Research Update:

Georgia Global Utilities JSC 'BB-' Rating On CreditWatch Positive On Planned Bond Issuance

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Rating Action Overview

- Georgia Global Utilities JSC (GGU) announced its intention to refinance most of its outstanding debt via a $300 million Eurobond issuance in July 2024. GGU's outstanding debt currently includes loans of about $200 million that are granted by its parent, the Spanish utility FCC Aqualia S.A. (BBB-/Stable/--), and $164 million of which are due in August 2024.
- If the planned Eurobond issuance is successful and enables GGU to raise enough capital in a cost-effective way, it will significantly bolster the group's liquidity profile, reduce refinancing risks, and improve GGU's creditworthiness, in our view.
- We therefore placed the 'BB-' long-term issuer credit rating on GGU on CreditWatch with positive implications. At the same time, we assigned our 'BB-' rating to the proposed senior unsecured bond and put it on CreditWatch positive.
- The CreditWatch placement indicates that we would likely upgrade GGU to 'BB' over the next 90 days if the group manages to improve its liquidity position meaningfully and reduce its refinancing risks via the planned $300 million Eurobond issuance in July 2024, ahead of the maturity of its $164 million shareholder loan, at a cost that would not reduce the company's S&P Global Ratings-adjusted funds from operations (FFO) to debt below 15% over 2024-2026.

Rating Action Rationale

If it is successful, we expect the planned Eurobond issuance will improve GGU's liquidity, reduce refinancing risks, and help the group deliver its capital investment program. The planned Eurobond issuance would significantly improve GGU's liquidity position, which we currently assess as less than adequate. This is because of the imminent maturity of most of the group's outstanding debt, including a $164 million loan that was granted by FCC Aqualia and is due in August 2024. The planned Eurobond issuance would also benefit GGU's investment program. We expect the planned Eurobond would mature in July 2029, which significantly reduces the group's refinancing risk. Given the magnitude of GGU's planned capital expenditure (capex) of Georgian lari (GEL) 620 million (about $220 million) over 2024-2026 and GGU's internally generated funds, we also consider new funding is essential for the successful execution of the investment plan. Since the Eurobond would be U.S. dollar-denominated, we consider the existing currency mismatch between GGU's financing sources and the group's cash flows, which are mainly in Georgian lari, would remain after the issuance. GGU's sole source of U.S. dollars is its electricity generation business, which we project will only account for about 20% of the group's EBITDA over 2024-2026. We therefore expect this contribution will not be sufficient to cover future interest payments. This is because of the expected increase in debt and interest rates after the planned Eurobond issuance, compared with existing financing arrangements. We understand, however, that at least 90% of the group's cash balance will be held in U.S. dollars. We consider this is a key mitigant to the currency mismatch between the group's debt service needs and internal cash flow generation.

We will continue to assess GGU as moderately strategic to its parent, even though we consider the terms of the planned Eurobond issuance will likely be less favorable for GGU than the terms under current financing arrangements. We consider the refinancing of the shareholder loan at GGU's level is less cost-effective than current financing arrangements, given our expectations of a likely higher coupon for GGU--compared with interest payments of 7.35% on its existing $164 million shareholder loan--and the lower rating than that on its parent. That said, we will continue to assess GGU's importance to its parent as moderately strategic as we expect FCC Aqualia would provide extraordinary support to its Georgian subsidiary if necessary. This leads to a one-notch enhancement to the rating on GGU. For instance, if GGU was unable to execute on its planned Eurobond issuance, we would expect its parent to extend, on a timely basis, the August maturity on the $164 million shareholder loan by six to 12 months.

The water regulatory update for 2024-2026 is broadly supportive, although an increase in capital intensity will limit any significant deleveraging prospects. The increase in water tariffs for the 2024-2026 regulatory period supports GGU's credit quality. In December 2023, the regulator for the water sector in Georgia, the Georgian National Energy and Water Supply Regulatory Commission, published its new regulation methodology for the period 2024-2026. It significantly increased water tariffs for commercial customers and non-households, while keeping them stable for households. As a result, allowed water revenue will increase by 46% in 2024-2026 compared to 2021-2023. The regulatory pre-tax weighted average cost of capital was set at 15.44%, from 14.98% previously. The significant increase in allowed revenue is reflected in our upgrade of GGU to 'BB-' in February 2023, when we raised our assessment of the regulatory framework for Georgian water companies to somewhat supportive. We consider the magnitude of the increase in allowed revenue supports GGU's credit quality. We also expect a significant increase in the group's regulatory asset base (RAB) since GGU will make large investments, averaging GEL210 million annually over 2024-2026. These investments are on top of the significant increase in capital deployed to GEL194 million in 2023, compared with an average of GEL100 million over 2021-2023. Large investments are necessary to support the reliability and safety of the Georgian water infrastructure network, most of which was built under the Soviet Union. While we expect these investments will increase the group's RAB and revenue, we also consider that the significant rise in capital intensity will limit deleveraging prospects over the current regulatory period. This is because we expect negative free cash flow generation to dilute the positive effect of a significant increase in allowed revenue on the group's adjusted FFO to debt. We expect credit metrics to stabilize at about 18% by the end of the current regulatory period.

