

CREDIT OPINION

18 September 2020

Update

✓ Rate this Research

RATINGS

Chelyabinsk Pipe Plant PJSC

Domicile	Russia
Long Term Rating	Ba3
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Denis Perevezentsev, +7.495.228.6064
 CFA
 VP-Sr Credit Officer
denis.perevezentsev@moodys.com

Olga Moshkina +7.495.228.6157
 Associate Analyst
olga.moshkina@moodys.com

Victoria Maisuradze +7.495.228.6067
 Associate Managing Director
victoria.maisuradze@moodys.com

Chelyabinsk Pipe Plant PJSC

Update to credit analysis

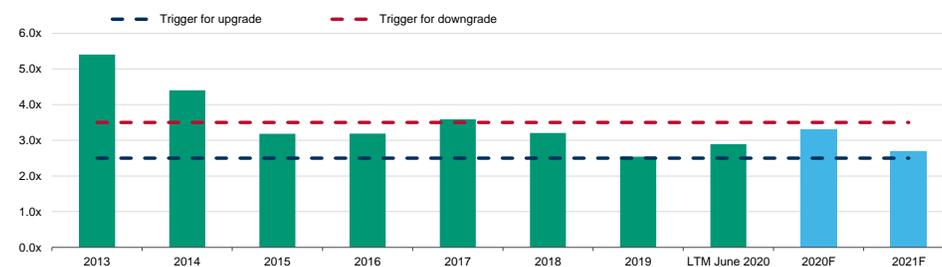
Summary

[Chelyabinsk Pipe Plant PJSC's](#) (ChelPipe) Ba3 rating factors in the company's (1) position as one of the largest pipe producers globally and its solid market share in oil country tubular goods (OCTG), seamless industrial pipes, and large diameter pipes (LDP) in Russia; (2) balanced product mix, ongoing shift towards production of higher-margin seamless pipes, and technological advancements across the pipe products range; (3) integration in scrap collection and billet production, which supports the profitability in pipe manufacturing and reduces the exposure to steel price volatility; (4) fairly low costs because of its integration in billet production, proximity to main feedstock suppliers, and operational enhancements; (5) moderate leverage of 2.9x (Moody's-adjusted debt/EBITDA) as of 30 June 2020, which we expect to remain below 3.5x in 2020-21; and (6) long-term debt maturity profile, sufficient liquidity and balanced liquidity management.

The rating also takes into account the company's (1) lack of geographical diversification in assets and sales, with its two core production sites located in the Urals region of Russia and more than 80% of its revenue generated from domestic sales; (2) significant exposure to the oil and gas sector; (3) elevated dividend payouts and an anticipated increase in capital spending beyond 2021, which could curb deleveraging; (4) concentrated ownership-related risks, including potential related-party transactions; and (5) uncertainties regarding the potential merger with Zagorsk Pipe Plant (ZTZ).

Exhibit 1

ChelPipe's leverage will decline in 2021 driven by EBITDA growth Moody's-adjusted total debt/EBITDA



All figures are calculated using Moody's estimates and standard adjustments.

Sources: Moody's Financial Metrics™ and Moody's Investors Service estimates

Credit strengths

- » Second-largest market position in Russia and balanced product mix
- » Integration in billet production and scrap collection, resulting in fairly low costs
- » Moderate leverage

Credit challenges

- » Lack of geographical diversification in assets and sales
- » Significant exposure to Russia's oil and gas sector, and volatile demand for LDP
- » Growing capital spending and high dividends, which will exert pressure on free cash flow generation

Outlook

The stable outlook reflects our expectation that over the next 12-18 months ChelPipe will maintain its Moody's-adjusted debt/EBITDA below 3.5x on a sustained basis, maintain healthy liquidity, and pursue balanced financial policies.

Factors that could lead to an upgrade

We would upgrade the rating if the company were to reduce its Moody's-adjusted debt/EBITDA towards 2.5x on a sustained basis, maintain healthy liquidity, and continue pursuing balanced financial policies.

Factors that could lead to a downgrade

We would downgrade the rating if ChelPipe's Moody's-adjusted debt/EBITDA were to rise above 3.5x on a sustained basis, operating performance or market position weakens materially, or liquidity deteriorates and the company fails to address its upcoming debt maturities in a timely manner.

