

Electric-Corporate
Poland
Update

PGE Polska Grupa Energetyczna S.A.

Ratings

Foreign Currency	
Long-Term IDR	BBB+
Senior unsecured	A-

Local Currency	
Long-Term IDR	BBB+
Senior unsecured	A-

Outlooks

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

Financial Data

PGE Polska Grupa Energetyczna S.A.

	31 Dec 09	31 Dec 08
Revenue (PLNm)	21,623	19,409
Operating EBITDAR (PLNm)	7,842	5,303
Funds from operations (PLNm)	7,800	5,664
Capital expenditure (PLNm)	4,022	4,124
Free cash flow (PLNm)	2,097	662
Total debt (PLNm)	5,028	7,512
Funds from operations/ gross interest expense (x)	16.0	10.7
Total adjusted debt net of cash/operating EBITDAR (x)	-0.3	1.0

Analysts

Arkadiusz Wicik, CFA
+48 22 338 6286
arkadiusz.wicik@fitchratings.com

Jacek Kawalczewski, CFA
+48 22 338 6291
jacek.kawalczewski@fitchratings.com

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)
- [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

- PGE Polska Grupa Energetyczna S.A.'s (PGE S.A.) ratings reflect PGE Group's (PGE; PGE S.A. and its subsidiaries) vertically integrated operations in the Polish electricity market, including dominance in power generation (42% of the country's generation in 2008) and a strong position in electricity distribution and supply (26% market share in 2008). The group's generation mix is based on lignite-fired plants, which enables it to generate a strong EBITDA margin, but also exposes PGE to increasing carbon dioxide costs, especially after 2012.
- PGE has a net cash position following an equity increase through an IPO in Q409. However, the ratings incorporate Fitch Ratings' projections of an increase in net debt to EBITDA to about 2x-2.5x by 2013-2014 due to a large capex programme that will be partly debt funded. This leverage is commensurate with the current ratings, and is largely in line with projected medium-term leverage for other central European electricity utilities rated by Fitch.
- The ratings reflect PGE's medium-term target for net debt to EBITDA not to exceed 2.5x – despite the large capex plan, which is mainly devoted to new power plant projects and modernisation of existing generation and distribution assets. PGE is considering lowering its ambitious capex for renewables.
- The ratings are constrained by the group's short track record of operations and relatively low integration between PGE S.A. and its main subsidiaries. The latter is addressed by PGE's consolidation programme, which aims to enhance the holding company's position within the group. The agency views positively the improvement in PGE's debt structure due to early repayment of PLN1.65bn loans at its subsidiary PGE Elektrownia Bełchatów S.A. in April 2010.
- The senior unsecured rating of 'A-' incorporates an uplift of one notch over the IDR, reflecting Fitch's expectation of above-average recovery prospects for debt instruments issued by vertically integrated European power utilities.

What Could Trigger a Rating Action?

- The ratings could be positively affected by: successful implementation of capex, resulting in a stronger business profile; progress on group integration; and a stronger position for PGE S.A. in terms of group cash flow and debt.
- Financial leverage beyond the company's maximum target of 2.5x, due, for example, to large debt-funded acquisitions or capex substantially above the current plan, would be negative for the ratings. Fitch believes that the potential acquisition of Energa S.A., Poland's fourth-largest electric utility – for which PGE is among the five short-listed bidders – would be unlikely to put immediate pressure on the ratings due to the group's net cash position. However, it may constrain PGE's capex growth in 2013-2014 in order for leverage not to exceed the target. In such a scenario, the monetisation of non-core assets, planned by PGE, could provide some financial headroom for the group. The Energa acquisition may strengthen PGE's business profile by creating a more balanced mix of generation versus distribution and supply, and by increasing the proportion of regulated cash flow.

Liquidity and Debt Structure

Liquidity is ample. At end-March 2010, PGE had PLN7.7bn of unrestricted cash and cash equivalents against short-term debt of PLN2.5bn.

Peer Group

Issuer	Country
A- CEZ, a.s.	Czech Republic
BBB+ PGE Polska Grupa Energetyczna S.A.	Poland
BBB Slovenske elektrarne, a.s. TAURON Polska Energia S.A.	Slovakia Poland

Issuer Rating History

Date	LT IDR (FC)	Outlook/ watch
02 Sep 09	BBB+	Stable

Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

Rating factor	Status ^a	Trend
Operations	Average	Neutral
Market position	Strong	Neutral
Finances	Strong	Worsening
Governance	Average	Neutral
Geography	Average	Neutral

^a Relative to Peer Group
Source: Fitch

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 solid and stable cash flow generation. Negative free cash flow (FCF) will remain common across the sector due to large capex plans with limited short-term flexibility. Leading integrated utilities generally have good access to capital-market funding.

