# JSC Georgian Oil and Gas Corporation

## Update

## Ratings

**Foreign Currency**

| | |
|---|---|
| Long-Term IDR | BB- |
| Short-Term IDR | B |
| Senior unsecured | BB- |

**Local Currency**

| | |
|---|---|
| Long-Term IDR | BB- |
| Short-Term IDR | B |

## Outlooks

| | |
|---|---|
| Foreign-Currency Long-Term IDR | Positive |
| Local-Currency Long-Term IDR | Positive |

## Financial Data

**JSC Georgian Oil and Gas Corporation**

| | 31 Dec 13 | 31 Dec 12 |
|---|---|---|
| Revenue (GEL 000) | 325,761 | 299,551 |
| Operating EBITDA (GEL 000) | 108,439 | 100,774 |
| Operating EBITDA margin (%) | 33.3 | 33.6 |
| Funds from operations (GEL 000) | 123,377 | 99,456 |
| Cash flow from operations (GEL 000) | 152,081 | 65,563 |
| Free cash flow (GEL 000) | 43,278 | -282,578 |
| FFO gross interest coverage (x) | 4.1 | 7.426 |
| Total debt/EBITDA (x) | 4.0 | 4.1 |
| FFO adjusted net leverage (x) | 2.0 | 2.5 |

## Related Research

Fitch Revises Georgian Oil and Gas Corporation's Outlook to Positive; Affirms at 'BB-' (March 2015)

Georgia (October 2014)

## Analysts

Slava Demchenko
+7 495 956 9901
maxim.edelson@fitchratings.com

Jakub Zasada
+48 22 338 6295
jakub.zasada@fitchratings.com

## Key Rating Drivers

**Positive Outlook:** The ratings for indirectly state-owned JSC Georgian Oil and Gas Corporation (GOGC) are aligned with the sovereign's ratings as the government of Georgia (BB-/Positive) considers the company critical to national energy policy. The revision of the Outlook to Positive from Stable in March 2015 followed a similar rating action for Georgia's IDRs. In aligning GOGC's ratings, Fitch considers the 100% indirect state ownership and strong management and governance links between GOGC and the state.

**Strong Ties with Government:** GOGC's operations are supervised by the Ministry of Energy and the company has the status of national oil company operating within the contractual framework of inter-governmental agreements between Georgia and Azerbaijan. The Georgian government has also stressed its commitment to continue supporting the financial health of GOGC in its discussions with Fitch.

**Power Plant Construction on Track:** GOGC and the Partnership Fund (PF, BB-/Positive) are constructing a USD220m 239 megawatt capacity gas-fired power plant in Gardabani (expected completion in 4Q15). GOGC is financing the project through equity contributions and loans to the power plant SPV and the PF, while GOGC retains managerial control of the SPV. The power plant has the status of guaranteed capacity provider and will receive a regulated revenue stream with an IRR of 12.5% over its asset life, guaranteed by the government.

**'B+' Standalone Profile:** We assess GOGC's standalone profile as commensurate with a 'B+' rating supported by the contractual nature of GOGC's revenues. GOGC receives a relatively stable income from regulated gas supply operations with SOCAR Gas Export and Import, a subsidiary of the State Oil Company of the Azerbaijan Republic (SOCAR, BBB-/Stable). Stable fee income from gas and oil transit operations also provides a predictable and high-margin revenue stream.

**Leverage Depends on Investments:** GOGC's gross leverage was broadly equal to 4.0x EBITDA in 2012-2014, which is in line with Fitch's guidance for a standalone rating in the upper 'B' category. We forecast a gradual decrease in leverage as the new power plant starts to generate revenue in the Autumn of 2015, but GOGC's credit metrics will depend on the company's future investment plans. GOGC is considering building a gas storage reservoir in a former oil field with the final investment decision expected in the second half of 2015.

**Size, Capex Constrain Ratings:** The principal rating constraints are the company's small size, high leverage until at least end-2015 and funding issues for the Gardabani power plant resulting in a negative free cash flow.

