Russian Corporates
Face A Long Road To Recovery

December 2020
Key Takeaways

- Most of our Russian corporate ratings have remained unchanged since the start of the pandemic, although companies’ financial metrics have weakened.
- We expect the Russian corporate sector will recover gradually in 2021, with most companies only achieving 2019 credit metrics from 2022.
- We don’t see any major sources of growth for Russian companies, apart from recovery, with a few exceptions.
- Dividends will likely remain high, given the strong financial position of many companies.
- The impact of the pandemic across sectors of the Russian economy was similar to that in EMEA. Utilities, infrastructure, telecommunications, and food retail were relatively unaffected, and residential developers performed stronger than expected due to subsidized mortgages. However, the long-term implications for sectors that depend on consumer spending in Russia could be more negative.
- Commodity producers continue to be more dependent upon global industry trends, but the government’s negative intervention as well as the exchange rate are also important factors for recovery.
Russian Corporate Ratings Have Seen Limited Movement

- The impact of the pandemic on Russian corporate ratings has been very limited, unlike other markets.
- Some companies were even able to improve their credit quality.

Source: S&P Global Ratings.
The pandemic has had limited impact on companies’ capital expenditure (capex), except for in the commodities sector, which has seen project delays from the global market outlook.

We don’t see any impetus for investment growth following the pandemic, given the state of the Russian economy.

Commodities’ Capital Expenditure

Noncommodities’ Capital Expenditure


S&P Global Ratings
Recovery Of Free Operating Cash Flow Will Be Gradual

We believe the largest Russian companies will only see free operating cash flow (FOCF) return to 2019 levels in 2022, given our oil and metals price assumptions.

Commodities’ FOCF

Noncommodities’ FOCF

We believe dividends will remain meaningful for the largest companies, both private and state-owned.

Even companies with low net income for the year will likely distribute sizeable amounts to shareholders.
Financial Metrics Weakened, But Less So Than In Other Regions

- We note a significant weakening of financial metrics in 2020, although less pronounced than in most other countries.
- The rating headroom has reduced and it will take at least two years before metrics return to pre-pandemic levels.

LiquidityRemainsRobust

- Russian companies we rate have maintain their liquidity, thanks to conservative liquidity management.

Source: S&P Global Ratings.
Russian Companies Maintain Good Access To Global Markets

- Russian companies continue to enjoy stable access to capital markets despite external risks.
- The decreased issuance in fourth-quarter 2020 is the result of companies being unwilling to borrow at higher rates, and likely temporary.

As of Nov. 16, 2020. Source: Cbonds.ru.

**The Russian Corporate Sector's Eurobond Issuance**

**The Russian Corporate Sector's Eurobond Maturity Profile**

As of Nov. 16, 2020. Source: Cbonds.ru.
# The Pandemic’s Impact In EMEA Across Sectors

## Sector Level Impact And Recovery

### EMEA

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Healthcare - Pharmaceuticals</td>
<td>Low</td>
<td>No decline</td>
<td>No decline</td>
<td>No Increase</td>
</tr>
<tr>
<td>Retail - Essential/Grocery</td>
<td>Low</td>
<td>No decline</td>
<td>No decline</td>
<td>&lt;5%</td>
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<tr>
<td>Cons Prod - Pack, Food/Pers &amp; Home Care/Agri</td>
<td>Low</td>
<td>No decline</td>
<td>No increase</td>
<td>No Increase</td>
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<tr>
<td>A&amp;D - Defense Contractors</td>
<td>Low</td>
<td>0% to 5%</td>
<td>0% to 5%</td>
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<tr>
<td>Utilities</td>
<td>Low</td>
<td>0% to 5%</td>
<td>0% to 5%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Healthcare - Services</td>
<td>Low</td>
<td>0% to 5%</td>
<td>0% to 5%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Telecom</td>
<td>Low</td>
<td>0% to 5%</td>
<td>0% to 5%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Cons Prod - Tobacco &amp; Alcoholic Beverage</td>
<td>Low</td>
<td>5% to 10%</td>
<td>0% to 10%</td>
<td>No Increase</td>
</tr>
<tr>
<td>Business &amp; Consumer Services</td>
<td>Moderate</td>
<td>5% to 10%</td>
<td>0% to 10%</td>
<td>No Increase</td>
</tr>
<tr>
<td>Real Estate (REITs)</td>
<td>Moderate</td>
<td>5% to 10%</td>
<td>0% to 10%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Technology</td>
<td>Moderate</td>
<td>5% to 10%</td>
<td>0% to 10%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Engineering &amp; Construction</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>10% to 15%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Healthcare - Equipment</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>10% to 15%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Transportation - Shipping</td>
<td>Moderate</td>
<td>5% to 10%</td>
<td>5% to 10%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Capital Goods</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>10% to 15%</td>
<td>&lt;5%</td>
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<tr>
<td>Building Materials</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>10% to 15%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>10% to 15%</td>
<td>&lt;5%</td>
</tr>
<tr>
<td>Metals &amp; Mining</td>
<td>Moderate</td>
<td>10% to 15%</td>
<td>0% to 10%</td>
<td>&lt;5%</td>
</tr>
</tbody>
</table>

