FITCH AFFIRMS POLAND'S TAURON AT 'BBB'; STABLE OUTLOOK

Fitch Ratings-Warsaw/London-21 June 2013: Fitch Ratings has affirmed TAURON Polska Energia S.A.'s (Tauron) Long-term foreign and local currency Issuer Default Ratings (IDR) at 'BBB' with Stable Outlooks.

The ratings reflect Tauron's leading position in Poland's electricity distribution and strong position in power generation. At the same time, the ratings are constrained by the worsening financial performance of the generation segment, concentrated generation fuel mix (e.g. mostly coal-fired) and the deterioration of the company's credit metrics forecast by Fitch over 2013-2017. The increased EBITDA of the regulated power distribution segment, mainly thanks to the full-year contribution of Gornoslaski Zaklad Elektroenergetyczny S.A. (GZE) acquired in December 2011, allowed the company to mitigate the negative impact of declining profitability of the power generation segment in 2012. Nevertheless, Fitch expects Tauron's funds from operations (FFO) adjusted net leverage to increase to around 3x by 2015 from 1.3x at end-2012 due to a combination of weaker FFO driven by the forecast weaker performance of the generation segment and large capex.

KEY RATING DRIVERS

--GZE Acquisition Boosts 2012 EBITDA
Tauron's EBITDA in 2012 grew by 25% mainly because of the strong performance of the regulated power distribution segment driven by the full-year contribution from GZE, which was acquired in December 2011 from Vattenfall AB (A-/ Stable). This mitigated weaker cash flows in the power generation segment. Operating performance was affected by lower electricity generation volume (which fell by 10%) due to lower power demand and changes in the country's merit order due to the commissioning of a new large lignite fired unit in Belchatow operated by PGE Polska Grupa Energetyczna (PGE, 'BBB+'/Stable).

--Increased Regulated Business
The acquisition of GZE also resulted in a sizeable increase of the predictable, regulated portion of EBITDA from the electricity distribution segment to 51% in 2012 from 43% in 2011. Tauron's ratio is higher than the 44% at Enea S.A. (BBB/Stable) and 25% at PGE, but lower than 75% at ENERGA S.A. (Energa; BBB/Stable). Fitch expects that in the medium term the share of Tauron's regulated EBITDA will be well above 50% boosted by the regulatory asset base (RAB) remuneration process and increased grid revenue due to the large capex of the distribution segment, along with expected weak performance of the generation segment.

--Deteriorating Performance of Generation Segment
Fitch expects that in the next few years Tauron's operating cash flows from the generation segment will be under pressure due to weak generation margins and the fact that additional cash flow received by Tauron, related to compensation for the termination of long-term power purchase agreements (PPAs), will only be reported until 2013. Furthermore, Tauron's substantial exposure to carbon dioxide costs and the necessity to purchase missing CO2 certificates will results in a further erosion of profits from the generation segment from 2013.

-- Weakness of the Generation Fleet
The ratings are constrained by the group's limited generation fuel mix diversification (coal-fired plants account for 93% of generation capacity), which is unlikely to change materially by 2017. This will result in a lower generation profit margin compared with most of its CEE peers rated by the agency, and also in substantial exposure to carbon dioxide costs. Conversely, Tauron benefits from partial integration of its generation activity with the company's own coal mines, which meet around 35% of the group's fuel needs.

--Net Leverage to Increase
Fitch forecasts that after a temporary improvement in the credit metrics at end-2012 due to the full-year cash flow contribution from GZE, Tauron will continue to increase its leverage as a result of negative free cash flow due to the large capex plan for 2013-2017 mostly related to the investment in generation and distribution grids. According to Fitch's projections, FFO adjusted net leverage will increase to around 3x by 2015. The single largest investment project is the Jaworzno III 910 MW coal-fired power plant (net investment of PLN4.4bn) whose construction is expected to start in H213 and be completed in 2018.

LIQUIDITY & DEBT STRUCTURE
--Liquidity Driven by Available Lines
Tauron's pre-capex liquidity was adequate at end-March 2013 with unrestricted cash of PLN324.4m and a committed (fully available) PLN300m three-year revolving line against PLN426.4m of short-term financial liabilities. Fitch estimates free cash flow for 2013 at around negative PLN1.5bn, to be funded by funds available under the European Investment Bank (EIB) loans (PLN450m) and PLN2.7bn available under the domestic bond issue programme (fully underwritten by the banks) and new facilities that are being arranged. The debt maturity profile is balanced with limited maturities until 2015.

--Further Progress in Arranging Funding
Tauron made further progress in arranging external funding in H212 and Q113 by increasing the amount of the domestic bond programme up to PLN7bn and securing long term financing from the EIB of PLN1.4bn. The company is about to arrange a further financing for PLN1bn which will result in the pre-funding of capex for another 18-24 months and a substantial reduction of the funding risk.

RATING SENSITIVITIES
Positive: Future developments that could lead to positive rating actions include:
- Rating upside potential for Tauron in the short-to-medium term is limited. A successful implementation of the capex plan in the long term without jeopardising the financial profile together with operating cost reduction and substantially reduced exposure to CO_2 costs could be positive for the ratings.

Negative: Future developments that could lead to negative rating action include:
- Substantial increase in FFO adjusted net leverage to above 3x on a sustained basis - for example, due to full implementation of capex in a scenario of weaker-than-expected operating cash flows - would be negative for the ratings.

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Applicable criteria, 'Corporate Rating Methodology', dated 8 August 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Corporate Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684460