

# Rating Actions Taken On Four Russian And European Steel Companies As A Bad 2019 Turns Into A Worse 2020

**March 31, 2020**

- The coronavirus pandemic is weakening European steel demand and production.
- With European GDP contracting by 4% or more in the second quarter of 2020, the slump in the demand for steel will be a multiple of this.
- Governments and companies are shutting down production facilities across the continent.
- For now, margins are also suffering from resilient raw material prices for iron ore and coking coal.
- We are therefore revising our outlooks on NLMK, MMK, and SSAB, and placing Metinvest on CreditWatch with negative implications.

LONDON (S&P Global Ratings) March 31, 2020--S&P Global Ratings today took the following rating actions on four Russian and European steel companies:

- We revised our outlook on NLMK PJSC to stable from positive and affirmed the 'BBB-' rating.
- We revised our outlook on Magnitogorsk Iron and Steel Works (MMK) PJSC to stable from positive and affirmed the 'BBB-' rating.
- We revised outlook on SSAB AB to negative from stable and affirmed the 'BB+' rating.
- We placed our 'B' rating Metinvest B.V. on CreditWatch with negative implications.

The rating actions reflect the anticipated collapse in demand and deterioration of operating conditions following the spread of the coronavirus across Europe.

After an already challenging 2019, European steel producers are facing a very difficult second quarter with uncertain recovery prospects later in 2020. The effects on ratings varies, in part reflecting which plants are still operating and what measures and supports are in place. Importantly--unlike the oil markets--moderating supply in the face of contracting demand should soften the blow. Also, governments' financial support schemes for workforces could alleviate cash costs.

At this stage, projecting EBITDA for 2020 is challenging, with so much uncertainty about key variables. According to preliminary calculations, and if taking broad assumptions of lower deliveries of up to 10% compared to 2019, and EBITDA margins declining by up to 250 bps, the steelmakers could see profitability shrinking by 15%-50% in 2020. But mitigation measures are

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likely to offset the blow.

## **Three months into 2020, the European steel industry is taking a dramatic turn**

With more governments deciding on lockdowns, we are seeing a collapse in demand for steel. The perfect storm that hit the European steel industry in 2019, fuelled by the automotive industry and very high commodity prices, was seen three months ago as a one-off. Our previous expectations for improved demand from the automotive industry and very low inventory levels led us to believe that a recovery, even if muted, was on the way.

The evolution of the COVID-19 pandemic will determine how the steel industry will look in 2020, and we believe companies will need to take quick steps to cut production amid unknown demand. We understand that steel companies started this year with encouraging order intakes, which continued into March. However, order intakes in the second quarter are likely to fall by up to 50%, especially for the flat steel that goes to the automotive and machinery industries.

In our view, unless widespread COVID-19 lockdowns continue into late 2020, we assume that most of the drop in the demand for steel will be only temporary, before rapidly recovering until normal levels are reached toward mid-2021. At this stage, compared to 2019 we assume 2021 steel demand to be about 2% lower in Europe, and up to 1% lower in the U.S. (in 2021 compared to 2019).

Overall, compared to the financial crisis in 2009, we assume this downturn to be less severe. In 2019, European GDP contracted by slightly more than 5%; the demand for steel collapsed by 40% before bouncing back by about 25% in the following year.

## **The name of the game is companies' ability to adjust their production, balancing between timing and magnitude**

Unlike the mini-mills in the U.S., which can turn production on and off fairly quickly, the blast furnaces in Europe are subject to longer lead times and higher costs. In this respect, European steelmakers are in limbo: should they keep facilities running on the assumption of back to normality in a few weeks, or shut down capacity assuming the low part of the cycle is still ahead of us?

The answer seems to be the latter--reflecting very low expected demand in the second quarter and absent a clear path to recovery. Some recent announcements include ArcelorMittal, Tata Steel Europe, and Liberty Steel. These were mainly linked to the production of the flat products that are being used in the severely affected automotive industry. We view as a game changer the growing number of governments allowing companies to temporarily reduce their workforce without extra costs. It should allow companies to slash their fixed costs, and to accelerate some decisions about production levels. For example, when ArcelorMittal decided to shut down its Italian operations it reduced its workforce by 5,000.

