

Credit rating of revenue bonds
GO/GO-ŁTR/u/376-00/06
issued by Miejskie Przedsiębiorstwo
Komunikacyjne - Łódź Spółka z o.o.

CREDIT RATING	24.08.2018
Long-term national rating	A-
Long-term international rating	BBB
Outlook	Stable

The main rating factors

The revenue bonds rating reflects the stable income from the project's revenues guaranteed by the agreement between MPK - Łódź Spółka z o.o. (Issuer) and the City of Łódź (the main recipient of services), the issuer's high ability to finance investments from its own funds, the current liquidity situation of the City's budget, as well as the Issuer's liquidity – factors being a component of the securities' credit risk assessment. The rating also takes into account the issue agreement guaranteeing the security of payments to the Bondholders.

The Issuer's debt policy is implemented in a safe manner and guarantees its correct service and timely repayment in subsequent periods. Liabilities planned by the Issuer in subsequent periods should not significantly affect its ability to settle long-term liabilities resulting from revenue bonds.

The rating reflects the stable liquidity of the revenue bonds program, which in our opinion remain sufficient and well-protected until bonds' maturity. We also expect that the program will still be separated from other operations of the Issuer. The City of Łódź and its debt program are included in this assessment according to the INC Rating's methodology of the municipal companies sector's assessment in Poland.

The City of Łódź regulates its obligations, resulting from contracts for the provision of transport services under the Łódzki Tramwaj Regionalny (ŁTR) project, towards the Issuer without delay. Both the project and the Issuer are strongly connected at the legal, strategic level, control and integration with the structures of the City of Łódź (the City owns 100% shares of the Issuer). At the end of May 2018 (the last bond redemption date), the value of remaining bonds to be bought back amounted to PLN 86.8 million (from PLN 166 million of primary issue), which accounted for 21.58% of the Issuer's liabilities (as at 31/12/2017 less the value of bonds bought back in May 2018).

The main factors of the rating change

Both the Issuer and its sole shareholder (the City of Łódź) have a stable financial base. The trend of generating an operational surplus by the City of Łódź is stable, and the operating income of the Issuer covers its current liabilities. The Issuer correctly sets up provisions for future or potential expenses.

Liabilities planned by the Issuer in subsequent periods should not significantly affect its ability to settle long-term liabilities.

Factors determining the upgrade of the rating: The full guarantee from the City of Łódź covering all liabilities of MPK - Łódź Spółka z o.o. resulting from the revenue bonds program or upgrade of the credit rating of the City of Łódź may lead to an upgrade of the rating.

Factors determining the downgrade of the rating: The revenues bonds rating may be downgraded if the protection of bondholders decreases or the Issuer's liquidity deteriorates significantly. Any weakening of the strategic importance of MPK - Łódź Spółka z o.o. towards the City of Łódź leading to a reduced willingness to support the company may cause a downgrade. The downgrade may also result from weaker fiscal efficiency or higher indebtedness of the City of Łódź, leading to deterioration of the internal assessment of creditworthiness by the Bondholders.

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Description of the methodology applied by INC Rating as well as all restrictions and reservations to which credit ratings issued by INC Rating is subject can be found on the official website of the agency: www.incrating.pl.

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KRS 0000535140, NIP: 781-19-02-148, REGON: 302860944
Share capital: PLN 2.350.000, Capital paid: PLN 2.350.000

Cash flows resulting from ŁTR project are presented below:

Period	Project's revenues	Revenues resulting from capital injections from the City of Łódź	Principal payment	Interest	Project's costs	Payment to Bondholders	Amount withdrawn by Issuer
16.05.2012 - 15.05.2013	22 585 518,96	5 540 770,00	7 199 918,00	7 184 274,00	21 750 736,42	14 384 192,00	13 168 904,97
16.05.2012 - 15.05.2013	24 056 486,97	10 626 360,00	7 199 918,00	7 256 726,00	20 907 853,48	14 456 644,00	12 907 269,15
16.05.2014 - 15.05.2015	26 198 304,80	5 085 590,00	7 199 918,00	3 833 922,00	23 850 167,28	11 033 840,00	25 976 587,50
16.05.2015 - 16.05.2016	26 203 932,82	4 933 870,00	7 199 918,00	3 770 999,00	21 796 609,62	10 970 917,00	20 708 607,00
16.05.2016 - 15.05.2017	26 561 839,16	4 782 140,00	7 199 918,00	2 458 798,00	22 278 021,51	9 658 716,00	21 884 011,00

