORTANT DISCLAIMER – PAGE 11

February 1, 2024 – Viceroy Research will debate Christian Kopfer of Handelsbanken this Friday, February 2, 2024, on DITV. This serves as an opportunity to address aspects of our analysis that were disregarded in his last appearance.

Viceroy offers this summary of our work. Breaking out the valuation methodology of Viceroy, SCA, sell-side analysts, and requisite inputs for full transparency and so viewers can follow along.

Viceroy has made a business of repudiating the work of complacent analysts for more than eight years. When it comes to scrutinizing our analysis and challenging our conclusions we welcome facts - rather than unfounded appeals to management & audit authority, or logical fallacies, as has been the case to date.

1. What's Viceroy's Problem?

SCA's book value of its forestry assets and its portrayed picture of its future earning potential does not reflect economic reality.

They have used small parcel sized sales information to which they are a party to inflate their assets. Revised high growth and harvesting assumptions inflate short term values of 100-year asset cycles in line with issues facing Swedish foresters is inappropriate.

If you mark the assets of SCA back to reality you get a very different picture, one that shows SCA to be overvalued.

Viceroy can condense our economic argument to 4 main points, and these do not consider the impact of biological risk facing SCA's forest assets.

1. Yield of Forestry Assets is ~1%

SCA attributes a SEK 101b valuation to its forestry assets which, on a standalone basis, generates 'cash EBITDA' – as a proxy for FCF – of SEK 1.3b.

Forest EBITDA SEKm	2017	2018	2019	2020	2021	2022	2023
Revenue	5,070	5,455	6,956	6,486	6,148	6,686	7,748
EBITDA (incl. FV gain)	1,364	1,394	1,740	2,213	2,644	2,696	3,511
FV gain	(617)	(697)	(16,759)	(1,262)	(1,753)	(1,825)	(2,198)
Cash EBITDA (excl. FV gain)	747	697	(15,019)	951	891	871	1,313

Figure 1 – Viceroy Analysis¹

The Handelsbanken SOTP valuation attributes SEK 91b (71%) of SCA's value to forest assets. This represents a ~1.4% FCF Yield.

¹ <https://viceroyresearch.org/2024/01/30/sca-making-a-market/>



2. Log Price Inflation is Flat

Historical sawlog prices in Northern Sweden have grown 1.18%pa since 1995 which includes two outliers of more than 10% [YoY] in 2022 and 2023, which is unsustainable and is bound to return to mean.

The price growth from 1995 to 2021 (excluding 2022 and 2023 outliers) averaged only 0.45%pa.

