



TAURON GROUP'S STRATEGY

2016-2025

September
2016

TAURON GROUP'S 2016-2025 STRATEGY

AGENDA



I. Premises of the new Strategy

II. Mission and Vision

III. Strategic priorities

- Financial stability
 - Strong Capital Group
 - New organization
-

IV. Business objectives and aspirations

V. Dividend policy

VI. Installed capacity and CAPEX plan

VII. TAURON Group's vision in 2025



This document presents the main conclusions from the works on TAURON GROUP'S strategy

CHALLENGES REQUIRE NEW STRATEGIC ACTIONS

MAIN FACTORS IMPACTING TAURON GROUP



Deteriorating financial position and rising debt



2016-2015 STRATEGY ASSUMPTIONS

- Maintaining financial stability (implementing possible actions aimed at optimizing expenses and asset structure)
- Preparing a contingency plan to reduce the CAPEX program



Ambitious CAPEX program well underway



- Continuing the CAPEX program underway while rationalizing expenditures
- Implementing the plan to optimize the Group's financing
- Capital partnership



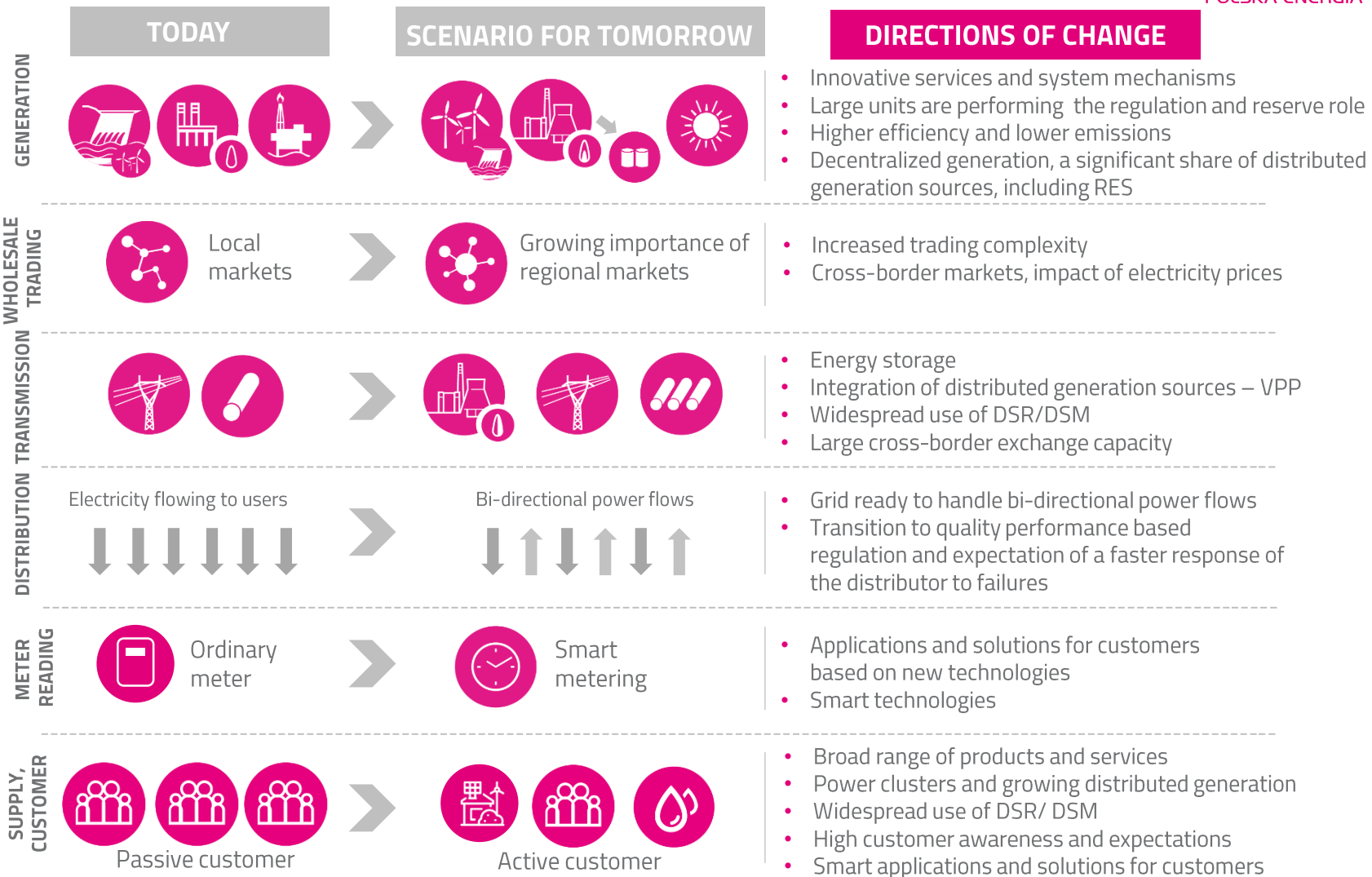
Increasing customer requirements and new technologies



- Customers at the center of TAURON Group's strategy
- Implementing new business models (without material capital expenditures) that would prepare TAURON for the power industry of tomorrow

KEY CHALLENGES FACING TAURON GROUP (1/3)

TAURON MUST PREPARE FOR POWER INDUSTRY OF TOMORROW



KEY CHALLENGES FACING TAURON GROUP (2/3)

PREMISES OF THE NEW STRATEGY

AREA

TRENDS AND CHANGES

IMPLICATIONS FOR TAURON GROUP

Regulations



- Potential introduction of the dual commodity market (capacity market)
- De-carbonization policy and successive regulations aimed at reducing emissions
- Quality and efficiency performance based regulation in the distribution
- Uncertainty regarding RES support as the regulations change
- EU actions aimed at creating a common energy market

- + Potential benefits of the capacity market for maintaining generation capacity
- + Potential benefits of active regulation activities and of shifting the assets to the regulated segment
- Risk of rising costs of conventional assets as environmental fees go up
- Risk of pressure on the regulated revenue
- Rising wind farm (minimum distance law) and hydroelectric power plants maintenance costs and uncertainty regarding the future RES support
- Risk of pressure on electricity prices as the cross-border exchange increases (lower prices on foreign markets)

Market



- Low electricity prices and limited Clean Dark Spread growth potential
- Structural oversupply on the coal market
- Continually rising demand for electricity (~1% per annum). Growing demand for capacity
- Increasing competition on the retail market
- Growing RES generation
- Retreat of the European players and tighter financing for the coal-fired power generation

- Risk of margin decline and of the lower load factor of some assets
- +/- Shutdown of some assets as there is no support from the capacity market
- Need for additional CAPEX in generation capacity in Poland
- Competitive mining assets on the Polish market, however profitability in jeopardy at current coal prices
- Risk of losing substantial volume and profitability in the supply segment, particularly in B2B
- Financing cost and availability risk

KEY CHALLENGES FACING TAURON GROUP (3/3)

PREMISES OF THE NEW STRATEGY

AREA

TRENDS AND CHANGES

IMPLICATIONS FOR TAURON GROUP

Customer



- Growing customer awareness, increasing requirements with respect to fulfilling the needs, comprehensiveness of the offering (including additional services)
- Higher expectations with respect to customer service quality and availability

