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Haitong Bank in a report from May 29 (08:00) initiates coverage of PGNiG with a SELL rating and a FV of PLN 5.02. In the short term, analysts expect lower natural gas spot prices to continue mainly as a result of massive LNG capacity coming online in 2018-2020 and some of the ‘old’ flows being redirected from Asia due to the low adjusted JKM-TTF price spread.

**Valuation Methodology**

Our valuation approach for PGNiG uses two methods: a discounted cash flow (DCF) and a peer valuation. We calculate the final FV as the weighted average of the two results with 75% and 25% weights for DCF and relative valuation, respectively. We believe that due to higher exposure to the gas market PGNiG should be priced at a discount vs its international peers exposed to crude oil and hence we believe the relative valuation is less relevant vs a DCF.

**Risks to Fair Value**

**Market risks**

Commodity risk – related to changes in natural gas prices, crude-related products, CO2 allowances and even LNG cargo freight rates. The natural gas market: the natural gas market is regional in nature with different benchmark prices determined by different factors; for instance the US Henry-Hub benchmark price is set entirely by gas-to-gas competition whereas European and Asian gas benchmarks are indexed in full or in part to oil product prices. The situation when crude prices are going up whilst gas prices are staying flat or even going down may have a negative impact on the Trading&Storage segment results. To the extent set by the upstream exposure to crude price the situation described above may be offset to some extent.

Currency risk – natural gas purchases are settled in foreign currencies whilst sales in Poland are set in Polish Zloty. Even though prices in Poland account for FX changes, higher currency volatility may not be transferred in full for offtakers, especially in the short-term. Also, PST activities abroad along with upstream activities in Norway are naturally exposed to FX risk.

**Sector risks**

The overall economic situation along with weather conditions has a material effect on natural gas consumption levels and thus has a bearing on the sales and prices realized by the PGNiG Group. members do not reach a consensus and MUX8 keeps its low coverage ratio, it could reduce the pace of the expected WPL TV recovery.

**Upstream activities risks**

The upstream projects carried out by PGNiG are subject to a number of geological and operational risks that may prevent the Group from earning expected profits. Implementation of such projects may be delayed or may fail to succeed, chiefly because of high exploration risk inherent in this type of business, cost overruns, lower-than-expected crude and gas prices, a higher than expected fiscal burden, adverse changes in sectorial regulations, shortage of equipment and qualified staff, bad weather, or difficulty finding partners to share the risks and costs related to project implementation. Project execution may often entail using new and advanced technologies, which are expensive to develop, acquire and implement and may not operate

as expected.

**Risk related to the legal dispute with GAZPROM**

PGNiG filed for arbitration with the Stockholm Arbitration Tribunal in a dispute with Gazprom whereby it asked the company to renegotiate the price of natural gas delivered to Poland under a long-term contract. According to our calculations, the total retroactive payment that may or may not be granted to PGNiG would be in the range of PLN 2.5bn and PLN 3bn, which constitutes 35- 30% of 2018 EBITDA. We think that the immediate Gazprom dispute poses a major upside risk to the fair value estimated by us. In the event of the Stockholm Arbitration Court’s prompt positive decision, the net positive effect vs our valuation could be PLN 0.20 per share, i.e. ca. 4.3% vs the current share price.

**Political and legal risks**

State-controlled companies may be exposed to the risk of being forced by the Government to invest in unprofitable projects such as the first nuclear power plant, the Ostroleka coal power plant, rescuing Polish coal plants (PGNiG already took part in a couple of financing rounds for PGG (Polish Mining Group)) etc. Even though the investment process in the majority of these projects will be phased over time, the information itself would be reflected in the market price instantaneously.

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