

## CREDIT OPINION

25 June 2019

Update

 Rate this Research

### RATINGS

#### JSC Georgia Capital

Domicile	Georgia
Long Term Rating	B2
Type	LT Corporate Family Ratings
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## JSC Georgia Capital

### Credit Opinion Update

#### Summary

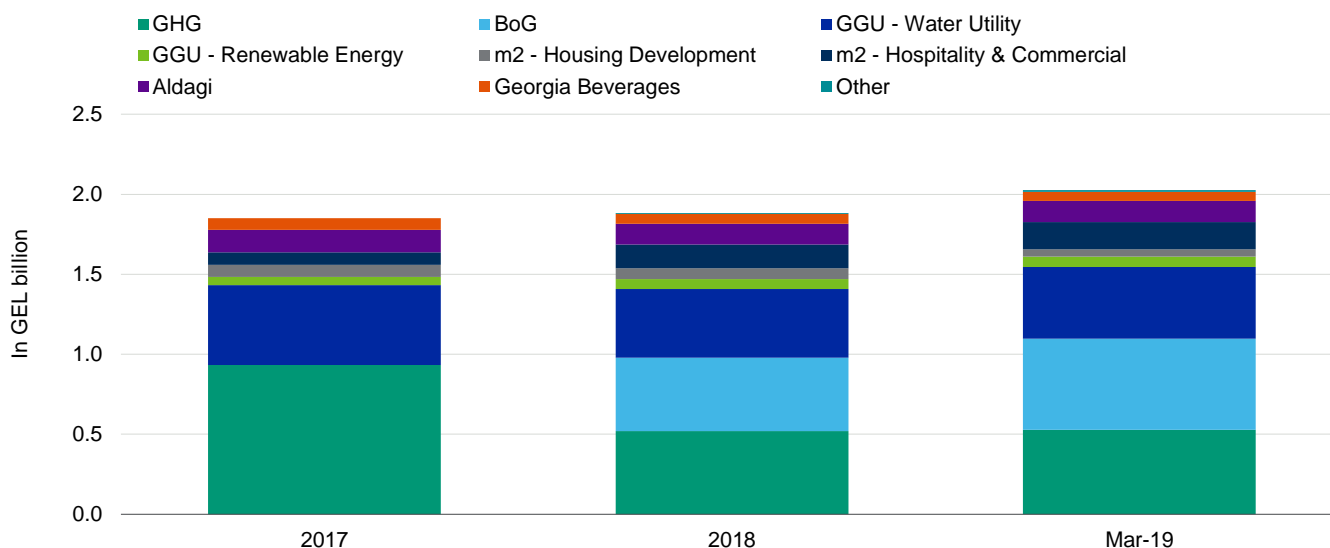
JSC Georgia Capital's B2 Corporate Family rating is mainly supported by the company's (i) clearly defined investment strategy focused on the Georgian economy, (ii) good track record of raising capital (both debt and equity), which gives it a competitive edge in acquiring Georgian assets with little if any bidding competition from both local or international investors, (iii) a portfolio of defensive investments with a stable dividend stream, (iv) a relatively good business diversification across its investment portfolio especially in light of the small size of the portfolio (around \$752 million as per 31st March 2019; GEL / USD of 0.37) although there is value concentration on the top 3 assets in the portfolio (approximately 66% of the portfolio value) and (v) a relatively moderate market value leverage of around 29% as per 31st December 2018 (~20% if taking into account inter-company loans given by Georgia Capital to its investments in the calculation of the gross asset value of the portfolio) and a management commitment to maintain market value leverage below 30% (excluding inter-company loans from the gross asset value calculation of the portfolio of investments) at any point-in-time during the market cycle.