- + Potential for expanding the service offering for customers based on TAURON brand and addressing their needs
- + Opportunity for growth by focusing on the customer without the need for large capital investments
- Risk of an increasing loss of customers and arrival of new competitors (including from other sectors, e.g. telecommunications companies)
- +/- Need for new competences, business model and change of the organizational culture in order to compete effectively in these areas

Technology



- Declining prices of renewable and distributed technologies, rising competitiveness versus conventional generation sources
- Change of the role of the distribution due to the growth of power generation by prosumers (distributed generation))
- Growth of smart technology, microgeneration and energy storage

- + Potential of additional services related to new technologies (e.g. renewable technologies, smart technologies, microgeneration, energy storage)
- +/- Need to adjust by implementing new operational models
- +/- Need for new competences and business model in order to compete effectively in these areas
- Long term risk of declining volumes (in distribution and generation), due to prosumers



To compete effectively in the future new competences and organizational culture need to be built now as part of the new model

MISSION / VISION OF TAURON GROUP



MISSION

With passion and commitment we are delivering modern solutions that provide energy in the constantly changing world

VISION

We are a company that best meets customer needs in the Polish energy industry



PRIORITIES OF TAURON GROUP'S STRATEGY

1



Ensuring financial stability

- Efficiency Improvement Program
- Strategic initiatives
- Investment efficiency improvement

2



Building a strong capital group based on three pillars

- Customer relationship as a long term growth platform
- Stable regulatory asset base
- Efficient conventional assets

3



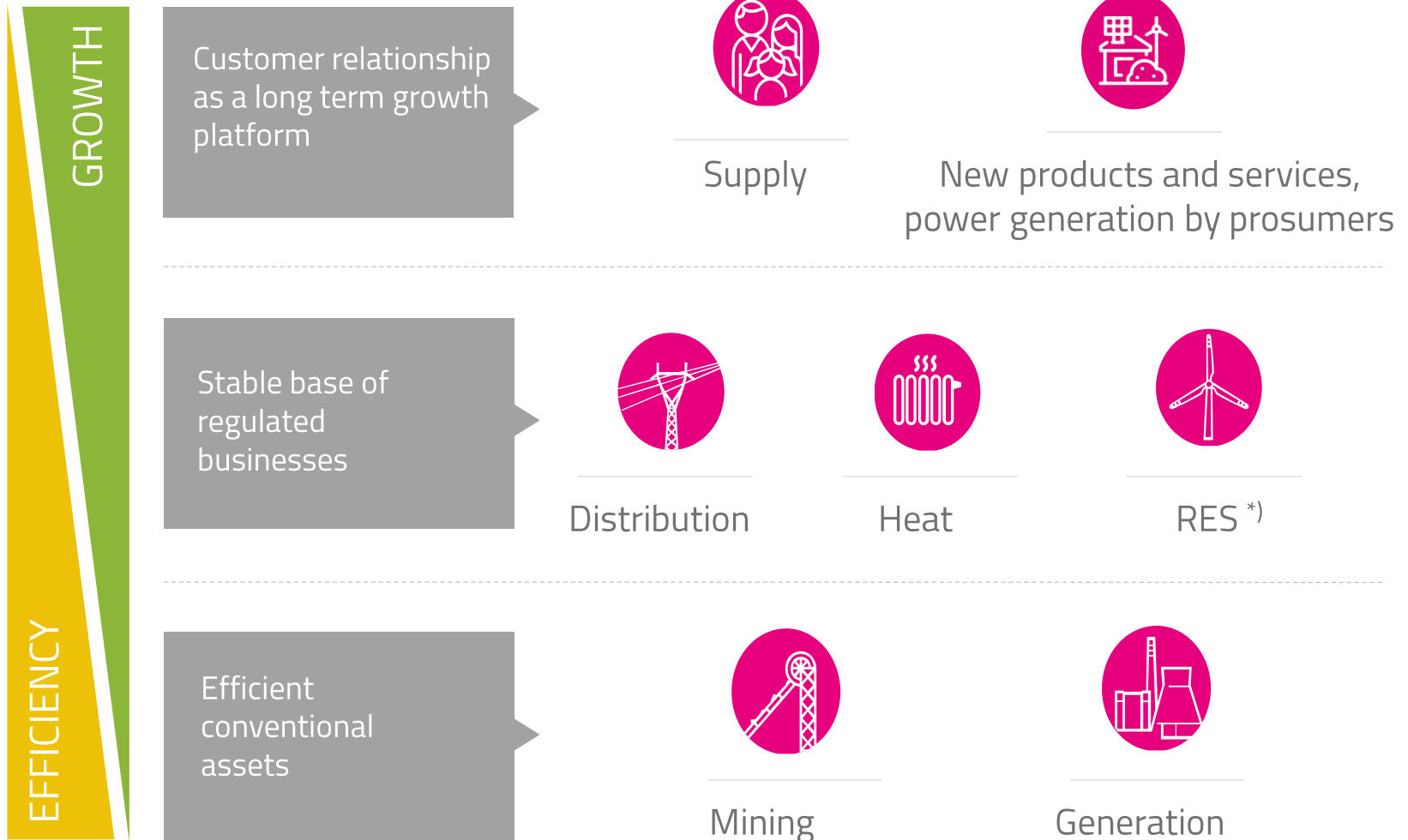
Deploying organizational changes to support the implementation of the strategy

- Implementation of the new operational model
- Innovative organizational culture



