EDISON

Georgia Capital

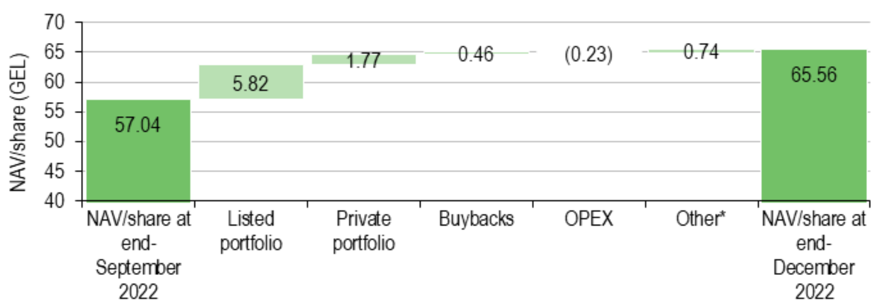
Nearing deleveraging target

Investment companies
Private equity

8 March 2023

Georgia Capital's (GCAP's) NAV per share total return in Q422 was 14.9% in Georgian lari (GEL) terms (8.5% in sterling), bringing the full year return to 4.0% (33.2% in sterling terms due to the significant appreciation of GEL). The portfolio value uplift in the quarter was mainly driven by the strong share price performance of Bank of Georgia (BoG), up 31% in sterling terms. This allowed GCAP to bring holding leverage closer to its target level, while maintaining a good liquidity position (up 14% y-o-y in US dollar terms). Meanwhile, GCAP shares continue to trade at a wide discount to NAV, currently 61%, based on GCAP's 'live' NAV estimate, implying that the value of BoG shares and the put option on the water utility business is currently higher than GCAP's market capitalisation.

NAV per share development in Q422



Source: GCAP. Note: *Includes liquidity management, foreign exchange effects and other.

GCAP executes its deleveraging strategy

Amid the high interest rate environment, GCAP is focusing on deleveraging, both at the holding level and in the underlying portfolio. It is targeting net capital commitments (NCC) as a percentage of portfolio value of 15% by 2025, which stood at 21.1% at end December 2022 after decreasing by 3.3pp during the quarter. The reduction was driven predominantly by a higher portfolio valuation, while NCC were broadly flat. At the current portfolio valuation, GCAP calculates that it needs to decrease NCC by US$72m (from the current US$250m) to reach its target. This could be funded by disposals of some of its subscale businesses, as well as income from regular dividends paid by its portfolio holdings. GCAP expects to receive GEL150–160m (US$57–61m) in dividends in 2023, which is 22–30% higher than in 2022 (including a BoG share buyback as an alternative to a standard dividend).

As at end December 2022, GCAP's debt at the holding level comprised US$300m 6.125% Eurobonds, of which US$51m were held in treasury. While GCAP aims to reduce holding-level debt to zero within three to four years, it intends to refinance US$150–200m of the bonds (which mature in Q124). Meanwhile, GCAP's liquid resources increased by 13.8% q-o-q to US$152.4m following repayment of the US$80m loan issued to the renewable energy business.

Price	**832p**
Market cap	**£358m**
NAV*	**£903m**
NAV per share*	2,012p
Discount to NAV	66.0%

*At end-December 2022.

Yield	N/A
Ordinary shares outstanding*	43.0m
Code/ISIN	CGEO/GB00BF4HYV08
Primary exchange	LSE Premium
AIC sector	N/A

52-week high/low	840p	479p
NAV high/low	2,012p	1,292p

*As at end-December 2022.

Gearing

Net gearing at 31 December 2022	13.5%

Fund objective

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

Bull points

- The majority of the portfolio is 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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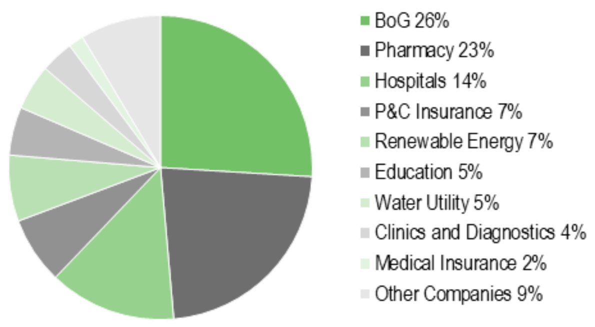
Portfolio update

