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Atomic Energy Power Corporation (JSC)

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Atomic Energy Power Corporation (JSC)

Major Rating Factors

Strengths:

- Our assumption of a "very high" likelihood of government support in an event of financial distress.
- The government's provision of asset transfers, large capital injections, and political backing.
- Vertically integrated business model, with full nuclear cycle capabilities and a monopoly in Russia.
- Continued favorable outlook for growth in the nuclear industry.

Weaknesses:

- Complex and evolving structure with a nascent track record of operations.
- Limited transparency due to a lack of consolidated IFRS reporting.
- High operational and construction-related contingent exposures.
- Ambitious capital-expenditure program, albeit partly state financed with capital injections.

Sovereign Credit Rating

BBB-/Stable/A-3

Russia National Scale Rating
ruAAA/--/--

Rationale

The ratings on Russia's state-owned Atomic Energy Power Corporation (JSC) (AtomEnergProm) reflect our expectations of a "very high" likelihood of timely and sufficient extraordinary support from the Russian government in the event of financial distress. In addition, we think the company benefits from a vertically integrated business model and a secure monopoly over the civil nuclear segment in the Russian Federation (foreign currency BBB/Stable/A-3; local currency BBB+/Stable/A-2; Russia national scale 'ruAAA'). AtomEnergProm is a holding company and 100% subsidiary of State Atomic Energy Corporation Rosatom (Rosatom; not rated).

However, we view the company as having weak transparency because it has not yet prepared a set of consolidated accounts under International Financial Reporting Standards (IFRS). A lack of predictability is a further constraining factor, in our view, given the company's size, short track record as a separate entity, and still evolving corporate structure.

In accordance with our criteria for rating government-related entities (GREs), our view of a "very high" likelihood of extraordinary government support is based on our assessment of AtomEnergProm's:

- "Very important" role for the government. The company is very important for the Russian economy because it manages civil nuclear industry assets, including nuclear power station operations, providing 17% of all electricity output in Russia, and construction. It also manages uranium extraction (9%-12% of the global market according to different estimates) and enrichment, as well as fuel production (17% globally) across the full cycle. AtomEnergProm employs about 160,000 people; and
- "Very strong" link with the Russian government. As specified in legislation, the Russian government wholly owns AtomEnergProm through Rosatom, a state corporation. The privatization of major nuclear assets is not on the agenda, and such a move would nevertheless require legislative amendments. The company's activities are closely

monitored by the government.

We assess AtomEnergProm's stand-alone credit profile (SACP) at 'bb-'. We note that the government provides strong ongoing support in the form of equity injections, which we expect to continue until at least 2015-2020. In addition, profitability from AtomEnergProm's electricity generation is higher than that of its Russian peers, and we expect the company to benefit from market liberalization in the future. Moreover, the company enjoys a solid market position in uranium extraction, conversion, and enrichment, as well as in fuel assembly production segments--all of which are enhanced by a favorable growth outlook for the nuclear industry worldwide. However, AtomEnergProm has a short history of control over its subsidiaries because it was established in its current form in 2007. Specifically, we consider a lack of consolidated IFRS accounts to be a key information risk, especially in the area of future asset retirement obligations. Furthermore, AtomEnergProm is highly exposed to operational, engineering, and construction-related contingencies, in our view.

AtomEnergProm has an ambitious capital-expenditure program, which is likely to result in gradual debt accumulation in 2011-2015. However, the company expects the state to finance about 25%-30% of its capital spending in 2010-2015 via capital injections outlined in various government programs.

Liquidity

AtomEnergProm currently has an "adequate" liquidity position, in our opinion. As of Oct. 1, 2010, AtomEnergProm and its subsidiaries had Russian ruble (RUB) 134 billion (\$4.4 billion) in cash and deposits against RUB81 billion of debt. It also has a committed credit line totaling RUB5 billion from Sberbank (not rated) and, under existing "bank limits", has access to other banks' offers totaling more than RUB100 billion. We understand the company will maintain about RUB10 billion of available credit lines through 2011, although we note it does not plan to use them.

We expect AtomEnergProm's liquidity position to remain adequate for the rating level despite its plans to gradually increase debt to finance the investment program. The company benefits from well-established relationships with state-owned Russian banks. However, unless committed, we do not view loans from these banks as readily available liquidity sources.

