MOODY'S
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Credit Opinion: Metinvest B.V.

Global Credit Research - 10 Apr 2014

Netherlands

Ratings

Category	Moody's Rating
Outlook	Negative
Corporate Family Rating	Caa2
Senior Unsecured	Caa2/LGD4
NSR Corporate Family Rating	B1.ua

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Key Indicators

[1]**Metinvest B.V.**

	2013	2012	2011	2010	2009
Revenue (USD Billion)	**$12.8**	**$12.6**	**$14.2**	**$9.4**	**$6.0**
EBIT Margin	**9.9%**	**8.7%**	**19.6%**	**17.9%**	**12.1%**
Return on Average Tangible Assets	**8.3%**	**7.3%**	**20.9%**	**15.5%**	**8.0%**
EBIT / Interest	**3.8x**	**3.6x**	**8.9x**	**6.6x**	**4.3x**
Debt / EBITDA	**2.2x**	**2.5x**	**1.3x**	**1.7x**	**2.3x**
Debt / Total Capital (most recent)	**34.3%**	**32.1%**	**32.6%**	**32.5%**	**27.3%**
(CFO - Div) / Debt	**18.5%**	**12.4%**	**21.7%**	**8.9%**	**39.2%**

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying *User's Guide*.

Opinion

Corporate Profile

Metinvest B.V., registered in the Netherlands, is the holding company of a vertically integrated group, Metinvest, which is one of the largest steelmakers and iron ore producers in the Commonwealth of Independent States (CIS). The company has three iron and steel plants with the capacity to produce approximately 15 million tonnes (mt) of crude steel annually, equivalent to approximately 45% of all steel cast in Ukraine in 2013, a rolling mill and a large diameter pipe mill in Ukraine, and also has rolling mills in Italy, Bulgaria and the UK.

The company produces finished flat- and long-steel products, large diameter pipes and semi-finished steel products (slabs and billets). In 2013, around 29% (2012: 33%) of company's external sales were in Ukraine with the remainder generated in Europe, the Middle East, North Africa, Southeast Asia, the CIS (except Ukraine) and

North America. Metinvest is vertically integrated, with its iron ore mines located entirely in Ukraine and its coal mines located in Ukraine and the US.

In 2013, Metinvest produced approximately 12.4 mt (2012: 12.5 mt) of crude steel and 36.9 mt (2012: 36.2 mt) of iron ore concentrate, and mined 11.4 mt (2012: 11.6 mt) of coking coal. In 2013, Metinvest reported revenue of $12.8 billion (2012: $12.6 billion) and EBITDA of $2.3 billion (2012: $2.0 billion). The company is privately owned: the major shareholders of the group are a Ukrainian investment holding company, System Capital Management (SCM), with a 71.25% share in Metinvest, and Smart group, which owns 23.75%.

Rating Drivers

- Sovereign rating of Ukraine

- Vertical integration into iron ore and coking coal operations

- Low-cost iron ore operations

- Capital expenditure focused on efficiency improvements

Rating Rationale

Metinvest's Caa2 corporate family rating (CFR) is currently constrained by Ukraine's foreign-currency bond country ceiling, which was downgraded to Caa2 on 4 April 2014 (while the sovereign bond rating was downgraded to Caa3 from Caa2 with a negative outlook). We consider that Metinvest's capacity to serve its foreign-currency debt could be exposed to actions taken by the Ukrainian government to preserve the country's foreign-exchange reserves. For additional information on Ukraine sovereign ratings, please refer to the webpage containing Moody's related announcements http://www.moodys.com/eusovereign.

The rating is constrained by (1) Ukraine's fiscal and legal environment, (2) the company's dependence on highly volatile markets for iron ore and steel products, which can lead to significant swings in operating performance; and (3) potentially large multi-year capital expenditure targeting improved efficiency, product mix and quality improvements and expansion. Despite Metinvest's high volume of exports the company remains subject to trade barriers and the Ukrainian political environment given that most of the company's production facilities are located within Ukraine.

