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Research Update:

Swedish Steelmaker SSAB Upgraded To 'BB' On Continued Deleveraging; Outlook Positive

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Overview

- Healthy market conditions for the steel industry are expected to further improve the Swedish steel maker SSAB's profitability and cash flow generation in 2018 and 2019, compared with our previous base-case.
- We believe that the management's focus on balance sheet strengthening and improving the company's product mix and capital structure could make SSAB more resilient in the next industry downturn.
- We are therefore raising our long-term ratings on SSAB to 'BB' from 'BB-'.
- The positive outlook reflects a further upside for the rating in the coming 12-18 months, if the current market environment remains supportive, translating into strong credit metrics and a reduction in the company's reported net debt.

Rating Action

On June 25, 2018, S&P Global Ratings raised its long-term issuer credit rating on Swedish steelmaker SSAB AB to 'BB' from 'BB-'. At the same time, we affirmed the 'B' short-term issuer credit ratings on the company. The outlook is positive.

We also raised our issue ratings on SSAB's senior unsecured debt to 'BB' from 'BB-'. The recovery rating on this debt is unchanged at '3', indicating our expectation of meaningful recovery (50%-70%; rounded estimate: 65%) in the event of a payment default.

Rationale

The upgrade reflects our expectation for credit metrics to strengthen faster on the back of continued strong end-market demand. In our view, the current market conditions may soften a bit in 2019, but will remain favorable compared with 2017. We now expect SSAB to have an adjusted EBITDA of SEK10 billion in 2018, compared with the previous assumption of SEK8 billion, translating into an adjusted FFO to debt exceeding 60% in 2018 and well above 85% in 2019. Moreover, we understand the company will continue to emphasize strengthening its balance sheet and the majority of the free cash flow will be allocated to reducing its reported debt. In our view, the positive trend can support further rating upside to 'BB+' in the coming 12 to 18 months.

We view the company's actions over the past few years to reduce its absolute debt positively, as running the company in the future with lower debt is a corner stone for the existing rating and over time may support a higher rating. We understand the company would like to maintain a robust balance sheet to absorb the intrinsic volatility of the steel industry. As of March 31, 2018, the company had a net reported debt of SEK11 billion, compared with a peak net debt level of SEK25 billion in 2014. Under our base-case, we expect the company to generate about SEK4.0 billion of discretionary cash flow in each of the coming two years, which could dismiss SSAB's net reported debt. Furthermore, we think that the company will likely stick to its current dividend policy.

We continue to view SSAB's business risk profile at the high end of the weak category, reflecting the company's strong market share in specific regions and products, but at the same time its relative weak profitability historically, although it has shown an upward trend since 2016. We believe SSAB's business risk profile compares favorably with peers such as US Steel and AK Steel.

In response to the industry downturn in recent years, SSAB, like most steel producers, has focused on efficiency (including shutting down capacity, lowering the headcounts, and more). We now expect SSAB to have EBITDA margins of more than 12% in 2018 (compared with EBITDA margins of about 5%-7% during the trough of the cycle in 2013-2015). That said, the healthy margins cannot be linked solely to the improvement of the business, and are also driven by the favorable conditions of the industry. In this respect, we believe the company will need to take further steps to improve its resilience through the cycle, namely improving the portion of special steel and premium products out of total sales (35% in 2017 of total production). The demand for special steel, unlike commodity grade steel, is more stable and profitable. That said, the special steel remains a niche market and requires the producers to work with the end users on the application of special steel in their products.

SSAB's key strength is its strong market position in special-grade steel products. For example, it is a global market leader (market share of about 40%) in quenched and tempered steels, along with a 5% market share in some advanced high strength steels, and around 28% in heavy plates in North America, according to its own estimates. Following the merger with Rautaruukki, it also commands about a 40% share of the flat carbon steels and tubes market in the Nordic region.