Rosatom is developing a centralized treasury management function for its subsidiaries (including AtomEnergProm). This, in our view, could further enhance the company's liquidity position.

Outlook

The stable outlook reflects our expectations that the Russian government will continue to provide substantial ongoing support to AtomEnergProm. Furthermore, we do not expect to see any changes in policy or the regulatory framework that would alter our expectations of a "very high" probability of government support, either presently or over the medium term.

Ratings upside could result from the company significantly reducing the level of information risk by implementing IFRS reporting, especially when combined with stronger accountability at its subsidiaries. Further upside could result from increased centralization of liquidity and investment management.

If AtomEnergProm's liquidity position deteriorates or it accumulates debt more aggressively than we currently expect, the SACP could come under pressure, which could in turn lead us to lower the ratings. A change in our view

of the expectations of extraordinary government support for AtomEnergProm--including but not limited to decisions that diminish the company's importance and role for the government--could also put downward pressure on the ratings. A negative rating action on the sovereign would not necessarily result in a similar action on AtomEnergProm, provided that we do not revise our estimation of the likelihood of extraordinary government support.

State Ownership And Rating Methodology

We consider AtomEnergProm to be a GRE that benefits from a "very high" likelihood of timely and sufficient extraordinary support from the Russian government. We view AtomEnergProm as a "very important" company with a "very strong" link to the Russian government.

A company that is integral to the Russian economy

AtomEnergProm is very important for the Russian economy because it manages civil nuclear industry assets. Its responsibilities include:

- The operation of nuclear power stations (17% of all electricity output in Russia);
- Construction of nuclear power stations; and
- Uranium extraction (9% of world market), enrichment (45%), and fuel production (17%) for the full cycle, but with certain limitations on private activities in the sector.

The holding company and subsidiaries together employ about 160,000 people, which is about 0.25% of Russia's total workforce. AtomEnergProm's government-mandated role is to implement the state's policy in the civil nuclear sector. Nuclear technologies were touted as a top government priority in its efforts to restructure Russia's economy. We understand that AtomEnergProm's main goals are:

- The security of energy supplies;
- Nuclear security; and
- The innovative development of Russia's civil atomic industry.

In line with these goals, the government expects nuclear electricity production to expand by 45% by 2015 (compared with 2008 production levels). Moreover, to support economic growth and diversify away from gas-fired generation, the overall share of atomic electricity production in Russia's total electricity production is set to increase to 18.6% by 2015, and to 25%-30% by 2030, up from the current 17%.

Through certain of its subsidiaries, AtomEnergProm is an important Russian foreign policy tool, with projects across Asia, including China and India, Eastern Europe, and important supply contracts in Western Europe and the U.S. (mostly under international agreements). Consequently, the reputational aspect of the company's operations is very important for the Russian government because the foreign contracts of AtomEnergProm and Rosatom--such as constructing power stations and long-term fuel supply--run the risk of being cancelled in an event of nonpayment of debt. In addition, foreign-based assets controlled by AtomEnergProm or Rosatom subsidiaries--for example, large uranium deposits in Kazakhstan and Canada--might be seized in an event of nonpayment of debt.

Very strong link to the government

A presidential decree outlining the consolidation of all the country's civil nuclear assets led to AtomEnergProm's creation in July 2007. The company's owner, Rosatom, is the legal successor of the abrogated Federal Agency on

Nuclear Energy and was created by a federal law. The government fully owns Rosatom and profit is not the primary goal of this entity. Rosatom enjoys a special bankruptcy regime, enshrined in law, and is a government policy tool for the nuclear sector as a whole, including military applications. Rosatom also controls other important and valuable energy assets such as a large stake in InterRAO (not rated), an electricity exporter. Rosatom is the only state corporation that legally implements government functions, since it is one of the branches of executive power.

In 2008-2010, the ownership of designated subsidiaries was transferred to AtomEnergProm from Rosatom in the form of equity injections. The consolidation process is largely complete, although we note several immaterial subsidiaries could still be transferred and the company's consolidated corporate governance system continues to evolve.

