S&P Global
Ratings

RatingsDirect®

NOVATEK PJSC

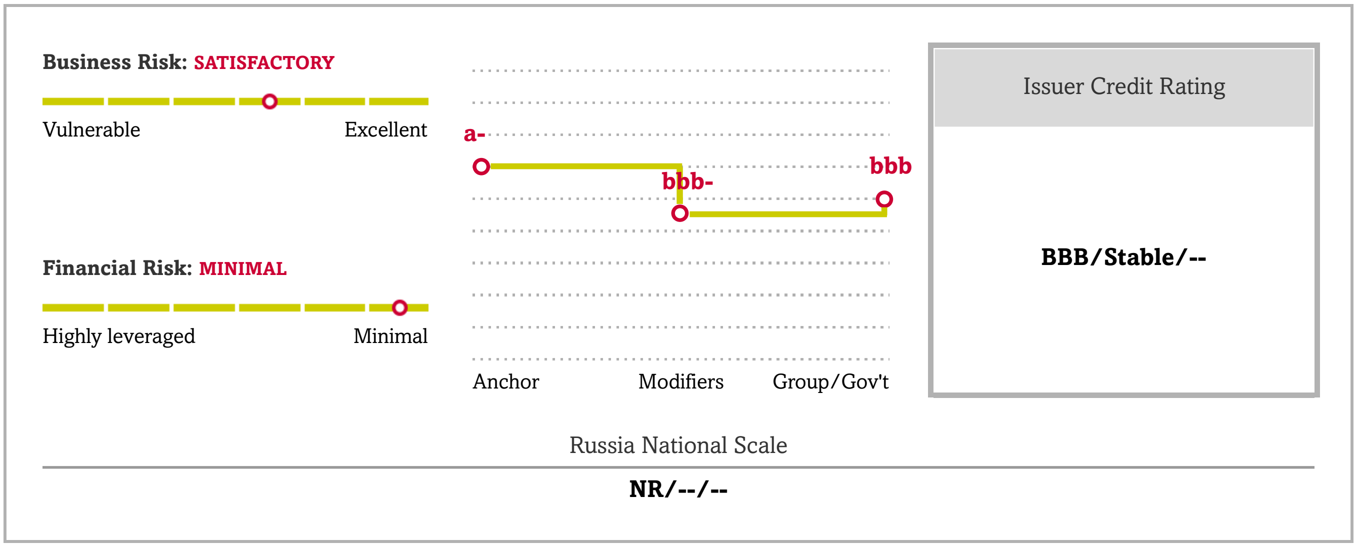
Primary Credit Analyst:
Elena Anankina, CFA, Moscow (7) 495-783-4130; elena.anankina@spglobal.com

Secondary Contact:
Alexander Griaznov, Moscow (7) 495-783-4109; alexander.griaznov@spglobal.com

Table Of Contents

Table Of Contents (cont.)

NOVATEK PJSC



Credit Highlights

Overview

Key strengths	Key risks
Low leverage, with Russian ruble (RUB) 152 billion (about $2.2 billion) of reported debt at year-end (YE) 2019 and projected funds from operations (FFO) to debt above 60% in our base case.	High consolidated capital expenditure (capex), with a RUB200 billion peak in 2020, and ambitious growth plans.
Low cost position and stable domestic gas business.	Potentially increasing dividend payout compared with the current 30% floor.
Healthy profitability of joint ventures (notably Yamal LNG), and non-recourse nature of their sizeable debt to Novatek.	Currently challenging global oil and gas markets.
High growth potential in liquefied natural gas (LNG), a rapidly expanding segment of the global gas market.	Current U.S. sanctions against the company, which constrain financing options.
One of the largest companies globally in terms of gas reserves.	Exposure to Russia-specific country risks, including taxes, regulation, and exchange rate volatility.

S&P Global Ratings expects Novatek's FFO/debt to stay above 60%, despite a capex peak and potentially increasing dividend payout. Novatek has a track record of very low leverage, with year-end 2019 reported debt of RUB152.1 billon compared with RUB273 billion in EBITDA. In 2020, we expect EBITDA to materially decline on lower liquids prices while capex increases to RUB200 billion, leading to negative free operating cash flow (FOCF). We also understand that the company is considering an increase in the dividend payout ratio compared with the minimal 30% in its dividend policy. Still, we expect FFO to debt to stay above 60% in 2020. In 2021-2022, we expect metrics to further strengthen and FOCF to turn positive again as global oil and gas markets recover, which should increase margins on Novatek's consolidated liquids sales and trigger higher dividends from joint ventures.

We expect Novatek's profitability to be resilient to low global hydrocarbon prices, thanks to low costs and stable domestic gas sales. Despite ongoing pressures on oil and gas markets, with the average Brent price declining to about $30 per barrel (/bbl) in May 2020 from above $60 per barrel in 2019, and Title Transfer Facility spot prices plunging to below $2/mmbtu (million British thermal units) in May 20202 from above $8 in 2018 and about $4/mmbtu in 2019, we expect Novatek to retain healthy profitability in its core business. Domestic gas sales are resilient in terms of both volumes and prices, and currently offer netback premium over export, implying stable annual EBITDA contribution of about RUB90 billion-RUB110 billion, we estimate. Novatek's profits on liquid sales are inherently more volatile but also solid, thanks to revenue-linked taxes and low costs, so we estimate breakeven price to be below $30/bbl. Novatek's exposure to currently difficult LNG markets is indirect, via its 50.1% stake in non-consolidated Yamal LNG.