It is necessary to undertake parallel actions in line with the three priorities

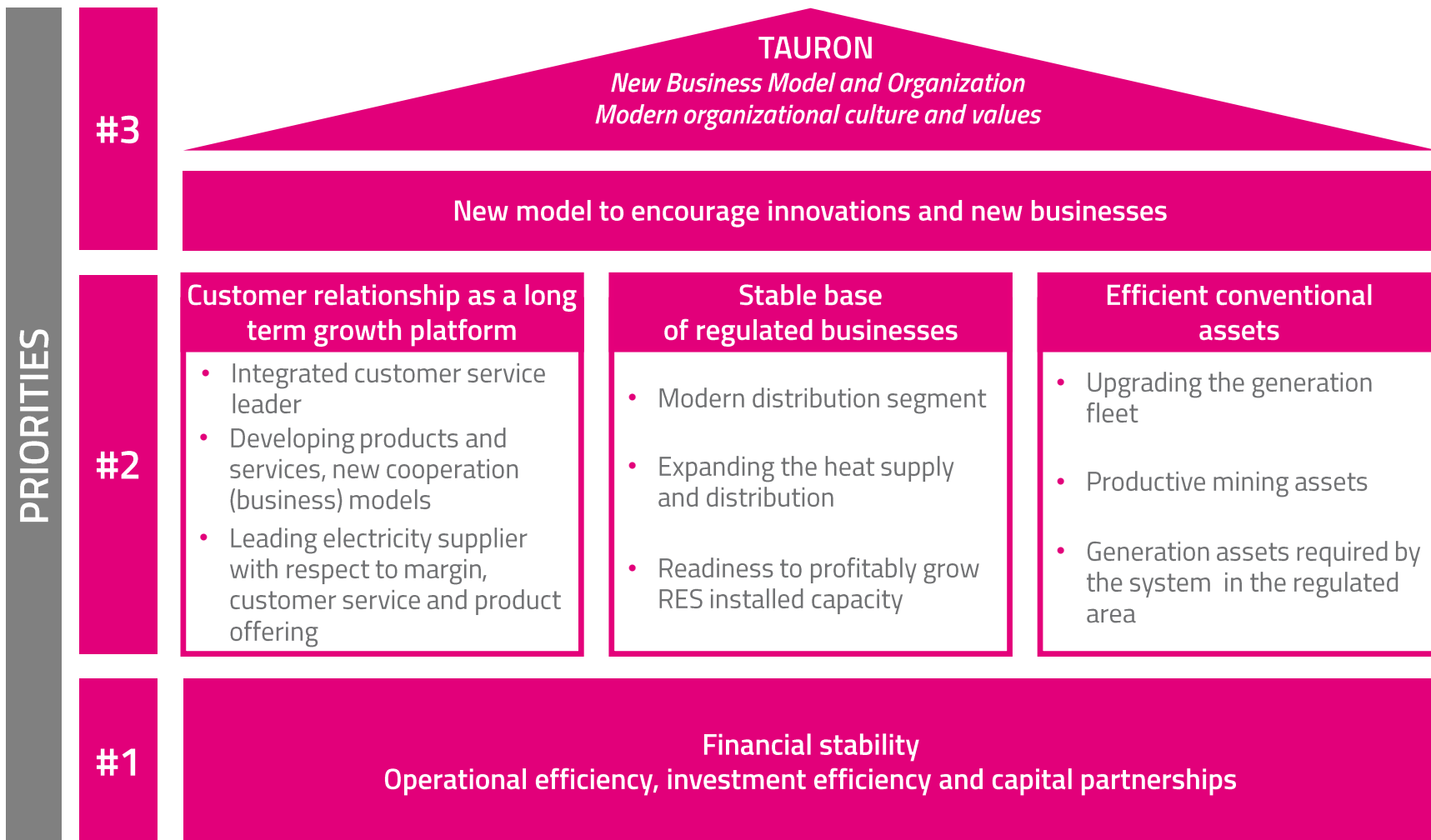
PROSPECTS FOR INDIVIDUAL SEGMENTS OF TAURON GROUP



*) Renewable Energy Sources excluding electricity generation by prosumers

IMPLEMENTING PRIORITIES BASED ON THE PILLARS

PILLARS OF TAURON'S STRATEGY





#1 ENSURING FINANCIAL STABILITY; NOT TAKING ANY ACTIONS MAY LEAD TO LIQUIDITY ISSUES IN 2017



ACTIONS

- 1 Efficiency Improvement Program (EIP) 2016-2018
- 2 Strategic initiatives in 2017-2020
- 3 Investment efficiency improvement 2017-2020
 - Reduction of the CAPEX program
- 4 Optimizing the asset structure, including resignation from unprofitable assets
- 5 Operational excellence in all businesses with particular attention paid to asset management
- 6 Optimizing the Group's financing and preparing a contingency plan
 - Improved effectiveness of capital allocation with the use of strategic partners
 - Preparing some assets for sale

ASSUMPTIONS AND ESTIMATED EFFECTS

Financial effects

- Cumulative EBITDA growth by PLN 1.0bn in 2016-2018
- CAPEX reduction by PLN 0.3bn
- Recurring impact on EBITDA from 2018 of approx. PLN 0.4bn

Financial effects

- Cumulative EBITDA growth by PLN 1.2bn in 2017-2020
- Recurring impact on EBITDA from 2020 of approx. PLN 0.3bn

Financial effects

- PLN 0.7bn as a result of rationalizing expenditures
- PLN 1.5bn as a result of stopping the investment in Łagisza

- Selling or shutting down distributed assets that do not generate synergies in the Group
- Taking unprofitable assets out of service

- Operational excellence program (among others as a result of the employee innovations program)
- Implementing the asset management program at subsidiaries

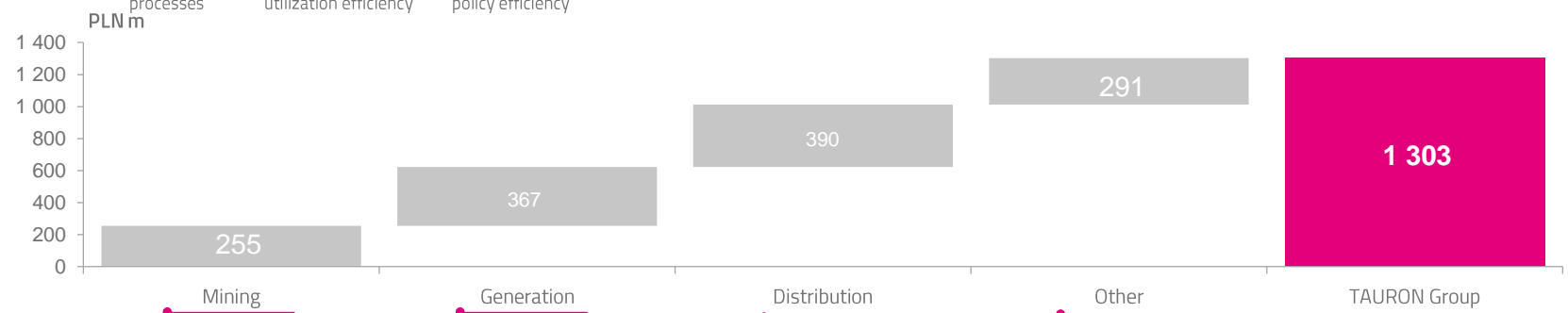
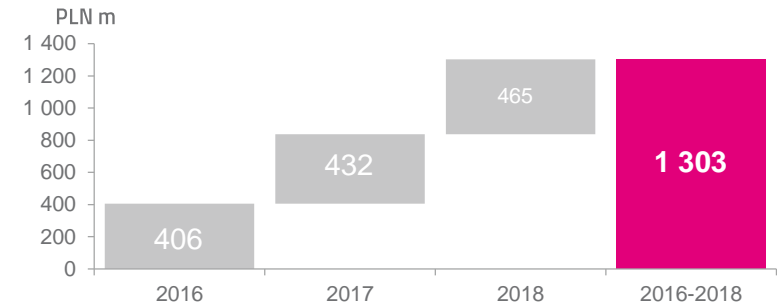
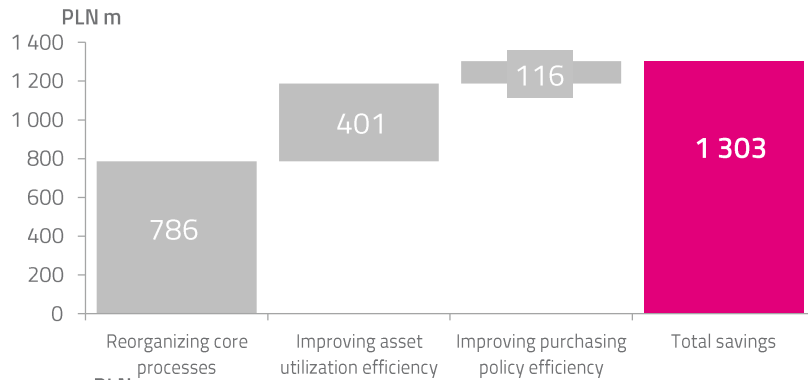
- Business partnerships to grow core business operations and acquire financing in order to lighten the balance sheet, among others selling a stake in the 910 MW investment project
- As part of the contingency plan, preparing to sell core business operations assets



