MOODY'S INVESTORS SERVICE

ISSUER IN-DEPTH

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Latvenergo AS

Green Bond Assessment

Summary Analysis

Summary Opinion

A GB1 (Excellent) grade is assigned to the green notes issued by Latvenergo AS (Baa2 stable), the largest power supply utility in the Baltics. The grade is supported by a well-defined organization and decision-making process focused on financing qualifying energy efficiency and environmental preservation projects, transparent management of proceeds, and effective reporting and disclosure practices, which reflect commitments to broaden impact disclosures in future reporting. Key considerations in our assessment include:

» Latvenergo has implemented an internal system for approving eligible projects funded by green bonds, which aims ensure all projects adhere to best practices of corporate governance.

» Allocations target categories that include renewable energy, energy efficiency and environmental preservation, while proceeds will not go towards nuclear or fossil fuel projects.

» While individual projects were not cited at the time of the offering, the company published a thorough disclosures on use of proceeds, which detailed what percentage of funds has been allocated to particular projects.

» An amount equal to net proceeds will be credited to a special account, where the balance will be held on deposit until all funds are disbursed. An internal audit unit at Latvenergo has conducted oversight.

» Commitment to publish annual green bond reports as long as notes remain outstanding, and ultimately expand disclosures to include expected environmental outcomes and benefits.

THIS REPORT WAS REPUBLISHED ON 2 AUGUST 2017 WITH AN UPDATED EXHIBIT 1

Factor	Factor Weights	Score	Weighted Score
Organization	15%	1	0.15
Use of Proceeds	40%	1	0.40
Disclosure on the Use of Proceeds	10%	1	0.10
Management of Proceeds	15%	1	0.15
Ongoing Reporting and Disclosure	20%	1	0.20
Weighted Score			1.00

The transaction's weighted score, using the green bond scorecard, is 1.0. This, in turn, corresponds to a GB1 grade.

Transaction Summary

Latvenergo is the first state-owned company in Eastern Europe to issue green bonds, which now represent about 49% of the company's total bonds outstanding. It has issued two tranches of senior unsecured green bonds in the form of notes pursuant to a second program for the issuance of notes in the combined amount of €100 million. These transactions include:

» €75 million, 1.9% senior unsecured fixed-rate notes due 2022, which were issued on 10 June 2015

» €25 million, 1.9% senior unsecured fixed rate notes due 2022, which were issued on 14 April 2016

The proceeds have been intended to finance and refinance, in whole or in part, eligible projects that target (a) mitigation of climate change, including investments in low-carbon and clean technologies, such as renewable energy and energy efficiency projects; (b) environmental preservation, including flood protection projects; and (c) projects related to a sustainable environment, that will account for up to 10% of the issued amount. The Green Bond Assessment was assigned as of 12 October 2016.

Strengths and Weaknesses

Strengths	Weaknesses
Well-defined organization structure and decision making process for considering, evaluating and approving eligible projects.	
100% of the proceeds are allocated to qualifying environmental eligible projects.	
Latvenergo has committed to publishing annual reports and to continue publishing such disclosures as long as the notes are outstanding.	
An amount equal to the net proceeds derived from the issuances of the notes had been credited to a special account that was used to support the firm's financing of its eligible green projects.	
Latvenergo has disclosed the identity of individual projects funded, including project categories, operating segment, project name, status, project completion date as well as the financial allocation in EUR terms.	

Organization

Ahead of its green bond launch in June 2015, Latvenergo adopted a Green Bond Framework that sets forth a process for evaluating and selecting environmental projects; defining and enumerating eligible project categories and projects and procedures for earmarking proceeds derived from the bond offerings; and reporting practices. The framework was assessed by an external party, the Center for International Climate and Environmental Research, Oslo (CICERO).

Latvenergo has implemented a well-defined organizational structure and decision-making process for considering, evaluating and approving eligible projects. All expenditures and capital projects that are undertaken pursuant to Latvenergo's Green Bond

Framework are subject to approvals in line with its adoption of broader general best practices of corporate governance. These are intended to ensure accountability and operational efficiency pursuant to which capital investments and expenditures generally are approved according to Latvenergo's internal approval procedures that form part of its integrated management system. The integrated management and project management systems have been designed to comply with International Organization for Standardization (ISO) guidelines and are subject to external audits that are performed by externally certified institutions.

With regard to green bonds, the list of possible eligible projects initially is compiled by Latvenergo's business planning and control department. The projects are then reviewed and approved by the environment and occupational health and safety unit, consisting of environmental specialists and environmental engineers, following which the projects are reviewed by the treasury department. Final reviews are conducted, approved by the CFO. Such decisions are recorded and fully documented.

