

Georgia – still good place to Invest?

“There are two questions facing prospective investors in Georgia”, says Andrew Coxshall, Managing Partner at KPMG Georgia, he speaks to GF about what are the main drivers of economic growth likely to be in 2015 and shares his views on the potential areas offering good opportunities for investment.



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Andrew Coxshall has more than 25 years' experience working in more than 10 countries around the world including over 10 years as a Partner in the Big 4. For the last 7 years Andrew has been the Managing Partner for KPMG Georgia, where he, with the KPMG team, provides assurance and advisory services to the largest companies in Georgia in various sectors including transportation, energy, hospitality, financial services, telecoms etc.

LIVING IN A VOLATILE REGION

2014 saw a dramatic shift in the economic fortunes and prospects of many countries of the former Soviet Union as a result of the occupation of Crimea, and then in Eastern Ukraine, which led directly to the imposition of sanctions by the United States, the European Union, Canada and others. At the same time the huge decrease in the price of oil impacted the main oil and gas produc-

ing countries in the region including Russia, Kazakhstan and Azerbaijan, while in Turkey the economy started to slow with growth reducing from 4.5% in 2013 to only 1.7% in the third quarter of 2014.

At the end of 2014 and the very beginning of 2015 Georgia seemed to have largely escaped the consequences of this triple shock to the region (war, sanctions and the oil price collapse). However, at the end of February 2015 the Georgian Government reduced their growth forecast from 5% (GDP growth in 2014 had reached 4.7%) down to 2%.

Given this background there are two questions facing prospective investors in Georgia. Firstly, what are main drivers of economic growth likely to be in 2015 and secondly what are the potential areas offering good opportunities for investment?

A PRETTY GOOD TRACK RECORD OF ECONOMIC GROWTH

A small country without significant natural resources or a large diaspora to support it, Georgia has always needed foreign direct investment (FDI) to grow and to balance the budget. In this respect, Georgia has done well over the last 5 years despite the financial crisis and having a significant proportion of its territory occupied by foreign forces.

The economic reforms and focus on the economy of the Saakashvili government in the years 2004–2012 led to an increase of 15.2% (compound

growth rate) in GDP and turned a country on the edge of being declared a “failed state” to the darling of the World Bank and a regular feature on the London Stock Exchange (Bank of Georgia, Georgian Railways and Georgian Oil and Gas Company). In addition the strictly enforced clampdown on corruption led to a fundamental shift in the attitudes of businesses towards taxation, bribery and methods of conducting business.

Despite the high-profile corruption cases brought by the new government since coming to power in October 2012, it would appear that the Saakashvili-era reforms have become entrenched such that, on a transactional level, corruption has become uncommon for most people and most businesses operating in Georgia. This is borne out by the recent Business Bribery Risk Index by Trace International and the RAND Corporation which showed Georgia in 11th place (other countries in the top 15 include Sweden, Canada and Singapore). This is a fundamental difference between Georgia and all countries in the CIS region (Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Russia, Turkmenistan, Tajikistan, Ukraine and Uzbekistan) where corruption is endemic, often getting worse and, in most cases, accepted and tolerated by the governments in those countries. Indeed this is one of the differentiators that Georgia could focus on to attract further investment.



MAIN DRIVERS OF GROWTH IN 2015

In 2014 the economy turned in a respectable 4.8% growth in GDP although this was not as good as had been hoped due to many reasons and was not helped by new Government legislation in the areas of visas, ownership of agricultural land and foreigner work permits. The key drivers in 2014 were the following (all figures are for the third quarter of 2014 compared to the third quarter of 2013 based on Government of Georgia statistics and represent the contribution to overall GDP growth):

- Wholesale and retail trade +1.6%
- Construction +1.2%
- Manufacturing +1.1%
- Transportation +0.7%
- Public administration, Education, Health and Social Work +1%
- Agriculture only contributed

- +0.4% to overall growth
- Overall no sectors of the economy showed a decline.

For 2015 one would expect similar trends to those of 2014 (due to the election in 2012 the 2013 GDP growth figures do not really represent a reliable indicator of future expected performance). However, negative changes in the entire region mean that GDP growth is likely to slow considerably with 2%–2.5% being the most often-quoted range. Also the key focus areas of growth have come under specific pressure in recent months.

Tourism – the decline in the purchasing power of the Russian Rouble, the Azeri Manat and the Ukrainian Hryvnia mean that Georgia can expect less visitors from these countries. Also the visa debacle in

the second half of 2014 has created a lot of confusion for visitors from other countries with lots of conflicting data and messages on the internet.

Agriculture – the surge in exports for Georgian wine and water in 2014 was mainly driven by exports to Russia, which for the same reasons as stated above, are expected to decline in 2015. However, this impact may be softened a little with the depreciation of the Georgia Lari (down by 25% from October and down by 18% since the New Year).

