

Warsaw, 30 November 2018

## **EuroRating revises the outlook on the credit rating of PGE S.A. to negative from stable**

### **RATING ACTION**

**Warsaw, 30 November 2018 – The EuroRating credit rating agency has revised the outlook on the long-term issuer credit rating of Poland's largest power generation company Polska Grupa Energetyczna S.A. (PGE) to negative from stable. At the same time, EuroRating has affirmed the long-term issuer credit rating of PGE at "A-".**

### **RATING ACTION RATIONALE**

The change in the credit rating outlook of Polska Grupa Energetyczna to negative is related mainly to: the long-term financial risk for the company associated with the planned by the Polish government program of nuclear power plants' construction in Poland; worsening of macroeconomic conditions for producers of electricity from coal; a weakening of the current credit risk profile of the company over the last few quarters; and to the announced another new investment not related to the company's core business.

EuroRating assesses, that an implementation of the plans contained in the draft document "Energy policy of Poland until the year 2040" presented recently by the Poland's Ministry of Energy, would mean a creation of new sources of power generation in the next two decades in the overwhelming majority by state-owned companies (this mainly concerns the planned construction of six nuclear power plants, as well as large offshore wind farms).

The credit rating agency assumes, that due to the enormous capital expenditures required, very long construction time, as well as to a high uncertainty regarding the profitability of energy production by nuclear power plants, no private entities are likely to undertake these projects. Due to the fact, that PGE is the largest power generation company in Poland and it had previously been appointed by the government as a leader in the Polish nuclear power plants program, EuroRating assumes, that the company would be most heavily burdened with the necessity to execute and finance these projects. This assumption is confirmed by the recent PGE's announcement of an intention to acquire from the other three state-owned shareholders 30 percent of shares in the SPV company – PGE EJ1, set up to prepare the construction of the first Polish nuclear power plant.

EuroRating emphasizes, that although the commencement of the nuclear power plants program planned by the Ministry of Energy has not yet been officially approved by the Polish government, an increasing probability of that scenario creates a significant financial risk for PGE. Although there are no details known yet concerning the amount of the required capital expenditures and the method of their financing, the agency expects, that the company's commitment to the construction of nuclear power plants would mean, that PGE would have to invest enormous cash amounts in assets, that would not generate any revenues during over a dozen years.

A large increase in the company's debt expected in such scenario is not the only risk associated with the construction of nuclear-based generating capacities. EuroRating draws attention to the fact, that in the time horizon, in which the nuclear power plants would be launched in Poland (ie. in 15-20 years), costs of power generating from renewable sources (ie. mainly from onshore and offshore wind farms and photovoltaics), may further decrease substantially. In case if at the same time a significant development of technology in the field of electric energy storage would occur, the renewable sources of energy would become decisively the cheapest one, and the production of electricity from an inflexible source with fixed high costs (including depreciation of huge fixed assets), which are nuclear power plants, would become unprofitable.

The EuroRating's decision to change the outlook of PGE's credit rating to negative was also influenced by deteriorating macroeconomic conditions for producers of electricity from coal. The agency points out the risk, that a large increase in coal prices and rising prices of CO2 emission allowances will not be fully compensated by an increase in prices of power, what might negatively affect the margins on sales achieved by PGE.

The agency also takes into account a slight deterioration of the current overall credit risk profile of the company observed in the recent quarters. It is related to, among others, an increase in the value of net debt (at the end of the third quarter of 2018 it reached the highest level in the company's history of PLN 9.6 billion), and also to a deteriorating time structure of the debt, what negatively affects the liquidity ratios.

In the context of the credit risk assessment of the company, EuroRating includes also to the negative factors the recently announced by the president of the ruling party in Poland plan to takeover by PGE from other state-owned companies of the Autosan bus manufacturer. In the PGE group, that company is supposed to develop a production of electric vehicles – including buses and specialized trucks. The agency points out, that for PGE that transaction would be another investment (after recapitalization of the PGG coal mining company and the Polimex-Mostostal construction company, which were threatened by a bankruptcy) in a business not related to the company's core operations.