The Russian government tightly supervises the sector and any private activity involving nuclear-related technologies requires government approval. A presidential decree presents an exhaustive list of entities that are allowed to possess nuclear materials and assets. All nuclear activities, except those implemented by the defense ministry, are also subject to licensing by Rosatom. The special bankruptcy regime, which to our knowledge has not been tested in practice, is supposed to cover all nuclear-sector-related enterprises, in order to secure full state control over nuclear-related assets. In a bankruptcy, the government has the preferential right to buy the affected entity or assets, and any deal that leads to the transfer of nuclear materials or assets to an entity not on the presidential list would be legally null and void. Over the short to medium term, we do not expect AtomEnergProm to be privatized, and to do so would require a presidential decree to be legal.

The government tightly monitors AtomEnergProm

AtomEnergProm's board consists of two Rosatom representatives and CEOs from the company's largest subsidiaries. The Russian president appoints Rosatom's head, and the appointment of other Rosatom managers is also under full government control. In addition to other reporting, AtomEnergProm submits weekly financial reports to Rosatom: the owner sets AtomEnergProm's financial policies and manages its financials under a management contract.

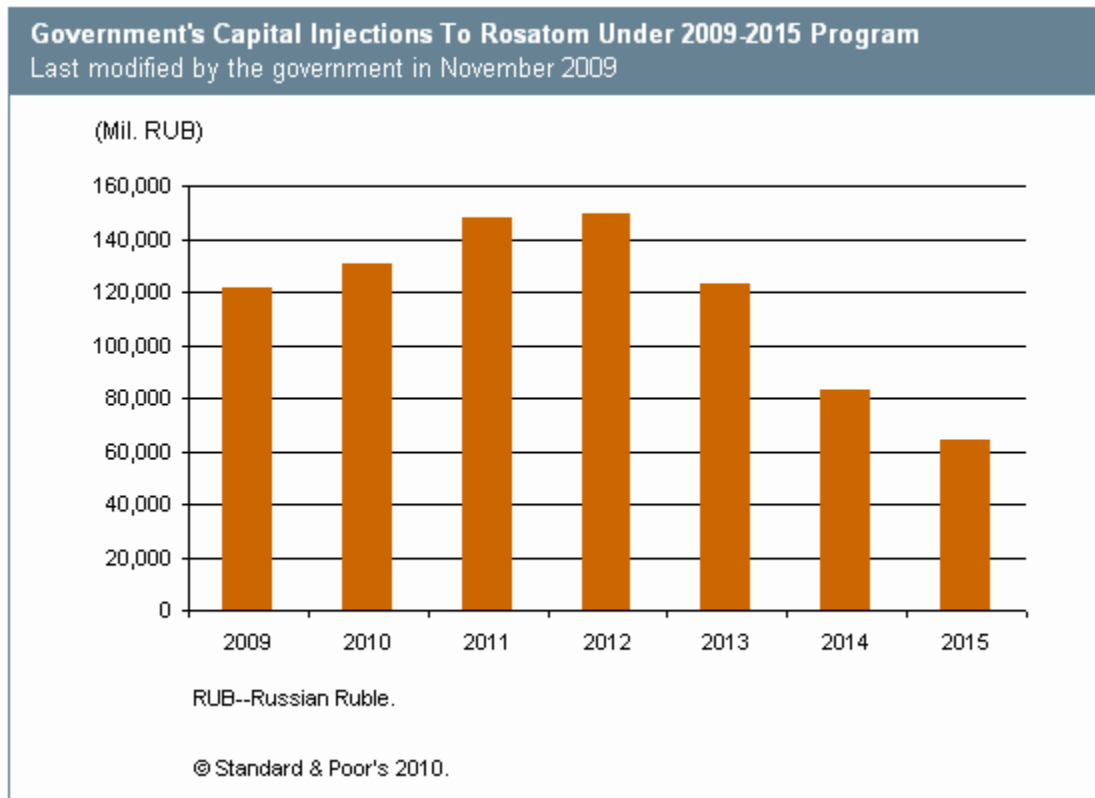
Strong Ongoing State Support

We think AtomEnergProm enjoys very strong ongoing state support in various forms, and we expect this support to continue in the medium term.

Capital injections

Capital injections for nuclear-related civil activities remain among the government's top spending priorities for the medium term. The state approved a program for Rosatom's activities, setting out various strategic goals for 2009-2015. The program foresees budget capital investments of RUB819 billion (to be adjusted for inflation and not legally binding), which are mostly pass-through investments to AtomEnergProm. We note that AtomEnergProm is eligible for the entire amount of investments earmarked for the construction of new power stations.

