Research Update:

SSAB 'BB+' Rating Placed On CreditWatch Negative On Steel Industry Recovery Woes And The Potential Tata Steel Deal

November 23, 2020

Rating Action Overview

- The second wave of lockdowns across Europe and North America might slow the recovery of the steel industry in 2021 more than previously expected, possibly resulting in lower profitability for steelmakers, including Sweden-based SSAB AB.
- At the same time, we understand that the company is in preliminary discussions with Tata Steel on the potential acquisition of the latter's assets in the Netherlands.
- In our view, the lower-than-expected 2021 results, alongside potential additional debt if the Tata Steel transaction materializes, could drop SSAB's credit metrics below the thresholds of the current rating in the short term.
- We are therefore placing our 'BB+' long-term rating on SSAB on CreditWatch with negative implications.
- The CreditWatch reflects a potential one-notch downgrade to 'BB' in the coming months, depending on recovery prospects in 2021 and better visibility on the potential acquisition.

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Rating Action Rationale

Our expectation of lower EBITDA in 2021 indicates that SSAB could have difficulties sustaining its credit quality in line with our 'BB+' rating. Based on weaker-than-expected results year to date and uncertainties stemming from the renewed COVID-19-related restrictions and lockdowns in Europe and the U.S., we project the group's EBITDA will fall to Swedish krona (SEK) 6.5 billion-SEK7.0 billion in 2021. SSAB reported EBITDA for the first nine months of 2020 of SEK1.9 billion, down 70% year-on-year. This leads us to expect an EBITDA for full-year 2020 of no higher than SEK2.7 billion-SEK2.9 billion. In our previous review, when we revised the outlook on SSAB to negative from stable, we projected 2020 EBITDA of SEK5 billion-SEK6 billion (see "Rating Actions Taken On Four Russian And European Steel Companies As A Bad 2019 Turns Into A Worse 2020," published March 31, 2020, on RatingsDirect). Considering potential fallout from the second wave of COVID-19 infections, we anticipate a potentially slower pick-up in demand for steel end-use products (i.e. automobiles, construction and machinery). This would consequently delay recovery of the steel industry. Compared with 2019, we assume 2021 steel demand will contract between 5% and 10% in Europe (versus our assumption in March of a contraction of about 2%).

Muted prospects across the industry are behind our downward revision of SSAB's EBITDA in 2021 to SEK6.5 billion-SEK7.0 billion. The revised projections translate into an adjusted funds from operations (FFO) to debt of 15%-20% in 2020 and, more importantly, to slightly above 40% in 2021, compared with the 45% that we view as commensurate with our 'BB+' rating. At the same time, the company's ability to generate positive free cash flow (excluding changes in working capital) and maintain strong liquidity ease the immediate pressure on the rating.

Additional profitable steel capacity and exposure to new markets could support SSAB's business position over the medium term, but also put immediate pressure on its financials. On Nov. 13, 2020, SSAB announced that it is in preliminary discussions with Tata Steel to purchase the latter's Netherlands-based assets, notably the Ijmuiden steel mill and related downstream assets, with an overall capacity of about 7.0 metric tons (mt), compared with SSAB's 8.8 mt, of which 6.4 mt are in Europe. The additional capacity would take SSAB into the top five largest players on the continent, but it is still well behind ArcelorMittal (nearly 40 mt of capacity in Europe) and a medium-sized player by global standards. In our view, the cost position and profitability through the cycle of the new assets will determine the impact on SSAB's business risk profile. There is uncertainty regarding the profitability of the assets, the price, the financing, and the potential synergies between the two companies. As a result, the risks and rewards that could emerge are somewhat blurred at this stage. For example, a debt-funded transaction with limited contribution to EBITDA could be a rating constraint, while a more debt-friendly funding structure (i.e. high equity content), immediate EBITDA contribution, and material synergies between the companies could support--or, in the long term, even bolster--SSAB's creditworthiness.

We take into account SSAB's track record of equity-funded acquisitions. The merger with the Finnish steelmaker Rautaruukki in 2014, for example, consolidated SSAB's position as a Nordic leader. In order to protect its balance sheet, SSAB funded this transaction with its shares. We also note that SSAB was able to unlock synergies over two years. This, alongside SSAB's deleveraging over the past five years, leads us to assume that a fully debt-funded transaction is less likely. Based on Tata's communication, we understand that the divestment could be completed within the coming six to nine months, which could translate into a binding agreement in the coming quarter.

CreditWatch

We expect to resolve the CreditWatch placement in the next three months, after reviewing the company's fourth-quarter results and obtaining clearer insight on the shape of the recovery in 2021. In addition, we believe that more information about the ongoing transaction will become available in the coming three months, facilitating a more complete assessment of the potential rating impacts for SSAB, if the transaction materializes.

We will likely lower the rating if we see that the FFO to debt is likely to stay below 45%, which is the level commensurate with the current rating. This could occur if we projected EBITDA of SEK6.5 billion or below for 2021, or SSAB concluded a transaction that resulted in a substantial increase in debt with limited contribution to profitability and only moderate improvement in its competitive position in the short term. However, EBITDA of SEK7 billion or more, alongside balanced risks and rewards of the ongoing transaction, could prompt a rating affirmation.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Rating Actions Taken On Four Russian And European Steel Companies As A Bad 2019 Turns Into A Worse 2020, March 31, 2020

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
SSAB AB		
Issuer Credit Rating	BB+/Watch Neg/B	BB+/Negative/B