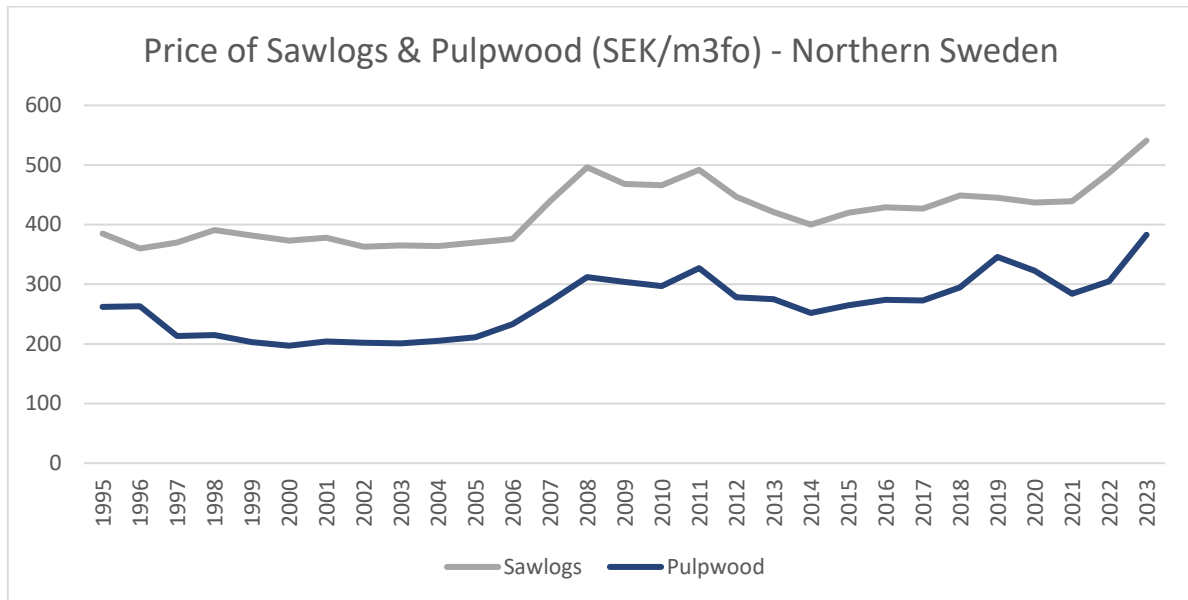


Figure 2 – Skogsstyrelsen²

3. Underlying Value Outpaced

The current management of SCA values their forestry assets at 395 SEK/m3fo using mark-to-market data. It currently receives only 265 SEK/m3fo EBITDA from its harvest at all-time, irregularly high raw material prices.

	2020	2021	2022	2023
Fair value per m3fo	291	324	366	395
EBITDA (excl. FV gains)	951	891	871	1,313
EBITDA per harvested m3fo	197	208	196	265
Delta	-32.2%	-35.7%	-46.3%	-32.9%

Figure 3 – Viceroy Analysis³

Volume growth disagreements aside:

- SCA's reported pre-harvesting forest growth is ~3.6-3.8% pa⁴.
- The average age of forest is 40 years, meaning the average tree will not be cut down for another 40-60 years.
- The average price inflation is historically ~1% per annum.

Viceroy suggest that SCA's Forest assets present a ROIC of 3.6%-3.8%⁵ (ex. sawlog & pulpwood inflation) against a sell-side WACC of 6.1% (on the low end, Handelsbanken).

If SCA can sell its forest assets at SEK 395/m3fo, then they should do it.

² <https://www.skogsstyrelsen.se/en/statistics/>

³ <https://viceroyresearch.org/2024/01/30/sca-making-a-market/>

⁴ SCA 2021-2022 Annual Report

⁵ ROIC attached to harvesting growth, assuming OPEX grows proportionally to revenues.



4. Harvesting Yields Don't Add Up

Viceroy has shown various examples of SCA appearing to overharvest, over-estimate growth, and over-estimate total volume. This will exacerbate flaws in the valuation.

We reiterate that SCA:

- Claims a volume density (m3fo/ha) is 35% higher than peers with a similar age and geographic profiles.

Forest cubic meters per hectare peer comparison				All figures in m3fo/ha	
	2018	2019	2020	2021	2022
SCA	117.50	124.50	126.00	128.00	130.00
Holmen		107.56	107.56	108.85	108.70
Stora Enso	84.72		84.82	89.53	91.62
Sveaskog*	77.85	78.36	91.12	91.45	92.74
Average of peers**	81.29	92.96	94.50	96.61	97.69
Weighted average of peers***	79.46	79.66	93.70	94.41	95.50

* Northern sweden concentrated but not reported or clean cut
 ** Unweighted, excluding SCA
 *** Weighted by holdings ('000s ha) in Norrland, excluding SCA

Figure 4 – Forest cubic meters per hectare peer comparison

- Attribute the difference to their trees growing faster than said peers.

