Fitch Ratings

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Fitch Revises Outlook on Bulgarian Energy Holding to Positive; Affirms at 'BB+'

Fitch Ratings - Warsaw - 20 Mar 2024: Fitch Ratings has revised the Outlook on Bulgarian Energy Holding EAD's (BEH) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) to Positive from Stable and affirmed the IDRs at 'BB+'. Fitch has also affirmed BEH's senior unsecured rating, including on EUR600 million bonds due 2025 and EUR600 million bonds due 2028, at 'BB+'/'RR4'.

The revision of the Outlook is driven by the potential improvement of the Standalone Credit Profile (SCP), which is currently 'bb'. We expect the company's business profile to improve thanks to growing earnings from network businesses following investments, and rising profitability supported by progressing liberalisation, which enables the company to sell all energy generated at market prices. We also expect low leverage to persist during the forecast horizon.

The IDR continues to reflect a one-notch uplift to reflect government support (Bulgaria is rated BBB/ Positive), based on our Government-Related Entities (GRE) Rating Criteria.

Key Rating Drivers

SCP on Improving Trend: We expect BEH's EBITDA from regulated gas and electricity transmission and transit to increase under the rating case, rising to an average 40% of total EBITDA over 2024-2027 from 20% in 2021-2022, which was particularly low, mostly due to high prices inflating the generation business results. The almost completed liberalisation of the Bulgarian energy market and its full integration with neighbouring countries should support BEH's profitability, since the company has occasionally been penalised by the regulated tariffs set for its generation.

Benefits of Liberalisation: From July 2024, generators within BEH Group will sell its entire energy production volume on the free market. As a result, we expect better performance of the nuclear power plant Kozloduy, which was previously selling 25% of its production at unfavourable regulated prices. From July 2024, the subsidiary NEK will no longer act as a public supplier but will focus its operations on electricity generation from hydro power plants, which should translate into more predictable results. We assess these developments positively, as free market transactions are more transparent and not prone to government interference.

Low Leverage: We expect BEH to maintain a strong financial profile in 2024-2027 with funds from operations (FFO) net leverage at 1.8x on average, and solid FFO interest coverage following decreasing debt burden. This is based on our expectations of an average annual consolidated capex of close to BGN1 billion and an 100% dividend payout ratio from BEH's consolidated accounts from 2024.

Financial Results Stabilisation: After an extraordinary 2022 performance, EBITDA normalised in 2023 to BGN2.3 billion, mainly due to lower electricity demand and declining energy prices, and as a result of growing production from renewables. The market trend had a negative effect on the financial results of BEH's thermal power plant (TPP Maritsa East 2), while price caps upheld for 2023 (with some reduction from July 2023) limited the performance of its nuclear power plant (NPP Kozloduy). We expect weak performance of the mining segment following the considerably lower volumes sold to power plants located in Maritsa-East basin.

Limited Visibility of New Nuclear: Following the Bulgarian government's decision at end- 2023, we expect BEH to start planning the construction of two new nuclear units under its subsidiary NPP Kozloduy -New Builds EAD. The main construction activities should start in 2029, with commissioning expected in 2034-2037. Fitch has not included this project in its rating case as there are no details of the corporate and financing structure yet and the scheduled construction phase is beyond the forecast horizon. However, we assume elevated leverage when the construction phase starts and we deem it very important to understand the state's role in the project structure**.**

Criteria Update: The updated notching guideline under our new GRE Rating Criteria maintains the bottom-up approach for BEH. The total GRE support score is 25, compared with 17.5 previously, resulting in no change to the one-notch uplift for the IDR.

Responsibility to Support: Fitch assesses 'decision-making and oversight' as 'Very Strong' because the Bulgarian state is BEH's ultimate shareholder (100% of shares), approves its strategy and business plan and tightly controls BEHs' operations. We view the Bulgarian government's 'precedents of support' as 'Strong', as it provided guarantees for about 5% of BEH's debt at end-2022 (expected to rise to around 10-15% in the forecast horizon under Fitch's rating case), preferential state loans (also for covering working capital needs), and regulatory support when needed.

