RATING ACTION COMMENTARY

Fitch Downgrades Enerjisa to 'AA(tur)'; Outlook Negative

Thu 23 Nov, 2023 - 12:12 PM ET

Fitch Ratings - Dubai - 23 Nov 2023: Fitch Ratings has downgraded Enerjisa Enerji A.S.'s (Enerjisa) National Long-Term Rating to 'AA(tur)' from 'AA+(tur)'. The Outlook is Negative.

The downgrade reflects Enerjisa's decreased financial flexibility, following much higher rates for new bonds, combined with a high share of short-term debt. It also reflects rising net debt to fund capex above the regulatory allowance, for which returns are delayed.

The Negative Outlook mirrors high rates on new debt leading to deterioration of funds from operations (FFO) interest coverage to below our negative sensitivity of 2x in 2024-2025, and the need to finance large negative free cash flow (FCF) in 2024-2026.

Enerjisa's rating is constrained by the liquidity risk related to its short-term debt maturity profile and reliance on continued access to domestic funding. Rating strengths are predictable regulated earnings in the distribution segment, moderate leverage and low foreign exchange (FX) risk.

KEY RATING DRIVERS

Higher Cost of New Debt: In 2023 Enerjisa placed around TRY17 billion of new bonds, mostly with a two-year tenor, becoming one of the largest borrowers on the local capital market. Interest rates on new bonds have risen sharply to 48%-49.5% in 4Q23, compared with 33% in 1Q23. Higher interest rates followed several key rate hikes by the Central Bank of Turkiye and imposed restrictions on bank lending to largest corporates, which despite some of them having been lifted recently limited alternative funding sources for Enerjisa.

Deteriorating Interest Coverage: We forecast that increased cost of new debt will drive cash interest costs higher to TRY13 billion-TRY14 billion in 2024-2025, 3x the levels in 2022. As a result, we expect FFO interest coverage to fall below our negative sensitivity of 2x in 2024-2025.

Net Debt Rising: Fitch-calculated net debt increased to TRY21 billion at end-3Q23, including short-term debt of around TRY14 billion, up from TRY11 billion at end-2022. Enerjisa was raising new debt not only for refinancing, but also to fund capex increase above the regulatory allowance to lock in regulatory returns in times of high inflation. Return on investments within the regulatory allowance starts next year, while investments above the allowance will be remunerated in the new regulatory period from 2026.

Capex-Driven Negative FCF: Enerjisa expects capex to increase to an average TRY20 billion annually over 2023-2026 from TRY6 billion in 2022, mostly in the distribution segment. We expect these investments to generate healthy returns based on real weighted average cost of capital (WACC) of 12.3%. However, negative FCF may further increase pressure on Enerjisa's liquidity.

Moderate Leverage: We forecast FFO net leverage to gradually rise to 2.6x in 2026 from 1.6x in 2023 and 0.9x in 2022. This is backed by healthy EBITDA on average of around TRY21 billion over 2023-2026, which is driven by

financial income and capex reimbursement, and income from efficiency incentives. However, we expect FCF to be negative at an average of TRY13 billion over 2023-2026 on working-capital (WC) outflow, capex and dividends.

WC Stabilises: WC outflow for 9M23 amounted to TRY0.7 billion (5% of Fitch-calculated EBITDA) versus TRY7 billion in 9M22 (74% of Fitch-calculated EBITDA). The improvement was a result of regulatory support measures in the supply segment and stabilisation of merchant prices from June 2023. Enerjisa expects WC to worsen in 4Q23 due to insufficient tariff increases in retail activities. The company forecasts that new support measures by the regulator, including the sale of electricity by government-owned electricity generation company EUAS to retail companies at below-market prices, will mitigate WC outflows.

Stable Distribution Business: Enerjisa's electricity distribution remains fairly transparent and stable and therefore supportive of ratings. Distribution fees increased 2.3x from January 2023 and by a further 10% from July 2023. The key parameters set for the fourth regulatory period of 2021-2025, such as regulatory asset base (RAB) methodology, real WACC of 12.3%, a 10-year reimbursement period and efficiency incentives, continue to support profitability. In 4Q23 the regulator announced higher operating spending (opex) limits, which will enable Enerjisa to overcome opex underperformance caused by high inflation.

