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RATING ACTION COMMENTARY

Fitch Affirms Georgia Global Utilities at 'BB-'; Outlook Stable

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Fitch Ratings - Milan - 08 Jul 2024: Fitch Ratings has affirmed Georgia Global Utilities JSC's (GGU) Long-Term Issuer Default Rating (IDR) at 'BB-'. The Outlook is Stable.

The affirmation reflects Fitch's unchanged assessment of GGU's Standalone Credit Profile (SCP) at 'b+' as well as the Parent Subsidiary Linkage (PSL) with its majority shareholder FCC Aqualia S.A. (BBB-/Stable), resulting in a one-notch uplift to GGU's IDR. The PSL links mirror Aqualia's strategic incentives to support its weaker subsidiary GGU.

The recent tariff increase for the 2024-2026 water regulatory period is a positive development for GGU's SCP. However, the likely high exposure to foreign-exchange (FX) risk after the upcoming refinancing, the expected re-leveraging due to its ambitious capex plan, and the operating environment remain key constraints for GGU's SCP.

The Stable Outlook reflects Fitch's expectation that GGU's leverage metrics will remain within its sensitivities for the SCP of 'b+' during 2024-2027, while interest coverage could be weak for the SCP, ultimately depending on the conditions for intercompany debt refinancing.

KEY RATING DRIVERS

Upcoming Refinancing, Restricted Terms: Since its acquisition by Aqualia and bond repayment in 2022, GGU holds almost no financial debt other than shareholder loans (SHLs), which the company targets refinancing with restricted terms. We expect Aqualia to remain supportive if the refinancing does not materialise as expected. GGU also has to fund investments targeted for the 2024-2026 regulatory period (RP) at its water business. Fitch's rating approach factors in that Aqualia will hold GGU as a non-recourse subsidiary in the medium term.

Tariff Increase Credit Positive: The Georgian water sector regulator has set the tariffs for the 2024-2026 RP. Water tariffs for Georgia Water and Power LLC's (GWP) commercial customers in Tbilisi have been substantially increased by about 35%, while household tariffs are unchanged. Our updated rating case reflects the tariff increase, with water revenues increasing by 45% in the 2024-2026 RP compared with the 2021-2023 RP.

Ambitious Investment Plan: GGU has increased its investment plan, which is earmarked for modernising pumping stations (to achieve energy savings) and refurbishing the water network infrastructure (to reduce leakages), among other things. In 2024-2026, annual capex will average about GEL210 million, almost exactly matching the average forecast EBITDA in our rating case. Due to high capex, we estimate funds from operations (FFO) net leverage will gradually increase from 3.4x expected at end-2024 to 4.4x in 2026, leaving almost no headroom under our leverage guidelines.

Higher FX Risk Post-Refinancing: With the planned refinancing, we expect GGU to hold most of its debt in foreign currency, resulting in higher exposure to FX risk. This risk is mitigated by GGU's electricity revenues being denominated in US dollars, which could cover roughly half of the interest payment, based on our preliminary estimate. We also expect the company to hold a sufficient amount of US dollar-denominated cash deposits after refinancing. Our forecasts conservatively factor in a negative FX impact on GGU's debt and interest, in line with our current FX estimates.

Medium Links with Aqualia: Fitch views the financial contribution from GGU to the consolidated Aqualia group as reasonable (around 14% of consolidated EBITDA). In our view, GGU offers moderate growth potential for Aqualia, given the subsidiary's investment requirements to modernise its water infrastructure, reduce large water losses and its own electricity consumption. The rating uplift under the PSL analysis reflects our view that Aqualia has a 'medium' strategic incentive to support GGU, while we assess both the legal and the operational incentives to support as 'low'.

New Electricity Market: The launch of organised electricity markets in Georgia (including balancing and ancillary services market) is scheduled for 2025. The proposed market reforms aim to establish a "Georgian Energy Exchange" with daily and intra-day trading, introducing marginal pricing. This could support higher electricity prices for GGU (and in turn further mitigate its FX risk). However, we have incorporated only limited upside from higher power prices into our rating case, given the limited visibility of the impact and various delays to the reform implementation.

Volume Risk in Electricity Business: Under the current electricity market, GGU typically sells its hydroelectric generation to industrial customers through 12-month bilateral contracts. If GGU cannot deliver committed volumes due to low hydro resource availability, the group reimburses the difference between contracted price and the wholesale balancing price.

