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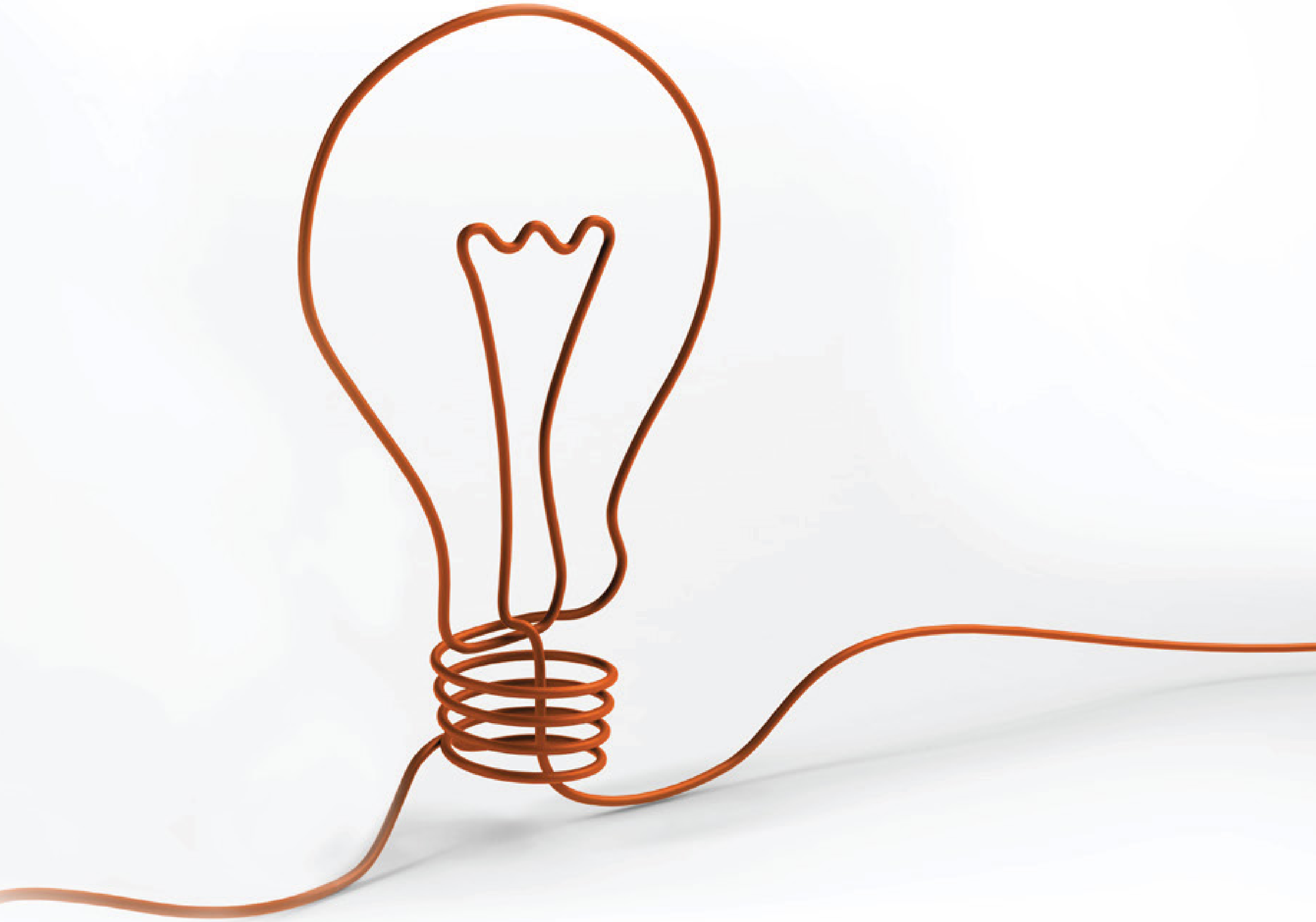
Georgia's Energy Sector
Changes Create Opportunities



Georgia | Energy
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Executive summary

Electricity is a capital-intensive sector with reasonable profits. Georgia's investor-friendly regulations, upgraded transmission networks and export opportunities have attracted substantial investment in recent years. The energy sector was the second-largest FDI recipient in 2007-17. The sector's EBITDA margin averaged 19% in 2012-17, above the business sector's level of 13%.

Electricity consumption in Georgia increased by 1.6x (4.4% CAGR) in 2008-18 and is expected to double by 2030. Electricity consumption is correlated with GDP, and in recent years growth in consumption has been driven by the non-residential sector. We project average annual growth of 5.7% in consumption in 2019-30, with the commercial sector being the key driver. As a result, by 2030, electricity consumption is expected to almost double and reach 24.5TWh.

Despite growth, generation capacity is still insufficient to satisfy demand. Since 2012, Georgia's installed capacity has increased by 25.3%, reaching 4.2GW in 2018. However, this was not enough to satisfy the growing demand, and Georgia became a net importer of electricity after having been a net exporter in 2007-11.

Georgia can become a net exporter of electricity again. Georgia has a solid pipeline of power plants, supported by government policy. Currently, 150 ongoing projects (installed capacity 5.4GW) are at various stages of development with identified investors. However, government policy has tightened significantly since 2016, which makes full implementation of the pipeline less likely. Nonetheless, we estimate that even partial implementation of these 150 projects will make Georgia a net exporter of electricity from 2021. Without the addition of new capacity, Georgia might need to import electricity, even in the summer months.

A new wave of reforms will result in a competitive market model and attract new types of investor. Georgia became a member of the Energy Community of EU and its neighbours in 2017, obliging it to harmonize its legislation with EU standards in the energy sector by 2025. This will eventually lead to a new market model with more competitive and transparent rules for power trading. This new energy market is expected to attract new types of investor, and it opens up the possibility of trading via Turkey to Eastern European countries, since Turkey is connected to the EU market and has a compatible market structure.

We expect fundamental changes in the energy market. Upcoming reforms should shorten the settlement period from one month to one day/hour, introduce an imbalance settlement mechanism, diversify power trading channels via the creation of day-ahead and intraday markets, increase the number of direct consumers, enhance power trading activities, and unbundle distribution and supply. In the context of these upcoming changes, we believe that future market prices will be dictated by neighbouring market prices and decisions on the integration of electricity generated from old regulated HPPs and from HPPs with Power Purchase Agreements.

Turkey remains an attractive export market for Georgia. Despite the dramatic fall in Turkish electricity prices in 2012-18, Turkey's geographic proximity, its compatible market structure, and the expected growth in prices will see it remain an attractive export destination, in our view. Another promising export market is Armenia, despite its small size, as the country is expected to face an electricity deficit due to the decommissioning of a nuclear plant in 2026.

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