GALT & TAGGART
RESEARCH

Silknet - 1H21 update

Eurobond call in April 2022 highly likely

Fixed Income Research | Georgia
Silknet
September 29, 2021

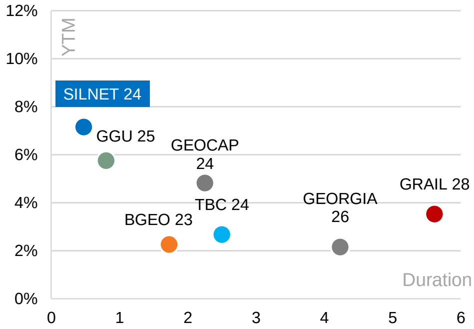
Silknet's performance improved considerably in 2Q21, boosted by faster than expected recovery of Georgian economy and gradual revival of tourism. The company generated GEL 197.8mn (+6.9% y/y) in revenue and GEL 100mn (+4.5% y/y) EBITDA in 1H21 (excluding IFRS 16). Mobile data continues to drive the growth in 1H21, however favorable results are also seen in other segments. Namely, fixed broadband revenue was up 1.5% y/y, while pay-TV revenue was up 5.0% y/y on the back of increased ARPUs. Notably, Silknet lags behind Magticom in new customer acquisitions in fixed broadband and pay TV segments, explained by Magticom's aggressive strategy to penetrate rural areas. Despite strong performance in terms of revenue the company's profitability margins slightly deteriorated in 1H21, with adjusted EBITDA margin at 53.9% in 1H21 vs 55.2% in 1H20. This decline stems from increased electricity tariffs, FX-related increases in operating expenses and higher salaries. On a positive note, Silknet's leverage declined from 2.98x as of Dec-2020 to 2.83x by end June 2021, supported by GEL's appreciation against USD. Notably, from 1st of July the retail price regulation has been abolished, giving flexibility to the existing mobile operators to adjust tariffs when needed. Silknet's US$ 200mn Eurobond, which is callable from 2 April 2022 (at 105.5%), was trading at 109.06% of par for an yield (YTM) of 7.0% as of Sep-21. At this pricing level, it is highly likely that Silknet will recall its Eurobonds in 2Q22.

Silknet released audited 1H21 results. The company generated GEL 197.8mn (+6.9% y/y) in revenue and GEL 100mn (+4.5% y/y) EBITDA in 1H21. After the slight decline in commercial revenue (90% of total) in 1Q21 (-0.6% y/y) the growth accelerated in 2Q21, with revenue up 11.4% y/y. Mobile data revenue continues to drive the growth in 1H21, with revenue up 19.4% y/y to GEL 36.6mn, however favorable results are also seen in other segments (fixed broadband, pay-TV and carrier service revenues). Silknet's 1H21 performance was boosted by faster than expected recovery of Georgian economy, which quickly regained COVID crisis losses helped by pent-up demand, strong goods exports, solid remittances, and ongoing recovery in tourism (tourism revenues recovered to c. 21% of pre-pandemic level in 1H21). Real GDP growth came in at 12.5% y/y in 1H21, which is also 5.7% higher vs. 1H19 level, beating market expectations.

Eva Bochorishvili - Head of Research
| evabochorishvili@gt.ge | +995 32 2401 111 ext. 8036

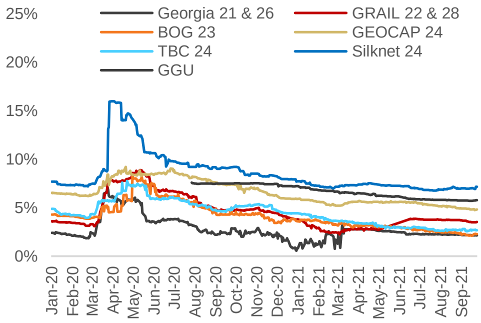
Ana Nachkebia - Senior Research Associate
| ananachkebia@gt.ge | +995 32 2401 111 ext. 8137

Figure 1: Georgian Eurobond universe



Source: Bloomberg, as of 27 September 2021

Figure 2: Georgian Eurobonds



Source: Bloomberg, as of 27 September 2021

Table 1: Key financial highlights

GEL '000	1H20	1H21	Change, y/y
Revenue	184,907	197,758	*6.95%*
of which commercial:	*168,622*	*177,428*	*5.22%*
Adjusted EBITDA*	102,013	106,651	*4.5%*
Adjusted EBITDA margin	*55..2%*	*53.9%*	*-1.3ppts*
Net income	-39,635	17,796	*n/a*
Net profit margin	*n/a*	*9.00%*	*n/a*
Assets	866,843	838,735	*-3.24%*
Liabilities	878,631	880,253	*0.18%*
Equity	-11,788	-41,518	*-452.2%*
Net Debt	611,578	621,247	*1.58%*

