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**Research Update:**

## Outlook On Swedish Steelmaker SSAB Revised To Positive On Strengthened Credit Metrics; Ratings Affirmed At 'B+/B'

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## Research Update:

# Outlook On Swedish Steelmaker SSAB Revised To Positive On Strengthened Credit Metrics; Ratings Affirmed At 'B+/B'

## Overview

- Significant debt reduction and a strengthening of the steel price environment has strengthened earnings and cash flow and improved credit metrics for Swedish steelmaker SSAB in 2016.
- We are therefore revising our outlook on the long-term ratings on SSAB to positive from stable and affirming the ratings at 'B+/B'.
- The positive outlook reflects our expectation that leverage should continue to decline in 2017 on the back of positive discretionary cash flow generation and no dividend payment. We expect debt to EBITDA of less than 4x and funds from operations (FFO) to debt of above 20% in 2017, as well as an ongoing strong liquidity position.

## Rating Action

On March 22, 2017, S&P Global Ratings revised the outlook on the long-term ratings on Swedish steelmaker SSAB AB to positive from stable. We affirmed our 'B+' long- and 'B' short-term corporate credit ratings.

At the same time, we affirmed our 'B+' issue ratings on SSAB's senior unsecured debt. The recovery rating on this debt is unchanged at '3' indicating our expectation of 50%-70% recovery in the event of a payment default.

## Rationale

The outlook revision reflects our view that SSAB has made good progress in debt and cost reduction amid improved steel market conditions in Europe and the U.S. following the introduction of import duties on Chinese steel, among others. We expect SSAB to continue to work toward its Swedish krona (SEK) 10 billion debt reduction target in 2017. In addition, we expect it to repay another SEK3.7 billion of debt in 2017 using existing cash and short-term deposits.

We expect higher shipments and prices in the near term and anticipate 2017 full-year EBITDA of more than SEK6 billion.

We continue to view favorably SSAB's 30% net debt-to-equity target, which is lower than 34% at Dec. 31, 2016. The company has generated positive

discretionary cash flow over the past three years, in 2016 helped by positive working capital movements and no dividend payment. We expect this to continue in 2017, helped by that fact that no distribution to shareholders is proposed.

SSAB operates in the highly cyclical steel industry, with end markets such as heavy transportation, construction, machinery, and mining. Metal prices typically move in line with demand and supply over the long term, and can be volatile in the short term, as happened in the second half of 2016.

SSAB's key strength is its strong market position in special-grade steel products. For example, it has a global market share of about 40% in quenched and tempered steels, along with about 5% in some advanced high strength steels, and around 25% market share in heavy plates in North America, according to its own estimates. Following the merger with Rautaruukki, it also commands a 40%-50% share in the flat carbon steels and tubes market in the Nordic region.

In our opinion, the main challenges for SSAB are the risk of new specialty grade steel capacity from competitors and the pace of take-up of special-grade steel products by equipment manufacturers.

In our base case for SSAB, we assume:

- EBITDA of around SEK6 billion per year in 2017 and 2018. This improvement from 2015 reflects a full run rate of cost savings and higher industry margins in the U.S. and Europe.
- Capital expenditures (capex) of SEK2 billion annually.
- No dividend in 2017 and 50% of net income thereafter.

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures:

- FFO to debt of 20%-25% in 2017 and 25%-30% in 2018.
- Debt to EBITDA of 3.0x-4.0x in 2017 and 2.5x-3.5x in 2018.

## **Liquidity**

We assess SSAB's liquidity as strong because we forecast the company's liquidity sources will cover its uses by more than 2x over the next 24 months. The company passes the new net debt to equity covenant of 60% comfortably in this assessment.

Principal liquidity sources for the 12 months from Dec. 31, 2016 are:

- Cash and cash equivalents of SEK5.7 billion. This includes SEK1.8 billion of pledged cash, which we understand will be used to retire short-term debt in 2017.
- Availability under long-term committed credit lines of SEK7 billion.
- FFO of about SEK4.5 billion-SEK5.0 billion over the coming 12 months (our estimate).

Principal liquidity uses for the same period are:

- Short-term debt of SEK5.3 billion, including off-balance-sheet receivable securitization.

- Capex of about SEK2 billion in 2017.
- No dividend payment in 2017.

## Outlook

The positive outlook reflects our expectation that leverage should continue to decline in 2017 on the back of positive discretionary cash flow generation and no dividend payment. We expect debt to EBITDA of less than 4x and FFO to debt of above 20% in 2017 (4.1x and 18.4% for 2016, respectively), while SSAB maintains a strong liquidity position. We view positively the improved market conditions in Europe and the U.S., helped by antidumping measures taken by the relevant authorities.

### Downside scenario

We could revise the outlook back to stable if adjusted debt to EBITDA remained above 4x. This could occur if market conditions deteriorated, resulting in neutral discretionary cash flow. Moreover, we could remove the one-notch uplift we currently factor into the ratings on SSAB for its strong liquidity position if it weakened, potentially prompting our reassessment of the outlook and/or rating.

### Upside scenario

We could consider an upgrade if SSAB were to sustainably maintain lower leverage, with debt to EBITDA comfortably in the 3x-4x range and FFO to debt of 20%-30%, in a mid-cycle environment.

## Ratings Score Snapshot

Corporate Credit Rating: B+/Positive/B

Business risk: Weak

- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (+1 notch)
- Financial policy: Adequate (no impact)
- Management and governance: Satisfactory (no impact)

- Comparable ratings analysis: Neutral (no impact)

## **Recovery Analysis**

### **Key analytical factors**

- SSAB's senior unsecured debt has an issue rating of 'B+' and recovery rating of '3'. The recovery rating is underpinned by SSAB's substantial asset base, and minor prior-ranking liabilities, offset by the unsecured nature of the debt and substantial debt at pari passu level. Recovery is about 55% and may come under downward pressure if SSAB incurs additional secured debt.
- In our hypothetical payment default scenario, we take into account our view of the cyclical nature of the markets in which SSAB operates, and sustained weakness in steel demand that leads to a drop in volumes, utilization rates, and prices.
- We value SSAB as a going concern, given its strong position in the heavy plate market in North America and in special-grade steel products, and its competitive assets.

### **Simulated default assumptions**

- Year of default: 2021
- EBITDA at emergence: SEK3.5 billion
- Implied enterprise value multiple: 5.5x
- Jurisdiction: Sweden

### **Simplified waterfall**

- Net value available to creditors (after administrative costs): SEK18.4 billion
- Priority claims: SEK2.8 billion
- Senior unsecured debt claims: SEK27.9 billion\*
- Recovery expectation: 55%

\*All debt amounts include six months of prepetition interest.

## **Related Criteria**

- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 07, 2016
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Downstream Industry, Dec. 20, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
SSAB AB		
Corporate Credit Rating	B+/Positive/B	B+/Stable/B
Senior Unsecured	B+	B+
Recovery Rating	3(55%)	3(55%)

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