Implementation of the above actions will significantly reduce the risk of breaching the net debt/EBITDA covenant



2016-2018 EFFICIENCY IMPROVEMENT PROGRAM (EIP) ADOPTED ON 9 MARCH 2016



- Mining**
- Employment restructuring, reduction of labor costs and increasing their flexibility, reorganizational measures
 - Use of electronic auctions in the purchasing process
 - CAPEX plan optimization

- Generation**
- Optimizing overhauls and other assets maintenance costs
 - Employment restructuring
 - Purchasing efficiency improvement
 - Optimization of the carburizing and de-ashing systems' operation services
 - Maintenance services costs control
 - CAPEX plan optimization

- Distribution**
- Reorganization and employment restructuring
 - Asset maintenance costs control
 - Purchasing efficiency improvement
 - Outsourcing the storage services
 - Sale of redundant real estate

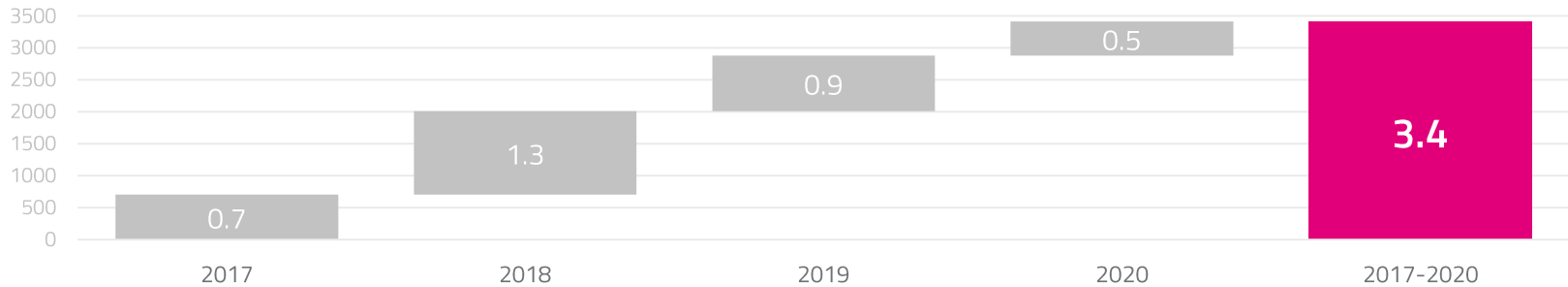
- Other**
- Employment restructuring
 - Reduction of the scope of IT services
 - Change of the printouts and reminder notices handling process
 - Customer service costs control
 - Optimization of the costs of promotional and sponsoring activities
 - Overhead (administration) costs control



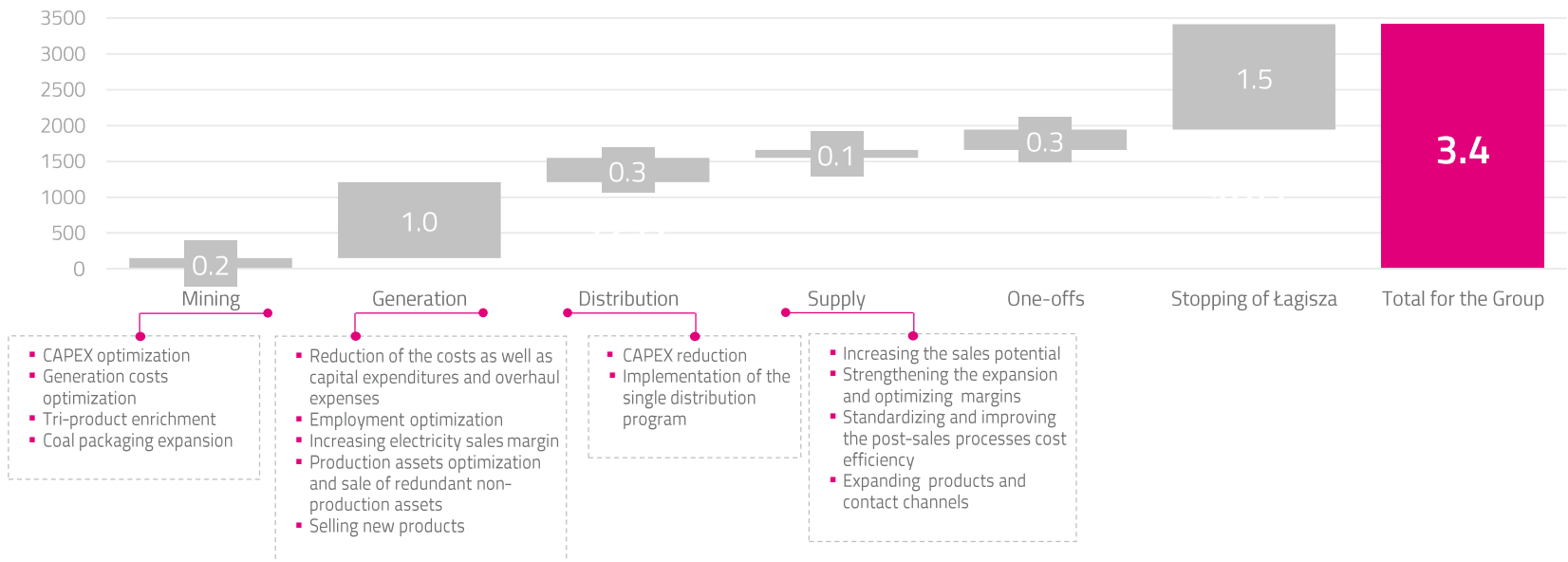
STRATEGIC INITIATIVES AND CAPEX RATIONALIZATION 2017-2020



Financial impact of the initiatives in billions of PLN



Financial impact of the initiatives in the lines of business in billions of PLN





TAURON'S LEGACY CAPEX WAS PLN 20.2BN; AS A RESULT OF RATIONALIZATION PLN 2.2BN IN SAVINGS ALREADY REALIZED



Efficient and stable mining

- Construction of Grzegorz shaft at Sobieski coal mine
- Construction of 800m level at Janina coal mine
- Investments at Brzeszcze coal mine



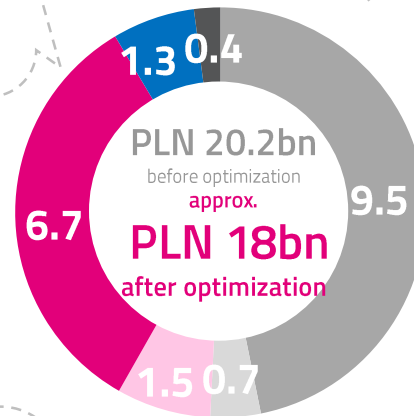
Expansion of the distribution grid

- Connecting new consumers and sources of electricity
- Upgrading and replacing existing grid assets