The Pandemic’s Impact In Russia Across Sectors

<table>
<thead>
<tr>
<th>Sectors</th>
<th>COVID-19 Impact</th>
<th>Recovery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>Low</td>
<td>Fast</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>Low</td>
<td>Fast</td>
</tr>
<tr>
<td>Telecom</td>
<td>Low</td>
<td>Fast</td>
</tr>
<tr>
<td>Metals and mining</td>
<td>Low</td>
<td>Fast</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Low</td>
<td>Moderate/Fast</td>
</tr>
<tr>
<td>IFR and transport</td>
<td>Medium</td>
<td>Moderate</td>
</tr>
<tr>
<td>Real estate</td>
<td>High</td>
<td>Slow/Moderate</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>Very High</td>
<td>Slow</td>
</tr>
<tr>
<td>Restaurants</td>
<td>Very High</td>
<td>Slow</td>
</tr>
<tr>
<td>Tourism</td>
<td>Very High</td>
<td>Slow</td>
</tr>
<tr>
<td>Airports</td>
<td>Very High</td>
<td>Slow</td>
</tr>
<tr>
<td>Airlines</td>
<td>Very High</td>
<td>Slow</td>
</tr>
</tbody>
</table>

Source: S&P Global Ratings.

- The impact of the pandemic on sectors of the economy in Russia was similar to that in EMEA.
- Some sectors proved to be even more resilient than in many emerging markets.
- Sectors that depend on discretionary consumer spending face the highest long-term risk, due to a decline in disposable incomes and reduced savings.
Sector Review
Oil & Gas | Prices And Volumes Will Take Years To Recover

The recovery of oil prices and volumes will take years.

Prices to remain lower for longer. We expect $50 per barrel on average in 2021-2022.

OPEC+ production cuts will constrain the recovery of the Russian oil and gas sector.

Taxes are increasing with further hikes being a risk.

Consistently high expectations for dividends will further pressure the sector’s cash flow and credit metrics.

In the oilfield services sector, risks come from the fall in hydrocarbon volumes and prices.


- The capex reduction was only moderate compared to the EBITDA fall, since companies are developing more complex projects.
- Dividends will remain high, given that the government expects a high payout ratio from state-owned companies.
- Lower EBITDA combined with high capex and dividends will put pressure on FOCF and leverage metrics.
 Metals & Mining | Steel Is Under Pressure While Gold Shines

- Open Asian markets will remain key for resilient performance of Russian steel producers.
- Gold prices will remain high due to low rates and lasting economy risks. We forecast the price per ounce at: $1,900 until the end of 2020, $1,700 in 2021, $1,500 in 2022, and $1,300 thereafter.
- Gold companies will perform well, but credit metrics will depend on financial policies.
- MMC Norilsk Nickel will deliver strong results, but environmental risks add to rating uncertainty.
- The diamond market is recovering, with the main risk being a second wave of COVID-19.
- Increasing fiscal pressure is the main risk for the whole mining industry’s recovery.


- Investments and dividends will peak across sector in next years.
- Steel producers will generate negative free cash flows as lower EBITDA will not support full capex and dividend payments.
- Norilsk Nickel and gold producers’ free cash flows will remain positive on strong results.
Fertilizers | Pressured Pricing Is Mitigated By Rising Demand

- The pricing environment will remain subdued in 2021.
- Long-term trends to remain favorable, specifically domestically.
- Environmental, social, and governance aspects will gain strong momentum for fertilizers.

Fertilizers (continued)

Phosphate Price Evolution

Potash Price Evolution

- We think fertilizer prices hit bottom in 2020 and expect gradual, but modest recovery through 2021.
- Improving cash flow generation is likely to be diverted to dividends.
- Capex is still sizable and might increase in 2021-2022.