Key indicators

Exhibit 2

Chelyabinsk Pipe Plant PJSC

	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	LTM (Jun-20)	2020-proj.	2021-proj.
Revenue (USD billions)	2.4	2.0	2.7	2.9	3.0	2.7	2.0	2.4
EBIT Margin %	15.0%	15.1%	10.6%	11.9%	14.0%	14.7%	12.8%	13.6%
EBIT / Avg. Tangible Assets	17.2%	15.6%	12.1%	15.5%	19.9%	19.2%	13.8%	18.5%
Debt / EBITDA	3.2x	3.2x	3.6x	3.2x	2.5x	2.9x	3.3x	2.7x
(CFO - Dividends) / Debt	12.8%	14.8%	16.8%	13.1%	15.8%	11.9%	10.5%	8.2%
EBIT / Interest Expense	1.7x	1.6x	1.7x	2.3x	2.8x	3.0x	2.2x	3.4x
Debt / Book Capitalization	90.6%	86.0%	92.9%	94.8%	92.6%	91.9%	95.1%	91.2%

All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's Projections (proj.) are Moody's opinion and do not represent the views of the issuer. Periods are financial year-end unless indicated.

Source: Moody's Financial Metrics™

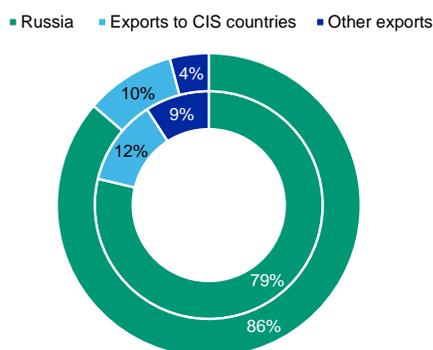
This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Profile

Headquartered in Russia, Chelyabinsk Pipe Plant PJSC (ChelPipe) is one of the largest producers of steel pipe products in Russia and globally. The company produces seamless industrial and O&G pipes, LDP, welded pipes and trunk pipeline systems, and provides oilfield services. ChelPipe operates two pipe-rolling plants in Russia, two trunk pipeline equipment producers in Russia and one in the Czech Republic, scrap collection and processing and oilfield services businesses in Russia, and a distribution network in Russia and Kazakhstan. For the 12 months that ended 30 June 2020, the company shipped 1.8 million tonnes of steel pipe products, and generated revenue of RUB178.3 billion and Moody's-adjusted EBITDA of RUB34.5 billion. ChelPipe's major shareholder is Andrey Komarov, who directly and indirectly owns around 86.58% of the company's shares.

Exhibit 3

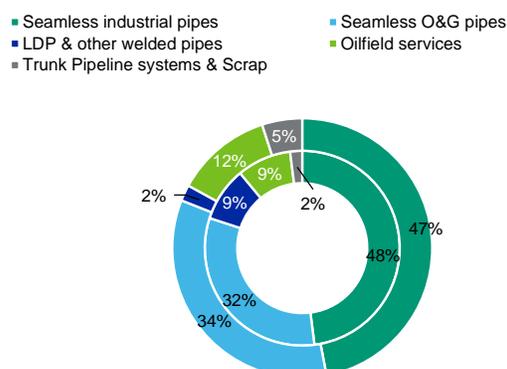
Revenue breakdown by sales destination



Inner circle: H1 2019; outer circle: H1 2020.
Source: ChelPipe

Exhibit 4

EBITDA breakdown by product/service



Inner circle: H1 2019; outer circle: H1 2020.
Source: ChelPipe

Detailed credit considerations

Balanced product mix and integration in billet production support a strong market position and low costs

ChelPipe is one of the largest producers of steel pipes globally, with an output volume of 1.8 million tonnes for the 12 months that ended 30 June 2020. The company's two core pipe manufacturing plants are located in Chelyabinsk and Pervouralsk in the Urals region of Russia, 250 kilometers apart from each other and in relative proximity to feedstock suppliers and the oil-rich Western Siberia and Volga regions, where its key customers operate. The Chelyabinsk plant specialises mainly in single-seam welded LDP, while the Pervouralsk plant produces steel billets from scrap via the electric arc furnace route and manufactures seamless OCTG and industrial pipes for the machinery, energy, petrochemical, construction and other sectors.

