Power industry groups still have potential to invest

For the construction and financial sectors, as well as for some other branches of the economy, this is yet another year to set their sights on the declared investment boom in the power industry. According to experts' estimates, the required capital outlays will reach PLN200 billion by 2020, and the same amount over the following decade. In the meantime, however, nothing changes in this matter. Or almost nothing.

Jan Sosna

While time is ticking away, the Polish power industry is failing to undertake any firm action, even regarding the general, structural and technical reconstruction of the sector, the functioning of which determines the continued growth of the entire economy. The threat of not closing the power balance by 2016, the expected rise in prices resulting from the necessity for investments, and the obligation to purchase emission rights, the need to meet stricter climate and environmental requirements, the decapitalisation of infrastructure, and low energy efficiency - these are just a few of the problems to be overcome.

The Brussels' blockade

Despite the strategic importance of these challenges, for years they have been ignored as a public topic. The first shock for society was the doubts surrounding the adoption of the EU Climate and Energy Package. Experts warned PM Tusk that Poland was not prepared to implement the goals proposed by the European Commission and would not handle them financially in the first place. Consequently, for Poland and other new EU members, a temporary (valid until 2020) derogation was negotiated, which released newly-built power plants from the obligation to purchase CO_2 emission rights at a European auction. However, they could do it on condition that at least half the amount saved would also be invested in projects reducing CO_2 emissions.

Thus it seemed the problem could have been be solved. Poland and other countries will be allowed to launch new power plants, changing the fuel mix and reducing CO_2 emissions without any extra costs, while the "green energy" sector will obtain the guarantee of an additional, financial boost. But then it turned out the devil - as usual - was in the detail. The detail here was the condition to agree with the respective EC Directorates-General on a list of investment projects eligible for derogation. Optimists believed this would take a few months. In reality, after 3.5 years, this procedure has still not been completed. Who is to blame? Definitely not Poland, as we suffer the most due to this nearly 4-year paralysis of the investment process. After all, it is virtually impossible to compile a business plan for any project or organise its funding without basic economic parameters, such as the incurring (or not) of the purchasing costs of CO_2 emission rights, let alone their price, which is another issue EC is unable to deal with.

A great deal of money is at stake

At least for Polish circumstances. The initial calculations even met with disbelief. Professor Krzysztof Żmijewski, Secretary General of the Public Board of the National Programme for Emissions Reduction (SR NPRE), estimated them at PLN180-200 billion by the year 2020 in the production and distribution sector, and ca. PLN100 billion in the associated heat-engineering sector. According to the first report commissioned by the Ministry of Economy and drawn up by M. Purta and W. Bogdan from McKinsey, the consulting company, the necessary capital outlays in the power industry oscillate around PLN112–139 billion (or PLN152–195 billion after including the costs of preparing the construction of nuclear power plants and the improvement in the energy efficiency level to correspond with solutions offered in the EU Climate and Energy Package).

Later reports showed similar data. Piotr Piela, a partner at Ernst&Young, assessed that in order to cater for the needs of the Polish power industry by 2020, investments in the following areas are required – ca. PLN100 billion for production and ca. PLN70 billion for the distribution network. In terms of production, ca. PLN18 billion should be devoted to the restoration of generating capacity withdrawn from the National Energy System (KSE), ca. PLN32 billion would be the cost of complying with the ETS Directive on the greenhouse gas emission allowance trading scheme (the value of gratuitous rights has been estimated at ca. PLN19 billion), and ca. PLN50 billion would be required to implement the provisions of the Directives (on energy from renewable sources), on industrial emissions, and on the geological storage of carbon dioxide.

Where can we get the funding?

According to Ernst&Young, Polish power industry groups still have considerable reserves when it comes to investment potential. The four largest – PGE, Turon, Enea, and Energa – by the end of 2010, had a high debt capacity. Their cash surplus exceeded PLN2.9 billion, and the total EBITDA was PLN12.4 billion. Hence, their overall investment potential could be estimated at ca. PLN8 billion.

This potential, of course, largely depends on dividend policies and the possibility of obtaining additional capital from shareholders through the stock exchange and the issue of shares. Nevertheless, even if the capital is not raised and the annual dividend is not paid to the level of 50% of consolidated net profit, these four energy groups would be able to finance, between 2011 and 2020, investment projects reaching PLN83 billion. If they refrained from paying dividends, this would amount to PLN170.8 billion. And, obviously, the issue of new shares would even further widen their investment financing capabilities. In Ernst&Young's opinion, although these four groups could fund the necessary investment programme, the key role here belongs to the Treasury's ownership decisions.

The SR NPRE Working Group for finances, led by Dariusz Ledworowski, PhD, thinks differently. They have estimated the sector's investment potential at ca. PLN117 billion, of which a maximum of PLN65 billion could be generated on the basis of equity, and another maximum of PLN52 billion could be obtained from borrowing. The five leading Polish energy groups have publicly presented an investment programme amounting so far to ca. PLN130 billion. Based on the projection of their creditworthiness made by the Group's experts, taking into account, among other factors, the expected EBITDA for 2010, their general ability to finance this Programme with debt can be estimated at PLN55–60 billion at a maximum (both the balance debt and the project finance). This leaves a gap of at least PLN80 billion, meaning that 40% of the required funding is still needed. How can we strike this balance?

No high hopes should be pinned on the State budget – permanently in deficit and burdened with public-debt servicing. Banks operating in Poland are also reluctant to finance infrastructural projects. Their assets amount to ca. PLN1,100 billion. Consumer credits are PLN600 billion, and investment credits for all sectors of the economy PLN120 billion. According to estimates, less than 10% of them is currently allocated to infrastructure whose total investment needs connected with the entire climate package will have reached PLN1,280 billion by 2030, i.e. PLN64 billion a year.

Not only banks treat the financing of infrastructural projects with reserve. This also applies to large international energy concerns, initially expected to be very active in the investment area. We still have to decide on the method of tackling the issue of derogation. Nor do we know when and to what extent the Polish economy will be burdened with the purchasing costs for CO_2 emissions. Of course, the Government is trying to negotiate the best conditions with the European Union, but the conclusion remains unknown.

What can we do?

First and foremost, as stated in the SR NPRE White Paper, we should provide stable legal conditions and reach political consensus regarding infrastructural projects. This would mainly involve completing the privatisation of energy concerns, verifying the concept of so-called national champions, developing an energy market which is transparent and free from potential manipulations, and creating a legislation system which would spare infrastructural investors from the need to "crawl" along the red-tape road through hell. It is also vital to solicit support from financial institutions such as the European Bank for Reconstruction and Development and the European Investment Bank. Another extremely important task, in SR NPRE's view, is the construction of cross-border transfer networks to connect the Polish "energy island" to the European market, hence to ensure national energy security, weakened by the decapitalised sector, and facilitate price competition. ::