

## Transneft Rating Raised To 'BBB+' Due To Government Support; Off Watch; Outlook Stable

### *Rationale*

On Nov. 29, 2006, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Russia-based pipeline operator OAO AK Transneft to 'BBB+' from 'BB+' and removed the rating from CreditWatch, where it had been placed with positive implications on Nov. 15, 2006. This follows a review of the Russian government's influence on government-related companies. The outlook is stable.

Standard & Poor's has reevaluated the Russian government's ability to enhance both Transneft's stand-alone credit quality and our expectation of extraordinary state support for the company in a distress situation. The ongoing positive influence comes from largely favorable, albeit nontransparent, regulation and tariff setting, and has led to a one-notch increase of the company's stand-alone credit quality, which is now assessed as 'BBB-' on a stand-alone basis. The ratings have received a further two-notch increase due to Transneft's strategic position as the delivery network for most of Russia's oil output and resulting tight links to the government.

Russia has made the nationalization of its natural resources a higher priority, and has demonstrated an increased willingness to support state-owned companies in the sector, particularly those in the Russian oil and gas sector. The government's willingness to support Transneft is based on the company's strategic role in transporting about 90% of the country's crude oil production and its involvement in large national development projects. The government's considerable ability to support companies is highlighted by its substantial liquidity reserves and the growing size of state-owned banks, which could be used to provide Transneft with liquidity, should it not be available in the market.

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## ***Transneft Rating Raised To 'BBB+' Due To Government Support; Off Watch; Outlook Stable***

Although the long-term rating on Transneft is now at the same level as the long-term foreign-currency sovereign rating on the Russian Federation (foreign currency BBB+/Stable/A-2; local currency A-/Stable/A-2), we continue to use a bottom-up approach when analyzing the rating on Transneft. We differentiate the rating from those on the federation to reflect Transneft's position as a commercial entity.

The stand-alone rating on Transneft is supported by the company's strong operating profile and historically cautious financial management, unique market position as the key transporter of Russia's crude oil production to domestic and export destinations, and highly competitive costs compared with those of shipping alternatives. Constraining factors include the evolving regulatory and political environment and risks associated with the company's major multi-billion U.S. dollar capital projects, such as the Eastern-Siberia-to-Pacific-Ocean (ESPO) pipeline. These projects will weaken the company's financial position.

### ***Liquidity***

Transneft's liquidity position is subject to the terms and conditions of the new debt that it will draw to finance the ESPO project. Nevertheless, we expect that liquidity resources from state-owned financial institutions and the market will be available for the company to support its position, if needed. The company's free operating cash flow is expected to be heavily negative during the period of intensive construction for the ESPO project.

### ***Outlook***

The stable outlook reflects our expectation that Transneft will retain its position as Russia's sole oil pipeline network operator, and thus its strategic importance to the government. Rating evolution will be largely driven by any changes in ongoing and extraordinary state support and evidence of adequate tariff increases or other forms of government financial support to finance new investments.

Standard & Poor's will continue to monitor Russia's evolving energy policies and the state's willingness to support politically and economically important companies such as Transneft. Unexpected variations of the company's investment policy, resulting in excessive debt increases, could pressure the rating if not offset by growing actual or expected state support.

The evolution of Transneft's stand-alone credit quality will depend on adequate structures for its ongoing investment projects (including the ESPO pipeline), such as adequate financing, tariff levels, and crude volumes.

### ***Ratings List***

To	From
OAOK Transneft	
Corporate credit rating	
BBB+/Stable/—	BB+/Watch Pos/—

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