

Rating Action: Moody's takes rating actions on six Russian utility and infrastructure companies

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Actions follow the action on Russia's government bond rating

London, 21 October 2014 -- Moody's Investors Service has today downgraded the issuer ratings of Russian utility companies OAO AK Transneft (Transneft) and JSC Atomenergoprom (Atomenergoprom) to Baa2 from Baa1, and to Baa3 from Baa2, respectively. The agency also downgraded the senior unsecured rating of the outstanding \$1.05 billion loan participation notes issued by TransCapitalInvest Limited, Transneft's special purpose vehicle (SPV), to Baa2 from Baa1. The outlooks remain negative.

Concurrently, Moody's has changed the outlooks to negative from stable and affirmed the corporate family ratings (CFR) and probability of default ratings (PDR) of JSC RusHydro (RusHydro), JSC Inter RAO (Inter RAO) and JSC ROSSETI (Rosseti) at Ba1 CFR and Ba1-PD PDR, and RusHydro's senior unsecured rating of its RUB20 billion (around \$500 million) loan participation notes at Ba1.

Moody's has also affirmed JSC FGC UES' (FGC UES) Baa3 issuer rating, the (P)Baa3 senior unsecured rating of its RUB100 billion (around \$2.5 billion) loan participation note programme, and the Baa3 rating of the first series of RUB17.5 billion (around \$430 million) worth of notes issued by Federal Grid Finance Limited, an SPV of FGC UES. The outlooks remain negative.

These actions follow the weakening of Russia's credit profile, as reflected by Moody's downgrade of Russia's government bond rating to Baa2 from Baa1 on October 17th 2014. For additional information, please refer to the related announcement: Moody's Downgrades Russia's Ratings to Baa2; Outlook Negative: https://www.moody.com/research/--PR_310632.

RATINGS RATIONALE

- DOWNGRADES

The downgrades of Transneft's and Atomenergoprom's issuer ratings, as well as the downgrade of the senior unsecured rating of TransCapitalInvest Limited's outstanding \$1.05 billion loan participation notes, reflect their strong linkages with the Russian sovereign and their high sensitivity to changes in sovereign creditworthiness. Transneft and Atomenergoprom are strategically important to the Russian economy and enjoy high state support. Atomenergoprom's rating contains a significant uplift to the company's creditworthiness due to the high probability of the state support in case of financial distress. Transneft's standalone creditworthiness is high and does not rely on any significant rating uplift driven by state support. At the same time, in Moody's view, default dependence between the companies and the government ranges from high for Transneft to very high for Atomenergoprom which benefits from government's funding. Overall, Transneft's and Atomenergoprom's ratings are closely aligned with that of the government, with their creditworthiness affected by a weakening of the sovereign creditworthiness reflected in the recent downgrade of the sovereign rating.

- OUTLOOK CHANGES TO NEGATIVE FROM STABLE

The changed outlooks to negative from stable on the CFR and PDR ratings of RusHydro, Inter RAO, Rosseti, and the senior unsecured rating of RusHydro's RUB20 billion (around \$500 million) loan participation notes, signal the companies' links with the Russian sovereign, which could exert downward pressure on the ratings in the case of a further sovereign downgrade.

- AFFIRMATIONS

The affirmations of the CFR and PDR ratings of Inter RAO, Rosseti, RusHydro, as well as of the senior unsecured rating of RusHydro's loan participation notes, FGC UES' issuer rating, FGC UES' RUB100 billion loan participation notes and the first series of notes issued by its SPV Federal Grid Finance Limited reflect Moody's view that the strong probability of state support assumption embedded within the companies' ratings remains in place given that the Russian government's credit strength remains sufficient. The negative outlooks on the ratings reflect their high

dependence on the Russian sovereign and mirror that of Russia's government bond rating.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Upward pressure on all of the aforementioned ratings is unlikely at present, given the negative outlooks on the ratings. Moody's could change the outlook on the ratings to stable if it were to change the outlook on Russia's government bond rating to stable, provided there is no material deterioration in company-specific factors, including operating and financial performance and liquidity.

Moody's could downgrade some or all of the ratings (1) following the downgrade of the Russian government rating; or (2) if the rating agency sees a lower likelihood of the Russian government providing extraordinary support to the companies in the event of financial distress. Moody's notes that a one-notch downgrade of Russia's Baa2 government bond rating, together with continued robust support assumptions for the Ba1 ratings of Inter RAO, Rosseti and RusHydro, would not necessarily result in a downgrade of these ratings.

In addition, downward pressure on individual companies' ratings could develop for the following reasons:

Moody's could lower Transneft's ratings if the company is unable to implement its investment programme without bringing about a permanent and material deterioration in its financial metrics (i.e., retained cash flow (RCF)/net debt below 15%; FFO net interest coverage below 4.0x; FFO/net debt below 25%) and pressure on liquidity.

