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Fitch Affirms Aqualia's EUR650 million Senior Secured Bond at 'BBB'; Remove RWN

Fitch Ratings - Barcelona - 11 Mar 2022: Fitch Ratings has affirmed FCC Aqualia S.A.'s EUR650 million senior secured bond at 'BBB' and removed it from Rating Watch Negative (RWN). This follows the unsuccessful consent solicitation to amend certain terms and conditions (T&C) of the bond, including the release of the security, and the company's decision to abandon the consent solicitation process.

Key Rating Drivers

Unsuccessful Consent Solicitation: The consent solicitation requested by Aqualia to move to an unsecured-type structure for its EUR650 million senior secured notes was rejected by the noteholders. The solicitation, which included a proposed consent fee of 0.2%, attained 62% of the votes, short of the 75% majority required for approval. Following the outcome of the vote, Aqualia's Board of Directors declined to modify or to opt for an alternative proposal, hence aborting the solicitation process.

Downgrade Averted: The proposal for the company's EUR650 million bond holders included the replacement of the security package by a negative pledge and the removal of the debt service reserve account, while it would have introduced looser restrictions on distributions (to a maximum 100% dividend pay-out if leverage is below 5.0x, 75% if it remains above), eliminating the previous dividend cap at 45% pay-out (0% if above 5.0x leverage). A successful consent solicitation would have removed provisions supporting the one-notch uplift to the secured notes' rating.

Rating Uplift Applicable for Secured Debt: We will continue to apply a one-notch uplift to Aqualia's senior secured bonds from the Issuer Default Rating (IDR) of 'BBB-', based on all the creditor-friendly provisions included in the company's financing package (ie the security, 12- month interest payment reserve account, and the covenanted structure). Any of these in isolation would not support the uplift but we believe that together they could delay default and improve recovery.

Prior-Ranking Debt to Increase Post-refinancing: Aqualia's plan to issue senior unsecured debt of about EUR800 million at holdco to largely refinance its EUR700 million senior secured bond maturing in 2022 remains unchanged, albeit subject to market conditions. Therefore, we expect the future co-existence of unsecured and secured instruments in the debt structure, which increases prior-ranking debt and subordination risk for the new unsecured funding.

We expect prior-ranking debt to increase to 2.3x EBITDA by end-2022 (from a negligible amount before) although still below the 2.5x level which could indicate a material possibility of subordination and lower recovery prospect for unsecured debt, according to our criteria.

Restricted Dividends until 2027: We expect the more restrictive provisions for the EUR650 million senior secured financing versus the new proposed EUR800 million bond to apply and to remain in place until it matures in 2027. This include the maximum dividend pay-out of 45% of cumulated net income from 2017, including a dividend lock up if leverage is above 5.0x.

Slightly Revised Dividend Forecast: As a result, we expect dividends distribution to be below our previous assumption of 56% pay-out for 2022-2025. This can result in improved credit metrics, if additional free cash flow (FCF) is retained in the company or if it is not fully allocated to additional growth.

Derivation Summary

Aqualia is a water and sewerage network operator that, unlike some of its European peers, does not fully own its asset base. However, its investments are supported by the value of its concessions. The company is firmly positioned relative to EU peers in water-cycle management activities. However, its water-infrastructure construction activity adds some volatility to cash flow compared with pure water asset operators including the Spanish peer Canal de Isabel II, S.A. (BBB+/Stable). Moreover, Aqualia operates in a decentralised and less developed regulatory environment than in Italy and the UK, which have independently regulated and consultative frameworks and longer licensed concession duration.

Holding d'Infrastructures des Metiers de l'Environnement's (SAUR; BBB-/Stable) is the closest peer in business mix and scale. Aqualia's municipal concessions and operation and maintenance (O&M) account for about 90% of EBITDA, compared with around 80% for SAUR. We also regard concessions in Spain and Portugal as stronger, given financial-equilibrium provisions that protect the value of concessions under certain circumstances. We believe France's regulatory framework for water and wastewater is less predictable than that in Spain.

Overall, we see Aqualia's business risk profile as slightly better than that of SAUR, with longer average concession residual life, higher renewal rates, better profitability due to higher capex intensity, and a contractual framework that includes financial-equilibrium mechanisms. This allows for a greater debt capacity at the same rating; 5.3x funds from operations (FFO) adjusted net debt at Aqualia compared with 5.0x for SAUR.

Finally, we do not apply the one-notch uplift associated with above-average expected recoveries for senior unsecured creditors that are common to regulated networks. This is due to the less developed regulatory framework in Spain than in other jurisdictions, the complexity of a highly granular base of contracts and the limited share of full ownership of its asset base.

Key Assumptions

- Volumes to recover to pre-Covid-19 volumes by 2022, followed by stable consumption to 2025

- Renewal rate of water concession contracts at 90%, in line with historical trends

- EBITDA margins of water and build-operate-transfer (BOT) concessions at around 25%, O&M at 11% and engineering, procurement and construction (EPC) at 9% to 2025

- Average net investments of about EUR286 million per year over 2022-2025, including the GGU acquisition (EUR160 million in 2022 and EUR55 million in 2025), and an additional EUR250 million buffer compared with management's

- Limited EBITDA and dividends received from new contracts awarded and acquisitions (about EUR90 million and EUR7 million, respectively in 2025)

- Dividends at 45% of net profit per year

RATING SENSITIVITIES

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

- Stronger cash flow leading to recourse FFO net leverage below 4.5x and recourse FFO interest coverage above 6.5x on a sustained basis

- Lower business risk, such as an independent and centralised water regulator or increased transparency in the regulatory framework, which could be credit-positive

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

- Weaker cash flow generation leading to recourse FFO net leverage above 5.3x and recourse FFO interest coverage below 5.0x.

- Higher business risk, such as a lower share of regulated activities in the business mix in favour of higher-risk ones (EPC or O&M) or a material increase in non-recourse funding

-Looser legal ring-fencing or more related-party transactions could lead us to reconsider the parent/ subsidiary linkage between Aqualia and Fomento de Construcciones y Contratas

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

Strong Liquidity: At end-2021 Aqualia's liquidity comprised readily available cash of EUR586 million and EUR1.1 billion of committed credit lines. The latter include an uncommitted credit facility of EUR0.9 billion maturing in January 2023, which was raised in 2021 as a liquidity buffer ahead of Aqualia's refinancing in 2022. Even without refinancing Aqualia's liquidity position would fully cover the

EUR700 million bond maturing in 2022 as well as expected negative FCF (post-dividend and M&A) over the next three years.

Issuer Profile

Aqualia is a water and wastewater network operator in Spain, as well as in markets outside of Spain, with projects throughout Europe, Latin America, the Middle East and north Africa in more than 700 municipalities.

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

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

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
FCC Aqualia, S.A.					
• senior secured	LT	BBB	Affirmed		BBB

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.15 Oct 2021) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

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

Additional Disclosures

Solicitation Status

Endorsement Status

FCC Aqualia, S.A. EU Issued, UK Endorsed

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