Electric-Corporate
Poland
Full Rating Report

# TAURON Polska Energia S.A.

## Ratings

| | |
|---|---|
| **Foreign Currency** | |
| Long-Term IDR | BBB |
| **Local Currency** | |
| Long-Term IDR | BBB |

## Outlooks

| | |
|---|---|
| Foreign-Currency Long-Term IDR | Stable |
| Local-Currency Long-Term IDR | Stable |

## Financial Data

**TAURON Polska Energia S.A.**

| | 31 Dec 09 | 31 Dec 08 |
|---|---|---|
| Revenues (PLNm) | 13,634 | 12,449 |
| Operating EBITDAR (PLNm) | 2,597 | 1,625 |
| Funds from operations (PLNm) | 2,250 | 1,588 |
| Capital expenditure (PLNm) | 1,440 | 1,792 |
| Free cash flow (PLNm) | 391 | -178 |
| Total adjusted debt (PLNm) | 2,039 | 2,349 |
| Funds from operations/ gross interest expense (x) | 15.5 | 8.9 |
| Total adjusted debt net of cash/operating EBITDAR | 0.4 | 0.9 |

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## Related Research

**Applicable Criteria**

- *Corporate Rating Methodology (November 2009)*
- *Parent and Subsidiary Rating Linkage: Fitch's Approach to Rating Entities Within a Corporate Group Structure (June 2007)*
- *Rating EMEA Utilities - Sector Credit Factors (May 2010)*
- *Fitch's Approach to Rating Competitive Generators (July 2007)*
- *Utilities Sector Notching and Recovery Ratings (March 2010)*

**Other Research**

- *Central European Utilities - 2010 Outlook (December 2009)*
- *Central European Electricity Sector (November 2009)*
- *Sovereign Ownership Impact on Corporate Ratings (June 2009)*

## Rating Rationale

- TAURON Polska Energia S.A.'s (Tauron S.A.) ratings reflect Tauron's (Tauron group comprising Tauron S.A. and its subsidiaries) vertically-integrated operations in the Polish electricity market, including a strong position in power generation (14% of the country's generation output) and in electricity distribution and supply (a 26% market share).
- Tauron has low financial leverage compared with other European utilities rated by Fitch Ratings. However, Fitch projects that the group's leverage is likely to increase to about 2x-2.5x by year-end 2013 (YE13) as a result of debt issued to co-fund its large mid-term capex plan. This leverage is commensurate with the current ratings, and is largely in line with projected mid-term leverage for other central European (CE) electric utilities rated by Fitch.
- The ratings are constrained by the group's limited diversification in fuel mix (hard coal-fired plants account for 93% of installed capacity), which is unlikely to change significantly by 2015 — resulting in a lower generation profit margin than its CE peers rated by the agency, and also in substantial exposure to carbon dioxide ($CO_2$) costs. On the other hand, Tauron benefits from partial integration of its generation activity with the company's own coal mines, which meet about 32% 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 (28% in 2009). This results in lower exposure of cash flow to power and fuel price volatility.
- Tauron has a short track record of operations, and relatively low integration between Tauron S.A. and its main subsidiaries, particularly regarding debt management across the group. The 'BBB' IDRs are currently notched down to 'BBB-' for structural subordination of the holding company's (Tauron S.A.) debt, as subsidiaries hold all group debt and generate most of group cash flow. However, the effect on the rating of debt subordination is mitigated by a one-notch uplift to 'BBB' for implicit state support — given the group's state ownership and strategic importance as the second-largest player in Polish power.
- Fitch expects the company to raise debt at the holding company level, and for the group to be more closely linked in supporting holding company debt.

## Key Rating Drivers

- The ratings could be positively affected by successful implementation of the capex plan, alongside the maintenance of a healthy financial profile, together with progress on group integration and operating cost reduction, as well as substantially reduced exposure to $CO_2$ costs and increased diversification of the fuel mix.
- Financial leverage beyond net debt to EBITDA of 2.5x, eg due to large capex and weaker-than-expected cash flow, would be negative for the ratings.

## Liquidity and Debt Structure

Available liquidity (comprising unrestricted cash of PLN973m, and unused long-term committed liquidity facilities of PLN175m) was sufficient to cover short-term debt of PLN632m at YE09.

## Company and Market Overview

Tauron, currently 88%-owned by the state, is the second-largest player in the Polish electricity market, after PGE Polska Grupa Energetyczna S.A. (PGE, 'BBB+'/Stable). The group is also a major electricity company in central Europe in terms of revenue and EBITDA. Tauron has a vertically-integrated position in the Polish market from coal mining, through power generation to distribution and supply. Its operations are located in southern Poland.

The two major segments in cash flow generation terms are generation (46% of group EBITDA in 2009) and distribution (28%). Tauron has a higher share of regulated income from distribution than its two larger CE peers, CEZ, a.s. (CEZ, 'A-'/Stable) and PGE — resulting in somewhat lower exposure of cash flow to cyclical factors, such as changes in electricity prices. Fitch does not expect Tauron's EBITDA split by segment to change substantially in the next three years.

Tauron has a higher market share in the domestic distribution and supply market (26%) than in generation (14%). This is driven by the company's larger volumes in distribution and supply, where it is the market leader — given its ownership of the largest distribution network in the country. In 2009, it sold 30.4 terawatt hours (TWh) of electricity to end-users compared with own generation of 20.9TWh.

Tauron owns 5.6 gigawatt (GW) of installed generation capacity. Coal-fired power plants account for most of the group's capacity (93% of 2009 capacity) and generation volumes. This places Tauron in a weaker position compared with its CE peers rated by Fitch in terms of profit margin on generation and flexibility of its generation fleet — given the limited diversification by fuel type and large exposure to $CO_2$ costs. Its Polish peer, PGE, has a competitive advantage over Tauron and other coal-fired generators in Poland, given its high share of lignite-fired plants in the generation mix (67% of 2009 generation). Lignite-fired plants have a lower cost of electricity production than hard-coal-fired plants — the latter set the wholesale prices in Poland, as overall hard coal is the main fuel for the country's power sector at 57% of 2009 generation volumes (see chart *Fuel Mix in Generation*).

Tauron and PGE, together with the remaining two smaller state-owned power groups — ENEA S.A. and Energa S.A. — control 64% of domestic generation and 84% of distribution (see table *Main Players in the Polish Power Sector*). Government plans a partial privatisation of both Tauron and PGE, but aims to maintain management control of Tauron and a majority stake in PGE. The two smaller state-owned groups, ENEA and Energa, are scheduled to be privatised by end-2010.

Foreign entities currently present in the Polish power market include subsidiaries of Electricite de France (EDF) ('A+'/Stable), Electrabel, Vattenfall AB ('A'/Negative) and CEZ, a.s. ('A-'/Stable) operating in generation; and subsidiaries of RWE AG ('A+'/Stable) and Vattenfall operating in distribution.

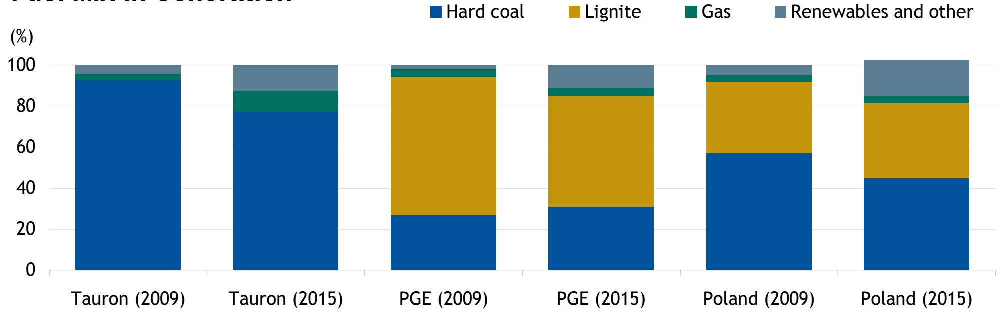
### Main Players in the Polish Power Sector

| Company | PGE | Tauron Polska Energia | ENEA | Energa | Other players |
|---|---|---|---|---|---|
| Ownership | State-owned, partial privatisation planned[a] | State-owned, partial privatisation planned[a] | Majority state-owned, expected to be privatised in 2010 | State-owned, expected to be privatised in 2010 | Several privatised companies including subsidiaries of EdF, Electrabel, Vattenfall, RWE, CEZ and other entities |
| Installed capacity (GW) | 12.4 | 5.6 | 2.9 | 1.1 | 10.6 |
| Own fuels (%) | 68 | 32 | 0 | 0 | n.a. |
| Market share in generation[b] (%) | 40 | 14 | 8 | 2 | 36 |
| Market share in distribution (%) | 26 | 26 | 15 | 16 | 16 |
| Revenue[c] (PLNbn) | 21.6 | 13.6 | 7.2 | 8.4 | n.a. |

