TAURON Polska Energia S.A.

Full Rating Report

Ratings

Foreign Currency

Long-Term IDR	BBB
Short-Term IDR	F3

Local Currency

Long-Term IDR	BBB
Short-Term IDR	F3

National

Long-Term Rating	A(pol)
Senior unsecured	A(pol)

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable
National Long-Term Rating	Stable

Financial Data

TAURON Polska Energia S.A.

	31 Dec 14	31 Dec 13
Revenue (PLNm)	18,441	19,131
Operating EBITDA (PLNm)	3,554	3,717
Operating EBITDA margin (%)	19	19
Funds from operations (PLNm)	2,760	3,686
Capital expenditure (PLNm)	-3,465	-3,934
Free cash flow (PLNm)	-1,418	-425
Lease adjusted debt (PLNm)	8,479	6,223
FFO adjusted net leverage (x)	2.3	1.4

Some financial data, including EBITDA and EBIT, have been adjusted according to Fitch's definitions

Related Research

TAURON Polska Energia S.A. – Ratings Navigator (August 2015)

Fitch Affirms Poland's Tauron at 'BBB'; Outlook Stable (July 2015)

EMEA Utilities – Ratings Navigator Companion (February 2015)

Fitch Rates Poland's Tauron's Domestic Bonds 'A(pol)' (November 2014)

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Key Rating Drivers

High Share of Regulated Business: The creditworthiness of TAURON Polska Energia S.A. (TAURON) benefits from a high contribution from regulated electricity distribution to its EBITDA of around 60% in 2014 and 2013, up from 51% in 2012. Fitch Ratings expects the share of distribution to increase to 65% in 2015-2017 at the expense of generation. Distribution's share may then slightly decrease in 2018-2019, when new power generation units come on stream.

Challenging Generation: TAURON's generation will remain under pressure in 2015-2016 due to low wholesale electricity prices, declining free carbon dioxide (CO_2) allowances, the rising share of renewables supported by subsidies and the expiration of the compensation scheme for the termination of TAURON's long-term power purchase agreements in 2013. This is partially mitigated by the operational capacity reserve mechanism introduced in 2014.

Weak Generating Diversification: The ratings are constrained by the group's lack of generation fuel mix diversification. Coal-fired plants account for 92% of generation capacity, which exposes TAURON's cash flows to rising CO_2 costs, and this is unlikely to change materially before 2018. The ratings are further constrained by the age of the generation fleet.

Large Capex: TAURON plans to invest PLN37bn in 2014-2023. Its 2015-2019 capex plan is allocated mostly to the distribution segment (49% of total capex) for network upgrades and expansion, and to the generation segment (44%) for replacement and expansionary capex.

Net Leverage to Increase: Fitch forecasts a gradual deterioration in credit metrics over 2015-2018, due to the large, partially debt-financed capex plans. According to Fitch's projections, FFO adjusted net leverage will increase to around 3.5x in 2017 from 2.3x in 2014. The net leverage ratio may temporarily exceed 3.5x in 2017 or 2018 until new generation units are commissioned in 2019, increasing FFO and lowering leverage.

Covenants Under Pressure: Fitch expects TAURON's net debt-to-EBITDA to be close to or above 3x in 2016-2018, which is the covenant in some financing arrangements. We assume that TAURON will renegotiate and increase the level of financial covenants in a timely manner or adjust capex so as not to breach the covenant. Failure to renegotiate the covenant well ahead of a possible breach may be negative for TAURON's liquidity and for the ratings.

Rating Sensitivities

Stronger Business Profile: Rating upside for TAURON is limited. However, a stronger business profile due to a more diversified fuel generation mix, lower CO_2 emissions per megawatt hour (MWh) and continued efficiency improvements could be positive for the ratings.

Higher Leverage: The ratings would be negatively affected by a deterioration in credit ratios, including FFO adjusted net leverage sustained above 3.5x. In addition, acquisitions or other support for state-owned mining companies leading to net leverage above 3.5x or a substantial deterioration in TAURON's business profile could be negative for the ratings.

Liquidity and Debt Structure

Sufficient Liquidity: At end-June 2015, TAURON had PLN751m of unrestricted cash and equivalents and PLN3.4bn of committed funding against short-term debt of PLN526m and negative free cash flow close to PLN2bn projected by Fitch for 2015. TAURON faces a large debt maturity of PLN3bn in December 2016, which it plans to refinance in the next few months.

This document focuses on the key credit issues relating to the issuer, and assumes background knowledge of TAURON as well as power industry in Poland and Europe.

Key Contents

Key Rating Issues

Strong Market Position

TAURON is the second-largest utility in Poland by EBITDA and power generation after PGE Polska Grupa Energetyczna S.A. (PGE, BBB+/Stable) as well as the largest power distributor. The company's creditworthiness benefits from a high EBITDA contribution from regulated electricity distribution, which enhances cash-flow visibility. We expect the share of distribution to increase from around 60% of EBITDA in 2014 to around 65% in 2015-2017 driven largely by poorer results in generation. The share of distribution may slightly decrease in 2018-2019 after the commissioning of new generation units.

Challenging Generation Environment

Fitch expects the generation segment to remain under pressure in 2015-2016 due to low wholesale electricity prices, declining free CO_2 allowances, and a rising share of renewables supported by subsidies. TAURON's generation is fully exposed to the volatility of wholesale electricity market prices following the expiry of the long-term power purchase agreement (PPA) compensation mechanism in 2013. Since 2014 TAURON has benefited from additional remuneration for some of its coal-fired units under the operational capacity reserve mechanism with transmission system operator, PSE S.A.

