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Key rating assessment factors

ACRA assigns AA+(RU) to JSC “HC “METALLOINVEST”, outlook Stable

The credit rating of [JSC “HC “METALLOINVEST”](#) (hereinafter, the Company) is based on the Company’s strong market position. The rating is also based on a very strong business profile assessment determined by a high-quality resource base. As such, the Company’s production cost is one of the lowest in the mining segment not only in Russia, but also in the world. A high assessment of geographical sales diversification, strong corporate governance, and a very strong financial profile support the Company’s rating.

The Company is a leading mining and metallurgical holding company in Russia and one of the world’s largest, supplying domestic and foreign markets with iron ore concentrate, pellets, hot-briquetted iron (HBI), as well as cast iron and steel products, including high-quality steel (Special Bar Quality). The Company holds one of the world’s largest reserves of high-quality and accessible iron ore, resulting in lower production costs. The main production assets of the Company are Lebedinsky GOK, Andrey Varichev Mikhailovsky GOK, OEMK, and Ural Steel. A. B. Usmanov is one of the largest beneficiaries of the Company.

Strong market position. The Company is one of the largest mining and metallurgical holding companies in Russia, ranking first in iron ore commodities and pellet production, and is also the country’s only producer of commercial HBI with a global market share of about 50%. This is used for steelmaking in electric arc furnaces and is the cleanest commodity in terms of impurities for smelting high-quality steel. The Company is one of the five largest steel producers in Russia. In addition, the Company is one of the world’s five largest iron ore producers and the second largest pellet producer in the world.

Very strong business profile. When assessing the business profile, ACRA considered the Company primarily a multi-profile mining holding company that has the world’s second-largest proven iron ore reserves (about 14 bln tons), which guarantees about 140 years of operational life at current production levels. Open-pit mining along with modern technologies used to enrich and process iron ore concentrate provide the Company with one of the lowest production costs of pellets and HBI/DRI not only in Russia, but also in the world (the monetary cost of production is in the first quartile of the global cost curve). This gives the Company a clear competitive advantage in the world market. The Company’s two iron ore deposits, which are located in regions least susceptible to climate and seismic risk factors, ensure the diversification and continuity of production processes. ACRA notes the high product diversification of the Company’s mining segment, which is based on high iron ore processing (iron ore pellets, HBI, and DRI). The steel segment, although significantly inferior to the mining segment in terms of profitability, is an additional step in ensuring the diversification and expansion of the Company’s product portfolio. ACRA notes that the Company’s steel segment products are niche in terms of market capacity compared to the products of major steel holding companies such as NLMK, Severstal, or MMK, which are characterized by a larger market capacity (flat steel, rolled steel, etc.). However, ACRA notes that the Company’s steel products, especially in the SBQ segment, are highly valued by consumers who have high requirements for the purity and strength of metal, namely, manufacturers of engines, bearings, transmissions, etc. SBQ steel products are supplied to the largest Russian and European automobile manufacturers and bearing conglomerates.

Very strong geographical diversification. The Company delivers its final products (both ore and steel) to a wide geographical area. About 60% of the Company’s revenue comes from exports, most of which are generated by deliveries to Europe, Asia, and the Middle East.

Strong corporate governance. The Company consistently implements a strategy aimed at modernizing current production, increasing the share of products with high added value, improving energy efficiency and reducing production costs. The increase in the share of high-processing products is aimed at meeting the growing demand for commodities with a high iron content for steelmaking in electric arc furnaces, which is part of a trend towards improving the environmental friendliness of metallurgical production. The risk management system is at a high level for the corporate sector as it features all elements of risk management. The assessment of the Company’s management structure takes into account a Board of Directors that defines strategic goals and objectives and forms key committees for solving problems in the field of risk management, dividend policy, employee motivation, compensation systems, etc. Three of the ten Board members are independent. The assessment of the group’s structure takes into account its minor complexity, which is typical for vertically integrated holding companies. ACRA expects that the Company will continue to search for the most optimal solution to simplify its corporate structure, which should make the process of paying dividends to shareholders as clear as possible for investors and creditors. In terms of financial transparency, ACRA notes the high quality of audited financial statements, important aspects of which are disclosed in notes. In addition, the Company regularly publishes operating results on its website and holds conference calls with investors.

Very strong financial profile. ACRA assesses the scale of the Company’s business as very large for the Russian corporate segment (FFO before net interest payments and taxes is over RUB 100 bln). The Company’s profitability is at a high level, with FFO before interest payments and taxes at 36.3% for 2019. A high-quality resource base with low production costs ensures high profitability. ACRA expects profitability to remain around 37% in the forecast period (2020–2023). ACRA assesses the Company’s leverage as low. Total debt to FFO before net interest payments was just over 2.0x for 2019. This is higher than in 2018 (1.6x) as operating flow was lower due to lower prices for steel products. ACRA expects the Company’s leverage to be below 2.0x in the forecast period. Debt servicing (FFO before net interest payments to interest payments) was about 7.0x for 2019.

ACRA assesses the Company’s liquidity as high. As of June 30, 2020, the Company had cash in its accounts in the amount of USD 473 mln. However, short-term debt equaled USD 284 mln, of which about USD 23 mln will be repaid in H2 2020. The Company had open undrawn credit lines in excess of USD 630 mln.

Over the last two reporting years, the Company’s free cash flow (FCF) after dividend payments has remained positive, which corresponds to the goals set by the Company’s Board of Directors in terms of financial risk management. Given the average annual investment expenditures of USD 540 mln expected in 2020–2023, as well as annual payments to shareholders under 50% of EBITDA, ACRA expects the Company to maintain a positive FCF in the forecast period. ACRA also notes the Company’s flexibility in the case of unfavorable market trends. The Company can reduce both the investment component in cash flows and the amount of payments to shareholders in order to avoid exceeding credit metrics over the comfortable target value.

Key assumptions

- Moderate average annual decline in global iron ore prices within 6% in 2020–2023 due to the recovery of supplies from Australia and Brazil;
- Lower global steel prices in 2020 due to reduced business activity followed by a moderate recovery in 2021–2023;
- Average capital expenditures at USD 540 mln in 2020–2023;
- Annual payments to shareholders below 50% of EBITDA during the forecast period.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Reduction in leverage below 1.0x with increase in debt servicing above 10.0x;
- Positive FCF.

A negative rating action may be prompted by:

- Decrease in FFO before interest payments and taxes below 30%;
- Increase in leverage above 3.5x;
- Reduction in FFO before fixed payments to fixed payments below 5.0x.

Rating components

SCA: aa+.

Adjustments: none.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Non-Financial Corporations Under the National Scale for the Russian Federation](#), and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to JSC "HC "METALLOINVEST" for the first time. The credit rating and its outlook are expected to be revised within one year following the publication date of this press release.

The credit rating was assigned based on the data provided by JSC "HC "METALLOINVEST", information from publicly available sources, as well as ACRA's own databases. The credit rating is solicited, and JSC "HC "METALLOINVEST" participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by JSC "HC "METALLOINVEST" in its financial statements have been discovered.

ACRA provided no additional services to JSC "HC "METALLOINVEST". No conflicts of interest were discovered in the course of credit rating assignment.

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