[a] The Polish government plans to maintain a majority stake in PGE, and management control of Tauron, despite partial privatisation
[b] Gross electricity generation; data for PGE and Tauron based on net electricity generation
[c] Revenue for 2009
Source: PGE, Tauron, Ministry of Treasury, the Energy Regulatory Office

The Polish power sector is a relatively closed market, as domestic generation covers domestic electricity demand with limited cross-border electricity flows. Generation is based mainly on hard coal (57% of 2009 generation) and lignite (35%), as Poland has large deposits of these two fuels. As a result of its large coal-based generation portfolio (92% of the country's fuel mix is coal or lignite compared with the EU average of 30%), the Polish power sector is highly exposed to $CO_2$ costs, especially from 2013. The government plans to reduce this exposure by diversifying away from coal to generation sources with no or limited $CO_2$ emissions by 2020-2025 — including wind, nuclear energy, and (to a lesser extent) gas-fired plants.

**Fuel Mix in Generation**[a]




[a] For Tauron fuel mix by capacity
Source: Tauron, PGE, Polish Energy Policy through 2030, Ministry of Economy, the Energy Regulatory Office

Despite a 4% decline in domestic consumption in 2009 (driven by the economic slowdown), long-term prospects for demand growth are favourable, with around 15% overall demand growth expected by 2020 according to the Polish Energy Policy through 2030. The decline in demand in 2009 has effectively delayed the expected tightening of the Polish market's reserve margin by several years. Capacity decommissioned between 2011 and 2015 will not be fully replaced with capacity additions, which should support wholesale electricity prices in the medium to long term.

## History and Group Structure

TAURON Polska Energia S.A. was incorporated by the state treasury in December 2006, and operated under the name Energetyka Południe S.A. (EP) until November 2007. The Tauron group was established in 2007 within the government programme to restructure and consolidate the power sector and create four large state-owned power groups. Tauron, as the second-largest group (after PGE), was created in May 2007, when the government increased EP's share capital by PLN13.7bn by contributing in kind 85% of shares of power generation companies, Południowy Koncern Energetyczny S.A. (PKE) and Elektrownia Stalowa Wola S.A., and two regional power distribution and supply companies, ENION S.A. and EnergiaPro S.A.

The two distribution and supply companies were then separated into distribution system operators (DSOs) and supply companies following legal unbundling. The 15% minority stakes in the main operating entities will be largely owned by the state due to the ongoing conversion of employee shares from subsidiary level to the Tauron S.A. level. The state treasury plans to increase Tauron S.A.'s share capital by September 2010, following the conversion of employee shares, by contributing in kind its minority stakes in the main operating companies.

Tauron S.A. is not a pure holding company, as it also operates as the main trading arm of the group. All sales and purchases of electricity on the wholesale market, $CO_2$ allowances and "green" and "red" certificates (renewable energy and heat production), are performed by Tauron S.A.

Management plans to simplify the group's complex structure which currently consists of 94 companies. By 2012, Tauron aims to implement an integrated business model, with one company for each business segments.

## Implicit State Support Mitigating Structural Subordination of Debt

Fitch rates Tauron according to the agency's *Parent and Subsidiary Rating Linkage* criteria — given that the company is 88%-owned by the Polish state (Poland's sovereign foreign currency IDRs are 'A-'/Stable/'F2'). Despite the planned partial privatisation in June 2010 — when the government wants to sell an approximately 52% stake in the company — the state intends to maintain management control over Tauron, according to the Polish Energy Policy through 2030.

The agency met with Poland's Deputy Minister of Treasury to discuss potential support from the state and Tauron's partial privatisation. The Deputy Minister gave clear indications of the government's willingness to provide support to Tauron either directly (through dividend policy supporting the capex programme — see *Dividend Policy* section below) or indirectly in case of need. This is driven by the strategic importance of Tauron to the Polish power sector — together with PGE.

Although Fitch does not generally incorporate implicit state support in its ratings for state-owned utilities in the European Union (see the agency's report *"Sovereign Ownership Impact on Corporate Ratings"*), it includes a one-notch rating uplift for state support in Tauron's ratings within a "bottom-up" approach.

This uplift is related to the current group debt structure, as Fitch feels the implicit state support mitigates the negative rating impact (one notch down from 'BBB' to 'BBB-') of structural subordination of Tauron S.A.'s debt — given that all group debt is located at Tauron subsidiaries (see section *Debt Structure* below and table *Group Debt by Main Companies at YE09*). Subsidiary debt, in particular debt at the main generation company PKE, had been predominantly raised before the Tauron group was created.

In addition, the uplift for state support reflects the group's relatively recent creation by the government in 2007 through in-kind contribution of generation and distribution assets to Tauron within the government programme to create stronger, integrated power groups with solid capital structures ahead of a substantial increase in capex in Polish power.

Fitch expects that state support will become less relevant to Tauron's ratings in 2011-2012, when Tauron S.A. will likely reduce its exposure to structural subordination, for example by raising new debt at the holding company level and repaying subsidiary debt. At the same time, the government stake is likely to decrease possibly to less than 50% within the privatisation.

Fitch believes it is unlikely that changes in the level of subordination and state support would not interact to offset each other over time (in other words, re-location of the majority of debt to the holding company (holdco) level would not necessarily result in an upgrade of the ratings, as there would likely be a reduction in perceived state support at that stage).

Fitch applied a similar approach to implicit state support and structural subordination of debt in the case of PGE.

### *Dividend Policy*

Tauron's dividend policy assumes a payout of at least 30% of consolidated net income related to 2010-2012 profits and 40%-50% of consolidated net profit in the longer term. However, the proposed dividend will reflect the company's large capex plan and commitment to maintain sufficient liquidity. The shareholders, including the state, have recently decided that there will be no dividend related to 2009 net profit, demonstrating a flexible approach to dividends. Tauron paid low dividends in 2009 and 2008 (respectively, 28% and 13% of consolidated net profit).

## Business Segments (Data in PLNm)

| | Mining | Generation | Renewable energy | Distribution | Wholesale and Retail | Other | Exclusions | Total |
|---|---|---|---|---|---|---|---|---|
| **2009** | | | | | | | | |
| Revenue | 1,167 | 5,338 | 123 | 4,085 | 11,522 | 518 | -9,121 | 13,634 |
| EBITDA[a] | 253 | 1,181 | 76 | 725 | 306 | 62 | -23 | 2,581 |
| Assets | 1,042 | 9,578 | 567 | 7,767 | 1,958 | 847 | 400 | 22,160 |
| Capex | 130 | 520 | 24 | 746 | 15 | 44 | | 1,479 |
| EBITDA - capex | 123 | 661 | 52 | -21 | 292 | 18 | | 1,124 |
| EBITDA margin (%) | 21.7 | 22.1 | 62.0 | 17.8 | 2.7 | 11.9 | | 18.9 |
| EBITDA contribution (%) | 9.8 | 45.7 | 3.0 | 28.1 | 11.9 | 2.4 | -0.9 | 100.0 |
| **2008** | | | | | | | | |
| Revenue | 1,004 | 3,782 | 105 | 4,232 | 9,947 | 363 | -6,985 | 12,449 |
| EBITDA[a] | 173 | 478 | 63 | 813 | 93 | 15 | -18 | 1,616 |
| Assets | 945 | 9,060 | 535 | 7,268 | 1,783 | 845 | 387 | 20,823 |
| Capex | 65 | 859 | 31 | 762 | 10 | 48 | | 1,774 |
| EBITDA - capex | 109 | -380 | 32 | 51 | 83 | -34 | | -140 |
| EBITDA margin (%) | 17.2 | 12.7 | 59.8 | 19.2 | 0.9 | 4.0 | | 13.0 |
| EBITDA contribution (%) | 10.7 | 29.6 | 3.9 | 50.3 | 5.7 | 0.9 | -1.1 | 100.0 |

[a] Segment EBITDA not adjusted by Fitch
Source: Tauron, Fitch calculations

## Segment Analysis

In 2009, the company's Fitch-adjusted EBITDA rose by 60% to PLN2.6bn, and funds from operations (FFO) grew by 42% to PLN2.3bn. Most of the growth came from the generation segment, the group's main contributor to EBITDA (see table: *Business Segments*).