Source: Company data
* Note: Incl. IFRS 16

Silknet credit ratings

Fitch Ratings
B
Stable
Downgraded Dec-2020

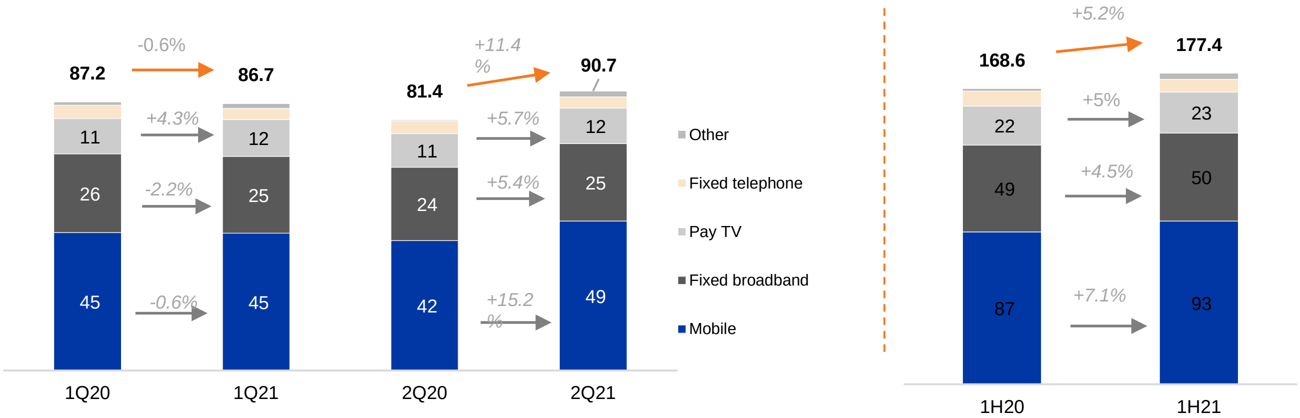
Moody's
B1
Negative
Affirmed Mar-2021

From 1st of July 2021, ComCom (Georgian Communication Commission), the regulatory body of the telecom market in Georgia, abolished the retail price regulation in the mobile market, giving flexibility to the existing mobile operators to adjust their tariffs when needed (the restriction was in force from 2020). The decision came in response to the appeal from the 3 mobile operators in Georgia, claiming COVID-19 related economic disruptions, elevated inflation and increased network overloads (which require significant operational and capital expenses) as the main reasons for the request. Notably, ComCom retains the right to regulate the retail pricing in case of abuse of a dominant position by the market player, in line with the Law of Georgia on Competition.

ComCom also outlined that all three telecom operators - MagtiCom, Silknet and Veon - confirm the readiness to give access of their network to the mobile virtual network operators (MVNO), which was one of the preconditions for the abolition of retail tariff control in European countries.The ComCom has indicated that the ex ante MVNO access regulation is likely to be abandoned, once the first bona fide MVNO concludes access agreement with existing mobile operators. Thereafter, mobile operators and prospective MVNOs will negotiate agreements on commercial terms, without regulatory involvement.

Commercial revenue, which combines 4 major business segments, mobile, fixed broadband, pay TV and fixed telephone, was up 5.2% y/y to GEL 177.4mn in 1H21. Growth in mobile segment explained more that 70% of total growth, while the rest was attributed to the fixed segment.

Figure 3: Commercial revenue up 5.2% y/y in 1H21, supported by strong 2Q21 results
Commercial revenue, GEL mn

