

December 29, 2011

## Atomic Energy Power Corp. (JSC)

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# Atomic Energy Power Corp. (JSC)

## Major Rating Factors

### Strengths:

- Our view of a "very high" likelihood of government support for the company in the event of financial distress.
- The government's provision of asset transfers, large capital injections, and political backing.
- A vertically integrated business model, with full nuclear cycle capabilities and a monopoly in Russia.
- Favorable outlook for Russian nuclear industry growth.

### Weaknesses:

- Complex and evolving structure with a nascent track record of operations.
- High operational and construction-related contingent exposures.
- Ambitious capital-expenditure program, leading to heavily negative free operating cash flows, albeit partly state financed with capital injections.

Issuer Credit Rating
BBB/Stable/A-3
<i>Russia National Scale Rating</i> ruAAA/--/--

## Rationale

The ratings on Russian state-owned Atomic Energy Power Corp. (JSC) (AtomEnergoProm) reflect Standard & Poor's Ratings Services' view of the company's "satisfactory" business risk profile and "significant" financial risk profile. The ratings also reflect our view of a "very high" likelihood of timely and sufficient extraordinary support for the company from the Russian government in the event of financial distress.

In addition, we consider that 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'). AtomEnergoProm is a holding company and 100% subsidiary of Rosatom State Atomic Energy Corp. (Rosatom; not rated).

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 AtomEnergoProm's:

- "Very important" role for the government because it manages the country's civil nuclear industry assets, including the power stations that provide 17% of Russia's electricity; and
- "Very strong" link with the Russian government, its owner. We understand that the privatization of major nuclear assets is not on the agenda, and the government closely monitors the company's activities.

The company also enjoys a solid market position in uranium extraction, conversion, and enrichment, as well as in fuel assembly production.

### S&P base-case operating scenario

Our base-case assumptions include continually strong, ongoing state support for AtomEnergoProm in the form of equity injections, at least until 2015-2020. In addition, the profitability of AtomEnergoProm's electricity generation,

at more than 40%, is higher than most Russian peers' and will likely remain so in the medium term. Margins might further improve in 2013 if regulatory control of electricity retail prices were to loosen.

We anticipate that the company will keep its solid market position in the construction of nuclear power stations, uranium extraction, conversion, and enrichment, as well as in fuel assembly production, supported by a favorable growth outlook for the Russian nuclear industry and the company's foreign operations.

However, AtomEnergoProm has a short history of control over its subsidiaries because it was established in its current form in 2007. Furthermore, AtomEnergoProm is highly exposed to operational, engineering, and construction-related contingencies, in our view.

### **S&P base-case cash flow and capital-structure scenario**

AtomEnergoProm has an ambitious capital expenditure program, which will likely result in heavily negative free operating cash flow and only gradual debt accumulation in 2011-2015. The company intends to spend about Russian ruble (RUB) 200 billion-RUB300 billion yearly on the program. However, it expects the state to finance about 25%-30% of its capital spending during this period via capital injections, and we expect that the actual extent of the company's capital spending will depend on availability of these injections.

Our base-case projections show the company's leverage (debt-to-EBITDA ratio) as remaining lower than 2.5x over the next three years, which we regard as commensurate with the ratings despite the investment program. We understand the company has some financial flexibility stemming from deferability of some of the projects. However, such decisions would need the government's approval.

### **Liquidity**

The short-term rating on AtomEnergoProm is 'A-3'. We assess the company's liquidity as "adequate", as defined in our criteria, and estimate the ratio of sources of liquidity to uses for the next 12 months at about 1.4x as of Oct. 1, 2011.

We expect that the level of capital spending will correlate with levels of equity injections from the state. Furthermore, we believe that the company may be able to defer some of the construction projects if state financing is reduced. We view the existence of about RUB70 billion of committed medium-term bank lines as of Oct. 1, 2011, as a positive factor. AtomEnergoProm has significant headroom under the existing covenants attached to various obligations, in our view.

## **Outlook**

The stable outlook on AtomEnergoProm reflects the outlook on the Russian Federation as well as our expectation that the Russian government will continue to provide substantial ongoing support to AtomEnergoProm.

Furthermore, we do not expect to see any changes in policy or the regulatory framework that would alter our view of a "very high" likelihood of government support, either presently or over the medium term.

