S&P Global Ratings

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Summary:

Public Joint Stock Company Transneft

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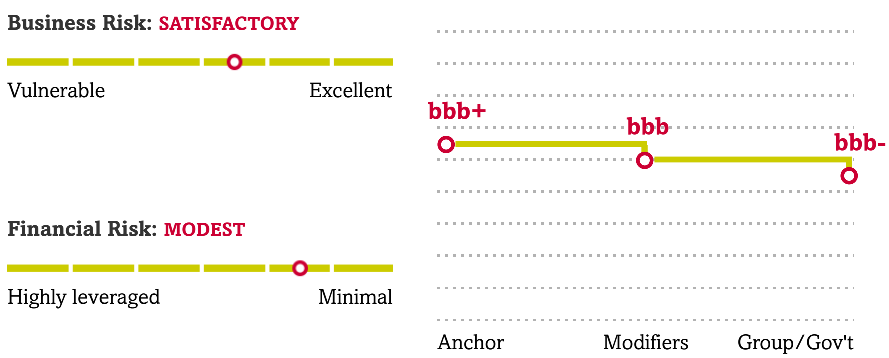

CORPORATE CREDIT RATING
Foreign Currency Rating
BB+/Stable/--
Local Currency Rating
BBB-/Stable/--

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Position as the monopoly crude oil pipeline operator in Russia, with stable transportation volumes. • Solid and resilient profitability, both historically and in our base-case scenario. • Somewhat opaque and politicized decision-making on capital expenditures (capex) and tariff regulation.	• Our expectation of robust financial metrics, with funds from operations (FFO) to debt above 60%, on average. • Our projection of negative free operating cash flow (FOCF) generation and somewhat weakening financial metrics in 2017, due to sizable capex.

Outlook: Stable

The stable outlook on Public Joint Stock Company Transneft mirrors our outlook on the sovereign.

Our current assessment of Transneft's stand-alone credit profile (SACP) factors in our assumption that the company will achieve FFO to debt above 60%, on average, for the next three years. Even if the ratio is slightly below this target, we expect it will rebound in 2018 when moderating capex should facilitate positive FOCF.

Downside scenario

We would lower the rating on Transneft if we lowered the ratings on the sovereign. We do not expect to rate Transneft above the sovereign because of our view of very strong links between the company and the government, which could leave room for potential negative government interference. Also, we view Transneft as a domestically-focused company exposed to country risks in Russia.

We may revise our assessment of Transneft's SACP if its FFO to debt were consistently below 60% and FOCF remained negative. This could happen if capex does not decline after 2018, if foreign exchange fluctuations constrain credit metrics beyond our current expectations, if costs increase well above tariffs, or if dividends are markedly higher than our current expectations, which we do not anticipate.

Given our expectation of an extremely high likelihood of extraordinary state support, downside risk to the local currency rating could stem from a deterioration of the company's SACP by three notches (or a full category) to 'bb'level. For us to consider a negative action on the foreign currency rating, the SACP would have to decline even further to 'b+'. This is far from our base-case scenario.

Upside scenario

Upside potential hinges on the sovereign rating on Russia. We would raise our rating on Transneft in the event of a sovereign upgrade.

Our Base-Case Scenario

Assumptions	Key Metrics
• Oil transportation tariff adjustment of 90%-100% of government-projected consumer price index (CPI) in 2017-2020. • Relatively stable transportation volumes. • Potential ruble (RUB) weakening, in line with our base-case scenario for the sovereign, to weigh on 2017 credit metrics. • The company to gradually prepay its foreign exchange-denominated debt and continue to keep a large part of its cash in foreign currency, to hedge associated risk. • 2017 capex of more than RUB300 million, broadly in line with 2016 levels, including East Siberia--Pacific Ocean pipeline (ESPO) expansion, oil product pipelines North and South, and material investments in supporting the existing vast network. • Capex to moderate to RUB 230 billion-RUB250 billion from 2018, when the key projects are completed. • Dividends to increase in 2017 and achieve 25% of consolidated net income in subsequent years, in line with the company's policy.	• FFO to debt of above 60%, on average, with a low slightly below 60% in 2017 followed by a strong rebound to comfortably above 60% in 2018 once key projects are completed, and positive FOCF starts to reduce adjusted debt. • Negative FOCF in 2017. • FOCF returning to positive, at RUB50 billion-RUB100 billion, in 2018 and beyond.