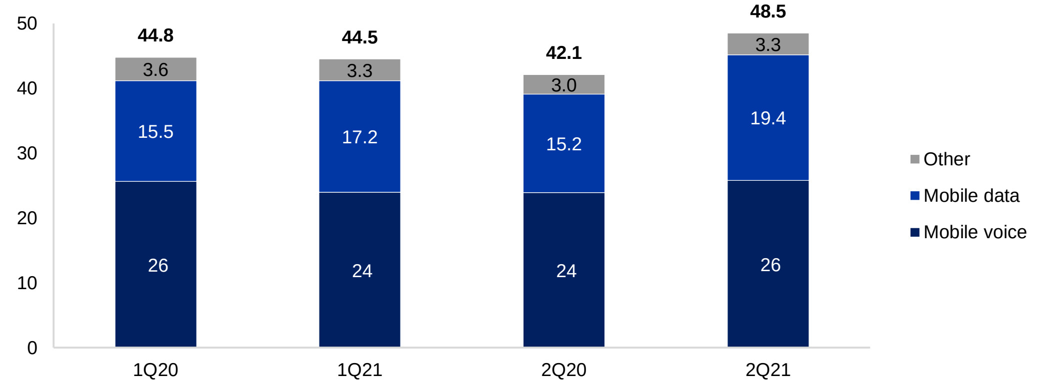


Source: Company data, Galt & Taggart Research

Mobile segment, which combines mobile voice and mobile data, was the driving force behind commercial revenue growth in 1H21, with revenue up 7.1% y/y to GEL 93.1mn. The growth was entirely driven by the surge in mobile data revenues, up 19.4% y/y to GEL 36.6mn in 1H21. This was supported by growing mobile internet penetration (standing at 65% in 2Q21, up from 57% in 1Q20) as well as increased per user data usage. Mobile voice revenues, accounting for more than half of total mobile segment, reduced 6.6% y/y in 1Q21 due to COVID-19 related slowdown in mobility, and recovered in 2Q, up 7.8% y/y. Overall mobile voice revenue remained mostly flat in 1H21 (+0.4% y/y).

Figure 4: Mobile segment revenue up by 7.1 % in 1H21 y/y, fueled by surging mobile data revenue

Mobile segment revenue, GEL mn



Source: Company data, Galt & Taggart Research

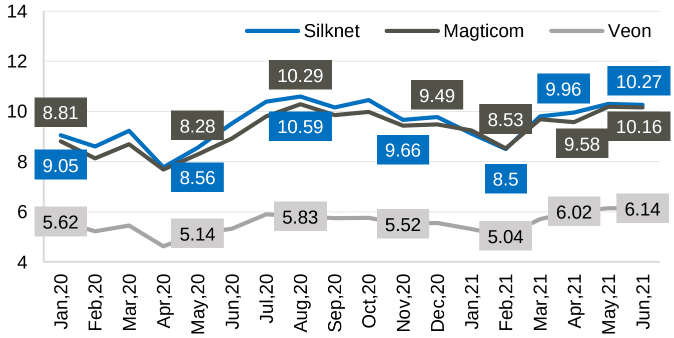
***Market position* - Competition in the mobile segment remained fierce in 1H21.** Magticom maintains leadership position in mobile subscribers, with 40.8% market share as of June 2021, followed by Silknet with 33.5% share. Silknet lost 40bps in market share in 1H21 as Magticom added c. 158,000 new customers since Dec-20, while Silknet added c. 82,000 in the same period. Most of the growth in subscriber base is related to the prevalence of multi-SIM ownership in Georgia.

Mobile ARPUs on the upward trajectory since Feb-2021. Mobile ARPUs in the sector started rising since Feb-21, when average sector ARPU dropped to GEL 7.74, the lowest level since May-20 (partially explained by seasonality). Since then ARPUs have been growing, with sector average reaching GEL 9.1 in Jun-21.

The growth in ARPUs is particularly apparent in retail segment. Notably, in retail, where Silknet earns slightly higher ARPUs compared to its main competitor Magticom, ARPUs increased significantly compared to Feb-21 lows, reaching GEL 10.3 in Jun-21 from GEL 8.5 in Feb-21 (constant compared to Jun-20 level). Veon, which is mostly a second-sim operator in the market has also managed to increase ARPUs, from average GEL 5.0 in the beginning of the year to GEL 6.1 by Jun-21. In corporate segment, despite the positive trend, the gap between Magticom and Silknet remains high, with Magticom earning GEL 10.9 vs GEL 8.0 earned by Silknet and GEL 7.6 by Veon in Jun-21.