Inflows to the project's account, kept in accordance with article 25 of the Act of Bonds, were marked with the green colour. Cash flows reducing the balance of the project's account were marked with the red colour – divided into the amounts transferred to the Bondholders and the amounts used by Issuer to cover project's costs.

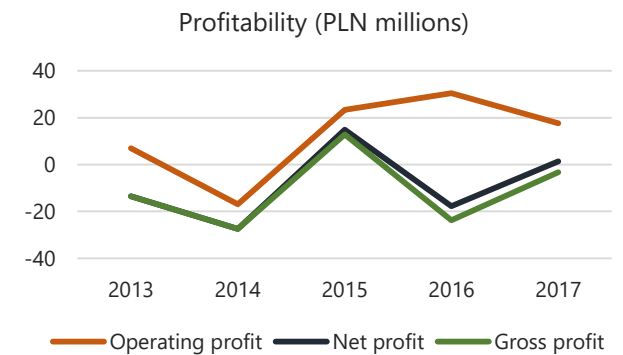
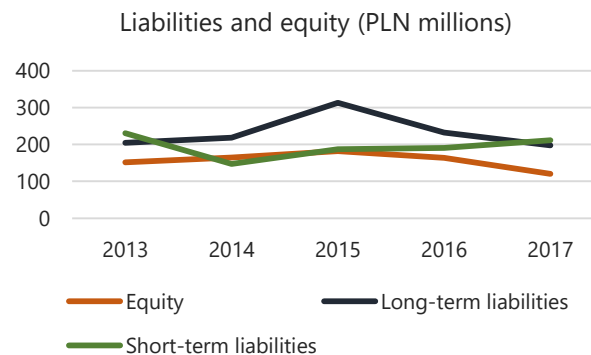
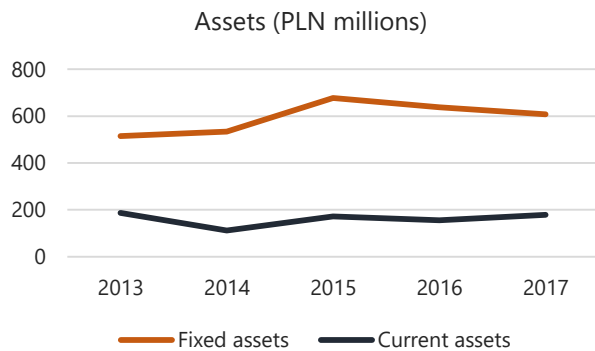
The revenues generated by the project together with the revenues related to the recapitalization by the City exceed the amount to be paid to the Bondholders on average by 157%. Thanks to this, the Issuer was able to cover a significant portion of the project's costs from the surplus over the amount paid to the Bondholders.

Pursuant to the Act on Bonds (Journal of Laws 2018, item 483), the Issuer has the right to limit its liabilities resulting from issued bonds to the amount of revenues or the value of the assets of the undertaking, provided that all revenues from the project on a fixed bank account for collecting and making withdrawals. The Issuer is not entitled to withdraw funds from this account for purposes other than satisfying the claims of bondholders entitled from revenue bonds (excluding payments related to the VAT tax) unless the account has sufficient funds to satisfy claims of bondholders entitled from revenue bonds in the next 12 months.

In the case of revenue bonds GO / GO-ŁTR / u / 376-00 / 06 issued by Miejskie Przedsiębiorstwo Komunikacyjne - Łódź Spółka z o.o., The Account Agreement regulates it strictly - withdrawals can be made only to cover the costs of the undertaking while maintaining the statutory limit on the minimum funds sufficient to satisfy bondholders' claims during the next 12 months.