Joint ventures should remain profitable and ring-fenced from Novatek. We expect Novatek's joint ventures to remain ring-fenced and to generate sufficient cash to service their own large debt (YE2019: RUB2.3 trillion total, of which RUB2.1 trillion is at Yamal LNG) so that they will not require Novatek's support beyond planned equity contributions. In first-quarter 2020, despite pressures on global gas prices, Yamal LNG generated RUB54.0 billion ($0.8 billion) in operating profit, thanks to its low cost position (according to management's estimates, $1.5/mmbtu-$1.75/mmbtu total cost delivered to Europe and about $2.0/mmbtu-$2.5/mmbtu to Asia), the start of more favorable long-term contracts, and production about 10% above nameplate capacity. In the longer term, depending on the pace of global gas market recovery, higher dividends from Yamal and other joint ventures provide additional upside to Novatek's EBITDA.

LNG investments will remain large, offset by the sale of a 40% stake in Arctic LNG 2 and Yamal LNG's successful commissioning. Novatek's second LNG project, Arctic LNG 2, is massive, with a total estimated cost of $21.3 billion and annual capacity of 19.8 million metric tonnes (MT). Still, Novatek has a track record of successfully commissioning the first three trains of its first 17.4 million MT Yamal LNG project ahead of time and within budget. We believe that received and fully committed cash proceeds for the sale of the 40% stake in Arctic LNG 2 in 2019 cover Novatek's large investments in the project in 2020-2021. Of about $9.3 billion in total proceeds (according to IFRS), RUB136.5 billion ($2.4 billion) was received in 2019, and RUB46.0 billion ($0.7 billion) in first-quarter 2020. Another RUB163 billion ($2.8 billion) is due in 2020, and subsequent tranches will depend on the project's progress and oil prices. We understand that despite the currently difficult global gas market, Arctic LNG 2 will continue in line with Novatek's strategy to expand in LNG and achieve 57 million-70 million MT per year of production by 2030, while other early-stage investments could be delayed, notably the smaller 5 million MT Obsky LNG, to 2024-2025.

Outlook: Stable

The stable outlook reflects our expectation of a very strong balance sheet, with solid headroom for additional capex and potential dividend increases. We expect Novatek's FFO to debt to remain consistently above 60% and FOCF to remain positive in 2022-2023 after being negative in 2020. We also assume that financing for the Arctic LNG 2 project will not represent an actual or contingent obligation for Novatek, beyond its equity contribution.

Downside scenario

We could lower the rating on Novatek if the geopolitical situation deteriorates further, for example, if Novatek is unable to raise debt for the Arctic LNG 2 project. This would require the company to use its own funds to finance this and similar LNG projects. However, we currently view the likelihood of such a scenario as relatively low.

Other than that, we could lower the rating if the company undertakes even larger capex or acquisitions, especially at a time when oil and gas prices are low, or makes large unexpected dividend distributions that cause FFO to debt to fall below 60%.

A negative rating action on the sovereign would not automatically trigger a similar action on Novatek, since the company can be rated above the transfer and convertibility assessment on Russia, given its high share of exports and low debt.

Upside scenario

We see limited upside in the rating in the next 18-24 months. An upgrade would require structural and fundamental improvements to country risk in Russia. We do not anticipate that this will occur in the near term.

An upgrade would also depend on a more clearly articulated dividend distribution policy. We generally expect dividends to increase in absolute terms as cash flows strengthen, but the company's current policy does not cap the maximum payment. We see this as a potential constraint for a higher rating. We note, however, that the company has a track record of distributing close to 30% of net income for the past seven years.

Our Base-Case Scenario

Assumptions

- A Brent oil price of $30/bbl for the rest of 2020, $50/bbl in 2021, and $55/bbl thereafter, in line with our price assumptions.
- Gas and condensate production growth of 3%-5%.
- Domestic gas prices growth of about 3% in ruble terms.
- Dividend payout increasing from the current 30% floor.
- Joint ventures to pay RUB10 billion-RUB20 billion annual interest, while their dividends increase from minimal levels in 2020 to RUB50 billion-RUB60 billion in 2021-2022.

- Cash capex of about RUB200 billion in 2020, then reducing to RUB100 billion-RUB140 billion in 2021-2022.

Key metrics

Novatek PJSC--Key Metrics			
	2019A	**2020E**	**2021F**
EBITDA (Bil. RUB)	273.5	150-180	270-300
Capex (Bil. RUB)	166.6	About 200	130-150
FOCF	133.7	-40-60	140-160
FFO/debt	2.9	60-70	>60%
Debt/EBITDA	0.2	1.2-1.4	1-1.2

A--Actual. E--Estimate. F--Forecast. FFO--Funds from operations. Capex--Capital expenditure. FOCF--Free operating cash flow. RUB--Russian ruble.

We expect oil and gas markets to recover after the 2020 trough, supported by demand growth. Although oil and gas prices are volatile and difficult to predict, in our base case we assume that demand growth should support price recovery in 2021-2022, with Brent prices increasing to $50 in 2021 and $55 thereafter. The gas markets are currently difficult due to fundamental oversupply resulting from recent massive LNG capacity additions and weaker-than-expected demand, further exacerbated by the COVID-19 pandemic and a warm winter. We expect gradual rebalancing on the gas market because the current spot price is well below full costs and even below marginal costs of most producers, and post-pandemic economic growth should increase gas demand. Still, the pace of the gas market's recovery remains uncertain.

We expect Novatek's production to be more resilient than domestic peers' since domestic market is stable and most liquid volumes come from condensate, which is not covered by Russia's oil production cut commitments. Of the 16.4 million tons of Novatek's liquid sales in 2019, only 4.8 million tons was crude oil and the rest came from condensate, naphtha, and other products. Novatek's plan to cut oil-related capex in 2020 (notably on North-Russkoye cluster) helps to keep free operating cash outflow manageable in 2020. We expect COVID-19 to have only a limited impact on the domestic gas market, because gas-fired generation remains stable and industrial production is not directly affected by government's restrictive measures. In addition, we understand Novatek has flexibility to adjust gas purchases from joint ventures to support gas netbacks even if gas sales volumes decline.