Figure 5: Silknet earns slightly higher ARPUs in retail segment

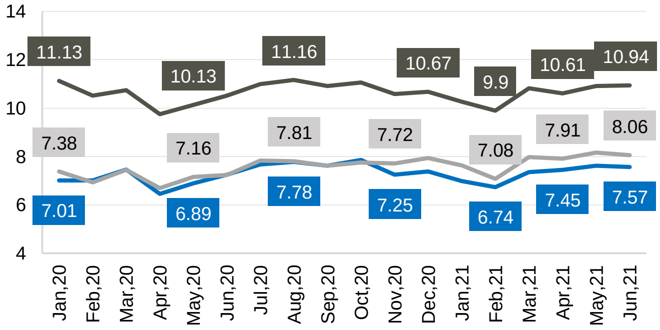
Mobile ARPUs in retail, GEL



Source: ComCom

Figure 6: Magticom dominates the corporate segment

Mobile ARPUs in corporate, GEL



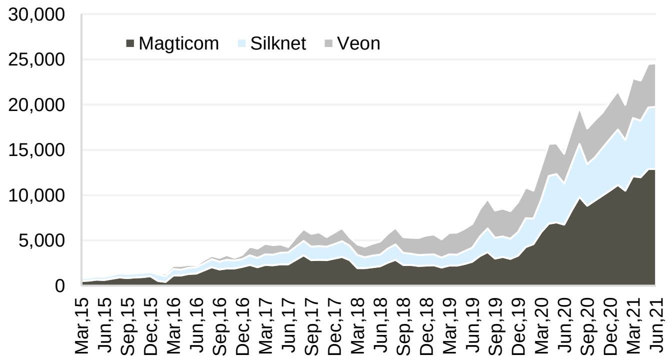
Source: ComCom

Growing subscriber base coupled with increasing ARPUs, resulted in overall mobile sector revenues to increase by 11.1% y/y to GEL 256.4mn in 1H21 (based on ComCom data). Magticom managed to increase mobile revenues by 13.4% y/y in 1H21 vs 7.6% y/y and 12.2% y/y growths achieved by Silknet and Veon, respectively. However, higher growth achieved by Magticom in 1H21 is explained by the low base of 1H20 (when revenues dropped by 4.7% y/y for Magticom, while, Silknet managed to post 1.5% y/y growth in the same period). Compared to 1H19 level, Silknet's 1H21 mobile revenues increased by 9.2% vs. 8.1% for Magticom and 13.6% for Veon.

Mobile data is driving the growth in overall mobie revenues for the sector. Surge in mobile data traffic continued in 1H21 albeit at a lower pace compared to 2020. Overall mobile data traffic increased by 69.4% y/y to 130,000 terabytes in 1H21. Magticom contributed the lion's share (45ppts) to the overall mobile data traffic growth in 1H21, followed by Silknet. This is explained by higher growth achieved by Magticom in subscriber base, as well as more data-intensive users.

Figure 7: Hike in data traffic continued in 2021

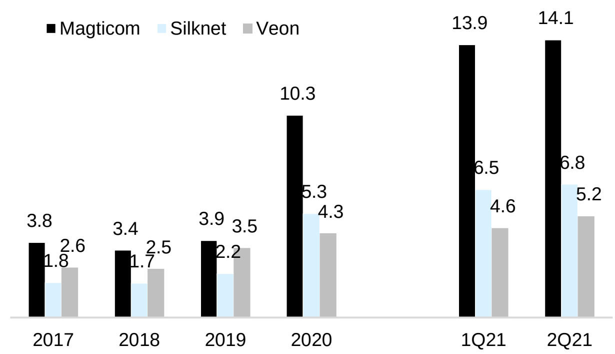
Mobile data traffic, terabytes



Source: ComCom

Figure 8: Per user data traffic reached new highs in 1H21

Average mobile data traffic per user, GB/month



Source: ComCom
Note: data excludes M2M customers

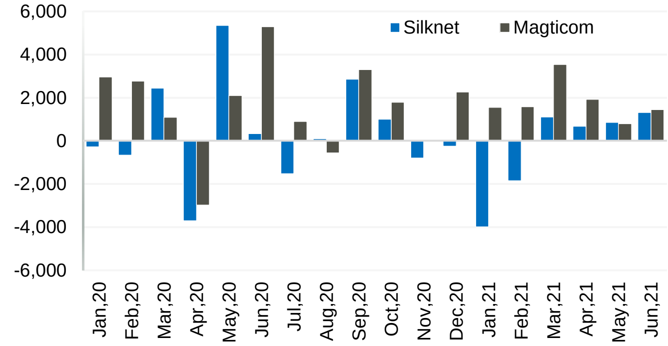
Fixed broadband, which made up 28% of total commercial revenue, was up 1.5% y/y to GEL 50.2mn in 1H21. The decining trend in fixed broadband segment in 1Q21 (-2.2% y/y), reverted in 2Q21 and revenues increased 5.4% y/y as the economy gradually opened, restrictions were lifted and increasing number of business entities resumed operations.

Silknet accounted for 30.3% of the fixed broadband market as of Jun-21, compared to 31.0% in Dec-20 and 32.7% in Jun-19. The loss in market share is explained by Magticom's (market leader in fixed broadband segment with 49.4% share as of Jun-21) strategy to penetrate rural areas, while Silknet's expansion strategy is more concentrated. Magticom added 10,800 new fixed broadband subscribers in 1H21, compared to c. 1,900 customers lost by Silknet in the same period. Notably, in FTTH (fiber internet), which made up 93% of Silknet's fixed broadband revenue, Silknet has added c. 3,500 new customers during 1H21 (vs. 11,300 added by Magticom). Silknet accounted for 31.5% of the FTTH market as of Jun-21, having passed c. 693,000 homes (63% of households). Notably, expansion in FTTH is cannibalizing Silknet's DSL and fixed LTE subscribers.

