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CLIENT SERVICES

JSC Georgia Capital

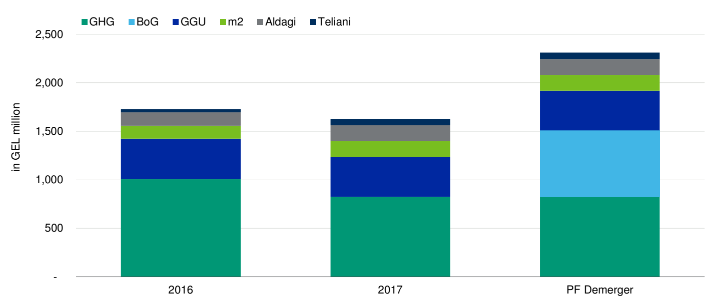
New issuer report

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 and international investors, (iii) a portfolio of defensive and not too levered 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 (less than $1 billion pro-forma of the demerger and listing) although there is value concentration on the top 2/3 assets in the portfolio and (v) a relatively moderate market value leverage of around 30% to 40% and a management commitment to maintain market value leverage below 35% 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 rated Ba2, (iii) the absence of track record of operating as an independent, listed and rated investment holding company notwithstanding that the former parent company and the bank have been rated entities in the past, (iv) a relatively high portfolio concentration with the top 2 / 3 assets accounting for respectively around 70% / 85% of the overall value of the portfolio of investments, (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, and (vi) 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, if needed.

Exhibit 1
Georgia Capital's recent portfolio value development



Same valuation multiples applied for GGU and Aldagi; based on book values for m2 and Teliani. The drop in GHG's market value in 2017 is a result of the sale of approximately 8% of the company's shares by Georgia Capital throughout the year.
Source: Company Information, Moody's Investors Service

Rating outlook

The stable outlook assigned to the rating reflects our expectation that JSC Georgia Capital will sustain a market value leverage of around 35% at all times during the market cycle and an interest cover of around 2.0x.

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

Overview of Transaction

On 03 July 2017, BGEO Group Plc, a UK listed holding company of Georgian assets, announced its intention to demerge BGEO Group into a London-listed banking business (Bank of Georgia Group Plc) and a London-listed investment business (Georgia Capital Plc). The demerger and the listing of Georgia Capital Plc on the London Stock Exchange is expected to be finalised by mid year 2018 and is still subject to shareholders' approval. We expect the shareholder structure of Georgia Capital to consist mainly of institutional investors with a large share of free float. There will be no anchor shareholder who would significantly influence the group's strategy and financial policy.

Georgia Capital Plc, the future ultimate holding company of the investment arm of BGEO Group Plc intends to issue $300 million of senior notes with a maturity of 5 years. The net proceeds from the issuance will be used (i) to repay a $105 million loan from BGEO Group Plc, which was obtained to finance the acquisition of GGU and to create a cash buffer of $30 million and (ii) to on-lend $165 million to the Georgia Capital Plc's investment business subsidiaries to fund new projects. The remaining $30 million net proceeds will be retained by the issuer and used for general corporate purposes.

Moody's has assigned a B2 Corporate Family rating to JSC Georgia Capital and a B2 instrument rating to the envisaged $300 million senior notes to be issued by JSC Georgia Capital, a wholly indirectly owned sub holding company of Georgia Capital Plc. The Corporate Family rating assumes the successful execution of the demerger of BGEO Group Plc into Georgia Capital and Bank of Georgia (subject to a shareholders vote in April 2018) and the listing of Georgia Capital and Bank of Georgia on the London Stock Exchange in the summer of 2018. The current Corporate family rating assumes that Georgia Capital will be demerged and will become an independent holding company with the only link with Bank of Georgia being a 19.9% equity stake in the bank.

Corporate Profile

JSC Georgia Capital, the issuer of the senior notes, is the 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 expected to be listed on the London Stock Exchange.

JSC Georgia Capital actively manages a portfolio of companies solely operating in Georgia. The group's current portfolio includes stakes in the following companies: (i) GGU, a water utility and renewable energy business (100% stake), GHG, a UK listed healthcare business (57% stake), (iii) Aldagi, a private and corporate insurance company (100% stake), m2, a real estate company (100% stake) and Teliani Valley, a beverage business (76% stake). Pro-forma of the demerger Georgia Capital will also own a 19.9% stake in Bank of Georgia Group Plc, the only financial link expected to remain between the two companies.

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, the investment arm of BGEO Group Plc 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 the investment arm of BGEO Group Plc 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 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, 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. Georgia Capital has also started building a track record of generating value through the successful development of its assets. The management team of the investment arm of BGEO Group 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 the investment arm of BGEO Group Plc 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 lack 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.

