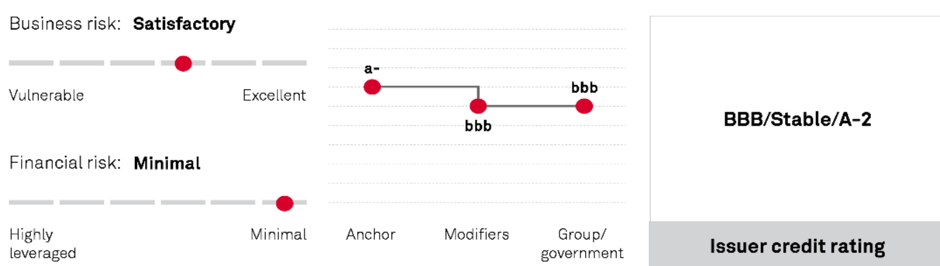
UPM-Kymmene Corp.

May 11, 2022

Ratings Score Snapshot



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Credit Highlights

Overview

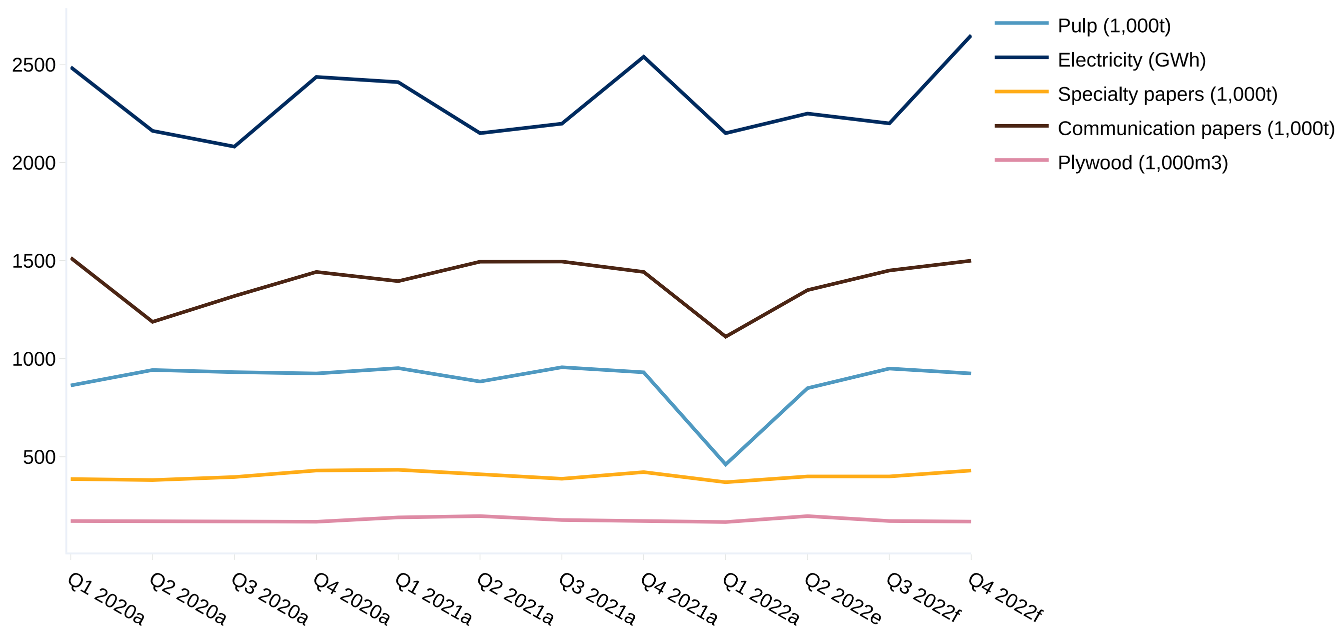
Key strengths	Key risks
Large and diversified operations.	Cyclical nature of the paper and forest products industries.
Leading market positions across a variety of industry segments.	Still-large exposure to structurally declining graphic paper.
Cost efficiency underpinned by large scale and vertical integration.	Stated financial policy allows for potentially higher leverage.
Strong innovation capacity underlined by massive investments in greenfield projects, which should generate significant earnings over the medium term.	Currently high capital expenditure (capex) with execution risk on greenfield projects.

UPM-Kymmene Corp. (UPM) performed very strongly in 2021, despite a continuously difficult market environment for its publication paper division. Sales increased by 14.4% versus 2020, and the S&P Global Ratings-adjusted EBITDA margin expanded by 340 basis points (bps) to 18.7%. This was primarily thanks to the outstanding performances of the pulp (UPM Biorefining), wood (UPM plywood), and energy (UPM Energy) businesses, which benefited from very high market prices. The packaging (UPM Specialty Papers) and labels (UPM Raflatac) margins were resilient in 2021, benefiting from continuously strong demand, although partially offset by higher input costs such as pulp and energy prices. Lastly, publication paper (UPM Communication Papers) profitability was affected by an unusually fast increase in input costs, particularly energy. Sales prices could not be increased in same phase due to existing customer contracts, despite tight paper markets.