Chart 1



The actual amount of injections is subject to budget approval every year, and might fluctuate depending on government finances and pace of capital spending. For 2009, a tough year from a budget perspective, the state initially budgeted RUB73.3 billion to construct new power stations, which was slightly less than provided for in the 2009-2015 program. The state increased that amount by a further RUB15 billion when the additional 2009 budget spending was distributed, taking the total to RUB88.3 billion. The state (through Rosatom) has also directly provided RUB64 billion to ARMZ to acquire new subsidiaries abroad. The total amount of injections was more than RUB150 billion. In 2010, the state approved another large program relating to new technologies development, which includes Rosatom receiving RUB110 billion of government funds in 2010-2020.

Investment tax privileges

AtomEnergProm enjoys special benefits on profit tax to finance investments in safety systems, asset retirement, and the development of nuclear stations. For 2010, AtomEnergProm estimates the total amount of profit tax to be more than RUB15 billion.

Subsidies

The government compensates AtomEnergProm for unfavorable tariff regulations in certain remote areas of Russia, for example Chukotka, and also to support exports: AtomEnergProm's subsidiaries are expected to receive about RUB600 million in 2010.

Debt policy supported by the state

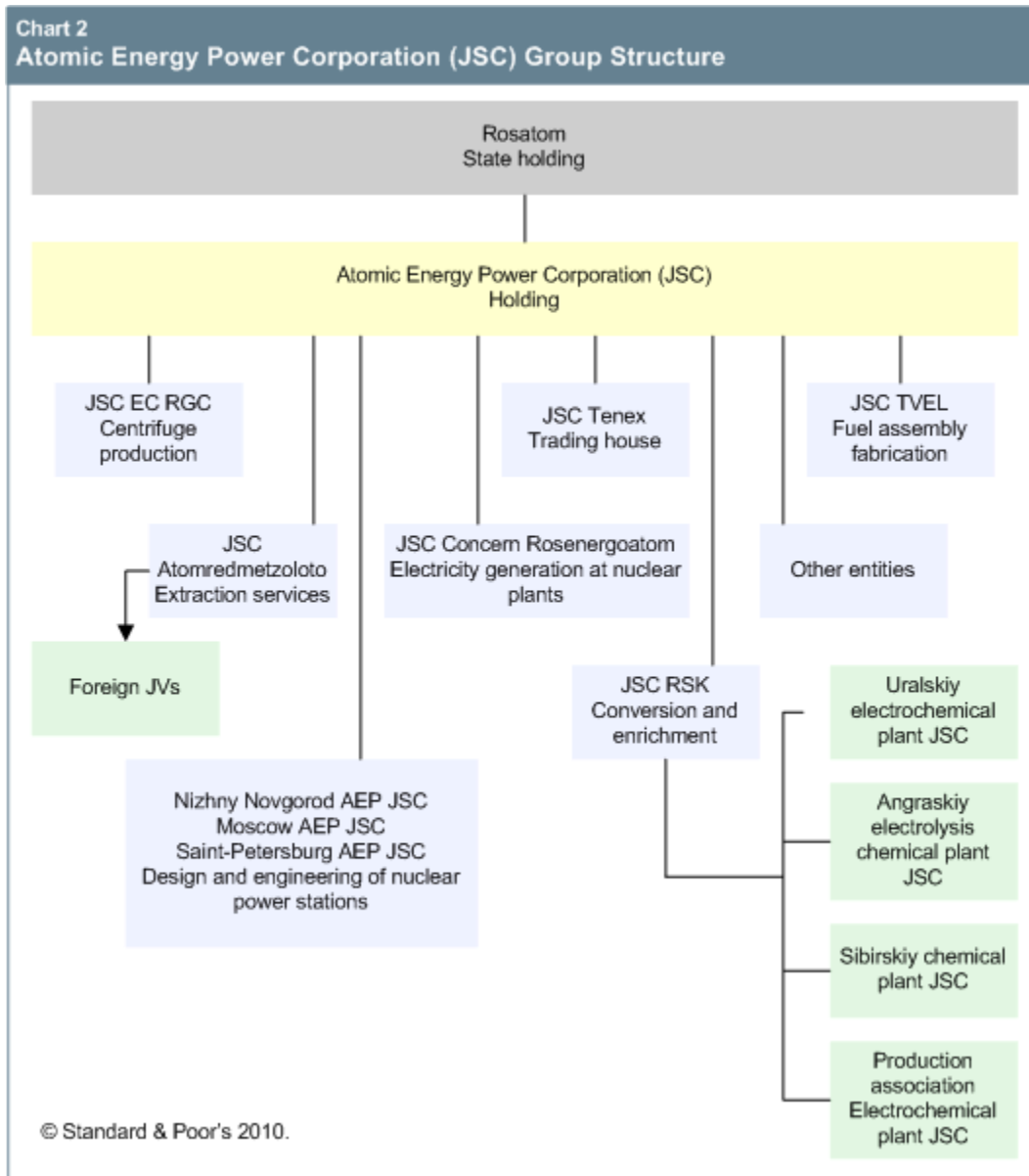
The company enjoys very good access to financing from state banks. Rosatom guaranteed its debut Russian ruble bond issue (RUB10 billion outstanding as of December 2010).

