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Research Update:

Swedish Steelmaker SSAB Upgraded To 'BB-' On Strengthened Credit Metrics; Outlook Stable

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Table Of Contents

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Overview

- Stronger demand for steel and cost reduction have improved earnings, cash flow, and credit metrics for Swedish steelmaker SSAB over the past year.
- We expect that the company will continue to generate healthy discretionary cash flow in the next 12 months.
- We are therefore raising our long-term ratings on SSAB to 'BB-' from 'B+'.
- The stable outlook reflects our expectation that leverage will continue to decline over the coming 12 months on the back of a supportive industry environment and positive discretionary cash flow generation.

Rating Action

On Oct. 31, 2017, S&P Global Ratings raised its long-term corporate credit rating on Swedish steelmaker SSAB AB to 'BB-' from 'B+'. At the same time, we affirmed the 'B' short-term corporate credit rating. The outlook is stable.

We also raised our issue rating on SSAB's senior unsecured debt to 'BB-' from 'B+'. The recovery rating on this debt is unchanged at '3' indicating our expectation of meaningful recovery (50%-70%; rounded estimate: 55%) in the event of a payment default.

Rationale

The upgrade follows strong results reported for the first nine months of 2017 and 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, notably on steel from China.

It also reflects that we expect SSAB to continue to work toward its net debt reduction target of Swedish krone (SEK) 10 billion (€1,028 million) by the end of 2017. We expect it to repay another SEK4.5 billion of debt in 2017 and 2018 using existing cash and short-term deposits. We anticipate 2017 full-year EBITDA of above SEK7.5 billion (versus SEK5.2 billion in 2016 and SEK6 billion for the first nine months of 2017).

We continue to view favorably SSAB's 30% net debt-to-equity target, compared with the reported ratio of 27% on Sept. 30, 2017. The company has generated positive discretionary cash flow over the past three years, helped in 2016 by positive working capital movements and no dividend payment. We expect positive discretionary cash flow to continue in 2017, supported by higher earnings, continued low capex, and no dividend payment.

In our base case for SSAB for 2017 and 2018, we assume:
- Continued supportive industry margins in the U.S. and Europe following the introduction of antidumping measures in the EU and U.S. and taking into account our GDP growth expectation of 2.0% for the EU and 2.2% for the U.S. in 2017, which should support demand growth in both markets.
- EBITDA of around SEK7 billion and an EBITDA margin of 13%. This improvement from SEK4 billion and 7% in 2015 reflects a full run rate of cost savings following the merger with Rautaruukki, in addition to a better industry environment.
- 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 in 2017 and 2018:
- Funds from operations (FFO) to debt of around 30%-35%.
- Debt to EBITDA of around 2.5x-3.0x.

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 2015.

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.

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 its new net debt to equity covenant of 60% comfortably in this assessment.

Principal liquidity sources for the 12 months from June 30, 2017, are:
- Cash and cash equivalents of SEK7.2 billion. This includes SEK2.4 billion of pledged cash, part of which we understand will be used to retire debt over the coming one year.
- Availability under long-term committed credit lines of SEK7.8 billion.

- FFO of about SEK5.5 billion-SEK6.0 billion over the coming 12 months (our estimate).

Principal liquidity uses for the same period are:

- Short-term debt of SEK6.5 billion, including off-balance-sheet receivable securitization.
- Capex of about SEK2 billion.
- From 2018, a dividend payment of 50% of profit before tax.

Outlook

The stable outlook reflects our expectation that leverage should continue to decline in 2017 on the back of a supportive industry environment and positive discretionary cash flow generation. We expect debt to EBITDA to be at the low end of the 3x-4x range (2.9x for the 12 months to Sept. 30, 2017) that we see as supportive for the 'BB-' rating through the cycle. Also, FFO to debt should be at the high end of the 20%-30% range (27.5% for the 12 months to Sept. 30, 2017). We view positively the improved market conditions in Europe and the U.S., helped by antidumping measures taken by the relevant authorities.

Downside scenario

Although not expected over the next 12 months, we could lower the ratings if steel market conditions deteriorated sharply, so that adjusted debt to EBITDA increased to above 4x or FFO to debt fell below 20%, or if the currently strong liquidity position weakened.

Upside scenario

We could consider a higher rating if SSAB were to continue deleveraging (including a reduction in gross debt), with debt to EBTIDA comfortably in the 2x-3x range and FFO to debt of 30%-45% consistently over a cycle. Upside could also be driven by improvement in company's operating margins and overall competitive position in the coming years.

Ratings Score Snapshot

Corporate Credit Rating: BB-/Stable/B

Business risk: Weak

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

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (+1 notch)
- Financial policy: Neutral (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 'BB-' 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 cyclicality 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

- 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 - Industrials: Key Credit Factors For The Metals And Mining Downstream Industry, Dec. 20, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 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

Upgraded; Ratings Affirmed

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

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