JSC Georgia Capital's rating is mainly constrained by (i) the investment portfolio's relatively small size, (ii) the strong geographical concentration of the portfolio on the Georgian economy, which is small and the Georgian government rated Ba2, (iii) a still short track record of operating as an independent, listed and rated investment holding company notwithstanding that the former parent company and the bank (which is not part of the investment holding) have been rated entities in the past, (iv) a relatively high portfolio concentration with the top 2 / 3 assets accounting for respectively around 47% / 66% of the overall value of the portfolio of investments notwithstanding that Georgia Capital has made investments with still low contribution to the overall portfolio value in auto service, education and digital businesses recently, (v) the increasing leverage from a low base at some of the portfolio companies linked to material organic investment which have resulted in substantial negative free cash flow generation, (vi) the high consolidated gross and net leverage of Georgia Capital with a reported consolidated gross leverage of 7.7x and a consolidated reported net leverage of 6.5x, and (vii) the relatively limited exit options and lack of tangible liquidity of the portfolio related to the scarcity of capital in Georgia, which makes it difficult to divest / exit investments very easily, notwithstanding that we have recently seen the acquisition of Adjarabet by London-listed Paddy Power Betfair Plc.

Exhibit 1

**Georgia Capital's healthcare group has lost significant value over the last 12-18 months**

Georgia Capital's recent portfolio value development



Source: Company information, Moody's Investors Service

**Credit strengths**

- » Clearly defined investment strategy
- » Superior knowledge of the Georgian economy and privileged access to capital
- » Portfolio focused on defensive assets (utilities, healthcare, education)
- » Relatively moderate market value leverage at the holding company level

**Credit challenges**

- » Small portfolio concentrated on the Georgian economy
- » Relatively short track record of operating as a standalone company
- » High portfolio concentration despite the recent investments in auto service, education and digital businesses that account for a small portion of the overall portfolio value
- » Elevated consolidated leverage and negative free cash flow generation at portfolio companies
- » Limited exit options and limited liquidity of portfolio given lack of capital in Georgia

**Rating outlook**

The stable outlook assigned to the rating reflects our expectation that JSC Georgia Capital will sustain a market value leverage of around 30% at all times during the market cycle and an interest cover of around 2.0x.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody.com](http://www.moody.com) for the most updated credit rating action information and rating history.

## Factors that could lead to an upgrade

- » Prolonged track record of successfully managing a portfolio of investments with a good balance between defensive / growth investments as well as between listed / private assets whilst generating value
- » Market value leverage below 35% at all times during the market cycle
- » Interest cover sustainably well in excess of 2.0x
- » Strong liquidity position

## Factors that could lead to a downgrade

- » Shift in investment strategy leading to more cyclical portfolio or more levered investments
- » Market value leverage sustainably above 40%
- » Interest cover falling sustainably below 2.0x
- » Deterioration of the group's liquidity position
- » Deterioration in macroeconomic conditions in Georgia in light of the concentration of the group's portfolio on the Georgian economy

## Key indicators

Exhibit 2

### Georgia Capital's key indicators

	2017	2018	Mar-19
GAV in GEL thousand	1,850,861	1,883,374	2,024,306
Net MVL (Moody's defined)	na	28.9%	25.2%
Net MVL (Georgia Capital defined)	na	19.9%	17.6%
Interest cover	1.8x	2.1x	na

Note: Net MVL includes guarantees issued and is based on management fair values; Georgia Capital defined net MVL includes loans issued to portfolio companies.

Source: Company Information, Moody's Investors Service

## Profile

JSC Georgia Capital, the issuer of the rated bond, is a Georgian-based intermediate holding company of a number of investments focused on the Georgian economy. JSC Georgia Capital is ultimately owned by Georgia Capital Plc, the parent company of the group listed on the London Stock Exchange.

JSC Georgia Capital actively manages a portfolio of companies solely operating in Georgia. The group's current portfolio (as per 31st March 2019) includes stakes in the following companies: (i) GGU, a water utility and renewable energy business (100% stake in water utility, 65% stake in renewable energy; both managed by GGU), GHG, a UK listed healthcare business (57% stake), (iii) Aldagi, a property and casualty insurance company (100% stake), m2, a real estate company (100% stake) and Georgia beverages, a beverage business focused on wine and beer (80% stake). Georgia Capital also owns a 19.9% stake in Bank of Georgia Group Plc, a Georgian bank listed on the London Stock Exchange.

JSC Georgia Capital is expected to actively manage its investments with a view to divest them within a time horizon of 5 to 10 years through IPOs, strategic sale or other available options. The group aims at achieving an internal rate of return of at least 25%.

## Detailed credit considerations

### A clearly defined investment strategy focused on the Georgian economy and supported by good access to capital

In light of its strong knowledge and experience of the Georgian economy, JSC Georgia Capital has focused its investment strategy on building a portfolio of assets solely exposed to the Georgian economy. We do not expect this strategy to change in the future as the strategy has been successful so far.

