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Key rating assessment
factors

ACRA affirms AA(RU) to PJSC Rostelecom, outlook Stable, and AA(RU) to bond issues

The credit rating of [PJSC Rostelecom](#) (hereinafter – the Company, or Rostelecom) is based on very strong business profile of the Company, its very large scope and leading market positions, as well as very high liquidity level and moderate support from the state. At the same time, medium leverage, the fact that some of the Rostelecom's infrastructure sections belong to different generations of telecommunications technology, and Company's substantial presence in segments with declining revenues limit the level of Company's rating assessment.

Rostelecom is one of the largest telecommunications companies in Russia, a leading fixed-line services provider in the majority of regions, and the largest broadband operator. Russian Federation is Company's major shareholder (the state directly owns 48.71% of ordinary shares through the Federal Agency for State Property Management (Rosimuschestvo) another 4.29% is owned by Vnesheconombank), 36.52% of ordinary shares are in free float.

Strong business profile stems from highly diversified activities of Rostelecom. The largest shares in Company's revenue structure are attributable to fixed-line services (26%) despite declining demand for these services over recent years, and broadband Internet (23%). The Company almost entirely owns its infrastructure making the activities more sustainable; however, some of its sections belong to different generations of telecommunications technology, which limits the rating level.

Medium leverage is determined by low level of total debt to FFO (funds from operations) before net interest payments (at 2.2x) and debt adjusted for operating lease to FFO before fixed payments (at 2.4x) ratios. The FFO before fixed charges to fixed charges ratio stands at 3.9x. Regardless that the quantitative leverage indicators have been stable, ACRA notes that the repayment schedule of the Company's debts has improved: about 85% of the debt will be due in 2022 or later. Therefore, we increased the assessment of this rating factor. According to ACRA's estimates, Rostelecom's leverage may increase if the Company has to make additional capital expenditures or finance M&A transactions. The need for such capital expenditures may arise, among other things, from amendments in the Federal Law "On Counteracting Terrorism" and in the Criminal Code of the Russian Federation.

Very large size and leading market positions are mostly determined by large market shares the Company holds in both the Russian telecommunications services market (about 17%) and its key market segments (about 60% for fixed-line segment and over 35% for broadband). Rostelecom has a vast customer base: 15.4 mln households and 3.3 mln corporates in the fixed-line segment, 12.0 mln households and 1.0 mln corporates in the broadband segment, and 9.9 mln households in the pay-TV segment. In 2017, the FFO before fixed charges and taxes amounted to RUB 101.9 bln.

Very strong liquidity position is based on availability of substantial amounts of undrawn credit lines (exceeding Company's loan portfolio by 43%). At the same time, committed credit facilities account for 29% of the undrawn credit lines. ACRA expects that, in 2018, the Company's FCF (free cash flow) after dividend payments will remain in the green, but the FCF margin will be close to zero.

High profitability is based on Rostelecom's ARPU (average revenue per user) figures exceeding average market values by 2–3% in the broadband segment and by up to 30% in the pay-TV segment. In 2017, the FFO margin before fixed charges was 33%. Although this figure is fairly high, it is somewhat lower than similar indicators demonstrated by peers in the Russian telecommunications industry.

Key assumptions

- Fixed-line telephony market contracting by 5%-6% annually;
- Substantial amount of undisbursed credit lines remains available including committed facilities;
- No one-off, heavy expenditures required to comply with requirements to communications providers (amendments in the Federal Law "On Counteracting Terrorism" and in the Criminal Code of the Russian Federation).

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:

- A drop in the ratio of debt adjusted for operating lease to FFO before fixed charges below 2.0x and a growth in the ratio of FFO before fixed charges to fixed charges above 5.0x.

A negative rating action may be prompted by:

- The ratio of debt adjusted for operating lease to FFO before fixed charges exceeding 3.0x;
- Annual average revenues from fixed-line telephony and wholesale services contracting by more than 6% in 2018–2020;
- A growth in revenues from new services below the expected level;
- A considerably worse access to external liquidity sources;
- Substantial capital expenditures caused by amendments to the Federal Law "On Counteracting Terrorism" and to the Criminal Code of the Russian Federation.

Rating components

Standalone creditworthiness assessment (SCA): aa-.

Adjustments: none.

Support: +1 notch to SCA.

Issue ratings

[Exchange-traded interest-bearing certified unregistered bond issued by PJSC Rostelecom \(ISIN RU000A0ZYG52\)](#), maturity date: November 09, 2027, issue volume: RUB 10 bln — AA(RU).

[Exchange-traded interest-bearing certified unregistered bond issued by PJSC Rostelecom \(ISIN RU000A0ZYIE3\)](#), maturity date: March 03, 2028, issue volume: RUB 10 bln — AA(RU).

Credit rating rationale. The issue represents senior unsecured debt of [PJSC Rostelecom](#). Due to the absence of either structural or contractual subordination of the issues, ACRA regards them *pari passu* with other existing and future unsecured and unsubordinated debt obligations of the Company. According to the ACRA methodology, the credit rating of the bond is equivalent to that of PJSC Rostelecom, i.e. AA(RU).

Regulatory disclosure

The credit ratings were assigned to PJSC Rostelecom and the bonds (ISIN RU000A0ZYG52, ISIN RU000A0ZYIE3) issued by PJSC Rostelecom 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](#), [Methodology for Analyzing Relationships between Rated Entities and the State](#), and the [Key Concepts Used by the Analytical Credit Rating Agency within the Scope of Its Rating Activities](#). The Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also applied to assign credit ratings to the above bond issues.

The credit ratings of PJSC Rostelecom and the bonds (ISIN RU000A0ZYG52, ISIN RU000A0ZYIE3) issued by PJSC Rostelecom were first published by ACRA on July 14, 2017, November 21, 2017, and March 16, 2018, respectively. The credit rating of PJSC

Rostelecom and its outlook as well as the credit ratings of the above bonds are expected to be revised within one year following the rating action date (June 20, 2018).

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

No material discrepancies between the provided data and the data officially disclosed by PJSC Rostelecom in its financial statements have been discovered.

ACRA provided additional services to PJSC Rostelecom. No conflicts of interest were discovered in the course of credit rating assignment.

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