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Lead analysts:

Natalia Porokhova, Senior Director
+7 (495) 139-0490
natalia.porokhova@acra-ratings.ru

Ekaterina Mozharova, Senior Director
+7 (495) 139-0498
ekaterina.mozharova@acra-ratings.ru

Key rating assessment
factors

ACRA assigns AAA(RU) to PJSC ROSSETI, outlook Stable

The credit rating assigned to [PJSC ROSSETI](#) (hereinafter, the Company, or Rosseti) is on par with the financial obligations of the Russian Government in view of very high systemic importance of the Company for the Russian economy and very high state influence on Rosseti.

The Company's standalone creditworthiness assessment (SCA) at aa- is driven by the monopolistic position in managing the Russian power grid complex, very high profitability, moderate leverage and very high liquidity. SCA is restrained by negative cash flow due to substantial capital expenditures.

PJSC ROSSETI is a power grid operator in Russia. It consolidates 15 power grid companies: FCG UES (managing high-voltage power transmission lines in Russia) and 14 subsidiaries (managing grid distribution complexes in various regions of Russia). Power transmission services represent a natural monopoly and are regulated by government rates. Also, the Company manages nine utilities companies. The state represented by Rosimuschestvo is the controlling shareholder with a 88% stake.

Strategic importance for the nation and state control over the Company. PJSC ROSSETI is a monopoly operator of the power grid complex of Russia - the only sector in the power industry where the state retained shareholding control and direct government regulation after electricity market liberalization. Rosseti performs quasi-government functions as to insurance of social risks (they assume electricity retail sales in case of bankruptcy of energy retailers), social support (cross subsidies in rates), technical policy, and power infrastructure development. The government invested RUB 72 bln into the Company's capital in 2010-2017, with subsidies totaling RUB 6.5 bln; Vnesheconombank purchased RUB 156 bln worth of infrastructure bonds of the group companies in the same period.

Infrastructure monopoly with moderate regulatory risk. The practice of holding down grid tariffs in order to sustain the overall electricity prices in Russia was used extensively in previous years as the share of the transmission tariff in the ultimate electricity price is high (67% for households and 40% for other power consumers), and the state has retained direct regulation of grid tariffs. Tough tariff policy in the grid complex including two tariff freezes in 2012 and 2014, has been in place since 2012; however, Rosseti improved its profitability in the above period and reduced leverage by virtue of optimizing operational and capital expenditures. The low inflation mode would make the Company less susceptible to the restraining tariff policy but more sensitive to non-payments as devaluation of problem debt would slow down.

Moderate leverage. According to ACRA estimates, the total debt to cash flow of Rosseti would be moderate in 2018-2020 (total debt to FFO before net payments and taxes ratio at 2.2x-2.4x). The Company would raise debt to finance its investment program in 2018-2019. According to the Company's projections, the share of borrowings in investment financing would decline to 8% in 2018 and to 0% in 2020. The entire Company's debt is ruble denominated; the bond debt accounts for 60% of the total debt.

The average maturity of borrowings is 11 years. 73% of the loan portfolio represent fixed rate borrowings; the floating interest rate risk is not hedged. Two subsidiaries (FCG UES and MOESK) generating two thirds of the Company's cash flow account for two thirds of the debt portfolio.

Negative cash flow. Free cash flow of the Company would remain negative in 2018-2020. High capital expenditures are the key factor for the negative cash flow. Investments to revenues ratio has peaked in 2011-2012. The ratio declined from 53% to 28% from 2012

to 2017. On average, 35%-40% of the investment program are used for fixed assets maintenance, with the rest spent on new construction. Capital expenditures are expected to remain at RUB 210-260 bln in 2018-2020. After 2020, capital expenditures may increase if the projects for development of the digital power grid complex are accepted.

Key assumptions

- In 2018-2020, the average tariff indexation rate to remain at 3.3%, the average inflation at 4.0%;
- In 2018-2020, the Company to successfully implement its capital investment program with annual investments of RUB 210-260 billion;
- Dividend payments at 50% of the IFRS net profit less the investment component.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A negative rating action may be prompted by:

- Loss of state control, for instance through privatization of the Company;
- A significant decline of the Company's systemic importance for the Russian economy;
- A substantial decrease in the financial support from the state and an increase of dividends in favor of the budget.

Rating components

Standalone creditworthiness assessment (SCA): aa-

Support: on par with RF.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation and is based on the [Methodology for Credit Ratings Assignment to Non-Financial Corporations under the National Scale for the Russian Federation](#), the [Methodology for Analyzing Relationships Between Rated Entities and the State](#), and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to PJSC ROSSETI for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (February 28, 2018).

The assigned credit rating is based on the data provided by PJSC ROSSETI, information from publicly available sources as well as ACRA's own databases. The assigned credit rating is based on the IFRS consolidated reporting of PJSC ROSSETI. The credit rating is solicited, and PJSC ROSSETI participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by PJSC ROSSETI in its financial statements have been discovered.

ACRA provided no additional services to PJSC ROSSETI. No conflicts of interest were discovered in the course of credit rating assignment.

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Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

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