We believe that JSC Georgia Capital has a competitive edge as an investor in the local Georgian economy mainly as a result of its strong access to capital. Foreign capital remains scarce in the Georgian economy due to its small size and JSC Georgia Capital has therefore faced very little competition if any when bidding for assets as there are no local investment firms with sufficient capital to compete for the same assets as JSC Georgia Capital and foreign investors might have limited interest as well due to the small size of the investments and of the economy. BGEO Group Plc, the former parent of JSC Georgia Capital through its public listing on the London Stock Exchange, its access to the international public debt capital markets and through the banking license of its bank has proven able to raise around \$5 billion of capital through different channels over the last ten years. This has enabled the group to make investments in either relatively undervalued companies and / or to generate incremental value through providing capital for value accretive investment projects at its investments.

We expect JSC Georgia Capital to continue benefiting from this competitive edge as foreign capital will remain scarce in the Georgian economy and we do not expect material competition for bidding assets to emerge over the foreseeable future. JSC Georgia Capital has also started building a track record of generating value through the successful development of its assets. The management team of JSC Georgia Capital usually involves itself fairly actively in the management of its investments during the early phase of the investment period with a strong focus on the strategic development of the asset whilst the active involvement reduces over time when the investments mature.

In recent years the investment strategy of JSC Georgia Capital has been focused on the services industry and on defensive industries with high valuation multiples. The focus on the services industry makes sense as the Georgian economy has no strong industrial businesses as the economy clearly lacks scale and local industrial businesses could not compete with large industrial conglomerates. We believe that the strategy will remain focused to a large extent on the services industry in Georgia with a focus of investing in defensive businesses. Recent investments have been in the fields of auto services industry (80% stake in Amboli LLC, a Georgian importer, distributor, wholesaler and retailer of car consumables and spare parts, such as tires, oil, batteries and lubricants for light vehicles) or digital marketing services (60% stake in Redberry LLC). JSC Georgia Capital has also launched the organic development of a mandatory vehicle inspection services, an immature market in Georgia. Lastly JSC Georgia Capital has started investments in private education although the investment sum remains modest at this stage (GEL 7 million as per 31st March 2019 as well as an additional \$10.1 million investment in British-Georgian Academy LLC, a large Georgian private school, in June 2019).

The investment strategy in recent years has been successful but the group's track record as an independent investment holding company still needs to be built. We also highlight the relatively leveraged capital structure of JSC Georgia Capital as a group with a year-end 2018 reported gross leverage of around 7.7x and net leverage of around 6.5x with negative free cash flows due to high level of capex required to build and develop the underlying businesses. The leverage of certain investments has increased markedly in recent years to accommodate organic growth projects.

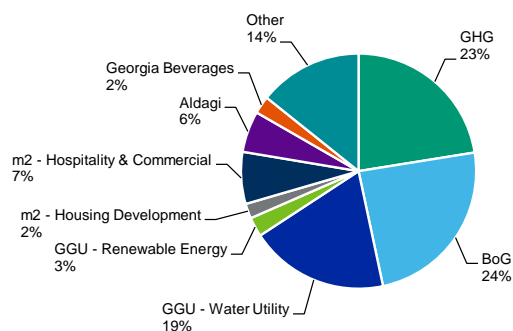
JSC Georgia Capital will aim at divesting its investments after a 5 to 10 years ownership period with the preferred route to exit being an IPO (issuer has a good track record in listing assets on the London Stock Exchange), although divestments to strategic buyers could also be considered notwithstanding that the scarcity of capital will represent a hurdle for this exit route.

### Focus on Georgian economy and small size leads to high asset concentration and weak geographical diversification

While we believe that JSC Georgia Capital will have a competitive edge in investing in Georgian assets, this strategy implies a high asset concentration, a lack of geographical diversification and a small size of the overall portfolio (approximately \$752 million at 31st March 2019). As illustrated in the exhibit below, JSC Georgia Capital's portfolio of investments will be highly concentrated with the two / three largest holdings accounting for respectively around 47% / 66% of the portfolio's overall value. This concentration is only partly mitigated by the defensiveness of some of the underlying assets such as the group's investment in healthcare and utility.