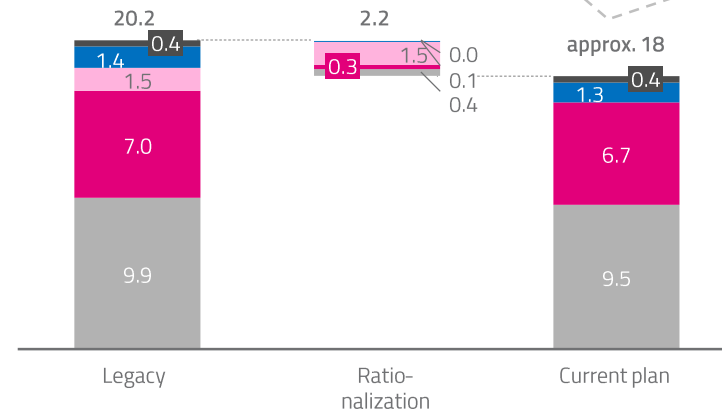
Optimization of the CAPEX plan underway

- Plan already reduced by PLN 2.2bn, including stopping the investment at Łagisza Power Plant (PLN 1.5bn) and rationalization of expenditures (approx. PLN 0.7bn)
- Planned further review of capital expenditures and their rationalization or delay



Modernization of the generation fleet and expansion of the heat business

- Construction of new generation capacity, among others the 910 MW coal-fired unit in Jaworzno, the 450 MW CCGT unit in Stalowa Wola
- Expansion of the heating network – including the Low Emission Liquidation Program



Supply and other Mining El. Łagisza Generation Distribution Optimized expenditures

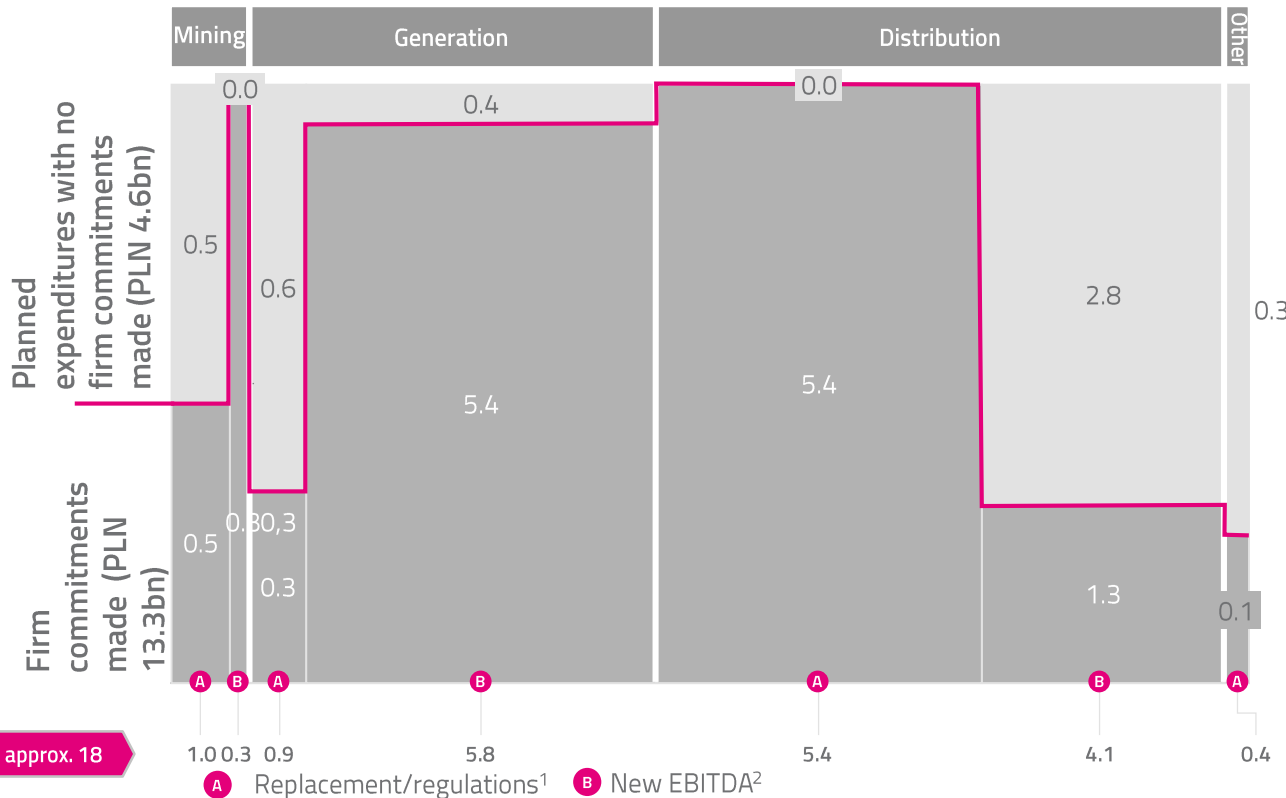


CURRENT CAPEX IS APPROX. PLN 18BN UNTIL 2020; LEGACY INVESTMENT COMMITMENTS COVER 75% OF CAPEX PROGRAM



2016-2020 CAPEX BREAKDOWN PER CATEGORY

Capital expenditures (PLN bn) per category



Comments

75% of the CAPEX plan (approx. PLN 13.3bn) represent firm investment commitments: continued or resulting from declarations made

- Commitments contracted or required by regulations (e.g. connections in Distribution)
- Investment projects underway (e.g. Jaworzno)
- Due to external obligations

25% of the CAPEX plan (approx. PLN 4.6bn) represent planned expenditures, however with no firm commitments made

- Among others, upgrading the Distribution, some maintenance expenditures



Company's financial position and investment projects already underway make it impossible to make new material commitments in the 2020 timeframe

1. Includes maintenance expenditures (i.e. maintaining assets in the undeteriorated condition), expenditures required by regulations and new investment projects to replace shutdown assets (e.g. a new unit to replace the old one)
 2. Investment projects leading to increased EBITDA



#2 BUILDING A STRONG GROUP BASED ON THREE PILLARS CUSTOMER RELATIONSHIP AS LONG TERM GROWTH PLATFORM



Developing competences and model with respect to analyzing customer needs, tailoring the product offering and effectively developing and implementing new cooperation models



ASPIRATION: Not less than 25% of supply segment's revenue/margin from new businesses by 2025



#2 BUILDING A STRONG GROUP BASED ON THREE PILLARS

STABLE BASE OF REGULATED BUSINESSES



DIRECTIONS

Modern distribution segment

- Integrating the segment's structure and processes – Single Distribution Program
- Polish market leader in the area of grid safety and operation efficiency
- Preparing the grid infrastructure and organization for the growth of distributed generation sources

Expanding the heat supply and distribution

- Participating in the Low Emission Liquidation program
- Increasing the infrastructure utilization by actively acquiring new customers and optimizing the use of own and external heat sources
- Seeking multi-fuel solutions (e.g. alternative fuels) for existing assets
- Expanding cogeneration and heat from distributed sources
- Securing heat supplies on the Dąbrowa market following the stopping of the Łagisza project

Readiness to profitably grow RES installed capacity

- Preparing to profitably grow renewable energy sources capacity
- Partner in the development of new renewable technologies