Silknet has managed to narrow the gap with Magticom in corporate fixed broadband segment. Silknet has been gradually increasing its corporate ARPUs, reaching average GEL 151.1 in 1H21 compared to GEL 148.4 in 1H20, while Magticom's corporate ARPUs have remained mostly flat. As a result, the gap between the two has narrowed from average GEL 34.3 in 1H20 to GEL 30.9 in 1H21. In retail fixed broadband segment, Silknet still manages to slighty outperform Magticom by ARPUs. Notably, both players managed to increase retail ARPUs in 1H21 up by 3.5% y/y and 4.4% y/y/ for Magticom and Silknet, respectively.

Figure 9: Magticom is aggressively adding new customers

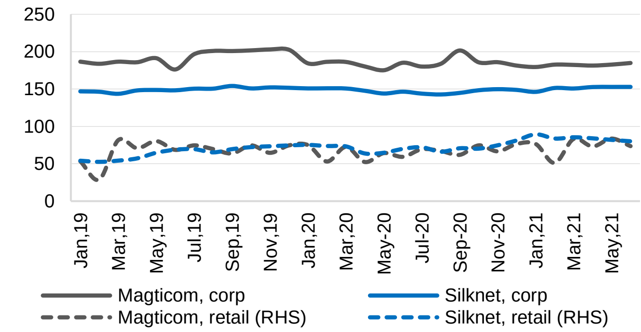
Number of new customers added, m/m



Source: ComCom

Figure 10: Fixed broadband ARPUs remained mostly flat

Fixed broadband ARPUs, GEL



Source: ComCom

Fixed broadband market revenue was up by 13.7% y/y to GEL 145.6mn in 1H21. Magticom and Silknet contributed for only 4.6ppts to this growth, while the remaining growth was stemming from smaller market players, mostly expanding in rural areas. Magticom dominates the fixed broadband markets, wth 46.4% share by revenue, followed by Silknet with 34% in 1H21.

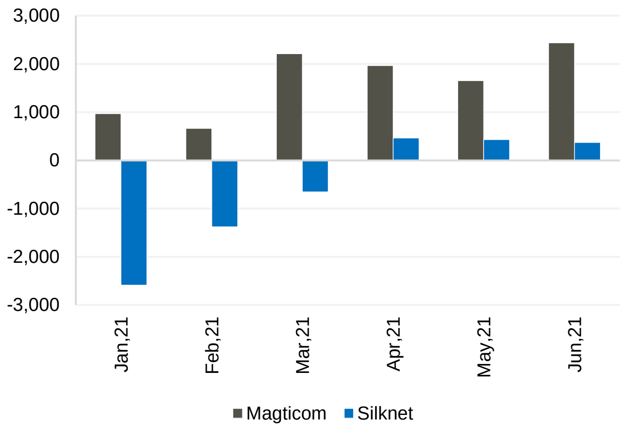
Silknet's pay-TV revenue, which makes up 13% of total commercial revenue, was up 5.0% y/y to GEL 23.4mn in 1H21. Competition in the market remains intense, with Magticom accounting for 51.6% of the market by subscribers, followed by 32.8% by Silknet.

After loosing c. 4,600 customers in 1Q21, the trend reverted and Silknet added c. 1,300 pay TV subscribers in 2Q21. Magticom was more aggressive in cutomer acquisition, adding c. 10,000 customers in 1H21. As a result, Magticom has grabbed c. 80bps of market share from Silknet in 1H21 (from 50.7% in Dec-20 to 51.6% in Jun-21).

On a positive note, Silknet has managed to earn higher ARPUs on pay TV customers compared to Magticom throughout 2021. Average 1H21 ARPUs for Silknet stood at GEL 16.8 in 1H21 vs. GEL 16.0 for Magticom and higher than the 1H20 level of GEL 15.9.