Despite a mild cost overrun and delayed schedule for the launch of its new mega pulp plant in Uruguay, as well as a labor strike in Finland which ended late April, we expect UPM's performance will be resilient in 2022. We anticipate that UPM's sales will increase by 5%-7% in 2022 as market prices remain exceptionally high across all divisions, with particularly marked increases for the plywood and communication paper business. We forecast adjusted EBITDA margins will decline slightly to 18%-18.5%, because of several factors. The business mix will be unfavorable with the solid growth we expect for the low margin communication paper division. The labor-conditions-related strike, which lasted from January to April 2022 at the Finnish sites of the Finnish units of UPM Pulp, UPM Biofuels, UPM Raflatac, UPM Specialty Papers, and UPM Communication Papers, cut EBITDA by €180 million-€220 million. Record high electricity prices in Europe will also negatively affect profitability in 2022, despite UPM's ability to pass on higher variable costs onto the client, its exposure being partially hedged, and the fact that it will benefit for the first time this year from the startup of the newly built Olikuoto nuclear plant production. The starting date for production at UPM's new state-of-the-art pulp mill in Uruguay was delayed from first-half 2022 to first-quarter 2023, which has a slightly negative effect on our forecast for the year. There will also be an associated 10% additional cost for the project because of the delay, bringing total costs to about $3.0 billion (€2.85 billion). We expect a negligible direct impact from the Russia-Ukraine conflict, because UPM's combined exposure in terms of sales to Russia and Ukraine combined is approximatively 2%, and its wood sourcing--which represented less than 10% of its total purchases--can easily be replaced.

UPM-Kymmene Corp. Deliveries By Product Per Quarter--2020a-2022f

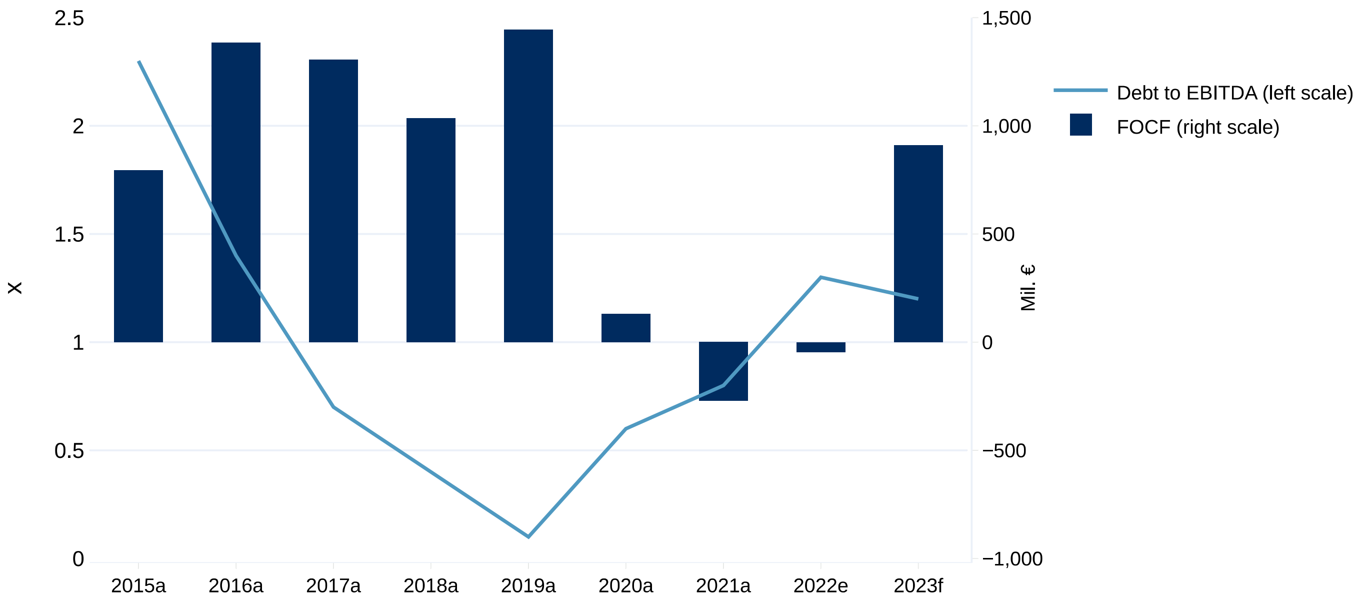
Deliveries for the specialty, communication papers, and pulp divisions were hit by the strike in Q1 2022



a--Actual. f--Forecast. e--Estimate. Q--Quarter. t--Metric tons. GWh--Gigawatt hours. m--Meters. Source: S&P Global Ratings. Copyright © 2022 by Standard

Headroom within the current rating remains ample, thanks to the exceptional performance in 2021. The very strong market conditions have enabled UPM to finance most of its record-high €1.51 billion capex with internally generated cash flow. The investment program nevertheless drove free operating cash flow (FOCF) into negative territory at minus €271 million, while adjusted leverage increased to 0.8x on Dec. 31, 2021, up from 0.6x one year before. We expect a resilient operating performance in 2022 will allow the continuously high capex of about €1.45 billion-€1.55 billion to not require any additional debt funding. However, it will maintain pressure on FOCF, which we expect to remain negative--between €0 and negative €100 million--in 2022. Meanwhile, we forecast adjusted leverage will continue to increase to 1.3x by year-end 2022.