Negative pressure on Atomenergoprom's ratings could develop if the company's financial profile deteriorates, reflected in a debt/EBITDA ratio above 3x, FFO interest coverage below 5.0x and RCF/debt below 25% materially on a continued basis (all ratios include our adjustments). In addition, the lack of adequate liquidity could put pressure on its ratings, and downward pressure could also develop if the company's key subsidiaries see their share of external debt materially exceeding 20% of total debt on a permanent basis.

Negative pressure on FGC UES's ratings could result from (1) a sustained negative shift in the developing regulatory regime and significantly deteriorating margins; (2) the company proving unable to manage its investment programme in line with the tariff regulation, as well as to contain a deterioration of its financial profile, with funds from operations (FFO) interest coverage and FFO/net debt falling materially and persistently below 3.5x and 25%, respectively; (3) pressured liquidity.

Downward pressure on Inter RAO's rating could develop if there were a negative shift in the evolving regulatory and market framework and the company failed to limit a deterioration of its financial profile, reflected in FFO interest coverage below 5.0x, RCF/debt below 30% and debt/EBITDA above 3x significantly and on a permanent basis. Furthermore, negative pressure could be exerted on the rating if the company were unable to proactively address its liquidity needs and maintain reasonable headroom under the financial covenants of its bank agreements.

Negative pressure on Rosseti's rating could result from (1) signs of weakening support from the government; (2) a negative shift in the developing regulatory regime without compensatory measures by the state, leading to significantly deteriorating margins; (3) pressured liquidity; (4) a failure of Rosseti to manage its investment programme in line with the tariff regulation and contain deterioration of its financial profiles, with FFO interest coverage and FFO/net debt falling materially and persistently below 3.0x and 20% respectively.

Downward pressure on RusHydro's rating could develop if there were a negative shift in the evolving regulatory and market framework and the company failed to limit a deterioration of its financial profile, reflected in a debt-to-EBITDA ratio above 3x and FFO interest coverage below 5.0x significantly (i.e. by 10%-15%, and on a permanent basis). The company's inability to maintain adequate liquidity could also pressure the rating.

PRINCIPAL METHODOLOGIES

The principal methodologies used in rating Rosseti, Transneft, FGC UES were Regulated Electric and Gas Networks Methodology published in August 2009, and the Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moody's.com for a copy of these methodologies.

The principal methodologies used in rating Atomenergoprom and Inter RAO were Unregulated Utilities and Power Companies Methodology published in August 2009, and the Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moody's.com for a copy of these methodologies.

The principal methodologies used in rating RusHydro were Unregulated Utilities and Power Companies Methodology published in August 2009, Loss Given Default for Speculative-Grade Non-Financial Companies in the U.S., Canada and EMEA published in June 2009 and the Government-Related Issuers: Methodology Update published in July 2010. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

COMPANY PROFILES

Fully controlled by the Russian government (the latter owns 100% of its voting shares), Transneft is the de-facto monopoly oil pipeline business in Russia, with 2013 reported sales of around RUB596.8 billion, or \$18.7 billion (net of revenues from crude oil supplies to China, which are mirrored by oil purchase costs).

Atomenergoprom and its subsidiaries represent the civil Russian nuclear industry, which covers the whole nuclear cycle from uranium mining and enrichment to nuclear fuel production, production of electricity at nuclear power plants and construction of nuclear power units/plants both in Russia and abroad. Atomenergoprom's consolidated revenue was RUB436.1 billion (around \$13.6 billion) in 2013. The company is 100%-owned by the Russian government through the State Atomic Energy Corporation Rosatom.

FGC UES is the monopoly electricity transmission system operator in the Russian Federation. The company's revenues amounted to RUB158.0 billion (around \$4.9 billion) in 2013 (other operating income of RUB6.2 billion, primarily from non-core activities, is not included). FGC UES is 80.13%-owned by Rosseti.

Inter RAO is a Russian major electric utility engaged in thermal electricity generation and retail electricity sales in Russia, cross-border electricity trading and electric utility operations abroad. Inter RAO's IFRS revenue was RUB662.3 billion (around \$21 billion) in 2013. Inter RAO is controlled by the Russian government, which owns 51.1% of the company through state-controlled entities.

Headquartered in the city of Moscow, Rosseti is the holding company for FGC UES and 15 distribution grid subsidiaries. The Russian government owns a 85.31% stake in the company. Rosseti's 2013 consolidated revenue was RUB759.8 billion (around \$24 billion).

RusHydro is Russia's largest hydropower business, accounting for around half of hydropower output in Russia, and is majority-owned (66.84% at mid-2014) by the Russian government. RusHydro's IFRS revenue was RUB313.6 billion (around \$10 billion) in 2013.

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