Georgian Oil and Gas Corporation
1H19 update

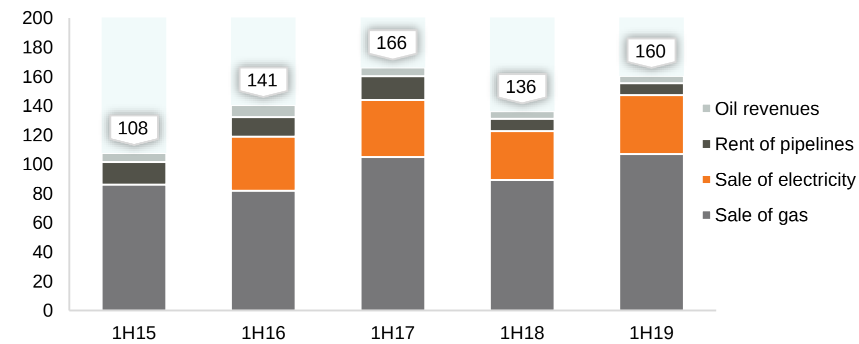
Georgia | Energy
Georgian Oil and Gas Corporation
October 31, 2019

GOGC released 1H19 unaudited results. Revenue was up 17.8% y/y to US$ 160.4mn in 1H19, mostly due to a 19.8% y/y (US$ 106.7mn) increase in sale of gas. Revenue from electricity generation, second largest revenue category, was also up 21.6% y/y, while GEL-denominated gas pipelines rental revenues were down 7.1% y/y. Meanwhile, operating expenses increased 14.9% y/y to US$ 130.9mn in 1H19. Higher revenues helped adjusted EBITDA to grow by 21.7% y/y to US$ 36.5mn. Notably, more than 90% of the construction works on Gardabani II CCPP have been completed as of October 2019. GOGC's strong financial position is attested by a one-notch rating upgrade from S&P in October 2019 to BB- outlook stable.

GOGC's 1H19 revenue was up 17.8% y/y to US$ 160.4mn, driven by increased gas sales revenue (+19.8% y/y to US$ 106.7mn). Gas demand was mostly affected by increased demand from TPPs as well as from commercial sector. Notably, increased demand from TPPs was a result of reduced hydro generation in 1H19 (down 9.7% y/y) due to unfavorable hydrological conditions. Importantly, gas sales to commercial sector were recorded for the first time, and this new category lifted average gas sale price to US$ 126.6/mcm in 1H19 compared to 115.5/mcm in 1H18.

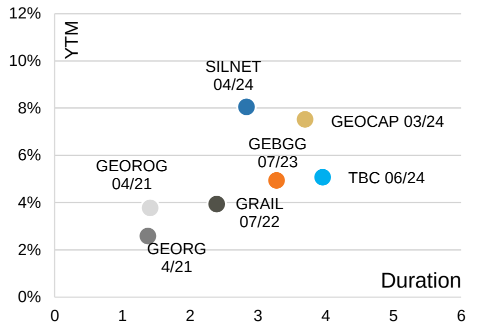
Gardabani TPP operated for 165 days during 1H19, compared to only 134 days in 1H18, as hydrogenation reduced. As a result, revenue from electricity generation was up 21.6% y/y to US$ 40.6mn in 1H19 (25.3% of total). Rent from gas pipelines is the only GEL-denominated revenue category for GOGC since September 2017, when an annual fixed GEL 42mn fee was introduced. Consequently, GEL's 10% depreciation against dollar in 1H19 (vs. 1H18 average) reduced pipeline rental revenue in US-terms by 7.1% y/y to US$ 7.9mn, while in GEL terms income remained flat. Oil transportation revenue declined 15.1% to US$ 3.6mn, as crude oil throughput in WREP was down. Significant growth in revenue from crude oil sales (up 70.8% y/y to US$ 1.6mn), which makes up only 1% of total revenue, was partially driven by increased volumes (up 53.9% y/y) as well as higher global crude oil prices.

Figure 1: Revenue, US$ mn



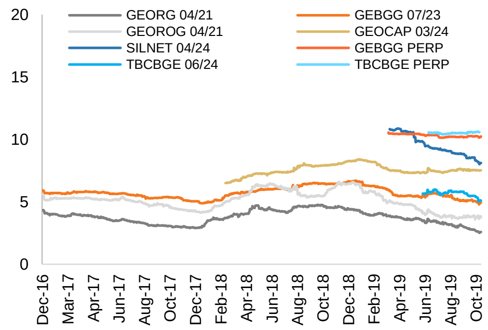
Note: Oil revenues include the following revenue lines: oil transportation, sale of crude oil, and oil trading.
Source: Company data