PRIORITIES / ACTIONS

Low emission liquidation

IMPLEMENTATION
2017-2022

8 cities

1.5 thou. buildings

34.9 thou flats

98.7 thou persons

CONNECTED CAPACITY
218 MW

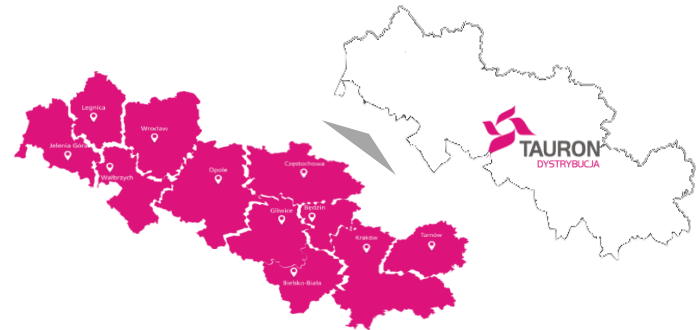
INCREASED SALES

ENVIRONMENTAL EFFECT

FINANCING
40% ASSISTANCE FUNDS | 60% OWN FUNDS

1.4 PJ/YEAR

-62.4 THOU. TONS CO2/ YEAR



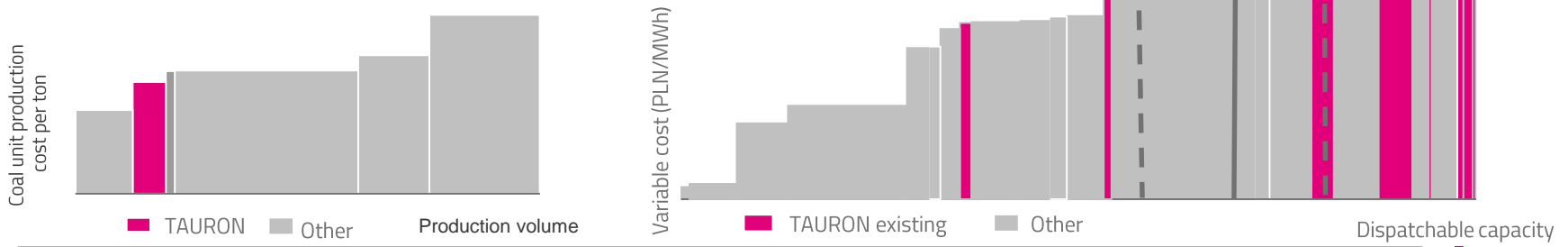
Single Distribution Program



#2 BUILDING A STRONG GROUP BASED ON THREE PILLARS EFFICIENT CONVENTIONAL ASSETS



PRIORITIES / ACTIONS





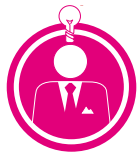
#3 DEPLOYING ORGANIZATIONAL CHANGES; NEW BUSINESS MODEL WILL SUPPORT IMPLEMENTATION OF THE STRATEGY



PRIORITIES OF THE NEW ORGANIZATIONAL CULTURE



Developing attitudes centered around such values as Partnership, Growth, Courage



Triggering innovations



Open communications



Team work, project teams

TO BE IMPLEMENTED BASED ON THE NEW PROCESS ORIENTED OPERATIONAL MODEL

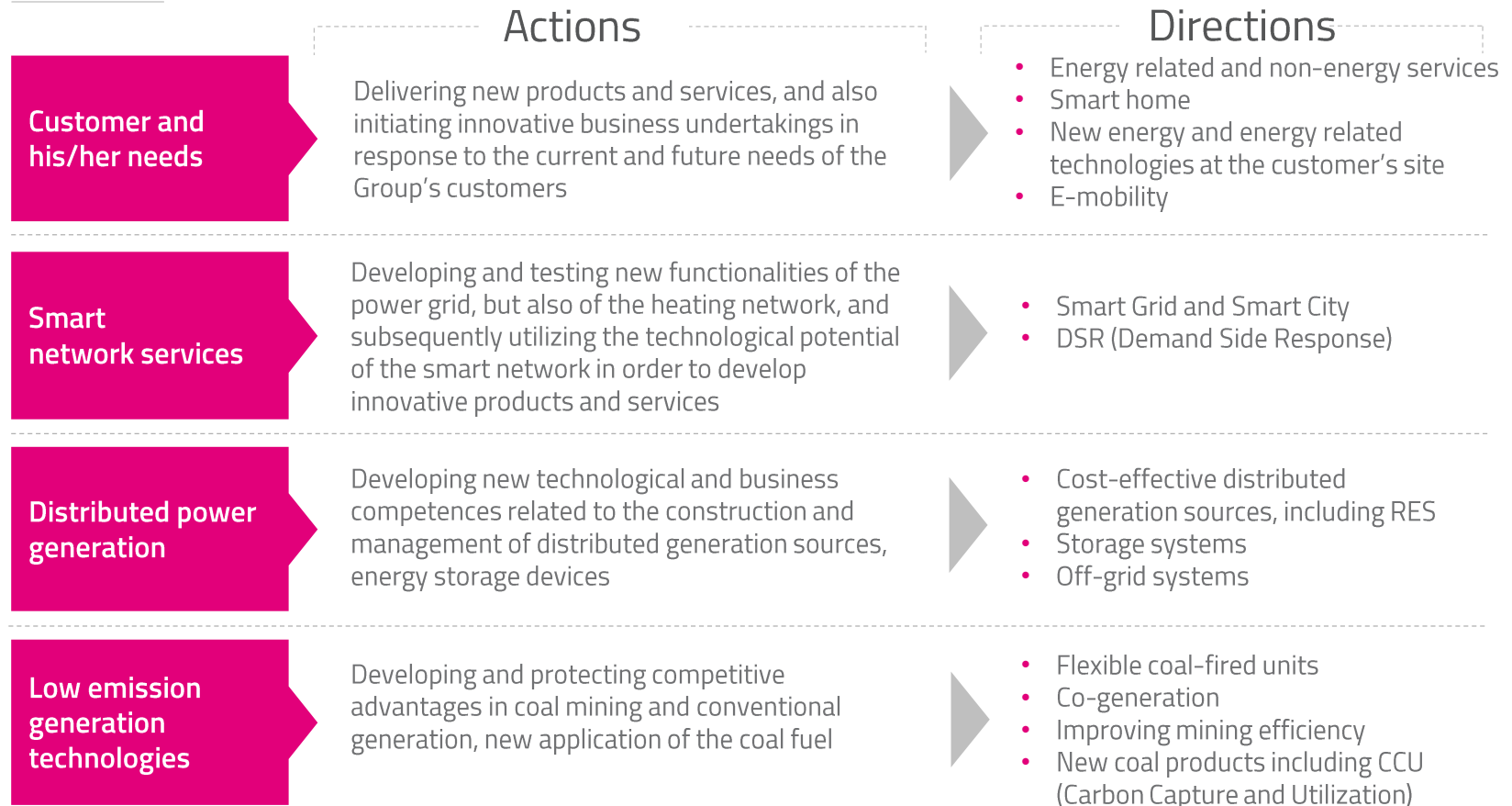




#3 INNOVATIONS AND RESEARCH & DEVELOPMENT ACTIVITIES PRIORITY DIRECTIONS



PRIORITY DIRECTIONS OF THE INNOVATIVE AND RESEARCH AND DEVELOPMENT ACTIVITIES



Allocating minimum 0.4% of the consolidated revenue to B+R+I starting from 2017, growth based on, among others, CVC and the long term return on portfolio, annual revision based on the company's financial position



