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# Georgia as a hub of trade and commerce linking Europe and Asia

Georgia has for over a decade hosted the South Caucasus energy corridor linking Caspian resources to Turkey and beyond. As a result, Georgia is today a major economic hub located at the crossroads of Europe and Asia. Bank of Georgia and TBC Bank, both traded on London Stock Exchange, actively support large and small domestic enterprise including health care and hospitals to alternative energy projects. Georgia's Black Sea ports and terminals at Batumi, Poti, Kulevi and Supsa are Central Asia's gateway to the Mediterranean and the world. In July, Tbilisi will host the 13th European Youth Olympic Festival. But Georgia's ability to enable broader Eurasian trade and transit, much less attract foreign direct investment from diverse sources, depends on encouraging the vitality and innovation of her entrepreneurial class and striking an enduring balance between competing states and formidable regional interests.

By Robert M. T. Jutson, Jr., Managing Director at Griffin Capital Partners

## SETTING THE STAGE: MARKET ACCESS

Following the dissolution of the Soviet Union, newly independent, oil-rich and landlocked Caucasus and Caspian states were anxious to access world markets. All viewed multiple pipelines as essential to their efforts to ensure that no regional power could exercise strategic control over energy transport, and their broader economic and political ties to western, Mediterranean and Asian partners.

Georgia provided a route to global markets which newly independent states like Kazakhstan, Azerbaijan and Turkmenistan used to export their oil and avoid the tolls and exactions imposed by northern routes. Russia naturally opposed multiple pipelines, reflecting a strong desire to retain control over strategic re-

sources, pipeline and infrastructure networks providing market access. The West's leadership has only recently awakened to how manifestly ambivalent Russia remains about the changed political, economic and military realities on its southern rim and the encroachment of NATO on its western flank.

The dynamic of forces throughout the region changed with the 2008 Georgia-Russia war over South Ossetia. Until that incident, many in Europe hoped the Central Asian republics and the promise of oil from the Caspian shelf would diminish their reliance for energy on Russia. Decades earlier, the US encouraged this expectation by supporting the construction of oil and gas pipelines bypassing Russia, in particular, the Baku-Tbilisi-Ceyhan (BTC) pipeline. The US opposed the shortest

pipeline route through Iran and favored the far longer BTC pipeline terminating at Ceyhan, Turkey. In so doing, the US minimized the involvement of Iran in the region's long-term energy developments. (Russia Review, 20 October 1999 <http://www.griffincap.com/rfp/r201099.pdf>)

"The building of BTC reconfigures the mental map with which political observers and decision-makers in the Caucasus look at the world" declared Svante E. Cornell and Mamuka Tsereteli of the Central Asia-Caucasus Institute in Washington (<http://www.cacianalyst.org/publications/analytical-articles/item/10010-analytical-articles-cacianalyst-2005-6-15-art-10010.html>). In the decade since the commissioning of the BTC pipeline in 2005, Georgia has established itself as a reliable

partner in international trade and commerce, in spite of the 2008 border conflict.

Upon that stable foundation, and an increasingly diversified economy, the IMF, EBRD and World Bank forecast growth in Georgia at 5% this year, declining to 2% in 2016 due to the continuing crisis in Russia. FDI (almost 6 percent of GDP) and official loans (2½ percent of GDP), in addition to remittances remain the main sources of external financing. Following IMF program approval last July, Moody's and Fitch upgraded the outlook on Georgia's sovereign rating to positive (Ba3/BB-), citing improved economic prospects with the provisional application of the Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU from September 2014. <http://www.imf.org/external/pubs/ft/scr/2015/cr1517.pdf>

The greatest near term risk to sustaining growth is weakness in its export markets and the stability of the Georgian lari relative to the US Dollar. This will diminish competitiveness with its Euro zone trading partners if USD rates rise while the EU applies quantitative easing. <http://www.imf.org/external/pubs/ft/scr/2015/cr1517.pdf> According to Fitch, the level of dollarisation in Georgia remains high at about 60% of loans and deposits, although these levels have fallen from over 70% in 2009.