UPM's Leverage And FOCF Evolution Over 2015a-2023f



FOCF--Free operating cash flow. Source: S&P Global Ratings.

Longer term, we could see upside to the current rating, should we see positive outcomes for UPM's financial policy. We would also want to see the company successfully ramp up its new projects which bear a high execution risk and replace the very low margin publication paper activity. UPM is at the forefront of the forest products industry transformation, with ongoing and planned greenfield projects such as biochemicals from wood-based raw materials (Leuna plant) or biofuels for the traffic, marine, aviation and chemicals industries. These projects are expected to yield EBITDA margins of about 20%, should they ramp up successfully. Execution risk is high, given that this is the first time UPM will produce and commercialize these products. Regarding existing operations, the profitability of the pulp division will also benefit from the exceptionally low cost of pulp production expected at its Uruguayan Pasos de los Toros plant. The constant decline of the very low margin (about 5%) publication paper division in UPM's sales will also contribute to increasing the overall group profitability. Should we expect over time that reported leverage will stay well below 2.0x through the cycle, we could consider a positive rating action in the longer term.

Outlook

The stable outlook reflects our expectations that UPM's strong and cost-efficient market positions will continue to support solid operating cash flow generation. We expect the group's large expansion investments will remain significant in 2022 and maintain FOCF in negative territory in 2022 of between €0 and negative €100 million. We expect adjusted leverage to increase but remain well below 2.5x over the next 24 months.

Downside scenario

We could lower the rating if:

- UPM's credit metrics deteriorated markedly from current levels such that our weighted-average ratio of adjusted FFO to adjusted debt fell below 40%; or
- Adjusted debt to adjusted EBITDA exceeded 2.5x.

Although significant headroom exists, a deterioration in credit metrics could follow a very large debt-funded acquisition, higher capex than already planned, or higher shareholder returns, combined with a sharp decline in business performance.

Upside scenario

We could raise the rating if UPM tightened its financial policy and amended its stated maximum leverage ceiling to reflect a commitment to maintain credit metrics commensurate with a modest financial risk profile. These include:

- Our adjusted weighted-average FFO to debt sustainably above 45%; or
- Adjusted debt to EBITDA of less than 2x.

We believe this would be in line with company-reported debt to EBITDA of about 1.5x.

We could also raise the rating if we saw a significant improvement in the company's business risk profile, possibly via further expansion into products with higher margins and stronger growth prospects.

Our Base-Case Scenario

Assumptions

- European GDP growth of 1.6% in 2022 and 2.4% 2023; North American GDP growth of 3.2% in 2022 and 2.1% in 2023; and Asia-Pacific GDP growth of 5.1% in 2021 and 4.6% in 2022.
- Revenue to increase by 5%-7% in 2022 as higher prices across all divisions will more than mitigate lower volumes for the pulp, publication, and specialty papers businesses stemming from the January 2022-April 2022 strike in Finland , which resulted in the shutdown of plants. We expect a 3%-5% revenue increase in 2023 as volumes benefit from a favorable comparable basis versus 2022, while the launch of the Pasos de los Toros pulp plant in Uruguay provides significant additional capacity.
- Adjusted EBITDA margin of about 18.0%-18.5% in 2022, from 18.7% in 2021, because of pressure from higher variable costs and lost EBITDA generation from the strike in Finland. EBITDA margin of 18.5%-19% in 2023, because the launch of the very profitable Pasos de los Toros pulp plant in Uruguay more than compensates for a more difficult pricing environment following the peak of 2022.
- Capex, including forest renewal costs, of about €1.5 billion in 2022 and €800 million in 2023. To derive these figures, we assume annual maintenance capex of about €200 million.
- Working capital outflows of about €200 million in 2022 and €100 million in 2023.
- Flat annual dividend distributions of €693 million in 2022 and in 2023.
- No acquisitions or share repurchases.

Key metrics

UPM-Kymmene Corp.--Key Metrics*

Mil. €	2019a	2020a	2021a	2022e	2023f
Revenue	10,238	8,580	9,814	10,300-10,500	10,600-10,800
Revenue growth (%)	(2.3)	(16.2)	14.4	5-7	3-5
EBITDA	1,832	1,314	1,833	1,800-1,900	1,950-2,050
EBITDA margin (%)	17.9	15.3	18.7	18-18.5	18.5-19.0
Funds from operations (FFO)	1,623	1,128	1,523	1,500-1,600	1,600-1,700
Capital expenditure	399	871	1,512	1,450-1,550	750-850
Free operating cash flow (FOCF)	1,444	130	(271)	(100)-0	850-900
Debt	230	768	1,466	2,350-2,450	2,400-2,500
Debt to EBITDA (x)	0.1	0.6	0.8	1.0-1.5	1.0-1.5
FFO to debt (%)	705.6	146.9	103.9	60-70	60-70
FOCF to debt (%)	627.8	16.9	(18.5)	(5)-0	30-40

