FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms ORLEN S.A. at 'BBB+'; Outlook Stable

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Fitch Ratings - Warsaw - 05 Mar 2024: Fitch Ratings has affirmed ORLEN S.A.'s (PKN) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB+'. The Outlook is Stable.

ORLEN's credit profile is supported by the large scale of its operations, strong business diversification and a presence in the utility sector, which generates more stable cash flows following its merger with Polskie Gornictwo Naftowe i Gazownictwo S.A. (PGNiG), a domestic natural gas utility. The ratings also take into account a large expected additional cost burden in 2024 and high capex.

We forecast high capex may lift EBITDA net leverage above 2.5x in 2026 and 2027, a negative sensitivity for its 'BBB+' rating. However, we assume ORLEN has a significant buffer in the form of hybrid bond issuance and additional project-finance (PF) funding to maintain leverage within its rating sensitivity. ORLEN also expects to announce new management board in the coming weeks and a strategy update cannot be ruled out, including a revision of its investment plan.

## KEY RATING DRIVERS

**Large Projected Capex:** ORLEN expects its capex to amount to PLN320 billion in 2023-2030. Key investment projects include expansion of a petrochemical complex in Płock, construction of an offshore wind farm in the Baltic Sea and CCGT power plants in Ostrołęka and Grudziądz. We forecast ORLEN's EBITDA net leverage will grow steadily to 2.6x in 2026 and 3.0x in 2027, exceeding its negative rating sensitivity of 2.5x. However, we believe ORLEN has the flexibility to maintain leverage within its sensitivity, which drives the Stable Rating Outlook.

**Baltic Power PF Excluded:** ORLEN plans to fund a significant portion of key capex projects via PF loans. Such loans have already been signed for CCGT in Ostrołęka and the Baltic

Power offshore wind farm, while ORLEN plans to sign agreements for PF-type funding for its petrochemical complex expansion in Płock in 2024. We exclude PF funding for Baltic Power from ORLEN's debt quantum due to the non-recourse nature of these loans. At the same time, we consolidate PF loans for petrochemical complex expansion and CCGT Ostroleka on the assumption it will be difficult for ORLEN to withdraw from these projects.

**Execution Risk:** In 2023, ORLEN announced that its olefin III petrochemical complex in Płock would cost PLN25 billion to develop, as opposed to the earlier expected cost of PLN13.5 billion, and would be completed in 2027 instead of 2024. We understand from management that the higher spending will not affect its overall capex plan due to planned lower capex in other areas, but such large projects entail execution risk, especially given still the unstable global political environment affecting supply chains and high inflation.

**Higher Costs in 2024:** As part of its support to consumers to soften increases in electricity and natural gas prices, the Polish government created in 2023 Price Difference Payment Fund (PDPF), where companies from certain industries were obliged to provide funding to support lower electricity and natural gas prices. ORLEN paid PLN15.5 billion to PDPF in 2023. The additional cost burden had limited net impact on ORLEN's cash flows in 2023 as it received compensation from PDPF. However, the cost will rise in 2024 as ORLEN's payment to PDPF of PLN15.5 billion would be larger than up to PLN5 billion compensations and PLN4.2 billion of overdue payments for 2023 from PDPF. We have reflected the higher cost burden in our forecasts.

**Strong Refining, Weak Petrochemicals:** ORLEN reported adjusted EBITDA last-in first-out (LIFO) before impairments of PLN44.8 billion in 2023, up from PLN38.8 billion in 2022. The increase was due mainly to the consolidation of PGNiG, which merged with ORLEN in November 2022. PGNiG's gas trading, storage and distribution activities were the largest contributor to consolidated EBITDA LIFO, followed by refining and energy. While we expect ORLEN to report strong results in the medium term, the results of the gas segment are likely to be significantly lower due to smaller payments from PDPF. Diesel crack spreads continue to be strong and should support refining margins.

**Petrochemicals Under Stress:** ORLEN's petrochemical activities saw three quarters of negative EBITDA in 2023 due to lower margins for key products such as olefins, polyolefins, aromatics, PVC and PTA. The results came on the back of a broader chemical industry slowdown. We expect a gradual recovery from 2024, albeit at a slower pace than we previously forecast. Over the long term, Fitch expects ORLEN's petrochemicals profitability to return to mid-cycle levels.