## GAINING EXPOSURE TO GEORGIA'S GROWTH

For those whose liquidity preference is strong, diversified exposure to Georgia's growth may easily be gained via Bank of Georgia Holdings PLC (LSE: BGEO LN), a FTSE 250 UK-incorporated holding company of Bank of Georgia. It is the largest bank in Georgia with a market share of over 35% of total assets. The bank offers a broad range of retail banking, corporate banking, investment management, brokerage and insurance services to its clients, and also owns healthcare and real estate busi-

nesses. Georgia Healthcare Group, the Bank's wholly-owned healthcare subsidiary, has a 22% market share of hospital beds in Georgia, and is currently planning its international stock market listing, scheduled for the second half of 2015.

As of 31 December 2014, the Bank served approximately 1.5 million client accounts, and this franchise was increased by a further 400,000 clients in January 2015 following the acquisition of Privatbank Georgia. Its shares are held 94% by Western institutional investors and 6% by management. It has little debt in its capital structure and a Tier 1 capital adequacy ratio of 22.1% (Basel I) (31 December 2014).

As many readers will know, the EBRD's relationship with Bank of Georgia dates back to 1995. Though no longer a shareholder, the EBRD has provided Bank of Georgia with a range of products, including SME and energy efficiency credit lines, co-financing facilities as well as subordinated and convertible loans. EBRD is today a shareholder of TBC Bank.

As for FDI, its sources vary considerably, reflecting commercial opportunities and encouraged by supportive government policy initiatives. Regional and global powers have outlined policy initiatives with specific objectives when it comes to promoting influence and supporting investment in the South Caucasus and Caspian region. For example, the "New Silk Road" policy of the US seeks "democracy promotion" while China's "Silk Road Economic Belt" simply promotes "economic development". Russia's policy is not so expressly defined.

After Georgia's August 2008 war with Russia, the United Arab Emirates became Georgia's leading foreign investor in 2009, according to greenfield investment monitor "fDi Intelligence". The United States took the lead in 2010 as did the Netherlands in 2011 and Germany in 2012.



**ROBERT M. T. JUTSON**  
Managing Director of Griffin Capital

Mr. Jutson founded Griffin Capital in 1985 to acquire corporate real estate and arrange finance for strategic assets and for early- and growth-stage enterprises. Russian and CIS clients include the Tbilisi Marriott Hotel, MTV Ukraine, KazakhstanEnergo, Moscow CableCom Corp., Sakhalin Telecom (Golden Telecom) and NTV Plus. Mr. Jutson served as a Director of Dal Telecom International (1999-2002), the largest GSM operator in Far Eastern Russia (Vimpelcom). He was previously a limited partner of Fieldstone Private Capital Group, L.P., a spinoff of Bankers Trust Company, a Vice President of Eastdil Realty, Inc. and Vice President of Gerald D. Hines Interests. Mr. Jutson graduated Rice University's School of Architecture and attended the Columbia University Graduate School of Business Administration. Mr. Jutson has appeared on CNN International regarding current events in Russia and presented to and chaired numerous finance conferences. [rmj@griffincap.ch](mailto:rmj@griffincap.ch)

In 2013, Georgia received USD 941MM and c. USD 1.27Bn in FDI in 2014 according to preliminary figures from Georgian National Statistics Department, GeoStat. In H1 2014, the greatest amount of investment went to the transport and communications sector (USD 101MM) followed by manufacturing (USD 58MM) and energy (USD 45MM). GeoStat estimates the leading sources of FDI in both 2013 and 2014 were the Netherlands, neighboring Azerbaijan and China.

Tentative improvements in Georgia's bilateral relationship with Russia



were illustrated by Russia's modest response to Georgia's signature on the DCFTA. Russia's economic leverage in Georgia is still quite low, accounting for less than 10% of Georgian exports in 1H14. Economic repercussions of the crisis in Ukraine on Georgia have proved limited to date but are beginning to bite with an adverse impact on GDP widely anticipated in 2015 and 2016.