Company Description

Novatek is Russia's largest independent natural gas producer after Gazprom and the third-largest holder of natural gas resources in the world. The company also has meaningful liquids production, which accounts for about 50% of its EBITDA on average. As of Dec. 31, 2019, Novatek had 17.5 billion bbl of oil equivalent (boe) of proven reserves under PRMS standards, mainly onshore or in areas that can be developed from onshore locations. Novatek's principal operating areas are concentrated in the Yamal-Nenets Autonomous Region in Western Siberia. At year-end 2019, total production amounted to 590 million boe, or average daily production of 1.6 million boe. Novatek is not allowed to export pipeline gas because of Gazprom's monopoly position; therefore it has focuses on LNG exports. In late 2018-2019, the company launched three out of the four trains of its first Yamal project with total capacity of 16.5 million tons of LNG per year.

Peer Comparison

Table 1

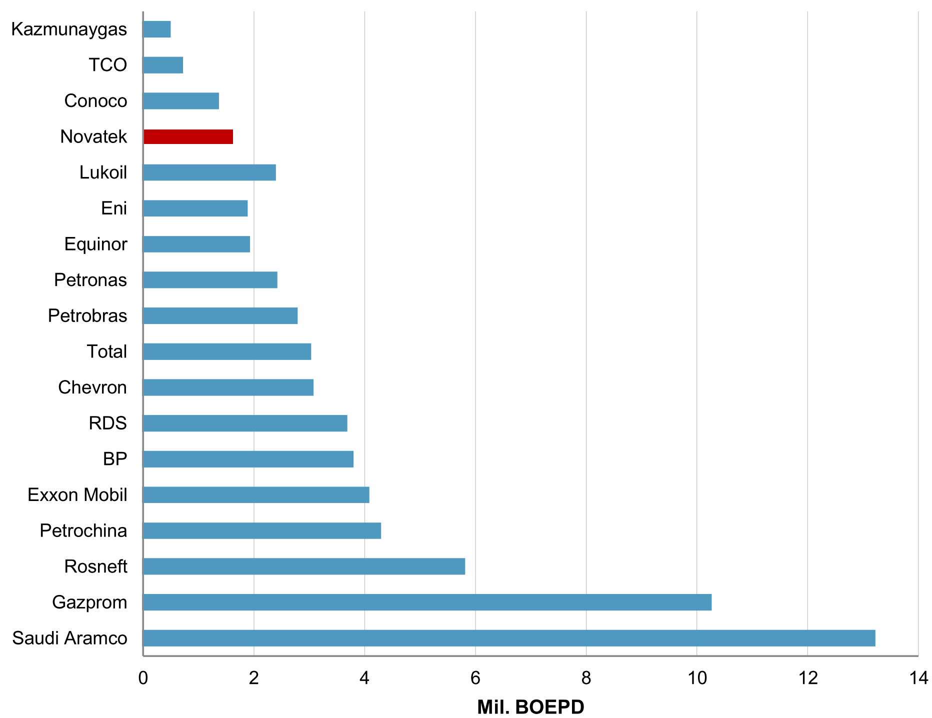
NOVATEK PJSC--Peer Comparison					
Industry sector: Oil and gas exploration and production					
	NOVATEK PJSC	**LUKOIL PJSC**	**Gazprom PJSC**	**Equinor ASA**	**Rosneft Oil Co. PJSC**
Ratings as of June 9, 2020	BBB/Stable/--	BBB/Stable/--	BBB/Negative/A-2	AA-/Negative/A-1+	BBB-/Stable/--
	--Fiscal year ended Dec. 31, 2019--				
(Mil. $)					
Revenue	13,896.3	126,291.1	122,963.9	64,358.0	138,125.1
EBITDA	4,404.3	20,727.6	33,025.2	24,945.0	30,649.7
Funds from operations (FFO)	2,534.0	17,518.4	25,037.5	14,379.0	22,484.0
Interest expense	171.7	674.1	3,836.2	2,409.0	5,862.6
Cash interest paid	131.1	669.8	2,754.6	1,203.0	4,509.7
Cash flow from operations	4,820.4	17,881.8	30,100.9	13,269.0	14,302.1
Capital expenditure	2,666.7	7,391.0	28,603.0	9,724.0	13,931.7
Free operating cash flow (FOCF)	2,153.7	10,490.7	1,497.9	3,545.0	370.4
Discretionary cash flow (DCF)	348.4	3,589.2	(4,617.8)	(239.0)	(5,782.1)
Cash and short-term investments	2,206.4	8,311.2	22,979.6	12,051.0	11,709.1
Debt	874.2	2,408.6	54,644.3	23,870.5	73,247.7
Equity	26,849.9	63,996.4	235,400.3	41,159.0	82,978.1
Adjusted ratios					
EBITDA margin (%)	31.7	16.4	26.9	38.8	22.2
Return on capital (%)	26.0	20.2	8.2	21.7	14.6
EBITDA interest coverage (x)	25.6	30.7	8.6	10.4	5.2
FFO cash interest coverage (x)	20.3	27.2	10.1	13.0	6.0
Debt/EBITDA (x)	0.2	0.1	1.7	1.0	2.4
FFO/debt (%)	289.9	727.3	45.8	60.2	30.7
Cash flow from operations/debt (%)	551.4	742.4	55.1	55.6	19.5
FOCF/debt (%)	246.4	435.5	2.7	14.9	0.5
DCF/debt (%)	39.9	149.0	(8.5)	(1.0)	(7.9)

In terms of capital structure, NOVATEK PJSC has lower leverage than key peers, which is a key supporting factor for the rating. Even though Novatek is smaller than Russia's oil giants-- Gazprom PJSC, Rosneft Oil Co. PJSC, and LUKOIL PJSC, the scale of its reserves and production compares well with other large oil majors.