SCA accumulated growth deficit (5 year average)					
	Weighting				
N Norrland	59%				
S Norrland	41%				
	m3fo/ha/year				
	2018	2019	2020	2021	2022
N Norrland	3.2	3.2	3.2	3.2	3.2
S Norrland	4.3	4.3	4.4	4.4	4.4
Norrland weighted average	3.65	3.65	3.69	3.69	3.69
SCA	1.9	3.0	3.1	2.6	2.8
Accumulated deficit	1.8	2.4	3.0	4.1	5.0

Figure 5 – SCA accumulated growth deficit

- Accounts for a greater percentage of harvested timber than the percentage of land it owns.

SCA as % of Land and Harvesting in Norrland		
	2013-17	2018-22
SCA harvesting	4.46	5.36
Norrland harvesting	29.20	30.60
SCA Harvest as % of all harvesting	15.3%	17.5%
SCA land	2,000	2,000
Norrland forest land	16,564	16,574
SCA Land as % of all forest land	12.1%	12.1%
Overharvest Rate	3.2%	5.4%

Figure 6 – SCA as % of land and harvesting in Norrland

- SCA cannot bring forward harvest age profile.

Tabell 4. Se 3 kap. 3 §. Lägsta tillåtna ålder för förnygringsavverkning i bestånd vars virkesförråd till minst hälften består av tall och/eller gran. Tabellen gäller vid avverkning i Norrbottens, Västerbottens, Jamtlands och Västernorrlands län.

	G28	G24	G20	G16	G12
Gran, ståndortsindex					
Tall, ståndortsindex	T28	T24	T20	T16	T12
Ålder, år	65	70	80	90	100

Figure 7 – Standortsindex showing minimum year of harvest according to classification

The best course of action would be to sell your forest while the market's hot & prove us wrong.



2. SCA's Book Value – Mark-to-Market

The fundamental basis of asset valuation takes into account the owner's ability to generate economic benefits by using the asset in its *highest and best use*, or by selling it to another market participant that would use the asset in its highest or best use.

This is verbatim IFRS 13's non-financial asset valuation principle⁶.

The only – and therefore best – use for SCA's forest assets, including the land, is to harvest and sell timber. The value of the land and the value of the lumber are intrinsically linked.

SCA, and its local competitors, take a vastly different view to Viceroy in the valuation of its land. They believe that the market value of their forest assets is greater than the value they can obtain by harvesting and selling timber.

Accordingly, in 2022 the value of SCA's 2.6m ha of forest assets are marked against 135 transactions in "areas where SCA owns forest", which add up to ~18k ha (0.7% of SCA's holdings).

Forest value
SCA bases the valuation of the company's forest assets on transactions in areas where SCA owns forest land in Sweden.

Figure 8 – SCA Annual Report 2022

SCA appears to be a party to almost half of these transactions, as we have demonstrated earlier reports:

Transactions in Norrland with SCA involvement (%)				
	2019	2020	2021	2022
SCA in % of Norrland Transactions	18.02%	35.27%	42.40%	43.84%

Figure 9 – Viceroy Analysis⁷

The remaining transactions which SCA bases its forest asset values are private between enthusiasts. SCA would be unable to sell its forests because there is not a large enough market of enthusiasts to offload 2.6mha of forest assets. And yet: SCA prescribes the value of its land as though it could sell all its forest tomorrow for this price.

The Value of the Land

The marked-to-market (**M2M**) value of SCA's forest assets are divided into 2 accounts:

1. A DCF value of Biological Assets
2. The Land Value, being the remainder.

$$\text{Land Value} = \text{Total Forest Asset Value (M2M)} - \text{Biological Asset Value (DCF)}$$

To be abundantly clear: Viceroy is of the opinion **SCA's Land has no discernable cash yield** other than the biological assets which sit on top of it. SCA's biological assets have appreciated, on the back of its DCF, an average of 3.3% per annum. SCA's land value has appreciated 25% per annum.