Selected financial data (in PLN) of the Issuer are presented below:

Indicator	2013	2014	2015	2016	2017
Assets	700 981 959,43	644 578 515,30	849 421 772,86	792 540 624,38	786 437 836,03
Fixed assets	514 786 395,75	533 252 510,46	677 281 520,31	637 489 053,84	607 860 962,51
Current assets	186 195 563,68	111 326 004,84	172 140 252,55	155 051 570,54	178 576 873,52
Stocks	12 149 089,76	20 643 833,11	27 027 232,19	24 077 119,94	16 081 060,71
Equity	151 618 461,11	164 443 177,79	182 305 928,57	163 402 321,26	120 681 655,79
Long-term liabilities	204 733 078,82	218 752 504,46	313 077 796,96	232 083 349,85	197 696 524,55
Short-term liabilities	230 500 810,25	147 384 341,98	187 269 102,67	191 016 256,84	211 741 391,13
Account payables	22 950 270,22	28 089 540,94	23 676 095,53	14 356 850,72	19 854 131,73
Sales	573 017 174,16	562 380 660,92	685 151 953,46	631 750 675,75	675 758 786,90
EBIT	6 898 068,99	- 16 923 421,00	23 398 445,96	30 442 455,05	17 662 257,51
EBT	-13 568 207,40	- 27 412 603,32	14 846 035,32	- 17 794 821,60	1 404 363,40
Net profit	-13 568 207,40	- 27 412 603,32	12 777 160,78	- 23 837 477,31	- 3 217 108,47



Based on the financial data, financial ratios were estimated that were used to assess the creditworthiness of the Issuer. These ratios are presented in the table below:

Ratio	2014	2015	2016	2017
Equity/assets	0,26	0,21	0,21	0,15
Equity/assets – relation to the sector	0,45	0,36	0,33	0,24
Short-term liabilities/assets	0,23	0,22	0,24	0,27
Debt ratio	0,74	0,79	0,79	0,85
Operating ROA	-0,03	0,03	0,04	0,02
Short-term liabilities/assets – relation to the sector	1,27	1,36	1,43	1,53
ROA	-0,04	0,02	-0,03	-0,01
Equity/assets – standard deviation	0,26	0,21	0,21	0,15
Working capital/assets	-0,06	-0,02	-0,05	-0,04
ROA – relation to the sector	-2,10	0,61	-0,93	-0,09
ROE	-0,17	0,07	-0,14	-0,02
Financial leverage – standard deviation	4,26	4,31	4,75	5,56
EBT ROS	-0,05	0,02	-0,03	0,00
Average payment period – relation to the sector	0,48	0,42	0,33	0,45
Net ROS	-0,05	0,02	-0,04	0,00
Net ROS – relation to the sector	-2,05	0,51	-0,93	-0,14
Financial leverage – relation to the sector	2,41	2,49	2,89	3,48
Quick ratio – relation to the sector	0,45	0,53	0,46	0,53
ROE – relation to the sector	-5,06	1,52	-2,67	-0,31
Financial leverage	4,26	4,31	4,75	5,56

Due to the nature of the project and the provisions of the bond issue agreement, the financial position of the City of Łódź is also of key importance to the Bondholders. Below selected financial data of the City are presented:

