

December 7, 2017

ACRA assigns AA+(RU) to JSC «FPC», outlook Stable

Lead analysts:

Evgeny Obydov, Associate Director
+7 (495) 139-0488
evgeny.obydov@acra-ratings.ru

Alexander Gushchin, Senior Analyst
+7 (495) 139-0489
alexander.gushchin@acra-ratings.ru

Key rating assessment factors

The credit rating assigned to [Joint Stock Company «Federal Passenger Company»](#) (hereinafter, the Company or FPC) is one rating notch below the financial obligations of the Russian Government, in view of a high systemic importance of the Company for the Russian economy and a very high influence of the state on the Company. ACRA notes that the level of systemic importance is not maximum achievable, which is due to a limited vulnerability of the national economy to a potential default of the Company.

The standalone creditworthiness assessment (SCA) of the Company (bbb+) hinges on its strong operating profile, medium business scale and profitability, moderate leverage, and adequate liquidity. The Company's SCA is restricted by the negative free cash flow caused by substantial capital investments.

The Company is the Europe's largest railway passenger carrier that covers about 95% of long-distance passenger train routes in Russia. In 2016, the Company serviced over 89.2 million passengers, and its revenue amounted to RUB 201.6 billion. The Company is 99.9% owned by JSCo "RZD" (RZD), which, in its turn, is 100% owned by the state.

High systemic importance of the Company for the Russian economy and very high state influence on the Company's creditworthiness. Regardless of the direct operating and shareholding control of RZD over the Company and the moderately high strategic importance of the Company for its holding entity (the Company comprises about 10% of RZD's assets), ACRA is of the opinion that the state support is a factor that plays the most significant role for the Company. High systemic importance for the state is because the Company is actually a long-distance passenger railroad monopoly, large employer and an inseparable part of the national economy. A very high state influence is based on the indirect operating and shareholding control, direct regulation of the Company through transportation tariffs, as well as the state support in the form of subsidies and tax benefits. In 2010–2015, the Company received RUB 166 billion in subsidies, or RUB 25–30 billion annually, since 2016, subsidies have been partially replaced by a lower VAT rate (10% in 2016 and 0% from 2017). ACRA expects that in 2018–2019, the annual subsidies will amount to at least RUB 8 billion and VAT will remain equal to zero.

Strong operating profile of the Company rests upon its monopolistic positions in the railway passenger transportation market in Russia. However, the Company's business is subject to a certain risk of tougher competition from airlines for long distance routes (over 1,000 km) and motor vehicles transportation for short-distance routes (less than 700 km), which, along with the deteriorating macroeconomic situation, has resulted in a 23% decline in the Company's passenger turnovers since 2010. The Company's strategy is aimed at stronger passenger turnovers and includes optimized network, innovative passenger cars, developed multimodal transportation, and lower travel time. But in ACRA's opinion, the strategy needs clearer measures to overcome current negative market trends. Other restrictive factors include outdated railcar fleet (with the average operational period of 19 years) and the 38% fleet decommissioning expected in 2017–2020.

Adequate level of corporate governance. The Company's board of directors possesses a substantial experience and consists of nine members, including seven members from RZD and two independent directors. The risk management function is regulated and allows for minimizing all key risks, and some documents, in particular, debt policy of the Company, are subject to approval by RZD. The financial transparency of the Company is high.

Substantial FCF shortage amid adequate liquidity. As of October 31, 2017, the amount of credit lines undrawn by the Company was RUB 16.9 billion or 75% of the current debt, but as early as in 2018, the Company will need to increase substantially the scope of liquidity sources. The Company's plans for 2018–2019 include capital expenses of over RUB 100 billion, including purchase of new rolling stock and overhaul of the existing rolling stock, and the FCF shortage, according to ACRA estimates, will be not less than RUB 70–75 billion in 2018–2019. The Agency notes that, in case of further decline in the passenger turnover, the FCF shortage may turn out to be higher. The passenger turnover has declined by 4% in 2017, and the Agency expects the FFO margin before fixed charges and taxes to go down to 9.0–9.5% (against 12.5% in 2016) and to remain unchanged provided that the passenger turnover is kept stable.

Low leverage that may grow substantially. According to ACRA estimates, in 2017, the ratio of total debt to FFO before fixed charges will not exceed 1.2x, while over 75% of the portfolio is to be repaid after 2021. On the other hand, with its investment program going on, the Company will have to substantially increase borrowings, and, according to ACRA estimates, the ratio of total debt to FFO before fixed charges will grow up to 2.5x in 2018 and to 4.0–4.5x in 2019, which, among other things, will require reconsideration of financial covenants. Debt service indicators are sufficiently high, but they will decline as early as in 2018, along with the growing leverage. Thus, the ratio of FFO before fixed charges to fixed charges is expected at about 9.0x in 2017 and to go down to 2.5–4.0x in 2018–2019.

Key assumptions

- Direct state subsidies and zero VAT to remain unchanged;
- Transportation tariffs and infrastructure lease charges to remain unchanged in 2018, and subsequently, they will be subject to indexation at the inflation level (within 4.0%);
- A passenger turnover declining by 4% in 2017 and remaining stable in 2018–2019;
- The 2018–2019 investment program of about RUB 100 billion;
- No dividend payouts or dividend refund as a contribution to the shareholder capital.