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 robust balance sheet structures of most underlying investments although the leverage of certain investments has increased markedly in recent years to accommodate organic growth projects and the good liquidity of the portfolio with an estimated ⅔ of the value of the portfolio stemming from publicly listed assets (pro-forma of the listing of both Georgia Plc Capital and Bank of Georgia)

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.

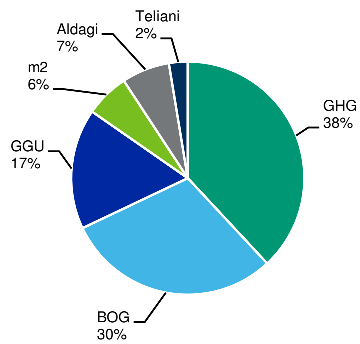
Focus on Georgian economy and small size leads to high asset concentration and weak geographical diversification

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 (less than $1 billion). As illustrated in the exhibit below, JSC Georgia Capital's portfolio of investments will be highly concentrated with the two / three largest holding accounting for respectively around 70% / 85% of the portfolio's overall value (excluding on-lent bond proceeds). 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. We also note that the underlying assets (apart from the beverage business, which is still loss making) are not materially levered so that the risk of a default of the individual investments is relatively low.

Exhibit 2

Georgia Capital's top 3 investments account for around 85% of the overall value of the investment portfolio (excluding on-lent bond proceeds)

Pro-forma contribution of the individual investments to the overall value of the investment portfolio



Source: Company Information, Moody's Investors Service

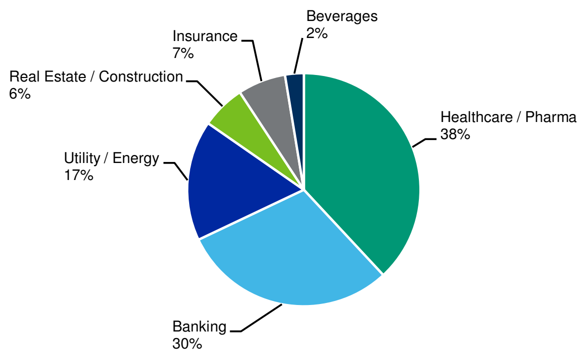
The focus on the Georgian economy also brings very weak geographical diversity and a strong exposure to the Georgian economy. We also note that the underlying investments are not only domiciled in Georgia but are almost solely exposed to the domestic economy.

Moody's has upgraded the local and foreign currency ratings of the government of Georgia to Ba2 from Ba3 in September 2017. The upgrade reflected the resilience of the Georgian economy in the wake of the regional economic shock which began in 2014 and ongoing economic reforms. At the same time we highlighted the downside risks posed by still significant banking sector risk and uncertainties around the economy's capacity to raise value adding in the economy due to constraints in the business environment including lack of clarity in areas such as insolvency law, land registration and the potential for vocational education improvements to boost the skilled labor supply. Georgia's large current account deficit, despite rising savings, and very large net international liability position represent significant exposure for the sovereign to potential negative turns in external financing conditions.

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 BGEO Group Plc is relatively well diversified across sectors. As illustrated in the exhibit below, Georgia Capital will have exposure to the healthcare (30% to 40% of the pro-forma portfolio value), utility sector (15% to 20% of the portfolio value) and the banking sector (around 30% 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 pro-forma 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).

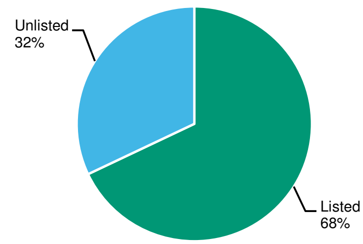
Exhibit 3
A reasonably well diversified investment portfolio in light of the small size (~$1 billion)
Pro-forma business sector contribution to the overall value of the investment portfolio



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 ⅔ 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 4
High share of listed assets improves transparency of valuation and liquidity of the portfolio
Pro-forma share of listed / unlisted assets in the investment portfolio