At the same time, Metinvest's Caa2 rating also incorporates (1) the company's ability to generate positive cash flows even in times of a severe downturn as observed in 2009 and more recently; (2) low leverage; (3) high degree of vertical integration; (4) large iron ore reserves; and (5) the geographically advantageous location of some of its major assets.

DETAILED RATING CONSIDERATIONS

MINING SEGMENT WILL CONTINUE TO DRIVE PROFITABILITY

The Mining division generated an EBITDA margin of 43% in 2013 as opposed to 2% EBITDA margin generated by the Metallurgical division of the company. Average prices for all steel products were lower in 2013 compared to 2012 except for railway products (which represent an insignificant 3% of metallurgical division's revenue). Given the higher gas prices in Ukraine, the company's slab cash costs of about $350-370/tonne in 2013 are estimated by Moody's to be slightly higher than the majority of Russian steel producers.

The Mining division's EBITDA was fairly stable at $2.25 billion in 2013 compared to $2.28 billion in 2012 and it continues to be the main driver of the company's overall results. The main products of the Mining division are iron ore concentrate, pellets and coking coal concentrate (24% in company's total revenue in 2013), with the biggest revenue generated in Ukraine (44%) and Southeast Asia (38%), with the rest of revenue being relatively insignificant: Europe (10%) and North America (6%).

Flat-steel products accounted for 38% of total Metallurgical division's revenue in 2013. The Metallurgical division's exposure to Europe is high as steel products are mainly exported to Europe (28%), but also to the Middle East and Northern Africa (22%) and the CIS (15%).

Metinvest's product portfolio, covering not only steel products, but also iron ore, coke and coal, gives Metinvest an advantage over steel companies that are not vertically integrated into iron ore (currently no benefits are conferred by being integrated into coking coal at currently low coking coal prices and taking into consideration relatively high cash costs of coking coal at the company's mines).

Metinvest is more than 100% self-sufficient in iron ore and 55% self-sufficient in coking coal (when US mining operations are taken into account). According to our estimates, the company's cash costs for iron ore concentrate and pellets are about $30/tonne and $45/tonne, respectively. International sea-borne prices for iron ore concentrate fell slightly in January-March 2014, but still are likely to remain robust in 2014 and, therefore, pellets and iron ore concentrate will continue to drive the profitability of the company's mining segment.

The company's cash costs for coking coal concentrate in Ukraine and the US are relatively high, and estimated by Moody's to be at about $100/tonne and $90/tonne, respectively (not counting an extra $30-35/tonne in shipping costs from the US to Ukraine). Moreover, benchmark prices for low-volatility hard coking coal based on "Free on Board" (FOB) Australia terms fell significantly, to $143/tonne for Q1 2014 deliveries, from $152/tonne for a previous quarter, which translates into an average price of around $135/tonne of coking coal concentrate for the US market and $107/tonne in Ukraine. A decrease in coking coal prices during 2H 2013 negatively impacted mining division's EBITDA margins in 2013.

CAPITAL EXPENDITURE IS FOCUSED ON EFFICIENCY, PRODUCT IMPROVEMENTS AND EXPANSION

Metinvest's updated mid-term corporate strategy is to produce 15 million tonnes of BOF (basic oxygen furnace) or converter steel. This could be achieved through decommissioning of the remaining open-hearth furnaces (OHF) at Ilyich Steel and modernisation of crude steel production with the BOFs.

Despite the likelihood of the potential pursuit of expansion projects, in the next 12 to 18 months Metinvest is likely to focus on efficiency and quality projects that will confer immediate benefits by improving its operations and adding value to its existing products. Capex in 2013 at around $747 million is in line with the prior year's level (a 2% fall y-o-y). The company equipped all its furnaces at Ilyich Steel with the pulverised coal injection (PCI) units and continued construction of a PCI unit at Yenakiieve Steel, which will significantly reduce the use of natural gas and coke in the blast furnace per tonne of pig iron (Ukraine imports gas from Russia at a price about three times higher than the domestically regulated price for Russian steel makers).

