

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).

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this rating action, and whose ratings may change as a result of this rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

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

© 2014 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATION") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS FOR RETAIL INVESTORS TO CONSIDER MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS IN MAKING ANY INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the

information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of

section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.