Source: Company information, Moody's Investors Service

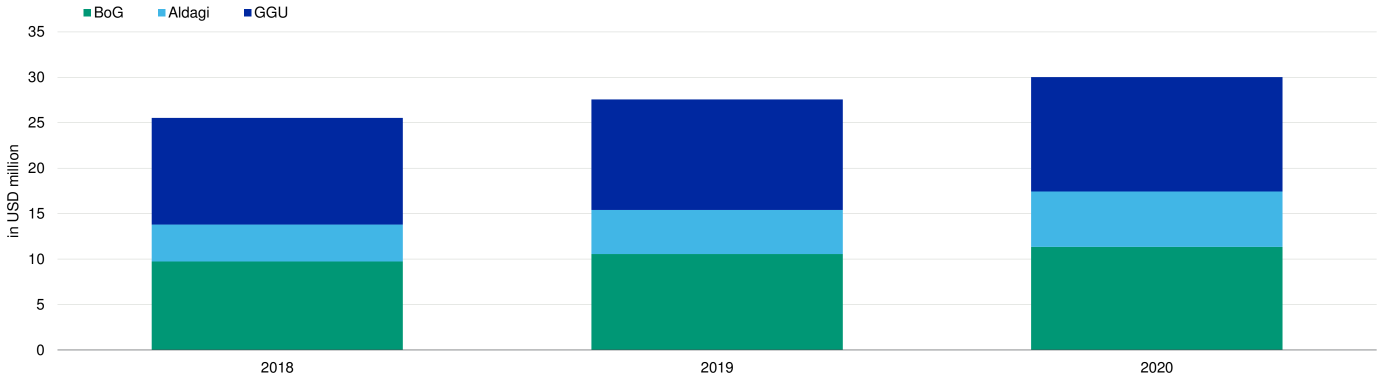
Relatively low pro-forma market value leverage with a commitment to maintain a relatively conservative market value leverage over time but increasing leverage at underlying investments

Pro-forma of the demerger and the issuance of $300 million of senior notes we expect JSC Georgia Capital's market value leverage to range between 30% and 40% depending on the underlying valuation assumptions used to assess the overall value of the investment portfolio. 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.

JSC Georgia Capital's management has committed itself to maintain a market value leverage of below 35% (excluding the value of the on-lent bond proceeds) 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 2.5x over the next three years supported by a growth of the underlying dividend streams from its investments.

Exhibit 5
JSC Georgia Capital will benefit from a stable 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 the investment arm of BGEO Group Plc have invested materially in recent years. As illustrated in the exhibit below this has lead to large negative free cash flows and to a leveraging up of the individual balance sheets from a very low level. 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.

Exhibit 6
Evolution of operating performance and leverage of GHG and GGU

in GEL million	GHG			GGU		
	2015	2016	2017	2015	2016	2017e
Sales	242.4	423.8	745.7	117.7	124.7	135.1
EBIT (Moody's defined)	46.6	55.8	77.3	29.8	50.4	48.5
EBITDA (Moody's defined)	60.9	74.2	103.0	47.7	68.3	68.7
EBITDA Margin	25%	18%	18%	41%	55%	51%
CFO (Moody's defined)	22.8	24.0	na	47.8	50.7	73.6
Capex	73.3	115.4	89.3	30.2	54.6	213.4
Dividends	0.0	0.0	na	0.0	13.0	28.2
FCF (Moody's defined after dividends)	(50.6)	(91.4)	na	17.6	(17.0)	(168.0)
Debt	174.1	265.2	381.5	74.1	106.3	312.3
Cash	145.2	23.2	63.6	11.6	27.5	70.3
Debt / EBITDA	2.9x	3.6x	3.7x	1.6x	1.6x	4.5x

2017 preliminary numbers for GHG.
Source: Company Information, Moody's Investors Service

Liquidity analysis

The liquidity profile of JSC Georgia Capital pro-forma of the issuance of the senior notes will be good. The investment arm of BGEO Group Plc had $144 million of cash on balance sheet at 31st December 2017 (GEL374 million with an exchange rate of GEL/USD of 2.5922) and has indicated in the offering memorandum for the bond issuance that it will retain around $50 million of the issuance as cash reserve. JSC Georgia Capital has committed itself in the offering memorandum of the notes 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 2023 when the senior notes will become due (assuming a 5-year maturity for the notes). We also highlight the good level of listed assets in the investment portfolio (2/3 of the value and listings in the UK) as a positive factor supporting the overall liquidity of the group.

Methodology and scorecard

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 Ba3 rating, two 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 35% 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

Rating Factors				
Georgia Capital Plc				
Investment Holding Companies Industry Grid	Current FY		Moody's 12-18 Month Forward View As of 2/15/2018	
Factor 1 : Investment Strategy (10%)	**Measure**	**Score**	**Measure**	**Score**
a) Investment Strategy	Ba	Ba	Ba	Ba
Factor 2 : Asset Quality (40%)				
a) Asset Concentration	Caa	Caa	Caa	Caa
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	Ba	Ba
Factor 5 : Debt Coverage and Liquidity (20%)				
a) (FFO + Interest Expense) / Interest Expense	1.9x	B	2x - 3x	Ba
b) Liquidity	Ba	Ba	Ba	Ba
Rating:				
a) Indicated Rating from Grid		Ba3		Ba3
b) Actual Rating Assigned				B2

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

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