#3 INNOVATIONS AND RESEARCH & DEVELOPMENT ACTIVITIES

NEW MODEL OF B+R+I ACTIVITIES

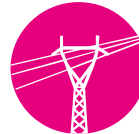


TAURON's Lines of Business

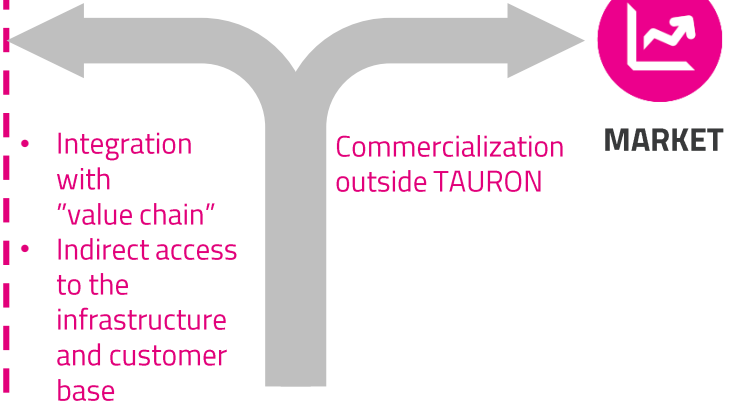
- Defining the needs with respect to technology development
- Generating new ideas, e.g.: through Employee Innovations
- Cooperating in deployments, testing and implementations
- Verifying the assumptions
- Upscaling, commercializing



Needs,
Ideas



Testing,
Implementations,
Innovations



- Joint R+D projects with the science (academic) sector and innovative enterprises
- Developing the Culture of Innovations
- Strategic technology alliances (science and industry)
- Knowledge management and IPR
- Widespread use of external funds
- International projects
- Open Innovation
- Coordinating the commercialization and implementations

TAURON Research and Innovations



MARKET
R+D INSTITUTIONS



TAURON CVC



MARKET
R+D INSTITUTIONS

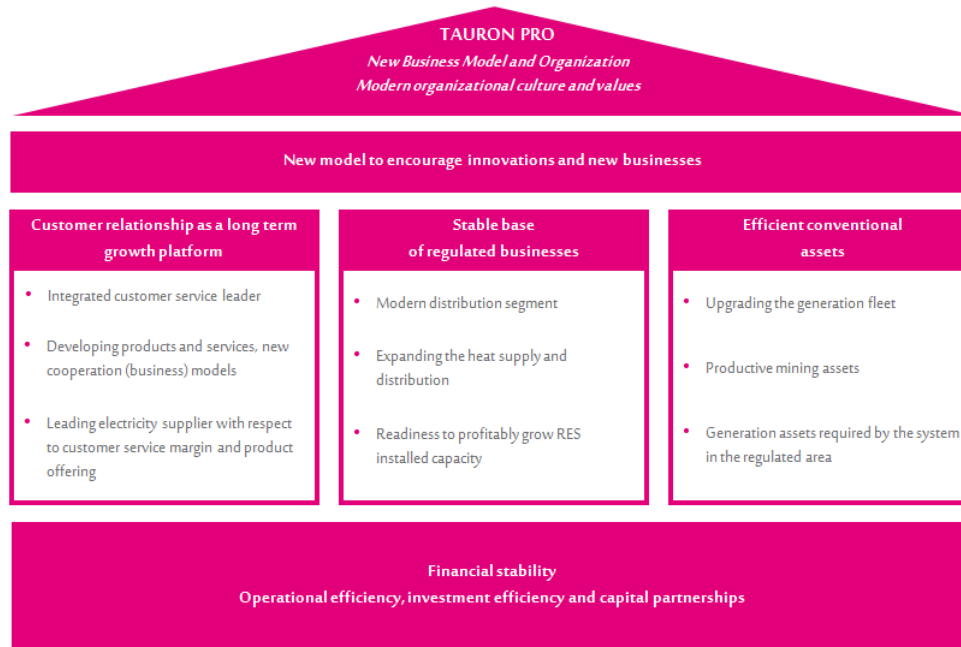
- Acceleration, incubation
- Investments in Seeds, Start-Ups, Spin-Offs,
- Government programs e.g.: "Start In Poland"
- New businesses
- Joint ventures with other financial institutions
- International activities (e.g. scouting)



BUSINESS OBJECTIVES AND ASPIRATIONS OF TAURON'S STRATEGY



ACTIONS WITHIN EACH OF THE PILLARS ON WHICH TAURON STRATEGY IS BASED ...



... WILL ALLOW TO ACHIEVE THE DESIGNATED KEY OBJECTIVES FOR THE GROUP¹

- EBITDA topping PLN 4bn in 2020
- Maintaining net debt/EBITDA covenant below 3.5x
- Maintaining a high CSI²
- Power plants posting positive cash flows by 2020
- Retaining the customer base
- Unit margin market leader among Poland's 4 largest electricity suppliers
- New businesses will represent at least 25% of supply segment's revenue/margin in 2025

1. The strategic assumptions and financial forecasts do not take into account any potential revenue from the capacity market. Potential capacity mechanisms should have a positive impact on the position of the generation segment. The current conditions of electricity supply to households were assumed.
2. Customer Satisfaction Index

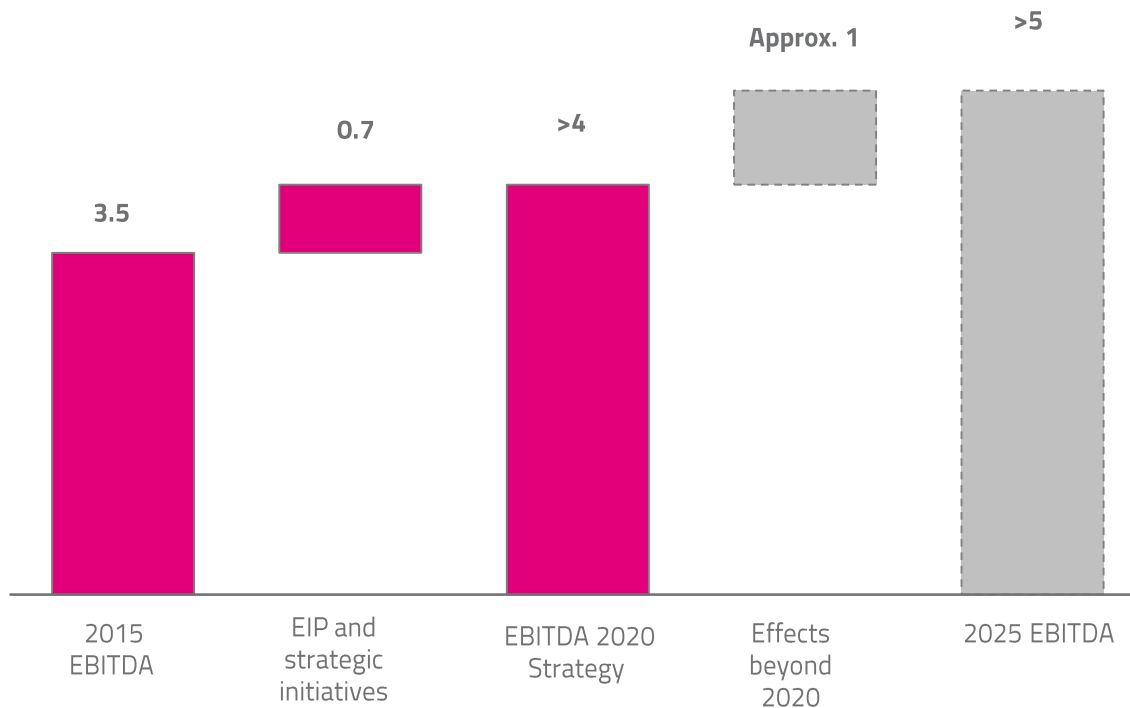


STRATEGY IMPLEMENTATION MEANS FINANCIAL STABILITY AND COMPLETION OF THE PLANNED INVESTMENT PROJECTS



2025 EBITDA HAVING TAKEN INTO ACCOUNT THE RISKS AND THE 2016-2025 STRATEGY (PLN BN)

RESULTS OF THE STRATEGY IMPLEMENTATION



Maintaining financial stability - net debt/ EBITDA ratio will not exceed 3.5x, and starting from 2018 the ratio will be declining