## **The last crisis changed the European steel industry;will this one bring more changes?**

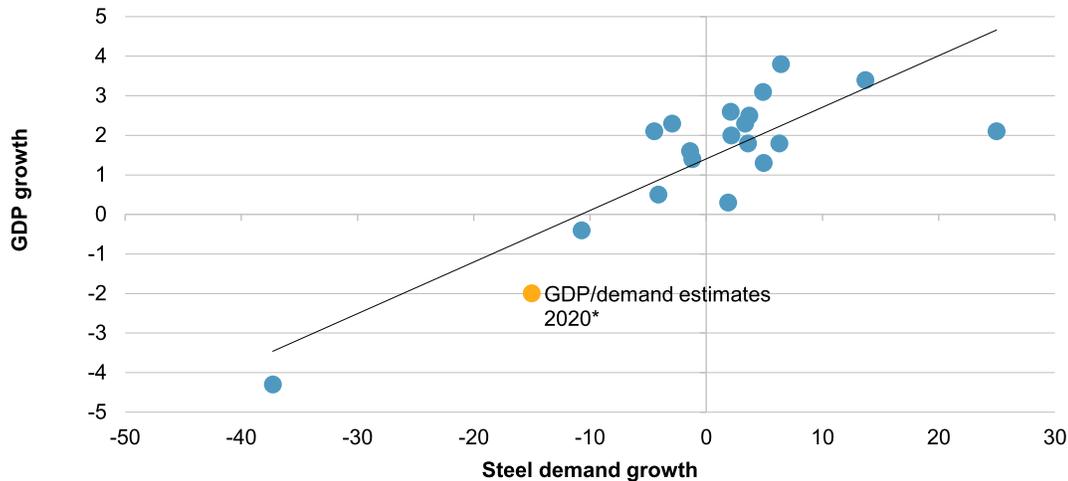
In 2009, steel production in Europe collapsed by 35% to about 140Mt from the industry's peak in 2007 (about 210Mt). We have since seen a recovery of the steel industry in Europe, but production

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never came even close to pre-crisis levels. In 2018, the European industry produced 160Mt of steel, before demand reduced in 2019. Over this decade, the industry in Europe transformed from being a steel exporter to a steel importer. In our view, if the demand for steel by end-2021 remains at the same level, current trade barriers stay in place, and more companies place more emphasis on local production as a key takeaway from the COVID-19 pandemic, we would not expect companies to permanently mothball significant capacity.

Chart 1

### Steel Demand Growth Rate To GDP Growth



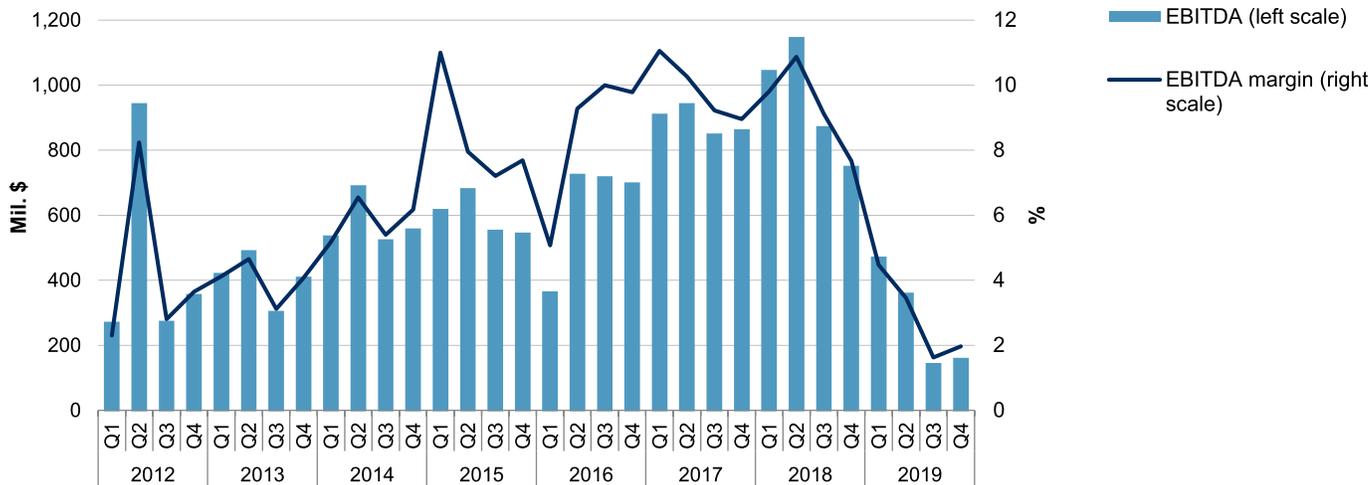
Source: S&P Global Ratings, World Steel Association, World Bank. \*World Steel Association and S&P Global Ratings' forecast.