Ratio	2013	2014	2015	2016	2017	2018^(plan)	Average
Net operating surplus/ Net current income	7,62%	9,38%	10,13%	9,48%	8,75%	9,58%	9,16%
Operating surplus / Current income	5,61%	7,43%	8,82%	8,05%	7,36%	6,90%	7,36%
Surplus (deficit) / Total income	-6,50%	-12,99%	-4,06%	1,74%	-1,16%	-4,16%	-4,52%
Budget balance / Total income	3,25%	6,36%	6,80%	5,44%	2,86%	0,00%	4,12%
Operating funds / Total income	6,67%	8,75%	9,02%	8,90%	8,70%	9,12%	8,53%
Operating surplus (% yoy)	504,99%	35,44%	23,74%	0,36%	-2,55%	-6,24%	92,63%
Own income (% yoy)	20,16%	-8,20%	7,19%	3,55%	2,07%	2,69%	4,58%
Direct debt (% yoy)	15,64%	25,80%	7,57%	-3,98%	-2,21%	3,09%	7,65%
Total debt (% yoy)	15,64%	25,80%	7,57%	-3,98%	-2,21%	3,10%	7,65%
Interest / Net operating surplus	31,63%	24,98%	20,94%	20,38%	20,11%	31,56%	24,93%
Direct debt service/ Own income	10,45%	10,59%	11,76%	12,46%	14,91%	14,31%	12,41%
Direct debt service / Current income	8,42%	7,66%	8,75%	8,73%	9,99%	9,86%	8,90%
Direct debt service / Operating funds	105,14%	78,46%	80,11%	87,55%	109,71%	99,46%	93,41%
Direct debt / Current income	71,05%	87,34%	90,13%	78,74%	72,19%	74,49%	78,99%
Total debt / Current income	71,21%	87,34%	90,13%	78,74%	72,19%	74,49%	79,02%
Direct debt / Operating surplus (years)	12,66	11,76	10,22	9,78	9,81	10,79	•
Total debt / Own income	88,34%	120,77%	121,20%	112,39%	107,68%	108,10%	109,74%
Direct debt / Own income	88,14%	120,77%	121,20%	112,39%	107,68%	108,10%	109,71%
Total net debt + indirect liabilities/ Current income	69,14%	83,52%	83,32%	71,24%	66,46%	73,05%	74,46%
Indicator from art. 243 of Public Finance Law	2,80%	6,66%	9,03%	11,61%	10,68%	10,84%	8,60%
Tax income / Current income	42,78%	43,36%	44,27%	42,29%	41,47%	43,31%	42,91%
Local taxes / Total tax income	35,51%	34,43%	33,69%	32,67%	31,87%	31,00%	33,19%
Grants and subsidies / Current income	31,34%	31,24%	30,42%	35,05%	36,25%	34,58%	33,15%
Current income / Total income	83,21%	89,61%	82,60%	89,23%	95,46%	91,97%	88,68%
Own income / Total income	67,07%	64,81%	61,42%	62,51%	64,00%	63,37%	63,87%
Salaries / (Current expenditure - Interest)	39,82%	40,71%	40,05%	37,00%	36,29%	36,45%	38,39%
Grants and subsidies / (Current expenditure - Interest)	34,07%	34,62%	34,15%	38,94%	39,88%	38,39%	36,68%
Capital expenditure / Total expenditure	26,26%	26,59%	27,63%	16,50%	12,58%	17,80%	21,23%
Interest / Average debt	3,63%	2,98%	2,42%	2,39%	2,40%	4,11%	2,99%
Operating surplus / Capital expenditure	16,70%	22,16%	25,33%	44,30%	55,19%	34,24%	32,99%
Capital income / Capital expenditure	60,04%	34,59%	60,54%	66,44%	35,70%	43,31%	50,10%
Change of net debt / Capital expenditure	28,60%	53,42%	18,23%	-17,95%	-12,24%	11,10%	13,53%
Surplus (deficit) / Capital expenditure	-23,26%	-43,25%	-14,13%	10,74%	-9,11%	-22,45%	-16,91%
(Operating surplus + Capital income) / Capital expenditure	76,74%	56,75%	85,87%	110,74%	90,89%	77,55%	83,09%
Total debt / Operating surplus (years)	12,69	11,76	10,22	9,78	9,81	10,79	•
Total debt / Operating funds	888,67%	894,78%	825,36%	789,48%	792,42%	751,11%	823,64%
Debt service / (Operating funds + Surpluses from previous years)	83,55%	56,36%	49,34%	49,99%	67,35%	86,88%	65,58%

The City of Łódź financial data (PLN million)

