



Moody's Investors Service

Credit Opinion: [Enel OGK-5, OJSC](#)

Global Credit Research - 14 Dec 2009

Moscow, Russia

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Ba3
NSR Corporate Family Rating -Dom Curr	Aa3.ru

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Key Indicators

Enel OGK-5, OJSC

	LTM H1 2009	2008	2007	2006
(FFO + Interest) / Interest	7.7x	9.4x	8.7x	6.9x
FFO / Debt	42.6%	59.4%	68.5%	30.0%
RCF / Debt	42.6%	59.4%	64.5%	21.9%
FCF / Debt	-61.9%	-112.2%	-87.0%	-42.0%
RCF / (Capex + Acquisitions - Divestitures)	42.8%	35.7%	43.2%	40.3%
Debt / EBITDA	2.0x	1.4x	1.6x	2.3x

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Company Profile

OJSC Enel OGK-5 ("Enel OGK-5"; former OGK-5) is one of Russia's six wholesale thermal power generation companies established as part of the restructuring of RAO UES of Russia ("RAO UES"), the Russian state-controlled dominant integrated electricity group, which ceased to exist in July 2008. The company, named OGK-5 until late June 2009, was a pilot power generator spun-off in the course of the RAO UES restructuring and among the first to have attracted a strategic international investor.

Enel OGK-5 is controlled by leading Italian electric utility Enel SpA ("Enel", rated A2/negative) via Enel Investment Holding B.V. (both are jointly referred to herein as "Enel"), which owns a stake of 55.86% in the company. The Russian government (rated Baa1/stable), represented by the Federal Property Agency, has directly owned 26.43% of Enel OGK-5. The government is expected to maintain its stake, although the latter is being transferred to InterRAO. InterRAO is a state-controlled electric utility holding, which consolidates state-controlled assets in the domestic power sector. The remaining 17.71% are owned by minorities, of which the largest are the EBRD (5.12%) and Russia's state-controlled Gazprombank (5.27%).

Enel OGK-5 has four fossil fuel-fired plants with total installed capacity of 8.7GW located in the central part of Russia (close to the Moscow region), in the Urals and in the south of the country. Approximately 56% of the capacity is gas-fired, while the remaining part is coal-fired. In 2008, the company's share in the total thermal generation capacity located in the European and Urals part of Russia was around 8.7%. Enel OGK-5's net electricity output was 40,729 GWh in 2008. The 9M 2009 output was 27,246 GWh, down by 12.7% compared to the similar period in 2008, on the back of reduced electricity consumption by large industrial companies in the Urals. The company posted 2008 revenues of RUB42.8 billion (US\$1.7 billion), with electricity and capacity sales accounting for around 95% of the revenues.

Recent Developments

On 8 December 2009, Moody's Investors Service affirmed the corporate family rating of Enel OGK-5 at Ba3 and stable outlook on this rating. At the same time, Moody's Interfax Rating Agency, which is majority owned by Moody's, affirmed the company's Aa3.ru national scale rating.

The rating affirmation considered Enel OGK-5's relatively high business risk profile, reasonably sustainable financial performance,

medium-term financial prospects and liquidity profile as well as advantages of its shareholder structure, which is dominated by the Enel and has included the Russian government as a blocking shareholder.

Moody's has observed the evolution of Enel OGK-5's shareholder structure and interaction between its key shareholders, namely Enel and the Russian government, over the past few years. The agency notes the control and sustainable dominance over the company established by Enel and the co-operating attitude towards this dominance demonstrated by the Russian government. Moody's also takes into account that so far direct involvement of the Russian government is being transformed now into indirect participation via the InterRAO holding, which is to receive under its management the government's stake in Enel OGK-5.