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The sector's volatility is highlighted by chart 2, which shows the variation in ArcelorMittal's European EBITDA since 2012.

Chart 2

**ArcelorMittal's European Division**



Source: S&P Global Ratings and Arcelor Mittal Quarterly Reports.  
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**Iron ore and coking coal prices remain resilient for now**

Despite the growing concerns around the global economy, iron ore prices remain elevated at above \$80 per ton. Total production is expected to decrease by about 40Mt-50Mt in 2020 before recovering fully and starting from 2021. Coking coal prices are currently trading at about \$160 per ton. Lower demand for steel should put pressure on prices, but lower supply due to COVID-19-related business disruptions in the mining industry will offset softer demand. For example, last week Anglo American said that its South African iron ore division production will reduce by 2Mt-3Mt because the workforce at its two mines will be halved. In our view, with demand for 60% of global iron production, China will continue to set the tone for raw material prices in the coming quarters, notably via its ability to stimulate the economy post-pandemic.

We understand that governments continue to view mining as an essential industry, and intend to keep it open, together with rail and port logistics infrastructure, while other aspects of their economies are under lockdowns.

**Rating Action Rationales and Outlooks**

**SSAB**

The outlook revision to negative reflects a potential downgrade within the coming 12 months on the back of an expected global recession and a second year of challenging steel market conditions. After it reported weaker-than-expected results in 2019, with EBITDA of about Swedish krona (SEK) 6.4 billion, we expected SSAB to see some recovery in 2020 and continue its

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deleveraging journey. However, with a sharp drop in demand for steel in Europe and the U.S., we have lowered our EBITDA assumption to SEK5.0 billion-SEK6.0 billion, from an already reduced SEK7.0 billion, translating to funds from operations (FFO) to debt of 35%-40%. At the same time, we expect the company to generate positive free operating cash flow (FOCF), which is the main reason we are affirming the rating at 'BB+'. In comparison with the last downturn in 2015, SSAB has had several years to improve its cost structure and product offering and its leverage is much lower. In addition, under new government schemes where it operates, the company will have more flexibility to introduce temporary layoffs, which should further improve its ability to flex its overall production and costs.

We believe SSAB's commitment to maintain a prudent financial policy and strong liquidity, notably its objective of reducing its overall debt, will also be key to maintaining the current rating. As of Dec. 31, 2019, adjusted debt was SEK14.7 billion (equivalent to reported net debt of SEK11.6 billion), compared with SEK12.6 billion in 2018. In our view, the company's capacity to allocate another SEK0.5 billion-SEK1.0 billion to net debt reduction in 2020 will further support its ability to absorb inherent steel market volatility. However, we expect deleveraging to now take longer than we previously forecast. On a positive note, post its earning release in January, the company decided to propose no dividend payments to its annual general meeting this year, compared with the previous announcement of SEK1.5 billion.

### Outlook

The negative outlook reflects that we could lower the rating in the coming six-to-12 months if the company's business model proved less resilient than peers' and its debt trajectory turned negative.

Under our base case, we now project adjusted EBITDA of SEK5.0 billion-SEK6.0 billion in 2020, translating to adjusted FFO to debt of 35%-40%, which is below our expectation of 45% at the bottom of the cycle (or above 60% under normal conditions). At the same time, we expect the company to generate positive FOCF of slightly more than SEK1 billion.

#### DOWNSIDE SCENARIO

We are likely to take a negative rating action upon one of the following:

- If the current recession was more severe and extended beyond 2020, hampering the company's ability to restore its credit metrics to 45% in 2021.
- EBITDA dropped below SEK5.0 billion in 2020, a level we witnessed in the last downturn.
- A deviation from the current financial policy, including embarking on an aggressive growth strategy or very sizable dividends, prompting much higher debt.

