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Fitch Rates Interpipe's USD300 million Guaranteed Notes 'B'

Fitch Ratings - Moscow - 11 May 2021: Fitch Ratings has assigned Interpipe Holdings plc's USD300 million 8.375% guaranteed notes due 2026 a final 'B' senior unsecured rating with a Recovery Rating of 'RR4'.

The notes constitute the majority of Interpipe's post-2020 capital structure, and rank senior to the group's subordinated shareholder loan (end-2020: USD47 million). The noteholders benefit from guarantees from Interpipe's major subsidiaries representing at least 80% of the group's consolidated EBITDA. The notes' documentation contains an incurrence net debt-to-EBITDA covenant of 2.0x and restricted payments clauses that cap shareholder distributions.

Interpipe's Long-Term Issuer Default Rating (IDR) of 'B' incorporates the group's smaller scale than peers', exposure to the Ukrainian operating environment and an evolving financial policy. Its pipe business is partly exposed to the oil and gas markets where customers have volatile capex alongside oil price fluctuations. Interpipe is also having to expand the geographic diversification of its wheels' sales following the Russian ban on imports of Ukrainian wheels. These weaknesses are counterbalanced by a high share of value-added steel products (pipes and railway products) and Interpipe's leading domestic and regional market position in seamless pipes and wheels. The group benefits from integration into competitively priced scrap and billets, and its sales are geographically diversified.

Key Rating Drivers

Notes Driving Debt Turnaround: We expect Interpipe's debt quantum to rebase at USD300 million - USD350 million following the notes placement, representing a structural capital structure turnaround from an all-time minimum debt of around USD50 million reached at end-2020. We expect the notes to form the majority of the post-2020 capital structure, with the rest being bilateral bank loan facilities. We do not treat the group's performance securities as debt as they are linked to cash flow generation nor its subordinated USD47 million outstanding shareholder loan.

Russian Wheels Import Ban: Russia, the market accounting for 23% of Interpipe's wheels sales in 9M20, announced an import ban on Ukrainian wheels in February 2021. This accelerated the normalisation of Interpipe's wheels segment performance we had expected earlier. Interpipe's response plan includes re-focusing on other CIS as well as lower-priced European markets. We expect this to only partly mitigate the Russian market closure. We have therefore lowered our estimates for the medium-term wheel segment's EBITDA to USD50 million-USD60 million, versus USD80 million estimated previously.

Wheels Sales to Moderate: We expect wheels sales volumes to moderate to around 150kt - 160kt from 2021, with Interpipe's geographical mix shifting away from CIS to non-CIS export markets (mostly Europe), which we expect to overtake the majority of wheels shipments from 2021. We estimate non-CIS shipments at 90kt - 100kt over the next three to four years, versus 77kt in 2020.

Divergence in Pipe Volume Recovery: Interpipe's oil country tubular goods (OCTG) sales volumes more than halved in 2020 due to a global downturn in oil & gas affecting domestic demand and exports to the US. We assume a full recovery in OCTG no earlier than 2022, mostly driven by Middle East and CIS markets. In contrast, seamless line pipes sales moderately grew in 2020 and are expected to be roughly flat in 2021-2022.

Recovery in volumes and prices driven by capex initiatives in the pipe segment should hasten the segment's EBITDA growth towards USD80 million-USD90 million, exceeding the USD35 million-USD50 million pre-pandemic.

Capex Revised Up: Interpipe's capex will peak at USD80 million-USD90 million in 2021-2022, driven by a number of initiatives including new pipe heat treatment equipment, pipe-rolling mill modernisation and new OCTG finishing line for casing. Wheels projects are aimed at expanding processing and painting capacity as well as at wheelset assembly expansion.

Building Up Financial Record: Interpipe's prudent approach to capex and record-high earnings have allowed debt repayment since the group's restructuring in 2019. Following the notes placement, we expect the group to gradually build up a record of newly established financial policies, shaped by covenants and/or by internally developed financial policies.

Barriers to Entry: Long-standing customer relationships and time-consuming certification processes in various jurisdictions, particularly in the wheels segment, provide barriers to entry. These benefits, however, come with higher volume risk and longer customer replacement periods, especially in export markets. It is also partly exposed to volatile oil markets via the pipes division and to the Ukrainian and CIS economies especially via the wheels business, which exacerbate market pressure during recessions; commodity market volatility; or escalating trade barriers.

Trade Restrictions Risk: Interpipe's exports exceed 70% of revenues, exposing the group to tariffs and quotas. Pipes are more exposed as proven by the recent 10% import duties introduced by Saudi Arabia and Turkey in 2Q20, on top of the trading restrictions imposed by Eurasian Customs Union, the EU, USA, Mexico and Brazil. The risk of trade restrictions in wheels is primarily related to the Eurasian Customs Union market where Interpipe faced Russia's import ban following the anti-dumping duty.

