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Ratings

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Research Update:

Grandbridge Energy Inc. Outlook Revised To Negative On Evolving Views Of Regulatory Jurisdiction; Ratings Affirmed

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Rating Action Overview

- The financial performance of the Ontario local distribution companies (LDC), regulated by the Ontario Energy Board (OEB), has gradually weakened, primarily reflecting regulatory lag. We view this development as negative for credit quality, which could lead to us to reassess Ontario's regulatory framework.
- We revised the outlook to negative from stable and affirmed our 'A' issuer credit rating on Grandbridge Energy Inc. (GBE).
- The negative outlook reflects the possibility that we could reassess our view of the Ontario regulatory framework because of regulatory lag that has weakened financial performance, increased cash flow volatility, and weakened financial predictability.

Rating Action Rationale

We have historically assessed the Ontario regulatory framework as one of the most credit supportive regulatory jurisdictions. Despite the OEB only authorizing its LDCs an average return on equity (ROE) and a significantly below average capital structure, reflecting a 40% equity ratio, we have consistently assessed the Ontario regulatory framework as one of the most credit supportive regulatory jurisdictions because of the LDCs consistent historical ability to generally earn at, or close to, their authorized ROE. However, this appears to be gradually weakening because of rising regulatory lag, which is the timing difference between when costs are incurred and when regulators allow those costs to be fully recovered from ratepayers. During the past two years, transmission costs and wholesale market charges have significantly increased. Although we expect the LDCs to recover these costs from ratepayers, it has taken as long as 24 months to fully recover these costs, leading to regulatory lag and a weakening of financial performance. In general, regulatory jurisdictions that we assess as most credit supportive have a regulatory construct in place that consistently minimizes regulatory lag.

GBE's historical financial measures have weakened. GBE's financial performance weakened in 2022, reflecting regulatory lag and a partial year of cash flows from Brantford Hydro Inc. as the merger completed on May 2, 2022. In 2022, funds from operations (FFO) to debt was 14.4%, modestly below our downgrade threshold of 15%. Under our base case of annual capital expenditures of C$35 million, annual dividend payments of about C$7 million, and the recovery of previously incurred costs, we expect financial measures will improve. Specifically, we expect FFO to debt to reflect 18%-19% over the next three years.

We continue to assess GBE's business risk profile as excellent. Our assessment of GBE's business risk profile reflects that it is a low-risk regulated LDC, operating under Ontario's regulatory framework, and its service territories benefit from higher economic growth prospects. Partially offsetting GBE's key credit strengths are the company's below average size, serving about 111,000 customers, and lack of geographic diversity. In addition, our assessment takes into account GBC's nonutility exposure (about 5% of consolidated EBITDA). These businesses include solar assets, telecom services, street lighting, and home comfort products. We view these businesses as having more risk than regulated utilities. However, our expectation is that the company will not materially grow these businesses in relation to the overall consolidated company.

Outlook

The negative outlook on GBE reflects our view that we could downgrade the company by one notch within the next 12 months, pending our review of the Ontario regulatory jurisdiction. Our outlook also incorporates our expectations that financial measures improve, reflecting FFO to debt of 18%-19% through 2025.

Downside scenario

We could lower our ratings by one notch within the next 12 months on GBE if we revise downward our assessment of Ontario's regulatory jurisdiction, assuming the company maintains FFO to debt above 15% in line with our baseline expectations.

If we do not revise our assessment of Ontario's regulatory jurisdiction, then we could lower our ratings on GBE if FFO to debt weakened consistently below 15%.

Upside scenario

We could affirm GBE's ratings and revise our outlook on GBE to stable if we revise downward our assessment of Ontario's regulatory jurisdiction and GBE's financial measures significantly improve such that FFO to debt is consistently greater than 20%.

We could also affirm GBE's ratings and revise GBE's outlook to stable over the next 12 months if we maintain our current assessment of Ontario's regulatory jurisdiction and GBE's FFO to debt consistently improves to greater than 15%.

Company Description

Grandbridge Energy Inc. (GBE) is a midsize Ontario LDC located in Southeastern Ontario. Almost all cash flows come from its regulated electricity distribution business. GBE delivers electricity to 111,000 customers through a fully owned extensive network of overhead and underground lines.

Liquidity

We assess GBE's liquidity as adequate and expect its sources to be 1.1x over its uses for the next 12 months. In addition, we anticipate its net sources would remain positive even if its forecast consolidated EBITDA declines 10%. We believe the company's generally predictable regulatory framework provides manageable cash flow stability, even in times of economic stress, which supports our use of slightly lower thresholds to assess its liquidity. In addition, we believe GBE could absorb high-impact, low-probability events, reflecting about C$70 million of committed loan facilities through 2027 and our belief it can maintain its capital spending (averaging about C$35 million annually through 2025) during stressful periods. This indicates that it would have a limited need for refinancing under such conditions. Furthermore, our assessment reflects GBE's generally prudent risk management practices. Overall, we believe the company would likely be able to withstand adverse market circumstances over the next 12 months with sufficient liquidity to meet its obligations.

Principal liquidity sources:

- Cash and cash equivalents of about C$16 million;
- Cash FFO of about C$27 million; and
- Committed loan facility availability of C$70 million.

Principal liquidity uses:

- Debt maturities of C$16.9 million;
- Capital expenditures of about C$32 million; and
- Dividend payments of about C$6.5 million

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors have no material influence on our credit rating analysis of GBE.

Issue Ratings - Subordination Risk Analysis

Capital structure

GBE's capital structure comprises about C$105 million of senior unsecured debt, nonrevolving term facility of about C$22 million and balance outstanding under revolving credit facility of about C$12 million.

Analytical conclusions

We rate GBE's senior unsecured debt 'A', the same as our long-term issuer credit rating, because it is the debt of a qualifying investment-grade utility.

Ratings Score Snapshot

Issuer Credit Rating: A/Negative/--

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/leverage: Intermediate

Anchor: a

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a

Group credit profile: a

Related Criteria

- 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: Reflecting Subordination Risk In Corporate Issue Ratings , March 28, 2018
- 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 | Utilities: Key Credit Factors For The Regulated Utilities Industry , Nov. 19, 2013
- General Criteria: Methodology: Industry Risk , Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions , Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology , 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

Ratings List

Ratings Affirmed; Outlook Action

	To	From
GrandBridge Energy Inc.		
Issuer Credit Rating	A/Negative/--	A/Stable/--
Ratings Affirmed		
GrandBridge Energy Inc.		
Senior Unsecured	A	