#### UPSIDE SCENARIO

We could revise the outlook to stable if we see positive signs of a global economic recovery, supporting improved results for SSAB in 2021, with adjusted FFO to debt recovering back to 45%.

### Metinvest

We have placed our 'B' rating on Metinvest on CreditWatch with negative implications due to the risk of a financial-covenants breach if the company doesn't achieve EBITDA of at least \$300 million in the second quarter. Current economic conditions mean the company's ability to achieve this is less visible (in fourth-quarter 2019 it reported EBITDA of negative \$17 million, excluding

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negative \$4 million from JVs, and we expect EBITDA of around \$300 million in first-quarter 2020). At the same time, we believe that pre-export finance (PXF) lenders are more likely to amend the covenants if this is requested, which is why we have not lowered the rating for now.

Looking beyond the immediate liquidity concerns, we previously saw 2020 as a pivotal year for Metinvest because it is about to complete several important projects in its steel division and it had weaker-than-expected results in 2019. We now forecast reported EBITDA of \$1.1 billion-\$1.3 billion in 2020, compared with the \$1.5 billion-\$1.7 billion we assumed when upgrading the company in September 2019 (see "Metinvest Upgraded To 'B', Outlook Stable; Proposed Senior Unsecured Notes Assigned Preliminary 'B' Rating"). In 2019, Metinvest continued to rely on its mining division, which benefited from iron ore price levels, while the steel industry contributed negative EBITDA of \$48 million (excluding negative \$59 million contribution from JVs) to the overall \$1.05 billion (excluding \$163 million from JVs). With low demand for steel in Europe in 2020, we expect the company to count once again on iron ore prices staying at current levels. Other supportive factors for performance this year include low energy prices and the depreciation of the local currency. We continue to view a minimum EBITDA of \$1.2 billion as a key anchor for the rating, supporting our current competitive business assessment, as well as the company's ability to achieve adjusted FFO to debt of 20%-40% through the cycle.

### CreditWatch

We expect to resolve the CreditWatch in the coming three months once we have better visibility on the company's first-half results, or if it secures an amendment from PXF lenders in relation to the upcoming financial covenant test. Although we believe the risk of a covenant breach has increased, we also think that a waiver or amendment is more likely. Absent such an agreement, a covenant breach may lead to debt acceleration.

### NLMK

The revision of the outlook to stable reflects uncertainties about near-term economic prospects, demand/supply and pricing for steel and raw materials, potential protection measures, and supply chain disruptions in the international steel markets. It also reflects our revised expectation that GDP will contract in Russia by 0.9%, from 1.8% growth previously, which, coupled with COVID-19 spread prevention measures, would result in a reduction in steel demand. At the same time, we continue to believe that NLMK's FFO to debt will remain above 60% on average, unless there is a major disruption to the group's operations.

Under our current base case, which assumes up to 5% lower sales and 5%-10% lower average selling prices, we forecast that NLMK's EBITDA will only decline to \$2.1 billion-\$2.3 billion in 2020 from \$2.6 billion 2019. We note that the depreciating ruble, which has lost about 25% of its value since the beginning of 2020, will mitigate lower selling prices and volumes, as roughly 70% of NLMK's costs are nominated in rubles. NLMK's nearly full integration into raw materials, which are produced in Russia, and the cheaper ruble will allow NLMK to remain among the most competitive steel producers globally in 2020, in our view.

A major event risk for NLMK currently would be its reliance on a single site in Lipetsk, Russia, where most of its crude steel is produced. Any operational disruptions or closure due to COVID-19 could have operational effects far beyond our current base case. We view this as unlikely given that producers in China generally did not halt production during the acute phase of the pandemic in February, and we do not include this scenario in our base case at the moment.

The unavailability of export markets due to supply chain disruptions or protection measures is

another risk. However, although close to 15% of NLMK's sales are made in Europe (and about an additional 45% in other export markets) it could (and has done previously) export to Asian markets and the U.S. Diverting most exports from Europe would result in lower margins given that we expect competition to intensify in 2020, but would enable the company to remain profitable. Such scenario, however, is not part of our current base case.