## Rating Sensitivities

**Government Support Key to Rating:** GOGC's ratings will track any changes in the sovereign rating of Georgia. An aggressive investment programme resulting in a significant deterioration in standalone credit metrics or unanticipated changes in the contractual frameworks forming GOGC's midstream position could be negative for the rating.

## Liquidity and Debt Structure

**Good Liquidity:** At end-2014, GOGC's short-term debt amounted to GEL7m and was fully covered by cash and short-term deposits of GEL176m.

## Peer Group

| Issuer | Country |
|---|---|
| **BBB-** | |
| Intergas Central Asia JSC | Kazakhstan |
| KazTransGas Aimak JSC | Kazakhstan |
| KazTransGas JSC | Kazakhstan |

## Issuer Rating History

| Date | LT IDR (FC) | Outlook/ Watch |
|---|---|---|
| 9 Mar 15 | BB- | Positive |
| 23 Apr 14 | BB- | Stable |
| 17 Dec 13 | BB- | Stable |
| 26 Apr 13 | BB- | Stable |
| 13 Mar 13 | BB- | Stable |
| 30 Oct 12 | BB- | Stable |
| 27 Apr 12 | BB- | Stable |
| 19 Apr 12 | BB- | |

## Immediate Peer Group – Comparative Analysis

### Sector Characteristics

*Operating Risks*

Operating risks for pipeline operators typically lie in tariff stability, the degree to which volume risk (and/or fuel price risk) is absorbed by other parties, catastrophic physical failures, or more frequently, by any expansion they undertake outside their central regulated activity. Gas supply companies typically face stronger market-based risks, including price- and volume-matching risk, hedging, counterparty risk and liquidity management.

*Financial Risks*

The seasonality of supply and the volatility of commodity and volume risks are the main financial threats for midstream companies. Financing capex needs, and pressure to increase dividend payments may result in additional free cash-flow volatility.

#### Peer Group Analysis (2013)

| | MRG BBB-/Stable | KazTransGas BBB-/Stable | KazTransOil BBB/Stable | GOGC BB-/Positive |
|---|---|---|---|---|
| Rating approach | Stand-alone | One notch below NC KMG | Stand-alone, capped by NC KMG | Aligned with sovereign |
| EBITDA (USDm) | 181 | 516 | 685 | 68 |
| FFO adj. net leverage (x) | 5.8 | 1.5 | Negative | 2.0 |
| FFO interest coverage (x) | 2.0 | 10.4 | n/a | 4.1 |

Source: Fitch, Companies

### Key Credit Characteristics

In addition to strong credit metrics, Fitch would consider transparent gas supply tariffs allowing for full cost pass-through as important for rating a gas pipeline and supplier at an investment-grade level. Long-term transportation contracts at specified volumes with strong counterparties would also be supportive.

### Overview of Companies

**Madrilena Red de Gas S.A.U.** (MRG, BBB−/Stable) – is the owner and operator of the third-largest natural gas distribution network in Spain. MRG is a pure unbundled regulated network company and therefore does not engage in any natural gas trading or supply activities. It has operations in more than 57 municipalities in the Autonomous Community of Madrid.

**KazTransGas JSC** (KTG, BBB−/Stable) – the ratings reflect its position as the operator of the Kazakh gas pipeline network, the only transit route for central Asian gas to Russia and Europe. The group's ratings are now notched down by one level from that of its parent, reflecting their close linkage, but also the limited legal ties between the two. KTG qualifies as a material subsidiary in JSC National Company KazMunayGas's (NC KMG, BBB/Stable) Eurobond documentation and is subject to cross-default provisions, but NC KMG does not guarantee KTG's debt.

**KazTransOil JSC** (KTO, BBB/Stable) – the ratings reflect its dominant position in the oil transportation sector in Kazakhstan, and the Kazakh economy's dependence on oil revenues. In 2012 KTO was granted “national operator” status which legally protects its monopolistic position. KTO shipped 60% of Kazakhstan's crude that year, excluding the volumes shipped by its two joint ventures with China National Petroleum Corporation (CNPC, A+/Stable) that operate the major parts of the Kazakhstan-China oil pipeline. KTO's ratings are capped by those of its parent NC KMG.

