



Fitch Affirms PKP Intercity at 'BBB+'; Outlook Stable

Fitch Ratings-Warsaw/London-19 March 2018: Fitch Ratings has affirmed PKP Intercity S.A.'s (PKPIC) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB+'. Simultaneously, Fitch has affirmed the National Long-Term Rating at 'AA(pol)'. The Outlooks are Stable.

Under its Government-Related Entities Criteria, Fitch views that the ability and willingness to provide support by PKPIC's ultimate owner, the Polish state (A-/Stable/F1+), is high. Using a top-down approach and our assessment of four factors under the strength of linkage and incentive to support by the ultimate owner the agency notches down PKPIC's IDRs once from those of Poland.

KEY RATING DRIVERS

Status, Ownership and Control - Assessed As Very Strong:

The company's ultimate parent is the Polish state. It indirectly owns 100% of PKPIC through the wholly state-owned company Polskie Koleje Państwowe S.A. (PKPSA; BBB+/Stable), which is PKPIC's sole direct owner. PKPIC's legal regime is determined by law approved by the Polish parliament, and as such the company is excluded from the commercial bankruptcy regime and may only be resolved by national law. In Fitch's view, this would likely entail an unconditional transfer of all its assets and liabilities to the state, or to another public entity designated by the state.

PKPIC is mandated by the state treasury to fulfil the central government's national railway strategy in operating interregional and international passenger railway. Through PKPSA the state exerts significant influence over PKPIC. It approves its strategy, investment and funding plans, appoints and dismisses members of the company's management board and controls its daily performance. Management and the supervisory board regularly report on the company's finances to the government.

Support Track Record and Expectations - Assessed As Very Strong:

The bulk of PKPIC's transport performance is generated by the interregional (75% of total passenger train-km in 2017) and international (5% in 2017) services, which is partially loss making. The government has public service contracts signed with

the company and pays it compensation for the unprofitable routes. Additionally, it ensures the company a reasonable profit (as per the EU Regulation (EC) No 1370/2007 of the European Parliament). The public service contracts are valid until February 2021 with an option to be prolonged by five years until 2026.

The monthly compensation payments made from the state budget to PKPIC are state grants and must be approved in the state budget annually. The revenue from the contracts provides PKPIC with a stable revenue stream. In 2017, the company received PLN557 million or 21% of total turnover (2016: PLN538 million or 22%) from the state budget, which was sufficient to ensure it a reasonable profit. In 2018-2019 PKPIC expects compensation payments of about PLN570 million annually on average.

The state supported the company in its large investment programme that concluded in 2015. PKPIC received a large equity injection from its direct owner PKPSA to be used for investment finance. From the PLN1 billion injection earmarked at financing investments, the company had still PLN840 million left at end-2017. This will be used for the company's new investment plans.

PKPIC has a large capex plan for 2018-2023 totalling PLN7.8 billion. It foresees the purchase of new rolling stock (PLN4 billion), modernisation of existing engines and carriages (PLN2.8 billion) and other smaller investments (about PLN1 billion). The company plans to fund it with debt (56% of total investment costs), own sources (34%) and EU funds. The programme is vital for PKPIC and we expect that after completion it should result in better network performance, allowing the company to compete more successfully not only in the domestic market, but also on cross-border connections. However, the investments need to be approved by the state and its start is subject to fund availability. We assume that the state will support the company's new investment plan, but at this stage it is too early to determine in which way.

The large investment programme concluded in 2013-2015 (PLN4 billion) was strongly supported by the state. Besides the equity injection of PLN1 billion, the state issued guarantees as collateral for the company's investment loans with the European Investment Bank. At end-2017, debt amounted to PLN2.5 billion and was 67% state-guaranteed. We expect this share to rise to about 80% by 2020, driven by faster redemption of non-guaranteed debt unless the company decides to raise new unguaranteed debt that may dilute the share.

Socio-Political Implications of a GRE's Default- Assessed As Moderate:

Fitch believes that PKPIC's financial default would not materially affect provision of service although it may prove difficult to substitute train service in the short to medium term. The company has a dominating market share (51.1% market share

as per passenger-km in 2017) in the railway sector, but its services could be substituted by other means of transport (planes, busses and cars).

Financial Implications of a GRE's Default - Assessed As Strong:

A default of PKPIC could lead to reputational risk for the Polish state. PKPIC, its owner PKPSA and the state treasury tap domestic and international capital markets for debt funding, as well as use loans from the IFIs, so any potential default of the former could to some extent influence the cost of funds for future debt financing of other government related entities or the state treasury.

This assessment under the Government-Related Entities criteria leads to a one-notch discrepancy from the sovereign's IDRs, irrespective of the standalone credit assessment.

Standalone Credit Profile:

PKPIC's debt continued its declining trend to PLN2.5 billion at end-2017 from PLN2.7 billion at end-2016. However, due to new investments, we expect PKPIC's debt to return to growth in 2019 but do not exceed PLN2.9 billion (peak at end-2015). Despite the debt growth, we project that net-debt-to-EBITDA will not exceed 5x-6x in the medium term (2017: preliminary 2x). Debt service will be smooth in 2018-2020, averaging PLN260 million annually.

PKPIC's liquidity is very strong as result of the PLN1 billion equity injection. Due to the significantly lower capex in 2016 and 2017, the company accumulated cash and PLN1.5 billion was in its bank accounts at end-2017. We expect that the majority of cash will be absorbed by capex planned for 2018-2023. However, Fitch assumes that the company will still have adequate liquidity to service its obligations.

RATING SENSITIVITIES

Changes to the state's IDRs will be mirrored in PKPIC's IDRs, assuming that the links between the sovereign and the company remain strong. Loosening links between PKPIC and the sovereign could lead to a widening of the notching differential. Conversely explicit statutory guarantee issued by the state for all present or future liabilities of PKPIC could lead to a narrowing of the notching differentiation.

Contact:

Primary Analyst

Dorota Dziedzic

Director

+48 22 338 62 96

Fitch Polska S.A.

16 Krolewska Street
Warsaw 00-103

Secondary Analyst
Maurycy Michalski
Director
+48 22 330 67 01

Committee Chairperson
Guilhem Costes
Senior Director
+34 93 32 38 410

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email:
athos.larkou@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Government-Related Entities Rating Criteria (pub. 07 Feb 2018)

(<https://www.fitchratings.com/site/re/10019302>)

National Scale Ratings Criteria (pub. 07 Mar 2017)

(<https://www.fitchratings.com/site/re/895106>)

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

(<https://www.fitchratings.com/site/re/10020113>)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

(<https://www.fitchratings.com/site/dodd-frank-disclosure/10024079>)

Solicitation Status (<https://www.fitchratings.com/site/pr/10024079#solicitation>)

Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT

SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided "as is" without any representation or

warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings

issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligator being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.