

Research Update:

Georgia-Based Investment Holding Company Georgia Capital 'B+' Rating Affirmed On Low Leverage; Outlook Remains Negative

April 5, 2023

Rating Action Overview

- Georgia Capital JSC (GC)'s S&P Global Ratings-adjusted loan-to-value (LTV) ratio meaningfully improved in 2022, reaching a solid 13.3% by the end of the year, down from 19.9% on end-2021. This followed the Georgian economy's strong rebound, with real GDP growth of 10.1% in 2022, and translated into a strong recovery in GC's portfolio value with a positive impact on asset prices and dividend income. In addition, the recent disposal of the majority of its water utility business (Georgian Global Utilities JSC; GGU) for \$180 million offered a strong deleverage boost.
- As a result, GC currently enjoys a solid cash balance of \$152.4 million as of the end of 2022, improving from \$88 million at the end of 2021. Although, these funds are not sufficient to cover its \$300 million eurobond maturing in March 2024 in full.
- We understand the company is currently discussing its refinancing plan in the local market, but this has not been finalized. As a result, we now assess GC's liquidity as less comfortably positioned than before. Therefore, we believe the holding is exposed to increased refinancing risk while the debt markets remain volatile.
- We therefore affirmed our 'B+' long-term issuer credit and issue rating on the company and its debt.
- The negative outlook reflects the possibility of more than a one-notch downgrade if GC fails to enact the refinancing of its \$300 million bond in the next six months.

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Rating Action Rationale

Positive momentum in the Georgian economy and business environment should continue to support GC's asset valuations, dividend payments, and ultimately its leverage over 2023-2024.

Georgia's economy experienced an extraordinarily positive 2022, thanks to a marked uptick in the tourism business and the influx of migrants and capital from Russia since the start of the

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Russia-Ukraine conflict. This resulted in its real GDP growing by about 10.1% in 2022. For 2023, we expect growth will weaken to 3.2% due to the less favorable external environment and tightening financial conditions (see "Georgia," published Feb. 13, 2023, on RatingsDirect).

As a result, GC's portfolio value, which relies on all assets incorporated in Georgia, increased by 4% in 2022 (if adjusting for the net effect of the disposal of 80% equity in GGU at the beginning of 2022), totaling Georgian lari (GEL) 3.2 billion by Dec. 31, 2022. The portfolio value recovered strongly from the 12.4% drop in first-quarter 2022 (adjusted for the GGU disposal) as a result of the Russian-Ukraine war. Recovery was, to a large extent, driven by the Bank of Georgia (BoG)'s strong share price appreciation (the bank is 20.6% owned by GC and its only listed asset, representing 26% of total portfolio value), which was up 56.2% on Dec. 31, 2022. The value of GC's private portfolio modestly declined by 1% as of Dec. 31, 2022, (adjusted for the GGU disposal), mainly explained by a normalization in the health care businesses following the pandemic. We expect private asset values will be supported by the resilience in the Georgian economy in the near term.

As a consequence, the group's LTV ratio continued to improve and reached 13.3% on Dec. 31, 2022, compared with 19.9% at the end of 2021 (pro forma the net proceeds from the partial sale of its GGU stake and subsequent shareholder loan to its energy business).

We expect cash dividend income and the sale of some of GC's BoG shares to offer organic deleveraging opportunities. The resilient performance of GC's assets will translate into its cash adequacy ratio improving to 2.0x-2.2x in 2023 from 1.3x in 2022, based on the forecast dividend inflow of GEL125 million-GEL135 million (\$46 million-\$50 million) in 2023, up from GEL94 million in 2022. The BoG's board proposed a total dividend of GEL7.65 per share for 2022, compared with GEL3.81 for 2021. The bank also recently announced an increase in its share buyback program by up to GEL148 million (in 2022 it completed GEL112.7 million). We understand GC will gradually sell shares in the BoG, reducing its stake back to 19.9% (it increased to 20.6% on Dec. 31, 2022). We expect this will lead to an approximate inflow of \$23 million. We anticipate GC will continue to focus on its deleveraging and do not forecast it will carry out material shareholder distributions or investments in 2023, at least until the refinancing of its notes has been secured. Based on this, we expect GC's net cash inflow to be \$50 million-\$55 million in 2023.

While leverage should remain defensive, GC has not yet secured the refinancing of its notes due in March 2024, which in our view is credit negative. The group enjoys a solid cash position since its disposal of 80% of Georgian Global Utilities JSC (GGU) at the beginning of 2022, for which it received \$180 million. Now, one of GC's strategic priorities is to deleverage the holding.

In addition to the \$65 million bond buyback during 2022, GC repurchased \$51 million of bonds outside that tender at 93%-97%, which we do not deem as distressed given current market prices. As a result, its outstanding debt maturity, excluding the repurchased GC bonds, reached \$249 million on Dec. 31, 2022. Although at this stage we do not anticipate an immediate liquidity crisis, we forecast GC's cash and liquidity funds (excluding the repurchased GC bonds) will not be sufficient to cover the bond due in 2024. As a result, we now assess the holding's liquidity as less than adequate. We understand GC intends to refinance the bonds in the local market. Positively, Georgian Renewable Power Operation's (previously owned by GGU) closing of a \$80 million green secured bond in October 2022 validates the group's access to the local market. However, we understand the refinancing has not been formally agreed on as of yet.