## Snapshot Profile: Major Issuer-Specific Rating Factors and Trends

| Rating Factor | Status[a] | Trend |
|---|---|---|
| Operations | Average | Neutral |
| Market position | Strong | Neutral |
| Finances | Average | Neutral |
| Governance | Average | Neutral |
| Geography | Average | Neutral |

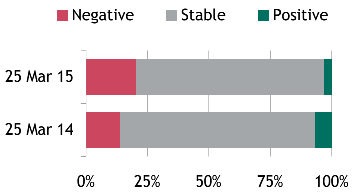
[a] Relative to peer group

**Related Criteria**

Corporate Rating Methodology (May 2014)

JSC Georgian Oil and Gas Corporation Energy (Oil & Gas) Median Emerging BB Cat Median
Source: Company data; Fitch.

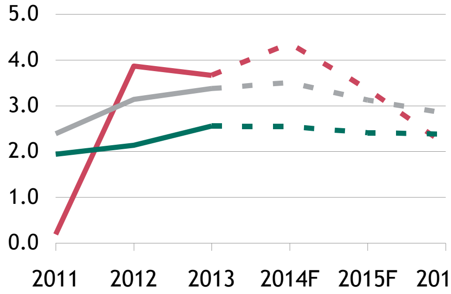
**Distribution of Sector Outlooks**
Directional Outlooks and Rating Watches



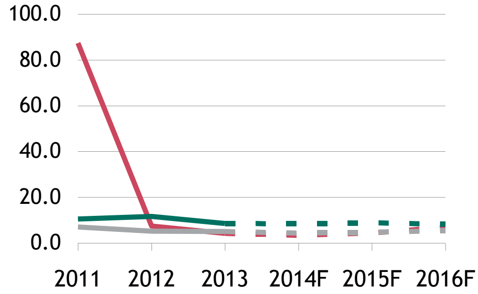

Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- stable pipeline rental and oil transportation revenues;
- USD220m capex for Gardabani construction;
- Gardabani EBITDA contribution from 4Q15.

**Leverage**
including Fitch expectations



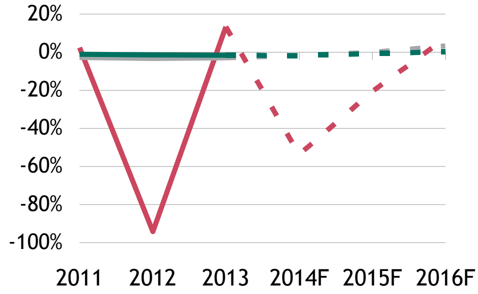

**Interest Cover**
including Fitch expectations




**Debt Maturities and Liquidity at 2014**

| Debt maturities | GEL000 |
|---|---|
| Short-term | 6,986 |
| Long-term | 457,007 |
| **Cash and equivalents** | 182,189 |

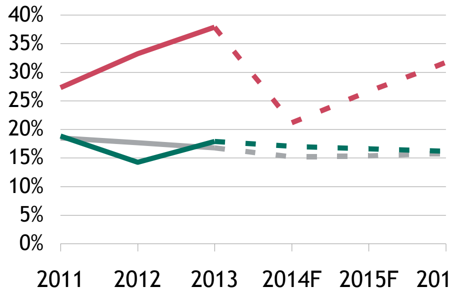
**FCF/Revenues**
including Fitch expectations



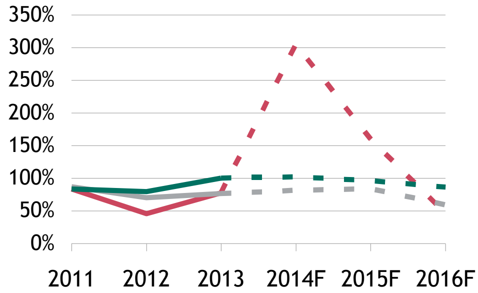

### Definitions

- Leverage: Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid minus interest received plus preferred dividends plus rental expense.
- Interest cover: FFO plus gross interest paid minus interest received plus preferred dividends divided by gross interest paid plus preferred dividends.
- FCF/revenue: FCF after dividends divided by revenue.
- FFO profitability: FFO divided by revenue.
- For further discussion of the interpretation of the tables and graphs in this report see Fitch's "*Interpreting the New EMEA and Asia-Pacific Corporates Credit Update Format*" Special Report, dated 25 November 2009 and available at www.fitchratings.com.

