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Research Update:

Swedish Steelmaker SSAB Outlook Revised To Negative On Weak Financial Results; 'BB/B' Ratings Affirmed

Primary Credit Analyst:

Elad Jelasko, CPA, London (44) 20-7176-7013; elad.jelasko@standardandpoors.com

Secondary Contact:

Andrey Nikolaev, CFA, Paris (33) 1-4420-7329; andrey.nikolaev@standardandpoors.com

Recovery Analyst:

Leandro De Torres Zabala, Madrid (34) 91-389-6965; leandro.detorreszabala@standardandpoors.com

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Overview

- The earnings of Swedish steelmaker SSAB AB in the third quarter of 2013 were very weak compared with those of its peers, and well below our previous forecasts. This was due to a weak product mix and tight margins.
- Consequently, we have revised downward our forecasts for SSAB's credit metrics for 2013 and 2014. As a result, we have revised downward our assessment of SSAB's financial risk profile to "aggressive" from "significant."
- We are therefore revising our outlook on SSAB to negative from stable, and affirming our long- and short-term corporate credit ratings on SSAB at 'BB/B'.
- The negative outlook reflects the possibility of us downgrading SSAB in the first half of 2014 if we believe that its EBITDA will not recover to SEK3 billion in 2014. Such recovery will require a clear improvement in the North American steel markets.

Rating Action

On Nov. 12, 2013, Standard & Poor's Rating Services revised its outlook on Swedish steelmaker SSAB AB to negative from stable. At the same time, we affirmed our 'BB' long-term and 'B' short-term corporate credit ratings on SSAB.

At the same time, we affirmed our issue rating on SSAB's senior unsecured debt at 'BB'. The recovery rating on this debt is unchanged at '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Rationale

The outlook revision follows a weakening of SSAB's earnings in the third quarter of 2013. SSAB's results were weaker than both those of its peers and our previous forecasts, due to a weak product mix and tight margins. Consequently, we have revised downward our forecasts for SSAB's credit metrics for 2013 and 2014, and our assessment of SSAB's financial risk profile to "aggressive" from "significant."

The outlook revision reflects the challenges that we consider SSAB will face

in turning its operations around and significantly improving its profitability in 2014. If we believe that SSAB's EBITDA will not recover markedly to Swedish krona (SEK) 3 billion in 2014, from the trough of SEK1.3 billion-SEK1.4 billion that we project this year, a further one-notch downgrade is likely in the first half of 2014. This would happen if SSAB's results in the coming quarters do not show a clear improvement in its North American operations and a lower contribution from its European operations. We consider Standard & Poor's-adjusted funds from operations (FFO) to debt of 20%-25% to be commensurate with the current rating, but our revised projection of EBITDA of SEK2.8 billion-SEK3.0 billion in 2014 equates to adjusted FFO to debt of only 12%-15%.

In the third quarter of 2013, SSAB reported EBITDA of only SEK8 million, while EBITDA in the first nine months of 2013 was SEK1.1 billion. For full-year 2013, we have revised our projection of adjusted EBITDA downward materially to SEK1.3 billion-SEK1.4 billion from SEK2.6 billion. If we deduct the savings from SSAB's ongoing cost-efficiency program of SEK500 million, SSAB's 2013 results would be even weaker. In our view, some of the factors that underpin SSAB's weak 2013 results include low demand for steel in Europe; unfavorable currency exchange rates of the Swedish krona versus the U.S. dollar; and tight margins for steel plates in the U.S. The EBIT margin of SSAB's North American operations dropped to about 1% in the first nine months of 2013, from 12% in 2011 and 2012.

Under our base-case credit scenario, we still project that SSAB's EBITDA will improve to SEK2.8 billion-SEK3.0 billion in 2014, compared with SEK2.5 billion in 2012 and only SEK1.3 billion-SEK1.4 billion this year. This scenario takes into account:

- A contraction in steel production in Europe and the U.S. by 4%-6% in 2013. For 2014, we factor in flat production in Europe and an increase in production of 0%-2% in the U.S.
- Slow growth in the demand for SSAB's specialty steel products. (Current production volumes are lower than before SSAB's investments in new facilities.)
- Tight margins and an unfavorable product mix in the fourth quarter of 2013, leading to EBITDA of about SEK0.2 billion-SEK0.3 billion.
- A further contribution in 2014 from SSAB's cost-efficiency program, although we understand the majority of savings were realized this year.

Despite our revised assumptions for SSAB's EBITDA, we still believe that the company will be able to generate free operating cash flow and deleverage. We now forecast that SSAB will generate discretionary cash flow before working capital swings of between SEK0.6 billion and SEK0.8 billion in 2014. This forecast factors in capital expenditure (capex) at a maintenance level of about SEK1.0 billion, and dividends of SEK0.3 billion in line with the previous distribution. In our view, SSAB's deleveraging will be influenced to some degree by swings in working capital.