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:

- Higher systemic importance of the Company for the national economy, and much wider functionality of the Company.

A negative rating action may be prompted by:

- A significant decline in the systemic importance of the Company for the national economy;
- A loss of shareholding control on the part of the state or a substantial decrease in the financial support.

Rating components

Standalone creditworthiness assessment (SCA): bbb+

Support: state — on par with the RF minus 1.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The credit rating was 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](#), the [Methodology for Analyzing Relationships Between Rated Entities and the State](#), the [Methodology for Analyzing Member Company Relationships within Corporate Groups](#), and the [Key Concepts Used by Analytical Credit Rating Agency within the Scope of Its Rating Activities](#).

The credit rating has been assigned to Joint Stock Company «Federal Passenger Company» for the first time. The credit rating and credit rating outlook are expected to be revised within one year following the rating action date (December 5, 2017).

The credit rating was assigned based on the data provided by Joint Stock Company «Federal Passenger Company», information from publicly available sources, as well as ACRA's own databases. The credit rating is solicited, and Joint Stock Company «Federal Passenger Company» participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by Joint Stock Company «Federal Passenger Company» in its financial statements were discovered.

ACRA provided no additional services to Joint Stock Company «Federal Passenger Company». No conflicts of interest were discovered in the course of credit rating assignment.

(C) 2017

Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

Analytical Credit Rating Agency (ACRA) was founded in 2015, with its 27 shareholders representing major Russian corporate and financial institutions and its authorized capital exceeding RUB 3 bn. ACRA's main objective is to provide the Russian financial market with high-quality rating products. Methodologies and internal documents of ACRA are developed in compliance with the Russian legislation and with regard to global rating industry best practices.

The provided information, including, without limitation, credit and non-credit ratings, rating assessment factors, detailed credit analysis results, methodologies, models, forecasts, analytical reviews and materials, as well as other information placed on the ACRA website (further referred to as Information), coupled with the ACRA website software and other applications, are intended for information purposes only. Information must not be modified, reproduced or distributed by any means, in any way or form, either in whole, or in part, in marketing materials, as part of public relations events, in news bulletins, in commercial materials or reports without a prior written consent from, and reference to, ACRA. Any use of Information in violation of these requirements or the law is prohibited.

ACRA credit ratings reflect ACRA's opinion about the ability of a rated entity to meet its financial obligations or about the credit risk of individual financial obligations and instruments of a rated entity at the time of publication of the relevant Information.

Non-credit ratings reflect ACRA's opinion about certain non-credit risks assumed by interested parties interacting with a rated entity.

The assigned credit and non-credit ratings reflect all material information pertaining to a rated entity and known by ACRA (including the information received from third parties), the quality and reliability of which ACRA considers appropriate. ACRA shall not be responsible for the accuracy of information provided by clients or relevant third parties. ACRA does not audit or otherwise verify the provided data and shall not be held responsible for their accuracy and completeness. ACRA conducts rating analysis of information provided by customers using its own methodologies, with the texts thereof available on ACRA's website – www.acra-ratings.com/criteria.

The only source that reflects the latest Information, including the one about credit and non-credit ratings assigned by ACRA, is ACRA's official website – www.acra-ratings.com. Information is provided on an "as is" basis.

Information shall be considered by users exclusively as ACRA's statement of opinion and must not be regarded as advice, recommendation or suggestion to buy, hold or sell securities or other financial instruments of any kind, nor shall it be viewed as an offer or advertisement.

Neither ACRA, nor its employees and persons affiliated with ACRA (further referred to as the ACRA Parties) provide any direct or implied guarantee expressed in any form or by any means regarding the accuracy, timeliness, completeness or applicability of Information for making investment and other decisions. ACRA does not act as a fiduciary, auditor, investment or financial advisor. Information must be regarded solely as one of the factors affecting an investment decision or any other business decision made by any person who uses ACRA's information. It is essential that each of such persons conduct their own research and evaluation of a financial market participant, as well as an issuer and its debt obligations that may be regarded as an object of purchase, sale or possession. Users of Information shall make decisions on their own, involving their own independent advisors, if they deem it necessary.

ACRA Parties shall not be responsible for any action taken by users based on Information provided by ACRA. ACRA Parties shall under no circumstances be responsible for any direct, indirect or consequential damages or losses resulting from interpretations, conclusions, recommendations and other actions taken by third parties and directly or indirectly connected with such information.

Information provided by ACRA is valid only as of the date of preparation and publication of materials and may be amended by ACRA in the future. ACRA shall not be obliged to update, modify or supplement Information or inform anyone about such actions, unless the latter was recorded separately in a written agreement or is required by the legislation of the Russian Federation.

ACRA does not provide advisory services. ACRA may provide additional services, if this does not create a conflict of interest with rating activities.

ACRA and its employees take all reasonable measures to protect all confidential and/or material non-public information in their possession from fraud, theft, unlawful use or inadvertent disclosure. ACRA provides protection of confidential information obtained in the course of its business activities as required by the legislation of the Russian Federation.