Georgian Oil and Gas Corporation
1H16 update

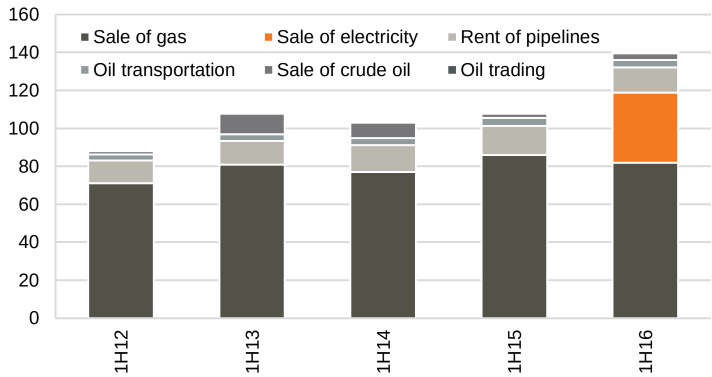
Georgia | Energy
Georgian Oil and Gas Corporation
September 23, 2016

S&P / B+ / Negative
Fitch / BB- / Stable

GOGC released 1H16 unaudited results. Revenue increased 30.6% y/y, boosted by electricity sales, which commenced in 3Q15. Operating expenses, dominated by cost of gas, increased 15.0% y/y. As a result, adjusted EBITDA almost doubled, compared to the same period last year, reaching US$ 47.0mn. Strengthening of GEL against US$ between end-15 and 1H16 led to a US$ 3.8mn non-cash FX gain, which boosted net income to US$ 40.4mn. Construction of Gardabani CCPP II is expected to start in 2017. The gas storage reservoir project has entered the second phase of the feasibility study, with construction expected to commence in early 2018.

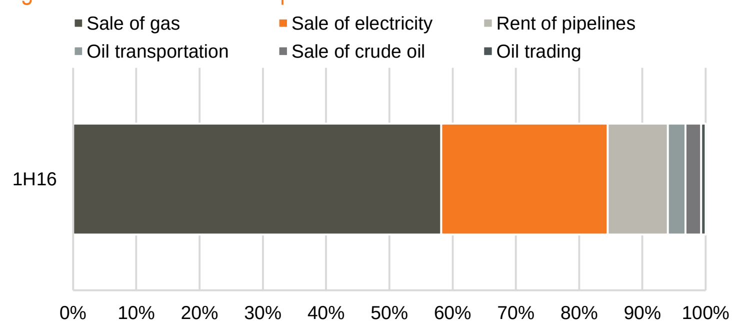
The addition of electricity sales (US$ 37.0mn) from Gardabani CCPP drove 30.6% y/y growth in revenue to US$ 140.6mn in 1H16. Sale of electricity seized a sizable 26.3% share in revenue, diversifying the top line. Sale of gas declined 4.8% y/y in US$ terms, as volume decreased 5.9% y/y to 686 mmcm in 1H16. Rent of pipelines and oil transportation revenues shrank 13.1% y/y to US$ 13.4mn and 5.7% y/y to US$ 3.9mn, respectively. Oil trading, a new business line for GOGC, yielded US$ 1.0mn in revenue, generated by providing logistical services for the transportation of Turkmen crude oil from Baku to Batumi.

