FitchRatings

RATING ACTION COMMENTARY

Fitch Publishes Interpipe Holding's 'B' IDR; Outlook Stable

Wed 11 Nov, 2020 - 12:51 PM ET

Fitch Ratings - Moscow - 11 Nov 2020: Fitch Ratings has published Interpipe Holding's Long-Term Issuer Default Rating (IDR) of 'B' with Stable Outlook.

The rating reflects a limited record of post-restructuring financial policy and governance practices, which results in uncertainty over post-2020 dividend distributions and thus leverage profile, once Interpipe's current restrictive covenants are lifted. The rating also reflects a smaller scale than steel peers' and exposure to the Ukrainian operating environment. The company's pipe business is exposed to oil markets where customers have volatile capex alongside oil price fluctuations.

The rating also incorporates a high share of value-added products (steel pipes and railway products), a leading domestic and regional position in seamless pipes and wheels, backward integration into scrap and billets and geographically diversified operations. The rating also reflects strongly improved credit metrics following a restructuring in 4Q19.

KEY RATING DRIVERS

Volumes under Pressure from Coronavirus: Interpipe managed to operate throughout 2020 without significant operational disruptions but faced coronavirus-driven demand slowdown, which was particularly pronounced in pipes (9M20 sales -24% yoy). Its oil country tubular goods (OCTG) segment was hardest hit (-54%) while line pipes were nearly flat. Its wheels division performed better with a modest 3% reduction in sales volumes. We forecast that OCTG will take three years to see full recovery from the 2020 lows and other segments' volumes to grow incrementally beyond 2020, except for wheels sales in Ukraine and CIS.

Cost-Cutting Helps: Interpipe's measures to cope with slowdown have included layoffs and a shortened four-day working week, as well as other cost-cutting measures. The company postponed all expansion capex and scaled back maintenance capex. This has allowed Interpipe to generate positive free cash flow (FCF) and build up its liquidity cushion (USD187 million reported cash and equivalents at end-2Q20).

Railway Products Market to Normalise: Russian wheels deficits in 2019 and 2020 driven by the 2017-2019 wagon maintenance cycle resulted in record-high EBITDA from wheels, exceeding USD200 million in 2019. We expect 2021 to be a transitional year as Russian and Ukrainian railcar manufacturers and operators cut wheel purchases by double-digits, resulting in segment EBITDA of USD110 million, and decreasing to USD70 million from 2022. This is still more than twice the 2017-2018 levels as the likely cancellation of the 34.22% Russian anti-dumping duty from January 2021 and Interpipe's expansion in European markets and into wheelsets assembly will support the segment's performance.

Pipes Recovery Will Take Years: COVID-19 impact on pipes was uneven, with particular pressure on OCTG and welded pipes in 1H20, as weaker sales volumes added to price pressure on revenues. Line pipes fared well in volume but saw mid-teens price declines. Weak domestic gas drilling and construction and fierce competition in the US oil and gas market were only partly offset by flat-to-rising sales volumes in European and Middle Eastern regions. We expect both the domestic economy and US oil production to take at least two years to recover to pre-pandemic levels, while we assume line pipes will see marginal growth.

Minimal Debt: Interpipe's restructuring in October 2019 led to USD400 million outstanding debt, versus USD1,354 million at end-2018 (6.6x funds from operations (FFO) gross leverage). Record-high EBITDA and modest capex allowed Interpipe to shrink debt to USD331 million (1.3x FFO gross leverage) at end-2019 and further to USD81 million in October 2020. We assume Interpipe to prepay notes in full by mid-2021 following its net cash position achieved in 2H20. We conservatively assume dividends to commence from 2021, gradually driving FFO gross leverage towards 2.0x-

2.5x from 2022-2023.

Post-Restructuring Financial Policy Key: We view the post-restructuring financial structure of Interpipe as strong for the rating. It has cut capex and optimised costs notwithstanding a solid cash balance and low net debt since the COVID-19 outbreak. However, Interpipe is yet to establish a track record of its new financial policy and determine the balance in capital allocation. Sustained adherence to a prudent financial policy supporting a strong financial profile may result in a positive rating action.

Trade Restrictions Risk: Interpipe is exposed to tariffs and quotas as it exports over 70% of pipes and wheels. The risk is higher in the pipes segment as proven by recent 10% import duties introduced by Saudi Arabia and Turkey in 2Q20, on top of existing widespread trading restrictions. The risk in the wheels segment is much lower and primarily related to the Eurasian Customs Union market where we see de-escalation of trade restrictions as likely, due to a limited number of suppliers in this market.

Fees Excluded from Leverage: Interpipe's restructuring agreement includes performance-sharing fees and/or an exit fee. A USD40 million exit fee falls due only if the notes and term loan are fully discharged after 25 October 2023. Performance-sharing fees apply once the notes and term loan are fully discharged over three consecutive years, and may range 15%-25% of adjusted consolidated EBITDA. Assuming the notes are fully prepaid by end-2021, performance fee outflows may amount to USD20 million-USD25 million in 2022-2024, based on our nearly USD150 million EBITDA assumption post-2021.