In H1 2020, ChelPipe shipped 254 thousand tonnes of industrial seamless pipes, 220 thousand tonnes of OCTG, 180 thousand tonnes of LDP and 87 thousand tonnes of other products. The company estimates that in H1 2020, OCTG generated 28% of ChelPipe's revenue, LDP sales generated 17%, industrial and other seamless pipes generated 35%. The remaining 20% of revenue comprised of oilfield services and sales of trunk pipeline systems. ChelPipe holds a solid share in all key domestic market segments; in H1 2020, the company estimates that it held market shares of 47% in seamless industrial pipes, 22% in the LDP segment and 17% in the OCTG segment.

In H1 2020, 73% of ChelPipe's pipe shipments were seamless pipes and 27% were welded pipes (mostly LDP). Seamless pipes are generally a higher-margin product for the company, contributing around 80% of its EBITDA. The profitability of ChelPipe's seamless pipe manufacturing is supported by its integration in production of billets. We estimate that ChelPipe needs up to 1.5 million tonnes of billets per year, assuming full utilisation of its seamless pipe capacity. The electric arc furnace at Pervouralsk facility has an annual capacity of around 1.25 million tonnes of billets, which implied an 89% self-sufficiency in H1 2020. ChelPipe also owns a scrap collection and processing network with more than 100% self-sufficiency in steel scrap (the volume that is not used in its own billet production is sold to third parties). This ensures smooth and low-cost steelmaking operations amid the shortage and volatile prices

of scrap domestically. The company estimates that its integration in scrap collection and billet manufacturing saves RUB10,000-RUB12,000 of operating costs per tonne of produced pipes.

The company also benefits from its proximity to its main suppliers of steel plate used for manufacturing of welded LDP, [Magnitogorsk Iron & Steel Works](#) (Baa2 stable) and Ural Steel, a plant owned by [JSC Holding Company METALLOINVEST](#) (Ba1 stable), which contributes to cost savings on plate transportation costs of up to RUB1,500 per tonne of pipes. ChelPipe's profitability is further supported by its operational efficiency programme launched in 2015. In 2020, the company expects to generate a positive effect of RUB3.5 billion, mostly because of production efficiency, staff optimisation, transportation cost reduction and implementation of smart equipment.

Significant exposure to the Russian oil and gas sector mitigated by a strong position in the industrial pipe segment

ChelPipe sells its products mainly in Russia, with exports accounting for only 14% of the company's consolidated revenue in H1 2020. The lack of geographical diversification of ChelPipe's sales is mitigated by higher profitability of domestic sales than export deliveries; low import threat because of the weak rouble, high transportation costs for imported pipes, trade barriers imposed against pipe imports from China and Ukraine, and established relations among the largest pipe producers and the Russian oil and gas majors; and the fact that some of the company's contracts with domestic customers are formula based, with an adjustment for currency exchange-rate fluctuations, which renders a substantial share of its revenue effectively pegged to foreign currency.

In H1 2020, over 50% of ChelPipe's revenue was generated from OCTG and LDP sales, as well as from oilfield services provided to Russian oil and gas companies. For the same period, the company's three largest customers accounted for around 32% of its total revenue, up from 27% in H1 2019.

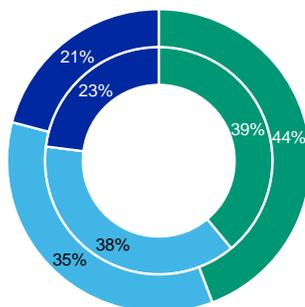
Exhibit 5

ChelPipe has a significant exposure to Russian oil and gas industry,

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Pipe segment's revenue breakdown by industry

■ Industrial and other seamless pipes ■ Oil segment ■ Gas segment



Inner circle: H1 2019; outer circle: H1 2020.

