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RESEARCH

Georgian Oil and Gas Corporation
1H14 update

Georgia | Energy
Georgian Oil and Gas Corporation
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GOGC's 1H14 revenues added just 1.6% y/y (in GEL terms) to US$ 103mn and we see FY14 growth of 2.2% as pipeline rentals (13.8% of total) will be a significant contributor with an estimated 8.4% y/y growth. The 1H14 bottom line weakened on increased gas costs. GOGC expects to finalize the construction of the Gardabani Combined Cycle Power Plant in 2015 with operations launching in 2016. The company had a 2.1x net debt-to-EBITDA ratio at the end of 2013 and is compliant with Eurobond covenants. Ratings Agency, Standard & Poor's (S&P) raised the company's credit rating to 'B+' from 'B' earlier this month.

Profitability flat, revenues inch higher

GOGC reported 1H14 revenue of US$ 103mn (+1.6% y/y in GEL terms), as gas sales, its largest revenue stream (74.8% of sales), added 1.0% y/y to US$ 77mn. Pipeline rentals, the 2nd largest revenue item, grew 20.7% y/y and accounted for 13.8% of sales, with the remaining 11.4% of revenues coming from upstream activities (-20.3% y/y) and oil transportation (+15.3% y/y). As for the company's bottom line, it weakened 11.8% y/y mainly on increased gas costs in 1H14. For FY14 we see revenues adding 2.2% y/y on a slight rise in gas revenues and expect pipeline rentals to be a significant contributor with an estimated 8.4% y/y growth. We further project 1.8% y/y increase of revenues in 2015.

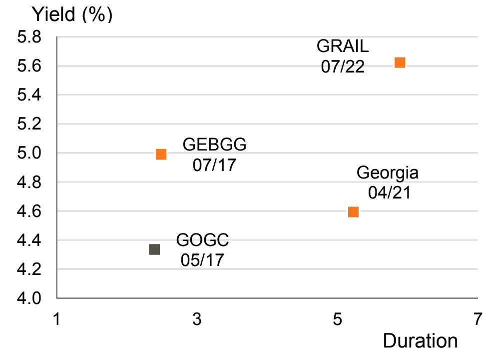
Gardabani power plant to be completed in 2015

GOGC plans to complete the construction of the Gardabani Combined Cycle Power Plant (CCPP) by the end of 2015 and full operations are slated to be launched in 2016. The plant will cost a planned US$ 220mn, with US$ 160mn in prepayments already made to the construction firm by the end of 1H14. GOGC had remaining capital commitments related to inventory purchases and the construction of Gardabani of around US$ 60mn.

Debt covenants remain stable and comfortable

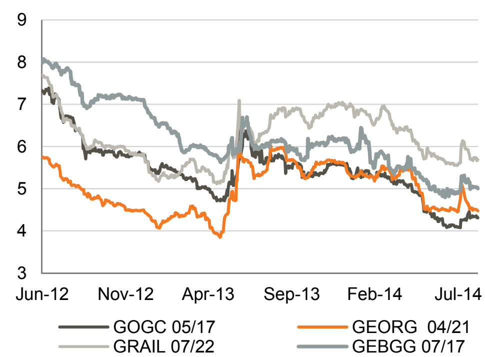
GOGC posted a 2.1x net debt-to-EBITDA ratio in 2013 vs 2.7x in 2012 and we expect the ratio to remain at the current level this year given 1H14 results. The company's commitment to the Gardabani plant and the consequent decline in cash reserves will be offset by an increase in EBITDA, in our view, which would maintain the ratio at the 2.1x level in 2014 and 2015. Term deposits (US$ 68mn in 2013) are not included as cash equivalents in net debt calculations, but they would further lower the ratio to 1.0x in 2013.

Figure 1: Georgian Eurobond universe



Source: Bloomberg

Figure 2: Georgian Eurobonds, YTM %



Source: Bloomberg

Table 1: Key financials (US$ mn) and ratios

	1H14	1H13	Chg, y/y*
EBITDA	38.0	43.5	-12.7%
EBITDA margin	36.9%	39.8%	-3.0bps
EBIT	33.3	37.7	-11.7%
EBIT margin	32.3%	34.5%	-2.2bps
Net income	29.7	36.3	-18.2%
Net margin	28.9%	33.3%	-4.4bps
Assets	626.7	538.7	16.3%
Equity	346.6	272.3	27.3%
Liabilities	280.1	266.4	5.1%