Figure 3: Georgian Eurobond universe



Source: Bloomberg

Figure 4: Georgian Eurobonds



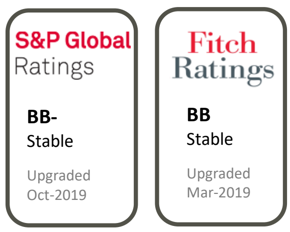
Source: Bloomberg

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

	1H18	1H19	Change, y/y
Revenue	136,142	160,439	*17.8%*
Adjusted EBITDA*	30,060	*36,595*	*21.7%*
Adjusted EBITDA margin	*22.1%*	*22.8%*	*0.73pps*
EBIT	22,792	29,914	*31.2%*
EBIT margin	*16.7%*	*18.6%*	*1.90pps*
Net income	37,813	11,926	*-68.5%*
Net profit margin	*27.8%*	*7.4%*	*-20.34pps*
Assets	703,545	623,656	*-11.4%*
Liabilities	293,092	266,072	*-9.2%*
Equity	410,452	357,584	*-12.9%*
Net Debt	63,050	177,453	*+181%*

Source: Company data
** EBITDA is adjusted to exclude other income*

GOGC credit ratings



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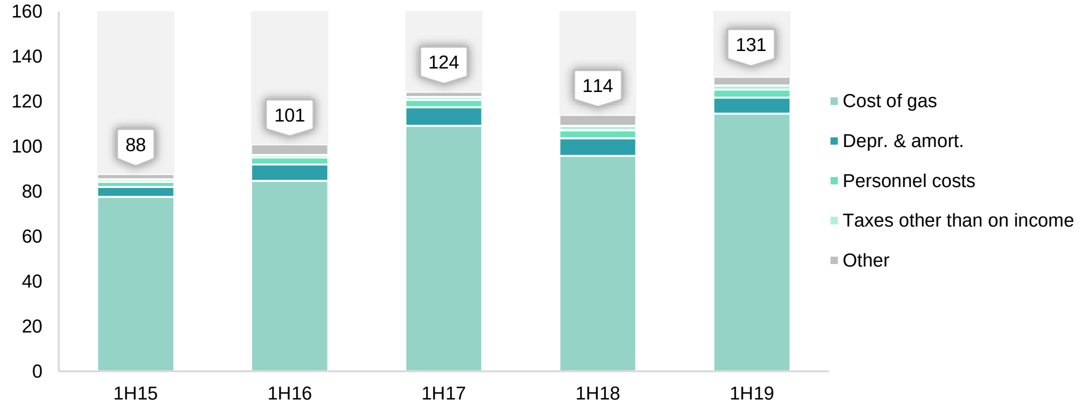
1H19 operating expenses were up 14.9% y/y to US$ 130.9mn. Cost of gas, largest expense category, which combines gas purchased for resale (85% of cost of gas) and gas used by Gardabani I, grew 19.6% y/y to US$ 114.5mn. Gas costs for resale increased in both, volume (+12.8% y/y) and price (+ 3.8% y/y) terms. As a result this category was up 16.7% y/y to US$ 97.9mn. Cost of gas used in electricity generation also grew 39.9% y/y to US$ 16.7mn as demand on gas from Gardabani I increased in the reporting period. Other expenses, accounting for 12.5% of total, decreased 9.9% y/y to US$ 16.4mn helped by GEL's depreciation in the period.

Figure 5: Operating expenses, US$ mn

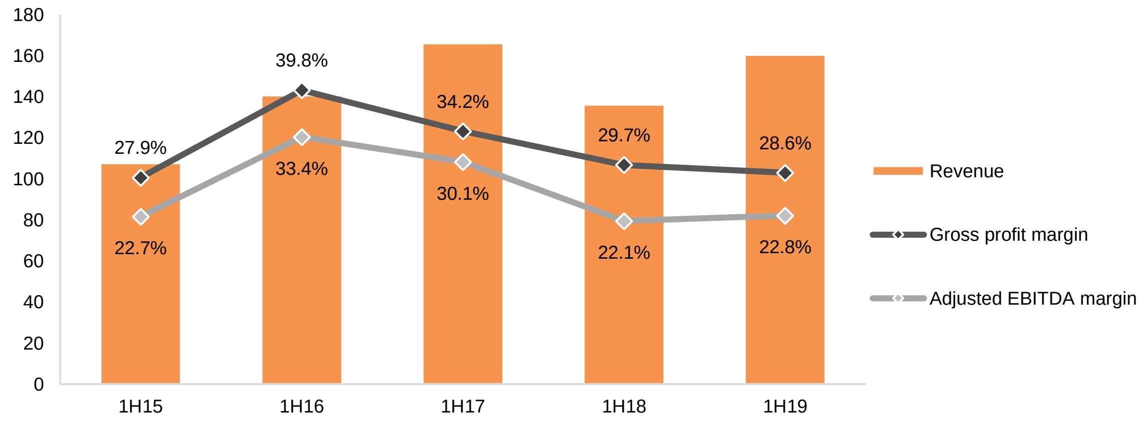


Source: Company data

1H19 adjusted EBITDA grew by 21.7% y/y to US$ 36.6mn, supported by high revenues. This translated into an adjusted EBITDA margin of 22.8% in 1H19, slightly above the last year's level (22.1% in 1H18). Income from equity investments plummeted to US$ 0.3mn in 1H19 vs. US$ 0.9mn a year before as Kartli Wind Power Station's equity was reduced.