### Generation and Mining (46% and 10% of Group EBITDA in 2009)

EBITDA in power and heat generation improved in 2009 as the earnings impact of a substantial increase in wholesale electricity prices in 2009 (based on contracts signed before the fall in wholesale prices) outpaced the earnings impact of higher fuel prices, mainly that of hard coal. EBITDA in this segment also grew due to higher revenue from power purchase agreement (PPA) compensation (PLN484m for the entire year 2009 compared with PLN192m in 2008).

The increase in hard coal prices (by 33% in 2009) was slightly higher than the increase in average wholesale electricity prices (25% growth during 2009). However, the cost of fuel, mainly consisting of hard coal, accounts for about 60% of electricity production cost. Fitch projects that Tauron's EBITDA and FFO will slightly decrease in 2010 on the back of lower energy wholesale prices in 2010 contracts and stable coal prices (see table*: Hard Coal and Electricity Prices*).

#### Hard Coal and Electricity Prices

| | 2008A | 2009A | 2010F | Change in 2010 (%) |
|---|---|---|---|---|
| Average hard coal price (PLN/GJ) | 8.1 | 10.8 | 10.8 | 0 |
| Average wholesale price of electricity including $CO_2$ (PLN/MWh) | 155.7 | 195.6 | 191.5 | -2 |

Source: Tauron, the Energy Regulatory Office

#### Hard Coal Supply Contracts

| Mining company | Delivery period |
|---|---|
| Kompania Węglowa S.A. | 1996-2012 |
| Południowy Koncern Węglowy S.A. | 2006-2010 |
| Katowicki Holding Węglowy S.A. | 2008-2012 |
| Jastrzębska Spółka Węglowa S.A. | 2009-2013 |

Source: Tauron

Tauron's business profile benefits from partial integration of generation and mining activities, as the group has two hard-coal mines, Janina and Sobieski, owned by subsidiary Południowy Koncern Węglowy S.A. (PKW), which produced 6.4 million tonnes in 2009 and covered around 32% of the group's annual hard coal needs. This lowers fuel supply risk, and also improves the predictability of fuel costs.

The company plans to increase coal production through capex and acquisitions, targeting 50% coverage of demand for coal with own production in the medium term. Hard coal is delivered to Tauron's main generating company, PKE, on the basis of long-term delivery contracts with PKW and three Polish state-owned mining companies (see table *Hard Coal Supply Contracts*). There is no specified pricing formula in the agreements, and the delivery prices are set on an annual basis as the result of negotiations between counterparties.

With a generation capacity of 5.6GW, Tauron lags behind the national leader PGE (12.4GW), but is ranked higher than Enea (2.9GW) and Energa (1.1GW). Tauron's generation fleet comprises several hard coal-fired plants located in the southern part of Poland (, Jaworzno, Łaziska, Łagisza, Siersza, Halemba, Blachownia and Stalowa Wola) and several combined heat and power (CHP) plants (Katowice, Bielsko-Biała, Tychy and Nowa).

Tauron's generation mix is highly tilted towards hard coal (93% of installed capacity in 2009), but the company plans to reduce this to around 77% by 2015. This should be achieved through gradual decommissioning of older, less efficient hard-coal power plants, and replacement with gas-fired plants (10% of capacity in 2015) and renewable energy sources (10%) — mainly wind farms and biomass. The company expects substantial EBITDA growth in this segment, but in the mid- to long-term capex spent for power generation will substantially exceed the operating cash flows generated by the segment, resulting in negative free cash flow (FCF).

Tauron sells its electricity production mostly under contracts for up to one year, which clearly improves cash flow predictability on a one-year horizon. However, most western European utilities use forward sales of electricity for longer periods, often up to three years.

### *Competitive Position*

Tauron is the second-largest power generator in the country after market leader PGE. Tauron's market position features a substantial deficit of electricity generation over supply (given that it has a 14% share in the country's generation, and 26% in supply). Tauron's shortfall of own generation versus supply amounted to around 9.5TWh in 2009, which had to be purchased from the wholesale market.

Fitch believes that the Polish electricity market has no transparent price-setting mechanisms for wholesale electricity and hard-coal prices. The latter are only partially linked to international coal prices, with most supply contracts being negotiated annually between domestic coal mines and power plants. Hard-coal prices are one of the main drivers for wholesale electricity prices, as hard-coal-fired plants are the marginal price setting plants in the merit order.

The ratings reflects Tauron's moderate profitability in mining and generation (combined EBITDA margin for these two segments of 22% in FY09 and 14% in FY08); which is substantially weaker than that of PGE (41% in FY09 and 40% in FY08), but close to the Polish sector average. The difference is mainly driven by PGE's cost advantage, as lower-cost lignite-fired plants account for 67% of PGE's production compared with Tauron's fuel mix which is based almost entirely on hard coal.

The agency expects that this competitive disadvantage of hard coal versus lignite is likely to narrow when $CO_2$ costs become a more important component of Poland's wholesale electricity prices in the medium- to long-term. Lignite-fired plants have about 15% higher emissions of $CO_2$ than hard-coal-fired plants — hence the higher the price of future emission allowances, the lower the cost disadvantage will be for coal-fired plants.

Tauron's "short position" in generation exposes cash flow to volatility in wholesale electricity prices, unless the position is properly managed through purchase and sale contracts. Electricity prices in Poland are likely to increase in the medium- to long-term due to structural issues surrounding the Polish electricity market, including a tightening supply/demand balance and $CO_2$ costs (as discussed below).

### *Exposure to $CO_2$ Costs*

Tauron's shortfall of $CO_2$ emission rights in NAP II for 2010-2012 is about 3.3 million tons (mt). This figure does not include additional $CO_2$ emission rights, which the group recently received for a new unit at the Łagisza power plant (6.7mt for 2010-2012). As Tauron's generation mix is similar to that of the overall Polish energy sector, it is likely that the additional cost related to the purchase of $CO_2$ rights in the NAP II and in the period from 2013 to 2020 will be largely passed on to end-users in the form of higher electricity prices. The Polish power market is relatively closed, with low cross-border flows, and as a result electricity prices are likely to be driven mostly by domestic factors — including increasing $CO_2$ costs.

Tauron's market exposure to $CO_2$ costs will increase substantially in 2013 with the start of the EU auctioning system for $CO_2$ allowances. On a positive note, Poland, together with some other central European countries, has received derogation from full auctioning of its $CO_2$ allowances until 2020. The amount of free allocation for Polish power plants is currently planned to gradually decrease from 70% in 2013 (30% to be purchased in auctions) to 0% in 2020 (100% to be purchased in auctions).

### *Compensation for PPA Cancellations*

The risk of lower cash flow in the generation business (in the case of a substantial decrease in wholesale prices) is partly mitigated by a cash compensation mechanism covering stranded costs related to the early termination of previous state-backed PPAs. The PPAs used to be collateral for bank loans granted to power generators, primarily in the 1990s. PKE is entitled to maximum compensation under this mechanism of up to PLN1.5bn, to be received over the period 2008 to 2012, according to the PPA Act.

The compensation is part of a government scheme that was finalised in 2008 to cancel long-term PPAs in the Polish power sector. The actual compensation received each year depends on many factors, including changes in power prices, and may increase if wholesale prices are lower than those assumed in the government's electricity price path used in the calculation of the compensation. As a result, this mechanism provides additional funds for debt service in case of a drop in wholesale prices, in a weak year for generation, further helping to stabilise margins. For example, in 2009, Tauron reported revenue from PPA compensation of PLN484m, which improved EBITDA of the generation segment.

However, compensation may be lower than projected by Tauron due to a discrepancy between some power generators, including Tauron and PGE and the Energy Regulatory Office (ERO) regarding the interpretations of the PPA Act and the calculation of annual compensation, in particular related to power plants operating as part of a group. Tauron is in a legal dispute with the ERO regarding the compensation for 2008. Fitch projects that in case the ERO's interpretation proves valid in court — leading to lower compensation and also lower EBITDA than currently expected by Tauron for 2010-2012 — the group's financial position would not change much, although a higher portion of capex would have to be funded from debt rather than operating cash flow.

