Bulgarian Energy Holding EAD

Update

Ratings

Foreign Currency

Long-Term IDR	BB−
Senior Unsecured	BB−
Proposed Senior Unsecured Eurobond	BB−(EXP)

Local Currency

Long-Term IDR	BB−

Outlook

Foreign and Local-Currency Long-Term IDRs	Negative

Financial Data

Bulgarian Energy Holding EAD

	31 Dec 15	31 Dec 14
Revenue (BGNm)	6,382	6,123
Operating EBITDA (BGNm)	671	149
Operating EBITDA margin (%)	10.5	2.4
Funds from operations (BGNm)	779	182
Cash flow from operations (BGNm)	958	496
FFO fixed charge coverage (x)	13.7	3.6
FFO adjusted net leverage (x)	0.9	5.3

Includes Fitch's adjustments

Related Research

Fitch Affirms BEH at 'BB−'; Negative Outlook; Rates Upcoming Bond 'BB−(EXP)' (July 2016)

Bulgarian Energy Holding - Ratings Navigator (July 2016)

Fitch Affirms Bulgaria at 'BBB−'; Outlook Stable (June 2016)

2016 Outlook: EMEA Utilities (December 2015)

Fitch Downgrades Bulgarian Energy Holding to 'BB−'; Negative Outlook (September 2015)

Fitch Downgrades Bulgarian Energy Holding to 'BB'; Places on RWN (March 2015)

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Key Rating Drivers

Liquidity, Cash Flow Challenges: The Negative Outlook reflects Fitch Ratings' projections that Bulgarian Energy Holding EAD (BEH) will have insufficient liquidity to cover short-term debt maturing mostly in April 2017, and negative free cash flow (FCF). Liquidity should cover the short-term debt and negative FCF after the long-term bond issue planned for 3Q16. We would then be likely to revise the Outlook to Stable.

Improved Cash Flow Generation: The ratings affirmation in July 2016 reflects the BEH group's substantially improved cash flow generation in 2015 after very weak results for 2014. This is largely due to a narrowed power tariff deficit at BEH's subsidiary Natsionalna Elektricheska Kompania EAD (NEK), the public supplier of electricity in Bulgaria, following a number of legislative and regulatory changes implemented during 2015.

As a result, NEK's EBITDA loss narrowed to BGN124m in 2015 from BGN503m in 2014. We expect it to improve further in 2016. Despite positive developments addressing NEK's tariff deficit, BEH has yet to establish a track record of higher cash flows. The Bulgarian operating environment remains subject to high regulatory and political risk, which is a rating constraint.

Repayment of Overdue Payables: In April 2016, BEH managed to raise a bridge loan of EUR535m (BGN1bn), which allowed NEK to repay overdue trade payables to two thermal power plants, AES-3C Maritsa East 1 EOOD and Contour Global Maritsa East 3 AD. After the repayment, NEK's renegotiated long-term contracts with these two power plants came into force, improving NEK's cash flows. The bridge facility is planned to be repaid from the proceeds of an upcoming bond issue.

Strong Links With State: BEH's rating is notched up one level to reflect its strong links with the Bulgarian state (BBB−/Stable), including guarantees for part of its debt (23% at end-2015, down from 50% in 2012). We expect the level of state guarantees to decline in 2016-2017, as the state-guaranteed debt is amortised and most of new debt is unlikely to be guaranteed. The share of state-guaranteed debt declining to less than 10%-15% of total group debt and not compensated by other support may lead to a removal of the uplift.

Rating Sensitivities

Liquidity, Leverage and Support: Prolonged tight liquidity, funds from operations (FFO) adjusted net leverage sustainably over 5x, weakening links between BEH and the Bulgarian state or sustained increase in prior-ranking debt above 2x EBITDA would be ratings negative.

Conversely, improved liquidity, FFO-adjusted net leverage sustainably below 5x, tangible government support, lower payments for the Belene equipment, a longer track record of a shrinking tariff deficit and market-based pricing in power generation would be ratings positive.

