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ACRA upgrades PJSC Evropeyskaya Elektrotekhnica to BBB-(RU), outlook Stable

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Key rating assessment factors

ACRA has upgraded the credit rating of [PJSC Evropeyskaya Elektrotekhnica](#) (hereinafter — Evropeyskaya Elektrotekhnica, the Company, or the Group) to BBB-(RU) because the Company substantially revised its plans for development, which reduced the risk of unfavorable implementation of large contracts. Additionally, the credit rating is based on the Group's low debt burden, high level of debt coverage, as well as high levels of liquidity and profitability.

ACRA points to the Company's below-average market position, small business size, and medium cash flow.

PJSC Evropeyskaya Elektrotekhnica is one of Russia's leading companies in terms of production of energy and power supply systems, lighting and low-current systems. In 2018, the Company purchased oil and gas production facilities in the Republic of Bashkortostan. Since its creation in 2004, Evropeyskaya Elektrotekhnica has transformed from a trading company into a full-fledged engineering one with its own production facilities (30% of products and equipment sold by the Group are manufactured using its own production facilities). In the first half of 2018, the Company's revenues amounted to RUB 1.5 billion (up 21% compared to the same period in 2017) with simultaneous growth of FFO before fixed charges and taxes up to RUB 159.4 million (2.6x increase).

Moderate assessment of operational risk profile. The market share of Evropeyskaya Elektrotekhnica does not exceed 0.5%. However, it occupies a leading position in some sectors (up to 25% of the market for hot-dip galvanized reinforced cable systems and cable holders for ultra-deep mines). The Company's business profile is supported by the high quality of its contract base: the Company has orders secured for the next 1.5-3 years. The potential impact of the failure of individual contracts on the Company's operations is minimal due to wide diversification of the contract base for buyers. The sales markets in which the Company operates are characterized by a low level of cyclicality: oil production and electric power show an upward trend (modernization of energy generating capacity in the Russian Federation); there is further development of the oil and gas sector (the construction of oil treatment plants (OTP) and flare systems at new fields). Dependence on subcontracting and components is at a moderate level: dependence on subcontracting is minimal (less than 3%), and the resale of components and equipment accounts for up to 70% of revenue. Local project offices generate orders and expand the Company's presence in the key consuming regions. Geographical diversification of production sales markets is at a moderate level with 20% of production being exported, mainly oil production equipment.

Moderate level of corporate governance. The Group's strategy is not formalized enough. As a positive factor, ACRA notes that since the Company's establishment, its business has been growing steadily despite crises that the Russian economy faced. At the same time, Evropeyskaya Elektrotekhnica, which functioned as a trading company at the first stage of its operations, is now a full-fledged engineering center with its own manufacturing sites. In 2018, the Company started operating in the high-margin segment of oil and gas equipment. The Group's risk management system is at a moderate level. Susceptibility to currency and interest rate risks is currently minimal, and the purchases of foreign components are compensated by revenue from export contracts (natural hedging).

ACRA notes that despite the fact that only two of the six members of the Board of Directors are independent, there still exists the risk of an "irreplaceable person." ACRA rates the structure of corporate governance as moderate. The structure of the Group is complicated, but this approach is justified by the nature of its business. ACRA evaluates

the Company's level of financial transparency as high. Records are published on a semi-annual basis, and regular meetings with investors are held, at which information on the Group's current operations and development plans is disclosed.

Small business size and high level of profitability. In 2017, FFO before fixed charges and taxes amounted to RUB 338 million. ACRA forecasts that the weighted average value of this indicator will be RUB 480-500 million in 2016-2021 given the Company's entry into the oil and gas sector. In the same period, FFO margin before interest and taxes will average 10.5%. This figure will be achieved thanks to the growth in profitability buoyed by the increase in the share of oil and gas equipment in the Company's sales structure. Evropeyskaya Elektrotekhnica does not have any active credit lines. ACRA evaluates the quality of liquidity as moderate. The Company has the opportunity to raise funds not only in the debt market, but also use equity financing.

According to ACRA estimates, the Group's net cash flow will be positive in 2018-2019, even considering the payment of dividends at a level no less than 20%. At the same time, the share of capital expenditure in total revenue will be very low.

Low debt burden with a high level of debt service. The Company currently has no significant external debt obligations. Given the change in its development strategy, ACRA expects that Evropeyskaya Elektrotekhnica's debt burden, weighted between 2016 and 2021, will be 0.2x (the ratio of total debt to FFO before net interest payments). Debt service costs will total 7.4x in the same period.

Key assumptions

- Annual revenue growth by 25% in 2018-2021;
- Maintaining gross profitability of electrical and oil and gas equipment at 18 and 35% respectively during the forecast period;
- Absence of large-scale debt financing to finance the acquisition of new assets.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Increase in the forecasted FFO before net interest payments and taxes above RUB 500 million coupled with simultaneous growth in FFO margin before interest and taxes above 15%;
- Increase in FFO margin before interest and taxes above 15%, or improvement of the debt service costs indicator (the ratio of FFO before net interest payments to interest payments) above 8.0x;
- Increase in the average weighted FFO before interest payments to interest payments above 8.0x coupled with simultaneous growth in FCF margin above 5%.

A negative rating action may be prompted by:

- Decrease in FFO margin before interest and taxes below 5% coupled with simultaneous growth in the debt burden (the ratio of total debt to FFO before interest and taxes) above 1.0x;
- Simultaneous decline in the short-term liquidity indicator below 1.5x, deterioration of debt service quality (FFO before net interest payments to interest payments) below 5.0x, decrease in FCF margin below 2%, and growth in the share of capital expenditure in total revenue above 5%.

Rating components

SCA: bbb-.

Adjustments: none.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation and is based on the [Methodology for Credit Ratings Assignment to Non-Financial Corporations under the National Scale for the Russian Federation](#) and the [Key Concepts Used by the Analytical Credit Rating Agency within the Scope of Its Rating Activities](#).

The credit rating of PJSC Evropeyskaya Elektrotekhnica was first published by ACRA on October 11, 2018. The credit rating and its outlook are expected to be revised within one year following the rating action date (January 31, 2019).

The assigned credit rating is based on data provided by PJSC Evropeyskaya Elektrotekhnica, information from publicly available sources, as well as ACRA's own databases. The credit rating is solicited, and PJSC Evropeyskaya Elektrotekhnica participated in its assignment

No material discrepancies between the provided data and data officially disclosed by PJSC Evropeyskaya Elektrotekhnica in its financial statements have been discovered.

ACRA provided no additional services to PJSC Evropeyskaya Elektrotekhnica. No conflicts of interest were discovered in the course of credit rating assignment.

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