Fitch Revises PAO SIBUR Holding's Outlook to Negative; Affirms at 'BB+'

03 Mar 2016 10:28 AM EST

Fitch Ratings-London-03 March 2016: Fitch Ratings has revised the Outlook on Russia-based petrochemical group PAO SIBUR Holding's (SIBUR) Long-term Issuer Default Rating (IDR) to Negative from Stable and affirmed the IDR at 'BB+'. Fitch also affirmed SIBUR's Short-term IDR at 'B', and SIBUR Securities Limited's five-year USD1bn guaranteed notes due 2018 at 'BB+'.

The Negative Outlook reflects Fitch's expectations of materially higher leverage during 2017-2019 due to expenditure on the multi-billion ZapSibNefteKhim petrochemical project (ZapSib-2) at a time of low and volatile petrochemical pricing. We expect funds from operations (FFO) net adjusted leverage to rise to 2.8x over 2017-2019 before reverting back to below our 2x rating guideline in 2020. This is despite SIBUR's operational performance benefiting from a weak rouble and a long-term drawdown period under its recent loan facilities obtained for the ZapSib-2 project. Fitch believes once completed in 2020, ZapSib-2 will provide a material enhancement to SIBUR's operational profile.

SIBUR's ratings are constrained by higher than average systemic risks associated with the Russian business and jurisdictional environment. Excluding these risks, Fitch assesses SIBUR's credit profile in the 'BBB' category, which reflects its leading market and cost position in the petrochemical sector, diversified portfolio and proven access to competitively priced feedstock.

KEY RATING DRIVERS

Leveraging on Transformational ZapSib-2 Project

SIBUR's USD9.5bn ZapSib-2 project is expected to add 1.5 million tonnes (mt) of steam cracking capacity and 2mt of polymer capacity, and will be transformational for SIBUR's operational profile. In particular, SIBUR's basic polymer capacity will triple from its current 1mt level and the share of internally processed liquefied petroleum gas (50% of SIBUR's energy product sales) will almost double. This will further reduce SIBUR's sales exposure to volatile, oil-linked energy products towards 30% from 45%, and increase the exposure to more resilient, value added petrochemical products to 60% from 40%.

ZapSib-2 is SIBUR's largest investment, accounting for 80% of 2016-2020 total capex. SIBUR has already raised long-term debt financing including USD2.3bn export credit agencies' funding, USD1.75bn loan from the National Wealth Funding, and USD210m loan from Russian Direct Investment Fund and its partners, with most facilities maturing beyond 2020 when the project is expected to launch. While SIBUR demonstrated flexibility in the past by postponing some of ZapSib-2's capex, we believe there is limited scope for this once the financing is raised. We expect SIBUR's capex will peak in 2016-2018 at over 35% of sales. At a time of low oil prices partly offset by weak rouble, this will put SIBUR's leverage under pressure over this period. This pressure, coupled with the risks around SIBUR's limited further flexibility to defer ZapSib-2 capex is reflected in the Negative Outlook.

Pricing Pressure Varies Across Products

SIBUR's product portfolio consists of energy products (48% of 1H15 sales) and petrochemical products (48%). Energy products are diversified across liquefied petroleum gas, natural gas, naphtha and other products, but most of these products have significant pricing correlation with oil. Petrochemical products are mostly presented by polypropylene, polyethylene, synthetic rubbers and other plastics, which are more resilient to oil price shocks. While the recent oil

shock sharply cut SIBUR's energy products performance, it had a less severe impact on petrochemical products' sales and aided its margins due to the cost of inputs decreasing.

Medium-term Margins and Leverage Pressure

We expect SIBUR's revenues to show consistent single-digit increases over the next five years driven by rubbers and polymers volume growth, oil price recovery and despite the strengthening rouble. The strengthening rouble and local inflation will also contribute to SIBUR's margin reduction from a 37%-39% peak in 2015-2016 to 33%-35% from 2017, which is more consistent with historical performance. Aggressive capex/sales exceeding 30% for 2016, 2017 and 2018, coupled with a 25% dividend payout ratio will exceed operational cash flows and translate into a high single digit negative free cash flow margin and leveraging to 2.5x in 2016 followed by further leveraging to 2.8x in 2017-2018 (2015E: 2.5x).

