Research Update:

Georgia Global Utilities Outlook Revised To Stable From Positive On Pending Acquisition By FCC Aqualia

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Rating Action Overview

- Georgia Capital (GCAP) plans to sell a 65% stake in Georgia Global Utilities (GGU) to Spanish water utility FCC Aqualia.
- Under the complex transaction, GGU's $250 million bond will be subject to a change-of-control offer. We understand that GGU plans to call the bond after the noncallable period expires in July 2022 to be able to complete the planned spin-off of its renewable assets. Although Aqualia and GCAP have publicly announced their plans to provide liquidity to GGU to repay the bond, the exact terms have yet to be finalized.
- We therefore revised our outlook on GGU to stable from positive, and affirmed our 'B' long-term issuer rating and issue rating on the company.
- The stable outlook reflects our view that the bond will be successfully refinanced with shareholder support and that in the next six-to-12 months, until the transaction is fully completed, uncertainty about GGU's exact liquidity arrangements and eventual capital structure will be largely balanced by potential upside from group support.

Rating Action Rationale

S&P Global Ratings believe that GGU's pending acquisition by Aqualia and the subsequent spin-off of its renewable assets could result in GGU's EBITDA declining. GCAP plans to sell a 65% stake in GGU to Spanish water utility Aqualia. The acquisition is still subject to shareholder approval by the end of January 2022, but the companies expect to close the two-stage transaction by end of third-quarter 2022. In the first stage, shortly after the shareholder meeting and assuming shareholder approval, GCAP will receive $180 million for a 65% stake in GGU, which includes its water and renewable energy assets. In the second stage, GGU will spin off its renewable assets (installed capacity of 91.1 megawatts [MW]), leaving GGU with its water business plus four water-linked hydro-power plants (total installed capacity of 149.1 MW) and increasing Aqualia's share in GGU to 80%. We estimate that this non-cash demerger could result in GGU's annual EBITDA declining by about 15%-20% to Georgian lari (GEL) 130 million-GEL145 million (€35 million–€40 million) from the GEL165 million-GEL175 million we estimate for 2021. Although we understand that GGU plans to spin off renewable assets with their share of debt, we believe that its eventual leverage is uncertain at this stage, since this will depend on the new shareholder's decisions.

Liquidity for GGU's planned bond redemption has yet to be secured. The first stage of the transaction, which the companies expect to complete in February 2022, will trigger a change-of-control event under GGU's $250 million bond. As such, bondholders will have the right to ask for a buyback at 101% of the principal amount plus accrued coupon. We understand that GGU plans to call the bond at 103.875% plus accrued coupon after the non-callable period expires in July 2022, to be able to complete the planned asset spin-off (otherwise restricted in the bond documentation). Considering that the current bond price is above 101%, we believe that bond redemption is likely to materialize after July 2022.

In line with the transaction structure, GCAP and Aqualia have committed to support the expected redemption of the $250 million bond, which will likely be split between the renewable energy business ($95 million) and the water business ($155 million). We understand that the exact terms of such support have yet to be confirmed. In our view, this creates some uncertainty about GGU's liquidity and eventual capital structure. That said, in our base case we assume that the shareholders will stand by their commitment to support the expected bond redemption.

GGU's eventual leverage and capital structure are uncertain at this stage GGU's eventual capital structure and leverage targets have yet to be disclosed and will depend on the new majority shareholder Aqualia. In particular, we will monitor GGU's exposure to foreign exchange risks. GGU's water business generates mostly local currency revenue. Until now, GGU's U.S. dollar-denominated revenue from its renewable electricity business (about 20%-30% in 2021) has served as a natural hedge for GGU's $250 million bond. After the planned demerger of the renewable electricity business and based on our estimates, GGU's revenue from the electricity business could decline by 60%-70% to the equivalent of GEL20 million. Depending on the outcome, we believe that reduced revenue from the dollarized business may increase foreign currency exposure and weigh on the company's stand-alone credit quality.

Potential support from the new shareholder has yet to be determined, but may be positive for the rating. We understand that Aqualia is a large group operating in a stable utility business in Europe, and we believe that its credit quality is likely well above that of GGU. If the deal is successfully completed, GGU will represent a tangible part of Aqualia (up to 10%-15% of consolidated EBITDA by our preliminary estimates). GGU's future role for the Aqualia group and any mechanisms for intragroup support are to be determined after the deal is closed. It is possible that potential extraordinary support to GGU from Aqualia would lead us to incorporate at least one notch of uplift from GGU's SACP in our rating.

Outlook

The stable outlook reflects that we believe GGU will successfully refinance the bond with shareholder support. It also reflects that in the next six-to-12 months, potential pressure to liquidity, credit ratios, and the capital structure will likely be balanced by possible positive momentum coming from potential group support from Aqualia. The outlook also indicates that under our base case GGU will maintain funds from operations (FFO) to debt of 11.5%-17.0% in the next two-to-three years, although this will largely depend on the transaction and on GGU's financial policy under the new shareholding structure.

Downside scenario

We may downgrade GGU if we saw material technical difficulties during the complicated transaction process, which could severely jeopardize the company's liquidity, though it is not part of our base case. We could also downgrade GGU if we revised down our assessment of the company's stand-alone credit profile (SACP) one notch to 'b-' and this is not compensated by Aqualia's support. Such SACP weakening could result from a weaker capital structure, more aggressive financial policy under the new controlling shareholder, or material underperformance of the business. If we consider GGU at least moderately strategic to Aqualia, a weaker SACP of 'b-' would be offset by shareholder support and not lead to downgrade.

