Research Update:

# Metso Corp. (Neles) Downgraded To 'BBB-/A-3'; Ratings Remain On CreditWatch Negative

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## Rating Action Overview

- Metso Corp.'s increased financial leverage--stemming from its recent acquisition of McCloskey for $300 million, poor working capital performance, and generous dividend distributions--is weighing on its consolidated financial performance, with funds from operations (FFO) to debt decreasing to about 40% in 2019 from above 80% at the end of 2018.
- Negative pressure from the COVID-19 pandemic, lower commodity prices, and weaker market conditions will all likely weigh on Metso Corp.'s credit metrics in 2020, leading to an adjusted FFO-to-debt ratio of about 25% in our base case.
- We are lowering our long- and short-term issuer credit ratings on Metso Corp. to 'BBB-/A-3' from 'BBB/A-2'. The issuer credit ratings remain on CreditWatch, where we placed them with negative implications on July 9, 2019.
- The CreditWatch placement reflects the risk that we could downgrade Metso Corp. (to be renamed Neles) again once it demerges from its minerals division, Metso Minerals, and transfers it to Outotec (see "Metso Outotec Outlook Revised To Negative On Increased Leverage Risk Due To COVID And Tie-Up; 'BBB-(Prelim)' Affirmed," published March 25, 2020). This downgrade would ultimately depend on Neles' final capital structure following the spinoff.

## Rating Action Rationale

**We think Metso Corp.'s credit metrics will be under pressure for 2020 due to the COVID-19 outbreak and lower commodity prices.** The downgrade primarily reflects the greater-than-expected weakening in Metso Corp.'s credit metrics. This stems from the recent acquisition of McCloskey for $300 million, as well as the proposed €220 million dividend on 2019 profits. Additionally, the recent significant oil price drop, downward trend of other commodity prices, and COVID-19 pandemic are all likely to exert pressure on the company's margins and topline. This could cause the company's S&P Global Ratings-adjusted FFO-to-debt ratio to decline to about 25% in 2020 from about 40% in 2019 and about 80% in 2018.

**We expect Metso Corp. (to be renamed Neles) to have a comparatively weaker credit standing following the spinoff of Metso Minerals, so our issuer credit ratings on Metso Corp. remain on CreditWatch with negative implications.** Metso Corp.'s flow control segment (Neles) generated revenue of €660 million in 2019, which accounted for 18% of revenue and €104 million of earnings before interest, tax, and amortization. This is markedly lower than the €381 million generated by the minerals division. In addition, Neles will derive its full earnings and cash flow from the valves business, reducing its diversification.

The valves business will be more profitable, with margins at about 17% versus about 15% for Metso Corp. (consolidated for the full year 2019), due to the minerals division's lower profitability. However, we do not currently have clear visibility on Neles' financial risk profile, since it will depend on cash following the demerger, working capital needs, divided policy, future investment strategies, transaction costs, and potentially higher headquarters costs, among other developing factors. We therefore expect to assess Neles at the transaction's closing, when we will know the full details of its capital structure and strategies.

**Given the very fluid and challenging environment generated by both the COVID-19 pandemic and lower commodity prices from 2020, we expect margins to drop by 300 basis points from 14.5% at end-2019.** The outbreak of COVID-19 has had a limited effect on Metso Corp.'s ordering intake and business activities in China. However, we anticipate a slowdown from the second quarter (Q2) of 2020. This will translate into organic growth falling by about 5%-10% from 2019 levels, excluding the recent McCloskey acquisition.

We also understand that the COVID-19 outbreak has not affected Metso Corp.'s operations or activities in China. However, we expect the increasing span of the pandemic to put pressure on margins and credit ratios.

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 between June and August, and we are using this assumption in assessing the economic and credit implications. We believe measures to contain COVID-19 have pushed the global economy into recession and could cause a surge of defaults among nonfinancial corporate borrowers (see "COVID-19 Macroeconomic Update: The Global Recession Is Here And Now" and "COVID-19 Credit Update: The Sudden Economic Stop Will Bring Intense Credit Pressure," published on March 17). As the situation evolves, we will update our assumptions and estimates accordingly.

## CreditWatch

We aim to resolve the CreditWatch placement when Metso Minerals spins off and merges into a new entity with Outotec, or when we have sufficient information to assess Neles' leverage, financial policies, operating stand-alone performance, and investment plans. We expect the merger of Metso Minerals with Outotec to occur by the end of Q2 2020.

At the deal's completion, we expect Neles' business to be materially weaker than that of Metso Corp. today. At this stage, given the size of the flow control division, as well as its limited business diversity at closing, we think a downgrade into the 'BB' category is likely.

