26 JAN 2022

Fitch Affirms Enerjisa and Baskent at 'AA+(tur)'; Withdraws Baskent's Rating

Fitch Ratings - Moscow - 26 Jan 2022: Fitch Ratings has affirmed the National Long-Term Ratings of Turkish utilities company Enerjisa Enerji A.S. and one of its main electricity distribution subsidiaries, Baskent Elektrik Dagitim A.S. at 'AA+(tur)' with Stable Outlooks. Fitch has simultaneously withdrawn Baskent's rating.

Enerjisa's ratings reflect the company's strong performance in the new regulatory period (2021-2025) and predictable regulated earnings, which include full capex reimbursement over 10 years at a real rate of return of 12.3%. We forecast funds from operations (FFO) net leverage to have sufficient headroom under the 3.0x negative sensitivity for the 'AA+(tur)' rating, driven by a rising asset base and income from efficiency incentives.

Fitch believes there has been a limited impact on Enerjisa from lira depreciation and rising inflation in Turkey, due to the regulated nature of its business and almost all debt being in local currency.

Enerjisa's rating remains constrained by the liquidity risk related to the short-term debt maturity profile and reliance on continued access to domestic bank funding on an uncommitted basis, despite some progress in attracting longer-term committed bank loans.

Fitch has withdrawn Baskent's rating for commercial reasons. Fitch will no longer provide ratings or analytical coverage of Baskent.

Key Rating Drivers

Limited Impact From Macro Volatility: Accelerated inflation in Turkey (36% at end-2021) and lira depreciation have had a limited impact on Enerjisa so far. In the distribution segment, which accounts for around 85% of total EBITDA, tariffs are based on the regulated asset base (RAB) and remuneration is linked to inflation. The deviation of actual regulatory parameters, including electricity purchase costs, from those projected is corrected via tariffs with a two-year lag together with adjustments for the time value of money. In the regulated retail segment, adjustments are made with a six-month lag.

Regulatory Stability to Be Tested: Enerjisa's distribution tariffs increased by 24% from 1 January 2022. We expect potential regulatory interference in an attempt to cap the growth of utility bills to be the key risk for Enerjisa in the next few years, when increased inflation and higher electricity purchase expenses will need to be incorporated into tariffs. This will be mitigated by the stability of RAB regulation since its launch in 2006, despite several macroeconomic crises in Turkey, and the limited 15%-20% share of the distribution component in the end-customer tariff.

Strong Performance in New Regulatory Period: In 9M21 Enerjisa's (Fitch-defined) EBITDA increased by around 50% yoy to TRY4.8 billion due to higher financial income and higher capex reimbursements, amid the RAB reaching TRY11.2 billion at end-3Q21 (up from TRY9.4 billion at end-2020), and increased remuneration for efficiency and quality. Free cash flow improved to -TRY0.6 billion vs. -TRY1.2 billion in 9M20, despite increased investments and dividends.

Negative Cash Flow, Moderate Leverage: Despite macro uncertainties, we forecast Enerjisa will generate healthy cash flow from operations of around TRY4.5 billion on average over 2021-2025. This will be backed by higher capex allowances in the new regulatory period, which drive financial income and capex reimbursement components, and income from efficiency incentives.

However, average free cash flow over 2021-2025 is expected to stay negative at around -TRY3 billion due to annual investments and dividends averaging TRY5.5 billion and TRY2.0 billion, respectively. This results in FFO net leverage in the range of 2.0x-2.5x (2.3x in 2020) and FFO interest coverage at 3x (3.4x in 2020) over 2021-2025.

Low FX Risks: Over 95% of Enerjisa's debt is denominated in Turkish lira, with the remaining in euros, for which the exposure is hedged. We view the low forex exposure as positive for the rating compared with corporate peers in Turkey.

