

Fitch Affirms Poland's ENEA at 'BBB'; Outlook Stable [Ratings](#) [Endorsement Policy](#)

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Fitch Ratings-Warsaw/London-27 April 2015: 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 ratings reflect 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, conventional power generation, is under pressure.

The ratings incorporate a balance of risks between a fairly stable regulated distribution segment and a generation business with a challenging operating environment, limited generation fuel mix diversification with a high reliance on coal and high asset concentration.

The company has currently low indebtedness but we project that due to a large capex plan, ENEA's funds from operations (FFO) net adjusted leverage will increase to about 3x in 2017-2019 from 0.7x in 2014. 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 (61% in 2014). We expect the share of regulated distribution in EBITDA to stabilise around 55%-60% in the medium term, depending on the sustainability of the regulatory income (with risks related to a decreasing weighted average cost of capital (WACC) due to low interest rates) and on the performance of the generation segment.

Challenged Generation Business

We expect ENEA's generation business (37% of 2014 EBITDA), with predominantly coal-fired generation, to remain under cash flow pressure in 2015-2016, mainly due to low wholesale electricity prices, decreasing volumes of free CO2 allowances allocated to the company and a rising share of renewables supported by subsidies in the market. In addition, the compensation scheme for the termination of long-term power purchase agreements concluded for ENEA in 2014, with the final adjustment for compensation likely to be received in 2015. As a result, cash flows in conventional generation will not be supported by the compensation scheme from 2016.

The impact of a challenging conventional generation environment is mitigated by ENEA's ongoing savings programme focused on the generation segment. We do not view the structural change in the Polish generation market to be as rapid and far reaching as in Germany and note that interconnections are also improving only gradually, giving domestic players time to adjust.

Limited Diversification of Generation Sources

ENEA's business profile is constrained by the group's limited generation fuel mix diversification and high asset concentration (over 90% of generation based on coal and produced in the Kozenice coal-fired plant). Given its coal-fired generation fleet, ENEA has substantial exposure to carbon dioxide costs which, however, is mitigated by the free CO2 allowances in Poland, which are nevertheless being gradually phased out in 2013-2020.

Financial Leverage to Increase

ENEA currently has low leverage and large financial headroom in the ratings. However, the company's large capex plan for 2015-2019, mostly related to the construction of a new 1GW unit in the Kozenice plant and the distribution segment, will result in negative free cash flow in this period and a considerable increase in debt. This is likely to increase FFO net adjusted leverage to about 3x in 2017-2019, according to Fitch's projections, from 0.7x in 2014 and a net cash position 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 Kozenice expansion) and the distribution segment, while PLN7.7bn is allocated to new projects in renewables and cogeneration of heat and power. Within this capex ENEA spent PLN2.6bn in 2014 and plans to reach a peak in capex in 2015 (PLN3.6bn). We understand from management that ENEA has flexibility on PLN7.7bn of additional investments, depending on cash flow generation and the level of credit metrics, including financial covenants incorporated in some debt funding agreements.

Our rating case projections assume that ENEA will spend capex of about PLN11.5bn in 2015-2019. Based on our cash flow projections ENEA's discretionary capex plan for renewables would have to be reduced in 2018-2019 for leverage to stay within the 3x threshold.

Cost Savings

ENEA's cost reduction programme mitigates the impact of adverse market conditions in conventional generation on ENEA's cash flows. In 2014 ENEA reduced costs by PLN252m, mostly in generation (PLN133m) and in distribution (PLN102m). The cost reduction programme includes improved utilisation of electricity generation assets and workforce reduction by 4% in 2014 (excluding the acquisition of MPEC Bialystok). In addition, ENEA has streamlined management of various business units across the group and improved qualitative ratios in the distribution segment.

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 rating uplift from state ownership 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.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- No major shifts in wholesale electricity prices within the forecast period
- Recovery in coal prices for ENEA to 2013's levels and around 50% increase in CO2 market price within a five-year rating horizon
- Increased electricity production volumes from mid-2017, due to commissioning of the 1GW Kozienice new block
- Stable distribution and sales volumes
- Capex of around PLN11.5bn in 2015-2019

RATING SENSITIVITIES

Rating upside potential for ENEA is limited given the company's large capex plan and our expectation that FFO net adjusted leverage will increase close to the 3x limit for the ratings in 2017-2019.

However, future developments that could lead to positive rating actions include:

- Stronger-than-expected cash flow generation and/or reduction of the capex plan leading to projected FFO net adjusted leverage below 2x on a sustained basis, supported by management's more conservative leverage target
- A more diversified fuel generation mix and lower CO2 emissions per MWh which, together with continued efficiency improvements, would result in a stronger business profile

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 for 2014-2020 in a scenario of low operating cash flows
- Acquisitions of stakes in coal mines or other form of support for the coal mining sector - which is facing financial difficulties - leading to net leverage above 3x or substantially worsening ENEA's business profile

LIQUIDITY AND DEBT STRUCTURE

ENEA's liquidity was strong at end-2014, with PLN1.2bn of unrestricted cash & equivalents and available credit lines and committed bonds of PLN3.5bn against short-term debt of PLN11m and negative free cash flow of about PLN2bn projected by Fitch for 2015. In addition, in February 2015 the company issued a PLN1bn five-year bond, boosting liquidity.

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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: Including Short-Term Ratings and Parent and Subsidiary Linkage', dated 28 May 2014, 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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