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Research Update:

Investment Holding Company Georgia Capital JSC Upgraded To 'B+'; Outlook Stable

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Rating Action Overview

- By now, Georgia Capital JSC (GC)'s adjusted portfolio value has reached $1.1 billion, up from about $850 million in the first quarter, benefitting from a positive asset price environment as well as a progressive strengthening of the Georgian lari (GEL) against the U.S. dollar.
- GC recently sold a 65% stake in Georgia Global Utilities (GGU) to Spanish water utility FCC Aqualia for $180 million, representing an internal rate of return (IRR) of 20% in U.S. dollars.
- As a result, GC's adjusted loan-to-value (LTV) ratio improved to about 20% from more than 30% at March 31, 2021.
- We therefore raised our long-term issuer credit and issue ratings on GC and its debt to 'B+' from 'B'.
- The stable outlook reflects our view that GC's S&P Global Ratings-adjusted LTV ratio will remain sustainably below 30%, including amid potential market turbulence and geopolitical instability, and that it can maintain ample liquidity buffers by proactively managing its upcoming maturity wall in 2024.

Rating Action Rationale

GC's LTV has reached about 20% amid supportive market conditions and moderate deleveraging in absolute terms after the sale of GGU's water business. Over 2021, GC's portfolio value markedly increased owing to a good rebound in asset prices and GEL appreciation against the U.S. dollar. For example, Bank of Georgia (19.9% owned by GC and its only listed asset) is currently trading at about £1.55 per share, which is 40% higher than a year ago. We also note that GC's private assets experienced the same positive trend. The equity value of the health care business increased to GEL724 million at Sept. 30, 2021, up 20% from March 31, 2021. Similarly, the equity value of the retail pharmacy business increased to GEL618 million, up 15% from March 31, 2021. As a result, GC's GEL-denominated portfolio value increased more than 15% to almost GEL3.5 billion compared with March 31, 2021. The holding has also benefitted from the GEL's about 15% appreciation against the U.S. dollar compared with March 31, 2021, at less than GEL3 per $1, providing some LTV uplift given all its debt is denominated in U.S dollars. Furthermore, GC sold a 65% stake in GGU to Spanish water utility FCC Aqualia on Feb. 3, 2022, for $180 million, of which the company will retain $85 million as cash after providing a shareholder loan to GGU to refinance its bond in July. As a result, GC's LTV, pro-forma the net sale, has reached about 20%, down from more than 30% at March 31, 2021.

The recent disposal of 80% of the water utility business highlights GC's ability to sell assets with good returns. The sale of a 65% stake in GGU, representing 80% of GGU's water utility business, is GC's first exit. This solidifies its strategy of investing in, expanding, and monetizing an asset via a cash exit. The GGU stake was sold at a premium to its latest valuation as of third-quarter 2021 and almost a 30% premium to its valuation in the first quarter. The IRR for the deal was 20% if measured in U.S. dollars. The first stage of the transaction triggered a change-of-control event under GGU's $250 million bond. As such, bondholders will have the right to ask for a buyback at 101% of the principal amount plus accrued coupon. We understand that GGU plans to call the bond at 103.875% plus accrued coupon after the noncallable period expires in July 2022, to complete the planned asset spin-off (otherwise this is restricted in the bond documentation). Considering the current bond price is above 101%, we believe that bond redemption is likely to materialize after July 2022. 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 ($95 million) and the water business ($155 million). We understand that the exact terms of such support have yet to be confirmed. In the second stage of the transaction, expected in third-quarter 2022 and only when GGU's outstanding 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's improved financial flexibility and cash buffer could support more effective leverage and liquidity management. We calculate GC will have close to GEL0.5 billion in cash, including almost GEL300 million in hard currency, pro-forma the GGU disposal and excluding the $95 million shareholder loan earmarked to repay GGU's bond. In our view, this is particularly important considering that CG's LTV and liquidity are exposed to foreign exchange risk and inherent GEL volatility. GC's debt consists of a U.S.-dollar-denominated $365 million (GEL1.1 billion) bond due September 2024. Conversely, all its dividend income is GEL-denominated. Therefore, we believe GC is exposed to risks related to geopolitical tensions potentially affecting assets price, or GEL instability, that it cannot fully mitigate. In 2020, the COVID-19 pandemic caused GC's LTV to rise to more than 40%, notwithstanding the holding's financial policy to retain an LTV not exceeding 30%. We therefore believe that some of the cash proceeds from the GGU transaction will help GC to increase its financial flexibility and preserve liquidity. In our view, some proceeds could also be dedicated to capital redeployment, for new early stage investments, and a residual portion for shareholder remuneration in the form of share repurchases. GC recently increased its share buyback program to $15 million, with $5 million already purchased in 2021.

About 80% of GC's portfolio is invested in unlisted Georgian assets, with limited creditworthiness and potential for dividend payments. This leads us to expect a cash adequacy ratio of about 1.0x in 2021 and 1.3x-1.7x in 2022. GC's key investee companies enjoy good competitive positions in their respective narrow markets. At the same time, they are typically Georgian assets with no or very limited international footprint. As such the weighted average creditworthiness of GC investee companies is in the 'B' area. 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 about GEL75 million in 2021 and more than GEL100 million in 2022, from GEL30 million in 2020.