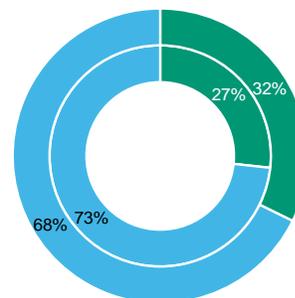
Source: ChelPipe

Exhibit 6

...which results in relatively high customer concentration

Revenue breakdown by customer

■ 3 largest customers ■ Other customer



Inner circle: H1 2019; outer circle: H1 2020.

Source: ChelPipe

The OCTG market in Russia demonstrated growth in 2015-19, driven by a rise in drilling activity. The continuing growth in the share of more complex and expensive horizontal drilling to 53% in 2019 from 30% in 2014 also supported strong demand for OCTG. However, in H1 2020, Russian oil companies trimmed drilling programmes on low oil prices and OPEC+ production cuts. As a result, production drilling in Russia in 2020-21, in terms of meters, will likely contract by around 10% from the 2019 level, leading to lower demand in the OCTG segment. In H1 2020, Chelpipe's OCTG shipments went down by 11%. Despite a challenging macroeconomic environment, demand for OCTG could be supported by the continued development of large-scale greenfield projects by the Russian oil majors, while declining well-flow rates at brownfield sites will require an increase in drilling reinforced by the continued growth in the share of horizontal drilling. In addition, the OCTG segment is to some extent protected from imports because of continuing import substitution.

ChelPipe currently lacks drilling pipe offerings and is less advanced than the Russian OCTG market leader, [PAO TMK](#) (TMK, B1 positive), in the high-tech segment of premium connections. However, the company recognises that premium products are becoming increasingly important for an OCTG producer because oil companies need to expand horizontal drilling and activities in offshore and

other complicated deposits, which require a technological edge because traditional deposits are gradually depleting. ChelPipe intends to develop its premium product and drilling pipe offerings, and technological solutions to improve its competitive position in OCTG. In particular, the company doubled its shipments of OCTG with premium connections in 2019 from that in 2016.

While demand for OCTG and industrial pipes is broadly stable and ChelPipe's seamless pipe capacity of 1.2 million tonnes per year is currently fully utilised, its shipment volumes and capacity utilisation also depend on the volume of LDP orders. The domestic LDP market is driven primarily by pipeline projects and maintenance needs of [Gazprom, PJSC](#) (Baa2 stable) and [Transneft, PJSC](#) (Baa2 stable), which represent 70%-85% of the market, with most of the demand being project based. The completion of these companies' large-scale projects resulted in domestic LDP demand declining to 2.1 million tonnes in 2019 from a peak of 3.4 million tonnes in 2015, according to the Fund for the Development of Pipe Industry. The Russian LDP market was further disrupted by the commissioning of ZTZ in 2016, which diverted around 0.5 million tonnes per year of LDP volume (primarily Gazprom's procurements) from existing producers, drove capacity utilisation below 50% and intensified price competition.

Domestic demand for LDP will remain volatile and dependent on the timing of a limited number of projects that may be subject to geopolitical considerations. We expect domestic LDP demand to be mainly driven by the ongoing pipeline maintenance programme of Gazprom and Transneft. ChelPipe is increasing its participation in foreign pipeline projects, including the North-South gas pipeline in Pakistan, the TAPI gas pipeline in Turkmenistan and BSGI gas pipeline from the Barents Sea. This could reduce the company's exposure to the volatility in the domestic LDP market.

ChelPipe's exposure to the OCTG sector is mitigated by the company's strong position in high-margin industrial pipes, which are used by a variety of sectors other than the oil and gas sector, including machinery, construction, chemicals, utilities and energy. Sales of industrial and other seamless pipes generated 44% of the company's pipe segment revenue in H1 2020, while the customer concentration is much lower than that in its oil and gas sector sales.

Leverage will improve in 2021 after weaker 2020 results, supported by EBITDA growth

We expect ChelPipe's revenue to decline towards RUB140 billion in 2020 from RUB178 billion in the 12 months that ended 30 June 2020 and RUB192 billion in 2019 on lower prices and volumes across all major product categories. The company's EBITDA margin will likely be 18%-19% in 2020, marginally down from the 19% as of 30 June 2020, but up from 18% in 2019 and 16% in 2018 because of ChelPipe's focus on high-margin products and the implementation of its operational efficiency programme. As a result, the company's Moody's-adjusted EBITDA for 2020 will decline to RUB26 billion from RUB34 billion in the 12 months that ended 30 June 2020 and RUB35 billion in 2019.