As a result, Moody's decided that it would no longer classify Enel OGK-5 as a government-related issuer (GRI) under Moody's rating methodology for GRIs. However, this decision had no rating implications for Enel OGK-5 and contributed to the latter's ratings affirmation. Moody's considers that the assumption of potential shareholder support, which provides uplift to the company's B1-equivalent standalone credit assessment by one notch to the Ba3/Aa3.ru rating, remains appropriate in the context of Enel as the controlling shareholder.

Rating Rationale

Enel OGK-5's Ba3/Aa3.ru corporate family rating combines its relatively risky profile of a pure generator, expectation of a short-term deterioration of the conservative financial profile and the possibility of support from its strong largest shareholder Enel. As mentioned above, the shareholder support drives the company's rating to Ba3 from the standalone assessment at B1. Thus, the rating reflects the company's position of a wholesale generator operating in a still developing and largely untested regulatory and market framework, exposed to a crisis-driven reduction in electricity demand and increasing price volatility in the domestic wholesale market, which is set to be fully liberalised by 2011. The rating positively factors some level of diversification of the company's operations (geographical diversification) and fuel mix. Its historically conservative financial profile provides some cushion in the weak market environment; however, it is expected to deteriorate under pressure from the company's sizeable investment programme. Depressed demand and free market pricing may contribute to the deterioration. At the same time, good access to bank facilities strongly supports the company's ability to continue investments and maintain its liquidity at a reasonable level. Moody's notes the company's exposure to foreign currency risk, with a sizeable part of its debt denominated in foreign currency. However, the agency considers that the impact of the risk of a potential deterioration of the financial metrics, the foreign currency risk exposure and possible liquidity pressures is captured within the Ba3 rating category, considering the uplift factored in for potential shareholder support.

Although the Russian wholesale power market remains 50% regulated, the liberalisation process continues and the market is set to be fully liberalised as of 2011 (household consumption not included). Thus, like other Russian wholesale generators, Moody's evaluates Enel OGK-5's rating by applying the Rating Methodology for Global Unregulated Utilities and Power Companies, which identifies key factors for assessing the relative fundamental credit quality of wholesale power companies. Based on the company's historical financial performance, the methodology grid results in a Ba1 rating assessment, two notches above the assigned Ba3 rating. As is the case with other rated Russian electric utilities, the gap between the methodology grid indicative assessment and the actual rating incorporates a degree of uncertainty associated with the long-term evolution of the company's financial profile in the Russian immature operating environment. Enel OGK-5's rating also positively incorporates the availability of shareholder support, which is not specifically considered in the methodology grid.

Rating Drivers

Rating Factor 1 - Market Assessment, Scale and Competitive Position

Like other Russian wholesale generators, the predictability of Enel OGK-5's revenue and cash flow is affected by the immature domestic power market framework, which is not yet fully established, is undergoing changes and needs to be reasonably tested from both a legal perspective and in a stressed environment. The domestic electric utility sector has operated in its current configuration for slightly over a year. The wholesale electricity market liberalisation process has covered 50% of total electricity. The regulatory environment is still adapted to support competition, cost-effective generation and capacity renovation in the wholesale electricity market. In Moody's view, this risky market environment is compatible with a B category and drives a ratings compression in the Russian electric utility sector, somewhat suppressing individual differences in the credit profiles of the sector's participants, even if they belong to sub-sectors that exhibit different business risks.

Moody's factors in the company's sustainable market position in the European part of Russia and in the Urals. These are highly populated and industrialised regions, which had been facing growing electricity consumption before the economic downturn. Having factored in the reasonable level of the geographical diversification of Enel OGK-5's operations across Russia's large territory, the agency also notes the concentration of the company's operations in the Urals, where electricity consumption of large industrial companies has been particularly affected by the crisis. The ongoing demand recovery has yet to prove sustainable. In the weak economic conditions and depressed pricing, the competition in the company's key markets is growing, challenging the company's capacity factor and escalating cost competition. Moody's believes the advantages of the company's sustainable market position are constrained in the weak economy and risky developing market framework. The geographic diversification of the company's operations is assessed by the agency as compatible with a Ba rating.

