MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Russia's Transneft to Baa3 and FGC to Ba1

Global Credit Research - 20 Jan 2015

Ratings remain on review for downgrade

London, 20 January 2015 -- Moody's Investors Service has today downgraded OAO AK Transneft's (Transneft) issuer rating and the senior unsecured rating of the outstanding $1.05 billion loan participation notes issued by TransCapitalInvest Limited, Transneft's special purpose vehicle (SPV), to Baa3 from Baa2. Moody's has also downgraded FGC UES, JSC's (FGC) issuer rating to Ba1 from Baa3. Concurrently, Moody's downgraded to (P)Ba1 from (P)Baa3 the senior unsecured rating of FGC's RUB100 billion (around $1.5 billion) loan participation note programme, and to Ba1 from Baa3 the rating of the first series of RUB17.5 billion's (around $270 million) worth of notes issued by Federal Grid Finance Limited, an FGC special purpose vehicle. All of the affected ratings remain on review for downgrade.

Today's action follows the weakening of Russia's credit profile, as reflected by Moody's downgrade of Russia's government bond rating to Baa3/Prime 3 (P-3) from Baa2/Prime 2 (P-2) on Friday 16 January and its placement of the rating on review for further downgrade. Concurrently, Moody's lowered the foreign-currency bond ceiling to Baa3/P-3 from Baa2/P-2 and local-currency bond/deposit ceilings to Baa2 from Baa1. Russia's foreign-currency deposit ceiling remains unchanged at Ba1/NP. For additional information, please refer to the related announcement https://www.moodys.com/research/--PR_316487.

The ratings of Transneft and FGC affected by today's announcement remain on review for downgrade, because of (1) the current review for downgrade of the sovereign debt rating; and (2) the companies' resilience to increased risk arising from the prevailing negative operating conditions, as described in Moody's earlier rating action on 45 Russian non-financial corporates (including infrastructure and utility companies) (see "Moody's reviews for downgrade ratings of 45 Russian non-financial corporates", 23 December 2014).

RATINGS RATIONALE

The weakening of Russia's credit profile, as captured by Moody's downgrade of the sovereign to Baa3 from Baa2, has prompted the rating actions on Transneft and FGC as they face an increasingly challenging operating environment.

The key drivers behind the downgrade of Russia's sovereign rating are Moody's (1) expectation that the substantial oil price and exchange rate shock will further undermine the country's already subdued growth prospects over the medium term; and 2) nearer-term concerns over the negative impact of the erosion in official foreign-exchange buffers and fiscal revenues on the government's financial strength. Both these factors are also leading to heightened systemic risks for Russia's infrastructure and utility companies.

According to Moody's, the severe -- and likely to be sustained -- oil price shock, coupled with Russian borrowers' highly restricted access to the international market due to ongoing sanctions, is undermining economic fundamentals and increasing financial stresses on both the public and private sectors, contributing to the challenges for Russian infrastructure and utility companies. Moody's expects real GDP contractions of around 5.5% in 2015 and 3% in 2016, bringing real growth over the 10 years through 2018 to virtually zero.

FACTORS TO BE CONSIDERED IN THE RATING REVIEW

With the ratings of Transneft and FGC remaining on review for downgrade, Moody's will continue its review of Russian infrastructure and utilities companies, including those not affected by this action but placed on review for downgrade on 23 December 2014, to assess their resilience to the increased risk arising from prevailing negative operating conditions in the domestic market.

In addition, Moody's will consider adjusting its assumptions regarding the Russian government's willingness to provide support to infrastructure and utilities companies corporates in the event of need. This consideration reflects the risk that the government's supportive stance towards a particular company may weaken if it faces requests for support from many entities and sectors. It also reflects the rising, albeit still low, risk that domestic Russian entities will be unable to access foreign currency to service their foreign-currency debt obligations, given recent and prospective pressure on Russia's foreign-currency reserves.

While Russia's foreign-currency reserves remain substantial, if they continue to diminish rapidly, the Russian government may consider rationing the provision of foreign currency to the economy, including the financing of certain non-financial corporates, in an adverse scenario.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Moody's believes there is little likelihood of any upward rating pressure on Transneft's and FGC's ratings, unless sovereign creditworthiness improve materially. The rating agency may consider confirming the ratings of Transneft and FGC in the event that sovereign credit quality stabilises and the companies show sufficient resilience to the deterioration of the macroeconomic environment.

Negative pressure on Transneft's rating will develop if Moody's downgrades the sovereign rating. The rating agency could also downgrade Transneft's ratings if the deterioration in the operating environment in Russia were to lead to (1) a significantly weaker financial profile (i.e., retained cash flow (RCF)/net debt below 15%, funds from operations (FFO) net interest coverage below 4.0x and FFO/net debt below 25%); and (2) increasing constraints on liquidity.

Moody's could downgrade FGC's ratings in the event that the sovereign rating is downgraded or the rating agency revises downwards its assessment of the probability of the government providing extraordinary support to FGC in the event of financial distress.

Negative pressure on FGC's rating could also result from (1) a sustainable negative shift in the developing regulatory regime and significantly deteriorating margins; (2) a failure of the company to manage its investment programme in line with the tariff regulation and contain a deterioration of its financial profile, with FFO interest coverage and FFO/net debt falling materially and persistently below 3.5x and 25%, respectively; and (3) pressured liquidity.

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Regulated Electric and Gas Networks published in November 2014, and Government-Related Issuers published in October 2014. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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.

Sergei Grishunin
Asst Vice President - 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