Outlook

The negative outlook reflects the possibility of more than a one-notch downgrade if GC fails to enact the refinancing of its \$300 million bond in the next six months.

Downside scenario

We could downgrade GC by more than one notch if it fails to finalize the refinancing of its bond maturing March 2024 over the next six months. We could take a negative rating action in a shorter time frame if we believe the company's access to debt markets has worsened. Under this scenario, we might see the ratio of liquidity sources to expected uses over the next 12 months deteriorating well below 1.0x; with arising concerns for a potential near-term liquidity crisis.

We would also downgrade GC if the company undertakes any repurchases, exchanges, consent solicitation, or other liability management activities regarding its 2024 note that we deem distressed, which we do not expect.

Upside scenario

We could raise the rating if:

- GC secures refinancing for its maturities, ensuring ample liquidity buffers on a permanent basis;
- Its LTV ratio remains defensive and materially below 30%; and
- The company's cash adequacy ratios remain healthy and sustainably above 1.0x.

Company Description

GC is an investment holding company based in Georgia. Its parent, Georgia Capital PLC, is listed on the London Stock Exchange. GC's portfolio companies are based in Georgia, and the Bank of Georgia is its only listed asset--representing 26% of the total portfolio value, which stood at \$1.2 billion at the end of 2022. The company also has a put option on its remaining 20% stake in the water utility business, with a highly observable value, which stood at GEL155 million (\$57 million) on Dec. 31, 2022. The company is well-diversified by industry with investments in banking, pharmaceuticals and health care, insurance, utilities, real estate and hospitality, private education, and renewable energy generation.

Our Base-Case Scenario

Assumptions

- S&P Global Ratings' estimate of real GDP growth in Georgia of 3.2% in 2023, normalizing from the strong 10.1% growth seen in 2022.
- Dividend income and interest income of GEL160 million-GEL170 million in 2023, improving to GEL180 million-GEL190 million in 2024, up from GEL127 million in 2022.

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- GC will gradually monetize its BoG shares, reducing its stake to the historical 19.9% level from currently 20.6%, which we expect to generate a cash inflow of approximately \$23 million (GEL62 million) when completed.
- No increase in operating costs, which we expect to be about GEL40 million per year over 2023-2024, in line with 2022 levels.
- Cash interest expense of about GEL40 million in 2023, down from GEL60.4 million in 2022 as a result of bond buybacks during 2022.
- No dividend distributions to shareholders, in line with previous years.
- No material share buybacks in 2023.

Liquidity

We assess GC's liquidity as less than adequate. We estimate its sources of liquidity cover uses by about 5.5x in 2023, and about 0.8x in 2024 as bonds with a nominal value of \$249 million--following GC's repurchases--are due March 2024.

We believe GC has sound relationships with local banks, given its position as a key investor in the country.

We estimate principal liquidity sources over the 12 months from Dec. 31, 2022, will include:

- Our assessment of GEL273 million cash as of Dec. 31, 2022. This excludes the GEL138.5 million (\$51 million) of GC bonds repurchased and kept as liquid funds.
- Unstressed dividends from portfolio companies and interest income of about GEL160 million-GEL170 million in 2023.
- Sale of BoG shares resulting in an approximate inflow of GEL60 million-GEL65 million.

We estimate the principal liquidity uses over the same period include:

- Operating costs of about GEL40 million.
- Interest expense of about GEL40 million.
- We do not fully exclude share repurchases, but expect the amount will be limited and, if any, below GEL15 million in 2023.

Covenants

The bond documentation only contains an incurrence ratio of net debt to adjusted equity valued below 45%. We believe the company has adequate headroom within these thresholds.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-3

Governance factors are a moderately negative consideration in our credit rating analysis of GC because all its investments concentrate in a single emerging market. Furthermore, we believe the

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holding's risk tolerances and liquidity management are quite aggressive because its 2024 maturity has not yet been addressed. Environmental and social factors are overall neutral considerations in our credit rating analysis of GC and its investee companies. The group's major sector exposure is represented by a retail pharmacy (23% of the adjusted portfolio value) and hospitals (13%), which we assess as having low environmental and social risks.

Issue Ratings - Subordination Risk Analysis

Capital structure

GC's capital structure includes the \$300 million unsecured bond due in March 2024.

Analytical conclusions

We rate the notes in line with our long-term issuer credit rating on the group, because no elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating	B+/Negative/--
Business risk:	Vulnerable
Country risk	Moderately high
Industry risk	Intermediate
Competitive position	Vulnerable
Financial risk:	Significant
Cash flow/leverage	Intermediate
Anchor	b+
Modifiers:	
Liquidity	Less than adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016

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- Criteria | Corporates | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Georgia Capital 'B+' Rating Affirmed On Partial Voluntary Bond Cash Tender Offer; Outlook Remains Negative, Oct. 21, 2022

Ratings List

Ratings Affirmed

Georgia Capital JSC

Issuer Credit Rating	B+/Negative/--
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Senior Unsecured	B+
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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