

Research Update:

# Special Chemicals Company Perstorp Holding Downgraded To 'B-' On Weakened Demand In COVID-19 Fallout; Outlook Negative

April 21, 2020

## Rating Action Overview

- We believe the COVID-19 pandemic and resulting recession are likely to hurt Perstorp Holding AB's sales and earnings.
- Although Perstorp will likely implement several measures to preserve margin and cash, we expect the group's credit metrics will weaken to levels below our previous base-case assumptions for 2020-2021.
- As a result, we are lowering to 'B-' from 'B' our issuer credit and issue ratings on Perstorp and its senior secured facilities.
- The negative outlook reflects that, over the coming 12 months, Perstorp's leverage will likely surpass 8.5x, as well as the potential for further deterioration and weaker liquidity in the event of worsening macroeconomic conditions.

## Rating Action Rationale

**The economic recession in many parts of the world, including the U.S. and Europe, will weaken Perstorp's EBITDA and credit metrics in 2020.** We believe that the debilitating economic effects of COVID-19 will lead to a further reduction in Perstorp's 2020 EBITDA and weaker credit measures. The group's operations are heavily exposed to cyclical end markets such as transportation (19% including auto and aviation), industrial (21%), and construction (27%). As a result, we anticipate revenue will decline by 5%-10% in 2020, resulting in a 8%-13% adjusted EBITDA contraction. We now anticipate Perstorp's debt to EBITDA, as adjusted by S&P Global Ratings, will surpass 8.5x in 2020, then deleverage to slightly below 8.0x in 2021. As such, we no longer think that Perstorp will improve its leverage in 2020 to adjusted debt to EBITDA below 6.5x, the threshold for our 'B' rating.

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**Perstorp will likely generate free operating cash flow (FOCF) over the next 12 months.** We understand the company expects to implement several strategic measures to protect margins and preserve cash. These include reducing fixed costs and postponing growth capital expenditure (capex). Following this, we forecast temporary positive FOCF in 2020 on the back of a material reduction in capex. Most of this capex is related to an expansion project in India that should resume when demand bounces back. At the same time, Perstorp recently drew down fully on its €100 million revolving credit facility (RCF), due 2025, as a precaution, and we assume these funds will stay on the balance sheet. Since we assess its business risk profile as weak and consider its financial-sponsor ownership, we do not net cash from debt in calculating Perstorp's leverage.

**Perstorp has maintained adequate liquidity so far, but constraints could appear given the concerns on COVID-19 fallout.** We expect the company to have sufficient liquidity over the next 12 months. At end-March 2020, we anticipate the company to have Swedish krona (SEK) 900 million-SEK1,000 million of available cash on the balance sheet, supported by the €100 million from the RCF. Over the next 12 months, we expect the company will see positive funds from operations (FFO) and curb capex. Limited debt repayments also support our liquidity assessment. We acknowledge, however, that liquidity pressure could intensify given the economic and credit distresses stemming from the COVID-19 pandemic.

**S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak.** Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

## Outlook

The negative outlook on Perstorp reflects potentially weaker-than-expected earnings and credit. In our base case, we assume a contraction in the U.S. and European economies and a pronounced slowdown in Asia-Pacific that will hinder demand for the company's products. Factoring in potential demand obstacles from a weaker macroeconomic environment, we expect S&P Global Ratings-adjusted debt to EBITDA of between 7x and 8x on a weighted-average, forward-looking basis. That said, we incorporate in our outlook further risks to our projections given the possibility of a greater economic slowdown

## Downside scenario

We could lower the rating by at least one notch if demand for Perstorp's products declined further, leading to a material EBITDA deterioration to below SEK1.1 billion and weakening overall liquidity. Liquidity sources to uses below 1.2x or the prospect of negative FOCF could also prompt a negative rating action.

## Upside scenario

We could revise the outlook to stable over the next 12 months if Perstorp's earnings do not weaken as much as we anticipate or if we see signs of a faster-than-expected recovery in end markets that

strengthens the group's debt to EBITDA. We could raise the rating over the next year if the company's business and performance strengthens materially beyond our expectations, such that debt to EBITDA improves to below 6.5x on a sustained basis. We would also expect the liquidity sources to uses ratio to remain above 1.2x.

## **Company Description**

Perstorp is a specialty chemicals company headquartered in Sweden and owned by private equity investors, including Landmark Partners. The company has approximately 1,400 employees and operates seven production sites in six countries. In 2019, Perstorp generated 55% of its sales in Europe, 23% in the Americas, and 21% in Asia-Pacific, with revenue of SEK11.6 billion and SEK1.5 billion of EBITDA.