Liquidity and Debt Structure

Liquidity After Bond Issue: The next large debt maturity following the planned bond issue and bridge loan repayment is in November 2018, when the EUR500m bond (BGN1bn) issued in 2013 matures. We expect BEH to start the bond refinancing process well ahead of maturity.

We expect the state to support BEH if the company has insufficient liquidity in a scenario of payment of the full arbitration amount (EUR550m or BGN1.1bn) recently ordered by an arbitration court in relation to the terminated Belene nuclear power plant project.

Comparison Table

IDR/Outlook	CEZ A−/Stable	PGE BBB+/Stable	TAURON BBB/Negative	EP Energy BB+/Stable	BEH BB−/Negative
Main shareholder (stake)	Czech state (69.78%)	Polish state (58.39%)	Polish state (30.06%)	Ultimately owned by Energeticky a prumyslovy holding, a.s (EPH)	Bulgarian state (100%), one-notch uplift for state support
Business profile	Vertically integrated	Vertically integrated	Vertically integrated	Vertically integrated	Vertically integrated
Regulated EBITDA (%)	31	30	67	~70[a]	Close to 30[c]
Generation capacity (GW)	15.9	12.7	5.1	5.3[b]	6.3
Generation mix (%)	44 nuclear, 38 lignite, 9 hard coal	73 lignite, 22 hard coal	90 hard coal	Mostly lignite	55 nuclear, 29 lignite, 16 hydro
Own coal/lignite mining (%)	~60	~70	~50	Largely disposed	~100
FFO adjusted net leverage 2015-17 (x)	2.7	1.4	3.1	3.6	2.7
Negative rating guideline for FFO adjusted net leverage (x)	Above 3.0	Above 3.0	Above 3.5	Above 4.0	Above 5.0
Expected FCF in mid term	Neutral	Strongly negative	Strongly negative	Neutral	Negative

[a] Post divestment of German operations, including mining and lignite generations
[b] Includes 4GW of heat capacity
[c] Through-the-cycle average
Source: Fitch

Wider Peer Group

Issuer	Country
A−	
CEZ, a.s.	Czech Republic
BBB+	
PGE Polska Grupa Energetyczna S.A.	Poland
BBB	
ENEA S.A.	Poland
Energa S.A.	Poland
TAURON Polska Energia S.A.	Poland
BB+	
EP Energy, a.s.	Czech Republic
BB−	
Bulgarian Energy Holding EAD	Bulgaria
Infinis Plc	United Kingdom
Viesgo Generacion, S.L.	Spain

Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
6 Jul 16	BB−	Negative
16 Sep 15	BB−	Negative
18 Mar 15	BB	RWN
6 Nov 14	BB+	Stable
18 Mar 14	BB+	Stable
12 Dec 13	BB+	Stable
1 Mar 13	BB+	Stable

"RWN" denotes Rating Watch Negative

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Most central European (CE) utilities have been performing relatively predictably, despite their varying degrees of vertical integration. The regulated segments, such as electricity distribution, and the quasi-regulated segments, such as renewables and heat generation, enhance business profiles through high cash-flow visibility in transparent and supportive regulatory regimes. In some countries, the regulatory framework continues to be less predictable and prone to political impact, which has negative implications for cash flow stability.

Power generation is higher risk, due to its exposure to changes in fuel and electricity prices, electricity demand and costs of CO2. The largely coal-and lignite-fired generation fleet in central Europe benefits from a gradual phase-out of free CO2 allowances until 2020, in exchange for environment-friendly capex, and from limited market openness in some countries.

Financial Risks

The financial profiles of CE utilities benefit from relatively healthy and stable cash-flow generation, although the generation segment of many companies is under cash flow pressure due to declining margins. Fitch expects negative free cash flow for utilities in the medium term due to large capex plans with limited short-term flexibility, as well as market-specific issues like claims related to the Belene nuclear power plant project in Bulgaria or consolidation with hard coal mining operations in Poland.

Access to capital markets funding differs among companies, with some being frequent issuers, and others for which market access has yet to be proven. CE utilities have demonstrated good access to bank funding.

