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ISSUER COMMENT
1 December 2016

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RATINGS

Bulgarian Energy Holding EAD	
Long-term corporate family rating	Ba1
Outlook	Stable

Source: Moody's

KEY METRICS:

Bulgarian Energy Holding EAD

	2015	2014	2013
FFO interest cover	6.6x	2.8x	7.8x
FFO/debt	20.9%	6.3%	19.1%
RCF/debt	20.9%	5.6%	12.3%

Source: Moody's Financial Metrics

Contacts

Velina Karadzhova 44-20-7772-5478
Analyst
velina.karadzhova@moodys.com

Andrew Blease 44-20-7772-5541
Associate Managing Director
andrew.blease@moodys.com

Bulgarian Energy Holding EAD

Government support for Belene settlement is credit positive, but choice of debt over equity limits financial flexibility

The approval of state support for Natsionalna Elektritseska Kompania EAD (NEK), a 100% subsidiary of Bulgarian Energy Holding EAD (BEH), for the settlement of the Belene arbitration court award is credit positive given the current weak liquidity position of the group. The action is neutral for BEH's Ba1 corporate family rating (CFR) and the Ba2 rating on its €550 million Eurobonds due 2021, as our ratings had assumed that this substantial government support would be forthcoming.

On 30 November, 2016 the Bulgarian government approved a €601.6 million payment as an additional state budget payment to be provided to NEK through its sole shareholder, the Ministry of Energy, by 9 December 2016. The payment, subject to state-aid approval from the European Commission, will be provided to NEK in the form of an interest-free 7-year unsecured shareholder loan. NEK will use the funds to fully settle the amounts due to Atomstroyexport (ASE) as compensation awarded to it by the International Arbitration Court in Geneva. After a recalculation and interpretation of the initial award decision requested by NEK, NEK and ASE agreed on corrections to the initially awarded amount, settling at €601.6 million including principal and accrued interest to 14 June 2016, the date of the initial award decision, which was accepted by the Court. On 26 October 2016, NEK and ASE signed a bilateral agreement under which ASE will forgo any interest accrued post 14 June in case of full settlement prior to 15 December 2016. After receipt of the state support, NEK is obliged to settle its obligation to ASE by 14 December 2016.

The provision of shareholder support for the full settlement amount is credit positive for BEH, given its weak financial profile and the lack of sufficient liquidity to cover an expenditure of this size without raising new debt funding. This is however rating neutral, as BEH's current Ba1 CFR incorporates three notches of rating uplift for extraordinary government support if such were needed in general and in particular for the Belene settlement.

The provision of the shareholder loan will however increase BEH's outstanding net debt for covenant calculation purposes by around 90%.

Exhibit 1

BEH's net reported debt will almost double as a result of the shareholder loan

All figures shown in BGN million

Column1	H1 2015	FY2015	H1 2016	H2 2016 movements	FY2016*
Reported EBITDA	264	676	289		c. 700**
Short term debt		231	1,203		
Long term debt		1,338	1,284		
Total debt as reported		**1,569**	**2,488**	**1,207**	**3,694**
Cash and cash equivalents		833	1,109	0	1,109
Net debt		**736**	**1,379**	**1,207**	**2,585**
Debt movements post June 2016					
Repayment of bridge to bond facility (€535 million)				(1,046)	
issuance of bonds due 2021 (€550 million)				1,076	
Government loan for Belene settlement (est. €602 million)				1,177	
Net increase in debt				**1,207**	

Note: * Debt balance is as estimated by Moody's and cash movements for 2016 second half are assumed to be nil; ** Moody's estimate for full year EBITDA, excluding post operating profit items

Source: Company's consolidated financial statements; Moody's calculations

This increase in debt will not impact Moody's calculated financial metrics. Given the shareholder loan is provided to NEK in order to overcome a restrained liquidity situation, as well as being interest free and longer-dated, Moody's will regard the amount as equity-like when calculating its standard adjusted financial ratios.

However, the loan is likely to be treated as indebtedness under existing financial covenants for BEH's outstanding Eurobonds of €500 million and €550 million due in 2018 and 2021 respectively. Based on Moody's estimates for an EBITDA of around BGN700 million for the 12 months ending 31 December 2016, additional debt of BGN1.2 billion will result in net debt to EBITDA of around 3.7x[1] as at December 2016 vs only 2x had the support been provided in the form of equity. The interest coverage covenant will remain unaffected as the loan is interest free.

