Georgia Capital

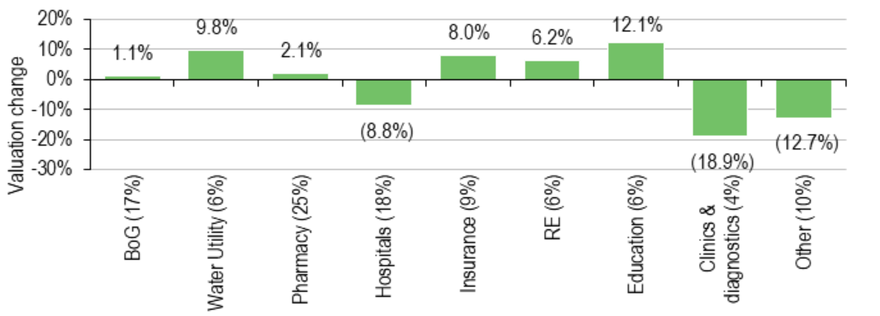
NAV per share stable in local currency in Q222

Investment companies
Private equity

25 August 2022

Georgia Capital's (GCAP's) NAV per share in Georgian lari total return (TR) terms remained broadly stable in Q222 (a 0.2% increase) after absorbing the impact from lower public market multiples and higher discount rates in Q122 (when NAV per share declined by 16.5% in TR terms). Having said that, the continued appreciation of the Georgian lari against sterling (driven by the strong local economy) resulted in a solid 14.4% NAV TR in sterling terms in Q222 (-2.1% in H122). We also note that the share price of Bank of Georgia recouped some of the Q122 losses in Q222 and rose further by 61% after end-June 2022 (well above 2021 levels), which brought GCAP's 'live' NAV estimate to £17.41 at 24 August. This now implies a 61% discount to NAV, well ahead of other listed private equity companies.

Revaluation of carried portfolio in Q222*



Source: GCAP. Note: *Calculated as 'value creation' (as reported by the company) divided by carrying value at end-March 2022. Share in the portfolio at end-June 2022 shown in brackets on the X axis.

Why consider Georgia Capital now?

GCAP provides diversified exposure to Georgia, mostly through resilient, market-leading businesses in sectors like healthcare, pharmacy, financials, renewable energy and education. This portfolio (of which 90% is valued externally) is available at a wide discount to carrying value and we note that the combined value of its Bank of Georgia stake and the remaining stake in the water utility business (valued based on the put option) alone equal c 81% of GCAP's market cap.

The Georgian economy exhibits extremely strong momentum (despite weaker global macro conditions), with real GDP growth of 10.5% y-o-y in H122 (after 10.4% in 2021). This is fuelled by, among other things, solid external demand (merchandise exports were up 35% y-o-y in H122), a surge in remittances by 65% y-o-y in H122 and a rebound in tourism arrivals to 80.6% of 2019 level in July 2022, including the migration effect, according to Galt & Taggart research. Georgia's solid economic prospects are illustrated by the World Bank's GDP forecasts (released in June 2022) for 5.0%+ growth in 2022–24. Local forecasters expect even higher real GDP growth in 2022, with the National Bank of Georgia recently raising its forecast from 4% to 9%, while Galt & Taggart and TBC Capital forecast 9.2% and 10.6%, respectively. This is supported by, among other factors, the inflow of migrants from Russia, Ukraine and Belarus following the outbreak of the war. TBC Capital estimates that 75,000 have arrived so far and that c 30,000 will stay permanently.

Price		**684p**
Market cap		**£307m**
NAV		**£654m**
NAV per share*		1,478p
Discount to NAV		53.7%
*At end-June 2022.		
Yield		0.0%
Ordinary shares outstanding*		44.2m
Code/ISIN		CGEO/GB00BF4HYV08
Primary exchange		LSE Premium
AIC sector		N/A
52-week high/low	725p	459p
NAV high/low	1,507p	1,248p
*As at end-June 2022		

Gearing

Net gearing at 30 June 2022	17.8%

Fund objective

Georgia Capital focuses on scalable private equity opportunities in Georgia. These opportunities have the potential to reach at least GEL300m equity value over the next three to five years and the company can monetise investments through exits as investments mature.

Bull points

- Majority of portfolio exposed to resilient and well-established businesses.
- Successful disposal of the water utility business reinforces confidence in GCAP's exit capabilities and portfolio valuations.
- Regular dividend income from several portfolio companies.

Bear points

- High discount to NAV limits GCAP's activity in terms of new investments.
- A concentrated portfolio exposed to a frontier economy is inherently higher risk.
- GCAP has just started building its track record of investment realisations.

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Post-pandemic normalisation in healthcare in Q222

Hospitals and diagnostics returning to pre-COVID-19 operations

The aggregate revenues of GCAP's private portfolio companies increased by 4.6% y-o-y in Q222, while aggregate EBITDA was down 20.0% y-o-y (or by c GEL15m). However, we note that this was largely driven by the expiry of COVID-19 government contracts (with hospitals EBITDA excluding IFRS 16 down to GEL13m from GEL20m in Q221) and the lower results of the diagnostics business amid a lower number of COVID-19 cases (resulting in a minor EBITDA loss for the diagnostics segment in Q222 vs a GEL2.5m profit in Q221). GCAP's management expects the results of these businesses to rebound in the coming quarters as they transition to the post-pandemic mode of operations, with July and August occupancy of its hospitals already at pre-COVID-19 levels. GCAP's CEO believes that the EBITDA margin of the hospitals business should recover to pre-COVID-19 levels in the next few quarters (Q222 margin excluding IFRS 16 stood at 18.3% vs Q219 margin of c 25.4%). Still, the carrying values of the hospitals and clinics & diagnostics businesses were reduced by c 9% and 19% vs end-March 2022, respectively.