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

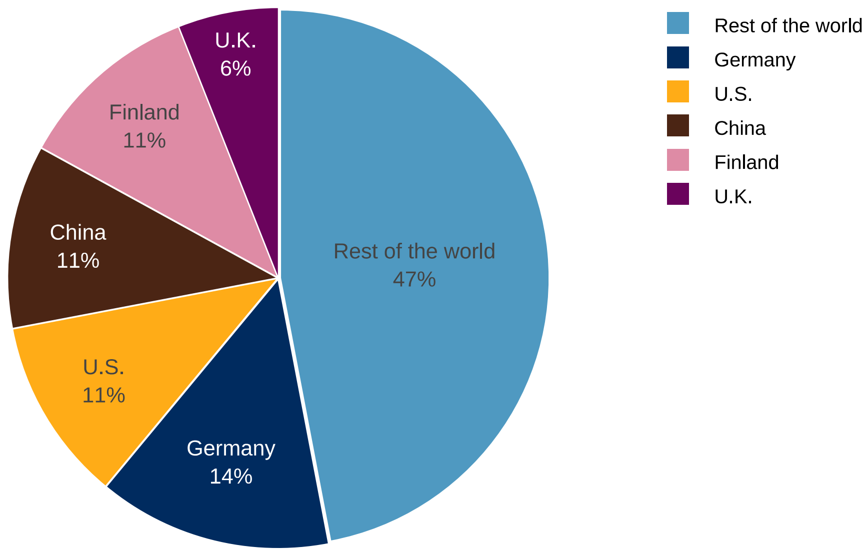
Company Description

UPM is one of the largest and most diversified forest and paper products companies in the world, with over €9.8 billion in sales and €1.83 billion in adjusted EBITDA in 2021. The group is listed on the Nasdaq Helsinki stock exchange.

It has leading positions in European publications paper, fine paper, and self-adhesive label materials. It also has large pulp and energy operations, as well as sizable manufacturing operations for plywood and sawn timber. UPM's 54 production plants are spread over 12 countries, primarily in Europe. UPM also has pulp production operations in Uruguay, as well as paper and label material plants in China and in the U.S.

In 2021, external sales before eliminations and reconciliations were split between communication papers (36%); biorefining including pulp, timber, and biofuels (30%); Raflatac self-adhesive labels for consumer goods (17%); specialty papers (15%); plywood (5%); energy (5%); and other operations (3%).

External Sales By Country In 2021



Source: Company reports.

Peer Comparison

UPM's closest rated peers include Holmen AB (BBB+/Stable/A-2), Svenska Cellulosa AB SCA (SCA; BBB/Stable/A-2), Mondi PLC (Mondi; BBB+/Stable), and Metsa Board Corp. (Metsa; BBB-/Stable/A-3).

Holmen has similar EBITDA margins than UPM but is significantly smaller and has lower product diversification. It also still has substantial exposure to the structurally declining printing paper segment. Likewise, it is vertically integrated with significant forest assets, and has a conservative financial policy with minimal leverage levels. It benefits from its ownership by L E Lundbergföretagen, which uplifts the issuer credit rating by one notch to 'BBB+'.

SCA had markedly stronger EBITDA margins in 2021 following its exit from the publication paper business and we forecast that it will stay at a higher level than UPM in the future. This is also because of its very efficient asset base. That said, the company is significantly smaller and less diversified in terms of product offering. Its financial policy also allows for higher leverage.

Mondi is slightly smaller than UPM but is more profitable and more diversified geographically, with a presence in high-growth emerging countries such as Russia and South Africa, resulting in a low cost base, albeit also in higher risk countries. In terms of product mix, it is less diversified than UPM, with a focus on packaging products. It has little vertical integration with some moderate forest assets ownership, which increases its vulnerability to pulp price increases.

Metsa Board is markedly smaller and less diversified than UPM because it only sells paperboard products and pulp. Its asset base is concentrated in Finland. It has low leverage, but its financial policy allows for re-leveraging through the cycle.

UPM-Kymmene Corp.--Peer Comparisons

	UPM-Kymmene Corp.	Mondi PLC	Holmen AB	Svenska Cellulosa AB SCA	Metsa Board Corp.
Foreign currency issuer credit rating	BBB/Stable/A-2	BBB+/Stable/--	BBB+/Stable/A-2	BBB/Stable/A-2	BBB-/Stable/A-3
Local currency issuer credit rating	BBB/Stable/A-2	BBB+/Stable/--	BBB+/Stable/A-2	BBB/Stable/A-2	BBB-/Stable/A-3
Period	Annual	Annual	Annual	Annual	Annual
Period ending	2021-12-31	2021-12-31	2021-12-31	2021-12-31	2021-12-31
Mil.	EUR	EUR	EUR	EUR	EUR
Revenue	9,814	7,723	2,027	1,830	2,084
EBITDA	1,833	1,512	403	705	324
Funds from operations (FFO)	1,523	1,244	334	635	278
Interest	28	98	5	12	11
Cash interest paid	35	78	4	17	15
Operating cash flow (OCF)	1,241	1,076	313	575	326
Capital expenditure	1,512	635	166	491	210
Free operating cash flow (FOCF)	(271)	441	147	84	116
Discretionary cash flow (DCF)	(976)	127	(22)	(53)	24
Cash and short-term investments	1,560	473	49	103	524
Gross available cash	1,560	473	49	103	524
Debt	1,466	1,894	433	883	0
Equity	11,106	4,889	4,570	8,077	1,846
EBITDA margin (%)	18.7	19.6	19.9	38.5	15.6
Return on capital (%)	11.4	16.5	5.9	6.8	20.0
EBITDA interest coverage (x)	65.5	15.4	84.6	56.7	29.7
FFO cash interest coverage (x)	44.5	16.9	77.4	37.5	19.3
Debt/EBITDA (x)	0.8	1.3	1.1	1.3	0.0
FFO/debt (%)	103.9	65.7	77.1	72.0	NM
OCF/debt (%)	84.7	56.8	72.3	65.2	NM
FOCF/debt (%)	(18.5)	23.3	34.0	9.5	NM
DCF/debt (%)	(66.6)	6.7	(5.1)	(6.0)	NM