Outlook

The stable outlook reflects our view that GC's S&P Global Ratings-adjusted LTV ratio will remain sustainably below 30% for the next 12 months. In our view, this will remain the case during potential future market turbulence and geopolitical tensions. We also expect GC to maintain an adequate liquidity profile and a material portion of its cash in hard currency, partially hedging its U.S.-dollar-denominated debt.

Downside scenario

We could lower the rating if GC's LTV rises above 30%. Alternatively, we could take a negative rating action if its cash flow adequacy ratio declines to less than 0.7x and the company does not take immediate remedial measures to restore its credit metrics. We could also lower the rating if there are any signs that GC's liquidity is deteriorating. This could materialize if GC does not proactively address its 2024 maturity well in advance.

Upside scenario

We see rating upside as remote for the next 12-18 months, considering GC's huge maturity wall in 2024. However, we could envisage a positive action if GC's portfolio characteristics--such as liquidity, asset quality, and diversification--materially improve all else being equal. Alternatively, portfolio valuation increases or use of potential exit proceeds for deleveraging, resulting in LTV ratios approaching 15% coupled with management's strong commitment to a more stringent financial policy and proven track record to maintain those levels under any market circumstances, could prompt a positive rating action. An upgrade would also depend on liquidity remaining adequate.

Company Description

Georgia Capital JSC is an investment holding company based in Georgia. Its parent, Georgia Capital PLC, is listed on the London Stock Exchange. All 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. The portfolio includes:

- Full ownership of GHG, a health care services provider (20.8% of GC's S&P Global Ratings-adjusted portfolio value).
- A 19.9% stake in the Bank of Georgia (19.7%).
- A 67% stake in GHG retail pharmacy (17.7%).
- A 35% stake in GGU, a water utility and renewable energy business (10%).

- Full ownership of Aldagi P&C, a property/casualty insurance company (6.2%).
- Full ownership of a medical insurance business (1.9%).
- A stake in an education business (3.7 %).
- Loans issued to portfolio companies (13%).
- Other business areas include beverages, auto services, digital services, commercial real estate, and housing development (7.1%).

Our Base-Case Scenario

Assumptions

- Real GDP growth in Georgia of 5.5% in 2022 and 5.0% in 2023.
- An average exchange rate of GEL3.25 per $1 at year-end 2022 and GEL3.30 at year-end 2023.
- Dividend income and interest income increases to about GEL90 million in 2021 from GEL51 million in 2020. We expect dividend and interest income to reach GEL135 million–GEL140 million in 2022, and GEL160 million–GEL170 million in 2023.
- No increase in operating costs, which we expect to be about GEL20 million per year over 2021-2023, in line with 2020.
- Cash interest expense of GEL70 million–GEL75 million per year over 2022-2023, compared with GEL63 million in 2020.
- No dividend distributions to shareholders, in line with previous years.

Key metrics

Georgia Capital JSC--Key Metrics*

	--Fiscal year ended Dec. 31--				
	2019a	2020a	2021e	2022f	2023f
Loan to value (%)	33.5	30.5	About 20	Less than 30	Less than 30
Cash flow adequacy (x)	1.6	0.5	0.9-1.1	1.3-1.7	1.5-2.0

a--Actual. e--Estimate. f--Forecast. *All figures adjusted by S&P Global Ratings. We fully deduct cash from the debt and don't apply a haircut to the reported values of unlisted companies

Liquidity

We assess GC's liquidity as adequate. We estimate that its sources of liquidity cover its uses by about 2.2x from Sept. 30, 2021. 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 back-up facilities. We note that the holding has a huge maturity wall in September 2024 when its $365 million notes will come due. We continue to anticipate that GC will address this well ahead of time, ensuring ample liquidity buffers. We also understand that management has committed to keeping at least $50 million of cash and equivalents in foreign currency to partially protect GC from foreign exchange risk.

We estimate that principal liquidity sources over the 12 months, started Oct. 1, 2021, include:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds) of GEL256.2 million.
- Dividends from portfolio companies and interest income of about GEL100 million.
- Net proceeds of $173 million from the GGU stake sale.

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

- Operating costs of about GEL20 million.
- Interest expenses of approximately GEL70 million–GEL75 million.
- A $95.4 million/GEL294 million shareholder loan offered to the renewable energy business to fund its upcoming bond repayment

Covenants

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

Issue Ratings - Subordination Risk Analysis

Capital structure

GC's capital structure includes the $365 million unsecured bond.

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+/Stable/--

Business risk: Vulnerable

- Country risk: High
- Industry risk: Intermediate
- Investment position: Vulnerable

Financial risk: Significant

- Cash flow/Leverage: Intermediate

- Funding and capital structure: Negative

Anchor: b+

Modifiers

- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b+

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

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

Ratings List

Upgraded

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