In terms of project selection, priorities at the macro level are given to projects contributing to Latvenergo's strategic goals as well as the European Union's commitments under the Paris Agreement. This calls for the EU's 28 member states, including Latvia (A3 stable), to achieve a binding target of reducing domestic greenhouse gas emissions by at least 40% by 2030 compared to 1990. Latvia's near-term goal of achieving an 8% reduction by 2020 relative to 1990 levels has already been met.

That said, while eligible projects categories and project types are set out in the Green Bond Framework, the criteria for qualifying such investments is more clearly articulated for internal decision-making rather than external disclosures.

In addition to the internal expertise provided by the professional staff of Latvenergo's environmental management unit, as well as the external capabilities derived from equipment manufacturers and contractors retained to implement eligible projects, Latvenergo teams up with independent organizations or scientists to conduct environmental research and impact studies.

Factor 1: Organization (15%)	Yes	No
Environmental governance and organization structure appear to be effective	●	
Policies and procedures enable rigorous review and decision making process	●	
Qualified and experienced personnel and/or reliance on qualified third parties	●	
Explicit and comprehensive criteria for investment selection, including measurable impact results	●	
External evaluations for decision making in line with project characteristics	●	
Factor Score	1	

Use of Proceeds

Latvenergo continues to gradually reconstruct the hydropower units at its three plants, Plavinas, Riga and Kegums, to replace outdated hydroelectric turbines and increase the installed capacity, efficiency rate and annual electricity output to ensure reliable, efficient, sustainable and competitive operation of the Daugava Hydro-Power Plants (HPPs). That will, in turn, ensure a more efficient use of water, as well as investments in transmission system assets, such as the Kurzeme Ring project.

Although allocations to individual projects may vary, 100% of the proceeds attributable to the combined transactions are expected to be allocated to project categories and projects that qualify under Latvenergo's Green Bond Framework and, in turn, eligible environmental project categories pursuant to widely accepted broad-based classifications. These include:

- Renewable energy and energy efficiency (construction and reconstruction of transmission and distribution networks to decrease network losses and provide possibilities to connect renewable energy; smart grid projects)
- Environment preservation (flood protection, waste and water management)

» Sustainable environment (may include environmental research and development and programs within nature conservation and biodiversity, up to 10% of proceeds)

Furthermore, green bond proceeds will not finance nuclear or fossil fuel projects. Latvenergo's stated intention was to allocate the majority of the green bond proceeds for financing of new projects and refinancing of eligible projects finalized within one year prior to the issue or later.

Factor 2: Use of Proceeds	Yes	No
>95% - 100% of proceeds allocated to eligible project categories that are determined based on the issuer's adopted policies and the categories established under the Green Bond Principles that will be further informed by one or more robust and widely recognized green bond frameworks or taxonomies that qualify eligible projects, including any applicable regulatory guidelines.	●	
Factor Score	1	

Disclosure on the Use of Proceeds

Latvenergo has committed to publishing green bond annual reports.

The identity of individual projects funded was not disclosed at the time of the offerings, however, following both issuances of notes, the company published comprehensive reports detailing the allocation of proceeds covering the entire sum. The comprehensive reports were integrated in the company's Sustainability and Annual Report and are also posted on the company's website.

The report disclosed that about 66% of the proceeds were allocated to generation projects, including electricity generation and thermal energy as well as electricity supply and whole generation operations, 24.9% to transmission oriented projects and around 9% to distribution projects. More specifically, the report notes that the major eligible projects involved the Kurzeme Ring and Daugava HPP hydropower reconstruction project and details project categories, operating segment, project name, status, project completion date as well as the financial allocation in euro terms.

At the same time, the report provides a descriptive justification for each project's eligibility and potential results have been added in the 2016 Annual Report. That said, Latvenergo has committed to expanding its disclosures in the future

Factor 3: Disclosure on the Use of Proceeds	Yes	No
Description of green projects, including portfolio level descriptions, actual or intended	●	
Adequacy of funding and/or strategies to complete projects	●	
Quantitative and/or qualitative descriptions for targeted environmental results	●	
Methods and criteria, both quantitative and qualitative, for calculating performance against targeted environmental results	●	
Issuer relies on external assurances: Second Party reviews, audits and/or third party certfications	●	
Factor Score	1	

Management of Proceeds

As set out in Latvenergo's Green Bond Framework, an amount equal to the net proceeds derived from the issuances of the notes will be credited to a special account that will support the company's financing of its eligible green projects. As long as the notes remain outstanding and the special account has a positive balance, at the end of every fiscal quarter funds will be deducted from the special account and added to Latvenergo's cash pool in an amount equal to all disbursements from that pool made during such quarter in respect to funding and/or refinancing of eligible projects.