Fees Excluded from Leverage: Interpipe's restructuring agreement as of 25 October 2019 includes performance-sharing fees. Performance-sharing fees apply once the previous notes and term loan are fully discharged over three consecutive years, and now stand at 15% of adjusted consolidated EBITDA. Interpipe's full redemption of previous notes in 1Q21 is in line with our earlier expectations, and triggers performance fees of around USD25 million-USD27 million per year in 2022-2024, based on our USD170 million-USD180 million post-2021 EBITDA assumption.

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, are higher value-added steel products characterised with 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-/RWN), 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 market dynamics.

Interpipe's EMEA steel peers also include Russia's PJSC Novolipetsk Steel, PJSC Magnitogorsk Iron & Steel Works and PAO Severstal (all BBB/Stable), EVRAZ plc (BB+/Stable) and ArcelorMittal S.A. (BB+/Positive), which benefit from partial or full integration into iron ore and/or coal, much bigger scale and, in the case of Russian peers, global 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 their more commoditised markets.

Interpipe's post-restructuring leverage profile is rebased at a higher level following the notes issue, placing the group between low-leveraged investment-grade Russian steel peers and higher-leveraged peers in the 'BB' rating category. We expect Interpipe's margins to moderate and converge with ChelPipe's, but remain below most steel peers', except for ArcelorMittal's, by 2022-2024.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Pipes volumes to recover towards 675kt by 2024 from around 485kt p.a. in 2020

- Wheels volumes at around 150kt from 2021, down from 193kt in 2020, following Russia's ban on imported wheels

- EBITDA to moderate towards USD190 million in 2021 and around USD170 million-USD180 million thereafter as the wheels segment's normalisation is partially offset by the pipes segment's rebound

- Performance-sharing fees to commence from 2H22, constituting 15% of two prior semi-annual EBITDA

- Capex to peak at 9%-10% of sales in 2021-2022 and average 5% in 2023-2024

- Shareholder distributions to commence at a USD230 million peak in 2021, moderating towards levels that are commensurate with neutral post-dividend FCF by 2023-2024

Key Recovery Analysis Assumptions

The recovery analysis assumes that Interpipe would be considered a going concern (GC) in bankruptcy and that it would be reorganised rather than liquidated.

Interpipe's GC EBITDA assumption of USD140 million is a combination of USD70 million EBITDA for the pipes segment, USD50 million for the wheels segment and USD20 million for the steel segment.

The GC EBITDA estimate reflects Fitch's view of a sustainable, post-reorganisation EBITDA level upon which we base the enterprise valuation. The wheels segment EBITDA reflects its vulnerability to trade restrictions at export destinations, as shown by the recent Russian ban on Ukrainian wheel products. The EBITDA estimate for pipes takes into account the 2020 oil-and-gas market volatility both domestically and abroad, but assumes Interpipe's investments into the segment including premium OCTG products will place the segment's GC EBITDA above the 2020 level.

We apply an enterprise value /EBITDA multiple of 4.0x to reflect the structurally cash-generative business consisting of two segments, but also reflecting Interpipe's small scale and asset base concentrated in Ukraine.

Interpipe's USD45 million bilateral secured bank facilities are senior to the company's USD300 million guaranteed notes.

After deducting 10% for administrative claims and taking into account Fitch's Country-Specific Treatment of Recovery Ratings Rating Criteria, our waterfall analysis generated a waterfall-generated-recovery calculation (WGRC) for the guaranteed notes in the 'RR4' band, indicating a 'B' instrument rating. The WGRC output percentage on current metrics and assumptions was 50%.

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

- Larger scale or increased diversification supporting resilience to commodities markets 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 14% 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

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: Interpipe enters 2021 with strong liquidity with a USD97 million cash buffer against USD6 million outstanding previous notes and a USD45 million bilateral bank facility due from 2023. We forecast liquidity to remain strong following the new USD300 million guaranteed notes issue. We do not anticipate additional substantial debt nor a drain on its cash position to materially below USD100 million from funding shareholder distributions. This is despite our assumptions of post-dividend FCF remaining negative in 2021 and moving towards neutral levels by 2023-2024.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. This means 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.

Date of Relevant Committee

26 April 2021

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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Interpipe Holdings Plc					
• senior unsecured	LT	B	New Rating	RR4	B(EXP)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub.05 Jan 2021)

Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria (pub.08 Jan 2021)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub.30 Apr 2021)

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

Solicitation Status

Endorsement Status

Interpipe Holdings Plc	UK Issued, EU Endorsed

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