FV Growth SEKm	2019	2020	2021	2022	2023
Forest Assets	69,233	74,900	84,497	97,882	107,481
Biological Assets	49,063	51,276	53,309	55,681	58,214
FV Growth		2.6%	3.4%	3.4%	3.9%
Land	20,170	23,624	31,188	42,201	49,267
FV Growth		17.1%	32.0%	35.3%	16.7%

Figure 10 – Viceroy Analysis

⁶ <https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2022/issued/part-a/ifrs-13-fair-value-measurement.pdf?bypass-on#:~:text=If%20the%20highest%20and%20best,on%20a%20stand%2Dalone%20basis.>

⁷ <https://viceroyresearch.org/2024/01/30/sca-making-a-market/>



The DCF Biological Assets

Viceroy further believe that SCA’s DCF valuation for its biological assets appears to be overly optimistic.

$$\text{Land Value} = \text{Total Forest Asset Value (M2M)} - \text{Biological Asset Value (DCF)}$$

The inputs of the DCF include:

- The discount rate applied.
- The price of wood.
- The cost of felling.
- The volume (amount) of wood.
- The harvesting rate (not disclosed by SCA).

Biological assets as a share of forest assets ²⁾			
Discount rate	Reduction by 0.1%	2,188	2,132
Wood price	Increase of 10%	11,584	10,154
Felling cost	Increase of 10%	-3,179	-3,053
Volume	Increase of 10%	5,749	5,196

Figure 11 – SCA Annual Report 2022

Discount Rate

We understand that this is the rate SCA uses to discount future value of free cash flows, and not the Swedish Policy rate which sits at 4.00% (and in which a 10bps spread would not cause such a dramatic, ~400bps impact on the biological asset value).

On a terminal rate we calculate SCA’s discount rate at 2.65% in 2022 is obscenely low. It is only ~30bps above the current 10-Year Swedish Bond Rate and 135bps below the current policy rate of 4%.

Discount rate analysis	2020	2021	2022
Cap rate (trial & error)	2.63%	2.60%	2.65%
Numerator	1348.6	1386.0	1475.5
Val	51,276	53,309	55,681
Cap rate less 10 bps	2.53%	2.50%	2.55%
Val less 10bps	53,303	55,441	57,865
Difference (trial & error check)	2,027	2,132	2,184
Sensitivity to 10bps (reported)	2,028	2,132	2,188

Figure 12 – Viceroy Analysis

Sweden’s policy rate has climbed 400bps since the start of 2020. The Swedish 10-year bond rate has similarly climbed 220bps from 2020. SCA biological asset valuation is by far more sensitive to discount rate movements than any other factor, and over this time SCA’s discount rate has not budged.

