FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Enerjisa's Outlook to Stable, Affirms at 'A(tur)'

Mon 18 Nov, 2024 - 11:22 AM ET

Fitch Ratings - Dubai - 18 Nov 2024: Fitch Ratings has revised Enerjisa Enerji A.S.'s (Enerjisa) Outlook to Stable from Negative, while affirming its National Long-Term Rating at 'A(tur)'.

The revision of the Outlook reflects our expectations of inflation moderation and expected policy rate cuts in Turkiye from 2025, which should reduce borrowing costs for Enerjisa, and improve its funds from operations (FFO) interest coverage and currently tight liquidity. Weak FFO interest coverage ratio (1.5x over 2023-2025) is the main constraint for the rating, but we view it as temporary. The rating is also constrained by the liquidity risk related to the short-term debt maturity profile and reliance on continued access to domestic funding.

Enerjisa's rating benefits from moderate leverage, low FX risk, good network quality, solid operating performance and some geographical diversification across Turkiye. It also incorporates regulated distribution revenues under a regulatory framework of investment renumeration and insulation from price and volume risk, although the framework is prone to social or political pressure that could lead to revenue underperformance and cash flow volatility, particularly in periods of high inflation.

KEY RATING DRIVERS

Expected Improvement in Financial Flexibility: Fitch expects that inflation in Turkiye will moderate to 43% at end-2024 and 21% at end-2025 from a 2024 peak of 75% in May 2024. We also expect policy rate cuts to 27.5% by end-2025 and to 21% by end-2026 from 50% at end-October 2024. In Fitch's view, this should reduce Enerjisa's borrowing costs and improve its FFO interest coverage above 2x from 2026. Lower interest expenses should also reduce the liquidity gap.

Moderate Leverage, Negative FCF: We forecast FFO net leverage to average slightly below 2x over 2024-2026, which is strong for the rating. We expect distribution tariffs to rise broadly with inflation from 2025, driving operating cash flow to around TRY11.5 billion per year on average for 2024-2026. However, we forecast free cash flow (FCF) to remain negative at an average of TRY13 billion over 2024-2026 on working-capital (WC) outflow, capex and dividends.

High Cost of New Debt: To date in 2024, Enerjisa has placed around TRY18 billion of new bonds, mostly under a floating rate linked to the key policy rate (now at 50%) plus 1%-4.75% spread with a two-year tenor. This is significantly higher than the average borrowing rate of 38% in 2023. Enerjisa plans to continue placing floating-rate bonds to refinance fixed-rate debt to take advantage from the expected reduction of interest rates. We forecast interest coverage to remain temporarily weak for the rating at 1.5x over 2024-2025 (1.5x in 2023), but to improve to above 2x in 2026 and close to 3x in 2027, driven by expected policy rate cuts from 2025.

WC Outflows: WC outflow for 9M24 was around TRY3 billion (14% of Fitch-calculated EBITDA) versus an outflow of 30% of Fitch-calculated EBITDA in 2023 and 19% in 2022. This was due to a combination of regulatory support measures in the supply segment for regulated volumes, stabilisation of merchant prices, 59% distribution fee increase from July 2024, but also the remaining tariff burden in the distribution segment due to insufficient accumulated tariffs indexation to match inflation in recent years.

We forecast limited working capital outflow from 2025, averaging 6% of EBITDA per year, driven by our expectations that distribution tariffs will rise broadly in line with inflation and lack of large tariff mismatch in the supply segment.

Regulatory Framework with Long Record: Distribution tariffs in Turkiye have been based on the regulated asset base (RAB) since 2006. The key parameters for the fourth regulatory period of 2021-2025, such as RAB, real weighted average cost of capital (WACC) of 12.3%, a 10-year reimbursement period and efficiency incentives, support profitability. Tariffs are protected from volume and inflation risks. Any deviation of actual results from projected figures is corrected via tariffs with a moderate lag, along with adjustments to compensate for the lag itself.

Regulatory Weaknesses: The regulatory framework in Turkiye has weaknesses, some of which have emerged since 2022 on the back of accelerating inflation and macroeconomic turbulence. These include delayed and insufficient tariff increases, or mismatch between supply tariffs and electricity purchase costs, creating tariff deficits. Regulatory decisions can be influenced by social and political reasons to cap utility bill growth.