## Distribution (28% of Group EBITDA in 2009)

This is the most stable segment for Tauron given its regulated revenue stream. Tauron's distribution activity is run through two entities, EnergiaPro and Enion, which own 10 regional DSOs together with associated distribution networks, located in southern Poland and covering 17% of the country's territory. The distribution segment supplies electricity to about four million customers, compared with five million customers of PGE, but Tauron distributed more energy in 2008 (32.3TWh) than PGE (30.7TWh), as the client portfolio has a higher proportion of industrial customers. Tauron's market share in distribution was equal to 26% in 2008.

The distribution activity is regulated by the ERO over three-year periods. Revenues are dependent on unit distribution tariffs that are proposed to and then accepted by the ERO, and comprise full coverage of justified costs and a market level of return on distribution assets calculated as the regulatory asset base (RAB) multiplied by a weighted average cost of capital (WACC) set by the regulator for each period. Capex plans for the next three years are revised annually, and accepted by the regulator each year.

Distribution revenues are planned to gradually increase in the next six to nine years, as the regulator has agreed to revalue the RAB from the historical book value to a valuation based on enterprise value and replacement cost. The company expects a gradual increase in EBITDA for the segment in the next five years as a result of increasing regulatory revenue and growing distribution volumes. However, the lion's share of cash flows generated will be spent on capex that is required to safeguard security of supply and achieve efficiency improvements in the network operation.

### Wholesale and Retail (12% of Group EBITDA in 2009)

The wholesale and retail market segments are low-margin businesses for Tauron, with an EBITDA margin of 2.7% in FY09. All end-customers (except households) are subject to a liberalised price-setting mechanism. In the past three years, tariffs for households have not fully reflected the steep rise in the cost of electricity generated from hard coal, which negatively affected the profitability of the segment.

### Renewables (3% of Group EBITDA in 2009)

The renewables segment, comprising 35 hydropower plants with a capacity of 131 megawatts (MW) and biomass co-firing in coal-fired plants, is a small contributor to group EBITDA and electricity generation. However, its importance is expected to increase as Tauron plans to generate up to 2TWh by 2014 — up from 0.4TWh in 2009 (or 14% of the energy generated in the group).

## Management Strategy

The key elements of Tauron's strategy are a large capex plan, group integration and efficiency improvements as mentioned above. The capex programme assumes PLN9bn of investment in 2010-2012, with 61% of capex allocated to the mining and generation segments and 34% to distribution (see table *Capex Programme for 2010-2012*). The largest portion of capex relates to investment in generation from conventional, fossil-fuel-fired power plants — mainly modern and more efficient coal-fired plants with lower $CO_2$ emissions per MWh than old plants.

Tauron plans to start construction of 3GW of new capacity by 2012. This is scheduled to be commissioned around 2016-2017. This is in order to replace old units being decommissioned (about 1.1GW by 2015) and to lower the large exposure to $CO_2$ costs — given its existing generation fleet. The group aims to have relatively stable capacity by 2016 due to capacity replacement. It then plans net capacity increases by about 50% between 2017-2020, to 8.5GW. Its most recent unit, the 460MW capacity Łagisza power plant, was commissioned in 2009.

Fitch notes that Tauron's modest capex plan for renewables accounts for a lower part of the total medium-term capex plan than in the case of PGE (around 12% and 23%, respectively).

Planned investment in distribution assets of PLN3.1bn is related to network modernisation, opex reduction, efficiency gains and increased security of supply. This capex is approved on an annual basis by the regulator and reflected in the distribution tariff.

**Capex Programme for 2010-2012**

| Investment item | Amount (PLNbn) | As a % |
|---|---|---|
| Mining, generation from conventional, fossil-fuel-fired power plants and renewables | 5.5 | 61 |
| Distribution assets | 3.1 | 34 |
| Other | 0.4 | 5 |
| **Total** | **9.0** | **100** |

Source: Tauron

Annual capex averages PLN3bn from 2010-2012, considerably up from an average PLN1.7bn per year spent in 2007-2009. According to Fitch's projections, the large capex increase is likely to result in negative FCF for 2010-2012 and the need to raise further debt. The agency notes that Tauron has some flexibility in the mid-term capex plan, as a substantial part of planned investment may be deferred should the need arise (for example due to weaker-than-expected cash flow).

Tauron's long-term capex plan for 2013-2020 amounts to PLN40bn, which includes planned generation projects to be conducted within JVs with third parties.

Fitch's rating for Tauron incorporates the company's lower appetite for acquisitions than CEZ and PGE, as it aims to focus on integration of group assets and implementation of the capex plan.

## Financial Analysis

### Comparability of Financial Results for 2007-2009

The contributions in kind of generation and distribution businesses by the state treasury in 2007 were classified as business combination under common control, as all the entities were owned by the state. All the Tauron group companies under business combination are included in the Tauron group consolidated financial statements since 1 January 2007, which is the transition date to IFRS. As a result, the Tauron group in its current form has three years of consolidated financial statements from 2007 to 2009.

### Capital Structure and Credit Ratios

Tauron has a solid capital structure, with limited usage of debt. This is mainly driven by the group's creation by government through in-kind contributions of the main assets in 2007.

Tauron reduced its adjusted net debt to PLN1.1bn at YE09 from PLN1.4bn at YE08, thanks to its FCF fuelled by stronger FFO and lower capex in 2009.

At YE09, Tauron's leverage ratio (adjusted net debt/EBITDAR) stood at a healthy level of 0.4x, down from 0.9x at YE08 thanks to stronger cash flow and lower net debt. Adjusted gross debt/EBITDAR was 0.8x. This level of leverage is considerably lower than the average for western European utilities rated by the agency (adjusted net debt to EBITDAR of about 3x in the peer group). Tauron's leverage also compares well with its central European peers — see the *Peer Analysis of Central European Utilities* section below.

Interest coverage ratios are also healthy, with FFO/interest of 15.5x in 2009.

### Projected Negative Free Cash Flow and Increased Leverage

Tauron expects to raise debt in order to co-fund the mid-term capex plan, as higher annual capex is likely to lead to negative FCF in the next five years. Debt is planned to be raised on an unsecured basis by Tauron S.A. rather than subsidiaries. Fitch projects that Tauron's net debt to EBITDA will increase to about 2x-2.5x by YE13, from 0.4x at YE09. This increase is largely in line with projected leverage for other central European electric utilities rated by Fitch (see *Peer Analysis of Central European Utilities*).

The agency believes that Tauron has some flexibility in the capex plan, as some projects may be delayed in the case of weaker cash flow.

### Tauron Group Debt at FYE09

| | PLNm | As a % |
|---|---|---|
| Total consolidated debt | 1,899 | 100 |
| - Of which secured debt | 1,572 | 83 |
| - Of which debt at holding level (Tauron S.A.) | 0 | 0 |

Source: Tauron, Fitch calculations

## Debt Structure

Group debt comprises bank loans (62% of the total), bonds (31%) and finance leasing (7%). The company expects to increase the share of bonds in its total funding mix by issuance of domestic bonds or Eurobonds in the next several years. The agency notes that large European utilities have good access to the bond market, and have been frequent bond issuers in 2009 and 2010-to-date.

Virtually all debt is at floating interest rates.

Given the debt structure across the group, Tauron S.A.'s rating reflects the structural subordination of Tauron S.A.'s creditors to the creditors at the subsidiary level. All group debt at YE09 was located at subsidiaries, primarily at the power generation company, PKE and two DSOs — see the table *Group Debt by Main Companies at YE09*.

Creditors of Tauron S.A. have weaker access to the cash flows of Tauron subsidiaries (where most cash flow is generated) than creditors lending directly to the subsidiaries. In addition, most of the subsidiary debt is secured on assets. As a result, the IDR for Tauron S.A. is reduced by one notch to 'BBB-' for subordination.