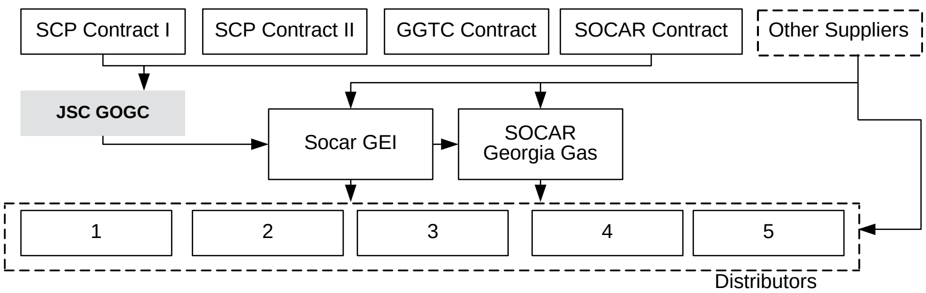
**FFO Profitability**
including Fitch expectations




**Capex/CFO**
including Fitch expectations




**Gas Supply Market**




Source: GOGC

Figure 1

## Reconciliation of Key Financial Metrics for GOGC

| (GEL 000) | 31 Dec 13 | 31 Dec 12 | 31 Dec 11 |
|---|---|---|---|
| Interest bearing loans and borrowings | 431,825 | 411,273 | 11,016 |
| - Equity credit | 0 | 0 | 0 |
| = Total debt with equity credit | 431,825 | 411,273 | 11,016 |
| + Total off-balance sheet debt (8 x long-term leases) | 0 | 0 | 0 |
| **= Total lease-adjusted debt (a)** | **431,825** | **411,273** | **11,016** |
| - Cash and equivalents (unrestricted) | 194,541 | 142,672 | 35,079 |
| **= Net lease-adjusted debt (b)** | **237,284** | **268,601** | **-24,063** |
| | | | |
| **Net cash from operating activities (as reported)** | **150,977** | **85,467** | **89,392** |
| - Net finance charges (d) | -5,564 | 6,908 | -6,994 |
| - Taxation paid | 4,460 | 12,996 | 18,140 |
| + Dividend received less dividends paid to minorities | 0 | 0 | 0 |
| = Cash flow from operations | 152,081 | 65,563 | 78,246 |
| - Change in working capital (a) | 28,704 | -33,893 | 12,768 |
| **= Funds flow from operations (FFO) (e)** | **123,377** | **99,456** | **65,478** |
| Long-term (LT) leases (g) | 0 | 0 | 0 |
| | | | |
| **FFO adjusted gross leverage (x)** | | | |
| Net lease-adjusted debt/(FFO + net finance charge + LT leases) (a/(e + d + g)) | 3.7 | 3.9 | 0.2 |
| **FFO adjusted net leverage (x)** | | | |
| Net lease-adjusted debt/(FFO + net finance charge + LT leases) (b/(e + d + g)) | 2.0 | 2.5 | -0.4 |

Note: (a) represents change in trade and other receivables and payables as reported in the balance sheet
Source: Fitch based on company reports