Incentive to Support: We assess the 'preservation of government policy role' as 'Strong', as BEH has a crucial role in the security of gas supply in Bulgaria, implementing the state-government strategy aimed at diversifying gas supplies to Bulgaria through the execution of three major investments (including extension of the sole underground storage facility UGS Chiren in Bulgaria and construction of the natural gas Interconnector between Bulgaria and Serbia). BEH also runs the country's main energy infrastructure with significant development capex plans and will play a key role in the national green energy transformation, also through the nuclear reactor construction.

Fitch does not see a material contagion risk, as a default at BEH's level should not have material implications for the government's ability to issue new debt or its cost.

Derivation Summary

BEH has a leading position in the Bulgarian gas and electricity market through its ownership of most of Bulgaria's power generation assets (including a nuclear power plant, lignite-fired and hydro power plants), the country's largest mining company, the country's electricity transmission network, gas transmission and transit networks and through its position as the public supplier of both electricity (until end-June 2024) and gas in Bulgaria.

BEH's integrated business structure and strategic position in the domestic market makes the group comparable with some of its central European peers such as MVM Zrt. (MVM, BBB/Negative) and PGE Polska Grupa Energetyczna S.A. (PGE, BBB+/Stable). However, BEH is a negative outlier in the peer group in terms of corporate governance and has lower cash-flow predictability, resulting from the higher merchant exposure of its generation assets. This is not mitigated through quasi-regulated capacity payments, as is the case for PGE, while regulated business have a lower weight on results. The liberalisation of the Bulgarian energy market, combined with its coupling with neighbouring countries' energy markets should improve transparency and limit any potential market interference.

BEH's rating includes a one-notch uplift from its SCP to reflect links with the sovereign, which is not the case for MVM or PGE.

Key Assumptions

Fitch's key assumptions within our rating case for the issuer:

- Group EBITDA averaging BGN1.9 billion a year over 2023-2027

- Total capex of BGN4.8 billion over 2023-2027

- Dividends at 100% of net income during 2024-2027

- Price caps for electricity generators in place until end-2024

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Stronger SCP due to FFO net leverage falling below 3.5x on a sustained basis, and supported by an internal corresponding leverage target, lower regulatory and political risk, higher earnings predictability, and better corporate governance

- Adequate visibility of the funding structure of the new nuclear power plant

- Further tangible government support to BEH, such as additional state guarantees materially increasing the share of state-guaranteed debt, or cash injections, which would more tightly link BEH's credit profile with Bulgaria's stronger credit profile

- Upgrade of Bulgaria by two notches

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Weaker SCP, for example due to FFO net leverage exceeding 4.5x on a sustained basis, escalation of regulatory and political risk, or insufficient liquidity

- Weaker links with the Bulgarian state

Liquidity and Debt Structure

Healthy Liquidity: At end-June 2023, BEH had BGN3.6 billion of unrestricted cash and equivalents and BGN0.8 billion of Fitch-projected negative free cash flow) after acquisitions in the 12 months from July 2023. This compares with short-term debt maturities of BGN0.3 billion. The next large debt maturity is in June 2025, when a EUR600 million (BGN1.2 billion) bond matures.

Issuer Profile

BEH is a 100% state-owned, integrated utility operating in Bulgaria. It is involved in electricity generation, electricity transmission, public supply of electricity, gas transmission and transit, public supply of gas, lignite mining and telecommunications.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Bulgarian Energy Holding EAD has an ESG Relevance Score of '4' for Group Structure due to {DESCRIPTION OF ISSUE/RATIONALE}, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

Bulgarian Energy Holding EAD has an ESG Relevance Score of '4' for Financial Transparency due to {DESCRIPTION OF ISSUE/RATIONALE}, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Bulgarian Energy Holding EAD	LT IDR	BB+ ⊕	Affirmed		BB+ ◘
	LC LT IDR	BB+ ⊕	Affirmed		BB+ ◘
• senior unsecured	LT	BB+	Affirmed	RR4	BB+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◎	◆
STABLE	◘	

Applicable Criteria

Corporate Rating Criteria (pub.03 Nov 2023) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.13 Oct 2023) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub.12 Jan 2024)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.03 Nov 2023)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Bulgarian Energy Holding EAD	EU Issued, UK Endorsed

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