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ACRA assigns BB+(RU) to PJSC Evropeyskaya Elektrotekhnica, outlook Stable

Lead analysts:

Maxim Hudalov, Director
+7 (495) 139-0496
maxim.khudalov@acra-ratings.ru

Alexander Gushin, Expert
+7 (495) 139 0489
alexander.gushchin@acra-ratings.ru

Key rating assessment factors

The credit rating assigned to [PJSC Evropeyskaya Elektrotekhnica](#) (hereinafter - PJSC Evropeyskaya Elektrotekhnica, the Company, or the Group) is due to its below average market position, the Group's small business size according to ACRA's methodology, the risk of implementing an especially large contract, and a low level of cash flow caused by implementation of said contract.

The rating level is supported by low debt burden, a high level of debt coverage, and a high level of profitability.

PJSC Evropeyskaya Elektrotekhnica is one of the leading Russian companies in the 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 inception in 2004, PJSC Evropeyskaya Elektrotekhnica has transformed from a trading company into a full-fledged engineering company with its own production facilities (30% of the 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 1.5 billion rubles (a 21% growth compared to the first half of 2017) with the simultaneous growth of FFO before fixed charges and taxes reaching 159.4 million rubles (2.6x increase).

Moderate assessment of operational risk profile. The market share of Evropeyskaya Elektrotekhnica does not exceed 0,5%, however in some sectors it occupies a leading position (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 operations of PJSC Evropeyskaya Elektrotekhnica is minimal due to the wide diversification of the contract base for buyers. The sales markets in which the Company operates are characterized by a low level of cyclicity: oil production and electricity show tendencies toward growth (modernization of energy generating capacity in the Russian Federation); there is a further development of the oil and gas sector (construction of oil treatment plants (OTP) and flare systems in new fields). Dependency on subcontracting and components is at a moderate level: dependency on subcontracting is minimal (less than 3%) and the resale of components and equipment provides up to 70% of revenue. Local project offices generate orders and expand the Company's presence in key regions in need of production. Geographical diversification of production is at a moderate level: 20% of production is exported, mainly oil production equipment.

Moderate level of corporate management. The Group's strategy is not formalized enough. However, as a positive factor, ACRA notes that since the Company's inception, its business has grown steadily despite crises experienced by the Russian economy. At the same time, Evropeyskaya Elektrotekhnica, which in the first stage of its operations functioned as a trading company, is today 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. Evropeyskaya Elektrotekhnica's risk management system is at a moderate level. At the present moment, susceptibility to currency and interest rate risks is minimum and purchases of foreign components are compensated by revenue from exported 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 a risk of an "irreplaceable person." ACRA rates the structure of corporate management as moderate. The structure of the Group is complicated, but this approach is justified by the nature of the business. ACRA evaluates

the Company's level of transparency as high. Records are published semi-annually and regular meetings with investors are held, resulting in the disclosure of information on the Group's current operations and plans of development.

Small business size, high level of profitability, and liquidity ratio. By the end of 2017, FFO before fixed charges and taxes equaled 338 million rubles. ACRA predicts that the weighted average value of this indicator in the period from 2016 to 2021 will be 641 million rubles, taking into account the implementation of the project to lease one of the vertically integrated Russian companies for large-scale oil production. In the said period, the return on FFO before interest payments and taxes will be on average at 12.7%. The realization of this indicator will contribute to the growth of profitability by increasing the share of oil and gas equipment in the sales structure of the Company. Evropeyskaya Elektrotekhnica does not possess any active lines of credit. ACRA evaluates the quality of liquidity as moderate, taking into account the possible raising of funds for the implementation of a particularly large contract. The Company has the opportunity to raise funds not only in the debt market, but also to use equity financing.

ACRA predicts that from 2018 to 2019, the value of net cash flow will be at a negative level. The reason is the expected growth of working capital costs in 2019 (due to the commissioning of a large oil and gas facility) and the payment of dividends at a level no less than 20%. At the same time, this will be offset by a very low share of capital expenditure in total revenue.

Low debt burden with a high level of debt service. At the present moment, the Company does not possess any external debt obligations. However, taking into account the commissioning of the above-mentioned oil and gas facility, ACRA predicts that Evropeyskaya Elektrotekhnica's debt burden, weighted for the period from 2016 to 2021, will increase 0.9 fold (ratio of total debt to FFO before net interest). The debt service for the same period will increase 5.3 fold.

Key Assumptions

- Revenue growth in the period from 2018 to 2021 annually by 25%
- Maintaining during the forecast period of gross profitability of electrical and oil and gas equipment at the level of 18 and 35%, respectively
- The need to increase working capital from 2019 to 2021 to the level of 250-450 million rubles per year
- Absence of large-scale debt financing to finance the acquisition of new assets
- Implementation of especially large contract in the oil and gas sector

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:

- Favorable contract terms
- growth of profitability in FFO before interest and taxes above 15% or reduction of debt burden (ratio of FFO to net interest payments to interest payments) above 8.0x
- improvement in short term liquidity (above 0.8x)

A negative rating action may be prompted by:

- reduction in the size of the business (FFO margin before net interest and taxes), weighted for the period from 2016-2021, to below 500 million rubles with a simultaneous drop in profitability of FFO before interest and taxes below 10% and a corresponding increase in the debt burden above 3.5x (the ratio of total debt to FFO margin before net interest)

- increase in the debt burden (the ratio of total debt to FFO margin before net interest) above 2.0x and the simultaneous deterioration of debt service (the ratio of FFO margin before net interest payments to interest payments) below 2.0x
- materialization of risks caused by lack of experience with large contracts in the gas and oil sector

Rating components

SCA: bb+.

Issue ratings

Adjustments: none.

No outstanding issues have been rated.

Regulatory disclaimer

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 Analytical Credit Rating Agency within the Scope of Its Rating Activities](#).

The credit rating has been assigned to PJSC Evropeyskaya Elektrotekhnica for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (October 9, 2018).

The assigned credit rating is based on the 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 the 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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Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)

75, Sadovnicheskaya embankment, Moscow, Russia

www.acra-ratings.com

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