Business Risk

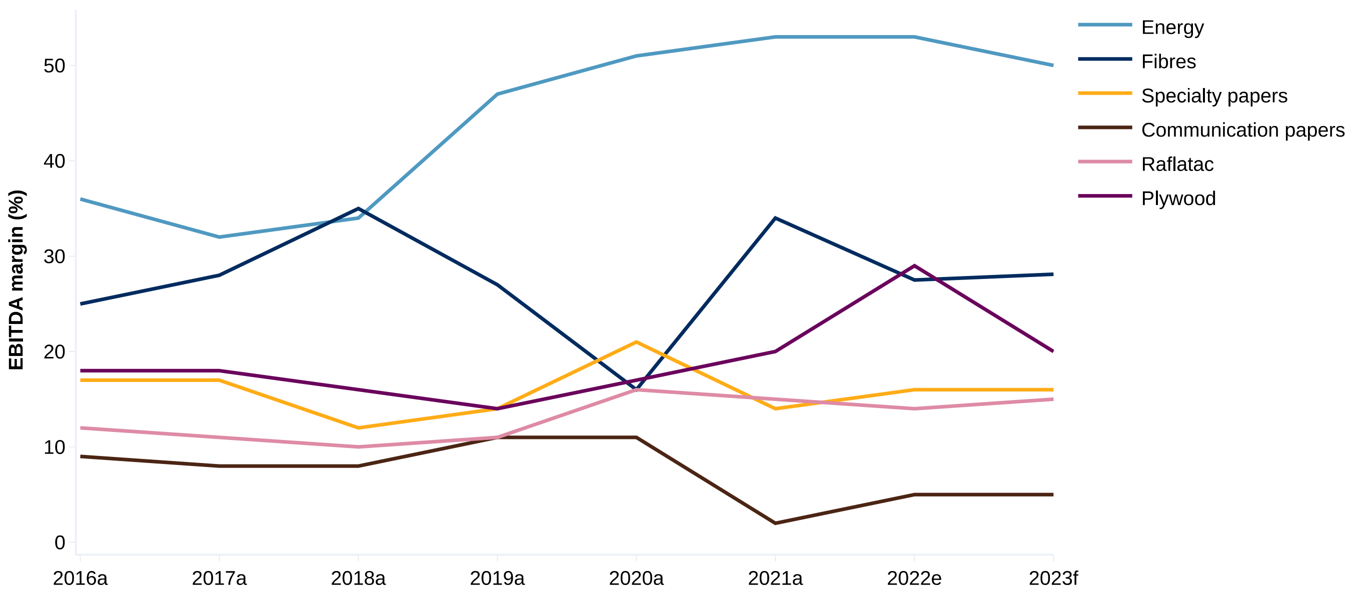
Our assessment of UPM's business risk profile is supported by its leading market positions, large scale, well-invested asset base, diversified operations and customer base, vertical integration, and focus on being a cost leader in capital-intensive segments such as pulp, graphic paper, and energy generation.

UPM has a track record of shifting exposure to higher-margin wood and paper products from publication papers, and continuous investments into its asset base to increase competitiveness. The group has a high degree of vertical integration and a broad product portfolio, with exposure to multiple grades of paper, pulp, wood products, biochemical products, energy, and label materials.

On the other hand, our assessment is constrained by UPM's large exposure to graphic paper, which accounted for about 36% of revenue and 4% of EBITDA in 2021. Demand in this segment (which is in structural decline) has been hit by the COVID-19 pandemic, with only a partial recovery to prepandemic levels expected once the impact has fully dissipated. Despite operating in a structurally declining publication paper market, UPM has a clear strategy for its communications paper division. The publication paper market has been structurally declining for several years in Europe as consumption trends have become more and more digital. Consequently, numerous players of the market have progressively wound down their production capacities, if not totally closed them, which has removed more offering from the market than demand for them has declined. Nevertheless, our understanding is that UPM intends to stay present in this market in coming years, although it will adapt its production capacities to market demand, as demonstrated by the closures in the second half of 2020 of newsprint mill UPM Chapelle, and paper mill UPM Kaipola,or the sale of the Shotton Mill, and the conversion of Paper Machine 2 in Nordland, Germany, from fine paper to specialty grades. UPM is therefore focusing on the most profitable sub-segments of the market, remaining profitable, thanks to its premium cost position and staying ahead of market decline. In 2022, we expect the communication paper division to show growth again, along with pandemic-related restrictions easing in most parts of the world, while margins will increase thanks to significantly higher prices. Despite this recent improvement, the segment's EBITDA margins have overall been declining in recent years in sync with the decline in volumes and prices. It is also exposed to further restructuring charges linked to site closures and capacity reductions.

