STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Summary:

Borets International Ltd.

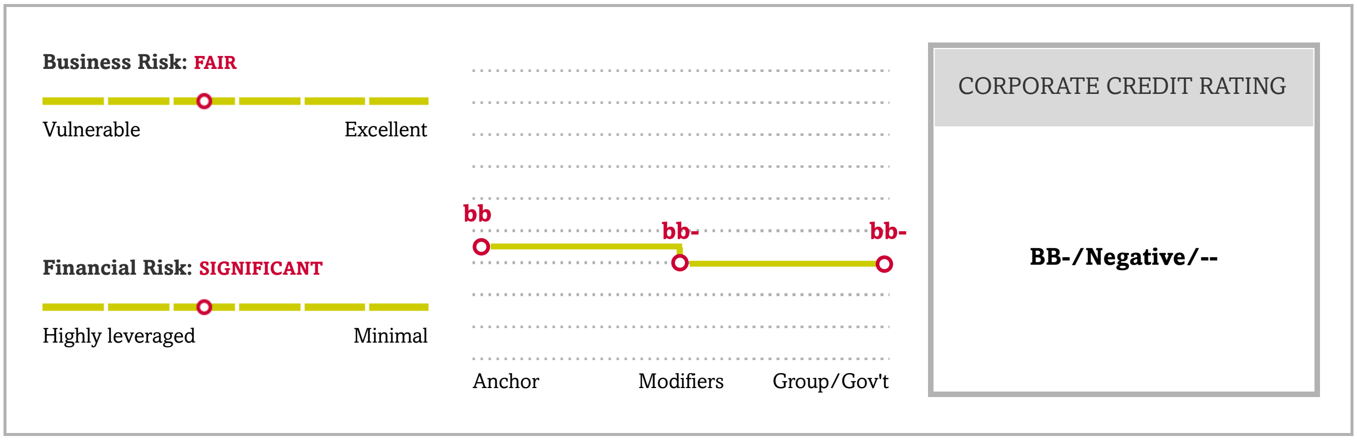
Primary Credit Analyst:
Maria Vinokur, London +442071763727; maria.vinokur@standardandpoors.com

Secondary Contact:
Edouard Okasmaa, Stockholm (46) 8-440-5936; edouard.okasmaa@standardandpoors.com

Table Of Contents

Summary:

Borets International Ltd.



Rationale

Business Risk: Fair	Financial Risk: Significant
• Strong and leading position in the electrical submersible pumps market in Russia, with limited competition; • Good long-term relationship with main customers; • Resilient profitability owing to ruble cost base and good pricing power; • Weak business diversity owing to small scale; and • Concentrated customer base.	• Track record of positive cash flow generation owing to flexible capital expenditure (capex) spending; • Considerable working-capital swings, which can constrain cash flow generation; and • Foreign exchange risk as debt is predominantly U.S. dollar denominated.

Outlook: Negative

Standard & Poor's Ratings Services' negative outlook reflects our view that the current volatile macroeconomic environment poses continued risks for Borets International, limiting the visibility of its revenues and credit metrics over the near term.

Downside scenario

There is a one-in-three chance that we could lower the rating within the next 12 months if Borets' operating performance deteriorates, leading to weaker credit metrics and/or a downward revision of the liquidity. This could occur as a result of significant cash outflows due to working capital financing, worsening operating performance, or material ruble deterioration leading to adjusted debt to EBITDA exceeding 4x and EBITDA interest coverage falling below 3x.

Upside scenario

We could consider revising the outlook to stable if we expected adjusted debt to EBITDA to be sustainably within the range of 3x-4x and adjusted EBITDA interest coverage to remain within the range of 3x-6x.

Standard & Poor's Base-Case Scenario

Under our base-case scenario, we assume that Borets will achieve organic underlying growth but its results are likely to be negatively affected by a weak ruble.

Assumptions

- Modest organic underlying growth in 2015;
- A fall in dollar-denominated revenues year-on-year in 2015, exacerbated by a significantly lower average ruble-dollar exchange rate compared with 2014;
- Standard & Poor's-adjusted EBITDA margin of about 16%-17% in 2015 supported by its ruble cost base;
- No dividends; and
- No acquisitions.

Key Metrics

	2014A	2015f	2016f
Debt/EBITDA(x)	3.1	3.4-3.6	3.4-3.6
FFO/debt(%)	21.5	17-20	17-20
EBITDA interest coverage	3.4	3-3.2	3-3.2

A—Actual. f--Forecast. FFO—Funds from operations.

