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Georgian Oil and Gas Corporation
1H15 update

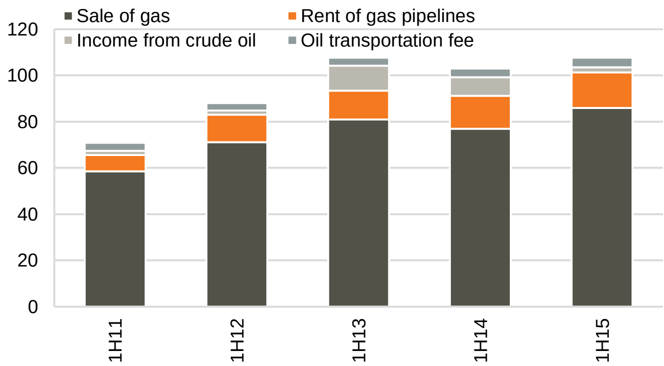
Georgia | Energy
Georgian Oil and Gas Corporation
October 1, 2015

S&P B+ / Fitch BB-

GOGC has released its 1H15 unaudited results. Sale of gas drove up 1H15 revenue 4.5% y/y, despite a drop in income from crude oil. Operating expenses increased 19.1% y/y and led to a 28.2% y/y drop in adjusted EBITDA. Lower finance income, coupled with FX loss-inflated finance costs, weighed on the bottom line. We expect operating performance to recover from 4Q15 onwards thanks to Gardabani CCPP's more profitable electricity generation business. We expect adjusted EBITDA to grow 3.3% y/y in FY15 and 62.4% y/y in FY16 (the first fully operational year of Gardabani CCPP). On the back of the recent loan repayment of US$ 60.0mn from the Partnership Fund, we expect end-FY15 net debt-to-EBITDA to improve to 1.9x, providing ample headroom up to the Eurobond covenant of 3.5x.

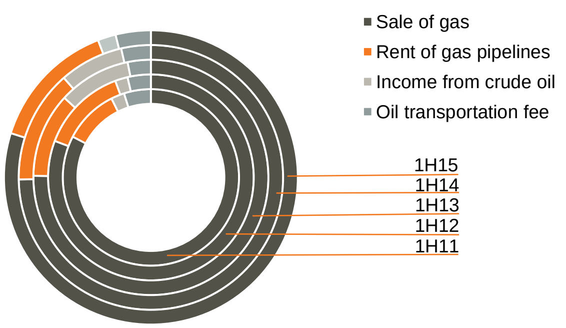
1H15 revenue showed a growth of 4.5% y/y (down 4.3% y/y in 1H14) to US$ 107.6mn (US$ 103.0mn in 1H14). The increase was driven by sale of gas and pipeline rental, growing 11.7% y/y (down 4.9% y/y in 1H14) and 8.1% y/y (up 13.7% y/y in 1H14), accounting for US$ 86.0mn (US$ 77.0mn in 1H14) and US$ 15.4mn (US$ 14.2mn in 1H14), respectively. Income from crude oil dropped off 73.4% y/y due to lower exploration activity and lower oil prices. In line with WREP pipeline throughput volume and an augmented tariff, oil transportation fee increased 11.9% y/y and reached US$ 4.2mn. In FY15, we project a growth of 9.3% y/y in revenue and 3.3% y/y in adjusted EBITDA, thanks to electricity sales from Gardabani CCPP.

Figure 1: Revenue, US$ mn



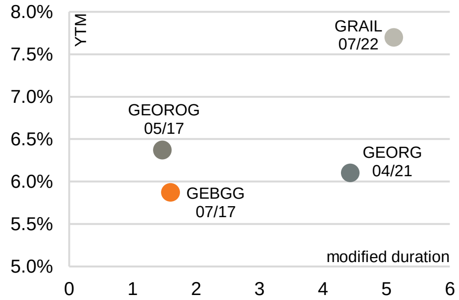
Source: Company data, Galt & Taggart Research

Figure 2: Revenue composition



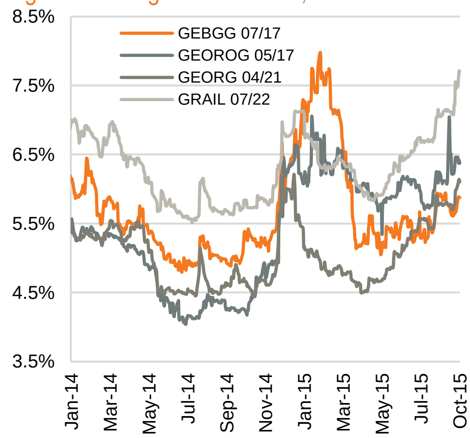
Source: Company data, Galt & Taggart Research