Rating Factor 2 - Cash Flow Predictability of Business Model

In mature markets, well established wholesale power generators tend to have medium- or long-term contractual arrangements and their cash flow predictability is commonly assessed from the angle of their hedging strategies. In contrast, in Russia, the cash flow predictability factor is currently considered, taking into account a material degree of regulated operations of the generators. The Russian wholesale electricity market is in a transition phase, with the market liberalisation process to be completed by 2011. Until 2011, a domestic wholesale power business will be regulated to a material extent, as the share of the electricity sold in the free market should reach 80% only in H2 2010. With an economic recovery on its agenda, the Russian government remains largely involved in the domestic sector, demonstrates commitment to its development and seeks not to distract current and potential investors. Regulated tariffs, albeit politically biased and not fully transparent, are expected to be relatively supportive for the sector. Under the circumstances, Enel OGK-5 scores a Ba for cash flow predictability.

Moody's positively notes that Enel OIGK-5 has a diversified fuel mix, with gas- and coal-fired assets accounting for 56% and 44%, respectively, of its total assets. However, until recently, the advantage of the diversification in coal was offset by the risk of exposure to a single coal supplier. The company's coal-fired assets were technologically-tailored to a certain type of coal (Ekibastuz coal basin), limiting the company's flexibility with regard to arrangements for coal supplies, although this technological dependence sometimes appears mutually burdensome for the company and coal suppliers. This year, the company's dependence on the single coal supplier has been significantly mitigated through diversification of coal suppliers from the Ekibastuz coal basin and by adding Kuznetsk basin-based coal suppliers thanks to technological developments allowing to burn limited quantities of other coal grades. Although this is certainly a positive development, the still considerable technological dependence on one type of coal sourced from one-basin-located deposits continues to limit the company's bargaining power with coal suppliers and its control over fuel risk. As a result, Enel OIGK-5 currently scores a B under the fuel mix factor.

Enel OIGK-5's 2009-2013 capex programme is RUB52 billion, according to the company's business plan approved in March 2009. The programme is balanced and well-spread, although with a peak investment in 2009. However, it stipulates significantly higher investments than in the past and therefore contains some execution risk. The company's flexibility with the programmes is limited, taking into account both a prolonged period of underinvestment it faced as part of the domestic power sector and its investment commitment under an agreement between its strategic controlling shareholder and the Russian state. The company's score under the capital requirements factor is B.

Factor 3 - Financial Policy

Enel OIGK-5's historically low-leveraged financial profile reflects its conservative financial policy of the past. Due to continuing sizeable investments in the currently weak economic conditions, the company has actually adjusted its financial policy, with more aggressive credit metrics assumed. However, Moody's understands that this is a temporary change, which is expected to result in limited leverage growth. The company plans its Debt-to-EBITDA ratio to peak to 2.5x-2.6x in 2009 on an unadjusted basis, with a material de-leveraging to be implemented starting from 2011.

Pressure of the sizeable investment programme on the company's liquidity is mitigated by long-term committed credit facilities issued to finance the company's investments. Moody's also positively notes the company's sizeable cushion under its financial covenants under available bank facilities. Moody's also understands that dividend decisions are subject to the company's financing needs. However, in Moody's view, this may not fully offset the liquidity risk going forward, given the company's increasing leverage (though in the short term), material share of short-term debt (around 35% at the end of Q3 2009) and exposure to FX risk (foreign currency debt accounts for 41% of the total debt) in the still developing market framework and weak and vulnerable economic conditions.

Given the expected increase in leverage, which is yet to prove temporary, the company's financial policy is regarded as compatible with a B rating.

