Fitch Ratings

Mr A. Rasim Akdogan
Cinigaz Dogalgaz Dagitim Sanayi ve Ticaret A.S.
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06520 Ankara
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February 13, 2014

Dear Mr Akdogan,

Re: Rating Letter for Cinigaz Dogalgaz Dagitim Sanayi ve Ticaret A.S.

Fitch (see definition below) assigns Cinigaz Dogalgaz Dagitim Sanayi ve Ticaret A.S. (Cinigaz) the following rating:

- National Long-term Rating of 'A(tur)'with a Stable Outlook.

KEY RATING DRIVERS
Predictable Gas Distribution
Cinigaz's rating is supported by the regulated nature of the company's operations. A large part of the company's Fitch-adjusted EBITDA comes from regulated gas distribution characterised by good predictability of cash flow. The company was granted its Natural Gas Distribution Licence for the region of Kütahya in western Turkey by the Turkish Energy Market Regulatory Authority (EMRA) in 2004 for 30 years.

One of the key drivers for Fitch-adjusted EBITDA is the allowed return on the regulatory asset base. On the cost side capex and operating expenditures are approved by EMRA are passed on to customers through tariffs. In addition, subscription fees from new customers connected to the network are also regulated by EMRA. However, Fitch excludes the subscription fees from its adjusted EBITDA and funds from operations (FFO) and treats them as the source for capex co-funding. Regulated gas distribution business usually allows for EBITDA predictability and stability, although historically there was some variation in cash flows, for instance in 2012, related to the pass-through of gas purchase cost to end-customers. We view the price risk within the supply component of the tariff as concerns within the regulatory framework.

Focus on Network Expansion
The main strategic goal of management is to expand the company's distribution network and grow the customer base. Management plans to reinvest free cash flow into the business rather than pay dividends. We expect Cinigaz to benefit in the next few years from the growing demand for gas due to an expanding gas network in the Kutahya region, connections of planned economic zones and also a growing local economy. We view the potential for uncompensated capex overspent as a credit constraint.

Moderate Financial Policy
We assess Cinigaz's financial policy as moderate due to management's focus on organic growth and the policy not to pay dividends as positive free cash flow is retained within the company.

Negative Working Capital
The company has a permanent negative working capital position not covered with cash. Such a situation could lead to a liquidity crunch in case suppliers decide to shorten payment terms. However, in the case of Cinigaz, the negative working capital position has been steady as Turkey's main gas

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supplier BOTAS allows gas distribution companies including Cingaz to pay for gas 15-30 days after the distributors have received cash from end-customers (Cinigaz has trade payables days outstanding to BOTAS of 60-70 days, and trade receivables days outstanding of 30 days).

Improving Fitch-Adjusted Leverage
We project FFO adjusted leverage to improve to about 3.5x in 2013 and to below 3x in 2014 from a high level of 4.7x in 2012. FFO adjusted leverage reflects two main adjustments:
- FFO is reduced by subscription fees received from customers (for instance TL3.9m in 2012) and
- gross adjusted debt is the sum of borrowings and negative working capital not covered with cash (trade payables plus inventory minus trade payables and advances from customers (unearned revenues) plus cash).

Small Scale, Privately-Owned Company
Cinigaz is a small company (2013 preliminary adjusted EBITDA of TL11m or USD6m) compared with Fitch-rated gas distribution peers, albeit its current regulatory framework does not pose significant efficiency challenges that would not be achievable given its scale. The company is owned by its chairman and general manager Rasim Akdogan who owns 81% of the shares. Mr Akdogan also owns construction company Setas A.S., which is Cinigaz's main related party as a contractor for network capex. This results in key man risk and is a constraining factor for the rating. Nevertheless, we do not view the current financial transparency as a limiting factor.

Exposure to FX Risk
The company has a currency mismatch of debt and operating cash flows. This exposes Cinigaz to deterioration in credit metrics if the Turkish lira depreciates significantly in a short period of time. This currency mismatch is often the case for Turkish corporates who borrow in US dollars and do not hedge their position. FX risk has increased from 2013 given that the new transportation tariff is denominated in TL while the previous tariff applicable for 2004-2012 was set in USD. FX risk is mitigated by the company's modest level of US-denominated debt to FFO.

Concentrated Counterparty Risk
Turkish incumbent gas transmission and wholesale trade company BOTAS remains the dominant supplier in Turkey in the wholesale market and is also the main gas supplier to Cinigaz. We do not view this as a constraining factor for the rating given BOTAS's size and diversification of its gas supplies coming mostly from imports.

RATING SENSITIVITIES
Positive: Rating upside is limited. Future developments that may, individually or collectively, lead to positive rating action, if the rating is maintained, include:
- Reduction of FFO adjusted leverage (adjusted for subscription fees and negative working capital) to 1.5x or below on a sustained basis.
- Longer track record of the current regulatory framework resulting in improved predictability of cash flows.

Negative: Future developments that could lead to negative rating actions include:
- FFO adjusted leverage above 4x on a sustained basis.
- Deterioration of regulatory predictability would be negative for Cinigaz's business profile.
- Change in financial policy, for instance an aggressive dividend policy or large debt-funded acquisitions.

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LIQUIDITY AND DEBT STRUCTURE

Negative Working Capital Weights on Liquidity

Liquidity is satisfactory given that at end-December 2013 the company had unrestricted cash of TL13.9m versus short-term debt of TL8.5m. However, the company has a permanent negative working capital position as its trade receivables and inventory are not sufficient to cover trade payables and advance payments from customers. At end-December 2013 cash of TL22.2m was not sufficient to cover negative working capital of TL32.8m. Liquidity adjusted for negative working capital was sufficient if unused bank lines of TL88.1m are taken into consideration.

Debt structure

The company's debt comprises of bank loans in the US dollar (USD7.8m, equivalent of TL16.5m at end-2013). The company does not plan to raise cash in the capital markets at least in the short to medium term.

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A record of the rating has been made in our permanent file. However, you recognize that the rating is not intended for public disclosure and is subject to the provisions with respect to disclosure in the related fee letter.

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We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please contact Arkadiusz Wicik at +48 22 338 62 86 or me at +44 20 3530 1287.

Sincerely,
Fitch
By:

Josef Pospisil
Head of EMEA Utilities and Transport

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