Supportive Fourth Regulatory Period: Fitch continues to evaluate Turkish electricity distribution regulation as fairly transparent and stable and therefore supportive of Enerjisa's rating. The key parameters set for the new regulatory period, such as return on RAB methodology, 10-year reimbursement period and efficiency incentives, remain and will continue to drive profitability. We expect a higher RAB, built up by a substantial increase in the initial capex allowances, to compensate for a lower real rate of return (set at 12.3% versus 13.6% in the previous regulatory period).

Derivation Summary

Compared with European networks, Enerjisa benefits from an attractive regulated rate of allowed return (real weighted average cost of capital of 12.3%) and a shorter principal payback period of 10 years. However, we consider electricity distribution companies in Turkey as riskier, due to the fact that the companies do not own the infrastructure assets and investments in the grid are treated as financial assets.

In the context of Turkish peers, we assess Enerjisa as relatively strong due to solid earnings visibility, limited forex exposure and strong access to domestic bank funding. Among the peers rated on a national scale, Arcelik (AAA(tur)/Stable), a white goods producer, benefits from exposure to international markets and FX-linked revenue. Migros Tiracet A.S. (AAA(tur)/Stable), a leading food retailer, has positive free cash flow through the cycle and good liquidity. Turk Telekomunicasyon A.S. (AAA(tur)/Stable), an incumbent fixed-line operator, benefits from large scale of operations and strong financial profile.

Key Assumptions

- Returns on RAB in the new regulatory period 2021-2025 at 12.3%

- Inflation of around 18% annually on average in 2021-2025

- Capex of TRY5.5 billion on average over 2021-2025

- Dividends with pay-out at 70% of previous year consolidated underlying net income, vs. the company's guidance of 60%-70% pay-out

- Regulated gross profit margins for regulated customers at 7%-9%

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We do not anticipate an upgrade due to the entirely domestic operations, liquidity risk related to the relatively short-term debt maturity profile and reliance on continued access to domestic bank funding on an uncommitted basis. However, a substantial improvement in the liquidity position and debt maturity profile could lead to positive rating action.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO net leverage above 3.0x and FFO interest coverage below 3.0x, both on a sustained basis

- Any adverse regulation effects including delays in recoveries of investments.

- Adverse developments in the process of the retail market liberalisation

- Deterioration in available liquidity

- Large unhedged foreign currency debt exposure

Liquidity and Debt Structure

We continue to view liquidity and debt management as rating constraints. At end-3Q21 available cash of TRY0.3 billion, proceeds from a TRY0.8 billion lira-denominated bond issued in October and a committed credit line signed with EBRD of around TRY1.3 billion were insufficient to cover short term debt of TRY6.4 billion and Fitch-expected negative free cash flow 12 months ahead. To fund the gap, Enerjisa plans to issue another bond on the Turkish bond market or use around TRY15 billion of credit lines in Turkish banks available on an uncommitted basis, in line with the Turkish market practice.

The liquidity has moderately improved since last year driven by another committed line signed with EBRD and continued record of uninterrupted access to bank and bond funding. However, the debt maturity profile remains short-term in nature, reflecting the limited availability of long-term funding from domestic banks. This is common among Turkish corporates but exposes the company to systemic liquidity risk.

Issuer Profile

Enerjisa is a large electricity distribution and supply company in Turkey with around 23% market share. Enerjisa operates through its three subsidiaries: Ayedas on the Asian side of Istanbul, Baskent in the Ankara region and Toroslar in the southern part of Turkey in Adana and Gaziantep.

Summary of Financial Adjustments

Fitch EBITDA and FFO includes cash effective capital expenditures and WACC reimbursements related to service concession arrangements.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Baskent	Natl LT	AA+(tur)	Affirmed		AA+(tur)

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Elektrik Dagitim A.S.					
	Natl LT	WD(tur)	Withdrawn		AA+(tur)
Enerjisa Enerji A.S.	Natl LT	AA+(tur)	Affirmed		AA+(tur)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.15 Oct 2021) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub.01 Dec 2021)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

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