## **Our Base-Case Scenario**

In our base case we assume:

- A deteriorating macroeconomic environment as the COVID-19 pandemic escalates and growth heads sharply lower against a backdrop of volatile markets and increasing credit stress. We now forecast a global recession this year, with 2020 GDP rising just 0.4%. In the eurozone, we now expect the economy to contract 2.0% this year. Whereas in the U.S., we now expect a contraction of 1.3%. Asia-Pacific growth in aggregate will likely more than halve to about 2.4%.
- Subdued demand from Perstorp's end markets, most of which are cyclical in nature and correlated with GDP. However, the group's presence in some fast-growing niches such as animal nutrition should support sales volumes partially above GDP level.
- Revenue to contract in 2020 due to weak demand. We expect a return to 3%-7% revenue growth in 2021. Our assumptions are closely tied to global and regional GDP growth, along with our expectation that demand in key cyclical end markets such as construction, industrial, and transportation will contract in 2020.
- Adjusted EBITDA margin of 12.0%-13.0% in 2020 and 2021, with demand weakness offset by favorable raw material cost declines
- Capex of about SEK500 million in 2020 and SEK1,000-SEK1,100 million in 2021.
- No acquisitions or further business disposals
- No dividend distribution.
- No pronounced changes in the exchange rates from year-end 2019. However, Perstorp is sensitive to foreign exchange fluctuations because its reporting currency is Swedish krona, while more than half of sales are generated in euros and another 31% in U.S. dollars. The costs are more evenly split between the three currencies (namely because more than half of the group's employees are based at Swedish sites), while 60% of the term loan B is euro-denominated and the rest is in U.S. dollars. To some extent, interest payments on debt have a natural hedge given euro/U.S. dollar-denominated sales. As such, a weaker Swedish krona leads to improvement in EBITDA and an increase in debt

Based on these assumptions, we arrive at the following credit measures:

- S&P Global Ratings-adjusted EBITDA of about SEK1.2 billion-SEK1.3 billion in 2020, rising to SEK1.4 billion-SEK1.5 billion in 2021.

- An adjusted debt-to-EBITDA ratio above 8.5x in 2020, improving to below 8.0x in 2021 (assuming constant SEK/euro exchange rate).
- Adjusted FFO to debt in the range of 5.5%-7.0% in 2020-2021.
- EBITDA interest coverage of about 2.0x in 2020-2021.

## **Liquidity**

We assess Perstorp's liquidity as adequate. This reflects our view that its liquidity sources will cover liquidity uses by more than 1.2x over the 12 months.

We anticipate that Perstorp will have the following principal liquidity sources for the 12 months started March 31, 2020:

- Unrestricted cash on balance sheet of SEK900 million-SEK1,000 million.
- Forecast FFO of about SEK650 million-SEK700 million.

We anticipate the following principal liquidity uses:

- Capex of about SEK500 million-SEK700 million over the next 12 months.
- Neutral year-end working capital plus intrayear seasonal working capital requirements of approximately SEK150 million.
- Moderate term loan B amortization of about SEK37 million per year.

## **Covenants**

The RCF contains one springing financial covenant tested on a quarterly basis when drawings exceed 40% of the RCF. Under the terms of the RCF, the senior secured net leverage ratio should not exceed 7.9x.

Given that the company has fully drawn its RCF recently, we expect Perstorp to remain in compliance with this covenant over the next 12 months but cushions could narrow depending on how much operating conditions deteriorate in 2020. It is worth noting that the compliance ratio calculations may differ from the adjusted ratios calculated by S&P Global Ratings.

## **Issue Ratings--Recovery Analysis**

### **Key analytical factors**

- The issue rating on the existing senior secured facilities, which include a dual tranche of €510 million and \$385 million TLB is 'B-' with a recovery rating of '3', indicating our expectation of meaningful (50%-70%) recovery prospects.
- The recovery rating is supported by the limited amount of prior-ranking liabilities comprised of a €125 million factoring facility, but undermined by large senior secured debt amount and our view of the relatively weak security package, comprising share pledges, intra-group receivables (not trade receivables) and bank accounts.
- In our hypothetical default scenario, we assume revenue and margin contraction, owing to

adverse macroeconomic developments and increased raw material volatility, amid strong competition, leading to a payment default.

- We value Perstorp as a going concern, given its leading market position in several sectors of the specialty chemicals market.

### **Simulated default assumptions**

- Year of default: 2022
- Jurisdiction: Sweden
- EBITDA at emergence: SEK1,245 million
- Enterprise value multiple: 5.5x

### **Simplified waterfall**

- Gross recovery value: SEK6,848 million
- Net recovery value for waterfall after admin. expenses (5%): SEK6,506 million
- Estimated priority claims (factoring): SEK687 million
- Remaining value for creditors: SEK5,819 million
- Estimated first-lien debt claims: SEK10,020 million\*
- Recovery range: 50%-70% (rounded estimate: 55%)
- Recovery rating: 3

\*All debt amounts include six months of prepetition interest.

### **Ratings Score Snapshot**

Issuer credit rating: B-/Negative/--

Business risk: Weak

- Country risk: Low
- Industry risk: Low
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/leverage: Highly leveraged

Anchor: b-

Modifiers

Diversification/portfolio effect: Neutral (no impact)

Capital structure: Neutral (no impact)

Financial policy: Financial sponsor-6 (no additional impact)

Liquidity: Adequate (no impact)

Management and governance: Fair (no impact)

Comparable ratings analysis: Neutral (no impact)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Europe Braces For A Deeper Recession In 2020, April 20, 2020

## Ratings List

### Downgraded

	To	From
<b>Perstorp Holding AB (publ)</b>		
Issuer Credit Rating	B-/Negative/--	B/Negative/--
Senior Secured	B-	B
Recovery Rating	3(55%)	3(55%)

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