Minimal dividend requirements

So far, the government's strategy has been to support AtomEnergProm through minimal dividend requirements. Profits are to be reinvested in AtomEnergProm's assets or to finance investment programs as required by government policies. The state has no stipulated long-term dividend policy, and we view the dividend requirements as supportive for the company's credit profile. We understand that AtomEnergProm is not a source of financing for Rosatom's investment activities.

Business Description

Established in 2007, AtomEnergProm consists of a vertically integrated group of companies that consolidate the nonmilitary parts of Russia's nuclear industry. The company covers all the technical stages of the nuclear cycle (see chart 2).



Business Risk Profile: Satisfactory; Vertically Integrated Nuclear Activities Tempered By High Engineering And Construction Risks

In our opinion, AtomEnergProm's "satisfactory" business risk profile benefits from having a vertically integrated business model with full nuclear cycle capabilities and a monopoly position in Russia. Moreover, we think the nuclear industry has favorable growth prospects. However, a key risk factor remains the harm caused by a nuclear accident.

Table 1

Atomic Energy Power Corporation (JSC)--2009 Management Accounts Information						
(Mil. RUB)	Conversion and enrichment	Fuel assembly production	Electricity generation	Other	Inter-segment eliminations	Total
Revenues	79,432	38,235	183,036	140,089	(190,240)	343,205
EBITDA	26,238	15,451	108,118	33,014	(10,383)	175,934
Capital expenditures	16,420	8,751	185,208	4,216	N/A	214,345
EBITDA margin (%)	33%	40%	59%	24%	N/A	51%

Source: Atomic Energy Power Corporation (JSC) management accounts. N/A--Not applicable. RUB--Russian ruble.

Nuclear mining division is an important part of the value chain

We note that AtomEnergProm is once again the formal owner of ARMZ, a company which consolidates uranium extraction assets in Russia and Kazakhstan and has a number of joint ventures in Canada, Armenia, and Namibia. AtomEnergProm utilized all of the production at its Russia-based fields, although we understand that the company intends to sell externally from 2010 onward, after consolidating the stakes in its foreign acquisitions.

We believe the key strengths of AtomEnergProm's mining division are:

- Sound position as the world's second-largest uranium mining company by resource base and the fifth-largest global producer in terms of uranium output;
- Favorable outlooks on uranium spot prices and uranium consumption; and
- A monopoly position in Russia.

These strengths could be tempered by:

- Substantial investment needs and long-term payback of investments; and
- Above-average development costs of Russian mining sites compared with peers' sites in other countries.

Enrichment: Advanced technology creates a competitive advantage, despite trade barriers

We consider the key strengths of its enrichment activity to be:

- Extremely high barriers to entry, given restricted access to technology (the company is one of only three companies in the world with access to low-cost centrifugal technology);
- A strong market position in the oligopolistic and mature nuclear enrichment industry, with an estimated 45% global market share (including enrichment of peers' tails); and
- A long-term contract portfolio, with a large portion contracted up to 2020.

These strengths could be challenged by:

- Existing trade barriers for AtomEnergProm. The company's direct access to Western European markets is currently restricted to a 25% market share. Furthermore, its presence in the U.S. market is also regulated; and
- Exposure to third party services in the nuclear transportation segment.

