FITCH REVISES GOGC'S OUTLOOK TO POSITIVE; AFFIRMS IDRS

Fitch Ratings-Warsaw/London/Moscow-29 March 2018: Fitch Ratings has revised the Outlook on JSC Georgian Oil and Gas Corporation's (GOGC) Long-Term Foreign-Currency Issuer Default Rating (IDR) to Positive from Stable and affirmed the rating at 'BB-'. A complete list of rating actions is available at the end of this commentary.

GOGC achieved a score of 25 points under Fitch's government-related entity (GRE) rating criteria. We assess GOGC's standalone credit profile (SCP) at 'BB-'. If the sovereign rating of Georgia is upgraded and GOGC's SCP is one notch below the sovereign, a one-notch uplift to the same rating as the government can be considered. This underpins the revision of GOGC's Outlook to Positive from Stable.

KEY RATING DRIVERS

Strong ties With Ultimate Parent: GOGC is 100% owned by the Partnership Fund (BB-/Stable), a fully government-owned investment vehicle. The company's operations and investment plans are overseen by the Georgian government. GOGC has received financial support from the government in the past in the form of contributions in kind and the earlier repayment of loans provided to the immediate parent. We assess the status, ownership, control factor and the record of, and expectations for support as strong.

GOGC is the primary party in Georgia to gas supply and transit agreements, and is a key government vehicle for ensuring the reliability of gas supplies through cooperation with local distributors and suppliers. We believe that GOGC's default could have serious consequences for the continued supply of gas in Georgia and assess the socio-political implications of the company's default as strong. We believe that GOGC's default would have a moderate impact on the availability and cost of funding for the government and other state companies and assess the financial implications of default as moderate.

First Power Plant Fully Operational: The construction of the first gas-fired power plant in Gardabani was completed in September 2015. The plant generated 30% of GOGC's total revenues in 2017, according to preliminary 2017 figures. It operates as a guaranteed electricity provider receiving a capacity fee, while electricity sales in its domestic market will be provided at cost. The government guarantees a 12.5% internal rate of return (IRR) over the asset's life, with sales of electricity for export providing possible upside to our forecasts.

Improved Results in 2017: Revenues increased by 6% yoy to GEL672 million in 2017 according to preliminary financials. Gross profit before unallocated costs increased by 14% yoy to GEL277 million on the back of improved results from the gas supply, and electricity generation and supply segments. Reported net debt to EBITDA decreased to 0.9x at end-2017 from 2.2x a year ago. GOGC's cash flow from operations (CFO) increased to GEL232 million in 2017, up from GEL159 million, as GOGC managed to reduce the amount of trade receivables by GEL36 million.

New Investments: GOGC plans to build an underground gas storage facility in Georgia and a second power plant in Gardabani. While details on the required spending are yet to be determined, based on the preliminary estimates we expect that GOGC's net debt to EBITDA will remain below 3.0x until 2020.

DERIVATION SUMMARY

GOGC received a score of 25 points under Fitch's GRE rating criteria. We assess GOGC's SCP at 'BB-'. If the sovereign rating of Georgia is upgraded and GOGC's SCP is one notch below the sovereign, a one-notch uplift to the same rating as the government can be considered. This underpins the revision of GOGC's Outlook to Positive from Stable.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- no cash income tax payments in 2018-2020;
- stable dollar-denominated revenues and EBITDA from core pipeline rental, oil transportation and power generation operations;
- gas supply obligations of GOGC for households and power generation will not exceed the amount of gas available to the company through existing contracts;
- average gas sale price equal to USD123/mcm in 2018-2020;
- investments in the second gas-fired power plant amounting to USD180 million until 2019 with the plant starting operations in mid-2019;
- total capex averaging GEL280 million in 2018-2020;
- USD/GEL 2.48 in 2018 and thereafter;
- dividend payout ratio equal to 35%.

RATING SENSITIVITIES

GOGC
Developments That May, Individually or Collectively, Lead to Positive Rating Action
- - A positive rating action for Georgia
Developments That May, Individually or Collectively, Lead to Negative Rating Action
- A negative rating action for Georgia
- Weakening state support and/or an aggressive investment programme resulting in a significant deterioration of standalone credit metrics, eg net debt/EBITDA above 3.5x on a sustained basis
- Unexpected changes in the contractual frameworks governing GOGC's midstream activities

Georgia
The main factors that could, individually or collectively, could lead to an upgrade of the sovereign are:
- strong and sustainable GDP growth consistent with macroeconomic stability;
- a reduction in external vulnerability;
- shrinkage in budget deficits and public-sector indebtedness.

The Rating Outlook is Positive. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a high likelihood of leading to a negative rating change. However, future developments that could individually, or collectively, result in the Outlook being revised to Stable include:
- an increase in external vulnerability, for example a widening of the current account deficit not financed by foreign direct investment;
- A worsening of the budget deficit, leading to a further rise in public indebtedness;
- a deterioration in either the domestic or regional political environment that affects economics policymaking or regional growth and stability

LIQUIDITY

Strong Liquidity: A cash balance of GEL499 million at end-2017 comfortably covered GOGC's short-term debt of GEL79 million and negative free cash flow of GEL185 million projected by Fitch.

FULL LIST OF RATING ACTIONS

Long-Term Foreign- and Local-Currency IDRs: Outlook Revised to Positive from Stable; affirmed at 'BB-;
Short-Term Foreign- and Local-Currency IDRs: affirmed at 'B';
Senior unsecured rating: affirmed at 'BB-'.

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Applicable Criteria
Corporate Rating Criteria (pub. 23 Mar 2018)
https://www.fitchratings.com/site/re/10023785
Government-Related Entities Rating Criteria (pub. 07 Feb 2018)
https://www.fitchratings.com/site/re/10019302
Parent and Subsidiary Rating Linkage (pub. 15 Feb 2018)
https://www.fitchratings.com/site/re/10019836