Despite the company's position in the North American market, the company presented fairly weak results in 2017 compared with other U.S. steel producers. For example, its EBITDA per ton in North America was about $50 per ton, compared with close to $80 per ton for US Steel or the North American division of ArcelorMittal. The company believes the structural change in the plate market in North America moving to a capacity deficit, should be very beneficial.

SSAB Europe should see the share of premium products increase to 40% by 2020 driven mainly by automotive take-up, while growth in the special steels

segment will likely come from customer upgrades, a process that takes longer to bear fruit but will have a meaningful impact on profitability. On the cost side, the more than SEK3 billion of cost savings (including workforce reductions, asset rationalization, and other measures post-Ruukki merger) provide a good basis for maintaining, if not increasing, profitability. In our view, challenges for SSAB include 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 scenario, we expect an adjusted EBITDA of SEK10 billion for 2018. During 2017, SSAB saw a strong demand for its products across its key markets (Europe and North America) and strengthening steel margins, resulting in EBITDA of about SEK7.8 billion. In the first quarter of the year, the company reported an adjusted EBITDA of SEK1.9 billion and for the full year, we forecast a step up in the profitability to be driven by macroeconomic factors such as a solid GDP growth (2.4%-3.0%), but also from the company's ability to improve its product mix (increasing share of special steels and premium products) and benefits from its past cost optimization efforts. Our forecast takes into account the strong demand for SSAB's products, higher utilization rates and margins in the second quarter, as well as positive market sentiment in the third quarter. In addition, we understand that some of the price increases that were announced in the previous quarters in North America will be reflected fully in the second half of the year. Looking into 2019, we assume EBITDA of SEK9.5 billion-SEK10 billion.

Our base-case for SSAB for 2018 and 2019 assumes:

- Continued favorable industry margins in the U.S. and Europe driven by recovering end-user demand, lesser impact from overcapacity and increasingly protected markets.
- GDP growth expectation of 2.4% for the EU and 2.9% for the U.S. in 2018, which should support demand growth in both markets.
- Although we have not factored in any impact on SSAB's metrics from the newly imposed U.S. sanctions on steel imports (section 232), we understand that the net impact should overall be positive for SSAB. Their US volumes will be excluded from the tariffs, while the remainder will either get exempted, or any increases will most likely be absorbed by the customers.
- EBITDA margin of around 13.5%-14.0%, improving meaningfully from 12% in 2017 and about 9% in 2016.
- Capital expenditure (capex) of SEK2 billion annually, of which SEK1.7 billion is maintenance and the remaining SEK300 million strategic capex to enhance automotive high-strength steels business and service expansion.
- Slightly negative or neutral change in working capital.
- SEK1 billion in dividends in 2018 and SEK2 billion in 2019, corresponding to 50% of previous year's net income - at the high end of company's guidance (30%-50%).

Based on these assumptions, we arrive at the following S&P Global Ratings-adjusted credit measures in 2018 and 2019:

- Funds from operations (FFO) to debt exceeding 60% in both 2018 and 2019.
- Debt to EBITDA of around 1.0x-1.5x in 2018 and below 1.0x in 2019.
- Discretionary cash flow (operating cash flow minus capex and dividends) of about SEK4 billion in each of coming years.

Liquidity

We assess SSAB's liquidity as strong, as we forecast the company's liquidity sources will cover its uses by more than 2x over the next 24 months. Our assessment is underscored by the company's sizeable cash balance and its newly refinanced fully available €600 million revolving credit facility with a five-year tenor (replacing €240 million due October 2019 and €495 million due June 2020). As of March 31, 2018, SSAB's average loan duration was 5.5 years.

We understand the company has a relatively high quantum of debt maturing in the coming 2.5 years of about SEK8.0 billion, mostly falling due in 2019. As of today, the company had built a long track record of a prudent risk management. Over the past few years the company used its free cash flows to reduce its absolute debt. In this respect, we expect the company to repay some of the maturities using its expected cash flows, decrease the absolute debt level, or take advantage of an opportunistic refinance in the market.