Peer Group Analysis (Data for 2009)

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

Source: Fitch, Companies

Key Credit Characteristics

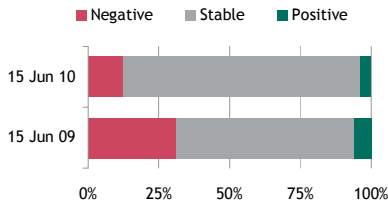
Large utilities with solid business profiles and strong-to-medium financial profiles generally have average-to-strong investment-grade ratings. Smaller companies with less-diversified business profiles, such as PGE, can attain low- or mid-investment-grade ratings. Ratings depend both on business factors – 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.s.** – 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 Polska Grupa Energetyczna S.A.** – 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.
- **Slovenske Elektrarne, a.s. (SE)** – 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.
- **TAURON Polska Energia S.A. (Tauron)** – Tauron, 88% owned by the Polish state, is the second-largest vertically integrated company in Polish power, after PGE. It has a relatively large presence in domestic distribution and supply compared with generation. The company has limited generation fuel mix diversification (hard-coal-fired plants account for 93% of installed capacity).

PGE Polska Grupa Energetyczna S.A. — Utilities Median — Emerging BBB Cat Median — Source: Company data; Fitch.

Distribution of Sector Outlooks
Directional Outlooks and Rating Watches

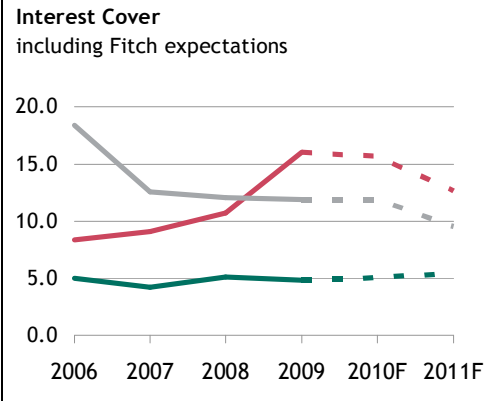
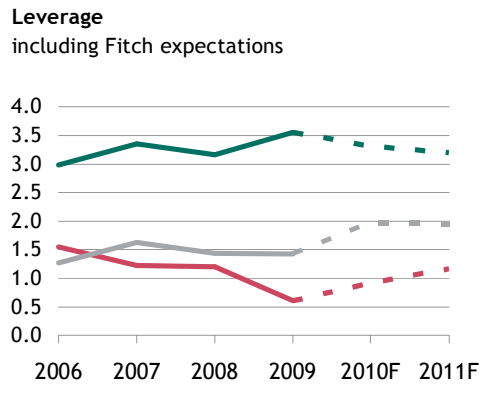


Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- decline in FFO and EBITDA in 2010 due to lower compensation for power purchase agreements and reduced generation driven by maintenance shutdowns;
- improved FFO and EBITDA in 2011 thanks to the commissioning of a new 858MW unit in Bełchatów;
- increase in annual capex in 2010-2011 compared with 2009; and
- need to raise new debt to co-fund capex.

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.

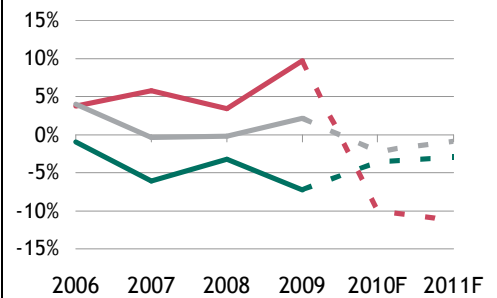


Debt Maturities and Liquidity at End-March 2010

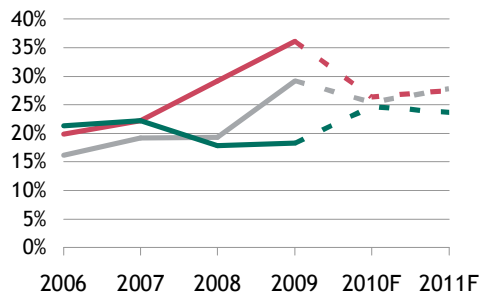
Debt maturities	(PLNm)
Up to 12 months	2,455
Long-term	2,267
Unrestricted cash and equivalents	7,667
Undrawn committed long-term facilities	245

Source: Fitch

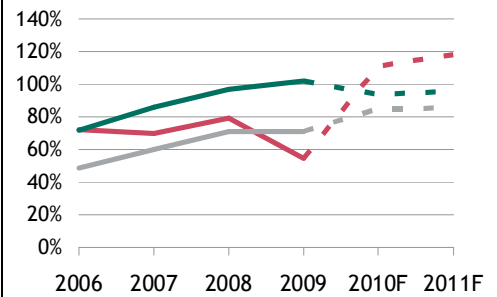
FCF/Revenues
including Fitch expectations



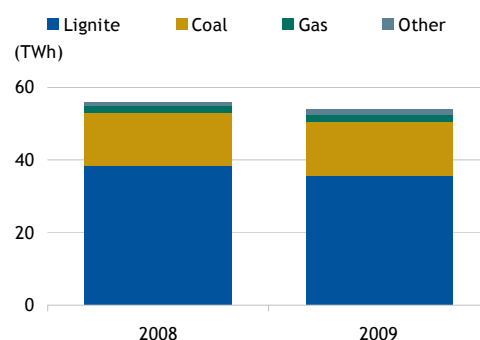
FFO Profitability
including Fitch expectations