** Change calculated in US$ terms*

Source: Company data, Galt & Taggart Research

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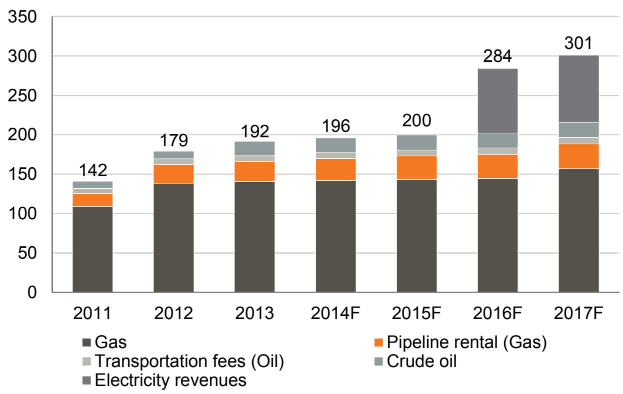
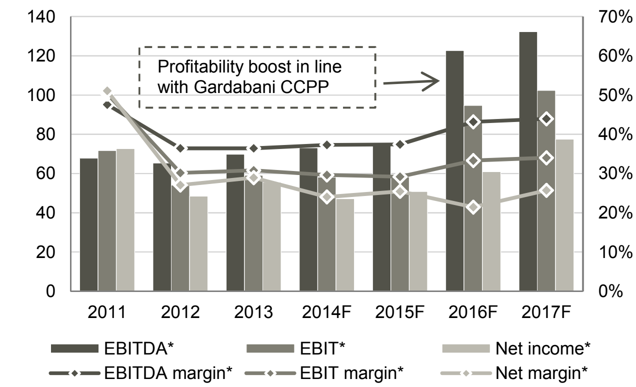
On the profitability side, we expect the EBITDA margin to add 0.9ppts to 37.3%, with EBITDA reaching US$ 73mn vs. our previous US$ 61mn forecast in 2014. The upward revision is mainly due to lower cost of gas (-0.7%) as well as personnel costs (-13.2%) compared to our previous FY14 estimate. We see the net margin shrinking 4.9ppts to 24.0% on a decline in finance income on lower deposits. We continue to expect that profitability (especially bottom line) will improve materially after 2015 as the Gardabani CCPP will contribute significantly (additional 5.7ppts to EBITDA) to the company's EBITDA as soon as it becomes fully operational.

Figure 3: GOGC revenue forecast, US$ mn



Source: Company data, Galt & Taggart Research

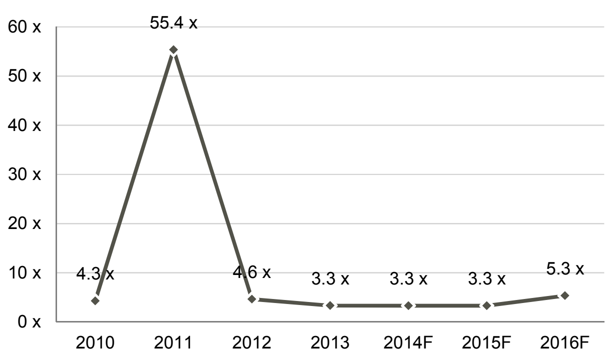
Figure 4: GOGC profitability measures, US$ mn



** Excluding impairment loss reversal in 2011 and Namakhvani impairment in 2012-2013*
Source: Company data, Galt & Taggart Research

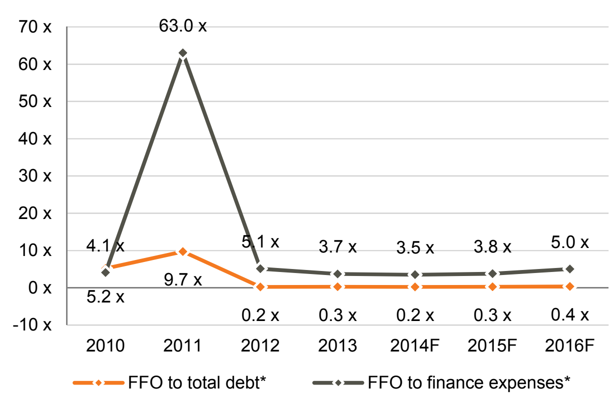
Interest coverage ratio to remain at current 3.3x level. Furthermore, we see the ratio improving in 2016 as the company's operating profit improves due to Gardabani CCPP contribution.