Until fully disbursed, the special account balance will be held on deposit with SEB Bank in the form of liquidity reserves.

Furthermore, in January 2017, an independent internal audit unit within Latvenergo issued an opinion on compliance on the management of proceeds from the bond issue and the compliance of the selection of eligible projects within the Green Bond Framework. The audit unit's work complies with the International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors, and whose activities are monitored by the Latvenergo's audit committee.

Factor 4: Management of Proceeds	Yes	No
Bond proceeds are segregated and separately tracked on an accounting basis or via a method by which proceeds are earmarked	●	
Application of proceeds is tracked by environmental category and project type	●	
Robust process for reconciling planned investments against actual allocations	●	
Clear eligibility rules for investment of cash balances	●	
Audit by external organization or independent internal audit unit	●	
Factor Score	1	

Ongoing Reporting and Disclosure

Latvenergo has committed to publishing annual reports and will continue to do so as long as the notes remain outstanding.

In line with its green bond reports already published, Latvenergo will disclose the identity of individual projects funded, including project types, operating segment, project name, status, project completion date and financial allocation in euro terms.

The company has committed to expand its disclosures in the future to include expected environmental outcomes and benefits, as well as quantified estimated benefits once the reconstruction projects have been completed, and expected environmental outcomes are reported in the 2016 Annual Report. Exhibit 1 shows the operating profile of the company.

Factor 5: Ongoing Reporting and Disclosure	Yes	No
Reporting and disclosure post issuance provides/to be provided detailed and timely status updates on projects	●	
Ongoing annual reporting is expected over the life of the bond	●	
Disclosures provide granular detail on the nature of the investments and their expected environmental impacts	●	
Reporting provides/to be provided a quantiative and/or qualitative assessment of the environmental impacts actually realized to-date	●	
Reporting includes/to include quantitative and/or qualitative explanation of how the realized environmental impacts compare to projections at the time the bonds were sold	●	
Factor Score	1	

Exhibit 1
Latvenergo's generation, distribution and transmission capacity

Segment	Measure	Units
Generation	Installed Electrical Capacity (MW)	2,569
	Installed Thermal Energy Capacity (MW)	1,842
Distribution	Line Length (km)	93,813
	Transformer Capacity (MVA)	5,892
Transmission	Line Length (km)	5,237
	Transformer Capacity (MVA)	8,950

Source: Latvenergo Group Sustainability and Annual Report 2016

About Latvenergo AS

Headquartered in Riga, Latvia, Latvenergo Group is the largest power supply utility in the Baltics, operating with three business segments. These include generation and supply, distribution, and lease of transmission system assets. Latvenergo Group is comprised of its parent company, Latvenergo AS, a public limited company incorporated in accordance with the laws of the Republic of Latvia, and seven subsidiaries. All shares in Latvenergo AS are owned by the Republic of Latvia.

Moody's Green Bond Assessment (GBA)

Moody's GBA represents a forward-looking, transaction-oriented opinion on the relative effectiveness of the issuer's approach to manage, administer and allocate assets to, and report on, environmental projects financed by proceeds from green bond offerings. GBAs are expressed using a five-point relative scale, ranging from GB1 (Excellent) to GB5 (Poor). A GBA does not constitute a credit rating.

Moody's Related Research

Methodology:

» Green Bonds Assessment (GBA), March 30, 2016

Sector In-Depth:

» Green Bonds - Global: France's Sovereign Offering Propels Strong First-Quarter 2017 Issuance, April 20. 2017

» Environmental Risks: Shift in US Climate Policy Would Not Stall Global Efforts to Reduce Carbon Emissions, February 16, 2017

» Green Bonds - Global: Record Year for Green Bonds Likely to Be Eclipsed Again in 2017, January 18, 2017

» Environmental Risks - Sovereigns: How Moody's Assesses the Physical Effects of Climate Change on Sovereign Issuers, November 7, 2016

» Regional and Local Governments - EMEA: Sub-sovereign green bond issuance has growth potential, September 21, 2016

» Environmental Risks: Risks and Opportunities: What the Paris Agreement Means for Capital Markets, July 20, 2016

» Cross Sector - Global: Moody's Approach to Assessing the Credit Impacts of Environmental Risks, November 30, 2015

» Environmental Risks: Heat Map Shows Wide Variations in Credit Impact Across Sectors, November 30, 2015

» Environmental, Social and Governance (ESG) Risks - Global: Moody's Approach to Assessing ESG Risks in Ratings and Research, September 8, 2015

Sector Comment:

» US - Utilities and Public Power: US Executive Order on Clean Power Plan Will Slow, But Not Halt, Transition Away From Coal, March 31, 2017

» Green Bonds - Global: Green Bond Principles (GBP) Are Updated and Expanded, August 31, 2016

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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