Split Of Company-Adjusted EBITDA Margins By Division Over 2016a-2023f

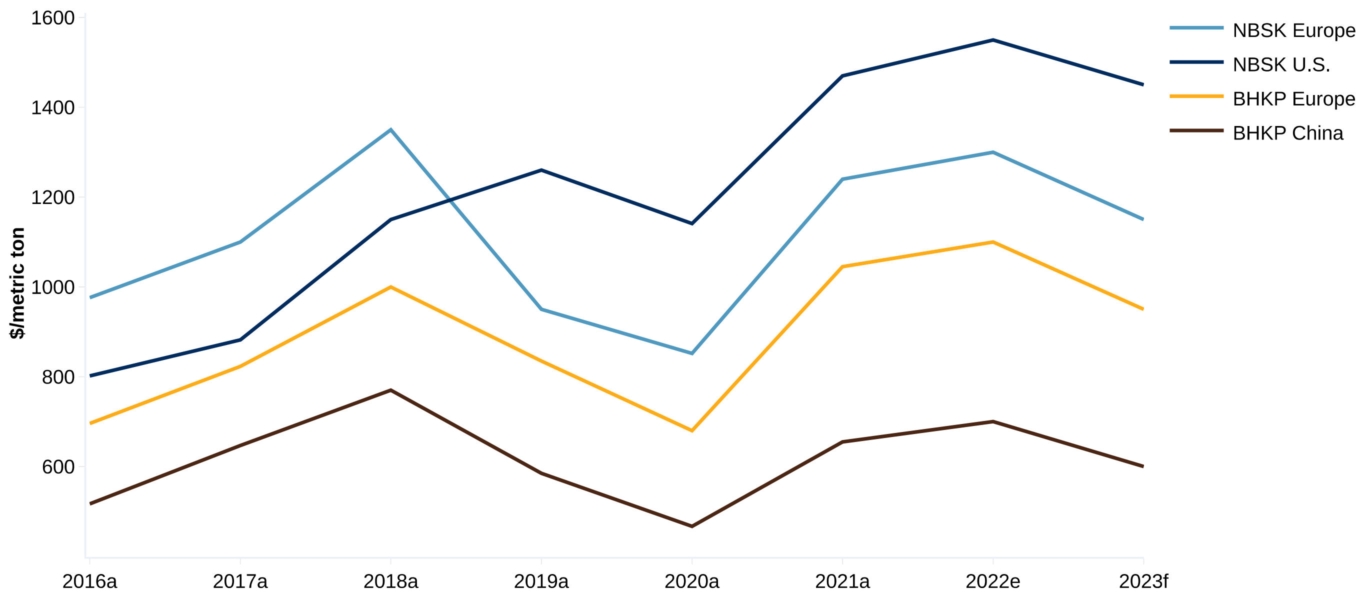
Company reported figures



a--Actual. e--Expected. f--Forecast. Source: Company reports. Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

UPM's pricing power is limited due to the commoditized nature of its products. It is exposed to the cyclicality of the pulp business. Prices increased very strongly in 2021 from previously low levels, and we expect them to slightly decrease in 2022, albeit still significantly above 2020 levels.

Benchmark Pulp Prices Assumptions



a--Actual. f-Forecast. e--Estimate. Source: S&P Global Ratings. Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

Financial Risk

UPM's financial risk profile is supported by its strong operating cash flow generation and low leverage. However, UPM is making substantial investments in a large eucalyptus pulp mill in Uruguay and a biofuel refinery in Germany. The two projects involve more than €3.5 billion of capex over 2020-2023. We therefore forecast that UPM's credit metrics will deteriorate in 2022 compared with previous years, before starting to recover in 2023, but will remain in line with the current rating.

UPM has significant financial headroom under the current rating. However, its cash flow generation is prone to volatility because of its exposure to pulp and graphic paper, where periods of overcapacity can depress prices.

UPM has an indirect share in nuclear power plants operated by Teollisuuden Voima Oyj (TVO) through its shareholding in Pohjolan Voima Oy (PVO), from which it buys electricity at cost. UPM's indirect share is 33% in Olkiluoto 1 and 2 and 31% in Olkiluoto 3.

Although UPM does not provide a guarantee for any of TVO's debt, all shareholders in TVO are obliged to cover their proportionate share of TVO's fixed and variable costs related to energy generation (including interest expenses). UPM has also indirectly provided funding to TVO in the form of shareholder loans through PVO to help fund a new, third reactor.

Despite certain ambiguities in TVO's and PVO's articles of association, UPM considers that its liabilities do not extend beyond the generation costs of the electricity it purchases from PVO.