The impact of a challenging conventional generation environment is mitigated by TAURON's ongoing savings programme focused on the generation segment. We do not view the structural change in the Polish generation market as rapid and far-reaching as in Germany, and highlight that interconnections are also improving only gradually, giving domestic players time to adjust.

Some Weaknesses in Regulatory Framework

Fitch views the regulatory framework for Polish distribution networks as supportive and stable. However, Poland's regulatory framework is weaker than in some western European countries. This includes the lack of a multi-year tariff-setting mechanism, and exposure to unexpected regulatory decisions, such as the 5% reduction in return on capital in 2015. There is also volume risk within the framework. For example, lower-than-expected distribution volumes reduce the distribution segment's EBITDA.

Some of the regulatory constraints have been addressed by the energy regulatory office. These include gradually increasing the return on the regulatory asset base (RAB) since 2010, and achieving a full return on the RAB in 2014. In addition, the gap between operating costs and costs approved by the regulator has been reduced, helped by TAURON's cost reduction programme in distribution, leading to stronger cost recovery within tariffs.

Weak Generating Diversification

The ratings are constrained by the group's lack of generation fuel mix diversification (coal-fired plants account for 92% of generation capacity), which is unlikely to change materially before 2018, as well as by the age of the generation fleet.

Related Criteria

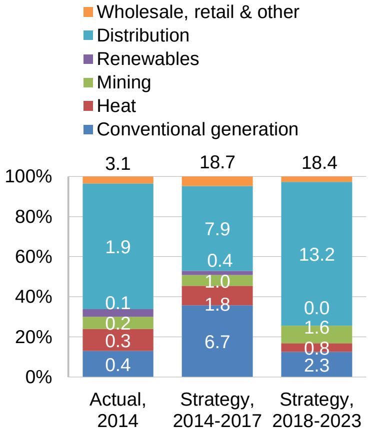
Corporate Ratings Methodology (August 2015)

The company's heavy coal-fired bias exposes its cash flow to rising CO_2 costs, which is partially mitigated by the gradual phasing out of free CO_2 allowances in Poland in 2013-2020. TAURON's generation activity benefits also from having around 40% of its fuel needs being met by the group's own coal mines.

Large Capex

TAURON plans to invest PLN37bn in 2014-2023. The 2015-2019 capex plan is allocated mostly to distribution (49% of total capex) for network upgrades and expansion, and to generation (44%) for replacement and expansionary capex. The single largest investment project is the Jaworzno III 910MW coal-fired power plant (net investment of PLN4.4bn, total project value of PLN6.2bn), whose construction started in 2H14 and should complete in 2019. Another large generation project is a gas-fired plant in Łagisza (413MW, net investment of around PLN1.5bn), run in cooperation with Polskie Inwestycje Rozwojowe, which should also be finalised by 2019. In 2015-2016 TAURON should commission a gas-fired unit in Stalowa Wola (450MW, built as a joint venture with Polskie Gornictwo Naftowe i Gazownictwo S.A., PGNiG).

Figure 1
TAURON's Capex
(PLNbn)



Source: Company information

In line with the strategy published in June 2014, the net effect of decommissioning and investments in generation should allow TAURON to increase installed capacity from 5.4GW to 6.1GW in 2023 (or lower by around 0.3GW if excluding Elektrownia Blachownia Nowa Sp. z o.o., a heat and power plant contributed in kind to TAMEH Holding Sp. z o.o., TAURON's joint venture with ArcelorMittal, in December 2014). Fitch's assumptions within its rating case for TAURON include capex in the range of PLN21bn in 2015-2019.

Nuclear Project

TAURON has acquired a 10% stake in an SPV established to build and operate the first nuclear power plant in Poland. The nuclear project is led by PGE, which owns 70% of the shares in the SPV. The remaining partners are ENEA S.A. (BBB/Stable) and KGHM Polska Miedź S.A., both owning 10% of shares.

A decision on the construction is expected in 2017-2018. We assume that any substantial cash outflows related to the nuclear project will not occur over the five-year rating horizon and therefore these have not been included in the Fitch rating case.

Implementation of the nuclear project without a support scheme could put downward pressure on the ratings. However, we will assess the rating impact of the nuclear project on TAURON and other companies involved in the project once its size and structure, and the impact on leverage, are known, together with details of a probable support scheme for the project's cash flows such as capacity payments or contracts for price difference.

Potential Support for Coal Mining

The government may approach Polish utilities, including TAURON, to acquire stakes in some coal mines from state-owned mining companies under financial pressure, such as Kompania Weglowa S.A. in order to support their financial and liquidity position. Potential acquisitions of new mines (apart from investments in already owned mining assets) have not been included in TAURON's strategy and the Fitch rating case. Acquisitions of stakes in coal mines or other forms of support for the coal mining sector leading to net leverage above 3.5x or substantially weakening TAURON's business profile could be negative for the ratings.

So far, TAURON's involvement in the potential acquisition of coal assets has been limited to the possible purchase of an organised business unit of a coal mine KWK Brzeszcze. In May 2015 the company signed a non-binding intention letter with the current owner of KWK Brzeszcze - Spolka Restrukturyzacji Kopaln S.A. (SRK). In August 2015 TAURON announced a list of preconditions for the deal, which includes accomplishment of the restructuring process of KWK Brzeszcze by SRK. If the transaction is to be concluded, it would likely be an off-balance-sheet asset purchase by a special-purpose vehicle in cooperation with third-parties.