GWP's hydro power plant Zhinvali has installed capacity of 130 MW and electricity production mainly covers the internal consumption of GWP, with the surplus sold in the wholesale market. The plant includes a storage reservoir that helps cover demand throughout the year and offers 12-month contracts to customers, whereas most competitors are unable to meet the demand for electricity in winter months, due to the market imbalance.

GWP Paramount for GGU: Following the internal merger between GGU's subsidiaries GWP and Rustavi Water LLC in 2023, GWP now represents almost all of GGU's revenues. The company is a regulated water utility with a natural monopoly in Tbilisi and ownership over its water and wastewater infrastructure. The remaining business segment relates to the generation and sale of electricity, with an installed capacity of 145MW. About 40% of GWP's electricity is generated for the company's own consumption, while excess electricity is sold predominantly through bilateral agreements. Any remaining portion is exposed to merchant risk.

DERIVATION SUMMARY

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

A close peer of GGU is ENERGO-Pro a.s. (EPas, BB-/Stable), a utility headquartered in the Czech Republic with operating companies in Bulgaria, Georgia, Spain and Turkiye. Its core activities are power distribution, grid support services and electricity generation. EPas's higher debt capacity than GGU's reflects its larger size, diversification by geography and type of business.

Other peers for GGU in the CIS regions are the small Kazak electricity distribution company Mangistau Regional Electricity Network Company JSC (MRENC, IDR BB-/Stable, SCP 'b+') and Uzbekistan-based distribution and supply company Regional Electrical Power Networks JSC (REPN, IDR BB-/Stable, SCP 'b-'). Like other utilities in Kazakhstan, MRENC is subject to regulatory uncertainties, especially due to macroeconomic shocks and possible political interference. MRENC has lower debt capacity than GGU, butits low leverage results in the same SCP. REPN has a larger asset base and greater geographical coverage than GGU, but this is more than offset by GGU's more established regulated asset base -based regulatory framework, driving the difference between the SCPs.

The IDRs are of MRENC and REPN are aligned with their owners due to strong parent-subsidiary links (Mangistau) and strong government-links (REPN).

KEY ASSUMPTIONS

- Total revenues to average GEL305 million a year in 2024-2026

- Water utility business allowed revenues increasing by 45% in the 2024-2026 RP compared with the 2021-2023 RP

- Electricity business to see annual generation volumes sold on average at about 224 GWh (gigawatt hour) in 2024-2026 and power prices on average at about 17 GELTetri/kWh in 2024-2026 based on Fitch's expectations

- EBITDA margin on average at 68% during 2024-2026

- Capex averaging GEL209 million a year over 2024-2026

- No distributions in 2024-2026. Fitch expects dividends of GEL30 million in 2027

- Refinancing of SHL, with external debt raised at GGU level with restricted terms similar to old bond (i.e. ring-fenced structure)

- Georgian lari/US dollar annual average exchange rate of 2.95 in 2024 and 3.1 in 2025 and 3.22 in 2026, based on Fitch's FX forecasts

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

- 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 material improvement in asset quality (i.e. 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

- 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

- A sustained reduction in profitability and cash flow generation (e.g. through a failure to reduce 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.

LIQUIDITY AND DEBT STRUCTURE

Liquidity Needs Refinancing or Support: At end-2023 GGU's GEL512 million debt comprised almost exclusively the USD164million SHL provided by Aqualia in 2022 and GEL62million drawn under a second EUR60million SHL extended by Aqualia in 2023.

GGU's cash on balance was low at GEL7 million at year-end but the company had around GEL105 million available under the second SHL extended by Aqualia in 2023. The interest payable on the USD164million SHL is being cumulated and capitalised under the second SHL extended by Aqualia.

We expect GGU to refinance the SHLs with own debt raised at GGU level with restricted terms. The SHLs are due in 2024 but we understand from management that Aqualia is prepared to extend their maturity if the refinancing does not take place. As a result, we assess GGU's liquidity position as sufficient, also considering the possibility of deferring the refinancing beyond 2025.

ISSUER PROFILE

GGU is a water utility and renewable energy business that supplies potable water and provides wastewater collection and processing services to almost 1.3 million people in Georgia. More than half of the electricity generated by GGU is sold to third parties, while the remainder 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

GGU 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.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Georgia Global Utilities JSC	LT IDR Affirmed	BB- Rating Outlook Stable	BB- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country-Specific Treatment of Recovery Ratings Criteria (pub. 03 Mar 2023)

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

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

Endorsement Policy

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Georgia Global Utilities JSC	EU Issued, UK Endorsed

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