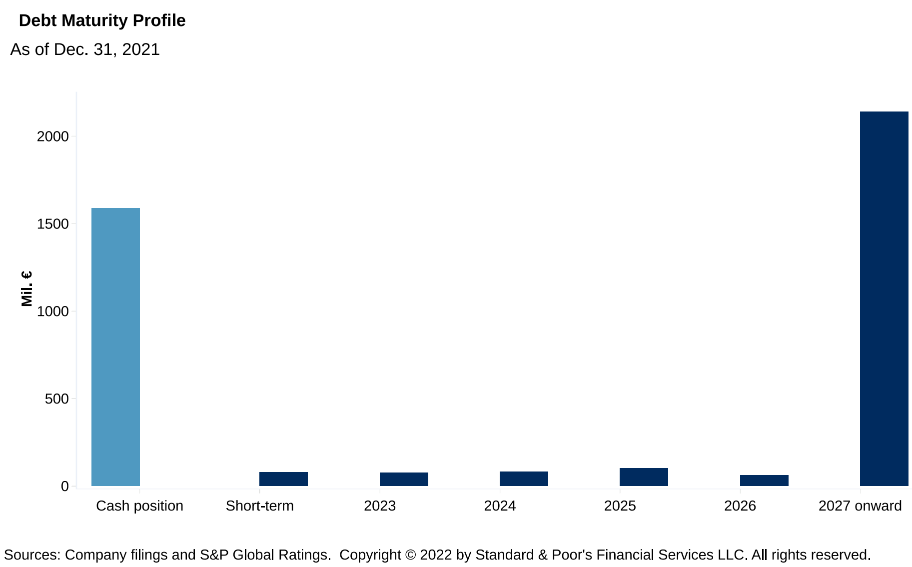
In the current context of skyrocketing energy prices, we acknowledge that UPM benefits from a key competitive advantage as it has a stable source of electricity, bought at nuclear production cost which is markedly below recent market prices. UPM will further benefit from the start of commercial production of the Olkiluoto 3 nuclear power to Finland's national grid in September 2022.

Although we do not adjust UPM's debt for any of TVO's liabilities, we continue to monitor the benefit for UPM of its indirect shareholding in TVO versus its obligations, and factor the cost of its electricity (corresponding to its proportional share of fixed and variable costs) into our base-case forecasts.

UPM's current credit metrics remain in line with a minimal financial risk profile with adjusted leverage expected to increase to 1.0x-1.5x at year-end 2022 and remain broadly stable by year-end 2023. However, the group's financial policy in terms of leverage specifies a maximum net debt to EBITDA of 2.0x (corresponding to about 2.5x on an adjusted basis), which allows UPM to make further shareholder returns via dividend payments or share buybacks, or make large debt-funded investments.

We therefore apply a negative financial policy modifier that adjusts our 'a-' anchor for UPM downward by two notches to 'bbb', reflecting that leverage could increase significantly from what we assume in our base case.

Debt maturities



UPM-Kymmene Corp.--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	9,812	10,010	10,483	10,238	8,580	9,814

UPM-Kymmene Corp.--Financial Summary

EBITDA	1,615	1,691	1,971	1,832	1,314	1,833
Funds from operations (FFO)	1,400	1,419	1,675	1,623	1,128	1,523
Interest expense	95	79	61	45	35	28
Cash interest paid	69	56	43	33	41	35
Operating cash flow (OCF)	1,726	1,610	1,385	1,843	1,001	1,241
Capital expenditure	343	304	350	399	871	1,512
Free operating cash flow (FOCF)	1,383	1,306	1,035	1,444	130	(271)
Discretionary cash flow (DCF)	983	799	422	751	(586)	(976)
Cash and short-term investments	992	716	888	1,536	1,720	1,560
Gross available cash	992	716	888	1,536	1,720	1,560
Debt	2,223	1,221	720	230	768	1,466
Common equity	8,238	8,664	9,797	10,174	9,513	11,106
Adjusted ratios						
EBITDA margin (%)	16.5	16.9	18.8	17.9	15.3	18.7
Return on capital (%)	9.7	11.6	14.1	12.7	7.4	11.4
EBITDA interest coverage (x)	16.9	21.4	32.1	40.7	37.5	65.5
FFO cash interest coverage (x)	21.2	26.4	39.6	50.2	28.5	44.5
Debt/EBITDA (x)	1.4	0.7	0.4	0.1	0.6	0.8
FFO/debt (%)	63.0	116.1	232.5	705.6	146.9	103.9
OCF/debt (%)	77.6	131.8	192.3	801.3	130.3	84.7
FOCF/debt (%)	62.2	106.9	143.7	627.8	16.9	(18.5)
DCF/debt (%)	44.2	65.4	58.6	326.5	(76.3)	(66.6)

Reconciliation Of UPM-Kymmene Corp. Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2021									
Company reported amounts	2,047	10,845	9,814	1,966	1,562	47	1,833	1,250	705	1,521
Cash taxes paid	-	-	-	-	-	-	(275)	-	-	-
Cash interest paid	-	-	-	-	-	-	(26)	-	-	-
Lease liabilities	574	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	487	-	-	1	1	3	-	-	-	-

