

Global Credit Research - 31 Mar 2009

Approximately USD4.4 billion of debt securities affected

New York, March 31, 2009 -- Moody's Investors Service has today downgraded to Baa1 from A3 the issuer rating of OAO AK Transneft ("Transneft"). At the same time, Moody's has downgraded Transneft's senior unsecured loan participation notes, totaling approximately USD4.4 billion, issued by TransCapitalInvest Limited ("TCI"), a special purpose vehicle that has issued notes for the sole purpose of financing loans to Transneft, to Baa1 from A3. The outlook for the ratings is stable. Today's rating action concludes the review for possible downgrade initiated on 15 December 2008, due to Moody's decision to review its assessment of the default dependence between Transneft and the Russian government, whose support is factored into the company's rating, in light of the global financial crisis and sharp fall in commodity prices.

Today's action reflects Moody's decision to change its default dependence assessment to medium from low in the context of Moody's methodology for Government Related Issuers (GRI). Recent economic and financial market developments suggest to Moody's that a rating for Transneft higher than the Russian Federation's rating of Baa1 is no longer appropriate, given the heightened degree of credit linkage in the environment in which the company operates.

Moody's assessment of Transneft's intrinsic creditworthiness as reflected in the baseline credit assessment (BCA) of the company is unchanged. This opinion takes into account (i) the relative resilience of Transneft's business profile in the current downturn; (ii) Moody's expectation that, despite a reduced cushion under the agency's guidelines for the current BCA (including FFO Net Interest coverage at 4-6x and FFO to Net Debt at 25-40%), Transneft's metrics will remain in line with the guidelines; (iii) the long-dated maturity profile of its foreign currency debt; and (iv) continued access to new funding at reasonable terms and conditions. Moody's also continues to believe that Transneft enjoys a high degree of government support. The one-notch downgrade reflects the view that, in the current market conditions, such support provides a lower level of enhancement to the company's own creditworthiness.

In light of the global financial crisis and sharp fall in oil prices, Moody's revised its assumption for the default dependence between Transneft and the Russian Federation, to medium from low. This decision reflects the increasing economic and political interrelationship between the financial health and stability of the federal government and that of Transneft. Recent events have highlighted the Russian economy's lack of diversification and critical dependence on oil prices and budget revenues. The government and Transneft increasingly share the risks of depressed volumes and weaker domestic oil businesses. Moody's recognises that the regulatory environment in which Transneft operates, including the tariff-setting process, has been sufficiently supportive thus far, with 2009 average annual increases in tariffs of approximately 23%. However, despite the challenging economic environment, Transneft continues to implement a very large government-requested investment programme, and Moody's believes the government may be more likely to suppress the rate of tariff increases going forward to limit the impact on oil producers' costs. The government's significantly expanded role in the markets for credit and foreign exchange also adds to dependence. The increased dependence between the company and the government results in a smaller uplift of Transneft's rating from its BCA and thus aligns the company's credit quality with that of the government.

The stable outlook reflects that of the Russian Federation, as, given the high support assumption, Transneft's ratings remain sensitive to changes in sovereign credit quality. A one-notch change in the sovereign rating would result in a commensurate change in the company's ratings, if other GRI inputs remain unchanged. A material change in the state support assumption for the company would also negatively affect its ratings, if there were no changes to other GRI inputs. Finally, changes in the BCA could also affect Transneft's ratings. No upward pressure for the BCA can be envisaged at the moment. Moody's could lower Transneft's BCA if it appears that Transneft is unable to implement its investment programme without a permanent impairment of its financial metrics below the minimum levels indicated for the current BCA.

The last rating action was implemented on 15 December 2008, when Moody's downgraded Transneft's and TCI's ratings to A3 following the change of the outlook on the sovereign ratings of the Russian Federation to stable from positive, and placed the ratings on review for possible downgrade due to the decision to review the default dependence assumption for the company.

The principal methodology used in rating Transneft is The Application of Joint Default Analysis to Government Related Issuers, published in April 2005, which can be found at moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory.

Headquartered in Moscow, OAO AK Transneft is fully controlled by the Russian government (the latter owns 100% of its voting shares) and is the largest crude oil transportation company in the world, with a 47,528 km pipeline system servicing both Russia's domestic crude oil needs and export operations. In 2007, the company transported 463.8 million tonnes of crude oil. IT reported sales of RUR221.9 billion (USD8.7 billion) for 2007.

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