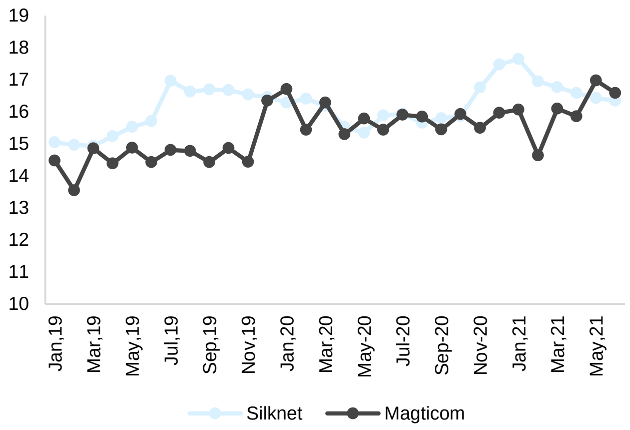
As a result, Silknet has managed to increase its pay TV revenues at a higher pace compared to Magticom, with revenues up 5.2% y/y for Silknet vs 4.8% y/y growth for Magticom in 1H21 (based on ComCom data).

Figure 11: Change in Pay TV subscribers m/m, '000



Source: ComCom

Figure 12: Pay TV ARPUs, GEL



Source: ComCom

Other commercial revenue streams, which combine fixed voice, facility rental and other services have posted a 8.3% y/y growth to GEL 10.8mn in 1H21. The drop in fixed voice revenues (down 14.8% y/y to GEL 7.3mn) was fully offset by increase in other service revenue streams.

Carrier service revenue, which accounts for 10% of total revenue, posted a strong 24.8% y/y growth in 1H21, reaching GEL 20.3mn. The growth reflects strong 2Q21 revenues (+43.4% y/y) driven by bulk SMS interconnect revenue and higher infrastructure capacity rental volume.

Leverage and profitability

Despite strong performance in terms of revenue, the company's profitability margins slightly deteriorated in 1H21. Namely, adjusted EBITDA margin came in at 53.9% in 1H21 compared to 55.2% in 1H20. Several factors contributed to the deterioration of the EBITDA margin:

- The key factor was the 15.9% y/y increase in purchased service expenses, driven by higher utility costs releated to electricity tariff hike by c. 50% from Jan-21.
- A 22.9% y/y growth in other expenses to GEL 9.4mn (excluding one-off items), was another reason for the deteriorated profitability in 1H21. This can be partially explained by 10% depreciation of GEL against USD during 1H21, as 24% of the company's operating expenses are FX-denominated.
- A 9.3% y/y growth is salary expenses in 1H21, also dragged down the EBITDA margin.

On net profit level, the company generated net profit of GEL 17.8mn in 1H21 compared to GEL 39.6mn net loss in 1H20 (the loss was mostly driven by GEL 40.3mn FX expenses following GEL's 6.5% depreciation against USD in 1H20).

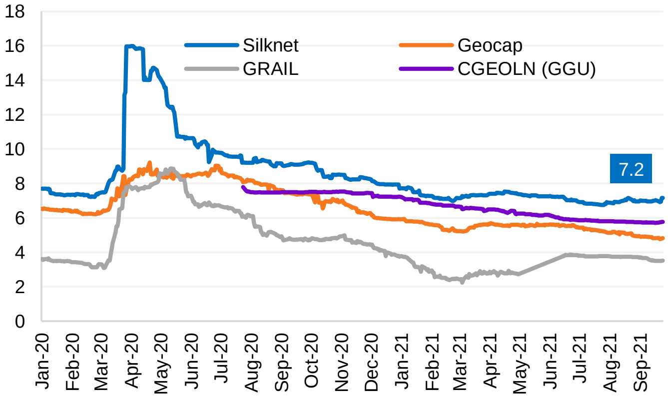
Silknet has managed to lower its leverage from 2.98x as of Dec-20 to 2.83x by end Jun-21. Notably, Silknet repaid the US$ 10mn private bond upon maturity in 1Q21, lowering the company's cash, as well as current loans balance. Furthermore, GEL's 3.5% appreciation against USD between 31 December 2020 and 30 June 2021, supported the reduction of US$ 200mn Eurobond balance (notably, it was partly offset by loss due to the revaluation of the principal of cross-currency hedging instrument).

Eurobond performance

Silknet's US$ 200mn Eurobond (maturing in April 2024) is callable between 2 April 2022-2023 at 105.5% of par, while in 2024 the bonds can be called at 102.75% of par. As of 17 September 2021, the bond was trading at 109.06% of par for an yield (YTM) of 7.0%. At this pricing level, it is highly likely that Silknet will recall its Eurobonds in 2Q22. Notably, yield to next call - YTC (the return a bondholder receives if the bond is held until the call date) - has dropped to 3.97% by 17 September 2021.

