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Key rating assessment
factors

ACRA assigns AA(RU) to PJSC Rostelecom, outlook Stable

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 45% of shares through Federal Agency for State Property Management (Rosimuschestvo) another 4% of shares are owned by Vnesheconombank), 31% of 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 (29%) despite declining demand for these services over recent years, and broadband Internet (22%). 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 2.0x) and debt adjusted for operating lease to FFO before fixed payments (at 2.3x) ratios. FFO before fixed payments to fixed payments ratio stands at 4.0x. According to ACRA's estimates, Rostelecom's leverage may increase if the Company has to make additional capital expenditures. 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. As no precise requirements to communications providers have yet been established, we do not consider these expenses in the base-case scenario for the Company's financial model.

Very large scope and leading market positions are mostly determined by large market shares the Company holds in both the Russian telecommunications services market (17%) and its key market segments (60% for fixed-line segment and over 35% for broadband). Rostelecom has a vast customer base: 16.5 mln households and 2.1 mln entities in the fixed-line segment, 11.8 mln households and 513 thousand entities in the broadband segment, and 9.4 mln pay-TV subscribers. In 2016, FFO before fixed payments and taxes amounted to RUB 101.2 bln.

Very strong liquidity position is based on availability of substantial amounts of undisbursed credit lines (exceeding Company's loan portfolio by 43%). At the same time, committed facilities account for 39% of the undisbursed credit lines amount. Although ACRA believes that Company's FCF (free cash flow) after dividend payments will remain in the green totaling RUB 1.5 bln in 2017, 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. FFO margin before fixed payments was at 34%. Although this figure is fairly high, it is somewhat lower than those of the Russian peers in the 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:

- Declining debt adjusted for operating lease to FFO before fixed payments ratio below 2.0x and advancing FFO before fixed payments to fixed payments ratio above 5.0x.

A negative rating action may be prompted by:

- Debt adjusted for operating lease to FFO before fixed payments ratio exceeding 3.0x;
- Revenues from fixed-line telephony and wholesale services contracting on average by more than 6% annually in 2017-2019;
- Access to external liquidity sources worsening considerably;
- Need of substantial capital expenditures in order to comply with requirements to telecommunications providers as detailed in 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

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](#), [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](#).

A credit rating has been assigned to PJSC Rostelecom for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (July 12, 2017).

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 an additional service to PJSC Rostelecom in the form of informational support (a practical seminar). No conflicts of interest were discovered in the course of credit rating assignment.

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