Figure 1: Revenue, US$



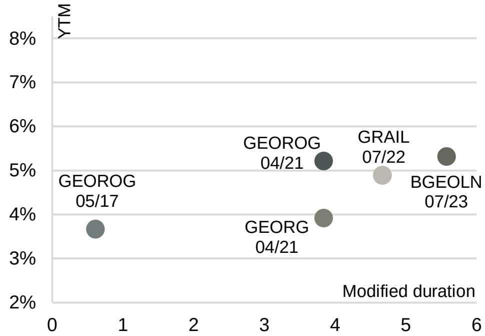
Source: Company data

Figure 2: 1H16 revenue composition



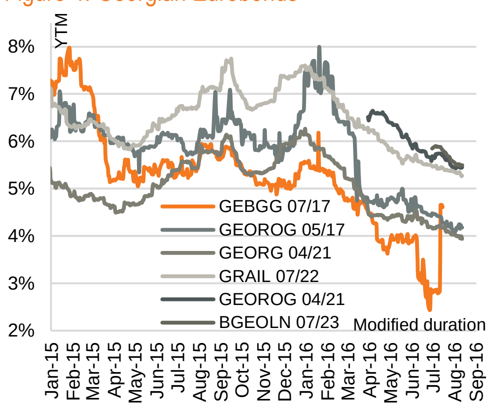
Source: Company data

Figure 3: Georgian Eurobond universe



Source: Bloomberg

Figure 4: Georgian Eurobonds



Source: Bloomberg

Table 1: Key financials (US$ '000) and margins

	1H15	1H16	Change, y/y
Revenue	107,630.2	140,552.4	*30.6%*
Gross profit	30,081.6	55,903.0	*85.8%*
Gross profit margin	*27.9%*	*39.8%*	*1,190bps*
EBITDA	26,779.7	53,727.7	*100.6%*
EBITDA margin	*24.9%*	*38.2%*	*1,330bps*
Adjusted EBITDA	24,415.4	47,004.1	*92.5%*
Adjusted EBITDA margin	*22.7%*	*33.4%*	*1,070bps*
EBIT	22,280.7	46,416.3	*108.3%*
EBIT margin	*20.7%*	*33.0%*	*1,230bps*
Net income	1,372.5	40,403.2	*2,843.8%*
Net profit margin	*1.3%*	*28.7%*	*2,740bps*
Assets	610,857.1	653,053.7	*6.9%*
Equity	301,373.5	340,966.3	*13.1%*
Liabilities	309,483.2	312,087.0	*0.8%*

Source: Company data

US$-GEL	1H12	1H13	1H14	1H15	1H16
Period-end	1.64	1.65	1.77	2.25	2.37
Average	1.65	1.65	1.76	2.18	2.32

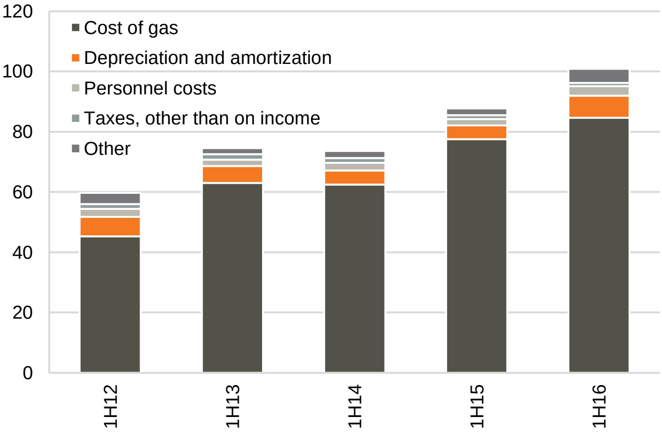
Source: NBG

Nino Papava
Head of Investment Research | n.papava@gt.ge | +995 32 2401 111 ext. 4693

David Ninikelashvili
Senior Analyst | dninikelashvili@gt.ge | +995 32 2401 111 ext. 8137

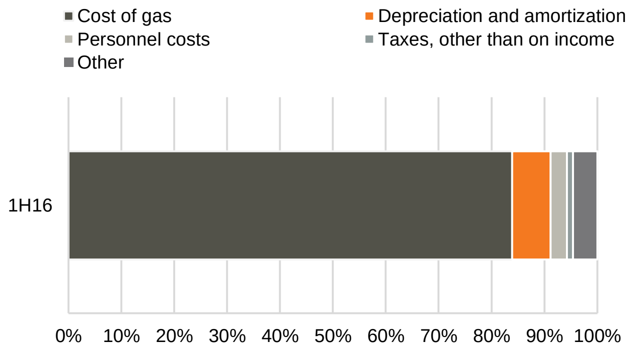
1H16 operating expenses increased 15.0% y/y to US$ 100.9mn, on the back of a 9.2% y/y increase in cost of gas. The latter includes cost of gas used in electricity generation, in addition to cost of gas sold. Cost of gas sold decreased 10.7% y/y to US$ 69.2mn, driven by the drop in average purchase price of gas, per the amendment (effective Mar-16) to the SOCAR Sales and Purchase Agreement (for additional gas volumes up to 350 mmcm). The amendment changed the pre-existing fixed purchase price to a price determined by calculating the weighted average price of oil and certain oil products. Although relatively minor on an absolute basis, personnel costs increased 41.8% y/y to US$ 3.2mn in 1H16, largely due to Gardabani CCPP's personnel costs.

