

## Fitch Rates ChelPipe's LPNs 'BB-(EXP)'; Affirms IDR at 'BB-'

---

Fitch Ratings-Moscow-04 September 2019:

Fitch Ratings has assigned PJSC Chelyabinsk Pipe Plant's (ChelPipe) proposed debut issue of loan participation notes (LPNs) an expected senior unsecured rating of 'BB-(EXP)'. At the same time, Fitch has affirmed ChelPipe's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB-' with Stable Outlook.

The rating of the notes, which are issued by Ireland-based Chelpipe Finance Designated Activity Company (FinCo) on a limited recourse basis for the sole purpose of funding a loan to ChelPipe, is on a par with ChelPipe's IDR. This is because the LPNs will constitute direct, unconditional senior unsecured obligations of ChelPipe and rank equally with all other present and future unsecured and unsubordinated obligations.

The affirmation reflects our view that ChelPipe's diversification into non-oil and gas pipe segments will mitigate medium-term margin pressure on large-diameter pipes (LDP) and support modestly positive free cash flow (FCF). ChelPipe's IDR continues to capture a 'BB' operational profile with a high share of value-added products (steel pipes), an established long-term customer base and a top-three position domestically across major seamless pipe types. Rating constraints include ChelPipe's exposure to the Russian economy and to the domestic oil and gas sector, in particular.

### Key Rating Drivers

**LPNs Guarantee:** The notes will also benefit from an irrevocable and unconditional guarantee from Joint Stock Company Pervouralsk Pipe Plant (PNTZ), ChelPipe's largest EBITDA-generating subsidiary, thus ranking equally with the existing bank debt at ChelPipe and PNTZ levels, and structurally senior to ChelPipe's RUB25 billion rouble bonds. Prior-ranking debt, represented by RUB3 billion of borrowings at operating subsidiaries excluding PNTZ, is deemed immaterial and not affecting the LPNs' recovery prospects. ChelPipe plans to use the proceeds to partly refinance bank debt that accounted for RUB65 billion of its RUB90 billion total debt at end-1H19.

**FX Exposure to Remain Manageable:** Over 60% of ChelPipe's revenues are directly or indirectly exposed to hard currencies against 20%-25% of costs in hard currencies. The group intends to keep hard-currency debt, including the LPNs, within one-third of total borrowings. This should not compromise ChelPipe's overall exposure as part of its FX debt would be structurally hedged by its

FX revenue and cost structure.

**Balanced Portfolio Supports Resilience:** ChelPipe's steel pipes, representing 80%-85% of total revenues, reflect a balanced mix of LDP (typically 35%-40% of pipe shipments), oil country tubular goods (OCTG, 20%-25%) and other seamless pipes (35%-40%). In 2018, this portfolio mix helped mitigate a combination of rising production costs per ton and broadly flat LDP pricing as double-digit growth in non-LDP realised prices helped lift EBITDA to RUB28 billion in 2018 from RUB23 billion in 2017. Some RUB4 billion in cost savings realised in 2018 were another major factor supporting EBITDA.

**Oil and Gas Exposure:** ChelPipe's has a high exposure to the Russian oil and gas sector, mostly through LDP, OCTG and oilfield services, both in terms of pipe shipments (historically above 60%) and revenues (above 50%). However, the trends have diverged since 2017 as an oversupplied LDP market precluded ChelPipe from passing through rising production costs entirely onto customers while the contribution of non-LDP increased owing to rising prices and margins. The OCTG market outlook is supported by our expectations of broadly flat oil and gas production in Russia, the stability derived from the need for drilling to replace depleting oil and gas deposits, and a gradually increasing share of horizontal drilling in the industry.

**LDP Structural Oversupply:** The launch of a 500 thousand tonnes (kt) Zagorsky pipe plant intensified the structural LDP overcapacity in Russia, where 5.7mt capacity was set against domestic and export shipments of 2.6mt, suggesting capacity utilisation rates of less than 50% in 2018 (against ChelPipe's 65%-70%). Overcapacity has translated into shrinking margins to single-digit levels since 2017. The impact of further price and margin pressure in the LDP market on ChelPipe is limited by the group's flexibility not to enter LDP supply contracts if their pricing implies neutral or negative margins.

**LDP Demand Likely Subdued:** The LDP market's upside is limited as demand is unlikely to boost sector-wide capacity utilisations to above 50% in the medium-term. Demand is sensitive to Gazprom's megaprojects, and expected to dip in 2020 after peaking in 2019, as Nord Stream-2 and Power of Siberia are near completion and further megaprojects are unlikely to support the market before 2021. Demand volatility is only partly mitigated by LDP replacement needs for the existing Russian pipeline system, one of the largest globally. We conservatively expect ChelPipe's LDP shipments to peak at above 850kt in 2019 and rebase at around 700kt over the 2020-2022.

**Industrial Seamless Pipes Peak:** ChelPipe's exposure to non-oil and gas seamless pipes is strong with market shares of at least 40% in machinery, energy, chemicals and general use pipes. ChelPipe's supplies to these segments were healthy and exceeded 700kt throughout 2017-2019, supported by intensified expansionary capex by a number of chemical companies. We have a

cautious view on post-2019 supplies and expect other seamless pipes shipments to moderate to 650kt-700kt.

FCF Margin Closer to Neutral: Fitch expects ChelPipe's EBITDA to peak at RUB30 billion on record-high 2.1mt pipe shipments in 2019 before drifting towards RUB27 billion-RUB28 billion thereafter. Simultaneously, we assume that ChelPipe will increase capex towards 6%-8% of revenues from 2020 in pursuit of a higher market share in premium pipe solutions. Coupled with RUB4 billion-RUB5 billion dividends assumed under our base case, this will lead to marginally positive free cash flow (FCF) generation with funds from operations (FFO) adjusted gross leverage declining to 3.4x in 2019 and to 3.2x over 2020-2022 (2018: 3.7x).