Figure 3: Georgian Eurobond universe



Source: Bloomberg, Galt & Taggart Research

Figure 4: Georgian Eurobonds, YTM



Source: Bloomberg, Galt & Taggart Research

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

	1H14	1H15	Change, y/y
Revenue	102,985.2	107,629.8	*4.5%*
Gross profit	40,482.2	30,081.6	*-25.7%*
Gross profit margin	*39.3%*	*27.9%*	*-1,136 bps*
EBITDA	37,955.4	26,778.8	*-29.4%*
EBITDA margin	*36.9%*	*24.9%*	*-1,197 bps*
Adjusted EBITDA	34,008.9	24,415.4	*-28.2%*
Adjusted EBITDA margin	*33.0%*	*22.7%*	*-1,034 bps*
EBIT	33,302.9	22,280.7	*-33.1%*
EBIT margin	*32.3%*	*20.7%*	*-1,164 bps*
Net income	29,731.0	1,372.5	*n/m*
Net profit margin	*28.9%*	*1.3%*	*n/m*
Assets	626,701.2	610,856.2	*-2.5%*
Equity	346,645.2	301,373.5	*-13.1%*
Liabilities	280,056.0	309,482.7	*10.5%*

Source: Company data, Galt & Taggart Research

US$-GEL	1H11	1H12	1H13	1H14	1H15
Period-end	1.67	1.64	1.65	1.77	2.25
Average	1.71	1.65	1.65	1.76	2.18

Source: NBG, Galt & Taggart Research

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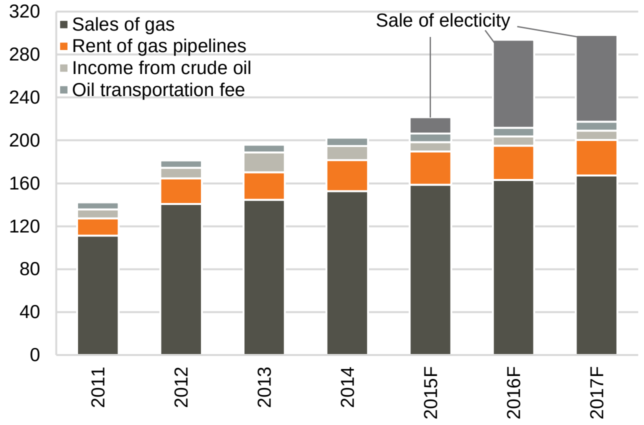
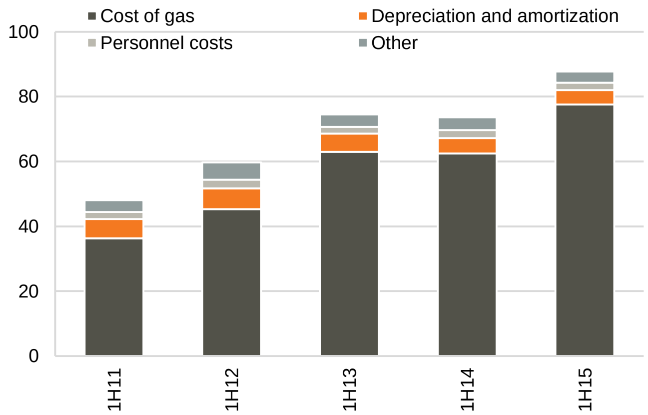
Figure 5: Revenue, US$ mn



Source: Company data, Galt & Taggart Research

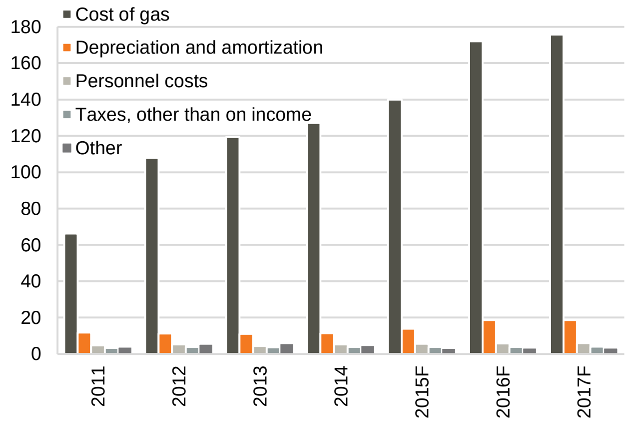
1H15 operating expenses increased 19.1% y/y (down 1.2% y/y in 1H14) to US$ 87.7mn (US$ 73.6mn in 1H14), on the back of a 24.1% y/y increase (down 0.7% y/y in 1H14) in cost of gas. Per company guidance, average gas purchase price increased 8.0% y/y as GOGC tapped higher gas volumes from the more expensive contract with SOCAR in 1H15. We expect GOGC's breakdown of gas sources to stay largely the same in FY15 as it was in FY14; therefore, cost of gas on an annual basis should not go up significantly as a lower average purchase price in the second half should partly compensate for the spike in the first half. All other operating expenses decreased y/y as they are mostly denominated in GEL.

