Fitch Ratings Russia & CIS -

Fitch: Koks Group off RWN; 'B' Rating Affirmed; Outlook Negative

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Fitch Ratings-Moscow/London-11 October 2016: Fitch Ratings has removed Russian pig iron company PAO Koks Group's (KOKS) ratings from Rating Watch Negative (RWN) and has affirmed the Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'B' with a Negative Outlook. The full list of rating actions is at the end of this commentary.

The affirmation of the ratings and their removal from RWN reflect reduced refinancing risk, underpinned with a smoother debt maturity profile over the short term since it made a partial Eurobond repayment in June 2016.

The Negative Outlook is driven by a combination of deleveraging and remaining liquidity risks. In particular, we expect KOKS to deleverage, with funds from operations (FFO)-adjusted leverage falling below 4x after being 4.2x at end-2016, and to progress in obtaining more diversified and longer-term funding. Failure to progress in deleveraging and to achieve further liquidity improvements would result in a rating downgrade.

KEY RATING DRIVERS

Liquidity Tight but Manageable
Fitch considers KOKS' liquidity tight as it relies on undrawn committed short-term facilities and the company's ability to roll over already drawn funds in due course. KOKS's short-term debt fell to RUB25bn at end-1H16 (FYE15: RUB37bn) but remained a significant 51% of total RUB49bn debt. This short-term debt largely consists of revolving credit facilities (RCFs) withannual pay-down features. We consider them short term even though some are multi-year facilities with a record of regular prolongations.

Taking into account the diversity of RCF creditors and the available undrawn long-term debt of above RUB2bn at end-1H16, we expect refinancing risk to have become more appropriate for the current rating since the last review in March 2016, as a large Eurobond repayment was due in June 2016.

Leverage Peak in 2016
We expect KOKS to deleverage in 2H16 to 4.2x and 3.7x in 2017 as pig iron and steel markets rebound after their lows in 2H15-1H16. Recovering pig iron prices, a weak rouble and increasing contributions from the Butovskaya mine are among the factors supporting sales at around RUB60bn and margin growth to 27% by 2017.

However, we expect leverage to stabilise at 3.6x-3.7x from 2017 due to post-2017 margin moderation back to below 25% on mid-single-digit cost inflation and the strengthening rouble. We also incorporate the upper amount of KOKS' RUB6bn-RUB12bn investment range assumed for the off-balance-sheet Tula-Steel project.

Partial Self-Sufficiency
KOKS is over 100% self-sufficient in coke, 71% in iron ore and 50% in coking coal. KOKS expects to achieve 100% self-sufficiency in coking coal by 2018 with the commissioning of the Tikhova mine in 2017 and further production ramp-up at the recently commissioned Butovskaya mine. The commissioning of the iron ore deposit at Kombinat KMA Ruda that would bring KOKS's self-sufficiency in iron ore to 100% is likely to be after 2018.

Strong Position in Pig Iron
KOKS is the world's largest exporter of merchant pig iron and top producer of merchant coke in Russia. In 2015 it

controlled 15% of the world's pig iron exports and 29% of total CIS pig iron sales. KOKS accounted for 25% of total coke sales in CIS. The company is geographically diversified in its pig iron sales with a strong presence in North America (38% of total sales), Europe (29%), Turkey and the Middle East (25%), and Asia (8%).

KOKS specialises in commercial pig iron, which is used in the automotive, machinery and tools industries, which require high-quality pig iron (low content of sulphur and phosphorus). KOKS' new de-sulphurising machine may increase the share of premium pig iron up to 50%, if economically feasible.

Tula-Steel Project
KOKS is developing a steel project in European Russia with two partners, DILON Cooperatif U.A. and LLC Steel. All three partners are ultimately controlled by the Zubitskiy family. At present LLC Steel and DILON control the Tula-Steel project through equity interests of 66.7% and 33.3%, respectively.

KOKS has no control, legal ties or debt recourse and does not consolidate the project in its financial results. However, it has so far been the only project funding source (end-2015: RUB6bn) excluding Gazprombank's committed RUB20bn eight-year project financing. We conservatively assume KOKS will provide a further RUB12bn.

The company expects a 2mtpa steel plant to be commissioned by end-2017 with ramp-up in 2018. The steel plant will produce specialty steel for the machinery and automotive sectors, sourcing pig iron from neighbouring Tulachermet, a subsidiary of KOKS.

KOKS may consider consolidating Tula-Steel should its leverage moderate. Fitch does not consolidate Tula-Steel, but its consolidation or higher-than-expected contributions from KOKS will create leverage and rating pressure. Consolidating the project may also create a significant secured debt layer affecting the recoveries of senior unsecured bondholders.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case for the issuer include:
- Average export pig iron price decline of 3% in 2016 with mid-single-digit recovery after 2016
- Further ramp-up at Butovskaya coal mine and commissioning of Tikhova coal mine in 2017
- Average USD/RUB 68.5 in 2016 with gradual rouble appreciation towards 57 in 2019
- Capex at below RUB5bn and no dividends until 2019
- RUB12bn funding contribution to non-consolidated Tula-Steel in 2016-2017

RATING SENSITIVITIES
Negative: developments that may, individually or collectively, lead to negative rating action include:
- tightening liquidity and increasing refinancing risk, coupled with an inability to improve the liquidity ratio to close to 1x by mid-2017;
- market deterioration, capex overrun or Tula-Steel project consolidation causing FFO-adjusted gross leverage to rise above above 4x;
- FFO fixed charge cover sustained below 2x.

Positive: Fitch does not expect any rating upgrade at this stage.
Developments that may, individually or collectively, lead to the revision of the Outlook to stable include:
- positive FCF across the cycle, leading to FFO-adjusted gross leverage reverting below 4x on a sustained basis;
- adequate liquidity position with manageable refinancing risk.

FULL LIST OF RATING ACTIONS
PAO Koks Group:
- Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'B' affirmed; Outlook Negative; off RWN
- Long-Term Local-Currency Issuer Default Rating (IDR) of 'B' affirmed; Outlook Negative; off RWN
- Short-Term IDR of 'B' affirmed; off RWN

Koks Finance Limited:
- Senior unsecured rating for Eurobond issue due in 2018 of 'B'(RR4) affirmed; off RWN

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 27 Sep 2016)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

meaning of the Corporations Act 2001