FITCH AFFIRMS PAO SIBUR HOLDING AT 'BB+'; OUTLOOK NEGATIVE

Fitch Ratings-Moscow/London-31 March 2017: Fitch Ratings has affirmed the Russia-based petrochemical group PAO SIBUR Holding's Long-Term Issuer Default Rating (IDR) at 'BB+' and maintained the Negative Outlook. Fitch also affirmed SIBUR's Short-Term IDR at 'B', and the senior unsecured ratings for SIBUR Securities Limited's USD616 million outstanding notes due 2018 and for PAO SIBUR Holding's rouble bonds totalling RUB30 billion at 'BB+'.

The Negative Outlook reflects our expectations of leverage pressure during 2017-2019 driven by investments in the multi-billion-dollar ZapSibNefteKhim petrochemical project (ZapSib) with funds from operations (FFO) adjusted net leverage peaking at 3x in 2018 before reverting close to our 2x rating guideline by 2020. This is despite SIBUR's operational performance, which benefits from a weak rouble and the remote maturities of its ZapSib-related debt. Fitch believes that ZapSib, once completed at end of 2019, will materially enhance SIBUR's operational profile.

KEY RATING DRIVERS

Leveraging on Transformational Project: SIBUR's USD9 billion ZapSib project will add 1.5 million tonnes (mt) of polyethylene capacity and 0.5mt of polypropylene capacity. The project will materially enhance SIBUR's operational profile as its polyolefin capacity will triple from its current 1mt and the share of internally processed liquefied petroleum gas will almost double. ZapSib will boost SIBUR's exposure to relatively price-resilient polyolefins to 35% from 19% of sales in 2016 while reducing its exposure to more volatile, often oil-linked, energy products to around 30% from 41%.

ZapSib accounts for 80% of 2017-2020 planned capex, with all long-term debt financing already obtained from export credit agencies and Russia's state-owned funds, and falling due after the project is completed at the end of 2019. The propensity to delay capex diminishes as the project progresses and the risk of market-driven leverage shocks increases. However, this is mitigated by declining capex overrun or timing risk and the improving visibility of SIBUR's post-2018 deleveraging path back towards 2x FFO adjusted net leverage.

Leverage Peaks in 2018: We expect SIBUR's revenues to grow by single digits annually over the next four years due to gradual oil recovery, despite a stronger rouble and broadly flat product mix and volumes. We project rising oil prices to be offset by rouble appreciation and local inflation resulting in medium-term EBITDAR margins around 36%, the level achieved in 2016. We expect aggressive ZapSib-driven capex/sales at above 30% to drive a double-digit negative free cash flow margin and leveraging in 2017-2018 followed by deleveraging, assuming SIBUR does not undertake significant projects driving capex intensity above 20% during 2019-2020.

Oil and FX Exposure Moderate: Fitch estimates that stronger oil prices coupled with a stronger rouble would have a roughly neutral effect on SIBUR's leverage. Prices for its products and its operating costs have varying degrees of correlation with oil prices and the rouble, but an increase in oil prices and the rouble exchange rate would cumulatively lead to lower rouble-based EBITDA, according to our projections. This reduction will be offset by decreasing capex, dividends and net debt, resulting in a limited impact on EBITDA-based leverage. A potential rise in oil prices would tend to drive leverage higher as SIBUR moves towards polymers by 2020-2021.

No Visible Subordination Risk: SIBUR's USD616 million notes due 2018 and RUB30 billion domestic bonds do not face subordination issues arising from the ZapSib financing. Debt at PAO SIBUR Holding and at the ZapSib subsidiary raised from Russia's National Welfare Fund and Russian Direct Investment Fund is not contractually senior to the bonds. The structural seniority of ZapSib debt will only materialise once the subsidiary becomes cash generative after 2020. However, we do not expect total debt at ZapSib to exceed RUB250 billion, well within Fitch's 2x-2.5x prior-ranking debt to group EBITDA guidance in 2017-2021, resulting in no subordination risk for bondholders.

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

DERIVATION SUMMARY

SIBUR is favourably positioned relative to its American peers Westlake Chemical Corporation (BBB/Stable), NOVA Chemicals Corporation (BBB-/Stable) and Methanex Corp. (BBB-/Stable) in terms of the relative feedstock cost translating into sustainably higher margins, and larger scale, with broader and more diverse commodity petrochemical product mix. We expect SIBUR's leverage, broadly in line with that of its peers, to moderate to 2x-2.5x by 2020 after it passes the peak of its expansionary project investments.

No Country Ceiling or parent-subsidiary considerations affect the rating. We apply a two-notch corporate governance discount to SIBUR's rating, as for most Russian corporates, incorporating the higher-than-average political, business and regulatory risks in Russia where the company operates.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- oil price at USD52.5/bbl in 2017, gradually growing towards USD65/bbl by 2020;
- USD/RUB at 61 in 2017, gradually strengthening towards 57 by 2020;
- energy products (excluding natural gas) continuing to generally follow oil price movements;
- polyolefins to grow in low single digits until 2020;
- capex/sales peaking at 35%-40% in 2017-2018, leading to double-digit negative free cash flow until 2018;
- dividend pay-out of 25% of net income.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
- Progress towards the completion of ZapSib combined with expectations of FFO-adjusted net leverage trending towards 2x could cause an Outlook revision to stable.
-Sustained positive FCF leading to FFO net adjusted leverage at or below 1.5x through the cycle could lead to an upgrade.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Material deterioration in the company's cost position or in access to low-cost associated petroleum gas
- Aggressive investments leading to inability to keep FFO-adjusted net leverage below 3x in 2017-2019 and towards 2x by 2020

LIQUIDITY

Liquidity Adequate, Tightening in 2018: SIBUR's cash balance of RUB61 billion at end-2016 covered its short-term debt of RUB22 billion. We expect the company to fund around RUB80 billion of negative FCF in 2017 by drawing on its committed credit lines, which mostly consisted of available ZapSib-related facilities and totalled RUB112 billion at 31 December 2016.

We estimate SIBUR will need to refinance its outstanding RUB37 billion Eurobonds due in January 2018 as it will need to cover a negative RUB50 billion FCF in 2018 due to investments in ZapSib. We do not view refinancing as a significant risk due to the company's proven long-term relationships with state-owned banks.

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Summary of Financial Statement Adjustments
- 6x multiple applied to RUB9.2 billion operating lease expense during FY16 as the issuer is located in Russia;
- RUB4.6 billion of off-balance-sheet factoring added back to the trade receivables and secured debt;
- RUB3 billion reclassified to Fitch-defined restricted/not readily available cash;
- RUB1.7 billion impairment and loss on disposal of property, plant and equipment were excluded from EBITDAR;
- RUB3.7 billion advances received (net of advances paid) under construction management reclassified from working capital and CFO as non-operating cash flow.

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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. 10 Mar 2017)
https://www.fitchratings.com/site/re/895493
Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 21 Nov 2016)
https://www.fitchratings.com/site/re/890199

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