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Research Update:

Er-Telecom Liquidity Assessment Revised To Adequate, From Less Than Adequate; 'B' Rating Affirmed; Outlook Stable

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Overview

- Russia-based cable operator Er-Telecom has put in place a long-term RUB45 billion term loan from VTB Bank. We expect it will use it to finance growth and for refinancing.
- We are affirming our 'B' issuer credit rating on Er-Telecom and revising our assessment of its liquidity to adequate, from less than adequate.
- Our stable outlook reflects our expectation that Er-Telecom's revenues will grow by 15%-20% annually in 2018-2019 and slightly improve its EBITDA margin, balancing higher capital expenditure (capex) and M&A-related spending, supporting adjusted debt to EBITDA of 3.5x-4.0x. We also expect its liquidity will remain adequate.

Rating Action

On June 27, 2018, S&P Global Ratings affirmed its long-term issuer credit rating on Russia-based cable operator Er-Telecom at 'B'. The outlook is stable.

Rationale

Our revised assessment of Er-Telecom's liquidity to adequate, from less than adequate, reflects our view that Er-Telecom will continue to benefit from access to a RUB45 billion long-term committed term loan from Russia-based VTB Bank. The revised assessment does not affect the issuer rating.

Er-Telecom continues to have access to a RUB45 billion term loan from VTB Bank (secured with a pledge of shares of Er-Telecom and its holding company) with the final maturity in February 2025 and amortization starting from May 2021. This facility, put in place in February 2018, has been partly used to refinance existing bank debt. As a result, Er-Telecom's debt maturity profile has materially improved.

The rating on Er-Telecom reflects its position as the second-largest Russian broadband operator, with a market share management assesses at 12%. Er-Telecom is demonstrating robust growth driven by M&A activity and supported by organic expansion. M&A activity is largely debt-financed, which has seen the company build up significant debt. Its S&P Global Ratings-adjusted leverage ratio is expected to remain about 4.0x in 2018 (4.1x at end-2017) with subsequent deleveraging anticipated in 2019-2020.

For the latest rationale see "Russia-Based Cable Operator Er-Telecom Downgraded To 'B' From 'B+'; Outlook Stable," published June 30, 2017, on RatingsDirect.

Liquidity

We have revised our assessment of Er-Telecom's liquidity to adequate, from less than adequate. This reflects our view that Er-Telecom's ratio of sources to uses will be above 1.5x in the next 12 months. Er-Telecom's liquidity position is supported by its access to the VTB Bank loan, which mitigates near-term liquidity and refinancing risks. We also take into account that Er-Telecom has a track record of accessing public capital markets, with three domestic bond issuances previously (RUB3 billion due in 2019; RUB3 billion due in 2020; and RUB5 billion due in 2021).

That said, we do not assess Er-Telecom's liquidity as strong because we assume it will not be able to meet high-impact low-probability events without refinancing. We also believe that, as a private company, Er-Telecom has somewhat more modest access to funding sources, which is currently limited to debt financing.

At the end of 2017, Er-Telecom had access to the following sources of liquidity:

- Cash and equivalents of around RUB1.4 billion.
- Availability under VTB facility of RUB22.6 billion.
- Our anticipation of FFO at close to RUB7.5-8.0 billion.

Principal liquidity uses as of the same date were as follows:

- Minimal debt maturities in the next 12 months. That said, we factor in that, in July 2019, Er-Telecom will need to repay its RUB3 billion bond. We expect that this bond will be refinanced with the VTB Bank loan.
- Annual capex of about RUB9 billion.
- Sizable acquisitions.
- Moderate negative working capital requirement.
- Repayment of a liability to the shareholder.

Compliance Expectations

We assess that Er-Telecom has headroom of over 15% under its maintenance financial covenant in 2018 in its major debt facility. That said, we are mindful that in 2019 and 2020 the covenants of Er-Telecom will be tightening. In our base-case forecast we expect Er-Telecom's debt leverage to decrease, supporting its ability to sustain adequate headroom under its covenants.

Outlook

Our stable outlook on Russia-based cable operator Er-Telecom reflects our expectation that its revenues will grow by around 15%-20% in 2018-2019 supported by organic growth and previous acquisitions, and that its EBITDA margin will slightly improve on the back of efficiency gains. This should balance higher capex (including related to the Yarovaya law) and M&A-related spending, translating into adjusted debt to EBITDA close to or below 4.0x. We also expect liquidity will remain adequate.

Downside scenario

We would downgrade Er-Telecom if its average adjusted leverage exceeds 4.5x, combined with continued materially negative FOCF. This might happen if Er-Telecom's ratios are materially affected by higher-than-expected capex required for implementation of the Yarovaya data storage law, resulting in higher debt and tighter headroom under Er-Telecom's covenants.

Upside scenario

We may take a positive rating action if Er-Telecom sustains its adjusted leverage ratio below 3.5x, supported by organic revenue growth and higher margins, coupled with positive FOCF generation and a solid liquidity position.

Ratings Score Snapshot

Issuer Credit Rating: B/Stable/--

Business risk: Weak
- Country risk: High
- Industry risk: Intermediate
- Competitive position: Weak

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Negative (-1 notch)

- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Er-Telecom	
Issuer Credit Rating	B/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.