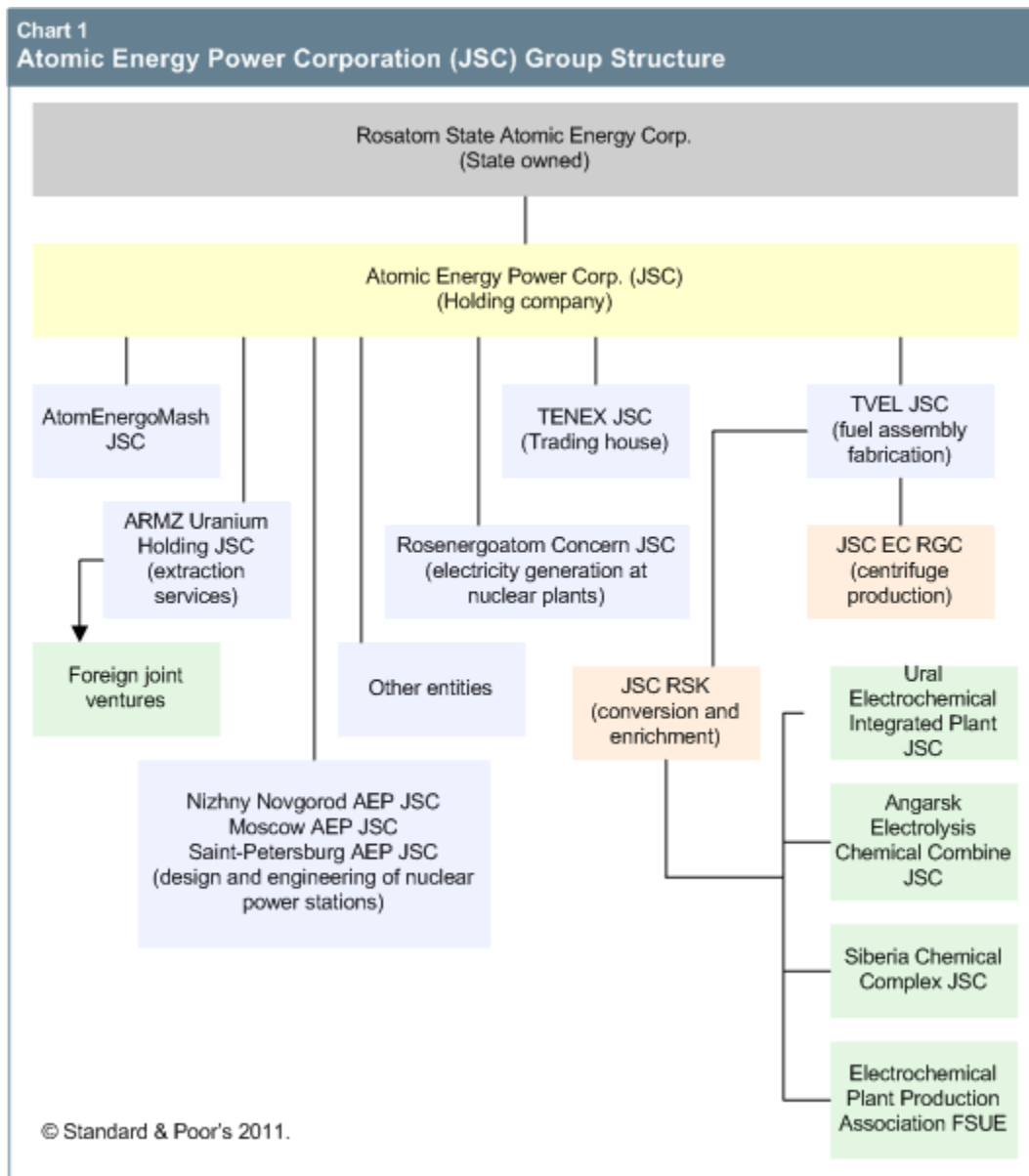
We could raise the rating following a positive rating action on the sovereign, if AtomEnergoProm also implemented moderate financial policies over the longer term, achieved a ratio of adjusted debt to EBITDA of less than 2.0x, and maintained adequate debt maturity and liquidity profiles.

If AtomEnergoProm's liquidity position deteriorated to below "adequate", according to our criteria, or it

accumulated debt more aggressively than we currently expect, we could lower our assessment of the stand-alone credit profile (SACP), which could lead to a downgrade. A change in our view of the likelihood of extraordinary government support for AtomEnergProm--for example, following decisions that diminish the company's importance and role for the government--could also put pressure on the ratings. A negative rating action on the sovereign would likely result in a similar action on AtomEnergProm, provided that our assessment of the SACP is unchanged.