Novatek's annual production of 1.6 million boe per day in 2019 compares well with Conoco Phillips (1.3 million boe per day) and ENI SpA (1.9 million boe per day). However, Novatek's FFO per unit of production is lower than peers', for two main reasons. First, Novatek faces high revenue-linked taxes in Russia. Still, taxes on condensate, which forms a large share of Novatek's liquids production, are lower than on crude oil. Second, Novatek sells its pipeline gas domestically, because in Russia, Gazprom has a legal monopoly on gas pipeline exports. Russian domestic gas prices have historically been well below export prices. Novatek's exposure to gas exports comes from LNG joint ventures only. In the future, these factors should make Novatek's profits more resilient to ongoing pressures on global oil and gas prices, because the amount of taxes on liquids declines in line with the oil price, and domestic gas prices are not affected by global pressures.

Chart 1

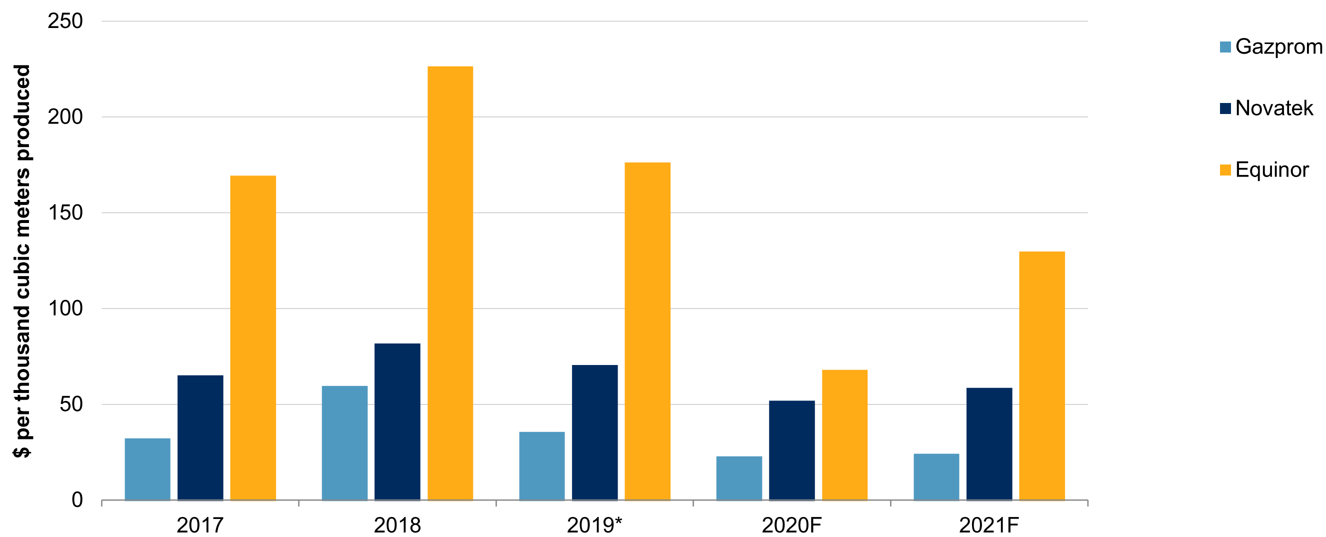
Global Oil And Gas Producers' 2019 Hydrocarbon Production



BOEPD--Barrels of oil equivalents per day. Source: S&P Global Ratings.

Chart 2

Novatek's EBITDA Per Unit Produced Is Below International Peers



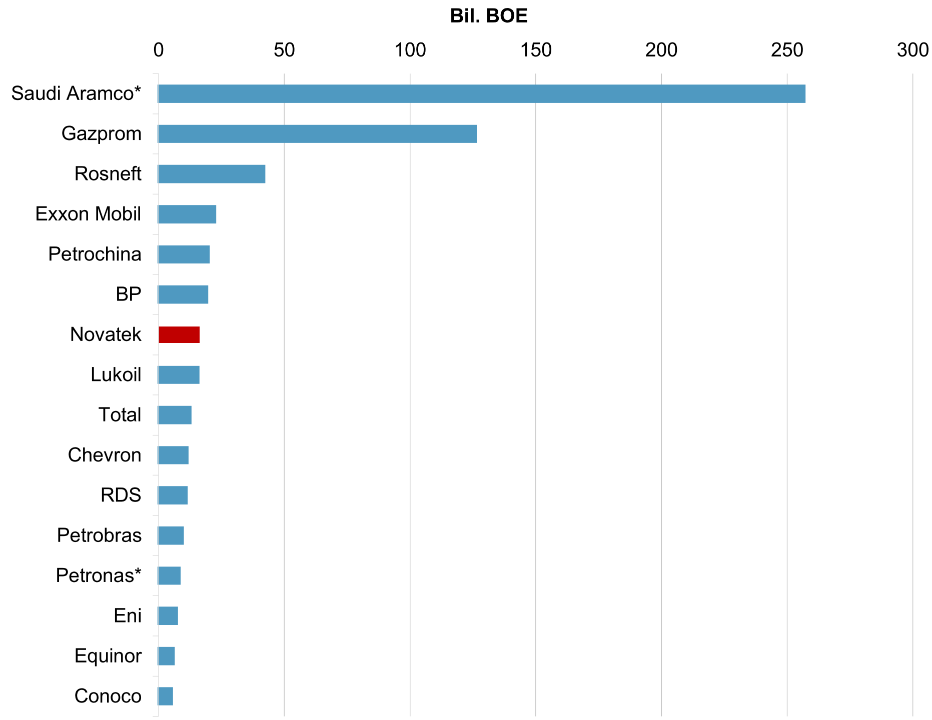
*2019 EBITDA Novatek calculation excludes gain on disposal of interest in JV. F--Forecast. Source: S&P Global Ratings.