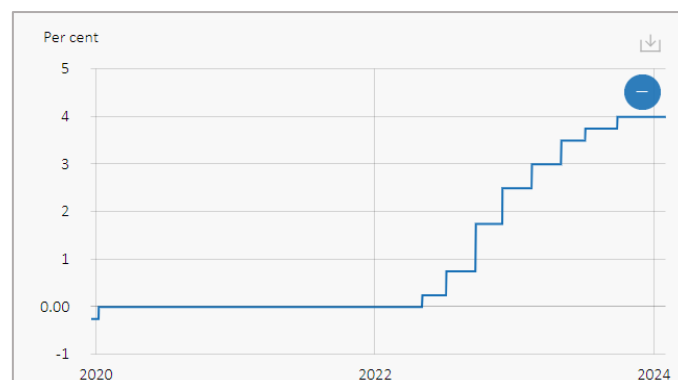


Figure 13 – Riskbank.se Current Policy Rate

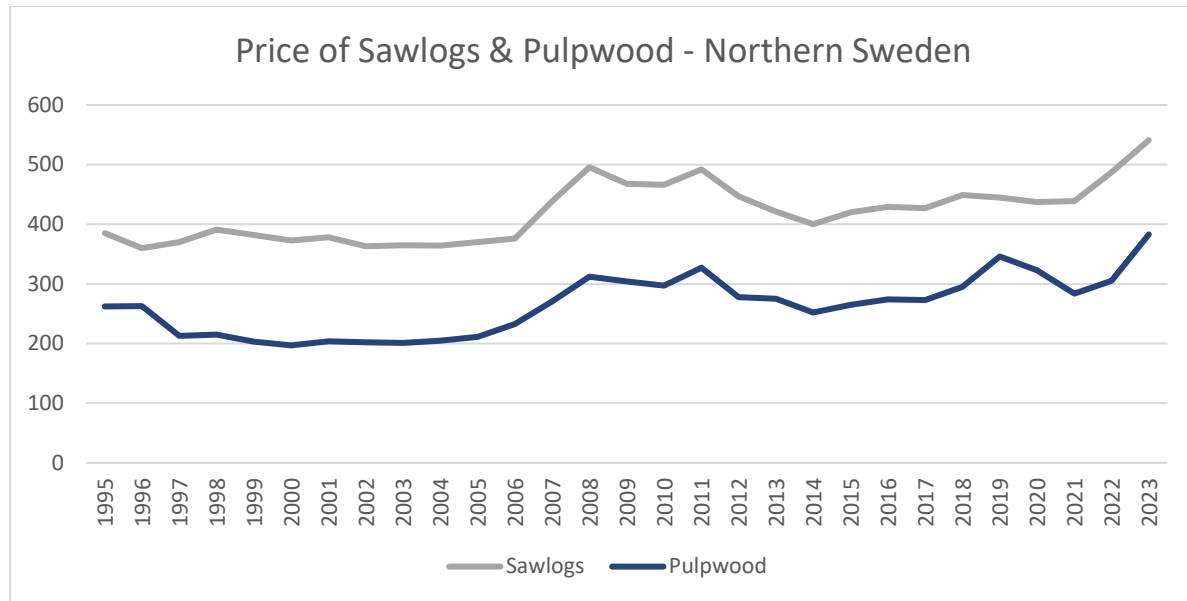
We suspect SCA may take issue with our calculated discount rate. **It’s likely the case that SCA’s DCF assumes massive, unwarranted short-term growth following increased harvesting capacity, with a terminal rate applied in the late future.** This is what most of the sell-side have done. SCA is the ultimate long-term asset and exaggerated expectations (outside of FV gains!) have not come to cash flow fruition:

“SCA takes a long-term view of the yield requirement on investments in forest assets and is unaffected by short-term movements in market interest rate” – SCA Annual report 2022



The Price of Wood

SCA's "Forest" P&L segment outlines the performance of its forest assets only. It substantially comprised of timber harvested and sold to SCA industrial operations. The price of wood directly impacts sales, and we are able to collect data samples of the price of sawlogs and pulpwood in Northern Sweden going back to 1995.



The price of sawlogs and pulpwood regularly fluctuate up to 10% across volatile periods and return to the mean. The average ex-inflation price of sawlogs and pulpwood has, on average, increased < 1% pa between 1995 and 2021.

2022 and 2023 have brought 2 consecutive periods of volatility that have broken the trend. The price of pulpwood and sawlogs were up about ~10%pa over the last 2 years, however if SCA have relied on this metric to value wood, then it will be susceptible to extreme write downs of this asset class on a return to mean.

Volume, Growth & Harvesting Rate

The volume, growth rate and harvest rate should play to the amount and timing of cash-flows in the DCF. **Viceroy has shown various examples of SCA appearing to overharvest, over-estimate growth, and over-estimate total volume.**

SCA's reported m3fo/ha is 35% higher than its peer group with similar aging profiles and geographical profiles.

