JSC Partnership Fund

Full Rating Report

Ratings

Foreign Currency

Long-Term Rating	BB-
Short-Term Rating	B

Local Currency

Long-Term Rating	BB-

Outlooks

Long-Term Foreign-Currency Rating	Stable
Long-Term Local-Currency Rating	Stable

Financial Data

JSC Partnership Fund

	31 Dec 11P
Revenue (GELm)	9.4
Operating profit from operations (GELm)	8.4
Net profit (loss) (GELm)	6.9
Equity (GELm)	521.6
Gross debt (GELm)	0.7
Gross debt/equity (x)	0.001

P – preliminary, unaudited data

Related Research

Georgia (December 2011)

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Key Rating Drivers

Sovereign Support: The ratings of JSC Partnership Fund (PF) are equalised with those of Georgia (Long-Term Foreign-Currency IDR ‘BB−’/Stable; Short-Term Foreign-Currency IDR ‘B’) to reflect its quasi-sovereign status and Fitch Ratings’ confidence in timely state support for PF’s financial debt and guarantees, in case of need. The standalone profile of the fund is weak due to the vulnerable dividend stream from strategic assets. Consequently, Georgia’s ability and intent to support the PF’s potential issued or guaranteed debt is a key factor.

Quasi-Governmental Status: PF is 100% owned by the Georgian state’s shareholding company established in June 2011. The state transferred stakes in key infrastructure companies, including 24% of Georgian Railway LLC (Grail, ‘BB−’/Stable), 24% of Georgian Oil and Gas Corporation LLC, 49% of Georgian State Electrosystem LLC, and 49% of Electricity System Commercial Operator LLC to fund the PF’s initial paid-in capital.

Private Equity Policy Arm: The entity is mandated to promote private equity investments in viable economic projects promising a significant return and generating positive economic externalities. The private equity market is undeveloped in Georgia. The establishment of PF meets an important economic need.

State Control Tight: PF reports to Georgia’s president and is supervised by the country’s prime minister, who heads the company’s supervisory board. The company’s supervisory board also includes the minister of finance, minister of economy and sustainable development, the minister of justice, and the minister of energy and natural resources. The government appoints PF’s auditors, authorises borrowing and has to approve its financial statements.

Low Debt: The debt of PF is low and limited to an open credit line (USD5m) with a local bank. The credit line matures in 2012, and is thus classified as short-term debt. By end-2011 the fund had drawn GEL0.7m (USD0.4m) for the credit line and by March 2012 PF had additionally drawn GEL6m (USD3.6m), effectively increasing its outstanding short-term debt up to GEL6.8m. PF’s debt and guarantees might increase upon launch of the fund’s investment operations by end-2012.

Limited Track Record: PF has no track record as its operations started in June 2011, and as of March 2012 PF had not funded any project. However, management expects to increase the asset portfolio from about GEL80m by end-2012 up to about GEL390m in 2016. According to its 2011 financial statements (preliminary not audited data), capturing six months performance by end-2011, PF reported net income of GEL6.9m, with an operating EBITDA margin of 73.4%.

What Could Trigger a Rating Action

Sovereign Linkage: An upgrade of Georgia, coupled with continued state support, would be rating positive. A downgrade of Georgia, or changes that would lead to a dilution, or reassessment of state support, such as material disposals of stakes in state-owned infrastructure companies, or changes in the goals of the fund could exert downward pressure on the rating.

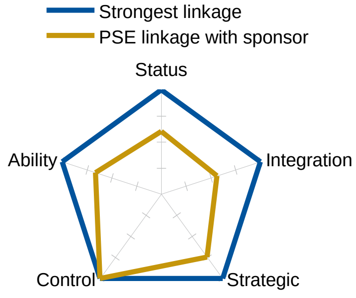
Company Overview and Principle Support Factors

Fund's Unique Legal Status

PF was established in June 2011 by the Georgian government to promote the private equity market in Georgia and develop support for targeted sectors of the economy. PF's activities are regulated by its own act – a law on JSC Partnership Fund, giving the entity unique legal status. The fund's supervisory board is chaired by the nation's prime minister with key ministers sitting on the board.

Figure 1

PF Rating Factors



Source: Fitch

PF is a joint stock company 100% owned by the Georgian state. Fitch understands that due to statutory arrangements no change in the shareholding structure is envisaged in the medium term and that PF will continue to be owned by the state.

The major policy roles of the fund are the promotion of projects aimed at establishing new employment opportunities, stimulating; the Georgian economy, providing assistance for projects meeting the Fund's investment criteria, and the gradual privatisation of successfully implemented projects.