Figure 5: Interest coverage ratio



** Excluding hist. impairment loss reversal in 2011*
Source: Company data, Galt & Taggart Research

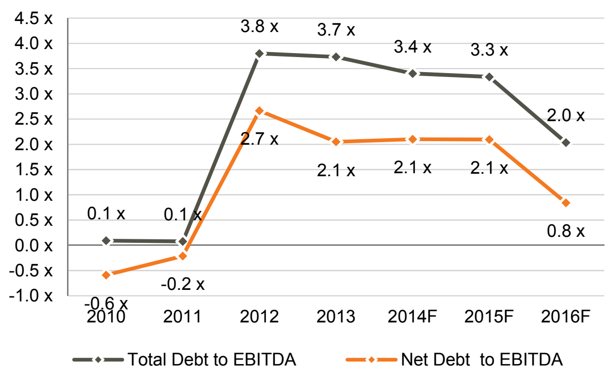
Figure 6: Liquidity



** Funds from operations; excluding hist. impairment loss reversal in 2011*
Source: Company data, Galt & Taggart Research

We expect GOGC's net debt-to-EBITDA ratio of 2.1x to remain stable over the next two years, as the company will have to use part of its excess cash on the construction of the Gardabani CCPP. Adjusted net debt-to-EBITDA was 1.0x in 2013 and we expect it at 1.7x in 2014 due to depletion of long term deposits.

Figure 7: Debt/EBITDA[1] (conventional)

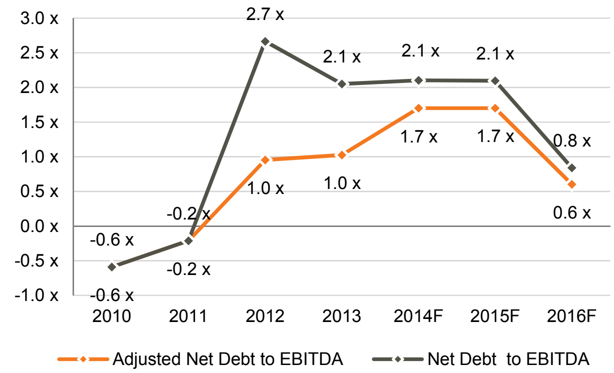


[1] EBITDA adjusted for impairment loss reversal in 2010-2011

Note: Net Debt is based on call deposits and current accounts in banks as sole cash equivalents

Source: Company data, Galt & Taggart Research

Figure 8: Adjusted Debt/EBITDA[1]

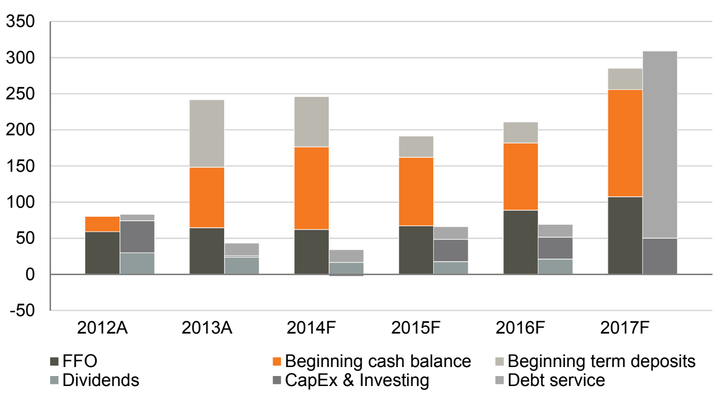


[1] Adjusted Net Debt includes long term deposits as cash equivalents

Source: Company data, Galt & Taggart Research

We expect liquidity to remain healthy, even though we maintain a 35% dividend payout in our model. In 2017 at the time of principal payment for the Eurobonds, GOGC will be able to access short-term debt financing of around US$ 6mn for liquidity needs as well as withhold dividends. The company's existing short-term credit facility of US$ 53mn is more than enough to cover any potential shortage.

Figure 9: GOGC funding sources and uses (US$ mn)



Source: Company data, Galt & Taggart Research

Earlier this month, the Rating Agency – S&P raised the company's credit rating to 'B+' from 'B', citing the company's improved operating performance and favorable cash flows as the main reason for upgrade.