The government is continuing talks with Polish utilities with respect to future cooperation between the power and mining sectors. The talks are being undertaken against a background of persistently low coal prices, the weak financial condition of the state-owned mining companies, and the upcoming general elections in October 2015.

Reassessment of Leverage Guidelines

We view the increased proportion of cash-flow contribution from regulated distribution as improving TAURON's business risk. As a result of the increased importance of the distribution segment we have widened the negative rating guidance for the 'BBB' rating to 3.5x from 3x.

We view regulated distribution as a lower risk business than generation, allowing for higher debt capacity. We assume that, for the 'BBB' rating category, TAURON's regulated distribution (59% of 2014 EBITDA) can support FFO adjusted net leverage of about 5x, while TAURON's generation segment (23% of 2014 EBITDA), comprising heat production, conventional power generation, renewables and mining supports FFO net leverage of about 2x. We expect the share of distribution to increase to 65% in 2015-2017 at the expense of the generation segment (18% of 2015-2017 EBITDA).

Net Leverage to Increase

Fitch forecasts a gradual deterioration in TAURON's credit metrics over 2015-2018, due to the large partially debt-financed capex plans. According to Fitch's projections, FFO adjusted net leverage will increase to around 3.5x in 2017 from 2.3x in 2014. The net leverage ratio may temporarily exceed 3.5x in 2017 or 2018 until new generation units are commissioned in 2019, increasing FFO and lowering leverage.

Fitch expects the company's net debt-to-EBITDA to be close to or above 3x in 2016-2018, which is the covenant in some financing arrangements. We assume that TAURON will renegotiate and increase the level of financial covenants in a timely manner or adjust its capex plan so as not to breach the covenant. Failure to renegotiate the covenant well ahead of a possible covenant breach may be negative for TAURON's liquidity and for the ratings.

Rated on Standalone Basis

TAURON is 30.06% owned and effectively controlled by the Polish state (A−/Stable), but Fitch rates it on a standalone basis with no rating uplift from state ownership factored in. The company operates on a wholly commercial basis and we assess legal, operational and strategic links with the state as moderate, in line with our parent and subsidiary rating linkage criteria.

Large Debt Repayment in 2016

The company faces a large debt maturity of PLN3bn in December 2016, issued off its medium-term notes programme underwritten by banks. We expect TAURON to cover this maturity with its available liquidity at least 12 months ahead of the due date. The company plans to refinance the bond programme in the next few months, which will enable it to cover the PLN3bn maturity. In July 2015 TAURON increased committed funding by PLN300m (in the form of a bond programme underwritten by Bank Gospodarstwa Krajowego).

Bonds accounted for the majority of debt (84% of total debt) at end-June 2015. This includes bonds issued within the programmes underwritten by banks (PLN4.2bn), domestic bonds of PLN1.75bn issued in 4Q14 and bonds issued on the German market (EUR168m; ie, PLN0.7bn) in 4Q14.

Rating Issues Register

Issue	Fitch view	Likelihood, timescale, rating impact	More information
Strong market position: TAURON is the largest electricity distributor in Poland as well as the second largest utility by EBITDA.	TAURON's creditworthiness benefits from a high (around 60%) EBITDA contribution from regulated electricity distribution. We expect this to continue in the future with possibly an even larger contribution of distribution to EBITDA in 2015-2017 on the back of a deteriorating generation environment and until new generation units are commissioned in 2018-2019. Fitch views Poland's regulatory framework for distribution as weaker than in some western European countries, though overall supportive and stable. We hence perceive regulated distribution as a lower risk and more predictable business than generation, allowing for higher debt capacity.	Likelihood: In place Timescale: Long term Rating impact: Positive	Potential consolidation in the market (though currently suspended, at least until the upcoming general elections in Autumn 2015) would further strengthen TAURON's market position.
Challenging generation: TAURON's generation fleet is second only to PGE's, but is largely conventional and exposed to negative market developments.	TAURON's generation will remain under pressure in 2015-2016 due to low wholesale electricity prices, rising CO2 costs (increasing market prices and decreasing free allocation), the rising share of renewables supported by subsidies and expiration of the compensation scheme for the termination of TAURON's long-term power purchase agreements in 2013. This should be partially mitigated by the operational capacity reserve mechanism in place since 2014 and also by lower hard coal market prices (though in Poland they continue to be higher than Amsterdam-Rotterdam-Antwerp (ARA) prices.	Likelihood: In place Timescale: Long term Rating impact: Negative	The profitability of conventional generation in Poland is better than in western Europe. It is due to the allocation of free CO2 allowances in return for environment-friendly capex (gradually phasing-out, currently around 50%), higher wholesale electricity prices and a better position in the merit order (low share of renewables, no nuclear plants).
Weak generating diversification: Around 92% of TAURON's generation capacity is in hard coal.	Lack of generation fuel mix diversification is a constraining factor for TAURON's ratings. The fuel mix is unlikely to change materially within the rating horizon due to very limited capex on renewables. Among the four state-owned utilities in Poland TAURON is the most keen on constructing gas-fired units (Stalowa Wola - 450MW to be commissioned in 2015-2016, Łagisza - 413MW planned for 2019), hence the gas share in TAURON's fuel mix can increase, subject to the level of gas prices in the Polish market.	Likelihood: In place Timescale: Long term Rating impact: Negative	Around 40% of TAURON's demand for hard coal is met by the group's own coal mines with the remaining part purchased in the Polish market, largely from Kompania Weglowa. The gas-fired power plant in Stalowa Wola is built in a joint venture with state-owned PGNiG, which will be the gas supplier for the project.
High capex: TAURON's strategy provides for capex of PLN37bn in 2014-2023.	TAURON's 2015-2019 capex plan is allocated mostly to distribution (49% of total capex) for network upgrades and expansion, and to generation (44%) for replacement and expansionary capex. The single largest investment project is the Jaworzno III 910MW coal-fired power plant (net investment of PLN4.4bn), whose construction started in 2H14 and should complete in 2019. Fitch assumes capex around PLN21bn in 2015-2019.	Likelihood: Ongoing Timescale: Long term Rating impact: Negative in short-term, positive in long-term	TAURON's actual capex in 2014 reached PLN3.1bn.
Leverage to increase: TAURON's leverage will increase, largely on the back of a sizeable capex.	Fitch forecasts a gradual deterioration in TAURON's credit metrics over 2015-2018, due to the large partially debt-financed capex plans. According to Fitch's projections, FFO adjusted net leverage will increase to around 3.5x in 2017 from 2.3x in 2014. The net leverage ratio may temporarily exceed 3.5x in 2017 or 2018 until new generation units are commissioned in 2019, increasing FFO and lowering leverage.	Likelihood: Likely Timescale: Mid-term Rating impact: Negative	TAURON's funding sources are quite diversified and include bank loans, bonds underwritten by banks, bonds issued in the Polish capital market and long-term bonds issued in the German market.
Financial covenants under pressure: Some financing arrangements include a net debt to EBITDA covenant at 3x.	Fitch expects the company's net debt-to-EBITDA to be close to or above 3x in 2016-2018. We assume that TAURON will renegotiate and increase the level of financial covenants in a timely manner or adjust its capex plan so as not to breach the covenant. Failure to renegotiate the covenant well ahead of a possible covenant breach may be negative for TAURON's liquidity and for the ratings.	Likelihood: Likely Timescale: Short term Rating impact: Negative	
Refinancing of existing facilities: TAURON faces a large debt maturity of PLN3bn in December 2016.	The PLN3bn debt maturity comprises bonds issued within the bond programme underwritten by banks. We expect TAURON to cover this maturity with its available liquidity at least 12 months ahead of the due date. The company plans to refinance the bond programme in the next few months, which will enable it to cover the PLN3bn maturity.	Likelihood: Likely Timescale: Short term Rating impact: Negative	At end-June 2015, TAURON had PLN751m of unrestricted cash and equivalents and PLN3.4bn of committed funding against short-term debt of PLN526m. Fitch projects negative free cash flow at PLN2bn in 2015.