In addition, since Autosan is a loss-making company and has a negative equity, the planned development of electric vehicles production would require a large recapitalization of the company by PGE in the following years, with an uncertain outlook for the company's positive profitability and satisfactory return rates on that investment for shareholders of PGE.

### **NEGATIVE RATING OUTLOOK**

The negative rating outlook means, that according to the current assessments of the EuroRating credit rating agency, the likelihood of the company's credit rating being downgraded over the next 12 months is greater than 1:3.

**RATING SENSITIVITY**

The current PGE's credit rating can be adversely affected, among others, by: a formal approval by the Polish government of the program for the construction of nuclear power plants and an involvement of PGE as the leader in that project; a further increase in prices of CO2 emission allowances; commencement of new projects related to coal mining and burning; further increase in the level of debt and a lack of improvement in its time structure; a maintaining liquidity ratios at the current relatively low levels; a possible decrease in the value of generated cash flows from operating activities and/or an increase in capital expenditures; and an execution of investments unrelated to the company's core business.

The credit risk assessment of the company could be positively influenced by: the government's resignation from plans to build nuclear power plants and/or by adjusting the announced Poland's long term energy policy to move away in a much faster rate from electricity production from coal to renewable sources; a simplification of administrative processes for a construction of offshore wind farms, resulting in a facilitation and acceleration of building of such projects; lower than currently expected PGE's capital expenditures in the subsequent years and a decrease in the level of financial debt; as well as macroeconomic parameters favorable for the company.

**ADDITIONAL INFORMATION NOTE**

EuroRating conducts a credit risk assessment of Polish companies included in the Warsaw Stock Exchange WIG20 stock index since 2007. The ratings assigned to the companies included in the WIG20 index (including PGE) are unsolicited ratings, issued on the agency's own initiative, and the analytical process is based on publicly available information.

EuroRating is formally registered by the European Securities and Markets Authority (ESMA) as a credit rating agency authorized to issue public credit ratings throughout the European Union, in accordance with the Regulation of the European Parliament and of the Council No. 1060/2009 on credit rating agencies and is under direct supervision of ESMA.

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**REGULATORY DISCLOSURES**

The credit ratings assigned by the EuroRating credit rating agency to the companies included in the WIG20 stock index are public unsolicited ratings. They are issued on the agency's own initiative, and the analytical process is based on public information ("ip" subscript), without a participation in the rating process of rated entities or related third parties.

The presented credit rating for Polska Grupa Energetyczna S.A. is a rating for the issuer – it represents a general assessment of the financial reliability of the rated entity and it relates to the credit risk of the entity's unsecured and unsubordinated financial liabilities.

The information on the assigned credit rating has been presented to the rated entity in advance. The rating was issued without any changes resulting from that disclosure.

The date of the first publication of the rating for the rated entity, the current rating level and the full rating history are published free of charge on the EuroRating credit rating agency's website ([www.EuroRating.com](http://www.EuroRating.com)) in the section "Credit ratings", in the appropriate tab on the rated entity. EuroRating takes no responsibility for information on the current credit rating for the rated entity provided by any third party.

EuroRating considers the scope and the quality of available information on the rated entity as sufficient to issue a reliable credit rating. The agency takes all necessary measures to ensure, that obtained information used in the rating process is of proper quality and is derived from sources deemed by the agency as reliable. EuroRating, however, is not able to check or confirm in each case the correctness, authenticity and reliability of the obtained information used in the rating process.

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The credit ratings assigned by the EuroRating credit rating agency constitute only an opinion of the agency on the financial and economic condition and the credit risk of rated entities and they cannot be treated in a different way.

A description of the rating methodology used by EuroRating is presented on the agency's website ([www.EuroRating.com](http://www.EuroRating.com)) in the section "Credit ratings" – "Methodology". Rating definitions and the rating scale used by EuroRating are published on the agency's website in the section "Credit ratings" – "Rating scale".

Lead rating analyst:

Robert Pienkos

Rating Analyst

email: [robert.pienkos@eurorating.com](mailto:robert.pienkos@eurorating.com)

phone: +48 22 349 21 46

Chairman of the Rating Committee:

Adam Dobosz

Rating Analyst

email: [adam.dobosz@eurorating.com](mailto:adam.dobosz@eurorating.com)

phone: +48 22 349 24 33