Business Risk: Fair

Dubai-headquartered manufacturer of electric submersible pumps, Borets, has relatively small-scale operations, narrow business diversity, and a fairly concentrated customer base. These factors are partially mitigated by the company's established niche positions in its core segments and sizable market shares, which we assume it will be able to sustain. We continue to assess its business risk profile as "fair." On a positive note, we observed that Borets was able to moderately increase profitability in 2014 with an EBITDA margin of 16.3% on a fully-adjusted basis, despite increased pricing pressures in the industry and inflationary expectations.

We noticed, furthermore, that Borets' 2014 underlying operating performance did not exhibit stress stemming from the low oil price environment--in fact, the company's ruble cost base provided a competitive advantage in the Russian market compared with foreign peers. While reported sales in 2014 were down 6.1%, mostly due to the ruble depreciation, organic growth was supported by Borets' large installed base and high share of replacement sales. Borets' sales are typically classified as operating expenses (opex) of oil and gas majors (rather than capex). As Borets' product is typically used for production, we believe the company will continue to have some resilience of earnings against any decline in oil price. For 2015 and 2016, we therefore expect Borets to be able to sustain its EBITDA margin around 16%-17%. Nevertheless, market conditions for the the oil industry and the wider macroeconomic environment remain challenging, and we therefore maintain that Borets' operating performance could suffer from tightening of payment terms by oil and gas majors and pricing pressures caused by higher inflation in 2015. Subdued oil prices could force oil and gas companies to revise their investment plan by targeting not only capex spending but also opex, to cut costs.

Financial Risk: Significant

In our view, Borets' ratios are at the low end of the range commensurate with a "significant" financial risk profile assessment. For 2015 we expect Borets' funds from operations (FFO) to debt and debt to EBITDA to be around 17%-20% and 3.4x-3.6x, respectively. This means that the company has limited flexibility to accommodate any possible profitability deterioration, or cash generation that is weaker than we assume in our base case, without putting pressure on the rating. This could be as a result of an increase in working capital requirements stemming from unfavorable payment terms. While the company has a good track record of adjusting its capital expenditure to manage cash flow, we consider levers such as these to be limited to a degree. We still expect the company to continue to post moderately positive free operating cash flows (FOCF) of around $4 million-$6 million in 2015.

At the same time, we believe that a mismatch between Borets' revenues and debt is captured by Standard & Poor's negative capital structure modifier. Borets generated about 65% of its revenues in rubles as of Dec. 31, 2014, while all of its debt and reporting is denominated in U.S. dollars. Therefore, we believe that Borets now has greater dependency on its international businesses and international cash balances to service its U.S. dollar debt. We forecast moderate growth for Borets' international business in 2016 and 2015. This should be enough to cover the interest on its $420 million bond. Moreover, Borets holds more than 50% of its cash balances in U.S. dollars. This should partly offset the risks of currency volatility. At the end of December 2014, cash held in U.S. dollars amounted to about $75 million.

Liquidity: Adequate

We currently assess Borets' liquidity as "adequate." We expect the company's international businesses to continue to generate sufficient U.S. dollar cash flows to service its dollar interest payments over the near term. As of Dec. 31, 2014, liquidity sources exceeded liquidity uses by more than 1.2x for the next 12 months.

Borets has no committed facilities and relies on existing cash balances to meet its liquidity needs, alongside the cash flow it generates. This leaves little buffer if operating cash flow falls short of management expectations. Borets' liquidity position could suffer if the company faces unexpected stress on working capital.

Borets' high-yield notes do not include maintenance covenants. The liquidity position is supported by a long maturity profile with no debt due for repayment until the 2018 maturity of the $420 million note.

Ratings Score Snapshot

Corporate Credit Rating

BB-/Negative/--

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:** Negative (-1 notch)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bb-

Recovery Analysis

Key analytical factors

- The recovery rating of '3' on the $420 million senior unsecured note is supported by Borets' moderate debt level but constrained by the unsecured nature of the note and the modest documentary protection. The 'BB-' issue rating reflects the corporate credit rating.
- Our hypothetical default scenario assumes depressed oil prices, weak demand for oil-related services, wage increases, and higher working capital requirements due to payment delays.
- We value Borets as a going concern due to its leading position in the electrical submersible pumps market and its solid profitability.
- We acknowledge that the group has recently located its headquarters in Dubai. However, due to the higher share of

assets and profit contribution from Russia, we view it as the relevant jurisdiction in our recovery analysis for the group.

Simulated default assumptions

- Year of default: 2018
- EBITDA at emergence: $62 million
- Implied enterprise value multiple: 4x
- Jurisdiction: Russia

Simplified waterfall

- Gross enterprise value at default: $248 million
- Administrative costs: $22 million
- Net value available to creditors: $226 million
- Senior unsecured debt claims: $429 million*
- Recovery expectation: 50%-70% (lower half of range)

*All debt amounts include six months of prepetition interest.

Related Criteria

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Key Credit Factors For The Capital Goods Industry, Nov.19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	**bb**	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com