Net profit dragged down mostly by non-cash FX costs. GEL's 7% depreciation against dollar during 1H19 led to a non-cash FX loss of US$ 16.7mn in 1H19, compared to US$ 11.2mn gain in 1H18 (when GEL strengthened). As a result, the bottom line plummeted 68.5% y/y to US$ 11.9mn in 1H19.

Figure 6: Revenue and profitability



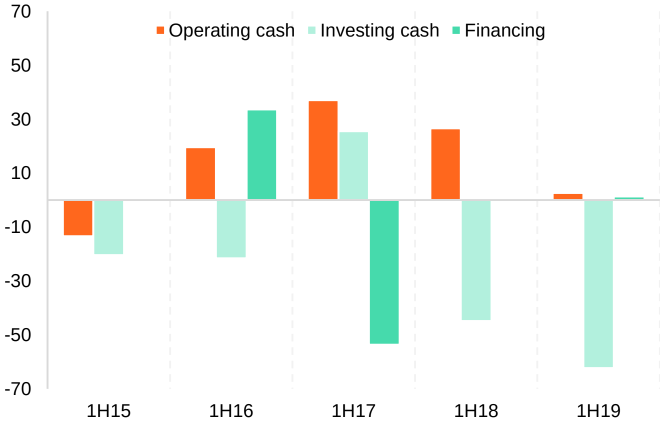
Source: Company data

Cash balance pressured by significant capital expenditures related to Gardabani II construction. Investments stood at US$ 62.3mn in 1H19, one of the highest capital investments made by the company. Construction of Gardabani II reached the final stage with c. 90% construction works already finalized by Oct-19. Test-regime is planned to start in November, with the launch of the CCPP expected in Dec-19.

Cash flows from operating activities stood at US$ 2.6mn in 1H19, compared to US$ 26.6mn in 1H18. GOGC made higher cash payments (+16.1% y/y) to suppliers in 1H19 mostly related to the increased gas sales volumes. At the same time, cash receipts from customers remained mostly flat (+0.2% in USD), causing the fall in operating cash flows. In addition, earnings on deposits plunged as high capex (related to Gardabani II) reduced cash balance at banks from US$ 182.8mn as of 1H18 to US$ 68.4mn by June-19.

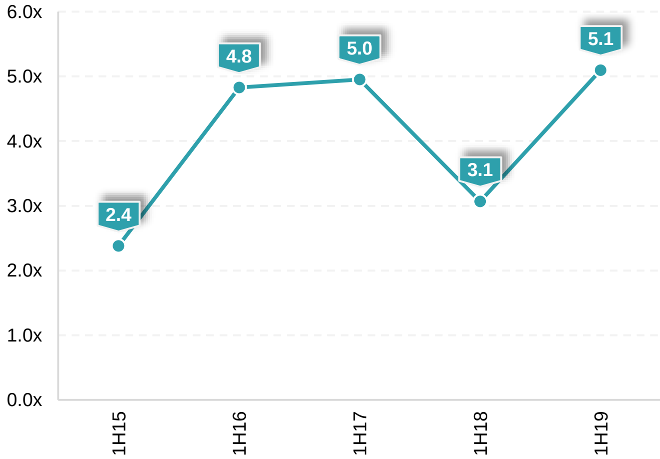
GEL's 17% depreciation against dollar as of end-June 2019 compared to end-June 2018, was the main reason behind the decreased balance sheet items. GOGC's asset structure has undergone significant transformation in 1H19 as Gardabani II construction reached the final stage. On the back of large investments related to this construction, GOGC's cash balance decreased significantly (down 62.6% y/y to US$ 68.4mn), while PPE balance increased (+10.1% y/y to US$ 395.1mn). GEL's depreciation reduced overall asset balance by 11.4% y/y (to US$ 623.6mn), while in GEL terms the balance increased (+3.7% y/y).

Figure 7: Cash flows, US$



Source: Company data

Figure 8: Adjusted EBITDA coverage ratio



Source: Company data
Note: EBITDA coverage is calculated based on 6 month data

After upgrading Georgia's sovereign rating from BB- to BB in October 2019, S&P Ratings lifted GOGC's rating from B+ to BB-. The decision was backed by GOGC's strong financial position (sizeable cash balance, stable earnings and steady cash flows from electricity segment). In addition, S&P Ratings expects the commissioning of the Gardabani II in late 2019 to improve company's financial position, after temporary deterioration of credit metrics (high capex, lower cash balance). Notably, S&P Ratings has not changed Georgian Railway's credit rating – another Government Related Entity, leaving at B+, two notches below that of government.

Disclaimer

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