	Forest cubic meters per hectare peer comparison			All figures in m3fo/ha	
	2018	2019	2020	2021	2022
SCA	117.50	124.50	126.00	128.00	130.00
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 *** Weighted by holdings ('000s ha) in Norrland, excluding SCA



SCA harvests disproportionately more timber relative to the land it owns. The vintage profiles in Norrland

SCA as % of Land and Harvesting in Norrland		
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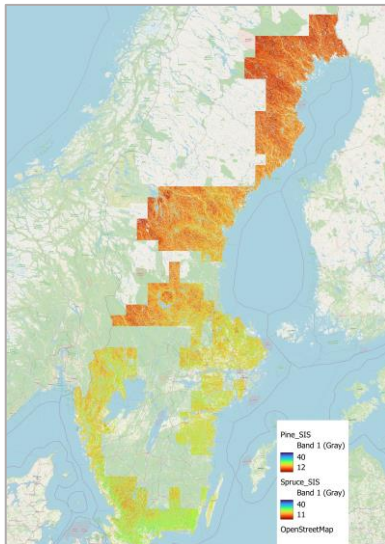
Figure 14 – Viceroy Analysis

SCA claims its trees grow faster than its local peers, yet SCA’s forest density growth is lower than other Norrland productive forest yet

SCA accumulated growth deficit (5 year average)					
	Weighting				
N Norrland	59%				
S Norrland	41%				
	m3fo/ha/year				
	2018	2019	2020	2021	2022
N Norrland	3.2	3.2	3.2	3.2	3.2
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Norrland weighted average	3.65	3.65	3.69	3.69	3.69
SCA	1.9	3.0	3.1	2.6	2.8
Accumulated deficit	1.8	2.4	3.0	4.1	5.0

Figure 15 – Viceroy Analysis

SCA cannot bring forward harvest ages: most of its forests are in areas where the minimum legal felling age is 100 years. SCA acknowledges this in its 100-year production cycle.



Tabell 4. Se 3 kap. 3 §. Lägsta tillåtna ålder för förnyringsavverkning i bestånd vars virkesföråd till minst hälften består av tall och/eller gran. Tabellen gäller vid avverkning i Norrbottens, Västerbottens, Jämtlands och Västernorrlands län.

Gran, ståndortsindex	G28	G24	G20	G16	G12
Tall, ståndortsindex	T28	T24	T20	T16	T12
Ålder, år	65	70	80	90	100

risks. SCA manages this by conducting a sensitivity analysis **TD3:1** in the form of changed wood price, felling costs and volumes. The calculation is performed for a production cycle for biological assets that SCA estimated to average 100 years. The change in value is recognized in the income statement on the line item for change in value in biological assets.

Figures 16, 17 & 18 – Pine and Spruce SIS Map, Skogsvårdslagen & SCA Annual Report 2022, respectively



The Cash Flow & The Best Use

The EBITDA yield (as proxy for FCF) on SCA's forests is about 1.3%. This is easily verifiable as SCA's forest sector is reported as its own profit center on its financial statements:

Forest EBITDA SEKm	2020	2021	2022	2023
Revenue	6,486	6,148	6,686	7,748
EBITDA (incl. FV gain)	2,213	2,644	2,696	3,511
FV gain	(1,262)	(1,753)	(1,825)	(2,198)
Cash EBITDA (excl. FV gain)	951	891	871	1,313
Value of forest assets	74,900	84,497	97,882	107,481
Cash EBITDA Yield (excl. FV gain)	1.27%	1.05%	0.89%	1.22%

Figure 19 – Viceroy Analysis

The average sawlog and pulp inflation over the last 30 years is ~1% (as seen above in “The Price of Wood”)

Harvesting & growth disagreements aside: SCA's reported net, pre-commercial forest growth rate is 3.6%

Growth in SCA's forest in 2022 ¹⁾		
SEKm	Million m ³ fo	%
Opening volume Sweden, 2022	256	
Gross forest growth	10.5	4.1
Natural losses and pre-commercial thinning	-1.4	-0.5
Available growth	9.1	3.6
Harvesting ²⁾	-5.3	-2.1
Net forest growth	3.8	1.5

Figure 20 – SCA 2022 Annual Report

SCA's total m3fo could be sold at today's prices for SEK 265/m3fo, against a fair value mark to market value of SEK 395/m3fo.