## **Business Description**

AtomEnergProm is a vertically integrated group of companies that consolidates Russia's nonmilitary nuclear industry (see chart 1). The group covers all stages of the nuclear cycle, from the extraction of uranium to the generation of electricity at nuclear power plants. AtomEnergProm is one of the most important Russian government GREs, particularly owing to its crucial role for the Russian economy.



## Peer Comparison

The operations of AtomEnergomash's nuclear electricity subsidiary--Rosenergoatom Concern JSC--are similar to those of Electricité de France S.A. (EDF). EDF's installed capacity, at 63 gigawatts (GW), is much larger than AtomEnergomash's 24GW and it operates in a more transparent environment. However, it enjoys much less government support than AtomEnergomash and, in our view, has a lower potential for extraordinary support due to EU competition laws. EDF generates higher free operating cash flow and has more visibility than AtomEnergomash. At the same time, both companies feature low-cost generation and higher margins than most national peers, occupy the leading positions in their segments, and are able to benefit from spot prices.

Another close peer is French conglomerate AREVA, whose business model also includes uranium extraction,

conversion, and enrichment. In contrast to AtomEnergyProm, AREVA does not generate electricity, although it owns transmission and distribution grids. AtomEnergyProm's margins are much higher than AREVA's, and its debt is much lower.

U.K.-based URENCO, a uranium enrichment company, enjoys the same benefits of low-cost centrifugal technologies as AtomEnergyProm. However, it has better visibility and predictability in the markets in which it operates. URENCO's profitability is somewhat higher than AtomEnergyProm's, but it carries more debt.

**Table 1**

<b>Atomic Energy Power Corp. (JSC)--Peer Comparison</b>						
<b>Industry Sector: Energy</b>						
	<b>Atomic Energy Power Corp. (JSC)</b>	<b>Federal Grid Co. of the Unified Energy System</b>	<b>RusHydro (OJSC)</b>	<b>AREVA</b>	<b>Russian Railways (JSC)</b>	
Corporate credit rating as of Dec. 29, 2011	BBB/Stable/A-3	BBB/Stable/--	BB+/Stable/B	BBB-/Stable/A-3	BBB/Stable/--	
<b>(Mil. \$)</b>	<b>--Fiscal year ended Dec. 31, 2010--</b>					
Revenues	13,058	3,781	13,945	12,276	47,256	
EBITDA	5,993	1,818	2,245	964	15,384	
Net income from continuing operations	3,082	634	350	(460)	6,380	
Funds from operations (FFO)	5,014	1,969	1,832	812	11,331	
Capital expenditures	4,533	4,680	2,067	2,774	14,037	
Free operating cash flow	(607)	(2,641)	(658)	(1,648)	(2,462)	
Discretionary cash flow	(719)	(2,641)	(710)	(2,068)	(2,593)	
Cash and short-term investments	3,111	606	637	335	3,336	
Debt	7,619	2,133	1,670	7,521	17,817	
Equity	36,138	29,137	17,253	12,193	60,106	
<b>Adjusted ratios</b>						
EBITDA margin (%)	45.90	48.09	16.10	7.84	32.55	
EBITDA interest coverage (x)	9.46	21.34	22.96	2.08	7.99	
EBIT interest coverage (x)	7.46	11.12	17.03	1.13	5.78	
Return on capital (%)	11.13	2.95	9.17	2.76	14.84	
FFO/debt (%)	65.82	92.30	109.67	10.77	63.60	
Free operating cash flow/debt (%)	(7.97)	(123.79)	(39.33)	(22.53)	(13.82)	
Debt/EBITDA (x)	1.27	1.17	0.74	7.81	1.16	
Total debt/debt plus equity (%)	17.41	6.82	8.83	38.15	22.86	

## Government Support And GRE Methodology Impact

AtomEnergyProm is a holding company and full subsidiary of state-owned Rosatom. We consider the company to have a "very high" likelihood of timely and sufficient support from the Russian government in the event of financial

distress.