Low FX Risks: Enerjisa's debt is denominated in Turkish lira, which protects the company from risks of lira depreciation. We view the low FX exposure as positive for the rating compared with many Turkish corporate peers.

DERIVATION SUMMARY

Enerjisa's 'AA(tur)' National Long-Term Rating balances limited financial flexibility and challenging funding conditions with reasonable earnings visibility, supportive regulation, low FX risks and proven access to domestic funding. Among the peers rated on a national scale, Arcelik A.S. (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 FCF through the cycle and good liquidity. Turk Telekomunicasyon A.S. (AAA(tur)/Stable), an incumbent fixed-line operator, benefits from large-scale operations and a strong financial profile.

Compared with western European networks, Enerjisa benefits from an attractive regulated rate of allowed return (real WACC of 12.3%) and a shorter principal payback period of 10 years. However, we view electricity distribution companies in Turkiye as higher risk, due to the lack of ownership of infrastructure assets and treatment of investments in the grid as financial assets.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer are as follows:

- Average interest rate for new debt at 40% in 2023, 45% in 2024 and 30% in 2025

- Real returns on RAB in the regulatory period 2021-2025 at 12.3%

- Average inflation of 52% in 2023-2024 and 35% in 2025

- Annual capex on average at TRY14 billion over 2023-2026, which is below management estimates

- Dividends on average of TRY4 billion annually over 2023-2026

- Regulated gross profit margins for regulated customers at 7%-8% over 2023-2026

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Due to the Negative Outlook, an upgrade is unlikely. However, improvement in FFO interest coverage above 2x by 2025, either due to stronger-than-expected operating performance or lower cost of new debt, together with stable WC and a reduction in the share of short-term debt, would lead to the Outlook being revised to Stable

Factors That Could, Individually or Collectively, Lead to Downgrade:

- Weaker access to bank and bond-market funding

- FFO net leverage above 4x and FFO interest coverage below 2x, both on a sustained basis

- WC outflow in the supply segment leading to an accelerated increase in short-term debt

- Adverse regulation effects including delays in recoveries of investments

- Large unhedged foreign-currency debt exposure

LIQUIDITY AND DEBT STRUCTURE

Liquidity Risk: We continue to view liquidity and debt management as rating constraints. At end-3Q23, Enerjisa had cash and deposits of around TRY9.1 billion, which was insufficient to cover short-term debt of TRY14 billion and Fitch-expected negative FCF in the next 12 months.

Tapping Local Capital Markets: In October 2023, Enerjisa issued bonds of TRY2.6 billion at 49.5% with a two-year maturity and green bonds of TRY2 billion at 48% with a 15-month maturity. To fund the liquidity gap, Enerjisa plans to continue placing bonds on the Turkish bond market and to resume raising loans in Turkish banks on an uncommitted basis. The company is also in the process of attracting loans from international financial institutions and developmental financial institutions.

ISSUER PROFILE

Enerjisa is a large electricity distribution and supply company in Turkiye with around a 25% market share in distribution connections and 22% in the number of retail customers.

SUMMARY OF FINANCIAL ADJUSTMENTS

Fitch-calculated EBITDA and FFO include cash-effective capex and WACC reimbursements related to service concession arrangements, and exclude financial income accrued but not yet paid.

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation of the materiality and relevance of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Enerjisa Enerji A.S.	Natl LT	AA(tur) Rating Outlook Negative	Downgrade	AA+(tur) Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Dmitry Doronin, CFA
Director
Primary Rating Analyst
+971 4 424 1246
dmitry.doronin@fitchratings.com
Fitch Ratings Ltd
Dubai Branch Maze Tower, 18th Floor Sheikh Zayed Road, P.O. Box 215584, Dubai

Katarzyna Sulek
Senior Analyst
Secondary Rating Analyst
+48 22 103 3032
katarzyna.sulek@fitchratings.com

Arkadiusz Wicik, CFA
Senior Director
Committee Chairperson
+48 22 103 3016
arkadiusz.wicik@fitchratings.com

MEDIA CONTACTS

Isobel Burke
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Enerjisa Enerji A.S.	-

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit

ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Copyright © 2023 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.