Figure 5: Operating expenses, US$



Source: Company data

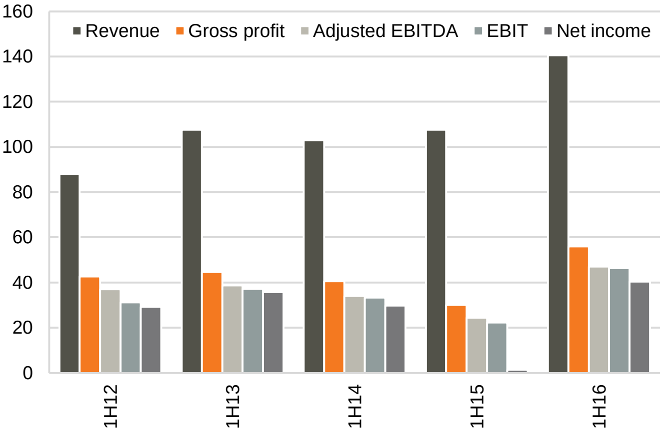
Figure 6: 1H16 operating expenses composition



Source: Company data

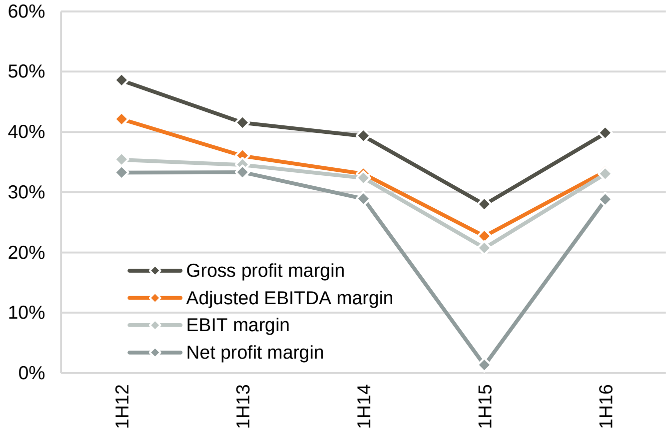
Sale of electricity, coupled with savings in cost of gas, pushed up 1H16 adjusted EBITDA to US$ 47.0mn, up 92.5% y/y. The adjusted EBITDA margin improved from 22.7% in 1H15 to 33.4% in 1H16. All other profitability margins also improved in 1H16, compared to the same period last year.

Figure 7: Income statement highlights, US$



Source: Company data

Figure 8: Profitability margins



Source: Company data

In 1H16, operating cash flows were at US$ 45.6mn, compared to a negative figure (US$ -13.4mn) in 1H15. In addition to the boost from electricity sales, savings in cost of gas had a positive impact on the increase in operating cash flows.

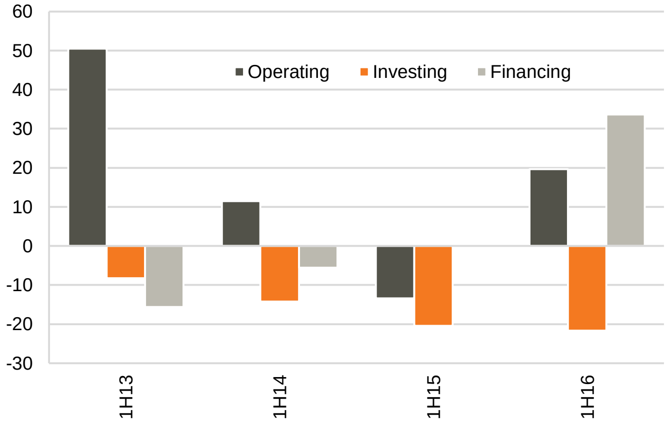
On the investing side, GOGC granted a US$ 10.0mn loan to Georgian Energy Development Fund (GEDF), a state-owned entity promoting the development of renewable energy sources. Per company guidance, the loan is expected to be repaid by end-16. In 1H16, GOGC also made a US$ 3.8mn equity investment in Kartli Wind Power Station LLC, a subsidiary of GEDF, after a US$ 2.4mn equity investment in

2015. Kartli Wind Power Station LLC will construct the first wind power station in Georgia, with a capacity of 20.7 MW, to be completed by the end of Sep-16.