### **"Very important" role in the civil nuclear sector and the state's foreign policy**

Nuclear technologies form part of the government's efforts to diversify Russia's economy away from oil and gas. The government plans to increase the share of electricity from nuclear power plants to 18.6% by 2015 and to 25%-30% by 2030, from the current 17%. We understand that AtomEnergProm's main goals are to maintain:

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

In addition, through certain subsidiaries, AtomEnergProm is an important Russian foreign policy tool, in our view. The group has projects across Asia, including China and India; Eastern Europe; and important supply contracts in Western Europe and the U.S. Consequently, we believe the company's reputation is important to the Russian government because nonpayment of debt could lead to the cancellation of sizable foreign contracts.

### **"Very strong" link to the government**

In July 2007, the Russian government consolidated most of the country's civil nuclear assets--that were in the form of joint stock companies--by creating AtomEnergProm. AtomEnergProm's owner, state-owned Rosatom, is the legal successor of the abrogated Federal Agency on Nuclear Energy. Rosatom is legally protected by a special bankruptcy regime that aims to ensure state control of the country's nuclear assets and to consolidate Russia's military and nonmilitary nuclear assets. Rosatom is the only state corporation authorized to implement government functions.

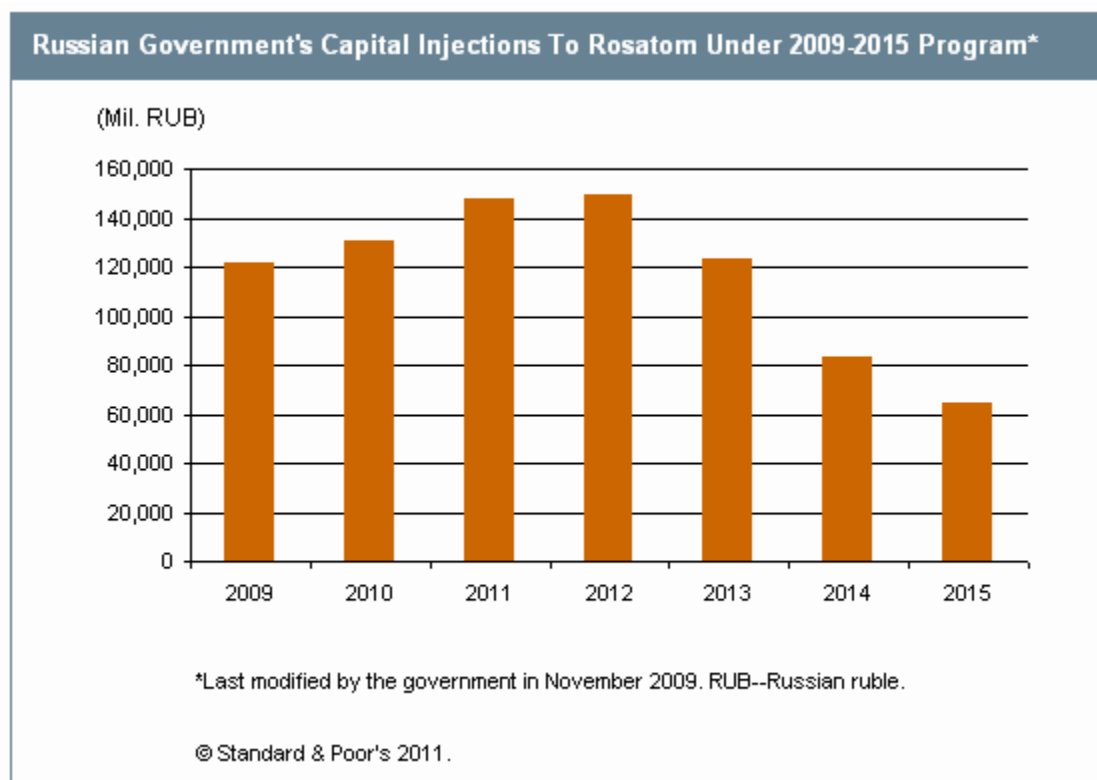
The Russian government tightly supervises the nuclear sector and any private activity involving nuclear technologies requires government approval. In the foreseeable future, we do not envisage AtomEnergProm's privatization, which would require a presidential decree.

AtomEnergProm's board consists of four Rosatom representatives and CEOs from the group's largest subsidiaries. The Russian president appoints Rosatom's head, and Rosatom defines AtomEnergProm's strategy, sets its financial policies, and manages its financials under a management contract.