### Group Debt by Main Companies at YE09

| Company | Business | Ownership by Tauron S.A. (%) | EBITDA (PLNm) | Debt (PLNm) | Total debt (%) | Comments |
|---|---|---|---|---|---|---|
| TAURON Polska Energia S.A. | Holding company and the sole company for wholesale electricity and certificates trading | n.a. | 88 | 0 | 0 | Currently no debt, but new group debt is expected to be raised at this level |
| Południowy Koncern Energetyczny S.A. | Power generation | 85 | 980 | 1,474 | 81 | Largely secured debt |
| ENION S.A. | Power distribution | 85 | 354 | 175 | 10 | Unsecured debt |
| EnergiaPro S.A. | Power distribution | 85 | 343 | 75 | 4 | Unsecured debt |
| Południowy Koncern Węglowy SA | Coal mining | 58 (85%-owned by PKE) | 253 | 14 | 1 | |
| Other | Various | | 565 | 88 | 4 | |
| **Total** | | | **2,583** | **1,812[a]** | **100** | |

[a] Total debt including finance leasing was PLN1,899m at YE09.
Source: Tauron, Fitch calculations

The company's funding strategy assumes raising debt for mid-term capex at the Tauron S.A. level, and to repay some debt of the subsidiaries — including secured bonds of PKE (outstanding balance of PLN593m, or 31% of total debt at YE09). Fitch believes that structural subordination could cease to be an issue for Tauron S.A.'s ratings if there is a substantial improvement in Tauron S.A. creditors' access to subsidiary cash flow. This may be achieved through substantially increasing the share of group debt raised at the holding company level, upstream guarantees for Tauron S.A. debt provided by material subsidiaries, or a large increase in recurring dividend flow from subsidiaries.

As mentioned earlier, Tauron S.A. is not a pure holding company as it performs electricity and certificates sales and purchases within centralised trading. In 2009, the company reported EBITDA of PLN88m and solid FCF. It had no debt, and a strong cash position of PLN214m at YE09.

### *Secured Debt*

Most of the group's debt is secured on assets (PLN1.6bn or 83% of total debt at YE09). This primarily relates to the main cash flow-generating entity, PKE, whose bank loans and bonds are largely secured on power plants. The existence of relatively high secured debt in relation to total debt is mainly the result of debt

## Tauron Pledged Assets at FYE09 (PLNm)

| | Pledged | Total | As % of total |
|---|---|---|---|
| Assets | 3,889 | 22,160 | 18 |
| - Of which property, plant and equipment | 3,771 | 17,261 | 22 |

Source: Tauron

raised by Tauron's subsidiaries before the creation of the group in 2007. New debt is expected by management to be raised on an unsecured basis.

Although most debt is currently secured, Fitch believes that this does not significantly affect the unsecured creditors' position and their recovery prospects in a distress situation. Secured debt accounts for only 7% of total group assets, and represents a moderate 0.6x EBITDA for YE09. In addition, the company keeps large cash reserves in relation to debt (about PLN1bn in 2007-2009 compared with total debt of PLN1.9bn).

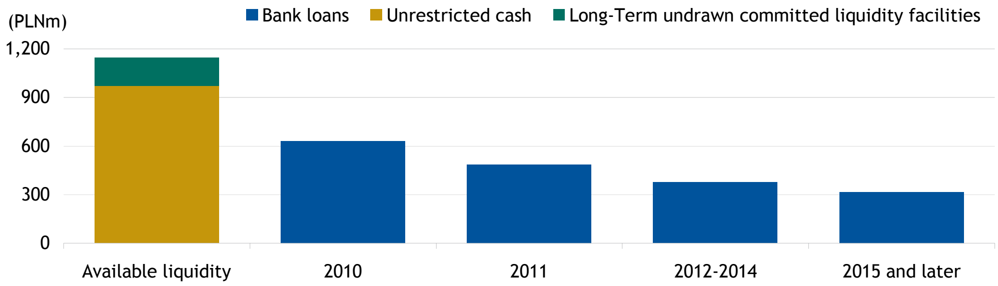
### *Loans at Below-Market Interest Rates*

Tauron's debt structure benefits from the presence of preferential loans (PLN329m, or 17% of total debt at YE09) with interest rates below market levels raised for some capex projects. This includes loans from Narodowy Fundusz Ochrony Środowiska i Gospodarki Wodnej (National Fund for Environmental Protection and Water Management).

## Debt Maturities and Liquidity

At YE09, available liquidity comprised unrestricted cash of PLN973m, and unused committed liquidity facilities with maturities longer than 12 months of PLN175m. This was sufficient to cover short-term debt of PLN632m.

**Tauron Group Debt Maturities At YE09**




Source: Tauron

## Peer Group

| Issuer | Country |
|---|---|
| **A-** | |
| CEZ | Czech Republic |
| | |
| **BBB+** | |
| PGE | Poland |
| | |
| **BBB** | |
| Tauron S.A. | Poland |
| SE | Slovakia |

## Issuer Rating History

| Date | LT IDR (FC) | Outlook |
|---|---|---|
| 08 April 2010 | BBB | Stable |

## Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

| Rating Factor | Status[a] | Trend |
|---|---|---|
| Operations | Average | Neutral |
| Market Position | Average | Neutral |
| Finances | Strong | Deteriorating |
| Governance | Average | Neutral |
| Geography | Average | Neutral |

[a] Relative to Peer Group

# Immediate Peer Group – Comparative Analysis

## Sector Characteristics

### *Operating Risks*

Vertically-integrated European electric utilities are relatively stable businesses. Electricity distribution and transmission in transparent regulatory regimes benefit from high cash flow visibility and predictability. Power generation is a higher-risk and more volatile segment due to its exposure to changes in fuel and electricity prices, and electricity demand. However, some business and financial risks in generation may be mitigated through hedging strategies.

### *Financial Risks*

The financial profile of integrated utilities benefits from a solid and stable cash flow generation. Negative FCF will remain common across the sector — given the large capex plans with limited near-term flexibility. These utilities generally have good access to capital-market funding.

### Peer Group Analysis (Data for 2009)

| Issuer name | CEZ A-/Stable | PGE BBB+/Stable | Tauron S.A. BBB/Stable | SE BBB/Stable |
|---|---|---|---|---|
| Operating EBITDAR (EURm) | 3,438 | 1,910 | 633 | 646 |
| Adjusted debt net of cash/ operating EBITDAR (x) | 1.4 | -0.3 | 0.4 | 0.3 |
| FFO interest coverage (x) | 15.7 | 16.0 | 15.5 | 37.4 |
| EBITDAR margin (%) | 46.3 | 36.3 | 19.0 | 31.5 |

Source: Fitch, companies

## Key Credit Characteristics

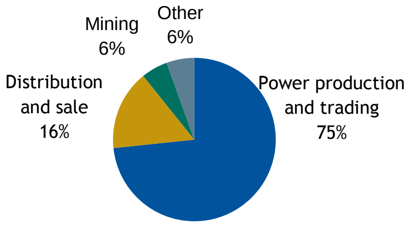
Large utilities with solid business profiles and strong-to-medium financial profiles generally have average-to-strong investment-grade ratings. Smaller players with less-diversified business profiles, such as Tauron, can attain low- or mid-investment-grade ratings. Ratings depend both on business factors — including market presence, degree of vertical integration, generation mix and earnings diversification — and on financial factors such as financial policy, leverage, profit margins, capex plans and approach to M&A.

## Overview of Companies

- **CEZ** ('A–'/Stable) — CEZ, 69.4%-owned by the Czech state, has a leading position and vertical integration in Czech power, and is the largest electric utility in central Europe. CEZ has a strong EBITDA margin, which is partly driven by its low-cost generation portfolio.
- **PGE** ('BBB+'/Stable) — PGE, 85%-owned by the Polish state, has a leading and vertically-integrated position in Polish power, including dominance in generation. PGE's main source of generation is lignite-fired plants, which benefit from relatively low production costs in Poland.
- **Tauron S.A.** ('BBB'/Stable) — Tauron, 88%-owned by the Polish state, is the second-largest vertically-integrated player in Polish power, after PGE. It has a relatively large presence in domestic distribution and supply versus generation. The company has limited generation fuel mix diversification (hard-coal-fired plants account for 93% of installed capacity).
- **Slovenske Elektrarne, a.s.** (SE; 'BBB'/Stable) — SE is the dominant power producer in Slovakia, 66%-owned by Italy's Enel SpA ('A–'/Stable). The company benefits from a good mix of generating sources, including nuclear (currently being expanded), hydro, gas and coal, but is less integrated than many of its peers.