Figure 13: Yield on SILKNET 24 dropped to 7.3% by end-March 2021

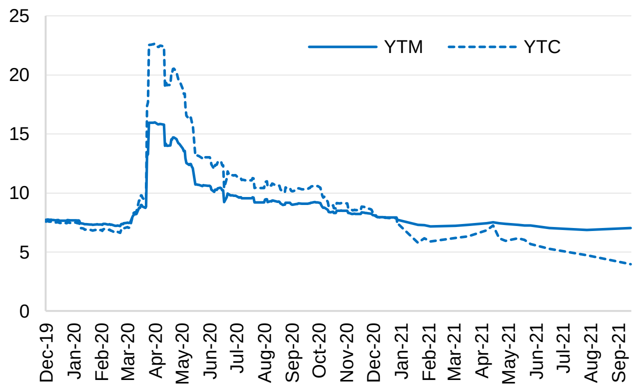
YTM on selected Georgian Eurobonds



Source: Company data

Figure 14: Mid yield to next call (YTC) has dropped to record low in 1H21

Silknet YTM and YTC



Source: Company data
Note: Yield to call (YTC) is a financial term that refers to the return a bondholder receives if the bond is held until the call date

Annex 1: Financials - TBU

Income Statement, GEL mn

	1H19	1H20	1H21
Total revenue	184.0	184.9	197.8
Commercial revenue	164.1	168.6	177.4
Carrier services	19.9	16.3	20.3
EBITDA, incl. IFRS 16	100.4	102.0	106.7
EBITDA margin	54.6%	55.2%	53.9%
D&A	-56.4	-58.3	-58.0
Financial costs (income), net	-51.5	-79.8	-29.2
PBT	-54.9	-40.5	18.0
Tax expense	-1.1	0.8	-0.2
Net income	-56.0	-39.6	17.8
Net margin	-30.4%	-21.4%	9.0%

Note: EBITDA is excluding IFRS 16 adjustments

Income Statement, US$ mn

	1H19	1H20	1H21
Total revenue	60.6	61.0	59.6
Commercial revenue	54.1	55.6	53.4
Carrier services	6.6	5.4	6.1
EBITDA, incl. IFRS 16	33.1	33.6	32.1
EBITDA margin	54.6%	55.2%	53.9%
D&A	-18.6	-19.3	-17.5
Financial costs (income), net	-17.0	-26.3	-8.8
PBT	-18.1	-13.3	5.4
Tax expense	-0.4	0.3	0.0
Net income	-18.5	-13.1	5.4
Net margin	-30.4%	-21.4%	9.0%

Balance Sheet, GEL

	1H19	1H20	1H21
Non-current assets	639.1	757.0	748.8
Net PP&E	366,8	374.8	388.8
Intangible assets and	205,5	206.9	206.4
Other	139.6	175.3	153.7
Current assets	165.6	109.8	89.9
Cash & equivalents	105.9	63.1	46.1
Receivables & prepayments	35.6	33.1	30.8
Other	24.1	13.6	13.0
Total assets	**804.7**	**866.8**	**838.7**
Shareholders' equity	**15.9**	**-11.8**	**-41.5**
Non-current liabilities	668.1	705.7	735.3
LT interest bearing debt	616.7	625.3	645.6
Other	51.4	80.4	89.8
Current liabilities	120.7	172.9	144.9
ST loans	15.7	49.5	21.7
Trade payables & prepaym.	72.7	89.9	87.2
Other	32.3	33.5	36.0
Total liabilities & equity	**804.7**	**866.8**	**838.7**

Balance Sheet, US$ mn

	1H19	1H20	1H21
Non-current assets	209.2	247.8	237.0
Net PP&E	120.1	122.7	123.0
Intangible assets and	67.3	67.7	65.3
Other	45.7	57.4	48.6
Current assets	54.2	35.9	28.4
Cash & equivalents	34.7	20.7	14.6
Receivables & prepayments	11.7	10.8	9.7
Other	7.9	4.5	4.1
Total assets	**263.4**	**283.7**	**265.4**
Shareholders' equity	**5.2**	**-3.9**	**-13.1**
Non-current liabilities	218.7	231	232.7
LT interest bearing debt	201.9	204.7	204.3
Other	16.8	26.3	28.4
Current liabilities	39.5	56.6	45.9
ST loans	5.1	16.2	6.9
Trade payables & prepaym.	23.8	29.4	27.6
Other	10.6	11	11.4
Total liabilities & equity	**263.4**	**283.7**	**265.4**

Disclaimer

This document is the property of and has been prepared by JSC Galt & Taggart ("Galt & Taggart"), a member of JSC Bank of Georgia group (‘Group”) solely for informational purposes and independently of the respective companies mentioned herein. This document does not constitute or form part of, and should not be construed as, an offer or solicitation or invitation of an offer to buy, sell or subscribe for any securities or assets and nothing contained herein shall form the basis of any contract or commitment whatsoever or shall be considered as a recommendation to take any such actions.