We understand that SSAB is subject to a gearing financial covenant under its loans. As of March 31, 2018, the company had ample headroom under the financial covenant, which is expected to further improve with the reduction in its absolute debt level.

Principal liquidity sources for the 12 months from March 31, 2018, are:

- Cash and cash equivalents of SEK6.5 billion (including short-term bank deposits in escrow).
- Availability under long-term committed credit lines of SEK6.2 billion, including a €600 million RCF due 2023.
- Our estimate of FFO of about SEK7.5 billion-SEK8.0 billion over the coming 12 months.

Principal liquidity uses for the same period are:

- Short-term debt of SEK3.6 billion, including off-balance-sheet receivable securitization. We expect the company to start repaying or refinancing some of the SEK6.2 billion 2019 maturities already this year.
- Capex of SEK2 billion, most of which is maintenance capex.
- Intra-year working capital swings of several hundreds, reflecting changes in the prices and seasonality. We understand that the company aims to further optimize its working capital management, which would likely lead to lower swings in the future.

- From 2018, a dividend payment of 50% of profit before tax, about SEK1.4 billion.

Outlook

The positive outlook reflects a further upside for the rating in the coming 12-18 months, if the current market environment remain supportive, translating into strong credit metrics and a reduction in the company's reported net debt.

Under our base-case, with an adjusted EBITDA of between SEK9.5 billion-SEK10.0 billion in 2018 and in 2019, we assume our adjusted FFO to debt to be more than 60% in 2018 and well above 85% in 2019, well above the adjusted FFO to debt of 45%-60% that we consider to be commensurate with the current rating in the current favorable market conditions (or an adjusted FFO to debt of more than 30% in a downturn).

Upside scenario

An upgrade would be subject to:

- Adjusted FFO to debt rising above 60% on average through the cycle during supportive or mid-cycle industry conditions, and about 45% during the bottom of the cycle.
- SSAB reducing its adjusted debt level to SEK8 billion or less (equivalent to a reported net debt of about SEK4.0 billion). Under our base-case, we assume the company would be able to reach this target already in 2019. In our view, such a debt level would allow the company to maintain a robust balance sheet and to absorb potential volatility in the market, including a material drop in EBITDA.

In our view, given the current favorable market conditions and relatively low capex spending, we expect the company to meet those thresholds already in 2019. In this respect, we will need to assess the company's ability and willingness to develop a longer track record.

Alternatively, we could also consider a higher rating if SSAB improved its competitive position, turning its business to be more resilient during downturns than in the past. In our view, a positive assessment of the competitive position would take into account the company's ability to present EBITDA margins of more than 12% in the current market conditions, further improvement in its product mix towards higher added-value products, and operational efficiency improvements.

Downside scenario

We could revise the outlook to stable should the current market conditions be short-lived, and if the company cannot meet the thresholds for a higher rating in the next 12-18 months, or we believe the company won't be able to establish a track record of a robust financial policy over the cycle (if among others:

introduced large scale growth projects and changed its dividend policy).

Ratings Score Snapshot

Issuer Credit Rating: BB/Positive/B

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

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bb

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

Issue Ratings--Recovery Analysis

Key analytical factors

- We rate SSAB's senior unsecured debt 'BB' with a 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 65% 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: 2023

- EBITDA at emergence: SEK3.3 billion
- Implied enterprise value multiple: 5.5x
- Jurisdiction: Sweden

Simplified waterfall

- Net value available to creditors (after administrative costs): SEK17.4 billion
- Secured claims: SEK3.3 billion
- Senior unsecured debt claims: SEK19.9 billion*
- Recovery expectation: 65%

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		
Issuer Credit Rating	BB/Positive/B	BB-/Positive/B

Senior Unsecured	BB	BB-
Recovery Rating	3(65%)	3(65%)

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at 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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