Exhibit 3

**Georgia Capital's top 3 investments account for 66% of the overall value of the investment portfolio**  
**JSC Georgia portfolio composition as per 31st March 2019**



Note: Other position includes GEL326 million of cash on balance sheet at 31st March 2019.

Source: *Company Information, Moody's Investors Service*

The focus on the Georgian economy also brings very weak geographical diversity and a strong exposure to the Georgian economy. We also note that the underlying investments are not only domiciled in Georgia but are almost solely exposed to the domestic economy.

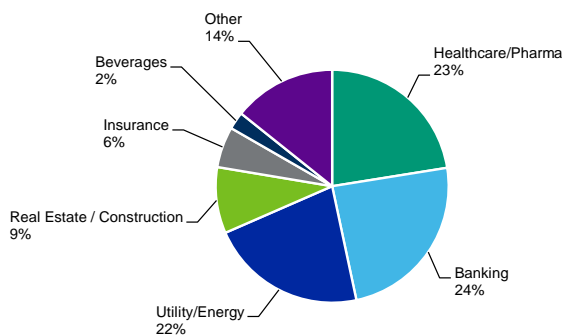
Moody's rates the Government of Georgia Ba2, stable. In our last credit opinion (22nd March 2019), we note that the Georgian economy's resilience in the wake of regional economic shocks demonstrates the increasing strength of its economy and institutions. Looking forward, ongoing economic reforms, supported by the International Monetary Fund, are likely to mitigate some of Georgia's underlying credit weaknesses. However, material banking sector and external vulnerability risks continue to constrain the rating.

**A reasonably good level of business diversification and investment portfolio transparency**

Despite an investment strategy focused both on the Georgian economy and on the service sector with a bias towards defensive end industries, the investment portfolio of the investment arm of JSC Georgia Capital is relatively well diversified across sectors. As illustrated in the exhibit below, Georgia Capital has exposure to the healthcare (23% of the portfolio value as per 31st March 2019), utility (22% of the portfolio value) and the banking sectors (24% of the portfolio value) with the real estate and insurance accounting for the remaining value of the portfolio. This is a reasonably good diversification level in light of the overall small size of the investment portfolio. We also note that whilst we consider the utility and healthcare assets as one sector respectively there is some diversification within the utility sector (water distribution and electricity generation) and the healthcare sector (hospitals, pharmacy and small medical insurance business).

Exhibit 4

**A reasonably well diversified investment portfolio in light of the small size (<\$1 billion)**  
**Business sector contribution to the overall value of the investment portfolio (as per 31st March 2019)**



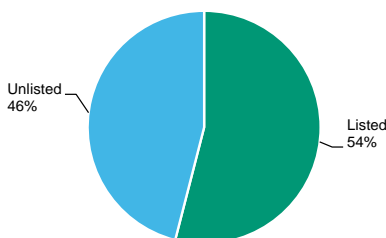
Note: Other position includes GEL326 million of cash on balance sheet at 31st March 2019.

Source: *Company information, Moody's Investors Service*

The level of investment portfolio transparency is also reasonable. BGEO Group Plc has made available in the past audited accounts for all its underlying investments, which has enabled us to precisely assess the underlying credit quality of the investments in the portfolio. As illustrated in the exhibit below, we also expect around  $\frac{2}{3}$  of the market value of the portfolio to stem from listed assets pro-forma of the demerger and listing of Georgia Capital Plc and Bank of Georgia.

Exhibit 5

**Share of listed assets has dropped markedly due to the reduction in value of GHG (~35% decline in value y-o-y)**  
**Share of listed / unlisted assets in the investment portfolio (as per 31st March 2019)**



Source: Company information; Moody's Investors Service

### Relatively moderate market value leverage with a commitment to maintain a relatively conservative market value leverage over time but increasing leverage at underlying investments

