

Rating Action: Moody's affirms PGE's Baa1 ratings; outlook stable

30 Jun 2021

Frankfurt am Main, June 30, 2021 -- Moody's Investors Service (Moody's) has today affirmed the Baa1 long-term issuer rating of PGE Polska Grupa Energetyczna S.A. (PGE). Concurrently, Moody's has affirmed the Baa1 backed senior unsecured rating and the (P)Baa1 guaranteed senior unsecured EMTN program rating of PGE Sweden AB (publ). The outlook on all ratings is stable.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

The rating affirmation reflects (1) PGE's currently strong financial risk profile, as demonstrated by funds from operations (FFO) to net debt of around 103% in 2020, which provides the company with some flexibility to absorb a large investment program and withstand potential changes in Poland's electricity market; and (2) Moody's view that there is a high probability that the Polish government's (A2 stable) plan to transform the domestic utility sector will, if it materializes, be supportive of PGE's credit risk profile.

Although PGE's currently strong financial risk profile will likely weaken over the next few years as its planned investments of PLN75 billion through 2030 will require new debt, and some renewable projects and distribution expenditures will only contribute to earnings with a time lag, Moody's expects the company to retain comfortable headroom against the current guidance of FFO to net debt of 30%, supported by continued dividend restraint (no pay-outs since 2017) of its majority owner, the government.

The rating action follows the publication on 16 April 2021 by the Polish Ministry of State Assets of details on its strategy to nationalize the coal and lignite generation assets of those utilities in which the state has an ownership stake, as is the case for PGE (57.4%)[1]. While a completion of the process is only expected by the end of 2022 and may require approvals from the EU Commission for state aid and competition aspects, Moody's deems it highly likely that PGE will either be able to transfer its conventional coal and lignite plants and lignite mines (together the "coal assets"), or, in case the transfer does not materialize, that the company will obtain some form of support from the Polish state. Uncertainties around the coal asset transfer include the valuation of these assets; the compensation paid to PGE, if any; and demands by the EU Commission to modify or abandon the transfer scheme.

The coal assets expose PGE to significant environmental risks, namely carbon transition risk. This is because higher carbon allowance prices, the growth of the renewable generation base in Poland and in neighbouring countries, and other competitive sources from interconnected markets exert severe pressure on the profitability of the coal assets. Furthermore, the retention of the coal assets will increasingly hamper PGE's access to external debt funding.

Moody's believes that a spin-off of the coal assets would strengthen the company's business risk profile since PGE would be able to implement its corporate strategy announced in October last year[2] to expand its already high share of regulated earnings from distribution grid operations and district heating (together 54% of reported EBITDA in FY 2020) and to grow its renewable generation base from some 1,150 megawatt (MW) today to around 7,650 MW by 2030 by adding 3,000 MW solar, 2,500 MW wind offshore and 1,000 MW wind onshore. In the case of the spin-off, carbon exposure would be limited to district heating operations, which will gradually be switched from coal to gas and biomass and to one or two new combined-cycle gas plants, but will be mitigated by capacity payments and free carbon allowances for district heating from cogeneration plants.

PGE falls under Moody's Government-Related Issuers Methodology due to its 57.4% ownership by the Government of Poland. The Baa1 issuer rating incorporates one notch of uplift from PGE's current Baseline Credit Assessment (BCA) of baa2, reflecting the combination of very high default dependence given the company's strategic importance to the domestic economy and strong likelihood of extraordinary support being provided by the Polish government in case of financial distress.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that the Polish government will take measures to protect PGE against the risks arising from its currently high carbon exposure; and that the company will be able to maintain solid leverage metrics, expressed as FFO to net debt above 30%.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward rating pressure is unlikely in the short to medium term, given (1) the dynamic evolution of the energy market in Poland and the lack of clarity around the final design of the spin-off of the coal assets; and (2) PGE's planned sizable capital investment program, which Moody's expects to lead to weaker credit metrics over time.

PGE's ratings could be downgraded if FFO/net debt were to decline below 30%; or if there were significant adverse changes in the Polish regulatory or market framework. In addition, negative rating pressure could develop if the planned coal asset spin-off failed to happen and was not replaced with other support by the government, with the consequence that PGE remains materially exposed to the carbon transition risk from its current conventional coal assets. A significant deterioration in the credit quality of the Polish government or a reduction in the support assumptions currently incorporated into Moody's assessment, or both, would also likely exert negative pressure on PGE's ratings.

The ratio guidance is likely to be reviewed once there is more clarity on PGE's credit profile following the potential spin-off of the coal assets or other measures to protect the company from the carbon transition risks.

LIST OF AFFECTED RATINGS

Issuer: PGE Polska Grupa Energetyczna S.A.

Affirmations:

...LT Issuer Rating, Affirmed Baa1

Outlook Actions:

...Outlook, Remains Stable

Issuer: PGE Sweden AB (publ)

Affirmations:

...Senior Unsecured Medium-Term Note Program, Affirmed (P)Baa1

...Senior Unsecured Regular Bond/Debenture, Affirmed Baa1

Outlook Actions:

...Outlook, Remains Stable

The methodologies used in these ratings were Unregulated Utilities and Unregulated Power Companies published in May 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1066389, and Government-Related Issuers Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1186207. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Headquartered in Warsaw, listed company PGE is the largest integrated electric utility group in Poland. PGE is majority-owned by the Government of Poland and reported EBITDA of PLN5,966 million on PLN45,766 million of total revenues in the financial year 2020.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1288435.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on www.moody.com.

REFERENCES/CITATIONS

[1] Government announcement, 16-Apr-2021 (<https://www.gov.pl/web/aktywa-panstwowe/rusza-transformacja-sektora-elektroenergetycznego>)

[2] PGE, Current report 29/2020, 19-Oct-2020 (<https://www.gkpge.pl/Investor-Relations/Current-reports/29-2020>)

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Mark Remshardt
Vice President - Senior Analyst
Corporate Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Paul Marty
Senior Vice President/Manager

Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454



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