### CEZ EBITDA Split in 2009

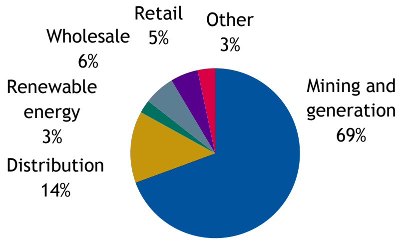
EBITDA of EUR3.4bn; EBITDA margin of 46%, Generation capacity of 14.3GW




Source: CEZ, Fitch calculations

### PGE EBITDA Split in 2009

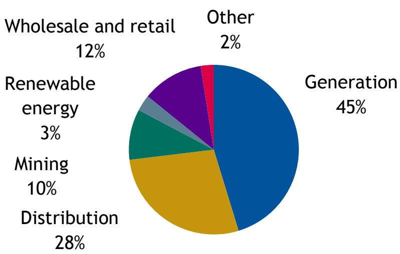
EBITDA of EUR1.9bn; EBITDA margin of 36%, Generation capacity of 12.4GW




Source: PGE, Fitch calculations

### Tauron EBITDA Split in 2009

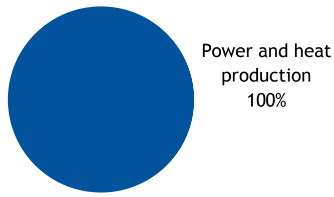
EBITDA of EUR0.6bn; EBITDA margin of 19%, Generation capacity of 5.6GW




Source: Tauron, Fitch calculations

### SE EBITDA Split in 2009

EBITDAR of EUR0.6bn; EBITDAR margin of 31%, Generation capacity of 6GW




Source: SE, Fitch calculations

## Peer Analysis of Central European Utilities

Tauron, PGE, CEZ and SE all have a leading market position in their home markets. In the agency's view, CEZ has the strongest business profile, followed by PGE, Tauron and SE, the latter being a pure generation company. Tauron's relative weakness is the limited diversification of fuel mix in generation.

Tauron has the lowest EBITDAR margin in the CE peer group, mainly due to lower profitability of its generation segment based on hard coal. It also has a higher share of lower-margin but also more stable distribution business than CEZ and PGE. Both CEZ and SE have a cost advantage regarding $CO_2$ as nuclear generation accounted for 39% and 66%, respectively, of their total electricity production in 2008. PGE's margin in generation is higher than Tauron's due to lower production cost from its lignite-fired plants.

Tauron had comparable credit ratios with SE, slightly weaker ratios than PGE (which had a net cash position mainly due to a large equity increase following an IPO in 2009) and better ratios than CEZ at YE09. According to Fitch's projections, all the companies will reach a comparable net debt/EBITDA of around 2x-2.5x by 2012-2013 (about 3x for SE in 2012). This leverage level is commensurate with the current ratings.

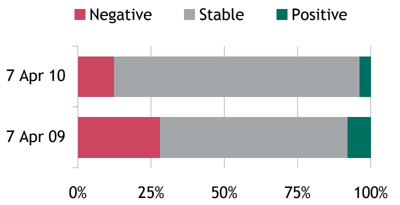
## Peer Group - Selected European Utilities (EURm)

| Issuer name | Long-Term IDR | Outlook | Statement date | Revenue | Operating EBITDAR | Total adjusted debt | Funds from operations | Free cash flow | Adjusted debt net of cash/ operating EBITDAR (x) | Funds from operations/ total adjusted debt | FFO interest coverage (x) | EBITDAR margin (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CEZ, a.s. | A- | Stable | 31 Dec 2009 | 7,421 | 3,438 | 5,926 | 2,995 | -378 | 1.4 | 50.5 | 15.7 | 46.3 |
| DONG Energy A/S | BBB+ | Negative | 31 Dec 2009 | 6,589 | 1,319 | 5,889 | 804 | -1,319 | 4.0 | 13.7 | 4.5 | 20.0 |
| E.ON AG | A | Stable | 31 Dec 2008 | 87,306 | 13,542 | 42,436 | 7,023 | -4,059 | 2.7 | 16.5 | 3.2 | 15.5 |
| Edison Spa | BBB+ | Negative | 31 Dec 2009 | 9,384 | 1,471 | 4,715 | 1,029 | -837 | 2.7 | 22.0 | 5.9 | 15.7 |
| EDP - Energias de Portugal, S.A. | A- | Stable | 31 Dec 2008 | 13,894 | 3,155 | 14,686 | 1,184 | -3,638 | 4.4 | 8.1 | 1.6 | 22.7 |
| Electricite de France (EDF) | A+ | Stable | 31 Dec 2009 | 66,336 | 18,829 | 58,140 | 12,133 | -2,152 | 2.5 | 20.9 | 5.5 | 28.4 |
| Endesa, S.A. | A- | Stable | 31 Dec 2008 | 22,836 | 6,895 | 18,504 | 4,333 | -2,340 | 2.0 | 23.4 | 3.8 | 30.2 |
| Enel SpA | A- | Stable | 31 Dec 2009 | 64,035 | 15,821 | 66,629 | 10,493 | -1,209 | 4.0 | 15.7 | 3.0 | 24.7 |
| Fortum Corporation | A- | Stable | 31 Dec 2009 | 5,435 | 2,315 | 6,979 | 2,245 | 531 | 2.6 | 32.2 | 10.3 | 42.6 |
| Iberdrola, S.A. | A- | Stable | 31 Dec 2008 | 25,196 | 6,511 | 32,032 | 4,895 | -9,575 | 4.6 | 15.3 | 4.0 | 25.8 |
| PGE Polska Grupa Energetyczna S.A. | BBB+ | Stable | 31 Dec 2009 | 5,266 | 1,910 | 1,226 | 1,900 | 511 | -0.3 | 154.9 | 16.0 | 36.3 |
| RWE AG | A+ | Stable | 31 Dec 2009 | 46,445 | 9,003 | 20,946 | 6,094 | -1,457 | 1.6 | 29.1 | 6.0 | 19.4 |
| Slovenske elektrarne, a.s. | BBB | Stable | 31 Dec 2009 | 2,049 | 646 | 331 | 365 | 86 | 0.3 | 110.3 | 37.4 | 31.5 |
| Statkraft As | BBB+ | Stable | 31 Dec 2009 | 2,377 | 1,518 | 5,541 | 730 | -619 | 3.2 | 13.2 | 2.6 | 63.9 |
| TAURON Polska Energia S.A. | BBB | Stable | 31 Dec 2009 | 3,320 | 633 | 497 | 548 | 95 | 0.4 | 110.4 | 15.5 | 19.0 |
| Vattenfall AB | A | Negative | 31 Dec 2009 | 20,036 | 4,925 | 21,062 | 3,580 | -823 | 4.1 | 17.0 | 4.8 | 24.6 |

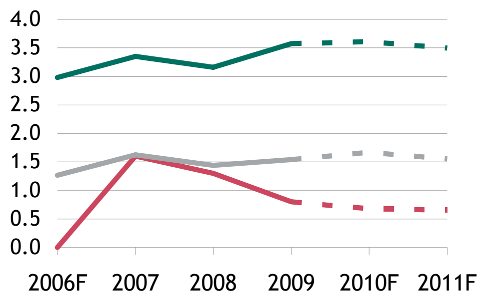
Source: Fitch, based on company reports

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

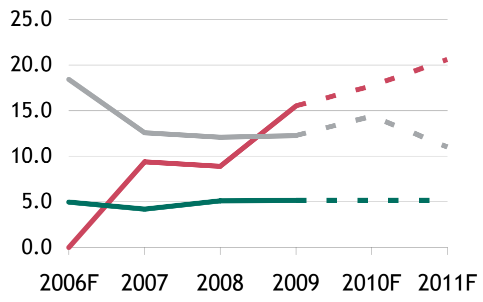
**Distribution of Sector Outlooks**
Directional Outlooks and Rating Watches




**Leverage**
including Fitch expectations




**Interest Cover**
including Fitch expectations



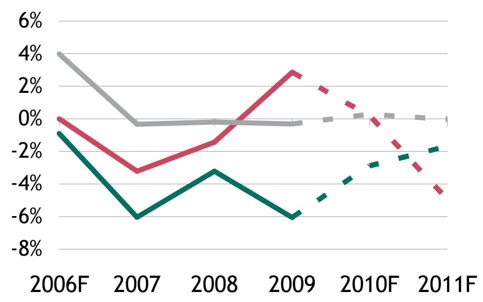

Fitch's expectations are based on the agency's internally-produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- moderate decline in FFO and EBITDA in 2010 due to lower wholesale prices;
- increase in annual capex in 2010-2011 compared with 2009
- need to raise new debt to co-fund capex in 2010-2011.

