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Research Update:

Oil Pump Producer Borets International Upgraded To 'BB-' On Improved Capital Structure; Outlook Stable

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Research Update:

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Overview

- Dubai-based capital goods company, Borets International Limited, which specializes in electric submersible pump systems, has demonstrated resilient earnings and an ability to improve profitability during tough market conditions. At the same time, Borets issued new $330 million five-year notes and partially repaid its existing $420 million notes.
- This has led to stronger credit metrics, an improved capital structure, and diminished refinancing risk.
- We are therefore upgrading Borets to 'BB-' from 'B+' and raising our Russia national scale rating on the company to 'ruAA-' from 'ruA+'.
- The stable outlook reflects our view that Borets will continue to strengthen its operating performance, delivering sustained profitability. This should enable Borets to maintain debt to EBITDA below 3.0x and funds from operations to interest coverage above 2.5x.

Rating Action

On April 28, 2017, S&P Global Ratings raised to 'BB-' from 'B+' its long-term corporate credit rating on electric submersible pump (ESP) producer Borets International Limited (Borets). The outlook is stable.

At the same time, we raised the Russia national scale rating on Borets to 'ruAA-' from 'ruA+'.

We also assigned our 'BB-' long-term corporate credit rating to Borets' wholly owned finance subsidiary, Borets Finance DAC, and our 'BB-' issue rating to the new $330 million unsecured notes.

In addition, we raised our issue rating on the $420 million unsecured notes to 'BB-'.

Rationale

The upgrade reflects Borets' resilient earnings and its ability to improve profitability during tough market conditions. We incorporate further improvement in 2017 on the back of contribution from the higher margin rental business and a reduction in operating costs. We now expect Borets to maintain debt to EBITDA below 3.0x and funds from operations (FFO) to cash interest above 2.5x in 2017-2018.

At the same time, the company successfully accessed bond markets with an issue of $330 million five-year notes in April 2017, with a more favorable coupon of 6.5%. The company used proceeds to partly refinance its existing $420 million notes due in September 2018. The outstanding amount on the existing notes is $133 million. We note that refinancing risks have diminished and the company's capital structure has become more sustainable in the long term due to a better maturity profile. Borets generates about 75% of its revenues in rubles, based on the current exchange rate and breakdown between its Russian and international businesses, while more than 90% of its debt is denominated in U.S. dollars. The local currency has appreciated by about 22% year-on-year to below Russian ruble (RUB) 60 to $1, its strongest level since mid-2015, partly owing to the improvement in oil prices and investor confidence. We now think that risks related to the currency mismatch between the company's U.S. dollar debt and ruble-denominated earnings are significantly lower. Along with lower-than-expected leverage of below 3.0x and the factors described above, we have reassessed our views on the company's capital structure to neutral from negative.

Borets' 2016 underlying operating performance did not exhibit stress as a result of the low oil price environment--in fact, the company's ruble cost base provided a competitive advantage in the Russian market. While reported sales were down 7.5%--mostly due to ruble depreciation--the company posted 11% organic sales growth in Russia, supported by a large installed base and a high share of replacement sales. In 2016, the adjusted EBITDA margin increased to 24.9% from 19.9%. The company also posted improved profitability as a result of the increased contribution of the equipment rental business, as well as a favorable contract mix and ruble-denominated cost base.

Borets' products are typically classified as operating expenses (opex) rather than capital expenditure (capex). As Borets' products are typically used for oil production, we've noted resilient earnings against the decline in oil prices during the last downturn. We expect current oil production levels in Russia to support demand for Borets' products despite a signed agreement by OPEC to reduce volumes. The pick-up in oil prices should ramp up oil and gas producers' capex, which should support new wells development. Organic growth is further supported by Borets' large installed base, high share of replacement sales, and rental business expansion. Therefore, we think that this trend will continue this year and expect the company to demonstrate good organic growth.

The company benefits from established niche positions in its core segments and a sizable market share of the ESP market, which we assume it will sustain. Our assessment is constrained by the relatively small-scale operations, narrow business diversity, and fairly concentrated customer base, with the largest customer contributing about 40% of revenues.

