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Research Update:

Investment Holding Company Georgia Capital Downgraded To 'B' On Increased Leverage Ratio Due To COVID-19; Outlook Stable

April 3, 2020

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Rating Action Overview

- Georgia Capital's loan-to-value (LTV) ratio rose to about 40% from less than 25% in July 2019, which is much higher than our previous forecast of maximum leverage of 30%.
- The leverage increase stemmed from the COVID-19 outbreak, which decreased the value of Georgia Capital's portfolio and from the Georgian lari's depreciation against the U.S. dollar.
- Moreover, we anticipate a material reduction in dividend income for Georgian Capital for 2020 and therefore limited deleveraging prospects.
- As a result, we are lowering our ratings on Georgian Capital to 'B' from 'B+'.
- The stable outlook reflects our view that that Georgia Capital's LTV ratio will remain below 45% in the next 12 months.

Rating Action Rationale

S&P Global Ratings-adjusted LTV ratio is no longer consistent with the ratings as the COVID-19 outbreak led to a substantial increase of the LTV ratio to about 40% from less than 25% in July 2019. The downgrade reflects the decline in Georgia Capital's portfolio value by about 25% (after applying a 30% haircut on unlisted assets' most recent values) since July 2019 and the lari's depreciation of about 20% at its peak versus the U.S. dollar in recent months. As of today, the lari has depreciated by 11% against its value on Dec. 31, 2019. Georgia Capital's current leverage is higher than the 30% LTV ratio commensurate with our 'B+' rating. Therefore we lowered our rating to 'B'.

A decline in the share of listed assets erodes asset liquidity. We note that, since July 2019, Georgia Healthcare Group's share price has declined by more than 60% and that of Bank of Georgia PLC by more than 30% because of recent equity markets volatility generated by the COVID-19 pandemic. The former accounts for about 15% of Georgia Capital's portfolio and Bank of

Georgia 25%, after our adjustments to the unlisted asset portfolio value. Additionally, in assessing the value of the company's unlisted assets, we applied a 30% haircut to recently reported value to reflect a decline in valuation multiples of peer companies. As a result, the share of listed assets in Georgia Capital's portfolio declined to 40% from about 50% in July 2019. If the share of listed assets remains below 40%, we could revise down our assessment of Georgia Capital's investment positon.

Lower dividend income in 2020 reduces deleveraging opportunities and the cash adequacy ratios could weaken. Recent capital markets volatility and implications of a global recession are likely to affect Georgia Capital's dividends from investee companies. We now expect its dividend income will decrease to just Georgian lari (GEL) 30 million ($9.1 million) in 2020 from more than GEL120 million in 2019, of which GEL70 million is a recurring dividend. We believe dividends from key dividend generating assets, such as Bank of Georgia, will be negligible and expect only private companies, such as Georgian Global Utilities and P&C Insurance, to continue upstreaming dividends comparable to those in 2019. As a result, Georgia Capital's cash flow adequacy ratio could decline to about 0.8x for 2020 from more than 1.5x for 2019. We, also understand the company is considering the sale of several of its private assets in the coming months, but the timing and scale are uncertain and could be difficult to implement in the current environment.

Investment portfolio remains fully concentrated on Georgia. Georgia Capital's investee companies are solely exposed to economic and business conditions in Georgia; according to management its investee companies' share of Georgia's GDP is about 10%. The Georgian economy remains constrained by relatively low per capita income (estimated at $4,200) and balance-of-payments vulnerabilities. However, the impact of COVID-19 could exert pressure on the economy. Georgia was upgraded to 'BB' from 'BB-' in October 2019 on improved economic resilience and has maintained comparatively high growth rates over the past few years, even in a challenging external environment. The economy expanded by nearly 4% on average over 2015-2018, weathering periods of anemic external demand as trading partners were hit by falling oil prices and some fell into recession, while regional currencies were devalued.

The relatively small portfolio and weak weighted average credit quality constrain the rating. In our view, Georgia Capital's weighted average creditworthiness of investee companies is in the 'B' rating category. With a portfolio size of about $600 million, Georgia Capital's investment portfolio is smaller than that of many other rated investment holding companies globally, which increases concentration risks.

Good competitive positions of key investee companies support the rating. Of the companies Georgia Capital has invested in, Bank of Georgia is the largest provider of banking services in Georgia, with a market share of about 40%. Georgian Global Utilities is a water utility monopoly in capital city of Tbilisi and surrounding area. Georgia Healthcare Co. is the largest pharmaceuticals distributor and private owner of hospitals in Georgia, with market shares of 30% and 25% in the respective segments.