Business Risk: Satisfactory

Our assessment of Novatek's business risk profile recognizes the company's large and high-quality oil and gas reserves which offer solid growth potential in LNG. Novatek's reported proven reserves of 17.5 billion boe under Petroleum Resources Management System (PRMS) correspond to 30 years life. This is higher than those of Shell and BP. Proven and probable reserves are even higher, at 28.7 billion boe. Over 80% of proven reserves is gas.

Chart 3

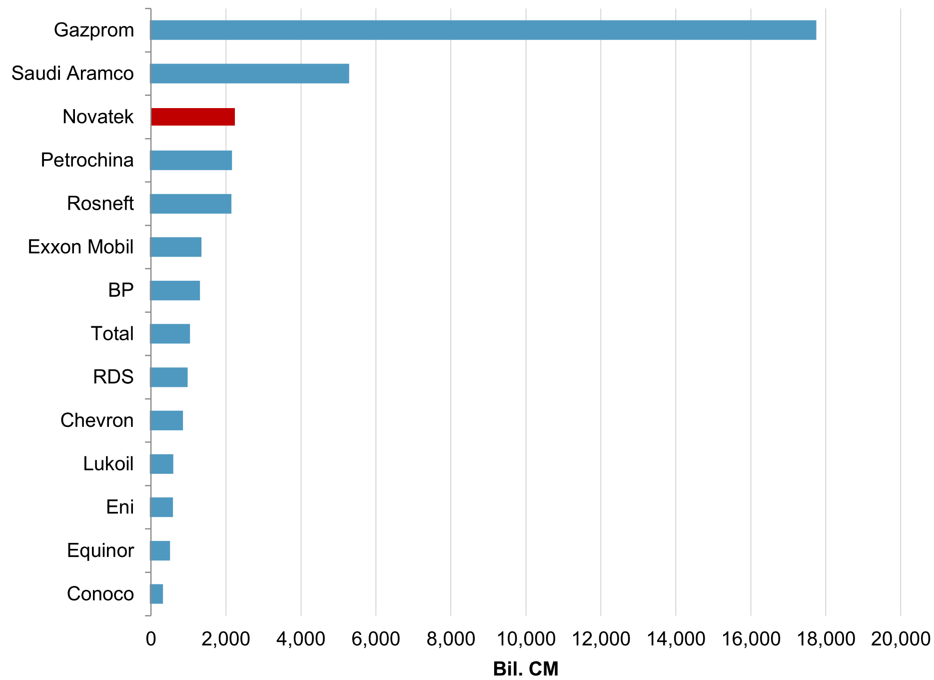
Global Oil And Gas Producers' Total Proved Reserves As Of Year End 2019



*As of end 2018. BOE--Barrels of oil equivalent. Source: S&P Global Ratings.

Chart 4

Global Oil And Gas Producers
Reserves proved gas, as of 2018



CM--Cubic meters. Source: S&P Global Ratings.

Importantly, Novatek's gas reserves support solid growth potential in LNG. We believe that LNG is the fastest growing segment of the global gas market because customers increasingly value flexibility and LNG is better positioned than pipeline gas to reach areas with increasing energy demand, such as Asia. Novatek has an ambitious strategy to become one of the world's largest LNG producers, with 57 million-70 million MT of production by 2030.

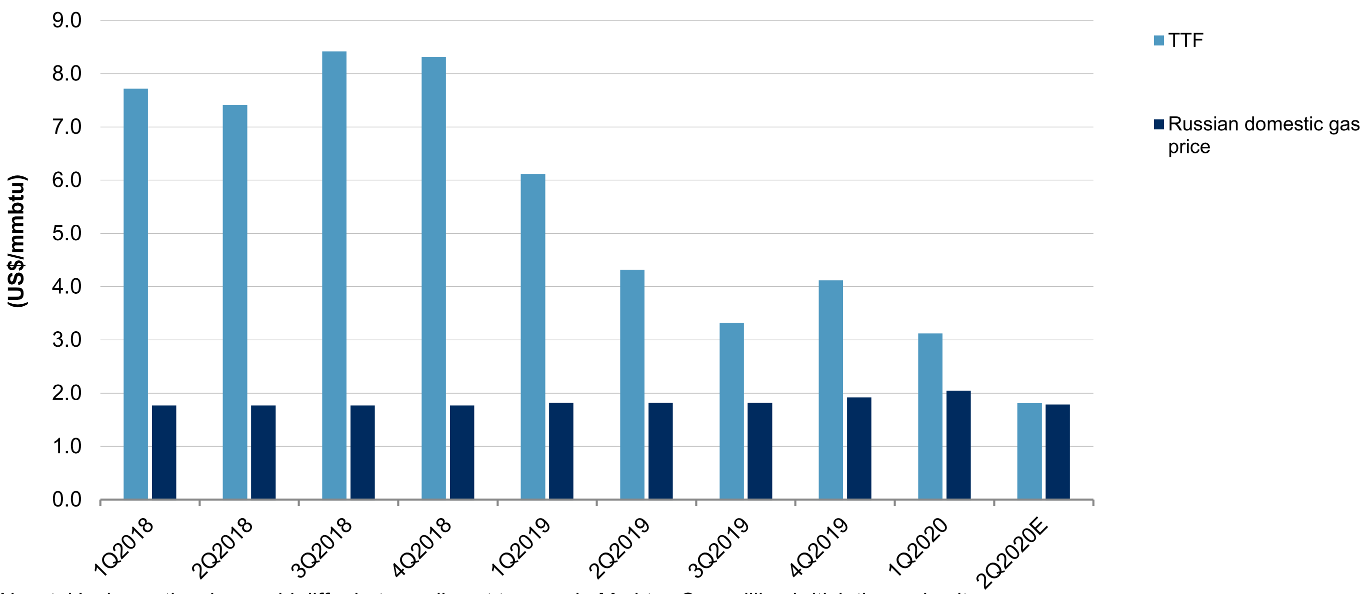
Novatek's healthy profitability is underpinned by fundamentally low costs and stable domestic sales. The following key factors support Novatek's profitability in our view:

