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Key rating assessment  
factors

## ACRA assigns A-(RU) to T2 RTK Holding LLC, outlook Stable

The credit rating assigned to [T2 RTK Holding LLC](#) (the Company) is a result of the high leverage and the strong liquidity assessment. The Company is assessed as a large-scale company, characterized by the high operating profile assessment, high profitability, and low free cash flow.

The Company is a mobile operator ranking 4<sup>th</sup> in terms of subscriber base and revenue in Russia. Company shareholders are PJSC Rostelecom (45%) and Tele2 Russia Holding AB (55%), through which the Company's shares are held by PJSC Bank VTB (27.5%), INVINTEL B.V. controlled by Alexey Mordashov (22%) and ABR Investments B.V. (5.5%) controlled by BANK "ROSSIYA".

**High leverage.** The total debt / FFO before net interest ratio was 4.5x at the end of 2017; bank loans borrowed by the Company are denominated in rubles and borrowed under floating interest rates. Taking into account the capitalization of operating leases, leverage indicators are also high: the ratio of debt adjusted for operating lease to FFO before fixed charges is 4.6x. In the next three years, this figure may decline to 4.0-4.3x, but it would not lead to a revision of our assessment. At the same time, in case the aggregate capital expenditures growth (caused by amendments introduced to the Federal Law "On Countering Terrorism" and the Criminal Code of the Russian Federation) exceeds the expected level of RUB 35-40 billion in 2019–2020, it may negatively affect the Company's leverage. The Company's coverage of interest payments is low: the ratio of FFO before net interest and taxes to interest was 2.3x in 2017. In the same period, the ratio of FFO before fixed charges to fixed charges was 1.7x, which indicates a low coverage. In the forecast period (2018–2020), we expect that this indicator will be in the range of 1.8–2.1x.

**Strong liquidity.** A significant portion of the loans borrowed by the Company will become due in 2018 and 2019 (23% and 43%, respectively). ACRA notes that the Company's debt mainly includes loans from shareholder banks (73%). Along with a significant amount of undrawn credit lines, the above fact reduces significantly the refinancing risks and supports the Company's liquidity.

**High operating profile assessment** is underpinned primarily by the strong business profile of the Company. In providing mobile phone and Internet services, the Company operates its own telecommunications infrastructure that supports various technologies (2G, 3G and 4G). ACRA notes that the geography of the Company's operations is wide and includes 65 regions of the Russian Federation, while wideband mobile Internet services are offered in 61 regions. At the federal level, the Company's market share lags behind the three largest players. According to ACRA estimates, in 2017, the market share of the Company was about 16%, which is almost twice lower than the market leader PJSC "MTS". ACRA assesses the quality of corporate governance as high. The Company has developed and implements the strategy for the period from 2018 to 2022. The shareholding structure is transparent, and the risk management functions are structured and formalized (however, the risk management regulations contain no restrictions on borrowing in a currency other than the currency of revenue). The Company composes its IFRS financial statements annually, but it has not published such statements since 2016.

**Large size and high profitability.** The average annual growth in the Company's subscriber base was 4.3% in 2016–2017. By December 31, 2017, the number of subscribers reached 40.6 million people. This growth was accompanied by an increase in the monthly average revenue per user (ARPU) (+11% in 2017), which resulted in a 16% revenue increase in 2017. Last year, the Company showed a 42% increase in FFO before fixed charges and taxes up to RUB 41.1 billion.

In 2018–2020, we expect that growth of the Company's subscriber base, ARPU, revenues, FFO before fixed charges and taxes will continue, but the growth rates will significantly decrease. In 2017, the Company managed to restore its profitability after the decrease in 2016 (the FFO margin before fixed charges returned to the level of 33%, which is high). We believe that in 2018–2020, this profitability will remain close to the current level.

**Free cash flow is low** caused by the Company's considerable expenses under its investment program. In 2017, the Company managed to reduce capex, which allowed the Company to demonstrate a positive free cash flow (FCF) for the first time in recent years, while the FCF margin amounted to 6%. According to ACRA estimates, in 2018–2020, the capex will increase again, which may drive the FCF margin into a negative zone.

## Key assumptions

- Growth rate of revenue higher than market average based on growing of subscriber base and ARPU;
- The substantial amount of undrawn credit lines will remain unchanged;
- The aggregate expenses required to comply with the new regulations (amendments introduced to the Federal Law "On Countering Terrorism" and the Criminal Code of the Russian Federation) will not exceed RUB 40 billion in 2019–2020.

## 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:

- The ratio of total debt adjusted for operational lease to FFO before fixed charges declining below 3.5x or the ratio of FFO before fixed charges to fixed charges growing above 2.5x.

### A negative rating action may be prompted by:

- The ratio of total debt adjusted for operational lease to FFO before fixed charges growing above 5.0x or the ratio of FFO before fixed charges to fixed charges declining below 1.0x;
- An annual shrink in ARPU amid stable subscriber base;
- Deteriorating structure of debt liabilities;
- Significantly deteriorating access to external sources of liquidity;
- The aggregate expenses required to comply with the new regulations (amendments introduced to the Federal Law "On Countering Terrorism" and the Criminal Code of the Russian Federation) exceeding RUB 40 billion in 2019–2020.

## Rating components

**Standalone creditworthiness assessment (SCA): a-**

**Adjustments:** none.

**Support:** no.

## 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 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 T2 RTK 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 (June 7, 2018).

The assigned credit rating is based on the data provided by T2 RTK Holding LLC information from publicly available sources, as well as ACRA's own databases. The credit rating is solicited, and T2 RTK Holding LLC participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by T2 RTK Holding LLC in its financial statements have been discovered.

ACRA provided no additional services to T2 RTK Holding LLC. No conflicts of interest were discovered in the course of credit rating assignment.

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