# JSC Georgian Oil and Gas Corporation
## FINANCIAL SUMMARY

| | 31 Dec 2013 GELth Year End | 31 Dec 2012 GELth Year End | 31 Dec 2011 GELth Year End |
|---|---|---|---|
| **Profitability** | | | |
| Revenue | 325,761 | 299,551 | 239,917 |
| Revenue Growth (%) | 8.75 | 24.86 | 39.16 |
| Operating EBIT | 90,198 | 82,112 | 90,760 |
| Operating EBITDA | 108,439 | 100,774 | 109,422 |
| Operating EBITDA Margin (%) | 33.29 | 33.64 | 45.61 |
| FFO Return on Adjusted Capital (%) | 15.18 | 14.05 | 17.90 |
| Free Cash Flow Margin (%) | 13.29 | (94.33) | 2.29 |
| **Coverages (x)** | | | |
| FFO Gross Interest Coverage | 4.13 | 7.43 | 87.42 |
| Operating EBITDA/Gross Interest Expense | 3.80 | 7.04 | 163.56 |
| FFO Fixed Charge Coverage (inc. Rents) | 4.13 | 7.43 | 87.42 |
| FCF Debt-Service Coverage | 2.07 | (13.82) | 0.56 |
| Cash Flow from Operations/Capital Expenditures | 1.29 | 2.20 | 1.20 |
| **Debt Leverage of Cash Flow (x)** | | | |
| Total Debt with Equity Credit/Operating EBITDA | 3.98 | 4.08 | 0.10 |
| Total Debt Less Unrestricted Cash/Operating EBITDA | 2.19 | 2.67 | (0.22) |
| **Debt Leverage Including Rentals (x)** | | | |
| Annual hire lease rent costs for long-term assets (reported and/or estimate) | n.a. | n.a. | n.a. |
| Gross Lease Adjusted Debt/Operating EBITDAR | 3.98 | 4.08 | 0.10 |
| Gross Lease Adjusted Debt /FFO+Int+Rentals | 3.67 | 3.87 | 0.19 |
| FFO Adjusted Net Leverage | 2.01 | 2.53 | (0.41) |
| FCF/Lease Adjusted Debt (%) | 10.02 | (68.71) | 49.88 |
| **Debt Leverage Including Leases and Pension Adjustment (x)** | | | |
| Pension and Lease Adjusted Debt /EBITDAR + Pension Cost | 3.98 | 4.08 | 0.10 |
| **Balance Sheet Summary** | | | |
| Readily Available Cash | 194,541 | 142,672 | 35,079 |
| Restricted/Not Readily Available Cash | 78,493 | 52,854 | n.a. |
| Short-Term Debt | 6,126 | 5,090 | 10,362 |
| Long-Term Senior Debt | 425,699 | 406,183 | 654 |
| Subordinated debt | n.a. | n.a. | n.a. |
| Equity Credit | n.a. | n.a. | n.a. |
| Total Debt with Equity Credit | 431,825 | 411,273 | 11,016 |
| Off-Balance-Sheet Debt | n.a. | n.a. | n.a. |
| Lease-Adjusted Debt | 431,825 | 411,273 | 11,016 |
| Fitch- identified Pension Deficit | n.a. | n.a. | n.a. |
| Pension Adjusted Debt | 431,825 | 411,273 | 11,016 |
| **Cash Flow Summary** | | | |
| Operating EBITDA | 108,439 | 100,774 | 109,422 |
| Gross Cash Interest Expense | (28,512) | (14,323) | (669) |
| Cash Tax | (4,460) | (12,996) | (18,140) |
| Associate Dividends | n.a. | n.a. | n.a. |
| Other Items before FFO (incl. interest receivable) | 47,910 | 26,001 | (25,135) |
| **Funds from Operations** | **123,377** | **99,456** | **65,478** |
| Change in Working Capital | 28,704 | (33,893) | 12,768 |
| **Cash Flow from Operations** | **152,081** | **65,563** | **78,246** |
| Total Non-Operating/Non-Recurring Cash Flow | 49,081 | (270,887) | n.a. |
| Capital Expenditures | (117,525) | (29,754) | (65,251) |
| Dividends Paid | (40,359) | (47,500) | (7,500) |
| **Free Cash Flow** | **43,278** | **(282,578)** | **5,495** |
| Net (Acquisitions)/Divestitures | 3,707 | 0 | n.a. |
| Net Equity Proceeds/(Buyback) | 0 | 0 | (28,434) |
| Other Cash Flow Items | (68,522) | (10,086) | 646 |
| Total Change in Net Debt | (21,537) | (292,664) | (22,293) |
| **Working Capital** | | | |
| Accounts Receivable Days | 84 | 71 | 42 |
| Inventory Days | 1 | 1 | 21 |
| Accounts Payable Days | 51 | 28 | 9 |

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2015 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004.Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.