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## Research Update:

# Oil Pump Producer Borets International Ltd. 'BB-' Ratings Affirmed; Outlook Stable

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## Overview

- Borets International Limited continues to demonstrate resilient performance, in line with our base case.
- Despite certain foreign exchange and political headwinds in its largest Russian market, we are confident that Borets will leverage on international expansion and value-added businesses.
- Alongside successful refinancing, this will lead to stronger credit metrics and positive cash flow generation.
- We are therefore affirming our 'BB-' long-term issuer credit rating and 'BB-' issue ratings on Borets.
- The stable outlook reflects our view that Borets will leverage on growth opportunities offered by recovering markets. We also incorporate our expectation of successful repayment of outstanding notes in September 2018.

## Rating Action

On April 27, 2018, S&P Global Ratings affirmed its 'BB-' long-term issuer credit and issue ratings on Dubai-based capital goods company, Borets International Limited, which specializes in electrical submersible pump (ESP) systems. The outlook is stable.

We also affirmed our 'BB-' issue credit ratings on the notes issued by Borets Finance DAC.

## Rationale

The affirmation reflects Borets' continued strong performance posted for the year-ended December 2017; revenues increased by 24% to $600 million, driven by operations both in Russia and internationally. Borets' EBITDA margin improved to 27% in 2017 from 25% the previous year, on an S&P Global Ratings-adjusted basis (includes $15 million in management costs). Improving performance is underpinned by the large installed base in Russia and ongoing service requirements. Borets has benefited from international expansion, whereby its dollar revenues increased by 40.5% in 2017, stemming from North America and the Middle East. We expect these trends to boost Borets' results in 2018-2019. Moreover, operating performance will be supported by the rising share of equipment rental sales. Hence, we now anticipate that Borets' top-line will increase by 3%-5% in 2018-2019, reaching $615 million-$645 million. Profitability will remain resilient, with the EBITDA margin reaching 27%-28% on an adjusted basis. Our assumption takes into account the Russian rubble (RUB) cost base and management focus on higher-margin value-added products (rental, services), which--together with the increasing share of U.S. dollar revenues--underpins resilience of the margins.

We also note that over the last downturn, Borets was able to consistently generate positive free operating cash flow (FOCF) and we expect this to remain $30 million-$45 million in 2018-2019, in spite of higher capital requirements related to rental equipment investments as well as progression on some of the orders. We also believe that Borets will repay its $133 million outstanding notes due in September 2018. The company has $50 million set aside for the repayment, and is aiming to raise an additional $50 million with international institutions. As of the end of December 2017, Borets held about $42 million on its balance sheet. Considering our assumption that the company will continue to generate positive FOCF, we believe that it will be able to accumulate additional funds for the repayment.

Borets generates about 73% 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 is expected to remain volatile throughout 2018-2019 on the back of political headwinds. We incorporate a certain amount of stress to account for the devaluation of the ruble in our base case, although this doesn't lead to a material effect on credit metrics. Any sharp prolonged deterioration in the exchange rate beyond the lowest levels experienced in the first quarter of 2016 (RUB82.4 per U.S. dollar as of Jan. 21, 2016), will decrease under the company's leverage metrics and will be assessed separately.

During the recent downturn, Borets' 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% in 2016--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. Borets' products are typically classified as operating expenses rather than capital expenditure (capex). Despite Borets' products being 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 OPEC agreement 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.

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:

- Economic growth in Russia has picked up and the recovery is set to continue, although at a slow pace. Similar to our previous forecast, we project that real GDP growth will likely increase to 1.8% in 2018, followed by a modest 1.7%, on average, over 2019-2021. Economic recovery will likely be supported by the rebound in oil prices, a moderate expansion of domestic demand backed by gradual monetary easing, and the global economic upswing.
- West Texas Intermediate (WTI) price of $55 per barrel (/bbl) in 2017-2018, and Brent crude at $60/bbl for 2018, declining to $55/bbl from 2019.
- The above factors should support moderate positive revenue growth of about 3%-5% in 2018 and 2019 for Borets, reaching about $615 million-$545 million on the back of increasing international sales and rental business expansion.
- Broadly flat growth in Russia in 2018 underpinned by production cuts. International, dollar-denominated revenues will increase 15%-20% year-on-year in 2018 on the back of stabilizing oil markets and new contracts signed in the Middle East.
- An adjusted EBITDA margin of about 27%-28% in 2018 and 2019, supported by Borets' ruble cost base and contribution from the higher-margin equipment rental business and services.
- Rental equipment investment of about $50 million in 2018.
- No dividends.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted funds from operations (FFO) to debt of about 30%-40%;
- Debt to EBITDA of below 3.0x; and
- FFO interest coverage of 5x-6x.

## Liquidity

We currently assess Borets' liquidity as adequate, with liquidity sources exceeding uses by more than 1.2x for the next 12 months.

Our current base case assumes that Borets will repay the remaining $133 million of existing notes using a combination of proceeds from the anticipated loan of $50 million (which is expected to be signed in the next month), $50 million of cash set aside for the notes repayment, 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 Borets to have the following principal liquidity sources during the 12 months, to include:

- Cash of $42 million;
- FFO of about $110 million-$120 million;
- Full availability of RUB600 million under its revolving credit facility;
- $50 million available for the purpose of notes repayment; and
- $50 million anticipated loan.

We project that liquidity uses for the same period will include:

- $133 million notes due in September 2018; and
- Capex of about $30 million.

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

## Outlook

The stable outlook reflects our view that Borets will leverage on growth opportunities offered by recovering markets. We also incorporate the expected successful repayment of outstanding notes in September 2018. The stable outlook also takes into account that Borets' performance will remain resilient against currency fluctuations, whereby debt to EBITDA will remain below 3.0x and FFO cash interest of above 4x.

### 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 4x. This may be due to the loss of one of the company's main clients, sharp and prolonged 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 Borets significantly expanded its scale, reduced concentration risks, and increased the share of U.S. dollar revenues.

## Ratings Score Snapshot

Corporate Credit Rating: BB-/Stable/--

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

Financial risk: Significant
- Cash flow/Leverage: Significant

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: Negative (-1 notch)

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Capital Goods Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

## Ratings List

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Ratings Affirmed

Borets International Ltd.
Borets Finance DAC
 Corporate Credit Rating                BB-/Stable/--

Borets Finance DAC
 Senior Unsecured                       BB-
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