Other projects aimed at addressing efficiency or environmental issues include (1) the construction of a new turbine air blower, air separation plant and a new sinter plant at its Yenakiieve Steel (Metallurgical division); and (2) construction of a crusher and conveyor belt system at its Northern GOK (Mining division) and Affinity mining complex at its United Coal Company in the US (Mining division). To address environmental risks faced by the local communities, the company closed three obsolete coke batteries and mothballed a sinter plant at Azovstal in Mariupol, Ukraine. According to the company, the new sinter plant at Yenakiieve Steel will be environmentally friendly. The company is also considering modernising the sinter plant at its Ilyich Steel.

Liquidity Profile

Metinvest has adequate liquidity. As of 31 December 2013, it had $783 million of cash. During the past several years, the company's debt maturity profile has improved with the portion of short-term debt kept consistently at around 30-40%.

In 2014 the company has to repay debt maturities of approximately $870 million. During this period, the company expects to generate operating cash flows of around $1.7 billion. We expect the maintenance capex of $400-$450 million in 2014, while discretionary capital expenditures is likely to be limited to about $300 million. We note that there is currently sufficient headroom under financial covenants (net debt/EBITDA less than 3.0).

Structural Considerations

We estimate that around 5% of Metinvest's indebtedness is secured, which - according to the result of our loss-given-default methodology - does not justify any notching between the company's Caa2 CFR and the rating for its senior unsecured bonds.

Rating Outlook

Negative outlook on the company's ratings is in line with the negative outlook on sovereign rating of Ukraine and reflects the fact that a potential further downgrade of Ukraine's sovereign rating may result in the further lowering of Ukraine's foreign and/or local currency bond country ceiling. In addition to considerations related to the sovereign rating, Moody's will also be monitoring Metinvest's ability to address increasing country and foreign exchange risks.

What Could Change the Rating - Up

Given a negative outlook, we do not currently expect an upward pressure on Metinvest's rating. However, Moody's could upgrade the rating if (1) it raises the foreign-currency bond country ceiling; and (2) Metinvest maintains a good liquidity profile and further improves its debt maturity profile, while at the same time maintaining reasonable profitability and positive free cash generation.

Despite the fact that domestic sales account for a fairly low proportion of Metinvest's total sales (29% in 2013), it remains subject to the Ukrainian legal and political environment, given that a major part of the company's production assets are located within Ukraine. Therefore, the company's rating will be ultimately dependent on further developments at the sovereign level.

What Could Change the Rating - Down

Downward pressure could be exerted on Metinvest's rating as a result of a further potential downgrade of the sovereign rating and/or further lowering of the foreign-currency bond country ceiling.

Rating Factors

Metinvest B.V.

Steel Industry Grid [1][2]	**Current FY 31/12/2013**		[3]**Moody's 12-18 Month Forward ViewAs of 09/04/2014**	
Factor 1 : Business Profile (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Business Profile	Ba	Ba	Ba	Ba
Factor 2 : Size (20%)				
a) Revenue (USD Billion)	$12.8	Baa	$12.4 - $12.6	Baa
Factor 3 : Profitability (22.5%)				
a) EBIT Margin (3 Year Avg)	13%	Baa	8% - 9%	Baa
b) Return on Average Tangible Assets (3 Year Avg)	12%	A	5% - 7%	Ba
c) EBIT / Interest (3 Year Avg)	5.4x	Baa	2.2x - 2.5x	B
Factor 4 : Financial Policies (10%)				
a) Financial Policies	Ba	Ba	Ba	Ba
Factor 5 : Leverage and Cash Flow Coverage (27.5%)				
a) Debt / EBITDA (3 Year Avg)	1.9x	A	2.1x - 2.3x	Baa
b) Debt / Total Capital (most recent)	34%	A	27% - 30%	Aa
c) (CFO - Div) / Debt (3-year Average)	17%	Ba	35% - 40%	A
Rating:				
a) Indicated Rating from Grid		Baa2		Baa3
b) Actual Rating Assigned				Caa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 31/12/2013; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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