Infrastructure & Transportation | Moderate Hit To Freight, But Shock For Passenger Segment

- For freight transportation, we expect EBITDA recovery to pre-COVID levels in late 2021-2022, depending on global commodities markets and OPEC+.

- COVID-19-related mobility restrictions, social distancing, and behavioral changes hurt the passenger segment significantly more than the freight sector, and will result in longer recovery.

- The freight segment has been moderately hit by the pandemic’s fallout, with freight volumes up to 10% lower in 2020.

EBITDA Evolution

Funds From Operations To Debt


S&P Global Ratings
Recovery in passenger traffic to 2019 level is unlikely until 2023.

The extent of government supporting measures – together with recovery trends – are key factors for the ratings.

Availability of vaccine is fundamental for recovery.

We expect rail travel in Russia to rebound faster than air, largely because tickets are more affordable.

Air traffic in Russia is likely to recover faster than that of global peers. Local flights were at about half of 2019 volumes as of September 2020.

- Considerable capex in the sector despite the pandemic will translate to heavily negative FOCF.
- Government is motivating companies to maintain investments by proposing different compensation options from the state.
- State support will not fully mitigate the shock from the pandemic.
Regulated Utilities | Financials Are Comfortable Despite Volume Dip

EBITDA Evolution

- Regulatory framework should provide sufficiently resilient to the economic downturn.
- Tariff increases continue, in contrast to the 2014 freeze.
- Capex cuts and pre-existing financial headroom will help offset missing revenue on lower volumes.

Funds From Operations To Debt

Capital Expenditure

- We expect utilities to offset lower 2020 revenue with capex cuts or delays.
- We don’t expect any meaningful reduction in dividends, given the government’s 50% payout target and already low market capitalization.

Free Operating Cash Flow

(120) (80) 0 (40) 40


Dividends

0 50 100 150


Power Generation | Lower Capacity Revenue, But Leverage Is Low

- Lower capacity revenue after CSA-1* expiration should pressure thermal EBITDA post-2020.
- New capacity in nuclear and hydro support EBITDA growth.
- Leverage will remain low, due to moderate capex on technological freeze and demand constraints.
- Gradually increasing focus on reducing greenhouse gases.

EBITDA Evolution

Funds From Operation To Debt

Higher dividends will be affordable, thanks to relatively low leverage and only modest capex plans aside from the significant spending on new nuclear construction abroad that will be partly prepaid by the government.

Homebuilders | Subsidized Mortgages Support The Sector

- Subsidized mortgages will support new housing demand until mid-2021, volumes and prices.
- Supply of new houses will somewhat contract in 2020 due to COVID-19.
- New project finance loans will increase leverage of developers.
- Increasing prices will support margins, likely balancing COVID-19 expenses.

EBITDA Evolution

Funds From Operations To Debt

**Homebuilders (continued)**

**New Housing Under Construction**

- **Sales not open**
- **Sold**
- **Not sold**

**Free Operating Cash Flow**

- FOCF will contract due to negative working capital swings as homebuyers’ cash will be restricted in escrow accounts.
- The effect will be partly mitigated by lower interest rates.
- Dividends will increase, but will remain within the financial policy.


**New Housing Prices To Increase**

Growth as % change of nominal prices to previous month

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S&P Global Ratings
Retail | High Degree Of Resilience To COVID-19 Pressures

EBITDA Evolution

- Food retail and pharmaceuticals benefit from robust demand.
- Large retailers expand their presence and experiment with store formats to attract diverse customer groups.
- Discounter formats are expanding on the back of lower household income.
- E-commerce will increasingly scale up, challenging supply management capabilities and potentially requiring more investments in working capital.

Funds From Operations To Debt

Retail (continued)

- Capital investments growth to resume in 2021-2022.
- Dividends may increase, but will remain within existing financial policy.

Telecom | Digitalization & Tariff Increases Support Performance

EBITDA Evolution

- The industry has been relatively resilient to the impact of the pandemic, with pockets of vulnerability like roaming or equipment sales.

- The competitive environment for the mobile sector is becoming more rational, with tariff increases.

- Telecoms are focusing on areas beyond connectivity, with efforts to create an ecosystem of digital services to reduce churn and increase the average return per user.

- Operating performance is supported by cloud and data center services, as well as corporate business solutions addressing demand for cybersecurity and remote working solutions.

- Leverage has remained broadly stable at a moderate level.

Funds From Operations To Debt

We expect capex will increase only moderately in next two years as the rollout of 5G networks in scale is still years away.

- Digital services and corporate business solutions should boost FOCF.
- Dividends/share buybacks continue to absorb most of cash flows

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