Figure 6: Operating expenses, US$ mn



Source: Company data, Galt & Taggart Research

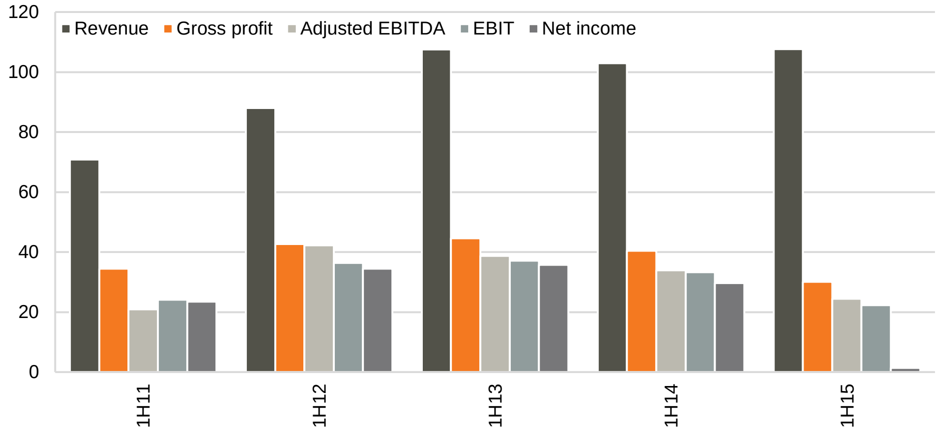
Figure 7: Operating expenses, US$ mn



Source: Company data, Galt & Taggart Research

1H15 adjusted EBITDA shrank 28.2% y/y (down 12.2% y/y in 1H14) to US$ 24.4mn (US$ 34.0mn in 1H14), on the back of lower income from crude oil and higher operating expenses. A significant FX loss, non-cash and unrealized, triggered by the sharp GEL depreciation, weighed on net income, bringing it down to US$ 1.4mn (US$ 29.7mn in 1H14).

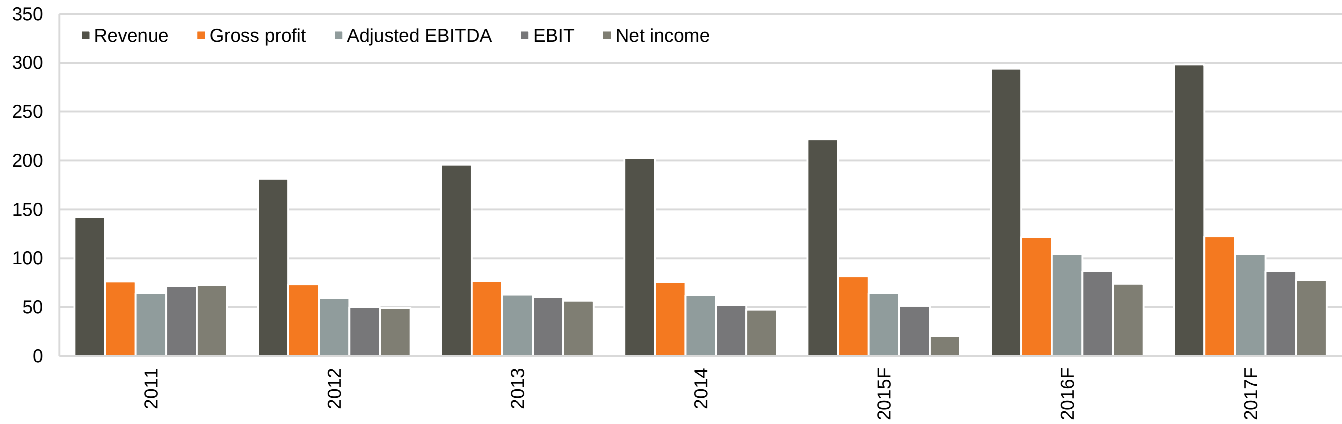
Figure 8: Revenue, gross profit, adjusted EBITDA, EBIT and net income (US$ mn)



Source: Company data, Galt & Taggart Research

In FY15, we project growth rates of 9.3% y/y in revenue and 3.3% y/y in adjusted EBITDA, on the back of higher-margin electricity sales, as Gardabani CCPP is expected to become operational in 4Q15. In FY16, the first full year of Gardabani CCPP operations, we anticipate a substantial 62.4% y/y increase in adjusted EBITDA.

