FITCH AFFIRMS BASKENT AND ENERJISA AT 'AA(TUR)'; OUTLOOKS STABLE

Fitch Ratings-London-18 January 2019: Fitch Ratings has affirmed the National Long-Term Ratings of Turkish utilities company Enerjisa Enerji A.S. (Enerjisa) and one of its main electricity distribution subsidiaries, Baskent Elektrik Dagitim A.S. (Baskent) at 'AA(tur)' with Stable Outlooks.

Enerjisa and Baskent benefit from a majority of regulated earnings, with 13.6% real returns and revenues linked to inflation and visibility until the end of 2020. Both companies have limited FX exposure, which in the current Turkish economic environment represents a relative strength compared with many local corporates. In addition, both companies benefit from cash flow flexibility as capex can be managed within the five-year regulatory period. However, we expect slightly increased leverage due to capex and working capital outflow and weak coverage reflecting the higher cost of debt. We rate Enerjisa and Baskent on a consolidated basis.

KEY RATING DRIVERS
Liquidity Management: Enerjisa continued to access required funds during 2018 through loans and bonds but also some additional measures. The company managed cash flows by timing its investments, over which it had some flexibility due to the early execution of projects in the current regulatory period (2016-2020). In addition, the companies managed liquidity within the Enerjisa group though inter-company loans. A small portion of the financing needs were procured through the wider Sabanci group, by borrowing at arm's length from companies outside Enerjisa. However, all these loans were repaid during 2018. External bank funding also remains open to the company.

Weaker Working Capital: We expect retail to grow at a slower pace due to a delay in liberalisation leading to negative changes in working capital mainly due to a different sourcing mix and higher unit costs. The transfer of customers from regulated to liberalised tariffs was slower than previously anticipated. This should be reversed after 2021 as more customers are likely to switch to liberalised tariffs over time. The improvement in working capital will also be dependent on future sourcing costs, overall wholesale power prices and the actual commodity prices in Turkish lira.

Healthy Performance: Enerjisa performed well in its first three years of the current regulatory period of 2016-2020 (RP3), due to higher than expected investments. The company has increased its capex projection for RP3 based on expansion needs. Fitch maintains a more conservative view on growth, but we also assume more investments than the original amount allowed by the regulator at the start of RP3. With the majority of investments spent at the beginning of the period, leading to steeper growth of the regulatory asset base (RAB), we expect over investments to start in 2019 for which reimbursements will be paid in the next regulatory period from 2021 onwards.

Weak Coverage: We forecast negative free cash flow (FCF) for the next five years, under the assumption that the regulator will delay the recovery of over investments from RP3, while the company will continue to invest and also pay dividends (subject to net debt to EBITDA remaining below 3.5x), leaving funds from operations (FFO) net adjusted leverage between 3x-4x, still commensurate with the ratings. This partly offsets weak fixed charge coverage below 2x as we expect the cost of debt to remain elevated. With higher cash flows from 2021, we only expect a material decrease in FFO adjusted net leverage to 2.2x after then.

Limited Forex Risk: Enerjisa's debt is denominated in Turkish lira with the exception of EUR62 million (5% of total debt) in legacy EIB and World Bank loans, for which the exposure is hedged on a yearly basis. Enerjisa and its subsidiaries, including Baskent, have also accessed some foreign currency loans on the Turkish market. However, this exposure is fully hedged at the time of the loan use. We view the limited forex exposure as positive for the rating compared with corporate peers in Turkey. However, we see some interest rate risk, particularly since debt maturities are fairly short term.

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 would be reflected in our recovery assumptions and any instrument rating. This assessment is in line with Fitch's view that when there are multiple operating entities, Fitch evaluates the claims at the entity level and views only residual cash flows as being available to the parent's creditors.

DERIVATION SUMMARY
Compared with other regulated peers, Baskent and Enerjisa benefit from an attractive regulated rate of allowed return and a shorter principal payback period of 10 years. However, compared with other European networks we consider electricity distribution companies in Turkey to be riskier, due to the fact that the companies do not own the infrastructure assets and investments in the grid are treated as financial assets. In the context of Turkish peers, we assess Baskent and Enerjisa as relatively strong due to limited forex exposure and the well diversified liquidity lines as well as better earning visibility.

KEY ASSUMPTIONS
Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Investment of TRY 5.6 billion for Enejisa and TRY2.4 billion for Baskent for 2019 to 2023
- We assume some churning and demand efficiency leading to declining volumes in the retail business, but at improving margins
- Average achieved interest rates of 20-25% between 2019-2023
- Working capital to be negatively impacted by the sourcing mix and higher costs mainly due to the slower transition to liberalised customers
- Dividend pay-out ratio of 60-70%

RATING SENSITIVITIES
Enerjisa
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, both on a sustained basis
- Better clarity on regulation after high-intensity investment ends
- Improvement in liquidity position and debt maturity profile.

Developments That May, Individually or Collectively, Lead to Negative Rating Action
- FFO adjusted leverage above 4.0x and FFO fixed charge cover below 2.0x, both on a sustained basis
- Any adverse regulation effects including delays in recoveries of investments.
- Adverse developments in the process of the retail market liberalisation
- Deterioration in available liquidity
- Unhedged foreign currency debt exposure

Baskent
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, both on a sustained basis
- Better clarity on regulation after the capital-intensive investment ends
- Improvement in liquidity position and debt maturity profile

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, both on a sustained basis
- Adverse regulation effects including delays in recoveries of investments
- Weakening of available liquidity
- Unhedged foreign currency debt exposure

LIQUIDITY

We view liquidity and debt management as rating constraints. Enerjisa and Baskent maintains minimum cash balance (TRY175 million and TRY8 million, respectively as of FYE17) and the average tenor of total debt is under three years. We forecast neutral to negative FCF for 2018-2023. 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. However funding sources are well-diversified, and Enerjisa and Baskent have a solid track record of utilising these credit lines.

As of November 2018 Enerjisa had available uncommitted credit lines of TRY11.4 billion and Baskent of TRY2.6 billion from various local banks.

Forex exposure is limited since the companies' debt is mostly denominated in Turkish lira (around 85% of total debt) and US dollar and euro-denominated loans are fully converted to Turkish lira with the exception of EUR62 million loans which are hedged on a yearly basis.

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Summary of Financial Statement Adjustments:
Net collections from financial assets related to the service concession arrangements are treated as part of FFO and added to EBITDA.

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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
Corporate Rating Criteria (pub. 23 Mar 2018)

https://www.fitchratings.com/site/re/10023785
National Scale Ratings Criteria (pub. 18 Jul 2018)
https://www.fitchratings.com/site/re/10038626
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)
https://www.fitchratings.com/site/re/10036366