Fitch Affirms Poland's Tauron at 'BBB' with Stable Outlook

Fitch Ratings-Warsaw/London-30 June 2011: Fitch Ratings has affirmed TAURON Polska Energia S.A.'s (Tauron S.A.) Long-term foreign and local currency Issuer Default Ratings (IDR) at 'BBB' with Stable Outlooks.

The rating reflects Tauron's (Tauron Group, comprising Tauron S.A. and its subsidiaries) solid market position in the Polish power sector, limited diversification of the fuel mix in generation and prudent financial policy. Fitch believes that thanks to its low financial leverage, Tauron has substantial rating headroom to co-fund its ambitious medium-term capex plan with debt and maintain the current rating.

"The affirmation of Tauron's ratings also reflects that Fitch has simultaneously removed the notching down to 'BBB-' for structural subordination of the holding company's debt and the one-notch uplift to 'BBB' for implicit state support," says Jacek Kawalczewski, Associate Director in Fitch's EMEA Energy and Utilities team.

At end-2010, Tauron substantially improved its structural subordination by raising new debt at Tauron S.A. and repaying most of the debt at the subsidiary level. At YE10, around 60% of total debt was issued at the holding level (compared to zero at YE09). This improves the position of Tauron S.A.'s creditors as they previously had weaker access to the cash flows of Tauron subsidiaries (where most cash flow is generated) than creditors lending directly to the subsidiaries, especially as 83% of debt was secured on fixed assets at YE09 and Tauron's current bond programme is unsecured. Furthermore, Fitch expects that all new debt will be raised at the Tauron S.A. level and the remaining debt at the subsidiaries level will be almost fully repaid within two to three years. Progress in operational integration and application of the central financing model (including cash pooling and internal bond programme) reinforces Fitch's view that structural subordination has ceased to be a constraining factor for Tauron's IDR.

As expected by Fitch, concurrent with the debt relocation to the holding company level, the state support became less relevant to Tauron's rating on the back of the privatisation process, which reduced the state treasury's stake in Tauron to 30% from 88%. Tauron continues to be a state-controlled company with strategic importance as the second-largest player in the Polish power sector after PGE Polska Grupa Energetyczna S.A. (PGE, 'BBB+'/Stable), but the agency believes that after the privatisation the potential direct support of the Polish government is less likely.

The ratings continue to reflect Tauron's vertically-integrated operations in the Polish electricity market, including a strong position in power generation and a leading position in electricity distribution and supply.

At YE10, Tauron was able to reduce financial leverage (Fitch-adjusted net debt to EBITDA) to 0.1x from 0.4x at end-2009). However, Fitch projects that as a result of new debt that Tauron plans to raise to co-fund its large mid-term capex plan, the group's leverage is likely to increase to about 2x-2.5x by YE15. This level would still be commensurate with the current ratings and is largely in line with projected leverage in the medium term for other central European (CE) electric utilities rated by Fitch, which also pursue large capex plans.

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 2015. This results in a lower generation profit margin compared with its CE peers rated by the agency, and also in substantial exposure to carbon dioxide costs. On the other hand, Tauron benefits from partial integration of its generation activity with the company's own coal mines, which meet 25% of the group's fuel needs.

Tauron's smaller scale, less dominant market position and lower profitability in generation than its CE peers is partly mitigated by a higher contribution to EBITDA of regulated electricity distribution earnings (41% in 2010) which is on a par with Enea S.A. (‘BBB’/Stable) 42% and substantially higher than PGE (21%) or CEZ, a.s. (‘A-‘/Stable) with 19%. This results in lower exposure of cash flow to power and fuel prices and greater predictability of cash flow.

Tauron’s liquidity was ample at YE10 with unrestricted cash of PLN1.3bn and a five-year credit line of PLN450m fully underwritten by the banks against short-term financial liabilities of PLN349m. The debt maturity profile created as the result of the debt restructuring in December 2010 is regarded as beneficial with rather limited maturities until 2014.

Contact:

Primary Analyst
Jacek Kawalczewski, CFA
Associate Director
+48 22 338 62 91
Fitch Polska S.A.
Krolewska 16

Secondary Analyst
Arkadiusz Wicik, CFA
Director
+48 22 338 62 86

Committee Chairperson
Josef Pospisil, CFA
Senior Director
+44 20 3530 1287

Additional information is available on www.fitchratings.com.

Applicable criteria, 'Corporate Rating Methodology', dated 13 August 2010, is available at www.fitchratings.com.