FitchRatings

Fitch Affirms Borets International at IDR 'BB-'; Outlook Stable

Fitch Ratings-London/Moscow-16 April 2018: Fitch Ratings has affirmed Borets International Limited's Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) at 'BB-' and Short-Term Foreign and Local Currency IDRs at 'B'. The Outlook is Stable. Fitch has also affirmed Borets Finance DAC's senior unsecured 'BB-'.

The ratings reflect Borets' lack of geographic, product and customer diversification against the company's high profitability and solid financial profile, with a funds from operations (FFO) margin exceeding 15%. The ratings also reflect the leading position of Borets in a niche market in Russia and globally, stable demand for its key products and a solid share of aftermarket service revenue.

KEY RATING DRIVERS

Strong Position in Niche Market: Borets specialises primarily in production of electrical submersible pump (ESP) systems and is a leading manufacturer globally with a market share of about 28% by installed base and the third largest global player in value terms. Almost all global oil wells rely on artificial lift technology, of which ESP systems contribute about 16% by unit and about 38% by value. Strong position, successful long-term cooperation with major oil producers and high capital expenses in manufacturing facilities act as significant barriers to entry in the company's niche market.

Resilient to Oil Fluctuations: Demand for ESPs has low-to-moderate correlation with oil price fluctuations as these systems are vital for oil producers and funds spent on it are viewed as operating expenses rather than capex. Without ESP systems oil production would be impossible in existing oilfields. Installed ESPs have to be replaced after the end of their average life cycle of two to five years due to the severe environment of a well bore. Resilience of the ESP market to oil price fluctuations provides sustainable revenue generation for Borets in the long-term.

Recurring Revenue Underpins Profitability: The company has a wide network of service centres located close to major oilfields and provides aftermarket services to oil producers globally, but primarily in Russia. Besides aftermarket services the company actively provides rental services of its ESP systems. The rental business is more profitable and rentals are usually contracted over four to six years, enhancing Borets' profit inflows.

Service and rental revenue has gradually increased as a share of total revenue to 44% in 2017 from 31% in 2012. The company aims to maintain a high share of aftermarket revenue, which will provide further support to business stability. Moreover, Borets plans to enlarge its rental business in Russia, which should support its EBITDA margin in the medium-term.

Weak Diversification: Borets' ratings are constrained by limited geographic diversification, a narrow range of products and customer concentration mainly on Rosneft. Business activity is primary focused on production of ESP systems for oil extraction, making its revenue sensitive to output of oil producers as key customers of the company. Limited range of products is mitigated by a material share of aftermarket services and rental revenues as well as by the resilient nature of ESP business, resulting in stable demand for ESP in the long-term. Borets derives the majority of its revenue from Russia while revenue generated outside Russia represents 25%-30% of total sales.

Solid Financial Profile: Borets sustainably generates positive free cash flow (FCF) of over 2% and FFO exceeding 15%, which enables the group to repay debt and finance business operations. Solid cash flow generation is a rating positive, which compares Borets favourably with peers.

Moderate FX Risk: The company has some exposure to FX risk. Operating mainly in Russia, Borets' operating costs are exclusively in roubles but about a quarter of revenue is correlated to non-rouble currencies. Furthermore, as the company's bond debt is linked to USD a sharp depreciation of the rouble could lead to a material increase in leverage. Nonetheless, Fitch's base case does not include major movements in the USD/RUB exchange rate.

No Impact from Sanctions: Borets is not currently impacted by sanctions imposed on certain Russian corporates and we do not expect it to be affected in the future. However, as the company is based in Russia, it may become difficult to quickly raise new funding should Russia's political relations deteriorate further. This risk will be treated on a case-by-case basis alongside political developments.

DERIVATION SUMMARY

The ratings of Borets are underpinned by its leading market position in a niche market, stable long-term demand for ESPs produced by the company, higher profitability than peers', a solid share of aftermarket revenue and sustainable FCF generation. However, the ratings are capped by limited geographical and customer diversification, smaller scale of operations versus international peers' and a limited product range.

Borets is comparable to some of its Russian and foreign manufacturing peers, such as CJSC Transmashholding (TMH; BB-/Positive), JSC HMS Group (HMS; B+/Stable) and Flowserve Corporation (BBB/Negative). Smaller scale of operations versus TMH and lack of diversification versus Flowserve, which constrain Borets' ratings, are offset by a strong position in a niche market with high barriers to entry, a solid financial profile and stable demand for ESPs. Moreover, Borets' higher share of aftermarket revenue, higher profitability and sustainably positive FCF results higher ratings than HMSs.

No country-ceiling, parent/subsidiary or operating environment aspects have an impact on the ratings.

KEY ASSUMPTIONS

Fitch's Key Assumptions within our Rating Case for the Issuer
- Single-digit rise of revenue in 2018-2021 of 4% annually, constrained in the short-term by declining oil production at wells
- Slightly declining EBITDA margin towards historical levels. Nevertheless, EBITDA margin should remain high due to an expanding, more profitable rental business
- Repayment of bonds in line with the maturity schedule
- Capex increase to about 4.8% of revenue in 2018, mainly attributed to rental tools financing as the company expands this part of its business. This figure is expected at to ease to about 3.5% of revenue thereafter
- No dividend payments over 2018-2021

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action
An upgrade is unlikely unless the business profile improves materially, including a major increase in scale and improvement in geographical diversification
Developments That May, Individually or Collectively, Lead to Negative Rating Action
-FCF margin below 1% on a sustained basis
-Extensive capex, acquisition programme or significant adverse change in the dividend policy
-FFO adjusted net leverage above 3.5x on a sustained basis (2017: 2.5x)
-FFO fixed charge coverage below 3.0x on a sustained basis (2017: 4.5x)

LIQUIDITY

Healthy Liquidity: Borets reported healthy liquidity with unrestricted cash of USD83 million as of end-2017- and unused credit facilities of about USD71 million (RUB4.1 billion). Together it is sufficient to cover expected bond redemption in 2018 of USD133 million. In 2017 Borets successfully placed a new Eurobond of USD330 million to redeem a material share of its previously issued bond via a buyback, which helped to smooth its debt repayment schedule to 2022.

Contact:

Principal Analyst
Marina Bordakova
Associate Director
+7 495 956 2400

Supervisory Analyst
Alexey Evstratenkov
Associate Director
+44 203 530 1089
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Committee Chairperson
Emmanuel Bulle
Senior Director
+34 93 323 84 11

Media Relations: Adrian Simpson, London, Tel: +44 203 530 1010, Email: adrian.simpson@fitchratings.com

Summary of Financial Statement Adjustments
-Operating lease expenses were capitalised using a multiple of 6x as the company is based in Russia.
-USD10 million is considered as restricted cash needed to cover working capital swings during a year.

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
Corporate Rating Criteria (pub. 23 Mar 2018)
(https://www.fitchratings.com/site/re/10023785)

Sector Navigators (pub. 23 Mar 2018)
(https://www.fitchratings.com/site/re/10023790)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
(https://www.fitchratings.com/site/dodd-frank-disclosure/10026955)
Solicitation Status (https://www.fitchratings.com/site/pr/10026955#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or

guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO’s credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.