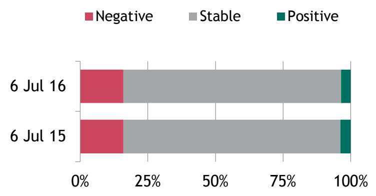
Key Credit Characteristics

Large utilities with solid business profiles and strong to medium financial profiles generally command investment-grade ratings. Ratings depend both on business factors – including market presence, degree of vertical integration, generation mix and earnings diversification – and financial factors such as financial policy, leverage, margins, capex plans and approach to M&A activity. Most rated CE utilities have solid credit ratios. Ratings reflect the expectation for FFO adjusted net leverage to rise to 3.0x-3.5x in the medium term for most issuers.

Related Criteria

Corporate Rating Methodology (August 2015)

Distribution of Sector Outlooks
Directional Outlooks and Rating Watches



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

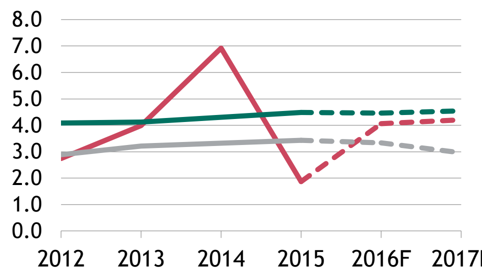
- improvement in NEK's EBITDA from a BGN0.5bn loss in 2014 to a BGN0.1bn profit in 2016 on the back of regulatory and legislative changes and renegotiation of power purchase agreements;
- proceeds from the upcoming bond issue used to repay EUR535m (BGN1bn) bridge loan raised in April 2016;
- capex of BGN3bn in 2016-2019, co-funded with EU grants and CO2 reimbursement;
- NEK to pay EUR550m (BGN1.1bn) to the Russian party by end-2017;
- forthcoming tangible state support in case of prolonged tight liquidity position.

Definitions

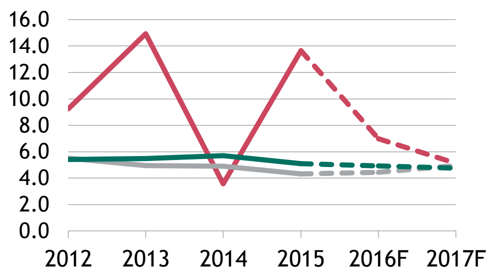
- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "*Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format*" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

Bulgarian Energy Holding EAD — Utilities Median — Emerging BB Cat Median —
Source: Company data; Fitch

Leverage
including Fitch expectations



Interest Cover
including Fitch expectations



Debt Maturities and Liquidity at End-April 2016 - As is with bridge-to-bond loan maturing in April 2017

Debt maturities	(BGNbn)
2016	0.2
2017	1.1
2018	1.1
2019	0.1
After 2019	<0.1
Total debt	**2.6**
Unrestricted cash	**1.2**
Short-term debt (until April 2017)	1.2
Free cash flow proxy for 12 months from end-April 2016	-0.3
Liquidity shortfall	-0.4

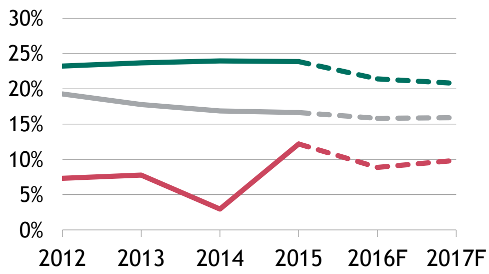
Source: Fitch

Debt Maturities and Liquidity at End-April 2016 - Pro forma assuming bridge-to-bond loan is refinanced in 3Q16