Fuel assembly fabrication: Good market position but the threat from rivals is increasing

We believe this division benefits from the following advantages:

- Generally, each reactor type has historically required a certain fuel assembly type, thus creating an entry barrier for rivals. The company currently enjoys a monopoly position on the VVER (the Russian name for a pressurized

water reactor) and RBMK (a high-power channel reactor) markets--which combined totals 17% of the global nuclear fuel assembly fabrication market. Furthermore, it services reactors in 14 countries.

- Good contract predictability stemming from the long-term nature of nuclear fuel deliveries; and
- A favorable, medium-term growth outlook because five nuclear generating units are currently under construction abroad by AtomStroy Export (a sister company owned by Rosatom) and a further nine are under construction in Russia.

These advantages could be tempered by the following weaknesses:

- The choice of nuclear fuel provider potentially being determined by a need to diversify suppliers or for political reasons, which could threaten AtomEnergoProm's market share; and
- Existing obligations for timely deliveries and associated contract risk.

Electricity generation: Excellent profitability despite a material investment program

We believe the key strengths of the electricity generating division are:

- Strong ongoing government support. The company expects injections from the state to cover about 30%-35% of its capital-expenditure budget in 2010-2015;
- Leading capacity utilization position compared with that of peers, because the output of a nuclear power plant cannot be adjusted quickly;
- Expected higher-than-average benefits from electricity market deregulation due to historically low tariffs;
- A positive outlook for nuclear electricity generation based on the government's intention to increase the share of nuclear electricity generation in the total electricity output;
- Higher profitability because of lower-than-average operating costs in an industry context; and
- A diversified customer base.

These strengths are offset by:

- The implementation of a substantial investment program, which stipulates that the division spend RUB1.374 trillion in 2010-2015. The largest part (RUB1.111 trillion) is for the construction of new nuclear electricity generating capacity, with the goal of increasing output by 45%, to 234 billion kilowatt-hours a year in 2015;
- The inherent operational risks of nuclear power generation; and
- The risk of the authorities in the electricity industry imposing a quasi-regulatory regime on the company, despite ongoing deregulation.

Profitability: Boosted by low cost of generation

We think AtomEnergoProm enjoys strong profitability, compared with that of its peers, because of:

- The lower costs of generating electricity at nuclear power plants; and
- The use of centrifugal technologies for uranium enrichment, because it is 40x-50x less energy-intensive than gaseous diffusion technologies.

AtomEnergoProm's electricity generation division produces about 61% of the company's EBITDA. Based on Russian statutory financial statements, this division had an EBITDA margin of 59% in 2009, which is substantially higher than that of AtomEnergoProm's peers. As electricity market deregulation continues (with the complete opening of the wholesale electricity market commencing in 2011), we think the company's profitability will continue to improve due to historically low tariffs. However, there remains a risk of the authorities imposing a

quasi-regulatory regime on AtomEnergProm, in order to control electricity prices, in our opinion. Additionally, we note that results reported under IFRS might differ significantly from statutory accounts.

Financial Risk Profile: Aggressive Due To High Information Risk And Developing Corporate Governance

We consider the main weaknesses of AtomEnergProm's financial risk profile to be a lack of both consolidated IFRS financial statements and a tested unified financial policy (although we note the company approved a policy in 2010). A further constraint, in our view, is an evolving corporate structure with only a nascent track record of operations and a still-developing controls system.

Accounting

In our analysis, we have used AtomEnergProm's statutory consolidated financial statements prepared under Russian generally accepted accounting principles (GAAP). A lack of audited consolidated financial statements under IFRS creates above-average information risk, in our view, which also contributes to our assessment of the company's aggressive financial risk profile. We note AtomEnergProm plans to prepare audited IFRS financial statements for 2010 by mid-year 2011.

In our analysis, we have made several adjustments to the company's reported figures under Russian GAAP:

- We excluded capital-expenditure-related cash outflow of RUB152.5 billion from operating cash flow and added it to capital expenditure;
- We reversed the accrued expense on the development reserve of RUB67.5 billion because we view this item to be virtual, given that actual expenses related will be incurred in later periods;
- We transferred a RUB79.2 billion capital injection to capital from payables;
- We reclassified RUB19 billion of depreciation from the cost of sales to depletion, depreciation, and amortization; and
- We added RUB85 billion of asset retirement obligation liabilities, based on the management's estimates.

