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INVESTORS SERVICE

Rating Action: Moody's changes outlook on Russian Grids' Ba1 ratings to stable, affirms ratings

Global Credit Research - 07 Feb 2014

Affirms ratings of six subsidiaries, stable outlook

London, 07 February 2014 -- Moody's Investors Service has today changed to stable from developing the outlook on Russian Grids, JSC's ratings. Concurrently, Moody's has affirmed the Ba1 corporate family rating (CFR) and the Ba1-PD probability of default rating (PDR) of Russian Grids, as well as the ratings of six Russian Grids' subsidiaries. The six subsidiaries are: FGC UES, JSC (Baa3 issuer rating), which operates the Russian national transmission grid; and IDGC of Center and Volga Region, JSC, IDGC of Urals, JSC, IDGC of Volga, JSC, Lenenergo, JSC and MOESK, OJSC (all Ba2 CFR), which operate distribution grids. The outlook on the ratings is stable.

A detailed list of the rating actions can be found at the end of this press release.

Today's announcement follows Moody's consideration of (1) the reorganization of the major part of the Russian grid sector under management of Russian Grids which was fully completed in September 2013 and, more importantly; (2) the potential impact on the rated companies' credit quality of the Russian government's decisions to freeze grid tariffs for 2014 and cap the tariff growth at the level of inflation of the previous year in 2015-16.

RATINGS RATIONALE

--CHANGE OF OUTLOOK ON RUSSIAN GRIDS' RATINGS TO STABLE FROM DEVELOPING--

In stabilizing the outlook on Russian Grids, Moody's recognizes the holding company's strengthened links to the Russian government and enhanced role as manager of the Russian grid sector following the take-over of control over FGC UES's national transmission business from the government. The stable outlook also factors in Moody's expectation that the pressure on Russian Grids' subsidiaries and consolidated profile from the government's tariff freeze decision made in September 2013 will likely be mitigated by a reduction in capex programmes for the majority of the company's subsidiaries. As a result, Moody's expects Russian Grids to be able to limit deterioration of its consolidated financial profile over the next 12-18 months to within the current rating category, with funds from operations (FFO)/interest coverage ratio and FFO/net debt ratio likely to remain above 3.0x and 20%, respectively. Regulatory pressure and uncertainty in the context of weakening economic conditions remain currently the key rating constraints. In this environment, Moody's positively considers Russian Grids' ongoing negotiations with the Russian government to access government's long-term funding to support its subsidiaries' investment needs.

Under the rating methodology for government-related issuers (GRIs), Russian Grids' Ba1 CFR incorporates a two-notch uplift to the company's baseline credit assessment (BCA) -- a measure of its standalone credit quality -- of ba3, given Moody's current assessment of "high" default dependence between the company and the Russian government and "strong" probability of extraordinary state support for the company in a distress situation. The CFR also incorporates the Baa1 local-currency rating of the Russian government.

--RATINGS OF RUSSIAN GRIDS' SIX OPERATING SUBSIDIARIES AFFIRMED--

Similarly to the affirmation of Russian Grids' rating, the affirmation of the ratings with stable outlooks of its six operating subsidiaries, FGC UES and five rated distribution grid subsidiaries, factors in Moody's expectation that the government will allow the subsidiaries to maintain a degree of linkage between tariffs and investment programmes. The rating agency's expectation also takes into account compensatory measures introduced for distribution grids exposed to revenue losses following the cancellation of the so-called 'last-mile' agreements.

Moody's notes that tariff decisions under the new tariff freeze guidance have been taken for five rated distribution grids. However, tariff decisions for FGC UES have yet to be made. Investment programmes for all grids are under review and expected to be finally approved by April 2014. Moody's positively considers that all the rated subsidiaries, except Lenenergo, are discussing a reduction of investment programmes with the government to avoid a material deterioration in their financial profiles. However, the actual reductions and their impact on the companies' financial profiles are yet to be known and assessed.

Lenenergo may even increase investments compared to its previous plan. However, the company should benefit from exceptional tariff decisions made by the regulators, factoring in the strategic importance of these investments to the regional economy.

Overall, while a linkage between tariffs and investment decisions is an important mitigant of the low predictability of domestic grid regulation, the linkage cannot offset the risk of government-initiated new tariff revisions in weakening economic conditions. The evolving regulation remains a key risk and a key component in determining the ratings of Russian Grids and its subsidiaries, largely suppressing differences in rated businesses' credit profiles. As a result, the standalone credit quality of rated grids remains concentrated in the Ba category. However, MOESK, which services the Russian wealthiest Moscow area, is distinguished for its relatively strong financial profile compared to other rated distribution grid subsidiaries.

All of the rated distribution grids are not categorized as GRIs under Moody's methodology. However, their Ba2 CFRs incorporate one notch of uplift to their standalone credit quality, which is seen by Moody's as being comparable to Ba3, as a result of state support, which is available through Russian Grids.

FGC UES's Baa3 ratings continue to factor in its stronger standalone credit quality in comparison with the distribution grids, strategic importance for the whole country, closer links with the state and strong state support under Moody's GRI methodology.