PF is subject to bankruptcy law regulating commercial entities. For the liquidation of the fund a presidential decree would be necessary, as the fund was set up by a special law. The fund's strong operational ties with the state, as well as the latter's ultimate moral responsibility for losses and debt implies, in Fitch's view, that state financial support would be highly likely if needed.

Strategic Importance

PF is the first specialised public sector entity (PSE), established by Georgia's government. It is poised to play an instrumental role in sustaining the government's policy for the gradual development of capital market institutions.

In the energy sector the fund is a policy instrument of the government, implementing the development of hydro power plants (HPPs), a sector of paramount importance for substituting energy imports in peak demand during the winter and securing the country's export revenue in summer, when local use of electricity is lower. In most cases HPP developers require a guarantee, which will be issued by the fund on behalf of the state.

Integration

PF is closely linked with the Georgian state and its ministries. PF's accounts are not consolidated with the ministry of finance and the fund has no earmarked revenue allocation from the state budget.

PF's close financial ties with its sponsor are indicated by the transfer of the blocks of shares of key national infrastructure companies to the fund as well as the state's expected decision to appropriate to the fund the entire dividend payments of Grail for 2011, which will be paid in 2012.

Control by the State

Tight State Oversight

The fund according to the law guiding its operations is accountable to the president of the country. The state approves the appointment of PF's auditors, while its financial statements are approved by the state. KPMG was selected as an independent auditor of the fund in 2011.

Related Criteria

Tax Supported Rating Criteria (August 2011)

Rating of non-US Public Sector Entities (March 2012)

The fund operates under tight supervision by the state. Its budget requires the approval of its supervisory board as do any amendments to the initial budget. The board also approves all of the fund's policies, its strategic decisions regarding investments and their actual implementation, including project specifics such as tariffs or interest rates. The decision of the government is required in order to authorise any borrowing by the fund.

Adequate Governance

The fund's CEO position is currently vacant. The employees of the fund have quasi-public servant status and were interviewed personally by the prime minister; their contracts are subject to renewal upon completion of the initial three-year term.

The fund's main executive bodies are its investment board (IB) and risk committee (RC). The IB is headed by the chief investment officer and is responsible for reviewing projects for potential support, project presentation to the supervisory board, and follow-up of the selected project company on all matters relating to the project during its life cycle. The RC, headed by the fund's CFO evaluates risks associated with the projects brought by the IB and comes with mitigation strategy. The final decision on the project's support is up to PF's supervisory board.

Fitch views the fund's corporate structure as adequate, allowing for some reduction of the financial risks associated with its projects through the delineation of the investment appraisal and risk evaluation functions between the IB and the RC. At the same time, the lack of independent members on the supervisory board could lead to underestimation of the business risks of the projects as the board is entirely composed of top-ranking government officials.

Willingness and Ability to Support

Fitch has classified PF as a "dependent" public sector entity, based on its unique legal status, strategic policy role and strong financial and organisational ties with the state. The overall liabilities expected to be on the fund's 2012 balance sheet are not significant, consisting only of the Nenskra power plant project amounting up to USD80m. The formal process for authorising capital injections into the fund in case of need is delegated to the Ministry of the Economy and Sustainable Development if it falls within its operating budget parameters, no consent of the parliament is needed, thus expediting the transfer of relief funds.

Fitch believes that the Georgian state will support the fund in case of distress to avoid the harmful effects that its failure would have on the economy and the creditworthiness of Georgia itself. A letter of comfort, signed by the prime minister, expressly outlines the government's commitment to extend support to the fund in case of distress.

PF's Operational Outlook

PF has a very limited track record as its operations only started in June 2011. The company operates with one office Tbilisi. Target sectors in which the fund will be investing are manufacturing, agriculture, energy, and real estate.

The company's main acitivities will be providing investment and guarantees. PF could invest by injecting equity, or by providing a subordinated loan (convertible or non-convertible), a senior loan (convertible or non-convertible), or extend a guarantee (energy sector). The guiding principle in equity participation is to hold a minority stake (less than 49% of the project company's equity and less than 25% participation in the entire project), with certain exceptions.

As of March 2012 PF had not funded any project, while according to the management's business plan the asset portfolio is expected to increase from GEL80m in 2012 up to GEL391m in 2016.

PF's Funding

PF's capital was funded by the Georgian government with the transfer of shares of key infrastructure assets to PF in 2011. At the time of the Fund's incorporation, the government made an initial capital injection of shares of 24% of Grail, 24% of Georgian Oil and Gas Corporation LLC (GOGC), 49% of Georgian State Electrosystem LLC (GSE), and 49% of Electricity System Commercial Operator LLC (ESCO).

