Fitch Affirms ENEA at 'BBB'; Outlook Stable

Fitch Ratings— Warsaw/London —30 April 2014: Fitch Ratings has affirmed Poland-based ENEA S.A.'s Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB' and National Long-term rating at 'A(pol)' with Stable Outlooks.

The affirmation reflects a high share of the regulated distribution business in ENEA's EBITDA, which contributes to cash flow predictability and stabilises cash flows at a time when another key segment, power generation, is under pressure. The ratings reflect a balance of risks between a fairly stable regulated distribution segment and a generation business with a challenging operating environment and high asset concentration. We project that due to large capex plan, ENEA's funds from operations (FFO) adjusted net leverage will increase to about 3x in 2017-2018 from a net cash position of PLN1bn in 2013. We view net leverage of 3x as a maximum level for the current ratings.

KEY RATING DRIVERS

Predictable Regulated Business

ENEA's ratings continue to benefit from the high share of predictable, regulated electricity distribution in EBITDA (50% in 2013). ENEA's growing EBITDA of the regulated power distribution segment allowed the group to post a 5% increase in total EBITDA in 2013, despite weaker cash flows in the power generation segment. We expect the share of regulated distribution in EBITDA to be around 50%-60% in the medium term.

Challenged Generation Business

We expect ENEA’s generation business (31% of 2013 EBITDA) to remain under cash flow pressure in 2014-2016, mainly due to low wholesale electricity prices and decreasing volumes of free CO2 allowances allocated to the company. The segment’s weak underlying cash flow will be supported in 2014 by compensation of up to PLN200m for the termination of long-term power purchase agreements.

ENEA's business profile is constrained by the group's limited generation fuel mix diversification (96% of capacity based on coal) and high asset concentration in power generation with the Kozienice coal-fired plant accounting for 91% of 2013 generation capacity. Given its coal-fired generation fleet, ENEA has substantial exposure to carbon dioxide costs which, however, is mitigated by the gradual phasing-out of free CO2 allowances in 2013-2020.

Financial Leverage to Increase

ENEA's large capex plan for 2014-2018, mostly related to the construction of a new 1GW unit in the Kozienice plant and the distribution segment, will result in negative free cash flow in this period and considerable debt funding requirements. This is likely to increase FFO adjusted net leverage to about 3x in 2017-2018, according to Fitch's projections, from a net cash position of PLN1bn in 2013. We view net leverage of 3x as a maximum level for the current ratings.

Large Capex
ENEA's capex plan for 2014-2020 amounts to PLN20bn, of which PLN11.8bn relates to core capex for conventional power generation (including Kozienice expansion) and the distribution segment, while PLN7.7bn is allocated to additional investments in new projects in renewables and cogeneration of heat and power. We understand that management has flexibility on the PLN7.7bn for additional investments, depending on cash flow generation and the company's leverage ratio. Our rating case projections assume that ENEA will spend capex of about PLN11bn in 2014-2018.

Rated on a Standalone Basis
ENEA is 51.5%-owned by the Polish state (A-/Stable), but Fitch rates it on a standalone basis with no state support factored in, as the company operates on a wholly commercial basis and we assess legal, operational and strategic links with the state as moderate in line with the Parent and Subsidiary Rating Linkage criteria.

RATING SENSITIVITIES

Rating upside potential for ENEA is limited. However, future developments that could lead to positive rating actions include successful implementation of the capex plan leading to a more diversified asset base without jeopardising the financial profile. Implementation of cost reductions could also be positive.

Negative: Future developments that could lead to negative rating action include:
- Increase in FFO adjusted net leverage to above 3x on a sustained basis – for example, due to full implementation of the PLN20bn capex plan in a scenario of low operating cash flows

LIQUIDITY & DEBT STRUCTURE

ENEA's liquidity was strong at end-2013, with PLN1.8bn of unrestricted cash and equivalents as well as PLN4.7bn of committed funding in form of the PLN4bn bond issue programme fully underwritten by banks and bank loans. This compares with short-term debt of PLN26m and negative free cash flow of about PLN2bn projected by Fitch for 2014.

Contact:

Principal Analyst
Artur Galbarczyk
Associate Director
+48 22 338 6291

Supervisory Analyst
Arkadiusz Wicik
Senior Director
+48 22 338 6286
Fitch Polska S.A.
Krolewska 16
00-103 Warsaw

Committee Chair
Angelina Valavina
Senior Director
+44 20 3530 1314

Additional information is available on www.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, 'Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage', dated 5 August 2013, are available at www.fitchratings.com.

Related Research: