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Research Update:

Georgia-Based Investment Holding Georgia Capital JSC Outlook Revised To Negative On Challenging Economic Conditions

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Rating Action Overview

- Georgia-based investment holding company Georgia Capital JSC (GC) is likely facing more challenging economic conditions, which could negatively affect its access international capital markets. Although the company enjoys a good liquidity buffer, with cash reaching Georgian lari (GEL) 719 million (about $232 million) at March 31, 2022, we believe our liquidity assessment could come under pressure absent a proactive refinancing of its $365 million due in March 2024.
- Positively, the group's leverage is still moderate, with an S&P Global Ratings-adjusted loan-to-value (LTV) ratio of about 26% (excluding $90 million-$95 million of cash to be offered as a shareholder loan to its renewable energy business) at March 31, 2022, worsening from about 20% at end-2021 (pro forma the net proceeds from the sale of the water utility business and subsequent shareholder loan to the energy business) as asset values have decreased since the Russia-Ukraine conflict started.
- We revised our outlook on GC to negative from stable and affirmed our 'B+' long-term issuer credit and issue ratings on the company.
- The negative outlook reflects the possibility of a downgrade over the next six-to-nine months if economic and financing conditions for the Georgian economy continue to deteriorate, which could result in worsening leverage and liquidity, and heightening the refinancing risk on its 2024 notes.

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Rating Action Rationale

Credit conditions have become less supportive and GC could face mounting refinancing risks for its $365 million bond due March 2024. We see increasing risk that a progressive slowdown of the global and the Georgian economy could further challenge the company's asset valuations, with negative effects both on its leverage and the group's access to international capital markets to refinance the bond due in March 2024. Earlier this year, S&P Global Ratings lowered its real GDP growth forecast for Georgia (BB/Stable/B) for 2022 to 2.5% from 5.5% (for more information, see "Sovereign Risk Indicators," published April 11, 2022; and "Georgia Outlook Revised To Stable On Stronger Growth And Moderating External Imbalances; 'BB/B' Ratings Affirmed," published Feb. 25, 2022, on RatingsDirect). As of March 31, 2022, GC reported NAV per share decreased to GEL52.62 per share against GEL63.03 per share at Dec. 31, 2021, a deterioration of 16.5%. At the same time, in May 2022, GC's NAV per share recovered by about 5% against the March-end figure. We anticipate somewhat volatile market conditions, and note that GC's share price discount exceeding 50%. Finally, the company's bond, which until just before the beginning of the Russia-Ukraine conflict traded above par, is now trading below par at about 96.

GC retains a comfortable liquidity buffer, but it has to contribute to Georgia Global Utilities JSC's (GGU; B/Stable/--) $250 million early redemption of the bonds. We do not anticipate imminent liquidity risks, but over the next 24 months from the time we write, GC's sources of cash will likely not cover cash outlays absent a proactive refinancing of GC's $365 million bond. The company has recently received $180 million for the disposal of 80% of GGU. This leads to reported cash and cash equivalents of about GEL719 million ($232 million) as of end-March 2022, which covers about 70% of the bond. At the same time, the first stage of the transaction triggered a change-of-control event under GGU's $250 million bond, and bondholders will have the right to ask for a buyback at 101% of the principal amount plus accrued coupon. We understand that the GGU bond is trading at par, and anticipate that after the noncallable period expires in July 2022, bonds will be fully redeemed. In line with the transaction structure, GC and FCC Aqualia have committed to support the expected redemption of the $250 million bond, which will likely be split between the renewable energy business ($90 million-$95 million) and the water business ($155 million). Under our base-case scenario, we have factored in $90 million-$95 million cash out from GC to support the transaction under the form of a shareholder loan, while the renewable energy business will try to seek permanent financing. In the transaction's second stage, expected in third-quarter 2022 and only when GGU's bond is fully redeemed, GGU will spin off its renewable assets. GC will retain 100% of these assets and 20% of the water utility business. The transaction is expected to include call-put options with FCC Aqualia that are exercisable in 2025-2026 for the remaining 20% minority stake.

GC has moderate LTV and retains the quasi-totality of its cash in hard currency. We calculate that the company's pro forma LTV ratio as of end-March 2022 is still moderate albeit increasing from leverage as of end-2021. Our pro forma adjusted LTV as of March 31, 2022, reached about 26% (when excluding the loans to investee assets from the portfolio value), up from about 20% at Dec. 31, 2021 (both ratios are assuming that GC will offer the $90 million-$95 million shareholder loan to the renewable utility business). We understand that GC retains the quasi-totality of its cash in hard currency, which somewhat limits the risks of exchange rate fluctuations between the GEL and the U.S. dollar. In addition, the GEL has not appreciated materially, trading at about 0.35 per dollar. Conversely, all its dividend income is GEL-denominated, if we exclude the renewable energy business that has cash flow in dollars and consequently pays divided in hard currency.