Figure 9: Revenue, gross profit, adjusted EBITDA, EBIT and net income (US$ mn)



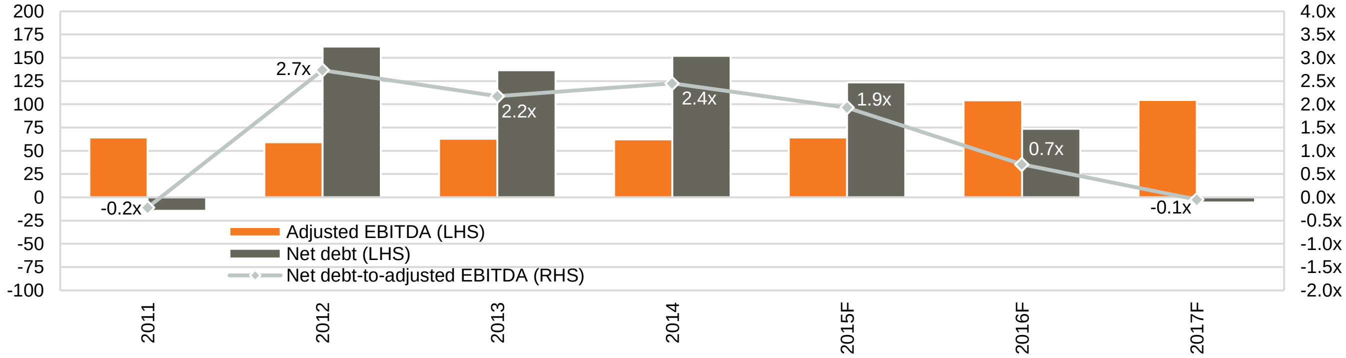
Source: Company data, Galt & Taggart Research

1H15 operating cash was at US$ -13.4mn (US$ 11.5mn in 1H14). Based on company guidance, a large prepayment for gas in April, coupled with an increase in the average purchase price, played the largest role. Furthermore, interest received decreased on the back of a lower cash balance due to investing outflows on Gardabani CCPP in 1H15 and 2H14. Lastly, we expect interest received to rebound in 2H15 as a significant portion of the currently accrued interest on bank deposits and loans will be collected in the second half of the year.

Based on company guidance, the Partnership Fund recently made a loan repayment in the amount of US$ 60.0mn, which should also boost interest income. Cash generation capacity is set to improve from 4Q15 thanks to the addition of more profitable electricity sales from Gardabani CCPP. In our view, the expected stable cash stream and subdued investing outflows (approximately US$ 15.0mn annually) should lead to a considerable increase in the cash balance in the coming years.

We expect end-FY15 net debt-to-EBITDA to improve to 1.9x (from 2.5x in FY14) on the back of the aforementioned repayment from the Partnership Fund, providing ample headroom up to the Eurobond covenant of 3.5x.

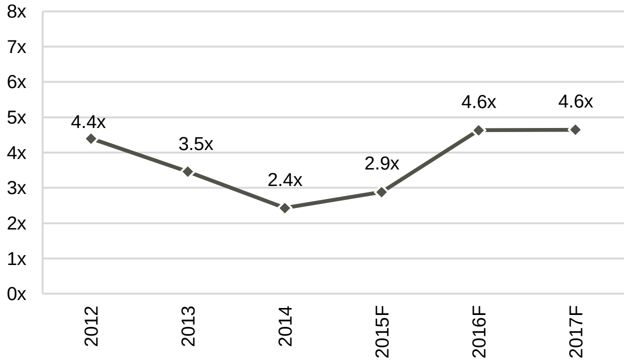
Figure 10: Adjusted EBITDA and net debt (US$ mn) and net debt-to-adjusted EBITDA



Source: Company data, Galt & Taggart Research

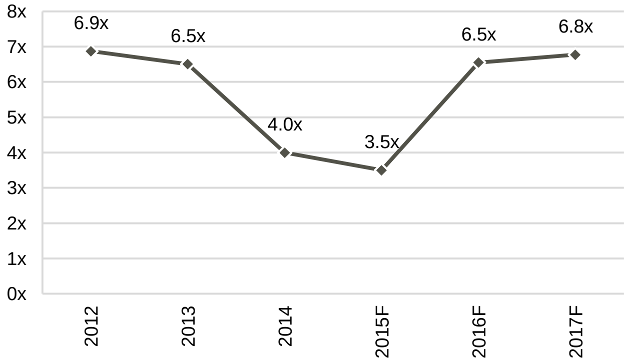
We expect coverage ratios to improve FY16 onwards mainly on the back of the new electricity generation business.

Figure 11: Adjusted EBIT coverage ratio



Source: Company data, Galt & Taggart Research

Figure 12: Cash coverage ratio



Source: Company data, Galt & Taggart Research

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