

Rating Action: OGK-5, JSC

Moody's assigns Ba3 rating to OGK-5, stable outlook

First-time rating

New York, October 17, 2006 -- Moody's Investors Service has today assigned a Ba3 corporate family rating to JSC "OGK-5" ("OGK-5", or "the company"), a Russian thermal electricity generator. The rating outlook is stable. At the same time, Moody's Interfax Rating Agency, which is majority owned by Moody's, assigned a Aa3.ru national scale credit rating ("NSR") to the company. This is the first time that Moody's has assigned ratings to OGK-5.

According to Moody's and Moody's Interfax ("Moody's"), the Ba3 global scale rating reflects the company's global default and loss expectation, while the Aa3.ru NSR reflects the standing of the company's credit quality relative to its domestic peers.

RATING RATIONALE

In assigning the ratings to OGK-5, Moody's has considered the company as a transitioning Government-Related Issuer ("GRI"), reflecting the Russian state's deep involvement both in the electricity sector and in the company, albeit indirectly through RAO UES of Russia, OGK-5's parent. In the course of the on-going restructuring of the electricity sector, OGK-5 is to be separated from RAO UES via a pro-rata spin-off, with the state's direct stake in the company to be reduced to 25% plus one share by the end of 2007. As the state is expected to decrease its stake and may finally dispose it in the consequent years, Moody's will closely monitor any changes to the company's GRI status.

The company's Ba3 Corporate Family Rating reflect the combination of a Baseline Credit Assessment ("BCA") of 14 (on the scale of 1 to 21 where 1 represents the equivalent risk of a Aaa, 2 of a Aa1 etc.), the Baa2 local currency rating of the Russian state, a high dependence and medium support. The overall credit enhancement applied to the BCA that results from the GRI status is limited to one notch.

The BCA of 14 -- equivalent to a B1 rating for companies without state support - reflects: (i) electricity consumption growth outpacing that of electricity supply in the company's target markets; (ii) sustainable market positions in the target regions of Central Russia and Urals; (iii) an acceptable financial profile; (iv) opportunity to increase revenues and margins via operations in the emerging competitive segment of the wholesale market and to attract a large strategic investor in the course of the forthcoming privatization.

At the same time, the company's BCA is constrained by i) uncertainties associated with the restructuring process of the Russian energy sector; (ii) the company's sole focus on the power generation business; (iii) a relatively high level of outdated assets and large capex programme; (iv) exposure to politically-sensitive regulated tariffs, operating cash flow volatility and possible shifts in debt burden; (v) expected increase in exposure to rising fuel prices largely dominated by its key supplier, Gazprom; (vi) lack of a track record of standalone operations; (vii) risks of operating in Russia's relatively vulnerable economic and regulatory environment, where OGK-5's financial performance largely depends on the balance it has to find between its position vis- a-vis the regulator on the one hand affecting its ability to increase tariffs and vis-a-vis Gazprom on the other hand affecting its operating expenses.

The current BCA does not incorporate any change in the concept or the general time frame of the restructuring process, which could materially affect OGK-5's creditworthiness.

High dependence reflects the fact that OGK-5 is a domestic electricity generator whose revenues are driven and will remain mainly driven in the mid-term by regulated tariffs. If the state were in a financial distress, this could seriously damage the company's business and its financial profile.

Medium support reflects the state's involvement in the electricity sector, which is strategically important for the country, as well as OGK-5's position of a major generator in the Central Russia and Urals and of a pilot generation business to be separated from RAO UES and attract private investments. The medium-level support is implied by Moody's within a limited time horizon of about two years. Within this period, the state is likely to keep a stake in the company and/or largely keep the company under its wing, given the market liberalization at an initial stage, necessity to encourage private investors stepping in the underinvested Russian electricity generation sector, and power shortage expected in an increasing number of Russian

regions.

OGK-5 has sustainable positions in the in attractive markets, in particular in the Urals and in the central Russia, which is very close to the Moscow region. These regions are highly urbanized, well developed and wealthy, demonstrating a rapidly growing demand for electricity and are expected to face a growing electricity shortage in the near future. With no large overall capacity additions scheduled in these regions in the mid-term, the company's market positions remain sustainable.

However, though the company's good market positions positively influence its business risk profile, the latter is regarded by Moody's as high. This opinion takes into account OGK's position as a pure generator without its own distribution business. In the mid term, OGK-5's activities are expected to remain largely regulated and thus exposed to the politically sensitive tariff regulation in Russia, which has focused on protecting consumers from higher prices and therefore may allow some financial deterioration of the utility businesses. Regulated tariffs, though based on a cost-plus principle, do not provide for cost recovery including sufficient provision for depreciation for the Russian energy sector to be able to maintain or improve its asset quality. Cost pass-through of fuel price increases may be limited, creating a pressure on the company's margins. The company's ability to benefit from the electricity demand outpacing supply in its target markets will largely depend on the pace of the wholesale market liberalization. However, there are risks that the liberalization process may be slower than initially targeted and expected by the Russian authorities.

The company's currently low debt and acceptable debt protection metrics are under pressure from its large capital expenditure programme up to 2010 of approximately Rbl 60 billion. About 40% of the capex is to support maintenance and modernization of the existing facilities. The other part is to finance new capacity construction to meet growing electricity demand. The company has some flexibility regarding its capex associated with new capacity additions. However, delays in investments in new capacity construction may damage OGK-5's market positions in the long run. Under a relatively conservative forecast of the market liberalization and free market prices, the company plans to finance a larger part of the programme from its cash flow and proceeds from the upcoming IPO. Moody's expects OGK-5 to finance its growth while maintaining its total debt to EBITDA level below 3x.

The rating outlook remains stable as Moody's expects the company to benefit from its sustainable positions in the Urals and Moscow region in the course of the market liberalization. The company's financial profile is expected to accommodate increasing debt if the company is successful in attracting funds through the planned IPO and improving margins by increasing operations in the free market segment.

Should the market liberalization and on-going sector restructuring result in material improvements in the operating environment for OGK-5, this could have a positive impact on the ratings. Should the company establish a positive track record of increasing margins and cash flow generation ahead of its projections as the market is liberalized, this may also positively influence the rating.

A negative shift in the regulatory regime affecting cash flows and the company's credit metrics will likely prompt Moody's to revisit the ratings. A negative pressure on the rating may result from the leverage exceeding the maximum target level of total debt to EBITDA ratio of 3x.

Due to the combination of the high dependency and medium support attributed to OGK-5 under the GRI methodology, the company's Ba3 rating is largely driven by its BCA. Moody's also notes that a one notch upgrade or downgrade in the sovereign rating would not have an impact on OGK-5's ratings.

COMPANY SUMMARY

Headquartered in the city of Moscow, JSC "OGK-5" ("OGK-5") was the first wholesale generation company ("WCG", or "OGK" in Russian) established as part of the restructuring of RAO UES of Russia, the Russian dominant integrated electricity group controlled by the state. 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. The company generates more than 90% of its revenues from sales of its electricity output. Currently 87.67%-owned by RAO UES, OGK-5 is a pilot entity that is scheduled to be separated from RAO UES via a pro-rata spin-off and will see the state's stake reduced to 25% plus one share in 2007. Further decrease in that stake is expected in the consequent years.

NATIONAL SCALE RATINGS

Moody's Interfax Rating Agency's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs in Russia are designated by the ".ru" suffix. NSRs differ from global scale ratings, as assigned by Moody's Investors Service, in that they are not globally comparable to the full universe of Moody's rated entities, but only with other rated entities within the same country.

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