Outlook

The stable outlook reflects our view that Georgia Capital's LTV ratio will remain below 45% in the next 12 months due to management's proactive measures to maintain leverage commensurate for the current rating and to selective disposals. We also expect Georgia Capital to maintain its liquidity buffers and refrain from lending and making capital contributions to investee companies until dividend inflow increases to previous levels and cash flow adequacy ratio recovers to more than 1x.

Downside scenario

We could lower the rating if there are any signs that Georgia Capital's liquidity is deteriorating. We could also lower the rating if Georgia Capital's LTV remains above 45% or cash flow adequacy ratio declines to less than 0.7x and the company does not take immediate action to restore its credit metrics. Rating pressure could also result from a material deterioration of the credit quality of any of Georgia Capital's core investments, which would erode valuations and increase the likelihood of Georgia Capital having to inject fresh capital for support.

Upside scenario

We could raise the ratings if Georgia Capital's portfolio characteristics--such as liquidity, asset quality, and portfolio diversification--materially improve. In addition, portfolio valuation increases keep LTV ratios well below 30% and management's strong commitment to a more stringent financial policy with a positive track record could prompt a positive rating action upgrade. An upgrade would depend on liquidity remaining adequate.

Company Description

Georgia Capital is an investment holding company based in Georgia. Its parent Georgia Capital PLC is listed on the London Stock Exchange and as of March 27, 2020, had a market value of £189 million. About 40% of its portfolio consists of listed shares and the remainder unlisted equity participations in investee companies in Georgia in banking, pharma, healthcare, utilities, real estate, hospitality, private education, insurance, beverages, auto services, and renewable energy generation. Its key investments include 19.9% of U.K.-listed Bank of Georgia, 70.6% of U.K.-listed Georgia Healthcare Group, 100% of Georgian Global Utilities, a water utility business; 100% of M2, a real estate and hospitality business; 100% of Georgian Renewable Power Company; 100% of Aldagi, a property and casualty insurance company; 100% of Greenway, a periodic technical inspection business; majority stakes of 70%-90% in three leading private schools; and an 87% stake in Georgia Beverages.

Our Base-Case Scenario

In our base case, we assume for 2019-2020:

- Real GDP growth in Georgia of 4.5% in 2020 and 4% in 2021.
- Interest income of about GEL25 million annually.
- Dividend income of GEL35 million-GEL40 million annually.
- Operating expenses at the holding company of about GEL20 million and interest expenses of GEL60 million per year.
- No further material debt incurred at Georgia Capital.

Based on these assumptions, we arrive at the following credit measures:

- An LTV ratio of around 40%.

- Cash flow adequacy ratio close to 0.8x in 2020 and 2021

Liquidity

We assess Georgia Capital's liquidity as adequate. We estimate that its sources of liquidity cover sources by more than 2x from Dec. 31, 2019. We don't assess the company's liquidity as strong because we believe it won't be able to absorb significant external shock without additional financing. We believe Georgia Capital has sound relationships with local banks, given its important position as a key investor in the country.

We understand the company has decided to postpone capital contributions and lending to investee companies to preserve liquidity in the current environment and in view of reduced dividend inflow. Nevertheless, its ability to refinance debt could be restricted, since the domestic capital markets are relatively shallow and Georgia Capital has no committed back-up facilities. That said, the company enjoys a smooth debt maturity profile, with the first large maturity in 2024 when the euro notes are due. We understand that management has committed to keep at least $50 million of cash and equivalents in foreign currency and that the company has no near-term debt maturities.

Principal liquidity sources

We estimate principal liquidity sources over the 12 months from Dec. 31, 2019, include:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds) of GEL212 million; and
- Dividends from portfolio companies and interest income of about GEL55 million.

Principal liquidity uses

We estimate that principal liquidity uses over the same period:

- Operating costs of around GEL20 million; and
- Interest expenses of approximately GEL60 million;

Covenants

The bond documentation contains only an incurrence ratio of net debt to adjusted equity value of below 45% and we believe the headroom is tightening. However we believe the company is putting in place adequate measures to restore it.

Ratings Score Snapshot

Issuer credit rating: B/Stable/--

Business risk: Weak

- Country risk: High
- Industry risk: Intermediate

- Investment position: Weak

Financial risk: Aggressive

- Cash flow/leverage: Aggressive

Anchor: b+

Modifiers

- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: b

Related Criteria

- 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 | 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 | Industrials: Key Credit Factors For The Health Care Services Industry, April 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Pharmaceutical Industry, April 8, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

	To	From
JSC Georgia Capital		
Issuer Credit Rating	B/Stable/--	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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.