That said, when it comes to FDI, Russian enterprise has a growing presence in strategic sectors of Georgia's economy including energy, transportation and power generation. In 2009, Russia's state-owned oil producer Rosneft announced offshore explorations and development of oil and gas fields in Abkhazia under an agreement signed between the company and Abkhazia's de facto government. It is unclear if anything further has come of the agreement. In late 2014, Rosneft entered Georgia's oil retail market by purchasing a 49 percent stake of Petrocas Energy Ltd., a Georgian oil transportation company which operates in the South Caucasus. (<http://www.osw.waw.pl/en/publikacje/analyses/2015-01-14/rosneft-to-invest-georgia>) Petrocas's assets include an oil terminal in Poti with a capacity of 1.9 million tons per year as well as a network of 140 gas stations in Georgia operating under the Gulf brand. (CACI, <http://www.silkroadstudies.org/publications/silkroad-papers-and-monographs/item/13075-a-western-strategy-for-the-south-caucasus.html>)

Rosneft will gain high-quality storage capacity in one of the major oil and oil products hubs in the region, broaden supply route options and enhance its upstream and downstream operations in the Central Asia and South Caucasus markets. Rosneft and Petrocas have also recently established a new joint venture to increase cargo transit through Georgia.

Russian investments have extended to other areas of Georgia's economy including finance, electricity, chemicals, mining, telecoms and agribusi-

ness. For example, in 2003, Russian state-owned electricity trader, Inter RAO, obtained 75 percent of Tbilisi's electricity distribution company Telasi, thermal power generating plants, as well as the management right of two hydropower plants; Khrami I and Khrami II. The Georgian government retained 25%. Russia's VTB Bank, Lukoil and Vimpelcom (Beeline) also operate in Georgia.

The common thread in many of these deals reflects Russia's strategy to strengthen its infrastructure capabilities in the South Caucasus to ensure uninterrupted delivery of oil and other products to Armenia, which recently became a member of the Eurasian Economic Union (EEU) but lacks common borders with other EEU members. The reconstruction of the railway through Abkhazia and the planned Avaro-Kakheti highway from Dagestan to eastern Georgia and then to Armenia support such a strategy.

Beyond energy and transportation, there is power generation. The EBRD reports the sustainability of energy system is still problematic in Georgia. The world's second biggest arch dam, the Enguri HPP, provides more than 40 percent of Georgia's electricity needs. It plays a critical role in Georgia's infrastructure. <http://www.ebrd.com/news/video/georgia-enguri-dam-keeps-the-power-flowing.html>

The Enguri HPP spans the Enguri river and is located both on Georgian and Abkhazian/Russian controlled territories. The dam itself is on the Georgian controlled side, while the electric station is on Abkhazian controlled territory. It produces about 1.3 GW of electricity a year.

According to an informal agreement reached between Tbilisi and Sokhumi in the 1990s, Abkhazia receives about 40 percent of the electricity generated by the plant as a Soviet-era concession with the balance allocated to Georgia.

In a similar spirit of cooperation and conciliation, five months after



the Russo-Georgian war, at the beginning of 2009, the Georgian government signed a memorandum with the Russian state-owned company Inter RAO to manage the plant for the mutual benefit of Georgia and Abkhazia.

Whether one is a portfolio investor or seeking strategic opportunities for direct investment in companies or projects, the compelling merits of Georgia as an investment destination have been clear to many for years: growth and increasing political stability at a crossroads of international trade. With a coherent national development strategy based on transparency, accountability and sound governance, Georgia will continue to grow and prosper, ensuring its most talented young men and women remain to participate. **GF**

Griffin Capital provides strategic advice to our clients and develops and assists in implementing funding strategies for their projects, acquisitions and dispositions. We have 20 years of experience advising enterprises across Eurasia from Kazakhstan to Georgia and Ukraine including the original developer of the Tbilisi Marriott Hotel and NatEx Georgia LLC, a licensed producer of Paclitaxel from Georgian yew trees.

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