Fitch Affirms Novatek at 'BBB-'; Outlook Stable

Fitch Ratings-London/Moscow-27 September 2012: Fitch Ratings has affirmed OAO Novatek's Long-term foreign and local currency Issuer Default Ratings (IDR) and senior unsecured ratings at 'BBB-' and its National Long-term rating and National senior unsecured ratings at 'AA+(rus)'. Novatek Finance Limited's foreign currency senior unsecured debt rating has also been affirmed at 'BBB-'. The Outlook on the Long-term ratings is Stable.

The development of the Yamal LNG project is a critical rating factor affecting Novatek's future business profile. Fitch anticipates this project will diversify production geographically and provide potential new marketing channels that enhance Novatek's business profile. It would also give Novatek a toehold into the global LNG market and position the company at the centre of one of Russia's key energy development projects. Yamal LNG has the potential to ultimately transform the company's core operations.

Financing of the project is also a critical rating factor. Novatek has not made a final decision about how the Yamal LNG project will be financed. The company could make a final investment decision in 2012. Negative rating action could occur if Novatek is responsible for funding large parts of the project on its own, finances the majority of the project through debt on its own balance sheet, or guarantees a material amount of the debt attracted to finance the project.

Delays to the project would not necessarily have immediate negative consequences for Novatek's business profile and credit ratings. Project delays would instead be reflected in a lack of positive business development constraining any upgrade.

Novatek also benefits from the government's plan to liberalise the price of natural gas sold on the Russian domestic market by 2015-2018. Fitch expects domestic gas prices in Russia to increase by around 15% per year to 2018. The company is also increasing its access to export markets in stable gas condensate and LPG. Fitch regards a greater proportion of revenue coming from exports as positive for the stability of cash flow generation and stability of the financial profile.

The Russian Finance Ministry is still considering the possibility of increasing the Mineral Extraction Tax (MET) rate for gas producers in 2013-2015. According to the plan announced in September 2012, the MET paid by Novatek may double by 2015. Fitch believes the rising tax burden will have a limited negative effect on the company's profits, and expects this to be offset by the rising internal gas prices and hence will not trigger a negative rating action.

Novatek continues to enjoy a healthy financial profile, with relatively low debt level, stable operating cash flows and manageable capital expenditures. In 2011 and in the last 12 months to 30 June 2012, its funds from operations (FFO) remained solid at RUB73bn (USD2.4bn) and RUB74bn, respectively. In 2009-2011 the company's pre-acquisition FCF (excluding acquisition expenditures and loans granted to JVs) on average amounted to RUB13bn p.a., or 11% of consolidated revenue. Fitch expects FFO-adjusted gross and net leverage not to exceed 1.4x and FFO interest coverage to be 12x or above in 2012-2014. Fitch also believes that Novatek has some additional leverage headroom at the current rating level. A negative rating action would probably result from the company consistently exceeding FFO-adjusted leverage of 2x and FFO interest coverage remaining consistently below 10x.

WHAT COULD TRIGGER A RATING ACTION?

Positive: Future developments that may, individually or collectively, lead to positive rating action include:

- Completion of Yamal LNG enhancing the company's business profile with greater access to export markets and more diversified operations
- Larger domestic market share to a level that makes Novatek a more serious Gazprom competitor
- Leverage consistently less than 0.5x; interest coverage consistently greater than 20x; and consistently positive free cash flow

Negative: Future developments that may, individually or collectively, lead to negative rating action include:

- Large self-financed cash outlays for Yamal LNG development, majority debt funding of Yamal LNG through Novatek's balance sheet, or Novatek guaranteeing a material portion of the debt attracted to finance the project
- Debt-financed acquisition-led growth strategy that results in a permanent departure from the presently conservative financial policy
- Leverage consistently greater than 2x; interest coverage consistently less than 10x; and consistently negative free cash flow
- Rising domestic competition that results in loss of market share or competitive position

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Applicable criteria, 'Corporate Ratings Methodology', dated 8 August 2012 are available at www.fitchratings.com.

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