Financials

Income statement, US$ mn

	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Net revenue	96.7	142.3	179.2	191.8	196.0	199.5	284.2	301.1
EBITDA[(1)]	43.0	67.7	65.3	69.8	73.1	74.7	122.7	132.3
EBITDA margin[(1)]	44.5%	47.6%	36.4%	36.4%	37.3%	37.4%	43.2%	43.9%
D&A	10.0	11.7	11.2	10.7	15.0	16.4	28.0	29.9
EBIT	56.3	71.7	54.1	59.1	58.1	58.2	94.7	102.4
EBIT margin	58.2%	50.4%	30.2%	30.8%	29.6%	29.2%	33.3%	34.0%
Financial expenses (income), net	5.0	(5.6)	(5.8)	(6.6)	2.7	(1.5)	10.3	(2.7)
PBT	51.4	77.3	59.9	65.7	55.4	59.7	84.4	105.1
Tax expense	6.6	9.7	6.9	10.2	8.3	9.0	12.7	15.8
Minority interest expense	0.0	0.0	0.0	0.0	0.0	0.0	10.8	11.9
Net income	44.7	67.7	53.0	55.5	47.1	50.8	60.9	77.5
Net margin	46.3%	47.5%	29.5%	28.9%	24.0%	25.4%	21.4%	25.7%
Profit from discontinued operations	10.0	5.0	0.0	0.0	0.0	0.0	0.0	0.0
Impairment of assets related to Namakhvani project	0.0	0.0	(4.5)	0.0	0.0	0.0	0.0	0.0
Net income after discontinued operations	54.7	72.7	48.5	55.5	47.1	50.8	60.9	77.5

[(1)] Excluding reversal of impairment losses (US$ 23.3mn – 2010; US$ 15.7mn – 2011)
Source: Company data, Galt & Taggart Research

Balance sheet, US$ mn

	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Non-current assets	150.4	188.9	313.7	373.0	493.9	533.7	518.6	491.5
Net PP&E	126.8	162.6	170.7	155.3	168.5	182.6	184.7	205.0
Gardabani CCPP	0.0	0.0	51.5	51.3	52.4	43.7	269.7	249.4
Term deposits	0.0	0.0	63.7	23.1	29.4	29.4	29.4	0.0
Other	23.6	26.3	27.9	143.3	243.6	278.0	34.8	37.0
Current assets	78.4	66.4	216.6	234.6	146.5	144.2	199.6	61.2
Cash & equivalents	32.5	21.0	86.1	112.0	95.0	92.8	148.5	8.0
Receivables & prepayments	14.4	18.2	52.2	36.6	37.3	36.9	36.4	37.7
ST deposits & investments	0.0	0.0	61.3	72.3	0.0	0.0	0.0	0.0
Other	31.5	27.2	17.0	13.6	14.2	14.5	14.6	15.5
Total assets	228.8	255.4	530.3	607.6	640.4	677.8	718.1	552.7
Shareholders equity	195.4	214.6	240.8	279.6	316.2	349.2	388.8	466.3
Non-current liabilities	5.8	6.8	251.0	302.7	307.7	308.4	309.1	60.0
LT interest bearing debt	1.3	0.4	245.2	245.2	248.7	249.2	249.7	0.0
Other	4.5	6.4	5.8	57.6	59.0	59.2	59.3	60.0
Current liabilities	27.6	34.0	38.5	25.2	16.5	20.2	20.3	26.4
ST loans	5.0	6.2	3.1	3.5	0.0	0.0	0.0	5.9
Trade payables & prepayments	1.7	1.6	15.0	17.7	12.3	15.9	16.0	15.9
Other	20.9	26.2	20.5	4.0	4.2	4.3	4.3	4.6
Total liabilities & equity	228.8	255.4	530.3	607.6	640.4	677.8	718.1	552.7