### **The state's strong support for AtomEnergProm is set to continue into the medium term**

The state has set Rosatom strategic goals under the program it has approved for 2009-2015, which foresees total capital injections of about RUB819 billion (as under the 2008 government decree; see chart 2). These investments will mainly be passed through to AtomEnergProm, and we note that AtomEnergProm is eligible for the entire amount earmarked for the construction of new power stations. The actual amount of injections is subject to budgetary approval every year and might fluctuate depending on government's finances and the pace of capital spending.

Chart 2



In 2010, AtomEnergProm received about RUB68 billion and the 2011 total is about RUB69 billion, owing to the financing of new power stations in Russia. For 2012-2014, more than RUB58 billion annually are forecast. Rosatom is also set to receive RUB110 billion in government funding until 2020 under a sizable program for the development of new technologies, with a portion to be allocated to AtomEnergProm.

In addition, the government is cofinancing AtomEnergProm's construction of a power station in Turkey in 2011-2014, for which it is expected to provide about RUB115 billion. AtomEnergProm received about RUB22 billion of these funds in 2011.

Further support stems from 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 2011, AtomEnergProm estimates the total amount of profit tax benefits to be more than RUB70 billion.

## Business Risk Profile: Vertically Integrated Nuclear Activities Are Tempered By High Engineering And Construction Risks

In our opinion, AtomEnergProm's "satisfactory" business risk profile benefits from its vertically integrated business model and monopoly position in Russia. Moreover, we think the country's nuclear industry has favorable growth prospects. However, the potential for a nuclear accident remains a key risk.

### **The nuclear mining division is an important part of the value chain**

AtomEnergProm's mining division, ARMZ, consolidates uranium extraction assets in Russia and Kazakhstan and has a number of joint ventures in Canada, Armenia, and Namibia.

We believe the mining division's key strengths are its:

- Sound position as the world's second largest uranium mining company by resource base and the fourth largest global producer in terms of uranium output;
- Increasing diversification and mining base after completing foreign acquisitions; and
- A monopoly position in Russia.

These strengths could be moderated 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.

### **Uranium enrichment: Advanced technology creates a competitive advantage, despite trade barriers**

We consider the key strengths of the nuclear enrichment division to be:

- Extremely high barriers to entry, given restricted access to technology. AtomEnergProm 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 reenrichment of peers' depleted uranium); and
- A long-term contract portfolio, with a large portion contracted up to 2020.

These strengths could be challenged by:

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

### **Fuel assembly fabrication: Solid 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, which acts as a barrier to competition. The company currently enjoys a monopoly position in Russian pressurized water reactors (VVER; Vodo-Vodyanoi Energetichesky reactors) and RBMK (high-power channel reactors) markets, which combined totals 17% of the global nuclear fuel assembly fabrication market. It also services reactors in 10 countries;
- Good contract predictability stemming from the long-term nature of nuclear fuel deliveries; and
- A favorable, medium-term growth outlook. AtomEnergProm, together with a sister company--AtomStroyExport--has contracts for 21 new nuclear generating units abroad and is currently constructing four. AtomEnergProm alone is constructing nine units in Russia. A new unit at Kaliniskaya power station has already been completed.

These advantages could be tempered by:

- Potential political reasons behind the choice of nuclear fuel providers or counterparties' need to diversify suppliers, both of which could threaten AtomEnergProm's market share; and

- Existing obligations for timely deliveries and associated contract risk.

### **Electricity generation: Good profitability, strong ongoing support, but 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 25%-30% of its capital-expenditure budget in 2011-2015;
- Leading capacity utilization position compared with peers' because the output of a nuclear power plant cannot be adjusted quickly;
- A positive outlook for nuclear electricity generation in Russia, based on the government's intention to increase the share of nuclear energy 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:

- Lack of a tested long-term regulatory environment for electricity industry. At the beginning of 2011, the Russian government introduced measures to cap the increase in electricity prices at 15% year on year, including cancellation of capacity payments indexation and special safety and investment components for the company.
- The implementation of a substantial investment program, which stipulates spending RUB1.37 trillion in 2010-2015. The majority (RUB1.11 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
- Regulatory pressure aimed at controlling the increase of retail electricity prices.

### **Financial Risk Profile: Strong Ongoing State Injections And Low Leverage, But Sizable Negative Free Cash Flows**

The major constraints of AtomEnergProm's "significant" financial risk profile are:

- Expectations of heavily negative free operating cash flows in the medium term. The company has been implementing an ambitious investment program with annual outflows of RUB200 billion-RUB300 billion planned for 2011-2015, which require significant external financing;
- Modest visibility and transparency of the company, owing to only one set of financial statements under International Financial Reporting Standards (IFRS) so far;
- A limited track record of operations; and
- Evolving cohesion of group financial policies, corporate structure, and control systems.

