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Research Update:

Russian Coal And Iron Producer Koks 'B-' Rating Affirmed Following Debt Payment; Off Watch; Outlook Negative

Primary Credit Analyst:
Ekaterina Kulikova, Moscow +7 (495) 783-4090; ekaterina.kulikova@spglobal.com

Secondary Contact:
Alexander Griaznov, Moscow (7) 495-783-4109; alexander.griaznov@spglobal.com

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Overview

- On June 24, 2016, Koks repaid its $134 million bond using available liquidity and recently raised bank lines.
- Although we do not expect a liquidity shortfall in the short term, we continue to assess the company's liquidity as weak, because its capital structure still features meaningful short-term debt maturities.
- We are affirming our corporate credit rating on Koks at 'B-' and removing it from CreditWatch, where it was placed with negative implications on March 1, 2016.
- The negative outlook reflects the residual risks related to the company's liquidity.

Rating Action

On June 29, 2016, S&P Global Ratings affirmed its 'B-' long-term corporate credit rating on Russia-based vertically integrated coking coal, coke, iron ore, and pig iron producer OAO Koks. The outlook is negative. We removed the rating from CreditWatch, where we had placed it with negative implications on March 1, 2016.

At the same time, we withdrew our 'CCC+' issue rating on Koks' $134 million senior unsecured Eurobond because it was repaid on June 24, 2016. Prior to withdrawal the rating was on CreditWatch negative, where we placed it on March 1, 2016.

Rationale

The affirmation follows Koks' repayment of its $134 million Eurobond on June 24, 2016. We no longer see immediate risk of further deterioration in Koks' liquidity. Although Koks continues to bear a meaningful short-term debt burden of more than Russian ruble (RUB) 12 billion, we think the company should be able to roll it over. We currently regard Koks' liquidity as weak, but we note that the company has a number of short-term committed credit facilities and approved bank limits, which should help the company manage its near-term financing needs. That said, we view the company's capital structure and aggressive liquidity management as constraints to a higher rating.

We note that Koks' operating performance remains healthy and its leverage manageable, with projected debt to EBITDA of 3.5x-4.0x at the end of 2016. We therefore believe that its weak liquidity is mostly an outcome of its aggressive approach to refinancing, rather than reduced market access. We understand the company is currently working on raising new financing, and we think it could see improvements in its capital structure over time.

We continue to view Koks' business risk as weak, based on its exposure to the very cyclical steel industry, particularly in its coke and pig iron segments--the company's main business lines. We believe this exposure underpins our view of the company's profitability as highly volatile. Additional pressure stems from moderately high industry risk and high operating risk in Russia, where all the company's assets are located. We view positively the company's substantial resource base, sufficient for decades of operations, and the high degree of self-sufficiency in its key inputs: coking coal and iron ore.

Our assessment of Koks' aggressive financial risk profile reflects our expectation of funds from operations (FFO) to debt of 12%-15% in 2016-2017, supported by healthy performance with sustainably high margins, largely thanks to a weak ruble. We note that the company generates positive free operating cash flow. This helps mitigate the impact of revaluation of its foreign currency debt, which weakened its credit metrics.

We continue to see a risk that Koks' leverage might increase beyond our base-case projection as a result of its involvement in the steel project OOO Tulachermet-Stal, which is currently not part of the group. We acknowledge that Koks sold its stake in the project and it is owned by Koks' ultimate shareholders. However, the company has previously provided a large long-term loan to OOO Tulachermet-Stal.

Under our base-case scenario, we do not forecast that Koks will make additional investments in the project. However, we reflect the possibility of such an investment or similar transactions going forward by applying a one-notch negative financial policy adjustment.

In our base case, we assume:
- Flat production volumes;
- Cost inflation of about 5% for 2016;
- An exchange rate of RUB75 to $1;
- Capital expenditures (capex) of RUB4.3 billion in 2016, and RUB4 billion-RUB5 billion thereafter;
- No dividends until 2017; and
- No material acquisition.

Based on these assumptions, we arrive at the following credit measures for 2016-2017:
- FFO to debt of about 12%-15%;
- Debt to EBITDA in the 3.5x-4.0x range; and
- Positive free cash flow generation.

Liquidity

We assess Koks' liquidity as weak, based in part on a ratio of sources to uses of 0.7x for the 12 months started June 23, 2016. We expect the company will be able to secure necessary financing, based on its track record. As such, our liquidity assessment also incorporates our view on Koks' liquidity management and its high reliance on revolving credit facilities and short-term financing.

We forecast that the company's liquidity sources for the 12 months started June 23, 2016, will include:
- Cash and short-term cash equivalents totaling about RUB800 million;
- Available long-term committed credit lines of about RUB3.6 billion; and
- Expected FFO of approximately RUB7 billion.

For the same period, we assume that the principal liquidity uses will comprise:
- About RUB12.4 billion in debt maturities; and
- Capex of about RUB4.4 billion.

Koks has revised its covenants, with the most strict being net debt to EBITDA of 6.5x as of June 30, 2016, and 4.0x afterward. We view the company's headroom above this covenant as adequate.

Outlook

The negative outlook on Koks reflects the residual risks related to the company's meaningful short-term debt burden. In our base-case scenario, we assume that the company's liquidity sources should enable it to finance operations and roll over its other short-term debt maturities. Still, we think that Koks' liquidity will remain sensitive to market conditions and underperformance.

Downside scenario

We could lower the rating if we see a risk that Koks might face issues extending its short-term debt maturities. A downgrade, driven by weaker operating performance or debt to EBITDA exceeding 6X, appears less likely at this stage. We generally think that such a scenario would hinge on additional investments in the steel project, which we do not anticipate.

Upside scenario

We could revise the outlook to stable if Koks strengthens its liquidity so that its ratio of sources to uses improves to at least 1x on a sustainable basis.

An upgrade would stem from adequate liquidity and a more sustainable improvement in the capital structure, including a material shift toward long-term debt instruments. Moreover, a positive rating action would not depend on stronger credit metrics, given that we would see FFO to debt of above 12% as commensurate with a 'B' rating.

Ratings Score Snapshot

Corporate Credit Rating: B-/Negative/--

Business risk: Weak
- Country risk: High
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Weak (-1 notch)
- Financial policy: Negative (-1 notch)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Metals And Mining Upstream Industry - December 20, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
OAO Koks		
Corporate Credit Rating	B-/Negative/--	B-/Watch Neg/--

Not Rated Action; CreditWatch/Outlook Action

	To	From
OAO Koks		
KOKS Finance Ltd.		
Senior Unsecured	NR	CCC+/Watch Neg

NR--Not rated.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.