Source: Company data, Galt & Taggart Research

Cash flow, US$ mn

	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Cash flows from operating activities	45.4	46.7	39.1	89.4	54.9	69.5	87.7	103.4
Net income	54.7	72.7	48.0	53.8	47.1	50.8	60.9	77.5
Depreciation and amortisation	10.7	12.4	11.2	10.7	15.0	16.4	28.0	29.9
Reversal of impairment losses	(21.4)	(16.2)	0.0	0.0	0.0	0.0	0.0	0.0
Change in working capital	(8.9)	(20.9)	(15.9)	3.6	(5.8)	3.8	0.4	(1.9)
Other	10.2	(1.2)	(4.1)	21.3	(1.4)	(1.5)	(1.6)	(2.0)
Cash flows from investing activities	(8.8)	(38.8)	(180.0)	(36.7)	(52.3)	(54.2)	(10.8)	(0.6)
Capital expenditures	(8.3)	(38.7)	(18.0)	(2.9)	(24.9)	(30.5)	(30.1)	(50.2)
Gardabani CCPP investment	0.0	0.0	(51.0)	(2.2)	0.0	8.8	(226.0)	20.2
Loans given to shareholder and state controlled entity	0.0	0.0	(26.7)	1.0	27.7	0.0	0.0	0.0
Increase in term deposits	0.0	0.0	(84.2)	28.9	40.3	0.0	0.0	29.4
Other	(0.4)	(0.1)	(0.1)	(61.4)	(95.4)	(32.4)	245.3	0.0
Cash flows from financing activities	(9.0)	(21.3)	203.6	(23.6)	(22.1)	(17.6)	(21.2)	(243.4)
Net borrowings (repayments)	(3.9)	0.0	240.0	0.0	(5.8)	(0.0)	(0.0)	(244.1)
Dividends paid	(5.1)	(4.4)	(30.0)	(23.2)	(16.5)	(17.8)	(21.3)	0.0
Other	0.0	(16.9)	(6.4)	(0.4)	0.2	0.2	0.1	0.7
Net cash inflows (outflows)	27.7	(13.4)	62.6	29.2	(19.4)	(2.2)	55.8	(140.6)
Beginning cash balance	4.9	32.5	21.0	86.1	112.0	95.0	92.8	148.5
FX effects on cash	0.0	0.0	3.3	3.2	0.0	0.0	0.0	0.0
Foreign currency translation gain (loss)	(0.1)	1.9	0.8	(4.6)	2.4	0.0	0.0	(0.0)
Ending cash balance	32.5	21.0	86.1	112.0	95.0	92.8	148.5	8.0

Source: Company data, Galt & Taggart Research

Financial ratios

	2010	2011	2012	2013	2014F	2015F	2016F	2017F
Profitability								
ROA[1]	9.9%	21.1%	12.3%	9.5%	7.5%	7.7%	8.7%	12.2%
ROE[1]	14.4%	24.9%	21.2%	20.7%	15.6%	15.3%	16.5%	18.1%
Liquidity and Solvency								
Current ratio	2.8 x	2.0 x	5.6 x	9.3 x	8.9 x	7.1 x	9.8 x	2.3 x
Quick ratio	2.6 x	1.9 x	5.6 x	9.3 x	8.8 x	7.1 x	9.8 x	2.3 x
Cash ratio	1.2 x	0.6 x	2.2 x	4.4 x	5.8 x	4.6 x	7.3 x	0.3 x
Total debt/Equity	0.0 x	0.0 x	1.0 x	0.9 x	0.8 x	0.7 x	0.6 x	0.0 x
Net debt/Equity [2]	(0.1 x)	(0.1 x)	0.7 x	0.5 x	0.5 x	0.4 x	0.3 x	(0.0 x)
Total debt/EBITDA[1]	0.1 x	0.1 x	3.8 x	3.7 x	3.4 x	3.3 x	2.0 x	0.0 x
Net debt/EBITDA[1] [2]	(0.6 x)	(0.2 x)	2.7 x	2.1 x	2.1 x	2.1 x	0.8 x	(0.0 x)
Adjusted Net debt /EBITDA[1] [3]	(0.6 x)	(0.2 x)	1.0 x	1.0 x	1.7 x	1.7 x	0.6 x	(0.0 x)
Financial leverage	1.2 x	1.2 x	2.2 x	2.2 x	2.0 x	1.9 x	1.8 x	1.2 x
Interest coverage[1]	4.3 x	55.4 x	4.6 x	3.3 x	3.3 x	3.3 x	5.3 x	11.6 x
FFO to total debt[1]	5.2 x	9.7 x	0.2 x	0.3 x	0.2 x	0.3 x	0.4 x	nm
RCF to net debt [2]	(1.1 x)	0.9 x	0.4 x	0.2 x	(0.1 x)	(0.0 x)	0.6 x	67.0 x
FFO to financial expenses[1]	4.1 x	63.0 x	5.1 x	3.7 x	3.5 x	3.8 x	5.0 x	12.1 x

[1] Calculated without reversal of impairment losses of US$ 23.3mn in FY10 and US$15.7mn in FY11
[2] Based on call deposits and current accounts in banks as sole cash equivalents
[3] Including current and non-current term deposits

Source: Company data, Galt & Taggart Research

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