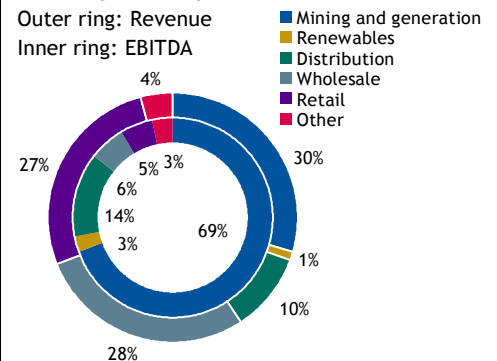
Capex/CFO
including Fitch expectations



PGE Generation by Fuel



FY09 Segmental Split



PGE Polska Grupa Energetyczna S.A.
Financial Summary

	31 Dec 2009 PLNm Original	31 Dec 2008 PLNm Restated	31 Dec 2007 PLNm Restated	31 Dec 2006 PLNm Original	31 Dec 2005 PLNm Original
INCOME STATEMENT					
Revenues	21,623	19,409	23,091	24,344	17,000
Revenue Growth	11	(16)	(5)	43	6
EBIT	5,587	3,501	2,374	2,521	818
Interest Expense Net of Interest Income	270	258	373	433	24
Net Income	3,381	1,908	2,123	1,438	804
BALANCE SHEET					
Cash and Equivalents	7,607	2,071	2,675	3,271	521
Total Assets	54,448	47,192	45,309	54,988	9,029
Short-term Debt	971	3,039	1,331	1,636	332
Senior Long-Term Debt	4,057	4,472	5,743	6,878	789
Subordinated Debt	0	0	0	0	0
Total Debt	5,028	7,512	7,074	8,514	1,121
Common Equity	31,168	22,810	21,252	27,302	5,372
Off-Balance Sheet Debt	8	9	5	0	0
Total Adjusted Capitalisation	43,886	37,696	36,500	43,230	6,549
Total Adjusted Debt	5,036	7,520	7,079	8,514	1,121
Preferred Stock + Minority Interests	7,681	7,366	8,168	7,415	56
CASH FLOW					
Operating EBITDAR (Op. EBITDAR)	7,842	5,303	4,584	4,786	1,495
Cash Interest Paid, Net of Interest Received	338	348	723	532	76
Cash Tax Paid	491	574	592	358	0
Associate Dividends	385	171	237	388	61
Other Changes before Funds From Operations**	402	1,112	1,634	562	15
FUNDS FROM OPERATIONS	7,800	5,664	5,140	4,847	1,494
Working Capital	(454)	(454)	58	(121)	42
CASH FLOW FROM OPERATIONS	7,346	5,210	5,197	4,726	1,536
Non-Operational Cash Flow*	0	0	0	0	0
Capital Expenditure	4,022	4,124	3,635	3,406	459
Dividends Paid	1,227	424	230	396	251
FREE CASH FLOW	2,097	662	1,332	924	826
Receipts from Asset Disposals	32	82	87	18	3
Business Acquisitions	265	1,933	0	0	0
Business Divestments	0	0	0	0	0
Exceptional & Other Cash Flow Items	228	314	(239)	394	(81)
NET CASH IN/OUTFLOW	2,092	(875)	1,180	1,336	748
Equity Issuance/(Buyback)	5,918	0	0	0	(0)
FX movement	0	0	0	0	0
Other Items Affecting Cash Flow**	10	(166)	(337)	(5,978)	(48)
NET CASH FLOW AVAILABLE FOR FINANCING	8,020	(1,041)	844	(4,643)	700
CLOSING NET DEBT	(2,579)	5,441	4,399	5,243	600
PROFITABILITY					
Op. EBITDAR/Revenues (%)	36.3	27.3	19.9	19.7	8.8
EBIT/Revenues (%)	25.8	18.0	10.3	10.4	4.8
FFO Return on Adjusted Capital (%)	19.0	16.6	15.8	12.7	24.3
CREDIT RATIOS					
Funds From Operations/Gross Interest Expense (x)	16.0	10.7	9.1	8.4	16.3
FFO Fixed Charge Cover (x)	16.0	10.7	9.1	8.4	16.3
Op. EBITDAR/Net Fixed Charges (x)	22.8	14.6	11.2	11.1	63.1
Adjusted Leverage/FFO (x)	0.6	1.2	1.2	1.5	0.7
Total Adjusted Debt Net of Cash/Op. EBITDAR (x)	(0.3)	1.0	1.0	1.1	0.4
Total Adjusted (Recourse) Debt/Total Adjusted Capitalisation (%)	11.5	20.0	19.4	19.7	17.1

Off Balance sheet debt reflects 8 times gross rent expense plus off balance sheet debt with full/limited recourse.

* Includes Analyst Estimate

** Balancing Item

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