We also use EBITDA as a proxy for AtomEnergProm's cash flow, because we consider that metric to be more reliable than measures based on reported cash flow figures to illustrate its cash flow generation capacity.

Corporate governance, risk tolerance, and financial policies

We view management's risk policies as weak based on the following factors:

- Established in 2007, it has a rather limited track record of operations as a holding company;
- There is an explicit unified group financial policy in place, but full implementation has not yet occurred; and
- Evolving corporate structure and control systems.

We understand management plans to develop control procedures, implement a unified financial policy across the group, and finalize the group structure. Once materialized, these steps could improve AtomEnergProm's financial risk profile.

Cash flow adequacy: Strong cash flow protection could weaken as debt increases

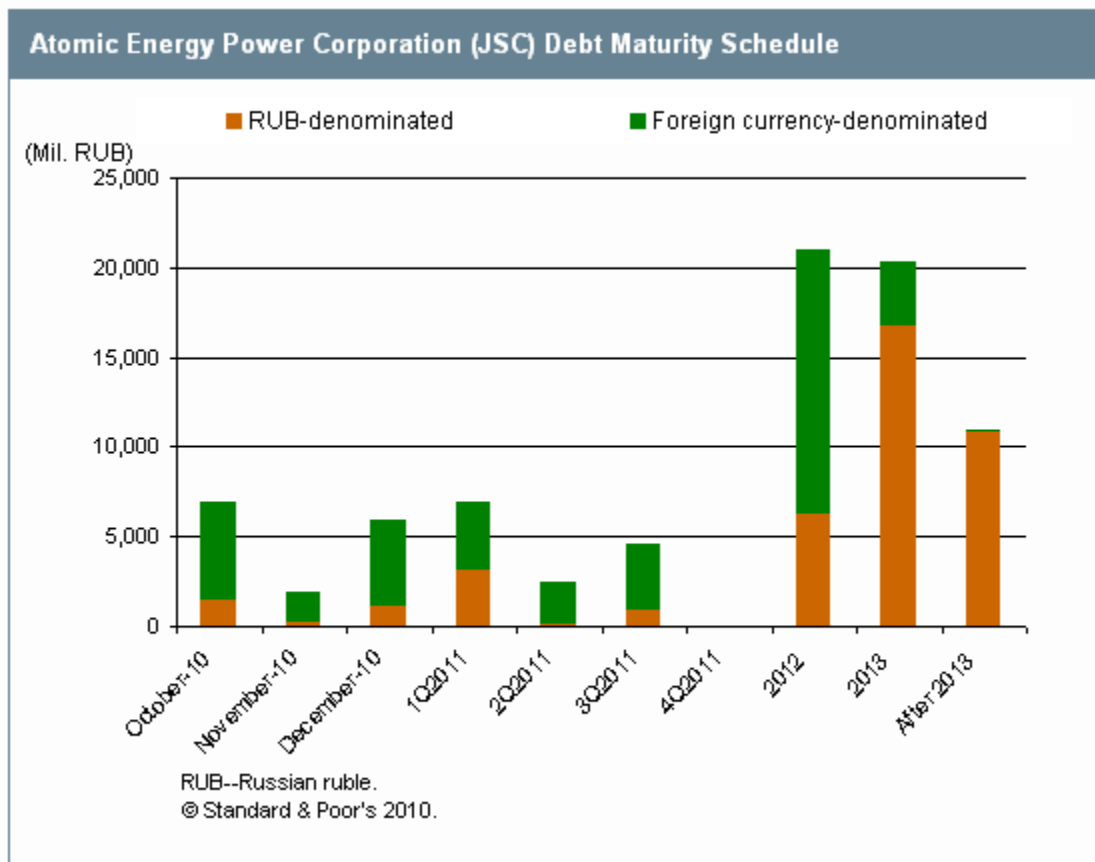
We expect free operating cash flow to be strongly negative in 2010-2015 due to the implementation of a large investment program, although we note that 25%-30% will be financed via injections from the state

In our assessment of the ratings, we assume that AtomEnergProm's cash flow protection will weaken in 2010-2012 as a result of increased investments and the potential disclosure of additional debt and debt-like liabilities (after the preparation of an audited, consolidated IFRS report). However, we think cash flow protection could remain adequate for the ratings and that the ratio of adjusted debt to EBITDA should remain at less than 2x.

