STANDARD & POOR'S RATINGS SERVICES

RatingsDirect®

Research Update:

Capital Goods Company Borets Outlook To Negative On Buyback Of Weatherford Minority Stake; Proposed Notes Rated 'BB'

Primary Credit Analyst:
Abigail Klimovich, CFA, London (44) 20-7176-3554; abigail.klimovich@standardandpoors.com

Secondary Contact:
Barbara Castellano, Milan (39) 02-72111-253; barbara.castellano@standardandpoors.com

Table Of Contents

Research Update:

Capital Goods Company Borets Outlook To Negative On Buyback Of Weatherford Minority Stake; Proposed Notes Rated 'BB'

Overview

- British Virgin Islands-registered capital goods company Borets International Ltd. (Borets) has announced a buyback of its minority shareholder Weatherford's 35.6% stake. In our view, the buyback will temporarily weaken Borets' credit metrics because it will be mostly debt-financed.
- We are therefore revising our outlook on Borets to negative from stable and affirming our 'BB' long-term corporate credit and 'ruAA' Russia national scale ratings on Borets.
- At the same time, we are assigning our 'BB' issue rating and '3' recovery rating to the proposed $420 million unsecured notes that Borets Finance Ltd. will issue to finance the share buyback.
- The negative outlook reflects a one-in-three chance of us lowering the ratings on Borets should its earnings and cash flow generation prove insufficient to offset the increase in debt, leading leverage to increase to over 3x in the next 12 months.

Rating Action

On Sept. 11, 2013, Standard & Poor's Ratings Services revised its outlook on British Virgin Islands-registered capital goods company Borets International Ltd. (Borets) to negative from stable. At the same time, we affirmed our 'BB' long-term corporate credit and 'ruAA' Russia national scale ratings on Borets.

In addition, we assigned our 'BB' issue rating to the proposed $420 million unsecured notes to be issued by Borets' wholly owned finance subsidiary Borets Finance Ltd. The recovery rating on the proposed notes is '3', indicating our expectation of meaningful (50%-70%) recovery in the event of a payment default.

Rationale

The outlook revision follows Borets' announcement of a $420 million unsecured notes issuance to finance the buyback of its minority shareholder Weatherford's 35.6% stake. The outlook revision reflects our view that the increase in debt could weaken Borets' credit metrics more than we anticipate under our base-case scenario, including Standard & Poor's-adjusted debt to EBITDA exceeding 3x. Such weakening could occur if Borets' earnings and cash flow generation prove insufficient to offset the increase in debt.

However, we continue to anticipate that Borets' operating performance will remain solid in 2013, maintaining the trend in recent years. We also anticipate that Borets will generate positive free operating cash flow (FOCF) of about $50 million in 2013.

In addition, we forecast that Borets' credit metrics will improve from 2013 levels in the next two years as a result of strong FOCF generation and what we anticipate will be a moderate financial policy, with a focus on deleveraging and no dividend distributions or significant acquisitions. We therefore anticipate that Borets' adjusted debt-to-EBITDA ratio will be close to 2x at year-end 2014, which we still view as commensurate with the 'BB' rating.

Furthermore, we have revised our assessment of Borets' business risk profile upward to "fair" from "weak" to reflect our view that Borets has successfully diversified its operations geographically and turned its U.S. operations around. For example, in 2012, the company's sales outside Russia reached 24% of revenues and 16% of EBITDA, up from 18% of revenues and close to 0% of EBITDA in 2011. Additionally, the company has maintained a relatively high level of profitability throughout the most recent economic cycle, posting an EBITDA margin in excess of 13% every year since 2007.

We believe that Borets' separation from Weatherford as a result of the latter selling its stake in Borets should not affect Borets' performance outside Russia. This is because the two companies had limited synergies and we did not factor in any support from Weatherford into our ratings on Borets.

We forecast that Borets' adjusted EBITDA margin will remain flat in 2013, at about 18%, thanks notably to contract extensions in Colombia and a continued recovery in the U.S. operations on account of Borets' restructuring efforts. Offsetting these positive factors will be some margin erosion in the Russian market, which is characterized by cost inflation.

Liquidity

We have revised our classification of Borets' liquidity downward to "less than adequate" under our criteria, from "adequate" previously. This reflects our forecast that the company's sources of liquidity will cover its uses by less than 1.2x in the next 12 months. We monitor Borets' liquidity position quarterly, and could revise our classification back to "adequate" if Borets restores its liquidity sources to a coverage ratio of at least 1.2x on a rolling 12-month basis.

