

Rating Action: Moody's downgrades PGNiG's ratings to Baa2; negative outlook

Global Credit Research - 20 Nov 2012

Approximately EUR500 million of rated debt affected

London, 20 November 2012 -- Moody's Investors Service has today downgraded the issuer rating of Polskie Gornictwo Naftowe i Gazownictwo S.A. (PGNiG) and the senior unsecured rating of its guaranteed subsidiary PGNiG Finance AB (publ) to Baa2 from Baa1. Concurrently, Moody's has downgraded the provisional, long-term senior unsecured rating on the EUR1.2 billion euro medium-term note programme of PGNiG Finance AB (publ) to (P)Baa2 from (P)Baa1. The outlook assigned to the ratings is negative. This concludes the review for downgrade initiated by Moody's on 4 September 2012.

RATINGS RATIONALE

Today's rating action reflects the sharp deterioration in PGNiG's credit metrics from the solid levels achieved in 2011.

Moody's notes that PGNiG is taking measures to improve its operational efficiency and has reached an agreement with OJSC Gazprom over the gas price it will pay under its long-term contract for natural gas imported from Russia. However, the positive impact of these actions is unlikely to be sufficient to offset the negative pressures on the group's earnings in the context of its evolving business risk profile, coupled with the changing operating environment in Poland.

PGNiG's results for 9M 2012 reflected wide-ranging pressures on its earnings and included a 44% decline in EBITDA to PLN1.4 billion (EUR345 million) from PLN2.6 billion (EUR621 million) in 9M 2011. Much of the deterioration in PGNiG's operating performance was due to the negative gas margin in its trade operations. Lower cash flow generation on the back of the group's investments and its acquisition of Vattenfall Heat Poland S.A. resulted in PGNiG's debt increasing to PLN10.3 billion (EUR2.5 billion) at 30 September 2012.

Moody's notes that the agreement with Gazprom cuts the price PGNiG would pay for Russian gas and furthermore includes retroactive payments by Gazprom. This will boost PGNiG's EBITDA by approximately PLN2.5-3 billion (EUR600-720 million) this year and strengthen its cash flows in 2012 and 2013. However, the rating agency also notes that the scale of future benefits from the lower price will be limited by the extent to which such reduction is passed through to final customers.

PGNiG falls under Moody's rating methodology for Government-Related Issuers (GRIs) given its 72.4% ownership by the Government of Poland (A2 stable). PGNiG's Baa2 rating incorporates uplift for potential government support to the group's standalone credit quality, which is expressed by Moody's as a baseline credit assessment (BCA), which the rating agency has revised downwards to baa3 from baa2 as part of this rating action.

NEGATIVE OUTLOOK

The negative outlook on the ratings reflects the evolving nature of the gas market in Poland and uncertainty around PGNiG's ability to adapt to these changes in the context of (1) its long-term take-or-pay contracts with Gazprom and other suppliers, (2) growing exploration and production activities, (3) volatile cash flows, and (4) high debt levels.

The Polish gas market is currently regulated by the Energy Regulatory Office. Moody's notes the proposed regulatory reforms to the country's gas sector which aims to introduce a competitive market through a gas trading obligation. At this stage, the extent and timing of a change in the gas market setup in Poland, where PGNiG has the dominant position, is uncertain. However, the rating agency believes that given increasing interconnector capacity and the virtual reverse flow on the Yamal-Europe pipeline (a procedure enabling buyers of Russian gas in Germany to sell it back to buyers in Poland), the Polish gas incumbent could gradually lose significant market share compared to its current 90%+ market share over the medium term. This is exacerbated by PGNiG's take-or-pay obligations under its long-term contracts, which may exert pressure on the group's earnings in the event of lower gas spot prices in western European countries.

Unregulated activities account for approximately 20% of PGNiG's revenues and will increase when the Skarv offshore project in Norway, in which PGNiG has a 12% stake, and the group's fully owned onshore Lubiatow-Miedzychod-Grotow (LMG) project in Poland become fully operational in 2013, more than doubling PGNiG's crude oil output from 0.48 to 1.1 million tonnes. Further growth in the exploration and production segment is a key element of PGNiG's strategy. PGNiG will direct part of this investment towards shale gas exploration and has already entered into cooperation agreements with several Polish energy groups interested in exploiting the potential gas reserves. However, Moody's notes that progress in this area has been slow. The complex planning and permits process and other potential delays, combined with uncertainty surrounding the possible taxation of oil and gas, mean that PGNiG's actual spending may fall some way below the amounts assumed in the group's strategy.