Source: Fitch

Sector Performance and Expectations

(PLNm)	2012	2013	2014	Expectation
Generation				
EBITDA	1,481	566	839	Generation will be under increasing pressure due to rising CO2 costs, expiration of compensation payments for the termination of power purchase agreements (PPAs) and only slow growth in renewables. Should wholesale electricity prices decrease further or coal prices rise, results in generation would deteriorate even further. Key upside is the commissioning of new blocks in Stalowa Wola in 2015-2016 and in Jaworzno and Łagisza in 2018-2019 with their additional generation volume, higher efficiency and lower emissions. Continuation of the operational capacity reserve mechanism, introduced in 2014, would be positive for TAURON's conventional generation results.
Conventional	220	51	252	
PPA compensations	567	-19	0	
Mining	287	166	98	
Heat	263	232	308	
Renewables	143	136	180	
Distribution				
EBITDA	1,956	2,208	2,157	EBITDA in distribution should remain an anchor for TAURON's cash flows. Due to the accomplishment of the asset revaluation process, further growth in EBITDA will be slow and dependent on volume increases and new investments in grids. A possible reduction in weighted-average cost of capital (WACC) should be more than covered by remuneration of new capex in the segment. We currently assume that manual interventions in the tariff by the Regulatory Office (URE) like the reduction in allowed return from distribution assets in 2015 by 5% will not be repeated in the future.
Wholesale and Retail				
EBITDA	478	899	608	Wholesale and Retail will remain a volatile segment shaped by strong market competition, efficiency of trading strategies and regulatory policy with respect to continuation of the tariff setting mechanism for households and the duty to provide certificates of power origin for redemption. We assume that EBITDA in this segment will further decrease in 2015 and then gradually recover to the 2014 level.

Source: Company/Fitch

Cash Flows

Fitch expects TAURON's free cash flow to decline over the next few years due to a deterioration in market conditions in generation and its extensive capex programme. We currently assume that TAURON's dividends will remain unchanged on an absolute level (rather than in relation to net profit), which altogether will result in TAURON being free-cash-flow negative within the next few years.

Credit Metrics

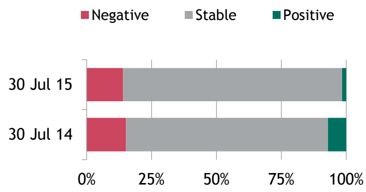
Cumulative negative free cash flows will result in a debt increase and deterioration in leverage metrics. We expect that TAURON's FFO adjusted net leverage will increase from 2.3x at end-2014 and 1.4x at end-2013 to around 3.5x in 2017. The net leverage ratio may temporarily exceed 3.5x in 2017 or 2018 until new generation units are commissioned in 2019.

Debt Structure

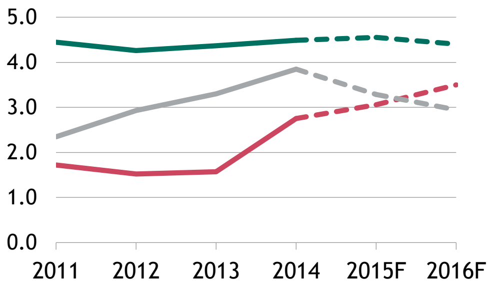
Out of PLN7.9bn of group debt at end-June 2015 around 90% has been taken on a holding level by TAURON. The largest facility on a subsidiary level is the long-term bonds (15-year, EUR168m) issued by TAURON Sweden Energy AB(publ), a financial company fully owned by TAURON and with its irrevocable and unconditional guarantees. The share of structurally subordinated debt is not a constraining factor for TAURON's ratings.