- Low costs. In 2019, average full production costs with DDA and taxes other than income were $5.28/boe at Novatek's subsidiaries, and $3.90/boe at its joint ventures, and 2020 numbers will be lower due to the weaker ruble and revenue-linked taxes. Novatek enjoys tax benefits on its key fields. We estimate that Novatek's average cost of domestic gas sales per thousand cubic meters (including non-income taxes, transportation, and cost of gas purchased from joint ventures) is about RUB2,900, compared to the RUB4,500 end-customer price, and the break-even price for liquids is comfortably below $30/bbl.
- Stable and profitable domestic gas sales. Novatek sells essentially all its pipeline gas domestically (65.6 billion cubic meters in 2019). Although domestic prices have historically been below export prices, in the 2020 depressed global market environment, domestic sales remain stable and can provide stronger netbacks compared with exports. Novatek benefits from long-term contacts with solid Russian industrial customers, and generates a solid return on minimal maintenance capex.

- Also, our projections for 2022-2023 are supported by our expectation of a liquids price recovery, with Brent price assumptions at $50 for 2022 and $55 for subsequent years.

Chart 5

Russian Domestic Gas Prices Are Low But Stable



* Novatek's domestic price could differ but usually not too much. Mmbtu--One million british thermal units. E--Estimate. TTF--Title transfer facility. Source: S&P Global Ratings.

Novatek should be resilient to current global gas market pressures because LNG projects are unconsolidated and low cost, and the share of sales under long-term contracts is going up. Novatek's exposure to global gas prices is effectively indirect, via its stakes in non-consolidated joint ventures where it does not have control. Novatek owns 50.1% of the 17.4 million MT Yamal LNG project, commissioned in late 2018-2019, along with its partners Total, China National Petroleum Corp. (CNPC), and Silk Road Fund. Also, Novatek has 60% in Arctic LNG 2, a new project with an estimated $21.3 billion total cost, expected annual production of 19.8 million MT of LNG, and a scheduled production start in 2023. We understand that Novatek is considering other LNG projects in the future (including Obsky LNG and Arctic LNG 1), but we cannot rule out timing changes depending on market conditions. Novatek is currently constructing a plant in Murmansk region that would produce modules for its future LNG plants. It is also currently testing its Arctic Cascade patented technology at the fourth Yamal train, scheduled for commissioning in late 2020.

Despite difficult market conditions this year, we believe that Novatek's LNG projects will be supported by low costs and the expected start of long-term contracts. Therefore, these projects should be able to generate sufficient cash to service their obligations without Novatek's support. Yamal LNG is not subject to export duty (compared with 30% export duty on Russian pipeline gas) and enjoys mineral-extraction tax benefits. Novatek's management estimates Yamal LNG's costs of production and liquefaction at about $0.50/mmbtu, leading to a full cost of $1.5/mmbtu-$1.75/mmbtu to Europe and $2/mmbtu-$2.5/mmbtu to Asia, which positions Yamal LNG at the lower end of the global cost curve before taking into account any credit for liquids.

Also, we understand that in 2019-early 2020, Novatek marketed its share of early gas from Yamal LNG at prices close to the market levels at that time. Since April 2020, 96% of Yamal's production capacity is under long-term contracts at the project level. Although Novatek doesn't disclose its pricing mechanism, the S-curve mechanism typical for such contracts could provide more stability and downside protection.

We believe that the delay in Yamal LNG's train 4 to late 2020 compared with the first quarter will have a minimal impact on Yamal LNG's performance. The fourth train is 74% complete, has only 0.9 million MT of capacity compared with the 16.5 million MT nameplate capacity of the first three trains, and is not covered by long-term contracts; while current LNG spot prices are very low. Meanwhile, the first three trains are operating at about 10% above the 16.5 million MT nameplate capacity, which effectively lowers the full unit costs.

We note that one of the factors supporting the competitiveness of Novatek's projects is the state policy. The Russian government, directly and via government-owned corporations, provides important infrastructure for Novatek. Notably, the opening of all-year navigation of the Northern Sea Route as well as construction of atomic icebreakers should be co-financed by the state and therefore enhance the economic viability of Novatek's future projects.

Novatek's close business ties with Total SA also support our assessment of its business. Apart from a direct shareholding in Novatek and equity participation in LNG projects, Total also shares technology, which further enhances Novatek's competitiveness. Total recently further increased its stake in Novatek to 19.4% and was the first company to commit its equity participation in Arctic LNG 2.

Our assessment of Novatek's business profile is primarily constrained by Russia-specific country risks, similar to other large Russian oil and gas producers. These risks include the high sensitivity of profits to potential changes in the tax system, a volatile exchange rate, and rapidly changing economic conditions. In addition, Novatek and its large shareholder Gennady Timchenko are under various U.S. sanctions. This does not have any immediate impact on Novatek's own operations or its LNG projects, but introduces uncertainty that could have an impact in the worst-case scenario.