ChelPipe's margin is largely driven by prices of feedstock, such as steel plates and billets, and the company's ability to pass these costs through to customers. These two factors — a potential growth in steel prices and lagging growth in selling prices for pipes — could limit the company's EBITDA margin. At the same time, the company's key customers and suppliers have high bargaining power, which could limit the potential for its profitability growth.

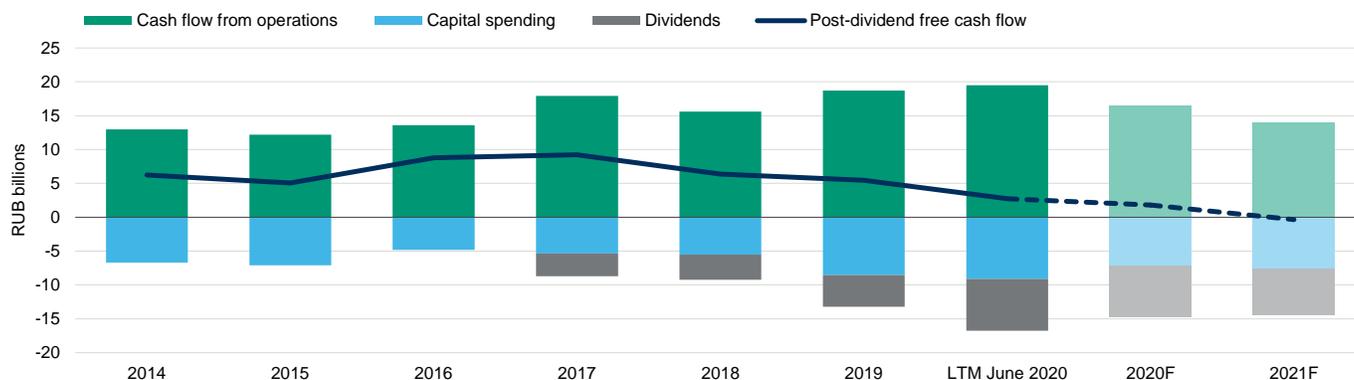
As a result of the EBITDA decline in 2020, we expect ChelPipe's Moody's-adjusted debt/EBITDA to rise above 3.0x by year-end 2020 from 2.9x as of 30 June 2020 and 2.5x as of 31 December 2019. We do expect the company to reduce its leverage towards 2.7x in 2021 on the back of EBITDA growth mainly driven by higher sales volumes. Significant deleveraging could be deterred by increasing capital spending beyond 2021 and elevated dividend payouts. Growth in capital spending will be primarily driven by strategic investments in seamless pipe facilities to enhance product mix, such as starting the production of drilling and stainless pipes. ChelPipe does not intend to invest in any capacity expansion projects, and its investment strategy is aimed at increasing margins via the production of more complex and niche products while keeping volumes broadly flat.

Working capital changes are another risk for ChelPipe's deleveraging. In H1 2020, ChelPipe's net working capital outflow amounted to RUB8.5 billion, mainly driven by a decrease in accounts payable. Although we expect a reversal of this trend in H2 2020, the company remains exposed to significant working capital fluctuations.

Following the refinancing of its syndicated loans in early 2017, ChelPipe is no longer subject to restrictions on dividend payouts, which enabled the company to pay dividends of RUB3.3 billion in 2017, RUB3.7 billion in 2018, RUB4.7 billion in 2019 and RUB7.7 billion in the 12 months that ended 30 June 2020. In February 2020, ChelPipe's board of directors approved the company's dividend policy,

aimed at increasing shareholder value and boosting shareholder returns. Previously, the company did not have a formal dividend policy and dividends were paid at the discretion of the board of directors. The dividend policy will improve the transparency and predictability of cash outflows, but will also delay deleveraging because it assumes the distribution of at least 100% of pre-dividend free cash flow or at least 70% of IFRS net income, whichever is higher, based on the company's current net leverage. We expect the company to pay dividends of RUB7 billion-RUB7.5 billion in 2020-21. We expect the company's future dividend payouts, coupled with elevated capital spending, to keep its post-dividend free cash flow, which has been consistently positive over the last several years, at around zero.

