



Tagging Info

Fitch Affirms Poland's Energa at 'BBB'; Outlook Stable Ratings Endorsement Policy
10 Oct 2013 12:38 PM (EDT)

Fitch Ratings-Warsaw/London-10 October 2013: Fitch Ratings has affirmed Energa S.A.'s Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB' with a Stable Outlook. A full list of rating actions is provided at the end of this rating action commentary.

The affirmation reflects a high share of the regulated distribution business in Energa's EBITDA, which contributes to cash flow predictability. It also reflects the company's progress in arranging external funding for capex and its ample liquidity. We project Energa's financial leverage (defined as funds from operations (FFO) adjusted net leverage) to increase to 2x by end-2013 from 1x at end-2012 due to capex and acquisitions. We expect leverage to increase further to close to 3x in 2015 which we see as the maximum level commensurate with the current rating.

KEY RATING DRIVERS

Distribution Supports Credit Profile

Energa's credit profile is strengthened by a continued increase in the contribution of regulated earnings to EBITDA to 70% in 2012, from 59% in 2011. The increase was driven by implementation of its capex plan in networks and a gradually rising return on the regulatory asset base (RAB), following the asset revaluation in 2010. We expect the share of regulated earnings to remain around 70% in the medium term, contributing to cash flow visibility.

Supportive Regulatory Framework; some Weaknesses

Fitch views the regulatory framework for Polish distribution networks as supportive and stable. However, it has several weaknesses compared with regulatory frameworks in western European countries. These include the lack of a multi-year tariff-setting mechanism and the return on RAB not yet fully reflecting the fair value of assets despite the progress made in this regard in the past three years. Additional weaknesses include a gap between operating costs and costs approved by the regulator, which nevertheless narrowed in 2010-2012, and volume risk within the framework.

Possible Upgrade of Senior Unsecured Rating

The abovementioned regulatory shortcomings do not warrant a one-notch senior unsecured uplift over the Long-term IDR, typically applied for network utilities in developed markets, for Energa. This is despite Energa's proportion of regulated cash flow being well above 50% of EBITDA. However, some of these shortcomings have been addressed by the energy regulatory office as the return on RAB has been gradually increasing since 2010 by up to 1.5% of total regulated revenue per year and the operating expense gap has also substantially narrowed since 2010. Energa expects to achieve the full return on RAB in 2014 which is likely to lead us to incorporate a one-notch senior unsecured uplift over the Long-term IDR for Energa and as a result to upgrade the senior unsecured rating of Energa and notes issued by its finance subsidiary Energa Finance AB (publ) to 'BBB+' from 'BBB'.

Renewables Growth through Acquisitions

In 2013 Energa accelerated the development of its renewables capacity by purchasing together with PGE Polska Grupa Energetyczna S.A. (BBB+/Stable) installed wind capacities of 114MW from Iberdrola, S.A. (BBB+/Rating Watch Negative) and 51MW from DONG Energy A/S (BBB+/Negative). Both transactions, costing PLN2.1bn between Energa and PGE, were finalised in mid-2013. Fitch considers that the transactions are in line with Energa's capex plan.

Credit Metrics to Deteriorate

FFO adjusted net leverage was low at end-2012 at around 1x. However, the ratings incorporate Fitch's projections of an increase in FFO-adjusted net leverage to about 2.5x-3x by 2014-2015 due to large capex. This leverage is commensurate with the current ratings and is broadly in line with projected leverage for other CE utilities rated by Fitch.

Energa's investment plan is focused on the distribution segment and is spread among many smaller projects (capex for a single project does not exceed annual EBITDA), leading to more capex flexibility. The modest size of the project also means the company can defer or cancel capex in case of weaker-than-expected cash flows, which should help it maintain leverage within the rating guideline of up to 3x.

Strong Distribution, Supply Segments

Energa's ratings continue to reflect its partially vertically-integrated operations, although its scale is smaller than that of its Polish peers. Energa also lacks a mining segment and has weaker generation assets. The company has a strong market position in distribution (16.4% in 2012) and supply (16.8% in 2012), but its market share in the generation amounted to only 2.5% in 2012. The group sells to end-customers much more electricity (20.5 TWh in 2012) than it generates (4.1 TWh). This could be viewed as beneficial in the low or falling wholesale power price environment compared with a utility with long generation position. However, Energa is nevertheless exposed to electricity price risk, albeit mitigated by its trading and hedging policy.

Rated on Standalone Basis

Energa is 84.2%-owned by the Polish state (A-/Stable), but Fitch rates it on a standalone basis because we view Energa's links with the state as weak and there is little tangible support from the state. The state will maintain control over Energa after the IPO planned for November/December 2013 as it will own slightly above 50% of the shares. Following recent changes to the company's articles of association (introduction of a 10% voting cap and voting privilege for some of the state's shares) Energa will remain controlled by the government as long as its share in Energa is above 10%.

Progress in Funding

Energa's progress in arranging external debt in 2013 mitigates its funding risk. In March 2013 the company issued eurobonds (EUR500m) and in June and July 2013 Energa also obtained two long-term bank loans from European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD) for PLN1bn and PLN0.8bn, respectively.

RATING SENSITIVITIES

Positive: Future developments that could lead to positive rating actions include:

- The upside potential for Energa's IDRs is limited because credit metrics are due to weaken on capex. Energa's and Energa Finance AB (publ)'s senior unsecured rating may be upgraded to 'BBB+' from 'BBB' in a one-notch uplift over the Long-term IDR if the company achieves full return on RAB, and if at the same time networks remain a dominant earning stream for Energa.

Negative: Future developments that could lead to negative rating action include:

Failure to contain FFO adjusted net leverage below 3x on a sustained basis would result in downward rating pressure.

LIQUIDITY AND DEBT STRUCTURE

At end-June 2013, the company's liquidity was ample as it had cash and equivalents of PLN3.3bn against short-term debt of PLN0.3bn. Debt maturities due within the five-year rating horizon are not significant. The first year of larger debt repayments is 2019 when PLN1.2bn of debt is due.

Negative free cash in 2013-2014 due to large capex is planned to be funded with cash and equivalents on the balance sheet and available committed undrawn medium- and long-term facilities, which stood at PLN2.8bn at the end of July 2013. These facilities include two long-term bank loans from the EIB and EBRD signed in June and July 2013.

Full list of rating actions:

Energa S.A.

Long-term foreign currency IDR affirmed at 'BBB'; Stable Outlook

Long-term local currency IDR affirmed at 'BBB'; Stable Outlook

National Long-term rating affirmed at 'A(pol)'; Stable Outlook

Foreign currency senior unsecured rating affirmed at 'BBB'

Local currency senior unsecured rating affirmed at 'BBB'

National senior unsecured rating affirmed at 'A(pol)'

Energa Finance AB (publ), guaranteed by Energa S.A.

Foreign currency senior unsecured rating affirmed at 'BBB'

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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 Methodology', dated 5 August 2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

Additional Disclosure

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