Financial Risk: Minimal

Our assessment of Novatek's financial risk profile reflects our forecast of solid credit metrics, with FFO to debt above 60%. Novatek's own debt has been declining over the past several years and was RUB152 billion at year-end 2019, including Eurobonds of $1.65 billion. We expect 2020 to be the low point for the company's credit metrics due to pressures on global markets and a peak in the company's capex at RUB200 billion (albeit down from the initial plan of RUB250 billion), leading to negative FOCF and FFO to debt declining to 60%-70% from well above 2.5x in 2019. We therefore expect Novatek's debt to temporarily increase in 2020. Still, we expect the metrics to catch up quickly in 2021-2022 as market improvement boosts operating cash flow.

Novatek's key risks stem from its ambitious growth projects, sizable joint ventures and potentially increasing dividend payout. Dividend payments increased year on year to RUB32.33 per share for 2019 net income from RUB26.06 on the 2018 net income. We understand the company is considering increasing its dividend payout ratio from the current minimal 30% level in its dividend policy. Novatek is also carrying out share buybacks, having recently extended its $600 million buyback program until June 2021.

Novatek does not guarantee any of the debt at its joint ventures including Yamal LNG, and we expect this to continue. The joint ventures arranged their own funding and, at year-end 2019, their debt totaled RUB2,348 billion (RUB2073 billion without debt to Novatek), including RUB2,111 billion at Yamal LNG (RUB1,911 billion net of debt to Novatek), RUB95 billion at Arctic, and RUB15 billion at Nortgas, which is relatively large compared with Novatek's on-balance-sheet debt. Still, all of the large existing joint ventures (including Yamal LNG and joint ventures with other Russian oil companies, Arcticgas and Nortgas) generate sufficient free cash flow to repay their debt and distribute dividends, as highlighted by solid operating profit (RUB270.0 billion in 2019, of which RUB164.1 billion was at Yamal LNG, even though it was at the production ramp-up stage, and RUB69.7 billion, including RUB54 at Yamal LNG, in first-quarter 2020 despite weak LNG markets). We believe joint venture dividends will support Novatek's cash flows in the longer term and that Novatek is unlikely to need to support them financially.

Novatek faces significant investments in Arctic LNG 2, which we understand is strategic to the company. However, we understand that Novatek's 2020-2021 investments in the project are covered by already received or fully committed tranches for the sale of a 40% stake in the asset for $9.3 billion in 2019, and that other project partners have committed to providing additional financing to the project.

In addition, we understand that Novatek might invest in the infrastructure required for its ambitious LNG projects on a joint venture basis and in the construction of production facilities to produce LNG modules in the Murmansk region. Such infrastructure could include terminals, railroads, shipbuilding, and, more generally, projects related to the Northern Sea Route. Also, we understand that Novatek may invest in additional LNG projects, including Obsky and Arctic LNG 1. Because these investments are difficult to predict, we do not include them in our base-case forecasts. However, the risks involved cause us to take a more conservative view of Novatek's underlying creditworthiness than its current credit metrics suggest.

Sanctions in the sector constrain Novatek's financing options and created a strong incentive to reduce leverage. The company's financial policy stipulates that the capital structure be conservative, and that debt to EBITDA be at 1x through the cycle, which supports our assessment.

Financial summary

Table 2

NOVATEK PJSC--Financial Summary					
Industry sector: Oil and gas exploration and production					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. RUB)					
Revenue	862,803.0	831,758.0	583,186.0	537,472.0	475,325.0
EBITDA	273,457.0	276,294.0	200,342.0	262,363.0	161,425.0
Funds from operations (FFO)	157,330.0	214,099.0	155,977.0	215,225.0	130,931.0
Interest expense	10,663.0	9,995.0	11,300.0	17,085.0	14,991.0
Cash interest paid	8,140.0	8,056.0	9,917.0	16,737.0	13,196.0
Cash flow from operations	299,293.0	208,293.0	170,482.0	157,054.0	119,668.0
Capital expenditure	165,572.0	90,205.0	37,046.0	31,027.0	44,537.0

Table 2

NOVATEK PJSC--Financial Summary (cont.)

Industry sector: Oil and gas exploration and production

	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
Free operating cash flow (FOCF)	133,721.0	118,088.0	133,436.0	126,027.0	75,131.0
Discretionary cash flow (DCF)	21,630.0	43,903.0	89,919.0	83,458.0	38,709.0
Cash and short-term investments	136,992.0	69,260.0	65,943.0	48,301.0	29,187.0
Gross available cash	136,992.0	69,260.0	65,943.0	48,301.0	29,187.0
Debt	54,276.8	130,785.0	112,737.7	181,627.1	337,660.9
Equity	1,667,076.0	886,595.0	775,659.0	657,720.0	428,171.0
Adjusted ratios					
EBITDA margin (%)	31.7	33.2	34.4	48.8	34.0
Return on capital (%)	26.0	21.5	23.4	41.8	17.9
EBITDA interest coverage (x)	25.6	27.6	17.7	15.4	10.8
FFO cash interest coverage (x)	20.3	27.6	16.7	13.9	10.9
Debt/EBITDA (x)	0.2	0.5	0.6	0.7	2.1
FFO/debt (%)	289.9	163.7	138.4	118.5	38.8
Cash flow from operations/debt (%)	551.4	159.3	151.2	86.5	35.4
FOCF/debt (%)	246.4	90.3	118.4	69.4	22.3
DCF/debt (%)	39.9	33.6	79.8	46.0	11.5

RUB--Russian ruble.