In Apr-16, GOGC refinanced its outstanding GEOROG 05/17 US$ 250.0mn Eurobond with a new US$ 250.0mn Eurobond maturing in 5 years. Approximately 80% of the outstanding bonds have been purchased by GOGC, while the rest remain to be redeemed in May 2017. In 1H16, GOGC paid its 2015 dividend in the amount of US$ 5.5mn.

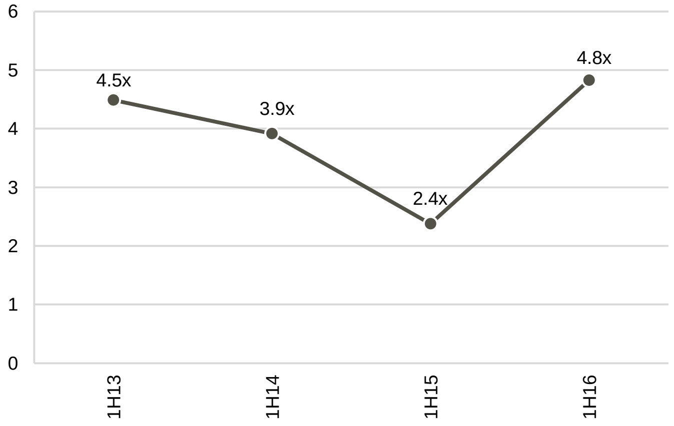
On the back of higher adjusted EBITDA, the adjusted EBITDA coverage ratio doubled, compared to the same period last year, reaching 4.8x.

Figure 9: Cash flows, US$



Source: Company data

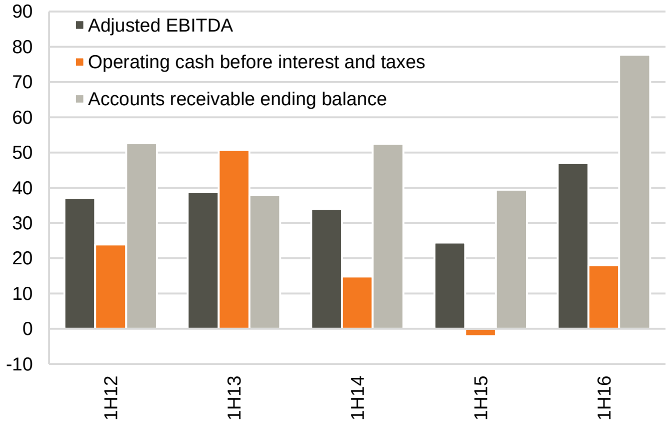
Figure 10: Adjusted EBITDA coverage ratio



Source: Company data

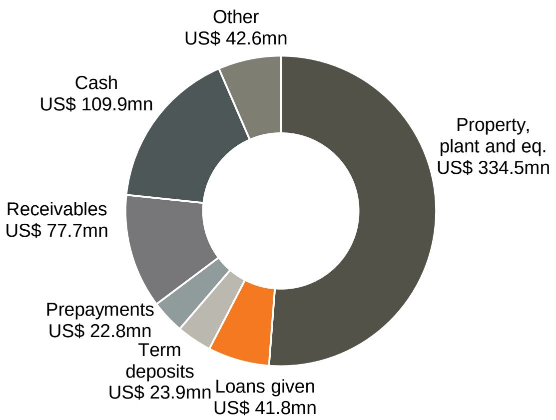
Notably, as of 1H16, the accounts receivable balance was up 96.9% y/y. SOCAR Gas Export-Import, which purchases gas from GOGC for distribution to end customers, accounts for the lion's share of the balance. Per company guidance, the balance is expected to gradually decrease over the next nine months.

Figure 11: Cash conversion highlights, US$



Source: Company data

Figure 12: Asset composition, 1H16



Source: Company data

We expect end-2016 net debt-to-adjusted EBITDA to come in at 1.5x, well below the Eurobond covenant of 3.5x, on the back of significant expected growth in adjusted EBITDA and lower capital spending in FY16.

Disclaimer

Head of Investment Research
Nino Papava | n.papava@gt.ge

Economist
Eva Bochorishvili | evabochorishvili@gt.ge

Economist
Alim Hasanov | ahasanov@gt.ge

Senior Associate
Giorgi Iremashvili | giremashvili@gt.ge

Senior Analyst
David Ninikelashvili | dninikelashvili@gt.ge

Analyst
David Kutidze | dkutidze@gt.ge

Analyst
Tamara Kurdadze | tamarkurdadze@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge