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Fitch Rates Bank of Georgia at 'B-'; Stable Outlook

Fitch Ratings-London/Moscow-12 April 2006: Fitch Ratings has today assigned Georgia-based Bank of Georgia ("BOG") ratings of Foreign and Local Currency Issuer Default 'B-' (B minus), Short-term Foreign Currency and Local Currency 'B', Individual 'D' and Support '5'. The Outlooks on both Issuer Default Ratings ("IDRs") are Stable.

BOG's ratings reflect the high credit risks resulting from rapid lending growth in the relatively high-risk Georgian economy. They also reflect its potentially vulnerable liquidity due to a predominance, to date, of primarily short-term customer funding. However, the bank has a strong domestic franchise, sound core profitability and adequate capitalisation as well as a well-defined, albeit aggressive, strategy, which was adopted in 2004 and is being executed by new management with international experience.

BOG is the second largest bank in Georgia by assets (end-Q106 unaudited: GEL606.3 million), serving both corporate and retail sectors. It strategically focuses on consumer and micro-finance lending where it has emerged as the market leader. Acquisitions of banks and other financial service companies have supported the development of the domestic franchise during the last two years, most recently that of the business of the troubled Intellectbank in March 2006. As a result of the latter, BOG received a one-year waiver from prudential regulation compliance from the National Bank of Georgia ("NBG"). However, Fitch notes that covenants imposed by the bank's foreign lenders, while generally less strict than NBG ratios, should limit any potential weakening of capitalisation, liquidity or risk concentrations to reasonable levels. Acquisitions of banks in other CIS countries, including Ukraine, are also being considered, although Fitch understands that these would more likely be owned by a holding company than on the balance sheet of BOG itself.

Credit risks result from the robust growth of lending operations, especially given the untested behaviour of BOG's target customer segments in times of macroeconomic distress. To date, the quality of loans originated by new management has been good, although track record remains relatively short in light of the longer-term nature of many of the facilities originated, and impairment could increase when the loan book seasons. A clean-up of the loan book was performed by the newly-appointed management in H204, resulting in substantial write-offs and provison charges; at end-2005, approximately 25% of outstanding loans had been granted by the previous management.

The funding base is potentially volatile, with 65% of liabilities effectively at demand (due to the early withdrawal option in Georgia for retail term depositors). However, the bank is focusing on diversifying its liabilities through longer-term foreign interbank and debt funding, and a USD100m borrowing plan for 2006 has already been partially implemented. Internal capital generation may deteriorate in 2006 on the back of substantial investments in franchise development. However, Fitch understands that there is strong demand for new equity issuance from existing and potential new shareholders, and capitalisation may be supported by an IPO in H206.

An extension of BOG's recent track record of sound asset quality and a strengthening of liquidity resulting from funding diversification could cause upside for the ratings, as could further improvements in the operating environment. In light of Fitch's view of the high propensity of the Georgian authorities to provide support to systemically important banks in case of need, BOG's IDR currently has a support floor of 'B-' (B minus). Hence downward pressure on the IDR is unlikely to arise even in case of a deterioration of the bank's financial position.

BOG had market shares of about 23% in retail loans and 19% in retail deposits at end-2005. The bank is currently broadly held and since 2005 foreign portfolio investors have, in aggregate, held a majority stake. Since H204 the bank has implemented an aggressive strategic plan with the ultimate target of attracting a strategic shareholder in the mid-term.

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