Galt & Taggart is authorized to perform professional activities on the Georgian market. The distribution of this document in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by Galt & Taggart to inform themselves about and to observe any and all restrictions applicable to them. This document is not directed to, or intended for distribution, directly or indirectly, to, or use by, any person or entity that is a citizen or resident located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would require any registration or licensing within such jurisdiction.

Investments (or any short-term transactions) in emerging markets involve significant risk and volatility and may not be suitable for everyone. The recipients of this document must make their own investment decisions as they believe appropriate based on their specific objectives and financial situation. When doing so, such recipients should be sure to make their own assessment of the risks inherent in emerging market investments, including potential political and economic instability, other political risks including without limitation changes to laws and tariffs, and nationalization of assets, and currency exchange risk.

No representation, warranty or undertaking, express or implied, is or will be made by Galt & Taggart or any other member of the Group or their respective directors, employees, affiliates, advisers or agents or any other person as to, and no reliance should be placed on, the fairness, accuracy, completeness or correctness of this document and the information contained herein (and whether any information has been omitted from this document) and no reliance should be placed on it. This document should not be considered as a complete description of the markets, industries and/or companies referred to herein. Nothing contained in this document is, is to be construed as, or shall be relied on as legal, investment, business or tax advice, whether relating to the past or the future, by Galt & Taggart any other member of the Group or any of their respective directors, employees, affiliates, advisers or agents in any respect. Recipients are required to make their own independent investigation and appraisal of the matters discussed herein. Any investment decision should be made at the investor's sole discretion. To the extent permitted by law, Galt & Taggart, any other member of the Group and their respective directors, employees, affiliates, advisers and agents disclaim all liability whatsoever (in negligence or otherwise) for any loss or damages however arising, directly or indirectly, from any use of this document or its contents or otherwise arising in connection with this document, or for any act, or failure to act, by any party, on the basis of this document.

The information in this document is subject to verification, completion and change without notice and Galt & Taggart is not under any obligation to update or keep current the information contained herein. The delivery of this document shall not, under any circumstances, create any implication that there has been no change in the information since the date hereof or the date upon which this document has been most recently updated, or that the information contained in this document is correct as at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. No representation or warranty, expressed or implied, is made by Galt & Taggart or any other member of the Group, or any of their respective directors, employees, affiliates, advisers or agents with respect to the accuracy or completeness of such information.

The information provided and opinions expressed in this document are based on the information available as of the issue date and are solely those of Galt & Taggart as part of its internal research coverage. Opinions, forecasts and estimates contained herein are based on information obtained from third party sources believed to be reliable and in good faith, and may change without notice. Third party publications, studies and surveys generally state that the data contained therein have been obtained from sources believed to be reliable, but that there is no guarantee of the accuracy or completeness of such data. Accordingly, undue reliance should not be placed on any such data contained in this document. Neither Galt & Taggart, any other member of the Group, nor their respective directors, employees, affiliates, advisors or agents make any representation or warranty, express or implied, of this document's usefulness in predicting the future performance, or in estimating the current or future value, of any security or asset.

Galt & Taggart does, and seeks to do, and any other member of the Group may or seek to do business with companies covered in its research. As a result, investors should be aware of a potential conflict of interest that may affect the objectivity of the information contained in this document.

Unauthorized copying, distribution, publication or retransmission of all or any part of this document by any medium or in any form for any purpose is strictly prohibited.

The recipients of this document are responsible for protecting against viruses and other destructive items. Receipt of the electronic transmission is at risk of the recipient and it is his/her responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

Head of Research
Eva Bochorishvili | evabochorishvili@gt.ge

Head of Macroeconomic Analysis and Forecasting
Lasha Kavtaradze | lashakavtaradze@gt.ge

Head of Analytics
Giorgi Iremashvili | giremashvili@gt.ge

Head of Sector Research
Bachana Shengelia | bshengelia@gt.ge

Senior Research Associate
Mariam Chakhvashvili | mchakhvashvili@gt.ge

Senior Research Associate
Ana Nachkebia | ananachkebia@gt.ge

Senior Research Associate
Kakhaber Samkurashvili | ksamkurashvili@gt.ge

Senior Analyst
Tatia Mamrikishvili | tmamrikishvili @gt.ge

Senior Analyst
Nino Peranidze | ninoperanidze@gt.ge

Analyst
Nikoloz Ghambashidze| nghambashidze@gt.ge