These weaknesses are partly mitigated by:

- Strong ongoing government support in the form of equity injections, a benign dividend policy, and subsidies. Modest dividend requirements mean that profits are reinvested in AtomEnergProm or Rosatom. In addition, the government compensates AtomEnergProm for unfavorable tariff regulations in certain remote areas of Russia, for example at Chukotka, which is a special price sector, and to support exports;
- Currently low debt leverage and ample liquidity deposits. In our view, the state supports the company's debt policy. In addition, Rosatom guaranteed the company's RUB10 billion Russian ruble bond issue in 2010;

- Strong bank relationships and a significant amount of available, committed long-term credit lines; and
- A favorable debt maturity profile.

## Financial Statistics/Adjustments

AtomEnergProm's first set of financial statements under IFRS was for 2010. Standard & Poor's makes its standard adjustments to the company's reported figures, including adding asset retirement and pension obligations, as well as guarantees issued to debt; reclassifying nonoperating income and expenses; and reversing losses on property, plant, and equipment and inventory disposals, which we treat as one-time items.

**Table 2**

<b>Reconciliation Of Atomic Energy Power Corp. (JSC) Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. RUB)</b>										
<b>--Fiscal year ended Dec. 31, 2010--</b>										
<b>Atomic Energy Power Corp. (JSC) reported amounts</b>										
	<b>Debt</b>	<b>Shareholders' equity</b>	<b>Revenues</b>	<b>EBITDA</b>	<b>Operating income</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Cash flow from operations</b>	<b>Dividends paid</b>	<b>Capital expenditures</b>
Reported	95,569	1,035,130	391,430	175,617	114,896	--	137,660	137,660	3,335	143,865
<b>Standard &amp; Poor's adjustments</b>										
Postretirement benefit obligations	23,254	--	--	1,651	1,651	2,156	(2,617)	(2,617)	--	--
Capitalized interest	--	--	--	--	--	7,993	(7,993)	(7,993)	--	(7,993)
Asset retirement obligations	106,578	--	--	--	--	8,837	(9,383)	(9,383)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	22,622	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	32,639	--	--
Minority interests	--	48,130	--	--	--	--	--	--	--	--
Debt - Guarantees	2,975	--	--	--	--	--	--	--	--	--
EBITDA - Other income/(expense)	--	--	--	2,386	2,386	--	--	--	--	--
Total adjustments	132,807	48,130	0	4,037	26,659	18,986	(19,993)	12,646	0	(7,993)
<b>Standard &amp; Poor's adjusted amounts</b>										
	<b>Debt</b>	<b>Equity</b>	<b>Revenues</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Funds from operations</b>	<b>Dividends paid</b>	<b>Capital expenditures</b>
Adjusted	228,376	1,083,260	391,430	179,654	141,555	18,986	117,667	150,306	3,335	135,872

RUB--Russian ruble.

Table 3

<b>Atomic Energy Power Corp. (JSC)--Financial Summary</b>	
<b>Industry Sector: Energy</b>	
<b>(Mil. RUB)</b>	<b>Fiscal year ended Dec. 31, 2010</b>
Revenues	391,430
EBITDA	179,654
Net income from continuing operations	92,376
Funds from operations (FFO)	150,306
Capital expenditures	135,872
Free operating cash flow	(18,205)
Discretionary cash flow	(21,540)
Cash and short-term investments	93,244
Debt	228,376
Equity	1,083,260
<b>Adjusted ratios</b>	
EBITDA margin (%)	45.90
EBITDA interest coverage (x)	9.46
EBIT interest coverage (x)	7.46
Return on capital (%)	11.13
FFO/debt (%)	65.82
Free operating cash flow/debt (%)	(7.97)
Debt/EBITDA (x)	1.27
Debt/debt and equity (%)	17.41

**Ratings Detail** (As Of December 29, 2011)**Atomic Energy Power Corp. (JSC)**

Issuer 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

**Issuer Credit Ratings History**

14-Dec-2011	BBB/Stable/A-3
15-Oct-2009	BBB-/Stable/A-3
15-Oct-2009 <i>Russia National Scale Rating</i>	ruAAA/--/--

**Business Risk Profile**

Satisfactory

**Financial Risk Profile**

Significant

\*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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