Of $78 million cash reported as of June 30, 2013 (net of overdraft drawings), Borets expects to use $50 million as part of its refinancing. This, combined with the absence of committed facilities maturing in more than 12 months' time, leaves a limited cushion if operating cash flow falls short of management's expectations. Changes in working capital have historically had a significant impact on FOCF, which in our view makes Borets' liquidity vulnerable to unexpected working capital changes.

We understand that Borets has no committed bank lines available, and according to our methodology, we do not consider Borets' overdraft facilities as a reliable liquidity source for the purpose of our liquidity analysis. We understand that Borets' proposed notes will not include maintenance covenants.

Borets' principal liquidity sources in the next 12 months include:

- $29 million of cash on the balance sheet as of June 30, 2013, pro forma the Weatherford buyout.
- Funds from operations of about $100 million-$115 million.
- No long-term committed revolving credit facilities (RCFs).

Borets' principal liquidity uses in the next 12 months include:

- Capital expenditures of about $45 million.
- No debt maturities until the proposed notes' due date.
- No dividends, as we anticipate in our base case.

Recovery analysis

The issue rating on the proposed $420 million senior unsecured notes to be issued by Borets' wholly-owned finance subsidiary, Ireland-registered Borets Finance, is 'BB', in line with the corporate credit rating on Borets. The recovery rating on the proposed notes is '3', indicating our expectation of meaningful recovery (50%-70%) in the event of a payment default.

The issue and recovery ratings on the proposed notes are primarily supported by our valuation of Borets as a going concern, its material asset base, and its moderate levels of debt. The recovery rating is constrained at '3' by the unsecured nature of the notes; the modest documentary protection against the raising of material additional debt; and Russia's insolvency regime, which we consider less creditor-friendly than other jurisdictions we assess (see "Debt Recovery For Creditors And The Law Of Insolvency In Russia," published on RatingsDirect on May 2, 2007).

Borets will use the proceeds of the $420 million proposed notes to buy out Weatherford's 35.6% stake and to repay and cancel existing loans from the European Bank for Reconstruction and Development, IFC, and Alef-bank. We understand that pro forma the issuance, the proposed notes will be the only material debt instrument in Borets' capital structure.

The proposed notes will be unsecured, but will benefit from an unconditional and irrevocable guarantee from subsidiaries that contribute at least 80% of Borets' EBITDA and assets. The notes' documentation will limit indebtedness up to a consolidated net leverage ratio of 3x, which could allow the company to levy a material amount of debt. The documentation will also include material permitted debt and lien baskets, including, among others, a $35 million RCF.

In order to determine recoveries, we simulate a default scenario. We believe that for Borets, a default would most likely occur due to weakness in oil prices and the demand for oil-related services, leading to a loss of customers/and or contract nonrenewals; an increase in wage costs, leading to a squeeze in the EBITDA margin; and an increase in working capital requirements. Under this scenario, we estimate a default on interest payments in 2017. At this hypothetical point of default, we estimate that EBITDA would have declined to about $84 million and that all cash would have been exhausted.

On this basis, we estimate Borets' stressed enterprise value at the hypothetical point of default at approximately $335 million, implying a stressed multiple EBITDA of 4x. After deducting enforcement costs of about $30 million, we arrive at a net enterprise value of $305 million. This allows for recovery prospects in the 50%-70% range for the proposed $420 million notes and prepetition interest, and corresponds to a recovery rating of '3'.

Outlook

The negative outlook reflects our view of a one-in-three chance of a downgrade in the next 12 months. We could downgrade Borets if its ability to generate FOCF weakened, for example, due to declining operating performance, large working capital swings, or other factors that would prevent Borets improving its credit metrics to the extent we anticipate in our base case. We would also consider lowering the ratings if Borets' ratio of adjusted debt to EBITDA rose above 3x.

We could revise the outlook to stable if Borets continues to generate significantly positive FOCF in 2013 and 2014, leading to a gradual improvement in credit metrics. Such metrics include adjusted debt to EBITDA of comfortably less than 3x by the end of 2013 and close to 2x at year-end 2014, which we consider commensurate with the 'BB' rating.

Related Criteria And Research

- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Key Credit Factors: Criteria For Rating The Global Capital Goods Industry, April 28, 2011
- Criteria Guidelines For Recovery Ratings On Global Industrial Issuers' Speculative-Grade Debt, Aug. 10, 2009
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Borets International Ltd.		
Corporate Credit Rating	BB/Negative/--	BB/Stable/--
Russia National Scale	ruAA/--/--	ruAA/--/--

New Ratings

Borets Finance Ltd.	
Senior Unsecured	
$420 mil. nts*	BB
Recovery Rating	3

*Guaranteed by Borets International Ltd.

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

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.

1189834 | 301408059