Growing Customer Solutions Business: Customer solutions segment, the fastest growing one for Enerjisa, accounted for 7% of Fitch-calculated EBITDA in 2023 and 8% in 9M24. This segment mainly includes installation of renewable capacities and efficiency projects, and development of network of charging stations for electric vehicles. Operating cash flow for the segment remains negative due to working capital outflows. However, we expect operating outflows to decrease gradually and the contribution of this segment to rise.

Low FX Risks: Enerjisa's debt is Turkish lira-denominated, 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 'A(tur)' National Long-Term Rating balances limited financial flexibility and tight liquidity with mostly regulated revenue, low FX risks and proven access to domestic funding. Among the peers rated on the national scale, Arcelik A.S. (AAA(tur)/Negative), 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, similarly to Enerjisa, has relatively weak coverage metrics, but has positive FCF through the cycle and negative net debt. Turk Telekomunikasyon A.S. (AAA(tur)/Stable), an incumbent fixed-line operator, benefits from large scale and a strong financial profile.

Compared with its electricity distribution sector peer in Turkiye, GDZ Elektrik Dagitim Anonim Sirketi (GDZ, Long-Term IDR of 'BB-'/Stable), Enerjisa is larger and more geographically diversified within the country. However, this is balanced by Enerjisa's exposure to the supply business which brings additional volatility at times of macroeconomic turbulence. Enerjisa has also considerably weaker interest coverage than GDZ but lower FX risk.

Compared with European networks, Enerjisa benefits from an attractive regulated rate of allowed return (real WACC of 12.3%), a shorter principal payback period of 10 years and also lower leverage. However, we consider electricity distribution companies in Turkiye as higher-risk, due to some regulatory weaknesses, like delayed and insufficient tariff increases or regulatory decisions being influenced by social and political reasons to cap utility bill growth.

KEY ASSUMPTIONS

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

- Average inflation of 59% in 2024, 31% in 2025 and 19% in 2026-2027

- Average interest rate for new debt at 51% in 2024, 37.5% in 2025, 24.5% in 2026 and 19% in 2027

- Distribution fee increase of 59% from July 2024 and in line with inflation from 2025

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

- Annual capex on average at TRY20 billion over 2024-2026

- Dividends on average of TRY4 billion annually over 2024-2026

- Lack of large working capital outflows in the supply segment

RATING SENSITIVITIES

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

- Improvement in FFO interest coverage above 2.3x, together with maintaining FFO net leverage below 4.5x, both on a sustained basis

- Improvement in liquidity position and debt maturity profile, with lower reliance on short-term debt

- Greater stability of the regulatory framework, as manifested in consistent tariff adjustments as foreseen by regulation and reduced working capital outflows

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Weaker access to bank and bond-market funding

- FFO net leverage above 5.5x and FFO interest coverage below 1.7x, both on a sustained basis

- WC outflow 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

Tight Liquidity: We continue to view liquidity and debt management as rating constraints. At end-3Q24, Enerjisa had cash and deposits of TRY8.6 billion and an unused credit line of TRY3.4 billion (USD100 million equivalent), which was insufficient to cover short-term debt of TRY29.2 billion and Fitch-expected negative FCF over 4Q24-2025 of around TRY20 billion.

Reliance on Local Capital Markets: At end-3Q24, Enerjisa's debt comprised mostly local bonds (TRY30.9 billion) and bank loans (TRY15.9 billion). In October-November 2024, Enerjisa issued bonds of TRY4.4 billion at key policy rate + 1% with a two-year maturity. To fund the liquidity gap, Enerjisa plans to continue placing bonds on the Turkish bond market. It also negotiates loans in Turkish banks on an uncommitted basis and from international financial institutions.

ISSUER PROFILE

Enerjisa is a large electricity distribution and supply company in Turkiye with around a 26% 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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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 on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Enerjisa Enerji A.S.	Natl LT	A(tur) Rating Outlook Stable	Affirmed	A(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

Yiying Ding
Senior Analyst
Secondary Rating Analyst
+86 21 6898 7986
yiying.ding@fitchratings.com

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

MEDIA CONTACTS

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.pinnington-mannan@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. 23 Dec 2020)

Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 22 Jun 2024)

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

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. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

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. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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.

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.