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Lead analysts:

Denis Krasnovskiy, Senior Analyst
+7 (495) 139-0480, ext. 188
denis.krasnovskiy@acra-ratings.ru

Alexander Gushchin, Associate Director
+7 (495) 139 0489
alexander.gushchin@acra-ratings.ru

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

The credit rating of PJSC Evropeyskaya Elektrotekhnica (hereinafter, Evropeyskaya Elektrotekhnica, the Company, or the Group) reflects the Company's good profitability and liquidity, high debt coverage, and low leverage. At the same time, ACRA points to the lower than average size of the Company's business as compared to the largest Russian companies, its medium cash flow, and assesses its market position as modest in view of the high granularity of the Russian engineering market.

Evropeyskaya Elektrotekhnica is one of Russia's leading companies in terms of production of energy and power supply systems, lighting and low-current systems. Since its creation in 2004, Evropeyskaya Elektrotekhnica has transformed from a trading company into a full-fledged engineering one with its own production facilities (41% of products and equipment sold by the Group are manufactured using its own production facilities). In 2018, the Company purchased certain oil and gas production facilities in the Republic of Bashkortostan, and finalized its legal title over them in 2020. In 9M 2020, the Company's revenues ran into RUB 2.5 bln (RUB 2.6 bln in 9M 2019) with simultaneous growth of FFO before net interest payments and taxes to RUB 352.5 mln (RUB 339.3 mln in 9M 2019), which was driven by focusing on higher-margin business lines. The Group's future development plans are related to the launch of a new high-margin business, sale and lease of innovative oil and gas equipment. The Company's key shareholders are S.N. Dubenok and I.A. Kalenkov.

Key rating assessment factors

Moderate assessment of operating risk profile. The market share of the Company does not exceed 0.5%. However, it occupies a leading position in some sectors (up to 37% of the market for hot-dip galvanized reinforced cable systems and cable holders for ultra-deep mines, up to 8% of the market for flare units). The Group's order book covers from one to three years of its operations (including highly likely contracts); occasionally, some contracts may be postponed for a few months, which may result in a corresponding postponement of some revenues in a given period. However, the potential effect from postponing contracts will not exceed 10% of the revenues, in ACRA's opinion, owing to a good diversification of the order book by customer. The Company's target markets exhibit moderate cyclicality. In 2019–2020, the share of engineering systems in the Company's revenues was 77%; the remaining portion was attributable to oil and gas equipment. The Company has plans to increase the share of oil and gas equipment to 40% in 2021–2022. Dependence on subcontracting and components is assessed as moderate, in general: dependence on subcontracting is minimal (about 2.5%), and the resale of components and equipment accounts for up to 60% of revenues. Geographical diversification of production sales markets is at a moderate level, with around 9% of products being exported, mainly oil and gas equipment. Thanks to the lower than average size of the Company, it has not been affected by the OPEC+ deal.

Adequate level of corporate governance. The Group's strategy is sufficiently formalized; it is approved by the board of directors; it is, however, subject to significant changes from time to time in response to the developments in external factors and the market environment. The strategy includes reaching the key financial and operating targets by 2021. The Company has developed a new strategy until 2025, which is undergoing the internal approval procedures in the board committees and expected to be approved in Q1 2021. The strategy implies a substantial increase in the higher-margin business line's share (equipment manufacturing for oil and gas and hydrocarbon processing industries) in the Group's total revenues. In 2020, the Company successfully underwent INTERGASCERT certification procedures, which allows the Company to make business with Gazprom group companies. ACRA notes that the Company has been strictly adhering to its strategy, including the growth in returns in 2019 against 2018 and in 9M 2020 y-o-y.

The risk management system of the Company is assessed as moderate because the currency and interest rate exposures are minimal and the purchase of components in overseas markets is offset by export revenues (natural hedge).

ACRA assesses the Company's corporate governance quality as adequate in view of, among other things, involvement of the Company's owners in its business. The Group includes seven entities, which is justified by the nature of its business. There are related-party transactions, the size of which, however, is insignificant in the total operations of the Group (about 1% in 2020) and controlled by the Company's board of directors. ACRA assesses the Company's level of financial transparency as high: financial reporting is published on a quarterly basis, and regular meetings with investors are held, at which information on the Group's current operations and development plans is disclosed.

Lower than average business size and high profitability. ACRA estimates FFO before net interest payments and taxes at RUB 483.9 mln in 2019 (RUB 283 mln in 2018). The Agency forecasts that this indicator will not change significantly in the nearest years. The FFO margin before interest payments and taxes reached 15% in 2019 and, in the nearest years, it will be at 10–15%. This margin will be maintained by the growth in profitability buoyed by the increase in the share of oil and gas equipment in the Company's sales structure. For 2019–2020, Evropeyskaya Elektrotekhnica has available credit lines worth RUB 1 bln from Promsvyazbank PJSC (ACRA rating: AA(RU), outlook Stable) and PJSC Sovcombank (ACRA rating: A+(RU), outlook Positive), and the Company is currently finalizing a loan agreement with Sberbank (ACRA rating: AAA(RU), outlook Stable) for a credit limit of RUB 0.5 bln. As of December 31, 2020, the amount of committed credit facilities available to the Company was RUB 860 mln, which will expire in 2022–2023. ACRA notes that the liquidity position of the Company has improved and the quality of liquidity is assessed as good. The Company has the opportunity to raise funds not only in the debt market, but also use equity financing.

In 2019, the Group's net cash flow was negative (-RUB 311 mln) due to an increase in receivables (the Company reached an agreement with suppliers to extend the payment deadlines for supplied products and provided its customers with a more comfortable payment schedule), purchase of equipment intended for lease and subsequent resale, and dividend payout. According to ACRA estimates, the net cash flow will become positive. At the same time, the share of capital expenses will be low, which, however, ACRA believes to be reasonable in view of the current business development strategy.

Low leverage and high coverage. Currently, the Company's external debt obligations are low (the ratio of total debt to FFO before net interest payments is less than 1x). ACRA is of the opinion that until 2022, the leverage will not exceed the above value. In addition, the coverage is and will be very high thanks to low interest rates.

Key assumptions

- The forecast period includes figures for 2020-2022 with weights of 30%, 15% and 5%, respectively;
- The inflation rate to average 3.6% in 2021–2022;
- The annual revenue growth rates in segments at levels not lower than in 2020;
- The 2021–2022 dividends not exceeding the dividend in 2020.

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 annual weighted average FFO before net interest payments and taxes above RUB 500 mln;
- Increase in the annual weighted average FFO margin before interest and taxes above 25%,
- Increase in the weighted average 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 leverage (the ratio of total debt to FFO before interest and taxes) above 1.0x and significant deterioration in the access to external sources of liquidity;
- Decline in the short-term liquidity indicator below 1.5x, deterioration of coverage quality (FFO before net interest payments to interest payments) below 5.0x, decrease in FCF margin below zero, growth in the share of capital expenditure in total revenue above 5%, and significant deterioration in the access to external sources of liquidity.

Rating components

SCA: bbb-.

Adjustments: none.

Issue ratings

There are no outstanding issues of the Company’s financial debt instruments.

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 publication date of this press release.

The 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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