Liquidity

We assess SSAB's liquidity as "strong" under our criteria. We estimate that SSAB's ratio of sources to uses of liquidity will remain materially more than 2x in 2014 and about 1.5x in 2015. Our assessment reflects sizable credit facilities available for general corporate purposes, with no financial covenants or rating triggers.

In our liquidity analysis, we factor in supportive domestic capital market conditions in the Nordic region. This support derives mainly from relatively low interest rates compared with the debt financing costs of SSAB's main peers.

We project the following sources of liquidity under our base-case scenario as of Sept. 30, 2013:

- SEK1.7 billion of cash--excluding SEK0.5 billion that we consider tied to operations--and SEK1.8 billion of cash that SSAB currently holds as a deposit in favor of certain debt instruments, but which it could use for general corporate purposes.
- SEK8.7 billion of undrawn committed credit facilities, of which SEK2.5 billion will be available by June 2015 and SEK5.9 billion will be available after 2015.
- FFO of about SEK2.1 billion in 2014 and SEK2.5 billion in 2015.
- Our assumption of no contribution from available carbon emissions rights, despite a low utilization rate. SSAB idled its blast furnace in Oxelösund in the second half of 2011, which translated into proceeds from the sale of emission rights of SEK270 million.

We project the following uses of liquidity under our base-case scenario as of Sept. 30, 2013:

- SEK1 billion in capex per year, in line with the maintenance level.
- SEK2.0 billion of long-term debt maturities in 2014 and SEK3.4 billion in 2015.
- SEK1.7 billion of short-term debt. This includes commercial paper and SSAB's Alabama tax revenue (ATR) bonds facility. Despite the nature of the ATR bonds facility as a long-term debt instrument, we classify it as a short-term instrument because the investors can call for immediate repayment and the guarantying bank provides a back-up facility of one year. (For further details, see "New Issue: Industrial Development Authority Of Mobile County - Series 2011," published Nov. 16, 2011, on RatingsDirect.)
- A dividends distribution of about SEK0.5 billion per year.
- Uncertain working capital outflow, which could be positive according to management. However, we believe that some outflows cannot be excluded because the working capital inflow since early 2012 (about SEK3 billion) might not be sustainable, depending on the prices of raw materials in 2014.

Recovery analysis

The issue rating on SSAB's senior unsecured debt is 'BB', in line with the corporate credit rating. The recovery rating on this debt is '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Recovery prospects are underpinned by SSAB's substantial asset base; our assessment of the business as a going concern post default; and what we consider to be the favorable insolvency regimes of the countries in which SSAB has its key manufacturing assets--Sweden and the U.S. Furthermore, with virtually all debt issued at the parent company level and very little secured or structurally senior debt ranking above that, we believe that the rated debt would be fairly senior in the event of a payment default.

To determine recoveries, we simulate a hypothetical payment default. In view of the cyclical markets in which SSAB operates, we assume that sustained weakness in steel demand leads to a drop in volumes sold and prices. This in turn reduces utilization rates as new capacity in global steel comes on stream. Under our scenario, a default is triggered by SSAB's inability to refinance its maturing debt. This hypothetical scenario leads to a default in 2017, with EBITDA declining to approximately SEK2.3 billion. We envisage a stressed enterprise value of about SEK12 billion at the point of default, which is equivalent to a 5x stressed EBITDA multiple.

After deducting priority liabilities--mainly comprising enforcement costs and 50% of pension liabilities--we arrive at a net enterprise value of about SEK11 billion. We envisage about SEK20 billion of senior unsecured debt outstanding at default, including drawings on the revolving credit facilities and six months of prepetition interest. This equates to recovery prospects of between 50%-70% for the unsecured lenders.

Outlook

The negative outlook reflects the possibility of us downgrading SSAB by one notch in the first half of 2014 if EBITDA in the coming two quarters does not indicate a material recovery in 2014. A negative rating action would be triggered by one or more of the following:

- Continuous weak results in the U.S. operations;
- An unfavorable product mix in Europe, with no pick-up in the demand for specialty steel products;
- A drop in the demand for steel in Europe; and
- Further strengthening of the Swedish krona.

We could revise the outlook to stable if the European macroeconomic and steel environments improve. An outlook revision to stable will depend on SSAB's EBITDA recovering markedly to at least SEK3 billion for full-year 2014. We believe this would equate to adjusted FFO to debt recovering to 15%, factoring in our assumption of continued positive free cash flow and a further

improvement in free cash flow in 2015. We consider adjusted FFO to debt of 20%-25% as commensurate with the current rating.

Related Criteria And Research

- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Key Credit Factors: Methodology And Assumptions On Risks In The Metals Industry, June 22, 2009
- Methodology For Revisions To Standard & Poor's Metals Price Assumptions, Jan. 16, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
SSAB AB		
Corporate Credit Rating	BB/Negative/B	BB/Stable/B
Senior Unsecured	BB	BB
Recovery Rating	3	3
Commercial Paper	B	B

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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