



Rating_Action: Moody's affirms Bulgarian Energy Holding's Ba1 ratings; changes outlook to positive

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Frankfurt am Main, February 06, 2023 – Moody's Investors Service ("Moody's") has today affirmed Bulgarian Energy Holding EAD's (BEH) long-term corporate family rating (CFR) of Ba1, the probability of default rating of Ba1-PD, and the Ba2 ratings of the senior unsecured eurobonds. The outlook is changed to positive from stable and the Baseline Credit Assessment (BCA) is upgraded to ba3 from b1.

RATINGS RATIONALE

The rating affirmation and upgrade of the BCA reflects an improvement in BEH's standalone credit profile driven by significantly improved financial metrics and progress in the liberalization of the Bulgarian electricity and gas markets, given the group's favorable electricity generation profile and dominant domestic position as gas supplier. Despite material capital expenditure, especially for gas infrastructure, BEH's leverage metrics improved over time and are likely to stay strong on the back of high power prices. The rating affirmation is further supported by the ongoing tangible financial support that has been provided by the company's sole owner, the Government of Bulgaria (Baa1 stable), leading to an overall final CFR of Ba1.

The change in outlook to positive reflects the increased probability that BEH will exhibit a profile commensurate with a ba2 BCA / Baa3 final rating over the short to medium term. The higher rating could be achieved if BEH continues to operate with low financial leverage, and the electricity and gas markets are fully liberalized, on the assumption that BEH's business profile doesn't deteriorate significantly through either a higher risk business mix or material negative government intervention that exposed the company to higher financial risks.

BEH's rating is supported by the group's low-carbon power generation mix with around 75% of output stemming from nuclear and hydropower plants and its ownership of strategic parts of the domestic energy infrastructure, such as the gas and electricity transmission grids, which are regulated and contribute around 25% of annual EBITDA. Furthermore, the progress in the liberalization of the electricity and gas markets has put BEH into a beneficial position to benefit from high power prices.

However, the rating is constrained by BEH's extraordinary contributions to the Security of the Electricity System Fund (SESF) in 2022 and a lack of visibility as to what such amounts may be in the future. Due to strong financial performance in combination with a lack of clear financial policies, we see a prevailing risk of further calls to fund compensation schemes for end-customers via the SESF or extended dividend payments to the government. In addition, the political instability in Bulgaria with new elections scheduled for 2 April 2023 creates uncertainties around the execution of Bulgaria's energy policy. Furthermore, we assess the stand-alone liquidity management as weak. BEH relies almost exclusively on internally generated cash flows for its liquidity management, which is centralized at the parent company level. As liquidity back-up lines only exist in the form of small overdraft facilities on subsidiary level, the company is exposed to market disruption risk.

Nevertheless, BEH currently displays financial flexibility and low leverage, expressed as funds from operations (FFO) to net debt, which in 2021 amounted to around 139%. Except for further extraordinary payments to the SESF or accelerated dividend payouts Moody's anticipates a further strengthening of the leverage metrics over the next months as a result of low-cost generation capacity and high electricity market prices. We expect BEH to be fully in compliance with its financial covenants.

BEH falls under Moody's Government-Related Issuers Methodology due to its 100% ownership by the Government of Bulgaria (Baa1 stable). Accordingly, and based on Moody's view of high default dependence and high support in case of financial distress, BEH's Ba1 CFR incorporates two notches of uplift from its BCA of ba3. The high support was underpinned in 2022 by the government granting a state loan to BEH's subsidiary Bulgargaz, the monopoly gas supplier in Bulgaria, in the total amount of BGN 800 million to secure the company's liquidity after the cessation of Russian gas supply.

The Ba2 rating (LGD5) of the senior unsecured Eurobonds is one notch below the Ba1 CFR and reflects a degree of structural subordination of noteholders to the significant amount of debt at BEH's subsidiaries.

RATIONALE FOR THE POSITIVE OUTLOOK

The positive outlook reflects Moody's expectations that BEH will continue to operate with low financial leverage, and will benefit from the continued liberalization of Bulgaria's energy markets. While the wholesale electricity market was fully liberalized in 2021, the retail market remains partly regulated until the end of 2025. However, from July 2023 electricity generators are expected to sell their generated volumes on the free market to end-suppliers, which is beneficial as higher sales prices can be achieved in comparison to regulated prices.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The rating could be upgraded if (1) the market liberalization process is fully completed and proves to remain beneficial for BEH, reflected in improved earnings of the group's generation subsidiaries subject to extraordinary payments to either the SESF or government; (2) the company is able to achieve a financial profile significantly above FFO / Net Debt of 25% on a sustained basis; and (3) the credit quality and Moody's support expectations of the Government of Bulgaria remain at least unchanged.

Downward pressure on the BCA could occur if BEH's financial profile were to deteriorate persistently below FFO / Net Debt of at least 25% as a result of, but not limited to, (1) adverse changes in the operating environment, including cash distributions above expectations; or (2) negative regulatory changes, or both. Downward pressure on the final rating may develop if (1) Moody's was to reassess the estimate of high support from the Bulgarian government, or (2) the government's rating was to be downgraded.

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017 and available at <https://ratings.moodys.com/api/rmc-documents/75129>, and Government-Related Issuers Methodology published in February 2020 and available at <https://ratings.moodys.com/api/rmc-documents/64864>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of these methodologies.

Headquartered in Sofia, Bulgarian Energy Holding EAD is the holding company of the largest utility group in Bulgaria. The group owns more than 50% of the country's generation capacity,

owns and operates the electricity and gas transmissions networks and is sole importer and main supplier of gas in the country. Bulgarian Energy Holding is 100% owned by the Government of Bulgaria. For the six months ended 30 June 2022, Bulgarian Energy Holding reported consolidated total revenues of BGN 9,845 million (around EUR 5,034 million) and EBITDA of BGN 2,837 million (around EUR 1,451 million).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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