TAURON Polska Energia S.A. — Utilities Median — Emerging BBB Cat Median —
Source: Company data; Fitch

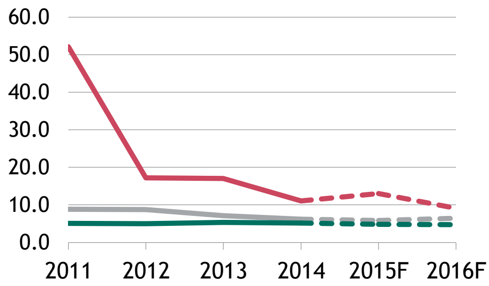
Distribution of Sector Outlooks
Directional Outlooks and Rating Watches



Leverage
including Fitch expectations



Interest Cover
including Fitch expectations



Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

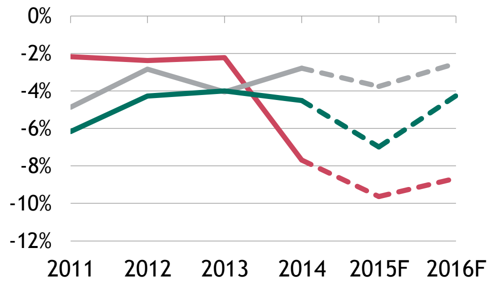
- no major shifts in wholesale electricity prices within the forecast period;
- recovery in coal prices for TAURON to 2013's levels and around 50% increase in CO2 market price within a five-year rating horizon;
- electricity production volumes to rise from 2019 due to commissioning of the 413MW Łagisza gas-fired power plant and the 910MW Jaworzno III coal-fired power plant;
- stable distribution and sales volumes;
- capex in the range of PLN21bn in 2015-2019.

Debt Maturities and Liquidity at End-June 2015

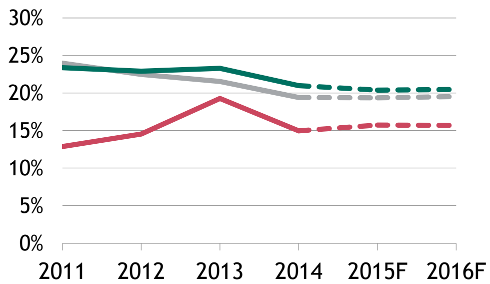
Debt maturities	(PLNbn)
Debt at end-June 2015	**7.9**
07-12.2015	0.4
2016	3.2
2017	0.2
2018	0.2
2019	2.0
After 2019	1.9
Cash and equivalents (unrestricted)	**0.8**
Available committed credit lines	3.4

Source: Fitch

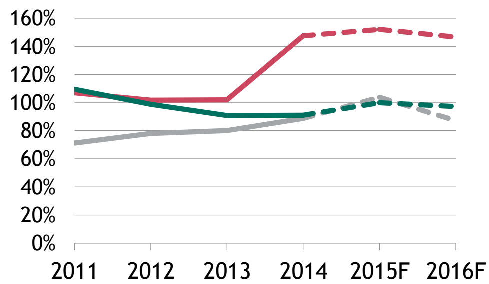
FCF/Revenues
including Fitch expectations



FFO Profitability
including Fitch expectations



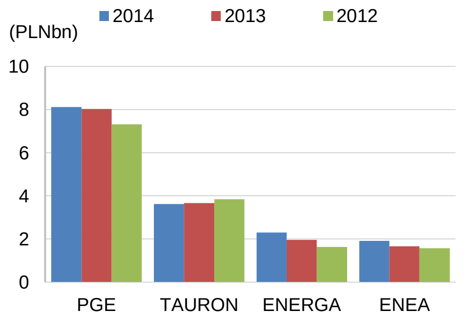
Capex/CFO
including Fitch expectations



Definitions

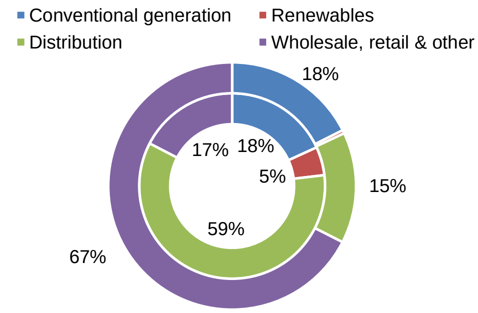
- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FCF/revenue: FCF after dividends divided by revenue.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "*Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format*" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

EBITDA
Polish integrated utilities, as reported



Source: Companies information

TAURON's 2014 Revenue & EBITDA
Outer ring: Revenue
Inner ring: EBITDA



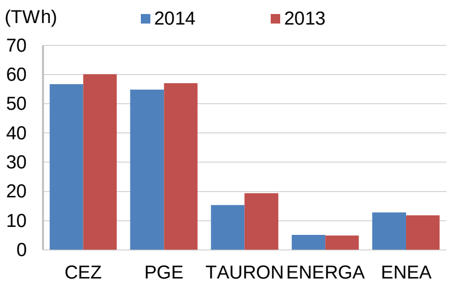
Source: Company information

Peer Group Table (FY14)