Established Regional Pipe Producer: ChelPipe's two Urals-based steel pipe plants retain the overall top-three market position with roughly a 20%-25% share each in LDP and OCTG, mainly used in the oil and gas industry. ChelPipe's market share in the non-oil and gas pipe sectors, eg machinery, energy and petrochemical seamless steel pipes, is stronger and is assessed by the company at over 40%. ChelPipe's competitive advantage is its relative proximity to Siberian and Far Eastern oil and gas fields and more than 75% integration into scrap-fed billet production. However, ChelPipe is lagging its competitors in the premium pipe connections segment.

Longer-Term Pipe Demand Risks: The Russian oil and gas pipeline system is the second-largest globally, but its high maintenance requirements will only partly mitigate volatility from Gazprom's expansionary projects. Longer-term risks stem from rising liquefied natural gas trade, increasing renewables contribution and decelerating global energy consumption per capita but are deemed remote before they start to pressure Russian pipe producers with some exposure to Asia. Fundamental limitations also include Russian pipe players' significant exposure to the oil and gas industry in a single region.

#### Derivation Summary

ChelPipe's IDR reflects a 'BB' operational profile with a high share of value-added products (steel pipes), a solid top-three domestic position across oil & gas and industrial seamless pipes, partial backward integration into scrap and billets, and an established long-term customer base. ChelPipe's constraints incorporate weak presence outside Russia, high exposure to the domestic oil and gas sector (typical for steel pipe players but not for steel players), and lack of exposure to margin-boosting premium pipe solutions.

ChelPipe lacks the scale, cost leadership and sales diversification of its Russian peers PAO Severstal (BBB/Stable), PJSC Novolipetsk Steel (NLMK, BBB/Stable) and OJSC Magnitogorsk Iron & Steel Works (BBB/Stable) but ranks above them in terms of value-added products (pipes).

ChelPipe's partial vertical integration into billets and scrap compares well with MMK's but not with more integrated NLMK's and Severstal's. ChelPipe's higher exposure to the Russian oil and gas sector and higher leverage are factors differentiating their ratings.

Operating environment does not impact ChelPipe's IDR.

## Key Assumptions

Fitch's Key Assumptions within our Rating Case for the Issuer

- LDP shipments to peak at above 850kt in 2019, averaging at around 700kt in 2020-2022
- Non-LDP shipments to remain broadly flat, fluctuating around 1,150kt-1,200kt in 2019-2022
- EBITDA margin to remain around 16%-17% translating into RUB27 billion-RUB30 billion EBITDA until 2022
- Capex/sales conservatively assumed to exceed 7% in 2021-2022, up from 5%-6% in 2019-2020 (2018: 3.1%)
- Dividend payments at or below RUB5 billion over 2019-2022, reflecting a 50% net profit payout ratio
- FCF margin modestly positive, averaging at below 1% in 2019-2022

## RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- FFO adjusted leverage consistently at or below 3.0x on a gross basis (2018: 3.7x) or 2.5x on a net basis

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- EBITDAR margin sustained materially below 16% (2018: 16%)
- FFO adjusted leverage sustained above 4.0x on a gross basis or 3.5x on a net basis
- Tightening liquidity and/or FFO fixed charge coverage falling below 2x (2018: 2.7x) for a sustained period

## Liquidity and Debt Structure

Manageable Liquidity: The forthcoming notes placement are expected to further smooth and stretch out ChelPipe's existing debt maturity profile. Its cash balances of RUB16 billion fell below short-term debt of RUB29 billion at end-1H19. It should be noted that RUB9 billion of short-term debt was obligations reclassified as short-term debt to reflect ChelPipe's irrevocable call option to prepay this debt. Moreover, liquidity is supported by RUB19 billion in undrawn committed credit lines and neutral-to-positive FCF generation forecast in the next 12 months.

## Summary of Financial Adjustments

- A multiple of 6x applied to the 2018 operating lease expense of USD31 million as the company operates in Russia.

## ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## Chelpipe Finance Designated Activity Company

---senior unsecured; Long Term Rating; Expected Rating; BB-(EXP)

PJSC Chelyabinsk Pipe Plant; Long Term Issuer Default Rating; Affirmed; BB-; RO:Sta

## Contacts:

Primary Rating Analyst

Dmitri Kazakov, CFA

Director

+7 495 956 7075

Fitch Ratings CIS Ltd

Business Centre Light House, 6th Floor 26 Valovaya St.

Moscow 115054

Secondary Rating Analyst  
Niels Vanden Bussche,  
Senior Analyst  
+44 20 3530 1971

Committee Chairperson  
Myriam Affri,  
Senior Director  
+44 20 3530 1919

Media Relations: Adrian Simpson, London, Tel: +44 20 3530 1010, Email:  
adrian.simpson@thefitchgroup.com  
Anna Bykova, Moscow, Tel: +7 495 956 9903, Email: anna.bykova@fitchratings.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

### **Applicable Criteria**

[Corporate Rating Criteria \(pub. 19 Feb 2019\)](#)

[Corporates Notching and Recovery Ratings Criteria \(pub. 23 Mar 2018\)](#)

### **Additional Disclosures**

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://www.fitchratings.com). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY

CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale

of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001. Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

---

**ENDORSEMENT POLICY** - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within



---

the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.