Exhibit 7

ChelPipe's free cash flow will be around zero in 2020-21

Sources: Moody's Financial Metrics™ and Moody's Investors Service estimates

Environmental, social and governance considerations

Environmental considerations

Steel is among the 11 sectors with an elevated credit exposure to environmental risk, based on our [environmental risk heat map](#). The global steel sector continues to face pressure to reduce CO₂ and air pollutant emissions and will likely incur costs to further reduce these emissions, which could weigh on its profitability. Additionally, the move to lighter-weight materials could lead to lower intensity of steel usage.

ChelPipe has a fairly low exposure to environmental risk, because the company's principal operations include rolling and welding steel pipes, which have a significantly lower environmental impact than steelmaking. Although ChelPipe is integrated into steelmaking, it produces steel via the electric arc furnace route, which has a much lower carbon footprint than the alternative blast furnace/basic oxygen furnace route. In H1 2020, ChelPipe invested RUB246 million in environmental projects (2019: RUB598 million).

Since 2018, the Russian government has increased its focus on environment, with a national project on ecology serving as a framework document. Part of this project, related to reducing atmospheric emissions of pollutants (the Clean Air project), focuses on improving air quality in 12 industrial cities, including Chelyabinsk, where ChelPipe's core facilities are located. More broadly, companies operating in highly polluting industries, such as steelmaking, are now required to develop road maps on reducing pollution levels to those consistent with "best available technologies". Although ChelPipe has a sizeable pipeline of environmental projects, we do not expect the company's environmental investments to have a significant impact on its financial metrics.

Governance considerations

Governance risks are an important consideration for all debt issuers and are relevant to bondholders because governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit a company's credit profile.

Similarly to its domestic peers, ChelPipe has a concentrated ownership structure, with 97.2% of the company's shares owned by Andrey Komarov and Pavel Fedorov. The risk of concentrated ownership is mitigated by the track record of a conservative financial policy, with the company's net leverage, measured by Moody's-adjusted net debt/EBITDA, not exceeding 3.0x since 2015, as well as through the oversight of independent directors, which make up three out of seven seats on the board of directors. In 2019-20, the company also developed a code of business ethics, while the company's board of directors approved a suit of documents covering corporate

governance issues, including regulations on the corporate governance committee of the board of directors, policy on the integrated management system, anti-abuse, anti-fraud and anti-corruption policy.

In February 2020, ChelPipe announced its dividend policy, based on the company's net leverage. The dividend policy will improve the transparency and predictability of cash outflow, but is likely to lead to higher shareholder distributions.

In August 2020, the company was assigned ISS ESG Corporate Rating D+, including Corporate Governance and Business Ethics Rating (C+, transparency level – Very High).

Liquidity analysis

As of 30 June 2020, ChelPipe had good liquidity. The company's cash balance of RUB25.5 billion, available long-term committed credit facilities of RUB19 billion and operating cash flow of around RUB15 billion, which we expect the company to generate over the following 12 months, will be sufficient to cover its short-term debt maturities of RUB28.4 billion and capital spending of RUB7 billion-RUB7.5 billion over the same period, as well as dividends of RUB7 billion-RUB7.5 billion.

Methodology and scorecard

Exhibit 8

Chelyabinsk Pipe Plant PJSC

Steel Industry Scorecard [1][2]	Current LTM 6/30/2020		Moody's 12-18 Month Forward View As of September 2020 [3]	
	Measure	Score	Measure	Score
Factor 1 : Scale (20%)				
a) Revenue (USD Billion)	\$2.7	B	\$2 - \$2.4	B
Factor 2 : Business Profile (20%)				
a) Business Profile	Ba	Ba	Ba	Ba
Factor 3 : Profitability (15%)				
a) EBIT Margin	14.7%	A	12.8% - 13.6%	A
b) Return on Tangible Assets (EBIT / Tangible Assets)	19.2%	Aa	13.8% - 18.5%	Aa
Factor 4 : Leverage and Coverage (35%)				
a) Debt / EBITDA	2.9x	Baa	2.7x - 3.3x	Baa
b) Debt / Book Capitalisation	91.9%	Ca	91.2% - 95.1%	Ca
c) (CFO - Dividends) / Debt	11.9%	B	8.2% - 10.5%	Caa
d) EBIT / Interest Expense	3.0x	Ba	2.2x - 3.4x	Ba
Factor 5 : Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Scorecard-Indicated Outcome		Ba2		Ba2
b) Actual Rating Assigned				Ba3

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

[2] As of 30/06/2020 (LTM).

