



## AK Steel Holding Corporation (AKS): Gloomy Anticipated 4Q Results Likely the Bottom; Entire Structure up to BUY

### Investment Thesis

Despite what we would characterize as a rather less-encouraging quarter from the integrated steelmaker in 3Q17, we still see value in AKS' outstanding notes and expect them to appreciate from today's levels once we get past what will likely be a dismal Q4-2017. AKS guided to lackluster results in 4Q due to input cost inflation amid stable steel prices that are likely to achieve higher levels and cover the cost inflation in Q1-2018. After a strong beginning to 2017, AKS' 2H-2017 results have underperformed expectations on account of higher-than-anticipated planned maintenance expense (which should be viewed as a positive in that AKS actually regularly services its various facilities, unlike some other steel peers) coupled with inflationary input costs. We are reinforcing our positive view of the steelmaker considering 1) the market is aware that 4Q17 is likely to be a bad quarter, 2) domestic steel pricing and capacity utilization is on the rise, and 3) we expect price hikes to offset increased input cost expense in 1Q18. More, the highest proportion of AKS' contracted prices renew around yearend; given higher spot steel prices, we would expect AKS' contracted-part of its pricing matrix to be higher YoY, particularly with automakers, which should help mitigate any potential volume weakness on the automotive front. Lastly, AKS' Precision Partners acquisition in July 2017 has yet to anniversary a full year of earnings and we expect 1H-2018 to benefit from the acquisition.

### Recommendation

Hence given our belief that most of this weakness is already baked-in to price levels, we are moving the entire capital structure to a Buy rating. We initiate on the 6.375% senior notes due 2025 (98.75 price, 6.6% YTW, 405 OAS) with a Buy rating. We are also increasing our rating on AKS' 7.625% senior notes due 2021 (103.75 price, 5.0% YTW, 333 OAS) to a Buy rating due to our expectation that AKS will come to market and refinance the earliest maturing note in 2018 now that the bonds have become callable at 103.813%. We reiterate our Buy rating on AKS' 7.5% senior secured notes due 2023 (108.25 price, 4.3% YTW, 233 OAS). While the 7.5% secured notes are rated B1/BB-, we see them as an upgrade candidate to Ba3 by Moody's and believe they should trade more in line with BB credits, especially considering a strong collateral package, inability to layer and solid 1.7x net leverage ratio. Similarly, we reiterate our Buy rating on AKS' 7.0% senior notes due 2027 (101.750 price, 6.7% YTW, 412 OAS) for the reasons listed above.

### Risks

Downside risks to our Buy ratings include increased imports of foreign steel, lower automotive production, share losses to aluminum, unplanned outages, an inability to offset inflationary input costs in 2018 with higher selling prices, union disputes, interest rate hikes.

Figure 4: AK Steel Holding Corporation (AKS) 3Q17 Capitalization

<b>Capitalization</b>	<b>Amount</b>	<b>Bid / NL</b>	<b>Mkt Value</b>	<b>YTW / NL</b>
Cash & Equivalents	\$64		\$64	
\$1.35bn L+200 ABL Revolver 9/13/22	415		415	
\$380mn 7.50% Sr Sec'd Nts 7/15/23	380	108.250	380	4.3%
Capital lease	25		25	
<b>Secured Debt</b>	<b>\$820</b>	<b>1.7x</b>	<b>\$820</b>	<b>1.7x</b>
\$150mn 5.00% Sr Converts 11/15/19	150	131.875	150	-10.0%
\$430mn 7.625% Sr Nts 10/1/21	406	103.750	406	5.0%
\$280mn 6.375% Sr Nts 10/15/25	280	98.750	277	6.6%
\$400mn 7.000% Sr Nts 3/15/27	400	101.750	400	6.7%
Industrial Rev Bonds due 2020-2028	99		99	
Other	(57)		(57)	
<b>Total Debt</b>	<b>\$2,098</b>	<b>4.5x</b>	<b>\$2,095</b>	<b>4.4x</b>
Market Capitalization as of 12/22/17	\$1,781	3.9x	\$1,781	3.9x
<b>Net Enterprise Value</b>	<b>\$3,815</b>	<b>8.4x</b>	<b>\$3,811</b>	<b>8.4x</b>

Source: Deutsche Bank, Company Reports