



RATING ACTION COMMENTARY

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

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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**

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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)

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Enerjisa Enerji A.S. -

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