	2020	2021	2022	2023
Fair value per m3fo	291	324	366	395
EBITDA (excl. FV gains)	951	891	871	1,313
EBITDA per harvested m3fo	197	208	196	265
Delta	-32.2%	-35.7%	-46.3%	-32.9%

Figure 21 – Viceroy Analysis

Viceroy suggest that SCA's Forest assets present a ROIC of 3.6%-3.8% (ex. sawlog & pulpwood inflation) against a sell-side WACC of 6.1% (on the low end, Handelsbanken).

If SCA can sell its forest assets at SEK 395/m3fo, then they should do it.

3. Sell-Side Assumptions

The sell-side, including Handelsbanken, approach SCA's valuation as a SOTP. A cursory view show that Forest assets account for ~70% of Handelsbanken's target price.

Again: 70% of the value attributed to SCA derives EBITDA of SEK ~1.3b,

Forest EBITDA SEKm	2017	2018	2019	2020	2021	2022	2023
Revenue	5,070	5,455	6,956	6,486	6,148	6,686	7,748
EBITDA (incl. FV gain)	1,364	1,394	1,740	2,213	2,644	2,696	3,511
FV gain	(617)	(697)	(16,759)	(1,262)	(1,753)	(1,825)	(2,198)
Cash EBITDA (excl. FV gain)	747	697	(15,019)	951	891	871	1,313

Figure 22 – Viceroy Analysis

This is equally problematic because the Forest segment is the only part of SCA's business that did not miss EBIT estimates, and presumably supports the valuation of the entire business. We presume the below adjusted EBIT includes FV gains.

Handelsbanken Review	Est. 2023 adj. EBIT	Actual 2023 adj. EBIT	Difference
Forest	2,929	3,279	11.9%
Wood	389	328	-15.7%
Pulp	590	559	-5.3%
Containerboard	520	482	-7.3%
Renewable	612	613	0.2%

Figure 23 – Viceroy Analysis

Further, we note SCA has consistently missed sell-side FCF without consequence. The sell-side dividend yield expectations have remains unchanged.

Jan 9, 2024	2020	2021	2022	2023e	2024e	2025e	2026e
FCF adj. yield	0.83%	0.92%	-0.21%	3.00%	5.40%	6.70%	7.20%
Dividend Yield	1.40%	2.00%	1.90%	1.70%	2.00%	2.30%	2.60%
Jan 29, 2024	2020	2021	2022	2023	2024e	2025e	2026e
FCF adj. yield	0.83%	0.92%	-0.21%	0.99%	3.60%	5.50%	N/A
Dividend Yield	1.40%	2.00%	1.90%	1.80%	2.20%	2.50%	N/A

Figure 24 – Handelsbanken

Given that FCF has been consistently unable to meet dividends: SCA has drawn debt to meet dividend obligations:

Jan 9, 2024	2020	2021	2022	2023
Loans Raised	3,875	1,481	4,223	2,099
Loans Amortized	(3,588)	(1,158)	(1,786)	(1,265)
Dividend	-	(1,405)	(2,282)	(1,756)

We propose that the sell-side value proposition relies on an undeserved mark to SCA's book value. Actual return metrics are inconsequentially altered to fit this narrative.



Attention: Whistleblowers

Viceroy encourage any parties with information pertaining to misconduct within Svenska Cellulosa, its affiliates, or any other entity to file a report with the appropriate regulatory body.

We also understand first-hand the retaliation whistleblowers sometimes face for championing these issues. Where possible, Viceroy is happy act as intermediaries in providing information to regulators and reporting information in the public interest in order to protect the identities of whistleblowers.

You can contact the Viceroy team via email on viceroy@viceroyresearch.com.

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