The state transferred two project companies, Nenskra power plant and Tbilisi Logistics Centre, to PF. The fund also participated with a 50% stake in Borjomi Likani International (BLI), a resort development project co-owned by Kazmunaigas Service Georgia.

Figure 2

Dividend History of PF Portfolio Companies

(GEL)m		2007	2008	2009	2010	2011E
Grail	Net income	39.2	36.1	15.8	101.5	174.4
	Dividends	72.1	0.0	36.0	36.0	28.0
GOGC	Net income	61.9	1.4	-37.3	97.6	122.5
	Dividends	0.0	0.0	0.0	45.0	20.0
GSE	Net income	22.7	27.8	99.5	0.0	
	Dividends	0.0	0.0	0.0	0.0	0.0
ESCO	Net income	4.1	2.1	2.3	4.7	
	Dividends	0.2	1.7	2.8	3.4	
Total	**Net income**	**127.9**	**67.3**	**80.3**	**265.7**	**296.9**
	Dividends	**72.3**	**1.7**	**38.8**	**48.5**	**48.0**

E – Expected
Source: PF, Fitch

Dividend payment from PF portfolio companies will be the prime source of funding for the fund's operations. PF considers Grail and GOGC its strategic assets, as these two companies contributed about 74% of the dividends, paid by the portfolio companies in 2010 and expected payments in 2011 represent about 72% of the total portfolio dividends. The payout ratio of Grail was quite small in 2008, translating funds to retained earnings of the company, which allowed it to pay high dividends in the subsequent year. Despite the relatively low net income of Grail in 2007 and 2009 due to high depreciation costs, EBITDA was sufficient to finance dividend distributions (see Figure 2).

PF's management expects to receive about GEL35m worth of dividend payments in 2012, which represents about 35% of overall expected dividends paid by the portfolio companies in 2011. Fitch assesses this estimate as conservative, in light of a potential move by the government to direct the entire dividend payment of Grail for 2011 to PF.

A review of PF's recent performance is of low analytical relevance due to the fund's relatively short operational history. However, Fitch has reviewed the 2011 financial statements, covering six months' performance. By end-2011 PF reported net income of GEL6.9m with EBITDA margin of 73.4%. According to management's expectations the fund's EBITDA should amount to USD72.4m (GEL120m) by end-2012 and will gradually increase up to USD120m (GEL200m) in 2016.

Debt and Liquidity

PF's Debt Limited

As of March 2012 PF's only debt was a credit line up to USD5m contracted from the local TBC Bank ('B+'/Stable). The credit line is short term, for 12 months, and each tranche could be received by the company upon request within one day. By end-2011 the company had GEL0.7m (USD0.4m) reported as short term debt, which is the actually drawn portion of the credit line. As of March 2012, PF had additionally drawn GEL6m (USD3.6m), effectively increasing its outstanding short-term debt up to GEL6.8m.

According to management expectations, PF might raise debt in the future to fund its investment activities. The company might consider a commercial loan, which could be guaranteed by the state. However, the likelihood of a sovereign guarantee is low as the government wants the fund to be self-sufficient. The company could also make use of structured finance. Any new borrowing by the fund is subject to government's approval. With the proper launch of PF's investing activities and expected increased borrowing, Fitch will review the debt stock of the company to asses its credit metrics.

Liquidity

PF's cash position was sufficient in 2011, and so the company did not resort to external funds for liquidity purposes. Fitch expects the fund to have an adequate level of cash in 2012. As the government decision on dividends was formalised in March 2012, the fund used the tranche of USD3.6m out of the credit line for short-term liquidity financing. The fund is expecting dividends from Grail and GOGC which will significantly increase PF's cash balances, exceeding actual cash requirements. Upon execution of the scheduled dividend payments and divestment of Grail shares the fund will deposit its excess cash with local banks.

Appendix

Figure 3

JSC Partnership Fund

(GELm)	2011P
Income statement	
Revenue	9.4
General and administrative expense	0.3
Other operating expense	0.7
Total operating expense	-1.0
Operating profit/(loss)	**8.4**
Non-operating income/(expense)	-1.6
Interest expense	0.0
Net income/(loss)	**6.9**
ROA (%)	1.3
ROE (%)	1.3
Balance sheet	
Cash and cash equivalents	0.1
Receivables and tax assets	0.1
PPE	0.2
Investments, including	
BLI	17.2
TLC	1.3
Nenskra	6.2
Grail	401.9
GOGC	114.6
Total assets	**541.6**
Payables	0.8
Financing costs payable	1.5
Committed capital investments	17.1
Short-term loans	0.7
Total liabilities	**20.1**
Paid in capital	514.6
Retained earnings	6.9
Equity	521.5
Total liabilities and equity	**541.6**

P – preliminary not audited data
Source: PF, Fitch

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