Modest Capex Anticipated: We do not expect any transformative capex as Interpipe has a modern electric arc furnace and is gradually and selectively investing to improve quality and add value to its products. We expect annual capex to average USD63 million in 2020-2021 and around USD70 million thereafter. The investments are for increasing the production capacity of OCTG with premium connections, new heat-treatment lines of OCTG pipes and a new wheel machining and finishing line.

DERIVATION SUMMARY

Interpipe is a small producer with a strong position in niche and consolidated segments such as steel pipes (top-10 globally) and wheels (top-five globally). Both segments, particularly wheels, have barriers to entry, long-standing customer relationships and certification processes in various jurisdictions. However, the segments are also exposed to high volume risk.

Interpipe's closest peer is PJSC Chelyabinsk Pipe Plant (BB-/Stable), a Russian seamless and large diameter pipe (LDP) producer with bigger scale, an incumbent position in Russia's steel pipes market, and partial integration into billets. ChelPipe's lack of wheels exposure is offset by diversification towards LDP with different dynamics. Interpipe's other EMEA peers include steel producers such as Russia's PJSC Novolipetsk Steel (NLMK), PJSC Magnitogorsk Iron & Steel Works (MMK) and PAO Severstal (all BBB/Stable), Evraz plc (BB+/Stable) and ArcelorMittal (BB+/Negative) which benefit from partial or full integration into iron ore and/or coal, bigger scale and, in the case of Russian peers, cost leadership in steel operations. They also have lower volume risk but lack Interpipe's value-added product share and higher barriers to entry compared with more commoditised markets.

Interpipe's post-restructuring leverage profile is very comfortable and places the company ahead of its Russian and European peers. However, its future financial profile is yet to be defined by the company's financial policies. Interpipe's margins in the medium term are expected to converge with ChelPipe's, and remain above ArcelorMittal's but behind other steel producers'.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Pipes volumes down towards 460,000-470,000 tonnes in 2020 from around 600,000 tonnes in 2019 on coronavirus-driven economic downturn, before recovering slowly to 600,000 tonnes by 2023
- Wheels volumes marginally lower in 2020 from around 200,000 tonnes in 2019, slowly growing towards 200,000 tonnes by 2023
- EBITDA at around USD245 million in 2020, down towards USD180 million in 2021 as wheels segment normalises, and around USD150 million in 2022-2023
- Capex rising to 8% to 9% of sales towards 2022-2023
- Dividends commencing from 2021, while allowing for a gradual and decelerating gross debt increase over 2021-2023 towards USD300 million-USD350 million, corresponding to 2.0x-2.5x FFO gross leverage after 2021
- Pre-dividend FCF margin in single digits from 2020

RATING SENSITIVITIES

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

- Record of a conservative financial policy and established corporate governance practices with FFO leverage sustained below 2.5x on a gross basis or 2.0x on a net basis (2019: 1.3x gross and 0.3x net)

- Larger scale or increased diversification supporting resilience to commodities market weakness and/or economic slowdown

- The above factors may lead to an upgrade only if Ukraine's sovereign rating is upgraded or Interpipe's hard currency debt service cover is above 1.0x on a 12-month rolling basis, as calculated in accordance with Fitch's Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria

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

- EBITDA margin sustained below 8% on adverse market developments and volume pressure

- FFO leverage sustained above 3.5x on a gross basis or above 3.0x on a net basis

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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

Strong Liquidity Post-Restructuring: At end-2Q20 Interpipe had a USD187 million cash cushion compared with USD211 million notes outstanding due from 2023 onwards. Liquidity is forecast to remain strong until 2023 with no significant maturities. We expect FCF generation to be positive in 2020-2021 if no dividends are paid in 2021. Performance sharing and/or exit fees are not expected to be a drag on liquidity.

Debt Quantum at Decade-Low: As of 30 June 2020, the company had USD211 million outstanding under its notes, and prepaid a further USD129 million during August-October. Interpipe's outstanding debt, represented by the notes, amounted to a decade-low level of USD81 million. We expect the company to prepay the remaining notes by mid-2021. In addition, Interpipe entered into a total return swap (TRS) in August 2020 with regard to the notes for the notional amount of USD70 million. The term of the TRS is up to one year.

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.

RATING ACTIONS

ENTITY/DEBT	RATING		
Interpipe Holdings Plc	LT IDR	B Rating Outlook Stable	Publish

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Dmitri Kazakov, CFA
Director
Primary Rating Analyst
+7 495 956 7075
Fitch Ratings CIS Ltd
Business Centre Light House, 6th Floor 26 Valovaya St. Moscow 115054

Niels Vanden Bussche, CFA
Associate Director
Secondary Rating Analyst
+49 69 768076 276

Angelina Valavina
Senior Director
Committee Chairperson
+44 20 3530 1314

MEDIA CONTACTS

Adrian Simpson
London
+44 20 3530 1010
adrian.simpson@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria (pub. 25 Feb 2020)

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

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 26 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

Interpipe Holdings Plc	-

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in

the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any

particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Energy and Natural Resources Corporate Finance Europe Cyprus