Reconciliation Of UPM-Kymmene Corp. Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Accessible cash and liquid investments	(1,538)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	-	-	9	(9)	(9)	-	(9)
Share-based compensation expense	-	-	-	13	-	-	-	-	-	-
Dividends from equity investments	-	-	-	2	-	-	-	-	-	-
Income (expense) of unconsolid. cos.	-	-	-	(2)	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	1	-	-	-	-	-
Noncontrolling/ minority interest	-	261	-	-	-	-	-	-	-	-
Debt: Fair value adjustments	(104)	-	-	-	-	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	(14)	(14)	-	-	-	-	-
EBITDA: Business divestments	-	-	-	(133)	(133)	-	-	-	-	-
D&A: Asset valuation gains/(losses)	-	-	-	-	(111)	-	-	-	-	-
Interest: Derivatives	-	-	-	-	-	(31)	-	-	-	-
Total adjustments	(581)	261	-	(133)	(256)	(19)	(310)	(9)	-	(9)
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	1,466	11,106	9,814	1,833	1,306	28	1,523	1,241	705	1,512

Liquidity

The short-term rating on UPM is 'A-2', reflecting the long-term issuer credit rating and our assessment of UPM's liquidity as strong. Our liquidity assessment is based on our view that the group's liquidity sources will cover its uses by more than 1.5x over the next 12 months and by over 1.0x in the 12 months from March 31, 2022. UPM's liquidity is supported by low debt maturities and our view of high standing in credit markets.

Principal liquidity sources

- Available cash balance of about €1.4 billion on March 31, 2022;
- About €1.4 billion available under committed credit facilities; and
- Our forecast cash FFO of about €1.55 billion-€1.65 billion.

Principal liquidity uses

- About €175 million of debt repayment including commercial paper;
- Capex of about €1.33 billion.
- Working capital outflows of about €200 million-€300 million; and
- Dividend payments of about €693 million.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental, social, and governance (ESG) factors are an overall neutral consideration in our credit rating analysis of UPM. Like other forest and paper companies, UPM faces the long-term risk that climate change could affect its forests. We see Finnish and Uruguayan forests as less exposed to this risk, given that they are located relatively far from the Equator and where an increase in temperature could result in higher yields while fire and disease risks would remain limited. Forest activities may generally benefit the environment, but we see risks arising from pulp and paper production given the use of chemicals and resultant greenhouse gas emissions.

In our view, the forest and paper product industry has significant and above-average environmental exposures. At the same time, we believe that UPM is better positioned than the sector average, given its focus on forest ownership, low-carbon energy generation, and ramping up production of sustainable substitutes for fuels and chemicals.

UPM focuses on sustainable forest management and plants about 50 million seedlings every year. All UPM's forests are certified and 84% of the wood it used in 2021 came from certified forests (that is, it met the requirements set by an independent third party for sustainable forest management). Wood harvesting levels are exposed to changes in weather conditions, even though the Finnish forest holdings would benefit from higher temperatures, which would result in higher yields but could also increase the risk of disease.

UPM emphasizes energy efficiency and low-emission energy generation via the production of hydro power, nuclear power, and biomass-based energy at its mills. Currently, about 70% of the fuels UPM uses are renewable. The company also increasingly focuses on sustainable substitutes for fuels and chemicals, with the ongoing construction of a 220 kiloton biochemical refinery in Germany--for a total investment of €750 million and scheduled to start operating at end-2023--which will give UPM a first-mover advantage in the untapped market for renewable and sustainable substitutes for global glycols and carbon black and silica markets, with applications in a wide range of industries.

In 2020, UPM signed a €750 million revolving credit facility (RCF) with a margin tied to two sustainability indicators, involving biodiversity in its Finnish forests and the reduction of carbon dioxide emissions from fuels and purchased electricity. It also has bilateral facilities with the same sustainability indicators. In November 2020 and March 2021, the company issued green bonds of €750 million and €500 million, respectively, and signed a green finance framework in connection with this program, committing to invest in sustainable projects.

Issue Ratings--Subordination Risk Analysis

Capital structure

On March 31, 2022, the capital structure comprised $375 million 7.45% unsecured notes due November 2027; €750 million 0.125% unsecured notes due November 2028; and €500 million 0.500% unsecured notes due March 2031, all issued by UPM-Kymmene Oyj. It also comprised €594 million of lease obligation and €423 million of loan liabilities.

Analytical conclusions

The $375 million 7.45% unsecured notes due 2027 and €750 million 0.125% unsecured notes due November 2028 issued by UPM-Kymmene Oyj are both rated 'BBB', the same as the long-term issuer credit rating, because we have not identified any sources of significant structural subordination. We do not rate the €500 million 0.500% unsecured notes due March 2031.

Rating Component Scores

Foreign currency issuer credit rating	**BBB/Stable/A-2**
Local currency issuer credit rating	**BBB/Stable/A-2**
Business risk	**Satisfactory**
Country risk	Low
Industry risk	Moderately High
Competitive position	Satisfactory
Financial risk	**Minimal**
Cash flow/leverage	Minimal
Anchor	**a-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-2 notches)
Liquidity	Strong (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb**

Related Criteria

- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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
- ARCHIVE | Criteria | Corporates | Industrials: Key Credit Factors For The Forest And Paper Products Industry, Feb. 12, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- ARCHIVE | General Criteria: Group Rating Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (as of May 11, 2022)*

UPM-Kymmene Corp.	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Issuer Credit Ratings History	
24-Jul-2018	BBB/Stable/A-2
14-Feb-2017	BBB-/Positive/A-3
25-Aug-2016	BB+/Positive/B

*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.