	2013	2014	2015	2016	2017	2018 ^(plan)	Average
Total income (1+4a)	3574,74	3396,63	3841,40	3908,46	3896,59	4040,97	3776,47
Total expenditure (2+4b)	3807,25	3837,98	3997,45	3840,39	3941,75	4209,16	3939,00
1. Current income (1a+1b+1c+1d)	2974,48	3043,65	3172,83	3487,34	3719,62	3716,52	3352,41
a. Tax income:	1272,51	1319,68	1404,72	1474,92	1542,48	1609,55	1437,31
- PIT	756,13	805,69	862,41	919,47	979,92	1030,38	892,34
- CIT	64,57	59,59	69,08	73,58	70,91	80,26	69,66
- Local taxes	451,80	454,40	473,24	481,87	491,65	498,90	475,31
b. Grants and subsidies	932,25	950,81	965,22	1222,48	1348,31	1285,26	1117,39
c. Fees and other operating income	757,21	760,28	775,01	771,05	814,31	807,99	780,98
d. Financial income	12,51	12,87	27,88	18,89	14,51	13,73	16,73
2. Current expenditure (2a+2b+2c+2d)	2807,56	2817,55	2893,06	3206,56	3445,99	3459,96	3105,11
a. Salaries	1089,51	1118,18	1131,82	1161,70	1227,00	1220,28	1158,08
b. Guarantees	0,00	0,00	0,00	0,00	0,00	0,00	0,00
c. Interest	71,43	71,01	66,71	67,03	65,24	112,00	75,57
d. Other	1646,62	1628,36	1694,53	1977,83	2153,75	2127,67	1871,46
3. Operating surplus (1-2)	166,93	226,09	279,77	280,79	273,63	256,56	247,29
4. Capital balance (4a-4b)	-399,44	-667,44	-435,82	-212,72	-318,79	-424,75	-409,83
a. Capital income:	600,26	352,99	668,57	421,11	176,97	324,45	424,06
- subsidies for investments	244,77	244,63	516,63	242,74	54,44	194,76	249,66
b. Capital expenditure	999,69	1020,43	1104,39	633,84	495,76	749,20	833,88
5. Surplus / deficit (3+4)	-232,51	-441,35	-156,05	68,06	-45,16	-168,19	-162,53
6. Net debt change (6a-6b)	287,17	541,85	201,43	-116,67	-56,53	83,17	156,73
a. New debt	466,34	703,95	412,29	120,83	250,00	337,73	381,86
b. Principal payments	179,17	162,10	210,86	237,50	306,53	254,57	225,12
6.1. Other revenues	61,59	116,49	216,10	261,39	213,10	85,02	158,95

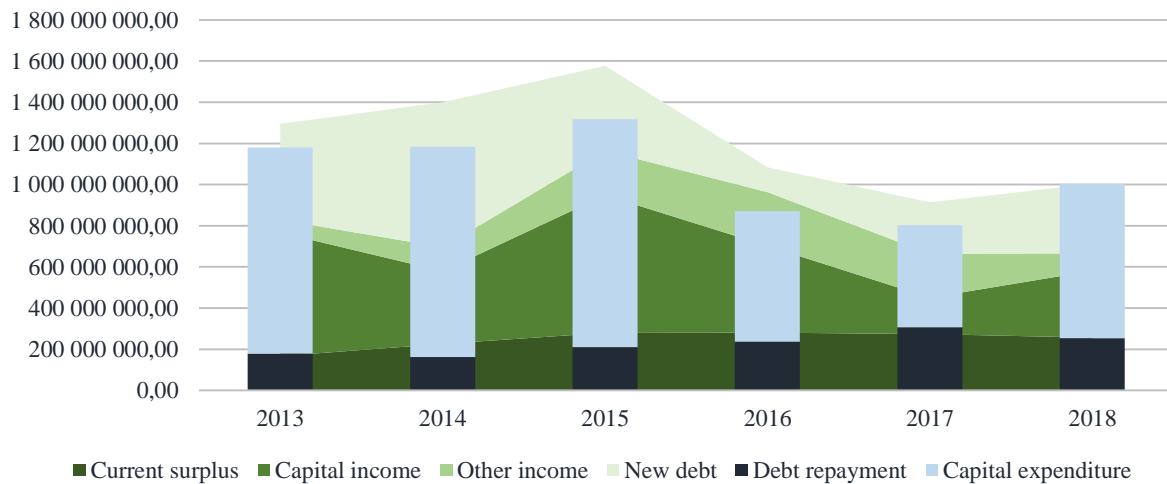
The City of Łódź debt (PLN million)

