FITCH AFFIRMS ENERJISA ENERJI A.S. AT 'AA(TUR)'; OUTLOOK STABLE

Fitch Ratings-London-10 July 2017: Fitch Ratings has affirmed Turkish utilities company Enerjisa Enerji A.S.' (Enerjisa; previously Enerjisa Elektrik Dagitim A.S. (EEDAS)) National Long-Term Rating at 'AA(tur)' with a Stable Outlook.

The affirmation reflects our expectation that Enerjisa, which merged with its subsidiary EEDAS, will carve-out its generation and trading division during 2017 and will keep the three distribution networks and associated sales companies that were previously directly owned by EEDAS.

The rating is supported by the regulated nature of a large part of Enerjisa's operations, favourable market reforms, the group's predictable operating cash flows and experienced shareholders. Following the carve-out of the generation and trading business about a quarter of Enerjisa's earnings will come from the retail and supply division, supported by the sector's transition to a liberalised market, and the remaining share will be generated by regulated distribution activities.

KEY RATING DRIVERS

Neutral Impact from Restructuring: In April 2017 EEDAS merged with its shareholder Enerjisa. EEDAS was dissolved and Enerjisa is the rated entity. Enerjisa consists of the generation and trading division and the old EEDAS divisions comprising three distribution and sales companies. Enerjisa will carve-out of the generation and trading division by end-2017; however the divisions will continue as a different business unit separately owned by the same shareholders. As a result, Enerjisa's post-restructuring business profile is expected to replicate that of EEDAS. The rating reflects Enerjisa's profile post- restructuring. However, Enerjisa's consolidated profile had already been a determining factor of EEDAS's rating as Fitch does not consider there to be effective ring-fences within Enerjisa.

Consolidated Approach: Enerjisa's management takes a top-down approach to cash flow within the group by diverting funds from cash-generating subsidiaries to capital-intensive parts of the business through inter-company loans and dividends. There are no upstream guarantees within the group; however, based on management commonalities and a centralised approach to treasury and funding Fitch does not consider there to be effective ring-fences within the group and assesses Enerjisa and its subsidiaries as consolidated entities.

Structural Subordination: Despite the consolidated approach to Enerjisa's rating we view its creditors as structurally subordinated to the creditors of the group's subsidiaries. This is reflected in our recovery assumptions and any instrument rating. This assessment is in line with Fitch's view that in instances where there are multiple operating entities Fitch evaluates the claims at the entity level and judges that the creditors of the parent have access to only residual cash flows

No Uplift for Shareholder Support: Enerjisa is owned by Haci Omer Sabanci Holding A.S. (50%) and indirectly by E.ON S.E. (50%, BBB+/Stable) and the ownership will not change post restructuring. Fitch does not provide any notching uplift for shareholder support due to weak linkages but highlights that the strong reputation and experience of both E.ON and Sabanci provide Enerjisa with ready access to capital markets, and operational knowledge.

Returns Driven by Investments: Regulated earnings are driven by return allowed on the distribution network investments and capex reimbursements but also incentives and outperformance of regulatory targets. It is unclear how regulation will treat maintenance and repair capex once capex requirements slow, as these costs are not remunerated by any additional allowed return. However, the Turkish distribution infrastructure requires investment and the high investment cycle is likely to continue well into the next decade.

Retail Market Liberalisation: The liberalised market should allow Enerjisa to increase earnings and achieve larger margins by optimising its sourcing costs and by increasing its customer base and its market share.

The retail market has historically been regulated, with a 2.38% gross mark-up margin on sourcing costs allowed on top of revenue for covering operating expenses and collection risk, but it has recently started to be liberalised, with 12TWh (around 33%) of volumes now sold to corporates and households. Full liberalisation of the market is expected by 2021.

DERIVATION SUMMARY

Enerjisa is characterised by more predictable earnings compared with other rated corporate issuers in Turkey but also by high investment requirements in the near term. Fitch views the current regulatory regime as favourable for investments; however, uncertainty remains over profitability once capex slows down after the current regulatory period which ends in 2020. No country-ceiling or operating environment aspect impacts the rating; however, based on the parent and subsidiary linkage analysis Fitch rates Enerjisa and its subsidiaries on a consolidated basis.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
-The carve-out of the generation and trading business during 2017;
-Slow decline in inflation to 7.4% in 2020 from 8% in 2016;
-Allowed weighted average cost of capital of 11.91% (pre-tax, real) for the third regulatory period (2016-2020);
-Supply volume growth of 3% CAGR (vs. management assumption of 6%), leading to lower EBITDA.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
-FFO adjusted net leverage below 3.0x, and FFO fixed charge cover above 3.0x, all on a sustained basis.
-Better clarity on regulation after high-intensity investment ends.

-Improvement in liquidity and debt maturity profile.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

-FFO adjusted net leverage above 4.0x, and FFO fixed charge cover below 2.0x, all on a sustained basis.

-Adverse regulation effects including delays to recoveries of investments.

-Adverse developments in the process of the retail market liberalisation.

-Deterioration in available liquidity.

-Unhedged foreign currency debt exposure.

LIQUIDITY

We view liquidity and debt management as rating constraints. Enerjisa maintains a minimum cash balance. We forecast neutral to negative free cash flow for 2016-2018. There are no committed facilities because the Turkish market operates on spot / overnight loans, which are utilised without any security or obligations from shareholders and there are no fees charged, since the amounts are not committed. Funding sources are well-diversified, and Enerjisa has a solid track record of utilising these credit lines. Forex exposure is limited since Enerjisa's debt is mostly denominated in TRY.

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Additional information is available on www.fitchratings.com. For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
https://www.fitchratings.com/site/re/895493
National Scale Ratings Criteria (pub. 07 Mar 2017)
https://www.fitchratings.com/site/re/895106
Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016)
https://www.fitchratings.com/site/re/886557