

FitchRatings

Fitch Assigns First-Time 'BB-' IDR to Borets International

Fitch Ratings-London-24 March 2017: Fitch Ratings has assigned Borets International Limited first-time Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) of 'BB-' and Short-Term Foreign- and Local-Currency IDRs of 'B'. Fitch has also assigned a senior unsecured rating of 'BB-' to the Borets Finance DAC's outstanding 2018 Eurobonds and a senior unsecured expected rating of 'BB-(EXP)' for its Eurobonds of up to USD400 million. The Outlook on the Foreign- and Local-Currency IDRs is Stable.

The ratings are supported by the company's high margins, moderate geographical diversification and good liquidity. However, a relatively weak business profile due to lack of product diversification constrains the ratings.

KEY RATING DRIVERS

Good Underlying Cash Flows: Borets consistently generates funds from operations (FFO) above 14% and free cash flow (FCF) margins above 2%. Fitch considers these good for the rating and broadly in line with industry peers. The company is vulnerable to the translation effect of foreign-currency swings, but its revenue and costs are closely matched by currency, which allows margin preservation to be maintained.

Solid Liquidity and Moderate Leverage: Borets' liquidity is adequate, with unrestricted cash at end-2016 of USD23 million and unused credit facilities of USD5 million, more than sufficient to cover short-term maturities of USD8 million relating to the interest payment on the company's Eurobonds. Gross and net leverage, at around 3x at end-2016, are in line with the present rating and Fitch expects them to remain broadly stable over the medium term.

Solid Position in a Niche Market: The market for Borets' electrical submersible pumps (ESPs) is relatively niche but also protected from new entrants due to the high technological content and the need for strong relationships with the key customers. Borets is the largest producer of ESPs globally by units. The relatively weak diversity due to its almost exclusive focus on ESPs is offset by its high portion of services and aftermarket revenue, strong and long-term relationships with major oil companies, low-cost production base, high vertical integration and relatively high barriers to entry.

Limited Product Diversification: Borets' business profile is restricted by a narrower product and customer range than some of its major peers. The group's product portfolio is limited to its ESP systems for the oil and gas industry, with most customers based in Russia (although this is changing), exposing it to the fortunes of these companies.

Market Protected from Oil Price Changes: Borets' products are accounted as operating expenditures for its customers. Oil production in the existing oilfields would be impossible without ESPs and therefore expenditures for acquiring them cannot be postponed. Furthermore, oil companies in Russia (and worldwide) are focusing more on brownfield projects, requiring more ESPs and making Borets less vulnerable to oil price shocks.

DERIVATION SUMMARY

Borets is moderately well positioned relative to peers. A relatively weak business profile, exemplified by poor product diversification, is offset by its strong market position in Russia and globally, most of the company's customers having good credit quality. Margins are stable and relatively high owing to the company's good execution capabilities and low cost position, while leverage is in line with peers.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- Modest revenue growth of 3%-5% annually, slightly below CAGR growth of 3%-6% for Borets' ESP installed base and ESPs under service agreements over the last 10 years
- Gradually declining EBITDA margin to around 23%, closer to the historical average
- Part of outstanding Eurobonds to be refinanced through the tender offer
- No dividend payments over the rating horizon
- Capex at around 4% of revenue over 2017-2020, slightly above the historical average of 3.5%

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

An upgrade is unlikely if the business profile does not improve materially, including a major increase in scale and improvement in the geographical diversification.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

- FCF margin below 1% on a sustained basis
- Extensive capital expenditures, acquisition programme or significant change in dividend policy
- FFO adjusted net leverage above 3.5x on a sustained basis
- FFO fixed charge coverage below 3.0x on a sustained basis

LIQUIDITY

Adequate Liquidity: Borets' liquidity is adequate, with unrestricted cash of USD23 million and unused credit facilities of USD5 million, more than sufficient to cover short-term maturities of USD8 million, which relate to the interest payment on the Eurobonds. The tender offer is announced for the whole amount of the outstanding bonds of USD373 million and financed by the proposed bond issue.

The portion of the newly issued Eurobond, which would not be used for the repayment during the tender offer, would be kept as cash in US dollars with the sole purpose of repayment of the 2013 Eurobond.

FULL LIST OF RATING ACTIONS

Borets International Limited

- Long-Term Foreign-Currency IDR 'BB-'; Outlook Stable
- Long-Term Local-Currency IDR 'BB-'; Outlook Stable;
- Short-Term Foreign-Currency IDR 'B';
- Short-Term Local-Currency IDR 'B'.

Borets Finance DAC

- Senior unsecured 'BB-';
- Senior unsecured 'BB-(EXP)'

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Summary of Financial Statement Adjustments

Operating leases: operating lease expenses were capitalised using a multiple of 6x as the company is based in Russia.

Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary

Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
(<https://www.fitchratings.com/site/re/895493>)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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