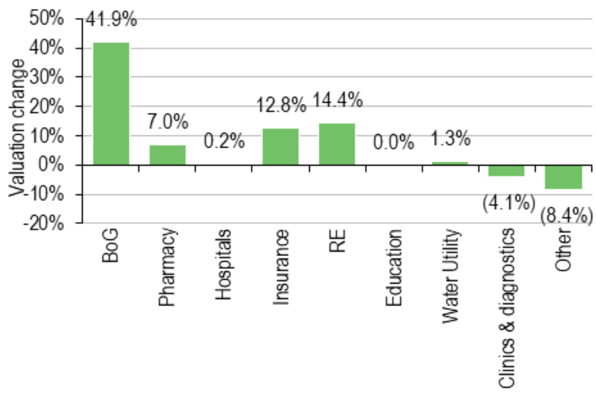
There was a 2.0% y-o-y increase in the aggregate revenues of GCAP's private portfolio companies and a 1.3% y-o-y increase in EBITDA in Q422. This was despite lower y-o-y results from hospitals, and clinics and diagnostics businesses. Excluding these (which make up 17% of the portfolio as at end-2022, see Exhibit 1), the remaining private companies (52% of the portfolio) recorded an aggregate 8% increase in revenues and a 24% y-o-y increase in EBITDA in Q422. On a full-year basis, the aggregated revenues of private portfolio companies increased by 7.6% y-o-y and aggregated EBITDA decreased by 5.5% y-o-y – respectively a 13.2% and 11.9% increase excluding healthcare services.

Exhibit 1: GCAP's portfolio at end-December 2022



Source: GCAP

Exhibit 2: Revaluation of carried portfolio in Q422*



Source: GCAP. Note: *Calculated as 'value creation' (as reported by the company) divided by carrying value at end-September 2022.

BoG's share price rally was the main driver of GCAP's NAV increase and it has reported strong FY22 results, with a 56% y-o-y increase in adjusted net profit to GEL1,132m, translating into a strong ROE of 32.4% (FY21: 25.8%). The loan portfolio increased by 4.3% y-o-y to GEL16,862m, with BoG retaining its 36% market share in gross loans (up 0.4pp y-o-y). Loan portfolio quality is good, with non-performing loans (NPLs) at 2.7% of gross loans and a 129% NPL coverage ratio (FY21: 2.4% and 148%, respectively). During the year, BoG distributed a GEL84m interim dividend and the board will recommend to the 2023 AGM (to be held in May 2023) a final dividend of GEL267m (bringing the total dividend to GEL351m, up 91% y-o-y). On top of that, BoG completed a GEL113m share buyback programme in December 2022, which it intends to further increase by up to GEL148m.

The **pharmacy** business (23% of portfolio) remains the largest private business in GCAP's portfolio. Its Q422 results were 3.3% lower y-o-y at the top line and 9.2% at the EBITDA level, bringing full year revenue to GEL790m and EBITDA to GEL77m (1.0% y-o-y growth each). The business continues to expand, with 24 pharmacies and five franchise stores added to the chain over the course of 2022, and now has 372 pharmacies and 12 franchise stores, representing 35% of the Georgian market, according to GCAP, and the expansion costs weigh on margins. At the same time, the transfer of the hospitals' procurement department from the pharmacy business to the hospitals business (completed in December 2022), reduced the revenues of the pharmacy business. Despite flat results, the business was revaluated by 7% on the back of multiples expansion.

The **hospitals** business (14% of portfolio) posted a y-o-y decrease in Q422 and FY22 revenue and EBITDA. This is because hospitals have not been able to fully ramp up occupancy following the suspension of COVID contracts by the government in Q122 (end-2022 occupancy rate of 69.6%, down 17.6pp y-o-y). The results were further affected by the temporary closure of the Iashvili

Hospital due to mandatory renovation, as well as a lack of revenues from the Traumatology Hospital, which was sold in April 2022. Q422 revenues and EBITDA were down 14.9% and 29% year-on-year, respectively. When adjusted for missing revenues from the above-mentioned two hospitals, revenue was down 7.7% and EBITDA up 3.5% y-o-y. Meanwhile, the valuation of the business was flat q-o-q despite lower results, which reflects the expected positive impact from the roll-out of a Diagnosis Related Group financing system, which is expected to better reflect inflation and other price pressures.

The **insurance** business (9% of portfolio) posted a 6% y-o-y increase in net premiums earned in Q422 (up 9% y-o-y in FY22), which was mainly driven by growth in the credit life, agricultural and border motor third-party liability insurance lines in the P&C segment, as well as higher prices of insurance policies in the medical segment. Net income in the business grew 15.4% y-o-y in Q422 and 11.7% y-o-y in FY22.

Given the current discount to NAV, GCAP is limiting its investments to share buybacks and its investment stage businesses (renewable energy and education) under its 360-degree framework (see our previous note for details). In September 2022, GCAP completed its US$25m share buyback programme (started in August 2021), with 3.1m shares (c 6.4% of issued capital) repurchased and cancelled. Management states that after achieving the target NCC ratio, it may increase the scale of buybacks, and we believe that until then GCAP will focus on divesting subscale businesses and small-scale buybacks.

Potential transfer to standard listing

GCAP intends to move from the LSE premium listing to a standard listing. The transfer will be proposed to shareholders, with voting concluding on 10 March and results announced at the AGM on 14 March. If accepted, the standard listing should commence on 13 April.

According to GCAP's management, the change in listing should provide the company with more flexibility in investment decisions, as it currently needs shareholder approval for any transaction representing a volume of more than 25% of its market capitalisation. Given GCAP's current discount to NAV, this limit translates to just 9.7% of portfolio value. Management also points to cost reduction, which will support reaching its target ratio of opex to NAV of 0.75% (FY22: 1.40% of average NAV).

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