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Research Update:

Eesti Energia AS Outlook Revised To Negative On Possible Investment In Lithuania Nuclear Plant

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Rationale

On Aug. 27, 2007, Standard & Poor's Ratings Services revised the outlook on Estonia-based integrated electric utility Eesti Energia AS (EE) to negative from stable to reflect the risk that the company's credit quality will weaken as a result of its possible participation in a prospective new nuclear power plant at Ignalina, Lithuania.

At the same time, the 'A-' long-term corporate credit rating on the company was affirmed.

The rating reflects EE's strong business risk profile, which is supported by its transmission and distribution monopolies, and its dominant position in electricity generation and supply in Estonia. It also reflects EE's strengthened position as a regional electricity exporter following the planned closure of aged reactors at the existing Ignalina nuclear plant and the January 2007 opening of the Estlink subsea cable to Finland.

The rating is underpinned by EE's supportive regulatory environment (reflected, for example, by the postponed opening of the Estonian electricity market to competition), and the absence of privatization and restructuring plans.

These strengths are offset by EE's reliance on Estonia's small electricity market, and the risk, albeit decreasing, of political interference in tariff setting and structural features.

The planned Ignalina nuclear project is based on a 2006 agreement between the governments of Lithuania, Estonia, Latvia, and (at a later stage) Poland. However, realization of the project, including funding, will be the responsibility of the participating state-owned power companies. EE could participate in the nuclear project with a 22% stake. The nuclear power plant would have maximum installed capacity of 3,400 MW at a projected cost of up to €4 billion. EE's counterpart in Lithuania, Lietuvos Energija (A-/Negative/A-2), is expected to be responsible for the plant's operations.

Construction of a first reactor unit at Ignalina is scheduled to start in 2009. There are a number of unresolved issues, however, including environmental permits and the distribution of ownership stakes in the project. These considerations could ultimately alter the technical and financial scope of the project.

Details about the financing arrangements, including risk transfer from the project to EE and the impact on the company's financial profile, were unavailable at the time of writing. However, if EE funds its share in the nuclear investment largely through new debt, the company's financial profile could weaken significantly from its currently strong levels, particularly as the company would be exposed to a lengthy construction period with no

corresponding revenues.

EE's strategic rationale for investing in nuclear power differs somewhat from that of its main project partner, Lietuvos Energija, given Lithuania's historic reliance on nuclear power generation. Notwithstanding, the investment in Ignalina could offer EE attractive diversification benefits given its carbon-intense generation portfolio. Furthermore, the investment would bolster EE's position as a regional electricity exporter.

EE's results for the fiscal year ended March 31, 2007 were strong and in line with our expectations for the rating. Despite mild weather, resulting in lower electricity exports and lower heating sales, revenues and EBITDA both improved on the back of strong domestic demand. EE has benefited from the sale of excess carbon dioxide emission allowances, improving its bottom line by €96 million for the full year ended March 31, 2007. Funds from operations (FFO) interest coverage was 14x and FFO to debt 65% in the same period.

Liquidity

EE's strong liquidity is underpinned by a cash position of €33 million and €235 million in deposits (at March 31, 2007), likely strong operating cash flows, and access to €105 million in unused long-term bilateral loan arrangements. This compares favorably with only €6.4 million in short-term debt, and €200 million in projected capital expenditure in the fiscal year ending March 31, 2008.

EE is subject to meeting certain covenants on its debt related to financial performance. At March 31, 2007, the company was in compliance with all of its covenants. EE's €300 million bond documentation contains an acceleration trigger linked to government ownership.

Outlook

The negative outlook reflects the potential for significant weakening of EE's financial profile if the company participates in the Ignalina project. A downgrade could occur on receipt of further details about EE's investment in the proposed plant, including firmer commitments and greater clarity about the financing arrangements. The extent of any downgrade will ultimately depend on the transfer of risk to EE and the impact on the company's financial profile. The outlook could be revised to stable if EE reduces its commitment to the nuclear project significantly, or in the unlikely event that the project does not materialize at all.

Ratings List

	To	From
Corporate credit rating	A-/Negative/--	A-/Stable/--

NB: This list does not include all ratings affected.

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