MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa1 issuer rating to EPSO-G; stable outlook

25 Apr 2022

Frankfurt am Main, April 25, 2022 -- Moody's Investors Service (Moody's) has today assigned a first-time long-term issuer rating of Baa1 to EPSO-G UAB (EPSO-G), the holding company for Lithuania's transmission system operators (TSO) Litgrid AB (Litgrid; electricity) and AB Amber Grid (Amber Grid; gas). At the same time, Moody's has assigned a baa3 Baseline Credit Assessment (BCA) and a stable outlook.

RATINGS RATIONALE

The Baa1 rating reflects (1) EPSO-G's low business risk profile, as nearly all earnings stem from the group's monopolistic TSO activities; (2) a supportive, well developed while yet evolving regulatory framework in Lithuania under which tariffs charged by the TSOs are set; (3) a solid financial profile, reflected in an estimated level of net debt to fixed assets of around 40% in 2021, which Moody's expects to increase over the next few years, given the partly debt-funded planned large investment program; and (4) Moody's expectation of strong support from the Government of Lithuania (A2 stable), the 100% ultimate owner of EPSO-G.

The rating is constrained by (1) the group's small size, compared to Western European peers; (2) some execution risks related to the planned significant capital expenditure program, mostly related to the synchronisation of the country's electricity grid with the Continental European Network (CEN); and (3) the structural subordination of EPSO-G's liabilities, given that the company primarily relies for its cash flows on its operating, debt-bearing subsidiaries Litgrid and Amber Grid.

EPSO-G was established in 2012 and over the years acquired majority stakes in Litgrid (97.5%) and Amber Grid (96.6%), while both companies remain listed on the Nasdaq Baltic stock exchange. Other subsidiaries include Tetas UAB (100%), a provider of grid development and maintenance services, GET Baltic UAB (100% owned by Amber Grid), an electronic natural gas exchange, Baltpool UAB (67%), an exchange for timber and biomass and administrator of Lithuania's renewables support scheme and Energy Cells UAB (100%), a company implementing 200MWh battery energy storage facility. The TSOs amongst them account for over 98% of group EBITDA. EPSO-G's role is to supervise the implementation of Lithuania's energy policy related to transmission infrastructure by the TSOs and to manage these companies on behalf of the government. The company also manages the group cash pool.

Litgrid and Amber Grid's tariffs are regulated by the National Energy Regulatory Council (NERC), the independent national regulator in Lithuania, under an incentive-based hybrid price-cap regime for electricity transmission and under an incentive based revenue cap regime for gas transmission. NERC applies a building block approach with a timely, inflation-adjusted recovery of operating expenses and temporary, limited volume risk, as tariffs are adjusted annually. The TSOs are allowed to realise a reasonable return, measured as pre-tax, nominal weighted average cost of capital (WACC) on their regulated asset base (RAB). The WACC is adjusted annually for costs of debt over the five-year regulatory period and is set at 4.03% for Litgrid and 3.94% for Amber Grid in 2022, the first and fourth year, respectively, of their current regulatory periods. The regime is relatively transparent but still evolving.

Given Lithuania's location as the southern-most Baltic country, its energy transmission infrastructure connects the region with continental Europe through electricity and gas interconnection points with Poland as well as with the Nordic countries, through the NordBalt power interconnector to Sweden. However, as of today, Lithuania and its Baltic peers Estonia, Government of (A1 stable) and Latvia, Government of (A3 stable) are still part of the unified energy system of Russia, Belarus, Lithuania, Latvia and Estonia (BRELL). Through the so-called Baltic Synchronisation project, the three countries aim to achieve full integration with CEN by 2025, which for Litgrid will lead to capital spending of some EUR580 million over the next 3-4 years, constituting the biggest part of EPSO-G's investments during that period. However, because most of the outlays will be funded by EU grants and congestion fees, Moody's expects that EPSO-G will maintain a solid financial profile, which is further underpinned by (1) the supportive regulatory framework; and (2) continued dividend restraint from its owner through at least 2026.

EPSO-G's liquidity is supported by EUR90 million of committed, freely accessible revolving bank facilities which are currently undrawn. The company currently bears no external debt, whereas Litgrid and Amber Grid have raised bank loans directly at the operating company level to finance their investments. Given the substantial investment program with some time lag to receive approved grants as well as some uncertainty around the magnitude of congestion revenues, EPSO-G and its subsidiaries have greater exposure to funding risks than European network peers.

Because all external debt is currently raised at the level of Litgrid and Amber Grid, creditors of holding company EPSO-G are structurally subordinated to creditors of the group's operating companies.

EPSO-G falls under Moody's Government-Related Issuers Methodology due to its 100% ownership by the Government of Lithuania through the Ministry of Energy. The rating incorporates two notches of uplift from EPSO-G's baa3 BCA, which measures its standalone credit quality, reflecting the combination of (1) very high default dependence, resulting from the group's preponderance of domestic earnings and the exposure of the government and the company to common risks; and (2) a strong likelihood of extraordinary support being provided by the Lithuanian government in case of financial distress, given the company's strategic importance to the domestic economy as responsible party for energy infrastructure.

EPSO-G's rating also incorporates ESG considerations, reflected in a low to neutral credit impact score (CIS-2), indicating that its ESG attributes are not material for the credit rating as the company's exposure to ESG risks is mitigated by Moody's expectation of government support, should the company encounter a situation of financial distress. In Moody's view, the company is exposed to moderate environmental risks, reflected in an environmental issuer profile score (IPS) of E-3, as the group's assets are to a large extent above ground and thus exposed to physical climate risk. Exposure to demographic and societal risks through potential adverse regulatory decisions is reflected a social IPS of S-3. EPSO-G's low to neutral governance IPS of G-2 reflects Moody's view of a solid governance structure and a prudent financial policy.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on EPSO-G reflects Moody's expectation that the company will be able to maintain funds from operations (FFO)/net debt sustainably above 12%.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The rating could be upgraded if EPSO-G were to consistently maintain FFO/net debt of at least 15% and maintained net debt to fixed assets below 60%, further underpinned by the absence of materially adverse changes to the regulatory framework.

The rating could come under downward pressure if FFO/net debt were to decline below 12% for a sustained period. Downward pressure could also be exerted on the rating as a result of (1) a deterioration in the credit quality of the Government of Lithuania; (2) a reduction in the government support assumptions currently incorporated into Moody's assessment; or (3) a materially unfavorable change in the regulatory framework, leading to a significant increase in the company's business risk.

PRINCIPAL METHODOLOGY

The methodologies used in these ratings were Regulated Electric and Gas Networks published in April 2022 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1322720 , and Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

EPSO-G UAB, based in Lithuania, Government of (A2 stable), is the state-owned holding company for the country's monopoly electricity and gas transmission system operators Litgrid AB and AB Amber Grid. In the financial year 2020 the company reported EUR272.2 million of consolidated revenues and a consolidated operating profit (EBIT) of EUR42.2 million.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security 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 credit rating action on the support provider and in relation to each particular credit 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 credit rating action, and whose ratings may change as a result of this credit 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.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288235 .

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moodys.com.

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.

Mark Remshardt
Vice President - Senior Analyst
Infrastructure Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Paul Marty
Senior Vice President/Manager
Infrastructure Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322

Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

credit ratings opinions and services rendered by it fees ranging from JPY100,000 to approximately JPY550,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.