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Research Update:

Swedish Steelmaker SSAB 'BB-' Ratings Put On CreditWatch Negative On Weak Credit Metrics And Flagging Market Conditions

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Overview

- Weak conditions in the steel markets will likely result in significantly lower-than-expected EBITDA for 2015 for Swedish steelmaker SSAB AB, and, as a result, SSAB's leverage metrics will continue to be well below our expectations.
- We have reassessed SSAB's liquidity as strong from adequate following debt maturity extensions in 2015.
- We are placing our 'BB-' long-term ratings on SSAB on CreditWatch negative, and affirming the 'B' short-term rating.
- The CreditWatch placement reflects the possibility of a one-notch downgrade in the coming quarters, if we believe SSAB is unlikely to reach FFO to debt of about 15% in 2016. Downside pressure on the ratings could also depend on the duration and severity of the current downturn in the steel industry.

Rating Action

On Dec. 21, 2015, Standard & Poor's Ratings Services placed its 'BB-' long-term corporate credit rating on Swedish steelmaker SSAB AB on CreditWatch with negative implications and affirmed the 'B' short-term rating. We also placed on CreditWatch negative our 'BB-' issue ratings on SSAB's senior unsecured debt. The '3' recovery rating on this debt is unchanged, indicating our expectation of meaningful recovery, in the lower half of the 50%-70% range, in the event of a payment default.

Rationale

The CreditWatch placement follows the company's profit warning for the fourth quarter of 2015 of less than Swedish krona (SEK) 250 million (about €27 million) EBITDA. We understand that Chinese, Russian, and Korean exports into Europe and the U.S. are putting significant downward pressure on prices and that key buyers have adopted a wait-and-see approach in view of rapidly falling iron ore prices.

Consequently, our adjusted EBITDA projection for 2015 may stand at about SEK4 billion (about €0.43 billion), falling markedly short of our previous expectation of about SEK6 billion (see "SSAB AB," published June 26, 2015, on RatingsDirect). Although the company expects to see better results in the

first quarter of 2016, we think the extent of market improvements remain unclear. Furthermore, the prolonged downturn in the global steel markets has created hurdles for SSAB in meeting the rating threshold of funds from operations (FFO) to debt of about 15% in 2016. We expect that the company's FFO to debt will likely be a mere 12% for 2015 (corresponding to debt to EBITDA above 6x). Still, we anticipate benefits of more than SEK1 billion year on year in 2016 thanks to synergies from the merger with Finnish steelmaker Rautaruukki Oyj (Ruukki) and from other cost efficiency measures.

SSAB's credit metrics are currently weak for our aggressive financial risk category. We acknowledge that the company has generated positive discretionary cash flow over the past three years. Also, shareholders have been supportive of lower dividend payments in times of weak cash generation, and we revised SSAB's liquidity to strong from adequate following the extension of the company's debt maturities.

SSAB operates in the highly cyclical steel industry, with end markets such as heavy transportation, construction, machinery, and mining. Volumes typically move in line with GDP over the long term, and can be volatile in the short term.

SSAB's strong market position in special-grade steel products is a key strength of its business risk profile. For example, SSAB has a global market share of about 40% in quenched and tempered, along with about 5% in some advanced high strength steels, and 20%-25% market share in heavy plates in North and South America, according to company estimates. Also, following the merger with Ruukki, SSAB has a 40%-50% share in the flat carbon steels and tubes market in the Nordic region.

In our opinion, key 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.

Under our base case, we assume:

- Revenue growth driven by full year contribution from Ruukki.
- Realized synergies in line with the company's public guidance.
- Capital expenditures of about SEK2.7 billion in 2015 and SEK2.0 billion in 2016.
- Low dividends in 2016.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted EBITDA of SEK4 billion in 2015, rising in 2016 on the back of Ruuki synergies, but equally depending on markets somewhat improving from currently depressed conditions.
- FFO to debt 12% or lower in 2015 and, depending on the extent of the market recovery, about 15% in 2016.
- Positive discretionary cash flow in 2015 and 2016.

Liquidity

Our strong assessment of SSAB's liquidity is based on our projection that the company's liquidity sources will cover its uses by 1.5x on a sustainable basis. Underpinning our assessment is the company's comfortable debt maturity profile, with an average term of 4.8 years. SSAB also has considerable undrawn committed long-term bank lines and no financial covenants in its loan agreements.

We calculate the following principal liquidity sources as of the end of September 2015:

- Cash and cash equivalents of SEK1.4 billion.
- Availability under long term committed credit lines of SEK8.5 billion.
- Estimated FFO of about SEK4.0 billion, depending on the degree of market recovery.

For the same period, we calculate the following principal liquidity uses:

- Short-term debt of about SEK5.0 billion, SEK4 billion of which is commercial paper.
- Capital expenditures of about SEK2.2 billion.
- Peak working capital swings of about SEK500 million.
- Limited dividends, given that shareholders have demonstrated a willingness to forgo dividend payments when needed.

CreditWatch

The CreditWatch reflects the risk of a one-notch downgrade if we observe that SSAB is unlikely to achieve FFO to debt of about 15% in 2016, the threshold for our 'BB-' rating. We believe volumes are key to SSAB's performance, and we will closely monitor market conditions--including any upside from recently announced price increases--and order intake over the coming quarters. Once we can evaluate the extent of EBITDA recovery in the first quarter of 2016, we aim to resolve the CreditWatch, most likely in the second quarter of 2016. Rating downside could, however, also stem from a reassessment of SSAB's business risk profile, given the protracted depressed steel market conditions globally and SSAB's highly volatile and difficult-to-predict earnings.

Ratings Score Snapshot

Corporate Credit Rating: BB-/Watch Negative/B

Business risk: Fair

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

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Metals And Mining Upstream Industry, Dec. 20, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009

Related Research

- SSAB AB, June 26, 2015

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
SSAB AB		
Corporate Credit Rating	BB-/Watch Neg/B	BB-/Stable/B
Senior Unsecured	BB-/Watch Neg	BB-
Recovery Rating	3L	3L

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