Financial Risk: Modest

We expect Transneft's core credit metrics to remain solid, with debt to EBITDA of 1.0x-1.5x and FFO to debt above 60%, on average, in the next three years. We expect negative FOCF in 2017 due to heavy capex plans on a number of key projects, notably ESPO expansion and oil product pipelines.

Transneft faces some foreign exchange risk, as about 70% of debt is denominated in U.S. dollars, while revenues are mostly in rubles. Still, Transneft's very manageable overall debt level and solid foreign currency-denominated liquid assets partially mitigate this risk.

Because of heavy capex and potential ruble weakening under our base-case sovereign scenario in 2017, we do not rule out that 2017 FFO to debt could be slightly below 60%. Still, we expect a rebound in 2018, as the company completes some of its key projects and repays some foreign exchange debt.

Our assessment of Transneft's SACP factors in uncertainties related to the company's financial policy. We see a risk that the company's currently low debt might increase because of higher capex or larger dividends, if so directed by the government.

Liquidity: Adequate

We now view Transneft's liquidity as adequate, with the ratio of liquidity sources to liquidity uses above 1.3x. We believe that the company's status as a GRE supports its stable relationships with local banks and its standing on the local credit market, even if access to international capital markets has been uncertain for Russian issuers for geopolitical reasons. We believe that the company has generally prudent risk management.

Furthermore, although Transneft reported losses of RUB19 billion in defaulted banks in 2015 and net RUB75.3 billion on derivatives in 2014, these losses were manageable given the company's solid cash balances and sound credit metrics.

Principal Liquidity Sources	Principal Liquidity Uses
At year-end 2016, we estimate that Transneft's principal liquidity sources included: • Sizable cash and short-term financial assets exceeding RUB300 million. We understand that most cash is held with first-tier Russian banks and short-term financial assets are liquid. • FFO of RUB300 million-RUB350 million. • We do not include in liquidity sources proceeds from the pending sale of its stake in Novorossiysk Commercial Sea Port PJSC because the details and timing of this sale are uncertain at this stage.	At the same time, we calculate that Transneft's principal liquidity uses included: • Large capex program of more than RUB300 million, including new projects and maintenance capex. We believe that most key projects are committed. • Short-term maturities of about RUB87 billion. • Dividends, which we expect to increase from the 2016 level, in line with the company's policy to pay out 15%-25% of net income. • Potential working capital outflows.

Other Credit Considerations

The $1 billion loan participation note is technically issued by the orphan special purpose vehicle Transcapitalinvest Designated Activity Company, and backed by equivalent-ranking obligations with equivalent payment terms issued by Transneft. We view Transcapitalinvest as a strategic financing entity set up solely to raise debt on behalf of Transneft. We believe that Transneft is willing and able to support Transcapitalinvest to ensure full and timely payment of interest and principal when due, as well as any of the vehicle's expenses, and therefore equalize the issue rating with the issuer credit rating on Transneft.

Government Influence

We regard Transneft as a GRE. We base our assessment of government support on Transneft's:

- Critical role for the functioning of the Russian oil industry, which is a major source of tax revenues and national income; and
- Very strong link with the Russian government, which has 100% of the voting rights, appoints board members, and

fully controls the group's strategy, tariffs, and major investment projects. We do not expect any change in ownership and control of Transneft. We understand, however, that Transneft makes operating decisions independently from the government.

We do not apply uplift for government support to the rating because our assessment of Transneft's 'bbb' SACP is higher than our long-term rating on Russia. However, government support potentially protects the rating from downside risk if Transneft's SACP were to deteriorate.

Ratings Score Snapshot

Corporate Credit Rating

Foreign Currency: BB+/Stable/--

Local Currency: BBB-/Stable/--

Business risk: Satisfactory

- **Country risk:** High
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

Financial risk: Modest

- **Cash flow/Leverage:** Modest

Anchor: bbb+

Modifiers

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

Stand-alone credit profile : bbb

- **Group credit profile:** bbb
- **Likelihood of government support:** Extremely high

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 01, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers,

Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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-

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