IDR/Outlook	CEZ A−/Stable	PGE BBB+/Stable	TAURON BBB/Stable	ENERGA BBB/Stable	ENEA BBB/Stable
Main shareholder (stake)	Czech state (69.78%)	Polish state (58.39%)	Polish state (30.06%)	Polish state (51.52%)	Polish state (51.5%)
Business profile	Vertically integrated	Vertically integrated	Vertically integrated	Mostly distribution	Vertically integrated
Regulated EBITDA (%)	27	28	59	67	61
Generation capacity (GW)	16.0	12.6	5.1	1.4	3.3
Generation mix (%)	48 nuclear, 36 lignite, 9 hard coal	71 lignite, 22 hard coal	92 hard coal	64 hard coal, 17 hydro, 13 biomass	92 hard coal
Own coal/lignite mining	Yes (~60% of needs)	Yes (71% of needs)	Yes (~40% of needs)	No	No
FFO (EURbn)	1.9	1.8	0.6	0.4	0.4
FFO fixed charge cover (x)	7.4	90	9.6	8.7	28
FFO adjusted net leverage (x)	2.5	-0.1	2.3	1.5	0.6
Forecast financial data					
FFO adjusted net leverage 2015-17 (x)	2.7	1.5	3.2	2.3	2.4
Expected FCF in mid-term	Neutral	Strongly negative	Strongly negative	Negative	Strongly negative

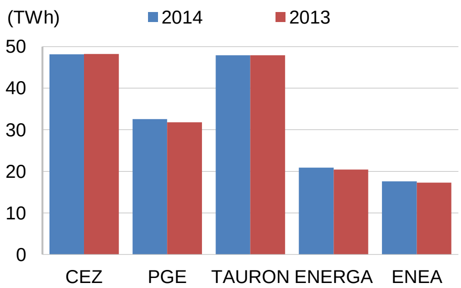
Source: Fitch

Figure 2
Generation Volume



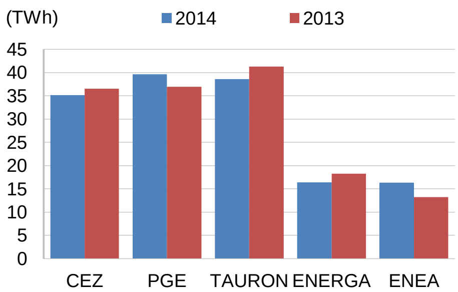
Source: Fitch

Figure 3
Distribution Volume



Source: Fitch

Figure 4
Sales to End-Customers



Source: Fitch

Peer Analysis

Issuer	Country
A−	
CEZ, a.s.	Czech Republic
BBB+	
PGE Polska Grupa Energetyczna S.A.	Poland
BBB	
ENEA S.A.	Poland
ENERGA S.A.	Poland
TAURON Polska Energia S.A.	Poland
BB+	
EP Energy, a.s.	Czech Republic
BB	
Bulgarian Energy Holding EAD	Bulgaria

Issuer Rating History

Date	FC LT IDR	Outlook
16 Jul 15	BBB	Stable
24 Oct 14	BBB	Stable
18 Jul 14	BBB	Stable
12 Dec 13	BBB	Stable
21 Jun 13	BBB	Stable
13 Mar 13	BBB	Stable
1 Nov 12	BBB	Stable
25 Jun 12	BBB	Stable
26 Aug 11	BBB	Stable
1 Jul 11	BBB	Stable
8 Apr 10	BBB	Stable

Immediate Peer Group – Comparative Analysis

Sector Characteristics

Operating Risks

Central European (CE) electric utilities have performed relatively predictably, despite their varying degrees of vertical integration. The regulated segments, such as electricity distribution, or the quasi-regulated segments, such as renewables or heat generation, enhance business profiles through high cash-flow visibility in transparent and supportive regulatory regimes. Power generation is higher risk, due to its exposure to changes in fuel and electricity prices, electricity demand as well as the rising costs of CO2. Limited market openness in Poland supports the generation segment to a degree. The largely coal and lignite-fired generation fleet in central Europe benefits from a gradual phase-out of free carbon dioxide allowances until 2020 (not immediate as in western Europe) in exchange for environment-friendly capex.