WHAT COULD CHANGE THE RATING UP/DOWN

Positive momentum for Russian Grids' and its subsidiaries' ratings could emerge if, in Moody's view, there were better visibility on the mid- to long-term evolution of the subsidiaries' and group's financial profiles against the backdrop of the evolving regulatory environment and weak economic conditions. In Moody's view, the approval of the companies' investment programmes and of additional government's funding for the group or specific grids later this year could add clarity if these positive developments were not offset by a further weakening of the domestic economy.

Moody's could downgrade the ratings if negative pressure is exerted on the Russian sovereign rating. Negative pressure on the ratings could also 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 the companies to manage their investment programmes in line with the tariff regulation and contain deterioration of their financial profiles, with FFO interest coverage and FFO/net debt falling materially and persistently below 3.0x and 20%, respectively, for Russian Grids; below 3.5x and 25% for FGC UES; below 3.0x and mid-teens for Lenenergo and MOESK; below 3.5x and 20% for IDGC of Center and Volga Region, IDGC of Urals, IDGC of Volga.

LIST OF RATING ACTIONS

Russian Grids, JSC

Ba1 CFR and Ba1-PD PDR affirmed

Outlook changed to stable from developing

FGC UES, JSC

Baa3 issuer rating affirmed

Stable outlook maintained

Federal Grid Finance Limited

(P)Baa3 senior unsecured rating of a RUB100 billion loan participation notes (LPN) programme affirmed

Baa3 senior unsecured rating of the first series of LPNs issued under the programme, affirmed

Stable outlook maintained

IDGC of Center and Volga Region, JSC

Ba2 CFR and Ba2-PD PDR affirmed

Stable outlook maintained

IDGC of Urals, JSC

Ba2 CFR and Ba2-PD PDR affirmed

Stable outlook maintained

IDGC of Volga, JSC

Ba2 CFR and Ba2-PD PDR affirmed

Stable outlook maintained

Lenenergo, JSC

Ba2 CFR and Ba2-PD PDR affirmed

Stable outlook maintained

MOESK, OJSC

Ba2 CFR and Ba2-PD PDR affirmed

Stable outlook maintained

PRINCIPAL METHODOLOGIES

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

The principal methodology used in rating IDGC of Center and Volga Region, JSC, IDGC of Urals, JSC, IDGC of Volga, JSC, Lenenergo, JSC and MOESK, OJSC was Regulated Electric and Gas Networks published in August 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Headquartered in the city of Moscow, Russian Grids is the holding company for FGC UES and 14 interregional and regional distribution grid subsidiaries. The Russian government owns a 85.31% stake in Russian Grids. Russian Grids' operating grid subsidiaries are regulated natural monopolies, whose electricity transportation revenues accounted for around 80.8% of the group's 6M 2013 consolidated revenue of RUB348.8 billion (\$11.4 billion), with FGC UES assumed to be consolidated from the beginning of 2013.

Headquartered in Moscow, Russia, FGC UES is the monopoly electricity transmission system operator in the Russian Federation. The company's revenues amounted to RUB140.3 billion (around \$4.5 billion) in 2012 (other operating income of RUB3.5 billion, primarily from non-core activities, is not included). FGC is 80.6% owned by Russian Grids.

Headquartered in the city of Nizhniy Novgorod, Russia, IDGC of Center and Volga Region is an interregional electricity distribution grid business, focused on nine regions in the European part of Russia. IDGC of Center and Volga Region's 2012 total revenues were RUB58.4 billion (around \$1.9 billion). Russian Grids holds 50.4% of the company's voting shares.

Headquartered in the city of Yekaterinburg, Russia, IDGC of Urals is an interregional electricity distribution grid business, focused on three regions in the Urals: Yekaterinburg, Chelyabinsk and Perm regions. The company's 2012 total revenues were RUB59.4 billion (\$1.9 billion). Russian Grids holds 51.52% of the company's voting shares.

Headquartered in the city of Saratov, Russia, IDGC of Volga is an interregional electricity distribution company, focused on seven regions in the European part of Russia. IDGC of Volga's 2012 total revenues were RUB45.9 billion (\$1.5 billion). Russian Grids holds 67.63% of the company's voting shares.

Headquartered in the city of St. Petersburg, Lenenergo is one of Russia's major regional electricity distribution grid companies, focused on the St. Petersburg region. Lenenergo's 2012 total revenues were RUB38.1 billion (before normal technological losses), or \$1.2 billion. The largest shareholder of Lenenergo is Russian Grids, which directly

and indirectly holds 60.56% of Lenenergo's voting shares. A blocking stake of 26.57% of voting shares is owned by the government of the city of St. Petersburg (Baa1 stable).

Headquartered in the city of Moscow, MOESK is Russia's largest regional power distribution grid company servicing the Moscow region. MOESK's 2012 total revenues amounted to RUB125.3 billion (\$4.0 billion). The largest shareholders of MOESK are the state-controlled Russian Grids (50.9%); other major shareholders are entities associated with OJSC Gazprom (Baa1 stable); and the Moscow city government (Baa1 stable).

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Ekaterina Botvinova
Vice President - Senior Analyst
Infrastructure Finance Group
Moody's Investors Service Limited, Russian Branch
7th floor, Four Winds Plaza
21 1st Tverskaya-Yamskaya St.
Moscow 125047
Russia
Telephone: +7 495 228 6060
Facsimile: +7 495 228 6091

Monica Merli
MD - Infrastructure Finance
Infrastructure Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

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