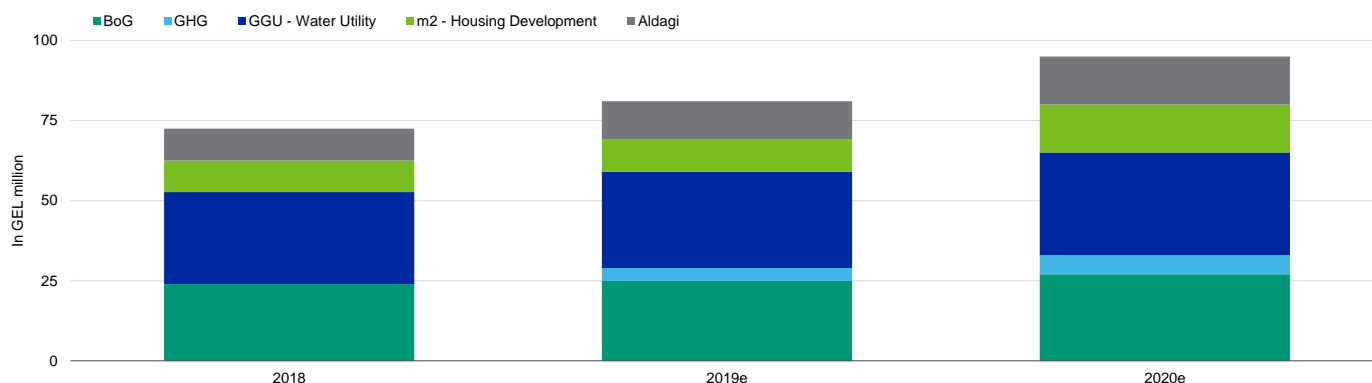
At 31st December 2018, JSC Georgia Capital's market value leverage stood at around 29% (~20% including inter-company loans granted by Georgia Capital to its investments in the calculation of the gross asset value of the portfolio of investments). This is a relatively low market value leverage also in light of the defensiveness of the underlying investments and their track record of generating a stable stream of dividends. We highlight that the market values of JSC Georgia Capital's investments can be fairly volatile as you would probably expect from businesses operating in frontier economies. In this regard we note that the value of Georgia Healthcare Group has dropped materially during the course of 2018 from a price of 350 pence per share beginning of 2018 to around 200 pence per share at year-end 2018. This was mainly driven by a material contraction in valuation multiples with the group's price to earnings ratio dropping to around 26x at year-end 2018 from more than 50x at year-end 2017. The company's operating performance remained solid with a revenue growth of around 14% and a reported EBITDA growth of around 22% in 2018.

JSC Georgia Capital's management has committed itself to maintain a market value leverage of below 30% (excluding the value of on-lending to investments) through the market cycle. This is the underlying assumption underpinning the current rating although the issuer still needs to build a track record of maintaining this market value leverage through the market cycle.

We expect JSC Georgia Capital's pro-forma interest cover to range between 2.0x and 3.0x over the next three years supported by a growth of the underlying dividend streams from its investments.

Exhibit 6

### JSC Georgia Capital is expected to benefit from a gradually increasing dividend stream from its investments



Source: Company information; Moody's Investors Service

On a more negative note we highlight that the underlying portfolio companies of JSC Georgia Capital have invested materially in recent years leading to a leveraging up of their individual balance sheets as well as a material increase in consolidated leverage at JSC Georgia Capital level. JSC Georgia Capital's leverage has increased from around 3.4x in 2017 to around 7.7x in 2018. We believe that some of the investments at the healthcare, utility and real estate businesses have not yet been finalised and will continue to lead to a leveraging up of the underlying balance sheet of the investments or at least to the maintenance of high leverage levels.

### Liquidity analysis

The liquidity profile of JSC Georgia Capital as per 31st March 2019 is adequate. JSC Georgia Capital had GEL326 million (~\$120 million) of cash and liquid funds on balance sheet at 31st March 2019. JSC Georgia Capital has committed itself to maintain liquid assets of \$50 million and an extra cash reserve of at least 180 days of expected cash outflows. The group will however not have access to a committed revolving credit facility for liquidity purposes. The group's liquidity buffer should be supported over time by a resilient stream of dividends from its investments and an interest cover moving towards 2.0x from 2019 onwards. JSC Georgia Capital will not face any maturity before 2024 when the senior notes become due. We also highlight the adequate level of listed assets in the investment portfolio (~50% of the value and listings in the UK) as a positive factor supporting the overall liquidity of the group.