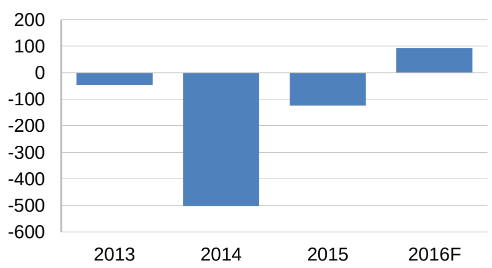
Debt maturities	(BGNbn)
2016	0.2
2017	0.1
2018	1.1
2019	0.1
After 2019	1.1
Total debt	**2.6**
Unrestricted cash	**1.2**
Short-term debt (until April 2017)	0.2
Free cash flow proxy for 12 months from end-April 2016	-0.3
Liquidity surplus	0.7

Source: Fitch

FFO Profitability
including Fitch expectations

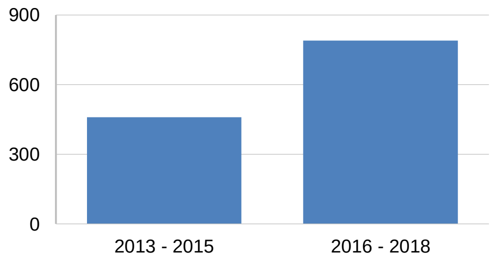


NEK's EBITDA
Including Fitch expectations for 2016
(BGNm)