## **Outlook**

The stable outlook balances NLMK's currently very significant financial cushion with our expectation of bottom-of-the-cycle conditions for the steel market in 2020 and risks related to the COVID-19 pandemic. We believe that NLMK's ratio of FFO to debt will be well above the 45% we see as commensurate with the current rating during this trough in the steel industry (60% when conditions are benign). Our current base case for 2020 assumes resilient EBITDA of \$2.1 billion-\$2.3 billion, supported by the weaker ruble, resulting in FFO to debt of 75%-80% this year with further improvement as markets stabilize in 2021. Importantly, we expect the company to generate neutral cash flow after dividends in line with its conservative financial policy.

### **UPSIDE SCENARIO**

We could eventually upgrade NLMK if market conditions get back to normal and the company demonstrates business resilience and commits to a conservative financial policy, with a moderate decline in EBITDA during the downturn, and keeps FFO to debt above 60%.

### **DOWNSIDE SCENARIO**

While currently unlikely, we may lower the rating if earnings decline severely, say as a result of a steep decline in GDP and steel demand in NLMK's Russian market combined with increased trade barriers in its key export markets. Also, if we were to lower the Russian sovereign rating below 'BB+' this would likely lead us to downgrade NLMK as we do not expect to rate NLMK more than one notch above the Russian sovereign.

## **MMK**

The revision of the outlook to stable reflects uncertainties about near-term economic prospects, demand/supply and pricing for steel and raw materials, potential protection measures, and supply chain disruptions in the international steel markets. It also reflects our revised expectation that GDP will contract in Russia by 0.9%, from 1.8% growth previously, which, coupled with COVID-19 spread prevention measures, would result in a reduction in steel demand. At the same time, we continue to believe that MMK's FFO to debt will remain above 60% on average, unless there is a major disruption to the group's operations.

We forecast that MMK's EBITDA will decline to \$1.1 billion-\$1.5 billion in 2020 from \$1.8 billion 2019. We expect EBITDA contraction in 2020 to be more pronounced at MMK than for some of its Russian peers. This is because MMK is the least integrated into raw materials of all the Russian steel producers, and therefore will not be able to reap the full benefits of the depreciating ruble, which has lost roughly a quarter of its value since the beginning of the year, as it will have to buy raw materials at market prices set in foreign currencies. In our 2020 forecast for MMK, we are incorporating an iron ore price of \$75 per metric ton; should the prices fall below this level, the effect on MMK's EBITDA would be positive.

At the same time, we do not expect MMK's leverage to become meaningful in 2020, as the company's debt was below its cash balances at the beginning of 2020 and, thanks to its financial policy, we do not expect MMK to accumulate more than \$100 million of additional debt during this

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year. We therefore anticipate MMK's FFO to debt to be much higher than 60% in the coming years, including 2020.

A major event risk for MMK currently would be its reliance on a single site in Magnitogorsk, Russia, where most of its crude steel is produced. Any operational disruptions, or its closure due to COVID-19, could have operational effects far beyond our current base case. We view this as unlikely given that producers in China generally did not halt production during the acute phase of the pandemic in February, and we do not include this scenario in our base case at the moment.

Although MMK's exports generate less than 20% of its revenues, if export markets become effectively closed for its competitors--due to logistics issues or protection measures across the globe (not our current base case)--competition in the domestic market could intensify. Although domestic prices in Russia reflect international ones, domestic premiums, which have traditionally ensured that prices in Russia stayed \$50-\$70 higher than in Europe, could diminish. This, coupled with much lower demand, could further hurt MMK's profitability, although it would still be well positioned in its core sales region of Urals, where Magnitogorsk is located, and Western Siberia, thanks to cheaper logistics and established customer relationships.

### Outlook

The stable outlook balances MMK's currently very significant financial cushion with our expectation of bottom-of-the-cycle conditions for the steel market in 2020 and risks related to COVID-19. We believe that MMK's ratio of FFO to debt will be well above the 45% we see as commensurate with the current rating during this trough in the steel industry (60% when conditions are benign). Our current base case for 2020 assumes resilient EBITDA of \$1.1 billion-\$1.5 billion, partly supported by the weaker ruble, resulting in FFO to debt of above 100% in 2020 and the coming years. Importantly, we expect the company to generate neutral cash flow after dividends in line with its conservative financial policy.

#### UPSIDE SCENARIO

We could eventually upgrade MMK if the company demonstrates business resilience and commits to a conservative financial policy with moderate decline in EBITDA during the downturn and keeps FFO to debt above 60%.

