MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns (P)Ba2 senior unsecured rating to Bulgarian Energy Holding EAD's proposed bond issuance; stable outlook

Global Credit Research - 15 Jul 2016

First-time bond rating

London, 15 July 2016 -- Moody's Investors Service (Moody's) has today assigned a provisional (P)Ba2 senior unsecured rating to Bulgarian Energy Holding EAD's (BEH) proposed bond issuance (Bonds), with a loss given default assessment of LGD5. At the same time Moody's has affirmed BEH's (P)Ba1 corporate family rating (CFR). The rating outlook is stable.

Moody's issues provisional ratings in advance of the final sale of securities and these ratings reflect Moody's preliminary credit opinion regarding the transaction only. Upon a conclusive review of the final documentation, Moody's will endeavour to assign a definitive rating to the Bonds. A definitive rating may differ from a provisional rating.

A CFR is an opinion of the BEH group's ability to honour its financial obligations and is assigned to BEH as if it had a single class of debt and a single consolidated legal structure.The (P)Ba2 senior unsecured rating is positioned one notch below the CFR, reflecting the structural subordination of the creditors at the holding company to those in the operating subsidiaries.

RATINGS RATIONALE

BEH's (P)Ba1 corporate family rating reflects (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 tariff deficit reduction measures put in place in August 2015 and expectation that these will continue to support the company's cash flows at least until the market becomes liberalised; 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 gas transit contracts; and (4) a weak liquidity management policy.

The rating incorporates three notches of uplift to BEH's standalone credit quality, expressed as a baseline credit assessment (BCA) of (P)b1, to reflect the high likelihood that the Government of Bulgaria (Baa2 stable), BEH's 100% owner, would step in with timely support to avoid a payment default of BEH if this became necessary. BEH's BCA is considered weakly positioned at the (P)b1 level.

BEH's strategy is to consolidate debt at the holding company level and after the proposed bond issuance this is expected to account for over 70% of total group debt. Holding company debt service is predominantly reliant on dividends being upstreamed, ensured through BEH's operating subsidiaries being required to distribute half of their net profits after certain allocations to retained earnings and reserves. Nevertheless, unsecured holding company creditors would be legally or structurally subordinated to claims of existing senior secured lenders and unsecured lenders/trade creditors of the subsidiaries.

Moody's cautions that BEH's liquidity is currently weak and is fully reliant on internal cash flow generation. The provisional rating is thus based on the assumption that the proposed bond issuance will substantially cover its short term debt maturities, mainly consisting of the EUR535 million bridge to bond facility due in April 2017. In this regard the successful issuance of the Bonds and the size of the issuance is key to the assigned rating as it will enable the company to remove near term refinancing risk and create financial flexibility to more comfortably accommodate potential cash flow volatility.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects the fact that, while BEH's standalone credit profile may be pressured over the short to medium term, the strategic role of the company in the Bulgarian energy sector and the oversight and support given by the Government would be supportive of BEH's overall financial status. Moody's notes the letter of support that the Bulgarian Government has provided to the holders of the Bonds as outlined in the Bonds prospectus.

The (P)b1 BCA of BEH could be downgraded if BEH were to make significant payments under a recent arbitration award without receiving compensating amounts that had the effect of materially weakening its financial profile. The International Court of Arbitration recently judged that Natsionalna Eletricheska Kompania (a BEH subsidiary) should be required to pay EUR550 million plus accruing interest to Atomstroyexport (ASE) with respect to nuclear equipment manufactured by the latter for the cancelled Belene project in Bulgaria. The stable outlook reflects Moody's view that a one notch downgrade of the BCA may not result in a downgrade of the final rating.

WHAT COULD CHANGE THE RATING UP/DOWN

Currently, there is limited upward rating potential in light of the uncertainties over the settlement of the Belene arbitration award and 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) BEH does not receive timely support from the Government if such were needed, including for potential payments to ASE; or (2) Moody's were to reassess the estimate of high support from the Government of Bulgaria; or (3) the Government's rating were to be lowered.

Moody's would expect BEH to maintain FFO/debt of at least in the high teens in percentage terms to maintain the existing (P)b1 BCA. 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.

The methodologies used in this rating were Regulated Electric and Gas Utilities published in December 2013, and Government-Related Issuers published in October 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

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 lignite plant, the input fuel for which is sourced at BEH-owned mining facilities. Through its subsidiary Natsionalna Elektricheska Kompania EAD, it is the single trader on the regulated wholesale power market. It also owns and operates the high voltage electricity transmission grid and the gas transmission and transit networks in Bulgaria, and is also the main regulated wholesale gas supplier. In 2015, BEH group generated BGN675 million of EBITDA (around EUR345 million).

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