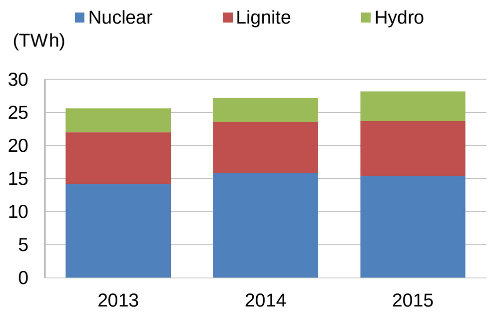
Source: Company

BEH Group's Average Capex
(BGNm) per annum, including discretionary capex



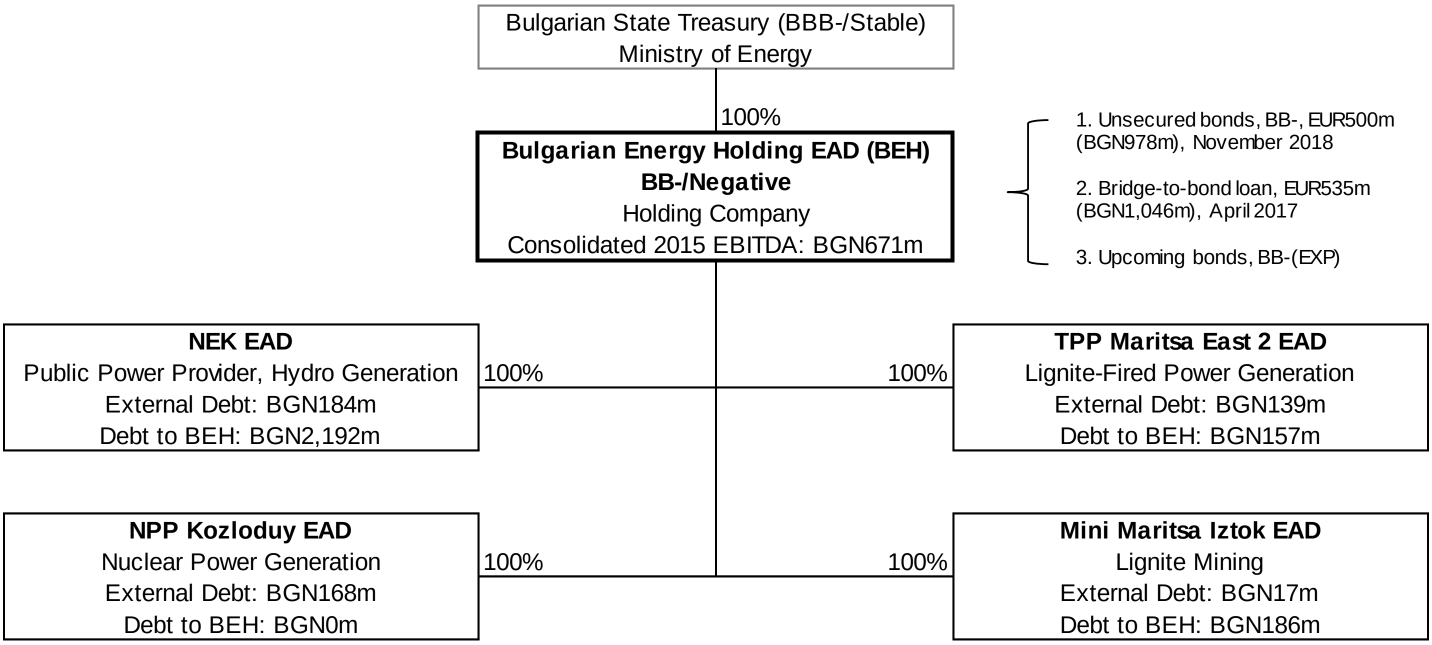
Source: Company

BEH Group's Power Generation



Source: Company

Simplified Group Structure Diagram



Source: Fitch, Company. Financial data as at end-April 2016

Bulgarian Energy Holding EAD — Forecast Financial Information

(BGNm)	Historical			Fitch forecast		
	31 Dec 13	31 Dec 14	31 Dec 15	31 Dec 16	31 Dec 17	31 Dec 18
Summary income statement						
Revenue	5,625	6,123	6,382	6,510	6,640	6,773
Revenue growth (%)	-12.7%	8.8%	4.2%	2.0%	2.0%	2.0%
Operating EBITDA	544	149	671	704	853	946
Operating EBITDA margin (%)	9.7%	2.4%	10.5%	10.8%	12.8%	14.0%
Operating EBITDAR	544	149	671	704	853	946
Operating EBITDAR margin (%)	9.7%	2.4%	10.5%	10.8%	12.8%	14.0%
Operating EBIT	-34	-395	86	105	244	335
Operating EBIT margin (%)	-0.6%	-6.5%	1.3%	1.6%	3.7%	5.0%
Gross interest expense	-48	-61	-60	-97	-159	-196
Pretax income	43	-170	80	8	85	139
Summary balance sheet						
Readily available cash	402	395	824	362	421	379
Total debt with equity credit	1,818	1,678	1,569	2,740	3,425	3,329
Total adjusted debt with equity credit	1,818	1,678	1,569	2,740	3,425	3,329
Net debt	1,416	1,284	746	2,378	3,004	2,950
Summary cash flow statement						
Operating EBITDA	544	149	671	704	853	946
Cash interest	-31	-68	-61	-97	-159	-196
Implied interest cost (%)	1.7%	3.9%	3.8%	4.5%	5.2%	5.8%
Cash tax	-27	-46	-42	-44	-53	-59
Associate dividends less distributions to NCI	16	16	10	15	15	15
Other items before FFO	-65	131	201	-0	-0	0
Funds flow from operations	437	182	779	579	655	706
FFO margin (%)	7.8%	3.0%	12.2%	8.9%	9.9%	10.4%
Change in working capital	-359	314	179	-920	-43	-34
Cash flow from operations (Fitch defined)	78	496	958	-341	612	672
Total non-operating/non-recurring cash flow						
Capital expenditure	-388	-385	-415			
Capital intensity (capex/revenue) (%)	6.9%	6.3%	6.5%			
Common dividends	-206	-21	0			
Net acquisitions & divestitures	0	2	6			
Capex, dividends, acquisitions & oth. items before FCF	-593	-404	-409	-1,447	-1,453	-849
Free cash flow after acquisitions & divestitures	-515	92	549	-1,788	-841	-177
Free cash flow margin (after net acquisitions) margin (%)	-9.2%	1.5%	8.6%	-27.5%	-12.7%	-2.6%
Other investing and financing cash flow items	-143	203	-12	155	215	231
Net debt proceeds	441	-93	-125	1,171	685	-96
Net equity proceeds	0	0	0	0	0	0
Total change in cash	-217	199	406	-461	59	-42
Coverage ratios (x)						
FFO interest coverage	14.9	3.6	13.7	7.0	5.1	4.6
FFO fixed charge coverage	14.9	3.6	13.7	7.0	5.1	4.6
Operating EBITDAR/gross interest expense + rents	11.4	2.5	11.3	7.3	5.4	4.8
Operating EBITDA/gross interest expense	17.8	2.2	10.9	7.3	5.4	4.8
Leverage ratios (x)						
Total adjusted debt/operating EBITDAR	3.3	11.2	2.3	3.9	4.0	3.5
Total adjusted net debt/operating EBITDAR	2.6	8.6	1.1	3.4	3.5	3.1
Total debt with equity credit/operating EBITDA	3.3	11.2	2.3	3.9	4.0	3.5
FFO adjusted leverage	4.0	6.9	1.9	4.1	4.2	3.7
FFO adjusted net leverage	3.1	5.3	0.9	3.5	3.7	3.3

