FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Usiminas at 'BB-'; Outlook Remains Stable

Fri 19 Jun, 2020 - 12:47 ET

Fitch Ratings - Chicago - 19 Jun 2020: Fitch Ratings has affirmed Usinas Siderurgicas de Minas Gerais S.A.'s (Usiminas) Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB-' and its National Scale rating at 'A+(bra)'. Fitch has also affirmed the 'BB-' rating of the senior unsecured notes due in 2026 that were issued by Usiminas International S.a r.l. and are guaranteed by Usiminas. The Rating Outlooks for the international Foreign and Local Currency IDRs of Usiminas and its National Scale rating remains Stable.

The rating affirmations reflect a positive pricing environment for iron ore during 2020 that should allow Usiminas to generate positive FCF despite the sharp drop in demand for flat steel in Brazil due to the coronavirus pandemic. The rating affirmations also reflect Usiminas' low absolute and relative debt levels, as well as its manageable debt amortization profile.

KEY RATING DRIVERS

Weak Steel Demand: The Brazilian Steel Institute is predicting domestic steel demand will fall 20% in 2020 due to weak economic activity and lockdown measures related to the coronavirus pandemic. Fitch projects that Usiminas' Brazilian sales volumes will drop by 25%, as it is exposed to the flat steel industry that has been hit hard by plummeting automobile production volumes and weak white goods sales. Usiminas closed two blast furnaces during April that have a combined production capacity of 1.3 million ton of crude steel per year and has concentrated its output in a larger blast furnace that has 2.3 million tons of production capacity. The company sold 1.050 million tons of steel during the first three months of 2020 and generated BRL523 million of EBITDA.

Positive FCF: Fitch is projecting that Usiminas will generate BRL1.3 billion of EBITDA and BRL300 million of FCF in 2020 based on 8.2 million tons of iron ore sales, average iron ore prices of USD75/ton and BRL600 million of capex. EBITDA and FCF will be higher if iron ore prices continue to remain elevated in the third quarter. These projected 2020 figures compare with BRL1.8 billion of EBITDA, BRL1.3 billion of FCF, BRL700 million of capex, 8.6 million tons of sales and an average benchmark price of USD93 per ton during 2019. Usiminas' results would have been much worse given Fitch's projection of a drop in Usiminas' steel sales to 3.1 million tons in 2020 from 4.1 million ton in 2019 had iron ore prices not been abnormally high due to the shortage of iron ore caused by Vale's accident in 2019 and weather related supply disruption in Australia during 2019 and Brazil during 2020.

Moderate Debt Burden: Fitch is projecting that Usiminas' net leverage will reach 3.4x in 2020 an increase from 1.9x in 2019. The company's operating income during the past two years has been bolstered by unique situations that have elevated iron ore prices. Over the medium to long term, Usiminas' results and credit profile are inextricably tied to its steel business. The company only exports around six million tons of iron ore, as more than two million tons of production are used internally, and at low prices its exports are not competitive given its cost position.

High Uncertainty: The cash flow Usiminas generates from iron ore should normalize to lower levels in 2021 as supply constraints begin to ameliorate. The timing and the degree of the recovery of flat steel demand in Brazil remains highly uncertain. A quick and substantial economic rebound in Brazil and more vibrant economic activity in South America, which is the key market for Brazilian exports of manufactured goods and automobiles, remain the key variables. Against this uncertain backdrop, Fitch is projecting that Usiminas steel sales will grow to 3.5 million tons in 2021 and 3.8 million tons by 2022 and that net leverage will fall to below 2x in 2021 and remain at this level in 2022.

DERIVATION SUMMARY

Usiminas' business risk is similar to that of peer Companhia Siderurgica Nacional (CSN; B/Stable), as both are highly exposed to the local steel industry in Brazil. While CSN has greater business diversification, with larger mining operations and operations in the cement industry, Usiminas' robust business position in its niche markets and solid operating margins are a competitive advantage. Both Usiminas and CSN have a much weaker business position compared with the other Brazilian steel producer, Gerdau S.A (BBB-/Stable), which has a diversified footprint of operations with significant operating cash flows from its assets abroad, mainly in the U.S., and a more flexible business model that allows it to better withstand economic and commodities cycles.

From a financial risk perspective, Usiminas benefits from much lower overall gross debt, more manageable cash outflows to maintain its capital structure and a better debt maturities ladder than CSN, which are all factored into the two-notch differential between the companies' ratings. Gerdau has the lowest financial risk of the three, and has been able to maintain positive FCF, strong liquidity and no refinancing risks over the last few years of recession in Brazil, as reflected in its investment-grade rating.

KEY ASSUMPTIONS

--Benchmark iron ore prices average USD75/ton in 2020 and USD60/ton in 2021;

--Iron ore costs decline 15% in 2020 to reflect BRL weakness and lower shipping costs;

--Brazilian steel volumes fall 25% in 2020 and then increase by 15% in 2021;

--Capex of BRL600 million in 2020 and BRL1 billion in 2021;

--An exchange rate of BRL5.30/USD1.00 at YE 2020 and BRL4.90/USD1.00 at YE 2021.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Net debt/EBITDA leverage ratios consistently below 2.5x would be a consideration for a potential upgrade.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Maintenance of net debt/EBITDA leverage ratios above 3.5x;

--Negative FCF;

--A significant change in industry dynamics or an increase of steel imports into Brazil;

--Return of shareholder disputes.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Low Refinancing Risk: Usiminas had BRL6.6 billion of debt as of March 31, 2020. The debt consist of BRL2 billion of Brazilian real denominated debentures that mature in 2023, 2024 and 2025; a USD750 million (BRL3.9 billion) note that matures in 2026; and BRL716 million of short-term forfaiting transactions that Fitch includes in its debt calculations.

Usiminas had BRL2.4 billion of cash and marketable securities at the end of March. About BRL350 million of the cash reported by the company is held at its

Mineracao Usiminas mining joint venture. The company doesn't face principal amortizations on its debt between 2020 and 2022. The debentures begin to amortize in 2023 when a BRL711 million payment is due.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Usiminas has an ESG Relevance Score of 4 related to board independence and effectiveness, based in part on the disputes between its largest shareholders, Ternium and Nippon Steel, which hampered the company's strategy and led to elevated business risks. The shareholder agreement in2018 brought more clarity to its long-term strategy, and both major shareholders terminated all pending disputes, which alleviated some concerns over board effectiveness.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Usiminas International S.a r.l.			
• senior unsecured	LT	BB-	Affirmed

ENTITY/DEBT	RATING		
Usinas Siderurgicas de Minas	LT IDR	BB- Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 08 Jun 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Usiminas International S.a r.l.	EU Endorsed
Usinas Siderurgicas de Minas Gerais S.A. (Usiminas)	EU Endorsed

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