FitchRatings

RATING ACTION COMMENTARY

# Fitch Upgrades Georgia Global Utilities to 'BB-'; off RWE; Outlook Stable

Fri 13 Jan, 2023 - 11:40 ET

Fitch Ratings - Madrid - 13 Jan 2023: Fitch Ratings has upgraded Georgia Global Utilities JSC's (GGU) Long-Term Issuer Default Rating (IDR) to 'BB-' from 'B+', and removed it from Rating Watch Evolving (RWE). The Outlook is Stable.

The upgrade reflects the completion of the acquisition of GGU by FCC Aqualia, S.A. (BBB-/Stable), including the repayment of GGU's USD250 million bond and spin-off of its independent renewable assets. Fitch views the strategic incentives for Aqualia to support its weaker subsidiary GGU as moderate, resulting in a one-notch uplift of the IDR from GGU's Standalone Credit Profile (SCP) of 'b+' under our Parent and Subsidiary Linkage Criteria (PSL).

We see no material changes to the debt capacity and SCP of GGU post de-merger. The Stable Outlook reflects Fitch's expectation that GGU will maintain credit metrics comfortably within our rating sensitivities for the 'b+' SCP during 2022-2025.

## KEY RATING DRIVERS

**Holding Company:** GGU is a holding company which, following the de-merger of its independent renewable assets in 2022, consolidates Georgia Water and Power LLC (GWP), Rustavi Water LLC, Gardabani Sewage Treatment LLC, Saguramo Energy LLC, Georgian Engineering and Management Company LLC and Georgian Energy Trading Company LLC (GETC, electricity trading arm of the group).

**Medium Links with Aqualia**: Fitch expects a reasonable financial contribution from GGU to the consolidated Aqualia group. In our view GGU offers moderate growth potential for Aqualia, for instance, given the subsidiary's investment requirements to modernise its water infrastructure, to shrink large water losses and to reduce own electricity consumption. The rating uplift under the PSL analysis therefore reflects our view of Aqualia's medium strategic incentives to support GGU, while we assess both the legal and the operational incentives to support as low.

**Non-recourse Subsidiary:** We expect Aqualia to hold GGU as a non-recourse subsidiary in the medium term, with our rating case including the repayment of Aqualia's shareholder loan in 2024 through the issue of a new bond at GGU level with restricted terms similar to its old bond called in 2022.

**Improved Capital Structure in 2022**: After the bond repayment and the spin-off of the independent renewable assets in September 2022, GGU holds no financial debt other than Aqualia's USD164 million shareholder loan, and we estimate funds from operations (FFO) net leverage (excl. connection fees) at below its positive rating sensitivity of 3.5x at end-2022 (end-2021: 4.6x). The deleveraging was driven by the improved capital structure post-transaction and positive foreign-exchange (FX) movements in 2022.

**Unchanged Debt Capacity**: We do not see the spin-off of the independent renewable energy assets entailing a significant change to GGU's underlying business risk. While this leaves GGU with a less diversified business mix, its credit profile is supported by a higher share of regulated earnings (on average around 80% of EBITDA in our rating case), further driven by a ramp-up of capex (GEL160 million a year) estimated by GGU for the 2024-2026 regulatory period (RP).

**No Visibility on Third RP:** There is no visibility yet on the main regulatory parameters for the next RP of 2024-2026. If GGU's investment plan is approved by the regulator, we foresee regulated water revenues increasing on average 30% versus the previous RP. The increased capex may also support higher electricity revenues as improving asset quality could bring higher volumes of electricity for sale.

**Credit Metrics within Guidelines**: Fitch forecasts FFO net leverage (excl. connection fees) to gradually increase up to 3.7x in 2024 and 2025, which is still close to the positive sensitivity for the SCP. This is below Aqualia's long-term net debt / EBITDA target of 4.0x for GGU. Our forecasts consider positive price dynamics in the electricity segment as well as GGU's indication of no dividend distributions to Aqualia in 2022 and 2023. The gradual increase in leverage reflects the capex ramp-up in 2023-2025 and Fitch's assumption that dividends will be reinstated in 2024 once the bond issue of GGU is launched and regulatory visibility improves.

**FX Risk Could Worsen Post-Bond:** GGU's stream of US dollar-denominated revenues has reduced following the spin-off of the independent renewable assets. Fitch expects GGU to issue bonds in foreign currency in 2024, potentially resulting in higher FX risk. A potential mismatch between coupon payments and its US dollar-denominated revenues would be credit-negative. Fitch expects a weakening of the Georgian lari against the US dollar over the rating horizon. Our forecasts assume a negative FX impact on GGU's debt and interest, and conversely, a positive impact on US dollar-denominated revenues.