Completion of the CAPEX plan by 2020

Implementation of new models to prepare TAURON for the power industry of tomorrow



DIVIDEND POLICY OF THE TAURON GROUP



LONG-TERM PERSPECTIVE

In the long term TAURON plans to pay out a dividend of minimum 40 percent of consolidated net profit



TAURON GROUP'S INTENTION

TAURON's intention is to provide a dividend yield that would be competitive versus the yield offered by long term debt instruments issued on the Polish market by investment grade rated companies

The final recommendation on the dividend will be affected by additional factors, including in particular:

- Legal requirements and provisions of the financing agreements, in particular related to not breaching the defined value of the leverage ratio
- Ensuring investment grade rating

- Implementation of the investment policy
- Market situation
- Group's liquidity position
- Cost and ability to obtain financing



The forecasts that the Strategy is based upon indicate that 2020 will be the first year when the dividend payout will be possible

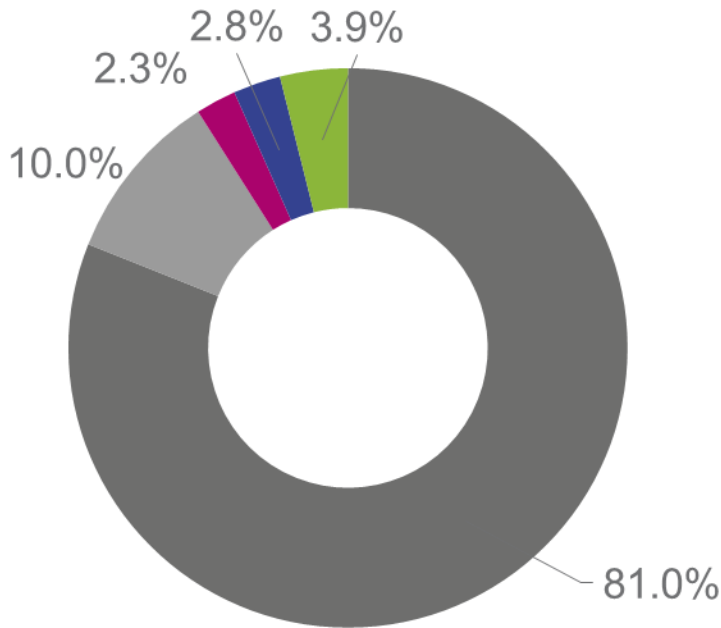


INSTALLED CAPACITY; CAPEX PROGRAM WILL ALLOW FOR REPLACING DECOMMISSIONED CAPACITY

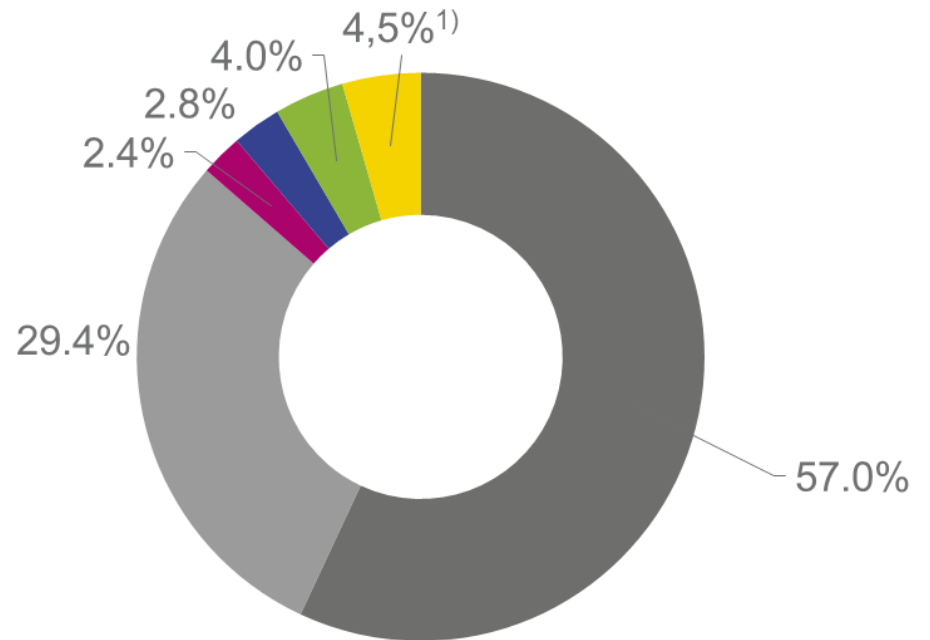


TAURON GROUP'S INSTALLED CAPACITY

2015 – 5.1 GW



2020 – 5.06 GW



■ coal (existing) ■ coal (new) ■ bio-mass ■ hydro ■ wind ■ gas

1) Gas-fired capacity assumed as 50% of the capacity of the newly built gas-fired unit at Stalowa Wola



**Additional investment potential in
2020-2025
more than PLN 6bn**



**Preferred investment
directions**



Regulated area

- Electricity distribution
- Heat generation and distribution
- RES with a stable support system
- Participation in the nuclear power generation
- Regulated conventional generation
- Diversification in the regulated area



New power industry

- E-mobility
- Distributed heat and electricity generation (including power generation clusters)
- Power generation by prosumers
- Digital solutions
- Smart Home and Smart City solutions
- Energy related services (e.g. energy efficiency)



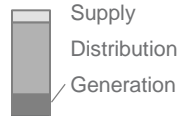
TAURON GROUP'S VISION IN 2025



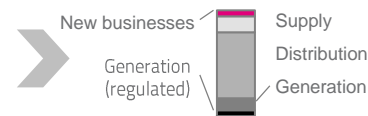
TAURON TODAY

TAURON 2025

EBITDA structure



3 main pillars of operations: distribution, generation, trading



Additionally:
New businesses and expansion of the supply segment, some generation assets shifted to the regulated segment

Customer



Focus on a single product – electricity



Customer=centricity – focus on various customer needs

Model of operations (mainly in regulated assets)



Distributed/dispersed (e.g. distribution)



Integrated asset management (e.g. "Single Distribution")

Conventional assets

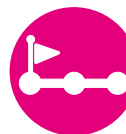


Generation assets not very competitive in the *merit order*



Upgraded, profitable and partly regulated asset base

Organization



Beginning of the road towards the culture of cooperation and openness



Organizational culture based on common values (Partnership, Growth, Courage)

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