### Rating methodology and scorecard factors

In assessing the credit quality of JSC Georgia Capital, we apply Moody's Investment Holding Companies and Conglomerates methodology published in December 2015. In our 12-18 months forward looking view, the grid indicates a Ba2 rating, three notches above the actually assigned rating.

The difference between the grid indicated rating outcome and the assigned rating reflects the small size of the overall investment portfolio (~\$1 billion) as well as the lack of track record of operating as a rated investment holding company and within the financial policy target of maintaining a market value leverage of below 30% (excluding inter-company loans from the gross asset value of the portfolio of investments) at all times during the market cycle. At the same time we note that JSC Georgia Capital has built a track record of managing a portfolio of investments whilst generating value.

Exhibit 7

## Investment Holding Companies and Conglomerates methodology grid

## Investment Holding Companies Industry Grid

	FY 2018		Moody's 12-18 Month Forward View As of 6/19/2019 [1]	
Factor 1 : Investment Strategy (10%)	Measure	Score	Measure	Score
a) Investment Strategy	Ba	Ba	Ba	Ba
Factor 2 : Asset Quality (40%)				
a) Asset Concentration	B	B	B	B
b) Geographic Diversity	Caa	Caa	Caa	Caa
c) Business Diversity	Ba	Ba	Ba	Ba
d) Investment Portfolio Transparency	Ba	Ba	Ba	Ba
Factor 3 : Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Factor 4 : Estimated Market Value-based Leverage (MVL) (20%)				
a) Estimated Market Value-Based Leverage	Baa	Baa	Baa	Baa
Factor 5 : Debt Coverage and Liquidity (20%)				
a) (FFO + Interest Expense) / Interest Expense	2.1x	Ba	2x - 3x	Ba
b) Liquidity	Baa	Baa	Baa	Baa
Rating:				
a) Indicated Rating from Grid		Ba2		Ba2
b) Actual Rating Assigned				B2

[1] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Financial Metrics

Exhibit 8

## Peer group

Company	JSC Georgia Capital		Koc Holding A.S		Ordu Yardimlasma Kurumu (OYAK)		Dogan Sirketler Grubu Holding A.S		Dogus Holding A.S.	
Rating	B2 / stable		B1 / negative		B1 / negative		B1 / negative		Caa1 / stable	
Domicile	Georgia		Turkey		Turkey		Turkey		Turkey	
	FY 2018		FY 2018		FY 2017		6/30/2018		6/30/2018	
Factor 1 : Investment Strategy (10%)	Measure	Score	Measure	Score	Measure	Score	Measure	Score	Measure	Score
a) Investment Strategy	Ba	Ba	Baa	Baa	Baa	Baa	Ba	Ba	Ba	Ba
Factor 2 : Asset Quality (40%)										
a) Asset Concentration	B	B	Baa	Baa	Ba	Ba	Aa	Aa	Baa	Baa
b) Geographic Diversity	Caa	Caa	B	B	B	B	B	B	B	B
c) Business Diversity	Ba	Ba	Baa	Baa	Baa	Baa	Ba	Ba	Ba	Ba
d) Investment Portfolio Transparency	Ba	Ba	A	A	Baa	Baa	B	B	B	B
Factor 3 : Financial Policy (10%)										
a) Financial Policy	Ba	Ba	A	A	A	A	Ba	Ba	B	B
Factor 4 : Estimated Market Value-based Leverage (MVL) (20%)										
a) Estimated Market Value-Based Leverage	Baa	Baa	Aaa	Aaa	Aaa	Aaa	Aaa	Aaa	B	B
Factor 5 : Debt Coverage and Liquidity (20%)										
a) (FFO + Interest Expense) / Interest Expense	2.1x	Ba	10.4x	Aaa	3.3x	Baa	1.1x	B	0.3x	B
b) Liquidity	Baa	Baa	Aaa	Aaa	Aaa	Aaa	Aaa	Aaa	Caa	Caa
Rating:										
a) Indicated Rating from Grid		Ba2		A2		A3		Baa2		B1
b) Actual Rating Assigned		B2		B1		B1		B1		Caa1

Source: Moody's Financial Metrics

## Ratings

Exhibit 9

Category	Moody's Rating
JSC GEORGIA CAPITAL	
Outlook	Stable
Corporate Family Rating	B2
Senior Unsecured	B2/LGD4

Source: Moody's Investors Service



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