Financial Risks

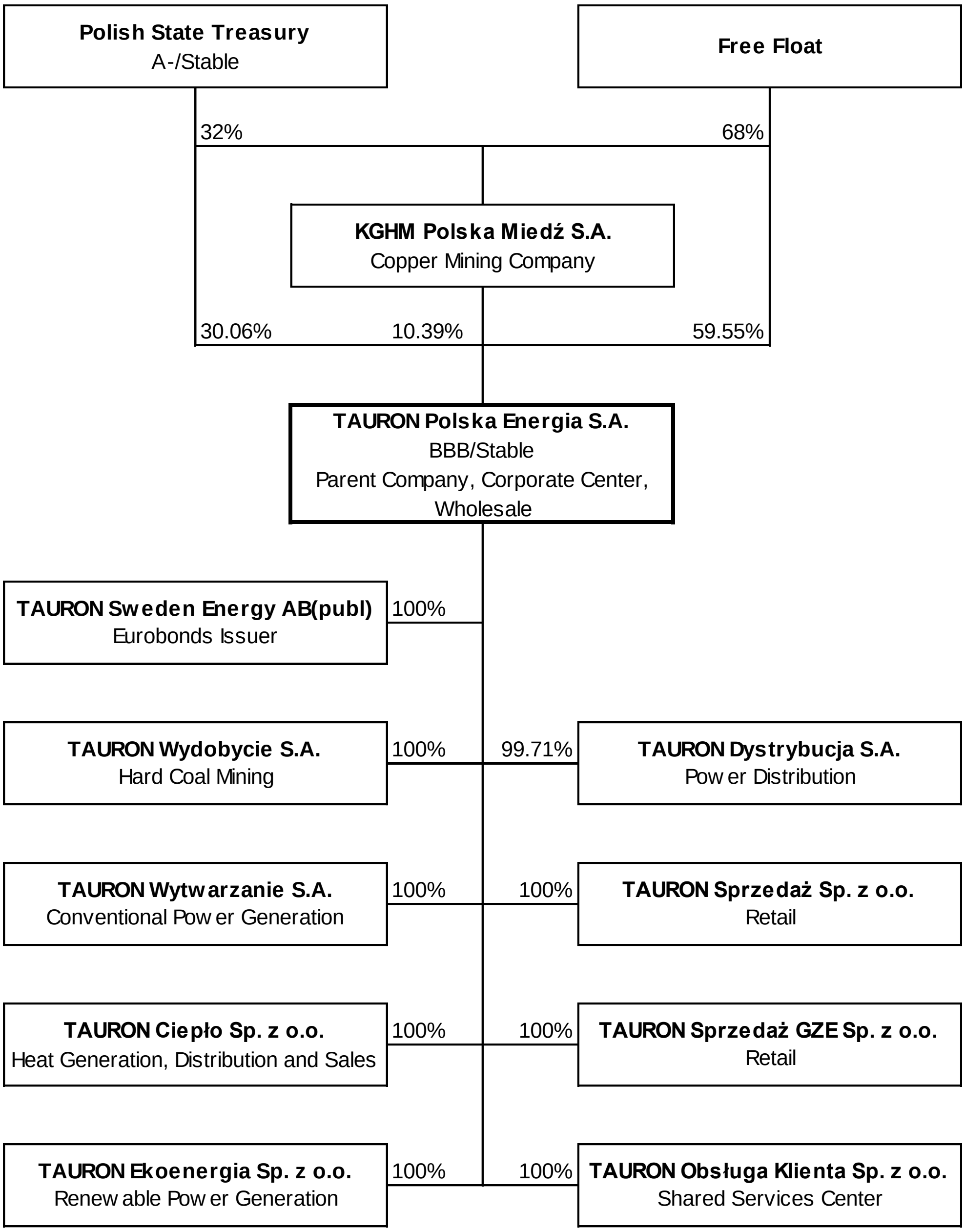
The financial profiles of CE utilities benefit from relatively healthy and stable cash-flow generation, but risks have surfaced in an environment of European macroeconomic stress. Fitch expects negative free cash flow in the mid-term for the utilities, due to large capex plans with limited short-term flexibility. Access to capital market funding differs among companies, with some companies being frequent issuers like CEZ or PGE, and others for whom market access is yet to be proven. CE utilities have demonstrated good access to bank funding.

Key Credit Characteristics

Large utilities with solid business profiles and strong to medium financial profiles generally command investment-grade ratings. Ratings depend both on business factors – including market presence, degree of vertical integration, generation mix and earnings diversification – and on financial factors such as financial policy, leverage, margins, capex plans and approach to M&A activity. Most rated CE utilities have solid credit ratios. Ratings reflect the expectation for FFO adjusted net leverage to rise to 3-3.5x in the medium term for most issuers.

Group Structure Diagram

Figure 5



Further information:
1. Around 90% of group debt has been taken by TAURON Polska Energia S.A.
2. The largest facility on a subsidiary level (around 9% of group debt) are the EUR168m bonds issued by TAURON Sweden Energy AB(publ)

Source: Fitch, TAURON. As at date.

Key Debt Instruments

Figure 6
Summary

Issuer, amount, maturity	ISIN	Rating	Ranking	Summary of terms
TAURON Polska Energia S.A., PLN300m, 4Yr (2015)	Non-quoted, underwritten by banks	NR	Senior unsecured	Bullet, WIBOR6M+margin
TAURON Polska Energia S.A., PLN3bn, 5Yr (2016)	Non-quoted, underwritten by banks	NR	Senior unsecured	Bullet, WIBOR6M+margin
TAURON Polska Energia S.A., PLN900m, 5-13Yr (2019-2027)	Non-quoted, underwritten by BGK	NR	Senior unsecured	To amortise over 2019-2027, floater
TAURON Polska Energia S.A., PLN1.75bn, 5Yr (2019)	PLTAURN00037	A(pol)	Senior unsecured	Bullet, WIBOR6M+90 bps
TAURON Sweden Energy AB(publ), EUR168m, 15Yr (2029)	Non-quoted, private issue	NR	Senior unsecured	Fixed rate

The information above is intended as summary information only. It is not intended to and cannot be a substitute for detailed analysis of the bond documents and consultation with legal counsel
Source: Fitch