[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

Source: Moody's Financial Metrics™

Ratings

Exhibit 9

Category	Moody's Rating
CHELYABINSK PIPE PLANT PJSC	
Outlook	Stable
Corporate Family Rating	Ba3
CHELPIPE FINANCE DAC	
Outlook	Stable
Bkd Senior Unsecured	Ba3/LGD4

Source: Moody's Investors Service

Appendix

Exhibit 10

Peer comparison

Chelyabinsk Pipe Plant PJSC

(in US millions)	Chelyabinsk Pipe Plant PJSC Ba3 Stable			PAO TMK B1 Positive			EVRAZ plc Ba1 Stable		
	FYE Dec-18	FYE Dec-19	LTM Jun-20	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-18	FYE Dec-19	LTM Jun-20
Revenue	\$2,860	\$2,972	\$2,679	\$4,394	\$5,108	\$4,767	\$12,836	\$11,905	\$10,748
EBITDA	\$452	\$538	\$518	\$661	\$706	\$611	\$3,774	\$2,583	\$2,174
Total Debt	\$1,303	\$1,424	\$1,399	\$3,654	\$3,199	\$3,348	\$4,787	\$5,108	\$5,277
EBIT Margin	11.9%	14.0%	14.7%	8.4%	8.2%	8.6%	25.2%	16.8%	14.6%
EBIT/Avg. Tang. Assets	15.5%	19.9%	19.2%	7.5%	7.8%	7.8%	36.9%	23.1%	18.4%
EBIT / Int. Exp.	2.3x	2.8x	3.0x	1.3x	1.7x	1.8x	9.0x	6.4x	5.0x
DEBT / EBITDA	3.2x	2.5x	2.9x	5.4x	5.0x	5.3x	1.3x	2.0x	2.4x
Total Debt/Capital	94.8%	92.6%	91.9%	77.7%	79.0%	79.4%	68.6%	69.1%	79.1%
(CFO - Dividends) / Debt	13.1%	15.8%	11.9%	1.3%	7.9%	10.4%	16.4%	21.1%	13.0%

All figures and ratios calculated using Moody's estimates and standard adjustments. FYE = Financial year-end. LTM = Last 12 months.

Source: Moody's Financial Metrics™

Exhibit 11

Moody's-adjusted debt breakdown

Chelyabinsk Pipe Plant PJSC

(in RUB millions)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	LTM Ending Jun-20
As Reported Debt	94,104	91,056	86,356	89,975	88,172	99,454
Pensions	302	313	306	216	254	254
Operating Leases	552	609	102	93	0	0
Non-Standard Adjustments	0	0	0	143	0	0
Moody's-Adjusted Debt	94,958	91,978	86,764	90,427	88,426	99,708

All figures are calculated using Moody's estimates and standard adjustments.

Source: Moody's Financial Metrics™

Exhibit 12

Moody's-adjusted EBITDA breakdown

Chelyabinsk Pipe Plant PJSC

(in RUB millions)	FYE Dec-15	FYE Dec-16	FYE Dec-17	FYE Dec-18	FYE Dec-19	LTM Ending Jun-20
As Reported EBITDA	28,817	29,796	23,281	27,811	32,286	30,999
Operating Leases	184	203	34	31	0	0
Unusual	865	-1,159	864	398	2,544	3,468
Non-Standard Adjustments	-7	-6	-7	-4	-6	-2
Moody's-Adjusted EBITDA	29,859	28,834	24,172	28,236	34,824	34,465

All figures are calculated using Moody's estimates and standard adjustments.

Source: Moody's Financial Metrics™

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