#### DOWNSIDE SCENARIO

While currently unlikely, we may lower the rating if there is a severe decline in earnings say from a steep decline in GDP and steel demand in its key Russian market combined with increased trade barriers in its export markets. Also, if we were to lower the Russian sovereign rating below 'BB+' this would likely lead us to downgrade MMK because we do not expect to rate MMK more than one notch above the Russian sovereign.

## Other Companies In The Spotlight

### ArcelorMittal (BBB-/Negative/A-3)

After weaker-than-expected results in FY2019, and the hope for a recovery in FY2020 (see "ArcelorMittal Counts On 2020 Steel Demand Increase Following Weaker-Than-Expected Results," Feb. 11, 2020), we now expect ArcelorMittal to experience its weakest year since the last crisis in 2009. Under our base-case scenario, we expect credit metrics like FFO to debt to remain well below 20%, for the second consecutive year, compared to the 25% threshold commensurate

with the 'BBB-' rating. We also continue to put most of our emphasis on the company's ability to generate FOCF and its commitment to maintaining an investment grade rating. On top of the measures the company has taken over the last few years to improve its cost structure, we believe that the new schemes allowing the company to temporary reduce its workforce without extra costs and to idle capacity will play a key role in offsetting some of current pressure.

### Thyssenkrupp AG (BB/Positive/B)

Following the sale agreement of the elevator business in early March, we revised the outlook on the rating to positive (see "Thyssenkrupp Outlook Revised To Positive On Expected Cash Inflow From Sale Of Elevator Business," March 4, 2020). Once the sale has closed, the company will start a new journey with much less debt on its balance sheet but with higher exposure the cyclical and less-profitable steel industry. We are likely to raise the rating once the transaction closes as planned and we gain clarity on the remaining group's new strategic direction and capital allocation.

### Groupe Ecore Holding (B-/Stable)

The downgrade to 'B-' with a stable outlook came after the company reported weaker-than-expected results in 2019 on the back of a contraction of the European steel industry in 2019. This is now also expected to continue in 2020 (see "French Ferrous Metals Recycler Groupe Ecore Holding Downgraded To 'B-' On Weaker Market Conditions; Outlook Stable," March 12, 2020). Based on preliminary indications, 2020 started with a good order intake but profitability remained subdued. However, the positive momentum has changed as more manufacturing facilities have shut down in the last few weeks following the COVID-19 pandemic. We expected credit metrics to remain elevated, but a comfortable maturity profile (debt maturity in 2023) and the ability to generate positive free cash flow at the bottom of the cycle remain the key considerations supporting the current rating.

### Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 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 | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013

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- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- Global Macroeconomic Update, March 24: A Massive Hit To World Economic Growth, March 24, 2020
- Metal Price Assumptions: Oil Prices And The Coronavirus Dulls Demand For Most Metals, March 16, 2020
- Research Update: French Ferrous Metals Recycler Groupe Ecore Holding Downgraded To 'B-' On Weaker Market Conditions; Outlook Stable, March 12, 2020
- Bulletin: ArcelorMittal Counts On 2020 Steel Demand Increase Following Weaker-Than-Expected Results, Feb. 11, 2020
- ESG Industry Report Card: Metals And Mining, Feb. 11, 2020
- Bulletin: SSAB Needs To Demonstrate Resilience To Challenging Steel Markets In 2020, Jan. 30, 2020
- Metal Bashing: European Steel Is Going Through The Mill (Again), Oct. 11, 2019

## Ratings List

\*\*\*\*\* Magnitogorsk Iron and Steel Works PJSC \*\*\*\*\*

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
<b>Magnitogorsk Iron and Steel Works PJSC</b>		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Positive/A-3

\*\*\*\*\* Metinvest B.V. \*\*\*\*\*

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
<b>Metinvest B.V.</b>		
Issuer Credit Rating	B/Watch Neg/--	B/Stable/--

\*\*\*\*\* NLMK PJSC \*\*\*\*\*

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
<b>NLMK PJSC</b>		
Issuer Credit Rating	BBB-/Stable/--	BBB-/Positive/--

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\*\*\*\*\* SSAB AB \*\*\*\*\*

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### Ratings Affirmed; CreditWatch/Outlook Action

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	To	From
<b>SSAB AB</b>		
Issuer Credit Rating	BB+/Negative/B	BB+/Stable/B

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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