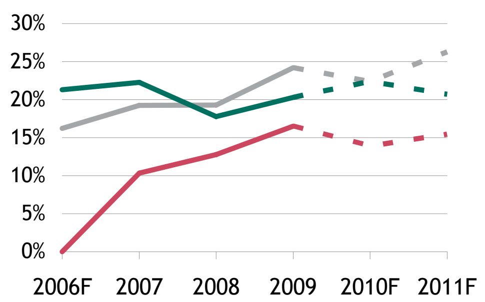
**Debt Maturities and Liquidity at end-2009**

| **Debt maturities** | **(PLNm)** |
|---|---|
| 2010 | 632 |
| 2011 | 487 |
| 2012-2014 | 567 |
| After 2014 | 214 |
| **Cash and equivalents** | **973** |
| **Long-Term Undrawn Committed Facilities** | **175** |

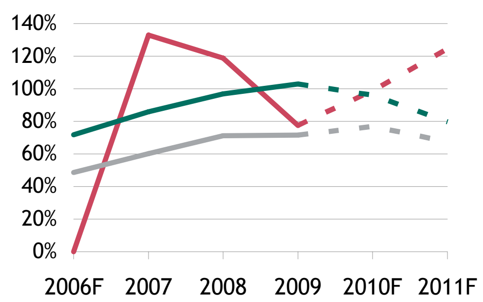
**FCF/Revenues**
including Fitch expectations




**FFO Profitability**
including Fitch expectations



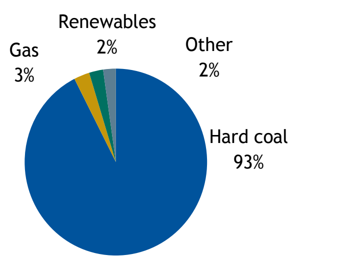

**Capex/CFO**
including Fitch expectations



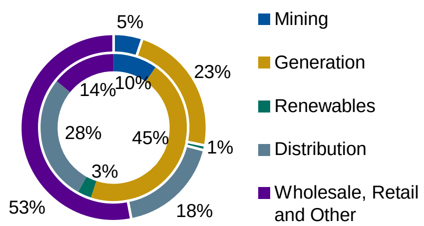

**Definitions**

- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- Interest Cover: FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- FCF/Revenues: FCF after dividends divided by revenues.
- FFO Profitability: FFO divided by revenues.
- 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.

**Tauron Generation Capacity by Fuel in 2009**




**FY09 Segmental Split**
Outer Ring: Revenue
Inner Ring: EBITDA



*TAURON Polska Energia S.A.*

| | 31 Dec 2009 PLNm Original | 31 Dec 2008 PLNm Original | 31 Dec 2007 PLNm Original |
|---|---|---|---|
| ***Summary Balance Sheet*** | | | |
| **ASSETS** | | | |
| Cash and Marketable Securities | 972.6 | 906.7 | 899.1 |
| Accounts Receivable/Trade Debtors | 1,875.0 | 1,275.3 | 1,230.0 |
| Inventory | 536.2 | 395.2 | 267.3 |
| Other Current Assets | 289.9 | 260.1 | 462.6 |
| Property, Plant & Equipment | 17,260.6 | 17,098.8 | 16,469.7 |
| Intangible Assets | 824.8 | 533.3 | 285.2 |
| Other Non-current Assets | 401.1 | 353.7 | 633.8 |
| **TOTAL ASSETS** | **22,160.2** | **20,823.1** | **20,247.7** |
| **LIABILITIES** | | | |
| Short-term Debt (inc. CPLTD) | 631.7 | 684.0 | 494.3 |
| Accounts Payable/Trade Creditors | 966.2 | 804.0 | 878.9 |
| Provisions | 2,122.6 | 1,932.4 | 1,906.3 |
| Other Short-term Liabilities | 2,299.3 | 1,891.4 | 1,625.7 |
| Other Long-term Liabilities | 688.5 | 619.1 | 452.8 |
| Long-term Secured Debt | 1,267.7 | 1,546.8 | 1,608.6 |
| Long-term Unsecured Debt | 0.0 | 0.0 | 75.0 |
| **TOTAL LIABILITIES** | **7,976.0** | **7,477.7** | **7,041.6** |
| **EQUITY** | | | |
| Minority Interest/Minorities | 2,367.7 | 2,219.5 | 2,179.3 |
| Equity Capital & Reserves | 11,816.5 | 11,125.9 | 11,026.8 |
| **TOTAL LIABILITIES & EQUITY** | **22,160.2** | **20,823.1** | **20,247.7** |
| **Adjusted Gross Debt** | **2,038.6** | **2,349.2** | **2,258.7** |
| ***Debt Schedule*** | | | |
| **DEBT PRIORITY** | | | |
| Lease Liabilities | 123.7 | 154.9 | 181.8 |
| Secured | 1,447.9 | 1,645.7 | 1,574.8 |
| Unsecured | 327.8 | 430.2 | 421.3 |
| Convertible | 0.0 | 0.0 | 0.0 |
| Subordinated | 0.0 | 0.0 | 0.0 |
| **Total Debt** | **1,899.4** | **2,230.8** | **2,177.9** |
| Off-Balance Sheet Debt | 139.2 | 118.4 | 80.8 |
| **Total Adjusted Debt** | **2,038.6** | **2,349.2** | **2,258.7** |
| Non-recourse + Equity Hybrid Component | 0.0 | 0.0 | 0.0 |
| **Total Adjusted Debt with Equity Credit** | **2,038.6** | **2,349.2** | **2,258.7** |
| **Adjusted Liabilities~~** | **2,038.6** | **2,349.2** | **2,258.7** |
| **DEBT SOURCE** | | | |
| Bank | 1,178.9 | 1,355.7 | 1,576.0 |
| Capital Markets | 596.8 | 592.8 | 420.1 |
| Other | 123.7 | 282.3 | 181.8 |
| **TOTAL DEBT** | **1,899.4** | **2,230.8** | **2,177.9** |
| **DEBT MATURITY** | | | |
| Less than 1 Year | 631.7 | 684.0 | 494.3 |
| 1 To 2 Years | 486.7 | 488.2 | 875.4 |
| 2 To 5 Years | 566.8 | 769.8 | 657.7 |
| More than 5 Years | 214.3 | 288.8 | 150.5 |
| **TOTAL DEBT** | **1,899.4** | **2,230.8** | **2,177.9** |
| Unrestricted Cash & Deposits | 972.6 | 906.7 | 899.1 |
| **CURRENT DEBT NET OF CASH** | **-340.9** | **-222.7** | **-404.8** |
| **TOTAL DEBT NET OF CASH** | **926.8** | **1,324.1** | **1,278.8** |
| **TOTAL ADJUSTED DEBT NET OF CASH** | **1,066.0** | **1,442.5** | **1,359.6** |
| **Adjusted Liabilities Net of Cash** | **1,066.0** | **1,442.5** | **1,359.6** |
| Restricted Cash & Deposits | 59.5 | 43.0 | 75.1 |

~ includes Restricted Cash
~~ Total Adjusted Debt with Equity Credit plus Debt-like Pref. Stock

## TAURON Polska Energia S.A.
## Summary Income Statement

| | 31 Dec 2009 PLNm Original | 31 Dec 2008 PLNm Original | 31 Dec 2007 PLNm Original |
|---|---|---|---|
| **SUMMARY INCOME STATEMENT** | | | |
| Revenue* | 13,633.6 | 12,448.7 | 12,264.0 |
| Cost of Goods Sold | 10,200.3 | 9,997.0 | 10,282.1 |
| **GROSS PROFIT** | **3,433.3** | **2,451.7** | **1,981.9** |
| Selling, Distribution & Administrative Expenses | 809.7 | 802.9 | 611.8 |
| Other Operating Expenditure** | 43.8 | 38.6 | 4.6 |
| Presentational only: L-T Rentals (incl. in SG&A above) | 17.4 | 14.8 | 10.1 |
| **Operating EBITDAR** | **2,597.2** | **1,625.0** | **1,375.6** |
| Depreciation & Amortisation | 1,321.2 | 1,269.3 | 1,198.4 |
| Non-recurring, non-operational and non-recourse income*** | -22.0 | 2.1 | 13.5 |
| Associate Income/Loss | 0.0 | 0.0 | 0.0 |
| Other Income/Expense | 5.7 | -10.8 | -3.8 |
| **EBIT** | **1,259.7** | **347.0** | **186.9** |
| Interest Income | 61.3 | 75.3 | 72.9 |
| Interest Expense | 116.0 | 117.3 | 120.6 |
| Non-interest Financial Income/Charges | -15.4 | -81.1 | 11.1 |
| **PBT** | **1,189.6** | **223.9** | **150.3** |
| Taxation | 271.0 | 63.0 | -0.1 |
| Minorities | -169.2 | -48.3 | 3.6 |
| **NET INCOME** | **749.4** | **112.6** | **154.0** |
| Extraordinary Items/Accounting Changes | 0.0 | 0.0 | 0.0 |
| NET INCOME AFTER EXTRAORDINARY ITEMS (before dividends) | 749.4 | 112.6 | 154.0 |

