MOODY'S
INVESTORS SERVICE

Rating Action: Moody's confirms KOKS's B3 rating; negative outlook

Global Credit Research - 24 Oct 2016

London, 24 October 2016 -- Moody's Investors Service (Moody's) has today confirmed JSC KOKS's corporate family rating (CFR) at B3 and its probability of default rating (PDR) at B3-PD. Moody's has also confirmed the B3 (LGD4) senior unsecured rating assigned to loan participation notes issued by KOKS Finance Limited. The outlook on all these ratings is negative. This concludes the ratings review initiated by Moody's on 13 July 2016 (CFR and PDR) and 22 December 2015 (senior unsecured rating).

RATINGS RATIONALE

Today's rating action reflects KOKS's improved liquidity and the reduced refinancing risk related to its significant short-term debt maturities.

As of 30 September 2016, KOKS's liquidity comprised $16 million in cash and equivalents, $104 million in available committed credit facilities maturing beyond the following 12 months, and around $140 million in operating cash flow, which Moody's expects the company to generate over the following 12 months. This liquidity is weak as should be sufficient to cover the company's short-term debt maturities and capex only until Q2 2017. Moody's understands that KOKS is close to procuring new bank loans which would cover its obligations until year-end 2017. The company also considers placing domestic rouble bonds.

KOKS's B3 CFR factors in the company's (1) weak liquidity, on-going refinancing risk and aggressive liquidity management; (2) small scale and limited operational and product diversification; (3) exposure to the weak global steel market environment; (4) deteriorated leverage and interest coverage metrics, with its Moody's-adjusted debt/EBITDA rising to 5.4x and EBIT interest coverage declining to 0.9x at 30 June 2016 from 4.4x and 1.6x, respectively, at year-end 2015; (5) debt-financed expansionary capex programme; and (6) concentrated ownership-related risks, with significant loans given to related parties.

More positively, the rating takes into account (1) the company's status as one of the leading merchant pig iron producers globally, with a diversified customer base and geography of sales; (2) its low-cost position, owing to the weak rouble and operational enhancements; (3) Moody's expectation that the company's financial metrics will improve over the next 12-18 months, owing to the recent rise in coking coal prices and also anticipated commissioning of Tikhova and Butovskaya mines which the company estimates to increase its consolidated EBITDA by more than 60% after ramp-up; (4) the improved product mix, with higher sales of premium grades of coke and pig iron; (5) KOKS's significant degree of vertical integration, with a 50% and 71% self-sufficiency in coking coal and iron ore, respectively; and (6) its large coking coal and iron ore reserves.

KOKS Finance's loan participation notes' senior unsecured rating is confirmed at B3, which reflects Moody's estimation that less than 20% of KOKS's consolidated debt is secured with assets, which results in KOKS Finance's loan participation notes rating being at the level of KOKS's CFR. If the share of secured debt were to be materially higher, the unsecured notes could be rated below the CFR because of their subordination to substantial secured debt.

RATIONALE FOR NEGATIVE OUTLOOK

The negative outlook reflects the uncertainty over KOKS's ability to maintain the necessary liquidity to meet its short-term debt maturities over at least the next 12 months on a sustainable basis, resulting from the company's continuing aggressive liquidity management.

WHAT COULD CHANGE THE RATINGS UP/DOWN

There is no upward pressure on the rating at this point. We can stabilize the outlook if the company improves its liquidity management, so that it maintains adequate liquidity on a sustainable basis, and subject to no deterioration in the company's operating performance and financial metrics. Over time, a positive pressure on the rating can build up if KOKS increases the share of longer-term debt in its debt portfolio, adopting practices of funding long-term investments with corresponding maturities, along with general improvements in leverage and other financial metrics.

The rating could be downgraded if KOKS's liquidity deteriorates and liquidity management practices are not improved, elevating a default risk on its short-term debt obligations. Downward pressure could also be exerted on the rating as a result of an unanticipated significant increase in leverage, decline in interest coverage, or a sharp weakening in global demand or prices for pig iron and coke.

LIST OF AFFECTED RATINGS

Confirmations:

..Issuer: JSC KOKS

....Corporate Family Rating, Confirmed at B3

....Probability of Default Rating, Confirmed at B3-PD

..Issuer: KOKS Finance Limited

....Backed Senior Unsecured Regular Bond/Debenture, Confirmed at B3 (LGD4)

Outlook Actions:

.. Issuer: JSC KOKS

.... Outlook, Changed To Negative From Rating Under Review

.. Issuer: KOKS Finance Limited

.... Outlook, Changed To Negative From Rating Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was "Global Steel Industry" published in October 2012. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

KOKS is a small Russia-based producer of coking coal, coke, iron ore and pig iron. In 2015, the company produced 1.9 million tonnes of coking coal, 2.7 million tonnes of coke, 2.2 million tonnes of iron ore concentrate and 2.1 million tonnes of pig iron. In 2015, the company generated revenues of RUB53.6 billion (2014: RUB47.2 billion) and Moody's-adjusted EBITDA of RUB12.7 billion (2014: RUB12.5 billion). KOKS is majority-owned by the Zubitsky family, which holds an 86% stake in the company.

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