Our base case assumes:

- In November/December 2016, in agreement with OPEC, Russia pledged to cut

its oil production. To date, the resulting global oil price increase has more than compensated for the losses from the reduced production volume.
- In December 2016, we revised our oil price assumptions (Brent) upward by $5 to $50 in 2017 and forecast that it will average $55 per barrel from 2018 through the remainder of this decade.
- Capex spending projected to increase globally by an average of 6%-10% due to the rebound in oil prices.
- GDP growth in Russia is expected to pick up, averaging about 1.7% in 2017-2020.
- The above factors should support moderate positive revenue growth of about 2%-4% in 2017 and 2018 for Borets, reaching about $500 million-$520 million, supported by solid organic growth in Russia and increasing rental sales.
- Broadly flat growth in dollar-denominated revenues year-on-year in 2017 and modest pick-up in 2016 of about 3% on the back of stabilizing oil markets and new contracts signed in the Middle East.
- An adjusted EBITDA margin of about 25%-28% in 2017 and 2018, supported by Borets' ruble cost base and contribution from the higher margin equipment business;
- Rental equipment investment of about $40 million in 2017; and
- No dividends.

Based on these assumptions, we arrive at the following credit metrics for Borets in 2017-2018;
- Adjusted FFO to debt of about 23%-28%;
- Debt to EBITDA of below 3.0x; and
- FFO interest coverage in the 3x-4x range.

Liquidity

We currently assess Borets' liquidity as adequate. Pro forma refinancing, liquidity sources exceeded uses by more than 1.2x for the next 12 months. The recent issuance of the $330 million notes and partial refinancing of the existing debt due in September 2018 has demonstrated the company's commitment to addressing refinancing risks in a timely manner. Our current base case assumes that Borets will repay the remaining $133 million of existing notes using a combination of proceeds from the new bond issue and cash generated from its operating activities. Risks to the liquidity position may arise if the company faces unexpected working capital stress. This would leave little buffer if operating cash flow falls short of management's expectations.

We forecast the following principal liquidity sources during the 12 months, pro forma refinancing, to include:
- Cash of $70 million;
- FFO of about $110 million-$115 million; and
- Full availability of RUB600 million under its revolving credit facility.

We project that liquidity uses for the same period will include:
- Limited contractual debt amortization, $23 million in loans;
- Rental capex of about $40 million; and
- Working capital outflow of about $50 million.

Borets' high-yield notes do not include maintenance covenants.

Outlook

The stable outlook reflects our view that Borets will continue to strengthen its operating performance, delivering sustained profitability. This should enable Borets to maintain debt to EBITDA below 3.0x and FFO interest coverage above 2.5x. We also expect Borets to be able to balance its rental investments and free operating cash flow generation while it expands the rental fleet.

Downside scenario

We could lower the rating if Borets' operating performance led to credit ratios weakening in the next 12 months, with adjusted credit ratios such as FFO to debt of below 20% and debt to EBITDA above 3.0x, along with FFO cash interest cover of below 2.5x. This may be due to the loss of one of the company's main clients, devaluation of the ruble, or reduced oil production leading to less demand for Borets' products. We would also consider lowering the rating if the company faces liquidity issues and is unable to repay upcoming debt maturities.

Upside scenario

An upgrade is currently unlikely. We might take a positive rating action if we expected adjusted FFO to debt consistently above 20%, debt to EBITDA of below 3.0x, and FFO interest coverage to stay above 4x. This may be the result of a material deleveraging.

Ratings Score Snapshot

Corporate Credit Rating: BB-/Stable/--

Business risk: Fair
- Country risk: High
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- 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: Ratios And Adjustments, 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating

Borets Finance DAC		
Corporate Credit Rating	BB-/Stable/--	
Senior Unsecured	BB-	

Upgraded

	To	From
Borets International Limited		
Corporate Credit Rating	BB-/Stable/--	B+/Stable/--
Russia National Scale	ruAA-/--/--	ruA+/--/--
Borets Finance DAC		
Senior Unsecured	BB-	B+

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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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the 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.