Factor 4 - Financial Strength Metrics

Like other rated electric utilities in Russia, the company's historical financial profile was generally strong for its rating, marked by low leverage (1.4x Debt-to-EBITDA at end-2008) and high FFO interest and debt coverage metrics (respectively, 9.4x and 59.4x at end-2008); all the metrics are adjusted in line with Moody's methodology). However, this profile was of a transitional nature and is expected to materially deteriorate by end-2009, due to pressure from the company's investment programme. In LTM to H1 2009, leverage increased to 2x, while the end-2009 leverage, as mentioned above, is planned by the company to reach 2.5x-2.6x on an unadjusted basis. More conservatively, given the size of the company's investment programme and uncertainties associated both with the developing market framework and electricity demand recovery, Moody's expects that the company might exhibit leverage at around 3.0x Debt-to-EBITDA at end-2009 (the ratio incorporates Moody's standard adjustments), which would be a relatively high leverage level for a Ba3-rated wholesale power business in emerging markets. However, the agency considers that the company should be able to reduce leverage in 2011, in line with its own plan, and materially reduce negative free cash flow in the coming years. Taking into account these expectations, changes in the company's financial profile should be accommodated under the current rating.

Liquidity

Enel OIGK-5's liquidity position is acceptable, factoring in the company's expected cash generation for the next 12 months. In July 2009, the company placed short-term commercial paper of RUB4 billion in preparation for the September 2009 put option under its RUB5 billion domestic bond. The company did not have its bond called and maintained proceeds from the commercial paper, while transforming the bond into a two-year debt obligation. As a result, at the end of Q3 2009, the company's cash and cash equivalents of around RUB5 billion covered its debt obligations maturing within in the next nine months. The liquidity assessment positively factors in a significant amount of undrawn funds (equivalent to around RUB7.3 billion as of the end of Q3 2009) under the company's long-term committed bank facilities with the EBRD and ABN-Amro. However, these funds are to be used to finance capex. Thus, they support the company's liquidity by mitigating the pressure on the company's own cash flow; however, they are not scheduled to back-up any refinancing.

As mentioned above, Moody's notes that challenges may be associated with the company's debt maturity and currency profile in the currently weak economic environment. Nevertheless, the agency considers the company to be able to cope with them based on the support from its controlling shareholder, which has facilitated the company's good access to foreign and Russian banks and the Russian bond market.

Rating Outlook

The rating outlook is stable, as Moody's expects Enel OIGK-5 to manage its financial profile and liquidity in line with the current rating category based on support from its controlling shareholder.

What Could Change the Rating - Up

No upward pressure on the rating is expected before the company proves it is able to de-leverage in line with its plan, with the Debt-

to-EBITDA trending towards 2x, generate sustainable free cash flow and show a track record of sustainable financial metrics.

What Could Change the Rating - Down

Negative pressure on the company's ratings could result from (i) weakening support from its shareholders, (ii) a negative shift in the developing regulatory and market framework, and deteriorating margins, (iii) failure to limit deterioration of the company's financial profile, with the Debt-to-EBITDA ratio materially and persistently above 3x, while FFO interest coverage and FFO/ Debt fall below 3.5x and 20%, respectively. An inability to maintain adequate liquidity could negatively impact the rating as well.

Rating Factors

Enel OGK-5, OJSC

Power Companies	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Market Assessment, Scale and Competitive Position (20%)							
a) Market and Competitive Position (15%)						X	
b) Geographic Diversity (5%)					X		
Factor 2: Cash Flow Predictability of Business Model (20%)							
a) Effectiveness of hedging strategy (10%)					X		
b) Fuel Strategy and mix (5%)						X	
c) Capital requirements and operating performance (5%)						X	
Factor 3: Financial policy (10%)						X	
Factor 4: Financial Strength - Key Financial Metrics (50%)							
a) FFO Interest Cover (15%) (3yr Avg)			8.6x				
b) FFO / Debt (20%) (3yr Avg)			52.7%				
c) RCF / Debt (7.5%) (3yr Avg)		49.0%					
d) FCF / Debt (7.5%) (3yr Avg)							-
							82.6%
Rating:							
a) Indicated Rating from Methodology					Ba 1		
b) Actual Rating Assigned					Ba 3		



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