Moody's considers that growth in the area of exploration and production represents both a material increase in the level of PGNiG's activity and a diversification away from its core regulated business. In addition, the rating agency notes that the profitability of this segment of operations will be dependent on the future taxation regime, details of which are currently being prepared by the government.

WHAT COULD CHANGE THE RATING UP/DOWN

Given the current negative outlook, Moody's considers an upgrade to be unlikely at this stage. However, the outlook on the Baa2 ratings could be stabilised if PGNiG's retained cash flow (RCF)/debt ratio were sustainably above 30% and there were more clarity regarding the evolution of the group in the changing operating environment.

PGNiG's ratings could come under downward pressure if the group's RCF/debt ratio were below 30% on a sustained basis or liquidity concerns arise. In addition, negative pressure on PGNiG's ratings could develop as a result of (1) material adverse changes in the operating environment in Poland, including the regulatory framework; (2) a substantial debt-financed M&A transaction; (3) significant expenditure on exploration and production activities that prove less successful than anticipated; or (4) a deterioration in the credit quality of the Government of Poland and/or a reduction in the support assumptions currently incorporated in Moody's assessment.

PRINCIPAL METHODOLOGIES

The methodologies used in these ratings were Regulated Electric and Gas Utilities, published August 2009, and Government- Related Issuers: Methodology Update, published July 2010. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

Polskie Gornictwo Naftowe i Gazownictwo S.A. is a holding company for a vertically integrated gas group in Poland. The company is majority-owned (72.4%) by the Government of Poland, with the remaining 27.6% of shares listed on the Warsaw Stock Exchange. PGNiG is the dominant player in the Polish natural gas market, covering the whole gas stream (excluding transmission), from oil and gas field development, hydrocarbon production, natural gas importation, storage and distribution to supply to consumers. Following its acquisition of Vattenfall Heat Poland S.A. in early 2012, the group is now also present in the power and heat generation market.

Domestically, PGNiG produces approximately 30% of total Polish natural gas sales (total sales of 14.4 billion cubic metres (bcm) in 2011), operates more than 117,000 km of distribution pipelines and supplies gas to approximately 194,000 commercial customers and almost 6.6 million households. PGNiG's revenues amounted to PLN23 billion (EUR5.5 billion) as at 31 December 2011.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moody.com.

The ratings have been disclosed to the rated entities or their designated agent(s) and issued with no amendment resulting from that disclosure.

Information sources used to prepare each of the ratings are the following: parties involved in the ratings, parties not involved in the ratings, public information, and confidential and proprietary Moody's Investors Service information.

Moody's considers the quality of information available on the rated entities, obligations or credits satisfactory for the purposes of issuing these ratings.

Moody's adopts all necessary measures so that the information it uses in assigning the ratings is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Moody's Investors Service may have provided Ancillary or Other Permissible Service(s) to the rated entities or their related third parties within the two years preceding the credit rating action. Please see the special report "Ancillary or other permissible services provided to entities rated by MIS's EU credit rating agencies" on the ratings disclosure page on our website www.moody's.com for further information.

Please see the ratings disclosure page on www.moody's.com for general disclosure on potential conflicts of interests.

Please see the ratings disclosure page on www.moody's.com for information on (A) MCO's major shareholders (above 5%) and for (B) further information regarding certain affiliations that may exist between directors of MCO and rated entities as well as (C) the names of entities that hold ratings from MIS that have also publicly reported to the SEC an ownership interest in MCO of more than 5%. A member of the board of directors of this rated entity may also be a member of the board of directors of a shareholder of Moody's Corporation; however, Moody's has not independently verified this matter.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moody's.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moody's.com for the last rating action and the rating history.

The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moody's.com for further information.

Please see www.moody's.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Joanna Fic
Asst Vice President - Analyst
Infrastructure Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Andrew Blease
Senior Vice President
Infrastructure Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA

United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454



© 2013 Moody's Investors Service, Inc. and/or its licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable, including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The ratings, financial reporting analysis, projections, and other observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. Each user of the information contained herein must make its own study and evaluation of each security it may consider purchasing, holding or selling. NO WARRANTY, EXPRESS

OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

MIS, a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MIS have, prior to assignment of any rating, agreed to pay to MIS for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for retail clients to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.