Research Update:

SSAB 'BB+' Rating Affirmed And Removed From CreditWatch On Strong Recovery In The Steel Industry; Outlook Stable

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PRIMARY CREDIT ANALYST

Lena Liacopoulou Staad
Paris
+ 33 14 420 6739
lena.liacopoulou@spglobal.com

SECONDARY CONTACT

Elad Jelasko, CPA
London
+ 44 20 7176 7013
elad.jelasko@spglobal.com

Rating Action Overview

- The global steel industry recovered more than we expected in the fourth quarter of 2020, and continues to recover in the first quarter of 2021, making us much more optimistic about Swedish steelmaker SSAB AB's ability to report healthy results in 2021.
- SSAB has also announced that it will not go ahead with the acquisition of Tata Steel's Dutch assets, removing the risk of it incurring additional acquisition-related debt.
- We are therefore affirming our long-term issuer credit rating on SSAB at 'BB+', and removing it from CreditWatch, where we placed it with negative implications on Nov. 23, 2020. We are also affirming our 'B' short-term issuer credit rating on SSAB.
- The stable outlook reflects our view that SSAB will continue to deleverage in 2021 and 2022, supported by the recovery in the global steel industry, and that its credit metrics will return to levels commensurate with the 'BB+' rating.

Rating Action Rationale

Steel market conditions have improved significantly. The market first showed signs of an accelerated recovery in the last quarter of 2020, and it has been strengthening ever since. Industry players are reporting full order books and even potential difficulties in meeting demand in the first quarter or half of this year. SSAB saw a 21% quarter-on-quarter increase in shipments in the fourth quarter of 2020, mainly driven by the Special Steels division and SSAB Europe.

SSAB should report healthy results in 2021. This is thanks to a combination of restocking in the first quarter of the year, along with strong apparent demand for steel in SSAB's core markets of Europe and the Americas throughout the year, and a lower cost base following a cost reduction of SEK1.6 billion in 2020. Healthy results in the first half of the year should soften somewhat in the second half of the year with some planned maintenance-related production outages. Under our revised base case, we now expect SSAB to report EBITDA of Swedish krona (SEK) 7.5 billion-SEK8.5 billion in 2021, compared with our previous expectation of SEK6.5 billion-SEK7.0 billion and exceptionally low EBITDA in 2020 of SEK3.4 billion.

The acquisition of Tata Steel's assets is off the table. SSAB's acquisition of Tata Steel's Ijmuiden steel mill in the Netherlands promised to consolidate the fragmented European steel industry and make SSAB a stronger player with much more operational flexibility. However, this did not come to fruition after SSAB decided to end its discussions with Tata Steel, citing insufficient synergies. At this stage, we do not expect SSAB to embark on another acquisition of a similar size or cost in the coming six-to-12 months. In our view, the company will now shift its focus to the conversion of the basic oxygen furnace (BOF) in Oxelosund, Sweden, through the use of new hydrogen breakthrough ironmaking technology, or HYBRIT. This implies an increase in capital expenditure (capex) of SEK0.6 billion in the pilot phase of the conversion, with the overall aim being to curb CO_2 emissions and become fossil fuel-free by 2045.

A track record of a prudent financial policy is key for a higher rating. In 2020, SSAB reported S&P Global Ratings-adjusted funds from operations (FFO) to debt of 25%, below our threshold of 45% at the bottom of the cycle. However, we saw the year as exceptional. As a result of higher EBITDA and slightly lower adjusted debt, we expect FFO to debt to improve to around 60%-65% in 2021. This is in line with our expectation for a 'BB+' rating. In our view, this would allow SSAB to continue deleveraging, as we do not expect the company to prioritize rapid organic growth and/or returns to shareholders. According to our calculations, a combination of adjusted debt in the range of SEK8 billion-SEK9 billion and annual EBITDA of about SEK6.5 billion over the cycle, or about SEK4.5 billion at the bottom of the cycle, should ensure financial headroom at the current rating. SSAB could achieve further headroom over time with improved EBITDA margins and less volatility in profitability, and this would support a potential upgrade.

Outlook

The stable outlook reflects our expectation that SSAB will continue to deleverage in 2021 and 2022, supported by the recovery in the global steel industry. In our view, deleveraging, alongside further improvements in the business model, will better position the company if the recovery in the market is short-lived. Under our base case, with adjusted EBITDA of SEK7.5 billion-SEK8.5 billion in 2021, we assume that adjusted FFO to debt will be slightly above 60% in 2021, with an additional improvement in 2022. This compares with adjusted FFO to debt of 60% that we consider to be commensurate with the 'BB+' rating in favorable market conditions, or of more than 45% in a downturn. We do not assume any mergers or acquisitions.

Downside scenario

We view pressure on the rating as remote in the coming six-to-12 months. Nevertheless, we could lower the rating if the recovery in the steel industry proved more short-lived than we expected, such that SSAB's EBITDA dropped materially, translating into adjusted FFO to debt below 45%. Other scenarios leading to a lower rating would include SSAB's deviation from its current financial policy, including the adoption of an aggressive growth strategy or the payout of sizable dividends, prompting much higher debt.