TAURON Polska Energia S.A.
FINANCIAL SUMMARY

	31 Dec 2014 PLNm Year End	31 Dec 2013 PLNm Year End	31 Dec 2012 PLNm Year End	31 Dec 2011 PLNm Year End	31 Dec 2010 PLNm Year End
Profitability					
Revenue	18,441	19,131	24,753	20,755	15,429
Revenue Growth (%)	(3.61)	(22.71)	19.26	34.52	12.66
Operating EBIT	1,757	1,990	2,216	1,664	1,412
Operating EBITDA	3,554	3,717	3,902	3,075	2,771
Operating EBITDA Margin (%)	19.27	19.43	15.76	14.82	17.96
FFO Return on Adjusted Capital (%)	11.63	16.49	17.01	13.22	16.27
Free Cash Flow Margin (%)	(7.69)	(2.22)	(2.37)	(2.16)	5.75
Coverages (x)					
FFO Gross Interest Coverage	11.09	17.07	17.20	52.16	23.52
Operating EBITDA/Gross Interest Expense	13.00	16.20	17.57	58.80	23.93
FFO Fixed Charge Coverage (inc. Rents)	9.65	14.44	14.79	35.75	19.72
FCF Debt-Service Coverage	(1.25)	(0.37)	(0.69)	(1.41)	2.16
Cash Flow from Operations/Capital Expenditures	0.68	0.98	0.98	0.94	1.58
Debt Leverage of Cash Flow (x)					
Total Debt with Equity Credit/Operating EBITDA	2.28	1.58	1.43	1.48	0.54
Total Debt Less Unrestricted Cash/Operating EBITDA	1.92	1.44	1.24	1.37	0.07
Debt Leverage Including Rentals (x)					
Annual hire lease rent costs for long-term assets (reported and/or estimate)	46	45	39	25	24
Gross Lease Adjusted Debt/Operating EBITDAR	2.36	1.65	1.49	1.53	0.60
Gross Lease Adjusted Debt /FFO+Int+Rentals	2.76	1.57	1.52	1.72	0.61
FFO Adjusted Net Leverage	2.33	1.44	1.33	1.60	0.14
FCF/Lease Adjusted Debt (%)	(16.72)	(6.83)	(9.96)	(9.47)	52.76
Debt Leverage Including Leases and Pension Adjustment (x)					
Pension and Lease Adjusted Debt /EBITDAR + Pension Cost	2.42	1.69	1.53	1.54	0.60
Balance Sheet Summary					
Readily Available Cash	1,304	516	741	329	1,308
Restricted/Not Readily Available Cash	117	121	290	176	166
Short-Term Debt	645	302	302	229	349
Long-Term Senior Debt	7,469	5,562	5,265	4,308	1,144
Subordinated debt	n.a.	n.a.	n.a.	n.a.	n.a.
Equity Credit	n.a.	n.a.	n.a.	n.a.	n.a.
Total Debt with Equity Credit	8,114	5,864	5,566	4,537	1,492
Off-Balance-Sheet Debt	366	358	310	198	188
Lease-Adjusted Debt	8,479	6,223	5,876	4,735	1,680
Fitch- identified Pension Deficit	510	306	311	220	80
Pension Adjusted Debt	8,990	6,529	6,187	4,955	1,761
Cash Flow Summary					
Operating EBITDA	3,554	3,717	3,902	3,075	2,771
Gross Cash Interest Expense	(273)	(229)	(222)	(52)	(116)
Cash Tax	(308)	(467)	(329)	(112)	(238)
Associate Dividends	3	10	(8)	(6)	(1)
Other Items before FFO (incl. interest receivable)	(215)	654	254	(229)	194
Funds from Operations	**2,760**	**3,686**	**3,597**	**2,676**	**2,609**
Change in Working Capital	(412)	174	(348)	(525)	(205)
Cash Flow from Operations	**2,348**	**3,860**	**3,249**	**2,152**	**2,405**
Total Non-Operating/Non-Recurring Cash Flow	32	(1)	12	(35)	n.a.
Capital Expenditures	(3,465)	(3,934)	(3,303)	(2,302)	(1,518)
Dividends Paid	(333)	(351)	(543)	(263)	0
Free Cash Flow	**(1,418)**	**(425)**	**(585)**	**(449)**	**887**
Net (Acquisitions)/Divestitures	48	30	12	(3,363)	(3)
Net Equity Proceeds/(Buyback)	n.a.	n.a.	n.a.	n.a.	n.a.
Other Cash Flow Items	(91)	(128)	(44)	(212)	(182)
Total Change in Net Debt	(1,461)	(523)	(618)	(4,023)	702
Working Capital					
Accounts Receivable Days	41	49	43	44	49
Inventory Days	14	16	12	11	15
Accounts Payable Days	53	60	47	43	40

Figure 7

Reconciliation of Key Financial Metrics for TAURON

(PLNm)	31 Dec 14	31 Dec 13
Interest bearing loans and borrowings	**8,114**	**5,864**
+ Subordinated debt	0	0
- Equity credit	0	0
= Total debt with equity credit	**8,114**	**5,864**
+ Total off-balance sheet debt (8 x long-term leases)	365	358
= Total lease-adjusted debt (a)	8,479	6,223
- Cash and equivalents (unrestricted)	1,304	516
= Net lease-adjusted debt (b)	**7,175**	**5,707**
Cash flows from operating activities (as reported)	**2,618**	**4,079**
+ Reversal taxation paid	308	467
= Net cash from operating activities (adjusted by Fitch)	**2,926**	**4,546**
- Gross interest paid (c)	273	229
+ Interest received (d)	1	0
- Taxation paid	308	467
+ Dividend received net paid to minorities	3	10
= Cash flow from operations	2,348	3,860
- Change in working capital	-412	174
= Funds from operations (FFO) (e)	**2,760**	**3,686**
Long-term (LT) leases (f)	46	45
FFO adjusted net leverage (x)		
Net lease-adjusted debt/(FFO + net finance charge + LT leases) (b/(e + c – d + f))	2.3	1.4
FFO fixed charge cover (x)		
(FFO + net interest paid + LT leases)/(gross interest paid + LT leases) ((e + c – d + f)/(c + f))	9.6	14.4
FFO gross interest coverage (x)		
(FFO + net interest)/gross interest ((e + c - d)/c))	11.1	17.1

Source: Fitch based on company reports

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