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Lead analysts:

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

Ekaterina Mozharova, Senior Director
+7 (495) 139-0498
ekaterina.mozharova@acra-ratings.ru

Mikhail Doronkin, Expert
+7 (495) 139-0484
mikhail.doronkin@acra-ratings.ru

Key rating assessment
factors

ACRA assigns A-(RU) to RKS-Holding LLC, outlook Stable

The credit rating assigned to [RKS-Holding LLC](#) (hereinafter, RKS-Holding, the Company, or the Group) is based on very low industry risks and strong market position, average business profile, acceptable leverage and profitability, as well as strong liquidity position coupled with low cash flow assessment.

RKS-Holding is one of the largest utilities operators in Russia providing water supply and water sewage services (key business) as well as heating and electric power supplies. The Company provides its services in 10 regions of Russia. The Group comprises 19 assets including subsidiaries operating on the basis of lease / concession agreements and other operating assets supporting Group's activities. RKS-Holding is owned by PJSC T Plus; the Company, however, directly reports to RENOVA Group of Companies. V.F. Vekselberg is the ultimate controlling beneficiary.

Infrastructure monopoly with a small-scale business and heightened regulatory risks. Services the Group provides qualify as a natural monopoly: competition in the utilities sector is virtually non-existent, service prices are relatively predictable, and the demand is non-elastic and almost unresponsive to price changes. The Company's position can be strengthened by increasing the share of regions in its revenues, in which concession agreements are made between the local administration and the Company, which, according to ACRA's estimates, could lower the risk of replacement of the water supply and sewage operator. Currently, the share of such regions is below 50% of the Company's revenues. The supply risks are related to non-payments by consumers. Receivables impairment reserve to revenues ratio stood at 4% in 2015-2016; in 2017, however, this ratio returned to the Company's average of 2%. In addition, the above share of non-payments is incorporated into the rates. The Company's regulatory risk is driven by high share of the regulated rates in the ultimate service price coupled with low business profitability: in 2015-2017, the FFO margin before net interest payments and taxes averaged 9%. Regions that the Group operates in exhibit a moderate level of social and economic development, by ACRA's estimates. The scale of business remains small: FFO before net interest payments and taxes amounted to RUB 3 bln in 2017. The investment program is small in view of the business scale: its share in revenues is around 6%-7%; in addition, the program is subject to revision if the investment component is not incorporated into the rates in full.

Moderate leverage. According to ACRA's estimates, total debt to FFO before net interest payments was around 2.4x as at end-2017; this indicator would stay at a similar level in 2018-2020. The Group has no foreign currency-denominated loans and loans at floating rates in its debt profile. The Company's interest coverage is acceptable. According to the preliminary 2017 data, FFO before net interest payments to interest payments ratio reached 4.3x, which is significantly higher than the 2015-2016 figures (2.3x on average), when RKS-Holding was forced to increase its provisions covering problem receivables. In 2018-2020, we expect the coverage indicator to remain at the 2017 level.

Strong liquidity position. The Company's liquidity is supported in 2018 by small payments under its debt obligations (11% of the total debt as at December 31, 2017). Substantial payments under the current portfolio of borrowings are expected in 2019 (63%). The liquidity is additionally supported by substantial unused credit limits as at early 2018 (RUB 4.2 bln, while the total loan debt was RUB 6.2 bln). ACRA estimates the short-term liquidity ratio to be quite high in 2018-2020, at around 2.2x.

The Group's weighted-average free cash flow would be close to zero in 2014-2020, according to ACRA's estimates, which stems from the fact that the capex program is comparable to the Company's operating cash flow.

Key assumptions

- In 2018-2020, the average tariff indexation rate to equal inflation (at 4% on average);
- Implementation of capital development program by the Company in compliance with the announced deadlines and scope (around 7% of revenues);
- Maintaining the current leverage ratios (total debt to FFO before net interest payments ratio below 3x);
- Retaining current access to external liquidity sources.

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:

- FFO margin before net interest payments climbing above 15%;
- FCF margin rising above 2%;
- Scale of business increasing substantially;
- FFO before net interest payments to interest payments ratio rising above 5x and total debt declining below 2.0x FFO;
- Share of regions where concession agreements between the local administration and the Company were made increasing above 70%.

A negative rating action may be prompted by:

- Higher regulatory risks;
- A substantial increase of leverage (total debt rising above 4.0x FFO) and a decline of FFO before net interest payments to interest payments ratio below 2.5x accompanied by deterioration of the debt profile;
- A decline of FFO margin before net interest payments and taxes below 3%;
- A decline of liquidity position.

Rating components

Standalone creditworthiness assessment (SCA): a-.

Adjustments: none.

Support: 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 and is based on [Methodology for Credit Ratings Assignment to Non-Financial Corporations under the National Scale for the Russian Federation](#) as well as the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to RKS-Holding LLC for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (March 23, 2018).

The assigned credit rating is based on the data provided by RKS-Holding LLC, information from publicly available sources as well as ACRA's own databases. The credit rating is solicited, and Russian Utility Systems RKS-Holding LLC participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by RKS-Holding LLC in its financial statements have been discovered.

ACRA provided no additional services to RKS-Holding LLC. No conflicts of interest were discovered in the course of credit rating assignment.

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

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