Construction – One of the key issues in the private sector is likely to be the ability of construction companies to sell the stock of completed or semi-completed housing inventory following the significant depreciation of the Lari since virtually all

apartments and houses in Georgia are priced in US dollars. However, with an election coming up in 2016 it would appear that the Georgian Dream coalition government is finally getting its act together and there is now a real focus on Infrastructure projects and public works, which should stimulate growth in public sector construction.

Electricity, gas and water supply may also make a positive contribution to the country's GDP in 2015 as 7 new hydro power plants have been completed in Georgia in the last year or so and these should become fully operational this year.

OPPORTUNITIES FOR INVESTORS

Given the above backdrop where could investors look for potential opportunities?

Tourism – as a tourist destination Georgia has a great deal to offer, from the Black Sea coast resort of Batumi with its casinos, bars and clubs to the unspoilt mountainous wildernesses of Tusheti and Svaneti; the wine region of Kakheti with its lake resorts and chateaus to the bustling capital city of Tbilisi with its great restaurants, historic sights, churches and synagogues of the old town and ever-increasing number of surprisingly good hotels.

However, in the recent past the Georgian Government has focused solely on visitor numbers, aiming for ever higher volumes of visitors, mainly from the region. The problem with regional visitors is that they do not actually spend very much money. Families from Armenia, Azerbaijan or Turkey load up their cars with food and drink to consume while they are in Georgia, they stay in modest guest houses or private apartments and drive from one end of the country to the other to stay for five or six days on the Black Sea coast and then return home.

Opportunities exist in attracting high-spending tourists from outside of the region, mainly Europe due to its proximity, but also, from Asia (data from the National Bureau of Statistics of China

indicated that outbound travel increased at a compound annual growth rate of 18.5% between 2000 and 2010, from approximately 10.5 million to 57.4 million travelers, respectively).

Travellers are always on the lookout for something a bit different and this is just what Georgia can offer. The slightly exotic – climbing Kazbegi, or horse-back riding with a local Svan for a guide – combined with the comfortably familiar – enough people who speak English, signs in English and a “European” feel to the place.

Georgia can also offer some great specialist tours, whether it be the wetlands of Gardabani for birdviewing, discovering wild flowers in mountain pastures, or a cultural visit to Georgia's many churches and cathedrals. European and other travelers are willing to pay well for such out-of-the ordinary trips but want to be looked after; to have their comforts; and to be well fed and watered. So, the opportunity is catering to this small but lucrative niche market – something that the locally owned and managed “Rooms” group of hotels seems to have done already but there is still plenty of scope for more investment in this area.


Agriculture – Although the Government has put a lot of financial resources into this sector, it is presently difficult to see any significant impact. While growth for 2013 was a healthy 9.8% it was only 4.6% in the first three quarters of 2014 – one of the worst performing sectors. The problem is that whilst everyone agrees that there are great prospects in agriculture, very few seem to have been able to tap this potential. One of the issues, according to an industry specialist, is that banks are still unwilling to lend into this sector. The Government scheme to give lower interest rate loans to companies in the sector has, in effect, just meant those businesses with loans have to pay less interest. However, it is still very difficult for businesses or individuals to get loans

at reasonable interest rates without mortgaging everything they own. The idea of a crop-based return or extended payment terms depending on the growing cycle are still alien concepts to bankers in Georgia.

So, where is the opportunity in Agriculture? The answer may well lie in the EU Association Agreement that Georgia signed in mid 2014 and the related DCFTA. As with the wide range of tourism options, Georgia has great bio-diversity for such a small country; as a result high yields of a wide variety of fruits and vegetables can be grown in Georgia that could be exported to Europe. However, according to a Georgia-based agronomist, Georgia should try to focus on the high value specialist products such as blueberries or kiwi fruit (trying to compete with tomatoes from Spain or Turkey for example is going to be very difficult in the current environment).

Lastly, following the successful IPO of TBC Bank on the London Stock Exchange in mid 2014, Georgia now has two banks listed on the LSE and as such it has become a little more familiar to European investors. In these times of very low or even negative interest rates there are investors out there who are willing to take a risk on a small country like Georgia. Depending on the investor preference this may be in a single asset (a power plant for example) or a portfolio of assets that are bundled up to be of sufficient size for investors with USD100m or more to invest.

CONCLUSION

In conclusion, 2015 will be a tougher year for Georgia than many had expected but, providing there are no further external shocks and the Government stays focused on the economy, Georgia should perform better than most economies in the region. Also with its low levels of corruption, very low levels of crime, comparative ease of doing business, low tax rates and reasonably stable Government, Georgia should be able to attract further investment in 2015 and, for the shrewd investor the returns could be very good. 



KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We have been working in Georgia since 2000 operating a full service office in Tbilisi and providing a combination of in-depth knowledge of local business and international practical experience.

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