S&P Global Ratings

Research

Research Update:

Latvian TSO Augstsprieguma Tikls Ratings Affirmed At 'BBB+'; Outlook Revised To Positive On Lower Country Risk

August 12, 2021

Rating Action Overview

- We have revised our country risk assessment on Latvia, which reflects our view about the improving business environment.
- Our rating on Augstsprieguma Tikls (AST), Latvia's state-controlled electricity transmission system operator (TSO) monopoly, continues to be constrained by sizable upcoming maturities in late 2021, which weigh on our liquidity assessment.
- We therefore affirmed our 'BBB+' long-term issuer credit rating on AST.
- The positive outlook reflects upgrade potential in the next 12 months from better business conditions in Latvia, subject to liquidity improvement and prudent financial policy at AST.

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Rating Action Rationale

The reduction in country risk is positive for AST's business. We revised our country risk assessment on Latvia to '3' (intermediate) from '4' (moderately high) on Aug. 6, 2021. This reflects our view about the improved business environment in the country, which we now believe is similar to other Baltic countries. For more details, see "Country Risk Assessments Update: August 2021," published Aug. 6, 2021, on RatingsDirect. The revision triggers a change in our view on AST's business risk. On the other hand, our view on Latvian regulation and the company's competitive position remain unchanged, and we have not made any material changes to our base case scenario (see "Latvian TSO Augstsprieguma Tikls Rated 'BBB+'; Outlook Stable," published Feb. 16, 2021). Still, stronger business creates more upward potential for the rating.

Despite improvements in business risk, the rating remains constrained by the company's less than adequate liquidity. AST faces a €116.2 million bridge loan maturity in December 2021. This maturity is very large compared with AST's expected funds from operations (FFO) of about €35 million and cash reserves of about €57 million. The bridge loan represents part of legacy liabilities from LET as a result of its merger with AST in 2020. As a regulated utility and a government-related entity, AST is well positioned to address the upcoming refinancing, and we expect the company will maintain a prudent and proactive approach to liquidity management. We understand that AST is looking at certain refinancing options, but this remains subject to market conditions and strategy, which we will closely monitor. With the ratio of fully committed liquidity sources to liquidity needs below 1.1x, we continue to view AST's liquidity as less than adequate. This constrains our assessment of the stand-alone credit profile (SACP) at 'bb+'. Factoring in our assessment of a high likelihood of extraordinary support, this constrains the rating at 'BBB+'.

Outlook

The positive outlook reflects our view that improved business conditions in Latvia could support rating upside, if the liquidity constraint is alleviated. In addition to refinancing of the upcoming maturity and a ratio of committed liquidity sources to liquidity needs sustainably above 1.1x, an upgrade would depend on our assessment of the company's financial policy, liquidity management, and access to funding. The outlook also takes into account our forecast of stable and predictable cash flows from AST's low-risk regulated transmission business, with FFO to debt of about 18%-22% in the next two-to-three years, as well as our anticipation of an unchanged high likelihood of extraordinary government support.

Downside scenario

We could revise the outlook to stable if the company relies on short-term facilities or if its approach to liquidity management is not sufficiently prudent and proactive. We could also revise the outlook to stable if we observed that the company's performance was more volatile and weaker than we currently expect, with FFO to debt sustainably below our expectations of 18%-22% and no prospects for near-term recovery. We could lower the company's long-term credit rating if AST fails the refinancing exercise or in case of sovereign downgrade, but this is not part of our base case.

Upside scenario

We could raise the company's long-term credit rating based on the combination of the following:

- Liquidity becoming at least adequate on a sustainable basis with over 1.1x coverage of the next 12 months' maturities with committed liquidity sources.
- The company demonstrating prudent liquidity management, including timely refinancing of material debt amounts, adequate standing on local and international credit markets, sound relationships with local and international banks, and compliance with all required debt covenants with sufficient headroom, as well as no significant governance issues.
- Financial metrics in line with our 18%-22% base case, including no material increase in capital expenditures funded by debt or higher dividends.

The combination of the above-mentioned factors could support an improvement of the SACP by two notches to 'bbb' and therefore drive the rating up.

Before AST's liquidity becomes adequate, the rating is limited at 'BBB+' even in the case of a sovereign upgrade.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Positive/--

Business risk: Strong

- Country risk: Intermediate
- Industry risk: Very low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less than adequate (-2 notches)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb+

- Sovereign rating: A+
- Likelihood of government support: High (+3 notches)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

- Country Risk Assessments Update: August 2021, Aug. 6, 2021
- Latvian TSO Augstsprieguma Tikls Rated 'BBB+'; Outlook Stable, Feb. 16, 2021

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Augstsprieguma Tikls		
Issuer Credit Rating	BBB+/Positive/--	BBB+/Stable/--

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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.