

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

Fitch Ratings-Warsaw/London-25 June 2012: 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 affirmation is driven by Tauron's stable operating and strong financial performance in FY11. Tauron's 2011 EBITDA improved by almost 10% to PLN3bn, mainly due to the strong performance of the distribution division, which accounted for 42% of EBITDA in FY11. The mining and generation segments supported Tauron's profitability and accounted for 43% of the group's EBITDA in 2011.

Furthermore, Tauron's market position in electricity distribution and supply was strengthened following its acquisition of Gornoslaski Zaklad Elektroenergetyczny S.A. (GZE) from Vattenfall AB ('A-/Stable) in mid-December 2011. GZE's full contribution to overall EBITDA in 2012 is likely to increase the distribution segment's share in Tauron's EBITDA and reduce the company's business risk.

EBITDA of the distribution segment will be also boosted by the RAB remuneration process and increased grid revenue due to additional capex. A similar trend is expected for Tauron's Polish peers including Energa S.A. with 60% of regulated EBITDA ('BBB-/Stable), 40% at ENEA S.A. ('BBB/Stable) and to a lesser extent for PGE Polska Grupa Energetyczna S.A. ('BBB+/Stable) with 23%.

In the next few years Tauron's EBITDA 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 could result in a further erosion of profits from the generation segment beyond 2012.

At end-2011 Tauron's funds from operations (FFO) adjusted net leverage increased to 1.6x from around zero at end-2010, mainly due to the debt-funded acquisition of GZE. Fitch projects that the leveraging process will be continued due to the necessity to co-fund its large mid-term capex plans, resulting in higher financial leverage, which is forecast to remain commensurate with the current ratings in the medium term. The agency notes that FFO adjusted net leverage approaching or exceeding 3.0x could lead to negative rating action.

Fitch notes substantial progress made by Tauron in arranging external funding in H112. Tauron is about to sign loan documentation for the increase of its bond programme's local banking sources and long term financing from the European Investment Bank. Finalising these processes will result in the pre-funding of capex for the next 18-24 months and a substantial reduction of the funding risk.

The ratings are constrained by the group's limited generation fuel mix diversification (coal-fired plants account for 93% of installed generation capacity), which is unlikely to change materially by 2016. This will result in a lower generation profit margin compared with 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 25% of the group's fuel needs.

Tauron's pre-capex liquidity was adequate at YE11 with unrestricted cash of PLN329m of unrestricted cash against PLN214.2m of short-term financial liabilities. In January 2012 Tauron was granted a committed (fully available) PLN300m three-year revolving line. Fitch estimates free cash

flow for 2012 at around negative PLN1.4bn, to be funded by new facilities that are being arranged. The debt maturity profile is balanced with limited maturities until 2015.

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The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Corporate Rating Methodology', dated 12 August 2011, is available at www.fitchratings.com.

Applicable Criteria and Related Research:

Corporate Rating Methodology

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647229

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