Fitch Ratings

Fitch Affirms OAO Novatek at 'BBB-'; Outlook Stable Ratings

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Fitch Ratings-London-05 October 2010: Fitch Ratings has today affirmed OAO Novatek's (Novatek) Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB-'. The agency also affirmed Novatek's senior unsecured ratings at 'BBB-', and National Long-term rating and senior unsecured national rating at 'AA+(rus)'. The Outlooks for the Long-term ratings are Stable.

Novatek's strong business profile, high production growth rate and unique role as a key incremental gas producer in relation to Russia's national energy balance support the current credit ratings. Novatek continues to benefit from the government's plan to liberalise the price of natural gas sold on the Russian domestic market by 2014. Fitch anticipates domestic gas prices in Russia to increase by c.15% in 2011.

The company is increasing its access to export markets in stable gas condensate and liquid petroleum gas (LPG). Fitch views a greater share of export volumes contributing to revenue as positive for the stability of cash flow generation. The business profile is challenged somewhat by its relatively small scale and lack of integration relative to peers. Fitch also anticipates that mid-term competitive pressure from integrated oil companies will increase in the domestic gas market; this could negatively affect the company's market share.

Novatek's financial profile benefits from rising cash flow generation despite a slowdown in the domestic economy. LTM'10 to June 2010 FFO increased to RUB38.3bn from RUB34.1bn in 2009, allowing the company to increase capex to RUB18.1bn at LTM'10 from RUB16.2bn in 2009 and achieve its investment objectives. Fitch expects the company to face high capital expenditure commitments after 2012 to develop Yamal LNG, which could put prolonged pressure on the company's leverage ratios and free cash flow metrics.

LTM'10 total debt increased to RUB45bn from RUB37.7bn in 2009, but FFO net leverage remains supportive of the ratings and declined to 0.7x from 0.8x over the same period partly due to higher cash on balance sheet. Fitch anticipates this debt level to remain broadly unchanged into 2011 if Novatek does not fund acquisitions with additional borrowing. However, Fitch views Novatek as having some additional headroom for debt-funded acquisitions at the current rating level. The company would need to maintain a mid-cycle FFO interest coverage ratio above 10x and an FFO gross leverage ratio of less than 2x to retain investment grade ratings.

Fitch believes Novatek's liquidity position is adequate for the current ratings. In July 2010, the company successfully extended its debt maturity profile by placing RUB10bn of domestic bonds maturing in 2013 and fully repaid a RUB5bn loan from OAO Sberbank ('BBB'/Stable). LTM'10 free operating cash flow (FCF) was RUB8.6bn, down from RUB10.7bn in 2009 due to higher capex, but still positive for the company's liquidity. Novatek's financial profile benefits from the company's flexibility to defer capex, as was the case in 2009; this helps the company to remain free cash flow positive and lessens its need to rely on borrowings to fund ongoing capital commitments.

Contact:

Primary Analyst
Jeffrey Woodruff, CFA
Senior Director

+44 (0)20 7682 7322
Fitch Ratings Limited
101 Finsbury Pavement
London, EC2A 1RS

Secondary Analyst
Josef Pospisil, CFA
Director
+44 (0)20 7682 7339

Committee Chairperson
Erwin Van Lumich, CFA
Senior Director
+34 93 323 8403

Media Relations: Anna Bykova, Moscow, Tel: + 7 495 956 9903, Email: anna.bykova@fitchratings.com; Peter Fitzpatrick, London, Tel: + 44 (0)20 7417 4364, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available at www.fitchratings.com.

Applicable criteria, 'Corporate Ratings Criteria', dated 16 August 2010, and 'Rating Oil and Gas Exploration and Production Companies - Sector Credit Factors', dated 6 April 2010 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology
Rating Oil and Gas Exploration and Production Companies: Sector Credit Factors