

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.

Contact:

Principal Analyst

Siddharth Singh

Analyst

+44 20 3530 1565

Supervisory Analyst

Ana Gaspar

Director

+44 20 3530 1601

Fitch Ratings Limited

30 North Colonnade

London E14 5GN

Committee Chairperson

Angelina Valavina

Senior Director

+44 20 3530 1314

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

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>

ALL 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](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. 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](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2017 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. 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 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