**GWP Paramount for GGU**: We expect GWP to represent over 90% of GGU's total revenues. The company is a regulated water utility with a natural monopoly in Tbilsi and ownership over the water infrastructure. The remaining business is electricity sales, with GWP operating hydro power plants with an installed capacity of 145MW linked to the water utility (out of 149 MW in total for GGU). Less than half of GWP's generated electricity is for own consumption, while excess electricity is sold predominantly through bilateral agreements with direct customers. Any remaining portion is exposed to merchant risk.

## DERIVATION SUMMARY

GGU's business mix combines a regulated water utility business and hydroelectric generation assets. The exposure to merchant risk in its electricity business is mitigated by the large share of regulated earnings of the water segment, which is based on a regulated asset base (RAB)-framework.

A close peer of GGU is JSC Energo-Pro Georgia, a subsidiary of Energo-Pro a.s. (EPas, BB-/Stable), which distributes electricity to all regions of Georgia except Tbilisi. EPas is a utility headquartered in the Czech Republic with operating companies in Bulgaria, Georgia and Turkiye. Its core activities are power distribution, grid support services and electricity generation.

GGU is comparable to European water utilities such as Miejskie Wodociagi i Kanalizacja w Bydgoszczy Sp. z o.o. (MWiK, BBB/Stable), and Aquanet S.A. (BBB+/Stable). These companies are mainly differentiated from GGU by more supportive regulation. Bulgarian Energy Holding EAD (BB/Positive) is significantly larger and more diversified with strong sovereign support benefiting its rating.

## KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Total revenues to average GEL262 million a year in 2022-2025

- EBITDA margin on average at 63% during 2022-2025

- Capex averaging GEL144 million a year over 2022-2025

- No distributions in 2022-2023. Fitch assumes dividends of GEL35 million per year over 2024-2025

- New bond issue of around USD 250million in 2024 at GGU level with restricted terms similar to old bond (i.e. ring-fenced structure)

- Georgian lari/US dollar average exchange rate of 3 in 2023 and 3.25 during 2024-2025 based on Fitch's FX forecasts

- Water utility business to see allowed revenues increase on average 30% in the next RP (versus last RP)

- Electricity business to see blended power price on average of about 19 GELTetri/kWh in 2023-2025 based on Fitch's expectations

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Stronger links between GGU and Aqualia could lead to an upgrade of GGU's IDR

- A positive revision of GGU's SCP could lead to an upgrade of GGU's IDR

For the SCP

- Improved FFO net leverage (excluding connection fees) sustainably below 3.5x if accompanied by a consistent financial policy

- Improved business risk resulting from a longer record of supportive regulation, a step improvement in asset quality (ie significantly smaller network losses or lower own electricity consumption), or a sustained positive effect resulting from the launch of organised electricity markets

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A reassessment of Aqualia's strategic incentives to support GGU as 'low' would imply a standalone rating approach for GGU and would lead to a downgrade of its IDR

- A negative revision of GGU's SCP could lead to a downgrade of GGU's IDR

For the SCP

- FFO net leverage (excluding connection fees) above 4.5x and FFO interest coverage (excluding connection fees) below 2.5x on a sustained basis

- Higher business risk

- Significantly lower-than expected allowed revenues from the water utility business in the next RP, a sustained reduction in profitability and cash flow generation (eg through a failure to shrink water losses or deterioration in cash collection rates); an aggressive financial policy with increased dividends; or a material increase in exposure to foreign-currency fluctuations

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

## LIQUIDITY AND DEBT STRUCTURE

**Adequate Liquidity**: As of November 2022, GGU held cash and cash equivalents of GEL41 million, which is sufficient to cover negative free cash flows in 2023. GGU's debt includes almost exclusively the USD164 million shareholder loan maturing in August 2024. We expect GGU to refinance the shareholder loan with proceeds from an upcoming bond issue.

We understand from management that Aqualia may extend the maturity of the shareholder loan by up to two years if capital markets do not offer attractive cost of financing. As a result, we assess GGU's liquidity position as adequate, also considering the possibility of deferring the refinancing beyond 2025. An adverse FX development increasing interest payments is mitigated by US dollar-denominated revenues from the sale of electricity.

## ISSUER PROFILE

GGU is a water utility and renewable energy business that supplies potable water and provides wastewater collection and processing services to almost 1.4 million people in Georgia. More than half of the electricity generated by GGU is sold to third parties, while the remaining electricity is used by its water supply and sanitation services business for internal consumption to power its water distribution network.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Georgia Global Utilities JSC has an ESG Relevance Score of '4' for water & wastewater management, due to heavily worn-out water infrastructure and large water losses, which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | PRIOR |
|---|---|---|---|---|
| Georgia Global Utilities JSC | LT IDR | BB- Rating Outlook Stable | Upgrade | B+ |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 01 Dec 2021)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 28 Oct 2022)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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Corporate Finance Utilities and Power Asia-Pacific Georgia