Breach of these covenants does not constitute a default under BEH's bond documentation, but would constrain the company's ability to raise additional debt, as they must be met in order to raise such additional debt. The lower headroom under the covenants, and hence more restricted ability to raise additional debt could make BEH more reliant on shareholder support in the future.

Exhibit 2

Choice of debt over equity reduces headroom under existing debt incurrence covenants

All figures shown in BGN million

	Debt Support	Equity Support	Notes
Existing debt incurrance covenants*			
EBITDA to Interest Expense (coverage test)	**> 4x**	**> 4x**	
Net Debt to EBITDA (leverage test)	**< 4.5x**	**< 4.5x**	
Estimated gross debt	3,694	2,514	BGN2,000 million Eurobonds (€1,050 million) BGN1,180 million State support for Belene settlement (€602 million) BGN500 million other loans (mainly bank loans at operating subidiary level)
Estimated net debt	2,585	1,385	
Estimated interest expense	110	110	BGN2,000 million of Eurobonds at average interest rate of 4.5%; BGN500 million bank loans at average interest rate of 3%; BGN1,180 million State support - interest free
EBITDA**	700	700	Moody's estimate for full year 2016
Pro-forma EBITDA to Interest Expense	**6.4**	**6.4**	
Pro-forma Net Debt to EBITDA	**3.7**	**2.0**	
Minimum EBITDA to meet coverage test	438	438	
Minimum EBITDA to meet leverage test	575	308	

Note: *as defined in bond documentation; ** EBITDA excludes post operating profit items such as minority share earnings and hence differs from definition as per bond documentation

Source: Company's consolidated financial statements, Moody's calculations

BEH's Ba1 CFR continues to reflect (1) the group's dominant position within the electricity generation industry in Bulgaria, which is an exporter of power to the wider Balkan region; (2) its improving financial profile as a result of deficit reduction measures put in place in August 2015; and (3) its ownership of Bulgaria's main gas transit and transmission and electricity transmission assets. However, the rating is constrained by (1) the volatile earnings profile of the group which limits cash flow visibility; (2) the uncertainty with respect to full liberalisation of the wholesale power market in Bulgaria and its impact on BEH; (3) the relatively un-transparent nature of the regulation of the gas and electricity transmission assets and the bilateral gas transit contract and (4) weak liquidity management. The rating incorporates three notches of uplift to BEH's standalone credit quality, expressed as a baseline credit assessment (BCA) of b1, to reflect the high likelihood that the Government of Bulgaria, BEH's 100% owner, would step in with timely support to avoid a payment default of BEH if this became necessary.

Currently, there is limited upward rating potential in light of the uncertainties over the timing and nature of the full liberalisation of the wholesale electricity market and its impact on BEH. Downward rating pressure may develop if (1) we were to reassess the estimate of high support from the Government of Bulgaria; or (2) the Government's rating were to be lowered. For the existing b1 BCA, we would expect BEH to maintain FFO/debt of at least in the high teens in percentage terms. Downward pressure could be exerted on the BCA if (1) the positive regulatory changes implemented in 2015 were to be reversed as a result of market liberalisation or other reasons, and this were to cause further deficits incurred by BEH; and (2) changes in BEH's operating environment, including due to market liberalisation, led to a significant deterioration in its financial profile.

Bulgarian Energy Holding EAD is the incumbent 100% state owned electricity and gas utility in Bulgaria. It owns around 50% of the electricity generation facilities in the country, including the 2,000MW nuclear power plant, 2,713 MW of hydro plants, as well as a 1,620MW lignite plant, the input fuel for which is sourced at BEH-owned mining facilities Through its subsidiary NEK, it is the single trader on the regulated wholesale power market. It also owns and operates the high voltage electricity transmission grid (15,130 km) and the gas transmission and transit networks in Bulgaria (1,700km and 945km respectively), and is also the main regulated wholesale gas supplier. In 2015, BEH group generated BGN675 million of EBITDA.

Moody's Related Research

Credit Opinion

» Bulgarian Energy Holding EAD, August 2016 (1034898)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 EBITDA used in the calculation excludes post operating profit items, so differs from bond documentation. Definition of "Consolidated EBITDA" as per bond documentation: the aggregate of the amount of: (a) profit before tax; (b) finance costs; and (c) depreciation and amortisation.

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