**Management Board Change:** Following parliamentary elections in Poland in October 2023, the new government changed ORLEN's supervisory board and management board in early February 2024 on an interim basis until a new board is formed. Our forecasts reflect key parameters of the strategy announced in February 2023, but we note that ORLEN has usually updated its strategy in the past following management changes.

**Rating on a Standalone Basis:** ORLEN is 49.9% owned by the State Treasury of Poland (A-/Stable). We view decision-making and oversight as well as preservation of the government policy role as 'Strong' resulting in an overall support score of 15 out of a maximum 60, leading us to rate ORLEN on a standalone basis, which is in line with Fitch's approach for the majority of EU-based corporate issuers.

## DERIVATION SUMMARY

ORLEN's closest peers are Repsol, S.A. (BBB+/Stable) and OMV AG (A-/Stable). ORLEN's upstream segment with a production of 173kboe/d in 2023 is smaller than Repsol's (consolidated production excluding JVs of 409kboe/d) and OMV's (total production of 364kboe/d). ORLEN and Repsol have a comparable refining capacity of 0.9 million barrels per day (mmbbl/d) and 1 mmbbl/d, respectively, while OMV's refining capacity is materially smaller at 0.3mmbbl/d.

ORLEN reported an adjusted EBITDA LIFO before impairments of EUR9.9 billion in 2023 versus Repsol's EBITDA of EUR9.3 billion and OMV's EUR8.6 billion. ORLEN's business profile also benefits from a higher share of utility and regulated cash flows than Repsol's and OMV's.

## KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for Issuer Include:

-Brent crude oil price of USD80/bbl in 2024, USD70/bbl in 2025, USD65/bbl in 2026 and USD60/bbl in 2027

-Capex excluding Baltic Power of PLN35.4 billion in 2024, PLN43 billion in 2025, PLN40 billion in 2026 and PLN35 billion on 2027

-Dividends of around PLN5.8 billion on 2024, and on average PLN5.4 billion annually in 2025-2027

-Minority dividends at net PLN300 million a year from 2024

## RATING SENSITIVITIES

**Factors That Individually or Collectively, Lead to Positive Rating Action/Upgrade:**

-Rating upside is limited without significant strengthening of the business profile with larger scale of operations and geographical diversification combined with lower execution risk of shifting the business towards lower-emission technologies

-EBITDA net leverage below 1.5x on a sustained basis

**Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:**

-EBITDA net leverage above 2.5x on a sustained basis

-Higher-than-expected variability of cash flows

-Aggressive financial policy with higher-than-expected dividend payments or debt-funded acquisitions

## LIQUIDITY AND DEBT STRUCTURE

**Modest Liquidity:** As of end-2023 ORLEN had PLN11.9 billion of unrestricted cash and equivalents versus short-term debt of PLN4.5 billion. In addition, ORLEN had unused PLN10 billion in its revolving credit facility (RCF) transferred from PGNiG and maturing in June 2026 as well as a EUR1.4 billion (PLN6.5 billion) RCF due in July 2024.

**Refinancing Needs:** We expect ORLEN to refinance its RCFs to support higher back-up facilities as well as continuously issue new debt to fund negative free cash flow from 2024 onwards.

Fitch understands from management that ORLEN is currently finalising the refinancing of its RCFs and we expect the company to maintain an adequate liquidity buffer and to raise additional funds through PF debt, bonds and hybrid bonds to fund rapid growth in investments.

ORLEN's subsidiary PGNiG Upstream Norway has also USD700 million (PLN3.1 billion) reserve-based lending of which USD545 million was undrawn as of end-December 2023.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| ORLEN S.A. | LT IDR | BBB+ Rating Outlook Stable | Affirmed | BBB+ Rating Outlook Stable |
| | ST IDR | F2 | Affirmed | F2 |
| | LC LT IDR | BBB+ Rating Outlook Stable | Affirmed | BBB+ Rating Outlook Stable |
| | LC ST IDR | F2 | Affirmed | F2 |
| | Natl LT | AA+(pol) Rating Outlook Stable | Affirmed | AA+ (pol) Rating Outlook Stable |

| | | | | |
|---|---|---|---|---|
| senior unsecured | LT | BBB+ | Affirmed | BBB+ |
| senior unsecured | Natl LT | AA+(pol) | Affirmed | AA+(pol) |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

Government-Related Entities Rating Criteria (pub. 12 Jan 2024)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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|---|---|
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