About 80% of GC's portfolio is invested in unlisted Georgian assets, with relatively weaker creditworthiness and somewhat limited potential dividend payments, compared to more diversified assets. This leads us to expect a cash adequacy ratio of 0.8x-1.2x in 2022, which could moderate in 2023 to 0.7x-1.1x. GC's key investee companies enjoy good competitive positions in their respective narrow markets. At the same time, they are domestic Georgian companies with no or very limited international revenue, limiting therefore the portfolio creditworthiness of GC's investee companies to the low single 'B' range. The Bank of Georgia is the largest provider of banking services in the country and has a market share of about 40%. Georgia Healthcare Group (GHG) is the largest pharmaceutical distributor and private owner of hospitals in Georgia, with market shares of 35% and 20% in the respective segments. In 2021, Bank of Georgia, GHG, the insurance companies, and renewable business were the main dividend contributors. Based on that, we expect dividends will surge to GEL90 million-GEL100 million in 2022, in line with the company's expectation. Early signs of direct impacts from the Russia-Ukraine conflict are emerging from noncore smaller assets, while as of the end of first-quarter 2022, core assets were not affected by the ongoing conflict. For example, GC's loans to investee assets will be reclassified as equity or quasi-equity instruments totaling GEL142.7 million ($49.4 million).

Outlook

The negative outlook reflects the possibility of a downgrade over the next six-to-nine months.

Downside scenario

We could downgrade the ratings one notch if the Georgian economy deteriorates. Under this scenario, we could see:

- GC's LTV increasing to about 30% or above; and
- Its cash adequacy ratio weakening to below 1.0x for 2023.

We could downgrade GC by more than one notch if the company fails to enact a credible plan to refinance its 2024 bond maturity or capital market conditions materially worsen. Under this scenario, we might see:

- The ratio of sources of liquidity over expected uses to deteriorate well below 1.2x; or
- A material deterioration of access to international capital markets.

Although not expected, we would consider as tantamount to default a debt restructuring that could be viewed as distressed, or should the group make material repurchases of its March 2024 notes below par.

Upside scenario

We could consider an outlook revision to stable if:

- GC enacts a credible and committed plan to refinance its maturities, ensuring ample liquidity buffers;
- The LTV remains defensive and materially below 30%; and
- The company's cash adequacy ratios remains healthy at 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 Bank of Georgia is its only listed asset. 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 2.5% in 2022.
- Dividend income and interest income of GEL105 million-GEL125 million in both 2022 and 2023 from GEL97.5 million in 2021.
- No increase in operating costs, which we expect to be about GEL30 million per year over 2022-2023, in line with 2021 levels.
- Cash interest expense virtually unchanged from 2021 levels.
- No dividend distributions to shareholders, in line with previous years.
- Some opportunistic share buybacks.

Liquidity

We assess GC's liquidity as adequate. We estimate that its sources of liquidity cover its uses by about 1.8x from April 1, 2022.

We believe that GC has sound relationships with local banks, given its position as a key investor in the country. Nevertheless, its ability to refinance debt could be restricted, since the domestic capital markets are relatively shallow, and GC has no committed backup facilities.

We estimate that the principal liquidity sources over the 12 months from April 1, 2022, include:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds denominated in U.S. dollars) of GEL719 million, with most cash in hard currency.
- Unstressed dividends from portfolio companies and interest income of about GEL105 million–GEL125 million.

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

- Operating costs of around GEL30 million.
- Interest expenses of GEL60 million-GEL80 million.
- A shareholder loan to GGU up to about GEL324 million.
- Discretionary share repurchases.

Covenants

The bond documentation only contains an incurrence ratio of net debt to adjusted equity valued below 45%. We believe that 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 Georgia Capital because all its investments are concentrated on a single emerging market, namely Georgia, which we view as having high country risk. GC's governance benefits from a diversified institutional ownership with no single controlling shareholder, a very high share of independent directors (five out of the six members), and transparency requirements through its public listing on the London Stock Exchange. Environmental and social factors are overall neutral considerations in our credit rating analysis of GC and its investee companies. GC's major sector exposure is represented by a retail pharmacy (22% of the adjusted portfolio value) and hospitals (18%), which we assess as having low environmental and social risks.

Issue Ratings - Subordination Risk Analysis

Capital structure

GC's capital structure includes the $365 million unsecured bond due in March 2024.

Analytical conclusions

We rate the notes in line with our long-term issuer credit rating on GC, 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	High
Industry risk	Intermediate
Competitive position	Vulnerable
Financial risk:	Significant
Cash flow/leverage	Intermediate
Funding and capital structure	Negative
Anchor	b+
Modifiers:	

Issuer Credit Rating	B+/Negative/--
Liquidity	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
- 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

- Global Credit Conditions Special Update: Inflation, War, And COVID Drag On, May 17, 2022
- Sovereign Risk Indicators, April 11, 2022. Interactive version available at http://www.spratings.com/sri
- Georgia Outlook Revised To Stable On Stronger Growth And Moderating External Imbalances; 'BB/B' Ratings Affirmed, Feb. 25, 2022
- Investment Holding Company Georgia Capital JSC Upgraded To 'B+'; Outlook Stable, Feb. 11, 2022
- ESG Credit Indicator Report Card: Investment Holding Companies And General Trading Investment Companies, Dec. 17, 2021

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Georgia Capital JSC		
Issuer Credit Rating	B+/Negative/--	B+/Stable/--
Senior Unsecured	B+	B+

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