Over the long term, we expect SIBUR to reduce capex from 2019 as most of the ZapSib-2 project capex is realised, resulting in gradual deleveraging towards below 2x post 2019. This is based on our assumption that SIBUR will not undertake new large projects on its balance before the ZapSib-2 ramp up. The potential project of Amur gas chemical complex is assumed to be financed using non-recourse project finance.

Sinopec's Stake Neutral for Ratings

In December 2015 China Petroleum & Chemical Corporation (Sinopec; A+/Stable) acquired 10% of SIBUR's equity and subsequently nominated one of the 10 directors on SIBUR's Board of Directors. SIBUR's investment and dividend strategy remains intact after the change of shareholder structure. Fitch views this strategic partnership positively, as China is a growing market for SIBUR's products and future collaborative petrochemical projects.

FX has Multiple Implications

SIBUR reports in roubles. Its costs are dominated in roubles while its revenues are mostly driven by the US dollar. Similar to other petrocurrencies, the rouble becomes weaker during low oil pricing and stronger otherwise. As a result, a two-thirds oil and oil derivative price contraction was to a large extent compensated by more than a halving of the value of the rouble against the US dollar. This translated into reduced sales and margins for SIBUR's energy products. However, the relative price resilience of polymers and rubbers compared with oil, coupled with a weaker rouble, translated into higher sales and margins for SIBUR's petrochemical products. The overall effect of a weak rouble and low oil prices is broadly neutral for rouble-reported sales but positive for margins, meaning that the rouble is mitigating the weak oil environment.

The weak rouble also has an impact on SIBUR's capex and dividends. All other things being equal, a weak rouble increases the foreign currency element of capex and leads to a higher dividend payout through higher net profits. SIBUR's debt is also mostly in foreign currencies and thus gets denominated at a higher level with a weak rouble. Therefore, the overall weak rouble impact is positive on operational free cash flow but drives up capex, dividends and debt, other things being equal.

Eurobonds Not Subordinated

SIBUR's USD1bn Eurobonds due 2018 are not facing subordination issues arising from the ZapSib-2 financing. In particular, neither of the loans obtained from Russia's National Welfare Fund or Russian Direct Investment Fund in 2H15 contain a direct seniority clause or presume structural seniority to Eurobonds. Therefore, Eurobond holders remain structurally subordinated only to the SIBUR's RUB35bn debt sitting at its operating subsidiary Tobolsk Polymer. However, as the Eurobonds' prior-ranking debt remains well below the Fitch's 2x-2.5x EBITDA guidance, there is no subordination pressure on the Eurobonds' ratings and recoveries.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for SIBUR include:
- Oil price at USD35/bbl in 2016 gradually growing towards USD65/bbl by 2019.
- USD/RUB gradually strengthening towards 57 in 2019 from its peak at 75 in 2016.
- Energy product prices follow oil price movements, petrochemical products drop by 15%-20% in 2016 with single digit recovery after 2016.
- Capex/sales peaking at above 35% during 2016-2018, and dividend pay-out of 25% of net income driving a strongly negative FCF margin until 2019.

RATING SENSITIVITIES

Positive: Future developments that may, individually or collectively, lead to positive rating action include:
- (Outlook Stabilisation) Progress towards the completion of ZapSib-2 project combined with expectations of FFO net adjusted leverage trending towards 2x.
- (Upgrade) Sustained positive FCF leading to FFO net adjusted leverage at or below 1.5x through the cycle.

Negative: Future developments that may, individually or collectively, lead to negative rating action include:
- Material deterioration in the company's cost position or access to low-cost associated petroleum gas.
- Aggressive investments leading to an inability to keep FFO adjusted net leverage well below 3x in 2017-2019 and below 2x by 2020.

LIQUIDITY

Historically, SIBUR had significant short-term debt which constitutes 25%-35% of total debt and is well above its cash cushion. However, SIBUR's continued access to undrawn committed credit lines mitigates the liquidity gap. At end-3Q15 SIBUR had RUB84bn of short-term debt maturities, which were covered by RUB15bn of cash and RUB151bn long-term committed credit lines. SIBUR's exposure to uncommitted credit lines (end-3Q15: RUB106bn) coupled with its proven long-term relationships with state-owned banks adds comfort to its liquidity balance.

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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

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015)

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