Reconciliation

Table 3

NOVATEK PJSC--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. RUB)

	--Fiscal year ended Dec. 31, 2019--						
NOVATEK PJSC reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
Reported	152,098.0	1,647,509.0	901,981.0	869,589.0	3,753.0	273,457.0	307,433.0
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(99,601.0)	--
Cash interest paid	--	--	--	--	--	(8,140.0)	--
Reported lease liabilities	10,463.0	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	5,111.0	--	(227.0)	(227.0)	269.0	--	--
Accessible cash and liquid investments	(123,292.8)	--	--	--	--	--	--
Capitalized interest	--	--	--	--	5,903.0	--	--
Dividends received from equity investments	--	--	46,050.0	--	--	--	--

Table 3

NOVATEK PJSC--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. RUB) (cont.)							
Asset-retirement obligations	9,897.6	--	--	--	738.0	--	--
Exploration costs	--	--	8,386.0	--	--	(8,386.0)	--
Nonoperating income (expense)	--	--	--	169,937.0	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(8,140.0)
Noncontrolling interest/minority interest	--	19,567.0	--	--	--	--	--
EBITDA: Business divestments	--	--	(682,733.0)	(682,733.0)	--	--	--
Total adjustments	(97,821.2)	19,567.0	(628,524.0)	(513,023.0)	6,910.0	(116,127.0)	(8,140.0)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	54,276.8	1,667,076.0	273,457.0	356,566.0	10,663.0	157,330.0	299,293.0

RUB--Russian ruble.

Liquidity: Adequate

We view Novatek's liquidity as adequate. Its ratio of sources to uses is above 1.2x for the 12 months from March 31, 2020. Our assessment is supported by the company's strong cash generation, limited debt maturities, and potential support from Russian banks. In our view, these factors partly offset Novatek's constrained capital market access due to sanctions. Novatek has very solid headroom under its financial covenants, which exist in only some of its credit facilities.

Principal liquidity sources

- Cash and cash equivalents totaling RUB112.5 billion, plus short-term bank deposits of RUB104.9 billion.
- €1.5 billion in committed bank lines longer than 12 months.
- Solid FFO generation of RUB140 billion-RUB160 billion or higher.
- Interest cash inflow from joint ventures of RUB10 billion-RUB12 billion, which in line with our methodology we report separately from FFO.
- Receivable for the Arctic LNG 2 stake of RUB173 billion, due in 2020.

Principal liquidity uses

- Debt maturities and short-term lease obligations of about RUB59.6 billion.
- Large capex of about RUB200 billion.
- Equity contributions to joint ventures, mainly Arctic LNG 2, of RUB155 billion.
- Dividends in line with the company's strategy to increase the payout compared with the current 30% floor.

Debt maturities

Table 4

NOVATEK PJSC--Debt Maturities*	
Period	**(Bil. RUB)**
2020	55.9
2021	14.0
2022-2025	94.0
Thereafter	32.4

*Data as of March 31, 2020. RUB--Russian ruble.

Covenant Analysis

Novatek does not have any financial covenants in the outstanding debt instruments

Environmental, Social, And Governance

We see above-average environmental risks for the oil and gas industry because of inherent material exposure to greenhouse gas emissions, pollution risks, and the pace of energy transition away from carbon-based fuels. Also, oil and gas companies generally have above-average exposure to social risks such as safety management and social cohesion (please see "ESG Industry Report Card: Oil And Gas," published on Feb. 11, 2020, on RatingsDirect).

Compared with peers, Novatek is favorably positioned, thanks to a high share of gas in its production, because gas results in lower CO2 emissions than other hydrocarbons. We believe that fundamentally, global demand for LNG will depend on the trajectory of energy transition.

Novatek operates in permafrost areas. Although we understand that Novatek is in compliance with applicable environmental regulations, generally, ice melting caused by climate change may increase the risk of accidents and requires additional soil freezing.

We assess Novatek's social risk as relatively low because the company has established a mutually beneficial relationship with the government and local communities in its key areas of operation. The company is a large employer in the Yamal region and its other LNG-related projects in the North of Russia will create more jobs and support overall economic growth.

From a governance standpoint, the key risks for Novatek lie in the existing sanctions and potential sanctions that can be imposed against the company, its shareholders, or its LNG projects. However, this is completely unpredictable and out of Novatek's control. Otherwise, we assess Novatek's governance as solid, in line with that of Russian privately owned peers, with three of the nine members of the board of directors being independent including one woman.

Rating Above The Sovereign

We rate Novatek one notch above the foreign currency rating on Russia, in line with our assessment of the company's stand-alone credit profile, because of the company's low leverage, very manageable maturities, and sizeable exports.

Issue Ratings--Subordination Risk Analysis

Capital structure

Novatek's capital structure primarily consists of two bonds ($1 billion maturing in 2022 and $650 million maturing in 2021), issued by an orphan special-purpose vehicle, Novatek Finance Ltd. The company also has smaller bilateral loans that total less than $1 billion.

Analytical conclusions

We rate the two bonds 'BBB', in line with the issuer credit rating. We believe there are no material subordination risks in Novatek's capital structure because all large debt instruments rank pari passu.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/--

Business risk: Satisfactory

- **Country risk:** High
- **Industry risk:** Intermediate
- **Competitive position:** Satisfactory

Financial risk: Minimal

- **Cash flow/leverage:** Minimal

Anchor: a-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-1 notch)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- 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 Oil And Gas Exploration And Production Industry, Dec. 12, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: 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, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	**Minimal**	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	**a/a-**	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of June 19, 2020)*

NOVATEK PJSC		
Issuer Credit Rating		BBB/Stable/--
Russia National Scale		NR/--/--
Senior Unsecured		BBB
Issuer Credit Ratings History		
29-Nov-2018		BBB/Stable/--
02-Nov-2016		BBB-/Stable/--
20-Sep-2016		BB+/Watch Pos/--
02-Jun-2017	*Russia National Scale*	NR/--/--

Ratings Detail (As Of June 19, 2020)*(cont.)	
02-Nov-2016	ruAAA/--/--
20-Sep-2016	ruAA+/Watch Pos/--
Related Entities	
Novatek Finance Ltd.	
Senior Unsecured	BBB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com