Upside scenario

We would consider taking a positive rating action as early as late 2021, subject to the following:

- Adjusted FFO to debt of about 60% and positive discretionary cash flow this year, and our belief that SSAB would be able to maintain such robust credit metrics in the coming years.
- A further reduction in absolute debt. Given our assumption of EBITDA of SEK4.5 billion at the bottom of the cycle and about SEK6.5 billion over the whole cycle, SSAB would need to reduce its adjusted debt to about SEK8 billion-SEK9 billion, equivalent to net reported debt of SEK4 billion-SEK5 billion. This compares to adjusted debt of SEK14 billion as of December 2020. In our view, this would allow the company to maintain a robust balance sheet throughout the cycle, notably during severe downturns. An increase in annual EBITDA over the cycle would translate into lower adjusted debt.
- A track record of a prudent financial policy, including debt well below the company's official public gearing objective of a maximum of 35% at most times, no changes in shareholder returns, and disciplined capex.
- Further enhancement of the business model, including a better product offering and a reduction in operating costs. This would be supported by consistently high or improving EBITDA margins of 12% or above throughout the cycle.
- Progress with the conversion of the BOF in Oxelosund, and later on with the company's other BOFs, as an important part of ensuring it has the assets to operate sustainably in the long term.

Company Description

SSAB produces high-strength steel, quenched and tempered steel, as well as strip, plate, and tube products, and provides construction solutions. It had sales of SEK65 billion and annual production capacity of 8.8 million tons in Sweden, Finland, and the U.S. in 2020. The company serves a number of end markets, such as industrial applications, automotive, heavy transport, construction, and energy. The company operates through five divisions:

- Special Steels (56% of EBITDA);
- Europe (14% of EBITDA);
- Americas (11% of EBITDA);
- Tibnor (6% of EBITDA); and
- Ruukki Construction (12% of EBITDA).

SSAB is headquartered in Stockholm, and its shares are traded on NASDAQ Stockholm and Helsinki, with 21.8% of the shares held by long-term strategic investors Industrivarden (11.8%) and Solidium (10%). The remaining shares are free float. Notable rated peers include Aperam S.A., U.S. Steel Corp., BlueScope Steel Ltd., ArcelorMittal, and Evraz PLC.

Our Base-Case Scenario

Considering the supportive trends in demand and prices, we expect SSAB to report EBITDA of around SEK7.5 billion-SEK8.5 billion in 2021, with an additional improvement in 2022. We see potential downside stemming from any time lag in SSAB passing on higher raw material costs to its customers, especially as iron ore is trading at a spot price of $164/ton, compared to an average price of $103/ton in 2020. In 2021, we expect losses from planned production outages to total SEK1.2 billion. On the other hand, we do not factor in any further cost reductions in 2021 after the SEK1.6 billion SSAB achieved in 2020.

Assumptions

- Capex of SEK3.0 billion-SEK3.5 billion annually, of which SEK1.0 billion-SEK1.5 billion is for the capacity extension of the quenched and tempered steel line at the Mobile steel mill in Alabama and the conversion of the BOF in Oxelosund.
- A slightly negative or neutral change in working capital, depending on the evolution of raw material prices in the coming quarters.
- No dividends in 2021. We expect SSAB to resume dividend payments from 2022 and estimate a payout of SEK1.0 billion-SEK1.5 billion, corresponding to 40% of the previous year's net income, in line with the company's dividend policy.

Key metrics

	2019A	2020A	2021E
Iron ore price ($/ton*)	85	103	115
Eurozone GDP growth (%)	1.3	(7.2)	4.8
U.S. GDP growth (%)	2.2	(3.9)	4.2
Eurozone steel demand growth (%)	(6.0)	(15.0)	11.0
U.S. steel demand growth (%)	(2.0)	(16.0)	7.0
Adjusted EBITDA (bil. SEK)	6.1	3.4	7.5-8.5
Adjusted EBITDA margin (%)	8.0	5.2	9-11
Adjusted debt to EBITDA (x)	2.5	4.1	1.0-1.5
Adjusted FFO to debt (%)	27	24	60-65
Capex	2.9	2.2	3.0-3.5
FOCF (bil. SEK)	2.1	2.2	2.5-3.0
Adjusted debt (bil. SEK)	15.0	14.0	10.5-12.0

*Metric ton. A--Actual. E--Estimate. FFO--Funds from operations. FOCF--Free operating cash flow. All ratios are S&P Global Ratings-adjusted.

Liquidity

We assess SSAB's liquidity as strong, as we forecast that its liquidity sources will cover its uses by more than 1.5x over the next 24 months. Our assessment is underscored by the company's sizable cash balance and its fully available €600 million and SEK2.0 billion revolving credit facilities (RCFs). As of Dec. 31, 2020, SSAB's average loan duration was 4.7 years. We understand that the company has about SEK9.5 billion of debt maturing in the coming three years. The company has built a long track record of prudent risk management.

Principal liquidity sources for the 12 months from Dec. 31, 2020, are:

- Cash and cash equivalents of SEK7.1 billion.
- Availability under its RCFs of about SEK8.0 billion, with €600 million due in 2023 and SEK2.0 billion due in 2025.
- Our estimate of FFO of about SEK6.2 billion-SEK6.6 billion over the coming 12 months.

Principal liquidity uses for the same period are:

- Short-term debt maturities of about SEK5.9 billion, including SEK2.3 billion of commercial paper and SEK3.6 billion of short-term financial debt.
- About SEK1.7 billion of off-balance-sheet receivable securitizations, although the company has a good track record of extending these.
- Capex of SEK3.3 billion, due to higher growth capex from 2021.
- Intra-year working capital swings of several hundred Swedish krona, reflecting changes in prices and seasonality. We understand that the company aims to optimize its working capital management further to lower such swings in the future.
- No dividends in the coming 12 months.

Covenants

We understand that SSAB is subject to a financial covenant under its loans specifying maximum gearing of 60%. As of Dec. 31, 2020, the company had ample headroom under this covenant, and we expect headroom to grow in 2021.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/B

Business risk: Fair

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

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral/Undiversified
- Capital structure: Neutral
- Liquidity: Strong

- Financial policy: Neutral
- Management and governance: Satisfactory
- Comparable rating analysis: Neutral

Stand-alone credit profile: bb+

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

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

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