## Summary Cash Flow

| | 31 Dec 2009 PLNm Original | 31 Dec 2008 PLNm Original | 31 Dec 2007 PLNm Original |
|---|---|---|---|
| **SUMMARY CASH FLOW** | | | |
| **Operating EBITDAR** | **2,597.2** | **1,625.0** | **1,375.6** |
| Cash Interest Paid, Net of Interest Income | 110.9 | 111.7 | 106.2 |
| Cash Tax Paid | 111.6 | 259.9 | 241.1 |
| Associate Dividends | 5.3 | 3.3 | 2.6 |
| Other Changes before Funds From Operations**** | -129.6 | 331.0 | 235.3 |
| **FUNDS FROM OPERATIONS** | **2,250.4** | **1,587.7** | **1,266.2** |
| Working Capital | -392.8 | -80.6 | 101.5 |
| **CASH FLOW FROM OPERATIONS** | **1,857.6** | **1,507.1** | **1,367.7** |
| Non-Operational Cash Flow*** | 32.4 | 141.5 | 89.5 |
| Capital Expenditure | 1,440.3 | 1,792.2 | 1,819.4 |
| Dividends Paid | 58.3 | 33.9 | 32.3 |
| **FREE CASH FLOW** | **391.4** | **-177.5** | **-394.5** |
| Receipts from Asset Disposals | 15.9 | 78.1 | 119.4 |
| Business Acquisitions | 4.2 | 0.1 | 162.5 |
| Business Divestments | 20.0 | 3.4 | 21.1 |
| Exceptional & Other Cash Flow Items | 7.0 | 2.3 | 6.7 |
| **NET CASH IN/OUTFLOW** | **430.1** | **-93.8** | **-409.8** |
| Equity Issuance/(Buyback) | 0.0 | 0.0 | 0.0 |
| FX movement | 0.0 | 0.0 | 0.0 |
| Other Items Affecting Cash Flow**** | -32.8 | 48.5 | -327.4 |
| **NET CASH FLOW AVAILABLE FOR FINANCING** | **397.3** | **-45.3** | **-737.2** |
| **OPENING TOTAL DEBT NET OF CASH** | **1,324.1** | **1,278.8** | **541.6** |
| Net Debt Increase/(Decrease) | -397.3 | 45.3 | 737.2 |
| **CLOSING TOTAL DEBT NET OF CASH** | **926.8** | **1,324.1** | **1,278.8** |

* Net of Sales, Royalty & Other Operational Taxes
** Excludes Depreciation & Amortisation
*** Analyst Estimate
**** Balancing Item

*TAURON Polska Energia S.A.*
*Ratio Analysis*

| | 31 Dec 2009 PLNm Original | 31 Dec 2008 PLNm Original | 31 Dec 2007 PLNm Original |
|---|---|---|---|
| **EARNINGS/PROFITABILITY** | | | |
| Revenue Growth (%) | 9.5 | 1.5 | n.a. |
| Gross Profit/Revenues (%) | 25.2 | 19.7 | 16.2 |
| Op. EBITDAR/Revenues (%) | 19.1 | 13.1 | 11.2 |
| EBIT/Revenues (%) | 9.2 | 2.8 | 1.5 |
| Pre-Tax Profit/Revenues (%) | 8.7 | 1.8 | 1.2 |
| Profit after tax/Revenues (%) | 6.7 | 1.3 | 1.2 |
| Effective Tax Rate (%) | 22.8 | 28.1 | 0.0 |
| Profit after tax/Average Equity (%) | 8.6 | 1.7 | 1.0 |
| Return on Average Assets (%) | 4.8 | 1.4 | 1.2 |
| FFO Return on Adjusted Capital (%) | 14.9 | 11.5 | 9.2 |
| Free Cash Flow Margin (%) | 2.9 | -1.4 | -3.2 |
| **COVERAGES** | | | |
| FFO/Gross Interest Expense and Preferred Dividends (x) | 15.5 | 8.9 | 9.4 |
| FFO Fixed Charge Cover (x) | 14.0 | 8.3 | 8.9 |
| (Op. EBITDAR-Capex)/Gross Fixed Charges(x) | 6.9 | -0.4 | -2.6 |
| Op. EBITDAR/Net Fixed Charges (x) | 23.2 | 11.5 | 15.7 |
| FFO/Interest Expense Net of Interest Income (x) | 24.8 | 13.6 | 17.3 |
| Free Cash Flow Debt Service Coverage (x) | 0.7 | 0.0 | -0.4 |
| Net Fixed Charges Cover (x) | 13.6 | 2.7 | 2.1 |
| **LEVERAGE** | | | |
| Total Adjusted Debt/Op. EBITDAR (x) | 0.8 | 1.4 | 1.6 |
| Total Adjusted Debt Net of Cash/Op. EBITDAR(x) | 0.4 | 0.9 | 1.0 |
| Adjusted Liabilities Net of Cash/Op. EBITDAR (x) | 0.4 | 0.9 | 1.0 |
| Adjusted Net Leverage/FFO (x) | 0.5 | 0.8 | 1.0 |
| Adjusted Leverage/FFO (x) | 0.8 | 1.3 | 1.6 |
| Free Cash Flow/ Adjusted Liabilities (%) | 19.2 | -7.6 | -17.5 |
| CFO/Total Debt Net of Cash (%) | 200.4 | 113.8 | 107.0 |
| CFO/Adjusted Liabilities Net of Cash (%) | 174.3 | 104.5 | 100.6 |
| Total Adjusted Debt/Total Adjusted Capitalisation (%) | 12.6 | 15.0 | 14.6 |
| **FINANCIAL STRUCTURE** | | | |
| Secured and Lease Debt/Total Debt (%) | 82.7 | 80.7 | 80.7 |
| Current Debt/Total Debt (%) | 33.3 | 30.7 | 22.7 |
| Off-Balance Sheet Debt/Total Adjusted Debt (%) | 6.8 | 5.0 | 3.6 |
| Total Debt Net of Cash/Tangible Equity (%) | 6.9 | 10.3 | 9.9 |
| **PENSION ADJUSTED RATIOS** | | | |
| Mixed Scheme Pension Liability | 95.6 | 115.7 | 104.5 |
| Pension Adjusted Net Leverage | 0.4 | 0.9 | 1.0 |
| Pension Adjusted Net Coverage | 0.0 | 0.0 | 0.0 |
| Pension Adjusted Net Coverage (Implied) | 14.8 | 7.5 | 8.7 |
| Implied Interest Cost | 5.5 | 6.4 | 5.7 |
| Pension Adjusted Gross Coverage | 0.0 | 0.0 | 0.0 |
| Pension Adjusted Gross Coverage (Implied) | 14.8 | 7.5 | 8.7 |
| **WORKING CAPITAL CYCLE** | | | |
| Average Inventory Processing Period (days) | 16.7 | 12.1 | 11.3 |
| Average Receivables Collection Period (days) | 42.2 | 36.7 | 34.9 |
| Gross Cash Cycle (days) | 58.8 | 48.8 | 46.2 |
| Average Payables Payment Period (days) | 31.7 | 30.7 | 30.2 |
| Cash Conversion Cycle (days) | 27.2 | 18.1 | 15.9 |
| **ADDITIONAL INFORMATION** | | | |
| Depreciation | 1,321.2 | 1,269.3 | 1,198.4 |
| Amortisation | 0.0 | 0.0 | 0.0 |
| Capital Expenditure/Depreciation (x) | 1.1 | 1.4 | 1.5 |
| CFO/Capital Expenditure (x) | 1.3 | 0.8 | 0.8 |
| Interest Capitalised | 39.7 | 84.5 | 29.9 |
| Hire/Lease/Rent Costs for Current Assets | 0.0 | 0.0 | 0.0 |
| Hire/Lease/Rent Costs for Long-term Assets | 17.4 | 14.8 | 10.1 |
| Contingent Liabilities | 0.0 | 0.0 | 0.0 |
| Operating Exceptionals in Operating Costs | 0.0 | 0.0 | 0.0 |
| Staff cost/Revenues (%) | 13.1 | 13.8 | 12.7 |
| R&D (net)/Revenues (%) | 0.0 | 0.0 | 0.0 |