We have downgraded Metso Corp.'s senior unsecured notes to 'BBB-' and removed them from CreditWatch. This reflects the successful closing of the bond solicitation process. On the date of the demerger, Metso Corp. will transfer the bonds to Metso Outotec, which has a preliminary 'BBB-' rating with a negative outlook.

## Company Description

Headquartered in Helsinki, Metso Corp. is an industrial company that provides equipment and services for mining, aggregates, recycling, oil, gas, pulp, paper, and process industries worldwide. The company operates through the minerals and flow control divisions, with 82% and 18% consolidated sales, respectively.

In 2019, Metso Corp. reported total revenue of €3.6 billion, an increase of about 15% compared with the previous year. Its adjusted EBITDA margin, on a consolidated basis, reached slightly more than 14.5% in 2019, up from 14.2% in 2018.

Metso Corp. is listed on the Nasdaq Helsinki Stock Exchange, with market capitalization of €3 billion as of March 19, 2020. The company employs more than 13,000 professional across 50 countries. The top 20 shareholders represent about 29% of company's share capital; the remainder is free float. Solidium Oy is the major shareholder with about 15% of Metso Corp.'s share capital.

In 2019, the company decided to spin off its minerals division and merge it with Outotec, forming a new entity, Metso Outotec. Both Metso Corp.'s and Outotec's annual general meetings approved the merger, as have their creditors. Consequently, Metso Corp. has reported its minerals division as discontinued operations for 2019. The transaction is subject to customary antitrust clearances. Metso Corp. expects the merger to occur by the end of Q2 2020.

## Our Base-Case Scenario

- Revenue declining by 0%-5%, supported by the recent McCloskey acquisition. We expect organic sales will drop by about 5%-10% on a consolidated basis. This would lead to sales of about €3.5 billion, slightly lower than 2019.
- Adjusted EBITDA margins of 11%-12% in 2020, falling by about 300 basis points from 2019 then improving to about 12% in 2021.
- Positive working capital inflow of about €80 million against more than €220 million negative in 2020.
- Capital expenditure (capex) of €80 million in 2020.
- Dividend payment of about €220 million in 2020, increasing from €180 million in 2019.

## Liquidity

Metso Corp. has a short-term issuer credit rating of 'A-3'. We assess the company's liquidity as strong, based on our forecast that the source-to-use ratio will be about 2.3x in 2020 and 1.5x in 2021.

Metso Corp. has only one capital structure covenant in its revolving credit facility (RCF), which would be tested only if the rating on the company were to drop into the speculative grade category or if we were to withdraw our ratings.

We expect principal liquidity sources over the 12 months from Dec. 31, 2019 will include:

- Cash and liquid assets €154 million. This excludes our assumption of up to €60 million for cash held in countries from which it is difficult to repatriate;

- Undrawn RCF totaling €600 million, maturing in 2024;
- Cash FFO of €220 million-€230 million, including the lease payments; and
- Working capital inflow of about €80 million.

We expect principal liquidity uses over the same period will include:

- Repayment of €60 million and a €300 million repayment in 2021 for the unsecured notes;
- Estimated intra-year working capital outflow of up to €100 million per year;
- Capex of about €70 million-€80 million; and
- Divided payment of €220 million.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

As of year-end 2019, Metso Corp.'s unadjusted debt amounted to about €880 million. Almost all the debt sits at the parent level and is unsecured. Therefore, we see no subordination risks.

Metso Corp.'s bonds are rated 'BBB-', at the same level as the preliminary rating on Metso Outotec.

## Ratings Score Snapshot

Issuer Credit Rating: BBB-/CreditWatch Negative/A-3

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers

- Diversification - Portfolio Effect: Neutral (No impact)
- Capital Structure: Neutral (No impact)
- Financial Policy: Neutral (No impact)
- Liquidity: Strong (No impact)
- Management and Governance: Satisfactory (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: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

- Metso Outotec Outlook Revised To Negative On Increased Leverage Risk Due To COVID And Tie-Up; 'BBB-(Prelim)' Affirmed, March 25, 2020
- Metso's Lower-Than-Expected Cash Generation And Softer Market Conditions Could Reduce Rating Headroom For Metso Outotec, Feb. 7, 2020
- Metso 'BBB' Ratings On CreditWatch Negative On Proposed De-Merger Of Its Mineral Business, July 9, 2019

## Ratings List

**Downgraded**

| | To | From |
|---|---|---|
| **Metso Corp.** | | |
| Issuer Credit Rating | BBB-/Watch Neg/A-3 | BBB/Watch Neg/A-2 |

**Downgraded; CreditWatch/Outlook Action**

| | To | From |
|---|---|---|
| **Metso Corp.** | | |
| Senior Unsecured | BBB- | BBB/Watch Neg |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.