DEBT	2013	2014	2015	2016	2017	2018 ^(plan)	Average
Long-term debt	2 113,25	2 658,37	2 859,70	2 745,92	2 685,26	2 768,28	2 638,46
Direct debt	2 113,25	2 658,37	2 859,70	2 745,92	2 685,26	2 768,28	2 638,46
+ Other liabilities	4,93	0,02	0,00	0,00	0,00	0,00	0,83
Total debt	2 118,18	2 658,39	2 859,70	2 745,92	2 685,26	2 768,28	2 639,29
- Surpluses from previous years	61,59	116,49	216,10	261,39	213,10	53,37	153,67
Total net debt	2 056,59	2 541,90	2 643,60	2 484,53	2 472,16	2 714,91	2 485,62
+ Guarantees (paid)	0,00	0,00	0,00	0,00	0,00	0,00	0,00
+ Municipal debt acquired	0,00	0,00	0,00	0,00	0,00	0,00 ¹	0,00
Total net debt and indirect liabilities	2056,59	2541,90	2643,60	2484,53	2472,16	2714,91	2 485,62

¹ As of 31.12.2017

Financial flows in the budget of the City of Łódź

The graph below illustrates the financial situation of the City in an aggregated way. Budget receipts are shown in the form of a cumulative layered chart, while expenditures and expenses are presented in the form of a cumulated bar chart.



Operating surplus

Operating surplus is the difference between current income and current expenditures. Pursuant to the Act on Public Finances, the current expenditure of the city must be financed entirely from current income, free funds and budget surplus from previous years. As the value of flows performed during the year is often different from the plan, local government units are thus obliged to maintain a positive operating surplus, acting as a security bugger. Operating surplus is the least rigorous category of budget funds in terms of spending, as there is no predetermined purpose for which it must be allocated.

Capital income

The second category regarding revenues to the budget of local government unit is capital income, and therefore all income related to subsidies not related to the current expenditure, and income related to the property owned by the local government unit.

New debt

The third category of budget inflows presented is the new debt. According to the article 89 of the Public Finance Act, units of the public finance sector can take out loans and borrowings, and also issue securities for the following purposes:

1. Covering the budget deficit of the local government unit that occurs during the year;
2. Financing the planned budget deficit of a local government unit;
3. Repayment of previously contracted obligations arising from the issue of securities and loans taken;
4. Prefinancing of activities financed with the funds from the European Union.

Other revenues

The last category of inflows is other revenues, which include, for example, surplus from previous years or revenues related to the privatization of LGU assets.

Capital expenditure, principal payments

The chart presents budget categories, covered by the City from its funds. The largest is definitely capital expenditures (most often these are investments). The second category presented on the chart is funds allocated for repayment of the unit's debt.

Rating scale

The rating scale implemented by INC Rating includes two levels of credit quality:

I. Investment grade credit rating – is a credit rating that falls within the range from AAA to BBB- and it is characterized by a relatively low risk associated with investing in instruments issued by the entity being evaluated. The probability of default or debt restructuring of such entity is minimal, and the risk concerns primarily the timely payment of liabilities.

II. Speculative grade credit rating – is a credit rating that falls within the range from BB+ to D and it is characterized by a relatively higher risk associated with investing in instruments issued by the entity being evaluated.

The methodology presented above is a description of the main components of the rating. The final rating is the result of the analysis of nearly two hundred different ratios, areas and trends observed in the budgets and the general situation of the entities assessed.

Rating	Risk description	
AAA	The lowest risk	Investment grade
AA+		
AA	Very low risk	
AA-		
A+		
A	Low risk	
A-		
BBB+		
BBB	Moderate risk	
BBB-		
BB+		Speculative grade
BB	Speculative level	
BB-		
B+		
B	Highly speculative level	
B-		
CCC		
CC	Significant risk	
C	Very high risk	
	In default with low improvement chance	
D	Default	

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