Recent political developments in Georgia currently have no impact on the group's day-to-day operations. In May 2024, the ruling Georgian Dream - Democratic Georgia (GDDG) party passed a bill, according to which, organizations that receive more than 20% of their funding from foreign donors must register as organizations "bearing the interests of a foreign power." We understand that GGU's day-to-day operations have not been affected by recent developments and political volatility in the country so far. Although this does not form part of our base case, we cannot rule out the possibility that GGU may postpone its Eurobond issuance if it considers issuance costs are not cost effective. If this happened, we would expect its parent company to extend the August maturity on its shareholder loan on a timely basis.

CreditWatch

The CreditWatch positive placement indicates that we would likely upgrade GGU to 'BB' over the next 90 days if the group manages to improve its liquidity position meaningfully and reduce its refinancing risks via the planned $300 million Eurobond issuance, ahead of the maturity of its $164 million shareholder loan in August 2024 and at a cost that would not reduce the group's adjusted FFO to debt below 15% over 2024-2026. We would likely resolve the CreditWatch placement and revise the outlook to stable if the planned Eurobond issuance fell significantly short of our expectation of $300 million. In this case, GGU would likely have to find new financing sources at the end of the current regulatory period by December 2026 and after the execution of its business plan.

An upgrade of GGU would also be contingent on:

- GGU holding at least 90% of its cash balance in U.S. dollars throughout the current regulatory period, at levels that can cover, with ample headroom, future debt service payments, to mitigate the currency mismatch between its financing sources and cash flows;
- Our expectations that current parental support from FCC Aqualia remains in line with our current assessment and that we continue to assess GGU as moderately strategic to its parent; and
- The absence of any negative rating actions on the sovereign rating on Georgia (BB/Stable/B) or any form of negative political interference in the group's operations that could, for instance, weaken our assessment of Georgia's water regulatory framework.

Company Description

GGU is one of the largest privately-owned utility companies in Georgia and historically operated in the natural monopoly water utility business and electricity generation. Following the transaction between FCC Aqualia and Georgia Capital JSC (GCAP), GGU is now mostly composed of the water utility segment that provides water supply and wastewater services to 1.3 million customers in Georgia's capital, Tbilisi, and its surrounding area, as well as 150 megawatts (MW) of electricity via hydro power plants. The remaining operating generation capacity of 71 MW has been demerged and is fully owned by GCAP. GGU's annual EBITDA was GEL128 million (about $45 million) in 2023.

Liquidity

We assess GGU's current liquidity as less than adequate since its liquidity sources will cover uses by about 0.2x over the next 12 months. Our liquidity assessment currently does not incorporate GGU's planned Eurobond issuance since its realization is still subject to market conditions. Our assessment includes the higher capex, as well as the August 2024 and December 2024 maturities of the shareholder loans from FCC Aqualia, though we expect the August maturity would be postponed if the planned Eurobond issuance was unsuccessful. We also note GGU's good relationships with local banks and supranational institutions. GGU has a proven track record of successful access to international capital markets.

We estimate principal liquidity sources for the 12 months from Dec. 31, 2023, include:

- Cash and cash equivalents of GEL7.0 million-GEL7.5 million; and
- Our cash FFO estimate of GEL145 million-GEL150 million.

We estimate principal liquidity uses for the same period include:

- Repayment of shareholder loans of $164 million (about GEL444 million) due in August 2024 and about €35 million (about GEL105 million) due in December 2024;
- Capex of up to GEL180 million-GEL190; and
- No dividend distributions over the current regulatory period.

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- 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: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Spanish Water Company FCC Aqualia 'BBB-' Rating Affirmed; Outlook Stable, July 1, 2024
- Georgia Global Utilities JSC, April 12, 2024
- Eastern Europe: Higher Yields Will Weaken Credit Metrics And Liquidity, Jan. 8, 2024
- Georgia Global Utilities Upgraded To 'BB-' On Improved Water Regulation Assessment And Strong Metrics; Outlook Stable, Feb. 17, 2023
- Georgian Water Regulatory Framework: Somewhat Supportive, Feb. 17, 2023

Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Georgia Global Utilities JSC		
Issuer Credit Rating	BB-/Watch Pos/--	BB-/Stable/--
Senior Unsecured	BB-/Watch Pos	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.