Upside scenario

The rating upside for GGU can stem from post-transaction group support or from strengthening of its SACP, provided that GGU's bond redemption goes ahead as planned and GGU doesn't have any significant liquidity gaps within 12 months (corresponding to our assessment of liquidity as less than adequate).

The potential uplift for group support will depend on our post-transaction assessment of GGU's role in the group and Aqualia's commitments and strategy.

In addition, longer term upside for GGU's SACP may materialize if GGU doesn't face any material foreign currency risk and its FFO to debt is consistently above 12% with substantial headroom, for a prolonged period, stemming from solid performance of the remaining water utility and electricity assets. This, in our view, will also depend on GGU's future financial policy under the new shareholder structure.

Company Description

GGU is a Georgian combined utility company, comprising a natural-monopoly water utility business and electricity generation and supply. The water utility segment provides water supply and wastewater services to 1.4 million customers in the capital of Georgia, Tbilisi, and its surrounding area. The company also owns and operates hydro and wind power plants (HPPs and WPPs) with total installed capacity of 240 MW. It posted GEL110 million of revenue in for six months 2021 according to International Financial Reporting Standards (IFRS).

Georgia Capital has been the sole shareholder of GGU. It is an investment holding company whose portfolio includes banking, pharmaceuticals, health care, utilities, real estate, hospitality, property and casualty insurance, and private education. We believe that GGU is relatively autonomous from the parent in its day-to-day operations, strategy, and financial management.

Following the two-stage transaction, which is still pending shareholder approval, Spain-based water utility FCC Aqualia S.A. will own 80% of GGU's business. Aqualia operates in the end-to-end water cycle business, and currently serves around 30 million people in 17 countries. In 2020, the company reported €1.2 billion of revenues according to IFRS.

Our Base-Case Scenario

Assumptions

- GGU's $250 million bond is successfully refinanced with shareholder support in 2022. GCAP is supposed to provide about $95 million and Aqualia the remaining $155 million.
- GGU will demerge renewable asset with their pro rata share of debt.
- GGU's post-transaction total debt will be GEL500 million-GEL650 million, depending on the new shareholders' decisions.
- We assume that annual revenue from electricity sales to decline to about GEL20 million from GEL 60 million-GEL70 million in 2021 following the demerger of renewable assets from GGU in 2022.
- The EBITDA margin staying in the 60%-65% range.
- GGU's capital expenditure (capex) staying at about GEL90 million annually.
- GEL20 million of dividends distribution from GGU to GCAP in 2022, in line with already paid amounts. GGU's dividend policy after the transaction is uncertain and subject to ongoing discussions.

Key metrics

Georgia Global Utilities--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. GEL)	**2019a**	**2020a**	**2021e**	**2022f**	**2023f**
Revenue	163.7	165.8	240-260	200-250	200-250
EBITDA	98.4	96.2	165-175	130-140	140-150
EBITDA margin (%)	60.1	58.1	65-70	60-65	60-65
Funds from operations (FFO)	71.5	31.3	100-110	70-80	80-90
Capital expenditure	91.4	88.0	89.4	90.0	90.0
Discretionary cash flow	(43.2)	15.5	Negative	Negative	Negative
Debt to EBITDA (x)	3.9	8.7	4.5-5.0	3.5-5.0	3.5-5.0
FFO to debt (%)	18.8	3.7	12.0-14.0	11.5-17.0	11.5-17.0

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. GEL--Georgian lari.

Liquidity

We currently assess GGU's liquidity as less than adequate, because the terms of proposed shareholder funding for the upcoming bond redemption are uncertain currently and will be agreed closer to the completion of the second stage of the deal. Technically, the ratio of committed liquidity sources to liquidity needs was 0.5x on Dec. 31, 2021. Still, we understand that the shareholders have a strong interest and a public commitment to provide the funds, and even though the final terms of financing are still under discussion, the shareholders have a strong interest for the bond to be successfully refinanced. In addition, we note GGU's healthy relationships with local banks and supranational institutions.

We estimate that principal liquidity sources as of Jan. 1, 2022, include:

- GEL100 million of cash and cash equivalents.
- Up to $95 million of shareholder support to be provided by GCAP to GGU, as publicly committed. We understand that terms and size of the respective support from Aqualia is under discussion and therefore we don't include it in committed liquidity sources before the final agreement.
- Our estimate of cash FFO of GEL65 million-GEL75 million.

We estimate that principal liquidity uses for the same period include:

- The $250 million of bond plus a 3.875% premium;
- Up to GEL90 million of capex; and
- GEL20 million of dividends, in line with already paid amount.

Covenants

The company has a number of covenants in its bond documentation, including net debt to EBITDA of below 5.0x in 2021, and below 4.5x thereafter. The company was in compliance with all covenants as of the end of 2021, and we expect the same until respective bond is redeemed.

Issue Ratings - Subordination Risk Analysis

Capital structure

The company's current debt portfolio consists of the sole $250 million bond due in 2025, issued at the holding level. There is no debt at GGU's subsidiaries.

Analytical conclusions

The issue rating on the debt is 'B', in line with the issuer credit rating, because no significant elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: B/Stable/--

Business risk: Weak

- Country risk: High
- Industry risk: Low
- Competitive position: Weak

Financial risk: Aggressive (standard volatility table)

- Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b

- Group credit profile: b
- Entity status within group: Nonstrategic

ESG credit indicators: E-4, S-2, G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- ESG Credit Indicator Report Card: Regulated Utility Networks, Nov. 18, 2021

Ratings List

Outlook Action; Rating Affirmed

	To	From
Georgia Global Utilities JSC		
Issuer Credit Rating	B/Stable/--	B/Positive/--
Senior Unsecured	B	B