Retail (pharmacy) continues to expand its store chain

Another major driver of the fall in private portfolio earnings was the retail (pharmacy) business, which posted declines of 3.5% and 11.4% y-o-y in Q222 revenues and EBITDA, respectively. This was mainly related to pricing adjustments resulting from the Georgian lari's appreciation against foreign currencies (Q222 same-store sales decline at -1.6%), as well as cost inflation and higher operating expenses associated with the addition of 33 pharmacies over the 12 months to end-June 2022 (in line with GCAP's strategy focused on the expansion of capital-light portfolio companies; see our previous note for details). GCAP's management highlighted that the business should be able to pass on at least some of the cost inflation at some stage to its customers. The carrying value of the business was marked up by 2%, assisted by the positive outlook for the business coming from a combination of chain expansion and strength of the Georgian economy.

Bank of Georgia's annualised ROAE at 32.8% in Q222

On 16 August 2022, Bank of Georgia reported a strong 36.3% y-o-y increase in net profit in Q222 to GEL275m, translating into an annualised return on average equity (ROAE) of 32.8%. The bank's loan book increased by 10.2% y-o-y (17.8% on a constant currency basis) and deposits grew by 8.3% y-o-y (16.0% on a constant currency basis). Bank of Georgia's non-performing loan (NPL) ratio increased slightly to 2.6% at end-June 2022 compared to 2.4% at end-2021. The bank retained a solid capital position with a CET-1 ratio of 14.0% (vs the regulatory requirement of 11.7%) and a liquidity coverage ratio of 113.5%.

Other major holdings posting good results

GCAP's P&C insurance business performed well, assisted by an increase in earned premiums (especially in the credit life and agricultural insurance lines) and an improved combined ratio of 79.6% (vs 80.2% in Q221), while the results of the medical insurance business were flat year-on-year. In turn, the overall insurance business posted revenue and net income rises of 9.3% and 9.0% y-o-y in Q222, respectively. Overall, the P&C business was revalued upwards by c 8%, implying a valuation multiple of 11.0x vs 10.6x at end-March 2022.

GCAP's education business maintained strong momentum with sales and EBITDA up 28.9% and 19.9% y-o-y in Q222, respectively, assisted by higher capacity utilisation at 96.5% versus 91.2% in Q221 (excluding the capacity expansion in the affordable segment in Q321), strong enrolment (with record-high intake for first graders for September, above expectations) and an increase in fee per learner. Consequently, its valuation increased by c 12%.

The revenue and EBITDA of the renewable business were down 7.6% and 5.9% y-o-y, respectively, in Georgian lari terms, but this was due to the Georgian lari's appreciation versus the US dollar (the business's functional currency is the latter). Its carrying value was raised by 5.1% in Q222.

GCAP's leverage continues to fall

GCAP's net capital commitment (NCC) ratio, introduced recently as part of its strategic deleveraging process (see our previous note for details), declined slightly to 27.0% at end-June 2022 versus 28.2% at end-March 2022 (and the over the cycle target of 15%), primarily assisted by foreign exchange, as its portfolio is denominated in Georgian lari, while most of its debt (US$365m six-year Eurobonds maturing in March 2024) is denominated in US dollars. After end-June 2022, the ratio improved further due to (1) the above-mentioned increase in the share price of Bank of Georgia, (2) continued strengthening of Georgian lari and (3) a US$7m expected reduction in guarantees on the debt of GCAP's beer business.

At end-June 2022, GCAP's liquid assets stood at US$234m, with US$123m in cash, US$104m in marketable securities and a US$8m dividend receivable from Bank of Georgia. We note that this fully covers its planned renewable energy and education investments (US$54.2m), announced buybacks yet to be executed (US$4.3m) and the contingency/liquidity buffer assumed by GCAP (US$50m). We understand that the NCC does not account for the US$95.4m shareholder loan GCAP will provide to Georgia Global Utilities (see our January 2022 note for details) to refinance the portion of the Green Eurobond attributable to the renewable energy business in August 2022, as it is only considered bridge financing until the business can raise new long-term debt funding.

On 23 June 2022, Moody's upgraded GCAP's corporate family rating to B1 from B2 with a stable outlook. Meanwhile, S&P Global Ratings reaffirmed its B+ long-term issuer rating on 3 June (upgraded from B in February 2022) but revised its outlook from stable to negative. This reflects the possibility of a downgrade over the subsequent six to nine months if macroeconomic conditions in Georgia deteriorate, which could have an impact on GCAP's leverage and liquidity and in turn the refinancing risk associated with its 2024 bonds. We believe that the risk may be at least partially mitigated by the extensive experience of GCAP's team in accessing the debt capital markets, which also covers the period under BGEO (before it was split into GCAP and Bank of Georgia in May 2018).

GCAP's year-to-date dividend income stands at GEL34.4m with a further GEL55–66m expected until end-2022, bringing the FY22 figure to GELL90–100m (compared to GEL74.4m in FY21 and GEL72.9m in FY19). The company continued to execute NAV-accretive share repurchases, buying back 0.8m shares (for US$6.3m) in Q222 and a further c 0.5m (for US$3.6m) after end-June 2022. Since buybacks were launched in August 2021, it repurchased 3.0m shares representing c 6% of its share capital. GCAP has extended the timeframe for its buyback and cancellation programme until end-2022.

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