Capital structure and asset protection: Modest leverage and a positive net debt liquidity position

The company currently has modest leverage compared with its levels of revenues and EBITDA: as of Oct. 1, 2010, the total amount of debt was RUB81 billion. The net debt liquidity position was positive. We note that only 35% of the company's total debt matures within next 12 months.

Chart 3



We do expect the debt level to increase, but we estimate that leverage will be adequate for the ratings and will not exceed 25% in 2010-2013. The only expected borrowing through 2010 is a \$500 million syndicated loan, which we understand is being considered by Tenex (not rated), a subsidiary of AtomEnergProm.

Foreign currency exposure is significant, in our opinion: 50% of total debt is denominated in U.S. dollars. We understand from management that foreign currency risk is offset only by U.S. dollar-denominated revenues and credit lines totaling \$240 million; there are currently no cross-currency hedges in place. Finally we note there is immaterial variable interest-rate exposure because 97% of the company's debt carries fixed interest rates.

Table 2

Atomic Energy Power Corporation (JSC)--Peer Comparison*						
	Atomic Energy Power Corporation (JSC)	AREVA†§	Urenco Ltd.¶	Electricite de France S.A.¶§	OJSC Oil Company Rosneft§	
Rating as of Dec. 17, 2010	BBB-/Stable/A-3	BBB+/Watch Neg/A-2	A-/Stable/A-2	A+/Stable/A-1	BBB-/Positive/--	
--Fiscal year ended Dec. 31, 2009--						
(Mil. \$)						
Revenues	11,533.6	12,324.1	1,608.3	95,172.4	34,695.0	
Net income from cont. oper.	4,348.8	408.9	491.8	5,602.5	6,514.0	
Cash flow from operations	5,076.7	599.0	735.7	14,733.9	10,340.8	
Capital expenditures	7,159.1	2,695.2	1,334.4	18,318.6	6,898.0	
Debt	6,968.6	7,295.6	3,595.1	106,353.2	21,531.6	
Equity	25,462.6	10,391.5	1,569.4	44,754.5	45,537.0	
Adjusted ratios						
Oper. income (bef. D&A)/revenues (%)	47.1	4.2	60.2	26.5	39.1	
EBIT interest coverage (x)	16.5	(1.1)	6.2	1.9	9.1	
EBITDA interest coverage (x)	16.7	1.2	8.3	3.0	13.3	
Return on capital (%)	18.5	(2.0)	16.0	10.9	13.5	
Cash flow from operations/debt (%)	72.9	8.2	20.5	13.9	48.0	
Debt/EBITDA (x)	1.3	16.4	3.7	4.3	1.6	
Total debt/debt plus equity (%)	21.5	41.2	69.6	70.4	32.1	

*Fully adjusted. †Fully adjusted (including postretirement obligations). §Excess cash and investments netted against debt.

Table 3

Atomic Energy Power Corporation (JSC)--Financial Summary*		
	--Fiscal year ended Dec. 31--	
	2009	2008
Rating history	BBB-/Stable/A-3	--/--/--
(Mil. RUB)		
Revenues	347,240	290,486
Net income from continuing operations	130,928	64,604
Cash flow from operations (OCF)	152,844	105,231
Capital expenditures	215,537	143,630
Debt	209,802	171,724
Equity	766,598	589,403
Adjusted ratios		
Oper. income (bef. D&A)/revenues (%)	47.1	36.9
EBIT interest coverage (x)	16.5	14.6
Return on capital (%)	18.5	11.3

Table 3

Atomic Energy Power Corporation (JSC)--Financial Summary* (cont.)		
OCF/debt (%)	72.9	61.3
Debt/EBITDA (x)	1.3	1.6

*Fully adjusted. RUB--Russian ruble.

Ratings Detail (As Of December 17, 2010)*		
Atomic Energy Power Corporation (JSC)		
Sovereign Credit Rating		BBB-/Stable/A-3
<i>Russia National Scale Rating</i>		ruAAA/--/--
Senior Unsecured (1 Issue)		BBB-
<i>Russia National Scale Rating (1 Issue)</i>		ruAAA
Sovereign Credit Ratings History		
15-Oct-2009		BBB-/Stable/A-3
15-Oct-2009	<i>Russia National Scale Rating</i>	ruAAA/--/--
Business Risk Profile		Satisfactory
Financial Risk Profile		Aggressive

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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