How to interpret the forecast presented

The forecast presented is based on the agency's internally produced, conservative rating case forecast. It does not represent the forecast of the rated issuer. The forecast set out above is only one component used by Fitch to assign a rating or determine a rating outlook, and the information in the forecast reflects material but not exhaustive elements of Fitch's rating assumptions for the issuer's financial performance. As such, it cannot be used to establish a rating, and it should not be relied on for that purpose. Fitch's forecasts are constructed using a proprietary internal forecasting tool, which employs Fitch's own assumptions on operating and financial performance that may not reflect the assumptions that you would make. Fitch's own definitions of financial terms such as EBITDA, debt or free cash flow may differ from your own such definitions. Fitch may be granted access, from time to time, to confidential information on certain elements of the issuer's forward planning. Certain elements of such information may be omitted from this forecast, even where they are included in Fitch's own internal deliberations, where Fitch, at its sole discretion, considers the data may be potentially sensitive in a commercial, legal or regulatory context. The forecast (as with the entirety of this report) is produced strictly subject to the disclaimers set out at the end of this report. Fitch may update the forecast in future reports but assumes no responsibility to do so.

Source: Fitch. Some financial data, including historical data, have been adjusted according to Fitch's definitions.

Reconciliation of Key Financial Metrics for BEH

(BGNm)	31 Dec 15
Total debt with equity credit	**1,569**
+ (ST leases * ST lease multiple)	0
+ (LT leases * LT lease multiple)	0
+ Other off-balance sheet debt	0
= Total adjusted debt with equity credit (a)	**1,569**
Readily available cash (Fitch-defined)	723
+ Readily available marketable securities (Fitch-defined)	100
= Readily available cash & equivalents	**824**
Net lease-adjusted debt (b)	746
Cash Flow from Operations (CFO)	958
- Change in working capital (Fitch-defined)[a]	179
= Funds From Operations (FFO) (c)	**779**
Interest received	2
Interest (paid) (d)	-61
= Net finance charge (e)	**59**
Preferred dividends (paid) (f)	0
Operating lease expense for assets with long economic life (g)	0
FFO adjusted net leverage (x)	
Net lease-adjusted debt/(FFO + net finance charge + LT leases - pref div paid) (b/(c+e+g-f))	0.9
FFO adjusted gross leverage (x)	
Lease-adjusted debt/(FFO + net finance charge + LT leases - pref div paid) (a/(c+e+g-f))	1.9
FFO fixed charge cover (x)	
(FFO + net finance charge + LT leases - pref div paid)/(gross interest paid + LT leases - pref div paid) ((c+e+g-f)/(-d+g-f))	13.7
FFO gross interest coverage (x)	
(FFO + net finance charge - pref div paid)/(gross interest paid - pref div paid) ((c+e-f)/(-d-f))	13.7

[a] The company's cash flow statement is based on a direct cash flow method, ie without the presentation of changes in working capital. Fitch calculated changes in working capital based on the difference in the balance sheet figures for inventory, trade receivables and trade payables during a year
Source: Fitch based on company reports

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.